

# The History of Oil Pipeline Regulation

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*Steven Reed*



STEPTOE&JOHNSON LLP

# 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
  - long-term storage and terminalling
  - in-line transfer documentation

# 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

# Canadian Pipeline Regulation

- National Energy Board established 1959 by NEB Act
- Regulates both oil pipelines and gas pipelines
- Broader powers than FERC (includes pipeline safety)
- No separation of functions
- Experimenting with incentive regulation

# 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)
- 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

# 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
- “Lighthanded” regulation now understood to mean market-based rates
- Burden is on pipeline to show lack of market power
- Geographic and product market definitions
- Use of market share and HHI data

# 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

# FERC Rulemaking

- FERC adopted indexing as “simplified and generally applicable” methodology
- Original index was Producer Price Index minus one percent (PPI-1)
- Base for indexing = rates in effect 12/31/94
- Challenges to indexed rates theoretically possible, but difficult to sustain

# **Indexing Developments**

- Year 2000 review – FERC initially decided to retain PPI-1 index
- D.C. Circuit reversed, ruling that FERC had improperly changed its standard
- On remand, FERC reverted to PPI as the index, effective as of July 1, 2001
- Most recent FERC review led to adoption of PPI+1.3 index now in effect
- Next review will occur in 2010

# Alternatives to Indexing

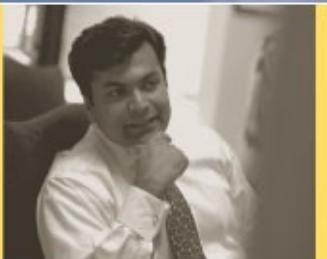
- FERC rulemaking under EPAct retained three alternatives to indexing
  - Cost of service rates (Opinion 154-B)
  - Market-based rates
  - Negotiated rates

# Recent Developments

- FERC addressing innovative proposals to adapt its existing regulatory regime to need for new pipeline infrastructure
- FERC continuing to evolve policy on grandfathering of rates under EPAct
- Recent policy statements addressed issues regarding FERC calculation of return on equity and tax allowance



# Conclusion



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