Kinder Morgan Pony Express Pipeline LLC

Belle Fourche Pipeline Company

ORDER ON PETITION FOR DECLARATORY ORDER

141 FERC ¶ 61,180 (2012)

In this case, Kinder Morgan Pony Express Pipeline LLC (Pony Express) and Belle Fourche Pipeline Company (Belle Fourche)(jointly, Petitioners) filed a petition for a declaratory order seeking a decision from the Commission approving , among other things, joint transportation rates but separate prorationing programs. The rates were for transportation service to take away crude oil from the Bakken formation and to move it to Oklahoma through Guernsey, Wyoming. That service was effectuated by Petitioners through various means including the expansion of existing lines, reversal of a segment of an existing line, construction of new lines, building tankage and pumping facilities, and the conversion of certain natural gas pipeline capacity to crude oil pipeline capacity. The joint rates would be subject to annual indexing. Further, after open seasons, potential shippers would sign agreements committing to ship certain volumes of crude oil for a five year term. Features of the joint rates include these. The joint rates for committed shippers for movements of oil would total no more than the sum of the local uncommitted rates for equivalent service, and the joint committed rates would vary inversely to the amount of committed volumes (i.e. the greater the volume, the greater the discount). The Commission approved the rate structure. With respect to prorationing programs, Petitioners maintained that their programs had features that included setting aside 90 percent of capacity for (regular) committed shippers and 10 percent for uncommitted shippers, using historical volumes during a base period to determine the apportionment in times of constraint, and giving uncommitted shippers an opportunity to become regular shippers. The Commission approved the prorationing programs.

141 FERC ¶ 61,180
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
Cheryl A. LaFleur, and Tony T. Clark.

Kinder Morgan Pony Express Pipeline LLC
Belle Fourche Pipeline Company

Docket No. OR12-26-000

ORDER ON PETITION FOR DECLARATORY ORDER

(Issued November 30, 2012)

1. On August 27, 2012, Kinder Morgan Pony Express Pipeline LLC (Pony Express) and Belle Fourche Pipeline Company (Belle Fourche) (jointly, Petitioners) filed a petition for a declaratory order approving proposed rate structures, services, and prorationing terms applicable to joint and local transportation services to be offered via new crude oil pipeline capacity. Petitioners state that the new capacity will consist of (a) a pipeline expansion constructed by Belle Fourche from Sandstone, Montana, to Belle Fourche's terminal at Guernsey, Wyoming (Phase III Project), (b) Pony Express' acquisition of approximately 432 miles of an existing natural gas pipeline and its conversion to crude oil service (Pony Express Mainline), and (c) Pony Express' construction of approximately 260 miles of new pipeline and ancillary facilities from the Pony Express Mainline to Ponca City and Cushing, Oklahoma (Cushing Extension).[1] The Petition is unopposed.

2. As discussed below, the Commission grants the petition for a declaratory order.

---

[1] The Belle Fourche Phase III Project, the Pony Express Mainline, and the Cushing Extension are referred to collectively in this order as the Project. The Pony Express Mainline and the Cushing Extension together are the Pony Express System.

I. Background and Details of the Project[2]

3. Petitioners state that, commencing in 2014, the Project will provide a new pipeline route for transportation of crude oil from the Bakken region and nearby production areas to Ponca City and Cushing, Oklahoma. Petitioners point out that production projections for the Bakken formation alone indicate that it will reach 1.2 million barrels of crude oil per day (bpd) by 2015 and that significant additional crude oil production is expected to be available from other parts of the region that are adjacent to the proposed Pony Express Mainline. According to Petitioners, the Project's expected additional 220,000 bpd of capacity will provide badly needed oil pipeline transportation from the region.

A. Belle Fourche's Current System and the Phase I, II, and III Projects

4. According to Petitioners, the Belle Fourche southern system provides transportation from fields in Converse, Campbell, and Crook Counties to Guernsey and East Salt Creek (all in Wyoming) and from Belle Creek to Alzada (both in Montana). Additionally, Petitioners state that the Belle Fourche northern system provides transportation from Sieler Station to Baker (both in Montana) or Alexander Station (in North Dakota) and from Billings County, Golden Valley, and Stark County to Alexander Station (all in North Dakota). Petitioners further state that the Belle Fourche northern system interconnects with Enbridge Pipelines (North Dakota) LLC at Alexander Station. Petitioners emphasize that the Belle Fourche system currently is unable to transport crude oil from Sandstone or Baker, Montana, to Guernsey, Wyoming, but that will become possible with the completion of Belle Fourche's Phase I and Phase III Projects.

5. Petitioners state that Belle Fourche held an open season in 2010 to obtain volume commitments for the Phase I Project, which will create approximately 40,000 bpd of capacity from Sandstone to Guernsey. They explain that the Phase I Project involves the construction of 90 miles of pipeline from Sandstone to the existing Belle Fourche pipeline in Alzada, Montana, reversal of the pipeline segment between Belle Creek and Alzada, and expansion of the existing infrastructure on Belle Fourche's southern system to equal to the new construction capacity from Sandstone to Alzada. Petitioners state that Belle Fourche received sufficient volume commitments for the Phase I Project, which it expects to complete during the spring of 2013.

6. Petitioners state that Belle Fourche held another open season in 2010 to obtain volume commitments for its Phase II Project, which will reverse the flow of the Belle

---

[2] Throughout the Petition, Petitioners rely extensively on the affidavits of John Eagleton and Henry A. True. Petition of Kinder Morgan Pony Express Pipeline LLC and Belle Fourche Pipeline Company for a Declaratory Order (August 17, 2012) Attachments A and B.

Fourche northern system to provide transportation from Alexander Station to Sandstone. They also explain that the Phase II Project will provide access to other pipeline export capacity beyond Sandstone via Butte Pipe Line Company (Butte), the Belle Fourche Phase I and Phase III Projects, and the proposed Keystone XL project.[3] Petitioners state that Belle Fourche received sufficient volume commitments for the Phase II Project, which it expects to complete no later than the third quarter of 2014.

7. Petitioners next assert that the proposed Phase III Project will create 60,000 bpd of additional capacity between Sandstone and Belle Fourche's Guernsey Terminal in Wyoming (Guernsey Terminal), resulting in approximately 100,000 bpd of transportation capacity between those points. Petitioners explain that this project will accept crude oil into the Pony Express Mainline at the Guernsey Terminal, thereby providing seamless access from the Bakken formation to the Ponca City and Cushing, Oklahoma markets. They further explain that the Phase III Project will require (a) construction of approximately 55 miles of pipeline between Sandstone and Donkey Creek Station, Wyoming; (b) expansion of the existing infrastructure on the Belle Fourche southern system equal to this new capacity from Sandstone to Donkey Creek Station, and (c) construction of additional tankage and pump capacity, including new facilities at the Guernsey Terminal. Petitioners add that, in July 2012, Belle Fourche and Pony Express completed the Phase III Project open season for joint transportation service volume commitments from Sandstone through the Guernsey Terminal to Ponca City and/or Cushing via Pony Express, as well as from the Guernsey Terminal to Ponca City and/or Cushing via Pony Express. According to Petitioners, the Phase III Project is expected to be completed during the third quarter of 2014.

B. Local Transportation on the Pony Express System

8. Petitioners reiterate that the Pony Express System will include the Pony Express Mainline and the Cushing Extension and will provide transportation service under local tariffs from Guernsey to Ponca City and Cushing. Petitioners state that, to accommodate the commitments received during the local open season, Pony Express will acquire certain pipeline and compression facilities from its affiliate, Kinder Morgan Interstate Gas Transmission LLC (KMIGT), at actual net book value,[4] and Pony Express will convert those facilities to crude oil pipeline capacity, as well as constructing other pipeline facilities.

---

[3] Petitioners state that the Keystone XL pipeline is intended to transport crude oil from Canada to the Gulf Coast, and it will include an origin for Bakken production in Baker, Montana.

[4] Petitioners state that the actual net book value as of May 31, 2012, is $90.3 million.

9. According to Petitioners, the Pony Express Mainline currently is part of an approximately 804-mile, 20-24-inch natural gas pipeline that is subject to Commission's Natural Gas Act (NGA) jurisdiction.[5] Petitioners explain that KMIGT has filed a related application in Docket No. CP12-495-000 seeking Commission authority to (a) abandon-by-sale a 432.4-mile segment of its natural gas pipeline system and appurtenant facilities from Guernsey to the proposed point of interconnection with the approximately 260-mile new extension line from a point near Dickinson, Lincoln County, Kansas, to Cushing; (b) construct certain natural gas replacement facilities to maintain service to its firm natural gas transportation customers; and (c) obtain such other approvals as necessary to maintain natural gas services on the re-configured KMIGT system. Petitioners state that the Pony Express System then will extend approximately 690 miles, with a capacity of up to 220,000 bpd.

C. Joint Transportation Services Offered by Pony Express, Belle Fourche, and Bridger Pipeline LLC (Bridger)

10. Petitioners next state that Belle Fourche and Pony Express will offer joint transportation service to Ponca City and Cushing from (a) Belle Fourche's terminal at Sandstone, through the Guernsey Terminal to Pony Express; (b) origins upstream of Sandstone on Belle Fourche and its affiliated pipeline, Bridger, (Upstream Infrastructure) for further movement through the Sandstone and Guernsey Terminals to Pony Express; and (c) Belle Fourche's Guernsey Terminal to Pony Express (collectively, the Joint Transportation Services). According to Petitioners, the Joint Transportation Services will be provided on, among other things, the approximately 60,000 bpd of new capacity between Sandstone and Guernsey as part of the Belle Fourche Phase III Project, which is in addition to the 40,000 bpd already under construction in Belle Fourche's Phase I Project, as well as an estimated 25,000 bpd of added take-away capacity at Guernsey Terminal and matching capacity within the Pony Express System. Petitioners explain that Belle Fourche and Pony Express will offer Joint Transportation Services under a joint tariff to be filed with the Commission by Belle Fourche, Bridger, and Pony Express.

D. The Open Seasons

1. The Joint Open Season and Routing on the Upstream Infrastructure

11. According to Petitioners, on May 18, 2012, they announced a joint open season to secure shipper commitments for the Joint Transportation Services (Joint Open Season). Petitioners state that interested shippers separately tendered executed throughput and

---

[5] Petitioners point out that, prior to 1997, this pipeline was employed for crude oil transportation service.

deficiency agreements (T&DA) to each Petitioner (individually, the Belle Fourche T&DA and the Pony Express T&DA, and collectively, the Joint T&DAs).[6]

12. Petitioners point out that, to ensure clarity, they did not seek volume commitments in the Joint Open Season for movements on the Upstream Infrastructure, which consists of (a) Bridger's Four Bears system; (b) Bridger's Poplar system; and (c) Belle Fourche's Phase II system. Petitioners state that Bridger currently provides transportation from McKenzie County and Dunn County, North Dakota, to Sandstone on the Four Bears pipeline system and that it also currently provides transportation capacity from Roosevelt, Richland, and Dawson Counties, Montana, to Sandstone on the Poplar system. The Petitioners state that the Phase II Project will provide crude oil transportation from, *inter alia*, Alexander Station, North Dakota, to Sandstone.

13. Petitioners observe that, although the routing to Ponca City and Cushing under the Joint Committed Rates includes (in some cases) movements over the Upstream Infrastructure, they limited the Joint Open Season to volume commitments for the Phase III Project and the Pony Express System because the Project will not add incremental capacity upstream of Sandstone on the Upstream Infrastructure. However, continue Petitioners, by making volume commitments in the Joint Open Season, Committed Shippers became eligible for the joint movements from origins on the Upstream Infrastructure to Ponca City and Cushing, which include transportation through the Phase III Project and the Pony Express System.

2. The Pony Express Open Season

14. Petitioners state that, commencing June 1, 2012, Pony Express held an open season for local transportation service from Guernsey and connections in Colorado to Ponca City and Cushing (Local Open Season). Petitioners state that interested shippers tendered executed T&DAs for the local transportation service (Local T&DA).

E. Rate Structures and Transportation Services for the Project

15. Petitioners state that the proposed initial Joint Committed Rates will be subject to annual adjustment in accordance with the Commission's indexing regulations.[7] In

[6] Petitioners state that a copy of the pertinent provisions (provisions governing the rates, deficiency obligations and rights, and prorationing rights) of the Belle Fourche T&DA is appended as Attachment D and a copy of the pertinent provisions of the Pony Express T&DA is appended as Attachment E.

[7] Petitioners state that they also have the right to pass through or otherwise be compensated for any regulatory-imposed costs and to account for pipeline handling shrinkage.

addition, continue Petitioners, the Joint T&DAs provide flexibility for shippers by providing for deficiency payments and limited make-up rights. Petitioners explain that the initial contract terms will be five years, with shippers having a one-time right to extend the term for five years, accompanied by the right to reduce committed volumes by 20 percent during the second term.[8]

16. Petitioners next describe the key Local T&DA provisions, and they state that the Local Committed Rates also will be subject to annual adjustments in accordance with the Commission's indexing regulations. Additionally, they explain that Pony Express will have the right to seek increases to recover costs incurred in complying with governmental actions. Further, state Petitioners, the Pony Express Local T&DA contains provisions for deficiency payments and limited make-up rights. Additionally, Petitioners state that the *pro forma* tariff provides for specified pipeline loss allowances and certain surcharges. They emphasize that the Local T&DAs also have five-year initial terms, subject to a one-time extension right of five years, accompanied by a right to reduce committed volumes by 20 percent during the second term.

II. Notice and Interventions

17. Notice of the Petition was issued August 21, 2012. Interventions and protests were due September 14, 2012. Pursuant to Rule 214 of the Commission's regulations,[9] all timely-filed motions to intervene and any unopposed motion to intervene out-of-time filed before the issuance date of this order are granted. Granting late intervention at this stage of the proceeding will not disrupt the proceeding or place additional burdens on existing parties. The Petition is unopposed.

III. Discussion

18. Petitioners contend that, commencing with its rulings in *Express Pipeline Partnership* (*Express*),[10] the Commission has recognized that advance rulings relating to the lawfulness of rate structures and terms of service for proposed oil pipeline projects can create regulatory certainty and allow the Commission to consider the issues without

---

[8] Petitioners state that the tariff provisions governing prorationing of the Phase III Project and Pony Express System were reflected in the *pro forma* tariffs attached to the Joint T&DAs.

[9] 18 C.F.R. § 385.214 (2012).

[10] 76 FERC ¶ 61,245, at 62,253 (*Express*), *reh'g denied*, 77 FERC ¶ 61,188 (1996).

being limited by tariff filing timetables.[11] Petitioners argue that these cases support Commission approval of the assurances they seek in this Petition.

A. Filing Joint and Local Committed Rates as Settlement Rates

19. While Petitioners acknowledge that the Commission's regulations do not specifically provide for negotiated initial rates with agreed-to future rate changes, they contend that, in cases where shippers sign T&DAs and commit to pay the contract volumes over a period of years, the Commission has treated these rates "settlement rates," as provided in 18 C.F.R. § 342.4(c).[12] Petitioners also assert that the Joint T&DAs provide that the Joint Committed Rates will be no more than the sum of the local uncommitted rates on Pony Express and Belle Fourche, despite the fact that local rates cannot be determined at this stage of the Project.

20. *Commission Analysis.* The Commission will grant the Petitioners' request. Although the local rates are unknown at this time because the Project has not been completed, Petitioners agree that the Committed Rates will be no greater than the uncommitted rate or any other committed rates for equivalent service.

---

[11] Petitioners cite, *e.g.*, *Shell Pipeline Co.*, 139 FERC ¶ 61,228 (2012); *Skelly-Belvieu Pipeline Co.*, 138 FERC ¶ 61,153 (2012); *Sunoco Pipeline, L.P*, 137 FERC ¶ 61,107 (2011); *Enbridge Pipelines (North Dakota) LLC*, 133 FERC ¶ 61,167, at P 40 (2010); *CCPS Transportation, LLC*, 121 FERC ¶ 61,253 (2007); *Calnev Pipe Line LLC*, 120 FERC ¶ 61,073, at P 23 (2007); *Colonial Pipeline Co.*, 116 FERC ¶ 61,078, at P 9 (2006); *Enbridge Energy Co., Inc.*, 110 FERC ¶ 61,211 (2005); *Plantation Pipe Line Co.*, 98 FERC ¶ 61,219 (2002).

[12] Petitioners cite *Express Pipeline Partnership*, 76 FERC ¶ 61,245, at 62,253, 62,258-59 (1996):

> The Commission will grant the request for waiver, so that prospective shippers may be substituted for current shippers in the verified statement required by section 342.4(c). The Commission will also grant the request for waiver, that Express not be required to re-apply for alternative rate treatment under sections 342.1 and 343.4(c) each time the agreed-to rate adjustment exceeds the generic index under section 342.3. Express does not have current shippers because its pipeline has not been constructed. Its statement that all of its term shippers have agreed to the two percent adjustment, while not consistent with the letter of section of 342.4(c), is certainly consistent with the spirit of that section.

21. The Commission's approval of Petitioners' request is consistent with Commission precedent in similar cases.[13] As Petitioners acknowledge, the Commission's regulations do not provide specifically for negotiated initial rates with agreed-to future rate changes. However, the Commission will continue to apply its policy of honoring contracts signed by committed shippers, such as the T&DAs here, which include the commitment to pay for contract volumes and other agreed-to charges for the terms of the contracts. The Commission finds that these rates are consistent with the spirit of section 342.4(c).[14]

B. Whether Key Provisions of the Joint T&DAs and the Joint Tariff Will Govern Joint Transportation Services

22. Petitioners further request a Commission finding that the key provisions of the T&DAs will govern the Petitioners' transportation services to their Committed Shippers during the term of the T&DAs. Petitioners contend that this requested ruling also is consistent with Commission precedent.[15]

23. *Commission Analysis.* The Commission will grant this requested ruling as well because it is consistent with Commission precedent. For example, in *Mid-America Pipeline Company, LLC*,[16] the Commission granted the petitioner's request that the Commission issue an order in which the petitioner sought a finding that the terms of the agreements executed by the committed shippers (including the agreed-to tariff, rate, and priority service structure) would be upheld and applied during the established terms of the agreements between the pipeline and the shippers that made volume commitments during the open season.

C. Structures of Joint Committed Rates and Local Committed Rates

24. Petitioners further seek a Commission determination that the structures of the Joint and Local Committed Rates are lawful. Petitioners point out that these rates vary with

---

[13] *See, e.g., Enbridge Pipelines (North Dakota) LLC*, 133 FERC ¶ 61,167 (2010).

[14] 18 C.F.R. § 342.4(c) (2012). *Express Pipeline Partnership*, 76 FERC ¶ 61,245, at 62,258-59 (1996).

[15] Petitioners cite, *e.g., Texaco Pipeline, Inc.*, 72 FERC ¶ 61,313 (1995) (Commission's policy for joint rates is that they should be no more than the sum of the underlying local rates); *see also Enbridge Pipelines (North Dakota) LLC*, 133 FERC ¶ 61,167 (2010); *Enbridge Pipelines (Southern Lights) LLC*, 122 FERC ¶ 61,170, at P 13 (2008) ("[T]he Commission clarifies that the agreed-upon terms of the TSA will govern the determination of the committed shippers' rates over the term of the TSA[.]").

[16] 136 FERC ¶ 61,087, at P 9 (2011).

the size of the shippers' volume commitments in the Joint and Local Open Seasons, as applicable, and that the greater the volume, the greater the discount.

25. *Commission Analysis.* The Commission previously has recognized that it is appropriate for shippers committing to larger volumes to pay discounted rates, versus shippers that do not commit to transport larger volumes.[17] Since its decision in *Express*, the Commission has recognized that uncommitted shippers are not similarly situated with shippers making longer term commitments, incurring greater costs and liabilities, and undertaking greater risks.[18]

D. Petitioners' Prorationing Policies

26. According to Petitioners, when capacity on the Project is over-subscribed in any month of operations, they have separate but similar prorationing policies that would govern allocations of capacity to shippers on their respective pipeline segments. Petitioners state that these policies are included in the *Pro Forma* Rules and Regulations Tariffs attached to their respective T&DAs.

1. Belle Fourche Prorationing Policy[19]

27. Petitioners explain that the capacity added to Belle Fourche's system during the Phase I, Phase II, and Phase III Projects, as well as the Existing Capacity, which is capacity that existed or will exist on Belle Fourche's system prior to these expansions, will be treated as separate pipeline segments for purposes of allocating capacity during

---

[17] *E.g., Plantation Pipe Line Co.*, 98 FERC ¶ 61,219 (2002); *Williams Pipe Line Co.*, 80 FERC ¶ 61,402 (1997).

[18] *Express Pipeline Partnership*, 76 FERC ¶ 61,245, at 62,254 (1996) in which the Commission stated:

> Each class of term shipper presents unlike circumstances because the longer term commitments provide greater assurances than the shorter term commitments, and hence more long-term revenue stability. Term volume shippers committing to longer terms assume greater risks than shippers assuming lesser shipment obligations because 15 and 10 year terms present very long lead times in the oil business.

[19] Petitioners state that the full text of Belle Fourche's proposed prorationing provisions is included in Attachment D to the Petition. Petition of Kinder Morgan Pony Express Pipeline LLC and Belle Fourche Pipeline Company for a Declaratory Order (August 17, 2012) Attachment D.

prorationing. Petitioners contend that, while this approach is administratively burdensome for Belle Fourche, it is designed to ensure that factors relating to the expansion capacity will not affect the allocation of capacity to shippers utilizing capacity in other Project phases.

28. Specifically, Petitioners explain that Belle Fourche will use an historical volume-based methodology to allocate Phase III Project capacity, with a base period of 12 months for historical volumes, and at least 10 percent of the capacity set aside for New Shippers. Petitioners also state that New Shippers will be limited to two and one-half percent of capacity and that they can become Regular Shippers after shipping for 12 consecutive months. Petitioners contend that this type of methodology is common, although they point out that in this case, there are some special features of the Phase III Policy affecting Committed Shippers. Petitioners describe these features as including the process by which up to 90 percent of the capacity will be allocated to Committed Shippers and the process that will enable New Shippers to become Regular Shippers in the rolling 12-month periods thereafter. They state that Committed Shippers can maintain their Regular Shipper status by shipping or paying for contracted capacity that they do not use because both the actual shipments and payments for unused capacity will become the basis for their Base Period shipments.

29. Further, state Petitioners, the Phase III Policy establishes the process by which all Phase III Project capacity not first allocated to New Shippers will be allocated to Regular Shippers. Petitioners also state that Belle Fourche has established a process for allocating Phase II Project capacity among shippers prior to the in-service date of the Phase III facilities.

2. Pony Express Prorationing Policy[20]

30. Petitioners explain that the Pony Express prorationing process likewise employs an historical volume-based methodology, with a base period of 12 months for historical volumes, and at least 10 percent of the capacity set aside for New Shippers, which individually will be limited to 2.5 percent of capacity and can become Regular Shippers after shipping for 12 months.

31. Petitioners point out that special features of the prorationing policy affecting Committed Shippers are that they would be deemed to have 12 months of volume history at the commencement of operations on the pipeline equal to their commitments under their Pony Express T&DAs, and they will be eligible to maintain their Regular Shipper

---

[20] Petitioners state that the full text of the Pony Express prorationing procedures is included in Item 48 of the Pony Express Rules and Regulations tariff.

status by transporting or paying pursuant to their Pony Express T&DAs because such payments or shipments will become the basis for their Base Period shipments.

32. Petitioners further explain that, for the first 12 months of Pony Express' operations, up to 90 percent of the volumes will be allocated to Committed Shippers, and in the rolling 12-month Base Periods thereafter, New Shippers that shipped during all 12 months of a Base Period will become Regular Shippers, displacing the relevant potion of Committed Shipper volumes and so on through the term of the T&DAs.

3. Reasonableness of Both Prorationing Policies

33. According to Petitioners, under both prorationing policies, a Committed Shipper will be deemed to be a Regular Shipper as of the in-service date of the Project and will be deemed, for the first 13 months following the in-service date of the Project, to have shipped its minimum volume commitment during each month of the base period. Further, state Petitioners, under both policies, a Committed Shipper's base period shipment history will be calculated using the greater of what the shipper actually shipped during the base period or otherwise paid for transportation under a Joint T&DA.

34. Petitioners explain that the Committed Shippers made the volume commitments that provided the economic rationale for the Project, and the Committed Shippers agreed that these additional prorationing rights were an important inducement in their decisions to make such volume commitments. Petitioners assert that these provisions are reasonable and not unduly discriminatory because of the different obligations and risks undertaken by the Committed Shippers. Moreover, continue Petitioners, because Committed Shippers have made volume commitments and have related deficiency payment obligations, it is reasonable to protect those Committed Shippers from allocation erosion during the first base period of pipeline operations by deeming them to have 12 months of volume history equal to their commitments under their T&DAs. Petitioners further state that, because the policies afford New Shippers the opportunity to become Regular Shippers and to gain access to 90 percent of Phase III Project/Pony Express capacity, the policies ensure that Committed Shippers are not receiving firm transportation service at a discount rate and that uncommitted shippers have a reasonable opportunity to gain access to significant pipeline capacity. Petitioners emphasize that, as New Shippers move into the Regular Shipper category, the allocations to Regular Shippers (including Committed Shippers) will be eroded. Finally, Petitioners state that Committed Shippers (that are Regular Shippers) may receive shipment history credit in any given month for their deficiency payments for unshipped volumes during that month; however, the failure of Committed Shippers to ship their volume commitments will free space for other Regular and New Shippers to use.

35. Petitioners argue that their prorationing policies are consistent with Commission precedent. They cite *TransCanada Keystone Pipeline, LP* (*TransCanada*),[21] in which the pipeline's rules and regulations contained a provision stating that the base period volume history of committed shippers for the first six months of service would be deemed to equal the committed shippers' volume commitment levels. Further, state Petitioners, the prorationing policy addressed in that case also provided that uncommitted shippers collectively would be allocated up to five percent of capacity and would not receive the base period volume benefits afforded to committed shippers. Petitioners contend that their proposed prorationing policies are similar to the proposal approved in *TransCanada.*

36. However, Petitioners acknowledge that their prorationing policies differ in some respects with the policy approved in *TransCanada*, although they maintain that these differences are not material. For example, they state that, in *TransCanada*, committed shippers were only deemed to be regular shippers for a six-month period upon startup, whereas in the Petitioners' policies, the Committed Shippers are deemed to be Regular Shippers for the 13-month period following the in-service date of the Project. Petitioners maintain that this difference in time is reasonable because it matches the base periods of the pipelines, and further, it does not prevent uncommitted shippers from becoming Regular Shippers by shipping regularly during the base period. In addition, continue Petitioners, the Petitioners' policies set aside 10 percent of capacity for New Shippers, whereas the proposed policy addressed in *TransCanada* set aside only five percent. Petitioners assert that the Commission has found 10 percent to be an acceptable level of reserved capacity for new shippers in previous orders.[22]

37. Petitioners also address their prorationing rules as they apply to the joint movements. They reiterate that the Phase III Policy to be included in Belle Fourche's local tariff will apply to the transportation of crude oil from Sandstone to Guernsey Terminal, and the Pony Express prorationing policy will be included in that company's local tariff. In addition, continue Petitioners, the prorationing rules applicable to the Upstream Infrastructure will apply to the portions of the Joint Transportation Services routed through that infrastructure.

38. For example, explain Petitioners, under Route 1 of the Joint Tariff, a shipper can ship crude oil from Highway 23 in North Dakota to Sandstone on Bridger's Four Bears system, from Sandstone to Guernsey Terminal on the Phase III Project, and from Guernsey Terminal to Cushing on the Pony Express System. According to Petitioners, Bridger's generally-applicable prorationing rules will apply to determine the shipper's allocation on the Four Bears system, the Phase III Policy will apply to determine the

---

[21] 131 FERC ¶ 61,139, at P 12 (2010).

[22] Petitioners cite, *e.g., Platte Pipe Line Co.*, 117 FERC ¶ 61,296, at P 56 (2006).

shipper's allocation on the Phase III Project capacity, and the Pony Express prorationing rules will apply to determine the shipper's allocation on the Pony Express System.

39. The Petitioners submit that this approach is just and reasonable because it ensures that volume commitments in the Joint T&DAs do not provide Committed Shippers with preferential capacity rights on the Upstream Infrastructure, most of which is already operational, to the detriment of the current shippers on that infrastructure. Moreover, state Petitioners, it also ensures that prorationing is not done in a manner that would provide a preference to joint movement shippers over local movement shippers. Petitioners clarify that they are not seeking approval of the prorationing policies applicable to the Upstream Infrastructure.

40. *Commission Analysis*. The Commission will approve the Petitioners' prorationing policies because they are generally consistent with Commission policy and precedent. Petitioners have sufficiently explained that certain provisions necessary because of the unique nature of the Project. Petitioners have demonstrated that the Project will be an important link in the currently constrained pipeline capacity moving crude oil from the Bakken region and other nearby production areas where production is projected to increase.

41. The Commission notes that Committed Shippers that signed T&DAs in the open seasons have agreed to be bound by these prorationing policies, which distinguish their rights and obligations versus those of shippers that did not choose to commit to the Project. Importantly, Petitioners have set aside an appropriate percentage of their capacity for uncommitted shippers and have provided a process whereby New Shippers can become Regular Shippers. Further, Petitioners conducted public open seasons, which gave all potential shippers the opportunity to become Committed Shippers.

E. Deficiency Payment Crediting Mechanism and Barrels Crediting Mechanism

42. Petitioners state that the provisions included in the Joint T&DAs provide the flexibility to allow Committed Shippers to ship more or less than their contracted amounts in any month. Petitioners explain that, if a Committed Shipper ships less than its contracted amount, the differential is booked in a Deficiency Payment Account created for each shipper. Petitioners point out that the T&DAs state that, if a Committed Shipper ships less than the monthly minimum volume commitment, that shipper is responsible for paying Petitioners the Committed Shipper rates for the actual number of barrels shipped, as well as a charge covering the deficiency of barrels not shipped, calculated as the monthly deficient barrels multiplied by the qualifying monthly rate. Petitioners further state that the amount in the Deficiency Payment Account may not be used as a credit against any other deficiency payments the shipper may owe. Additionally, Petitioners explain that the amount in the Deficiency Payment Account does not belong to the shipper; it vests fully with the Petitioners. Moreover, state

Petitioners, barrels attributable to deficiency payments are included in the Committed Shipper's shipment history for that month for the purpose of administering the prorationing policies.

43. Conversely, state Petitioners, subject to available capacity, a Committed Shipper could ship barrels in excess of its monthly volume commitment (Incremental Barrels). Petitioners state that they will apply any dollar amounts in the shipper's Deficiency Payment Account as a credit against transportation charges due from that shipper to the applicable carrier for the shipment of incremental barrels under the joint tariff. As stated above, the amount in the Deficiency Payment Account may not be applied as a credit against any other deficiency payment owed. Petitioners explain that this is intended to provide "make-up" rights to the shippers that include any deficiency payments caused by a *force majeure* event that prevents the shipper from meeting its obligation to tender volumes, as required by the T&DA. Petitioners state that transportation charges for incremental barrels that are paid from a Deficiency Payment Account will not be included in the shipper's shipment history for purposes of administering the prorationing policies.

44. *Commission Analysis.* The Commission will approve these provisions. They provide flexibility to both the Committed Shippers and the Petitioners.

45. Committed Shippers will have the ability to offset both deficiencies and Incremental Barrels under specified circumstances, but payments for deficiencies may not be credited against future deficiency obligations. Additionally, except in limited situations involving *force majeure*, the volumes for which transportation is paid from the Deficiency Payment Accounts will not be included in a shipper's shipment history when prorationing is required. While this benefits Committed Shippers by affording the flexibility in payment for their shipments, it also prevents them from obtaining an unfair advantage over uncommitted shippers by having their barrels counted twice when prorationing is necessary.

F. Term Extension Rights

46. Petitioners state that their Joint T&DAs include a provision giving shippers the ability to extend the initial term of their T&DAs for an additional five-year term. They explain that a Committed Shipper may exercise this right only if it extends both the Pony Express and the Belle Fourche Joint T&DAs for the same five-year period. Further, they emphasize that, with respect to this extended term, the Committed Shippers may also reduce their initial term volume commitments by 20 percent, provided that the reduction applies to their T&DAs with both Petitioners. Petitioners add that the rates paid by each Committed Shipper will be adjusted to correspond to its reduced volume commitment if such a reduction moves the Committed Shipper into a different rate and volume tier than that applicable to the Committed Shipper during its initial term.

47. *Commission Analysis.* The Commission will approve the contract extension and related rights established in Petitioners' Joint T&DAs. The Commission has approved similar contract extension/rollover rights in prior declaratory orders addressing proposed new pipeline capacity. For example, in *Enbridge Energy Company, Inc.*,[23] the Commission approved the requested findings for a project that gave shippers the right to renew 10-year transportation service agreements for a second 10-year period and also provided the right to increase their volumes commitments.[24]

G. Pony Express Recovery of Costs

48. Petitioners state that, before Pony Express makes the substantial financial commitments to convert the KMIGT system from natural gas service to crude oil service and to build additional significant pipeline assets, it seeks assurance of its right to recover the KMIGT costs in its cost-based oil transportation rates. Petitioners explain that these costs include:

- costs of building new compression, interconnections, booster stations, and lateral lines as replacement facilities to maintain service after abandonment of the Pony Express facilities and to record separately such amounts for lump-sum reimbursement as KMIGT Construction Costs;

- costs of contracting and paying for transportation of natural gas on alternative pipeline systems to re-route natural gas around the abandoned Pony Express

---

[23] 110 FERC ¶ 61,211 (2005).

[24] *Enbridge Energy Company, Inc.,* 110 FERC ¶ 61, 211, at P 10 (2005). The Commission stated as follows:

> Enbridge states that the initial term of the Spearhead TSAs is 10 years and that shippers have the option of extending the term for an additional 10 years if the pipeline does not cease operations at the end of the initial term. According to Enbridge, the minimum committed volume is 5,000 BPD, and commitments can either be fixed (i.e., the same fixed volume over the initial term) or escalating (i.e., the committed volume may be stair-stepped, with a greater commitment in later years). Moreover, adds Enbridge, each committed shipper has the right to increase its minimum volume commitment by an amount (the step-up volume commitment) that varies depending upon the level of the average initial commitment.

pipeline segment and maintain equivalent substitute service and to record and track such annual costs for reimbursement as KMIGT Substitute Pipeline Costs;

- costs of abandoning, removing, and restoring certain natural gas compressor sites along the corridor of the Pony Express facilities and to record such amounts for lump-sum reimbursement as KMIGT Abandonment Costs; and

- costs of abandoning by sale at net book value 432.4 miles of its Pony Express pipeline, together with associated natural gas compressors, and to make associated entries to record the KMIGT Acquisition Costs as a credit in its utility plant accounts.

49. Petitioners acknowledge that they cannot complete the steps outlined above until the Commission authorizes KMIGT to abandon certain facilities and to construct certain facilities. Those issues are pending before the Commission in Docket No. CP12-495-000. However, Petitioners maintain that the Commission may act in this proceeding now because this Petition has no bearing on the merits of the issues in the related proceeding.

50. According to Petitioners, Pony Express believes that there is support for its request to include and recover these costs should it need to support or defend its rate using an Opinion No. 154-B cost of service.[25] Petitioners assert that, while the KMIGT-related costs are not known with certainty at this time, the estimated level of such costs, when combined with the other costs to construct the Pony Express portion of the Project, are substantially less costly than constructing a new pipeline. Petitioners further contend that the total cost of the Project – composed of the approximately $90.3 million in transferred mainline facilities, $8.4 million in KMIGT Abandonment Costs, $56.6 million in KMIGT Construction Costs, and annual expenses of $9.3 million – also is far less than the cost of constructing a comparable pipeline, which would be approximately $650 million.

51. Petitioners assert that the proposed cost reimbursements between KMIGT and Pony Express allow for recovery of only the incremental and incurred costs of the Pony Express portion of the Project. Petitioners explain that the KMIGT Substitute Pipeline Costs will be tracked and billed to Pony Express annually and will vary based upon the requirements to maintain and continue service to affected shippers. Consequently, continue Petitioners, the yearly volume transported will depend on shipper demands and cannot be known now. Similarly, Petitioners explain that the rates paid to other interstate

---

[25] Petitioners observe that Pony Express also will incur other costs related to the conversion of the gas pipeline, the installation of pump stations, connections to pipeline facilities at Guernsey, and other costs that readily fit into the Commission's plant accounts in the Uniform System of Accounts for oil pipelines, 18 C.F.R. Part 352, and therefore they are not included in this Petition.

pipelines also may vary, but at rates equal to or less than FERC-approved tariff rates. Petitioners maintain that having KMIGT contract for such services with existing interstate pipelines, in lieu of constructing and operating its own pipeline, is prudent and less costly than the contingencies to maintain service to its affected natural gas customers. Conversely, continue Petitioners, they know with more certainty that the KMIGT Construction and Abandonment Costs primarily will be paid to construction and engineering contractors and accumulated in a work order for reimbursement as a lump sum. Petitioners state that KMIGT will separately track and bill to Pony Express the associated incremental costs of the Pony Express portion of the Project under the structure proposed.

52. Petitioners assert that Commission precedent supports permitting recovery of these costs because the KMIGT Construction Costs and Abandonment Costs are similar to contribution-in-aid reimbursements between pipelines and other parties addressed in natural gas pipeline cases.[26] Moreover, assert Petitioners, the Commission previously has authorized an oil pipeline to recover similarly unconventional costs in connection with the acquisition and conversion of a pipeline for new liquids service.[27] Petitioners contend that, in *Enbridge Southern Lights*, the Commission approved the asset swap, including the pipeline's proposal to include the costs it incurred to build pipeline facilities to maintain service to another pipeline's shippers, while the other pipeline would retain in its rate base the book cost of the asset transferred to Enbridge.[28]

53. Petitioners acknowledge that the proposed transaction by KMIGT and Pony Express differs in some ways from the "asset swap" in *Enbridge Southern Lights*, although there are several crucial similarities:

- In *Enbridge Southern Lights*, the newly-formed oil pipeline would pay the costs of constructing new facilities to ensure continued service to the transferring pipeline's existing customers. The KMIGT Construction Costs to be incurred by KMIGT are analogous in every way to the fact pattern in *Enbridge Southern Lights*.

---

[26] Petitioners cite, *e.g.*, *Fayetteville Express Pipeline LLC*, 129 FERC ¶ 61,235 (2009); *Florida Gas Transmission Co.*, 132 FERC ¶ 61,040 (2012); *Kern River Gas Transmission Co.*, 127 FERC ¶ 61,223 (2009).

[27] Petitioners cite *Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,310, at PP 32-34 (2007) (*Enbridge Southern Lights*).

[28] Petitioners cite *Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,310, at PP 36-38 (2007).

- In *Enbridge Southern Lights*, the transaction was structured so that the transferring pipeline's customers would not face higher costs as a result of the asset swap. Here, Pony Express' payment of the listed costs to KMIGT to provide continued gas transportation service to certain of its customers that would otherwise lose service due to the transfer; hence, it is appropriate for Pony Express to include such costs in its own revenue requirement for ratemaking purposes. Whether KMIGT constructs replacement facilities or contracts for services to replicate the functionality of its abandoned pipeline, the underlying purposes are the very same ones supported by *Enbridge Southern Lights*.

- In *Enbridge Southern Lights*, customers of the new diluent pipeline benefitted because, despite the costs of constructing new pipeline assets to replace part of the system being transferred to Enbridge, the overall cost of the new project was still lower than it would have been had the new diluent pipeline simply constructed its own new pipeline and not engaged in the asset swap. Here, the petroleum shippers of Pony Express would obtain a similar cost benefit relative to the alternative of the construction of a new pipeline.

- The Commission assessed this somewhat unconventional cost proposal under the "benefits test" used in acquisition premium cases and characterized the transaction as permitting Southern Lights to include as it were a "purchase price" in its rate base. This is similar to Pony Express's proposed inclusion of the cost of KMIGT Construction Costs for newly built facilities to be owned by KMIGT, as well as the Substitute Pipeline Transportation Costs that would be made in lieu of new facilities to provide transportation by KMIGT.

54. Additionally, Petitioners state that it is reasonable to amortize as a regulatory asset the lump sum and capitalized Abandonment Costs and KMIGT Construction Costs (other than the net book cost of the transferred pipeline assets that would continue to be used in oil pipeline service, in standard property accounts). According to Petitioners, other than the Substitute Pipeline Transportation Costs (which are clearly an annual expense), the transferred pipeline assets (which can be depreciated in the same manner as the newly-built assets of the Cushing Extension), the Abandonment, and the KMIGT Construction Costs are not the kind of costs that should be expensed, nor can they be fit easily into property accounts for purposes of depreciation. Petitioners request that these costs be subject to amortization over the potential 10-year life of the contracts.

55. *Commission Analysis.* The Commission finds that Petitioners have demonstrated that this proposal is the most efficient and equitable mechanism to recover the Abandonment Costs, the KMIGT Construction Costs, and the Substitute Pipeline Transportation Costs in its own cost of service, as described above.

56. KMIGT intends to transfer a pipeline to its affiliate, Pony Express, for conversion to a completely different service, and Pony Express seeks approval to include in its cost

of service the costs of ensuring continued service to customers of the transferring company. The Commission employs a "benefits exception" test when determining whether to permit a purchased asset to be included in the rate base at the full purchase price. This test is based on two considerations, which are (a) whether the acquired facility is being put to a new use, and (b) whether the purchase price is less than the cost of constructing a comparable facility.[29]

57. In this case, Petitioners have demonstrated that their proposal meets this test. As Petitioners have explained, the cost of converting the KMIGT facilities from natural gas transportation to oil pipeline transportation plus the other costs of their proposal ($259.9 million total) will be far less than the alternative cost of constructing a new pipeline with the same capacity ($650 million).[30] Allowing Pony Express to recover these costs is consistent with the general ratemaking principle that the carrier should have the opportunity to recover its prudently-incurred costs of providing the service.[31]

H. Belle Fourche's Interim Service Prorationing Proposal

58. Petitioners state that, because Belle Fourche is adding the Phase III Project capacity through a combination of refurbishments, expansions, and new construction, Belle Fourche anticipates that portions of the Phase III Project capacity may become available for use prior to the Phase III In-Service Date (Early Phase III Capacity) and that some shippers may wish to use this capacity. Therefore, continue Petitioners, in its *Pro Forma* Rules and Regulations tariff, Belle Fourche has proposed to allow any shipper that has made a reasonable request for service to use the Early Phase III Capacity until the Phase III In-Service Date, even if the shipper did not enter into a Belle Fourche T&DA for the Phase III Project capacity and notwithstanding that the Phase III Project is not entirely operational.

59. Additionally, Belle Fourche proposes that, during months when it receives more nominations for the Early Phase III Capacity than it is able to transport, the prorationing provisions applicable to its existing capacity will govern allocations of the Early Phase III Capacity to shippers. Petitioners state that these provisions provide for a typical "historical prorationing model."

---

[29] *Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,310, at P 38 (2007).

[30] Petition of Kinder Morgan Pony Express Pipeline LLC and Belle Fourche Pipeline Company for a Declaratory Order (August 17, 2012) Attachment A – Affidavit of John Eagleton at PP 24-25.

[31] *See, e.g., FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

60. Petitioners next explain that, following the Phase III In-Service Date, Belle Fourche proposes to use the Phase III Policy to allocate all of the Phase III Project capacity, including any Early Phase III Capacity. They state that Belle Fourche has specified in its *Pro Forma* Rules and Regulations that it will not use the shipment history accumulated by a shipper using the Early Phase III Capacity when administering the Phase III Policy after the Phase III In-Service Date. However, continue Petitioners, the tariff provides that Belle Fourche will use such shipment history for purposes of administering the prorationing procedures applicable to its Existing Capacity following the Phase III In-Service Date.

61. Finally, Petitioners state that, when the Phase III Project becomes operational, the Phase III Project capacity will be apportioned as a stand-alone pipeline for the protection of shippers that shipped on Belle Fourche prior to its Phase III In-Service Date. For this reason and to ensure that the availability of Phase III Early Capacity does not harm Committed Shippers, Petitioners emphasize that Belle Fourche will not allow the additional history accrued through use of the Early Phase III Capacity to apply to Phase III Project capacity following the Phase III In-Service Date. According to Petitioners, Belle Fourche must apply the limitations to shipments on the Early Phase III Capacity so that there will be no erosion of the benefits promised to Committed Shippers.

62. *Commission Analysis*. The Commission approves Belle Fourche's proposed interim prorationing methodology. It is in the public interest to provide access to additional capacity to transport crude oil from a region currently experiencing a shortage of available transportation capacity.

63. This proposal also protects the incentives promised to Committed Shippers by Belle Fourche as inducements for them to sign T&DAs for the Phase III Project capacity. When the Phase III capacity becomes operational, it will be apportioned as a stand-alone pipeline for the protection of shippers that shipped prior to the Phase III In-Service date, but the history established by the early shippers will not apply to the Phase III capacity following the in-service date.

I. Other Matters

64. Petitioners seek Commission action by November 30, 2012, so that they can complete the steps needed prior to actual construction of the facilities. Petitioners also maintain that the KMIGT application pending in Docket No. CP12-495-000 has no bearing on the merits of the issues to be determined in this proceeding.

The Commission orders:

The Petition for a declaratory order is granted, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

Document Content(s)