

116 FERC ¶ 61,078  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;  
Nora Mead Brownell, and Suedeen G. Kelly.

Colonial Pipeline Company

Docket No. OR06-8-000

ORDER ON PETITION FOR DECLARATORY ORDER

(Issued July 20, 2006)

1. In this order, the Commission addresses a petition for declaratory order (Petition) filed by Colonial Pipeline Company (Colonial) on May 22, 2006. Colonial requests an order approving certain rate methodologies and granting other assurances with regard to a proposed mainline pipeline expansion. The Commission grants the essential elements of Colonial's Petition as discussed below.

**I. Background**

2. Colonial transports approximately 2.4 million barrels per day of refined petroleum products (including gasoline, distillate, kerosene and jet fuel) over a 5,519-mile system. Colonial's system runs from Houston, Texas to Linden, New Jersey in the New York harbor area. The Colonial system serves numerous refineries in the Gulf Coast region as well as consumer markets throughout the Southeast and Mid-Atlantic states. Colonial serves such major metropolitan areas as Atlanta, Washington, D.C., Baltimore, Philadelphia, and New York.

3. Shippers on the Colonial system include independent and major oil companies, airlines, trading companies, petroleum marketers and the Department of Defense. Colonial indicates that most of the shippers are not affiliated with Colonial.<sup>1</sup> All of the product shipped on the Colonial system is owned by the shippers.

4. Colonial explains that, in recent years, capacity on its system has become constrained, particularly during the summer driving and winter heating seasons. As a

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<sup>1</sup> Colonial is owned by subsidiaries of five energy companies: CITGO, ConocoPhillips, Chevron, Koch, and Shell. Companies related to these entities may also ship on Colonial.

result, Colonial has had to prorate capacity on its system during these periods. For example, Colonial indicates that in 2004, some movements on Colonial's mainline were prorated approximately 25 percent of the time.

5. The majority of the volumes shipped on Colonial originate from refineries between Houston, Texas and Collins, Mississippi. Colonial states that, at and immediately beyond Collins, the pipeline is operating at essentially full capacity. Colonial explains that barrels leave the system at points north of Collins, with the largest delivery point at Atlanta, Georgia. As a result of this usage pattern, the pipeline is most constrained between Collins and Atlanta. Colonial also states that, absent the expansion, the constraint point will move further southwest (upstream) to Baton Rouge, Louisiana.

6. Colonial expects that demand for capacity will continue to increase so that, within the next two to three years, the proration that now occurs on a seasonal basis will become a routine occurrence. Colonial also indicates that several Gulf Coast refineries plan to increase their refining capacity in the next few years by approximately 700,000 barrels per day.<sup>2</sup> Colonial explains that the growing demand, as well as the increase in refinery capacity, will impose new demands on the Colonial system that the current system will not be able to meet. Colonial states that, although alternatives to Colonial exist, such as other pipelines, barges, railroads and trucks, those alternatives are themselves already constrained or do not transport product as reliably or as cost-effectively as pipeline service.

7. Colonial indicates that it already has taken steps to increase capacity by adding pumping power and taking other measures to incrementally increase throughput short of adding new pipe. However, Colonial states that it has exhausted all of those incremental options and the only real option available to Colonial to reduce prorationing and meet the anticipated demand is to expand its pipeline system.

8. Therefore, Colonial proposes to expand its system by adding a 36-inch diameter pipeline from Baton Rouge, Louisiana to Atlanta, Georgia. The 500-mile pipeline would be constructed mainly in Colonial's existing right-of-way. Colonial indicates that the expansion will have a nominal capacity of 800,000 barrels per day, which amounts to a 30 percent increase in Colonial's system capacity. Colonial explains that, because most of the volumes it ships originate at refineries and connecting pipelines between Houston, Texas and Collins, Mississippi, an expansion between Baton Rouge and Atlanta will relieve the most constrained part of Colonial's system. However, Colonial also expects that the expansion will result in sufficient capacity to meet anticipated growth in markets beyond Atlanta as well. Further, Colonial explains that the expansion will provide Gulf Coast refiners with improved access to East Coast markets. Likewise, the expansion will provide those markets with greater access to alternative supplies in the Gulf Coast.

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<sup>2</sup> Colonial explains that two Gulf Coast refinery expansions already have added a total of 165,000 barrels per day of refinery capacity.

Colonial explains that the expansion will provide an additional measure of protection from disruptions that could otherwise result in price spikes and spot outages similar to those experienced during pipeline outages after Hurricanes Katrina and Rita. Colonial states that the expansion should be adequate to meet expected demand for as much as the next 20 years.

9. Colonial projects that the expansion, which will be the largest expansion on Colonial's system since it was constructed in 1962, will cost \$1 billion. Colonial states that, assuming construction commences no later than the third quarter of 2006, the expansion could be in service by 2010. Colonial indicates that, given the size of the investment and the uncertainty that may arise in constructing such a major expansion, the project carries more risk than the typical pipeline expansion. Colonial indicates that it cannot commit to such a significant investment only to find out after the project is completed that it would be worse off economically. Therefore, in its Petition, Colonial seeks assurances from the Commission that, at the time Colonial seeks to recover the cost of the expansion in its rates, Colonial will be permitted to recover the cost of the expansion using certain rate methodologies and will receive other requested treatment.

## **II. The Petition**

10. Colonial does not seek approval of a specific rate under which it would recover the costs of the proposed expansion. Instead, Colonial asks the Commission to pre-approve several elements of the rate framework under which Colonial would recover the costs of the proposed expansion, and to give other assurances. Colonial states that these rulings are necessary for Colonial to assume the significant risks associated with the proposed expansion and that the expansion will not be made absent these assurances.

### **A. Colonial Requests That Its Existing Grandfathered Transportation Rates Not Be Subject To Change As A Result Of The Expansion**

11. Colonial explains that its current transportation rates were in effect on the date of enactment of the Energy Policy Act of 1992 (1992 EAct).<sup>3</sup> As a result, the rates are grandfathered and may only be challenged upon a showing that, since enactment of the 1992 EAct, there has been a substantial change "in the economic circumstances of the oil pipeline which were a basis for the rate" or "in the nature of the services provided which were a basis for the rate."<sup>4</sup> Colonial states that its existing rates have been indexed

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<sup>3</sup> Section 1803(b) of the Energy Policy Act of 1992, Pub. L. 102-486, 106 Stat. 2772 (1992).

<sup>4</sup> *Id.*

in accordance with the Commission's regulations, but the rates have not been the subject of rate litigation since the enactment of 1992 EAct.<sup>5</sup>

12. Colonial proposes to apply the same grandfathered rate applicable to service over its existing facilities to service over the expansion facilities. Colonial also proposes to recover the cost of the expansion through the application of a charge to shipments over the existing and the expansion facilities.

13. In the Petition, Colonial asks the Commission to hold that Colonial's existing grandfathered transportation rate will "have no greater vulnerability to challenge under the 'substantial change in circumstances' test as the result of this expansion project than if the project were not undertaken." Petition at 9. Colonial asserts that "it is not in a position to undertake the required investment if the result would be to expose the existing rate to challenges that otherwise would have been precluded or at least greatly restricted by EAct." Petition at 11. Colonial states that it is "seeking assurance that its existing grandfathered rates will not be disturbed as a consequence of having undertaken the expansion or added [Uniform Rate Component] to the existing rates." Petition at 11. In sum, Colonial seeks assurances that it "will not face the unacceptable risk of being made financially *worse* off as a result of the expansion project." Petition at 12.

14. Colonial states that its request is analogous to the assurances given in *Plantation Pipe Line Company*.<sup>6</sup> Further, Colonial stresses that it does not seek special treatment because Colonial's grandfathered rates will remain subject to challenge under the 1992 EAct and the Commission's indexing regulations. Colonial asserts that its request is consistent with the policies underlying the 1992 EAct and the Commission's regulations. Petition at 12.

**B. Colonial Requests That It Be Permitted To Recover The Expansion Costs Through A Uniform Rate Component That Would Be Added To Colonial's Existing Transportation Rate**

15. Colonial asks the Commission for permission to recover the expansion costs through a Uniform Rate Component (URC) that Colonial would add to its existing rates for service on its mainline and stub lines, including the expansion line. The URC would be applied equally to all barrels that originate at Gulf Coast origins and are delivered to destinations beyond Baton Rouge.<sup>7</sup> Under this plan, shippers will pay the same rate

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<sup>5</sup> Colonial is also authorized to charge market-based rates for service to certain markets. *Application of Colonial Pipeline Company for Authority to Charge Market-Based Rates*, 95 FERC ¶ 61,377 (2001).

<sup>6</sup> *Plantation Pipe Line Co.*, 98 FERC ¶ 61,219 at 61,867 (2002).

<sup>7</sup> Colonial defines Gulf Coast origins to include origin points at Houston/Pasadena,

regardless of whether their barrels move on the existing facilities or the expansion facilities.

16. Colonial asserts that the Commission authorized the use of an incremental charge to recover the cost of a system expansion in a settlement agreement accepted in *Lakehead Pipe Line Company*.<sup>8</sup> Colonial otherwise argues that good cause exists for the Commission to waive its regulations to permit Colonial to recover the costs of its proposed expansion through an incremental adder. For example, Colonial explains that the Commission has indicated a desire to encourage appropriate innovative proposals as a means to provide incentives for infrastructure investment and that Colonial's incremental rate adder is just such a proposal.<sup>9</sup> Colonial also states that there is a clear public interest in expanding capacity in Colonial's service corridor and that allowing the URC mechanism will best ensure that added reliability that will result from the proposed project will be achieved.

**C. Colonial Requests The Commission To Authorize Certain Rate Methodologies To Calculate the Proposed URC**

17. Colonial proposes that it will calculate the URC under the methodology of Opinion No. 154-B, as interpreted and implemented, except as follows:

- Equally apply the URC to all barrels that originate at Gulf Coast origins and are delivered to destinations beyond Baton Rouge;
- Include only incremental construction and operation costs in the URC;
- Use a capital structure based on the weighted average of the debt-to-equity ratios of the parents of Colonial's shareholders;
- Use an equity return based on that capital structure, using an approach consistent with that applied by the Commission in other oil pipeline cases (that is, a discounted cash flow methodology using data regarding a proxy group of publicly traded oil pipeline companies), set at the upper end of the range of reasonable returns as determined by the formula used to determine the cost of equity for oil pipelines; and

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Texas; Beaumont/Port Arthur, Texas; Lake Charles, Louisiana; Baton Rouge, Louisiana; Collins, Mississippi; and Moundville, Alabama.

<sup>8</sup> *Lakehead Pipe Line Co.*, 85 FERC ¶ 61,397 (1998).

<sup>9</sup> Citing Federal Energy Regulatory Commission, *FY 2007 Congressional Performance Budget Report* (February 2006).

- Use an accelerated depreciation rate based, for cost of service purposes, on a 20-year life.

18. Colonial asks the Commission to determine now that the above-described methodology is appropriate so that when Colonial files the URC for approval it will not be at-risk that the methodology will be found to be improper.

19. Colonial states that the Commission has approved returns on equity (ROE) in the upper end of the “zone of reasonableness” in the past to foster increased exploration and development, to encourage the construction of gas pipelines, and to eliminate bottlenecks in the nation’s electric transmission grid.<sup>10</sup> Colonial argues that granting its request would be consistent with those prior cases because, just like the applicants in those cases, Colonial is proposing investment that will result in a more robust and reliable transportation system for a critical commodity.

20. Colonial notes that, as a common carrier, it does not enjoy any guarantee of the recovery of its capital costs. Thus, Colonial states that it will be totally at-risk for the costs of the proposed expansion.

21. Although Colonial does not seek approval of any specific rate at this time, it projects that, if the initial URC is calculated in accordance with the criteria set forth in the Petition, the URC will total less than one-half cent per gallon, or approximately 15 cents per barrel.

### **III. Notice and Comments**

22. The Commission issued a notice of the Petition on May 26, 2006 requesting intervention and comments be filed by June 16, 2006. Plantation Pipe Line Company (Plantation) filed a motion to intervene. The Air Transport Association of America, Inc (ATA) and Hunt Refining Company (Hunt) each timely filed a motion to intervene and protest. Both ATA and Hunt agree the new transportation capacity is needed. However, ATA and Hunt oppose the rate and other assurances that Colonial seeks. United Parcel Service (UPS), Mansfield Oil Company (Mansfield), the State of Louisiana, George E. Warren Corporation (Warren), QuickTrip Corporation (QuickTrip), and Vitol, S.A., Inc. (Vitol) filed comments in support of the Petition, but did not move to intervene.

23. ATA argues that, based on information from Colonial's FERC Form No. 6, Colonial is already over-recovering its costs under current rates and that the rates are not

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<sup>10</sup> *E.g.*, *Shell Oil Co. v. FPC*, 520 F.2d 1061, 1081 (5<sup>th</sup> Cir. 1975) (encourage increased exploration and development); *San Particio Pipeline, LLC*, 112 FERC ¶ 61,101 (2005) (foster construction of gas pipelines); and *Sierra Pacific Resources Operating Companies*, 105 FERC ¶ 61,178, *reh’g*, 106 FERC ¶ 61,096 (2004) (incentive ROE to eliminate transmission bottlenecks).

just and reasonable. ATA is concerned that, if the assurances that Colonial seeks in the Petition are granted, Colonial will only further over-recover its costs. For example ATA asserts that, even if the proposed expansion results in half of the anticipated 800,000 barrels per day in new throughput, Colonial's existing rates (based on 2004 data) will result in approximately \$70 million in over-recovery plus an additional \$120 million per year from the new, incremental throughput. The result, ATA argues, is an annual over-recovery above the current cost of service by approximately \$190 million. ATA notes that these rates would be subject to further increase under the Commission's indexing rules.

24. ATA states that another way to show that the assurances will allow Colonial to continue to over-recover its costs is to consider that, under the existing rate plus the proposed URC applied to all existing and new volumes, Colonial will earn approximately \$267 million per year in new revenues if the post-expansion capacity is only half of the anticipated 800,000 barrels per day.<sup>11</sup> ATA states that Colonial's proposals will allow it to pay for the expansion in a few years and yet still recover the URC after the cost of the expansion is paid off. ATA argues that, given the "massive over-recoveries" that Colonial already earns, the Commission should not allow Colonial to charge an incremental adder but instead should issue a show cause order directing Colonial to defend its existing rates. ATA asks that the show cause proceeding also be used to investigate Colonial's market-based rate authority on the grounds that Colonial's existing over-recoveries may indicate that Colonial can exercise market power.

25. ATA urges the Commission to deny Colonial's proposal that the expansion should not be treated as a "substantial change in circumstances," which might affect the status of existing grandfathered rates. ATA argues that the Commission cannot issue an order that is contrary to the applicable statutory authority, here the 1992 EPAct and the Interstate Commerce Act. ATA also argues that the grandfathered-rate-protection proposal is ambiguous because Colonial states the proposal would, on the one hand, continue to allow shippers to challenge Colonial's grandfathered rates as though the expansion had not occurred but, on the other hand, Colonial should not bear the risk of being financially worse off as a result of the expansion. ATA argues that *Plantation Pipe Line*, on which Colonial relies to support finding no substantial change in circumstances, is inapposite. ATA states that the expansion in *Plantation* was a spur owned by an affiliate of Plantation that was built to serve a new downstream market, and those facts are not useful when considering an expansion to increase volumes to serve existing markets as proposed by Colonial. ATA understands Colonial's request to shield its

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<sup>11</sup> The \$267 million is based on Colonial recovering \$120 million under the existing grandfathered rate for the new volumes resulting from the expansion plus approximately \$147 million earned from applying the URC to existing volumes and to new volumes.

grandfathered rates to mean that, even though the expansion will result in a 30 percent increase in volumes and significantly more revenue for Colonial, a shipper could not use these facts to mount a future challenge to Colonial's grandfathered rates under section 1803(b) of the 1992 EPAct. ATA also argues that "the Commission cannot provide grandfathered rate protection to volumes that do not currently exist and that currently cannot physically be transported on Colonial's existing system." ATA at 13.

26. With regard to the URC, ATA argues that the Commission has not allowed pipelines to charge an incremental rate to recover expansion costs.<sup>12</sup> ATA also argues that, because Colonial's rates vary depending on distance and/or location, a uniform "one size fits all" rate for recovery of the expansion costs is not appropriate.

27. ATA also argues that, until Colonial actually files its cost of service data, it is premature for the Commission to address Colonial's rate design methodology proposals. ATA argues that the requested assurances must be based on the cost data submitted by Colonial and the requested assurances cannot be provided until after the data are filed. Further, ATA argues that Colonial has provided no basis to support its request for a 20-year depreciation period. ATA argues that Colonial has failed to support its request to develop a return based on its parents' capital structure rather than on its own capital structure. ATA faults Colonial's proposal because it would establish a rate base and cost of service based on "year one." ATA argues that Colonial should propose an adjustment to the year one rate base to reflect the lower rate base and cost of service in the years following the in-service date of the expansion. Finally, ATA argues that Colonial has shown no reason why it should be assured of a return at the higher end of the range of reasonableness.

28. Hunt raises many of the same issues raised by ATA. Hunt objects to imposing the URC on every barrel that flows from Baton Rouge onward. Hunt explains that Colonial's rates vary by location and that a shipper that takes product on Colonial at Hunt's refinery at Moundville, Alabama and takes product off Colonial at Atlanta (approximately 200 mile haul) pays a lower rate than a shipper that takes product on the system at Houston and ships it to Atlanta. Hunt objects to having to pay the same incremental rate for the 200 mile haul as would a shipper making a much longer haul starting in Houston. Hunt asserts that applying the URC to a shorter haul would constitute a much larger percentage rate increase than imposing the URC on a longer haul. Hunt argues that the URC would increase the rate for a shipment from Moundville, Alabama to Atlanta by nearly 30 percent but that the URC would constitute a rate increase on a shipment from Houston to Atlanta by only 18 percent. Hunt argues that such a rate increase is permissible only if Colonial can show that its current rates are now too low to allow it to recover its costs. Hunt argues that Colonial's failure to

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<sup>12</sup> *Citing SFPP, L.P.*, 102 FERC ¶ 61,089 (2003).

develop a URC based on distance is contrary to long-standing Commission case law that requires pipelines to have distance-based rates to ensure that shorter-haul shippers do not pay more than their fair share of the pipeline's costs.<sup>13</sup> Hunt argues that the case law Colonial cited in its Petition does not support Colonial's proposal.

29. Hunt next argues that the only thing innovative about Colonial's proposal is the boldness of Colonial's request. For example, Hunt states that, even without the URC, the expansion will result in sufficient additional revenues to compensate Colonial for the cost of the expansion under existing rates. Hunt argues that adding the URC to all volumes on top of the existing grandfathered rate would result in excessive revenues for Colonial. Hunt also criticizes Colonial's request to use the composite capital structure of its parents, which Hunt asserts contains an equity ratio of 77 percent. Hunt explains that Colonial is a separate corporate entity with approximately \$1 billion of its own debt. Hunt further explains that there is no reason to believe that Colonial will finance the proposed expansion primarily with equity contributions from its owners. Hunt states that, if the Commission allows Colonial to develop the cost of service for the expansion using the hypothetical 77 percent ratio for purposes of computing return and taxes, Colonial will then be able to finance the expansion primarily with debt and generate outsized returns on the much smaller percentage of equity investment actually committed to the project.

30. Hunt objects to allowing a higher ROE for the proposed expansion. Hunt indicates that a higher ROE may be warranted if Colonial were required to use a 70 percent/30 percent debt-equity ratio. However, because Colonial seeks a rate based on 77 percent common equity, Colonial's real risk is greatly reduced. In addition, Hunt argues that Colonial really does not face increased risk from the expansion because Colonial is not seeking to recover its costs solely from new customers or from incremental expansion, but from increasing rates for all customers. Further, Hunt argues that, because Colonial itself states that the purpose of the expansion is to serve anticipated growth and that capacity will be tight for years to come, Colonial really faces no heightened risk to warrant an incentive return.

31. Finally, Hunt asks the Commission to direct the parties, pursuant to 18 C.F.R. § 343.5, to use alternate dispute resolution procedures to negotiate a rate structure that is consistent with Commission methodology and acceptable to all shippers.

32. UPS, Mansfield, the State of Louisiana, Warren, and Vitol each indicate that there is a need for the expansion project and that the proposed cost recovery mechanism is

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<sup>13</sup> *Citing Northern Natural Gas Co.*, 14 FPC 11, 24 (1955), *aff'd*, 236 F.2d 372 (8th Cir. 1956), *cert. denied*, 352 U.S. 967 (1957).

reasonable. UPS, Mansfield, Warren and Vitol indicate that they would be willing to pay the rate increase to ensure additional capacity.

33. On June 30, 2006, Colonial responded to ATA's and Hunt's comments. Colonial's answer goes primarily to defending the rate incentive elements of its proposal, and not the 1992 EPCRA provisions governing challenges to grandfathered rates.

34. Colonial began by noting that, although ATA and Hunt protest the Petition, they both favor the proposed expansion. Colonial reiterated its position that it "will not undertake this important project unless it is economically justified, and that the requested rulings are necessary to that end." Colonial Response at 2. Colonial also stated that the opposing comments overlook the important benefits that the expansion will provide and that the benefits would be lost if the requested rulings were not granted. Colonial notes that ATA and Hunt move less than 2.5 percent of the volume transported on Colonial.

35. Colonial argues that nothing in the Commission's regulations prohibit an oil pipeline's rates from exceeding the rate index ceiling. Colonial asserts that the Commission already has authorized oil pipelines to recover cost-based surcharges that were added on top of the pipeline's existing indexed rate for the purpose of recovering specific costs not contemplated by the index.<sup>14</sup> Colonial states that its proposed URC is not directly comparable to the surcharges allowed by that prior precedent, but that the prior precedent supports a finding that a cost-based charge can exceed the rate ceiling without violating Commission rate principles. Colonial argues that Order Nos. 561 and 561-A support the recovery of a cost-based increment. Colonial states that pipeline expansions would be inhibited if the Commission concluded that the URC and the grandfathered rate will result in a rate that exceeds the just and reasonable cost-based rate.

36. Colonial reiterates its need for the URC to apply equally to all barrels rather than be based on distance. Colonial explains that making the URC a mileage-based charge would likely engender adverse reaction from a larger group of shippers than the current two protesting shippers. Colonial argues that a mileage-based charge could disrupt the market because it would change the existing differential for all movements on Colonial's system. For example, Colonial states that the rate from Houston to Atlanta is \$0.8282 and the rate from Moundville to Atlanta is \$0.5128. The difference between the two rates is \$0.3154. Colonial explains that a uniform URC would not change the differential between the two rates. However, a mileage-based rate would change the differential between the two rates to a degree that "might have significant market repercussions." Colonial Response at 9. Finally, in response to arguments that the URC would lead to inflated revenues, Colonial commits that it will "calibrate" the level of the URC to

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<sup>14</sup> Citing *Chevron Pipeline Co.*, 115 FERC ¶ 61,117 (2006); *Extraordinary Expenditures Necessary to Safeguard National Energy Supplies*, 96 FERC ¶ 61,299 (2001).

recognize the revenue that will result from the increased volume yielded by the expansion.

37. Colonial argues that it is appropriate to allow the URC to be based on Colonial's parents' capital structures because Colonial is owned by five energy companies which have the ability to establish Colonial's debt and equity in any ratio that they see fit. Colonial states that, in such instances, the Commission has allowed use of the parent's structure rather than the pipeline's.<sup>15</sup> Colonial also argues that the Commission's order in *Kuparuk Transportation Company* expressly allowed use of a weighted average of the parents' capital structure.<sup>16</sup> Colonial reiterates that the weighted average today would result in a 71 percent equity ratio, but that the actual inputs for the ratio would be determined when Colonial sought to recover the URC.

38. Colonial again argued that a return at the upper end of the zone of reasonableness is warranted because of the risk inherent in the proposed expansion.

39. In response to arguments that Colonial is currently over-recovering revenue, Colonial states that those issues should be raised in another forum and not in the context of a Petition that would not affect any base rates. Colonial also notes that the grandfathered rate protection in the 1992 EPAct grandfathers rates rather than volumes or pipeline facilities. Therefore, Colonial states that ATA's claim that the Commission "cannot provide grandfathered protection to volumes that do not currently exist and that currently cannot be transported on Colonial's existing system" is simply wrong. Colonial argues that the validity of its existing rates should not be an issue in this proceeding and that the Petition seeks "an increment over and above the existing rates to pay for the expansion costs (net of revenue at the existing rates on expansion-enabled volume)." Colonial Response at 13. Colonial states that the validity of its underlying rates is a separate matter that has no bearing on the incremental cost of the expansion.

40. In response to ATA's argument that the proposed methodology is flawed because there is no mechanism for a rate reduction after year one, Colonial states that it is not certain that the cost of service will be the highest year one and that there are processes in place if a shipper believes that the URC has become too high. Colonial also reiterated its request for a 20-year depreciation schedule. Finally, Colonial stated that the Commission should not require settlement talks because Colonial already met with many shippers which indicated broad shipper support for the Petition, settlement discussions are not required in a Petition for Declaratory Order proceeding, and settlement negotiations will only delay the necessary approvals.

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<sup>15</sup> Citing Opinion No. 154-B, *Williams Pipe Line Company*, 31 FERC ¶ 61,377 at 61,836 (1985).

<sup>16</sup> *Kuparuk Transportation Co.*, 55 FERC ¶ 61,122 (1991).

41. Plantation filed a response to the comments of the State of Louisiana.

#### **IV. Discussion**

##### **A. Procedural Matters**

42. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2005), the unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.<sup>17</sup> The Commission's regulations do not permit answers to protests. 18 C.F.R. § 385.213(b) (2005). However, Colonial's answer to the protests assisted the Commission in making its ruling and, therefore, we will accept Colonial's answer to protests.

##### **B. The Expansion Will Ensure Reliability and Reduce Congestion**

43. Colonial proposes to make a major expansion of its system that is designed to assure the reliable transportation of refined products from the Gulf Coast region to growing demand in numerous eastern markets. Colonial has demonstrated that the expansion is needed, that the expansion will ensure the reliable transportation of refined product, and that the expansion will reduce congestion (i.e., occurrences of prorating). For example, in recent years Colonial has had to limit shipments on certain segments of its system during critical high demand periods, such as during the summer driving season and the winter heating season. Colonial indicates that by 2008 these periods of prorating will occur during most of the year. The fact that existing congestion will get worse unless the pipeline is significantly expanded supports the need for the expansion proposed by Colonial. Further, Colonial is used to ship gasoline and jet fuel to military installations throughout its market area. Enhancing reliability and reducing congestion to those destinations is important for national security purposes. Because the expansion will relieve a capacity "bottleneck" between expanding refinery capacity in the Gulf Coast region and downstream markets and thereby allow more product to be delivered to those markets, the expansion is also pro-competitive. Finally, all intervenors agree that additional capacity is needed, although they dispute the breadth of the assurances sought by Colonial.

44. The Commission has recognized the need for investment in energy transportation infrastructure, whether for electric power, natural gas or oil, to meet the nation's growing

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<sup>17</sup> Because UPS, Mansfield, the State of Louisiana, Warren, QuickTrip, and Vitol did not seek to intervene, they are not parties to this proceeding.

demand for energy.<sup>18</sup> Further, the Commission also has recognized that certain rate treatments, or incentives, are appropriate to encourage this needed investment in infrastructure. *See supra* n. 9. The project that Colonial proposes is the type of project the Commission finds is appropriate to encourage as a means to ensure reliable deliveries of competitively priced product to consumers. For these reasons, the Commission will generally grant the Petition as set forth below.

**C. The Commission May Address The Proposed Rate Issues Now Through A Petition for Declaratory Order**

45. ATA and Hunt argue that it is premature for the Commission to address the rate issues through a Petition for Declaratory order. They argue that the Commission cannot address the proposed rate treatments and assurances until after Colonial files the data necessary to support the proposed URC. The Commission disagrees. Section 554(c) of the Administrative Procedure Act provides that an agency, at its discretion, may issue a declaratory order to terminate controversy or to remove uncertainty.<sup>19</sup> The Commission has found that, in certain instances, it is useful to remove uncertainty regarding rate methodology issues prior to construction of a project and prior to the filing of proposed rates because the assurances facilitate financing and other investment decisions.<sup>20</sup> Indeed, the Commission has addressed similar rate issues for other oil pipelines through petitions for declaratory orders prior to construction of a facility or the filing of a rate.<sup>21</sup> In addition, the Commission stresses that it is not ruling on any specific rate in this order. When Colonial actually files to recover the cost of the expansion, it must submit cost and other data to demonstrate that the recovery component is consistent with this order as

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<sup>18</sup> *E.g., Shell Oil Co. v. FPC*, 520 F.2d 1061, 1081 (5<sup>th</sup> Cir. 1975) (encourage increased exploration and development); *San Particio Pipeline, LLC*, 112 FERC ¶ 61,101 (2005) (foster construction of gas pipelines); and *Sierra Pacific Resources Operating Companies*, 105 FERC ¶ 61,178, *reh'g*, 106 FERC ¶ 61,096 (2004) (incentive ROE to eliminate transmission bottlenecks).

<sup>19</sup> 5 U.S.C. § 554(c) (2000).

<sup>20</sup> *See, e.g., Plantation Pipeline Co.*, 98 FERC ¶ 61,219 (2002); *Embridge Energy Co., Inc.*, 110 FERC ¶ 61,211 (2005); *Western Area Power*, 99 FERC ¶ 61,306, *reh'g denied*, 100 FERC ¶ 61,331 (2002), *aff'd sub nom. Public Utilities Commission of the State of California v. FERC*, 367 F.3d 925 (D.C. Cir. 2004); *Michigan Electric Transmission Co., LLC*, 105 FERC ¶ 61,214 (2003); *American Transmission Company, L.L.C.*, 105 FERC ¶ 61,388 (2003); *ITC Holdings Corp.*, 102 FERC ¶ 61,182, *reh'g denied*, 104 FERC ¶ 61,033 (2003).

<sup>21</sup> *E.g., Plantation Pipeline Co.*, 98 FERC ¶ 61,219 (2002); *Embridge Energy Co., Inc.*, 110 FERC ¶ 61,211 (2005).

well as the Commission's other ratemaking principles. Thus, intervenors' concerns that the Commission is acting prematurely are misplaced.

46. We find that a show cause order with respect to Colonial's existing grandfathered or market-based rates is not warranted at this time. If a party can provide evidence that there has been a substantial change in circumstances to challenge the current grandfathered rates or that Colonial has market-power in markets where it is authorized to charge market-based rates, the party may file a complaint.<sup>22</sup> Further, we find that ADR would not be useful or appropriate at this point, although the parties are always free to meet for purposes of resolving their concerns.

#### **D. Colonial's Existing Grandfathered Transportation Rates**

47. Colonial's existing transportation rates are grandfathered. As a result, the rates cannot be challenged unless there has been a "substantial change" after the enactment of the 1992 EPAct "in the economic circumstances of the oil pipeline which were a basis for the rate" or "in the nature of the services provided which were a basis for the rate . . ."<sup>23</sup>

48. Colonial seeks assurance that the Commission will not treat the proposed expansion, including the recovery of the URC, as a "substantial change in circumstance," that would trigger a review of Colonial's grandfathered rates. Colonial wants an assurance that "its existing grandfathered rates will not be disturbed as a consequence of having undertaken the expansion or added [Uniform Rate Component] to the existing rates." Petition at 11.

##### **1. Substantial Change in Circumstances Under Section 1803(b)**

49. The Commission addressed the "substantial change in circumstances" issue at length in Opinion No. 435.<sup>24</sup> In that series of orders, the Commission held that any party

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<sup>22</sup> ATA's reliance on *Public Service Commission of New York v. National Fuel Gas Supply Corp*, 115 FERC ¶ 61,229 (2006) to support its argument for a show cause order is misplaced because the investigation initiated in that proceeding was the result of a complaint.

<sup>23</sup> Section 1803(b) of the Energy Policy Act of 1992, Pub. L. 102-486, 106 Stat. 2772 (1992).

<sup>24</sup> *SFPP, L.P.*, Opinion No. 435, 86 FERC ¶ 61,022 (1999), *reh'g*, Opinion No. 435-A, 91 FERC ¶ 61,135 (2000), *Order on Clarification and Rehearing*, 97 FERC ¶ 61,138 (2001), *rev'd in part, BP West Coast Products, L.L.C. v. FERC*, 374 F.3d 1263 (D.C. Cir. 2004), *Order on Remand*, 111 FERC ¶ 61,334 (2005).

challenging a grandfathered rate must provide evidence to the Commission of a substantial change in the economic circumstances of the pipeline which were a basis for the rate. The change may not be merely “material,” it must be “substantial.”<sup>25</sup> The Commission also held that the justness and reasonableness of the rate in question is not relevant in making a determination of whether a complainant has established that there are “substantially changed circumstances.” Based on its prior decision in *Santee Distribution Co. v. Dixie Pipeline Co.*, in Opinion No. 435 the Commission held that it is possible that a challenged rate might not be just and reasonable if the Commission were to examine it without the presence of the jurisdictional threshold, but the statute would bar such an examination.<sup>26</sup> The Commission explained that, even if the level of a challenged rate might be reduced if the statutory threshold were met, reasonableness may not be determined unless the complainant first establishes that there has been a substantial change in the economic circumstances that are a basis for the rate.<sup>27</sup> The Commission has held that a change in volumes, revenue, cost of capital or other factors may provide a basis to demonstrate a substantial change in the economic circumstances has occurred.<sup>28</sup> However, the mere addition to rate base or increase in volumes does not necessarily constitute a “substantial change in circumstances.” A complainant must demonstrate that those changes resulted in a substantial change in the economic circumstances that formed a basis for the grandfathered rate.<sup>29</sup> Finally, section 1803(b) of the 1992 EAct grandfathers *rates*, not volumes that were transported as of enactment of 1992 EAct or pipeline facilities that were in service as of that date.

## **2. Decision Regarding the Grandfathered Rate Issue**

50. The Commission will allow Colonial to charge the grandfathered rate for shipments over the expansion line. Colonial indicates that the purpose of the expansion is to meet existing and new demand, not to transport a new product or to provide new services. A grandfathered rate may be applied to volumes shipped over new facilities where there is no change in service or a change in the types of product being transported. *See, e.g., BP West Coast Products LLC v. FERC*, 374 F.3d 1263, 1272-73 (D.C. Cir. 2004).

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<sup>25</sup> Opinion No. 435 at 61,065 (“The Commission finds that the ALJ was correct in concluding that a “substantial” change is a more rigorous test than a “material” change.”).

<sup>26</sup> *Santee Distribution Co. v. Dixie Pipeline Co.*, 75 FERC ¶ 61,254 (1996).

<sup>27</sup> Opinion No. 435 at 61,065.

<sup>28</sup> *Id.* at 61,067.

<sup>29</sup> *Id.* at 61,067-068.

51. We also hold that the mere act of charging grandfathered rates to incremental volumes created by an expansion of Colonial's mainline system does not constitute a "substantial change in circumstances of the oil pipeline which were a basis for the rate" or "in the nature of the services provided that were a basis for the rate" to trigger a review of Colonial's existing grandfathered rates under section 1803(b) of 1992 EPAct. The rate that Colonial proposes to maintain and use was in effect as of the enactment of the 1992 EPAct and Colonial's proposal here does not, by itself, constitute a substantial change in the circumstances which justified the rate or in the nature of the service provided. Thus, Colonial need not defend the use of its existing grandfathered rates simply because of the expansion.<sup>30</sup>

52. However, the Commission is concerned that Colonial's approach may result in an over-recovery of revenue in an amount that could call into question Colonial's grandfathered rates. As ATA and Hunt point out, Colonial proposes to include all incremental construction and operation costs in the URC and to equally apply the URC to all barrels that originate at Gulf Coast origins and are delivered to destinations beyond Baton Rouge. Colonial also proposes to apply its grandfathered rate to all expansion volumes. In its response to the protests, Colonial states that it recognizes that the revenue to be realized from the URC as proposed has two components, the URC itself and the revenue that will result from the "increased volume yielded by the expansion." Colonial Response at 9. Therefore, Colonial commits that it will recognize both the sources of revenue in "calibrating" the final URC. The Commission reads this commitment to mean that the revenue that Colonial will earn by charging its grandfathered rate for all of the volumes shipped over the expansion facilities will be accounted for in the design of the URC. Therefore, consistent with Colonial's commitment, the Commission will permit Colonial to establish a URC to recover its expansion costs so long as, in calculating the URC, Colonial subtracts the revenues earned by applying the existing rate to the volumes transported over the expansion.

53. These rulings do not leave shippers unprotected. As Colonial indicates in its Petition, the grandfathered rates will remain subject to complaint under the "substantial change in circumstances" standard. Thus, shippers will have no less right or ability to challenge those rates once the expansion is completed than they do today. Likewise, we hold that the URC designed to recover the net unrecovered expansion costs, whether collected for shipments on the existing or the expansion facilities, will not be

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<sup>30</sup> See, e.g., *SFPP, L.P.*, 80 FERC ¶ 63,014 at 65,194 (1997 (an increase in volumes of up to 43.20 percent in and of itself did not satisfy the substantial change in circumstances standard – the complainant must show how the increase in volumes resulted in a substantial change in the economic circumstances which were a basis for the rate), *aff'd*, 86 FERC ¶ 61,022 at 61,067 (1999), *reh'g*, 91 FERC ¶ 61,135 (2000); *BP West Coast Products, LLC v. FERC*, 374 F.3d 1263 (D.C. Cir. 2004) ), *Order on Remand*, 111 FERC ¶ 61,334 (2005).

grandfathered. Further, a complainant can continue to challenge any changes due to indexing of the rates charged for shipments on the existing pipeline and the expansion pipeline without having to satisfy the requirements of section 1803 of 1992 EPAct. Finally, this order does not prejudice any complaint that may be filed in the future, as economic and service-related circumstances may develop. Thus, the Commission's action here is fully consistent with the 1992 EPAct.

**E. Colonial Will Be Permitted To Recover Net Unrecovered Expansion Costs Through A Rate Component Included In The Rates Charged On All Shipments Originating In The Gulf Coast Region For Deliveries To Destinations Beyond Baton Rouge, LA**

54. As explained below, we will permit Colonial to recover the costs of its expansion project through a combination of its grandfathered rates and a URC that will be applied to all barrels that originate at Gulf Coast origins and are delivered to destinations beyond Baton Rouge, Louisiana. We believe that this approach, subject to our discussion in paragraph 51 of this order, is a reasonable means to allow Colonial to recover the costs of the expansion. We will authorize Colonial to file for and recover through a URC the net cost of service associated with its expansion not recovered through the use of its existing grandfathered rates.

55. Hunt and ATA argue that Colonial should not impose the URC on every barrel from Baton Rouge onward. We disagree. Colonial's system is most constrained between Collins, Mississippi and Atlanta, Georgia. Relieving the constraint between these two points will assure increased capacity not only between these two points but also downstream of that "bottleneck." In addition, Colonial explained that, absent the expansion, the bottleneck will extend upstream to Baton Rouge. Thus, the expansion will relieve congestion not only for shippers between Collins and Atlanta but for all shippers beyond Baton Rouge. These facts indicate that the shippers that will most benefit from Colonial's expansion will be those that transport product downstream from Baton Rouge. Therefore, we will allow Colonial to propose to recover the net cost of the expansion by a charge on all barrels that originate in the Gulf Coast region and that are delivered to destinations beyond Baton Rouge.

56. ATA argues that the Commission's order in *SFPP, L.P.*, 102 FERC ¶ 61,089 (2003), mandates that Colonial roll-in the expansion costs to the existing rates rather than recover the costs through an incremental charge. The Commission disagrees. In *SFPP*, the pipeline sought to roll-in the expansion costs with its existing rates and intervenors argued that the costs of the expansion should be recovered through an incremental charge imposed only on new shippers. In that proceeding, the Commission concluded that it would be inconsistent with Commission policy and the anti-discrimination provisions of the Interstate Commerce Act to impose a separate incremental rate only on new shippers. *Id.* P 18. In this proceeding, Colonial proposes to impose the same charge on all shippers. Thus, this proceeding does not raise the concerns addressed in *SFPP*.

57. Hunt and ATA argue that the URC should not be applied in a uniform fashion but instead should be applied based on the distance of each shipment, just like Colonial's existing transportation rates are applied. We will accept Colonial's request for uniform application of the URC. As Colonial explained, application of the URC in a uniform manner would maintain the existing rate differentials for all movements on the Colonial system. Colonial indicated that changing the existing differentials could have significant market repercussions. We believe that Colonial's proposal is a reasonable means to avoid those repercussions.

58. The Commission finds that the extent of the costs to be included in the surcharge<sup>31</sup> should be addressed when Colonial actually files the cost of service data to collect the rate. Further, to the extent not otherwise addressed in this order, Colonial will be required to address any other issues at that time regarding the data and methods used to calculate its proposed surcharge.

**F. Rate Methodologies**

**1. Rate of Return**

59. In Opinion No. 154-B, the Commission made clear that "the equity rate of return should be determined on a case-specific basis with reference to the risks and corresponding cost of capital associated with the oil pipeline whose rates are in issue."<sup>32</sup> We believe that a number of factors support Colonial's request for an ROE toward the upper end of the zone of reasonableness. For example, the length and scope of the project will present substantial challenges, even if Colonial is able to site the expansion mainly in the existing right of way. The project also requires an enormous investment, and thereby presents financing challenges not faced by the ordinary upgrade. The size of the investment, the challenges of constructing a multi-state project, and the time for completion of the project (four years) all support the request for an ROE toward the upper end of the range of reasonableness. Finally, Colonial has no obligation to expand its system but has voluntarily chosen to build major new facilities, with no guarantee that the throughput would be fully used.

60. However, we are not determining any particular ROE in this docket. Rather, Colonial must propose and support a particular ROE when it submits its cost of service to implement the URC.

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<sup>31</sup> Colonial proposes that the expansion rate component include only incremental construction and operation costs. Petition at 14. The Commission grants that request. However, Colonial will be required to demonstrate that the expansion rate component when filed, truly only includes incremental construction and operation costs.

<sup>32</sup> *Williams Pipe Line Co.*, Opinion No. 154-B, 31 FERC ¶ 61,377 at 61,836 (1985).

## **2. Use of Parents' Debt-Equity Ratios**

61. Colonial asks to be permitted to use the weighted average of its owners' debt-equity ratios rather than its own debt-equity ratio. Colonial explains that "use of its parents' capital structure is of critical importance for Colonial to gain the necessary support for the expansion from its Board of Directors." Petition, Exhibit C, P 5.

62. Colonial has indicated at the present that the weighted capital structure of the parent group is 71 percent equity and 29 percent debt. Petition at 8. This ratio is at the extreme of what we have approved in the past. We also recognize that this ratio might change by the time we are actually called upon to approve a ratio. We find that the Commission will impute the parents' capital structure if it is shown to be reasonable at that time in light of the unique circumstances of Colonial's capital structure and Commission precedent.

## **3. Accelerated Depreciation**

63. Colonial requests that expansion facilities be subject to a 20-year depreciation life. However, Colonial has not supported the requested 20-year depreciation rate or explained why this proposal is necessary to foster the proposed investment. Therefore, the Commission denies Colonial's request for a 20-year depreciation life for the expansion facilities at this time. Colonial may again request the 20-year depreciation at the time it files its cost of service for the expansion charge. However, Colonial will need to demonstrate that the depreciation rate requested is based on the projected economic or physical life of the proposed expansion.

## **V. Conclusion**

64. We issue this order based on the facts presented by the Petition. If any of the facts supporting the Petition change, Colonial must make a filing with the Commission to determine whether the ruling provided in this order would still be applicable.

65. Finally, this declaratory order does not approve any specific rate for recovery of the expansion costs. The declarations in this order are based on the condition that Colonial will, under typical rate filing requirements and consistent with Order No. 154-B, file a cost of service and adequate support for the level of the rate component it will seek to impose prior to imposing the component.

### **The Commission orders:**

(A) The declarations requested in Colonial's Petition are granted as set forth in the body of this order.

(B) ATA's request to direct Colonial to show cause why its rates should not be reduced is rejected.

(C) Hunt's request that the Commission initiate settlement talks under the Commission's alternative dispute resolution procedures is denied.

By the Commission.

( S E A L )

Magalie R. Salas,  
Secretary.