125 FERC ¶ 61,025
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

TransCanada Keystone Pipeline, LP Docket No. OR08-9-000

ORDER ON PETITION FOR DECLARATORY ORDER

(Issued October 8, 2008)

1. On March 28, 2008, TransCanada Keystone Pipeline, LP (Keystone) filed a petition for declaratory order requesting that the Commission approve the rate structure agreed to by Keystone and shippers that have signed Transportation Service Agreements (TSAs) under which they have made long-term commitments to utilize, or pay for, capacity on the Keystone pipeline system. Keystone also requests Commission approval of the methodology by which Keystone plans to design its uncommitted or "spot" rate. Finally, Keystone requests Commission approval to offer and provide a level of firm transportation, or unapportioned access, both to shippers in the United States that have signed TSAs to date and that are anticipated to sign TSAs in an upcoming open season for an expansion of the system. For the reasons discussed below, the Commission will grant in part Keystone's petition for declaratory order.

Background

2. The Keystone pipeline project is a proposal to transport a significant amount of Canadian crude oil to key U.S. markets. The initial Keystone system will originate at Hardisty, Alberta and extend to the international border near Haskett, Manitoba. From Haskett, Manitoba, the initial Keystone system will extend to delivery points at refineries in Wood River and Patoka, Illinois, and Cushing, Oklahoma. The Keystone project to serve these three delivery points involves construction of 1380 miles of new pipeline in the U.S. and 230 miles in Canada, as well as conversion of 540 miles of pipeline in Canada from natural gas to crude oil service.

3. The Keystone system will have an initial capacity of 435,000 barrels per day (bpd) to transport crude oil from Hardisty to Wood River and Patoka. Construction of the system from Hardisty to Wood River and Patoka was scheduled to begin in the spring of

2008, with a planned in-service date in the fourth quarter of 2009. Construction of the extension to Cushing, which will also involve additional facilities to increase Keystone's capacity to 591,000 bpd to Wood River, Patoka, and Cushing, is scheduled to start in the spring of 2010, with an in-service date for the Cushing delivery point anticipated for later in 2010.

4. Keystone states that the overall commercial arrangements for the Keystone project's initial facilities from Hardisty to Wood River, Patoka, and Cushing are now in place. Keystone states that it is currently in discussions with a number of shippers concerning extensions and/or expansions of the initial facilities to the Gulf Coast. The expansion and extension project would provide up to 500,000 bpd of additional capacity from Hardisty to Gulf Coast delivery points.

5. Following initial meetings with interested shippers, TransCanada conducted a widely-publicized open season in which all potential shippers had an opportunity to participate. In April 2005, TransCanada solicited non-binding expressions of interest from potential shippers for transportation from Hardisty to Wood River and Patoka and received expressions of interest in 500,000 bpd of capacity. In response to this considerable level of shipper interest, between November 1, 2005 and December 4, 2005, TransCanada conducted another widely publicized open season process, seeking binding long-term shipper commitments to provide financial support for the substantial capital expenditures necessary for the project.

6. Keystone states that while its "bullet line" design provides one uninterrupted, seamless transportation path from Hardisty to refineries in Wood River, Patoka and Cushing, Keystone Canada requires certificate authority and rate approval from the National Energy Board (NEB) and Keystone U.S. requires rate approval from this Commission. Keystone states that separate, although substantially similar, tariffs will be approved for the Canadian and U.S. systems. Keystone states that shippers have executed two transportation agreements -- a Canadian TSA and a U.S. TSA -- for the integrated transportation of crude oil from Hardisty to the Wood River, Patoka and Cushing delivery points.

7. Keystone states that the existence of the international border between the actual physical receipt points in Canada and the actual physical delivery points in the U.S. results in a nominal Canadian delivery point at the border and a nominal U.S. receipt point at that same location. Keystone states that there are no physical transactions at the border -- the crude oil will simply pass from one country to another. Keystone submits that under the terms of the Canadian TSA, firm capacity, or unapportioned access, is provided on Keystone Canada for a shipper's committed volume for the term of the TSA. Keystone states that the NEB determined that the "common carrier" requirement for Canadian oil pipelines was satisfied because the contracts were entered into pursuant to an open season and 25,000 bpd (5.75 percent of the 435,000 bpd of capacity to Wood

River and Patoka) would be available for spot transportation of crude oil. Keystone asserts that firm transportation capacity was a key feature of the terms of access and service provided to committed shippers, in recognition of the financial commitment they are providing to Keystone.

8. Keystone states that the rates and terms set forth in Keystone's long-term committed shipper contracts represent the end result of extensive negotiations in an open season process. Keystone states that the rates under the long-term committed shipper contracts are discounted below the level of strictly cost-based rates. Moreover, Keystone states that the committed rates may be further discounted below the project's actual construction costs by the terms of a Capital Variance Adjustment Mechanism in the TSA, which requires Keystone to absorb one half of the capital costs in excess of a pre-construction estimate.

9. Keystone states that the committed rates reflect the shippers' desire for a substantial level of rate certainty, as well as Keystone's need to recover both capital costs and operating costs. Keystone states that the committed rates include a fixed component that does not change over the term of the contracts and represents committed shippers' long-term financial support for the capital costs of the project. The greater the length of the shipper's contract, the lower the fixed rate, in recognition of the additional financial commitment provided by shippers who agree to longer terms.

10. Keystone states that a variable rate component in the committed shippers' contracts recovers non-capital costs under a flow-through mechanism. The variable rate will change over time and contains a true-up mechanism, with deferred recovery through positive or negative surcharges for amounts by which actual costs exceed estimates. Keystone states that the variable rate for transportation of light crude oil is set at 70 percent of the rate for higher density, heavy crude oil. Keystone states that a weighted "barrel-mile" approach to reflect distance of haul (and higher pump station electric power costs) is used in the calculation.

11. Keystone states that it plans to develop an uncommitted or "spot" rate which is a one-part, per barrel charge. Keystone states that the uncommitted rate will be higher than the combined fixed and variable rate for committed shippers. Keystone states that a higher uncommitted rate recognizes the substantially different circumstances between shippers that have made long-term financial commitments to the project and those that have not. Keystone states that as consideration for long-term price certainty, committed shippers have made significant long-term financial commitments to the project. In aggregate they have committed to pay fixed charges of $9.6 billion over the terms of their contracts and to also pay their proportionate share of Keystone's non-capital costs.

12. Keystone intends to file its FERC tariff and the rate for Wood River and Patoka deliveries 30-60 days prior to the 2009 in-service date of the initial system. In 2010,

Keystone will file a rate for Cushing deliveries. Keystone states that because the first year "interim" period involves committed volumes of only 207,500 bpd, which ramp up to 495,000 bpd when the Cushing extension/expansion is placed in service, Keystone may propose an "interim" rate for the first year and propose to delay the implementation of permanent rates applicable to Wood River, Patoka, and Cushing, until the 2010 in-service date of the expanded and extended system.

13. Keystone maintains its shippers require assurances from Keystone and the Commission that Keystone can provide firm capacity from Hardisty to the U.S. Gulf Coast for the entire period incorporated in their long-term contracts. Keystone also requests that its ability to provide firm capacity should not be abrogated or limited by future Commission policies, any prorationing policies implemented on Keystone, or by volumes that may enter the Keystone pipeline system at new receipt points. Keystone submits that absent these assurances, potential anchor shippers from Hardisty to the U.S. Gulf Coast will not commit to the contemplated expansion and extension of the Keystone pipeline system.

14. Keystone avers that in light of the start of planned construction, it is important to resolve the issues regarding the rate structure for these long-term shippers. Keystone asserts that the assurances requested are necessary to justify Keystone's substantial capital investment in the initial facilities. Keystone submits that action on its petition will provide critical information to advance the negotiations surrounding a potential Keystone expansion to the Gulf Coast.

15. Keystone states that without the additional pipeline capacity to transport western Canadian crude oil that Keystone will provide, a severe transportation shortfall will result. Keystone states that its origination point, Hardisty, is a major supply center for western Canadian crude oil and producers continue to make significant investments in oil sands production and expanded refinery capacity in the U.S. Keystone believes that substantial new transportation capacity is required by 2009 and beyond to link the increased Canadian production to U.S. markets. Keystone asserts that by providing access to increased western Canadian crude oil production and a transportation link for such production to U.S. refineries, Keystone provides an important addition to energy infrastructure.

16. Keystone requests that the Commission issue an order that approves: (1) the committed shipper rate structure; (2) the use of a revenue crediting mechanism to calculate the uncommitted rate; (3) the use of projected throughput in calculating the uncommitted rate; (4) the option of utilizing a depreciated original cost rate base in computing uncommitted rates; and (5) Keystone's ability to offer and provide firm capacity in the U.S. to match the level of service provided on the Canadian portion of the system.

Notice, Interventions and Comments

17. Public notice of Keystone's petition was issued on April 2, 2008, providing for interventions, protests or comments by April 17, 2008. Motions to intervene were filed by the Canadian Association of Petroleum Producers, ConocoPhillips Canada Limited (ConocoPhillips), National Cooperative Refinery Association, Sinclair Oil Corporation (Sinclair), and Valero Marketing and Supply Company (Valero). Additionally, ConocoPhillips, Sinclair, and Valero submitted comments urging the Commission to grant Keystone's petition in its entirety. They assert that granting Keystone's petition is crucial to provide the necessary rate guidance, and thereby investment certainty prior to the undertaking of such a major capital investment. They submit that the proposed pipeline will provide substantial new transportation capacity and will increase the amount of crude available to U.S. domestic markets.

Discussion

18. The Commission recognizes the need for additional oil pipeline infrastructure to accommodate the increasing supplies of Canadian crude oil destined for U.S. markets. The Commission also recognizes that Keystone and its shippers need assurances through the Commission's declaratory order process to justify the significant financial commitments necessary to complete the project. The Commission will grant, in large part, the rulings requested by Keystone in its petition for declaratory order. Based on the facts and representations made in Keystone's petition, the Commission will approve the committed shipper rate structure, the use of revenue crediting to establish the rate for uncommitted shippers, the use of projected throughput to establish the rate for uncommitted shippers, and the option of using a depreciated original cost rate base in computing rates for uncommitted shippers. The Commission finds that the rulings requested by Keystone are consistent with Commission precedent and policy. However, as discussed more fully below, the Commission finds that charging committed shippers a discounted rate for a premium service, i.e., firm capacity or unapportioned access, is inconsistent with the Commission's precedent and policy and Keystone's statutory common carrier obligation.

Committed Shipper Rate Structure

19. Keystone requests that the Commission approve the overall committed rate structure established under long-term contracts executed with shippers, and confirm that it will accept the committed rate structure, and the two-part rates and surcharges in the contracts, in any future proceeding. Keystone requests assurance that the rates established in the long-term contracts entered into by Keystone's committed shippers will be upheld and applied during the terms of the TSA. Keystone further requests the Commission to confirm that the rates for the committed shippers will not be subject to the Commission's indexing methodology and will be determined under the specific

methodology set forth in the TSA rate principles. Keystone asserts that the project will provide substantial benefits which are clearly in the public interest. Keystone submits that without the significant commitments provided by shippers who signed long-term contracts, the project could not be built. A critical element of those shippers' agreement to support the project was the long-term rate certainty agreed to by Keystone. Accordingly, Commission assurance that the rate structure set forth in those contracts will be upheld is essential to the success of the overall Keystone project.

20. Under Keystone's rate proposal committed shippers will receive a discounted rate based on a minimum volume commitment and the amount of the discount will increase based on the length of the contract. In addition, the rates may be further discounted below the project's actual construction costs by the terms of the Capital Variance Adjustment Mechanism, which requires Keystone to absorb one half of the capital costs in excess of the pre-construction estimate.

21. The Commission will grant this aspect of Keystone's petition. The Commission has approved a number of volume incentive programs to support pipelines' efforts to attract shippers that will make long-term volume commitments to support the construction of new facilities. As the Commission recognized in *Express Pipeline Partnership (Express)*,

> Without the rate incentives essential to attract those willing to make term commitments, the project might not be built at all. The proposed term rate structure of Express does not violate the antidiscrimination or undue preference provisions of the Interstate Commerce Act because such term rates were made available to all interested shippers and reflect relevant differences among term shippers, and between term shippers and uncommitted shippers.[1]

22. The Commission finds that Keystone's discount rate proposal does not violate the antidiscrimination or undue preference provisions of the Interstate Commerce Act (ICA) because all potential shippers had the opportunity during the November 1 to December 4, 2005 open season to sign a TSA containing a commitment to ship a minimum volume of 5000 bpd for a term of five, ten, fifteen or twenty years at negotiated, discounted rates. In addition, all potential shippers also were aware the rates could be further reduced based on the Capital Variance Adjustment Mechanism contained in the TSAs. Finally,

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[1] 77 FERC ¶ 61,188, at 61,756 (1996). *See also, Enbridge Energy Company, Inc.* 110 FERC ¶ 61,211, at P 38 (2005); *Mid-America Pipeline Company, LLC*, 116 FERC ¶ 61,040, at P 23 (2006); *Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,310, at P 31 (2007).

when Keystone files its initial rates, the Commission will determine at that time whether the proposed initial rates are just and reasonable and consistent with the Commission's policies.

Revenue Crediting to Calculate Uncommitted Rate

23. Keystone states that its uncommitted rate design methodology will incorporate a revenue crediting mechanism which first identifies a cost of service for uncommitted rates by taking the total system cost of service and subtracting the revenues generated by committed shippers. Keystone states that the difference is then divided by the projected uncommitted throughput to derive the uncommitted rate. Keystone states that it recognizes that the revenue crediting approach results in uncommitted shippers bearing a higher proportionate share of the pipeline's costs on a unit basis, that is, "walk-up" shippers pay more per barrel of transportation. However, Keystone asserts that there is nothing unjust or unreasonable about this result.

24. Keystone states that its uncommitted rate methodology incorporates a revenue crediting mechanism to recognize the fact that committed shippers have assumed a significant risk in committing volumes under long-term contracts. Keystone asserts that since the committed shippers have agreed to pay $9.6 billion over the terms of their contracts and thereby bear a significant portion of the financial risks of the project, their contracts provide them with a rate discount. Conversely, Keystone submits that the uncommitted shippers that do not bear any risk are not entitled to a free ride and may be required to pay a rate higher than would be expected under traditional average cost pricing. Keystone contends that this is consistent with prior Commission holdings which recognized that committed shippers, who have assumed the risks associated with term throughput commitments in order to enable construction of a pipeline, are not similarly situated with uncommitted shippers. Keystone asserts the Commission concluded it is appropriate that committed shippers receive discounts relative to rates applicable to uncommitted barrels, even where such discounts result in rates for uncommitted throughput that exceed those which would result under traditional average cost pricing.[2] Keystone submits that provided that all shippers are given an equal opportunity through an open season to obtain the lower committed rate -- an opportunity which Keystone provided in its open seasons -- there is no unlawful discrimination inherent in providing different rates for two classes of shippers that are plainly not similarly situated.

[2] *Citing, Express Pipeline Partnership,* 76 FERC ¶ 61,245, at 62,258 (1996). *See also, Enbridge Pipelines (Southern Lights) LLC,* 121 FERC ¶ 61,310 (2007), where the Commission approved a rate design for uncommitted shippers which would guarantee establishing an uncommitted rate at twice the committed shipper rate for the term of the committed shipper contracts.

25. The Commission will grant Keystone's request that the uncommitted rate can be calculated based on a revenue crediting mechanism which will result in uncommitted shippers bearing a higher share of the pipeline's cost on a per unit basis. In *Express*, the Commission approved an uncommitted rate that was higher than the rate for shippers making term commitments, and also approved a joint uncommitted rate that would be higher than a joint term rate. The Commission found that there was no undue discrimination because all potential shippers had the choice to sign a term contract during the open season or opt for the uncommitted rate. As the Commission observed:

> Term shippers are not similarly situated with uncommitted shippers because in any given month, uncommitted shippers may choose to ship on Express or not. Uncommitted shippers have the maximum flexibility to react to changes in their own circumstances or in market conditions. Uncommitted shippers do not provide the revenue assurances, planning assurances, and a basis for constructing the pipeline that term shippers provide. Each class of term shipper presents unlike circumstances because the longer term commitments provide greater assurances than the shorter term commitments, and hence more long-term revenue stability. Term volume shippers committing to longer terms assume greater risks than shippers assuming lesser shipment obligations because 15 and 10 year terms present very long lead times in the oil business.[3]

Projected Throughput to Calculate Uncommitted Rate

26. Keystone states that it plans to calculate its uncommitted rate based on projected uncommitted throughput. Keystone asserts that use of projected throughput to design rates is consistent with both the Commission's regulations and a number of Commission oil pipeline ratemaking precedents. Keystone submits that the Commission's regulations require pipelines filing initial cost-of-service rates to provide "throughput data" in support of those rates.[4] Keystone contends that use of design or maximum capacity is not required by the regulations. Similarly, Keystone asserts that Commission precedents

[3] *Express Pipeline Partnership*, 76 FERC ¶ 61,245, at 62,254 (1996).

[4] 18 C.F.R. § 342.2(a) (2008). *See also* 18 C.F.R. § 346.2(b)(2) (2008) which requires "throughput for test periods in both barrels and barrel-miles."

establishing oil pipeline rates have approved the use of projected throughput to determine a per barrel rate.[5]

27. Keystone states that its request for Commission assurance that the uncommitted rate may be calculated based on projected uncommitted throughput is prompted by the Commission's decisions in *Enbridge Energy Co.,*[6] where the Commission rejected rate calculations based on Spearhead's projected throughput, stating that "[t]he Commission's policy for designing rates on new pipelines is clear. . . [and] requires Enbridge to use the 125,000 bpd design capacity figure" and *Enbridge Pipelines (Southern Lights) LLC,*[7] where the Commission reaffirmed the principles of the 2005 *Spearhead* order. Keystone submits that the Commission was concerned that by basing its rates on projected throughput that was less than half of capacity, Spearhead could over recover its costs.

28. Keystone asserts that any concerns about cost over recovery are greatly reduced in Keystone's circumstances. Keystone states that under the rate principles applicable to committed shippers (whose volumes will likely account for 84 percent of Keystone's capacity), non-capital costs are "trued up" each year by allocating the total of such costs over <u>all</u> volumes, including uncommitted volumes, and committed shippers either are refunded or pay the difference between estimated and actual costs in the preceding year. Thus, Keystone asserts that uncommitted volumes effectively bear a proportionate contribution to cost recovery and the true-up mechanism ensures that Keystone does not over recover non-capital costs. However, Keystone contends that there is no guarantee that uncommitted shippers will use all of the unsubscribed capacity. Keystone argues the design of the uncommitted rate on the basis of a level of uncommitted throughput which assumes Keystone is 100% utilized would allow uncommitted shippers to avoid their fair share of cost responsibility in the event such shippers use less than 100 percent of uncommitted capacity.

29. Keystone asserts that basing initial rates on capacity as opposed to projected test period throughput is inconsistent with the Commission's policy that an oil pipeline should attempt to build its project in a cost effective and efficient manner.[8] Keystone contends

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[5] *Citing, Williams Pipe Line Co.,* 84 FERC ¶ 61,022, at 61,099 (1998); *ExxonMobil Pipeline Co.,* 91 FERC ¶ 61,182, at 61,662 (2000); *Colonial Pipeline Co.,* 89 FERC ¶ 61,095 (1999); and *Express Pipeline Partnership,* 76 FERC ¶ 61,245, at 61,303 (1996).

[6] 110 FERC ¶ 61,211 (2005) (*Spearhead).*

[7] 122 FERC ¶ 61,170 (2008).

[8] *Citing, Calnev Pipe Line LLC,* 120 FERC ¶ 61,073, at P 28 (2007) *(Calnev).*

that sizing Keystone to meet only current guaranteed demand would be highly inefficient and more costly over the life of the project, given that western Canadian crude oil production is projected to increase over the upcoming years. Keystone submits that basing rates on capacity as opposed to throughput would encourage Keystone and other pipelines to design their systems to meet only guaranteed current demand, and then expand their systems in the future. Keystone argues this path may lead to higher rates for all shippers, a result already contrary to the overall public interest.

30. The Commission will approve Keystone's request to calculate the uncommitted rate based on projected throughput. While the Commission recognizes it previously stated in several recent cases that pipelines should base uncommitted rates on design capacity rather than on projected throughput as proposed here, there are a number of factors here supporting the use of projected throughput. The major concern in the *Spearhead* and *Southern Lights* cases cited by Keystone as requiring design capacity for uncommitted rates was the potential for the over- recovery of costs. Here, because the TSAs contain a true-up mechanism which will allocate non-capital costs across all volumes, uncommitted shippers will bear a proportionate share of costs and the likelihood of over-recovery is low.

31. As discussed above, all potential shippers had an equal opportunity to sign a TSA for the lower, discounted committed rate. Further, no potential shipper protested or filed comments challenging Keystone's proposal to calculate the uncommitted rates based on projected throughput.

32. The Commission finds using projected throughput will permit Keystone to charge the uncommitted shippers their fair share of costs and is consistent with the principle discussed in *Calnev* that an entity should build an oil pipeline in a cost effective and efficient manner, which would include sizing the pipeline based on reasonable projections of future growth in markets. As Keystone has shown, the supply of western Canadian crude oil destined for U.S. markets is projected to increase over the upcoming years.

33. Finally, as an added protection, when Keystone files to implement its initial rates, if the initial uncommitted rate is protested, the Commission will require Keystone to comply with section 342.2(b) of the regulations[9] and support its uncommitted rate by filing cost, revenue, and throughput data supporting such rate in accordance with Part 346 of the Commission's regulations.[10]

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[9] 18 C.F.R. § 342.2(b) (2008).

[10] 18 C.F.R. Part 346 (2008).

Depreciated Original Cost Rate Base to Compute Uncommitted Rates

34. Keystone states that in Opinion No. 154-B,[11] the Commission adopted a trended original cost (TOC) methodology for deriving the rate base used in calculating oil pipeline rates. Keystone states that, among other things, the Commission found that TOC would "help newer pipelines . . . compete with older pipelines . . . and other modes of oil transport."[12] Keystone states that the Commission, however, also expressed its willingness to consider and adopt methodologies other than TOC in appropriate circumstances:

> The Commission recognizes that in some situations TOC might present problems for new pipelines. The Commission is willing in such situations to consider any innovative solutions which are presented to it.[13]

Keystone believes its particular circumstances justify the use of a depreciated original cost (DOC) rate base, rather than a TOC rate base, in calculating uncommitted rates. Keystone states that because of competitive market forces, Keystone agreed to substantially discounted rates for committed shippers, who have made binding commitments to utilize, or pay for, the vast majority of the pipeline's capacity. Keystone contends the level of long-term shipper commitments, and the discounts provided to them, have a number of consequences which support an exception to the Opinion No. 154-B TOC methodology.

35. Keystone submits its uncommitted rates will play a limited role in fostering a primary purpose of the TOC methodology, i.e., helping a new entrant to compete by enabling it to charge lower rates in the early years of its market entry. In the case of Keystone, that objective has already been achieved -- Keystone utilized its discounted committed rate structure to attract, and ultimately obtain, shipper commitments. Keystone asserts that discounted rates provided the inducement for shipper commitments and, because of the considerable level of such commitments, the discounted committed rates will largely determine Keystone's revenue stream. Keystone states that in the case of fixed charges which do not change during the term, there are limitations on Keystone's future revenue stream. Keystone contends that it needs the maximum opportunity to

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[11] *Williams Pipeline Company*, Opinion No. 154-B, 31 FERC ¶ 61,377 (1985), *order on reh'g*, Opinion No. 154-C, 33 FERC ¶ 61,327 (1985).

[12] Opinion No. 154-B, 31 FERC ¶ 61,377 at 61,834.

[13] *Id.* at 61,834 n.22.

recover costs from "spot" shippers using uncommitted capacity. Keystone argues that higher DOC rates are a reasonable means to support that opportunity.

36. Keystone states that the Commission's adoption of TOC was based in part on its concern that, because of competition, a new entrant might otherwise be unable to charge sufficiently high rates in its early years of operations to recover its costs, and "those lost revenues will be gone forever."[14] However, Keystone asserts that the "lost revenues" scenario can also occur when, as is the case with Keystone, a new entrant has offered substantially discounted rates for most of its capacity. Keystone states that unless it has the ability to charge higher rates for uncommitted capacity, it may be unable to recover all of its costs. Keystone submits that DOC will enhance Keystone's ability to recover its costs through higher rates in the early years. Keystone states that although it may provide volume or other discounts to the uncommitted rate on a nondiscriminatory basis, the use of DOC will enable Keystone to maximize potential revenues foregone by the committed rate discount.

37. Keystone states that as the Commission stated in Opinion No. 154-B, DOC and TOC are "essentially the same except for their treatment of inflation" -- specifically, the timing of the recovery of capital costs in periods of inflation.[15] Keystone asserts it already promoted the pro-competitive objectives of Opinion No. 154-B by entering the market and offering significant discounts to shippers. Keystone submits the higher "front-end" rates resulting from the use of DOC will increase the ability of Keystone to recover costs from its uncommitted capacity and to remain a viable competitor in the marketplace. Keystone further asserts its particular circumstances justify a reasonable exception to the use of the TOC methodology. Keystone contends the option of using an alternative methodology will give it the maximum opportunity to recover its costs and realize the revenues foregone by the committed rate discounts.

38. The Commission will grant the part of Keystone's petition requesting permission to use a depreciated original cost rate base in computing its uncommitted rates. As Keystone observed, while the Commission in Opinion No. 154-B preferred the TOC method for calculating the rate base, the Commission was willing to consider other solutions if the TOC method presented a problem. Here, Keystone has shown that use of the TOC method for the uncommitted rates could prevent Keystone from recovering all of its costs while the DOC method could permit Keystone to recover costs from the uncommitted shippers that would otherwise be lost because of the substantial discounts to the committed rates and the deferral of certain costs under the TOC method. Under these

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[14] *Id.* at 61,835.

[15] *Id.* at 61,834.

circumstances, in order to give Keystone the opportunity to recover costs from the uncommitted shippers, the Commission will permit Keystone to use the DOC method for calculating the rates for uncommitted shippers.

Provision of Firm Capacity to Committed Shippers

39. Keystone requests that the Commission, in recognition of the physical and commercial realities of the Keystone transportation path, authorize Keystone to provide a level of firm capacity on the U.S. portion of the pipeline system which matches the level of firm capacity that Keystone Canada can provide to shippers in Canada in accordance with the decisions of the National Energy Board (NEB).[16] Keystone asserts that the Keystone shippers require certainty that the level of firm service that they contract for with Keystone on the U.S. portion of the pipeline system will match with the level of firm capacity that Keystone Canada can provide to shippers to their respective delivery points, including the new contemplated delivery point(s) on the U.S. Gulf Coast.

40. Keystone submits that allowing shippers in its “seamless” cross-border project to match upstream firm entitlements is required by the overall public interest and supported by the important benefits provided by the Keystone project. Keystone contends that firm capacity entitlements are justified by the committed shippers' agreement to pay substantial fixed charges which support the capital costs of the project. Keystone asserts that potential shippers are willing to commit large volumes for up to 20-year terms if, and only if, they can remain confident that their firm rights will not be diminished to accommodate uncommitted shippers that have made no financial commitment to ensure that the pipeline system is built in the first place and that seek to pay only for significantly fewer volumes when (and if) they "walk up" and request transportation. Keystone argues that priority firm transportation service is also fundamental to shippers' ability to make long-term contractual arrangements with refiners and/or suppliers and invest substantial, long-term capital in oil exploration, production and refining facilities. Keystone argues that approval of firm capacity is not inconsistent with the Commission's statutory responsibilities and both Commission precedent and sound public policy considerations support the guaranteed availability of capacity for committed shippers.

41. Keystone states that section 1(4) of the ICA provides that it is “the duty of every common carrier subject to this chapter to provide and furnish transportation upon reasonable request therefor.” Keystone asserts that the duty to provide transportation services under section 1(4), however, is not absolute; it requires only that the carrier

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[16] Keystone is authorized to provide firm capacity in Canada, with 25,000 bpd, or 5.75 percent of the 435,000 bpd capacity reserved for spot shippers.

make "reasonable efforts to maintain the public service at all times."[17] Keystone contends that a common carrier therefore may "make reasonable and appropriate rules respecting the acceptance and transportation of traffic" as long as those rules do not vitiate its common carrier obligations under section 1(4).[18] Keystone argues that this principle applies to the allocation of capacity as well. Thus,

> the fact that shippers may not be able to move the volumes they wish to move on [a] capacity-constrained [pipeline] system does not violate the common carrier obligation to provide service, which requires that carriers provide transportation service upon reasonable request therefor.[19]

42. Keystone submits that a determination of whether the common carrier duty is met involves a factual inquiry and consideration of whether undue discrimination exists. Keystone asserts that the provision of firm service is not a *per se* departure from the common carrier obligation. Keystone contends that there is nothing in the statutory language or common law that requires a pipeline to accommodate all requests for capacity or to provide at least a portion of each request in all circumstances. Keystone argues that the duty of common carriers to provide and furnish transportation does not dictate that all nominations, including those made by disparate shipper classes, must be treated equally, or that some portion must be provided to all shippers on every occasion in which nominations exceed capacity.

43. Keystone asserts that an allocation of firm capacity in an open season for a greenfield project where all potential parties are eligible to obtain similar entitlements is consistent with "providing and furnishing transportation upon reasonable request therefor." Keystone submits that unapportioned access for shippers who pay substantial fixed charges under long-term contracts does not unduly discriminate against shippers who choose to make no commitments. Keystone contends that uncommitted shippers which request transportation in circumstances where aggregate nominations exceed capacity are not subject to unlawful discrimination if their nominations are in a lower priority than shippers with firm transportation entitlements. In short, Keystone submits that neither the statutory language nor the common law entitles shippers who declined to make the financial commitment necessary to create capacity in the first place to

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[17] *Citing, Brotherhood of Ry. and Steamship Clerks v. Florida East Coast Ry. Co.,* 384 U.S. 238, 245 (1966).

[18] *Citing, Lakehead Pipe Line Co.,* 71 FERC ¶ 61,338, at 62,325 (1995), *reh* 'g *denied,* 75 FERC ¶ 61,181 (1996).

[19] *Citing, Platte Pipe Line Co.,* 117 FERC ¶ 61,296, at 62,443 (2006).

transportation levels or an allocation priority on par with shippers who committed to pay for firm rights in an open season.

44. Keystone asserts the Commission previously approved firm capacity arrangements where an oil pipeline has set aside a portion of its capacity specifically for shippers who had entered into contracts with volume commitments.[20] Keystone also submits it met the requirements for approval of firm transportation service as set forth in the Commission's recent order in *CCPS Transportation, LLC*,[21] where the applicant requested the Commission to confirm the proposed capacity allocation for a planned expansion of the Spearhead pipeline facilities. Keystone states that although the Commission required CCPS to set aside a portion of the proposed expansion capacity for uncommitted shippers, it approved the applicant's request and determined that firm capacity could be provided as long as certain open season conditions were met. Keystone notes the Commission stated under its previous rulings, "a particular service can be offered exclusively to term shippers simply because they were the first to request service," as long as the pipeline "held open seasons available to any interested shippers."[22] In addition, Keystone asserts that although in *Texaco Pipeline Inc.*[23] the Commission rejected a tariff sheet that it believed would have provided unduly preferential firm transportation to contract shippers, Keystone considers this inconsistent with subsequent Commission precedent approving such arrangements and asserts it should be overruled.

45. For these reasons, Keystone requests the Commission grant the authority to provide firm transportation service both to its existing committed shippers from Hardisty to Wood River, Patoka and Cushing, and to potential committed shippers that are expected to execute TSAs during the open season for the expansion of the pipeline system from Hardisty to the U. S. Gulf Coast. Keystone contends this will ensure that all committed shippers on the pipeline system will have firm transportation service on the U.S. portion of the pipeline system that seamlessly matches the firm transportation service rights those shippers have or will have on the Canadian portion of the pipeline system.

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[20] *Citing, Mid-America Pipeline Co., LLC,* 116 FERC ¶ 61,040 (2006)(*MAPL*); *Enbridge Offshore Facilities, LLC,* 116 FERC ¶ 61,001, at P 1, 5, 19 (2006); *Caesar Oil Pipeline Co.,* 102 FERC ¶ 61,339, at P 3-4 and P 34-37 (2003); *Proteus Oil Pipeline Co., LLC,* 102 FERC ¶ 61,333, at P 9-10 and P 32-35 (2003).

[21] 121 FERC ¶ 61,253 (2007), *order on reh''g,* 122 FERC ¶ 61,123 (2008) (*CCPS*).

[22] *Citing, CCPS* at P 18-19.

[23] 74 FERC ¶ 61,071 (1996).

46. Keystone requests the Commission approve its proposal that committed shippers receive a discounted rate for committed volumes and that such committed volumes would never be subject to prorationing, i.e, committed shippers would receive firm service. In addition, Keystone proposes to set aside only 5.75 percent of the capacity for uncommitted shippers to mirror the proposal approved by the NEB for the Canadian portion of Keystone's pipeline. The Commission recently addressed the issue of providing firm service to shippers receiving discounted rates in *Enbridge (U.S.) Inc. and ExxonMobil Pipeline Company (Enbridge (U.S.) Inc.).*[24]

47. In *Enbridge (U.S.) Inc.*, the Commission determined that the same cases cited by Keystone here did not support giving committed shippers firm service at discounted rates. For example, in *CCPS*, the approved premium service was subject to higher rates in exchange for a guarantee that the capacity under contract would not be subject to prorationing. The capacity subject to this reservation consisted of expansion capacity. However, under the pipeline's tariff applicable to its base capacity, new or spot shippers were afforded a means by which they could become "regular" shippers based on their shipping patterns. In contrast, Keystone proposes that firm shippers pay a lower rate than the uncommitted shippers in addition to receiving a guarantee that their contracted volumes will never be subject to prorationing. Keystone's proposal would provide new or uncommitted shippers with access to only 5.75 percent of the pipeline's capacity on a permanent basis without any ability to increase that capacity by establishing an historical pattern of shipping. The Commission finds that this prorationing arrangement is unreasonable under the ICA and applicable Commission precedent.

48. The Commission also declines to overrule *Texaco* as requested by Keystone. In *Texaco,* the Commission rejected as preferential a proposed tariff provision that would essentially lock uncommitted shippers out of 80 percent of the pipeline's capacity. Similarly, in the instant case, uncommitted shippers would not have access to 94.25 percent of the pipeline's capacity for at least five years, which is the duration of the shortest contract for committed shippers. As in *Texaco*, Keystone's proposal guarantees firm capacity at discounted rates and therefore is unduly preferential. The instant case is unlike *CCPS*, where the firm capacity was supported by premium rates, thus making the preference not undue.

49. As for *MAPL*, there most of the pipeline's capacity would be available to uncommitted shippers, and both current and new shippers would have the opportunity to participate in the new volume incentive program. Thus, the *MAPL* case is distinguishable from the instant proposal which unreasonably restricts access by uncommitted shippers to all but 5.75 percent of the pipeline's capacity for many years.

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[24] 124 FERC ¶ 61,199 (2008).

50. The Commission also finds that Keystone's references to *Caesar* and *Proteus* are inapplicable because those petitions for declaratory orders were analyzed under the Outer Continental Shelf Lands Act (OCSLA) rather than the ICA since the Commission found that the ICA does not expressly cover pipelines transporting oil solely on or across the Outer Continental Shelf (OCS).[25]

51. Accordingly, the Commission denies Keystone's request that it approve the proposed discounted rate to be paid by committed shippers whose access to 94.25 percent of the pipeline's capacity would never be subject to prorationing. The Commission finds this proposal unjust, unreasonable, and unduly discriminatory under the ICA and applicable Commission precedent.

Conclusion

52. The Commission issues this order based on the facts and projections presented by the petition. If any of the facts or projections supporting the petition change, Keystone must make a filing with the Commission to determine whether the rulings in this order would still be applicable.

The Commission orders:

Keystone's petition for declaratory order is granted to the extent as discussed above.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

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[25] *Proteus Oil Pipeline Co., LLC*, 102 FERC ¶ 61,333, at P 29 (2003), *citing, Bonito Pipe Line Company*, 61 FERC ¶ 61,050, at 61,221 (1992).