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MARKETS

The Hottest Energy Trade: A Ride Aboard the Colonial Pipeline

Energy companies and trading firms are scrambling for space on the nation's biggest refined-fuel pipeline

A secondary market has sprung up around rights to ship on the Colonial Pipeline. Its operations near Atlanta are seen here.
PHOTO: KEVIN G. HALL/TNS/ZUMA PRESS

By Nicole Friedman

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Energy companies and trading firms are scrambling for space on the nation's biggest refined-fuel pipeline, as U.S. infrastructure fails to keep pace with the oil boom.

The Colonial Pipeline, which covers 5,500 miles stretching from Texas to New Jersey and delivers about 40% of the gasoline consumed on the East Coast, is full. Completed in 1964 and stretching across 13 states, the pipeline is the primary artery connecting the Gulf Coast, where much of the nation's gasoline, diesel and jet fuel is produced, to the East Coast, the biggest-consuming region.

The shortage of space on Colonial has spawned a secondary market for the right to ship fuel, creating new profit opportunities for anyone who can afford to apply for space. But it also raises the ire of fuel distributors and retailers that have long depended on the pipeline to carry fuel to their customers.

The competition underscores the strain on the country's infrastructure. Rising output in the U.S. has made it more profitable to process crude on the Gulf Coast than in the Northeast; many refineries in the Northeast—which didn't have easy access to cheap U.S. shale oil—shut down. As a result, more fuel now needs to be moved along Colonial.

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The pipeline's size has barely increased with the demand to transport fuel. For refiners, commodity-trading firms and gas-station networks, space on the pipeline used to be easy to get. Now, the pipeline's operator is forced to ration it.

Colonial allocates space on the pipeline six times a month by assigning companies a certain number of barrels that they can ship. Shippers can put products that they own on the pipeline, or they can use their space allocation to ship another company's fuel. No rules prohibit a company from reselling its pipeline space.

"Line-space trading" is akin to scalping tickets to an event, said Matthew Kohlman, a senior managing editor at pricing service Platts, a unit of McGraw Hill Financial Inc. "There's only a certain amount of tickets available," Mr. Kohlman said.

Traders have paid more than 20 cents a gallon, or $8.40 a barrel, to ship on Colonial's system, on top of standard transportation fees levied by the pipeline itself, according to pricing services. For a standard 25,000-barrel batch, that comes to $210,000.

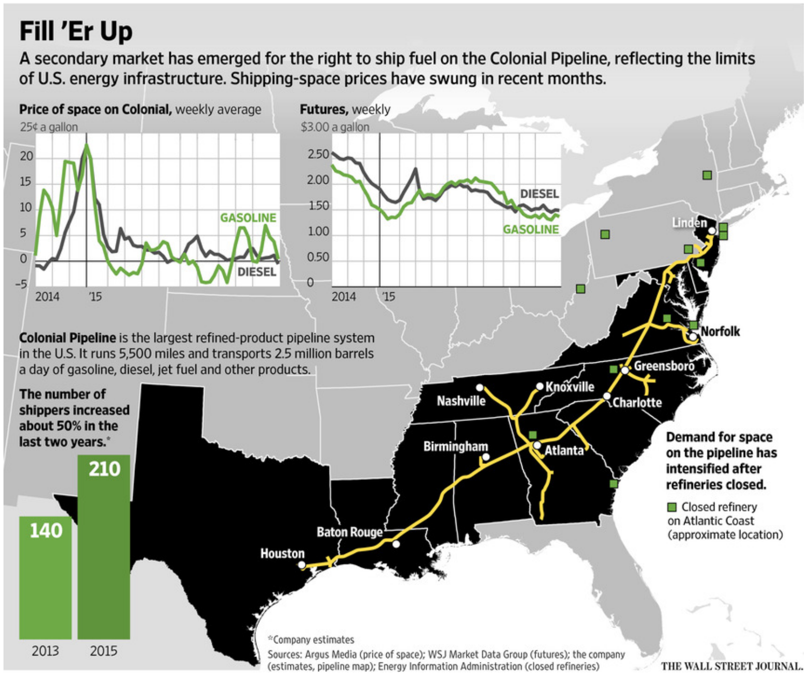
Roger Johnson's trucking company, Badlands Tank Lines LLC, applied for and secured space on Colonial through a partnership with another firm even though Badlands doesn't typically sell fuel.

"Most people are like, 'What are you guys doing?'" Mr. Johnson said. He didn't disclose the details of his Omaha, Neb., firm's financial arrangement or the identity of his business partner, but said the partner took care of all the logistics, including buying fuel to ship on the pipeline.

The additional costs are at times passed on to consumers in the form of higher prices. The impact at the pump, though, has been muted because retail gasoline and diesel prices have fallen to multiyear lows.

Most of the space is set aside for regular shippers such as Phillips 66 Co. that have moved a large amount of product in the past 12 months. The remaining 5% to 10% is doled out through a lottery system among remaining firms. If a company wins the lottery, it can ship at least 25,000 barrels of product on the pipeline—or sell that space to someone else.

“People figured out that if you signed up, they were going to give you 25,000 barrels, and there was value there,” said Jordan Fife, trader at BioUrja Trading LLC. “Everybody and their broker jumped in and tried to do it all at once.”



Between 2013 and 2015, the number of shippers on Colonial rose 50%, from about 140 to more than 210, according to operator Colonial Pipeline Co.

Colonial, which ships about 2.5 million barrels of refined products a day, charges about 5 cents a gallon to transport fuel from Houston to New York, a tariff approved by the Federal Energy Regulatory Commission. The pipeline’s owners are Koch Industries Inc., South Korea’s National Pension Service, KKR & Co., a Quebec pension fund, Royal Dutch Shell PLC and IFM Investors. The company reported net income of $76.8 million to FERC in the second quarter, up 14% from the prior year.

The price for space averaged 0.4 cent a gallon for gasoline and minus 0.55 cent for distillates, a category that includes diesel and jet fuel, in the week ended Nov. 6, according to pricing service Argus Media. A negative price indicates that companies with pipeline space would rather keep their fuel in the Gulf Coast and sell it to customers there, so they pay other companies to use the space they don’t need. Prices for line space for gasoline and distillates rose above 20 cents a gallon in late 2014 due to relatively high East Coast fuel prices.

Traders say the number of speculative players in the market has expanded, raising costs for end users that rely on the pipeline. As more shippers joined the fray, companies including gas-station chains Sheetz Inc. and QuikTrip Corp. told FERC, which oversees interstate pipelines, they were getting less space to ship on Colonial than they needed.

That “forced us to purchase more expensive fuel outside the Colonial system, directly affecting our ability to lower...costs,” said D. Sean Harp, Sheetz’s director of petroleum supply, in a FERC filing in 2013. Sheetz declined to comment beyond the filing.

Colonial is powerless to stop the trading of pipeline space, traders and brokers say. The trading takes place after the pipeline has allocated space to customers, and federal law requires the pipeline to allow any qualified company to ship on the pipeline. The practice of space trading is spreading to other pipelines, they add.

A surefire way to eliminate the speculative market for space would be to expand the system's capacity significantly. But at this point, said Dave Doudna, Colonial's chief financial officer, Colonial doesn't have support for a multibillion-dollar construction project.

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