State Pipeline Regulation: Survey of Developments and Implications for FERC Regulation

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Introduction and Overview

- Review interstate and intrastate jurisdiction
- Consider impact of jurisdictional posture
- Review variations in state regulatory approach
- Interaction of federal/state jurisdiction
- Experience and developments across the states

Brief Summary of Jurisdiction

- With rare exceptions, transportation of oil by pipeline across a state line is FERC jurisdictional under ICA.
- Transportation within a state may or may not be.
  - Depends on whether it is part of a continuous interstate movement—which is determined from variety of factors.
  - Need to consider marine, but don't consider trucking.
- In contrast to gas pipes under *Lo-Vaca,* same oil pipe may be subject to both federal and state jurisdiction.
- *Jurisdictional Jeopardy* gave a detailed review.

Brief Summary of Jurisdiction

- So, an oil pipeline jurisdictionally may be
  - Solely subject to FERC,
  - Solely subject to state law, or
  - Subject to both.

- Significance of which one depends in part on the state and in part on the specific circumstances of the pipe.

State Pipeline Regulatory Regimes

- While some states ignore oil pipelines, except for EHS purposes, many states have adopted particular regulatory regimes, and those vary significantly:
  - Certificate-based/public utility regulation
  - Light-handed regulation
  - Non-statutory regulation – which doesn't mean "no regulation"
- Can affect entry-exit from service, installation, expansion, rates, and service standards.

Certificate-based/Public Utility Regulation

- Some states require an oil pipeline to obtain a "Certificate of Public Necessity and Convenience" to operate.
  - *E.g.*, California, Kansas, Wyoming, Pennsylvania
- In those states, oil pipelines are viewed more as a "public utility" (though lacking a "franchise").
- One must obtain a certificate to install, operate, modify, buy, and sell an oil pipeline.
- Contrast with FERC's ICA authority
- Condemnation power

Light-handed Regulation

- Some states have statutory standards and a regulatory scheme, but afford flexibility.
  - *E.g.,* Texas
  - In those states, pipeline is generally treated as common carrier, subject to basic standards of reasonable rates and non-discriminatory service.
- Oversight is generally limited and complaint-based.

Non-Statutory Regulation

- Some states have no statutory standards comparable to the ICA and no regulatory scheme.
  - *E.g.,* Florida, Minnesota, New Jersey
- In those states, pipeline is not subject to any active regulatory oversight (outside of EHS).
- Generally, an aggrieved customer would go to state court and invoke "common law" standards for common carriage.

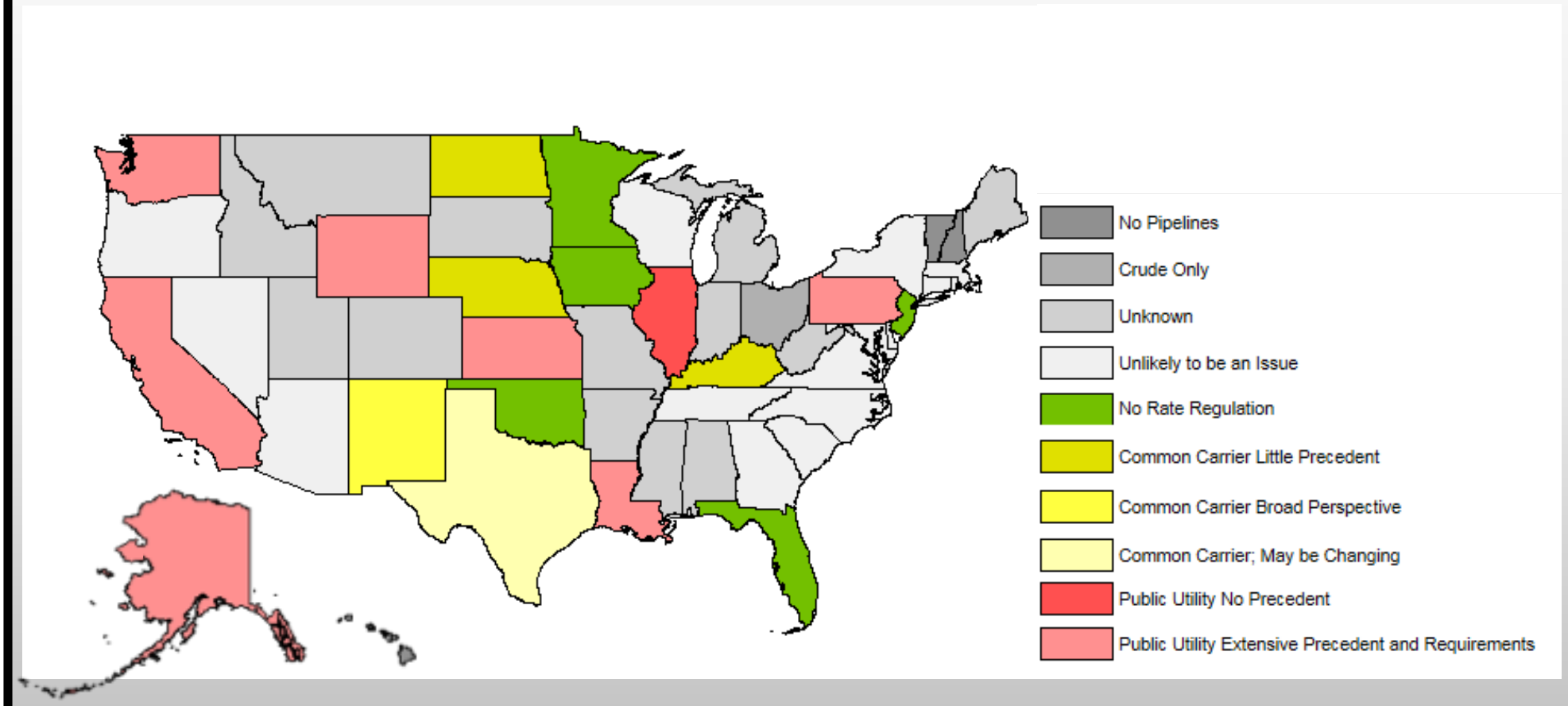
Non-Statutory Regulation

- What is “common law” common carriage?
  - Hint: ICA was viewed as embodying and codifying the common law.
- A review of the main conduct standards of the ICA gives a good sense of its meaning:
  - Rates to be just and reasonable
  - Services “held out” to public to be provided upon reasonable request
  - No unreasonable discrimination among customers

Why and When Does This Matter

- Given that states have differing methods for setting/reviewing rates and for regulating services and conduct, these differences can have implications
  - For commercial activity
  - In the context of an acquisition
    - Valuation
    - Authorization

Categorizing States



Light Handed Regulation Vs. Public Utility Regulation

Common Carriage Versus Public Utility

- Concepts of common carriage go back to medieval English Common law.
- For example a Public House, more commonly known as a “Pub” must serve everyone and charge reasonable prices.
- In regulatory economics one might imagine a continuum from purely private transactions (e.g. selling a bicycle on Craigslist) to goods provided by the state.

Public Goods

- Even in a largely free-market society such as the US many goods are (largely) provided by the state.
  - Roads
  - National Defense
  - Police
  - Fire
  - Schools
- Typically, these goods are most efficiently provided by a single provider and are in some way necessary to life.

Public Goods to Public Utilities

- Public utilities typically provide a good which has many characteristics of a public good.
  - Service to the Public
  - Monopoly Power (often guaranteed by the state)
  - Fixed Territory
  - Technological Limits
  - Duty to Serve
  - Reasonable Prices
- In some sense a public utility provides a service that could be provided by the state but is not.
- This concept leads to the notion of the Regulatory Compact.

Oil Pipelines Rarely Meet Key Conditions of A Public Utility

- Oil pipelines typically lack the protections from afforded to traditional public utilities.
- Oil pipelines rarely provide service to the “public” in the same way a traditional public utility does.
- Oil pipelines do not provide a service as vital to life as a traditional public utility.

Implications of the Differences

- There is typically much less theoretical justification for strict public utility regulation in an oil pipeline context.
- Instead regulation should focus on preventing an exercise of market power, preventing undue discrimination and ensuring reasonable prices.
- The FERC seems to have recognized these distinctions through its multifaceted regulatory structure.
- Some states have recognized this difference at times, including Texas and California—although this may be changing.

Characteristics of Light-Handed Regulation

- Market forces are explicitly considered.
- The Commission promotes setting rates through negotiations.
- Pipelines are allowed to enter and exit the market at will.

Characteristics of Public Utility Regulation

- Pipelines must obtain permission to enter or exit the market.
- All rates must be set on a strict cost-of-service basis.
- Commission has detailed requirements regarding the format in which a request for rate increase must be presented.
- Commission staff may be involved extensively in the rate case (often in a form that feels like an audit).

General Characteristics of COS in States

- Most states require COS should be calculated on Depreciated Original Cost.
- A few states may permit COS based on purchase price.
- Some states have a different treatment of income tax allowance.
- Some states have unique ways of addressing cost of capital.
- Many states DO NOT allow rates to go into effect subject to refund.

Practical Aspects of Dealing with State Agencies

- Few state agencies deal with oil pipelines with any frequency.
- Instead they deal with public utilities.
- They have an interest in promoting the interest of citizens of their state.
- Much of the precedent and practice has developed over decades.
- Collaborating with local counsel is vital.

State-Federal Interaction

- Before turning to developments in targeted states, look at the federal-state intersection
  - Pro's and con's of FERC versus State regimes
  - When worlds collide! Dual-jurisdictional pipelines

State-Federal Interaction

- Pro's and con's of FERC versus State regimes
  - Only matters where there is plausible optionality
  - Though there is a historical aversion to federal jurisdiction, FERC's steady development of its contract/open-season regime offers attractive opportunities to pursue new and expanded service under flexible, enforceable, and market-sensible terms.

State-Federal Interaction

- Pro's and con's of FERC versus State regimes
  - Though there is a historical preference for state light-handed jurisdiction, FERC-endorsed models have been replicated at the state level.
  - But these "replications" have not been tested before state agencies/courts

State-Federal Interaction

- Dual-jurisdictional pipelines
  - Generally, dual jurisdiction has not presented issue where interstate and intrastate transportation within the physical pipeline is all conducted under common carriage.
  - Implications of “firming” of capacity under one jurisdiction for service under the other jurisdiction?
  - ICA Section 13(4)

Experience and Developments in Particular States

Texas

- Oil pipelines in Texas are regulated by the Texas Railroad Commission ("TRRC") (which does not regulate railroads).
- Historically TRRC has applied light handed regulation.
- Statutory/regulatory scheme suggested TRRC only regulated crude oil pipelines.
- Over recent years, TRRC has become more active.

Texas

- In the *Westlake* case, TRRC asserted jurisdiction over an ethylene pipeline.
- The statute gives the TRRC the right to evaluate rates on the basis of market conditions or cost.
- Westlake argued that its rates should be evaluated on the basis of market conditions.
- TRRC rejected argument and evaluated on cost basis.

Texas

- In 2015, West Texas LPG Pipeline (“WTXP”) sought to increase rates for deliveries of NGL to Mont Belvieu.
- WTXP also sought to justify its rates on a market basis.
- Generally, the shippers argued that rates should be set on the basis of cost.
- WTXP argued that, if rates are set on cost, the calculation should be done based on purchase price.
- Hearings before an ALJ were held in March 2017.
- TRRC has remanded the case back to the ALJ and there will be a hearing in October 2018.

Texas

- The TRRC seems to be becoming more active in oil pipeline regulation.
- There is substantial uncertainty
  - Will the Commission allow rates to be set on a market basis.
  - If rates are set on a cost basis how will the calculation be performed.
- Texas does not *appear* to require oil pipelines to obtain a certificate.
- The TRRC initially allowed WTXP's rates to go into effect and then reversed itself.

California

- Historically, the California Public Utilities Commission("CPUC") employed light-handed regulation.

- In *Unocap* and *ARCO,* the CPUC explicitly permitted pipeline rates to be set on a market basis.

- In the last ten years in a series of decisions involving SFPP and San Pablo Bay, the CPUC has moved much closer to the Public Utility model.

California

- In California, a pipeline can file a 10% rate increase that becomes effective immediately subject to refund (if challenged).
- Any amount above this level can only be charged *after* the Commission issues a ruling.
- Contested rate cases tend to be long and expensive.
- A pipeline requires a certificate and therefore cannot enter or exit the market at will.

Wyoming

- The Wyoming Public Service Commission ("PSC")regulates oil pipelines as a traditional public utility.
- Rates must be justified on the basis of a depreciated original cost calculation.
- Belle Fourche had a hearing before the full Commission, despite the lack of a shipper protest.
- PSC Staff often review the underlying calculations extensively.
- Pipelines must obtain permission to abandon service.

Kansas

- The Kansas Corporation Commission ("KCC") regulates oil pipelines as a public utility.
- The KCC requires oil pipelines to obtain a certificate to enter or exist the market.
- Rates must be justified on the basis of cost-of-service.
- Rates are not set subject to refund.
- KCC Staff will conduct an extensive audit of the rate filing.

Alaska

- The Regulatory Commission of Alaska ("RCA") has substantial experience regulating oil pipelines.
- The RCA treats oil pipelines in the same manner as a public utility.
- The RCA requires oil pipeline rates to be set on the basis of depreciated original cost.
- The RCA has extensive and very precise filing requirements.
- On TAPS cases, the RCA and the FERC have held several joint hearings.

Washington

- The Washington Utility and Telecommunications Commission ("WUTC") regulates oil pipeline rates.
- They conducted a hearing involving Olympic Pipeline in 2002.
- Olympic was not allowed to set rates subject to refund.
- The rates were evaluated on the basis of depreciated original cost.
- Olympics rates have been set subject to a settlement for many years.

Pennsylvania

- The Pennsylvania Public Utilities Commission ("PA-PUC") regulates oil pipeline rates.
- Oil pipelines are required to obtain a certificate of public necessity and convenience.
- Rates would likely be set on the basis of depreciated original cost, although there has not been an oil pipeline rate case in Pennsylvania in decades.
- In 2018 the Commission denied Laurel's reversal of a portion of its intrastate pipeline between Pittsburgh, PA and El Dorado, PA.

Louisiana

- The Louisiana Public Service Commission regulates oil pipeline rates. No certificate obligation; but asset transfer/merger requirements.
- Traditionally the pipeline files a rate case based on a cost-of-service; more recently have had the option to raise rates by index.
- The Commission has been fairly receptive to FERC precedent.
- In a rate case, the Staff will review the details of the filing in a manner similar to an audit.
- Offer the option to file for tariff exceptions.

Oklahoma

- There is no statutory *rate* regulation in Oklahoma.
- The Oklahoma Corporation Commission does regulate safety of intrastate pipelines
- The website of the Oklahoma Corporation Commission notes that there is not a filing requirement but they will accept tariffs if people send a tariff to them. http://www.occeweb.com/tr/PipelineTariff.htm