

Fuel Storage Agreements: Key Commercial Issues

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A Practice Note discussing key commercial issues of storage agreements for fuel products in above-ground storage tanks used in the midstream industry. This Note identifies critical commercial topics that parties should address when negotiating and drafting fuel storage agreements, including delays in the construction of a new terminal, basic and additional services, contracted storage capacity, throughput reservation, dedication and commingling, capacity allocation, fees and charges, payment security, and breach and remedies.

Midstream companies often provide storage services in above-ground storage tanks for products refined from crude oil or used as fuel for various purposes including gasoline, jet fuel, fuel oil, diesel, and ethanol. Ethanol is a renewable fuel made from corn, sugar, or various plant materials known generally as biomass. In the US, 94% of ethanol is produced from the starch in corn grain. More than 98% of US gasoline is blended with ethanol, typically E10 (10% ethanol, 90% gasoline) to oxygenate the fuel, which reduces air pollution as the gasoline is more completely combusted.

In addition to one or more storage tanks, the facilities for the provision of fuel storage services (often referred as terminals) may include:

- Piping interconnecting the tanks and for the receipt and redelivery of product by pipeline.
- A truck or rail car rack for the unloading and loading of product into trucks or rail cars.
- A dock and appurtenant facilities for the unloading and loading of product into vessels.

Fuel products storage services are typically rendered under storage agreements entered into between the terminal owner (Owner) and an upstream producer, its trading affiliate, or a third party trader or buyer (Customer).

This Note discusses key commercial considerations that the owner and customer should address when negotiating and drafting storage agreements.

For additional information on storage generally, as part of the midstream industry, see [Practice Note, US Oil & Gas Industry: Overview: Activities Involved in the Midstream Segment](#).

For a discussion of other agreements typical of the midstream industry, see Practice Notes:

- [Gathering Agreements: Overview](#).
- [Gas Processing Agreements: Overview](#).
- [Oil & Gas Pipeline Transportation Agreements: Overview](#).

Construction of a New Terminal

Storage agreements are sometimes entered into before the terminal is built. This often happens when the owner needs to show contracted revenues to third party lenders as a condition to the lenders releasing the loans to pay for the construction of the terminal. Under these circumstances, key commercial issues the parties should consider include:

Defining the Scheduled Commencement Date

Defining the scheduled commencement date is critical for the customer because it must make arrangements:

- Upstream of the terminal to procure and deliver the products to the terminal.



- Downstream of the terminal to receive the products and transport them to the final points of marketing or consumption.

Defining a commencement date, however, is difficult for the owner when the construction of the terminal has not even begun.

The parties in these cases usually agree on:

- A time window within which the provision of the services must begin.
- Timelines or milestones for the progressive narrowing of the time window to arrive at a specific date.

Consequences of Delays

Delays in the commencement of services are damaging to both parties:

- The owner foregoes revenues and continues accruing interest on the construction loan.
- The customer may have invested in upstream and downstream infrastructure and commercial commitments. Additionally, the customer is foregoing the revenues from its downstream fuels business.

When delays occur relative to a narrowed and defined services commencement date, it is usually the customer who accrues remedies against the owner (unless the customer caused the delay). Customer's remedies may include:

- Liquidated damages (see Delay Liquidated Damages).
- Termination of the agreement (see Termination by Long Stop Date and Termination Liquidated Damages).

The customer may have agreed to enter into an agreement with the owner's lenders giving the lenders the right to cure a default of the owner before the customer exercises any termination rights. In this event, the customer's termination right will be subject to the provisions of the agreement with the owner's lenders.

Delay Liquidated Damages

Delay liquidated damages usually accrue for each day of delay relative to the scheduled commencement date. Usually the delay liquidated damages do not accrue when the delay is due to force majeure.

For a discussion of liquidated damages clauses generally, see [Practice Note, Damages for Breach of Commercial Contracts: Liquidated Damages Clause](#). For resources addressing force majeure generally, see [Force Majeure Toolkit](#).

Termination by Long Stop Date

Most storage agreements do not permit indefinite delays, even when delay liquidated damages are payable. In many instances the customer has the right to terminate the storage agreement if the services have not commenced by a deadline or long stop date. It is not uncommon that this termination right accrues even if the delay was due to force majeure.

Termination Liquidated Damages

In addition to liquidated damages for the delay itself, many customers insist on having the right to receive liquidated damages as compensation for the loss of the storage agreement on a termination by the customer due to the owner's failure to commence the services by the long stop date. In many cases these liquidated damages are payable only if the delay was attributable to the owner and not due to force majeure.

Conditions Precedent

Without prejudice to customer's remedies for delays (see Consequences of Delays), the owner will usually condition its obligation to provide the services to the satisfaction of the following conditions:

- Obtaining:
 - all required governmental permits and authorizations;
 - all required land use rights and third party consents (if applicable); and
 - third party financing (if applicable).
- Construction completion.

Services Provided

Definition of Products

The storage agreement must identify and define which fuel products will be covered. Terminals often receive and store only certain fuel products (for example, gasolines and diesel but not jet fuel) because:

- Fuel products delivered by one customer are commonly comingled in the tanks of the terminal with the products of other customers.
- The overall tank capacity in the terminal is limited.

The storage agreement also provides that the covered products must comply with certain standards or quality

specifications. This ensures that the product of one customer is not “contaminated” by the product of another customer. For example, in the US gasolines must comply with certain standards imposed by the Environmental Protection Agency (EPA):

- To address ground level ozone or “smog” and to reduce toxic emissions from the fuel burned in cars and trucks.
- That prohibit lead additives, limit sulfur content and certain toxic chemicals, and require certain formulations and addition of oxygenates.

Gasolines, in addition, are typically divided by octane ratings resulting in regular, midgrade, and premium gasoline. It is possible that a terminal can only accept regular gasoline.

It is the responsibility of the owner to all customers to ensure that the product received from any customer meets the requisite quality specifications of the product. The owner typically has the right to reject product tendered by a customer that fails to comply with the agreed specifications.

Definition of Terminal Services

The services provided by the owner under a storage agreement commonly include:

- Basic services (see Basic Services).
- Additional services (see Additional Services).

Basic Services

The basic services under storage agreements are:

- Receipt of the covered products tendered by the customer at the agreed receipt point. Depending on the configuration of the terminal and its interconnection capabilities, the customer may deliver products to the terminal by rail, truck, or pipeline. If the terminal is at a port, the customer may also deliver products by vessel.
- Storage of the customer’s product at the terminal.
- Redelivery of the products to the customer at the agreed delivery point. Depending on the configuration of the terminal and its interconnection capabilities, the owner may redeliver products to the customer by delivering them into a pipeline, loading them on rail cars or trucks or, if the terminal is at a port, by loading them onto a vessel. The customer is responsible to procure the receipt facilities or capacity rights in receipt facilities to take redelivery of the products from the owner.

Additional Services

Storage agreements may require that the owner provides additional services including:

- Blending of additives (provided by the customer) into the product. Many fuel retailers seek brand differentiation by including certain additives to the gasoline and therefore claim better or cleaner performance. Blend ratios (recipe) must be specified by the customer and any cost of testing or analyzing after the blending are for account of customer.
- Blending of gasoline with ethanol. Since this blending is required in the US, many terminals also offer this blending service. Usually, the customer provides both the gasoline and the ethanol for blending. Most terminals are not in the commercial business of selling product or additives to customers.
- Laboratory testing.
- Certain defined dock services to vessels, in the case of marine terminals.

Quantification of Contracted Storage Capacity Per Product and Per Customer

The storage agreement must specify the overall storage capacity that the customer has the right to use, divided per covered product. This capacity is usually measured in barrels. For example:

- The terminal may have a total storage capacity of one million barrels, distributed among three tanks of 200,000 barrels each and four tanks of 100,000 barrels each.
- Based on the demand of its customers and certain tank required specifications, the owner may allocate certain tanks to certain products, offering overall storage capacity per product, which is a fraction of the overall capacity of the terminal.
- In this example, a customer may contract for 150,000 barrels of total storage capacity, divided among:
 - 50,000 barrels of regular gasoline;
 - 25,000 barrels of midgrade gasoline;
 - 25,000 barrels of premium gasoline;
 - 10,000 barrels of ethanol;
 - 20,000 barrels of diesel; and
 - 20,000 barrels of jet fuel.

The customer may always use less than the contracted storage capacity if it so wishes because it pays the same

storage charge in consideration for the reserved right to store, regardless of its utilization. However, it may not use more than the contracted capacity without the prior agreement of the owner (and the payment of an excess storage fee) as all excess storage capacity may have been contracted with other customers.

Throughput Reservation Per Product Per Customer

Throughput is the rate (usually per day) at which the terminal may receive and redeliver product. Following with our example above, for a customer with a total contracted storage capacity of 150,000 barrels the storage agreement may provide for a throughput right of 25,000 barrels per day. The throughput reservation is also further allocated per product. If the customer wishes to deliver or receive more product than the agreed throughput right, the customer may do so only with the prior agreement of the owner and the payment of an excess throughput charge.

Dedicated Versus Shared Tanks

Product of customers with the same specifications are generally commingled in the terminal's tanks allocated by the owner to the product. However, a customer may require a dedicated tank for a variety of commercial reasons, including that the customer's product already comes blended to certain specifications and the specification would be diluted if commingled with other product. The storage charge for a dedicated tank is normally higher than for a shared tank.

Allocation of Available Capacity in Curtailment Events

Often times the terminal may not operate at full storage /or throughput capacity, or both. This may be due to maintenance, force majeure events, faulty operations, or other reasons. Aside from any remedies available to a customer due to reduced operational availability of the terminal, the storage agreement should specify how the owner will allocate the reduced operational capacity among the terminal's customers. Curtailment situations may affect:

- The rate at which the terminal receives product.
- The overall storage capacity.
- The rate at which the terminal redelivers product.

As a general rule, available operational capacity is allocated in proportion to the contracted capacity. Sometimes, however, owners:

- Give preference to certain customers giving them the right to maintain their contracted capacity, including customers:
 - that signed up first for capacity in the terminal; or
 - with large commitments.
- Allocate excess available operational capacity among the remaining customers, after meeting the needs of preferred customers.

The existence of a preference in favor of one or more customers must be disclosed in the storage agreement with all customers and the allocation rules be clearly provided.

Charges, Billing, and Payment

In consideration for the agreed services, the customer must pay the owner the fees, rates, and charges set out in the storage agreement. These usually include:

- Storage charge (see Storage Charge).
- Throughput charge (see Throughput Charge).
- Other charges (see Other Charges).

Storage Charge

This is the charge payable by the customer in consideration for the contracted storage capacity in the terminal. It is a dollar amount per barrel multiplied by the number of barrels of storage capacity. This amount is normally payable on a monthly basis. The storage charge is typically payable regardless of actual usage by the customer.

Throughput Charge

This is the charge payable by the customer in consideration for the daily throughput reservation right of the customer provided in the storage agreement. The throughput reservation is the maximum daily quantity of barrels of product that the customer has the right to deliver to the terminal and receive from the terminal. It is a dollar amount per barrel. As with the storage charge, the throughput charge is normally payable on a monthly basis. For example, if the total throughput reservation is 25,000 barrels per day, the throughput charge for a month is equal to the agreed charge per barrel, multiplied by the number of barrels of throughput reservation, multiplied by the number of days in the month. The throughput charge for the throughput reservation is typically payable regardless of actual usage by the customer.

In many agreements the storage charge and the throughput charge are factors of a single capacity charge (see Storage Charge).

Other Charges

The storage agreement may provide for additional charges, most commonly:

- Additive injection fees.
- Blending fees.
- Excess used storage capacity or throughput fees.

When the terminal is at a port, there may also be additional charges related to the loading or unloading of vessels and the usage of the terminal's dock. Port charges (for example, tug, pilot, and so on) for port services not provided by the terminal owner are payable by the customer directly to the appropriate port authority or third-party service provider.

Payment

The storage charge and throughput charge are usually payable even though service is curtailed or suspended if due to:

- Force majeure.
- Scheduled maintenance.
- Events attributable to the customer.

The customer usually has the right to suspend payments when service is curtailed or suspended due to:

- Unscheduled maintenance.
- Works at the terminal (like expansions or modifications).
- Events attributable to the owner.
- Events attributable to a third party.

Billing

The storage agreement will provide for the frequency of billing (usually monthly), the time within which the customer must pay the invoice to the owner, and for the event that the customer disputes an invoice.

If the customer disputes an invoice, unless there is manifest error, the customer is typically required to pay the disputed amount first and then resort to the mechanisms under the storage agreement for the resolution of disputes. If the customer is found to have overpaid, the owner is usually required to refund the excess amount paid plus interest.

Payment Security

Some storage agreements may provide that the customer must deliver security to support its payment obligations under the storage agreement. This security may take the form of a stand-by letter of credit or a payment guarantee from a credit-worthy affiliate.

Breach and Remedies

Customer's Breach

The owner often has the right to suspend the service for lack of payment by the customer. The owner may further exercise the right of early termination of the storage agreement if the customer:

- Fails to pay.
- Breaches a material obligation.
- Fails to provide credit support.
- Assigns the storage agreement without the consent of the owner.
- Breaches certain specified business conduct obligations.

Owner's Breach

If the owner fails to provide the service, the customer has the right to withhold payment and, sometimes, also the right to collect damages arising out of the lack of service. These damages generally are liquidated based on the number of days or barrels involved.

The customer may also exercise the right of early termination of the storage agreement if the owner:

- Fails to provide the services for an agreed extended period of time (even if due to force majeure).
- Assigns the agreement without the required consent of the customer.
- Breaches certain specified operating standards or business conduct obligations.

Other Issues

Nominations

The delivery of product by the customer to the terminal, and the redelivery of product by the owner to the customer, whether into or from a pipeline, truck, rail car or vessel, in either case starts with service nominations made

by the customer within its contract rights and with the requisite prior notice.

The nominations must indicate:

- The applicable number of barrels of each specific product.
- The day of service.
- The specific delivery and receipt point within the options provided in the storage agreement.

The nominations of the customer must be confirmed and executed by the owner. The storage agreement may also provide for the conditions under which the customer may change a nomination.

Capital Repairs

Under some storage agreements the owners seek to have the right to require that the customers contribute towards capital repairs necessary to restore service following an event of force majeure that damages the terminal.

Customers generally resist these provisions, requiring instead that the owner carry insurance and that the owner agrees to allocate insurance proceeds towards the repair of the terminal and, therefore, the resumption of the full services.

Changes in Law

Under some storage agreements the owners also seek to have the right increase the amounts payable by the customers if changes in law occurring after the signature date of the storage agreement require significant additional capital investment by the owner or that result in increased operations and maintenance costs. These provisions are most typically found in storage agreements covering a terminal to be built.

For a discussion on changes in law provisions in midstream agreements generally, see [Practice Note, Midstream Gathering, Compression, and Processing Agreements: Payment Risk and Change in Law Risk](#).

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Tank Heel and Line Fill

Storage tanks require a minimum volume of product to be above the level of the pump suction of the tank. This volume is generally referred to as “tank heel.” Over time, storage tanks accumulate sediment, dirt, water, and other substances at the bottom. These must be periodically cleaned up (this is an example of scheduled maintenance that renders the tank inoperative during the cleaning operations) and the settlings can be disposed of or treated by chemicals to recover additional hydrocarbons. These settlings are called “tank bottoms”.

Liquids pipelines have a certain volume of product that unavoidably resides in the pipeline net of receipts and deliveries. This is generally referred to as “line fill”.

Storage agreements typically provide that:

- Customers must provide their share of tank heel and line fill.
- Only inventory levels above the customer’s share of tank heel and line fill are available for redelivery in the ordinary course.

The owner usually redelivers the volume share of tank heel and line fill at the end of the storage agreement, as it will be replenished by subsequent customers. Storage agreements also provide for inventory deductions to account for tank bottoms.

Open Access

Many applicable jurisdictions impose a requirement of open access to the terminal. Generally, these “open access” requirements apply about unused capacity, either because it has not been contracted with a customer on a long-term basis or, if contracted, it is not actually being used by the customer. If these requirements apply, the storage agreement usually provides that:

- The customer acknowledges and agrees that when available capacity exists, the owner must provide open access to the terminal to third party users requesting terminal services.
- If available capacity is contracted (and paid for) but unused by a customer, the third party’s rights are interruptible (as the original customer can always resume the exercise of its storage rights) and the owner must credit back to the customer all or a portion of the fees paid by the third party up to the amounts paid by the customer.