REPORT OF THE COMMITTEE ON OIL PIPELINE REGULATION

This Committee Report covers the eighteen months from January 1, 1995 through June 30, 1996.[1]

I. Oil Pipeline Rulemakings - The Aftermath

A. *The Appeals*

In the fall of 1994, the Association of Oil Pipe Lines (AOPL), sought review of the FERC Order Nos. 561 and 561-A.[2] Total Petroleum, Inc., the Alberta Department of Energy, and the AOPL challenged the Commission's selection of the PPI-FG minus 1 as the index applicable to oil pipeline rates. AOPL also contested the Commission's authority: (1) to require the automatic filing of rate decreases if the index-based ceiling rates fell below existing rates without a hearing; (2) to permit challenges to index-based rate increases; (3) to prohibit the filing of market-based rates until after a hearing on the competitiveness of the markets at issue; and (4) to order detailed initial filing requirements for pipelines proposing a cost-based rate increase.

The Total petitioners argued that the index should not apply to the entire rate, that the Commission should be required to conduct a periodic review of individual pipeline costs rather than the projected industry-wide review, and that shippers should be entitled to contest the entire rate filed under indexation, rather than just the incremental increase. Total also alleged that the Commission's new protest and complaint procedures had the effect of improperly shifting the burden of proof to shippers.

Employing a deferential standard of review, the Court affirmed the Commission's order in all respects. The Court dismissed AOPL's challenge to the index choice, finding the Commission's rationale underlying the index adequately noticed and the choice itself supported by the record. The Court similarly denied Total's petition, finding that application of the index to the whole rate, rather than to selected costs, was actually closer to industry cost experience and therefore reasonable; that the Commission's protest and complaint procedures do not impermissibly shift the burden of proof as to the propriety of the rate filing; that concerns with respect to individual pipeline rates can be raised in the context of individual pipeline rate challenges; and that the limitation on rate protests to the pipeline's incremental rate increase is appropriate.

1. The Oil Pipeline Committee would like to acknowledge the assistance of Barbara C. Hickl, Counsel to Shell Oil Company, and of Caroline C. Whitmire, Assistant Editor of the *Oil Pipeline Monitor* in the preparation of this report.

2. Order No. 561, *Revision to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, III F.E.R.C. STATS. & REGS. ¶ 30,985, 58 Fed. Reg. 58,753 (1993); [hereinafter Order No. 561]; *order on reh'g*, III F.E.R.C. STATS. & REGS. ¶ 31,000, (1994), 59 Fed. Reg. 40,243 (1994) [hereinafter Order No. 561-A].

Turning next to AOPL's procedural challenges, the Court found no inconsistency in a Commission ordered rate decrease based on a "rebuttable finding" that "a rate level in excess of the ceiling established by the PPI-1 index is presumptively unjust and unreasonable."[3] Relying on *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*,[4] the Court found "no occasion" to adopt a view of the ICA that "would contravene a reasonable interpretation by the agency responsible for administering the statute." In addition, the Court found that the requirement under section 15(1) that the Commission conduct a "full hearing" prior to instituting a rate change was satisfied by the rulemaking process.

The Court then dismissed AOPL's claim that section 6(3) of the ICA limits the Commission's authority to impose filing documentation requirements. The Court adopted the Commission's rationale that it had broad authority to obtain information in connection with a cost-of-service rate filing because the Commission is authorized under section 12(1) to "obtain from such carriers and persons such information as the Commission deems necessary to carry out the provisions of [the ICA]."[5]

The Court also agreed with the Commission that a market-based rate application is not a rate filing. In the Court's view, the application procedure does not constitute an indefinite suspension or a prohibition on the filing of rates because pipelines may still file rate changes under the indexation or cost-of-service methodologies. As such, the Commission had not violated section 15(7)'s limited suspension of rate filings.[6] AOPL filed a petition with the Court on June 21, 1996, seeking rehearing with respect to the issues of the automatic rate decrease and the indefinite suspension of market-based rate filings.

B. *The Implementation*

Rates in effect on December 31, 1994, became subject to indexation as of January 1, 1995. The index formula established ceiling levels which individual rates may not exceed without meeting one of the prescribed exceptions. The initial index applicable from January 1, 1995, to June 30, 1995, permitted maximum rate increases of 0.2175%. The index applicable from July 1, 1995, through June 30, 1996, was *negative* 0.3585%.[7] Because rates in excess of the index ceiling must be reduced so as not to exceed the index ceiling,[8] most pipelines were obligated to file rate decreases effective July 1, 1995.

A number of pipeline rates, however, are in whole or half cents. The rate decrease begot a new issue with respect to rounding. Pipelines initially decreased rates using the normal rounding conventions that round amounts

3. Order No. 561-A, *supra* note 2, at 31,101.

4. 467 U.S. 837 (1984).

5. Order No. 561, *supra* note 2.

6. Order No. 561, *supra* note 2, at 58,757.

7. *Revision to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, 60 Fed. Reg. 27,727 (1995).

8. 18 C.F.R. § 342.3(e) (1996).

up from five and above and down from one through four. The Commission disagreed with this approach, explaining that all pipelines must calculate ceiling levels to one one-hundredths of a cent. The pipeline may then file a rate in whole or half cents so long as that rate does not exceed the ceiling level.[9]

Most pipelines reduced rates in response to the rate decrease. A few, however, pursued exceptions to indexation under the Commission's rules. Some produced affidavits that shippers had agreed to the existing rates, others filed letters with the Commission stating their rates were grandfathered under Section 1803(a) of the Energy Policy Act of 1992, and still others obtained waiver of the rules due to recently approved cost-of-service rates.[10]

After implementation of the index-imposed rate decrease, Colonial Pipeline Company filed the first application seeking to charge market-based rates in some origin and destination markets. Two shippers filed protests and the Commission set the matter for hearing.[11] The Commission identified five issues of particular interest: 1) the definition and nature of the origin and destination markets; 2) the appropriate competitive alternatives; 3) the calculation of market share; 4) the implications surrounding loss of market share; and 5) the need for safeguards.[12] A hearing is expected in 1997.

C. *The Alternative Dispute Resolution Rulemaking*

In Order No. 561, the Commission adopted alternative dispute resolution (ADR) measures to apply to oil pipelines rate proceedings.[13] On April 12, 1995, the Commission issued Order No. 578 amending its Rules of Practice and Procedure to adopt ADR rules applicable to all industries regulated by the FERC.[14] These rules are voluntary in nature. As part of the rulemaking process, the Commission consolidated almost all of the pipeline specific ADR rules with the rules of general application. However, it left intact the requirement for mandatory negotiations in oil pipeline rate proceedings.[15]

II. Pipeline Cases in the Lower 48

A. *Jurisdiction Over OCS Pipelines*

Before 1992, pipelines on the Outer Continental Shelf (OCS) considered themselves subject to the Commission's jurisdiction under the Outer

9. *See, e.g., Kaneb Pipe Line Operating Partnership, L.P.*, 71 F.E.R.C. ¶ 61,409 (1995); *Colonial Pipeline Co.*, 71 F.E.R.C. ¶ 61,415 (1995); *Explorer Pipeline Co.*, 71 F.E.R.C. ¶ 61,416 (1995).

10. *Plantation Pipe Line Co.*, 72 F.E.R.C. ¶ 61,035 (1995); *Yellowstone Pipe Line Co.*, 73 F.E.R.C. ¶ 61,075 (1995).

11. *Colonial Pipeline Co.*, 75 F.E.R.C. ¶ 61,047 (1996).

12. *Id.* at 61,182.

13. Order No. 561, *supra* note 2, at 30,970-74.

14. Order No. 578, Alternative Dispute Resolution, [1991-96 Regs. Preamble] III F.E.R.C. Stats. & Regs. ¶ 31,018, 60 Fed. Reg. 19,494 (1995) [hereinafter Order No. 578].

15. Order No. 578, *supra* note 14, at 31,319; *see also* 18 C.F.R. § 343.5 (1995).

Continental Shelf Lands Act[16] (OCSLA) and the Interstate Commerce Act (ICA). In 1992, the Commission issued *OXY Pipeline, Inc.*[17] and *Bonito Pipeline Co.*[18] deciding that the OCS is neither a State nor a territory under § 1(1) of the ICA. It concluded "that it has no jurisdiction under the ICA over pipelines engaged in the transportation of oil solely on or across the outer Continental Shelf."[19] The Commission decided that it did have jurisdiction to apply the non-discriminatory access provisions of the OCSLA.[20]

Pennzoil, Bonito's operator, appealed the finding that Bonito must provide access to Shell for its oil. Shell appealed the finding that the ICA does not apply to OCS pipelines. In early 1995, the U.S. Court of Appeals denied both appeals but determined appellant Shell's case was not ripe, *i.e.* Shell had not demonstrated actual or imminent injury, but would not be barred from raising the issue in a future petition for review.[21]

As a result of these decisions, the Minerals Management Service (MMS) determined that it would no longer accept tariffs filed at the FERC as the basis for transportation deductions for royalty purposes. The affected companies appealed the MMS ruling, claiming tariffs continued to be filed at the FERC and were paid by the affected shippers. The MMS director therefore wrote to the Chair of the Commission seeking the FERC's view on the matter. Chair Moler's response acknowledged that many OCS pipelines still file the FERC tariffs and that these tariffs are accepted for filing. The Commission would not question its jurisdiction over the filing pipeline unless the pipeline's tariff was protested. The Chair affirmed that a pipeline moving oil solely on or across the OCS is not governed by the ICA. In addition, the Chair stated that a pipeline beginning on the OCS and ending at a refinery would not be subject to ICA jurisdiction. However, the Chair acknowledged that a pipeline beginning offshore which interconnects directly with a pipeline or pipelines through which oil moves continuously in interstate commerce would be jurisdictional.[22]

B. *Williams Pipe Line Company*

1. Pipeline Competitiveness

On June 6, 1995, the Commission issued Opinion No. 391-A[23] modifying and clarifying Opinion No. 391,[24] the decision in Phase I of Williams Pipe Line Company's bifurcated proceeding. The Commission reversed its earlier competitiveness determination with respect to seven Williams' markets: Springfield (Missouri), Kansas City, Lincoln, Quincy, Omaha, Eau

16. Outer Continental Shelf Lands Act, 43 U.S.C. § 1331 (1995).
17. *OXY Pipeline, Inc.*, 61 F.E.R.C. ¶ 61,051 (1992) (OXY).
18. *Bonito Pipeline Companty*, 61 F.E.R.C. ¶ 61,050 (1992) (Bonito).
19. 61 F.E.R.C. ¶ 61, 051, 61,228, *see also Bonito*, at 61,221.
20. 61 F.E.R.C. ¶ 61,050, 61,222-23.
21. *Shell Oil Co. v. FERC*, 47 F.3d 1186, 1190 (D.C. Cir. 1995).
22. Letter from Elizabeth A. Moler, Chair, FERC, to Cynthia Quarterman, Acting Director, MMS (Mar. 15, 1996).
23. Order No. 391-A, *Williams Pipe Line Co.*, 71 F.E.R.C. ¶ 61,291 (1995).
24. Order No. 391, *Williams Pipe Line Co.*, 68 F.E.R.C. ¶ 61,136 (1994).

Claire, and Fargo; finding each of these markets competitive. The Commission determined that BEA specific cost tables that compare Williams' transportation costs with those of a number of internal and external sources is "a sound basis on which to evaluate the ability of external sources to serve a market competitively."[25] It also affirmed the use of capacity-based data to gauge market concentration, maintained that the use of capacity-based measures permits consideration of market responses to a price increase, and reiterated its rejection of corridors as the relevant geographic market.[26]

The Commission also re-examined whether rate differentials constitute rate discrimination, concluding "that rate differentials - even if not based on corresponding cost differences - are not necessarily tantamount to cross-subsidies."[27] The Commission clarified that it would not require re-examination of alleged discrimination issues in the *Williams* Phase II proceeding.

Texaco Refining and Marketing, Inc. (TRMI) appealed Opinion No. 391 and 391-A to the D.C. Circuit. The case is currently in abeyance pending resolution of Phase II.

2. Rates in Noncompetitive Markets

The role of Phase II of *Williams* concerns how rates in noncompetitive markets should be set. Hearings in Phase II were held in December 1995 and January 1996. The Initial Decision was issued on May 29, 1996.[28] The Presiding Administrative Law Judge found insufficient evidence to support a determination as to the reasonableness of Williams' rates. He, therefore, cancelled all rate increases filed since January 16, 1990, and ordered refunds of any amounts collected above rates in effect on January 15, 1990. He also directed that Williams' base rates for indexation purposes were those in effect on January 15, 1990.[29]

The Presiding Administrative Law Judge rejected Williams' proposed ratemaking methodology which relied on Constrained Market Pricing (CMP).[30] The Presiding Judge found CMP offered too broad a pricing range. He further found Williams failed to allocate costs in any meaningful way.[31] With no cost allocation, the Presiding Judge could not determine from the record whether cross subsidies existed. Williams, Commission staff, and TRMI filed exceptions to the Initial Decision in June 1996.

25. 71 F.E.R.C. ¶ 61,291, at 62,124.

26. *Id.* at 62,124-33.

27. *Id.* at 62,146.

28. *Williams Pipe Line Co.*, 75 F.E.R.C. ¶ 63,016, 65,061 (1996) (*Williams*).

29. *Id.* at 65,070.

30. CMP lets the market set the rates subject to certain constraints-no rate may fall below a marginal cost floor, above a stand alone cost ceiling, and company returns must not exceed Opinion No. 154-B allowed levels.

31. "This record-reflecting Williams' failure to allocate anything, coupled with Staff and Texaco's decision to use pure volumetric methods-provides no meaningful basis for even a 'first cut'." *Williams*, *supra* note 28, at 65,065.

3. Product Transfer Orders and Product Authorizations

In 1991, a dispute arose over new Product Transfer Order (PTO) and Product Authorization (PA) charges instituted by Williams. Shippers claimed these charges related to ICA jurisdictional services and, therefore, were subject to Commission oversight. They also argued that the charges were excessive. The Commission initially agreed with the shippers.[32] On rehearing, and based on additional facts submitted by Williams, the Commission reversed its decision. The Commission based its decision in part on additional evidence indicating that PTO and PA services generally occur after the product has been in the terminal for more than 40 days. Since Williams's transportation services terminate after the product enters the terminal, the Commission determined that the services in question "generally occur separately from Williams' jurisdictional services." The Commission therefore concluded that PTO and PA services are non-jurisdictional, mooting the question of reparations.[33] One of the shipper complainants, TRMI, filed an appeal with the D.C. Circuit.[34] Oral argument has been scheduled for September 30, 1996.

C. Lakehead Pipe Line Co., L.P.

The Commission resolved Phase I issues in this case with the issuance of Opinion Nos. 397 and 397-A.[35] Rejecting the arguments advanced by the Canadian Association of Petroleum Producers (CAPP) and the Alberta Department of Energy (ADOE), the Commission affirmed that Lakehead's rates should be evaluated using the trended original cost methodology set forth in Opinion No. 154-B, including a starting rate base. The Commission also resolved a number of other relatively minor ratemaking issues.

The most significant rulings made by the Commission in the *Lakehead* decisions related to the income tax allowance issue. In the initial decision, the Presiding Administrative Law Judge allowed Lakehead, which is organized as a master limited partnership, to include in its cost of service a full income tax allowance despite claims that Lakehead actually incurs and pays no tax at the partnership level.[36]

The Commission reversed the initial decision, however, finding Lakehead may not include, for purposes of a tax allowance, any income attributable to individual unit-holders.[37] The Commission based its decision on the premise that individual unit-holders avoid paying any tax on their distributions at the corporate level, and that the prior practice of allowing a tax allowance for such income permitted the pipeline to achieve an improp-

32. *Kerr-McGee Ref. Corp. v. Williams Pipe Line Co.*, 63 F.E.R.C. ¶ 61,349 (1993).

33. *Kerr-McGee Ref. Corp. v. Williams Pipe Line Co.*, 72 F.E.R.C. ¶ 61,274 (1995).

34. *Texaco Ref. and Mktg., Inc. v. FERC*, No. 95-1579 (D.C. Cir. filed Nov. 17, 1995).

35. Opinion No. 397, *Lakehead Pipe Line Co., L.P.*, 71 F.E.R.C. ¶ 61,338 (1995), *order on reh'g*, Opinion No. 397-A, 75 F.E.R.C. ¶ 61,181 (1996).

36. 71 F.E.R.C. ¶ 61,388, at 62,305 (discussing *Lakehead Pipeline Co., L.P.*, 65 F.E.R.C. ¶ 63,021 (1993)).

37. *Id.* at 62,315.

erly high rate of return.[38] Although the Commission continued to permit a cost of service tax allowance for income attributable to corporate unit-holders, application of the ruling resulted in a significant reduction in Lakehead's allowable cost of service.

On rehearing, the Commission affirmed its ruling with respect to the tax allowance for individual unit-holders asserting that "Congress did not endorse phantom taxes . . . [i]t simply endorsed this particular form (master limited partnership) in connection with taxing an enterprise."[39] The Commission then clarified its earlier ruling to disallow a tax allowance for income that is earned by and received by individual partners, but to exclude income taxes paid by a corporate partner under a curative allocation procedure.[40]

CAPP and ADOE had raised the curative allocation issue in their petition for rehearing. They also took issue with the Commission's ruling on the ratemaking methodology appropriate for Lakehead, including Lakehead's ability to use the starting rate base and trended original cost. The Commission affirmed Lakehead's right to both.[41]

Lakehead also addressed the scope of a common carrier pipeline's service obligation. Specifically, *Lakehead* involved whether the pipeline bore the obligation to provide breakout storage tank (BOST) facilities for shippers requesting national gas liquids (NGL) service. Lakehead's tariff required shippers to provide their own BOST facilities.

In Opinion No. 397, the Commission determined that Lakehead was not required to provide BOST facilities because no shipper in need of those facilities could gain access in Canada to the pipeline connecting with Lakehead. However, should a shipper gain such access, Lakehead's common carrier duties would require it to "transport NGLs, and to furnish services in connection therewith, on its system upon reasonable request."[42] Thus, if an NGL shipper gained access to the Canadian system, "Lakehead must provide or arrange for the provision of BOST facilities."[43]

On rehearing, the Commission affirmed its initial ruling, distinguishing BOST facilities from terminal facilities that may be abandoned at will. Claiming "BOST facilities are the functional equivalent of missing pipe," the Commission found them to be an "instrumentality and facility of shipment and carriage" required by section 1(3) of the ICA.[44] Lakehead, however, may request reconsideration of the policy if and when a concrete dispute arises.[45]

38. *Id.* at 62,315.

39. Opinion No. 397-A, 75 F.E.R.C. ¶ 61,181, at 61,596.

40. *Id.* at 61,597. See notes 30 to 32 for a discussion of curative allocation.

41. *Id.* at 61,590-93.

42. 71 F.E.R.C. ¶61,338, at 62,324.

43. *Id.* at 62,325.

44. 75 F.E.R.C. ¶ 61,181, at 61,601.

45. *Id.* at 61,600.

D. *SFPP, L.P.*

1. The Rate Case

Complainants, the FERC Staff and SFPP spent the last year and a half filing various rounds of prepared testimony, with pretrial briefs filed in March 1996 and the hearing conducted throughout April, May, and June 1996. In addition, two new complaints were consolidated with the ongoing proceeding.[46]

Complainants and the FERC Staff raised a wide range of challenges to SFPP's "South System" rates and practices. Central to these challenges is the argument that SFPP's South System lines-the East and West Lines-should be regulated as two separate systems, and that treating them as one system creates impermissible cross-subsidies. In addition, SFPP's West Line rates was deemed "just and reasonable" under the Energy Policy Act of 1992 (EPAct), and can only be challenged if a party were barred by a contractual prohibition from contesting the rates prior to enactment of EPAct, or if "changed circumstances" can be demonstrated.[47] Complainant Navaho Refining met the first criterion, other complainants did not. They argued instead that "changed circumstances" permitted their challenge.

Complainants and the FERC Staff also asserted that SFPP should use a stand-alone capital structure and should not be able to recover certain litigation, environmental and reconditioning expenses. Based on Lakehead's Order No. 397, they argued that SFPP's cost-of-service should not include any income tax allowance, or, alternatively, that it include an allowance only equal to the percentage of units owned by corporations, or that it include some intermediate allowance.[48] Finally, they argued that SFPP's prorationing policy and line reversal agreements should be included in its tariff.

SFPP argued that its predecessor company's capital structure (or that of its parent) as of June 30, 1985, for SFPP's starting rate base, and that its

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46. *Mobil Oil Corp. v. SFPP, L.P.*, Order Consolidating Proceedings, 73 F.E.R.C. ¶ 61,032 (1995); *Tosco Corp. v. SFPP, L.P.*, Order Consolidating Proceedings, 74 F.E.R.C. ¶ 61,056 (1996).

47. Pub. L. No. 102-486, § 1803, 106 Stat. 2776, 3010-12, (codified as 42 U.S.C. § 7172 (1994)). Subsection 1803(b) reads as follows:

> (b) CHANGED CIRCUMSTANCES. No person may file a complaint under section 13 of the Interstate Commerce Act against a rate deemed just and reasonable under subsection (a) unless -
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> (1) evidence is presented to the Commission which establishes that a substantial change has occurred after the date of enactment of this Act -
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> (A) in the economic circumstances of the oil pipeline which were the basis for the rate; or
>
> (B) in the nature of the services provided which were the basis for the rate; or
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> (2) the person filing the complaint was under a contractual prohibition against the filing of a complaint which was in effect on the date of enactment of this Act and had been in effect prior to January 1, 1991, provided that a complaint by a party bound by such prohibition is brought within 30 days after the expiration of the prohibition.

48. *Lakehead Pipe Line Co., L.P.*, 71 F.E.R.C. ¶ 61,338, at 62,315 (1995). See section II.C, *infra*, for a more detailed discussion of the Commission's *Lakehead* decision.

civil and regulatory litigation expenses should be included in its cost-of-service calculations. SFPP maintained that, even though organized as a master limited partnership, it should receive a full income tax allowance. In the alternative, it argued that any application of the *Lakehead* decision should only be prospective. Finally, SFPP asserted that its prorationing policy is already generally stated in its tariff, but that the Commission can not require that line reversal agreements be published in the company's tariff because the FERC does not have jurisdiction over line reversals.

2. Watson Station Complaints

On December 1, 1995, TRMI filed a separate complaint alleging that SFPP had failed to file the FERC tariffs for certain movements of product to the South System that, according to TRMI, constituted transportation subject to the Commission's ICA jurisdiction. TRMI further alleged that the rates charged for such movements were unjust and unreasonable, and unduly discriminatory. ARCO Products filed a similar complaint on January 16, 1996.

SFPP responded that lines to the facilities in question were part of a non-jurisdictional network of lines to origin points for pipeline service which included lines owned and operated by refiner owners and third parties. Should the Commission find these facilities to be jurisdictional however, SFPP contended it could defend the rates on a market basis. It also argued that complainants had, in fact, agreed to pay the rates in question instead of seeking other transportation alternatives. On June 14, 1996, the Commission consolidated the complaints and set the matter for hearing.[49]

E. Longhorn Partners Pipeline

On June 30, 1995, AXIS Gas Corporation filed a petition for a declaratory order seeking a Commission declaration that a new pipeline partnership, Longhorn Partners Pipeline (Longhorn) be allowed to include the full purchase price of a crude oil pipeline to be purchased from Exxon Pipeline Company (Exxon) in Longhorn's cost-of-service computations underlying the rates to be charged. Under the proposal, the facilities in question would be reversed and would carry petroleum products. The Commission approved the request, subject to certain conditions.[50]

The Commission found that Longhorn met the two-pronged substantial benefits test[51] permitting the write-up of jurisdictional facilities. First, Longhorn will be putting the Exxon line to a new use so the same ratepayers will not be paying twice for the line. Second, ratepayers will benefit because the line conversion will result in utilization of currently under-utilized facilities. The caveat, however, is that to the extent Exxon became an equity partner in the new pipeline, the valuation of the purchase price will be subject to further review.

49. *Texaco Ref. and Mktg. Inc. v. SFPP, L.P.*, 75 F.E.R.C. ¶ 61,292 (1996).
50. *Longhorn Partners Pipeline*, 73 F.E.R.C. ¶ 61,355 (1995).
51. *Id.* at 62,113.

F. Express Pipeline Partnership

A proposed pipeline sought a declaratory order, approving its proposed rates and rate structure. Express Pipeline Partnership anticipates constructing a new crude pipeline from the international border at Wild Horse, Alberta, to Casper, Wyoming, where Express would connect with other crude pipelines. Express proposed charging prospective shippers a progressively lower rate for longer term shipping commitments ranging from 5 to 10 to 15 years. Uncommitted shippers would pay a higher rate. Certain other variables applied.

Despite a number of protests, the Commission did not deny the petition or set the matter for hearing. Instead, it found it did not have enough information to resolve the matter. The Commission ordered Express to "provide a projected cost, revenue, and throughput study for each year in the 15 year period."[52]

G. Lease Cases

Two pending cases concerning whether a pipeline may lease capacity from another pipeline and base its rates on something other than the lessor's rates were settled during 1995. As reported last year, the proposed "contested" settlement in *Phillips Pipe Line Co.* was pending before the FERC at the beginning of 1995.[53] Phillips' settlement proposal provided for a roll back to the prior level of the lessor's rates, for the entire lease period. In the other proceeding, *Total Pipe Line Corp.,*[54] an offer of settlement was submitted in February 1995.

The FERC Staff and the protestant opposed both settlements on the ground that it would leave unresolved the recurring legal question concerning the validity of lessee rate practices. In two similar orders however, the Commission found no affected shipper objected to the settlements and approved them as "uncontested." The Commission refused to decide the certified questions, finding the issues moot in these proceedings and any decision to constitute an advisory opinion. The Commission stated its belief that the issues raised were unlikely to recur, because any future rates charged by lessee pipelines would be required to conform to the requirements of Order Nos. 561 and 561-A.[55]

H. Changed Circumstances

In November 1994, Santee Distributing Company (Santee) filed a complaint against Dixie Pipeline Company's rates. These rates were grandfathered under section 1803(a) of the EPAct.[56] The Commission determined Santee could not challenge the rates in questions without meet-

52. *See Express Pipeline Partnership*, 75 F.E.R.C. ¶ 61,303 at 61,967 (1996).

53. *See Phillips Pipe Line Co.*, 68 F.E.R.C. ¶ 63,001 (1994).

54. *See Total Pipe Line Corp.*, 69 F.E.R.C. ¶ 63,018 (1994).

55. *Phillips Pipe Line Co.*, 73 F.E.R.C. ¶ 61,280 (1995); *Total Pipe Line Corp.*, 73 F.E.R.C. ¶ 61,269 (1995).

56. 42 U.S.C. § 7172 (1994).

ing the changed circumstances requirements of section 1803(b) of EPAct. Finding that "it is not enough, as Santee argues, to merely raise a factual issue with regard to changed circumstances," the Commission dismissed Santee's complaint.[57] Santee sought a rehearing, which the Commission denied. The Commission found Santee had still not met EPAct's requirement that a person filing a complaint must present *evidence* establishing that a substantial change has occurred.[58]

I. Gaviota Terminal Company

Gaviota Terminal Company filed initial tariffs in 1994 for service from the Point Arguello oil field to the All American Pipeline. The tariff was protested by a number of off-shore producers known as the "Producer Group." The parties filed initial briefs on June 7, 1996. Among other things, the Producer Group claimed Gaviota violated the ICA by shipping oil without filing a tariff. The Producer Group sought refunds from operations in 1991 until Gaviota filed tariffs with the FERC. The FERC Staff also criticized Gaviota on this point, claiming Gaviota knew, or should have known that oil was moving in interstate commerce.

Gaviota maintained that it was not subject to Commission jurisdiction when it began operations in 1991. Gaviota stated that only a portion of the oil it currently handles moves in interstate commerce. Conceding its interstate service was subject to FERC jurisdiction, Gaviota argued good faith reliance on an earlier legal opinion determining that Gaviota was not a jurisdictional facility. Gaviota also argued that the Producer Group was not entitled to refunds for the period that Gaviota provided service but did not file a FERC tariff because the shippers acquiesced to Gaviota's conduct for their own purposes.

The Producer Group and the FERC staff contested Gaviota's claim that its rates were below cost-of-service allowable levels. A portion of Gaviota's facilities were purchased and then construction was undertaken to improve the storage capabilities and to add tankering facilities. The tankering facilities were only used for seven months before the *Exxon Valdez* spill occurred and permits were lost. The Producer Group and the FERC staff argued that Gaviota could not include the cost of its now unused marine terminal facilities in its rates. They also claimed that the facilities purchased by Gaviota were already in public use, thereby disallowing capitalization of the full purchase price. Gaviota replied that those costs were prudently incurred for the benefit of all Point Arguello producers and should be recoverable from the shippers, rather than borne by the shareholders.

The parties also differ on cost-of-service issues related to depreciation and dismantling, removal, and restoration (DR&R) costs. The FERC staff maintained that Gaviota's revenues exceed staff's cost of service for the period examined. Staff recommended use of unit-of-throughput (UOT)

57. *Santee Distributing Co. v. Dixie Pipeline Co.*, 71 F.E.R.C. ¶ 61,205, at 61,755 (1995).
58. *Santee Distributing Co. v. Dixie Pipeline Co.*, 75 F.E.R.C. ¶ 61,254, at 61,819 (1996).

depreciation for Gaviota's pipeline facilities, and straight-line depreciation for the terminal's marine facilities. While staff accepted Gaviota's estimate regarding DR&R costs (approximately $8,048,093), staff divided those costs between pipeline and marine facilities, with approximately $1 million allocated to the latter. Staff further proposed placing DR&R accruals in a separate account and subtracting the "DR&R reserve" from the rate base. Finally, staff opposed Gaviota's proposed 12.1% real rate of return on equity and recommends a rate of 8.2%. The Producer Group favored 7.73%.

A second Gaviota proceeding commenced in 1995. The Producer Group and Whiting Petroleum Corporation protested a proposed $0.32/barrel increase in Gaviota's rate for transportation from the Point Arguello Pipeline Company to the All American Pipeline. The parties agreed to be bound by the precedent established in the earlier case as to some issues, such as depreciation and DR&R costs. Gaviota submitted its direct testimony on June 18, 1996. Hearings are scheduled to commence on October 22, 1996.

J. *Kaneb Pipe Line Operating Partnership, L.P.*

On February 28, 1995, Kaneb filed a tariff supplement in which it proposed to cancel certain joint tariff rates with Mid-America Pipe Line Company (MAPCO) effective March 31, 1995. On March 9, 1995, Farmland Industries, Inc. (Farmland) protested, claiming that cancellation of the joint rates at issue would force it to pay individual tariff rates to MAPCO and Kaneb, thereby significantly increasing its costs for transporting product.

Concluding that it lacked sufficient information to determine whether the proposed cancellation was in the public interest, the Commission suspended that aspect of Kaneb's tariff supplement for seven months pending further investigation. The Commission sought further comment from MAPCO, Kaneb, and Farmland regarding both the basis for future interstate service to Farmland and the public interest issue.[59] MAPCO (together with its intrastate affiliate, MAPCO Intrastate Pipeline, Inc.) and Kaneb responded to the FERC's request for further comment; Farmland did not respond. MAPCO described several means by which future interstate service could be provided to Farmland, and asserted that the joint tariff cancellation at issue was in the public interest. Kaneb took no position concerning whether the proposed cancellation was in the public interest.

Based on these submissions, and absent any comment from Farmland, the FERC issued an order on October 25, 1995, lifting its suspension of Kaneb's joint tariff cancellation and discontinuing its investigation.[60] On November 20, 1995, Farmland sought a rehearing of the Commission's October 25th order. The Commission denied the request on both procedural and substantive grounds. The Commission first pointed out, that

59. *Kaneb Pipe Line Operating Partnership, L.P.*, 70 F.E.R.C. ¶ 61,367 (1995).
60. *Kaneb Pipe Line Operating Partnership, L.P.*, 73 F.E.R.C. ¶ 61,105 (1995).

Farmland never intervened in the proceeding, and was therefore not a party entitled to seek rehearing. Farmland also did not adequately explain its earlier failure to respond to the Commission's request for additional information. Finally, the information presented in Farmland's petition was found to be irrelevant to the issue of whether the cancellation was in the public interest.[61]

K. The Filed Rate Doctrine

In *Phillips Pipe Line Co. v. Diamond Shamrock Refining and Marketing Co.*,[62] the Tenth Circuit considered whether an agreement regarding use of a pipeline's capacity between two owners of an undivided joint interest pipeline violated the filed rate doctrine. Phillips Pipe Line Company (Phillips) and Diamond Shamrock Refining and Marketing Company (Diamond Shamrock) owned undivided interests of approximately 70 percent and 30 percent, respectively, in the Colorado Products Pipeline (CPP). Both Phillips and Diamond Shamrock operated their portions of the CPP as common carriers and filed tariffs with the FERC. However, the CPP construction and operating agreement provided that, whenever one owner would not use its entire share of capacity for a particular month, the other owner could lease the excess capacity at the rate of 15 cents/barrel.

In 1990, Phillips refused to lease excess capacity to Diamond Shamrock because the 15 cents/barrel lease price was far below the tariff rate for the capacity. Consequently, Phillips claimed that making the capacity available to Diamond Shamrock at the lower price might violate the filed rate doctrine.

The Tenth Circuit rejected Phillips' position. Resolution of Phillips' claims turned on whether the relationship between the parties was that of shipper and carrier or lessee and lessor. The Court reasoned that under the lease arrangement contained in the CPP construction and operating agreement, Phillips and Diamond Shamrock stood as lessor/lessee, not shipper/carrier. As a result, the lessee (Diamond Shamrock) became a carrier, not a shipper, with respect to the leased capacity; its own filed rate governed transportation of product through the capacity leased from Phillips.[63] Because only shippers are required to pay a carrier's filed rate, the Court concluded that "the filed rate doctrine does not trump the terms of the Lease."[64]

61. *Kaneb Pipe Line Operating Partnership, L.P.*, 74 F.E.R.C. ¶ 61,175, 61,611 (1996).

62. *Phillips Pipe Line Co. v. Diamond Shamrock Ref. and Mktg. Co.*, 50 F.3d 864 (10th Cir. 1995).

63. *Id.* at 867-69.

64. *Id.* at 869.

L. *Form 6 Issues*

1. Exemptions

a. Hunt Refining Company and East Mississippi Pipeline Company

On January 18, 1995, the Commission issued its order in Docket No. OR94-7-000[65] finding petitioners Hunt Refining Company and East Mississippi Pipeline Company to be jurisdictional pipeline carriers subject to the ICA, but granted them a temporary waiver from the filing and reporting requirements of the Act (49 U.S.C. App. 6, 19a, and 20).[66] The Commission, however, required the petitioners to maintain all books and records in a manner consistent with the Uniform System of Accounts for Oil Pipelines,[67] and make such books and records available to the Commission or its duly authorized agents upon request.[68] It emphasized that because the waivers were temporary, any changes in circumstances must be reported to the Commission immediately include, but are not limited to: increased accessibility of other pipelines or refiners to their facilities; changes in the ownership of the facilities; changes in the ownership of the oil or by-products being shipped; and shipment tenders or requests for service by any person.[69]

The petitioners argued that their facilities were private, proprietary systems, not subject to the Interstate Commerce Act (ICA), citing *The Pipe Line Cases*, 234 U.S. 548 (1914).[70] The Commission, however, viewed that decision as defining a private carrier narrowly, and relied, instead, on *Valvoline Oil Co. v. United States*[71] ("*Valvoline*"). In *Valvoline*, the Court stated that it was the purchase of oil from many sources and subsequent carriage that determined the applicability of the ICA to *Valvoline*, and distinguished it from the private pipeline carrier discussed in *The Pipe Line Cases*.[72]

As in *Valvoline*, the Commission noted that other producers are connected into the pipeline system,[73] and oil is delivered into the Choctaw Gathering System through facilities owned by Amerada Hess. As a result, the Commission ruled that the petitioners' facilities do more than move their own oil from their wells to their refinery.[74]

65. *Hunt Refining Co. and East Mississippi Pipeline Co.*, 70 F.E.R.C. ¶ 61,035 (1995) (*Hunt*).

66. *Id.* at 61,113. The Commission noted (n.8) that it "no longer conducts and issues pipeline valuations; thus, compliance with section 19(a) is unnecessary for all oil pipelines."

67. 18 CFR Part 352.

68. *Id.*

69. *Id.*

70. *Id.* at 61,111-12.

71. 308 U.S. 141 (1939).

72. *Hunt, supra* note 65, at 61,112.

73. The pipelines owned by Hunt Refining Company consist of the interconnected lines: the Choctaw Gathering System, the Melvin Line, and the Choctaw Pipeline System. East Mississippi Pipeline Company, a Hunt subsidiary, owns the pipeline assets of Clarco Pipeline Company that now interconnect with Hunt's gathering facilities; all of the pipeline facilities operated as an integrated system. *Id.* at 61,111.

74. *See id.* at 61,112.

While the Commission found jurisdiction to exist, its findings reflected a grant of petitioners' alternative request—an exemption from filing and reporting requirements.[75] In effect, the Commission gave credence to petitioners' arguments that *Sinclair Oil Co.*[76] and *United States v. Champlin Refining Co.*[77] ("*Champlin II*") warranted such action.[78] It reasoned that the pipeline facilities at issue are used solely to transport oil owned by Hunt to its refinery at Tuscaloosa, Alabama; that no oil is transported for a third party and such a request is unlikely; and that there are no other shippers to protect under the ICA.[79] The physical characteristics of the facilities and the limited nature of the pipeline operations therefore warranted the exemption.[80]

b. Ciniza Pipe Line, Inc.

On March 30, 1989, Ciniza Pipe Line, Inc., a wholly-owned subsidiary of Giant Industries, Inc., filed a request that the Oil Pipeline Board exempt it from the tariff filing requirements, annual reporting, accounting, and record-keeping provisions of 49 U.S.C. App. 6 and 20. Almost six years later, on December 14, 1994, the Board rejected the request in a letter indicating that the relief sought by Ciniza had been overtaken by recent events and Commission's Order Nos. 561, 561-A and 571.

Thereafter, on February 21, 1995, Giant Industries Arizona, Inc., of which Ciniza had become a division, filed a motion for leave to file an appeal out of time from the Board's order and submitted its appeal and exceptions to the Board order. It argued that the two rulemakings cited by the Board do not provide the relief it seeks, given the fact that the Ciniza petition sought exemption from the filing and reporting obligations. It stated that the Commission had provided similar relief in both *Hunt*[81] and *Sinclair*[82].

The Commission agreed, granting Ciniza a temporary waiver of the filing and reporting requirements.[83]

2. Rulemaking - Revision to FERC Form 6

On October 3, 1995, the Commission issued Order No. 583.[84] The Commission exempted from Form 6 filing requirements those pipelines whose jurisdictional operating revenues are at or below $350,000 for each of the three preceding calendar years.[85] Companies exempt from filing

75. *Id.* at 61,113.
76. 4 F.E.R.C. ¶ 62,026 (1978).
77. 341 U.S. 290 (1951).
78. *Id.*
79. *Id.*
80. *Id.*
81. *See supra* note 65.
82. *Sinclair Oil Corp.*, 4 F.E.R.C. ¶ 62,026 (1978).
83. *Ciniza Pipe Line, Inc.*, 73 F.E.R.C. ¶ 61,377 (1995).
84. Order No. 583, *Minimum Filing Requirements for FERC Form 6, Annual Report for Oil Pipelines*, III F.E.R.C. STATS. & REGS. ¶ 31,027; 60 Fed. Reg. 53114 (Oct. 12, 1995).
85. Order No. 583, at 31,526.

Form 6 must, nevertheless, prepare and file, for each reporting year, page 700, "Annual Cost of Service Based Analysis Schedule," of Form 6, and page 1 of Form 6 which includes the Identification and Attestation schedule of Form 6.[86] These provisions became effective January 1, 1995.[87] The change to the annual charges regulations became effective on November 11, 1995, 30 days after publication in the Federal Register, for the 1996 fiscal year.[88]

III. ALASKA PIPELINE CASES

A. *Trans Alaska Pipeline System (TAPS) Quality Bank Case*

As explained in the 1995 Committee Report, TAPS is a common stream pipeline that transports different grades of crude oil in a commingled stream from the producing fields on Alaska's North Slope to the Port of Valdez. The "quality bank" is the system used to make monetary adjustments among the TAPS shippers to account for differences in the value of the crude tendered by an individual shipper and the value of the commingled stream the shipper receives at Valdez.

Beginning in 1984, quality bank adjustments were made using a gravity-based methodology. This methodology was challenged beginning in 1989. A settlement was reached that proposed adoption of a distillation-based methodology. The Commission ultimately adopted a distillation-based methodology, but modified several elements of the methodology agreed to in the settlement. A number of the TAPS Carriers appealed the Commission's order to the D.C. Circuit.

The Court found the Commission acted appropriately in changing the quality bank methodology, but remanded various aspects of the valuation methodology.[89] The Court found the Commission's reasoning concerning valuation of distillate and resid cuts arbitrary. The Court also remanded to the Commission the question of allocation of quality bank funds, recommending that the Commission develop a well-reasoned policy.

Exxon Company, U.S.A. and OXY U.S.A., Inc., petitioned the Court for rehearing. The Court denied the petitions *per curiam*. The parties filed a number of comments with the Commission regarding issues on remand. These ranged from valuation of the distillate and resid cuts, to a suggested consideration of alternative quality bank methodologies.

The Commission decided to conduct further settlement discussions with respect to the remanded issues, prior to scheduling further hearings.[90] On May 9, 1996, the Settlement Judge terminated the settlement proceedings and returned the docket to the Commission. In early June, Exxon Company, U.S.A. filed a complaint alleging the TAPS quality bank methodology to be unjust, unreasonable and discriminatory. Exxon requested

86. *See* Order No. 583, *supra* note 80, at 31,526 n.2.
87. *See* Order No. 583, *supra* note 80, at 31,529.
88. *Id.*
89. *OXY USA, Inc. v. FERC*, 64 F.3d 679 (D.C. Cir. 1995).
90. *Trans Alaska Pipeline System*, 74 F.E.R.C. ¶ 61,317 (1996)

that its complaint be consolidated with the on-going quality bank proceedings. The Commission issued a notice of the complaint on June 25, 1996.[91]

B. *TAPS Pumpability Case*

On January 16, 1996, the parties appeared before the U.S. Court of Appeals for the District of Columbia Circuit for oral argument on both of the substantive issues and the tariff requirement issue, which were both described in last year's report.[92] A decision is expected in the summer.

C. *TAPS Corrosion Case*

On June 21, 1995, the TAPS Carriers and the State of Alaska submitted an Offer of Settlement to the FERC and the Alaska Public Utilities Commission. In a series of orders dated November 13, 1995, approving the settlement, the FERC noted that the settlement established a framework for continuation of the corrosion cooperative program and terminates the State's further participation in the TAPS corrosion case.[93] The Alaska Public Utility Commission (APUC) approved the settlement in March 1996 but ordered the TAPS Carriers to identify and quantify any costs included in its rates arising from the settlement.

D. *TAPS 1994 Tariff Case*

On April 13, 1995, the Commission reversed an Initial Decision that had held that certain costs involved in the litigation and settlement of civil cases arising out of the 1989 Exxon Valdez oil spill (LS Costs) were properly recordable in Account 610 of the Uniform System of Accounts as operating costs.[94] The Commission held that the LS Costs were infrequent and unusual and therefore should be recorded in Account 680.[95] The Commission noted that, in considering whether an event is infrequent and/or unusual, the size of an event is a relevant consideration.[96]

On March 27, 1996, the Commission decided that the plain language of the TAPS Settlement Agreement precludes recovery of the Account 680 extraordinary costs from operating expenses. The Commission ordered the TAPS Carriers to refund those costs that had already been collected, with interest.[97] The TAPS Carriers appealed to the D.C. Circuit in early May.[98] The other issues in this proceeding, the permissibility of including in TAPS rates certain public relations costs and amounts for Post Retirement Benefits Other Than Pensions (PBOPs), have been the subject of ongoing settlement negotiations between the parties.

91. 61 Fed. Reg. 33912 (July 1, 1996).

92. *Report of the Committee on Oil Pipeline Regulation*, 16 ENERGY L.J. 565, 581 (1995).

93. *Unocal Pipeline Co.*, 73 F.E.R.C. ¶ 61,195 (1995).

94. *Amerada Hess Pipeline Corp.*, 71 F.E.R.C. ¶ 61,040 (1995).

95. *Id.* at 61,166, 61,169-173.

96. *Id.* at 61,170, 61,173.

97. *Amerada Hess Pipeline Corp.*, 74 F.E.R.C. ¶ 61,318 (1996).

98. *Amerada Hess Pipeline Corp. v. FERC*, No. 96-1153 (D.C. Cir., filed May 9, 1996).

E. *TAPS 1995 Tariff Case*

In December 1994, the State protested the inclusion of what it alleges to be more than $225 million dollars for "repair and remediation activities relating to Alaska's failure to comply with legal and regulatory requirements."[99] The State's protest specifically challenges "costs required to remediate problems relating to electrical systems, as-built drawings and configuration control."[100]

Much of the activity in the first half of 1996 concerned a discovery dispute with respect to the production of documents prepared by the TAPS Carriers in connection with 1993 Congressional oversight hearings. The TAPS Carriers claimed these documents qualified for attorney work product protection because they were prepared in anticipation of litigation. The Commission agreed, ordering the Presiding Judge to examine each document in question and to consider when and how it was prepared.[101]

In May, the State of Alaska filed its direct testimony. On June 5, 1996, the TAPS Carriers moved for partial summary disposition, arguing that the State is barred by a prior settlement from alleging imprudence prior to January 1, 1985. Oral argument on the motion was scheduled for early July.

F. *TAPS 1996 Tariff Case*

Along with its protest of the 1996 TAPS tariff rates with respect to the issues discussed above, the State filed a complaint and petition for declaratory order alleging that the TAPS Carriers' DRA (Drag Reducing Agent) Agreement and related agreements constitute an unlawful agreement to "pool or divide traffic, service or earnings" in violation of section 5(1) of the Interstate Commerce Act. 49 U.S.C. app. § 5(1).[102] The State alleged that the effect of the DRA Agreement was to remove any competitive incentives for the TAPS Carriers to lower their rates.[103] The issues regarding the DRA Agreement were set for investigation, and consolidated with Exxon Pipeline Company's petition for declaratory order with respect to the TAPS allocation plan proposed by other TAPS Carriers.[104]

The effect of DRA use is to increase pipeline capacity, much as additional pump stations increase capacity. As throughput on the pipeline drops, pump stations and DRA are being eliminated. This reduces the overall capacity of the pipeline. The various TAPS Carriers are disputing how the remaining capacity is to be allocated under the TAPS Operating Agreement. That question is before the Alaska State Court.

99. Protest, Complaint and Petition by the State of Alaska for Investigation Into the Proposed 1996 TAPS Tariffs and Intervention in Any Subsequent Proceedings at 14 (Dec. 15, 1995) (1996 State Protest).

100. *Id.*

101. *ARCO Transportation Alaska, Inc.*, 75 F.E.R.C. ¶ 61,129 (1996).

102. 1996 State Protest, *supra* note 99, at 15. The State is seeking damages in connection with its complaint. 1996 State Protest, *supra* note 99, at 20.

103. 1996 State Protest, *supra* note 99, at 16.

104. *Amerada Hess Pipeline Corp.*, 73 F.E.R.C. ¶ 61,401 (1995).

On April 10, 1996, the Commission stayed its proceeding with respect to these issues pending resolution of the related proceedings in Alaska. The Commission noted that resolution of the underlying dispute concerning the TAPS Operating Agreement may render the asserted illegality of the DRA Agreement moot.[105]

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105. *Exxon Pipeline Co.*, 75 F.E.R.C. ¶ 61,034, 61,097 n.11 (1996).