REPORT OF THE COMMITTEE ON OIL PIPELINE REGULATION

This report summarizes developments of significance since the Committee Report published in the Fall 1996 edition of the Journal.

I. Cost of Service Issues

A. *Express Pipeline Partnership*

On March 8, 1996, Express Pipeline Partnership requested a declaratory order from the Commission that the rate and contract structure for its proposed pipeline from Wild Horse, Alberta, to Casper, Wyoming, is just and reasonable. Express's proposed rate structure was not based on its cost of service, but on commitments by shippers to ship volumes of crude oil on Express's proposed pipeline for five, ten or fifteen year terms. Express stated that it already had commitments from shippers for approximately 85% of its original daily throughput under this arrangement. Express planned to charge progressively lower rates as shippers committed to longer periods, and asserted that this arrangement was reasonable, because the shippers that contracted for longer terms assumed more risk than the uncommitted shippers. Conversely, uncommitted shippers would pay more for increased flexibility. Express also requested the right to raise its term rates up to 2% per year, rather than using the Commission's ratemaking index, stating that the term shippers had agreed to this increase. Finally, Express said that a proposed surcharge for medium and heavy crude oil also had been agreed to by the term shippers.

Express urged the Commission to approve its proposed rate structure under the authority of 18 C.F.R. § 342.2(b), stating that the rates had been agreed to by at least one non-affiliated shipper. Protests of Express's petition were filed by the Independent Petroleum Association of America, Butte Pipe Line Company, Imperial Oil Limited and the State of Wyoming.

On June 17, 1996, the Commission issued the requested declaratory order.[1] However, it found that Express had not provided sufficient information regarding its rate structure for the Commission to approve the tariff as filed. Since Express's initial rates were protested, the pipeline must file cost, revenue and throughput data supporting its initial rates, and the rates for each year of the 15-year committed period, and must also project expected revenues from the proposed Express/Platte joint rates.

In response, Express projected that it would be operating at maximum initial capacity by 1999. It also noted that, although its term rates would be raised by 2% each year, the uncommitted rate would be raised pursuant to the Commission's index, which it projected to be less than 2% per year during the 15-year period. Express forecast a net loss of $34 million for the first 15 years of its pipeline's operation, and emphasized that the loss could

1. *Express Pipeline Partnership*, 75 F.E.R.C. ¶ 61,303 (1996).

be greater if term shippers did not renew their contracts and there were no shippers to replace them. Express stated that its plan was to recover costs over time, and that, although this was not a traditional method of cost-recovery, it also was not anti-competitive.

Express added that if a cost-of-service ratemaking methodology were used, the uncommitted rates would be higher than proposed. Finally, Express stressed that it requested approval for uncommitted rates for 1997 only, and that beyond that time, its uncommitted rates will be subject to Commission regulation.

On September 11, 1996, the Commission issued its opinion on rehearing.[2] The Commission agreed with Express's argument that term shippers and non-term shippers are not similarly situated, and that the different classes of term shippers also are not similarly situated. The Commission stated that the flexibility retained by non-term shippers justified charging them a higher rate than term shippers.

The Commission next found Express's rates to be just and reasonable, allowing a 14% nominal rate of return. In addition, the Commission allowed Express to use a hypothetical capital structure, and a thirty-year useful life. The Commission also held that no provision of the pipeline's proposal violated the Interstate Commerce Act, and that its cost-of-service filing complied with the June 17, 1996 order. The Commission added that it would examine the actual cost of service when its tariff becomes effective. Finally, the Commission stated that the 2% per year rate increase for term shippers was reasonable, and granted Express's request for waiver of the Commission's indexing requirements. On November 18, 1996, the Commission denied Imperial Oil Limited's request for further rehearing.[3]

B. Gaviota Terminal Company

On May 20, 1997, Gaviota Terminal Company and the protesting "Producer Group" filed an offer of settlement to resolve all issues in the various pending Gaviota dockets. The settlement would allow Gaviota's rate to remain at $1.24 per barrel until December 31, 1997, after which Gaviota is to reduce its rate. The parties also agreed to attempt to persuade the County of Santa Barbara to allow Gaviota's facility to operate as inexpensively as possible, and the Producer Group agreed to cease all efforts to bypass Gaviota's facility. The settlement further provides that Gaviota will be responsible for the costs of abandonment.

On August 5, 1997, the FERC approved the settlement without modification.[4]

C. Lakehead Pipe Line Company, Limited Partnership

On September 5, 1996, Lakehead and its protesting shippers filed an offer of settlement resolving the appeals pending in the proceeding that

2. *Express Pipeline Partnership*, 76 F.E.R.C. ¶ 61,245 (1996).
3. *Express Pipeline Partnership*, 77 F.E.R.C. ¶ 61,188 (1996).
4. *Gaviota Terminal Co.*, 80 F.E.R.C. ¶ 61,204 (1997).

culminated in the Commission's Opinions 397 and 397-A.[5] The key terms of the agreement are:

- Lakehead will decrease its rates by approximately 6%, for an annual revenue decrease of about $17 million.
- Lakehead's new rates will be subject to the July, 1997 ratemaking index.
- The Canadian Association of Petroleum Producers and Alberta Department of Energy (jointly CAPP) will not challenge Lakehead's rates for five years after adoption of the agreement.
- Monetary relief in the amount of $120 million plus interest through October 1, 1996, will be paid to Lakehead's shippers. $82,855,876 of this amount will be paid through a 10% decrease (above the previously mentioned 6% decrease) in rates for approximately the next three years.
- Lakehead will decrease its share of joint tariff rates by 6%.
- Lakehead will perform a new depreciation study.

On February 28, 1997, the Commission approved the settlement, finding it to be fair, reasonable and in the public interest.[6]

D. Rio Grande Pipeline Company

On October 7, 1996, Rio Grande Pipeline Company[7] submitted a petition for declaratory order, requesting that the Commission approve its initial rates for a natural gas liquids (NGL) pipeline that would run from Lawson Junction in Ector County, Texas, to the U.S./Mexico border. In addition to the construction of new facilities, Rio Grande's project involves the conversion to NGL use of a petroleum products pipeline acquired from Navajo Refining Company.

Rio Grande requested permission to include in its rate base the full acquisition cost of the acquired line, which was greater than its net book value, arguing that the acquisition passes the two-prong test set out in *Williams Pipe Line Company*[8] and *Longhorn Partners Pipeline*.[9] That test requires that a company requesting inclusion in rate base of the full purchase price of a facility show: 1) that the acquired asset will be converted to a new public use; and 2) that the rate base write-up will confer substantial benefits on ratepayers. Rio Grande asserted that the line would be used solely for transportation of NGL, as opposed to its prior use in refined petroleum products service. It also stated that this new use will benefit shippers and the public by opening new and more stable markets, by providing lower-cost transportation and increased competition, by conferring environmental and safety benefits, and by furthering the policies of the North America Free Trade Agreement.

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5. *Lakehead Pipe Line Co.*, 65 F.E.R.C. ¶ 63,021 (1994), *aff'd in part and modified in part*, 71 F.E.R.C. ¶61,338 (1995).

6. *Lakehead Pipe Line Co.*, 78 F.E.R.C. ¶ 61,207 (1997).

7. Rio Grande is a partnership between Juarez Pipeline Company, Amoco Rio Grande Pipeline Company and Navajo Southern, Inc.

8. 21 F.E.R.C. ¶ 61,260 (1983).

9. 73 F.E.R.C. ¶ 61,355 (1995).

The Commission denied Rio Grande's motion for summary disposition of its petition, finding that the seller of the acquired line (Navajo Pipeline Company) would retain a 25% equity interest in the buyer (Rio Grande) through an affiliate. The Commission therefore did not reach the *Williams-Longhorn* test. It did, however, approve Rio Grande's initial rate under 18 C.F.R. § 342.2(b) because PEMEX, a non-affiliated shipper, had agreed to the rate and no party had protested it.[10]

On February 14, 1997, Rio Grande requested rehearing of the Commission's order. According to Rio Grande, the order announced a new 'general rule' which [the Commission] applied as an absolute threshold test, overriding any consideration of the two-prong test previously employed in such cases and without regard to the beneficial impact of Rio Grande's acquisition on ratepayers or the public.[11] It also emphasized that the sale of the pipeline was conducted at arm's length, and that Navajo was not affiliated with the other two Rio Grande partners until the pipeline sale agreement had been concluded. Longhorn Partners Pipeline moved to intervene and also requested rehearing of the Commission's order, expressing concern that the Commission's order might prejudice Longhorn's own ability to include its full purchase price in its rate base. The matter remains pending on rehearing.

II. Notice of Annual Change in the Producer Price Index

On May 19, 1997, the Commission announced the applicable index for computing the change in oil pipeline ceiling rates for the period beginning July 1, 1997, and ending June 30, 1998. The new index (the annual change in the Producer Price Index for Finished Goods minus one percent) is .016583. To calculate the new rate ceiling, oil pipelines must multiply their current rate ceilings by 1.016583.

III. Market Power and Grandfathered Rates Issues

A. *Colonial Pipeline Company*

On December, 11, 1996, Colonial Pipeline Company and Mobil Oil Corporation filed an offer of settlement to resolve the pending protest of Colonial's application for market-based rates proceeding.[12] The settlement, cast in the form of an experimental program, permits Colonial to set rates to pipeline destinations at Booth, Pennsylvania and northward (North East Market Area or "NEMA") in response to market forces. The experimental program includes the following features:

- Any increase in rates to or beyond the NEMA destinations that do not exceed 110% of what would be approved ceiling rates shall not be sub-

10. *Rio Grande Pipeline Co.*, 78 F.E.R.C. ¶ 61,020 (1997).

11. *Id.* at 61,082.

12. Mobil's protest argued that Colonial's market was not sufficiently defined and that there was a significant risk of price discrimination if Colonial showed a lack of market power in particular markets, but not for specific products. Mobil also asserted that Colonial's market share was in fact larger than Colonial calculated.

ject to protest, suspension or investigation. Any rate over 110% would be subject to a protest, suspension and investigation.

- Initial rates for any new services to existing destinations within or beyond the NEMA, and rates for new destinations on Colonial's system within or beyond the NEMA, must be justified under cost-of-service or sworn affidavit by a non-affiliated shipper.
- Reparations for any injury or damage alleged to have been sustained as a result of any rate effective during the pendency of the program shall be limited to injuries sustained commencing upon the earlier of the date of the filing of the complaint or the date of the termination of the program.
- Within sixty days following the first, second and third twelve-month periods during which the program is in effect, Colonial shall submit the following items, which the Commission shall maintain as confidential:
  - Reports that show the rates charged during the relevant twelve months and the quantities delivered at each rate and destination involved.
  - A shipper survey to be circulated to Colonial's shippers of record during the relevant twelve-month period. Additionally, shippers shall be permitted to respond to any commentary included in Colonial's annual report.
- After the Commission receives Colonial's third annual report, the Commission shall determine if this program shall be terminated, extended, altered, placed permanently in effect or some combination of those actions.
- Colonial shall continue to be subject to all provisions of the ICA and, except as the settlement otherwise provides, the Commission's regulations under the ICA.
- The Commission may terminate the program at any time.

On February 19, 1997, the ALJ certified the settlement to the Commission, and on March 31, 1997, the Commission accepted it as fair, reasonable and in the public interest.[13] The Commission addressed concerns regarding the subsidization of competitive markets by non-competitive markets, stating that rates for transportation to Colonial's less competitive markets will be capped by the Commission's index. The Commission also reaffirmed the applicability of section 4 of the Interstate Commerce Act, which provides that pipelines must obtain prior approval for any rate to a destination that is greater than the rate to a further destination.

B. *Santee Distributing Company v. Dixie Pipeline Company*

On June 3, 1996, the Commission denied the request of Santee Distributing Company and AmeriGas Propane, Inc. for rehearing.[14] In its order of May 23, 1995, the Commission had held that the rates protested in this matter were grandfathered under EPAct. In addition, the Commission stated that Santee should have offered evidence from the enactment of EPAct (October 24, 1992) forward in order to prove the changed circum-

13. *Colonial Pipeline Co.*, 78 F.E.R.C. ¶ 61,371 (1997).
14. *Santee Distrib. Co. v. Dixie Pipeline Co.*, 75 F.E.R.C. ¶ 61,254 (1996).

stances necessary to challenge grandfathered rates. In its request for rehearing, Santee again asserted that Dixie Pipeline Company's rates were not grandfathered under EPAct due to an additional odorization charge. The Commission's order denying rehearing again concluded that the odorization charge did not change Dixie's transportation rate, and that Santee had not proved that Dixie's circumstances had substantially changed since 1992.

IV. Jurisdiction and Discrimination Issues

A. *Texaco Refining and Marketing Inc. v. SFPP, L.P.*

This complaint proceeding alleged that SFPP had unlawfully failed to file tariffs for transportation over certain feeder pipelines upstream of its initial "South System" tariff origin point at Watson Station. The complainant's asserted that the subject movements are subject to the FERC's jurisdiction under the Interstate Commerce Act, and that SFPP's contractual charges for those movements are excessive.

The presiding administrative law judge's initial decision, issued in March 1997, found that the Commission lacks jurisdiction over the subject lines at issue.[15] Specifically, the judge relied on: (1) the very short length of the lines, (2) their location (wholly within the State of California), (4) their similarity to natural gas gathering lines, and, (5) the equities, which were found to weigh against the parties asserting jurisdiction. Because of the jurisdictional ruling, the decision does not address the rate issue.

On August 5, 1997, the Commission reversed the initial decision.[16] It found the subject movements to be regulated "transportation" because the "essential character" of the shipments is interstate in nature. The Commission ruled that jurisdiction "attaches at the point at which the pipeline connects to the shipper's refineries." The Commission rejected both the analogy to natural gas gathering lines and the relevance of equitable considerations in assessing jurisdiction. SFPP was ordered to file tariffs covering the movements at issue within 60 days of the decision.

B. *Express Pipeline Partnership*

On April 14, 1997, Big West Oil Company (Big West) protested the joint tariffs filed by Express, Frontier Pipeline Company (Express) and Anschutz Ranch East Pipeline, Inc. for crude oil service from International Boundary, Montana to Kimball Junction, Utah. Big West argued that due to changes in the market, it expected that it would have to start importing Canadian syncrude. According to Big West, Express's joint tariffs set forth rates for light petroleum, the characteristics of which allegedly encompass syncrude. Nevertheless, Express refused to assure Big West that it would accept syncrude for transportation.

15. *Texaco Refining and Marketing v. SFPP, L.P.*, 78 F.E.R.C. ¶ 63,017 (1997).
16. *Texaco Refining and Marketing v. SFPP, L.P.*, 80 F.E.R.C. ¶ 61,200 (1997).

In its defense, Express asserted that in fact syncrude could not be moved on the joint tariff without physical alterations on the Anschutz and Frontier legs. Express also pointed out that while it had declined to guarantee that syncrude would be moved, it had not refused to do so. The case is presently pending before the FERC.

V. Tariff Rules Issues

A. *Chevron Pipe Line Company*

On June 28, 1996, Shell Odessa Refining Company protested a Chevron Pipe Line Company tariff, on the ground that the prorationing policy set forth in the tariff "significantly reduces the ability of a new shipper to move products in the Chevron products pipeline."[17] Shell described the policy as allowing new shippers access to 5% of available capacity divided by the number of new shippers, or 1.25% of available capacity, whichever is less. Shell calculated that Chevron's capacity is approximately 25,000 barrels per day, and that the policy would allow Shell, as a new shipper, to ship only about 300 barrels per day. In addition, Shell complained that this volume would be its basis for the next year, and that its volumes would still be limited once it ceased to be classified as a new shipper.

In response, Chevron argued that Shell does not have the requisite economic interest to file a protest because it is not a shipper on Chevron's pipeline. In addition, Chevron maintained that it is reasonable to distinguish between regular and new shippers in allocating capacity.

The Commission rejected Shell's protest, and Chevron's tariff went into effect on July 11, 1996.[18]

B. *Platte Pipe Line Company*

On March 4, 1997, Sinclair Oil Corporation protested a Platte Pipe Line tariff relating to the transportation of crude oil from Byron, Wyoming to Wood River, Illinois. Platte's filing requires shippers to nominate volumes for transportation by the 25th day of the preceding month, with any unused nominated capacity to be paid for by the shipper. Sinclair contested the "ship-or-pay" provision because:

- It requires shippers to pay for amounts that may not be shipped, assertedly allowing Platte to collect revenues in excess of its published rates;
- Platte has the ability to replace amounts nominated but not shipped with crude oil from other shippers who do not submit nominations;
- Under Section 342.3 of the Commission's regulations, Platte may not collect more than its maximum capacity multiplied by its rate for a pipeline segment, a rule that allegedly would be violated if the tariff supplement was allowed to stand;

17. *Chevron Pipe Line Co.*, 76 F.E.R.C. ¶ 61,029 (1996).
18. *Id.*

- Shippers who nominate, but do not ship, will, in effect, pay higher rates than other shippers on the line who only pay for amounts they actually ship; and
- The "sudden imposition" of the ship-or-pay provision was not justified.[19]

The Commission set Platte's tariff supplement for investigation, stating that the ship-or-pay rule "raises a concern as to whether [it] may result in an overcollection of revenues that exceed the revenues based on indexed rate ceilings. . . ."[20] The Commission directed the Staff to convene a technical conference at which the practical impact of the rule could be addressed.

Following the technical conference, and the submission of comments by both sides, the Commission accepted Platte's tariff provision with one modification.[21] The Commission found it reasonable to require shippers to pay for reserved capacity during periods of proration and that such a penalty provision is not in violation of the ICA. Moreover, the Commission concluded that the penalty provision is consistent with a similar provision in the tariff of the immediately upstream pipeline, Express Pipeline Partnership, from which Platte receives significant through volumes. The Commission directed Platte to modify the penalty provision so that it operates only when the pipeline is in fact prorated.

C. *Total Petroleum, Inc. v. CITGO Products Pipeline*

On July 26, 1996, CITGO informed the Commission of the D.C. Circuit opinion in the Trans Alaska Pipeline System ("TAPS") pumpability decision discussed below. CITGO asserted that the portion of that opinion concerning information that must be published in tariffs was "all but dispositive" of the issue whether CITGO's prorationing policy must be included in full in its tariff. In response, Total argued that the Court's decision concerned allocation of carrier interests in capacity, rather than allocation of capacity among shippers, and therefore does not control the proration policy issue.

The Commission found that even though the proration policy was not published in CITGO's tariff, the pipeline had given sufficient notice of the change in its proration policy to satisfy the publication test.[22] Total thereafter withdrew its complaint.

VI. ALASKA PIPELINE CASES

A. *TAPS Pumpability Adjustment*

On July 23, 1996, the U.S. Court of Appeals for the District of Columbia Circuit remanded to the TAPS pumpability matter to the FERC.[23] The

19. Sinclair also contested the gravity bank provision in Platte's rules. The Commission rejected that element of Sinclair's protest, stating that the gravity bank adjustments were simply brought forward unchanged from Platte's previous tariff supplement.

20. *Platte Pipe Line Co.*, 78 F.E.R.C. ¶ 61,307 (1997).

21. *Platte Pipe Line Co.*, 80 F.E.R.C. ¶ 61,036 (1997).

22. *Total Petroleum, Inc. v. Citgo Products Pipeline*, 76 F.E.R.C. ¶ 61,164 (1996).

23. ARCO Alaska, Inc. v. FERC, 89 F.3d 878, 882-84 (D.C. Cir. 1996).

Commission had endorsed a pumpability adjustment based on use of capacity. The court agreed that the Commission may consider non-cost justifications in reviewing rates for different grades of crude oil, but found that the Commission had not adequately explained how the TAPS differential was justified in light of the sharp decline in TAPS throughput.

The court also reversed the Commission's ruling that the allocation of capacity among the TAPS Carriers must be published in their tariffs. Noting that "publication in tariff form entails quite serious consequences" — including the legally binding force of tariff terms and the requirement to provide 30 days advance notice of tariff filings with the ensuing possible challenge, suspension and investigation of the same — the court held that section 6 of the ICA does not empower the Commission to extend its authority over "all minutiae bearing upon cost."[24]

On remand of the pumpability ruling, the parties reached a complete settlement of the matter.

B. EXXON VALDEZ Oil Spill Litigation Costs

On July 8, 1997, the D.C. Circuit affirmed the Commission's ruling that the TAPS owners may not include in their rates the costs of litigating and settling various civil suits involving the EXXON VALDEZ oil spill.[25] Specifically, the court upheld the Commission's ruling that the plain language of the TAPS Settlement Agreement precludes recovery of FERC Account 680 extraordinary costs as operating expenses.[26]

The remaining issues in the case have been the subject of continuing settlement negotiations. On July 14, 1997, the State of Alaska and the TAPS Carriers filed a settlement agreement with respect to public communications and government relations costs, and the parties have moved to terminate the proceeding with respect to those issues. On August 8, 1997, the parties notified the Presiding Administrative Law Judge that they had reached an agreement-in-principle to settle the issue regarding Post Retirement Benefits Other Than Pensions.

C. Electrical Code Remediation Costs

This proceeding principally involves the State of Alaska's protest of the inclusion in rates of some $225 million in TAPS repair and remediation costs, largely involving violations of the National Electrical Code. The State alleged that the costs were the result of imprudence and mismanagement on the part of the TAPS owners. The parties settled the matter and on May 2, 1997, moved to terminate the proceeding. The presiding administrative law judge ruled that the parties must submit the settlement under

24. *Id.* at 885-86.

25. Amerada Hess Pipeline Corp. v. F.E.R.C., 117 F.3d 596 (D.C. Cir. 1997).

26. *Amerada Hess Pipeline Corp.*, 74 F.E.R.C. ¶ 61,318, at 62,008-09 (1996). The FERC had previously held that the LS Costs should be booked in Account 680 as infrequent and unusual costs. *Amerada Hess Pipeline Corp.*, 71 F.E.R.C. ¶ 71,040 (1995).

rule 602 of the Commission's procedural rules.[27] The Commission reversed the judge's order, holding that 18 C.F.R. § 343.3(d) allows a party simply to withdraw its protest.[28] The case subsequently was terminated.

27. *ARCO Transportation Alaska, Inc.*, 79 F.E.R.C. ¶ 63,008 (1997).
28. *ARCO Transportation Alaska, Inc.*, 79 F.E.R.C. ¶ 61,230 (1997).