

Report of the Committee on Oil Pipeline Regulation

I. INTRODUCTION

Approximately three years have passed since the Federal Energy Regulatory Commission (FERC or Commission) issued Opinion No. 154-B, which imposed on oil pipeline regulation a new methodology combining elements of a unique "trended original cost" approach with elements more like conventional public utility-type regulation.¹ However, as the FERC's Chairman Hesse recently noted, "the Commission has not yet issued any oil pipeline orders either implementing or revisiting the principles set out in [Opinion] 154-B."²

Nonetheless, initial decisions and significant procedural orders issued by FERC administrative law judges have begun to emerge, giving shape to the likely course of future events. The pending cases indicate two major areas of concern: (1) problems of rate design and cost allocation, and (2) issues regarding the intent of the Commission with respect to specific components of its new rate methodology.

Interest in deregulation of the oil pipeline industry continues. Legislation that would accomplish this objective is currently pending in both Houses of Congress.

II. CASES INVOLVING OPINION NO. 154-B ISSUES

A. *Southern Pacific Pipe Line Co.*

The procedural background and the initial decision by Presiding Administrative Law Judge Howe in the *Southern Pacific* case were described in detail in the 1987 committee report. Since that time, virtually all parties to the proceeding have contested various elements of the initial decision. Briefs on exceptions have been submitted, and the case has been pending before the Commission since July 1987.

B. *Kuparuk Transportation Co.*

Last year, the committee noted that briefing had concluded in the *Kuparuk Transportation Co.* case, and that separate proposed findings of fact and conclusions of law had been filed on April 10, 1987. The case has been awaiting an initial decision by Presiding Administrative Law Judge Fitzpatrick since that time.

C. *ARCO Pipe Line Co.*

Since the last report, the rate proceeding involving ARCO Pipe Line Company (ARCO) has moved through the hearing and briefing stages, and

1. Opinion No. 154-B, Williams Pipe Line Co., 31 F.E.R.C. ¶ 61,377, *reh'g granted in part and denied in part*, Opinion No. 154-C, Williams Pipe Line Co., 33 F.E.R.C. ¶ 61,327 (1985).

2. Remarks by Chairman Martha O. Hesse, API Annual Pipeline Conference (Apr. 26, 1988).

has been the subject of a partial initial decision. The case is presently awaiting an initial decision by Presiding Administrative Law Judge Benkin on the remaining issues.

To summarize briefly, in March 1986 ARCO filed a general rate increase to be effective April 30, 1986. The Oil Pipeline Board suspended ARCO's new rates and, after a period of approximately four months, during which the Board considered whether to go forward with a proceeding, ARCO's rates were set for investigation. At that point, the Commission staff was the only challenging party, and the case has proceeded without any intervenors.

For purposes of the proceeding, ARCO and the staff stipulated that ARCO's pipeline operations in the lower-forty-eight states would be divided into two parts, corresponding to ARCO's system for transporting crude oil and its system for transporting petroleum products. The parties further stipulated that each "system" would be the subject of a separate cost of service calculation, to be compared against the revenues attributable to that system.³

Evidence filed by both parties, ARCO and the Commission staff, demonstrated that ARCO's cost of service for its products system exceeded products system revenues, although the parties disagreed as to the magnitude of the undercollection. ARCO therefore moved for summary disposition of the issue of whether its products tariffs were just and reasonable. That motion was granted in the form of a partial initial decision by Judge Benkin on November 9, 1987.⁴ The judge refused to resolve questions regarding the amount of the undercollection, noting that "[o]nce the 'bottom line' question of the lawfulness of the rates is no longer in dispute, as is the case here, there is no further occasion for the Commission to concern itself with the principles under which those rates were calculated."⁵

With regard to the crude system rates, ARCO's testimony showed an undercollection, while the staff's showed an overcollection. The issues involving ARCO's crude tariffs were the subject of a hearing that commenced on November 9, 1987. Initial briefs were filed in February 1988 and reply briefs were submitted in May 1988. The case is now awaiting an initial decision on the crude system rates.

D. Buckeye Pipe Line Co.

The *Buckeye Pipe Line* case is currently set for hearing on July 26, 1988 before Presiding Administrative Law Judge Grossman. The case began when Buckeye Pipe Line Co. (Buckeye) filed a six percent general rate increase, effective in March 1987, on products movements in various eastern and mid-western states. USAir protested the increase, but later withdrew its protest after Buckeye cancelled proposed increases relating to the Pittsburgh Airport. By an order issued March 13, 1987, the Oil Pipeline Board suspended the rates for one day, and ordered an investigation.⁶ The committee noted in its last

3. In accordance with the *Southern Pacific* initial decision, the evidence in *ARCO* was also divided along interstate-intrastate lines in the evidentiary presentations of both ARCO and the staff.

4. *ARCO Pipe Line Co.*, 41 F.E.R.C. ¶ 63,015, *aff'd*, 41 F.E.R.C. ¶ 61,397 (1987).

5. 41 F.E.R.C. ¶ 63,015, at 65,082.

6. Several subsequent filings have been consolidated with this proceeding: *McCallum Enterprises*,

report that the Air Transport Association (ATA) was later granted leave to intervene out of time.

Several months after being allowed to intervene, ATA filed a motion for summary disposition, contending that Buckeye's rate increase should be rejected because the evidence presented had not justified each of Buckeye's several hundred tariff rates on an individual cost-of-service basis. The Association of Oil Pipe Lines (AOPL) then intervened, arguing that the Interstate Commerce Act does not require point-to-point rate justification. The Commission staff agreed with the ATA position. ATA's motion for summary disposition was denied, but the administrative law judge agreed to keep the record open to allow Buckeye to submit additional testimony "containing its rate design justification, cost-based or otherwise."⁷ Buckeye did file additional point-to-point rate justification in February; the staff and ATA submitted their responsive presentations in May. Additional testimony from the staff, ATA and Buckeye was scheduled to be filed in June and July of 1988.

A procedural skirmish with potential substantive significance is in the process of being fought in *Buckeye*. Buckeye presented its original company-wide cost testimony in a publicly-available, non-confidential manner. However, when Buckeye filed its point-to-point rate justification, it concluded that making that data public would subject it to significant competitive harm. Consequently, all such material was filed under seal.

The presiding administrative law judge found that Buckeye had "fully met its burden of demonstrating the likelihood of substantial competitive injury" because it had a number of unregulated competitors (e.g., barges, trucks, private pipelines) that were not required to publish any cost data.⁸ Nevertheless, he concluded that it would be impossible to hold the required public hearing if all pertinent cost-of-service information was accorded confidential treatment and therefore ruled that the public interest in an open hearing outweighs Buckeye's private interest in confidentiality.

Buckeye has appealed this order to the Commission and, on June 1, 1988, the Commission issued a notice of intent to act. Thus, at least until the Commission rules on Buckeye's appeal, the data will remain protected. Because one of the administrative law judge's premises was that all other oil pipelines will be required to submit similar rate justification data, the Commission's consideration of this issue may take on a significance beyond the specific confidentiality question. Indeed, the notice specifically commented that the Commission may use this appeal as an occasion to determine "whether cost based, rate-by-rate ratemaking will be followed in this and future oil pipeline rate proceedings."⁹

In a related development, ATA filed a complaint on April 29, 1988, requesting the Commission to initiate an investigation under section 13 of the

Small Power Production and Cogeneration Facilities, 39 F.E.R.C. ¶ 62,245 (1987); *Texas E. Transm'n Corp.*, 39 F.E.R.C. ¶ 62,303 (1987); *Texas E. Transm'n Corp.*, 40 F.E.R.C. ¶ 62,048 (1987).

7. *Buckeye Pipe Line Co., Order Denying Summary Disposition, Granting Intervention and Scheduling Filing of Direct Testimony* (FERC issued Dec. 22, 1987).

8. *Buckeye Pipe Line Co.*, 43 F.E.R.C. ¶ 63,007, at 65,107 (1988).

9. *Buckeye Pipe Line Co., Notice of Intent to Act* at 1 (FERC issued June 1, 1988).

Interstate Commerce Act into all of Buckeye's rates for the transportation of aviation jet fuel since January 1, 1987. The Commission is currently considering whether to consolidate that investigation with the pre-existing section 15 proceeding.

E. Four Corners Pipe Line Co.

One case discussed in last year's committee report, *Four Corners Pipe Line Co.*, has been terminated. In that proceeding, both the Commission staff and the pipeline—which were the only parties—agreed to a stipulated dismissal. On August 21, 1987, without opposition, Presiding Administrative Law Judge Megan entered an initial decision granting summary disposition and terminating the proceeding.¹⁰ The judge noted that the Commission staff was “convinced that this proceeding need not continue, although various issues remain unresolved with respect to the application of the Commission's Opinion Nos. 154, 154-B, and 154-C.”¹¹

F. Other Opinion No. 154-B Cases

Two other Opinion No. 154-B cases that are still in their early stages deserve brief mention. Endicott Pipeline Company (Endicott), a new TAPS feeder line, filed its initial tariffs to be effective on October 1, 1987. Following complaints and protests by the State of Alaska and the Arctic Slope Regional Corporation, the rate was suspended and set for investigation on September 30, 1987.¹² Endicott filed its case-in-chief on December 1, 1987. Since that time, developments in the proceeding concentrated on discovery matters. The procedural schedule called for the staff to submit its top sheets by August 15, 1988.

The other pending case involves the Point Arguello Pipeline (PAPCO), an offshore crude oil pipeline that enters California near Santa Barbara. PAPCO is a partnership headed by Chevron Pipe Line. Anticipating a January 1988 start-up, PAPCO filed its initial tariff in December 1987. After a protest by Pennzoil (a Pennzoil affiliate being one of the PAPCO partners), the tariff was suspended, and PAPCO was ordered to file its direct case.¹³

The company filed its direct presentation in February, although the pipeline had not yet begun operations. After it became clear that start-up would be delayed for some time due to environmental permitting difficulties, the parties agreed to an unusual procedural approach. A full schedule, beginning with the opportunity for the pipeline to revise its February 1988 testimony, was adopted. The schedule is to be triggered by the commencement of operations, and contemplates a hearing one year from start-up. This approach was accepted by Presiding Administrative Law Judge Fitzpatrick. Consequently, this case is now dormant until operations begin.

10. *Four Corners Pipe Line Co.*, 40 F.E.R.C. ¶ 63,035 (1987).

11. *Id.* at 65,152.

12. *Endicott Pipeline Co.*, 40 F.E.R.C. ¶ 62,397 (1987).

13. *Point Arguello Pipeline Co.*, 41 F.E.R.C. ¶ 62,327 (1987).

III. THE EMERGING OPINION NO. 154-B ISSUES

Although the initial decisions issued thus far have given scant guidance on the application of the Commission's new methodology, the litigated cases provide the beginning of an outline of the types of issues that will probably dominate the Commission's oil pipeline agenda for the foreseeable future.

Questions of cost allocation and rate design, in particular the question of the proper unit to examine when comparing costs with revenues, are becoming increasingly important. Opinion No. 154-B gives no definitive direction on whether rates should be regulated on a company-wide basis, on a system-by-system basis, or on a point-to-point basis. In some cases, as with a single-tariff, single-purpose company such as Endicott, it makes no difference which approach is taken. However, it can make a great deal of difference to companies with multiple tariffs or non-contiguous or non-integrated operations.

In *Southern Pacific*, although the initial decision did not turn on this ground, the judge found that the company's east and west sections were separate systems whose costs and revenues must be evaluated independently from one another. In *Buckeye*, as noted above, following an indication by the judge that it may be necessary for Buckeye to justify each of its several hundred rates individually, data has been filed setting forth cost data on a tariff-by-tariff basis.

In the *ARCO* case, the company and the staff stipulated that both parties would evaluate ARCO's rates on the basis of two systems, crude and products, with no subdivisions below that level. ARCO provided a detailed allocation of costs between the crude and products operations down to the most basic accounting level; the staff ultimately adopted the company's allocation. Only a relatively minor rate design issue arose in the *Kuparuk* proceeding. Kuparuk operates one contiguous crude oil pipeline, with one intermediate take-on point. In spite of the fact that a separate rate was established for the intermediate point, each of the parties independently analyzed the Company's rates on the basis of a single system.

A separate major area of controversy involves determination of the elements of cost of service under Opinion Nos. 154-B and 154-C. In both *Southern Pacific* and *ARCO*, for example, significant issues arose regarding the treatment of the inflation element of the Opinion No. 154-B transition or starting rate base. Another key issue in *ARCO* was the appropriate method of applying the respective debt and equity rates of return to the debt and equity components of the Opinion No. 154-B rate base. Other common issues under Opinion No. 154-B include the proper approach to deferred taxes, the appropriate treatment of the allowance for funds used during construction (AFUDC), and the correct determination of the so-called "real" equity rate of return to be applied to the trended original cost component of the rate base.

IV. PENDING CASES THAT DO NOT IMPLICATE OPINION 154-B

A. *The TAPS Case*

Although the long-standing *TAPS* rate case has moved closer to final disposition, the case has not yet been finally resolved. On October 27, 1987, the

United States Court of Appeals for the District of Columbia Circuit dismissed the challenge brought by the Arctic Slope Regional Corporation (ASRC) to the *TAPS* settlement.¹⁴ In its opinion, the court endorsed the Commission's view that the settlement is strongly in the public interest and rejected ASRC's contention that FERC could not terminate the *TAPS* proceeding without rendering an immediate decision on the merits of ASRC's claims.¹⁵

ASRC's petitions for rehearing and rehearing *en banc* were denied by the court of appeals in January. ASRC's petition for certiorari, filed in May, is currently pending before the Supreme Court.

B. *Gulf Central Pipeline Co.*

In September 1987, Gulf Central Pipeline Company (Gulf Central), operator of an anhydrous ammonia pipeline, applied for a waiver of section 6(3) of the Interstate Commerce Act (ICA) to permit it to enter into confidential contracts with certain shippers on terms and conditions more favorable than those contained in the published tariffs on file with the Commission. The contracts would have been made available to the Commission on a confidential basis, but would have been protected against disclosure to other parties, including other shippers. A shipper that had not been offered the more favorable terms objected, contending that the pipeline was collecting rates that were both secret and inherently discriminatory. Gulf Central argued in response that it was meeting the prices of non-regulated competitors, and that contract-type rates are permissible under the ICA. On January 22, 1988, the Commission affirmed the Oil Pipeline Board's ruling that a non-public tariff would contravene the anti-discrimination provisions of the ICA, and rejected the Company's argument that its proposal would promote competition.

In April, Gulf Central filed revised tariff sheets. The new filing, which called for publicly available rates, implemented what the Commission described as "selective discounting," that is, it provided discount rates that were not available on an equal basis to all shippers, but rather were designed to attract new, or "incremental," shippers.¹⁶ The Commission again found the Company's proposal to be in violation of the ICA's prohibition against special rates and undue discrimination or preferences, and therefore rejected Gulf Central's filing.

C. *Cook Inlet Pipe Line Co.*

Cook Inlet, a pipeline in southern Alaska, is regulated both by the FERC and by the Alaska Public Utilities Commission (APUC). Like many other pipelines in similar situations, Cook Inlet maintained identical rates for interstate and intrastate movements between the same points. In January 1987, the APUC issued an order analyzing Cook Inlet's 1982 intrastate rates under a depreciated original cost methodology, and finding them to be unlawfully

14. Arctic Slope Regional Corp. v. FERC, 832 F.2d 158 (D.C. Cir. 1987), *petition for cert. filed*, 56 U.S.L.W. 3806 (U.S. May 14, 1988) (No. 87-1869).

15. *Id.* at 166-67.

16. Gulf Central Pipeline Co., 43 F.E.R.C. ¶ 61,231 (1988).

high. The APUC ordered a decrease of approximately twenty-five percent in the intrastate rates.

In December 1987, Cook Inlet petitioned the FERC for a declaratory order to the effect that the APUC decision is invalid to the extent that it requires the pipeline to charge a lower rate for intrastate shipments than it charges for identical interstate shipments. Cook Inlet contended that compliance with the APUC order would cause it to violate the antidiscrimination provisions of sections 2 and 3 of the ICA.

The pipeline's largest shipper (Tesoro Alaska) and the APUC opposed the filing. Both essentially argued that the exclusive mechanism under the ICA for seeking relief from unduly preferential rates is set out in section 13(4) of the Act. That section authorizes the Commission to adjust intrastate rates that have an undue negative impact on interstate commerce. Consequently, it was argued that Cook Inlet should be denied relief because the company had not proceeded under the correct statutory provision. Moreover, the argument continued, the rates in question do not have the negative impact necessary to warrant awarding relief to the pipeline.

The matter is presently awaiting Commission decision. It is of particular interest as it is the first definitive ruling in some time to address the relationship between the FERC and state agencies with dual jurisdiction over the same pipelines and pipeline routes.

V. DEREGULATION

Proposals to deregulate the oil pipeline industry are pending in both Houses of Congress. Measures supported by the Reagan Administration are based on the premise that elimination of all economic regulation is desirable for oil pipelines that are sufficiently competitive.¹⁷ In those instances, the sponsors apparently consider antitrust statutes to be a satisfactory restraint on potential abuses. Thus, under the Administration's recommendations, absent a finding by the Secretary of Energy that continued regulation is necessary in a particular case because a pipeline possesses excessive market power, existing oil pipelines would not be subject to economic regulation. New oil pipelines would not be subject to the Commission's regulatory jurisdiction at all.

The industry has sponsored an alternative pair of bills.¹⁸ Under the industry's approach, the common carrier and anti-discrimination provisions of current law would continue to apply to oil pipelines, but the Commission would lose its jurisdiction over the reasonableness of oil pipeline rate levels. Moreover, the Commission would be expressly prohibited from beginning an investigation upon its own motion. At the time of this report, negotiations continue among the Administration, the Congress, the oil pipeline industry,

17. Under these proposals (S. 656, 100th Cong., 1st Sess. (1987) and H.R. 1960, 100th Cong., 1st Sess. (1987)), TAPS would continue to be regulated as it is now.

18. Congressman Synar introduced the House version, H.R. 2734, 100th Cong. 1st Sess. (1987), in June; its companion, S. 2028, 100th Cong., 2d Sess. (1988), was introduced by Senator Breau in February 1988.

and shippers in an effort to reach a consensus that would allow all to support a single bill.

The FERC's Chairman Hesse has indicated support for deregulation on at least two occasions. Speaking before the API Annual Pipeline Conference in Houston on April 26, the Chairman stated her belief that "reform, especially for pipelines without significant market power, is highly desirable." She continued, "although FERC *could* institute some reforms under current law and precedent, . . . history strongly suggests that legislation will be a surer, more efficient and quicker way to obtain meaningful reform."

Chairman Hesse reiterated that position in a concurring statement attached to the Commission's May 4 *Gulf Central* opinion: "I remain committed to moving forward to allow competition to play a greater role in the Commission's regulation of oil pipelines." Referring to the 1986 report of the Department of Justice, which found the vast majority of United States oil pipelines to be competitive, she concluded that "[w]here workable competition exists, the market—and not the regulators—should govern price and allocation, consistent with safety, health and environmental considerations."

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