New Developments in Pipeline Expansions: Executing the Deal

Presenters:

Joe Graham, Nustar

Chris Barr, Post & Schell

Michael Webb, REG

Bill Williams, Sidley Austin

ASSOCIATION OF OIL PIPE LINES
2011 ANNUAL BUSINESS CONFERENCE
WESTIN DENVER DOWNTOWN
DENVER, CO
September 15, 2011

Format of the Presentation

- Our panel will present a mock session involving an in house business development executive and his in house lawyer discussing a new project with company counsel, outside counsel and a regulatory consultant

- The project is a new Greenfield pipeline, including potential later expansion and the legal/ regulatory issues associated with each, in light of recent Commission orders and policies.

The Role Players

- Joe Graham as the business development executive
- Bill Williams an in-house lawyer
- Chris Barr as an outside lawyer
- Michael Webb as a regulatory consultant

The Project

- A massive deposit of crude oil, trapped in shale, has been discovered in Appalachia.
- Megadyne has announced that it will expand an existing refinery in Washington D.C.
- Currently Megadyne supplies the refinery by rail and barge transportation of 50,000 barrels per day.
- The refinery will require 100,000 bpd post-expansion.
- The pipeline will be named the Megadyne Appalachian Refinery Value Enhancement Line ("MARVEL").
- An anchor shipper has committed to 25,000 bpd.
- MARVEL will provide an alternative mode for Megadyne and other producers and an expanded source of supply for the refinery.

MARVEL Project Basics

- MARVEL will cost approximately $1 billion to construct, expand or extend.
- MARVEL will cost $50 million per year to operate.
- Commercially viable rates must produce returns that meet internal hurdle rates.

Key Preliminary Business Decisions and Legal Parameters

Building "On Spec"

- Advantages of a 50,000 bpd pipeline ?
- Disadvantages of a line smaller or larger?

Shipper Affiliate Funding of the Project

- Advantages?
- Disadvantages?

Finding Additional Anchor Shippers

- Advantages?
- Disadvantages?

Creating Different Classes of Customers

- Is it “undue discrimination” to treat different shippers differently?
- If one group of shippers funds the pipeline should they receive different terms of service?
- What might these different terms of service look like?

Ensuring Anchor Shipper Access: Different Options

- **Firm or Priority Service – unapportioned access**
  - Can oil pipelines provide firm/priority service?
  - Under what circumstances has the FERC allowed oil pipelines to provide firm service?
  - What principles and facts have persuaded FERC to allow firm service and how much?

- **Historic Volume-Based Allocation, with "new shipper" set-aside**
    - Benefits and Problems
    - Recent Orders

- **Leasing**
    - Benefits, Disadvantages and Limitations

- **"Private Pipeline" Option?**

Other Key Legal Planning Issues

- **Setting up the terms of the Transportation Service Agreements**
  - Contract rates
    - May shippers who provide commitments receive a discount?
    - Do all the discounts or benefits of committed shippers need to be in the FERC tariff?
    - Can the spot rates be require to be higher or lower than the contract rates?
    - Open seasons – What is required? What are the advantages?

- **TSA term issues**
  - Throughput agreement terms
  - MFN clauses
  - Rollover and evergreen issues.
- **Storage options and issues**
  - Should the pipeline offer storage service at the destination?
  - How else could it be structured?

Procedural Issues

- **Declaratory Order**
  - Is it necessary?
  - What are the options?
  - What is the effect?
  - What is the likely timeframe?
- **What happens if someone challenges the uncommitted rate after the pipeline is constructed and the first tariff is filed?**

Appendix

Useful Orders and Other Materials Relevant to the Discussion Topics

Creating Different Classes of Customers

Ensuring Anchor Shipper Access:
Different Options

Firm or Priority Service – unapportioned access

Belle Fourche Pipeline Co., 28 FERC ¶ 61,150, at 61281 (1984) (*citing The Pipe Line Cases* in stating that oil pipeline companies are common carriers under the statute)

Enbridge Pipelines (North Dakota) L.P., 133 FERC ¶ 61,267 (2010) (order approving priority prorationing rights for contract shippers, and explaining the current criteria, see esp. P 39-40)

TransCanada Keystone Pipeline, L.P., 125 FERC ¶ 61,025 (2008) and *Enbridge (U.S.) Inc*., 124 FERC ¶ 61,199 (2008) (orders declining to approve priority rights in prorationing for contract shippers in light of the circumstances)

Historic Volume-Based Allocation, with "new shipper" set-aside

Platte Pipe Line Co., 117 FERC ¶ 61, 296 (2006) (accepting a change from pro rata to historic volume based allocation during prorationing and discussing the operation, merits and precedents for volume-based allocation)

See Transmittal Letter, *Enbridge Pipelines (North Dakota) LLC*, Dkt. No. IS11-299-000, dated April 15, 2011, illustrating the potential problems arising from "new shipper" provisions; the letter states "[t]o demonstrate the prorationing issue on the system, there are currently 211 approved shippers, 196 of which nominated a total of *32,569,512* bpd for transportation in April 2011, while the total system capacity is only *185,000* bpd" (Emphasis added))

See Bridger Pipeline LLC, 135 FERC ¶ 61,188 (May 27, 2011) (order accepting escalating penalties to address shipper efforts to game the proration process)

Leasing

Western Refining Southwest, Inc. v. TEPPCO Crude Pipeline, LLC, 125 FERC ¶ 61,053 (2009) (illustrating FERC's approach to leases in the context of a complaint by a lessee against a lessor)

"Private Pipeline" Option

Hunt Refining Co., 70 FERC ¶ 61,035 (1995) (denying a request for determination that a pipeline supplying a refinery with crude oil was non-jurisdictional)

Texaco Refining and Marketing, Inc. v. SFPP, L.P., 80 FERC ¶ 61,200 (1997) (reversing an Initial Decision that had concluded a pipeline facility was non-jurisdictional, broadly reviewing precedents)

Tesoro Refining and Marketing Company and Tesoro Logistics Operations, LLC, 135 FERC ¶ 61,116 (2011) (finding that certain pipeline spurs attached to a refinery were not jurisdictional)

Setting up the terms of the Transportation Service Agreements

Discount policy: (1) discounts are permitted for contract shippers making commitments, see generally *Express Pipeline Partnership*, 75 FERC ¶ 61,303, *order on reh'g*, 76 FERC ¶ 61,245 (1996), Enbridge Energy Company, Inc., 110 FERC ¶ 61,211 (2005); and (2) discounted rates for contract shippers seeking priority rights during prorationing are not, under current FERC policy, likely to be approved with the requested priority rights. *TransCanada Keystone Pipeline, L.P*., 125 FERC ¶ 61,025 (2008) and *Enbridge (U.S.) Inc*., 124 FERC ¶ 61,199 (2008).

TSA content issues: Pro forma Transportation Service Agreements were filed and discussed in by the petitioners in the following declaratory order proceedings (among others): the initial Spearhead petition for declaratory order (Dkt. No. OR05-1), the subsequent Spearhead petition for declaratory order (Dkt. No. OR07-17), the Southern Lights petition for declaratory order (Dkt. No. OR07-15) and in the White Cliffs petition for declaratory order (Dkt. No. OR08-8).

Storage options and issues

TE Products Pipeline Company, LLC, 130 FERC ¶ 61,257, *order on reh'g*, 131 FERC ¶ 61,277 (2010) (accepting tariffs canceling terminaling services and discussing the limited scope of FERC jurisdiction over terminal service after delivery by the pipeline)

Procedural Issues

Declaratory Order

Express Pipeline Partnership, 75 FERC ¶ 61,303, *order on reh'g*, 76 FERC ¶ 61,245 (1996) (issuing first declaratory order in advance for a new oil pipeline project)

See also, *Enbridge (U.S.) Inc.*, 124 FERC ¶ 61,199 (2008); *CCPS Transportation, LLC*, 121 FERC ¶ 61,253 (2007); *Calnev Pipe Line LLC*, 120 FERC ¶ 61,073 (2007).

Challenges to the non-contract rates after filing the initial tariff

Enbridge Pipelines (Southern Lights) LLC, 131 FERC ¶ 61,288 (2010) (setting for hearing issues related to the initial non-contract rates of a new pipeline that had previously been the subject of a declaratory order concerning contract rates and rate structure)

Imperial Oil v. Enbridge Pipelines (Southern Lights) LLC, 136 FERC ¶ 61,115 (2011) (dismissing a complaint by parties alleging that the terms affecting contract shippers approved in a prior declaratory order had become unlawful)