Oil Pipeline Ratemaking Methodologies

Unlike the traditional cost-based rates that generally apply to regulated utility assets, such as electric transmission and natural gas pipelines, tariff rates charged by oil pipelines are set pursuant to several approaches, predominantly the oil pipeline rate index, negotiations and settlements, and by competition (market-based rates), with traditional cost-of-service ratemaking being employed only in limited circumstances. Moreover, in the Energy Policy Act of 1992, so-called “grandfathered” rates were deemed just and reasonable as a matter of law. As discussed in FERC’s Order 561, an oil pipeline may employ one or more of the following rate methodologies for services on its system.

Indexation: The FERC oil pipeline rate index is the primary methodology pipelines rely upon to set rates. Rates are adjusted annually using an index set at the Producer Price Index for Finished Goods (PPI-FG) plus or minus a percentage. The currently effective rate index is PPI-FG + 2.65%. The level of the index, which is reviewed every five years, is calculated based on the change in pipeline costs as compared to the change in PPI-FG during the preceding five-year period. Indexed rates promote efficient and innovative operations where the benefits are generally shared between the oil pipeline and its shippers.

Cost-of-Service: A pipeline may submit a filing with FERC to charge cost-of-service rates. To demonstrate that its cost-of-service rates should be higher than those permitted under indexation, a pipeline must show that its revenues under indexed rates will "substantially diverge" from its costs. If rates are reviewed under a cost-of-service standard, the method used for determining the overall earnings level is Trended Original Cost (TOC) (see Opinion 154B). While cost-of-service rates have widespread use in industries that lack meaningful competition, such as with regulated utilities, the methodology is used in limited circumstances in the oil pipeline industry because competitive market forces are more at play.

Market-Based Rates: An oil pipeline may charge market-based rates if it demonstrates to FERC that an origin and destination market are adequately competitive. See Opinion No. 360 and Order Nos. 391 and 391-A. A number of oil pipelines have obtained authorization from FERC to charge market-based rates for one or more transportation routes on their systems.

Negotiated Rates: A pipeline may file a rate without index, cost or market support if the pipeline has the unanimous consent of all shippers to charge the rate.

Settlement Rates: A settlement rate may be charged as well. This applies when an initial rate is supported by at least one non-affiliated shipper. Negotiated and settlement rates result from agreements willingly entered into between parties. Given the industry’s competitive dynamics, oil pipelines charge negotiated and settlement rates in many cases.

FERC’s oil pipeline rate methodologies and procedures are set forth in Part 342 of FERC’s regulations under the Interstate Commerce Act.