Report of the Committee on Oil Pipeline Regulation

I. Introduction

Several significant developments in the field of oil pipeline regulation have occurred since the Committee's last report. The Federal Energy Regulatory Commission (FERC or Commission) has issued the first two definitive opinions subsequent to Opinion No. 154-B in *Williams Pipe Line Co.*[1] In *ARCO Pipe Line Co.*,[2] the Commission addressed significant issues in the interpretation of Opinion No. 154-B, and in *Buckeye Pipe Line Co.*,[3] the Commission concluded that the extent of a pipeline's market power will affect how it is regulated, a decision disputed by the Interstate Commerce Commission (ICC) in *Ashley Creek Phosphate Co. v. Chevron Pipe Line Co.*[4] Other significant developments include: (1) decisions that anhydrous ammonia pipelines should be regulated by the ICC rather than the FERC, (2) FERC approval of the use of alternate dispute resolution in a FERC proceeding, (3) repeal of section 10 of the Clayton Act, (4) procedural changes by the FERC and its staff designed to improve the process of regulating oil pipelines, and, (5) the continued lack of success in deregulating oil pipelines.

II. Interpretation of Opinion No. 154-B

In *ARCO Pipe Line*, the first rate proceeding to be decided since *Williams Pipe Line*, the Commission addressed issues that indicate how it will apply Opinion No. 154-B and the trended original cost (TOC) approach to determine oil pipeline rates. In general, the *ARCO Pipe Line* decision: (1) confirms that the Commission prefers to utilize an actual rather than hypothetical capital structure to calculate the pipeline's Starting Rate Base (SRB), (2) indicates that the SRB calculation produces a single rate base figure to which the current capital structure is applied to determine the pipeline's overall return allowance, (3) disallows the amortization of the initial write-up (i.e., the increase over depreciated original cost) in the SRB as a component of the cost of service, (4) permits the pipeline to add Allowance for Funds Used During Construction (AFUDC) to its rate base only for a new plant placed in service after 1983, and (5) determines that deferred taxes should be deducted from rate base before the SRB calculation is made.

On March 31, 1986, ARCO Pipe Line Company (ARCO), a wholly-owned subsidiary and common carrier of oil by pipeline, filed a general rate increase to be effective April 30, 1986. The Oil Pipeline Board suspended ARCO's rates, making them effective subject to refund and further investiga-

1. 31 F.E.R.C. ¶ 61,377, *order denying reh'g in part, modifying No. 154-B in part*, Opinion No 154-C, 33 F.E.R.C. ¶ 61,327 (1985).

2. Opinion No. 351, 52 F.E.R.C. ¶ 61,055 (1990), *aff'g in part*, 43 F.E.R.C. ¶ 63,033 (1988), *reh'g granted in part and denied in part*, Opinion No. 351-A, 53 F.E.R.C. ¶ 61,398 (1990).

3. 44 F.E.R.C. ¶ 61,066 (1988).

4. No. 40131, I.C.C. LEXIS 280 (Aug. 1990).

tion.[5] On June 17, 1988, the ALJ issued his initial decision,[6] and in July of 1990, the Commission issued its decision affirming in part and modifying in part the ALJ.[7] The following is a summary of both the rationale provided by the ALJ, and the Commission's decision.

A. Capital Structure for Starting Rate Bases Calculation

In the initial decision, the ALJ held that the parent company's capital structure should be utilized to calculate ARCO's Starting Rate Base (SRB).[8] The ALJ relied heavily on Opinion No. 154-B, which reflects the general policy of using an actual rather than hypothetical capital structure to calculate a regulated pipeline's rates.[9] In that regard, the ALJ noted that whether the pipeline does not issue long-term debt, issues long-term debt to its parent or has its long-term debt guaranteed by its parent, the parent's actual capital structure should be used.[10] Without discussion in its opinion, the Commission affirmed the ALJ's decision that "the capital structure is not representative of the pipeline's risk," and an actual capital structure should be used.

B. Capital Structure for Rate of Return and Overall Return Allowance

The ALJ determined that the SRB calculation produces two rate bases: a trended original cost rate base and a depreciated original cost rate base.[11] Under that approach the rate of return on equity and return on debt are applied to respective portions of rate base to calculate the overall allowed return.

In its decision, however, the Commission reversed the ALJ and adopted the position of the Commission Staff. The Commission's position is that the SRB calculation produces a single rate base figure to which the current capital structure is applied to determine the pipeline's overall return allowance.[12] This approach places greater emphasis on the current capital structure of the pipeline for purposes of calculating the allowed rates of return on a prospective basis. For example, to the extent a pipeline's current equity ratio is lower than it was on June 30, 1985, the pipeline will only be permitted to earn a return on a portion of its equity rate base at the rate of its debt costs. To the extent the pipeline's overall cost of debt is currently greater than the real rate of return, this works to the benefit of the pipeline. In its decision on rehearing, however, the Commission made some adjustments to the calculation of the overall return when the weighted cost of capital is lower than the real rate of return, indicating that this issue may not be completely settled.[13]

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5. ARCO Pipe Line Co., 35 F.E.R.C. ¶ 62,202 (1986).
6. ARCO Pipe Line Co., 43 F.E.R.C. ¶ 63,033 (1988).
7. Opinion No. 351, ARCO Pipe Line Co., 52 F.E.R.C. ¶ 61,055 (1990).
8. 43 F.E.R.C. ¶ 63,033, at 65,378-82.
9. Opinion No. 154-B, Williams Pipe Line Co., 31 F.E.R.C. ¶ 61,377, at 61,836 (1985).
10. *Id.*
11. 43 F.E.R.C. ¶ 63,033, at 65,375.
12. Opinion No. 351, ARCO Pipe Line Co., 52 F.E.R.C. ¶ 61,055, at 61,242 (1990).
13. ARCO Pipe Line Co., 53 F.E.R.C. ¶ 61,398, at 62,388 (1990).

C. Amortization of Starting Rate Base Write-Up

In the initial decision the ALJ denied ARCO the right to amortize in its cost of service the initial write-up in its rate base that resulted from the SRB calculation.[14] In reaching this decision the ALJ relied on the fact that under the old ICC valuation method the ICC did not allow the pipeline to amortize or otherwise recover the "write-up" for inflation occurring under that methodology.[15] The Commission adopted this rationale, indicating that the initial SRB write-up is not analogous to deferred earnings[16] and is "transitional" and must therefore be amortized below the line.

D. Treatment of AFUDC

The ALJ found that Opinion No. 154-B methodology permits the pipeline to add AFUDC to rate base only for a new plant added after December 31, 1983.[17] The basic rationale for this is that Opinion No. 154-B is intended to facilitate the transition from valuation to TOC and not to permit the pipeline to recalculate its rate base as if TOC was in effect prior to 1983. Without elaborating on the ALJ's decision the Commission appears to adopt this rationale.[18]

E. Deferred Taxes—Reduction in Rate Base

Relying on the Commission's long-standing practice of preventing a pipeline from earning a return on so-called cost-free capital,[19] the ALJ concluded that ARCO Pipe Line's rate base should be trended before it is credited with deferred taxes.[20] The Commission, however, reversed the ALJ, holding that trending should occur after the rate base is credited with deferred taxes.[21]

III. MARKET POWER CASES

In *Buckeye Pipe Line Co.*,[22] the FERC adopted a new bifurcated procedural mechanism for determining whether the proposed rates of an oil pipeline are just and reasonable. The Commission ordered a bifurcated proceeding that would address "initially" to what extent Buckeye Pipe Line had market power within relevant markets and whether it is subject to effective competition in those markets.[23] Once Buckeye's market position is determined by the ALJ, the Commission will then consider whether further scrutiny is required

14. 43 F.E.R.C. ¶ 63,033, at 65,372.
15. *Id.*
16. Opinion No. 351, ARCO Pipe Line Co., 52 F.E.R.C. ¶ 61,055, at 61,236-37 (1990).
17. 43 F.E.R.C. ¶ 63,033, at 65,373.
18. 52 F.E.R.C. ¶ 61,055, at 21,234-35.
19. *See, e.g.*, Williams Pipe Line Co., 31 F.E.R.C. ¶ 61,377, at 61,839 (1985).
20. 43 F.E.R.C. ¶ 63,033, at 65,394-95.
21. Opinion No. 351, ARCO Pipe Line Co., 52 F.E.R.C. ¶ 61,055, at 61,238 (1990). This, the Commission stated, would "ensure that the pipeline would earn a return only on capital invested in rate base that is not cost free." *Id.*
22. Buckeye Pipe Line Co., 44 F.E.R.C. ¶ 61,066 (1988).
23. In this respect, the Commission requested Buckeye to submit evidence that demonstrates its lack of significant market power in those markets in which it desires light handed regulation. *Id.* at 61,186.

as to the cost justification for those rates.[24]

Administrative Law Judge Stephen L. Grossman presided over the first phase of the contemplated bifurcated proceeding focusing on the market power issue.[25] The relevant "market product" for purposes of the initial decision was the "transportation of all refined pipelineable petroleum products."[26] Recognizing that Buckeye's rate proceeding represented a case of first impression before the agency, Judge Grossman found that Buckeye Pipe Line did not exercise market dominance in any market in which it was a competitor. After reviewing the record, the Judge concluded that "the evidence presented supports findings that Buckeye lacks significant market power . . . in each market is serves."[27] The Judge did not address the cost basis of the proposed rates or its interrelationship with the market dominance finding. Nevertheless, the Judge certified the market dominance findings to the entire Commission.

On December 31, 1990, the Commission, with Commissioner Moler dissenting in part, issued Opinion No. 360, affirming the conclusions of the ALJ as to 15 of the 22 markets served by Buckeye.[28] In addition, the Commission: (1) did not address the two markets for which Buckeye did not have tariffs on file, (2) found that Buckeye exercised significant market power in five markets and remanded to the ALJ the determination of the appropriate rates in the five markets and the amount of any reparations owed shippers, (3) addressed the rate methodology to be used by Buckeye in the future; and (4) approved Buckeye's rate proposal for a three-year period to cap price increases and decreases in markets where Buckeye possesses market power to those price changes in markets where it lacks significant market power.[29] In order to monitor these price changes, the Commission ordered Buckeye to file annual reports of the price and revenue changes in each market.[30]

In *Ashley Creek Phosphate Co. v. Chevron Pipe Line Co.*,[31] the Interstate Commerce Commission declined to follow the market dominance path taken by FERC. The ICC denied the defendants' requests for a bifurcated proceeding for the consideration of the reasonableness of proposed rates and practices for the transportation of phosphate slurry. According to the ICC, the Interstate Commerce Act does not require a finding of market dominance, and the ICC would not do so prior to reviewing the pipeline's proposed rates.[32] While the ICC acknowledged that "[FERC] is currently applying a market dominance analysis in ratemaking proceedings for oil pipelines."[33] The ICC held that "[t]here is no statutory basis for treating market dominance as a prerequi-

24. *Id.* The Commission has ordered identical bifurcated proceedings in Williams Pipe Line Co., 52 F.E.R.C. ¶ 61,084 (1990), Amoco Pipeline Co., 52 F.E.R.C. ¶ 61,138 (1990), and ARCO Pipe Line Co., 52 F.E.R.C. ¶ 61,153 (1990). These cases have not yet reached the decision stage.

25. Buckeye Pipe Line Co., 50 F.E.R.C. ¶ 63,011 (1990).

26. *Id.* at 65,047.

27. *Id.* at 65,061.

28. Opinion No. 360, Buckeye Pipe Line Co., 53 F.E.R.C. ¶ 61,473 (1990).

29. *Id.* at 62,659.

30. *Id.* at 62,680.

31. No. 40131, I.C.C. LEXIS 280 (Aug. 1990).

32. *See Id.* I.C.C. LEXIS 280, *5.

33. *Id.* I.C.C. LEXIS 280, *2, at n.3.

site to our examining the reasonableness of a pipeline rate."[34] Rather, the applicable statute only requires an initial market dominance determination for rail rates.[35]

IV. JURISDICTION OVER ANHYDROUS AMMONIA PIPELINES

Gulf Central Pipeline Co.[36] began as a complaint proceeding filed at the FERC against Gulf Central Pipeline Company (Gulf Central), alleging a broad array of violations of the Interstate Commerce Act by Gulf Central, which transports anhydrous ammonia. The original complaint was brought by one of Gulf Central's shippers, Farmland Industries, Inc. (Farmland).

In response to a motion filed by Gulf Central, the FERC disclaimed jurisdiction over pipelines transporting anhydrous ammonia. Seven months later, the ICC determined that it does have jurisdiction over anhydrous ammonia pipelines.[37]

The FERC's decision was appealed to the District of Columbia Circuit Court by a shipper on the pipeline and an intervenor in the FERC proceeding, CF Industries, Inc. Gulf Central and Farmland Industries joined the FERC in defending the Commission's decline of jurisdiction. On February 19, 1991, the court affirmed the FERC's decision.[38] C.F. Industries also petitioned the D.C. Circuit Court for review of the ICC's decision to exert jurisdiction. The complaint proceeding is moving forward at the ICC, with discovery now underway.[39]

V. DECISION AUTHORIZING THE USE OF ALTERNATE DISPUTE RESOLUTION TECHNIQUES

Amerada Hess Pipeline Corp.,[40] was instituted by the FERC to investigate allegations by the State of Alaska that certain costs incurred by carriers owning interests in Trans Alaska Pipeline System (TAPS) to repair corrosion damage along TAPS have not been prudently incurred and are thus not eligible for recovery in the tariff rates for the carriers. From the outset of the proceeding—an outgrowth of the 1985 TAPS rate case settlement that took place after more than seven years of litigation—FERC Administrative Law Judge Jon G. Lotis encouraged the parties to consider alternate dispute resolution techniques. On April 17, 1990, Judge Lotis certified the parties Alternative Dispute Resolution Agreement to the Commission,[41] and in October of 1990, the

34. *Id.* I.C.C. LEXIS 280, *5.
35. 49 U.S.C. § 10709(b).
36. Gulf Cent. Pipeline Co., 50 F.E.R.C. ¶ 61,381 (1990).
37. Gulf Cent. Pipeline Co., 7 I.C.C.2d 52 (1990).
38. Cf. Indus., Inc. v. FERC, 925 F.2d 476 (D.C. Cir. 1991). CF Industries also petitioned for review of the ICC decision, CF Indus., Inc. v. ICC, No. 90-1516, 1991 WL 105536 (D.C. Cir. 1991), and requested that the proceeding be held in abeyance until the FERC appeal is decided because the ruling in that case would be dispositive of the issue presented in the ICC review proceeding.
39. Farmland Indus., Inc. v. Gulf Cent. Pipeline Co., No. 40411, I.C.C. (1990).
40. Amerada Hess Pipeline Corp., 50 F.E.R.C. ¶ 63,018 (1990).
41. Amerada Hess Pipeline Corp., 51 F.E.R.C. ¶ 65,009 (1990).

Commission approved it.[42]

VI. REPEAL OF CLAYTON 10

Section 10 of the Clayton Antitrust Act[43] prohibits

> common carriers from having any dealings in securities, supplies or other articles of commerce, or [from making] or [having] any contracts for construction or maintenance of any kind, to the amount of more than $50,000, in the aggregate, in any one year . . . when the said common carrier [had] on its board of directors or as its president, manager or as its purchasing or selling officer, or agent in the particular transaction, any person who [was] at the same time a director, manager, or purchasing or selling officer of, or who had any substantial interest in, such other corporation, firm, partnership or association, unless and except such purchases [were] made from, or such dealings were with, the bidder whose bid is the most favorable to the common carrier, to be ascertained by competitive bidding . . . prescribed by . . . the Interstate Commerce Commission.

On November 16, 1990, President Bush signed into law Public Law 101-588, the Antitrust Amendments Act of 1990, which repealed section 10 of the Clayton Act.[44]

VII. IMPROVEMENT AND EXPLANATION OF THE FERC'S OIL PIPELINE PROCESSES

A. *Streamlining Commission Procedures for Review*

On December 3, 1990, FERC issued Order No. 530[45] adopting new regulations which, as to oil pipelines, eliminate the requirement for a two-step review process as to decisions of the Oil Pipeline Board. Instead of filing both an appeal of staff action and a rehearing request, the new regulation permits exceptions by interested parties to Oil Pipeline Board orders within twenty days of their issuance or, if no exceptions are filed in twenty days, requests for rehearing pursuant to Rule 713 by interested parties within fifty days.[46] Requests for rehearing of orders issued by the Commission on exceptions to Oil Pipeline Board orders would also be permitted pursuant to Rule 713.[47]

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John W. Ebert, *Vice Chairman*

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42. Amerada Hess Pipeline Corp., 53 F.E.R.C. ¶ 61,061 (1990).
43. 15 U.S.C. § 20 (1988).
44. Antitrust Amendments Act of 1990, Pub. L. No. 101-588, 104 Stat. 2879 (1990).
45. Order No. 530, Regulations Preambles 1986-90 ¶ 30,906, 55 Fed. Reg. 50,677 (1990) (to be codified at 18 C.F.R. pt. 385).
46. 18 C.F.R. § 385.1902(b) (1991).
47. 18 C.F.R. § 385.713 (1991).