

THE ROLE OF THE OIL PIPELINE INDUSTRY IN TODAY'S
ENERGY ENVIRONMENT

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This paper discusses the two major areas impacting the oil pipeline industry today and develops potential scenarios for the future of the industry.

I appreciate the opportunity to meet with this group and discuss the role of the oil pipeline industry in today's energy environment. Had this presentation been made 10 years ago, it would have been very easy to prepare and equally easy to do justice to the pipeline industry's role in the time allotted in tonight's program. I simply would have discussed the oil pipeline industry's history of steady growth and high operating efficiency and its excellent safety and environmental record, provided appropriate statistics, and compared those to the three other surface transport modes. Then I would have closed by saying the obvious: namely that the oil pipeline industry is a vital transportation link in our nation's energy systems and has served the country well.

I can still say all of those things and make those comparisons but to do so would take time away from, what I view as the critical issues facing our industry today. I hope you will accept as a matter of fact all of those items I enumerated and if there is time available for questions later, I would be happy to furnish data to support those statements.

What I will spend my time on this evening are the areas of government involvement in the oil pipeline business, the current energy supply/demand outlook, and the potential impact of these areas on the economic health of our industry. I feel that in both areas choices are available and the range of potential results is from a continuation of a healthy industry to that of an industry which is so financially and structurally weakened as to chill future investment which in turn would force the nation to other less effective transportation modes.

Government involvement in the energy industry has increased dramatically over the last decade and at an ever accelerating rate. This activity has been in a multitude of areas including construction permitting, environment, safety, personnel, operations, rate making, and even ownership. While all of these areas can materially affect the industry, I will focus my remarks on the last two: rate making and ownership.

Since early in this century, the oil pipeline industry has been regulated with regard to its rates and its operating practices insofar as they relate to its shippers access to and use of its lines. This regulation was administered by the Interstate Commerce Commission until October of 1977 and has been administered by the Federal Energy Regulatory Commission since that time. The regulatory approach used by the Interstate Commerce Commission was generally one of only monitoring companies activities through the means of their annual report Form P's. It was only where shipper protests were involved as a result of a specific pipeline's tariff action that the ICC instituted formal hearings.

The industry was aware of the earnings guidelines it was subject to as a result of two landmark ICC cases and a 1941 consent decree with the Justice Department. One major attribute of the historic method of regulation was that the fair value style of regulation used by the ICC allowed rate of return standards established in the 1930's and 1940's to remain reasonably compensatory over time since automatic adjustments in the rate base reflected in large part the inflationary pressures felt by the industry. At the time the FERC was established and assumed the ICC's former authority over oil pipelines, my company, Williams Pipe Line, along with Explorer Pipeline, had a rate case pending on appeal before the Federal District Court in Washington, D.C. This was a case which had been resolved in an administratively final manner by the ICC using its traditional guidelines. This administrative decision had been appealed to the judicial branch by the small group of shippers who had protested Williams tariff increases and who also had advocated changes in the historic ICC method of regulation. Although the ICC supported its decision before the court, the FERC asked that the case be remanded in order that the FERC could establish its own style of regulation. Even though the proceeding already encompassed a time period beginning in 1971, the Court honored the FERC's request and remanded the case in early 1978. This has now become what appears to be the landmark case which will determine the FERC's method of regulation for the oil pipeline industry. Phase I, which is proceeding currently, will establish comprehensive general rate making principles. Because the FERC staff is primarily composed of former FPC employees, it has adopted a position on rate making which is the same as it has historically used on gas pipelines. It is a net original cost

rate base approach. This, combined with staff attitude which seems to be very negative with regard to the industry and its former regulator, means the industry faces some trying and potentially damaging times in the near future. Hopefully, the general rate making procedures will be developed on a factual basis and not an emotional one. It is obvious the financial viability of a critical industry is at stake.

The second area of government activity which I said I would discuss is that of ownership of oil pipelines. For several years there have been various administrative and legislative assaults on the ownership of oil pipelines by vertically integrated oil companies. The substantial majority of existing pipelines have just such an ownership. While the Justice Department and some members of Congress have been advocates of divestiture in the past, the banner is currently being carried by the FTC. The FTC has asked for public comments and appears to be moving forward on a thesis which presumes divestiture is warranted. The issues here are whether or not ownership of oil pipelines gives "shipper-owners" unfair advantages in the marketplace through either unreasonably high pipeline earnings or by control of access to those markets. The proponents of divestiture have proposed several theories to support their position but have presented no facts to support those theories. Once again, choices are available to us and once again they must be made on a factual and not an emotional basis. It would come as no surprise if I said our nation's energy supply is becoming increasingly tenuous. As the supply of petroleum is limited to the point that it equals or surpasses demand the elasticity is removed from the logistics system. The refining capacity in this country is concentrated in a limited geographic area and in turn serves a broad geographic area. This obviously requires an extensive distribution network which, for the most part, consists of pipelines. The logical question one might ask regarding the existing pipeline network is why should the tightening of supplies have any impact. The answer is fairly simple. Historic supplies have allowed sufficient inventories to be carried in the ultimate distribution areas to allow pipeline capacity to be designed at essentially average annual throughput rates with the storage accommodating the winter demand peaks for middle distillates and the summer demand peaks for gasolines. Because of the broad geographic areas served by our refining centers they must concentrate an increasing percentage of the inventory at the refinery origin as the overall inventory levels decline. In effect the pipelines are being asked to accommodate current demand on a current basis. In many cases this requires capacity increases and much wider fluctuations in month to month capacity demands.

Without question, the level of general business uncertainty in the energy area is as high as it has been in the modern history of our country. With in excess of 50% of our petroleum needs being supplied by foreign countries over which we have no control and, in many cases, little influence, the supply picture is very unclear. With nothing other than these fundamental supply/demand questions to be faced, it is obvious the oil pipeline business would be faced with making investment and operating decisions in an even higher risk environment than has been the case for the past 30 years.

Now we move to the point which I feel is the crux of the issues I just outlined. What is the current impact of these issues and what is the range of future impacts on the industry.

When you superimpose the unanswered questions of, What is my real earnings potential even assuming I realize the volume of traffic I anticipate? and Will I be able to retain ownership of this property even if I make the investment? On the substantially increased levels of normal business risk growing out of the uncertain supply situation the impact on the industry is predictable. Investments will be minimized, if made at all, and even those that are made may require business needs external to the basic transportation system to support them.

The question I pose to this group today is, At this critical point in our country's history can we afford to chill an industry that plays such a vital role in helping meet our nation's critical energy needs? It seems to me the answer is no. This is an industry with a proud history of innovation and one which I am confident can rise to meet our nation's needs if it is allowed to do so. But it is also one whose very roots are being threatened. The time to make the choice is now.

A COAL SLURRY PIPELINE

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Twenty years ago Florida Gas began the transportation of natural gas to Florida and remains today as the only major gas transmission company supplying Florida. One of the major factors justifying the construction of the Florida Gas system was the availability of a plentiful supply of cheap natural gas which could be supplied to the Florida electric utilities as well as to industry and for domestic use. Another key factor that made the Florida Gas system possible was the contractual commitments from the electric utilities to transport their gas needs over long periods of time. The pipeline system was expanded over its first ten years as the demand for natural gas grew.

In the early 1970's the demand for natural gas began to exceed the new discoveries of natural gas. Studies made in 1974 of the future supply of natural gas convinced Florida Gas that one of its parallel pipelines from Louisiana to Florida would not be required for natural gas service upon the expiration of some of the original transportation contracts. Florida Gas proposed to convert a 24-inch (610 mm) line into a petroleum products pipeline to bring up to 350,000 barrels (55,700 cubic meters) per day of gasoline, jet fuel, and heating oil to Florida. The Federal Energy Regulatory Commission has yet to approve this project. However, approval is expected in the near future.

As most of you know, the evolving energy policy of the Federal government over the past several years indicates that the use of natural gas under boilers is an inferior use and compels the utilities to switch to other fuels. The oil embargo of 1973 and the present proposed restrictions limiting the amount of imported oil have increased and will accelerate the interest of the electric utilities in the use of coal for future plants. The cost, delays in permitting, and perceived danger of nuclear plants have also increased the appeal of coal as the fuel preferred for most future electric power plants.

With Florida Gas' history and experience in energy transportation, and the obvious need for radical solutions to our energy problems, Florida Gas decided to study the feasibility of supplying the transportation of the future coal requirements of the Florida utilities by the construction of a coal slurry pipeline. Since the likely sources of