UNITED STATES OF AMERICA
BEFORE THE
DEPARTMENT OF INTERIOR
MINERALS MANAGEMENT SERVICE

CHEVRON PIPE LINE COMPANY'S COMMENTS IN RESPONSE TO THE ADVANCE NOTICE OF PROPOSED RULEMAKING ON THE OPEN AND NON-DISCRIMINATORY MOVEMENT OF OIL AND GAS AS REQUIRED BY THE OUTER CONTINENTAL SHELF LANDS ACT

The Minerals Management Service ("MMS"), Department of Interior, published an Advance Notice of Proposed Rulemaking on the open and non-discriminatory movement of oil and gas as required by the Outer Continental Shelf Lands Act ("OCSLA") in the Federal Register on April 12, 2004.[1] The Advance Notice requested comments from interested parties on various issues arising under the MMS' authority to regulate open and non-discriminatory access to pipelines operating under right-of-way grants on the Outer Continental Shelf ("OCS").

Chevron Pipe Line Company ("CPL") operates oil pipelines on the OCS under right-of-way grants from the MMS. Some of these pipelines are located wholly on the OCS, while others transport crude oil from the OCS and State waters to onshore. As such, CPL is knowledgeable about the regulatory environment in which such pipelines operate and it will be affected by any regulations adopted by the MMS.

The Advance Notice indicates that the MMS' interest in potential regulations stems from the decision issued last year by the Court of Appeals for the District of Columbia, Williams Cos. v. FERC, 345 F.3d 910 (2003). The Advance Notice states that in that decision, the Court affirmed that Sections 5(e) and 5(f) of the OCSLA grant the Federal Energy Regulatory Commission ("FERC") only limited authority to enforce open

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[1] 69 F.R. 19137 (2004).

access rules on the OCS. Therefore, the MMS is considering whether it should adopt regulations pertaining to open and non-discriminatory access and, if so, what should be the scope of those regulations.

CPL urges the MMS to proceed cautiously and refrain from adopting regulations until it is provided sufficient evidence that open access issues with respect to oil pipelines exist to the extent that regulatory action would be beneficial. If open access were a serious problem for oil pipelines operating on the OCS, one would expect that numerous complaints would have been filed with the FERC (at least, prior to the Court of Appeals decision last fall). This has not happened, however. Nor are the reports of FERC's complete disclaimer of Interstate Commerce Act ("ICA") jurisdiction of pipelines serving the OCS accurate, as will be discussed below. If FERC continues to claim jurisdiction under the ICA over some OCS pipelines, a position it has recently affirmed, and the MMS adopts wide-ranging regulations, the result could be conflicting regulatory schemes and confusion on the part of pipelines, producers and shippers as to which regulatory scheme is applicable and which forum to approach for resolution of specific issues.

I. THE MMS SHOULD ADHERE TO ITS STATUTORY AUTHORITY UNDER THE OCSLA.

Sections 5(e) and 5(f) of the OCSLA require pipelines operating under right-of-way grants to provide open and non-discriminatory access. What open access and non-discrimination means is often dependent on the specific facts of a situation. What is clear, however, is that neither Sections 5(e) or 5(f), nor any other section of the OCSLA, provide explicit rate regulation authority to the MMS or any other governmental agency. CPL urges the MMS to be cognizant of the limitations on authority granted to the MMS by the OCSLA.

The MMS should be wary of reading more into its open access and non-discrimination authority than the plain language of the statute provides, for a simple reason. Rate regulation of oil or gas pipelines was not a new concept when the Congress enacted the OCSLA in 1953 or significantly amended it in 1978. If Congress had intended for rate regulation to be a facet of the OCSLA, it could have provided so in clear language. Congress has demonstrated, for more than a century, that it knows how to provide an agency with rate regulatory authority. Starting with the passage of the Interstate Commerce Act in 1887 and continuing with the Natural Gas Act ("NGA"), the Federal Power Act, the Federal Communications Act, the Federal Aviation Act, and the Natural Gas Policy Act, Congress has shown that it understands the need to provide explicit rate regulatory authority when it wants an agency to have that authority. Congress did not provide any such authority in the OCSLA.

The FERC examined this very issue in the rulemaking that led to the issuance of Order No. 639, the FERC Order at issue in Williams. FERC came to the conclusion that any rate authority under the OCSLA was, at best, limited. FERC recognized that the OCSLA does not provide for the imposition of cost-based rates and concluded that it could not inquire into rates as long as the rates charged customers were comparable and not inequitable. Where differences were found to exist, and the OCS service provider could present an acceptable rationale for offering its customers the different rates and/or services, FERC determined that it could find such differences acceptable.[2]

[2] Order No. 639-A, 65 FR 47294, 47302-47303 (2000). The Commission made these determinations in the rulemaking addressed to gas pipeline OCS service providers, but they apply equally to oil pipelines because both gas and oil pipelines operate under Sections 5(e) and 5(f) of the OCSLA.

The Court of Appeals Williams decision, which has precipitated this MMS proceeding, reflects a narrow reading of FERC's authority under the OCSLA. It would be unwise for MMS to adopt an expansive interpretation of its authority under that statute. CPL submits that it would be a vastly expansive interpretation of the OCSLA for MMS to conclude that it could undertake a cost-based examination of rates for OCS pipeline transportation.

There is another consideration for MMS to factor in. Examining rates on a cost-of-service basis is an extremely complicated endeavor. Oil pipeline rate cases at the FERC have tended to be extraordinarily lengthy and highly-contested matters. The parties disagree not only on the details of the cost-of-service methodology but also on key factors such as allocation of costs, rate of return and capital structure. While the MMS does have some expertise in analyzing transportation costs, it does not have the extensive or experienced staff that would be necessary to perform cost-of-service analyses on a wide-spread basis.

CPL therefore urges the MMS to carefully consider the parameters of its OCSLA authority. CPL suggests that MMS consider providing for informal and formal dispute resolution processes, which would allow the MMS to receive and resolve any complaints regarding lack of access or discrimination. Any regulations the MMS adopts should be carefully tailored and not overstep into rate regulation issues.

II. MMS SHOULD NOT ADOPT A "ONE SIZE FITS ALL" APPROACH TO OPEN ACCESS ISSUES.

During at least two of the public sessions MMS held in conjunction with this proceeding, the suggestion was made that MMS should require oil pipelines to transport whatever crude oil can be physically connected to the pipeline, regardless of the quality of that crude oil. In CPL's view, such an action would be a mistake. It would be detrimental to the crude oil production and refining industry as a whole while providing benefits to relatively few producers.

A main quality issue for Gulf of Mexico production is the amount of sulfur contained in the crude oil. Crude oil with a sulfur content equal to or below 0.5% by weight is "sweet" crude and crude oil exceeding that limit is "sour" crude. Sour crude is less valuable in the marketplace—the differential between the market price for sweet versus sour crude may equal (or exceed) several dollars per barrel. Even within the universe of sour crude, some sour crude is less valuable than another. For example, sour crude with a sulfur content of 2.0% will be less valuable than sour crude whose sulfur content is only 0.7%.[3] Requiring that a pipeline commingle sour crude from certain producers with sweet crude from other producers can result in an obvious inequity to the sweet crude producers. If their sweet crude is rendered sour by the commingling, they have lost a substantial amount of the value of their sweet crude. If the common stream remains sweet even after commingling, the sweet producers' crude oil has been used to provide an uplift in value to other producers' (and most likely competitors') crude, perhaps without any, or sufficient, recompense to the sweet producers.

The financial impact on the producers is not the entire story, however. The primary hub for CPL's Gulf of Mexico pipelines is CPL's Empire Terminal, located in Louisiana. The sweet crude that CPL transports on its pipelines to Empire Terminal is sold in the market as heavy Louisiana sweet or "HLS." The refining industry in

[3] One (but only one) reason for that is that a crude oil purchaser can blend sweet crude with sour crude to arrive at a blended sweet crude. The higher the sulfur content of the sour crude used for blending, a greater quantity of the more expensive sweet crude is necessary for the blending.

southeastern Louisiana relies heavily on HLS and other sweet crudes. If the MMS were to mandate that OCS pipelines accept all qualities of crude and, as a result, the common streams delivered to CPL's Empire Terminal all become sour crude common streams, there would be an immediate, detrimental impact on the refining industry. The refineries could be left without an economic, domestic source of the sweet crude necessary for their refinery operations.

It is possible, and perhaps even likely, that the southeastern Louisiana refining industry will have to undertake modifications to facilities in the coming years to be in a position to utilize sour crude to a greater extent than it does now. But implementation of such changes requires time. Such a shift would involve significant lead time for ordering of equipment and materials required, budgeting for costs, and acquiring environmental clearances. These are only a few of the considerations that would have to be addressed. MMS should not adopt rules that might force this change on the refining industry on a schedule that it might not be able to accommodate.

One "solution" put forward for dealing with the financial impacts on sweet crude producers if sour crude is commingled in the same pipeline is a sulfur bank. Sulfur banks are used in the pipeline industry and do provide some recompense to the sweet producer for the loss in value of his crude. They are, however, more effectively implemented to compensate a producer of less-sour crude for loss of value occurring during mingling with more-sour crude. They are not a complete answer for the producer of sweet crude, however. Sweet crude producers have told CPL that sulfur (and gravity) banks, while useful, do not fully compensate them for the loss in market value they suffer when they tender a barrel of sweet crude but receive a sour crude barrel back to sell in the marketplace. One reason for that is sulfur banks generally use an arithmetic scale based on the change in sulfur content. They therefore do not take into account the step change in value that occurs when a sweet barrel is transformed into a sour barrel.

Additionally, sulfur banks do not provide any solution to the problem of assuring the necessary sweet crude supply for the refineries that are configured to utilize primarily sweet rather than sour crude. Utilizing sour versus sweet crude requires different refinery equipment and processes. The MMS' commitment to its "4C's" philosophy should dictate that the MMS remain open to consultations with the end-users of the OCS crude oil regarding regulations that it may adopt, as the sour crude producers are not the only stakeholders to be impacted by this issue.

Further, CPL supports the position of the Indicated Producers[4] with regard to implementation of open-access principles within production facilities. As pointed out by Indicated Producers in their comments, production activities are undertaken under rights held by producers under oil and gas leases issued by the MMS, not under right-of-way grants which impart to pipelines the responsibilities for non-discrimination and open access. An implementation of open-access with regard to production facilities would simply move farther upstream, to the production facilities, the issues of degradation of quality and impairment of refining capacity as have been set forth above.

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4 Indicated Producers are an *ad hoc* group of companies having interests in natural gas transported on interstate pipelines and production-related facilities in the Gulf of Mexico. The members of the group for purposes of these Comments are BP America Production Co., Chevron U.S.A. Inc., ExxonMobil Corporation and Shell Offshore Inc.

III. MMS SHOULD NOT IMPOSE REPORTING REQUIREMENTS

Some speakers at the MMS public hearings urged the MMS to adopt reporting requirements for OCS pipelines. This request, at least as it pertains to oil pipelines, appears to be based on the belief that the vast majority of OCS pipelines are operating without public tariffs. CPL submits that reporting requirements are not necessary for oil pipelines.

Contrary to what the MMS may have been told, oil pipelines are not engaged in wholesale cancellation of their FERC tariffs for movements on or from the OCS. CPL is aware that a number of tariffs for OCS-only movements have been cancelled since FERC issued its decision in Bonito Pipe Line Co., 61 FERC ¶ 61,050 (1992), but a number of such tariffs remain on file with the FERC. CPL alone has 13 tariffs with 18 OCS-only movements on file with the FERC.[5]

It is important to bear in mind that the FERC's decision in Bonito disclaimed ICA jurisdiction over only those pipelines operating wholly on the OCS. FERC has taken the position that an oil pipeline that begins on the OCS and transports crude oil onshore may remain subject to the FERC's ICA jurisdiction, even if that pipeline itself ends in the first onshore state. FERC's current determination to maintain its ICA jurisdiction over such pipelines can be seen in its response to a proposed tariff cancellation several months ago. The Mars Oil Pipeline Company filed to cancel its FERC tariffs for movements from the OCS to Clovelly and Fourchon, Louisiana, the first onshore state reached by the Mars Pipeline. The FERC rejected the tariff cancellation, requiring Mars Pipeline to maintain its FERC tariffs. Mars Oil Pipeline Co., Docket No. IS04-214-000, Letter Order (March

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5 CPL also has other tariffs on file for OCS to onshore movements.

31, 2004). FERC's Letter Order stated that its review of tariffs on file with the FERC showed that other pipelines could interconnect with the Mars pipeline at Clovelly and Fourchon and could transport the crude previously moved on the Mars pipeline to a second state. Id. at 2. FERC said that Mars had failed to prove that all the volumes it transported onshore were destined for the intrastate market and concluded that, absent evidence to the contrary, it was reasonable to assume that significant portions of those barrels ultimately enter the interstate market. Id. at 3.

FERC's current view thus appears to be that an OCS to onshore pipeline cannot cancel its FERC tariffs unless it can prove that all of the barrels it transports onshore remain within the first onshore state. If this is and remains FERC's policy, it is CPL's view that very few, if any, OCS to onshore pipeline tariffs will be cancelled in the future.[6] The pipeline generally does not know what becomes of the crude oil once it transfers that crude oil out of its system. It will be virtually impossible for a pipeline to prove to FERC that all of the crude that it transports onshore remains in the first onshore state and thus impossible for that pipeline to cancel its FERC tariffs.

The filing of tariffs with the FERC—or, alternatively the public posting of rates, terms and conditions such as on a company website—should be sufficient to provide oil producers with the information that they require to assess whether they are being subjected to discrimination. The MMS should not impose additional reporting requirements in the absence of compelling evidence that there is any problem that needs to be and can be addressed by reporting. The FERC has recently imposed new quarterly financial reporting requirements on oil and gas pipelines, which are adding significantly

[6] A pipeline that is capable of delivering only to a refinery located within the first onshore state would probably be able to meet this standard.

to the administrative burden these pipelines face. For MMS to add another reporting requirement, the demonstrated need and benefit should be clear and convincing. CPL submits that the need and benefit have not been demonstrated.

IV. MMS SHOULD FOLLOW ESTABLISHED PRECEDENT WITH RESPECT TO DISCRIMINATION AND CONSIDER COORDINATING ITS EFFORTS WITH THE FERC.

Another issue which arose at the public hearings was the question of whether the use of the term “discrimination” instead of “undue discrimination” in the OCSLA means the standard under the OCSLA is different than under the ICA or the NGA. Without delving into legal analysis and legislative history, CPL urges the MMS to adhere to established precedent regarding discrimination. To do otherwise would cause unnecessary confusion among oil pipelines and their customers. There is within the industry and its customers a general understanding of what constitutes discrimination based upon the precedent that has been developed over the decades. It would be a great disservice to all the parties to deviate from that precedent.

MMS should also consider coordinating its efforts with the FERC, to the extent possible. As discussed above, FERC is still asserting ICA jurisdiction over oil pipelines that transport from the OCS to onshore. If an issue of potential discrimination arises with respect to such a pipeline, which agency has primary jurisdiction? CPL submits that prolonged wrangling over the proper forum could ensue, which would not be to the long-term benefit of any party. Perhaps the answer would be for the MMS to defer to the FERC if a tariff is in effect and unless FERC determines that it does not have jurisdiction over the controversy, for example, because that shipper’s movements do terminate in the first onshore state. CPL submits that coordinating with the FERC will serve MMS’ agency goals of cooperation and conservation. Its cooperation with FERC can result in conserving both governmental and industry resources. This is an issue that the MMS should carefully consider.

V. CONCLUSION

Chevron Pipe Line Company, as the owner and operator of oil pipelines both on the OCS and from the OCS to onshore, appreciates the opportunity to provide these comments to the MMS. CPL urges the MMS to proceed cautiously and refrain from (1) adopting regulations in the absence of evidence of a compelling need for and benefit from the regulations; or (2) exceeding the statutory plainly set out in the OCSLA by engaging in rate regulation.

Respectfully submitted,

Ruth A. Bosek

Ralph J. Pearson, Jr.
Vice President and General Counsel
Chevron Pipe Line Company
2811 Hayes Rd.
Houston, TX 77082-2642
281/596-2153

Ruth A. Bosek
Bosek Law Firm
1090 Vermont Ave., N.W.
Suite 800
Washington, D.C. 20005
202/326-5256

Dated: June 14, 2004