

## II. HISTORICAL OVERVIEW OF OIL PIPELINE RATE REGULATION

The antitrust laws that seek to prevent monopolistic and anti-competitive behavior were enacted in the late nineteenth century in response to the perceived monopoly power of large industrial trusts that existed at the time, including the Standard Oil Trust.<sup>87</sup> Regulation of oil pipeline rates began with the enactment of the Hepburn Act of 1906,<sup>88</sup> which amended the Interstate Commerce Act to bring within its purview “common carriers engaged in...the transportation of oil...by pipe line.”<sup>89</sup> Like railroads and other common carriers subject to regulation under the Interstate Commerce Act, oil pipelines were required to post tariffs with the Interstate Commerce Commission,<sup>90</sup> to charge only just and reasonable rates,<sup>91</sup> and to avoid unjust discrimination and undue preferences.<sup>92</sup>

From 1906 until the late 1930s, there were few, if any, litigated proceedings before the Interstate Commerce Commission addressing oil pipeline rates.<sup>93</sup> In 1940, for the first time, the Interstate Commerce Commission enunciated a standard for assessing the reasonableness of oil pipeline rates.<sup>94</sup> That standard used a weighted average of both the original cost of the pipeline infrastructure and the cost of reproducing that infrastructure under the conditions at the time of the rate case to determine a “valuation” or “fair value” rate base.<sup>95</sup> The pipeline’s allowable revenues were determined by applying a fixed rate of return (ultimately set by the Interstate Commerce Commission at 8% for crude oil pipelines and 10% for petroleum products pipelines) to the valuation rate base.<sup>96</sup>

This “fair value” methodology used by the Interstate Commerce Commission for oil pipelines was based on its ratemaking treatment of railroads and the United States’ Supreme Court’s approval of such methodologies in *Smyth v. Ames*, 169 U.S. 466, 546-47 (1898).<sup>97</sup> The Interstate Commerce Commission issued only three other published opinions on its oil pipeline

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<sup>87</sup> See *Standard Oil Co. of New Jersey v. United States*, 221 U.S. 1 (1911); Barak Orbach & Grace Campbell Rebling, *The Antitrust Curse of Bigness*, 85 S. CAL. L. REV. 605, 606 (2012).

<sup>88</sup> Pub. L. No. 59-337, 34 Stat. 584 (codified as amended in scattered sections of 49 U.S.C.).

<sup>89</sup> 49 U.S.C. app. § 1(1)(b) (1988). The Interstate Commerce Act as it applies to oil pipelines is the Act as it stood on the date of the enactment of the Department of Energy Organization Act, Pub. L. No. 95-91, 91 Stat. 565 (1977), which provided among other things for the transfer of jurisdiction over oil pipelines to the newly created FERC. Revised Interstate Commerce Act, Pub. L. No. 95-473 § 4(c), 92 Stat. 1337, 1470 (1978). For this reason, the 1978 recodification of the Interstate Commerce Act beginning at 49 U.S.C. § 10101 and all subsequent amendments to that Act are inapplicable to oil pipelines. The version of the ICA that does apply to oil pipelines is found in the appendix to the 1988 edition of Title 49 of the United States Code.

<sup>90</sup> 49 U.S.C. app. § 6 (1988).

<sup>91</sup> 49 U.S.C. app. § 1(5) (1988).

<sup>92</sup> 49 U.S.C. app. §§ 2, 3(1) (1988).

<sup>93</sup> See Steven Reed & Pantelis Michalopoulos, *Oil Pipeline Regulatory Reform; Still in the Labyrinth?*, 16 ENERGY L.J. 65, 68 (1995).

<sup>94</sup> See *Reduced Pipe Line Rates and Gathering Charges*, 243 I.C.C. 115 (1940).

<sup>95</sup> See *Farmers II*, 734 F.2d at 1495.

<sup>96</sup> *Reduced Pipe Line Rates and Gathering Charges*, 272 I.C.C. 375 (1948); *Petroleum Rate Shippers’ Ass’n v. Alton & So. R.R.*, 243 I.C.C. 589 (1941).

<sup>97</sup> See *Farmers II*, 734 F.2d at 1495 n.29; see also *Farmers Union Central Exchange v. FERC*, 584 F.2d 408, 414 (D.C. Cir. 1978), cert. denied, 439 U.S. 995 (1978) (“*Farmers I*”).

valuation methodology after its establishment,<sup>98</sup> and it did so principally before the landmark decision in *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). In that case, the U.S. Supreme Court established the fair and reasonable deference test toward rate determinations and approved prudently invested original cost less depreciation to determine rate base.<sup>99</sup>

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<sup>98</sup> See *Petroleum Rate Shippers' Ass'n*, 243 I.C.C. 589 (1941); *Minnelusa Oil Corp. v. Continental Pipe Line Co.*, 258 I.C.C. 41 (1944); and *Reduced Pipe Line Rates and Gathering Charges*, 272 I.C.C. 375 (1948).

<sup>99</sup> See also *Farmers I*, 584 F.2d at 413-14.