

The History of Oil Pipeline Regulation

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Three Questions

- How did oil pipelines come to be regulated by the federal government?
- How has federal regulation evolved over time?
- What does it mean today?

Background of U.S. Oil Pipeline Regulation

- Development of U.S. Oil Industry
- John D. Rockefeller/Standard Oil
- 1906: Pivotal Year

Origins of the Oil Industry

- What does “Moby Dick” have to do with the origins of the oil industry?
- Who was “Colonel” Edwin Drake?
- Why does a barrel of oil contain 42 U.S. gallons?
- Who was Samuel Van Syckel?

Standard Oil

- Founded in 1870 by John D. Rockefeller in Cleveland, Ohio
- Controlled 90% of oil refining and 80% of oil transportation markets in U.S.
- “Posted prices”
- Rebates and drawbacks
- Squeezed out independents

Hepburn Act of 1906

- Brought oil pipelines under Interstate Commerce Act of 1887 (originally applied only to railroads)
- President Theodore Roosevelt and Senator Henry Cabot Lodge, both Republicans, spearheaded the Hepburn Act
- Enacted rapidly in a climate of public outrage

Was this trip necessary?

- Standard Oil monopoly already threatened by new competitors (Gulf, Sun, Texaco, Phillips, etc.)
- U.S. v. Standard Oil -- antitrust suit to break up Rockefeller monopoly (succeeded in 1911)
- Growth of demand for gasoline and aviation fuel as 20th century dawned

What did the Hepburn Act cover?

- Interstate
- Common Carrier
- Transportation
- Of Oil
- By Pipeline

Regulated Activities Under ICA

- Rates and charges
- Terms of service (rules and regulations)
- Form and content of tariffs
- Accounting (USOA)
- Reporting (Form 6)
- Disclosure of shipper information (15(13))

What does the ICA leave unregulated?

- Construction and abandonment of oil pipelines (entry and exit)
- Sales and leases of oil pipeline assets
- Securities transactions
- Provision of non-transportation services

Contrast Oil Pipeline and Gas Pipeline Regulation

- OIL PIPELINES
 - Common carriage
 - Unregulated entry and exit
 - Highly competitive
 - Unique regulatory model
- GAS PIPELINES
 - Public utilities
 - Approval required for construction and abandonment
 - Natural monopoly model

Oil Pipeline History

ICC Era: 1906-1977

- Pipeline Cases (1914)
- ICC Inactivity (1906-1940)
- Atlantic Refining Consent Decree (1941)
- ICC Valuation Methodology (1940's)
- Williams Pipe Line proceeding (1970's)
- Trans Alaska Pipeline System opens (1977)

Oil Pipeline History

FERC Era: 1977-Present

- 1977-1985: Failed efforts to regulate
- 1985: Opinion 154-B
- 1988: Buckeye market-based rate alternative
- 1992: Energy Policy Act
- 1994: FERC rulemaking and adoption of indexing methodology

1977-1985: Failed Efforts

- Formation of FERC (Department of Energy Organization Act -- 1977)
- Farmers Union I (D.C. Circuit 1978)
- Opinion 154, Williams (FERC 1982)
- American Petrofina Order (FERC 1982)
- Farmers Union II (D.C. Circuit 1984)

1985: Opinion 154-B

- Opinion 154-B, Williams -- adopted modified trended original cost (TOC) methodology for oil pipelines
- Provided for “transition rate base” between valuation and TOC called SRB
- Intended to be cost-based rate methodology
- Many details left to individual cases

Cost-of-Service Cases

- ARCO Pipe Line – Opinion 351 (FERC 1990)
- Kuparuk Transportation Company– (FERC 1991)
- Endicott Pipeline Initial Decision (1991)
- Continued uncertainty about certain elements of Opinion 154-B methodology

1988: Buckeye market-based rate alternative

- Buckeye proceeding involved setting cost-based rates under Opinion 154-B
- Dispute arose over disclosure of confidential cost information by Buckeye
- On appeal, FERC ruled Buckeye could obtain “lighthanded regulation” by showing “lack of significant market power in the relevant markets”

Market-based Rate Alternative

- Buckeye rule broadened to all oil pipelines
- Pipelines originally had an election to defend filed rates on market power or cost-of-service grounds
- “Lighthanded” regulation now understood to mean market-based rates
- Burden is on pipeline to show lack of market power

Energy Policy Act of 1992

- “Grandfathered” existing rates as of 10/24/92
- Ordered FERC to develop “simplified and generally applicable” methodology
- Also required FERC to “streamline” procedures for oil pipeline regulation

Conclusion