

INSIGHTS

Shippers Rolling the Dice to Gain Oil Pipeline Capacity

May 15, 2013

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With the growing capacity constraints on oil pipelines, the Federal Energy Regulatory Commission ("Commission") has recently extended the bounds of what it considers acceptable methods of apportioning limited capacity. In *Seaway Crude Pipeline Company LLC*, 143 FERC ¶ 61,036 (2013), the Commission approved a new lottery system that will select, at random, new shippers who will be permitted to tender the minimum monthly volume requirement. The catch, however, is that there are approximately 275 new shippers on the system, meaning a given shipper has roughly only a 5 percent chance of winning the lottery each month. And to achieve regular shipper status and thus gain access to the 90 percent of system capacity reserved for regular shippers, it must win that lottery twelve consecutive times. After reversing flow on its Longhaul System and commencing north-to-south transportation service, Seaway saw the number of new shippers dramatic multiply from 5 (when to service commenced) to 275 by April, 2013. Seaway alleged that some of the proliferation was due to shippers attempting to game the system and broker capacity in the secondary market. Like other oil pipelines, Seaway dedicates 90 percent of the system capacity to regular shippers and 10 percent to new shippers, and to achieve regular shipper status, Seaway's customers must tender the minimum volume (60,000 barrels per month) for 12 consecutive months. Before the lottery, Seaway allocated the 10 percent of capacity to new shippers on a *pro rata* basis, but with so many new shippers, none was able to meet the requirements to achieve regular shipper status because of the relatively high minimum tender requirement. As a result the number of new shippers multiplied with those shippers informally aggregating batches to meet Seaway's minimum monthly tender requirement. Seaway concluded that such a system was unworkable and proposed a lottery system to replace its existing *pro rata* system. The lottery system will use a software-generated random process to determine which new shippers will be allowed to tender the 60,000 barrel minimum each month, meaning about 13 new shippers will get capacity for a given month. Despite several protests, the Commission approved Seaway's lottery system for two main reasons. First, the Commission reasoned that the lottery system will deter manipulation during the nomination process and thus make capacity more readily available to legitimate new shippers; and second, the lottery would not be unduly discriminatory because the system would apply to all new shippers. Although this is not the first time that the Commission has approved the use of a lottery system to award new shipper capacity when a pipeline faces apportionment problems, Seaway's proposed lottery system,

coupled with the requirement that new shippers must tender the minimum monthly volumes for 12 consecutive months, means that it will be highly improbable for new shippers to ever achieve regular shipper status, unless the number of new shippers dramatically decreases. Thus, the decision treads slightly new ground on what the Commission is willing to consider as a "reasonable" remedy to address the multiplication of new shippers and the vast over-nomination issues some crude pipelines are facing in the current environment. Finally, the *Seaway* decision underscores the importance of open seasons as being the principle method of obtaining reliable transportation service on oil pipelines. For example, gaining access to the Longhaul System as a new shipper is difficult enough because a prospective new shipper will now have to win the lottery simply to tender the minimum amount requirement in one month. However, to gain access to the remaining 90 percent of system capacity, that prospective customer must win the new shipper lottery 12 consecutive times. By contrast, *Seaway* held two opens seasons for capacity on its Longhaul System and committed shippers were able to access the 90 percent of the system capacity reserved for regular shippers. Thus, shippers seeking access to reliable capacity might consider a commitment during an open season rather than gambling on a future "and perhaps unforeseen" lottery.