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 dawning
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

• “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