

147 FERC ¶ 61,266
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Tallgrass Pony Express Pipeline LLC

Docket No. OR14-25-000

ORDER ON PETITION FOR DECLARATORY ORDER

(Issued June 30, 2014)

1. On March 31, 2014, Tallgrass Pony Express Pipeline LLC (TPEP or Tallgrass Energy¹) filed a petition for a declaratory order (PDO or petition) requesting that the Commission approve a specified rate framework and the service terms and conditions, as well as an acquisition adjustment of \$105 million on the grounds that it meets the Commission's net benefits test. The petition concerns a significant expansion of TPEP's pipeline system into the oil producing areas of northeast Colorado (the Northeast Colorado Lateral, or NECL Project). The Commission approves TPEP's petition, as discussed below.

Project Details

2. The NECL Project represents a major expansion and extension of the facilities and services that were the subject of two previous PDOs granted to Kinder Morgan Pony Express Pipeline.² Kinder Morgan acquired El Paso Corporation's assets in June 2012, triggering a Federal Trade Commission antitrust order to divest its western gas assets; the divestiture was completed, to Tallgrass Energy, in November 2012.

¹ "Tallgrass Energy" denotes Tallgrass Energy Partners, LLC, which acquired and became the parent company of both TPEP and Tallgrass Interstate Gas Transmission, LLC.

² See *Kinder Morgan Pony Express Pipeline LLC*, 141 FERC ¶ 61,180 (2012) (*KMPXP I*) and *Kinder Morgan Pony Express Pipeline LLC*, 141 FERC ¶ 61,249 (2012) (*KMPXP II*).

3. TPEP designated the NECL Project to provide transportation for rapidly expanding production from the Niobrara Formation in Colorado. It comprises an aggregate design capacity of 90,000 barrels per day (bpd) that will enable transportation from Weld County, Colorado to an interconnection and operational storage at the TPEP mainline near Sterling, Colorado. The NECL Project includes approximately 55 miles of new 20-inch pipeline from the mainline to Buckingham, Colorado, and an additional 15 miles of new 16-inch pipeline from Buckingham to Pawnee, Colorado. Additionally, a new mainline connection will be located at the terminus of the Northeast Colorado Lateral at the TPEP Sterling pump station that will also provide shippers with operational storage from a new affiliated terminal at Sterling. The NECL Project adds approximately 2,300 of incremental horsepower associated with its Initial Project and 41,200 horsepower for five new mainline pump stations. The proposed NECL Project will increase overall system transportation capacity by approximately 40 percent, from approximately 230,000 bpd to 320,000 bpd, inclusive of walk-up shippers.

4. TPEP will lease crude oil storage to provide operational storage as part of its transportation service on the NECL Project and the mainline. TPEP states it requires operational storage to allow full use of the system capacity while maintaining the integrity of different quality grades of crude coming from both Guernsey, Wyoming, and the NECL Project. TPEP states an affiliate plans to construct 1.3 million barrels of storage capacity comprised of four 250,000 barrel tanks and two 150,000 barrel tanks for TPEP shippers' use. TPEP states it will lease any operational storage capacity required to provide jurisdictional transportation and will include those lease payments in its cost-of-service. TPEP states it is not seeking any rate making determination regarding the appropriate specific dollar amounts of such lease payments for inclusion in its cost-of-service. TPEP expects the cost of the NECL Project and associated mainline expansions to be approximately \$219 million, which does not include the affiliate investment in the Sterling terminal.

5. TPEP states the NECL Project addresses the need for pipeline capacity to move crude from the Niobrara Formation and other regional producing formations to refineries and market centers in the United States. TPEP anticipates the NECL Project will displace transportation by rail and truck and provide environmental and safety benefits. Moreover, it will increase the utilization of the potential capacity of the Pony Express asset downstream of the Sterling pump station.

Open Season

6. TPEP states that it held a successful open season November 1, 2013 through December 11, 2013. The open season offered shippers a volume commitment ramp-up option, with the caveat that an increase would not cause capacity available to walk-up shippers to fall below ten percent of the total system capacity. TPEP states its shippers contracted for a total of 77,580 bpd for a five-year initial term, with a one-time shipper

right to extend the contract for another five years. TPEP included a *pro forma* Throughput and Deficiency Agreement (T&DA) with its submission of its PDO.

Requested Rulings

7. Consistent with the precedent established by the Commission's order in *Express Pipeline Partnership*,³ Tallgrass Energy seeks advance approval for the rate framework, and the service terms and conditions of a financially significant project, in order to obtain regulatory certainty and to address issues outside the compressed timetable of normal tariff filings.⁴ TPEP requests the Commission approve elements of the Project as just and reasonable and not unduly discriminatory or preferential. The Commission addresses the T&DA elements below. TPEP also seeks approval of its acquisition adjustment.

Notice and Interventions

8. Notice of the Petition issued April 3, 2014. Interventions and protests were due April 30, 2014. Pursuant to Rule 214 of the Commission's regulations,⁵ 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.

Discussion

I. Treatment of Committed Rates as Settlement Rates

9. TPEP requests the Commission approve the initial Committed Rates and any subsequent adjustments of the Committed Rates pursuant to the Commission's indexing methodology, consistent with section 342.4(c) of the Commission regulations as settlement rates during the term of the T&DAs. TPEP states that under the proposal, the

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

⁴ TPEP cites, *e.g.*, *Shell Pipeline Co. LP*, 139 FERC ¶ 61,228 (2012) (*Shell*); *Skelly-Belvieu Pipeline Co.*, 138 FERC ¶ 61,153 (2012); *Sunoco Pipeline, L.P.*, 137 FERC ¶ 61,107 (2011) (*Sunoco*); *Enbridge Pipelines (North Dakota) LLC*, 133 FERC ¶ 61,167, at P 40 (2010); *CCPS Transp., LLC*, 121 FERC ¶ 61,253 (2007) (*CCPS Transp.*); *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).

⁵ 18 C.F.R. § 385.214 (2013).

Committed Shippers would pay agreed-upon Committed Rates during the terms of their T&DAs, subject to adjustment in accordance with the terms of the contract (including revisions contractually tied to indexation), government compliance cost increases, and further obligations as to pipeline loss allowance and potential surcharges.

Commission Determination

10. The Commission has approved similar requests in previous declaratory orders. As the Commission recently stated in *Seaway*, “although the Commission’s regulations do not provide specifically for negotiated initial rates with agreed-to future rate changes, the Commission has ruled that such contracts ‘are consistent with the spirit of section 342.4(c) of the Commission’s regulations.’”⁶ Accordingly, the Commission approves TPEP’s treatment of Committed Rates as settlement rates for the term of the T&DAs, consistent with Commission policy.

II. Provisions of the T&DAs Governing Committed Shippers’ Transportation Services during the Contract Term

11. TPEP asks the Commission to confirm the provisions of the T&DA, the accompanying *pro forma* Rules and Regulations, and the tariff rate structure will govern the rates and service for the Committed Shippers during the terms of their T&DAs, irrespective of the uncommitted rates. TPEP states that the request is similar to the requests approved in *MAPL*⁷ and *Seaway I*.

Commission Determination

12. The Commission confirms that the provisions of the T&DA will govern transportation services provided to Committed Shippers for the duration of the contract. The Commission previously approved similar requests for this type of assurance,⁸ and will also approve the like provisions for which assurance is sought in the instant PDO.

⁶ See *Seaway Crude Oil Pipeline Co. LLC*, 142 FERC ¶ 61,201, at P 12 (2014) (*Seaway II*), citing *Express Pipeline P’ship*, 76 FERC ¶ 61,245 at 62,258 (1996)

⁷ *Mid-America Pipeline Co., LLC*, 136 FERC ¶ 61,087, at P 9 (2011) (*MAPL*).

⁸ See *MAPL*, 136 FERC ¶ 61,087 at P 9; *KMPXP I*, 141 FERC ¶ 61,180 at P 22. See also *Seaway Crude Pipeline Co. LLC*, 142 FERC ¶ 61,201 (2013) (*Seaway I*). In *Seaway I*, the Commission specifically affirmed that the rate design embodied in the TSA to establish the rates for committed and uncommitted shippers “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” *Seaway I*, 142 FERC ¶ 61,201 at P 13. The Commission cautioned, however, that if an

(continued...)

III. Structure of Committed Rates

13. TPEP requests confirmation that the structure of the Committed Rates in the T&DAs, which are tiered with respect to term and volume, is just and reasonable and not unduly preferential. TPEP notes the Committed Rates vary with the size of a shipper's volume commitments. Namely, the greater the volume, the greater the discount relative to the rates applicable to lower volume Committed Shippers.⁹ TPEP states the Commission has long recognized that shippers committing to larger volumes may appropriately pay a discounted rate relative to those not committing to transport larger volumes, and argues the proposal falls well within Commission policy.

Commission Determination

14. The Commission finds the Committed Rate structure proposed in the instant PDO is just and reasonable, and should govern during the terms of the T&DAs. Since the *Express* decision, the Commission has recognized that shippers making greater volume and longer term commitments incur costs and liabilities and undertake risks that make them not similarly situated with shippers that do not make the same volume or term commitments.¹⁰ The Commission confirms that a discounted rate for larger committed volumes is well within Commission policy.¹¹

IV. Approval of Deficiency Payment Crediting Mechanism, Incremental Barrels Mechanism

15. TPEP requests Commission confirmation that the obligations of the Committed Shippers under the T&DAs with respect to their minimum volume commitments and payment commitments, including their obligation to pay deficiency payments, are lawful under Commission precedent. TPEP notes that the methodology of deficiency payments for which approval is requested is consistent with the PDOs that have been approved by the Commission in *KMPXP I* and *KMPXP II*.

16. TPEP explains that the first provision requires TPEP to create a deficiency payment account for each Committed Shipper, wherein it will book any deficiency payment the shipper makes to TPEP. TPEP states a second provision requires it to create

uncommitted rate is protested, the pipeline must comply with section 342.2(b) of the Commission's regulations to support such rate.

⁹ See Eagleton Affidavit at ¶ 16; T&DA at Exhibit B.

¹⁰ See *Express*, 76 FERC ¶ 61,246 at 62,254.

¹¹ See *Williams Pipe Line Co.*, 80 FERC ¶ 61,402 (1997).

an Incremental Barrels account for each Committed Shipper, wherein any payments made to TPEP for incremental barrels will be deposited. Finally, TPEP states a third provision provides that a Committed Shipper's barrels attributable to deficiency payments shall be included in that shipper's shipment history for that month for the purposes of administering prorationing.

17. TPEP states it designed the provisions to provide flexibility to any Committed Shipper that may have more or less crude oil to ship in a particular month than it had committed to ship in its T&DA. Further, TPEP states it intended the deficiency payment account provision to provide a means for a Committed Shipper to make up any volumes it could not ship due to a force majeure event, but for which it was nevertheless required to make a deficiency payment to cover. The provisions have certain limitations on what volumes can be used for purposes of calculating the Committed Shipper's shipment history and prohibits any double counting.

Commission Determination

18. The Commission finds the deficiency payment and incremental barrel mechanisms described herein are consistent with those approved in the previous two PDOs related to this project, and are therefore within Commission policy and precedent.

V. Approval of Extension and Ramp-Up Rights

19. TPEP requests Commission confirmation that the provisions in the T&DAs providing for an additional five-year term extension at the option of the shipper, and for "ramp-up rights," are just and reasonable, and not unduly discriminatory or preferential. TPEP states that a Committed Shipper may only make such an extension election if it extends the T&DA for the same five-year period, and the rates paid by each Committed Shipper will be adjusted to correspond to its obligation under the contract, inclusive of indexation and surcharges, if applicable.

Commission Determination

20. The Commission has previously approved contract extension and rollover rights in prior declaratory orders.¹² TPEP held an Open Season where all interested entities had notice of the contract extension provision in the T&DA. Additionally, the T&DA provides shippers with the ability to adjust to changing market conditions without being

¹² See *CenterPoint Energy Bakken Crude Servs., LLC*, 144 FERC ¶ 61,130, at P 35 (2013) (accepting TSA contract extension provisions); *KMPXP II*, 141 FERC ¶ 61,249 at PP 19-20 (approving the contract extension and related rights established in the T&DAs).

locked into a long term contract. The Commission finds the T&DA contract extension provision is not unduly discriminatory or preferential, and approves the provision.

VI. Acquisition Adjustment

21. TPEP states that after the PDOs were filed by Kinder Morgan in *KMPXP I* and *KMPXP II*, there were significant changes affecting the ownership, scope, and cost of the project now owned by TPEP. These changes prompt TPEP to seek assurance from the Commission concerning the recovery of certain additional costs in any proceeding regarding TPEP's cost-of-service support for its rates. TPEP states that after purchasing Kinder Morgan's proposed Initial Project on November 13, 2012, which included the purchase of the PXP Asset then in natural gas service along with the conditional contract rights to support the oil project, Tallgrass Energy fully assumed the material development risks of completing the conversion project. After purchase, Tallgrass Energy proceeded to secure from the Commission appropriate abandonment authority to terminate existing natural gas service, to construct new facilities to maintain the existing natural gas service, and to convert the PXP Asset from natural gas to oil service.

22. Tallgrass Energy states in accordance with the requirements of the Accounting Standard Codifications 805 (ASC 805), an acquirer must recognize any assets acquired, liabilities assumed, and any non-controlling interest in the acquirer at fair value as of the acquisition date within a year of the acquisition. Tallgrass Energy states the accounting requirement obligated Tallgrass Energy to allocate the acquisition adjustment among the accrued business units, and based on an independent evaluation, \$105 million of the acquisition premium paid by Tallgrass was assigned and recorded on the books of TPEP as of November 2013. TPEP notes that its \$105 million acquisition premium share represents approximately 8 percent of the total investment by Tallgrass Energy in the Initial Project and NECL Project, and only approximately 24 percent of the total acquisition premium.

23. Tallgrass Energy states it provided capital and secured the financing for the \$1 billion cost of the Initial Project. Tallgrass Energy also proceeded to substantially expand the Initial Project contemplated by Kinder Morgan, which originally targeted a minimum economic threshold quantity of 110,000 bpd of contract commitments and a maximum estimated capacity of 220,000 bpd. TPEP expanded initial capacity on the mainline of the Initial Project to 230,000 bpd, and then further expanded the project scope with its proposed NECL Project, to include transportation service from additional oil production areas, resulting in a total Project capacity of 320,000 bpd. Tallgrass Energy states that it was solely responsible for developing the NECL Project, which will increase mainline capacity by more than 40 percent above the capacity contemplated by Kinder Morgan. TPEP states it plans to commit an additional \$219 million to construct the NECL Project, in addition to an estimated \$1 billion required to complete the Initial Project, of which only \$3.3 million was expended by Kinder Morgan prior to the acquisition by Tallgrass Energy.

24. Tallgrass Energy asserts its acquisition of the PXP Asset and development rights to the Initial Project, and its subsequent decision to finance, construct, and proceed with an expanded project, will provide substantial benefits and value to shippers and to the country in terms of energy security, development, and transportation. TPEP asserts the Project will bring much needed pipeline access to Bakken, Niobrara and other production areas, relieve bottlenecks in pipeline capacity, and provide a needed alternative to rail and truck transportation.

25. TPEP requests that the Commission find that the acquisition premium paid by Tallgrass Energy meets the Commission's net benefit test and is therefore qualified and appropriate for rate recovery in TPEP's tariff rates.

Commission Determination

26. Under the benefits exception test laid out in *MoPSC*, the "exception to the rule disallowing acquisition premiums takes into account: (1) whether the acquired facility is being put to a new use; and (2) whether the purchaser has demonstrated specific dollar benefits resulting directly from the sale. FERC also considered: (3) whether the transaction at issue is an 'arm's length' sale between unaffiliated parties; and (4) whether the purchase price of the asset at issue is less than the cost of constructing a comparable facility."¹³

27. The Commission previously found that conversion of an oil line to a natural gas line is conversion to a "new use" for the purposes of the "benefits test,"¹⁴ and previously determined that the conversion costs of the PXP Asset in the instant project met the benefits test.¹⁵

28. Further, in *KMPXP I*, the Commission found that the conversion proposed by Kinder Morgan met the "benefits test," ruling the construction of a new pipeline far exceeded the sum of the costs of converting the PXP Asset to oil service. The Commission finds the significant costs savings of the PXP Asset is not changed by the proposed acquisition premium. TPEP states that, based on updated calculations, construction savings for the future oil pipeline at approximately \$290 million, demonstrating the specific dollar benefit from the sale as opposed to the costs TPEP

¹³ *Missouri Public Service Comm'n v. FERC*, 601 F.3d 581, 586 (D.C. Cir. 2010) (*MoPSC*).

¹⁴ *See Missouri Interstate Gas LLC*, 142 FERC ¶ 61,195 (2013) (*Missouri Interstate*).

¹⁵ *See KMPXP I*, 141 FERC ¶ 61,180 at P 57.

would have incurred had it built a new pipeline. Based on TPEP's assertions, the Commission finds TPEP has adequately shown the cost of purchasing and refitting the acquired facility to a new use was substantially less than the cost of constructing a comparable new facility.

29. As discussed above, Tallgrass Energy and Kinder Morgan have never been affiliates. The sale of the assets in question was a result of the Federal Trade Commission's antitrust approvals for Kinder Morgan's acquisition of El Paso Corporation.

30. The Commission finds that TPEP has met the net benefits test as discussed above. However, the Commission makes this determination based on the representations of TPEP in the instant petition. If any of the relevant circumstances relating to the acquisition adjustment change prior to the in-service date of TPEP, the Commission reserves the right to revisit the issue. The Commission expects that, when the initial rates are filed with the Commission prior to the Project's in-service date, TPEP's filing will validate and confirm the representations made in the PDO, and reflect no material changes in the acquisition adjustment representations described in the instant petition. Of course, should the rates be challenged, TPEP must support the acquisition premium to meet the net benefits test with appropriate evidence.

The Commission orders:

TPEP's petition is granted, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.