AT&T Kentucky
601 W. Chestnut Street
Room 407
Louisville, KY 40203

T: 502.582.8219
F: 502.582.1573
mary.keyer@att.com

May 22, 2008

**VIA HAND-DELIVERY**

RECEIVED

MAY 22 2008

PUBLIC SERVICE
COMMISSION

Ms. Stephanie Stumbo
Executive Director
Public Service Commission
211 Sower Boulevard
P. O. Box 615
Frankfort, KY 40602

Re: BellSouth Telecommunications, Inc.'s Notice of Intent to Disconnect SouthEast Telephone, Inc. for Nonpayment
PSC 2005-00519

SouthEast Telephone, Inc., Complainant v. BellSouth Telecommunications, Inc., Defendant
PSC 2005-00533

Dear Ms. Stumbo:

Enclosed for filing in the above-referenced cases are the original and ten (10) copies of AT&T Kentucky's Motion for Rehearing and/or Reconsideration.

Thank you for your attention to this matter.

Sincerely,

Mary K. Keyer
General Counsel/Kentucky

cc: Parties of Record

711899

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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|---|---|---|
| BELLSOUTH TELECOMMUNICATIONS, INC.'S NOTICE OF INTENT TO DISCONNECT SOUTHEAST TELEPHONE, INC. FOR NONPAYMENT | ) | CASE NO. 2005-00519 |
| AND | | |
| SOUTHEAST TELEPHONE, INC.<br>COMPLAINANT<br>VS.<br>BELLSOUTH TELECOMMUNICATIONS, INC.<br>DEFENDANT | ) | CASE NO. 2005-00533 |

RECEIVED
MAY 22 2008
PUBLIC SERVICE COMMISSION

**MOTION FOR REHEARING AND/OR RECONSIDERATION**

Pursuant to KRS § 278.400, BellSouth Telecommunications, Inc., d/b/a AT&T Kentucky ("AT&T Kentucky"), respectfully requests that the Kentucky Public Service Commission ("Commission") reconsider its order dated May 2, 2008 ("*Remand Order*")[1] and issue an Order that: (1) enforces the parties' interconnection agreement ("ICA") and; (2) requires SouthEast Telephone, Inc. ("SouthEast") to immediately pay the past due balance on its resale account. In its *Remand Order*, the Commission held that it had no jurisdiction to award damages in this case or to set rates retroactively.[2] In so doing, the Commission effectively reinstated an unlawful Commission Order (the

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[1] Under KRS 278.400, an application for rehearing is due 20 days after service of a Commission order.

[2] *Remand Order* at 7-9.

Commission's August 16, 2006 Order ("*271 Order*")) by putting SouthEast in the same position it would have been in if the *271 Order* had been upheld, even though on appeal the *271 Order* was declared unlawful.[3] As explained below, there is ample authority for the position that the Commission has the jurisdiction to undo the effects of its legal errors. Accordingly, the Commission should issue an Order requiring SouthEast to pay the resale rates for the resale services SouthEast ordered under the parties' ICA. To do otherwise would be to give full legal effect to an unlawful order.

## STANDARD FOR REHEARING

KRS § 278.400 allows any party to apply for rehearing with respect to "any of the matters" determined by the Commission.[4] The primary purpose of rehearing is for the Commission to consider its order in light of clarification of the facts used by the Commission to reach its decisions. The Commission, in construing KRS § 278.400, has determined that "the administrative agency retains full authority to reconsider or modify its order during the time it retains control over any question under submission to it."[5] Further, the Commission has determined that it can reconsider an order based upon evidence adduced at the initial hearing or new evidence presented at rehearing.[6] AT&T

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[3] Opinion and Order, *BellSouth Telecommunications, Inc. v. Kentucky Public Service Commission, et al.*, Civil Action No. 06-65-KKC, United States District Court, Eastern District of Kentucky (September 18, 2007) at 21 ("Since the PSC had no authority to act pursuant to § 271, the PSC's Order is hereby declared unlawful and enjoined from enforcement.").

[4] *See Adjustment of the Rates of Kentucky-American Water Company*, Case No. 2000-120 (Feb. 26, 2001).

[5] *Kentucky Power Company*, Case No. 7489 (Jun. 27, 1980).

[6] *See Adjustment of the Rates of Kentucky-American Water Company*, Case No. 2000-120 (Feb. 26, 2001).

Kentucky requests that the Commission invoke its authority under KRS § 278.400 and issue a ruling that corrects the legal errors in its *271 Order.*[7]

## ARGUMENT

### A. The Commission has the authority to correct its legal errors and issue an Order that enforces the parties' ICA.

In the *Remand Order*, the Commission disagreed with AT&T Kentucky's position that this matter is a breach of contract case and therefore refused to enforce the parties' ICA, which would have required SoutEast to pay for the resale services it bought under the parties' ICA.[8] Having summarily dispensed of the parties' contract, the Commission then ruled that it lacked jurisdiction to award damages in this case because it lacked the authority under 47 U.S.C. § 271 ("Section 271") to set rates for elements provided under Section 271:

> While the Commission has the authority to prescribe rates, the District Court has determined that this Commission is without power to establish a rate under Section 271. Moreover, for the Commission to determine rates on a retrospective basis, we would be required to establish rates for those network elements mandated to be provided by Section 271. This determination would run afoul of the District Court's decision that we lack jurisdiction to act pursuant to Section 271. Accordingly, without knowing the proper rate, we cannot reach back and change the rates established and apply new rates retroactively.[9]

The above Commission ruling, coupled with the Commission's refusal to enforce the parties' contract, results in a perverse outcome because it places SouthEast in the exact same position that it would have been if the Commission's unlawful *271 Order* had been upheld on appeal. That is, the Commission's Remand Order places

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[7] In this Motion, AT&T Kentucky has identified only a few of the more egregious errors set forth in the *Remand Order* and reserves all rights, including the right to seek judicial review of any aspect of the *Remand Order*.

[8] *Remand Order* at 6-7.

[9] *Id.* at 8.

SouthEast in the same position SouthEast was in for the period of time between the issuance of the *271 Order* (August 16, 2006) and the District Court's determination that such order was unlawful (September 18, 2007). SouthEast no longer occupies the same position.

The Commission's conclusion that the District Court decision somehow deprives the Commission of its ability to undo the consequences of its own past legal errors is wrong as a matter of law. In fact, an agency has both the authority and the duty to correct the effect of its own errors on private parties. As the United States Supreme Court has held, "[a]n agency, like a court, can undo what is wrongfully done by virtue of its order.[10] In *Callery*, the Court noted that the agency "has no power to make reparation orders, its power to fix rates . . . being prospective only." *Id.* (internal quotation marks and citation omitted). But that power to fix rates, the Court held, "is not so restricted where its order, which never became final, has been overturned by a reviewing court." *Id.* ("Here the original certificate orders were subject to judicial review; and judicial review at times results in the return of benefits received under the upset administrative order.").

Indeed, if the Commission were correct in its view that it lacked power to correct the harm caused by its unlawful *271 Order*, then the Commission would be giving legal effect to an unlawful order. That inequitable result "would make a mockery of the error-correcting function of appellate review. It would be to say that ... [SouthEast] must prevail now because they (wrongfully) prevailed below."[11]

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[10] *United Gas Improvement et al v. Callery Props.*, 382 U.S. 223, 229, 86 S. Ct. 360, 364. For the Commission's convenience, the cases cited in the argument section are attached hereto as Exhibit 1.

[11] *Verizon v. FCC*, 269 F.3d 1098, 1111 (D.C. Cir. 2001).

Rather than rendering the District Court's ruling meaningless, the Commission should correct its legal errors and issue an order that enforces the parties' ICA and requires SouthEast to pay for the resale services it ordered from AT&T Kentucky, which would place the parties in the position they would have been in absent the Commission's past legal error.[12] Under established law, this is the appropriate remedy here: "'[W]hen [an agency] commits legal error, the proper remedy is one that puts the parties in the position they would have been in had the error not been made.'"[13] That is because it is "typically not reasonable" for a party to rely on an order that "had never been judicially confirmed" and was "under unceasing challenge before progressively higher legal authorities."[14]

It is plain that SouthEast could not reasonably rely on the Commission's unlawful *271 Order* - including the interim rate set therein pursuant to Section 271 - because the *271 Order* was immediately challenged by AT&T Kentucky. Indeed, AT&T Kentucky appealed the *271 Order* on September 12, 2006 – less than one month after its issuance on August 16, 2006. "[A] holding on nonretroactivity . . . cannot be premised on a single, recent agency decision . . . that is still in the throes of litigation when it is overruled."[15] A remedy requiring the status quo to be restored following an agency's unlawful action is not impermissibly "retroactive" or disfavored, as the Commission

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[12] Contrary to the Commission's conclusion that it cannot resolve this matter because it lacks the authority to establish a rate and/or apply such rate on a retroactive basis (*Remand Order* at 8), the Commission does not need to establish any rate at all. Rather, the rates to be applied are the resale rates contained in the parties' ICA and approved by this Commission. These rates have existed during the totality of the dispute. Further, the amount of such rates (as opposed to their applicability) has not been disputed.

[13] *Exxon Co., U.S.A. v. FERC*, 182 F.3d 30, 49 (D.C. Cir. 1999) (quoting *Public Utils. Comm'n of Cal. v. FERC*, 988 F.2d 154, 168 (D.C. Cir. 1993)).

[14] *Verizon v. FCC*, 269 F.3d 1098, 1110 (D.C. Cir. 2001).

[15] *Clark-Cowlitz Joint Operating Agency v. FERC*, 826 F.2d 1074, 1083 n.7 (D.C. Cir. 1987) (en banc).

suggests, but instead is an appropriate remedy for unlawful agency action.[16] Here, restoring the status quo necessarily requires a Commission ruling that enforces the parties' ICA.[17]

Although the cases and authority discussed above are sufficient for the Commission to grant rehearing and reverse its *Remand Order*, it is also well-established that "[t]he rule against retroactive ratemaking does not extend to cases in which customers are on adequate notice that resolution of some specific issue may cause a later adjustment to the rate being collected at the time of service."[18] From the outset, AT&T Kentucky has billed SouthEast for the resale services ordered by SouthEast. Moreover, immediately following SouthEast's pronouncement in October 2005, that SouthEast did not intend to pay the resale rates for the resale services which had been ordered and provisioned,[19] AT&T Kentucky (then known as BellSouth) demanded payment for such services. Following SouthEast's refusal to pay, on December 6, 2005, AT&T Kentucky notified the Commission of its intent to disconnect SouthEast for non-payment. Without question, SouthEast has been on notice that it was obligated to pay AT&T Kentucky resale rates for the resale services it ordered.

In short, the Commission has the power to right the wrongs caused by its unlawful *271 Order*.

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16 *See MCI Telecomms. v. FCC*, 143 F.3d 606, 609 (D.C. Cir. 1998)(declining to vacate rate held to lack proper justification "on the clear understanding that if and when on remand the Commission establishes some different rate," it would order refunds).

17 This is particularity true for the period of time between April 2005 and the issuance of the Commission's *271 Order* (August 16, 2006). During this period of time, SouthEast ordered resale services under the ICA and simply refused to pay the resale rates for such services. It is not for the Commission to re-write the parties' ICA or give SouthEast an option SouthEast did not have in its ICA (i.e. the right to buy 271 checklist items).

18 *Oxy USA, Inc. v. FERC*, 64 F.3d 679, 699 (D.C. Cir. 1995) (internal quotation marks omitted). For the Commission's convenience, the cases cited in the argument section are attached hereto as Exhibit 1.

19 Letter dated October 20, 2005, from SouthEast counsel (David Sieradzki) to BellSouth (Allessandra Richmond and John Hamman). The letter is attached hereto as Exhibit 2.

### B. The Commission's ruling that SouthEast did not order resale services cannot be reconciled with the undisputed facts.

In its *Remand Order*, the Commission declined to enforce the parties' ICA and thus declined to require SouthEast to pay for the resale services SouthEast ordered from AT&T Kentucky. In doing so, the Commission concluded that "[i]t is clear that SouthEast did not order or utilize AT&T Kentucky's resale services."[20] This conclusion cannot be logically reconciled with the undisputed facts of this case as noted by the Commission and admitted by SouthEast.

That is, SouthEast used "the resale ordering systems of AT&T Kentucky"[21] to obtain certain Section 271 checklist elements (local switching and local transport) that were unavailable under the parties' ICA. Indeed, SouthEast concedes that it ordered resale services under the parties' ICA based on its meritless and unfounded contention that it had no other means to obtain such elements.[22] Further, SouthEast concedes that it continued to order resale services to obtain Section 271 elements (such as local switching) even though such elements were not contained in the parties' ICA.[23] Under the ICA, the only way SouthEast could obtain the combination of elements it sought was to order resale services. Additionally, there has been no finding that AT&T Kentucky has violated its Section 271 obligations. Given the undisputed facts, the Commission should correct its error and find that SouthEast did in fact order resale services from AT&T Kentucky.

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[20] *Remand Order* at 7.

[21] *Remand Order* at 6.

[22] *See e.g.,* SouthEast Telephone's Response to Motion for Issuance of Damages Award at 3 ("SouthEast used the resale ordering system to submit orders for Section 271 elements . . . .")

[23] SouthEast Telephone, Inc.'s Further Response to AT&T Kentucky and Supplement to Response to Motion For Issuance of Damages Award at 3 (SouthEast "ordered *network elements*, something required by law to be available, but a product that was not in the parties' contract.")

In support of its conclusion that SouthEast did not order resale services, the Commission cites the dispute resolution provision of the parties' ICA, which according to the Commission "required AT&T Kentucky to continue its obligations under the interconnection agreement while the dispute resolution was pending."[24] If the dispute resolution provision is applicable, then it required AT&T Kentucky to continue its ICA obligations, and the only relevant obligation was to offer resale. Accordingly, AT&T Kentucky is now entitled to be paid the resale rate for the services it provided while this dispute was before this Commission and the federal courts. Importantly in this regard, and as conceded by SouthEast, AT&T Kentucky has no *contractual* obligation to provide the requested Section 271 checklist items under the parties' ICA. Nothing in the ICA purports to grant that right to SouthEast. Accordingly, SouthEast must pay for the services it ordered at the resale rate under its ICA. Even if the Commission's reasoning were correct (i.e., that the parties' contractual dispute resolution provision somehow required AT&T Kentucky to provide services that are outside the parties' contract), then such obligation ended on October 31, 2006, when the parties executed a contract amendment removing the language relied on by the Commission.[25]

In sum, the Commission erred when it concluded that SouthEast did not order resale services from AT&T Kentucky. Even if the Commission agrees with SouthEast's baseless contention that it was "unreasonably compelled to use the resale ordering

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[24] *Remand Order* at 7.

[25] Specifically, the amendment removed the following language from the ICA's dispute resolution provision: "Furthermore, the Parties agree to carry on their respective obligations under this Agreement, while any dispute resolution is pending." At the time of the execution of the amendment the Commission's unlawful *271 Order* had been issued and appealed. That said, to undo the legal errors of its *271 Order*, the Commission can reasonably conclude (if necessary) that the parties' dispute resolution provision does not impact AT&T Kentucky's right to be paid resale rates for the resale services provided to SouthEast.

systems to purchase Section 271 checklist elements,"[26] that contention does not change the fact that resale services were ordered under the parties' ICA and that AT&T Kentucky has no contractual duty to provide any other substitute service under the ICA that was binding on the parties. Accordingly, the Commission should issue an order finding that SouthEast ordered resale services from AT&T Kentucky and requiring SouthEast to pay for the resale services it ordered.

## CONCLUSION

For the reasons stated herein, the Commission should grant AT&T Kentucky's Motion for Rehearing and/or Reconsideration and issue an order that corrects the legal errors in its *271 Order*; finds that SouthEast ordered resale services from AT&T Kentucky and enforces the parties' ICA by requiring SouthEast to immediately pay the past due balance on its resale account.

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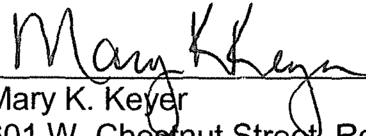
[26] SouthEast Telephone's Response to Motion for Issuance of Damages Award at 5. This tired contention lacks any semblance of credibility because it completely ignores the fact that AT&T Kentucky (then known as BellSouth) had made available to all competitive local exchange carriers (including SouthEast) a commercial agreement for "CLECs who wish to serve their customers with the combinations of switching and loops that constituted UNE-P." *See* Carrier Notification SN91085094, dated April 26, 2005. The aforementioned Carrier Notification pre-dates SouthEast's decision to buy resale services in an attempt to obtain Section 271 elements that were unavailable under the parties' ICA.

Respectfully submitted,



Mary K. Keyer
601 W. Chestnut Street, Room 407
Louisville, KY 40203
(502)582-8219
mary.keyer@bellsouth.com

Robert Culpepper
Suite 4300
675 W. Peachtree St., NW
Atlanta, GA 30375
(404) 335-0740

COUNSEL FOR BELLSOUTH
TELECOMMUNICATIONS, INC.
d/b/a AT&T KENTUCKY

711546

## CERTIFICATE OF SERVICE -- KPSC 2005-00519 and 2005-00533

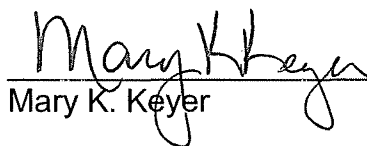
It is hereby certified that a true and correct copy of the foregoing was served on the following individuals by U.S. mail, this 22nd day of May 2008.

Darrell Maynard
SouthEast Telephone, Inc.
106 Power Drive
P. O. Box 1001
Pikeville, KY 41502-1001
Darrell.Maynard@setel.com

Hon. Jonathon N. Amlung
AMLUNG Law Offices
616 S. 5th Street
Louisville, KY 40202
Jonathon@amlung.com

Bethany Bowersock
SouthEast Telephone, Inc.
106 Power Drive
P. O. Box 1001
Pikeville, KY 41502-1001
Beth.Bowersock@setel.com

Hon. David L. Sieradzki
Hogan & Hartson, L.L.P.
555 Thirteenth Street, N.W.
Washington, DC 20004-1109
dlsieradzki@hhlaw.com



Mary K. Keyer

# EXHIBIT 1

**OXY USA, INC., Petitioner,**

**v.**

**FEDERAL ENERGY REGULATORY COMMISSION, Respondent,**

**Amerada Hess Pipeline Corporation, BP Pipelines (Alaska) Inc., Exxon Pipeline Company, Mobil Alaska Pipeline Company, Phillips Alaska Pipeline Corporation, Unocal Pipeline Company, State of Alaska, ARCO Alaska, Inc., ARCO Transportation, Alaska, Inc., MAPCO Alaska Petroleum, Inc., BP Exploration (Alaska), Inc., Tesoro Alaska Petroleum Company, Petro Star, Inc., and Exxon Company, U.S.A., Intervenors.**

**Nos. 94–1061, 94–1132, 94–1402, 94–1430, 94–1466, 94–1476 and 94–1487.**

United States Court of Appeals, District of Columbia Circuit.

Argued Feb. 16, 1995.

Decided Aug. 29, 1995.

Rehearing Denied Nov. 2, 1995.

Petroleum shippers petitioned for judicial review of Federal Energy Regulatory Commission (FERC) order mandating new methodology for valuation of petroleum shipped on Alaska petroleum pipeline for making of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline. The Court of Appeals, Buckley, Circuit Judge, held that: (1) fact that shippers entered into settlement agreement, which changed valuation from existing gravity differential methodology to assay methodology, did not render shippers without standing to petition for judicial review of Commission's subsequent adoption of assay methodology; (2) Commission was not required to find that changes in circumstances were unforeseen or not reasonably foreseeable at time of prior Commission decision before adopting new methodology; (3) decision to change valuation methodology was supported by substantial evidence and was not arbitrary and capricious; (4) Commission acted arbitrarily and capriciously in valuing light distillate at market price of jet fuel and valuing heavy distillate at market price of fuel oil, without discounting for processing costs; (5) Commission acted unreasonably in valuing heavy residual fuel oil at unaltered market price for fuel oil product; (6) evidence did not support decision to value lighter residual fuel oil at price of No. 6 fuel oil; (7) rule against retroactive ratemaking precluded Commission from retroactively applying new methodology and ordering refunds; and (8) matter would be remanded for establishment of consistent and reasoned position as to whether Commission had jurisdiction over method by which carriers distributed commingling offset payments among co-owners of streams delivered to pipeline.

Petitions granted in part and denied in part, cases remanded.

**1. Compromise and Settlement ⟹15(1)**

Fact that petroleum shippers entered into settlement agreement, which changed from existing gravity differential methodology to assay methodology for valuation of petroleum shipped on Alaska petroleum pipeline for making of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline, did not render shippers without standing to petition for judicial review of Federal Energy Regulatory Commission's (FERC) subsequent adoption of assay methodology, in light of Commission's modification of methodology in agreement; by advocating specific settlement, shippers did not forfeit their standing to object to elements of settlement to which they had agreed if changes made in others by Commission worked to their overall disadvantage. 28 U.S.C.A. § 2344.

**2. Administrative Law and Procedure ⟹668**

**Carriers ⟹34**

Only parties "aggrieved" by final Federal Energy Regulatory Commission (FERC) order issued under Interstate Commerce Act (ICA) may bring petition for review. 28 U.S.C.A. § 2344; Interstate Commerce Act, § 1 et seq., 49 U.S.C.(1976 Ed.) § 1 et seq.

**3. Carriers ⟹31**

Federal Energy Regulatory Commission (FERC) was not required to find that

changes in circumstances were unforeseen or not reasonably foreseeable at time of prior Commission decision before adopting new changed methodology to be implemented for valuation of petroleum shipped on Alaska petroleum pipeline for making of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline. Interstate Commerce Act, §§ 1(5), 15(1), 49 U.S.C.(1976 Ed.) §§ 1(5), 15(1).

**4. Carriers ⇐31**

Federal Energy Regulatory Commission (FERC) decision approving portion of settlement agreement adopting new assay methodology to be implemented for valuation of petroleum shipped on Alaska petroleum pipeline for making of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline, rather than continuing to utilize existing gravity differential methodology, was supported by substantial evidence and was not arbitrary and capricious; administrative law judge (ALJ) found that changes in circumstances had increased relative volume of natural gas liquids injected into pipeline common stream, and that gravity-based methodology did not accurately value such liquids. 5 U.S.C.A. § 706(2)(A); Interstate Commerce Act, §§ 1(5), 15(1), 49 U.S.C.(1976 Ed.) §§ 1(5), 15(1); 18 C.F.R. § 385.602(h)(1)(i).

**5. Administrative Law and Procedure ⇐760, 763**

For purposes of review of administrative agency decisions, inquiry of Court of Appeals under arbitrary and capricious test is narrow, and court is not to substitute its judgment for that of agency. 5 U.S.C.A. § 706(2)(A).

**6. Administrative Law and Procedure ⇐759**

For purposes of review of administrative agency decisions, when necessary analysis requires high level of technical expertise, Court of Appeals must defer to informed discretion of responsible federal agencies. 5 U.S.C.A. § 706(2)(A).

**7. Administrative Law and Procedure ⇐502**

**Carriers ⇐34**

For purposes of review of Federal Energy Regulatory Commission (FERC) decisions, Court of Appeals requires Commission to engage in rational decisionmaking and, when changing course, it must supply reasoned analysis indicating that prior policies and standards are being deliberately changed. 5 U.S.C.A. § 706(2)(A).

**8. Administrative Law and Procedure ⇐759**

**Carriers ⇐34**

For purposes of judicial review of Federal Energy Regulatory Commission (FERC) order mandating new methodology to be implemented for valuation of petroleum shipped on Alaska petroleum pipeline for making of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline, determining effect of natural gas liquids on stream's value was question of fact that called for high level of technical expertise, requiring Court of Appeals to defer to informed discretion of agency. 5 U.S.C.A. § 706(2)(A); Interstate Commerce Act, §§ 1(5), 15(1), 49 U.S.C.(1976 Ed.) §§ 1(5), 15(1).

**9. Carriers ⇐31**

In its order mandating new assay methodology to be implemented for valuation of petroleum shipped on Alaska petroleum pipeline for making of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline, Federal Energy Regulatory Commission (FERC) did not act irrationally in approving new methodology for two upstream points on pipeline but retaining existing gravity differential methodology for downstream point; precision of valuation methodology was much less important at downstream point than at other points. 5 U.S.C.A. § 706(2)(A); Interstate Commerce Act, §§ 1(5), 15(1), 49 U.S.C.(1976 Ed.) §§ 1(5), 15(1).

**10. Administrative Law and Procedure ⇐662**

**Carriers ⇐34**

Petroleum shippers' failure, until after Federal Energy Regulatory Commission

(FERC) had issued its rehearing order, to object to Commission's decision respecting valuation of distillate cut did not preclude shippers from raising issue, on grounds of failure to exhaust administrative remedies, on judicial review of Commission order mandating new methodology to be implemented for valuation of petroleum shipped on Alaska petroleum pipeline for making of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline. Interstate Commerce Act, §§ 1(5), 15(1), 49 U.S.C.(1976 Ed.) §§ 1(5), 15(1); 18 C.F.R. § 385.1902(b).

**11. Administrative Law and Procedure ⟹662**

Court of Appeals will not require aggrieved party to seek optional administrative appeals prior to petitioning for judicial review of administrative agency decision.

**12. Carriers ⟹31**

In its order mandating new assay methodology to be implemented for valuation of petroleum shipped on Alaska petroleum pipeline for making of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline, Federal Energy Regulatory Commission (FERC) reasonably concluded that assay methodology should place higher value on light distillate than on heavy distillate; Commission subdivided distillate because light distillate was often refined into jet fuel, whereas heavier distillate was incompatible with that use and was processed into less valuable products. 5 U.S.C.A. § 706(2)(A); Interstate Commerce Act, §§ 1(5), 15(1), 49 U.S.C.(1976 Ed.) §§ 1(5), 15(1).

**13. Carriers ⟹31**

In its order mandating new assay methodology to be implemented for valuation of petroleum shipped on Alaska petroleum pipeline for making of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline, Federal Energy Regulatory Commission (FERC) acted arbitrarily and capriciously in valuing light distillate at market price of jet fuel into which such distillate was refined and valuing heavy distillate at market price of fuel oil into which such distillate was processed, without discounting for processing costs, while valuing other cuts of petroleum in pipeline at their market price before processing. 5 U.S.C.A. § 706(2)(A); Interstate Commerce Act, §§ 1(5), 15(1), 49 U.S.C.(1976 Ed.) §§ 1(5), 15(1).

**14. Carriers ⟹34**

Court of Appeals may affirm Federal Energy Regulatory Commission (FERC) on judicial review only on grounds upon which it relied in exercising its power.

**15. Carriers ⟹31**

In its order mandating new assay methodology to be implemented for valuation of petroleum shipped on Alaska petroleum pipeline for making of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline, Federal Energy Regulatory Commission (FERC) acted unreasonably in valuing heavy residual fuel oil at unaltered market price for fuel oil product, while valuing other cuts of petroleum in pipeline at their market price before processing; record demonstrated no more than that price of product bore some remote relationship to value of heavy residual fuel oil as feedstock. 5 U.S.C.A. § 706(2)(A); Interstate Commerce Act, §§ 1(5), 15(1), 49 U.S.C.(1976 Ed.) §§ 1(5), 15(1).

**16. Carriers ⟹31**

For purposes of its order mandating new assay methodology to be implemented for valuation of petroleum shipped on Alaska petroleum pipeline for making of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline, evidence supported Federal Energy Regulatory Commission's (FERC) decision to expand range of components of petroleum streams that it categorized as residual fuel oil to include petroleum with boiling point between 1,000 and 1,050 degrees; witness testified that Commission's prior selection of 1,050 degrees as minimum for category was arbitrary and that 1,000 degrees was more consistent with refineries' characterization of residual fuel oil. 5 U.S.C.A. § 706(2)(A); Interstate Commerce Act, §§ 1(5), 15(1), 49 U.S.C.(1976 Ed.) §§ 1(5), 15(1).

**17. Carriers ⚡31**

Evidence did not support Federal Energy Regulatory Commission (FERC) decision to value lighter residual fuel oil at price of No. 6 fuel oil, in order mandating new assay methodology to be implemented for valuation of petroleum shipped on Alaska petroleum pipeline for making of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline; there was no evidence in record suggesting that price of No. 6 fuel oil bore close relationship to value of petroleum from area of pipeline with boiling point between 1,000 and 1,050 degrees. 5 U.S.C.A. § 706(2)(A); Interstate Commerce Act, §§ 1(5), 15(1), 49 U.S.C.(1976 Ed.) §§ 1(5), 15(1).

**18. Administrative Law and Procedure ⚡668**

**Carriers ⚡34**

Petroleum producer that sold petroleum that was subsequently shipped by shipper through Alaska petroleum pipeline was "aggrieved" by Federal Energy Regulatory Commission (FERC) order mandating new methodology to be implemented for valuation of petroleum shipped on pipeline for making of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline as required to have standing to challenge order's prospective-only status on judicial review; expert calculated money that would be due to producer if Commission ordered refunds retroactively, and producer was at least arguably within zone protected or regulated by Interstate Commerce Act (ICA). 28 U.S.C.A. § 2344; Interstate Commerce Act, §§ 1 et seq., 1(5), 13(1), 15(1), 49 U.S.C.(1976 Ed.) §§ 1 et seq., 1(5), 13(1), 15(1).

See publication Words and Phrases for other judicial constructions and definitions.

**19. Administrative Law and Procedure ⚡668**

**Carriers ⚡34**

To be "aggrieved" as required for standing to contest on judicial review Federal Energy Regulatory Commission (FERC) order mandating new methodology to be implemented for valuation of petroleum shipped on Alaska petroleum pipeline for making of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline, petroleum producer that sold petroleum that was subsequently shipped by shipper through pipeline had to have suffered injury in fact traceable to Commission's action, decision in its favor had to be capable of redressing that injury, and its interest had to be arguably within zone protected or regulated by statutory provision in question. 28 U.S.C.A. § 2344; Interstate Commerce Act, §§ 1 et seq., 1(5), 13(1), 15(1), 49 U.S.C.(1976 Ed.) §§ 1 et seq., 1(5), 13(1), 15(1).

**20. Administrative Law and Procedure ⚡668**

**Carriers ⚡34**

In determining whether party is "aggrieved" as required for standing to seek judicial review of final Federal Energy Regulatory Commission (FERC) order under Interstate Commerce Act (ICA), Court of Appeals evaluates aggrievement by reference to traditional principles of standing. 28 U.S.C.A. § 2344; Interstate Commerce Act, § 1 et seq., 49 U.S.C.(1976 Ed.) § 1 et seq.

**21. Carriers ⚡30**

Alaska petroleum pipeline carriers did not violate prior pipeline tariffs by transporting petroleum streams laden with natural gas liquids, which allegedly increased gravity of common stream and thus allegedly increased payments made by owners of streams relatively low in such liquids under prior gravity differential methodology for valuation of petroleum shipped on pipeline for making of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline; tariffs specifically permitted shipment of such liquids and did not require carriers to demand assays of tendered petroleum streams. Interstate Commerce Act, §§ 1(5), 15(1), 49 U.S.C.(1976 Ed.) §§ 1(5), 15(1).

**22. Carriers ⚡34**

On judicial review of Federal Energy Regulatory Commission (FERC) order mandating new methodology to be implemented for valuation of petroleum shipped on Alaska petroleum pipeline for making of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline,

Court of Appeals owed substantial deference to Commission's interpretation of pipeline carriers' tariff provisions. Interstate Commerce Act, §§ 1(5), 15(1), 49 U.S.C.(1976 Ed.) §§ 1(5), 15(1).

**23. Carriers ⚷34**

On judicial review of Federal Energy Regulatory Commission (FERC) order mandating new methodology to be implemented for valuation of petroleum shipped on Alaska petroleum pipeline for making of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline, in reviewing Commission's interpretation of pipeline carriers' tariff provisions, Court of Appeals would inquire whether Commission's interpretations were amply supported both factually and legally and would accept them only if they were result of reasoned and principled decisionmaking that could be ascertained from the record. Interstate Commerce Act, §§ 1(5), 15(1), 49 U.S.C.(1976 Ed.) §§ 1(5), 15(1).

**24. Carriers ⚷31**

In its order mandating new assay methodology to be implemented for valuation of petroleum shipped on Alaska petroleum pipeline for making of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline, rule against retroactive ratemaking precluded Federal Energy Regulatory Commission (FERC) from retroactively applying new methodology and ordering refunds to carriers charged under prior methodology. Interstate Commerce Act, §§ 1(5), 13(2), 15(1), 49 U.S.C.(1976 Ed.) §§ 1(5), 13(2), 15(1).

**25. Carriers ⚷189**

"Filed rate doctrine" forbids regulated entity to charge rates for its services other than those properly filed with appropriate federal regulatory authority.

See publication Words and Phrases for other judicial constructions and definitions.

**26. Carriers ⚷189**

Filed rate doctrine is based on long-established principles of regulatory law that rate of carrier duly filed is the only lawful charge and that shippers on common carriers are entitled to rely on filed rates until those rates are changed.

**27. Carriers ⚷31**

Filed rate doctrine's corollary is rule that federal regulatory agencies may not alter rates retroactively.

**28. Carriers ⚷31**

Rule against retroactive ratemaking does not extend to cases in which customers are on adequate notice that resolution of some specific issue may cause later adjustment to rate being collected at time of service.

**29. Administrative Law and Procedure ⚷819**

**Carriers ⚷34**

On judicial review of Federal Energy Regulatory Commission (FERC) decision finding that Commission lacked jurisdiction over method by which Alaska petroleum pipeline carriers compensated co-owners of petroleum streams shipped on pipeline to offset commingling of petroleum on pipeline, Court of Appeals could not deferentially review both Commission's explicit opinion that it lacked such jurisdiction and its implicit opinion, through its past approval of carriers' current method of dividing payments among unit stream co-owners on pro rata basis, that it did not lack such jurisdiction; therefore, Court would remand matter to Commission with instruction to establish consistent and reasoned position as to whether it had such jurisdiction. Interstate Commerce Act, §§ 1(5), 15(1), 49 U.S.C.(1976 Ed.) §§ 1(5), 15(1).

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Eugene R. Elrod and Stephen S. Hill argued the cause and were on the joint briefs for Exxon Co., U.S.A., petitioner in No. 94–1402 and intervenor in No. 94–1061.

John W. Griggs argued the cause and filed the briefs for OXY USA, Inc., petitioner in No. 94–1061 and intervenor in No. 94–1132.

Bradford G. Keithley, with whom Carolyn Y. Thompson was on the briefs, argued the cause for BP Exploration (Alaska), Inc., petitioner in No. 94–1132 and intervenor in No. 94–1061.

Randolph L. Jones Jr. argued the cause and was on the joint briefs for MAPCO Alaska Petroleum, Inc., petitioner in No. 94-1430 and intervenor in Nos. 94-1061 and 94-1132.

W. Stephen Smith argued the cause and was on the joint briefs for State of Alaska, petitioner in No. 94-1487 and intervenor in No. 94-1061.

Robert H. Benna and Jeffrey G. DiSciullo were on the joint briefs for Tesoro Alaska Petroleum Co., petitioner in No. 94-1466 and intervenor in No. 94-1061. James C. Reed and David S. Berman entered appearances for Tesoro Alaska Petroleum Co.

O. Yale Lewis and Richard A. Curtain were on the joint briefs for Petro Star, Inc., petitioner in No. 94-1476 and intervenor in Nos. 94-1061 and 94-1132.

Samuel Soopper, Federal Energy Regulatory Com'n ("FERC"), with whom Jerome M. Feit, Sol., Joseph S. Davies, Deputy Sol., and Edward Geldermann, Atty., FERC, and Anne K. Bingaman, Asst. Atty. Gen., and John J. Powers III, and Robert J. Wiggers, Attys., U.S. Dept. of Justice, were on the brief, argued the cause for respondents.

Matthew W.S. Estes, with whom Clifford M. Naeve was on the brief, argued the cause for intervenor ARCO Alaska, Inc.

Steven H. Brose and Steven Reed were on the brief for intervenor ARCO Transp., Alaska, Inc.

John E. Kennedy and Albert S. Tabor Jr. were on the brief for intervenors Amerada Hess Pipeline Corp., et al.

Before BUCKLEY, WILLIAMS and SENTELLE, Circuit Judges.

Opinion for the court filed by Circuit Judge BUCKLEY.

BUCKLEY, Circuit Judge:

The Trans Alaska Pipeline System ("TAPS") provides the sole means of shipping petroleum produced from the North Slope of Alaska south to the Port of Valdez, Alaska. Because there are multiple shippers and only a single pipeline, TAPS commingles the various shippers' petroleum. Necessity dictates that TAPS return to shippers a portion of that "common stream" at Valdez, regardless of whether their contributions were more or less valuable than the resulting mixture. The TAPS "Quality Bank" is an accounting arrangement approved by the Federal Energy Regulatory Commission ("FERC" or "Commission") that makes monetary adjustments between shippers in an attempt to place each in the same economic position it would enjoy if it received the same petroleum at Valdez that it delivered to TAPS on the North Slope. To accomplish this, the Quality Bank charges shippers of relatively low-quality petroleum who benefit from commingling and distributes the proceeds to shippers of higher quality petroleum whose product is degraded by commingling.

While the concept is simple enough, the devil is in the details: it is difficult to determine which contributions improve or degrade the value of the common stream, and to what extent. The operators of the pipeline must employ a method of estimating the value of various contributions to the common stream and for determining the relative values of the petroleum products delivered at Valdez. This methodology, which the Commission must approve pursuant to its authority under the Interstate Commerce Act ("ICA"), 49 U.S.C.App. §§ 1 *et seq.* (1988); *see also* 42 U.S.C. § 7172(b) (1988) (transferring authority to regulate oil pipeline rates under the ICA from the Interstate Commerce Commission to FERC); *Exxon Pipeline Co. v. United States,* 725 F.2d 1467, 1468 n. 1 (D.C.Cir. 1984) (explaining transfer of authority), is embodied in tariffs filed by the owners of TAPS ("TAPS Carriers").

In 1993, FERC determined that due to changed circumstances the existing Quality Bank valuation methodology was no longer just and reasonable; and it consequently ordered a new one to be implemented. *Trans Alaska Pipeline System,* 65 F.E.R.C. ¶ 61,-277 (1993) (*"1993 Order"*). Various shippers filed petitions for review, claiming that aspects of the new methodology violated substantive provisions of law or were arbitrary and capricious and thus violated the Administrative Procedure Act ("APA"), 5 U.S.C. § 706(2)(A) (1994). We consolidated these

petitions and now grant them in part and deny them in part. We find that the Commission was justified in ordering a change in the Quality Bank valuation methodology and in declining to order certain refunds. We also find, however, that two aspects of the new methodology and the Commission's claim that it lacked jurisdiction to consider one shipper's complaint do not comport with the APA's requirement of reasoned decisionmaking.

## I. Background

### A. The TAPS Quality Bank

TAPS is a 48-inch diameter pipeline that extends nearly 800 miles from its origin on Alaska's North Slope near Prudhoe Bay to its terminus at Valdez on Alaska's south central coast. The pipeline is jointly owned by seven TAPS Carriers. Affiliates of some of the TAPS Carriers constitute a subset of the group of companies that ship petroleum through the line. TAPS carries a mixture of crude oils and natural gas liquids ("NGLs") from a series of North Slope oil fields. The Quality Bank makes monetary adjustments among the shippers to compensate for the commingling of differing qualities of crude oil.

The Quality Bank operates at three locations. At Pump Station No. 1, located at the Prudhoe Bay origin of the pipeline, the Bank values the petroleum streams delivered to TAPS by the various shippers. It charges some shippers and makes payments to others based on the difference in value between their individual contributions and the weighted average of all incoming streams. More than 400 miles south of Prudhoe Bay, at the junction of TAPS and the Golden Valley Electric Association pipeline ("GVEA") near Fairbanks, refineries operated by petitioners MAPCO Alaska Petroleum, Inc. ("MAPCO") and Petro Star, Inc. ("Petro Star") divert a portion of the common stream and remove certain petroleum products from it. That portion of the common stream less the products removed, known as the refinery "return stream," is then returned to TAPS. At GVEA, the Quality Bank compares the value of the diverted portion of the common stream to that of the return stream, charging the refiners and compensating other shippers for the reduction in the common stream's value caused by the removal of the refinery products. Finally, at the Port of Valdez, TAPS returns the common stream to the shippers in amounts proportionate to the quantity of petroleum they originally delivered to the pipeline. Because there are minor daily fluctuations in the value of the petroleum delivered at Valdez, the Quality Bank makes price adjustments based on the difference in value between the petroleum received by a shipper on a given day and the average value of the common stream at Valdez over the course of the month. Thus shippers who receive a tanker-full of oil of a higher-than-average quality will make a payment to the Quality Bank so that it may in turn compensate those who receive oil of a lower-than-average value.

In 1984, following years of litigation between the TAPS Carriers and MAPCO over the valuation methodology used by the Quality Bank, FERC approved a settlement between the parties that embodied a notably simple approach. *Trans Alaska Pipeline System*, 29 F.E.R.C. ¶ 61,123 (1984) (*"1984 Order"*). Because lighter, high gravity crude oil (as gravity is measured on the American Petroleum Institute ("API") scale) is generally more valuable than a heavier, low gravity crude, the settlement proposed to equate the gravity of the petroleum with its value: contributors of petroleum having a gravity higher than that of the TAPS common stream would receive payments from the Quality Bank while contributors of petroleum having a gravity lower than that of the stream would make payments to the Bank. Under this system, known as the "intra-field gravity differential" methodology, the amounts of these payments were calculated using the adjustments to the posted prices for variations in gravity appearing in the postings for a number of Texas and California crude oils having a range of gravity that includes the average API gravity of the TAPS commingled stream. *Id.* at 61,239.

Tesoro Alaska Petroleum Co. ("Tesoro"), a TAPS shipper, contested the settlement on the ground that the gravity of petroleum is an inaccurate measure of its value. Tesoro favored a "distillation" methodology that

would value the petroleum based on the boiling point of various hydrocarbons in the streams. *Id.* In approving the settlement over Tesoro's objection, FERC conceded that there is no perfect valuation methodology and that other approaches might produce more accurate measurements than the one proposed by the settlement. Nevertheless, the Commission found that the proposed gravity method passed the threshold test of being "just and reasonable." *Id.* The Commission noted that Tesoro or any other interested party had the ability to propose another methodology in the future. *Id.* at 61,240.

B. The Challenge to the Gravity Methodology

In 1989, the issue of the Quality Bank valuation methodology reemerged. Following routine practice, the TAPS Carriers filed new tariffs, to be effective July 1, 1989, which proposed slight adjustments in the value of TAPS streams consistent with changes in market prices of crude oils of various gravities. *See Amerada Hess Pipeline Corp.*, 47 F.E.R.C. ¶ 62,336 at 63,654–55 (1989) (*"Pipeline Board Order"*). Petitioner OXY USA, Inc. and Conoco, Inc. challenged the filings as unjust and unreasonable, alleging both that the Carriers improperly calculated the new gravity values and that they had violated the terms of their previously filed tariffs by permitting shippers to include NGLs in the petroleum they shipped through TAPS. *Id.* at 63,655.

Underlying the OXY/Conoco challenge, and critical to the petitions for review now before us, is the concern of some shippers over the increase in the amount of NGLs shipped through the pipeline between 1984 and 1989. NGLs have a very high gravity relative to other petroleum products but, according to the critics of the gravity methodology, they do not have as high a value as that attributed to them by that methodology. The critics believe that shippers with a high percentage of NGLs in their petroleum streams were actually *reducing* the value of the common stream but were being compensated by the Quality Bank as if they were increasing its value.

FERC's Oil Pipeline Board suspended the new rates for one day and then permitted them to become effective subject to refund following a hearing concerning their lawfulness, *id.* at 63,656, pursuant to the Commission's authority under section 15(7) of the ICA. That section provides that

> in case of a proposed increased rate or charge ... the Commission may by order require the interested carrier or carriers to keep accurate account ... and upon completion of ... hearing and decision may by further order require the interested carrier or carriers to refund, with interest ... such portion of such increased rates or charges as by its decision shall be found not justified.

49 U.S.C.App. § 15(7) (1988). On appeal, the Commission affirmed the Oil Pipeline Board's decision and explained that it would order refunds, retroactive to the date the rate adjustments were filed, should a hearing before an administrative law judge ("ALJ") reveal that the adjustments were incorrectly calculated or that the TAPS Carriers were in violation of the terms of their tariffs by transporting NGLs, but stated that "because the TAPS owners ha[d] not proposed to change the existing methodology, any change in [the Quality Bank valuation] methodology [would] be effected prospectively." *Trans Alaska Pipeline System*, 49 F.E.R.C. ¶ 61,349 at 62,264–65 (1989) (*"1989 Order"*); *see also Trans Alaska Pipeline System*, 51 F.E.R.C. ¶ 61,062, at 61,137 (1990) (*"1990 Order"*). That said, the Commission ordered an investigation into the lawfulness of the Quality Bank gravity methodology pursuant to section 13(2) of the ICA, *1989 Order*, 49 F.E.R.C. ¶ 61,349 at 62,265, which grants the Commission

> full authority and power at any time to institute an inquiry ... concerning ... any of the provisions of this chapter ... on its [own] motion ... including the power to make and enforce any order or orders ... excepting orders for the payment of money.

49 U.S.C.App. § 13(2) (1988).

In November 1991, an ALJ assigned to investigate both the OXY/Conoco objections to the new tariff filings and the underlying

reasonableness of the Quality Bank valuation methodology issued his opinion on all of the issues raised. First, he determined that the Quality Bank's past charges were proper and that there had been no violations of the TAPS Carriers' tariffs because the shipment of NGLs was consistent with the terms of the FERC-approved 1984 settlement. *Trans Alaska Pipeline System,* 57 F.E.R.C. ¶ 63,-010 at 65,041–42 (1991) (*"ALJ Decision"*). After reexamining the Quality Bank's valuation methodology, however, he determined that "the evidence indicates that the current straightline gravity basis for valuing crude oil does not assign an accurate value for NGLs." *Id.* at 65,050. Coupled with his finding that shipments of NGLs had increased precipitously since 1984, this led the ALJ to conclude that circumstances surrounding the TAPS Quality Bank had "changed significantly," that the evidence "strongly establishes the distortion of value caused" by the NGLs delivered at Pump Station No. 1 and present in the GVEA return stream, and therefore that the gravity methodology as applied at Pump Station No. 1 and GVEA "no longer yield[ed] a just and reasonable result." *Id.* at 65,049–50, 65,052–53. To remedy this problem, he recommended a prospective alteration of the gravity methodology at those two locations, the details of which are not relevant to the claims before us. *Id.* at 65,069. The ALJ also found, however, that "[t]here is no evidence of any change in conditions at Valdez," and thus determined that the current gravity valuation method continued to be appropriate at that location. *Id.* at 65,053, 65,066.

C. The Commission's Orders

Rather than adopting the ALJ's proposed changes in the gravity methodology, the Commission referred the case to a settlement judge to see if the affected parties could negotiate an agreement amongst themselves. In 1993, the settlement judge submitted to FERC, for its consideration, a settlement agreement executed by many, but not all, of the TAPS Carriers and affected shippers, which largely abandoned the gravity methodology. *1993 Order,* 65 F.E.R.C. ¶ 61,277 at 62,285–86.

The proposed "assay methodology," which was similar to the methodology Tesoro favored in 1984, would divide each petroleum stream entering TAPS into eight components or "cuts" based on the temperature at which particular petroleum products boil out of the stream. Each of the eight cuts would be individually valued, and then combined to determine the stream's value. Under the proposed settlement, the five lightest cuts (those with the lowest boiling points)—propane, isobutane, normal butane, natural gasoline, and naphtha—would be valued at published market prices for those products. Because there were no readily available market prices for the three heaviest cuts, namely distillate, gas oil, and residual fuel oil ("resid"), the settlement suggested the use of market prices of similar products *adjusted* to take account of product differences. The Quality Bank would continue to calculate debits and credits by comparing the value of the common stream with that of each shipper's contribution to it. *Id.* Consistent with the ALJ's proposal, the parties would implement the new methodology at Pump Station No. 1 and GVEA while leaving the gravity methodology in place at Valdez. *Id.* The settlement agreement also provided a mechanism for resolving a dispute between the co-owners of the Prudhoe Bay Unit petroleum stream over the allocation of payments made to them by the Quality Bank. *Id.*

In November 1993, FERC adopted the settlement with modifications. *1993 Order,* 65 F.E.R.C. ¶ 61,277. Various combinations of petitioners now challenge five specific aspects of the Commission's Order. We briefly review the position the Commission assumed concerning these five contested issues and then evaluate the merits of each petitioner group's contentions.

*1. The assay methodology*

FERC accepted the settlement's proposal to replace the gravity valuation methodology with an assay methodology. It observed that the purpose of the Quality Bank is to

> establish the relative value of the different quality oils that are tendered to TAPS. As such, it must incorporate a valuation methodology that is a reasonable proxy for

the differences in the market value of the TAPS streams.

*Id.* at 62,286. The Commission agreed that due to the changed circumstances noted by the ALJ, the gravity methodology was no longer acceptable and that a new methodology was required. *Id.* at 62,287. It then found that the proposed assay methodology, with modifications to the methods of valuing two of the eight petroleum cuts, was "just and reasonable." *Id.* at 62,290.

*2. The distillate cut*

The settlement agreement proposed to label petroleum that boils out of a stream between 350 and 650 degrees Fahrenheit as "distillate" and to value it at the market price of No. 2 fuel oil plus an adjustment of .001 cents per barrel. FERC decided to deviate from this proposal in two respects. First, it modified the settlement to split the distillate cut into two parts, light distillate (350–450 degrees) and heavy distillate (450–650 degrees), on the ground that light and heavy distillates "are distinctly different and marketed separately." *Id.* at 62,288. Second, the Commission

> believe[d] that market prices, uncomplicated by subjective adjustments, must be used for the Quality Bank adjustments to be non-discriminatory, in appearance as well as in fact. Market prices have the advantage of being objective, non-discriminatory, easily ascertainable, and generally not susceptible to manipulation.

*Id.* at 62,289. Accordingly, it rejected the settlement agreement's addition of an adjustment factor to a market price to arrive at a value. Instead, it ordered the Quality Bank to value light distillate at the market price of jet fuel and heavy distillate at the market price of No. 2 fuel oil, the finished products into which those cuts are often refined. *Id.* at 62,290.

*3. The resid cut*

The settlement proposed to classify oil with a boiling point above 1050 degrees Fahrenheit—the heaviest, most viscous portion of the stream—as resid. Because there is no market price for resid, which is what is left of the petroleum stream after the more valuable products are removed, the settlement proposed to value it at the average market price of two lighter products, No. 6 fuel oil and fuel oil 380 ("FO–380"), adjusted to account for the cost of blending agents that would be needed to actually convert the resid into these proxy products. *Id.* at 62,289. FERC discarded the proposed blending approach and ordered that the Quality Bank value resid at the average market price of No. 6 fuel oil and FO–380. *Id.* at 62,290. After several shippers argued that to do so would significantly overvalue heavy, resid-laden petroleum streams, FERC expanded the resid category to encompass oil with a boiling point higher than 1000 degrees. This had the effect of reducing the size of the more valuable gas oil cut (previously consisting of oil with a boiling point between 650 and 1050 degrees), and thus potentially reducing the relative value of heavier streams depending, of course, on the precise composition of those streams. FERC also decided to value resid with a boiling point higher than 1050 degrees at the price of FO–380 while valuing the lighter resid with a boiling point between 1000 and 1050 degrees at the price of the more expensive No. 6 fuel oil. *Trans Alaska Pipeline System,* 66 F.E.R.C. ¶ 61,188 at 61,419–20 (1994) (*"Rehearing Order"*).

*4. Prospective application*

Consistent with FERC's prior announcements that any change in the Quality Bank methodology would be prospective, the settlement agreement contained no provision for refunds to shippers who had paid more into the Quality Bank under the gravity methodology than they would be assessed under the assay methodology, even though the former had been found to be no longer just and reasonable. FERC affirmed the prospective nature of the shift in valuation methodology, noting that because the gravity methodology had been approved by FERC, the TAPS Carriers were justified in relying on it until it was changed. *1993 Order,* 65 F.E.R.C. ¶ 61,277 at 62,291–92. According to the Commission, the retroactive application of the assay methodology would violate the filed rate doctrine. *Id.* at 62,292.

*5. Prudoe Bay Unit dispute*

FERC rejected the settlement agreement's proposed resolution of the dispute among the co-owners of the Prudhoe Bay Unit stream concerning the Quality Bank's payments. It reasoned that this was a matter of private contract beyond the Commission's jurisdiction because it concerned events that occur before the commingled Prudhoe Bay Unit crude is delivered to the pipeline. *Id.* at 62,291. Accordingly, FERC ordered that the proposed dispute resolution procedures not be included in the TAPS Carriers' tariff filings. *Id.*

## II. Discussion

A. Change in Methodology

Petitioners Exxon Company, U.S.A. ("Exxon"), MAPCO, and Petro Star challenge the most basic aspect of the Commission's Order: the decision to abandon the Quality Bank's gravity valuation methodology and replace it with an assay methodology. Intervenors State of Alaska ("Alaska"), ARCO Alaska, Inc. ("ARCO"), BP Exploration (Alaska), Inc. ("BP"), OXY USA, Inc. ("OXY"), and Tesoro urge, as an initial matter, that these petitioners are estopped from raising their challenge because all three were signatories to the settlement agreement that proposed the methodological change. We find that petitioners' challenge is properly before us, but that it lacks merit.

*1. Estoppel/standing*

[1, 2] Although the intervenors label their challenge to petitioner's right to raise their claim as an "estoppel" argument, their argument is more properly characterized as a claim that petitioners lack standing to raise their challenge. Only parties "aggrieved" by a final Commission order issued under the ICA may bring a petition for review. 28 U.S.C. § 2344 (1988); *Shell Oil Co. v. FERC,* 47 F.3d 1186, 1200 (D.C.Cir.1995). The intervenors contend that because petitioners supported the change in methodology as it was embodied in the proposed settlement agreement, they cannot now claim to be aggrieved by the change.

The intervenors' argument mischaracterizes the factual background of the dispute. "It is the general rule that a party may not appeal from a disposition in its favor," *Showtime Networks, Inc. v. FCC,* 932 F.2d 1, 4 (D.C.Cir.1991), but the Commission's order cannot be fairly characterized as being in petitioners' favor. Petitioners supported a change in methodology, but not the change ultimately ordered. The proposed settlement would have valued the distillate and resid cuts quite differently than does the Commission's methodology, thus altering the relative value assigned to various petroleum streams to the intervenors' detriment. By advocating a specific settlement, petitioners did not forfeit their standing to object to elements of the settlement to which they had agreed if changes made in others by the Commission work to their overall disadvantage. This recognizes the reality that businessmen will yield on particular points if they are satisfied that the net results of an agreement will accrue to their benefit.

The sole case cited by the intervenors to support their position, *Southern Natural Gas Co. v. FERC,* 877 F.2d 1066 (D.C.Cir.1989), is not to the contrary. In that case, we found that the petitioner could not be "aggrieved" by FERC's denial of an alternative proposal when the Commission granted the one that was actually its first choice. *Id.* at 1070–71. Here, petitioners' first choice was clearly the settlement *as proposed;* and Exxon made it clear to the Commission that it preferred the retention of the gravity methodology to the adoption of the assay method as modified by FERC. *See Rehearing Order,* 66 F.E.R.C. ¶ 61,188 at 61,417. Because the Commission rejected the settlement to which they had agreed, petitioners may challenge the assay methodology as modified by the Order. *See Eastern Shore Natural Gas Co.,* 43 F.E.R.C. ¶ 61,489 at 62,212 (1988) ("If [petitioner] does not want to accept the settlement with the modifications that the Commission found were necessary ... [it] can reject the modified settlement and litigate the issues.").

*2. Merits of the change in methodology*

*a. Unforeseeability*

[3] Petitioners' initial challenge to FERC's decision to replace the gravity meth-

odology with the assay methodology is premised on the assumption that the proponents of change bore the burden of proving not only changes in circumstances, but also that the changes were "unforeseen or not reasonably foreseeable at the time of the prior Commission decision." Brief for Petitioners at 10. While they concede that there has been an increase in the amount of NGLs injected into the common stream since FERC approved the gravity methodology in 1984, they claim that the record is devoid of evidence that this increase was not foreseeable and, as a consequence, that the Commission erred as a matter of law in approving the change.

Petitioners' premise misstates the law. The ICA requires that all rates charged be "just and reasonable," 49 U.S.C.App. § 1(5), and empowers FERC to prescribe "just and reasonable" rates or charges when it determines that any rate or practice of a carrier is "unjust or unreasonable," 49 U.S.C.App. § 15(1), without regard to foreseeability. "FERC has a continuing obligation to ensure that pipeline rates are just and reasonable.... The fact that a rate was once found reasonable does not preclude a finding of unreasonableness in a subsequent proceeding." *Texas Eastern Transmission Corp. v. FERC,* 893 F.2d 767, 774 (5th Cir. 1990); *see also Norfolk & Western Ry. v. United States,* 768 F.2d 373, 378 (D.C.Cir. 1985) ("rate orders are *generally* not *res judicata* because every rate order made may be superseded by another") (emphasis in original, internal quotation marks omitted). Petitioners refer to cases in which the Commission has cited knowledge of future conditions as a factor where it has refused to modify a carrier's terms of service, *see, e.g., Trailblazer Pipeline Co.,* 50 F.E.R.C. ¶ 61,188 at 61,608 (1990), but these decisions in no way suggest that a finding of unforeseeability is required before the Commission may reach the conclusion that a rate that was previously just and reasonable is no longer so.

*b. Substantial evidence/arbitrary and capricious*

[4] In the alternative, petitioners contend that even if a foreseeable change in circumstances can serve as a basis for FERC's reevaluation of the Quality Bank's valuation methodology, the ALJ decision that served as the basis for the Commission's Order was not supported by substantial evidence; and, because it did not adequately explain the shift in policy, it was also arbitrary and capricious. We disagree.

[5-7] Petitioners are correct that FERC's decision to approve a portion of a contested settlement must be supported by substantial evidence, 18 C.F.R. § 385.602(h)(1)(i) (1995), and that we must set aside agency actions that are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). Our inquiry under the arbitrary and capricious test, of course, is "narrow and a court is not to substitute its judgment for that of the agency." *Motor Vehicle Mfrs. Ass'n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co.,* 463 U.S. 29, 43, 103 S.Ct. 2856, 2860, 77 L.Ed.2d 443 (1983) ("*State Farm*"). Where the necessary analysis "requires a high level of technical expertise, we must defer to the informed discretion of the responsible federal agencies." *Marsh v. Oregon Natural Resources Council,* 490 U.S. 360, 377, 109 S.Ct. 1851, 1861, 104 L.Ed.2d 377 (1989) (internal quotation marks omitted). Nevertheless, we require the Commission to engage in rational decision-making, *see, e.g., State Farm,* 463 U.S. at 43, 103 S.Ct. at 2866-67; *Laclede Gas Co. v. FERC,* 997 F.2d 936, 945 (D.C.Cir.1993), and, when changing course, it "must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed." *Michigan Consol. Gas v. FERC,* 883 F.2d 117, 122 (D.C.Cir.1989) (quoting *Hall v. McLaughlin,* 864 F.2d 868, 872 (D.C.Cir.1989)). For the reasons described below, we find that the ALJ's recommendation to abandon the gravity methodology, which the Commission adopted, satisfies these requirements.

FERC approved the gravity methodology as just and reasonable in 1984 over Tesoro's objection not because it believed that methodology precisely valued the petroleum delivered to TAPS, but because the impact on the common stream of materials not accurately

valued by the gravity method—i.e., NGLs—did not have a "measurable impact...." *1984 Order*, 29 F.E.R.C. ¶ 61,123 at 61,239. In 1991, the ALJ found that "[c]ircumstances on TAPS have changed significantly since 1984." *ALJ Decision*, 57 F.E.R.C. ¶ 63,010 at 65,050. First, shippers were injecting substantially larger quantities of NGLs into the petroleum delivered at Pump Station No. 1. *Id.* Second, MAPCO expanded its refinery at GVEA and Petro Star constructed its own refinery there, thus increasing the amount of valuable mid-weight products that was stripped from the common stream. As a consequence, the petroleum returned to TAPS at GVEA contained a still higher percentage of NGLs. *Id.* at 65,053. These changes, which increased the relative volume of NGLs injected into the common stream at both Pump Station No. 1 and GVEA, were material because "the current gravity-based methodology does not accurately value NGLs." *Id.* at 65,052. Together, they provide adequate factual support for the Commission's conclusion that "due to changed circumstances, the existing methodology is no longer just and reasonable, and that a new methodology is required." *1993 Order*, 65 F.E.R.C. ¶ 61,277 at 62,286 (footnote omitted).

Petitioners argue that the ALJ's reasoning that the gravity methodology is unjust because it fails to properly value NGLs is nonsensical in the context of the TAPS Quality Bank. They point out that NGLs are not delivered separately to TAPS, but merely constitute a portion of various petroleum streams, and argue that how a stream acquires its "quality" is "irrelevant to an assessment of that quality in the market place." Brief for Petitioners at 19. The ALJ recognized that the issue was not whether the gravity methodology accurately valued NGLs *per se*, but whether it placed a proper value on petroleum whose gravity had been increased as a result of the injection of substantial quantities of NGLs. He examined the evidence and concluded that "the current straightline gravity basis for valuing crude oil does not assign an accurate value for NGLs." *ALJ Decision*, 57 F.E.R.C. ¶ 63,010 at 65,050. It follows from this conclusion that shippers delivering oil with a high NGL content were either being overcompensated or undercompensated under the gravity methodology for their contribution to the value of the common stream.

Petitioners' arguments that the ALJ's reasoning was arbitrary or illogical must fail because what is really at issue is a disagreement between petitioners and the ALJ over whether the weight of the evidence indicates that the gravity methodology fairly values petroleum with a high NGL content. Petitioners strenuously argued to the ALJ that the high gravity of NGLs commensurately increases the value of the stream into which it is injected, but the ALJ considered their "evidence on this point ... not convincing," *id.*, and, in fact, was of the view that "the more substantial evidence indicate[d] that NGLs devalue the common stream...." *Id.*

[8] Determining the effect of NGLs on a stream's value is a question of fact. It calls for "a high level of technical expertise," requiring us to "defer to the informed discretion" of the agency. *Oregon Natural Resources Council*, 490 U.S. at 377, 109 S.Ct. at 1861; *see also Board of Trade of Kansas City v. United States*, 314 U.S. 534, 546, 62 S.Ct. 366, 372, 86 L.Ed. 432 (1942) (observing that "[t]he process of rate making is essentially empiric" and "Congress has therefore delegated the enforcement of transportation policy to a permanent expert body...."). Here, petitioners point to nothing in the record undermining the evidence—and the Commission's conclusion—that the gravity method is an inaccurate method for valuing a common stream with NGLs in as high a proportion as prevail at Pump Station No. 1 and GVEA.

[9] Finally, shifting gears, petitioners contend that it was irrational for the Commission to approve a change in methodology at Pump Station No. 1 and GVEA based on the finding that the gravity methodology is no longer just and reasonable at those locations while retaining that methodology at Valdez where NGLs unarguably are still present in the common stream. Again we disagree. It is no doubt true that if the assay methodology provides a more accurate valuation at Pump Station No. 1 and GVEA,

it will provide a more accurate valuation at Valdez as well. But the Commission may approve the methodology proposed in the settlement agreement if it is "just and reasonable"; it need not be the only reasonable methodology, or even the most accurate. *Cf. City of Bethany v. FERC,* 727 F.2d 1131, 1136 (D.C.Cir.1984) (when determining whether proposed rate was "just and reasonable," as required by Federal Power Act, FERC properly did not consider "whether a proposed rate schedule is more or less reasonable than alternative rate designs").

At Valdez, the Quality Bank adjusts for the differences in the quality of the common stream from one day to the next, rather than the differences in quality between the petroleum streams delivered to TAPS by various shippers or refiners. This difference is important for two reasons. First, as the record indicates, because the daily variations in the gravity of the common stream at Valdez are slight, Quality Bank adjustments there are "relatively inconsequential." Testimony of William H. Clifton, *reprinted* in Joint Appendix ("J.A.") at 2061–62. Second, any overvaluation of NGLs will not systematically adversely affect certain shippers and advantage others, because whether a particular shipper obtains a tanker of petroleum with a marginally higher or lower NGL content is a matter of random chance. Because the precision of the valuation methodology is so much less important at Valdez than at the other Quality Bank locations, it is not surprising that no shipper presented evidence to the Commission suggesting that the gravity methodology produced unjust or unreasonable results at Valdez, *see ALJ Decision,* 57 F.E.R.C. ¶ 63,010 at 65,053, or that the proposed settlement did not seek a change in the valuation method there. On the basis of this record, it was entirely reasonable for the ALJ to recommend, and FERC to approve, the maintenance of the status quo at the TAPS' terminus.

B. The Distillate Cut

Petitioners MAPCO, Petro Star and Alaska challenge, as arbitrary and capricious, FERC's decision to value the distillate cut by splitting it into "light" and "heavy" distillates and valuing the former at the price of jet fuel and the latter at the price of No. 2 fuel oil. Intervenors ARCO, BP, OXY, and Tesoro assert that this challenge is not properly before the court because none of the petitioners raised this objection in the original petitions for rehearing filed subsequent to the *1993 Order.* We find the intervenors' procedural challenge meritless and agree with petitioners that FERC's valuation of distillate is arbitrary.

*1. Exhaustion*

[10] The intervenors' procedural argument appears to be a claim that petitioners did not exhaust their administrative remedies because they failed to raise their objection to FERC's distillation cut methodology in a petition for rehearing. Their basic complaint is that, although the *1993 Order* described the Commission's decision to split the distillate cut and value light and heavy distillates separately, petitioners did not object to this decision until after the Commission had issued its *Rehearing Order.* The intervenors urge us to refuse to sanction this delay, which they call a "tactical ruse." Brief for Intervenors at 12.

[11] We need not investigate the propriety of petitioners' delay in seeking rehearing. The intervenors' argument must fail because there is no statutory or regulatory requirement that petitioners seek rehearing of an order issued by FERC under the ICA prior to seeking judicial review, 18 C.F.R. § 385.1902(b) (1995); and we will not require an aggrieved party to seek optional administrative appeals prior to petitioning for our review. *Darby v. Cisneros,* — U.S. —, — – —, 113 S.Ct. 2539, 2544–45, 125 L.Ed.2d 113 (1993) (exhaustion of administrative remedies doctrine limited to requirements "the statute or rule clearly mandates"); *compare Tennessee Gas Pipeline Co. v. FERC,* 9 F.3d 980, 981 (D.C.Cir.1993) (noting that a request for rehearing is a prerequisite for judicial review of FERC orders issued under the statutory authority of the Natural Gas Act, 15 U.S.C. § 717r).

2. *FERC's methodology*

The Commission's method of valuing distillate in the TAPS streams deviates from the proposed settlement in two material respects. First, FERC determined that heavy and light distillates are "distinctly different and are marketed separately," and thus should be valued separately. *1993 Order*, 65 F.E.R.C. ¶ 61,277 at 62,288. Second, because of its determination that all cuts should be valued at unaltered market prices, FERC rejected the proposed settlement's concept of arriving at valuations by adjusting market prices of similar but not identical products. Instead, it ordered the distillate cuts valued at the precise spot market prices of jet fuel and No. 2 fuel oil. Petitioners assert that both departures from the proposed settlement were arbitrary and capricious and/or not supported by substantial evidence.

[12] Petitioners contest FERC's decision to split the single distillate cut into heavy and light cuts by arguing that the record is devoid of evidence that the two cuts are, in fact, marketed separately. This objection reads FERC's rationale for splitting the cut too narrowly. The Commission subdivided the distillate cut into light and heavy components because lighter distillate is often refined into jet fuel and then marketed as such, whereas the heavier distillate is incompatible with this use and is therefore processed into and marketed as less valuable products. The record amply supports this conclusion. Given the differences in uses, the Commission reasonably concluded that the assay methodology should place a higher value on light distillate than on heavy distillate.

[13] Petitioners' more compelling argument is that FERC's decision to value light distillate at the market price of jet fuel and heavy distillate at the market price of No. 2 fuel oil is flawed because these market proxies are the prices of finished products rather than of raw materials. They claim that considerable processing is necessary before light distillate can be sold as jet fuel, or heavy distillate as No. 2 fuel oil, and that FERC's valuation methodology thus overvalues both light and heavy distillates relative to other cuts in the common stream by not taking these costs into account.

The Commission does not dispute petitioners' claim of overvaluation; rather, it defends its methodology on the ground that jet fuel and No. 2 fuel oil spot prices are "reasonable proxies" for light and heavy distillate and explains that it chose to avoid attaching adjustment formulas to the finished products' market prices to protect the objectivity of the Quality Bank's valuation methodology. Thus, it contends, the pricing decision fell within its proper discretion.

We cannot agree. The goal of the Quality Bank valuation methodology, as all parties agree, is to assign accurate relative values to the petroleum that is delivered to TAPS and becomes part of the common stream. In order to achieve this goal, FERC must accurately value all cuts—not merely some or most of them—or it must overvalue or undervalue all cuts to approximately the same degree. If light and heavy distillates are overvalued and other cuts are not, streams rich in these distillates will be overvalued relative to other streams and their owners will receive a windfall in the form of Quality Bank credits. FERC's position appears to be that because jet fuel bears some relation to light distillate and No. 2 fuel oil bears some relation to heavy distillate, the prices of the finished products are close enough to the values of the raw materials to serve as their proxies, although it presents no data to indicate how close the values are in fact. We find this reasoning arbitrary and capricious and thus conclude that, absent a more persuasive justification, FERC's method of valuing distillates violates the APA. 5 U.S.C. § 706(2)(A).

[14] The intervenors who support the Commission present a stronger argument. Focusing on light distillate, they concede that converting the raw material into jet fuel requires some processing but contend that this treatment is minimal and not unlike the minor processing required to bring other cuts of the common stream up to the specifications assumed by the spot market prices used to value them. This premise, if true, might support the reasonableness of FERC's light distillate valuation method. It is not the reason that the Commission adopted,

however, and we may affirm the agency only on the grounds upon which it relied in exercising its power. *See SEC v. Chenery Corp.*, 318 U.S. 80, 95, 63 S.Ct. 454, 462–63, 87 L.Ed. 626 (1943); *Puerto Rico Higher Educ. Assistance Corp. v. Riley*, 10 F.3d 847, 850 (D.C.Cir.1993). It is also not supported by substantial evidence in the record. Although one witness characterized the processing required to turn light distillate into jet fuel and heavy distillate into No. 2 fuel oil as "minor," Testimony of William Stancil, *reprinted in* J.A. at 1232, there is no attempt in the record that we are aware of to quantify these "minor" costs or to project the extent to which ignoring them would result in the overvaluation of TAPS streams heavily laden with distillate.

We are conscious of the difficult and necessarily imprecise task FERC faces when it must split petroleum streams into component parts and then place a value on each of them. We agree with the Commission that there is no "perfect way" to value the different quality oils shipped on TAPS, *1993 Order*, 65 F.E.R.C. ¶ 61,277 at 62,286, especially in the case of products without a readily ascertainable market price; and we will not hold the Commission to an impossibly high standard. But if the agency chooses to value some cuts of petroleum at the prices they command in the market without the benefit of processing, as it appears to have done, it must attempt, to the extent possible, to value all cuts at the price they would command without processing. It cannot, consistent with the requirement of reasoned decisionmaking, value some cuts precisely and others haphazardly. Accordingly, we must remand its distillate valuation methodology for further consideration.

C. The Resid Cut

Recall that the settlement agreement proposed that the TAPS Quality Bank value resid—the heaviest portion of the petroleum stream—at the price of FO–380 less the cost of converting it into FO–380. Under this approach, all resid would not be valued equivalently: its value would vary based in part on its viscosity, as more viscous resid would require more of a blending agent to be converted into FO–380.

The Commission found this "blending" valuation methodology "arbitrary, unreasonable, and impractical," *1993 Order*, 65 F.E.R.C. ¶ 61,277 at 62,288, due to its determination that "[r]esid is primarily used as a [refinery] feedstock [to manufacture other products] in processes where its viscosity is irrelevant to its value...." *Trans Alaska Pipeline System*, 67 F.E.R.C. ¶ 61,175 at 61,531 (1994). The Commission decided it was appropriate to value all resid with a boiling point higher than 1050 degrees identically because such a valuation would be consistent with "the use to which the overwhelming majority of North Slope resid is put." *Id.* Notwithstanding this position, in an attempt to accommodate shippers who feared that a departure from the blending methodology would result in the overvaluation of resid, the Commission expanded the resid cut to include petroleum with a boiling point as low as 1000 degrees, valuing resid with a boiling point higher than 1050 ("1050+ resid") at the price of FO–380 and petroleum with a boiling point between 1000 and 1050 degrees ("lighter resid") at the price of No. 6 fuel oil.

As is true of distillate, there is no published market price for resid, which makes valuing it difficult. In spite of the vexing nature of the problem and the deference we owe the Commission's judgments, we find that its approach to resid valuation fails to satisfy the APA's basic requirement of reasoned decisionmaking. *See, e.g., State Farm*, 463 U.S. at 43, 103 S.Ct. at 2866–67; *Laclede Gas Co.*, 997 F.2d at 945. Consequently, we remand this portion of the assay methodology to the Commission for further consideration.

*1. The 1050+ resid*

The Commission searched for a proxy price for the 1050+ resid that would be consistent with its belief that objectivity was best served by valuing petroleum cuts only at unadjusted market prices. It offered the following justification for its selection of the published price of FO–380 as an appropriate proxy:

> We are cognizant that [FO–380] does not correlate directly with the specifications of [resid]; however, it is the best commonly available published pricing indicator which

most closely approximates the specifications of [resid]. This reference price represents the least desirable, heaviest gravity product still traded on major markets. Moreover, since the purpose of the Quality Bank is only to establish relative values for the TAPS crude streams ... our purpose is adequately served by this reference pricing scheme.

*Rehearing Order*, 66 F.E.R.C. ¶ 61,188 at 61,420.

[15] Petitioners Exxon, Alaska, and Tesoro challenge FERC's valuation of the 1050+ resid and in doing so reiterate their support for the settlement proposal's methodological approach. They believe that FERC's methodology significantly overvalues resid, thus penalizing shippers of petroleum having a low content of the 1050+ resid.

The Commission's resid valuation methodology suffers from the same conceptual flaw that plagues its distillate methodology: the record demonstrates no more than that the price of FO-380 bears some remote relationship to the value of 1050+ resid as a feedstock. FERC offers two arguments in defense of its use of FO-380 as a proxy, neither of which is convincing. First, relying on expert testimony, the Commission claims that FO-380 can substitute for the 1050+ resid as a feedstock. Notably, neither the witness who so testified nor any other stated that it was a common industry practice to use FO-380 as a feedstock when resid would do the job. Consequently, although the cited testimony supports the conclusion that FO-380 and the 1050+ resid share some physical properties, it in no way suggests the two materials have equal or even near-equal market values. As petitioners aptly note, FERC's reasoning is akin to suggesting that if diamonds can be substituted for coal as a source of carbon, the price of diamonds would be an appropriate proxy for the price of coal. The Commission's conclusion simply does not follow from its premise.

The Commission's alternate justification is that it has assigned, as a proxy for this least valuable component of the common stream, the petroleum product having the lowest published price. The fact that FO-380 is cheaper than other petroleum products with active markets, however, in no way demonstrates that its value is even remotely commensurate with that of resid. If the Commission values other cuts in the TAPS streams using relevant market prices but significantly overvalues resid, the Quality Bank will consequently overvalue resid-laden petroleum streams relative to those with a significantly lower resid content. We therefore find the 1050+ resid portion of the assay methodology arbitrary and capricious and remand it to the Commission for further consideration.

Petitioners' criticism of the Commission's 1050+ resid valuation methodology, however, runs deeper than the methodology's most obvious shortcoming. Petitioners object to the Commission's emphasis on resid's value as a feedstock. They argue that, according to basic economic principles, a product's marginal use—not its most prevalent use—dictates its market price. While conceding that most North Slope resid is used as a feedstock, petitioners contend, and FERC does not dispute, that the 1050+ resid's marginal use is as an ingredient of FO-380 or similar fuel oils. To convert this resid into the less viscous FO-380, lighter oils more expensive than FO-380 must be used as a blending agent. This leads petitioners to their ultimate conclusion that 1050+ resid must be less valuable than FO-380. The Commission, in its various orders, has failed to respond to this argument.

It is true that a competitive market will set a product's price at its marginal use value, *see* Paul A. Samuelson and Anthony Scott, *Economics: An Introductory Analysis* 471 (1966), but this hardly proves that a market would price resid precisely at its value as a blending agent to the refiners that use it for that purpose. If there are market imperfections, petitioners' position might not be correct. Thus, their suggested resid valuation methodology is not necessarily the only reasonable one. Nonetheless, petitioners' argument has sufficient analytical force. On remand, the Commission should explicitly address whether the marginal use of 1050+ resid should be taken into account in that cut's valuation methodology.

*2. The lighter resid*

Petitioners also challenge FERC's decision to expand the resid cut to include petroleum with a boiling point between 1000 and 1050 degrees, and to value that portion of the resid cut at the price of low-sulfur No. 6 fuel oil. They claim that there is no evidence in the record that supports either of these decisions.

[16] We believe there is sufficient evidence to support the Commission's decision to expand the range of the components of the petroleum streams that it categorizes as "resid." In the rehearing proceedings, an Exxon consultant testified that the Commission's previous selection of 1050 degrees as the cut-off point for the resid cut was arbitrary and that 1000 degrees was more consistent with what West Coast refineries tend to characterize as residual fuel oil. Aff. of Joe F. Moore, *reprinted in* J.A. at 2162–63. In light of the fact that there is no published market price for resid and, consequently, no precise specifications for it, we find it was well within FERC's discretion to rely on this testimony to reach its decision to expand the resid cut.

[17] Petitioners are correct, however, that there is no evidence in the record to justify the Commission's decision to value the lighter resid at the price of No. 6 fuel oil. FERC defends this decision on the ground that it has a lower viscosity than the 1050+ resid and thus is more valuable. This response is inconsistent with the Commission's position, discussed above, that the viscosity of resid has no bearing on its value because most resid is used as a feedstock. In addition, as is the problem with the Commission's valuation of the 1050+ resid and the light and heavy distillates, we know of no evidence in the record that suggests that the price of No. 6 fuel oil bears a close relationship to the value of North Slope petroleum with a boiling point between 1000 and 1050 degrees. As a result, we must remand the Commission's method of valuing the lighter resid as well.

D. Refunds

Petitioner OXY challenges FERC's determination that changes in the Quality Bank valuation methodology would be prospective only. Intervenors ARCO, Exxon, MAPCO, and the TAPS Carriers collectively counter with a challenge to OXY's standing to contest the Commission's ruling. We find that OXY demonstrated that it was "aggrieved" by FERC's order and thus has standing, but that the Commission properly declined to order refunds.

*1. Standing*

[18–20] As noted above, only "aggrieved" parties may seek judicial review of a final FERC order issued under the ICA. 28 U.S.C. § 2344; *Shell Oil*, 47 F.3d at 1200. We evaluate aggrievement by reference to traditional principles of standing. *Water Transport Ass'n v. ICC*, 819 F.2d 1189, 1193 (D.C.Cir.1987). To be aggrieved, then, OXY must have suffered an "injury in fact" traceable to FERC's action, a decision in its favor must be capable of redressing that injury, and its interest must be "arguably within the zone protected or regulated by the ... statutory [provision] ... in question." *Id.* OXY bears the burden of proof on all of these elements. *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 559–61, 112 S.Ct. 2130, 2136, 119 L.Ed.2d 351 (1992).

Intervenors first argue that OXY has not satisfied its burden of proving injury in fact because there is no evidence that it would have benefited from a refund of past Quality Bank payments. It is undisputed that OXY is not a TAPS shipper; it sells petroleum to Conoco, Inc., which in turn sells petroleum to TAPS shippers. The intervenors concede that OXY may have an interest in the methodology employed by the Quality Bank in the future because that methodology might affect the prices it can charge for its petroleum, but they argue that there is no evidence that OXY would be contractually entitled to share in any rebate the Commission might order.

We disagree. In a 1990 TAPS hearing, an expert witness testifying on behalf of OXY and Conoco concerning a potential change in methodology calculated the amount of money that would be due to OXY for 1989 and 1990

if the Commission ordered refunds. In the absence of any counter-evidence suggesting OXY would not, in fact, participate in any refund, we find in this testimony a sufficient demonstration of injury to satisfy the Supreme Court's requirement that the injury be "actual ... not conjectural or hypothetical." *Id.* (internal quotation marks omitted).

Intervenors also contend that OXY does not fall within the ICA's zone of interest because the primary purpose of the ICA is to protect shippers. They have far too narrow a view of the statute's objectives. The ICA grants the Commission broad authority to respond to complaints concerning "anything done or omitted to be done by any common carrier" subject to the statute lodged by

> [a]ny person, firm, corporation, company, or association, or any mercantile, agricultural, or manufacturing society or other organization, or any body politic or municipal organization, or any common carrier....

49 U.S.C.App. § 13(1) (1988). The statutory scheme indicates a congressional intent to protect the interests of a broad category of entities affected by the practices of common carriers. Conversely, nothing in the statute suggests that concern is limited to parties in privity with common carriers. We believe it would be impossible to say that companies like OXY, *i.e.*, those that produce and sell petroleum that is subsequently shipped through TAPS, are not at least "arguably within the zone protected or regulated by the [ICA]...." *Water Transport*, 819 F.2d at 1193. Therefore, we conclude that OXY was "aggrieved" by FERC's decision to not order refunds and may challenge that decision here.

*2. Tariff violations*

[21] FERC has consistently maintained that shippers would be entitled to refunds from July 1, 1989, the effective date of the updated tariff filings, only if it were found that the NGLs were being shipped in violation of the tariffs or that Quality Bank debits and credits were being incorrectly calculated. *1993 Order*, 65 F.E.R.C. ¶ 61,277 at 62,292; *see also 1990 Order*, 51 F.E.R.C. ¶ 61,062 at 61,137; *1989 Order*, 49 F.E.R.C. ¶ 61,349 at 62,264–65. The ALJ found no tariff violations or calculation errors. *ALJ Decision*, 57 F.E.R.C. ¶ 63,010 at 65,041–45. Consistent with this finding, the proposed settlement did not call for refunds. FERC's approval of the settlement reiterated that the change in the Quality Bank methodology would be prospective only, presumably agreeing with the ALJ that no tariff violations had occurred. *See 1993 Order*, 65 F.E.R.C. ¶ 61,277 at 62,291–92. OXY now challenges that determination.

[22, 23] Recognizing the Commission's technical expertise in the area of pipeline ratemaking, we owe "substantial deference" to its interpretation of the TAPS Carriers' tariff provisions. *Natural Gas Clearinghouse v. FERC*, 965 F.2d 1066, 1070 (D.C.Cir.1992). Deference does not imply abdication of our obligation to review the Commission's orders, however. We inquire whether the Commission's interpretations are "amply supported both factually and legally" and accept them only if they are "the result of reasoned and principled decision-making that can be ascertained from the record." *Tarpon Transmission Co. v. FERC*, 860 F.2d 439, 442 (D.C.Cir.1988) (internal quotation marks omitted). The ALJ's interpretation of the TAPS Carriers' tariffs easily meets this standard.

OXY argues that the TAPS Carriers violated three provisions of their tariffs by transporting NGL-laden petroleum streams which increased the gravity of the common stream and thus increased the payments owed the Quality Bank by the owners of streams relatively low in NGLs. First, OXY claims the Carriers violated tariff provisions permitting them to transport only petroleum that had a gravity of between 17 and 40 degrees, which it believes effectively prohibits the direct shipment of the high-gravity NGLs. The ALJ pointed out, however, that "[n]othing contained in the tariffs ... requires the carriers to separately test the components of the streams," *ALJ Decision*, 57 F.E.R.C. ¶ 63,010 at 65, 043, and that all of the Carriers' tariffs specifically permit the shipment of "unrefined liquid hydrocarbons including gas liquids"—*i.e.*, NGLs. *Id.* From these facts, the ALJ reasoned that the tariffs' gravity limitations pertain to petrole-

um streams as delivered to TAPS, not to the individual components of those streams. As OXY concedes that no petroleum shipped on TAPS has ever exceeded the gravity restrictions, the ALJ reasonably found that the inclusion of NGLs in the crude delivered to the pipeline did not violate the tariffs.

Second, OXY claims that the TAPS Carriers violated their tariffs by failing, on some occasions, to demand assays of tendered petroleum streams prior to shipment. It believes that the Carriers should have used the assays to determine that excessive NGL injections were devaluing the common stream and explore ways to address the problem. The ALJ determined that the purpose of the assay provisions is to help the Carriers transport petroleum safely and efficiently, not to benefit the shippers in any way. In support of this interpretation, he pointed out that some of the tariffs permit the Carriers to demand an assay but do not require that they do so. One tariff, for example, provides that the "Carrier may require ... a suitable assay of the tendered Petroleum," while another permits a Carrier to reject any petroleum tendered without such an assay. *Id.* at 65,041. The ALJ was clearly justified in concluding that any failure to conduct assays prior to shipment on the part of the TAPS Carriers did not constitute a violation of their tariffs or harm the shippers.

Third, OXY contends that the shipment of NGLs violated tariff provisions that require the TAPS Carriers to reject petroleum whose characteristics will materially affect the quality or value of other shippers' petroleum unless the Quality Bank makes reasonable monetary adjustments. OXY argues that the ALJ's findings that the gravity valuation methodology no longer produces just and reasonable results demonstrates that the Quality Bank failed to compensate it for the loss it incurred as a result of the commingling of its petroleum with streams that had a high NGL content. The ALJ viewed this argument as essentially addressed to the propriety of the gravity methodology, which FERC had approved as just and reasonable in 1984, rather than to the manner in which the Carriers had implemented the Commission tariffs. He succinctly and appropriately reasoned that

> [t]he concept of the transport of NGLs was anticipated at the time of the [1984] Settlement. The Quality Bank was established to provide reasonable monetary adjustments for the varying quality of shipments. The TAPS Carriers have the right to rely upon the Quality Bank to do so. I find no violation of this tariff provision.

*ALJ Decision,* 57 F.E.R.C. ¶ 63,010 at 65,-042. In other words, when FERC approved the gravity valuation methodology in 1984, the Quality Bank adjustments made pursuant to that methodology *de facto* became "reasonable monetary adjustments." *Cf. Montana-Dakota Utilities Co. v. Northwestern Public Service Co.,* 341 U.S. 246, 251, 71 S.Ct. 692, 695, 95 L.Ed. 912 (1951) ("[T]he right to a reasonable rate is the right to the rate which the Commission files or fixes....")

*3. Retroactive application of the new methodology*

[24] The Commission has consistently defended its decision not to apply the assay methodology retroactively on two related grounds. First, it points out that it launched its investigation into the methodology pursuant to section 13(2) of the ICA, which does not permit the Commission to issue "orders for the payment of money." 49 U.S.C.App. § 13(2). *See 1990 Order,* 51 F.E.R.C. ¶ 61,-062 at 61,137. Second, it contends, essentially, that because the Quality Bank valuation methodology and the resulting cash adjustments among shippers are integral parts of the TAPS tariff structure, changes must conform to the filed rate doctrine, which protects the ability of shippers and common carriers to rely on filed rates until they are formally changed. *1993 Order,* 65 F.E.R.C. ¶ 61,277 at 62,292,

OXY counters that FERC suspended the TAPS Carriers' 1989 rate filings pursuant to its authority under section 15(7) of the ICA, which gives it the authority to order refunds of "increased rates or charges as by its decision shall be found not justified." 49 U.S.C.App. § 15(7). Because the Commission has found that the gravity methodology

is no longer just and reasonable, OXY believes FERC has the authority to retroactively implement the new methodology and the responsibility to provide a reasoned opinion for its failure to exercise that authority.

We conclude that FERC properly determined that it lacked the authority to apply the new methodology retroactively. Although the Quality Bank valuation methodology is a formula rather than an actual "rate," we agree with FERC that the methodology has been an integral element of the TAPS Carriers' tariff structure since it approved the 1984 settlement. *1993 Order*, 65 F.E.R.C. ¶ 61,277 at 62,292. That structure establishes the conditions governing the shippers' access to the pipeline. As we observed in *Moss v. C.A.B.*, 430 F.2d 891, 897 (D.C.Cir. 1970), "[a]s a practical matter, the [agency's] order [of a ratemaking formula] amount[s] to the prescription of rates...." Thus, the filed rate doctrine applies to changes in that methodology.

[25, 26] The filed rate doctrine "forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority." *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577, 101 S.Ct. 2925, 2930, 69 L.Ed.2d 856 (1981). The doctrine is based on the long-established principles of regulatory law that "the rate of the carrier duly filed is the only lawful charge," *Louisville & Nashville R.R. v. Maxwell*, 237 U.S. 94, 97, 35 S.Ct. 494, 495, 59 L.Ed. 853 (1915), and that shippers on common carriers are entitled to rely on filed rates until those rates are changed. *Arizona Grocery Co. v. Atchison, Topeka and Santa Fe Ry.*, 284 U.S. 370, 387–88, 52 S.Ct. 183, 185, 76 L.Ed. 348 (1932) (A carrier "cannot have reparation from the shippers for a rate collected under [an Interstate Commerce Commission] order upon the ground that it was unreasonably low.")

[27, 28] The doctrine's corollary, applicable here, is the rule that agencies may not alter rates retroactively. *See, e.g., Arizona Grocery*, 284 U.S. at 389, 52 S.Ct. at 186; *Town of Concord v. FERC*, 955 F.2d 67, 71 (D.C.Cir.1992). Together, these principles prevent unjust discrimination and, more relevant to this case, they ensure predictability. *See Natural Gas Clearinghouse*, 965 F.2d at 1075. The rule against retroactive ratemaking, however, "does not extend to cases in which [customers] are on adequate notice that resolution of some specific issue may cause a later adjustment to the rate being collected at the time of service." *Id.* The goals of equity and predictability are not undermined when the Commission warns all parties involved that a change in rates is only tentative and might be disallowed.

The provisions of the ICA reflect these general doctrinal rules. Section 13(2), which the Commission invoked in this case, authorizes it to investigate and, in appropriate circumstances, to change an existing rate, with this qualification: FERC may not issue "orders for the payment of money." Thus the Commission has no authority under that section to apply a change retroactively. On the other hand, section 15(7), on which OXY relies, creates a mechanism by which FERC may allow a challenged rate increase to take conditional effect pending an investigation into its reasonableness. Section 15(7) procedures do not undermine the rule against retroactive ratemaking because all parties are placed on notice that the agency has the authority to order a refund of any part of the increase that it finds to be unjustified. This statutory scheme is similar in structure to other statutes that govern FERC's ratemaking authority. *See City of Batavia v. FERC*, 672 F.2d 64, 75–76 (D.C.Cir.1982) (distinguishing between section 205 of the Federal Power Act, which provides FERC with authority to order refunds of new schedules found to be unjust, and section 206, which permits FERC to investigate existing rates and change them prospectively); *Sea Robin Pipeline Co. v. FERC*, 795 F.2d 182, 189 n. 7 (D.C.Cir.1986) (finding FERC may not order a retroactive refund after finding a filed rate unjust subsequent to an investigation launched on its own initiative pursuant to section 5 of the Natural Gas Act).

Section 13(2) governs the change to the assay methodology for two independent reasons. In their 1989 filing, the TAPS Carriers proposed increases in the Quality Bank adjustments; they did *not* propose a change in the gravity methodology. Thus while it

was entirely proper for the Commission to consider the proposed adjustments under the provisions of section 15(7) and, if warranted, to order refunds, the gravity methodology could not be subject to those proceedings because it remained the established method of calculating Quality Bank credits and debits. Furthermore, because the filing had placed no one on notice that a change to the assay methodology was in prospect, the change could not have been imposed retroactively without violating the filed rate doctrine. On the other hand, the Commission's investigation into the gravity methodology pursuant to section 13(2) was clearly appropriate, as was its statement that any change would be prospective only. *See 1989 Order,* 49 F.E.R.C. ¶ 61,349 at 62,264–65; *1990 Order,* 51 F.E.R.C. ¶ 61,062 at 61,137. Because any refund would have constituted impermissible retroactive ratemaking, the Commission quite properly applied the assay methodology prospectively.

E. The Prudhoe Bay Unit Dispute

The final challenge to FERC's *1993 Order* relates only indirectly to the TAPS Quality Bank valuation methodology. The Prudhoe Bay Unit's petroleum stream ("Unit stream"), which flows into TAPS at Pump Station No. 1, is co-owned by eleven petroleum producers ("Unit shippers") including petitioner BP. This petroleum is itself a combination of two feeder streams produced from different areas within the Unit, which are commingled at a location some 700 feet upstream of Pump Station No. 1. One of the two feeder streams consists primarily of NGLs; the other, known as the Separator Liquid Production ("SLP") stream, does not. Under the assay methodology, the petroleum in the SLP stream has a higher value than does that in the NGL stream, *Rehearing Order,* 66 F.E.R.C. ¶ 61,188 at 61,420, whereas under the gravity methodology the reverse was the case.

The Unit shippers own varying interests in the fields from which the two streams are produced. Because BP owns a larger interest in the SLP stream than in the NGL stream, its per barrel contribution to the Unit stream has a higher value under the new methodology than does the per barrel contribution of certain other shippers who own a larger interest in the NGL than in the SLP stream. Nevertheless, although the TAPS Carriers are aware of the Unit shippers' respective ownerships in the two feeder streams, they make Quality Bank payments to them on a "pro rata" basis; that is, payments are based on the total number of barrels a shipper contributed to the Unit stream rather than on their value.

BP complains that as a result of this payment practice, it does not receive its proper portion of the Quality Bank payments and objects to the Commission's refusal to require the Carriers to employ some practice that would allocate the payments among the Unit shippers based on the contribution that each of them makes to the value of the Unit stream. While not resolving the merits of BP's claim, the proposed settlement agreement spoke to it by containing a dispute resolution procedure that the TAPS Carriers would apply when confronted with a dispute among shippers over rights to Quality Bank payments resulting from their co-ownership of a single incoming stream. *1993 Order,* 65 F.E.R.C. ¶ 61,277 at 62,291; *Rehearing Order,* 66 F.E.R.C. ¶ 61,188 at 61,420–21.

The Commission declined to approve the proposed dispute resolution procedure as part of the settlement for the following reasons:

> The ownership dispute relates to events that occur before the petroleum is injected into TAPS. We agree that these provisions relate to a private contractual matter that is outside the scope of the Commission's jurisdiction. Accordingly, our approval of the settlement does not constitute approval of these provisions, and those procedures should not be part of the tariff filing made by the TAPS Carriers.

*1993 Order,* 65 F.E.R.C. ¶ 61,277 at 62,291 (footnote omitted). On rehearing, FERC elaborated on the problem but maintained its initial position that "[t]he Commission's jurisdiction applies to the streams transported on TAPS, and does not cover events that precede[d] it." *Rehearing Order,* 66 F.E.R.C. ¶ 61,188 at 61,421. It reasoned that Quality Bank adjustments should be paid based on

the assays of the streams tendered to TAPS. *Id.* at 61,421–22. If particular Unit shippers felt they were entitled to more than their *pro rata* payment, the Commission suggested that they renegotiate their private contracts with their co-owners or litigate against them. *Id.* at 61,422.

[29] BP now argues that the Commission erred by finding it lacked jurisdiction over the dispute. Section 15(1) of the ICA provides, in pertinent part, that

> [w]henever, ... the Commission shall be of [the] opinion that any ... practice whatsoever of ... carriers subject to the provisions of this chapter, is or will be unjust or unreasonable or unjustly discriminatory or unduly preferential or prejudicial, ... the Commission is authorized and empowered to determine and prescribe what ... practice is or will be just, fair, and reasonable....

49 U.S.C.App. § 15(1). BP believes that the TAPS Carriers' method of making Quality Bank payments to Unit shippers based on the quantity of the stream they owned without regard to the quality of what they owned constitutes a "practice" subject to the Commission's jurisdiction under this section. FERC continues to characterize the issue as a dispute among the Unit shippers as to how to allocate the Quality Bank payments that is "not integral to the operation of the TAPS," Brief for Respondent at 47, and that the method of resolving it is not a proper subject for the TAPS Carriers' tariff filings.

The Commission has staked out an internally inconsistent and thus untenable position. On the one hand, it claims to lack jurisdiction over how the Quality Bank payment due the Unit shippers is to be divided. Yet at oral argument the Commission conceded that, as BP charges, it has *approved* the TAPS Carriers' current method of dividing payments among the co-owners of the Unit stream on a *pro rata* basis because that method is embodied in previous filings. FERC thus has acted in the past as if it has jurisdiction over the very issue that it now explicitly maintains it lacks the authority to consider.

Until the Commission articulates a consistent position on the limits of its jurisdiction, we are unable to resolve BP's specific challenge. We have held that an agency's interpretation of the limits of its jurisdiction is entitled to "*Chevron* deference." *Oklahoma Natural Gas Co. v. FERC,* 28 F.3d 1281, 1283–84 (D.C.Cir.1994) (referring to deference due an agency's interpretations of statutes it is charged with administering, as set forth in *Chevron U.S.A. Inc. v. NRDC,* 467 U.S. 837, 842–44, 104 S.Ct. 2778, 2781–82, 81 L.Ed.2d 694 (1984)). We cannot deferentially review both the Commission's explicit opinion that it lacks jurisdiction and its implicit opinion that it does not. Therefore, we remand the matter to the Commission with the instruction that it establish a consistent and reasoned position as to whether it has jurisdiction over the method by which the TAPS Carriers distribute Quality Bank payments among co-owners of streams delivered to TAPS.

## III. Conclusion

We deny the petitions for review to the extent that they challenge the Commission's decisions to replace the TAPS Quality Bank's gravity methodology with an assay methodology and to implement the new methodology prospectively only. We grant the petitions to the extent they challenge the Commission's methods of valuing the distillate and resid cuts and its decision that it lacked jurisdiction over the method by which the TAPS Carriers compensate the co-owners of petroleum streams shipped on TAPS. The cases are remanded to the Commission for further consideration in accordance with this opinion.

*So ordered.*

pose, we will deem a prisoner to have "file[d] an appeal in forma pauperis" as soon as he has both filed a notice of appeal and been granted *in forma pauperis* status, but not before.

Although requiring prisoners denied *in forma pauperis* status to pay the full fees even though their appeal is not considered would arguably provide an additional deterrent to prisoner filings, our disposition here can hardly be viewed as encouraging prisoner appeals. Unless he pays the required fees, Smith's appeal will be dismissed. In addition, our conclusion that Smith has three strikes will allow summary treatment of any future applications for *in forma pauperis* status. In our view, requiring prisoners to pay the full fees in such situations would create either administrative difficulty or an incentive for the prisoners to continue to pursue their appeals. If a prisoner did not have sufficient funds to pay the fees, requiring immediate payment in full would result primarily in an ongoing collection effort for the office of the clerk of this Court. If, on the other hand, a prisoner was able to pay the fees in full, our requiring him to do so whether or not he proceeded with his appeal would leave him no disincentive to proceeding—if the prisoner would be responsible for the full fees in any case, it would only make sense for him to continue to pursue his appeal. In contrast, by imposing the fees only if a prisoner who has been denied *in forma pauperis* status proceeds further, our approach should give such a prisoner every incentive to consider carefully whether his appeal warrants further pursuit.

IV. Conclusion

Because Smith had three strikes at the time he filed this appeal, we deny his application to proceed *in forma pauperis* pursuant to 28 U.S.C. § 1915(g). If he pays the filing fee within fourteen days of receiving the court's opinion and order, then his appeal may proceed. If not, then it will be dismissed. *See Wooten*, 129 F.3d at 208.

tions for when the appeal is filed for purposes of F.R.A.P. 4.

**EXXON COMPANY, U.S.A., Petitioner,**

**v.**

**FEDERAL ENERGY REGULATORY COMMISSION, et al., Respondents.**

**Tesoro Alaska Petroleum Company, et al., Intervenors.**

**Nos. 95–1520, 96–1078, 96–1464, 97–1733, and 98–1005.**

United States Court of Appeals, District of Columbia Circuit.

Argued April 30, 1999.

Decided July 13, 1999.

Rehearing and Rehearing En Banc Denied Sept. 15, 1999.*

Petroleum shippers petitioned for judicial review of Federal Energy Regulatory Commission (FERC) order mandating new distillation methodology for valuation of petroleum shipped on Alaska petroleum pipeline, for purpose of monetary adjustments between shippers to compensate for commingling of petroleum in pipeline. The Court of Appeals, 64 F.3d 679, approved order in part, and remanded for further proceedings on specified grades of petroleum products. On remand, FERC revised valuation methodology for those grades, in accordance with contested settlement, and some shippers sought review. The Court of Appeals, Sentelle, Circuit Judge, held that: (1) FERC's failure to account for intragrade differences in quality was not arbitrary and capricious; (2) reference price alterations for heavy distillate were supported by evidence; (3) FERC was not

* Chief Judge Edwards and Circuit Judges Wald, Silberman, Henderson and Garland did not participate in thsi matter.

required to employ marginal use of residual fuel oil as a blending agent in establishing its valuation methodology; (4) choice of proxy for valuing residual fuel oil was arbitrary and capricious; (5) shipper that raised additional challenges had standing; (6) FERC could consider processing costs in valuing distillate cuts; (7) calculation of costs of sulfur removal was not improper; (8) FERC could value light residual fuel oil cut as vacuum gas oil (VGO); (9) procedures employed by FERC satisfied due process clause; and (10) decision to implement settlement prospectively only was abuse of discretion.

Petition for review granted in part, FERC order vacated in part, and remanded.

**1. Carriers ⚷34**

Decision of Federal Energy Regulatory Commission (FERC) to approve a portion of a contested settlement must be supported by substantial evidence, and Court of Appeals must set aside FERC's approval if it was arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. 5 U.S.C.A. § 706(2)(A), (E).

**2. Administrative Law and Procedure ⚷763**

Inquiry of Court of Appeals into administrative decision, under the arbitrary and capricious test, is narrow, and a court is not to substitute its judgment for that of the agency.

**3. Administrative Law and Procedure ⚷759, 790**

Where, on review of agency decision, the analysis to be performed requires a high level of technical expertise, Court of Appeals must defer to the informed discretion of the responsible federal agencies, although agency must engage in rational decisionmaking.

**4. Carriers ⚷29**

Failure of Federal Energy Regulatory Commission (FERC) to account for differences in quality among the heavy distillate cuts of individual petroleum streams before streams were commingled in Alaska pipeline's common stream, in determining value of distillate cuts for purpose of monetary adjustments between shippers that compensated for commingling, was not arbitrary and capricious; relative proportions of various cuts in each stream was sufficiently accurate as method of determining relative value of streams, and fact that more precise method existed for determining relative value of streams did not render decision to adopt less accurate, but more administrable, method arbitrary and capricious.

**5. Carriers ⚷34**

Federal Energy Regulatory Commission (FERC) decision which, on remand from Court of Appeals, altered reference prices for determining value of heavy distillate, for purpose of calculating monetary adjustments between shippers that compensated for commingling of separate petroleum streams in Alaska pipeline's common stream, were supported by expert testimony regarding proper proxy products and necessity of treating heavy distillate cut to reach necessary sulfur level.

**6. Carriers ⚷29**

Federal Energy Regulatory Commission (FERC) was not required to employ marginal use of residual fuel oil as a blending agent for fuel oil rather than its value as coker feedstock in establishing valuation methodology for residual fuel oil, for purpose of calculating monetary adjustments between Alaska pipeline shippers which compensated them for commingling of their separate oil streams, in view of expert testimony that residual fuel oil was rarely traded but was instead used as coker feedstock.

**7. Carriers ⚷29**

Failure of Federal Energy Regulatory Commission (FERC) to account for differences in quality, due to varying Conradson Carbon Residue Content (CCR), among

the residual fuel oil cuts of individual petroleum streams before streams were commingled in Alaska pipeline's common stream, in determining value of those cuts for purpose of monetary adjustments between shippers that compensated them for commingling, was not arbitrary and capricious.

**8. Carriers ⊂=29**

Decision of Federal Energy Regulatory Commission (FERC) to value residual fuel oil at price of FO-380, adjusted by 4.5 cents per gallon as processing cost, for purpose of calculating monetary adjustments between Alaska pipeline shippers that compensated them for commingling of shippers' petroleum streams, was arbitrary and capricious, absent demonstrated relationship between figures derived from use of those adjusted proxies and value of residual fuel oil.

**9. Carriers ⊂=24**

Former shipper of petroleum over common Alaska pipeline was sufficiently aggrieved to establish standing to challenge Federal Energy Regulatory Commission (FERC) order that revised valuation methodology for certain grades of petroleum products, for purpose of calculating monetary adjustments that compensated shippers for commingling of petroleum in pipeline, as shipper would suffer competitive injury if other shippers were advantaged by unfair valuations. 28 U.S.C.A. § 2344.

**10. Carriers ⊂=24**

Court of Appeals uses traditional standing principles to determine if party is sufficiently aggrieved to seek judicial review of final Federal Energy Regulatory Commission (FERC) order issued under Interstate Commerce Act; thus, to be aggrieved, party must have suffered injury in fact traceable to FERC's action, decision in its favor must be capable of redressing that injury, and its interest must be within zone of interests protected by statute. 28 U.S.C.A. § 2344; Interstate Commerce Act, § 1 et seq., 49 U.S.C.App.(1988 Ed.) § 1 et seq.

**11. Carriers ⊂=29**

Consideration by Federal Energy Regulatory Commission (FERC) of processing costs in valuation of distillate cuts, for purpose of calculating monetary adjustments between Alaska pipeline shippers that compensated them for commingling of petroleum in pipeline, did not render valuation of other lighter cuts unfair, although processing costs were not considered as to lighter cuts, since lighter cuts were of sufficiently comparable quality to their market proxies that no further processing, and thus no cost adjustment, was needed.

**12. Carriers ⊂=29**

Calculation by Federal Energy Regulatory Commission (FERC) of costs of sulfur removal was not improper, for purpose of calculating monetary adjustments between Alaska pipeline shippers to compensate for commingling of petroleum in pipeline, although there was higher per-unit cost to remove sulfur from heavy distillate than from residual fuel oil, in view of expert testimony that different methods would be needed to bring the two products into compliance with their respective reference products.

**13. Carriers ⊂=29**

Finding of Federal Energy Regulatory Commission (FERC) that 0.5 cents per gallon was proper processing cost adjustment for light distillate was supported by evidence, and thus could be used in calculating monetary adjustments between Alaska pipeline shippers that were used to compensate them for commingling of petroleum in pipeline.

**14. Carriers ⊂=29**

Federal Energy Regulatory Commission (FERC) could properly eliminate light residual fuel cut, with cut point between 1000 and 1050 degrees, and instead value that cut as vacuum gas oil (VGO), for purpose of calculating monetary adjustments between Alaska pipeline shippers

that were used to compensate them for commingling of petroleum in pipeline, in view of industry standards and expert testimony.

**15. Carriers ⚬29**

Use of Waterborne Gasoil as proxy product for valuing West Coast heavy distillate, by Federal Energy Regulatory Commission (FERC), for purpose of calculating monetary adjustments between Alaska pipeline shippers that were used to compensate them for commingling of petroleum in pipeline, was not improper, despite claim that Waterborne Gasoil was not West Coast product.

**16. Carriers ⚬29**

Shipper of petroleum that used Alaska pipeline had adequate opportunity, under due process clause, to present its position to administrative law judge and Federal Energy Regulatory Commission (FERC), in proceeding to determine proper valuation of various grades of product for purpose of monetary adjustments among shippers that were used to compensate them for commingling of petroleum in pipeline, notwithstanding lack of live hearings or cross-examination, since technical dispute at issue was amenable to resolution by resort to the written record. U.S.C.A. Const.Amend. 5.

**17. Carriers ⚬29**

Federal Energy Regulatory Commission (FERC) decision which approved settlement as to methodology for valuing distillate and residual fuel oil grades of petroleum, for purpose of calculating monetary adjustments between Alaska pipeline shippers that compensated them for commingling of petroleum in pipeline, but which implemented settlement order prospectively only, was abuse of discretion, although settling parties stated that they would not support settlement if it applied retroactively, since decision left nonsettling parties without a remedy for years of unlawful valuations, and all Alaska pipeline shippers were on notice that valuations were contested.

**18. Carriers ⚬34**

When the Federal Energy Regulatory Commission (FERC) commits legal error, the proper remedy is one that puts the parties in the position they would have been in had the error not been made, although this is not to say that FERC must do so in every case if the other considerations properly within its ambit counsel otherwise.

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On Petitions for Review of an Order of the Federal Energy Regulatory Commission.

Carter G. Phillips argued the cause for petitioner Exxon Company, U.S.A. With him on the joint briefs were Eugene R. Elrod, Stephen S. Hill, Stephen F. Smith, Robert H. Benna and Jeffrey G. DiSciullo. Clifton D. Harris, Jr., and Thomas M. Roche entered appearances.

Robert H. Benna argued the cause for petitioner Tesoro Alaska Petroleum Company. With him on the briefs was Jeffrey G. DiSciullo. James C. Reed, Jeanne M. Bennett and David S. Berman entered appearances.

Andrew K. Soto, Attorney, Federal Energy Regulatory Commission, argued the cause for respondents. With him on the brief were Joel I. Klein, Assistant Attorney General, U.S. Department of Justice, John J. Powers, III, and Robert J. Wiggers, Attorneys, Jay L. Witkin, Solicitor, Federal Energy Regulatory Commission, and Susan J. Court, Special Counsel. David H. Coffman, Attorney, entered an appearance.

John A. Donovan argued the cause for intervenors Arco Alaska, Inc., et al. With him on the brief were Matthew W.S. Estes, Bradford G. Keithley, Charles William Burton, Jason F. Leif, John W. Griggs, W. Stephen Smith, Randolph L. Jones, Jr., Alex A. Goldberg and Richard Curtin. Carolyn Y. Thompson, Richard D.

Avil, Jr., and Marvin T. Griff entered appearances.

Albert S. Tabor, Jr., John E. Kennedy and S. Scott Gaille were on the brief for intervenors TAPS Carriers. Dean H. Lefler entered an appearance.

Before: GINSBURG, SENTELLE and RANDOLPH, Circuit Judges.

Opinion for the Court filed by Circuit Judge SENTELLE.

SENTELLE, Circuit Judge:

Exxon Company, U.S.A. and Tesoro Alaska Petroleum Company petition for review of the Federal Energy Regulatory Commission's ("FERC" or "Commission") order revising the valuation methodology for specified grades of petroleum products after our partial remand of the Commission's earlier order adopting the distillation method for determining compensation due shippers on the Trans Alaska Pipeline System for differences between the oil streams injected and oil streams received. *See* Order Modifying and Adopting Contested Settlement Proposal, Trans Alaska Pipeline Sys., 65 FERC ¶ 61,277 (1993) ("1993 Order"), *approved in part and remanded in part, OXY USA, Inc. v. FERC,* 64 F.3d 679, 684 (D.C.Cir.1995) ("*OXY*"). In the order before us, FERC approved with modifications a contested settlement over the objection of petitioners. We grant the petition for review in part and vacate and remand for further proceedings those parts of FERC's order approving the use of proxies for the market valuation of one grade of petroleum product and the decision to apply the settlement prospectively only.

## I. BACKGROUND

The Trans Alaska Pipeline System ("TAPS") provides the only commercially-viable method for moving crude oil pumped from the oil fields on Alaska's North Slope to the shipment point at Valdez, Alaska, the Alaskan gateway to the world market. Several oil companies own interests in various oil fields on the North Slope. The oil in those fields differs significantly in quality, but the realities of shipping that oil on the single pipe of the TAPS requires the blending of the oil streams from different fields. Unlike packages shipped by a common carrier, the oil streams cannot be segregated during shipping, and the blended streams cannot be separated at the Valdez end of the pipeline. Instead, at the Valdez end of the pipeline, each shipper receives a quantity of the blended common stream equivalent to the amount it injected at the North Slope end. Companies that inject higher quality crude receive oil at the Valdez end of the pipeline identical in quality to that received by companies that inject lower quality crude oil. The TAPS carriers file tariffs specifying how the shippers will compensate each other for these differences in quality, and their methodology must be approved by the Commission pursuant to its authority under the Interstate Commerce Act ("ICA"), 49 U.S.C.app. § 1 *et seq. See also* Department of Energy Organization Act, Pub.L. No. 95–91, § 402(b), 91 Stat. 565, 584 (1977), *codified at* 42 U.S.C. § 7172(b) (1988) (repealed 1994), *recodified as amended at* 49 U.S.C. § 60502 (transferring authority to regulate oil pipeline rates under the ICA from the Interstate Commerce Commission to FERC); *Exxon Pipeline Co. v. United States,* 725 F.2d 1467, 1468 n. 1 (D.C.Cir. 1984) (explaining transfer of authority). TAPS has created a system which requires companies injecting lower-quality oil to compensate companies injecting higher-quality oil by creating a "Quality Bank," which awards shippers credits for high-quality oil and debits for low-quality oil. The TAPS Quality Bank is an arrangement that "makes monetary adjustments [among] shippers in an attempt to place each in the same economic position it would enjoy if it received the same petroleum at Valdez that it delivered to TAPS on the North Slope." *OXY,* 64 F.3d at 684.

While this is simple enough in concept, determining the relative value of the injected streams is in fact a complex technical task. There is no independent market to set the relative price of the various streams of North Slope crude because the crude is not sold until after it is commingled and brought to Valdez. When the system was originally created, the relative value of oil was determined by the "API gravity"[1] of the oil because lighter, high-gravity crude is generally more valuable than heavier, low-gravity crude. *See id.* at 685. The "straight-line gravity method" measured the gravity of each incoming stream and compared it to the gravity of the oil received by that shipper at the far end, and determined Quality Bank credits or debits accordingly. *See id.* In 1989, however, OXY USA and Conoco, Inc. challenged this methodology, and in 1991 a FERC Administrative Law Judge ("ALJ") determined that it "no longer yield[ed] a just and reasonable result." 57 FERC ¶ 63,010, at 65,049–50, 65,052–53 (1991). (For a full explication of the proceedings, *see OXY,* 64 F.3d at 683–89.)

The majority of North Slope shippers in an attempt to settle the tariff dispute proposed abandoning the straight-line gravity method in favor of a "distillation" or "assay" methodology, which would value crude oil based on the market price of the various component products (called "cuts") created when the crude oil is heated to a series of specific temperatures and the evaporated products produced at each temperature are recondensed. *See OXY,* 64 F.3d at 687. The five cuts created by this process at the lower boiling points—propane, isobutane, normal butane, natural gasoline, and naphtha—and one of the heavier cuts, gas oil, are not at issue here, as we upheld the method of valuing those cuts in our earlier review. *See id.* at 701. We vacated and remanded for further proceedings as to distillate and residual fuel oil ("resid").

A. Distillate

Under the original 1993 settlement offer, the distillate cut included the portion of the stream that evaporated between 350 and 650 degrees Fahrenheit. Under the 1993 settlement order, FERC split this proposed cut into two cuts, light distillate (350–450 degrees) and heavy distillate (450–650 degrees). FERC determined that it would price light distillate as jet fuel and heavy distillate as No. 2 fuel oil, the products into which those cuts are normally refined, without adjustment for processing costs. *See* 1993 Order, 65 FERC¶ 61,277, at 62,288. We rejected that methodology because each cut would require further processing to reach the quality required for the proxy product. *See OXY,* 64 F.3d at 693. Because the settlement as modified by FERC essentially valued a raw material as if it were a finished product, we determined that it overvalued these heavier cuts, resulting in a windfall to those shippers whose streams contained the highest relative proportion of heavy crude. *See id.* Although we recognized that we could not require FERC to achieve a perfect method of valuing petroleum streams, particularly streams including cuts without a market, we nonetheless held that FERC must be consistent in its methodological choices. That is, if the Commission chose to value a portion of the cuts at market without adjusting for processing costs, then it must, at least "to the extent possible," attempt to approximate the market value of other cuts without processing. *Id.* at 694. That is, the Commission cannot "consistent with the requirement of reasoned decisionmaking, value some cuts precisely and others haphazardly." *Id.* We therefore remanded the distillate valuation for further consideration by FERC.

B. Resid

As the name implies, the residual, or "resid," cut consists of the portion of the

1. API gravity is a measure of density created by the American Petroleum Institute. Under API gravity analysis, unlike the more familiar concept of specific gravity, a higher number indicates a less dense crude oil or petroleum product.

petroleum stream remaining after distillation of all other cuts at lower boiling points. In the 1993 settlement order, FERC split the resid into two cuts—light resid (1,000 to 1,050 degrees Fahrenheit) and heavy resid (all remaining material). The order valued these cuts in relation to the market price of proxies: No. 6 fuel oil for light resid and FO-380 for heavy resid with no adjustment for the processing necessary to receive these market prices. We upheld FERC's decision to create a separate light resid cut, but vacated the valuation of that cut at the price of No. 6 fuel oil as we found that the record did not disclose a relationship between the price of that purported proxy and the value of the cut. Likewise, we concluded that the record did not demonstrate that FO-380 was a reasonable proxy for heavy resid because the market price of FO-380 bore only a limited and unquantified relation to the value of heavy resid as a blending component. *See id.* at 695. While we concluded that expert testimony in the record supported a "conclusion that FO-380 and the 1050+ resid share some physical properties," it did not even suggest that "the two materials have equal or even near-equal market values." *Id.* We therefore remanded the valuation of the resid cuts to the agency for further proceedings consistent with our opinion.

In our review of FERC's order approving the 1993 settlement, we rejected not only the specifics of the FO-380 comparison, but also FERC's decision to value resid based on its use as a feedstock for "cokers," refinery equipment which breaks resid down even further into lighter fuel products and a heavy residue, which might be asphalt at some plants, or other materials with differing uses. Exxon and others argued that resid should be priced at its marginal use value, which Exxon claimed was as a blending component for FO-380. When remanding, we observed that this economic argument, while it might not by itself carry the day, did possess enough "analytical force" that the Commission should on remand "explicitly address whether the marginal use of 1050+ resid should be taken into account in that cut's valuation methodology." *Id.*

C. FERC's Proceedings on Remand

In response to our opinion, FERC initiated settlement proceedings regarding these remanded issues. When this effort failed, FERC set the matter for hearing. At the same time, the Commission's Chief ALJ made further attempts to secure a settlement. The parties filed three separate settlement proposals, one by nine parties[2] ("the Nine Party Settlement"), and unilateral proposals from Exxon and Tesoro. The ALJ provided opportunity for all parties to file materials in support of or in opposition to the settlement offers. Following the submissions, the ALJ heard oral argument and the parties filed supplemental briefs. *See* Certification of Contested Settlement and Ruling on Motion to Omit the Initial Decision, *Trans Alaska Pipeline Sys.*, 80 FERC ¶ 63,015, at 65,-212–13 ("1997 Opinion").

The ALJ ultimately certified the Nine Party Settlement to the Commission, and opted not to certify the unilateral proposals from Exxon and Tesoro, finding that legal precedent required this decision and that in any event the proposals were biased in favor of the proposing parties. The ALJ reviewed the record in detail and determined that the only issues properly before him were the remands for valuation of light and heavy distillate and light and heavy resid. He found that the Nine Party Settlement's proposed valuations, which follow, were fair and reasonable and supported by record evidence. *See* 1997 Opinion, 80 FERC ¶ 63,015, at 65,233.

2. The nine settling parties are Amoco Production Company, ARCO Alaska, Inc., BP Exploration (Alaska), Inc., MAPCO Alaska Petroleum, Inc., OXY USA, Inc., Petro Star, Inc., Phillips Petroleum Company, the State of Alaska, and Union Oil Company of California. *See* 1997 Order, 81 FERC ¶ 61,319, at 62,458 n. 5.

**Light distillate**: valued based on a weighted average of the West Coast and Gulf Coast prices of jet fuel, adjusted by 0.5 cents per gallon to reflect processing costs.

**Heavy distillate**: valued based on weighted average of the West Coast price of Waterborne Gasoil, reduced by 1 cent per gallon to reflect processing costs and the Gulf Coast price of No. 2 fuel oil reduced by 2 cents per gallon to reflect processing costs. (The processing costs were based on the testimony of Nine Party expert witness John O'Brien who stated that ANS crude oil needed to be processed to reach the 0.5 percent level for sulfur demanded by the market.)

**Light resid** (1000 degrees F to 1050 degrees F): The 1993 settlement had eliminated separate treatment of light resid and combined it with the 1050+ cut. The Nine Party Settlement approved by the ALJ instead rolled it into the Vacuum Gas Oil ("VGO") cut, by raising the top end of that cut to 1050 degrees, which the nine parties claim conforms with industry practice.

**Heavy resid** (1050+): continued use of the West Coast price of FO–380 as a West Coast reference price, subtracting 4.5 cents per gallon as a processing cost. Added Gulf Coast 3 percent sulfur No. 6 fuel oil as a Gulf Coast reference product, and adjusted that figure by the same 4.5 cents.

The ALJ noted that the nine parties supported the settlement only if it applied prospectively. *See id.* at 65,241. The ALJ determined that the remand did not require that the new methodology be applied retroactively and that the Commission retained the discretion to determine when to make the settlement effective. *See id.* at 65,243. The ALJ also recommended prospective application under the circumstances. *See id.*

The Commission reviewed and accepted the ALJ's recommendations as to each valuation, finding in its order that each determination was based on substantial evidence. FERC found that there was no active market for resid, and opted to price resid based on its value as a coker feedstock. FERC determined that the two reference products were the actively-traded petroleum products that had physical characteristics most resembling resid, and used these adjusted prices as a proxy for the value of resid as a coker feedstock. It also decided to apply the new rates prospectively, stating that this was consistent with the 1993 Order applying the new rates prospectively, which was affirmed by this court in *OXY*. "[The new settlement] does not change the methodology to be used, but modifies how to value the remanded cuts." *See* 1997 Order, 81 FERC ¶ 61,319, at 62,467. The Commission noted that the TAPS Quality Bank was *sui generis,* so precedents cited by Exxon and Tesoro as supporting retroactive application of the new methodology were not dispositive.

## II. STANDARD OF REVIEW

[1–3] The standard of review applicable to FERC's approval of this proposed settlement of the issues remaining on remand is the same as it was in *OXY.* FERC's decision to approve a portion of a contested settlement must be supported by substantial evidence, and we must set aside FERC's approval if it was "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A), (E). Our inquiry under the arbitrary and capricious test is "narrow and a court is not to substitute its judgment for that of the agency." *Motor Vehicle Mfrs. Ass'n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co.,* 463 U.S. 29, 43, 103 S.Ct. 2856, 77 L.Ed.2d 443 (1983). Where, as in the instant case, the analysis to be performed "requires a high level of technical expertise, we must defer to the informed discretion of the responsible federal agencies." *Marsh v. Oregon Natural Resources Council,* 490 U.S. 360, 377, 109 S.Ct. 1851, 104 L.Ed.2d 377 (1989)

(internal quotation marks omitted). Nonetheless, the Commission must engage in rational decisionmaking, *see, e.g., State Farm,* 463 U.S. at 43, 103 S.Ct. 2856; *OXY,* 64 F.3d at 690. We held in *OXY* that the agency had supplied a reasoned analysis for changing its prior policies when it adopted the distillation methodology. *See OXY,* 64 F.3d at 690. However, more important for purposes of the petitions now before us, we granted the petitions for review of the 1993 Order to the extent that they challenged the Commission's methods of valuing the distillate and resid cuts.

## III. CHALLENGES TO THE NEW SETTLEMENT

The petitioners make multiple arguments challenging the valuation of specific cuts and FERC's failure to require that qualitative differences between the same cuts of different streams be considered when determining the relative value of each stream. They argue that FERC acted arbitrarily by failing to value resid based on its marginal use as a fuel oil blendstock instead of as a coker feedstock; improperly failed to account for differences in quality among the same cuts of different streams when valuing resid; improperly chose a price proxy for its value as a coker feedstock; and failed to address challenges to the methodology for determining resid's value as a coker feedstock. The petitioners also challenge FERC's decision to implement the new valuation methodology prospectively only. We address first the valuation challenges, and uphold the agency's decisions as supported by substantial evidence with the exception of the use of FO–380 less 4.5 cents and 3 percent sulfur No. 6 fuel oil less 4.5 cents as proxy prices for heavy resid. The adjusted valuation solves none of the problems we identified in our prior opinion because there is no evidence that the prices of the reference products, even after the 4.5 cents adjustment, bear any rational relationship to the market value of resid. We therefore vacate and remand the portion of FERC's order affecting the valuation of heavy resid.

## IV. INTRA–CUT QUALITY DIFFERENCES

[4] Exxon[3] argues that FERC's failure to account for differences in quality among the heavy distillate cuts of the individual streams before they are commingled in the TAPS common stream violates the terms of our earlier remand in *OXY,* and is arbitrary and capricious. We disagree.

Petitioners claim that the goal of the Quality Bank is to place an accurate value on the streams flowing into the TAPS, and failure to account for quality differences in the distillate cuts of the streams coming from different oilfields is not reasoned decisionmaking. We disagree that Exxon's argument follows logically from our remand. In *OXY,* we recalled that the goal of the Quality Bank is "to assign accurate *relative* values," 64 F.3d at 693 (emphasis added), to the diverse streams delivered to the pipeline. We vacated in part the last order because the methodology approved therein had favored one class of cuts above others. We remanded in order that FERC might provide a methodology with a reasoned relative uniformity, knowing that absolute precision at any level of the cuts was unachievable. That is, we did not remand because the old method was inaccurate, but because it was unfairly nonuniform. To have demanded 100 percent accuracy would have been to hold the agency to "an impossibly high standard." *Id.* at 694. The specific purpose in our remand was to require the agency to resolve the relative overvaluation of some cuts, which were valued at the market price for their proxy despite the fact that significant processing was required to bring those products up to a market standard. Exxon

3. Exxon and Tesoro filed a joint petition for review. For simplicity's sake, we will refer to the joint arguments of the two petitioners as Exxon's arguments.

seeks to expand the duty of the Commission to refining the degree of distinction among component streams within individual cuts. Specifically, Exxon seeks to have us vacate FERC's order insofar as it does not recognize and adjust for differences in the sulfur content of distillate as a key factor in determining market value. Part of the adjustment to the per-barrel price of distillate is to account for removing sulfur so that it can be sold as jet fuel or No. 2 fuel oil. In implementing that methodology, FERC assumed that all streams had the same sulfur content, when Exxon had shown that such was not the case. Exxon argues that FERC should not use the sulfur content of the commingled streams when determining the value of the cut, but must determine the sulfur content and thus the value of the distillate cut of the oil from each field before it enters the common stream. Because some streams have a higher sulfur content, they would require more processing and consequently have a lower value once processing costs were factored into the per-barrel price. Other streams with a lower sulfur content would have a higher value because no further processing would be needed to bring the oil up to the quality of the proxy product.

Exxon further argues that treating all of the streams as if they have the same sulfur content violates *OXY*, which calls for accurately valuing the streams; that it is arbitrary and capricious because it makes assumptions contrary to fact; and that FERC's failure to even consider the issue is arbitrary and capricious. Specifically, Exxon argues that FERC improperly determined that the scope of its actions was limited by the terms of our remand, but that in any event, FERC cannot claim that it addressed only the issues required by the court because it did more than we ordered when it changed the West Coast proxy for heavy distillate, even though no party challenged the one adopted in the 1993 and 1994 orders, and eliminated the light resid cut, even though it was affirmed in *OXY*. Exxon contends that having opened the door, so to speak, FERC was obligated to consider the information provided by Exxon and Tesoro about the differences in quality among the streams because it has an obligation under the ICA " 'to ensure that pipeline rates are just and reasonable.' " *OXY*, 64 F.3d at 690 (quoting *Texas Eastern Transmission Corp. v. FERC*, 893 F.2d 767, 774 (5th Cir.1990)). Exxon argues that refusing to consider the quality differences was therefore arbitrary and an abuse of discretion. In its 1997 Order, FERC noted that it had rejected the same argument in its 1993 Order, and that we had not reversed or vacated that ruling. Exxon argues nonetheless that by adjusting the market prices of the proxies to account for removing sulfur, FERC itself has now determined that sulfur content is an important aspect of valuing heavy distillate.

We reject Exxon's argument that FERC's failure to differentiate between the streams was arbitrary and capricious. In *OXY*, we required FERC to take into account the significant processing costs that rendered its unadjusted use of a proxy product unreasonable in relation to the valuation of other portions of the stream. Exxon's contention that FERC must value each stream at the wellhead based on its individual sulfur content calls for more than we required. We did not hold in *OXY* that differences in quality between the streams must be considered, and do not do so now. Inherent in our approval of FERC's adoption of the distillation methodology in *OXY* was our approval of the agency's conclusion that there was no need to consider intra-cut quality differences, and that the agency properly determined that the relative proportions of the cuts in each stream is sufficiently accurate as a method of determining the relative value of the streams. *See* 65 FERC ¶ 61,277, at 62,287 (1993), and 66 FERC ¶ 61,188, at 61,240 (1994). In any event, it was not arbitrary and capricious to determine the value of each cut in the TAPS stream after it has been mixed, instead of separately valuing the

cuts of each stream. The fact that a more precise method exists for determining the relative value of the streams does not render the decision to adopt a less accurate, but more administrable, method arbitrary and capricious. FERC has opted to use a magnifying glass to determine the values of the streams, and we will not fault it for not using a microscope.

[5] We also uphold against challenge FERC's two changes to the price of heavy distillate, both of which are supported by the record. FERC changed the reference price for the West Coast from No. 2 fuel oil to Waterborne Gasoil, and adjusted the price of Waterborne Gasoil by one cent per gallon and the Gulf Coast price of No. 2 fuel oil by two cents to account for processing. *See* 1997 Order, 81 FERC ¶ 61,-319, at 62,460. These adjustments were based on the testimony of expert witnesses John O'Brien and Christopher Ross. Ross testified that these products most closely resembled Alaskan North Slope ("ANS") heavy distillate, *see* Affidavit of Christopher E. Ross, ¶ 19 (Jan. 29, 1997), and O'Brien testified that the ANS heavy distillate cut required treatment to reach the necessary sulfur level, *see* Affidavit of John O'Brien, ¶¶ 13–15 (Jan. 28, 1997). These decisions were supported by adequate record evidence and we uphold the agency.

## V. RESID CUT VALUATION ISSUES

### A. Exxon and Tesoro's Challenges

In *OXY*, we noted that resid like distillate did not trade on an open market and therefore was difficult to evaluate. Nonetheless, and even in the face of "the deference we owe the Commission's judgments," we concluded that the 1993 settlement approach to valuation of resid did not "satisfy the APA's basic requirement of reasoned decisionmaking." *OXY*, 64 F.3d at 694 (citing *State Farm*, 463 U.S. at 43, 103 S.Ct. 2856). We therefore remanded that portion of the assay methodology to the Commission for further consideration.

The method before us in the present review fares no better than the last, and for the same reasons: even with the 4.5 cents per gallon adjustment, "the record demonstrates no more than that the price[s] of FO–380 [or No. 6 fuel oil] bear[ ] some remote relationship to the value of 1050+ resid as a feedstock." *Id.* at 695. We remand FERC's decision to value resid at the price of FO–380 less 4.5 cents on the West Coast and Waterborne 3% sulfur No. 6 fuel oil less 4.5 cents on the Gulf Coast. The figures derived from the use of these proxies with a subsequent adjustment do not bear a demonstrated relationship to the value of resid, either as a coker feedstock or as a blending agent for fuel oil. Exxon and Tesoro raise multiple challenges to FERC's valuation process for this cut.

#### 1. Marginal Use

[6] Exxon argues that FERC erred again, as it did in the 1993 Order in not employing the marginal use of resid as a blending agent for fuel oil rather than its value as coker feedstock in establishing the valuation methodology for that cut. Exxon contends that the error is a fundamental one in that the ALJ's finding, adopted by the Commission, that there is no active market for resid is flawed. In Exxon's view, although there are few trades of resid, there is in fact a market, and a sparsity of open trades is only due to the fact that the refiners who use resid rarely need to purchase it from others because they already obtain it as a byproduct of their own refining operation. Exxon further argues that there are formulae that can be used to derive resid's value as a blendstock despite the absence of market trades. Thus Exxon prays the court to vacate the relevant portion of FERC's order and remand the controversy for valuing of resid as a blendstock.

FERC responds that there was conflicting evidence regarding the existence of a market for ANS resid, and the ALJ and the Commission reasonably adopted the

testimony of Nine Party witnesses A.L. Gualtieri and Benjamin Klein, who testified that resid was rarely traded, and was instead used as a coker feedstock. *See* 1997 Opinion, 80 FERC ¶ 63,015, at 65,-238–41. The ALJ also determined, based on the record, that it was inappropriate to value resid based on its marginal use as fuel oil blendstock because most of the refineries did not seek to purchase resid but created it as part of their refinery process. *See id.* 65,240. The absence of an active market for resid made the economic principle of marginal use, which depends on a liquid market, unreasonable in this circumstance. *See id.* 65,240–41.

We see no reason to disturb FERC's adoption of the ALJ's determination that resid is best valued based on the market value of its constituent products. The expert testimony of Klein constitutes substantial evidence in support of FERC's decision that marginal use analysis does not require the valuation of resid as a blendstock.

2. Conradson Carbon Residue Content

[7] As with distillate, Exxon argues that FERC arbitrarily ignored quality differences in the streams which affect the value of the different cuts. The Conradson Carbon Residue Content ("CCR") of resid affects its value, and the different streams delivered to the TAPS undisputedly have differing CCR content. Exxon reiterates the argument it made concerning sulfur that failing to account for differing CCR content was arbitrary and capricious. The CCR content figure used by FERC was not even derived from the oil shipped over TAPS, but from a blend used by an expert which included other crude oils. FERC responds that it properly rejected the suggested intra-cut differentials based on CCR content for the same reasons it rejected the quality differentials based on sulfur content. For the reasons stated in Parts III and IV above, we hold that FERC was not required to consider intra-cut differences in CCR content when determining market value.

3. Choice of Proxies

[8] Exxon next argues that FERC acted arbitrarily when it chose to use the adjusted price of FO–380 as a proxy for valuing resid as a coker feedstock. In *OXY,* we found that using the unadjusted market price of FO–380 as a proxy was arbitrary and capricious. The 4.5 cents adjustment now adopted is arbitrary for the same reasons. There is no demonstrated relationship between the value of FO–380 and coker feedstock other than an observed rough correlation in price, and even the data relied on by FERC shows inconsistent relationships in the price of FO–380 and the coker feedstock values calculated by the experts. Exxon argues that determining resid's value as a coker feedstock "requires determining the identity, quantity, and value of products produced in a coker from resid *and* subtracting from the value the costs of producing those products and placing them in a marketable condition." *See* Joint Brief of Petitioners Exxon Company, U.S.A. and Tesoro Alaska Petroleum Company at 42. Exxon also argues that FERC chose the wrong feedstock to value because it used a blend of crudes which would be used by a hypothetical refinery, rather than actual individual North Slope crude streams. Exxon further contends that it presented numerous challenges to the methodology ultimately adopted by FERC, showing inaccuracies in the expert's assumptions regarding cost calculations, product outputs and product yields. Finally, it argues that because the ALJ never allowed discovery, it could not replicate the expert's computer modeling on the PIMS system (a standardized petroleum industry modeling system used to calculate refinery needs and outputs). The ALJ and the Commission did not specifically address these arguments, which Exxon contends makes their decisions arbitrary and capricious.

FERC responds that the 4.5 cents per gallon adjustment to the price of FO–380 on the West Coast and No. 6 fuel oil on the Gulf Coast as proxies for resid was reasonable, based on expert witness O'Brien's testimony and administrative ease. These are the lowest-quality products actively traded, and the adjustment was within the range of variation between the calculated value of resid as a coker feedstock and the per-gallon price of FO–380. *See* Ross Affidavit ¶ 21. O'Brien derived the calculated value of resid as a coker feedstock using the PIMS model and compared those calculated values to the market price of FO–380 over the same five-year period. The relationship varied from resid being worth $1.21 per barrel more than FO–380 in 1993 to being worth $3.01 per barrel less than FO–380 in 1995, and averaged being worth $1.12 per barrel less over the five-year period. *See* 1997 Opinion, 80 FERC ¶ 63,015, at ¶ 65,239 (citing O'Brien Affidavit ¶¶ 56–598 Exhibit QB ar–23). O'Brien testified that the 4.5 cents per gallon adjustment (equal to $1.89 per barrel less than FO–380) proposed by the Nine Party Settlement fell within the observed range of variation over the five-year period and was therefore reasonable. *See id.* FERC also notes that Exxon and Tesoro both suggested a method that tied the price of heavy resid to FO–380. The difference is that Exxon uses a complex formula to adjust the price.[4]

B. Analysis

While we find substantial record evidence supporting the intermediate steps FERC took in determining the value of resid—i.e., its determinations that no active market exists, that resid is best valued as a coker feedstock rather than as a blender for fuel oil, and that FO–380 and No. 6 fuel oil are the actively-traded products in the relevant markets most similar in physical characteristics to resid—we cannot conclude that the last step follows logically from these premises. We therefore cannot uphold the use of FO–380 less 4.5 cents on the West Coast and Waterborne 3% sulfur No. 6 fuel oil less 4.5 cents on the Gulf Coast as a proxy price for resid.

The 4.5 cents adjustment, while it falls within the range of the observed variation, does no more than that. There is no evidence that the prices of the proxy products are more than coincidentally related to the value of resid as a coker feedstock. Moreover, the calculated value of resid using the PIMS model does not even vary consistently with the price of FO–380. As petitioners noted when this case was before us in *OXY*, by the same logic we could use the price of coal with an adjustment as a proxy for the price of diamonds because both are a source of carbon, even if the prices fluctuate inconsistently. With only five years' data to consider, the sample is too small to convince us that there is some other, unstated relationship at work which guarantees that the price of FO–380 and the value of resid will correlate consistently within some specified range. We recognize that the agency is addressing the Quality Bank Administrator's concerns that more complex systems may give the appearance that the price of resid is open to manipulation, and thus is seeking a product that is traded on the market to use as a proxy, which would allow the Quality Bank Administrator to perform a simple market-based calculation when determining the value of resid. These goals of administrative efficiency and objectivity do not free the agency from the requirement that the chosen proxy bear a rational relationship to the actual market value of resid. We remand once again to the agency to determine a logical method for deriving a value for resid. Because we remand, we do not reach the technical objections

4. FERC's suggestion that Tesoro and Exxon somehow validated their choice of FO–380 as a reference product is misleading because Exxon and Tesoro's use of FO–380 as a reference price ties the value of resid to the value of FO–380 when valuing resid as a blendstock for fuel oil, not as a coker feedstock.

Exxon and Tesoro raise regarding specific calculations.

## VI. TESORO'S INDEPENDENT CHALLENGES

### A. Tesoro's Standing

[9] In addition to the arguments raised jointly with Exxon, Tesoro raises numerous additional challenges to FERC's decision. However, before we address the arguments raised by Tesoro in its individual brief, we must consider as a threshold matter whether Tesoro has standing to petition us for review. Intervenors argue that Tesoro lacks standing because it is no longer a shipper on the TAPS system and therefore no longer has a legally cognizable stake in the outcome. As a result, they argue, the case is moot as to it and issues raised only by Tesoro are not properly before us. Intervenors also argue that because Tesoro passed its Quality Bank costs through to its shippers, it was not aggrieved by the orders under review.

Tesoro counters that it has standing as a competitor of MAPCO, one of the shippers on the TAPS system, which is subsidized by TAPS because its stream is overvalued. We have held that even non-shippers and competitors may be within the ICA's zone of interest. *See OXY,* 64 F.3d at 697. Tesoro also notes that it currently purchases ANS crude from one supplier and hopes to acquire more from another. Tesoro Reply Brief at 19 n.10.

[10] The Intervenors are correct that only "aggrieved" parties may seek judicial review of a final FERC order issued under the ICA. *See* 28 U.S.C. § 2344; *OXY,* 64 F.3d at 696; *Shell Oil Co. v. FERC,* 47 F.3d 1186, 1200 (D.C.Cir.1995). We use traditional standing principles to determine if a party is indeed aggrieved. *See OXY,* 64 F.3d at 696; *Water Transp. Ass'n v. ICC,* 819 F.2d 1189, 1193 (D.C.Cir.1987). To be aggrieved, Tesoro must have suffered an "injury in fact" traceable to FERC's action, a decision in its favor must be capable of redressing that injury, and its interest must be within the zone of interests protected by the statute. Tesoro has shown that it would suffer competitive injury if other shippers were advantaged by unfair Quality Bank valuations, a decision on our part altering those valuations would redress that injury, and the ICA permits a very broad range of parties to complain to FERC about pipeline operations. The ICA permits the Commission to respond to complaints about "anything done or omitted to be done by any common carrier" subject to the statute lodged by, *inter alia,* "[a]ny person, firm, corporation, company, or association." 49 U.S.C.app. § 13(1). Tesoro has standing to challenge the decision here.

### B. Tesoro's Position

Tesoro marshals additional attacks on FERC's approval of the settlement, some technical and some that are arguably procedural.

#### 1. Considering Processing Costs for Only Two Cuts

[11] Tesoro argues that FERC erred in singling out the light and heavy distillate cuts for processing cost calculations when processing costs associated with other cuts are ignored. It argues that this violates the requirement in *OXY* that streams be valued equally. In *OXY* we remanded the light distillate and heavy cuts for new valuation because further processing was required before they could be sold as jet fuel and No. 2 fuel oil respectively. Tesoro now claims that FERC arbitrarily ignored the question of whether further processing was needed before the other cuts could be sold as the proxy products FERC used to value them. Failing to do so, it claims, skews the valuation in favor of the heavier streams. This argument fails to comprehend our earlier opinion. There we upheld the agency's finding that the lighter cuts were of sufficiently comparable quality to the market proxies that no further processing was needed, and therefore no cost adjustment was

needed. Essentially, the market price was correct because in those instances the distillation method resulted in a market-ready product. We will not reexamine this issue now. For the reasons given above in Parts III, IV, and V.A.2, we do not entertain the argument that quality differences between the streams must be considered at this stage.

2. Costs of Sulfur Removal

[12] Tesoro argues that internal inconsistencies in the Nine Party data show that the processing costs for sulfur removal are not credible, specifically because there is a higher per-unit cost to remove sulfur from heavy distillate than from resid. Tesoro presented evidence challenging these calculations, which the ALJ and FERC failed to fully address.

FERC responds that Tesoro's argument that there are inconsistencies in O'Brien's cost calculations for sulfur removal was never raised before the Commission, and cannot be raised now before the court. If the issue was preserved, the agency argues that Tesoro has produced no evidence showing that the calculations are incorrect, and that the agency could reasonably have adopted O'Brien's calculations.

We hold that Tesoro preserved this issue for review when it argued before the Commission that there was "no way, absent discovery, to determine that O'Brien's cost estimates are not totally arbitrary" and that the conflicting testimony of its experts supported a lower cost per unit for removing sulfur. Motion of Tesoro Alaska Petroleum Company for Expèdited Reconsideration and Remand or to Permit Appeal Concerning Certification of Nine Party Settlement ¶¶ 36–37 (Oct. 15, 1997). As for the merits of the issue, we hold that FERC reasonably relied on the testimony of Nine Party witness O'Brien in reaching the adjustment. Witness O'Brien testified that different methods would be needed to bring the two products into compliance. Heavy distillate could be blended with a lighter product to bring it into compliance with the 0.5% market tolerances for sulfur in West Coast Waterborne Gasoil, the reference product on the West Coast. However, such blending would not be economically feasible to bring it down to the 0.2% sulfur content of Gulf Coast No. 2 fuel oil, the Gulf Coast reference product, so it would have to be processed to remove the excess sulfur. *See* 1997 Opinion, 80 FERC ¶ 63,015, at 65,234; O'Brien Affidavit ¶¶ 13–15. This difference in approach accounts for the difference in cost. Thus, there is no inconsistency warranting the relief Tesoro seeks.

3. Processing Costs for Light Distillate

[13] Tesoro argues that FERC arbitrarily and capriciously accepted the Nine Parties' processing cost adjustment for light distillate. Tesoro argues that its expert testified that no further processing was required for light distillate to meet the requirements for jet fuel, the proxy product used for valuation of the light distillate cut. FERC arbitrarily accepted the Nine Parties' experts' claims that 0.5 cents per gallon in processing was required before the cut would meet the standard. Tesoro also argues that its expert pointed out unreasonable additions to the cost of the processing, such as unnecessary pumping and inflated administrative costs, and that FERC accepted this flawed estimate without considering contrary evidence and thus failed to satisfy the substantial evidence standard. We find this objection to be without merit. There is substantial record support for the Commission's determination that a 0.5 cent/gallon adjustment was required to account for the processing of light distillate into jet fuel. That evidence consisted of expert testimony before the ALJ by Nine Party witness O'Brien supporting the processing costs figures eventually adopted by the ALJ and thereafter by the Commission. *See* Reply Comments of the Nine Settling Parties in Support of the Nine Party Settlement at 4–5 (Mar. 17, 1997).

4. Coker Feedstock Value Based on Improper Assumptions and Calculations Not in the Record

Tesoro next argues that FERC ignored substantial and important criticism of the coker valuation of resid. Under the adopted method, resid's coker feedstock value is deemed to be the value of the products created less the cost of processing. Tesoro argues that the other experts' opinions were based on the wrong mix of product yields, that the PIMS model used is not in the record, and that Tesoro's expert could not replicate the results. Tesoro also argues that its expert showed that the coker operating costs used by the Nine Parties' experts were overstated. Because the PIMS model is not in the record, FERC could not make a rational connection between the facts and the conclusions drawn therefrom.

Given that we are remanding the question of valuation of resid because FERC has not provided a reasoned explanation for its determination to set resid's value as a coker feedstock and to use FO-380 less 4.5 cents on the West Coast and Waterborne 3% sulfur No. 6 fuel oil less 4.5 cents on the Gulf Coast as a proxy price, we need not decide this detailed factual question, as the factual record may change on remand. FERC will necessarily address these issues when it revalues resid, and such complex technical questions belong first to the informed discretion of the agency. *See OXY,* 64 F.3d at 691.

5. Eliminating the Fuel Oil Cut

[14] Tesoro argues that FERC improperly eliminated the light resid cut and determined that the 1000–1050 degree cut should be valued as VGO. (We had previously affirmed FERC's creation of the light resid cut, but had remanded for new valuation.) The Nine Parties had suggested this change, and FERC approved it. Tesoro argues that the new cut is beyond the capability of many refineries. It suggests that the ALJ was confused when he determined that this change was consistent with the Commission's treatment of this cut.

FERC reasonably found, in resolving this technical matter, that the record evidence supports a determination that "the standard industry cut point shown on assays is 1050°, and that the published specifications for VGO permit cut points to 1100°." *See* 1997 Order, 81 FERC ¶ 61,319, at 62,464. This finding, coupled with the testimony of expert witness O'Brien, *see id.* at 65,236–37, provided substantial evidence supporting the agency's decision that VGO is a permissible product on which to base the valuation of 1000 to 1050 degree resid.

6. The Choice of Waterborne Gasoil

[15] Tesoro argues that FERC arbitrarily and capriciously approved the Nine Parties' selection of Waterborne Gasoil as the proxy product for valuing West Coast heavy distillate. Tesoro argues that Waterborne Gasoil is not a West Coast product, but is a Singapore product created in Singapore and is thus subject to Far East refining and market economics. This, it argues, is inconsistent with the stated goal of the settlement of valuing the product on the coast where it is "delivered and used." Waterborne Gasoil, a high-sulfur product, cannot be sold on the West Coast. *See* Tesoro Brief at 19–21.

The agency states that "the reference price used is 'Platt's U.S. West Coast spot quote for Waterborne Gas oil less 1 cent per gallon for processing costs.' ... That quoted Platt West Coast Waterborne Gas Oil price represents the value of significant Gas oil transactions on the United States West Coast." 1997 Order, 81 FERC ¶ 61,319, at 62,463–64. Witness Ross stated that the price for Waterborne Gasoil was a West Coast price, even if the product was ultimately exported to Singapore. *See* Affidavit of Christopher E. Ross ¶¶ 7–10 (Mar. 17, 1997). Given this record support, we will not disturb FERC's determination.

7. Inconsistent Treatment of Heavy Distillate and Resid

Tesoro also argues that the valuation of heavy distillate is inconsistent with the valuation of resid. West Coast heavy distillate is valued based on its marginal use as the lowest-value product requiring the least processing (high sulfur Waterborne Gasoil), whereas resid is valued based on its highest-value use as a coker feedstock. Tesoro argues that this impermissible inconsistent treatment overvalues the heaviest streams. This amounts to a reiteration of the question addressed above regarding FERC's determination that it is appropriate to value resid as a coker feedstock in the absence of a liquid market for the product. We uphold FERC's decision for the reasons stated above in Section V.A.1.

8. Naphtha and Gas Oil

Tesoro argues that FERC should have reevaluated other cuts, particularly naphtha and gas oil. Specifically, Tesoro argues that FERC failed to value these two cuts based on a weighted valuation of the prices on both the West Coast and Gulf Coast, which violates the "dual-market principle." *See* Brief of Petitioner Tesoro Alaska Petroleum Company at 22. None of these products are valued based on Gulf Coast prices, which overvalues gas oil and undervalues naphtha, thus favoring heavy streams. Whatever the merits of these arguments might be, the issues they raise are beyond the scope of the limited remand, and therefore not properly before us.

C. Procedural Questions

**[16]** Tesoro next argues that FERC arbitrarily and capriciously failed to provide for adequate procedures to ensure a reliable record. Specifically, Tesoro argues that FERC should have ordered discovery and hearings with cross-examination to resolve contested issues because of the vastly differing positions of the experts. Live hearings would have permitted the ALJ to make credibility determinations, and cross-examination would have permitted Tesoro to challenge specific portions of the experts' testimony. For instance, Tesoro objects that the PIMS computer model is not in the record, and thus the assumptions underlying the coker feedstock valuations could not be tested,[5] and argues that some of the Nine Parties advocated higher payments into the Quality Bank earlier in the litigation. Tesoro cites *Astroline Communications Co. Ltd., Partnership v. FCC,* 857 F.2d 1556, 1571 (D.C.Cir.1988); *Porter v. Califano,* 592 F.2d 770, 783 (5th Cir.1979); and *Xerox Corp. v. Genmoora Corp.,* 888 F.2d 345, 355 (5th Cir.1989), as establishing the principle that review of a contested settlement on the merits requires discovery and cross-examination.

FERC responds that the procedures employed by the ALJ provided ample opportunity for the parties to advance all supporting evidence for their proposals and to illuminate defects in the counter proposals. Specifically, the ALJ permitted the parties to file affidavits and other materials in support of the proposals; the ALJ heard oral arguments from all parties in support of the proposals; the ALJ further permitted the parties to file post-argument briefs. FERC contends that these opportunities were adequate to fulfill all due process requirements and allowed the parties to adequately present their positions to the ALJ and the Commission. We agree.

While it is true that live testimony and cross-examination can facilitate a fact-finder's attempts to sort out the truth, we have not held that such procedures are necessary in all cases. In fact, we have held that "FERC may resolve factual issues on a written record unless motive, intent, or credibility are at issue or there is a dispute over a past event." *Union Pac. Fuels,*

5. In light of our remand for reevaluation of heavy resid as a coker feedstock, the absence of the PIMS model from the record could in any event be no more than harmless error.

*Inc. v. FERC,* 129 F.3d 157, 164 (D.C.Cir. 1997); *see also Louisiana Ass'n of Indep. Producers & Royalty Owners v. FERC,* 958 F.2d 1101, 1113 (D.C.Cir.1992) (party may not complain that it was deprived of a fair hearing after receiving notice of expert testimony on which opposing party relied, an opportunity to review it, a chance to submit briefs criticizing it and evidence opposing it, and the opportunity to argue before the Commission). In this case, there is a dispute among experts over the proper method for valuing petroleum streams. This type of technical dispute is amenable to resolution by resort to the written record, particularly where Tesoro had significant opportunities to submit evidence of its own and criticize the evidence submitted by the Nine Parties. We decline to overturn FERC's decision.

## VII. PROSPECTIVE APPLICATION OF THE SETTLEMENT

### A. Exxon and Tesoro's Position

**[17]** Exxon and Tesoro argue that FERC committed legal error when it decided that it would implement the settlement order prospectively only. The method that we found unreasonable and remanded has been in effect since 1993, and the Commission stated when it was adopting the distillation methodology that in the event it was reversed and Exxon suffered economic losses, it could correct any legal errors after the appeal. *See* Order on Rehearing, *Trans Alaska Pipeline Sys.,* 66 FERC ¶ 61,188, at 61,423 (1994). Now, when it has corrected the legal errors identified in *OXY,* the Commission has opted to apply the new rates prospectively only, leaving the parties without remedy for the years of unlawful valuations, and granting the settling parties a windfall.

Exxon argues that this circuit's precedents require FERC to return the parties to the position they would have occupied had this legal error not been made. *See Public Utils. Comm'n of the State of California v. FERC,* 988 F.2d 154, 168 (D.C.Cir.1993) ("*CPUC*") (citing cases); *see also, e.g., Panhandle Eastern Pipe Line Co. v. FERC,* 907 F.2d 185, 189 (D.C.Cir.1990); *Office of Consumers' Counsel, State of Ohio v. FERC,* 826 F.2d 1136, 1139 (D.C.Cir.1987) (per curiam). This rule is drawn from "the logic of the statute itself." *Natural Gas Clearinghouse v. FERC,* 965 F.2d 1066, 1074 (D.C.Cir.1992).

FERC's reasons for refusing to do so, Exxon argues, are wrong as a matter of law. First, the agency agreed with the ALJ that the cases cited by Tesoro and Exxon are not dispositive because, while *CPUC* and *Panhandle* "recognized that the Commission has the authority in some circumstances to issue orders which have retroactive effect, neither of those cases required it." 1997 Opinion, 80 FERC ¶ 63,015, at 65,242. Exxon argues that the language from those cases explicitly states that "when the Commission commits legal error, the proper remedy is one that puts the parties in the position they would have been in had the error not been made." *CPUC,* 988 F.2d at 168. This use of the word "*the,*" as opposed to "a," proper remedy suggests FERC must order retroactive payment when it commits legal error.

Exxon also argues that FERC improperly attempts to rely on the filed rate doctrine as mandating prospective application of its order. *See* 1997 Order, 81 FERC ¶ 61,319, at 62,467. Exxon argues that despite its protestations, FERC has the authority to correct its error, and that the shippers had notice that there might be a later correction to the rate, which " 'changes what would be purely retroactive ratemaking into a functionally prospective process by placing the relevant audience on notice at the outset that the rates being promulgated are provisional only and subject to later revision.' " *Natural Gas Clearinghouse,* 965 F.2d at 1075 (quoting *Columbia Gas Transmission Corp. v. FERC,* 895 F.2d 791, 797 (D.C.Cir. 1990)).

Exxon next argues that even if FERC did have discretion to determine whether to apply the corrected valuation retroactively, its failure to do so in this case amounts to an abuse of that discretion. FERC stated as reasons for its decision the observations that the change here was one of valuation, not of methodology, and that the Quality Bank was *sui generis*. Neither of these reasons, it contends, supports the decision not to remedy the injury to Exxon and Tesoro. Exxon notes that FERC had retroactively applied adjustments in vacuum gas oil rates that were set under the distillation method, rendering both justifications meaningless. Exxon also points out that FERC does not explain how the *"sui generis"* nature of the Quality Bank has any bearing on whether the aggrieved parties should be made whole.

Exxon further argues that the refusal to make the aggrieved parties whole violates the central purpose of the Quality Bank, which was created as part of FERC's " 'continuing obligation to ensure that pipeline rates are just and reasonable.' " *OXY*, 64 F.3d at 690 (citing 49 U.S.C. § 1(5) and quoting *Texas Eastern Transmission Corp.*, 893 F.2d at 774). Moreover, it contends, this abuse of discretion is compounded because FERC refused the injured parties a stay pending appeal in 1994 on the basis that it could correct any legal errors later found on appeal.

Exxon cites a string of our precedents holding that it is proper to correct such legal errors retroactive to the time they occurred. In *Tennessee Valley Municipal Gas Association v. FPC*, 470 F.2d 446 (D.C.Cir.1972), we held: "If the policy of the Natural Gas Act is not arbitrarily to be defeated by uncorrected Commission error, the [injured party] must be put in the same position that it would have occupied had the error not been made." *Id.* at 452. In *Public Service Co. of Colorado v. FERC*, 91 F.3d 1478 (D.C.Cir.1996), we stated: "Absent detrimental and reasonable reliance, anything short of full retroactivity ... allows [some parties] to keep some unlawful overcharges without any justification at all. The court strongly resists the Commission's implication that the Congress intended to grant the agency the discretion to allow so capricious a thing." *Id.* at 1490. The *Public Service Co.* decision was made in the context of the Natural Gas Policy Act. We held that the parties were on notice of a potential change in the way a tax would be charged to customers, and thus did not detrimentally rely on the agency's prior position. As a result, we held that it was fair to make refunds of those tax charges retroactive to the date of notice.

Finally, Exxon argues that FERC's so-called equitable exercise of its discretion failed to give any weight to the injury to the parties and the resulting windfall to the Nine Parties, who benefit because of agency error, rendering the agency's ultimate decision irrational.

B. FERC's Position

FERC argues that the Commission properly concluded that the equitable approach would be to implement the settlement on a prospective basis, as all other TAPS settlements had been. The cases cited by Exxon address the issue of whether FERC is barred from applying a remedy retroactively, not whether it is required to do so. FERC's discretion is at its zenith when deciding what kind of remedy to apply. *See Towns of Concord, Norwood, & Wellesley, Mass. v. FERC*, 955 F.2d 67, 76 (D.C.Cir.1992). FERC asserts that it made its decision based on several equitable factors[6]:

> FERC took note (1) that parties supported the Nine Party Settlement only if it were implemented prospectively; (2) that all prior TAPS cases resolved by

6. Factor number one, we note, is mentioned only in the agency's brief to this court and not in its decision.

settlements have been on a prospective basis; (3) that the changes adopted by the Settlement Order only modify limited aspects of the distillation methodology put in place in 1993; and (4) that the TAPS Quality Bank is *sui generis*. 81 FERC at 62,467.

FERC Brief at 59. Therefore, FERC argues, it did not abuse its discretion. FERC also notes that it did not "bait and switch" Exxon in denying the stay because each remedy must be decided on its own merits.

C. Intervenors' Position

Intervenors note that we have made clear that FERC has discretionary authority over whether a settlement should have retroactive effect. *See CPUC,* 988 F.2d at 168. *See also Cities of Batavia, Naperville, Rock Falls, Winnetka, Geneva, Rochelle and St. Charles, Ill. v. FERC,* 672 F.2d 64, 85 (D.C.Cir.1982) ("It is clear ... that in denying a refund in this case the Commission also considered the practical consequences and the purpose of the Act; hence we are required to uphold its exercise of discretionary power"); *Second Taxing Dist. of the City of Norwalk v. FERC,* 683 F.2d 477, 490 (D.C.Cir.1982) ("Refunds are not mandatory; the Commission has discretion to decide whether a refund is warranted in light of the interests of the customer and the utility."). *OXY* did not require any result in this case, and in the absence of a clear mandate, they argue, FERC properly exercised its discretion.

D. Analysis

We agree that FERC does have a measure of discretion in determining when and if a rate should apply retroactively. However, such discretion is not without its limits, and we hold that FERC abused that discretion.

The agency's passing mention of the filed rate doctrine has no bearing on FERC's discretion to reallocate Quality Bank credits to correct FERC's erroneous valuations of the distillate and resid cuts because all of the TAPS shippers were on notice as of 1993 that the valuations were contested. FERC mentioned the filed rate doctrine not as a justification for its exercise of discretion, but in discussing the prior decision, in which the filed rate doctrine was decisive. As we stated in *OXY,* "[t]he rule against retroactive ratemaking ... 'does not extend to cases in which [customers] are on adequate notice that resolution of some specific issue may cause a later adjustment to the rate being collected at the time of service.' The goals of equity and predictability are not undermined when the Commission warns all parties involved that a change in rates is only tentative and might be disallowed." 64 F.3d at 699 (quoting *Natural Gas Clearinghouse,* 965 F.2d at 1075). In fact, all of the parties participated in the proceedings before the agency. Any reliance that they may have placed on the rates in light of these proceedings was unwarranted. As we stated in *Public Service Co.,* "[a]bsent detrimental and reasonable reliance, anything short of full retroactivity ... allows [some parties] to keep some unlawful overcharges without any justification at all." 91 F.3d at 1490.

[18] There is also a strong equitable presumption in favor of retroactivity that would make the parties whole. As we have stated, "when the Commission commits legal error, the proper remedy is one that puts the parties in the position they would have been in had the error not been made." *CPUC,* 988 F.2d at 168. This is not to say that FERC must do so in every case if the other considerations properly within its ambit counsel otherwise. However, FERC's listed equitable factors have no bearing on the decision and do not explain its decision not to make whole parties who are clearly injured by undervaluation. Given the strong presumption in favor of making injured parties whole and the incentive that this creates for the parties to litigate regarding past errors and for the agency to correct those errors,

on the record before us we hold that FERC abused its discretion when it failed without adequate explanation to make the revaluation and concomitant Quality Bank adjustments retroactive to 1993, when the distillation method was adopted.

We recognize FERC's concern that the Nine Parties have stated that they would not support the settlement if it applied retroactively. However, we cannot uphold on this basis a contested settlement in which the settling parties agree to divvy up a windfall at the expense of the contesting parties. The agency cannot simply take a head count among the parties in a contested settlement and decide that since those who will benefit from a settlement outnumber those who will suffer, it is fair to allow the majority to settle the issue in their favor. In settlements where the power of the agency is not being invoked to overcome the objections of some parties, all sides typically give up something to arrive at a mutually painful but acceptable position. It should be unsurprising that the Nine Parties are unwilling to support the settlement unless it remains in their favor if they can invoke the might of FERC to cram such a settlement down the minority's throats. Parties raising legitimate legal objections cannot be overlooked simply because they are outnumbered, even if the result is that it sends all parties back to the negotiating table or the hearing room. The issue of the effective date of the new valuation method is remanded for action consistent with this opinion.

## VIII. CONCLUSION

We uphold FERC's decision with two exceptions—we find that the decision to use FO–380 less 4.5 cents on the West Coast and Gulf Coast Waterborne 3% sulfur No. 6 fuel oil less 4.5 cents on the East Coast as proxies for the market valuation for resid was not supported by substantial evidence and that the decision to apply the settlement prospectively was an abuse of discretion. We vacate those portions of FERC's order and remand to the agency to reconsider these issues in light of our opinion. We deny the petitions for review in all other respects.

**VERIZON TELEPHONE COMPANIES, et al., Petitioners,**

**v.**

**FEDERAL COMMUNICATIONS COMMISSION and United States of America, Respondents.**

**Sprint Corporation, et al., Intervenor.**

**No. 00–1207.**

United States Court of Appeals, District of Columbia Circuit.

Argued Sept. 6, 2001.

Decided Nov. 9, 2001.

Local exchange carriers (LECs) petitioned for review of order of Federal Communications Commission (FCC) determining that LECs violated unreasonable charge provisions of Communications Act in imposing End User Common Line (EUCL) fees on independent payphone providers (IPPs) for payphones used in same manner as LEC-owned "public" payphones, which were exempt from EUCL fees. The Court of Appeals, Harry T. Edwards, Circuit Judge, held that: (1) order was final even though it did not decide issue of damages, and (2) fact that FCC had initially allowed LECs to impose EUCL fees on IPPs did not preclude FCC from subsequently holding LECs liable for imposing such fees.

Petition denied.

**1. Telecommunications ⇐337.1**

Order issued by Federal Communications Commission (FCC), holding local exchange carriers (LECs) liable for imposing End User Common Line (EUCL) fees on independent payphone providers (IPPs) for payphones used in same manner as LEC-owned "public" payphones, was final appealable order, even though it did not decide issue of damages, inasmuch as there was no indication FCC would revisit its decision in future, order had some legal consequences for LECs, and relevant jurisdiction-conferring statute provided that order concluding investigation of lawfulness of charge was final order. 28 U.S.C.A. § 2342(1); Communications Act of 1934, §§ 201(b), 208(b), 47 U.S.C.A. §§ 201(b), 208(b).

**2. Telecommunications ⇐11.1**

As a general proposition, a Federal Communications Commission (FCC) order is final and thus appealable if it: (1) represents a terminal, complete resolution of the case before the agency, and (2) determines rights or obligations, or has some legal consequence. 28 U.S.C.A. § 2342(1); Communications Act of 1934, § 208(b), 47 U.S.C.A. § 208(b).

**3. Administrative Law and Procedure ⇐704**

**Federal Courts ⇐585.1**

When a tribunal elects to resolve the issue of liability in a particular action while reserving its determination of damages on that liability, that decision generally is not considered final for purposes of judicial review; this basic understanding of finality is the norm not only in civil litigation, but also in the administrative context, at least where the relevant statute does not embrace a non-traditional view of finality.

**4. Telecommunications ⇐337.1**

"Lawfulness," as used in the statute stating that any Federal Communications Commission (FCC) order concluding an investigation of "the lawfulness of a charge" commenced at the behest of a party complaining about the actions of a common carrier shall be final for purposes of appeal, means that which is allowed or permitted by law. Communications Act of 1934, § 208(b), 47 U.S.C.A. § 208(b).

See publication Words and Phrases for other judicial constructions and definitions.

**5. Telecommunications ⚖337.1**

When the Federal Communications Commission (FCC) enters an order dealing solely with the lawfulness of a charge, that order is final for purposes of appeal even if it fails to resolve a complainant's properly presented claim for damages; however, no FCC order is subject to review unless it actually terminates an investigation of the lawfulness of a common carrier's activities. Communications Act of 1934, § 208(b)(3), 47 U.S.C.A. § 208(b)(3).

**6. Telecommunications ⚖323**

Fact that Federal Communications Commission (FCC) had initially allowed local exchange carriers (LECs) to impose End User Common Line (EUCL) fees on independent payphone providers (IPPs), for payphones used in same manner as LEC-owned "public" payphones, did not preclude FCC from subsequently holding LECs liable for imposing such fees, after FCC determined that fees constituted unreasonable charges; FCC's initial decisions were not legislative so as to be subject to prohibition on retroactive repeals of quasi-legislative ratemaking, and FCC's change in position did not amount to "new" rule that could not be applied retroactively. Communications Act of 1934, § 201(b), 47 U.S.C.A. § 201(b).

**7. Administrative Law and Procedure ⚖498**

In a case in which there is a substitution of new law for old law that was reasonably clear, a decision to deny retroactive effect to an agency decision is uncontroversial, but in cases in which there are new applications of existing law, clarifications, and additions, the courts start with a presumption in favor of retroactivity.

**8. Administrative Law and Procedure ⚖498**

Retroactivity of an agency decision will be denied when to apply the new rule to past conduct or to prior events would work a manifest injustice.

**9. Telecommunications ⚖337.1**

Contention by local exchange carriers (LECs), that equitable restitution, and not legal damages, was sole remedy available to independent payphone providers (IPPs) for LECs' imposition of unreasonable End User Common Line (EUCL) fees, was not ripe for adjudication, where Federal Communications Commission (FCC) had not yet entered final order with respect to damages. 28 U.S.C.A. § 2342(1); Communications Act of 1934, §§ 201(b), 208(b), 47 U.S.C.A. §§ 201(b), 208(b).

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On Petitions for Review of Orders of the Federal Communications Commission.

Aaron M. Panner argued the cause for petitioners and supporting intervenors. With him on the briefs were Michael K. Kellogg, Michael E. Glover, John M. Goodman, James D. Ellis, Roger K. Toppins, Jeffry A. Brueggeman, Jay C. Keithley, and Michael B. Fingerhut.

John E. Ingle, Deputy Associate General Counsel, Federal Communications Commission, argued the cause for respondents. With him on the briefs were Daniel M. Armstrong, Associate General Counsel, Laurel R. Bergold and Lisa E. Boehley, Counsel, John M. Nannes, Acting Assistant Attorney General, United States Department of Justice, Robert B. Nicholson and Robert J. Wiggers, Attorneys. Christopher J. Wright, General Counsel, Federal Communications Commission, and Lisa S. Gelb, Counsel, entered appearances.

Michael J. Thompson, Albert H. Kramer, Katherine J. Henry, and Andrew J. Phillips were on the joint brief of intervenors ABTEL Communications, Inc., et al. Robert F. Aldrich entered an appearance.

Michael E. Glover, John M. Goodman, James D. Ellis, Roger K. Toppins, Jeffry A. Brueggeman, Michael K. Kellogg, Aaron M. Panner, Jay C. Keithley, and Michael B. Fingerhut were on the brief of Local Exchange Carrier intervenors.

Before: GINSBURG, Chief Judge, EDWARDS and SENTELLE, Circuit Judges.

Opinion for the Court filed by Circuit Judge HARRY T. EDWARDS.

HARRY T. EDWARDS, Circuit Judge:

A group of local phone companies (known as "local exchange carriers," or "LECs") seek review of an order of the Federal Communications Commission ("FCC" or "Commission") holding them liable for violating the unreasonable charge provisions of 47 U.S.C. § 201(b) (1994). The violations occurred when the LECs wrongfully imposed so-called End User Common Line ("EUCL") fees on certain "independent payphone providers" ("IPPs"). In an agency adjudication that addressed complaints challenging the fees, the FCC initially construed the rules enunciated in an earlier rulemaking, *In re MTS and WATS Market Structure,* 97 F.C.C.2d 682, 1983 WL 183026 (1983) ("*Access Charge Reconsideration*") (setting rules by which LECs could recover costs associated with calls made on payphones), to allow the imposition of the fees. However, the FCC's decision did not survive judicial review. In *C.F. Communications Corp. v. FCC,* 128 F.3d 735 (D.C.Cir.1997), the court held that the *Access Charge Reconsideration* did not allow for the fees. The case was remanded, leading the Commission to reverse itself in the order now under review. *See In re C.F. Communications Corp. v. Century Tel. of Wisconsin, Inc.,* 15 F.C.C.R. 8759, 2000 WL 374484 (2000) ("*Liability Order*"). In changing its position following judicial review, the FCC conclusively determined that the LECs had violated the applicable *Access Charge Reconsideration* rules by imposing the EUCL charges; the Commission decided, however, that the question of what damages should flow from that violation was best reserved for another day.

In their present petition, the LECs contend, first, that the *Liability Order* is final, and thus immediately reviewable by this court. Second, they argue that the agency may not now sanction them for conduct that had been expressly approved, and may have even been compelled, by the Commission itself. The FCC responds that we lack jurisdiction at this time, because by leaving the issue of damages unresolved, the *Liability Order* was rendered non-final. Moreover, the Commission asserts that even if we do reach the merits, the LECs' retroactivity argument must fail, as whatever reliance those carriers placed on ultimately erroneous FCC pronouncements cannot excuse their violations of governing law – as that law is *properly* construed. We conclude that the *Liability Order* is final, and that we therefore have jurisdiction to review it. It is true that the general rule is that an adjudicatory decision resolving only liability and not damages is *not* final. In this case, however, the relevant jurisdiction-conferring statute, 47 U.S.C. § 208(b), provides that an order "concluding an investigation ... of the lawfulness of a charge" is a final order subject to immediate appeal. We are presented with just such an order here.

On the merits, we hold that it was appropriate for the FCC to find the LECs liable for their EUCL charges, even though the Commission initially construed the *Access Charge Reconsideration* rules to allow the charges. We do not believe that the Commission should be prevented from stating the law correctly merely be-

cause it may have misconstrued the applicable rules in the past. We emphasize, however, that this holding does not necessarily doom the LECs' retroactivity arguments. Because the FCC has not yet fixed the means by which it will calculate damages, the LECs are not foreclosed from presenting their equitable concerns to the agency during the next phase of the proceedings. We therefore express no opinion as to the Commission's authority to impose damages on the LECs for charges that they may have collected in reliance on the agency's initial (and mistaken) interpretations of the *Access Charge Reconsideration* rules.

## I. Background

Much of the regulatory and procedural background to the present petition is set out in *C.F. Communications*. *See* 128 F.3d at 736–38. We will not repeat that entire discussion here, but rather will concentrate on the most salient points. The underlying issue in this case is how local phone companies are to recover the costs that they incur when long-distance calls are made on coin-operated telephones. The story begins in 1983, when the FCC issued general rules establishing a regulatory mechanism for LECs to be compensated for providing long-distance carriers (known as "interexchange carriers" or "IXCs") access to their local networks. *In re MTS and WATS Market Structure, Third Report and Order*, 93 F.C.C.2d 241, 1983 WL 183053 (1983) ("*Access Charge Rulemaking*"), *modified on recon.*, 97 F.C.C.2d 682, 1983 WL 183026 (1983), *modified on further recon.*, 97 F.C.C.2d 834 (1984), *aff'd and remanded in part sub nom. Nat'l Ass'n of Regulatory Util. Comm'rs v. FCC*, 737 F.2d 1095 (D.C.Cir. 1984). For most phones, the Commission decided that these costs were to be footed by "end users" who would be assessed EUCL charges by the LECs. Pay telephones, however, which tend to have no predetermined end-user, required a different solution. Accordingly, the FCC decided to exempt public payphones from EUCL fees altogether, instead allowing the LECs to recover their costs from the IXCs directly, in the form of Carrier Common Line ("CCL") charges. *See Access Charge Reconsideration* at 705. Not *all* payphones were exempted, however. Instead, the FCC distinguished between true "public" payphones – such as those in airports and on street corners – and those which it labeled "semi-public" – a category that included coin-operated phones found in restaurants and gas stations, where "there is a combination of general public and specific customer need for the service." *Id.* at 704 & n. 40. Reasoning that this latter class could be linked to identifiable subscribers, the Commission allowed the LECs to impose flat EUCL charges on those subscribers, just as they would do for ordinary private phones. *See id.* at 706.

At the time when the *Access Charge Reconsideration* was issued, all of the nation's payphones were owned by the LECs themselves. This situation was soon undermined when the FCC allowed a group of "independent" providers to enter the payphone market. *See Registration of Coin Operated Telephones*, 49 Fed.Reg. 27,763 (July 6, 1984). These IPPs brought with them a technological advantage: so-called "smart" phones, which connected to ordinary phone lines rather than to the special coin lines that linked the LEC-owned phones to the central processors that supervise their calls. The new phones, which were able to perform this managerial task internally, needed no such specialized hookup. However, despite their architectural and cognitive differences, the two types of phones are found in the same kinds of places and are basically indistinguishable from the lay user's perspective. Nevertheless, when it came to

EUCL charges, the LECs decided to treat the smart phones rather differently from their less sophisticated cousins. Acting at first without any guidance from the Commission other than the original *Access Charge Reconsideration*, the LECs imposed EUCL fees on *all* of the new phones – not merely those located in semipublic places – and assessed these tolls on the IPPs directly.

Unsurprisingly, the IPPs balked at these charges. Their concerns, however, were not well received by officials at the FCC. In 1988 and 1989, informal complaints filed by two IPPs generated two letters from Anita J. Thomas, an analyst in the Enforcement Division of the Commission's Common Carrier Bureau. In both of these letters, Thomas declared that by imposing EUCL fees on IPPs, the LECs violated neither their own tariffs nor the agency's regulations. *See* Letter from Anita J. Thomas to LeRoy A. Manke, Manager, Coon Valley Farmers Telephone Co. (Apr. 4, 1989), *reprinted in* Joint Appendix ("J.A.") 154; Letter from Anita J. Thomas to Lance C. Norris, Vice President, American Payphones, Inc. (Sept. 14, 1988), *reprinted in* J.A. 152. In May of 1989, another IPP, C.F. Communications Corp. ("CFC"), filed a formal complaint, alleging that the LECs' conduct had violated various provisions of the Communications Act and seeking reparations for the wrongfully collected EUCL charges. This challenge proved unsuccessful at the agency level, as both the Common Carrier Bureau and ultimately the Commission itself sided with the LECs. *In re C.F. Communications Corp. v. Century Tel. of Wisconsin*, 8 F.C.C.R. 7334, 1993 WL 407902 (Com. Car. Bur.1993); 10 F.C.C.R. 9775, 1995 WL 521362 (1995) ("*EUCL Decisions*"). In rejecting CFC's complaint, the FCC concluded that IPPs were properly considered "end users" and thus could be subjected to EUCL charges. Moreover, the agency held that the IPPs' payphones were "semi-public" within the meaning of the *Access Charge Reconsideration* no matter where they were located or how they were used.

CFC sought review of the FCC decision in this court and found some success. In *C.F. Communications*, the court vacated the *EUCL Decisions*, holding both that the classification of IPPs as "end users" was an unreasonable interpretation of the relevant regulation, 47 C.F.R. § 69.2(m), and that the FCC had not adequately justified allowing EUCL charges to be collected for IPP phones while exempting similarly situated LEC-owned payphones from such fees. *See* 128 F.3d at 738-42. In deciding this second issue, the court pointedly rejected the FCC's theory that a payphone should be denied "public" (and thus EUCL-exempt) status under the *Access Charge Reconsideration* merely because it was *capable* of private use. Rather, the court stated that the relevant question was how a phone was *actually* used, that is, the manner in which it was held out to the public. *Id.* at 741-42. These holdings were significant because they undermined the legal basis on which the LECs had relied to rationalize their disparate treatment of independently owned "smart" payphones. And, without such support, the LECs' actions seem to collapse into the kind of unreasonable discrimination proscribed by the Communications Act. *See* 47 U.S.C. § 202(a). However, the court in *C.F. Communications* declined to decide "whether the Commission's interpretation compelled LECs to discriminate under Section 202(a), or the precise consequences if it did," leaving those issues for another day. 128 F.3d at 742.

On remand, the FCC chose not to mount a renewed defense of its decision to allow the LECs to assess end-user fees on the IPPs. Instead, the Commission decided to hold the LECs liable for devising and im-

plementing that policy in the first place. In the *Liability Order* now on review, the FCC concluded that, in light of the *C.F. Communications* decision, a EUCL fee imposed on an independent payphone that is used in the same manner as a LEC-owned "public" payphone is an "unreasonable charge" under 47 U.S.C. § 201(b). *See Liability Order* at 8766, ¶ 20. The agency then concluded that an award of damages for such liability was appropriate. *Id.* at 8768-69, ¶¶ 27-29. At the same time, however, the agency postponed a final ruling on damages, reasoning that further briefing and argument were needed in order to fix the proper amount of the award. *Id.* at 8771, ¶¶ 33-34. The LECs filed the present petition for review before that phase of the proceedings commenced.

## II. Discussion

This petition presents two central questions, one jurisdictional and one merits-based. The first is whether the FCC's *Liability Order* is final and therefore subject to immediate judicial review. We answer this question in the affirmative. The second is whether it was permissible for the Commission to hold the LECs liable for imposing charges that had previously been condoned by the FCC itself. We answer this question in the affirmative as well. At the same time, however, we note that, because the agency has not yet conclusively determined how it will measure damages, the LECs still will be able to raise their concerns about retroactivity and reliance with the FCC during the next phase of these proceedings. And, until the Commission reaches a conclusion on that issue, we are unable to review the propriety and permissible extent of damages in this case.

### A. *Finality under 47 U.S.C. § 208(b)*

[1] Under 28 U.S.C. § 2342(1) (1994), this court has jurisdiction to determine the validity of "all final orders of the Federal Communications Commission made reviewable by section 402(a) of title 47." In turn, 47 U.S.C. § 208(b) states that "[a]ny order concluding an investigation" of, *inter alia*, "the lawfulness of a charge" commenced at the behest of a party complaining about the actions of a common carrier "shall be a final order and may be appealed under section 402(a) of this title." The jurisdictional question in this case, then, is whether the *Liability Order* "concluded" the investigation that began with CFC's original 1989 complaint against the LECs.

All parties agree that, in the *Liability Order*, the FCC reached a final determination that the LECs had imposed unreasonable charges in collecting EUCL fees from the IPPs, thereby violating 47 U.S.C. § 201(b). *See Liability Order* at 8773, ¶¶ 40-41. This decision is undoubtedly final, in the sense that there is no indication that the agency will revisit it in future proceedings. Indeed, neither the Commission's brief nor agency counsel's argument on appeal claimed that the finding of liability is subject to further review by the FCC sans a court order requiring it. Nonetheless, the Commission contends that its decision to bifurcate the damages phase of its investigation from the liability phase stripped the entire *Liability Order* of its finality. In other words, according to the FCC, an investigation under § 208 of a single complaint that seeks a determination of liability *and* an award of damages is not over until the Commission has resolved both aspects of the complaint. *See* Br. for Respondents at 27.

[2] As a general proposition, an FCC order is final if it "(1) represents a terminal, complete resolution of the case before the agency, and (2) determines rights or obligations, or has some legal consequence." *Capital Network Sys., Inc. v. FCC*, 3 F.3d 1526, 1530 (D.C.Cir.1993) (internal quotations and citations omitted).

Here, we are sure that the *Liability Order*, even without a concomitant determination of damages, has "some legal consequence" for the LECs. The actions of the FCC bear this out. Agency officials have relied on the *Liability Order* at least twice in unrelated cases to deny requests made by SBC Communications, one of the named LECs, to have sanctions against it mitigated. *See In re SBC Communications, Inc.*, 16 F.C.C.R. 10963, 10968, ¶ 15 & n. 38, 2001 WL 618665 (Enf. Bur. rel. May 24, 2001); *In re SBC Communications, Inc.*, 16 F.C.C.R. 5535, 5543, ¶ 19 & n. 53, 2001 WL 253187 (Enf. Bur. rel. Mar. 15, 2001). If the *Liability Order* now furnishes the basis for agency judgments in subsequent cases, the FCC is hard pressed to deny that the finding of legal liability is sufficient to satisfy the second prong of the finality test. *Cf. Consolidation Coal Co. v. Fed. Mine Safety & Health Review Comm'n*, 824 F.2d 1071, 1078 (D.C.Cir. 1987) (holding that an agency designation that "became a part of [the regulated party's] permanent record, thereby exposing [it] to more severe sanctions for later violations" supplied "the 'modicum of injury' necessary to support jurisdiction") (quoting *Meredith Corp. v. FCC*, 809 F.2d 863, 868 (D.C.Cir.1987)).

[3] The FCC is, however, quite correct to point out that, under a well-established principle of finality, when a tribunal elects to resolve the issue of liability in a particular action while reserving its determination of damages on that liability, that decision generally is not considered "final" for purposes of judicial review. *See Franklin v. District of Columbia*, 163 F.3d 625, 628 (D.C.Cir.1998) ("In damage and injunction actions, a final judgment in a plaintiff's favor declares not only liability but also the consequences of liability – what, if anything, the defendants must do as a result."); *see also Liberty Mut. Ins. Co. v. Wetzel*, 424 U.S. 737, 744, 96 S.Ct. 1202, 47 L.Ed.2d 435 (1976) (holding that a summary judgment order imposing liability is not considered final under 28 U.S.C. § 1291 where "assessment of damages or awarding of other relief remains to be resolved"). This basic understanding of finality is the norm not only in civil litigation, but also in the administrative context, at least where the relevant statute does not embrace a non-traditional view of finality. *See, e.g., Rivera-Rosario v. United States Dept. of Agric.*, 151 F.3d 34, 37 (1st Cir.1998) ("A final decision in an adjudicatory proceeding is one that resolves not only the claim but, if liability is found, also the relief to be afforded."); *Washington Metro. Area Transit Auth. v. Dir., Office of Workers' Comp. Programs*, 824 F.2d 94 (D.C.Cir.1987); *accord AAA Eng'g & Drafting, Inc. v. Widnall*, 129 F.3d 602, 603 (Fed.Cir.1997) (holding that an order of the Armed Service Board of Contract Appeals was not final because it resolved only "entitlement" (liability) while reserving decision as to "quantum" (damages)).

In this case, however, this norm of finality has been supplanted by statute. Congress added subsection (b) to 47 U.S.C. § 208 in 1988. *See* Pub.L. No. 100-594, § 8(c), 102 Stat. 3021 (1988). This amendment converted what had been § 208 – which allowed a broad group of entities to bring complaints to the FCC challenging the actions of common carriers, thus triggering investigations by the Commission of the "matters complained of" – into what is now subsection (a). In turn, the new provision, subsection (b), established time limits pursuant to which certain investigations cognizable under subsection (a) had to be concluded, and decreed that dispositions in those investigations would be subject to immediate judicial scrutiny. Thus, when the FCC conducts an investigation into the "lawfulness" of a (1) charge, (2) classification, (3) regulation, or (4) practice, "any order concluding" such an investigation is deemed to be a final order under § 208(b).

This case falls squarely within the meaning of this expediting amendment.

[4] Our conclusion is compelled by the statutory text. The crucial word in § 208(b) is "lawfulness," which must be read to mean what it says, namely that which is "allowed or permitted by law." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 1279 (1993); *cf. Holland v. Williams Mountain Coal Co.,* 256 F.3d 819, 826 (D.C.Cir.2001) (Sentelle, J., concurring) ("While it is fashionable in some legal circles to deride 'hyper-technical reliance upon statutory provisions,' this Court does not – and should not – move in them.") (citing *Palm Beach County Canvassing Bd. v. Harris,* 772 So.2d 1220, 1227 (Fla.2000), *vacated,* 531 U.S. 70, 121 S.Ct. 471, 148 L.Ed.2d 366 (2000)). As such, interpreted literally (as we think is proper), § 208(b) applies to final determinations of liability of the sort that the FCC has delivered here.

This conclusion is further buttressed by the fact that § 208(b) does not mention damages. By contrast, damages are specifically covered in three other sections of the chapter: § 206 makes common carriers who do anything "declared to be unlawful" liable for damages; § 207 allows any party harmed by the actions of a common carrier to file a complaint with the FCC seeking damages; and § 209 authorizes the Commission to "make an order directing the carrier to pay to the complainant the sum to which he is entitled" if it determines that damages are appropriate. Given that § 208(b) was designed to render only a limited category of FCC decisions final, the failure of that provision to mention damages, set against the explicit reference to damages in these other provisions, militates in favor of applying § 208(b) as it is written.

It is also noteworthy that § 201(b) declares all "charges, practices, classifications, and regulations" that are "unjust or unreasonable" to be "unlawful." The categories listed in § 201(b) are coterminous with those cognizable under § 208(b), further suggesting that, as to this class of investigations, a determination of lawfulness is separate and distinct from a determination of what damages (if any) should flow from a violation of the law. For, even if the FCC ultimately decides that the LECs need not pay any damages for their EUCL charges, it would not follow from such a decision that they had done nothing unlawful. One can violate the law without being made to pay for it. Accordingly, when the FCC conclusively resolved that the EUCL charges were unreasonable within the meaning of § 201(b) and the *Access Charge Reconsideration, see Liability Order* at 8766, ¶ 20, it simultaneously and necessarily concluded its investigation into the "lawfulness" of those charges, as it left nothing more to be said on the question of whether the LECs had run afoul of the statute's proscriptions.

To the argument that the original "investigation" has not been concluded because CFC's original complaint sought damages, and the agency's failure to determine damages means that it has not resolved all of the "matters complained of" under § 208(a), our answer is simple. The class of investigations contemplated by § 208(b), and subject both to that subsection's time limitations and finality rules, is narrower than the class of investigations contemplated by § 208(a). Indeed, the FCC has conceded as much. *See* Br. for Respondents at 32. This difference in coverage is stark, and plain on the face of the statute. Under § 208(a), investigations can be launched regarding "anything done or omitted to be done by any common carrier subject to this chapter in contravention of the provisions thereof." By contrast, § 208(b) governs only the four types of investigations enumerated above. Its text refers *not* to investigations "of the

matters complained of," but rather to investigations "of the lawfulness of a charge, classification, regulation, or practice."

[5] Taken together, then, the language of § 208(b), which speaks only of lawfulness, and the structure of the common carrier chapter, which contemplates separate determinations of lawfulness and damages, compel the conclusion that when the FCC enters an order dealing solely with the lawfulness of a charge, that order is final under § 208(b)(3) even if it fails to resolve a complainant's properly presented claim for damages. Our holding in no way limits how the Commission may elect to investigate complaints under § 208. No FCC order is subject to review under § 208(b)(3) unless it actually *terminates* an investigation of the lawfulness of a common carrier's activities. Thus, had the agency not bifurcated the proceedings in this case, but instead reserved final judgment on the LECs' liability until it was in a position to consider damages simultaneously, this court would have been compelled to wait as well. But, having elected to bifurcate, and thus to render a conclusive finding that the LECs acted unlawfully, the FCC subjected its decision to immediate review. Accordingly, we proceed to the merits of the LECs' petition.

*B. The LECs' Liability for Imposing EUCL Charges*

[6] The LECs argue that the *Liability Order* was arbitrary and capricious for two related reasons. First, they contend that the Supreme Court's decision in *Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Railway Co.*, 284 U.S. 370, 52 S.Ct. 183, 76 L.Ed. 348 (1932), precludes a finding of liability where a common carrier imposes charges pursuant to and in reliance on the Commission's official mandate. Second, they assert that the FCC's change in position amounted to a "new" rule, and, therefore, the agency was foreclosed from applying it retroactively. We reject both claims. In doing so, we emphasize that our analysis here is limited to the question of whether it was permissible for the FCC to hold the LECs liable for violating the Communications Act. We do not decide the question of whether the FCC may award damages for the LECs' charges that have been found to be unlawful.

1. The *Arizona Grocery* Rule

In *Arizona Grocery*, the Supreme Court held that the Interstate Commerce Commission could not order a common carrier to pay reparations for charging a rate that the agency had explicitly approved at the time it was collected, but subsequently determined to have been unreasonable. In that case, the ICC had, in a proceeding described by the Court as "quasi-legislative," 284 U.S. at 388-89, 52 S.Ct. 183, ordered railroads shipping sugar from California to Phoenix, Arizona to charge no rate exceeding 96.5 cents per 100 pounds. In response, the carriers adopted a rate of 86.5 cents, which they later reduced to 84 cents; these rates were then challenged before the Commission. In that proceeding, which the Court described as "quasi-judicial," *id.* at 389, 52 S.Ct. 183, the agency determined that this rate was unreasonable to the extent that it exceeded 71 to 73 cents and awarded the sugar shippers reparations from the carriers for the difference. The Supreme Court ultimately held that this damages award was improper:

> Where the Commission has, upon complaint and after hearing, declared what is the maximum reasonable rate to be charged by a carrier, it may not at a later time, and upon the same or additional evidence as to the fact situation existing when its previous order was promulgated, by declaring its own finding as to reasonableness erroneous, subject a carrier which conformed thereto to the payment of reparation measured

> by what the Commission now holds it should have decided in the earlier proceeding to be a reasonable rate.

*Id.* at 390, 52 S.Ct. 183.

Despite the superficial appeal of this passage, the rule enunciated therein is of no help to the LECs in this case. First, *Arizona Grocery* deals only with the power of the ICC to award reparations to shippers for unreasonable rates that they had paid to carriers. *See id.* at 381, 52 S.Ct. 183 ("This case turns upon the power of the Interstate Commerce Commission to award reparations with respect to shipments which moved under rates approved or prescribed by it."). *Arizona Grocery* has been and should be understood in the terms in which it was decided, as a proscription against the retroactive revision of established rates through ex post reparations. *See, e.g., Alabama Power Co. v. ICC,* 852 F.2d 1361, 1373 (D.C.Cir.1988) (suggesting that *Arizona Grocery* stands for the proposition that requiring railroads "to pay refunds, based on a determination that the earlier Commission-approved rates were impermissible, runs counter to the well-established prohibition against retroactive ratemaking"); *AT&T v. FCC,* 836 F.2d 1386, 1394-95 (D.C.Cir.1988) (Starr, J., concurring) (citing *Arizona Grocery* for the "basic rule of ratemaking" that "when the Commission determines that existing rates are excessive, it cannot order a refund of past payments under the revoked rate"); *cf. Sea Robin Pipeline Co. v. FERC,* 795 F.2d 182, 189 n. 7 (D.C.Cir. 1986) ("FERC may not order a retroactive refund based on a post hoc determination of the illegality of a filed rate's prescription.").

As such, neither *Arizona Grocery* nor the rule it announced are concerned with a situation such as the one presented here, in which we must decide not whether the FCC may force the LECs to repay that which they took through EUCL charges, but rather whether the Commission may make a retroactive determination that those charges were unlawful at the time that they were imposed. Indeed, the rule against retroactive ratemaking is premised on the implicit understanding that an established rate is not made *illegal* if it is later found to be impermissible or unreasonable. *See, e.g., Arizona Grocery,* 284 U.S. 370, 389, 52 S.Ct. 183, 76 L.Ed. 348 (1932) (the ICC "could repeal the order as it affected future action, and substitute a new rule of conduct as often as occasion might require, but this was obviously the limit of its power, as of that of the legislature itself"); *Town of Norwood, Mass. v. FERC,* 53 F.3d 377, 381 (D.C.Cir.1995) ("The retroactive ratemaking doctrine prohibits the Commission from authorizing or requiring a utility to adjust current rates to make up for past errors in projections. If a utility includes an estimate of certain costs in its rates and subsequently finds out that the estimate was too low, it cannot adjust future rates to recoup past losses."); *Sea Robin,* 795 F.2d at 189 n. 7 ("Sea Robin had a right to rely on the legality of the filed rate once the Commission allowed it to become effective."). The subsequent determination rejecting the earlier rate prescription is similar to a congressional action revising an earlier statutory enactment – the later action may suggest that the original legislative act was ill-advised, but this will not justify reparations for persons who were disadvantaged by the original legislative enactment. This case does not involve the sort of ratemaking contemplated by *Arizona Grocery,* so the same assumptions do not apply here.

Second, in light of the implicit assumptions underlying the rule against retroactive revision of established rates through ex post reparations, it is not surprising that the Court in *Arizona Grocery* observed that the ICC had prescribed a legal rate in its "quasi-legislative capacity." 284

U.S. at 388, 52 S.Ct. 183. The Court recognized that ratemaking – "fixing rates or rate limits for the future" – is a legislative function, and held that once the Commission had exercised such a power it could only undo the results prospectively. *Id.* at 388-89, 52 S.Ct. 183. In other words, *Arizona Grocery*, by its own terms, does not apply where an adjudicating agency alters, even with retroactive effect, a policy established in a previous quasi-judicial action. Nor has it ever been so applied. The lines between these categories of activity are not always clear – indeed, in *Arizona Grocery* itself the quasi-legislative rates were established in an adjudicatory proceeding, *see id.* at 388, 52 S.Ct. 183. Nevertheless, the Court in *Arizona Grocery* made clear that there is an important distinction between rules resulting from quasi-adjudication and rules resulting from quasi-legislation. We are therefore bound to follow the Court's mandate and apply this distinction.

With these principles in mind, we are constrained to conclude that the FCC's actions in this case are not governed by the rule established in *Arizona Grocery*. The *Access Charge Reconsideration*, a rulemaking designed to establish how the LECs were to recover end-user costs in the future, was undoubtedly *legislative* in character. But this rulemaking was not "revised" by the *Liability Order* that the LECs now challenge. Rather, the *Liability Order* merely corrected the *EUCL Decisions*, agency adjudications that had erroneously interpreted the original *Access Charge Reconsideration* by holding that particular instances of challenged conduct on the part of the LECs did not violate the regulations arising from that rulemaking. In those decisions, the FCC did not purport to substitute a new legislative rule for an old one. Moreover, when the court in *C.F. Communications* vacated the judgment in the *EUCL Decisions*, it did so on the grounds that the FCC had misconstrued the *Access Charge Reconsideration* rulemaking. *See* 128 F.3d at 741-42. Our opinion in that case did not, however, suggest that the underlying rulemaking was in any way infirm. And on remand, the FCC issued the *Liability Order* to rectify the errors found pursuant to the judicial review of the *EUCL Decisions*.

Therefore, the FCC's actions in issuing the orders in the *EUCL Decisions* and the *Liability Order* were not analogous to the situation in *Arizona Grocery*. In *Arizona Grocery*, the ICC purported to retroactively revise an established rate (that was the product of a "quasi-legislative" action); in this case, by contrast, the FCC purported to interpret and apply legislative regulations in succeeding adjudications.

There is no doubt that the *EUCL Decisions* were intended to have prospective application, in the sense that these adjudicatory actions purported to interpret the *Access Charge Reconsideration* rulemaking, which remained in force all along. But this fact does not advance the LECs' argument. It is well understood that judicial interpretations of legislative enactments have consequences for parties in the future; yet, this does not render the statutory construction a legislative activity. *See Japan Whaling Ass'n v. Am. Cetacean Soc.*, 478 U.S. 221, 230, 106 S.Ct. 2860, 92 L.Ed.2d 166 (1986) ("[u]nder the Constitution, one of the Judiciary's characteristic roles is to interpret statutes . . ."); *Northwest Airlines, Inc. v. Transport Workers Union of Am.*, 451 U.S. 77, 95 & n. 34, 101 S.Ct. 1571, 67 L.Ed.2d 750 (1981) (emphasizing that "the federal lawmaking power is vested in the legislative, not the judicial, branch of government," but that once the legislature speaks, "the task of the federal courts is to interpret and apply statutory law"). So too with adjudication by administrative agencies. *See Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 216-17,

109 S.Ct. 468, 102 L.Ed.2d 493 (1988) (Scalia, J., concurring) ("Adjudication ... has future as well as past legal consequences, since the principles announced in an adjudication cannot be departed from in future adjudications without reason."); *Goodman v. FCC,* 182 F.3d 987, 994 (D.C.Cir.1999) ("[T]he nature of adjudication is that similarly situated non-parties may be affected by the policy or precedent applied, or even merely announced in dicta, to those before the tribunal."). To suggest, as the LECs do here, that the *EUCL Decisions* were somehow "legislative" merely because they interpreted a rulemaking or because they had some future impact would entirely collapse the distinction between rulemaking and adjudication, and thus the very distinction on which *Arizona Grocery* rests. As such, we hold that when the FCC departed from the *EUCL Decisions* in a subsequent adjudication, it was not constrained by *Arizona Grocery's* blanket prohibition on retroactive repeals of quasi-legislative ratemaking.

2. The Retroactivity Doctrine

This is not to say that agency adjudications that modify or repeal rules established in earlier adjudications may always and without limitation be given retroactive effect. To the contrary, there is a robust doctrinal mechanism for alleviating the hardships that may befall regulated parties who rely on "quasi-judicial" determinations that are altered by subsequent agency action. Over fifty years ago, in *SEC v. Chenery Corp.,* 332 U.S. 194, 203, 67 S.Ct. 1575, 91 L.Ed. 1995 (1947), the Supreme Court cautioned that the ill effects of retroactivity "must be balanced against the mischief of producing a result which is contrary to a statutory design or to legal and equitable principles."

[7, 8] In the ensuing years, in considering whether to give retroactive application to a new rule, the courts have held that

> [t]he governing principle is that when there is a "substitution of new law for old law that was reasonably clear," the new rule may justifiably be given prospectively-only effect in order to "protect the settled expectations of those who had relied on the preexisting rule." *Williams Natural Gas Co. v. FERC,* 3 F.3d 1544, 1554 (D.C.Cir.1993). By contrast, retroactive effect is appropriate for "new applications of [existing] law, clarifications, and additions." *Id.*

*Pub. Serv. Co. of Colo. v. FERC,* 91 F.3d 1478, 1488 (D.C.Cir.1996) ("*PSCC*"). *See also Aliceville Hydro Assocs. v. FERC,* 800 F.2d 1147, 1152 (D.C.Cir.1986) (discussing the distinction between "new applications of law" and "substitutions of new law for old law"). In a case in which there is a "substitution of new law for old law that was reasonably clear," a decision to deny retroactive effect is uncontroversial. *Epilepsy Found. of N.E. Ohio v. NLRB,* 268 F.3d 1095, slip op. at 12-13 (D.C.Cir. 2001). In cases in which there are "new applications of existing law, clarifications, and additions," the courts start with a presumption in favor of retroactivity. *See, e.g., Health Ins. Ass'n of Am. v. Shalala,* 23 F.3d 412, 424 (D.C.Cir.1994). However, retroactivity will be denied "when to apply the new rule to past conduct or to prior events would work a 'manifest injustice.'" *Clark-Cowlitz Joint Operating Agency v. FERC,* 826 F.2d 1074, 1081 (D.C.Cir.1987) (en banc) (quoting *Thorpe v. Housing Auth. of the City of Durham,* 393 U.S. 268, 282, 89 S.Ct. 518, 21 L.Ed.2d 474 (1969)); *see also Consol. Freightways v. NLRB,* 892 F.2d 1052, 1058 (D.C.Cir.1989).

This court has not been entirely consistent in enunciating a standard to determine when to deny retroactive effect in cases involving "new applications of existing law, clarifications, and additions" resulting from adjudicatory actions. In *Clark-Cowlitz,* the *en banc* court adopted a

non-exhaustive five-factor balancing test, *see* 826 F.2d at 1081-86 (citing *Retail, Wholesale & Dep't Store Union v. NLRB,* 466 F.2d 380, 390 (D.C.Cir.1972)). In a subsequent case, however, we substituted a similar three-factor test. *See Dist. Lodge 64 v. NLRB,* 949 F.2d 441, 447-49 (D.C.Cir.1991) (citing *Chevron Oil Co. v. Huson,* 404 U.S. 97, 106-07, 92 S.Ct. 349, 30 L.Ed.2d 296 (1971)). And in other cases, the court has jettisoned multi-pronged balancing approaches altogether. *See Cassell v. FCC,* 154 F.3d 478, 486 (D.C.Cir.1998) (declining to "plow laboriously" through the *Clark-Cowlitz* factors, which "boil down to a question of concerns grounded in notions of equity and fairness"); *PSCC,* 91 F.3d at 1490 (concluding that "the apparent lack of detrimental reliance ... is the crucial point supporting retroactivity").

In the present case, the LECs argue that the *Liability Order* should not be given retroactive effect, because it would be grossly unfair to punish them for imposing EUCL charges that were approved, and perhaps even required, by the authoritative pronouncements of the Commission itself. Before addressing these concerns, we note that even if we were to accept the LECs' argument in full, there would still remain a period of approximately four years – from the IPPs' entry into the payphone market in 1984 until the first Thomas letter in 1988 – during which no claim of reliance can possibly be maintained. During this period, the LECs imposed EUCL fees on the IPPs wholly on their own initiative, *i.e.,* without specific guidance from the FCC, and thus entirely at their own risk.

That said, we conclude that the FCC's decision to hold the LECs liable for EUCL charges levied even after the Commission had spoken on the issue was not an abuse of discretion or otherwise impermissible. In reaching this determination, we rely primarily on two factors. The first is the fact that the FCC's policy regarding the propriety of imposing end-user fees on IPPs was never authoritatively articulated outside of the same complaint proceeding in which it was eventually reversed. Indeed, the two *EUCL Decisions,* on which the LECs' reliance argument primarily rests, were part of a single chain of decisions triggered by CFC's original complaint, a chain whose natural progression led to this court, where the Commission's holdings were vacated. Thus, the agency orders on which the LECs claim to have relied not only had never been judicially confirmed, but were under unceasing challenge before progressively higher legal authorities. Our cases indicate that under such circumstances reliance is typically not reasonable, a conclusion that significantly decreases concerns about retroactive application of the rule eventually announced. *See Clark-Cowlitz,* 826 F.2d at 1083 n. 7 ("[A] holding of nonretroactivity ... cannot be premised on a *single,* recent agency decision ... that is still in the throes of litigation when it is overruled.").

Indeed, our holding in *PSCC* is directly on point here. In that case, a group of natural gas producers increased the prices that they charged their pipeline customers in order to recover an *ad valorem* tax imposed by the state of Kansas; the legal theory behind this increase was that this tax was a severance tax under § 110 of the Natural Gas Policy Act. These price hikes were challenged before FERC, which sided with the producers, holding that the Kansas tax came within the meaning of § 110. Reviewing this decision, this court found that FERC's statutory interpretation was unreasonable and reversed. On remand, the Commission retreated from its earlier analysis and found that the tax did not qualify as a severance tax, and therefore that the producers had overcharged the pipelines. We upheld the ret-

roactive application of this decision, in the process rejecting the claims of reliance advanced by the producers, claims that uncannily echo those made by the LECs in the present case. 91 F.3d at 1488-91. The court held that as soon as the pipelines had petitioned the Commission for a ruling that the producers' preferred interpretation of § 110 was incorrect, the producers were put on notice that the recoverability of the tax was "in dispute." Once this challenge had been lodged, it was then unreasonable for the producers to rely on that interpretation, even though it was explicitly endorsed by the agency before ultimately being reversed by this court. *Id.* at 1490. Thus, we concluded that it was appropriate for FERC to hold the producers liable for that which they had taken when the law was uncertain but the Commission was on their side. Just so here. Because the object of the LECs' reliance was neither settled (but rather was perpetually enmeshed in litigation) nor "well-established," *see Clark-Cowlitz,* 826 F.2d at 1083 ("[T]he Commission's ruling in that solitary proceeding can scarcely be viewed as 'well-established.' "), we are skeptical that retroactive liability against the LECs would actually impose a manifest injustice. In light of the ongoing legal challenges to the *EUCL Decisions,* whatever reliance the LECs placed on those rulings was something short of reasonable for purposes of the retroactivity analysis.

The second factor pointing toward retroactive liability is that the agency pronouncements on which the LECs relied were subsequently held by this court to be mistaken as a matter of law. As such, the FCC's *Liability Order* was largely an exercise in error correction. We have previously held that administrative agencies have greater discretion to impose their rulings retroactively when they do so in response to judicial review, that is, when the purpose of retroactive application is to rectify legal mistakes identified by a federal court. *See Exxon Co., USA v. FERC,* 182 F.3d 30, 49-50 (D.C.Cir.1999); *cf. Pub. Utils. Comm'n of the State of Cal. v. FERC,* 988 F.2d 154, 161-63 (D.C.Cir.1993) (noting that the normal rule against retroactive ratemaking may be relaxed where the original order was challenged and determined by this court to be *unlawful*). Indeed, there can be little dispute that had the FCC originally (whether in 1993 or 1995) held in favor of the IPPs, the Commission at that point would have been well within its rights to have held the LECs liable for violating the unreasonable charge provisions of 47 U.S.C. § 201(b). As such, the LECs' argument that the FCC may not reach the same conclusion now reduces to the assertion that the agency may not retroactively correct its own legal mistakes, even when those missteps have been highlighted by the federal judiciary. But this is not the law. *See United Gas Improvement Co. v. Callery Props., Inc.,* 382 U.S. 223, 229, 86 S.Ct. 360, 15 L.Ed.2d 284 (1965) ("An agency, like a court, can undo what is wrongfully done by virtue of its order."); *Natural Gas Clearinghouse v. FERC,* 965 F.2d 1066, 1073 (D.C.Cir.1992) (reading *Callery* to embody the "general principle of agency authority to implement judicial reversals").

In sum, then, the IPPs should not be denied now what they asked for in their original complaint – a determination that the LECs violated the law – merely because the FCC bungled their case the first time around. To do so would make a mockery of the error-correcting function of appellate review. It would be to say that the LECs must prevail now because they (wrongfully) prevailed below. We are unwilling to tie the Commission's hands in this way. *Cf. Exxon USA,* 182 F.3d at 49 ("There is also a strong equitable presumption in favor of retroactivity that would make the parties whole."). As such, we conclude that the *Liability Order* rep-

resented a permissible exercise of the FCC's discretion and therefore deny the LECs' petition for review.

[9] Having upheld the imposition of retroactive liability, we decline to address whether a similar finding regarding damages would be equally permissible. As described above, the FCC has not yet entered a final order with respect to damages. Both the amount that the LECs will ultimately have to pay, and the time period that those payments will cover, remain for determination. As such, the LECs' contention that equitable restitution, and not legal damages, is the sole remedy available to the IPPs, *see Atlantic Coast Line R.R. Co. v. Florida*, 295 U.S. 301, 55 S.Ct. 713, 79 L.Ed. 1451 (1935); *Moss v. Civil Aeronautics Bd.*, 521 F.2d 298, 314 (D.C.Cir. 1975), is plainly not ripe for adjudication at this time. *See Abbott Labs. v. Gardner*, 387 U.S. 136, 149-50, 87 S.Ct. 1507, 18 L.Ed.2d 681 (1967). Only after the Commission both commits itself to a method for calculating the proper amount of the award, and concretely applies that method to the LECs, will this court be in a position to evaluate the arguments regarding damages. *See Eagle-Picher Indus., Inc. v. EPA*, 759 F.2d 905, 915 (D.C.Cir.1985). By bifurcating the proceedings as it did, the FCC left those decisions for another day.

As we read the *Liability Order*, the FCC has suggested a possible means for figuring damages, but has not foreclosed the possibility of modifying that suggestion during the next phase of the proceedings. *See Liability Order* at 8771, ¶¶ 33-34. Specifically, the FCC has not reached a conclusive determination that it will compel the LECs to return all of the monies that they collected in possible reliance on the FCC's official pronouncements. Nor has it rendered a final judgment that the LECs are not entitled to some kind of equitable offset in light of such reliance. We will not prejudge these issues in advance of the agency.

### III. Conclusion

For the reasons given above, we hold that the *Liability Order* is final despite its failure to reach the issue of damages. Rejecting the LECs' arguments that either the *Arizona Grocery* doctrine or the rule against retroactivity bars the FCC from imposing liability, we deny the petition for review and uphold the Commission's finding that the LECs violated the unreasonable charge provisions of the Communications Act. At the same time, we express no opinion as to whether damages or some other monetary remedy are appropriate in this case, or whether such a remedy, if appropriate, may be imposed retroactively.

**ASSOCIATION OF CIVILIAN TECHNICIANS, Puerto Rico Army Chapter, Petitioner,**

**v.**

**FEDERAL LABOR RELATIONS AUTHORITY, Respondent.**

**No. 00–1486.**

United States Court of Appeals, District of Columbia Circuit.

Argued Oct. 10, 2001.

Decided Nov. 9, 2001.

Federal employee union petitioned for review of a decision of the Federal Labor Relations Authority (FLRA) determining that a collective bargaining agreement provision that seeks reimbursement for out-

**CLARK-COWLITZ JOINT OPERATING AGENCY, Petitioner,**

**v.**

**FEDERAL ENERGY REGULATORY COMMISSION, Respondent,**

**People of the State of California, et al., Pacific Power & Light Company, Edison Electric Institute, Sacramento Municipal Utility District, et al., Pacific Gas & Electric Company, Public Utility Commissioner of the State of Oregon, Washington State Department of Fisheries, et al., American Paper Institute, Inc., City of Santa Clara, California, et al., American Public Power Association, Intervenors.**

**No. 83-2231.**

United States Court of Appeals, District of Columbia Circuit.

Argued En Banc March 31, 1986.

Decided Aug. 11, 1987.

Petition was filed for review of order of the Federal Energy Regulatory Commission in case involving competing applicants for hydroelectric power project license. On en banc decision, the Court of Appeals, Starr, Circuit Judge, held that: (1) neither preclusion nor retroactivity principles prevented Commission from abandoning prior interpretation of statutory preference for municipal applicants; (2) Commission's new interpretation, that preference was inapplicable in relicensing proceeding in which incumbent licensee was competing for license, was consistent with congressional intent and was otherwise reasonable; and (3) though Commission could consider economic consequences of its award, it had not sufficiently analyzed relative economic impact of particular award involved and remand for that purpose was warranted.

Judgment accordingly.

Mikva, Circuit Judge, dissented and filed opinion in which Spottswood W. Robinson III and Harry T. Edwards, Circuit Judges, joined.

**1. Judgment ⇐713(2), 715(1), 720**

Fundamental requisite of issue preclusion is identity of issue decided in earlier action and that sought to be precluded in later action; similarly, to preclude raising of claim, it must be shown that claim was or could have been raised in prior proceeding.

**2. Judgment ⇐617**

Issue preclusion attaches only to such issues as parties litigated adversely to each other in prior litigation, and success of party's defense in one proceeding does not bar it from asserting different position in later proceeding under principles of claim preclusion.

**3. Electricity ⇐10**

Federal Energy Regulatory Commission was not precluded from abandoning its prior interpretation of preferance for municipal applicants in hydroelectric relicensing proceedings; propriety of Commission's new view that preference was inapplicable where incumbent licensee was competing had not been addressed in prior proceeding, in which present adversaries had litigated the same position. Federal Power Act, § 7(a), as amended, 16 U.S.C.A. § 800(a).

**4. Administrative Law and Procedure ⇐330**

Agency may apply new interpretation of statute in proceeding before it when it interprets that statute as incident of its adjudicatory function, though retrospective application can properly be withheld when application of new rule to past conduct or prior events would work manifest injustice.

**5. Administrative Law and Procedure ⇐498**

**Electricity ⇐10**

Federal Energy Regulatory Commission's application in particular case of new interpretation of statutory preference for municipal applicants in hydroelectric relicensing proceeding was consistent with principles of retroactivity; new interpretation was announced in that case and was not departure from well-established practice, municipality would not be burdened by

retroactive imposition as it retained right to compete, overriding congressional interest in ensuring that best qualified contestant operated project favored retrospective application, and other similarly situated municipal applicants could no longer claim benefit of that preference in wake of enactment of new federal statute. Federal Power Act, § 7(a), as amended, 16 U.S.C.A. § 800(a); Electric Consumer Protection Act of 1986, § 11, 100 Stat. 1243.

**6. Electricity ⚡10**

Federal Energy Regulatory Commission could determine that no municipal preference applied in hydroelectric relicensing proceedings in which incumbent licensee was competing for license; that interpretation of statutory preference was consistent with congressional intent embodied in Federal Power Act and was otherwise reasonable. Federal Power Act, § 7(a), as amended, 16 U.S.C.A. § 800(a).

**7. Administrative Law and Procedure ⚡507**

**Electricity ⚡10**

Federal Energy Regulatory Commission could generally consider economic consequences of award of hydroelectric project license, but its analysis of relative economic impacts of award in particular case was insufficient under Administrative Procedure Act. Federal Power Act, §§ 7(a), 10(a), as amended, 16 U.S.C.A. §§ 800(a), 803(a); 5 U.S.C.A. § 706(2)(A).

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Petition for Review of an Order of the Federal Energy Regulatory Commission.

Christopher D. Williams, with whom Robert L. McCarty and George H. Williams, Jr., Washington, D.C., were on the brief, for petitioner.

Jerome M. Feit, Sol., F.E.R.C., with whom William H. Satterfield, Gen. Counsel, Joseph S. Davies and John N. Estes, III, Attys., F.E.R.C. were on the brief, for respondent. Arlene P. Groner, Atty., F.E.R.C., Washington, D.C., also entered an appearance for respondent.

Thomas H. Nelson, Portland, Or., for intervenor, Pacific Power & Light Co., Hugh Smith, Portland, Or., also entered an appearance for intervenor.

Janice E. Kerr, J. Calvin Simpson and Peter G. Fairchild, San Francisco, Cal., were on the brief for intervenors, People of the State of California, et al.

James B. Liberman, Ira H. Jolles and Peter B. Kelsey, Washington, D.C., were on the brief for intervenor, Edison Elec. Institute.

Robert C. McDiarmid, Daniel I. Davidson, Frances E. Francis, Ben Finkelstein, G. Philip Nowak and Charles H. Cochran, Washington, D.C., were on the joint brief for public intervenors, Sacramento Mun. Utility Dist., et al.

Robert Ohlbach and Jack F. Fallin, Jr., San Francisco, Cal., were on the brief for intervenor, Pacific Gas & Elec. Co. Malcolm H. Furbush, San Francisco, Cal., also entered an appearance, for intervenor.

W. Benny Won, Salem, Or., was on the brief for intervenor, Public Utility Commissioner of Oregon.

Rigdon H. Boykin, New York City, was on the brief for intervenor, American Paper Institute, Inc.

Richard K. Willard, Asst. Atty. Gen. and Michael Kimmel, Atty., Dept. of Justice, Washington, D.C., were on the brief for amicus curiae, U.S., urging affirmance.

James M. Johnson, Olympia, Wash., entered an appearance for intervenor, Washington State Dept. of Fisheries, et al.

Frederick H. Ritts, Washington, D.C., entered an appearance for intervenor, American Public Power Ass'n.

Before ROBINSON, MIKVA, EDWARDS, RUTH B. GINSBURG, BORK, SCALIA*, STARR and

* Judge (now Justice) Scalia was a member of the Court at the time this case was argued, but did not participate in this opinion.

BUCKLEY, Circuit Judges, and WRIGHT [**], Senior Circuit Judge.

Opinion for the Court filed by Circuit Judge STARR.

Dissenting opinion filed by Circuit Judge MIKVA, with whom Circuit Judges ROBINSON and EDWARDS join.

STARR, Circuit Judge:

This case involves a contest for a license to operate a hydroelectric power plant in the Pacific Northwest. The legal issues generated by the contest, however, far transcend the question of which of two competitors will win the right to operate the plant in question. To the contrary, the case involves fundamental issues of the power of an administrative agency to change its interpretation of law and to take regulatory action based upon that new interpretation.

The specific issue before us is whether in competing for a license, a public entity, the Clark-Cowlitz Joint Operating Agency, was entitled to the municipal (and State) preference prescribed in section 7(a) of the Federal Power Act, 16 U.S.C. § 800(a) (1982).[1] The Federal Energy Regulatory Commission determined that Congress did not intend the statutorily prescribed municipal preference to apply in relicensing proceedings in which, as here, the incumbent licensee was competing for the license. In reaching this determination, however, FERC overruled its contrary conclusion articulated only three years earlier in declaratory proceedings in which both Clark-Cowlitz and the incumbent licensee, Pacific Power & Light Company, participated.

The petitioner here, Clark-Cowlitz, contends that the Commission acted unlawfully in accomplishing this about-face as to parties who participated in the earlier declaratory proceedings. Initially, we are called upon to decide whether principles of preclusion or retroactivity bar FERC from applying its reinterpretation of section 7(a) in the contest between Clark-Cowlitz and Pacific Power. If we conclude that FERC is not barred, then we must consider whether FERC's new interpretation is permissible under the principles enunciated in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984). *See also Immigration & Naturalization Service v. Cardoza-Fonseca*, — U.S. —, 107 S.Ct. 1207, 94 L.Ed.2d 434 (1987). For the reasons that follow, we hold that FERC was not precluded from applying its new interpretation of section 7(a) in the present proceeding. We also uphold its interpretation as reasonable and consistent with Congressional intent. One aspect of the Commission's substantive analysis, however (apart from statutory interpretation), falls short of the standards of reasoned decision making and thus requires a remand of the case to the agency.

## I

The relevant facts can be briefly stated. Pacific Power & Light Company is the incumbent licensee of the Merwin Hydroelectric Power Project. That facility is situated on the Lewis River in the State of Washington, between the Counties of Clark and Cowlitz. Pacific Power has owned, operated, and maintained the Merwin

** Senior Circuit Judge Wright participated in oral argument of this case, but subsequently recused himself from further participation.

1. Section 7(a) provides as follows:

> In issuing preliminary permits hereunder or licenses where no preliminary permit has been issued and in issuing licenses to new licensees under section 808 of this title the Commission shall give preference to applications therefor by States and municipalities, provided the plans for the same are deemed by the Commission equally well adapted, or shall within a reasonable time to be fixed by the Commission be made equally well adapted, to conserve and utilize in the public interest the water resources of the region; and as between other applicants, the Commission may give preference to the applicant the plans of which it finds and determines are best adapted to develop, conserve, and utilize in the public interest the water resources of the region, if it be satisfied as to the ability of the applicant to carry out such plans.

16 U.S.C. § 800(a) (1982). The parties do not dispute that Clark-Cowlitz is a "municipality" for purposes of section 7(a). *See id.* § 796(7).

project since 1941, when Pacific Power's predecessor transferred the 50-year license originally issued in 1929 for the project to the investor-owned utility. Anticipating the looming expiration of the original license, Pacific Power filed an application for a new license in 1976. Shortly thereafter, public utility districts in Clark and Cowlitz Counties formed the Clark-Cowlitz Joint Operating Agency to compete for the Merwin license. Clark-Cowlitz filed its competing application in 1977, claiming the benefit of the municipal preference of section 7(a).

At that time, the original licenses for many other hydroelectric projects were likewise about to expire. A common issue arose as to whether States and municipalities contending for new licenses at the various projects could claim the benefit of section 7(a)'s municipal preference when *incumbent licensees* also sought new licenses for the projects. In view of the recurring nature of this issue, FERC decided to address the question in a declaratory order proceeding. *See* 5 U.S.C. § 554(e) (1982). Numerous parties, including Clark-Cowlitz and Pacific Power, intervened and participated in that proceeding. Then, in an opinion issued in 1980, FERC concluded that the section 7(a) municipal preference applied in *all* relicensing proceedings, including those in which incumbent licensees were competing to maintain authority to operate their respective projects. *City of Bountiful*, 11 F.E.R.C. ¶ 61,337, at 61,706, *reh'g denied*, 12 F.E.R.C. ¶ 61,179, at 61,-459 (1980).

Not surprisingly, FERC's decision failed to win universal acclaim. No less than thirty-eight petitioners appealed the agency's decision in the *Bountiful* declaratory order proceeding to the Eleventh Circuit. That court reviewed FERC's interpretation of section 7(a) under the deferential standard that " 'the construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong.' " *Alabama Power Co. v. FERC*, 685 F.2d 1311, 1318 (11th Cir.1982) (quoting *CBS, Inc. v. FCC*, 453 U.S. 367, 382, 101 S.Ct. 2813, 2823, 69 L.Ed.2d 706 (1981)), *cert. denied*, 463 U.S. 1230, 103 S.Ct. 3573, 77 L.Ed.2d 1415 (1983). Under this standard of "great deference," the court upheld FERC's interpretation as "consistent with the statute's language, structure, scheme, and available legislative history." *Id.*[2] The Eleventh Circuit's opinion issued in September 1982.

As the *Bountiful* litigation proceeded in Atlanta, however, back in Washington, D.C., FERC was busily re-evaluating its stance on the applicability of the municipal preference. The Commission ultimately concluded that its *Bountiful* interpretation was contrary to Congressional intent, and that the preference did *not* apply when, in addition to a state or municipal applicant, the incumbent licensee sought a new license for an existing project. The first notice of this reassessment appeared in a brief filed by the Solicitor General in the United States Supreme Court on the petition for certiorari in *Alabama Power*. *See* Brief for the Federal Energy Regulatory Commission on Petitions for a Writ of Certiorari at 8–9, *Utah Power & Light Co. v. FERC*, 463 U.S. 1230, 103 S.Ct. 3573, 77 L.Ed.2d 1415 (1983), Joint Appendix ("J.A.") at 95, 106–07. There, the Solicitor General urged the Court, in light of FERC's reinterpretation, to grant the petitions and remand the case to the Eleventh

2. The court canvassed the legislative history and concluded that it contained only "weak" support for FERC's position (that the preference applied in all relicensings, even those in which the incumbent licensee was seeking to obtain a new license for the project). *Alabama Power*, 685 F.2d at 1317. Nonetheless, it accepted FERC's assertion that its interpretation accorded with the language and structure of the statute. At the same time, it acknowledged that the contrary reading proffered by the private utilities (that the preference was inapplicable in relicensings that involved the incumbent) was also "a reasonable interpretation" of the language and structure. *Id.* at 1316. The court went on to opine in *dicta*, however, that this reading would lead to "absurd results." *Id.* at 1316–17. Specifically, it believed that the alternative interpretation championed by the private utilities gave incumbents an undue advantage and left the Commission with no "tie-breaking" preference to apply in certain situations. *Id.* *But cf. Pacific Power & Light Co.*, 25 F.E.R.C. ¶ 61,052, at 61,184–85 (1983) (asserting that no such absurd result obtained under this interpretation).

Circuit. The Court, however, declined the invitation and denied certiorari. *Utah Power & Light Co. v. FERC,* 463 U.S. 1230, 103 S.Ct. 3573, 77 L.Ed.2d 1415 (1983).

At this juncture in the rather baroque history of the municipal preference issue, we return from the *Bountiful* litigation and rejoin Clark-Cowlitz in its efforts before the Commission to secure the Merwin license. Following FERC's decision in *Bountiful,* Clark-Cowlitz, along with numerous applicants for licenses at other sites, pressed FERC to begin hearings on individual projects. As luck would have it, hearings on the Merwin relicensing were the first out of the gate; indeed, those hearings got underway only three days after the Eleventh Circuit affirmed *Bountiful.* To Clark-Cowlitz's chagrin, however, in ultimately ruling on the Merwin applications, FERC formally announced its change of mind signalled in the Solicitor General's brief before the Supreme Court. The Commission expressly overruled *Bountiful* and awarded the license to Pacific Power, the delighted incumbent. *Pacific Power & Light Co.,* 25 F.E.R.C. ¶ 61,052, at 61,174, *reh'g denied,* 25 F.E.R.C. ¶ 61,290 (1983) [hereinafter *Merwin* ].

In addition to repudiating *Bountiful,* FERC went on to evaluate the specific plans of the two contestants for the Merwin license. The Commission found that even under *Bountiful* the municipal preference would not obtain in the *Merwin* proceedings because Clark-Cowlitz's and Pacific Power's plans were not "equally well adapted," the statutory condition precedent to applying the preference. *See supra* note 1. The Commission based this finding on the relative economic impact of awarding the license to one contestant or the other. Specifically, the Commission determined that Pacific Power would incur greater costs in securing an alternative to Merwin Project power than would Clark-Cowlitz. Under this analysis, Pacific Power's customers, in the aggregate, would therefore suffer more if the incumbent lost the license than Clark-Cowlitz's would gain were Clark-Cowlitz to receive it. This meant, as FERC saw it, that Pacific Power's plans for operating Merwin were better adapted to "utilize in the public interest the water resources of the region." 16 U.S.C. § 800(a) (1982) *see supra* note 1.

Clark-Cowlitz thereupon brought this appeal. *See* 16 U.S.C. § 825l(b). While the appeal was pending, Congress amended section 7(a) of the Federal Power Act to eliminate the municipal preference in all relicensings except the *Merwin* proceedings. Electric Consumers Protection Act of 1986 (ECPA), Pub. L. No. 99-495, §§ 2, 11, 100 Stat. 1243, 1255.[3] What had thus shaped up in this litigation as a major confrontation between the advocates of public power projects, on the one hand, and the champions of private (albeit regulated) enterprise on the other, reduced on the surface to an important but nonetheless parochial struggle over the license rights to a particular project. But Congress' amendment of the statutory prescription governing new licenses for existing projects, by keeping alive the Merwin controversy, did nothing to resolve the fundamental question as to an agency's ability to change its mind about the law and to act upon its new interpretation. It is to that bedrock issue of administrative law, brought into sharp relief by this case, that we now turn.

## II

[1-3] Clark-Cowlitz's primary argument is that principles of res judicata or collat-

3. Section 2 of the 1986 Act amends section 7(a) of the Federal Power Act, quoted in full *supra* note 1, so that 7(a) now begins as follows:

> In issuing preliminary permits hereunder or *original* licenses where no preliminary permit has been issued, [and in issuing licenses to new licensees under section 808 of the title] the Commission shall....

ECPA, § 2, 100 Stat. 1243 (additions italicized; deletions bracketed). Section 11 of the ECPA provides in relevant part:

> The amendments made by this Act ... shall not apply to the Federal Energy Regulatory Commission proceeding involving FERC Project Number 935 (FERC Project Number 2791), relating to the Merwin Dam in Washington State.

*Id.* § 11.

eral estoppel bar FERC from applying its present interpretation of section 7(a) in the struggle between the two contestants. Clark-Cowlitz reasons that FERC is bound by the interpretation embraced in the *Bountiful* declaratory proceeding, to which both contestants for the Merwin license were parties (as intervenors).

For us to resolve this issue, it is unnecessary to plumb the depths of res judicata and collateral estoppel and their modern avatars, claim preclusion and issue preclusion. They have received lengthy expatiation elsewhere. *See, e.g., Migra v. Warren City School District Board of Education,* 465 U.S. 75, 77 n. 1, 104 S.Ct. 892, 984, n. 1, 79 L.Ed.2d 56 (1984); *Nevada v. United States,* 463 U.S. 110, 128–31, 103 S.Ct. 2906, 2917–19, 77 L.Ed.2d 509 (1983); *Synanon Church v. United States,* 820 F.2d 421, 424–25, 426–27 (D.C.Cir.1987); *Carr v. District of Columbia,* 646 F.2d 599 (D.C. Cir.1980); 18 *C. Wright, A. Miller & E. Cooper, Federal Practice and Procedure* §§ 4401–4478 (1981). Suffice it to say that, in general, these doctrines are designed to invest judicial resolutions of legal controversies with finality. *See, e.g., Montana v. United States,* 440 U.S. 147, 153–54, 99 S.Ct. 970, 973–74, 59 L.Ed.2d 210 (1979). Examined in light of preclusion principles, Clark-Cowlitz's argument is flawed in two fatal respects.

*First.* Whether it travels under the rubric of issue or claim preclusion, Clark-Cowlitz's argument fails because it misreads the Eleventh Circuit's decision as having conclusively determined the same issue (or claim) that confronts us. A fundamental requisite of issue preclusion is an identity of the issue decided in the earlier action and that sought to be precluded in a later action. Similarly, to preclude a party's raising a claim, it must be shown that the claim was (or could have been) raised in a prior proceeding. *See, e.g., Gould v. Mossinghoff,* 711 F.2d 396, 398–99 (D.C.Cir. 1983); *see also Jack Faucett Associates, Inc. v. American Telephone & Telegraph Co.,* 744 F.2d 118, 124 (D.C.Cir.1984), *cert. denied,* 469 U.S. 1196, 105 S.Ct. 980, 83 L.Ed.2d 982 (1985). The Second Restatement of Judgments makes clear the importance of these related requirements:

> The principle underlying the rule of claim preclusion is that a party who *once has had a chance to litigate a claim* before an appropriate tribunal usually ought not to have another chance to do so. A related but narrower principle—that one who has *actually litigated an issue* should not be allowed to relitigate it—underlies the rule of issue preclusion.

Restatement (Second) of Judgments at 6 (1982) (emphasis added); *see also Montana v. United States,* 440 U.S. at 153, 99 S.Ct. at 973.

In the case at hand, the Eleventh Circuit neither addressed nor had the opportunity to address the specific issue (or claim) before us, namely the propriety of FERC's *present,* anti-*Bountiful* view that the municipal preference does *not* obtain in relicensings to which the incumbent licensee is a party. *See I.A.M. National Pension Fund v. Industrial Gear Manufacturing Co.,* 723 F.2d 944, 947–49 (D.C.Cir.1983) (preclusion does not attach to issues not necessarily litigated or claims that could not have been raised in earlier proceeding). The Eleventh Circuit was, instead, called upon to assess the reasonableness of FERC's view enunciated in the short-lived *Bountiful* decision, namely that the preference applied in all relicensings. Its decision that *Bountiful* was both consistent with the statute and otherwise reasonable does not, as a matter of law or logic, resolve the distinct issue of whether FERC's recent interpretation is also reasonable and in accordance with the statute.[4] It should

4. It is irrelevant to preclusion analysis that in dicta the Eleventh Circuit suggested that the interpretation now taken by FERC would lead to absurd results. *See supra* note 2. Preclusion attaches only to issues the resolution of which is *necessary* to support the judgment in the first action. *See, e.g., Synanon Church v. United States,* 820 F.2d 421, 424 (D.C.Cir.1987); *Jack Faucett Assocs.,* 744 F.2d at 125; *Association of Bituminous Contractors, Inc. v. Andrus,* 581 F.2d 853, 860 (D.C.Cir.1978); 18 *C. Wright, A. Miller & E. Cooper, Federal Practice and Procedure* § 4421 (1981). Under the deferential standard of review employed by the reviewing court, it had only to determine the reasonableness of FERC's prior interpretation, not the correctness

go without saying that an ambiguous or broadly worded statute may admit of more than one interpretation that is reasonable and consistent with Congressional intent. *See, e.g., Japan Whaling Association v. American Cetacean Society,* — U.S. —, 106 S.Ct. 2860, 2867, 92 L.Ed.2d 166 (1986); *Chevron v. NRDC,* 467 U.S. at 863–64, 104 S.Ct. at 2792; *Chisholm v. FCC,* 538 F.2d 349, 364 (D.C.Cir.), *cert. denied,* 429 U.S. 890, 97 S.Ct. 247, 50 L.Ed.2d 173 (1976); *see also Office of Communication of the United Church of Christ v. FCC,* 590 F.2d 1062, 1068–69 (D.C.Cir.1978); *cf. ICC v. American Trucking Associations, Inc.,* 467 U.S. 354, 363–64 n. 7, 104 S.Ct. 2458, 2463–64 n. 7, 81 L.Ed.2d 282 (1984); *Immigration & Naturalization Service v. Jong Ha Wang,* 450 U.S. 139, 144–45, 101 S.Ct. 1027, 1031, 67 L.Ed.2d 123 (1981). That is to say, there may be more than one "right" interpretation if Congress has painted with a broad (or at least non-specific) brush so as to permit an agency flexibility in carrying out its duties.

*Second.* Another ground on which the municipality's preclusion argument founders is that Clark-Cowlitz and FERC were fellow travelers in the *Bountiful* proceeding. Both advanced the position, now rejected by FERC, that the municipal preference applies in *all* relicensings. Issue preclusion, however, attaches only to such issues as the parties litigated adversely to each other in the prior litigation. *See, e.g., Jack Faucett,* 744 F.2d at 125; Restatement (Second) of Judgments § 38. Similarly, as to claim preclusion, FERC's successfully defending its position (at that time) in *Alabama Power* does not bar it from asserting a different position in the current proceedings. *See, e.g., I.A.M. National Pension Fund,* 723 F.2d at 945 & n. 1. All that is precluded by virtue of FERC's earlier success is another action by the petitioners in *Alabama Power,* among whom Clark-Cowlitz was of course not to be found (being, indeed, on the opposite side), on the claim of *Bountiful*'s invalidity. *See Nevada v. United States,* 463 U.S. at 134–35, 103 S.Ct. at 2920; Restatement (Second) of Judgment § 19.

In summary, preclusion principles do not foreclose FERC's applying a reinterpretation of section 7(a) in the *Merwin* proceedings.[5] The Court of Appeals' decision in

of competing interpretations. The same reasoning applies if we treat Clark-Cowlitz's argument in terms of claim preclusion. The present "claim"—that FERC's present interpretation of section 7(a) is incorrect—could not have been entertained by the Eleventh Circuit before FERC adopted this interpretation. *Cf. I.A.M. National Pension Fund,* 723 F.2d at 947–49.

5. The dissent's argument that the real issue of preclusion is whether Pacific Power should be bound by *Bountiful* is, with all respect, misguided. It is true as a general matter that preclusion principles can apply to parties to administrative proceedings, but that principle is irrelevant here. The doctrine of preclusion is meant to prevent parties from rearguing issues they have already lost. But Pacific Power has never argued that *Bountiful* did not apply to it. It was the *decisionmaker,* FERC, that changed its position. Thus, to the extent preclusion analysis is appropriate at all, it is applicable to the extent that FERC participated as a party before the Eleventh Circuit. Preclusion principles are meant to provide an affirmative defense that one party to a prior proceeding may raise against another party that took an adverse position in that proceeding.

Assuming *arguendo* the appropriateness of addressing whether Pacific Power should be precluded by virtue of its participation, we would reach the same conclusion. *Bountiful* was, it must be remembered, a declaratory order proceeding, *see* 5 U.S.C. § 554(e), and as such was structured expressly in order to address a pure issue of law: the applicability of the municipal preference of section 7(a) to relicensing. *See Bountiful,* 11 F.E.R.C. at 61,710. It is well settled that the determination of an issue of law should not be accorded preclusive effect if such effect would result in "inequitable administration of the law." *See* Restatement (Second) of Judgments § 28(a); *see also Staten Island Rapid Transit Operating Auth. v. ICC,* 718 F.2d 533, 542 (2d Cir.1983). We think that would be the precise consequence of applying preclusion in this case for the reason we discuss *infra* section III. It would grant Clark-Cowlitz a benefit which similarly situated parties—namely, the numerous other municipalities who participated in *Bountiful*—would be denied by virtue of passage of the Electric Consumers Protection Act. Correlatively, it would burden a party, Pacific Power, in a way that similarly situated parties—namely, the numerous private utilities in *Bountiful*—would not be burdened.

Moreover, the dissent's attempt to equate *Bountiful* with ordinary federal court proceedings ignores the fact that administrative proceedings vary much more widely than judicial

*Alabama Power* did not address the issue of the propriety of FERC's present interpretation, nor could the claim that this agency interpretation was invalid have been raised before the Eleventh Circuit.

## III

[4, 5] Since the interpretation of section 7(a) that FERC first applied in the contest between Pacific Power and Clark-Cowlitz represented a reversal of the position the Commission had espoused in *Bountiful*, it is appropriate for us to consider whether the application of its change in position was consistent with principles of retroactivity. We are persuaded that it was.

In this circuit, *Retail, Wholesale & Department Store Union v. NLRB*, 466 F.2d 380 (D.C.Cir.1972), provides the framework for evaluating retroactive application of rules announced in agency adjudications. *See Local 900, International Union of Electrical, Radio & Machine Workers v. NLRB*, 727 F.2d 1184, 1194–95 (D.C.Cir. 1984); *see also Yakima Valley Cablevision, Inc. v. FCC*, 794 F.2d 737, 746 & n. 35 (D.C.Cir.1986). The general principle is that when as an incident of its adjudicatory function an agency interprets a statute, it may apply that new interpretation in the proceeding before it. *See NLRB v. Wyman-Gordon*, 394 U.S. 759, 765–66, 89 S.Ct. 1426, 1429, 22 L.Ed.2d 709 (1969) (plurality opinion); *see also NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 294–95, 94 S.Ct. 1757, 1771–72, 40 L.Ed.2d 134 (1974); *Thorpe v. Housing Authority of the City of Durham*, 393 U.S. 268, 282, 89 S.Ct. 518, 526, 21 L.Ed.2d 474 (1969); *McDonald v. Watt*, 653 F.2d 1035, 1042 (5th Cir.1981) ("While at one time the determination that a rule was properly established in adjudication would have compelled the conclusion that it should be applied with full retroactive effect, the accepted rule today is that in appropriate cases the court may in the interest of justice make the rule prospective."); 4 *K. Davis, Administrative Law Treatise* § 20:8, at 30 (2d ed. 1983) ("[A]n agency having rulemaking power is forbidden by ... *Wyman-Gordon* to make new law in an adjudication if it is to be limited to prospective effect."); *Tennessee Gas Pipeline Co. v. FERC*, 606 F.2d 1094, 1114, 1115 (D.C.Cir.1979) (reading *Bell Aerospace* as affording an agency "broad discretion to announce policy in adjudication ... subject to an exception in a case of severe impact and justifiable reliance on contrary agency pronouncements"), *cert. denied*, 445 U.S. 920, 100 S.Ct. 1284, 63 L.Ed.2d 605 (1980); *cf. Mullins v. Andrus*, 664 F.2d 297, 302–03 (D.C.Cir.1980) ("[J]udicial decisions normally are to be applied retroactively.") (footnote omitted); *National Association of Broadcasters v. FCC*, 554 F.2d 1118, 1130 (D.C.Cir.1976) ("The general rule of long standing is that judicial precedents normally have retroactive as well as prospective effect.").

Nevertheless, a retrospective application can properly be withheld when to apply the new rule to past conduct or prior events would work a "manifest injustice." *See Thorpe*, 393 U.S. at 282, 89 S.Ct. at 526. The *Retail, Wholesale* court set forth a non-exhaustive list of five factors to assist courts in determining whether to grant an exception to the general rule permitting "retroactive" application of a rule enunciated in an agency adjudication:

> (1) whether the particular case is one of first impression, (2) whether the new rule represents an abrupt departure from well established practice or merely attempts to fill a void in an unsettled area of law, (3) the extent to which the party against whom the new rule is applied relied on the former rule, (4) the degree of the burden which a retroactive order imposes on a party, and (5) the statutory interest in applying a new rule despite the reliance of a party on the old standard.

*Id.* at 390.

The first factor of *Retail, Wholesale* recognizes that "a number of reasons call[ ]

proceedings. Since as a general matter preclusion principles are to be applied more flexibly to administrative adjudications than to judicial proceedings, *see generally* Restatement (Second) of Judgments § 83; 4 *K. Davis* § 21:9, withholding preclusive effect as to a single party is especially justified in light of the unique nature of the *Bountiful* proceedings and the scope of participation in those proceedings by private parties.

for the application of a new rule to the parties to the adjudicatory proceeding in which it is first announced." *Id.; see also Local 900,* 727 F.2d at 1195. For one thing, by granting the benefit of a change in the law to those whose efforts may have helped bring about the change, retroactive application of a new principle encourages parties to "advance new theories or ... challenge outworn doctrines." *Retail, Wholesale,* 466 F.2d at 390. For another, the Administrative Procedure Act generally contemplates that when an agency proceeds by adjudication, it will apply its ruling to the case at hand; when, on the other hand, it employs rulemaking procedures, its orders ordinarily are to have only prospective effect. *See* 5 U.S.C. §§ 551(4)–(7), 553, 554; *see also Wyman-Gordon,* 394 U.S. at 764, 89 S.Ct. at 1429. Inasmuch as *Merwin* was the first proceeding in which FERC announced its reinterpretation, the first *Retail, Wholesale* factor points in favor of retroactive application.[6]

The second factor requires the court to gauge the unexpectedness of a rule and the extent to which the new principle serves the important but workaday function of filling in the interstices of the law. It implicitly recognizes that the longer and

6. The *Retail, Wholesale* court somewhat misleadingly refers to this first factor as an inquiry whether the agency adjudication at issue is one of "first impression." This nomenclature contains within it seeds of confusion, insofar as it differs from the more typical understanding of the term as referring to situations in which an agency confronts an issue that it has not resolved before. *See, e.g., SEC v. Chenery,* 332 U.S. 194, 202–03, 67 S.Ct. 1575, 1580, 91 L.Ed. 1995 (1947). Nonetheless, this potential confusion is quickly dispelled upon examination of the facts of *Retail, Wholesale.* There the *Retail, Wholesale* court labeled the case before it one of second impression and on that basis distinguished it from the agency decision, *The Laidlaw Corporation,* 171 NLRB No. 175 (June 13, 1968), in which the NLRB first overruled a well-established rule to the contrary. In discerning this distinction, the court clearly labelled *Laidlaw* a case of "first impression" for purposes of analysis under the first factor, even though *Laidlaw* addressed an issue which the agency had addressed before:

> First, while the Supreme Court has observed in *Chenery* that "[E]very case of first impression has a retroactive effect ...," this is not a case of first, but of second impression. The case in which the rule in question was adopted by the Board was *Laidlaw* itself, and, although the Seventh Circuit upheld its application to the employer there, it must be recognized that "[t]he problem of retroactive application has a somewhat different aspect in cases not of first impression but of second impression."

466 F.2d at 390 (footnotes and citations omitted). It could not be clearer that *Laidlaw* was not a decision of the sort typically referred to as one of "first impression"—that is, it was not the first time that the NLRB had ever addressed the issue (whether an employer had to seek out affirmatively and offer reinstatement to employees replaced during an unfair labor practice strike). Rather, *Laidlaw* was one of "first impression" in a different sense, namely that it decided for the first time that employers did in fact have a duty to seek out and offer to reinstate such employees. In announcing this rule, the *Laidlaw* decision squarely overruled numerous NLRB decisions that had addressed this same issue but reached the opposite result. *Id.* at 387–88 & n. 17. Thus, the dissent misinterprets the term "first impression" as used in *Retail, Wholesale* in concluding that *Merwin* was "a classic example of a case of second impression." Dissent at 1094. *Merwin* clearly qualifies as a case of first impression under the *Retail, Wholesale* analysis, which, the dissent acknowledges, is the "seminal case fixing the law of the circuit for retroactive application of agency adjudications." *Id.* at 1093.

The dissent goes on to suggest that the first factor of *Retail, Wholesale* loses meaning if a case enunciating a new rule is viewed as a case of "first impression." *Id.* at 1094. But the apparent conceptual oddity disappears when one focuses not upon the nomenclature, which is indeed misleading, but on the concept which the *Retail, Wholesale* court was seeking to convey. And that point was well captured by the court's observation that *parties who challenge old doctrines should be rewarded for bringing about the change in the law.* That is, to deny the fruits of victory to those who bring about a change in the law "might have adverse effects on the incentive of litigants to advance new theories or to challenge outworn doctrines." *Id.* at 390. Thus, we are convinced that the dissent, with all respect, has been misled by the admittedly misleading nomenclature employed by the *Retail, Wholesale* court, and has overlooked the real point—*the first factor points in favor of retroactive application of a rule in the adjudication in which the new rule or principle is announced.* Odd as it may seem to the dissent, the first factor tends by its nature to cut in favor of retroactive application of a new principle. That factor, however, can obviously be counterbalanced by the weight of the other factors, which boil down, as we shall presently see, to a question of concerns grounded in notions of equity and fairness.

more consistently an agency has followed one view of the law, the more likely it is that private parties have reasonably relied to their detriment on that view. *See, e.g., Hanover Shoe, Inc. v. United Shoe Machinery Corp.,* 392 U.S. 481, 495–502, 88 S.Ct. 2224, 2232–36, 20 L.Ed.2d 1231 (1968); *see also NLRB v. Majestic Weaving Co.,* 355 F.2d 854, 861 (2d Cir.1966). But here, FERC's prior interpretation of section 7(a) cannot in reason rise to the level of a "well established practice." For one thing, application of the prior interpretation was never a "practice." *Bountiful* was, after all, FERC's sole pronouncement on an issue that had lain dormant for almost fifty years. Indeed, the entire purpose of the declaratory order proceeding was to provide a forum for resolving this emerging issue. For another thing, the Commission's ruling in that solitary proceeding can scarcely be viewed as "well established." The reader will recall that judicial review of *Bountiful* had not even concluded when FERC changed its mind as to the meaning of section 7(a).[7]

Now it is true that, by virtue of *Bountiful*'s existence, FERC was not "required by the very absence of a previous standard" to confront the issue raised in *Merwin* and to supply a rule. *Retail, Wholesale,* 466 F.2d at 391. The second factor thus favors retrospective application less than would be the case in situations where formulation of a rule is necessary to "fill[ ] in the interstices of the [statute]," *id.* (quoting *SEC v. Chenery,* 332 U.S. at 202–03, 67 S.Ct. at 1580). On the other hand, FERC's need to apply its reinterpretation in *Merwin* was more compelling than those in which an agency shifts its position solely as a result of a change in agency policy. Here, FERC was animated by the conviction that its prior interpretation thwarted Congressional intent; to make bad matters worse, the prospect loomed that an erroneous interpretation would be locked in for a generation, embodied in licenses that would last well into the Twenty-First Century. *See Chisholm v. FCC,* 538 F.2d at 364 (agency's discretion to change its course is broader when agency believes its prior course is contrary to statutory design); *see also Chenery,* 332 U.S. at 203, 67 S.Ct. at 1581 ("[R]etroactivity must be balanced against the mischief of producing a result which is contrary to a statutory design ..."). On balance, it seems to us that the second factor weighs against granting an exception to the general rule of retrospective application.

Next, in evaluating possible reliance on *Bountiful,* we can see little if any period during which Clark-Cowlitz would reasonably have relied on FERC's earlier interpretation. Both the formation of Clark-Cowlitz and its initial efforts toward securing the Merwin license occurred before *Bountiful* was rendered, at a time when the

7. Consideration of *Hanover Shoe,* 392 U.S. 481, 88 S.Ct. 2224, 20 L.Ed.2d 1231, illustrates the fundamental defect in the dissent's analysis of this case under the second *Retail, Wholesale* factor. In *Hanover Shoe,* the Court assessed whether "a party ha[d] significantly relied upon a clear and established doctrine" so as to warrant nonretroactive application of a judicially articulated rule concerning the law of monopolization. *Id.* at 496, 88 S.Ct. at 2223. It surveyed case law extant when the rule was first clearly announced and determined that there was no "sharp break in the line of earlier authority or an avulsive change which caused the current of the law thereafter to flow between new banks." *Id.* at 499, 88 S.Ct. at 2234. Just as the second *Retail, Wholesale* factor looks to whether there has been a departure from past *practice,* 466 F.2d at 390, the *Hanover Shoe* Court's use of terms like "line of authority" and "current of the law" demonstrates that retroactivity analysis must consider the "longstanding" nature of the displaced prior rule. And that is why a holding of nonretroactivity, as urged by the dissent, cannot be premised on a *single,* recent agency decision (*Bountiful*) that is still in the throes of litigation when it is overruled. It is precisely those situations in which a preexisting rule has withstood the test of time and been faithfully applied or explicitly reaffirmed that justifiable reliance may exist. To this extent, the dissent's suggestion, Dissent at 6, that the three-year interval between *Bountiful* and *Merwin* is somehow comparable to the seven years of decisions overruled by the *Laidlaw* decision at issue in *Retail, Wholesale, see supra* note 6, is simplistic and misleading. The prior rule at issue in *Retail, Wholesale* had been applied and confirmed in at least six decisions over those seven years, 466 F.2d at 387 n. 17 (listing cases), five of which held up to judicial review. That is a far cry from the situation here.

applicability of the municipal preference to relicensing proceedings had not been resolved.[8] Obviously, no reliance could have preceded *Bountiful.* Thereafter, Clark-Cowlitz might optimistically have viewed *Bountiful*'s interpretation as at least tentatively settled after the Eleventh Circuit's favorable decision. But, upon analysis, a sanguine view as to *Bountiful*'s permanence would necessarily have been short-lived, for only six months elapsed between the Eleventh Circuit's decision in November 1982 and May 1983, when the Solicitor General revealed FERC's about-face. *See* FERC's Brief in Support of Petitions for Certiorari at 8–9, J.A. at 106–07. Any reliance on agency fidelity to *Bountiful* after this development would manifestly have been unreasonable, inasmuch as the agency had concluded (and announced) that its prior reading was wrong as a matter of law.[9]

In sum, viewed most favorably to Clark-Cowlitz, the period during which it could have relied on FERC's prior interpretation spanned no more than six months. Moreover, the presumably sunny prospects for *Bountiful*'s vitality during this brief period were beclouded in some measure by knowledge of possible Supreme Court review (or, at a minimum, the likelihood of an effort by the incumbent licensee and other private utilities to secure Supreme Court review). We have discovered no legal authority (nor do we see in logic any reason) to support carving out an exception to the rule of retroactivity based on reliance on an agency interpretation so briefly embraced. *Cf. Retail, Wholesale,* 466 F.2d at 387 & n. 17 (prior interpretation applied in numerous decisions over at least seven years). Although hope springs eternal, hope is no surrogate for reliance.

Clark-Cowlitz's situation fares no better under the fourth *Retail, Wholesale* factor, to wit, the degree of burden which a retroactive order imposes. As a result of FERC's change in interpretation, Clark-Cowlitz lost the benefit of what is admittedly a highly attractive procedural advantage in competing for a hydroelectric power license. Nevertheless, Clark-Cowlitz obviously retained the unfettered right to compete for the license. It was simply forced to do so on the same terms as non-municipal applicants, entitled to the license only if it proved that its plans were "best adapted to develop, conserve, and utilize in the public interest the water resources of the region." 16 U.S.C. § 800(a). Thus, the situation "is not [one] in which some new liability is sought to be imposed on individuals for past actions which were taken in

8. In fact, prior to *Bountiful,* the only indication of how this legal issue would be resolved cut against a municipality's reliance on the availability of the preference. That indication had come in 1967, when the General Counsel of the Federal Power Commission, FERC's predecessor, informed Congress that the FPC interpreted section 7(a) to withhold the municipal preference in relicensing proceedings in which the incumbent licensee was seeking the license. *See Bountiful,* 11 F.E.R.C. at 61,722–23.

9. The dissent's attempt to ignore the significance of this disclosure and maintain that the overruling of *Bountiful* was "completely unforeshadowed," Dissent at 9, blinks at reality. The Solicitor General's certiorari brief clearly and unequivocally foreshadowed *Bountiful*'s demise when it gave notice to Clark-Cowlitz as well as the Court that "a majority of the [FERC] Commissioners ... expressed their disagreement with the Commission's earlier position [in *Bountiful*]" and that "the Commission now wishes to reconsider the case [*Bountiful*], and ... a majority of the Commissioners appear to be ready to overrule [*Bountiful*] and adopt the contrary position." Solicitor General's Brief in Support of Certiorari at 8–9, J.A. at 106–07. In light of this clear indication that *Bountiful* was in mortal danger, it is irrelevant for purposes of gauging reasonable reliance that the Commission, as a litigation matter, expressed concern over the possible binding effect of *Bountiful.* This latter concern was merely that; it scarcely negates the expression of intent to overrule *Bountiful.* What is more, this articulated concern must be viewed in its context, namely as part of the Commission's litigation strategy. It cannot be overlooked that at that juncture the Commission was fervently seeking to convince the Supreme Court that the case was worthy of the Court's attention. Thus, assuming *arguendo* that Clark-Cowlitz expended time and money toward securing a hearing *after* May 1983 (when the Solicitor General revealed the Commission's forthcoming change in interpretation), that effort simply cannot be said to have been in "reasonable reliance" on the continued vitality of *Bountiful.* We are thus left with whatever efforts born of optimism may have taken place over six months, which the dissent itself describes as "admittedly ... modest." Dissent at 1095.

good-faith reliance on [agency] pronouncements. Nor are fines or damages involved here." *Bell Aerospace*, 416 U.S. at 295, 94 S.Ct. at 1772. Measured against the burdens weighed in other cases, the burden imposed on Clark-Cowlitz is, as we see it, marginal at best. *Cf. Local 900*, 727 F.2d at 1195 (upholding retroactive application that resulted in imposition of money damages).[10]

The fifth and final factor—the statutory interest in applying a new rule despite the reliance of a party on the old standard—likewise favors retrospective application. Withholding retroactive application would grant Clark-Cowlitz a 30-year benefit to which FERC now believes it is not entitled. The overriding Congressional interest in ensuring that the best qualified contestant (as FERC sees it) operate hydroelectric power projects, in other words, would not be fulfilled at the Merwin site for three decades.[11] This 30-year delay looms large when measured against whatever optimism Clark-Cowlitz may have felt during the six months between judicial affirmance of *Bountiful* and revelation of FERC's disavowal of that briefly held position.

In addition to application of the *Retail, Wholesale* analysis, we discern yet another consideration in favor of permitting FERC to apply its reinterpretation. To hold oth-

10. For reasons stated in the text, the dissent is wrong to describe the effect of retroactive application as "[d]eprivation of that license," Dissent at 1097, since Clark-Cowlitz still could have received the license if it had been better qualified than Pacific Power. Moreover, the dissent ignores the bedrock fact that Clark-Cowlitz *never received a license*. All Clark-Cowlitz ever had was a favorable ruling from an ALJ, which was subject to plenary review by the full Commission. Finally, it is worth emphasizing that although Clark-Cowlitz was, as the dissent notes, formed for the express purpose of seeking the Merwin license, its failure to obtain that license was a risk it undertook knowingly; the Authority was formed, after all, when prevailing authority suggested that it was entitled to no preference. *See supra* note 8.

11. We are puzzled by the dissent's discounting FERC's view of Congress' interest with respect to hydroelectric relicensings. *See* Dissent at 1098. FERC did, after all, reach its decision as a result of a careful examination of the relevant statutory framework and legislative history surrounding it; it was not engaging in policy making. We are, of course, obliged when Congress' intent is not clear and unambiguous to defer to an agency's reasonable interpretation of that intent. *See Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 844–45, 104 S.Ct. 2778, 2782–83, 81 L.Ed.2d 694 (1984); *see also INS v. Cardoza-Fonseca*, — U.S. —, 107 S.Ct. 1207, 1220–21, 94 L.Ed.2d 434 (1987); *Clarke v. Securities Indus. Ass'n*, — U.S. —, 107 S.Ct. 750, 759–60, 93 L.Ed.2d 757 (1987); *United States v. Riverside Bayview Homes*, 474 U.S. 121, 106 S.Ct. 455, 461, 88 L.Ed.2d 419 (1985); *Chemical Mfrs. Ass'n v. Natural Resources Defense Council*, 470 U.S. 116, 125, 105 S.Ct. 1102, 1108, 84 L.Ed.2d 90 (1985). Equally important, Congress' statutory interest in awarding the license to the best qualified applicant, an interest discerned by the Commission in an interpretation that we consider reasonable, *see infra* section IV, would not be fulfilled at least at the Merwin site *for three decades* if nonretroactive application of *Merwin* is required. The need immediately to announce and apply its reinterpretation of *Bountiful* obviously occurred to FERC, as is evident from the outset of the *Merwin* decision. FERC acknowledged that "it [did] not matter whether the municipal preference ... [was] applied [to the case before it] because the Commission is in full agreement that the plans of PP & L are better adapted than those of [Clark-Cowlitz] and, consequently, that there [was] no tie." This overruling was obviously necessary because after the round of relicensings then under way, no more adversary relicensings would take place for three decades, as all the parties to *Bountiful* and *Merwin* were undoubtedly aware. Since eight of the "future" relicensings were already pending, as FERC noted, if the Commission had decided to postpone announcing its overruling of *Bountiful*, or to withhold retroactive application, its new interpretation would not be applied to nine different sites for thirty years. The dissent now appears to criticize FERC for not considering singling out Clark-Cowlitz for nonretroactive application of *Merwin* at the expense of the eight other applicants. *See* Dissent at 1098. We believe that this was hardly an "obvious alternative," *cf. Yakima Valley*, 794 F.2d at 746. For one thing, as we discuss in the text, Clark-Cowlitz demonstrated no unique degree of reliance or hardship sufficient to justify such disparate treatment. For another, this alternative was not so "obvious" as to occur to Clark-Cowlitz itself, which argued in its petition for rehearing that FERC was bound to apply *Bountiful* to all parties to *Bountiful*, comprising "virtually the entire investor-owned utility industry and a substantial number of publicly-owned utilities." *See* Clark-Cowlitz's Request for Rehearing of Opinion No. 191, at 10 (Nov. 4, 1983), J.A. at 708, 725; *see also id.* at 17–19, J.A. at 732–34 (discussing retroactivity principles without suggesting that Clark-Cowlitz should be singled out for favorable treatment).

erwise would grant Clark-Cowlitz the benefit of a municipal preference that Congress, by enacting the ECPA, has seen fit to deny to all other municipal applicants. Yet eight of these applicants had applications pending at the time when FERC announced its decision to overrule *Bountiful.* As a result of FERC's reassessment, eight other applicants suffered disappointment differing from that experienced by Clark-Cowlitz only by what appear to be evanescent shades of graduation. We can see nothing warranting the singling out of Clark-Cowlitz for this boon solely because its application was the first to proceed to the hearing stage.[12]

To the contrary, the more equitable approach would be to treat Clark-Cowlitz like the other similarly situated municipal applicants, which, no one disputes, can no longer claim the benefit of the municipal preference in the wake of the ECPA. *See, e.g., Bradley v. School Board of the City of Richmond,* 416 U.S. 696, 714–16, 94 S.Ct. 2006, 2017–18, 40 L.Ed.2d 476 (1974). And it should not go unnoticed that equal treatment is exactly what Clark-Cowlitz has been asking for all along, contending, for example, that it "and every other party [to *Bountiful* ] reasonably relied on the assertion of FERC" in *Bountiful.* Petitioners' Brief at 31.

## IV

[6] This brings us at last to the substantive heart of the petition for review: the propriety in law of FERC's determination that no municipal preference applies in relicensing proceedings in which the incumbent licensee is seeking to remain on the project. Confronted with an agency's interpretation of the statute that Congress has charged it with administering, we must first employ the traditional tools of statutory construction to determine whether Congress has spoken directly to the precise question at issue. If Congress has not addressed the precise question, or if it has addressed the issue but done so ambiguously, the question becomes whether the agency's interpretation is a reasonable (or permissible) one. *See, e.g., Cardoza-Fonseca,* 107 S.Ct. at 1220–22; *Chevron v. NRDC,* 467 U.S. at 844, 104 S.Ct. at 2872; *Rettig v. Pension Benefit Guaranty Corp.,* 744 F.2d 133, 141 (D.C.Cir.1984). Upon analysis of the statute, we are persuaded that Congress has not in this instance clearly and specifically addressed the role of the municipal preference in relicensings and that FERC's interpretation of section 7(a) should be upheld as reasonable.

The focus of this dispute is the language of two provisions of the Federal Power Act. Section 7(a) of the Act, 16 U.S.C. § 800(a), which is set forth *supra* note 1, creates a preference for municipal applicants. It specifies three situations in which the preference applies: when the Commission is (1) "issuing preliminary permits" under section 5 of the Act, *id.* § 798; *see also id.* § 797(f); (2) "[issuing] licenses where no preliminary permit has been issued"; and (3) "issuing licenses to new licensees under section 808 of this title."

The third category of section 7(a) is the only one arguably applicable here because the proceedings before the Commission were relicensing proceedings carried out under section 15 of the Act, 16 U.S.C. § 808, the provision to which section 7(a) makes express reference. Indeed, Clark-Cowlitz concedes that neither the first nor the second situation obtains here. Petitioner's Brief at 34. That, then, brings us to section 808 (section 15 of the Federal Power Act), which concerns relicensing proceedings. It provides in pertinent part as follows:

12. We in no way suggest that Congress' most recent legislation controls our decision concerning Clark-Cowlitz's entitlement to the municipal preference. We recognize that in enacting the ECPA Congress deliberately left to this court resolution of the pending controversy involving FERC and Clark-Cowlitz. *See, e.g.,* H.R.Rep. No. 507, 99th Cong., 2d Sess. 16–17 (1986), U.S. Code Cong. & Admin.News 1986, p. 2496; *see also supra* note 3. We only emphasize that considerations of fairness, which lie at the heart of exceptions to the general rule of retroactivity, militate against treating Clark-Cowlitz differently from the many similarly situated municipalities subject to Congress's enactment.

> (a) If the United States does not, at the expiration of the original license, exercise its right to take over, maintain, and operate any project or projects of the licensee, as provided in section 807 of this title, the commission is authorized to issue a new license to the original licensee upon such terms and conditions as may be authorized or required under the then existing laws and regulations, or to issue a new license under said terms and conditions to a new licensee, which license may cover any project or projects covered by the original license, and shall be issued on the condition that the new licensee shall, before taking possession of such project or projects, pay such amount, and assume such contracts as the United States is required to do in the manner specified in section 807 of this title: Provided, That in the event the United States does not exercise the right to take over or does not issue a license to a new licensee, or issue a new license to the *original* licensee, upon reasonable terms, then the commission shall issue from year to year an annual license to the then licensee under the terms and conditions of the original license until the property is taken over or a new license is issued as aforesaid.

*Id.*

FERC determined that the third (and final) situation described in the municipal preference clause of section 7(a) did not govern the proceedings before it. *Merwin,* 25 F.E.R.C. ¶ 61,052. It reasoned that Pacific Power was an "original licensee," not a "new licensee," within the meaning of section 15. Under this analysis, the Commission was not "issuing [a] license[ ] to a new licensee," under section 7(a). *Id.* § 800(a). Rather, it was issuing "a new licensee to the original licensee."

The Commission thus relied on the statutory distinction in section 15 between an "*original* licensee" and a "*new* licensee." *Id.* § 808(a) (emphasis added). The Commission further found that this interpretation, mandated by the terms of sections 7 and 15, was inconsistent with neither the structure of the Act nor its legislative history. By virtue of this analysis, the Commission concluded that its contrary view in *Bountiful* was "legally erroneous." Having interpreted the municipal preference clause not to apply in relicensings involving "original licensees," the Commission considered the relevant standards to be contained in the second clause of section 7(a), which applies "as between other applicants." *Id.* § 800(a). Thus, in FERC's view, any relicensing in which one of the applicants was an incumbent (or more precisely, "original") licensee was a proceeding "between other applicants."

In our view, the Commission's new interpretation (withholding the municipal preference in relicensing proceedings in which the *original* licensee is involved) represents a reasonable reading of the statute. Indeed, to embrace the contrary interpretation the reader must modify either the statute or the facts in one of two ways; (1) by characterizing Pacific Power, the incumbent, as a "new licensee" when it is in fact the "original licensee"; or (2) by rewording the provision to mandate application of the municipal preference when "*entertaining applications for* a license to a new license." 16 U.S.C. § 800(a).

Both approaches do violence to the terms of the statute. The first ignores the distinction in section 808(a) between "original licensees" and "new licensees." Indeed, the first approach renders surplusage the concept of "original licensee," an act of judicial surgery which should be avoided when means are at hand to save the entire statute. *See, e.g., Reiter v. Sonotone Corp.,* 442 U.S. 330, 339, 99 S.Ct. 2326, 2331, 60 L.Ed.2d 931 (1979); *National Insulation Transportation Committee v. ICC,* 683 F.2d 533, 537 (D.C.Cir.1982); *In re Surface Mining Regulation Litigation,* 627 F.2d 1346, 1362 (D.C.Cir.1980). The second approach ignores the fact that the provisions distinguish between "issuing" a license and "entertain[ing] applications for" a license. *Compare id.* § 808(a) *with id.* § 807(b).[13] Congress would, it seems to

13. Section 807(b) provides in relevant part as follows:

us, likely have employed the latter term in § 800(a) had it intended to refer to the process of receiving applications for the issuance of a license to a new licensee.[14] Thus, compared to the competing interpretation championed by Clark-Cowlitz, FERC's reading has the substantial virtue of giving meaning to *all* of the words of the statute and depending *only* on the words that Congress employed in drafting it. *See, e.g., United States v. Menasche,* 348 U.S. 528, 538–39, 75 S.Ct. 513, 519–20, 99 L.Ed. 615 (1955); *Market Co. v. Hoffman,* 101 U.S. (11 Otto) 112, 115–16, 25 L.Ed. 782 (1879). In addition, FERC's approach construes the phrase "issu[ing] a license to a new licensee" in section 7 of the Act to have the same meaning as that phrase does in section 15, the provision expressly incorporated in section 7. *Cf. Stafford v. Briggs,* 444 U.S. 527, 535–36, 100 S.Ct. 774, 780, 63 L.Ed.2d 1 (1980); *Atlantic Cleaners & Dyers, Inc. v. United States,* 286 U.S. 427, 433, 52 S.Ct. 607, 609, 76 L.Ed. 1204 (1932).

On the other hand, the merit of FERC's present interpretation is not entirely free from doubt. Specifically, it is in tension with the opening phrase of the second clause of section 7(a), "as between other applicants." [15] Clark-Cowlitz's argument—that the municipal preference (in the first clause of section 7(a)) applies in any contest between a State or municipality and a private entity, and that the second clause applies "between other applicants," i.e., in relicensing proceedings between any two private entities, including original licensees—is not without force. This interpretation arguably gives a more natural reading to the phrase "between other appli-

> No earlier than five years before the expiration of any license, the Commission shall entertain applications for a new license and decide them in a relicensing proceeding pursuant to the provisions of section 808 of this title....

16 U.S.C. § 807(b).

14. The dissent misreads our opinion "to say that FERC can first decide to whom to award a license and *then* apply the municipal preference to the formal act of issuing the license," Dissent at 1100. Not so. As FERC reads section 800(a), the municipal preference applies only in relicensing proceedings in which the Commission is "issuing a license to a new licensee," which can only include contests among applicants who are not "original licensees." This reading by the expert agency does not, as the dissent would have it, require application of the preference only after the decision is made as to who gets the award. The Commission obviously knows from the outset whether an original licensee is participating in the proceeding. Employing its misreading of our opinion, the dissent then attempts to justify modifying the language of section 800(a). The dissent would twist the statute so as to trigger the municipal preference in *any* relicensing proceeding in which a state or municipality has filed an application to become a new licensee—i.e., where the Commission is "entertaining" an application, 16 U.S.C. § 807(b), *supra* note 13, for the issuance of a license to a new licensee. We believe FERC's contrary interpretation is at least as reasonable as, if not preferable to, an interpretation that requires amending the statute to add language that Congress saw fit to leave out of this provision and chose to use elsewhere, indeed in a neighboring provision. *See id.*

15. We need not dwell at length on the dissent's belief that this particular portion of section 7(a), 16 U.S.C. § 800(a), yields an "obvious" meaning. *See* Dissent at 1100. We think the susceptibility of this provision to varying but reasonable interpretations is suggested by the fact that interpretation of this provision has, so far (1) been the subject of two lengthy and careful Commission decisions reaching contrary results; (2) provided a subject of fierce debate among "virtually the entire" industry, *see* Clark-Cowlitz's Rehearing Petition, *supra* note 11, at 10; and (3) led to judicial review by this court sitting *en banc* with differences of opinion.

As for the "more subtle" problem that the dissent purports to discern in FERC's interpretation of section 7(a), that "problem" is nothing more than a recasting of the dissent's *first problem* concerning the phrase "as between other applicants," which we acknowledge in the text to be ambiguous. The dissent asserts that "a proceeding cannot arise under the second half of [section 7(a)]," Dissent at 1100, which is itself a remarkable proposition inasmuch as it appears to deny meaning to fully one-half of the provision. It appears to us that under either of the competing interpretations a relicensing proceeding in which no municipality was involved would require application of the second half of section 7(a). But in any event, in asserting that the first half of section 7(a) covers all possible proceedings, the dissent simply presumes the correctness of its interpretation, namely that "new licensees" includes "original licensees." Such judicial presumptions are not, with all respect, in keeping with *Chevron* principles.

cants"; on the other hand, it suffers from the shortcomings adumbrated above.

Fortunately, we are not without guidance in this unhappy (but hardly unfamiliar) situation of plausible competing interpretations of statutes. The Supreme Court only recently reminded us that a court cannot substitute what it considers the "more natural" construction of an ambiguous statute for a reasonable interpretation advanced by an agency. *See Young v. Community Nutrition Institute,* 477 U.S. 974, 106 S.Ct. 2360, 2364–65, 90 L.Ed.2d 959 (1986); *see also Cardoza-Fonseca,* 107 S.Ct. at 1220 n. 29; *Chevron v. NRDC,* 467 U.S. at 842–44, 104 S.Ct. at 2781–82. Since it is beyond cavil that section 7(a) is reasonably susceptible to the interpretation proffered by FERC, we are duty bound to uphold it.

Nothing in the legislative history warrants upsetting this construction of the statute. As a general matter, the legislative history in this respect is not especially illuminating; indeed, the "legislative history here as usual is more vague than the statute we are called upon to interpret." *United States v. Public Utilities Commission,* 345 U.S. 295, 320, 73 S.Ct. 706, 720, 97 L.Ed. 1020 (1953) (Jackson, J., concurring); *see also Burlington Northern Railroad Co. v. Oklahoma Tax Commission,* — U.S. —, 107 S.Ct. 1855, 1859–60, 95 L.Ed.2d 404 (1987). It certainly points in no specific direction. On the one hand, the history favoring Clark-Cowlitz's position is, to quote the Eleventh Circuit's charitable characterization, "weak." *Alabama Power Co.,* 685 F.2d at 1317. On the other hand, some portions of the history provide modest, albeit scarcely overpowering, support for FERC's *present* position.[16] But what does appear beyond question is that resort to the legislative history yields no "compelling indications" of the sort necessary to overturn an agency's reading that is in harmony with the express language of the legislation. *See, e.g., Burlington Northern,* 107 S.Ct. at 1860; *Chemical Manufacturers Association v. Natural Resources Defense Council, Inc.,* 470 U.S. 116, 126, 105 S.Ct. 1102, 1108, 84 L.Ed.2d 90 (1985); *CBS,* 453 U.S. at 382, 101 S.Ct. at 2823; *Ford Motor Credit Co. v. Milhollin,* 444 U.S. 555, 565–68, 100 S.Ct. 790, 796–98, 63 L.Ed.2d 22 (1980); *see also, e.g., Consumer Product Safety Commission v. GTE Sylvania, Inc.,* 447 U.S. 102, 108, 100 S.Ct. 2051, 2056, 64 L.Ed.2d 766 (1980). *But cf. Board of Governors v. Dimension Financial Corp.,* 474 U.S. 361, 106 S.Ct. 681, 88 L.Ed.2d 691 (1986).

Finally, FERC's interpretation accords with the broader purposes animating Congress, to the extent those purposes can fairly be discerned from the structure and terms of the statute itself. The statutory mechanism provides for long-term licenses, at the end of which the United States or a subsequent licensee may, in effect, "buy out" the original licensee. This approach recognizes the need on the part of private capital for stability and a return on investment, *see, e.g., FPC v. Hope Natural Gas Co.,* 320 U.S. 591, 603, 605, 64 S.Ct. 281, 288, 289, 88 L.Ed. 333 (1944); *Jersey Central Power & Light Co. v. FERC,* 810 F.2d 1168, 1176 (D.C.Cir.1987), and, at the same time, the need to safeguard the public interest, which is, of course, the agency's *raison d'etre.* FERC's view of the limited circumstances in which the municipal preference is available is, we believe, consistent with this balancing of competing interests. Municipalities are entitled to a preference in relicensing over all other applicants when the incumbent licensee does not seek a new license. When, on the other hand, the original licensee seeks a renewed license, the municipality must show that it is better adapted than the incumbent if it is to unseat the original licensee. While the Act confers no "renewal expectancy," as is the case in the FCC's stewardship over broadcast licenses, neither does it, as the Commission reads the statute, obliterate 50 years of investment, improvement and administration of a project by conferring a special preference based entirely on the identity of the entity seeking to unseat the incumbent. Far from being an "absurd

16. The Commission canvassed this lengthy, largely inconclusive history in both *Bountiful,* 11 F.E.R.C. at 61,712–25 (1980), and *Merwin,* 25 F.E.R.C. at 61,180–84, J.A. at 620–26.

result," FERC's view of the statute appears reasonably to accommodate the public and private interests taken into account by the Act.

## V

[7] Having determined that the Commission could properly jettison *Bountiful* and apply its new interpretation of section 7(a) in the contest between Clark-Cowlitz and Pacific Power, we confront two final, related issues: *first,* whether FERC could properly take into account the relative economic impacts of an award to one or the other contestant; and *second,* if so, whether the Commission's assessment of these impacts avoids the APA's proscription of "arbitrary" and "capricious" agency action. 5 U.S.C. § 706(2)(A). We are satisfied that FERC may include in its deliberations consideration of the economic consequences of the grant of a license. We are unable to conclude, however, that FERC's consideration of those consequences in the *Merwin* proceedings passes muster as reasoned decision making.

### A

Under the standards governing review of agency interpretations of statutes, *see supra* text at 26, we have no difficulty in upholding FERC's interpretation as a permissible construction. As we have already discussed, FERC properly could, consistent with *Chevron* principles, consider the *Merwin* proceedings as arising under the latter half of section 7(a). That portion of the statute provides:

> [A]s between other applicants, the Commission may give preference to the applicant the plans of which it finds and determines are best adapted to develop, conserve, and utilize in the public interest the water resources of the region, if it be satisfied as to the ability of the applicant to carry out such plans.

Although it is certainly arguable that the economic impacts of an award are not factors properly subsumed within consideration of competing applicants' plans, two aspects of the language support FERC's position that it was nonetheless permissible to consider these impacts. First, in contrast to the initial part of 7(a), the second half contains the permissive verb "may." To be sure, "may" can sometimes express the language of command. *See, e.g., Commonwealth v. Lynn,* 501 F.2d 848, 854 & n. 21 (D.C.Cir.1974); *cf. Association of American Railroads v. Costle,* 562 F.2d 1310, 1312 (D.C.Cir.1977). Nevertheless, the fact that Congress saw fit to employ "shall" in the first clause of section 7(a) powerfully suggests that the distinction has meaning—that its use of "may" in the second clause was intended to vest in FERC, in proceedings "between other applicants," the discretion to consider factors extrinsic to the applicants' plans. *Cf. United States v. Hohri,* — U.S. —, —, 107 S.Ct. 2246, 2250, 96 L.Ed.2d 51 (1987). In addition, the second clause of section 7(a) does not, like the first, contain a provision permitting applicants under certain circumstances to modify their plans to be "equally well adapted" as those of competing applicants. The presence of this provision in the municipal preference clause tends to suggest that relicensing decisions under that clause should be based exclusively on the plans themselves. The absence of this provision in the second clause buttresses the Commission's view that in proceedings like the one at hand, section 7(a) does not force FERC to close its eyes to factors extrinsic to the plans of the license applicants.

Further support for the Commission's interpretation is found in section 10(a) of the Federal Power Act, which prescribes a broad public interest inquiry to guide the Commission in crafting conditions for licenses.[17] As FERC persuasively argues,

17. Section 10(a) of the Federal Power Act provides in relevant part as follows:

> All licenses issued under this subchapter shall be on the following conditions:
> (a) ... That the project adopted ... shall be such as in the judgment of the Commission will be best adapted to a comprehensive plan for improving or developing a waterway or waterways for the use or benefit of interstate or foreign commerce, for the improvement and utilization of water-power development,

the breadth of the public-interest inquiry permitted under section 10(a) should inform the interpretation of section 7(a)'s directions as to who should hold the license.

Finally, deferring to the Commission's expertise in technical, economic considerations is consistent with venerable case law interpreting sections 7 and 10 of the Act. *See, e.g., National Hells Canyon Association v. FPC,* 237 F.2d 777, 779–80 (D.C.Cir. 1956), *cert. denied,* 353 U.S. 924, 77 S.Ct. 681, 1 L.Ed.2d 720 (1957) (noting that recurrence in sections 7(b) and 10(a) of the phrase "in the judgment of the Commission" emphasizes Commission's broad discretion); *see also United States ex rel. Chapman v. FPC,* 345 U.S. 153, 171, 73 S.Ct. 609, 619, 97 L.Ed. 918 (1953) (judgments about technical and economic issues committed to Commission's discretion).

In sum, we believe the Commission reasonably interpreted the statutes governing licensing of hydroelectric projects to permit *considerations* of the economic consequences of its award. We turn, then, to the Commission's application of this interpretation.

B

In addition to attacking FERC's authority to take economic impacts into account, petitioner faults the Commission's assessment of these impacts. We are constrained to agree.

The Commission focused solely on the consequences of its decision on the customers of Pacific Power and Clark-Cowlitz. *See Merwin,* 25 F.E.R.C. at 61,196–201. Assessing the long-term impacts of the decision confronting it, FERC found that if it awarded the license to Clark-Cowlitz, Pacific Power would ultimately be forced to replace the lost Merwin power with much more expensive power, either from thermal generating facilities that Pacific Power would have to construct or from power supplied by the Bonneville Power Administration at its so-called "New Resources" rate. *Id.* at 61,197–98. In contrast, Clark-Cowlitz could, if it failed to obtain the Merwin license, service its customers with additional purchases from Bonneville at the latter's preferential "Priority Firm" rate. Thus, although precise calculation was impossible, it was clear that Pacific Power's alternative costs would greatly exceed those of Clark-Cowlitz. Moreover, in the short term, the decrease in Clark-Cowlitz's cost of power in the event of an award to it paled in comparison to the increased cost of power Pacific Power would incur in that event. *Id.* at 61,198. In general, the Commission found, these impacts would be passed along to customers of the two entities. Balancing the heavy cost increase that a significant portion of Pacific Power's customers would absorb as against the more modest benefits Clark-Cowlitz's would receive should the latter obtain the license, FERC determined to place the license in Pacific Power's hands. *Id.* at 61,201.

The Commission's analysis, upon reflection, overlooks important aspects of the problem before it. *See Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co.,* 463 U.S. 29, 43, 103 S.Ct. 2856, 2867, 77 L.Ed.2d 443 (1983). To be sure, the Commission rightly perceived that measurable dislocation would flow from unseating Pacific Power from the Merwin project. We also recognize the commonsense force of FERC's taking into account Clark-Cowlitz's access as a municipal entity to federally subsidized Bonneville power. Nevertheless, the Commission's truncated analysis raises as many questions as it answers.

For one thing, the Commission's analysis would appear invariably to favor the *status quo* and (other things being equal) all but guarantee an award to the incumbent licensee where a competing State or municipal applicant has preferential access to subsidized power. This seems to transmogrify the second clause of section 7(a)—which, as we have seen, contemplates an award to the best-suited applicant, regardless of

and for beneficial public uses, including recreational purposes.... 16 U.S.C. § 803(a).

identity—into a virtual *per se* (or at least strong) preference favoring the incumbent.

For another, the Commission's exclusive focus on the customers of the two contestants blinds it to economic ramifications meriting its consideration. Specifically, the Commission appears to have ignored the fact that an award to Clark-Cowlitz would (presumably) free up low rate ("Priority Firm") Bonneville power for other customers in the Pacific Northwest. Thus, countervailing the detriment to Pacific Power's customers was not only the benefit to Clark-Cowlitz's customers, but also the benefits presumably accruing to other power customers in the region. The third element of the equation, however, is entirely missing from the balance struck in the Commission's decision.

Finally, FERC's dispositive emphasis on the dislocation attendant to unseating an incumbent licensee appears not to take into account the fact that the energy needs of the region and available sources of power within the region remain constant regardless of which applicant ultimately secures Merwin license. It would seem, in other words, that shifting the control of a single power source in the region does not alter the energy landscape of the region. Subsidized Bonneville power will still exist even if Clark-Cowlitz uses less of that power and replaces it with power from the Merwin project. The benefits (in the form of lower rates) from Bonneville power will presumably remain and find their way to consumers in the region, albeit to different groups of consumers (depending obviously on which applicant receives the Merwin license).

Our observations in this respect should not, however, be misconstrued or overread. We emphatically do not require FERC to embrace any particular economic theory from the range of rational approaches. What we do require is that the Commission come to grips with the obvious ramifications of its approach and address them in a reasoned fashion.

## VI

To summarize our holding, we conclude that neither preclusion nor retroactivity principles prevented FERC from abandoning in the *Merwin* relicensing proceedings the interpretation of section 7(a) it adopted in *Bountiful.* Furthermore, this later interpretation is consistent with Congressional intent embodied in the Federal Power Act and is otherwise reasonable. We conclude, however, that the Commission's analysis of the relative economic impacts of its award of the Merwin license is insufficient to pass muster under the APA. We therefore remand this case to the Commission for further elucidation of its determination that Pacific Power's higher alternative costs justified awarding the license to it. Its order in all other respects is hereby affirmed. *See* 16 U.S.C. § 825*l*(b).

*Judgment Accordingly.*

MIKVA, Circuit Judge, with whom Circuit Judges ROBINSON and EDWARDS join, *dissenting*:

In the seven years since the Federal Energy Regulatory Commission (FERC) determined, with apparent finality, that the municipal preference embodied in the Federal Power Act, 15 U.S.C. § 791a *et seq.* (1982), applies to relicensing proceedings, this case has been beset by an unusual and extended series of twists and turns, confounding the parties as well as this court. In permitting FERC to overrule its prior holding and apply its new interpretation retroactively to petitioner Clark-Cowlitz Joint Operating Agency (Clark-Cowlitz), this court today adds its own contribution to the tortuous unfolding of this case. The majority's conclusions are marred at every step by skewed articulation of the facts and warped application of the law. The court today manages in one opinion to do violence to principles of preclusion, retroactivity, and statutory interpretation. I dissent.

## I.

### A. *Retroactivity Doctrine and Administrative Adjudications*

The largest part of the court's opinion is devoted to its finding that FERC's applica-

tion of its reversal of field to the parties in *Pacific Power & Light Co.*, 25 F.E.R.C. (CCH) ¶ 61,052, *reh'g denied*, 25 F.E.R.C. (CCH) ¶ 61,290 (1983) (*"Merwin"*), was consistent with principles of retroactivity. The court begins its analysis by citing a "general principle" that retroactive application of a new interpretation announced in an agency adjudication is favored, and prospective application is permissible only if necessary to avoid a "manifest injustice." Majority opinion (Maj. op.) at 1081. There is no such general principle under the law. Courts reviewing an agency's attempt to retroactively apply a new policy announced in an administrative adjudication must make an independent determination whether "the inequity of retroactive application [is] counterbalanced by sufficiently significant statutory interests." *Retail, Wholesale & Dep't Store Union v. NLRB*, 466 F.2d 380, 390 (D.C.Cir.1972). This determination incorporates neither a presumption of retroactive application nor a presumption of prospective application. Rather, as the Supreme Court has made clear, it involves a straight-word balancing test in which the ill effect of retroactive application is weighed against the damage to the statutory design caused by prospective application. *See SEC v. Chenery*, 332 U.S. 194, 203, 67 S.Ct. 1575, 1580, 91 L.Ed. 1995 (1947). It is highly inappropriate for this court to transform this test by adjusting the scales in favor of retroactive application. Moreover, the "manifest injustice" test to which the court refers comes from *Thorpe v. Housing Authority of the City of Durham*, 393 U.S. 268, 89 S.Ct. 518, 21 L.Ed.2d 474 (1969), a case that is completely inapposite. In *Thorpe*, the Court found that it would not be manifestly unjust for the agency to apply a new standard that *already had been established* at the time of the proceeding. The equities are far sharper, and the legal test quite different, when an agency seeks to apply a new standard to the parties to the very adjudication in which the reversal is announced.

As the majority recognizes, the seminal case fixing the law of the circuit for retroactive application of agency adjudications is *Retail, Wholesale & Dep't Store Union v. NLRB*, 466 F.2d 380 (D.C.Cir.1972). In *Retail, Wholesale*, this court refused to give retroactive effect to a new rule adopted in the course of a National Labor Relations Board adjudication. The court listed five factors which courts must put into the balance in determining whether a decision should have retroactive effect:

> (1)whether the particular case is one of first impression, (2) whether the new rule represents an abrupt departure from well established practice or merely attempts to fill a void in an unsettled area of law, (3) the extent to which the party against whom the new rule is applied relied on the former rule, (4) the degree of the burden which a retroactive order imposes on a party, and (5) the statutory interest in applying a new rule despite the reliance of a party on the old standard.

*Retail, Wholesale*, 466 F.2d at 390. These considerations provide in the context of agency adjudication a way to attend to the principal concerns of retroactivity analysis —"lack of notice and the degree of reliance on former standards." *Id.* at 390 n. 22. The *Retail, Wholesale* test attempts to reconcile the interests of the litigants with the overall public interest in effectuation of a statutory scheme: retroactive application is appropriate only if the court is satisfied that the prejudice to parties who justifiably relied on the previous standard is outweighed by the need to advance the statutory purpose which the new rule will serve. *See McDonald v. Watt*, 653 F.2d 1035, 1045 (5th Cir.1981); *Sierra Club v. EPA*, 719 F.2d 436, 468 (D.C.Cir.1983).

The *Retail, Wholesale* test is specifically adapted to the unique circumstances of agency attempts to retroactively apply a new policy announced in an administrative adjudication. Although the principles of retroactive application of judicial decisions serve as a general guide in the context of administrative adjudications, 4 K. Davis, *Treatise on Administrative Law* § 20.7, at 23 (2d ed. 1983); *see Daughters of Miriam Center for the Aged v. Matthews*, 590 F.2d 1250, 1259 (3rd Cir.1978), analysis of administrative decisions is colored by agen-

cies' ability to announce new policy via either adjudication or rulemaking. On the one hand, the agency needs and enjoys considerable discretion in choosing which vehicle is the more appropriate for formulating new standards in a given case. *See SEC v. Chenery Corp.*, 332 U.S. 194, 202–03, 67 S.Ct. at 1580 (1947). On the other hand, this flexibility means that an agency is less justified in relying upon adjudication to impose new standards of conduct retroactively, because the agency, unlike courts, has the option to promulgate a rule prospectively and thereby avoid imposing burdens on parties who have relied on the prior standard. *See NLRB v. Majestic Weaving Co.*, 355 F.2d 854, 860 (2d Cir. 1966) (Friendly, J.); Bonfield, *The Federal APA and State Administrative Law*, 72 Va.L.R. 297, 330 (1986).

Several additional principles emerge from cases in which this court has reviewed agency decisions applying a new standard retroactively. First, whether a new standard should be applied is a question of law. Agencies possess no particular expertise on the issue of retroactivity, and reviewing courts in turn have "no overriding obligation of deference" to an agency's decision to give retroactive effect to a new rule. *Retail, Wholesale*, 466 F.2d at 390. Second, agency decisions to apply an order retroactively must be the product of rational analysis, and "the law requires that an agency explain ... how it determined that the balancing of the harms and benefits favors giving a change in policy retroactive application." *Yakima Valley Cablevision, Inc. v. FCC*, 794 F.2d 737, 746 (D.C.Cir. 1986). Third, an agency's failure to consider the less drastic alternative of prospective application may be considered arbitrary and capricious and thus constitute grounds for reversal. *Id.*

B. *Application*

Applying the *Retail, Wholesale* test to the facts of this case compels the conclusion that FERC should not have applied its reversal of policy to Clark-Cowlitz. The first *Retail, Wholesale* factor—whether the particular rule is one of first impression—is anchored in a recognition that "the problem of retroactive application has a somewhat different aspect in cases not of first but of second impression, where an agency alters an established rule defining permissible conduct which has been generally recognized and relied on throughout the industry that it regulates." *NLRB v. Majestic Weaving Co.*, 355 F.2d 854, 860 (2d Cir.1966); *see Retail, Wholesale*, 466 F.2d at 390. Thus, when an agency already has considered the issue and established a firm rule, a court is more likely to require prospective application of the agency's reinterpretation. We have here a classic example of a case of second impression. As the majority observes, *see* Maj. op. at 1076, three years before the orders under review, the Commission convened a special declaratory proceeding for the explicit purpose of resolving the municipal preference issue. It then adopted a clearcut interpretation of section 7(a), and ordered the parties to proceed on the basis of that interpretation. This factor thus weighs squarely on the side of prospective application.

The majority concludes that "inasmuch as *Merwin* was the first proceeding in which FERC announced its reinterpretation, the first *Retail, Wholesale* factor points in favor of retroactive application." Maj. op. at 1082. This conclusion is, simply put, baffling. The majority flatly misinterprets the use of the term "first impression" in *Retail, Wholesale*. Of course *Merwin* was the first proceeding in which FERC announced its reversal; retroactivity analysis assumes that the decision at issue changed the law. *See Retail, Wholesale*, 466 F.2d at 389 (retroactivity analysis permits courts to determine whether to grant or deny retroactive force to *newly established* rules). Thus, the first factor does not look to whether the very decision at issue had ever been articulated before; such an inquiry would make the first factor meaningless. Rather, the court was inquiring whether the agency had previously decided the underlying issue and was now seeking to depart from its previous resolution. Moreover, the court cited the very language from the Supreme Court's opinion in *Chenery* which the majority concedes

contains "the more typical understanding of the term [first impression] as referring to situations in which an agency confronts an issue that it has not resolved before." Maj. op. at 1082 n. 6. Finally, the court in *Retail, Wholesale* noted that it was reviewing "not a case of first, but of *second* impression." *Retail, Wholesale,* 466 F.2d at 390 (emphasis added). The majority thus has indulged in a tendentious and utterly fanciful rewriting of this part of the *Retail, Wholesale* opinion.

The second *Retail, Wholesale* factor requires the court to determine "whether the new rule represents an abrupt departure from well established practice or merely attempts to fill a void in an unsettled area of law." *Retail, Wholesale,* 466 F.2d at 390. If the new rule falls into the former category rather than the latter, it impinges on the "principal concern of [retroactivity analysis]—lack of notice and the degree of reliance on former standards." *Id.* n. 22. The Commission's about-face in *Merwin* falls more naturally into the first category rather than the second. Unlike the agency in *Chenery,* in which retroactive application was allowed, FERC was not "filling in the interstices of the Act." 332 U.S. at 202, 67 S.Ct. at 1580. Rather, as in *Retail, Wholesale,* in which retroactive application was refused, it was announcing a 180-degree turnaround from a prior clear standard. *See Retail, Wholesale,* 466 F.2d at 391. The Commission previously had given careful consideration to the issue—conducting an unprecedented full day of oral argument—and then determined unanimously that the municipal preference applies to relicensing proceedings. The majority points out that only three years elapsed in this case between the agency's initial determination and its subsequent reversal, whereas the interval in *Retail, Wholesale* was seven years. Besides the fact that the difference in intervals is hardly dramatic, the majority's position falsely equates "well established" with "longstanding." The firmness of a precedent may, but need not, be connected to its longstandingness. Indeed, the majority's assumption that more recent precedent is somehow "soft" is inimical to the rule of law. In this case, the question had been conclusively settled when the Commission announced a sudden and complete reversal of field. Thus, the second factor also cuts in favor of prospective application.

The third *Retail, Wholesale* factor is the extent of Clark-Cowlitz's reliance on the Commission's decision in *City of Bountiful, Utah,* 11 F.E.R.C. (CCH) ¶ 61,337 (June 27, 1980), *reh'g denied,* 12 F.E.R.C. (CCH) ¶ 61,179 (Aug. 21, 1980) (*"Bountiful"*). This third factor also counsels in favor of prospective application. The majority concludes that Clark-Cowlitz could only have reasonably relied on the prior interpretation until May of 1983, when the Solicitor General revealed FERC's dissatisfaction with the result in *Bountiful.* Such a degree of reliance admittedly would be modest, although not impalpable. However, Clark-Cowlitz's reliance reasonably extended considerably beyond May of 1983. To see why this is so, it is necessary to fill in somewhat the majority's statement of facts, which omits a few critical details that demonstrate that Clark-Cowlitz's reasonable reliance on the *Bountiful* decision was significant.

In its unanimous decision in *Bountiful,* the Commission included an order that all pending relicensing applications "go forward in light of this declaratory order." 11 F.E.R.C. (CCH) ¶ 61,337 at 61,736. In accord with the Commission's directive, Clark-Cowlitz filed in October of 1980 the first of two motions requesting a hearing on the Merwin license. The Commission also specifically declined to postpone the hearing pending judicial review of *Bountiful.* See J.A. 289. Thus, although the majority discounts them, Clark-Cowlitz's preliminary efforts after the successful resolution of *Bountiful* were certainly in reasonable reliance on (indeed, mandated by) the *Bountiful* decision, and in fact they enabled Clark-Cowlitz to become the first (and, given subsequent events, the only) municipal applicant to proceed to a hearing in a competitive relicensing proceeding.

Three days after the decision of the Eleventh Circuit (before whom the Commission strenuously and successfully defended its

position in *Bountiful*), the *Merwin* hearing convened. Both parties agreed that the municipal preference applied to the *Merwin* proceeding and focused only on the remaining statutory issue under 7(a)—whether the two entities were "equally well adapted to conserve and utilize the water resources of the region." Joint Statement of Major Contested Issues, *reprinted in* J.A., at 298–300. Clark-Cowlitz's efforts at this hearing therefore also were taken in reliance on *Bountiful*. The Administrative Law Judge concluded that the two applicants were equally well adapted to conserve and utilize the region's water resources. He therefore applied the municipal preference and entered an order awarding the license to Clark-Cowlitz. Pacific Power immediately appealed to the Commission on the ground that it was the superior candidate and therefore deserved the license notwithstanding the municipal preference.

To this point the *Merwin* controversy had been an unremarkable outgrowth of the Commission's original decision in *Bountiful;* with Clark-Cowlitz having gone a fair way towards securing the license, however, the case began to take on unusual convolutions. The Commission had undergone a substantial change in personnel following the 1980 election. Three days before the ALJ's decision in *Merwin*, the reconstituted Commission met in secret session. *See Clark-Cowlitz Joint Operating Agency v. FERC*, 798 F.2d 499 (D.C. Cir.1986). As the Commission later revealed, at that closed meeting a majority of the Commissioners registered disagreement with their predecessors' decision in *Bountiful*. They voted to ask the Solicitor General to recommend that the Supreme Court grant the private utilities' pending petitions for certiorari and remand the case to the Commission. *See* Brief for the Federal Energy Regulatory Commission on Petitions for a Writ of Certiorari at 8, *Utah Power & Light Co. v. FERC*, 463 U.S. 1230, 103 S.Ct. 3573, 77 L.Ed.2d 1415 (1983), *reprinted in* J.A. 106, at 107. A principal reason for this request was the Commission's conviction that if certiorari were denied, the *Bountiful* decision would be binding as to applicants who participated in *Bountiful* under principles of res judicata. *See id.*, J.A. at 106–07. The Solicitor did not comply precisely with the Commission's request. Instead, he urged the Supreme Court to remand the case to the Eleventh Circuit for reconsideration in light of "intervening circumstances"—to wit, the fact that "a majority of the Commissioners, four of whom were appointed after the issuance of [*Bountiful*], expressed their disagreement with the Commission's earlier position in these orders." *Id.*, J.A. at 106. The Supreme Court, however, denied certiorari. *See Utah Power & Light Co. v. FERC*, 463 U.S. 1230, 103 S.Ct. 3573, 77 L.Ed.2d 1415 (1983).

The denial of certiorari might have appeared to quiet any potential argument against granting Clark-Cowlitz a license to operate the *Merwin* Project. A majority of the Commission, however, decided to continue to pursue its opposition to the municipal preference. In its review of the ALJ's decision in *Merwin*, the Commission, in a 3–2 decision, simply overruled *Bountiful*. 25 F.E.R.C. (CCH) ¶ 61,052 (Oct. 7, 1983). Although the majority obscures this vital fact, the Commission's volte-face was completely unforeshadowed: the *Bountiful* interpretation had never been challenged during the course of the *Merwin* litigation, the parties had not briefed it, and the Commission had given no indication that the issue might even be *open* for reconsideration.

The above scenario differs materially from that obtaining in other proceedings in which a rule is changed. Normally parties will be on notice that the previous interpretation is subject to revision in that proceeding; any reliance on the old standard in the party's litigation efforts therefore would be unreasonable. Here, however, the parties had no notice that FERC considered *Bountiful* to be open for reconsideration in *Merwin* and thus reasonably proceeded on the assumption that the municipal preference applied. Moreover, the Commission's request for certiorari only made it more reasonable to rely on *Bountiful*, because the Commission had indicated that the mu-

nicipal preference certainly would apply to pending relicensing proceedings if the Court denied the application, as it did. Thus, under the unusual facts of this case, Clark-Cowlitz's efforts during the course of the *Merwin* proceeding must also be counted as part of its reasonable reliance on the Commission's decision in *Bountiful.*

In the three years between the Commission's proclamations in *Bountiful* and *Merwin*, Clark-Cowlitz relied on the established standard to a degree unique among the many municipal suitors for expiring licenses. Clark-Cowlitz was the only municipal applicant to proceed to hearing in a competitive relicensing proceeding. The municipality's efforts to get the Commission to schedule a hearing, as well as the two-year course of the *Merwin* proceeding, entailed a substantial outlay of time and money. Clark-Cowlitz participated in voluminous discovery, engaged experts in several fields, prepared memoranda and four briefs (none of which addressed the supposedly settled municipal preference issue), and presented its case in prehearing conferences and the actual hearing before the ALJ. This reliance was significant, especially for a municipal applicant of limited resources. The third *Retail, Wholesale* factor therefore cuts distinctly in favor of prospective application.

The degree of burden which the retroactive order imposes on Clark-Cowlitz, the fourth *Retail, Wholesale* factor, also counsels in favor of prospective application. Clark-Cowlitz is a municipal corporation formed for the express purpose of seeking the *Merwin* license. Deprivation of that license—the effect of applying the Commission's order retroactively—is therefore quite a severe hardship for the municipality. It thwarts the single purpose which is quite literally Clark-Cowlitz's raison d'etre.

The first four factors, which gauge the litigants' personal interest in not being judged under a newly announced standard, thus present a fairly compelling case for prospective application. Although there is room for reasonable disagreement as to the force of some of these factors in the instant case, the important point, which the majority fails to recognize, is that whatever the impact of the first four factors, retroactive application is appropriate only if the court finds that the first four factors are counterbalanced by the fifth factor—the statutory interest in applying a new rule. "Unless the burden of imposing the new standard is *de minimis*, or the newly discovered statutory design compels its retroactive application, the principles which underlie the very notion of an ordered society, in which authoritatively established rules of conduct may fairly be relied upon, must preclude its retroactive effect." *Retail, Wholesale*, 366 F.2d at 392. *See id.* at 390 ("courts have not infrequently declined to enforce administrative orders when in their view the inequity of retroactive application has not been counterbalanced by sufficiently significant statutory interests."); *see also Sierra Club v. EPA*, 719 F.2d 436, 468 (D.C.Cir.1983), *cert. denied*, 468 U.S. 1204, 104 S.Ct. 3571, 82 L.Ed.2d 870 (1984) ("The statutory interest in applying the new rule despite individual reliance is, of course, the crucial consideration in the context of requiring an agency to apply one of its rules retroactively."). In this case, the majority makes no such finding, nor could it, because there is no statutory interest in retroactive application.

Normally, of course, assuming a new interpretation is not unfaithful to the statutory scheme, there will be some statutory interest in retroactive application, and the court must weigh that interest against the ill effects of retroactivity. *See Chenery*, 332 U.S. 194, 203, 67 S.Ct. 1575, 1580, 95 L.Ed. 1995 (1947). In this respect, however, as in so many others, this case is a true rara avis. The current statutory scheme *specifically disavows* any interest in denying Clark-Cowlitz the benefit of the municipal preference. With the Electric Consumers' Protection Act, Congress has amended the Federal Power Act so as to remove the municipal preference from all pending relicensing proceedings with one explicit exception: the Merwin project. *See* 100 Stat. 1243 § 11. Congress has pointedly informed us, with truly unusual specificity, that it has no preference one way or the other as to whether Clark-Cowl-

itz receives the benefit of the municipal preference. Thus, retroactive application of the Commission's decision in *Merwin* could not possibly advance any statutory benefit to offset the considerable harm it would do to Clark-Cowlitz. *Cf. Mullins v. Andrus*, 664 F.2d 297, 304 (D.C.Cir.1980) (no statutory objectives to be served where new statutory machinery is in place). Moreover, in this respect, as in respect to its degree of reliance, Clark-Cowlitz is unique among the many municipalities that participated in *Bountiful*.

The majority nevertheless concludes that there is a statutory interest in retroactive application. The majority reasons that, "[w]ithholding retroactive application would grant Clark-Cowlitz a 30-year benefit to which *FERC now believes* it is not entitled. The overriding Congressional interest in ensuring that the best qualified contestant (*as FERC sees it*) operate hydroelectric power projects, in other words, would not be fulfilled at the Merwin site for three decades." Maj. op. at 1085 (emphasis added). But this no more than restates FERC's decision adverse to Clark-Cowlitz. It in no way speaks to *Congress'* interest in having the new standard apply retroactively to Clark-Cowlitz. If the agency can simply reiterate its decision on the merits as the statutory interest in retroactive application, then the fifth *Retail, Wholesale* factor is meaningless. In fact, it is our province to determine whether retroactive application advances the statutory interest and in this case there is an extraordinarily clear answer in the text of the amended Federal Power Act: retroactive application of FERC's interpretation in no way advances Congress' statutory design.

Finally, it must be noted that the majority is not deferring to the Commission's reasoning for applying *Merwin* retroactively. The Commission offered no reasoning at all. It simply applied its unanticipated reversal to Clark-Cowlitz without giving any consideration whatsoever to prospective application. Indeed, the Commission gave no thought to prospective application even though it determined to overrule *Bountiful* "so that the correct preference provision will be applied in *future relicensing proceedings*." *Merwin*, 25 F.E.R.C. ¶ 61,052, at 61,177 (emphasis added). In supplying reasoning for the Commission, the majority completely ignores that "the law requires that an agency explain ... how it determined that the balancing of harms and benefits favors giving a change in policy retroactive application." *Yakima Valley Cablevision, Inc. v. FCC*, 794 F.2d 737, 746 (D.C.Cir.1986). The court at the very least should reverse and remand to the agency for an explanation of its decision. On this ground alone, today's decision is manifestly unjust.

In sum, this is a case in which "the prospectivity side of the scale [is] full and the retroactivity side empty." *McDonald v. Watt*, 653 F.2d 1035, 1046 (5th Cir.1981). Moreover, the Commission did absolutely nothing to fulfill its legal obligation to explain why it opted for retroactive application. Under such circumstances, the Commission's application of its new interpretation to Clark-Cowlitz can only be adjudged to be the type of retroactivity which is condemned by law.

The majority also rejects Clark-Cowlitz's argument that principles of collateral estoppel dictate that it have the benefit of the municipal preference in the competition for the Merwin license. My objection to this section of the majority opinion is less with its conclusions than with its premises. In deciding that FERC did not become bound to apply the municipal preference by virtue of the Eleventh Circuit's decision in *Alabama Power v. FERC*, 685 F.2d 1311 (11th Cir.1982), *cert. denied*, 463 U.S. 1230, 103 S.Ct. 3573, 77 L.Ed.2d 1415 (1983), the court is attacking a paper tiger. The more important and interesting issue for purposes of preclusion doctrine is whether Pacific Power & Light is precluded from reaping the benefit of FERC's volte-face by virtue of FERC's decision in *Bountiful*. I conclude that Pacific Power & Light is so precluded and that Clark-Cowlitz, having once successfully litigated the municipal preference issue with respect to its pending application for the Merwin license, cannot

now be denied the fruits of its earlier victory.

The guiding principle for application of preclusion doctrine to agency adjudications is that "res judicata applies when what the agency does resembles what a trial court does. Such a resemblance or lack of it applies to determinations of law as well as to determinations of fact." K. Davis, 4 *Administrative Law Treatise* 52 (2d ed. 1983). *Bountiful*, it will be remembered, was a separate declaratory proceeding that progressed to final judgment. If the *Bountiful* declaratory proceeding had taken place in federal court, as it certainly could have, the litigants would be bound by the ultimate determination that the municipal preference applies in relicensing proceedings. That is not to say that a court—or in this case FERC—could not later, subject to the principles of stare decisis, decide to adopt the opposite view. But such a subsequent revision could not change the original outcome as to the original parties. If parties' fates could be so put at the mercy of subsequent revision, it would decimate the policies that preclusion doctrine is designed to advance: protection from the vexation and expense of repetitious litigation, promotion of confidence in the conclusiveness of decisions, and, especially, securing of peace and repose of society. Thus, while FERC may be entitled to change its interpretation of the Federal Power Act, its ability to revise its view does not extend to undoing the preclusive effect of a declaratory order resolving a ripe controversy.

As the majority points out, underlying the rule of issue preclusion is the principle that "one who has actually litigated an issue should not be allowed to relitigate it." Restatement (Second) of Judgments 6 (1982). Yet Clark-Cowlitz and Pacific Power & Light did actually litigate the municipal preference issue in *Bountiful*. Clark-Cowlitz and Pacific Power & Light were competitors in a pending relicensing hearing that was suspended to resolve the municipal preference issue in a declaratory proceeding. The two parties litigated vigorously—all the way to the Supreme Court—with the reasonable expectation it would resolve the crucial issue in their ongoing controversy. Thus, Clark-Cowlitz and Pacific Power & Light have been afforded an adequate opportunity to litigate a ripe claim before an administrative tribunal. This court therefore does violence to the principles underlying preclusion doctrine by permitting Pacific Power & Light not to be bound by the decision in *Bountiful*.

The majority argues in one of its footnotes that preclusion should not apply because it was FERC, and not Pacific Power, that changed its position:

> Thus, to the extent preclusion analysis is appropriate at all, it is applicable to the extent that FERC participated as a party before the Eleventh Circuit.

Maj. Op. at 1080 n. 5. FERC is the *named party* in the Eleventh Circuit proceedings and participated fully as it had to do. The issue of municipal preference went to final judgment, and certiorari was denied. Everybody, including FERC, Pacific Power and Clark-Cowlitz, assumed that with the denial of certiorari the issue of municipal preference was finally resolved as to Clark-Cowlitz. The majority's effort to rebut this point raises sophistry to a new pinnacle—surpassed only by the alternative position advanced by the court to justify in general the curious procedures of FERC. If we allowed preclusion, says the court, it would benefit Clark-Cowlitz over the other municipalities that participated in *Bountiful*—and burden Pacific Power over the other utilities involved in *Bountiful*. The court even cites the reason for such disparity, but gives it no weight: the passage by Congress of a law which *specifically* put Clark-Cowlitz and Pacific Power in a category separate from the other parties. It is appropriate that such a rebuttal to the dissent's concerns is expressed in a footnote.

The court's decision also will greatly undermine parties' confidence in the valuable tool of administrative declaratory proceedings. *See* 5 U.S.C. § 554(e) (1982). Henceforth, parties will be justifiably concerned that such proceedings, even of the scope and effort that characterized *Bountiful*, may in fact be mere dress rehearsals whose result as to the parties is subject to

complete reversal in a subsequent adjudication. The court's result thus works a substantial disservice to both preclusion doctrine and administrative law.

## II.

The question of the merits of FERC's reinterpretation of the Federal Power Act has been rendered virtually academic by virtue of the Electric Consumer Protection Act of 1986, Pub.L. No. 99-495, 100 Stat. 1243. While carefully excepting the controversy at bar from its provision, Congress now has provided that the municipal preference will not apply to future relicensing proceedings. The majority's analysis of the unamended Federal Power Act, however, suffers from two flaws so substantial that I must dissent from that portion of the opinion as well.

First, in upholding FERC's new interpretation, the majority relies heavily on the distinctions between *entertaining applications* for a license—i.e., the process of selecting a licensee—and the process of actually *issuing* a license. The majority suggests that section 7(a) of the Act must be read to refer to the latter process in order to give full meaning to the statute. In fact, such a reading leaves the statute meaningless. The municipal preference obviously is intended to be used in the decision-making process as a tiebreaking device to select one licensee from among equally well-adapted candidates. It makes no sense to say that FERC can first decide to whom to award a license and *then* apply the municipal preference to the formal act of issuing the license. The municipal preference must come into play in determining which candidate wins the competition, not in awarding the prize. The majority's analysis on this point is untenable.

The second flaw in the majority's review comes in its determination that the *Merwin* proceeding arose under the second half of section 7(a)—the "as between other applicants" clause. The majority already has detailed one problem with its interpretation: the second clause of 7(a) refers to "other applicants." The obvious meaning of this phrase is "applicants other than municipal entities," and Clark-Cowlitz is a municipal entity. But there is a more subtle, although no less significant, problem with the majority's analysis. A careful reading of section 7(a) demonstrates that a proceeding cannot arise under the second half of that provision. Section 7(a) first specifies three situations to which it pertains. It then instructs FERC how to proceed in any of these situations, depending on the identity of the applicants. Those instructions are: 1) if an equally well-adapted state or municipality is among the applicants, award it the license; 2) as between other applicants, the Commission may give preference to the best-adapted candidate as defined in the clause. In short, the "as between other applicants" clause refers back to the three situations section 7(a) addresses; it is not a general catch-all clause designed to cover any and all other situations. Thus, FERC's decision to rely on the "as between other applicants" clause as a separate jurisdictional provision, and the court's deference to that decision, are at odds with Congress' statutory scheme.

## III.

The rule of law is premised on a concept of reliance. Courts and policymakers have struggled to give full measure to that concept, while recognizing that the results are not always comfortable for society. Retroactivity conflicts are particularly acute when an administrative agency seeks to balance the need for flexibility and change in the administrative law sector with the parties' right to rely on what the agency has said and done previously. Here FERC generated considerable reliance on a rule it then proceeded to reverse without notice. The retroactive application of its new standard to Clark-Cowlitz was unlawful and unreasoned. It also violated well-established principles of preclusion doctrine. Finally, it was premised on a statutory inter-

pretation that at least in some respects was unreasonable. Although Congress' recent amendment to the Federal Power Act has greatly diminished the scope of the dispute, the court today works a grave disservice to the one municipal applicant who still has a right, preserved by statute, to have its application decided under FERC's prior interpretation.

*I dissent.*

**NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, et al., Petitioners,**

**v.**

**FEDERAL COMMUNICATIONS COMMISSION and the United States of America, Respondents,**

**GTE Service Corp., et al., National Telephone Cooperative Association, et al., American Telephone & Telegraph Co., Ameritech Operating Co., Mountain States Telephone & Telegraph Co., et al., Satellite Business Systems, U.S. Telephone Association, Telecommunication Research & Action Center, South Central Bell Telephone Co., Southwestern Bell Telephone Co., Intervenors.**

**AMERICAN TELEPHONE AND TELEGRAPH COMPANY, Petitioner,**

**v.**

**FEDERAL COMMUNICATIONS COMMISSION and the United States of America, Respondents,**

**U.S. Telephone Association, GTE Service Corp., et al., Mountain States Telephone & Telegraph Co., et al., Bell Operating Companies, Southwestern Bell Telephone Co., Intervenors.**

**The MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY, et al., Petitioners,**

**v.**

**FEDERAL COMMUNICATIONS COMMISSION and the United States of America, Respondents,**

**GTE Service Corp., et al., Ameritech Operating Co., American Telephone & Telegraph Co., Bell Operating Companies, Southwestern Bell Telephone Co., Intervenors.**

**PACIFIC BELL, et al., Petitioners,**

**v.**

**FEDERAL COMMUNICATIONS COMMISSION and the United States of America, Respondents,**

**GTE Service Corp., et al., Mountain States Telephone & Telegraph Co., et al., Ameritech Operating Co., American Telephone & Telegraph Co., Bell Operating Companies, Southwestern Bell Telephone Co., Intervenors.**

**Nos. 85-1087, 85-1457, 85-1471, 85-1472.**

United States Court of Appeals, District of Columbia Circuit.

Argued Oct. 30, 1986.

Decided Aug. 21, 1987.

AT&T and numerous former AT&T operating telephone companies petitioned for review of FCC order requiring them to grant rate reduction. The Court of Ap-

ments are constitutionally forbidden not only for the reasons stated in Brown v. Board of Education, 347 U.S. 483, 74 S.Ct. 686, 98 L.Ed. 873, but also because petitioners are thereby prevented from taking certain courses offered only at another high school limited to white students, see State of Missouri ex rel. Gaines v. Canada, 305 U.S. 337, 59 S.Ct. 232, 83 L.Ed. 208; Sipuel v. Board of Regents, 332 U.S. 631, 68 S.Ct. 299, 92 L.Ed. 247; Sweatt v. Painter, 339 U.S. 629, 70 S.Ct. 848, 94 L.Ed. 1114. Petitioners are entitled to immediate relief; we have emphasized that "[d]elays in desegregating school systems are no longer tolerable." Bradley v. School Board, 382 U.S. 103, at 105, 86 S.Ct. 224, at 226. Pending the desegregation of the public high 200 schools of Fort Smith according to a general plan consistent with this principle, petitioners and those similarly situated shall be allowed immediate transfer to the high school that has the more extensive curriculum and from which they are excluded because of their race.

[5] 3. From the outset of these proceedings petitioners have challenged an alleged policy of respondents of allocating faculty on a racial basis. The District Court took the view that petitioners were without standing to challenge the alleged policy, and accordingly refused to permit any inquiry into the matter. The Court of Appeals sustained this ruling, holding that only students presently in desegregated grades would have the standing to make that challenge. 345 F.2d 117, 125. We do not agree and remand for a prompt evidentiary hearing on this issue.

[6] Even the Court of Appeals' requirement for standing would be met on remand since petitioners' transfer to the white high school would desegregate their grades to that limited extent. Moreover, we reject the Court of Appeals' view of standing as being unduly restrictive. Two theories would give students not yet in desegregated grades sufficient interest to challenge racial allocation of faculty: (1) that racial allocation of faculty denies them equality of educational opportunity without regard to segregation of pupils; and (2) that it renders inadequate an otherwise constitutional pupil desegregation plan soon to be applied to their grades. See Bradley v. School Board, supra. Petitioners plainly had standing to challenge racial allocation of faculty under the first theory and thus they were improperly denied a hearing on this issue.

Vacated and remanded.

Mr. Justice CLARK, Mr. Justice HARLAN, Mr. Justice WHITE and Mr. Justice FORTAS would set the case down for argument and plenary consideration.

382 U.S. 223

**UNITED GAS IMPROVEMENT CO. et al., Petitioners,**

**v.**

**CALLERY PROPERTIES, INC., et al.**

**PUBLIC SERVICE COMMISSION OF the STATE OF NEW YORK, Petitioner,**

**v.**

**CALLERY PROPERTIES, INC., et al.**

**OCEAN DRILLING & EXPLORATION COMPANY, Petitioner,**

**v.**

**FEDERAL POWER COMMISSION et al.**

**FEDERAL POWER COMMISSION, Petitioner,**

**v.**

**CALLERY PROPERTIES, INC., et al.**

**Nos. 21, 22, 26 and 32.**

Argued Oct. 18, 19, 1965.

Decided Dec. 7, 1965.

Rehearings Denied Jan. 17, 1966.
See 382 U.S. 1001, 86 S.Ct. 526.

Proceedings on petition for review of orders of the Federal Power Commission. The United States Court of Appeals for the Fifth Circuit, 335 F.2d 1004, reversed and remanded the orders,

and certiorari was brought. The Supreme Court, Mr. Justice Douglas, held that Federal Power Commission has ample authority to attach appropriate protective conditions to issuance of certificate for sale of gas, and Commission had authority to temporarily bar, for protection of consumers, rate increases by natural gas companies beyond 23.55 cents per Mcf. pending a determination of just and reasonable rates, and Commission could properly conclude that public interest required natural gas producers to make refunds for period in which they sold their gas at prices exceeding those properly determined to be in the public interest.

Reversed.

Mr. Justice Harlan dissented in part.

**1. Gas ⚷14.3(3)**

Federal Power Commission need not permit gas to be sold in interstate market at producer's contract price pending a determination of just and reasonable rates. Natural Gas Act, § 5, 15 U.S.C.A. § 717d.

**2. Gas ⚷6**

Federal Power Commission has ample authority to attach appropriate protective conditions to issuance of certificates for sale of gas. Natural Gas Act, § 7(e), 15 U.S.C.A. § 717f(e).

**3. Gas ⚷14.3(2)**

Federal Power Commission can properly conclude that adequate protection to public interest requires as an interim measure that natural gas not enter interstate market at prices higher than existing level. Natural Gas Act, § 7, 15 U.S.C.A. § 717f.

**4. Gas ⚷14.3(3)**

Federal Power Commission had authority to temporarily bar, for protection of consumers, rate increases by natural gas companies beyond 23.55 cents per Mcf. pending a determination of just and reasonable rates. Natural Gas Act, § 7(e), 15 U.S.C.A. § 717f(e).



**5. Gas ⚷14.6**

While Federal Power Commission has no authority to make reparation orders, its power to fix rates being prospective only, it is not so restricted where its order, which never became final, has been overturned by reviewing court. Natural Gas Act, § 5, 15 U.S.C.A. § 717d.

**6. Administrative Law and Procedure ⚷491**

An agency, like a court, can undo what is wrongfully done by virtue of its order.

**7. Gas ⚷14.6**

Federal Power Commission could properly conclude that public interest required natural gas producers to make refunds for period in which they sold their gas at prices exceeding those properly determined to be in the public interest. Natural Gas Act, §§ 4(d, e), 5, 7(e), 15 U.S.C.A. §§ 717c(d, e), 717d, 717f(e).

**8. Gas ⚷14.6**

Federal Power Commission could properly measure refunds due from natural gas producers to customers for periods in which producers sold their gas at prices exceeding those properly determined to be in the public interest by the difference between rates charged and "in-line" rates to which the original certificates should have been conditioned. Natural Gas Act, §§ 5, 7(e), 15 U.S.C.A. §§ 717d, 717f(e).

**9. Gas ⚷14.6**

Duty of Federal Power Commission where refunds are found to be due is to direct their payment at earliest possible moment consistent with due process.

**10. Gas ⚷14.6**

Where excessive natural gas rates had been collected by producers since 1958, Federal Power Commission was not required to delay refunds further.

**11. Gas ⚷14.6**

Imposition of interest on refunds due from producers of natural gas to cus-

tomers for overcharges was an appropriate means of preventing unjust enrichment.

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Richard A. Solomon, Washington, D. C., for Federal Power Commission.

William T. Coleman, Jr., Philadelphia, Pa., for United Gas Improvement Co. and others.

Kent H. Brown, Albany, N. Y., for Public Service Comm'n of New York.

J. Evans Attwell, Houston, Tex., for Ocean Drilling & Exploration Co.

Herbert W. Varner, Houston, Tex., for Superior Oil Co. and others.

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Richard F. Generelly, Washington, D. C., for Callery Properties, Inc. and others.

Paul W. Hicks, Dallas, Tex., for Placid Oil Co. and others.

Mr. Justice DOUGLAS delivered the opinion of the Court.

The Federal Power Commission in 1958–1959 granted unconditional certificates of public convenience and necessity to numerous producers of gas in south Louisiana, the sales contracts of the producers calling for initial prices ranging from 21.4 cents to 23.8 cents per Mcf. After deliveries commenced under those contracts, consumer interests challenged the orders in various courts of appeals. The Court of Appeals for the Third Circuit sustained the Commission's action (United Gas Improvement Co. v. Federal Power Comm'n, 3 Cir., 269 F.2d 865) but we vacated the judgment (Public Service Comm'n of State of New York v. Federal Power Comm'n, 361 U.S. 195, 80 S.Ct. 292, 4 L.Ed.2d 237) for reconsideration in light of Atlantic Refining Co. v. Public Service Comm'n (CATCO), 360 U.S. 378, 79 S.Ct. 1246, 3 L.Ed.2d 1312; and the other courts of appeals did likewise.[1]

The Commission thereupon instituted an area rate proceeding for south Louisiana and consolidated the remanded

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cases with that proceeding. 25 F.P.C. 942. It advised the producers of their potential obligation to refund any amounts eventually found to be inconsistent "with the requirements of the public interest and necessity" under § 7 of the Natural Gas Act, 52 Stat. 824, as amended, 15 U.S.C. § 717f. 27 F.P.C. 15. Later the Commission in the interest of expedition severed the present group of applications and set them for a hearing in a consolidated proceeding under § 7. 27 F.P.C. 482. At the end, the Commission imposed two conditions on the certificates granted in these cases. *First,* it provided that the producers commence service at 18.5 cents per Mcf., plus 1.5 cents tax reimbursement where applicable, a price that it found to be "in line" with prices for Commission-certificated sales of gas from the southern Louisiana production area under generally contemporaneous contracts, 30 F.P.C. 283, 288–289. *Second,* it provided that until just and reasonable area rates are determined for south Louisiana, or until July 1, 1967, whichever is earlier, the producers shall not file any increased rates above 23.55 cents, the level at which rate filings might trigger increased rates by other producers under the escalation provisions of their contracts with the pipeline companies here involved. 30 F.P.C. 283, 298.

In addition, the Commission ordered the producers to refund to their customers the amounts in excess of the proper initial price which they had already col-

1. See United Gas Improvement Co. v. Federal Power Comm'n, 9 Cir., 283 F.2d 817; Public Service Comm'n of State of New York v. Federal Power Comm'n, 109 U.S. App.D.C. 292, 287 F.2d 146; United Gas Improvement Co. v. Federal Power Comm'n, 10 Cir., 287 F.2d 159; United Gas Improvement Co. v. Federal Power Comm'n, 5 Cir., 290 F.2d 133; and United Gas Improvement Co. v. Federal Power Comm'n, 5 Cir., 290 F.2d 147.

lected under the original certificate. 30 F.P.C. 283, 290.

On review the Court of Appeals held that the Commission erred in limiting producers to an initial "in-line" price without first canvassing evidence bearing on the question of what would be a just and reasonable price for the gas. It further held that the Commission had no power to place an upper limit on future rates that a producer might file. Finally, the Court of Appeals, while

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upholding the power of the Commission to order refunds, held that the measure of such refunds was not to be the difference between the "in-line" price and the original contract price, but between the latter and the just and reasonable price subsequently to be fixed. 335 F.2d 1004. We granted certiorari, 380 U.S. 931, 85 S.Ct. 935, 13 L.Ed.2d 820. We reverse the Court of Appeals.

[1-3] We think the Commission acted lawfully and responsibly in line with our decision in the CATCO case where we held that it need not permit gas to be sold in the interstate market at the producer's contract price, pending determination of just and reasonable rates under § 5, 52 Stat. 823, 15 U.S.C. § 717d, 360 U.S. 378, 388-391, 79 S.Ct. 1246, 1253-1255. Rather, we held that there is ample power under § 7(e),[2] to attach appropriate protective conditions. And see Federal Power Comm'n v. Hunt, 376 U.S. 515, 524-527, 84 S.Ct. 861, 866-868, 11 L.Ed.2d 878. The fixing of an initial "in-line" price establishes a firm price at which a producer may operate, pending determination of a just and reasonable rate, without any contingent obligation to make refunds should a just and reasonable rate turn out to be lower than the "in-line" price. Consumer protection is afforded by keeping the "in-line" price at the level where substantial amounts of gas have been certificated to enter the market under other contemporaneous certificates, no longer subject to judicial review or in any way "suspect." We believe the Commission can properly conclude under § 7 that adequate protection to the public interest requires as an interim measure that gas not enter the interstate market at prices higher than existing levels. To consider in this § 7 proceeding the mass of evidence relevant to the fixing of just and reasonable

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rates under § 5 might in practical effect render nugatory any effort to fix initial prices.[3] We said in CATCO that § 7 procedures are designed "to hold the line awaiting adjudication of a just and reasonable rate" (360 U.S., at 392, 79 S.Ct., at 1255), and that "the inordinate delay" in § 5 proceedings (360 U.S., at 391, 79 S.Ct., at 1255) should not cripple them.

[4] The second condition, which temporarily bars rate increases beyond 23.55 cents per Mcf., was likewise aimed at

2. Section 7(e) provides in part:
"The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require."

3. In the early post-CATCO cases, the Commission apparently proceeded on a case-by-case basis, considering whatever evidence might have been presented. See, e. g., Continental Oil Co., 27 F.P.C. 96, 102-108. Experience convinced it that the minimal utility derived from cost and economic trend evidence was outweighed by the administrative burdens and delays its consideration inevitably produced. See Skelly Oil Co., 28 F.P.C. 401, 410-412. The Commission properly and constructively exercised its discretion in declining to consider this large quantity of evidence. To have done so would have required a considerable expenditure of manpower, cf. State of Wisconsin v. Federal Power Comm'n, 373 U.S. 294, 313, 83 S.Ct. 1266, 1276, 10 L.Ed.2d 357. We have previously encouraged the Commission to devise reasonable means of streamlining its procedures, see Federal Power Comm'n v. Hunt, supra, 376 U.S., at 527, 84 S.Ct., at 868, and we regard the Commission's decision here as an appropriate step in that direction. Cf. Federal Power Comm'n v. Texaco Inc., 377 U.S. 33, 44, 84 S.Ct. 1105, 1112, 12 L.Ed.2d 112.

keeping the general price level relatively constant pending determination of the just and reasonable rate. We noted in Federal Power Comm'n v. Hunt, supra, 376 U.S., at 524, 84 S.Ct., at 867, that "a triggering of price rises often results from the out-of-line initial pricing of certificated gas" and that the possibility of refund does not afford sufficient protection. And see Federal Power Comm'n v. Texaco Inc., 377 U.S. 33, 42–43, 84 S.Ct. 1105, 1110–1111, 12 L.Ed. 2d 112. We think, contrary to the Court of Appeals, that there was ample power under § 7(e) for the Commission to attach these conditions for consumer protection during this interim period though the certificate was not a temporary one, as in Hunt, but a permanent one, 229 as in CATCO and Federal Power Comm'n v. Texaco Inc., supra.

The "in-line" price of 18.5 cents is supported by the contract prices in the south Louisiana area that were not "suspect," and the selection of 23.55 cents beyond which a price increase might trigger escalation reflects the Commission's *expertise*.

[5–7] We also conclude that the Commission's refund order was allowable. We reject, as did the Court of Appeals below, the suggestion that the Commission lacked authority to order any refund. While the Commission "has no power to make reparation orders," Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 618, 64 S.Ct. 281, 295, 88 L.Ed. 333, its power to fix rates under § 5 being prospective only. Atlantic Refining Co. v. Public Service Comm'n, supra, 360 U.S., at 389, 79 S.Ct., at 1254, it is not so restricted where its order, which never became final, has been overturned by a reviewing court. Here the original certificate orders were subject to judicial review; and judicial review at times results in the return of benefits received under the upset administrative order. See Securities & Exchange Comm'n v. Chenery Corp., 332 U.S. 194, 200–201, 67 S.Ct. 1575, 1579–1580, 1760, 91 L.Ed. 1995. An agency, like a court, can undo what is wrongfully done by virtue of its order. Under these circumstances, the Commission could properly conclude that the public interest required the producers to make refunds[4] for the period in which 230 they sold their gas at prices exceeding those properly determined to be in the public interest.

[8–11] We think that the Commission could properly measure the refund by the difference between the rates charged and the "in-line" rates to which the original certificates should have been conditioned. The Court of Appeals would delay the payment of the refund until the "just and reasonable" rate could be determined. We have said elsewhere that it is the duty of the Commission, "where refunds are found due, to direct their payment at the earliest possible moment consistent with due process." Federal Power Comm'n v. Tennessee Gas Transmission Co., 371 U.S. 145, 155, 83 S.Ct. 211, 216, 9 L.Ed.2d 199. These excessive rates have been collected since 1958; under the circumstances, the Commission was not required to delay this refund further. And the imposition of interest on refunds is not an inappropriate means of preventing unjust enrichment. See Texaco, Inc. v. Federal Power Comm'n, 5 Cir., 290 F.2d 149, 157; Philip Carey

4. The problem of refunds for amounts collected above the "in-line" price is not affected here by any filing under § 4 for increases within the limits of the triggering moratorium. 52 Stat. 822, 15 U.S.C. § 717c. Under § 4(d), a 30-day notice to the Commission and to the public is required for all rate increases, the Commission having authority under § 4(e) to suspend the new rate for five months and thereafter to act only "after full hearings." If the Commission has not acted at the expiration of the period of suspension, the new rates become effective. The Commission may require the producer to furnish a bond, and thereafter may compel refund of "the portion of such increased rates or charges by its decision found not justified."

Mfg. Co.; Miami Cabinet Division v. National Labor Relations Board, 6 Cir., 331 F.2d 720, 729–731.

Reversed.

Mr. Justice FORTAS took no part in the consideration or decision of these cases.

Mr. Justice HARLAN, concurring in part and dissenting in part.

While the Commission's expansive view of its powers seems to me largely defensible in the abstract, I believe its actual decision reveals error and unfairness in important respects.

I.

The price condition, alone of the three key prongs of the Commission's order, can in my view be wholly sustained. The chief challenge to it stems from the exclusion

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in the § 7 hearing of a mass of cost and supply-demand evidence tendered by producers.[1] Although the encompassing § 7 standard of public convenience and necessity encourages a broad inquiry, the Commission has given valid reasons for limiting itself to the in-line price for the time being. Area pricing ultimately aims to simplify proceedings under the statute, but the transition to it is said to strain the Commission's present resources for investigation. See State of Wisconsin v. FPC, 373 U.S. 294, 298–300, 313–314, 83 S.Ct. 1266, 1269–1270, 1276–1277, 10 L.Ed.2d 357. The in-line price, comparatively easy to fix, provides a firm basis for producers, helps avoid unrefundable initial overcharges, and exerts a downward pressure on price; at the same time, producers can file increases under § 4 with a six-month delay at most. The Commission has given a fair trial to cost evidence,[2] and nothing in the offer of proof suggests a supply-demand crisis warranting court intervention with this administrative approach.

In locating the in-line price, the Commission has ignored a number of contemporaneous high-price contracts labeled "suspect" because then under review, disapproved, or deemed influenced by those under review or disapproved. Although the danger of using a crooked measuring rod demands some precaution, this blanket exclusion also chances some distortion in favor of an unduly low in-line price. In the main the producers have chosen not to brief this question, apparently under the misapprehension that the Government has not here sought to sustain the exclusion of these contracts or that the lower court's failure to reach the question precluded this Court from doing so.[3] But while the suspect order rule may by default be abided in this instance, I would

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not close the door to future arguments for a different solution of the dilemma.

A last troubling aspect of the in-line price derives from a critical and unusual circumstance: it, like the other conditions in this case, was imposed for the first time on remand, several years after an unconditional permanent certificate had issued. Presumably for six months hence, producers will be compelled to sell at a price they might not have accepted when free to refuse; for all that appears, the price may even be below cost, let alone a fair profit. However, in general the producers apparently did not seek an option to cancel future sales if dissatisfied by the newly conditioned certificates, the six-month delay is both brief and familiar, and I cannot say the Commission did not have a legitimate interest in imposing the in-line price at the time it did.

1. Section citations herein are all to the Natural Gas Act, 52 Stat. 821, as amended, 15 U.S.C. §§ 717–717w (1964 ed.).

2. See the majority's note 3, ante, p. 363.

3. See Petition of the FPC for Certiorari, p. 15, n. 14.

II.

The price-increase moratorium also seems to me a measure not generally beyond the Commission's grasp, but it should not be sustained on the record before us. Recognizing force in the contrary view of the Court of Appeals, I do not believe that § 4 must be read to bestow on producers an invincible right to raise prices subject only to a six-month delay and refund liability. Cf. FPC v. Texaco Inc., 377 U.S. 33, 84 S.Ct. 1105, 12 L.Ed.2d 112; FPC v. Hunt, 376 U.S. 515, 84 S.Ct. 861, 11 L.Ed.2d 878. A freeze until 1967 is not permanent price-fixing, and in this interregnum between individual and area pricing, the hazard of irreversible price increases warrants imposing some brake. A lengthy moratorium—coupled with a refusal to consider cost or supply-demand figures in setting prices for the duration—might present a real risk of choking off supply, but such a case is not before us.

Nevertheless, a moratorium instituted on remand is a hazardous device at best, and the present one is simply not supported by evidence. Because the producers have

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no chance to refuse the certificates after commencing delivery, the ceiling may coerce sales at unfairly low prices. Yet while the present moratorium must be endured longer than the in-line price, at least it permits the producers to charge a markedly higher amount; and as the safety valve for a price explosion, the moratorium could be upheld. At this point, however, the Government's argument fails for lack of proof that a price explosion is likely if increases rise above the moratorium figure. The Commission's figure was not considered by its hearing examiner, who made no recommendation for a moratorium. The Commission report itself devotes no more than one conclusory sentence, qualified by a footnote, to the question of what specific price rise will trigger increases at large, 30 F.P.C., at 298; rather than amplifying, the Government brief merely contends that the point has not been adequately preserved under § 19—a contention I do not accept.[4] Several producers state that the Commission's fear of triggering has not been realized although sales are currently being made by them at levels above the intended moratorium price.

III.

While agreeing that the Commission has power to order refunds in the case before us, I believe the measure of repayment it selected is illogical and harsh. On the initial question of power, it must be conceded that nothing

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in the statute provides for refunds when a sale has been approved without qualification; but approval in the present instances had not become final for want of judicial review, and an equitable power to order refunds may fairly be implied.

The measure of refunds is another matter. The Commission has now directed that the producers repay the difference between the amounts collected over four to six years and the figure it has now established as the original in-line price.[5]

4. This precise ground of attack upon the moratorium was set forth by at least one producer. See ODECO Application for Rehearing Before the FPC. R. 603. Applications of other producers argued instead that any moratorium was plainly illegal under the Fifth Circuit's decision in Hunt v. FPC, 5 Cir., 306 F.2d 334, which had not then been reversed by this Court. 376 U.S. 515, 84 S.Ct. 861, 11 L.Ed.2d 878. See Petition of Placid Oil et al. for Rehearing Before the FPC, p. 35. Under these circumstances, § 19 does not seem to me to preclude allowing all producers the benefit of the error pinpointed by ODECO.

5. Deliveries commenced under all or nearly all the contracts in 1959 at prices exceeding 18.5 cents. The Commission's order directing the in-line price, refunds, and the moratorium issued four years later in 1963, and it has been under judicial review for the past two years. The record does not clearly indicate what rate increases the producers may already have filed with the Commission.

Since the in-line price has been fixed without reference to cost evidence and falls below the opening levels set in the negotiated contracts, the producers may well be receiving less than cost, as some of them expressly claim; and this imposed revision downward of prices covers not six months but a period of years.

The obvious refund formula, implicated by the statute itself and adopted by the Court of Appeals, would call for repayment of all amounts collected in excess of the "just and reasonable" price; that price, measured under §§ 4 and 5, naturally takes due account of costs. The Government retorts that producers have no "right" to sell their gas for a "just and reasonable" price under the statute, a proposition perhaps true in the limited sense that the public convenience and necessity might yet exclude fair-profit sales by a uniquely high cost producer or in the face of a glutted market. No attempt is made, however, to class the present facts with such imaginable situations. Nor is advance exclusion from the interstate

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market so fearsome as an unexpected repricing of a completed sale depriving the seller of profit or costs.

On the present facts the Government has failed to point to any public interest overriding the potent claims of the producers to a fair return on their past four to six years of sales. Any triggering caused by the amounts previously charged has already spent its force and cannot be undone. Unconvincingly, the Government implies the producers may be comparatively well off with the present formula because it provides a final figure now and the "just and reasonable" price might prove to be below the in-line price; however, instant certainty as to past prices is no great gain since taxes and royalties have already been paid, and the chance that producers may get more than they deserve by following the in-line price is not a substitute for assuring them a fair return. About the only concrete advantage cited by the Government for the in-line price is that it speeds refunds to consumers. Assuming that a compromise cannot be reached as in other cases,[6] elaborate cost data should become available in the next year or two with the completion of the southern Louisiana area rate proceeding. Consumers, who assuredly expected no refunds when they paid their gas bills as long ago as six years, certainly do not suffer seriously in waiting a bit longer for refunds that individually must be minute in most cases.

The incongruity of the Commission's refund formula is well portrayed by considering what would have happened if the Commission had originally granted the certificates now thought proper by this Court. By accepting certificates conditioning sales at the in-line price, the producers

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could immediately have filed for increases, suffering at most a six-month delay. Even if the Commission's moratorium survived, the ceiling during this four-to-six-year period would have been 23.55 cents rather than the 18.5-cent figure now imposed. Thus, even had the Commission not erred in the first instance in favor of the producers, they still could have collected payments well in excess of 18.5 cents subject only to the ultimate finding of a "just and reasonable" price now denied them by the Commission.

In line with the foregoing discussion, I would uphold the Commission's decision fixing an in-line price, remand the case for further findings on the triggering price for a moratorium if the Commission wishes to pursue the point, and set aside the refund with leave to order repayments based on the "just and reasonable" price.

6. On several occasions, the Commission has approved agreements by producers to refund a fixed fraction of the difference between the amounts collected and the settlement price. See Texaco Inc., 28 F.P.C. 247 (other producers severed from the instant case); Continental Oil Co., 28 F.P.C. 1090 (on remand from CATCO).

**MCI TELECOMMUNICATIONS CORPORATION, et al., Petitioners,**

**v.**

**FEDERAL COMMUNICATIONS COMMISSION and United States of America, Respondents,**

**Sprint Corporation, et al., Intervenors.**

**Nos. 97-1675, 97-1685, 97-1709 and 97-1713.**

United States Court of Appeals, District of Columbia Circuit.

Argued May 8, 1998.

Decided May 15, 1998

Telephone service providers challenged order of Federal Communications Commission (FCC) setting rate for coinless payphone calls. The Court of Appeals held that: (1) petitions for review were ripe for adjudication, and (2) FCC's explanation of its derivation of rate set for coinless payphone calls was inadequate, necessitating remand.

Petition for review granted in part; cause remanded.

**1. Federal Courts ⟹13**

Petitions for review challenging order of Federal Communications Commission (FCC) setting charge for coinless payphone calls were ripe for adjudication, even though parties other than petitioners had pending petitions for reconsideration before FCC that asserted challenges to same rate; case presented concrete legal issue regarding reasonableness of FCC's methodology in deriving rate, and resolution of pending petitions for reconsideration would benefit from resolution of instant case, particularly given that FCC did not indicate intent to reconsider its rate-setting approach and its treatment of pending petitions would not shed light on issue presented by case. Telecommunications Act of 1996, 47 U.S.C.A. § 276(b)(1)(A).

**2. Telecommunications ⟹336**

Federal Communications Commission's (FCC) explanation of its derivation of rate set for coinless payphone calls was inadequate, necessitating remand, given FCC's failure to explain why market-based rate for coinless calls could be derived by subtracting costs from rate charged for coin calls. Telecommunications Act of 1996, 47 U.S.C.A. § 276(b)(1)(A).

**3. Telecommunications ⟹343**

Despite its finding that Federal Communications Commission (FCC) failed to explain adequately its derivation of rate set for coinless payphone calls, Court of Appeals would exercise its discretion to remand rule for further explanation without vacating it, inasmuch as vacation would leave payphone service providers all but uncompensated for coinless calls made from their payphones and disrupt business plans made on basis of expectation of compensation. Telecommunications Act of 1996, 47 U.S.C.A. § 276(b)(1)(A).

**4. Administrative Law and Procedure ⟹817.1**

One factor Court of Appeals considers in exercising its discretion to remand rule for further explanation without vacating it is the potential for disruption that might be caused by vacating order.

**5. Telecommunications ⟹336**

Federal Communications Commission (FCC) has authority to order refunds when overcompensation has occurred. Communications Act of 1934, § 4(i), 47 U.S.C.A. § 154(i); Telecommunications Act of 1996, 47 U.S.C.A. § 276(b)(1)(A).

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On Petitions for Review of an Order of the Federal Communications Commission.

John B. Morris, Jr. argued the cause for petitioners MCI Telecommunications Corporation, et al., with whom Donald B. Verrilli, Jr., Jodie L. Kelley, H. Richard Juhnke, Jay C. Keithley, Leon M. Kestenbaum, Robert L. Hoggarth, Scott Blake Harris and Kent D. Bressie were on the briefs.

Albert H. Kramer argued the cause for petitioner Illinois Public Telecommunications

Association, with whom Robert F. Aldrich was on the joint briefs.

Kenneth L. Doroshow, Attorney, Federal Communications Commission, argued the cause for respondents. Joel I. Klein, Assistant Attorney General, U.S. Department of Justice, Robert B. Nicholson and Robert J. Wiggers, Attorneys, Christopher J. Wright, General Counsel, Federal Communications Commission, Daniel M. Armstrong, Associate General Counsel, John E. Ingle, Deputy Associate General Counsel, and Laurel R. Bergold, Counsel, were on the brief. Laurence N. Bourne, Counsel, entered an appearance.

Michael K. Kellogg argued the cause for intervenors Ameritech Corporation, et al., with whom Albert H. Kramer, Robert F. Aldrich, Richard P. Bress, Karen Brinkmann and Bruce W. Renard were on the brief.

Danny E. Adams, Steven A. Augustino, James S. Blaszak, Carl W. Northrop, E. Ashton Johnston, Robert M. McDowell, Charles H. Helein, Daniel R. Barney, Robert Digges, Jr., Sarah F. Seidman, Howard J. Symons, David W. Carpenter, Mark C. Rosenblum, Genevieve Morelli, John J. Heitmann, Dana Frix, James M. Smith, Michael J. Shortley, III, Glenn B. Manishin, James E. Magee, Frederick M. Joyce, Christine McLaughlin, Wendy I. Kirchick, Charles C. Hunter, Catherine M. Hannan and Richard S. Whitt were on the joint brief of intervenors MCI Telecommunications Corporation, et al. Jay C. Keithley and Leon M. Kestenbaum entered appearances.

Before: EDWARDS, Chief Judge, SILBERMAN and ROGERS, Circuit Judges.

PER CURIAM:

Because the Federal Communications Commission ("Commission") failed to explain adequately its derivation of a rate for coinless payphone calls, we grant the petition for review in part and remand this case to the Commission for further proceedings.

### I. Background

The Telecommunications Act of 1996 ("the Act") required the Commission to promulgate regulations ensuring that payphone service providers would be "fairly compensated" for calls made on their payphones. *See* 47 U.S.C.A. § 276(b)(1)(A) (West Supp.1998). In *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996,* Report and Order, CC Docket No. 96–128, FCC 96–388 (September 20, 1996), *reprinted in* Joint Appendix ("J.A.") 219 ("First Order"), the Commission decided to set the charge for coinless payphone calls at the same $.35 rate that it found was prevalent for coin calls in several states that had deregulated their payphone markets. In *Illinois Public Telecom. Ass'n v. FCC,* 117 F.3d 555, 563–64 (D.C.Cir.1997), the court vacated this portion of the First Order on the ground that the Commission had ignored record evidence that the costs of coinless payphone calls and coin calls differ markedly. *See id.*

On remand, in *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996,* Second Report and Order, CC Docket No. 96–128, FCC 97–371 (October 9, 1997), *reprinted in* J.A. 1418 ("Second Order"), the Commission purported to derive a market-based rate for coinless calls. No discernible "market rate" for coinless payphone calls actually existed, because, prior to passage of the Act, payphone service providers never had been fully compensated for coinless calls. Nonetheless, the Commission constructed a market rate for coinless payphone calls by, first, starting with the $.35 rate, which it called the "market rate" for coin calls, and then subtracting costs of $.066 per call, which it found to be the difference between the costs of coinless and coin calls. *See* Second Order ¶ 42, J.A. 1436. This led the Commission to adopt a compensation rate of $.284 per coinless call from October 7, 1997, to October 6, 1999, after which the default rate would be determined by subtracting $.066 from the coin call rate in a given locale. Petitioners challenge the reasoning of the Commission's general approach as well as its specific computation of the $.066 cost differential.

## II. Analysis

### A. *Ripeness*

[1] All parties agree that the Second Order is a final order definitively establishing the disputed compensation rate. There is therefore no doubt that the court has jurisdiction to resolve the petitions for review. Although some parties other than Petitioners here have filed pending petitions for reconsideration before the Commission challenging the computation of the $.066 cost differential, neither the Commission nor the parties in the instant case contend that the matter before us is unripe for judicial disposition. Indeed, during oral argument, most counsel seemed to agree that prudential considerations militate in favor of a prompt judicial decision. We agree.

There is no reason for the court to delay deciding the issues now before us. This case presents a concrete legal issue regarding the reasonableness of the methodology used to derive the $.284 rate. This is a question that is ripe for judicial review. *See Better Government Ass'n v. Department of State,* 780 F.2d 86, 92–93 (D.C.Cir.1986). Additionally, the pending petitions for reconsideration raise issues related to and contingent on the central problem of the legitimacy of the Commission's methodology in establishing the $.284 rate; thus, resolution of the petitions for reconsideration will benefit from a resolution of the present case. Furthermore, the Commission has given no indication that it intends to reconsider its rate-setting approach, and its treatment of the petitions for reconsideration will not shed light on this threshold matter. In short, the instant case is ripe for review. We therefore proceed to the merits of the matters before us.

### B. *Merits*

[2] Having examined the record thoroughly, we find the Commission's explanation of its derivation of the $.284 rate plainly inadequate. The Commission never explained why a market-based rate for coinless calls could be derived by subtracting *costs* from a *rate* charged for coin calls. If costs and rates depend on different factors, as they sometimes do, then this procedure would resemble subtracting apples from oranges. If the Commission simply subtracted one quantity from another, logically independent quantity, its action was unreasoned.

During oral argument, it was suggested that paragraph 42 of the Second Order suffices to justify the Commission's position in this case. *See* Second Order ¶ 42, J.A. 1436. But in this paragraph the Commission merely says that "[t]he majority of the costs associated with a payphone are joint and common costs that are shared by the different types of calls made by means of the payphone.... By making no adjustment to the coin rate for these costs, we conclude that each call placed at a payphone should bear an equal share of joint and common costs." This reasoning is utterly unhelpful in explaining why the Commission is correct in assuming that the "market rate" for coinless calls, from which costs are deducted, should be the same as the rate for coin calls.

The Commission's reasoning may have depended on the premise that the market rate for coin calls generally reflects the costs of those calls. This assumption would hold true in a competitive market in which costs and rate converge. Unfortunately, the Commission never went through the steps of connecting this premise with its reasoning in the Second Order. Nor did the Commission expressly claim that costs and rate do in fact converge in the coin call market: it merely rested on the assertion that "our approach continues to rely on market-based rate (the local coin rate)." Second Order ¶ 25, J.A. 1430. Some articulation of this crucial assumption was required, especially because the Commission itself has suggested that the assumption may not be accurate. The Commission acknowledged in the First Order that, because of locational monopolies and incomplete information endemic to the payphone market, the coin call rate may potentially diverge from coin call costs. *See* First Order ¶¶ 13–16, J.A. 226–28. In the Second Order, without explanation, the Commission merely declared itself "confident that market forces will keep payphone prices at competitive levels." Second Order ¶ 118, J.A. 1469.

In principle, a market-based rate—as opposed to a cost-based rate—could satisfy the

statutory fair compensation requirement. *See Illinois Public Telecom. Ass'n*, 117 F.3d at 563 ("A market-based approach is as much a compensation scheme as a rate-setting approach."). But some explanation of the logic of the derivation of the market-based rate is still required. In *Illinois Public Telecom. Ass'n*, we did not reach the question of the reasonableness of deriving a market-based rate for coinless calls from the coin call rate, because we found that there was unexplained record evidence contradicting the Commission's claim that the costs of coinless and coin calls were similar. *See id.* at 563–64. While we held that "it was not unreasonable for the Commission to conclude that market forces generally will keep prices at a reasonable level, thereby making locational monopolies the exception rather than the rule," *id.* at 562, this holding went to the Commission's decision to deregulate the coin call market, *not* to the question of whether coin call rates converge with costs.

C. *Remedy*

[3, 4] Although we conclude that the Commission did not adequately explain the action at issue here, we exercise our discretion to remand the rule for further explanation without vacating it. *See A.L. Pharma, Inc. v. Shalala*, 62 F.3d 1484, 1492 (D.C.Cir. 1995). One factor we consider in exercising such discretion is the potential for disruption that might be caused by vacating the order. *See id.* Here, vacating the order would leave payphone service providers all but uncompensated for coinless calls made from their payphones, and disrupt the business plans they have made on the basis of their expectation of compensation. However, the Commission must respond promptly to our remand. Congress required the Commission to prescribe regulations ensuring fair compensation "within 9 months after February 8, 1996," 47 U.S.C.A. § 276(b)(1), and this deadline has already passed. If, within six months from the issuance of our mandate, the Commission has not responded adequately to our remand, any adversely affected party may request effective relief from the court. *See Telecommunications Research and Action Ctr. v. F.C.C.*, 750 F.2d 70, 74–78 (D.C.Cir.1984).

We choose not to vacate the $.284 rate on the clear understanding that if and when on remand the Commission establishes some different rate of fair compensation for coinless payphone calls, the Commission may order payphone service providers to refund to their customers any excess charges for coinless calls collected pursuant to the current rate. The Commission itself has acknowledged that it has the authority to adjust the compensation rate retroactively "should the equities so dictate." *See Pleading Cycle Established for Comment on Remand Issues in the Payphone Proceeding*, CC Docket No. 96–128, FCC 97–1673 (Aug. 5, 1997), *reprinted in* J.A. 572; *see also In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Memorandum Opinion and Order, CC Docket No. 96–128, FCC 98–642, 1998 WL 153171 (F.C.C.) (April 3, 1998); *In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Memorandum Opinion and Order, CC Docket No. 96–128, FCC 98–481, 1998 WL 99371 (F.C.C.) (March 9, 1998).

[5] It is clear that the Commission has the authority to order refunds where overcompensation has occurred, on the basis of the statutory provision permitting the Commission to take such actions "as may be necessary in the execution of its functions." 47 U.S.C. § 154(i) (1994). In addition, the Telecommunications Act of 1996 requires the Commission to "take all actions necessary (including any reconsideration)" to promulgate regulations to ensure fair compensation to payphone service providers. *See* 47 U.S.C. § 276(b)(1). This language authorizes the Commission to order refunds where doing so is necessary to ensure fair compensation.

III. CONCLUSION

The Commission's order is remanded for further proceedings consistent with the decision of the court.

*Petition for review granted in part; case remanded for further proceedings.*

**PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, Petitioner,**

**v.**

**FEDERAL ENERGY REGULATORY COMMISSION, Respondent,**

**Mojave Pipeline Company, et al., Intervenors.**

**Nos. 97-1028, 97-1058, 97-1059, 97-1060, 97-1061, 97-1062, 97-1078, and 97-1082.**

United States Court of Appeals, District of Columbia Circuit.

Argued April 2, 1998.

Decided May 22, 1998.

Interstate shippers sought relief before Federal Energy Regulatory Commission (FERC) after state public utilities commission authorized tariff under which intrastate natural gas pipeline could charge rates for interconnection applicable to deliveries nominated into pipeline's intrastate system. FERC ruled that tariff was illegal, but deferred remedy. All parties petitioned for review. The Court of Appeals, Harry T. Edwards, Chief Judge, held that: (1) FERC acted reasonably when it determined that tariff was access charge; (2) access charge belonged within FERC's jurisdiction; and (3) FERC acted arbitrarily when it delayed remedy after properly finding that tariff was illegal access charge.

Petition for review granted in part and denied in part.

**1. Gas ⇨9**

Federal Energy Regulatory Commission (FERC) acted reasonably when it determined that tariff which state public utilities commission authorized intrastate pipeline to charge interstate shippers was not permissible charge for intrastate services rendered by pipeline, but rather was access charge for privilege of introducing natural gas into pipeline's intrastate system; pipeline did not render any identifiable services to shippers. 5 U.S.C.A. § 706(2)(A).

**2. Gas ⇨9**

Federal Energy Regulatory Commission (FERC) reasonably interpreted Hinshaw Amendment to Natural Gas Act, which created exception from FERC jurisdiction for persons engaged in transportation of natural gas received by person at or within state boundary, if such gas was consumed within state, to mean that, when intrastate pipeline receives gas from interstate pipeline within or at the border of its state, jurisdiction switches from FERC to state. Natural Gas Act, § 1(c), 15 U.S.C.A. § 717(c).

**3. Gas ⇨1**

Court of Appeals defers to interpretation by Federal Energy Regulatory Commission (FERC) of FERC's authority to exercise jurisdiction if it is reasonable.

**4. Gas ⇨9**

Under Hinshaw Amendment to Natural Gas Act, access charge which state public utilities commission authorized intrastate pipeline to charge interstate shippers for introducing natural gas into pipeline's intrastate system belonged within jurisdiction of Federal Energy Regulatory Commission (FERC), in that charge related to something which occurred prior to transfer of gas from shippers to pipeline. Natural Gas Act, § 1(c), 15 U.S.C.A. § 717(c).

**5. Gas ⇨9**

Hinshaw Amendment to Natural Gas Act only exempts from jurisdiction of Federal Energy Regulatory Commission (FERC) persons "engaged in or legally authorized to engage in" intrastate gas transport for the purposes of their involvement in intrastate gas transport, not for purposes of their in-

# EXHIBIT 2

**EXHIBIT 2**

# HOGAN & HARTSON
L.L.P.

DAVID L. SIERADZKI
PARTNER
(202) 637-6462
DLSIERADZKI@HHLAW.COM

COLUMBIA SQUARE
555 THIRTEENTH STREET, NW
WASHINGTON, DC 20004-1109
TEL (202) 637-5600
FAX (202) 637-5910
WWW.HHLAW.COM

October 20, 2005

*BY E-MAIL AND BY CERTIFIED MAIL*

Alessandra Richmond
John Hamman
BellSouth Interconnection Services
675 West Peachtree Street
Atlanta, GA 20275

**RE: BellSouth-SouthEast Interconnection Dispute**

Dear Ms. Richmond and Mr. Hamman:

On behalf of SouthEast Telephone, Inc. ("SouthEast"), this letter follows up on my September 23, 2005 letter, discusses certain financial obligations between SouthEast and BellSouth, and responds to your October 7, 2005 letter.

As you know, on September 16, 2005, the U.S. District Court for the Eastern District of Kentucky issued a decision affirming the September 29, 2004 order of the Kentucky Public Service Commission ("PSC") that SouthEast is entitled to opt in immediately to the dispute resolution provision of BellSouth's agreement with Cinergy Communications. *BellSouth Telecommunications, Inc. v. SouthEast Telephone, Inc., et al.*, Civil Action No. 3:04-CV-84-JH, Memorandum Opinion and Order, (E.D. Ky. Sept. 16, 2005). Under the terms of the court decision and the underlying PSC order, this means that the pre-existing interconnection agreement between SouthEast and BellSouth, incorporating the Cinergy dispute resolution (specifying that BellSouth will "carry on their respective obligations under [their pre-existing interconnection] agreement while any dispute resolution is pending"), is effective now and has been effective since before March 11, 2005, notwithstanding any generic rulemaking decisions to the contrary.

Pursuant to our existing, effective interconnection agreement, SouthEast is entitled to continue ordering the Unbundled Network Element Platform ("UNE-P"), and is entitled to pay the established TELRIC rates for both pre-existing UNE-P lines and new orders,

until the resolution of the pending dispute between the two companies. We demand that you resume taking orders for UNE-P lines immediately.

Moreover, BellSouth has billed SouthEast for all new orders at the resale rates. These bills are not supported by our existing, effective interconnection agreement or by governing law. Accordingly, SouthEast is entitled to a credit of $727,259 for the difference between the resale rate and the UNE rate for the time period of May 2005 through September 2005. (The supporting documentation evidencing the credit due on account 502 Q93-9811 811 is being submitted under separate cover.) This amount has been withheld from the current amount due of $622,273 for the above mentioned account, and a credit or a refund check for the difference of $104,986 is due and payable immediately to SouthEast Telephone.

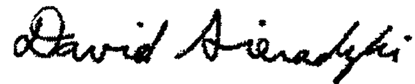
Finally, your October 7, 2005 letter makes it clear that BellSouth is continuing to refuse to negotiate in good faith (or in any other way) with SouthEast, since that letter merely reiterates the positions that your company has consistently taken for the past six months. Accordingly, we are planning to commence a formal proceeding before the PSC to resolve the issues in dispute between our companies. Significantly, the PSC recently specifically rejected BellSouth's contention that the PSC "may not regulate the rates, terms, and conditions for elements required to be provided by BellSouth pursuant to Section 271." *Joint Petition for Arbitration of NewSouth Communications Corp., et al., of an Interconnection Agreement with BellSouth Telecommunications, Inc.*, Case No. 2004-00044, Order, at 10 (Sept. 26, 2005). Rather, the PSC held that BellSouth continues to be obligated to "commingle" UNEs with elements that it is required to provide under Section 271, and that the PSC has authority with regard to the latter elements, which are provided "within this Commonwealth and are used to provide intrastate service." *Id.*

Accordingly, in our list of disputed issues between SouthEast and BellSouth that must be resolved going forward, we plan to ask the PSC to determine not only the TELRIC rates for UNEs such as unbundled voice-grade loops, but also the "just and reasonable" rates for the unbundled local switching and shared transport elements – the "port" component of UNE-P – which BellSouth is obligated to provide pursuant to Section 271 at "just and reasonable" rates. We plan to send you this list of the specific disputed issues in the near future. Given the newly clarified scope of the PSC's authority and BellSouth's continued refusal to negotiate with us or even to provide a substantive response to our various proposals, we are retracting any and all proposals regarding interconnection and commercial agreements that we have offered in the past.

As noted above, pending resolution of these disputes, the rates, terms, and conditions in our pre-existing interconnection agreement remain in full force and effect.

Thank you very much. Please contact me if you have any questions.

Very truly yours,



David L. Sieradzki
Counsel for SouthEast Telephone, Inc.

cc: Darrell Maynard
Amy Dougherty, Kentucky PSC