July 26, 2013

Burnaby Refinery not a Priority Destination under Pipeline Tariff

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Case commented on:

Chevron Canada Limited Priority Destination Designation Application (15 July 2013) MH-002-2012 (NEB).

Most shippers on the Trans Mountain Pipeline will no doubt be pleased with the recent decision of the National Energy Board (NEB) denying a Priority Destination Designation for Chevron's Burnaby Refinery. Chevron applied for an order designating Chevron's Burnaby Refinery as a Priority Destination pursuant to section 1.58 of the Tariff of Trans Mountain Pipeline ULC. The Burnaby Refinery serves a key function as it refines Alberta crude oil into gasoline for the Lower Mainland of BC.

"Priority Destination" is defined under section 1.58 of the Tariff as a refinery, marketing terminal or other facility connected to and capable of receiving petroleum from the Trans Mountain Pipeline system and so designated by the NEB by reason that it is not capable of being supplied economically from alternative sources. (emphasis added)

Context

Currently, the demand for capacity on crude oil pipelines to tidewater greatly exceeds the available capacity. Alberta crude oil that cannot be shipped to tidewater is sold at a substantial discount to the world price for oil. This pricing dynamic has created strong competition among shippers trying to secure pipeline capacity for refineries on the west coast and for offshore markets. Since November 2010, the Trans Mountain Pipeline has been under apportionment, meaning that Uncommitted Shippers have been able to ship proportionally lower volumes of crude oil than the volumes they nominated.

The Trans Mountain Tariff stipulates that in times of apportionment, available capacity will be allocated first to Firm Shippers (shippers that signed long term contracts with the Pipeline). Of the remaining capacity, Uncommitted Shippers (shippers that did not sign long term contracts with the Pipeline) nominating to Priority Destinations will have priority over all other nominations.

Prior to this application the NEB had not approved any Priority Destination Designations (PDDs). The NEB approves tariffs of pipeline companies under its jurisdiction, and has the power to prescribe tariffs, pursuant to section 65 of the *National Energy Board Act*, RSC 1985, c N-7.

Chevron's Position

Chevron stated that the Burnaby Refinery has not been getting the crude petroleum it needs since November 2010 due to the high level of apportionment. While Chevron has explored other alternatives to the Pipeline, these alternatives are not economic, nor can they be used to provide material volumes of crude oil to the Refinery for a variety of reasons.

In the short term, Chevron has purchased a limited volume of partially refined petroleum (known as "Intermediates"), but this is not an ideal solution, as Intermediates are already partially refined and further refinement requires only a portion of the facilities within the Burnaby Refinery. Chevron has also purchased crude petroleum in the pipeline and additional shipping capacity on the pipeline from other shippers, but there is no guarantee that either of these options would be available to Chevron in the future.

Chevron also explored the possibility of receiving crude oil by rail or by ship. Chevron stated that it cannot take delivery of crude by ship as the ships are too large for Chevron's dock and storage capabilities. Rail delivery would require significant up-front capital costs, and due to space constraints at the Burnaby Refinery, only a limited number of rail cars could be accommodated.

Chevron concluded that in order to obtain supply from alternative sources, it would have to incur substantial capital costs and to pay transportation operating costs that would be about five times higher than the transportation costs pursuant to the Tariff.

Interventions

BP Canada Energy Group ULC, Imperial Oil Limited, Phillips 66 Canada ULC, Shell Trading Canada, and Tesoro Canada Supply & Distribution Ltd (collectively, the Intervening Shippers) opposed the designation of the Burnaby Refinery as a Priority Destination. The Intervening Shippers argued that the test for whether alternative sources were "economic" under section 1.58 of the Tariff could not be focused on a comparison of the transportation costs to the Pipeline toll costs. If this test were adopted, each of the Intervening Shippers could show that alternative transportation costs would be more expensive than the Pipeline toll, and as a result, every shipper could successfully apply for designation of a refinery as a Priority Destination.

Four of the five Intervening Shippers – BP, Phillips 66, Shell, and Tesoro, known together as the Puget Sound Refiners – have refineries in Washington State that are supplied by the Pipeline. Tesoro argued that Chevron competes with Tesoro, BP, Phillips 66 and Shell in a common British Columbia/Washington State refined products marketplace and that granting a PDD to Chevron would mean that the Puget Sound Refiners would, in effect, subsidize their competitor. Tesoro and Imperial argued that granting a PDD to Chevron would only serve to reallocate capacity and transfer wealth from other pipeline shippers to Chevron. While the Puget Sound Refiners had made considerable investments in equipment and facilities to enable them to receive crude oils from world markets in the event of apportionment on the Pipeline, Tesoro argued that Chevron had chosen not to invest in the facilities needed to enable it to receive crude oil from other sources. BP pointed out that Chevron should be required to accept responsibility for the risks it undertook in not securing adequate alternative sources of supply.

NEB Decision

As noted above, the Board denied Chevron's application. In its decision, the NEB noted that the PDD provision should only be used to provide relief "in extraordinary circumstances" (at page 10), and that it should be a "measure of last resort" (at page 13). It should only be used for a limited period of time to allow a refinery "a brief respite from a severe supply shortfall" (at page 13) and give the refinery the opportunity to develop or increase other supply options. The NEB noted that this approach was consistent with the concept of allowing market forces to work where appropriate.

The NEB established two criteria that must be met in order for a refinery to qualify as a Priority Destination:

i. The refinery must be "unable to meet, or [be] at substantial risk of not meeting, its minimum run rate", and
ii. The refinery must be unable to reasonably ensure its long-term viability without a Priority Destination Designation. (at page 14)

The first criterion was designed to provide a refinery with the incentive to pursue "other feasible supply options" (at page 11) so as to mitigate the risk of supply disruptions. (The minimum run rate of a refinery is the volume below which a refinery would no longer be able to operate its equipment). The NEB noted that Chevron had consistently been able to meet its minimum run rate by using the alternative supply options available to it. Therefore, the Burnaby Refinery had so far been able to meet, and was not at substantial risk of failing to meet, its minimum run rates in the foreseeable future.

With respect to the second criterion, the NEB noted that other refiners who were part of the proceeding had used several supply options to mitigate supply risk, and that Chevron had a responsibility to establish alternative supply options to mitigate its supply risk. Given the NEB's finding that Chevron did not meet the first criterion, it was unnecessary for the NEB to make a finding on the second criterion.

In its decision, the NEB also directed Trans Mountain to revise its nomination or capacity allocation procedures to address the current apportionment on the Pipeline, to consult with all shippers regarding its proposed procedures, and to submit its proposed procedures to the NEB on or before 30 September 2013.

Conclusions

To date, the NEB has never granted a shipper a PDD. This decision is consistent with comments made by the NEB in two previous decisions to the effect that designation of Priority Destinations is to be kept to a minimum. (*Interprovincial Pipe Line Inc. Application re: Apportionment of Pipeline Space*, (July 1985), MH-3-85; and *Interprovincial Pipe Line Inc. Application re: Facilities and Toll Methodology* (December 1997), OH-2-97). It is also consistent with the NEB's public interest mandate and with the principle of allowing the market to function provided that no abuse of market power is at play.

The NEB has now established clear criteria for the designation of refineries as Priority Destinations. A shipper will only be able to obtain a PDD for a refinery in extraordinary circumstances, as a measure of last resort, and for a limited period of time.