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Chapter 13

Going Against the Flow: The Background and Evolving Nature of Federal Regulation of Common Carrier Oil Pipelines

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Synopsis

§ 13.01. Overview.

For most of the last century, oil pipelines — transporters of crude oil, refined petroleum products and natural gas liquids — occupied a largely invisible corner of the federal regulatory landscape. During the bulk of

1 The author acknowledges with great appreciation the contribution of his colleague Joseph Hicks to the preparation of this chapter.

that period, oil pipelines typically were owned by large integrated oil companies, a fact that had two major consequences: (1) third-party shippers (if any) were generally minority users of most pipeline systems, and (2) projects to construct or expand existing infrastructure were determined principally based on the integrated company's strategic needs and vision. As a result, pipeline rates and practices only rarely engendered protests or complaints. At the same time, as crude oil reserves in many areas dwindled, and refineries were closed or resized in the process of industry-wide facility rationalization, few pipeline projects of any magnitude were undertaken. Oil pipelines accordingly attracted the attention of the Federal Energy Regulatory Commission (FERC) and its predecessor regulator, the Interstate Commerce Commission (ICC), only episodically, and even then most often in "one-off" controversies.

Those days are over. The rise of the master limited partnership organizational form has transformed the liquids pipeline industry into one that is now increasingly dominated by stand-alone pipeline companies that function essentially as independent transporters of crude oil and petroleum products. At least as important, the discovery of massive new production areas, coupled with the dramatic expansion of the use of hydraulic fracturing and directional drilling technology, has led to a pressing need for significant additions to and alterations of the nation's pipeline capacity. Simply put, the nation's pipeline network was too small, went to or from the wrong places, and was not designed to meet the rapidly changing demand for liquid petroleum commodities.

While the need for major infrastructure enhancement continues, the oil pipeline industry has responded with an unprecedented number of major undertakings. The serious shortage of pipeline capacity has variously been met by new greenfield construction projects, expansions or extensions of existing systems, and re-purposing of existing pipelines by reversing the direction of flow or retrofitting systems to allow the transportation of different products than the facility had previously served.

The ability to bring those projects to fruition, however, has been complicated by the regulatory environment in which oil pipelines operate. Since 1906, oil pipelines have been governed by the venerable Interstate Commerce Act (ICA), the original nineteenth century federal regulatory statute, which was designed to control the rates and practices of railroads.[2] While the regulation of rail carriers has since been removed from the ICA and transferred to an entirely different statute, oil pipelines remain subject to the ICA.

Unlike other federal regulatory statutes, such as the Federal Power Act and the Natural Gas Act, that manage their respective industries under a fundamentally conventional public utility model, the ICA treats oil pipelines as common carriers. That distinction brings with it both advantages and difficulties. On the one hand, it means, among other things, that oil pipelines do not need to secure from the FERC certificates of public convenience and necessity and, conversely, they can abandon service without seeking permission from the agency. On the other hand, it places substantial limitations on the ability of pipelines to enter into the kinds of individualized arrangements with shippers that can be critical in providing the mutual incentives to allow large projects to be undertaken.

As the need for enhanced infrastructure has grown more urgent, pipelines and shippers have made great strides in adapting to the statutory and regulatory structure by crafting creative measures that in past decades would have been considered questionable for entities such as oil pipelines that are regulated as common carriers. While the contours of the rules of the road continue to evolve, pipelines and shippers have been remarkably successful in fashioning innovative contractual structures that the FERC has found itself able to approve consistent with its regulatory obligations under the ICA.

The current state of federal oil pipeline regulation cannot be fully appreciated without first understanding where it came from. That is especially so given the stark differences between the way the FERC regulates oil pipelines and the much more familiar rules that apply to natural gas pipelines. This chapter therefore reviews the historical context and reach of the federal

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2 The ICA originally vested the regulation of both railroads and oil pipelines in the Interstate Commerce Commission (ICC). In 1977, the Department of Energy Organization Act transferred jurisdiction over oil pipelines to the newly created Federal Energy Regulatory Commission. 42 U.S.C. §§ 7155, 7172(b).

regulation of oil pipelines, and how that regulation has generally been applied. It then describes where the permissible bounds of contracts between pipelines and shippers stand today. Finally, it identifies the remaining limitations on the ability of the industry's players to shape agreements among themselves within the bounds of the FERC's concept of common carriage.

§ 13.02. Interstate Commerce Act (ICA) Jurisdiction Over Oil Pipelines.

[1] — Overview of Jurisdiction Under the ICA.

Section 1 of the ICA provides for federal regulatory authority over "common carriers engaged in . . . [t]he transportation of oil or other commodity, except water and except natural or artificial gas by pipeline . . ." between different states, or between a state and another country.[3] While that provision may at first blush appear to be relatively straightforward, in fact there has been uncertainty — and litigation — surrounding all of its key terms since the ICA was amended in 1906 to bring oil pipelines within its ambit.

Most fundamentally, one hundred years ago, the Supreme Court defined the only clear exemption from the ICA for a pipeline that moves oil across state lines: "[W]hen, as in this case, a company is simply drawing oil from its own wells across a state line to its own refinery for its own use, and that is all, we do not regard it as falling within the description of the Act, the transportation being merely an incident to use at the end."[4] Other than that, the ICA applies, although the FERC has seen fit to grant temporary waivers from the tariff, rate and annual report requirements that otherwise would apply, if a pipeline can show that only its (or an affiliate's) product moves through the line and no third-party has expressed an interest in using the system.[5]

That does not mean, however, that questions about ICA jurisdiction do not continue to arise. For federal regulatory jurisdiction to apply, the carrier

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3 34 Stat. 589 (1906). The FERC reviewed the lead-up to the Hepburn Act in Opinion No. 154, Williams Pipe Line Co., 21 FERC ¶ 61,260, at 61,578-83 (1982), *reh'g denied*, 22 FERC ¶ 61,086 (1983).

4 United States v. Ohio Oil Co., 234 U.S. 548, 562 (1914).

5 *See, e.g.*, United States v. Champlin Ref. Co., 341 U.S. 290 (1951); Hunt Ref. Co.& East Mississippi Pipeline Co., 70 FERC ¶ 61,035 (1995).