Before the Pennsylvania Senate Majority Committee On Policy

Testimony of David B. MacGregor, Post & Schell, P.C.

On behalf of Laurel Pipe Line Company

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Introduction.

Mr. Chairman and Senators, my name is David MacGregor. I represent Laurel Pipe Line Company in connection with its proposed reversal of oil pipeline transportation service between Altoona and Pittsburgh. This project will provide major public benefits for all Pennsylvanians in the form of lower gasoline prices, more reliable service and a reduced reliance on foreign oil imported from overseas.

I am here today because I am trial counsel in the ongoing proceeding before the Pennsylvania Public Utility Commission ("Commission"). This is a rigorous proceeding before an Administrative Law Judge, begun over a year ago, and involving extensive discovery, depositions, expert testimony, public hearings and a week-long evidentiary hearing, which ended just a few weeks ago. The result is a substantial, detailed record of information on the legal, regulatory, commercial, environmental and safety aspects of the proposed reversal. As in many cases of this type, a significant portion of the record has been classified as highly confidential, in part because it contains specific shipper information, whose release is restricted under the Interstate Commerce Act. In addition, the record contains a significant amount of competitive and proprietary information, which has been disclosed under seal to protect the interests of all parties. Under the terms of the protective order at the PUC, no employee of Laurel and no employee of our opponents can see any of this information. It can only be seen by outside legal counsel and our outside experts. While I cannot divulge the specifics of any confidential information, I can tell you with certainty that everything I am going to say to you today is proven not only by Laurel's testimony and exhibits, but also by the confidential internal statements and documents of our opponents. Because of the confidential nature of this information, it would be prudent, in my view, for this Committee to let the Commission, who has full access to this confidential information, decide this matter based on a full record.

Basic Description of the Project.

The Laurel pipeline currently provides westbound petroleum products transportation service from New Jersey, Delaware and Philadelphia to terminals in the areas of Reading, Harrisburg, Altoona and Pittsburgh. Products transported include gasoline, diesel, fuel oil and jet fuel. On November 14, 2016, Laurel filed Applications with the Commission to change the direction of transportation service over a portion of its pipeline system. Specifically, Laurel seeks Commission approval to cease the westbound flow of petroleum products over its pipeline system from Altoona to terminals in Pittsburgh and to initiate the eastbound flow of petroleum products from origin points in the Midwest to Altoona. All Pittsburgh terminals will continue to receive delivery of all of the same products received before the reversal. These products will simply come in from a different direction. All of the service provided on the reversed segment will be in interstate commerce, subject to the exclusive jurisdiction of the Federal Energy Regulatory Commission.

Benefits of the Proposed Reversal.

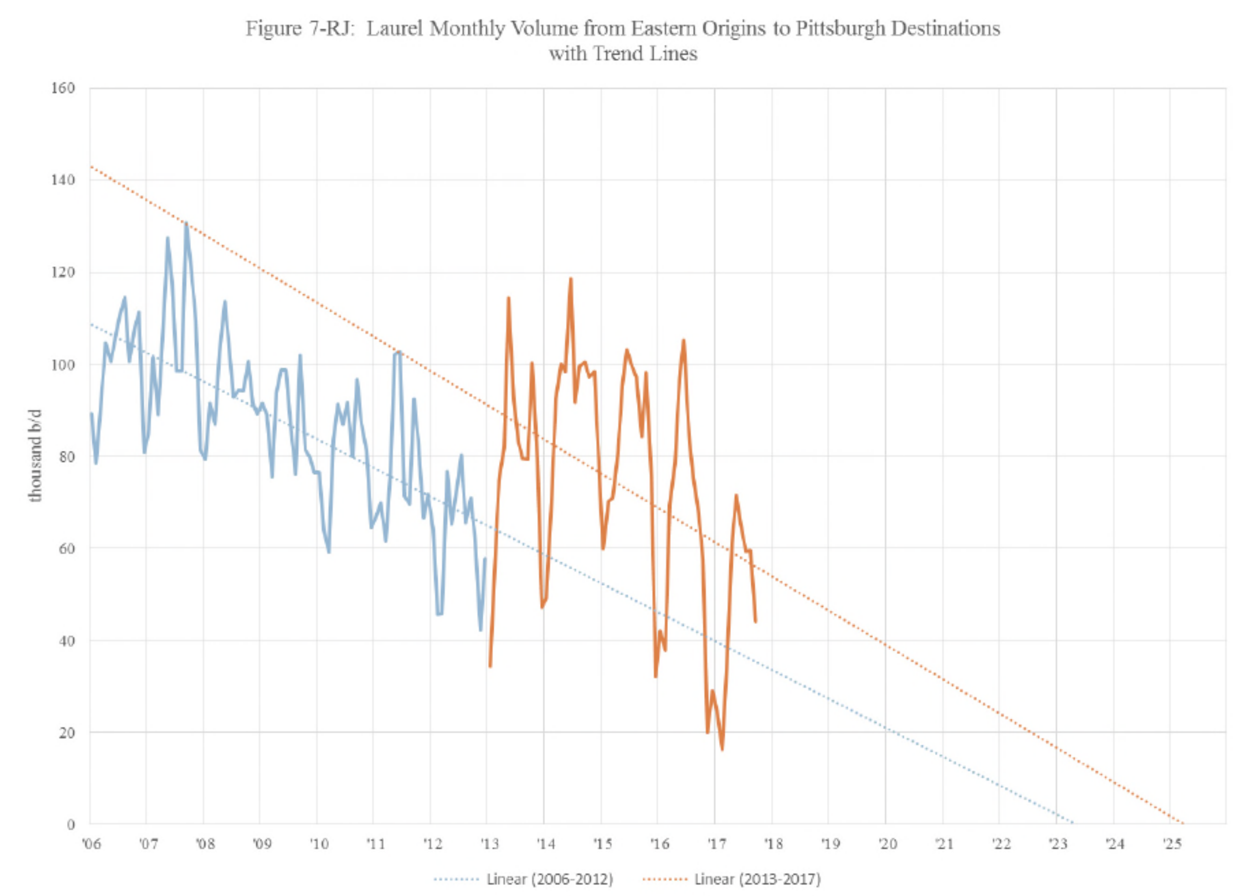
As you know, we are in the middle of the Shale Revolution, which is fundamentally changing where and how America gets its energy supply. There are two parts to this revolution: shale gas and shale oil.

Pennsylvania has already seen the benefits of shale gas. Ten years ago, gas utilities in Pennsylvania purchased almost all of their natural gas from Louisiana, Texas and Oklahoma, and it was transported to Pennsylvania over long-line interstate pipelines. Today, most natural gas consumed in Pennsylvania is purchased from producers of the Marcellus Shale and transported over new and reversed pipelines. This has resulted in a dramatic and unprecedented decline of over 60% in natural gas prices for consumers. This has also reduced costs to businesses, made them more competitive, and allowed them to hire more workers. It also has resulted in the increased use of natural gas to generate electricity and significantly lower electricity prices to consumers and businesses. The Commission has previously estimated that Marcellus Shale development would "unleash billions of dollars of natural gas production" and would "have untold impacts on our economy," citing estimates of "$13.5 billion per year in economic value" and the creation of "175,000 jobs in Pennsylvania alone by 2020."[1]

Pennsylvania is now poised to see similar benefits from the oil side of the Shale Revolution. Increased production of lower-cost North American shale oil from the Dakotas and South Central Canada, as well as Canadian oil sands production, is being processed by Midwest refineries who have invested billions of dollars to increase their ability to refine and process this lower-cost North American crude oil. The cost of crude oil is the overwhelming factor in determining the retail cost of gasoline, i.e., lower cost crude oil equals lower cost gasoline. These benefits are already being seen by consumers in the Midwest, who today are enjoying some of the lowest priced gasoline in the country. Midwest refineries now have excess production capacity and are seeking new domestic markets for their lower-cost gasoline to the south and to the east. Some of these low-cost interstate supplies are already reaching Pittsburgh.

[1] *See Jurisdictional and Pipeline Safety Issues Related to the Marcellus Shale*, Docket No. I-2010-2163461, 2010 Pa. PUC LEXIS 729, at *1-2 (Order entered Apr. 1, 2010).

In fact, interstate supply from the Midwest is already replacing supply from the East. As shown in the table below, shipments to Pittsburgh from the east have already declined by over 55%, are projected to decline further and approach zero in the next few years. The situation for Laurel under its current operating circumstances is dire; the Laurel pipeline is a wasting asset and is already beginning to see operational problems due to the decline in volumes moving from the east.



But, there is one problem: transportation bottlenecks are preventing this lower-cost Midwest-refined gasoline from reaching Central and Eastern Pennsylvania. The reversal, along with a companion debottlenecking project in Ohio by Laurel's affiliate, Buckeye Pipe Line Company, will help unlock the door to Central Pennsylvania and bring an increased supply of lower cost petroleum product. After the reversal, for the first time, lower-cost Midwest supplies and corresponding lower-priced gasoline will be able to reach Central Pennsylvania by pipeline, including Johnstown, Altoona, State College and the surrounding areas. And, as more volumes move east from the Midwest, they will push out higher cost supplies on the East Coast, particularly product imports from overseas, which are the highest cost supply to the East Coast. This will reduce reliance on foreign oil and result in lower gasoline prices in Eastern Pennsylvania, including Philadelphia.

In addition, the reversal will significantly improve reliability of supply for Central Pennsylvania. Market participants in Pittsburgh currently have access to eight (8) delivery alternatives, including Laurel under its current configuration. Philadelphia refineries and market participants similarly have seven (7) alternatives to get their product to market. Central Pennsylvania lacks this array of alternatives and currently can only receive product from: (1) westbound petroleum deliveries from East Coast suppliers via trucks and Laurel; and (2) trucks from terminals south of Pennsylvania. The reversal will effectively double the core supply to Central Pennsylvania – from one pipeline to two pipelines.

This project is a win, win, win for PA: substantially lower gasoline prices across the Commonwealth; increased supply options for Central Pennsylvania; and reduced reliance on foreign oil.

Opposition.

Our opponents raise three primary arguments: (1) supply from the Midwest to Pittsburgh is already unconstrained, so the project is not needed; (2) loss of supply to Pittsburgh from the East Coast will result in decreased reliability of supply, and increased and more volatile gasoline prices; and (3) the reversal will result in lost sales and lost profits for Philadelphia refineries and for marketers, resulting in financial harm and job loss. The record before the PUC demonstrates that each of these arguments is simply wrong.

Supply Constraints. As to supply constraints in the Midwest, there are in fact numerous constraints that prevent Pittsburgh from fully accessing Midwestern supply. The extent of these constraints was best summarized by our opponents' own witness, Greg Johnston from Gulf Operating, LLC, who testified that: "It is almost logistically impossible to move petroleum products from Chicago-area refineries to the Pittsburgh area due to pipeline capacity limitations." Moreover, and apart from Pittsburgh, it is undisputed that there is currently no reasonable access to Central Pennsylvania from the Midwest. The proposed reversal, in conjunction with a related debottlenecking project in Ohio, will bring increased lower cost North American refined products supplies into Central Pennsylvania, resulting in substantially lower gasoline prices for consumers. One can fully expect a dramatic and sustained price war producing massive savings for Pennsylvania consumers. A single penny reduction in gasoline prices in Pennsylvania will save consumers over $70 million per year. The proposed reversal will result in hundreds of millions of dollars of savings to Pennsylvania consumers, which in turn will increase consumer spending, expand the economy and produce new jobs.

Pittsburgh. As to the loss of East Coast pipeline supply to Pittsburgh, two points should be made. First, as noted above, Pittsburgh today has eight sources of supply; after the reversal it will still have seven. There will be no reduction in the reliability of supply. By contrast, Central Pennsylvania today has one pipeline source of supply; after the reversal it will have two.

Second, prices will not increase in Pittsburgh, nor will they be more volatile. As a result of the shale oil revolution, Midwest consumers currently enjoy some of the lowest gasoline prices in the country, and everyone agrees, including our opponents, that the reversal will result in lower prices in Central and Eastern Pennsylvania. Yet, somehow our opponents contend that prices in Pittsburgh will go up after the reversal. This just doesn't make any sense as shown on the attached map which sets forth expected conditions before and after the reversal. The only way prices will go up in Pittsburgh is if the Commonwealth interferes with free market competition and restricts eastbound interstate transportation on the reversed segment of the Laurel pipeline.

Lost Profits. Our opponents also allege that Pittsburgh is an important, highly profitable market and allege that loss of access to the Pittsburgh market will result in lost profits, financial harm and lost jobs. There are several fundamental problems with this argument. First, Pittsburgh is not a highly profitable market for the Philadelphia refineries. They do not make more money if the product goes to Pittsburgh, versus any other destination. The destination is irrelevant; the profit is the same. In fact, the Philadelphia refineries do not even know how much of their product goes to Pittsburgh.

Second, the refineries' argument that Pittsburgh is an important market is belied by the fact that they and their customers ship very little of their product to Pittsburgh and are shipping less and less all the time. As noted above, shipments from the east to Pittsburgh have declined by over 55% in the last ten years and continue to decline at a substantial and consistent rate. In particular, the Philadelphia refineries, collectively ship very little product to Pittsburgh. In 2017 through September, volumes moved under the PUC tariffs to Pittsburgh destinations were a de minimis percentage of the production capacity of the two Pennsylvania refineries attached to Laurel – it is simply not a significant market.

Third, any loss of the Pittsburgh market will not cause the Philadelphia refineries to lose any sales; the refiners still have ample access to very large markets in Pennsylvania and New York, through their uninterrupted connections to Laurel and Buckeye. Instead, after the reversal overseas imports, which are the highest-cost (*i.e.* marginal) supplier, will be backed out of the East Coast market, and the Philadelphia refineries will step in and make those sales.

Our opponents also assert they have no alternative outlets for their product. The record at the PUC demonstrates that this is simply not true. By their own admission, these refineries have many alternatives to get their product to market, which they have been using, are actually using today and will continue to use in the future to make up for their ever declining shipments to Pittsburgh. PESRM itself has candidly stated in public filings with the United States Securities and Exchange Commission that it has: "a vast network of truck loading racks, pipelines, barges, refined product storage terminals and docks located at, or downstream of the Philadelphia refining complex that enable [Philadelphia Energy Solutions] Refining to market and distribute its refined products throughout PADD I and internationally." Monroe also has good alternatives which they are actively using today. Moreover, as a part of the proposed Laurel reversal, both refiners would be afforded a newly expanded alternative pipeline connection to move additional volumes into Upstate New York, which would largely offset any de minimis impact from the loss of access to the Pittsburgh market.

While the Philadelphia refineries will not lose any sales, all parties agree the proposed reversal will increase competition and reduce gasoline prices in Central and Eastern Pennsylvania. This may result in reduced profits for refiners and marketers. However, this socalled "harm" results directly from the affirmative public benefit of lower gasoline prices and provides no basis for rejecting the proposed reversal.

Finally, a lot has been said about the financial condition of Philadelphia area refineries, and it has not all been consistent. Before the PUC they argue financial distress. To their investors, it is a far different story. I don't know which is true, but this issue should be fully investigated by this Committee before it reaches any conclusions. I personally hope the refineries are doing well, but if they are not, perhaps the legislature should act to help them. But, there are many ways to do this. For example, in 2015, the state gave PESRM $25 million to help support its operations. There have been some issues regarding where the money went, and whether it did anything to protect jobs or improve operations. In any event, the wrong answer here is to try and insulate the refineries from free market competition from the Midwest and deny Pennsylvanians hundreds of millions of dollars of benefits from lower gasoline prices. This is not necessary, not in the public interest and would be extraordinarily poor public policy.

Again, the Marcellus Shale provides an apt precedent. Lower natural gas and electricity prices from the Marcellus Shale have placed significant competitive pressure on Pennsylvania's coal and nuclear power plants. As a result, a number of those plants are now operating at a loss and may go out of business. For instance, in Ohio, state law makers are considering whether "zero emissions credits" would keep local nuclear plants from shuttering due to increased competition from natural gas power generation.[2] In our own state, both houses of the Pennsylvania legislature recently addressed this issue, and approved resolutions encouraging the FERC to consider a proposal by the Department of Energy that would provide guarantees to the coal and nuclear power industries. I am not here today to address the merits of these subsidies. Notably, however, no one is proposing that we help the coal and nuclear plants by interfering

[2] http://www.cleveland.com/business/index.ssf/2017/02/firstenergy_corp_to_sell_or_cl.html.

with the competitive market, restricting greater access to Marcellus Shale gas and thereby denying Pennsylvanians the benefits of lower priced natural gas and electricity. Similarly, if the Commonwealth determines that Philadelphia refineries require some form of assistance, so be it, but we should not help the refineries by protecting them from the free market and interstate competition and thereby burden the public with artificially high gasoline prices. This is not a reasonable result.

Conclusion.

So, where do we go from here? The bottom line is the PUC is faced with a decision, one that should be made based on the facts and record developed before the ALJ. The PUC proceeding has been underway for over a year, has produced a voluminous, detailed record on which the Administrative Law Judge will base her recommended decision. The Judge and the Commission have access to the full record and should be encouraged to weigh the evidence and render a decision based on the law, the facts and the good of the consumers of the Commonwealth, not the wants of special interests or the opinions of those who don't have all of the facts.

The proposed reversal is an exciting opportunity to bring lower cost gasoline, diesel fuel, heating oil and jet fuel to all Pennsylvanians, improve reliability of service and reduce reliance on foreign oil imported from overseas. Thank you for your time and attention. We would be happy to address any questions.