

A Report of The Joint Committee on Public Domain
ON
CRUDE OIL PIPELINES IN CALIFORNIA



A REPORT OF
THE JOINT COMMITTEE ON PUBLIC DOMAIN

ON

CRUDE OIL PIPELINES IN CALIFORNIA

COMMITTEE MEMBERS

KENNETH CORY, CHAIRMAN
JOHN A. NEJEDLY, VICE CHAIRMAN

Assembly:

Bill Bond
John V. Briggs
Charles Warren
Henry A. Waxman

Senate:

Ralph C. Dills
Joseph M. Kennick
James R. Mills

MAJOR CRUDE OIL PIPELINES IN CALIFORNIA

See Appendix, Pages 48 - 61

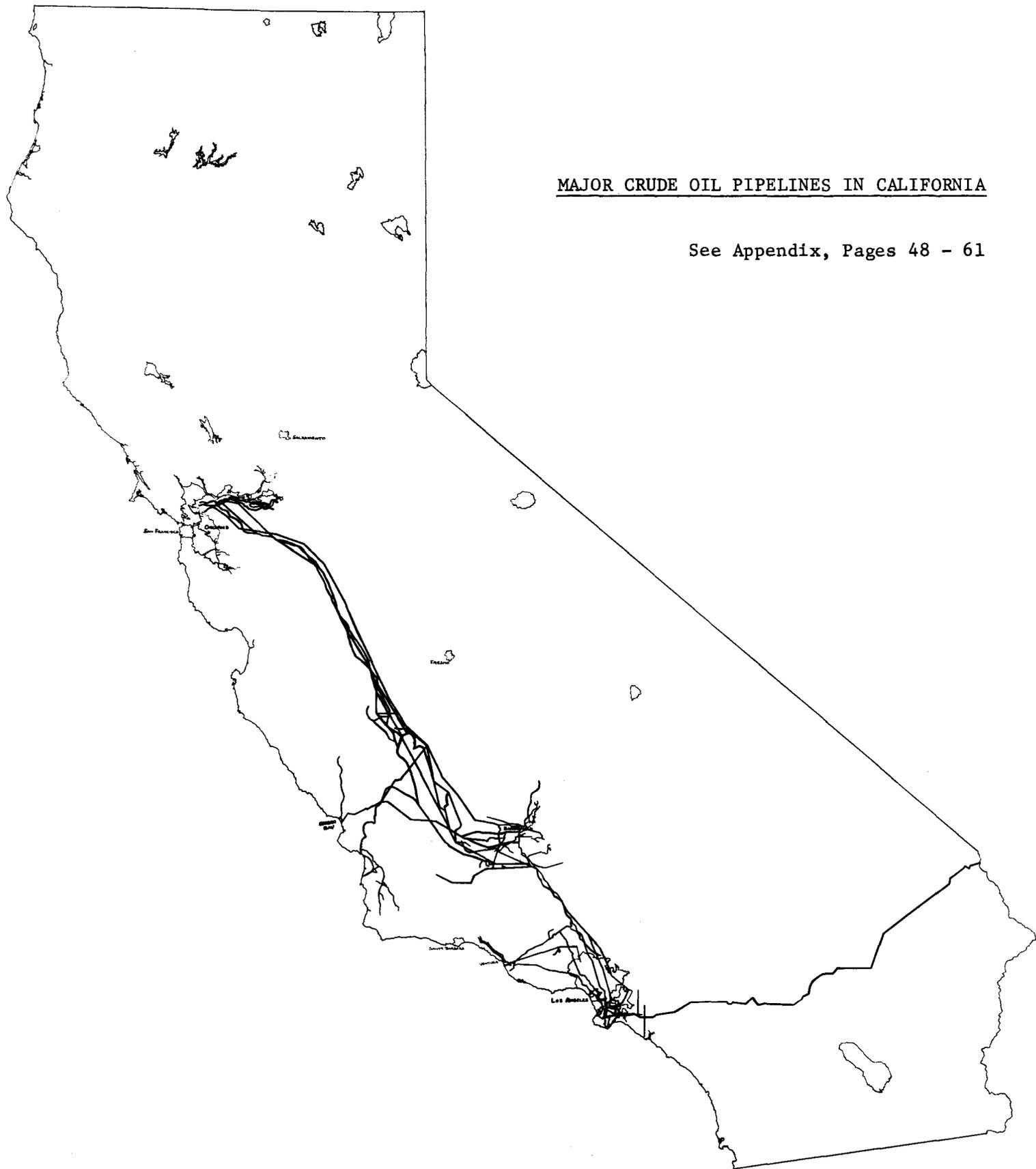


TABLE OF CONTENTS

<u>SECTION</u>	<u>PAGE</u>
<u>SUMMARY</u>	
<u>INTRODUCTION</u>	i
I. <u>STRUCTURE OF THE PETROLEUM INDUSTRY IN CALIFORNIA</u>	1
II. <u>LEGAL PRINCIPLES PERMITTING NON-COMPETITIVE MARKET STRUCTURE</u>	10
III. <u>THE OPERATION OF THE SYSTEM</u>	18
IV. <u>GOVERNMENTAL SOLUTIONS</u>	29
V. <u>CONCLUSION</u>	47
<u>APPENDIX</u>	48

SUMMARY

The major oil companies control the California crude oil market by their ownership and control of the crude oil pipelines. This control artificially depresses prices paid to independent producers and restricts the supply of crude oil to the independent refiners. Starving the independent refiners inhibits competition at the retail products level, and results in too-high prices at the gasoline pump.

This report sets out the sources of the power of control, and the means by which it is wielded. Finally, the report makes recommendations for the elimination of that power.

To achieve that end, action is required both by the Legislature and the Public Utilities Commission.

INTRODUCTION

This report is the third in a series of fact-finding reports by the Joint Committee on Public Domain on matters relating to the California oil-bearing tidelands. It is focused on the crude oil pipeline system in the State of California.

It would appear on the surface that the answer to "fair price" could be arrived at easily and with dispatch. The housewife instinctively blames the supermarket, the farmer, the producer or the packager of the foods she buys when prices are too high. It is all too easy to overlook other major contributing factors that may be reflecting alarmingly on the final market price of a consumer product purchased or a consumer product sold.

One of those "contributing factors" in any arena of marketing is the cost of transportation. How much will it cost to get the

product to market? Or even, can we get the product to market at all? It is this facet of the sale of crude oil produced on State-owned lands with which we are herein concerned. It is this heretofore shadowy, but highly significant, factor that can effectively enable the major oil companies to place a firmly-cemented, easily controlled, yet invisible ceiling on the price the State of California receives for its oil.

It is the intention of this report to describe the means by which the "private carrier" pipeline system, functioning in clear defiance of the State Constitution and opposite to the intent of the Legislature, is apparently robbing the State of California of revenue it should justly be receiving from the sale of crude oil produced by State-owned production facilities and from State-owned lands. Indirectly it will be shown that the underpricing of crude oil in the State (and to the State) is discouraging further discovery and development of mineral-rich deposits

in the State.

The Committee's findings indicate that the State of California has become the unwitting victim of either an intentional or an unintentional manipulation of the price paid for crude oil in this State. This manipulation is made possible by the ability of the major oil companies to control the pipeline flow of any oil purchased in the State. In the State of California the control of the price paid for crude oil--regardless of demand and regardless of whether the buyer is a major or an independent refiner--is effectively exercised in the ability to transport crude oil to the refinery for processing.

The report is submitted to advise the Legislature regarding the broad

outlines of the pipeline system, its particular problems, and the significant position the system occupies in the oil industry in the State of California.

I. STRUCTURE OF THE PETROLEUM
INDUSTRY IN CALIFORNIA

In order to understand the critical effect of pipelines on the price of crude oil in California it is necessary to understand the structure of the industry. There are three major segments of the industry relevant to this report: production, refining and transportation.

"Production" means, simply, the extracting of crude oil from the ground. Obviously the "production" of oil must take place "where the oil is."

"Refining," the second major segment of the industry, is the process of breaking down the crude oil into various marketable products. The refining process can be as crude or as sophisticated as the refiner demands or as he is capable of developing-- and its products will be as varied as the sophistication of the refinery methods permit. Even the "sludge" that is residue for some refineries (because of their lesser sophistication of refinery) is valuable to refineries with higher capabilities. Refining

can be done anywhere, provided, of course, that the crude oil is available at that place to be processed. Refineries are scattered throughout the State, but concentrated in the Los Angeles area, particularly around Wilmington, and in the San Francisco Bay area.

"Transportation" is self-defining. It means, simply, the means by which crude oil is transported from its indigenous geographical location to the place where it can be refined, distributed, and sold. Transportation is achieved by a variety of means, but at great cost differentials. The major means of transporting oil are by tankers, barges, pipeline, tank trucks and rail tank cars.

There are two categories of oil companies operating within the industry: the so-called "independents" and the "integrated" companies. The integrated companies are those that can and do perform all of the functions: they produce their own oil, they transport it, and they refine it into its various products for

the consumer market. They are considered in the national market to be the "major" companies. Independent companies, on the other hand, may be in any facet of the oil industry, but usually they play only a single part in the total petroleum picture. There are independent producers, independent refiners, and independent marketers.

It is here that the State of California differs from most other oil-producing states. In most states the integrated companies produce most of their own crude oil. In California the integrated companies do not produce the bulk of their own oil. Although many of the integrated companies in the State produce some of the crude oil they require, they purchase most of it from independent producers, the largest of which is the State of California itself. In California there are also independent refiners who must compete with the integrated companies in purchasing crude oil from the independent producers.

As is well known, it does not matter to

an integrated company where it takes its profits (tax consideration aside). A company which makes \$80 million a year can spread it out as \$20 million in each of production, refining, transportation and marketing, or may allocate the whole \$80 million to refining. It is solely a matter of bookkeeping.

However, tax considerations cannot be discounted in the petroleum industry. Outside California the integrated companies own most of the crude oil which they refine. Profits are allocated largely to production, necessitating a high "paper" posted price, which maximizes the depletion allowance.

In California, the situation is reversed. There are limitations on the depletion allowance which peculiarly come into effect in California because of the high cost of production. This is aggravated by the fact that the California majors are crude deficient and must go outside their corporate entities and purchase much of their refinery supply of crude oil from independent producers. Thus,

it is to the advantage of the majors to keep buying prices low in order to minimize costs.

This pattern, ideal for the large, integrated company, can cause severe problems for the independent producer which must sell in a low-priced market, and has no refinery in which to pick up a profit.

In such circumstances, in a free market, competitive economic theory would predict that: first, production of crude oil would decline as high-cost producers gradually go out of business; second, bidding of buyers for the smaller supply would raise the price later, and bring about an increase in production.

In California, however, this economic reaction has not occurred. The explanation for this lies in the third substantial segment of the industry,

the transportation system, the crucial tie between the producers and the refiners.

There are several alternative modes of crude oil transportation, but in terms of cost, pipelines are considerably more economical than any other. A recent federal study summarized this:

The development of the pipelines on land was inevitable if for no other reason than the tremendous volume of crude oil and products needed to be

moved. The pipeline is the cheapest way to move oil over land. The cost of moving oil by pipeline is considerably less than by truck and rail.

The following is a general cost relationship; short haul rates are higher:

	<u>Cents per ton mile</u>
Barges	0.15 to 0.60
Pipelines	0.17 to 0.60
Tank Trucks	3.00 to 5.00
Rail Tank Cars	2.00 to 7.00

(Vulnerability of Total Petroleum Systems,
Office of Oil Department of the Interior
prepared for the Defense Civil Preparedness
Agency, Washington, D. C. 20301, May 1973,
page 17)

Because of this cost advantage, pipelines have come to occupy a major place in the transportation system. Nation-wide, they handle over 75% of the total crude oil tonnage. The cost advantage is important because crude oil is relatively heavy in relation to unit value, and transportation can be a significant

percentage of the total product cost.* At the same time, pipelines are uniquely suited to the nearly continuous flow by which crude oil is brought to the surface, aggregated into useful quantities, and moved to and through the refinery.

Pipelines are particularly important in California. Over half of the oil production in the State is located in inland areas, principally the San Joaquin Valley, where no waterways are available. Of the remaining modes, trucks are impractical for several reasons. Truck hauls to markets are long and hazardous. The noise, air pollution and nuisance of truck movements in the dense metropolitan areas where the principal refinery

* A barrel of oil (42 gallons) at 18° A.P.I. weighs about 331 pounds and sells for about \$4.21. To carry a barrel by truck from Bakersfield to Los Angeles, a distance of about 125 miles at 4¢ per ton mile, would cost about 83¢, or 20% of the cost of the oil. Carrying the same barrel the same distance by pipeline at .35¢ per ton mile, would cost 7.24¢, or less than 2% of the cost of the crude.

centers are located makes this mode practically impossible, as well as economically disadvantageous. The following example illuminates this point. Annual production from the Long Beach Unit of the East Wilmington oil field exceeds 8 million tons of crude oil which is concentrated and flows through one shipping-pump station in Long Beach. Eight million tons of oil would fill 336,000 tank-truck-and-trailer rigs, each 60 feet long. At 88 trucks to the mile, bumper-to-bumper, such a procession would stretch 3,800 miles, or be enough to block nine freeway lanes solid, all the way from Los Angeles to San Francisco. Production in the San Joaquin Valley is nearly $2\frac{1}{2}$ times this amount.

Pipelines, then, are the crucial connection between producers and refiners. If access to the lines is not free, open-market competition cannot flourish.

II. LEGAL PRINCIPLES PERMITTING
NON-COMPETITIVE MARKET
STRUCTURE

California is not the only state that produces oil. California is not the only state where oil is piped hither and yon.

But California is the only state without some public interest regulatory "say" about the operation of its substantial network of pipelines.

Why? Because some judges, as we will see, have pulled hard and fast in the opposite direction from the Legislature.

On October 10, 1911, the California Constitution went through a change. The amendment, appearing as Article XII, Section 23, is still with us. It empowers the State to exercise such control and regulation of pipelines as the Legislature might provide. This authority was to be exercised through what was then the Railroad Commission, today's Public Utilities Commission.

The amendment provided a skeleton. A June 4, 1913, statute sought to flesh it out. What kind of pipeline corporations would be defined as "common carriers" subject to regu-

latory action? The tests: Did they own, operate, manage or control all or any part of any pipeline or pipeline plant or equipment for the transportation of crude or petroleum products? Was this transporting done, directly or indirectly, to or for the public for any higher compensation or consideration?

Such carriers would be deemed to be public utilities subject to the Public Utilities Act of December 23, 1911. Clear enough ... until the Railroad Commission sued Associated Pipeline Company in 1917.*

Two things about the decision must be reviewed. After outlining what flowed from one, the other will be traced.

The court held that subjecting a private company to public utilities status would be a "taking of property" in violation of the Fourteenth Amendment of the U.S. Constitution. The finding hewed to a U.S. Supreme Court position that a state could not declare a

* Associated Pipeline Co. v. Railroad Commission, 176 Cal. 516 (1917)

company to be a common carrier, if the company did not act as a common carrier before being so declared. Previous activity as a common carrier is known as "dedication."

The requirement of dedication effectively clogged pipeline regulation law. California legal tradition seemed to say that all comers can make use of property only if the owner takes some kind of dedication action. This would appear to mean a private carrier--carrying for his own use--could contract exclusively with particular individuals to carry their oil if, as owner of the property, he did not extend the invitation to use his pipeline to everyone.

Behind this interpretation: the then U.S. Supreme Court definitions of "taking without just compensation."

But in 1934, the Court had more to say. In Nebbia v. New York,* it declared that governmental regulation for the public welfare was not necessarily a "taking" under the Fifth

* 291 U.S. 502 (1934)

or Fourteenth Amendments. If one goes into a business which public interest demands shall be regulated, he must realize that public accountability will ensue. The appropriate laws could not be unreasonable, arbitrary or capricious, but reasonable regulatory means to a public welfare end do not constitute a "taking."

Would the absence of dedication continue to block regulation? It seemed that the Court was poking the dedication plug out of pipeline regulation law. Blockage to application of "common carrier" status, as embodied in the Associated Pipeline case, was being cleared. California courts could begin to take the language of the State Constitution and statutes at face value.

Well, not quite. In 1960, the California Supreme Court (in a natural gas pipeline case) found the concept of dedication still applicable. The tribunal conceded (Richfield Oil Corp. v. Public Util. Comm.*) that the 1934, U.S. High Court decision wounded

* 54 Cal. 2nd 419 (1960)

"dedication" ... but had not killed it with reference to California pipeline regulation.

Why? Because in the course of several reenactments of public utilities laws since 1934, the Legislature had never specifically worded a "coup de grace" for "dedication."

The court seemed to be saying that for "dedication " to be legally dead would require a death certificate signed by the Legislature ... followed by an open-casket funeral. Better yet, the lawmakers should display bloody hands to demonstrate, beyond doubt, their intent.

Now, back to the other aspect of the Associated Pipeline case. It has to do with a significant question: What are the implications of ownership of the crude or petroleum products passing through the pipeline?

A 1914 case^{*} dealt with several pipelines owned in monopoly by the Standard Oil Company. However, there was brief mention of the Uncle

* United States v. Standard Oil Company
(The Pipe Line Cases), 234 U.S. 548 (1914).

Sam Oil Company. It had a refinery in Kansas and wells in Oklahoma. It had a pipeline connecting the two "which it used for the sole purpose of conducting oil from its own wells to its own refinery." This was determined not to be "commerce," and therefore, not regulatable.

In the Associated Oil case, the California High Court seized this language, even though the situations were not the same. Some of the oil Associated pushed through its pipeline it bought going in and sold coming out.

How did the court handle the distinction? The Associated pipeline system "has never at any time since the construction thereof been devoted to carrying oil or products other than those produced by Associated Oil Company or purchased in the field by it in its business of producing, buying and selling oil both in crude and refined forms."*

For legal purposes (and with apology for the play on words), the transitory ownership

* Associated Oil Co. v. Railroad Comm., 176 Cal. 516, (1917) (emphasis supplied).

of all oil moving through the pipeline still made the oil the company's own for its own business, now identified as producing, buying and selling as well as transporting.

The broad view of the company's business does not square with that of the U.S. Supreme Court. In interpreting the decision language that related to the Uncle Sam Oil Company, the High Court twice held that purchases and sales at the ends of pipelines do make a difference.* It really amounts to carrying for others; it is to be considered transportation for purposes of the Interstate Commerce Act.

This is true even if all the oil going in comes from one's own wells, but the terminal end leads to sales. It is true if the oil going in is purchased and coming out goes to one's own refinery.

California's situation? As long as California courts lean upon the broad definition

* Champlin Refg. Co. v. United States, 329 U.S. 29 (1946); Valvoline Oil Co. v. United States, 308 U.S. 141 (1939).

of business and allow oil companies the subterfuge of transitory ownership of what passes through the pipe, California pipelines are likely to remain private carriers and escape public interest control. If statutory language is carefully drawn to limit the definition of "business" as it relates to these practices, we can close this loophole.

This course would create the foundations on which free enterprise competition could thrive for the common good.

As we will see, the pipeline systems of California are operated, not always successfully, to try to take advantage of these loopholes.

II. THE OPERATION OF THE SYSTEM

Control of access to pipelines in California brings with it control of the crude oil market. When others need to move oil from the field to the refinery, you have the only pipeline in the area, and you are able to arbitrarily grant or withhold the right of access to the line without interference from public agencies, you control the market. The Associated Pipeline case created the means of pipeline control. So long as the pipeline owner does not "hold himself out" as willing to carry for others, and owns the oil while it is in his line, he may escape public regulation.

As the description of the pipeline system in the Appendix makes obvious, the requirement of ownership of the oil results in a proliferation of sales and resales of the same oil among the competitors in the industry. For instance, only two companies own pipelines south to Los Angeles from the San Joaquin Valley, Mobil and Arco. But this does not mean that the only oil flowing through those lines is oil produced by these

companies or even purchased by them from the producer. The lines connect with pipelines of several other companies in the San Joaquin Valley. Texaco has two pipelines in the south San Joaquin Valley which connect with gathering systems in the oil fields but terminate at the Arco and Mobil lines to Los Angeles. The Mobil line connects with some 34 other pipelines owned by other oil companies in the lower San Joaquin Valley. This pipeline "duopoly" also does not mean that all of the oil is delivered to Arco's or Mobil's refineries. At its terminus in the Los Angeles Basin, the Mobil line connects with nineteen pipelines of other companies and directly to the refineries of two other companies. Mobil, to maintain its control of its pipeline, purchases oil from the owners of all of those pipelines in the Valley, and sells it to the owners of the pipelines in the Basin. The owners of those lines are, by and large, its major competitors. This pattern of purchase and sale to enable one company to

feed oil from its lines to a competitor's lines, and receive oil back at its refinery, without being subjected to public control, is repeated throughout the pipeline network.

All of the major companies (those engaged in all aspects of the industry) own production in various areas of the State, not all within reach of their pipeline systems. To get oil to their refineries through competitors' pipelines and still maintain the legal niceties of ownership in the pipelines, the majors have developed an exchange system. A company with oil in the field trades it to a competitor with a nearby pipeline; in return, the competitor delivers oil to the first company's refinery or pipeline at another location. This provides transportation for the first company without requiring it to build its own pipelines and without the need for a common carrier pipeline. These exchanges are standing agreements. The majors are in a fairly secure position because in one area or another each depends on others for transportation. If one company refused to carry for another, it might find itself unable to get crude to its refinery

from another field where it is using someone else's pipelines.

The independent refiners are in no such enviable position. Generally engaged solely in the refining end of the business they have, at most, minimal pipeline systems for carrying crude from a nearby field to their refineries. But production from most of the fields has declined and the fields no longer produce enough crude to keep the refineries running. They need crude oil from areas of the San Joaquin Valley more distant from their refineries. Without crude oil pipelines they must ask the majors for access to the majors' systems. Although the majors frequently grant them access, this dependence on the magnanimity of the majors has a crushing effect on the competitive spirit of the independents.

As J. G. Benton, Vice-President of San Joaquin Refining in Bakersfield, put it,

"We have no hope of obtaining the volume of crude oil necessary to meet our refining capacity without the cooperation of the majors...

"Chairman Cory: ...you've got to walk a rather careful line in getting as much as you can locally [By offering bonuses over posted price to producers] but keeping everybody else happy with you too.

"Mr. Benton: That's right. We have to exist in this business and we can't burn any bridges behind us, that's for sure.

...

"Chairman Cory: You're kind of between a rock and a hard place all the way around.

"Mr. Benton: Well, I can't say too much because the gentleman [a major oil company representative] is sitting right behind me."

(Transcript of Proceedings, Joint Committee on Public Domain, August 24, 1973, at 46-47, 60-61)

In early July 1973, the Joint Committee on Public Domain became increasingly concerned about the pipeline problem. It sent letters to the independent refiners of California inquiring, among other things, about the part which major oil companies' control of pipelines was playing in their operation. One of the questions asked was,

What means do you use to get crude oil into your refinery?

- a. If pipeline, who owns the pipeline and what is the charge for pipeline use?
- b. If means other than pipelines, what is the charge for these other means?

In response, the Committee discovered that the independents rely heavily on major oil company pipeline deliveries. For example, two-thirds of the crude oil available to Witco Chemical's Golden Bear Refinery in Bakersfield come through major oil

company pipelines. (For Witco the transportation cost by pipeline was 1/5 that of truck.) Virtually all of Mohawk's 17,000 barrel/day capacity was received through major oil company pipelines. The situation is similar with regard to the other refiners in the State. One effect of this private carrier system is that the small independent refineries in the San Joaquin Valley are running at about 85% of capacity despite the fact that they are located in the middle of an area which produces nearly three times as much crude as they can use.

Both the importance of pipeline availability to the independent refiners and the effect on the State's oil income were emphasized in a State Lands Division hearing in 1971 on the sale of State crude oil from the Long Beach Unit. The purpose of the hearing was to obtain the views of the prospective purchasers on various proposed sell-off terms. An independent refiner's representative, Mr. Ralph Hand, said:

Mr. Hand: One more question I would like to ask. There is no provision for what would be, like, for small refineries to pick up their crude oil in their trucks; in their transports. If it is all by pipeline, we are precluded, many times, from doing business with the City or State.

Chairman Hortig (Executive Director

are no available facilities for truck terminal delivery as Mr. Hayward pointed out

" Mr. Hayward: Yes. Well, I will leave that off. Due to the large amount of crude oil that might be available, it would be rather impractical to make delivery by truck.

" Also, we must consider the environmental situation, the possibility of some damage to the environment by using trucks in that particular part of the City.

" So, the ground rules that we are speaking of are such that oil would be taken only by pipeline.

" Mr. Hand: Well, then, this means only the large independent companies and the majors have the opportunity to bid on the State royalty oil. And this precludes any small independents from ever purchasing any oil, because most of us never have any exchange agreements by pipeline." (State Lands Commission Hearing,

Long Beach, California, April 20, 1971;
emphasis supplied.)

In sum, where the State was proposing to exercise its statutory right to sell-off crude oil as an aid to the small refiners, the latter were precluded from bidding because pipeline transportation was practically unavailable, and even the high-cost alternative of trucking could not be used.

The system in effect is one of private negotiations. The independent refiners must be able to propose deals advantageous to the majors if they hope to gain access to the system. The extent of the advantage necessary was discovered in Committee hearings. In 1971, a sell-off of State tidelands crude oil was held. Two of the winning bidders were located in the San Joaquin Valley. Together they bid an average price of 16¢ per barrel higher than posted for 11,000 barrels per day of State crude oil. The oil was inaccessible to the refineries, since no pipelines pump oil from the Los Angeles Basin to the San Joaquin Valley. Instead, the

two refiners arranged a trade with a major oil company. The major would buy the Long Beach oil at posted price (16¢ less per barrel than the independent refiners were paying for it) and sell 5,500 barrels per day (half the amount it was "purchasing") to the independents at posted price. (There were other terms of the contract not relevant here.) In effect, San Joaquin and Kern County Refining were paying 32¢ per barrel higher than posted price for oil in the San Joaquin Valley which the major would not sell them straight out. It is one of the curious results of the private pipeline system that the independents had to engage in these machinations to purchase oil near their refineries at prices well above "market price."

The difficulty of getting access to the pipeline system is matched by the ease of being excluded from it.

In one instance of which we are aware, an independent producer cancelled his contract with an integrated oil company which had the

only pipeline in his area. The producer inquired of the independent refiners to see whether they were willing to pay more than posted price for the oil. They indicated that they were. However, when the bidding date arrived not a single bid was received from the independent refiners. Informally, and not for attribution, the independents said that the major had told them to "lay off," and had refused them access to the pipeline. Without the pipeline, it would be uneconomical to try to get the oil to their refineries.

The willingness of the major to exclude the independent refiners from that pipeline (in effect, leaving the producers with unsaleable crude oil) served as a good lesson to the independents. They all depend on major oil company pipelines for their existence. Despite their willingness to pay more for crude oil than the majors (a willingness demonstrated by the State's tidelands oil sell-offs) they do not dare outbid the majors with private producers.

This control is so great that the independent refiners in the State have refused to talk with members of the Joint Committee on Public Domain staff for attribution. Privately, they have indicated a willingness to pay more for crude oil if they could be assured of transportation. But they did not feel it healthy to say so in open hearings. The "private carrier" pipeline system has squelched the independent refiners as a competitive force in the market.

A vice-president of Standard Oil Company of California told the Joint Committee on Public Domain,

"... (W)e take the view that if our crude prices are too low, somebody else is going to raise them and they're going to take the crude away from us."

The Committee wonders where this competition will come from. We suggest that only elimination of the private carrier pipeline system will create enough independence to ensure competition.

IV. GOVERNMENTAL SOLUTIONS

The opening of the pipeline system will require governmental action. The fastest immediate solution may well lie in administrative action which is long overdue. Legislation will also be necessary to fill in the gaps.

A. Administrative Solutions

1. Mineral Leasing Act of 1920 and Trans-Alaska Pipeline Bill

Paragraph 28 of the Federal Mineral Leasing Act of 1920 requires the Secretary of Interior to condition any application for a right-of-way to build a crude oil pipeline across federal public lands under the jurisdiction of the Department of Interior on the acceptance by the pipeline owner of the obligation of common carriage.

This was an important point in Richfield Oil Corp. v. Public Util. Comm. In this case, the Southern California Edison Company became dissatisfied with purchasing natural gas from the local gas utility, Southern Counties, on interruptable service. It contracted with

Richfield for Richfield to build a natural gas line to service Edison directly. The gas line went through the Los Padres National Forest and received a right-of-way permit subject to the condition of common carriage. Southern Counties which didn't want to lose a major customer asked the P.U.C. to halt construction of the line. The P.U.C. did this and the order was appealed. In discussing the P.U.C.'s argument that Richfield had dedicated its pipeline by accepting the permit condition, the court said,

"... (W)e believe that the holding out to serve the public implicit in common carriage is at least substantial evidence that would support a finding that a federal permittee had dedicated its pipeline to public use for the common carriage of gas.

"Richfield, however, does not seek to use its pipeline for the common carriage of gas and it may never be called upon to do so. It wishes to use its pipeline solely to transport its own gas in the course of its nonpublic utility activities, and at most it has evidenced a willingness to operate its pipeline as a common carrier when and if it is called upon to do so.

"The Public Utilities Act is not concerned with Richfield's purely nonpublic utility activities (Citations), and its certification provisions may not therefore

be invoked to prohibit the construction and use of facilities for such nonpublic utility activities merely because Richfield may in the indefinite future wish or be called upon to make such facilities available for public use. When and if Richfield wishes or is called upon to make its pipeline available for the common carriage of gas, it may then be determined whether its private use must be curtailed to avoid conflict with any obligation to the public it assumed in accepting a federal permit subject to the common-carriage condition." (Richfield Oil Corp. v. Public Util. Comm., 54 Cal. 2nd 419, 435 (1960)) (Emphasis supplied)

In other words, the court held that the permit condition was strong evidence of dedication, but until the P.U.C. called on Richfield to post tariffs and assume the obligations of a common carrier, it could not halt the building of the line.

Since that decision, nothing has come to our attention to indicate that the P.U.C. has requested Richfield to post tariffs, or in any other way attempted to get a ruling that the acceptance of the condition enumerated in the federal law operated a dedication.

This is especially important because the two trunk lines from the Bakersfield area to the Los Angeles area run through the Angeles

and Los Padres National Forests and have such permits. Additionally, one pipeline owned by Standard Oil Company of California from Estero Bay to Kettleman Hills (a junction with other pipelines in the San Joaquin Valley) is acknowledged to be a common carrier line, as are some in the vicinity of the Elk Hills Reserve. These Standard pipelines all terminate in "private" carrier pipelines owned by another corporate entity of Standard Oil Company. The Public Utilities Commission has not tested the effects of the disjoinder of corporate entities on the common carrier status of the system.

Another attack the Public Utilities Commission can make regarding dedication is the extent to which the companies have dedicated their lines by implication. From the documents the Joint Committee has received, it is apparent that most companies, in fact, carry more crude for others than for themselves. The Committee subpoenaed from the companies documents to indicate the total throughput of their crude lines in the State and the total crude oil

produced or purchased by them and delivered through their own pipelines to their own refineries. Of all the oil carried by one company, only 1.6% of it was its own from wellhead to refinery. The other 98.4% was carried for a variety of others. Although this is extreme (other companies carrying from 65% to only 13% for others), in at least one other instance an individual line carried none of the owning company's crude from its wellhead to its refinery. In other words, it carried 100% of its throughput for others.

Dedication requires that the owner declare that the pipeline is available to anyone who wishes its use. But if, without uttering the legal "magic words", it in fact makes its line available to all others, can we not infer that it has in fact dedicated its line? Shall it be the policy of the State that a pipeline owner can carry for numerous customers but can exclude anyone arbitrarily because it hasn't made the right noises? The Joint Committee considers this a legal issue worthy of a test.

A third thing that the Public Utilities Commission can do is test the enforceability of a statute which declared it to be against

public policy to build a crude oil pipeline longer than 35 miles except as a common carrier (ch. 286, 1913 Cal. Stat.). This statute was construed by the court in Slater v. Shell Oil Co., 39 Cal. App. 2d 535 (1940) to mean that the building of a pipeline which met the requirements was evidence of dedication. To our knowledge, the Public Utilities Commission never enforced the statute. Although it was repealed in 1954, the question of the effect of the dedication still remains. The P.U.C. should determine whether these pipelines are subject to its control.

Finally, we are aware of one instance in which a private carrier dedicated its pipeline to public use in the presence of members of the State Lands Division and a representative of the Attorney General's Office. At the hearing of the State Lands Division on April 20, 1971 in Long Beach, Harry Rothschild, President of Powerine Oil Company, discussed transportation from the Long Beach area. After stating that truck transportation was hazardous, he said,

"We now have, are now taking oil by pipeline from the THUMS Unit, and we would be willing to consider making oil exchanges to any independent, with any independent who was a successful bidder, on a mutually agreeable basis."

This appears to be precisely the sort of general offer to the world at large that is defined as dedication. This should be investigated by the Public Utilities Commission.

B. Legislative Solutions

Two bills were introduced in the Assembly this session to deal with the pipeline problem. They represent significantly different approaches to the problem. Although the Assembly bills were both killed in committee, they deserve discussion for possible future legislative actions.

A.B 3487, introduced by Assemblymen Waxman and Cory, deals precisely with legal loopholes enumerated above. It would add a new sub-section, 216(d), to the Public Utilities Code, to read:

"(d) Nothing in this section or any other provision of law shall require that any pipeline corporation dedicate its property or any portion thereof to a public use in order to be a public utility subject to the jurisdiction, control, and regulation of the commission and the provisions of this part."

This section of the bill eliminates the concept of dedication, and thus clears the way for the opening of pipelines to common carriage. In effect, it would make the pipelines public utilities subject to the provisions of the Public Utilities Code and control by the P.U.C. There are minimal ambiguities in the rights and duties of the people seeking access to the pipelines and the owners of the pipelines since the Code has been subject to considerable judicial construction.

In a very important sense it would also recognize the present operation of the system, changing only its coercive aspects. As of the moment, the system is generally made available

to all comers, although the independents can be excluded on whim. Any refiner can "negotiate" its way onto the system. Under the bill, instead of negotiating at an extreme disadvantage, a refiner (or producer) would have a right of access at a reasonable fee set by the Public Utilities Commission. Further, it would prevent the fear of being cut off by the pipeline owner and thereby restore the ability of the independent refiners to compete vigorously.

Additionally, the Assembly bill would have amended paragraph 228 of the Public Utilities Code to eliminate the requirement that the pipeline corporation carry for compensation in order to be deemed a public utility. This would close the "transitory ownership" loophole.

The major criticism of this bill was based on Legislative Counsel's suggestion that the State could not simply declare a company to be a common carrier. It reached this conclusion by a selective reading of the California Constitution. In a letter to the Chairman of the Assembly Committee on Commerce and Public

Utilities, a deputy legislative counsel stated that the requirement of dedication could not be removed by legislation. The letter reads, in part,

"Section 23 of Article XII of the State Constitution provides, in part, that every corporation, individual, and association of individuals owning, operating, managing, or controlling the specified enterprises, 'either directly or indirectly, to or for the public,' is a public utility." (emphasis supplied)

The constitutional section actually provides, in more detail,

"Sec. 23. Every private corporation, and every individual or association of individuals, owning, operating, managing, or controlling any ... pipe line, plant, or equipment, or any part of such ... pipe line, plant or equipment within this State, for the transportation or conveyance of passengers, or express matter, or freight of any kind, including crude oil, ... either directly or indirectly, to or for the public and every common carrier, is hereby declared to be a public utility subject to such control and regulation by the Railroad Commission as may be provided by the Legislature, and every class of private corporations, individuals, or associations of individuals hereafter

declared by the Legislature to be public utilities shall likewise be subject to such control and regulation." (emphasis supplied)

The omission in the Legislative Counsel's letter of the phrase "and all common carriers" is crucial, because the California Constitution, Article XII, paragraph 17, provides, in part,

"Sec. 17. All railraod, canal, and other transportation companies are declared to be common carriers, and subject to legislative control."

(emphasis supplied)

A pipeline company, being a transportation company is therefore a common carrier, and it is possible that dedication would not be required. However, dedication may be found for those pipelines which were built subsequent to 1879, when the Constitution was adopted. Pipelines which were built after this date must be deemed to have been built subject to this provision of the Constitution, and no property rights can be deemed to have been taken by the

requirement. See Pierce Oil Co. v. Phoenix Refg. Co., 259 U.S. 125 (1922).

Further, it is difficult to reconcile the language of the court in Richfield Oil Corp. v. Public Util. Comm., 54 Cal. 2d 419, (1960), with the view that the Legislature cannot eliminate the requirement of dedication. The court, in essence, held that this requirement was a legislative one, not one constitutionally mandated. If the Legislature cannot eliminate the provision, yet it is not constitutionally required, one must wonder on what principle of natural law the concept rests.

By contrast, the A.B. 4250 (now dead) took a completely different tack. It did not attempt to make the pipelines common carriers, but tried to open them to use on an ad hoc basis. In effect, it would merely put a legislative blessing on the coercive negotiation now going on.

Under this bill, the first step required, for someone wishing access to a pipeline, was to have the person negotiate with the pipeline

owner (which happens now). If that proved unsuccessful, the person could petition the Public Utilities Commission to require access at a reasonable fee. The person would have to prove that it was in the interest of the public health, safety or welfare and that it was necessary and economically and physically feasible to develop and insure the continued supply of natural gas or petroleum in the State. It was unclear from the bill whether the petitioner, having proved this, was to get permanent permission to use the pipeline, or whether the requisite showing had to be made for each individual shipment of oil the shipper wished to make.

Even if the clearances granted were permanent, the bill ignores the fact that the independent refiners do not dare bring an action against the major oil companies. In fact, one independent refiner told a member of the Joint Committee staff that he knew several refinery owners who sued the major oil companies. He said that by the time they got their cases to court, they were dressed in

overalls (apparently were driven out of business). The refiner said he would not take that risk.

The draftsman of the bill (a deputy attorney general) demonstrated its complete ineffectiveness in testimony in support of A.B. 4250 before the Assembly Committee on Commerce and Public Utilities on June 20, 1974. He said that he had talked that morning with an independent refiner who supported the bill but was afraid to be quoted in public. Why the proponent of the bill believes that an independent refiner would be any less fearful of petitioning the Public Utilities Commission for access to a major oil company's pipelines is a mystery to the Joint Committee. By the time the petition had been decided by the Commission and passed upon by the courts, even if favorably, the petitioner would have won the right to ship crude oil to a long-bankrupt refinery. As we noted above, the major oil companies do exercise their power to prohibit access to their pipelines.

The difference in approach between the bills extends to other problems in the area. The public utility concept is well defined in law. Numerous sections of the Public Utilities Code, long since litigated, would apply under A.B. 3487 that would not have applied under A.B. 4250. Division 1, Part 1, Ch. 3, Article 2, requires the posting of tariff, which eases the enforcement of anti-price discrimination provisions. A.B. 4250 had no such posting provision. Section 460, the long-haul-short-haul provision, Section 556, requiring the setting of joint rates on interline interchanges, Section 454, preventing the raising of rates without prior finding by the P.U.C. of justification, would all be made applicable to pipelines by A.B. 3487, but not by the special interest approach of A.B. 4250.

The approach of A.B. 3487 clearly recognizes that the blood of the independents flows through the pipelines of the majors. It does not require the independents to risk their business lives by bringing action against the

majors. It leaves the initiation of action to the Public Utilities Commission. The basic flaw of A.B. 4250 is that it would require the independents, in essence, to sue the majors in the vain hope that they can win before they go bankrupt for lack of raw material.

A.B. 4250 would plainly not provide any relief to the independent refiners, and therefore would not revitalize them as a competitive force in the market.

The sole effect of this bill, in fact, would be to prevent any meaningful regulation from taking place. The Trans-Alaska Pipeline Act was drafted to ensure that the requirements of the Mineral Leasing Act were being met. Thus, it amends Section 30, U.S.C. 158 (r) (5) to provide:

"Whenever the Secretary [of Interior] has reason to believe that any owner or operator subject to this section is not operating any oil or gas pipeline in complete accord with its obligations as

a common carrier hereunder, he may request the Attorney General to prosecute an appropriate proceeding before the Interstate Commerce Commission or Federal Power Commission or any appropriate State agency or the United States District Court for the District in which the pipeline or any part thereof is located, to enforce such obligation or to impose any penalty provided therefore, or the Secretary may, by proceeding as provided in this section, suspend or terminate the said grant of right-of-way for noncompliance with the provisions of this section."

However, this is limited by any exemption when the pipelines are under local regulation. The local regulation proposed by A.B. 4250 might short-circuit the requirement imposed on the Secretary of Interior by the Trans-Alaska Pipeline Act without substituting effective regulation by the State. The passage of A.B. 4250 would help only the major oil

companies; complete inaction of the Legislature would bring more benefit to the State, both as producer and as consumer, than the passage of this bill.

V. CONCLUSION

The private carrier pipeline system has a devastating effect on competition in California. Because of the need to use other companies' pipelines in various areas of the State, cooperation rather than competition is the rule among major refiners. For the independent refineries, servile submission to the majors is the rule.

The Public Utilities Commission has the power to do something about this situation, but has not. The Legislature also has this power, but must exercise it wisely. One course proposed to the Legislature would be more harmful than inaction. The Legislature must redefine the concept of "dedication" to enable free competition to operate in the crude oil market.

APPENDIXTHE CALIFORNIA CRUDE OIL
PIPELINE SYSTEM

One of the most striking things about the California pipeline network is how little valid information is publicly available. Considering that the pipeline system carries between one-sixth and one-fifth of total freight tonnage in California, and is a critical component of the energy supply, it is remarkable that none of the public agencies in California has shown enough concern with the pipeline systems even to map them, much less to determine their ownership, capacities or their costs and conditions of use.

In large part, the California pipeline system compares most unfavorably with the rest of the Nation. Despite the fact that California is the third largest oil producing state, the crude oil pipeline network, for the most part, consists of small, old lines, with only a fraction of its mileage consisting of pipe as large as twenty inches in diameter.

Part of this is due to the almost total absence of common carrier crude oil pipelining in California, reflecting the fact that the

transportation system was long ago designed to serve the particular plans of the large refiners. As the industry developed, however, even these refiners have found it necessary to resort to the use of other company lines--no single crude oil pipeline in this State carries only the oil produced by an integrated company for use in its own refinery. Instead, interconnection and interline shipment is the basic common practice.

This is clearly delineated by a review of the geography of the principal segments of the California crude oil trunk pipeline system. We, therefore, review in broad outline the geography and ownership of the principal trunk line systems within this State.

CRUDE OIL
TRUNK LINE SYSTEMS

There are reported to be more than 4400 miles of pipelines within the State which are classified as crude oil trunk lines, connecting more than 2700 miles of gathering lines to the principal refining centers. These trunk lines fall generally within six main system groups: The San Joaquin Valley-Los Angeles Basin lines,

connecting the oil fields in the lower Valley to the Los Angeles Basin; the Valley-San Francisco Bay Area lines, connecting the same area to the Bay Area refineries; the set of lines from the Ventura area to the Basin; a virtual spiderweb of lines within the Los Angeles Basin moving crude from the Valley lines, from the Harbor lines, and from local production, to the various refineries in the Basin; the lines from the Estero Bay coastal area connecting to the Valley lines, permitting shipment to or from the coast; and a single interstate crude oil common carrier line, the Four Corners Pipe Line, a joint venture system bringing crude oil from the Four Corners area into the Los Angeles Basin.

1. San Joaquin Valley to Los Angeles Basin

Two sets of pipelines are available for handling shipments of crude oil from the lower Valley into the Los Angeles Basin,

one owned by Mobil Oil Company, the other by Atlantic Richfield Company (Arco):*

a. The Mobil Oil Company system is a complex of 8" to 16" lines, originating in the Lost Hills area of the lower San Joaquin Valley, west of Bakersfield, and terminating in the Los Angeles Basin web of Mobil and other company lines. The capacity of this complex is around 50,000 b/d. Significantly, at Newhall, the Mobil lines receive shipments from the Texaco pipeline which originates near Ventura. Mobil indicates that this part of its system connects to some 36 pipelines owned by other companies in the lower Valley, in addition to the connections to Mobil's own

* Pending clarification of the status of the Arco documents, the material herein used to describe that system is derived from other company sources. Despite the facts that every mile of right-of-way is recorded in the land records, each highway and rail crossing is similarly recorded, and its easements across State and Federal lands are similarly a matter of public record, Arco has represented that the maps of its lines are "business confidential," never disclosed to any competitor.

gathering systems. In the Los Angeles Basin, this system is reported by Mobil to connect to approximately 19 other company pipelines and to 2 other company refineries. In 1973, 52,242 barrels per day of crude oil were pumped through the San Joaquin system.

b. The Arco system consists of two lines from the Bakersfield area, one a 10" and one a 14" line. The 10" line is reported to be idled, and reports indicate that Arco is contemplating the possibility of reversing its flow to carry imported crude from the Harbor lines into the Bakersfield area.

c. Texaco, Inc. Texaco operates two trunk lines in the lower Valley to handle oil destined for the Los Angeles Basin, an 8" line originating near Edison, and the other a 10" line originating near Midway oil field. Neither line, however, comes directly into the Basin, but, instead, interconnects with the Arco and Mobil lines.

2. San Joaquin Valley to San Francisco Bay Area

Three main trunk lines carry crude from

the San Joaquin Valley into the San Francisco Bay Area. These lines are owned by Standard Oil Company of California, Getty, and Union. Shell also has a pipeline system running from the Valley to the Bay Area, but the major portion of it has been inactivated by use of the Getty 20" system.

a. Standard Oil Company of California.

Pipelines from Wait Station and Midway Station in the San Joaquin Valley connect with a 12" pipeline at Rio Bravo. From Rio Bravo crude oil flows up to Richmond via pipelines varying in size from 8" to 18" and capacities ranging from 65,000 to 100,000 b/d along the various segments. In 1972, throughput along the trunk line from Rio Bravo to Los Medanos in the San Francisco Bay Area amounted to 170,281 b/d.

b. Union Oil Co. Kern River and Sunset are the location from which two Union pipelines originate in the San Joaquin Valley. They approach McKittrick, where the two 8" lines continue to Oleum in the San Francisco Bay Area. From McKittrick to San Francisco, the pipeline

size varies from 8" to 16". The capacity of the 12" line from Junction to Coalinga is 60,000 b/d and along the 16" line from Coalinga to San Francisco it is 78,000 b/d.* The throughput along this route was 54,298 b/d in 1972.

c. Shell Oil Co. Shell has 8" pipelines from Mt. Poso, Round Mountain (which connects with a Mobil line), and Ten Section which converge in the vicinity of Bakersfield. From Bakersfield a 14" line with a capacity of 82,000 b/d runs in a northwesterly direction to Caliola. Two lines, an 8"-10" line and an 8"-12" line, exist over the route from Caliola to Martinez, but have been inactivated by use of the Getty 20" system. In 1972, the throughput along the Bakersfield system averaged 56,250 b/d.

d. Getty Oil Co. Getty Oil Co. owns and operates a 20" pipeline that runs from

* Within the Valley, the Union pipelines make numerous connections with the lines of Standard Oil, Mobil, Getty, Shell and others. North of McKittrick, the Union line connects with Standard and Getty lines.

Coalinga to the San Francisco Bay Area. The pipeline follows the same route as the Union, Standard, and Shell pipelines. With a present capacity of 100,000 b/d, it delivers crude to the refineries of Shell, Exxon and Phillips in the San Francisco Area. Currently there is only one pumping station at Coalinga, but with the addition of more pumps the capacity of this line could be increased to at least 200,000 b/d.

This pipeline was built with a mutual understanding between Shell Oil Co. and Getty that Shell was to transport crude for Getty along its three main pipelines in the Bakersfield area and Getty was to take over in the northern section of the route.

3. Ventura to Los Angeles Basin

Shipments of crude from the fields in the Ventura vicinity can reach the Los Angeles Basin through three company trunk line systems, owned by Texaco, Inc., Union Oil Company and Shell Oil Company.

a. Shell Oil Co. Shell operates a 10"

line from connections in the Ventura area to the Los Angeles Basin, with a total capacity of 51,000 b/d. In the Los Angeles Basin, it connects to the Los Angeles Basin web and, within that web, to every other major oil company refinery in the Basin. Shell's throughput on the Ventura line in 1972 averaged some 44,915 b/d.

b. Union Oil Co. The Union Ventura-Basin line consists of an 8" line from Ventura to Torrey Canyon, with a capacity of 18,000 b/d at that point, and a 12" segment from Torrey Canyon into the Los Angeles Basin with a capacity of 48,000 b/d. During 1972, its throughput averaged 32,343 b/d. Within the Basin, it delivers to the Shell 10" line from Ventura, and to a Standard line. Deliveries from this system are made also to Fletcher Oil Company and to the Golden Eagle Refining Company, both independent refiners, and to Mobil and Arco refineries.

c. Texaco, Inc. Texaco operates an 8" line from the Ventura area through Fillmore

to Newhall, with a capacity of 18,000 b/d in the Ventura-Fillmore segment and 33,000 b/d in the Fillmore-Newhall segment. In 1973, 8,250 b/d were pumped through the former segment and 9,450 b/d through the latter. The Texaco line connects in Ventura to pipelines owned by Mobil, Union, Gulf, Superior, Marathon and Westates. At Newhall, it connects for deliveries into the Los Angeles Basin to the Arco and Mobil systems.

c. Mobil Oil Co. A 22" pipeline with a capacity of 170,000 b/d lies between the Rincon Field and the Ventura Marina. This line connects with another 12" line running along the Ventura River which in turn connects with the Shell and Texaco trunk lines to the Los Angeles Basin.

4. The Pipeline Web of the Los Angeles Basin

The central Los Angeles Basin has more than one thousand separate pipelines now in existence. They range from two inches to 36 inches in diameter and include lines for crude oil, for refined products, and for natural

gasoline and other natural gas liquids.

Crude oil production in the Basin began before 1900 and over the years many small refineries and a few large ones were built on the edges of the oil fields. Pipes were laid to connect the wells to the refineries, and to connect the refineries to the markets. Multiple lines were laid, connecting one refinery to several fields, and even refineries to other refineries.

In the 1920's, crude production in the Los Angeles Basin expanded very rapidly reaching peaks in 1923 and 1929 which have never since been matched. The supply exceeded local demand and oil was shipped to other states and to other countries. To accomplish this, more pipelines were built connecting the oil fields and the refineries to the loading ports for salt water shipment.

By 1941, there were 94 refineries on Professor Joe S. Bain's list of Pacific Coast refineries.* Although he did not give their

* The Economics of the Pacific Coast Petroleum Industry, Part I, 1944.

addresses, it is known that most of them were in the Los Angeles Basin. Most were small, and owned by independent companies. Today, there are only 15 refineries in the Basin, and 37 in the entire State of California.

Some of these refineries were abandoned. The majority, however, were bought up by larger companies. Only one western company, Union, made the transition of status from independent to major. The existing pipeline networks survived the demise of the refineries and continued in operation.

In consequence of the acquisitions, the remaining companies have various parallel or duplicate systems.

Mainly, the pipelines were laid more than 25 years ago when Southern California was much less densely populated and still mainly devoted to agriculture. Both rights-of-way and construction costs were relatively cheap at the time the fixed investments were plowed in.

Costs to duplicate the existing pipeline system today would be fantastic with the great population density, the price of land

and the number of highly expensive freeway crossings that would be required.

5. San Joaquin Valley to Coast
and Return

Standard Oil Company and Union Oil

Company own and operate pipelines connecting the central coastal area with the San Joaquin Valley.

a. Standard Oil Co. Standard has two pipelines which transport crude between Estero Bay and the San Joaquin Valley. One of the lines branches off the Rio Bravo-Richmond trunk line at Belridge. This 12" line has a capacity of 65,000 b/d and is connected to the lines of Getty Oil Co. and Belridge. Another 10" line with a 59,000 b/d capacity lies between Shandon and Estero. This line makes one connection with Mobil Oil Co.

In 1972, an average of 69,518 b/d of crude were pumped along the route from Belridge to Estero.

b. Union Oil Co. 8" and 12" lines from Bell and Orcutt converge at Avila. Avila and

Junction are connected by two 8" lines with a combined capacity of 48,000 b/d. Crude oil flows in either direction. In 1972, an average of 55,556 b/d of crude oil flowed along these lines.