

# Report of The Committee On Oil Pipeline Regulation

## I. INTRODUCTION

During 1983, the ratemaking methodology established for oil pipelines by the Federal Energy Regulatory Commission ("FERC" or "Commission") in *Williams Pipe Line Company*<sup>1</sup> remained on appeal before the United States Court of Appeals for the District of Columbia Circuit.<sup>2</sup> By the end of July, all parties had filed briefs and, in November, oral argument was held. As FERC has stayed the consideration and disposition of almost all the remaining oil pipeline rate matters pending the appellate court's decision, few developments on the administrative level have occurred in the federal regulation of oil pipelines. Similarly, little Congressional action has been taken in response to the deregulation bills submitted in the 98th Congress. [Ed. note: As this issue went to press, the D.C. Circuit announced its decision remanding the case to the Commission on March 9, 1984.]

## II. WILLIAMS PIPELINE CASE

### A. Appeal of Williams Decision

The decision of FERC in the *Williams* case is currently on appeal to the United States Court of Appeals for the D.C. Circuit.<sup>3</sup> The appeal is being pursued by the Farmers Union Central Exchange ("Farmers Union") (representing various shipper interests) and the United States Department of Justice ("DOJ"). For its part, FERC is defending the appeal, aided by the Association of Oil Pipe Lines ("AOP"), Williams Pipe Line Company, and other pipelines.<sup>4</sup>

In its appellate brief, Farmers Union challenged FERC's interpretation of the "just and reasonable" standard for the regulation of rates under the Interstate Commerce Act ("ICA"). In *Williams*, FERC found that the "just and reasonable" standard permitted the collection of all rates short of "egregious exploitation" and "gross abuse." Farmers Union contended that this controlling standard confined FERC approval to rates equal to the cost of providing the subject service plus a reasonable profit. In addition, Farmers Union argued that the legislative history of the Hepburn Act Amendments of 1906 to the ICA indicates that the ICA was intended to broadly protect consumers from the monopoly power of oil pipelines — protection still required in the present day. Finally, Farmers Union claimed that FERC retention of the rate base methodology earlier rejected by the identical appellate court on its remand of the initial ICC *Williams* decision to FERC in 1978, constituted an arbitrary and capricious action that must be reversed by the court.

The DOJ characterized FERC's decision as inconsistent with the express language of the ICA and subsequent judicial opinions. Furthermore, DOJ

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<sup>1</sup>21 FERC § 61,260 (1982).

<sup>2</sup>*Farmers Union Central Exchange, Inc. et al. v. FERC*, Nos. 82-2412, et al. (D.C. Cir. Mar. 9, 1984) (Wald, J.).

<sup>3</sup>*Williams Pipe Line Co.*, Opinion No. 154, 21 FERC ¶ 61,260 (1982). The *Williams* decision and its implications are discussed more fully in the 1982 Report of the Committee On Oil Pipeline Regulation. 4 Energy L.J. 143 (1983).

<sup>4</sup>The Association of Oil Pipe Lines and Williams Pipe Line appealed limited portions of FERC's opinion that concerned improvements in the valuation formula and the deduction of accumulated deferred tax amounts from the rate base. *Williams* also appealed on the questions of retroactivity and of FERC's failure to consider the *Williams*' purchase price for any ratemaking purposes. However, for the most part, both parties defended FERC's decision.

challenged FERC's reliance on the presence of competitive restraints to hold down oil pipeline rates contending that the record was void of any evidentiary support for FERC's finding. Consequently, the DOJ sought reversal of the *Williams* opinion.

In defense of its decision, FERC argued that as a regulatory agency it enjoys broad discretion in selecting a ratemaking methodology consistent with the ICA. FERC stated that the methodology selected in *Williams* is in accord with the Congressional intent — expressed in the Hepburn Act Amendments — to lessen the monopoly power of the Standard Oil Company and its discriminatory rate practices and prohibitive pricing. Finally, FERC claimed that producers are able presently to gain access to the necessary pipelines because of extensive competition in the oil pipeline industry. Therefore, FERC found no compelling need to alter the existing ratemaking methodology.

The remaining parties to the appeal, the oil pipelines, support the decision in *Williams*. Citing FERC's broad discretion in formulating and adopting ratemaking methodologies and the judicial deference accorded administrative agencies in areas of their expertise, the pipelines argued that the *Williams* decision should be affirmed under the reasonableness standard of appellate court review.

On November 18, 1983, oral argument in the case was heard by a panel of the U.S. Court of Appeals for the District of Columbia Circuit, consisting of Judges Wald, Edwards and Starr. It is possible that further appellate and administrative procedures will follow the court's decision and postpone a final resolution of the appropriate ratemaking methodology for oil pipelines.

#### B. Phase II of *Williams*

In the *Williams* decision, FERC ordered the ratemaking methodology formulated in Phase I of the proceeding applied to the Williams Pipe Line Company. This application is to occur in Phase II of the proceeding in which the Commission will determine the reasonableness of past rates, establish future rates, and calculate necessary refunds. For the Phase II proceeding, the presiding Administrative Law Judge, Isaac D. Benkin, established a revised procedural schedule, jointly requested by the parties. The following dates were set for the various submissions: (i) November 28, 1983 as the date for the filing of motions to compel discovery or strike data requests; (ii) December 2, 1983 as the prehearing conference date for consideration and disposition of discovery disputes; (iii) the filing of the ICC record will be simultaneous with the original briefs of the parties; (iv) February 9, 1984 for the case-in-chief; (v) March 26, 1984 for answers; and (vi) May 7, 1984 for the beginning of hearings. As of the date this report went to press, the parties have thus far adhered to the hearing schedule established for Phase II of the *Williams* proceeding.

#### C. Stay of FERC Proceedings

The pendency of the appellate court's decision in *Williams* has delayed FERC action on most remaining pipeline ratemaking matters.<sup>5</sup> In that regard, the investigation of rate increases proposed by the Cook Inlet Pipeline Company ("Cook Inlet") has been stayed pending the outcome of *Williams*. Docket No. IS80-40 *et al.* In this proceeding, the State of Alaska is seeking revival of an investigation terminated

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<sup>5</sup> However, one must remember that in the wake of *Williams*, FERC dismissed over 500 cases where no protests had been filed to the proposed rates of sixty-nine pipelines. See *American Petrofina Pipe Line Company, et al.*, 21 FERC ¶ 61,314 (1982).

by FERC, in the wake of *Williams*, on the grounds that the ratemaking methodology adopted in *Williams* is inapplicable to Cook Inlet because the latter enjoys a monopoly position similar to the Trans Alaska Pipeline System. In another proceeding, on April 15, 1983, FERC reinstated an investigation of the Phillips Pipeline Co. as requested by the DOJ, but stayed further action pending the court's decision in *Williams*.<sup>6</sup> Docket No. IS78-1 *et al.* Finally, in *Gulf Central Pipeline Company*, Docket No. IS83-26, FERC is investigating a six percent rate increase for the transportation of anhydrous ammonia. The increase was protested by CF Industries and International Minerals & Chemicals Corporation. This proceeding is the first ratemaking case in which the methodology adopted in *Williams* was employed in testimony filed with the Commission. The direct testimony, containing the *Williams* analysis, was filed on May 13, 1983 before Administrative Law Judge Bruce L. Birchman. On June 9, 1983, CF Industries offered to settle the case, accepting Gulf Central's direct testimony as within the scope of *Williams*, but subject to the condition that the case be reopened should the Commission's holding in *Williams* be remanded by the court. Gulf Central opposed this condition. On September 21, 1983, FERC issued a notice staying action on the offer of settlement until final judicial resolution of *Williams*. 24 FERC ¶ 61,370 (1983).

The only proceeding still active at FERC is the investigation of Kuparuk Pipeline Company, Docket No. IS82-54, where Administrative Law Judge Thomas I. Megan denied a jointly filed motion for a stay of further proceedings pending the *Williams* decision. The ALJ cited FERC insistence on expeditious disposition of pending oil pipeline rate matters and the probable delay in issuance of a decision in the *Williams* appeal as support for denying the stay. The judge recommended settlement negotiations as a means of resolving the rate dispute instead of waiting for the appellate court's decision.

### III. TRANS-ALASKA PIPELINE SYSTEM

#### A. Phase I of TAPS

Phase I of the Trans Alaska Pipeline System ("TAPS") case, Docket No. OR78-1, was remanded by FERC on November 30, 1982, for the limited purpose of determining whether the ratemaking methodology established in *Williams* applied to the system.<sup>7</sup> On February 10, 1983, Administrative Law Judge Benkin outlined the following issues for consideration and disposition in Phase I: (1) TAPS' overall competitive situation; (2) the monopoly power of TAPS and its owners; (3) the effect of soon-to-be established rates on North Slope exploration and development; (4) the effect of these rates on consumers; (5) the applicability of *Williams* ratemaking methodology to TAPS; (6) the effect of rates on the State of Alaska and its tax revenues and royalties for governmental and non-governmental units; and (7) the long-term effects of *Williams* on the development of, and investment in, "frontier" oil pipeline facilities. In July, the respective parties outlined their positions on these

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<sup>6</sup>Although this particular proceeding was not stayed, FERC approved a settlement and agreement on May 25, 1983, filed in the investigation proceeding of Dome Pipeline Corporation. Docket Nos. IS81-60 and IS82-25. The Stipulation and Settlement Agreement prescribes a method for determining rates through January 1, 1986, based on original cost annual straight-line depreciation and amortization charges not less than 3.5%, and an interest rate on debt of 11%. The Stipulation states that although original cost methodology is used as the basis for the settlement, the parties do not intend that to be precedent for any future rate cases.

<sup>7</sup>A complete discussion of both Phase I and Phase II of the TAPS proceeding is contained in the 1982 Report of The Committee On Oil Pipeline Regulation. 4 Energy L.J. 143 (1983).

issues in filings with FERC. On August 6, 1983, the Department of Energy withdrew from the TAPS proceeding, leaving the Department of Justice as the representative of the federal government's interests.

On November 1, 1983, the respective parties filed their direct testimony in Phase I. The testimony concentrated to a large extent on the seven major areas of inquiry outlined above. Dr. Alfred E. Kahn, on behalf of the DOJ, the State of Alaska and the Arctic Slope Regional Corporation, concluded that the *Williams* decision should not apply to TAPS because the competitive restraints recognized in the former are not present in the latter. Rebuttal testimony was filed on December 23, 1983. The cross-examination of the Phase I witnesses began on January 16, 1984 and is expected to continue until the end of the month.

#### B. Phase II of TAPS

The hearings begun in 1982 into the costs of construction of TAPS continued throughout most of 1983 with the cross-examination of various witnesses. On September 23, 1983, this cross-examination was concluded and TAPS filed testimony on the noncost of construction issues. This testimony became the subject of cross-examination on October 24, 1983, with the resumption of hearings. On September 20, 1983, a prehearing conference was convened to resolve discovery disputes associated with the third Quality Bank Adjustment on TAPS (22¢/bbl. per degree API gravity). This adjustment is necessary to equalize the effect of commingling various grades of oil in the system. On October 28, 1983, all interested parties submitted direct evidence on the differential. The hearing on the disputed issues commenced on December 12, 1983 and ended on December 19, 1983. On January 1, 1984, the adjustment was superseded by a 21¢/bbl. adjustment.

During 1983, cross-examination continued on the testimony submitted on the noncost of construction issues, including the computation of federal and state income taxes and the costs associated with research studies undertaken and completed. On December 12, 1983, this cross-examination ended. A prehearing conference was scheduled for March 12, 1984, to allow the parties an opportunity to report to administrative Law Judges Kane and Benkin on settlement of the noncost of construction issues.

#### C. Related Proceedings

In a related proceeding at FERC, the Commission held that the Alaska Public Utilities Commission possessed sole jurisdiction over the intrastate transportation of oil via TAPS to the Fairbanks refinery of MAPCO Alaska, Inc. Opinion No. 171, *Trans Alaska Pipeline System*, 23 FERC ¶ 61,352 (1983). FERC opined that even though some commingling may occur within the TAPS system between intrastate oil and oil destined for interstate commerce, the "engineering and scientific test" by which the United States Supreme Court confirmed FERC jurisdiction in the past<sup>8</sup> is inapplicable to matters involving oil pipelines. The Commission explained that producers and shippers of oil are not subject to federal jurisdiction. *Id.* at 61,764. In addition, even if the regulatory structure is abused by misclassification of intrastate sales, FERC retains the power under the ICA to remedy any "discrimination against interstate commerce caused by intrastate rates which are too low." *Id.* Therefore, FERC refused to subject the involved intrastate transportation to its jurisdiction.

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<sup>8</sup>See *California v. Lo-Vaca Gathering Co.*, 379 U.S. 366, 369 (1965).

In a separate docket, BP Pipelines, Inc., filed a tariff on March 2, 1983, proposing an increase in its rates for the transportation of certain crude oil through TAPS, with an effective date of April 1, 1983. *BP Pipelines, Inc.*, Docket No. IS83-29. On March 21, the State of Alaska filed a protest and petition for suspension claiming that the proposed rate increase was unjust, unreasonable and discriminatory and suggested a seven month suspension. On March 24, Arctic Slope Regional Corporation filed a similar protest. On March 31, one day before its effective date, the Commission suspended the proposed rate increase for seven months and ordered an investigation into the lawfulness of the rate.<sup>9</sup> The Commission also ordered that while the investigation would be conducted separate from the TAPS docket, no further proceedings would be set pending a decision in TAPS. On May 16, 1983, FERC affirmed the suspension while denying a motion of the State of Alaska to consolidate the BP proceeding with TAPS.<sup>10</sup>

#### IV. ADMINISTRATIVE MATTERS

On June 20, 1983, FERC adopted regulations amending Subpart N of the Commission's Rules of Practice and Procedure, requiring annual updating of subscriber lists by oil pipelines. In addition, the amended regulations established new time frames for protesting oil pipeline tariff proposals. Under the new regulations, for tariffs with a thirty-day notice period, all protests and petitions to intervene are due at least twelve days prior to the tariff's proposed effective date. As for tariffs with a ten-day notice period, filings must be made five days before the proposed effective date.

In a case of first impression at the FERC, the Commission granted a request of the Exxon Pipeline Company to reclassify 2,911 miles of trunkline and 1,036 miles of gathering lines from common carrier to noncarrier service. Docket No. IS82-178. The reclassification occurred in preparation of Exxon's 1981 valuation report and was based on the following regulation:

[c]arrier property is that which is used exclusively for common carrier purposes. Noncarrier property is that which is used exclusively for purposes other than those of a common carrier. These definitions are to be interpreted as disregarding incidental or immaterial use.

18 C.F.R. § 361.6. The Commission agreed with Exxon and found that use of a pipeline "for carrier purposes below five percent would be 'incidental' or 'immaterial' use and should be disregarded in accordance with Section 361.6 of the Commission's regulations governing the reporting of property changes." *Order Granting Reclassification of Property*, 25 FERC ¶ 61,242 (1983).

Although FERC accepted Exxon's Valuation Report, the Commission was careful to limit the extent of its holding. In very clear and concise language, FERC left little doubt that, should this decision be viewed as diminishing the anti-discriminatory protections accorded shippers by the ICA or the Commission's

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<sup>9</sup>The investigation and seven month suspension were based on the detrimental impact that the proposed rates might have on royalty payments to the State of Alaska and its citizens.

<sup>10</sup>A similar rate suspension and procedural framework were followed in *Exxon Pipeline Company*, Docket No. IS 83-27. Recently, the United States Court of Appeals for the District of Columbia Circuit upheld the administrative suspensions in both the BP and Exxon cases and reaffirmed FERC's "broad authority to determine its policy on the length of suspensions either through rulemaking or case-by-case adjudication." *Exxon Pipeline Co., et al. v. United States, et al.*, Nos. 83-1299 and 83-1626 (D.C. Cir. Jan. 27, 1984).

ality to regulate the rates and practices of pipelines subject to FERC jurisdiction, the Commission "could require the pipeline to file a valuation report on a line with less than five percent interstate usage, on the grounds that such usage is no longer considered inconsequential or immaterial within the meaning of 18 C.F.R. § 361.6." *Id.* at 61,617.

[Ed. note: On March 23, 1984, the Commission issued a final rule transferring oil pipeline regulations to title 18 of the Code of Federal Regulations from title 49, which deals with regulation by the ICC. *See* Transfer of Oil Pipeline Regulations, 49 Fed. Reg. 12,898 (Mar. 30, 1984).]

#### V. LEGISLATIVE PROPOSALS AND THE ADMINISTRATION'S REACTION

In the 98th Congress, legislation has been proposed that would have an impact upon existing regulation of oil pipelines. The principal bill at this time is H.R. 2677, introduced on April 21, 1983, by Representatives Breaux, Anderson, Shuster, Fields, Gramm, Wilson, and Tauzin. The bill states as its goals to increase competition, induce investment, and eliminate "unnecessary" regulations. To accomplish its goal, the bill is intended to repeal Section 306 and amend Section 402 of the DOE Organization Act, and amend Sections 1, 13, and 15 of the Interstate Commerce Act. The bill would retain the antidiscriminatory provisions and leave unchanged the present status of oil pipelines as common carriers.

H.R. 2677 is similar to two bills introduced in the 97th Congress, H.R. 4488 and H.R. 6815. Hearings were held on both bills, but no further action was taken. The basic premise of H.R. 2677 is that pipelines are competitive and should be further deregulated so that even the rates of lead common carriers would not be subject to regulation. On November 9 and 10, 1983, hearings were held on the bill by the House Subcommittee on Surface Transportation of the Public Works Committee. These hearings, which were chaired by Rep. Glen Anderson, were the only ones held by Congress on oil pipeline deregulation legislation in 1983.<sup>11</sup>

The Subcommittee on Surface Transportation heard testimony from various groups, including the Association of Oil Pipe Lines, Crown Central Petroleum Corporation, Independent Gasoline Marketers Council, Farmland Industries, Inc., National Council of Farmer Cooperatives, Exxon Pipeline Company, and various federal and state administrative agencies and elected representatives. After receipt of the testimony, the hearings were adjourned with no action taken.

In response to the legislative initiatives proposed for the deregulation of oil pipelines, the DOJ is currently preparing a report for release in the near future. In its testimony before the House Subcommittee on Surface Transportation, DOJ opposed the wholesale rate deregulation of H.R. 2677 on antitrust grounds.<sup>12</sup> DOJ would prefer total deregulation except for pipelines with monopoly power, such as TAPS.

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<sup>11</sup>No hearings were held during 1983 before the Subcommittee on Fossil and Synthetic Fuels (Rep. Sharpe, Chairman) of the House Committee on Energy and Commerce (Rep. Dingell, Chairman).

<sup>12</sup>H.R. 2677 has no companion Senate bill. Another bill concerning oil pipelines is S. 975, introduced by Senator Chafee on April 5, 1983. This bill is intended to amend Title III of the OCSLAA. The aim of the bill is to consolidate all existing oil spill regulation. Overwhelming interest for this bill does not exist presently among the Senators, but it may be incorporated into another OCS bill at a later date.

Two additional bills, S. 1441 and H.R. 3314, regarding safety of oil pipelines have also been introduced. H.R. 3314, introduced by Rep. Bruce Vento (D-Minn.), would require periodic testing and inspection of all oil and hazardous liquids pipelines. However, no action is planned presently on either bill.

In both the 97th and 98th Congress, the bills introduced to deregulate the oil pipeline industry have received, with certain reservations, the support of the Reagan Administration. First, the Presidential Task Force on Regulatory Relief observed that "there are isolated markets where individual pipelines appear to have significant market power and (as such) continued rate regulation may be justified."<sup>13</sup> Presently, DOJ and the Office of Management and Budget are attempting to formulate suitable guidelines for defining the exempt segment of the oil pipeline industry.

The second reservation of the Administration concerns the proposed rate regulation of non-exempt markets. The Department of Energy supports a procedural framework in which the complaining shipper would assume the burden of establishing the excessiveness of the rate in a non-competitive market. On the other hand, FERC favors a comparison of the challenged rate with a rate of a similar pipeline in a competitive market.<sup>14</sup>

The third and final reservation of the Administration concerns the common carrier obligations of oil pipelines that would be exempt under the legislative proposals. The bills introduced are intended to relieve pipelines from rate regulation, but all do not address the common carrier obligations of those pipelines. The DOJ has been opposed in the past to pipeline compliance with the common carrier provisions of the ICA and OCSLA in the absence of rate regulation. According to William F. Baxter, former Assistant Attorney General in charge of the Antitrust Division, continued common carrier obligations in the absence of rate regulation would "facilitate collusion among the rivals."<sup>15</sup> DOJ contends that the regulation of common carrier obligations is necessary only if rate regulation is also necessary.

Considering the differences between the Reagan Administration, members of Congress and the various administrative agencies, consensus during this session of Congress on the major piece of legislation, H.R. 2677, seems unlikely. However, the legislative proposals introduced demonstrate an interest on the part of Congress and the Administration in reforming oil pipeline regulation. The proposals have favored removing government regulation of oil pipeline rates, in accord with FERC's decision in *Williams*. While the impact of any such approach on the common carrier obligations of pipelines still remains uncertain, Congress can be expected to consider legislation in the future that will have impacts upon, and most likely change, the present regulation of oil pipelines.

## VI. CONCLUSION

While the *Williams* decision remained pending before the United States Court of Appeals for the District of Columbia Circuit, few developments occurred in the federal regulation of oil pipeline ratemaking. FERC has stayed most proceedings involving oil pipeline ratemaking until the court's decision is issued. In addition, Congress has held only two days of hearings on the major piece of legislation affecting oil pipelines. Therefore, although various parties have made numerous presentations before both the United States Court of Appeals for the D.C. Circuit

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<sup>13</sup> Presidential Task Force on Regulatory Relief (August 11, 1983).

<sup>14</sup> "Petroleum Pipeline Deregulation: A Competitive Analysis," Leonard L. Coburn, reprinted in U.S. Senate (1982).

<sup>15</sup> "Statement of William F. Baxter, Assistant Attorney General, Antitrust Division," in U.S. Senate (1982).

and Congress, it seems that until the appellate opinion is issued in *Williams* the languor that has affected oil pipeline regulation during 1983 will continue.

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