Shell Pipeline Company LP

ORDER ON PETITION FOR DECLARATORY ORDER

139 FERC ¶ 61,228 (2012)

In this case, Shell Pipeline Company LP (Shell) filed a petition for a declaratory order seeking a decision from the Commission approving, among other things, a rate and priority of service structure for essentially a project in which Shell reverses the east-to-west flow of heavy crude oil from origination points in Louisiana to refineries in the Houston area, so that lighter crude oil from regions as far away as the Bakken deposits in North Dakota and the Eagle Ford deposits in south Texas, could flow west-to-east from the Houston area to suitable refineries in Louisiana. Through its website, in March 2012, Shell launched a binding open season which permitted shippers to contract to commit to ship volumes of product at 3-year commitment and 5-year commitment rates which moved inversely to the amount of volumes that would be shipped (greater volumes lower per barrel rates). The 5-year rates were also lower than the 3-year rates for the same volumes shipped. Further, contract shippers paid a premium relative to non-contract shippers that was at least one cent higher, and the former as a class received up to 90 percent of the capacity on the reversed system with priority transportation during prorationing. A unique feature was that Shell proposed to rank order contract requests base on a net present value methodology. The Commission noted that the net present value methodology was commonly used by natural gas pipelines in their open seasons, and it approved the methodology for oil pipelines along with Shell's proposed rate and priority of service structure.

139 FERC ¶ 61,228
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.

Shell Pipeline Company LP Docket No. OR12-11-000

ORDER ON PETITION FOR DECLARATORY ORDER

(Issued June 21, 2012)

1. This order addresses Shell Pipeline Company LP's (Shell) March 30, 2012 petition requesting that the Commission issue a declaratory order approving Shell's proposed contract rates, proposed service priority rights and prorationing provisions for shippers, and its use of a net present value (NPV) methodology to allocate requests for contract capacity during its binding open season, for proposed transportation service from Houston, Texas to Houma, Louisiana and certain other destinations and origins. For the reasons discussed below, the Commission grants Shell's petition.

Background

2. The Houston-to-Houma Pipeline System (Ho-Ho) is owned and operated by Shell and is a batched system that provides both interstate transportation subject to the jurisdiction of this Commission and also intrastate transportation subject to the jurisdiction of the Texas Railroad Commission and Louisiana Public Service Commission. The Ho-Ho System is comprised of over 350 miles of pipe in two main flow patterns originating at Clovelly and Houma, Louisiana. The westbound segment is a 22 inch system to the Port Arthur, Texas area with a 360,000 barrel per day (bpd) capacity and a 20 inch system from Port Arthur to Houston with a 250,000 bpd capacity. The northbound segment is an 18 inch system to St. James, Louisiana with a 260,000 bpd capacity. The Ho-Ho System has multiple delivery points, including more than 15 delivery points serving major Gulf Coast refineries, and access to storage facilities at Houma and Erath, Louisiana, as well as in the Port Arthur area of Texas.

3. Shell plans to reverse its system to transport crude petroleum from Houston eastward to refineries in the Port Arthur and Louisiana markets.[1] Shell states that this Ho-Ho Reversal is driven largely by the recent and ongoing surge of light, sweet crude supplies into the Houston area market from shale plays in Texas and other western U.S. regions, as well as an influx of heavier Canadian production. Shell states that the proposed Ho-Ho Reversal would provide much-needed alternatives to shippers seeking access to markets for swelling North American sweet, light crudes now entering the Houston market. Shell states that Houston refiners tend to "prefer" heavier sour crude types while Louisiana refineries "prefer" sweeter, lighter crude types currently supplied by imports and declining production in the Gulf. Shell states that the Ho-Ho Reversal would provide pipeline access to supplies for the U.S. Gulf of Mexico refining complex from the following production areas: Eagle Ford, Bakken, Barnett, West Texas Intermediate, West Texas Sour, Canadian and other crudes originating in Texas and the mid-continent. Shell states that the Ho-Ho Reversal would create numerous benefits for shippers, including a pipeline alternative to barge transportation, access to significant storage in Louisiana, and a de-bottlenecking of the petroleum pipeline transportation network out of the Houston market, thus alleviating the potential for pricing differentials to develop between light crudes west and north of Houston. Shell states that potential shippers demonstrated considerable demand for the service in a non-binding open season held in the fall of 2011. On March 8, 2012, Shell launched a binding open season seeking shipper commitments for the current project.

4. Shell states that the cost of the Ho-Ho Reversal is expected to be over $100 million. Shell submits that the substantial capital costs of the reversal stem not only from the need to alter existing pump stations, but also from the need to engage in a large-scale replacement of sections of pipeline caused by the pressure dynamics of reversing the flow of the pipeline. Because of the demand for new pipeline capacity to export growing new supplies entering the Houston area during mid- to late-2012, Shell seeks to put the Ho-Ho Reversal into service in the first quarter of 2013, assuming that commercial and engineering considerations support that timeframe. To support this major investment, Shell requires firm, multi-year commitments by shippers. In turn, the shippers need assurance that they will be charged the agreed-upon contract rates and as well as certainty of access to capacity. Shell, therefore, seeks a declaratory order from the Commission that certain aspects of the proposed Ho-Ho Reversal project are lawful. The details of the proposal are discussed below. Shell plans to commence service by the first quarter of 2013. Because of the extensive pipe, pump, and valve-related work

---

[1] The entire system would not be reversed; transportation on the 18 inch line from Houma to St. James would continue without a change in direction, although that segment would be incorporated into the new rate structure.

required for the reversal, including substantial lead times for acquiring certain equipment, Shell submits that it needs to receive the requested declaratory order by the end of July 2012.

5. Shell first formally explored shipper interest through a non-binding open season held from mid-August through mid-October 2011. The significant level of response prompted further refinement of the proposed rates and services. On March 8, 2012, Shell launched a binding open season through a website with explanatory and contract documents for the proposed Ho-Ho Reversal Project. On March 30, Shell issued a notice on its website that the non-contract rates were being amended to reflect the rate structure presented in this petition. In addition to the usual features of such an open season, Shell has provided shippers with information about the manner in which requests for contract service will be allocated should the capacity requested in qualifying transportation service agreements (TSAs) exceed the proposed capacity of the Ho-Ho Reversal available for contract shippers, i.e., use of an NPV methodology to rank-order the contract requests. Under the procedures in the open season, binding requests for service were due by April 20, 2012. Shell filed its Petition for Declaratory Order on March 30, 2012, and on April 4, 2012, notice of Shell's Petition for Declaratory Order was published in the Federal Register with comments due April 20, 2012. No comments were filed, and the petition is unopposed.

Shell's Petition

6. Shell proposes to offer two types of shipper service on the Ho-Ho Reversal. Shippers may choose to use the regular, uncommitted, non-contract tariff service, which will be offered under the existing rules and regulations of Shell's tariffs (Uncommitted Shippers).[2] Alternatively, shippers may choose to enter into TSAs, under which they would contract to either ship or pay for stated quantities of crude petroleum, for a period of either 3 years or 5 years, subject to certain make-up rights (Committed Shippers or contract shippers). Contract rates are tiered, declining as the level of volume commitment and term length increases (minimum level, 10,000 barrels/day, highest volume category, 100,000 plus barrels/day).

7. Committed Shippers and Uncommitted Shippers would receive service under the same rules and regulations, except for prorationing, but under different rates. Committed Shippers would have priority rights during prorationing for their contract volumes in 90 percent of the capacity of the Ho-Ho Reversal. All nominations for non-contract volumes would be allocated by Shell's existing prorationing methodology (a historical

---

[2] Shell's relevant rules and regulations tariff is FERC No. S-120.3.0, and successor tariffs.

rolling 12-month average of actual movements). Volumes transported on the Houma to St. James segment (which is not being reversed) would not be subject to any priority contract rights in prorationing and would not experience any change in prorationing rules.

8. Shell states that contract shippers would pay the rates specified in the *pro forma* contracts. A premium payment by the lowest contract rate shipper is proposed relative to the base uncommitted rate. In other words, the contract shippers pay a premium relative to the rate applicable to Uncommitted Shippers for that volume tier. For example, as shown in the table below, for Route 1, the uncommitted rate would be 74 cents/barrel; the rate applicable to the 3-year contract meeting a minimum volume commitment of 10,000 to 24,999 barrels/day would be 80 cents/barrel, and the rate applicable to the 5-year contract meeting a volume commitment of 10,000 to 24,999 barrels/day would be would be 75 cents/barrel. In addition, for each level of contract rate volume commitment, the tariff will offer a discounted non-contract rate for a non-contract shipper meeting an equivalent volume for a given month. For Route 1, the rate applicable for the non-contract shipper that transports 10,000 to 24,999 barrels/day in a given month would be 73 cents/barrel. For the next level of volume commitments, the rate relationships remain the same: the 3 and 5 year contract rates are set at a premium of at least one cent higher than the rate applicable to an Uncommitted Shipper tendering the same volume commitment for a given month.

Route 1

	Non-contract rate ($/bbl)	**3 year contract rate ($/bbl)**	**5 year contract rate ($/bbl)**
N/A	0.74		
10,000-24,999	0.73	0.80	0.75
25,000-49,999	0.69	0.75	0.70
50,000-99,999	0.64	0.70	0.65
100,000+	0.59	0.65	0.60

9. Because the Ho-Ho Reversal project may be oversubscribed during the current open season, Shell plans to allocate contract capacity rights to shippers using a NPV methodology. Shell states that the shippers that will be allocated the capacity using the NPV methodology will be those that submitted contract requests with the highest values amongst all shippers seeking contracts, thereby demonstrating a stronger market need for the capacity. For purposes of calculating the NPVs of the requested contract volumes, Shell will use an annual discount rate of 7 percent.

10. Shell proposes to file both the non-contract rates and the contract rates for which approval is sought in this Petition shortly before the project is commissioned. The non-contract rates will be filed pursuant to the Commission's regulations for initial rates (18 C.F.R. § 342.2). All contract rates will be subject to indexing by non-negative

increases in the generic Commission oil pipeline index during the term of the contracts, and all volumes will be subject to a viscosity surcharge of 14.56 cents/barrel if the volumes have a viscosity greater than 130 centistokes at 60° F.

11. Shell specifically requests the following Commission declarations concerning the Ho-Ho Reversal project.

(1) That the terms of the TSA and the accompanying *pro forma* tariff rates and service terms for Committed Shippers are lawful, and that the stated contract rates will be the just and reasonable rates to govern the Committed Shippers' service during the terms of the TSA (including the Committed Rates set out in the *pro forma* contract, the agreed-upon escalation by the Commission's non-negative generic index during the contract term, and the viscosity surcharge).

(2) That Shell may provide up to 90 percent of the capacity of the Ho-Ho Reversal System for priority transportation of the contract volumes of Committed Shippers, as provided in the pro forma TSA and tariff language regarding prorationing.

(3) That Shell's proposal to allocate capacity among prospective Committed Shippers during the Open Season process, in the event that requests for contract rights exceed available capacity, may be done on the basis of a uniform, non-discriminatory NPV ranking of requests for contract rights, as described in Shell's Information Memorandum and the Affidavit of Geoffrey Gauthier.[3]

12. Shell asserts that it is appropriate for the Commission to issue a declaratory order as requested. Shell asserts that the Commission has long held that it has the authority to provide advance holdings via the issuance of a declaratory order under 18 C.F.R. § 385.207(a) regarding the lawfulness of rates and terms of service for proposed oil pipeline projects similar to the Ho-Ho Reversal project. Shell submits that the Commission first issued such guidance in a decision regarding *Express Pipeline Partnership*,[4] and has since repeatedly recognized the need for pipelines to obtain up-front regulatory approvals before undertaking major capital expenditures.[5] Shell

---

[3] Attached as Appendix A to Shell's Petition.

[4] *Express Pipeline Partnership*, 76 FERC ¶ 61,245, at 62,253, *order on reh'g*, 77 FERC ¶ 61,188 (1996) (*Express*).

[5] *See e.g.*, *Skelly-Belvieu Pipeline Co., L.L.C.*, 138 FERC ¶ 61,153 (2012) (*Skell-Belvieu*); *Sunoco Pipeline, L.P.*, 137 FERC ¶ 61,107 (2011); *Enbridge Pipelines (North Dakota) LLC*, 133 FERC ¶ 61,167, at P 40 (2010) (*Enbridge North Dakota)*; *CCPS Transportation, LLC*, 121 FERC ¶ 61,253 (2007) (*Spearhead)*; *Calnev Pipe Line LLC*,

(continued…)

contends that without regulatory certainty regarding the rates and terms of service for which approval is sought in this petition, the shippers will not be able to justify taking up the balance sheet and commercial burdens associated with the ship or pay commitment required by the TSAs; in turn, Shell would not be able to justify the expense of reversing the line at the cost of $100 million, as well as the other expenses and opportunity costs of the reversal.

13. Shell states that 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. Shell submits that the proposed Committed Rates fall within that well-established policy. Further, Shell states that since the decision in *Express*, the Commission has recognized that shippers making longer term commitments incur costs and liabilities and undertake risks that make them not similarly situated with shippers that do not make longer term commitments. Shell submits that here, as in *Express* and numerous later proceedings, the proposal calls for different classes of term shippers to pay differing rates depending on the length of term and the volume commitment. Shell asserts that term shippers agreeing to five year terms, rather than three year terms, present "unlike circumstances because the longer term commitments provide greater assurances than the shorter term commitments," and for the other reasons the Commission noted in *Express*. Consequently, Shell argues the Commission should find both that the contract rates are just and reasonable rates and should govern during the course of the TSAs, and that the Committed Rate structure is just and reasonable.

14. Shell asserts that the proposed priority, or firm, transportation rights are lawful under the Commission's policy. Shell submits that the Commission has approved such proposals when the applicant has shown that the project would create beneficial new capacity needed to serve growing or changing market needs, and that the project requires substantial capital investment which in turn calls for certainty of shipper commitments. Shell submits that the Commission has required pipelines in these circumstances to ensure that there is "a significant amount of capacity for Uncommitted Shippers." For a new pipeline service, the Commission has found that preserving at least 10 percent of the pipeline's capacity for Uncommitted Shippers, that have not signed a term contract, is sufficient. Shell asserts that this requirement is aligned with the Commission's broader policy regarding the allocation of capacity in prorationing, where the Commission has held that reserving 10 percent of a pipeline's capacity for "new shippers" (as opposed to shippers receiving allocations on the basis of historical volumes) is reasonable. Shell

---

120 FERC ¶ 61,073, at P 23 (2007); *Colonial Pipeline Co.*, 116 FERC ¶ 61,078, P 9 (2006); *Enbridge Energy Co., Inc.*, 110 FERC ¶ 61,211 (2005); *Plantation Pipe Line Co.*, 98 FERC ¶ 61,219 (2002) (*Plantation).*

submits that the Ho-Ho Reversal project has reserved 10 percent of the newly reversed pipeline's capacity for Uncommitted Shippers, which is consistent with the Commission's policies.

15. Shell asserts that the Commission has also approved priority rights for contract volumes when the applicant pipeline has held "open seasons [that] appropriately gave all potential shippers the opportunity to become Committed Shippers by entering into TSAs."[6] Shell contends that if all potential shippers are given a fair opportunity to enter into term commitments for contract obligations and associated priority rights, or to remain Uncommitted Shippers without any obligation to use the system or to pay for it, there is no undue discrimination when later the uncommitted volumes are not accorded the same prorationing rights. Shell states that it held a publicly-noticed, fair and transparent open season that meets the Commission's policy.

16. Shell argues that its tiered volume incentive rates are consistent with Commission policy. Shell states that shippers eligible for discounted rates on the basis of volume submitted are not similarly situated with shippers making either no commitment for a given month or shippers submitting lesser volumes – as the Commission has previously concluded.[7] Shell asserts that, among the contract shippers, shippers with the same volume commitment but different terms of contract length are also not similarly situated, and the Commission has previously held that longer contract terms may support lower rates on the grounds that these classes of contract shippers are not "similarly situated."[8] Shell submits that for each route and each level of volume commitment, therefore, the proposed tariffs provide "rates consistent with the obligations of each class of shipper,"[9] by ensuring that the Committed Shippers pay a premium relative to the rate due from an Uncommitted Shipper at an equivalent level of volume movements for a given month, and that Committed Shippers with shorter terms pay higher rates than those with longer terms with similar volume commitments.

17. Finally, Shell asserts that the use of an NPV methodology to allocate requests for service in the event of an oversubscribed open season is reasonable and non-discriminatory. Shell argues that a *pro rata* allocation approach would likely be unfair to shippers willing to make commitments of higher value than other shippers, and to the

---

[6] *Skelly-Belvieu* at P 18; *see also e.g.*, *Sunoco* at P 15.

[7] *Express*, *supra*, at 62,254.

[8] *See MAPL*, *supra*; *Plantation*, *supra*; *Williams*, *supra*.

[9] *Enbridge North Dakota* at P 40.

pipeline attempting to maximize contract utilization and to gain sufficient support to justify the commitment of large financial and other resources to introduce new pipeline capacity. Shell has reviewed the Commission's policies regarding the resolution of this issue as it arises in open seasons for natural gas pipeline companies subject to the Natural Gas Act (NGA), and submits that the Commission has the authority to adopt a similar approach in an oil pipeline context. Shell submits that the Commission has long approved the use of an NPV-based approach for allocating capacity in open seasons for natural gas companies, based on the conclusion that NPV was a non-discriminatory methodology that both allocated capacity to the party that valued it the most, as well as allowed the pipeline to ensure that the capacity was being allocated to those parties providing the greatest value to the system.[10]

18. Shell contends that although there are differences in a number of respects between the Commission's policies in administering the ICA and the NGA, in this respect the goal should be the same: allocation of oversubscribed capacity in an open season context in a non-discriminatory, transparent manner that allocates the contract rights to those parties that value them the most. Shell assets that the NPV methodology achieves this, while further ensuring that the pipeline grants contract rights to those shippers that offer to contribute the most to full utilization of the pipeline capacity. This approach is superior to other non-discriminatory approaches, such as strict *pro rata* allocation, which could leave the pipeline undersubscribed on some segments and would also fail to meet the allocative efficiency goal of directing capacity to those shippers that value it the most. Shell asserts that to ensure that the methodology is completely transparent and understood by potential Committed Shippers, it has provided the discount rate that it intends to use (7 percent) as well as a set of examples of different contract requests and how they would be assessed.

<u>Discussion</u>

19. In its petition for declaratory order Shell seeks three rulings with respect to the rates, and terms and conditions of service for its Ho-Ho Reversal Project. First, Shell

---

[10] *See e.g., Tenn. Gas Pipeline Co.*, 76 FERC ¶ 61,101, at 61,522 (1996), *order on reh'g*, 79 FERC ¶ 61,297 (1997), *order on reh'g,* 82 FERC ¶ 61,008 (1998), *remanded sub nom. Process Gas Consumers Group v. FERC*, 177 F.3d 995 (D.C. Cir. 1999), *order on compliance*, 91 FERC ¶ 61,333 (2000), *order on remand*, 91 FERC ¶ 61,053 (2000), *reh'g denied*, 94 FERC ¶ 61,097 (2001), *petitions for review denied sub nom. Process Gas Consumers Group v. FERC*, 292 F.3d 831, 837 (D.C. Cir. 2002) ("*Tennessee*") ("This [NPV] method allocates capacity to the shipper who will produce the greatest revenue and the least unsubscribed capacity. As such, it is an economically efficient way of allocating capacity and is consistent with Commission policy.").

requests approval of the rates, and terms and conditions of service for Committed Shippers as embodied in its TSA. Second, it requests approval for priority rights for Committed Shippers for up to 90 percent of the pipeline capacity. Finally, it seeks approval of an NPV allocation methodology in the event capacity is oversubscribed during its open season.

20. Consistent with the precedent established by the Commission's order in *Express,* Shell has sought advance approval for the rates, and terms conditions of a financially significant project in order to obtain regulatory certainty and to address issues outside the compressed timetable of normal tariff filings. Also, consistent with *Express* and its progeny, Shell has offered committed rates to all shippers in a widely publicized open season. Because all shippers had the opportunity to take advantage of competitive rates based on volume commitment and contract term, there is no issue of undue discrimination or undue preference among the resulting classes of shippers differentiated by contract term and volume commitment. Such shippers are not similarly situated by their own choices.

21. Shell's proposal for priority rights for Committed Shippers for up to 90 percent of the capacity is also consistent with Commission precedent. The preferential prorationing rights were offered during an open season, there is an appropriate amount of capacity (10 percent) made available to Uncommitted Shippers, and Committed Shippers are paying a premium rate, i.e., at least one cent higher, compared to Uncommitted Shippers.[11]

22. The only element of Shell's proposal that the Commission has not previously addressed with respect to oil pipelines is the use of an NPV allocation methodology in the event of oversubscribed capacity during the open season. As Shell has recognized, the Commission has approved the use of an NPV allocation methodology for open seasons for natural gas pipelines. The Commission finds that such an allocation methodology is also appropriate for allocating capacity in the event of oversubscription during an oil pipeline open season. Here, all potential shippers had notice of the use of the NPV methodology, including detailed examples of how the methodology would be implemented. There is no issue of discrimination because all shippers had the ability to determine how their contracts would be structured based on volume and term, and knew in advance what the impact of the contact terms would be for the purpose of evaluating their bid. The Commission finds that such an approach ensures full utilization of the capacity of the pipeline by those shippers that value it most and who provide the greatest

[11] *See, e.g., Sunoco, supra. Compare, Magellan Pipeline Company, LP,* 138 FERC ¶ 61,177 (2012) (rejecting proposal where the lowest level committed rate with priority rights paid the same rate as uncommitted shippers).

financial value to the system. The NPV methodology also avoids the possibility of certain pipeline segments being undersubscribed or underutilized, thus furthering the principle of allocative efficiency.

23. In sum, based upon the circumstances described in the petition and the representations made therein, the Commission finds that Shell's proposed rate structure and terms and conditions would be just and reasonable and would not result in undue discrimination or undue preference. Accordingly, the Commission grants Shell's petition for declaratory order, including the specific rulings discussed in P 11 above.

The Commission orders:

Shell's petition for declaratory order is granted, as discussed in the body of this order.

By the Commission. Commissioner Clark voting present.

Kimberly D. Bose,
Secretary.