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124 FERC ¶ 63,016
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Mid-America Pipeline Company, LLC	Docket Nos. IS05-216-003 IS05-260-003 IS06-238-000 IS06-520-000
Williams Energy Services, LLC and Williams Power Company, Inc. v. Mid America Pipeline Company, LLC, and Seminole Pipeline Company	Docket No. OR06-5-000

INITIAL DECISION

(Issued September 3, 2008)

Appearances

Steven H. Brose, Daniel J. Poyner, Andrew R. Knudsen, Steven Reed, Christon E. Ball, and *Kathryn L. McCoy* on behalf of Mid-America Pipeline Company, LLC and Seminole Pipeline Company

Richard E. Powers, Jr., Steven A. Adducci, Christopher K. Diamond, and *Judith M. Andrade* on behalf of National Propane Gas Association, AmeriGas Propane, L.P., CHS Inc., ConocoPhillips Company, Targa Liquids Marketing and Trade and Ferrellgas, L.P.

Randolph L. Jones, Jr., Rabeha S. Kamaluddin, Excetral K. Caldwell and *Shelley Carter* on behalf of Williams Energy Service, LLC and Williams Power Company, Inc.

Andrew T. Swers and *Joseph S. Koury* on behalf of Burlington Resources Trading, Inc.

Donald A. Heydt and *Debora E. Lyon* on behalf of the Federal Energy Regulatory Commission

EDWARD M. SILVERSTEIN, Presiding Administrative Law Judge

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Preliminary Statement

1. Mid-America Pipeline Company, LLC (Mid-America), on March 31, 2005, filed a cost justified tariff with the Commission proposing to increase most general commodity rates for transportation of natural gas liquids (sometimes NGLs) on its three pipeline systems by 23%, which was assigned Docket No. IS05-216-000.[1] *Mid-America Pipeline Co.*, 111 FERC ¶ 61,128 at P 1, 4 (2005). The Commission accepted and suspended the tariffs[2] subject to refund, effective May 1, 2005. *Id.* Interventions and protests were submitted by Burlington Resources Trading, Inc. (Burlington), Navajo Refining Company, L.P. (Navajo), and Williams Power Company, Inc., and Williams Energy Services , LLC (jointly Williams).

2. To cancel FERC Tariff No. 37, on May 20, 2005, Mid-America filed Tariff No. 40 which was assigned Docket No. IS05-260-000. *Mid-America Pipeline Co., LLC*, 111 FERC ¶ 61,483 at P 1 (2005). Williams and Burlington protested this filing. *Id.* The Commission accepted the filing, suspended the tariff subject to refund, and consolidated the proceeding with Docket No. IS05-216-000. *Id.* In FERC Tariff No. 40, Mid-America "propose[d] to decrease certain General Commodity Rates in Item 210 for Demethanized Mix movements originating in Groups 100, 101, and 102 for delivery to the Hobbs Fractionator and Group 950 destinations." *Id.* at P 3. The Commission noted that these rates were not at issue in Docket No. IS05-216-000 and that Mid-America also proposes two new items (320 and 320A) "which offer a new Demethanized Mix incentive rate program for movements from the same origins to the same destinations, but with different qualifying provisions that its existing incentive program under Items 310 and 310C that shippers must satisfy to receive the incentive rate." *Id.*

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[1] The Commission described the Mid-America system as follows:

> [Mid-America] consists of three pipeline systems. The Rocky Mountain/Four Corners System is approximately 2,548 miles long and transports NGLs from points in Wyoming to Hobbs-Gains, Texas. The Central System is a bi-directional pipeline approximately 1,938 miles long that extends between Hobbs-Gains, Texas, and Conway, Kansas. The Northern System is a 2,740 mile pipeline that moves NGLs north from Conway, Kansas, through the upper Midwest to destinations in Minnesota and Wisconsin.

Mid-America Pipeline Co., LLC, 111 FERC ¶ 61,128 at P 3.

[2] FERC Tariff No. 37 relates to the Rocky Mountain/Four Corners System; FERC Tariff No. 38 relates to the Northern System; and FERC Tariff No. 39 relates to the Central System. *Mid-America Pipeline Co., LLC*, 111 FERC ¶ 61,128 at n.1.

3. On March 31, 2006, Mid-America filed FERC Tariff No. 41 cancelling FERC Tariff No. 38. *Mid-America Pipeline Co., LLC*, 115 FERC ¶ 61,124 at P 1 (2006). According to the Commission, FERC Tariff No. 41 would "increase most of the General Commodity Rates in Items 230 through 270 for movements" on Mid-America's Northern System to various destination, change wording regarding origin points for certain movements, and establishes a new Seasonal Discount Program in Item 400. *Id.* at P 4. This filing was protested by the Propane Group (National Propane Gas Association, AmeriGas Propane, L.P., CHS, Inc., ConocoPhillips Company, Targa Liquids Marketing and Trade, and Ferrellgas, L.P.), Williams, and Burlington. *Id.* at P 2. The Commission accepted and suspended the tariff subject to refund, effective May 1, 2006, and consolidated this proceeding with Docket Nos. IS05-216-000 and IS05-260-000. *Id.* at P 3.

4. Williams, on March 6, 2006, filed a complaint against Mid-America and Seminole Pipeline Company (Seminole)[3] alleging that the Mid-America/Seminole "joint rates, as well as the underlying local rates, were unjust, unreasonable, unduly discriminatory, or otherwise invalid."[4] *Williams Energy Services, LLC and Williams Power Co., Inc. v. Mid-America Pipeline Co., LLC and Seminole Pipeline Co.*, 116 FERC ¶ 61,175 at PP 1-2 (2006). The Commission, though dismissing the complaint as regards Mid-America's rates,[5] set the complaint regarding Seminole's FERC Tariff No. 3 for hearing consolidating it with the instant proceeding and stated that the "justness and reasonableness of Seminole's local rate has not been determined."[6] *Id.* at PP 13, 39.

---

[3] Mid-America, the Commission notes, is a subsidiary of Enterprise Products Partners ("Enterprise") and "Seminole is a separate entity that is owned in large part by certain Enterprise Product Partners subsidiaries." *Williams Energy Services, LLC and Williams Power Co., Inc. v. Mid-America Pipeline Co., LLC and Seminole Pipeline Co.*, 116 FERC ¶ 61,175 at PP 4-5. Seminole's pipeline system "originates at the Hobbs-Gaines interconnection and extends to a loop near the Texas Gulf Coast, at Clemens, Stratton Ridge, and Mont Belvieu, Texas." *Id.* at P 5.

[4] Seminole and Mid-America provide a joint service originating on the latter's Rocky Mountain System and terminating at Group 950 on Seminole's under a joint tariff which Mid-America filed. *Williams Energy Services, LLC and Williams Power Co., Inc. v. Mid-America Pipeline Co., LLC and Seminole Pipeline Co.*, 116 FERC ¶ 61,175 at P 5.

[5] The Commissioned reasoned that the Mid-America tariffs in question were either cancelled or already under review in the instant proceeding. *Williams Energy Services, LLC and Williams Power Co., Inc. v. Mid-America Pipeline Co., LLC and Seminole Pipeline Co.*, 116 FERC ¶ 61,175 at P 23.

[6] The Commission did reject Williams's contention that Seminole did not establish

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5. Mid-America, on August 18, 2006, filed FERC Tariff No. 45 which cancelled FERC Tariff No. 42, was to be effective September 18, 2006, and was assigned Docket No. IS06-520-000. *Mid-America Pipeline Co., LLC*, 116 FERC ¶ 61,249 at P 1 (2006). Williams protested that filing. *Id.* The Commission indicated that Williams stated:

> FERC Tariff No. 45 cancels a portion of Item 210, *i.e.*, the separate rates for the "Ethane Component of Demethanized Mix" originating in Groups 100, 101, and 102 and moving to the Hobbs Fractionator and Group 950 . . . [subjecting] these movements . . . to the single Demethanized Mix rate shown in Item 210 [and cancelling] the previously-discounted rates from Groups 100-110 to the Hobbs Fractionator also in Item 210.

Id. at P 3. This proceeding also was consolidated with the ongoing proceedings. *Id.* at P 2.

6. After the parties, failed to reach an amicable agreement on their dispute, the proceeding was assigned to me as Presiding Administrative Law Judge on February 14, 2006.[7] After lengthy pretrial proceedings resulting from the numerous filings and consolidations, the hearing on this matter finally began on October 2, 2007, and ended on December 6, 2007. During the hearing 14 witnesses testified, and 564 exhibits were placed into evidence. At the end of the hearing, the parties agreed that the issues for decision were as follows:

> 1. Has Mid-America shown a "substantial divergence between the actual costs experienced by the carrier and the rate resulting from application of the index" under Section 342.4(a) of the Commission's regulations for the March 2005 and March 2006 filings, respectively?
>
> 2. What are the appropriate base and test periods for Mid-America's March 2005 and March 2006 filings, respectively?
>
> 3. Should the reasonableness of Mid-America's rates be determined on

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its initial rate in FERC Tariff No. 3 properly. *Williams Energy Services, LLC and Williams Power Co., Inc. v. Mid-America Pipeline Co., LLC and Seminole Pipeline Co.*, 116 FERC ¶ 61,175 at P 37.

[7] *See* "Order of Chief Judge Terminating Settlement Judge Procedures, Designating Presiding Administrative Law Judge, and Establishing Track III Procedural Schedule," issued February 15, 2006.

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the basis of the cost of service for the total company or separately for each pipeline system (*i.e.,* Rocky Mountain System, Central System and Northern System)?

4. What is the appropriate cost of service for each applicable period?

A. What is the appropriate level of rate base for each applicable period?

(1) What are the appropriate historical capital structures for use in calculating the deferred return component of rate base[,] and what is the appropriate net deferred return?

(2) What is the appropriate level and treatment of accumulated deferred income taxes (ADIT)?

(3) What is the appropriate basis for the allocation of rate base among the pipeline systems?

(4) What is the appropriate allocation to interstate and intrastate property?

B. What is the appropriate overall rate of return on rate base?

(1) What is the appropriate current capital structure?

(2) What is the appropriate cost of equity?

(3) What is the appropriate cost of long-term debt?

C. What is the appropriate income tax allowance?

D. What is the appropriate level of operating expense excluding depreciation?

(1) What is the appropriate allocation of common and indirect costs, including the appropriate amount of labor cost to use in the allocation?

(2) What is the appropriate allocation of corporate overhead costs?

(3) What is the appropriate level of fuel and power costs?

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(4) What is the appropriate level of pipeline integrity costs?

(5) What is the appropriate treatment of operating expenses associated with the ammonia pipelines?

(6) What is the appropriate allocation of expenses to interstate and intrastate service?

5. What is the appropriate level of throughput, in barrels and barrel-miles, for designing rates for each period?

6. What is the proper treatment of storage costs and revenues?

A. Are the storage services Mid-America offers to its shippers within the jurisdiction of the Commission?

B. Should Mid-America include a separate rate for storage in its tariff, and, if so, what is the appropriate rate?

C. Should Mid-America include storage costs in its transportation rates, and if so what is the appropriate amount?

7. What is the appropriate rate and cost[-]of[-]service treatment of Mid-America's contract with the East Red Line shipper?[8]

A. What is the jurisdictional status of transportation of the East Red Line Shipper's volumes from Channahon, Illinois[,] to Morris, Illinois[,] and what is the appropriate cost[-]of[-]service treatment for this service?

B. What is the appropriate rate and cost[-]of[-]service treatment of the Incentive Reliability payments by the East Red Line Shipper?

C. What is the appropriate rate and cost[-]of[-]service treatment

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[8] Mid-America, with the agreement of the other parties, insisted that the identity of the East Red Line Shipper be maintained confidential. I noted during the prehearing stage of these proceedings and at the hearing on a number of occasions that, while I would agree to this fiction, anyone with a modicum of internet knowledge could find out who the Shipper is through the use of Google. *See, e.g.,* Transcript at pp. 221-22, 3108.

of the Cochin volume shortfall payment from the East Red Line Shipper?

D. What are the appropriate tariff, rate and cost[-]of[-]service treatment of propane movements between Clinton, Iowa[,] and Conway, Kansas by the East Red Line shipper?

8. What is the appropriate rate design?

A. Is a discount adjustment, including the "iterative gas discounting methodology" associated with any shipper, including the East Red Line Shipper, appropriate for designing Mid-America's rates for the applicable periods?

B. If so, did Mid-America apply that discount adjustment correctly?

C. Should the rates be designed on fully allocated costs or the iterative gas discounting methodology?

D. What is the appropriate rate design for the seasonal discount program?

E. What is the appropriate rate design for volumes shipped under incentive rate programs?

F. What is the appropriate treatment of revenue credits in rate design?

9. Is the cancellation of the incentive rates for the transportation of the ethane component of demethanized mix in [FERC] Tariff No. 45 just and reasonable and otherwise lawful?

<u>Seminole Pipeline Company</u>

10. Is Seminole a FERC jurisdictional pipeline?

11. What are the appropriate volumes to use for rate design?

12. Is the currently effective [FERC] Tariff No. 3 rate just and reasonable, and if not, what is the appropriate rate?

13. If the [FERC] Tariff No. 3 rate is unjust and unreasonable, what

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reparations or refunds, if any, does Seminole owe shippers?

> 14. If the [FERC] Tariff No. 3 rate is unjust and unreasonable, how should the Mid-America/Seminole joint rates to Group 950 destinations be adjusted?

These issues will be addressed seriatim.

7. The omission of any discussion or argument raised by the parties herein does not indicate that it has not been considered. Rather, such matters are found to be irrelevant, immaterial, and/or without merit. In addition, any arguments made on brief which were not supported by reference to evidence in the record or to legal precedent were given no weight.[9] Finally, the testimonial evidence considered in this case was limited to factual statements of witnesses. Legal argument, conclusions of fact, conclusions of law, and supposition are not evidence and were given no evidentiary weight in the decision.

Stipulations[10]

8. Without necessarily agreeing with all of the conclusions drawn by the Propane Group from the facts stipulated to below, Mid-America makes the following Stipulations:[11]

> (a) Mid-America stipulates that all of the labor and salary numbers in Exhibit [No.] NPG-1 at pages 32-56 are accurate.
>
> (b) Mid-America stipulates that the data on page 1 of [Exhibit No.] NPG-69 and the data on Table 27, page 120 of Mr. O'Loughlin's testimony ([Exhibit No.] NPG-1) are accurate.
>
> (c) Mid-America agrees to the inclusion of Tri-States NGL Pipeline, LLC in the Massachusetts formula for allocating overhead in these

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[9] In a number of places in their briefs, one or more of the parties cited to documents, *e.g.*, complaints, letters, etc., which were not introduced and accepted into evidence at the hearing. Claims made by those parties relating to such citations were considered as being unsupported by record evidence and given no weight.

[10] In addition to the four stipulations repeated below, there were two additional stipulations (Joint Exhibit Nos. 4, 7) which involved agreements to the accuracy of certain data too numerous and detailed to be repeated here.

[11] Joint Exhibit No. 2.

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proceedings.

9. Mid-America and the Propane Group stipulate to the following facts regarding the current contract between Mid-America and the East Red Line Shipper, which is found in Exhibit No. NPG-93.[12]

(a) Mid-America stipulates that the December 24, 2003[,] filing of FERC No. 24, which implemented new incentive rates effective January 1, 2004, and which is referred to in the contract between Mid-America and the East Red Line Shipper, on page 22 of Exhibit No. NPG-93, as Exhibit "L", is contained in Exhibit No. NPG-180 (at pages 2 to 17).

(b) Mid-America stipulates that the two annual adjustments to its rates based on changes to the Producer Price Index for Finished Goods and changes to fuel prices that were made by Mid-America and referred to at Exhibit [No.] M-46, page 37, footnote 14, are (1) and adjustment to [FERC] Tariff No. 38[,] effective January 1, 2006, and contained in Exhibit No. NPG-180 (at pages 18 – 21), and [(]2) an adjustment to [FERC] Tariff No. 41, effective January 1, 2007[,] and contained in Exhibit No. NPG-180 (at pages 22 – 26).

10. The parties stipulate that the allocation of Mr. Bacon's salary is made monthly, based on that same month's total of the allocation of the salaries of the employees under Mr. Bacon.[13]

11. The parties stipulate that the conversion from the Enterprise account codes to account codes under the [Commission's] Uniform System of Accounts for Oil Pipelines is done by the regulatory accountants at Enterprise who are responsible for putting together the Form 6, and that the conversion is done as part of the process of preparing the Form 6.[14]

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[12] Joint Exhibit No. 3.

[13] Joint Exhibit No. 5.

[14] Joint Exhibit No. 6.

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MID-AMERICA ISSUES – SUMMARY OF THE EVIDENCE[15]

A. JAMES M. COLLINGSWORTH

12. James M. Collingsworth (Collingsworth) is the Senior Vice President of Regulated Natural Liquids Pipelines for Enterprise Products Company,[16] and testified on behalf of Mid-America. Exhibit No. M-1 at pp. 1-2. Collingsworth has responsibilities in the business unit for Mid-America, Seminole, Enterprise Terminals & Storage, LLC (Enterprise Terminals),[17] and Dixie Pipeline Company. *Id*. He stated that Mid-America

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[15] As the portion of these proceedings which involve Mid-America regard two tariff filings it made exactly one year apart, one of the complications inherent has been the difficulty, at times, in grasping the period of time being addressed by the parties and witnesses. To aid the reader, therefore, I provide the following explanation:

> (a) With regard to the March 2005 filing: (1) The Base Period is January 1, 2004, through December 31, 2004; and (2) the Test Period which includes the Base Period is January 1, 2004, through September 30, 2005. *See* Exhibit No. S-4 at p. 7; Staff Initial Brief at p. 7; Propane Group Initial Brief at p. 7.
>
> (b) With regard to the March 2006 filing: (1) The Base Period is February 1, 2005, through January 31, 2006; and the Test Period which includes the Base Period is February 1, 2005, through October 31, 2006. *See* Staff Initial Brief at pp. 7-8; Propane Initial Brief at pp. 7-8; Mid-America Initial Brief at pp. 6-7; Exhibit Nos. S-4 at p. 7; S-12 at p. 3; M-24 at pp. 9-10; NPG-1 at p. 29;

In addition, when the term Locked-In Period is used in connection with the March 2005 filing, the period referred to is May 1, 2005, through April 30, 2006. *See* Exhibit No. M-100 at p. 10; Mid-America Initial Brief at pp. 6-7. Moreover, some witnesses and parties have been using the vague terms "Period I" and "Period II." According to one witness, the former term refers to the period covered by the March 2005 filing (FERC Tariff No. 38), and the latter refers to that covered by the March 2006 filing (FERC Tariff No. 41). *See* Exhibit No. S-19 at pp. 3-5.

[16] The parties and witnesses referred to this entity sometimes as Enterprise Products Company and sometimes as EPCO, Inc., or EPCO. It was never made clear whether this reflected a name change or whether the latter was an abbreviation of the former. In any event, this entity appears to be the ultimate parent of all of the companies related to Mid-America and use of either of its aliases herein are to the same entity.

[17] This entity has been referred to as "Terminals," Terminaling," "Terminalling," and "ETS." In response to an email from my law clerk subsequent to the filing of initial

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was established in 1960 as an independent company which was publicly traded on the New York Stock Exchange and that, as it grew, the parent company MAPCO, Inc. (MAPCO) was formed. *Id.* at p. 2. According to Collingsworth, in 1998, ownership of MAPCO was transferred to Williams, and then, in 2002, Enterprise Products Company bought Mid-America from Williams, which still maintained control over MAPCO. *Id.* Continuing, Collingsworth added, Enterprise Products Company created Enterprise Product Partners, L.P. (Enterprise Product Partners) in 1998, which began operating Mid-America in February 2003. *Id.* at pp. 2-3.

13. According to Collingsworth, Mid-America transports natural gas liquids, which are the heavier hydrocarbons comprising natural gas. *Id*. These heavier hydrocarbons, Collingsworth said, including propane, butane, and natural gasoline are routinely removed from the gas stream at a processing plant and then moved in a liquid form, sometimes combined with other materials. *Id*. Collingsworth testified that one such combination is called a demethanized mix, which may contain ethane. *Id.* Because of this, he claimed, Mid-America's tariff reflects incentives to shippers to transport ethane in their demethanized mix, rather than in their natural gas stream on competing pipelines. *Id*. Also, Collingsworth stated that a process known as fractionation[18] allows the natural gas liquids to be separated into their individual components called purity products. *Id*. at p. 4.

14. Collingsworth testified that construction on Mid-America's first pipeline began in 1960 as a single line, used to transport purity products, running from near "Hobbs, New Mexico," to Conway, Kansas (the "South Leg").[19] *Id.* The pipeline has two extensions, Collingsworth asserted, one running from Conway to Pine Bend, Minnesota (the "West Leg"), and the other running from Conway to Janesville, Wisconsin (the "East Leg"). *Id*. A second pipeline was built in 1969, as an extension of the South Leg, he stated. *Id*. Around that time, Collingsworth added, Mid-America started to transport both purity products and demethanized mix. *Id*. He contended that, in 1978, Mid-America reversed the flow on one of the South Legs, allowing one line to move product from Hobbs to the north, and the other line moved product from Conway to the south. *Id*. According to Collingsworth, this flow pattern still exists today, and the South Leg lines are referred to as Mid-America's "Central System." *Id*. at pp. 4-5.

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briefs, counsel for Mid-America indicated that the correct name of it is "Enterprise Terminals & Storage, LLC."

[18] Fractionation is the process in which demethanized mix is separated into individual components. Transcript at p. 287.

[19] Although Collingsworth correctly identified Hobbs as a city in New Mexico, a review of the maps admitted into evidence indicates that Mid-America's Hobbs facility is in Gaines County, Texas, not New Mexico. *See* Exhibit Nos. M-2; NPG-142.

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15. Additionally, Collingsworth stated, between 1968 and 1973, Mid-America built another line onto the East Leg, called the East Red Line, which runs to Iowa City, Iowa, and Morris, Illinois. *Id*. at p. 5. He went on to state that, between 1969 and 1979, a line was added to the West Leg, called the West Red Line, which stretches from Conway, Kansas to Mankato, Minnesota. *Id*. According to Collingsworth, the East and West Lines, together, are referred to as Mid-America's "Northern System." *Id*. at p. 6.

16. Collingsworth asserted that, in 1973, Mid-America built a pipeline to transport demethanized mix, running from Hobbs to Farmington, New Mexico, called the Four Corners Line. *Id*. In 1980, Collingsworth stated, a line was constructed from Farmington, New Mexico, to Rock Springs, Wyoming, called the Rocky Mountain Line. *Id*. He claimed that both the Four Corners and Rocky Mountain lines underwent a process called looping in which more pipe was added to accommodate volume growth. *Id*. Taken together, the Four Corners and Rocky Mountain lines are referred to as the "Rocky Mountain System." *Id*. at pp. 6-7.

17. Continuing, Collingsworth explained that Mid-America filed three tariffs at the Commission on March 31, 2005: (1) FERC Tariff No. 37 for the Rocky Mountain System; (2) FERC Tariff No. 38 for the Northern System; and (3) FERC Tariff No. 39 for the Central System. *Id*. at p. 7. The tariffs, he claimed, increased the majority of Mid-America's local transportation commodity rates by 23%; however, they did not increase any joint or volume incentive rates. *Id*. Collingsworth testified that Mid-America filed these tariffs because it believed its pipelines were underearning, and because it experienced a significant, recent increase of operating expenses, to wit: (1) the cost of fuel to operate the pump stations; (2) pipeline integrity work required by the Department of Transportation; and (3) right-of-way clearing also mandated by the Department of Transportation. *Id*. at pp. 7-8. These tariff filings, he reported, were protested by: (1) the Propane Group;[20] (2) the Navajo Refining Company, L.P, a shipper on the Central System; (3) Burlington Resources Trading, Inc., a shipper on the Rocky Mountain System; and (4) Williams, also a shipper on the Rocky Mountain System. *Id*. at p. 8. Following the protests, according to him, the Commission suspended the tariffs and permitted them to go into effect on May 1, 2005, subject to refund and hearing procedures in Docket No. IS05-216-000. *Id*.

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[20] The Propane Group, according to Collingsworth, is comprised of Ferrellgas, L.P., Dynegy (now Targa), Liquids Marketing and Trading, Amerigas Propane, L.P., CHS Inc., ConocoPhillips Company, and the National Propane Gas Association. Exhibit No. M-1 at p. 8. Most of these entities are shippers on the Northern System, however, the National Propane Gas Association is not a shipper on any Mid-America pipeline, he noted. *Id.*

18. Mid-America filed FERC Tariff No. 40 on May 20, 2005, which decreased various joint rates between Mid-America and Seminole Pipeline as well as affecting some rates that had not been altered under FERC Tariff No. 37, Collingsworth stated. *Id.* He added that FERC Tariff No. 40 initiated a new incentive rate program and also decreased some Rocky Mountain System incentive rates previously unaffected by the filing of FERC Tariff No. 37. *Id.* at pp. 8-9. The tariff went into effect on July 1, 2005, according to him, subject to refund and a hearing investigation in Docket No. IS05-260-000, which was consolidated with Docket No. IS05-216-000. However, Collingsworth noted, Mid-America withdrew both FERC Tariff Nos. 37 and 40 on May 1, 2006. *Id.* at p. 9.

19. Collingsworth related that Mid-America filed FERC Tariff No. 41 on March 31, 2006, and that it established a seasonal discount program and additionally increased the Northern System's general commodity rates as raised by FERC Tariff No. 38. *Id.* This filing was protested by the Propane Group, according to him. *Id.* Continuing, Collingsworth reported that the Commission suspended the Tariff and allowed it to go into effect on May 1, 2006, subject to refund and investigation in Docket No. IS06-238-000, which was further consolidated with the Docket Nos. IS05-216-000 and IS05-260-000. *Id.* Also, Collingsworth explained that FERC Tariff Nos. 38 and 41 contain incentive programs and a seasonal discount program that applies to the Northern System, and that FERC Tariff No. 39 contains two volume incentive programs that apply to the Central System.[21] *Id.* at p. 10.

20. According to Collingsworth, there are two incentive programs on Mid-America's Northern System: (1) In Item 300 of FERC Tariff Nos. 38 and 41, a rate of 74.51 cents for movements of propane and ethane/propane mix from Conway to Clinton, Iowa and Morris, Illinois (compared with general commodity rates of 131.27 cents to Clinton and 161.65 cents to Morris); and (2) In Item 350 of Tariff Nos. 38 and 41, a rate of 79.10 cents for both propane and ethane/propane mix shipped south from the Mid-America interconnection with the Kinder Morgan Cochin Pipeline (Cochin Pipeline)[22] near Clinton, Iowa, to Conway Holding (compared with 262.62 cents for propane and 162.82 cents for ethane/propane mix). *Id.* at p. 11. He also described a seasonal discount

[21] Collingsworth additionally noted that, on May 1, 2006, Mid-America also filed FERC Tariff No. 42, which reduced certain Rocky Mountain rates, and to which Williams protested, but which has not been consolidated with this proceeding. Exhibit No. M-1 at pp. 9-10.

[22] In his rebuttal testimony, but not in his direct testimony, Collingsworth identified this as the "Kinder Morgan Cochin pipeline" *See* Exhibit No. M-46 at p. 27. He indicated that, until March 20, 2007, it was known as Dome Pipeline LLC, and that, on that date, "Kinder Morgan Cochin LLC filed adoption supplements, providing notice of the change in name and ownership and adopting the Dome tariffs." *Id.* at p. 27 n.11.

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program contained in Item 400 of FERC Tariff No. 41, which Mid-America intended to ameliorate the rate increase contained in that Tariff over the rate contained in FERC Tariff No. 38 which it superseded. *Id.* at pp. 11-12. According to Collingsworth: "The specific discount rates vary based on Mid-America's assessment of competitive considerations at various locations, but they averaged approximately 23 percent below the general commodity rates posted in [FERC] Tariff No. 41." *Id.* at p. 12.

21. Mid-America, Collingsworth claimed, is authorized to justify its rates under FERC Tariff No. 38 by using actual data from its effective period of May 1, 2005, through April 30, 2006. *Id*. at p. 13. After consultation with Mid-America's regulatory experts, he stated that he came to believe that Mid-America's expenses during this period were of a recurring nature. *Id*. However, he stated that, to simplify the analysis, he instructed Mid-America witness George R. Ganz (Ganz) to make only Test Period adjustments to the Base Period data that decreased the cost of service. *Id*. at p. 14.

22. Collingsworth also said that he reviewed Base Year data for FERC Tariff No. 41 using the time period from January 31, 2005, through January 31, 2006, and alerted Mid-America's regulatory consultants of five developments to decide whether test year adjustments should be made: (1) $29.8 million in carrier property[23] was expected to go into service by the end of October 2006; (2) 10.3 million barrels, valued at $6.6 million, moved from Channahon, Illinois, to Morris, Illinois, incorrectly had been treated as interstate instead of as intrastate movements; (3) the full year impact of the May 1, 2005, rate changes to the Northern System was $7.7 million greater than shown in the Base Period; (4) a change in the treatment of movements from the Mid-America's interconnection with the Cochin Pipeline, effective April 1, 2006, decreased mileage attributed to those movements by 525.8 million barrel-miles; and (5) movements between Conway, Kansas, and Clinton, Iowa, were double-counted, resulting in an overstatement of 1.8 million barrels and 882.1 million barrel-miles in the base year. *Id*. at pp. 14-15. According to Collingsworth, for FERC Tariff No. 41, there were no non-recurring costs. *Id*.

23. In his rebuttal testimony, Collingsworth testified that Propane Group witness Matthew O'Loughlin's (O'Loughlin) assertion that Mid-America's intent is to "skew costs" away from the Rocky Mountain System to its Northern System is completely unwarranted. Exhibit No. M-46 at pp. 3-4. Additionally, Collingsworth asserted that there is no validity in the suggestion that Mid-America has unfairly raised rates on its Northern System while lowering them on the Rocky Mountain System in order to advantage affiliates because it is in Mid-America's interest to maximize its revenue on all

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[23] Collingsworth defined "carrier property" as an asset found on Mid-America's plant, property, and equipment books. Transcript at p. 960.

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three systems consistent with the Commission's regulations and the constraints of competition. *Id.* at p. 4. He disagreed with O'Loughlin's suggestion that the discounts on the Rocky Mountain System were designed to benefit Mid-America's affiliates because the Rocky Mountain System serves both affiliated and non-affiliated shippers. *Id.* at p. 5. According to Collingsworth, approximately 90% of the volumes on the Rocky Mountain System are moved by non-affiliated shippers and thus, he claimed, Mid-America would have every incentive to establish rates at the highest possible lawful level, subject to the constraints of competition, which is consistent with maximizing volume and revenue from non-affiliates. *Id.* Collingsworth contended that, although Mid-America is currently constrained by competition from charging rates at the general commodity level (and thus is required to discount its Northern System rates), its general commodity rates should not be set at a level below Mid-America's cost of service, and that Mid-America should be permitted to raise its discounted rates (within the just and reasonable rate ceiling) as competitive forces permit. *Id.* at p. 6.

24. Disagreeing with both O'Loughlin's and Ganz's direct labor expense figures, Collingsworth claimed that they understated the amount of indirect expenses properly attributable to the Northern System. *Id.* at pp. 6-7. He testified that Mid-America's corrected Kansas-Nebraska allocation was highly conservative because the Northern System predominates with respect to the factors that affect indirect expense.[24] *Id.* Moreover, he stated that a large portion of the difference in the original cost of plant for the systems simply reflected inflation in labor and building materials, rather than any difference that would lead to a greater incurrence of indirect expense. *Id.* at pp. 7-8.

25. According to Collingsworth, the Northern System has more direct labor than the Rocky Mountain System for three reasons: (1) the Northern System is considerably older than the Rocky Mountain System, which results in a greater amount of direct labor related to maintenance of the line; (2) the Northern System is more complex to operate than the Rocky Mountain System, with more delivery points (30 delivery points as opposed to the Rocky Mountain's one), more product types (eight as opposed to the Rocky Mountain's one), and bi-directional flow; and (3) the Northern System has a substantially greater amount of right-of-way issues (including more landowners, more construction activity and more vegetation growth), which results in more direct labor related to right-of-way maintenance. *Id.* at p. 7. Collingsworth added that the Rocky Mountain gross plant cost is higher than that of the Northern System because it is a newer system and inflation increased the costs of construction. *Id.* at pp. 7-8.

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[24] Collingsworth argued that the Northern System has more miles of pipe than either the Central or Rocky Mountain Systems, moves more types of products, and has substantially more shippers and delivery points than the Rocky Mountain System. Exhibit No. M-46 at p. 7.

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26. Collingsworth explained that all of the terminals owned by Enterprise Terminals on Mid-America's Northern System are fully automated and unmanned, accessible 24 hours a day, seven days a week, where the truck driver who takes delivery of the product is responsible for performing every function required to load propane from the time the truck arrives at the terminals gates until it leaves. *Id.* at p. 12. Thus, he claimed, Enterprise Terminals is fully capable of operating its terminals, in winter or summer, with roughly 1.2 full-time equivalent employees. *Id.* at p. 13. Collingsworth also testified that O'Loughlin mistakenly assumed that "employees working on Mid-America's transportation operations perform similar functions across its system [and] that a number of employees staffed on each segment should be roughly proportionate to the number of miles of pipeline on each segment." *Id.* Moreover, he claimed that there was no basis for O'Loughlin's unsupported assumption that Mid-America's employees and managers were improperly recording time to Mid-America instead of to Enterprise Terminals. *Id.* at p. 14.

27. In Collingsworth's opinion, a substantial portion of Mid-America's indirect labor costs is attributable to the Northern System. *Id.* at pp. 14-15. He added that, as a consequence, using direct labor in the Kansas-Nebraska formula results in an allocation of indirect labor and overall indirect expenses to the Northern System that is conservative. *Id.* at p. 15. Collingsworth testified that the Mid-America portion of the control center has three manned consoles, two of which are dedicated to the Northern System and one dedicated to the Rocky Mountain and Central Systems. *Id.* He explained that, approximately, five full-time employees are required to staff each console to ensure coverage for each shift plus vacation time for the employees, and a shift supervisor, along with other support personnel who operate and maintain the Supervisory Control and Data Acquisition system. *Id.*

28. Allocating only 36% of the overall indirect expenses to the Northern System is highly conservative, in Collingsworth's opinion. *Id.* at p. 20. He reasoned that, because many of the indirect expenses such as administrative services, office supplies, and health insurance are closely related to direct costs, and since more of Mid-America's direct and indirect labor involves the Northern System, it is reasonable to allocate these related indirect expenses to the Northern System. *Id.* at p. 19. Moreover, Collingsworth asserted that, because additional employee time is dedicated to the Northern System, other indirect expenses should be allocated to the Northern System. *Id.*

29. According to Collingsworth, Staff's volumetric allocation formula did not accurately reflect the functions and relative usage of the Conway costs, at least as Staff applied it. *Id.* at p. 20. He stated that the Kansas-Nebraska formula,[25] which the Propane

[25] Collingsworth described the Kansas-Nebraska formula as follows: (1) configure the dollar value associated with each of the three systems from the total plant, property, and equipment on the books and configure each system's percentage of the total;

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Group used, allocated approximately 65% of the Conway costs to the Northern System. *Id.* at p. 20. While he claimed that 65% may have understated the costs that should have been allocated to the Northern System, it was more reasonable than Staff's proposal of 40 - 44%. *Id.* at pp. 20-21. Collingsworth insisted that, for the fixed costs at Conway that do not vary with volumes, the volumetric approach has no relationship to cost incurrence. *Id.* at p. 21. Moreover, he maintained that, even as to the types of costs for which volumes could matter, Staff's volumetric approach failed to capture the relative usage of the Conway assets. *Id.* Collingsworth explained that Staff's method failed to reflect the fact that the vast majority of the costs at Conway relate to product that moves out of Conway (outbound movements involve substantially more costs than inbound movements), and that the majority of product moving out of Conway does so on the Northern System. *Id.* at p. 22.

30. Continuing, Collingsworth added that Mid-America did not believe it was reasonable to adjust the actual Locked-In and Base Period volumes. *Id.* at p. 23. He disagreed with O'Loughlin's assertion that the actual volumes experienced during February 2005 through April 2006 were abnormally low, and the higher 2004 volumes were more representative of the future. *Id.* at p. 23.[26] According to him, there is no reason to believe, as O'Loughlin did, that future Northern System volumes will return to the 2004 level, because propane volumes, which make up a relatively large portion of the total Northern System volumes, have declined and will continue to decline. *Id.* at pp. 24-25.[27] Collingsworth suggested that propane volumes on the Northern System will continue to decline because there is a reduced demand for propane in individual homes due to competition from natural gas and electricity and increased fuel efficiency, as well as a reduced demand for it in agricultural uses due to increased use of hybrid corn and the use of corn in ethanol production. *Id.* at pp. 25-26. In addition, he contended that propane volumes will decline as production increases at local refineries and fractionators, and increased competition from Canadian propane. *Id.* at p. 26.

31. The winter of 2005/2006 was not "abnormal" as O'Loughlin asserted, according to Collingsworth, who claimed that there were other reasons for the reduction in propane volumes. *Id.* at p. 28. He testified that in recent years propane volumes on the Northern System have also declined during the summer and fall, and moreover, that the other

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(2) configure a percentage of the direct labor total for each of the three systems;
(3) average the two percentages above; and (4) multiply that average by the indirect cost. Transcript at p. 906. The result, he said, is allocated as indirect costs to the particular systems. *Id.*

[26] *See* the table at p. 24 of Exhibit No. 46; *see also* Exhibit No. M-48.

[27] *See* Exhibit Nos. M-49, M-50.

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products (butane and ethane/propane mix) moved on the Northern System are not affected by changes in temperature. *Id.* at pp. 28-29. Added Collingsworth, the winter of 2005/2006 appeared to be close to the median of recent winters when measuring it by the number of heating degree days. *Id.* at p. 29. He asserted that O'Loughlin's benchmark for "normal" was the average number of heating degree days from 1971-2000, and as measured by this benchmark, recent winters have all been below "normal." *Id.* Furthermore, Collingsworth stated, global climate change is causing increased temperatures throughout the world, and the trend toward warmer winters over the past several years will continue. *Id.* at pp. 29-30.

32. Responding to O'Loughlin's claim that Mid-America's actual Locked-In Period and Base Period volumes were not representative of future volumes, Collingsworth explained that O'Loughlin was referring to "ethane rejection," which is hard to predict, since its occurrence depends on relative commodity prices.[28] *Id.* at p. 31. Thus, he claimed, it is impossible to determine whether the amount of ethane rejection in a particular year will be representative of future years. *Id.* Additionally, he noted that ethane rejection only affects volumes on the Rocky Mountain System, which moves natural gas liquids tendered by gas producers to fractionators at Hobbs and Mont Belvieu and has no direct or appreciable effect on Northern System volumes. *Id.*

33. Further, in response to O'Loughlin's suggestion replacing actual volumes with the higher 2004 volumes, Collingsworth stated that, if that were done, the fuel costs also should be adjusted upward (which O'Loughlin failed to do). *Id.* at p. 32. He explained that, assuming constant fuel prices, increased volumes always result in higher fuel costs because more energy is required to pump the additional volumes. *Id.* at p. 33. He further testified that, as volumes increase, more pumps are required to move the product, but because friction increases at higher pumping rates, the number of pumps required, as well as the cost to operate them, increases exponentially. *Id.* Moreover, Collingsworth asserted, Mid-America generally attempts to use cheaper electric pumps and turns on its turbine-driven pumps (which are more expensive to operate) only when volumes increase. *Id.* at p. 34.

34. Collingsworth testified that for certain movements of ethane/propane mix primarily on the East Red Line, Mid-America would not be able to charge rates at the level Ganz shows would result from a fully allocated cost rate design methodology because there are two volume incentive programs in place related to those movements.

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[28] Collingsworth testified that "[e]thane rejection occurs when the relative price of natural gas and ethane as a petrochemical feedstock makes it more profitable for a gas producer to ship ethane as part of the natural gas stream than to recover it as a natural gas liquid." Exhibit No. M-46 at p. 31.

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Id. at p. 35.[29] He stated that the two incentive programs relate to movements from Conway, Kansas, to Clinton, Iowa, and Morris, Illinois, and from the interconnection of Mid-America and the Cochin Pipeline near Clinton to Conway. *Id.* The incentive rates, he added, are essential to retain additional volumes moved by the shipper that owns the plants at Clinton and Morris and that had pipeline alternatives available to it in 1993 when the incentive rates were originally posted. *Id.*

35. Additionally, Collingsworth testified that, on the lines that predominantly move propane (the East Blue, West Blue, and West Red lines), competition prevents Mid-America from being able to charge the fully allocated cost rate to destinations that account for over 80% of Mid-America's total propane movements on its Northern System. *Id.* at p. 36. He claimed that Mid-America faces increased competition from the Cochin Pipeline at several of Mid-America's northern-most delivery points (specifically, Sanborn, Jackson, Mankato, and the Pine Bend destinations on the West Leg, and Iowa City, Dubuque, and the Janesville destinations on the East Leg). *Id.* Moreover, Collingsworth asserted that Mid-America's terminals at Kearney and Moberley, Missouri, face direct competition from the ConocoPhillips Pipe Line Company terminals at Paola, Kansas, and Jefferson City, Missouri, respectively. *Id.* Also, he testified, Mid-America's terminals at Farmington, Illinois, Iowa City, Iowa, and Ogden, Iowa, compete with the Kinder Morgan Operating L.P. "A" pipeline terminals at Tampico, Illinois, Iowa City, Iowa, and Des Moines, Iowa, respectively. *Id.* Finally, Collingsworth insisted that Mid-America's terminals at Greenwood, Nebraska, and Whiting, Iowa, compete with the Kaneb Pipe Line Operating Partnership, L.P. pipeline terminals at Geneva, Nebraska, and Norfolk, Nebraska, respectively. *Id.* Collingsworth maintained that the seasonal discount rates are the highest rates Mid-America currently can charge consistent with the competitive conditions at the various destinations on those lines without unduly distorting the current rate structure. *Id.* at pp. 36-37.

36. Next, Collingsworth testified that the 60% increase in the FERC Tariff No. 41 Northern System general commodity rates over those in FERC Tariff No. 38, was justified by Mid-America's Northern System costs. *Id.* at pp. 37-38. However, he noted, at the time FERC Tariff No. 41 was filed, Mid-America believed that, because of competition at various locations, it would not be able to charge rates at the new general commodity levels. *Id.* Collingsworth explained that, while Mid-America would have preferred to have kept the seasonal discount uniform across all of its rates, it was forced to offer a somewhat greater discount for movements to certain destinations where there was direct competition from other pipelines. *Id.* According to Collingsworth, because of competitive forces, it will be some time before Mid-America is able to raise its rates to the level of the FERC Tariff No. 41 general commodity rates. *Id.* at pp. 38-39.

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[29] *See also* Exhibit No. M-1 at p. 11.

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37. Denying Staff witness Bonnie J. Pride's (Pride) claim that Mid-America is "gaming the system," Collingsworth stated that Mid-America filed its general commodity rates at the maximum level justified by its cost of service. *Id.* at p. 39. He added that he knew of no reason why a pipeline whose rates were currently constrained by competition should be required to file a new cost of service each time it seeks to increase discounted rates that are at or below the just and reasonable level. *Id.*

38. Collingsworth testified that, while it is possible that rates to certain specific destinations with less competition could be increased more than others, Mid-America would prefer, if possible, to keep the rate increases generally uniform (*i.e.,* raising all of its rates by roughly the same percentage) so as not to disrupt the current rate structure and the settled expectations of shippers with respect to the various differentials. *Id.* at pp. 39-40. Moreover, Collingsworth claimed that, although rates to some destinations may be less constrained by competition, were Mid-America to raise rates to those destinations disproportionately, shippers would simply truck product in from nearby terminals where the rates are competitively constrained. *Id.* at p. 40. Collingsworth also indicated that the current rate structure contains somewhat lower rates for long-haul movements than would otherwise be the case if rates were designed strictly on a distance basis because Mid-America does not want the long-haul rates on the Northern System to become disproportionately expensive as the long-haul movements account for a large percentage of the volumes and revenue on the system. *Id.* at p. 41.

39. Mid-America would not be able to recover fully allocated cost rates for its East Red Line Movements from Conway to Clinton, Iowa and Morris, Illinois, Collingsworth claimed. *Id.* at p. 41. He reasoned that Mid-America's rates on the East Red Line are capped by contract and claimed that, if Mid-America had the ability to charge rates at the level suggested by the Propane Group and Commission Staff, it certainly would not have agreed to the substantially lower incentive rates as part of the contract. *Id.* at pp. 41-42. Collingsworth stated that the original East Red Line contract was the result of a competitive bidding process in which Mid-America and Northern Natural Pipeline (Northern Natural) both tried to obtain the East Red Line Shipper's business, and had Mid-America not offered a sufficient discount, it would have lost all of its East Red Line volumes to Northern Natural. *Id.* at p. 43. By offering the discount, Collingsworth said, Mid-America was able to hold onto its existing Conway to Clinton volumes as well as gain volumes from the Conway to Morris movements. *Id.* Furthermore, he claimed that Mid-America would likely have had to increase the other Northern System rates much earlier if Mid-America had not been successful in winning this business. *Id.* at pp. 43-44.

40. The discounts offered on the East Red Line are still necessary, Collingsworth insisted, because the discounts were a result of a long-term contract, and because the East Red Line Shipper continues to have competitive alternatives available to it that also provide an additional constraint on Mid-America's ability to raise its rates. *Id.* at p. 44. He testified that the Kinder Morgan Operating L.P. "A" pipeline provides a competitive

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alternative to Mid-America for the Clinton and Morris plants.[30] *Id.* Additionally, Collingsworth testified that the East Red Line Shipper or another pipeline could build a competing line from Conway and Aux Sable to Clinton and Morris, or the East Red Line Shipper could close its plants at Clinton and Morris if it were forced to pay higher rates for ethane/propane feedstock. *Id.* at p. 45. In sum, he asserted that, were Mid-America to attempt to charge rates at the levels proposed by the Propane Group and Staff, it would likely lose the business of the East Red Line Shipper and, were that to happen, it would have to idle the East Red Line because the East Red Line Shipper is the only shipper on that line. *Id.* at p. 46.

41. Moreover, Collingsworth stated that the East Red Line could not be converted to propane service if the East Red Line Shipper were to cease transporting ethane/propane mix because the East Blue Line would be sufficient to handle all movements of propane and "heavies" for the foreseeable future. *Id.* Furthermore, he asserted that, were Mid-America to lose the East Red Line Shipper's business, although it would no longer incur variable expenses (primarily fuel costs), it would still incur many of the fixed costs (*e.g.* costs to maintain the lines and the right of way) currently incurred on behalf of both the East Red Line and East Blue Line for the latter. *Id.* at p. 47. Furthermore, he indicated that Mid-America would not be able to cut its labor expenses significantly, as most, if not all, of the current employees still would be needed to operate the East Blue Line. *Id.*

42. According to Collingsworth, if Mid-America lost the East Red Line Shipper's business, the other Northern System shippers would have to bear the remaining costs without the revenue derived from the East Red Line Shipper's volumes. *Id.* at p. 48. He further stated that the ethane/propane mix movements on the East Red Line generate more revenue than the variable cost of operating the line, and thus, the loss of the East Red Line revenue would outweigh the benefits derived by the cost savings. *Id.* While the East Red Line has been operating at 80-90% of capacity for the past several years, Collingsworth testified, that the Northern System lines, by contrast, have much lower capacity utilization, and thus, the ethane/propane movements on the East Red Line provide consistent, steady revenue in excess of variable cost, which subsidizes the declining propane movements. *Id.*[31] He stated that Mid-America, from 2004-2006,

[30] Although he had indicated in response to a discovery request, on August 30, 2006, that the Cochin Pipeline also would offer such competition, Collingsworth testified that he no longer believed Cochin will be able to provide ethane/propane mix to the East Red Line Shipper at a competitive rate because of a new tax policy under consideration by the Province of Alberta which seeks to encourage consumption of Canadian ethane in Canada. Exhibit No. M-46 at pp. 44-45.

[31] *See also* Exhibit No. M-58.

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received $2,887,150 in annual revenue for the Cochin to Conway movements even though no volumes were shipped, that this was as if the East Red Line Shipper had moved the full 3,650,000 barrels at the rate of 79.10 cents per barrel, and that it is unrealistic to expect it to charge the East Red Line Shipper $1.1019 for the Cochin to Conway movements as O'Loughlin suggested. *Id.* at p. 49.

43. Collingsworth explained that the East Red Line Shipper prefers to process purity ethane at its plants at Clinton and Morris, but that Mid-America is not able to deliver purity ethane from Conway because the Conway fractionators are able to produce only ethane/propane mix. *Id.* at pp. 50-51. He stated that the Northern Natural (now Kinder Morgan) pipeline that was competing with Mid-America for the East Red Line Shipper's business had the ability to deliver purity ethane, and thus, in order to overcome this competitive disadvantage, Mid-America agreed to the propane credit included in its tariff. *Id.* at p. 51.

44. According to Collingsworth, under the propane credit, the East Red Line Shipper fractionates the propane contained in the ethane/propane mix delivered to it by Mid-America from Conway, keeping the purity ethane and returning the resulting propane to Mid-America; Mid-America then returns the propane to the East Red Line Shipper's inventory at Conway and credits the East Red Line Shipper for the payment it previously made to move the propane portion of the ethane/propane mix. *Id.* By fractionating the ethane/propane mix and reconsigning propane to Mid-America at Clinton, Collingsworth claimed that the East Red Line Shipper provides a benefit to the system by paying to move a product that it does not need from Conway to the Iowa City. *Id.* He also contended that, by treating this credit as if it actually represented a product movement from Clinton to Conway, both O'Loughlin and Pride appear to expect the East Red Line Shipper to pay to move propane from Conway to Clinton and back — thus paying double the transportation rate for product for which it has no use for (and at the higher fully allocated cost rate). *Id.*

45. Responding to O'Loughlin's suggestion that the movements of ethane/propane mix from Channahon, Illinois, to Morris, Illinois, should be treated as interstate, Collingsworth opined that it is unlikely — if not impossible — for a particular shipper to know where its particular product is going when it delivers it to the Alliance Pipeline or even what form that product will take after it leaves Aux Sable. *Id.* at pp. 52-53. He claimed that O'Loughlin's description of the Alliance Pipeline was incorrect because the Alliance Pipeline is a natural gas pipeline — not a natural gas liquids pipeline.[32] *Id.* at

[32] Collingsworth stated: "Although Alliance allows some [natural gas liquids] to be injected into the line at certain locations, the [natural gas liquids] are not moved in batched form, but instead became part of the natural gas stream." Exhibit No. M-46 at p. 53.

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pp. 53-54. Collingsworth further noted that, contrary to O'Loughlin's assertion, there are storage facilities at Channahon. *Id.*[33] The presence of the Aux Sable plant at Channahon has provided Mid-America with a lower cost method for delivering some of the requirements of the East Red Line Shipper's plants, according to Collingsworth, because the contract with the latter was at a set price and it could deliver ethane/propane mix from Channahon at a lower cost than from Clinton or Morris. *Id.* at p. 56.

46. In response to O'Loughlin, Collingsworth claimed that storage expenses are legitimate costs that should be included in Mid-America's cost of service. *Id.* at p. 57. Mid-America does not own any storage facilities, but leases storage capacity from its affiliate, Enterprise Terminals, at Conway, Kansas, "Hobbs, New Mexico," Iowa City, Iowa, Greenwood, Nebraska, and Mocane, Oklahoma.[34] *Id.* In addition, he said, there are two storage facilities located entirely on the Northern System — one at Iowa City on the East Leg and one at Greenwood on the West Leg — which are used to meet Mid-America's operational needs. *Id.* at p. 58.[35]

47. Mid-America uses the storage at Conway primarily for operational purposes which benefits all of the Northern System and Central System shippers, Collingsworth stated. *Id.* He added that it also offers a certain amount of merchant storage at Conway at below market rates. *Id.* at p. 60. Moreover, he testified that, since Mid-America has historically considered this storage to be non-jurisdictional merchant storage, the fee for it was not included in Mid-America's tariff, but instead was sent to all shippers in an annual "Memo to Shippers." *Id.*[36]

48. Collingsworth also indicated that the storage facility at Hobbs serves both the Central and the Rocky Mountain System and primarily is needed for Mid-America's operational purposes for the benefit of all Central and Rocky Mountain System shippers. *Id.* at p. 61. Mid-America also offers long-term holding storage to shippers at Hobbs for

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[33] *See* Exhibit No. NPG-98 at p. 8.

[34] Enterprise Terminals owns and operates all of the above storage facilities, except Conway, which is owned and operated by Williams Midstream Natural Gas Liquids, Inc., but leased by Enterprise Terminals and subleased to Mid-America. Exhibit No. M-46 at pp. 56-57, 61.

[35] According to Collingsworth, having storage capacity at Greenwood and Iowa City assists the operational efficiency of the line by maximizing throughput and pumping capacity, and allows customers to have access to additional barrels during periods of high demand. Exhibit No. M-46 at p. 58.

[36] *See also* Exhibit No. M-63.

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an annual fee set forth in the Memo to Shippers, according to Collingsworth, but during the periods at issue here, no shipper purchased this additional long-term holding storage. *Id.*

49. It was not until after Enterprise Products Partners began operating Mid-America in February 2003, Collingsworth claimed, that Mid-America became aware that certain of the storage assets were erroneously listed on its books and decided that these assets should properly be recorded in the Enterprise Terminals' asset books. *Id.* at p. 62. As a consequence, he added, it transferred the assets to Enterprise Terminals around September 2004.[37] *Id.* Collingsworth testified that Mid-America was not attempting to evade regulation, but had an independent study conducted to determine what an appropriate price would be for the storage based on market rates in the area. *Id.* at p. 64. He stated that Mid-America and Enterprise Terminals set the price for storage at Hobbs, Iowa City, Greenwood, and Mocane at a per barrel charge equal to the median price shown in the study for storage provided by non-affiliated entities in the same geographical areas. *Id.* According to Collingsworth, the charge for storage at Hobbs, Iowa City, Greenwood, and Mocane during the periods at issue was $2.10 per barrel times the capacity leased, with the capacity determined by estimation of the amount of storage Mid-America needed for the contract year. *Id.*

50. Further, Collingsworth explained that when Enterprise Products Partners purchased the Mid-America and Seminole assets, Williams agreed that its storage affiliate, Williams Midstream Natural Gas Liquids (Williams Mid-stream) would provide the same storage services to the Enterprise-owned pipeline as had been provided to the Williams-owned pipeline. *Id.* at pp. 64-65. Therefore, he testified, the storage previously provided by Williams Midstream to Mid-America at no charge was stated in the lease between Williams Midstream and Enterprise Terminals as also being at no charge. *Id.* at p. 65.

51. Collingsworth claimed that Pride's calculated storage rates of $1.22 and $1.1614 per barrel, depending upon the Base Period, were incorrect because: (1) she applied the storage rate to all of the storage facilities connected to Mid-America regardless of whether Mid-America offered storage to shippers at those locations (Iowa City, Greenwood, and Mocane are used solely for operational purposes); (2) she incorrectly assumed there was "storage available for shipper use" at these locations by comparing the

[37] Collingsworth claimed that the transferred assets should have been taken off of Mid-America's books and put on Enterprise Terminals' books prior to the transfer in September 2004. Transcript at p. 692. He referred to the transfer as a "paper transfer." *Id.* at p. 698. Legal title was always in the storage company, Collingsworth states, and did not transfer in September 2004 – only the books were corrected to accurately reflect legal title. *Id.* at p. 707.

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annual average amount of product stored at the particular caverns with the total capacity for each cavern;[38] and (3) storage at Hobbs and Conway is primarily used for operational purposes, which benefits all shippers, making it difficult to determine what the charge for the merchant storage function at these locations should be based purely on cost (or based on Pride's capacity usage percentage method, which is equally inapplicable to Hobbs and Conway). *Id.* at p. 66. Collingsworth opined that Pride's proposed storage rates were inappropriately low because there are numerous storage options available to shippers at Conway and Hobbs, and because Mid-America does not have a monopoly on storage at either location. *Id.* at pp. 66-67.

52. In response to O'Loughlin's claim that Mid-America has a lower than average risk compared to other pipelines because it does not have market-based rates, Collingsworth argued that, even though it does not have such rates, it still faces competition for the services it offers. *Id.* at p. 67. He testified that Mid-America has substantial competition on its Northern System and on its Central System at both Hobbs and Conway, and that another interstate natural gas liquid line, the Overland Pass Pipeline,[39] is being constructed, which will directly compete with the Rocky Mountain System. *Id.* Collingsworth explained that the Overland Pass Pipeline Project caused Mid-America to lose a major shipper (with Williams agreeing to dedicate its equity natural gas liquid volumes from its two Wyoming plants for transport on Overland Pass Pipeline under a long-term shipping agreement), and has, therefore, made it necessary for Mid-America to offer substantial volume discounts to retain its long-term shippers. *Id.* at pp. 67-68. As the Central System primarily moves propane, ethane/propane mix, and "heavies" between Conway and Hobbs, and since both Hobbs and Conway are large trading and processing hubs, Collingsworth claimed that there are numerous alternatives at both locations for exporting, receiving, and selling product. *Id.* He asserted that Mid-America's proposed rate increases are justified by its costs, and further stated that, as a natural gas liquid line, Mid-America faces the risk of lower volumes due to lower demand for natural gas liquids. *Id.* at p. 69. Moreover, he explained that products moved by Mid-America are also heavily affected by the relative price of natural gas liquids and natural gas. *Id.*

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[38] Collingsworth indicated that, though an annual average may show these facilities as having capacity available for shipper use, Mid-America cannot hold itself out as able to provide storage to individual shippers at these locations because, on many days, especially during the peak winter months, Mid-America is using all of the capacity. Exhibit No. M-46 at p. 66.

[39] "The Overland Pass Pipeline project is a joint venture between Williams and ONEOK, Inc., to build [a natural gas liquid] pipeline from southwestern Wyoming to central Kansas, near Conway." Exhibit No. M-46 at p. 67.

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53. Additionally, Collingsworth maintained, Mid-America faces substantial regulatory risk because the Department of Transportation pipeline integrity requirements impose substantial risk of increased costs related to pipeline assessment and remediation. *Id.* at p. 70. He stated that proposed Department of Homeland Security regulations also may increase Mid-America's costs and reduce demand for propane among end users. *Id.* Finally, Collingsworth claimed that Mid-America also faces the risk that it will be unable to recover its costs through the ratemaking process because that process is time consuming and expensive, and consequently, protesting shippers are able to impose a high cost on any pipeline that seeks a rate increase. *Id.* at p. 71. He asserted that, in his opinion, this gives protestors a great deal of leverage to force the pipeline to compromise for less than its true cost of service. *Id.*

54. At the hearing, Collingsworth testified that the Northern System consists of the East Leg, which are the two lines that extend out of Conway on an easterly route northeast. Transcript at p. 291. He added that its East Red Line, which operates 24/7/365 in ethane/propane service providing feedstock to two major petrochemical plants along the line, extends from Conway to the Kearney, Missouri, area, turns north towards Cantril, goes to the Iowa City station, and extends from Iowa City to Clinton, Iowa, and to Morris, Illinois. *Id.* According to him, the East Red Line is a bidirectional line and has only one shipper. *Id.* at p. 293.

55. The Northern System's East Blue Line, Collingsworth stated, which moves only propane, operates 24/7, and has approximately 35 shippers, takes a similar route as the East Red Line to Missouri, heads a little more eastward, turns north near Moberly, Missouri, goes up to Iowa City, and then extends into Dubuque, Iowa, and Janesville, Wisconsin. *Id.* He added that there is a lateral extending off the East Blue Line at Birmingham Junction that goes to Farmington, and a lateral off of Iowa City going east and connecting to the Clinton plant. *Id.*

56. Collingsworth explained that the Northern propane system consists of the West Red Line, East Blue Line, and the West Blue Line with the exception of the line that runs from Morris down to Tuscola carrying propane. *Id.* at p. 295. The lines are dedicated to propane and are not batch systems.[40] *Id.* at pp. 298-99. He emphasized that the East Red Line carries only ethane/propane mix. *Id.* at p. 295.

57. According to Collingsworth, the Illini System, which runs from Morris to Clinton and Clinton to Channahon is approximately 119 miles and is bidirectional, and consists of an eight-inch and a six-inch line. *Id.* at pp. 295, 297. He indicated that one moves

[40] A batch system is a mode of operations wherein several different products are shipped within the same line in a manner that allows Mid-America to keep them in their purity forms. Transcript at pp. 314, 403.

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propane originating at the Aux Sable fractionator to the Tuscola storage cavern; the other is leased to a shipper who transports ethylene from Tuscola to the Morris petrochemical complex. *Id.* Collingsworth testified that Mid-America characterizes these movements as intrastate. *Id.* at p. 296. He explained that Aux Sable and Channahon are the same facility. *Id.* Mid-America takes propane from the Channahon facility where there is a fractionator and moves it south to a cavern at Tuscola, according to Collingsworth. *Id.* Moreover, he noted that ethane/propane mix is transported from Channahon, Illinois, to Morris, Illinois, and then to Clinton, Iowa. *Id.* at pp. 296-99.

58. Collingsworth explained that there are 15 terminals owned by Enterprise Terminals which are located at Kearney, Moberly, Cantril, Farmington, Iowa City, Dubuque, Janesville, Clay Center, Greenwood, Whiting, Ogden, Canton, Sanborn, Mankato, and Pine Bend. *Id.* at p. 300. He stated also that there are two terminals owned by Enterprise Products Operating, one located at Jackson and the other at Rosemount (Pine Bend area). *Id.* at p. 301. According to Collingsworth, there are nine third-party terminals located at Inver Grove, Pine Bend Ferrellgas, Pine Bend Rosemount, Jackson, LeCompton, Carrollton, Fort Madison, and Janesville. *Id.* at pp. 301-02. Collingsworth described the terminals as a piece of pipe that extends off of the main line of a pipeline, wherein a motor-operated valve allows flow into or out of the pipeline into the terminals and a metering facility.[41] *Id.* at p. 305. Furthermore, from that point, he added, a piece of pipe extends into above-ground steel storage, also known as bullets. *Id.* at p. 305. He added, the terminals also contained a driveway and lighting facilities, and are enclosed by a fence. *Id.* at pp. 305-06.

59. Collingsworth stated that Enterprise Terminals leases storage facilities at Conway from Williams for natural gas liquids (ethane/propane mix, propane, isobutene, normal butane, and natural gasoline). *Id.* at pp. 308-09. According to him, Mid-America does not own any storage at Conway or anywhere on the eastern leg of the Northern System. *Id.* at pp. 309-10. However, he agreed, Enterprise Terminals owns two underground storage caverns at Iowa City, one handling ethane/propane mix, and the other handling propane services. *Id.* at p. 310. Collingsworth added that the cavern handling ethane/propane mix serves the East Red Line, and the cavern handling propane serves the

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[41] Truck drivers, Collingsworth stated, can access the terminal, which may contain numerous docks, through a fingerprint reader and pull up to the loading docks. Transcript at p. 306. At the dock, he said, product is taken out of the above-ground storage by a pump, is stored in a tank, and then is measured and injected into the truck after the driver has entered into the loading bay area and input the correct information that releases the product out of the tanks for his account. *Id.* A bill of lading, according to Collingsworth, is created for the truck driver to take with him, and that part of the equipment is housed in a building that is usually associated with the terminals. *Id.*

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East Blue Line. *Id.* Yet because Enterprise Terminals leases the storage handling ethane/propane mix to Mid-America for operational storage, he claimed, the ethane/propane mix storage lowers operating costs for the total Northern System. *Id.* at pp. 311-312. With regard to the West Leg, Collingsworth indicated that Enterprise Terminals has an underground cavern at Greenwood, Nebraska, servicing propane. *Id.* at p. 312. The storage at Conway, Iowa City, and Greenwood, he said, comprise the entire storage on the Northern System. *Id.* at pp. 312-13.

60. In a presentation dated March 29, 2007, to Enterprise Products Partners' investors, Collingsworth admitted, Mid-America represented Overland Express as a competitor but did not represent any competitive analysis of any aspect of the Northern System. *Id.* at pp. 316-17.[42] He explained that a competitive analysis was omitted with respect to the Northern System because the presentation was meant to represent only new competition, not competition that had existed since the pipelines were placed in service. *Id.* at p. 318.

61. Were only affiliated shippers moved on Mid-America, Collingsworth opined, Enterprise Products Partners would be indifferent to the rate because the money would stay within the Enterprise related companies and simply moves from one hand to another. *Id.* at p. 320. The main concern, according to him, is that EPCO, Inc., be profitable, whether or not an individual subsidiary or affiliate is profitable. *Id.* at pp. 322-23.

62. Collingsworth testified that the March 31, 2005, tariff filing consisted of the tariff filings for the Rocky Mountain System (FERC Tariff No. 37), for the Northern System (FERC Tariff No. 38), and for the Central System (FERC Tariff No. 39). *Id.* at pp. 329-30. He agreed that these tariff filings increased most of Mid-America's local transportation general commodity rates by 23%, but asserted that they did not increase the volume incentives. *Id.* at p. 330. Collingsworth also claimed that the FERC Tariff No. 38 rates were not constrained by competition, but admitted that there are discounted rates in the tariff — Items 300, 320, 340, and 350 are volume incentive rates. *Id.* at pp. 333-35.

63. According to Collingsworth, with respect to the Item 300 volume incentive program, there are rates for ethane/propane mix originating at Channahon, Conway Holding Group 140 to Clinton and Morris, and a propane rate from Conway Holding Group 140 to Clinton. *Id.* at pp. 335-36. The ethane/propane mix is on the East Red Line, he said, and the propane is on the East Blue Line. *Id.* at p. 336. Collingsworth did admit that the only shipper shipping under these rates is the East Red Line Shipper. *Id.* Approximately 12 million interstate barrels of ethane/propane mix moved annually under Item 300 since January 1, 2004, he stated. *Id.* at p. 727. Collingsworth also testified that approximately 220,000 barrels of propane moved under Item 300 in 2004, 10,000 barrels

[42] *See also* Exhibit No. NPG-144.

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in 2005, and 4,000 barrels in 2006. *Id.* He admitted that the East Red Line Shipper is the only shipper using the Item 320 rate, covering the Cochin Pipeline east to group 950. *Id.* at p. 337. Item 340 only covers ethane/propane mix, according to Collingsworth, who added that there has been no shipment by any shipper using this rate. *Id.* at pp. 338-39. Collingsworth explained that the Item 350 rate covers ethane/propane mix or propane, and no other shipper besides the East Red Line Shipper uses it. *Id.* at p. 339.

64. With respect to the four items on FERC Tariff No. 38, Collingsworth admitted, there was no competitive analysis conducted to determine whether an incentive or discounted rate was warranted. *Id.* at pp. 339, 341. He stated that, in FERC Tariff No. 38, Mid-America raised the general commodity rates 23% because its costs had substantially increased on the entire system since the time it had bought the assets. *Id.* at p. 342. Collingsworth added that Mid-America had done a cost-of-service on its entire system, wanted the increases to be equal across the three systems, and thought it could be justified. *Id.* Moreover, he explained that not all of the incentive rates were increased because some were restricted by contractual commitments. *Id.* at pp. 343-44.

65. The rates that were in effect prior to the March 31, 2005, cost-of-service filing, Collingsworth testified, never had been involved with a cost-of-service rate case, and that none of Mid-America's rates had been set by the Commission after an investigation and hearing. *Id.* at p. 344. According to Collingsworth, the March 31, 2006, tariff filing was directed at the Northern System only, and FERC Tariff No. 41 contained a rate increase of approximately 60% above the rates in FERC Tariff No. 38. *Id.* at p. 350. In FERC Tariff No. 41, he said, Mid-America instituted a seasonal discount program providing discounts for propane and certain natural gas liquids that applied to most of the destinations on the Northern System. *Id.*

66. According to Collingsworth, Item 300[43] did not change under FERC Tariff No. 41, and the East Red Line Shipper is the only shipper that has used that rate since 2004 when Mid-America entered into a contract with it. *Id.* at pp. 366, 370. He explained that, under Item 300, there have been a few propane movements made since Mid-America contracted with the East Red Line Shipper in 2004. *Id.* at p. 371. Item 320, volume incentive program, and Item 340, Cochin Pipeline East to group 50 and Conway Holding, Collingsworth also asserted, were canceled prior to the filing of FERC Tariff No. 41. *Id.* He also explained that Item 350, Cochin Pipeline East to Conway Holding, has had no volumes moved on that rate since the contract with the East Red Line Shipper in 2004. *Id.* Finally, Collingsworth testified that Item 390, Conway Holding to Pine Bend Flint Hill Resources, had expired prior to the filing of FERC Tariff No. 41. *Id.* at p. 373.

[43] Item 300 includes: (1) Conway Group 140, Conway Holding to Clinton and Morris; and (2) Channahon to Clinton and Morris. Transcript at p. 370.

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67. Collingsworth explained that the discount rates Mid-America charges at all the terminals under the seasonal discount program are approximately 23% lower than the general commodity rates posted in FERC Tariff No. 41. *Id.* at pp. 375-77. He stated that Mid-America did not consider the rates charged by competition in setting its general commodity rates. *Id.* at p. 380. Mid-America looked at historical volumes, according to him, multiplied those movements by the general commodity rates to derive total revenue, and set FERC Tariff No. 41 rates slightly below what was permitted under its cost-of-service. *Id.* at p. 381.

68. The ConocoPhillips pipeline, which originates in the Wichita area and extends to the edge of Kansas into Missouri and up through half of Illinois, Collingsworth stated, is approximately 35 miles south of Mid-America's Northern System. *Id.* at p. 389. The Valero line, he added, starts at Conway, travels up to Geneva, has a couple of west routes off of that, and continues on to North Fork, Yankton, and Wolsey, South Dakota. *Id.* at p. 392.

69. According to Collingsworth, the Kinder Morgan pipeline has several lines around the Wichita, Hutchinson, Bushton, and Conway, Kansas area. *Id.* at p. 393. Continuing, Collingsworth explained that one line leaves Bushton and moves northeast through Clay Center, Plattsmouth and Des Moines; another line leaves Bushton, moves north to Des Moines and to Clear Lake, and then two lines move east through Iowa City and on to the Rockford, Lemont, and Morris, Illinois area. *Id.* at p. 394. The Kinder Morgan line, he added, also consists of a line going southeast from Bushton to Reno, Hutchinson and another line from Bushton to Conway, down to Wichita. *Id.* Collingsworth claimed that these pipelines are competitive with Mid-America at certain locations. *Id.* at p. 395. In determining whether a pipeline is a competitor, Collingsworth asserted, Mid-America considered: (1) how close the potential competitors' terminals are to Mid-America's terminals; (2) mileage; and (3) the rates potential competitors charge. *Id.* at pp. 396-98.

70. Under FERC Tariff No. 133, Collingsworth stated, ConocoPhillips ships liquefied petroleum products — butane, propane, natural gasoline, and sweet naphtha. *Id.* at pp. 402-03. He agreed that Ferrellgas, CHS, ConocoPhillips, AmeriGas, and Targa did not ship propane on the ConocoPhillips line in 2004, 2005, or 2006; and also that, among other products, propane and refined products, including natural gasoline, are shipped in batches on the Valero line. *Id.* at pp. 406, 413.[44] Collingsworth also testified that propane, normal butane, isobutane, refinery grade butane, and natural gasoline are shipped on the Kinder Morgan pipeline. *Id.* at p. 421.

71. According to Collingsworth, Mid-America has a propane supply assurance program which likely provides it a competitive advantage over batched systems. *Id.* at

[44] *See also* Exhibit No. M-125.

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pp. 460-61. He said its Northern System dedicates 90% of its system to propane transportation, meaning continuous on demand. *Id.* at p. 463. Collingsworth declared that the portion of the system not on demand and not dealing exclusively in propane service is just that part of the system north of Mankato, Minnesota (on the West Leg). *Id.* at pp. 463-64. The Board of Directors of Enterprise Products Partners, Collingsworth agreed, indicated that there was $65 million of revenue associated with the annual transport volumes on the Northern System. *Id.* at pp. 465-67.[45] He claimed that the volume level for the year 2004 was an anomaly if one were to look at recent years instead of the last fifteen years (1990-2005), and recent trends made the last few years more representative than the last 15 years in determining future volume levels on the Northern System. *Id.* at pp. 475-77. The propane delivery volumes for the years 2005 and 2006, Collingsworth asserted, were lower than the average for all the years 1990-2006. *Id.* at pp. 496-97.

72. Mid-America, Collingsworth insisted, cannot charge the East Red Line Shipper the fully allocated rate, and all of the seasonal discount rates on the propane system are less than the fully allocated costs, except Sanborn, where the seasonal discount rate equals the fully allocated cost rate. *Id.* at pp. 561, 625. Collingsworth claimed that non-uniform rate increases would have undesirable market effects; *e.g.*, he claimed that, had Mid-America substantially raised the rates from Conway to LeCompton, but not the rates from Conway to Clay Center or Conway to Kearney in the same relationship, the owner of the LeCompton Terminals would have complained that the Mid-America Pipeline was discriminating against it. *Id.* at p. 569. Furthermore, Collingsworth alleged that, if Mid-America had engaged in non-uniform rate increases, LeCompton would have taken away a market share in the particular location of the pipeline facing an increase in its rates. *Id.* at p. 569.

73. Collingsworth claimed that propane demand has been decreasing due to competition from natural gas and electricity. *Id.* at pp. 572-73. Furthermore, he added, the demand for propane in agricultural use has declined due to a decrease in grain drying and improvements in grain drying technology. *Id.* at pp. 573-74.

74. Enterprise Terminals owns and operates fifteen terminals on the Northern System, Collingsworth stated, which are fully automated and unmanned and operate on a 24/7 basis.[46] *Id.* at pp. 598-99. He explained that a remote controlled operated valve shuts off delivery into a terminal from a pipeline, and a meter, which sits between the terminals and pipeline, demarcates where Mid-America's ownership begins and stops. *Id.* at p. 603.

[45] *See also* Exhibit No. NPG-156.

[46] However, Collingsworth testified that the other Enterprise-affiliated terminals and non-Enterprise third-party-affiliated terminals connected to the Northern System are not unmanned or automated. Transcript at pp. 601-02.

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75. Collingsworth testified that, in Mid-America's Northern Region, the Vice-President of Operations, the Northern Region Regional Manager, and the Greenwood Area, Pine Bend Area, Kearney Area, and Iowa City Area Pipeline Supervisors supervise the Mid-America pipeline employees and some of the employees doing work on Enterprise Terminals. *Id.* at p. 642.[47] He stated that Greenwood, Pine Bend, Kearney, and Iowa City all have terminal facilities associated with Enterprise Terminal, but none of the aforementioned individuals have Enterprise Terminals responsibilities with respect to the above areas, although they do have pipeline responsibilities, *e.g.*, the technicians have responsibilities associated with accuracy and verification of truck loadings.[48] *Id.* at pp. 447, 643-44.

76. Collingsworth estimated that the level of Mid-America's Northern System storage rights is approximately 800,000 to 900,000 barrels. *Id.* at pp. 688-89. He also stated that Enterprise Terminals' Hobbs facility has one terminal and 2.9 million barrels of storage rights. *Id.* at p. 689. He claimed that Iowa City has 525,000 barrels, and Greenwood has 340,000 barrels, totaling 865,000 barrels of storage rights in the Greenwood/Iowa City area. *Id.*

77. According to Collingsworth, and as previously noted, in September 2004, the storage assets were transferred from Mid-America to Enterprise Terminals. *Id.* at p. 692. Following the transfer of storage assets to Enterprise Terminals from Mid-America, he stated, Mid-America entered into a lease agreement with Enterprise Terminals because Mid-America needed that storage to efficiently and effectively operate the pipeline system. *Id.* at p. 693. Collingsworth testified that Mid-America did not pay Enterprise Terminals for storage prior to entering into a contract with it. *Id.* at p. 876. While Collingsworth was unable to confirm that, at every location, a payment was made, he was

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[47] *See also* Exhibit No. NPG-170 at p. 4.

[48] According to Collingsworth, the technicians work at the terminals Monday through Friday, a few hours each day, unless a specific problem has to be addressed. Transcript at p. 649. In general, he added, the technician "proves" the loading meter to ensure it registers the correct amount. *Id.* at p. 648. Moreover, he stated, technicians are on-call 24 hours a day to respond to pipeline problems, and will record his or her time to the Enterprise Terminals if the problem involves a terminal and a technician will record his or her time to the pipeline if the problem is on the pipeline. *Id.* at p. 651. Were an Enterprise Terminals employee not at a terminal, Collingsworth asserted, then a driver must call a toll-free number connecting him or her to a control center in the Enterprise Products Company Houston office. *Id.* at p. 661. An employee at the Houston office then contacts the appropriate field person(s) to alleviate the problem at the specific location the driver is calling from. *Id.* at p. 661.

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able to confirm that there were payments made at Greenwood and Iowa City. *Id.* at pp. 695, 703.

78. The 2004 East Red Line Shipper agreement, Collingsworth asserted, involved three primary ethane/propane mix transportation routes that were reflected in Mid-America's FERC tariffs: (1) Channahon, Illinois to Clinton, Iowa; (2) Conway Mid-America Holding to Clinton; and (3) Conway Mid-America Holding to Morris. *Id.* at pp. 731-32. The agreement also covered the Channahon to Morris movement for ethane/propane mix, a transportation path which Mid-America considers intrastate, he claimed. *Id.* at pp. 732-33.

79. The East Red Line Shipper's volume incentive rates for transportation from Conway to Clinton and Morris are below fully allocated costs, according to Collingsworth. *Id.* at p. 733. Collingsworth also testified that Mid-America has received the $1 million incentive reliability payment from the East Red Line Shipper every year since the 2004 East Red Line Shipper agreement and expects to receive it for 2007 as well. *Id.* at p. 737. Under the East Red Line Shipper agreement, he explained, the Cochin to Conway volume commitment generates approximately $2.9 million annually for Mid-America, and Mid-America receives this amount whether or not the East Red Line Shipper actually ships volumes. *Id.* at p. 740. The East Red Line Shipper, Collingsworth testified, has transported no volumes under the agreement from January 1, 2004, through 2006, and likely will not transport any in 2007. *Id.* at p. 740.

80. Collingsworth stated that the East Red Line Shipper has full and complete ownership of the propane in the ethane/propane mix transported by the East Red Line Shipper from Conway to Clinton, and when the propane comes back from Clinton, the East Red Line Shipper designates whether it wants the propane back in its inventory at Conway or whether it wants the propane delivered to another destination. *Id.* at p. 744. For example, he said, as a result of providing Mid-America with propane volumes at Iowa City, Mid-America credits the East Red Line Shipper's inventory at Conway. *Id.* at p. 745.

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81. Mid-America does not lease any propane storage at Iowa City, Collingsworth testified. *Id.* at p. 749. He explained that Mid-America leases the space at the Iowa City underground propane storage from Enterprise Terminals, and if Mid-America put propane in the underground storage cavern at Iowa City, title to the propane would be in Mid-America. *Id.* at pp. 749-50. The East Red Line Shipper, according to Collingsworth, only pays the tariff on the propane volume contained in the ethane/propane mix that it keeps. *Id.* at p. 750.

82. Collingsworth stated that, were propane shipped to Janesville from Conway, the shipper would have to pay the applicable tariff rate from Conway to Janesville as well as a propane supply assurance program fee. *Id.* at pp. 751-52. Under the propane supply assurance program, he explained, any shipper that delivers a barrel to Conway can immediately load that barrel at one of the terminals connected to the pipeline. *Id.* at p. 752.

83. The Channahon location does not have the capability of producing the entire amount of ethane/propane mix that the East Red Line Shipper desires, Collingsworth testified. *Id.* at p. 757. He stated that the level 1 volume commitment is 19,746,500 barrels, and were the East Red Line Shipper not to meet its level 1 volume commitment, it still had to pay as if it had shipped that volume. *Id.* at p. 758. Collingsworth explained that, in terms of the transportation rate paid in association with the level 1 volume commitment, the rate paid from Channahon is the same as the rate paid from Conway, Kansas. *Id.* at p. 760.

84. According to Collingsworth, if the East Red Line were idled, Mid-America would no longer incur any of the variable costs, primarily fuel and power, associated with the East Red Line. *Id.* at pp. 773-74, 776-77. He further testified that, were the East Red Line idled, Mid-America could lower its field labor, but only by an insignificant amount. *Id.* at p. 776. Revenue[49] exceeded variable cost, admitted Collingsworth. *Id.* at p. 780. He also asserted that the totality of maintenance expenses associated with the East Red Line is the same whether the East Red Line is in operation or is idled. *Id.* at p. 783.

85. Collingsworth further testified that, should the pipeline go idle, the costs associated with pipeline integrity would not be eliminated or reduced because the Department of Transportation requires maintenance of pipeline integrity whether the pipeline is in use or not. *Id.* at pp. 786-87. Therefore, he suggested, pipeline integrity costs are not variable. *Id.* at pp. 789-90.

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[49] Collingsworth defined “revenue” as the tariff rate on the total amount of barrels of ethane/propane mix delivered to the East Red Line Shipper. Transcript at p. 782. However, he stated that “revenue” did not include the Cochin-to-Conway volume commitment payment or the incentive reliability payment. *Id.*

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86. The specific labor cost of $1.3 million for the Rocky Mountain System initially was misreported as Northern System costs, Collingsworth claimed. *Id.* at pp. 818-19. He asserted that the Kansas-Nebraska formula understated the amount of indirect expenses attributed to the Northern System. *Id.* at pp. 821-22. Collingsworth ranked, from greatest to least, the three systems according to direct labor associated with the day-to-day operations of moving the volumes in the pipeline as follows: the Northern System, the Central System, and the Rocky Mountain System. *Id.* at pp. 824-25, 831. Furthermore, Collingsworth ranked, from greatest to least, the three systems according to complexity of operation[50] as follows: the Northern, the Central, and the Rocky Mountain System. *Id.* at p. 831.

87. Right of way maintenance is the most costly for the Northern System, according to Collingsworth, with the Central and the Rocky Mountain System being interchangeable. *Id.* at pp. 831-33. The Northern System, he said, is the most costly because the Central and the Rocky Mountain System consist mostly of desert with no vegetation concerns, and the Northern System has more stream crossings, trees, and a higher population density that result in more road crossings and construction around the pipeline. *Id.* at pp. 832-33.

88. Collingsworth admitted that Mid-America is not charging the highest possible lawful rate for most of the movements in Group 100 on the Rocky Mountain System due to competitive constraints. *Id.* at p. 855. He testified that Mid-America was underearning before and after it was acquired by Enterprise Products Company.[51] *Id.* pp. 855-56. There was a 23% across-the-board rate increase because of the underearning and substantial increases in operating at cost from the time Enterprise Products Company bought the asset, he stated. *Id.* at pp. 856-57. Moreover, Collingsworth testified that he does not remember any analyses or studies of rate design conducted before the 23% rate increase was submitted in tariffs. *Id.* at pp. 857-58. According to him, subsequent to being filed, the 23% rate increase was reduced or discontinued on the Rocky Mountain System, and there were second rate increases on the Northern System. *Id.* at p. 861.

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[50] Collingsworth stated that, in giving that answer, he considered "what's going on inside the pipe, what we have to do to facilitate the movements, *e.g.*, "all the different ways you could batch product, the amount of testing you had to do, all that." Transcript at p. 825. He added that he also considered the "burden on right-of-way," and further whether the pipeline flowed in both directions, the number of different products which were carried on it, and the number of destinations on it. *Id.*

[51] According to Collingsworth, the underearning determination was based on a systemwide cost-of-service, not on a segmented cost-of-service basis. Transcript at p. 856.

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89. According to Collingsworth, FERC Tariff No. 40 added two new groups — Groups 101 and 102 — from what the dedicated shippers' agreement had in 1999. *Id.* at p. 891. Additionally, Collingsworth said, FERC Tariff No. 40 included an ethane incentive provision that never existed in any of the tariffs before Enterprise Products Company bought the assets, and established the ethane discount rate. *Id.* at pp. 891-92. Collingsworth noted that FERC Tariff No. 42 was issued, replacing FERC Tariff No. 37 and FERC Tariff No. 40, both of which were withdrawn. *Id.* at p. 892.

90. Collingsworth testified that, under FERC Tariff No. 45, no shipper in Groups 100 through 104 was affected by the increase in the joint rates, except for Williams, which was the only shipper that did not sign an incentive volume agreement, and it was affected only in February 2007. *Id.* at pp. 895-96. He added that FERC Tariff No. 45 also canceled the discount rates for ethane, but that the discount was reinstated in FERC Tariff No. 47 for shippers that had signed a long-term incentive agreement. *Id.* at pp. 896-97, 899, 901. Williams, noted Collingsworth, is the only shipper on the Rocky Mountain System that did not sign a dedication agreement with Mid-America, and therefore, is the only shipper on Rocky Mountain that does not have the ethane discount. *Id.* at pp. 899-900.

91. According to Collingsworth, demand in Mid-America's Northern System markets was down since 2004 and has been dropping steadily since then. *Id.* at p. 942. He claimed that demand will continue to decline, and also that demand for propane in 2007 will be no higher than the demand in 2005. *Id.* at pp. 942-43. Collingsworth noted that, while demand may be flat on a nationwide basis, demand is down on the Mid-America system. *Id.* at p. 945.

92. Collingsworth asserted that Mid-America faces competition from Nustar, the Cochin Pipeline, the Kinder Morgan Pipeline, now owned by ONEOK, and the ConocoPhillips Pipe Line. *Id.* at p. 961. He also declared that Mid-America's seasonal discount rates were set at a level comparable to Mid-America's competitors' rates. *Id.* at p. 964. According to Collingsworth, were Mid-America to charge the general commodity rate, it would lose much of its volume to the competing pipelines. *Id.* Admitting that Mid-America, as a whole, is operating at a profit, as well as, each individual system, he said that the Rocky Mountain System was earning as close to its Opinion 154-B cost-of-service calculation as it could earn.[52] *Id.* at p. 966. However, Collingsworth claimed that the Central System was underearning by $23 million on an annual basis, and the Northern System was underearning by $34 million on an annual basis. *Id.* at p. 967. Collingsworth suggested that $47 million is what Mid-America

[52] Collingsworth referred to the Commission's Opinion No. 154-B, *Williams Pipe Line Company*, 31 FERC ¶ 61,377 (1985).

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should be getting from return on equity, depreciation, and the tax allowance. *Id.* at p. 987.

93. According to Collingsworth, the majority of storage used by Mid-America is operational storage. *Id.* at p. 968. The commodities being stored, he maintained, are demethanized mix, ethane/propane mix, propane, isobutane, normal butane, and natural gasoline. *Id.* The cost of storage, he claimed, is treated as an operating expense since Mid-America does not own the storage facilities, and thus, the cost of storage is not included within its rate base. *Id.* at pp. 969-70.

94. Collingsworth claimed that, at Hobbs, there are no intrastate movements that utilize that storage, and that at Conway, less than ten percent are intrastate. *Id.* at p. 974. He stated that Mid-America will be able to move the general commodity rate up over the seasonal discount rate in three to five years. *Id.* at p. 975.

95. The dividing line between Seminole and Mid-America, Collingsworth stated, is at Hobbs storage and fractionator. *Id.* at p. 989. According to Collingsworth, there are approximately 250,000 barrels a day moved on the Rocky Mountain System, and 125,000 barrels a day goes on to Seminole and Mont Belvieu. *Id.* at p. 990. He added that demethanized mix coming off the Rocky Mountain sits in storage at Hobbs no more than seven or eight days. *Id.* at p. 993.

B. J. PETER WILLIAMSON[53]

96. J. Peter Williamson (Williamson) is the Laurence F. Whittemore Professor of Finance Emeritus at the Amos Tuck School of Business Administration, Dartmouth College. Exhibit No. M-17 at p. 1.

97. Because Mid-America had no debt of its own from 1984 to 1986, Williamson said he used the capital structure of its parent company, MAPCO. *Id*. at p. 17. In 1987, Mid-America had its own debt, therefore, from 1987 through 2001, Williamson asserted, he used the capital structure of Mid-America. *Id*. In August 2002, he added, Enterprise Products Partners bought Mid-America and since then has guaranteed its debt. *Id*. Thus, from 2002 to 2005, Williamson said he used the capital structure of Enterprise Product Partners. *Id*. In order to calculate the debt costs for Mid-America, Williamson claimed he relied on MAPCO's cost of debt from 1983 to 1986, then on Mid-America's debt costs from 1987 to 2001, and Enterprise Products Partners' debt costs from 2003. *Id*. at p. 18. Finally, for 2002, Williamson testified, he averaged Mid-America's 2001 debt costs and

[53] As a result of the parties' stipulations, *see* Exhibit No. JE-4, certain portions of Williamson's testimony have been mooted. Transcript at p. 1004-08. That portion of his pre-filed testimony, although entered into the record, is not summarized.

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Enterprise Products Partners 2003 debt costs. *Id.* In each case, Williamson said he determined the weighted average of the embedded cost of long-term debt available to finance the pipeline as of December 31.[54] *Id.*

98. For the period 1984 to 1993, Williamson claimed that he relied on the compliance filing which was the subject of *SFPP, L.P.,* 86 FERC ¶ 61,135 (1999), *on reh'g*, 91 FERC ¶ 61,135 (2000), in which the Commission adopted an 11.73% real cost of equity. Exhibit No. M-17 at pp. 18-19.

99. In his rebuttal testimony, Williamson noted that Staff witness Green and Propane Group witness O'Loughlin objected to his use of Mid-America's own capital structure for the period 1987-2001 and claimed that the capital structures of Mid-America's parent companies should be used. Exhibit No. M-84 at p. 3. Williamson testified that he relied on the capital structure of Mid-America because, during the years in question, Mid-America made use of its own non-guaranteed debt without borrowing from affiliates and without parent guarantees. *Id.* at p. 4. Further, he stated that only eight Commission-regulated oil pipelines issue rated long-term debt, and these pipelines make up only 5.1% of the entire set of FERC Form 6 filers. *Id.* at p. 6. If the Commission required only pipelines with rated long-term debt to use their own capital structures, asserted Williamson, the capital structure of the parent, rather than the capital structure of the pipeline itself, would almost always be used. *Id.* at p. 7.

100. O'Loughlin, Williamson maintained, did not explain why matching the capital structure of Mid-America to those of the two parent companies ensured that the capital structure was appropriate for the risk in Mid-America and why its own capital structure was not. *Id.* at p. 8. He added that he does not "understand why such consistency is necessary." *Id.* On the other hand, he agreed with O'Loughlin that "resulting real return on common equity is only an unrealistic 6.51%," and that the "minimum risk premium [O'Loughlin] ought to have added to his return for this differential is 100 basis points." *Id.* at p. 10.

101. Both he and Green, testified Williamson, used the capital structure and the debt cost of Enterprise Products Partners to determine debts costs for Mid-America, but they diverged with respect to the year 2002 — the year in which ownership of Mid-America passed to Enterprise Products Partners. *Id.* at p. 11. Green used the capital structure of Enterprise Products Partners for that year, but Williamson stressed that, because ownership changed in mid-year,[55] he used the average of debt cost at the "two ends of the

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[54] *See also* Exhibit No. M-22.

[55] Williamson claimed that, typically, the debt cost for a year is determined by looking to the company's debt cost at year-end. Exhibit No. M-84 at p. 11. In this case, he asserted, "the appropriate company reference changed in mid-year," and therefore, the

year 2002." *Id.*

102. Under cross-examination at the hearing, Williamson testified that he used Mid-America's FERC Form 6 capital structures for the years 1987 through 2001 in calculating deferred return. *Id*. at p. 1011. He also said he used Mid-America's FERC Form 6 filings in his determination of Mid-America's capital structure, and not its parent, for the time frame 1987 to 2001. *Id*. at pp. 1011-12. Moreover, he explained that he used Mid-America's FERC Form 6 to determine that there was no long-term borrowing, although there were "obligations to affiliates during those years." *Id*. at p. 1012. However, Williamson could not cite to any support for his position that there were no parent guarantees of Mid-America's long-term borrowing." *Id.* at p. 1013. As questioning continued, Williamson went on to say that he employed the capital structure of Mid-America's parent, MAPCO, for the period 1983 to 1986 because Mid-America did not have long-term debt issued solely on its own credit. *Id*. at pp. 1013-14. Although during questioning about Exhibit No. NPG-63 Williamson admitted that, in 1987, "Mid-America's parent had in place a policy of financing Mid-America's operations through the use of intercompany payable activity or borrowing," he claimed that it had a non-guaranteed debt of $86 million in 1987 owed to Prudential Insurance Company and Barclays Bank.[56] *Id.* at p. 1015-16. According to Williamson, Mid-America's parent appeared, in 1987, to be constructing a specific capital structure for Mid-America in the range of 75% equity, 25% debt. *Id*. at p. 1016.

103. Next, Williamson testified that, in 1987, MAPCO controlled Mid-America's financing, which is typical of a parent/subsidiary relationship. *Id*.[57] MAPCO, explained Williamson, used payables to affiliated companies in financing Mid-America's activities, but he noted that these payables were current liabilities and not long-term debt. *Id*. at p. 1017. Mid-America's long-term debt, he continued, remained at $90 million for several years, and the level of Mid-America's paid-in capital between 1996 and 2000 remained relatively constant. *Id*. at p. 1020. Furthermore, he agreed that Mid-America made dividend payments to its parent in the amount of $139 million between the years of 1992 and 1996. *Id.* at pp. 1022-23.

104. During further cross-examination, Williamson stated that, if a subsidiary relies on the parent for long-term debt, either borrowing from the parent or with a guarantee from

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correct source at the beginning of 2002 was Mid-America, while the correct source at the end of that year was Enterprise Products Partners. *Id.*

[56] According to Williamson, this was a "private placement" and did not require a debt or bond rating. Transcript at p. 1017.

[57] *See also* Transcript at pp. 1107-22; Exhibit No. NPG-182.

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the parent, using the parent's capital structure is appropriate. *Id*. at p. 1024. Conversely, he suggested, if the subsidiary issues debt on its own credit, using the capital structure of the subsidiary is appropriate. *Id*. at p. 1024. According to Williamson, if a pipeline does not report debt on its FERC Form 6, its capital structure is 100% equity and zero percent long-term debt. *Id*. at p. 1031. Finally, he emphasized that having a bond rating indicates a company's ability to obtain financing, but it is unnecessary to achieve financing. *Id*. at p. 1033. He added that Mid-America has no bond rating because its loans had come from a private placement. *Id.* at pp. 1033-34.

C. MICHAEL J. KNESEK

105. Michael J. Knesek (Knesek) is the Senior Vice President, Controller and Principle Accountant Officer of Enterprise Products, GP, LLC, the general partner of Enterprise Products Partners, L.P. Exhibit No. M-3 at p. 1.[58] In his current position, Knesek supervises approximately 300 employees working in the following departments: (1) Financial Accounting; (2) Operational Accounting; (3) Financial Reporting; (4) Regulatory Compliance and Reporting; (5) Risk Control; (6) Payroll Accounting; and (7) Tax. *Id*. at p. 2.

106. Knesek testified that his staff submitted financial data to the Regulatory Economics Group, which employs Mid-America witness Ganz, to enable it to calculate the cost of service for Mid-America's Northern System rates.[59] *Id.* at p. 3. He noted that all the data provided was of the kind maintained in the ordinary course of business and was the same data used in Mid-America's 2004 and 2005 FERC Form 6. *Id*. Mid-America, asserted Knesek, needed to make an adjustment to its carrier property accounts to rectify an error that occurred when Enterprise Product Company acquired Mid-America from Williams. *Id*. at pp. 4-5. Erroneously, Knesek said, Mid-America included assets as carrier property after that transaction which were retained by Williams. *Id.* at p. 5. Removing these assets from Mid-America's asset ledger, he said, reduced the net carrier property by roughly $1.77 million. *Id.*

107. Further, Knesek testified, Enterprise Products Partners used a modified version of

[58] *See also* Transcript at p. 1207.

[59] According to Knesek, the following data was provided: (1) 2002-2005 property and fixed asset subledgers; (2) property pages from FERC Form 6 reports; (3) property location codes; (4) 1982 Valuation Report; (5) 2002 Depreciation Study; (6) detailed Mid-America revenue information, expense data by cost center and point-to-point pipeline mileage; (7) basis for EPCO, Inc.'s overhead expense allocation to Enterprise Products Operating and Enterprise Products Operating overhead expense allocation to Mid-America; and (8) account listing used to convert financial records to FERC's Uniform System of Accounting for Form 6 purposes. Exhibit No. M-3 at p. 3.

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the Massachusetts formula for allocating general overhead costs from a parent company to a regulated subsidiary. *Id.*[60] Specifically, he said, the modified formula attributed a portion of the corporate overhead allocated on Mid-America's labor, property, and gross margin in relation to labor, property, and gross margin of Enterprise Products Partners and its subsidiaries as a whole. *Id.* He added that Enterprise Products Operating uses the same approach in allocating general overhead costs to its subsidiaries on its financial records. *Id.*[61]

108. In his rebuttal testimony, in response to the contention of Propane Group witness Daniel S. Arthur (Arthur) that gross margin should be used only "for entities that receive revenue through 'regulated pass-through mechanisms' such as purchased gas adjustments," Knesek testified that the reasons for using gross margin instead of gross revenue are as applicable here as they are in the narrow factual scenario described by Arthur. Exhibit No. M-70 at p. 2. He added:

> The purpose of the Massachusetts formula is to allocate overhead to corporate subsidiaries. While gross revenue may in some instances provide a reasonable proxy for the relative size of a particular enterprise and consequently the relative amount of administrative and overhead expenses incurred by the parent on behalf of the enterprise, it does not make sense to use gross revenue in certain other situations.

Id. at p. 3. Using gross margin, he claimed, provides a more meaningful and fair allocation than using gross revenue and a better proxy for the amount of overhead used by each entity.[62] *Id.* at p. 4. Furthermore, Knesek testified that the use of gross margin treats entities that buy and sell commodities equally with entities that provide services. *Id.*

109. Next, Knesek addressed Arthur's claim that three entities — Tri-States Natural Gas Liquid Pipeline, LLC, Dixie Pipeline Company, and Belvieu Environmental Fuels, Inc. — were inappropriately excluded from the Massachusetts Formula calculations. *Id.*

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[60] *See also* Exhibit No. M-70 at p. 2.

[61] *See also* Exhibit No. M-70 at p. 2.

[62] As an example, Knesek noting that, while Enterprise Products Operating had gross revenues of $698.2 million, it only had a gross margin of $27.7 million, *i.e.*, its gross revenues exceeded its gross margin by over 25 times, said: "Dr. Arthur suggests that the $698.2 million figure is appropriate to include in the Massachusetts formula, but in my opinion this would allocate a disproportionate amount of overhead to that entity." Exhibit No. M-70 at p. 3.

at p. 5. First, he stated that Tri-States was excluded in the overhead allocation because it is not operated either by Enterprise Products Operating or Enterprise Products Partners; rather, it is operated by BP Amoco under a separate operating agreement. *Id*. Second, he explained that Dixie Pipeline Company was excluded in the overhead allocation because, from 2003 through June 2005, it was operated by ConocoPhillips. *Id.* Finally, Knesek testified that Belvieu Environmental Fuels was excluded because it is operated under a separate service agreement under which it pays a direct charge to EPCO, Inc., for overhead services. *Id*.

110. Also, Knesek addressed Arthur's criticism that the property, plant, and equipment related to GulfTerra Energy Partners, L.P., and its subsidiaries and two other acquired affiliates[63] were excluded from the 2004 overhead allocation calculation even though the property, plant, and equipment for these entities were included on Enterprise Products Partners' 2004 10-K. Initially, he noted, Enterprise Products Operating calculates its overhead allocation on a monthly basis; thus, it does not technically perform a "2004 allocation" or a "2005 allocation." *Id*. at p. 6. Enterprise Products Partners acquired all three entities mentioned above in September 2004, he said, but it did not begin fully operating those companies until January 2005. *Id*. Consequently, Knesek claimed, the three companies were not included in the monthly overhead allocation until January 2005, when both the overhead costs allocated to the companies as well as the overhead costs generated by the companies were included. *Id*. at pp. 6-7. Additionally, Knesek explained, Mid-America excluded the purchase accounting adjustments from the gross property, plant, and equipment figure used to calculate overhead because the purchase accounting adjustments related to rate-regulated entities. *Id*. at p. 9. Finally, he testified that all of the purchase accounting adjustments made in 2004 and 2005 related to rate-regulated Enterprise Products Partners subsidiaries. *Id*.[64]

111. As cross-examination at the hearing began, Knesek explained that all of the employees that work for Mid-America and Enterprise Terminals and Storage are employees of EPCO, Inc., and that it employs all or the vast majority of employees working for the Enterprise family of companies. Transcript at pp. 1048-49.[65] Next, Knesek described a home cost center as part of the company's Human Resources (sometimes HR) payroll system, which tracks the EPCO, Inc., employees' compensation

[63] "The two affiliates were El Paso Hydrocarbons, LP and GulfTerra NGL Marketing, LP, which were later renamed Enterprise Hydrocarbons, LP and Enterprise NGL Marketing, LP." Exhibit No. M-70 at p. 6, n.3.

[64] *See also* Exhibit Nos. M-70 at pp. 8-9 tbls.1, 2; M-138; Transcript at pp. 1185-88.

[65] *See also* Transcript at p. 1069.

and represents where a particular employee spends the majority of his or her time and services. *Id.* at p. 1049. When asked to explain the difference between a home cost center and a home company, Knesek replied that a home company is one of the subsidiary companies under EPCO, Inc., and a home cost center represents the actual location within that entity where costs are captured. *Id.*

112. Upon further cross-examination, he testified that the Northern System terminals have a cost center. *Id*. at p. 1050. According to Knesek, if an EPCO, Inc., employee provides services for more than one cost center, there is a default allocation set up for recording a portion of his or her time to each cost center. *Id.* at p. 1051. However, he stated that there are no audits or checks on the accuracy of the default percentages. *Id*. at p. 1053. If employees begin performing more or less than their default percentages, according to Knesek, then they, or their managers or supervisors, are responsible for communicating that to the Human Resources payroll group. *Id*. at p. 1053. Managers, noted Knesek, are required to submit default percentages for all of their employees. *Id*. at p. 1056. EPCO, Inc., reported Knesek, has one HR department and provides HR services to all of the entities below EPCO, Inc. *Id*. at p. 1052.

113. As cross-examination continued, Knesek claimed that the change in Mid-America's direct and rebuttal testimony — the addition of $1.3 million in Rocky Mountain direct labor expenses — was a result of an EPCO, Inc., account discrepancy. *Id*. at pp. 1057-58. The persons associated with those expenses were EPCO, Inc., employees and not outside contractors, however, erroneously, the work done by these employees was charged or coded to an outside service major account, according to Knesek. *Id*. at pp. 1057-58.

114. When asked to elaborate on the type of work associated with account 84001, Knesek answered that the account is associated with repair and maintenance, such as right of way maintenance, pipeline repair, terminal repair, and storage repair, all of which would be present on the Northern and the Rocky Mountain System. *Id.* at pp. 1060-62.[66] The Northern System pipeline employees record a majority of their time in account 80099, Knesek stated, while the Rocky Mountain System employees record a majority of their time in account 84001. *Id.* at p. 1063. One possible explanation for the difference among the systems, he suggested, is that the managers across the Mid-America system have different practices for instructing their employees how to record their time. *Id*. at p. 1065.

115. Further, Knesek explained that the Massachusetts formula[67] is used to allocate

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[66] *See also* Exhibit Nos. NPG-185, NPG-186.

[67] According to Knesek, typically, the elements of the formula include gross revenues, gross property, plant, and equipment costs, and direct labor payroll. Transcript

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general overhead costs, and agreed that, if one of the elements were erroneously high for one subsidiary, the allocated overhead for that entity would be higher.[68] *Id*. at pp. 1066-67. Mid-America, he continued, used a modified Massachusetts formula to allocate overhead. *Id*. at p. 1068. Essentially, explained Knesek, Mid-America used two of the three elements of the Massachusetts formula, but used gross margin or gross profit or net revenue (gross revenue less cost of sales) instead of gross revenues. *Id*. at pp. 1068-69. This modified formula, noted Knesek, was developed in mid-2002 after Enterprise Products Company acquired the Mid-America Pipeline entity and assets. *Id*. at p. 1069.

116. Under further cross-examination, Knesek testified that EPCO, Inc., provides an allocation of overhead first to Enterprise Products Operating. *Id*. at p. 1069. After noting that EPCO, Inc., is "where all the employees are maintained," Knesek agreed that these costs are first allocated to Enterprise Products Operating. *Id.* at pp. 1069-70. He further explained that Enterprise Products Operating is the wholly owned subsidiary of Enterprise Products Partners, the publicly traded master limited partnership. *Id*. at p. 1070. In addition, Knesek testified that contracts exist between EPCO, Inc., and the entities for which it provides services, and they provide very specific terms for charging direct costs and related indirect costs for services rendered. *Id*. at pp. 1070-71. Knesek noted, Enterprise Products Operating has no employees. *Id*. at p. 1072. Additional overhead, he claimed, is added to the amount that was allocated from EPCO, Inc., to Enterprise Products Operating which, subsequently, is allocated down to the subsidiaries of Enterprise Products Partners. *Id*. There are direct general overhead charges paid to third-party vendors that are solely for the benefit of Enterprise Products Operating and are recorded and paid directly by it. *Id.* at pp. 1072-73.

117. According to Knesek, the basis for Mid-America's decrease in property, plant, and equipment and the Enterprise Terminals increase in property, plant, and equipment between August and September 2004 is the direct result of the transfer of storage assets from Mid-America to Enterprise Terminals. *Id*. at p. 1079. Furthermore, he said, Mid-America's gross property, plant, and equipment included the subject storage assets from at least January 2004 through August 2004. *Id*. at p. 1080. If including storage assets in the gross property, plant, and equipment of Mid-America was incorrect, Knesek asserted, then for all months in 2004 where these storage assets were included in Mid-America's property, plant, and equipment, the property levels for Mid-America would also be incorrect. *Id*. Additionally, he maintained, the removal of these storage assets from Mid-America's property would have a direct effect on the amount of corporate overhead allocated to Mid-America. *Id*.

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at p. 1066.

[68] Knesek also agreed that the reverse also would be true. Transcript at p. 1067.

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118. When asked to define the term "purchase accounting adjustment," Knesek described it as an increase in the value of the assets from the books and records of the entity acquired to its current fair market value. *Id*. at p. 1082. Continuing, he stated that a "negative purchase accounting adjustment" exists when the carrying value of the fixed assets on the books and the balance sheet of the entity for which is being purchased are in excess of the then-current fair market value of those assets. *Id*. at p. 1083. Further, Knesek explained, an "original cost" asset is the price paid for the asset when it is constructed. *Id*. at p. 1089.

119. According to Knesek, GulfTerra Texas Pipeline is a natural gas pipeline regulated by the Texas Railroad Commission for which, he said, $1.1 billion of additional value was placed on the assets acquired by Enterprise Product Partners over and above the carrying value (original cost less accumulated depreciation) of the assets acquired by Enterprise Product Partners. *Id*. at pp. 1090-92. Also, Knesek claimed that the GulfTerra Texas Pipeline first appeared in the Massachusetts formula for Mid-America in January 2005. *Id.* at p. 1093.

120. When further questioned on gross margin, Knesek defined "gross margin" as gross revenue less the cost of goods sold. *Id.* at p. 1100. The substitution of gross margin for gross revenue in the Massachusetts formula, insisted Knesek, is a more reasonable and fair way to allocate corporate overhead costs for Enterprise Products Partners. *Id.* at pp. 1100-01. Knesek reported that, for a majority of entities in the Massachusetts formula for Mid-America, the gross margin equals gross revenue. *Id*. at p. 1101. Mid-America, according to him, has only service-related revenues, as opposed to marketing revenues. *Id*. Enterprise Products Partners' subsidiaries, he added, sell natural gas liquid products and have not received authority to institute a pass-through mechanism, via a federal or state regulatory authority. *Id*. at pp. 1101-02. Gross margin, claimed Knesek, depends upon the purchase price by Enterprise Product Partners and the sale price of the commodity. *Id.* at p. 1102. Furthermore, he testified, market prices for the commodities Enterprise Products Partners subsidiaries sell can fluctuate substantially month to month, and consequently, the gross margin for the Enterprise subsidiaries may fluctuate significantly from month to month. *Id*. Gross margin, he explained, can be negative under the Massachusetts formula, meaning for that particular entity, cost of goods sold exceed gross revenues. *Id*. at p. 1103. Were gross margin of an entity to be negative, he continued, the allocation of overhead for that entity with respect to the gross margin element would decrease, and the allocation potentially could be pushed to other subsidiaries. *Id*.

121. Questioned further, Knesek explained that "negative payroll" implies an accounting correction from payroll numbers from prior months or prior periods. *Id*. at p. 1106. Should the Massachusetts formula reflect a negative payroll amount, according to Knesek, then other entities would have more overhead allocated to them as a result. *Id*. at pp. 1106-07. Mid-America, he went on to say, excluded various GulfTerra entities

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from its Massachusetts formula calculations for 2004. *Id.* at p. 1110. Knesek continued, GulfTerra Energy was consolidated in October 2004, and the property, plant, and equipment of Enterprise Products Partners increased significantly with the acquisition of the GulfTerra entities. *Id*. at p. 1111. According to Knesek, there was little, if any, corporate overhead generated with respect to the GulfTerra transaction. *Id.* at p. 1112.

122. As a result of the Enterprise Products Partners merger with GulfTerra in 2004, Knesek agreed, the former reorganized its business activities into four reportable business segments made up of offshore pipeline and services, onshore natural gas pipeline and services, natural gas liquid pipeline and services, and petrochemical services. *Id*. at p. 1116. The reorganization, maintained Knesek, generated very minimal corporate overhead. *Id*. According to him, when Enterprise Products Partners files its Securities and Exchange Commission Form 10-K, it refers to unallocated corporate overhead as general and administrative. *Id*. Finally, he testified, the GulfTerra assets were the primary assets acquired or consolidated in 2004 by Enterprise Products Partners. *Id*. at pp. 1117-18.

123. When asked to clarify a few terms, Knesek explained that "NH_3 100%" means that a cost center set up and used to record operating costs associated with the Magellan ammonia system may have its costs reimbursed by Magellan. *Id.* at p. 1118. In addition, he stated that "NH_3 nonbillable" means that those costs may not be passed on to Magellan; Mid-America absorbs those costs. *Id.* Thirdly, he reported that the term "NH_3 shared" represents the situation in which assets are operated jointly, and costs associated with the operation of those assets are shared between Enterprise Products Partners and Magellan. *Id*. at pp. 1119-20. According to Knesek, the sharing arrangement is based on a written agreement between Magellan and Enterprise Products Partners, which reflects monthly throughput of the two pipelines for the section in which costs are shared. *Id*. at p. 1120. If there is no NH_3 designation associated with a cost center, stated Knesek, then that cost center is not associated with the ammonia line. *Id*. Furthermore, Knesek testified, if Mid-America performs pipeline integrity management functions associated with the ammonia line, those associated costs are recorded separately from the pipeline integrity management costs associated with Mid-America's Central, Northern, and Rocky Mountain Systems and billed to Magellan. *Id.* at pp. 1120-21.

124. When asked to define "headroom," Knesek replied that it meant that pipeline rates exceed the costs. *Id.* at p. 1130. Further, he explained that accounting for Mid-America Pipeline is done on a company, not a system, basis. *Id.* at p. 1131. All of Mid-America's in-house lawyers, stated Knesek, are part of the EPCO, Inc., cost center, and all outside legal fees are recorded in either account 86002 or account 86007. *Id.* at pp. 1132-33. The fees for the instant case and fees related to GulfTerra, claimed Knesek, fall into account 86007, which is set up to capture legal expenses related to regulatory matters. *Id.* at p. 1133-34. Account 86002 is set up to capture legal expenses related to general litigation matters. *Id.* at p. 1134. Bills from outside law firms, Knesek

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contended, can be directly assigned to the particular Enterprise entity, but within Mid-America Pipeline, law firm bills are not divided on a system basis. *Id*. at p. 1137.

125. Under further cross-examination, Knesek claimed that the $1.3 million transferred from Account 320 to Account 300 represented internal labor charges. *Id*. at pp. 1159-60. Knesek agreed, after referring to the Code of Federal Regulations to refresh his recollection, that Account 300 covers salaries and wages for supervisory and other personnel directly engaged in transportation operation and maintenance and repair of transportation property and that Account 320 covers outside services and includes labor costs paid to outside contractors for provided services. *Id.* at pp. 1161-62; 1165-66. The $1.3 million, maintained Knesek, came from Account 320 and was the only Account 320 funds transferred to FERC Account 300. *Id*. at p. 1169-70.

126. Knesek testified that pipeline integrity work is generally specific to each system, though there are shared right of ways wherein two pipes share the same ditch. *Id.* at p. 1171. Furthermore, he continued, the pipeline integrity authority for expenditure (sometimes AFE) account is used for large projects that will have significant dollars incurred to accomplish the pipeline integrity work. *Id.* at p. 1172. There is a written policy, according to him, governing approval for different types of expenditures. *Id*. at pp. 1172-73. Moreover, he stated, EPCO, Inc., reviews all of its costs, including allocated costs and operating expenditures on a monthly basis. *Id*. at p. 1173. Specifically, he asserted, there is a general review session with commercial people and input from operations, wherein actual costs are compared to deducted costs, and prior month data is compared to current month data, and explanations are given for any significant variances. *Id*. Following the general review session, Knesek added, an executive meeting is held, wherein all the results, including revenues, volumes, and costs for all the businesses are reviewed in depth. *Id*. at p. 1174. Finally, he claimed, quarterly federal review meetings are also held, focusing on operating costs for the quarter compared to the budget for the quarter and prior quarter. *Id*. at p. 1174.

127. Next, Knesek reported that the compensations of top-level executives are charged to the administrative department, and the compensations and costs of the internal attorneys are charged to the legal department. *Id*. at pp. 1190-91. Mid-America and Seminole in 2006, he claimed, were charged with legal fees related to this proceeding. *Id.* at p. 1196.

128. According to Knesek, there is storage at the Hobbs fractionator and that is the only storage within the Rocky Mountain System. *Id.* at p. 1199. Furthermore, he stated, there is considerable storage in the Conway area, Iowa City, Iowa, and Greenwood, Nebraska. *Id*. Also, Knesek testified that costs can be assigned directly to cost centers for individual terminals. *Id*. He explained that there is a cost center at Hobbs for the fractionator, and labor costs could be assigned to those cost centers. *Id*. Assigning the Rocky Mountain System the largest percentage of storage assets is appropriate in his view, even though

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there are no storage facilities on that line except at the Hobbs fractionator. *Id*. at pp. 1201-02.

129. Knesek explained that there are contractual agreements setting storage fees, which are invoiced to the customer. *Id*. at p. 1208. Further, he testified, when the fees are invoiced, they are recorded as storage revenue in Mid-America's books and records, and then when a payment is received, Mid-America records receipt to cash. *Id.*

130. When asked to explain "demurrage charges," Knesek said they were fees charged by a pipeline, terminal or storage facility to a customer or shipper for retaining product longer than normally required. *Id.* at pp. 1210-11. Mid-America, asserted Knesek, has received demurrage charges, and they were recorded in Account 240. *Id.* at p. 1211.

131. According to Knesek, in order to establish a market rate in transactions between Enterprise Products Partners' subsidiaries, a study is conducted by an independent consultant to determine the fair market rate. *Id.* at pp. 1217-19. Acknowledging that Mid-America leases storage space from its affiliate Enterprise Terminals, Knesek said that the latter records revenue and bills Mid-America Pipeline for those storage charges that are contractually in place, and subsequently, Mid-America Pipeline records those charges as expenses and pays those fees and invoices back to Enterprise Terminals. *Id*. at p. 1218-19.

132. On re-direct examination, Knesek claimed that EPCO employees are categorized as exempt employees or nonexempt employees. *Id*. at p. 1222. Exempt employees are typically supervisors or managers, he added. *Id*. at pp. 1222-23. Continuing, he reported, exempt employees are assigned a home cost center company and a cost center, to which their compensation is charged. *Id*. at p. 1223. According to Knesek if the exempt employees perform duties for more than one cost center, they provide the payroll department an allocation of their time based on where they spent it between the assets, and thereafter, their compensation is distributed accordingly to the company cost centers. *Id*. Furthermore, he noted, employees suggest an appropriate default percentage and then their immediate supervisors approve the suggested default percentage before it is sent to the payroll department. *Id.* at pp. 1226-27. Exempt employees, Knesek continued, are required quarterly to confirm the accuracy of their default percentages and update their default percentages to reflect any changes. *Id.* at p. 1227. If the exempt employees' day-to-day duties change, he asserted, and the change is temporary, they must fill out an exception time sheet whereby they keep track of the hours, cost centers, and assets where they are providing services. *Id*. at p. 1229. Next, he explained, the exempt time sheet hours are submitted to payroll, and they override the employees' home cost center. *Id*. at pp. 1228-29.

133. As re-direct examination continued, Knesek stated that nonexempt employees are hourly workers (*e.g.,* field line employees, clerks, and administrative assistants). *Id*. at

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p. 1230. Nonexempt employees, claimed Knesek, are required biweekly to fill out time sheets in which their service time, companies, and cost centers are reflected. *Id.* at p. 1230. Knesek noted that their immediate supervisors then approve their time sheets and submit them to payroll so that their compensation is allocated accordingly. *Id.* at p. 1230. According to Knesek, the EPCO, Inc., payroll department covers all of the Enterprise entities. *Id.* at p. 1236.

134. During my examination, Knesek maintained that Enterprise Products Partners has used the modified Massachusetts formula since it started pushing down overhead to the subsidiary companies (August or September of 2002). *Id.* at p. 1244. Knesek claimed that he and his staff developed the modified Massachusetts formula. *Id.* at p. 1245. Enterprise Product Partners, according to Knesek, applied the modified Massachusetts formula to Mid-America as an entity, not to its three operating systems. *Id.*

135. Under further cross-examination, Knesek testified that the EPCO, Inc., employees fill out overtime on their time sheets, and their immediate supervisors and the timekeeper verify and approve it. *Id.* at p. 1250. He explained that overtime is based on a 40-hour week basis and not a daily basis. *Id.* at p. 1251. Additionally, he stated, should an employee's allocation of time and services change, then the employee would make the change on the following quarter even if he or she expects that, in the next quarter, his or her allocation of time and services will resume to his or her normal default percentage. *Id.* at p. 1253. If the employee's allocation of time and services resumes to his or her normal default percentage, the employee must wait until the next quarter again to change the allocation back. *Id.* at p. 1255.

D. GRAHAM BACON

136. Graham Bacon (Bacon) has worked for EPCO, Inc., for over 16 years, and has been its Vice President for Western Operations since June 2006. Transcript at p. 1266. Bacon is responsible for overseeing the groups which operate assets in the field including Mid-America, Enterprise Terminals, Enterprise Products Operating, Chaparral Pipeline, Seminole Pipeline, San Juan Basin, Piceance Basin, Jonah and Pinedale Basins of Wyoming, and the California and Nevada area. *Id.* at pp. 1267-68, 1273.

137. According to Bacon, he is an exempt employee and is considered a shared services employee. *Id.* at p. 1269. Bacon's compensation allocation, he testified, is built up from those who work under him, and his compensation is allocated by cost center,[69] whereas Knesek's is allocated to the public entities. *Id.* at pp. 1269-70. His allocation of salary is

[69] Bacon said cost centers are a "tool to capture costs and monitor costs so [the company] would have information for which [sic] to control the costs." Transcript at p. 1285.

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made on a monthly basis, and it uses the same percentages for which the salaries of the employees that work under him are charged to the various cost centers in the same month for which Bacon's allocation is made.[70] *Id*. at pp. 1276, 1413.

138. During cross-examination at the hearing, Bacon explained that each individual that joins EPCO, Inc., is assigned to a home cost center. *Id.* at p. 1274. If a new employee replaces a particular employee's position, he went on to say, the new employee takes on the home cost center of the departing employee, and typically, in the case of an exempt employee, the same default allocation as the departing employee. *Id*. at pp. 1274-75.

139. Additionally, he stated that no one monitors the allocations of his level of employee because the allocations go to one cost center on a formula basis, and not on any type of estimated basis. *Id*. at p. 1278. He continued, the formula was established in late 2006, and prior, Bacon's allocation was based on an estimated amount of time in support of a particular asset. *Id*. at pp. 1280-81. Asked to relate how his salary was allocated between cost centers, Bacon gave the following example:

> I have 530 employees. In a particular region, there may be 20 employees. We add up the total of the salaries that would be supporting all of my cost centers, and then the percentage of that individual cost center would be allocated based on the salaries of that particular cost center relative to all the cost centers.

Id. at p. 1276. In clarification, he added that his "salary and other administrative costs are allocated based on a percentage of that individual cost center's contribution to the whole of the cost centers that [he] supports." *Id.* Bacon said that the allocation is made on a monthly basis. *Id.* at p. 1278. Asked about how pre-2006 allocations were made, Bacon claimed that it was done on an estimate of the time spent in support of a particular asset. *Id.* at pp. 1280-81.

140. Under further cross-examination, Bacon reported that, quarterly, he reviews the exempt employees under his supervision with default allocations. *Id*. at p. 1281. Specifically, he noted that each exempt employee determines his or her own allocation, and only if it seems highly inappropriate or unreasonable, does he recommend an alternative. *Id*. at pp. 1282-1283. In the end, claimed Bacon, the individual employee makes the ultimate determination. *Id.* at p. 1283. Interestingly, he testified, no written or standardized guidelines to determine a default allocation are given to the employees under Bacon's supervision. *Id*. at p. 1284.

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[70] *See also* Exhibit No. JE-5.

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141. Further, Bacon explained, Enterprise Terminals, as a stand-alone entity, is reviewed separately by Enterprise Products Partners management for cost control purposes instead of a combination of Mid-America and Enterprise Terminals. *Id.* at pp. 1285-86. Similarly, he elaborated, the profits of Enterprise Terminals are tracked separately from an operating margin purpose. *Id.* at p. 1286. Meetings discussing the costs and profits of Enterprise Terminals and Mid-America, Bacon claimed, take place monthly. *Id.* Indeed, he noted, there are meetings at the higher and lower levels. *Id.* Bacon testified that he attends the lower level meetings and reports cost increases on a segmented basis of Mid-America Pipeline. *Id.* at pp. 1287-88.

142. Asked further about time allocations, Bacon stated that, in allocating time, only the nonexempt employees' time sheets and the cost centers to which that person applied the time are considered and examined. *Id*. at p. 1295. Continuing, he explained that an employee's allocation can be to Enterprise Terminals, Mid-America, or the ammonia pipeline, but the latter would fall under Mid-America and be used to bill out the cost for providing the ammonia system. *Id*. at p. 1297. Typically, Bacon related, verbal instructions on how best to allocate time are provided to the nonexempt employees from their supervisors. *Id*. at p. 1298.

143. There are three EPCO, Inc., field employees that work almost exclusively on the ammonia system according to Bacon. *Id.* at pp. 1299-1300. One employee works on the Central segment, and the other two work on the Northern System. *Id*. at p. 1300. Moreover, Bacon admitted, labor costs associated with the ammonia system which are nonbillable show up as a salary on the Mid-America cost center report. *Id*. at pp. 1300-01. All terminal operations and storage operations on the Northern System, explained Bacon, are performed by technicians and operators with the title "pipeline technician." *Id*. at p. 1304. EPCO, Inc., employees who are assigned to Mid-America's Northern System, continued Bacon, are provided terminal and storage training. *Id*. at p. 1304. Additionally, he reported, some of the personnel who work and operate the Enterprise Products Operating Limited Partnership terminals also perform Mid-America services. *Id.* at p. 1305. A timekeeper, asserted Bacon, translates the employees' time into a code. *Id*. at p. 1307. The payroll department, elaborates Bacon, gives the timekeeper specific procedures for entering payroll data into the timekeeping software. *Id*. at p. 1308.

144. When asked to address the Greenwood and Iowa City storage facilities, Bacon replied, pumps are used to transfer product out of the storage wells, but no equipment is used to transfer product into the storage well. *Id.* At Greenwood, he continued, the pump is operated remotely by the pipeline control center, and at Iowa City, it is operated by the local facility operator. *Id.* at p. 1325. Bacon stated that product is tested at the storage facilities of Greenwood and Iowa City and explained that the storage operations at those facilities do not require an employee to be on site daily, though typically, that is the case. *Id.*

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145. Continuing, Bacon asserted, the Enterprise Products Operating Limited Partnership terminals, have one manned — Inver Grove — and one unmanned — Pine Bend — terminal. *Id.* at p. 1328. When asked to define "storage," he described it as underground cavern storage and considered above ground storage as part of the Terminals. *Id.*

146. As cross-examination progressed, Bacon testified that the terminal assets on the Northern System and Mid-America are held in an entity other than Mid-America for cost accounting purposes only. *Id.* at pp. 1332-33. Also, he explained that internal labor costs are generally the salaries of those individuals and other departments outside of the direct operating group that are charging time to a particular cost center. *Id.* at p. 1334. The call-out policy, contended Bacon, allows, should an employee be called out, that he/she be compensated for four hours of pay, regardless of the amount of time the employee spends on the job. *Id.* at p. 1337. The call-out, he noted, is not included in overtime calculations. *Id.* According to Bacon, overtime is calculated by the hours beyond 40, and the timekeeper determines where overtime is allocated when he or she enters overtime into the payroll system. *Id.* at pp. 1337-38. As the vice president of engineering, Bacon stated that his costs were allocated to capital "authority for expenditures" based on a percentage of its contribution to the total of the open "authority for expenditures." *Id.* at p. 1343.

147. Enterprise Products Partners constructed a fractionator at Hobbs, and Bacon maintained that it is currently in operation. *Id.* at p. 1345. The fractionator, insists Bacon, is operated by an Enterprise Products Operating Limited Partnership company. *Id.* at p. 1346. He added that there are, approximately, 14 employees assigned to the fractionator cost center, and ten employees with a Hobbs terminal and storage cost center. *Id.* Williams owns the fractionator at Conway, asserts Bacon, and no employee has any time assigned to that fractionator. *Id.* at p. 1347. Upon further questioning regarding Conway and Hobbs, Bacon answered that there is storage at Conway and at Hobbs. *Id.* In addition, he related that there were ten Enterprise Terminals' employees working at the Hobbs storage facility. *Id.* at p. 1348. Bacon added that there are 15 caverns at the Hobbs storage facility and that the total capacity of storage at Hobbs is much larger when compared to the total capacity at Greenwood or Iowa City. *Id.* Some employees at Hobbs, explained Bacon, have a Mid-America cost center and charge time to the fractionator at times when they specifically work on an issue at it. *Id.* at p. 1349.

148. Next, Bacon stated that the Chaparral Pipeline runs from West Texas into the Mont Belvieu area and has assets near Hobbs. *Id.* at p. 1352. Besides Seminole and Chaparral, Bacon noted that the West Texas Pipeline is utilized to move barrels from Conway or Rocky Mountain down to Mont Belvieu. *Id.* Furthermore, he continued, the barrels that go through the fractionator at Hobbs are predominantly from the Rocky Mountain pipeline. *Id.* at p. 1353. Ethane and ethane/propane mix, he went on to say, are the two predominant products from the fractionator that go into the Seminole line for

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batching. *Id*. at p. 1355.

149. Product that comes into Conway from the Central System, reported Bacon, is measured, filtered, dehydrated, and then routed into the outbound pipelines. *Id.* at p. 1356. Mid-America Pipeline operators on site at the Conway station, he maintained, provide the dehydration service to volumes coming into Conway from the Central System. *Id.* The product coming from the Central System is pumped into Conway, he added. *Id*. According to Bacon, the majority of the pumps are on the Central System south of Conway. *Id.* at p. 1366. The process for sending product from Conway south into the Central System, insisted Bacon, is basically the same as the process for receiving inbound products. *Id*. at p. 1357. Employees that charge their time to Mid-America, described Bacon, oversee the testing of inbound and outbound products for product quality. *Id*. Dehydration, continued Bacon, is performed on ethane/propane mix and ethane delivered into the Central System and outbound products going into the Northern System. *Id.* at p. 1358.[71] In addition, he testified, isobutane, natural gasoline, and normal butane also flow south into the Central System but typically are not dehydrated. *Id*. at p. 1361.

150. The process for sending product north into the Northern System, Bacon carried on, is the same as the process for receiving inbound products. *Id.* at p. 1359. He acknowledged that product flowing south from the Northern System into Conway was rare. *Id*. at p. 1360. Finally, Bacon testified, products flowing into the Conway facility are typically filtered, and if they are ethane or ethane/propane mix, they are dehydrated on the outbound side, or they can be routed to various third-party interconnects. *Id*. at p. 1361.

151. On re-direct examination, Bacon claimed that, prior to 2006, the process of assigning default percentages for exempt employees was very similar to the current process. *Id*. at p. 1363. Additionally, he stated, before 2006, the process of using time sheets for nonexempt employees also was very similar to the current process. *Id.*

152. On further re-direct examination, Bacon asserted that demethanized mix is tightlined[72] into the fractionator without being defractionated. *Id*. at p. 1365.

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[71] *See also* Exhibit No. S-70.

[72] When asked to define “tightline,” Bacon replied that it meant that a product flowing into a facility could be “routed through a system of routing and routed right out of the facility without any specific action taking place.” Transcript at p. 1365.

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E. MICHAEL J. PALMER

153. Michael J. Palmer (Palmer), an employee of EPCO, Inc., is the Director of Pipeline Integrity for Enterprise Products Operating and, as such, oversees all pipeline integrity operations on the liquids and natural gas pipelines operated by it, which includes Mid-America and Seminole. Exhibit No. M-79 at p. 1; Transcript at p. 1394. Pipeline integrity costs, Palmer maintained, are recurring expenses that Mid-America will incur every year. Exhibit No. M-79 at p. 1. According to Palmer, while the amount of pipeline integrity costs for a particular system may vary from year to year, the actual amounts expended by Mid-America on the Northern System during the Locked-In Period and the Base Period are representative of the level of pipeline integrity costs that Mid-America is likely to incur on a going-forward basis on the Northern System. *Id.* at p. 3.

154. Enterprise Products Operating, Palmer reported, operates its hazardous liquids pipeline integrity management program pursuant to regulations established in 2001 by the Department of Transportation. *Id.* The regulations, claimed Palmer, require all liquid pipelines to: (1) identify each segment of the line[73] that could affect a "high consequence area;"[74] (2) develop a written integrity management program that addresses the threats to each line segment that could affect a high consequence area; (3) carry out baseline assessments of the identified segments pursuant to a "baseline assessment plan;" (4) engage in a continual process of assessment and re-assessment to maintain the pipeline's structural integrity; (5) remediate any defects found; (6) identify preventive and mitigative measures to protect high consequence areas; and (7) measure the integrity management program's effectiveness. *Id.*

155. According to Palmer, Enterprise Products Operating identified its line segments by December 31, 2001, and developed its integrity management program by March 31, 2001, in compliance with the Department of Transportation (sometimes DOT) requirements.[75] *Id.* at p. 4. For purposes of the integrity management program, he noted,

[73] In later testimony, Palmer indicated that a line segment is the start and stop points to perform assessments, *i.e.*, "it's where you have a current pig trap or launcher receiver for an inline inspection tool on either end of it." Transcript at p. 1524.

[74] As defined by the Department of Transportation, a high consequence area means: (1) "a commercially navigable waterway," (2) any "high population area" or "other populated area," or (3) "an unusually sensitive area," which includes sources of drinking water and ecologically sensitive areas. 49 C.F.R. §§ 195.450, 195.6; Exhibit No. M-70 at p. 4.

[75] Palmer noted that a copy of Enterprise Products Operating integrity management program is attached to the record as Exhibit No. NPG-115. Exhibit No. M-79 at p. 4.

a line segment is not necessarily the entire length of a particular pipeline. *Id.* Enterprise Products Operating, he continued, assessed (which included discovering pipeline integrity issues on the identified line segments and providing a benchmark for measuring future changes in the pipeline) at least 50% of the identified line segments by September 30, 2004, as the regulations required. *Id.* at p. 5. Palmer related that the regulations require that the reassessment interval be five years, not to exceed 68-months, though each pipeline is required to base the reassessment intervals on the specific characteristics of each line segment. *Id.* at p. 5.[76]

156. There are three different types of costs associated with pipeline integrity, explained Palmer: (1) "make ready" costs for preparing the pipeline for inspection; (2) costs for assessment of the line segments; and (3) costs for remediation of any defects. *Id.* at p. 6. Assessment expenses, he elaborated, are the costs of actually performing the pipeline inspection, and for in-line inspection assessments, the primary costs include rental of the inspection tools, labor associated with launching, tracking, and receiving the tools, and analysis of the data obtained by the tools. *Id.* According to him, the primary account currently used to record pipeline assessment expenses is Account 83200, which contains the expenses associated with Mid-America's pipeline assessment authorizations for expenditures. *Id.* Prior to the establishment of the current account system in the fall of 2004, the Account 83200 charges, noted Palmer, were included in Account 84999 along with many other types of authorizations for expenditures. *Id.*[77]

157. Enterprise Products Operating, stated Palmer, tests all of the line segments identified in the Integrity Management Program (which on the Northern System account for approximately 98% of the total miles on that system) for deformation and corrosion, generally using in-line inspection tools such as an electronic gauging pig[78] to identify deformation and a magnetic flux leakage tool to identify corrosion. *Id.* at p. 7. Palmer described normal corrosion as the "general deterioration of pipe metal and its properties, whether due to oxidization or other processes," and stress corrosion cracking as "the formation of cracks due to the simultaneous action of tensile stress and a corrosive

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[76] *See also* 49 C.F.R. § 195.452(j)(3).

[77] *See also* Exhibit No. M-82.

[78] Palmer explained that an electronic gauging pig is used, primarily, to find dents and other deformations in the pipe in contrast with a magnetic flux leakage tool which is used to find corrosion or metal loss. Transcript at pp. 1584-85. Further, he stated, a "dumb pig" may have brushes and cups on it and is used for cleaning the pipe. *Id.* at p. 1429. He also indicated that pipelines rent the pigs and assessment tools from contractors, and pipeline personnel work in conjunction with an expert sent by the contractor to operate the pig. *Id.* at pp. 1585-86.

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environment." *Id.* at p. 8. Stress corrosion cracking, he pointed out, is more serious than normal corrosion and is more expensive to detect and remediate. *Id.*

158. Palmer stated that there are general factors that put a pipeline at risk of stress corrosion cracking, such as the era in which the pipeline was built, whether a particular type of coating was used on the line, and how the coating was applied. *Id.* The possibility of stress corrosion cracking, he stressed, may be found while the pipeline dents or corrosion are being repaired. *Id.* Enterprise Products Operating, insisted Palmer, uses an ultrasonic testing tool to assess for stress corrosion cracking, and testified that, since this tool only tests for stress corrosion cracking, it also must run both the normal in-line inspection tools to detect deformities and corrosion, as well as, the specialized stress corrosion cracking tool on line segments where the risk of stress corrosion cracking exists. *Id.* at p. 9. Using the ultrasonic testing tool, contended Palmer, is much more expensive than using both of the normal in-line tools that test for deformation and corrosion because the ultrasonic testing tool requires that a product with predictable sonic characteristics, such as gasoline, be moved on the particular line segment it is assessing. *Id.* Thus, he said that, on systems that normally move natural gas liquids such as propane or ethane/propane mix, additional costs are incurred to obtain the batch of gasoline and to clean the line after the testing is completed. *Id.*

159. Hydrostatic testing, continued Palmer, involves emptying the line of product and pumping in water to a pressure of at least 125% of normal maximum operating pressure for four continuous hours and for another four hours at least at 110% of normal maximum pressure, unless leaks are detected sooner. *Id.* at p. 10. The purpose of the test, he said, is to determine if there are any portions of the line that have become degraded, *i.e.*, the segments would leak when pressure is applied. *Id.* Hydrostatic testing, in his view, is not the preferred option for testing because it is expensive[79] and slow, *i.e.*, it may require a portion of the pipeline to be shut down for weeks or months at a time. *Id.* "However," he added, "since hydrostatic testing assesses for all threats (even normal deformation and corrosion), a pipeline operator may in some circumstances elect not to utilize the normal in-line inspection tools in addition to performing hydrostatic testing." *Id.*

160. Arthur's proposed pipeline integrity cost — $3.9 million — was too low in Palmer's opinion, and he reasoned, Arthur understated the 2006 actual costs by using the amount budgeted for that year instead of the actual costs incurred. *Id.* at p. 11.[80]

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[79] According to Palmer, the cost is comparable to the cost of using an ultrasonic testing tool, but "does not include costs related to lost time or profits because the line is out of service." Exhibit No. M-79 at p. 10.

[80] *See also* Transcript at pp. 1453-54.

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Moreover, he claimed that the budgeted amounts used by Arthur for the years 2007-2011 were likely to be significantly lower than actual expenses primarily due to the likelihood of additional stress corrosion cracking on the Northern System. *Id.* By averaging pipeline integrity expenses over the five-year period from 2004 through 2008, Palmer continued, Arthur used a time period that was unlikely to be representative of forward looking costs and which failed to account for the probable need to reassess large portions of the Northern System line segments on a four-year, rather than a five-year, cycle. *Id.* Additionally, Palmer emphasized, Arthur's budgeted amounts included the costs of reassessment related to stress corrosion cracking on the East Red Line, where stress corrosion cracking had already been found and did not include assessment costs for the stress corrosion cracking-like anomalies, which were found on the West Red Line more recently. *Id.* at p. 12.

161. The following reasons were given by Palmer as to why it appears extremely likely that Mid-America will need to assess substantial portions of the West Red Line for stress corrosion cracking: (1) stress corrosion cracking has already been found on the East Red Line; (2) the West Red Line has certain characteristics in common with the East Red Line that put them both at risk of stress corrosion cracking; (3) both Lines have polyethylene tape coating, which is more susceptible to stress corrosion cracking; (4) both lines had the tape coating applied in the field prior to installation, which is more susceptible to stress corrosion cracking than pipelines whose tape coating was applied in the factory; and (5) anomalies of the type associated with stress corrosion cracking have been discovered on two of the line segments on the West Red Line during repairs of pipeline deformations and/or metal loss, using magnetic particle inspection. *Id.* at pp. 13-14. The budgeted costs, asserted Palmer, would increase substantially if Mid-America were required to assess the West Red Line for stress corrosion cracking because there are as many as five segments that may need to be tested, and because hydrostatic testing would be necessary as there are not currently any in-line inspection tools that can test for stress corrosion cracking on a line as small as eight-inches in diameter. *Id.* at p. 14. According to Palmer, it would cost $1 million per line segment to test the East Red Line for stress corrosion cracking and an additional $6 million to test the West Red Line for it. *Id.*

162. According to Palmer, pipeline integrity costs have increased at a rate that is generally higher than inflation because the inspection tools are becoming more sensitive and sophisticated, and demand on integrity testing tools and personnel have increased. *Id.* at p. 15. Mid-America's actual Locked-In Period and Base Period costs, he said, are likely to be more representative of going-forward costs on the Northern System than the figure derived from Arthur's 2004-2008 average. *Id.* Palmer criticized the use of an average cost, especially Arthur's five-year average, which included past years such as 2004, and used a five-year average instead of a more sensible four-year average (corresponding to Palmer's suggested four-year reassessment cycle of the West Red Line segments). *Id.* at pp. 16-17.

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163. Moreover, Palmer maintained that Staff witness Sherman's integrity cost — $2.6 million — also was "significantly too low" for the same reasons given in response to Arthur's integrity costs and for two additional reasons: first, Sherman did not attempt to separate the Northern System pipeline assessment costs from those of the other systems, as Ganz and Arthur did, but simply took the total Mid-America pipeline assessment expenses and allocated them over all three systems on a mileage basis;[81] and second, Sherman averaged the pipeline assessment costs over the period from 2003-2006 ignoring that future costs on the Northern System were "likely to be significantly higher due to additional stress corrosion cracking assessment and the general increase in pipeline assessment costs." *Id.* at p. 18. The year 2003, in Palmer's opinion, was further unrepresentative of future years' pipeline assessment costs because the pipeline integrity management program did not become fully operational until the second half of that year. *Id.* at pp. 18-19.

164. At the hearing, on direct examination, Palmer stated that the Department of Transportation, on March 31, 2001, promulgated regulations governing pipeline integrity programs. Transcript at pp. 1373-74. A "high consequence area," explained Palmer, is defined by the DOT regulations as either a commercially navigable waterway, a high-populated area, an ecologically sensitive area, or drinking water sources. *Id*. at p. 1374. According to Palmer, Mid-America is considered a Category 1 pipeline, because it existed prior to May 29, 2001, and is over 500 miles in length. *Id*. at p. 1375. Additionally, he stated, Category 1 pipelines were required to identify all the pipeline segments that could affect high consequence areas not later than December 31, 2001. *Id*. Williams, which owned Mid-America Pipeline in 2001, timely identified all of the affected pipeline segments according to him. *Id.* at p. 1376. The pipeline operator, testified Palmer, has the responsibility of identifying all of the high consequence areas that might be affected by a release of product from particular line segments.[82] *Id*. Palmer contended that the vast majority of the line segments on Mid-America affect high consequence areas. *Id.* For example, he said, 98% of the Northern System pipeline miles affect high consequence areas. *Id.*

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[81] Averaging the pipeline integrity costs over the entire Mid-America mileage, contended Palmer, ignores the differences among the three Systems and understates the costs related to pipeline integrity on the Northern System. Exhibit No. M-79 at p. 18.

[82] Palmer also noted that, although it is the pipelines' responsibility, the DOT posts a map on its web page identifying high consequence areas. Transcript at p. 1376. He also noted that pipelines identify high consequence areas "by modeling releases from pipelines and determining how far a product spill or a cloud of gas might travel to determine if" an area might be affected. *Id.*

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165. Further, Palmer testified, after identifying the line segments that could affect a high consequence area, the DOT regulations required that the pipeline operator, not later than March 31, 2002, develop a written integrity management program to address the threats each line segment posed to high-consequence areas. *Id.* at p. 1377. Each line segment, he stated, was given a risk score that accounted for various factors, such as, the age of the pipe,[83] the type and quality of the pipe coating, the results of prior assessments, the leak history of the line, and the existing knowledge of corrosion, stress corrosion, cracking, or seam failures on the line. *Id*. at p. 1378. On March 31, 2002, according to Palmer, Williams still owned Mid-America, and established an integrity management program that included Mid-America. *Id*. at p. 1377. Yet, he went on to say, Mid-America is now covered by the Enterprise Products Operating integrity management program.[84] *Id*.

166. On further direct examination, Palmer explained that the DOT regulations also required a baseline assessment plan for evaluating each of the identified line segments.[85] *Id*. at pp. 1378-79. Additionally, he testified, the baseline assessment plan was intended to discover pipeline integrity issues on the identified line segments and provide a benchmark for measuring future changes in the pipeline. *Id*. at p. 1379. For Category 1 pipelines, he reported, at least 50% of the identified line segments were required to be assessed by September 30, 2004. *Id*. Palmer noted that Enterprise Products Operating met that requirement. *Id.* Further, he stated, the baseline assessment for the remaining identified segments are to be completed by March 31, 2008. *Id*.

167. According to Palmer, the DOT regulations require a reassessment every five years not to exceed 68-months.[86] *Id.* However, Palmer asserted that the pipeline operator may need to reassess on a more frequent basis than every five years if conditions are risky.[87]

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[83] During later testimony, Palmer explained that the Blue Lines of the Northern System were built in the 1960s, the Red Lines were built in the 1970s, and the Rocky Mountain System was built in the 1980s and 1990s. Transcript at p. 1578.

[84] *See* Exhibit No. NPG-115.

[85] *See also* Exhibit No. M-142.

[86] Palmer testified that pipeline operators are required to measure the effectiveness of its integrity management program, which it does in various ways: (1) measure the frequency and size of leaks and other unintended releases to assess whether the integrity program reduces them; and (2) measure the number of pipeline miles assessed and the number of repairs made.

[87] According to Palmer, Enterprise Products Operating has determined that, where stress corrosion cracking has been found, a four-year reassessment cycle is necessary.

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Id. at p. 1380. On the other hand, explained Palmer, a pipeline may be able to reassess certain segments on a 68-month basis, if it can provide an engineering basis for a longer assessment interval. *Id*. at pp. 1379-80, 1381-82. Yet DOT approval for an extended schedule is very rare, if not nonexistent, noted Palmer. *Id.* at p. 1382.

168. When an assessment of a line segment identifies a problem, Palmer related, the pipeline operator is required to remediate the defects. *Id*. Next, as questioning continued regarding the DOT regulations, Palmer answered that they require preventive and mitigative measures including: (1) conducting a risk analysis on the pipeline segments; (2) implementing damage prevention best practices; (3) monitoring of cathodic protection where corrosion is a concern; (4) establishing shorter inspection intervals; (5) installing emergency flow restrictive devices on the pipeline segment; (6) modifying the systems that monitor pressure and detect leaks; (7) providing additional training to personnel on response procedures; and (8) conducting drills with local emergency responders. *Id.* at pp. 1382-83.

169. Asked about the costs of the pipeline integrity program, Palmer listed them as follows: (1) capitalized costs, *e.g.*, installing inspection tool launchers and receivers; (2) assessment costs which are expense items, *i.e.*, the costs of actually inspecting the line; and (3) the remediation costs which also are capitalized unless the total annual systemwide costs are less than $250,000. *Id.* at pp. 1384, 1437-38. He added that the cost of using in-line inspection tools is about $250-300,000 per line segment, depending on the length of the segment. *Id.* at 1386. Furthermore, he asserted that, if a line segment is suspected of having a seam failure, it may be necessary to run a more specialized tool at a cost of $500-900,000 per line segment, depending on the length of the segment. *Id.* Should stress corrosion cracking be suspected, he declared, it would be necessary to use an ultrasonic testing tool at a cost of approximately $1 million per line segment, depending on the length of the line segment.[88] *Id.* at pp. 1386-87.

170. Palmer testified that Enterprise Products Operating creates a budget during August or September of each year. *Id.* at p. 1387. The budget, he said, forecasts the cost that the integrity department estimates it will incur during the coming year, as well as the four following years. *Id*. With respect to the Northern System, continued Palmer, the current budget includes costs related to assessment and reassessment of stress corrosion cracking of all the segments on the East Red Line, one segment on the West Red Line, and one segment on the East Blue Line. *Id*. at p. 1388. And with respect to the East Red Line, he

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Transcript at p. 1380.

[88] Palmer stated: "A rule of thumb that is sometimes used for estimating [ultrasonic testing] tool costs is that it will cost about $115,000 per segment plus $12,000 per mile." Transcript at p. 1387.

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asserted, the current budget includes costs related to reassessment of all segments on a four-year cycle. *Id*. at pp. 1389-90. The East Blue Line, Palmer estimated, would cost approximately $8 to $10 million to assess. *Id.* at p. 1391.

171. Lastly, on direct examination, Palmer noted that the DOT monitors and reviews the pipeline safety program and that Mid-America expends some of its resources on accommodating the review. *Id*. at pp. 1391-92. In particular, he replied, the costs associated with accommodating the DOT reviews are covered as personnel costs, and generally, time sheets are coded to the home cost center. *Id*. at p. 1392.

172. Under cross-examination, Palmer pointed out that Enterprise Terminals, to the extent that breakout tanks are incident to the transportation of product, is covered by the same pipeline integrity management plan as Mid-America. *Id.* at pp. 1402-03, 1417. The Pine Bend Terminal, maintained Palmer, also is included within Mid-America's pipeline integrity assessment program because it can affect a high consequence area. *Id.* at p.1420. Later, Palmer suggested that the integrity management costs related to a terminal was lower than for a pipeline, but he could not even guess at the range for such costs. *Id.* at p. 1424.

173. All the costs associated with the pipeline integrity management program in this proceeding were expensed, according to Palmer. *Id*. at p. 1438. Mid-America's baseline assessment program, claimed Palmer, became fully operational in late 2003, and during the years 2004, 2005, and 2006, Mid-America actively performed assessments. *Id*. Upon further questioning, Palmer answered, pipeline integrity expenses for the Northern System recur each year at a level of approximately $7.9 to $10.8 million. *Id*. at p. 1443. When asked to define "recurring expenses," he replied that they are expenses one would expect to have again, not merely a one-time expense. *Id*. at p. 1445. In the 2005 budget, Palmer stated that Mid-America planned to inspect 18 of 36 segments on the Northern System. *Id*. at p. 1449. Additionally, Palmer testified that, in its 2008 budget, Mid-America plans to inspect three segments on the Northern System under the baseline assessment plan. *Id*. at p. 1452.

174. During further cross-examination, Palmer stated that the East Red Line is on a four-year reassessment cycle for stress corrosion cracking, which was accounted for in the 2007 budget and included in the forecasts for 2008 through 2011 period. *Id*. at p. 1458. In 2005, he noted, Mid-America's actual systemwide expenditures for the pipeline integrity program was under the amount budgeted. *Id*. at pp. 1460-61. According to Palmer, stress corrosion cracking-like anomalies have been detected on the East Blue Line of the Northern System, and in his opinion, will likely lead to assessments for stress corrosion cracking on the East Blue Line on a four-year assessment cycle. *Id*. at p. 1463.[89] Palmer emphasized that the DOT regulations mandate that the entire

[89] *See also* Exhibit No. NPG-199.

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pipeline be assessed upon finding such anomalies. *Id*. at p. 1465. After finding stress corrosion cracking-like anomalies, Palmer claimed that Mid-America can run a pig through it, assess other pipes that have the exact same attributes as the pipe with the anomalies, or take steps all the way up to cutting the particular pipe out and sending it to a metallurgist to be evaluated. *Id*. at pp. 1466-67. In addition to the East Blue Line, Palmer revealed that stress corrosion cracking-like anomalies also have been found on the West Red Line. *Id*. at pp. 1469-70.[90] The budgets, clarified Palmer, include what has to be done, but not what is likely to be done. *Id*. at p. 1473. The budgets that Mid-America prepares, contended Palmer, have a 3% annual inflation adjustment factor included in them. *Id*. at pp. 1475, 1476-77.

175. Next, Palmer admitted that stress corrosion cracking has been found on five of the eight major segments on the East Red Line. *Id.* at p. 1478-79. Continuing on the subject, Palmer reported that these five segments already are on a four-year reassessment cycle and were included in the Mid-America budgets submitted in August 2006. *Id*. at p. 1479. The pipeline integrity testing on the other three segments, testified Palmer, remains on a five-year cycle. *Id*. Assessment costs related to stress corrosion cracking on the East Red Line, according to Palmer's estimates, were about $3.391 million during the May 2005 through April 2006 period and $6.678 million during the February 2005 through January 2006 period. *Id.* at p. 1480-81.

176. In discussing pipeline integrity, Palmer testified that there are 122 employees in Mid-America's pipeline integrity group. *Id*. at p. 1484. He explained that the integrity assessment projects are assigned to the pipeline integrity project managers on a work load basis. *Id*. There are about 17 employees, he claimed, in the liquids pipeline section of the pipeline integrity group under his responsibility. *Id*. at pp. 1486-87. Additionally, he noted, all 17 employees in the liquids pipeline section are exempt employees. *Id*. at p. 1487. On the one hand, he explained, if the employees work directly on an authority for expenditure or work order, they charge directly to that authority for expenditure or work order number; on the other hand, he pointed out, if the employees work on a specific asset, and there is no authority for expenditure or work order associated with that work, then they charge directly to that asset. *Id*. Furthermore, he discussed, for work not being performed pursuant to an authority for expenditure or work order and nondirect asset work, the employees charge their time to the group's home cost center. *Id*. According to Palmer, the integrity management program has an integrity assessment method selection procedure; following that procedure, data is collected and an assessment method is chosen. *Id*. at p. 1498.

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[90] *See also* Exhibit No. NPG-200.

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177. When asked, in connection with Exhibit No. NPG-198, to define "AFD," "MFL," and "EGP," Palmer answered that "AFD" refers to an axial flux detection tool, "MFL" refers to magnetic flux leakage, and "EGP" refers to electronic gauging pig. Transcript at pp. 1497-98. Particularly, he elaborated, a magnetic flux leakage tool will identify metal loss such as corrosion, and an axial flux detection tool will identify in-service seam failure. *Id.* at p. 1499. In addition, he testified that the axial flux detection tool has been used primarily on the Northern System. *Id.* Finally, he testified, the ultrasonic testing tool (UT) is the most expensive to run of the three pigs. *Id*. at p. 1500.

178. Upon further questioning, Palmer claimed that the age of the pipeline and pressure inside the pipe are factors relating to stress corrosion. *Id.* at p. 1501. Mid-America, asserted Palmer, on a temporary basis, has reduced the pressure at which products are flowing through the systems. *Id*. at p. 1502. If the pressure is reduced, he explained, transporting barrels has a higher cost than were the pressure at the normal operating level. *Id*. at p. 1503. Also, he noted, pressure is reduced upon assessment reports indicating anomalies, and the pressure is required to stay reduced until problems have been remedied. *Id*. at p. 1504. The additional costs incurred as a result of any pressure reduction, according to Palmer, are not reflected in the authority for expenditures. *Id*. at p. 1505. The El Dorado Coffeyville route of the Central System, continued Palmer, had been put on a three-year assessment cycle. *Id*. at p. 1506. Because of the higher costs due to stress corrosion cracking and anomaly testing, Palmer reported that the Northern and Central Systems have higher costs for the integrity assessment program than the Rocky Mountain System.[91] *Id*. at pp. 1511-12. Palmer advocated charging costs directly to the cost center of the assets that are worked on because the costs differ on each of the three Mid-America systems. *Id*. at p. 1512.

179. Mid-America, he admitted, currently has exceeded the Northern System budget, $1.7 million, for 2007. *Id*. at pp. 1537, 1550-53.[92] Moreover, he declared that pipeline integrity costs are generally increasing. *Id*.

180. On further re-direct examination, Palmer asserted that, if using an average of the Northern System pipeline integrity expenses to determine a representative level of Northern System pipeline integrity level expenses for the future was found to be proper,

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[91] Later Palmer stated that the Rocky Mountain System and the Northern System differ in that there are no stress corrosion cracking costs associated with the former. Transcript at p. 1580.

[92] *See also* Exhibit Nos. M-143, M-145. The latter exhibit, which Palmer described during a lengthy direct and cross examination, represents how he would estimate an annual cost for the integrity assessment program across all of Mid-America's segments. *See* Transcript at pp. 1554-77.

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he would take the regular costs of a metal loss and deformation and figure it in over five years, and would take the stress corrosion cracking assessment costs and look at those over a four-year period. *Id.* at p. 1553-54.

181. Upon further cross-examination, Palmer pointed out that unlike the Central and Northern Systems, no stress corrosion cracking has been found on the Rocky Mountain System. *Id.* at p. 1590. Yet, he said, deformation anomalies and metal loss anomalies have been found on all three systems. *Id.* As of March 2006, Palmer admitted, Mid-America knew that the East Red Line had stress corrosion cracking. *Id.* at pp. 1593-94. In addition, Palmer estimated that every four years Mid-America is going to have, not including inflation, approximately, $6 million in assessment costs for the East Red Line and $8-$10 million for the East Blue Line. *Id.* at p. 1598. Consequently, he contended, Mid-America would have costs on an annual basis for the East Red Line of $1.5 million ($6 million divided by 4), $1.5 million for the West Red Line, and $2-$2.5 million for the East Blue Line. *Id.* In sum, he asserted, Mid-America would have approximately $5-$5.5 million per year of costs for stress corrosion testing on the Northern System. *Id.* at pp. 1598-99.

F. GENE PETRU

182. As the Director of Tax, Gene Petru (Petru) is responsible for all tax matters for EPCO, Inc. and its subsidiaries. Exhibit No. M-4 at p. 1. Initially, Petru testified that Mid-America is owned by Mapletree, LLC (Mapletree), which, in turn, is owned by Enterprise Products Operating. *Id.* at p. 3. Additionally, he explained, Enterprise Products Operating is owned by a general partner with a 0.001% share, Enterprise Products OLPGP, Inc., and a limited partner, Enterprise Products Partners owning a 99.999% interest.[93] *Id.* According to Petru, 62% of Enterprise Products Partners is owned by public unitholders, the remaining interest is owned by Dan L. Duncan, the Chairman of EPCO, Inc., or by Duncan family trusts. *Id.* Enterprise GP Holdings L.P., asserted Petru, owns the general partner of Enterprise Products Partners called Enterprise Products, LLC. *Id.* Further, he continued, Enterprise GP Holdings, L.P. is a publicly traded partnership, and approximately 15% of its unitholders are public unitholders. *Id.* at p. 4.

183. After calculating Mid-America's taxable income, Petru said he flowed that income up through Mid-America's various parent companies to its ultimate owners, allocating income to the various owners based on the rules set forth in the applicable partnership agreement. *Id.* Because Mid-America is wholly owned, Petru testified that it is disregarded for tax purposes and does not file a tax return. *Id.* Instead, he explained, Mapletree files a return that includes all the income generated by Mid-America. *Id.*

[93] *See also* Exhibit Nos. M-9; M-11 at Article VI.

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According to Petru, he calculated Mid-America's taxable income for 2004 as $39,852,696. *Id*. at p. 5. Next, he allocated 100% of that income to Mapletree, a limited liability company that is treated as a corporation for tax reasons. *Id*. Since purchasing a 2% share from E-Birchtree, LLC, in June 2005, Enterprise Products Operating has owned 100% of Mapletree, he added. *Id*. at p. 6. Therefore, Petru indicated he flowed 100% of Mid-America's taxable income through Enterprise Products Operating. *Id*.

184. Enterprise Products OLPGP, Inc., testified Petru, is a Subchapter C corporation and accordingly files an individual corporate tax return. *Id*. at p. 8. Further, he stated, Enterprise Products Partners is a publicly traded Master Limited Partnership and is treated as a partnership for tax purposes. *Id*.

185. Next, Petru testified, he allocated Mid-America's taxable income to Enterprise Products Partners unitholders, according to the applicable partnership agreements, first allocating to the general partner in the amount equal to the incentive distribution and then allocating based on the ownership percentage any remaining income.[94] *Id.* at pp. 9-10. Distributions of cash made by Enterprise Products Partners to its unitholders, reported Petru, is quarterly and is based on percentage of ownership. *Id*. at pp. 9-10. However, due to the partnership agreement, as the amount of distributions increase, an increased percentage is given to the general partner, he stated. *Id*. According to him, an incentive distribution is defined as any amount given to the general partner that exceeds what that general partner would have received based on ownership percentage alone. *Id*. Therefore, Petru asserted, he calculated the percentage of incentive distributions and applied that percentage to the money generated by Mid-America, resulting in Mid-America's incentive distribution. *Id.* at p. 10. Finally, Petru claimed, he allocated to the general partner the amount of Mid-America's taxable income that was equal to the incentive distributions attributable to Mid-America. *Id*.

186. Petru contended that he did not make any adjustments to Enterprise Products Partners' income to take into account section 704(c) of the Internal Revenue Code[95] allocations because Mid-America's assets were purchased by the partnership, not contributed to the partnership by a partner. *Id*. at p. 11. Further, Petru said he considered whether any allocations to the income were necessary because of the numerous equity offerings made by Enterprise Products Partners since July 2002. *Id*. The analytical complexity involved, Petru claimed, was not justified by such a small resulting impact.

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[94] S*ee also* Exhibit Nos. M-12; M-13; M-14.

[95] Petru stated: "The general purpose of Section 704(c) is to ensure that the partner that contributed the property remains liable for the built-in gain (or loss) attributable to the difference between the fair market value of the contributed property and the contributing partners' tax basis." Exhibit No. M-4 at p. 11.

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Id. at p. 12. Those allocations, in his opinion, did not have any material effect on Mid-America's income tax allowance. *Id*.

187. According to Petru, the Enterprise Products Partners units, of which there are 158,000, are owned by: (1) Subchapter C Corporations; (2) individuals; (3) mutual funds; (4) others such as pension funds, IRAs, Keough Plans and other entities.[96] *Id.* at p. 13. He added that, although he could identify who ultimately paid taxes on the partnership's income in some instances, he could not do it in all cases. *Id.* at p. 16. In those cases, Petru assigned the following marginal tax rates: (1) a 35% marginal tax rate to Subchapter C corporations, but Subchapter S corporations were removed from the corporation category and assigned a 28% marginal tax rate; (2) individuals were assigned a 28% marginal tax rate; (3) mutual funds were assigned a 28% marginal tax rate, although mutual funds that failed to meet the tax code requirements for Regulated Investment Companies, explained Petru, would be taxed like a Subchapter C corporation, and even if a mutual fund met those requirements, it was taxed like a Subchapter C corporation for any income not distributed to shareholders as a dividend; and (4) a 28% marginal tax rate was assigned to all category four entities *Id*. at pp. 19-22. For non-exempt entities in category (4), Petru did not seek to apply a higher marginal tax rate than 28%. *Id.* at p. 22. Finally, Petru assigned a 0% marginal tax rate for exempt entities in category (4). *Id*. at p. 23. The resulting weighted average that he provided for use in Mid-America's cost-of-service calculations was 28.7030%, Petru noted. *Id*.

188. The 2002 sale of 98% of Mid-America to Enterprise Products Partners from Williams, a Subchapter C corporation, alleged Petru, was a taxable event for Williams, as was its 2005 sale of the remaining 2%. *Id*. at p. 24.

189. In his rebuttal testimony, Petru stated that, calculating the weights of each category of unitholder based on percentage, as O'Loughlin advocated, resulted in a 2004 weighted average tax rate of 28.8%, which was a little higher than a tax rate of 28.7% calculated by Mid-America using each owner's share of income generated by Mid-America. Exhibit No. M-71 at p. 2.[97] Because the income generated by Mid-America is generally allocated to its owners in proportion to their ownership interest, Petru claimed that, in this case, using income or ownership percentage to determine the weights for each of the six categories of owners makes little difference. *Id.* The only significant exception to this rule, he noted, relates to the incentive distributions made to Enterprise Products GP, LLC, which is the general partner of Enterprise Products Partners, L.P. — the publicly traded partnership that owns Mid-America. *Id.* at

[96] *See also* Exhibit No. M-9. Petru also indicated that the entities in category (4) may be taxpaying or exempt. Exhibit No. M-4 at p. 13.

[97] *See also* Exhibit No. M-72.

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p. 3. Petru asserted that the adjustment for incentive distributions allocates income away from the corporate category of owners, which tends to reduce the overall weighted average marginal tax rate.[98] *Id.*

190. Mid-America, declared Petru, was correct in using the income generated by Mid-America to determine the weighted income tax rate and not the income generated by Enterprise Products Partners, which is affected by the numerous other companies it owns. *Id.* at p. 4. Petru further noted that, while Enterprise Products Partners' cash distributions, in general, are made in proportion to ownership, its general partner receives a greater distribution "as an incentive to manage the partnership so as to increase the total amount of cash available for distribution." *Id.* at p. 5.[99] Concluding this portion of his testimony, Petru opined that "Mid-America's method is conservative and results in a slightly lower weighted income tax allowance than" O'Loughlin's proposal. *Id.* at p. 6.

191. By assigning a zero marginal tax rate to all but the Subchapter-C corporation category, Petru claimed, O'Loughlin's calculation yielded an unreasonably low 4.74% weighted average federal income tax rate for Mid-America. *Id.* at pp. 7-8. He reasoned that less than 1% of the income generated by Mid-America is allocated to entities that are completely tax exempt, and over 99% of the income generated by Mid-America ultimately is allocated to entities that will incur income tax liability on that income — generally at the Commission's presumed marginal rate of 28% or at a higher rate. *Id.* at p. 8.

192. Since Mid-America was not challenging the Commission's income tax allowance policy which assigns a 28% marginal tax rate to mutual funds, Petru insisted that Mid-America had no reason to contradict O'Loughlin's assumption that most mutual fund owners of Enterprise Products Partners qualified as Regulated Investment Companies. *Id.* at p. 9. Yet he maintained that O'Loughlin's assumption provided no reason to reject the Commission's presumed 28% income tax rate for mutual funds, and furthermore, it did not support O'Loughlin's further assumption that all of the Mid-America income allocated to mutual funds ultimately incurred no income tax liability. *Id.* at p. 10. According to Petru, the unitholders that O'Loughlin referred to as "Pensions, IRAs, Keoghs" are actually defined by the Commission as "other unitholders such as pension funds, IRAS, Keogh Plans, and other entities that are not normally tax paying entities, but would be expected to have taxpaying beneficiaries or owners." *Id.*[100] The Commission, he added, again assigns a rebuttable presumption of a 28% marginal

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[98] *See also* Exhibit No. M-9.

[99] *See also* Exhibit No. NPG-74.

[100] *See also SFPP, L.P.*, 113 FERC ¶ 61,277 at P 45 (2005).

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tax rate to this group of entities, and nothing in O'Loughlin's testimony rebutted this presumption. *Id.* at pp. 10-11.

193. Unlike O'Loughlin, Petru contended that a unitholder does not have to reside in a particular state to be liable for income tax in that state. *Id.* at pp. 11-12.

194. Moreover, Petru stated that he reconfigured his tax calculations in his Direct Testimony, which were based on the 2004 taxable year, using 2005 data. *Id.* at p. 12. The ownership structure based on the 2004 taxable year, he explained, did not need to be updated to calculate his 2005 weighted average tax rates. *Id.* at p. 13. Petru reported that the 2004 weighted average federal income tax rate (adjusted to reflect the 34% marginal tax rate for Subchapter-C corporations) was 28.58%, and the 2005 weighted average federal income tax rate was substantially the same – 28.51%. *Id.*

195. Under cross-examination, Petru testified that the flow of Mid-America income to owners was central to his determination of Mid-America's proposed marginal income tax rate that was included in Ganz's cost-of-service. Transcript at p. 1611. If Mid-America had no taxable income to flow through to owners, Petru said, he would have used the ownership percentage of the ultimate taxpayer in the ultimate final partnership (unitholders of Enterprise Products Partners) to derive the weighted average marginal tax rate. *Id*. at p. 1612. Also, he claimed that the weighted marginal tax rate would not change significantly if Mid-America had no taxable income to flow through to owners. *Id*.

196. In addition, Petru explained, the Mid-America 2004 taxable income is a pro forma tax return — a hypothetical taxable income number based on actual revenue and expenses.[101] *Id*. at p. 1615. He continued, the flow of Mid-America's income to owners is an actual flow of taxable income based on that pro forma return for Mid-America.[102] *Id.* at p. 1616. The taxable income of Mid-America and Enterprise Terminals, contended Petru, flows into and out of Mapletree without being reduced for any expenses. *Id*. According to Petru, before Enterprise Products Partners bought out Williams' share of Mapletree, Mapletree was a pass-through entity and had to file a partnership tax return; after it purchased Williams' share, Mapletree also became a disregarded entity. *Id*. at pp. 1616-17.

[101] As Mid-America is 100% owned by Mapletree, it is a "disregarded entity," therefore, a "pro forma" tax return was created, Petru said, by going to the books and records of Mid-America and preparing a tax return as if one were required. Transcript at pp. 1614-15.

[102] *See also* Exhibit No. M-9.

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197. Next, noted Petru, from a tax standpoint, Enterprise Products Partners tracks Mid-America separately because it has its own financial statements. *Id.* at p. 1619. There are approximately 100 entities, reported Petru, which make up the total revenue and expenses of Enterprise Products Operating. *Id*. at p. 1620. Being further questioned about Enterprise Products Operating, he answered that it has its own assets and generates its own revenues and expenses in addition to receiving revenue from other entities. *Id*. The income of all of Enterprise Products Partners' subsidiaries (including Mid-America), testified Petru, has been flowed through two entities, Mapletree and Enterprise Products Operating, and into Enterprise Products Partners, and then out of Enterprise Products Partners without being reduced for any expenses. *Id.* at p. 1621.

198. When asked to explain state apportionment factors, Petru replied that a state apportionment factor is the factor applied to a federal taxable income to determine a particular state's allocated share of that income. *Id*. at p. 1622. Petru's state apportionment factors differed between his direct and rebuttal testimony because, in his direct testimony, he included Enterprise Terminals, and in his rebuttal testimony, he used only Mid-America. *Id*. at p. 1624. Essentially, Petru explained, his direct testimony was done on the basis of the Mapletree level, and his rebuttal testimony was done on the basis of Mid-America individually. *Id*. According to Petru, from a financial standpoint, Mid-America made up most of Mapletree in the 2004 time frame. *Id*. In addition, he continued, Mapletree had its own apportionment factors at the time Petru developed his direct testimony because it had to file a tax return in every state that Mid-America and Enterprise Terminals were located — Colorado, Illinois, Iowa, Kansas, Minnesota, Missouri, Nebraska, New Mexico, Oklahoma, Utah, Texas, and Wisconsin. *Id.* at p. 1625.

199. Finally, Petru claimed that the Enterprise Products Partners public unitholders are informed of the income allocated to them by state. *Id*. at p. 1636. According to Petru, if an Enterprise Products Partners public unitholder was allocated a loss rather than taxable income, the unitholder would not be required to pay state income taxes in that current year. *Id.* at pp. 1636-37.

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200. Ganz is a Director of the Regulatory Economics Group, LLC. Exhibit No. M-24 at p. 1. According to him, unlike electric utilities and natural gas pipelines that use a depreciated original cost methodology, oil pipelines use a modified trended original cost model.[103] *Id*. at p. 5. Oil pipelines, claimed Ganz, are entitled to recover their operating

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[103] Ganz stated:

> The primary difference between the depreciated original cost and the trended original cost methodologies revolves around the treatment of the

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expenses, including depreciation expense, a return on rate base, and an income tax allowance in its cost-of-service. *Id*. Under the trended original cost methodology, described Ganz, the nominal equity rate of return is divided into (1) the real equity rate of return and (2) the inflation component of the equity return. *Id*. at p. 6. Additionally, he stated, the real equity rate of return is applied to the rate base and then included in the cost of service for the current year. *Id*. In contrast, he continued, the inflation component is stored in the rate base and added into the cost of service as it is amortized. *Id*. While the inflation component is stored in the rate base, a pipeline, asserted Ganz, can earn a return on the deferred earnings percentage of its rate base. *Id*. As a general matter, he testified, the cost of service under the trended original cost is lower in the beginning years of a pipeline than under a depreciated original cost approach, but later the reverse occurs. *Id*. at pp. 6-7.

201. According to Ganz, Commission policy calls for a transition mechanism to cover the gap between previous oil pipeline methodology and the current trended original cost model. *Id*. at p. 7. This transition mechanism, contended Ganz, requires the calculation of a starting rate base, providing the starting point for the trended original cost model. *Id*. Additionally, he maintained that Commission policy requires that the starting rate base is the sum of: (1) a pipeline's debt ratio multiplied by its net book value, excluding right of way and land; (2) a pipeline's equity ratio multiplied by its Cost of Reproduction New depreciated by the same percentage as its gross carrier property, excluding right of way and land; and (3) the original cost of land, plus the unamortized portion of the right of way, plus a working capital allowance, and less accumulated deferred income taxes. *Id*. at pp. 7-8. Further, Ganz asserted that the starting rate base determination requires the use of a correct capital structure. *Id*. at p. 8. He testified that it is typical for the 1983 starting rate base amount to be more than the 1983 depreciated original cost rate base amount, the difference between the two being known as the starting rate base write-up. *Id*.

202. All oil pipelines, in Ganz's view, are not required to file rates employing a cost-of-service methodology. *Id.* Instead, he said, under the Commission's regulations, 18 C.F.R. Part 342, in addition to cost based rates, pipelines are permitted to file indexed, settlement or market-base rates. *Id*. at pp. 8-9. However, Ganz noted, a pipeline filing

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> nominal equity return as part of the cost of service. Under the depreciated original cost methodology the entire nominal equity rate of return is applied to the rate base, and the result is included in the cost of service in the current year. In contrast, under the trended original cost methodology the nominal equity rate of return is split into two components that are included in the cost of service in different ways.

Exhibit No. M-24 at p. 6.

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cost-of-service rates is required to use the Commission-accepted methodology[104] and show a substantial divergence between its costs and its revenues. *Id.* at p. 9.

203. Ganz claimed that he reviewed Mid-America's books and records and that he removed items that were not related to the assets and operations of its natural gas liquids transportation system to develop total company data. *Id.* at p. 10. Also, he said he used information listed by cost center to allocate the total system data between the Northern, Central, and Rocky Mountain Systems. *Id.* While a number of costs could have been ascribed to a specific line, Ganz stated, some common costs needed to be allotted between the three systems. *Id.* In connection with this, he said, the Conway common costs were split between the Northern and Central Systems, the Hobbs common system were allocated between the Central and Rocky Mountain Systems, and the total company common costs were divided among the three systems. *Id.* at p. 11. The Kansas-Nebraska approach, he testified, was used to allocate these common costs. *Id.* Ganz also claimed that, to develop the appropriate allocation factors, he used "an equal weighting of the percentage of gross property and payroll for an individual system compared to the total of all systems that share the common costs subject to allocation," and that he "separated interstate costs from intrastate costs using a ratio of interstate barrel-miles to total barrel-miles." *Id.*

204. To calculate the costs of service, Ganz said he required historical data for carrier property, accrued depreciation, working capital, and accumulated deferred income taxes for the period of December 31, 1983, until the date when the starting rate base was to be determined.[105] *Id.* at p. 12. Mid-America's FERC Form 6 annual reports and Mid-America's asset ledger, claimed Ganz, were reviewed to determine total company carrier property and accrued depreciation data. *Id.* He then stated that he removed amounts related to assets that were not involved with the natural gas liquids transportation system after consulting Mid-America's books. *Id.* at p. 13. Furthermore, he contended, to comply with the Commission-accepted methodology, he subtracted the amount associated with capitalized interest during construction for post-1983 investment. *Id.* Ganz testified he then calculated segmented carrier property and accrued depreciation data by consulting Mid-America's asset ledgers appropriately to divide costs among the three systems, and used a similar approach to calculate the 1983 Cost of Reproduction New value. *Id.*

[104] In his testimony, Ganz noted that he used the methodology set out by the Commission in *Williams Pipe Line Co.*, 31 FERC ¶ 61,377.

[105] According to Ganz, total company carrier property and activity for 1983 and subsequent periods can be found in Exhibit No. M-26, Workpaper 7. Exhibit No. M-24 at p. 15.

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205. According to Ganz, it was necessary to remove certain costs from Mid-America's carrier property to determine Mid-America's total company costs for its natural gas liquid pipeline system, to wit: (1) For the period 1983-89, the costs of the ammonia system;[106] (2) the costs of a few crude oil pipelines Mid-America operated prior to 2001; (3) certain non-jurisdictional costs erroneously recorded on carrier property records; (4) the costs of an addition to the Seminole Pipeline System erroneously recorded in 2004 and corrected in 2005; (5) costs of assets which Mid-America had not acquired, but which were erroneously recorded in its asset ledger; and (6) the costs associated with capitalized interest during constructions for post-1983 investments. *Id.* at pp. 15-16.

206. To develop total company working capital data, Ganz claimed to have used Mid-America's FERC Form 6 for the amounts related to oil inventory and operating oil supply, materials and supplies, and prepayments, but removing working capital related to the ammonia system in forms from 1983 to 1989 and working capital related to the oil industry beginning in 2004 because Mid-America included it in another tariff that year. *Id*. at pp. 17-18. Finally, Ganz stated he allocated the total working capital among the three systems to determine segmented working capital. *Id.* at p. 18.[107]

207. Ganz declared that the Commission mandates that oil pipelines reflect income tax normalization to determine any income tax allowance in the cost of service. *Id*. He added that tax normalization recognizes that there may be temporary differences in certain kinds of depreciation if it is reported for accounting or tax purposes, but that difference will ultimately be nullified when an asset is fully depreciated for both accounting and tax purposes. *Id*. at pp. 18-19. The consequence of this temporary difference is, according to Ganz, that, for the equivalent revenues, the income measured on a financial accounting basis will be different from the income measured on a tax reporting basis. *Id*. This results in different income taxes for the two bases, he claimed. *Id*. Companies with rates based on cost of service, he testified, can collect revenues that cover operating expenses, including depreciation expenses, a return on rate base, and a normalized tax allowance. *Id*. This normalized tax allowance, Ganz maintained, is consistent with the tax expense measured on only the financial reporting basis, resulting in an income tax expense that is different from the payable income taxes. *Id*. at pp. 19-20. He claimed that the cumulative total of deferred income taxes is deducted to offset the rate base preventing the company from earning a return on monies collected from rate payers for income taxes that will not be paid until a subsequent period. *Id*. at

[106] According to Ganz, Exhibit No. M-26, Workpaper 13 shows data associated with the ammonia system that was removed from total company costs. Exhibit No. M-24 at p. 17.

[107] According to Ganz, Exhibit No. M-26, Workpaper 25 shows working capital and construction work in progress. Exhibit No. M-24 at p. 17.

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p. 20.

208. On occasion, the top marginal federal interest tax rate for corporations change, and as a result, stated Ganz, a company could have an over or under-funded accumulated deferred income tax. *Id.* In such an event, he continued, the over or under-funded amount is measured from the time of the change and amortized prospectively. *Id.* This allows an over-funded company, explained Ganz, to return to rate-payers over time the over-funded amounts or provides for a collection of any under-funded deferred income taxes. *Id*. at pp. 20-21.

209. He added that, should an asset be sold as part of a taxable event, the deferred income tax account is extinguished, and the offset against rate base would be reduced to zero as of the date of the transaction. *Id.* at p. 21.[108] Williams' purchase of Mid-America in 1998, Ganz testified he was led to understand, was not a taxable event. *Id*. at p. 22. Yet the subsequent sale of Mid-America to Enterprise Products Partners in 2002, he asserted, was a taxable event, and therefore, the accumulated deferred income tax balance was eliminated. *Id*.

210. To determine Mid-America's accumulated deferred income tax data, Ganz said he used company asset ledgers to establish total company and segmented carrier property balances by vintage year. *Id.* Specifically, Ganz explained, he used categories, including right of way, buildings, communications systems, office furniture and equipment, vehicles and other work equipment, and all other depreciable property, and for each, he deducted the book deduction rates from the tax depreciation rates to find annual depreciation timing difference factors and accumulated the deferred tax provision factors from 1962 through 1983 and subsequent periods to develop the factors used to calculate unadjusted Accumulated Deferred Income Tax (sometimes ADIT) balances for those periods. *Id.* at p. 23. He went on to say that he used a similar approach to calculate several adjustments to ADIT for overfunded and underfunded amounts and to amortize those ADIT adjustments. *Id.* To reflect the extinguishment of accumulated deferred income tax in 2002, he said he conducted two separate sets of accumulated deferred income tax calculations, one for the period up until 2002, and one for the period including and beyond 2002. *Id.* at p. 24. For the first set of calculations, according to Ganz, he employed the top marginal income tax rates for corporations, while for the second set he used weighted marginal income tax rates for corporations and individuals based on Mid-America witness Petru's income allocation percentages. *Id.*

211. Further, Ganz reported, he determined operating expense data by making adjustments to the expenses recorded in Mid-America's general ledger to reflect changes

[108] *See also Enbridge Pipelines (KPC)*, on reh'g, 102 FERC ¶ 61,310 at P 68 (2003).

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to the accounting for certain costs that became effective on January 1, 2006. *Id.* at p. 25. He said he then segmented expenses and assigned certain individual costs directly to each of the three systems, allocated common costs at Hobbs and Conway, and allocated total company indirect expenses among the three systems. *Id.* Moreover, referring to Exhibit No. M-27, he testified, he included indirect costs from Enterprise Products Partners in the total company indirect expenses for Mid-America. *Id.* at p. 26. Additionally, he stated, he took revenue and throughput data directly from Mid-America's books and determined segmented revenue and throughput data based upon where the movements occurred on the three systems. *Id.* at p. 27. For capital structure, debt cost, and nominal and real equity rates of return, Ganz said he used the analyses of Mid-America witness Williamson. *Id.* Finally, he related, he used inflation rates from the Consumer Price Index for All Urban Consumers. *Id.*

212. According to Ganz, he followed Commission policy[109] to determine the appropriate income tax allowance and used the weighted marginal income tax rate provided by Mid-America witness Petru. *Id.* at pp. 28-30. Ganz explained that he calculated the weighted state income tax rate based on the apportionment factors and marginal income tax rates for each of the states in which Mid-America operates. *Id.* at pp. 30-31.[110]

213. Three normalizing adjustments to cost-of-service data, Ganz testified, were made to determine the total company and segmented cost of service for the Locked-In Period of May 1, 2005, through April 30, 2006: (1) certain pipeline mileage data were updated; (2) any 2005 volumes associated with movement between Channahon, Illinois and Morris, Illinois, during the Locked-In Period were included as intrastate throughput; and (3) certain historical throughput data for propane volumes that were separated from the mixed stream and moved as propane volumes to Conway were reduced. *Id.* at pp. 33-34.

214. Along with a Total Company cost-of-service,[111] segmented costs-of-service were calculated for the Locked-In Period for the Total Company and for the Northern[112] and

[109] Ganz cited *Policy Statement on Income Tax Allowances*, 111 FERC ¶ 61,139 (2005); *SFPP, L.P.*, 113 FERC ¶ 61,277 (2005).

[110] Ganz said his calculations appear in Exhibit No. M-29. Exhibit No. M-24 at p. 30.

[111] Ganz said his total company cost-of-service for the Locked-In Period is in Exhibit No. M-30. Exhibit No. M-24 at p. 34.

[112] Ganz said his Northern System cost-of-service presentation for the Locked-In-Period is in Exhibit No. M-31. Exhibit No. M-24 at p. 39.

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Central[113] Systems, stated Ganz. *Id.* at p. 39. Additionally, he explained, the Total Company cost-of-service for the Locked-In Period was $227,323,000, with revenues of $180,442,000. *Id.* The cost-of-service for the Northern System, reported Ganz, was $72,282,000 with revenues of $38,174,000, and the cost-of-service was $51,922,000 for the Central System, with revenues of $28,837,000. *Id.*

215. Cost based rates for the Locked-In Period, stated Ganz, were developed by conducting a fully allocated cost analysis to allocate the segmented costs of service to the individual movements within each segment. *Id.* Non-distance costs, Ganz claimed, were assigned using barrel rate determinants and distance costs using barrel-mile rate determinants. *Id.* at p. 43. The Commission, according to Ganz, allows natural gas pipelines to reduce ratemaking throughput downward to acknowledge competitive discounts and thereby ensure that costs will equal the revenues collected under discounted rates. *Id.* at pp. 43-44. Thus, Ganz testified, he applied an iterative process[114] to reduce the volumes according to his policy, such that the rates allow the pipeline to collect revenues which equal its cost of service. *Id.* at pp. 43-46.

216. By starting with the total cost of service and removing all non-distance related costs found in several general and administrative operating expense accounts, Ganz explained, he developed cost-based rates for the Northern System for the Locked-In period.[115] *Id.* at p. 47. Additionally, he noted, the total of these non-distance related costs were assigned to movements using barrels, while the remaining cost-of-service total was allocated to movements using barrel-miles. *Id.* Furthermore, Ganz asserted, he used fully allocated cost rates, using actual volumes for the Locked-In Period in the first

[113] Ganz said his Central System cost-of-service presentation for the Locked-In-Period appears in Exhibit No. M-32. Exhibit No. M-24 at p. 39.

[114] Later, Ganz explained the basic theory behind the iterative process as follows: “[i]f you had to offer a discount to get the additional movements, that you shouldn’t assume that you will get the same level of volumes if you were to charge [other shippers] a rate that was higher, which may be the fully allocated cost rate.” Transcript at p. 2264. *See also id.* at pp. 2287-89. He added: “Essentially what happens is to the extent that you can’t recover a fully allocated cost rate from one move, the underrecovered level of cost would be redistributed to the other movements and would increase the rates that you could charge from the moves that are not constrained by competitive forces.” *Id.* at p. 2265. He stated that he presented an example of the “iterative process” at Exhibit No. M-24 at p. 44 tbl.4, and a simpler example at Exhibit No. M-148. Transcript at pp. 2266-76.

[115] Ganz said his calculations appear in Exhibit No. M-34. Exhibit No. M-24 at p. 47.

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iteration. *Id*. Then, Ganz continued, he adjusted rates downward in the second iteration, because many filed rates were below the fully allocated cost rates. *Id*. According to Ganz, these cost based rates were not lower than Mid-America's FERC Tariff No. 38 rates. *Id*. This approach, contended Ganz, also was used to calculate cost based rates for the Central System for both the Locked-In Period and the 2004 Test Period. *Id*. at p. 48.[116] Again, he maintained that these cost-based rates were not less than the Mid-America FERC Tariff No. 39 rates. *Id.* at p. 48.

217. For Mid-America's March 31, 2006, rate filing,[117] Ganz reported, the base year was February 1, 2005, through January 31, 2006, and data for the test period reflected adjustments for known and measurable changes occurring within nine months after the end of that year. *Id.* at p. 50. For the Test Period, he stated, the Total Company cost-of-service was about $239 million with revenues before the rate increase of about $185 million and about $211 million after it. *Id.* at pp. 49-50. To determine operating expenses, Ganz said he used records from the company for the Base Period with no adjustments to operating expenses for the Test Period. *Id.* at p. 50. In addition, he noted, he used the 2005 capital structure of Enterprise Products Partners, which was 46% debt and 54% equity. *Id.* Enterprise Products Partners' 2005 cost of debt was 5.65% with an estimated real equity rate of return of 11.12%, related Ganz. *Id.* at p. 51. A $29.8 million Test Period adjustment to carrier property, he testified, was made per Mid-America witness Collingsworth's calculations. *Id.*

218. Ganz stated he made several adjustments to the data associated with the cost of service Mid-America submitted with its March 31, 2006, filing, to wit: (1) the income tax rate and the deferred income tax amount was adjusted to reflect the amount of income allocated by Mid-America to its various owners; (2) the capital structure and costs of capital were adjusted to reflect Mid-America witness Williamson's recommendations; (3) costs associated with assets erroneously recorded in Mid-America's books were removed; and (4) costs associated with the ammonia system were eliminated. *Id.* at pp. 52-53. He also said that he made several adjustments to the calculation of the cost-of-service. *Id.* at p. 53.[118]

219. According to Ganz, he developed the Northern System cost-of-service in the same

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[116] Ganz stated his calculations appear in Exhibit Nos. M-35, M-36, respectively. Exhibit No. M-24 at p. 48.

[117] Ganz stated that the data submitted by Mid-America in support of its filing was attached to the record as Exhibit No. M-38. Exhibit No. M-24 at p. 49.

[118] Ganz indicated that the adjusted Total Company cost-of-service is attached to the record as Exhibit No. M-39. Exhibit No. M-24 at p. 53.

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manner. *Id.* at p. 54.[119] He indicated that he made several adjustments, to wit: (1) the actual plant balance as of the end of the base year for the Northern System as well as Test Period additions that reflected a Northern System cost center were included; (2) common costs were allocated based on the Kansas-Nebraska formula using Test Period property and payroll percentages; and (3) interstate costs were apportioned using an interstate percentage consistent with the interstate barrel/miles projected to move in the test Period. *Id.* Ganz related that the unadjusted Total Company cost of service during the test year was $238,899,000 with revenues of $210,531,000, and $230,506,000 with revenues of $211,640,000 adjusted during that same period. *Id.* at p. 55. He also stated that the Northern System cost of service during the Test Period was $75,336,000 with revenues of $65,791,000. *Id.*

220. In response to Propane Group witness O'Loughlin, Ganz, in his rebuttal testimony, stated that there is nothing odd or unusual about an oil pipeline company being purchased at a price that exceeds its net book value. Exhibit No. M-100 at p. 4. O'Loughlin, he insisted, mischaracterized the nature of the assets that Enterprise Product Partners acquired, stating it paid approximately $933 million for Mid-America, even though the net book value of Mid-America's property, plant, and equipment as of the date of purchase was $614 million. *Id.*[120] O'Loughlin, he argued, failed to account for Mid-America's entire rate base, which as of July 31, 2002, was $765.8 million,[121] making the acquisition premium approximately $167 million — approximately half of that calculated by O'Loughlin. *Id.* No acquisition premium, declared Ganz, would establish that Mid-America has over- or under-recovered its cost of service for the periods at issue and an acquisition premium cannot show whether an individual system is experiencing an over- or under-recovering. *Id.* at p. 5. In any event, Ganz emphasized, any discussion of an acquisition premium is irrelevant in this case, since Mid-America has made no purchase price adjustment to its rate base. *Id.* Ganz objected to O'Loughlin's suggestion that the increases on the Northern System rates without corresponding increases on the Rocky Mountain and Central System rates were inconsistent with the $87 million under-recovery of cost reflected in Mid-America's filling, which, he said, "calls into question the validity of Mid-America's $277 million cost-of-service figure." *Id.* The rate

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[119] Ganz stated that his Northern System cost-of-service presentation for the March 2006 filing appears in Exhibit No. M-40. Exhibit No. M-24 at p. 54. In his rebuttal testimony, Ganz said he updated this presentation and attached it as Exhibit No. M-103. See Exhibit No. M-100 at p. 11.

[120] Ganz referred to O'Loughlin's testimony at Exhibit No. NPG-1 at p. 12. Exhibit No. M-100 at p. 4.

[121] Ganz referred to the calculations at Exhibit No. M-130, Statement E1. Exhibit No. M-100 at p. 4.

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adjustments in Mid-America's tariff filings, claimed Ganz, reflected the different commercial environment and competitive pressures related to each system. *Id.* at p. 6.

221. Ganz also disagreed with O'Loughlin's suggestion that Mid-America's March 2006, tariff filing was unwarranted in light of the reduction in the total company cost-of-service between its March 2005 and March 2006 tariff filings, as well as the rate relief it received, subject to refund, in its March 2005 tariff filing. *Id.* The rate increases on Mid-America's Northern System, he asserted, must be justified based on that System's costs, not whether Total Company costs declined between the two tariff filings. *Id.* at pp. 6-7. Ganz reiterated Collingsworth's testimony[122] that it is simply not in Mid-America's interests to shift costs away from one system to another in a particular rate case. *Id.* at p. 8. Moreover, both Mid-America and the Propane Group, in Ganz's opinion, appear to agree that separate costs of service should be calculated for each system and that costs should be allocated among the systems using the Commission's Kansas-Nebraska methodology. *Id.*

222. With respect to O'Loughlin's and Staff witness Sherman's recommendations concerning the FERC Tariff No. 38 March 2005 rate filing, Ganz testified that he disagrees with them because the data they used, he alleged, was not representative of the period in which the FERC Tariff No. 38 rates were in effect. *Id.* at pp. 9-10. He also noted that Williams witness Olson agrees with him regarding the use of the Locked-In Period. *Id.* at p. 9. Moreover, Ganz said he disagreed with O'Loughlin's and Sherman's recommendations concerning the FERC Tariff No. 41 March 2006 rate filing because, he argued, the adjustments to the data they recommended were inconsistent with the Commission's regulations. *Id.* at pp. 9-10.

223. Ganz testified that he developed Mid-America's cost-of-service presentation in support of the FERC Tariff No. 38 rates on the basis of the Locked-In Period, May 1, 2005, through April 30, 2006. *Id.* at p. 10. He continued, the cost-of-service presentation in support of the FERC Tariff No. 41 rates was developed using a base year of February 1, 2005, through January 31, 2006, and "reflecting test period adjustments that were known and measurable with reasonable accuracy at the time of the filing and that would become effective within nine months of the end of the base year, or October 31, 2006." *Id.* at pp. 10-11. On May 31, 2007, Ganz reported, Mid-America filed FERC Tariff No. 48, which increased the seasonal discount rates from those contained in FERC Tariff No. 41. *Id.* at p. 11. Collingsworth, according to Ganz, instructed him (in order to minimize controversy) to make only those Test Period adjustments to the 2004 Base Period costs of service that would reduce costs, producing volume declines since 2004 and cost increases. *Id.* at pp. 11-12. Furthermore, Ganz testified, the Base Period pipeline

[122] Ganz referred to Collingsworth's testimony at Exhibit No. M-46 at p. 4. Exhibit No. M-100 at p. 8.

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integrity costs were significantly lower than what forward-looking pipeline integrity costs likely are to be on the Northern System. *Id.* at p. 12. Despite what he claimed are conservative assumptions in the 2004 Northern System cost of service, Ganz declared that the FERC Tariff No. 38 rates were fully justified by the costs incurred during that period. *Id.*

224. Analyzing the FERC Tariff No. 38 rates using the actual costs incurred during the period when those rates were in effect, Ganz claimed, is more appropriate than using a Base Period and Test Period approach. *Id.* at p. 13. Since actual costs are known for the entire period the rates were in effect, contended Ganz, using those costs makes more sense than engaging in a hypothetical exercise regarding whether changes that would occur by September 2005 were known and measurable as of the end of the 2004 Base Period. *Id.* Moreover, he claimed that, as the FERC Tariff No. 38 rates were superseded by the FERC Tariff No. 41 rates on May 1, 2006, determining whether the Locked-In Period costs are representative of what costs will be on a forward-looking basis, as is the goal of the Commission's normal Base and Test Period procedures, is unnecessary. *Id.* Even were FERC Tariff No. 38 rates analyzed using a 2004 Base Period adjusted for known and measurable changes through October 2005, Ganz disagreed with the Test Period adjustments O'Loughlin made to the 2004 Base Period. *Id.* First, according to Ganz, O'Loughlin reflected a normalizing adjustment to pipeline integrity expenses, as developed by Arthur, which reduced Mid-America's expenses to a level below that which Mid-America experienced during the Locked-In Period and below the level it would likely incur on a forward-looking basis. *Id.* at pp. 13-14. Second, Ganz stated, O'Loughlin used the volume level experienced in calendar year 2004 to develop rates, resulting in volumes at a level above that which Mid-America experienced during the Locked-In Period, and indeed above what it had experienced in 2005, 2006, and 2007 through May. *Id.* at p. 14.

225. Using the Locked-In Period of May 2005 through April 2006, stressed Ganz, overlaps with the base year of February 2005 through January 2006 that was used for Mid-America's March 2006 rate filing, but he noted, this will not result in a double recovery of pipeline integrity expenses. *Id.* Pipeline integrity expenses, in Ganz's view, should be included in the Locked-In Period to determine whether Mid-America's FERC Tariff No. 38 rates are justified by the costs that were actually incurred during the period the rates were in effect. *Id.* at p. 15. Pipeline integrity expenses, he claimed, also should be included in the Base Year for Mid-America's March 2006 filing in order to determine an appropriate level of expenses to include in the Test Period cost-of-service for the FERC Tariff No. 41 rates. *Id.* In addition, Ganz testified that, because Mid-America's costs were lower and its volumes were higher during the 12-month period ending September 30, 2005, than during the Locked-In Period, and because the rates that were filed on March 31, 2005, were effective only during the Locked-In Period, the result of reflecting Sherman's recommended approach will not be representative of the period during which the rates were in effect. *Id.* at pp. 15-16.

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226. Continuing, Ganz disagreed with O'Loughlin's and Sherman's recommendations concerning adjustments to data for the Test Period used in connection with Mid-America's March 2006 rate filing, claiming the adjustments were inconsistent with the Commission's regulations.[123] *Id.* at p. 16. In its March 2006 tariff filing, reported Ganz, Mid-America reflected actual Base Year volumes for the twelve-month period February 2005 through January 2006, with adjustments for events that occurred during the Base Period. *Id.* at p. 17. It did not adjust volumes up or down for future events, testified Ganz, because such events were not known and measurable. *Id.* O'Loughlin violated the Commissions' test period regulations, claimed Ganz, by ignoring Mid-America's actual base year volumes and by failing to identify any known and measurable changes that became effective before the end of the Test Period. *Id.* Moreover, Ganz maintained, Staff's approach is inconsistent with the Commission's test period regulations because it did not begin with actual data for the Base Year that Mid-America used in its filing, and because Staff had not identified any known and measurable changes to Base Year data in the manner required by the regulations. *Id.* at pp. 18-19. Additionally, Ganz insisted, when Mid-America filed FERC Tariff No. 41 on March 31, 2006, it could not possibly have used the actual data for the 12-month period ending seven months later on October 31, 2006. *Id.* at p. 19. Ganz emphasized that the information that was not available at the time of the filing could not have been known and measurable at the time of the filing, as required under the Commission's test period regulations. *Id.* at p. 19. Further, Ganz argued, Sherman's assertion that the most recent post-filing data is the best available information was incorrect because this would always mean that an oil pipeline's cost-of-service filing is irrelevant. *Id.* at p. 20.

227. Corporate overhead, stated Ganz, is allocated from Enterprise Products Operating to Mid-America and other subsidiaries using a modified version of the Massachusetts formula. *Id.* at p. 21.[124] This method, Ganz explained, involves allocating overhead based on the amount of each subsidiary's gross margin, labor, and property, plant, and equipment in relation to the gross margin, labor, and property, plant, and equipment of Enterprise Products Operating and its subsidiaries as a whole. *Id.* The allocation method used, Ganz stated, is a "modified version of the Massachusetts formula because it uses gross margin (*i.e.,* net revenue or profit) instead of gross revenue." *Id.*

228. Although Enterprise Products Operating sometimes takes title to the product it fractionates (which results in greater book revenue when the product is sold), Ganz

[123] In support, Ganz referred to 18 C.F.R. § 346.2(a)(1). See Exhibit No. M-100 at p. 16.

[124] Ganz referred to Knesek's testimony at Exhibit Nos. M-70 at p. 2; M-3 at p. 5. Exhibit No. M-100 at p. 21.

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asserted that this method of structuring the fractionation service does not result in a greater amount of overhead expenditures than the situations in which the fractionation service is performed on a fee-for-service basis without the fractionator taking title to the product. *Id.* Thus, Ganz insisted, under Arthur's gross revenue approach, the same service, which generates the same amount of profit and overhead expense, would result in a significantly different allocation of overhead depending upon how the contract for the service was structured. *Id.* Use of gross margin, in Ganz's view, provides a fairer allocation method in situations where some subsidiaries are engaged in buying and selling commodities and others simply provide services or transport products. *Id.* Additionally, Ganz stated, any additional risk resulting from the way in which the fractionation contract is structured would likely be reflected in the company's profit and thus would be accounted for in the overhead allocation through the use of gross margin. *Id.*

229. Mid-America, in the interest of reducing the matters at issue in this case, explained Ganz, decided to include all three entities — Dixie Pipeline Company, Tri-States NGL Pipeline Company, LLC, and Belvieu Environmental Fuels — in its calculation of the Massachusetts formula (as Arthur suggested). *Id.* at p. 25. Furthermore, Ganz agreed with Arthur that it would be appropriate to remove the purchase price from the Massachusetts formula. *Id.* at p. 26. Additionally, in the interest of reducing the matters at issue in this case, according to Ganz, Mid-America decided to back out the Seminole overhead allocation and remove the credit for the payment received by Seminole.[125] *Id.* at p. 27. However, Ganz said that Arthur's recommendation to use end-of-period balances was reasonable because Arthur made no corresponding change to the level of corporate overhead expenses to which he applied his allocation factors. *Id.* at p. 28. Moreover, he noted that while the end-of-period property balance was known and measurable, the corresponding change in the level of overhead expenses was not. *Id.*

230. According to Ganz, there is "general agreement" that Mid-America's rates should be analyzed on a segmented basis. *Id.* He also stated that, with two exceptions, O'Loughlin's disagreement with certain direct labor expenses and Sherman's assertion that the costs related to Conway and Hobbs should be allocated on a volumetric basis rather than by use of the Kansas-Nebraska formula, there is general agreement with his use of the Kansas-Nebraska formula to allocate costs among the three systems. *Id.* at p. 29. Ganz asserted that he does agree with one of the corrections that O'Loughlin proposed to Mid-America's direct labor expense data, to wit: the $1.3 million of Rocky Mountain System labor expenses that were recorded in the FERC Account 320 (Outside Services), rather than in Account 300 (Salaries and Wages), do represent direct labor expenses that should have been recorded in Account 300. *Id.* at p. 30. Consequently, he

[125] Ganz stated that his revised calculations regarding these two matters are attached to the record as Exhibit No. M-115.

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reported, the correction of the Kansas-Nebraska methodology reduced the amount of direct labor attributed to the Northern System from 63.2% to 50.7% and reduced the overall allocation of total company common costs to the Northern System from 42.07% to 35.81%. *Id.* at p. 31.[126] However, in reply to O'Loughlin argument that the direct labor expenses are inappropriately weighted to the Northern System even under the corrected Kansas-Nebraska factors, Ganz claimed that the ratio of direct labor to indirect expenses does not appear unusual. *Id.* at p. 32. In particular, he reasoned, the Northern System is older, more complex to operate, and has significantly more right-of-way issues, all of which lead to more direct labor expense. *Id.*[127]

231. O'Loughlin also erred, Ganz asserted, in proposing to remove direct labor expenses associated with operating Magellan's ammonia pipeline from the Kansas-Nebraska formula because it would distort the allocation of common costs as well as the allocation of the credit for the payment received by Magellan, which exceeds the costs Mid-America incurs. *Id.* at p. 32. Moreover, Ganz claimed that including the direct labor related to the ammonia line in the Kansas-Nebraska allocation formula was necessary, so that the overhead costs as well as the $1.3 million credit to outside services could be properly attributed to each System. *Id.*

232. Similarly, Ganz disagreed with O'Loughlin's next assertion that Northern System direct labor expenses were overstated in part because Mid-America personnel provided services to Enterprise Terminals, but did not charge enough labor time for those services. *Id.* at p. 33. There is simply no reason that the number of full-time employees per 100 miles of pipeline, maintained Ganz, should be relatively similar among Mid-America's systems. *Id.* at p. 34. He said that he sees no basis for changing from the Commission approved methodology of equally weighting plant and direct labor to one that would give equal weighting to plant and mileage — mileage, after all, being simply another plant based element. *Id.* at p. 35

233. Ganz also testified that he disagreed with O'Loughlin's Total Company cost-of-service approach. *Id.* at p. 36. Referring to O'Loughlin's claim that a Total Company cost-of-service approach should be used because Mid-America's labor expense data is unreliable, Ganz argued that, even had O'Loughlin's concerns any validity, his "corrected [Kansas-Nebraska] methodology would appear to ameliorate his concerns regarding direct labor expense and Mid-America's overall application of the [Kansas-Nebraska] methodology." *Id.* He added that, in any event, all parties agreed that evaluating Mid-America's rate increases on a segmented basis was inappropriate, and that a total company cost-of-service was insignificant because it said nothing about

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[126] *See also* Exhibit No. M-100 at p. 31 tbl.1.

[127] In support Ganz cited Exhibit No. M-46 at p. 9.

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whether each system was bearing its own costs, while neither subsidizing nor being subsidized by other systems. *Id.* at pp. 36-37.

234. With regard to Sherman's volumetric approach for allocating Conway and Hobbs common costs, Ganz disagreed, reasoning that: (1) Conway has numerous fixed costs that do not fluctuate with volume;[128] (2) the volumetric allocation factors reflect both inbound and outbound volumes, thereby treating all volumes as though they bear the same level of costs, yet the vast majority of the costs at Conway relate to product that moves out of the facility rather than volumes received; and (3) Staff's approach methodology does not allocate cost to the services that generate the cost. *Id.* at pp. 37-38.

235. According to Ganz, Sherman claimed that he reduced Mid-America's carrier property and accumulated depreciation for amounts associated with an ammonia pipeline Mid-America no longer owned, and, purportedly to be consistent, removed the operating expenses associated with the ammonia pipeline. *Id.* at p. 38. Ganz opposed Sherman's adjustment and stated that his cost-of-service calculations properly treated the expenses Sherman attributed to the ammonia pipeline. *Id.* The expenses incurred to operate the ammonia pipeline, explained Ganz, are recorded in cost centers that are identified with the phrase "NH_3 Shared" and "100% NH_3," the first indicating costs that are shared between the natural gas liquids system and the ammonia system; the second indicating costs that are associated only with the movement of ammonia. *Id.* at p. 39. Magellan, which owns the ammonia pipeline, related Ganz, pays Mid-America to operate the ammonia pipeline and also makes a separate payment, approximately $1.3 million per year, to cover overhead costs associated with operating the ammonia pipeline facilities. *Id.* Sherman took no account of the overhead cost payment from Magellan, Ganz claimed. *Id.* Furthermore, Ganz contended, because the payments from Magellan serve to reduce the Mid-America cost-of-service, and do so to at least as great an extent as the expenses to which they relate, there is no reason to exclude any expenses, as Sherman proposed. *Id.* Adjusting Mid-America's operating expenses to remove direct and common costs associated with operating the ammonia pipeline system, testified Ganz, was unnecessary, because they already were offset by payments from Magellan and, thus, Sherman's operating expenses were understated. *Id.* at p. 43.[129]

236. Ganz testified that O'Loughlin left both the cost and the payment in the operating expense accounts (as Ganz does), but in making his Kansas-Nebraska allocation, O'Loughlin removed the direct labor cost associated with the ammonia system. *Id.* O'Loughlin's treatment, insisted Ganz, is inconsistent, since including the direct labor related to the ammonia line in the Kansas-Nebraska allocation is necessary so that both

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[128] In support Ganz cited Exhibit No. M-46 at pp. 20-21.

[129] *See also* Exhibit No. 100 at pp. 41-42 tbls.2, 3.

the costs and benefits related among the systems. *Id.*

237. Mid-America's pipeline integrity expenses, Ganz said he believed, should not be normalized. *Id.* at p. 44. Moreover, unlike Sherman, Ganz said, he does not believe that pipeline integrity expenses should be spread evenly or proportionally among Mid-America's pipeline systems because pipeline integrity management addresses issues and concerns that are specific to each of Mid-America's pipeline systems, with the amount of pipeline integrity expenses Mid-America incurs for a segment dependent upon the conditions and characteristics of that segment. *Id.* at pp. 44-45. In Ganz's cost-of-service presentations developed for the Locked-In Period, the level of Mid-America's pipeline integrity expenses he reflected, Ganz testified, was the actual amount of expenses that were incurred during the period in which the FERC Tariff No. 38 rates were collected. *Id.* at p. 45. Arthur's normalizing adjustment, Ganz contended, would reduce pipeline integrity expenses below the amount actually incurred. *Id.*

238. His cost-of-service presentations developed for the FERC Tariff No. 41 Base Period, Ganz testified, reflected the level of Mid-America's pipeline integrity expenses that were incurred during the Base Year. *Id.* Referring to the testimony of Mid-America witness Palmer,[130] Ganz explained that pipeline integrity costs are recurring because they are expenses that Mid-America incurs every year. *Id.* He added that the actual amounts of pipeline integrity costs expended by Mid-America on the Northern System during the February 2005 through January 2006 Base Period were representative of the level of pipeline integrity expense that Mid-America is likely to incur on a going-forward basis on that System. *Id.* at pp. 45-46.

239. Ganz criticized Sherman's approach to normalizing Mid-America's pipeline integrity expenses in which she averaged company-wide pipeline integrity expenses as though the cost per mile was the same, by asserting that, in reality, pipeline integrity expenses are not incurred evenly or proportionally. *Id.* at p. 47. According to Ganz, Sherman's approach was inappropriate because it ignored the locations where pipeline integrity expenses were actually incurred, and because it shifted costs among the system in a manner similar to the problem created in using the Total Company cost-of-service approach to determine rates. *Id.* Sherman, he further explained, normalized costs using the average annual pipeline integrity expenses incurred for the years 2003 through 2006, but because pipeline integrity expenses generally increased during that period, Ganz asserted that the historical average did not reflect reasonable expectations of future costs. *Id.* Additionally, Ganz testified that 2003 was especially unrepresentative of the level of future pipeline integrity costs because the pipeline integrity program did not become fully operational until the second half of that year. *Id.*

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[130] Ganz referred to Palmer's testimony at Exhibit No. M-79 at p. 18. Exhibit No. M-100 at p. 45.

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240. Even were replacing Mid-America's actual pipeline integrity costs with a normalized amount appropriate, Ganz suggested that the normalized level of costs proposed by Arthur is inappropriately low for the following reasons: (1) Arthur used an amount for 2006 based on a budgeted figure rather than the actual amount causing the Mid-America's pipeline integrity costs to be understated; and (2) Arthur used a five-year period to average pipeline integrity expenses, based on the maximum amount of time allowed between assessments under applicable regulations, even though reassessments in connection with stress corrosion cracking must be performed within four years. *Id.* at pp. 49-50. The five-year average, argued Ganz, may thus understate the average level of costs for the Northern System. *Id.* at p. 50.

241. Ganz stated that he disagreed with O'Loughlin's argument that Mid-America should not be permitted to include any costs related to storage in its cost-of-service and claimed that, as the storage Mid-America provides allows the system to operate more efficiently and provides a benefit to all shippers, allowing Mid-America to recover the costs of providing this service is only fair. *Id.* at p. 51. He further claimed that, as Mid-America does generate additional revenue from merchant storage at Conway, crediting the revenue Mid-America earns from this activity against the storage cost at Conway is appropriate. *Id.* at p. 51. Accordingly, he explained, he only includes the net amount of storage costs resulting from Mid-America's operations at Conway in its cost-of-service.[131] *Id.* For the same reason, Ganz stated, he "credit[s] the revenue from Mid-America's Pine Bend storage operations." *Id.* at pp. 51-52.

242. Suggesting that the cost for storage at the remaining locations should be included in Mid-America's cost-of-service, Ganz asserted that, even though the facilities are leased from an affiliate, "the lease payments were based on a study of the market rate for storage in the area." *Id.* at p. 52. He claimed that a study conducted by Mid-America reflected that there was a market for storage in the area served by its Northern System and that the rates it paid to its affiliate, Enterprise Terminals, were market based. *Id.*

243. The costs related to each storage facility, Ganz testified, should be assigned directly to the appropriate system instead of being allocated based on the Kansas-Nebraska method because the storage facilities benefit specific systems. *Id.* at p. 53. He asserted that the Iowa City and Greenwood costs should be charged to the Northern System; the Mocane costs to the Central System, and the Conway and Hobbs costs allocated between the two Systems they serve. *Id.*[132] Ganz opposed Pride's suggestion that Mid-America should have unbundled its storage costs from its base

[131] *See* Exhibit Nos. M-108, M-110.

[132] *See also* Exhibit Nos. M-108, M-109, M-110.

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transportation rate because: (1) Mid-America does not offer storage to individual shippers at all of its storage locations; and (2) Pride's method was based on average capacity usage rather than peak capacity usage, causing storage to be imputed to shipper use that was actually essential for pipeline operations. *Id.* at p. 53.

244. There are three main differences, in Ganz's opinion, between O'Loughlin's calculation of a weighted income tax rate for Mid-America and his own: (1) O'Loughlin used ownership percentages to weight the income tax rates for the various categories of owners, whereas Ganz used taxable income allocation percentages; (2) O'Loughlin assumed that the marginal income tax rate was zero percent for all categories of owners except for Subchapter C Corporations, whereas Ganz used the marginal income tax rates previously established by the Commission as rebuttable presumptions;[133] and (3) O'Loughlin excluded state income taxes, whereas Ganz's calculations recognized state income taxes. *Id.* at pp. 55-56.

245. In this case, Ganz noted, whether taxable income or ownership is used to derive the weighted average tax rate makes little difference because the taxable income generated by Mid-America is generally allocated on the basis of ownership percentage, with the main exception being the incentive distribution.[134] *Id.* at p. 56. O'Loughlin's assertion that using the taxable income of Mid-America instead of the taxable income of Enterprise Products Partners, suggested Ganz, is erroneous because it is at odds with the Commission's stand-alone tax policy.[135] *Id.* at p. 57.

246. After Mid-America filed its direct testimony, testified Ganz, the Commission reduced the rebuttable presumption for the Subchapter C Corporation category from 35% to 34%, and thus, Mid-America revised its income tax allowance calculations shown in its direct testimony to reflect this lower marginal rate and more current information.[136] *Id.* at p. 60.[137] According to Ganz, both Mid-America and O'Loughlin assigned a 0% tax rate to the category of non-taxpaying entities. *Id.* However, Ganz claimed that, with respect to the four remaining categories, O'Loughlin inappropriately assigned each

[133] In support Ganz cited to *SFPP, L.P.,* 113 FERC ¶ 61,277.

[134] In support Ganz cited to *SFPP, L.P.,* 113 FERC ¶ 61,277 at P 46; *SFPP, L.P.*, 117 FERC ¶ 61,285 at P 64-65 (2006).

[135] In support Ganz cited to *SFPP, L.P.,* 113 FERC ¶ 61,277 at P 33, 46, 56.

[136] Ganz cited to *SFPP, L.P.*, 117 FERC ¶ 61,285 at P 60.

[137] In support Ganz referred to Exhibit Nos. M-118, M-119. Exhibit No. M-100 at p. 60.

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category a zero percent tax rate, whereas the Commission's rebuttable presumption for these is a 28% tax rate. *Id.*

247. Ganz testified that he took issue with O'Loughlin's assigning a zero percent income tax rate to owners who are not Subchapter C corporations. *Id.* at pp. 60-61. He claimed that Commission policy rejected eliminating income tax allowances from costs of service.[138] *Id.* at pp. 61-62. In particular, Ganz argued that assigning a zero percent income tax rate to Unrelated Taxable Income entities and Mutual Fund unitholders violates Commission policy.[139] *Id.* According to Ganz, Commission policy establishes a 34% tax rate for Subchapter C corporations and a 28% rate for individuals. *Id.* at p. 62. He added that the Commission extended the latter rate to fiduciary unitholders such as mutual funds, pensions, and trusts. *Id.*

248. In his view, Ganz stated, Mid-America should be allowed to include an allowance for state income taxes, because they, like federal income taxes, are costs that arise from Mid-America's jurisdictional activities, and they should be included in Mid-America's cost of service like any other cost. *Id.* at p. 65.

249. Ganz stated that, for the period prior to mid-2002, he calculated accumulated deferred income taxes using the top marginal corporate rate because, prior to Enterprise Products Partners purchase of it, Mid-America was owned by a corporation. *Id.* at pp. 65-66. For the period after that, he said, he used weighted marginal income tax rates for corporations and individuals based upon allocations developed by fellow Mid-America witness Petru. *Id.* at p. 66. O'Loughlin, according to Ganz, argued that the top marginal corporate rate ought to be used for both periods. *Id.* Ganz testified, in response, that using a weighted marginal income tax rate instead of the top corporate marginal income tax rate for the latter period is more appropriate because, following its acquisition by Enterprise Products Partners, Mid-America's income tax costs changed. *Id.* at p. 66. Were Mid-America required to calculate accumulated deferred income tax from mid-2002 until the relevant test year at the top corporate rate, he claimed, Mid-America would have to provide for deferred income taxes it, and its owners, did not incur. *Id.* at p. 67. Ganz asserted that neither of O'Loughlin's recommended income tax rates (0% or 4.74%) are appropriate to use in calculating accumulated deferred income tax for Mid-America. *Id.* In any event, he suggested, there is no reasonable basis for preventing Mid-America from recognizing a change in its income tax costs at the time the change occurred, while, at some later date, compelling Mid-America to recognize the change in tax costs prospectively through rate reductions. *Id.*

[138] Ganz cited to *Policy Statement on Income Tax Allowances*, 111 FERC ¶ 61,139 at P 31-32 (2005).

[139] In support Ganz cited to *SFPP, L.P.*, 117 FERC ¶ 61,285 at P 59-63.

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250. According to Ganz, O'Loughlin developed factors based on the ratio of 2004 volumes as compared to volumes for the relevant period, and he applied this factor to all volumes that actually moved in the relevant period — for the Northern System Locked-In Period he multiplied the volumes by 1.12, and for his 2006 test year, he multiplied volumes by 1.14.[140] *Id.* at pp. 68-69. According to Ganz, there are two problems with O'Loughlin's approach: (1) O'Loughlin's volume numbers represented hypothetical, not actual, movements; and (2) O'Loughlin understated the volume-related costs in his rate calculation for the Locked-In Period and his 2006 test year because, though he recognizes an increase in volume, he made no increase to the actual expense.[141] *Id.* at pp. 69-70.

251. For periods before 2006, Ganz reflected volumes moving from Channahon, Illinois, to Morris, Illinois, as intrastate throughput, which, he said, is the way Mid-America records these movements. *Id.* at p. 70. He claimed that Staff rejected this adjustment for Staff's Period I, but accepted it for Staff's Period II.[142] *Id.* Ganz asserted that, were reflecting this movement as intrastate in Staff's Period II appropriate, then reflecting it as intrastate in Period I also should be appropriate. Exhibit No. M-100 at p. 71. Nothing in the nature of this movement, Ganz reasoned, had changed since it began in 2001, and he continued, rejecting this adjustment for Period I because Mid-America previously accounted for the volumes in a different manner would be the same as rejecting the adjustment to remove the ammonia pipeline assets from Mid-America's rate base in the 1980's because that is how it was accounted for in the Form No. 6 report at that time. *Id.*

252. In connection with normalizing volumes related to Item 150 of both Mid-America's FERC Tariff Nos. 38 and 41, Ganz testified that he eliminated volumes that are accounted for in Mid-America's throughput data as moving from Clinton, Iowa, to Conway, Kansas, under the Item. *Id.* at p. 72. He indicated that Staff witness McComb rejected this adjustment for the period associated with Mid-America's March 31, 2005, filing of FERC Tariff No. 38,[143] but not for the period associated with Mid-

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[140] Ganz referred to O'Loughlin's testimony in Exhibit Nos. NPG-1, NPG-109 and NPG-112. Exhibit No. M-100 at p. 68.

[141] Ganz referred to O'Loughlin's testimony at Exhibit No. NPG-1 at pp. 136-43. Exhibit No. M-100 at pp. 69-70.

[142] Ganz referred to Staff witness McComb's testimony at Exhibit No. S-19 at pp. 7-9, 12. Exhibit No. M-100 at p. 70.

[143] This refers to a calendar year 2004 Base Period adjusted for known and measurable changes through September 30, 2005. Exhibit No. S-19 at p. 3.

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America's March 31, 2006, filing of FERC Tariff No. 41,[144] because Staff witness Pride asserted that Item 150 was unreasonable as it results in "undue preference and prejudice" and offers free transportation for volumes shipped" that "have a transportation cost to Mid-America that other shippers are being asked to pay for."[145] *Id.* Ganz further indicated that O'Loughlin also rejected this adjustment claiming that Mid-America was providing backhaul service for a negative price. *Id.*

253. According to Ganz, while the propane reconsigned by the East Red Line Shipper to Mid-America is returned to the shippers' propane inventory at Conway, in reality, Mid-America does not physically move the propane barrels back to Conway. *Id.* at p. 73. Rather, he asserted, Mid-America stores the product at Iowa City for use in fulfilling demand north of Iowa City. *Id.* As a result, Ganz argued, these volumes represent a bookkeeping entry to implement the credit provision of Item 150 and not barrels that actually move, and thus, there is no free transportation or costs being incurred for which other shippers are being asked to pay. *Id.*

254. With respect to Williams' witness Olson's general rate design principles, Ganz said he largely agreed, but he declared disagreement with Olson's assertion that Mid-America's discounted rates were inadequately explained. *Id.* at p. 75. Mid-America, stated Ganz, is not attempting to defend the specific level of the seasonal discount rates other than to show that they are below the ceiling level, and is not attempting to reallocate to other shippers the difference between the discounted rates and the general commodity rates. *Id.* Here, Ganz's claimed, Mid-America is defending its revised ceiling rates, which are the rates contained in FERC Tariff No. 38 and the general commodity rates in FERC Tariff No. 41. *Id.* Also, he argued, establishing an artificially high burden for a pipeline to justify a discount is inappropriate. *Id.* Finally, while Ganz said he agreed that rates generally should be higher for transportation over greater distances, he disagreed that the rate per barrel-mile should necessarily be the same. *Id.* at p. 76. Competitive forces, he reasoned, may prevent a pipeline from charging rates equal to the full distance-based rates at all destinations, and if a pipeline is restricted solely to distance-based rates, it may not be able to recover its cost of service. *Id.*

255. Ganz asserted that he cannot agree with the approach Pride and O'Loughlin used to develop rates for Mid-America. *Id.* at p. 77. While he said he agreed that a fully

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[144] This period consists of a February 1, 2005, through January 31, 2006, Base Period adjusted for known and measurable changes through October 31, 2006. Exhibit No. S-19 at p. 4.

[145] Ganz referred to Staff witness Pride's testimony at Exhibit No. S-26 at pp. 26-27. Exhibit No. M-100 at p. 72.

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allocated cost rate design methodology is a starting point for designing rates, he argued that it should not be applied mechanically to all movements when a pipeline is not able to charge rates at the fully allocated cost level for some movements due to factors such as competition or contracts. *Id.* A fully allocated cost methodology, he claimed, may allocate costs to movements where substantial competition prevents the pipeline from recovering its full cost of service. *Id.* at p. 80. Mid-America's general commodity rates, he insisted, should be evaluated using the Commission's accepted iterative gas discounting methodology, and that designing fully allocated cost rates under the assumption that the same level of volumes will remain on the system if the pipeline were required to charge rates higher than the discounted level is inappropriate. *Id.* at p. 78. Ganz added that, while fully allocated rates can generate reasonable results in situations where the pipeline faces minimal competition, "in the presence of competition, [they] can lead to unreasonable results." *Id.* at pp. 79-80.

256. Disagreeing with both Pride and O'Loughlin, Ganz contended, with respect to the Northern System, that the volume incentive programs with the East Red Line Shipper were the result of a competitive bidding process which caused Mid-America to enter into a long-term contract that capped its rates. *Id.* at pp. 81-82. He maintained that, had Mid-America not offered a discounted rate, it would not have been successful in bidding for the East Red Line Shipper's business, and that Mid-America remains subject to competition for that business. *Id.*

257. The second type of discount, continued Ganz, involves the FERC Tariff Nos. 38 and 41 general commodity rates that are below the fully allocated cost-based level. *Id.* Recognizing that Pride claimed that the East Red Line volume incentive rates are not true discounts, but instead are "negotiated rates," which, she contended, are not eligible for a discount adjustment absent additional support,[146] Ganz submitted that the term "negotiated rates"[147] does not apply to the situation here. *Id.* at pp. 83-84. The East Red Line volume incentive rates, suggested Ganz, are more analogous to discounted gas rates than negotiated gas rates for the following reasons: (1) the East Red Line volume incentive rates are clearly below the maximum rates set out in Mid-America's tariff; (2) the East Red Line volume incentive rates are above Mid-America's variable cost for

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[146] Ganz referred to Pride's testimony at Exhibit No. S-26 at p. 19. Exhibit No. M-100 at p. 80.

[147] Ganz claimed that the term "negotiated rate" is a technical term which has the following meaning in a gas pipeline context: "rates that are above the maximum rate or below the minimum rate set out in the gas pipeline's tariff." Exhibit No. M-100 at pp. 83-84. He distinguished that from the term "discounted rates" which he claims are "rates a pipeline is permitted to offer an individual shipper, which are below the maximum rate and above the minimum rate contained in the pipeline's tariff." *Id.*

those movements, which is analogous to the "minimum rate" concept in the natural gas context; (3) although the East Red Line volume incentive rates were negotiated, they are also set out in Mid-America's tariff, thus ensuring no discrimination among shippers and further distinguishing the volume incentive rates from "negotiated rates" in a gas context; and (4) even a "negotiated rate" in the gas context is eligible for adjustment under the gas discounting methodology if the pipeline can show that it is the result of competition. *Id.* at pp. 84-85. Mid-America, in his view, he stated, has shown its rates to be the result of competition, which would permit it to use the iterative gas discounting method even if its rates are considered analogous to "negotiated rates." *Id.* at p. 85.

258. According to Ganz, Mid-America is not able to raise its current rates to the level contained in FERC Tariff No. 41 because of the competition it faces. *Id.* at p. 85. He added, however, that its rate should not be set below a just and reasonable level simply because it is not able to charge those rates. *Id.* Mid-America, declared Ganz, is not "gaming the system" as Pride suggested.[148] *Id.* at pp. 85-86. By defending its general commodity rates, he contended, "Mid-America is seeking to establish lawful rate ceilings and to have some flexibility to adjust its rates in the future in a manner that is not overly burdensome, as long as they stay below the general commodity rates." *Id.* at p. 86. Ganz asserted that Mid-America is not seeking pre-approval of its rates, but just approval of rates that "reflect its current cost of service." *Id.*

259. Responding to O'Loughlin's claim that Mid-America was inappropriately "shifting one misprice piece of the contract (the Channahon to Morris piece) to intrastate authority to evade Commission regulation,"[149] Ganz declared that the Channahon to Morris movement is an intrastate movement because the movement of ethane/propane mix from the Aux Sable plant at Channahon, Illinois, to Morris, Illinois, is a new movement that begins and ends within the state of Illinois. *Id.* at pp. 86-87.

260. Ganz also replied to O'Loughlin's alternative argument that, even were the movement from Channahon to Morris intrastate, the revenue received by Mid-America from this intrastate movement "should be recognized" in designing interstate rates,[150] declaring that the Commission lacks jurisdiction over intrastate movements and cannot simply "recognize" revenue received from these non-jurisdictional movements in

[148] Ganz referred to Pride's testimony at Exhibit No. S-26 at p. 25. Exhibit No. M-100 at pp. 85-86.

[149] Ganz referred to O'Loughlin's testimony at Exhibit No. NPG-1 at pp. 166-77. Exhibit No. M-100 at p. 86.

[150] Ganz referred to O'Loughlin's testimony at Exhibit No. NPG-1 at p. 171. Exhibit No. M-100 at p. 87.

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designing jurisdictional interstate rates. *Id.* at p. 87. Moreover, Ganz asserted that, to the extent the Commission has jurisdiction to consider intrastate revenue in designing interstate rates, and examine the "whole contract . . . for the revenue contribution it makes toward Mid-America recovering its cost of service," as O'Loughlin suggested, theoretically, crediting the revenue received by Mid-America under the contract against Mid-America's cost of service and removing the volumes from the rate design calculation all together is more appropriate. *Id.* at pp. 87-88. In that way, Ganz claimed, the non-East Red Line shippers would have their rates designed based on the remaining costs. *Id.* at p. 88. He added that O'Loughlin's assumption that the East Red Line volumes would remain on the system at the same level if the East Red Line Shipper were charged fully allocated cost rates is incorrect. *Id.*

261. Furthermore, Ganz opposed O'Loughlin's suggestion that the East Red Line Shipper and Mid-America should bear any fully allocated costs that it does not recover from individual transportation movements under the terms of the East Red Line Shipper contract instead of allocating any shortfall to other shippers. *Id.* Essentially, Ganz maintained, O'Loughlin is asking the East Red Line Shipper and Mid-America to subsidize the other shippers' movements. *Id.* at p. 89.

262. Ganz said he disagreed with O'Loughlin's claim that it was not appropriate to use the Commission's iterative gas discounting methodology for the non-East Red Line general commodity rates, even though they were below the fully allocated cost level.[151] *Id.* at p. 89. Although Mid-America inherited the current rate structure and is not aware of its specific origins, explained Ganz, Mid-America has come to believe that the current rate differentials are appropriate given the competitive pressures on the line and the distances between the various terminals. *Id.* at pp. 89-90. Moreover, Ganz claimed, since the rate differentials have been in place for several years without objection, Mid-America believes it is important not to disturb the settled expectations of shippers with respect to relative rate differentials to each destination. *Id.* at p. 90. The fact that the general commodity rates were not first set on a fully allocated cost basis and then discounted, contended Ganz, does not make them any less discounts below the fully allocated cost rate level, and it does not provide any reason for why Mid-America cannot use the iterative gas discounting method to justify its current rates. *Id.* The theory behind the gas discounting methodology, testified Ganz, is that fully allocated cost rates should not be designed using volume levels that are the result of rates that are themselves below the fully allocated cost level. *Id.* That rationale, according to Ganz, applies to rates that are constrained by competition regardless of whether or not they were previously set on a fully allocated cost basis. *Id.*

[151] Ganz referred to O'Loughlin's testimony at Exhibit No. NPG-1 at p. 184. Exhibit No. M-100 at p. 89

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263. Commission policy, Ganz argued, does not require the crediting of revenues received under a throughput and deficiency agreement.[152] *Id.* at p. 91. According to Ganz, O'Loughlin's approach used the volume deficiency payment to calculate assumed volumes and then allocated additional costs to those movements under the fully allocated cost rate design method and he said he opposed it because he knows of no factual or ratemaking justification for this approach. *Id.* The cost-of-service, Ganz asserted, should not be reduced by the amount of the reliability incentive payments. *Id.* at p. 92. The reliability incentive payments, Ganz testified, result from an agreement between the East Red Line Shipper and Mid-America which is not unreasonable and does not grant undue preferences or prejudices. *Id.* Therefore, he claimed, the reliability incentive payments should not be credited against the cost-of-service. *Id.*

264. Next, Ganz testified that he calculated rates using the updated cost-of-service calculation for the Locked-In Period and the Test Period for the Northern System. *Id.* at p. 92. The revisions he incorporated into his cost-of-service calculations were as follows: (1) all corrections that were provided to the parties on September 21, 2006, were incorporated; (2) the calculation of overhead costs allocated from Enterprise Product Partners to Mid-America was revised to reflect the inclusion of Dixie, Tri-States, and Belvieu in developing the allocation factors, and to eliminate overhead allocated to Seminole and the payment received from Seminole; (3) the amount of direct labor for the Rocky Mountain System was corrected, which changed the Kansas-Nebraska allocation factors used to allocate common costs; (4) the treatment of storage expenses were revised to assign costs directly to the applicable Systems, and to credit the fees Mid-America receives for merchant storage services at Conway and Pine Bend; (5) the carrier property amounts were revised to reflect the corrected Kansas-Nebraska allocation factors, and an error in reflecting a retirement of land at Hobbs, which was mislabeled as a Conway retirement, was corrected; (6) the income tax allowance and accumulated deferred income tax were revised to reflect (a) the 34% marginal rate for Subchapter C Corporations, (b) updated state apportionment factors, and (c) the revised carrier property amounts in the calculation of accumulated deferred income tax; and (7) the real equity rate of return and the inflation rate for the Test Period related to FERC Tariff No. 41 were updated to reflect fellow Mid-America witness Williamson's recommendations in his rebuttal testimony. *Id.* at pp. 92-93.

265. Under cross-examination, at the hearing, Ganz testified that he used actual expenses related to Mid-America's pipeline integrity management program without any adjustments in the 2004 Base Period, the 2006 Base Period, and the Locked-In Period. Transcript at pp. 1690-91. According to Ganz, pipeline integrity management expenses are recorded in FERC Account No. 320, outside services. *Id.* at p. 1692. As questioning continued, Ganz reported that there was a Test Year period adjustment in Account No.

[152] Ganz cited to *SFPP, L.P.*, 86 FERC ¶ 61,022 at p. 61,078 (1999)

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320 of approximately $17 million, which related mostly to pipeline integrity assessment costs.[153] *Id.* at pp. 1693-94. The expenses related to Mid-America's pipeline integrity management program, explained Ganz, were not presented separately, but were aggregated with other Mid-America outside expenses[154] and presented as a total in Account No. 320. *Id.* at p. 1695.

266. The level of pipeline integrity management expenses included in Mid-America's 2006 Base Period cost-of-service relating solely to the Northern System, Ganz agreed, was approximately $10.8 million. *Id.* at p. 1696. Additionally, he asserted, the $10.8 million was a representative level of recurring expenses. *Id.* at p. 1701. Also, he claimed that Mid-America's actual expenses for the Northern System pipeline integrity management program was $3.3 million in 2004 and is not a recurring expense level for pipeline integrity management-related costs on the Northern System.[155] *Id.* at p. 1712. Ganz added that, at the time of the March 2005 filing, Mid-America anticipated spending significantly more than that on pipeline integrity. *Id.* In 2005, Mid-America's actual expenses for the Northern System pipeline integrity management program, he went on to say, were approximately $10 million. *Id.* at p. 1717. The $10 million, he said he believed, is a recurring expense level for pipeline integrity management-related costs on the Northern System. *Id.* at pp. 1717-18. In 2006, he reported, Mid-America's actual expenses for the Northern System for pipeline integrity were approximately $3.5 million. *Id.* at pp. 1719-20. The $3.5 million, he maintained, is not a recurring expense level for pipeline integrity-related costs on Mid-America's Northern System. *Id.* at p. 1720.

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[153] Ganz stated:

> In fact, this test period adjustment was made in the March 31, 2005 filing on a total company basis. But in my cost-of-service presentations that reflect the 2004 adjusted period, I, at Mr. Collingsworth's instructions, only included the test period adjustments that are reflected in this filing in [Exhibit No.] M-37 [and] only the adjustments that reduced expenses.

Transcript at p. 1694.

[154] Ganz indicated that such expenses would have included the cost associated with other outside vendor services such as for metering, calibration, corrosion prevention. Transcript at p. 1695.

[155] Asked to define what the term "recurring cost" meant, Ganz indicated that both the type of expense as well as the level of the expense had to be considered. Transcript at p. 1717. In other words, as I interpret his answer, an expense could be recurring if it were incurred on a regular basis even though the particular amount involved might change; on the other hand, an event occurring on a regular basis could have a particular amount associated with it. Here, with regard to pipeline integrity, I find the former circumstance.

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267. Under further cross-examination, Ganz explained that the approach used "to develop the rates that were filed in March 2005 and March 2006 was to compare the revenues that were being generated by the preexisting rates to the cost of service and based on that relationship to determine an amount by which each of the filed rates would be increased." *Id*. at p. 1743. In performing his analysis of the rates filed by Mid-America, Ganz agreed, he used the iterative discounting methodology to design rates.[156] *Id*. at pp. 1743-44. He further agreed that he did not use the iterative method to establish rates, but simply used it to evaluate the rates which Mid-America had filed. *Id.* at p. 1747. This approach, insisted Ganz, reflected that Mid-America's rates were cost justified. *Id*. at p. 1750. The two kinds of discounts Ganz testified he accounted for in his iterative discounting methodology were (1) the volume incentive rates in the Northern System tariff for service to the East Red Line Shipper, and (2) the rates that were below a fully allocated cost level. *Id*. at pp. 1750-51. The fully allocated cost based rates, asserted Ganz, are the rates that result from allocating nondistance-related costs to the movements using volumes and distance-related costs using barrel-miles. *Id.* at p. 1751.

268. Ganz stated that he considered the FERC Tariff No. 41 general commodity rates to be discounted. *Id*. at pp. 1799-1800. Further, he explained that he did not reflect the seasonal discounts in developing the iterative discounting calculation because he was not attempting to use the seasonal discount rates in justifying the general commodity rates. *Id*. at p. 1800. Ganz also admitted that costs were reallocated from the East Red Line Shipper to the non-East Red Line shippers through the iteration process. *Id.* at p. 1802.

269. During further cross-examination, Ganz suggested that rates for transportation over greater distances may be lower than the rates for transportation over shorter distances when the competitive circumstances prevent the rates from being higher, or there are incentive rates governing the longer hauls.[157] *Id*. at pp. 1802-03. Additionally, asked about Exhibit No. M-124, Ganz insisted that, if Mid-America is held to the lower of its filed tariff rate or the fully allocated cost, it will not have the opportunity to recover its full cost of service. *Id.* at pp. 1807-08.

270. Ganz reported that the East Red Line Shipper movements (Channahon to Clinton; Conway to Clinton; and Clinton to Morris) received a 74.51 cent rate during the Test

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[156] Ganz later agreed that, mechanically, the iterative method works by reducing volumes and spreading the cost and revenue responsibilities to all the remaining shipments. Transcript at p. 1833.

[157] Ganz refused to say whether this would be appropriate; merely stating that it "would depend on the specific situation of the pipeline and the markets served." Transcript at p. 1803.

Period under FERC Tariff No. 41. *Id*. at pp. 1811-14. The rates, he explained, were discounted when they were initially negotiated in the East Red Line Shipper agreement, but were not discounted in his analysis. *Id*. at pp. 1813-14.

271. Further, Ganz testified that he used $70,674,000 as the cost of service and a 35,110,387 barrel total for the 2006 Test Period for FERC Tariff No. 41. *Id*. at pp. 1823, 1829. He continued, Mid-America would have failed in justifying all but five of its general commodity tariff rates if only one iteration was performed. *Id.* at p. 1829. In addition, under the existing rate structure, at the general commodity rate level, three rates in addition to the East Red Line Shipper rates were below fully allocated costs in the first iteration. *Id*. at p. 1832. Based on the general commodity rates in FERC Tariff No. 41, after the first iteration, Ganz stated, the majority of the undercollection resulted in the movements from Conway to Morris and Clinton by the East Red Line Shipper. *Id*. at pp. 1832-33.

272. Should the East Red Line Shipper's rates be increased, with all else remaining equal, Ganz claimed that there would be fewer iterations and a smaller difference between the discounted revenue and the fully allocated cost revenue. *Id*. at p. 1834. He noted that iteration 60 was the first iteration in which all of the fully allocated cost rates exceeded the FERC Tariff No. 41 rates. *Id*. at p. 1840. At iteration 60, Ganz said, most of the movements on the Mid-America system were discounted (the difference between the fully allocated cost rate and the general commodity rate in FERC Tariff No. 41). *Id*. at p. 1841. Later, he added that all of the rates under FERC Tariff No. 41 were discounted below the fully allocated cost level, and that competition prevented Mid-America from recovering its full cost-of-service. *Id.* at pp. 1850-52.

273. A $65,953,000 cost-of-service for FERC Tariff No. 38, according to Ganz, was used to design fully allocated cost rates. *Id*. at p. 1871. Being further questioned on his iteration methodology, Ganz answered that the percent of volume that was discounted and reflected in the first iteration was 92% of the total volumes for throughput on Mid-America for the Locked-In Period. *Id*. at p. 1874. Ganz claimed that most of the volumes that were not discounted were those coming from the North Pool Holding interconnection. *Id*. at p. 1874. Given the iteration 1 fully allocated cost tariff rates, Ganz admitted that the carrier would have to move costs from 92% of the movements over to eight percent of the movements to recover its full cost of service. *Id.* at p. 1876. In other words, Ganz acknowledged the fact that eight percent of the movements must subsidize 92%. *Id*. at pp. 1876-77.

274. As cross-examination continued, Ganz stated that for the Locked-In Period of May 2005 through April 2006 of FERC Tariff No. 38, he relied on actual costs, actual throughput, and actual revenue. *Id*. at pp. 1898, 1901. When asked to define "normalizing adjustment," Ganz described it as an adjustment to the actual Base Year data. *Id.* at p. 1901. He compared it with a "test period adjustment," which he described

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as an adjustment for known and measurable changes. *Id.*

275. From at least 2001 through December 31, 2005, Ganz maintained, Mid-America charged the East Red Line Shipper the rates determined in their contract. *Id*. at p. 1903. The contract rate was filed subsequently in the FERC tariff. *Id*. Further, he testified that, from the inception of the Channahon to Morris service through December 31, 2005, Mid-America reported the revenue received from the East Red Line Shipper for the Channahon to Morris movement as interstate revenue in its FERC Form 6. *Id.* However, he claimed that, as of late 2005, Mid-America determined that the Channahon to Morris movement should be reflected as intrastate. *Id.* A normalizing adjustment, according to Ganz, was made to the FERC Tariff No. 38 analysis for the Locked-In Period to reduce actual throughput data associated with the East Red Line Shipper's transportation of ethane/propane mix from Conway to Clinton and the return of certain propane volumes from Clinton or Iowa City to Conway. *Id.* at p. 1904.

276. As cross-examination continued, Ganz insisted that the Locked-In Period of May 2005 through April 2006 is not representative of the costs and revenues that Mid-America will experience on a forward-looking basis. *Id.* at pp. 1921-22. On the other hand, Ganz considered his 2006 Test Period to be representative. *Id.* at p. 1922. Furthermore, Ganz said, he removed the East Red Line Shipper incentive reliability payment from Mid-America's cost and revenue analysis because he did not think that the payment was part of the jurisdictional transportation revenue that arose from an agreement between the shipper and carrier, and he did not believe that everything in the agreement was necessarily jurisdictional. *Id*. at p. 1927. Also, Ganz claimed that he rejected the notion that the East Red Line incentive payment is related to specific costs incurred by Mid-America stating that he did not understand that it was required to do anymore than routine maintenance on the pipeline. *Id.* at pp. 1928-29. He did agree that, but for Mid-America's contract with the East Red Line Shipper, it would not receive that payment. *Id.* at p. 1931.

277. The Cochin-to-Conway volume commitment payment, as Ganz said he understood it, requires the East Red Line Shipper to ship 3,650,000 barrels of ethane mix or ethane/propane mix from the Cochin East connection to Conway and to pay a rate of 79.1 cents per barrel whether or not it ships that committed level. *Id.* at pp. 1933, 1935. Moreover, as Ganz noted, the East Red Line Shipper's Cochin-to-Conway volume commitment payments were recorded on Mid-America's FERC Form 6 as incidental revenues. *Id*. at p. 1933. The Cochin-to-Conway volume commitment rate, asserted Ganz, was included in Mid-America's FERC Tariff No. 38. *Id*. at p. 1935. Based on Ganz's interpretation of "past Commission decisions," he eliminated the Cochin-to-Conway volume commitment from Mid-America's jurisdictional cost of service and revenue analysis. *Id*. at pp. 1937-38

278. The 3,650,000 barrels associated with the Cochin-to-Conway volume commitment

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payment for the East Red Line Shipper, reported Ganz, were not included in the Northern System cost and revenue analysis and allocation of costs because no volumes were moved under that provision of the Tariff. *Id*. at pp. 1938-39. Item 350 in both FERC Tariff Nos. 38 and 41, testified Ganz, covered the volume commitment payment from Cochin to Conway. *Id*. at p. 1943.

279. Asked to describe the propane supply assurance program,[158] Ganz replied that it is a transportation service, and the costs that Mid-America has incurred to provide it were related to the purchase of line fill. *Id.* at p. 1958. According to Ganz, line fill is product that Mid-America acquires in a quantity that would be sufficient to fill the pipeline so that it can offer on-demand service and allow a shipper to receive deliveries at the same time that they provide product into the system elsewhere. *Id.* He agreed that line fill facilitates transportation, but said that carriers were not required to provide it. *Id.*

280. The Conway-to-Clinton propane credit associated with the East Red Line Shipper, Ganz went on to say, involves the shipment of ethane/propane mix from Conway to Clinton. *Id.* at p. 1960. He claimed that there are actual costs involved with that movement. *Id.* At Clinton, explained Ganz, the East Red Line Shipper provides a certain amount of propane back to Mid-America, and Mid-America then takes that propane and moves it to Iowa City for storage. *Id.* The East Red Line Shipper, elaborated Ganz, also receives a monetary credit on a barrel-per-barrel basis as it respects the propane volumes that are returned back to Mid-America at Clinton. *Id.* at p. 1961. Additionally, Ganz explained, the East Red Line Shipper may also nominate those volumes for delivery elsewhere or direct Mid-America to deliver those to another shipper's account. *Id.* He said he excluded 2 million barrels from the rate design calculations because the volumes that are held in storage at Iowa City are used to serve propane movements north of it. *Id.* at p. 1965. At some point, contended Ganz, a shipper will nominate volumes from Conway to someplace north of Iowa City and will have to pay the tariff rate for that move.[159] *Id.* Finally, Ganz reported, the costs are allocated to the propane movements that are served from the Iowa City storage, and those movements will look in the

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[158] Later, Ganz described Mid-America's propane supply assurance program, which he said was an on-demand service, as follows: "Mid-America purchased line fill and charges for participating in the program, but with that extra charge, it permits a shipper to inject their [sic] product into the system and simultaneously withdraw it from somewhere else in the same system." Transcript at p. 2293. He added that, but for that service, the shipper would have to wait until the product it injected physically reached its destination. *Id.* at pp. 2293-94.

[159] Ganz claimed that, as Mid-America is being paid for this transportation, the credit to the East Red Line Shipper prevents Mid-America from being paid twice for the same movement. Transcript at p. 1965.

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database like movements from Conway to someplace north of Iowa City. *Id*. at p. 1966. He agreed that this results in more costs being allocated to the non-East Red Line shippers on the Northern System. *Id.*

281. During further cross-examination, Ganz said that Mid-America charges the East Red Line Shipper the same rate from Conway to Clinton and Morris as it does from Channahon to Clinton and Morris. *Id.* at pp. 1982-83. He claimed that the East Red Line Shipper is the only shipper that could possibly use Item 300, given the fact that shippers must have executed the contract prior to March 1, 2004. *Id*. at p. 1985. Volumes transported under Item 300, Ganz stated, were included in his analysis of volumes and revenues. *Id*. at pp. 1985-86. Item 300, he explained, provides for two levels of volume commitment, and the East Red Line Shipper elected the level 1 volume commitment. *Id*. at p. 1986. The East Red Line Shipper, testified Ganz, moved approximately 10.5 million barrels in the March 2006 filing base period (February 2005 through January 2006). *Id*. at p. 1987. Ganz asserted that he used a 74.51 cents per barrel rate pursuant to Item 300. *Id*. at p. 1988. The East Red Line Shipper, claimed Ganz, met its level 1 volume commitment in 2004 and 2005 through interstate and intrastate volumes (from Channahon to Morris). *Id.* at pp. 1989-90. Similarly, Ganz related, the East Red Line Shipper would fail to meet its level 1 volume commitment in 2006 under Mid-America's Illinois Tariff No. 5 were one to focus only on intrastate shipments. *Id*. at pp. 1991-92. For purposes of his analysis, Ganz stressed that the East Red Line Shipper's interstate and intrastate volumes and revenues must be treated completely independently even though it cannot reach the state and federal level 1 volume requirements without the total of both volumes. *Id*. at pp. 1992-94.

282. In response to more questioning, Ganz testified that, after Mid-America's transfer of its storage assets to Enterprise Terminals in September 2004, Mid-America's storage expense went up on average approximately 500%. *Id*. at p. 1998. There was a study conducted, Ganz claimed he understood, to identify the market price for storage services in the Conway area, and based on the results from that study, Mid-America determined a price level it would agree to in an agreement with Williams, through Enterprise Terminals, and other storage facilities. *Id*. at pp. 2001-02. Mid-America, maintained Ganz, the lease payments to Enterprise Terminals on its books as an operating expense, and those lease payments were included in the operating expenses in Ganz's cost of service. *Id*. at p. 2005. Further, he stated that there were no reductions to the storage lease expense in his analyses. *Id*. at p. 2006. Additionally, the lease payments made by Mid-America to Enterprise Terminals for the Greenwood and Iowa City storage assets, he asserted, were not based on the original cost or the costs to the owner of the storage facilities to operate the facilities. *Id*. at pp. 2009-10. Finally, he suggested that the lease payments made by Mid-America to Enterprise Terminals for all of the storage assets were not in any way related to the original cost of those assets. *Id.* at p. 2010.

283. According to Ganz, the Conway storage assets, unlike the Greenwood and Iowa

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City storage assets are integral to the operation of the Mid-America system. *Id*. at pp. 2011-12. He added that "having volumes already staged up north, for example, at Iowa City allows them [sic] to meet the demand for delivering product north of Iowa City that would otherwise go unmet." *Id.* at p. 2012. Amplifying on that thought, Ganz stated:

> As I understand it, there's a limit to how much throughput you can get through the pipe going north out of Conway. And during the peak demand season, there's the nominations for deliveries north of Iowa City, I'll say on the east side of the Northern System, just to focus on the Iowa City storage, that the demand for deliveries north of there exceeds Mid-America's ability to move the barrels there.

Id. at p. 2013. The storage facilities, contended Ganz, enhance the efficiency of the system by allowing Mid-America to meet its peak needs. *Id*. at pp. 2018-20.

284. The revenues from the East Red Line Shipper, reported Ganz, exceeded the variable costs associated with providing service to East Red Line Shipper. *Id.* at p. 2023. He added that, if the revenues did not exceed those costs, it would be an example of cross-subsidization.[160] *Id.* at p. 2024. Further, Ganz testified, referring to Exhibit Nos. M-124 and M-126, the interstate volumes shipped by the East Red Line Shipper generated revenues of approximately $7.5-$8 million which exceeded Mid-America's variable cost of providing that transportation. *Id.* at pp. 2027-28. Ganz claimed that he did not include the incentive reliability payment or the Cochin-to-Conway volume commitment payment. *Id*. at p. 2028.

285. In developing the direct labor Kansas-Nebraska factor, Ganz explained that he got the direct labor figure from the general ledger in the operating expense work papers and database that was provided to all of the parties in the proceeding. *Id*. at p. 2031. Specifically, Ganz reviewed all of the costs in the general ledger seeking the operating expense accounts mapped to FERC Account 300. *Id*. at p. 2032. The Rocky Mountain direct labor costs previously recorded to Account 84001, Ganz pointed out, are now being recorded in Account 80099. *Id.* at p. 2034.

286. As cross-examination continued, Ganz noted that his Kansas-Nebraska formula allocated common costs incurred at the Conway cost center between the Central and the Northern Systems. *Id*. at pp. 2051-53. Specifically, he reported, for the Test Period, 35.9% was allocated to the Central System, and 64.1% was allocated to the Northern System. *Id*. at p. 2052. The Northern System, he went on to say, received 64% of the

[160] Earlier, Ganz stated that cross-subsidization occurs if the tariff for a movement does not cover its variable costs. Transcript at p. 1981.

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Conway area costs under his formula. *Id*. at pp. 2059-60. Pipeline integrity costs, Ganz stated, are included in the Conway area cost center. *Id*. Additionally, he related, the total Northern System costs are then allocated to interstate and intrastate transportation services based on barrel-miles. *Id*. at p. 2060. The transportation volumes on the Conway to Coffeyville line, he clarified, are classified as intrastate volumes. *Id*. Ganz added, the interstate percentage for the Northern System was 98.5%. *Id.* at p. 2063. According to Ganz, he allocated 98% of the Conway-to-Coffeyville in the Bushton lateral transportation and pipeline integrity costs to the Northern System interstate portion, along with 98.5% of all of the other costs incurred on the Northern System. *Id.* Furthermore, he testified, 2% of the Conway-to-Coffeyville transportation costs and pipeline integrity costs associated with the Bushton lateral and the Coffeyville-to-Conway lateral went to intrastate movements, along with 1.5% of all of the other costs incurred on the Northern System. *Id*. at pp. 2063-64. Further, Ganz stated, the 64% of the Conway area costs allocated to the Northern System were not allocated back to the actual Conway-to-Coffeyville lateral. *Id*. at p. 2064.

287. Under further cross-examination, Ganz agreed that both he and O'Loughlin included the direct cost of operating the ammonia line and the offsetting payment from Magellan in operating expense accounts. *Id*. at p. 2066. In addition, Ganz further agreed that both he and O'Loughlin considered that the Magellan ammonia payments completely offset the direct costs of operating the ammonia line. *Id*. Ganz also indicated that, because the payments from Magellan completely offset the costs of operating the ammonia pipeline, it was appropriate to leave both in the operating expense database since they cancel each other out and leave only the expenses related to the natural gas liquid system. *Id.* at pp. 2066-67.

288. Ganz stated that, in his view, "the proper evaluation for this proceeding should be done on a segmented basis," and that directly assigning costs on each system where possible is appropriate. *Id.* at pp. 2113-14.

289. According to Ganz, EPCO, Inc., is the entity which employs all of the people who perform work for Enterprise Product Partners. *Id.* at 2152. With respect to Mid-America, Ganz continued, if an EPCO, Inc., employee is assigned to Mid-America as a home company, his or her cost would be considered as direct labor. *Id*. Moreover, if an employee is not assigned to Mid-America as a home company, but performs work for it, that person's work would be considered internal labor and be recorded to FERC Account 320 as an outside service. *Id*. at p. 2152. He later added that, within each home company, the person would be assigned to a home cost center. *Id.* at pp. 2154-55. The Kansas-Nebraska formula, agreed Ganz, should be used in this proceeding only to allocate costs which cannot be directly assigned to a particular system's cost center. *Id*. at pp. 2152-53.

290. If the Northern System cannot recover its fully allocated cost due to discounting,

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Ganz admitted, those costs must be recovered from the other two Mid-America segments if Mid-America is to operate at a profit and not a loss. *Id.* at pp. 2178-79.

291. The Locked-In Period in FERC Tariff No. 38, stated Ganz, was a 12-month period from May 2005 to April 2006. *Id*. at p. 2187. He also said that, with adjustments, one could use a 13-month, 11-month, or a 21-month period as well.[161] *Id.* at pp. 2187-88. With respect to FERC Tariff No. 38, he continued, the end of the adjustment period was September 30, 2005, and the Locked-In Period extended seven months past the end of the adjustment period. *Id*. at p. 2191. During that seven-month period, he reported, Mid-America's costs increased, and its volumes decreased compared to the prior years' costs. *Id*. at pp. 2191-92. The cost-of-service for the Locked-In Period for the Northern System was approximately $66 million. *Id*. at p. 2193. Furthermore, he went on to say, the cost of service for the 2004 Base Year, including adjustments that reduced expenses, was approximately $54.5 million, or about $11.5 million less than the Locked-In Period. *Id*. at p. 2194.

292. When asked to define "common costs," Ganz answered that they are costs that relate to more than one type of service or more than one system. *Id.* at p. 2204. As examples, he pointed to Conway which is used by both the Northern and Central Systems, and Hobbs which serves both the Central and Rocky Mountain Systems. *Id.* In those instances, Ganz said, costs were allocated between the two Systems using the services; total company common costs, which also could be referred to as "indirect costs," he added, were allocated between the three Systems. *Id.* at pp. 2204-05. Additionally, he explained, "indirect costs" would be costs not directly assignable to a particular segment of the pipeline. *Id.* at p. 2205. Ganz explained that he used the Kansas-Nebraska formula[162] to allocate common costs. *Id.* at p. 2206. Direct labor and gross property, according to Ganz, were used to develop the Kansas-Nebraska formula. *Id*. at p. 2208.

293. Turning to issues regarding the East Red Line Shipper, Ganz claimed that, if a shipper other than the East Red Line Shipper shipped propane from Conway to a destination point north of Iowa City, and the propane that was actually delivered at that

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[161] Ganz also said that he believed that a locked-in period which contained two peak demand seasons, *i.e.*, two winters, and only one summer, could be used provided that a study was performed to determine how that influenced the "numbers and the nature of the results that you're measuring." Transcript at p. 2188.

[162] Ganz described the purpose of the Kansas-Nebraska formula as follows: "[It] is used to allocate common costs within a regulated entity so that you can attribute portions of indirect or common costs to portions of a system or different services provided within a system." Transcript at p. 2206.

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destination point came out of storage at Iowa City, Mid-America, while it would incur costs when it moved the ethane/propane mix up to Clinton, it would not incur costs to "move" the barrels of propane from Conway to Iowa City. *Id*. at pp. 2210-11. However, he said, even though there were no costs to make that "move" since the product was stored at Iowa City, the rates charged to that shipper included some distance-based costs from Conway to Iowa City.[163] *Id.* at p. 2211. Ganz claimed that the charge accounted for the costs that were incurred when the volumes moved in the ethane/propane stream.[164] *Id*.

294. The East Red Line Shipper's pumps at Clinton, explained Ganz, provide the power to move barrels tendered at Clinton into storage at Iowa City, and thus, Mid-America incurs no variable costs for that movement. *Id*. at p. 2212. Continuing, he testified that there are fixed costs, depreciation, right-of-way costs, insurance, property tax, and regular repair maintenance costs incurred by Mid-America to move product that is tendered by the East Red Line Shipper at Clinton and moved by the pipeline to Iowa City. *Id.* at pp. 2234-36.

295. Ganz contended that the East Red Line Shipper makes reliability incentive payments under the contract between it and Mid-America. *Id*. at p. 2242. Yet that provision of the contract, noted Ganz, is not included in Mid-America's tariff. *Id*.

296. On re-direct examination, Ganz claimed that the Kinder Morgan Pipeline provides competition with Mid-America's East Red Line and has a tariff for movements of natural gas liquids. *Id.* at pp. 2250-51.

297. Further, Ganz explained, there were three reasons for the difference between the $8 million in storage and demurrage revenue on Mid-America's FERC Form 6 for the calendar year 2006 and the $2 million in storage revenues credited in Mid-America's FERC Tariff No. 41 cost-of-service calculations: (1) the Form 6 included a charge for off-spec product, which was a one-time charge that was incurred to remedy a situation with some product that did not meet specifications; (2) the Form 6 figure included three

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[163] Ganz also noted that, under the Mid-America/East Red Line Shipper contract, the East Red Line Shipper receives a credit related to the "movement" of propane from Clinton to Conway. Transcript at p. 2216. As explained by him, should the East Red Line Shipper ship 1,000 barrels of ethane/propane mix from Conway to Clinton, and return 100 barrels of propane previously stored in Iowa City, it would receive a credit of 100 barrels of propane at Conway and only be charged for moving 900 barrels of ethane/propane mix from Conway to Clinton. *Id.* at pp. 2245-49.

[164] The movement in the ethane/propane stream was accomplished pursuant to contract Mid-America had with the East Red Line Shipper. Transcript at pp. 2245.

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quarters of the year's increased merchant storage rates; and (3) the storage and demurrage revenue in the Form 6 figure included the revenue from the propane supply assurance program. *Id*. at pp. 2251-53.

298. As re-direct examination continued, Ganz stated that Mid-America Account 80210 was not included in the salaries and wages calculation for the Kansas-Nebraska calculation because it consisted of internal labor costs — the salaries and wages of individuals who were employed by EPCO, Inc., but were assigned to a home company other than Mid-America. *Id*. at p. 2254. Account 84001, Ganz said, consists of payroll costs for individuals whose home company is Mid-America and who have been working on specific projects on the Rocky Mountain System. *Id*. at pp. 2254-55. According to him, by including the Account 84001 amounts as part of direct payroll, the payroll percentage of the Rocky Mountain System increased, and the payroll percentage for the Central and Northern Systems decreased.[165] *Id*. at p. 2255. Overall, according to Ganz, the inclusion increased the Kansas-Nebraska allocation percentages for the Rocky Mountain System and reduced the allocation percentage for the Northern System. *Id*.

299. After discussing, in general, the iterative process, Ganz indicated that Mid-America offered the East Red Line Shipper a discount in order to get its business during a time when Mid-America was "seeking to retain and expand" its business. *Id.* at p. 2276. He opined that, had it failed to do so, Mid-America would have lost all of the East Red Line Shipper's business. *Id.* However, he admitted, the result of giving the East Red Line Shipper a discount was to raise the rate for other movements on the Northern System. *Id.*

300. Ganz, during further examination, maintained that all the shippers on the Northern System are paying the seasonal discount rate, which is less than the fully allocated cost of service, but were not receiving the same discount which the East Red Line Shipper receives. *Id*. at pp. 2289-90. He agreed that, as a result, the Northern System is operating at a loss, *i.e.*, is not recovering its full cost-of-service.[166] *Id*. at p. 2290. When questioned further, he claimed that there are no costs associated with the Mid-America incentive reliability payments, and he testified that he did not include the reliability incentive payments in his calculations. *Id*. at pp. 2302-03.

[165] Ganz distinguished Account 84001 from Account 80210 stating that the latter is used for the salaries and wages of persons employed by EPCO, Inc., but who are assigned to a home company other than Mid-America and that when any of these people provide services to Mid-America the cost would be recorded in that Account. *Id.* at p. 2254.

[166] Ganz later suggested that Mid-America's Central System also was not recovering it full cost of service. Transcript at p. 2292.

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301. Under further cross-examination, Ganz reported that he and O'Loughlin used a different level of pipeline integrity costs, storage costs, and taxes, and applied the Kansas-Nebraska allocation formula differently. *Id.* at pp. 2322-23. Ganz stated that he attributed 1.8% of the costs of operating the system to intrastate shipments. *Id.* at p. 2329.

302. On re-direct examination, Ganz testified again that all of the barrel-miles that moved on the Northern System, 1.8%, could be specifically attributable to intrastate movements. *Id.* at p. 2362. In particular, Ganz explained, he calculated the total intrastate cost-of-service by multiplying the 1.8% by the total cost of service. *Id.* According to Ganz, he did not include the revenues and volumes attributable to intrastate movements in his presentation. *Id.* at pp. 2363-64.

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303. O'Loughlin is a Principal at the economic and management consulting firm, The Brattle Group, who testified on behalf of the Propane Group, which consists of past, current, and future shippers and consumers of propane on Mid-America's Northern System. Exhibit No. NPG-1 at pp. 1, 3. According to him, Mid-America has overstated its Northern System costs and understated the System's revenues for the 2005 Test Year, the May 2006 Locked-In Period, and the 2006 Test Year. *Id.* at p. 8. He accused Mid-America of "faulty cost allocation, failure to normalize non-recurring costs to be representative of recurring levels, misclassification of revenue, deliberate exclusion of revenue, and a lack of rational rate design." *Id.*

304. O'Loughlin testified that Enterprise Product Partners purchased Mid-America for a sum substantially greater than its net book value in 2005, and also that it was underearning. *Id.* at p. 10. He suggested that the pipeline's 2005 rate increase did not include increases for "several high volume paths," but rather was confined to the Northern System. *Id.* at pp. 10-11. Additionally, he asserted, Mid-America's 2006 rate increase reflected a decreased cost-of-service[167] over the previous year and a rate increase for the Northern System of 60% over the 2005 rate and 97% over the 2004 rate. *Id.* at p. 11. In contrast with this Northern System rate increase, O'Loughlin claimed that, since early 2005, Mid-America has reduced rates on the Rocky Mountain System. *Id.* at p. 15. Furthermore, he declared that Mid-America failed to include the revenues received from the East Red Line Shipper in its Northern System cost of service. *Id.* at p. 12. Lastly, according to O'Loughlin, Mid-America included the costs of its operation of the

[167] O'Loughlin noted that, according to Mid-America's own calculations, the company's total company costs-of-service declined by 14%, from $277 million in its 2005 filing to $239 million in its 2006 filing. Exhibit No. NPG-1 at p. 16.

Magellan ammonia pipeline in determining the allocation of indirect costs resulting in an overstatement of the allocation to the Northern System. *Id.*

305. Mid-America, in its own business records, described the March 31, 2006, tariff filing as an exercise designed to raise the Northern System rates to their maximum levels, so that Mid-America could have the ability to charge higher rates in the future without the need to provide support regarding the justness of these rates, contended O'Loughlin. *Id*. at pp. 18-19. He testified that this strategy would permit future rate increases with no additional cost-of-service filing or negotiated rates. *Id*. at pp. 19-20. Mid-America, as he pointed out, concurrently filed for incentive rates so that Mid-America shippers would not immediately be subjected to this maximum rate ceiling. *Id*. at p. 20. Additionally, O'Loughlin claimed that the targeted increases to Mid-America's Northern System are important to Enterprise Products Partners in order to keep the rates on the Rocky Mountain System lower. *Id*. The Rocky Mountain basin is one of the fastest growing natural gas basins in the nation, and O'Loughlin contended that Enterprise Products Partners believes that the gas production in this region will expand by 33% between 2005 and 2010. *Id.* at p. 22. In a presentation to investment analysts, O'Loughlin claimed, Enterprise Products Partners revealed that access to natural gas and natural gas liquid production growth in the Rocky Mountains was driving the company's expansion strategies for both its regulated and unregulated business. *Id.*[168]

306. Continuing, O'Loughlin stated that Mid-America anticipates a large volume growth through its Rocky Mountain System into Hobbs, estimating an increase from 200,000 barrels in 2006 to 350,000 barrels in 2010. *Id.* at p. 24.[169] Unlike the increased rates proposed for the Northern System, he contended that Mid-America has reduced a number of Rocky Mountain rates, particularly those flowing to Hobbs and Mont Belvieu, up to 42%. *Id.* at pp. 25-26.[170] Additionally, O'Loughlin stated that Mid-America instituted an incentive program, Item 330 of FERC Tariff No. 42, which fixed reduced Rocky Mountain System rates for a period of ten to twenty years if shippers were to agree to ship all Rocky Mountain volumes with Mid-America. *Id*. at p. 26. Mid-America has been very successful in signing shippers to these long-term incentive contracts, reported O'Loughlin. *Id*. at p. 27.[171]

307. FERC Tariff No. 38 was filed on March 31, 2005, O'Loughlin stated, and it

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[168] In support, O'Loughlin cited Exhibit No. NPG-10.

[169] In support, O'Loughlin referred to Exhibit No. NPG-1 at p. 25 fig.6.

[170] In support, O'Loughlin referred to Exhibit No. NPG-1 at p. 26 tbl.4.

[171] In support, O'Loughlin referred to Exhibit No. NPG-1 at p. 27 tbl.5.

proposed rate increases based on a total company cost of service, with 2004 Base Year and Test Period adjustments for the first nine months of 2005. *Id*. at p. 28. O'Loughlin continued, Mid-America is no longer using these Base and Test Year Periods, he noted, to justify the increases contained in FERC Tariff No. 38, but instead is relying on data from May 1, 2005, through April 30, 2006, the Locked-In Period. *Id*. The Locked-In Period, in his opinion, should not be used to determine whether the rates proposed in FERC Tariff No. 38 are just and reasonable. *Id*. at p. 9. Instead, O'Loughlin proposed following the Commission's policy of applying a 12-month base period with known and measurable adjustments through the nine months following the end of the base period because using a test period develops forward-looking rates, and forward-looking rates are not the result of relying on locked-in period data. *Id*.

308. Mid-America, O'Loughlin stated, made a number of errors in its cost-of-service calculations. *Id*. at pp. 31-32. First, he claimed that Mid-America overstated the Northern System 2006 Test Year cost of service by inappropriately assigning indirect expenses to that system. *Id*. at p. 32. Specifically, he noted, Mid-America incorrectly calculated direct labor expense figures that were later used in allocating indirect expenses. *Id*. Of the $119 million in total company operating expenses being claimed by Mid-America, continued O'Loughlin, indirect expenses represent $47 million. *Id*.

309. Although O'Loughlin said he agreed with Mid-America's use of a Kansas-Nebraska allocation factor, he took issue with the company's derivation of direct labor expense. *Id*. at p. 33. He stated that, although the Rocky Mountain System represents 63% of Mid-America's gross property, plant and equipment, 44% of its volume, and 64% of its revenue, while the Northern System represents 21% of its gross property, plant and equipment, 25% of its volume, and 24% of its revenue,[172] Mid-America proposes to allocate only 37% of its indirect costs to the Rocky Mountain System and 42% to its Northern System. *Id.* at pp. 33-34.

310. To calculate a Kansas-Nebraska allocation factor, O'Loughlin testified, Mid-America determines a percentage of gross property, plant, and equipment for a single system as compared to the total of all three systems. *Id.* at p. 35. Next, he stated that Mid-America calculates the same percentage using each system's direct labor expense. *Id*. The Kansas-Nebraska factor, he explained, is the simple average of these two percentages. *Id*. According to O'Loughlin, Mid-America calculated that the Northern System had 63.2% of the direct labor expense, while the Rocky Mountain System only had 11.2% even though the Rocky Mountain System had 63.4% of Mid-America's gross property, plant, and equipment. *Id*. at pp. 35-36.[173] This indicates,

[172] In support, O'Loughlin referred to Exhibit No. NPG-1 at p. 34 tbl.6.

[173] In support, O'Loughlin referred to Exhibit No. NPG-1 at p. 35 tbl.7.

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he claimed, that Mid-America skewed the allocation of indirect expenses to the Northern System. *Id*. at p. 37. For every $1 of direct labor expense, O'Loughlin stated, $9 in indirect expenses was allocated.[174] *Id*. at p. 38. The direct labor expenses used in the Kansas-Nebraska allocation factor were relatively small, and therefore, he suggested, small changes in the amount of direct labor expense attributed to one of the three systems can result in large swings in the Kansas-Nebraska allocation factors and the resulting amount of indirect expense allocated to a specific system. *Id.* at pp. 39-40. After "correcting" for his perceived errors, O'Loughlin testified he reduced the Northern System percent of total labor expense to 38% in the 2005 Test Year and 40% in the 2006 Test Year. *Id.* at p. 56.

311. There are two problems, O'Loughlin argued, with Mid-America's treatment of storage expenses in its cost-of-service presentations: first, Mid-America sought to evade cost-based regulation of storage operations through a non-arms-length transfer/sale of its storage facilities to its unregulated affiliate, Enterprise Terminal, and Enterprise Terminals' subsequent lease back to Mid-America of storage services at well above original cost-based levels; and second, Mid-America inconsistently included the expenses associated with storage in its cost-of-service, but excluded all revenues received from storage operations from the cost-of-service and revenue comparisons presented in its testimony. *Id.* at p. 57, 61.

312. During most of 2004 (and prior years), O'Loughlin pointed out, Mid-America owned storage assets at "Hobbs, New Mexico",[175] Mocane, Oklahoma, Conway, Kansas, Iowa City, Iowa, Greenwood, Nebraska, and Pine Bend, Minnesota, incurred associated operating costs, and included the assets in its carrier property, except for the Conway facility. *Id.* at p. 57. In September 2004, he continued, Mid-America transferred its Hobbs, Iowa City, Greenwood, and Mocane storage assets to its unregulated affiliate, Enterprise Terminals, and subsequently began renting the storage facilities for a fixed fee from it. *Id.* at p. 58. Additionally, he testified, Enterprise Terminals leased the Conway storage to Mid-America in a separate lease agreement. *Id.* Mid-America, according to O'Loughlin, uses the storage facilities at Iowa City, Greenwood, and Mocane to provide an operational storage service without charging a separate storage fee. *Id.* O'Loughlin

[174] O'Loughlin gave three reasons why he believed that the direct labor expenses were not correct: (1) Inclusion of the direct labor expenses related to the operation of the Magellan ammonia pipeline in the Northern and Central systems expenses;
(2) Mid-America employees are being used to do work on the Enterprise Terminals terminals located on the Northern System; and (3) failure to include expenses on all related FERC account numbers. Exhibit No. NPG-1 at pp. 37, 41-56.

[175] *See* n.19, *supra*.

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also testified that Mid-America offers an Earned Storage[176] service to its customers at Conway and Hobbs free of charge, and it offers an enhanced Earned Storage service at Conway. *Id.* at p. 59. Moreover, Mid-America, he stated, also retains the right to lease capacity to customers for a fee at Hobbs under a service called Holding Storage, and provides and charges for a fifth storage service at Pine Bend. *Id.* The Conway, Hobbs, and Pine Bend storage services for which Mid-America charges a fee are not subject to tariff, as he explained that Mid-America claims each "is [] an additional service offered for the convenience of shippers," and furthermore are "not FERC jurisdictional." *Id.*[177]

313. Although Mid-America charges a fee for three of its storage services and no fee for two of its services, O'Loughlin stated that Mid-America does not attempt to segregate its costs associated with the storage services for which it charges a fee and the ones it provides for free. *Id.* at pp. 59-60. He also emphasized that Mid-America included all of the costs associated with all of its storage services in the costs of service it had prepared for the instant proceeding. *Id.* at p. 59. Mid-America's proposed storage expenses, he asserted, should be excluded from calculations of a cost-of-service to establish just and reasonable rates for Mid-America's transportation service for the following reasons: (1) the asserted costs of service are neither based on the original cost of the assets nor the underlying cost to operate the assets; and (2) the exclusion of storage expenses is consistent with Mid-America's exclusion of storage revenues from storage operations in the analysis presented in its testimony. *Id.*

314. The contract between Enterprise Terminals and Mid-America, wherein Mid-America promised to lease storage assets back from Enterprise Terminals for a fee, was made retroactive, and consequently, O'Loughlin contended, Mid-America effectively began paying Enterprise Terminals the lease price on July 1, 2004, while it still owned the Hobbs, Greenwood, Iowa City, and Mocane storage assets. *Id.* at pp. 60-61. Additionally, he testified that new contracts were made annually. *Id.* at p. 61.

315. O'Loughlin claimed that the lease price was not based on the original cost of the storage assets that were transferred or the actual cost to operate the storage assets. *Id.* at p. 63. Rather, he argued, the lease price reflected a rudimentary market-based rate, although no market power measures were analyzed. *Id.* at p. 64. Additionally, subjective allocations of select employees' salaries and benefits, O'Loughlin asserted, were made to Enterprise Terminals, while leaving much of the expenses associated with the employees' salaries and benefits as a Mid-America expense. *Id.* at pp. 64-65. In sum, he contended,

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[176] The Earned Storage service ties the amount of storage made available to a customer to that customer's most recent twelve months of deliveries. Exhibit No. NPG-1 at p. 59.

[177] In support, O'Loughlin referred to Exhibit No. NPG-29.

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not only has Mid-America managed to transfer assets from it to a non-regulated affiliate, but it also managed, by paying Enterprise Terminals well above cost-based levels for the storage facilities in its lease arrangement, to include a storage expense in its transportation cost of service which is considerably above its original cost. *Id.* at p. 65.

316. Mid-America misrepresented its transfer of storage assets to Enterprise Terminals,[178] O'Loughlin claimed. *Id.* at p. 66. The storage assets, according to O'Loughlin, have been sitting in Mid-America's property accounts for quite some time and were not transferred there from Williams Mid-Stream just prior to the sale of Mid-America to Enterprise Terminals. *Id.* at p. 67. The evidence, while incomplete, he argued, is consistent with the notion that the storage assets were included in the Mid-America property records that underlie its 2001 FERC Form 6 year-end carrier property balances, *i.e.*, the assets were sitting in Mid-America well before the sale of Mid-America to Enterprise Terminals. *Id.* at p. 67.[179] Moreover, O'Loughlin said he opposed Mid-America's suggestion that Williams erroneously transferred the storage assets from Williams Mid-Stream, pointing out that Enterprise Products Partners waited until late 2004 to transfer the storage assets to its unregulated affiliate and then developed contracts between Enterprise Terminals and Mid-America. *Id.* at p. 69. He further testified that the lease price Mid-America pays Enterprise Terminals for the Conway storage facilities is the price Enterprise Terminals pays Williams for leasing the storage. *Id.* at pp. 70-71. This pass-through arrangement, O'Loughlin noted, is only applicable to the Conway storage facilities — the storage facilities at Greenwood, Iowa City, Mocane, and Hobbs were transferred to Enterprise Terminals from Mid-America and then leased back to Mid-America based on the rudimentary market price analysis. *Id.* at p. 71.

317. The significant increase in storage expenses between the 2005 Test Year and the other later periods, stated O'Loughlin, was a direct result of increased lease payments by Mid-America to its unregulated affiliate, Enterprise Terminals. *Id.* at p. 73. Furthermore, he claimed that, while Mid-America included 100% of the expenses related to storage service in its cost of service, it did not include any of its storage revenues as an offset to expenses. *Id.* For example, he explained, Mid-America did not include storage revenue (charging its customers at Conway $1.20 per barrel) in its cost-of-service or revenue calculations reported in its testimony, because Mid-America did not consider the storage revenue to be FERC jurisdictional. *Id.* at p. 73.

318. O'Loughlin excluded Mid-America's storage expenses from his cost-of-service

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[178] Mid-America asserted that the storage assets should not have been in Mid-America to begin with and attributes it to an accounting snafu that occurred when Enterprise bought the assets from Williams. Exhibit No. NPG-1 at p. 66.

[179] In support, O'Loughlin referred to Exhibit No. NPG-1 at p. 68 tbl.14.

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calculations, he explained, because there was no evidence that the rates in the storage lease contracts were in any way related to the underlying cost of providing storage services or in any way connected to the original cost of the assets. *Id.* at p. 74. Moreover, he suggested that Mid-America is not segregating the expenses for necessary storage, which may be considered an integral part of transportation, and unnecessary storage. *Id.* In his view, he declared, the storage lease payments from Mid-America to Enterprise Terminals appear to be an attempt to shift costs to the regulated entity, Mid-America, to increase its regulatory cost-of-service, and in turn, shift profits to the unregulated affiliate, Enterprise Terminals. *Id.* at p. 75. At a minimum, O'Loughlin argued, should Mid-America be permitted to include a cost-based level of storage expenses in its transportation cost of service, storage revenues associated with the same storage facilities should be factored into the analysis as a revenue credit, and therefore, only net storage expenses should be allocated to transportation rates. *Id.* at p. 75.

319. Mid-America witness Williamson erred, claimed O'Loughlin, in his calculations regarding Mid-America's return on equity.[180] *Id.* at pp. 75-76. According to him, Williamson errs in three ways:[181] (1) Williamson ignored the fact that a publicly traded master limited partnership's distribution is not the same as a dividend, and thus, a distribution yield is not the same as a dividend yield in the discounted cash flow formula; (2) Williamson excluded the Social Security Administration's long-term GDP forecast from his growth calculation; and (3) Williamson understated the inflation rate to be deducted from the nominal return on equity in deriving the real return on equity. *Id.* at p. 76. Specifically, O'Loughlin explained that, because Williamson's equity estimate is for the May 31, 2006, period, his inflation rate should correspond to the same period, but instead he used a lower inflation rate for the 12-months ending December 31, 2005. *Id.* at p. 77. O'Loughlin criticized Williamson's mechanical application of the Commission's standard discounted cash flow methodology to oil pipeline master limited partnerships — without adjustment — and use of the median figures that result from his proxy group. *Id.* at p. 77. To treat a master limited partnership's distribution as though it were a dividend when the evidence indicates that a substantial portion of the distribution is not from earnings is inappropriate, O'Loughlin insisted. *Id.* at p. 80. Williamson's use of a discounted cash flow analysis based on master limited partnership distributions, in

[180] According to O'Loughlin, Williamson calculated Mid-America's return on equity, as of May 31, 2006, to be 13.21%. Exhibit No. NPG-1 at p. 75. O'Loughlin continued, Williamson then "inexplicably" deducted calendar year 2005 inflation, 3.42%, to derive his real return on equity recommendation of 9.79%. *Id.* *See* Exhibit Nos. M-17 at p. 2; M-19.

[181] O'Loughlin also suggested that Williamson ignored the nominal and real return on equity figures contained in Mid-America's March 31, 2005, and March 31, 2006, Tariff filings. Exhibit No. NPG-1 at p. 76.

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this proceeding, without any adjustment, claimed O'Loughlin, resulted in an overstatement of the estimated return on equity. *Id.* at p. 81.

320. Unlike Williamson, O'Loughlin asserted that a significant portion of a master limited partnership's distribution is a return on capital if it exceeds income since a portion of that money must come from a non-cash expense such as depreciation. *Id.* at p. 83. Cash distributions that exceed earnings, in his view, O'Loughlin stated, make it inappropriate to use the distribution yield in place of the dividend yield (as Williamson does) in the discounted cash flow methodology calculation. *Id.* at p. 84. On one hand, he added, when cash flow from both net income and depreciation are paid out to investors (in the case of master limited partnerships) through a distribution and are not reinvested in the utility plant, the rate base declines and, subsequently, earnings decline; on the other hand, when the cash flow associated with depreciation is fully reinvested in the utility plant, and no earnings are retained, the rate base remains unchanged. *Id.* at pp. 85-87.

321. Although O'Loughlin said he had not done a formal analysis of Mid-America's risk relative to other oil pipelines or to the proxy group used by the Commission in its ruling in *Kern River Gas Transmission Co.*,[182] he suggested that, when compared with other oil pipelines, Mid-America is of lower than average risk for the following reasons: first, Mid-America has no market-based rates under Commission regulation and has not been able to establish that any of its routes face sufficient competition to warrant it; and second, Mid-America is attempting to push through large percentage rate increases (which effectively double rates on the Northern System) without concern for loss of load or bypass. *Id.*

322. After describing three alternatives to Williamson's approach,[183] for the 2006 Test Year, O'Loughlin stated that the nominal return on equity from the three range from a low of 10.22% to a high of 11.46%. *Id.* at p. 98. He recommended using the simple average of the three methods, 10.83%, which he used in his 2006 Test Year cost-of-service. *Id.* His calculations for the 2005 Test Year and the May 2006 Locked-In Period costs of service, he testified, is 11.13%. *Id.*[184] O'Loughlin recommended a real return on equity for the 2006 Test Year of 6.51%. *Id.*[185] This figure, he explained, equals the nominal return on equity of 10.83%, less the inflation rate for the corresponding 12-

[182] 117 FERC ¶ 61,077 (2006).

[183] The three alternatives are described at length by O'Loughlin in Exhibit No. NPG-1 at pp. 89-96, and will not be detailed here.

[184] In support, O'Loughlin referred to Exhibit No. NPG-61.

[185] In support, O'Loughlin referred to Exhibit No. NPG-1 at p. 99 tbl.24.

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months ending June 2006, 4.32%. *Id.* He also said that he calculated the year-end 2004 real rate of return on equity to be 7.87%, which equals the nominal return of 11.13%, less the 2004 inflation rate of 3.26%. *Id.*

323. O'Loughlin also complained about Williamson's use of Mid-America's FERC Form 6 capital structure in calculating the deferred return component of rate base for the 1987 to 2001 period. *Id.* at p. 99. He claimed that Mid-America overstated the equity component of the capital structure on those forms, which resulted in an inflated deferred equity return. *Id.* According to him, use of Mid-America's capital structure failed to meet Commission policy because its parent appeared to be in control of its finances during that period and because the substantial decrease in Mid-America's capital structure during that period was unreasonable.[186] *Id.* at pp. 101-05.

324. Mid-America claimed to have complied with Commission policy in calculating the income tax allowance in its cost of service filings, O'Loughlin stated.[187] *Id.* at p. 105. Referring to the Mid-America exhibit, he described in detail the six steps which it followed to calculate that a weighted Total Company state and federal income tax rates is 31.51%, and a Northern System state and federal income tax rates is 32.37% for the purpose of determining Income Tax Allowances in its cost-of-service calculations for the May 2006 Locked-In Period and the 2006 Test Year. *Id.* at pp. 105-106. Accusing Mid-America of erring in making its calculations, O'Loughlin noted that neither Mid-America nor Enterprise Products Partners pays income taxes as they are "pass-through" entities.[188]

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[186] O'Loughlin cited to *Transcontinental Gas Pipe Line Corp.*, 84 FERC ¶ 61,084 (1998), in support. Exhibit No. NPG-1 at p. 100. There, he asserted, the Commission explained its two prong alternative test, originally announced by it in *West Virginia Gas Co.*, 2 FERC ¶ 61,139 (1978), for invalidating the use of a company's own capital structure should either of the following circumstances exist: (1) if its financing is controlled by another entity, such as a corporate parent; or (2) if the pipeline's capital structure doesn't reflect its operating risk. Exhibit No. NPG-1 at p. 100.

[187] With regard to the Commission's announcement of its policy in this regard, O'Loughlin cited to *Policy Statement on Income Tax Allowances*, 111 FERC ¶ 61,139 (2005). *See also SFPP, L.P.*, 113 FERC ¶ 61,277 at P 10-47.

[188] O'Loughlin stated:

> The rationale for an income tax allowance is that a regulated company subject to income taxes should be provided with an income tax allowance in its cost of service in order to permit the entity the opportunity to recover its allowed rate of return after it pays income taxes. . . . Mid-America is not subject to income taxes. No income tax allowance is needed in order for Mid-America to recover its allowed return and pass the same on[to] its

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Id. at pp. 106-08.

325. Applying the Commission's policy on income tax allowances, O'Loughlin calculated a weighted average federal income tax rate of 4.74% for the owners of Mid-America for the 2004 calendar year, and a weighted average federal income tax rate of 5.20% for the 2005 calendar year.[189] *Id.* at p. 112. O'Loughlin said he used the ownership percentages and tax rate assumptions[190] for the various types of entities (individuals, corporations, unrelated business taxable income entities, etc.) underlying Mid-America's ownership structure. *Id.* Using the ownership percentages as weights, O'Loughlin stated, he developed the weighted average income tax rate across the various classes of entities. *Id.*

326. O'Loughlin criticized Mid-America's attempts to use hypothetical income allocations as the weights for its proposed weighted income tax rate. *Id.* at p. 116. Mid-America's use of taxable income allocations as the measure for deriving weights, contended O'Loughlin, makes no sense, and moreover, it incorrectly implemented the calculation by: (1) using taxable income from Mid-America instead of Enterprise Products Partners; and (2) making an inappropriate adjustment for incentive distributions. *Id.* Ownership proportions, in his view, are the most objective and fair weights to use in developing an appropriately weighted or blended income tax rate. *Id.* Furthermore, O'Loughlin claimed, the use of taxable income to develop weights is illogical when some or all of the partners are allocated zero or negative taxable income. *Id.* at p. 118. However, negative weights based on the allocation of taxable income, according to him, are a realistic possibility. *Id.* at p. 119.[191] Mid-America failed to use the appropriate entity's purported taxable income in developing income tax weights in its cost-of-service calculations, O'Loughlin continued, because it attempted to hypothetically trace its own taxable income instead of Enterprise Products Partners' taxable income to Enterprise Products Partners' partners in each ownership group. *Id.*

327. Had Mid-America used Enterprise Products Partners' taxable income in its

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owners.

Exhibit No. NPG-1 at p. 108.

[189] However, O'Loughlin suggested, citing to an Initial Decision, *SFPP, L.P.,* 116 FERC ¶ 63,059 at P 120 (2006), that the policy may not be responsive to the Circuit Court decision to which it was intended to respond. Exhibit No. NPG-1 at pp. 111-12.

[190] In support, O'Loughlin referred to Exhibit No. NPG-1 at p. 113 tbl.26.

[191] In support, O'Loughlin referred to Exhibit No. NPG-1 at p. 120 tbl.27.

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allocations, O'Loughlin claimed, it would have encountered negative income and losses for a number of the Commission-specified ownership categories, resulting in an anomalous weighted tax rate outcome. *Id.* Most of the partners of Enterprise Products Partners, he went on to say, were allocated negative taxable income in 2004, and consequently, assigning negative weights to unitholders would be illogical. *Id.*

328. Establishing the income tax allowance for Mid-America subject to the incentive distribution provisions of Enterprise Products Partners' partnership agreement, argued O'Loughlin, makes no sense because the allowance becomes subservient to Enterprise Products Partners' cash distribution policy, which Enterprise Products GP, LLC (as Enterprise Products Partners' general partner) has considerable discretion to influence. *Id.* at p. 120.

329. O'Loughlin said he calculated a Mid-America "stand-alone" incentive distribution amount by computing the ratio of total 2004 Mid-America cash flow to total Enterprise Products Partners units and applying the applicable incentive distribution percentages referenced in Enterprise Products Partners' 2004 Form 10-K. *Id.* at p. 123. Mid-America's 2004 annual cash flow of $67,396,429, when expressed on a per unit basis, O'Loughlin claimed, is approximately 16 cents per unit, which means Mid-America's cash flow would satisfy the general partnership's first tier incentive distribution of 2% for quarterly distributions less than 25.3 cents per unit. *Id.* O'Loughlin said he applied the 2% to Mid-America's cash flow and received an allocated incentive distribution on a stand-alone basis of $1,347,929. *Id.* Although he disagreed with taking incentive distributions into account, O'Loughlin asserted that the correct figure to use if one were to take them into account is $1.3 million, not the $4.98 million proposed by Mid-America witness Petru. *Id.* Concluding, he insisted that the use of ownership weights is the only methodology that does not produce illogical or anomalous results. *Id.*

330. With respect to income tax rates, O'Loughlin assigned a zero percent federal income tax rate to all classes except the Subchapter C Corporations class, to which he assigned, for purposes of this analysis, Mid-America's assumed federal income tax rate of 35%. *Id.* at p. 126. Stating that Mid-America had not explained why or how its proposed composite tax rate represented the effective tax rate for its corporate owners, O'Loughlin testified, he had not attempted to determine an effective income tax rate for Mid-America's corporate owners. *Id.* For individuals, mutual funds, pensions/IRAs/Keoghs, and Unrelated Business Taxable Income Entities, he explained, the presence of a 28% federal income tax rate implies that individuals will be the ultimate beneficiaries, and consequently, the point where tax liability will reside. *Id.* at p. 127. Further, he claimed, because the above four categories already have a component for individual income taxes embedded in the allowed rate of return, compensating them twice for the same tax allowance by putting a 28% individual income tax rate in the weighted income tax rate calculation is nonsensical. *Id.* at p. 128. In sum, he concluded

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that the appropriate figure to use here is zero percent for these four categories. *Id.*

331. Additionally, O'Loughlin said, he assigned a zero percent state income tax rate. *Id.* at p. 129. Mid-America witness Ganz, contended O'Loughlin, failed to explain or describe any rational nexus between the development of state apportionment factors and the state income tax liability of unitholders. *Id.* There is no evidence, he pointed out, establishing any nexus between unitholders and the states used in the calculation. *Id.*

332. If it is determined that the appropriate income tax rate is zero percent, then, in O'Loughlin's view, he added, Mid-America's entire Accumulated Deferred Income Tax balance will be overfunded and would need to be amortized prospectively back to shippers in rates. *Id.* at p. 131. Mid-America erred in its calculation of its proposed Accumulated Deferred Income Tax balance, he suggested. *Id.* According to him, Mid-America witness Ganz's 2006 Test Year Accumulated Deferred Income Tax balances represented the accumulation of deferred income taxes from mid-2002 through the 2006 Test Year, and, starting from a balance of zero in mid-2002, Ganz reported a Northern System Accumulated Deferred Income Tax balance of $6.7 million for the 2006 Test Year. *Id.* at pp. 131-32. O'Loughlin disagreed with Ganz's use of the weighted income tax rates developed by Petru, because, without justification, Ganz switched from "using 'the top marginal income tax rates for corporations' (which is what Ganz use[d] for all of the years prior to 2002) to using 'weighted marginal income tax rates for corporations and individuals based upon the income allocation percentages developed by'" Petru. *Id.* at p. 132. The overfunded amount, O'Loughlin advocated, should be amortized back to shippers through a reduction in rates as described by Ganz. *Id.* at p. 133.

333. With regard to the level of Mid-America's fuel and power expenses included in its costs-of-service, O'Loughlin declared one problem: Mid-America may have a non-recurring level of fuel and power expenses in its costs-of-service. *Id.* Further, he noted, Mid-America's total fuel and power expense increased from approximately $36.6 million during the 2004 Base Period to $40.6 and $40.1 million during the 2006 Base and May 2006 Locked-In Periods, respectively. *Id.* at pp. 133-34.[192]

334. The testimony of Mid-America witness Collingsworth that the level of fuel and power expense applicable to each of the three periods — 2004 Base, 2006 Base, and May 2006 Locked-In — is recurring coincided with his findings, O'Loughlin said. *Id.* at pp. 134-35. According to O'Loughlin, he used the 2004 Base Period Northern and Total System volumes for the development of just and reasonable rates applicable to the 2005 Test Period, May 2006 Locked-In Period, and the 2006 Test Period. *Id.* at p. 136. Using Mid-America's actual fuel and power expenses in each of the costs of service without adjustment, he stressed, is appropriate. *Id.* No adjustment to fuel and power expense to

[192] In support, O'Loughlin referred to Exhibit No. NPG-1 at p. 134 tbl.28.

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correspond to an increase in volume is necessary, he stated, because there did not appear to be a relationship between volume and fuel and power expense (which is consistent with Mid-America's failure to identify a relationship). *Id.* Additionally, he noted, Mid-America's ability to substitute between fuel inputs mitigates the impact of changes in relative market prices, and that the recent decline in natural gas prices should reduce Mid-America's fuel and power costs. *Id.*

335. Mid-America has no established methodology for quantifying the relationship between station volumes and fuel and power expense, rather, O'Loughlin testified, Mid-America reported actual energy expense as throughput changes. *Id.* at p. 137. A simple relationship between transportation volumes and pumping station fuel usage, in his opinion, did not appear to exist. *Id.* at pp. 137-38. The evidence, claimed O'Loughlin, suggested that Mid-America has fuel-switching capability at some of its pumping stations. *Id.* at p. 138.

336. Mid-America's average per unit cost for electricity, insisted O'Loughlin, increased slightly, from 52 cents/kwh during the 2004 Base Period to 58 cents/kwh during the 2006 Base Period and to 61cents/kwh during the May 2006 Locked-In Period. *Id.* at pp. 139-40.[193] Also, he suggested, changes in natural gas prices during the 2006 Test Period indicated that adopting Mid-America's fuel and power expenses for the 2006 Test Year may be a conservatively high assumption. *Id.* at p. 140. The price for natural gas liquids, reported O'Loughlin, increased during late 2005 and remained relatively high during the 2006 Test Period. *Id.* at p. 141. The increase in natural gas liquids and natural gas prices in and of itself, argued O'Loughlin, did not explain the increase in fuel and power expenses between the 2006 Base Period and the May 2006 Locked-In Period relative to the 2004 Base Period, because there had been switching of fuel inputs at some pumping stations, as well as, an increase in fuel usage at other stations, despite a decrease in transportation volumes. *Id.* at p. 142.

337. Absent a clear relationship between transportation volumes and fuel and power expenses, continued O'Loughlin, an adjustment to Mid-America's actual fuel and power expenses applicable to the 2004 Base Period, 2006 Base Period, and May 2006 Locked-In Period is not appropriate even in the presence of his proposed use of Base Year 2004 volumes for the 2005 Test Period, 05/06 Locked-In Period, and the 2006 Test Period. *Id.* at p. 143. Thus, O'Loughlin stated that he accepted Mid-America's actual fuel and power expense levels and did not propose any test year adjustments given his recommended volume adjustments. *Id.* at p. 143.

338. O'Loughlin asserted that Mid-America used volumes that were rather abnormally low (*e.g.,* as compared to 2004 actual volume levels) due to warm weather during the

[193] In support, O'Loughlin referred to Exhibit No. NPG-1 at p. 140 fig.9.

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2005/2006 winter and reduced volumes of demethanized mix on the Rocky Mountain System (due to the relative prices of natural gas liquids and natural gas during the periods). *Id.* at pp. 143-44. Moreover, he disagreed with several of Mid-America's adjustments to its Northern System volumes and revenues that are related to its contract with the East Red Line Shipper. *Id.* at p. 144.

339. Next, O'Loughlin said he developed Northern System revenue and volume (barrel and barrel-mile) figures for the 2005 Test Year, 05/06 Locked-In Period, and the 2006 Test Year. *Id.* However, he said he diverged from Mid-America's attempts to substitute lower volume levels for the 05/06 Locked-In Period and 2006 Test Period and utilized the 2004 Base Period volume levels for all three periods for both Northern System and Total Company volume. *Id.* at p. 145. Mid-America's actual interstate volume, explained O'Loughlin, showed a significant decline from the 2004 Base Period to both the 2006 Base Period and the May 2006 Locked-In Period, and he noted, Mid-America used these unrepresentative lower volume levels in attempting to justify its need for its proposed Northern System rate increases. *Id.* at p. 145.[194] Additionally, he testified, Mid-America used the revenue rates in effect for the period in question, although it annualized any rate increases that took effect during the Base Period (*e.g.*, Mid-America annualized the FERC Tariff No. 38 rates, which went into effect on May 1, 2005, in deriving its revenue for the 2006 Test Year). *Id.* at p. 147.

340. Because the winter of 2005-2006 (the winter contained in both the May 2006 Locked-In Period and the 2006 Base Period) was warmer than anticipated, O'Loughlin testified that the volume of propane and demethanized mix (mixture of natural gas liquids extracted from natural gas at natural gas processing plants) — two dominant products shipped on Mid-America's Northern System — decreased, and consequently, the revenues as well. *Id.* at p. 149.[195] In other words, O'Loughlin suggested, because the winter of 2005-2006 was much warmer than normal, the volumes and revenues used by Mid-America in its May 2006 Locked-In Period and 2006 Test Period were not representative of normally recurring conditions. *Id.* at p. 152. Although the winter of 2004-2005 was warmer than normal, O'Loughlin insisted, it was not nearly as warm as the winter of 2005-2006; accordingly, he suggested 2004 to be a reasonable period, volume-wise, for developing forward-looking rates. *Id.*

341. As evidenced in the January 27, 2006, internal Mid-America e-mail regarding financial results, O'Loughlin claimed, revenues and volumes decreased due to ethane rejection[196] on the Rocky Mountain System, which, in turn, reduced Total Company

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[194] In support, O'Loughlin referred to Exhibit No. NPG-1 at p. 146 tbl.31.

[195] In support, O'Loughlin referred to Exhibit No. NPG-1 at p. 151 fig.12.

[196] Ethane rejection occurs when natural gas producers leave ethane in the

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barrel and barrel-miles below expected levels. *Id.* at p. 153. Enterprise Product Partners was aware of the impact of ethane rejection on its business, he continued, because its SEC Form 10-K identified the reduction in supply and demand for natural gas liquids products, including ethane, as a risk related to its business. *Id.* Additionally, he testified, an Enterprise Products Partners' analyst's presentation, dated May 26, 2004, acknowledged that ethane production was discretionary and stated that, were ethane extraction minimized (*i.e.,* maximum ethane rejection), total natural gas liquid volumes would be reduced by 10-20%. *Id.* at p. 155. Noting that Mid-America increased its Rocky Mountain capacity by 50,000 barrels/day, O'Loughlin further suggested that it must have believed that its pre-expansion Rocky Mountain System was being relatively fully utilized or it would not have been spending $203 million to expand it. *Id.* at pp. 155-56. Accordingly, O'Loughlin argued, the 2004 Base Period Rocky Mountain System actual volume is the best measure of full utilization, not the unrepresentative lower volume levels experienced in the May 2006 Locked-In Period or the 2006 Base Period. *Id.* at p. 156.

342. For each of the three segments (Rocky Mountain, Central, and Northern), O'Loughlin said he adjusted the volume on each origin-destination pair by the ratio of a segment's 2004 Base Period volume to its 2006 Test Year volume. *Id.* In other words, he stated, the volume on each origin-destination pair on a segment was scaled up so that the segment's total volume equaled its 2004 Base Period volume. *Id.* He added that "Total Company volume equals the sum of the volume for the three segments, it also equals Total Company 2004 Base Period volume." *Id.* Furthermore, O'Loughlin said he derived Northern System revenue for any given period by: (1) applying the applicable Northern System tariff rates to the corrected Northern System volume figures; and (2) correcting Mid-America's erroneous treatment of the revenues related to the East Red Line Shipper contract. *Id.* at pp. 156-57. O'Loughlin claimed that the level of volume used to design the rates will have a significant effect on the revenues ultimately collected. *Id.* at p. 157. Moreover, if an unduly low level of volume is used to design the rates, O'Loughlin stressed, the pipeline will over-recover its cost of service when the resulting rates are applied to a normal level of throughput. *Id.*

343. While Mid-America receives a total of approximately $18 million per year from the East Red Line Shipper under the terms of its contract, O'Loughlin stated that Mid-America included only about $7 million of that $18 million in its evaluation of whether its interstate rates on its Northern System were just and reasonable. *Id.* at p. 158. Mid-America, declared O'Loughlin, mistreated the East Red Line Shipper contract for purposes of this proceeding to exclude the majority of the revenue associated with the contract from consideration. *Id.*

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processing stage in the natural gas stream. Exhibit No. NPG-1 at p. 153.

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344. Mid-America and the East Red Line Shipper, testified O'Loughlin, entered into a ten-year contract, beginning January 1, 2004, for transportation on Mid-America's system to the East Red Line Shipper's two facilities at Clinton, Iowa, and Morris, Illinois. *Id.* at p. 159. According to him, the contract contained volume incentive rates for the East Red Line Shipper, but these rates were also coupled with a volume commitment whereby the East Red Line Shipper would pay for any volume shortfall below the specified levels. *Id.*[197] Additionally, he testified, the contract contained a $1 million per year "Annual Reliability Incentive Payment," whereby the East Red Line Shipper would pay Mid-America $1 million per year to maintain its facilities in such a manner to avoid any disruptions of deliverability to the East Red Line Shipper's plants at Clinton, Iowa, and Morris, Illinois.[198] *Id.* O'Loughlin maintained that the contract specified that Mid-America would provide free storage service to the East Red Line Shipper, and Mid-America would perform a free service of blending propane with ethane/propane mix for the East Red Line Shipper. *Id.* Finally, he added, Mid-America would provide transportation of propane from Clinton, Iowa, to Conway, Kansas, at a negative price, which was a dollars/barrel credit equal to the price of transporting ethane/propane mix from Conway, Kansas, to Clinton, Iowa. *Id.* at pp. 159-60.

345. Ethane/propane mix, noted O'Loughlin, is transported at the same rate of 58.86 cents/barrel (escalated annually) for all of the origin-destination pairs despite very different mileages. *Id.* at p. 160. For the 2006 Test Period, he stated, Mid-America included $6.9 million in revenues related to the tariff transportation movements for four transportation paths: (1) from Conway, Kansas, to Clinton, Iowa; (2) from Conway, Kansas, to Morris, Illinois; (3) from Channahon, Illinois, to Clinton, Iowa, and (4) from Clinton, Iowa, to Conway, Kansas (this last path being a transportation credit or reduction in revenues). *Id.* at p. 161.[199] According to O'Loughlin, Mid-America excluded $11.2 million in revenues from the East Red Line Shipper in its 2006 Test Year cost-of-service and revenue comparisons. *Id.* at p. 161. The revenues from the East Red Line Shipper that Mid-America excludes from its calculations, he explained, consist of three elements: (1) transportation service from Channahon, Illinois, to Morris, Illinois, which Mid-America now treats as intrastate transportation revenue; (2) a $1 million Annual Reliability Incentive payment that is to be made every year under the terms of the contract with the East Red Line Shipper; and (3) a $2.9 million volume commitment shortfall payment that was made for transportation service in 2004 and 2005. *Id.* at pp. 161-62.

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[197] In support, O'Loughlin referred to Exhibit No. NPG-1 at p. 160 tbl.33.

[198] Mid-America ignored this $1 million in revenue in its cost of service and revenue calculations, according to O'Loughlin. Exhibit No. NPG-1 at p. 159.

[199] In support, O'Loughlin referred to Exhibit No. NPG-1 at p. 162 tbl.34.

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346. The elements of the contract between Mid-America and the East Red Line Shipper, contended O'Loughlin, are interrelated because the prices of providing the independent services are not related to the costs of providing the service. *Id.* at p. 163. Mid-America's revenue from the East Red Line Shipper for the one-mile movements between Channahon, Illinois, and Morris, Illinois, reported O'Loughlin, was $7.0 to $7.7 million per year, which was $6.2 to $6.7 million greater than the corresponding total intrastate cost of service. *Id.* at pp. 163-64. The revenue from the transportation service from Channahon, Illinois, to Morris, Illinois (which is solely a byproduct of the contracting parties' decision to apply a postage stamp rate to all transportation movements under the contract), relative to the underlying cost of service, suggested O'Loughlin, demonstrated that the service was priced significantly greater than the cost of providing the service by "at least $6 million/year." *Id.* at pp. 164-65.[200] He maintained that this over-recovery was offset by the provision of the negatively price propane transportation, free storage service, free blending service, and possibly by an under-recovery of cost on other transportation paths that Mid-America considered to be interstate in its analysis. *Id.* at pp. 165-66. In sum, O'Loughlin asserted, the individual prices for each element should not be examined separately; rather the whole contract should be examined for the revenue contribution each element makes toward Mid-America recovering its cost of service. *Id.* at p. 166.

347. Because the prices of providing transportation service in the East Red Line Shipper contract were determined jointly, O'Loughlin claimed that separating them between interstate and intrastate jurisdictions and examining them individually (as Mid-America attempted) would be inappropriate. *Id.* He contended that Mid-America began classifying transportation from Channahon, Illinois, to Morris, Illinois, as intrastate on January 1, 2006, and filed the same rates reflected in Mid-America's interstate tariff and governed by the terms of the East Red Line Shipper contract at the Illinois Commission. *Id.* Mid-America's reclassification of the movements from Channahon, Illinois, to Morris, Illinois, as intrastate, argued O'Loughlin, is a blatant attempt by Mid-America to artificially justify its March 31, 2005, and March 31, 2006, rate increases by shifting revenues from interstate service to intrastate service. *Id.* at p. 167. The movements from Channahon, Illinois, to Morris, Illinois, he claimed, resembles an interstate movement more than an intrastate movement, reasoning that the ethane/propane mix transported is received from the Aux Sable facility connected to the Alliance Pipeline, which transports a mixture of natural gas and natural gas liquids from Alberta, Canada, to Channahon, Illinois. *Id.* at p. 168. In response to the claim that interstate transportation somehow ends at the Aux Sable facility, O'Loughlin replied that the claim is contradicted since: (1) natural gas liquids, such as propane, ethane, or ethane/propane mix, are not manufactured at the Aux Sable facility since a significant portion of these

[200] In support, O'Loughlin referred to Exhibit No. NPG-1 at p. 164 tbl.35.

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natural gas liquids are already in existence and are being injected into the pipeline prior to ever reaching the Aux Sable facility; and (2) there is no possibility that the natural gas liquids are being consumed at the Aux Sable facility given that the facility's function is in part to simply re-separate the natural gas liquids that were injected and commingled for transportation purposes with the natural gas upstream in Canada. *Id.* at p. 170. The facts, according to O'Loughlin, suggest that the transportation of these natural gas liquids "is nothing more than an extension or continuation of the interstate movements on Alliance to the Aux Sable facility in Channahon, Illinois[,] and beyond." *Id.* at p. 171.

348. O'Loughlin claimed that Mid-America excluded the $1 million received annually as the "Incentive Reliability Payment" from the revenue amounts reflected in its testimony and tariff filings "because those payments were not considered to be Trunk Revenues consistent with the definition contained in Account 210 of the Uniform System of Accounts for Oil Pipelines." *Id.* at p. 172.[201] Also, O'Loughlin asserted, Mid-America did not reflect the $1 million as a revenue credit (or negative expense) in the operating and maintenance expenses included in its costs of service. *Id.* at p. 172. As for the $1 million "Incentive Reliability Payment," he recommended that it be treated as a negative expense and be deducted from Mid-America's cost of service, both at the total system level, as well as at a segmented Northern System level. *Id.* at p. 173. This treatment, he argued, is consistent with Mid-America's treatment of the $1.3 million payment it receives annually to operate the Magellan ammonia pipeline. *Id.*

349. According to O'Loughlin, the East Red Line Shipper agreed to transport 3,650,000 barrels/year from Cochin Iowa City to Conway Holding or Conway Underground on Mid-America's system at a rate of 79.1 cents/barrel, and when it fails to do so, the East Red Line Shipper annually pays Mid-America approximately $2.9 million. *Id.* at pp. 173-74. In O'Loughlin's view, he claimed, Mid-America erroneously excluded the $2.9 million from the revenue amounts reflected in its testimony and tariff filings, and erroneously reasoned that the revenues "do not represent Trunk Revenues as defined by Account 210 of the Uniform System of Accounts." *Id.* at p. 174. Mid-America, he noted, also did not reflect the $2.9 million as a revenue credit or a negative expense in the operating and maintenance expenses included in its costs of service. *Id.* Including the volume commitment level in the Northern System barrels and barrel-miles used to derive fully allocated cost-based rates on the Northern System, insisted O'Loughlin, is appropriate. *Id.* at p. 175. Moreover, he claimed that it would be inappropriate to allocate no costs to the service when the East Red Line Shipper chooses not to ship any volumes because Mid-America is contractually obligated to maintain the facilities and incur the associated costs (and receive the committed revenue), regardless of whether the East Red Line Shipper transports a volume lower than the commitment level. *Id.*

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[201] In support, O'Loughlin cited Exhibit No. NPG-99.

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350. Under the East Red Line Shipper's contract, O'Loughlin explained, the East Red Line Shipper receives a per barrel credit for each barrel of propane transported which is equal to the price of transporting ethane/propane mix from Conway, Kansas, to Clinton, Iowa. *Id.* at pp. 175-76. Therefore, O'Loughlin asserted, Mid-America provides this propane transportation service for a negative price to the East Red Line Shipper. *Id.* at p. 176. He testified that Mid-America accounted for the negative revenues generated by the transportation of propane from Clinton, Iowa, to Conway, Kansas, in the revenue figures shown in its testimony. *Id.* However, O'Loughlin asserted, Mid-America excluded the propane volumes from Clinton, Iowa, to Conway, Kansas, as well as an equal number of ethane/propane mix volumes from Conway, Kansas, to Clinton, Iowa, from the volumes used in its rate design calculations. *Id.* In doing so, O'Loughlin claimed, Mid-America assumed, for purposes of its rate design calculations, that neither the propane volumes from Clinton, Iowa, to Conway, Kansas, nor an equal number of ethane/propane mix volumes from Conway, Kansas, to Clinton, Iowa, were moved on its system, and thus resulted in no allocation of costs to these volumes. *Id.* The volumes of propane moved from Clinton, Iowa, to Conway, Kansas, under the terms of the East Red Line Shipper contract, declared O'Loughlin, should be included in the fully allocated rate calculation, and furthermore, no volumes of ethane/propane mix from Conway, Kansas, to Clinton, Iowa, should be subtracted from the total ethane/propane volumes transported from Conway, Kansas, to Clinton, Iowa. *Id.* Mid-America provided no economic justification for the volume incentive rates in the East Red Line Shipper contract, but rather, he contended, Mid-America simply stated that it had the ability to meet the needs of what it thought the East Red Line Shipper was seeking and that the rates were negotiated between the two parties. *Id.* at p. 179. Competition was not a significant factor that limited the price Mid-America could charge, according to O'Loughlin. *Id.* For example, he insisted, the rate from Channahon, Illinois, to Morris, Illinois, is so much greater than the cost of providing that service that the rate could not possibly be the result of competition. *Id.*

351. To the extent that Mid-America does not recover the fully allocated costs that are allocated to individual transportation movements under the terms of the East Red Line Shipper contract, O'Loughlin asserted, Mid-America should bear those costs and not allocate this shortfall to other shippers thereby requiring them to subsidize Mid-America's arrangement with the East Red Line Shipper. *Id.* at p. 180. Moreover, he continued, to the extent that there is any shortfall between the fully allocated cost rates to the East Red Line Shipper and the contract rates, the rates that are effective during the Test Period for each Base Period should be used to determine any shortfall. *Id.* at pp. 180-81.

352. Mid-America's use of the word "discounts," according to O'Loughlin, represents three distinctly different phenomena: (1) the first type of "discount" — the only real discounted rate on Mid-America's system, in his opinion — is a volume incentive discount, which is a discount off of the maximum tariff rate in exchange for a shipper

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moving greater than a threshold volume during a year; (2) the second type of "discount" is the "seasonal discount," implemented by Mid-America on the Northern System in its FERC Tariff No. 41 filing that began to be collected on May 1, 2006, which Mid-America is not trying to defend in this proceeding, according to O'Loughlin; and (3) any filed rate in FERC Tariff Nos. 38 or 41 that happens to be less than the fully allocated rate calculated by Mid-America from its cost-of-service calculations. *Id.* at pp. 181-87. As to the last, O'Loughlin accused Mid-America of making a blatant attempt to shift costs and avoid the "fact" that its FERC Tariff Nos. 38 and 41 proposed rates are completely lacking in any underlying, fundamental rate design. *Id.* at p. 183. He claimed that, because Mid-America has provided no economic (cost based or otherwise) justification for the rate design of its filed rates in FERC Tariff Nos. 38 and 41, any differences between its fully allocated rates and its filed rates are not the result of "discounts," but are simply the result of two unrelated rate design mechanisms. *Id.*

353. Based on O'Loughlin's corrected Northern System costs of service, he asserted, Mid-America's Northern System revenues at the proposed FERC Tariff No. 38 rates, as well as the existing FERC Tariff No. 33 rates, exceeded Mid-America's Northern System 2005 Test Period cost of service. *Id.* at p. 188. O'Loughlin used two methodologies to reach this conclusion: the Northern System-segmented methodology and the Northern System-Total Company methodology. *Id.* at p. 188. Under the Northern System-segmented methodology, O'Loughlin claimed he began with Mid-America's Northern System-segmented cost of service for the 2005 Test Year, which assigned direct costs to the Northern System and allocated indirect costs to the Northern System using Mid-America's Kansas-Nebraska allocation methodology, and then made corrections (as described in the Answering Testimony of Propane Group witness Arthur) to Mid-America's cost-of-service elements (*e.g.,* operating expenses, Allowed Return, Income Tax Allowance). *Id.* He added that he calculated Mid-America's Northern System-Segmented 2005 Test Year cost of service to be $46.1 million.[202] *Id.* at pp. 188-89.

354. Further he stated, under the Total Company methodology, he began by developing a corrected Total Company cost-of-service for Mid-America for the 2005 Test Year, and then made corrections (as described in the Answering Testimony of Propane Group witness Arthur) to Mid-America's cost-of-service elements (*e.g.,* operating expenses, Allowed Return, Income Tax Allowance), calculating Mid-America's Total Company 2005 Test Year cost of service to be $167.7 million. *Id.* at p. 189.[203] Of this amount, O'Loughlin testified, $160.1 million was appropriately allocated on a distance (per

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[202] According to O'Loughlin, his 2005 Test Year cost-of-service results and associated tables can be found in Exhibit No. NPG-104. Exhibit No. NPG-1 at p. 189.

[203] *See also* Exhibit No. NPG-1 at p. 190 tbl.39.

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barrel-mile) basis, while $7.6 million was allocated on a non-distance (per barrel) basis, and Mid-America's corrected 2005 Test Year System-wide volume was 194.5 million barrels and 85.9 billion barrel-miles. *Id.* On a per unit basis, he claimed, Mid-America's Total Company costs are 3.91 cents/barrel and 0.19 cents/barrel-mile. *Id.* Furthermore, O'Loughlin maintained, when these unit figures are applied to Mid-America's 2005 Test Year Northern System volumes (58.3 million barrels and 19.9 billion barrel-miles), the resulting cost allocated to the Northern System is $39.3 million. *Id.* He claimed he used the Total Company methodology to avoid the problems created by Mid-America's direct labor expense data because the methodology allocates costs between segments based on barrels and barrel-miles, which is the same methodology Mid-America used to allocate costs between interstate and intrastate operations. *Id.* at p. 190-91.

355. At the FERC Tariff No. 33 rates, O'Loughlin explained, the Northern System 2005 Test Year revenue was $51.1 million, which over-recovered both the Northern System-Total Company 2005 Test Year cost of service ($39.3 million) by $11.2 million and the Northern System-Segmented 2005 Test Year cost-of-service ($46.1 million) by $5.1 million. *Id.* at p. 191. In other words, O'Loughlin argued, the existing FERC Tariff No. 33 rates are more than adequate, thereby making the proposed FERC Tariff No. 38 rates unjust and unreasonable. *Id.* O'Loughlin testified that he derived just and reasonable rates, and in many cases, they were below the existing FERC Tariff No. 33 rates.[204] *Id.* at p. 192.

356. O'Loughlin suggested that Mid-America's proposal to increase Northern System rates by an additional 60% in FERC Tariff No. 41 is unjustified and would result in unjust and unreasonable rates. *Id.* at p. 195. He estimated, for the 2006 Test Year, the corrected Northern System-Segmented cost-of-service to be $51.2 million, and calculated Mid-America's Total Company 2006 Test Year cost-of-service to be $167.9 million. *Id.* Of this amount, he claimed, $161 million was appropriately allocated on a barrel-mile basis, while $6.9 million was allocated on a per barrel basis, and Mid-America's corrected 2006 Test Year system-wide volume became 194.5 million barrels and 87.3 billion barrel-miles. *Id.* at pp. 195-96. Thus, he suggested that, on a per unit basis, Mid-America's Total Company costs are 3.54 cents/barrel and 0.018 cents/barrel-mile, and consequently, when these unit figures are applied to Mid-America's 2006 Test Year Northern System volumes (58.3 million barrels and 20.3 billion barrel-miles), the resulting cost allocated to the Northern System becomes $39.4 million. *Id.* at p. 196.

357. At the FERC Tariff No. 33 (2004) rates, O'Loughlin suggested that the Northern System 2006 Test Year revenue was $55.6 million, which over-recovered both the Northern System's portion of the Total Company 2006 Test Year cost-of-service ($39.4

[204] The rates O'Loughlin derived appear in Exhibit No. NPG-1 at pp. 193-94 tbl.41.

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million) by $16.2 million and the Northern System-Segmented 2006 Test Year cost of service ($51.2 million) by $4.4 million. *Id.* O'Loughlin explained that the FERC Tariff No. 33 rates create revenues that are more than adequate to recover Mid-America's Northern System cost-of-service under either methodology, thereby making the proposed FERC Tariff No. 41 rates unjust and unreasonable. *Id.* Moreover, O'Loughlin stated, he calculated just and reasonable Northern System rates for the 2006 Test Year by origin-destination pair using the Northern System-Segmented cost of service he derived, and testified that in many instances, the just and reasonable rates were below the existing FERC Tariff No. 33 rates. *Id.* at p. 197.

358. During direct testimony at the hearing, O'Loughlin explained that he had modified his cost-of-service recommendations as a result of the parties' stipulation,[205] and to accommodate the Commission's policy statement on income tax allowances.[206] Transcript at pp. 2375-78.[207] He stated that, taking them into consideration, he reduced his Northern System 2005 Test Period cost-of-service calculation from $46,050,000 to $45,966,000. *Id.* at p. 2377. O'Loughlin also testified that he raised his Northern System 2006 Test Period cost-of-service calculation from $51,187,000 to $53,530,000. *Id.* at pp. 2377-78. Under cross-examination, O'Loughlin agreed that the changes he made in his cost-of-service recommendation would "percolate" through some of his other exhibits, but that he did not change them because they would not change his basic "conclusions." *Id.* at p. 2386.

359. O'Loughlin also testified that he used a fully allocated cost methodology to design the rates he recommended. *Id.* at p. 2389. Under his methodology, he stated, non-distance-related costs were allocated over the number of barrels moving over a particular path, and distance-related costs were allocated over the number of barrel-miles for a particular path. *Id.* According to O'Loughlin, he used the 2004 Base Period Northern System total volumes for it, the Locked-In Period, and the 2006 Base Period. *Id*. at p. 2391. Cross-examined about his reasons for doing so, O'Loughlin replied that it represented "normal volume levels" whereas the other periods were impacted by abnormally warm winters. *Id.* at pp. 2396-97. He also expressed some concern because the East Red Line Shipper's volume declined from 2004 to 2005 and 2006.[208] *Id.* at

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[205] *See* Exhibit No. JE-4.

[206] During cross-examination, O'Loughlin agreed that the income tax rate he used for each period was 4.74%. Transcript at pp. 2567-68.

[207] O'Loughlin's recalculation appears in Exhibit No. NPG-237.

[208] According to O'Loughlin, "the data show that [the East Red Line Shipper's] volume dropped by 9 percent between 2004 and the locked-in period and 2006." Transcript at p. 2397.

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p. 2397.

360. Asked about the relationship of weather to volume, O'Loughlin testified that the colder the winter, the higher the volume shipped for heating. *Id.* at p. 2398. Discussing what types of product are shipped on the Northern System, O'Loughlin testified that propane makes up 80-90% of the volume, and that normal butane, isobutane, and natural gasoline make up 5-10% of the volume. *Id.* at pp. 2398-99. Northern System FERC Tariff Nos. 38 and 41, he said, included the above products, as well as, naphtha and refinery grade butane. *Id.* at p. 2399. When asked further questions regarding naphtha and refinery grade butane, he replied that he believed them to be primarily used as a refinery feedstock or chemical plant feedstock. *Id.* at p. 2399. Additionally, he stated that ethane/propane mix is used as a petrochemical feedstock. *Id.* at p. 2400.

361. O'Loughlin testified that, in his opinion, a test year using a base period of calendar year 2004 should be used in evaluating the FERC Tariff No. 38 rates. *Id.* at p. 2442. He further, referring back to his pre-filed testimony, stated that data for the 2005-2006 Locked-In Period was irrelevant in determining whether the FERC Tariff No. 38 rates were just and reasonable. *Id.* at p. 2443.

362. When questioned about the FERC Tariff No. 38 rates, O'Loughlin agreed that, as with FERC Tariff No. 41, he used the 2004 actual volumes for evaluating the rates. *Id.* at p. 2451. He further agreed that the total unadjusted 2004 Northern System volume figure, excluding the adjustments made either by O'Loughlin or Mid-America, was approximately 54.6 million barrels. *Id.* at p. 2451. O'Loughlin also conceded that the 2004 Northern System actual volume claimed by Mid-America during the Locked-In Period was 44.6 million, but said that that figure excluded the Channahon-to-Morris volume for the first four months of 2006 because it re-classified them as intrastate. *Id.* at p. 2452. According to O'Loughlin, if the January to April 2006 Channahon-to-Morris volume (3.2 million barrels) was added to the 44.6 million barrels, the total would equal 47.8 million barrels and that would be comparable to the total unadjusted 2004 Northern System volume figure — 54.6 million barrels. *Id.* at pp. 2452-54. O'Loughlin contended that, for any 12-month period, actual volume from 2005 to the present did not reach the 2004 total unadjusted annual volume. *Id.* at p. 2454. Further, he used the 2004 actual volume level as opposed to the actual Locked-In Period volumes because he believed it to be more representative of the period under evaluation for the FERC Tariff No. 38 rates, and because Mid-America predicated its case on that level of volumes. *Id.* at pp. 2454-55.

363. Under cross-examination regarding the East Red Line Shipper, O'Loughlin testified that it committed to move 3.65 million barrels at 79 cents per barrel from Cochin to Conway. *Id.* at pp. 2480-81. He continued, the East Red Line Shipper did not ship any barrels from the Cochin interconnection to Conway during the periods at issue in this matter. *Id.* at p. 2481. However, O'Loughlin claimed the pipeline incurred costs

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associated with the barrels that did not move — the cost to have the pipeline standing ready to provide the service. *Id.* at pp. 2482-83. O'Loughlin claimed that the just and reasonable rate that would result from the fully allocated cost for the East Red Line Shipper volume commitment from Cochin to Conway is $1.67/barrel or $1.1019/barrel, depending on the period. *Id.* at p. 2484. He did acknowledge that, under its contract with the East Red Line Shipper, Mid-America could only collect 79 cents/barrel and that this would result in it not being able to collect $800,000 to $1 million less than he included in his cost-of-service. *Id.* at pp. 2485-87.

364. According to O'Loughlin, the East Red Line Shipper ships ethane/propane mix to Clinton, and some of the propane extracted from that mix is stored at Iowa City rather than being shipped back to Conway.[209] *Id.* at pp. 2487-88. [At this point in the hearing, a colloquy occurred among counsel for Mid-America, counsel for the Propane Group and me in which it was agreed that when the propane volumes are stored at Iowa City the physical barrels become part of Mid-America's inventory, but the same number of barrels are credited to the East Red Line Shipper at Conway. *Id.* at pp. 2490-92. It was further agreed as part of this colloquy, that, when a shipper from Conway wants to move barrels north of Iowa City, Mid-America takes them out of storage at Iowa City and charges the full line rate from Conway to the destination point. *Id*. at pp. 2493-95.]

365. For the 2005 Test Period, 2006 Test Period, and the Locked-In Period, O'Loughlin recommended that the corresponding Base Period actual fuel and power expenses for the Northern System be used without adjustment. *Id*. at p. 2511. In other words, O'Loughlin held the volume constant (using 2004 volume for each period), but varied the fuel and power expense for each period. *Id.* The 2005 Test Period fuel and power expense for the Northern System, reported O'Loughlin, was approximately $10 million, and for the 2006 Test Year, it was $13-$14 million. *Id*.

366. The more volume moving into a pipeline, O'Loughlin agreed, the more pumping power and, thus, more fuel, is needed to move it. *Id*. at pp. 2513-14. Electricity prices per kilowatt hour, he contended, increased more than 11% between the 2004 Base Period and the 2006 Base Period. *Id.* at p. 2517. Also, he further agreed, there was a 17% increase in Mid-America's total system average unit electric costs between the 2004 Base Period and the Locked-In Period, and that there were even higher increases in the natural gas input prices and propane prices during those same periods. *Id*. at pp. 2517-18.[210]

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[209] The extracted propane is credited to the East Red Line Shipper as if it were stored in Conway. Transcript at p. 2491.

[210] O'Loughlin also agreed that there was an increase in unit fuel prices for propane in excess of 27% between the 2004 Base Period and the 2006 Base Period, and an increase of approximately 32% between the 2004 Base Period and the Locked-In Period. Transcript at pp. 2518-19.

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367. Mid-America, in O'Loughlin's view, allocated too much indirect expense to the Northern System, and as a result, the Northern System cost-of-service was overstated. *Id.* at pp. 2538-39. In the calculation of the Kansas-Nebraska allocation factor, which Mid-America used to allocate indirect and common costs, he stated, the direct labor component was miscalculated so that it overstated the labor component, which resulted in an overstatement of the Kansas-Nebraska factor which allocated the indirect costs to the Northern System. *Id.* at p. 2539. Mid-America's inclusion in the Northern and Central System expense figures of direct labor expenses associated with the ammonia line was inappropriate, he continued, because the costs are related to a service being performed for another company and because Mid-America was being fully reimbursed for that activity.[211] *Id.* at p. 2545. O'Loughlin testified that he reduced the Kansas-Nebraska percentage for the Northern System by the amounts associated with the ammonia system labor. *Id.* at pp. 2547-48.

368. Further cross-examination revealed that O'Loughlin's believed that Mid-America inappropriately included in its Northern System direct labor cost amounts that should have been attributed to Enterprise Terminals. *Id.* at p. 2548. In support of this position, O'Loughlin noted that Enterprise Terminals has no employees on the Northern System available to perform services on its behalf and asserted, therefore, that Mid-America employees were used for this. *Id.* at p. 2549. He also expressed his concern that the amount of time Mid-America employees were spending on Enterprise Terminals related activities was not being properly recorded on their time sheets. *Id.* at pp. 2552-53.

369. Mid-America, O'Loughlin stated, leases storage from Enterprise Terminals at three locations on the Northern System: Conway, Greenwood, and Iowa City. *Id.* at p. 2554. He testified that Williams owns the facilities at Conway, which is leased by Enterprise Terminals and subleased to Mid-America. *Id.* at p. 2554-55. Furthermore,

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[211] O'Loughlin agreed with counsel for Mid-America that Magellan paid Mid-America, approximately, $1.3 million for that service, and that payment was recorded as a negative entry reducing indirect operating expenses. Transcript at pp. 2546-47. The payment, he also agreed, was intended to compensate Mid-America for the overhead costs associated with operating the ammonia pipeline. *Id.* at p. 2547. The payments from Magellan, insisted O'Loughlin, who claimed agreement with Mid-America witness Ganz, eliminated the costs associated with operating the ammonia system so that the only costs remaining were the natural gas liquid costs, the Mid-America Pipeline costs, and those were the costs both O'Loughlin and Ganz allocated with the Kansas-Nebraska allocator for the indirect expenses. *Id.* O'Loughlin also agreed with counsel for Mid-America that the mathematical result of this is to reduce the Kansas-Nebraska percentage for the Northern System by the amounts associated with the ammonia system labor. *Id.* at pp. 2547-48.

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O'Loughlin claimed that the rent Mid-America pays Enterprise Terminals for the Conway storage capacity is the same amount that Enterprise Terminals pays Williams. *Id*. at p. 2555. With respect to the Northern System, he noted, Mid-America earns storage revenue only at Conway and to a lesser degree at Pine Bend. *Id*. at p. 2556.

370. In O'Loughlin's opinion, the only costs that Mid-America can include in its cost-of-service that are related to Iowa City and Greenwood storage are the actual operating cost to Enterprise Terminals plus the original cost of the facilities. *Id*. at p. 2558.

371. Under further cross-examination, O'Loughlin testified that most of the decrease in Total Company barrels between the 2004 Base Period and the 2006 Base Period, the 2006 Base Period and the Locked-In Period, and the 2004 Base Period and the Locked-In Period, was due to the lower volumes on the Northern System during those time periods. *Id*. at p. 2590. In addition, he also asserted that there was no direct correlation between the Rocky Mountain direct cost and investment when compared to the Northern System direct cost allocation and investment. *Id*. at pp. 2608-09. O'Loughlin agreed with counsel for Williams that, because the Northern System had four pipelines which were not on the same right of way while the Rocky Mountain System only has two pipelines, one could assume that cost of operating the former would be higher than the cost of operating the latter. *Id.* at pp. 2611-12. He also agreed that batching exists on one of the Northern System's pipelines while none exist on the Rocky Mountain System and that batching adds costs to transporting products. *Id.* at p. 2613.

372. When asked to explain indirect operating expenses, O'Loughlin answered, indirect operating expenses include both indirect and common expenses. *Id*. at p. 2615. General expenses, which are booked in FERC Account 500, he argued, should be allocated on the basis of the Kansas-Nebraska allocators — direct labor and gross plant. *Id*. The general operating expenses were included in his definition of indirect operating expenses, according to O'Loughlin. *Id*. The Kansas-Nebraska method, he further declared, should be used to allocate common operating expenses. *Id*. at p. 2616.

373. On re-direct examination, O'Loughlin stated that Mid-America treated the Conway to Clinton and Clinton to Conway movements as two separate movements, and Mid-America treated the Conway to Clinton and Clinton to Conway movements as associated with revenue in both instances, although it treated Clinton to Conway as being negative revenue. *Id.* at p. 2632. He explained that there were six specific transportation movements in the Mid-America/East Red Line Shipper contract,[212] to wit: (1) Conway to Clinton, (2) Conway to Morris, (3) Channahon to Clinton, (4) Channahon to Morris, (5) Cochin volume commitment, and (6) Clinton to Conway propane movement. *Id.* at

[212] *See* Exhibit No. NPG-93.

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pp. 2632-33. The six transportation movements were included in O'Loughlin's ratemaking analyses, he added. *Id.* at p. 2633. O'Loughlin, claiming that the contract was not entered into through competitive bidding, characterized it as follows:

> It appears to be a negotiated contract where there was clearly discussion over the various components and the pricing of those components, but for example, we did not see a hypothetical pipeline competitor study being done by Mid-America prior to or in the context of the negotiation of this contract.

Id. at p. 2633.

374. The East Red Line Shippers' contract had an escalation provision that allowed the contract price to change from year to year, O'Loughlin said. *Id.* at p. 2635. With respect to the movements from Conway to Clinton and Morris, and Channahon to Morris, O'Loughlin stated that the contract price was 59 cents in 2004, 64 cents in 2005, 75 cents in 2006, and is presently 90 cents. *Id.*

I. DANIEL S. ARTHUR

375. Daniel S. Arthur (Arthur) is a Principal at The Brattle Group, an economic and management consulting firm. Exhibit No. NPG-113 at p. 1. Arthur argued that Mid-America incorrectly included non-recurring expenses related to a pipeline integrity management program in its 2006 Base and Test Year cost of service, as well as its May 2006 Locked-In Period cost-of-service, for both total company and Northern System calculations. *Id.* at p. 3. A normalizing adjustment is necessary, in Arthur's opinion, because the operating and maintenance expenses, to be included in a cost-of-service calculation, only should include the level of expenses that are representative of the costs expected to be incurred on a going forward basis. *Id.*

376. The Department of Transportation, explained Arthur, started a Pipeline Integrity Management Program, in 2001, that required pipeline operators to create a written plan developing a baseline for the integrity of its hazardous materials pipelines over a five-year period, with reassessments occurring every five years. *Id.* at pp. 3-4. Locations where expenses are incurred for any given year within a five-year assessment period, according to Arthur, are not representative of other years within the period. *Id.* at p. 4. However, he claimed, the year-to-year magnitude of the assessment costs and the location along the company's pipeline where these costs will be incurred is reasonably foreseeable over a five-year time frame. *Id.* For the 2004 Base Period, Arthur testified, Mid-America's actual pipeline integrity management expenses were $5.2 million, with the Northern System comprising 63% of the total. *Id.* at p. 5. Additionally, he continued, for the 2006 Base Period, the expenses totaled $14.7 million, and the Northern System comprised 73% of these costs. *Id.* Finally, Arthur reported, the expenses for the

Locked-In Period were $12.6 million, and the Northern System accounted for 63% of the total. *Id.*

377. Arthur argued that Mid-America witness Collingsworth provided no evidence for his claim that each of the levels of the company's operating and maintenance expenses for the 2004 Base year, the Locked-In Period, and the 2006 Base Period are recurring. *Id.* at pp. 6-8. Immense increases in total operating expenses between the 2004 and 2006 Base Periods, Arthur contended, indicate that the pipeline integrity management costs are not recurring. *Id.* at p. 8. Additionally, because Mid-America's actual and budgeted expenses for the pipeline integrity management program fluctuate greatly over the 2004 to 2011 period for both Total Company and Northern System levels further proves, he stated, that the expenses over the 2006 Base Period need to be normalized. *Id.* at pp. 8-11. The five-year period of 2004 through 2008, in Arthur's opinion, is the appropriate time frame to use to normalize Mid-America's pipeline integrity management program expenses. *Id.* at p. 11.

378. Under the Department of Transportation's program, according to Arthur, Mid-America was required to finish testing its system by March 31, 2008. *Id.* at p. 14. He added that Mid-America completed testing on 50% of its system by September 30, 2004. *Id.* at 14. Under Mid-America's Baseline Assessment Plan, according to him, it is required to reassess each pipeline section every five years. *Id.* at pp. 14-15. Thus, pipeline sections that were initially assessed in 2004 will have to be reassessed by 2009, he declared. *Id.* at p. 15. According to him, an average of the actual and budgeted expenses over a five-year period provided a reasonable and normalized expense level to include in Mid-America's costs of service instead of the non-recurring actual expense levels it includes. *Id.* He claimed he favored using the average pipeline integrity management expense levels over the 2004 through 2008 period, which consists of two years of actual data and three years of budgeted information. *Id.* at p. 16. The Total Company average expenses over this period, Arthur testified, are $9.0 million, and Northern System expenses are $3.9 million. *Id.* Mid-America's budgeted expenses tend to exceed its actual expenses, and therefore, Arthur argued, a time period of 2004 through 2008 is more appropriate than a 2005 through 2009 period because using the actual expenses of 2004, instead of the budgeted expenses of 2009, results in a more accurate finding. *Id.* at pp. 16-17.

379. There were several deficiencies, contended Arthur, made by Mid-America to the Commission's Massachusetts formula for allocating Enterprise Products Partners' unallocated corporate overhead expenses to Mid-America and other subsidiaries. *Id.* at p. 19. The Massachusetts formula assigns corporate overhead costs to subsidiaries that cannot be directly allocated, explained Arthur. *Id.* at p. 22. All subsidiaries must be included in the formula allocation, according to him, unless that subsidiary received no benefits from the corporate cost center. *Id.* at p. 23. Continuing, Arthur stated that Mid-America used the gross margin and not the gross revenues, excluded certain

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subsidiaries, improperly allocated overhead to Mid-America that should have been allocated to Seminole, and used monthly balances instead of end-of period balances. *Id.* at pp. 19-20. Consequently, Arthur suggested, these errors caused an inflation of the overhead expense allocated to Mid-America for the purposes of a cost-of-service calculation. *Id.* at p. 20.

380. Enterprise Products Operating is the operating subsidiary of Enterprise Products Partners, explained Arthur, so the allocation of overhead to subsidiaries is performed as an allocation from it to the remaining subsidiaries. *Id.* He added that Mid-America changes the Massachusetts formula by using the gross margin, which typically inputs the average of a subsidiary's gross revenues, rather than gross margins. *Id.* at p. 21. Arthur further explained that there also is an allocation of corporate overhead expenses from the ultimate parent EPCO, Inc., to Enterprise Products Partners that includes costs which are later allocated to Mid-America. *Id.* at p. 22. However, the allocation from EPCO, Inc., to Enterprise Products Partners is a subjective determination, he went on to say, that is not based on any formula. *Id.*

381. According to Arthur, Mid-America uses the "Distrigas[213] method," which is a modified Massachusetts formula, in which gross margin is calculated as gross revenue minus the cost of goods sold. *Id.* at p. 24. While Mid-America's gross margin is roughly equal to the company's gross revenue, Arthur noted, for other Enterprise Products Partners' subsidiaries, gross margin is substantially less. *Id.* Subsidiaries with a lower gross margin received a lower assignment of Enterprise Products Partners' overhead in Mid-America's model; thus, he testified, Mid-America received a higher allocation of overhead. *Id*. at p. 25. Because, according to him, Mid-America presented no evidence that any Enterprise Products Partners' subsidiary has a regulated pass-through mechanism creating revenues requiring minimal oversight, Arthur argued, Mid-America's use of the Distrigas method was incorrect. *Id.* Moreover, Mid-America and the other Enterprise Products Partners' subsidiaries did not have a purchased gas cost adjustment that automatically passes through the recovery of commodity costs to customers, so Arthur contended, the use of gross margin instead of gross revenue was inappropriate. *Id.* at p. 27. In fact, the only energy commodity marketing activity identified by Arthur was related to natural gas liquids without anything like a purchased gas cost adjustment clause. *Id*. at pp. 27-28.

382. Arthur advocated the use of gross revenue and not the gross margin in the Massachusetts formula because, he claimed, Mid-America failed to show that its natural gas liquids marketing did not require significant oversight. *Id.* at p. 28. Mid-America's total gross revenue was reported in its FERC Form 6, testified Arthur, and included revenues from its affiliates. *Id*. As he believes it is appropriate to use consistent figures

[213] *See Distrigas of Massachusetts Corp.*, 41 FERC ¶ 61,205 (1987).

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for Mid-America and Enterprise Products Partners, Arthur asserted that it is appropriate to use a measure of the latter's gross revenue equal to the sum of each of its subsidiaries gross revenue, all containing the revenues of affiliated companies. *Id.* at pp. 28-29.

383. Mid-America excluded Dixie Pipeline, Tri-States, and Belvieu Environmental Fuels, three Enterprise Products Partners' subsidiaries, from its Massachusetts model analysis, according to Arthur. *Id.* at p. 29. The effect of the exclusions, he explained, was to allocate to subsidiaries, such as Mid-America, a portion of the Enterprise Products Partners' overhead that should have been allocated to Dixie, Tri-States, and Belvieu Environmental Fuels. *Id.* Arthur rejected Mid-America's explanation that, because there were operating agreements between EPCO and each of the subsidiaries, they should have been excluded from the calculation. *Id.* at p. 30. Instead, Arthur stated, there is evidence that Enterprise Products Partners performs administrative services for these three subsidiaries. *Id.* The evidence, Arthur submitted, shows that Mid-America witness Collingsworth has responsibilities overseeing the commercial development of Dixie Pipeline, and Enterprise Products Partners performs the administrative consolidation of the subsidiaries' financial and operating results in Enterprise Products Partners' SEC Form 10-K, among other things. *Id.* at pp. 30-33. Because Enterprise Products Partners performs administrative services for each of the three subsidiaries that are distinct from operating responsibilities provided by a contractual fee, Arthur claimed that these subsidiaries should be included in the Massachusetts formula calculation. *Id.* at p. 33.

384. The total gross property, plant, and equipment used in Mid-America's Massachusetts model calculations for 2004 and 2005, Arthur noted, was substantially lower than the amount contained in the 2004 and 2005 SEC Form 10-Ks for Enterprise Products Partners. *Id.* at p. 34. Essentially, Arthur contended, the effect of using a lower total property, plant, and equipment balances was a greater allocation of Enterprise Products Partners' overhead to Mid-America. *Id.* The 2004 imbalance, he explained, was due to the fact that the gross property of GulfTerra and its subsidiaries, as well as, the assets of Dixie Pipeline, Belvieu Environmental Fuels, and Tri-States was left out of the Massachusetts formula calculation performed by Mid-America. *Id.* at p. 35. Additionally, he stated, the 2005 imbalance was due to the exclusion of $1.0 billion in purchase price adjustments, assets of the three previously mentioned subsidiaries, and $1.2 billion in gross property, plant, and equipment added in December 2005. *Id.* at p. 36. Arthur contended that all of the adjustments made by Mid-America in its 2004 Base Period and 2005 Test Period Massachusetts formula calculation to the gross property, plant, and equipment reported in Enterprise Products Partners' 2004 SEC Form 10-K were inappropriate, and the correct amount should have been the original $8.4 billion reported in that 2004 SEC Form 10-K. *Id.* at pp. 36-37. Likewise, none of the adjustments made by Mid-America in its formula to the gross property, plant, and equipment reported in Enterprise Products Partners' 2005 SEC Form 10-K were appropriate, argued Arthur, and the company should have used the $9.0 billion originally reported in that form. *Id.* at p. 37. While Arthur agreed that it was correct to exclude any

purchase price accounting adjustments associated with any regulated Enterprise Products Partners' subsidiaries that were regulated and had rates based on original cost ratemaking principles, he alleged that Mid-America presented no evidence that the $1.0 billion in purchase price accounting adjustments were related to any rate-regulated Enterprise Products Partners' subsidiary. *Id*. at pp. 37-38.

385. The Enterprise Products Partners' overhead which should be assigned is $34.0 million for the 2004 Base Period, $51.2 million for the 2006 Base Period, and $47.8 million for the Locked-In Period, according to Arthur. *Id*. at p. 38. The deduction of direct charges of overhead expense specifically assigned to Mid-America from Enterprise Products Partners' total overhead expense prior to performing the Massachusetts formula calculation was correct in Arthur's opinion. *Id*. However, Arthur took issue with Mid-America's allocation of EPCO, Inc.'s corporate overhead to Enterprise Product Partners because Mid-America characterized the allocation as a subjective determination by EPCO, Inc., and there was an unjustified allocation increase to Enterprise Product Partners occurring in October 2005. *Id*. at pp. 39-40. Yet, despite these issues, Arthur stated he accepted Mid-America's calculation of the total Enterprise Product Partners' overhead to be allocated to its subsidiaries. *Id.* at p. 40.

386. With respect to Mid-America's allocation of Enterprise Products Partners' overhead expense, Arthur testified that Mid-America performs them on a monthly, not an annual, basis using end-period balances. *Id*. at p. 43. Because pipelines must set rates on a going forward basis, Arthur claimed that end of Base Period or end of Test Period balances are more accurate than monthly Massachusetts formula allocations. *Id*. at p. 44.

387. Arthur testified that he performed the Massachusetts formula allocation based on end-of-period balances, used gross revenues, and included all the Enterprise Products Partners subsidiaries in the calculation. *Id*. at p. 45. The resulting unallocated corporate overhead expenses assigned to Mid-America, he claimed, were $3.7 million for the 2005 Test Period, $3.4 million for the 2006 Test Period, and $3.1 million for the Locked-In Period. *Id*. at pp. 46-47.

388. On direct examination, at the hearing, Arthur claimed his Massachusetts formula calculation had to be changed. Transcript at p. 2680. Specifically, he testified that the total Enterprise Products Partners gross property was changed from $9.0 billion to $7.8 billion which, in turn, changed the total Massachusetts formula percentage of overhead that was allocated to Mid-America from 6.59 to 7.08%. *Id.* at p. 2681. Upon further questioning, using the 2006 Test Period, Arthur recommended $3.6 million for the level of overhead costs for Mid-America. *Id.* at p. 2682.

389. Under cross-examination, Arthur agreed that, with respect to the pipeline integrity assessment costs, adjustments to the costs included by Ganz in his cost-of-service were necessary because the actual operating expenses related to pipeline integrity assessment

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that Ganz used were at a nonrecurring level. *Id.* at p. 2686. When asked, Arthur defined "recurring expense," as an expense that will be incurred on a regular basis going forward through time, or an expense whose level does not significantly or materially fluctuate through time, or whose level is not expected to fluctuate through time. *Id.* at p. 2687. Agreeing that pipeline integrity expenses were recurring, Arthur testified that he would allocate 20% of the five-year total pipeline integrity cost. *Id.* at pp. 2688-91.[214] For example, Arthur used four different five-year averages of anticipated pipeline integrity costs: 2004-08, 2005-09, 2006-10, and 2007-11. *Id.* at p. 2692. For the Northern System, Arthur reported, the figure ranges from $3.9 million to $5.1 million, depending on which five-year average was used. *Id.* at p. 2692. More specifically, Arthur recommended the use of the 2004-08 period. *Id.* He did agree, under further cross-examination, that actual expenses for the Northern System in 2006 exceeded the budget he used in his testimony and that actual expenses also exceeded his budget in 2007. *Id.* at p. 2693.

390. Under further cross-examination, Arthur agreed with Ganz that Dixie Pipeline, Tri-States NGL Pipeline Company, and Belvieu Environmental Fuels should be included in the Massachusetts formula. *Id.* at p. 2694. Also, Arthur stated that including the Gulf Terra assets in the 2004 Base Period was appropriate because, during the time period, GulfTerra assets were merged into Enterprise Products Partners, and it incurred significant overhead related to that merger, both before September 30, 2004, and after September 30, 2004. *Id.* at p. 2709.

391. With respect to the pipeline integrity assessment costs, Arthur contended that they vary by system on Mid-America Pipeline. *Id.* at p. 2719.

J. CHARLES E. OLSON

392. Charles E. Olson (Olson) is an economist and currently teaches courses in economics and international business to MBA students as a professor at the University of Maryland, Robert H. Smith School of Business. Exhibit No. WIL-1 at pp. 1-3; Transcript at p. 2734. Olson also is a public utility and pipeline rate consultant. Exhibit No. WIL-1 at pp. 3-5.

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[214] *See also* Transcript at pp. 2718-19.

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393. After reviewing the testimony of Williamson regarding the appropriate capital structure information to be used to develop the deferred return component of rate base for Mid-America, Olson asserted that he does not agree with Williamson. *Id.* Williamson, claimed Olson, was incorrect in his conclusion that, for the period 1987 through 2001, Mid-America was responsible for its own debt, *i.e.*, the company had its own financial management capable of handling its public debt offerings and issued stand-alone debt. *Id*. at p. 7. From 1987 through 1998, Olson reported, Mid-America was a subsidiary of MAPCO and while the latter had significant amounts of outstanding rated debt, none was listed for Mid-America. *Id.* at pp. 7-8. The privately placed debt identified by Williamson,[215] testified Olson, was issued by MAPCO's financial management and was not rated. *Id.* at p. 8. According to Olson, there was no evidence that Mid-America had the capacity to issue its own debt, nor did it have its own bond rating. *Id*. at pp. 8-9.

394. Olson stated: "The excessive common equity ratios over the 1987 – 2002 period result in a higher deferred return than is appropriate and a higher annual amortization of that deferred rate. This resulted in the revenue requirement being overstated." *Id*. at p. 9. For the Test Period ending October 31, 2006, Olson related, Mid-America claimed the segmented revenue requirement for the Rocky Mountain System was $105,700,000, including a deferred return rate base component of $83,961,000. *Id*. at p. 9. However, after Olson corrected the revenue requirement, he said, the revised revenue requirement was $101,658,000, and the deferred return component of the rate base was reduced to $67,087,000, with an amortization of deferred return of $2,183,000. *Id*. at p. 10.

395. In Olson's opinion, three primary principles govern rate design: first, rates should recover revenue that equals the cost-of-service, not more and not less; second, the costs must be equitably proportioned across the multiple users of the system; and third, rates must not encourage uneconomic use, so there ought to be no discounted rates during peak times of the year. *Id.* at pp. 10-11. The governing principle in this case, suggested Olson, is that rates ought to be based on segmented costs. *Id*. Mid-America, in reality, is three geographically distinct systems he pointed out. *Id.* at p. 12.[216] Further, Olson testified, Mid-America keeps segmented accounting records for each of the three pipeline systems that segment rate base, labor, and fuel costs. *Id*. Given the divisions that occur at Hobbs, Texas, and Conway, Kansas, Olson insisted that Mid-America's three systems should be separated and segmented for ratemaking. *Id.* He added:

> Mid-America maintains segmented accounting records that . . . separate rate base, labor and fuel costs for reach of these systems. Relatively small amounts of cost and expense at Hobbs have to be allocated between the

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[215] *See* Exhibit No. M-21.

[216] *See also* Exhibit No. M-2.

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> Rocky Mountain and Central Systems. The same is true at Conway where some costs have to be allocated between the Northern and Central Systems. Overall, there are clear lines that distinctly delineate these systems.

Id. at pp. 12-13.

396. FERC Tariff No. 41, noted Olson, contained a seasonal discount program that set rates for propane and other heavier natural gas liquids below the general commodity rates. *Id.* at p. 13. However, Olson alleged, Mid-America failed to justify this discount with competitive considerations. *Id.* Validation of a discount rate program, in Olson's view, requires a showing of excess capacity, and discounted rates likely will bring in greater revenues than if no discount were offered. *Id.* Similarly, Olson objected to other discounted programs on the Northern and Rocky Mountain Systems because they lacked appropriate justification. *Id.* at pp. 13-14.

397. Oil pipeline rates for a firm service, Olson maintained, should be greater than those for a service that is less firm. *Id.* at p. 14. Under Mid-America's Item 100 allocation condition, if shipper requirements exceed carrier capacity, Olson asserted, the carrier prorates capacity. *Id*. Thus, a shipper with a higher probability of coming under this allocation rule, according to Olson, ought to pay a lower rate than a shipper who has secured priority. *Id.* However, Olson testified, the rate design currently employed by Mid-America on the Rocky Mountain System has the exact opposite effect, and a shipper coming under the allocation rule pays a higher rate. *Id.*

398. Further, while conceding that the flow rate for some products is higher than others, Olson claimed, these differences are not large enough to warrant rate differentials based on products. *Id.* at pp. 14-15. He suggested that Mid-America failed to justify rate differentials based on product. *Id.* at p. 15. On the other hand, agreeing with Mid-America witness Ganz, Olson stated that Mid-America's rates ought to be distance based because historically they were distance based. *Id.* at pp. 15-16.

399. Olson said he disagreed with O'Loughlin's interpretation of the Mid-America series of rate filings. Exhibit No. WIL-8 at p. 2. Specifically, he contended that Williams and Burlington would not have been granted status as intervenors if the Rocky Mountain rate increases on Group 100 to Group 950 traffic had not been proposed. *Id.* at p. 3. Mid-America, continued Olson, proposed significant rate increases on the other Rocky Mountain System traffic as well. *Id*. Additionally, although he agreed with O'Loughlin that total company cost-of-service data showed a drop between March 2005 and March 2006 filings, Olson pointed out that O'Loughlin omitted the fact that a segmented cost-of-service study was conducted which showed that rates were well above costs on the Rocky Mountain System and well below costs on the Northern System. *Id.* He suggested that "[a] fundamental principle of ratemaking is that prices should be based on cost." *Id.*

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400. Even though the prices of regulated utility and pipeline companies whose shares trade on public markets exceed book value by a large margin, Olson testified, this should not be taken to mean that no rate increases are ever justified for such companies. *Id.* at p. 4. Furthermore, he explained, although Enterprise Products Partners thought it made a good decision in buying Mid-America in 2002 this does not mean that a rate increase cannot be justified in 2005 or 2006 because costs can increase. *Id.* However, Olson noted, "Mid-America's rates were never subject to a fully allocated cost-of-service analysis until after the March 2005 rate filings." *Id.* This study reflected, asserted Olson, contrary to O'Loughlin's claim that Mid-America rate increases were selective and focused only on the Northern System, the Northern System rates, as of 2004, were well below cost and the Rocky Mountain System rates were well above cost. *Id.* at p. 4.

401. The Rocky Mountain System revenues, argued Olson, subsidized the Northern System over the 2005, 2006, and the Locked-In Periods.[217] *Id.* at p. 5.[218] Furthermore, he asserted, although there were some rate reductions on the Rocky Mountain System, there were increases as well, and stressed that the Rocky Mountain System was generating a revenue requirement that was well in excess of its cost of service.[219] *Id.* The Rocky Mountain and Central Systems, revealed Olson, experienced significant rate increases via the May 31, 2006, indexation filing, while no comparable increases were imposed in that filing on the Northern System.[220] *Id.* Finally, Olson claimed that O'Loughlin failed to explain, in his testimony, that the reductions made by Mid-America on the Rocky Mountain System were rate design changes that were completely unrelated to Northern System revenue requirements and rates, and he reasoned that there could be no impact on the Northern System because the revenue reduction from a lower rate on the Rocky Mountain System could not be shifted to the Northern System. *Id.* at p. 6.

402. Olson stated that he disagreed with Staff's and O'Loughlin's assertion that a

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[217] In his testimony at the hearing, Olson said he based his opinion on two things: "Number one, over this period of time there haven't been any rate cases. Number two, for oil pipelines, the relationship between revenues, expenses and rate base is typically stable." Transcript at p. 2752. *See also id.* at p. 2753.

[218] Olson cited to Exhibit No. M-24 tbl.2.

[219] Olson referred to his testimony at Exhibit No. WIL-1 at p. 10.

[220] Olson testified that (1) the increase for service from Groups 100, 101, 102, and 104 to Groups 115 and 120 was ten percent; (2) there were no increases for service from Groups 105 and 110 to Groups 115 and 120; and (3) there were increases from all origins to Group 140. Exhibit No. WIL-8 at pp. 5-6.

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locked-in period should not be used to determine if Mid-America's FERC Tariff No. 38 rates were just and reasonable because actual costs could be used to determine FERC Tariff No. 38 rates without reviewing and evaluating various adjustments. *Id.* at p. 7. Both the test year and Locked-In Period approaches, suggested Olson, will likely show that the initial increase of 23% was justified. *Id.*

403. Additionally, Olson disagreed with O'Loughlin's assertion that Mid-America incorrectly used the Kansas-Nebraska allocation formula to allocate indirect and common operating expenses to its three systems. *Id.* at p. 8. O'Loughlin, Olson claimed, incorrectly allocated indirect and common expenses, because he focused on volume and revenue, which were not factors in the Kansas-Nebraska formula. *Id.* Gross plant (a measure of size) and direct labor (a measure of expenses), asserted Olson, are the focus in the Kansas-Nebraska formula. *Id.* at p. 9. "Labor expense," he noted, "is relatively low on the Rocky Mountain System (11.2%) because there are relatively few inlet and outlet points, no terminal facilities, and the operation was highly automated." *Id.* Conversely, Olson explained, "the Northern System had numerous delivery points, many terminals, was older and less automated, required significant maintenance, and has many more miles of pipe." *Id.* For these same reasons, Olson asserted, O'Loughlin errs in claiming that there are more employees per 100 miles of pipeline on the Northern System than on the Central and Rocky Mountain Systems because those employees are used to perform work on other systems. *Id.* at pp. 9-10.

404. O'Loughlin's adjustment of the number of full-time equivalent employees per 100 miles of pipeline on the Northern System to equal the number on the Rocky Mountain System, Olson claimed, is inconsistent with the proper implementation of the Kansas-Nebraska formula. *Id.* at p. 10. The Kansas-Nebraska formula, he explained, is a simple approach that weighs actual labor expenses and gross plant costs equally and applies the resulting factors to indirect and common expenses.[221] *Id.* O'Loughlin's adjustments, Olson declared, were arbitrary, non-expense based, and complicating, causing the Kansas-Nebraska formula to be unusable. *Id.*

405. Olson continued, O'Loughlin's recommended real return on common equity (10.83% with an inflation factor of 4.32%)[222] was considerably understated for the following reasons: (1) his inflation number was unduly impacted by rising fuel prices in late 2005 and early 2006; (2) oil pipelines are riskier than natural gas pipelines, *i.e.*, the

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[221] Olson alleged: "O'Loughlin simply throws the formula away as he tilts the playing field. For the 2006 Base Period, he changes the direct labor factor for the Rocky Mountain System from 11.2 percent . . . to 37.0 percent . . . and the Northern System direct labor factor from 63.2 percent to 39.8 percent." Exhibit No. WIL-8 at p. 10.

[222] *See* Exhibit No. NPG-1 at p. 99 tbl.24.

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minimum risk premium he ought to have added to his return should have been 100 basis points (providing for the risk differential between oil pipelines and natural gas pipelines); (3) the earnings capped discounted cash flow model he used to obtain a 10.22% return on equity was rejected by the Commission; and (4) the Commission eliminated the use of natural gas proxy companies for oil pipeline rate of return determination. *Id.* at pp. 10-11.

406. Additionally, Olson maintained that there is no evidence that Mid-America's risk was lower or higher than average. *Id.* Moreover, although there are no other interstate natural gas liquid pipelines in the Rocky Mountain geographic region served by Mid-America at the moment, a major new project, Overland Pass, revealed Olson, will come on line in 2008, which will affect investors' perceptions. *Id.* at pp. 11-12. All of this indicates, stated Olson, that the Northern System is old, requires a high cost to operate, and faces new competition. *Id.* at p. 12. According to him, although the Northern System "has been heavily cross subsidized by the Rocky Mountain System," a segmented cost approach will require that its rate must rise. *Id.* Concluding this portion of his testimony, Olson asserted that Mid-America ultimately will have to discount its Northern System propane rates and will have difficulty earning whatever return is authorized in this case — clearly a risk on the Northern System which should not be passed on to the Rocky Mountain System shippers. *Id.*

407. Olson opposed O'Loughlin's suggestion that adjustments be made to the 2005-06 Locked-In Period and 2006 volumes on the Rocky Mountain System. *Id.* at p. 13. While he conceded that the 2005-06 winter was warmer than normal, Olson asserted, there are factors other than weather that impact volumes on a natural gas liquid pipeline such as higher prices for natural gas and propane, which will probably have more long-term impact than weather. *Id.* Olson argued that "there should be no volume based adjustments for the Rocky Mountain System or for any rates that might be set on a Mid-America total company basis." *Id.*

408. O'Loughlin's Total Company approach (a lumping together of the segmented data for the three Mid-America Systems into a composite), declared Olson, also should be rejected, because it is not cost based. *Id.* at p. 14. The three systems, according to Olson, should be treated separately, and costs should be allocated on a segmented basis, reasoning that the systems are discrete and the necessary data is available. *Id.*

409. Olson also disagreed with Staff witness Sherman's testimony concerning the Locked-In Period and the treatment of pipeline integrity costs.[223] *Id.* at p. 15. First, he

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[223] According to Olson, he disagreed with Staff witness Green on return of common equity, but declared himself in general agreement with Staff witness McComb's testimony. Exhibit No. WIL-8 at p. 14.

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stated that the Locked-In Period, using actual Test Period numbers, accomplishes the same goals for Period 1 as it would if using forward estimates that are available at the time the case is filed. *Id.* Second, Olson claimed it would be simpler to use the Locked-In Period and to normalize those expenses. *Id.* Finally, Olson asserted, Sherman inconsistently and incorrectly spread pipeline integrity costs because she used direct assignment for all other segment specific costs, and because pipeline integrity expenses were only partly a function of distance — they vary with inlet and outlet points and the terminal facilities on the pipeline. *Id.* at p. 16. Reiterated Olson, the Northern System with its many inlets, outlets, and terminal facilities, is generally going to have a higher level of such expenditures than the Rocky Mountain System and should be required to pay the integrity costs that go along with them. *Id.*

410. Staff witness Pride's rate design, stressed Olson, should be rejected because it was inconsistent with Sherman's allocation of intrastate and interstate costs. *Id.* According to Olson, while Sherman allocated intrastate and interstate costs on a per barrel basis, Pride treated those costs as fixed. *Id.* He declared that, were intrastate and interstate costs allocated on a per barrel-mile basis, rates should be designed in the same way. *Id.* However, he argued, inconsistent with Sherman's approach, Pride's rate design failed to do so. *Id.*

411. Under cross-examination, Olson testified that Mid-America had no debt of its own during the period 1987 through 2001 because all of the debt it reported on its FERC Form 6 was MAPCO debt.[224] Transcript at p. 2737. However, he admitted that there was evidence which could be interpreted to indicate that MAPCO distinguished between its debt and that of Mid-America.[225] Transcript at pp. 2738-40.

412. During further questioning, Olson enunciated several rate design principles: (1) Demethanized mix shipments should not subsidize propane shipments and vice versa; (2) laterals should be paid for by their users, *i.e.*, the costs of operating a lateral should be assigned to the pipe segment to which they are attached, but their allocated costs should be paid by the rates specific to that lateral; and (3) segmenting costs results in accurate rate. *Id.* at pp. 2741-47.

413. Olson testified that he agreed with Ganz's Kansas-Nebraska formula and related allocators — direct labor and capital. *Id.* at pp. 2749-50. According to him, Staff also agreed with Ganz and, he opined, "typically that's a good safety check." *Id.* at p. 2749.

[224] Olson said that he considered it MAPCO debt because there was no mortgage and no bond rating. Transcript at p. 2737. He added: "There was nothing to indicate from Moody's that it was specific to Mid-America." *Id.* at pp. 2737-38.

[225] *See also* Exhibit Nos. M-164 at p. 17; NPG-63 at pp. 4-5.

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414. Upon further questioning, he reasserted his opinion that the Rocky Mountain System had been subsidizing the Northern System for more than ten years.[226] *Id.* at p. 2752. When asked, Olson said he based his opinion on two factors: (1) there has not been a rate case during that period; and (2) "for oil pipelines, their relationship between revenues, expenses and rate base is typically stable."[227] *Id.*

415. Continuing, Olson explained that the existence of a purported locked-in period comes closer to guaranteeing a recovery of all costs incurred in that period than a base period or test period approach could. *Id.* at p. 2760. He added: "I think there's somewhat of a guarantee anyway with doing the base and test period thing, but I think there's a fair trade-off in terms of reducing rate case expenses, and I think that's a worthwhile trade-off." *Id.*

K. KATHLEEN L. SHERMAN

416. Kathleen L. Sherman (Sherman) is employed by the Commission in the Office of Administrative Litigation as an Energy Industry Analyst. Exhibit No. S-4 at pp. 3-4. According to her, the Test Period[228] for the initial Mid-America rate increase, filed on March 31, 2005, used the 2004 calendar year as a Base Period, adjusted for known and

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[226] Asked several hypotheticals, Olson testified that, if there were evidence indicating that the Northern and Central Systems collected more revenue than their costs, it would indicate that they were not subsidized by the Rocky Mountain System. Transcript at p. 2754. He also said he thought that, should the data indicate that the Rocky Mountain and Northern Systems were collecting more revenue than their costs, but that the Central System was not, it would indicate that the former two were subsidizing the latter. *Id.* at pp. 2754-55.

[227] Olson added the following:

> The central facts involved in formulating [his] opinion entail the 2004 base period, 2005 test period, the locked-in period, the 2006 test period showing that for all of those periods, that Rocky Mountain was subsidizing the Northern and the Central System[s].

Transcript at p. 2753. He also stated that, based on the data from these periods, the subsidy had gone on for many years. *Id.*

[228] A test period, Sherman said, is a base period adjusted for any changes in revenues and costs that are known and measurable at the time of the filing and will be effective within nine months after the last month of actual experience used in the filing. Exhibit No. S-4 at p. 7.

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measurable changes through September 30, 2005. *Id*. Further, she explained, the Test Period for the second Mid-America rate increase, filed on March 31, 2006, used a Base Period of February 2005 to January 2006, adjusted for known and measurable changes through October 31, 2006. *Id*. Since its original filing, claimed Sherman, Mid-America changed from its initial Test Period to a Locked-In Period of May 2005 to April 2006, which is the time the initial rates were effective. *Id*. In Sherman's opinion, the use of a locked-in period of actual costs was an unreasonable deviation from Commission policy. *Id*. at p. 8. Mid-America's Locked-In Period overlapped both the initial and second filing Test Periods, according to her, which resulted in the double counting of pipeline integrity plan expenses for the Northern System. *Id*.[229] Also, Sherman emphasized, the use of a locked-in period is the same as a retroactive adjustment to filings and violates the Commission's test period methodology. *Id*.

417. Sherman said she used cost-of-service studies provided by Mid-America for the Northern, Central, and Rocky Mountain Systems. *Id*. at p. 9. Mid-America, reported Sherman, allocated common costs for Conway and Hobbs hubs on the basis of which pipeline each hub serves and allocated total company common costs using the Kansas-Nebraska allocation methodology. *Id*. at p. 10. The Kansas-Nebraska methodology,[230] continued Sherman, is generally used to allocate administrative and general expenses in the 500 series accounts. *Id*. at p. 11. However, Sherman testified that the expenses allocated for Conway and Hobbs, not only included these acceptable administrative and general expenses in the 500 series accounts, but also included operation and maintenance expenses in the 300 series accounts. *Id*.

418. In her own calculations, Sherman stated, she used only the Kansas-Nebraska methodology to allocate administrative and general common costs to the three systems. *Id*. To determine the allocation of common costs for the hubs more accurately, she contended she used a volumetric allocator that separated interstate and intrastate volumes to find an interstate volume weight for each pipeline served by the hub. *Id*. at pp. 11-12. This different approach, claimed Sherman, resulted in an adjustment to the rate base in her cost of service studies from the original numbers provided by Mid-America using the Kansas-Nebraska allocator. *Id*. at pp. 12-13.

419. Additionally, according to Sherman, she utilized a volumetric allocator for the assignment of operating expenses, instead of the Kansas-Nebraska allocator used by

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[229] *See also* Exhibit No. S-4 at p. 8 fig.1.

[230] Sherman testified that the Kansas-Nebraska formula is a simple average of (1) the ratio of direct carrier gross plant to total gross plant in service; and (2) the ratio of the direct carrier labor costs to total company labor costs; multiplied by the total indirect costs. Exhibit No. S-4 at pp. 10-11.

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Mid-America "because this approach more accurately reflects the functions and relative usage of the hubs, than does a percentage of gross property and payroll. *Id*. at pp. 12, 15.[231] Sherman said she allocated interstate costs based on the following percentage calculated by Staff witness Meagan K. McComb: Period I – 98.15%; Period II – 98.6%. *Id.* at p. 13.[232]

420. Moreover, Sherman testified, she removed any expenses related to the ammonia pipelines, removed all storage expenses, and adjusted the pipeline integrity expenses from Mid-America's proposed cost of service. *Id*. at p. 15. Although Mid-America witness Ganz removed amounts related to the ammonia pipeline from the company's carrier property and accumulated depreciation, Sherman noted, Mid-America's filings included operating expenses related to the ammonia pipelines. *Id*. at p. 16. For consistency, Sherman claimed, she removed these operating expenses. *Id*.

421. Mid-America's pipeline integrity expenses for the initial rate period and the second rate period, Sherman asserted, are not representative of average annual costs. *Id*. at p. 17. She indicated that she disagreed with Mid-America's allocation of pipeline integrity expenses by directly assigning expenses to individual systems and using a Kansas-Nebraska approach for Conway. *Id*. at p. 18. Because Mid-America's allocation was based on the location of the work being done in the rate periods, and since the location of the work was not proportionate among the pipelines, Sherman stated, "an unduly higher expense could be locked in for rate making purposes for one of the systems, if a large amount of work was done for that system in the period being used to develop the rates, unless the costs are normalized." *Id*.[233] To do so, Sherman testified she decided to calculate the average annual pipeline integrity expense to date and divided the amount by the miles in Mid-America's system to reach an expense per mile. *Id.* Then, she indicated, she multiplied the specific number of miles for each system by the expense per mile to reach an allocated expense per year. *Id*. Finally, Sherman declared, she adjusted the amounts in the Pipeline Integrity-Authorization for Expenditure to match the allocated expense per year. *Id*.

422. Under cross-examination, at the hearing, Sherman testified that she used the actual data for the 12-month period that ends September 2005 in the analysis of the FERC Tariff

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[231] *See also* Exhibit No. S-4 at p. 12 Corrected Table 1.

[232] Exhibit Nos. S-5 at p. 19, S-11 at p. 19.

[233] During cross examination, Sherman said: "[T]he problem with the pipeline integrity expenses is that it is a seven-year plan before the entire system was inspected. So taking a locked in-period within that cycle is not likely to give you a representative cost for those expenses." Transcript at p. 2791.

No. 38 rates. Transcript at pp. 2788-89. With respect to her cost-of-service, she admitted that she removed the operating expenses and revenues related to the ammonia pipeline that Mid-America operates on behalf of Magellan. *Id*. at pp. 2792-93. Furthermore, Sherman noted, she excluded the cost centers related to the ammonia pipeline included in the cost of service. *Id*. at p. 2794. As cross-examination continued, Sherman agreed that Magellan reimburses Mid-America for these costs. *Id.* at pp. 2794-95.

423. Sherman went on to say, under further cross-examination, she used the Kansas-Nebraska percentage for general overhead and a volumetric allocator for Hobbs and Conway. *Id.* at p. 2800. Under the volumetric allocation approach, according to her, approximately 64-65% of the common costs at Conway were allocated to the Central System. *Id*. at p. 2812.

424. In answer to questions regarding pipeline integrity assessment expenses, Sherman claimed that the pipeline integrity assessment expenses in Mid-America's Account 83200 should be normalized. *Id*. at p. 2815. Upon further questioning, she stated, Mid-America did not incur any pipeline integrity assessment expenses in the first quarter of 2003 and expended approximately $70,000 in the second quarter. *Id*. at pp. 2821-22.

425. After she derived the annual total average amount for the pipeline integrity expenses, according to Sherman, she allocated the total among the three systems on a mileage basis. *Id*. at p. 2827. Her allocation on a mileage basis, she said, was based on the assumption that the amount of work required to inspect a length of pipeline is similar regardless of where the pipeline is located. *Id*.

426. When asked whether direct allocation of costs is preferred, Sherman said: "If you have sufficient information available, I think it's generally best to assign costs directly to cost causation, if it's possible, if the information is there." *Id.* at p. 2850. Questioned further, she said that the Kansas-Nebraska method does not accurately capture costs directly allocable to a pipeline or a system. *Id.*

427. According to Sherman, movements associated with the Bushton and Coffeyville lateral lines are intrastate movements. *Id.* at p. 2851. Additionally, she testified, the only direct assigned pipeline integrity cost account is FERC Account 83200. *Id*. at p. 2864. Sherman also testified that some of the costs for Conway and Hobbs are directly assigned to hubs, but they are not directly assigned to any of the segments — they are allocated. *Id*. at p. 2877.

428. Finally, in response to my questions, Sherman asserted that mileage is a fair way of allocating pipeline integrity costs because miles of pipeline are inspected. *Id*. at p. 2881. She also stated that the age of the pipe might be a factor to consider because older pipelines might require more extensive repairs. *Id.*

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L. MEAGAN K. MCCOMB

429. Meagan K. McComb (McComb) is an Energy Industry Analyst for the Commission. Exhibit No. S-19 at p. 1. Because Trial Staff disagreed with Mid-America's use of a locked-in period for the initial rate period, McComb said, she used actual data from the 12-month period, October 1, 2004 - September 30, 2005, to calculate the volume and barrel-mile data. *Id*. at p. 4. For the second rate period, McComb testified that, instead of the Test Period, actual data from the 12-month period, November 1, 2005 - October 31, 2006, should be used to analyze the volumes and barrel-miles to yield a more accurate indicator of Mid-America's current throughput capabilities. *Id*. at pp. 4-5.

430. Next, McComb stated, she calculated interstate percentages by dividing each system's interstate barrel-miles by the total barrel-miles for that individual system. *Id*. at p. 7. For the initial rate period, after using the actual data from the 12-month period described above, McComb said she determined Mid-America's total throughput for its entire system to be 226,108,133 barrels and 85,743,682,100 barrel-miles. *Id*. at p. 8. Mid-America, using the Locked-In Period, asserted McComb, determined the total throughput to be 210,667,883 barrels and 81,560,991,081 barrel-miles. *Id*.

431. Mid-America, according to McComb, made three normalizing adjustments to its data for the Locked-In Period: (1) updating pipeline mileage data; (2) recording certain movements as intrastate in January 2006 and adjusting the associated 2005 volumes as intrastate throughput; and (3) reducing historical throughput data for certain propane volumes. *Id*. at p. 7. McComb stated, for Period I, she has calculated the following barrels and miles:

DESCRIPTION	NORTHERN	ROCKY MTN	CENTRAL
Interstate Barrels	51,606,838	76,651,690	45,512,688
Intrastate Barrels	2,610,862	30,101,398	19,624,657
Total	54,217,700	106,753,088	65,137,345
Interstate Barrel-Miles	17,372,399,692	50,502,382,789	16,280,489,233
Intrastate Barrel-Miles	236,349,823	407,919,544	944,141,019
Total	17,608,749,515	50,910,302,333	17,224,630,252
Interstate Percentage	98.66%	99.20%	94.52%

Id. at p. 8.

432. Further, she noted she accepted Ganz's update to Mid-America's pipeline data, but not his "proposal to switch recording the movement from Channahon[, Illinois,] to

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Morris[, Illinois,] from interstate to intrastate throughput,"[234] or his "proposal to reduce the historical throughput data for propane volumes that moved from Conway, Kansas[,] to Clinton, Iowa."[235] *Id.* at pp. 8-9.

433. For the second rate period, McComb testified that she calculated the volumes and barrel-miles using 12 months of actual data from the November 1, 2005, to October 31, 2005 Test Period. *Id.* at pp. 11-12. McComb testified, for Period II, she calculated the following barrels and miles:

DESCRIPTION	NORTHERN	ROCKY MTN	CENTRAL
Interstate Barrels	38,148,626	76,852,364	53,421,778
Intrastate Barrels	13,228,134	26,447,249	12,907,248
Total	51,376,760	103,299,613	66,329,026
Interstate Barrel-Miles	17,062,300,403	49,286,678,750	16,244,867,951
Intrastate Barrel-Miles	252,178,778	191,315,818	725,681,992
Total	17,314,479,181	49,477,994,568	16,970,549,943
Interstate Percentage	98.54%	99.61%	95.72%

Id. at p. 11.

434. McComb also claimed that Mid-America made the same three adjustments to its volumes and barrel-miles for the second rate period as it did for the Locked-In Period. *Id.* at p. 11. In this instance, McComb acknowledged that she accepted both the update to Mid-America's pipeline mileage, as well as, the proposed revisions to alter certain movements as interstate rather than intrastate. *Id.* at p. 12. She accepted the second adjustment because the time at which Mid-America began recording these movements, in her view, fell within the time period used to analyze the volumes for the second rate period. *Id.* However, as for the first period, McComb asserted that she did not accept Ganz's proposal to reduce the historical throughput data for propane volumes moved from Conway, Kansas, to Clinton, Iowa.[236] *Id.* at pp. 12-13.

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[234] McComb claimed that she did not accept this proposal because Ganz testified that Mid-America did not start keeping a record of movements from Channahon to Morris until January 2006, while the 12-month period she used ended before that month. Exhibit No. S-19 at p. 9; *see also* Transcript at p. 2886.

[235] According to McComb, Staff witness Pride does not believe this adjustment is reasonable because the tariff provision on which it is based, Item 150, should be eliminated. Exhibit No. S-19 at pp. 9-10; *see also* Transcript at pp. 2886-87.

[236] McComb stated: "I did not accept Mr. Ganz's proposal to reduce the historical

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435. McComb claimed that she calculated the percentage of interstate volumes through the Hobbs and Conway hubs at the request of Staff witness Sherman to assist the latter in allocating costs between the Mid-America segments. *Id*. at pp. 13-14. This percentage, continued McComb, was determined by calculating the total interstate and intrastate volumes that passed through each point based on the origin and destination points for every Mid-America segment. *Id*. at p. 14. Subsequently, McComb claimed, she divided each segment's total volumes through the Conway and Hobbs hubs by the total volumes through those hubs to arrive at the percentage that ought to be allocated to each segment. *Id*.

436. Under cross-examination, McComb testified that she accepted Ganz's proposal to the barrel-mileage numbers in Periods I and II. Transcript at p. 2886. However, she goes on to say, she did not accept Ganz's characterization of the Channahon to Morris movement as intrastate in Period I because "the change was made outside the test period."[237] *Id*. at pp. 2886-87.

M. DOUGLAS M. GREEN

437. Douglas M. Green (Green) is a Financial Analyst Subject Matter Expert in the Office of Administrative Litigation at the Commission. Exhibit No. S-1 at p. 1. To calculate the common equity ratios, Green said, he applied the capitalizations of Mid-America's parent entities using long-term debt and equity balances over various time periods, as well as certain findings of Mid-America witness Williamson. *Id.* at pp. 6-7. Also, he testified, he used Mid-America's parent company because Mid-America did not have its own bond rating, and Mid-America's own common equity ratio was well outside the range of other companies. *Id.* at pp. 7-9. He completed this portion of his testimony by noting the following:

> For the periods ended December 31, 1985[,] through December 31, 1997, I used the common equity ratios of MAPCO, Inc.; for the periods ended December 31, 1998[,] through December 31, 2001, I used the common equity ratios of Williams; and for the periods ended December 31, 2002[,] through December 31, 2006, I used the common equity ratios of Enterprise.

Id. at p. 9.

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throughput data for propane volumes that moved from Conway, Kansas[,] to Clinton, Iowa. I made this determination for the same reasons as I stated . . . [for] Period I." Exhibit No. S-19 at pp. 12-13.

[237] McComb admitted that she did not investigate to determine whether the propane actually moved in interstate or intrastate commerce. Transcript at p. 2887.

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438. There are two 12-month test periods, Green stated, one ending on September 30, 2005, and the other ending on October 31, 2006. *Id*. Additionally, Green reported, the capital structure for the initial Test Period was 45.89% long-term debt and 54.11% equity. *Id*. The capital structure for the second Test Period, continued Green, was 44.97% long-term debt and 55.03% common equity. *Id*. at pp. 9-10. In calculating the capital structure for the second Test Period, Green asserted, he used data from Mid-America's parent company that went beyond the period's October 31, 2006, end date to reflect the most current cost of capital data available. *Id*. at p. 10. Because the cost of long-term debt could not be determined for Mid-America directly, Green explained, for the calculation, he applied the cost of long-term debt of Enterprise Products Partners, Mid-America's parent company. *Id.* According to him, the cost of long-term debt for the first Test Period was 5.39%, and the cost for the second Test Period was 5.73%. *Id*.

439. A company, in his view, Green testified, is entitled to recover its costs, including the cost of common equity.[238] *Id*. at p. 12. In addition, Green maintained, regulators use data considered by investors when they set the price for a company's stock in order to determine the rate of return on common equity. *Id*. at pp. 12-13.

440. Green stated that the Commission's formula for determining the appropriate rate of return on equity is: k = D/P (1+0.5g) = g, where "k" equals the investor-required return on common equity, "D" equals the cash distribution, "D/P" equals the current cash distribution yield, "g" equals the cash distribution growth rate, and "(1+0.5g)" equals the adjustment factor for quarterly cash distribution payments.[239] *Id*. at p. 15.[240]

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[238] The cost of common equity, Green noted, is determined by investors; thus, it is forward-looking and cannot be based on past returns on equity. Exhibit No. S-1 at p. 12.

[239] According to Green, "D" equals the annualized indicated dividends per share information contained in the *S&P Stock Guides* for the months of September 1, 2006, through February 28, 2007; and "P" equals the average of the high and low stock prices for the same time period based on information from the *S&P Research Insight*. Exhibit No. S-1 at pp. 31-32. He added that "g" represents a composite of the short term growth rate (the "median five-year earnings growth estimate published by *IBES* in the *Monthly Summary Data (US Edition)*) multiplied by two-thirds and long-term growth rate (an average of the long-term growth rates estimated by The Global Insight, The Energy Information Administration, and the Social Security Administration's *Federal Old Age and Survivor's Insurance and Disability Insurance Trustees Report*) multiplied by one-third. *Id.* at pp. 33-37.

[240] *See also SFPP, L.P.*, 86 FERC ¶ 61,022.

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441. According to Green, he used a proxy group of Equitable Resources, Inc., National Fuel Gas Company, Questar Corporation, and The Williams Companies, Inc., to estimate Mid-America's cost of common equity.[241] *Id.* at p. 16. Following Commission policy that an entity must prove that a master limited partnership's distributions are sufficiently similar to corporate dividends if a master limited partnership is included in a proxy group,[242] Green stated, he determined that none of the five master limited partnerships passed the test from 2003 through 2007 because none had earnings per unit levels in excess of the distributions per unit during that five year period. *Id.* at pp. 21-22. Additionally, Green said he considered master limited partnerships that were mentioned in other testimony before the Commission to see whether they might be eligible for inclusion in a proxy group and discovered that Energy Transfer Partners, Plains All American Pipeline, L.P. and TC Pipelines, L.P. met Commission policy for 2005 and 2006, and Boardwalk Pipeline Partners, L.P. met it for 2006.[243] *Id.* at p. 22.

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[241] Green stated that he developed this proxy group using a two step process that was first applied in *Texaco Refining and Marketing, Inc. v. SFPP, L.P.*, 117 FERC ¶ 61,285 (2006), to the oil and product pipelines that have evolved from the proxy group adopted by the Commission in *SFPP, L.P.*, 86 FERC ¶ 61,022 (1999). Exhibit No. S-1 at p. 17. Next, Green explained, he looked at the proxy groups used by the Commission in *High Island Offshore Systems, L.L.C (*sometimes *HIOS)*, 110 FERC ¶ 61,043 (2005) and *Kern River Gas Transmission Co.*, 117 FERC ¶ 61,077 which consisted of Buckeye Partners, L.P., Enron Liquids Pipeline, L.P., Kaneb Pipe Line Partners, L.P., Lakehead Pipeline Partners (the predecessor of Enbridge Partners, L.P.), Santa Fe Pacific Pipeline Partnerships, L.P., and TEPPCO Partners, L.P. Exhibit No. S-1 at p. 19. However, he noted, the proxy group now consists of Buckeye Partners, L.P., Enbridge Partners, L.P., TEPPCO Partners, L.P., Kinder Morgan Energy Partners, L.P., and Valero. *Id.* at pp. 17-20. Because Kinder Morgan, Inc., was being taken private, Green said he decided that its use in the proxy group was inappropriate. *Id.* Moreover, Green stated, he determined that Williams now should be included in the proxy group because the company had recovered from its prior financial difficulties. *Id*.

[242] According to Green, this requirement arose out of Commission concern that because master limited partnerships have pay-out ratios exceeding partnership income for a given year, these payouts would represent a return of capital. Exhibit No. S-1 at p. 18. Green referred to this as the *HIOS* test. *Id.*

[243] Green said he also considered whether to include El Paso, a company that was excluded from the proxy group used by the Commission in *Kern River Gas Transmission Co.*, 117 FERC ¶ 61,077 due to financial difficulties and discounted cash flow results that were too near to the cost of debt for a non-investment company. Exhibit No. S-1 at p. 28. In the end, he stated, he decided against including it in the proxy group in this case because the company announced its intent to form a master limited partnership for its gas pipelines which could have distorted stock prices, and it was still suffering from financial

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442. Green declared that his proxy group for the second Test Period included Equitable Resources, Inc., National Fuel Gas Co., Questar Corp., and The Williams Companies, Inc. *Id.* at pp. 29-30. Because, he maintained, there is no viable oil pipeline proxy group to use to estimate Mid-America's return on equity,[244] Green suggested that using his proxy group of gas pipelines, "which includes companies that are most similar to oil pipelines with regard to business operations, and for whom a viable proxy group of companies can be found that produces meaningful [discount cash flow] results," is appropriate.[245] *Id.* at p. 30.

443. According to Green, to determine the "D" component of the discounted cash flow formula, he "used the annualized indicated dividends per share information published in the *S&P Stock Guides* for each of the proxy group companies, for each month from September 1, 2006[,] through February 28, 2007." *Id.* at p. 32. He further testified that, to determine the "P" component of the formula, he "used the average of the high and low stocks prices for each month during the same six-month period using data obtained from *S&P's Research Insight.*" *Id.* The D/P component was calculated as the average of the six month yields for each company, Green continued.[246] *Id.*

444. After selecting the proxy group, Green stated that he applied the discounted cash flow (sometimes DCF) formula to each company in the group. *Id.* at p. 32. Having determined all the components of the discounted cash flow formula, Green said, he inserted the values into the formula to determine a zone of reasonableness of investor-required nominal return on equity for each member of the proxy group and calculated the median return on equity as 9.60%, with a low of 8.08% and a high of 13.03%. *Id.* at p. 38.

445. Continuing, Green testified that he compared the risk profile of his gas pipeline proxy group with that of the master limited partnership oil pipeline group by evaluating the *Value Line* safety ranks and the S&P Corporate Credit Rating (sometimes "CCR")[247]

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issues. *Id.* at p. 29.

[244] *See also* Exhibit No. S-1 at pp. 17-16.

[245] *See also* Exhibit No. S-1 at p. 31 where Green noted that *Value Line*, an investor service, considers four oil pipeline master limited partnerships "to have business operations similar to those of gas pipelines."

[246] *See also* Exhibit No. S-2, sch.1.

[247] Green stated: "*Standard & Poor's Ratings Service* assigns two types of credit ratings – the issuer and issue credit ratings. The CCR is the issuer credit rating that *S&P* assigns to corporate issuers. The issue credit rating is assigned to individual corporate

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for the two groups and found that the industries were similar in risk.[248] *Id.* at pp. 38-42. However, Green noted, though the industries are similar, it was impossible to perform a completely accurate risk assessment because of incomplete or possibly incompatible risk factors. *Id.* at p. 42. With respect to comparing the risk profile of the gas pipeline proxy group with Mid-America's parent, Enterprise Product Partners, Green declared that it would be inappropriate because Mid-America is only a very small percentage of Enterprise Products Partners' overall business. *Id.* at pp. 44-45.

446. Mid-America's nominal equity rate of return, Green suggested, should be 10.10%, a number that is 50 basis points above the proxy group median return on equity, to determine the cost-of-service for the 12-month test period ended October 31, 2006. *Id.* at p. 46. Furthermore, he claimed that he followed the Commission's policy in raising the proxy group's median by 50 basis points. *Id.* at pp. 44, 46-47.

447. Asked whether he thought that his proposed 10.10% return on equity for the 12-month Test Period ending October 31, 2006, was sufficient for Mid-America to attract capital, Green answered in the affirmative. *Id.* at p. 48. He added that his work shows that a 10.10% nominal return on common equity was 437 basis points greater than the company's cost of long-term debt, 542 basis points greater than the recent six-month average yield on ten-year Treasury bonds, 419 basis points greater than the recent six-month average bond yield on *Moody's* "A" rated public bond index, and 396 basis points greater than the six-month average bond yield on *Moody's* "Baa" rated public utility index. *Id.* Therefore, Green suggested, his proposed return on equity for the second Test period was sufficient for Mid-America to attract capital, assure confidence in the companys' financial integrity, and maintain its credit level. *Id.* at pp. 48-49.

448. For the initial Test Period, ending September 30, 2005, Green proposed a nominal return on equity of 10.91%. *Id.* at p. 50. In making this determination, Green did not use the proxy group he used to develop the return on equity for the second Test Period instead he used the proxy group adopted by the Commission in *Kern River Gas Transmission Co.*, 117 FERC ¶ 61,077 (2006). Exhibit No. S-1 at p. 48.

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debt issues (or other financial obligations)." Exhibit No. S-1 at p. 40. He added that the *S&P* Corporate Credit Rating represents the current opinion on the ability of a company's ability to meet its financial obligations. *Id.*

[248] Green elaborated at the hearing as follows: The *S&P* Corporate Credit Rating is "a single rating for a company based on its overall basic profile as opposed to an issuer. An issue specific credit rating would relate to a specific issue and the terms and conditions and collateral, and they can differ." Transcript at p. 2910.

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449. Green stated that he used Mid-America's real return on equity, rather than its nominal return on equity, to determine his proposed after-tax, weighted average costs of capital, because this was required by the Commission's trended original cost methodology.[249] *Id*. at p. 51. Trended original cost and original cost methodologies, explained Green, are essentially the same, although inflation is treated differently. *Id*. at p. 52. A trended original cost model, elaborated Green, reflects inflation by an automatic adjustment to the rate base, while an original cost model reflects approximated inflation in the nominal rate of return.[250] *Id*. According to him, the real return on equity for the Test Period ending October 31, 2006, of 8.02%, is the inflation rate of 2.08% for the 12-month period, ending January 2007, subtracted from the nominal return on equity — 10.10%.[251] *Id*. Additionally, he reported, the real return on equity for the Test Period ending September 30, 2005, of 6.22%, is the inflation rate of 4.69% for the 12-month period ending September 30, 2005, subtracted from the 10.91% nominal return on equity. *Id.* at p. 53.

450. Using a long-term debt/common equity ratio of 44.97/55.03, a cost of debt of 5.73%, and a real cost of common equity of 8.02%, Green contended, an overall weighted average cost of capital of 6.99% should be used by Mid-America for the Test Period ending October 31, 2006, to determine rates. *Id*. at p. 54. Also, using a long-term debt/common equity ratio of 45.89/54.11, a cost of debt of 5.39%, and a real cost of equity of 6.22% for the Test Period ending September 30, 2005, Green asserted that an overall weighted average cost of capital of 5.84% should be used to determine Mid-America's rates. *Id*. at p. 55.

451. For the Test Period ending October 31, 2006, Green said he performed the Commission's discount cash flow methodology using the five oil pipeline master limited partnerships used by the Commission in *Texaco Refining and Marketing, Inc. v. SFPP, L.P.*, 117 FERC ¶ 61,285: Buckeye, Enbridge, Kinder Morgan, TEPPCO, and Valero, calculating a 12.49% nominal return on equity. Exhibit No. S-1 at p. 55. However, Greens stated, as Valero acquired Kaneb on July 1, 2005, he excluded each from the proxy group for the Test Period ending October 31, 2006. *Id*. at p. 56. Therefore, using a

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[249] Green noted that the Commission adopted this methodology in *Williams Pipe Line Co*., (sometimes Opinion No. 154-B), 31 FERC ¶ 61,377 (1985). Exhibit No. S-1 at pp. 51-52.

[250] Green noted that he "calculated the inflation rates using data from the Consumer Price Index – All Urban data published on February 21, 2007[,] from the Department of Labor, Bureau of Labor Statistics website." Exhibit No. S-1 at p. 53. *See also* Exhibit No. S-3, Workpaper No. 17 at p. 1.

[251] *See also* Exhibit No. S-2.

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proxy group comprised of Buckeye, Enbridge, Kinder Morgan, and TEPPCO, according to Green, he derived a 12.29% nominal return on equity for the test period ending September 30, 2005. *Id*. at p. 56. After subtracting the inflation rate from these two results, Green declared, he arrived at an overall weighted average cost of capital of 8.31% for the test period ending October 31, 2006, and 6.58% for the Test Period ending September 30, 2005. *Id*.

452. Green testified that Mid-America witness Williamson's use of the company's FERC Form 6 data to determine its capital structure for the period of 1987 to 2001 runs contrary to Commission policy. *Id*. at pp. 58-59. None of the four oil pipeline master limited partnerships used by Williamson to compose his proxy groups for both Test Periods, claimed Green, had a level of distributions per unit for each year that was less than the earnings per unit during the five-year period. *Id*. at pp. 61-62. Further, Green stated, these four master limited partnerships were inappropriately used by Williamson in a proxy group because Williamson failed to show that, for each company, the distribution used in the discounted cash flow model was a payment of earnings and not a return on investment. *Id*. at p. 62. Williamson's GDP growth calculation, Green asserted, was inconsistent with Commission policy because it did not include data from the Social Security Administration. *Id*. at pp. 63-65. Moreover, according to Green, Williamson artificially increased the single distribution yield level representative of the six-month period for master limited partnerships that did increase their distribution levels during the six-month periods because Williamson mixed stock prices from his entire six-month period with distribution levels that existed only at the end of his six-month period. *Id*. at p. 65.

453. As Williamson mismatched his inflation calculation with the data period used in his discounted flow analysis, according to him, Green objected to Williamson's nominal return on equity calculation for 2006. *Id*. at p 67. He asserted that Williamson used an inflation rate developed for the calendar year 2005, a time period that fell five months short of his discounted cash flow model data period ending May 31, 2006. *Id*. at p. 67. This resulted in a higher real return on common equity than it would have been if Williamson had properly matched his inflation calculation, Green argued. *Id*. Had Williamson matched these time periods, Green suggested, he would have arrived at a 4.17% inflation rate and a real return on equity of 9.04%. *Id.* at p. 68.

N. BONNIE J. PRIDE

454. Bonnie J. Pride (Pride) works as an Energy Industry Analyst in the Office of Administrative Litigation at the Commission. Exhibit No. S-26 at p. 1. She stated that the first rate filing used a Test Period of January 1, 2004, to December 31, 2004, adjusted for known and measurable changes, through September 30, 2005. *Id.* at p. 7. She noted, however, that Mid-America, instead of using this period, used data from the May 2005 through April 2006 Locked-In Period. *Id.* The second rate increase she said, uses a Test

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Period consisting of a Base Year of February 2005 to January 2006, adjusted for known and measurable changes, through October 31, 2006. *Id.*

455. According to Pride, instead of offering it as a separate service, Mid-America bundles storage services with transportation services. *Id.* at p. 8. Mid-America justified this practice, explained Pride, by claiming that, as storage is necessary for the operation of a pipeline, including storage in its base transportation rates is appropriate. *Id.* at pp. 8-9. Further, Pride stated, while Mid-America's jurisdictional rates include a separate storage cost element, the company does not consider the supplementary storage services offered to its customers at Conway, Hobbs, and Pine Bend to be jurisdictional services. *Id.* at p. 9. Yet that storage is plainly a jurisdictional service regulated under Sections 1(3) and 1(6) of the Interstate Commerce Act, claimed Pride. Exhibit No. S-26 at p. 9. Mid-America, contended Pride, requires and regularly uses operational storage and considers its cost to be properly related to providing jurisdictional transportation service. *Id.* at p. 10.

456. The storage costs related to pipeline operation, asserted Pride, are properly included in the transportation rates, however, she explained "costs associated exclusively with shipper use of Mid-America's storage should be unbundled from the transportation rates and included in a jurisdictional cost of service specific to storage shippers." *Id.* Mid-America, she noted, failed to make the distinction between operational storage costs and shippers' use storage costs in either filing. *Id.* at pp. 10-11. Pride testified that shippers that do not use non-operational storage, in her opinion, should not be forced to bear the costs for these services. *Id.* at p. 11. Mid-America, asserted Pride, is in violation of both 18 C.F.R. § 341.8 of the Commission's regulations and Section 6(1) of the Interstate Commerce Act because the company's tariffs do not treat the shipper storage service as a jurisdictional service and fail to publish storage rates and appropriate rules and regulations regarding storage use. Exhibit No. S-26 at pp. 11-12.

457. Mid-America, reported Pride, leases storage at Conway, Hobbs, Greenwood, Iowa City, and Mocane from Enterprise Terminals. *Id.* at p. 12.[252] Additionally, Pride testified that Mid-America provides "in-line" storage at Pine Bend, so the company does not lease any additional storage facilities for this service. *Id.* Mid-America provides an "earned storage" service to its transportation customers at Conway and Hobbs, according to Pride, and will charge a fee unrelated to the amount of requested storage.[253] *Id.* at pp. 12-13.

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[252] *See also* Exhibit Nos. S-30, S-31, S-32, S-33.

[253] According to Pride, Mid-America explains how earned storage is calculated as follows:

> Earned Storage offered will be equal to a customer[']s most recent 12 (twelve) calendar month's deliveries to [Mid-America's] Groups 130, 135,

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Continuing, Pride went on to say, Mid-America's shippers have two "earned storage" options at Conway: Option A permits shippers to pay an annual fee of $1.38 per barrel and store barrels in multiples of seven and fourteen; and, under Option B, available only at Conway, shippers pay no fee, but can store product only in a multiple of one. *Id.* at p. 13. Shippers also are provided "earned storage" for no fee at Hobbs, but can lease additional storage for $2.10 per barrel, she added. *Id.* If a shipper's inventory at Conway or Hobbs exceeds its prearranged storage, Pride stated, it is charged five cents per barrel per day. *Id.* at pp. 13-14.

458. Next, Pride testified that Mid-America allocated its storage costs using the Kansas-Nebraska formula. *Id.* at p. 14. This method was inappropriate, she asserted, because the Kansas-Nebraska formula only should be used to allocate administrative and general expenses, not storage costs. *Id.* Alternatively, Pride suggested, any storage costs properly included in the transportation cost of service should be allocated using a volumetric method. *Id.* Further, Pride noted, Mid-America failed to differentiate between storage costs for operational use and the storage costs allocated for shipper use, which should not have been included in the transportation cost of service. *Id.* at p. 15.

459. Pride explained that she allocated the storage costs by averaging the total usage of all the leased storage facilities over the last 12 months of the two rate periods and compared that usage with the total capacity of the facilities for each period. *Id.* Next, Pride testified, she applied the percentage of usage for operational purposes to the lease costs of each facility. *Id.* Finally, she reported, she allocated any remaining costs to storage for shipper use, effectively unbundling these costs into a separate storage cost of service. *Id.* at pp. 15-16. Using this approach, Pride determined that the total interstate lease storage costs for Period I[254] were $10,997,074, with total interstate operational costs of $6,627,880, and assigned the remaining $4,369,194 to shipper use storage costs.[255] *Id.*

> 140, 145, and 220 tariff generating destinations plus tariff generating movements to Group 950 where the origin is not Group 120 divided by 365 days times the appropriate multiplier . . . .

Exhibit No. S-26 at p. 13. At the hearing, Pride defined "earned storage" as: "the amount of storage that Mid-America offers free to its shippers based on their recent deliveries over the last 12 months." Transcript at p. 3016. She added that Mid-America included the costs for this service in its transportation rates. *Id.*

[254] *See* Exhibit No. S-39 for copies of the leases for Period I.

[255] According to Pride, "[t]he cost per barrel of interstate operational storage costs allocated to each system for Period I is $.0381 per barrel." Exhibit No. S-26 at pp. 16-17; *see also* Exhibit No. S-37.

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at pp. 16-17.[256]

460. With regard to Period II, according to Pride, by taking the lease payments Mid-America made to Enterprise Terminals, multiplying that amount by the interstate barrel-miles calculated by Staff witness McComb (98.6%) she determined the percentage of operational use for each storage location and applied that percentage to the lease cost of each facility.[257] *Id.* at p. 17. Following this procedure, Pride said, she calculated the total interstate storage costs as $11,103,729, with interstate operation costs of $6,530,230 and storage costs for shipper use of $4,573,499.[258] *Id.* at p. 17. Additionally, Pride declared that a revenue credit to the transportation cost of service for the Northern System was appropriate in the case of the Pine Bend storage because there was no lease of storage facilities; rather the pipeline was used for this purpose. *Id*. at pp. 17-18. Mid-America, in her opinion, should be required to include storage rates and rules in a tariff to be submitted in a compliance filing. *Id*. at p. 18.

461. According to Pride, she calculated the storage costs for Periods I and II by first determining available capacity for shipper use by deducting the capacity used for operation storage from the total capacity of the caverns. *Id.* After she calculated those capacities, Pride stated, she divided those volumes by the storage costs for shipper use. *Id.* She said that she then determined that "[t]he annual rate . . . for Period I is $1.3206 per barrel and the annual rate for Period II is $1.3296 per barrel. *Id.*[259]

462. Mid-America witness Ganz, stated Pride, adjusted volumes using an iterative discount adjustment for both rate periods in justifying its rates for the Northern System. *Id*. at p. 19. The discount adjustment, insisted Pride, was incorrect because Mid-America failed to show that a discount was necessary for competitive reasons. *Id.* Also, she said she disagreed with the discount adjustment because the volume incentive rates, terms, and conditions were negotiated by Mid-America and therefore were negotiated rates unto which the Commission does not allow discount adjustments. *Id*. Finally, she explained, during Period II, all shippers transported volumes under discounted rates, so no shipper was being charged Mid-America's maximum rates. *Id*.

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[256] *See also* Exhibit No. S-37 at p. 1.

[257] *See* Exhibit No. S-40 for copies of the Period II leases.

[258] According to Pride, "[t]he interstate cost per barrel of operational storage costs allocated to each system is $.0393 per barrel." Exhibit No. S-26 at p. 17.

[259] *See also* Exhibit Nos. S-41; S-42.

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463. According to Pride, Mid-America gives one Northern System shipper a volume incentive discount, but it fails to justify this decision, according to her, leading to an inequitable situation. *Id*. at pp. 19-20. Mid-America entered into a pipeage agreement contract with this shipper in 1993, she testified, and the terms of this agreement were not published in its Tariff. *Id*. at pp. 20-21. This pipeage agreement represented a negotiated rate, in Pride's opinion, she said, and Commission policy does not permit discount adjustments to negotiated rate agreements if there is inappropriate cost shifting. *Id*. at p. 21. Mid-America, contended Pride, is inappropriately attempting to raise rates for all other shippers on the Northern System so that they can continue to subsidize rates to this one shipper. *Id*.

464. Under the pipeage agreement, Pride stated, Mid-America received incentive reliability payments in 2004 and 2005 and anticipates that the company will earn such a payment in 2006.[260] *Id*. at p. 22. Because Pride views the provision permitting the payment of these incentive reliability payments as part of the negotiate rates contained in the pipeage agreement, she recommended that Mid-America not be required to credit the revenues to the Northern System. *Id*. Also, she suggested, the volume deficiency payments were made as if transportation occurred so the revenues should be treated as transportation revenues for the two rate periods.[261] *Id*. at pp. 22-23. These revenues should be treated as trunk revenues, she claimed, even though Mid-America did not report them as such. *Id*. at p. 23.[262]

465. Mid-America, testified Pride, proposed to increase its general commodity rates on the Northern System by approximately 23% in its initial rate filing. *Id*. Then, in its second rate filing, Mid-America proposed to increase its general commodity rates by an additional 60%. *Id*. In that second rate filing, on March 31, 2006, Pride asserted, Mid-America included a seasonal discount program which offered discounted rates of roughly 23% less than the second period rates for the Northern System shippers. *Id*. According to Pride, all active Northern System shippers are eligible for the seasonal discount rates. *Id*. at pp. 23-24. Because Mid-America increased its general commodity rates for the second rate period and filed a seasonal discount plan available to all of its shippers, Pride suggested, this was a strategic plan to avoid filing another rate case for

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[260] According to Pride, the incentive reliability payment was $1 million annually. Exhibit No. S-26 at p. 22.

[261] According to Pride, "[t]he deficiency payments for 2004 and 2005 were $2,887,150 based on a volume deficiency of 3,650,000 barrels multiplied by $.791 per barrel." Exhibit No. S-26 at pp. 22-23. She also indicated that Mid-America was poised to receive a deficiency payment in 2006 as well. *Id*. at p. 23.

[262] *See also* Exhibit No. S-46.

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several years. *Id*. at p. 24. Furthermore, because none of the shippers are being charged the maximum rates, she asserted that a discount adjustment is inappropriate. *Id*. at pp. 24-25. Rather, Pride testified, pancaking its rates, Mid-America is using the system to avoid review by the Commission whenever it does implement the higher rate.[263] *Id*. at p. 25. Mid-America, Pride contended, is seeking to establish rates that it does not intend to charge in the foreseeable future, so that the company will be able to increase rates at any time up to the limit of that maximum rate without Commission review. *Id*. This practice is inconsistent with fundamental cost-based ratemaking, she emphasized. *Id*.

466. Item 150, according to Pride, is an unusual and unreasonable provision in Mid-America's Tariff. *Id*. at p. 26. This provision, explained Pride, offers free transportation for volumes shipped and a credit for future shipments. *Id*. at pp. 26-27. There is only one shipper, she noted, the same shipper that receives discounted transportation under the volume incentive program, that ships an ethane-propane mix north from Conway to Clinton and then ships propane from Clinton to Conway. *Id.* at p. 26. Thus, she claimed, this is the only shipper eligible for the credit provided in Item 150. *Id*. This provision, maintained Pride, results in an undue preference and violates Section 3(1) of the Interstate Commerce Act because there is an unreasonable cross-subsidization of the company's cost of service among its Northern System customers. *Id*. at pp. 26-27.

467. Finally, Pride testified, she calculated the proposed Northern System rates for both periods and separated the costs into distance and non-distance related costs. *Id*. at p. 27. The distance costs included items such as depreciation, return, taxes, and operation and maintenance costs, she testified, while the non-distance costs consist of non-mileage sensitive costs. *Id*.

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[263] Pride described pancaking as follows:

> [A] shipper that was shipping propane from Iowa City Holding to Conway Holding Kansas prior to Mid-America's first rate increase filing was charged a rate of $1.3237 per barrel. When Mid-America filed FERC Tariff No. 38, the rate was increased to $1.6282 per barrel, a 23 percent increase. Subsequently, a year later Mid-America filed FERC Tariff No. 41 and increased the rate another 660 percent to $2.6051 per barrel. In this tariff, Mid-America also filed a seasonal discount program which is applicable year round with no restrictions on the time of the year when the rates apply. It is my understanding that all of Mid-America's shippers qualify for the seasonal discount. Under this seasonal discount the shipper pays a rate of $2.0353 per barrel.

Exhibit No. S-26 at p.24.

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468. On direct examination at the hearing, after hearing Collingsworth's testimony, Pride proposed a change to the operational use storage allocation and the shipper use storage allocation at Conway. Transcript at p. 2914. At Conway, which Mid-America leases from Enterprise Terminals, which is operated by Williams, and which is used both for Mid-America's system operation and for shippers' use, Pride asserted, 50% of the leased cost and capacity should be allocated to operational storage, and 50% of leased cost and capacity should be allocated to shipper use storage. *Id.*

469. Under cross-examination, Pride suggested that transportation begins at the point of receipt of the product into Mid-America's possession, and transportation ends when the product is no longer in Mid-America's custody. *Id.* at p. 2921-22. Additionally, she explained that breakout tankage is operational tankage when product is being staged for transportation. *Id.* at p. 2925. According to Pride, Mid-America has operational storage at Iowa City, Greenwood, Mocane, Conway, and Hobbs. *Id.* at p. 2927. Upon further questioning, Pride asserted that only the costs necessary for operational use storage should be included in the cost of service, and any excess capacity available at those locations should be used for shipper use storage. *Id.* at p. 2928.

470. Under further cross-examination, Pride stated that the storage at Conway and Hobbs should be designated as "common carrier jurisdictional storage service" rather than "merchant storage," as Mid-America has designated it. *Id.* When asked to define the term "merchant storage," she replied, it was storage being used by the shipper, as opposed to the operational use of the pipeline. *Id.* at pp. 2930-31.

471. Moving on to the subject of terminaling, Pride explained that it occurs when product is delivered into a particular terminal. *Id.* at p. 2933. She added that there is a terminal service that is provided and a fee charged for that terminal. *Id*. at p. 2934. Further, Pride claimed that the costs of terminaling should not be included in the cost of service for an oil pipeline. *Id*. Also, she insisted that the costs associated with a terminal facility should be a separate charge in the Tariff. *Id.* Pride noted that she separated out merchant from operational storage, and then assigned the resulting dollars to the systems on a volumetric basis. *Id.* at p. 2937.

472. Next, Pride testified, Mid-America incurred an expense of approximately $11 million to lease the Hobbs, Iowa City, Greenwood, Mocane, and Conway caverns. *Id.* at pp. 2946-47. Pride said she attributed $6.7 million to operational use and the remaining $4.4 million to the storage function. *Id.* at p. 2947. She continued, Mid-America offers storage services at Conway and Hobbs, but receives revenue only from the storage at the Conway facility. *Id*. Additionally, she went on to say, Mid-America also offers earned storage at the Hobbs and Conway facilities. *Id*. at pp. 2947-48. According to Pride, Mid-America leased more storage space than it needed and, she asserted, its customers should not have to pay for this excess storage. *Id.* at p. 2951.

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473. As cross-examination continued, Pride reiterated her previous assertion that Item 150, which relates to the propane returned by the East Red Line Shipper from Clinton to Conway, was unreasonable even though the propane did not physically move that distance.[264] *Id.* at pp. 2973-74. She agreed that, if the propane moved from Conway to somewhere beyond Clinton, the East Red Line Shipper paid the rate set by the Tariff. *Id.* at p. 2975. When challenged to explain her problem with the transaction, Pride stated:

> The problem I have is that the tariff doesn't explain any of this scenario. The tariff says, when volumes are moving from Clinton to Conway, there's going to be a credit for this particular movement. Apparently, the tariff provision doesn't reflect this scenario at all.
>
> * * * *
>
> My problem is that it appears to me that there is a subsidy there, that there are costs associated with the pipe in providing this service, and that the East Red Line Shipper is not paying for this accommodation.

Id. at p. 2978.

474. Further questioned, Pride acknowledged that Conway, Greenwood, and Iowa City storage operations are all jurisdictional. *Id.* at p. 2992. Mid-America's Northern System propane on-demand service, contended Pride, allows a propane shipper, for a separate fee, to inject in Conway and immediately take out at any other point on the Northern System. *Id.* at pp. 2993-94.

475. The Greenwood and Iowa City storage operations, Pride testified, are an integral part of the service offered to the Mid-America shippers, and therefore, should be bundled in the transportation rate for the Northern System. *Id.* at pp. 2998-99. If the Greenwood and Iowa City storage operations were not found to be an integral part of the service offered to the Mid-America shippers, then Pride claimed, those costs should not be included in the cost of service. *Id.*

476. Finally, Pride testified that the only storage actually connected to the Rocky Mountain System is at Hobbs, but she allocated the operational use storage on a system

[264] In other words, the propane is credited, in a bookkeeping transaction, to the East Red Line Shipper's account at Conway even though the propane remains in Clinton. Transcript at pp. 2973, 2976-77. The credit at Conway is accomplished without the East Red Line Shipper having to pay a fee for transporting the propane from Clinton back to Conway. *Id.* at p. 2976.

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basis, allocating storage to the three systems. *Id.* at p. 3006.

SUMMARIES OF THE PARTIES' ARGUMENTS AND RULINGS

ISSUE NO. 1: HAS MID-AMERICA SHOWN A "SUBSTANTIAL DIVERGENCE BETWEEN THE ACTUAL COSTS EXPERIENCED BY THE CARRIER AND THE RATE RESULTING FROM APPLICATION OF THE INDEX" UNDER SECTION 342.4(a)[265] OF THE COMMISSION'S REGULATIONS FOR THE MARCH 2005 AND MARCH 2006 FILINGS, RESPECTIVELY?

A. MID-AMERICA

477. According to Mid-America, "substantial divergence" is a threshold filing requirement that a carrier must satisfy in order to amend its rates under the Commission's cost-of-service methodology. Mid-America Initial Brief at p. 1 (*citing* 18 C.F.R. § 342(a) (2007)). It further stated as follows:

> Order No. 571[266] thus provides that the substantial divergence standard is to be applied at the same time a carrier proposes to charge a rate based on its cost-of-service, so that the Commission may determine at that stage whether the carrier's *filing* is permissible under the regulations. If the carrier passes that hurdle, and if a protest has been submitted that the Commission concludes warrants suspension and investigation of the filed

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[265] Specifically, the regulation provides:

18 CFR § 342.4(a) Other rate changing methodologies

(a) *Cost-of-service rates.* A carrier may change a rate pursuant to this section if it shows that there is a *substantial divergence* between the actual costs experienced by the carrier and the rate resulting from application of the index such that the rate at the ceiling level would preclude the carrier from being able to charge a just and reasonable rate within the meaning of the Interstate Commerce Act. . . .

18 C.F.R. § 342.4(a) (2007) (emphasis added).

[266] *Cost-of-Service Reporting and Filing Requirements for Oil Pipelines*, 59 Fed. Reg. 59, 137 (Nov. 16, 1994), FERC Stats. & Regs. [Regs. Preambles, 1991-1996] ¶ 31,006 (1994) (Order No. 571).

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> rate under 18 C.F.R. § 3433 (2007), the carrier then has the burden of establishing that the rate is in fact just and reasonable under sections 1(5) and 15(1) of the Interstate Commerce Act ("ICA"). 49 U.S.C. app. §§ 1(5), 15(1) (1988) ("ICA"). The substantial divergence test in Section 342.4(a) does not impose an additional substantive burden that the carrier must satisfy in order for its rate to be found lawful at the conclusion of the Commission-ordered investigation.

Id. at p. 3 (footnote added).

478. With respect to its March 2005 and March 2006 filings, Mid-America argued that it proved a substantial divergence between actual costs and the rates resulting from the application of the index. *Id.* at p. 4 (*citing* Exhibit Nos. M-37 at p. 4; M-38 at p. 14; Transcript at pp. 2242-43). Indeed, Mid-America emphasized that the Commission's order suspending the March 2005 filing and setting the case for hearing expressly noted that Mid-America had met its burden and made a showing of substantial divergence. *Id.* at pp. 4-5 (*citing Mid-America Pipeline Co.,* 111 FERC ¶ 61,128 at P 10, 22). Furthermore, it claimed that the Commission, in its order suspending the March 2006 filing, also found a showing of substantial divergence in setting that filing for hearing. *Id.* at p. 5 (*citing Mid-America Pipeline Co.,* 115 FERC ¶ 61,124). Mid-America stressed that neither of the orders set the issue of substantial divergence as a matter to be addressed at the hearing. *Id.* In any case, Mid-America argued that it has shown a substantial divergence between its Northern System cost of service and the revenue resulting from the application of the index, and consequently the revenue resulting from the index ceilings for those rates, both in the original cost-of-service filing and this hearing. *Id.*[267]

479. In reply, with respect to the Propane Group's assertion that Mid-America's tariff filings require rejection because Mid-America failed to show the requisite substantial divergence, Mid-America contended once again that substantial divergence is a threshold filing requirement that must be satisfied by a carrier prior to filing an amendment to its rates. Mid-America Reply Brief at p. 2. It claimed that rulemaking authorities and Commission precedent make clear that a carrier must show "at the outset" a substantial divergence between the actual costs experienced by the carrier and the rate resulting from application of the Commission's indexing methodology. *Id.*[268] Thus, Mid-America

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[267] In support, Mid-America cited: Exhibit Nos. M-102 at p. 19 (Statement G); M-103 at p. 19 (Statement G); M-104 at p. 19 (Statement G); M-122; M-123; NPG-234 at pp. 3-4; Transcript at pp. 2285, 2289-90.

[268] In support, Mid-America cited: Order No. 571, Regs. and Preambles ¶ 31,006; *SFPP, L.P.,* 115 FERC ¶ 61,279 at P 20 (2006); *Bridger Pipeline, LLC,* 112 FERC ¶ 61,151 at P 11 (2005); *Rocky Mountain Pipeline System, LLC,* 115 FERC ¶ 61,390 at P

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asserted, once the Commission finds that the carrier has made the threshold showing (as it claims is the case here), requiring a pipeline to make the same showing at hearing is unnecessary and inappropriate. *Id.*

480. According to Mid-America, the Propane Group argued that, because Mid-America submitted its initial filing based on the cost data of the total company and then subsequently at the hearing defended its rates on a system basis, the Propane Group was prevented from contesting Mid-America's substantial divergence showing at the threshold state and thus should be permitted to raise the issue at hearing. *Id.* at p. 3. In response to that argument, Mid-America maintained that its filings complied with the Commission's regulations, which contemplate the precise circumstances and issues the Propane Group raised. *Id.* Specifically, Mid-America insisted that its initial tariff filings complied with 18 C.F.R. § 346.2(b)(1), and its hearing stage submission complied with Order No. 571 at pp. 31,165-66, requiring a carrier to present detailed cost allocation and rate design data in the event a protest is set for hearing.

481. For argument sake, even were it required to make a substantial divergence showing in this proceeding, Mid-America declared that, in fact, it made such a showing by demonstrating that its Northern System cost-of-service exceeded its revenue by approximately $14.6 million, which it contended qualifies as a substantial divergence. *Id.* (*citing* Exhibit No. M-104).

B. PROPANE GROUP

482. The Propane Group argued that Mid-America failed to meet its burden of proof of establishing a substantial divergence between its Northern System costs and the FERC Tariff No. 33 rates (*i.e.,* the rates effective before FERC Tariff Nos. 38 and 41). Propane Group Initial Brief at p. 2. In fact, the Propane Group insisted, Mid-America's Northern System is significantly overrecovering its cost-of-service at its FERC Tariff No. 33 (2004) rates. *Id*. (*citing* Exhibit No. NPG-1 at pp. 6-7 tbl.1).

483. Moreover, the Propane Group continued, Mid-America's March 31, 2006, filing changed only the Northern System rates. *Id.* at p. 4. Yet Mid-America asserted a substantial divergence justification for the total company, not for the Northern System only. *Id.* (*citing* Exhibit No. M-38 at pp. 13-31). The Propane Group suggested that Mid-America's approach places protestors in "a catch-22." *Id.* at p. 5. According to them, it is not possible to determine whether there is a substantial divergence without segmented cost-of-service and rate design analyses for the Northern System (as advanced by Mid-America), but Mid-America declared that it was not required to file segmented

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cost-of-service or rate design analyses with its initial rate filing.[269] *Id.* at pp. 5-6. Consequently, because no protestors have the necessary information to rebut Mid-America's initial claims, the Propane Group argued that Mid-America's FERC Tariff No. 41 filing should be rejected as a threshold matter. *Id.* at p. 6.

484. In reply, the Propane Group reiterated that, for both the March 2005 and March 2006 filings, Mid-America's Northern System revenues exceed the Northern System cost-of-service under the rates developed by the Commission's indexing procedure. Propane Group Reply Brief at p. 2 (*citing* Exhibit Nos. NPG-1 at pp. 6-8; NPG-235; NPG-236; NPG-237). Therefore, the Propane Group submitted, Mid-America has failed to make a substantial divergence showing. *Id.* According to the Propane Group, as the substantial divergence test is a threshold matter substantively, not procedurally, the Commission's regulations do not limit the substantial divergence issue solely to the initial filing stage. *Id.*

485. In this case, the Propane Group emphasized that, at the initial stage, there were no data available to assess whether there was a substantial divergence with respect to the Northern System rates because only total company cost-of-service data was provided. *Id.* at pp. 2-3. As a practical and ethical matter, the Propane Group asserted that limiting consideration of the substantial divergence test to a stage of the proceeding where relevant information was lacking would effectively eliminate the requirement altogether in cases such as this. *Id.* at p. 3. Moreover, the Propane Group noted, no case has been found analogous to the case here — where the relevant evidence was unavailable at the initial filing stage and became available during the course of discovery and hearing. *Id.*

486. Furthermore, the Propane Group asserted, in addressing Mid-America's contention that the omission of the substantial divergence issue from the Commission's orders suspending the March 2005 and March 2006 filings indicated that the Commission decided this issue in its favor, that this argument is coherent only if one assumes the regulations require the substantial divergence question to be decided at the initial filing stage. *Id.* at pp. 4-5. Rather, the Propane Group insisted, the regulations do not include such a requirement, and the omission of such a holding means that the Commission left the issue to be decided at the hearing. *Id.* at p. 5. Accordingly, the Propane Group contended that, for both the March 2005 and March 2006 filings, the record shows that Mid-America's Northern System cost-of-service is less than its revenue under the rates determined by the Commission's indexing procedure, and thus, Mid-America's substantial divergence showing fails, and its proposed rate increases should be rejected in

[269] The Propane Group asserted that Mid-America claimed that these materials were protected by the attorney work product doctrine, and therefore, did not provide such material in discovery. Propane Group Initial Brief at p. 6 n.3 (*citing* Exhibit Nos. WIL-16 at pp. 2-3; WIL-29).

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their entirety. *Id.* at p. 6.

C. WILLIAMS

487. Williams stated that an oil pipeline must make a prima facie case for substantial divergence. Williams Initial Brief at p. 5 (*citing* Order No. 571, Regs. and Preambles ¶ 31,006 at pp. 31,164-65; *Association of Oil Pipelines v. FERC,* 83 F.3d 1424, 1431 (D.C. Cir. 1996)). It further asserted that the Commission has held that the term "substantial change," as used in the Energy Policy Act of 1992, 42 U.S.C. § 7172 note (EPAct), means more than a ten percent difference. *Id.* at p. 6 (*comparing SFPP, L.P.*, 86 FERC ¶ 61,022 at P 16 with *SFPP, L.P.*, 104 FERC ¶ 61,163 at P 8-12 (2003)). Additionally, Williams explained, the Commission has not defined "substantial divergence" or established a bright-line test, but follows an established principle that revenues must at least fall within a "zone of reasonableness," so that the resulting rates are neither "less than compensatory" nor "excessive." *Id.* at p. 7 (*citing Farmers Union Central Exchange v. FERC,* 734 F.2d 1486, 1502-03 (D.C. Cir. 1984), *cert. denied,* 469 US 1034 (1984)).

488. While Williams claimed that it does not address the issue of substantial divergence because only the Mid-America's March 2005 and March 2006 rate filings for the Northern System are at issue, it asserted that the substantial divergence determination must be made on the basis of the Northern System's cost-of-service rather than total company cost-of-service. *Id.* at p. 9. In any event, Williams argued that, because Mid-America's revenues exceed its cost-of-service, it should not be seeking to increase its rates. *Id.* at p. 8.

489. In its Reply Brief, Williams concurred with Mid-America that substantial divergence is generally a threshold requirement applicable to the oil pipeline's rate filing. Williams Initial Brief at p. 3. Additionally, Williams maintained that, once the substantial divergence threshold is met, the pipeline must establish, at hearing, that its filed rates are just and reasonable. *Id.* at p. 4. However, Williams submitted, the substantial divergence question should not completely be barred from a subsequent investigation and hearing and that, if at hearing the evidence reveals that the alleged substantial divergence submitted with the filed rate cannot be supported, then a negative inference that it did not exist and that the submitted rates were not just and reasonable should be drawn. *Id.*

D. STAFF

490. Agreeing with Mid-America, Staff contended that substantial divergence is a threshold issue appropriately addressed as an initial matter at a pipeline's rate filing and questions whether it is an issue at all in this subsequent proceeding. Staff Initial Brief at

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p. 2.[270] It pointed to Section 342.4(a) of the Commission's regulations, 18 CFR § 342.4(a), maintaining that oil pipelines can change their rates through cost-of-service filings if they establish a substantial divergence between their actual costs and the revenues generated by the indexed rates. *Id.* at pp. 2-3.[271]

491. According to Staff, the Commission has never dealt with the substantial divergence test in a litigated rate case, but only as a "threshold" issue. *Id.* at p. 4. Moreover, Staff claimed that, in the rulemaking promulgating Section 342.4(a), the Commission indicated that it intended that a pipeline make a threshold showing of substantial divergence only in its rate filing, not in a subsequent hearing. *Id.* (*citing* Order No. 571, FERC Stats. & Regs. ¶ 31,006 at p. 31,165). Finally, Staff argued, requiring a pipeline to make a showing of substantial divergence at hearing, rather than in its initial rate filing, is administratively inefficient. *Id.* at p. 6. Accordingly, Staff claimed that the remedy after a hearing should be the fixing of just and reasonable rates, not the late rejection of the cost-of-service filing. *Id.* at p. 6.

492. As it did in its Initial Brief, Staff agreed in its Reply Brief with Mid-America's position — namely, the Commission should determine the question of substantial divergence as a threshold matter based on the pipeline's rate filing, but recognized that, here, the Commission failed to address this issue in the hearing orders. Staff Reply Brief at p. 4. According to Staff, all the Commission did was to recognize that Mid-America "'met its burden related to the required content of its cost of service filing, as required by section 346.1 of the Commission's regulations,'" and explained that this only meant that "Mid-America filed the requisite statements and supporting workpapers." *Id.* at pp. 4-5 (*citing Mid-America Pipeline Co., LLC*, 111 FERC ¶ 61,128 at P 22; 18 C.F.R. § 346.1).

493. Lastly, Staff admitted that the Propane Group makes a valid point regarding the absence of a segmented cost-of-service at the initial filing, but noted that the Commission's regulations require that a pipeline "present its cost of service on a total system basis." *Id.* at p. 5 (*citing* 18 C.F.R. 346(b)(1) (2007)). Staff stated that, "absent including a segmentation study as part of its initial filing, the pipeline can not make a

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[270] Staff noted, citing Order 561, *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, (Order 561) FERC Stats. & Regs. ¶ 30,985 at pp. 30,946-56 (1993), *order on reh'g and clarification* (Order No. 561-A), FERC Stats. & Regs. ¶ 31,000 at pp. 31,091-105 (1994), that "the Commission promulgated rules that provided a simplified method of changing oil pipeline rates through indexing."

[271] Staff also cited to *Rocky Mountain Pipeline System, L.L.C.*, 115 FERC ¶ 61,390 at P 17.

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substantial divergence showing in that filing if . . . it seeks to raise the rates on only one segment of its system." *Id*. at pp. 5-6.[272]

DISCUSSION AND RULING

494. The issue to be decided is whether a showing of substantial divergence is purely a threshold requirement to be made at the initial filing, not at a full hearing on the merits. If it must be shown at a hearing, the issue then becomes whether Mid-America has proven substantial divergence between its actual costs and the revenues from its indexed rates. *See* 18 C.F.R. § 342.4(a) (2007).[273] The Commission has yet to define the term "substantial divergence," and therefore, no bright line rule exists establishing the level of difference between a carrier's costs and revenues that would constitute substantial divergence under Section 342.2(a), *i.e.*, a showing of substantial divergence is determined by a subjective judgment.[274]

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[272] While not relevant to the matter at bar, Staff suggested that "[i]n the future, the pipeline can resolve this dilemma by filing a segmented cost of service along with a total system cost of service. If it fails to do so, a protesting shipper can point out this failure to the Commission." Staff Reply Brief at p. 6.

[273] Section 342.4(a) of the Commission's regulations provide:

> (a) *Cost-of-service rates.* A carrier may change a rate pursuant to this section if it shows that there is a substantial divergence between the actual costs experienced by the carrier and the rate resulting from application of the index such that the rate at the ceiling level would preclude the carrier from being able to charge a just and reasonable rate within the meaning of the Interstate Commerce Act. A carrier must substantiate the costs incurred by filing the data required by part 346 of this chapter. . . .

18 C.F.R. § 342.4(a).

[274] In *SFPP, L.P.,* 102 FERC ¶ 61,089 at P 25, 29-30 (2003), the Commission granted a petition for a declaratory order, finding that an expected showing of an investment resulting in cost-of-service rates exceeding SFPP's current indexed rates by more than twenty percent would constitute a substantial divergence. The Commission affirmed these findings on rehearing. *See also SFPP, L.P.,* 104 FERC ¶ 61,163 at P 8-12.

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495. The Commission stated in its *Cost-of-Service Reporting and Filing Requirements for Oil Pipelines* order:

> The Commission is adding a new Part 346 to its regulations that sets for the *threshold* filing requirements for oil pipelines seeking to establish initial rates on a cost-of-service basis, or to pursue a cost-of-service alternative to indexing as a means of establishing just and reasonable rates. The Commission is also amending sections 342.2 and 342.4 to reflect the addition of Part 346.
>
> A. *Authority for Filing Requirements*
>
> Cost-based rates are a part of this scheme but are allowed a pipeline only as an alternative to indexing, and only if the pipeline can meet certain *threshold* conditions. Thus, the pipeline must demonstrate *at the outset* that it meets the substantial divergence test of Order No. 561—*i.e.,* that there is a substantial divergence between the actual costs experienced by the pipeline and the rate resulting from application of the index such that rates at the indexed ceiling level would preclude the pipeline from charging a just and reasonable rate. The *threshold* filing requirements for cost-of-service ratemaking adopted in this rule are the means that the Commission has decided are necessary for a pipeline to make a *prima facia* demonstration that it should be allowed to pursue the cost-of-service alternative as a means of establishing just and reasonable rates. The materials required to be filed with a cost-of-service optional filing thus are designed to address the *threshold* issue of whether there is such a substantial divergence as to warrant a cost-of-service filing.

Order No. 571, 59 Fed. Reg. 59, 137 (Nov. 16, 1994) FERC Stats. & Regs. ¶ 31,006 at pp. 31,164-65 (1994); *see e.g., SFPP, L.P.,* 115 FERC ¶ 61,279 at P 20 (2006); *Bridger Pipeline, LLC,* 112 FERC ¶ 61,151 at P 11 (2005).

496. Mid-America argued that a showing of substantial divergence is merely a threshold filing requirement, which permits a carrier to proceed with its cost-of-service filing. Mid-America Initial Brief at p. 1. That is, Mid-America asserted, substantial divergence is a matter to be addressed at a carrier's initial rate filing, not after a full hearing. *Id.* at p. 3. Accordingly, Mid-America submitted that, in both its March 2005 and March 2006 rate filings, it made a showing of substantial divergence between its actual costs and the rates resulting from application of the index,[275] and the Commission's order suspending the March 2005 filing and setting the case for hearing

[275] *See* Exhibit Nos. M-37 at p. 4; M-38 at p. 14; Transcript at pp. 2242-43.

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expressly found a showing of substantial divergence. *Id.* at pp. 4-5 (citing *Mid-America Pipeline Co.,* 111 FERC ¶ 61,128 at P 10, 22). Additionally, it claimed that the Commission order suspending the March 2006 filing necessarily also found a showing of substantial divergence in setting that filing for hearing. *Id.* at p. 5 (citing *Mid-America Pipeline Co.,* 115 FERC ¶ 61,124). In any event, Mid-America maintained that it established at the hearing that its Northern System cost-of-service substantially exceeds the revenue generated by its filed rates, and consequently, substantially exceeds the revenue generated by the index ceilings for those rates. *Id.* at p. 5.

497. In response to Mid-America's argument, the Propane Group insisted that the substantial divergence test is a threshold matter substantively, not procedurally. Propane Group Reply Brief at p. 2. In other words, the Propane Group maintained that a carrier may be required to make a showing of substantial divergence at a full hearing on the merits. *Id.* To hold otherwise, claimed the Propane Group, would place protestors in a "catch-22," as, it suggested, is the case here, to wit: because Mid-America's March 2006 filing changed only the Northern System rates, determining substantial divergence without segmented cost-of-service and rate design analyses for the Northern System is unworkable, yet Mid-America declared that it was not required by the Commission's regulations to file segmented cost-of-service or rate design analyses with its initial rate filing, even though the segmented cost-of-service analyses was available to it. *Id.* at pp. 5-6. Finally, the Propane Group contended that Mid-America failed to meet its burden of proof in establishing a substantial divergence existed between its Northern System costs and the FERC Tariff No. 33 rates (*i.e.,* the rates effective before FERC Tariff Nos. 38 and 41). *Id.* at p. 2. Indeed, the Propane Group submits that the Mid-America Northern System is significantly overrecovering its cost of service at its FERC Tariff No. 33 (2004) rates. *Id.* at pp. 2-3 tbl.1.

498. While Williams concurred with Mid-America that substantial divergence is generally a threshold requirement applicable to the oil pipeline carrier's initial rate filing, it contended that the substantial divergence issue should not be completely barred from a subsequent investigation and hearing. Williams Reply Brief at p. 4. Although Williams does not address the issue of whether Mid-America proved substantial divergence in this proceeding, it insisted that the issue must be determined on a segmented, not a total company, cost-of-service basis. *Id.* at pp. 5-6.

499. Like Mid-America, Staff asserted that substantial divergence is a threshold issue appropriately addressed as an initial matter at a pipeline's rate filing. Staff Initial Brief at p. 2. Staff questioned whether substantial divergence is an issue in the present proceeding. *Id.* According to Staff, the Commission has never dealt squarely with the substantial divergence test in a litigated rate case, and the rulemaking promulgating 18 C.F.R. § 342.4(a) indicated that the Commission intended a pipeline to make a threshold showing of substantial divergence only in its rate filing, not in a subsequent hearing. *Id.*

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at p. 4.[276] Moreover, Staff argued that addressing the issue of substantial divergence at a hearing is administratively inefficient, and thus, the remedy after a hearing should be the fixing of just and reasonable rates, not the late rejection of the cost-of-service filing. *Id.* at p. 6. Finally, Staff noted that, while the Propane Group asserted a valid point regarding the absence of a segmented cost-of-service at the initial filing, the presiding judge should move forward and decide the cost-of-service and rate design issues raised by the filing. Staff Reply Brief at pp. 5-6.

500. After reviewing all of the evidence and the precedent to which the parties cited, I am compelled to agree with Staff and Mid-America that the issue of substantial divergence is a threshold requirement to be determined at an oil pipeline carrier's initial rate filing, not after a full hearing on the merits. Therefore, I do not need to determine whether Mid-America made a showing of substantial divergence at the hearing.

501. The Commission's language in Order No. 571 promulgating 18 C.F.R. § 342.4(a) makes patently clear that the Commission intended the substantial divergence question to be a threshold requirement determined at a carrier's initial rate filing, not after a full hearing on the merits. Its regulations permit cost-based rates "only if the pipeline can meet *threshold* conditions," and thus, "the pipeline must demonstrate *at the outset* that it meets the substantial divergence test of Order No. 561." Order No. 571, FERC Stats. & Regs. ¶ 31,006 at pp. 31,164-65 (emphasis added). Additionally, the Commission established as necessary those "*threshold filing requirements*" as the means for a pipeline "to make a *prima facia* demonstration that it should be allowed to pursue the cost-of-service alternative." *Id.* at p. 31,165 (emphasis supplied).

502. Moreover, to date, the Commission has never made a substantial divergence determination in a litigated case. In *SFPP, L.P.,* 116 FERC ¶ 63,059 at P 218, the presiding judge was confronted with the issue: "Whether SFPP Has Shown A Substantial Divergence Between Its North Line Costs And The Current Ceiling Rate Revenue Which Precludes The Pipeline From Charging A Just And Reasonable Rate?" Yet the parties did not confront, and the presiding judge did not decide, squarely, whether a showing of substantial divergence had been made. Specifically, the presiding judge's decision simply stated:

> All participants link the answer to this issue to the findings and conclusions reached under the amalgam of other issues and do not address it on a discrete basis. This issue therefore is generally resolved in the affirmative in accordance with all other findings and conclusions reflected in this Initial Decision.

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[276] In support, Staff cited Order No. 571, FERC Stats. & Regs. ¶ 31,006 at p. 31,165.

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Id.

503. Consequently, Commission precedent, or lack thereof, and the Commission's language in the rulemaking promulgating Section 342.4(a), lead me to conclude that the issue of substantial divergence is a threshold matter procedurally, and must be determined at a carrier's initial rate filing, not after a full hearing on the merits. Accordingly, I now turn to the matter of whether, in this case, the Commission determined at the initial rate filing whether Mid-America made a showing of substantial divergence between its costs and the rate resulting from application of the index.

504. As an initial matter, the fact that the Commission set this case for hearing creates a presumption that Mid-America made a showing of substantial divergence in its initial rate filing. Mid-America argued that the Commission, in its order suspending the March 2005 filing expressly noted that Mid-America met its filing burden and made a showing of substantial divergence. Mid-America Initial Brief at pp. 4-5. While I cannot say that the Commission *expressly* found a showing of substantial divergence, at the very least, it impliedly and necessarily found a showing of substantial divergence. *See Mid-America Pipeline Co.,* 111 FERC ¶ 61,128. Indeed, the Commission's order stated that Burlington's protest includes allegations that Mid-America "fail[ed] to provide credible cost, revenue, and throughput information to establish a 'substantial divergence' between its actual costs and the rates allowed under indexing, as required by the applicable regulations." *Id.* at P 10. Yet the Commission denied Burlington's and Williams' request to reject the filing summarily, finding Mid-America "met its burden related to the required content of its cost of service filing, as required under section 346.1 of the Commission's regulations," and set the case for hearing. It must be concluded, therefore, that, in the face of allegations that Mid-America's filing had not demonstrated the required substantial divergence, as the Commission proceeded to set the case for hearing, it must have concluded that Mid-America met its burden of showing a substantial divergence.

505. Similarly, the Commission's order suspending the March 2006 filing set that case for hearing and consolidated it with the proceedings involving the March 2005 filing. *See Mid-America Pipeline Co.,* 115 FERC ¶ 61,124. Thus, here also, I conclude the Commission impliedly and necessarily found a showing of substantial divergence in setting the case for hearing. Significantly, neither order set the issue of substantial divergence as a matter to be resolved at the hearing.[277]

[277] It is clear that the questions of whether to require a pipeline to provide a segmented cost-of-service filing or whether to assign the burden on a pipeline of proving, at a hearing, that substantial divergence exists are matters for the Commission to decide. However, in all fairness to shippers, at the very least, when a pipeline seeks to raise rates on only one segment of its total pipeline system, it ought to be required to file a segmented cost-of-service.

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ISSUE NO. 2: WHAT ARE THE APPROPRIATE BASE AND TEST PERIODS FOR MID-AMERICA'S MARCH 2005 AND MARCH 2006 FILINGS, RESPECTIVELY?

A. MID-AMERICA

506. Mid-America asserted that the Locked-In Period (May 1, 2005, through April 30, 2006), as opposed to the test year approach suggested by the other parties should be applied to determine the reasonableness of the FERC Tariff No. 38 rates because it was in effect for exactly one year (May 1, 2005, through April 30, 2006). Mid-America Initial Brief at p. 6. With regard to evaluating FERC Tariff No. 41, Mid-America claimed that the 12 most recent months (February 1, 2005, through January 31, 2006) for which actual data was available at the time of the tariff filing, adjusted for known and measurable changes, should be used. *Id.*

507. In addressing first the FERC Tariff No. 38 Locked-In Period, Mid-America argued that the typical test period rules are inapplicable because they are designed to ensure that forward-looking rates represent a reasonable projection of costs and revenues during the period in which the rates are expected to be in effect, and in this case, the FERC Tariff No. 38 rates were replaced by the FERC Tariff No. 41 rates, causing FERC Tariff No. 38 to have no forward-looking impact. *Id.* at p. 7. The regulations, emphasized Mid-America, permit "reasonable deviation from the prescribed test period" for "good cause shown." *Id.*[278] According to Mid-America, no record evidence counters its position that the FERC Tariff No. 38 rates should be evaluated as a locked-in period. *Id.* at p. 8. In support, it noted the following: (a) FERC Tariff No. 41 completely superseded FERC Tariff No. 38; (b) the FERC Tariff No. 38 rates therefore have no forward-looking effect for which a test year analysis is needed; (c) all of the relevant material was available prior to the filing of testimony; and (d) under these circumstances, a locked-in period avoids the inherently artificial exercise of determining whether particular costs and revenues were known and measurable at a certain point in history, since it is now known with certainty the costs and revenues. *Id.* at pp. 8-9 (*citing* Exhibit No. M-100 at pp. 13-16; Transcript at p. 2192).[279]

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[278] Mid-America cited 18 C.F.R. § 346.2(a)(ii) (2007), and relied on *Williams Natural Gas Co.,* 80 FERC ¶ 61,158 at pp. 61,678-79 (1997), in which, it claims, the Commission allowed the use of actual data because the rates in that case were locked-in by the filing of a new rate case.

[279] Mid-America noted, Mid-America Initial Brief at p. 9, that I did grant it permission to use actual data. *See* "Order Granting Motion for Approval to Use Actual Data," issued June 21, 2006. However, there is nothing in my order which indicated that this approval extends any further than permission to submit this "actual data" as evidence at the hearing. In other words, in the June 21, 2006, Order, I did not indicate that I would

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508. Switching from FERC Tariff No. 38 to FERC Tariff No. 41, Mid-America claimed that it conformed to the Commission's regulations: first, Mid-America asserted it used a Test Period which consisted of a base period that included actual costs for the twelve most recent months for which there was complete data available at the time of the tariff filing (through January 2006); second, it reviewed the data to determine whether normalizing adjustments were necessary; finally, it determined whether there were changes in revenues and costs that were known and measurable with reasonable accuracy at the time of the filling. *Id.* at pp. 11-12.

509. Mid-America argued that Staff's test period approach ignores the Commission's test period regulations and is arbitrary. *Id.* at p. 12. Essentially, claimed Mid-America, Staff's starting and ending dates are incorrect. *Id.* at pp. 12-13. Specifically, it stated, Staff begins nine months too late and ends at a date seven months after the filing of FERC Tariff No. 41. *Id.* at p. 13.[280] Lastly, Mid-America declared that Staff failed to determine if the actual data that it used should itself have been adjusted for known and measurable changes in order to make the result appropriate as the basis for setting forward-looking rates.[281] *Id.*

510. In its Reply Brief, Mid-America endorsed the use of a locked-in period for the FERC Tariff No. 38 rates. Mid-America Reply Brief at p. 6. While recognizing that the Commission prohibits extending the use of actual data beyond the end of the test period, Mid-America claimed that the question is "whether rates that were in effect for a fixed period, and that have since been superseded, are justified by the costs and revenues for that same period. *Id.* at pp. 6-7. In that context, Mid-America declared that Staff's criticism of its use of data from beyond the "end-of-test period" is without merit. *Id.* at p. 7.

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rely on the "actual data" in ruling on the merits of this matter.

[280] Further, Mid-America claimed that Staff's use of actual data ends four months after Mid-America witness Ganz filed his direct evidence. Mid-America Initial Brief at p. 13. It added that Staff compounds this error by using actual data for the test period adjustments while, it asserted, the "regulations require that such adjustments be based on changes that are known and measurable at the time of the rate filing." *Id.* (*citing ANR Pipeline Co.*, 78 FERC ¶ 63,003 at p. 65,034 (1997)).

[281] Mid-America declared that both its witness Ganz and Williams witness Olson testified that "Staff's approach effectively turned the test period into a locked-in period, albeit one applicable to rates with forward-looking effect, and based on data with no particular relations to the rates at issue." Mid-America Initial Brief at p. 13 (*citing* Exhibit No. M-100 at p. 15; Transcript at p. 2765).

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511. To further substantiate its use of the locked-in period, Mid-America insisted that the Commission has allowed, and in some cases, required the use of actual data for a locked-in period where it produces a representative and credible cost of service. *Id.*[282] It further alleged that the cases[283] cited by Staff and the Propane Group fail to support their positions that actual locked-in period data should not be used in this case. *Id.* Further, Mid-America claimed that, in *Michigan Wisconsin Pipe Line Co.,*[284] the Commission permitted the use of actual post-test period data during a locked-in period, reasoning that the use of actual or recorded data is always preferable to estimated data. *Id.* at pp. 7-8. In addition, Mid-America pointed to *Williams Natural Gas Co.*, 80 FERC ¶ 61,158, and *Williston Basin Interstate Pipeline Co.*, 52 FERC ¶ 61,170, for support of its position. In those cases, it claimed the end-of-test period data was the most recent data available in the record. *Id.* at p. 8.[285] Here too, Mid-America submitted, the actual costs for the 12-month Locked-In Period are in the record and all parties have had ample access to the relevant data, and thus, there is no reason not to use the Locked-In Period data. *Id.* at p. 8.

512. Next, with respect to Staff's assertions that Mid-America's proposal creates "practical and ratemaking issues," Mid-America opined that those assertions are completely illusory. *Id.* First, Mid-America stated, its proposal actually *shortens* the period at issue, and thus does not extend the period at issue by "many months" as Staff suggested. *Id.* It insisted that, to the contrary, its approach looks at a total of 18 months (a Locked-In Period running from May 2005 through April 2006, and a Test Period for the FERC Tariff No. 41 period running from February 2005 through October 2006),

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[282] In support, Mid-America cited *Arkansas-Louisiana Gas Co.,* 22 FERC ¶ 61,125 at pp. 61,198-99 (1983); *Ozark Gas Transmission System,* 39 FERC ¶ 61,142 at p. 61,506, *reh'g den.*, 41 FERC ¶ 61,207 (1987), *rev'd on other grnds sub nom.*, *Public Service Comm'n of New York v. FERC*, 866 F.2d 487 (D.C. Cir. 1989); *Alabama-Tennessee Natural Gas Co.,* 25 FERC ¶ 61,151 at pp. 61,424-25 (1983); *Southwest Public Service Co.,* 60 FERC ¶ 61,052 at p. 61,189 (1992).

[283] *Williams Natural Gas Co.*, 80 FERC ¶ 61,158 at p. 61,687; *Williston Basin Interstate Pipeline Co.*, 72 FERC ¶ 61,074 at p. 61,382 (1995); *Gaviota Terminal Co.*, 76 FERC ¶ 63,004 at pp. 65,019-22 (1996); *Williston Basin Interstate Pipeline Co.,* 52 FERC ¶ 61,170 at p. 61,645 (1990); *Ozark Gas Transmission System*, 39 FERC ¶ 61,142; *Alabama-Tennessee Natural Gas Co.*, 25 FERC ¶ 61,151, at pp. 61,424-25. *See* Staff Initial Brief at pp. 8-11; Propane Group Initial Brief at pp. 10-11.

[284] 21 FPC 306, at p. 331 (1959).

[285] *Williams Natural Gas Co*., 80 FERC at p. 61,687; *Williston Basin Interstate Pipeline Co.*, 52 FERC at p. 61,648.

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while Staff's analysis consisted of 34 months (a 2004 Base Period extending through October 2006). *Id.* at pp. 8-9. Although Staff claimed a "problematic overlap" between Mid-America's data for a FERC Tariff No. 38 Locked-In Period and a FERC Tariff No. 41 Test Period, Mid-America pointed out that Staff does not provide reasons for such an assertion and noted that the Propane Group's approach also includes overlapping periods.[286] *Id.* at p. 9.

513. In conclusion, Mid-America emphasized that neither the Propane Group nor Staff explained the logic or the reasonableness in using a test period approach in evaluating the FERC Tariff No. 38 rates. *Id.* at p. 11. Essentially, Mid-America continued, test periods should be used to set forward-looking rates based on costs and volumes determined to be representative for forward-looking periods. *Id.* (*citing Northwest Pipeline Corp.,* 87 FERC ¶ 61,266 at p. 62,055 (1999)). With the exception of the Propane Group's fanciful hypothetical in which the FERC Tariff No. 38 rates come to life because of a rejection of the FERC Tariff No. 41 rates, Mid-America asserted, nothing about FERC Tariff No. 38 has any prospective application whatsoever. *Id.*

B. PROPANE GROUP

514. With respect to the March 2005 filing, FERC Tariff No. 38, the Propane Group argued that the appropriate Test Period includes the Base Period — the calendar year 2004 (the "2004 Base Period") — adjusted for known and measurable changes during the subsequent nine months, ending September 30, 2005 (the "2005 Test Year"). Propane Group Initial Brief at p. 7. As to the March 2006 filing, FERC Tariff No. 41, the Propane Group agreed with Mid-America that the appropriate test period includes the base period — February 1, 2005, through January 31, 2006 (the "2006 Base Period") — adjusted for known and measurable changes within the subsequent nine months, ending October 31, 2006 (the "2006 Test year"). *Id.*

515. Beginning with the FERC Tariff No. 38 rate, the Propane Group asserted that Mid-America's argument, that FERC Tariff No. 38 is not forward looking because FERC Tariff No. 41 superseded it, is premature because it assumes that both the Commission and I will find that FERC Tariff No. 41 is just and reasonable. *Id.* at p. 8. Consequently, the Propane Group argued that a rate using the base and test period required under the Commission's regulations is proper because designing a rate based on a fixed period, but which is used going forward, is inappropriate. *Id.*

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[286] Mid-America also rejected Staff's claim that it was "gaming" the system in an attempt "to capture the highest costs and lowest throughput for any particular period," stating that Staff failed to prove this allegation. *Compare* Staff Initial Brief at p. 14 with Mid-America Reply Brief at p. 10.

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516. The Propane Group distinguished *Williams Natural Gas Co.*, 80 FERC ¶ 61,158 and *Michigan Wisconsin Pipe Line Co.*, 22 FERC ¶ 61,125 (1983), both relied on by Mid-America, from the case at hand. Specifically, the Propane Group stated, the cost-of-service analyses in those cases used the base and test period structures, supplementing them with end-of-test period actuals. *Id.* at p. 9. Thus, both cases, submitted the Propane Group, avoid the problem found in this proceeding, where the pipeline's cost-of-service and rate design abandon the base and test period structure and yet the resulting rate could end up as the going-forward rate. *Id.*

517. According to the Propane Group, the Commission has declared that it is "more appropriate" to use base and test period data than to use actuals, but the approach described in *Arkansas-Louisiana Gas Co.*, 22 FERC ¶ 61,125, with respect to locked-in periods is an exception that applies "when it can be shown that its use is necessary to produce a representative and credible cost of service." *Id.* at p. 10 (*citing Ozark Gas Transmission System,* 39 FERC p. 61,506). In this case, they insisted, Mid-America has made no such showing of necessity. *Id.* Further, the Propane Group stressed, the Commission rejects the use of actuals instead of base and test period data when the party advocating the use of actuals is unable to show that the base and test period data would produce "unreasonable results." *Id.*

518. Here, the Propane Group asserted, Mid-America has not proven the use of base and test period data would be unreasonable, and they alleged that the use of actuals is in fact unreasonable. *Id.* (*citing Alabama-Tennessee Natural Gas Co.,* 25 FERC at pp. 61,424-25). In the first place, the Propane Group claimed, the Locked-In Period data could be used to justify the FERC Tariff No. 38 rate as the going-forward rate; this would be improper. *Id.* at pp. 10-11. Second, it contended that using actuals would improperly shift risk from Mid-America to its customers with respect to its cost-of-service because, when pipeline integrity assessment costs and overall costs for a particular year are relatively high (as is the case here), a pipeline could recover those costs by filing a pancake rate and creating a locked-in period. *Id.* at p. 11. Indeed, the Commission, stressed the Propane Group, has denied the use of actuals based on "the need for the proper allocation of risks between [the pipeline] and its customers." *Id.* (*citing Ozark Gas Transmission System,* 39 FERC at p. 61,056).

519. In reply, the Propane Group cited *Williston Basin Interstate Pipeline Co.,* 56 FERC ¶ 61,103 (1991), in which, it claimed, the Commission rejected the parties' agreement to use actual data for a 12-month period rather than the Commission's test period methodology. Propane Group Reply Brief at p. 9. Specifically, it noted, the Commission held:

> There are no unique or compelling circumstances here for the Commission, sua sponte, to disregard its test period methodology, or to permit Williston's rates here to be based on post-test period actual data . . . . In

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> instances where actual data during the period the rates are in effect rather than projections based on test period data have been used, it was because, for example, data consistent with those required by the regulations were not filed and actual data were the best substitute. Such is not the case here; test period data and projected volumes consistent with the Commission's methodology and the regulations were in the record and should have been considered.

Id. (*quoting Williston Basin Interstate Pipeline Co.,* 56 FERC at pp. 61,352-53 (footnotes omitted)). Analogously, the Propane Group asserted that, as in *Williston*, no unique or compelling circumstances that would allow Mid-America to depart from the Commission's test period methodology exist. *Id.* Indeed, the Propane Group maintained that the record contains all of the necessary information to reach a decision built on base and test period data in compliance with the Commission's regulations. *Id.*

520. Further, in response to Mid-America's contention that there is no possibility that the FERC Tariff No. 38 rates will have prospective application, the Propane Group pointed out that Mid-America failed to address the possibility that a compliance filing could produce a FERC Tariff No. 41 rate *below* the Tariff No. 38 rate. *Id.* at p. 10. In that case, the Propane Group contended that Mid-America could withdraw FERC Tariff No. 41 and leave FERC Tariff No. 38 as the going-forward rate. *Id.*

521. Finally, regarding Mid-America's claim that the use of a locked-in period does not "preclude adjustments to the actual data," the Propane Group pointed out that Mid-America refused whenever substantive issues arose in this proceeding where such an adjustment was necessary to make any adjustment to its locked-in period data. *Id.* at p. 11.

C. WILLIAMS

522. Agreeing with Mid-America, Williams maintained that the appropriate Base Period for the March 2005 filing is the Locked-In Period of May 1, 2005, through April 30, 2006, reasoning that the use of the Locked-In Period eliminates issues regarding rate base, volume, and revenue that have to be addressed separately. Williams Initial Brief at p. 10. In addition, with respect to the Base Period for Mid-America's March 2006 rate filing, Williams agreed with Mid-America that the appropriate base period is February 1, 2005, through January 31, 2006. *Id.* In its Reply Brief, Williams simply concurred with Mid-America in all respects on this issue. Williams Reply Brief at pp. 6-7.

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D. COMMISSION TRIAL STAFF

523. Staff asserted that it adopted Mid-America's Base and Test Periods for the March 2006 filing with respect to FERC Tariff No. 41. Staff Initial Brief at p. 7. In contrast, with respect to the FERC Tariff No. 38 rate filings, Staff argued that the Commission's standard test-period ratemaking methodology should be applied. *Id.* at p. 14.

524. Regarding the FERC Tariff No. 38 filing, Staff maintained that the regulations permit deviation from the prescribed Test Period, but only for good cause, which Mid-America has failed to prove. *Id.* at p. 9 (*citing* 8 C.F.R. § 346.2(a)(1)(ii) (2007)). For example, Staff noted, in *Williston Basin Interstate Pipeline Co.,* 56 FERC ¶ 61,103, the Commission rejected the parties' agreement to use post-test period throughput data. *Id.* at p. 10. As in *Williston Basin,* according to Staff, Mid-America has failed to show the necessary justification to allow a deviation from the Commission's test period methodology, and use of actual post-test period data will lead to retroactive adjustments to Mid-America's filed amounts and to impermissible retroactive ratemaking. *Id.* at p. 11.

525. Finally, aside from the Commission precedent which it claimed prevents use of the Locked-In Period data, Staff asserted that there are other impediments to Mid-America's proposal: first, from an administrative perspective, the use of a locked-in period may be inefficient as its use extends the period of analysis for an additional seven months beyond the 21-month base and test period; second, the use of the Locked-In Period for the FERC Tariff No. 38 rates creates an overlap of the data related to FERC Tariff No. 38 with the data related to FERC Tariff No. 41 because double counting of unusual costs may result; and, third, the use of Mid-America's Locked-In Period allows it to "game" the system, so as to capture the highest costs and lowest throughput possible.[287] *Id.* at pp. 11-14 (*citing* Exhibit Nos. S-4 at p. 8; S-73; Transcript at pp. 2188, 2191).

526. In its Reply Brief, aside from repeating arguments previously made, Staff interpreted the case cited in support of Mid-America's position, *Williams Natural Gas Co.,* 80 FERC at p. 61,677, as supporting Staff's proposal to use test period actuals. Staff Reply Brief at p. 9. In that case, according to Staff, the rates at issue at the hearing were not locked-in and became locked-in only after the hearing and by the time the case reached the Commission. *Id.* Staff insisted that none of the parties, and certainly not the Commission, ever suggested using post-test period, locked-in period data to determine the rates. *Id.* Similarly, Staff argued that the second case cited in support of

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[287] With regard to the "gaming" allegation, citing Transcript at pp. 2191-92, Staff noted that Mid-America's costs increased and its throughput decreased relative to the Test Period during the seven months extending beyond the end of the filed-for-Test Period. Staff Initial Brief at p. 14.

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Mid-America's position, *Arkansas-Louisiana Gas Co.,* 22 FERC ¶ 61,125, in fact supports its position that the use of actuals through the end of the test period is appropriate. *Id.* at p. 10. Specifically, in that case, Staff stated, there was no locked-in period, and neither of the parties argued for the use of any data that extended beyond the end of the prescribed adjustment period. *Id.*

DISCUSSION AND RULING

527. While all parties to this proceeding agree on the appropriate base and test periods for Mid-America's March 2006 filing, the issue becomes focused more narrowly on the proper base and test periods for Mid-America's March 2005 filing.

528. The Commission's regulations require an oil pipeline in filing for an initial rate or change in an existing rate to use a base and test period as defined below:

> (a) *Base and test periods defined.* (1) For a carrier which has been in operation for at least 12 months:
>
> (i) A base period must consist of 12 consecutive months of actual experience. The 12 months of experience must be adjusted to eliminate nonrecurring items (except minor accounts). The filing carrier may include appropriate normalizing adjustments in lieu of nonrecurring items.
>
> (ii) A test period must consist of a base period adjusted for changes in revenues and costs which are known and are measurable with reasonable accuracy at the time of filing and which will become effective within nine months after the last month of available actual experience utilized in the filing. For good cause shown, the Commission *may allow reasonable deviation from the prescribed test period.*

18 C.F.R. § 346.2(a)(1) (2007) (emphasis supplied). "*Generally speaking,* the rate filing and the data supplied at the time of the filing according to the rules should provide the basis for the hearing and the decision." *Michigan Wisconsin Pipe Line Co.,* 21 FPC 306 (1958).

529. The Commission declared that it is "more appropriate" to use base and test period data, but it has found reason to deviate from such ratemaking methodology when "necessary." Specifically,

> The Commission has generally found that it is more appropriate to use adjusted test period data than to use actual data developed during periods subsequent to the base period. . . . We are not stating that the use of actual

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> costs for a locked-in period will be routinely rejected when it can be shown that its use is necessary to produce a representative and credible cost of service.

Ozark Gas Transmission System, 39 FERC at p. 61,056.

A. March 2005 Filing

530. For the March 2005 filing (FERC Tariff No. 38), Mid-America argued that a locked-in period — May 1, 2005, through April 30, 2006 — should be used to determine the reasonableness of the FERC Tariff No. 38 rates. Mid-America Initial Brief at p. 6.[288] It pointed out that the regulations permit "reasonable deviation from the prescribed test period" for "good cause shown." *Id.* at p. 7 (*citing* 18 C.F.R. § 346.2(a)(ii) (2007)). According to Mid-America, the typical test period rules are inapplicable in this proceeding because they are designed to ensure that forward-looking rates represent a reasonable projection of costs and revenues during the period in which the rates are expected to be in effect, and here, the FERC Tariff No. 38 rates were replaced by the FERC Tariff No. 41 rates, causing the FERC Tariff No. 38 rates to have no forward-looking impact. Finally, Mid-America contended that the actual costs for the 12-month Locked-In Period are in the record and all parties have had ample access to the relevant data, and thus, it argued, there is no reason not to use the more accurate Locked-In Period data. *Id.* at p. 8 (*citing Williams Natural Gas Co.,* 80 FERC at p. 61,687; *Williston Basin Interstate Pipeline Co.,* 52 FERC at p. 61,648).

531. With respect to the March 2005 filing, the Propane Group insisted that the appropriate test period includes the base period (the 2004 calendar year), adjusted for known and measurable changes during the subsequent nine months, ending September 30, 2005, (*i.e.*, the January 1, 2004, through December 31, 2004, Base Period, and a January 1, 2005, through September 30, 2005 Test Period). Propane Group Initial Brief at p. 7. They rejected Mid-America's argument that the FERC Tariff No. 38 rate is not forward-looking since it was superseded by FERC Tariff No. 41 as premature because FERC Tariff No. 41 may not be determined to be just and reasonable, or may fall below the FERC Tariff No. 38 rate, which would allow Mid-America to withdraw FERC Tariff No. 41 in favor of the higher FERC Tariff No. 38 rate. *Id.* at p. 8; Propane Group Reply Brief at p. 10.

532. While the Propane Group acknowledged that the Commission deviates from its typical test year ratemaking period methodology when necessary, it insisted that Mid-America has made no such showing of necessity. *Id.* at p. 10. Further, the Propane

[288] Williams concurred with Mid-America's use of the Locked-In Period for the March 2005 filing. Williams Initial Brief at p. 10.

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Group stressed that the Commission rejects the use of actuals instead of base and test period data when the party advocating the use of actuals is unable to show that the base and test period data would produce “unreasonable results.” *Id.* Indeed, the Propane Group asserted, Mid-America has not proven the use of base and test period data would be unreasonable, and it alleged that the use of actuals is in fact unreasonable. *Id.* (*citing Alabama-Tennessee Natural Gas Co.,* 25 FERC at pp. 61,424-25). Lastly, it submits, the record contains all of the necessary information to reach a determination built on the base and test periods. Propane Group Reply Brief at p. 9 (*citing Williston Basin Interstate Pipeline Co.,* 56 FERC at pp. 61,352-53).

533. Unlike Mid-America, Staff argued that, for the March 2005 filing, the Commission’s standard test-period ratemaking methodology should be used. Staff Initial Brief at p. 14. Essentially, it maintained that the appropriate Base Period is the 12-month period ending December 31, 2004, with the Test Period including the Base Period adjusted for known and measurable changes through September 30, 2005. Staff Reply Brief at p. 6. According to Staff, the Commission will deviate from the prescribed test period, but only for good cause which, it contended, Mid-America has failed to prove here. Staff Initial Brief at p. 9. Further, Staff declared, the use of the Locked-In Period for the FERC Tariff No. 38 rates may cause a problematic overlap with the data in the FERC Tariff No. 41 rate period because double counting of unusual costs may result. *Id.* at p. 11.[289]

534. Based on the record and the precedent cited by the parties, I find the positions of the Propane Group and Staff to be persuasive. Although it has found reason, on occasion, to deviate from its prescribed test period, the Commission declared that it is “more appropriate” to use base and test period data. *Ozark Gas Transmission Co.*, 39 FERC at p. 61,056. Moreover, when a party advocating the use of actuals for a locked-in period cannot demonstrate that the base and test period data produce “unreasonable results,” a finding of necessity to deviate from the base and test period data cannot be made. *See Alabama-Tennessee Natural Gas Co.,* 25 FERC at pp. 61,424-45.

535. Mid-America argued that the typical test period rules are not applicable to this proceeding because they are designed to ensure that forward-looking rates represent a reasonable projection of costs and revenues during the period in which the rates are expected to be in effect, and here, FERC Tariff No. 41 superseded FERC Tariff No. 38, rendering FERC Tariff No. 38 to have no forward-looking impact. Mid-America Initial Brief at p. 7. Yet this argument is not completely accurate,[290] nor is there any evidence in

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[289] Exhibit No. S-4 at p. 8.

[290] Although perhaps unlikely, the Propane Group makes a valid point: Mid-America’s argument incorrectly assumes that the Commission will find the FERC Tariff No. 41 just and reasonable, and moreover, that the FERC Tariff No. 41 will be

the record supporting a conclusion that the use of base and test period data would produce "unreasonable results," which is required as a justification for using actual data outside the prescribed test period. Moreover, Staff correctly asserted that the use of the Locked-In Period for the FERC Tariff No. 38 rates could produce an overlap with the data in the FERC Tariff No. 41 base and test period which could result in double consideration of pipeline expenses in total or at levels which may not be recurring. For example, Staff witness Sherman testified:

> While in the abstract, the use of a locked-in period to set rates for the same period may have some initial appeal, in my view this is not a reasonable deviation from the Commission's test period practice. This is because there are unusual costs that occur in Periods I and II, and the locked-in period overlaps both Periods. My specific concern is with pipeline integrity plan expenses, which vary considerably between the Periods. Further using actual costs for the locked-in period is equivalent to a retroactive adjustment to the filed amounts, which is neither an appropriate nor equitable deviation from the prescribed test period.

Exhibit No. S-4, at p. 8.[291]

536. In *Williston Basin Interstate Pipeline,* the Commission held:

> There are no unique or compelling circumstances here for the Commission, sua sponte, to disregard its test period methodology, or to permit Williston's rates here to be based on post-test period actual data . . . . In instances where actual data during the period the rates are in effect rather than projections based on test period data have been used, it was because, for example, data consistent with those required by the regulations were not filed and actual data were the best substitute. Such is not the case here; test period data and projected volumes consistent with the Commission's

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higher than the FERC Tariff No. 38 rate, providing Mid-America with no reason to withdraw such rate. However, if neither assumption comes to fruition, FERC Tariff No. 38 will be forward looking. *See* Propane Group Initial Brief at p. 8; Propane Group Reply Brief at p. 10.

[291] Additionally, I am also concerned that using actual data could result in a shifting of the risk that a pipeline would not recover its cost-of-service from it to its customers. Propane Group Initial Brief at pp. 11-12. Adherence to the Commission's test period standard avoids this undesirable result. *Ozark Gas Transmission System,* 41 FERC at p. 61,506; *see also FPC v. Tennessee Gas Transmission Co.*, 371 U.S. 145, 152-53 (1962). Indeed, these higher expenses most appropriately are accounted for in the base and test years of the March 2006 filing, as they lie within the context of that review.

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> methodology and the regulations were in the record and should have been considered.

56 FERC at pp. 61,352-53 (1991) (notes omitted). Here, the record does not contain any evidence that unique or compelling circumstances exist which would permit me to deviate from the Commission's test period methodology and allow Mid-America's rates to be based on post-Test Period actual data for all issues related to the 2005 rate filing.[292] Thus, the Base Period for the March 31, 2005, filing is January 1, 2004, through December 31, 2004, and the Test Period is January 1, 2004, through September 30, 2005.

B. March 2006 Filing

537. For the March 2006 filing, all of the parties agree that the 12 most recent months for which actual data was available at the time of the tariff filing, adjusted for known and measurable changes, should be used, *i.e.* a February 1, 2005, through January 31, 2006, Base Period and a February 1, 2005, through October 31, 2006, Test Period. Mid-America Initial Brief at pp. 6, Mid-America Reply Brief at p. 8; Propane Group Initial Brief at p. 7; Williams Initial Brief at p. 10; Staff Initial Brief at p. 7.

538. As there is no dispute regarding the appropriate base and test periods for the March 2006 filing, my decision follows easily. Specifically, I adopt the 12-month period ending January 31, 2006, as the Base Period, and a Test Period that includes the Base Period adjusted for known and measurable changes through October 31, 2006.

ISSUE NO. 3: SHOULD THE REASONABLENESS OF MID-AMERICA'S RATES BE DETERMINED ON THE BASIS OF THE COST OF SERVICE FOR THE TOTAL COMPANY OR SEPARATELY FOR EACH PIPELINE SYSTEM (i.e., ROCKY MOUNTAIN SYSTEM, CENTRAL SYSTEM AND NORTHERN SYSTEM)?

A. MID-AMERICA

539. In its Initial Brief,[293] Mid-America noted that all parties to these proceedings recognize that its pipeline operations consist of three distinct components: the Northern

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[292] Of course, individual rate issues which are based on the merits of the various parties' positions may require closer examination of the actual data available in the record. These determinations will be made on a specific basis.

[293] There is nothing in Mid-America's Reply Brief which adds to the discussion in its Initial Brief. Mid-America Reply Brief at pp. 12-13.

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System, the Central System, and the Rocky Mountain System; and that only the Northern System rates are at issue here. Mid-America Initial Brief at p. 14.[294] Because Mid-America's three systems act as distinct operating units with discernable shippers, products, origin and destination points, tariffs, and costs, Mid-America claimed, Commission policy mandates that the rates for each system be determined based on each system's individual characteristics. *Id.* at pp. 14-15 (*citing SFPP, L.P.,* 86 FERC ¶ 61,022 (1999)).[295]

540. According to Mid-America, the following factors also support treating the Northern, Central, and Rocky Mountain Systems separately:

(1) Each system serves different markets and has different origin and destination points in various parts of the country.[296]

(2) Each system transfers different products: Indeed, the Rocky Mountain System moves only demethanized mix; the Central System moves various purity products, ethane/propane mix, and demethanized mix; and the Northern System moves mostly propane and ethane/propane mix, along with lesser amounts of purity products.[297]

(3) Each line's shippers are distinguishable; members of the Propane Group ship only on the Northern System, and Williams is the only shipper on the Rocky Mountain System.

(4) Historically, Mid-America has filed separate tariffs for each of the lines.[298]

(5) Each system varies by size, age, and pattern of investment.[299]

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[294] In support, Mid-America referred to Exhibit Nos. M-100 at p. 28; M-116; WIL-1 at pp. 11-13; S-4 at pp. 9-11; NPG-1 at pp. 187-91.

[295] In support, Mid-America also cited *Farmers Union Central Exch. v. FERC,* 734 F.2d at 1528-29; *Williams Pipe Line Co.*, 84 FERC ¶ 61,022 (1998).

[296] In support, Mid-America cited: Exhibit Nos. M-2; NPG-142; M-37 at pp. 35-39, 47-53, 55-58.

[297] In support, Mid-America cited Exhibit Nos. NPG-142; M-1 at pp. 4-7; M-46 at pp. 9-10; M-49; M-151.

[298] In support, Mid-America cited Exhibit No. M-37.

[299] In support, Mid-America cited Exhibit Nos. M-1 at pp. 4-7; M-46 at pp. 8-9;

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Id. at pp. 16-17. While acknowledging that the system share certain facilities,[300] Mid-America noted that the Commission has held that shared facilities by the different systems and coordinated operations merely implies that a pipeline is a multi-product company with significant amounts of joint and common costs and does not "mitigate the separateness of the systems for ratemaking purposes." *Id.* at p. 17 (*citing SFPP, L.P.,* 86 FERC at p. 61,081). In conclusion, Mid-America argued that the reasonableness of Mid-America's Northern System rates should be determined by the costs specifically associated with the Northern System operations (including indirect costs properly allocated to the Northern System). *Id.* at p. 20.

B. PROPANE GROUP[301]

541. The Propane Group, in their Initial Brief,[302] declared that it agreed with all of the parties that the reasonableness of Mid-America's rates should be determined on the basis of a segmented cost of service for the Northern System. Propane Group Initial Brief at p. 13.[303] They also suggested that the "factual evidence indicates that the Northern System is operationally and economically distinct from the Central and Rocky Mountain Systems." *Id.* (*citing* Exhibit Nos. M-1 at pp. 4-7; NPG-12 at pp. 41-52).

542. On the other hand, the Propane Group disagreed with Mid-America regarding the boundaries of that segmentation, *i.e.*, they are concerned about Mid-America's ability to manipulate data. *Id.*[304] For instance, asserted the Propane Group, Mid-America

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NPG-142.

[300] Mid-America cited Transcript at pp. 2204-05 in support.

[301] The Propane Group, in their Initial Brief at p. 15, make an argument that Mid-America should be prohibited from "cherry-picking" the manner in which it justifies its rate on a case by case basis. Williams, in its Initial Brief at p. 11, agreed. In other words, they want Mid-America to be forbidden from justifying its rates on a system-wide basis in the future if it is allowed to justify its rates on a segmented basis here. This matter is not before me and will not be discussed or ruled upon. *See Sierra Pacific Power Co.*, 104 FERC ¶ 61,223 at pp. 61,782-83 (2003).

[302] There is nothing in the Propane Group's Reply Brief which adds to the discussion in their Initial Brief. Propane Group Reply Brief at pp. 13-19.

[303] In support, the Propane Group cited Exhibit Nos. M-24 at pp. 42-43; NPG-1 at pp. 187-91; M-116; S-4 at p. 21; S-26 at pp. 27-28; WIL-1 at pp. 11-13.

[304] In its Reply Brief, Staff agreed with the Propane Group that there is a danger in giving a pipeline the ability to manipulate the allocation of costs among the segments

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inappropriately includes costs attributed to the Bushton and Coffeyville laterals (which were buried in Conway "common" costs) in the Northern System cost-of-service even though it attributes the volumes associated with these laterals to the Central System. *Id.*[305]

543. The Propane Group said they accepted Mid-America's inclusion of the East Red Line in the Northern System analysis even though it questioned whether the East Red Line should be treated as distinct and separate from the rest of the Northern System (*i.e.,* the East Blue Line, the West Blue Line, and West Red Line) because it ships only ethane/propane mix for one shipper, the East Red Line Shipper, while the other lines serve approximately 35 shippers and move propane and heavy products. *Id.* at pp. 13-14 (*citing* Transcript at pp. 291-94, 298-99; Exhibit Nos. M-1 at pp. 4-6; NPG-142; NPG-143 at pp. 8-9).

C. WILLIAMS

544. Similar to the other parties involved, Williams stated that a segmented cost of service determined separately for each individual Mid-America system should be employed to determine the reasonableness of Mid-America's rates in this proceeding. Williams Initial Brief at p. 11 (*citing* Exhibit Nos. M-100 at pp. 28-29; WIL-1 at pp. 11-13; WIL-35 at p. 2; Transcript at p. 2149, 2587, 2591, 2593-99, 2606, 2610, 3013)).[306]

D. COMMISSION TRIAL STAFF

545. Staff stated that it agreed with the rest of the parties' that the reasonableness of Mid-America's rates should be determined on a segmented cost-of-service basis. Staff Initial Brief at p. 15. In support of its position, Staff enumerated the following: (1) The Northern, Central, and Rocky Mountain Systems were constructed at different times; (2) Mid-America keeps its accounting records by segment with separate rate bases, labor and fuel costs; (3) Each system moves different products and serves different shippers, *e.g.*, Williams ships on the Rocky Mountain System only, while members of the Propane

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possibly producing an over-recovery of costs on a total company basis. Staff Reply Brief at p. 12.

[305] The Propane Group stated that it discusses this particular question under Issue No. 4.A.(3), *infra*.

[306] In reply, Williams reiterated the agreement by all parties to this proceeding that the rates for the three Mid-America Pipeline systems must be determined on a segmented basis. Williams Reply Brief at p. 8.

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Group ship almost entirely on the Northern System;[307] (4) The three systems are geographically and operationally distinct; (5) Costs and revenues on each system vary greatly; (6) Each system has its own tariff rates. *Id.* at pp. 15-18 (*citing* Exhibit Nos. M-1 at pp. 4-7; WIL-1 at p. 12; M-37 at pp. 39, 47-50, 55-57; M-132 at p. 2; NPG-1 at p. 3; S-26 at p. 4; *Mid-America Pipeline Co., LLC*, 111 FERC ¶ 61,128 at P 17 (2005)).

546. According to Staff, the Commission held, in *SFPP, L.P.,* 86 FERC at pp. 61,079-81, that SFPP should develop reasonable rates on the basis of separate costs of service for its East and West Line segments instead of its entire South System.[308] *Id.* at p. 19. The Commission reasoned, Staff claimed, that the two lines had different markets with different shippers, and reflected different investment patterns and pipeline sizes and "reiterated its objective to assure that shippers pay only for the costs of the services that they are using, and that pipelines do not recover shortfalls in some markets by recovering excess revenues in other markets." *Id.* at pp. 19-20 (footnotes omitted) (*citing SFPP, L.P.*, 86 FERC at p. 61,081).

DISCUSSION AND RULING

547. Because only the Northern System rates are at issue in these proceedings, the question is whether the justness and reasonableness of the Northern System rates should be determined on the basis of a segmented cost-of-service for the Northern System or, alternatively, a total company Mid-America cost-of-service.

548. Mid-America insisted that, as a matter of law, the reasonableness of its Northern System rates must be determined on a system basis, not a total company basis. Mid-America Initial Brief at p. 14. Specifically, it asserted, Commission policy mandates that the rates for each system be determined according to each system's individual characteristics, where, as here, a pipeline's individual systems act as distinct operating units with discernable shippers, products, origin and destination points, tariffs, and costs. *Id.* at pp. 14-15 (*citing SFPP, L.P.,* 86 FERC ¶ 61,022). The Propane Group, Williams

[307] According to Staff: "Only demethanized mix flows on the Rocky Mountain system, while purity products and propane-ethane mix flow on the Northern system. All three product types – demethanized mix, purity products, and propane-ethane mix – flow on the Central system." Staff Initial Brief at pp. 15-16 (footnotes omitted)(*citing* Exhibit Nos. M-1 at pp. 3-4; M-37 at p. 39, 47-50, 55-57; Transcript at p. 972).

[308] Citing *Transcontinental Gas Pipe Line Corp.* 76 FERC ¶ 61,021 at pp. 61,068-72 (1996), *rev'd on other grnds sub nom., Exxon Corp. v. FERC*, 206 F3d 47 (D.C. Cir. 2000), Staff also stated that the Commission noted, while finding it was not applicable there, that its general policy was that a customer should pay only for costs properly allocated to the service it receives. Staff Initial Brief at pp. 18-19.

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and Staff agree. *See* Propane Group Initial Brief at p. 13; Williams Initial Brief at pp. 11, 14-15; Staff Initial Brief at p. 15.

549. As all parties to this proceeding agree, and based on the record, I find that the justness and reasonableness of Mid-America's Northern System rates must be determined on the basis of a segmented cost-of-service for the Northern System, not a Mid-America total company cost-of-service.

550. Commission precedent and the facts of this case require that the reasonableness of Mid-America's rates be determined on the basis of a segmented cost of service, rather than on the costs and revenues of the pipeline company as a whole. For example, in a prior proceeding, the Commission held that the reasonableness of SFPP's rates should be determined on the basis of separate analyses of its East Line and West Line segments, rather than on the basis of its South System as a whole, reasoning that the two lines served different markets and different shippers, reflected different investment patterns, and were of different sizes. *SFPP, L.P.,* 86 FERC at pp. 61,079-81. In so holding, the Commission sought "to assure that shippers pay for the costs of the services they are using," *i.e.*, costs incurred on one line should not cause a rate increase on another. *Id.* at p. 61,080 (*citing Williams Pipe Line Co.,* 84 FERC ¶ 61,022 (1998)).[309]

551. Similarly, the facts of this proceeding require separate treatment of Mid-America's Northern, Central, and Rocky Mountain Systems, to wit:

(1) Each system varies by age, as each was constructed separately at different times. Exhibit No. M-1 at pp. 4-7.

(2) Each system varies by size and reflects a different pattern of investment, with costs and revenues contrasting greatly. Exhibit Nos. M-46 at pp. 8-9; NPG-142.

(3) Mid-America keeps its accounting records by segment, with separate rate bases and labor and fuel costs. Exhibit No. WIL-1 at p. 12.

(4) The three systems are geographically and operationally distinct, as each serves different markets and has different origin and destination points in various parts of the country. Exhibit Nos. WIL-1 at pp. 4-7, 12; M-2; NPG-142; M-37 at

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[309] The Commission also referred to *Farmers Union Central Exchange v. FERC*, 734 F.2d at pp. 1528-29 (footnotes omitted) quoting it as holding: "Because oil pipeline rates are charged on a point-to-point basis, such cost allocation [by shipment] ensures that the costs of providing service over a given territory will be recovered only from the companies that use that particular service."

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pp. 35-39, 47-53, 55-58; S-26 at p. 4.

(5) Each system's shippers are distinguishable. For example, Williams ships only on the Rocky Mountain System, while the Propane Group ships almost entirely on the Northern System. Exhibit No. NPG-1 at p. 3.

(6) Each system moves different products: the Northern System moves mostly propane and ethane/propane mix; the Rocky Mountain moves only demethanized mix; and the Central System moves various purity products, ethane/propane mix, and demethanized mix. Exhibit Nos. M-1 at pp. 4-7; M-37 at pp. 39, 47-50, 55-57; M-46 at pp. 9-10; M-49; M-151; NPG-142.

(7) Mid-America has filed separate tariffs for each of the lines. Exhibit No. M-37.

552. Accordingly, based on the evidence and Commission precedent, I find that the reasonableness of Mid-America's Northern system rate must be determined on a system basis rather than a total company basis.[310]

ISSUE NO. 4: WHAT IS THE APPROPRIATE COST OF SERVICE FOR EACH APPLICABLE PERIOD?

A. WHAT IS THE APPROPRIATE LEVEL OF RATE BASE FOR EACH APPLICABLE PERIOD?

[310] I note that the Propane Group took issue with the boundaries of such segmentation. Specifically, it argued that Mid-America (1) inappropriately included costs attributed to the Bushton and Coffeyville laterals in the Northern System cost of service, while attributing the volumes associated with these laterals to the Central System; (2) should be precluded from attempting to justify future rate increases on a total company basis, as it has chosen to use a segmented cost of service in this proceeding; (3) should apply the three corrections recommended by the Propane Group witness O'Loughlin (Exhibit No. NPG-1 at p. 54) to Mid-America's direct labor expense data and then use the resulting Kansas-Nebraska allocation factor to determine segment costs of service; and (4) inappropriately used its total cost-of-service in its initial justification for increasing rates on only the Northern System. Propane Group Initial Brief at pp. 13, 15-18. I address none of them here: the first point will be addressed under Issue No. 4.A.(3); the issue raised by the second point is not relevant or material to the issues referred to me by the Commission; the third point will be addressed under Issue No. 4.D.(1); and the fourth point was addressed under Issue No. 1.

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(1) What are the appropriate historical capital structures for use in calculating the deferred return component of rate base and what is the appropriate net deferred return?

A. MID-AMERICA

553. Mid-America claimed that this issue turns on whether to use Mid-America's own capital structure for the period 1987 through 2001 or the capital structure of Mid-America's parent companies, MAPCO for the period 1987 through 1997 and The Williams Companies for the period 1998 through 2001.[311] Mid-America Initial Brief at p. 21. It supported use of the former, while, it claimed, the other parties support the latter. *Id.* According to Mid-America, the appropriate historical capital structures for use in calculating the deferred return component of rate base are found in its witness Williamson's Exhibit No. M-21,[312] and the appropriate net deferred return amounts are found in Statement E2 of its witness Ganz's Exhibit Nos. M-102, M-103, and M-104. *Id.*

554. In support of its position, Mid-America referred to the following Commission holding in *Williams Pipe Line, Co.,* 31 FERC ¶ 61,377 at p. 61,836 (1985):

> [A] pipeline which has issued no long-term debt or which issues long-term debt to its parent or which issues long-term debt guaranteed by its parents to outside investors should use its parent's actual capital structure. However, a pipeline which issues long-term debt to outside investors without any parent guarantee should use its (the pipeline's) own capital structure.

Mid-America Initial Brief at pp. 21-22. Because Mid-America issued no long-term debt to outside investors guaranteed by its parent during the period 1987 through 2001, it

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[311] Mid-America noted that no party disputed its use of the capital structures of Mid-America's parent companies for the periods 1984 through 1986 (MAPCO, Inc.) and 2001 through 2004 (Enterprise Products Partners). Mid-America Initial Brief at p. 21 n.10.

[312] Mid-America noted that, for the period 1984-86, Williamson used MAPCO's capital structure because Mid-America had no long-term debt of its own, and that, from 2002 forward, Williamson used Enterprise Product Partners' capital structure because, after it purchased Mid-America, it began guaranteeing Mid-America's debts. Mid-America Initial Brief at p. 21 n.10 (*citing* Exhibit Nos. M-84 at 4; M-17 at p. 17). Mid-America claimed that no party takes issue with this. *Id.* (*citing* Exhibit Nos. NPG-1 at pp. 99-105; S-1 at pp. 6, 58-59; WIL-1 at pp. 1-2, 6-9).

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argued that *Williams Pipe Line* requires the use of its own capital structure for the 1998 - 2001 period. *Id.*

555. Mid-America asserted that the Propane Group's and Williams' "financial control" test is inconsistent with the Commission's oil pipeline methodology because *Williams Pipe Line* does not require that the pipeline control its own financing for the pipeline's capital structure to be used. *Id.* Moreover, Mid-America claimed that the case relied upon by Propane Group witness O'Loughlin supporting the financial control test, *Kentucky West Virginia Gas Co.,* 2 FERC ¶ 61,139 (1978), is no longer controlling having been replaced by *Transcontinental Gas Pipe Line Corp.,* 80 FERC ¶ 61,084 at p. 61,658 (1997), *aff'd on reh'g*, 84 FERC ¶ 61,084 at pp. 61,411-15 (1998). Mid-America Initial Brief at p. 23. According to it, *Transcontinental* now controls, and, in that case, the Commission held that "a subsidiary commonly has financial, operational, and managerial relationships with its corporate parent; however, such ties typically have not caused the Commission to employ the parent's capital structure unless the subsidiary pipeline issues no long-term debt, issues long-term debt only to its parent, or issues long-term debt to outside investors only with the guarantee of its parent." *Id.* (*quoting Transcontinental Gas Pipe Line Corp.,* 80 FERC at p. 61,658 (footnote omitted)). Thus, according to Mid-America, even had its parent directed its financing, it is irrelevant in determining whether Mid-America's own capital structure applies.[313] *Id.*

556. According to Mid-America, prior to 1987, its financing was arranged by MAPCO, but stated that this arrangement ended in 1987 when it began financing its own debt with MAPCO only contributing equity. *Id.* at p. 24. Also, Mid-America noted, the equity capital paid by MAPCO to Mid-America did not make MAPCO the guarantor of Mid-America's debt obligations. *Id.* It further added that the Mid-America debt issuance was a private placement, and, thus, no bond rating was required. *Id.* at p. 24 (*citing* Transcript at pp. 1033-34, 2906).

557. In response to the assertion that its equity structure was excessive, Mid-America asserted that the Commission prefers the use of actual capital structure unless it is abnormal. *Id.* (*citing Kuparuk Transportation Co.,* 55 FERC ¶ 61,122 at p. 61,377 (1991); *ARCO Pipe Line Co.*, 52 FERC ¶ 61,055 at p. 61,233 (1990)). Mid-America further contended that its actual capital structure during the period 1987 through 2001 (averaging 74.75) is not unlike those which the Commission previously has approved. *Id.* at pp. 25-26 (*citing Kuparuk Transportation Co.,* 55 FERC at p. 61,377; *Colonial Pipeline Co.,* 116 FERC ¶ 61,078 at P 62 (2006); *Arkansas Louisiana Gas Co.,* 31 FERC

[313] Mid-America stated: "Regardless of which entity may have directed [it] to arrange the financing, [it] issued its own non-guaranteed debt and was the party responsible for repaying the loan." Mid-America Initial Brief at p. 23 (*citing* Exhibit Nos. M-84 at p. 5; M-169; Transcript at pp. 1037-38).

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¶ 61,318 at p. 61,726 (1985); *Transcontinental Gas Pipe Line Corp.,* 80 FERC at p. 61,415 n.27).

558. Mid-America, in reply, with respect to the Propane Group's suggestion that an increase in intercompany payables owed from Mid-America to its parent between 1996 and 2000 proves that the parent was "controlling Mid-America's financing," submitted that the intercompany payables were short-term financing, not long-term debt, and thus, the use of Mid-America's capital structure remains appropriate. Mid-America Reply Brief at p. 16.

559. Next, with respect to Williams' and Staff's arguments that, because Mid-America lacked an independent bond rating, its parent's capital structure should be used, Mid-America asserted that their arguments rely upon natural gas pipeline precedents that cannot override a specific oil pipeline precedent establishing that a bond rating is not required. *Id.* at p. 17 (*citing Williams Pipe Line Co.,* 31 FERC at p. 61,836). Also, Mid-America noted that a bond rating requirement effectively would render meaningless the Commission's preference for the pipeline's capital structure as stated in *Williams Pipe Line Co.*, 31 FERC ¶ 61,377 because only five percent of FERC-regulated oil pipelines issue rated long-term debt. *Id.*

560. Further, regarding Williams' claim that the bond rating requirement assured that the rated entity has a capital structure that is free from manipulation by the parent company, Mid-America pointed out that the note agreement with Prudential provides the lender with much more assurances regarding Mid-America's capital structure and general ability to repay the loan than a public debt-holder would receive from a bond rating. *Id.* at pp. 17-18.

561. Lastly, addressing the Propane Group's assertion that Mid-America's equity ratio during the years 1987 through 2001 was unrepresentative of the pipeline's risks because it was higher than the parent companies' equity ratios during the years 1984 through 1986 and 2002 through 2004, Mid-America insisted that the fact that the parent company equity ratios were generally lower than those of Mid-America failed to demonstrate that Mid-America's capital structure was unrepresentative of its risks. *Id.* at p. 19.

B. THE PROPANE GROUP

562. The Propane Group argued that the capital structure of Mid-America's parent companies during the period 1987 through 2001 (MAPCO for the period 1987-1997, The Williams Companies, Inc., for the period 1998-2001) should be used to derive a reasonable deferred return component of rate base. Propane Group Initial Brief at p. 19. Citing *Transcontinental Gas Pipe Line Corp.,* 84 FERC at pp. 61,411-12, the Propane Group asserted that a regulated pipeline's own capital structure is preferred unless (1) it does not control its own financing, or (2) its actual capital structure does not represent its

level of risk. Propane Group Initial Brief at p. 19.[314] According to the Propane Group, since before 1987, Mid-America's parent company has been controlling its finances through intercompany financing. *Id.* at pp. 20-21 (*citing* Exhibit Nos. NPG-1 at pp. 101-02; NPG-62 at p. 6; NPG-63 at p. 44; NPG-83 at pp. 7-8; Transcript at pp. 1016-17, 1024-28, 1032). Continuing, it insisted that Mid-America's capital structure during the period 1987 through 2001 did not represent its level of risk because its debt percentage average during that period was significantly lower than the immediately preceding or following periods. *Id.*[315] On the other hand, the Propane Group emphasized, Mid-America's parent companies' capital structures were consistent with its capital structure during the immediately preceding and following periods. *Id.* at pp. 21-22.[316]

563. In its Reply Brief, the Propane Group contended that Mid-America incorrectly claimed that, in 1997, the Commission replaced the "financial control" test established in *Kentucky West Virginia Gas Co.*, 2 FERC ¶ 61,139, with a requirement that the pipeline issue its own non-guaranteed debt and have a bond rating. Propane Group Reply Brief at p. 21. Contrariwise, the Propane Group asserted, in *Transcontinental Gas Pipe Line Corp*, 80 FERC ¶ 61,157, the Commission continued the practice of first establishing whether a pipeline controls its own financing. Propane Group Reply Brief at p. 22. Moreover, the Propane Group added, in *Transcontinental Gas Pipe Line Corp.*, 90 FERC ¶ 61,279 at pp. 61,927-28 (2000), the Commission held that, if it were to deviate from its preference to use the pipeline's own capital structure, it would first look to whether the pipeline is an independent financial entity, which can be evidenced by the existence of a bond rating and the pipeline's issuance of its own debt. Propane Group Reply Brief at p. 22. They also noted that, in *SFPP, L.P.,* 91 FERC ¶ 61,135 at p. 61,504 (2000), the Commission's most recent oil pipeline proceedings regarding the issue of capital structures, it stated that the "Opinion No. 154-B methodology includes a strong presumption in favor of using the parent company's capital structure in situations where

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[314] The Propane Group also cited *Kentucky West Virginia Gas Co.*, 2 FERC ¶ 61,139; *Transcontinental Gas Pipe Line Corp.,* 80 FERC ¶ 61,157; *Transcontinental Gas Pipe Line Corp.*, 85 FERC ¶ 61,323 (1998). Propane Group Initial Brief at p. 20.

[315] According to the Propane Group, Mid-America's debt percentage averaged 25% during the period 1987 through 2001, while its debt percentage during the period 1984 through 1986 was 43%, and 54% during the period 2002 through 2004. Propane Group Initial Brief at p. 21 (*citing* Exhibit Nos. NPG-1 at pp. 102-04 tbl.25; M-30; NPG-64).

[316] According to the Propane Group, the capital structure of Mid-America's parent companies averaged 54% during the period 1987 through 2001. Propane Group Initial Brief at p. 22 (*citing* Exhibit Nos. NPG-1 at pp. 103-04 tbl.25; NPG-64).

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the pipeline does not have a capital structure determined by its independent participation in the capital markets." Propane Group Reply Brief at pp. 22-23. The Propane Group also suggested that Mid-America's capital structure and its lack of participation in the capital markets show that Mid-America did not have independent financial control. *Id.* at p. 23 (*citing* Exhibit No. NPG-1 at pp. 99-105).

564. According to the Propane Group, contrary to Mid-America's position, the lack of an independent bond rating for debt issued by a pipeline is an important factor in determining whether or not the pipeline exercises its own independent financial control. *Id.* They asserted that the lack of an independent bond rating for a pipeline's debt results in the failure to meet one of the requirements of the Commission's capital structure test. *Id.* (*citing Michigan Gas Storage Co.,* 87 FERC ¶ 61,038 at pp. 61,154-56 (1999)). Accordingly, the Propane Group submitted, since Mid-America lacked an independent bond rating on the debt issued in 1987, it should be concluded that Mid-America did not independently control its own financing during the period 1987 through 2001. *Id.* at pp. 23-24.

565. The Propane Group further argued that Mid-America provided no evidence in support of its claims that its equity ratio was not excessive during the period 1987 through 2001 and that its risk was higher than its parent company. *Id.* at pp. 24-25. To the contrary, the Propane Group declared that, because Mid-America has not shown any significant competitive threats in this proceeding, Mid-America likely had a lower risk than the unregulated operations of its parent company during the period 1987 through 2001. *Id.* at p. 25. Also, the Propane Group noted that Mid-America advocated the use of its parent company's debt level for the period 2002 through 2004 (54% debt), yet it provides no evidence that would justify the use of a much lower debt level (25%) for the period 1987 through 2001. *Id.* at pp. 25-26.

C. WILLIAMS

566. Williams stated that the use of a pipeline's own capital structure is preferred if the pipeline "issues its own non-guaranteed debt, has its own bond ratings, and has a common equity ratio within the range of other common equity ratios approved by the Commission." Williams Initial Brief at p. 17.[317] It argued that Mid-America did not issue its own debt with the prescribed bond rating for the period 1987 through 2001. *Id.* Additionally, Williams maintained, Mid-America's 1987-2004 capital structure ratios are inappropriate because it had not been financed on a stand-alone basis from 1984 to 2006. *Id.* at p. 20 (*citing* Exhibit No. WIL-1 at p. 10). Consequently, Williams insisted on using the capital structure of Mid-America's parent, and in doing so, suggested that the deferred return component be $67,087,000. *Id.*

[317] In support, Williams cited *Panhandle Eastern Pipeline Co.,* 71 FERC ¶ 61,228 at p. 61,827 (1995).

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567. In reply, Williams alleged that Mid-America missed the mark in interpreting its position. Williams Reply Brief at p. 13. Specifically, Williams argued that, without a bond rating, Mid-America's debt fails to meet the standard set out in *Panhandle Eastern Pipeline Co.*, 71 FERC ¶ 61,228, and *Transcontinental Gas Pipeline Corp*., 84 FERC ¶ 61,084. Williams Reply Brief at pp. 13-14. Therefore, Williams recommended that Mid-America's parent company's capital structure be used for the period 1987 through 2001. *Id.* at p. 14.

568. Williams added that Mid-America's interpretation of *Williams Pipeline Co.*, 31 FERC ¶ 61,377, is incomplete. Williams Reply Brief at p. 16. Contrary to Mid-America's position, Williams claimed that, in that decision, the Commission demonstrated that its oil and gas pipeline policies regarding capital structure are identical. *Id.* In support, Williams noted that the Commission, in *Williams Pipeline Co.*, 31 FERC at p. 61,386, stated the following: "The Commission recently expressed for gas pipelines a general policy of using actual capital structures rather than hypothetical capital structures. The Commission believes that this approach is appropriate for oil pipelines. The actual capital structure could be the actual capital structure of either the pipeline or its parent." Williams Reply Brief at p. 16.

D. COMMISSION TRIAL STAFF

569. Staff does not dispute Mid-America's capital structures for the periods 1985 through 1986 and 2002 through 2005. Staff Initial Brief at p. 20. However, Staff disagreed with Mid-America's use of its own capital structure for the period 1987 through 2001. *Id.* Rather, Staff contended, the capital structures of Mid-America's parent companies are the appropriate capital structures to be used for the period 1987 through 2001 (specifically, MAPCO for the years 1987 through 1997, and The Williams Companies for the years 1998 through 2001). *Id.* at pp. 20-21.

570. According to Staff, the Commission's policy is to use an entity's own capital structure if it issues non-guaranteed debt, has its own bond rating, and has a capital structure within the range of capital structures approved by the Commission. *Id.* at p. 21 (*citing ITC Holdings Corp.,* 121 FERC ¶ 61,229 at P 49 (2007)). It contended that Mid-America has no bond rating, and its equity ratios for the years 1987 through 2001 are excessive. *Id.* at p. 22. In fact, declared Staff, the Commission has never approved an equity ratio higher than 68.86% in any litigated case, and with one exception, all of Mid-America's common equity ratios during the period 1987 through 2001 are higher than 68.86%. *Id.* (*citing Pacific Gas Transmission Co.,* 62 FERC ¶ 61,109 at pp. 61,778-79 (1993)). Accordingly, Staff uses the capital structures of MAPCO for the years 1985 to 1986 and 1987 through 1997, the capital structure of The Williams Companies during the period 1998 through 2001, and the capital structures of Enterprise Products Partners for the period 2002 through 2005. *Id.* at pp. 22-23.

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571. In reply, Staff asserted that, similar to the electric transmission and gas pipeline industries, a bond rating is required to determine the capital structure of oil pipelines because the Commission has never exempted oil pipelines from such a requirement. Staff Reply Brief at p. 14. For example, Staff cited *ITC Holdings Corp.,* 121 FERC ¶ 61,229 at P 49 (2007), an electric transmission case, and *Transcontinental Gas Pipe Line Corp.,* 84 FERC at p. 61,413, a gas pipeline case, in which the Commission affirmed the bond rating requirement for electric utilities and gas pipelines. Staff Reply Brief at pp. 13-14. Moreover, Staff asserted that, in Opinion No. 154-B,[318] the Commission based its policy for determining capital structures for oil pipelines on the Commission's policy for gas pipelines. *Id.* at p. 15. Opinion No. 154-B, argued Staff, also calls for the use of the actual capital structures of the pipeline or its parent rather than hypothetical capital structures. *Id.*

572. In closing, Staff alleged that Mid-America's average equity ratio of 74.7% during the years 1987 through 2001 is ten percent more than the equity ratio approved by the Commission in *ARCO Pipe Line Co.*, 52 FERC at p. 61,233, which Mid-America relied on to support its equity ratios. Staff Reply Brief at pp. 15-16. Furthermore, Staff declared that in *Kuparuk Transportation Co.*, 55 FERC ¶ 61,122, a case cited by Mid-America in support of its high equity ratio, the Commission did not approve a 70% equity ratio. Staff Reply Brief at p. 16.

DISCUSSION AND RULING

573. All parties agree that the capital structure of MAPCO, Mid-America's parent company for the period 1984 through 1986, and the capital structure of Enterprise Products Partners, Mid-America's parent company for the period 2002 through 2004, should be used in calculating the deferred return component of rate base for the periods 1984 through 1986 and 2002 through 2004, respectively. Mid-America Initial Brief at p. 21 n.10. Consequently, the issue to be decided is whether, for the period 1987 through 2001, Mid-America's own capital structure or that of its parent company should be used in calculating the deferred return component of rate base. For the reasons set forth below, I conclude that the appropriate capital structure to be used in calculating the deferred return component of rate base is the capital structure of Mid-America's parent companies during the period 1987 through 2001, which are MAPCO, for the period 1987 through 1997, and The Williams Companies for the period 1998 through 2001.

574. Mid-America argued that, for the period 1987 though 2001, its own capital structure should be used to derive a reasonable deferred return component of rate base. Mid-America Initial Brief at p. 21. Because Mid-America issued long-term debt to outside investors not guaranteed by its parent during the period 1987 through 2001, it

[318] The cite to Opinion 154-B is *Williams Pipe Line Co.*, 31 FERC ¶ 61,377.

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claimed that the Commission allows the use of its own capital structure for the period 1987 through 2001. *Id.* at pp. 21-22. Moreover, Mid-America declared that its equity ratio is not excessive and is not atypical of those the Commission has approved. *Id.* at p. 25.

575. In contrast to Mid-America's position, the Propane Group, Williams, and Staff asserted that the capital structure of Mid-America's parent companies during the period 1987 through 2001 (MAPCO and The Williams Companies, Inc.) should be used to derive a reasonable deferred return component of rate base. Propane Group Initial Brief at p. 19; Williams Initial Brief at p. 20; Staff Initial Brief at pp. 20-21.

576. The Propane Group's position rested on the following facts: (1) Mid-America's parent companies have been controlling its finances through intercompany financing; (2) Mid-America's capital structure during the period 1987 through 2001 did not represent its level of risk because its debt percentage average during that period was significantly lower than the immediately preceding or following periods; and (3) Mid-America lacked an independent bond rating for its issued debt. Propane Group Initial Brief at pp. 20-22; Propane Group Reply Brief at pp. 23-24.

577. While Williams admitted that Commission policy prefers the use of a pipeline's own capital structure, it advocated the use of the capital structure of Mid-America's parent companies for the period 1987 through 2001 because it contended that Mid-America did not issue its own debt with the Commission prescribed bond rating and was not financed on a stand-alone basis from 1984 to 2006. Williams Initial Brief at pp. 17, 20.

578. In agreement with the Propane Group and Williams, Staff claimed that, because Mid-America has no bond rating (and had no bond rating during the period 1987 through 2001), and because its equity ratios for the years 1987 through 2001 are excessive, the capital structure of Mid-America's parent companies should be used for the period 1987 through 2001. Staff Initial Brief at p. 22. Staff further declared that the Commission has never approved an equity ratio higher than 68.86%, and, with one exception, all of Mid-America's common equity ratios during the period 1987 through 2001 are higher than 68.86%. *Id.*

579. In Opinion No. 154-B, the Commission stated:

> The Commission concludes that a pipeline which has issued no long-term debt or which issues long-term debt to its parent or which issues long-term debt guaranteed by its parent to outside investors should use its parent's actual capital structure. However, a pipeline which issues long-term debt to outside investors without any parent guarantee should use its (the pipeline's) own capital structure.

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Williams Pipe Line Co., 31 FERC at p. 61,836. In a later decision, the Commission further clarified its policy indicating a preference for the use of the pipeline's own capital structure in developing the pipeline's rate of return unless "(1) the pipeline's financing is controlled by another entity, such as a corporate parent, or (2) the pipeline's actual capital structure does not reasonably reflect its operating risk." *Transcontinental Gas Pipe Line Corp.,* 84 FERC at pp. 61,411-12. In other words, in determining whether a departure from its general preference is appropriate, the Commission "first looks to the issue of whether the pipeline is an independent financial entity," *i.e.*, "whether the pipeline has its own bond rating *and* whether it provides its own debt financing." *Transcontinental Gas Pipeline Corp.,* 90 FERC at p. 61,928. Upon an affirmative determination, the Commission then considers whether the pipeline's equity ratio falls within the zone of reasonableness." *Transcontinental Gas Pipe Line Corp.,* 84 FERC at 61,413.[319]

580. Based on the record here, I find that Mid-America is not an independent financial entity. Specifically, although Mid-America issued long-term debt to outside investors without any parent guarantee during the period 1987 through 2001,[320] it did not have its own bond rating.[321] Mid-America argued that, in using a pipeline's own capital structure, the Commission requires only that the oil pipeline issue its own debt without guarantees. Mid-America Initial Brief at pp. 21-22. This argument is misplaced and inadequate. In Opinion No. 154-B, the Commission relied on its policy for gas pipelines in determining an appropriate capital structure for oil pipelines,[322] and, in the gas context, the Commission has looked at whether a pipeline provides its own debt financing *and* whether it has its own bond rating. *Transcontinental Gas Pipeline Corp.,* 90 FERC at p. 61,929.[323]

581. Second, while the Commission has noted and found reasonable equity ratios near 74.7%,[324] Mid-America's equity ratios during the period 1987 through 2001, which ranged from 67.26% to 83%, averaging 74.7%, is excessive.[325] Generally, the

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[319] S*ee also ITC Holdings Corp.,* 121 FERC ¶ 61,229 at P 49.

[320] Exhibit Nos. M-84 at p. 5; M-169; Transcript at pp. 1037-38.

[321] Exhibit No. S-1 at pp. 7-8.

[322] *Williams Pipeline Co.*, 31 FERC at p. 61,836.

[323] S*ee also Michigan Gas Storage Co.,* 87 FERC at p. 61,504.

[324] *See Kuparuk Transportation Co.,* 55 FERC at p. 61,377; *Colonial Pipeline Co.,* 116 FERC ¶ 61,078 at P 62; *Pacific Gas Transmission Co.*, 62 FERC at pp. 61,778-79.

[325] Exhibit No. M-21 at pp. 1-6.

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Commission has found lower equity ratios to be reasonable. *See Mobile Oil Corp. v. SFPP, L.P.* 96 FERC ¶ 61,281 at pp. 62,064-65, 62,068 (2001).

582. Further suggesting the excessiveness of Mid-America's equity ratios during the 1987 through 2001 period is the fact that Mid-America's debt percentage averaged 43% during the period 1984 through 1986, and averaged 54% between 2002 and 2004. Yet its debt percentage averaged 25% during the period 1987 through 2001. Exhibit No. NPG-1 at pp. 102-04. In contrast, the debt percentage of Mid-America's parent companies averaged 54% during the period 1987 through 2001, which is more consistent with Mid-America's capital structure during the periods 1984 through 1986 and 2002 through 2004. Exhibit Nos. NPG-1 at pp. 103-04 tbl.25; NPG-64. Thus, the record reflects that the average debt ratio of Mid-America's parent (54%) for the time frame at issue (1987-2001) is more consistent with Mid-America's debt ratio for the period before (43%) and the period after (54%) than is Mid-America's for that same period (25%). From this, it is not hard to conclude that Mid-America's claimed 74.7% equity ratio is excessive.

583. In sum, because Mid-America did not have, and does not now have, its own bond rating, and because its equity ratios during the period 1987 through 2001 were excessive, I find the appropriate capital structure to be used in calculating the deferred return component of rate base to be the capital structure of Mid-America's parent companies during the period 1987 through 2001, which are MAPCO, for the period 1987 through 1997, and The Williams Companies for the period 1998 through 2001.

(2) What is the appropriate level and treatment of accumulated deferred income taxes (ADIT)?[326]

A. MID-AMERICA

584. According to it, from 1983 through mid-2002, Mid-America accumulated each system's ADIT balance using the top marginal income tax rate for corporations, and after Enterprise Products Partners acquired Mid-America in 2002, it accumulated a new ADIT balance using the weighted marginal income tax rates developed by Mid-America witness Petru. Mid-America Initial Brief at p. 28 (*citing* Exhibit Nos. M-24 at p. 24; M-100 at pp. 65-67). In support of its calculations, Mid-America claimed that the Commission has allowed the weighted average marginal tax rate to become "the basis for determining the tax component of the ADIT calculation." *Id.* (*citing SFPP, L.P.,* 121 FERC ¶ 61,240 at P 141 (2007)). Accordingly, Mid-America reported that the appropriate level of ADIT for each year is found on Statement E1 and Workpaper 4 of

[326] Williams did not address this issue in either its Initial or Reply Brief. Williams Initial Brief at p. 20; Williams Reply Brief at p. 17.

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Mid-America witness Ganz's Exhibit Nos. M-102, M-103, and M-104. Mid-America Initial Brief at p. 28.

585. In reply, Mid-America argued that the Propane Group, in suggesting that the corporate income tax rate should be used, failed to recognize that the Commission held, in *SFPP, L.P.,* 121 FERC ¶ 61,240 at P 23, that "the ADIT calculation should use the weighted marginal tax rate of the partners." Mid-America Reply Brief at p. 21. Additionally, Mid-America stated that, because Mid-America's rates were in effect without challenge for at least one year before the enactment of the Energy Policy Act of 1992, those rates were "grandfathered" and made subject to the Commission's indexing methodology. *Id.* (*citing* 42 U.S.C. §§ 7172 note, 1803(a) (2000); Order No. 561, Regs. Preambles ¶ 30,985 (1993); Order No. 561-A, Regs. Preambles ¶ 31,000 at p. 31,107 (1994)). Thus, Mid-America contended that, even if the prior rate originally had a cost-of-service basis, imputing specific cost-of-service elements (including actual or potential liability for income taxes) after nearly a decade of indexing would be impossible. *Id.* at p. 22.

586. Moreover, Mid-America declared that the Propane Group's supposition that certain assumptions regarding ADIT are "embedded" in the previously existing rate, which must be used in the calculation of ADIT up until the date the new rate took effect, was rejected by the Commission in the *SFPP, L.P.,* 121 FERC ¶ 61,240. *Id.*

587. In any event, Mid-America insisted that the proper calculation of ADIT is not dependent upon the prior rate level, but even were it, Mid-America claimed the ADIT balance was extinguished when Enterprise Products Partners purchased Mid-America. *Id.* (*citing* Exhibit No. M-24 at pp. 21-22). From that point, it claimed, the appropriate tax rate for a partnership during the period from 2002 through the present is the weighted average marginal tax rate calculated pursuant to the current income tax allowance policy. *Id.* at p. 23.

588. Finally, Mid-America maintained that the current income tax allowance policy has been applied by the Commission to periods when the previously existing policy had been in effect. *Id.* It contended that the weighted marginal tax rate calculated under the Policy Statement is "now the basis for determining the tax component of the ADIT calculation."[327] *Id.*

B. PROPANE GROUP

589. The Propane Group disagreed with Mid-America and instead submitted that Mid-America should accumulate its ADIT balances forward from mid-2002 to the

[327] *SFPP, L.P.*, 121 FERC ¶ 61,240 at P 141.

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relevant test year at the top marginal income tax rates for corporations. Propane Group Initial Brief at p. 23 (*citing* Exhibit Nos. NPG-1 at pp. 130-33; M-100 at p. 65). According to the Propane Group, Mid-America erroneously understands the ADIT to be a reflection of the rate at which the actual or potential income tax liability is incurred during the period at issue. *Id.* at p. 24. Rather, claimed the Propane Group, ADIT should reflect the accumulated deferred income taxes that have resulted from the pipeline's rates through the income tax allowance set in place. *Id.*

590. Moreover, the Propane Group asserted that the Commission's regulations, 18 C.F.R. § 342.3(d), require Mid-America to start its indexation rate changes based on the rates it had in place on December 31, 1994, the date on which Mid-America was indisputably owned by a corporation. *Id.* at p. 24. Consequently, argued the Propane Group, Mid-America has not met its burden of proof in rebutting the clear presumption that on December 31, 1994, the rates in effect included an income tax allowance based on the top marginal income tax rate for corporations. *Id.*

591. Finally, the Propane Group analogized this case to *SFPP, L.P.*, 86 FERC at pp. 61,093-94, where, they claimed, the Commission rejected SFPP's similar attempt to adjust its ADIT in connection with a partial income tax allowance starting in 1989 when the pipeline became a partnership rather than the actual time period at issue. *Id.* at p. 25. Accordingly, the Propane Group contended, because the period at issue is Mid-America's 2005 request for a prospective rate increase, Mid-America's attempt to modify ADIT balances based on a partnership premised income tax allowance prior to its filing is precluded. *Id.*

592. In reply, the Propane Group argued that Mid-America's proposal to use the lower weighted marginal income tax rates developed by Mid-America witness Petru in mid-2002 is supported by only one Commission decision, *SFPP, L.P.*, 121 FERC ¶ 61,240 at P 141-44, which Mid-America mischaracterizes. Propane Group Reply Brief at p. 27. In that case, they asserted, the Commission applied its current income tax policy to the time period for which the case applied, not the time when the pipeline converted to a partnership as proposed by Mid-America. *Id.* at p. 28 (*citing SFPP, L.P.*, 121 FERC ¶ 61,240 at P 144). In this case, the Propane Group suggested, the first period to which this case applies is the 2005 test year and that is the period in which Mid-America should start to reflect a lower weighted marginal income tax rate in its ADIT balance calculations. *Id.* Lastly, the Propane Group added that any over-funding of the ADIT balance that results from the switch in the marginal tax rate in mid-2002 should be amortized prospectively in the Mid-America cost of service used to derive just and reasonable rates. *Id.*

C. COMMISSION TRIAL STAFF

593. In agreement with Mid-America, Staff, in its Initial Brief, suggested that

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Mid-America's ADIT allowance should be calculated using the weighted marginal tax rate of the partners that own its ultimate parent. Staff Initial Brief at pp. 26-27.

594. Although Staff agreed with Mid-America's position on ADIT in its Initial Brief, in its Reply Brief, it acknowledged the validity of the Propane Group's arguments. Staff Reply Brief at p. 18. First, Staff insisted that neither of the cases cited by the Propane Group or Mid-America is exactly on point. *Id.* Yet Staff agreed with the Propane Group's assertion that Mid-America should have begun accumulating a new ADIT balance based on the marginal income tax rates implicitly embedded in its rates (*i.e.,* the corporate tax rate) at the time Enterprise Product Partners purchased it in 2002. *Id.* at p. 19. Staff added that only after the FERC Tariff No. 38 rates became effective should Mid-America have begun deferring taxes based on its partnership owners' tax rates. *Id.* Thus, Staff declared that Mid-America overfunded its ADIT for a period of time because the corporate tax rate was higher than the current partnership rates. *Id.*

DISCUSSION AND RULING

595. There is no dispute regarding the use of the top marginal income tax rates for corporations to accumulate Mid-America's ADIT balance for all years prior to July 31, 2002 (the date on which Enterprise Products Partners purchased Mid-America). Thus, the issue is whether the top marginal tax rates for corporations should continue to be used to accumulate Mid-America's ADIT balance from mid-2002 to the relevant test year, or whether the weighted marginal income tax rates for corporations and individuals, which reflect the limited partnership ownership status of Mid-America since mid-2002, should be used.

596. According to Mid-America, it correctly began using weighted marginal tax rates to calculate its ADIT balance in mid-2002 when Enterprise Products Partners purchased it. Mid-America Initial Brief at p. 29. It argued that, in *SFPP, L.P.,* 121 FERC ¶ 61,240 at P 141, the Commission held that the weighted marginal tax rate calculated pursuant to the income tax allowance policy also "becomes the basis for determining the tax component of the ADIT calculation." *Id.* at p. 28.

597. Unlike Mid-America, the Propane Group and Staff argued that Mid-America should accumulate its ADIT balances forward from mid-2002 to the relevant test year at the top marginal income tax rates for corporations. Propane Group Initial Brief at p. 23; Staff Reply Brief at p. 19. According to the Propane Group, Mid-America erroneously understands the ADIT to reflect the rate at which the actual or potential income tax liability is incurred during the period at issue. *Id.* at p. 24. Rather, the Propane Group contended, the ADIT should reflect the accumulated deferred income taxes that have resulted from the pipeline's rates through the income tax allowance set in place. *Id.*

598. Further, the Propane Group asserted that, in *SFPP, L.P.*, 121 FERC ¶ 61,240 at

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P 141-144, the Commission applied its current income tax policy to the time period for which the case applied, not the time when the pipeline converted to a partnership. Propane Group Reply Brief at p. 28. Consequently, the Propane Group (with the support of Staff) maintained that the first period to which this case applies is the 2005 Test Year and that is the period in which Mid-America should begin reflecting a lower weighted marginal income tax rate in its ADIT balance calculations, not the date on which the partnership purchased Mid-America. *Id.* at p. 29; Staff Reply Brief at p. 19.

599. Based on the instant record, I conclude that Mid-America should accumulate its ADIT balances forward from mid-2002 to the relevant Test Year at the top marginal income tax rates for corporations for the following reasons:

600. First, Mid-America's proposal to begin using a weighted marginal income tax rate in mid-2002 is contrary to Commission precedent. Specifically, in *SFPP, L.P.,* 86 FERC ¶ 61,022, the oil pipeline sought to make a similar adjustment to its ADIT in connection with a partial income tax allowance under the *Lakehead* doctrine,[328] beginning in 1989 when it became a partnership, rather than the actual time period at issue. The Commission denied the pipeline's proposed adjustment and ordered it to begin using the lower weighted marginal income tax to calculate its ADIT in 1992 — the year when the first complaints were filed against the pipeline in the consolidated proceeding — rather than in 1989 when the pipeline converted to a limited partnership. *SFPP, L.P.,* 121 FERC ¶ 61,240 at P 141-44. It reasoned that its "practice [was] to base its decision on the policy in effect in the year a regulatory decision [was] made, and then apply that decision to the time frame to which the case applies." *SFPP, L.P.,* 86 FERC at pp. 61,093-94.

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[328] Mid-America provides a succinct synopsis of the *Lakehead* doctrine:

> The original *Lakehead* policy did not permit an income tax allowance for partnership interests owned by individuals. *See Lakehead Pipe Line Co.*, 71 FERC ¶ 61,338 (1995), *reh'g denied*, 75 FERC ¶ 61,181 (1996). That policy was amended in 1999, to deny an income tax allowance for all partnership interests other than Subchapter-C corporations. *SFPP, L.P.*, 86 FERC ¶ 61,022, at 61,102-104 (1999) ("Opinion 435"). The Opinion 435 amendment to the *Lakehead* policy, however, never became final, and was remanded by the D.C. Circuit in *BP West Coast Products, LLC v. FERC*, 374 F.3d 1263, 1290 (D.C. Cir. 2004), *cert. denied*, 544 U.S. 1043 (2005). On remand, the Commission replaced it with the current income tax allowance policy. *Policy Statement on Income Tax Allowances*, 111 FERC ¶ 61,139 (2005). The Policy Statement was upheld by the D.C. Circuit in *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945 (D.C. Cir. 2007).

Mid-America Reply Brief at p. 23.

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601. In this proceeding, the first time period at issue is Mid-America's March 2005 filing for a prospective rate increase. Accordingly, the 2005 test year is the first period in which Mid-America should begin to reflect a lower weighted marginal income tax rate in its ADIT balance calculations. *SFPP, L.P.,* 86 FERC at pp. 61,093-94; *SFPP, L.P.,* 121 FERC ¶ 61,240 at P 144. Consequently, any over-funding of the ADIT balance resulting from any change in the marginal tax rate used in Mid-America's ADIT calculations beginning with the 2005 Test Period, instead of in mid-2002, should be amortized prospectively in the Mid-America cost-of-service used to derive just and reasonable rates. *See* Exhibit No. NPG-1 at pp. 130-31.

602. Second, Mid-America inappropriately contended that its ADIT calculations are necessary to reflect the rate at which the actual or potential income tax liability is incurred by the pipeline during the period at issue. The more appropriate focus, however, is that of the Propane Group: "Accumulated Deferred Income Tax should reflect the accumulated deferred income taxes that have resulted from the pipeline's rates via the income tax allowance embedded therein." Propane Group Initial Brief at p. 24. Prior to the March 2005 filing, Mid-America had filed rate increases only pursuant to the Commission's indexing regulations. Exhibit No. M-100 at pp. 66-67. Because the Commission's indexing regulations required a pipeline to base its indexation rate changes on the rates it had in effect on December 31, 1994,[329] and because Mid-America was owned by a corporation at this time,[330] it only can be presumed that Mid-America's rates in effect on December 31, 1994, included an income tax allowance based on the top marginal income tax rate for corporations. Moreover, each Mid-America rate change under the Commission's indexing regulations perpetuated the use of a top marginal corporate tax rate in the income tax allowance portion of the rates until Mid-America's March 2005 filing.

603. In sum, I agree with the following statement by Staff:

> When Enterprise [Product Partners] purchased Mid-America in 2002, the transaction immediately extinguished Mid-America's ADIT balances, reducing them to zero. [At that time] Mid-America should have begun accumulating a new ADIT balance based on the marginal income tax income rates implicitly embedded in its rates at the time (that is, the corporate tax rate). Only after the [FERC] Tariff No. 38 rates became effective, as a result of the instant rate case, should Mid-America have begun deferring taxes based on its partnership owners' tax rates. Since the

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[329] *See* 18 C.F.R. § 342.3(d) (2007).

[330] *See* Exhibit No. NPG-1 at p. 131.

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> corporate tax rate was higher than the current partnership rates, Mid-America's rates overfunded its ADIT for a period of time and it should return the amount so overfunded to ratepayers in some fashion.

Staff Reply Brief at p. 19 (footnote omitted).

(3) What is the appropriate basis for the allocation of rate base among the pipeline systems?

A. MID-AMERICA

604. Mid-America stated that it assigned costs directly to one of the three systems where possible, but found it necessary to allocate Conway (Kansas), Hobbs (Texas), and total company common costs between and among the three systems. Mid-America Initial Brief at p. 30 (*citing* Exhibit No. M-24 at pp. 12-18). It pointed out that all of the parties seem to agree that general overhead assets should be allocated using the Kansas-Nebraska method.[331] *Id.* (*citing* Exhibit Nos. M-106 at pp. 25-29; S-15 at pp. 57-62; NPG-1 at p. 56 n.58). Nevertheless, explained Mid-America, the parties produce different results because they disagreed on certain Kansas-Nebraska percentages and disputed over the Conway and Hobbs facilities. *Id.*

605. With respect to the Conway and Hobbs assets, Mid-America argued that its application of the Kansas-Nebraska method is the correct one, not the volumetric approach used by Staff.[332] *Id.* at p. 31. The Commission, asserted Mid-America, typically applies the Kansas-Nebraska method when allocating common or indirect costs between systems. *Id.* (*citing, e.g., Questar Pipeline Co.,* 74 FERC ¶ 61,126 at pp. 61,454-56 (1996); *SFPP, L.P.,* 86 FERC at pp. 61,081-82). Yet, according to Mid-America, Staff inappropriately used the volumetric approach because its witness

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[331] Mid-America explained that the Kansas-Nebraska method was first implemented in *Kansas-Nebraska Natural Gas Co.,* 53 FPC 1691, 1721-22 (1975), and allocates costs based on two factors: labor and gross plant. Mid-America Initial Brief at p. 30 n.11.

[332] According to Mid-America, its Kansas-Nebraska method allocated approximately 64% of the Conway capital costs to the Northern System and approximately 69% of the Hobbs capital costs to the Rocky Mountain System (the remainder going to the Central System). Mid-America Initial Brief at p. 31. On the other hand, it insisted, Staff's volumetric approach allocated approximately 36% of the Conway capital costs to the Northern System and approximately 85% of the Hobbs capital costs to the Rocky Mountain System (the remainder going to the Central System). *Id.* at pp. 30-31 (*citing* Exhibit Nos. S-9; S-15 at p. 57; M-105; M-106; M-107 at p. 25).

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Sherman believed "[t]he design and operation of the hubs are directly related to the volumes of the pipeline systems that go through the hubs." *Id.* (*citing* Exhibit No. S-4 at p. 12). Mid-America argued that Sherman is not a qualified expert on the "functions, usage, design, or operations of the Conway and Hobbs storage facilities or how they relate to volumes on the systems." *Id.* at p. 32. To the contrary, Mid-America contended, Collingsworth is a qualified expert on the facilities' functions and reported that capital costs at the facilities do not fluctuate with volume. *Id.* (*citing* Exhibit Nos. M-1 at p. 1; M-46 at pp. 20-21; Transcript at pp. 917-18). Also, Mid-America maintained that there is a nexus between the Conway and Hobbs costs and the Kansas-Nebraska factors — direct labor and gross plant. *Id.* (*citing* Transcript at pp. 908-10). Specifically, Mid-America pointed out that the assets at Conway are designed to serve both systems and the labor at Conway handles deliveries into both the Northern and Central Systems. *Id.* (*citing* Transcript at pp. 2618, 2621).

606. Finally, Mid-America claimed that, by using both inbound and outbound volumes at Conway, Staff's volumetric approach skews costs to the Central System, contrary to the actual usage of the Conway assets. *Id.* at pp. 32-33. Mid-America explained that all Northern System lines begin at Conway and move approximately 83,000 barrels per day out of Conway, while the two Central System lines that move product out of Conway average approximately 69,000 barrels per day of throughput. *Id.* at p. 33. Further, it continued, although the Central System moves approximately 50,000 barrels per day into Conway, Staff missed the fact that outbound movements from Conway involve more costs than inbound movements. *Id.* (*citing* Exhibit No. M-46; Transcript at p. 1365). Even were a volumetric approach appropriate, according to Mid-America, Staff failed to account for the increased costs associated with outbound as compared with inbound movements. *Id.* at p. 33.

607. In reply, stating it was addressing the Propane Group's claim that the rate base and expenses related to the Bushton and Coffeyville laterals should be removed from the Conway hub and assigned to the Central System, Mid-America asserted that Ganz testified that he removed them from the cost-of-service through the interstate/intrastate separation factor. Mid-America Reply Brief at p. 24 n.16. (*citing* Transcript at pp. 2060-61). According to Mid-America, the Propane Group raised the issue briefly at the hearing, but failed to show that the Bushton and Coffeyville laterals were treated improperly and failed to provide any information sufficient to perform a different allocation or direct assignment and, therefore, it argued, the record fails to contain a basis on which to treat the laterals any differently than Ganz did in his cost-of-service testimony. *Id.*

608. Mid-America responded to Staff's suggestion that Mid-America's use of the Kansas-Nebraska formula to allocate common rate base improperly expanded the application of that method by pointing out that Staff also used the Kansas-Nebraska method to allocate rate base that is common to all three systems (*e.g.,* the Houston central

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office and control room). *Id.* at p. 25. It insisted that no reason exists for using the Kansas-Nebraska method to allocate some common assets, but not those at Conway. *Id.* Moreover, Mid-America asserted that it used the Kansas-Nebraska method and not a volumetric approach because many of the Conway fixed costs do not vary with volumes, and the costs related to volumes are largely related to the outbound volumes rather than the combination of inbound and outbound volumes that Staff uses. *Id.* (*citing* Exhibit Nos. M-46 at pp. 20-22; M-100 at p. 38; M-46 at p. 21; Transcript at pp. 909-10).

609. Further, Mid-America argued, Staff ignored the fact that inbound demethanized mix volumes to Conway are tightlined[333] to a nearby fractionator and do not need to be sampled, tested, or dehydrated. *Id.* at p. 26. Because it claimed that demethanized mix volumes make up the majority of the inbound volumes at Conway, Mid-America suggested that inbound volumes do not incur the same level of costs as the outbound volumes. *Id.* In addition, Mid-America insisted that Staff ignored the fact that six of the seven pumps at Conway are dedicated to transporting product on the Northern System, while only one is dedicated to the Central System. *Id.* (*citing* Exhibit No. M-46 at p. 22). Even were a volumetric approach appropriate, Mid-America added, only the outbound movements should be used as the measuring rod. *Id.* Thus, Mid-America contended, Staff's method, which allocated approximately 60% of the Conway costs to the Central System, is clearly unreasonable. *Id.* (*citing* Exhibit No. M-46 at p. 21).

610. Next, regarding Staff's argument that the "use of the hub facilities bears no articulable relationship to the relative level of Mid-America's labor or capital expenses for its Central and Northern Segments," Mid-America declared that the record demonstrated the existence of a nexus between the Conway and Hobbs costs and the Kansas-Nebraska factors. *Id.* at p. 27 (*citing* Transcript at pp. 908-10). For one, Mid-America maintained that the assets at Conway are more heavily weighted toward serving the Northern System. *Id.* (*citing* Transcript at p. 909). Moreover, Mid-America noted that that even Propane Group witness O'Loughlin agreed that a nexus exists since the labor at Conway handles deliveries into both the Northern and Central Systems and because the Conway assets are designed to serve both systems. *Id.* (*citing* Transcript at pp. 2618, 2621).

611. Lastly, Mid-America explained, the volumetric approach used to allocate common costs between Mid-America and the Magellan ammonia pipeline was the result of an agreement between Mid-America and Magellan and thus provided no reason to depart from the Kansas-Nebraska method for the allocation of other costs. *Id.* According to Mid-America, its witness Knesek's statement that "a volumetric allocation is the most reasonable and objective method of allocating shared costs," was directed only to the

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[333] According to Mid-America, "tightline" implies direct movement without interruption. Mid-America Initial Brief at p. 185 (*citing* Transcript at p. 3128).

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allocation of the costs between Mid-America and the ammonia line. *Id.* (*citing* Transcript at pp. 909-10, 1221-22; Exhibit No. M-46 at pp. 20-22).

B. PROPANE GROUP

612. The Propane Group stated that it does not dispute Mid-America's direct assignment of rate base assets and associated depreciation to one of the three systems. Propane Group Initial Brief at p. 26. However, the Propane Group objected to Mid-America's allocation of certain Conway common costs, claiming that the allocations contradict the fundamental principle that costs should follow causation. *Id.* They insisted that Mid-America incorrectly treated costs directly identifiable to the "Bushton Lateral" and "Coffeyville Lateral" as costs incurred at Conway for both the Central and Northern Systems while assigning all of the volumes and associated revenues of the two laterals to the Central System and not the Northern System.[334] *Id.* at pp. 26-27 (*citing* Transcript at pp. 2064-66; Exhibit No. NPG-231).[335] In support of their argument, the Propane Group claimed that Mid-America witness Ganz could not identify any Northern System service that produced the costs associated with the Bushton and Coffeyville Laterals that have been allocated to the Northern System. *Id.* at p. 29 (*citing* Transcript at p. 2065). Consequently, the Propane Group recommended that Mid-America be required to remove all currently allocated Bushton and Coffeyville lateral costs embedded in the Northern System costs of service and allocate these costs to the Central System as has been done with the corresponding volumes and revenues. *Id.*

613. In their Reply Brief, the Propane Group asserted that the rate base assets, associated depreciation, and operating and maintenance expenses related to the Bushton and Coffeyville Laterals are directly identifiable in the asset database used by Mid-America to assign assets to Mid-America's three systems. Propane Group Reply Brief at p. 32 (*citing* Transcript at pp. 2053-59; Exhibit Nos. NPG-229; NPG-230). Additionally, the Propane Group argued that the volumes, and thus revenues, related to the Bushton and Coffeyville Laterals are also directly identifiable in the volume database used by Mid-America to assign volumes, and thus revenues, to one of Mid-America's three systems.[336] *Id.* (*citing* Transcript at pp. 2064-66; Exhibit No. NPG-231).

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[334] The Bushton and Coffeyville Laterals extend outward from Conway. Propane Group Initial Brief at p. 26 (*citing* Exhibit No. NPG-142).

[335] According to the Propane Group, Mid-America allocated the costs associated with the two laterals to the Northern and Central Systems using a Kansas-Nebraska allocation factor — 64.1% being allocated to the Northern System and 35.9% allocated to the Central System in the 2006 Test Period. Propane Group Initial Brief at p. 27 (*citing* Transcript at pp. 2051-53; Exhibit No. M-109 at p. 2).

[336] According to the Propane Group, direct costs should be assigned directly, and

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C. WILLIAMS

614. According to Williams, the appropriate basis for the allocation of rate base among the pipeline systems is the segmented costs methodology because the three systems are clearly delineated. Williams Initial Brief at p. 21. The "Total-Company" approach used by the Propane Group asserted Williams, fails to recognize or account for the nature of the three distinctly separate systems and the segmented data that is available. *Id.* at pp. 21-22 (*citing* Exhibit No. WIL-8 at pp. 13-14). In contrast, contended Williams, because the total revenue requirement is apportioned to the three segments under the segmentation approach, costs are more accurately represented. *Id.*[337]

D. COMMISSION TRIAL STAFF

615. Staff noted that it contests only Mid-America's allocation of common costs associated with the Conway and Hobbs hubs. Staff Initial Brief at p. 27. While it agreed that the Conway costs, including rate base, should be allocated to the Northern and Central Systems, it did not agree with the specific allocation factors suggested by Mid-America witness Ganz and challenged Ganz's approach of developing a rate base allocation factor for each of the systems based on an equal weighting of the capital and payroll costs attributable to the two systems as inappropriate and baseless. *Id.* at p. 29 (*citing* Exhibit No. M-26 at p. 26).

616. In the alternative, Staff suggested using a volumetric allocator for the common rate base at Conway and Hobbs. *Id.* at p. 29. Staff contended that volumes more accurately reflect the function and relative usage of the hubs than do the ratios of gross property and payroll associated with the pipeline segments served by the hubs. *Id.* (*citing* Exhibit No. S-4 at pp. 11-14). Furthermore, Staff maintained that Mid-America measures, filters, dehydrates, and pumps product between Conway and the two systems in relative proportion to the throughput on the two systems. *Id.* at p. 30 (*citing* Transcript at pp. 1356-57, 1359-60). This indicated, claimed Staff, "that Mid-America performs these functions directly on volumes and in relative proportion to the throughput on the Central and Northern Systems," while their use "bears no articulable relationship to the relative level of Mid-America's labor or capital expenses for its Central and Northern Systems." *Id.* (*citing* Transcript at pp. 907-08, 1221-22).

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only indirect costs should be assigned by formula. Propane Group Reply Brief at p. 32 (*citing Kern River Gas Transmission Co.*, 117 FERC ¶ 61,077).

[337] Williams added nothing new in its Reply Brief regarding this issue. Williams Reply Brief at p. 17.

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617. In its Reply Brief, Staff criticized both cases cited by Mid-America in support of its position – *Questar Pipeline Co.,* 74 FERC ¶ 61,126 (1996); and *SFPP, L.P.,* 86 FERC ¶ 61,022 (1999) — arguing that the cases address the allocation of indirect costs, not the allocation of common rate base at issue here. Staff Reply Brief at pp. 21-22.[338] Moreover, in response to Mid-America's attacks on Staff witness Sherman's competence, it insisted that an expert witness does not need pipeline operational experience or engineering expertise to evaluate cost allocation. *Id.* at p. 22. Staff added that, in a recent case, *Entergy Services, Inc.*, 116 FERC ¶ 61,296 at pp. 62,506-07 (2006), the Commission found that a Staff witness was competent to evaluate Entergy's request for proposals for electric power supply even though the witness's job experience did not entail overseeing or participating in a request for such proposals. *Id.* at p. 23.

Discussion and Ruling

618. As the parties do not contest Mid-America's direct assignment of the majority of rate base assets and associated depreciation to one of the three systems,[339] the only issue remaining is how to allocate the common assets associated with the Conway, Kansas hub. Specifically, the issue is whether to allocate common rate base at Conway using the Kansas-Nebraska formula[340] or a volumetric approach.[341]

619. Mid-America submitted that the Conway assets should be allocated using the Kansas-Nebraska method rather than Staff's proposed volumetric approach. Mid-America Reply Brief at p. 24.[342] Mid-America's Kansas-Nebraska method allocates approximately 64% of the Conway capital costs to the Northern System, the remainder going to the Central System. Mid-America Initial Brief at p. 31. On the other hand,

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[338] In support, Staff cites *Questar Pipeline Co.,* 74 FERC at pp. 61,454-56; *SFPP, L.P.,* 86 FERC at pp. 61,081-82.

[339] *See* Mid-America Initial Brief at p. 30; Propane Group Initial Brief at p. 26; Williams Initial Brief at p. 21; Staff Initial Brief at p. 27.

[340] *See Kansas-Nebraska Natural Gas Co.,* 53 FPC 1691.

[341] The Propane Group agreed with Mid-America that the Kansas-Nebraska formula should be used to allocate common costs at Conway between the Northern and Central Systems, but it disputed the calculation of that formula. Mid-America Reply Brief at p. 24; Propane Group Initial Brief at p. 26. Specifically, the Propane Group recommended changes to Mid-America's direct labor data. Exhibit No. NPG-1 at p. 33. This question is addressed in detail under Issue No. 4.D.(1), i*nfra.*

[342] Exhibit No. M-24 at pp. 12-17.

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according to it, Staff's volumetric approach allocates approximately 36% of the Conway capital costs to the Northern System, the remainder going to the Central System. *Id.* at pp. 30-31.[343]

620. Mid-America contended that Collingsworth is a qualified expert on the facilities' functions and reported that capital costs at the facilities do not fluctuate with volume. *Id.*[344] Also, Mid-America maintained that there is a nexus between the Conway costs and the Kansas-Nebraska factors — direct labor and gross plant, to wit: the assets at Conway are designed to serve both systems and the labor at Conway handles deliveries into both the Northern and Central Systems. *Id.*[345]

621. Conversely, while Staff agreed that the Conway costs, including rate base, should be allocated to the Northern and Central Systems, it contested Mid-America's approach in developing a rate base allocation factor for each of the systems based on an equal weighting of the capital and payroll costs attributable to the two systems. Staff Initial Brief at p. 29.[346] Instead, Staff suggested using a volumetric approach to allocate common rate base at Conway which, it contended, more accurately reflects the function and relative usage of the hubs than do the ratios of gross property and payroll associated with the pipeline segments served by the hubs. *Id.*[347]

622. The Propane Group contended that the directly identifiable costs related to the Bushton and Coffeyville Laterals should be directly assigned to the Central System just as Mid-America assigned all directly identifiable volumes and revenues associated with the Bushton and Coffeyville Laterals to the Central System, regardless of whether a Kansas-Nebraska allocation factor or a volumetric allocation factor is used. Propane Group Reply Brief at pp. 31-32.[348]

623. Based on the record, I conclude that the common rate base at Conway and Hobbs should be allocated using the Kansas-Nebraska method, not the volumetric approach. I find the testimony of Mid-America witness Collingsworth, as he manages and oversees

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[343] Exhibit Nos. S-9; S-15 at p. 57; M-105; M-106; M-107 at p. 25.

[344] Exhibit Nos. M-1 at p. 1; M-46 at pp. 20-21; Transcript at pp. 917-18.

[345] Transcript at pp. 908-10, 2618, 2621.

[346] Exhibit No. M-26 at p. 26.

[347] Exhibit No. S-4 at pp. 11-14.

[348] Transcript at pp. 2064-66; Exhibit No. NPG-231.

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operations of the Mid-America facilities,[349] more credible than that of Staff witness Sherman. Accordingly, I accept Collingsworth's testimony stating that the incurrence of the capital costs at Conway bears little relationship to the volumes flowing both into and out of those facilities as is reflected in Staff's methodology. Collingsworth testified as follows:

> [I]n my opinion Staff's volumetric allocation formula does not "accurately reflect[] the functions and relative usage" of the Conway costs, at least as Staff applies it. It is my understanding that the [Kansas-Nebraska] formula allocates approximately 65 percent of the Conway costs to the Northern System. Although this may actually understate the costs that should be allocated to the Northern System, it is certainly a more reasonable outcome than allocating only 40-44 percent of the Conway costs to the Northern System as Staff suggests.

Exhibit No. M-46 at pp. 20-21 (citations omitted). Moreover, Collingsworth testified at the hearing that the Conway costs and the Kansas-Nebraska factors — direct labor and gross plant — have a nexus because the assets at Conway are designed to serve both systems, and labor at Conway handles deliveries into both the Northern and Central Systems. Transcript at pp. 908-10, 2618, 2621. In view of this testimony, I find that these costs cannot reasonably be assigned to the Northern and Central Systems using the volumetric approach proposed by Staff.

624. Further, I am convinced that, by using both inbound and outbound volumes at Conway, Staff's volumetric approach skews costs to the Central System, contrary to the actual usage of the Conway assets. All Northern System lines begin at Conway and move approximately 83,000 barrels per day out of Conway, while the two Central System lines that move product out of Conway average approximately 69,000 barrels per day of throughput. Exhibit No. M-46 at pp. 21-22. Although the Central System moves approximately 50,000 barrels per day into Conway, Staff misses the fact that outbound movements from Conway, since they must be metered, sampled, tested, and dehydrated, involve substantially more costs than inbound movements. Exhibit Nos. M-46; M-167; Transcript at p. 1365. Conversely, inbound demethanized mix volumes, accounting for over 86% of inbound volumes at Conway are tightlined to a nearby fractionator — in other words, they move directly through the Conway facility without needing to be sampled, tested, or dehydrated. Exhibit Nos. M-167; M-46 at p. 22; Transcript at p. 1365. Finally, outbound volumes also need to be pumped, and six of the seven pumps at Conway are dedicated to transporting product on the Northern System, while only one is dedicated to the Central System. Exhibit No. M-46 at p. 22. As a result, I am compelled to agree with Mid-America that, because the costs associated with outbound

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[349] *See* Exhibit No. M-1 at p. 1; Transcript at pp. 917-18.

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and inbound movements vary greatly, allocating costs on a volumetric basis is inappropriate.

625. Lastly, I conclude that Mid-America must remove all currently allocated Bushton and Coffeyville Lateral costs from the Northern System and should directly assign to the Central System all such directly identifiable costs related to the two laterals. Such assignment is appropriate because it is consistent with Mid-America's assignment of all volumes and associated revenues of the two laterals to the Central System. Transcript at pp. 2064-66; Exhibit No. NPG-231.

(4) What is the appropriate allocation to interstate and intrastate property?

A. MID-AMERICA

626. With respect to this issue, according to Mid-America, all of the parties agree on using a barrel-mile allocation percentage to allocate property between interstate and intrastate service and arrive at the same percentages. Mid-America Initial Brief at p. 34[350] (*citing* Exhibit Nos. M-24 at p. 27; NPG-1 at pp. 190-91; NPG-110 at p. 120; S-12 at p. 2; S-19 at p. 8; Transcript at pp. 2328, 2769). According to Mid-America, to derive an interstate-only cost of service, the number of barrel-miles moved in interstate commerce is divided by the number of barrel-miles moved on a system, and then the resulting interstate allocation percentages are applied to each system. *Id.* (*citing* Exhibit Nos. M-102 at p. 20; M-103 at p. 20; M-104 at p. 20).

627. Where the parties differ, according to Mid-America, is in their use of different volume levels for each period and in their treatment of the Channahon to Morris volumes. *Id.* Mid-America argued that the actual volumes moved during the Locked-In Period and Base Period, adjusted for known and measurable changes, should be (and was by Mid-America) used in accordance with the regulations. *Id.* (*citing* 18 C.F.R. § 346.2(a)(ii)).

B. PROPANE GROUP

628. While the Propane Group does not debate the methodology Mid-America used to separate interstate costs from intrastate costs (ratio of interstate barrel-miles to total barrel-miles), it does object to several of the adjustments made by Mid-America to volumes that directly affect the calculation of the ratio of interstate barrel-miles to total

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[350] Mid-America did not add anything new to its argument in its Reply Brief. Mid-America Reply Brief at p. 28.

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barrel miles.[351] Propane Group Initial Brief at p. 30.[352]

C. WILLIAMS

629. Williams argued that the total revenue requirement should be split between interstate and intrastate using barrel-miles.[353] Williams Initial Brief at p. 23. Because the Commission allocates interstate and intrastate total costs, rather than property and expenses, on a barrel-mile basis, Williams asserted that this method should be applied to the allocation of property between interstate and intrastate costs associated with Mid-America's three systems. *Id.* (*citing* Exhibit No. S-4 at p. 12).

D. COMMISSION TRIAL STAFF

630. On this issue, Staff referred to the testimony of its witness McComb who, it claimed, for FERC Tariff No. 38 rates, "based her proposed interstate allocations on actual pipeline throughput[354] for the twelve months ended September 30, 2005." Staff Initial Brief at p. 31 (*citing* Exhibit No. S-19 at pp. 6-15) (footnote added)). It noted that this corresponds to the Test Period which it advocated. *Id.* Staff added that, for FERC Tariff No. 41, McComb used the actual throughput for that tariff's Test Period, the 12 months ending October 31, 2006. *Id.*

631. Further, Staff noted that, for the FERC Tariff No. 38 rates, it did not accept Mid-America's proposals (1) to change the shipments from Channahon to Morris, Illinois, from interstate to intrastate because Mid-America did not record this change until

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[351] Specifically, the Propane Group asserted that the following should be treated as interstate volumes when developing the dollar/barrel and dollar/barrel-mile costs for interstate rates for individual origin-destination pairs: (1) the Channahon, Illinois, to Morris, Illinois, volumes; (2) the propane volumes moving between Clinton, Iowa, and Conway, Kansas; and (3) the 3,650,000 barrel volume commitment by the East Red Line Shipper for transportation from Cochin pipeline to Conway, Kansas. Propane Group Initial Brief at pp. 30-31. These matters are discussed in Issue Nos. 5, 7.A., 7.C., and 7.D.

[352] The Propane Group added nothing new in its Reply Brief. Propane Group Reply Brief at p. 35.

[353] Nothing in Williams Reply Brief adds to what it submitted in its Initial Brief on this Issue. *See* Williams Reply Brief at p. 18.

[354] Staff explained that the issue of throughput is discussed and argued in detail under Issue No. 5. Staff Initial Brief at p. 31 n.127.

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after the end of the FERC Tariff No. 38 period, and (2) to eliminate the barrels associated with the movement of propane from Conway, Kansas, to Clinton, Iowa, because it believes these movements were related to an unreasonable provision in Mid-America's tariff. *Id.* at p. 32.[355] In contrast, for the FERC Tariff No. 41 rates, Staff accepted Mid-America's adjustment associated with the Channahon to Morris movements, since Mid-America recorded these movements as intrastate during the FERC Tariff No. 41 test period. *Id.* (*citing* Exhibit No. S-19 at p. 12).

632. In its Reply Brief, Staff argued that, for the Conway hub cost allocation, a ratio based on barrels only, not barrel-miles, should be used. Staff Reply Brief at pp. 23-24 (*citing* Exhibit No. S-19 at pp. 13-15; Transcript at pp. 3012-13). It explained that this is so because the hub represents a point on the system without any substantial length of pipe. *Id.* at p. 24 (*citing* Transcript at p. 2880).

Discussion and Ruling

633. All the parties to this proceeding agree that a barrel-mile allocation percentage should be used to allocate property between interstate and intrastate service, only Staff offers any disagreement.[356] Mid-America Initial Brief at p. 34; Propane Group Initial Brief at p. 30; Williams Initial Brief at p. 23; Staff Reply Brief at p. 23. Staff insisted that the costs associated with the Conway hub should be allocated using a ratio based on barrels only, not barrel-miles, because the hub represents a point on the system without any substantial length of pipe. Staff Reply Brief at pp. 23-24 (*citing* Exhibit No. S-19 at pp. 13-15; Transcript at pp. 2880, 3012-13).

634. As no party disputes this issue and as supported by the record, I find that the appropriate allocation to interstate and intrastate property should be determined using a barrel-mile allocation percentage. *See* Exhibit Nos. M-24 at p. 27; NPG-1 at pp. 190-91; NPG-110 at p. 20; S-19 at pp. 8, 11; S-12 at p. 2; Transcript at pp. 2328, 2769. In sum, this method divides the number of barrel-miles moved in interstate commerce by the total number of barrel-miles moved on a system to produce an interstate allocation percentage

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[355] Exhibit No. S-19 at pp. 9-10.

[356] The following matters are discussed by the parties as related to this issue, but are more specifically addressed in Issue Nos. 5 and 7, *infra*, and will be decided there: (1) What are the appropriate throughput figures for each period?; (2) Should the Channahon to Morris, Illinois, movements be treated as interstate or intrastate? (3) Should the propane volumes moving between Clinton, Iowa, and Conway, Kansas, be treated as interstate or intrastate?; and (4) Should the 3,650,000 barrel volume commitment by the East Red Line Shipper for transportation from Cochin pipeline to Conway, Kansas, be treated as interstate or intrastate?

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for each relevant period, and these interstate allocation percentages are then applied to each system to derive an interstate-only cost of service. *See* Exhibit No. M-24 at p. 27.

635. With regard to the matter raised by Staff in its Reply Brief, I do not find persuasive its suggestion that the interstate percentages for the allocation of costs associated with the Conway hub should be based on barrels only. *See* Staff Initial Brief at p. 33; Staff Reply Brief at pp. 23-24. First, I already have determined that the common rate base at the Conway hub should be allocated using the Kansas-Nebraska method; and second, after reviewing the record, I find Staff's proposal to be unsubstantiated. In support of its claim, Staff can cite only to one sentence in Staff witness Pride's testimony at the hearing. *See* Staff Reply Brief at pp. 23-24 (*citing* Transcript at p. 2880).[357] That single comment, which is barely pertinent, is insufficient for Staff to carry its burden of proof.[358]

636. Moreover, the record demands a conclusion that the Conway facilities support the whole of the Northern System operations. *See* Exhibit Nos. M-46 at pp. 21-22, 58-61; S-26 at p. 10. Consequently, as Conway is clearly an integrated part of the Northern System, the cost of these facilities should be allocated to the System on the same basis as are other transportation costs related to it.

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[357] Staff witness Pride having been asked, on cross-examination, whether she "could . . . have done a volumetric allocation on a barrel-mile basis," referred to Exhibit No. S-5 at p. 19 (the cost-of-service model prepared by Staff witness Sherman) and stated: "To me [a hub allocation on an interstate barrel-mile basis] doesn't make sense because there's [sic] no miles on Hobbs. It's not a segmented point."

[358] Staff does make another assertion; however, I do not think its assertion is raised to the level of argument. It noted that its witness McComb calculated "interstate percentages for the allocation of costs associated with" the Conway Hub and that her calculations "yielded an interstate allocation factor for the Northern system [sic] of 35.48% for Rate Period I and 35.56% for Rate Period II." Staff Initial Brief at p. 33 (footnotes omitted). This data, after reviewing the exhibits cited by Staff (Exhibit Nos. S-24 at pp. 1-2; S-19 at p. 15), turns out to refer to the percentage of interstate barrels passing through the Conway hub attributable to the Northern System in comparison with the total number of barrels passing through the facility, at the same time reflecting that 100% of the Northern System barrels moved in interstate commerce. While the evidence to which Staff cited may bear on the question of how much of the Conway hub costs should be allocated to the Northern System shippers, I fail to see any relevance or materiality to the issue at bar here.

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B. WHAT IS THE APPROPRIATE OVERALL RATE OF RETURN ON RATE BASE?

(1) What is the appropriate current capital structure?

A. MID-AMERICA

637. In its Initial Brief, Mid-America suggested that the appropriate capital structure to use in calculating return on rate base is the capital structure of its parent, Enterprise Products Partners, as of December 31, 2005, for both the Locked-In Period and the FERC Tariff No. 41 Base Period. Mid-America Initial Brief at p. 36.[359] Using this, Mid-America calculated an equity ratio of 54.02%. *Id.* (*citing* Exhibit No. M-21 at p. 7). According to Mid-America, Staff used a different capital structure of Enterprise Products Partners because it believes that test periods should reflect actual results incurred in the last three months of the base period plus the nine months of actual results during the Test Period. *Id.* Mid-America argued Staff's reasoning is flawed. *Id.*[360]

B. PROPANE GROUP

638. The Propane Group stated that they do not oppose the use of the year-end 2005 current capital structures used by Mid-America for the 2005 Test Year, the 2006 Test Year, and, to the extent applicable, the 05/06 Locked-In Period. Propane Group Initial Brief at p. 32 (*citing* Exhibit Nos. M-17 at pp. 17-18; M-21 at p. 7; NPG-237 at pp. 2, 5, 8).[361]

C. WILLIAMS

639. In its Initial Brief, Williams contended that the appropriate current capital structure should be the capital structure of Mid-America's parent for both the Test Period ending September 30, 2005, and the Test Period ending October 31, 2006. Williams Initial Brief at p. 23. Accordingly, for the period ending September 30, 2005, Williams suggested that the appropriate ratio for long-term debt be 45.89% and the appropriate ratio for common equity be 54.11%, which are the figures Staff advocated. *Id.* at pp. 23-24. Additionally, for the period ending October 31, 2006, Williams derived a ratio for

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[359] In support, Mid-America cited Exhibit Nos. M-21 at p. 7; M-102 at p. 5; M-103 at p. 5; M-104 at p. 5.

[360] Mid-America repeated its arguments in its Reply Brief. Mid-America Reply Brief at p. 29.

[361] The Propane Group added nothing new in its Reply Brief. Propane Group Reply Brief at p. 36.

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long-term debt of 44.97% and a ratio of 55.03% for common equity, which are also the figures Staff advocated. *Id.* at p. 24.

640. In its Reply Brief, Williams departed from the position in its Initial Brief and agreed that Mid-America's and the Propane Group's positions are more persuasive than Staff's. Williams Reply Brief at p. 19. Specifically, Williams agreed that a locked-in period should be used for Period I, and thus, it accepted Mid-America's common equity percentage of 54.02 for both Period I and Period II. *Id.* at pp. 19-20.

D. COMMISSION TRIAL STAFF

641. In contrast with Mid-America, Staff recommended a capital structure of 45.89% debt and 54.11% equity for the 12-month Test Period ending September 30, 2005, and a capital structure of 44.97% debt and 55.03% equity for the 12-month Test Period ending October 31, 2006.[362] Staff Initial Brief at pp. 33-34. Staff stated that, while both Mid-America and Staff relied on the capital structure of Mid-America's parent, Enterprise Products Partners, Staff used Enterprise's Security and Exchange Commission reports to make its calculations, while Mid-America used the data provided by Enterprise Products Partners' treasury group. *Id.* at p. 34 (*citing* Exhibit Nos. S-1 at p. 10; S-3 Workpaper No. 3; M-17 at p. 2; M-21 at p. 7). According to Staff, because its proposed capital structures were supported by publicly available and verifiable data, its calculations should be adopted. *Id.*

642. Moreover, Staff took issue with Mid-America's reliance upon the 2005 capital structure for both rate periods contending that the Commission requires the most representative (most recent) data to calculate the cost of service, and data through December 31, 2006, is available. *Id.* at p. 35 (*citing Middle South Services, Inc.*, 16 FERC ¶ 61,101 at p. 61,223 (1981)). Staff further asserted that the end of the second Test Period was October 31, 2006, and that it calculated Mid-America's capital structure using Enterprise Product Partner's data through December 31, 2006. *Id.* It suggested that, as the rates based on the second Test Period will be forward-looking, "they should reflect the most current cost of capital data for Mid-America that is available." *Id.* (*citing* Exhibit No. S-1). Furthermore, according to Staff, the Commission favored use of the most current data. *Id.* (*citing Transcontinental Gas Pipe Line Corp.*, 84 FERC at p. 61,427; *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260 at P 186).

643. In its Reply Brief, Staff asserted that Mid-America's use of a capital structure as of December 31, 2005, for FERC Tariff No. 38 is improper because the Test Period for that tariff ended on September 30, 2005. Staff Reply Brief at p. 26. According to Staff,

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[362] According to Staff, Mid-America derived a 2005 capital structure of 45.98% debt and 54.02% equity, and used these figures for both its 2005 and 2006 filing. Staff Initial Brief at p. 34 (*citing* Exhibit Nos. M-21 at p. 7; M-31 at p. 5; M-40 at p. 5).

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the December 31, 2005, date reflects a purely arbitrary choice between the end of the Test Period and the end of the Locked-In Period. *Id*. It maintained that relying on data beyond the end of the Test Period is unjustified for a locked-in period. *Id.*

644. Staff also stated, addressing Mid-America's use of the September 30, 2005, date for FERC Tariff No. 41, that the Test Period for that tariff ended on October 31, 2005, and that, unlike Mid-America which used the December 31, 2005, data,[363] it used data available as of December 31, 2006. *Id.* at p. 26. According to Staff, the Commission has found utilization of updated financial data applying to a period two months following the close of the test period to be reasonable. *Id.* at p. 27 (*citing Transcontinental Gas Pipe Line Corp.,* 84 FERC at p. 61,427). Consequently, because its updated financial data continues two months after the close of the test period for FERC Tariff No. 41, Staff argued that its proposed capital structure for FERC Tariff No. 41 complies with Commission precedent supporting the use of the latest available evidence of a company's capital structure. *Id.*

Discussion and Ruling

645. All parties agree that the capital structure of Mid-America's parent company, Enterprise Products Partners, should be imputed as the appropriate capital structure of Mid-America in determining its rate of return on rate base.[364] However, Mid-America and Staff disagreed on whether Enterprise Products Partners' capital structure as of December 31, 2005, or as of September 30, 2005, should be used to determine the appropriate equity ratio for the March 2005 filing, and whether Enterprise Products Partners' capital structure as of December 31, 2005, or as of December 31, 2006, should be used to determine the appropriate equity ratio for the March 2006 filing.

646. With regard to both the March 2005 and March 2006 filings, Mid-America, the Propane Group, and Williams all agree that the capital structure of Enterprise Products Partners as of December 31, 2005, should be used to determine the appropriate equity ratio. Mid-America Initial Brief at p. 36; Propane Group Initial Brief at p. 32; Williams Reply Brief at pp. 19-20. Based on the data for that date, the parties calculated an equity

[363] According to Staff, Mid-America justified the use of the December 31, 2005, date by noting that the base period for FERC Tariff No. 41 was February 5, 2005, through January 31, 2006. Staff Reply Brief at p. 26 (*citing* Mid-America Initial Brief at p. 36).

[364] *See* Exhibit Nos. S-1 at p. 10; M-17 at p. 2; Mid-America Initial Brief at p. 36; Propane Group Reply Brief at p. 36; Williams Initial Brief at p. 23; Staff Initial Brief at p.34.

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ratio of 54.02%.[365] Mid-America Initial Brief at p. 36 (*citing* Exhibit No. M-21 at p. 7; p. 5 Statement C of Exhibit Nos. M-102, M-103, and M-104); Williams Reply Brief at pp. 19-20.

647. In contrast, Staff argued that the capital structure of Enterprise Products Partners as of September 30, 2005 (the end-of-Test Period date), should be used to determine the appropriate equity ratio for the March 2005 filing. Staff Initial Brief at p. 33.[366] Staff contended that December 31, 2005, the date Mid-America uses to calculate Enterprise Product Partners' capital structure for FERC Tariff No. 38 falls outside the Test Period and, therefore, should not be used. Staff Reply Brief at p. 26. Accordingly, for the March 2005 filing, based on data for September 30, 2005, Staff advocated an equity ratio of 54.11%.[367] *Id.* at p. 25.

648. As I decided in Issue No. 2 that there is no reason to deviate from the Commission's prescribed base and test periods,[368] the appropriate Test Period for FERC Tariff No. 38 ended on September 30, 2005.[369] Consistent with this decision, I agree with Staff that the capital structure of Enterprise Products Partners, as of September 30, 2005, should be used as it is the date on which the Test Period for FERC Tariff No. 38 ended and, therefore, is the latest available evidence of the company's capital structure. *See Middle South Services, Inc.*, 16 FERC at p. 61,223. Accordingly, I also agree with Staff that, for the purposes of FERC Tariff No. 38, the appropriate equity ratio for Mid-America is 54.11%.[370] Exhibit No. S-1 at p. 3.

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[365] As of December 31, 2005, Enterprise Products Partners' long-term debt equaled $4,833,781,000, and its stockholders equity equaled $5,679,309,000, totaling $10,513,090,000. Exhibit No. M-21 at p. 7. Thus, the stockholders equity, divided by the total, yields an equity percentage of 54.02. *Id.*

[366] Exhibit No. S-1 at pp. 2-3.

[367] As of September 30, 2005, Enterprise Products Partners' long-term debt equaled $4,788,840,000, and its stockholders equity equaled $5,647,700,000, totaling $10,436,540,000. Exhibit No. S-2 at p. 13. Thus, the stockholders equity, divided by the total, yields an equity percentage of 54.11. *Id.*

[368] *See* 18 C.F.R. § 346.2(a)(1) (2007).

[369] *See* Exhibit No. S-4 at p. 7.

[370] As of September 30, 2005, Enterprise Products Partners' long-term debt equaled $4,788,840,000, and its stockholders equity equaled $5,647,700,000, totaling $10,436,540,000. Exhibit Nos. S-2 at p. 8; S-3 at p. 60. Thus, the stockholders equity, divided by the total, yields an equity percentage of 54.11. *Id*. Similarly, the long-term

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649. With respect to the March 2006 filing, Mid-America also suggested that its parent's capital structure as of December 31, 2005, is appropriate with an equity ratio of 54.02%. Mid-America Initial Brief at p. 36. On the other hand, Staff argued that the capital structure of Enterprise Products Partners as of December 31, 2006, is more appropriate. Staff Reply Brief at p. 26. It contended that, although this date requires it to use financial data reflecting two months beyond the close of the Test Period for FERC Tariff No. 41, Commission policy permits it to do so because, as is the case here, it is in the public interest to utilize the most current financial data available. *Id.* (*citing Transcontinental Gas Pipe Line Corp.,* 84 FERC at p. 61,427). Accordingly, for the March 2006 filing, Staff advocated an equity ratio of 55.03%.[371] Staff Initial Brief at pp. 33-34.

650. Similarly, for FERC Tariff No. 41, all parties agree that the capital structure of Mid-America's parent company, Enterprise Products Partners, should be imputed as the appropriate capital structure of Mid-America in determining its rate of return on rate base.[372] Moreover, for FERC Tariff No. 41, as I decided under Issue No. 2 that there is no reason to deviate from the Commission's prescribed base and test periods[373] the appropriate Test Period for FERC Tariff No. 41 ended October 31, 2006.[374] Consistent with this decision, the capital structure of Enterprise Products Partners as of October 31, 2006, should reflect the latest available company capital structure for that period. However, no party adduced this information.

651. Since no data in the record reflects the status of Enterprise Products Partners' capital structure as of October 31, 2006, I am compelled therefore to seek an alternative. Mid-America suggested that I use December 31, 2005. Mid-America Initial Brief at p. 36. However, that date is three months prior to the date on which it filed FERC Tariff

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debt divided by the total, yields a debt percentage of 45.89. *Id.*

[371] As of December 31, 2006, Enterprise Products Partners' long-term debt equaled $5,295,590,000, and its stockholders equity equaled $6,480,230,000, totaling $11,775,820,000. Exhibit No. S-2 at p. 8. Thus, the stockholders equity, divided by the total, yields an equity percentage of 55.03%. *Id.*

[372] *See* Exhibit Nos. S-1 at p. 10; M-17 at p. 2; Mid-America Initial Brief at p. 36; Propane Group Reply Brief at p. 36; Williams Initial Brief at p. 23; Staff Initial Brief at p. 34.

[373] *See* 18 C.F.R. § 346.2(a)(1) (2007).

[374] *See* Exhibit No. S-4 at p. 7.

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No. 41, eleven months after the beginning of the Base Period,[375] and ten months before the end of the Test Period. While, perhaps, difficult, it is not impossible to imagine that a company could manipulate the filing date of a tariff to its advantage were the Commission to accept a capital structure three months before it filed a tariff. Moreover, a capital structure ten months before the end of a test period must be concluded to be stale. Consequently, I reject Mid-America's suggestion.

652. I also reject Staff's suggestion that I use Enterprise Products Partners' December 31, 2006, capital structure as it falls two months after the end of the Test Period. While it may be the latest data available in the record, as it falls beyond the Test Period, I conclude that it is not as relevant as other data which also is in the record. Moreover, I was not convinced by Staff that *Transcontinental Gas Pipe Line Corp.,* 84 FERC ¶ 61,084, is germane to this decision. In that case, the Commission was addressing the presiding judge's use of out of test period data to find the zone of reasonableness for the pipeline's return on equity. *Id.* at pp. 61,424-27. Here, we are not seeking to locate a zone, but are seeking to identify a very specific data point which will be used as part of the calculation of Mid-America's return on equity. I believe that, if the record contains sufficient evidence to identify that data point at a relevant time within the Test Period, it ought to be used. Moreover, I also believe that using a single data point beyond a test period suffers from the same possibility of manipulation as does the use of a single data point before the beginning of a test period.[376] Furthermore, Staff's argument in favor of using Enterprise Products Partners' December 31, 2006, capital structure is inconsistent with the argument it made with regard to the use of Enterprise Products Partners' capital structure as of December 31, 2005, for the Locked-In Period.[377]

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[375] The Base Period began February 1, 2005. Propane Group Initial Brief at p. 7.

[376] See *Ozark Gas Transmission System,* 39 FERC at p. 61,056: The Commission declared that it is "more appropriate" to use base and test period data, but it has found reason to deviate from such ratemaking methodology when "necessary." Here it is not necessary.

[377] With regard to FERC Tariff No. 38, Staff objected to Mid-America's suggestion that Enterprise Products Partners' capital structure of December 31, 2005, be used because the date was three months beyond the end of the Test Period for that tariff (September 30, 2005); yet, with regard to FERC Tariff No. 41, it argued in favor of a capital structure two months beyond the Test Period. I do not see any distinction between the two periods, they are both substantially beyond the Test Period. And I am not convinced by Staff, who suggested that use of the December 31, 2006, data is appropriate because the rates in FERC Tariff No. 41 are forward-looking, that its arguments are not inconsistent.

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653. I conclude that the most appropriate capital structure of Enterprise Products Partners' to be used in calculating Mid-America's return on rate base is that as of September 30, 2006, which is the latest available data relating to Enterprise Products Partners' capital structure which falls within the Test Period for FERC Tariff No. 41.[378] Accordingly, for the 12-month test period ending October 31, 2006, the appropriate equity ratio for Mid-America is 57.33%.[379]

(2) What is the appropriate cost of equity?

654. The parties stipulated to the appropriate cost of equity as follows: (1) a nominal return on equity of 11.25% for both the FERC Tariff No. 38 rate period and the FERC Tariff No. 41 rate period; (2) an inflation rate of 4.00%, resulting in a real return on equity rate of 7.35% for the FERC Tariff No. 38 rate period; and (3) an inflation rate of 1.97%, resulting in a real return on equity rate of 9.28% for the FERC Tariff No. 41 rate period. Exhibit No. JE-4; *see also* Mid-America Initial Brief at p. 37; Propane Group Initial Brief at p. 33; Williams Initial Brief at p. 25; Staff Initial Brief at p. 36.

(3) What is the appropriate cost of long-term debt?

655. The parties stipulated that, for both the FERC Tariff No. 38 rate period and the FERC Tariff No. 41 period, the cost of long-term debt is 5.73%. Exhibit No. JE-4.

C. WHAT IS THE APPROPRIATE INCOME TAX ALLOWANCE?[380]

A. MID-AMERICA

656. Mid-America claimed that its income tax allowance is consistent with the Commission's *Policy Statement on Income Tax Allowance,* 111 FERC ¶ 61,139

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[378] I will note, however, that, if the September 30, 2006, data was not in the record, I would have accepted Staff's position as it seems to me that the December 31, 2006, data, is more current, and therefore more reliable, than the December 31, 2005, data, which I believe would be stale by October 31, 2006.

[379] As of September 30, 2006, Enterprise Products Partners' long-term debt equaled $4,884,261,000, and its stockholders equity equaled $6,563,514,000, totaling $11,447,775,000. Exhibit No. S-3 at p. 62. Thus, the stockholders equity, divided by the total, yields an equity percentage of 57.33. *Id.* Similarly, the long-term debt divided by the total, yields a debt percentage of 42.67. *Id.*

[380] Williams did not address this issue. Williams Initial Brief at p. 25; Williams Reply Brief at p. 20.

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(sometimes "*Policy Statement*"). Mid-America Initial Brief at p. 39. According to it, in the December 2005 Order, the Commission articulated rebuttable presumptions regarding the appropriate marginal tax rate for the six Commission-prescribed groups of owners:[381] "[U]nless a party provides evidence to the contrary, the marginal tax bracket for partners that are Schedule C corporations or LLCs filing a Form 1120 return [is] 35 percent,[382] for partners that are tax payers other than a Schedule C corporation the marginal tax bracket is 28 percent, and for municipalities and other exempt entities the relevant marginal tax bracket is zero." *Id.* at pp. 40-41 (*quoting SFPP, L.P.,* 113 FERC ¶ 61,277 at P 32). Next, Mid-America described, the marginal tax rates for each group are to be multiplied by the "percentage of taxable partnership income imputed to each group" to obtain the overall weighted average marginal tax rate. Mid-America Initial Brief at p. 40 (*citing SFPP, L.P.,* 113 FERC ¶ 61,277 at P 46).

657. Mid-America claimed it took the following steps in calculating its weighted average marginal tax:[383] (1) identified the ownership interests and classified them into one of the six Commission-prescribed categories;[384] (2) "it determined the percentage of partnership income attributable to each group of unitholders;" and (3) assigned the appropriate marginal income tax rate for each group of unitholders to calculate the appropriate weighted average marginal tax rate.[385] *Id.*

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[381] The six groups are: (1) Subchapter-C corporations; (2) individuals; (3) mutual funds; (4) other unitholders (*e.g*., pension funds, IRAs, Keogh Plans), and other entities that are not normally tax paying entities, but would be expected to have tax paying beneficiaries or owners; (5) such entities as listed in (4) that may be tax paying because income from SFPP or KMEP would be deemed unrelated business taxable income; and (6) those institutions and exempt entities, if any, which do not have obligations to pay out income or declare it (*e.g.,* municipalities). Mid-America Initial Brief at p. 40 (*citing SFPP, L.P.,* 113 FERC ¶ 61,277 at P 45).

[382] Mid-America reported that, after filing its direct testimony, the Commission modified its rebuttable presumption for the Subchapter-C corporation group from a 35% marginal tax rate to a 34% marginal tax rate. Mid-America Initial Brief at p. 41 n.18 (*citing Texaco Refining and Marketing, Inc. v. SFPP,* 117 FERC ¶ 61,285 at P 60).

[383] Mid-America explained that it followed the same process in deriving an allowance for state income taxes. Mid-America Initial Brief at p. 41.

[384] In support, Mid-America cited Exhibit Nos. M-4 at pp. 3-4, 13-18; M-6; M-7.

[385] Mid-America cited Exhibit Nos. M-4 at pp. 18-23; M-118; M-119 in support. In its rebuttal testimony, Mid-America noted, it revised the weighted average tax rate in accordance with the Commission's modification to the rebuttable presumption for the Subchapter-C corporation group. Mid-America Initial Brief at p. 41 n.18 (*citing* Exhibit

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658. There are three areas, Mid-America asserted, in which it disagreed with the Propane Group: first, Mid-America suggested that the Propane Group's use of ownership percentages (rather than income) to weight the marginal income tax rates of the six categories of owners is incorrect. *Id.* at p. 42. In many cases, maintained Mid-America, the Commission has repeatedly held that "the allocated income percentages should be used" and not ownership percentages. *Id.* at pp. 42-43 (*citing Texaco Refining and Marketing, Inc. v. SFPP, L.P.,* 117 FERC ¶ 61,285 at P 64-65).[386]

659. Further, Mid-America contended "that the taxable income resulting from its own activities" rather than the combined taxable income and losses generated by Enterprise Products Partners and all of its subsidiaries should be used in calculating the weights for the various categories of unitholders. Mid-America Initial Brief at p. 43. In support of its position, Mid-America cited cases in which the Commission held that the weighted income tax rate should be applied only to the net income of the regulated entity. *Id.* at pp. 43-44.[387] Additionally, Mid-America emphasized, using Mid-America's income avoids any "illogical results" (as suggested by the Propane Group) which could occur if some or all of the partners are allocated zero or negative taxable income because Mid-America had positive taxable income, and no owners were allocated zero or negative taxable income. *Id.* at pp. 44-45.

660. Continuing, Mid-America addressed another Propane Group criticism regarding Mid-America's treatment of the incentive distribution. *Id.* at p. 44. According to it, the Commission has held that income allocated in connection with incentive distributions should be included in deriving the weighted marginal income tax rate. *Id.* at pp. 44-45.[388] Thus, Mid-America claimed that it accounts for the incentive distribution by applying to Mid-America the same ratio of incentive distributions to total cash distribution that applied to Enterprise Products Partners as a whole. *Id.* at p. 45.

661. The second area with which Mid-America disagreed with the Propane Group is the

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Nos. M-71 at pp. 6-7; M-73; M-75; M-100 at p. 60; M-118; M-119).

[386] Mid-America also cited *SFPP, L.P.,* 113 FERC ¶ 61,277 at P 46; *SFPP, L.P.,* 121 FERC ¶ 61,240 at P 43-44, in support.

[387] Mid-America also cited *SFPP, L.P.*, 113 FERC ¶ 61,277 at P 28; *Texaco Refining and Marketing, Inc. v. SFPP,* 117 FERC ¶ 61,285 at P 56; *SFPP, L.P.,* 121 FERC ¶ 61,240 at P 45-48, in support.

[388] Mid-America cited *Policy Statement on Income Tax Allowance*, 111 FERC ¶ 61,139 at P 43; *SFPP, L.P.,* 121 FERC ¶ 61,240 at P 54-58; *America West Airlines, Inc. v. Calnev Pipe Line,* 121 FERC ¶ 61,241 at P 10 (2007), in support.

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question of marginal tax rates. *Id.* On one hand, according to it, the Propane Group asserted that all the owners, except for the Subchapter-C corporations, should be assigned a zero percent marginal tax rate. *Id.* On the other hand, Mid-America argued that the prescribed presumptive marginal tax rates determined by the Commission should be applied. *Id.* The Propane Group, declared Mid-America, did not meet its burden of proving that the entities pay income tax at a rate lower than the Commission's presumed marginal tax rate. *Id.* (*citing SFPP, L.P.,* 121 FERC ¶ 61,240 at P 35-39).

662. According to Mid-America, the Propane Group, in suggesting that all owners except for the Subchapter-C corporations be assigned a zero percent marginal rate, seeks to eliminate an income tax allowance for all partnership interests not owned by Subchapter-C corporations. *Id.* at p. 46. However, claimed Mid-America, the Commission has addressed the issue of whether to "eliminate all income tax allowances and set rates based on a pre-tax rate of return" and rejected that option.[389] *Id.* (*citing Policy Statement,* 111 FERC ¶ 61,139 at P 31-33).[390]

663. Moreover, while Propane Group witness O'Loughlin justified his position, in part, on his claim that mutual funds do not pay income taxes on the amounts they give to their shareholders as dividends, Mid-America suggested that, in establishing the 28% marginal rate with respect to mutual funds, the Commission already considered that fact. *Id.* at pp. 47. In any event, asserted Mid-America, the mutual funds' shareholders pay taxes on the dividends. *Id.* It added that, in choosing the 28% marginal income tax rate, the Commission was aware that individuals are the beneficiaries of mutual funds, and that the Propane Group has not shown that either mutual funds or their beneficiaries pay an income tax rate lower than 28%. *Id.* at p. 48.

664. According to Mid-America, with respect to entities with unrelated business taxable income (UBTI) and entities such as pensions, IRAs, and Keoghs, the Propane Group argued that Mid-America should not receive an income tax allowance. *Id.* Yet, Mid-America pointed out, the Commission included these in the fourth category of owners because, while they are not typically tax paying entities, they are expected to have

[389] According to Mid-America, the Propane Group's position — denying an income tax allowance for all partnership interests except Subchapter-C corporations — is a reversion to the policy established by the Commission in *Lakehead Pipe Line Co.*, 71 FERC ¶ 61,338 (1995), *reh'g denied*, 75 FERC ¶ 61,181 (1996), which the United States Court of Appeals for the District of Columbia rejected in *BP West Coast Products, LLC v. FERC*, 374 F.3d 1263, 1290 (D.C. Cir. 2004), *cert. denied*, 544 U.S. 1043 (2005). Mid-America Initial Brief at p. 46.

[390] Mid-America suggested that the Commission rejected arguments similar to the Propane Group's in the following rulings: *SFPP, L.P.,* 121 FERC ¶ 61,240 at P 52-53; *America West Airlines, Inc., v. Calnev Pipe Line,* 121 FERC ¶ 61,241 at P 10.

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tax paying beneficiaries or owners. *Id.* at p. 49 (*citing SFPP, L.P.*, 113 FERC ¶ 61,277 at P 45). Moreover, it asserted, some of these entities in category four actually may be tax paying entities because some of their income may be deemed unrelated business income; in that case, the entities may be subject to higher marginal rates and moved to category five. *Id.*

665. Finally, with respect to the third area of dispute, Mid-America contended that there should be an allowance for state income taxes. *Id.* at p. 50. It argued that "[s]tate income taxes are a traditional cost-of-service element, and a pipeline is entitled to a state income tax allowance if its methodology is reasonable." *Id.* (*citing SFPP, L.P.,* 121 FERC ¶ 61,240 at P 59). Although, it stated, the Propane Group insisted that there is no nexus between unitholders and the states used in the calculation, Mid-America explained that each unitholder pays state income taxes in the states in which it generates income regardless of whether the unitholder lives in that state. *Id.* (*citing* Exhibit No. M-71 at p. 11).

666. In reply, Mid-America asserted that, in making the argument that Mid-America's federal income tax allowance should be calculated using the income of Mid-America's parent, Enterprise Products Partners, rather than Mid-America's income, Staff misreads the Commission's ruling in *SFPP, L.P.,* 121 FERC ¶ 61,240, incorrectly declaring that it stands for the proposition that the regulated pipeline should determine its "weighted income tax allowance using partnership income, rather than pipeline income, as a factor." Mid-America Reply Brief at p. 32. According to Mid-America, in that decision, the Commission approved SFPP's application of the "weighted marginal tax rate to *SFPP's* net income to determine the dollar amount of SFPP's income tax allowance. *Id.* at pp. 32-33 (*quoting SFPP, L.P.,* 121 FERC at P 45). Mid-America asserted that it calculated its income tax allowance consistently with the Commission's *SFPP* order, to wit: it (1) determined the amount of its regulated income that flows up to its various owners, including its publicly traded parent, Enterprise Products Partners; (2) determined the percentage of the publicly traded partnership's income that is distributed to each group of unitholders at the Enterprise Products Partners level; and (3) accounted for 99.999% of Mid-America's regulated income that flows up to Enterprise Products Partners and for the 0.001% of Mid-America's income that flows to Enterprise Products OLPGP, Inc., the general partner of the operating affiliate Enterprise Products Operating, L.P. *Id.* at pp. 33-34.

667. Next, in addressing its state income tax allowance, Mid-America maintained that the use of the income taxes for the state in which the pipeline operates coincides with the Commission's stand alone tax policy[391] because it focuses on the tax liability that attaches to the income generated by the regulated entity. *Id.* at pp. 34-35. Furthermore, it

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[391] In support, Mid-America cited *SFPP, L.P.*, 86 FERC ¶ 61,022 at pp. 61,103-04 (1999).

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insisted that each unitholder incurs state income tax liability in the states where income is generated by the partnership regardless of whether the unitholder lives in that state. *Id.* at p. 35. Mid-America argued that, although the Commission ruled in *SFPP, L.P.,* 121 FERC ¶ 61,240, that the state income taxes should have been based on the states in which the publicly traded partnership operates and not on the state in which the pipeline operates, the Commission still permitted recovery of a state income tax allowance and did not articulate precisely the method in which the state income tax rate should be calculated. *Id.* at pp. 34-36. Thus, Mid-America argued that, until the issue is resolved in subsequent orders, and the Commission articulates its policy regarding state income taxes in a way that differs from Mid-America's approach here, Mid-America also should be permitted to modify its state income tax allowance in a compliance filing. *Id.* at p. 36.

668. Regarding Mid-America's incentive distributions, Mid-America asserted that its method for calculating the incentive distribution is consistent with the stand alone policy and the Commission's recent tax allowance precedent. *Id.* at p. 36. In this case, Mid-America claimed that the issue is how to determine the amount of the overall incentive distribution made by Enterprise Products Partners to its general partner that comes from income generated by Mid-America. *Id.* Mid-America noted that, to the extent the total Enterprise Products Partners cash distribution in 2004 was at or below 25.3 cents per unit, the general partner received 2% of the overall cash distribution as an incentive distribution; to the extent the total cash distribution was between 25.3 cents and 30.85 cents per unit, the general partner would receive 15% of the cash distribution above 25.3 cents per unit; and to the extent the total cash distributions exceeded 30.85 cents, the general partner would receive 25% of the cash distribution above 30.85 cents per unit. *Id.* at p. 37. Because determining whether the cash generated by Mid-America was used to reach the 25.3 cents per unit threshold or was used to pay cash distributions above the 30.85 cents per unit threshold is impossible, Mid-America said it used the average incentive distribution by calculating the percentage of total Enterprise Products Partners cash distributions that were incentive distributions and applying that percentage to the cash generated by Mid-America. *Id.*

B. PROPANE GROUP

669. The Propane Group admitted that, in accordance with the *Policy Statement on Income Tax Allowances*, 111 FERC ¶ 61,139, Mid-America is entitled to an income tax allowance, but argued that the appropriate composite income tax rate to use in deriving Mid-America's income tax allowance is 4.74%. Propane Group Initial Brief at pp. 35-36 (*citing* Exhibit No. NPG-1 at p. 113).

670. Second, the Propane Group asserted that to be consistent with the *Policy Statement* and Commission precedent, ownership weights, not taxable income allocations, should be used in developing income tax allowance and the associated weighted marginal tax rate. *Id.* at p. 37. It contended that allocating taxable income in calculating a weighted income

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tax rate is improper because

> (i) the use of income allocations as the weights for its proposed weighted tax rate was not supported by relevant Commission precedent and would lead to illogical results, and (ii) even if income allocations were appropriate, Mid-America failed to use the appropriate entity's taxable income in developing the income tax weights.

Id. at pp. 38-39. While the Propane Group agreed that the Commission recently endorsed the use of income allocation to develop a weighted marginal tax rate, it suggested that using ownership percentages instead of income allocation does not significantly affect the development of the weighted average federal income tax rate for calculating Mid-America's income tax allowance. *Id.* at p. 39 (*citing SFPP, L.P.,* 121 FERC ¶ 61,240).

671. Third, the Propane Group insisted that Mid-America's incorporation of incentive distributions in deriving a weighted federal income tax rate is contrary to the Commission's well-established stand-alone tax principle. *Id.* As explained by the Propane Group, the stand-alone tax principle provides that the tax allowance for a regulated entity will be developed based on its own revenues and expenses, not the affiliates' operations. *Id.* at pp. 39-40 (*citing SFPP, L.P.,* 113 FERC ¶ 61,277 (2005)). Thus, the Propane Group asserted, Mid-America incorrectly relied on the financial results of all Enterprise Products Partners subsidiaries rather than only Mid-America's. *Id.* at p. 41. Rather, argued the Propane Group, after including only Mid-America's 2004 annual cash flow into Enterprise Products Partners' incentive distribution scheme, the incentive distribution amount to be attributed to Mid-America's taxable income is approximately $1.3 million. *Id.*

672. Fourth, while the Propane Group agreed with the 34% federal income tax rate for Subchapter C Corporations, it advocated a zero percent tax rate for the remaining ownership groups as more appropriate than Mid-America's presumptive marginal tax rates. *Id.* at p. 42. Regardless of any presumption supporting the 28% individual income tax rate, the Propane Group claimed, an income tax allowance combined with the return on equity estimated by the Commission's Discounted Cash Flow model inappropriately allows individual investors double recovery of an income tax allowance. *Id.* at p. 43.

673. Also, the Propane Group contested the rebuttable presumption for the mutual fund and UBTI/Pensions-IRA-Keogh ownership classes. *Id.* They pointed out that a mutual fund is typically not subject to income tax for monies received by the fund and claimed that they can find no case in which a mutual fund or regulated investment company has failed to distribute all of its taxable income as a dividend to shareholders to avoid its income tax obligation. *Id.* at p. 44. Moreover, the Propane Group characterized Mid-America's position — that amounts distributed to shareholders are still subject to tax

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— as misleading because, they said, the *Policy Statement* emphasizes the tax obligation of the partners, not the investors or owners of the partners. *Id.* (*citing Policy Statement on Income Tax Allowance,* 111 FERC ¶ 61,139 at P 41). In any event, continued the Propane Group, if mutual funds are "required to derive 90% of their income from qualified sources," including partnerships, and as long as 90% of its income is paid to investors as dividends, it will not be taxed. *Id.* Moreover, they added, once master limited partnership income "is received by the mutual fund, it is converted into a fund dividend and therefore qualifies as a qualified dividend," which is subject to the same low tax rates that apply to long-term capital gains. *Id.* at pp. 43-44. As a result, the Propane Group suggested, there is no basis for assigning a 28% federal income tax rate to the mutual fund ownership group. *Id.* at p. 44.

674. The Propane Group noted that Pensions/IRAs/Keoghs and UBTI entities typically are not taxed or subject to tax unless they receive a threshold level of unrelated business taxable income of $1000. *Id.* at p. 45 (*citing* 26 C.F.R. §§ 1.6012-2(e), 1.6012(a)(5)). According to the Propane Group, Mid-America failed to demonstrate that any of the UBTI entities have received $1000 or more in unrelated business gross income for any time period, and that Enterprise Product Partners' unitholder K-1 information showed that UBTI entity unitholders have not received unrelated business taxable income even remotely close to the threshold. *Id.*

675. Fifth, the Propane Group took issue with Mid-America's state income tax rate proposal in establishing the pipeline's income tax allowance. *Id.* at p. 46. They contended that the Commission recently ruled on the same type of proposal and rejected it. *Id.* (*citing SFPP, L.P.,* 121 FERC ¶ 61,240). Finally, the Propane Group maintained that there is no rational nexus between the development of state apportionment factors and the state income tax liability of unitholders. Propane Group Initial Brief at p. 46.

676. In reply, the Propane Group submitted that, as the rate applicant, proponent, and pass-through entity, Mid-America "has the affirmative burden of proof 'to establish the actual or potential income tax liability on public utility income for each partner or member interest reflected in the claimed allowance.'" Propane Group Reply Brief at p. 39 (*citing SFPP, L.P.,* 116 FERC ¶ 63,059 at P 142-43). They claimed that Mid-America failed to do so. *Id.*

677. While acknowledging the Commission's recent endorsement of the use of income allocation to establish a weighted marginal tax rate for income tax allowance purposes, the Propane Group noted, and claimed that Mid-America concedes, that the use of income allocation or ownership percentage in this proceeding is irrelevant. *Id.* at pp. 39-40 (*citing SFPP, L.P.,* 121 FERC ¶ 61,240 at P 46-48).

678. The Propane Group claimed that Mid-America's use of incentive distributions in the development of its weighted federal income tax rate is unsupported and without merit.

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Id. at p. 40. Contrary to Mid-America's claim, the Propane Group maintained that the Commission's long-established stand alone tax policy requires the rejection of Mid-America's proposed use of incentive distributions. *Id.* at pp. 40-41. In other words, the Propane Group recommended that, pursuant to the Commission's stand alone tax policy, only Mid-America annual cash flow should be included in Enterprise Product Partners' incentive distribution scheme to determine the appropriate related allocation of income and not, as suggested by Mid-America, the cash flow of all of Enterprise's subsidiaries. *Id.* at p. 41.

679. Similarly, the Propane Group opposed Mid-America's reliance on *SFPP, L.P.*, 121 FERC ¶ 61,240, because, they assert, such reliance is misplaced. Propane Group Reply Brief at p. 42. First, the Propane Group suggested that the Commission Order does not modify the Commission's stand alone tax policy prohibiting the operations of affiliates from influencing the development of an income tax allowance. *Id.* Second, insisted the Propane Group, the Commission ruling in *SFPP, L.P.*, 121 FERC ¶ 61,240, does not reconcile the requirements of the stand alone tax policy with the inclusion of unadjusted incentive distributions in developing a just and reasonable income tax allowance. *Id.* While Congress has authorized corporate jurisdictional entities to be part of a consolidated group where the group files a tax return and pays taxes based on the cumulated revenues and deductions of all affiliates and the parent, the Propane Group declared, the Commission unambiguously has refused to allow the operations of affiliates, in these circumstances, to decrease or enhance the tax allowance of the jurisdictional entity. *Id.* Accordingly, the Propane Group argued, if a corporate pipeline's income tax allowance cannot be diminished or enhanced based on the operations of affiliates, a partnership pipeline's income tax allowance enhanced by the operations and cash flow of its affiliates' and parent's operations is necessarily impermissible. *Id.* at p.p. 42-43.

680. Moreover, the Propane Group argued, Mid-America failed to legitimately refute the fact that the nominal return on equity specified for the pipeline in these proceedings already includes an income tax component for the public limited partner unitholders. *Id.* at pp. 44-45. In short, the Propane Group suggested that the 28% marginal income tax rate for non-corporate public limited partner unitholders unreasonably allows the double recovery of the purported tax cost and results in overcompensation for the public limited partner unitholders. *Id.* at p. 45.

681. Further, the Propane Group declared that the *Policy Statement* simply rejected the position that all income tax allowance should be eliminated and that rates be determined on a pre-tax rate of return. *Id.* They also claimed that their position is consistent with the *Policy Statement* as its recommendation permits an income tax allowance and merely acknowledges and precludes the double recovery of an income tax allowance as it respects the public unitholders. *Id.*

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682. Finally, with respect to Mid-America's use of a 28% marginal tax rate for mutual funds, the Propane Group pointed out that the Commission established the 28% rebuttable presumption for the mutual fund category based on test years which did not reflect the changes in the tax status and character of partnership distributions related to mutual funds that have since occurred. *Id.* at pp. 45-46. Additionally, the Propane Group asserted, because the *Policy Statement* declares that pass-through entities are required to develop a weighted marginal tax rate to prevent the ratepayers from paying more than the actual tax cost the investors incur and that a partner should be subject to an actual or potential liability for any income earned from the regulated assets, no rational basis exists for "assigning a twenty-eight percent Federal income tax rate to the mutual fund ownership class when the income from the regulated assets is not subject to an actual or potential income tax at the mutual fund partner level and such tax rate bears no relation to the potential liability of the regulated asset income at the beneficiary level." *Id.* at p. 47.

C. COMMISSION TRIAL STAFF

683. In general, Staff agreed with Mid-America's proposed methodology for determining an income tax allowance. Staff Initial Brief at p. 36. Yet it challenged two aspects of Mid-America's methodology as inconsistent with Commission policy. *Id.* at p. 37.[392] First, it disagreed with Mid-America's developing a weighted average federal income tax rate based on an allocation of the pipeline's taxable income to the ownership categories. *Id.* at pp. 39-40. In *SFPP, L.P.*, 121 FERC ¶ 61,240 at P 45-48, according to Staff, the Commission held that a pipeline, owned by a master limited partnership, properly used the partnership income rather than its own income in determining its weighted income tax allowance, reasoning that at the partnership level, all items of income are consolidated, and at that point distributive income is established for income tax purposes. *Id.* at p. 40. Analogously, Staff argued that Mid-America should use the partnership income of its parent, Enterprise Products Partners — also a master limited partnership — in determining its weighted average marginal tax rate. *Id.*

684. Second, Staff asserted that, in using the percentage of Mid-America's taxable income allocated to the partners in its calculation of state income allowance, Mid-America defies Commission policy. *Id.* at p. 41. It stated that, in *SFPP, L.P.,* 121 FERC ¶ 61,240 at P 59-61, the Commission rejected SFPP's proposed methodology for a state income tax allowance where SFPP applied marginal state tax rates to the income of SFPP, rather than of the partnership, in the states where the pipeline operated. *Id.* at pp. 41-42. Similarly, according to Staff, Mid-America, as with the federal income tax methodology, fails to use partnership income instead of the pipeline's income in calculating its allowance for state income taxes. *Id.* at p. 42.

[392] Staff added nothing new in its Reply Brief.

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Discussion and Ruling

685. With the exception of Mid-America's methodology for a state income tax allowance, I find that Mid-America, in establishing its weighted average marginal tax rate,[393] correctly: (1) identified the ownership interests[394] and classified them into one of the six Commission-prescribed categories;[395] (2) established the percentage of taxable income attributable to each group of unitholders and used these amounts to derive the percentages for each group;[396] and (3) assigned the appropriate marginal income tax rate for each group of unitholders to calculate the appropriate weighted average marginal tax rate.[397]

686. According to Mid-America, in calculating its income tax allowance, it followed the Commission's *Policy Statement on Income Tax* Allowance, 111 FERC ¶ 61,139, and *SFPP, L.P.,* 113 FERC ¶ 61,277. Mid-America Initial Brief at pp. 39-41. Specifically, Mid-America claimed it took the following steps in establishing its weighted average

[393] The Commission has noted that "a corporate tax allowance has almost always been the maximum corporate statutory, or marginal, rate when a corporation is involved . . . because investment decisions are made at the margin and the marginal tax rate applied at the end of the tax year will determine how much of the incremental income will be retained by the investor." *SFPP, L.P.,* 121 FERC ¶ 61,240 at P 35. It added that, as a result, "the income tax allowance of a passthrough entity will be determined by the weighted marginal tax rate of the owning partners." *Id.*

[394] In identifying the ownership interests, I conclude that Mid-America appropriately determined the amount of its regulated income that flows up to its various owners, including its publicly traded parent, Enterprise Products Partners. *See* Exhibit Nos. M-4 at pp. 5-8; M-9 at p. 2. Mid-America properly accounted for 99.999% of its regulated income that flows up to Enterprise Products Partners and for the 0.001% of its income that flows to Enterprise Products OLPGP, the general partner of the operating affiliate Enterprise Products Operating. *See* Exhibit Nos. M-4 at p. 3; M-6 at p. 2; M-9 at pp. 1-2.

[395] *See* Exhibit Nos. M-4 at pp. 3-4, 13-18; M-6; M-7.

[396] *See* Exhibit Nos. M-4 at pp. 4-12; M-73 at Column D; M-75 at Column C; M-118 at Schedule 1; M-119 at Schedule 1.

[397] *See* Exhibit Nos. M-4 at pp. 18-23; M-118; M-119.

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marginal tax rate:[398] (1) it identified the ownership interests[399] and classified them into one of the six Commission-prescribed categories; (2) "it determined the percentage of partnership income attributable to each group of unitholders" and used these amounts to derive the percentages for each group; and (3) it assigned the appropriate marginal income tax rate for each group of unitholders to calculate the appropriate weighted average marginal tax rate. *Id.* at p. 41.

687. Next, Mid-America argued that Commission precedent requires income, not ownership interest, be used to weight the marginal tax rates of the six categories of owners. *Id.* at p. 42. Further, Mid-America maintained that the incentive distribution to Enterprise Products Partners' general partner should be included when developing its weighted marginal income tax rate because the Commission has held that income allocated in connection with incentive distributions should be reflected in developing the weighted marginal income tax rate. *Id.* at p. 44.

688. With respect to the marginal tax rate issue, Mid-America contended that the Commission-prescribed presumptive marginal tax rates should be applied "unless a party provides evidence to the contrary, the marginal tax bracket for partners that are Schedule C corporations or LLCs filing a Form 1120 return [is] 35 percent, for partners that are tax payers other than a Schedule C corporation the marginal tax bracket is 28 percent, and for municipalities and other exempt entities the relevant marginal tax bracket is zero." *Id.* at pp. 40-41, 45. The Propane Group, declared Mid-America, did not carry its burden of proving that the entities pay income tax at a rate lower than the Commission's presumed marginal tax rate — 28% — in applying a zero percent marginal rate to all entities except for the Subchapter C corporations. *Id.* at p. 45.

689. Finally, Mid-America asserted that "'[s]tate income taxes are a traditional cost-of-service element,' and a pipeline 'is entitled to a state income tax allowance if its methodology is reasonable.'" *Id.* at p. 50. In contrast to the Propane Group's position, Mid-America insisted that there exists a nexus between the unitholders and the states used in calculating its allowance for state income taxes, as "each unitholder incurs state income tax liability in the states where income is earned by the partnership regardless of whether the unitholder lives in that state." *Id.* While Mid-America admitted that the Commission recently ruled that the state income taxes should be based on the state in which the publicly traded partnership operates and not on the state in which the pipeline

[398] Mid-America explained that it followed the same process in deriving an allowance for state income taxes. Mid-America Initial Brief at p. 41.

[399] Mid-America asserted that, in identifying the ownership interests, it first determined the amount of its regulated income that flows up to its various owners, including its publicly traded parent, Enterprise Products Partners. Mid-America Reply Brief at pp. 33-34.

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operates,[400] it claimed that the Commission still permitted recovery of a state income tax allowance and did not articulate precisely the method in which the state income tax rate should be calculated. Mid-America Reply Brief at pp. 34-36.

690. Unlike Mid-America, the Propane Group argued that the *Policy Statement* and Commission precedent require ownership weights, not taxable income allocations, to be used in establishing income tax allowance and the associated weighted marginal tax rate. Propane Group Initial Brief at p. 37. Yet they admitted that the Commission recently endorsed the use of income allocation to develop a weighted marginal tax rate. *Id.* at p. 39 (*citing SFPP, L.P.*, 121 FERC ¶ 61,240 at P 46-48). However, the Propane Group asserted that using ownership percentages rather than income allocation in the context of these proceedings does not materially affect the development of the weighted average federal income tax rate for determining Mid-America's income tax allowance. *Id.*

691. Additionally, the Propane Group submitted that Mid-America's incorporation of incentive distributions in deriving a weighted federal income tax rate is contrary to the Commission's well-established stand-alone tax principle. *Id.* at p. 39. As explained by the Propane Group, the stand-alone tax principle provides that the tax allowance for a regulated entity will be developed based on its own revenues and expenses, not the affiliates' operations. *Id.* at pp. 39-40. Thus, the Propane Group asserted that Mid-America incorrectly relied on the financial results of all Enterprise Products Partners' subsidiaries rather than only Mid-America's. *Id.* at p. 41.

692. Further, while the Propane Group agreed with the 34% federal income tax rate for Subchapter C Corporations, it advocated a zero percent tax rate for the remaining ownership groups as more appropriate than Mid-America's presumptive marginal tax rates. *Id.* at p. 42. Specifically, the Propane Group argued that (1) an income tax allowance combined with the return on equity estimated by the Commission's discounted cash flow model inappropriately allows individual investors double recovery of an income tax allowance; (2) a mutual fund is typically not subject to income tax for monies received by the fund; (3) any income received by a mutual fund from a master limited partnership is converted into a qualified dividend subject to the same low tax rates that apply to long-term capital gains; and (4) pensions/IRAs/Keoghs and UBTI entities typically are not taxed or subject to tax unless they receive a threshold level of UBTI ($1000), which was not attained in this case. *Id.* at pp. 43-44.

693. Lastly, the Propane Group contended that no rational nexus between the development of state apportionment factors and the state income tax liability of unitholders exists. *Id.* at p. 46. Moreover, the Propane Group asserted that the Commission recently ruled on the same type of proposal as that presented by Mid-America and rejected the same as unjustified and deficient. *Id.* (*citing SFPP. L.P.*,

[400] *See SFPP. Inc.*, 121 FERC ¶ 61,240 at P 61.

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121 FERC ¶ 61,240 at P 59-61).

694. While Staff agreed with Mid-America's proposed methodology for determining an income tax allowance, it challenged two aspects of Mid-America's methodology as inconsistent with Commission policy. Staff Initial Brief at pp. 36-37. First, Staff insisted that the Commission precedent requires that Mid-America use the partnership income of its parent, Enterprise Products Partners, in determining its weighted average marginal tax rate. *Id.* at p. 40. Second, Staff argued that the Commission recently rejected a pipeline's proposed methodology for a state income tax allowance where it applied marginal state tax rates to the income of the pipeline rather than of the partnership in the state where the pipeline operated. *Id.* at pp. 41-42 (*citing SFPP, L.P.*, 121 FERC ¶ 61,240 at P 59-61).

695. Based on the evidence presented, I find that Commission precedent supports the use of Mid-America's taxable income allocations to weight the marginal income tax rates of the six groups of unitholders, and consequently, I find the Propane Group's use of ownership percentages to be inappropriate. *See SFPP, L.P.*, 121 FERC ¶ 61,240 at P 44:[401]

> [T]he issue at hand is the imposition of the tax cost to the partners, and through them, the tax burden on the partnership's capital. Thus if income is allocated to a partner in excess of its nominal partnership interest, that income becomes the partner's *distributive* income for the purpose of applying the *Policy Statement*. It is that income upon which the partner's income tax liability will be based, and as such it is the income that should be used in determining the weighted marginal tax cost to be applied in developing the partnership's income tax allowance. The Protesting Parties' emphasis on the nominal partnership interests undercuts the purpose of the *Policy Statement* and has no practical application in the [master limited partnership] context.

696. Staff took the question one step further suggesting that the partnership income of Mid-America's parent, Enterprise Products Partners, should be used to determine its weighted average marginal tax rate. *See* Staff Initial Brief at pp. 36-37. Staff cited *SFPP, L.P.*, 121 FERC ¶ 61,240 at P 45-48, in support. In its Reply Brief, in response to Staff, Mid-America claimed that the steps it followed in calculating its income tax allowance are consistent with the *SFPP* case. *See* Mid-America Reply Brief at pp. 32-34. According to it, first it determined how much of its regulated income flowed to its various owners (including its parent, Enterprise Products Partners); and second, at the Enterprise Products Partners' level, it determined what percentage of Enterprise Products Partners' income is distributed to each group of unitholders. *Id.* at p. 33. Noting that

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[401] *See also SFPP, L.P.,* 113 FERC ¶ 61,277 at P 46; *Texaco Refining and Marketing, Inc. v. SFPP, L.P.,* 117 FERC ¶ 61,285 at P 64-65.

99.999% of its regulated income flowed to Enterprise Products Partners, Mid-America declared that use of its income "would result in practically the same weighted average income tax allowance as that calculated by Mid-America."[402] *Id.* at p. 33. Based on this explanation, it asserted that it "calculated its weighted average income tax rate appropriately." *Id.* at p. 34.

697. In its *SFPP* order, the Commission indicated that "the proper distributive income to be used in determining the weighted marginal tax cost is that of the partners that ultimately received that income." *SFPP, L.P.*, 121 FERC ¶ 61,240 at P 46. It added that the "marginal tax rate is properly determined based on the relative amounts of income allocated to these various partners based on their relative shares." *Id.* The Commission then indicated that the next step was to determine how much of the pipeline's income flowed up through its controlling partner, and how much does not, and then to make an allocation within the controlling partner based on the relative share of the controlling partner's income allocated to each of the different categories of its partners since, at that level, "the tax burden incurred is based on the *distributive*" controlling partner's income made to the controlling partner's partners. *Id.* That the controlling partner may have other income is irrelevant because "[i]n a partnership context, it is the *partner's distributive* income that is used to determine the weighted marginal tax rate." *Id.* at P 47 (emphasis in original). Once the controlling partner's weighted income allowance is determined, it is applied to the pipeline's jurisdictional income "since that is the income being regulated and where the tax cost of the partner must be compensated." *Id.* at P. 48.

698. In the instant case, Mid-America failed to follow all of the steps approved by the Commission in *SFPP, L.P.*, 121 FERC ¶ 61,240.[403] I agree with Staff that it must correct that omission. That the result may turn out to be the same is not material. To be consistent with the Commission's prior rulings, and to avoid any chance of future confusion, form, not substance, must prevail in this instance.

699. I further conclude that the incentive distribution to Enterprise Products Partners'

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[402] Mid-America also claimed to have accounted for the .001% of its income ($399) which flowed to Enterprise Products OLPGP, Inc., the general partner of the operating affiliate Enterprise Products Operating, L.P. Mid-America Reply Brief at p. 34.

[403] Staff noted that, to be consistent with the Commission's ruling in *SFPP, L.P.*, 121 FERC ¶ 61,240, "Mid-America should use the partnership income of its parent, Enterprise Products Partners, rather than its own taxable income, in the calculations of the weighted average marginal tax rate;" and "should calculate an appropriate income tax allowance [using its parent's marginal tax rates rather than its own] for both rate periods based on data for the 2005 tax year, the latest available in the record, including a provision for state income taxes." Staff Initial Brief at pp. 38-42.

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general partner should be included when developing Mid-America's weighted marginal income tax rate. *Id.* at P 57.[404] In *SFPP, L.P.*, the Commission held that incentive distributions did not improperly distort the income tax allowance calculation even though much of the partnership's income came from sources other than the pipeline reasoning that, while available cash used in making the incentive distributions came from many sources, and incentive distributions provided incentives for excessive distributions, such issue was not a regulatory income tax allowance matter. *Id.* Rather, it continued, such issue was more of a cash management or service matter, and consequently, would be appropriately addressed in a venue other than a rate proceeding. *Id.* (*citing BP West Coast Products, LLC v. SFPP, L.P.,* 119 FERC ¶ 61,241 (2007); *ExxonMobil Oil Corp. v. Calnev Pipe Line, LLC* 120 FERC ¶ 61,075).

700. Accordingly, the issue now becomes how to determine what portion of the overall incentive distribution made by Enterprise Products Partners to its general partner comes from income generated by Mid-America. Mid-America noted that, to the extent the total Enterprise Products Partners cash distribution in 2004 was at or below 25.3 cents per unit, the general partner received 2% of the overall cash distribution as an incentive distribution; to the extent the total cash distribution was between 25.3 cents and 30.85 cents per unit, the general partner received 15% of the cash distribution above 25.3 cents per unit; and to the extent the total cash distributions exceeded 30.85 cents, the general partner received 25% of the cash distribution above 30.85 cents per unit. Mid-America Reply Brief at pp. 36-38.

701. As Mid-America witness Petru explained, determining whether the cash generated by Mid-America was used to reach the 25.3 cents per unit threshold or was used to pay cash distributions above the 30.85 cents per unit threshold is impossible. Exhibit No. M-71 at p. 5. Consequently, Mid-America used the average incentive distribution, by calculating the percentage of total Enterprise Products Partners cash distributions that were incentive distributions and applying that percentage to the cash generated by Mid-America. Exhibit Nos. M-71 at p. 5; M-4 at p. 10; M-9 at p. 2. I find reasonable Mid-America's method, as it does not attempt to reallocate the entire incentive distribution, but only that portion fairly attributable to cash generated by Mid-America.[405]

702. Furthermore, I find that Mid-America appropriately calculated its income tax allowance and associated weighted average marginal tax rate using the

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[404] S*ee also America West Airlines, Inc. v. Calnev Pipe Line,* 121 FERC ¶ 61,241 at P 10.

[405] It should be noted that Mid-America's method results in a slightly *lower* weighted income tax allowance than the Propane Group's approach because it allocated income away from the higher tax rate Subchapter C corporation category of owners. *See* Exhibit Nos. NPG-1 at pp. 120-21; M-4 at p. 10.

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Commission-prescribed presumptive marginal tax rates. *See SFPP, L.P.*, 113 FERC ¶ 61,277 at P 29-32. The Commission has articulated the following presumptive marginal tax rates unless a party provides evidence to the contrary: (1) the marginal tax bracket for partners that are Schedule C corporations or LLCs filing a Form 1120 return is 34%;[406] (2) for partners that are tax payers other than a Schedule C corporation the marginal tax bracket is 28%; and (3) for municipalities and other exempt entities the relevant marginal tax rate is zero percent. *Id.* at P 32.

703. The Propane Group attempted to rebut the Commission-prescribed presumptive marginal tax rates, claiming that all entities other than Subchapter C corporations should be assigned a zero percent marginal rate. I find the Propane Group's proposals to be without merit.[407] First, the Propane Group argued that "the provision of an income tax allowance in addition to the return on equity estimated by the Commission's discounted cash flow model unreasonably compensates individual investors in the limited partnership twice for any income tax liability." Propane Group Initial Brief at p. 43. This argument conflicts with the *Policy Statement* where the Commission concluded that an income tax allowance for all entities or individuals owning public utility assets should be permitted, provided that an entity or individual has an actual or potential income tax liability to be paid on that income from those assets. *Policy Statement on Income Tax Allowance*, 111 FERC ¶ 61,139 at P 32. In so concluding, the Commission considered and rejected the idea of eliminating all income tax allowances and setting rates based on a pre-tax rate of return. *Id.* at P 31. The Propane Group's proposal would prevent an income tax allowance for all partnership interests not owned by Subchapter-C corporations, a position which the Commission has fully considered and rejected. *See BP West Coast Products, LLC v. FERC,* 374 F.3d 1263, 1290 (D.C. Cir. 2004), *cert. denied,* 544 U.S. 1043 (2005); *Policy Statement on Income Tax Allowance,* 111 FERC ¶ 61,139 at P 32-33; *SFPP, L.P.,* 121 FERC ¶ 61,240 at P 52-53; *America West Airlines, Inc.,* 121 FERC ¶ 61,241 at P 10.

704. Further, I find the Propane Group did not carry its burden in rebutting the presumptive marginal tax rates for mutual funds. They argued that mutual funds do not pay income tax on the amounts they dividend to their shareholders as long as at least 90%

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[406] The Commission modified its rebuttable presumption for the Subchapter-C Corporation group from a 35% marginal tax rate to a 34% marginal tax rate. *See Texaco Refining and Marketing, Inc. v. SFPP L.P.,* 117 FERC ¶ 61,285 at P 60; *SFPP, L.P.,* 121 FERC ¶ 61,240 at P 37.

[407] As the Propane Group sought to rebut the presumptive marginal tax rates, it carried the burden of showing that a departure from such presumptive marginal tax rates is warranted because those entities pay income tax at a rate lower than the Commission's presumed marginal tax rate — 28%. *See SFPP, L.P.*, 113 FERC ¶ 61,277 at P 32; *SFPP, L.P.,* 121 FERC ¶ 61,240 at P 35-39.

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of the mutual fund income is derived from qualified sources and is passed through as dividends. Propane Group Initial Brief at p. 43. Thus, they continued, fund managers are presumed to meet these conditions and avoid income taxes, unless Mid-America identified any instance to suggest otherwise. *Id.* at pp. 43-44. However, the Propane Group's argument is misplaced. Clearly, the Commission was aware of the law governing mutual funds when it established the 28% rebuttable presumption for the mutual fund category. *SFPP, Inc.,* 113 FERC ¶ 61,277 at P 31, 45; *SFPP, Inc.,* 121 FERC ¶ 61,240 at P 38. While the Propane Group noted that the tax status and character of partnership distributions associated with mutual funds have changed since the Commission's previous determinations, the Propane Group has failed to carry its burden of rebutting that, *in this proceeding*, Mid-America's mutual fund owners or their beneficiaries pay income tax at a rate lower than 28%. Consequently, contrary to the Propane Group's assertion, the burden did not shift to Mid-America to prove otherwise.

705. Equally unavailing is the Propane Group's contention that the 28% marginal income tax rate is inappropriate because the dividends of mutual funds qualify for lower long-term capital gains tax rates of 5 and 15%, depending on the tax bracket. First, as Mid-America pointed out, not all mutual fund dividends qualify for long-term capital gains rates, and those that do not, may be taxed at ordinary income tax rates, which may well exceed 28%. 26 U.S.C. § 852; 26 C.F.R. § 1.852-4; 26 U.S.C. §§ 1, 61(a)(7). Second, mutual funds pay income taxes at Subchapter C rates on any income that is not distributed to shareholders or, if the fund fails to qualify as a Regulated Investment Company in any given year, on 100% of the fund's income in that year. Exhibit Nos. M-4 at p. 20; M-71 at p. 9; 26 U.S.C. §§ 851-52. Third, as previously noted, the Commission was well aware of the taxation laws governing mutual funds when it established the 28% presumptive marginal tax rate, and the Propane Group's evidence failed to prove that, in this proceeding, Mid-America's mutual fund owners or their beneficiaries pay income tax at a rate lower than 28 percent. *See SFPP, Inc.,* 113 FERC ¶ 61,277 at P 31, 45; *SFPP, Inc.,* 121 FERC ¶ 61,240 at P 38.

706. Finally, the Propane Group contended that Mid-America should not receive any income tax allowance for entities with unrelated business taxable income because such entities are subject to an actual or potential income tax obligation only to the extent they receive a threshold level of UBTI — $1000, and Mid-America has not adduced any evidence that UBTI entities have been allocated $1000 or more in unrelated business gross income. Propane Group Initial Brief at p. 45. Once again, the Propane Group has failed to carry its burden of proof. As sole support for their contention, the Propane Group references O'Loughlin's testimony at Exhibit No. NPG-1 at pp. 128-29. Propane Group Initial Brief at p. 45. There, O'Loughlin offered no factual evidence, but merely reported his understanding of Internal Revenue Service regulations as they impact UBTI entities. From this discussion, he made certain assumptions and then concluded that "Mid-America completely has failed to put forth any evidence that UBTI entities have received or have been allocated $1000 or more in unrelated business gross income." *See*

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Exhibit No. NPG-1 at p. 128. His testimony, in this regard, can be classified as no more than opinion; it certainly is not evidence.[408] Thus, at best, the Propane Group's proposal is supported merely by their assertion that Mid-America has not put forth evidence as to why the presumptive marginal rates should be used in this proceeding. This simply is insufficient to rebut the presumptive marginal rates.

707. Further, although the Propane Group presents a K-1 analysis demonstrating that UBTI entity unitholders have not received unrelated business taxable income approaching the IRS threshold for triggering UBTI liability, I find this information to be insufficient to support a departure from the Commission's presumptive marginal rates. First, the Commission has recognized that category four entities may actually be taxpaying entities themselves if the regulated entity generated income that could be deemed unrelated business income. *SFPP, L.P.,* 113 FERC ¶ 61,277 at P 32, 45. Since the top marginal rates for unrelated business taxable income are higher than 28%, the Commission permits regulated entities to rebut the presumptive 28% marginal income tax rate for this category by demonstrating that some or all of them should be moved to the next group — category five.[409] *Id.*[410]

708. In addition, even had Mid-America assigned any unitholders to category five, the Propane Group's suggestion that UBTI marginal tax rates would be improper in this case because most UBTI entities receive less than $1,000 in unrelated business taxable income from Enterprise Products Partners would be contrary to Commission precedent. Specifically, in calculating marginal rates, "the Commission must look at the partner's total taxable income to determine the marginal tax rate, not just marginal tax rate of the regulated income that is included on the partner's return. 117 FERC ¶ 61,285 at P 55.

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[408] The opinions of expert witnesses may be accepted as evidence when it is given on matters on which they have an expertise and based on facts in the record, but I daresay that would not include matters involving legal opinion or ultimate conclusions related thereto. Thus, O'Loughlin's opinion on this matter is given no evidentiary weight.

[409] The Commission defined category five to include "those entities listed in [category four] that may be taxpaying entities because income from the [regulated entity] would be deemed unrelated business income." *SFPP, L.P.,* 113 FERC ¶ 61,277 at P 45.

[410] *See also* Exhibit No. M-4 at p. 22; I.R.C. §§ 1, 11, 511. It also should be noted that Mid-America asserted that, in attempting to reduce the number of contested issues, it did not seek a higher marginal tax rate for entities in category four that would generate UBTI and thus move such entities to category five. In fact, it did not use category five for purposes of calculating the weighted average marginal tax rate for any entity. Thus, in this proceeding, there may very well be entities paying rates greater than the presumptive 28%.

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709. As I previously indicated, I do not agree with the way in which Mid-America accounted for state income taxes. "State income taxes are a traditional cost-of-service element," and if a pipeline "establishes that it should receive a federal income tax allowance, it is entitled to a state income tax allowance if its methodology is reasonable." *SFPP, L.P.*, 121 FERC ¶ 61,240 at P 59. In that ruling, while the Commission did not expressly articulate how the state income tax rate should be calculated, it rejected the pipeline's state income tax methodology. *Id.* at P 59-61. Specifically, the pipeline began with the income generated by the regulated entity and applied the applicable tax rates for the state in which the regulated entity operates. *Id.* at P 59-61. Further, the pipeline's methodology failed to account for tax credits between states where income had been declared. *Id.* at P 59-61. Mid-America's state income tax methodology is similar, if not identical, to the state income tax methodology the Commission rejected in *SFPP*. *See* Exhibit No. M-71 at p. 11. Accordingly, I reject Mid-America's state income tax allowance proposal.[411]

D. WHAT IS THE APPROPRIATE LEVEL OF OPERATING EXPENSE EXCLUDING DEPRECIATION?

(1) What is the appropriate allocation of common and indirect costs, including the appropriate amount of labor cost to use in the allocation?

A. MID-AMERICA

710. Mid-America suggested that the proper methodology to be used in allocating common or indirect costs is the Kansas-Nebraska method.[412] Mid-America Initial Brief at p. 51. Although, it claimed, the Propane Group and Staff dispute two aspects of Mid-America's calculations, Mid-America contended that its approach is more consistent with Commission precedent and with the facts at hand. *Id.* at p. 53.

711. According to Mid-America, the Propane Group disputed the amount of direct

[411] I note that Commission precedent indicates that, were Mid-America to base its state income taxes on the income of the partnership and apply the applicable tax rates for the state in which the publicly traded partnership operates, it would be permitted to include an allowance for state income taxes. *SFPP, L.P.*, 121 FERC ¶ 61,240 at P 59-61.

[412] Mid-America described the Kansas-Nebraska method as one that "averages the proportions of direct labor and gross plant that can be directly attributed to a system, relative to total company direct labor and gross plant," and then takes the resulting Kansas-Nebraska factors and applies them to the pool of common and indirect costs to calculate the amounts attributable to each system. Mid-America Initial Brief at p. 52.

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labor costs Mid-America attributes to the Northern System, claiming that the allocation of direct labor costs to the Northern System is too high when compared to the Rocky Mountain System allocation.[413] *Id.* at pp. 53-54. Mid-America stated that 50.7% of the total Test Period direct labor costs that can be assigned to specific portions of its systems is attributed to the Northern System, and consequently (combining that percentage with the Northern System's percentage of Mid-America's total plant costs), 35.81% of Mid-America's common costs can be allocated to the Northern System under the Kansas-Nebraska method. *Id.* at p. 53 (*citing* Transcript at pp. 1654-55; Exhibit Nos. M-100 at p. 31; M-106).[414]

712. There are many reasons, insisted Mid-America, why Northern System direct labor costs are higher than the other systems, namely: (a) the Northern System has more miles of pipeline, which results in more maintenance and right-of-way expenses; (b) the Northern System is older, resulting in more maintenance; (c) the Northern System is more complex because (1) it moves eight different products; (2) it has thirty delivery points; (3) it has bi-directional flow capabilities; (4) its propane movements are frequently transferred into and out of the terminals; (5) its batched operation and multiple product types cause products to be switched at both the origin and destination ends of the movements, which cannot be measured automatically; and (6) its transferred product is continuously sampled and tested; and (d) the Northern System faces more right-of-way issues than does the Rocky Mountain System. *Id.* at pp. 55-57 (*citing* Exhibit Nos. M-1 at pp. 4-7; M-46 at pp. 8-11; Transcript at pp. 825, 832-33).

713. Furthermore, because Mid-America's Northern System terminals, which are owned by Enterprise Terminals, are fully automated and unmanned, Mid-America dispelled the Propane Group's supposition — that Mid-America's employees improperly recorded their time to the pipeline instead of to Enterprise Terminals — as unsupported and unfair. *Id.* at pp. 58-59. For the foregoing reasons, Mid-America argued that the direct labor cost figures from Mid-America's records are appropriate to use in the Kansas-Nebraska methodology. *Id.* at p. 61.

714. Staff argued, according to Mid-America, that the Kansas-Nebraska methodology should not be used in allocating common costs related to the Conway cost center, but

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[413] Mid-America suggested that Propane Group witness "O'Loughlin's criticism rests on nothing more than his feeling that the Northern System direct labor costs *seem* too high, rather than on factual evidence that any actual item of direct labor *is* too high." Mid-America Initial Brief at p. 54. In contrast, it added that its witness, Ganz, based his calculations on Mid-America's books and records. *Id.*

[414] The Rocky Mountain System received 46.05% of Mid-America's costs, and the Central System received 18.14%. Mid-America Initial Brief at p. 53 (*citing* Exhibit Nos. M-100 at p. 31; M-106).

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rather, a volumetric approach should be used. *Id.* at p. 53. Mid-America explained that there are two reasons why it uses the Kansas-Nebraska method to allocate common costs at Conway, to wit: (1) the Commission generally uses this approach in allocating common costs among systems within a regulated company;[415] and (2) there is a nexus between the common costs and the Kansas-Nebraska direct labor and gross plant factors. *Id.* at p. 62. Accordingly, Mid-America attributed approximately 64% of the common costs at Conway to the Northern System, (the remainder going to the Central System, for the period February 2005 through January 2006). *Id.* at p. 63 (*citing* Transcript at p. 2052; Exhibit No. M-109).

715. In contrast with its use of the Kansas-Nebraska formula, according to Mid-America, Staff used a volumetric approach and allocated approximately 36% of the common costs at Conway to the Northern System, the remainder going to the Central System. *Id.* (*citing* Exhibit No. S-16). According to Mid-America, Staff's approach is flawed because "many of the costs at these two locations do not fluctuate with volume." *Id.*[416] Moreover, it asserted, even when volumes do affect costs, Staff's approach failed to represent the fact that most product moving out of Conway does so on the Northern System, and outbound movements from Conway entail significantly higher costs than inbound movements.[417] *Id.* at pp. 63-64.

716. Finally, Mid-America contended that the presumptive approach for allocating

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[415] Mid-America cited *SFPP, L.P.,* 86 FERC at pp. 61,082-83 as an example of the Commission's adoption of the Kansas-Nebraska approach in allocating common costs among systems. *Id.* at p. 62.

[416] For example, Mid-America explained, operation and maintenance are necessary regardless of the system on which the volumes move. Mid-America Initial Brief at p. 63 (*citing* Exhibit No. M-46 at p. 21).

[417] Mid-America stated:

> Outbound movements must be metered, sampled, tested and dehydrated. In contrast, inbound demethanized mix volumes (which account for over 86 percent of inbound volumes at Conway, *see* Exhibit [No.] M-67) are "tightlined" to a nearby fractionator – that is, they flow directly through the Conway facility without needing to be sampled, tested or dehydrated. Exhibit [No.] M-46 at 22; Tr. 1365. Outbound volumes also need to be pumped; of the seven pumps at Conway, six are dedicated to moving product on the Northern System while only one is dedicated to the Central System. Exhibit [No.] M-46 at 22.

Mid-America Initial Brief at p. 64.

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common costs among jurisdictional systems is the Kansas-Nebraska approach. *Id.* at p. 65.[418] As a result, Mid-America argued, Staff failed to carry its burden of proving that departure from such method is appropriate. *Id.*

717. In its Reply Brief, Mid-America, referring to the Propane Group Initial Brief at pp. 49-50, claimed that, while the latter agreed with the movement of $1.3 million in Rocky Mountain labor costs from Account 84001 to Account 80099,[419] the Propane Group claimed Mid-America over-allocated costs to the Northern System as compared with the Rocky Mountain System. Mid-America Reply Brief at pp. 41-43. Mid-America asserted that much of the Propane Groups' opposition is based on "unproven assumptions and innuendo." *Id.* at p. 42. In some detail, it cited to the evidence which it claimed the Propane Group ignored in reaching its allegations: (1) Enterprise Terminals' terminals are unmanned and employees only go there when there is a problem; and (2) labor costs are appropriately assigned to cost centers. *Id.* at pp. 43-46.[420] Moreover, Mid-America stated that it failed to understand why the accuracy of its labor allocation is complicated by the fact that its pipeline field offices are sometimes located at an Enterprise Terminals terminal. *Id.* at p. 45. It asserted that labor expenses are charged directly to the appropriate company based on the tasks the employees perform or, in the case of exempt employees, through the use of an allocation percentage, and the location of the field offices in no way complicates this process. *Id.* at pp. 45-46.

718. Additionally, Mid-America maintained that the ammonia pipeline's direct labor expenses should be included in the Kansas-Nebraska allocation formula. *Id.* at p. 46. Contrary to the Propane Group's argument that such inclusion skews costs toward the Northern System, Mid-America declared that, because the payments received from Magellan (and thus, the credits to the cost of service) are greater than the costs generated by operation of the Magellan pipeline, such inclusion was necessary so that overhead costs and offsetting revenue credits could be properly allocated among the systems. *Id.* at pp. 46-47.

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[418] Mid-America cited *Questar Pipeline Co.,* 74 FERC pp. 61,454-56; *SFPP, L.P.,* 86 FERC at pp. 61,081-82, in support.

[419] In support, Mid-America noted that the correction was explained by Ganz at the hearing. Mid-America Reply Brief at pp. 41-42 (*citing* Transcript at pp. 1311-12; Exhibit No. M-100 at pp. 30-31).

[420] In support, including to the references in its Initial Brief, Mid-America cited to the following portions of the record: Transcript at pp. 305-07, 599-600, 662-67, 917-18, 1072-74, 1222-35, 1237, 1242, 1257-58, 1269-71, 1274, 1276, 1281-83, 1295-96, 1307-08, 1363-67; Exhibit Nos. M-46 at pp. 12, 15-17; M-47; M-139; M-140.

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B. PROPANE GROUP

719. While the Propane Group agreed with Mid-America that the Kansas-Nebraska method should be used to allocate indirect costs among the systems, even at Conway and Hobbs, it disputed the direct labor expense data. Propane Group Initial Brief at pp. 47-48. First, the Propane Group disagreed with Mid-America's inclusion of cost centers related to Mid-America's operation of Magellan's ammonia pipeline system in its direct labor expense figures for the three systems. *Id.* at p. 50. Because the Rocky Mountain System does not have expenses associated with the operation of the ammonia pipeline, the Propane Group contended that the inclusion of these cost centers unreasonably skews Mid-America's Kansas-Nebraska allocation and associated costs towards the Northern System and away from the Rocky Mountain System. *Id.* at pp. 50-51 (*citing* Exhibit No. NPG-1 at p. 42). Further, continued the Propane Group, allocating a higher proportion of common costs to Northern System shippers based on labor expenses that do not benefit them and have already been factored out of the costs to be allocated is unreasonable. *Id.* at p. 52.

720. More significantly, the Propane Group asserted, there are no net common costs associated with the ammonia pipeline in the set of indirect costs that are being allocated by Mid-America in its Kansas-Nebraska allocations. *Id.* at p. 52. According to the Propane Group, evidence adduced at the hearing reflected that Mid-America's indirect costs allocated in Mid-America's Kansas-Nebraska methodology were already net of the ammonia pipeline system indirect costs. *Id.* at p. 52 (*citing* Transcript at pp. 2070-72; Exhibit No. M-109 at p. 9). Thus, opined the Propane Group, Mid-America's Kansas-Nebraska allocation calculation is biased by ammonia pipeline-related direct labor expenses when ammonia indirect costs are not allocated. *Id.* at pp. 52-53 (*citing* Transcript at pp. 2070-72; Exhibit No. M-109 at p. 9).

721. Finally, in addressing the issue of the ammonia pipeline, the Propane Group claimed that the indirect costs associated with the ammonia pipeline system in the Mid-America accounts have already been offset by the $1.3 million reimbursement payment made by Magellan for such costs, and thus, only Mid-America-related indirect costs are left to be allocated. *Id.* at p. 53.

722. The second argument made by the Propane Group is that Mid-America's Kansas-Nebraska allocation calculations are overstated because Mid-America employees understate their time (and consequently, expense) related to Enterprise Terminals work, resulting in an overstatement of direct labor expense for the Northern System. *Id.* at p. 54. As an initial matter, the Propane Group exclaimed, no Mid-America employee designates his or her home company as Enterprise Terminals. *Id.* at p. 55 (*citing* Transcript at pp. 1161-62). They added that the evidence shows that Mid-America's employees frequently perform many tasks related to the Enterprise Terminals'

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terminals.[421] *Id.* at pp. 56-57. With regard to these activities, according to the Propane Group, there are no formal written policies regarding timekeeping between Mid-America and Enterprise Terminals and no supervision or auditing of the employees' timekeeping records. *Id.* (*citing* Transcript at pp. 1051-53).

723. According to the Propane Group, when all of the "corrections" suggested by their witness O'Loughlin are made, the result is a Northern System direct labor expense component of 39.8% for the 2006 Test Period, and a Northern System Kansas-Nebraska allocation factor for the same time period of 30.3%. *Id.* at p. 61 (*citing* Exhibit No. NPG-110 at p. 42).

724. In its Reply Brief, the Propane Group first responded to Williams' claim that they "tricked" Mid-America into recognizing $1.3 million in Rocky Mountain System direct labor expense as there was no record support for it. Propane Group Reply Brief at p. 51. Responding, the Propane Group asserted that, if Mid-America's Kansas-Nebraska allocation formula were based only on gross plant (the result of applying Williams' argument that Mid-America does not meet the requirements for the labor part of the formula because all of its personnel are employed by EPCO) instead of a 50%-50% weighting of gross plant and direct labor, the allocation factors will be more heavily weighted toward the Rocky Mountain System. *Id.* at p. 52 (*citing* Transcript at p. 613).[422] In further explanation, the Propane Group noted that the record does contain evidence establishing the source of the $1.3 million and its initial erroneous classification. *Id.* at pp. 54-55 (*citing* Exhibit Nos. NPG-1 at p. 52 n.56; NPG-26; NPG-28; JE-2).

725. Additionally, the Propane Group asserted that, because the $1.3 million payments from the ammonia pipeline (sometimes "Magellan") offset the expenses to which they relate, thereby eliminating the costs associated with the operation of the Magellan line from Mid-America's operating expenses, there is no need to skew the Kansas-Nebraska allocation factor by including ammonia pipeline-related direct labor in the direct labor expense as Mid-America has done. *Id.* at pp. 57-58. Also, the Propane Group noted that, while it does not dispute with Mid-America that the Northern System requires more

[421] For example: (1) testing the product in a terminal tank; (2) maintaining bill of lading equipment; (3) maintaining the mercaptan injection equipment; (4) proving the loading meter; (5) maintaining the terminal assets on a regular program; (6) training to operate a terminal; (7) addressing driver needs; and (8) filling out reports on a daily basis. Propane Group Initial Brief at p. 56 (citing Transcript at pp. 607-08, 647-49, 652, 657, 659-63, 1327; Exhibit No. NPG-172).

[422] To be accurate, the record citation only goes to the fact that EPCO, Inc., is the employer of all persons who perform work for Mid-America as well as all of its affiliates, including Enterprise Products Partners and Enterprise Terminals. As to the rest of its assertion, Mid-America failed to cite to any record evidence.

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direct labor than the Rocky Mountain System, it does, however, dispute several of Mid-America witness Collingsworth's specific claims regarding the greater complexity of the Northern System. *Id.* at p. 59.[423]

726. Further, although Mid-America suggested that its Kansas-Nebraska allocation calculations are reliable because they were based solely and directly on Mid-America's books and records, the Propane Group pointed out that perfunctory reliance on such books and records has been undeniably shown to be faulty, noting the mistake in booking the direct expenses related to the ammonia pipeline and Mid-America witness Bacon's admission that several Rocky Mountain System employees charged their time to the incorrect account as a result of improper training. *Id.* at p. 60 (*citing* Exhibit No. NPG-1 at p. 39; Transcript at pp. 1311-13). Although Mid-America asserted that its Kansas-Nebraska allocation calculations likely under-allocate indirect costs to the Northern System, the Propane Group insisted that there is no reason to justify the use of incorrect or inappropriate labor expense data in the Kansas-Nebraska allocation formula. *Id.* at p. 61.

C. WILLIAMS

727. Williams suggested that direct costs should be allocated on a segmented basis. Williams Initial Brief at p. 26. With respect to indirect and common costs,[424] Williams agreed that they should be allocated using the Kansas-Nebraska formula,[425] but it disagreed with Mid-America's subsequent transfer of $1.3 million from FERC Account 320 to FERC Account 300.[426] *Id.* at pp. 27-33. According to Williams, Propane Group witness O'Loughlin's testimony that Mid-America erroneously assigned labor costs totaling approximately $1.3 million to Account 300 rather than to Account 320 was not

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[423] According to the Propane Group, Mid-America witness Collingsworth's claims regarding the complexity of the Northern System are significantly inflated and have been directly contradicted in the pipeline's statements to the Commission. Transcript at pp. 595-96; Exhibit No. NPG-83 at pp. 7-8.

[424] According to Williams, indirect costs are costs incurred generally for Mid-America Pipeline as opposed to directly for one of its individual systems. Williams Initial Brief at pp. 26-28. While, it added, direct costs should be borne by the individual system benefitting from the expense, indirect and common costs are shared by each of the systems which benefit from the expense. *Id.*

[425] In support, Williams cited *Questar Pipeline Co.*, 72 FERC at p. 61,197; Exhibit No. WIL-8 at p. 10.

[426] These FERC account numbers correspond to Mid-America accounts 84001 and 80099, respectively.

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based on any "direct evidence."[427] *Id.* at p. 29. It, further, contended that Mid-America witness Ganz accepted O'Loughin's testimony without a justification and moved the $1.3 million to Account 300 which resulted in increasing that Account to, about, $1.8 million which amount was included in the Kansas-Nebraska formula. *Id.* (*citing* Transcript at pp. 2155-56). This resulted, according to Williams, in increasing the Rocky Mountain System direct labor percentage from 11.2% to 28.5%, and a concomitant decrease in the Northern System direct labor from 42.07% to 35.89%, and the Central System direct labor from 25.6% to 18.15%. *Id.* at p. 30 (*citing* Exhibit No. M-100 at p. 31). In turn, these changes, Williams asserted, effected changes to the initial Kansas-Nebraska formula percentages used for cost allocation purposes for the Locked-In Period as follows: an increase from 37.25% to 45.96% for the Rocky Mountain System; a decrease from 42.07% to 35.89% for the Northern System; and a decrease from 20.68% to 18.15% for the Central System. *Id.* at p. 30 (*citing* Exhibit No. M-100 at p. 31).

728. In further regard, Williams referred to the testimony of Mid-America witness Knesek who, it claimed, testified that: (1) he was not consulted about movement of the $1.3 million from FERC Account 300 to FERC Account 320; (2) as "Controller and Principal Accounting Officer of Enterprise Products GP, LLC (the general partner of Enterprise Product Partners, L.P.)" he would expect to be contacted regarding such a change; (3) the applicable FERC Form 6 was not corrected; and (4) inasmuch as the $1.3 million in costs which were moved represented expenditures for "outside services," since they were a labor expense and the employees performing those services worked for EPCO, Inc., not Mid-America, they were appropriately placed in Account 320. *Id.* at pp. 31-34 (*citing* Transcript at pp. 1059, 1061, 1126-27, 1161-62).[428]

729. Next, Williams contended that there is an exception to using the Kansas-Nebraska formula in allocating common costs. *Id.* at p. 38. Specifically, it agreed with Staff that a volumetric allocation for the Conway hub is more appropriate because the hub separates interstate and intrastate volumes, such that an interstate volume weight for each pipeline served by the hub is generated. *Id.* at pp. 38-39. However, Williams claimed that Staff's calculations were incorrect. *Id.* at pp. 39-40.

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[427] Later, Williams suggested that O'Loughlin contradicted himself in testifying that, "[after reviewing the percentages] there's not a direct correlation between the Rocky Mountain direct cost and investment compared to the Northern System direct allocation," and in agreeing that "the direct percentages for the [three] systems relative to the total direct expense for Mid-America, those percentages are closer to the [Kansas-Nebraska] percentages in Mid-America's direct testimony, Exhibit [No.] M-27." Williams Initial Brief at p. 35 (*quoting* Transcript at pp. 2606-10).

[428] Williams also dismissed the testimony of Mid-America witness Bacon, who it said was called "in order to address this issue in detail," saying it does not contradict Knesek. Williams Initial Brief at pp. 33-34 (*citing* Transcript at pp. 1268-69, 1312-13).

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730. In its Reply Brief, Williams reiterated its objection to Mid-America's acceptance of the Propane Group's suggested $1.3 million adjustment to the Rocky Mountain System's direct labor component of the Kansas-Nebraska formula. Williams Reply Brief at p. 23. It argued that there is no evidence supporting such adjustment except, perhaps, for hearsay regarding the underlying subject time sheets. *Id.* at p. 24. Williams emphasized that no witness in this proceeding looked at the underlying subject time sheets and no evidence in the record demonstrated that the subject time sheets were from employees whose assigned home company and home cost center were linked to the Rocky Mountain System. *Id.* at pp. 24-25.

731. With respect to the allocation of costs at Conway, Williams clarified that it does not support the use of Staff's volumetric approach to allocate common costs at Conway. *Id.* at p. 29. Williams agreed to Mid-America's reasoning that the costs at this location does not fluctuate with volume, and therefore, the Kansas-Nebraska approach is more appropriate than a volumetric approach. *Id.* at pp. 29-32.

D. COMMISSION TRIAL STAFF

732. With respect to the allocation of Mid-America's indirect, general costs, Staff claimed that the Commission supports the use of the Kansas-Nebraska formula in allocating administrative and general expenses. Staff Initial Brief at p. 44 (*citing Panhandle Eastern Pipe Line Co.,* 74 FERC at pp. 61,379-80). Additionally, Staff asserted that the components of labor costs represent the actual Test Period labor costs incurred by Mid-America for the two rate periods. *Id.* at pp. 42-43. Next, regarding its position on the volumetric approach for the common costs associated with the Conway hub, Staff stated that its explanation is discussed in Issue No. 4.A.(3), *supra. Id.* at p. 43.

733. In its Reply Brief, Staff reasserted its position supporting the use of a volumetric approach and opposition to Mid-America's use of "a variant of" the Kansas-Nebraska method to allocate common costs associated with the Conway hub among its systems because it knows of no Commission precedent permitting use of such a method to allocate common costs between systems. Staff Reply Brief at p. 31. Rather, Staff submitted that the Commission has approved the Kansas-Nebraska method as an allocator for indirect costs. *Id.*

734. Further, Staff refuted Mid-America's characterization of *SFPP, L.P.*, 86 FERC ¶ 61,022, as supporting its use of the Kansas-Nebraska method to allocate common costs related to the Conway hub. *Id.* at p. 32. Specifically, Staff contended that the Commission held, in that case, that the allocation of indirect overhead costs among the pipeline's jurisdictional and non-jurisdictional operations should be determined by the Kansas-Nebraska method. *Id.* at p. 32 (*citing SFPP, L.P.,* 86 FERC at p. 61,082). According to Staff, this decision does not support Mid-America's position because (1) indirect costs are a separate category of costs from the common costs at issue in this

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proceeding, and (2) in *SFPP*, the Kansas-Nebraska method was used to allocate costs between jurisdictional and non-jurisdictional operations on a single pipeline system, not common costs among different pipeline systems. *Id.* at p. 33. Similarly, Staff suggested that the *Questar* decision, also cited in support by Mid-America, stands for the proposition that the Kansas-Nebraska formula is appropriate to use to allocate administrative and general expenses, and also does not address how to allocate the kind of common costs at issue here. *Id.* at pp. 33-34 (*citing Questar Pipeline Co.,* 74 FERC at pp. 61,455-56).

735. Moreover, Staff contested Mid-America's reliance on labor and plant in allocating common costs between the systems because Staff claimed that neither gross plant costs nor direct labor costs have any direct effect on common cost incurrence. *Id.* at p. 34. It asserted that the fact that labor and the assets at Conway serve both the Northern and Central Systems merely establishes that an allocation must be made between the two systems. *Id.* at p. 35. Staff added that it does not, however, establish that direct labor or gross plant costs bear any causal relationship to common costs incurred at Conway. *Id.*

Discussion and Ruling

736. While the parties generally agreed that the proper methodology to be used in allocating common and indirect costs is the Kansas-Nebraska method, they disputed the proper methodology in allocating common costs associated with the Conway cost center and the appropriate amount of direct labor costs attributed to the Northern System. Specifically, the issues are as follows: (1) whether approximately $1.3 million of Rocky Mountain System labor costs had been incorrectly characterized as FERC Account 320 indirect labor costs rather than FERC Account 300 direct labor costs, and consequently, whether Mid-America's inclusion of the $1.3 million in its Kansas-Nebraska allocation factor calculation was proper; (2) whether Mid-America's Northern System direct labor expense is overstated due to a faulty allocation of employee payroll costs between Mid-America and Enterprise Terminals; (3) whether Mid-America's Kansas-Nebraska allocation factors improperly include direct labor associated with Magellan's ammonia pipeline system; and (4) whether the Kansas-Nebraska methodology or a volumetric approach should be used in allocating common costs associated with the Conway hub.[429]

737. The proper methodology to be used in allocating common or indirect costs, contended Mid-America, is the Kansas-Nebraska method. Mid-America Initial Brief at p. 51. In contrast with the Propane Group's position, Mid-America stated it does not believe its allocation of direct labor costs to the Northern System is too high when compared to the Rocky Mountain System allocation. *Id.* at p. 53. It insisted that its

[429] I decided in Issue No. 4.A.(3), *supra,* that the common costs associated with the Conway hub should be allocated using the Kansas-Nebraska methodology, thereby rejecting Staff's volumetric proposal.

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employees were not improperly charging time to pipeline operations cost centers that should have been charged to non-jurisdictional storage and terminal operations. *Id.* at p. 58. Continuing, it argued that its Northern System labor costs are not inflated and emphasized that the Northern System terminals owned by Enterprise Terminals require very little manpower, as they are fully automated and unmanned. *Id.* at pp. 58-59.

738. Next, Mid-America argued that the inclusion of ammonia pipeline direct labor expenses in the Kansas-Nebraska allocation formula was proper because the payments made by Magellan (the owner of the ammonia pipeline), and thus, the credits to the cost-of-service, are greater than the costs generated by operation of the Magellan pipeline. Mid-America Reply Brief at pp. 46-47.

739. The Propane Group disputed Mid-America's direct labor expense data. Propane Group Initial Brief at pp. 47-48. First, the Propane Group argued, because the Rocky Mountain System does not have expenses associated with the operation of the ammonia pipeline, the inclusion of these cost centers unreasonably skews Mid-America's Kansas-Nebraska allocation and associated costs towards the Northern System and away from the Rocky Mountain System. *Id.* at pp. 50-51. They also claimed that the indirect costs associated with the ammonia pipeline system in the Mid-America accounts have already been offset by the $1.3 million reimbursement payment made by Magellan for such costs, and thus, because no net ammonia related indirect costs were allocated by Mid-America's Kansas-Nebraska methodology, ammonia-related direct labor expenses should also be excluded from Mid-America's Kansas-Nebraska allocation factors. *Id.* at pp. 53-54.

740. Additionally, the Propane Group suggested that Mid-America's Kansas-Nebraska allocation calculations are overstated because Mid-America employees understate their time related to work they perform for Enterprise Terminals. *Id.* at p. 54. They asserted that Enterprise Products Partners' timekeeping policies are not well-specified or well-kept. *Id.* at p. 57.

741. Similar to Mid-America, Williams supported the use of the Kansas-Nebraska methodology in allocating indirect and common costs. Williams Initial Brief at p. 26; Williams Reply Brief at p. 29. However, it disagreed with Mid-America's transfer of $1.3 million from FERC Account 320 to FERC Account 300. *Id* at pp. 27-33. Specifically, Williams contended that there is no evidence supporting such adjustment, and that the evidence relied upon by Mid-America, at best, is only hearsay. Williams Reply Brief at p. 24.

742. Staff advocated the use of the Kansas-Nebraska methodology in allocating indirect costs. Staff Initial Brief at p. 42. It stated that its reasoning is contained in its discussion of Issue No. 4.A.(3). *Id.* at p. 43.

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743. Based on the record, I find Mid-America's transfer of approximately $1.3 million of Rocky Mountain System labor expenses from FERC Account 320 (Outside Services) to FERC Account 300 (Salaries and Wages) to be supported by substantial evidence. Williams is the only party to contest this transfer, claiming that there is no direct evidence to support the correction made by Mid-America. The record reflects the contrary.

744. The transfer is supported by the testimony of Propane Group witness O'Loughlin who reviewed the particular databases — MAPL 16844 and 16845 — which reflected the employee-specific base salary and benefits information for all employees with a home company designation of Mid-America. Exhibit No. NPG-22 at pp. 2-3.[430] Upon considering such data, O'Loughlin determined that the base salary and benefits data was only for Mid-America-based employees and did not include time charged to Mid-America by other EPCO employees that did not have Mid-America designated as their home company. Exhibit No. NPG-1 at p. 52 n.55. Continuing, O'Loughlin testified that, "[b]ecause the employees are assigned by Enterprise to Mid-America as their home company, there does not appear to be any basis for assigning the majority of the Rocky Mountain labor expenses as 'Outside Services' in FERC Account 320 and omitting the expense amount from the Kansas-Nebraska allocation." *Id.* at pp. 53-54.

745. Moreover, the testimony of O'Loughlin and Mid-America witnesses Ganz, Knesek, and Bacon all confirm that Mid-America initially recorded the $1.3 million in the wrong account. *See* Exhibit No. M-100 at pp. 30-31; Transcript at pp. 2031-34, 1058-62, 1311-12. Specifically, Mid-America witness Ganz testified:

> First, I agree with one of the corrections that Mr. O'Loughlin proposes to Mid-America's direct labor expense data. Mr. O'Loughlin identified $1.3 million of Rocky Mountain System labor expenses that were recorded in FERC Account 320 (Outside Services), rather than in Account 300 (Salaries and wages). Based on discussions with Enterprise [Products Partners] accounting personnel it appears that these costs do, in fact, represent direct labor expenses that should have been recorded in Account 300. I have incorporated this correction to direct labor expenses in my analyses.

Exhibit No. M-100 at p. 30 (citation omitted). Further, Bacon testified at the hearing that the incorrect recording resulted because employees in the Rocky Mountain area were improperly trained and instructed to charge some of their time to Account 84001 (which is mapped to FERC Account 320) rather than Account 80099 (which is mapped to FERC

[430] *See also* Exhibit No. NPG-1 at Table 12 (summarizing the data in MAPL 16485 to illustrate the disparity between the labor expense figures used by Mid-America in its direct testimony Kansas-Nebraska calculations and the amounts reported by Mid-America home company employees).

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Account 300). Transcript at pp. 1311-12.

746. Simply put, the record established that the Propane Group and Mid-America considered the relevant data relating to the $1.3 million booking and the proposed alternative to transfer this booking from FERC Account 320 to FERC Account 300 and reasoned that the transfer was proper. Thus, I find the testimony of Mid-America and the Propane Group persuasive and accept the transfer of the $1.3 million from FERC Account 320 to FERC Account 300 and consequent inclusion in Mid-America's Kansas-Nebraska allocation factor calculation.

747. Further, after reviewing the record, I conclude that Mid-America's Northern System direct labor expense used in its Kansas-Nebraska allocation calculations is not overstated due to a misallocation of labor time to pipeline operation cost centers instead of to non-jurisdictional storage and terminal operations. As an initial matter, I find Mid-America witness Collingsworth to be the most credible source of evidence related to the terminal operations, as he has had years of experience with them. Exhibit No. M-1 at pp. 1-2. To refute the Propane Group's supposition that "not enough labor time was being charged to [Enterprise Terminals]," he testified to the following: (1) the Northern System terminals owned by Enterprise Terminals are "fully automated and unmanned, accessible 24 hours a day, seven days a week, wherein the truck driver delivering the product possesses upon arrival at the terminal gate and through departure the responsibility of performing every function required to load product;" (2) the truck drivers (who are not Mid-America or Enterprise Terminals employees) gain access to the terminal by a thumb print pad and key pad and obtain information regarding the product they are to receive through computer systems located at the terminals; (3) the responsibilities related to the verification of truck loadings can be accomplished even if an employee is located at the terminal on a "sporadic" basis; (4) an employee responsible for proving the loading meter would probably have to be present at the terminal, but the task would take, if he is slow, only an hour or two; (5) "[u]nless there was a specific problem," this employee does other jobs at the terminal only "from time to time," stopping by for "a few hours Monday through Friday;" (6) on-call employees are not paid on a 24/7 basis, and therefore, charge time to the terminal if they are called out to the terminal, and time sheet their time to the pipeline if they do work on the pipeline; (7) even though the Enterprise Terminals terminals associated with the Northern System may be old when compared to the Rocky Mountain System, they do not require additional labor costs as does the Northern System because they are almost completely run through electronics and many pieces of them have been replaced with newer and more updated equipment; and (8) in sum, the terminals owned by Enterprise Terminals require very little manpower. *See* Exhibit No. M-46 at p. 12; Transcript at pp. 305-07, 599-600, 647, 649, 651, 655-56.

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748. While the Propane Group pointed out general flaws in EPCO's timekeeping procedures,[431] alleging that Mid-America employees consequently charge their time to the wrong entity, such flaws are not sufficient to overcome the evidence adduced by Mid-America that the amount of labor attributed to the Northern System is not overstated. First, while any entity's timekeeping procedures can be improved and tweaked, I find Mid-America's timekeeping system as presented in the record generally to be reliable. *See* Transcript at pp. 917-18, 1222-35, 1237, 1257-58, 1271, 1274, 1281-83, 1295-96, 1307-08, 1363-67; Exhibit Nos. M-140; M-139; M-141. Second, the Propane Group could point to no specific instance in which time was charged incorrectly to the pipeline instead of Enterprise Terminals.

749. Thus, in view of the above, and based on the record, I find Mid-America's direct labor expense in its Kansas-Nebraska allocation calculations to be appropriate.

750. Additionally, I conclude that Mid-America incorrectly included direct labor costs associated with its operation of the Magellan ammonia pipeline system as part of its Kansas-Nebraska calculations. Although Mid-America sought to include both the reimbursement payment received from ammonia pipeline owner Magellan as well as the costs associated with the operation of the ammonia pipeline,[432] including the direct labor costs in the Kansas-Nebraska allocation factors over-allocated costs toward the Northern System and away from the Rocky Mountain System. Exhibit No. NPG-1 at p. 42. As a result, the Northern System cost centers bear the bulk of the labor expense associated with the operation of the ammonia pipeline in comparison with the Central and Rocky Mountain Systems. *See id*. at pp. 41-43.[433]

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[431] Mid-America has no employees of its own. Transcript at pp. 1161-62. EPCO employs the individuals that work at its various subsidiaries, including Mid-America. Thus, when the Mid-America FERC Account 300 direct labor expense is referred to, the reference is to EPCO employees whose home company is Mid-America and who charged time to Mid-America. *Id.* at pp. 2039-42.

[432] Mid-America alleged that the Magellan payment is actually greater than the costs incurred from operating the ammonia line, which results in a net revenue credit. Exhibit No. M-100 at p. 33. Yet Mid-America provided no evidence of the indirect costs associated with operating the ammonia pipeline, not even an estimation or calculation, and, consequently, it is unclear as to how the costs measure up with the payments. Exhibit Nos. M-46 at p. 14 n.8; M-100 at p. 39. A complete evaluation of these costs and their impact on Mid-America's customers must include not only the alleged net effect presented by Mid-America, but also any and all indirect labor expenses allocated by Mid-America's Kansas-Nebraska formula which uses ammonia pipeline direct labor expenses in its derivation, such as that done by the Propane Group.

[433] *See* Exhibit No. NPG-1 at p. 41 tbl.9; Transcript at p. 718.

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751. Further, this over-allocation is highlighted by the high ratio of indirect costs to the direct labor costs used in the derivation of Mid-America's Kansas-Nebraska allocation. Specifically, for every $1 of ammonia pipeline direct labor expense that Mid-America includes in its Kansas-Nebraska factor for the Northern System, $9 of indirect costs are attributed to the Northern System. *Id.* at pp. 38, 42. It is clear that these ammonia pipeline direct labor expenses, associated with a dedicated non-jurisdictional pipeline, in no way benefit Mid-America's jurisdictional services or customers. Indeed, the ammonia pipeline is owned by Magellan and is a non-jurisdictional pipeline that has never provided natural gas liquid transportation service. *Id.* at p. 42; Exhibit No. M-24 at p. 15; Transcript at p. 715. Consequently, including the ammonia pipeline's direct labor expenses is inappropriate in calculating a truly representative allocation factor for other indirect jurisdictional expenses of any kind on the Mid-America System through use of the Kansas-Nebraska formula.

752. Moreover, the indirect costs allocated using Mid-America's Kansas-Nebraska methodology already are net of the ammonia pipeline system indirect costs. *See* Exhibit No. M-109 at p. 9.[434] Mid-America excludes the ammonia pipeline indirect costs to be allocated by its Kansas-Nebraska methodology because the indirect costs have already been completely offset by Magellan's $1.3 reimbursement payment. Transcript at pp. 2066-72. Accordingly, because there are no net ammonia-related indirect costs that need to be allocated by Mid-America via the Kansas-Nebraska formula, I find that, in addition to the jurisdictional deficiencies discussed above, the Kansas-Nebraska allocation factors should exclude the direct labor expense associated with the ammonia pipeline and reflect only the direct labor expense associated with the operation of the Mid-America pipeline.[435]

(2) What is the appropriate allocation of corporate overhead costs?

A. MID-AMERICA

753. According to Mid-America, corporate overhead costs are allocated to Mid-America by Enterprise Products Operating, the operating partner of its parent Enterprise Products Partners, using a modified Massachusetts formula. Mid-America Initial Brief at p. 66 (*citing* Exhibit Nos. M-100 at p. 21; M-70 at p. 2; M-3 at p. 5). It claimed that three aspects of the allocation are challenged by the Propane Group: (1) use of net revenue instead of gross revenue; (2) calculation of the gross property, plant, and equipment figure for Enterprise Products Operating; and (3) calculation of overhead on a

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[434] *See also* Transcript at pp. 2070-72.

[435] The Kansas-Nebraska factors which should be used to implement this decision should be the end-of-Test Period amounts for both the 2005 and 2006 filings.

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monthly, instead of an annual, basis. *Id.* at pp. 66-67.

754. With regard to use of net, rather than gross, revenue, Mid-America claimed that the Propane Group argued that the use of the former is incorrect because Enterprise Products Partners does not have regulated subsidiaries with mechanisms to directly pass through certain costs to customers. *Id.* at pp. 67-68 (*citing* Exhibit No. NPG-113 at p. 24). However, Mid-America asserted that the use of net revenue instead of gross revenue is well-accepted and has been termed the "Distrigas method" or the "Modified Massachusetts formula." *Id.* at p. 67.[436] It contended that, because the use of gross revenue "does not reflect the relative impact on [the parent company's] expenditure of time and money on administration and other overhead activities vis-à-vis its expenditures relative to its numerous other . . . business activities," the use of net revenue is more appropriate. *Id.* at p. 68 (*citing Distrigas of Massachusetts Corp.,* 41 FERC at p. 61,557). Mid-America also maintained that Knesek explained that net revenue provided a better proxy for the overhead quantity than did gross revenue. *Id.* (*citing* Exhibit No. M-70 at p. 4; Transcript at pp. 1100-01). It further suggested as follows: "Although those affiliates sometimes take title to the product being fractionated or processed (which results in greater book revenue when the product is sold), this method of structuring the fractionation or processing service does not result in a greater amount of overhead expenditures than the situations in which the fractionation or processing service is performed for a fee." *Id.* at pp. 68-69 (*citing* Exhibit Nos. M-70 at pp. 3-4; M-100 at pp. 22-23).

755. Mid-America argued that Propane Group witness Arthur erroneously asserted that Mid-America's net revenue figure is incompatible with *Distrigas*, claiming that its approach is consistent with the ruling because it eliminates the distortion caused by fuel prices on the gross revenues of the entities that purchase and sell commodities. *Id.* at p. 69. In *Distrigas*, Mid-America declared, the Commission was most concerned with the fuel costs that inflated the gross revenue figure. *Id.* (*citing Distrigas of Massachusetts Corp.*, 41 FERC at p. 61,557).

756. Additionally, claimed Mid-America, the Propane Group erred in suggesting that Enterprise Products Operating incurs more economic risk when it purchases natural gas liquids instead of including a purchased gas cost adjustment clause in its regulated rate structures. *Id.* at p. 71. In fact, emphasized Mid-America, because the sale price is generally determined at the time the product is purchased, Enterprise Products Operating does not incur substantially more economic risk when it takes ownership title to the

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[436] *Distrigas of Massachusetts Corp.,* 41 FERC ¶ 61,205. Mid-America claimed its use of gross revenues less cost of goods sold is also consistent with *Northwest Pipeline Corp.,* 82 FERC ¶ 63,012 at p. 65,032 (1998); *ANR Pipeline Co.,* 78 FERC ¶ 63,003 at pp. 65,035-36 (1997); *SFPP, L.P.,* 113 FERC ¶ 61,277 at P 84. Mid-America Initial Brief at pp. 69-70.

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product instead of receiving a fee for the fractionation service. *Id.* (*citing* Exhibit No. M-70 at p. 4). Lastly, with respect to this issue, Mid-America maintained that its gross margin figure is more compatible with the labor and plant figures than is the Propane Group's gross revenue figure. *Id.*

757. Next, Mid-America attacked the Propane Group claim that it excluded the following from its calculation of the gross Enterprise Products Partners' property, plant, and equipment: (1) the property, plant, and equipment related to GulfTerra Energy Partners, L.P. and its subsidiaries and two other entities (El Paso Hydrocarbons, LP and GulfTerra NGL Marketing, LP) acquired in 2004; and (2) the December property additions for 2004 and 2005. *Id.* at p. 72. Mid-America explained that, because Enterprise Products Partners did not begin to fully operate GulfTerra and the other two entities until January 2005, including the three companies in the monthly overhead allocation before January 2005 would be inappropriate. *Id.* (*citing* Exhibit No. M-70 at pp. 6-7). It contended that including the three entities in the overhead allocation for 2004, as suggested by Propane Group witness Arthur, would produce an under-allocation of overhead costs to Mid-America because the total amount of those costs allocated in 2004 does not include any of the overhead costs generated by the three entities. *Id.* (*citing* Exhibit No. NPG-240 at p. 2; Transcript at pp. 2715-17).

758. While the Propane Group recommended the overhead allocation be calculated on an annual basis, Mid-America asserted that it must be done on a monthly basis. *Id.* at p. 73. The Propane Group, Mid-America noted, does not use end-of-period balances for its gross plant numbers or its revenue or payroll figures; thus creating a mismatch between the various factors in the Massachusetts calculation. *Id.* Mid-America distinguished this proceeding from the Commission precedent the Propane Group cited supporting its position, *SFPP, L.P.*, 113 FERC ¶ 61,277 at P 81-86, in which, according to Mid-America, the issue was whether to use end-of-period balances or a thirteen-month average of gross plant. Mid-America Initial Brief at p. 73. Although acknowledging that the Commission required the pipeline to recalculate its Massachusetts formula based on Staff calculations, which used end-of-period balances, Mid-America contended that its decision was based on other factors and did not particularly address the end-of-period issues. *Id.*

759. In reply, responding to the Propane Group's contention that the modified Massachusetts formula should only apply to regulated entities, Mid-America argued that the modified Massachusetts formula is not limited to the allocation of overhead among regulated entities. Mid-America Reply Brief at p. 49 (citing *Northwest Pipeline Corp.,* 82 FERC at p. 65,032). In addition, Mid-America insisted that the level of risk involved in the purchase and sale of a commodity is not the primary consideration in deciding whether the modified Massachusetts formula should be applied. *Id.* at p. 49. It contended that, where certain affiliates, whether regulated or not, incur substantial commodity costs such that a "disproportionate amount of the allocated cost would flow to

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that company without any attendant administrative burden or without generating any more net income," the use of the modified Massachusetts formula is appropriate. *Id.* at p. 50 (*citing Northwest Pipeline Corp.,* 82 FERC at p. 65,032). Accordingly, in this case, Mid-America maintained that the use of net revenue provides a better proxy for the amount of overhead used by each entity than gross revenue. *Id.*

760. Contrary to the Propane Group's assertion, Mid-America submitted that nothing in Exhibit No. NPG-233 proved that processing agreements are being re-structured to minimize risks to independent processors and that a processor's risk is high when it holds title to a product. *Id.* at p. 51. To support its claim, Mid-America insisted that the Propane Group cited information taken from a general presentation of nationwide ethylene industry trends, which does not address any specific Enterprise contract. *Id.* (*citing* Exhibit No. NPG-233 at pp, 10, 23). Also, Mid-America contended that, generally, the Enterprise Products Partners' fractionation and processing contracts are more like the low risk contracts described in the presentation, as the typical Enterprise Products Partners contracts involve either a fee-for-service arrangement or, in the case of a processor that does take title, the purchase and sale commodity price is agreed upon in advance so that the resulting "fee" is locked-in. *Id.* (*citing* Exhibit Nos. M-70 at p. 4; NPG-192 at p. 4).

761. With respect to the Propane Group's assertion that the property, plant, and equipment of GulfTerra Energy Partners, L.P., El Paso Hydrocarbons, LP, and GulfTerra NGL Marketing, LP should be included as of the end-of-year 2004 because overhead costs were incurred in 2004 in relation to those entities, Mid-America stressed that those overhead costs all involve the cost to Enterprise Products Partners of acquiring GulfTerra. *Id.* at p. 54. Mid-America submitted that those costs are properly allocated to Enterprise Products Partners because they were for its benefit as opposed to costs directly associated with running GulfTerra. *Id.* (*citing* Transcript at pp. 1114-16).

B. PROPANE GROUP

762. The Propane Group asserted that Mid-America's cost-of-service data includes a range of $4.7 million to $7.4 million of Enterprise Products Partners' corporate unallocated overhead costs allocated to Mid-America, wherein $1.7 million to $2.6 million is included in Mid-America's Northern System rates, depending on the particular test period at issue. Propane Group Initial Brief at p. 62 (*citing* Exhibit Nos. M-108; M-110; M-115). The Massachusetts formula, according to the Propane Group, allocates corporate overhead expenses to a regulated utility subsidiary using an average of three ratios: "(1) the regulated subsidiary's gross revenue to total corporate gross revenues; (2) the regulated subsidiary's gross property, plant, and equipment to total corporate gross property, plant, and equipment; and (3) the regulated subsidiary's gross payroll (or direct labor costs) to total corporate gross payroll." *Id.* (*citing KN Interstate Gas Transmission Co.,* 88 FERC ¶ 61,270 at p. 61,848 (1999)). In their opinion, three deficiencies arise in

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Mid-America's modified Massachusetts formula: (1) the use of gross margin instead of gross revenue; (2) the exclusion of GulfTerra Energy Partners, L.P. and its subsidiaries and two acquired affiliates, El Paso Hydrocarbons, LP and GulfTerra NGL Marketing, L.P. (GulfTerra entities) in the 2004 Massachusetts formula calculation; and (3) the use of monthly balances instead of end-of-period balances. *Id.* at p. 63.

763. With respect to Mid-America's use of gross margin, the Propane Group asserted that Mid-America did not employ the *Distrigas* method but actually altered it. *Id.* at p. 64. In *Distrigas* the Propane Group maintained, net income was allowed because of the presence of a pass-through mechanism for a regulated subsidiary. *Id.* (*citing Distrigas of Massachusetts Corp.*, 41 FERC at pp. 61,555-56). Conversely, the Propane Group pointed out two factors that they claim distinguish this case from the *Distrigas* case: (1) the Mid-America subsidiaries which have gross margin applied are all unregulated subsidiaries with no regulated pass-through mechanism; and (2) the *Distrigas* method used net income, not revenue minus energy-commodity purchase cost. *Id.* at pp. 64-65.

764. Elaborating on the first point, the Propane Group explained that an unregulated entity with no pass-through mechanism is at risk for the underlying energy-commodity purchase cost, and consequently, oversight must be employed regarding the purchase and sale of the energy-commodity, with the inference that as trading volume increases, oversight and associated overhead increases. *Id.* at pp. 64-65. Also, the Propane Group contended that, since Mid-America included many subsidiaries with negative gross margins (resulting in zero or negative overhead for the subsidiary) in its Massachusetts formula calculations, there was an artificial increase in the overhead being allocated to Mid-America and others where gross margin cannot be negative because it equals gross revenue. *Id.* at p. 65 (*citing* Exhibit No. NPG-232 at pp. 20-24, 26, 28-32, 35). Furthermore, regarding Mid-America's claim that Enterprise Products Partners does not incur substantially more economic risk when it takes ownership title to the product instead of receiving a fee for the fractionation service, the Propane Group declared the claim baseless and contradicted by material presented in 2004 by Enterprise Products Partners. *Id.* at p. 66 (*citing* Exhibit No. NPG-233 at p. 34).

765. Further, the Propane Group insisted that, because Enterprise Products Partners acquired or merged with the GulfTerra entities in September 2004 and incurred significant overhead during 2004 as a result, Mid-America inappropriately excluded the GulfTerra entities from its 2004 overhead allocations. *Id.* at p. 67. They contended that, contrary to Mid-America witness Knesek's assertions, "the record demonstrated that there was significant overhead incurred during 2004 associated with the GulfTerra entities." *Id.* (*citing* Transcript at pp. 1113-18; Exhibit Nos. NPG-194 at p. 2; NPG-195 at p. 2).

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766. Allocating Enterprise Products Partners' corporate overhead expense on an annual basis using end-of-period balances, the Propane Group argued, is representative of operations on a going forward basis as assets change during the period, and is consistent with Commission precedent. *Id.* at pp. 68-69 (*citing* Exhibit Nos. NPG-113 at pp. 43-44; NPG-240). In addition, they claimed that the Commission recently reaffirmed the use of end-of-period balances for application in the Massachusetts formula. *Id.* at p. 69 (*citing SFPP, L.P.,* 113 FERC ¶ 61,277 at P 81-86).

767. Erroneously, according to the Propane Group, Mid-America allocated Enterprise Products Partners' corporate overhead expense on a monthly basis because, according to Mid-America witness Ganz, if material changes to an entity's operations occur during a year, adjusting the actual overhead costs incurred during a year to reflect those changes would be appropriate. *Id.* (*citing* Exhibit No. M-100 at p. 28). Yet the Propane Group asserted that, in doing so, Mid-America ignores the fact that both parties relied on the actual data from the 2004 Base Period and the 2006 Base Period for their overhead allocations. *Id.* (*citing* Exhibit Nos. M-115; NPG-240). Furthermore, the Propane Group claimed, the actual overhead costs related to a material increase in assets (*e.g.,* the GulfTerra acquisition in 2004), should have a portion of the actual overhead allocated to the acquired entities based on partial year direct labor and gross revenue balances of the acquired entity to avoid improper cross-subsidies of overhead costs. *Id.* (*citing* Transcript at pp. 2721-22).

768. In reply, the Propane Group argued that, contrary to Mid-America's assertion, *Distrigas* is not applicable here. Propane Group Reply Brief at p. 62. They suggested that the modified Massachusetts formula allowed in that case "was based on *regulated* entities directly passing purchased gas costs to customers, thereby creating a unique situation where little oversight was required for pass-through revenues" whereas, here, none of Enterprise Products Partners' subsidiaries included in Mid-America's modified Massachusetts formula "are regulated subsidiaries with pass-through mechanisms, and therefore those subsidiaries *are* at risk for the underlying-commodity purchase cost." *Id.* at pp. 62-63 (emphasis in original) (*citing Distrigas of Massachusetts Corp.*, 41 FERC at pp. 61,555-56; *Williston Basin Interstate Pipeline Co.*, 104 FERC ¶ 61,036 at P 74 (2003); Transcript at pp. 1102-03).

769. The Propane Group also argued that Mid-America's reliance on *Northwest Pipeline* and *ANR Pipeline* for support of its use of gross margin rather than gross revenue is misplaced. Propane Group Reply Brief at p. 65. According to them, in *Northwest Pipeline Corp.*, the Commission did not address the use of gross margin in the Massachusetts formula because such use was unopposed at the Commission level. *Id.* at p. 66 (*citing Northwest Pipeline Corp.*, 82 FERC at p. 62,046 and n.129). They added that, in *ANR Pipeline Co.*, the presiding judge failed to follow Commission precedent and that, as the proceeding was resolved by settlement, the Commission never addressed the issue. *Id.*

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770. Further, according to the Propane Group, with respect to Mid-America's argument that its gross margin percentage is more in line with the labor and plant figures than is gross revenue, the Propane Group insisted that whether the three factors in the Massachusetts formula have similar percentages is irrelevant, and if each factor was expected to yield similar percentages, then there would be no reason to use an average of three factors. *Id.* at pp. 66-67. The Propane Group stressed that the advantage of the "three factor formula is that it attempts to even out that allocation of indirect costs to affiliates who may have different types of businesses." *Id.* at p. 67 (*citing Mojave Pipeline Co.,* 81 FERC ¶ 61,150 at p. 61,677 n.21 (1997)).

771. Turning to the issue of the GulfTerra subsidiaries, the Propane Group disputed Mid-America's claim that there was no overhead associated with the GulfTerra entities during 2004 because Mid-America did not begin operating these entities until January 2005. *Id.* at pp. 67-68. They pointed out that there was a $9.1 million increase in overhead expense in 2004, largely due to assets acquired during 2004 (of which the GulfTerra entities were primary), and there were significant debt and equity issuances during 2004 prior to the acquisition/merger but directly related to the GulfTerra entities. *Id.* at p. 68 (*citing* Transcript at pp. 1113-18; Exhibit Nos. NPG-194 at p. 2; NPG-195 at p. 2). In sum, the Propane Group submitted that the GulfTerra entities generated and benefited from overhead activities in 2004 and thus should be included in the 2004 Massachusetts formula calculation. *Id.* (*citing* Transcript at pp. 2721-22; Exhibit Nos. NPG-113 at pp. 36-37; NPG-240).

772. Finally, regarding Mid-America's use of monthly allocations of overhead expense, the Propane Group claimed that the December 2005 *SFPP* decision specified the use of end-of-period balances in the Massachusetts formula calculation rather than an average of factors over a multi-month period. *Id.* at pp. 68-69 (*citing SFPP, L.P.,* 113 FERC ¶ 61,277 at P 81, 83, 86). Although the Propane Group discovered that Mid-America's monthly data was "shifted" one month from its understanding of Mid-America's monthly data (*i.e.,* December 2004 actually reflected data for November 2004), the Propane Group maintained that a corresponding change to its calculations would not have a material impact on its calculations, and the Propane Group's data was as near to the end-of-period balances as possible — within one month of the end-of-period balance for all three periods at issue. *Id.*

C. WILLIAMS

773. In agreement with Mid-America, in its Initial Brief,[437] Williams agreed that the modified Massachusetts formula provides an appropriate allocation of corporate overhead costs. Williams Initial Brief at p. 41. It asserted that the use of gross margin rather than

[437] Williams adds nothing new in its Reply Brief. Williams Reply Brief at p. 32.

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gross revenue avoids distortion of the corporate overhead allocation where a subsidiary is involved in buying and selling commodities, and the subsidiary's total revenue might be disproportionate to the subsidiary's net profits (or gross margin). *Id.* at p. 42 (*citing* Exhibit No. M-70 at p. 3). The Propane Group, according to Williams, failed to account for the fact that Enterprise Products Partners participates in various processing activities that effectively produce significantly greater revenue than gross margin (*i.e.,* when customers sell propane/propylene mix to Enterprise Products Partners and buy back the resulting product at a price that reflects the valuation service). *Id.* (*citing* Exhibit No. M-70 at p. 4). Further, Williams asserted that the use of the Massachusetts formula is in line with Commission precedent. *Id.* at p. 43 (*citing Williston Basin Interstate Pipeline Co.,* 104 FERC ¶ 61,036 at P 77).

COMMISSION TRIAL STAFF

774. Similar to Mid-America, in its Initial Brief,[438] Staff supported the use of a modified Massachusetts formula for the allocation of corporate overhead costs. Staff Initial Brief at p. 44. According to it, the Commission described the calculation of the Massachusetts formula as follows: (1) compute the ratio of a company's gross revenues, gross property, plant, and equipment costs, and direct labor costs of the regulated pipeline subsidiary to the parent's costs; and (2) average the three ratios and apply the resulting allocation factor to the parent's indirect overhead costs to obtain the pipeline subsidiary's share of those costs. *Id.* at p. 45 (*citing SFPP, L.P.,* 113 FERC ¶ 61,277 at P 84). Furthermore, noted Staff, the Commission has recognized the use of net operating revenues before taxes and interest, rather than gross revenues, as an allocation factor. *Id.* (*citing Distrigas of Massachusetts Corp.,* 41 FERC at p. 61,557).

Discussion and Ruling

775. The issue to be decided is whether Enterprise Products Operating (the operating partner of Mid-America's parent, Enterprise Products Partners) should allocate corporate overhead costs to Mid-America using the Massachusetts formula or the modified Massachusetts formula.[439] Ultimately, the issue becomes whether the use of net revenue[440] or gross revenue is more appropriate in allocating corporate overhead costs to

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[438] In its Reply Brief, Staff simply reasserted its agreement with Mid-America's allocation of corporate overhead costs. Staff Reply Brief at p. 38.

[439] The modified Massachusetts formula, or the *Distrigas* formula, alters the traditional Massachusetts formula by replacing gross revenue with net revenue as one of the three allocation factors. *See Distrigas of Massachusetts Corp.,* 41 FERC at p. 61,557.

[440] Mid-America actually uses gross revenue less cost of goods sold ("gross margin") to calculate net revenue. *See* Transcript at pp. 1068-69.

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Mid-America.

776. According to Mid-America corporate overhead costs should be allocated to Mid-America from Enterprise Products Operating using a modified Massachusetts formula, also known as the *Distrigas* method. Mid-America Initial Brief at p. 66.[441] Mid-America argued that the use of net revenue in the *Distrigas* calculation is more appropriate than the use of gross revenue because the latter "does not reflect the relative impact on [the parent company's] expenditure of time and money on administration and other overhead activities vis-à-vis its expenditure relative to its numerous other . . . business activities." *Id.* at p. 68. Additionally, it claimed that the energy-commodity trading activities of Enterprise Products Operating resulted in contracts that increase gross revenue even though there is no more risk or overhead expense incurred than if the entity had simply received a fee for its processing or fractionation service. *Id.* at p. 71.

777. Next, Mid-America maintained that, because Enterprise Products Partners did not begin to fully operate the GulfTerra entities until January 2005, including the three companies in the monthly overhead allocation before January 2005 is inappropriate. *Id.* at p. 72. Finally, Mid-America advocated that overhead allocation be calculated on a monthly basis. *Id.* at p. 73.

778. In opposition to Mid-America, the Propane Group asserted that the Massachusetts formula be used in allocating corporate overhead costs to Mid-America, and that gross *revenue* be used in the allocation. Propane Group Initial Brief at p. 62. According to them, the modified Massachusetts formula and the use of gross *margin* is inappropriate in this case because the Mid-America subsidiaries which have gross margin applied are all unregulated subsidiaries with no regulated pass-through mechanism. *Id.* at pp. 64-65. The Propane Group explained that an unregulated entity with no pass-through mechanism is at risk for the underlying energy-commodity purchase cost, and consequently, oversight must be employed regarding the purchase and sale of the energy-commodity, with the inference that as trading volume increases, oversight and associated overhead increases. *Id.* at p. 65.

779. Continuing, the Propane Group insisted that, because Enterprise Products Partners acquired or merged with the GulfTerra entities in September 2004 and incurred significant overhead during 2004 as a result, Mid-America inappropriately excluded the GulfTerra entities from its 2004 overhead allocations. *Id.* at p. 67. Lastly, the Propane Group claimed that the Commission, in *SFPP, L.P.*, 113 FERC ¶ 61,277, specified the use of end-of-period balances in the Massachusetts formula calculation rather than an average of factors over a multi-month period (which Mid-America attempted to do). *Id.*

[441] Both Staff and Williams supported the use of the modified Massachusetts formula and net revenue in allocating corporate overhead costs to Mid-America. Williams Initial Brief at p. 41; Staff Initial Brief at p. 44.

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at pp. 68-69.

780. Based on the record, I find the use of net revenue, and consequently, the use of the modified Massachusetts formula, rather than the Massachusetts formula, in allocating corporate overhead costs to Mid-America to be just and reasonable. The latter calculates ratios of (1) gross revenues, (2) gross property, plant, and equipment costs, and (3) direct labor costs based on the subsidiary's costs to the parent's costs. *SFPP, L.P.,* 113 FERC ¶ 61,277 at P 84. The three ratios are then averaged and the resulting allocation factor is applied to the indirect costs assigned by the parent to the subsidiary. *Id.* However, the Commission has accepted a variation of the Massachusetts formula, permitting, on a case-by-case basis, the use of net income or net revenue, rather than gross revenue, as an allocation factor. *Distrigas of Massachusetts Corp.,* 41 FERC at p. 61,557; *Williston Basin Interstate Pipeline Co.,* 104 FERC ¶ 61,036 at P 77.

781. The Propane Group correctly noted that, in *Distrigas*, the Commission accepted the use of net operating revenues before interest and taxes because of the presence of a pass-through mechanism for a regulated subsidiary, which required little oversight for those pass-through revenues. *Distrigas of Massachusetts Corp.,* 41 FERC at pp. 61,555-56. They argued that the modified Massachusetts formula is inappropriate in this case because none of the Enterprise Products Partners' subsidiaries in Mid-America's Massachusetts formula version are regulated subsidiaries with pass-through mechanisms. Exhibit No. NPG-113 at pp. 27-28. In other words, the Propane Group contended that the Enterprise Products Partners' subsidiaries are at risk for the underlying-commodity purchase cost, which requires oversight to be exercised regarding both the purchase and sale of the energy commodity. Transcript at p. 1102.

782. I find the Propane Group's argument to be unpersuasive. While the facts of this case are not entirely analogous to the facts in *Distrigas*, the underlying rationale for using net revenue exists here. Specifically, the inclusion of commodity costs in the gross revenue figure does not reflect accurately the amount of overhead expended in relation to a particular entity:

> [T]he Commission adopts [S]taff's use of net income rather than gross income for the third allocation factor. In Opinion No. 240,[442] the Commission applied its long-standing policy to use gross revenues for allocation of the indirect expenses of a jurisdictional parent to a jurisdictional subsidiary. The Commission did, however, observe the significant increases over the years in the portion of a pipeline's total revenues that are related to its purchased gas costs, thus calling into question the appropriateness of the Massachusetts method on this issue.

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[442] *Tennessee Gas Pipeline Co*., 32 FERC ¶ 61,086 (1985), *aff'g in part Tennessee Gas Pipeline Co.*, 25 FERC ¶ 63,052 (1983).

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> Here the issue does not turn so much on whether [the subsidiary's] percentage of gas costs has risen as it does on the fact that overhead expenses that are being allocated to it come from an unregulated entity, [the parent company]. The gross revenues of an unregulated [parent company] do not reflect automatic passthrough of massive costs as is the case with purchased gas costs in [the subsidiary's] regulated setting. Thus, the relatively huge gross revenues of a regulated pipeline with a purchased gas cost adjustment clause in its tariff such as [the subsidiary], does not accurately reflect the relative impact on [the parent company's] expenditure of time and money on administration and other overhead activities vis-à-vis its expenditures relative to its numerous other . . . business activities . . . . It is for these reasons that the Commission believes that a ratio of net revenues is a more accurate measure here . . . .

Distrigas of Massachusetts Corp. , 41 FERC at p. 61,557 (footnote omitted) (footnote added).

783. In this case, and based on the record, I conclude that the use of net revenue provides a more accurate and fair allocation and a better proxy for the amount of overhead used by each entity than gross revenue. *See* Exhibit No. M-70 at p. 4; Transcript at pp. 1100-01. Allocating overhead expenses using gross revenue would skew the allocation to entities that purchase and sell commodities even though the overhead cost to manage these types of entities is no greater than for those that transport product or provide services. Exhibit No. M-70 at pp. 4-5. Contrary to the Propane Group's position, when Enterprise Products Partners' affiliates take title to product being fractionated or processed (resulting in greater book revenue when the product is sold), the economic risk does not increase substantially because the sale price is usually determined at the time the product is purchased (at least within a particular range).[443] *Id.* at p. 4.

784. Finally, I note that Mid-America's use of gross revenue less cost of goods sold instead of all operating expenses (less interest and taxes) to calculate net revenue is consistent with the *Distrigas* method and has been approved in prior cases. *See Northwest Pipeline Corp.,* 82 FERC at pp. 65,032-33; *ANR Pipeline Co.,* 78 FERC at pp. 65,035-36 (1997). Moreover, it must be noted that in *SFPP, L.P.,* 113 FERC ¶ 61,277 at P 84, referring to *Tennessee Gas Pipeline Co.,* 32 FERC ¶ 61,086, the Commission stated: "A variation of the Massachusetts formula uses a net revenue factor

[443] In some instances, Enterprise Products Operating will perform the fractionation service for a fee while the customer retains title to the product. Exhibit No. M-70 at p. 4. In other instances, the customers will sell propane/propylene mix to Enterprise Products Operating and buy back the resulting product at a price that reflects the value of the fractionation service, causing gross revenue to be substantially greater than gross margin. *Id.*

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(gross revenues less cost of goods sold)." Here, the "goods sold" are natural gas and natural gas liquids associated with the processing and fractionation services of particular Enterprise Products Partners' affiliates. Exhibit No. M-70 at pp. 3-4. In *Distrigas,* the Commission modified the Massachusetts formula because of similar energy commodity costs which tend to inflate the gross revenue figure disproportionately and inaccurately reflect the relative impact on the expenditure of time and money on administration and other overhead activities. *Distrigas of Massachusetts Corp.,* 41 FERC at p. 61,557.

785. I further decide that the GulfTerra entities, which were acquired by, or merged with, Enterprise Products Partners in September 2004, should be included in Mid-America's 2004 overhead allocations, as they generated and benefited from overhead activities in 2004. *See Williams Natural Gas Co.,* 85 FERC ¶ 61,285 at p. 62,137 (1998). Exclusion of these entities would unreasonably shift overhead costs to Mid-America in the 2004 overhead allocation.

786. In contrast with Mid-America's position, the record reflects that significant overhead costs and oversight actions related to the GulfTerra entities were present during 2004. Transcript at pp. 1113-18; Exhibit Nos. NPG-194 at p. 2; NPG-195 at p. 2. More specifically, Mid-America witness Knesek testified that, during August 2004, Enterprise Products Partners began to tender offers to purchase $915 million of the outstanding debt of the GulfTerra entities and entered into an agreement with the Acquisition Credit Facility to provide $2.25 billion interim financing for transactions related to acquiring the GulfTerra entities. Transcript at pp. 1113-15; Exhibit No. NPG-194 at p. 2. Additionally, on September 30, 2004, Enterprise Products Partners issued 104.5 million new common units in connection with the acquisition/merger of the GulfTerra entities, which raised $1 billion in new equity and added over $4 billion in gross property, plant, and equipment to Enterprise Products Partners' assets. Transcript at pp. 1113-15; Exhibit Nos. NPG-194 at p. 2; NPG-113 at p. 35; NPG-137 at pp. 2-3. Moreover, Enterprise Products Partners' 2004 SEC Form 10-K specifically assigned a $9.1 million increase in general and administrative (*i.e.,* overhead) costs to assets acquired or consolidated during 2004. Exhibit No. NPG-195 at p. 2; Transcript at pp. 1116-18. Clearly, the record demonstrates that both before and after the GulfTerra transaction, Enterprise Products Partners in 2004 incurred substantial overhead costs and took oversight actions related to the GulfTerra entities.

787. The last matter which needs to be addressed here is whether the allocation of Enterprise Products Partners' corporate overhead expense should be performed on an annual basis using end-of-period balances or on a monthly basis. In *SFPP,* the Commission directed the pipeline to recalculate its Massachusetts formula based on Staff's position, which specifically rejected a multi-month average and instead supported the Commission's ratemaking policy of using end-of-period balances. *SFPP, L.P.*, 113 FERC ¶ 61,277 at P 81-86. Consequently, I must conclude that allocation of Enterprise Products Partners' corporate overhead expense should be performed on an annual basis

using end-of-period balances.

(3) What is the appropriate level of fuel and power costs

A. MID-AMERICA

788. The appropriate levels of fuel and power costs, argued Mid-America, are the actual costs incurred during the applicable periods. Mid-America Initial Brief at p. 74.[444] According to Mid-America, all the parties involved agreed with the level of Mid-America's fuel and power costs and use the actual fuel and power expenses without adjustment in their costs of service. *Id.* However, Mid-America emphasized, to the extent that any party adjusted Mid-America's actual volume levels upward, the fuel and power costs also must be increased. *Id.*

789. Mid-America declared that, as volumes increase, fuel and power costs increase because, as volumes increase, more pumps are activated and/or the pumping rates on existing pumps increase, and this requires more energy. *Id.* (*citing* Exhibit No. M-46 at pp. 32-34). Moreover, increased friction at higher pumping rates causes more difficulty in transferring successive volumes, which results in more energy use. *Id.* (*citing* Exhibit No. M-46 at p. 33). Also, continued Mid-America, more costly fuels are needed as volumes increase because not only are the efficient electric pumps activated, but the turbine-driven pumps, which require more costly natural gas liquids and natural gas fuels, also are activated. *Id.* at pp. 74-75 (*citing* Exhibit No. M-46 at pp. 33-34).

790. In the face of those uncontroverted facts, according to Mid-America, the Propane Group rejected the notion that fuel and power costs need to be increased when volumes are assumed to be higher than those actually moved. *Id.* at p. 75. Mid-America noted that, in support of its position, the Propane Group asserted the following: (1) no relationship between volume and power exists; (2) additional costs can be offset by switching fuels and exploiting a decline in natural gas prices; and (3) recurring costs, such as fuel and power costs, do not need to be adjusted. *Id.* (*citing* Exhibit No. NPG-1 at p. 136; Transcript at p. 2530). Yet, Mid-America claimed that it has demonstrated that, to the contrary, there is a relationship between fuel and power costs and volumes. *Id.* (*citing* Exhibit No. M-46 at pp. 32-34).

791. Secondly, Mid-America added that its employees monitor fuel prices to ensure that the pipeline employs the more cost effective fuels first and limits usage of higher cost fuels to peak demand periods. *Id.* at p. 77. Further, with respect to the Propane Group's second assertion, Mid-America claimed that fuel prices for all three inputs —

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[444] In support, Mid-America cited Statement B of Exhibit Nos. M-102, M-103, and M-104 for the fuel and power costs for each period.

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electricity, natural gas, and propane — increased significantly from the 2004 Base Period to the February 2005 to January 2006 Base Period and the Locked-In Period. *Id.* at p. 78 (*citing* Exhibit No. NPG-1 at p. 140).

792. Finally, Mid-America claimed that the Propane Group's third complaint, which was based on Mid-America witness Collingsworth's statement, was taken out of context. *Id.* at p. 79. Mid-America insisted that, when Collingsworth stated that Mid-America expenses were recurring, he was not contemplating the Propane Group's proposed volume adjustments. *Id.* (*citing* Transcript at p. 2530).

793. In its Reply Brief, Mid-America explained that, if the Propane Group's higher 2004 volume levels are accepted (and replace the actual volumes) for the FERC Tariff No. 38 Locked-In Period and the FERC Tariff No. 41 Base Period, the fuel and power costs must be increased accordingly. Mid-America Reply Brief at p. 56. Mid-America submitted that, because the Propane Group, not Mid-America, seeks to replace and adjust the actual volume levels for both the FERC Tariff No. 38 Locked-In Period and the FERC Tariff No. 41 Base Period, it bears the burden of proving that its proposal is reasonable and avoids a mismatch between volumes and fuel and power costs. *Id.* at p. 57. Lastly, Mid-America agreed with the Propane Group that, if I accept the Propane Group's proposed volume levels, at a minimum, it should recover a linear extrapolation of its Northern System fuel and power expenses. *Id.* at pp. 58-59.

B. PROPANE GROUP

794. The Propane Group submitted that Mid-America's actual fuel and power expenses for the 2004 Base Period, the 2006 Base Period, and, to the extent applicable, the Locked-In Period should be used together with the 2004 Base Year volumes. Propane Group Initial Brief at p. 70. More to the point, the Propane Group stated that the parties agreed that the use of actual 2004 Base Period fuel and power costs for the 2005 Test Period is appropriate.[445] *Id.* However, the Propane Group departed from Mid-America and used the higher 2004 Base Period volumes for the Locked-In Period and the 2006 Test Period without adjusting the fuel and power costs for the Locked-In Period or the 2006 Base Period. *Id.*

795. The Propane Group gave the following three reasons for not adjusting fuel and power costs for the Locked-In Period or the 2006 Base Period: (1) no relationship exists between Mid-America's volumes and its fuel and power expense; (2) the ability of

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[445] According to the Propane Group, actual Northern System interstate fuel and power costs were $10.4 million for the 2004 Base Period (Exhibit No. NPG-104 at p. 4), $13.8 million for the Locked-In Period (Exhibit No. NPG-106 at p. 4), and $13.8 million for the 2006 Test Period (Exhibit No. NPG-110 at p. 4). Propane Group Initial Brief at p. 70.

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Mid-America to substitute between fuel inputs reduces the impact of change in market prices; and (3) the recent decline in natural gas prices reduces Mid-America's fuel and power costs. *Id.* (*citing* Exhibit No. NPG-1 at pp. 136, 143; Transcript at pp. 2529-30). According to them, no methodology showing the relationship between volumes, pump usage, and fuel and power costs was given by Mid-America. *Id.* at p. 71. Also, the Propane Group pointed out, the ability of Mid-America to switch fuel inputs at some of its pumping stations proves the lack of any established methodology for adjusting fuel usage relative to throughput. *Id.* at p. 72. Lastly, the Propane Group noted that the change in fuel prices for electricity, natural gas, and natural gas liquids affects the ability to determine a simple relationship between volumes and fuel and power costs. *Id.*

796. Further, the Propane Group asserted that Mid-America failed to demonstrate how it should calculate adjustments to fuel and power expense when volumes change and failed to suggest an appropriate adjustment to the Propane Group's fuel and power costs. *Id.* at pp. 73-74. It is a well-settled principle, they declared, that a negative inference must be drawn when a party with access to particular information fails to produce it.[446] *Id.* at p. 72. Thus, the Propane Group recommended the adoption of its actual fuel and power costs for each of the applicable periods. *Id.* at p. 73.

797. In the alternative, if its throughput recommendation is adopted, but its fuel and power expense recommendation is not, the Propane Group suggested that the fuel and power costs for the Locked-In Period and the 2006 Test Period should be adjusted using a linear extrapolation from the actual Northern System fuel and power expense figures for each period.[447] *Id.*

798. In its Reply Brief, the Propane Group noted that, while it agreed with Mid-America that prices for all three inputs — electricity, natural gas, and propane —

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[446] This argument is specious. If the Propane Group felt that this information was significant to its presentation, and it apparently does, it should have sought it in discovery. Even if it did not do so, during the two months or so that the hearing lasted, its attorneys had every opportunity to inquire of any number of Mid-America's witnesses during their lengthy cross-examination of them. Having failed to do so, the Propane Group is not in a position to claim a negative inference. Moreover, they failed to make a showing that this information was unique to Mid-America and that only Mid-America had this information available. As the Propane Group consists of a number of individual pipelines as well as a trade association, I rather suspect that this same information was available to them as well. Lastly, the argument is beggared by the logic that, as volumes increase, so must the cost of fuel used in connection therewith.

[447] Essentially, this alternative method would result in a 2006 Test Period fuel and power expense that is $1.4 million higher than the actual 2006 Test Period fuel and power expense used by the Propane Group in its analysis. Propane Group Initial Brief at p. 74.

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increased from the 2004 Base Period to the 2006 Base Period, they have already reflected this increase in using Mid-America's actual expenses, which increased from $10.5 million in the 2004 Base Period to $13.8 million in the 2006 Base Period. Propane Group Reply Brief at pp. 73-74.

C. WILLIAMS

799. Initially, in agreement with the Propane Group, Williams stated that, for the 2005 and 2006 Test Periods, the corresponding Base Period fuel and power expenses should be used without adjustment even with the use of 2004 Base Year volumes. Williams Initial Brief at p. 45. Specifically, using actual costs, Williams asserted that the appropriate level of fuel and power costs for the Locked-In Period May 2005 through April 2006 is $13,859,000, and the appropriate level of fuel and power costs for Period II is $13,929,000. *Id.* at pp. 44-45 (*citing* Exhibit Nos. M-31 at p. 4; M-103 at p. 4).

800. In its Reply Brief, Williams agreed with Mid-America that, if its actual volume levels are adjusted as the Propane Group proposed, the fuel and power costs should also be adjusted accordingly to the extent that Mid-America provided the actual costs available. Williams Reply Brief at p. 33.

D. COMMISSION TRIAL STAFF

801. Staff agreed with Mid-America's proposed level of fuel and power costs, with one exception; namely, it advocated the use of actual Test Period data — the 12 months ending September 30, 2005, and October 31, 2006, respectively. Staff Initial Brief at p. 46. Under this approach, for the FERC Tariff No. 38 rate period, Staff calculated a fuel and power cost level of $11,392,000, and for the FERC Tariff No. 41 rate period, it calculated a level of $12,025,000. *Id.* at p. 47.[448]

Discussion and Ruling

802. As no party challenged the level of Mid-America's fuel and power costs, and all parties use the actual fuel and power expenses without adjustment in their costs of service,[449] the issue is whether fuel and power costs must be adjusted should Mid-America's actual volume levels be adjusted (as advocated by the Propane Group). Specifically, the issue is whether the use of the higher FERC Tariff No. 38 Base Period (January 1, 2004, through December 31, 2004) volumes for the FERC Tariff No. 41 Test Period (February 1, 2005, through October 31, 2006), requires a corresponding increase in the 2006 Test Period actual fuel and power costs, as these actual costs were associated

[448] Staff added nothing new in its Reply Brief. Staff Reply Brief at pp. 38-39.

[449] *See* Exhibit Nos. NPG-1 at p. 143; S-4 at p. 19; Transcript at p. 2882.

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with lower volumes.

803. The appropriate levels of fuel and power costs, asserted Mid-America, are the actual costs incurred during the applicable periods except that, to the extent that its actual volume levels are adjusted upward in any particular period, the fuel and power costs also must be increased because, as volumes increase, more pumps are activated and/or the pumping rates on existing pumps increase, requiring more energy. Mid-America Initial Brief at p. 74. Moreover, Mid-America added, increased friction at higher pumping rates causes more difficulty in transferring successive volumes, which results in more energy use. *Id.* Continuing, Mid-America claimed that as volumes increase, more costly fuels are needed because not only are the efficient electric pumps activated, but the turbine-driven pumps, which require more costly natural gas liquids and natural gas fuels, also are activated. *Id.* at pp. 74-75.

804. Conversely, the Propane Group argued that the higher FERC Tariff No. 38 Base Period volumes should be used for the FERC Tariff No. 41 Test Period without adjusting the actual fuel and power costs of the FERC Tariff No. 41 Test Period. Propane Group Initial Brief at p. 70. Supporting its position, the Propane Group enumerated the following reasons: (1) no relationship exists between Mid-America's volumes and its fuel and power expense; (2) the ability of Mid-America to substitute between fuel inputs reduces the impact of change in market prices; and (3) the recent decline in natural gas prices reduces Mid-America's fuel and power costs. *Id.* (*citing* Exhibit No. NPG-1 at pp. 136, 143; Transcript at pp. 2529-30).

805. Similar to Mid-America, Williams submitted that, if Mid-America's actual volume levels are adjusted, the fuel and power costs also should be adjusted. Williams Reply Brief at p. 33.

806. Staff asserted that Mid-America should include a level of fuel and power costs in its cost of service equal to the costs it actually incurred during the Test Periods applicable to the FERC Tariff No. 38 and FERC Tariff No. 41 rates. Staff Initial Brief at p. 46. Staff advocated the use of actual Test Period data from the 12 months ending September 30, 2005, and October 31, 2006, respectively, to establish representative levels of operations and maintenance expense. *Id.*

807. As I reject the Propane Group's proposal to use the higher FERC Tariff No. 38 Base Period volume levels for the FERC Tariff No. 41 Test Period,[450] this issue is

[450] To the extent applicable, the Propane Group advocated the use of FERC Tariff No. 38 Base Period volume levels for the Locked-In Period with no corresponding increase to the actual Locked-In Period fuel and power costs. Propane Group Initial Brief at p. 70. Yet, as I rejected the use of a locked-in period for FERC Tariff No. 38 in my ruling in Issue No. 2, the issue as to the appropriate fuel and power costs for the

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rendered moot. *See* discussion *infra* Issue No. 5. That is, I accept the use of Mid-America's actual volumes for the FERC Tariff No. 41 Test Period, and not the higher FERC Tariff No. 38 Base Period volume levels, and thus, no question arises as to whether a corresponding increase in the FERC Tariff No. 41 actual fuel and power costs is required. Accordingly, for both the FERC Tariff No. 38 and FERC Tariff No. 41 Test Periods, the appropriate levels of fuel and power costs to include in Mid-America's rates are the actual costs incurred during the applicable periods.

808. Assuming arguendo that the higher FERC Tariff No. 38 Base Period volumes were used for the FERC Tariff No. 41 Test Period as recommended by the Propane Group, I would find a corresponding increase in the fuel and power costs to be appropriate. Essentially, I find that a relationship between fuel and power costs and volumes exists. Specifically, I agree with Mid-America's position that, as volumes increase, fuel and power costs increase. *See* Exhibit No. M-46 at pp. 32-34. The following three factors support such a finding: (1) the movement of additional volumes requires the activation of more pumps and/or an increase in pumping rates, which requires more energy; (2) increased friction at higher pumping rates causes more difficulty in moving successive volumes, which also causes energy usage and expenditures to rise; (3) as volumes increase, Mid-America uses more costly fuels to power its pumps. *Id.* at pp. 32-34.

(4) What is the appropriate level of pipeline integrity costs?

A. MID-AMERICA

809. Mid-America contended that the appropriate level of pipeline integrity costs is the actual amount incurred by Mid-America during the FERC Tariff No. 38 Locked-In Period and the FERC Tariff No. 41 Base Period.[451] Mid-America Initial Brief at p. 80. Although recognizing that the Propane Group and Staff reduce its pipeline integrity costs through various normalization techniques, Mid-America argued that they failed to prove that its actual pipeline integrity costs are non-recurring or require normalization at all. *Id.* Assuming, arguendo, that normalization is required, Mid-America insisted that the proposals of the Propane Group and Staff are flawed and failed to reflect Mid-America's ongoing pipeline integrity expenses. *Id.*

810. The Commission's regulations, 18 C.F.R. § 346.2(a), Mid-America stated, provide that the actual costs incurred during the base period are to be used unless there are known

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Locked-In Period does not arise.

[451] Mid-America cited to Exhibit No. M-146 for the actual costs for each period.

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and measurable changes or the costs are non-recurring. *Id.* Therefore, pursuant to the regulations, Mid-America claimed that it extrapolated that, because there are no known and measurable changes (and no party has suggested any such adjustment), and because Mid-America's pipeline integrity costs are incurred every year, and the level of the costs incurred by Mid-America during each applicable period was neither abnormal nor non-recurring, Mid-America's actual integrity costs for each period at issue should be used. *Id.* at pp. 80-81.

811. Additionally, Mid-America declared, Commission precedent establishes the use of actual test period amounts unless good reason is shown to use other data. *Id.* at p. 81 (*citing Williston Basin Interstate Pipeline Co.,* 67 FERC ¶ 61,137 at p. 61,364 n.51 (1994); *Northwest Pipeline Corp.,* 87 FERC at p. 62,055). According to Mid-America, the other parties have failed to establish any good reason to depart from the actual pipeline integrity expense levels. *Id.*

812. To determine whether actual test period expenses are at a normal level, Mid-America maintained, they must be representative of the costs the pipeline will likely incur on a going forward basis. *Id.* (*citing Williams Natural Gas Co.*, 77 FERC at p. 62,180; *Kern River Gas Transmission Co.*, 117 FERC ¶ 61,077 at P 266; Exhibit No. NPG-113 at pp. 2-3). Thus, in this case, it added, the question becomes whether the Northern System pipeline integrity expenses are representative of the costs that Mid-America will likely incur on that system. *Id.* Mid-America noted that the pipeline integrity costs must be reviewed on an individual system basis because each system is different and consequently will have different pipeline integrity levels. *Id.* at pp. 81-82.

813. Mid-America suggested that the actual Northern System pipeline integrity expenses were $7.9 million during the Locked-In Period and $10.8 million during the FERC Tariff No. 41 Base Period. *Id.* at p. 82.[452] It claimed that the following factors supported its assertion that the actual Northern System pipeline integrity costs are representative of the level that Mid-America will likely incur on a going-forward basis: (1) Mid-America is required to comply with the Department of Transportation (DOT) regulations, which mandate the continual assessment of pipeline integrity systems; (2) pipeline assessment costs tend to increase over time because the most current and most sophisticated tools and integrity testing processes are typically used, and they are the

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[452] Mid-America quoted its witness Palmer testifying that "'[w]hile the amount of pipeline integrity costs expended for a particular system may vary somewhat from year to year, the actual amounts expended by Mid-America on the Northern System during the locked-in period and the base period . . . are representative of the level of pipeline integrity costs that Mid-America is likely to incur on a going forward basis on the Northern System.'" Mid-America Initial Brief at p. 82 (*quoting* Exhibit No. M-79 at pp. 2-3).

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most expensive; moreover, those tools detect potential integrity problems, which then require additional assessment and reassessment; (3) stress corrosion cracking on the Northern System assures that ongoing pipeline integrity assessment expenses will be at or above the levels incurred during the Locked-In Period and the FERC Tariff No. 41 Base Period;[453] (4) the Northern System will continue to require stress corrosion cracking assessment because the East Red Line must be reassessed on a four-year schedule, and stress corrosion cracking-like anomalies have been found on the West Red Line and the East Blue Line, which will require assessment and reassessment every four years as well. *Id.* at pp. 82-84 (*citing* 49 C.F.R. § 195.452; Exhibit Nos. M-79 at pp. 3-5, 12, 14-15; M-142 at pp. 18-19; Transcript at pp. 1373-83, 1388-90). Accordingly, factoring in inflation, Mid-America suggested that it would incur an average of $8.4 million per year in Northern System pipeline integrity assessment expenses (assuming constant 2005 dollars). *Id.* at p. 84. In other words, Mid-America declared, the actual Northern System pipeline integrity expenses of $7.9 million and $10.8 million are not abnormal or non-recurring when compared to that average. *Id.*

814. Asserting that it has made a showing of recurring actual test period expenses, Mid-America argued that the burden of proof shifts to the party alleging normalization of such expenses to rebut that showing and demonstrate that the normalized expenses are more representative of future expense levels than the expense levels actually incurred. *Id.* at p. 85 (*citing Williams Natural Gas Co.,* 77 FERC ¶ 61,277 at p. 62,180 (1996)). Mid-America contended that, in its attempt to rebut Mid-America's showing, Staff failed to reflect the significant differences among the three systems, which caused Staff's assertion — that pipeline integrity costs should be the same on a per mile basis on all three Systems — to be in error. *Id.* at p. 86. For example, Mid-America pointed out, stress corrosion cracking-like anomalies have been found on the Northern System and parts of the Central System, but none have been found on the Rocky Mountain System. *Id.* (*citing* Exhibit No. M-79 at p. 18; Transcript at p. 1590).

815. Mid-America stated that Staff averages costs incurred from January 1, 2003, through November 30, 2006. *Id.* at p. 87 (*citing* Transcript at pp. 2816-17; Exhibit Nos. S-10 at p. 11; S-16 at p. 11). As Enterprise Products Partners did not begin operating Mid-America until February 2003, and as the pipeline integrity management program did not become active until the latter half of 2003, Mid-America argued that Staff's 2003

[453] Mid-America asserted that its witness Palmer testified that stress corrosion cracking is the most expensive type of risk to assess. Mid-America Initial Brief at p. 83 (*citing* Exhibit No. M-79 at pp. 8, 15). Further, according to it, detection of stress corrosion cracking requires a specialized in-line inspection tool or hydrostatic testing, either of which can cost approximately $1 million or more per line segment. *Id.* (*citing* Exhibit Nos. M-79 at pp. 9-10; M-142 at pp. 16-17).

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time period is inappropriate.[454] *Id.* Likewise, explained Mid-America, the 2004 level is also lower than future levels of Northern System pipeline integrity costs because the 2004 level does not include costs associated with stress corrosion cracking assessment. *Id.*

816. With respect to the Propane Group's use of the average costs incurred between 2004 and 2008, Mid-America pointed out that the Propane Group used outdated budgets that understate the likely future costs on Mid-America's system. *Id.* at p. 88. Moreover, according to Mid-America, the budgets do not include the recent cost estimates related to stress corrosion cracking on the Northern System. *Id.* In justifying its pipeline integrity costs, Mid-America noted, the Propane Group maintained that information that arose after the base and test periods should not be considered. *Id.* at p. 89. Yet Mid-America opined that this time limitation is actually applicable only to the suggestion of "known and measurable" changes. *Id.* (*citing* 18 C.F.R. § 346.2(a)(1)). This is not the case here, declared Mid-America, because it is defending its actual rate levels. *Id.*

817. Finally, for arguments sake, even accepting a normalization requirement, Mid-America submitted that the levels of integrity costs of the Propane Group and Staff are still unacceptable. *Id.* at p. 90. To the extent normalization is required, Mid-America contended, the proper amount would be $8.4 million. *Id.* at p. 91 (*citing* Exhibit No. M-145). Moreover, Mid-America claimed that the other parties' methods are flawed because Staff's method is not based on an individual system basis, the Propane Group's method relies on outdated budgets, and both methods include non-representative costs. *Id.* at p. 91. Additionally, continued Mid-America, the Propane Group's selection of the time period 2004-2008 to average costs is without justification because the Propane Group failed to show that budgeted expenditures on the Northern System exceeded actual

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[454] Mid-America noted as follows:

> The 2003 time-period included by Ms. Sherman in her average is especially inappropriate, because Enterprise did not begin operating Mid-America until February 2003, and the pipeline integrity management program was not fully operational until the second half of 2003. Exhibit [No.] M-79 at [p.] 18. As a result, no expenditures related to pipeline integrity were authorized in the first quarter of 2003, and less than $70,000 was spent in the second quarter on Mid-America overall. *See* Exhibit [Nos.] M-79 at [pp.] 18-19; M-83; [Transcript at pp.] 2821-22. The 2004 level is also lower than likely future Northern System pipeline integrity costs, because it does not include costs associated with stress corrosion cracking assessment, which did not begin until 2005. Exhibit [Nos.] NPG-198 at [p.] 2; M-79 at [p.] 14.

Mid-America Initial Brief at p. 87.

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expenses in more than one year. *Id.* at p. 92.

818. Furthermore, Mid-America claimed that Staff improperly deducted $3.2 million in costs associated with the ammonia pipeline, even though the pipeline integrity expense deducted from the $3.2 million included less than $25,000 in ammonia pipeline costs. *Id.* at p. 93 (*citing* Exhibit Nos. M-100 at pp. 47-48; S-16 at p. 11; S-10 at p. 11; Transcript at pp. 2816-21). Lastly, Mid-America stated that Staff's mileage data contained errors because Staff only used miles inspected for the entire year 2006 even though only costs through November 2006 were included, and incorrectly assigned miles associated with Conway and Hobbs to the Rocky Mountain System. *Id.*

819. In its Reply Brief, Mid-America asserted that, contrary to the Propane Group's claims, Exhibit No. M-145 is the most precise estimate of annualized stress corrosion cracking. Mid-America Reply Brief at p. 66. According to Mid-America, earlier estimates were based on costs of approximately $1 million per line segment incurred to assess stress corrosion cracking on the East Red Line in 2005, but the estimate in Exhibit No. M-145 of $7.3 million is more exact, as it is based on budgeted numbers for specific segments and a formula that reflects the precise length of each segment to be assessed. Mid-America Reply Brief at p. 66 (*citing* Transcript at pp. 1391, 1559, 1597-99).

B. PROPANE GROUP

820. Unlike Mid-America, the Propane Group insisted that the level of Mid-America's pipeline integrity expenses are non-recurring, and thus argued that the pipeline integrity expenses should be normalized based on an average of the actual and budgeted expenses for the five-year period 2004 through 2008.[455] Propane Group Initial Brief at p. 75 (*citing ARCO Pipeline Co.,* 52 FERC ¶ 61,055 at p. 61,245 (1990)). Evaluation of the baseline assessment program, claimed the Propane Group, showed that testing on the entire system and each individual system varies from year to year, and consequently, related expenses vary from year to year. *Id.* at p. 76. For example, the Propane Group indicated, total system actual pipeline integrity expenses for the 2004 Base Period were $5.2 million, of which the Northern System accounted for $3.3 million (63%), and total system actual pipeline integrity expenses for the 2006 Base Period were $14.7 million, of which the Northern System accounted for $10.8 million (73%). *Id.* at p. 77 (*citing* Exhibit No. NPG-113 at pp. 5-6 and Table 1).

821. Further, according to the Propane Group, the fluctuation of Mid-America's actual and budgeted expenses, both for the total company and the Northern System, from 2004

[455] The Propane Group stated that all parties agree that pipeline integrity costs are recurring, but that they disagree as to what the level of the costs are. Propane Group Initial Brief at p. 75.

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through 2011 also demonstrated that Mid-America's pipeline integrity expenses are not recurring. *Id.* (*citing* Exhibit No. NPG-113 at pp. 8-11 including Table 2 and Figure 1). They claimed that total company actual and budgeted expense levels for the pipeline integrity management program range from $5.2 million to $13.9 million per year, with pipeline integrity management expenses for the Northern System ranging from $1.3 million to $10.1 million per year. *Id.* at pp. 77-78 (*citing* Exhibit No. NPG-113 at pp. 8-11 including Table 2 and Figure 1). According to the Propane Group, Northern System expenses increased in the 2006 Base Period (ending January 31, 2006) to $10.8 million. *Id.* at p. 78 (*citing* Exhibit No. NPG-113 at p. 6 tbl.1). They asserted that Mid-America's 2006 Base Period Northern System expense of $10.8 million exceeded both the actual and budgeted expenses for each year (by approximately $3.9 million) during the 2004 through 2011 period. *Id.* at p. 78 (*citing* Exhibit No. NPG-113 at p. 10).

822. The Propane Group agreed that, because Mid-America must comply with the five-year assessment requirement mandated by the Department of Transportation, further testing must occur on a five-year cycle and thus, using an average of the actual and budgeted expenses over a five-year period, will provide a reasonable, normalized level as opposed to the actual, non-recurring levels for a single year. *Id.* at p. 79. They added that using this period is reasonable because Mid-America's actual expenses were less than the amount it budgeted in 2004 and 2005, even though its actual expenses exceeded the budgeted amount in 2006.[456] *Id.* at p. 80. Consequently, the Propane Group recommended the five-year average of 2004 through 2008 for both the 2005 and 2006 Test Year costs of service, with total company average expenses of $9.0 million (including Northern System average expenses of $3.9 million). *Id.*

823. According to the Propane Group, Mid-America's proposal to use Northern System actual expenses of $7.9 million for the Locked-In Period and $10.8 million for the 2006 Base Year are not representative of costs it will incur on a going forward basis. *Id.* at pp. 80-81. In support, the Propane Group made the following claims:
(1) Mid-America's pipeline integrity program did not become fully operational until late 2003 with active inspections in 2004 through 2006; (2) pipeline integrity expenses in 2004 and 2005 were atypical because those years were spent bringing the pipeline into compliance with the DOT regulations; (3) during 2005, the baseline assessment program necessitated the inspection of 18 out of the 36 Northern System segments, but will not do so every year; (4) Mid-America's calculations constructing an average annual pipeline integrity cost were supported by no workpapers and only mere speculation that there was

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[456] The Propane Group explained: "Although the five-year average [(2004-2008)] is based in part on a budget that was developed after the end of the 2005 Test Year (*i.e.*, September 30, 2005), it is based on the best, and only, information available given there were no budgets provided for 2007 and 2008 that existed in September 2005." Propane Group Initial Brief at p. 80 (*citing* Transcript at p. 2691).

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stress corrosion on the East Blue Line and the West Red Line. *Id.* at pp. 80-81 (*citing* Transcript at pp. 956-57, 1438, 1449-51, 1532-36; Exhibit No. NPG-120 at pp. 3-5).

824. Reviewing Mid-America witness Palmer's testimony, the Propane Group suggested that even he recognized that the pipeline's integrity costs will vary on a year to year basis, and that it will range between $7.9 million and $10.8 million with the actual amount not being on the high end of the range. *Id.* at p. 81 (*citing* Exhibit No. M-79 at pp. 2-3; Transcript at p. 1443).

825. In reply, the Propane Group asserted that (1) its actual and budgeted numbers reflect and are based on Mid-America's compliance with DOT regulations, and (2) the stress corrosion cracking costs that have been incurred and identified are included in the actual expenditures and budgets used by the Propane Group. Propane Group Reply Brief at p. 80 (*citing* Exhibit No. NPG-113 at pp. 4-19). The Propane Group emphasized that all eight segments on the East Red Line are on a four-year reassessment cycle in the August 2006 budget that the Propane Group used, even though Mid-America witness Palmer testified that three of the eight segments may no longer need to be on a four-year reassessment cycle. *Id.* at p. 81 (*citing* Transcript at pp. 1478-80).

826. Finally, the Propane Group maintained that it did not rely on "historic data and outdated budget assumptions" as Mid-America argued, but instead relied on data furnished by Mid-America during the relevant base and test periods. *Id.* at p. 84. The Propane Group insisted that it used the best information available, as Mid-America did not provide budgets for 2007 and 2008 that were created before September 30, 2005, in discovery. *Id.* at p. 85. In any event, the Propane Group contended that the budgets created in September 2007, which Mid-America provided as evidence of increased pipeline integrity costs, when compared with the budget created in September 2006, do not display the type of cost increases that would justify the use of Mid-America's actual pipeline integrity expenses for the Locked-In Period or the 2006 Test Year as the level of expense to be recovered going forward. *Id.* at p. 85. Specifically, the Propane Group argued, the five-year Northern System average for the September 2006 budgets is $4.5 million, while the five-year average for the September 2007 budgets is $5.8 million. *Id.* at p. 86. According to the Propane Group, this data supports two themes:
(1) Mid-America's proposed level for the Locked-In Period of $7.9 million for pipeline integrity expenses and $10.8 million for the 2006 Test Year is unjustified; and (2) the annual level of Mid-America's pipeline integrity costs fluctuates significantly from year to year. *Id.* at p. 86.

C. WILLIAMS

827. Initially, Williams declared that there is no dispute that almost all of the pipeline integrity costs incurred by Mid-America can be directly assigned to one of its three systems. Williams Initial Brief at p. 46. Continuing, Williams asserted that the pipeline

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integrity work is particular to each system, and such costs vary significantly between the systems. *Id.* at p. 47. It noted that "the primary reason" that costs vary is because stress corrosion cracking has been found on the Northern and Central Systems, but not on the Rocky Mountain System. *Id.* (*citing* Transcript at pp. 1511-12, 1580).

828. To determine the Mid-America costs for pipeline integrity, according to Williams, the best place to start is in Exhibit No. M-145 in which, according to Mid-America witness Palmer, the latest information was used to formulate a budget. Williams Initial Brief at p. 49. Williams argued that, in 2008 dollars, this would result in an annual pipeline integrity assessment cost for the Northern System of $9.2 million.[457] *Id.* at p. 48. In addition, Williams claimed, it would also result in an annual basic assessment cost of $6.74 million for the Central System,[458] and $1.82 million for the Rocky Mountain System. *Id.* at pp. 48-50.

829. In reply, Williams criticized Staff's approach in allocating the pipeline integrity costs "based on the pipeline miles in each segment, using the annual average expense per mile of pipeline inspected for the whole pipeline" because pipeline integrity expenses are only partly a function of distance and vary depending on the pipeline system. Williams Reply Brief at pp. 37-39 (*citing* Exhibit Nos. WIL-8 at p. 16; M-79 at p. 18; Transcript at pp. 1171, 1512, 1590). Williams also noted that stress corrosion cracking is found only on the Northern and Central Systems, not the Rocky Mountain System, which results in varying costs among the three pipeline systems. *Id.* at pp. 38-39 (*citing* Exhibit No. M-79 at p. 18; Transcript at pp. 1590). Therefore, as Mid-America will not incur any costs for stress corrosion cracking testing on the Rocky Mountain System, Williams contended that Staff's proposal to assign pipeline integrity costs on a mileage basis results in a cost for a service the Rocky Mountain System does not need being assigned to it. *Id.* at p. 39.

830. Williams also criticized the Propane Group's proposal which it claimed will "grossly understate" the Northern System's average annual costs for pipeline integrity. *Id.* at p. 40. According to Williams, the Propane Group proposal "uses an unrealistic time period, 2004-2008, and an unrealistic averaging period, five years, as well as unrepresentative integrity costs, 'two years of actual expense data and three years of

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[457] According to Williams, Palmer calculated this as being composed of $1.82 million (in 2008 dollars) for metal loss and seam assessment, and $7.38 million for stress corrosion cracking testing. Williams Initial Brief at pp. 47-48 (*citing* Exhibit No. M-145; Transcript at pp. 1564-65, 1575).

[458] About $4.92 million of which represents the cost of stress corrosion cracking testing, according to Williams. Williams Initial Brief at p. 48 (*citing* Transcript at p. 1597).

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budgeted expense data.'" *Id.* It added that, while Mid-America witness Palmer included the cost of the recently discovered stress corrosion cracking in his calculations, Propane Group witness Arthur did not, resulting in an understated estimate of costs. *Id.* at pp. 40-41 (*citing* Transcript at pp. 1388-89, 1451-52, 2689, 2693; Exhibit No. M-145). Williams also dismissed the Propane Group's five year cost average asserting that the relatively recent discovery of the stress corrosion cracking makes its use "inappropriate," especially as lines in which it is discovered will have to be inspected more often than every five years. *Id.* at p. 42 (*citing* Transcript at pp. 1389, 1505-07).

D. COMMISSION TRIAL STAFF

831. Staff suggested that the appropriate level of pipeline integrity annual expenses for the Northern System cost of service is $3.4 million. Staff Initial Brief at p. 47 (*citing* Exhibit Nos. S-4 at pp. 16-19; S-10 at p. 11; S-16 at p. 11). According to Staff, it took a multi-year average of total system pipeline integrity expenses and then allocated it to the three segments on a dollar-per mile basis. *Id.*

832. Mid-America's proposal of pipeline integrity expenses of $7.9 million for the Locked-In Period and $10.8 million for the 2006 Base Year is based on a flawed analysis, Staff insisted. *Id.* at pp. 47-48. First, Staff claimed, Mid-America's proposed pipeline integrity expenses ignore the DOT pipeline safety regulations and the extent to which they affect Mid-America's discretion as to the frequency of its pipeline integrity assessments. *Id.* at p. 48. Second, Staff insisted, no single year of the baseline assessment period for any of the three systems is representative of future expenses in any given year during the five-year reassessment cycles because the number of Northern System segments which Mid-America inspects will fluctuate from year to year depending on Mid-America's discretion.[459] *Id.* at pp. 49-50. It asserted that, in 2005, Mid-America's inspection of the Northern System mileage constituted 66% (1,019.40

[459] Staff implied that the DOT only requires that the "totality" of Mid-America's system be inspected every five years and that Mid-America has the discretion as to which segments will be inspected in any given year. Staff Initial Brief at p. 49. This is close to bosh and nonsense. First of all, Staff's argument diminishes the complexity of the DOT required assessment program. *See* 49 C.F.R. § 195.452 (2007). Moreover, Staff misinterprets the DOT requirements which go far beyond merely requiring an inspection of an entire pipeline every five years. *See, e.g.*, 49 C.F.R. §§ 195.452(f), (g), (h) (2007). In fact, each *segment* of a pipeline must be inspected every five years under the DOT regulations. *See* 49 C.F.R. § 195.452(j) (2007). So, if a segment is inspected in year one, it must be re-inspected not later than year six. In other words, the segment cannot be inspected in year one and then not be re-inspected until year ten, as Staff implied, even though the totality of the pipeline system was inspected once in years one through five and again in years six through ten.

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miles of Northern System) of total system mileage inspected.[460] *Id.* at p. 50. Yet in 2006 and 2007, according to Staff, only 115.36 miles and 138.86 miles of the Northern System, respectively, were inspected. *Id.* at p. 51 (*citing* Exhibit No. S-73 at p. 1). In other words, the year 2005 is merely a fluctuation, because, Staff suggested, if Mid-America continued to inspect at such a rate every year, the requirements of the DOT would be substantially surpassed. *Id.* at pp. 50-51. In sum, while recognizing that the DOT requires pipelines to alter their pipeline integrity program based on operating experience,[461] and while recognizing that Mid-America has done so,[462] Staff attacked the pipeline's methodology for assuming that pipeline integrity costs for a single year are fixed and will recur every year in approximately the same amount. *Id.* at p. 52. Additionally, Staff claimed that, if Mid-America inspected the Northern System every year at its proposed rates, it would incur unreasonable economic costs and would be unable to meet the five-year reassessment requirements mandated by the Department of Transportation. *Id.* at p. 54.

833. Finally, in addressing Mid-America's assertion that, because the Locked-In Period/Period II Base Period costs are higher than normal, they accurately represented increases in future stress corrosion cracking inspection costs, Staff claimed that the future increased costs have a cause (increase in stress corrosion testing costs) entirely unrelated to that responsible for the increased Locked-In/Period II Base Period Costs (more miles inspected). *Id.* at pp. 56-57.

834. In calculating Mid-America's pipeline integrity expenses, Staff advocated the normalization of such expenses over the duration of Mid-America's initial assessment program. *Id.* at p. 57. Commission policy, according to Staff, allows a reasonable deviation from test period data for "good cause shown." *Id.* (*quoting* 18 C.F.R. § 346.2(a)(1)(ii) (2007)). Staff asserted that good cause is present here because Mid-America's average pipeline integrity costs between 2003 and 2006 deals with costs that fluctuate cyclically, and the average is predictive of future costs. *Id.* at p. 58 (*citing United Fuel Gas Co.,* 12 FPC 251 at p. 264 (1953), *rev'd on other grounds sub nom. Manufacturers Light and Heat Co.*, 44 FPC 314 (1970); *Williston Basin Interstate Pipeline Co.,* 84 FERC ¶ 61,081 at p. 61,365 (1998)).

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[460] Staff pointed out that the inspection costs for this particular year constituted a significant part of the costs during the months covered by the Locked-In Period applicable to the FERC Tariff No. 38 rate increase and the Base Period applicable to the FERC Tariff No. 41 rate increase. Staff Initial Brief at p. 50.

[461] Staff cited 49 C.F.R. § 195.452(f) (2007), in support.

[462] Staff cited Transcript at p. 1458, in support.

835. Staff recommended an annual expense of $3,415,469 for the pipeline integrity program on Mid-America's Northern System. *Id.* at p. 59. According to Staff, to calculate this amount, Sherman, totaled Mid-America's expenses for the 2003-2006 period, removed the expenses associated with the ammonia pipeline, and allocated the expenses to its three systems on a mileage basis "using the annual average expense per mile of pipeline inspected for the whole pipeline." *Id.* at pp. 58-59 (*citing* Exhibit Nos. S-4 at p. 18; S-10 at p. 11; S-16 at p. 11). Staff noted that its four-year average is appropriate notwithstanding the DOT five-year reassessment cycle requirement for three reasons: (1) Mid-America has indicated it will employ a four-year inspection cycle for a large part of its Northern System; (2) utilizing expenditures made by the prior operator (Williams) to calculate Mid-America's costs would be inappropriate; and (3) Staff had no way of accounting for Mid-America's total costs incurred in 2007, as its calculation was conducted before the end of the year 2007. *Id.* at pp. 59-60.

836. In reply, contrary to Mid-America's argument that a cost must be non-recurring to warrant normalization, Staff contended that the Commission permits the use of multi-year normalization of particular costs where such costs consistently fluctuate from year-to-year, even where such costs are ostensibly recurring in nature. Staff Reply Brief at p. 41 (*citing United Fuel Gas Co.*, 12 FPC at p. 264; *Southern Natural Gas Co.*, 29 FPC 323 at p. 331 (1963)). As an example, Staff pointed to the Commission's treatment of gas pipeline regulatory expenses where, according to it, the Commission ordered pipelines to average their regulatory expenses for a three-year period to avoid "large year-to-year variations." *Id.* (*citing Williams Natural Gas Co.,* 77 FERC at p. 62,180; *Boston Edison Co.*, 8 FERC ¶ 61,077 at p. 61,281 (1979); *SFPP, L.P.*, 86 FERC at p. 61,106). Similarly, Staff submitted that, since Mid-America's integrity expenses consistently fluctuate from year to year, they should be normalized over a multi-year period. *Id.* at p. 42. Further, it insisted that year-to-year costs will fluctuate in the absence of specific and identified yearly inspection requirements, as the DOT regulations require only that 100% of the system must be inspected within every five years. *Id.* at pp. 42-43.

837. While Mid-America advocated the assessment of pipeline integrity costs on an individual system basis, Staff contended that a company-wide approach was more appropriate because there is a correlation among Mid-America's expenditure level for one line and its expenditures across the three pipelines. *Id.* at pp. 47-48. Particularly, Staff pointed out that, during the initial assessment period, for any given year wherein one system was inspected beyond the minimum mileage needed to comply with the DOT required five-year cycle, one or both of the other systems were inspected below the five-year attainment levels. *Id.*

Discussion and Ruling

838. Two issues arise in determining the appropriate level of pipeline integrity costs:

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(1) whether Mid-America's pipeline integrity costs should be assessed on an individual system basis or a total system basis; and (2) whether Mid-America's actual pipeline integrity costs require normalization.

839. According to Mid-America, the appropriate level of pipeline integrity costs is the actual amount incurred by Mid-America during the FERC Tariff No. 38 Locked-In Period and the FERC Tariff No. 41 Base Period. Mid-America Initial Brief at p. 80. As it claimed that its pipeline integrity costs are incurred every year and that the level of the costs incurred by it during each applicable period are recurring and normal, Mid-America argued that its actual pipeline integrity costs do not require normalization. *Id.* at pp. 80-81. It noted that integrity costs must be assessed on an individual system basis because each system is distinctive and consequently will have different pipeline integrity cost levels. *Id.* at pp. 81-82. Accordingly, Mid-America submitted that the appropriate pipeline integrity costs should be the actual Northern System pipeline integrity expenses of $7.9 million during the Locked-In Period and $10.8 million during the FERC Tariff No. 41 Base Period. *Id.* at p. 82.

840. In contrast with Mid-America, the Propane Group advocated the normalization of pipeline integrity expenses based on an average of the actual and budgeted expenses for the five-year period 2004 through 2008 because it insisted that the level of Mid-America's pipeline integrity expenses are non-recurring. Propane Group Initial Brief at p. 75. Evaluation of the baseline assessment program, insisted the Propane Group, shows that testing on the entire system and each individual system varies from year to year, and consequently, related expenses vary from year to year. *Id.* at p. 76. Thus, the Propane Group recommended the five-year average of 2004 through 2008 for both the 2005 and 2006 Test Year costs of service, with total company average expenses of $9.0 million (including Northern System average expenses of $3.9 million). *Id.* at p. 80.

841. In agreement with Mid-America, Williams asserted that, in 2008 dollars, the annual pipeline integrity assessment cost for the Northern System should be $9.2 million. Williams Initial Brief at p. 48. Williams insisted that Mid-America's figures are proper because they are based on the most recent cost statement, including the recent discoveries of stress corrosion cracking. *Id.* at p. 49. It attacked Staff's approach asserting that pipeline integrity expenses are only partly a function of distance and vary depending on the pipeline system. Williams Reply Brief at pp. 37-39.

842. According to Staff, the appropriate level of pipeline integrity annual expenses for the Northern System cost of service should be $3.4 million. Staff Initial Brief at p. 47. Staff explained that it took a multi-year average (January 1, 2003, through October 31, 2006) of total system pipeline integrity expenses and then allocated it to the three segments on a dollar-per mile basis. *Id.* Staff asserted that good cause exists to use a multi-year average because Mid-America's average pipeline integrity costs between 2003 and 2006 deals with costs that fluctuate cyclically, and the average is predictive of future

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costs. *Id.* Continuing, Staff insisted that no single year of the baseline assessment period for any of the three systems is representative of future expenses in any given year during the five-year reassessment cycles because the number of Northern System segments which Mid-America inspects will fluctuate from year to year depending on Mid-America's discretion. *Id.* at pp. 49-50.

843. I cannot fully subscribe to any one party's proposal. As an initial matter, I reject Staff's proposal to assess pipeline integrity costs on a company-wide basis rather than on an individual system basis. Staff's assumption that costs per mile are the same on each of Mid-America's three systems is flawed because pipeline integrity expenses are only partly a function of distance and vary depending on the pipeline system. Indeed, while stress corrosion cracking has been found on the Northern and Central Systems, it has not been found on the Rocky Mountain System. *See* Exhibit No. M-79 at p. 18; Transcript at p. 1590. Moreover, most pipeline integrity costs incurred by Mid-America are specific to each Mid-America system and can be directly assigned to one of the three systems. Transcript at pp. 1512, 1171.

844. Next, I find that the appropriate level of pipeline integrity costs is the actual end-of-test period amount experienced for each rate period at issue in these proceedings. In other words, I reject the Propane Group's and Staff's proposed multi-year averages, as they deviate from Test Period data, and I reject Mid-America's use of actual figures, as they do not capture the actual end-of-*test* period levels of pipeline integrity expenses.

845. Commission policy prefers the "latest test period actual data because it generally provides the best evidence of representative data." *Williston Basin Interstate Pipeline Co.,* 71 FERC at p. 61,081. "[U]nless there is a good reason to use other data," the Commission generally uses test period amounts. *Williston Basin Interstate Pipeline Co.,* 67 FERC at p. 61,364 n.51. As it relates to pipeline integrity expenses, I do not find "good reason" to deviate from test period amounts, specifically, actual end-of-test period amounts.

846. First, Mid-America's pipeline integrity expenses are incurred every year, and the level of the costs was not abnormal or non-recurring. *See* Exhibit No. M-29 at pp. 2-3. The following factors support the conclusion that Mid-America's actual Northern System pipeline integrity costs are representative of the future level of Northern System pipeline integrity costs:

> (1) Mid-America is required to comply with the DOT regulations, which mandate the continual assessment of pipeline integrity systems. 49 C.F.R. § 195.452(j); Exhibit No. M-79 at pp. 3-5; Transcript at pp. 1373-83.
>
> (2) Pipeline assessment costs tend to increase over time because the most current and most sophisticated tools and integrity testing processes are typically

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used, and they are the most expensive. Moreover, those tools detect potential integrity problems, which then require additional assessment and reassessment. Exhibit No. M-79 at p. 15.

(3) Stress corrosion cracking on the Northern System ensures that ongoing pipeline integrity assessment expenses will be at or above the levels incurred during the FERC Tariff No. 38 Test Period and the FERC Tariff No. 41 Test Period.[463]

(4) The Northern System will continue to require stress corrosion cracking assessment because the East Red Line must be reassessed on a four-year schedule, and stress corrosion cracking-like anomalies have been found on the West Red Line and the East Blue Line, which will require assessment and reassessment every four years as well. Exhibit Nos. M-79 at p. 14; M-142 at pp. 18-19; Transcript at pp. 1388-90.

847. Second, I reject Staff's and the Propane Group's averages because neither carried their burden of demonstrating good reason to normalize Mid-America's actual Test Period data. *See Williams Natural Gas Co.,* 77 FERC at p. 62,180. Although both Staff and the Propane Group pointed out that testing on the entire system and each individual system varies from year to year, and consequently, related expenses vary from year to year, I find this fact insufficient to support normalization of Mid-America's actual pipeline integrity expenses. There are other variables that influence the level of pipeline integrity costs incurred during a given period, such as the type of assessment performed on each segment. Exhibit No. M-79 at pp. 18-19; Transcript at pp. 1386-87. Thus, even were the number of miles assessed during the relevant test periods higher than other years, it does not mean that the actual costs incurred during those periods were unrepresentative of future cost levels, especially considering the increased need, on a going forward basis, to assess for stress corrosion cracking on the Northern System. Indeed, Staff's and the Propane Group's proposed averages likely underestimate Mid-America's future pipeline integrity costs, as they rely on outdated budgets,[464] which have been shown to be lower than the actual 2006 and 2007 costs,[465] and fail to capture

[463] Mid-America witness Palmer testified that stress corrosion cracking is the most expensive type of risk to assess. Exhibit No. M-79 at pp. 8, 15. Further, detection of stress corrosion cracking requires a specialized in-line inspection tool or hydrostatic testing, either of which can cost approximately $1 million or more per line segment. Exhibit Nos. M-79 at pp. 9-10; M-142 at pp. 16-17.

[464] Transcript at pp. 1387-88; 1586-87.

[465] *See* Transcript at pp. 2689, 2693, 1451-52; *see also* Exhibit Nos. M-100 at

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the future stress corrosion cracking assessment cost levels.[466] Additionally, the 2004 level, included in both parties' multi-year averages did not include costs associated with stress corrosion cracking assessment. *See* Exhibit No. NPG-198 at p. 2; Exhibit No. M-79 at p. 14. In sum, the parties do not demonstrate Mid-America's actual Test Period pipeline integrity costs are unrepresentative of its future levels of pipeline integrity expenses; nor are their proposed averages more representative of Mid-America's future pipeline integrity costs.

848. Accordingly, for the March 2005 filing, I accept as an appropriate level of pipeline integrity expenses the Northern System actual end-of-test period amount of $8,685,796. *See* Exhibit No. S-10 at p. 11.[467] Similarly, for the March 2006 filing, I accept as appropriate the Northern System actual end-of-test period amount of $7,262,597. *See* Exhibit No. S-16 at p. 11.[468]

(5) What is the appropriate treatment of operating expenses associated with the ammonia pipelines?[469]

A. MID-AMERICA

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p. 50; M-117; *compare* Exhibit No. M-144 at p. 3 *with* Exhibit No. NPG-113 at p. 10.

[466] *See* Exhibit Nos. M-142 at pp. 17-18; M-143.

[467] Although Staff did not advocate the actual end-of-test period figures, it presented such data in its Workpapers. *See* Exhibit Nos. S-10 at p. 11; S-16 at p. 11. While no other party included the actual end-of-test period figures in their exhibits to confirm Staff's figures, no party contested Staff's figures. Thus, I have no reason not to accept Staff's figures as accurate. Moreover, Mid-America calculated an average of $8.4 million per year in Northern System pipeline integrity expenses, and thus, as this figure falls between the actual end-of-test period figures for Period I and Period II, it supports the reliability of Staff's figures. *See* Exhibit No. M-145.

[468] Mid-America claimed here and under Issue No. 4.D.(5) that Staff inappropriately adjusted the pipeline integrity expenses by deducting approximately $3.2 million, which it attributed to ammonia line expenses, from a pipeline integrity figure that included less than $25,000 in ammonia line costs. Yet the resolution of this dispute has no effect on my decision to adopt Northern System actual end-of-test period figures presented in Staff's workpapers, and thus, I do not attempt to resolve it.

[469] Williams did not address this issue in its Initial or Reply Brief. Williams Initial Brief at p. 50; Williams Reply Brief at p. 44. According to the Propane Group, they included their response to this issue in their response to Issue No. 4.D.(1). Propane Group Initial Brief at p. 89; Propane Group Reply Brief at p. 88.

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849. Because Magellan reimbursed Mid-America for any cost incurred from operation of the ammonia pipeline, Mid-America contended that those costs effectively are eliminated from its operating expenses. Mid-America Initial Brief at p. 94 (*citing* Exhibit No. M-100 at p. 39). Continued Mid-America, Magellan also pays Mid-America approximately $1.3 million per year to cover overhead costs related to operating the ammonia pipeline. *Id.* at p. 95 (*citing* Exhibit No. M-165 at p. 2).

850. In contrast, Mid-America explained, Staff asserted that the costs to operate the ammonia line should be removed from Mid-America's operating expense rather than having Magellan's payments credited against Mid-America's operating expense. *Id.* at p. 95. However, Mid-America maintained that, since the Magellan payments are recorded as credits to Mid-America's operating expense and effectively eliminate the costs associated with the operation of the ammonia line, there is no purpose in removing those costs. *Id.* at p. 95. Also, according to Mid-America, the Magellan payments exceed the costs associated with the operation of the ammonia line, and thus, Mid-America's treatment of these expenses serves to reduce its operating expenses. *Id.*

851. Even assuming Staff's approach is acceptable, Mid-America asserted three significant errors in the application of such an approach. *Id.* at p. 96. First, Mid-America insisted that Staff incorrectly eliminated all of the expenses recorded in the NH_3 Shared cost center from Mid-America's cost-of-service even though, it claims, "only a small portion . . . are related to the ammonia line.[470] *Id.* (*citing* Exhibit Nos. M-100 at pp. 40-42; M-46 at p. 14 n.8; M-165; Transcript at pp. 2794-99). According to Mid-America, Staff's total exclusion results in an over reduction in the range of $1.4 million to $1.6 million depending on the period.[471] *Id.* (*citing* Exhibit Nos. M-166; M-100 at pp. 41-42). Second, Mid-America pointed out that Staff inappropriately adjusted the normalized pipeline integrity expenses by subtracting approximately $3.2 million, which was attributed to ammonia line expenses, from a pipeline integrity figure that included less than $25,000 in ammonia line costs. *Id.*[472] Third, according to

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[470] According to Mid-America, the costs recorded in the NH_3 Shared cost center relate to both the operation of the Magellan line and the Mid-America pipeline. Mid-America Initial Brief at p. 94. It added, the costs recorded in that cost center are allocated between Magellan and Mid-America on the basis of the relative volumes in each line and in accordance with the operating agreement between the two companies. *Id.* (*citing* Exhibit No. M-165).

[471] Mid-America submitted that Staff witness Sherman admitted that a portion of the costs recorded in the NH_3 Shared cost center should be allocated to Mid-America. *Id.* at p. 96 (*citing* Transcript at p. 2799).

[472] Mid-America referred to Issue No. 4.D.(4), *supra*.

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Mid-America, Staff inappropriately adjusted its Kansas-Nebraska formula related to ammonia line costs. *Id.* (citing *supra* Issue No. 4.D.(1)).

852. In its Reply Brief, Mid-America addressed Staff's claim that, while revenues from the ammonia line exceeded costs by $700,000 during the 2006 Base Period, costs exceeded revenues by $300,000 during the Locked-In Period. Mid-America Reply Brief at p. 72. Responding, it stated that Staff erred "because [its numbers] include expenses that are not related to the Magellan ammonia line, and because they fail to recognize all of the payments received from Magellan." *Id.* at p. 73 (*citing* Exhibit No. M-100 at pp. 39-42). In particular, Mid-America claimed that, while Staff excludes all expenses in the NH_3 Shared Cost Center, only a 20-25% of those costs relate to the ammonia line. *Id.* (*citing* Exhibit Nos. M-46 at p. 14 n.8; M-100 at pp. 40-42; M-165; Transcript at pp. 2794-99). It added that, were this error corrected, revenues during the Locked-In Period would have exceeded costs. *Id.* at p. 74. According to Mid-America, Staff also ignored the $1.3 million overhead payment made by Magellan. *Id.* (*citing* Exhibit No. M-100 at p. 39).

B. COMMISSION TRIAL STAFF

853. Because the ammonia pipeline is non-jurisdictional, Staff submitted that the operating expenses associated it should be removed from Mid-America's cost-of-service (as Mid-America removed the costs associated with it from its rate base). Staff Initial Brief at p. 61. Thus, according to Staff, for the Locked-In Period, operating expenses decrease by $3.7 million for the Northern System and by $6.9 million for the total pipeline; for the 2006 Base Year, operating expenses decrease by $4.8 million for the Northern System and by $9.6 million for the total pipeline. *Id.* (*citing* Exhibit No. S-4 at p. 16).

854. Addressing Mid-America's argument that, since the payments it receives from Magellan for operating the ammonia line are credited to its cost of service, the related expenses are offset, Staff asserted that a mismatch of revenue and expense can occur, as Staff claimed it did during the Locked-In Period, when expenses exceeded revenues, and during the 2006 Base Year Period, when revenues exceeded expenses. *Id.* at pp. 61-62 (*citing* Exhibit No. S-4 at p. 16 tbl.2). Furthermore, emphasized Staff, Mid-America presented no evidence that it first calculated its total costs related to the ammonia pipeline and then guaranteed that it received and credited a sufficient payment from Magellan to offset those costs which it would be required to do under its revenue crediting approach. *Id.* at pp. 62-63.

855. Responding to Mid-America's claim that Staff, by removing expenses from the NH_3 Shared cost centers removed costs not only related to the Magellan ammonia pipeline, but also costs associated with Mid-America's natural gas liquids pipeline, it asserted, while admitting that costs recorded in that cost center may include those related

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to Mid-America's jurisdictional pipeline, that Mid-America fails to segregate the ammonia pipeline expenses from the latter expenses. *Id.* at p. 63.

856. In its Reply Brief, responding to Mid-America's claim that Staff removed some legitimate jurisdictional costs by removing from the cost of service all costs associated with cost centers shared by the ammonia pipeline and Mid-America's jurisdictional pipeline, Staff insisted that Mid-America, which it claimed carried the burden of proof on issues relating to the cost-of-service, failed to sustain its burden because its burden because it grouped jurisdictional and non-jurisdictional costs together in shared cost centers. Staff Reply Brief at pp. 52-53 (*citing* 49 U.S.C. app. § 15(7) (1998); *National Fuel Gas Supply Corp.,* 51 FERC ¶ 61,122 at p. 61,334 (1990) *aff'd on other grounds sub nom. National Association of Regulatory Utility Commissioners v. FERC,* 832 F.2d 1377 (10th Cir. 1987)).

Discussion and Ruling

857. As no party disputed that Magellan, the owner of the ammonia pipeline operated by Mid-America, makes payments to Mid-America for costs incurred from operation of the pipeline, the issue centers around the proper treatment of such costs and revenues. Specifically, the question is whether to exclude both the costs and revenues associated with the ammonia pipeline from Mid-America's cost-of-service or to include the costs and credit Magellan's payments against them.

858. Mid-America claimed that the payments from Magellan offset the expenses to which they relate, and thereby eliminate from Mid-America's operating expenses the costs related to operating the ammonia line. Mid-America Initial Brief at p. 94. Moreover, Mid-America asserted that Magellan pays it approximately $1.3 million per year to cover overhead costs associated with operating the ammonia pipeline. *Id.* at p. 95. In any event, Mid-America contended that the payments in total exceed the costs incurred by Mid-America in operating the ammonia line, and thus, its treatment of these expenses is conservative and serves to reduce Mid-America's operating expenses. *Id.* Finally, even were Staff's approach acceptable, Mid-America insisted that Staff incorrectly eliminated all of the expenses recorded in the NH_3 Shared cost center from Mid-America's cost-of-service. *Id.* at p. 96.

859. Asserting the ammonia pipeline is non-jurisdictional, Staff submitted that the operating expenses associated with the ammonia pipeline should be removed from Mid-America's cost-of-service (as Mid-America removed the costs associated with the ammonia pipeline from its rate base). Staff Initial Brief at p. 61. Contrary to Mid-America, Staff contended that a mismatch of revenue and expense can occur, as it did in Period I (expenses exceeded revenues) and Period II (revenues exceeded expenses). *Id.* at p. 62 (*citing* Exhibit No. S-4 at p. 16 tbl.2). Additionally, responding to Mid-America's claim that Staff removed some legitimate jurisdictional costs by

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removing from the cost-of-service all costs associated with the NH_3 shared cost center irrespective of the costs of the ammonia pipeline, it insisted that Mid-America carried the burden of proof on issues relating to the cost-of-service and failed to do so in grouping jurisdictional and non-jurisdictional costs together in shared cost centers. *Id.* at pp. 52-53.

860. For the following reasons, I conclude that both the costs and revenues associated with the Magellan ammonia pipeline should be excluded from Mid-America's cost-of-service. First, Mid-America removed the costs associated with the ammonia pipeline from its rate base because the ammonia pipeline is owned by Magellan and is non-jurisdictional. Exhibit Nos. NPG-1 at p. 42; M-24 at p. 15; Transcript at p. 715. For this same reason, operating expenses and revenues associated with the ammonia pipeline should be removed.[473] *See* Exhibit No. S-4 at p. 16.

861. Mid-America argued that there is no purpose in removing the costs associated with the ammonia line because the Magellan payments credited against its operating expense effectively eliminate such costs. Mid-America Initial Brief at p. 95. However, I find this argument to be unavailing. As Staff pointed out, Mid-America's operating expenses for the ammonia pipeline exceeded revenues for the March 2005 filing. Exhibit No. S-4 at p. 16. While the Magellan payments exceeded the expenses associated with the operation of the ammonia line for the March 2006 filing, Mid-America cannot guarantee that this will be the case in the future. In any event, including non-jurisdictional costs and revenues in a jurisdictional cost of service is simply inappropriate, even if the non-jurisdictional revenues exceed the non-jurisdictional costs. *See Mountain Fuel Supply Co.,* 27 FERC ¶ 61,316 at p. 61,587 (1984).

862. Second, Mid-America made a valid argument that Staff may have eliminated costs associated with the petroleum products pipeline from Mid-America's cost-of-service in eliminating all expenses recorded in the NH_3 Shared cost center. Mid-America Initial Brief at p. 96. However, Mid-America carried the burden of separating the jurisdictional expenses from the non-jurisdictional ammonia pipeline expenses[474] and failed to do so.

863. The record reflects that 75%-80% of the NH_3 shared costs relate to Mid-America's jurisdictional pipeline business and not the ammonia line. *See* Exhibit No. M-46 at p. 14 n.8. There, Mid-America witness Collingsworth stated: "[A] substantial majority (in the

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[473] There is an issue as to whether pipeline integrity program expenses associated with the ammonia pipeline should be removed, but that question is discussed under Issue No. 4.D.(4), *supra*.

[474] S*ee* 49 U.S.C. app. § 15(7) (1998); *National Fuel Gas Supply Corp.,* 51 FERC at p. 61.

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range of 75-80%) of the costs charged to the NH_3 shared accounts on the Northern System relate to non-ammonia line costs."[475] *Id.* Staff witness Sherman, during cross-examination, said she couldn't agree or disagree with this testimony because she "didn't know the basis [on which] he made the statement," but later agreed that "it appears that the natural gas liquids should have a portion of that cost included in the operating expenses." Transcript at pp. 2795-96, 2799.

864. While I agree with Staff that Mid-America improperly intermixed jurisdictional and non-jurisdictional expenses in the NH_3 Shared cost center, in view of the record described above, I conclude that Staff's elimination of all of the expenses recorded in that cost center is inappropriate. Mid-America has established that 21.26% of the costs in the NH_3 Shared cost center during the Locked-In Period and 20.6% of the costs in the NH_3 Shared cost center during the 2006 Base Period represent costs related to the ammonia pipeline. Exhibit No. M-165. Those costs should be removed from its cost-of-service for the respective test periods.

(6) What is the appropriate allocation of expenses to interstate and intrastate service?

A. MID-AMERICA

865. Mid-America explained that, while all the parties agree on a barrel-mile approach in allocating expenses between interstate and intrastate,[476] they disagreed on the appropriate volume figures. Mid-America Initial Brief at p. 98. Mid-America argued that its volume figures are the correct ones, and consequently, its interstate/intrastate allocation percentages should be used to determine interstate operating expenses. *Id.* (*citing* Exhibit Nos. M-111; M-112; M-113).[477]

B. PROPANE GROUP

866. The Propane Group agreed with Mid-America's methodology in separating interstate costs from intrastate costs — using a ratio of interstate barrel-miles to total barrel-miles. Propane Group Initial Brief at p. 90 (*citing* Exhibit No. M-24 at p. 11). Yet the Propane Group disputed Mid-America's volume adjustments that affect the calculation of the ratio of interstate barrel-miles to total barrel-miles. *Id.* Consequently,

[475] *See also* Exhibit Nos. M-165 at pp. 2-66; M-166.

[476] In support, Mid-America cited Exhibit Nos. M-111; M-112; M-113; M-102 at p. 20; M-103 at p. 20; M-104 at p. 20; NPG-110 at p. 20; S-12 at p. 12.

[477] Mid-America added nothing new in its Reply Brief. Mid-America Reply Brief at p. 75.

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the Propane Group asserted that its volume figures should be used. *Id.*[478]

C. WILLIAMS

867. Williams contended that the appropriate allocation of interstate and intrastate percentages should be determined by a barrel-mile approach. Williams Initial Brief at p. 51 (*citing* Exhibit No. S-4 at p. 13). It insisted that Staff's interstate percentages are appropriate — 98.15% for Period I and 98.06% for Period II. Williams Initial Brief at p. 51 (*citing* Exhibit Nos. S-4 at p. 13; S-5; S-6; S-7; S-8; S-11; S-12; S-13; S-14; S-17).

868. In reply, Williams departed from its support for Staff's figures and claimed that Mid-America's percentages are appropriate because its approach is "consistent with the underlying rate design principle that the 'locked-in' period should be used for Period I, and [because Staff is unwilling] to accept the locked-in period." Williams Reply Brief at pp. 44-45. Accordingly, Williams submitted that the percentage should be 98.54% for the Locked-In Period and 98.50% for Period II. *Id.* at p. 45 (*citing* Exhibit Nos. M-111; M-112).

D. COMMISSION TRIAL STAFF

869. Staff agreed that interstate allocation factors should be based on the ratio of interstate barrel-miles to total barrel-miles of throughput on Mid-America's system. Staff Initial Brief at p. 64 (*citing* Exhibit No. S-19 at pp. 6-13). It then suggested that the total system interstate allocation factor for Period I expenses is 98.15% and that the interstate allocation factor for Northern System expenses is 98.66%; and that, for Period II expenses, the total system interstate allocation factor is 98.60% and that the interstate allocation factor for Northern System expenses is 98.50%. *Id.* (citing Exhibit Nos. S-5 at p. 19; S-12 at p. 19).

870. In its Reply Brief, Staff argued that interstate expenses should be separated from intrastate expenses using a ratio of interstate barrel-miles to total system barrel-miles, except in the case of the Conway hub expense. Staff Reply Brief at p. 53 (*citing* Exhibit No. S-19 at pp. 6-13). Because the hub represents a point on the system and not miles of pipe, Staff submitted that these expenses should be allocated on the basis of barrels of throughput only. *Id.* at pp. 53-54 (*citing* Exhibit No. S-24 at pp. 1-2). Accordingly, Staff asserted that, for Conway hub expenses, the interstate allocation factor for the Northern System is 35.48% for Rate Period I and 35.56% for Rate Period II. *Id.* (*citing* Exhibit Nos. S-24 at pp. 1-2; S-19 at p. 15).

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[478] The Propane Group added nothing new in its Reply Brief. Propane Group Reply Brief at pp. 89-90.

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Discussion and Ruling

871. As all parties to this proceeding agree that the appropriate method for allocating expenses between interstate and intrastate service is the barrel-mile approach with the exclusion of the Conway hub expenses, the only issue left to be determined is the appropriate volume inputs, such as the appropriate period to determine the volumes and the proper characterization of certain volumes as interstate or intrastate.

872. Mid-America explained that while all the parties agree on a barrel-mile approach in allocating expenses between interstate and intrastate, they disagreed on the appropriate volume figures. Mid-America Initial Brief at p. 98; Propane Group Initial Brief at p. 90; Williams Reply Brief at p. 44; Staff Reply Brief at pp. 53-54. Arguing that its volume figures are appropriate, Mid-America advocated in support of the following interstate percentages for the Northern System: (1) for the May 2005-April 2006 period, 98.54%; (2) for the February 2005-January 2006 period, 98.50%; and (3) for the 2004 calendar year period, 98.85%.[479] *Id.*

873. Staff recommended that interstate expenses should be separated from intrastate expenses using a ratio of interstate barrel-miles to total system barrel-miles, except in the case of the Conway hub expense, which it argued should be allocated on the basis of barrels of throughput only because they represent points on the system and not miles of pipe. Staff Reply Brief at pp. 53-54. Specifically, Staff contended that the total system interstate allocation factor for Rate Period I expenses is 98.15%, and the interstate allocation factor for Northern System expenses is 98.66%. Staff Initial Brief at p. 65. In addition, it claimed that the total system interstate allocation factor for Rate Period II expenses is 98.60%, and the interstate allocation factor for Northern System expenses is 98.50%. *Id.* Finally, it maintained that, for Conway hub expenses, the interstate allocation factor for the Northern System is 35.48% for Rate Period I and 35.56% for Rate Period II. Staff Reply Brief at p. 54.

874. In my ruling on Issue No. 4.A.(4), I determined that the appropriate allocation of expenses to interstate and intrastate property should be made using barrel-miles, even for the expenses associated with the Conway hub. *See* discussion *supra* Issue No. 4.A.(4). The parties have given me no reason to alter that ruling here.[480]

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[479] Williams supported Mid-America's position. Williams Reply Brief at pp. 44-45.

[480] With respect to the appropriate throughput levels for each period and the proper treatment of the Channahon to Morris movement, the parties argued, and I discuss, these matters in ruling on Issue Nos. 5 and 7.A., respectively. Similarly, the issue as to whether the propane volumes moving between Clinton, Iowa, and Conway, Kansas,

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ISSUE NO. 5: WHAT IS THE APPROPRIATE LEVEL OF THROUGHPUT, IN BARRELS AND BARREL-MILES, FOR DESIGNING RATES FOR EACH PERIOD?

A. MID-AMERICA

875. For the FERC Tariff No. 38 Locked-In Period, Mid-America claimed that Ganz began with the volume data found in the company's books and subsequently made the following three adjustments to that data to reflect necessary normalizing adjustments: (1) updates in particular pipeline mileage data; (2) reclassification of movements from Channahon to Morris, Illinois, from interstate to intrastate; and (3) removal of propane volumes moved from Conway, Kansas, to Clinton, Iowa, that were returned to Mid-America by the East Red Line Shipper (avoiding double counting with volumes transferred by other shippers to destinations north of Clinton). Mid-America Initial Brief at p. 99 (*citing* Exhibit Nos. M-24 at pp. 27, 33-34; M-28; M-100 at p. 73). For the FERC Tariff No. 41 Test Year, Mid-America stated that Ganz began with the actual volume data for the Base Period February 1, 2005, through January 31, 2006, and subsequently applied the same three adjustments described above to that data. *Id.* (*citing* Exhibit Nos. M-24 at p. 52; M-112).

876. Conversely, explained Mid-America, the Propane Group used 2004 volumes to determine Northern System rates for each of the time periods at issue, alleging that the 2004 volumes are more representative. *Id.* Mid-America contended that the 2004 throughput data inflated Mid-America's assumed volumes significantly, and consequently, unfairly reduced the rates the Propane Group proposed in this case. *Id.* at p. 100. Even more, continued Mid-America, Staff departed from both Mid-America and the Propane Group and used actual data for the 12-month period October 2004 through September 2005 for FERC Tariff No. 38 and November 2005 through October 2006 for FERC Tariff No. 41. *Id.* Staff's approach, opined Mid-America, violates Commission base and test period regulations. *Id.* (*citing* 18 C.F.R. § 346.2(a) (2007)).

877. Claiming that Northern System volumes have been declining, Mid-America argued that its throughput figures are conservative and more representative of the actual and forward-looking periods at issue than is the data for the year 2004 advocated by the Propane Group. *Id.* at p. 101. It asserted that the 2004 volume level is atypically high when compared to the previous five years and that it is unlikely that a return to the 2004 volume level will occur in the foreseeable future. *Id.* Mid-America also noted that, while Northern System ethane/propane mix movements remained steady during the 2004

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should be treated as interstate or intrastate, and the issue as to whether the 3,650,000 barrel volume commitment by the East Red Line Shipper for transportation from Cochin pipeline to Conway, Kansas, should be treated as interstate or intrastate are discussed in my rulings on Issue Nos. 7.C. and 7.D, respectively.

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through 2006 period, and the movement of "heavies"[481] increased slightly during that period, propane volumes, which comprised a much higher percentage of total Northern System deliveries than do heavies, decreased dramatically. *Id.* at p. 102 (*citing* Exhibit Nos. M-46 at p. 24; M-49; M-51). Moreover, this declining trend, maintained Mid-America, is unlikely to be reversed in the foreseeable future for various reasons: (1) in the states served by the Northern System, propane typically has been used for home heating, cooking, and water heating, but currently, fewer homes are being built that use propane for those purposes; (2) in the states served by the Northern System, there has been a reduced demand for propane in agricultural uses due to the increased use of hybrid corn and the use of corn in ethanol production; (3) the local refineries and fractionators located in the areas served by the Northern System have increased their production of propane; and (4) Mid-America has been facing increased propane competition from the Kinder Morgan Cochin pipeline, which delivers propane from Canada. *Id.* at pp. 102-04 (*citing* Exhibit No. M-46 at pp. 25-26; M-137; Transcript at pp. 941-42, 945).

878. In response to the Propane Group's supposition that warmer than usual weather conditions in the winter of 2005 to 2006 was the real cause of the decline in Northern System throughput, Mid-America argued that the decline occurred not only in that particular winter, but also throughout the entire year. *Id.* at p. 104 (*citing* Exhibit Nos. M-46 at pp. 30-31; M-53; Transcript at pp. 948-49). Besides that, Mid-America asserted that the winter of 2005 to 2006 was normal, claiming it was actually colder than three others in the past nine years and was near the median of recent winters. *Id.* at pp. 104-05 (*citing* Exhibit Nos. M-100 at p. 18; M-120). It also declared that the heating degree day information on which the Propane Group witness, O'Loughlin, relied verified this claim. *Id.* at p. 105 (*citing* Exhibit Nos. M-152; NPG-1 at p. 51 fig.12; Transcript at pp. 2436-39). Stating that O'Loughlin was trying to ignore that more recent winters have been warmer than historic averages, Mid-America asserted: "Whether or not that is the result of global climate change (a development that Propane Group member ConcocoPhillips publicly acknowledged in April 2007), the 2005-06 winter season needs to be assessed in that context." *Id.* (*citing* Exhibit Nos. M-46 at pp. 29-30; M-52).

879. In effect, according to Mid-America, the Propane Group's use of 2004 volume levels will prevent Mid-America from recovering its full cost of service. *Id.* at p. 107. The difference between the Propane Group's and Mid-America's volume levels is approximately six million barrels per year in both the Locked-In Period and the Test Period. *Id.* In short, declared Mid-America, if these six million barrels do not move, as the evidence suggested they will not, Mid-America will not have a reasonable opportunity to recover its Northern System cost of service. *Id.*

880. Not only did Mid-America suggest that there are flaws in the rationale supporting

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[481] "Heavies" include butane, isobutane, natural gasoline, and naphtha. Mid-America Initial Brief at p. 102 (*citing* Exhibit Nos. M-46 at p. 24; M-51).

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the Propane Group's approach, it also claimed there are flaws in the application of the Propane Group's approach. *Id.* Mid-America stated that the Propane Group developed a factor representing the ratio between actual period volumes and the 2004 volumes and multiplied the volumes for each movement by this factor. *Id.* According to Mid-America, the Propane Group incorrectly applied this factor to ethane/propane mix and the heavies, which are not weather dependent. *Id.* at p. 108. Moreover, Mid-America maintained that the Propane Group produced implausible results because it applied a single factor to all movements. *Id.* As example Mid-America stated that, although no barrels moved between Conway and Ft. Madison in 2004, the Propane Group's rate design calculation increased the volumes for that movement above the amount that actually moved during the Locked-In Period and the FERC Tariff No. 41 Base Period. *Id.* (*citing* Transcript at pp. 2404-06; Exhibit No. M-121). The effect of this misapplication, Mid-America contended, is that the Propane Group's resulting volumes calculated for individual movements unfairly shift volumes (and thus costs) away from propane movements and onto movements of other products. *Id.*

881. Next, Mid-America argued that Staff's approach violated the Commission's regulations, as it deviated without cause from the essential base/test period structure and created a test period adjustment without any evidence that its proposed throughput represents a proper, known and measurable change. *Id.* at p. 109 (*citing* 18 C.F.R. § 346.2(a)). Although the known and measurable change standard does not apply in the case of the Locked-In Period, Mid-America argued that no reason can be shown for making normalizing adjustments. *Id.* It argued, there is no evidence suggesting the actual throughput experienced during the Locked-In Period was atypical, much less that some other level — the 2004 Northern System throughput — was more typical. *Id.*

882. In its Reply Brief, Mid-America first addressed the differences in Staff's approach from its own, namely, (1) for FERC Tariff No. 38, Staff does not use actual Locked-In Period data, and (2) for both FERC Tariff No. 38 and FERC Tariff No. 41, Staff used actual data for a 12-month period ending with the last month of the Test Period without demonstrating that such data reflected appropriate known and measurable changes or normalizing adjustments to Base Period data. Mid-America Reply Brief at p. 76. Essentially, Mid-America explained that Staff diverged from Mid-America's throughput data used in evaluating the FERC Tariff No. 38 rates because Staff disagreed with the propriety of evaluating those rates on a locked-in period basis. *Id.* As to the second difference, Mid-America contended that Staff completely departed from the Base Period it claimed to support and replaced the data for that period with actual data for the period November 1, 2006 through October 31, 2006, which is effectively a locked-in period and impermissible under the Commission's regulations. *Id.* at p. 77. Finally, Mid-America insisted that Staff failed to demonstrate that the throughput data it supported is representative of the period in which the rates are expected to remain in effect. *Id.* at p. 78.

883. Next, Mid-America attacked the Propane Group's attempt to include pipeline integrity testing as a factor that allegedly reduced Northern System volumes during the Locked-In Period and the FERC Tariff No. 41 Base Period because the only testimony on that issue related to reductions in pressure on the East Red Line, which was not linked to any specific level of reduction in volumes. *Id.* In any case, Mid-America stated that the East Red Line moves only ethane/propane mix volumes, not purity propane, which decreased less than 5% between 2004 and 2006, not more than 9% as the Propane Group alleged, and increased from 2005 to 2006. *Id.* (*citing* Exhibit No. M-49).

884. Finally, Mid-America criticized the Propane Group's reliance on a presentation Mid-America made to investors in 2007, which estimated Northern System volumes as being between 45 and 53 million barrels. *Id.* at p. 81. Mid-America explained that the throughput figures in that presentation included both interstate and intrastate barrels and failed to include adjustments for the barrels associated with the Item 150 propane credit discussed under Issue No. 7.D, *infra*. *Id.* (*citing* Transcript at pp. 1733-35).

B. PROPANE GROUP

885. While they claimed that both they and Mid-America agreed that the 2004 Base Period volumes should be used for the 2005 Test Year, the Propane Group stated that, while Mid-America would use the 2005-06 Locked-In Period volume to establish the rates for FERC Tariff No. 38, they would use the 2004 Base Period volumes also. Propane Group Initial Brief at p. 92. Adjustments to base and test period data are appropriate, claimed the Propane Group, where the data is not representative going forward and would result in unreasonable rates. *Id.* at p. 93 (*citing Southwestern Public Service Co. v. FERC*, 952 F.2d 555, 556-58 (D.C. Cir. 1992)). According to the Propane Group, this is the case here, as an adjustment accounts for the abnormally warm weather in the 2005 and 2006 time frame. *Id.* at pp. 93-94. Moreover, the Propane Group contended that its position is in line with Commission policy favoring the use of data outside the test year where test period figures "would yield unreasonable results." *Id.* at p. 94 (*quoting National Fuel Gas Supply Corp.,* 51 FERC at p. 61,334).

886. The Propane Group contested Mid-America's proposed volume levels as unrepresentative and unreasonable for designing rates on a going-forward basis. *Id.* Lower actual volume levels for the 2005/06 Locked-In Period and the 2006 Base Period, the Propane Group insisted, reflected three adjustments (two of which the Propane Group claimed are improper) to the Northern System barrels and barrel-miles, to wit: the removal of the Conway to Clinton propane volumes, the removal of the Channahon to Morris ethane/propane mix volumes, and the change in mileage used to calculate barrel-miles for volumes received from Cochin pipeline (which the Propane Group did not dispute). *Id.* In addition to the improper adjustments and the abnormally warm weather, the Propane Group added that the extensive pipeline integrity testing during the 2006 Base Period makes the 2006 Base Period volumes unrepresentative. *Id.* at p. 95 (*citing*

Exhibit No. NPG-1 at pp. 149-152).

887. Unlike gas pipeline and electric cases where contract quantities are known, stated the Propane Group, oil pipelines recover their costs through a volumetric charge. *Id.* Therefore, they asserted, volumes designated in a rate case have a significant impact on a pipeline's recovery of its costs. *Id.* The Propane Group added, should the volume level be set too low, the pipeline will "over-recover its cost of service when the resulting rates are applied to a normal level of throughput." *Id.* According to the Propane Group, weather conditions reduced propane throughput on the Northern System rendering the "volumes during the 2005/06 Locked-In Period and the 2006 Base and Test Periods" unusable for designing forward-looking rates. *Id.* at pp. 195-96 (*citing* Exhibit No. NPG-1 at pp. 149-52).

888. In support of its assertion that propane volumes were lower than usual in 2005 and 2006 due to the unseasonably warm weather in 2005 and 2006, the Propane Group referred to Mid-America's own internal correspondence as indicating that unseasonably warm weather was the cause of its less than anticipated propane volumes. *Id.* at p. 96 (*citing* Transcript at p. 503; Exhibit Nos. NPG-1 at p. 149; NPG-84 at pp. 4, 5-7). Additionally, the Propane Group claimed that data from the National Oceanic and Atmospheric Administration of the U.S. Department of Commerce showed that the winter of 2005/2006 was much warmer than normal (as measured by the 30-year data for the winter heating season November to March). *Id.* at pp. 96-97 (*citing* Exhibit No. NPG-1 at pp. 149-52). According to them, also, Mid-America's own analysis showed a relationship between heating degree-days and volume. *Id.* (*citing* Exhibit No. NPG-158; Transcript at pp. 497-500, 623-24). Thus, the Propane Group asserted that "the uncontested record evidence . . . demonstrates abnormal weather conditions in 2005 and 2006, . . . shifting the burden to Mid-America" to prove that such volumes would not result in unreasonable rates, which it failed to do. *Id.* at pp. 97-98 (*citing Southwestern Public Service Co. v. FERC,* 952 F.2d at pp. 556-58; *National Fuel Gas Supply Corp.,* 51 FERC at p. 61,334).

889. Further, according to the Propane Group, the record reflects that: (1) propane deliveries to Northern System terminals were at average volumes for the 1990-2006 period; (2) the 2004 volumes were at the average for the 1990-2006 period; (3) the volumes for 2005 were below the average for the 1990-2006 period; (4) the volumes for 2006 were significantly below the average for the 1990-2006 period; and (5) "propane deliveries from January through May 2007 [were] higher than in 2006 despite the fact that the weather continue[d] to be warmer than normal throughout the 2005 through 2007 period." *Id.* at p. 99 (*citing* Exhibit Nos. NPG-1 at pp. 1, 32; NPG-210; M-46 at p. 24; M-50 at p. 1; Transcript at pp. 491-93, 496-97).

890. In addition, the Propane Group declared that Mid-America witness Ganz used actual 2006 Base Period volumes of, approximately, 35 million barrels for designing rates

on the Northern System even though a March 29, 2007, investor presentation given by Mid-America witness Collingsworth represented Northern System volumes as between 45 and 53 million barrels. *Id.* at pp. 100-01 (*citing* Exhibit Nos. NPG-214 at pp. 6-7; NPG-144; Transcript at pp. 1733-34). Furthermore, the Propane Group stressed, neither witness could reconcile the difference. *Id.* at p. 101 (*citing* Transcript at pp. 458-459, 1733-34).

891. The Propane Group, while continuing to press its attack on Mid-America's proposal stated that Staff's use of Test Period actuals was more representative of volume levels than Mid-America's Base Period actuals. *Id.* at pp. 101-02 (*citing Trunkline Gas Co.*, 90 FERC ¶ 61,017 at p. 61,081 (2000)).

892. Finally, in addressing Mid-America's claim that propane volumes will continue to decline on the Northern System, the Propane Group asserted that Mid-America presented no evidence demonstrating a reduced demand for propane in residential or agricultural uses. *Id.* at p. 102. To the contrary, they asserted, without indicating that the presentation did not apply to the areas served by the Northern System, a presentation by Vicent Di Cosimo, Vice President, Marketing, Enterprise Products Partners, indicated that the United States level of residential demand for propane was increasing. *Id.* at p. 103 (*citing* Exhibit No. NPG-160 at pp. 10, 13-14, 18; Transcript at pp. 504-08). Furthermore, the Propane Group insisted that Mid-America witness Collingsworth's statement that increased propane production at local refineries in Kansas and Illinois resulted in a decrease in pipeline usage was contradicted by evidence that production has not increased in those two states, or in Minnesota, the only other state served by the Northern System. *Id.* at pp. 103-04 (*citing* Exhibit Nos. NPG-161 at p. 1; NPG-164 at pp. 3-4; Transcript at pp. 516, 518, 525, 527-28). In addition, the Propane Group claimed that Mid-America's assertion regarding competition from the Kinder Morgan Cochin pipeline is unsupported because Mid-America witness Collingsworth could not identify any shipper or volume that Mid-America had lost to Cochin pipeline. *Id.* at pp. 104-05 (*citing* Transcript at pp. 440-43).

893. In reply, the Propane Group noted that 2.4 million barrels of the 5.8 million barrels associated with its "scaling" adjustment (*i.e.,* the use of 2004 Base Period volumes as representative of 2006 Test Period conditions) are attributed to the East Red Line Shipper. Propane Group Reply Brief at p. 97. Thus, they asserted that, when the East Red Line Shipper's volumes are properly accounted for, their scaling adjustment for the propane and heavies combined is only 3,333,576 barrels. *Id.* at p. 99. Also, the Propane Group maintained that the route-by-route volume figures reported in Exhibit Nos. NPG-108 and NPG-112 are irrelevant to its rate design calculations, as the route-by-route volumes do not enter into the unit rate components and thus do not enter into the rate design calculation of the Northern System rates. *Id.* at pp. 91-92, 101-03.

894. With respect to Mid-America's analysis, the Propane Group insisted that

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Mid-America's use of the Locked-In Period runs the risk of retroactive ratemaking and unreasonably permits a riskless cost of service. *Id.* at pp. 94-95 (*citing Williston Basin Interstate Pipeline Co.,* 56 FERC at p. 61,353).

895. Contrary to Staff, the Propane Group submitted that the Channahon-to-Morris movement be treated as an interstate movement for purposes of FERC Tariff No. 41. *Id.* at p. 104.

C. WILLIAMS

896. Williams suggested that the appropriate level of throughput for designing rates for Period I is the Northern System's 36,291,835 interstate barrels per year and 16,278,114,360 interstate barrel-miles per year. Williams Initial Brief at p. 51 (*citing* Exhibit No. M-28). Also, it submitted that the appropriate level of throughput for designing rates for Period II is the Test Period total Mid-America Pipeline System figures of 35,110,000 barrels per year and 15,532,723,000 barrel-miles per year. *Id.* (*citing* Exhibit No. M-40 at p. 2). It supported Mid-America's suggestion that "a locked-in period and actual costs (versus estimated costs) . . . be utilized for rate calculations." *Id.* at p. 52 (*citing* Transcript at pp. 1892-93, 2758-59). Williams also contended that, as the parties agreed that the Test Period related to the March 2006 filing should be used, the appropriate throughput in barrels for Period II is 35,110,000 and 15,523,723 barrel/miles. *Id.* at p. 53 (*citing* Exhibit M-40 at p. 2).

897. In reply, Williams disputed the Propane Group's use of the 2004 Base Period volumes insisting that they do not represent going-forward volumes. *Id.* at p. 48. For example, Williams pointed out, even the Propane Group acknowledged significant decline in propane deliveries on the Northern System between 2004 and 2006. *Id.*

D. COMMISSION TRIAL STAFF

898. Claiming it is in accordance with Commission regulation and precedent, Staff advocated the use of the 12-month actual throughput data through the end of the Test Periods for designing rates for both FERC Tariff No. 38 and FERC Tariff No. 41. Staff Initial Brief at p. 66 (*citing* Exhibit No. S-19 at p. 5). Specifically, Staff insisted that a 2004 Base Period for FERC Tariff No. 38 and a test period ending September 30, 2005, nine months after the base period, are appropriate. *Id.* at p. 67 (*citing* Exhibit No. S-19 at p. 3). With respect to FERC Tariff No. 41, Staff suggested a Base Period of February 1, 2005, to January 31, 2006, with a test period adjusted for known and measurable changes through October 31, 2006, to be appropriate. *Id.* at p. 68. In other words, Staff used the 12-month actual data from October 1, 2004, to September 30, 2005, to evaluate FERC Tariff No. 38, and the 12-month actual data from November 1, 2005, to October 31, 2006, to evaluate FERC Tariff No. 41. *Id.* (*citing* Exhibit No. S-19 at p. 4). Accordingly, for FERC Tariff No. 38, Staff supported a total throughput level of 226,108,133 barrels

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and 85,743,682,100 barrel-miles; for FERC Tariff No. 41, Staff supported a level of 221,005,399 barrels and 83,763,023,692 barrel-miles. *Id.* at pp. 69-70 (*citing* Exhibit No. S-19 at pp. 8, 12).

899. According to Staff, the goal of regulation is to achieve a just and reasonable rate rooted in the base period cost-of-service data. *Id.* at p. 70 (*citing Iroquois Gas Transmission System*, 84 FERC ¶ 61,086 at p. 61,473 (1998)). Thus, Staff stated that it used Mid-America's actual Test Period throughput data, adjusted for known and measurable changes. *Id.* Also, Staff claimed it accepted Mid-America's mileage adjustments for both tariffs and Mid-America's reclassification of the Channahon, Illinois, to Morris, Illinois, movement from interstate to intrastate for FERC Tariff No. 41. *Id.* at pp. 71-72 (*citing* Exhibit No. S-19 at pp. 5, 12). Finally, Staff adopted the change in name of the origin points for North Pool Holding to Cochin Pipeline West Holding and Cochin Pipeline East Holding to comply with Mid-America's transmittal letter for the FERC Tariff No. 41 filing. *Id.* at p. 71 (*citing* Exhibit No. S-19 at p. 13).

900. However, Staff asserted that it rejected Mid-America's reclassification of the Channahon to Morris movement from interstate to intrastate for FERC Tariff No. 38 purposes because this change did not occur until January 2006, well after Staff's Test Period for FERC Tariff No. 38 ended (September 30, 2005). *Id.* at p. 71 (*citing* 18 C.F.R. § 346.2(a)(1)(ii)). Also, Staff declared that it rejected, for both periods, Mid-America's proposal to reduce the historical throughput data for propane volumes that moved from Conway, Kansas, to Clinton, Iowa. *Id.* at p. 72 (*citing* Exhibit No. S-19 at p. 9).

901. In reply, Staff opposed Mid-America's use of volume data from a locked-in period for FERC Tariff No. 38 because, according to it, there is no Commission regulation permitting the use of volume data from a locked-in period. Staff Reply Brief at p. 56.[482] As for FERC Tariff No. 41, Staff disputed Mid-America's use of actual volume data for the Base Period February 1, 2005, through January 31, 2006, because it claimed that the Commission has approved the use of actual volume data through the end of the test period where those data are representative of the pipeline's experience for the relevant period, and for both FERC Tariff No. 38 and FERC Tariff No. 41, Mid-America's actual throughput data are available through the end of the test period. *Id.* at p. 57 (*citing Iroquois Gas Transmission System,* 84 FERC at p. 61,473; *Williston Basin Interstate Pipeline Co.,* 67 FERC at p. 61,375; 18 C.F.R. § 346.2(b)(2) (2007)).

902. Next, Staff stated that, while it agreed with the Propane Group that Mid-America's volumes for FERC Tariff No. 41 are abnormally low and Mid-America's volumes for FERC Tariff No. 38 are unrepresentative, it diverged from the Propane Group regarding the appropriate measurement of Mid-America's throughput. *Id.* at pp. 60-61. Because the 2004 Base Period volumes (which the Propane Group proposed) do not represent data

[482] In support, Staff cited 18 C.F.R. § 346.2(b)(2) (2007).

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as recent as Staff's actual volumes through the end of the Test Periods, Staff argued that actual adjusted throughput data through the end of the test periods are more representative of Mid-America's throughput than the 2004 Base Period volumes. *Id.* at p. 61. Staff asserted that the actual adjusted throughput data through the end of the test periods capture recent, known and measurable throughput levels. *Id.*

Discussion and Ruling

903. The parties have presented three proposals for the appropriate level of throughput. Mid-America advocated, for FERC Tariff No. 38, the actual Locked-In Period throughput levels, and for FERC Tariff No. 41, the actual volume levels for the Base Period February 1, 2005, through January 31, 2006. Mid-America Initial Brief at p. 99.[483] In addition, Mid-America suggested the following three adjustments should be made to the actual volume data: (1) updates in particular pipeline mileage data; (2) reclassification of movements from Channahon to Morris, Illinois, from interstate to intrastate; and (3) removal of propane volumes moved from Conway, Kansas, to Clinton, Iowa, that are returned to Mid-America by the East Red Line Shipper.[484] *Id.*

904. In contrast with Mid-America, the Propane Group proposed, for both FERC Tariff No. 38 and FERC Tariff No. 41, the use of the volume levels of the Base Period January 1, 2004, through December 31, 2004. Propane Group Initial Brief at p. 92. Claiming the 2004 volumes are more representative of Mid-America's future volume levels, the Propane Group argued that deviation from test period data is appropriate. *Id.* at p. 93.

905. For FERC Tariff No. 38, Staff advocated the use of the 12-month actual throughput data from October 1, 2004, through September 30, 2005, and, for FERC Tariff No. 41, the use of the 12-month actual data from November 1, 2005, through October 31, 2006. Staff Initial Brief at p. 68. According to Staff, the Commission adopts the use of actual volume data through the end of the test period where those data are representative of the pipeline's experience for the relevant test period. Staff Reply Brief at p. 57.

906. For both FERC Tariff No. 38 and FERC Tariff No. 41 purposes, I accept Staff's proposal. Specifically, I accept the use of the 12-month actual throughput data for the Test Period related to the March 2005 filing, October 1, 2004, through September 30, 2005, for designing the FERC Tariff No. 38 rate, and similarly, I accept the use of the 12-month actual throughput data for the Test Period related to the March 2006 Filing,

[483] Williams agreed with Mid-America's proposal. Williams Initial Brief at pp. 52-53.

[484] The second and third proposed adjustments are addressed in my rulings on Issue No. 7.A. and Issue No. 7.D, respectively.

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November 1, 2005, through October 31, 2006, for designing the FERC Tariff No. 41 rate.[485]

907. Commission policy prefers the "latest test period actual data because it generally provides the best evidence of representative data." *Williston Basin Interstate Pipeline Co.,* 71 FERC at p. 61,081. "[U]nless there is a good reason to use other data," the Commission generally uses test period amounts." *Williston Basin Interstate Pipeline Co.,* 67 FERC at p. 61,364 n.51. Accordingly, because Mid-America's actual throughput data are available through the end of the Test Periods and capture recent, known, and measurable throughput levels, I accept such data in designing rates for both FERC Tariff No. 38 and FERC Tariff No. 41.[486]

908. In other words, for FERC Tariff No. 38, I conclude that Mid-America's use of actual locked-in period volumes is inappropriate, as Mid-America's Locked-In Period continues seven months past the end of the FERC Tariff No. 38 Test Period even though Mid-America did not demonstrate good reason to deviate from the Test Period data. *See* Exhibit No. S-19 at pp. 8, 12.[487] Moreover, Mid-America's Locked-In Period volume levels appear to be unrepresentative of its future volume levels because (1) it improperly removed particular volumes relating to the East Red Line Shipper;[488] and (2) it failed to submit substantial evidence that the lower Locked-In Period volume levels will continue. *See* Transcript at pp. 440-44, 516, 527-28, 572-73, 948-49; Exhibit Nos. NPG-161; NPG-164.

909. Additionally, while the Propane Group's throughput proposal stays within the FERC Tariff No. 38 Base and Test Periods, the actual end-of-test period throughput data is more recent, and thus more representative of Mid-America's future throughput levels associated with FERC Tariff No. 38. *See* Exhibit No. S-19 at pp. 4-5.

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[485] However, I do not accept one adjustment made by Staff — the reclassification of the Conway-to-Clinton movements as intrastate for FERC Tariff No. 41— and Staff's volume throughput for FERC Tariff No. 41 will have to be adjusted accordingly. *See* discussion *infra* Issue No. 7.A.

[486] No party contested Mid-America's proposed mileage adjustments for both periods. In fact, Staff's volume levels adopted such adjustments, and I find them to be appropriate. Exhibit No. S-19 at p. 5.

[487] See also *supra* Issue No. 2 where the inappropriateness of the use of a locked-in period in this proceeding was discussed.

[488] *See* discussion *infra* Issue Nos. 7.A. and 7.D where the question of these adjustments is addressed.

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910. Similarly, for FERC Tariff No. 41, I conclude that the Propane Group's use of the FERC Tariff No. 38 Base Period (the 2004 calendar year) throughput levels in designing the FERC Tariff No. 41 rate is inappropriate. While the record suggests that the actual FERC Tariff No. 41 Base Period volume levels are unrepresentatively low, the Propane Group failed to present good reason to deviate from the actual FERC Tariff No. 41 Test Period volume levels. The actual FERC Tariff No. 38 Base Period volumes do not capture data as recent as Staff's actual volumes through the end of the Test Period, and consequently, I find that the best indicator of the Mid-America's future throughput levels is the FERC Tariff No. 41 Test Period data. *See* Exhibit No. S-19 at pp. 4-5.

ISSUE NO. 6: WHAT IS THE PROPER TREATMENT OF STORAGE COSTS AND REVENUES?

A. ARE THE STORAGE SERVICES MID-AMERICA OFFERS TO ITS SHIPPERS WITHIN THE JURISDICTION OF THE COMMISSION?[489]

A. MID-AMERICA

911. In its Initial Brief, Mid-America contended that its operational storage is jurisdictional because it is offered as a necessary part of transportation, while its merchant storage is not jurisdictional because it is offered only for the convenience of shippers. Mid-America Initial Brief at p. 110. Further, Mid-America declared that Staff's assertion that all of its storage services are jurisdictional is procedurally and substantively incorrect. *Id.* at p. 111.

912. As a matter of procedure, Mid-America asserted that, since neither FERC Tariff No. 38 nor FERC Tariff No. 41 proposed changes to the storage service under the prior tariffs, and since the issue was not raised in the protests, Staff has no basis on which to challenge the jurisdictional status of Mid-America's provision of merchant storage. *Id.* at pp. 111-112 (*citing* Interstate Commerce Act § 15(7); *BP West Coast Products, LLC v. FERC,* 374 F.3d at p. 1278; *SFPP, L.P.*, 63 FERC ¶ 61,014 at p. 61,125 (1993)).

913. Mid-America insisted that, even were there no procedural issue here, Staff's claim is still substantively incorrect. *Id.* Whether a storage service is jurisdictional or not, maintained Mid-America, depends upon the circumstances of the storage. *Id.* at p. 112. Specifically, it stated, "[T]he test is whether the service in question is so essential to transportation that the carrier has a duty to provide it, or whether, instead, the service is merely a matter of convenience to shippers, without which adequate transportation service could still be provided." *Id.* (*citing Lakehead Pipe Line Co., L.P.,* 71 FERC at

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[489] Williams did not address this issue. Williams Initial Brief at p. 53; Williams Reply Brief at p. 50

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p. 62,325).

914. Several factors, according to Mid-America, indicate that Mid-America's merchant storage is non-jurisdictional. *Id.* at p. 113. First, Mid-America claimed, its merchant storage is not physically necessary for transportation to occur. *Id.* at pp. 113-14. Unlike the situation in *Lakehead Pipe Line*, Mid-America maintained, where the Commission held that a pipeline had a duty to provide physical facilities essential to a complete system, the merchant storage at issue in this case is entirely optional and is offered at origin and destination points on the line. *Id.* at p. 114 (*citing* Exhibit Nos. M-46 at p. 60; M-63). Mid-America pointed out that no shipper elected to purchase the additional storage at Hobbs during any period at issue. *Id.* In the same way, Mid-America insisted that, at Conway and Pine Bend, the merchant storage is not physically necessary to move product from one point to another. *Id.* (*citing* Exhibit Nos. M-46 at p. 66; M-63).

915. Second, according to Mid-America, jurisdictional storage must occur either during transit or immediately before or after the transportation function occurs. *Id.* at p. 114.[490] It added, "[s]torage that is not related to immediate delivery or receipt, but which occurs over a longer period, is not jurisdictional." *Id.* at pp. 114-115.[491] At Hobbs, declared Mid-America, the storage that occurs, if at all, is long term, and similarly at Conway, the merchant storage occurs for periods that are longer than that required for immediate receipt or delivery, since Mid-America already offers a basic level of storage without charge. *Id.* at p. 115 (*citing* Exhibit Nos. M-63; M-46 at p. 60). Furthermore, because both Hobbs and Conway are large trading hubs for natural gas liquids, and shippers store product at both locations while deciding whether to move the product on Mid-America or another pipeline, sell it, or continue to store it, the service is non-jurisdictional because the product is ultimately under the shippers' control. *Id.* (*citing Kerr-McGee Refining Corp. v. Williams Pipe Line Co.,* 72 FERC ¶ 61,274 at p. 62,198 (2006)).

916. Third, Mid-America stated, many non-pipeline companies offer similar storage services as those at issue in this proceeding and such storage is non-jurisdictional. *Id.* at p. 115 (*citing Thompson v. Chicago, Burlington & Quincy R.R. Co.,* 157 I.C.C. 775, 778 (1929)). Collingsworth, its witness, according to Mid-America, testified that there were eight to twelve different companies with salt dome caverns that lease storage at Conway. *Id.* at p. 116 (*citing* Exhibit No. M-46 at p. 66; Transcript at p. 710).

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[490] In support, Mid-America cited *Practices of Carriers Affecting Operating Revenues and Expenses,* 198 I.C.C. 134, 195 (1933).

[491] In support, Mid-America cited *Coastal States Trading, Inc., v. Shell Pipeline Corp.,* 573 F.Supp. 1415, 1422 (S.D. Tex. 1983); *Consolidation Rule on Shipments at Seattle & Spokane, Wash.,* 22 M.C.C. 295, 299 (1940); *Reconsignment and Storage of Lumber and Shingles,* 27 I.C.C. 451, 456 (1913).

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917. A fourth factor, according to Mid-America, is how the service is treated by the oil pipeline industry and the industry, it added, generally treats storage services as non-jurisdictional. *Id.* at p. 116 (*citing Tipco Crude Oil Co. v. Shell Pipe Line Corp.*, 19 FERC ¶ 61,105 at p. 61,198 (1982); Exhibit Nos. M-100 at p. 52; M-46 at pp. 60, 62). Mid-America also noted that even Staff witness Pride admitted that the oil pipeline industry typically treats storage as non-jurisdictional and could recall only three tariffs with published storage rates. *Id.* (*citing* Transcript at pp. 2919, 2932-33).

918. In reply, Mid-America attacked the Propane Group's claim that the storage at Iowa City and Greenwood is not jurisdictional because it has been rendered unnecessary by the Propane Supply Assurance Program. Mid-America Reply Brief at p. 83. According to Mid-America, the storage at these locations is operational storage and increases the amount of product that can be supplied during periods of excess demand. *Id.* at p. 84 (*citing* Exhibit No. M-46 at p. 58; Transcript at pp. 669-70). In contrast, Mid-America maintained, the Propane Supply Assurance Program relieves seasonal supply constraints. *Id.* (*citing* Exhibit No. NPG-159 at p. 1; Transcript at pp. 462-63). Mid-America explained that, while the Propane Supply Assurance Program permits shippers on-demand service consistent with the capacity of the pipeline, the operational storage at Iowa City and Greenwood helps to increase the line's operational capacity and, therefore, is jurisdictional because it expands the role of the line pipe and pumps. *Id.* at pp. 85-86 (*citing* Exhibit No. M-46 at p. 58).

B. PROPANE GROUP

919. According to the Propane Group, the Greenwood and Iowa City storage services, are not operationally necessary and should not be included in the Northern System transportation rates. Propane Group Initial Brief at p. 107.[492] They reasoned that these facilities are not an integral part of the Northern System because Mid-America witness Collingsworth testified that Mid-America could operate the on-demand service[493] in the same way without the Iowa City and Greenwood storage facilities. *Id.* at p. 108 (*citing*

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[492] The Propane Group indicated that, while it agreed with Mid-America that the operational storage at Conway is jurisdictional and the merchant storage is not, it claimed that Mid-America failed to establish the amounts of operational storage and merchant storage at Conway. Propane Group Initial Brief at pp. 106-07. This question is addressed in Issue No. 6.B., *infra*.

[493] According to the Propane Group, the on-demand service allows a shipper to put product in at Conway and instantaneously withdraw product anywhere else on the system. Propane Group Initial Brief at p. 107 (*citing* Exhibit No. NPG-159). It added that Mid-America ensures this service by having product filling the line between Conway and points north, excluding the East Red Line and, at times, a segment between Mankato and Pine Bend. *Id.*

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Transcript at p. 671). Even if these storage facilities assisted Mid-America's Propane Supply Assurance Program in providing sufficient linefill during periods of high propane demand, or increased the efficiency of the on-demand service, the Propane Group contended that charging shippers twice for this function by including the cost of the Greenwood and Iowa City storage facilities in the Northern System transportation cost of service would be inappropriate as well as surcharging the Propane Supply Assurance Program.[494] *Id.* at pp. 109-10 (*citing* Exhibit Nos. NPG-155 at pp. 3-6; NPG-159 at pp. 1-2). Thus, submitted the Propane Group, Mid-America should not be allowed to use this proceeding to charge more for the same service. *Id.*[495]

C. COMMISSION TRIAL STAFF

920. Unlike Mid-America, Staff submitted that, under the Interstate Commerce Act and Commission precedent and regulation, all of Mid-America's storage services are jurisdictional. Staff Initial Brief at pp. 73-77 (*citing* 49 U.S.C. app. §§ 1(3), 1(6), 6(1) (1988); *Lakehead Pipe Line Co.*, 71 FERC at p. 62,234; *Wolverine Pipe Line Co.*, 92 FERC ¶ 61,277 at p. 61,929 (2000)).[496] More particularly, Staff contended that Mid-America's merchant storage services at Conway, Hobbs, and Pine Bend are jurisdictional. *Id.* at p. 77 (*citing* Exhibit No. S-28 at p. 1). It further argued that Mid-America witness Collingsworth's claim that such storage is non-jurisdictional because it is not a necessary part of the transportation service Mid-America provides lacks legal and factual support. *Id.*[497]

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[494] The Propane Group noted that the surcharge was the subject of a dispute before the Commission and was approved. Propane Group Initial Brief at p. 110 (*citing Mid-America Pipeline Co.*, 104 FERC ¶ 61,263 at pp. 61,850-51 (2003)).

[495] In its Reply Brief, the Propane Group added nothing of substance to the arguments made in their Initial Brief. Propane Group Reply Brief at pp. 106-09.

[496] In support, Staff also cited *Kerr-McGee Refining Corp. and Texaco Marketing, Inc. v. Williams Pipe Line Co.*, 63 FERC ¶ 61,349 (1993). Mid-America correctly noted that, on rehearing, the Commission reversed its holding that the subject storage was jurisdictional. Mid-America Reply Brief at p. 83 (*citing Kerr-McGee Refining Corp. and Texaco Marketing, Inc. v. Williams Pipe Line Co.*, 72 FERC ¶ 61,274 (1995)). However, I must note that, while the Commission reversed its holding on the basis of evidence presented to it after its June 30, 1993, Order, it did not reconsider its remarks regarding the nature of regulation under the Interstate Commerce Act. *See Kerr-McGee Refining Corp. and Texaco Marketing, Inc. v. Williams Pipe Line Co.*, 63 FERC at pp. 63,219-20.

[497] In its Reply Brief, Staff added nothing of substance to the arguments made in its Initial Brief. Staff Reply Brief at pp. 62-66.

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Discussion and Ruling

921. The question is whether Mid-America's storage services are operationally necessary to the transportation of product on the Mid-America pipeline system, or whether they merely provide convenience to the shippers. To the extent Mid-America's storage is operationally necessary to the transportation of product, it falls within the Commission's jurisdiction. *Lakehead Pipe Line Co., L.P.,* 71 FERC at p. 62,325.

922. According to Mid-America, its operational storage is jurisdictional as it is an integral part of transportation, and conversely, its merchant storage is non-jurisdictional because it is offered only for the convenience of shippers. Mid-America Initial Brief at p. 110 (*citing Lakehead Pipe Line Co., L.P.,* 71 FERC at p. 62,325). Specifically addressing the Propane Group's position, Mid-America argued that its storage at Iowa City and Greenwood is jurisdictional and is not rendered unnecessary by the Propane Supply Assurance Program. Mid-America Reply Brief at p. 83. Similar to Mid-America, the Propane Group submitted that Mid-America's operational storage at Conway is jurisdictional, and its merchant storage is not. Propane Group Initial Brief at pp. 106-07. Yet it asserted that the storage services at Iowa City and Greenwood are not necessary operationally and, thus, are non-jurisdictional. *Id.* at p. 107. Unlike Mid-America and the Propane Group, Staff insisted that the Interstate Commerce Act confers jurisdiction on all of Mid-America's storage services. Staff Initial Brief at p. 73 (citing 49 U.S.C. app. §§ 1(3), 1(6), 6(1) (1988)).

923. Storage service is jurisdictional if the service is "so essential to transportation that the carrier has a duty to provide it . . . and [is] not merely a matter of convenience to shippers, without which adequate transportation service could still be provided." *Lakehead Pipe Line Co., L.P.,* 71 FERC at p. 62,325; *Coastal States Trading, Inc. v. Shell Pipeline Corp.,* 573 F. Supp. 1415, 1423 (S.D. Tex. 1983). As Mid-America's operational storage is offered as a necessary part of transportation, it is jurisdictional; while Mid-America's merchant storage is not jurisdictional because it is offered only for the convenience of shippers. *See* Exhibit Nos. M-46 at pp. 60, 63; M-63; M-46 at p. 68; Transcript at p. 710.

924. Having decided that Mid-America's operational storage is jurisdictional, and its merchant storage is non-jurisdictional, the question becomes whether Mid-America's particular storage services are operationally necessary or integral (operational storage), or whether they are merely for the shippers' convenience (merchant storage). I find, and the Propane Group conceded, that Conway provides both operational and merchant storage.[498] *See* Exhibit No. M-46 at pp. 59-60, 66.

[498] As previously noted, the question of how much of each takes place at Conway is addressed in the discussion of Issue No. 6.B.

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925. Further, I conclude that Mid-America's storage services at Greenwood and Iowa City have not been rendered unnecessary by the Propane Supply Assurance Program. The storage services at Greenwood and Iowa City serve to reduce the impact of periods where demand for pipeline transportation exceeds pipeline capacity. Exhibit No. M-46 at p. 58; Transcript at pp. 669-70. It accomplishes this by maximizing throughput and pumping capacity and allowing customers to have access to additional barrels during periods of high demand. *Id.* The Propane Supply Assurance Program, on the other hand, was not intended to affect periods when propane demand exceeds the maximum operational capabilities of the pipeline. Exhibit Nos. NPG-155 at pp. 3, 12; NPG-159 at p. 1; Transcript at pp. 462-63. Rather, the Propane Supply Assurance Program permits shippers on-demand service consistent with the capacity of the pipeline; it does not serve to increase the line's operational capacity (as does the storage service). *Id.* In other words, the role of the Propane Supply Assurance Program differs from that of the storage at Iowa City and Greenwood, and the former does not render the latter unnecessary. Accordingly, I find the storage at Iowa City and Greenwood to be operational storage, as it is certainly an integral part of transportation on the Mid-America pipeline system, increasing the efficiency of operation and capacity of the pipeline, and not merely increasing the convenience to shippers.

B. SHOULD MID-AMERICA INCLUDE A SEPARATE RATE FOR STORAGE IN ITS TARIFF, AND, IF SO, WHAT IS THE APPROPRIATE RATE?[499]

A. MID-AMERICA

926. Mid-America suggested, as do the other parties, that it should not be required to include a separate rate for operational storage in its tariff. Mid-America Initial Brief at p. 117. However, it stated that, while it takes the same position with regard to merchant storage, Staff asserted a contrary position. *Id.* (*citing* Exhibit No. S-26 at p. 10; Transcript at pp. 2926-28). As it did with regard to Issue No. 6.A, Mid-America argued that the Commission has no authority to require it to include a separate rate for storage in its tariff because neither FERC Tariff No. 38 nor FERC Tariff No. 41 proposed to change the storage service under the prior tariffs, the issue was not raised in any protest, and the Commission did not initiate a complaint investigation regarding this issue. *Id.* Furthermore, it added, even had Commission the authority to do so in this proceeding, Mid-America's merchant storage is not jurisdictional, and, thus, there is no basis for the Commission to require Mid-America to publish rates for that service in its tariff. *Id.* (*citing Tipco Crude Oil Co. v. Shell Pipe Line Corp.*, 19 FERC at p. 61,198).

927. In any event, Mid-America claimed that Staff's method for deriving a storage rate

[499] Williams did not address this issue. Williams Initial Brief at p. 53; Williams Reply Brief at p. 50.

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is without support. *Id.* at p. 118. First, while Staff derived a single storage rate for all of Mid-America's storage locations, Mid-America is unable to offer storage to individual shippers at Iowa City, Greenwood, and Mocane. *Id.* (*citing* Exhibit No. M-46 at p. 65; Transcript at p. 2950). Second, it claimed that Staff overstated the amount of storage capacity that is even theoretically available on a merchant basis by comparing the annual average amount of product stored in the caverns, instead of the amounts at peak demand, with the total cavern capacity. *Id.* (*citing* Exhibit Nos. M-46 at p. 66; M-66; Transcript at pp. 2962-70).

928. If, on the other hand, Mid-America were required to charge a separate rate for merchant storage in its tariff, it advocated the use of a market rate, which the Commission has permitted in cases where markets are competitive. *Id.* at p. 119 (*citing Natural Gas Pipeline Co.,* 41 FERC ¶ 61,119 at 61,288, *aff'd in relevant part*, 41 FERC ¶ 61,358 (1987); *Farmers Union Central Exchange, Inc. v. FERC,* 734 F.2d at 1509; *Distrigas Corp.,* 45 FERC at p. 62,354). Mid-America also claimed that, to the extent it is required to charge a separate rate for its merchant storage service, such a rate must be prospective only. *Id.* (*citing* 49 U.S.C. app. § 15(1) (1988)).

929. In reply, responding to Staff's claim that it did not distinguish operational storage from merchant storage, Mid-America asserted that it "eliminated any cross-subsidization by crediting all of the revenue received from the merchant storage functions against [its] cost of service" and that this "is an accepted method for determining the jurisdictional cost of service." Mid-America Reply Brief at p. 88.

B. PROPANE GROUP

930. The Propane Group declared that, because the Greenwood and Iowa City storage facilities are non-jurisdictional, there is no need for them to have a separate FERC tariff rate and their costs should not be included in the Northern System rates. Propane Group Initial Brief at p. 112. According to the Propane Group, both they and Mid-America agreed that the Greenwood and Iowa City storage facilities are not within the Commission's regulatory purview and, therefore, are not a part of Mid-America's tariff obligations. *Id.* (*citing* Exhibit Nos. M-37; M-100 at p. 65; Transcript at pp. 926, 2023, 2339). In view of this, the Propane Group insisted, the costs related to the operation of these facilities should be excluded from Mid-America's cost-of-service. *Id.* at pp. 112-13.

931. Insisting that "the record demonstrates that the Greenwood and Iowa City storage facilities do not benefit Northern System shippers," the Propane Group claimed that, were they providing any benefits, the shippers were already paying for the service under Mid-America's Propane Supply Assurance Program surcharge. *Id.* at p. 113.[500]

[500] Solely with regard to the claim related to the surcharge, in support, the Propane

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932. Addressing the leased storage used by Mid-America, the Propane Group noted that, in September 2004, Mid-America transferred its storage assets to Enterprise Terminals, an unregulated affiliate. *Id.* at p. 114 (*citing* Exhibit Nos. NPG-1 at pp. 60-61; NPG-39; NPG-40). They further stated that Enterprise Terminals then leased these facilities to Mid-America in a lease executed during October 2004, but effective in July 2004. *Id.* (*citing* Exhibit Nos. NPG-1 at p. 61; NPG-31). The Propane Group then suggested that the lease prices did not reflect arms length transactions. *Id.* at pp. 114-16 (*citing* Exhibit Nos. NPG-1 at pp. 61, 63-64; NPG-31; NPG-37; NPG-41; NPG-42; NPG-43; NPG-44; Transcript at pp. 263, 320, 709, 2009-10).

933. According to the Propane Group, Mid-America's cost of storage increased from $200,000, when it owned the storage, to $1 million after the transfer to Enterprise Terminals without any change in benefits to the shippers. *Id.* at p. 115 (*citing* Exhibit Nos. NPG-1 at p. 72; NPG-49; Transcript at p. 702, 1332). In addition, they asserted, even were the Greenwood and Iowa City storage services deemed operationally necessary (and thus jurisdictional), or even were they providing a beneficial service to shippers for which the shippers were not already paying a separate surcharge, including a separate rate in the tariff based on the costs of the lease agreement between Mid-America and Enterprise Terminals would be inappropriate. *Id.* at p. 116. They argued that the lease agreement between Mid-America and Enterprise Terminals artificially inflated costs, contrary to the Commission's rules for original cost ratemaking. *Id.*

934. Finally, to the extent the Conway storage is operationally necessary (and thus jurisdictional), the Propane Group agreed with Mid-America's decision not to include a separate rate in the tariff. *Id.* at pp. 116-17. If the Conway storage is found to be merchant storage (non-jurisdictional), the Propane Group suggested that neither the costs nor the revenues generated from this storage should be included in Mid-America's Northern System transportation cost-of-service, even under a separate rate. *Id.* at p. 117. To the extent merchant storage is found to be jurisdictional, the Propane Group asserted that the rate for Conway merchant storage should be unbundled from Mid-America's transportation rates. *Id*. (citing Exhibit No. S-26 at pp. 10-11).[501]

C. COMMISSION TRIAL STAFF

935. In its Initial Brief, Staff claimed that Mid-America's storage service is jurisdictional and suggested that the costs exclusively related to the shippers' use of

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Group cited Exhibit Nos. M-46 at p. 58; NPG-155 at pp. 3-6. Propane Group Initial Brief at p. 113.

[501] The Propane Group added nothing new in its Reply Brief. Propane Group Reply Brief at pp. 110-12.

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Mid-America's storage should be unbundled from its transportation rates. Staff Initial Brief at p. 77. It then added that Mid-America, in a compliance filing, should "be required to include separate storage rates and appropriate storage rules and regulations for storage associated exclusively with shipper use in tariffs." *Id.* at pp. 77-78. In connection with its suggestion, Staff recommended an annual rate of $1.3206 per barrel for FERC Tariff No. 38, and an annual rate of $1.3296 per barrel for FERC Tariff No. 41. *Id.* at p. 78 (*citing* Exhibit No. S-26 at p. 18; Transcript at pp. 2915-16).

936. In order to calculate those rates, Staff stated that it assumed that some of Mid-America's storage is operational and some is for shipper use.[502] *Id.* (*citing* Exhibit No. S-26 at p. 10). Staff declared that any storage not used for operational purposes is available for shipper use. *Id.* (*citing* Exhibit No. S-6 at p. 10; Transcript at p. 2914-15). The volumes available for shipper use are then divided into storage costs for shipper use, according to Staff, to calculate the rates. *Id.* (*citing* Exhibit No. S-26 at p. 18).

937. In its Reply Brief, Staff claimed that both the Interstate Commerce Act and the Commission's hearing order allowed Mid-America's storage services to be addressed. Staff Reply Brief at p. 68 (*citing* 49 U.S.C. app. § 13(1) (1988); *Mid-America Pipeline Co., LLC,* 111 FERC ¶ 61,128 at Ordering Paragraph (B)). Next, Staff disputed Mid-America's assertion that, to the extent Mid-America is ordered to charge a separate rate for merchant storage, such rate must be prospective only. *Id.* at p. 69. According to Staff, the Commission set Mid-America's tariffs for hearing under the Interstate Commerce Act sections 13(1) and 15(1), and thus is not bound by the provision in section 15(1) requiring prospective application. *Id.* at pp. 69-70 (*citing* 49 U.S.C. app. § 13(1), 15(1) (1988); *Mid-America Pipeline Co., LLC,* 111 FERC ¶ 61,128 at Ordering Paragraph (B)).

Discussion and Ruling

938. All parties agreed that Mid-America should not be required to include a separate rate for operational storage — storage that is integral to the transportation function — in its tariff. *See* Mid-America Initial Brief at p. 117; Propane Group Initial Brief at p. 112; Staff Initial Brief at p. 79. Thus, the question becomes whether Mid-America should be required to include a separate rate for merchant storage — storage offered for the convenience of individual shippers — in its tariff.[503]

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[502] It added that costs of operational storage should be included in Mid-America's transportation rates. Staff Initial Brief at p. 18 (*citing Panhandle Eastern Pipe Line Co.*, 62 FERC ¶ 61,288 at p. 62,840 (1993)).

[503] Procedurally, Mid-America declared that the Commission has no authority to order Mid-America to include a separate rate for storage in its tariff because neither FERC Tariff No. 38 nor FERC Tariff No. 41 proposed to change the storage service

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939. Asserting merchant storage is non-jurisdictional, Mid-America and the Propane Group argued that the Commission has no authority to direct Mid-America to publish rates for that service in its tariff. Mid-America Initial Brief at p. 117; Propane Group Initial Brief at p. 112. Accordingly, both parties insisted that, to the extent the Conway storage is operationally necessary to the transportation system, Mid-America should not be required to put it in a separate rate, and to the extent the Conway storage is merchant storage, Mid-America should not be required to publish rates for that service in its tariff.[504] Where the parties differ is in their characterization of the storage services at Greenwood and Iowa City.[505]

940. Unlike Mid-America and the Propane Group, Staff submitted that both operational and merchant storage are jurisdictional, but merchant storage costs should be unbundled from the transportation rates and included in a jurisdictional cost of service particular to shippers that use the storage. Staff Initial Brief at p. 77. Staff argued that Mid-America should be required to charge a separate rate for merchant storage in its tariff because shippers that do not use merchant storage service should not be required to pay for them. *Id.* at pp. 77-78.

941. As all parties agree, I find that Mid-America shall include the cost of its operational storage in its tariff. Because these costs are jurisdictional and are integral to the transportation on the Mid-America pipeline system, Mid-America should be permitted to recover such costs under its transportation rate. *See SFPP, L.P.,* 96 FERC ¶ 61,281 at p. 62,070.

942. However, after concluding in my discussion of Issue No. 6.A., *supra*, that storage which is offered solely for the convenience of individual shippers (merchant storage) is

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under the prior tariffs, the issue was not raised in any protest, and the Commission did not initiate a complaint investigation regarding this issue. Mid-America Initial Brief at p. 117. There is no merit to this argument. *See* 49 U.S.C. app. §§ 13(1), 15(1) (1988); *Mid-America Pipeline Co., LLC,* 111 FERC ¶ 61,128 at Ordering Paragraph (B).

[504] The Propane Group contended that neither the costs nor the revenues generated from the Conway merchant storage should be included in Mid-America's Northern System transportation cost of service, even under a separate rate. Propane Group Initial Brief at p. 117; Exhibit No. NPG-1 at p. 74. Mid-America, on the other hand, includes all storage costs and credits all storage revenues against the storage costs. Exhibit No. M-100 at p. 51.

[505] *See supra* Issue No. 6.A: The Propane Group contended the storage services at Greenwood and Iowa City are merchant storage and not operationally necessary, while Mid-America argued that such storage is operational storage.

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non-jurisdictional, these costs and revenues associated with non-jurisdictional merchant storage should not be included under separate rates in its tariff. *See Tipco Crude Oil Co. v. Shell Pipe Line Corp.,* 19 FERC at p. 61,198; *SFPP, L.P.,* 96 FERC at p. 62,070.

943. Accordingly, because I concluded under Issue No. 6.A., *supra*, that the storage services at Greenwood and Iowa City were *operational* storage, the costs and revenues associated with such storage shall be included under Mid-America's Northern System cost of service, but not as a separate rate. Similarly, the costs and revenues associated with the Conway storage that is operationally necessary shall be reflected under Mid-America's Northern System transportation rate.

944. The last question addressed is whether the costs and revenues associated with the Conway *merchant* storage should be included in Mid-America's Northern System cost-of-service. Had the instant record contained *any* evidence by which anyone could determine the percentages of Conway storage used for operational services or for merchant services, consistent with my holding in Issue No. 6.A., *supra*, I would hold that the latter ought not be included in Mid-America's cost-of-service. However, the record is missing any such evidence. As a result, I conclude that all of the storage services offered at Conway must be treated as operational storage and that all of the expenses and revenues associated with that service must be accounted for within the Northern System's jurisdictional cost-of-service. Therefore, in order to calculate the Northern System's cost-of-service, all revenues received for storage at Conway must be credited against all of the expenses necessary to provide the storage service at Conway during the applicable test periods involved in these matters. *See* Exhibit Nos. M-100 at pp. 50-53; M-108 at pp. 5-9; M-109 at pp. 5-9; NPG-1 at pp. 73-75.

C. SHOULD MID-AMERICA INCLUDE STORAGE COSTS IN ITS TRANSPORTATION RATES, AND IF SO WHAT IS THE APPROPRIATE AMOUNT?

A. MID-AMERICA

945. Mid-America took the position that, if storage costs reflect the operational needs of the pipeline and any revenue generated by merchant storage is credited against the costs, it should be permitted to include storage costs in its transportation rates. Mid-America Initial Brief at p. 121. Accordingly, Mid-America, suggested the appropriate amount of storage expenses to be included in its cost of service for each period are included on page 7 of Exhibit Nos. M-108, M-109, and M-110. Mid-America Initial Brief at p. 121 (*citing* Exhibit No. M-100 at pp. 50-53). In contrast with its position, Mid-America explained, the Propane Group asserted that Mid-America should not be allowed to include any storage expenses in its cost of service because those expenses involve payments to Mid-America's affiliate, Enterprise Terminals. *Id.* (*citing* Exhibit No. NPG-1 at p. 60). Additionally, claimed Mid-America, while Staff

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acknowledged the fact that costs related to operational storage should be included in rates, its method for calculating storage expenses results in an amount which will not allow Mid-America to recover its full costs. *Id.* (*citing* Exhibit S-26 at p. 10).

946. Initially, Mid-America claimed that the costs for storage, other than Conway, should be included in its cost-of-service because, while it leases storage from its affiliate, Enterprise Terminals, the lease payments for storage at the non-Conway locations were based on the market rate for storage in the area. *Id.* at pp. 121-22 (*citing* Exhibit Nos. M-46 at p. 64; NPG-43 at pp. 3, 6-16). To establish what the market rates were, continued Mid-America, the Regulatory Economics Group conducted a study of the relevant market and found that the average price for storage was $2.36 per barrel, and the median price was $2.10 per barrel; the latter of which served as the basis of the lease payment between Mid-America and Enterprise Terminals. *Id.* (*citing* Exhibit No. NPG-43 at pp. 6-16; M-163).

947. Next, with respect to Staff's approach, Mid-America claimed it is inadequate as it prevents Mid-America from capturing its full costs. *Id.* at p. 124. In fact, at the hearing, Mid-America submitted, Staff witness Pride testified that, were Mid-America limited to recovering what she purports, it will be unable to recover its cost to obtain the storage capacity. *Id.* (*citing* Transcript at pp. 2942-55). According to Mid-America the aim of Staff was to avoid having transportation customers pay for more storage than necessary, but it added that taking the average annual capacity and comparing it to the total capacity, as Staff did, was not a reasonable way of distinguishing between operational and merchant storage. *Id.* at p. 125 (*citing* Nos. Exhibit S-37; Transcript at pp. 2938, 2942). Mid-America declared that Staff ignored that operational storage capacity must be available to meet peak demands, not merely the average annual usage. *Id.* (*citing* Exhibit No. M-46 at p. 66; Transcript at pp. 669-70, 2962-66).

948. Mid-America asserted that Staff's position implicitly assumed that it has leased more operational storage than is necessary. *Id.* According to Mid-America, a party challenging the prudence of another must make a specific allegation that raises a serious doubt as to the prudence of expenditure. *Id.* at pp. 125-26 (*citing Iroquois Gas Transmission System,* 87 FERC ¶ 61,295 at p. 62,168 (1999); *Algonquin Gas Transmission Co.,* 77 FERC ¶ 61,057 at p. 61,216 (1996)). However, Mid-America contended that, not only did Staff fail to plead its claim with specificity or raise a serious doubt as to the prudence of any of Mid-America's storage expenditures, it also failed to present any evidence to dispute Mid-America witness Collingsworth's testimony that storage is necessary for operational purposes to facilitate the efficiency of the system's operations. *Id.* at p. 126 (*citing* Exhibit No. M-46 at pp. 58-61; Transcript at pp. 669-70, 2968-70). Consequently, Mid-America declared it must be concluded that its operational storage is necessary and prudent. *Id.*

949. In conclusion, Mid-America argued that its approach in deducting merchant

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storage revenue from the total storage costs is consistent with Commission precedent. *Id.* at pp. 126-27 (*citing Kuparuk Transportation Co.*, 55 FERC at p. 61,375. Also, Mid-America claimed that its approach is consistent with Interstate Commerce Commission precedent and the Commission's treatment of similar revenues in the natural gas context. *Id.* at p. 127 (*citing Atchison, Topeka & Santa Fe Railway,* 135 I.C.C. 633, 634-35 (1928); *Danville & Western Railway,* 84 I.C.C. 227, 239-40 (1924); *Northwest Pipeline Corp.,* 49 FERC at 61,308-11).

950. In its Reply Brief, addressing the Propane Group's argument that it would be able to include a write-up greater than original cost by including the lease payments for the Iowa City and Greenwood storage in its cost of service, Mid-America claimed that there is no evidence that it is seeking to "write-up" its rate base, and it is merely including in rates the cost to lease the storage from Enterprise Terminals. Mid-America Reply Brief at p. 92. Also, Mid-America maintained that it did not sell the storage assets to Enterprise Terminals, as the Propane Group claimed, but merely transferred title to the storage assets which were purchased from Williams to Enterprise Terminals and removed them from its books when it was discovered that the storage property had been incorrectly recorded. *Id.* at pp. 92-93 (*citing* Exhibit No. M-46 at p. 63; Transcript at pp. 706-08, 877-78, 950).

951. Further, according to Mid-America, the Propane Group alleged that, although the Williams storage assets may have been transferred to Sapling, LLC, Mid-America owned 100% of Sapling and Sapling owned the storage assets at the end of the transaction. *Id.* at p. 93 (*citing* Exhibit No. NPG-181 at pp. 6-7). In response to that allegation, Mid-America replied that there is no evidence to contradict its witness Collingsworth's testimony that, while Williams contributed 100% of its ownership interest in Sapling to Mid-America, Sapling remained a separate company, and after the transfer, Sapling became Enterprise Terminals, and its ownership was transferred to Mapletree, LLC — the parent of both Mid-America and Enterprise Terminals. *Id.* (*citing* Exhibit Nos. M-4 at p. 4; M-62; M-10 at p. 4; NPG-181 at pp. 5-7; Transcript at pp. 877-78).

952. With respect to the Propane Group's imprudence supposition, Mid-America noted that the Propane Group formed this opinion because it assumed that Mid-America sold the storage assets to Enterprise Terminals and leased the facilities back at a higher cost. *Id.* at p. 95. As explained above, Mid-America asserted that this assumption simply is not true. *Id.* Moreover, Mid-America argued that there is no imprudence in the "500 percent" increase in storage costs to which the Propane Group referred. *Id.* It explained that its monthly storage payments increased because it had been leasing far less storage from Williams before entering into the lease with Enterprise Terminals. *Id.* (*citing* Exhibit Nos. M-62; M-65; Transcript at p. 876). Further, Mid-America claimed that it previously had not been paying Enterprise Terminals or anyone else for that storage, and therefore, characterizing the costs of the Iowa City and Greenwood storage as a 500% increase is inaccurate. *Id.* (*citing* Transcript at p. 876).

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B. PROPANE GROUP[506]

953. The Propane Group asserted that, even were the Greenwood and Iowa City storage assets found to be jurisdictional, Mid-America impermissibly conducted a lease transaction with its unregulated affiliate, Enterprise Terminals, to artificially increase its storage costs at these locations by 500%. Propane Group Initial Brief at p. 118. First, the Propane Group contended that Mid-America's approach in establishing its Greenwood and Iowa City costs violates the Commission's standards for original cost ratemaking. *Id.* at pp. 118-19. According to them, the Commission continuously has held that the original cost is to be applied, with limited exception, for all ratemaking purposes, and if the purchase price is different from the original cost, it is to have no influence on the development of rates. *Id.* at p. 119 (*citing Williams Pipe Line Co.,* 21 FERC at p. 61,635). Furthermore, added the Propane Group, "[A] mere change in ownership should not result in an increase in the rate charged for a service if the basic service rendered itself remains unchanged." *Id.* (*citing Northern Border Pipeline Co. v. FERC*, 129 F.3d 1315, 1318 (D.C. Cir. 1997)). They added that the same principle has been applied to leases. *Id.* (*citing Total Pipeline Corp.*, 69 FERC ¶ 63,018 at p. 65,134 (1994); *Kuparuk Transportation Co.*, 55 FERC at p. 61,368). Thus, the Propane Group claimed, Mid-America should not be allowed to include a 500% increase in its storage costs simply because it transferred storage facilities to Enterprise Terminals and subsequently leased them back with no change in the service rendered. *Id.* at pp. 119-20. Essentially, maintained the Propane Group, permitting Mid-America to change its costs (and thus its rates) using a lease transaction with an affiliate would allow the manipulation of rates that prompted the Commission to mandate the use of original cost in the first place. *Id.* at p. 120.

954. Furthermore, the Propane Group claimed that the Regulatory Economics Group study demonstrated that the price Mid-America pays Enterprise Terminals under the lease agreement is unrelated to the original cost of the assets as well as the actual cost to operate the assets. *Id.* at p. 121. They declared that no case suggests that a transfer of assets, with no change in service and no benefit to shippers, should support a rate increase simply because the pipeline claimed that its newly-inflated costs reflect market prices. *Id.* The Propane Group, noting that the Commission has provided procedures for setting market-based rates, asserted that the Regulatory Economics Group study does not correspond to those particular procedures and is thus ineffective in supporting market-based ratemaking. *Id.* at pp. 121-22 (*citing* 18 C.F.R. Part 348 (2007)).

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[506] The Propane Group also argued here that Mid-America failed to establish how much of Conway's storage was operational. Propane Group Initial Brief at p. 118. I resolved that question in my ruling on Issue 6.B., *supra*.

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955. Regarding the lease transaction between Mid-America and Enterprise Terminals, the Propane Group asserted that the resulting increased costs were not prudently incurred and therefore should not be included in Mid-America's cost-of-service. *Id.* at p. 122 (*citing Midwestern Gas Transmission Co.,* 30 FERC ¶ 61,260 at p. 61,543 (1985)). Admitting that a party asserting that a pipeline's cost was imprudently incurred must raise a "serious doubt" as to the prudence of the expenditure, the Propane Group claimed that two circumstances related to the lease transaction cast serious doubt on Mid-America's prudence, namely: (1) Mid-America's costs increased by 500% as a result of the transaction; and (2) no change in service related to the 500% increase occurred and no operational purpose existed. *Id.* at p. 123 (*citing SFPP, L.P.,* 116 FERC at p. 66,299; Exhibit No. NPG-49; Transcript at pp. 702, 1332).

956. Next, the Propane Group disclaimed as irrelevant Mid-America's characterization of the lease transaction between Mid-America and Enterprise Terminals as a bookkeeping error. *Id.* at pp. 123-24. It suggested that Mid-America produced no documents or evidence to support its claims that (1) after Enterprise Terminals purchase of Mid-America from Williams, Sapling, LLC became Enterprise Terminals; and (2) the assets owned by Sapling, LLC were subsequently transferred to Enterprise Terminals. *Id.* at pp. 124-25. The Propane Group added their assertion that "there is evidence in the record that casts doubt on Mid-America's explanation."[507] *Id.* at p. 125. Specifically, the Propane Group pointed out that, were everyone to assume, as Mid-America implies, that the storage assets were owned by Enterprise Terminals all along, there would have been a lease agreement under which Mid-America used the storage assets owned by Enterprise Terminals beginning from the time when Enterprise Terminals began to operate Mid-America in 2003. *Id.* at p. 125 (*citing* Exhibit No. NPG-1 at p. 69). In other words, the Propane Group alleged that the lack of a lease until the alleged discovery of the bookkeeping error (recording of the storage assets in Mid-America's name when Enterprise Terminals had legal title all along) indicated that the transfer was not merely a bookkeeping error. *Id.* at p. 126 (*citing* Exhibit Nos. NPG-31; NPG-1 at p. 69). Moreover, after comparing Mid-America's property database with the carrier property balances shown in Mid-America's FERC Form 6, the Propane Group further claimed that the storage assets were included in Mid-America's property records as far back as 2001 and perhaps earlier (long before the sale of Mid-America to Enterprise Products Partners). *Id.* at p. 126 (*citing* Exhibit No. NPG-1 at pp. 67-69).

957. Finally, the Propane Group noted that the transfer of the Greenwood and Iowa

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[507] In fact, this statement is totally misleading because it is clear from their explanation that the Propane Group is not referring to any affirmative evidence, but rather is addressing what they claim to be evidence which is not in the record. Propane Group Initial Brief at p. 125. When a party states that "there is evidence in the record," I expect them to point to an exhibit or to a witness's testimony, not the absence of an exhibit.

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City storage assets to Enterprise Terminals shifted labor costs to Mid-America. *Id.* at p. 127 (*citing* Exhibit No. NPG-1 at pp. 64-65). Because, they declared, there is no evidence establishing the accuracy of Mid-America's allocation of labor expense between Mid-America and Enterprise Terminals, the Propane Group contended that Mid-America could impermissibly include labor costs relating to these storage assets in its transportation cost of service, while Enterprise Terminals records the related revenues. *Id.* (*citing* Exhibit No. NPG-165).

958. In its Reply Brief, in response to Mid-America's assertion that its use of a lease agreement to inflate storage costs is permissible under General Instruction 1-14 because it defines just and reasonable payments as those not exceeding fair market value, the Propane Group contended that "[i]t is difficult to conceive that the Commission intended one sentence in its general instructions for the Uniform System of Accounts to allow for the mooting of original cost-based ratemaking." Propane Group Reply Brief at p. 116. They added that, under Mid-America's proposal, all a pipeline would have to do to increase its cost-of-service and thereby its rates would be to buy utility property at a price higher than original cost. *Id.* at pp. 116-17 (*citing Northern Border Pipeline Co. v. FERC*, 129 F.3d at p. 1318; *Total Pipeline Corp.*, 69 FERC at p. 65,133).

959. Regarding Mid-America's suggestion that the Propane Group failed to refute Mid-America's study as an accurate way of establishing market price, the Propane Group asserted: (1) Commission oil pipeline precedent prohibits the use of artificial write-ups to manipulate rates, regardless of the method used to estimate market price; (2) should Mid-America seek to use market price, it should do so pursuant to the procedural mechanism provided in 18 C.F.R. Part 348; and (3) even if the study conducted by Mid-America was relevant, the Propane Group denied that its witness O'Loughlin admitted to the accuracy of the Regulatory Economics Group study.[508] *Id.* at pp. 117-118 (*citing* Transcript at p. 2562).

960. Similar to Mid-America's reliance on the electric cases, the Propane Group suggested that Mid-America's reliance on *Kuparuk Transportation Co.*, 55 FERC ¶ 61,122, is also inapposite. *Id.* at pp. 119-20. Specifically, they alleged, although the Commission's decision permitted the pipeline to include non-jurisdictional costs in its cost-of-service while crediting the related rental revenues, the decision was not based upon the difficulty of the allocation. *Id.* Rather, they suggested, the decision was based on the fact that the customer renting the asset was financially unhealthy. *Id.* at p. 120.

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[508] According to the Propane Group, while O'Loughlin stated that, as a general matter, asking storage providers about their prices could be an effective method for determining market price, he did not testify that the Regulatory Economics Group study had gone about this effectively. Propane Group Reply Brief at p. 118 (*citing* Exhibit No. NPG-43 at pp. 9-10, 13).

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The Propane Group insisted that this is not the case here — Mid-America does not insinuate any concern for the financial health of its customers. *Id.*

C. WILLIAMS

961. Williams did not address this issue in its Initial Brief. Williams Initial Brief at p. 53. In its Reply Brief, Williams opposed "Staff's total company per barrel approach" because, according to it, the approach is inconsistent with allocating costs on a segmented basis and to shippers based on their use of storage. Williams Reply Brief at p. 50. Particularly, Williams asserted that Staff's approach results in the transfer of all of Northern System storage costs and all but 0.02% of the Conway storage costs used by the Central System and the Northern System to the Rocky Mountain System, even though its shippers do not benefit from that storage. *Id.* at pp. 50-51 (*citing* Exhibit No. S-19 at p. 15; Transcript at pp. 3006-07). According to Williams, should operational storage costs be included in transportation rates, "they need to be determined and allocated on an individual segment basis only." *Id.* at p. 51. In connection with this assertion, Williams pointed out that the Rocky Mountain System transports only one type of product, and therefore, it does not need the storage that the Central and Northern Systems require to ship multiple products, which are shipped in batched lots. *Id.* at p. 51 (*citing* Transcript at pp. 829-31, 969).

D. COMMISSION TRIAL STAFF

962. Staff stated that operational storage should be included in Mid-America's transportation rates. Staff Initial Brief at p. 81 (*citing Williams Pipe Line Co.,* 84 FERC at p. 61,110). However, distinguishing between storage costs that benefit all shippers and those which benefit only one or more segments of the pipeline, Staff contended that storage costs incurred for shipper use should not be included in Mid-America's transportation rates. *Id.* at p. 82 (*citing Consolidated Gas Transmission Corp.*, 84 FERC ¶ 61,129 at p. 61,318 (1987)).

963. According to Staff, it compared the average usage for operational use of each of the leased storage caverns over the last 12 months of Period I and Period II to the total capacity of the cavern for each period to derive a percentage. *Id.* at p. 83. Next, Staff applied the percentage of usage for operational purposes to the lease costs of each facility and assigned the residual costs to storage available for shipper use. *Id.* (*citing* Exhibit No. S-26 at p. 10). Based on this analysis, Staff claimed that the total interstate operational storage cost, for FERC Tariff No. 38 is $6,627,880 and the interstate storage costs for shipper use is $4,369,194.[509] *Id.* at p. 84 (*citing* Exhibit No. S-26 at pp. 16-17;

[509] According to Staff, the "total interstate lease storage costs for [FERC] Tariff No. 38 are $10,997,074." Staff Initial Brief at p. 83 (*citing* Exhibit No. S-26 at p. 16). Staff also contended that "[t]he cost per barrel of interstate operational storage costs

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Transcript at p. 2915). Similarly, for FERC Tariff No. 41, Staff claimed that the total interstate operational storage cost is $6,530,230 and the interstate storage costs for shipper use is $4,573,499.[510] *Id.* at p. 85 (*citing* Exhibit No. S-26 at p. 17; Transcript at p. 2915).

964. Staff argued that Mid-America, in both of its filings at issue here, failed to distinguish between costs associated with operational storage and those associated with storage for shippers use. *Id.* It contended that the storage costs for operational use and storage costs for shipper use should be determined and charged separately in order to avoid subsidization. *Id.* According to Staff, the principle that cost recovery should follow cost incurrence is well established, and unnecessary bundling of services is per se unjust and unreasonable unless there are countervailing circumstances. *Id.* at pp. 85-86 (*citing Mountain Fuel Supply Co.*, 27 FERC at p. 61,587; *Transcontinental Gas Pipe Line Corp*., 112 FERC ¶ 61,170 at p. 61,926 (2005), *aff'd, Transcontinental Gas Pipe Line Corp. v FERC* 518 F.3d 916 (D.C. Cir. 2008)). Staff submitted that this is not the case here. *Id.* at p. 86.

965. "Operational storage costs should be assigned to Mid-America's three systems on a volumetric basis," Staff contended. *Id.* (*citing Transcontinental Gas Pipe Line Corp*., 112 FERC ¶ 61,170). It suggested that the Kansas-Nebraska formula is only appropriate for allocating administrative and general costs, not for allocating storage costs, and that a "volumetric allocator more accurately reflects the functions and relative usage of Mid-America's operational storage." *Id.* (*citing Questar Pipeline Co.*, 72 FERC ¶ 61,129 at p. 61,926 n.6 (1995)).

966. In its Reply Brief, Staff contended that Mid-America "should unbundle storage for shipper use from operational storage," and should allocate to transportation customers only those storage costs which benefit those customers. Staff Reply Brief at p. 73 (*citing Mountain Fuel Supply Co.*, 27 FERC at p. 61,587). It insisted that Mid-America has not proven that all of the storage it considers operational does in fact benefit its transportation customers. *Id.*

967. With respect to the Propane Group's position, Staff agreed that the Commission's regulations provide procedures for obtaining market-based rate authority for jurisdictional services, and Mid-America failed to meet these requirements. *Id.* at p. 76

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allocated to each system for [FERC] Tariff No. 38 is $0.0381 per barrel." *Id.* (*citing* Exhibit No. S-26 at pp. 16-17; Transcript at p. 2915).

[510] According to Staff "[t]he total amount of interstate storage costs for [FERC] Tariff No. 41 is $11,103,729." Staff Initial Brief at p. 84 (*citing* Exhibit No. S-26 at p. 17).

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(*citing* 18 C.F.R. pt. 348 (2007)). While Staff did not oppose Mid-America's storage costs on this basis, Staff stated that it would not object to denying or modifying these costs based on that rationale. *Id.*

Discussion and Ruling

968. No party disputed including operational storage costs in Mid-America's transportation rates, as they are jurisdictional. The question is whether non-jurisdictional merchant storage costs and revenues should be included in Mid-America's transportation rates.

969. Mid-America argued that it should be permitted to include operational and merchant storage costs in its transportation rates, so long as any revenue received from merchant storage is credited against the costs. Mid-America Initial Brief at p. 121. Further, it asserted that the Greenwood and Iowa City storage costs should be included in its cost-of-service because (1) they are jurisdictional costs, and (2) the lease payments to its affiliate, Enterprise Terminals, for storage at these locations were based on an independent study of the market rate for storage in the area and were thus the result of an appropriate affiliate transaction. *Id.* at p. 122. Finally, it denied any imprudence related to the lease agreement with Enterprise Terminals, emphasizing the fact that its monthly storage payments increased because it had been leasing far less storage from Williams[511] before entering into the lease with Enterprise Terminals. Mid-America Reply Brief at p. 95.

970. Claiming the storage services at Greenwood and Iowa City are for merchant storage, the Propane Group maintained that the costs and revenues from these facilities should not be included in Mid-America's rates. Propane Group Initial Brief at p. 118. Even were the Greenwood and Iowa City storage assets found to be jurisdictional, the Propane Group asserted that the costs and revenues related to these storage facilities should be excluded from Mid-America's rates because Mid-America's approach in establishing the storage costs related to them violates the Commission's standards for original cost ratemaking. *Id.* at pp. 118-19. Moreover, the Propane Group contended that the lease transaction relating to these storage facilities was the result of an imprudent transaction because (1) Mid-America's costs increased by 500%, and (2) no change in service related to the 500% increase occurred and no operational purpose existed. *Id.* at pp. 122-23.

971. Williams asserted that Staff's volumetric approach in allocating storage costs is inconsistent with allocating costs on a segmented basis and to shippers based on their storage use. Williams Reply Brief at p. 50.

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[511] Williams owned the Iowa City and Greenwood storage assets before they were later acquired by Enterprise Terminals. Exhibit Nos. NPG-181 at pp. 5-7; M-10 at p. 4.

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972. Staff agreed with the Propane Group that merchant storage costs should not be included in Mid-America's transportation rates. Staff Initial Brief at p. 82. However, Staff insisted that Mid-America failed to show that all of the storage it considers operational does in fact benefit its customers, and thus, it submitted that its allocation of storage costs based on average annual capacity is reasonable. Staff Reply Brief at p. 73. Additionally, unlike Mid-America, Staff argued that the allocation of operational storage costs should be done on a volumetric basis. Staff Initial Brief at p. 86.

973. While I conclude that jurisdictional operational storage costs and revenues should be included in Mid-America's transportation rates, I find that non-jurisdictional merchant storage costs and revenues should not be included in those rates. *See Mountain Fuel Supply Co.,* 27 FERC at p. 61,587. Accordingly, transportation rates should only reflect storage costs that support the operation of the pipeline and not storage costs acquired for shipper use. *Williams Pipe Line Co.,* 84 FERC at p. 61,110.

974. Because the storage at Greenwood and Iowa City is jurisdictional, the costs and revenues associated with these storage services should be included in Mid-America's transportation rates. In doing so, I accept Mid-America's proposed Greenwood and Iowa City storage costs, which include lease payments for the storage based on the market rate for storage in the relevant areas. *See* Exhibit Nos. M-46 at p. 64; NPG-43 at pp. 3, 6-16.

975. I note that the Propane Group asserted that, even were the storage services at Greenwood and Iowa City jurisdictional, their costs and revenues should not be included in Mid-America's transportation rates because they were imprudently incurred as a consequence of the lease between Mid-America and its affiliate, Enterprise Terminals. Propane Group Initial Brief at pp. 122-23. The Commission policy on whether the costs reflected in rates were prudently incurred is set out in *Indiana and Michigan Municipal Distributors Association and City of Auburn, Indiana v. Indiana Michigan Power Co.*, 62 FERC ¶ 61,189 at p. 62,238 (1993):

> If costs are incurred through a non-affiliate transaction, we presume prudence and typically assume an arm's-length relationship between the buyer and seller. In this circumstance, the complainants have the initial burden to come forward and present evidence casting serious doubt as to the prudence of the utility's conduct. If costs are incurred through an affiliate transaction, we cannot presume prudence or assume such an arm's-length relationship. Instead, we look to a range of market prices for comparable transactions during the same time period. In either event, if the price paid by the utility falls within the range of market prices for comparable goods, services, etc., it becomes especially difficult for the complainant to demonstrate imprudence.

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The Commission further indicated that its "standard is based on the principle that [it] should not, using the benefit of hindsight, replace the business decision of a utility with its own." *Id.* Under the Commission's prudence standard, the complainant has the initial burden of proof which does not transfer to the utility unless the complainant raises "serious doubt" as to the prudence of the subject transaction. *Id.* at p. 62,239.

976. Although the Propane Group argument that the storage costs at Greenwood and Iowa City were imprudently incurred has some appeal, it does not rise to the level of "serious doubt." *Id.; see also SFPP, L.P.,* 116 FERC ¶ 63,059 at p. 66,299 (2006)). More is needed than a bare allegation. *Enbridge Pipelines*, 100 FERC ¶ 61,260 at P 333 (2002). Here, the Propane Group relied on its plaint that, when Enterprise Terminals became the titular owner of the storage at Greenwood and Iowa City, Mid-America's storage costs increased by 500%; they also alleged that ownership of the storage was transferred to Enterprise Terminals by Mid-America. Propane Group Initial Brief at pp. 118-20. It does not offer any direct evidence of imprudence, but relies solely on its suppositions and its claim that a "negative inference" establishes the accuracy of its allegations.[512] *Id.* at pp. 122-125.

977. In response to the Propane Group, Mid-America presented the testimony of its witness, Collingsworth. Collingsworth testified to the following: (1) originally the storage at Greenwood and Iowa City were owned by Williams Midstream Natural Gas Liquids, Inc., which created a new company, Sapling, LLC, at the time it sold them to Enterprise Products Partners; (2) Sapling, LLC, eventually became Enterprise Terminals; (3) Mid-America's interest in Sapling/Enterprise Terminals was transferred to Maple Tree, LLC;[513] (4) legal title to the storage at Greenwood and Iowa City always was in Sapling/Enterprise Terminals, not Mid-America, even though some of Mid-America's business records erroneously indicated that it held title; (5) after discovery of the error, a correcting entry was made on the records of Mid-America as well as Enterprise Terminals; (6) the price Mid-America paid Enterprise Terminals was established pursuant to an independent study which established the market rate for storage.[514] Transcript at

[512] At the hearing, Propane Group witness O'Loughlin testified that he did not try to establish a market price for the storage at Greenwood or Iowa City and that he did not attempt to confirm the validity of the Mid-America independent study. Transcript at pp. 2558-59.

[513] Collingsworth also stated that Maple Tree was the parent of both Mid-America and Enterprise Terminals. Transcript at pp. 877-78.

[514] Also see Exhibit Nos. M-62 at p. 6 and M-163 at pp. 3-5 which reflect that Mid-America's cost study accurately reflects market prices. The parameters of the study are addressed in Exhibit No. NPG-43 at pp. 6-16. As a result of the study, Mid-America was able to receive reliable quotes from seven companies for many different locations.

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pp. 706-09, 877, 950, 2558-67; Exhibit Nos. NPG-43 at pp. 6-16; NPG-46 at pp. 14, 18; M-46 at pp. 63-64.

978. Based on the record, it is clear that even had the Propane Group raised a "serious question" as to the prudence of Mid-America's storage transaction with Enterprise Terminals, and I do not believe it presented sufficient substantive evidence to reach that level of proof; it has been rebutted. *See New England Power Co.*, 31 FERC ¶ 61,047 at pp. 61,084-87 (1985); *Northwest Pipeline Corp.*, 92 FERC ¶ 61,287 at pp. 61,993-98 (2000). *Cf. Enbridge Pipelines*, 100 FERC ¶ 100 at P 337-39. Moreover, I find Collingsworth's testimony in this regard totally credible. For the same reasons, I reject the Propane Group's claim that "Mid-America's explanation for its transfer of the storage assets to [Enterprise Terminals] is not supported by the record."[515]

979. The last argument made by the Propane Group which requires attention is its claim that "Mid-America's method of calculating the costs of its Greenwood and Iowa City storage facilities violates the Commission's standards for original cost ratemaking." Propane Group Initial Brief at pp. 118-19. In their reply brief they added that 18 C.F.R. Part 352, General Instructions 1-13 (2007), "requires a comparison between the affiliates supplier's original and actual cost and the fair market value of the service." Propane Group Reply Brief at p. 115. While the Propane Group was not very specific in making this argument in either brief, it appears that, when using the term "original cost", they are referring to one of three transactions: (1) the transfer of the storage assets from Williams Midstream Natural Gas Liquids, Inc., to Sapling, LLC (which later became Enterprise Terminals); (2) the purported transfer of the storage assets between Mid-America and Enterprise Terminals; or (3) the contractual price of storage paid by Mid-America to Enterprise Terminals.

980. General Instruction 1-13 in 18 C.F.R. Part 352 governs transactions between affiliates. Therefore, as the transfer from Williams Midstream to Sapling, LLC, was between non-affiliated businesses in an arm's-length transaction it is not subject to the General Instruction. Exhibit Nos. M-4 at p. 4; M-62; M-10 at p. 4; NPG-181 at pp. 5-7; Transcript at pp. 877-78. Moreover, since the purported transfer of the storage assets from Mid-America to Enterprise Terminals amounted merely to a book transaction needed to correct an erroneous entry, as discussed above, even though the correction involved affiliates, it also is not subject to General Instruction 1-13.

Id. at p. 13. The study demonstrated that the average price for storage was $2.36 per barrel and the median price was $2.10 per barrel. *Id.* at p. 15. Consequently, Mid-America and its affiliate, Enterprise Terminals, based the lease payments on the lower median price of $2.10 per barrel. Exhibit No. M-62 at p. 6.

[515] *See* Propane Group Initial Brief at p. 124.

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981. That leaves the question of the storage fees paid by Mid-America to Enterprise Terminals. As the Propane Group noted, for transactions between affiliated companies, the Commission's regulations require a comparison between the affiliate supplier's actual cost and the fair market value of the service where no invoice price is available. *See* 18 C.F.R. Part 352, General Instructions 1-13 (d) (2007):

> The Carrier shall record, as the cost of assets or services received from an affiliated supplier, the invoice price . . . . If no such price list exists, the charges shall be recorded at the lower of their cost to the originating affiliated supplier (less all applicable valuation reserves in case of asset sales), or their estimated fair market value determined on the basis of a representative study of similar competitive and arm's-length or bargained transactions.

The Propane Group claimed that Mid-America failed to present the data representing the "original cost," of the storage services, and consequently, no comparison can be made. *See* Exhibit No. NPG-1 at p. 75. However, as I interpret that term as used in this case to refer to the charge made by Enterprise Terminals for its storage service, I must conclude that the Propane Group errs because such information is in the record since the contract for the leasing of the storage facilities between Mid-America and Enterprise Terminals is in evidence.[516] *See* Exhibit Nos. NPG-43 at pp. 6-16; M-62 at p. 6. That contract reflects that Mid-America pays Enterprise $2.10 per barrel for the storage service. The record also reflects that this price was developed through a market study conducted by Mid-America witness Ganz. *See* Exhibit No. NPG-43 at pp. 6-16. As to that study, in its Initial Brief, Mid-America noted as follows:

> As the [Regulatory Economics Group, LLC] memorandum explained '[Regulatory Economics Group, LLC] was able to identify about 20 firms

[516] I note that the Propane Group could be suggesting that the term "original cost" refers to either Williams Midstream's or Enterprise Terminals' cost for the storage assets. While it is true that this cost may not be in evidence, I cannot imagine how the Commission could require either non-jurisdictional entity (one of which may no longer exist) to conduct a cost-of-service study or even how such a study could be conducted. I acknowledge, in stating this, the Propane Group's suggestion that this might allow for a scheme to increase the cost-of-service to consumers, *see* Propane Group Reply Brief at pp. 116-17, however, I see no evidence of that here. The only evidence that such a scheme might have existed is the Propane Group's claim that Mid-America's storage costs increased after the 2004 purported transfer. Propane Group Initial Brief at p. 123. However, Mid-America's explanation, the increase in storage costs reflects its use of additional storage, Mid-America Reply Brief at p. 95, is totally credible.

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> who were potential suppliers of [natural gas liquid] storage. While some firms contacted were unwilling to provide either an unbundled price or were unwilling to divulge pricing information, [Regulatory Economics Group, LLC] received reliable quotes from seven companies for a number of different locations.' The results of the study showed that the average price for storage was $2.36 per barrel and the median price was $2.10 per barrel. The lease payment between Mid-America and Enterprise Terminals & Storage was based on the lower price of $2.10 per barrel. The documents that Mid-America was able to obtain in discovery from the members of the Propane Group confirm that the price Mid-America is paying for storage is consistent with that charged by other storage providers in the area.

Mid-America Initial Brief at p. 123 (citations omitted).

982. In other words, in this proceeding, the "cost to the originating affiliated supplier" equals the fair market value because the contract price reflects a market study (and thus, the fair market value). *See* Exhibit No. NPG-43 at pp. 6-16; Exhibit No. M-62 at p. 6. Accordingly, I find that Mid-America's cost-of-service satisfies 18 C.F.R. Part 352, General Instructions 1-13.

ISSUE NO. 7: WHAT IS THE APPROPRIATE RATE AND COST OF SERVICE TREATMENT OF MID-AMERICA'S CONTRACT WITH THE EAST RED LINE SHIPPER?

A. WHAT IS THE JURISDICTIONAL STATUS OF TRANSPORTATION OF THE EAST RED LINE SHIPPER'S VOLUMES FROM CHANNAHON, ILLINOIS, TO MORRIS, ILLINOIS, AND WHAT IS THE APPROPRIATE COST OF SERVICE TREATMENT FOR THIS SERVICE?

A. MID-AMERICA

983. In its Initial Brief, Mid-America asserted that the movement of ethane/propane mix from Channahon, Illinois, to Morris, Illinois, is intrastate, and consequently falls out of the Commission's jurisdiction under the Interstate Commerce Act. Mid-America Initial Brief at p. 129. Accordingly, Mid-America suggested that all costs and volumes associated with this movement should be excluded in its rate calculation. *Id.* In contrast, Mid-America explained, the Propane Group argued that this particular movement is interstate in nature and consequently included the associated volumes (but not the costs) in its rate calculation. *Id.*

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984. Mid-America declared that the legal test for determining whether a movement is interstate in nature is whether, at the time the shipment begins, the shipper intends to transfer product in a continuous, unbroken movement across state lines. *Id.* at p. 130.[517] Still, added Mid-America, even with the requisite intent, a movement may be deemed intrastate if the chain of commerce is broken by any of a number of factors. *Id.* at pp. 130-31. For example, Mid-America explained that such factors may include storage while further movement is arranged, or the processing of product en route, so as to change its character. *Id.* at p. 131 (*citing Northville Dock Pipe Line Corp. and Consolidated Petroleum Terminal, Inc.*, 14 FERC ¶ 61,111; *Interstate Energy Co.*, 32 FERC ¶ 61,294 (1985)). In addition, noted Mid-America, transportation to and from the point of interruption must be analyzed and characterized separately. *Id.*

985. Claiming that the ethane/propane mix transported on Mid-America is produced in Illinois and moves entirely within the State of Illinois, it insisted that the movement is intrastate in nature, unless a showing is made that the ethane/propane mix actually moves continuously in that form to or from another state (with the Channahon to Morris leg constituting only part of the continuous movement). *Id.* at pp. 131-32. According to Mid-America, the Propane Group asserted that the movement to Morris actually originate in Canada on the Alliance Pipeline, not at Channahon, and that the intent of the shipper is always to transport the product in interstate commerce beyond the Aux Sable facility (which facilitates the gas processing at Channahon) because the product is not consumed, used as a feedstock, or stored at the Aux Sable facility. *Id.* at p. 132.

986. Mid-America insisted that the Propane Group's assertion is incorrect: first, it claimed, there is no evidence supporting the assumption that Aux Sable is the shipper on Alliance, and even if Aux Sable were the shipper on Alliance, it is not the shipper on Mid-America — the East Red Line Shipper is the shipper of ethane/propane mix from Channahon to Morris; second, according to Mid-America, a shipper cannot determine when it delivers product into the Alliance natural gas stream where any component part will end up or what form the final delivered product will take; third, it asserted, the essential character of Alliance is overlooked by the Propane Group in that Alliance is a natural gas pipeline, not a natural gas liquids pipeline. *Id.* at pp. 132-34 (*citing* Exhibit Nos. NPG-1 at p. 169; M-46 at p. 53; M-157 at p. 4).

987. In its Reply Brief, Mid-America attacked the Propane Group's suggestion that the Alliance pipeline can be characterized as a natural gas liquids pipeline as well as a natural

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[517] In support, Mid-America cited *Texaco Refining & Marketing, Inc. v. SFPP, L.P.,* 80 FERC at p. 61,805; *Amoco Pipeline Co.*, 62 FERC ¶ 61,119 at p. 61,803 (1993); *Interstate Energy Co.*, 32 FERC ¶ 61,294 (1985); *Hydrocarbon Trading and Transport Co., Inc. v. Texas Eastern Transmission Corp.*, 26 FERC ¶ 61,201 at p. 61,470 (1984); *Northville Dock Pipe Line Corp. and Consolidated Petroleum Terminal, Inc.*, 14 FERC ¶ 61,111 (1981).

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gas pipeline. Mid-America Reply Brief at p. 99. It asserted that, although the Aux Sable plant at Channahon has the right to extract natural gas liquid molecules from the natural gas stream, the Alliance pipeline does not become a natural gas liquids line. *Id*. (*citing* Exhibit Nos. M-157 at p. 26; M-158). Contrary to the Propane Group's assertion, according to Mid-America, the evidence to which they cite, Alliance's natural gas tariff, establishes that it is a "natural gas company" that owns a "natural gas transmission system" and "is engaged in the business of transporting natural gas for shippers in interstate commerce." *Id.* (*citing* Exhibit No. M-157 at p. 4).

988. Disagreeing with the Propane Group, Mid-America maintained that Aux Sable is not the shipper of the natural gas liquids, nor does it "direct" the injection of natural gas liquids into the Alliance pipeline. *Id.* at pp. 99-100. Rather, claimed Mid-America, Aux Sable simply has the right to extract natural gas liquid molecules from the Alliance shippers' natural gas and enters into agreements with the Alliance shippers to perform the extraction at Channahon. *Id.* at p. 100 (*citing* Exhibit Nos. M-157 at p. 26; M-158 at p. 2). Continuing, Mid-America added that, even were natural gas liquids injected into Alliance (as only the Propane Group alleges), they do not remain separate products, but instead become part of the natural gas stream. *Id.* Moreover, it declared that nothing in the record suggested that the natural gas shippers on Alliance intended to move specific quantities of ethane/propane mix from Canada to Channahon and on to Morris. *Id.*

989. Concluding, Mid-America insisted that Collingsworth never testified that Mid-America's position regarding the Channahon to Morris movement is "illusory." *Id.* at p. 101. Nor, according to Mid-America, did he state that the individual natural gas liquids products resulting from fractionation at Hobbs move under Seminole's interstate tariff. *Id.* Rather, Mid-America maintained that Collingsworth suggested that the products leaving the Hobbs fractionator moves on a Seminole Texas intrastate tariff, similar to the ethane/propane mix that results from processing and fractionation at Channahon, which moves on a Mid-America Illinois intrastate tariff. *Id.* (*citing* Transcript at pp. 3165-70; Exhibit No. WIL-57).

B. PROPANE GROUP

990. The Propane Group argued that the Channahon to Morris movement is interstate in nature and, therefore, subject to the Interstate Commerce Act and within the Commission's jurisdiction. Propane Group Initial Brief at p. 128. Consequently, they insisted that the costs, revenues, and volumes associated with this movement should be included in the Northern System cost and revenue analysis. *Id.* In the alternative, were the movement found to be non-jurisdictional, the Propane Group contended that the interrelated elements of the East Red Line Shipper agreement and Mid-America's treatment of these volumes and revenues under its tariffs required that the revenues and costs related with this movement be reflected by any Northern System cost and revenue analysis. *Id.*

991. According to the Propane Group, the fact that a transportation service occurs wholly within one state is not determinative of jurisdiction. *Id.* at pp. 128-29 (*citing United States v. Illinois Terminal Railroad Co.,* 168 F. 546, 548 (S.D. Ill. 1909)). Further, the Propane Group explained, the Commission's general policy is to consider all interstate related product movements jurisdictional unless circumstances prove a sufficient break in the continuity of transportation such that shippers do not have a fixed and persisting intent to move product in interstate commerce. *Id.* at p. 129 (*citing Texaco Refining & Marketing, Inc. v. SFPP, L.P.,* 80 FERC at p. 61,805). According to the Propane Group, the fixed and persisting intent of the relevant shippers of the ethane/propane mix is to ship interstate, beginning the movement in Canada and ending at the plant of the East Red Line Shipper in Morris, Illinois. *Id.* at p. 130. Additionally, the Propane Group insisted that there is not a sufficient break in continuity of this transportation of ethane/propane mix. *Id.*

992. Further, the Propane Group submitted, the shipper of the natural gas liquids on Alliance through to Mid-America's system at Channahon is Aux Sable as it is the only entity that can direct the injection of purity natural gas liquids into the pipeline in Canada, and it has the exclusive right to any and all natural gas liquids separated from the gas stream at the Aux Sable facility. *Id.* at p. 131 (*citing* Exhibit Nos. NPG-98 at p. 25; M-158 at p. 2). Because throughout the entire movement from Canada to the East Red Line Shipper, the buyer, the consumer, and the ultimate destination of the ethane/propane mix are known and fixed, the Propane Group maintained that the Aux Sable facility should not be considered a break in the interstate chain of transportation. *Id.* at p. 132.[518] They asserted that the movement of the ethane/propane mix from Channahon to Morris ought to be considered as a continuation of the transportation from Alberta to Channahon. *Id.* at p. 133.

993. In the alternative, according to the Propane Group, should the Channahon to Morris movement be found intrastate in nature, they recommended that the revenue related to this movement be included in the Northern System's interstate cost and revenue analysis and in any alleged East Red Line Shipper discount. *Id.* The Propane Group maintained that the East Red Line Shipper agreement is an interrelated and integrated contract that was negotiated and modified to include the Channahon to Morris movement as an interstate service. *Id.* Both Mid-America's intrastate and interstate tariffs for the East Red Line Shipper, claimed the Propane Group, are structured so that the requirements of each are completely dependent upon the other. *Id.* (*citing* Exhibit No.

[518] After a lengthy discussion of the transportation of the ethane/propane mix from its origin on the Alliance Pipeline in Alberta, Canada, to its termination at the Aux Sable Natural Gas Liquid facility at Channahon, Illinois, and then on to the East Red Line shipper at Morris, Illinois, the Propane Group cited to Exhibit Nos. NPG-1 at p. 169; NPG-98 at p. 25; M-157 at p. 26; M-158 at p. 2; Transcript at pp. 559, 2501.

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NPG-1 at p. 163; NPG-167; NPG-168; Transcript at pp. 540-43).

994. Lastly, the Propane Group noted that Mid-America's suggestion of crediting all of the East Red Line Shipper's revenue to the Northern System cost-of-service failed to reflect an appropriate and fair allocation of costs to services because the crediting lacks barrels and barrel-miles and consequently would skew the East Red Line Shipper costs to the remaining Northern System shippers (*i.e.,* unfair subsidization). *Id.* at p. 134.

995. In reply, the Propane Group began by asserting that the burden of proof in establishing that the Channahon to Morris movement is not subject to the Commission's Interstate Commerce Act jurisdiction falls upon Mid-America because the Commission's general policy is to consider all interstate-related product movements to be jurisdictional unless the facts suggest otherwise; a burden which the Propane Group submitted Mid-America failed to carry. Propane Group Reply Brief at p. 124 (*citing SFPP, L.P.,* 122 FERC ¶ 61,126 at P 9).

996. The Propane Group argued that Mid-America incorrectly asserted that the jurisdictional status of the Alliance Pipeline has an impact on the treatment of the Channahon to Morris line. *Id.* at p. 126. According to the Propane Group, "if the essential character of transportation, as determined primarily by the shipper's intent, is interstate . . . that interstate character [cannot] change[] when one leg of the journey is performed by a carrier that happens to be exempt from ICC regulation." *Id.* (*quoting Central Freight Lines, Inc. v. ICC,* 899 F.2d 413, 423 (5th Cir. 1990)).[519]

997. Equally unavailing, contended the Propane Group, is Mid-America's argument that it is "implausible" that natural gas liquids are injected into Alliance with the intent to later separate these from the gas stream for further movement in interstate commerce. *Id.* at p. 127. To rebut Mid-America's argument, the Propane Group listed the following "undisputed facts": (1) in 2004, Aux Sable directed the injection of approximately 8.2 million barrels per day into Alliance, and in 2005, it directed the injection of approximately 9.5 million barrels per day; and (2) Alliance was designed to move natural gas liquids and wet gas with the intent that Aux Sable would separate the natural gas liquids from the stream for sale and further movement. *Id.* (*citing* Exhibit Nos. NPG-98 at p. 22; M-158 at p. 2). In sum, the Propane Group insisted that Aux Sable would not inject into Alliance millions of barrels of liquid natural gas annually without the intent of separating them from the stream, especially since ethane is generally more valuable as a liquid than as a gas, and Aux Sable has a long-term contract with an Enterprise affiliate for all ethane/propane mix separated at Aux Sable. *Id.* (*citing* Exhibit No. M-158 at p. 1).

998. In response to Mid-America's jurisdictional contention based on the lack of knowledge by the natural gas liquid shipper of the destination of particular natural gas

[519] In support, the Propane Group also cited *International Brotherhood of Teamsters v. ICC,* 921 F.2d 904, 910 (9th Cir. 1990).

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liquid barrels, the Propane Group argued that a shipper's lack of knowledge regarding the final destination or consignee at the time of shipment is insufficient to change the interstate character of subsequent transportation. *Id.* at p. 128.[520] However, in this case, the Propane Group asserted, Aux Sable has a stable and recurring pattern of transporting the separated ethane and propane and resulting ethane/propane mix past its facility for the sole and ultimate benefit of the East Red Line Shipper. *Id.* The Propane Group added that, on 320 of 365 days during the period February 2005 through January 2006, Aux Sable provided the Channahon to Morris line with more than 10,000 barrels per day. *Id.*

999. Finally, the Propane Group claimed, one factor influencing the determination of the existence of a sufficient break in continuity of interstate transportation is whether the product has undergone processing or a substantial modification resulting in a product materially different in character, utility, and value. *Id.* at p. 129.[521] In this case, the Propane Group submitted that Mid-America failed to establish "that any new or different product emerges at Aux Sable." *Id.* They claimed that, at Aux Sable, the already existing ethane and propane are merely separated or re-separated and recombined or repackaged to generate the ethane/propane mix for the East Red Line Shipper. *Id.* Additionally, the Propane Group continued, the propane and ethane injected into Alliance in Canada, commingled, and separated at Aux Sable remains propane and ethane, and the repackaging of the two products does not result in a new product. *Id.*[522]

C. WILLIAMS

1000. Similar to Mid-America, Williams argued that the transportation of the East Red Line Shipper's volumes from Channahon to Morris is intrastate in nature. Williams Initial Brief at p. 54. It asserted that, although the natural gas liquids are shipped from Canada to Aux Sable at Channahon, Illinois, it is fractionated there into a variety of products in addition to the ethane/propane mix. *Id.* at p. 55 (*citing* Exhibit No. M-46 at p. 54). Williams contended that the movement of the new ethane/propane mix created at the Aux Sable fractionator and then moved within the State of Illinois, between Channahon and Morris, is undeniably intrastate. *Id.* at p. 56.

1001. In its Reply Brief, Williams claimed that the intent to ship the natural gas liquids

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[520] In support, the Propane Group cited *Policy Statement – Motor Carrier Interstate Transportation – From Out-of-State Through Warehouses to Points in Same State,* 8 ICC 2d 470, 474 (1992); *Musarra v. Digital Dish, Inc.,* 454 F. Supp. 2d 692, 712 (S.D. Ohio 2006).

[521] In support, the Propane Group cited *Musarra v. Digital Dish, Inc.,* 454 F. Supp. 2d at 715-16; *Anheuser-Busch Brewing Ass'n v. United States,* 207 U.S. 556 (1908).

[522] The Propane Group cited *Musarra v. Digital Dish, Inc.,* 454 F. Supp. 2d at 715-16.

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interstate when tendered to the Alliance natural gas pipeline for transportation is not present. Williams Reply Brief at p. 56. It asserted that Aux Sable is not the shipper of the natural gas liquids on the Alliance pipeline,[523] but rather, it has the right to extract natural gas liquids at its Channahon facility. *Id.* (*citing* Exhibit Nos. M-157 at p. 26; M-158 at p. 1). Additionally, Williams continued, title to the natural gas liquids that Aux Sable extracts at Channahon only passes after the extraction occurs, and Aux Sable's decision regarding the ethane "is made only on a daily basis depending on the relative price of natural gas and natural gas liquids, with the result being a wide variation in the amount of ethane/propane mix produced by Aux Sable at Channahon." *Id.* at pp. 56-57 (*citing* Exhibit Nos. M-46 at pp. 54-55; M-60; M-158 at p. 4).

D. COMMISSION TRIAL STAFF

1002. For FERC Tariff No. 41, Staff, as does Mid-America, submitted that the Channahon to Morris movement is an intrastate movement because Mid-America began recording such movement as intrastate during the Test Period of FERC Tariff No. 41. Staff Initial Brief at p. 87. However, for FERC Tariff No. 38, Staff recommended that the Channahon to Morris movement be treated as interstate because Mid-America recorded such movement as interstate during the FERC Tariff No. 38 Test Period. *Id.* Furthermore, Staff noted, it did not seek to determine on its own whether the Channahon to Morris movement was physically interstate or intrastate. *Id.* Rather, Staff indicated that it simply followed Mid-America's recorded classification of the movement for each particular Test Period. *Id.* In its Reply Brief, Staff agreed with Mid-America and the Propane Group that the test for establishing whether a movement is interstate depends on the character of the movement and the intent with which the shipment was made. Staff Reply Brief at p. 79.

Discussion and Ruling

1003. Although the natural gas liquid shipment which moves between Channahon and Morris, Illinois, originates in Canada, it is processed at Channahon before it is shipped to Morris. As the movement between Channahon and Morris clearly occurs entirely within the state of Illinois, the question turns on whether that movement constitutes a link in an interstate chain of movements. *Texaco Refining & Marketing, Inc. v. SFPP, L.P.,* 80 FERC at p. 61,805; *Hydrocarbon Trading & Transportation Co., Inc.,* 26 FERC at p. 61,470.

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[523] Williams fails to identify the shipper if it is not Aux Sable. *See* Williams Reply Brief at p. 56.

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1004. Mid-America argued that the movement of ethane/propane mix from Channahon to Morris, Illinois, is intrastate. Mid-America Initial Brief at p. 129.[524] It declared that nothing in the record suggested that the natural gas shippers on Alliance intend to move specific quantities of ethane/propane mix from Canada to Channahon and on to Morris. Mid-America Reply Brief at p. 100. Specifically, Mid-America maintained that (1) Aux Sable is not the shipper on Alliance, and the shipper of ethane/propane mix from Channahon to Morris is the East Red Line Shipper; (2) no shipper can determine when it delivers product into the Alliance natural gas stream where any component part will end up or what form the final delivered product will take; (3) unlike Mid-America, Alliance is a natural gas pipeline, not a natural gas liquids pipeline; and (4) the natural gas liquid molecules extracted at Channahon change form through the processing of the raw natural gas and the subsequent fractionation of the resulting natural gas liquids into individual natural gas liquid products. *Id.*

1005. Unlike Mid-America, the Propane Group argued that the Channahon to Morris movement is interstate in nature. Propane Group Initial Brief at p. 128. They declared that the fixed and persisting intent of the relevant shippers of the ethane/propane mix is to ship interstate, beginning in Canada and ending at Morris, Illinois. *Id.* at p. 130. Additionally, they asserted that there is not a sufficient break in continuity of this transportation. *Id.* The Propane Group insisted that the shipper of the natural gas liquids on Alliance through to Mid-America's system at Channahon is Aux Sable because it is the only entity that can direct the injection of purity natural gas liquids into the pipeline in Canada, and it has the exclusive right to any and all natural gas liquids separated from the gas stream at the Aux Sable facility. *Id.* at p. 131. In sum, the Propane Group contended that the Aux Sable facility should not be considered a break in the interstate chain of transportation because, throughout the entire movement from Canada to the East Red Line Shipper, the buyer, the consumer, and the ultimate destination of the ethane/propane mix are known and fixed. *Id.* at p. 132.

1006. Staff did not seek to determine whether the Channahon to Morris movement was interstate or intrastate in nature, but rather, it followed Mid-America's recorded classification of the movement for each particular test period. Staff Initial Brief at p. 87.

1007. Determining whether an oil pipeline movement is interstate or intrastate "depends on the essential character" of the movement and the fixed and persisting intent with which the shipment is made. *Baltimore & Ohio Southwestern Railroad Co. v. Settle,* 260 U.S. 166, 170 (1922). While a movement beginning and ending in one state may constitute a link in a jurisdictional interstate chain of movements, a "sufficient break in the continuity of transportation" demonstrating the lack of intent by the shipper to move product interstate may remove federal jurisdiction.

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[524] Williams agreed with Mid-America. Williams Initial Brief at p. 54; Williams Reply Brief at p. 56.

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See, e.g., *Texaco Refining & Marketing, Inc. v. SFPP, L.P.*, 80 FERC at 61,805. In determining whether interstate commerce is involved, the Commission seeks the essential character of the shipment, *i.e.*, it attempts to ascertain the intent of the shipper at the time of the shipment. *Hydrocarbon Trading and Transport Co., Inc. v. Texas Eastern Transmission Corp.*, 26 FERC at p. 61,471. Quoting from *Petroleum Products Transported Within a Single State*, 71 M.C.C. 17 at p. 29 (1957), the Commission noted that:

> [T]he major manifestations of this intent, or the absence thereof, may be found in the following: (1) at the time of shipment there is no specific order being filled for a specific quantity of a given product to be moved through to a specific destination beyond the terminal storage; (2) the terminal storage is a distribution point or local marketing facility from which specific amounts of product are sold or allocated; (3) transportation in the furtherance of the distribution within the single state is specifically arranged only after sale or allocation from storage.

Hydrocarbon Trading and Transport Co., Inc. v. Texas Eastern Transmission Corp., 26 FERC at p. 61,471.

1008. I agree with the Propane Group and conclude that the record reflects that the movement of ethane/propane mix from Channahon to Morris, Illinois, is interstate in nature and, consequently, is subject to the Commission's jurisdiction under the Interstate Commerce Act. Specifically, I find that the Channahon-to-Morris ethane/propane movement is one link in the overall chain of interstate transportation.

1009. The movement of ethane/propane mix begins on the Alliance Pipeline originating in Canada and terminating at the Aux Sable facility at Channahon, Illinois. Exhibit No. NPG-1 at p. 169. The Aux Sable gas processing plant at Channahon, Illinois, which extracts liquids from natural gas, is connected to Alliance Pipeline. Transcript at p. 543. After the natural gas liquids are processed at Aux Sable, Mid-America receives ethane/propane mix from the plant.[525] *Id.* From the Aux Sable facility, the ethane/propane mix is moved on the Mid-America Pipeline on behalf of, or by, the East Red Line Shipper to Morris, Illinois, where it is used as a feedstock.[526] Transcript at p. 559. The Alliance Pipeline can be characterized as a natural gas liquid pipeline

[525] Until 2010, by contract, Enterprise Products Operating LLC, has the right to purchase all of the ethane/propane mix produced at Aux Sable and, in turn, sells it, by exchange, to the East Red Line Shipper at Conway. *Id.* at pp. 546-47, 559.

[526] According to Collingsworth, the East Red Line Shipper returns the exact amount of volume it received at Channahon to Enterprise Products Operating LLC, formerly Enterprise Operating LP, at Conway. Transcript at p. 559.

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because it moves wet gas, which is raw natural gas that has not had any of the natural gas liquids inherent in it stripped out. Transcript at p. 2501; Exhibit Nos. M-157 at p. 26; M-158 at p. 2; NPG-1 at p. 169. Aux Sable is the only entity that may direct the injection of purity natural gas liquids, such as ethane, propane, or ethane/propane mix, that have already been separated from the natural gas in Canada, into Alliance, and it possesses the exclusive right to any extracted natural gas liquids from the Alliance gas stream. Exhibit Nos. M-158 at p. 2; NPG-1 at p. 169; NPG-98 at p. 25.

1010. Contrary to Mid-America's assertion that the ethane/propane mix is manufactured at Aux Sable,[527] the record reflects that natural gas liquids are already in existence and being injected in Canada by the direction of Aux Sable before reaching the Aux Sable facility at Channahon. Exhibit Nos. NPG-1 at p. 170; M-158 at p. 2.

1011. Accordingly, although Aux Sable does not know how much ethane/propane mix will be separated daily from the gas stream it receives from the Alliance Pipeline,[528] I conclude that the fixed and persisting intent of the shipper owning or having the exclusive rights to all of the ethane/propane mix separated from the Alliance gas stream (Aux Sable) is to continue the transportation of the ethane/propane mix in interstate commerce, especially in light of the fact that the shipper directly sells under contract all of the ethane/propane mix to one buyer (Enterprise Products Operating LLP), who then sells all of the ethane/propane mix to one shipper (the East Red Line Shipper) for delivery beyond Aux Sable. Thus, the record clearly reflects that the movement of ethane/propane mix from Channahon, Illinois, to Morris, Illinois, is interstate in nature and therefore subject to the Commission's jurisdiction.

B. WHAT IS THE APPROPRIATE RATE AND COST OF SERVICE TREATMENT OF THE INCENTIVE RELIABILITY PAYMENTS BY THE EAST RED LINE SHIPPER?[529]

A. MID-AMERICA

1012. Mid-America contended that it should not be required to adjust its cost of service to reflect the incentive reliability payments[530] it receives from the East Red Line Shipper.

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[527] Exhibit No. M-46 at pp. 53-54.

[528] Exhibit No. M-46 at pp. 54-55.

[529] Williams did not address this issue. Williams Initial Brief at p. 57; Williams Reply Brief at p. 57.

[530] Mid-America explained that, if it maintains its pipeline so that the East Red

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Mid-America Initial Brief at p. 136. It asserted that these payments should not be credited against its cost-of-service because they are not a necessary part of jurisdictional transportation, but rather are part of a mechanism developed for the convenience of the shipper. *Id.* Moreover, it continued, no expenses or rate base items related to this revenue are included in Mid-America's cost-of-service. *Id.*

1013. According to Mid-America, for a commercial arrangement between a pipeline and its shipper to be jurisdictional, the service provided by a pipeline must be so necessary to the transportation that the carrier has a duty to provide it. *Id.* at p. 137.[531] Here, Mid-America argued, the reliability incentive payment is not necessary to the transportation service. *Id.* It analogized the incentive reliability payment to an insurance plan, wherein the pipeline is not required to provide such insurance against all transportation interruptions, and the insurance or guarantee is not necessary for the transportation to occur. *Id.* at pp. 137-38.

1014. Further, Mid-America argued, the incentive reliability payments also can be analogized to deficiency payments resulting from a shipper's failure to meet a shipment commitment. *Id.* at p. 138. For instance, described Mid-America, in *SFPP, L.P.*, 86 FERC ¶ 61,022, the Commission affirmed the presiding judge's finding that an agreement between a shipper and a pipeline providing for annual volume and revenue guarantees "'constitutes an exchange of important rights and obligations among two sophisticated parties,' with a payment simply by operation of the contract agreed to by the shipper." Mid-America Initial Brief at pp. 138-39 (*quoting SFPP, L.P.*, 80 FERC at p. 65,164). Likewise, asserted Mid-America, the agreement at issue was negotiated by two sophisticated parties, the payments were specific to this shipper and were not paid as a consequence of costs incurred by any other shipper, and the payments do not relate to barrels moved. *Id.* at p. 139.

1015. To conclude, Mid-America submitted that there is no basis on which to credit the revenue received from the incentive reliability payment against Mid-America's cost-of-service. *Id.* It further noted that the incentive reliability payments are not associated with the incurrence of any specific costs. *Id.* at p. 140. Hence, Mid-America maintained that there are no costs to allocate between jurisdictional and non-jurisdictional

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Line Shipper faces no plant disruptions or shutdowns in a calendar year, it receives from the East Red Line Shipper a $1 million payment for that particular year. Mid-America Initial Brief at p. 136; *see also* Exhibit No. NPG-93 at p. 16. According to Mid-America, it met these conditions and received the payment in each of the years at issue in this proceeding. Mid-America Initial Brief at p. 136; Transcript at pp. 737-38.

[531] In support, Mid-America cited *Kerr-McGee Refining Corp. v. Williams Pipe Line Co.,* 72 FERC ¶ 61,274 at p. 62,199 (1995); *Tipco Crude Oil Co. v. Shell Pipe Line Corp.,* 19 FERC ¶ at p. 61,198.

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service and no reason to credit revenue received from non-jurisdictional activities. *Id.*

1016. In its Reply Brief, Mid-America argued that its only obligation under the Interstate Commerce Act is to provide non-discriminatory service as offered in its tariff upon reasonable request from its shippers. Mid-America Reply Brief at p. 103 (*citing* 49 U.S.C. app. §§ 1(4), 6). The incentive reliability payment provision of the East Red Line Shipper contract, contended Mid-America, does not fall under that obligation. *Id.* It pointed out that, simply because the essential terms of the East Red Line Shipper's relationship with Mid-America are necessarily set out in the published tariff, does not mean that all aspects of the dealings between the two parties necessarily become subject to Commission jurisdiction under the Interstate Commerce Act. *Id.* at p. 104. In this case, Mid-America claimed that the actual interstate movement of natural gas liquids for the East Red Line Shipper is wholly governed by Mid-America's FERC Tariff, yet the incentive reliability payment has no relation to any such actual movement and consequently is outside the Tariff. *Id.*

1017. Alternatively, if the payments are credited to the Northern System cost-of-service as the Propane Group recommended, Mid-America insisted that improper cost shifting would result. *Id.* at p. 105. Mid-America declared that the rates charged to the Propane Group members would be reduced by the amount of the incentive reliability payments, even though those members contributed nothing to the payments and even though their service was in no way affected by the arrangement that produced the payments. *Id.* To the extent it receives incidental revenue not associated with its jurisdictional service, Mid-America submitted that retaining it is completely appropriate, if not more appropriate than transferring the benefits of incidental revenue to shippers that do not generate it through the vehicle of a credit to the Northern System cost of service. *Id.* at pp. 105-06.

B. PROPANE GROUP

1018. The Propane Group recommended that Mid-America's cost-of-service be reduced by the amount of the incentive reliability payments received by Mid-America. Propane Group Initial Brief at p. 135. They contended that Mid-America receives the $1 million incentive reliability payment for doing nothing more than its ordinary maintenance and operation in ensuring deliverability of on-spec product for the other pipelines on the Northern System. *Id.* at p. 136. In effect, emphasized the Propane Group, by excluding the $1 million payment from the cost and revenue analyses in this case, while including the costs serving the basis for this payment, Mid-America unreasonably double recovers costs related to the East Red Line service from the other Northern System shippers; once through the non-recognition of the incentive reliability payments themselves and once through the other Northern System shippers who have these same costs embedded in their cost-of-service rates. *Id.* at p. 137.

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1019. In response to Mid-America's contrary position, the Propane Group first claimed that Mid-America misrepresented the Commission's decision in *SFPP, L.P.*, 86 FERC at p. 61,078. Propane Group Initial Brief at p. 138. They pointed out that, in that ruling, while the Commission found that the throughput and deficiency agreement were not integral to the issue at hand, it held that the related volumes, revenues, and the term of the contract affected the ratemaking process in a maximum rate case, and to that extent they would be integral to a rate at issue in such a proceeding. *Id.* Second, the Propane Group noted that Mid-America witness Collingsworth testified that the reliability, delivery, maintenance, and upgrade goals for the East Red Line Shipper were the same goals Mid-America has for all Northern System shippers. *Id.* (*citing* Transcript at pp. 736-37). Third, the Propane Group asserted that the incentive reliability payment provision was represented in the 2004 East Red Line Shipper contract negotiation documents as an integral element in the development and design of the East Red Line Shipper's new rate. *Id.* at p. 139 (*citing* Exhibit No. NPG-177 at pp. 31, 36, 44).

1020. In its Reply Brief, the Propane Group reasserted their claim that the incentive payment is for nothing more than the service which Mid-America already provides for the rest of the Northern System, to wit: (1) delivering on-specification product; (2) implementing necessary upgrades or additions; and (3) performing regular maintenance and operating the Northern System, including the East Red Line, such that delivery of nominated product volumes is reliable. Propane Group Reply Brief at p. 132. In other words, the Propane Group argued that the incentive payment is a necessary part of the Northern System transportation. *Id.* (*citing* Transcript at pp. 736-37; Exhibit No. NPG-93 at p. 16).

1021. Although Mid-America claimed that it is not required to provide "insurance" against interruptions in the transportation of product, the Propane Group claimed that the Interstate Commerce Act requires Mid-America to "provide and furnish transportation upon reasonable request thereof." *Id.* (*citing* 49 U.S.C. app. § 1(4)). They maintained that "furnish" necessarily implies the provision of all the essentials for performing the transportation function, including maintenance and operational services, and thus, the express foundations for the incentive payments — necessary and regular maintenance and reliable operation of the Northern System — are clearly encompassed within the Interstate Commerce's use of the term. *Id.* at pp. 132-33.

1022. In response to Mid-America's analogy of the incentive payment to a throughput and deficiency charge, the Propane Group contended that the Commission expressly found in *SFPP, L.P.*, 86 FERC at p. 61,078, that the related volumes, the revenues, and the term of the contract — such as a throughput and deficiency agreement — would clearly be relevant to designing a rate in a maximum rate case. Propane Group Reply Brief at p. 133. Thus, the Propane Group submitted that, even under Mid-America's analogy, the incentive payment is integral to the design of rates in this proceeding and should be included in any cost and revenue analyses, including the establishment of any

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East Red Line Shipper discount. *Id.*

1023. In conclusion, the Propane Group advocated treating the incentive payments as negative expenses and deducting them from Mid-America's cost of service. *Id.* at p. 134. In any event, the Propane Group submitted that, if the incentive payments are deemed non-jurisdictional and excluded from any cost and revenue analyses in this proceeding, the payments must still be included in any determination of whether there is an East Red Line Shipper discount. *Id.* at pp. 134-45. In making such recommendation, the Propane Group stressed that the incentive payments were a significant feature of the East Red Line Shipper Agreement negotiations and were clearly integral to the establishment and design of the East Red Line Shipper's new rate. *Id.* at p. 135.

C. COMMISSION TRIAL STAFF

1024. Staff took the position that the East Red Line Shipper's incentive reliability payments should not be included in the Northern System cost-of-service. Staff Initial Brief at p. 93 (*citing* Exhibit No. S-26 at p. 22). It reasoned that the incentive reliability payments are individualized rates contained in a negotiated pipeage agreement between the East Red Line Shipper and Mid-America for service over an extended period. *Id.* Commission policy, according to Staff, allows pipelines to negotiate individualized rates so long as rate-paying shippers are protected against inappropriate cost shifting. *Id.* (*citing Wyoming Interstate Co., Ltd.*, 117 FERC ¶ 61,150 at P 9 (2006)). Staff submitted that Mid-America and the East Red Line Shipper entered into such an agreement which provides an individualized rate for the latter, and imposes obligations on the former which are not published in its Tariff. *Id.* at p. 94 (*citing* Exhibit Nos. S-26 at p. 20; S-44 at pp. 1, 16). Since "the incentive reliability payments are not published in the Mid-America's Tariffs or paid by any other shipper on the Northern System . . . these payments should not be credited to the other Northern System shippers," it insisted. *Id.* at p. 95.

1025. In reply, Staff disputed the Propane Group's characterization of the incentive reliability payments as an over-recovery of costs. Staff Reply Brief at p. 83. Instead, Staff characterized the payments as a reward for service that is specific to the East Red Line Shipper, which seems to be entirely unrelated to costs. *Id.* at pp. 83-84. Consequently, Staff insisted that, as long as the incentive does not create additional costs or affect the service provided to other shippers, Mid-America should be permitted to retain the benefit of the reward. *Id.* at p. 84 (*citing* Transcript at pp. 3002-03). To say otherwise, claimed Staff, would leave Mid-America with no incentive to perform according to the needs of the East Red Line Shipper. *Id.*

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Discussion and Ruling

1026. Whether Mid-America should be required to reflect the incentive reliability payments it receives from the East Red Line Shipper as a credit to its cost-of-service depends on the jurisdictional nature of the incentive reliability payments. Specifically, the issue is whether the incentive reliability payments (and its associated service) are a necessary part of Mid-America's jurisdictional transportation. To the extent they are, they should be reflected in Mid-America's cost-of-service as jurisdictional revenue. *Kerr-McGee Refining Corp. v. Williams Pipe Line Co.,* 72 FERC at p. 62,199.

1027. According to Mid-America, the incentive reliability payments it receives from the East Red Line Shipper should not be credited against its cost-of-service because the payments are not a necessary part of jurisdictional transportation, but rather are a part of a mechanism created for the convenience of a shipper. Mid-America Initial Brief at p. 136. Further, Mid-America insisted that these payments are not associated with the incurrence of any specific costs. *Id.* at p. 140.

1028. In contrast, the Propane Group asserted that Mid-America receives the $1 million incentive reliability payment for doing nothing more than its ordinary maintenance and operation, which is performed to ensure the deliverability of on-spec product for the other pipelines on the Northern System. Propane Group Initial Brief at p. 136. In other words, they maintained that the incentive payment is a necessary part of the Northern System transportation. Propane Group Reply Brief at p. 132. Thus, they argued that Mid-America's cost of service should be reduced by the amount of the incentive reliability payments. Propane Group Initial Brief at p. 135.

1029. While Staff agreed with Mid-America that the East Red Line Shipper's incentive reliability payments should not be included in the Northern System cost of service, it reasoned differently. Staff Initial Brief at p. 93. Specifically, it contended that the incentive reliability payments are individualized rates contained in a negotiated pipeage agreement between the East Red Line Shipper and Mid-America for service over an extended period. *Id.* It declared that Commission policy permits pipelines to negotiate individualized rates so long as rate paying shippers are protected against inappropriate cost shifting, as it maintained is the case here. *Id.* at pp. 93-94.

1030. Based on the record, I conclude that the incentive reliability payments made to Mid-America by the East Red Line Shipper are a necessary part of the Northern System jurisdictional transportation. A commercial agreement between a pipeline and its shipper must be necessary to the transportation service, not merely a convenience to the shipper, if such agreement is to be considered jurisdictional. *See, e.g., Kerr-McGee Refining Corp. v. Williams Pipe Line Co.,* 72 FERC at p. 62,199; *Tipco Crude Oil Co. v. Shell Pipe Line Corp.,* 19 FERC at p. 61,198. In short, Mid-America receives the $1 million incentive reliability payment for doing nothing more or less than it already performs for

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the rest of the Northern System: (1) delivering on-specification product; (2) implementing necessary upgrades or additions; and (3) performing regular maintenance and operating the Northern System, including the East Red Line, such that reliable delivery of nominated product volumes is guaranteed. Transcript at pp. 736-37; Exhibit Nos. NPG-93 at p. 16; NPG-174 at p. 2. In fact, Mid-America witness Collingsworth testified at the hearing that the express goals of the incentive reliability agreement were no different than the goals the pipeline possessed for all of its Northern System shippers and the related products received, transported, and delivered. Transcript at pp. 736-37.

1031. Additionally, the incentive reliability agreement was reflected in the 2004 East Red Line Shipper contract negotiation documents as an integral element in the establishment and design of the East Red Line Shipper's new rate. Exhibit No. NPG-177 at pp. 31, 36, 44; Transcript at pp. 742-43. Significantly, the negotiations resulted in a new East Red Line Shipper's rate, which doubled the incentive payment from $500,000 to $1 million. Exhibit No. NPG-177 at p. 31; Transcript at pp. 769-71.

1032. Moreover, Collingsworth admitted that all of the costs associated with meeting the goals of the incentive reliability agreement were embedded in the current costs of service being proposed by Mid-America in this proceeding. Transcript at p. 737. Consequently, were the $1 million incentive reliability payment excluded from Mid-America's cost and revenue analyses in this proceeding, Mid-America unreasonably would double recover costs associated with its East Red Line service from the other Northern System shippers — through the non-recognition of the incentive payments and then through the cost-of-service rates (which include the costs associated with the East Red Line service) charged to the other Northern System shippers.

1033. To conclude, I find unavailing Mid-America's argument that it provides only "insurance" against all transportation interruptions pursuant to the incentive reliability agreement, which is not required of it under the Interstate Commerce Act. In sum, performing regular and necessary maintenance and providing reliable operation, which are the express foundations for the incentive reliability payments, are required of a pipeline carrier under Section 1(4) of the Interstate Commerce Act. *See* 49 U.S.C. app. § 1(4) (1988).

1034. Accordingly, for the reasons explained above, the East Red Line Shipper incentive reliability should be credited to Mid-America's cost-of-service. *See* Exhibit No. NPG-1 at p. 173.

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C. WHAT IS THE APPROPRIATE RATE AND COST OF SERVICE TREATMENT OF THE COCHIN VOLUME SHORTFALL PAYMENT FROM THE EAST RED LINE SHIPPER?[532]

A. MID-AMERICA

1035. Mid-America explained that Item 350 of FERC Tariff Nos. 38 and 41 provides a volume incentive rate of 79.10 cents per barrel for any shipper that committed, by December 21, 2000, to move a minimum of 3,650,000 barrels per day to Conway, Kansas, from the eastern interconnection of Mid-America with Cochin Pipeline. Mid-America Initial Brief at p. 141 (*citing* Exhibit Nos. M-37 at p. 53; M-38 at p. 9). Continuing, Mid-America added that, if a shipper commits to the minimum volume and fails to meet such requirement, the shipper must pay Mid-America the difference between (a) the revenue Mid-America would have otherwise received had the shipper met its commitment and (b) the transportation revenue Mid-America actually received from the shipper. *Id.* In the case of the East Red Line Shipper, because it had committed to transfer the minimum volume in Item 350 and failed to do so, it made deficiency payments to Mid-America in the annual amount of approximately $2.9 million in both periods at issue. *Id.* (*citing* Exhibit No. S-46; Transcript at pp. 371-72, 2481-82).

1036. Although the other parties disagreed, Mid-America treated the annual Cochin to Conway deficiency payments as non-jurisdictional revenue and thus argued that those amounts should not be included in its rate analyses in this proceeding. *Id.* at p. 142 (*citing* Exhibit No. M-100 at p. 91). According to Mid-America, its position falls in line with Commission precedent and regulation. *Id.* (*citing* 18 C.F.R. pt. 352, Item 210 (2007)). First, it argued, the deficiency payments by the East Red Line Shipper do not constitute "transportation" revenues, which is required under the definition of trunk revenues. *Id.* Second, Mid-America claimed that a shortfall payment under a throughput and deficiency obligation is irrelevant in determining just and reasonable rates for transportation service. *Id.* at pp. 142-43 (*citing SFPP, L.P.*, 86 FERC at p. 61,077). Further, Mid-America noted that, with the *SFPP* decision in mind, the payments at issue are unrelated to any costs that are being assessed to any other Mid-America shipper, and thus, the other parties' approaches would unfairly reduce the rates that Mid-America should be permitted to charge for the transportation service it provides. *Id.* at p. 143.

1037. In its Reply Brief, while agreeing with the Propane Group that a throughput and deficiency agreement is relevant in designing rates, Mid-America claimed that, since no volumes moved on the Cochin to Conway path, designing a rate for it using purely

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[532] Williams did not address this issue. Williams Initial Brief at p. 57; Williams Reply Brief at p. 58.

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hypothetical volumes, as the Propane Group suggested, is absurd. *Id.* at pp. 108-09. Mid-America insisted that the Propane Group's approach actually results in improper cross-subsidization, allocating a substantial portion of Mid-America's Northern System cost of service to a route for which there have been no movements and no related costs for several years. *Id.* at p. 110. It maintained that no additional costs are incurred as a result of the Cochin to Conway agreement because the line on which the hypothetical Cochin to Conway volumes would move, actually, already is used for northbound propane movements. *Id.* (*citing* Exhibit No. M-46 at p. 49). Mid-America also noted that the Propane Group excluded the barrel-miles related to the Cochin to Conway movement in calculating its fuel and power costs, and therefore, it argued that the Propane Group should not be permitted to include the movements for purposes of rate design. *Id.* at p. 111.

B. PROPANE GROUP

1038. The Propane Group disputed Mid-America's treatment of the Cochin shortfall revenues. Propane Group Initial Brief at pp. 140-41. They submitted that Mid-America's interpretation and application of the definition of "trunk revenues" to the deficiency payments are erroneous. *Id.* at p. 141. In addition, the Propane Group suggested that Mid-America's interpretation of the Commission's 1999 *SFPP* decision is inadequate, as the Commission went on to hold that the related volumes, revenues, and the term of the contract are relevant in designing a rate in a maximum rate case, and to that extent, they would be integral to a rate at issue in such a proceeding. *Id.* at p. 142 (*citing SFPP, L.P.,* 86 FERC at p. 61,078; Transcript at p. 1938; Exhibit No. M-100 at p. 91). Finally, the Propane Group pointed out that even Mid-America witness Ganz conceded that, by not including the 3.65 million barrels in his rate design, costs associated with the Cochin service necessarily were forced on to all of the other shippers on the Northern System — clearly an improper cross subsidization. *Id.* at pp. 143-44 (*citing* Transcript at pp. 1939-41).

1039. Rather, the Propane Group argued, Mid-America should recognize the revenue from the Cochin shortfall payments and include the volume commitment level in the barrels and barrel-miles used to derive fully allocated cost based rates on the Northern System. *Id.* at p. 143 (*citing* Exhibit No. NPG-1 at p. 175). They noted that allocating no costs to the service based on the fact that the East Red Line Shipper chose not to transport any volumes would be inappropriate since Mid-America is contractually required to maintain the facilities and incur the related costs, regardless of whether the East Red Line Shipper moves a volume lower than the commitment level. *Id.* (*citing* Transcript at pp. 741, 1940-41).

1040. In its Reply Brief, the Propane Group contended that Account 210 of the Uniform System of Accounts, which it stated defines "Trunk Revenues" as "'revenues on the basis of tariff charges for trunk line transportation of crude oil, oil products or other

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commodities,'" in no way requires the incurrence of physical transportation, as Mid-America proposes. Propane Group Reply Brief at p. 137 (*citing* 18 C.F.R. pt. 352, Account No. 210). Rather, the Propane Group asserted, the revenues need only have their basis in charges reflected in the tariff and associated with trunk line transportation. *Id.* Here, the Propane Group suggested, the Cochin shortfall payments clearly satisfy this requirement. *Id.* (*citing* Exhibit No. NPG-146 at pp. 16, 25, 37 (Item 350)). Moreover, the Propane Group pointed to *Texaco Refining & Marketing, Inc., v. SFPP, L.*P, 117 FERC ¶ 61,285*,* where, according to them, the Commission analyzed and relied on such throughput and deficiency agreements in determining an appropriate rate base and designing just and reasonable rates. *Id.* at p. 138. They stated, "the appropriate treatment of the Cochin shortfall payments is to recognize the revenue in the cost and revenue analyses and include the associated volume commitment in the barrels and barrel-miles used to derive fully-allocated cost-based rates on the Northern system." *Id.* at p. 139 (*citing* Exhibit No. NPG-1 at p. 175).

C. COMMISSION TRIAL STAFF

1041. Staff asserted that the Cochin volume shortfall payments from the East Red Line Shipper should be treated as trunk revenues, and accordingly, credits the Cochin volume shortfall payments as revenues under the FERC Tariff Nos. 38 and 41 costs of service. Staff Initial Brief at p. 95. It maintained that the deficiency payments are revenues received just as if the transportation occurred, and thus, fall squarely within the definition of trunk revenues. *Id.* at pp. 97-98 (*citing* 18 C.F.R. Part 352 §§ 4-2, 210 (2007).

1042. In reply, Staff insisted that *SFPP, L.P.,* 86 FERC at p. 61,078, which Mid-America cited, fails to support Mid-America's position because the Commission held that revenues from a throughput and deficiency agreement are relevant to designing a rate in a maximum rate case. Staff Reply Brief at pp. 85-86.

Discussion and Ruling

1043. The appropriate rate and cost-of-service treatment of the Cochin volume shortfall payment from the East Red Line Shipper depends on the jurisdictional nature of the payment. Specifically, the issue is whether the Cochin volume shortfall payment is jurisdictional trunk revenue.

1044. Mid-America treated the annual Cochin to Conway deficiency payments as non-jurisdictional revenue, and consequently argued that they should be excluded from its rate analyses. Mid-America Initial Brief at p. 142. First, it contended that, because no actual movement occurs on Mid-America from Cochin to Conway, the deficiency payments do not constitute "transportation" revenues, which is required under the Commission's regulations. *Id.* Second, it asserted that, in *SFPP, L.P.*, 86 FERC ¶ 61,022, the Commission found that a shortfall payment under a throughput and

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deficiency obligation does not need to be treated as a revenue credit. Mid-America Initial Brief at pp. 142-43.

1045. In contrast with Mid-America's position, the Propane Group argued that Mid-America should recognize the revenue from the Cochin shortfall payment and include the volume commitment level in the barrels and barrel-miles used to derive fully allocated cost based rates on the Northern System. Propane Group Initial Brief at p. 143. According to the Propane Group, allocating no costs to the service based on the fact that the East Red Line Shipper chose not to transport any volumes would be inappropriate since Mid-America is contractually required to maintain the facilities and incur the related costs, regardless of whether the East Red Line Shipper moves a volume lower than the commitment level. *Id.*

1046. Although Staff agreed with the Propane Group that the Cochin volume shortfall payment from the East Red Line Shipper should be treated as trunk revenue, it took a different approach than the Propane Group and credited the Cochin volume shortfall payments as revenues to the costs of service of FERC Tariff Nos. 38 and 41. Staff Initial Brief at p. 95. Staff submitted that the deficiency payments are revenues received as if the transportation occurred, and thus, fall squarely within the definition of trunk revenues. *Id.* at pp. 97-98. Further, it insisted that, in *SFPP, L.P.,* 86 FERC at p. 61,078, the Commission held that revenues from a throughput and deficiency agreement were relevant to designing a rate in a maximum rate case. Staff Reply Brief at pp. 85-86.

1047. I agree with the Propane Group and Staff that the Cochin volume shortfall payments from the East Red Line Shipper should be treated as jurisdictional trunk revenues because they are "revenues [based] on . . . tariff charges for trunk line transportation of crude oil, oil products or other commodities." 18 C.F.R. pt. 352, Account No. 210 (2008). Accordingly, the Cochin volume shortfall payments which Mid-America received from the East Red Line Shipper should be credited against the costs of service of FERC Tariff Nos. 38 and 41.[533]

1048. No party disputed that the underlying Cochin service, the Cochin volume commitment, the Cochin shortfall rate, and all of the relevant provisions associated with the Cochin service, including the calculation of the shortfall payment itself, are expressly provided for in Item 350 (Cochin Volume Incentive Program) of Mid-America's tariffs.

[533] The East Red Line Shipper failed to meet the Cochin volume requirement in both periods at issue in this proceeding. Exhibit No. S-46; Transcript at pp. 371-72, 740, 2481-82. Consequently, the East Red Line Shipper had been making an annual Cochin shortfall payment of $2,887,150 (*i.e.,* 79.10 cents/barrel times the minimum volume commitment of 3,650,000 barrels) to Mid-America in each of the years at issue. *See* Exhibit No. NPG-1 at p. 174.

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Transcript at pp. 1935-36.[534] Thus, as revenue based on specific FERC tariff charges, the Cochin shortfall payments, clearly fall within the definition of "Trunk Revenue" under the Commission's regulations. *See* 18 C.F.R. pt. 352 Account No. 210 (2008).

1049. Mid-America's argument that physical transportation is required for revenue to be considered "Trunk Revenues" misses the mark. The term "Trunk Revenues" under the Commission's regulations do not require physical transportation, but rather, it requires only that the revenues have their bases in charges reflected in the tariff and associated with trunk line transportation. *See* 18 C.F.R. pt. 352 Account 210; Exhibit No. NPG-146 at pp. 16, 25, 37. Accordingly, the deficiency payments are revenues received as if the transportation related to Item 350 of FERC Tariff Nos. 38 and 41 occurred.

1050. Second, allocating no cost responsibility to the transportation service associated with the volume commitment on the basis that the East Red Line Shipper chose not to ship any volumes is entirely improper because Mid-America is contractually obligated to maintain the subject facilities and incur the associated costs regardless of whether the East Red Line Shipper transports a volume lower than the commitment level. Exhibit No. NPG-1 at p. 175; Transcript at pp. 741, 1940-41. Carriers use throughput and deficiency agreements to (1) retain and/or maintain volumes and revenues so they do not leave the system; (2) compensate the pipeline for the costs associated with maintaining the subject facilities; and (3) avoid the risk of underrecovery of its investment, operating costs, and equity costs when volumes are not as expected. *See Texaco Refining & Marketing, Inc., v. SFPP, L.P.,* 117 FERC ¶ 61,285 at P 15. Thus, allowing Mid-America to exclude the Cochin shortfall payments in its Northern System cost and revenue analyses unreasonably would permit it to over-recover its investment, operating costs, and equity costs, and improperly shifts costs away from the East Red Line Shipper onto other Northern System shippers who pay for Mid-America's investment and operating costs through tariff rates.

1051. Finally, I note that, in supporting its position, Mid-America mischaracterizes the presiding judge's treatment of a throughput and deficiency agreement in *SFPP, L.P.*, 80 FERC ¶ 63,014 (1997). Specifically, Mid-America argued that the presiding judge held that the throughput and deficiency agreement "should play no part in the evaluation of the per barrel rate charged to the shipper for volumes actually moved by the shipper." Mid-America Initial Brief at p. 143 (*citing SFPP. L.P.,* 80 FERC at p. 65,164). This assertion misconstrues the presiding judge's ruling. The issue before the presiding judge was "whether any provisions of the Reversal Agreement (which appears to be similar to the provision at issue here) are illegal, and if so what remedies are required." *See SFPP, L.P.*, 80 FERC at p. 65,164. Holding that the Agreement did not constitute a preference or involve discrimination against other shippers, the presiding judge stated: "The reversal

[534] *See also* Exhibit No. NPG-146 at pp. 16, 25, 37

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agreement constitutes an exchange of important rights and obligations among two sophisticated parties. To the extent [that the shipper] has incurred a deficiency payment, that is the result of its failure to meet its contractual obligations, not because SFPP is exacting a charge in excess of the filed rate." *Id.* Thus, the question at bar in that case was whether the shipper had a valid complaint regarding the deficiency payments it was required to pay. The matter at issue here does not involve that question. Rather, we deal here with whether the deficiency payment ought to be considered in calculating Mid-America's cost-of-service.

1052. Moreover, while as Mid-America claimed, the Commission affirmed that ruling, it went on to hold that "SFPP was not attempting to design a rate through the use of the Agreement, it was simply applying the rate on file" and also that "[t]he related volumes, the revenues, and the term of the [throughput and deficiency] contract would clearly be relevant to designing a rate in a maximum rate case; to the extent they would be integral to a rate at issue in such a proceeding." *SFPP, L.P.,* 86 FERC at p. 61,078. I take this as a clear indication that the Commission would include such payments in a pipeline's rates. Consequently, based on Commission precedent as well as the record evidence, the Cochin shortfall payments should be reflected in designing Mid-America's rates.

D. WHAT ARE THE APPROPRIATE TARIFF, RATE AND COST OF SERVICE TREATMENT OF PROPANE MOVEMENTS BETWEEN CLINTON, IOWA, AND CONWAY, KANSAS, BY THE EAST RED LINE SHIPPER?[535]

A. MID-AMERICA

1053. Mid-America explained that, under Item 150[536] of FERC Tariff Nos. 38 and 41, the East Red Line Shipper is allowed to return to Mid-America, at Clinton, the propane component of its delivered ethane/propane mix. Mid-America Initial Brief at p. 144

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[535] Williams did not address this issue. Williams Initial Brief at pp. 57-58; Williams Reply Brief at p. 58.

[536] Item 150 of Mid-America's tariffs provides:

> Propane separated from ethane-propane mix delivered by Carrier to Clinton and reinjected into Carrier's system will be returned to Shipper's propane inventory at Conway Holding facilities. For propane returned to Conway Holding facilities, Shipper will receive a credit on a Barrel for Barrel basis against transportation charges to Clinton.

Exhibit No. M-38 at p. 4; Exhibit No. NPG-146 at pp. 19, 33.

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(*citing* Exhibit Nos. M-37 at p. 47; M-38 at p. 4). If such redelivery occurs, it added, the East Red Line Shipper is credited at Conway (the origin point of the ethane/propane mix movement) in an amount equal to the transportation charge that it paid on the ethane/propane barrels it moved to Clinton, multiplied by the number of propane barrels returned to Mid-America. *Id.* In essence, according to Mid-America, the crediting causes the East Red Line Shipper to be treated as though it had moved only the number of barrels of ethane/propane mix that it received at Clinton, net of any propane barrels it returned to Mid-America. *Id.* Lastly, Mid-America stated, the returned propane is then stored at Iowa City and is used to supply the needs of other shippers. *Id.*

1054. As it claimed there is no physical movement associated with the "Clinton to Conway" movements, Mid-America stated that it excluded the purported movements from both the FERC Tariff No. 38 Locked-In Period and the FERC Tariff No. 41 Test Period rate calculations. *Id.* at p. 146. It added that "[t]he barrels returned to the pipeline at Clinton are never actually moved back to Conway for redelivery to Clinton and points north; indeed, such movement would be entirely wasteful, since having already been moved to Clinton they can be used to serve the needs of shippers wishing to have the propane delivered north of that point. . . ." *Id.* (*citing* Exhibit No. M-46 at p. 51). Furthermore, Mid-America claimed, if the propane barrels returned by the East Red Line Shipper at Clinton are considered to have been transported back to Conway, when in actuality they were not, double counting of those barrels would result because the barrels delivered to a shipper who moves them to a destination north of Clinton are treated as having been moved all the way from Conway. *Id.* at pp. 146-47 (*citing* Transcript at pp. 1963-65).

1055. Mid-America asserted that there is no "valid transportation movement" from Clinton to Conway. *Id.* at p. 149 (*citing* Transcript at pp. 2487-88). It contended that, including barrels and barrel-miles to reflect this non-existent movement inflates the volume component of the rate calculation and decreases the rates for the Northern System below a just and reasonable level. *Id.* Similarly, Mid-America maintained that the East Red Line Shipper is not advantaged at the expense of other shippers by the crediting arrangement because Item 150 does not result in "free transportation" to anyone as no transportation occurs, and is available on equal terms to all shippers that avail themselves of it. *Id.*

1056. In its Reply Brief, addressing the Propane Group's argument that the propane credit is analogous to a "backhaul"[537] in the natural gas context, which would be accounted for in designing a natural gas pipeline's rates, Mid-America insisted that, in the oil pipeline context, the Commission does not recognize exchanges as jurisdictional

[537] Mid-America explained that, in the natural gas context, a "backhaul" is simply an exchange of product and constitutes transportation. Mid-America Reply Brief at p. 114 (*citing* 18 C.F.R. § 284.1).

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transportation. Mid-America Reply Brief at pp. 113-14 (*citing Western Refining Pipeline Co.,* 122 FERC ¶ 61,210 at P 14-16 (2008)). Distinguishing the movements under Item 150 from a backhaul, Mid-America explained that, while the purpose of a backhaul is for a shipper to tender natural gas in one location and receive the same amount of natural gas in another location, here, the East Red Line Shipper does not seek to move propane to Conway; it seeks ethane/propane mix of a certain quality delivered from Conway to Clinton and Morris. *Id.* at p. 115.

1057. With respect to the Propane Group's argument that the system is no more benefited by the storage of propane at Iowa City than it is already receiving from the Propane Supply Assurance Program,[538] Mid-America responded that, while the Propane Supply Assurance Program provides shippers with on-demand service consistent with the capacity of the pipeline, the storage of propane at Iowa City and the movement of propane to Iowa City on the East Red Line as part of the stream of ethane/propane mix serve to increase the line's operational capacity. *Id.* at pp. 116-17.

B. PROPANE GROUP

1058. The Propane Group agreed with Staff's position that Item 150, governing the East Red Line Shipper propane movement from Clinton to Conway, results in undue preference for the East Red Line Shipper at the expense of other shippers. Propane Group Initial Brief at p. 145 (*citing* Exhibit Nos. S-26 at pp. 26-27; NPG-146 at p. 7, 19, 33; NPG-93 at p. 13).

1059. Because Mid-America treats the propane volumes moved from Clinton to Conway and the equivalent volumes of ethane/propane mix moved from Conway to Clinton as non-existent movements, the Propane Group argued that Mid-America effectively under allocates costs to this service, which consequently forces the remaining actual costs of this service to be allocated to other Northern System shippers. *Id.* at pp. 146-47 (*citing* Exhibit No. NPG-1 at p. 176; Transcript at pp. 1939-41). According to the Propane Group, Commission policy requires that backhaul transportation or transportation by exchange volumes be accounted for in developing rates just as forward haul volumes are recognized and accounted for. *Id.* at pp. 146-47, 150-51 (*citing Iroquois Gas Transmission System, L.P.,* 84 FERC at p. 61,468). Additionally, the Propane Group emphasized that these barrels also are unreasonably excluded from Mid-America's Test Period volume levels, depressing the actual volumes transported during any of the relevant test years. *Id.* at p. 147 (*citing* Transcript at pp. 1970-71).

[538] According to the Propane Group, the Propane Supply Assurance Program is a line fill program, which allows the provision of on-demand service (*i.e.,* a shipper can put product in at Conway and instantaneously withdraw or load-out product anywhere else on the system). Propane Group Initial Brief at p. 148 (*citing* Exhibit No. NPG-159).

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1060. In addressing Mid-America's claim that its rate design treatment of the approximately 2 million propane credit barrels produces efficiency and service for the customers north of Iowa City, the Propane Group asserted that the propane credit volumes returned to Mid-America are simply the operational equivalents of line fill. *Id.* at p. 148 (*citing* Exhibit No. NPG-176; Transcript at pp. 753-55). Continuing, the Propane Group insisted that, should Mid-America operate its on-demand service in the same way it does today without the Iowa City storage facility (as testified to by Mid-America witness Collingsworth), then clearly, the propane credit volumes stored at Iowa City have no effect on the functioning and efficiency of on-demand propane service. *Id.* (*citing* Transcript at p. 671).

1061. Next, with respect to Mid-America's claim that the crediting of propane barrels achieves a proper matching of costs and revenues, the Propane Group pointed out that the result of excluding the propane credit barrels and barrel-miles is the reallocation of costs from the East Red Line Shipper to other Northern System shippers, causing them to subsidize the service offered to the East Red Line Shipper. *Id.* at pp. 149-50. In fact, the Propane Group declared, the propane credit scheme is the functional equivalent of Mid-America paying the East Red Line Shipper to move volumes. *Id.* at p. 150.

1062. In their Reply Brief, the Propane Group claimed that, absent Mid-America witness Collingsworth's testimony, the record lacks any documentary or other evidence supporting any conclusion that Mid-America's propane credit scheme was the product of competition. Propane Group Reply Brief at p. 142 (*citing* Exhibit No. M-46 at p. 50). Contrary to Collingsworth's assertion that the East Red Line Shipper prefers to process purity ethane which could not be supplied from Conway, the Propane Group insisted that the record indicates that the East Red Line Shipper has no such preference and actually uses various levels of the propane in the ethane/propane mix delivered to its plants. *Id.* (*citing* Transcript at pp. 541-42, 744). Additionally, the Propane Group contended that the Aux Sable facility has the capacity to supply pure ethane for the benefit of the East Red Line Shipper, as the ethane/propane mix from Aux Sable will combine a range of ethane from 80-92%. *Id.* at p. 143 (*citing* Transcript at pp. 541-42; Exhibit No. NPG-167).

1063. Addressing Mid-America's denial that backhauls constitute transportation, the Propane Group noted that, under the Natural Gas Act, backhauls constitute transportation. *Id.* at pp. 143-44 (*citing* 18 C.F.R. § 2841(a)). It stated further that it was "disingenuous" of Mid-America to deny that backhauls are transportation as its witness Collingsworth testified that "backhauls or 'virtual transportation' are a common practice" on it and that it "does not hesitate to charge full tariff rates to shippers, other than the [East Red Line] Shipper, for such 'virtual transportation' or backhauls, notwithstanding that the pipeline is paid for doing nothing." *Id.* at p. 144 (*citing* Transcript at p. 747).

1064. Further, in addressing its characterization of the Conway to Clinton movements as

backhaul, and Mid-America's subsequent rejection of it, the Propane Group distinguished this case from the recent Commission order, *Western Refining Pipeline Co.*, 122 FERC ¶ 61,210, in which the Commission indicated that exchanges do not involve transportation. Propane Group Reply Brief at p. 144. According to the Propane Group, in that case, two shippers requested that the Commission direct the pipeline to facilitate exchanges between them, and the pipeline declined. *Id.* Continuing, the Propane Group explained that the Commission's decision rested upon the fact that the exchange was a private contractual arrangement between the shippers, and the involvement of the pipeline was unnecessary. *Id.* Conversely, here, the Propane Group argued that Mid-America actively facilitates and provides backhauls or "virtual transportation" arrangements and charges its posted tariff rates despite its "virtual transportation" status. *Id.*

C. COMMISSION TRIAL STAFF

1065. Staff submitted that Item 150 in FERC Tariff No. 41 be declared unlawful because it results in an undue preference for the East Red Line Shipper. Staff Initial Brief at p. 98. According to Staff, pursuant to Section 3(1) of the Interstate Commerce Act, 49 U.S.C. app. § 3(1) (1988), tariffs that grant unreasonable preferences to a special class of shippers violate common carrier obligations. *Id.* at pp. 98-99. Here, argued Staff, the East Red Line Shipper is granted an unreasonable preference under Item 150 of FERC Tariff No. 41. *Id.* at pp. 99-100. Staff contended that only the East Red Line Shipper qualifies for the credit under Item 150 as it is the only shipper that moves ethane/propane mix north from Conway to Clinton and then ships propane from Clinton to Conway Holding. *Id.* at p. 100. Therefore, stated Staff, the East Red Line Shipper receives an undue preference to the detriment of all other Northern System shippers. *Id.* at p. 100. It added that there is a cost to provide this transportation and, as the East Red Line Shipper receives free transportation, all other Northern System shippers are required to pay for this cost. *Id.* Finally, Staff asserted: "Mid-America could physically move the product back to Conway, but it is more operationally efficient for Mid-America to move the product to storage in Iowa City. Consequently, Mid-America uses the product to fulfill demand for propane north of Iowa City. However, Item 150 of FERC Tariff No. 41 does not reflect this scenario." *Id.* at p. 100 (*citing* Transcript at p. 2978).

1066. In its Reply Brief, Staff asserted that both (1) the propane volumes transported by exchange or backhaul from Clinton/Iowa City to Conway, and (2) the equivalent volume of ethane/propane mix actually transported from Conway to Clinton, are valid transportation movements. Staff Reply Brief at pp. 89-90. Additionally, Staff supported the Propane Group's assertion that Mid-America failed to establish that the propane credit was necessary due to competitive forces and concurred with the Propane Group's contention that Commission precedent requires that backhaul transportation be reflected in rate design. *Id.* at p. 90.

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1067. In response to Mid-America's procedural claim, Staff maintained that it properly challenged Item 150 under the Interstate Commerce Act. *Id.* Staff declared that the Commission set Mid-America's tariffs for hearing under both section 13(1) and section 15(1) of the Interstate Commerce Act. *Id.* at p. 91.[539] In sum, Staff argued that it complied with both the Interstate Commerce Act and the Commission's order by addressing this tariff provision, as section 13(1) reads: "[I]t shall be the duty of the Commission to investigate the matters complained of in such a manner and by such means as it shall deem proper." *Id.* (*citing* 49 U.S.C. app. § 13(1) (1988)).

Discussion and Ruling

1068. With respect to the appropriate treatment of the East Red Line Shipper propane movements between Clinton, Iowa, and Conway, Kansas, two specific issues must be decided: (1) whether Item 150, the tariff provision governing the East Red Line Shipper propane movements, is unduly discriminatory; and (2) whether these propane volumes should be included in the fully allocated cost based rate calculation.

1069. As no barrels physically move from Clinton to Conway, Mid-America submitted that the Clinton to Conway movements should be excluded from its rate calculations. Mid-America Initial Brief at p. 146. In other words, Mid-America argued that the propane credit at Conway does not involve transportation for which jurisdictional rates can be designed. Mid-America Reply Brief at p. 113. Further, Mid-America maintained that Item 150 is not unduly discriminatory because it is neutrally stated and is available on equal terms to all shippers that avail themselves of it. Mid-America Initial Brief at p. 149.

1070. Staff asserted that the East Red Line Shipper is granted an unreasonable preference under Item 150 of FERC Tariff No. 41.[540] Staff Initial Brief at p. 98. It added that, as the East Red Line Shipper is the only shipper that moves ethane/propane mix north from Conway to Clinton and then ships propane from Clinton to Conway Holding it is the only shipper that qualifies for the credit under the tariff provision. *Id.* at p. 100. Moreover, Staff maintained that the propane volumes transported by exchange or backhaul from Clinton/Iowa City to Conway and the equivalent volume of ethane/propane mix actually transported from Conway to Clinton, are valid transportation movements. Staff Reply Brief at pp. 89-90.

1071. The Propane Group stated that, with regard to Item 150, it "support[ed] Staff witness Pride that this tariff provision results in an undue preference and is unduly

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[539] Staff cited 49 U.S.C. app. §§ 13(1), 15(1) (1988); *Mid-America Pipeline Co., LLC,* 111 FERC ¶ 61,128 at Ordering Paragraph (B) in support.

[540] It must be noted that Staff did not address Item 150 in FERC Tariff No. 38.

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discriminatory and should be removed." Propane Group Initial Brief at p. 145 (citations omitted).[541] Further, they argued that the propane volume credit at Conway constituted a valid transportation movement, and thus, treating the returned barrels as a physical movement from Clinton to Conway for volume and rate design purposes is proper. *Id.* at p. 147. Additionally, they declared that all of the propane volumes should be reflected in Mid-America's fully allocated cost based rate calculation because Commission policy requires that backhaul transportation or transportation by exchange volumes be accounted for in developing rates just as forward haul volumes are recognized and accounted for. *Id.* at pp. 150-51.

1072. I find the Propane Group's and Staff's positions persuasive, and consequently, I conclude that (1) Item 150 in both FERC Tariff Nos. 38 and 41, which governs the East Red Line Shipper propane movements, is unduly discriminatory; and (2) the East Red Line Shipper propane volumes transported by exchange or backhaul from Clinton to Conway and the ethane/propane mix actually transported from Conway to Clinton are valid transportation movements and thus should be reflected in Mid-America's fully allocated cost based rate calculation for both FERC Tariff Nos. 38 and 41.[542]

1073. The Interstate Commerce Act provides:

> It shall be unlawful for any common carrier subject to the provisions of this chapter to make, give, or cause any undue or unreasonable preference or advantage to any particular person, company, firm, corporation, . . . or any particular description of traffic, in any respect whatsoever; or to subject any particular person, company, firm, corporation, . . . or any particular description of traffic to any undue or unreasonable prejudice or disadvantage in any respect whatsoever. . . .

49 U.S.C. app. § 3(1) (1988). If a rate structure is made available on equal terms to all shippers, then that rate structure does not violate the anti-discrimination provision of the Interstate Commerce Act. *See, e.g., Enbridge Pipelines (Southern Lights) LLC,* 121

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[541] It is noted that Staff witness Pride only addressed Item 150 in FERC Tariff No. 41. Exhibit No. S-26 at pp. 26-27. She did not indicate that she had a problem with Item 150 in FERC Tariff No. 38.

[542] Although Staff indicated that it agreed with the Propane Group that "backhaul transportation or transportation by exchange [should] be recognized in the development of rates," inexplicably, it did not assert that it challenges Item 150 in FERC Tariff No. 38 as well as Item 150 in FERC Tariff No. 41. *See* Staff Reply Brief at p. 90 (footnote omitted). However, the Propane Group does challenge Item 150 in both tariffs. Therefore, as I find the evidence adduced to be equally applicable to both tariffs, I find that Item 150 in each tariff is troublesome.

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FERC ¶ 61,310 at P 31 (2007).

1074. While Mid-America argued that Item 150 is not unduly discriminatory because it is neutrally stated and is made available on equal terms to any shipper that avails itself of it,[543] I find this argument to be illusory. Item 150 effectively applies only to the East Red Line Shipper. Exhibit No. S-26 at p. 26. In fact, the East Red Line Shipper is the only shipper that qualifies for the propane credit under Item 150 as it is the only shipper that moves ethane/propane mix from Conway to Clinton and then ships propane from Clinton to Conway Holding. *Id.* Consequently, all other Northern System shippers are forced to subsidize the East Red Line Shipper's service, notwithstanding that it has not been shown that they have a need for, or benefit from, the returned propane barrels at Clinton. *Id.* at pp. 26-27.

1075. Evidence that other Northern System shippers are forced to subsidize the East Red Line Shipper lies in the redirect examination of Mid-America witness Ganz where, being asked, hypothetically, to address a circumstance where the East Red Line Shipper received 1000 barrels of propane at Clinton at 75 cents/barrel and returned 100 of those barrels, the witness noted that the East Red Line Shipper would be charged $750 for the 1000 barrels and be credited $75 for the 100 barrels it returned. Transcript at pp. 2244-45. Moreover, its inventory would be credited for 100 barrels at Conway although it returned the 100 barrels at Clinton and although the 100 barrels were moved from Clinton to Iowa City. *Id.* at pp. 2245, 2247. Ganz further testified that, if at some point another shipper nominated 100 barrels to Dubuque, which is north of Iowa City, Mid-America would receive the 100 barrels at Conway although the 100 barrels nominated barrels would be shipped from Iowa City, and the shipper would be charged as if the movement was from Conway to Dubuque. *Id.* at pp. 2247-48. According to Ganz: "So essentially, the volumes that were received from the East Red Line Shipper are prestaged at Iowa City and at some point later, when a shipper nominates volumes to move as in this example to Dubuque, they're moved from Iowa City instead of from Conway. And the shipper . . . would pay the rate from Conway to Dubuque . . . ." *Id.* at p. 2247. In other words, as I understand Ganz's testimony, the East Red Line Shipper receives free transportation of the 100 barrels from Conway to Clinton and then from Clinton to Iowa City, and Mid-America recovers, and perhaps over-recovers this expense, by charging the subsequent shipper for transportation from Conway to Dubuque although it only transports the barrels from Iowa City to Dubuque.

1076. Accordingly, I conclude Item 150 is unduly discriminatory and gives undue preference to the East Red Line Shipper in a violation of the Interstate Commerce Act, and thus, I order the removal of the Item from both FERC Tariff No. 38 and FERC Tariff

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[543] Exhibit No. M-38 at p. 4.

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No. 41.[544]

1077. Furthermore, I conclude that both the propane volumes transported by exchange or backhaul from Clinton to Conway and the equivalent volume of ethane/propane mix actually transported from Conway to Clinton are valid transportation movements. Accordingly, for volume and rate design purposes, both movements shall be treated as if they had physically moved.[545] *See* Exhibit No. NPG-1 at p. 158; Transcript at pp. 747, 1959-63; *Williams Natural Gas Co.,* 59 FERC ¶ 61,306 at p. 62,119-30 (1992).

1078. In effect, the propane credit service provided by Item 150 is analogous to backhaul transportation services within the natural gas industry. It is clear that the East Red Line Shipper returns a portion of the propane originally contained in the ethane/propane mix that moved on the pipeline from Conway to Clinton to Mid-America at Clinton. Transcript at p. 744; Exhibit No. NPG-176 at p. 2. Further, upon return of the propane by the East Red Line Shipper, Mid-America (1) transports the propane from Clinton to storage at Iowa City, Iowa, and (2) transports by exchange the propane returned at Clinton to the East Red Line Shipper's storage account at Conway. Transcript at pp. 745-48, 1960-62; Exhibit No. NPG-1 at p. 175. Analogously, because Commission's natural gas policy requires that backhaul transportation volumes be recognized in the development of rates just as forward haul volumes are recognized and accounted for, I conclude that the propane backhaul transportation or propane transportation by exchange should be recognized and included in the development of Mid-America's rates. *See, e.g., Williams Natural Gas Co.,* 59 FERC ¶ 61,306 at p. 62,119-30 (1992).

1079. Mid-America cited *Western Refining Pipeline Co.,* 122 FERC ¶ 61,210 at P 14-16, in support of its argument that the Commission does not recognize exchanges as jurisdictional transportation in the oil pipeline context. However, the facts of this case are distinguishable. In *Western Refining Pipeline Co.,* the Commission was addressing a matter where two shippers, who would not be customers of the pipeline, were attempting to compel the pipeline to allow them to engage in an exchange which they believed would result in their receiving a higher price for their crude oil than if they actually had shipped it. *Western Refining Pipeline Co.,* 122 FERC ¶ 61,210 at P 13-15. The

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[544] Mid-America contended that Staff improperly challenged Item 150 under the Interstate Commerce Act because Mid-America did not change or alter Item 150 in any tariff filing at issue. However, Staff's challenge is appropriate because the Commission set Mid-America's tariffs for hearing under both section 13(1) and section 15(1) of the Interstate Commerce Act, which permits the Commission to determine complaints "in such a manner and by such means as it shall deem proper." *See* 49 U.S.C. app. §§ 13(1), 15(1) (1988); *Mid-America Pipeline Co., LLC,* 111 FERC ¶ 61,128 at P 29.

[545] The volumes from both movements equate to approximately 2 million barrels per year. Transcript at pp. 1963-64.

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Commission refused to order the pipeline to facilitate exchanges for the two shippers, reasoning that the exchange was a private contractual arrangement between the parties exchanging volumes, did not involve transportation services, and was, therefore, outside the Commission's jurisdiction. *Id.* at P 14-16. In contrast, unlike the Western Refining Pipeline which was not involved in the transaction between the two shippers, the transactions here directly involve transportation service provided by Mid-America and the rates related to that transportation. Transcript at p. 1964; Exhibit No. NPG-146 at pp. 19, 33. In other words, the focus here is on an actual transportation service Mid-America provides and not on a request from shippers who were not customers of a pipeline for non-transportation related service not provided by a pipeline, as was the case in *Western Refining*. Accordingly, there is little question that the Commission does have jurisdiction and that *Western Refining Pipeline* does not apply to the factual circumstance before me.

ISSUE NO. 8: WHAT IS THE APPROPRIATE RATE DESIGN?

A. IS A DISCOUNT ADJUSTMENT, INCLUDING THE "ITERATIVE GAS DISCOUNTING METHODOLOGY" ASSOCIATED WITH ANY SHIPPER, INCLUDING THE EAST RED LINE SHIPPER, APPROPRIATE FOR DESIGNING MID-AMERICA'S RATES FOR THE APPLICABLE PERIODS?[546]

A. MID-AMERICA

1080. Mid-America suggested that the Commission's iterative discounting methodology should be used in making an appropriate discount adjustment in designing Mid-America's Northern System rates because competition on the Northern System requires Mid-America to offer discounts on many of its rates. Mid-America Initial Brief at p. 151 (*citing* Exhibit Nos. M-46 at pp. 35-52; M-55; M-56; M-59). Further, it asserted that using a fully allocated cost methodology to set rates would prevent it from recovering its properly incurred costs. *Id.*

1081. According to Mid-America, the Commission first used the iterative discounting methodology in natural gas matters. *Id.* at p. 152 (*citing Policy for Selective Discounting by Natural Gas Pipelines*, IV FERC Stats. & Regs. ¶ 35,547 (2004)). It also contended that the methodology is "consistent" with the Interstate Commerce Act alleging that it is the same as "differential pricing" which the Commission already has extended to pipelines. *Id.* (*citing Williams Pipe Line Co.*, 84 FERC at p. 61,102). Mid-America also claimed that the Commission has approved the use of the iterative methodology in oil pipeline rate cases. *Id.* (*citing Laclede Pipeline Co.*, 114 FERC ¶ 61,335 (2006), *on*

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[546] Williams did not address this issue. Williams Initial Brief at p. 58; Williams Reply Brief at p. 58.

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reh'g, 119 FERC ¶ 61,236 (2007)).[547]

1082. Mid-America admitted that, before the Commission will approve its use of the iterative method, it has the burden of showing that its discounts were necessary "to meet competition," but contended that, once it "explains" that it must offer the discount rate to non-affiliated shippers to meet competition, "parties opposing the discount . . . have the burden of producing evidence that discounts to non-affiliates were not justified by competition." *Id.* at p. 154 (emphasis removed). It also exclaimed that the discounted rates must be "sufficient to cover the variable costs incurred in moving the associated volumes." *Id.*

1083. According to Mid-America, both types of Northern System discounts at issue — (1) the volume incentive rates under the East Red Line Shipper agreement, and (2) the general commodity rates that are below the fully allocated cost level — are at levels above variable cost, result from competitive forces, and are with non-affiliated shippers. *Id.* at p. 155. It further explained that the East Red Line Shipper incentive rates were the result of an effort by Mid-America to attract and hold additional volumes moved by the East Red Line Shipper which held pipeline alternatives, and that these incentive rates remain essential today to retain those volumes against competition from the existing Kinder Morgan Operating, L.P. pipeline, or a potential pipeline running from Clinton to Morris. *Id.* at pp. 156-58 (*citing* Exhibit Nos. M-1 at pp. 10-12; M-24 at p. 46; M-46 at pp. 35, 42-45, 47-48; M-59; M-100 at p. 89; M-126; NPG-179; Transcript at pp. 795-810, 2227). As for the second type of discount, Mid-America claimed that it faces competition from four other natural gas liquids pipelines: Cochin Pipeline Company; ConocoPhillips Pipe Line Company; Kinder Morgan Operating L.P.; and Kaneb Pipe Line Operating Partnership, L.P. *Id.* at p. 160 (*citing* Exhibit Nos. M-46 at p. 36; M-55). Thus, declared Mid-America, the discounts attract volumes that contribute to the overall fixed costs of the System, and the discounts should receive a presumption of necessity and appropriateness. *Id.* (*citing Policy of Selective Gas Discounting,* IV FERC Stats. & Regs. ¶ 35,547 at P 27). Additionally, Mid-America insisted that neither the Propane Group nor Staff have met their burden of proving that these discounts to non-affiliates were not justified by competition. *Id.* at p. 156.

1084. Mid-America argued that Staff's assertion that the East Red Line volume incentive rates are not true discounts and are instead "negotiated rates," ineligible for a discount

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[547] After carefully reading both of the Commission's rulings, I find no support for Mid-America's claim. While it is true that Laclede Pipeline offered a "discount rate with a financial incentive so the rate would be competitive," the Commission never indicated that the pipeline used an interative methodology to calculate its rate, but did indicate that Laclede's return on equity was based on the standard Commission discounted cash flow methodology. *Laclede Pipeline Co.*, 114 FERC ¶ 61,335 at P 8; *see also* Propane Group Reply Brief at pp. 154.

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adjustment absent additional support, is baseless. *Id.* at p. 162. Essentially, Mid-America submitted that the East Red Line volume incentive rates are more analogous to "discounted gas rates" than "negotiated gas rates,"[548] because the East Red Line volume incentive rates are below the maximum rates set out in Mid-America's tariff and above Mid-America's variable cost, which is similar to the "minimum rate" concept in the natural gas context. *Id.* at pp. 162-63. Mid-America added that, even were volume incentive rates the result of bargaining between the pipeline and shipper, they are not "by definition" the same as negotiated gas pipeline rates, as Staff suggested. *Id.* at p. 163. Furthermore, Mid-America pointed out, pipeline discounted rates often are the product of negotiation. *Id.* at p. 163. In any event, claimed Mid-America, the East Red Line volume incentive rates were set out in Mid-America's tariff, consequently preventing discrimination among shippers and further distinguishing the volume incentive rates from gas pipeline "negotiated rates." *Id.*

1085. With respect to the Propane Group's claim that the East Red Line Shipper rates are not true discounts because Mid-America's discount on the Conway to Clinton and Morris movements is offset by an over-recovery on the one-mile Channahon to Morris movement, Mid-America asserted that, to the contrary, the rate paid by the East Red Line Shipper for the delivery of product to its plants is set by contract and by the competitive alternatives available to that shipper. *Id.* Indeed, Mid-America stressed, at the time of the contract, the Aux Sable plant at Channahon was not in existence, and thus, there was no Channahon to Morris movement. *Id.* at p. 163. Whatever the case may be, Mid-America emphasized that the Channahon to Morris movement is an intrastate movement, and thus, as the Commission does not have jurisdiction over intrastate movements, it cannot "recognize" revenue received from non-jurisdictional movements in establishing jurisdictional interstate rates.[549] *Id.* at p. 164.

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[548] Mid-America explained that, for gas pipelines, "discounted rates" are rates a pipeline is allowed to offer a shipper that fall between the maximum and minimum rates included in the pipeline's tariff. Mid-America Initial Brief at p. 162. Continuing, Mid-America declared that, in a rate case, the pipeline is allowed to apply the iterative discounting methodology to adjust for the effect of the discounting rates on the pipeline's volumes. *Id.* Conversely, Mid-America added, "negotiated rates" are rates that fall above the maximum rate or below the minimum rate included in the gas pipeline's tariff. *Id*. According to Mid-America, shippers that accept negotiated rates with a gas pipeline, must be permitted to use the "recourse rate" (*i.e.,* the tariff rate) upon request. *Id.* Similarly, Mid-America submitted, gas pipelines also are permitted to use the iterative discounting methodology for negotiated rates, but the burden is on the pipeline to prove that the rate is the result of competition. *Id.* With regard to this discussion, for support, Mid-America cited *Northern Natural Gas Co.*, 105 FERC ¶ 61,299 at P 2-4 (2003).

[549] I note that I already have determined that the Channahon to Morris movement is in interstate commerce. *See* Issue No. 7.A., *supra*.

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1086. Finally, Mid-America criticized the Propane Group's position that the non-East Red Line general commodity rates are not true discounts because (1) prior to FERC Tariff Nos. 38 and 41, the rates "were not set on a traditional cost of service and fully allocated cost rate design;" and (2) they do not "arise from the business realities of attempting to recover the fully allocated costs in rates and then 'discounting' to customers in the face of competition." *Id.* at pp. 164-65 (*citing* Exhibit No. NPG-1 at pp. 184, 186). While Mid-America claimed it is uncertain of the specific origins of its inherited rate structure, it contended that the current rate differentials are appropriate under the competitive circumstances and the distances between the various terminals. *Id.* at p. 165. Also, because the rate differentials have been set for several years without objection, Mid-America stated that it did not wish to disturb the settled expectations of the shipper regarding the relative rate differentials to each destination. *Id.* Also, Mid-America opined that, even though the general commodity rates were not first set on a fully allocated cost basis and then discounted, they are still discounts below the fully allocated cost rate level. *Id.*

1087. In its Reply Brief, Mid-America asserted that, if a fully allocated cost methodology were used in this proceeding, Mid-America would under-recover its Northern System cost of service for the FERC Tariff No. 41 Test Period by $10.5 million. Mid-America Reply Brief at p. 118 (*citing* Exhibit No. M-100 at p. 80). Further, Mid-America claimed that, under Staff's approach, Mid-America would under-recover by $28.9 million. *Id.* (*citing* Exhibit Nos. M-172; S-49; Transcript at pp. 2983-89). Mid-America also submitted that, even under the iterative method, it would not recover its entire cost-of-service, but would have "greater cost recovery than the fully allocated cost methodology without any adjustment." *Id.* at pp. 118-29 n.75 (*citing* Exhibit No. M-103 at p. 2).

1088. Next, Mid-America claimed, because the East Red Line Shipper is not an affiliate, Mid-America does not carry the burden of justifying its discounts in the first instance; rather, it is required to explain generally that competition forces generated the need for its discounts. *Id.* at p. 120 (*citing Policy for Selective Discounting by Natural Gas Pipelines,* 111 FERC ¶ 61,309 at P 59). Accordingly, Mid-America declared, as its witness Collingsworth explained the nature of the discounts, and in discovery, data was provided regarding the discounts, it has carried its burden. *Id.* Consequently, Mid-America submitted that, after meeting its initial burden, the burden shifted to the Propane Group and Staff to prove, or raise sufficient doubt, that the discounts were not justified by competition. *Id.* at pp. 120-21 (*citing Policy for Selective Discounting by Natural Gas Pipelines,* 111 FERC ¶ 61,309, at P 59; *Williston Basin Interstate Pipeline Co.,* 67 FERC at p. 61,380; *Panhandle Eastern Pipe Line Co.,* 74 FERC ¶ 61,109 at p. 61,404 (1996)). Mid-America contended, however, that neither carried such burden, as each simply criticized Mid-America's initial showing. *Id.* at p. 121.

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1089. As to the case cited by Staff, *Southern California Edison Co.,* 50 FERC ¶ 63,012 (1990), Mid-America argued, the Presiding Judge merely held that a party seeking new rates must, in its pre-filed direct testimony, present all the evidence which it intended to provide in support of the issue for which they have the burden of proof and the initial burden of going forward. *Id.* at pp. 121-22 (*citing Southern California Edison Co.,* 50 FERC at p. 63,065). Mid-America maintained that it explained the discounts in its initial pre-filed testimony and therefore carried its burden. *Id.* at p. 122 (*citing* Exhibit Nos. M-1 at pp. 7-12; M-24 at pp. 43-46).[550] Additionally, Mid-America stated that, contrary to Staff's and the Propane Group's claims, it provided in discovery substantial information regarding the history of the East Red Line Shipper discount and the related competitive factors. *Id.* (*citing* Exhibit No. S-43). As examples, Mid-America pointed to (1) the testimony of its witness Collingsworth explaining the East Red Line Shipper discount was necessary to meet competition; (2) the database provided in discovery, which showed all volumes moved by each shipper on each discounted and non-discounted path; (3) the agreement itself; (4) the rates set forth in Mid-America's tariff, showing that the rates paid by the East Red Line Shipper are well below Mid-America's general commodity rate for those movements; (5) the maps and tariffs establishing that Kinder Morgan Operating, L.P. "A" pipeline is a genuine competitive alternative for the East Red Line Shipper; (6) the records of its negotiations with the East Red Line Shipper; and (7) the documentation demonstrating that the East Red Line Shipper or another pipeline could build a competing line to Clinton and Morris. *Id.* at pp. 123-25 (*citing* Exhibit Nos. M-1 at pp. 10-12; M-37 at pp. 50-53; M-38 at pp. 8-9; M-46 at pp. 35-52, 44-45; M-59; M-123 at p. 1; NPG-1 at pp. 193, 198; NPG-177; NPG-179 at p. 1; Transcript at pp. 795-810).

1090. With respect to the Propane Group's argument that the East Red Line Shipper discounts do not qualify for an adjustment because the East Red Line Shipper contract allows the escalation of the discounted rates, Mid-America contended that the Commission permits pipelines to enter into discounted rate agreements that use formulas that result in fluctuating transportation rates during the term of the agreement, so long as the rates remain within the range established by the maximum and minimum rates laid out in the pipeline's tariff. *Id.* at p. 128 (*citing Northern Natural Gas Co.,* 105 FERC ¶ 61,299 at P 12). In the instant case, Mid-America claimed, the East Red Line Shipper contract sets forth the basis for the annual rate adjustment, and given the large difference between the maximum rate levels and the current discounts, Mid-America insisted that the discounts will remain below the maximum rate level for the foreseeable future.[551] *Id.*

[550] Mid-America also claimed that, even were this testimony not sufficient, additional record evidence supported its position. Mid-America Reply Brief at p. 122 (*citing* Exhibit Nos. M-35 through M-52; M-55; M-56; M-59).

[551] Mid-America stated that the maximum rate for the Conway to Morris movement is 161.65 cents per barrel, and the Volume I level discounts have ranged from

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B. PROPANE GROUP

1091. The Propane Group stated that the burden of proof falls upon the pipeline to demonstrate that all discount adjustments are appropriate and justified. Propane Group Initial Brief at p. 152 (*citing Williston Basin Interstate Pipeline Co.,* 67 FERC at p. 61,379). Generally, the Propane Group continued, the pipeline is given an initial presumption that it has set the highest possible rate for non-affiliated shippers. *Id.* at p. 153 (*Williston Basin Interstate Pipeline Co.,* 67 FERC at p. 61,379). Additionally, the Propane Group explained, the burden shifts back to the pipeline once a protesting party rebuts the presumption by establishing a reasonable question as to whether competition required the discounts given to non-affiliate shippers. *Id.* (*citing Iroquois Gas Transmission System, L.P.,* 84 FERC at p. 61,477). Finally, they stated, the pipeline must justify the discount through, for example, documentation or probative data. *Id.*[552] According to the Propane Group, Mid-America has not provided sufficient evidence regarding its "discounts," and even more puzzling according to them, Mid-America claimed that its self-determined, self-initiated FERC Tariff No. 41 general commodity rates are discounted because the fully allocated cost rates subsequently prepared by Mid-America witness Ganz exceed the FERC Tariff No. 41 general commodity rates. *Id.* at pp. 153-54 (*citing* Exhibit No. NPG-216; Transcript at pp. 1850-53).

1092. With respect to the East Red Line Shipper discount adjustment, the Propane Group first asserted that Mid-America failed to provide any evidence supporting its claim that competition committed Mid-America to future rate discounts *Id.* at pp. 154. Similarly, the Propane Group pointed out that Mid-America could produce no documentation establishing the competitive alternatives facing the East Red Line Shipper, and specifically pointed to Mid-America witness Collingsworth's testimony that "'we have not found any competitive analysis that Mid-America has done.'" *Id.* at p. 155 (*citing* Exhibit No. NPG-177 at p. 2; Transcript at pp. 339, 341). As to the threat of competition from a new pipeline, the Propane Group maintained that there is no evidence that Mid-America did any corresponding analysis during the 2003 negotiations with the East Red Line Shipper. *Id.* (*citing* Exhibit No. NPG-177 at p. 2; Transcript at pp. 764-771). Rather, the Propane Group declared that Mid-America presented a hypothetical new

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64.40 cents per barrel (cpb) to 89.58 cpb, and the Volume II level discounts have ranged from 69.08 cpb to 96.10 cpb. Mid-America Reply Brief at p. 128 (*citing* Exhibit Nos. M-38 at p. 4; M-46 at p. 37 n.14).

[552] In support, the Propane Group cited *Panhandle Eastern Pipe Line Co.,* 74 FERC at pp. 61,404-05; *Williston Basin Interstate Pipeline Co.,* 67 FERC at p. 61,380; *Iroquois Gas Transmission System, L.P.,* 79 FERC ¶ 61,394 at pp. 62,691-92 (1997), *vacated on other grounds,* 91 FERC ¶ 61,116 (2000); *Iroquois Gas Transmission System, L.P.,* 84 FERC at p. 61,477.

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pipeline analysis that has no relation to the 2004 contract and is based on unreliable assumptions. *Id.* at pp. 155-56 (*citing* Transcript at pp. 795-96). Moreover, the Propane Group questioned whether Mid-America, in fact, faces competition from the Cochin and Kinder Morgan pipelines because of the existence of a new tax policy under consideration in Alberta and lack of evidence showing shipper or volumes lost to Cochin. *Id.* at p. 156 (*citing* Exhibit No. M-46 at pp. 44-45; Transcript at p. 440).

1093. Next, regarding the East Red Line Shipper discount adjustment, the Propane Group contended that there is no evidence that volume incentive discounts in the renegotiated 2004 East Red Line Shipper contract represent a legitimate discount, and that the contract, in total, does not reflect a discount relative to fully allocated cost rates. *Id.* at pp. 156-57 (*citing* Transcript at pp. 2632-34). In addition, the Propane Group noted that, where a purported discount agreement includes a rate escalation clause (as here), discount-type adjustments are inappropriate unless the pipeline can quantify how long the discount will continue. *Id.* at p. 157 (*citing Iroquois Gas Transmission System, L.P.,* 84 FERC at pp. 61,477-78). In this case, the Propane Group declared that Mid-America has failed to quantify the effect of the rate escalation clause with respect to its purported inability to charge a fully allocated cost rate. *Id.*

1094. Finally, the Propane Group argued, the East Red Line Shipper contract is a "negotiated" rate, which does not qualify for a discount-type adjustment. *Id.* at p. 158. According to the Propane Group, with respect to "negotiated" rates, the Commission requires that a pipeline provide evidence such as any formula upon which they are based and must disclose any other agreements, understandings, negotiations, or considerations related to the "negotiated" rate. *Id.* (*citing Southeast Supply Header, LLC,* 119 FERC ¶ 61,153 at p. 61,972 (2007); *ANR Storage Co.,* 119 FERC ¶ 61,220 at p. 62,285 (2007)). Furthermore, the Propane Group insisted that the contract can only be classified as a "negotiated" rate agreement because the contract is complex and includes several interrelated parts establishing the services Mid-America will provide the East Red Line Shipper and the payments it will receive.[553] *Id.*

1095. According to the Propane Group, even where the Commission has allowed iterative discount adjustments in the natural gas pipeline area, it has refused to permit it when there are negotiated rates "so as to ensure that costs or risks of underrecovery . . . are not shifted to maximum or recourse rate shippers" except when a discounted rate is converted into a negotiated rate. *Id.* (*citing NorAm Gas Transmission Co.*, 75 FERC

[553] The Propane Group noted for example that the East Red Line Shipper agreement includes "(1) volume incentive rates coupled with volume commitments and related payments when and if such commitments are not met; (2) annual incentive reliability payments and the provision of free storage services; and (3) propane transportation from Clinton, Iowa, to Conway, Kansas, at a negative price." Propane Group Initial Brief at p. 158 (*citing* Exhibit No. NPG-1 at pp. 159-60).

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¶ 61,091, *on reh'g*, 77 FERC ¶ 61,011 at p. 61,036 (1996), *on reh'g*, 81 FERC ¶ 61,204 at p. 61,872 (1997); *Northwest Pipeline Corp.*, 79 FERC ¶ 61,416 (1997), *on reh'g*, 84 FERC ¶ 61,109 (1998)). They added: "However, where a pipeline seeks to employ a discount-type adjustment pursuant to this exception, the Commission applies the standards used for evaluating affiliate discounts (*i.e.*, careful scrutiny) to ensure that it is non-discriminatory and justified based on competition." *Id.* (*citing Northwest Pipeline Corp.*, 79 FERC at p. 61,605).

1096. With respect to the non-East Red Line Shipper rates, the Propane Group maintained that no discount adjustment is justified. *Id.* at pp. 159-60. First, the Propane Group claimed that Mid-America's post-hoc transportation analysis is flawed and improperly reflects transportation rates on alleged competing pipelines and fails to reflect all of its own alleged discounted transportation routes. *Id.* at p. 160. Significantly, the Propane Group emphasized that Mid-America cannot identify any shippers or volumes it has lost as a consequence of these alleged competing pipelines and cannot identify the capacity, contractual commitments, current utilization rate, volume of shipped product, existence of prorationing, and the existence of market based rates on these alleged competing pipelines. *Id.* at p. 160 (*citing* Transcript at pp. 408-421, 440).

1097. The Propane Group also attacked Exhibit No. M-56 which it stated Mid-America offered as a comparison of the rates charged by three competing pipelines (ConocoPhillips, Kinder Morgan, and Kaneb (now Valero)). Propane Group Initial Brief at p. 160. First, they stated that this exhibit was not prepared in the ordinary course of business, but was specifically prepared for the litigation; and second they noted that it was offered through Mid-America witness Collingsworth who admitted that he did not prepare it and had not checked the information contained on it. *Id.* at pp. 160-61 (*citing* Transcript at p. 419). Moreover, the Propane Group contended: (1) Mid-America did not establish that the three pipelines were, in fact, competitors; (2) "Exhibit [No.] M-56 does not reflect an accurate comparison of Mid-America's rates to" the three alleged competitors; and (3) the exhibit only covers seven of the Northern System's terminal destinations reflecting that the majority of the Northern System terminals have no competition. *Id.* at p. 161.

1098. Moreover, the Propane Group asserted that the testimony of Mid-America witness Ganz contradicted the testimony of Mid-America witness Collingsworth, to wit:
(1) While Collingsworth testified that the FERC Tariff No. 38 rates were not constrained by competition, Ganz testified that they were discounted as a result of competition; while Ganz claimed that the FERC Tariff No. 41 general commodity rates were set well below his fully allocated cost rates in response to competition, Collingsworth claimed these rates are set so far above competitive levels that Mid-America cannot possibly charge them. *Id.* at pp. 161-63 (*citing* Transcript at pp. 1850-53, 1882-83; Exhibit Nos. NPG-216; NPG-220; M-46 at p. 38).

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1099. Turning back to Exhibit No. M-56, the Propane Group argued that, on its face, the exhibit reflects that (1) the rates for ConocoPhillips exceed Mid-America's general commodity rates; and (2) Kinder Morgan's non-incentive tariff (FERC Tariff No. 92) rates at Iowa City and Des Moines are greater than Mid-America's general commodity rates, and at Tampico, the rate for Kinder Morgan is within ten cents of Mid-America's general commodity rate. *Id.* at pp. 164-65 (*citing* Exhibit Nos. M-56 at p. 1; NPG-149 at p. 10; NPG-150 at p. 2). Additionally, as Mid-America's analysis only covers seven terminals, and Mid-America claimed that trucking would constrain rates at other locations, the Propane Group pointed out that no trucking study exists to support this claim. *Id.* at p. 165 (*citing* Exhibit No. M-46 at p. 40). They also claimed that the rates used by Mid-America on Exhibit No. M-56 are not accurate rendering its analysis unreliable, to wit: (1) the Kaneb rate used did not include a 13.08 cent charge contained in the pipeline's tariff, but did include a 20.56 cent storage rate at Kaneb although no storage rate was included in the Mid-America rate; (2) the Kinder Morgan rate used included a 42 cent loading or terminalling fee although the tariff rate includes such service; (3) Collingsworth did not know whether the Mid-America rate used its security surcharge. *Id.* at p. 165 (*citing* Transcript at pp. 429-34; Exhibit Nos. M-46 at p. 36; NPG-148 at p. 7). Finally, the Propane Group declared that the ability of Mid-America's unregulated affiliate, Enterprise Terminals, to maintain its 42 cents per barrel terminal fee in the face of competition, casts doubt as to Mid-America's claim of competitive pressures. *Id.* at pp. 165-66.

1100. In its Reply Brief, the Propane Group again argued that Mid-America's position regarding its discounted adjustments relies on unsupported allegations of competition and alleged benefits provided to the Northern System. Propane Group Reply Brief at p. 152.[554] Next, the Propane Group discussed the Commission's consideration of discounted rates in relation to the variable costs in moving the associated volumes, emphasizing that Mid-America has not filed any tariff rate which reflects only variable costs. *Id.* at p. 155. In addition, they criticized the evidence Mid-America does provide in support of its contention that both types of discounted rates are at levels above variable costs because, they claimed, none of the evidence deals with the non-East Red Line shippers or otherwise suggest that Mid-America has filed the equivalent of a minimum tariff rate reflecting only variable costs.[555] *Id.*

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[554] In support, the Propane Group cited *Transcontinental Gas Pipe Line Corp.,* 112 FERC ¶ 61,170 at P 110.

[555] According to the Propane Group, "[t]here is no evidence in the record at all with respect to the variable costs associated with any of the purportedly discounted" non-East Red Line Shipper rates. Propane Group Reply Brief at p. 155. They further suggested that, while Mid-America acknowledged that the only variable costs are fuel and power ($3 million), it ignored pipeline integrity costs ($6.7 million), labor ($2.9 million), and storage ($390,000). *Id.* at p. 156.

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1101. The Propane Group submitted that Mid-America failed to establish that real competition exists. *Id.* at p. 157 (*citing* Transcript at pp. 339, 341). They also claimed that, while Mid-America declared that Kinder Morgan and Cochin provide it with competition, it admitted that the latter is not and, the Propane Group asserted, neither is Kinder Morgan. *Id.* (*citing* Exhibit Nos. M-46 at p. 45 n.21; M-59 at p. 11; NPG-180 at p. 26; Transcript at pp. 417, 420-21).

1102. The Propane Group also asserted that Mid-America's definition of "negotiated rates" falls short in explaining that negotiated rates do not need to reflect the same rate design as the tariff rates, as do discounted rates. *Id.* at p. 161 (*citing Northern Natural Gas Co.,* 105 FERC ¶ 61,299 at P 16). Because the East Red Line rates were established entirely through contract negotiation between Mid-America and the East Red Line Shipper — and not based on fully allocated cost or the iterative discounting methodology used to design the rest of the Northern System rates — the Propane Group argued that the East Red Line rates fail to meet at least one of the two requirements determined by the Commission for discount rates, to wit: they do not reflect the same rate design as the tariff rates. *Id.* Moreover, the Propane Group argued, the East Red Line rates also fail to meet the minimum rate/maximum rate requirement because Mid-America's rates are below its variable cost and, therefore, fail to qualify for a discount as a negotiated rate. *Id.*

C. COMMISSION TRIAL STAFF

1103. Staff contended that Mid-America failed to justify its proposed adjustments related to volumes attributable to the East Red Line Shipper and the general commodity rates in FERC Tariff Nos. 38 and 41, applicable to other shippers. Staff Initial Brief at p. 101. With respect to the East Red Line Shipper discount, Staff asserted that Mid-America failed to demonstrate that the pipeline needed to provide the discount for competitive reasons. *Id.* at p. 103. Staff argued that, besides the one self-serving statement made by Mid-America witness Collingsworth — that the pipeline instituted the incentive rates for the East Red Line Shipper in 1993 to keep and attract additional volumes to plants that had pipeline alternatives available to them — Mid-America provided no analysis or documentation supporting these alleged circumstances of fourteen years ago and their effect on the current circumstances. *Id.* at p. 104 (*citing* Exhibit No. S-26 at p. 20; Transcript at p. 2239). Further, Staff claimed that the East Red Line Shipper contract reflects a negotiated rate agreement, for which Commission policy does not allow discount adjustments. *Id.* at pp. 104-05 (*citing Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines,* 74 FERC ¶ 61,076 at pp. 61,240-41 (1996)). Because it freely negotiated the rate in the East Red Line Shipper contract, Staff argued, Mid-America should abide by the negotiated rate agreement without any discount adjustment shifting costs to other Northern System shippers. *Id.* at pp. 105-06.

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1104. Regarding Mid-America's general discount adjustment and the seasonal discount program set out in Item 400 of FERC Tariff No. 41, Staff claimed that Mid-America provided no evidence supporting its need to offer such discount rates due to competition. *Id.* at p. 107. According to Staff, Mid-America witness Ganz testified that, because Mid-America's general commodity rates already were reduced from its fully allocated, cost based rates, he used an iterative methodology to determine rates and demonstrate that its proposed rates were below its fully allocated rates. *Id.* (*citing* Exhibit No. M-43 at pp. 43, 46). However, Staff argued, Mid-America has failed to establish that it needed to offer discounts to counter competition or by how much.[556] *Id.*

1105. Moreover, Staff argued that Mid-America has not discounted its rates from maximum tariff rates in compliance with Commission policy. *Id.* at p. 108. Typically, suggested Staff, a pipeline designs fully allocated, maximum rates, places them in its tariffs, and discounts from that level. *Id.* To the contrary, Staff contended that Mid-America attempts to justify its tariff rates by first calculating fully allocated rates and then demonstrating that its existing tariff rates are lower. *Id.* at p. 109. Yet Staff added, the Commission has never examined Mid-America's rates in a litigated proceeding. *Id.* (*citing* Exhibit No. NPG-103 at p. 9). Thus, declared Staff, Mid-America's existing rates do not result from rational design, but instead result from the residue of rate changes that occurred over the years to reflect various agreements with shippers and other uncontested rate filings. *Id.* (*citing* Exhibit Nos. M-100 at p. 89; NPG-103 at p. 9; Transcript at p. 580).

1106. In reply, Staff maintained that Commission policy requires a pipeline to demonstrate the basis for the discounts when seeking a discount adjustment. Staff Reply Brief at p. 92 (*citing Iroquois Gas Transmission System, L.P.,* 84 FERC at p. 61,476). Staff continued, in *Panhandle Eastern Pipe Line Co.,* 71 FERC ¶ 61,228 at p. 61,867 (1995) and *Panhandle Eastern Pipe Line Co.,* 74 FERC at pp. 61,404-05, the Commission found that a pipeline met its initial burden by providing evidence demonstrating its general discounting policies, including a request that customers submit documentation justifying the need for the discounts. *Id.* According to Staff, in Mid-America's direct case, it failed to provide justification through documentation or its tariff for the alleged "discount" for the East Red Line Shipper. *Id.* at pp. 92-93.

1107. Further, Staff asserted that the Commission requires discounted rates, unlike negotiated rates, to (1) remain within the maximum and minimum rates set out in its tariff and (2) be based on the same rate design as its tariff rates. *Id.* at pp. 93-94 (*citing Northern Natural Gas Co.,* 105 FERC ¶ 61,299 at P 12). Having failed to comply with

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[556] Staff stated: "Ganz just assumed that because Mid-America's proposed rates are below what he calls fully allocated rates, the rates are not voluntarily discounted but are required to be discounted." Staff Initial Brief at p. 108 (*citing* Exhibit No. M-46 at p. 43).

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this policy, according to Staff, Mid-America is not "entitled" to shift costs from the East Red Line Shipper to other shippers on the Northern System. *Id.* at p. 94.

Discussion and Ruling

1108. In determining whether a discount adjustment is appropriate in designing Mid-America's rates for the applicable periods, the question is whether the pipeline justified the appropriateness of the discount adjustments associated with the East Red Line Shipper incentive rates and the general commodity rates in FERC Tariff Nos. 38 and 41, applicable to other shippers.

1109. According to Mid-America, the iterative discounting methodology should be used in designing Mid-America's Northern System rates because competition on the Northern System requires Mid-America to offer discounts on many of its rates. Mid-America Initial Brief at p. 151. It submitted that it met its burden in demonstrating that the volume incentive rates under the East Red Line Shipper Agreement and the general commodity rates (set below the fully allocated cost level) are the result of competitive forces, and the burden shifted to the Propane Group and Staff to prove otherwise; a burden which they failed to carry. *Id.* at p. 155.

1110. Further, Mid-America claimed that the East Red Line Shipper incentive rates are not "negotiated rates," but are more analogous to "discounted gas rates" because they are below the maximum rates set out in Mid-America's tariff and above Mid-America's variable cost, which is similar to the "minimum rate" concept in the natural gas context. Mid-America Initial Brief at pp. 162-63. With respect to the non-East Red Line general commodity rates, Mid-America opined that, even though they were not first set on a fully allocated cost basis and then discounted, they are still below the fully allocated cost rate level. *Id.* at p. 165. Thus, Mid-America argued, the iterative discounting methodology is still appropriate. *Id.*

1111. In contrast with the pipeline's position, the Propane Group argued that Mid-America failed to provide any evidence or documentation supporting its claim that competition necessitated the East Red Line Shipper incentive rates. Propane Group Initial Brief at p. 154. Further, the Propane Group maintained that the East Red Line Shipper contract is a "negotiated" rate because the contract is complex and includes several interrelated parts establishing the services Mid-America is to provide the East Red Line Shipper and the payments it is to receive, and consequently, does not qualify for a discount-type adjustment. *Id.* at p. 158.

1112. With respect to the non-East Red Line Shipper rates, the Propane Group submitted that a discount adjustment is not justified because (1) Mid-America failed to prove competition existed, and (2) Mid-America's discounts were not based on rational design, but were simply the result of an inherited rate scheme and uniform rate increases.

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Propane Group Reply Brief at p. 162.

1113. Similar to the Propane Group, Staff argued that Mid-America failed to justify its proposed discount adjustments. Staff Initial Brief at p. 101. Specifically, Staff asserted that Mid-America failed to demonstrate that the competition necessitated the East Red Line Shipper discounts, as well as, the general commodity discount rates. *Id.* at pp. 103, 108. Additionally, Staff contended that the East Red Line Shipper contract reflects a negotiated rate agreement, for which Commission policy does not allow discount adjustments. *Id.* at pp. 104-05. Lastly, Staff submitted that the general commodity discount rates were not discounted from maximum tariff rates in compliance with Commission policy, as the rates do not result from rational design, but rather, from the residue of rate changes through various shipper agreements and other uncontested rate filings.

1114. I conclude that no discount adjustment is appropriate in designing Mid-America's Northern System rates because Mid-America failed to justify the appropriateness of either the discount adjustments associated with the East Red Line Shipper incentive rates or those in the general commodity rates in FERC Tariff Nos. 38 and 41.

1115. A pipeline seeking permission to offer discounts has the ultimate burden of demonstrating that its discounts were required to meet competition. *Policy of Selective Gas Discounting*, IV FERC Stats. & Regs. ¶ 35,547 at P 7; *Williston Basin Interstate Pipeline Co.,* 67 FERC at p. 61,379. Initially, it is presumed that the pipeline has sought the highest possible rate from non-affiliated shippers, *i.e.*, the pipeline has only to "explain generally that it gives discounts to non-affiliates to meet competition." *Id.* Upon such showing, the burden of proof shifts to the party opposing the discounts who must demonstrate that discounts to the non-affiliated shippers were not justified by competition. *Id.* Finally, to the extent the party opposing the discount adjustment raises "reasonable question" as to whether competition existed, the burden shifts back to the pipeline to provide "sufficient evidence" showing that competition required the questioned discounts. *Iroquois Gas Transmission System, L.P.,* 84 FERC at p. 61,477; *Policy of Selective Gas Discounting*, IV FERC Stats. & Regs. ¶ 35,547 at P 7.

1116. With respect to the East Red Line Shipper incentive rates,[557] I find that Mid-America did not meet its initial burden in "explaining generally" that competition necessitated the discounts it gives to the East Red Line Shipper, a non-affiliate. A review of the record reflects that Mid-America presented no evidence establishing that requests for discounts from its customers were received or were required by its general discounting policies. *See, e.g., Panhandle Eastern Pipe Line Co.,* 74 FERC at

[557] The East Red Line Shipper incentive rates relate to movements from (1) Conway, Kansas, to Clinton, Iowa, and Morris, Illinois; and (2) the interconnection of Mid-America and Cochin Pipeline near Clinton to Conway. Exhibit No. M-46 at p. 35.

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pp. 61,404-05; *Williston Basin Interstate Pipeline Co.,* 67 FERC at p. 61,380; *Iroquois Gas Transmission System, L.P.,* 84 FERC at p. 61,477.

1117. Also, in arguing that its discounts to the East Red Line Shipper were necessary to meet competition, Mid-America essentially provided only one, self-serving statement in support, to wit: Mid-America witness Collingsworth stated that the pipeline was required to offer the East Red Line Shipper a long-term discount, in 1993, to obtain its business, and existing competitive alternatives continue to constrain its ability to raise the contract rates. Exhibit Nos. M-1 at p. 11; M-46 at p.44. However, Mid-America failed to provide any documentation (either its own or from the East Red Line Shipper) or competitive analysis justifying the need for such discounts in 1993, 2004 (the time of the renegotiated contract between Mid-America and the East Red Line Shipper), or presently. Exhibit Nos. S-26 at p. 20; NPG-177 at p. 2; Transcript at pp. 339, 341, 764-771. A review of the record clearly establishes that Mid-America failed to present "sufficient evidence concerning why it granted the specific discounts in question in order to show that competition required it to give those discounts in order to obtain the customers in question." *See Iroquois Gas Transmission System, L.P.*, 84 FERC at p. 61,477 (footnote omitted).

1118. However, even had I found that Mid-America had carried its initial burden of proof, I would have concluded that the Propane Group and Staff provided sufficient evidence to raise reasonable question as to whether such competition existed and that Mid-America failed to adduce sufficient evidence to counter it. As the Propane Group pointed out, no competitive analysis was performed by Mid-America to support Collingsworth's assertion that the East Red Line Shipper incentive rates were, and are, required by competitive forces. Exhibit Nos. S-26 at p. 20; NPG-177 at p. 2; Transcript at pp. 339, 341, 764-771. In addition, as acknowledged by Collingsworth, the Cochin pipeline will be less likely than Mid-America to provide ethane/propane mix to the East Red Line Shipper at a competitive rate because a new tax policy under consideration by the Province of Alberta encourages consumption of Canadian ethane in Canada. Exhibit Nos. M-46 at pp. 44-45; M-57. Moreover, the record is devoid of any information regarding the Cochin volumes transported to the United State from Canada or the number of shippers or volumes lost to Cochin. Transcript at pp. 440, 442-43. Also, a real question exists as to Cochin's "viability as a shipper of light hydrocarbons from Canada to the United States." Exhibit No. NPG-153 at p. 1; Transcript at pp. 451-52. In sum, the record is clear that the existence of any genuine competition from the existing Cochin pipeline is dubious.

1119. With respect to new pipeline competition, no competitive analysis was performed during the 2003 negotiations with the East Red Line Shipper to determine if competition existed. In fact, only in late 2006 or 2007 did Mid-America create a hypothetical new pipeline analysis, which was entirely unrelated to the 2004 contract and was more than a year outside any of the relevant test periods. *See* Exhibit No. NPG-179; Transcript at

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pp. 795-96. This hypothetical analysis is purely speculative and based on unreliable assumptions that (1) a new competitor will take over all the East Red Line volumes; (2) the East Red Line Shipper will move significantly more volumes (75,000 barrels/day) than it did from 2004 through 2006 (67,000 barrels/day); and (3) the East Red Line Shipper will break its contract with Mid-America, which will give it the exclusive right to transport up to 75,000 barrels/day of ethane/propane mix from Conway and Channahon through December 21, 2013. *See* Transcript at pp. 797, 805-06, 809-810. Accordingly, I find that a discount adjustment through the iterative discounting methodology for the East Red Line Shipper incentive rates is inappropriate in designing Mid-America's Northern System rates because Mid-America did not carry its initial (and ultimate) burden of demonstrating that its discounts were required to meet competition.

1120. In any event, I find that the East Red Line Shipper contract is a "negotiated" rate, for which the Commission does not generally allow discount adjustments. *See Wyoming Interstate Co., Ltd.,* 117 FERC ¶ 61,150 at P 10; *Northern Natural Gas Co.,* 105 FERC ¶ 61,299 at P 16.

1121. The Commission permits a pipeline to enter into negotiated rate contracts so long as recourse rates are available to the shippers upon request. *Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines,* 74 FERC at pp. 61,240-41. In addition, the Commission requires, for a negotiated rate contract, that a pipeline file either the contract or numbered tariff sheets, which should include any formula upon which the negotiated rate is based and "the name of the shipper, the negotiated rate, the type of service, the receipt and delivery points applicable to the service, and the volume of gas to be transported." *Southeast Supply Header, LLC,* 119 FERC at p. 61,972. Unlike negotiated rates, "discounted" rates (1) must stay within the maximum and minimum rates set out in a pipeline's tariff and (2) must be based on the same rate design as its tariff rates. *Northern Natural Gas Co.,* 105 FERC ¶ 61,299 at P 12, 16. Further, the minimum rates must reflect only variable costs. *Id.* at P 2.

1122. The complexity of the East Red Line Shipper contract reflects that the East Red Line Shipper incentive rates are "negotiated" rates, to wit: (1) it reflects multiple interrelated elements specifying the services Mid-America will provide the East Red Line Shipper and the payments that it will receive in return; and (2) transportation is also nominally priced on a postage stamp basis without regard to distance or cost and clearly reflects a balancing of the various provisions and payments. Exhibit No. NPG-1 at pp. 159-66. Moreover, while Mid-America asserted that it set out the East Red Line volume incentive rates in its tariff, preventing discrimination among shippers and further distinguishing the volume incentive rates from "negotiated" rates, I find this claim to be disingenuous. The East Red Line Shipper has been, and is, the only shipper on the East Red Line, and consequently, the relevant elements of the incentive rates were structured for the unique use of the East Red Line Shipper. *See* Transcript at pp. 292-93.

1123. It also is clear that the East Red Line Shipper incentive rates are not "discounted" rates: (1) Mid-America has never established maximum and minimum rates; and (2) it has never established its rates through a rational rate design process in a general rate proceeding. *See* Exhibit No. M-100 at p. 89. In fact, the rates on the East Red Line were established entirely through contract negotiation between Mid-America and the East Red Line Shipper, not on fully allocated cost or the iterative discounting methodology used to design the rest of the Northern System rates. *Id.* at pp. 89-90. Accordingly, the East Red Line Shipper incentive rates, as negotiated rates, do not qualify for discount adjustments, which would shift costs to other Northern System transportation services. *NorAm Gas Transmission Co.*, 81 FERC ¶ 61,204 at p. 61,872 (1997).[558]

1124. Similarly, with respect to the non-East Red Line Shipper general commodity discount rates, I find that no discount adjustment is appropriate. First, Mid-America failed to carry its burden of demonstrating that the discounts were required to meet competition. Mid-America witness Ganz assumed that the general commodity rates are not voluntarily discounted, but are required to be discounted by competition because they are lower than what Mid-America now asserts are the fully allocated cost rates (determined by Ganz's iterative discounting methodology and cost-of-service analysis in this proceeding). *See* Exhibit No. NPG-216, Transcript at pp. 1850-53. Not only is this assumption insufficient to support a finding of competitive forces, it is directly contradicted by Collingsworth's testimony regarding the origin of the general commodity "discounted" rates. As the Propane Group pointed out, Collingsworth's testimony at the hearing undermined any claim of competition.

1125. When asked whether the FERC Tariff No. 38 rates were constrained by competition, Collingsworth answered: "Based on what the other parties had at the time, no." Transcript at pp. 333-334. Continuing on redirect, Collingsworth admitted that, at most of Mid-America's locations, the 23% increase in the FERC Tariff No. 38 rates did not "bump up" against the rates charged by Mid-America's competitors. *Id.* at pp. 937-38. In the same vein, when asked whether the general commodity rates in FERC Tariff No. 41 were set by virtue of competition, Collingsworth answered: "[Mid-America] did not consider the competitions and what the competition charged when we set our general commodity rates." *Id.* at p. 380. In contrast, Collingsworth also stated that "competition certainly was a factor in the [FERC] Tariff [No.] 38 rates," and "I can't charge [the FERC Tariff No. 41 general commodity rates] because of the competition today." *Id.* at pp. 937-38, 380. These contradictory statements makes Collingsworth's entire testimony regarding the existence of competition less than credible. As a consequence, I cannot find that Mid-America has carried its burden of proof on this point.

1126. While Mid-America submitted a rate comparison of other pipelines relative to Mid-America, Exhibit No. M-56, as it was prepared only for purposes of this proceeding,

[558] *See also Wyoming Interstate Co., Ltd.*, 117 FERC ¶ 61,150 at P 10.

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as Mid-America was unable to present any competitive analyses it used in the ordinary course of business, and as it was not sufficiently supported by Collingsworth, I find it unconvincing.[559] Significantly, when asked about the exhibit, Mid-America witness Collingsworth did not know the basic information needed to determine whether a pipeline was a competitive alternative to Mid-America, to wit: he did not know the capacity of the alleged competing pipelines, their current construction commitments or utilization, the volume of product shipped by them, whether they are or have been subject to prorationing, or whether they have market based rates. Transcript at pp. 408-426. Moreover, Collingsworth was unable to identify any customer Mid-America has lost to these pipelines or customers that have requested discounts from Mid-America. Transcript at pp. 440-43.

1127. Moreover, and perhaps more importantly, Mid-America has not discounted its rates in accordance with Commission policy and applicable precedent in the natural gas context. *See, e.g., Iroquois Gas Transmission System, L.P.,* 84 FERC at p. 61,476; *Williams Natural Gas Co.,* 77 FERC at p. 62,206. Typically, in rate cases, a natural gas pipeline seeks a determination of its fully allocated maximum rate, and then in subsequent rate cases, the pipeline seeks to discount such maximum rate when competitive forces require it to do so. *See* 18 C.F.R. §§ 284.10(c)(4)(i), 284.10(c)(5)(i), 284.10(c)(5)(ii)(A) (2007).

1128. This is not the case here. Mid-America seeks in this proceeding to justify its "discounted" tariff rates by establishing fully allocated cost rates and then showing that its existing tariff rates are lower. *See* Transcript at p. 579. It called the resulting difference between the two sets of rates "discounts." *See* Exhibit No. NPG-1 at p. 182. Yet the Commission has never evaluated Mid-America's rates in a litigated proceeding. Exhibit No. NPG-103 at p. 9. In other words, Mid-America's existing rates are not the result of rational design and do not discount a maximum fully allocated rate established in a rate case. *See* Exhibit No. M-100 at p. 89. Rather, Mid-America's general commodity rates in FERC Tariff Nos. 38 and 41 were the result of a uniform rate increase to a rate structure developed over the years through various rate agreements and

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[559] Even aside from his general lack of credibility on the subject of competition, Collingsworth's testimony on this document was less than probative. While the rate comparison was prepared by a person who reports to Collingsworth, he took the comparison as "true and accurate" without personally verifying the analysis. Transcript at p. 419. Thus, he was unable to confirm whether the person who actually prepared the numbers looked at Kinder Morgan's FERC Tariff No. 92, as well as FERC Tariff No. 98. *Id.* at pp. 419. In other words, Collingsworth could not confirm whether all of the Kinder Morgan tariffs were evaluated in conducting the rate comparison. *Id.* at pp. 418-19. Consequently, while Exhibit No. M-56 may have been sufficiently authenticated for admission into the record, *Enbridge Pipelines (KPC*), 102 FERC ¶ 61,310 at P 47-51, the credibility of the information contained in it is doubtful.

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other uncontested rate filings. *See* Exhibit Nos. M-46 at p. 40; M-100 at p. 89; NPG-103 at p. 9; S-26 at p. 23. In this context, discount adjustments are nonsensical. Accordingly, I reject Mid-America's proposed discount adjustments through the iterative discounting methodology.

B. IF SO, DID MID-AMERICA APPLY THAT DISCOUNT ADJUSTMENT CORRECTLY?[560]

A. MID-AMERICA

1129. In its Initial Brief, Mid-America submitted that it applied the iterative discounting adjustment correctly. Mid-America Initial Brief at p. 166.[561] According to Mid-America, its witness Ganz testified that the iterative discounting approach first compares the pipeline's proposed rates to the rates based on fully allocated costs (*i.e.,* allocating the non-distance-related costs on a barrel basis and the distance-related costs on a barrel-mile basis). *Id.* Mid-America added, to the extent the proposed rates fall below the fully allocated cost rates, the iterative discounting methodology decreases the volumes related to that path. *Id.* Therefore, in subsequent iterations, fewer costs are allocated to the paths where rates are constrained, and relatively more costs are allocated to the less constrained paths. *Id.* Mid-America noted that it is defending its filed rates, not proposing to charge the rates produced in the final iterations in Exhibit Nos. M-122 and M-123. Mid-America Initial Brief at p. 167 (*citing* Transcript at pp. 1790, 1863-65). In sum, Mid-America asserted that its filed rates at issue are just and reasonable because they are below the cost-based levels generated by the iterative discounting methodology. *Id.*

1130. Mid-America asserted that, although the Propane Group contended that its calculations took too many iterations to resolve and showed very high rate levels for particular movements in the later iterations, those criticisms serve no basis to abandon the iterative discounting approach. *Id.* According to it, the iterative discounting methodology permitted it to recover its costs more closely than a fully allocated cost methodology would allow because the iterative discounting methodology accounts for the competitive pressures in which the pipeline operates rather than allocating costs to the different paths without any consideration of whether Mid-America can collect those costs.[562] *Id.* at pp. 167-68. In addition, Mid-America explained, even after applying the

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[560] Williams did not address this issue. Williams Initial Brief at p. 58; Williams Reply Brief at p. 58.

[561] According to Mid-America, Exhibit Nos. M-122 and M-123 display its calculations for the Locked-In Period and the February 2005 through January 2006 Base Period. Mid-America Initial Brief at p. 166.

[562] Referring to Exhibit Nos. M-103 and M-124, Mid-America declared that "the

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iterative discounting methodology, there still remain more costs to be allocated than it can reasonably recover in rates; thus, some of the rates will necessarily appear high. *Id.* at p. 168. Significantly, Mid-America pointed out that this result merely underscores the disparity between the Northern System costs and the revenue generated under the filed rates. *Id.*

1131. Next, in response to the Propane Group's suggestion that the iterative discounting methodology is meaningless because it would ultimately approve any rate level so long as costs exceed revenues, Mid-America insisted that the disparity between current Northern System revenue and cost of service provides all the more reason to use a rate design methodology that considers a pipeline's ability to collect the resulting rates. *Id.* at p. 169. In any case, Mid-America noted that the iterative discounting methodology cannot be used to approve all rate structures as it will never permit revenues to exceed costs. *Id.* at p. 170. Additionally, Mid-America contended that the Commission must find sufficient competition, determine whether the discounted rates are sufficient to cover variable costs and make a contribution to fixed costs, and establish whether the recipients of the discounts are affiliates or non-affiliates before the iterative approach can be applied at all. *Id.*

1132. In its Reply Brief, Mid-America first addressed what it considers to be the primary criticism of its approach — that it did not use the iterative discounting methodology to set maximum rates. Mid-America Reply Brief at p. 133. In response to that criticism, Mid-America claimed, while it did not propose to charge rates as high as the maximum rates generated by the iterative discounting methodology, that does not make the maximum rates derived from the iterative approach any less useful as a yardstick for establishing the justness and reasonableness of Mid-America's general commodity rates. *Id.* Mid-America added that, because its general commodity rates fall below the maximum rates generated by the iterative discount methodology, the rates are necessarily just and reasonable. *Id.*

1133. Regarding Staff's claim that Mid-America's rates failed to account for length of haul, Mid-America pointed out that, even if the maximum rate for the Morris movement in later iterations is slightly higher than that of another somewhat shorter movement, Staff cannot assume that Mid-America's rates fail to account for length of haul. *Id.* at p. 136. Whatever the case may be, Mid-America submitted that its tariff rates charge more for longer hauls. *Id.* (*citing* Exhibit Nos. M-37; M-38).

1134. Finally, Mid-America asserted, the Propane Group's Exhibit Nos. NPG-217 and NPG-221 prove nothing because the exhibits reflect an incorrect assumption that the

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fully allocated cost methodology leads to a significantly greater under-recovery of costs than does the iterative discounting methodology." Mid-America Initial Brief at p. 168 n.81.

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actual volumes Mid-America was able to achieve during the test period by charging discounted rates would remain at the same level if rates were increased.[563] Mid-America Reply Brief at p. 137.

B. PROPANE GROUP

1135. Even assuming arguendo that a discount adjustment is appropriate, the Propane Group asserted that Mid-America improperly applied the Commission's iterative gas discounting methodology. Propane Group Initial Brief at p. 167 (*citing Farmers Union Central Exchange, Inc. v. FERC,* 734 F.2d at 1502). Specifically, the Propane Group maintained, Mid-America's iterative discounting approach fails to produce converging rates (*i.e.,* a point where the maximum or final rate does not change) and fails to result in maximum tariff rates for the services at issue. *Id.* at pp. 167, 170. Moreover, the Propane Group declared, Mid-America's iterative discounting methodology unsuccessfully justifies any rates, but rather, generates "fully allocated" cost based rates that are significantly higher than the FERC Tariff No. 41 general commodity rates, which are unreasonable by any standard. *Id.* at p. 167. In addition, according to them, contrary to natural gas precedent, Mid-America's approach produced discounts that were not in existence at the time the rates were filed, with no evidence that these so-called discounts have any linkage to competition. *Id.* at pp. 167-68 (*citing Iroquois Gas Transmission System, L.P.,* 84 FERC at p. 61,476; Transcript at p. 1750).

1136. Moreover, the Propane Group noted, according to Mid-America witness Ganz, who testified on the iteration process, he relied on its witness Collingsworth's assertion that the discounts were necessary because of competition. *Id.* at p. 169 (*citing* Transcript at pp. 1853-60, 1881-83; Exhibit Nos. NPG-216 at p. 2; NPG-220 at p. 2). They further noted that Collingsworth testified that the only discounted rates in FERC Tariff Nos. 38 and 41 were two incentive programs for the East Red Line Shipper and the seasonal discount program and that he did not address specific discount levels. *Id.* at pp. 168-69 (*citing* Exhibit No. M-1 at pp. 10-12; Transcript at pp. 384-85, 1853-54).

1137. Moreover, the Propane Group stressed that Mid-America's methodology was not used to establish final maximum tariff rates.[564] *Id.* at p. 169. Typically, the Propane

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[563] Mid-America explained that, in these exhibits, the Propane Group multiplies the maximum rates generated by the iterative discounting method for the FERC Tariff Nos. 38 and 41 periods by the corresponding actual volumes moved on each path during the test period. Mid-America Reply Brief at p. 137.

[564] The Propane Group asserted that "[t]he iterative process is [only] used to determine final maximum tariff rates." Propane Group Initial Brief at p. 168 (*citing Williston Basin Interstate Pipeline Co.,* 107 FERC at pp. 61,623-26; *Williston Basin Interstate Pipeline Co.*, 84 FERC at pp. 61,401-02; *Northwest Pipeline Corp.*, 71 FERC

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Group explained, under the Commission's iterative gas discounting methodology, one concludes with an iteration that results in the maximum tariff rate, and the iterations stop when there are no additional changes from the rate in the prior iteration. *Id.* at p. 170 (*citing* Transcript at pp. 1761-62). However, Mid-America's version of the iterative rates do not converge, *i.e.*, there is no point where the maximum or final rate does not change. *Id.* (*citing* Exhibit Nos. M-122 and M-123).

1138. Moreover, according to the Propane Group, despite the fact that, for the 2006 Test Year, the iteration 60 rates are often three to ten times greater than the FERC Tariff No. 41 general commodity rates, and for the 05/06 Locked-In Period the iteration 6 rates are often six to eight times greater than the FERC Tariff No. 38 general commodity rates, Mid-America declared that the Commission could set rates at these iteration levels (though it does not recommend this approach), as the rates allegedly would be cost justified. *Id.* at p. 171. Additionally, the Propane Group argued, Mid-America's suggestion that, to use the iteration 60 or 6 rates, another iterative analysis would be necessary to determine if any particular rate would be reasonable "makes no sense." *Id.* at pp. 171-72.

1139. Exacerbating the absurdity of Mid-America's methodology, the Propane Group claimed that multiplying the fully allocated iteration 60 rates for FERC Tariff No. 41 by Mid-America's Test Period volumes of 35,100,387 barrels, generates revenues of approximately $610 million — where Mid-America's Northern System cost-of-service for the 2006 Test Year is only $70,674,000. *Id.* at p. 172 (*citing* Transcript at pp. 1862-67; Exhibit Nos. NPG-214 at pp. 5-7; NPG-217). Continuing, the Propane Group reported that multiplying the fully allocated iteration 6 rates for FERC Tariff No. 38 by Mid-America's Test Period volumes of 35,335,306 barrels for its Locked-In Period, generates revenues of approximately $374 million — where the Northern System cost-of-service for the Locked-In Period is only $66 million. *Id.* (*citing* Transcript at pp. 1888-91; Exhibit Nos. NPG-218 at pp. 1-5; NPG-221).

1140. Finally, the Propane Group disputed Ganz's version of the iterative methodology. *Id.* at p. 172 (*citing* Exhibit No. M-149). According to them, this version treats only the East Red Line Shipper rate as a discount and sets the tariff rate for all other routes and shippers at a hypothetical $100/barrel. *Id.* at pp. 172-73 (*citing* Transcript at pp. 2280-81). Similarly, the Propane Group noted that Ganz does not recommend using this approach either. *Id.* at p. 173 (*citing* Transcript at p. 2283). Lastly, it argued that Mid-America did not reconcile the use of the $100/barrel tariff rates with the Commission's established iterative discounting methodology, which does not require such artifices, and the iterations were based on an inflated Northern System cost of service for the 2006 Test Year. *Id.*

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at pp. 62,004-09).

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1141. In its Reply Brief, the Propane Group declared that the iteration methodology offered by Mid-America was not like the methodology approved by the Commission in natural gas cases because in the natural gas cases: "(1) the discounts were in existence when the pipeline filed its rates; (2) the rates resulting from the iterative process were the maximum tariff rates; and (3) the iterations converged or stopped changing at a certain point;" while, in the instant case: (1) the discounts (with the exception of the co-called [East Red Line] Shipper discount) did not exist when Mid-America filed either tariff rate case; rather they resulted from Mr. Ganz's iterations; (2) the rates resulting from the iteration process are not maximum tariff rates; and (3) the iterations do not converge or stop changing." Propane Group Reply Brief at p. 163 (citations omitted).

1142. Moreover, the Propane Group asserted, the iterations produce "absurd" results "with rates many time larger than the general commodity rates Mid-America is attempting to justify." *Id.* at p. 164. According to the Propane Group, Mid-America's response, that it is not intending to charge those rates, makes no sense especially as Ganz claimed that another iterative analysis would have to be done to establish whether any of the final results of his iterative analysis (iteration 60 with regard to FERC Tariff No. 41; iteration 6 with regard to FERC Tariff No. 38) would be reasonable. *Id.* (*citing* Transcript at pp. 1792-93). In any event, they suggested that permitting Mid-America to proceed on the basis of the iteration 60 and iteration 6 rates could have serious consequences. *Id.* at p. 165. That is, as Mid-America proposed to charge the shippers a discounted rate — the general commodity rates — instead of the iteration 60/iteration 6 rates, the Propane Group suggested that it is not unreasonable to conclude that Mid-America maintained it would be justified in subsequently withdrawing this discount and charging the fully allocated cost rates shown in iteration 60 and iteration 6 — based on the cost of service established in this proceeding. *Id.* at pp. 164-65.

1143. With regard to the workpapers supporting Exhibit No. M-123 (FERC Tariff No. 41), the Propane Group submitted the following: (1) if a traditional fully allocated cost analysis using even Mid-America witness Ganz's inflated cost of service were performed, 53 of the 58 FERC Tariff No. 41 rates would not be just and reasonable since they exceed the fully allocated cost rates; (2) the movements in lines 6, 21, 33, 34, and 35 of Exhibit No. NPG-214 have rates that are all less than their initial fully allocated cost rates and, therefore, purportedly cause Mid-America to under-recover its costs from the East Red Line Shipper by at least $15 million, at least under Ganz's cost-of-service; and (3) the $15 million of cost not recovered from the East Red Line Shipper is shifted to other Northern System shippers. Propane Group Reply Brief at pp. 165-66 (*citing* Exhibit No. NPG-214; Transcript at pp. 1820-21, 1827-34).

1144. Similarly, upon examining the workpapers behind Exhibit No. M-122 (FERC Tariff No. 38), the Propane Group contended that costs from 92% of the movements are being shifted to eight percent of the movements. Propane Group Reply Brief at pp. 167-68 (*citing* Transcript at pp. 1875-76).

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C. COMMISSION TRIAL STAFF

1145. Staff opposed a discount adjustment and specifically opposed Mid-America's proposed adjustments as unreasonable and baseless. Staff Initial Brief at p. 110. According to it, under the Commission's iterative process, "a pipeline first adjusts the volumes that flowed under a discount by multiplying them by the ratio of the average discounted rate to the just and reasonable rate determined in the rate proceeding" and "then employs an iterative process, recalculating its maximum rates based on the discount adjustment as many times as necessary until the maximum rate does not change." *Id.* at pp. 110-11 (*citing Williston Basin Interstate Pipeline Co.*, 84 FERC at pp. 61,401-02). Calling it "'nonsense on stilts,'"[565] Staff described Mid-America's iterative process as "making rate iterations, by downwardly adjusting design throughput, until all of the rates resulting from his iterative process exceeded the proposed [FERC] Tariff No. 38 and [FERC] Tariff No. 41 rates." *Id.* at p. 111 (footnote omitted).

1146. Claiming that Mid-America's iterative process assigns higher rates to maximum rate shippers "in recognition that some volumes would not flow absent discounting," Staff opined that Mid-America's iterative discounting methodology produces maximum rates that no Mid-America shipper would ever pay. *Id.* at pp. 111-12. Furthermore, in comparison, Staff reported its calculations for FERC Tariff No. 41 rates, made without any "discount" adjustments, result in a narrow range of rates, the highest being $2.4646 per barrel, while, for example, Mid-America's methodology produces a rate as high as $24.12 per barrel under iteration 21. *Id.* Also, Staff noted that unlike Mid-America's proposed rates, Staff's rates reflect haul length, as Commission policy recognizes distance as the prime determinant of the cost of pipeline transportation. *Id*. (*citing Northern Natural Gas Co.,* 14 FPC 11, 24 (1955)).

1147. In reply, Staff claimed that Mid-America is not using the iterative process to design rates, but rather is using it to justify its proposed rates. Staff Reply Brief at pp. 95-96. It noted that, according to Mid-America, based on the iterative process, it could never recover its cost-of-service based on its filed rates, and Staff asserted, were this true, the pipeline would be better off defending its rates by a simple explanation that it increased its existing rates by uniform percentages and now is unable to collect its cost-of-service under the increased rates, rather than justifying its rate increases through the use of an iterative discount methodology. *Id.* at p. 96. Closing its argument, Staff claimed that the theory behind the Commission's iterative process is the adjustment of throughput to account for volumes flowing under discounted rates, but Mid-America never did offer discount rates making its proposal absurd. *Id.* at pp. 96-97.

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[565] With a paean to Jeremy Bentham, *Anarchical Fallacies* in Human Rights 32 (A. Meldon ed. 1970).

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Discussion and Ruling

1148. As I have determined that a discount adjustment calculated by the iterative discounting methodology is inappropriate, the issue of whether Mid-America applied such discount adjustment properly is rendered moot.[566] However, were it necessary for me to decide the question, I would have rejected Mid-America's proposed methodology.

1149. Mid-America argued that it applied the iterative discounting adjustment properly, and its filed rates at issue in this proceeding are just and reasonable because they are below the cost-based levels generated by the iterative discounting methodology. Mid-America Initial Brief at pp. 166-67. Additionally, Mid-America contended that the iterative discounting methodology accounts for the competitive pressures surrounding the operation of its three systems. *Id.* at pp. 167-68.

1150. Even assuming arguendo that a discount adjustment is appropriate, the Propane Group asserted that Mid-America's iterative discounting approach is inappropriate because it (1) fails to end up with an iteration that results in the maximum tariff rate, and (2) fails to produce iterative rates that converge (*i.e.,* at a point where the maximum or final rate does not change). Propane Group Initial Brief at pp. 167-170.

1151. Staff asserted that a discount adjustment is inappropriate, and even were the use of a discount adjustment approved, it submitted that Mid-America's iterative discounting adjustment is unreasonable. Staff Initial Brief at p. 110. Specifically, it contended that Mid-America's iterative discounting methodology produces maximum rates that no shipper will ever, or would ever, want to pay. *Id.* at p. 112. According to Staff, its calculations for FERC Tariff No. 41 rates, made without any "discount" adjustments, result in a narrow range of rates, the highest being $2.4646 per barrel, while, for example, Mid-America's methodology produces a rate as high as $24.12 per barrel under iteration 21. *Id.* (citing Exhibit No. S-49 at pp. 1-2).

1152. In general, the iterative discounting process accounts for discounted volumes in existence at the time a pipeline files its rate case and determines the maximum rates that recourse shippers pay. *See Iroquois Gas Transmission System, L.P.,* 84 FERC at p. 61,476 ; *Northwest Pipeline Corp.,* 71 FERC at pp. 62,004-09. The iterative process recalculates its maximum rates based on the discount adjustment until the maximum rate does not change. *Williston Basin Interstate Pipeline Co.,* 84 FERC at p. 61,402. I could not find, and no party could provide, any Commission precedent in which the iterative discounting process does not end up with an iteration that produces the maximum tariff rate and does not stop when there are no additional changes from the rate in the prior iteration. *See* Transcript at pp. 1761-62.

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[566] *See* discussion *supra* Issue No. 8.A.

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1153. In short, even assuming arguendo that Mid-America's discounts were justified by competition, Mid-America's iterative process is inconsistent with the Commission's iterative discounting methodology because it (1) does not produce rates that converge (at a point where the maximum or final rate does not change), (2) does not result in maximum tariff rates for the services at issue, and (3) reflects discounts which did not exist when Mid-America filed either of its rate cases.

1154. Mid-America's iterative rates do not converge at a point where the maximum or final rate does not change from the rate derived in the immediately preceding iteration. *See Williston Basin Interstate Pipeline Co.,* 107 FERC at pp. 61,623-26; Exhibit Nos. M-122; M-123. Instead, Mid-America only stopped iterating when all of the rates resulting from its iterative process exceeded the proposed FERC Tariff Nos. 38 and 41 rates. *See* Exhibit Nos. M-34; M-41; M-24 at pp. 48, 55; Transcript at pp. 1792-93, 1796-1800. For FERC Tariff No. 38, the iterative rates exceeded the proposed FERC Tariff No. 38 rates after six iterations. *See* Exhibit Nos. M-34; M-122 at pp. 1-3; Transcript at pp. 1796-1800. For FERC Tariff No. 41, this result occurred after sixty iterations. Exhibit Nos. M-41; M-123 at p. 5; Transcript at pp. 1792-93. Indeed, with respect to FERC Tariff No. 41, a subsequent iteration would produce rates that would increase yet again. Transcript at pp. 1792-93. Moreover, Mid-America witness Ganz admitted that, because the revenues under Mid-America's iterative process are less than its proposed cost-of-service, every filed tariff rate will eventually be exceeded by Mid-America's proposed fully allocated cost rate if the iterations continued. Transcript at p. 1793. Consequently, in contrast to the Commission's iterative discounting methodology, Mid-America's iterative process never produces converging rates at which point a maximum rate is determined, and is accordingly, unreasonable. *Williston Basin Interstate Pipeline Co.,* 107 FERC at p. 61,624.[567]

1155. Additionally, Mid-America claimed that it uses its iterative methodology to justify its general commodity rates, not to justify charging the rates shown in the final iterations. Transcript at pp. 1787-88, 1863-65. This claim is ludicrous. The purpose of the Commission's iterative discounting methodology is to adjust the design throughput to account for volumes that flowed under discounts in existence when the pipeline filed its rate case and produce maximum rates that some shippers *will actually pay*. *Williston Basin Interstate Pipeline Co.,* 84 FERC at p. 61,401; *Williams Natural Gas Co.,* 77 FERC at p. 62,205; Transcript at p. 1806.

1156. With the exception of the East Red Line Shipper discount, the so-called discounts identified by Mid-America did not exist when Mid-America filed either its March 2005 or 2006 rate case, and Mid-America did not represent that any of the routes in its FERC

[567] I note that, for FERC Tariff No. 41, the sheer number of Mid-America's iterations, 60, casts doubt upon the reasonableness of Mid-America's iterative discounting process. *See Williston Basin Interstate Pipeline Co.,* 107 FERC at p. 61,624.

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Tariff Nos. 38 or 41 were "discounted" when it filed these tariffs. Transcript at p. 1806; Exhibit Nos. M-100 at pp. 10-12, 81-82; NPG-1 at pp. 177-81. While Ganz claimed that "it's implicit that there are some discounts from a fully allocated cost-based rate," he admitted that one does not know "explicitly what they are until you develop a fully allocated cost rate level and compare it to the filed rate." Transcript at p. 1806. Effectively, the "discounts" Mid-America referred to are the differences between the general commodity rates in FERC Tariff No. 38 and the fully allocated cost rates after the sixth iteration, and between the general commodity rates in FERC Tariff No. 41 and the fully allocated cost rates after the 60th iteration. Transcript at pp. 1787-1800, 1841-53; Exhibit Nos. NPG-215 at p. 8; NPG-216 at p. 2. In other words, the "discounts" Mid-America identified were not in existence when it made its March 2005 and 2006 filings, and it has never discounted a transportation rate from a maximum, fully allocated tariff rate. *See Northwest Pipeline Corp.,* 71 FERC at p. 62,008 n.158.

1157. Moreover, Mid-America's iterative process produces rates that no Mid-America shipper will ever pay, or would ever want to pay. *See* Staff Initial Brief at p. 112; Mid-America Initial Brief at p. 167; *see also* Transcript at pp. 1889-90. Accordingly, as applied by Mid-America and under the circumstances surrounding these filings, the iterative discounting methodology it uses does not comport with that which the Commission has approved for use in natural gas cases, and cannot be said to be just or reasonable.

C. SHOULD THE RATES BE DESIGNED ON FULLY ALLOCATED COSTS OR THE ITERATIVE GAS DISCOUNTING METHODOLOGY?

A. MID-AMERICA

1158. Mid-America argued that the Northern System rates should be established by an iterative discounting methodology because a fully allocated cost rate design methodology is not required by Commission precedent and would result in a massive under-recovery of Mid-America's cost of service. Mid-America Initial Brief at p. 171. Asserting that the Commission does not require the use of a fully allocated cost methodology in all situations, Mid-America claimed that a fully allocated cost methodology can produce reasonable results where the pipeline faces minimal competition, but where competition is present, as it declared is the case here, the fully allocated cost methodology can lead to unreasonable results by allocating costs to movements where they cannot be recovered due to competition. *Id.* at pp. 172-74 (*citing Williams Pipe Line Co.,* 84 FERC at p. 61,103; *SFPP, L.P.,* 86 FERC at p. 61,079). It insisted that, if a fully allocated cost methodology is used in this case, Mid-America would recover only $55.7 million of its $70.7 million total Northern System cost-of-service for the FERC Tariff No. 41 Test Period. *Id.* at p. 174 (*citing* Exhibit No. M-100 at p. 80).

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1159. Even were a fully allocated cost approach applicable here, Mid-America submitted that the Propane Group incorrectly calculated volumes for the Locked-In Period and the FERC Tariff No. 41 Base Period. *Id.* at p. 174 (*citing* Exhibit Nos. NPG-109; NPG-112). It claimed that the Propane Group manipulated volumes in order to shift costs away from propane movements and onto the movements of other products. *Id.* at pp. 174-76 (*citing* Exhibit Nos. NPG-1 at p. 156; M-151; Transcript at pp. 2396, 2410-14).

1160. In its Reply Brief, in response to the Propane Group's contention, Mid-America asserted that no oil pipeline precedent or Commission ruling places a "heavy burden" on a pipeline proposing an alternative methodology to a fully allocated cost methodology. Mid-America Reply Brief at p. 139.[568] With respect to the two natural gas cases cited by the Propane Group in support of its "heavy burden" contention, *Kern River Gas Transmission Co.,* 117 FERC at p. 61,374; *Questar Pipeline Co.,* 65 FERC ¶ 61,352 at p. 62,853 (1993), Mid-America claimed that those cases merely refer to the burden the Commission has imposed by rule on natural gas pipelines proposing a departure from a straight fixed-variable rate design method. *Id.* at p. 40.[569] According to Mid-America, in the natural gas context, there is no "heavy burden" on pipelines proposing to use iterative discounting because that method is presumed to be appropriate in the context of non-affiliate discounts. *Id.*[570] Moreover, Mid-America declared that the decision in *Farmers Union Central Exchange v. FERC,* 734 F.2d at 1528, cited by the Propane Group also does not support the "heavy burden" argument. *Id.* Mid-America declared that nothing in that decision indicates that point-to-point rates are required to be set on a fully allocated cost basis rather than an iterative discounting approach, let alone that a pipeline seeking an alternative to fully allocated cost bears a heavy burden. *Id.*

1161. Further, while the Propane Group insisted that differential pricing is not permitted for oil pipelines since the Interstate Commerce Act expressly forbids any undue discrimination or preference, Mid-America asserted that the Commission rejected that specific argument in *Williams Pipe Line Co*., acknowledging that "differential pricing was always permitted under the version of the [Interstate Commerce Act] that governed both rail and pipeline carriers before the enactment of the first of the rail reform statute in

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[568] In support, Mid-America cited *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992,* Order No. 561-A, FERC Stats. & Regs. ¶ 31,000 at p. 31,107 (1994); *Cost of Service Reporting and Filing Requirements for Oil Pipelines,* Order No. 571, FERC Stats. & Regs. ¶ 31,006 at p. 31,166 (1994).

[569] In support, Mid-America cited Order No. 636, FERC Stats. & Regs., Regs. Preambles ¶ 30,939 at p. 30,434 (1992).

[570] In support, Mid-America cited *Policy for Selective Discounting by Natural Gas Pipelines,* 111 FERC ¶ 61,309 at P 59.

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1976." *Id.* at p. 141 (*citing Williams Pipe Line Co.,* 84 FERC at p. 61,102). It argued that the courts have interpreted the anti-discrimination provisions of the Interstate Commerce Act to permit the Interstate Commerce Commission to approve differential pricing justified only by competitive conditions. *Id.* at p. 142 (*citing Associated Gas Distributors v. FERC,* 824 F.2d 981, 1011 (D.C. Cir. 1987)).

1162. Turning to the Propane Group's assertion that the revenue generated by the East Red Line Shipper discount fails to recover Mid-America's variable costs, it stated that, to the contrary, the revenue generated by the East Red Line discounts, $7.9 million during the FERC Tariff No. 41 Base Period and $7.7 million during the Locked-In Period, exceeds the variable costs, fuel and power, by about $3 million in each period. *Id.* Additionally, Mid-America explained that its witness, Collingsworth, discussed variable costs with the operating employees involved and other individuals on his staff and understood that the variable costs had to be compared to the revenue derived from the tariff rate on the total amount of barrels of ethane/propane mix delivered to the East Red Line Shipper. *Id.* at p. 143 (*citing* Transcript at pp. 776-79, 782).

1163. Mid-America maintained that, as a practical matter, and according to the Department of Transportation regulations, pipeline integrity assessment would need to continue if the line were ever to be used in the future. *Id.* at pp. 143-44 (*citing* Transcript at pp. 785-90). With respect to labor, Mid-America emphasized that labor cost reductions would not be significant if the East Red Line was idled, as the number of employees needed to operate the line does not fluctuate appreciably based on the number of barrels moved. *Id.* at pp. 144-45 (*citing* Transcript at pp. 775-76). Finally, Mid-America noted that, even were the East Red Line idled, the storage space at Iowa City, Iowa, could be used for a purpose other than storing ethane/propane mix. *Id.* at p. 145 (*citing* Transcript at pp. 790-91). In any event, Mid-America insisted, given the approximate $5 million difference between the revenue generated from the East Red Line Shipper and variable cost, the storage lease payments would not cause the discount to fall below variable cost. *Id.*

B. PROPANE GROUP

1164. The Propane Group asserted that a fully allocated cost methodology should be used to determine Mid-America's rates. Propane Group Initial Brief at p. 174. According to the Propane Group, when a pipeline seeks to depart from the Commission's traditional rate design method, the pipeline bears a "heavy burden." *Id.* (*citing Kern River Gas Transmission Co.,* 117 FERC at p. 61,374; *Questar Pipeline Co.,* 65 FERC at p. 62,853). Claiming that the Circuit Court decision in *Farmers Union Central Exchange, Inc. v. FERC,* 734 F.2d 1486, is controlling, the Propane Group suggested that "the Commission has found that its 'subsequent decisions are consistent with'" that court's requirement that the cost of providing a service be borne by the shippers that use it. *Id.* (*citing SFPP, L.P.*, 86 FERC at p. 61,080). The Propane Group declared that

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Mid-America's proposed iterative discounting methodology is not only unjustified and unsupported, but it forces other Northern System shippers to subsidize the pipeline's East Red Line Shipper, the services the East Red Line Shipper receives, and the East Red Line Shipper's "discounted" contract in violation of the Interstate Commerce Act and Commission precedent. *Id.* at p. 175.

1165. Although they admitted that the Commission's holding in *Williams Pipe Line Co.* permits one set of shippers to be charged rates above fully allocated costs in order to compensate for another customer or group of customers having rates below a fully allocated cost level, the Propane Group argued that this subsidization falls within the legislation amending the rail portions of the Interstate Commerce Act, which does not apply to oil pipelines. *Id.* at p. 176 (*citing Williams Pipe Line Co.,* 84 FERC at p. 61,102). Further, even were the form of differential pricing found in *Williams Pipe Line Co.* authorized under the Interstate Commerce Act for oil pipelines, the Propane Group claimed that Mid-America failed to carry its burden of showing that competitive forces gave rise to any of the discounts on the Northern System and that the East Red Line Shipper revenue is in excess of its variable cost to provide transportation service to the East Red Line Shipper. *Id.* at pp. 177-81.

1166. The Propane Group insisted that Mid-America is entitled to no presumption of reasonableness with respect to any of its purported discounts, let alone its East Red Line Shipper "discount." *Id.* at p. 178. They added, given the "undisputed fact" that Mid-America recognized only approximately $6.9 million of East Red Line Shipper "discount" revenue compared to the approximately $18 million received by Mid-America under the East Red Line Shipper contract, there can be no presumption that Mid-America sought the highest possible transportation rate from the East Red Line Shipper. *Id.* (*citing* Exhibit No. NPG-1 at pp. 158-62). Accusing Mid-America of "attempting to reap a windfall of additional revenue, as well as the double-recovery of costs, by unreasonably shifting a phantom 'discount' risk to all other Northern System shippers," the Propane Group argued that Mid-America's claim that the revenue received from the East Red Line Shipper exceeds the East Red Line's variable costs "lacks credibility and is completely refuted by" record evidence. *Id.* Moreover, they accused Mid-America witness Collingsworth of ignoring multiple variable costs in testifying that the only costs were for fuel and power. *Id.* at pp. 178-79 (*citing* Exhibit Nos. NPG-1 at pp. 158-62; NPG-177 at p. 17; NPG-178 at p. 2; NPG-202 at p. 2; M-46 at p. 48; M-79 at p. 1; M-100 at p. 89; M-126; Transcript at pp. 310, 776-79, 788-90, 1480-81). Thus, the Propane Group claimed, Mid-America inappropriately excluded additional East Red Line variable costs associated with pipeline integrity assessments ($7.6 million), labor ($2.9 million), and storage ($3.9 million) and thus, the East Red Line variable costs of at least $12.99 million exceed the East Red Line Shipper revenue of $6.9 million. *Id.* at p. 181 (*citing* Transcript at pp. 2322-23).

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1167. In their Reply Brief, the Propane Group began by pointing out that, while Mid-America stated that its Northern System rates should be designed using the iterative discounting methodology, it does not do so, and instead, uses the iterative methodology to justify existing rates, not to design rates. Propane Group Reply Brief at p. 170. Simply put, the Propane Group claimed that Mid-America is not proposing to charge the rates in the final iterations it offered into evidence, and therefore, they contended, it has not proposed any ratemaking methodology which supports its FERC Tariff Nos. 38 and 41 rate increases. *Id.* at pp. 170-71.

1168. In response to Mid-America's assertion that there is no reason why it could not continue to use its existing rate structure which takes into account the business realities of its system, which is distance-related, does not result in an over-recovery, and is not discriminatory, the Propane Group contended that Commission precedent is directly to the contrary. *Id.* (*citing Williams Pipe Line Co*, 84 FERC at 61,099-100). Moreover, the Propane Group submitted that the Commission recently held that "[i]t is important to recognize that the most accurate measure of whether a pipeline's rates are just and reasonable is a full cost-of-service determination." *Id.* (*citing Big West Oil Co. v. Frontier Pipeline Co.,* 122 FERC ¶ 61,138 at P 30 (2008)).

1169. Continuing, the Propane Group reasserted that, using the proper costs and revenues, Mid-America over-recovers its cost-of-service whether one uses the FERC Tariff No. 41 seasonal rates or the FERC Tariff No. 41 general commodity rates. *Id.* at pp. 172-73. Specifically, according to the Propane Group, their approach diverged from Mid-America's approach in the following: (1) the Propane Group suggested that the cost of service for the 2006 Test Year (FERC Tariff No. 41) is $53.5 million, while Mid-America claimed it is $70.7 million; (2) the Propane Group included a pipeline integrity expense of $7.6 million and a storage expense of $3.9 million, which Mid-America excluded; (3) Mid-America excluded approximately $13.4 million in revenues associated with the East Red Line Shipper, while the Propane Group did not; and (4) Mid-America excludes revenues associated with the incentive reliability payment ($1 million), the Cochin/Conway volume commitment ($2.9 million), and the Channahon to Morris revenue ($9.5 million), while the Propane Group included such revenues. *Id.* at p. 172 (*citing* Exhibit Nos. NPG-235; NPG-236; Transcript at pp. 2322-27).

1170. Finally, with respect to Mid-America's contention that the Propane Group's volume numbers are inaccurate, and therefore, costs are shifted from the propane movements to the movements of other products, the Propane Group maintained that the scaling of the 2006 Base Period volumes (as opposed to using the 2005 Test Period barrels) had no significant impact on the ultimate rates derived, since total barrels and barrel miles are used to derive rates. *Id.* at pp. 173-74 (*citing* Transcript at pp. 2414-17). They stated that total barrels remained the same, and the scaling resulted in a Test Period 2006 barrel-mile figure (20,264,231,092 barrel-miles) that was 1.8% greater than the 2005 Test Period figure (19,903,251,285 barrel-miles). *Id.* at p. 174. Moreover, asserted

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the Propane Group, the "scaled" 2006 Test Period barrel-miles results in a lower rate for "heavies" (*i.e.,* Conway to Pine Bend isobutane at $1.2840/barrel) as compared to the result if the 2005 Test Period barrel-miles (isobutane at $1.3064/barrel) were used. *Id.* at pp. 174-75 (Transcript at p. 2414). Also, the Propane Group noted, Mid-America's volume level is reduced by 87% from its first iteration to its iteration 60. *Id.* at p. 175. In addition, the Propane Group suggested that the distribution of volumes to individual movements in iteration 60 is also substantially different from the original test period volumes contained in Iteration 1. *Id.* (*citing* Exhibit No. NPG-214 at pp. 8, 67). In sum, the Propane Group argued, Mid-America's method, not its own, generates unreasonable results and uses volumes that bear no relation to actual volumes in any period. *Id.* at p. 176.

C. WILLIAMS

1171. Williams did not address this issue in its Initial Brief. Williams Initial Brief at p. 58. In its Reply Brief, Williams concurred with Staff's position that Mid-America should use fully allocated costs in designing its rates. Williams Reply Brief at p. 60. Lastly, Williams asserted that the availability of recourse rates to shippers electing not to enter into negotiated rate agreements and the restrictions regarding discounts to negotiated rate agreements should be included in the rate design applicable to all existing and future negotiated rate agreements entered into by Mid-America with any shipper on any of its systems. *Id.*

D. COMMISSION TRIAL STAFF

1172. Staff declared that Mid-America's rates should be designed by a fully allocated cost methodology. Staff Initial Brief at p. 113. It stated:

> [O]il pipelines generally . . . file a conventional cost of service with projected units of throughput and propose a rate per unit of throughput based on these elements. . . . A pipeline can use a discount adjustment to reduce its projected units of throughput to recognize that discounted test period volumes would not flow if charged maximum rates. Once a pipeline determines the appropriate level of design throughput through discounting iterations, it uses that throughput level to derive rates based on its cost of service. It thus ends up allocating its cost of service to each unit of projected throughput, as adjusted by the discounting methodology, so that each unit bears the same share of cost. In this sense the pipeline has fully allocated costs to each unit of throughput used to design its maximum transportation rates.

Id. at pp. 113-14 (footnotes and citations omitted). According to Staff, Mid-America did not actually design Northern System rates, rather the evidence it adduced was intended to

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justify across-the-board increases to its existing rates. *Id.* at p. 114. For this reason, Staff asserted, Mid-America failed to propose rates based on fully allocated costs. *Id.* at p. 115. On the other hand, Staff argued, its witness, Pride, designed rates allocating "a full share of the costs of providing the service." *Id.* (*citing* Exhibit Nos. S-48; S-49).[571]

Discussion and Ruling

1173. As I already have determined that a discount adjustment, and specifically the iterative discounting methodology as used by Mid-America, were inappropriate and unreasonable,[572] the question remains is whether designing Mid-America's Northern System rates by a fully allocated cost methodology is appropriate.

1174. According to Mid-America, its rates should be determined by the iterative discounting methodology because competition prevents it from being able to charge the fully allocated cost rates for certain movements. Mid-America Initial Brief at p. 171. Continuing, it added that a "heavy burden" is not placed on a pipeline proposing to use iterative discounting because that method is presumed to be appropriate in the context of non-affiliate discounts. Mid-America Reply Brief at p. 40. Further, Mid-America argued that the Interstate Commerce Act permits differential pricing justified by competition. *Id.* at p. 142.

1175. In contrast to Mid-America, the Propane Group submitted that the Northern System rates should be determined by a fully allocated cost methodology. Propane Group Initial Brief at p. 174. In addition, the Propane Group contended that Mid-America bears a "heavy burden" in seeking to depart from the Commission's traditional rate design method. *Id.* Further, it continued, even were differential pricing permitted under the Interstate Commerce Act, Mid-America failed to carry its burden in demonstrating its Northern System discounts were the result of competition, and that its East Red Line Shipper revenues were greater than the East Red Line Shipper variable costs. *Id.* at pp. 177-81.

1176. According to the Propane Group, Mid-America has not proposed any ratemaking methodology to be used in designing its Northern System rates, but instead, uses the iterative discounting to justify an across-the-board increase in its existing rates. Propane Group Reply Brief at p. 170. The Propane Group suggested that that approach is impermissible and noted that the Commission recently held in favor of the full cost-of-service methodology. *Id.* at p. 171. Similarly, Staff recommended that

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[571] Nothing substantive was added in Staff's Reply Brief. *See* Staff Reply Brief at pp. 97-98.

[572] *See* discussion *supra* Issue Nos. 8.A; 8.B.

Mid-America's rates be designed by a fully allocated cost methodology because the Commission approves use of that methodology, and Mid-America's iterative discounting approach is inappropriate. Staff Initial Brief at pp. 113-115.[573]

1177. Based on the record and Commission precedent, I hold that Mid-America's Northern System rates must be designed by a fully allocated cost methodology. *Big West Oil Co. v. Frontier Pipeline Co.,* 122 FERC ¶ 61,138 at P 30; *Williams Pipe Line Co.,* 84 FERC at 61,098. Although the Commission does not require the use of a fully allocated cost methodology for rate design in all cases,[574] Mid-America's proposed iterative discounting process is not just or reasonable. *See* discussion *supra* Issue Nos. 8.A.; 8.B.

1178. In any event, it is clear that Mid-America did not even use the iterative discounting methodology to *design* rates as required by Commission precedent,[575] rather it used the methodology to attempt to *justify* its uniform increase of a rate structure developed over the years through various rate agreements and other uncontested rate filings. *See* Exhibit Nos. M-46 at p. 40; M-100 at p. 89; NPG-103 at p. 9; S-26 at p. 23. Moreover, it does not seek, in this proceeding, permission to charge the rates resulting from its iterations. *See* Exhibit Nos. M-122; M-123; Transcript at pp. 1787, 1863-65. Based on this, I am compelled to conclude that Mid-America has failed to propose any ratemaking methodology to support its FERC Tariff Nos. 38 and 41 rate increases under the Commission's regulations and precedent.

1179. As Mid-America has not presented sufficient evidence to justify using an alternative methodology, it also follows that its rates must be based on a fully allocated methodology. *Williams Pipe Line Co.*, 31 FERC ¶ 61,377; *Williams Pipe Line Co.*, 84 FERC ¶ 61,022.

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[573] Williams concurred with Staff's position. Williams Reply Brief at pp. 60-61.

[574] *Se, e.g., SFPP, L.P.,* 86 FERC at p. 61,079.

[575] *See e.g. Williston Basin Interstate Pipeline Co.,* 84 FERC at pp. 61,401-02; *Williams Natural Gas Co.,* 77 FERC at pp. 62,205-07.

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D. WHAT IS THE APPROPRIATE RATE DESIGN FOR THE SEASONAL DISCOUNT PROGRAM?[576]

A. MID-AMERICA

1180. In its Initial Brief, Mid-America asserted that, if it is successful in defending its general commodity rate levels, the seasonal discounts, which are lower, also would be just and reasonable. Mid-America Initial Brief at p. 177. In short, Mid-America argued that the seasonal discounts should be ignored for rate design purposes. *Id.* According to Mid-America, the FERC Tariff No. 38 rates raised its general commodity rates by 23% and FERC Tariff No. 41 raised the FERC Tariff No. 38 rates by an additional 60%, but that it established certain seasonal discount rates below those rates because it faced competition at various locations. *Id.* (*citing* Exhibit Nos. M-37; M-38; M-46 at pp. 37-38). Mid-America further noted that it is not seeking to defend the specific level of the seasonal discount rates other than to show that they are below the ceiling level; nor, it stated, does it seek to reallocate to other shippers the difference between the seasonal rates and the general commodity rates through its iterative discounting methodology. *Id.* at pp. 177-78 (*citing* Exhibit Nos. M-24 at p. 55; M-100 at p. 75).

1181. Mid-America argued that it makes no sense to set its rates at a level below those which would be found to be just and reasonable just because it cannot charge them, and denied Staff's supposition that it is "gaming the system," as it claimed it simply is attempting to determine lawful rate ceilings and to establish some flexibility to adjust its rates in the future as competitive forces permit, provided the rates stay below the just and reasonable rate ceiling. *Id.* at p. 178. Mid-America insisted that this is consistent with Commission indexing regulations, which permit an oil pipeline to set its rates at any level below the indexed rate ceiling without having to provide cost justification. *Id.* (*citing* 18 C.F.R. § 342.3(a) (2007)).[577]

B. PROPANE GROUP

1182. The Propane Group argued that nothing in the record supports the "rate design" for the seasonal discount program, which was filed as part of the March 31, 2006, tariff filing. Propane Group Initial Brief at pp. 182-83. As to the seasonal rates, according to the Propane Group, Mid-America claimed that it desired to keep rate increases uniform so that the current rate structure would not be disrupted and produce undesirable market

[576] Williams did not address this issue. Williams Initial Brief at p. 58; Williams Reply Brief at p. 61.

[577] Mid-America added nothing substantive in its Reply Brief. *See* Mid-America Reply Brief at p. 146.

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effects; yet, the Propane Group emphasized, Mid-America produced no study as to these alleged undesirable effects and relied only on the bald claims of Mid-America witness Collingsworth. *Id.* at p. 182 (*citing* Transcript at pp. 567-70). In any event, the Propane Group declared, FERC Tariff Nos. 38 and 41 are unjust and unreasonable, and thus, the seasonal rates also are unjust and unreasonable. *Id.* at p. 183 (*citing* Exhibit No. NPG-1 at pp. 4-10, 187-200).

1183. In reply, the Propane Group argued that all of Mid-America's rates at issue in this proceeding, including its seasonal rates, are unduly discriminatory and preferential under section 3(1) of the Interstate Commerce Act. Propane Group Reply Brief at p. 177. Particularly, the Propane Group declared, Mid-America admitted that its existing Northern System rate structure does not produce as great a disparity between long haul and short haul rates as would result from a strict application of the fully allocated cost methodology. *Id.* (*citing* Mid-America Initial Brief at p. 172; Transcript at pp. 2170-77). Moreover, the Propane Group asserted, while Mid-America argued that this rate has been in effect for years and "reflects 'business realities'" making them just and reasonable, this position is not supported by the record. *Id.* at pp. 177-78. Furthermore, according to the Propane Group, Mid-America has presented no evidence supporting its contention that its differentials between delivery points are important to shippers. *Id.* at p. 178. Accordingly, maintained the Propane Group, the FERC Tariff Nos. 38 and 41 rates cannot be charged because they are unduly discriminatory and preferential and refunds should be issued to the level of the FERC Tariff No. 33 rates (*i.e.,* the rates in effect before the FERC Tariff No. 38 rates). *Id.*

C. COMMISSION TRIAL STAFF

1184. Staff opposed Mid-America's seasonal discount program in FERC Tariff No. 41, and contended it should "base its rates on fully allocated costs and projected units of service, without using the artifice of a seasonal discounting scheme that applies to virtually all Northern system [sic] rates." Staff Initial Brief at p. 116 (footnote omitted) (*citing* Exhibit No. S-26 at pp. 24-25). According to Staff, Mid-America filed the seasonal discount plan as an attempt to set its rates at an artificially high level allowing it to charge a higher rate in the future without having to seek Commission permission. *Id.*[578] It takes the position that Mid-America's seasonal discount program proposal is an

[578] In support, Staff cited to Exhibit No. S-47 at p. 2, a Mid-America internal memo in which Mary Anne Collins, Mid-America's former Director of Tariffs and Planning, described the reason for the filing of FERC Tariff No. 41 as follows:

> A pancake rate filing to further increase rates on the Northern System is being prepared. This will allow [Mid-America] to defend rates higher than currently published during the FERC [h]earing, with the objective of establishing maximum ceiling rates. Ceiling rates can be used to support

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attempt to "game the system," allowing the pipeline to implement higher rates up to a ceiling level whenever it chooses without further Commission review. *Id.* at p. 117 (*citing* Exhibit No. S-26 at p. 25). Staff added: "This kind of advanced rate approval contravenes fundamental cost-based ratemaking principles." *Id.* In other words, Staff asserted that approving a rate today that largely exceeds the rates Mid-America plans to charge in the near future allows the pipeline a "free pass" to avoid justifying that rate based on the pipeline's costs at the time it actually implements the rate. *Id.* In sum, Staff asserted that the seasonal discount program should be ignored in designing rates, and Mid-America should be required to design its rates for the Northern System only on fully allocated costs and projected units of throughput without a discount adjustment. *Id.*[579]

Discussion and Ruling

1185. Mid-America argued that the seasonal discounts should be ignored for rate design purposes because, if its general commodity rates prove just and reasonable, its seasonal discounts, which are lower than the general commodity rates, will be just and reasonable as well. Mid-America Initial Brief at p. 177. It denied Staff's argument that it is "gaming the system," as it claimed that it is seeking only to determine lawful rate ceilings and to establish some flexibility to adjust its rates in the future as competitive forces permit, provided the rates stay below the just and reasonable rate ceiling. *Id.* at p. 178.

1186. On the other hand, the Propane Group asserted that there is no evidence in the record supporting the rate design for the seasonal discount program. Propane Group Initial Brief at p. 183. Furthermore, the Propane Group argued that the seasonal discount rates are unduly discriminatory and preferential in violation of Section 3(1) of the Interstate Commerce Act. Propane Group Reply Brief at p. 177. Particularly, the Propane Group emphasized, Mid-America's existing Northern System rate structure does not produce as great a disparity between long haul and short haul rates as would result from a strict application of the fully allocated cost methodology. *Id.*

1187. Staff contended that the seasonal discount program should be ignored in designing rates, and Mid-America should design its rates for the Northern System only on fully allocated costs and projected units of throughput without a discount adjustment. Staff Initial Brief at p. 117. According to Staff, Mid-America's seasonal discount program is an attempt to "game the system" because Mid-America seeks Commission approval of ceiling rates today, so that it can raise its future rates up to such ceiling level without further justification or Commission review at such time. *Id.*

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future rate increases and reduce the requirements for another cost of service filing or the concurrence of all current shippers . . . .

[579] Staff added nothing new in its Reply Brief. Staff Reply Brief at p. 99.

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1188. Based on the instant record, it must be concluded that the seasonal discount program should be ignored in designing Mid-America's Northern System rates. In other words, as I previously held, Mid-America's Northern System rates should be designed solely on fully allocated costs and projected units of throughput, without a discount adjustment. Thus, as the parties did not address the question, it is not necessary for me to address the question of what is the appropriate rate design for the seasonal discount program.

1189. The seasonal discounts should be ignored for rate design purposes for two reasons: (1) Mid-America fails to carry its burden of justifying the seasonal discount program, as it does not even attempt to justify the rate design for its seasonal discount program, but simply argues on brief that, in this proceeding, it seeks only to defend its general commodity rates, not the lower seasonal discount rates; and (2) the seasonal discount program is part of an attempt by Mid-America to avoid scrutiny for future rate increases, which is contrary to fundamental cost-based ratemaking principals. Mid-America Initial Brief at p. 177; Exhibit No. S-47.

1190. Staff witness Pride's testimony on this point, especially when taken with the Mid-America internal memo, is very credible and clearly establishes that, through its seasonal discount program, Mid-America seeks to avoid justifying its currently charged rates and receive an approval for a ceiling rate much higher than the currently charged seasonal rates, so that it can implement higher rates in the future up to this ceiling level without further Commission review at such time. *See* Exhibit No. S-26 at p. 25. In other words, it clearly is an attempt to, as Pride suggested, "game the system." As a cost-based rate today could be substantially higher or lower than a cost-based rate in the future; Mid-America should be required to justify its future rates based on its costs and overall operations at the time it actually decides to implement them.

1191. Consequently, because Mid-America failed (and did not even attempt) to justify any discount adjustment in the design of its rates, and because the seasonal discount program is part of an attempt to defy fundamental cost-based ratemaking principles, I conclude that the seasonal discounts should be ignored in Mid-America's rate design.

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E. WHAT IS THE APPROPRIATE RATE DESIGN FOR VOLUMES SHIPPED UNDER INCENTIVE RATE PROGRAMS?[580]

A. MID-AMERICA

1192. Mid-America stated, with respect to the East Red Line incentive rate program involving movements of propane and ethane/propane mix to Clinton, Iowa, and Morris, Illinois, that they are appropriately treated as discounts in the iterative discounting calculation for the reasons discussed under Issue No. 8.A. Mid-America Initial Brief at p. 179. Moreover, it contended that, with respect to the East Red Line incentive rate program involving the Cochin to Conway throughput and deficiency agreement between Mid-America and the East Red Line Shipper, the revenue generated from this program should not be credited against Mid-America's cost-of-service, and no rates should represent this non-existent movement. *Id.* at pp. 179-80. Mid-America reasoned that (1) no volumes moved on that path since at least 2003, and, (2) as discussed under Issue No. 7.C, the deficiency payment received by Mid-America cannot be considered transportation revenue. *Id.*[581]

B. PROPANE GROUP

1193. As an initial matter, the Propane Group stated that, as discussed under Issue No. 8.A, the volume incentive rates provided under the East Red Line Shipper contract are negotiated rates, and as discussed under Issue No. 7, these rates should be established on a fully allocated cost basis without iterations. Propane Group Initial Brief at p. 184. Additionally, the Propane Group claimed that the revenues and volumes related to the East Red Line Shipper agreement should be included in the Northern System cost and revenue analysis. *Id.*

1194. Further, the Propane Group stressed that, should Mid-America not recover the fully allocated costs of individual transportation movements under the East Red Line Shipper agreement and FERC Tariff Nos. 38 and 41, it should bear these costs, not other shippers. *Id.* As discussed under Issue No. 8.A, the Propane Group contended that there is no basis for a discount-type adjustment related to the East Red Line Shipper's rates. *Id.*[582]

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[580] Williams did not address this issue. Williams Initial Brief at p. 58; Williams Reply Brief at p. 61.

[581] Mid-America added nothing new in its Reply Brief. Mid-America Reply Brief at p. 147.

[582] In reply, the Propane Group added nothing new. Propane Group Reply Brief at

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C. COMMISSION TRIAL STAFF

1195. As discussed under Issue Nos. 8.A and 8.F, Staff contended that Mid-America should fully allocate costs to the transportation service provided to the East Red Line Shipper, treating the East Red Line Shipper contract as a negotiated agreement. Staff Initial Brief at p. 118. Furthermore, while Staff maintained that Mid-America should credit the revenues received from the East Red Line Shipper as a result of the volume deficiency payments to its cost-of-service, Staff asserted that Mid-America may keep the incentive reliability payments. *Id.*[583]

Discussion and Ruling

1196. This issue breaks down into three individual questions, each of which was previously decided:

1. What is the appropriate rate design for volumes shipped under the incentive rate program? The volume incentive rates provided to the East Red Line Shipper for movements of propane and ethane/propane mix from Conway to Clinton and Morris and from Channahon to Clinton are negotiated rates, and for rate design purposes, should be determined on a fully allocated cost basis without iterations. *See* discussion *supra* Issue No. 8.A.

2. What is the appropriate treatment of the Cochin volume shortfall payment received from the East Red Line Shipper? The Cochin volume shortfall payment should be counted as revenue in Mid-America's cost-of-service. *See* discussion *supra* Issue No. 7.C.

3. What is the appropriate treatment of the $1 million annual incentive reliability payment received from the East Red Line Shipper? The $1 million annual incentive reliability payment made by the East Red Line Shipper should be included in all of Mid-America's cost and revenue analyses in this proceeding. *See* discussion *supra* Issue No. 7.A.

F. WHAT IS THE APPROPRIATE TREATMENT OF REVENUE CREDITS IN RATE DESIGN?[584]

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pp. 179-80.

[583] Staff added nothing new in its Reply Brief. Staff Reply Brief at p. 99.

[584] Williams did not address this issue. Williams Initial Brief at p. 58; Williams Reply Brief at pp. 61-62.

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A. MID-AMERICA

1197. Mid-America contended that two types of revenue should be credited against its Northern System cost-of-service: (1) revenue associated with the merchant storage operations at Conway and Pine Bend; and (2) revenue received from operating the Magellan ammonia pipeline. Mid-America Initial Brief at p. 181. It added that the first was discussed under Issue No. 6.B, and the second as part of Issue No. 4.D.(5). *Id.* Mid-America argued that, because both types of revenue were deducted from the total Northern System cost-of-service before the costs were allocated to individual rates, the revenue credits play no role in designing any of the individual rates, except to the extent they decrease the overall Northern System cost of service. *Id.*

1198. According to Mid-America, the inappropriateness of the Propane Group's proposal to deduct the incentive reliability payment received by Mid-America from the East Red Line Shipper from Mid-America's Northern System cost of service was discussed in Issue No. 7.B. *Id.* Similarly, the appropriateness of Staff's proposed deduction of the revenue received from the Cochin to Conway throughput and deficiency agreement was discussed in Issue No. 7.C. *Id.*

1199. In reply, Mid-America contended that its "proposal to include all of the Conway costs and credit the merchant storage revenue is superior to Staff's" proposed allocation of Conway costs between operational and merchant storage. Mid-America Reply Brief at p. 148. It added that this matter was discussed in Issue No. 6.B. *Id.* Moreover, Mid-America noted that the Propane Group agreed with its treatment of the ammonia line costs and revenues, but disagreed with its treatment of ammonia line direct labor in the Kansas-Nebraska formula. *Id.* at pp. 148-49. Mid-America explained that this matter was discussed under Issue No. 4.D(1). *Id.* at p. 149.

B. PROPANE GROUP

1200. The Propane Group declared that there are three types of revenue which should be credited against Mid-America's Northern System cost-of-service prior to determining just and reasonable rates on a fully allocated basis: (1) storage revenue, which is not received pursuant to a separate tariff, should be credited against any storage costs included in the pipeline's transportation cost of service; (2) $1.3 million received from Magellan for the ammonia pipeline; and (3) $1 million received from the East Red Line Shipper as an Incentive Reliability Payment. Propane Group Initial Brief at p. 185. According to them, they do not oppose Mid-America's crediting of Conway storage revenues to the extent merchant storage costs are included in the Northern System transportation cost of service. *Id.* Nor, the Propane Group stated, do they oppose the crediting of storage revenues from Mid-America's Pine Bend storage operations that are provided as line fill, which utilize Mid-America transportation pipeline assets. *Id.* at p. 186.

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1201. Regarding the revenue received from operating the Magellan ammonia pipeline, the Propane Group does not dispute Mid-America's inclusion of both the operating costs of the ammonia pipeline and the corresponding payments as a revenue credit in its cost of service because these costs and payments offset each other. *Id.* However, the Propane Group recommended that only the direct labor expense associated with the operation of the Mid-America pipeline be reflected in the Kansas-Nebraska allocation factor, and not the direct labor expense associated with the ammonia pipeline because the payments from Magellan cover both the direct and indirect operating expenses related to the operation of the ammonia pipeline, leaving only indirect expenses associated with operating Mid-America's natural gas liquids system to be allocated by the Kansas-Nebraska formula. *Id.* (*citing* Exhibit No. NPG-1 at pp. 41-43). They added that this matter is discussed in Issue No. 4.D.(1), *supra*. *Id*.

1202. Finally, with respect to the annual $1 million Incentive Reliability Payment, the Propane Group contended that, because it allows Mid-America to recover the costs of maintaining the pipeline and guaranteeing reliability and delivery of a product meeting certain specifications, treating the $1 million payment as a revenue credit prevents the double recovery of Northern System costs, corresponds with the payment being made in connection with Mid-America's provision of transportation service, and corresponds with Mid-America's treatment of the annual $1.3 million it receives to operate the Magellan pipeline as a revenue credit, or negative expense. *Id.* at p. 187 (*citing* Exhibit No. NPG-100).

1203. Referring to arguments made on Issues Nos. 6, 4.D.(1) and 7.B, the Propane Group argued that "the record is clear that each of these three sources of annual revenue directly allows Mid-America to recover the precise costs that Mid-America proposes to include in its transportation cost of service." *Id.* Therefore, they claimed, these three sources of revenue ought to be credited in calculating Mid-America's Northern System cost of service. *Id.* at pp. 187-88.

1204. In reply, the Propane Group added that it agreed with Staff that there should be an accounting for the revenue received from the Cochin volume shortfall payment. Propane Group Reply Brief at p. 181. However, referring to the argument they made on Issue No. 7.C, the Propane Group submitted, the Cochin volume shortfall payment should be treated as revenue, not as a revenue credit or a negative expense. *Id.* at pp. 181-82.

1205. Next, the Propane Group attacked Staff's position that Mid-America should keep the East Red Line Shipper incentive reliability payment since Mid-America's East Red Line Shipper contract is a negotiated rate. *Id.* at p. 182. According to the Propane Group, *Wyoming Interstate Co.*, 117 FERC ¶ 61,150, which is cited by Staff in support of its position, stands for two propositions: (1) Mid-America is not entitled to a discount adjustment for the East Red Line Shipper contract as it constitutes a negotiated rate; and (2) the non-East Red Line shippers should not subsidize the East Red Line Shipper. *Id.*

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In support of its position on negotiated rates, the Propane Group offers the following quote from *Wyoming Interstate Co.,* 117 FERC at p. 61,808:

> [I]n order for a pipeline to seek such a discount adjustment [*i.e.,* a discount adjustment for a negotiated rate] in its next rate case, the pipeline must include in the negotiated rate provisions of its tariff a protective mechanism that will ensure that its negotiated rates transactions will not cause any inappropriate cost shifting to the recourse rate shippers.

Id. Accordingly, the Propane Group submitted, because it claimed that the East Red Line Shipper contract includes no such rate protection, Mid-America is entitled to no discount adjustment for the East Red Line Shipper contract. *Id.*

1206. Regarding the incentive reliability payment, the Propane Group argued that pipelines may keep the profits from negotiated rates above the maximum recourse level. *Id.* at pp. 182-83 (*citing Wyoming Interstate Co.,* 117 FERC at p. 61,809). However, the Propane Group asserted that, in this proceeding, the maximum recourse rates, the fully allocated cost rates without iterations, have not yet been determined and that *Wyoming Interstate* did not address the question of whether a regulated oil pipeline should be permitted to negotiate shipper side-agreements for payments that result in the over-recovery or double recovery of costs. *Id.* at p. 183. In any case, the Propane Group argued that shifting costs from the East Red Line Shipper to non-East Red Line shippers through discount adjustments is improper. *Id.*

C. COMMISSION TRIAL STAFF

1207. Staff submitted that Mid-America should credit the revenues under (1) the lease agreements for its in-line storage facilities at Pine Bend, Minnesota, and (2) the volume deficiency provision in the East Red Line Shipper contract. Staff Initial Brief at p. 119. However, it recommended that Mid-America keep the revenues, without crediting, from the incentive reliability provision of the East Red Line Shipper contract. *Id.*

1208. With respect to the first type of revenue, Staff stated that crediting this type of revenue is proper because Mid-America owns the Pine Bend storage and does not lease it from a third party, and because the Pine Bend storage costs are included in Mid-America's transportation rate base and is paid for by its ratepayers. *Id.* at p. 120 (*citing* Exhibit Nos. S-26 at p. 18; S-30 at p. 1; S-39; S-40). Accordingly, Staff recommended a credit of $187,500 for the Pine Bend lease for Period I and a credit of $185,000 for Period II. *Id.* (*citing* Exhibit Nos. S-48; S-49).

1209. With respect to the second type of revenue, because the East Red Line Shipper makes these deficiency payments under the terms of the tariff just as if Mid-America performs the transportation, Staff argued that Mid-America should recognize the

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payments as transportation revenue and credit it to the Northern System cost-of-service. *Id.* at pp. 121-22 (*citing* Exhibit No. S-26 at p. 23). Consequently, Staff recommended a credit of $2,887,150 for both Periods I and II for the East Red Line Shipper volume deficiency payments. *Id.* at p. 122 (*citing* Exhibit Nos. S-48 at p. 1; S-49 at p. 1).

1210. Third, regarding the incentive reliability payment Mid-America receives from the East Red Line Shipper, Staff maintained that Mid-America need not credit these revenues against its cost of service because they derive from a negotiated rate agreement with the East Red Line Shipper. *Id.* at pp. 122-23. According to Staff, the circumstances of this case fall within the Commission's holding in *Wyoming Interstate Co., Ltd.,* 117 FERC ¶ 61,150, which permitted pipelines to keep revenues above recourse rate levels under a negotiated rate agreement to the extent the pipelines avoided shifting costs to other shippers through discount adjustments. *Id.* at p. 123.[585]

Discussion and Ruling

1211. The question here involves four matters which I previously have decided, to wit: What is the appropriate treatment of the following revenues:

1. The Conway merchant storage revenue. In Issue No. 6.B, *supra*, I determined that Mid-America failed to distinguish between operational and merchant storage at Conway and that I had no choice but to treat all of the storage as operational.

2. The revenue received from operation of the Magellan ammonia pipeline. In Issue No. 4.D.(5), *supra*, I determined that both the costs and revenues associated with the Magellan ammonia pipeline should be excluded from Mid-America's cost of service; and in Issue No. 4.D.(1) *supra*, I concluded that Mid-America incorrectly included direct labor costs associated with its operation of the Magellan ammonia pipeline system as part of its Kansas-Nebraska calculations and that the Kansas-Nebraska allocation factors should exclude the direct labor expense associated with the ammonia pipeline and reflect only the direct labor expense associated with the operation of the Mid-America pipeline.

3. The incentive reliability payment received from the East Red Line Shipper. In Issue No. 7.B, *supra,* I determined that the East Red Line Shipper incentive reliability should be credited to Mid-America's cost of service.

4. The revenue received from the Cochin volume shortfall payment. In Issue No. 7.C, *supra*, I determined that the Cochin shortfall payments should be reflected in designing Mid-America's rates.

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[585] Staff added nothing new in its Reply Brief. Staff Reply Brief at pp. 99-101.

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1212. Having made those determinations, the only question left to be decided is whether Mid-America should be permitted to credit the storage revenues it receives under leases for the storage of product at the Pine Bend holding facility against its Northern System cost of service. Mid-America argued that the Pine Bend merchant storage costs should be included in its Northern System cost-of-service and the Pine Bend merchant storage revenue should be credited against its Northern System cost-of-service. Mid-America Initial Brief at p. 181. The Propane Group asserted that it is appropriate to credit storage revenues from Mid-America's Pine Bend storage operations that are provided as line fill, which utilizes Mid-America's transportation pipeline assets that are included in its transportation cost-of-service. Propane Group Initial Brief at p. 186.

1213. Staff claimed that Mid-America should credit the Pine Bend storage revenues because, unlike storage facilities on other parts of Mid-America's system, the storage at Pine Bend is owned by Mid-America. Staff Initial Brief at p. 120. Further, it contended that, because the cost of the Pine Bend storage is included in Mid-America's transportation rate base and is paid for by its ratepayers, it should credit the revenues it receives under the Pine Bend storage leases in designing its transportation rates.

1214. I find, and no party contests,[586] that the revenues Mid-America receives under leases for the storage of product at Mid-America's Pine Bend holding facility should be credited against Mid-America's Northern System cost-of-service.[587] That is, because the cost of Pine Bend storage is included in Mid-America's transportation rate base and is paid for by its ratepayers, Mid-America should be permitted to credit the revenues it receives under the Pine Bend storage leases in designing its transportation rates. *See* Exhibit Nos. NPG-1 at p. 57; S-26 at pp. 17-18. Accordingly, for the March 2005 filing, the appropriate revenue credit amount should be the storage revenue figure reflected by the last 12-months of the Test Period ending September 2005, and for the March 2006 filing, the appropriate revenue credit amount should be the storage revenue figure reflected by the last 12-months of the Test Period ending October 2006. *See* Exhibit Nos. S-48 at p. 1; S-49 at p. 1.

ISSUE NO. 9: IS THE CANCELLATION OF THE INCENTIVE RATES FOR THE TRANSPORTATION OF THE ETHANE COMPONENT OF DEMETHANIZED MIX IN TARIFF NO. 45 JUST AND REASONABLE AND OTHERWISE LAWFUL?[588]

[586] Mid-America Initial Brief at p. 181; Propane Group Initial Brief at p. 186; Staff Initial Brief at p. 120.

[587] *See* Exhibit Nos. S-39 (lease agreement for Period I); S-40 (lease agreement for Period II).

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A. MID-AMERICA

1215. Mid-America maintained that Williams has failed to provide any reason why Mid-America should be prevented from cancelling the ethane incentive rates. Mid-America Initial Brief at p. 182. Also, Mid-America insisted that, because the ethane incentive rate is a discount rate, which it is not required to offer at all, there is no reason to prohibit the cancellation of the rate. *Id.* (*citing Laclede Pipeline Co.*, 119 FERC ¶ 61,236 at P 8; *Express Pipeline LLC,* 99 FERC ¶ 61,229 at P 10 (2002)).[589] According to Mid-America, its reasons for cancelling the rate stem from the business realities it faces and does not discriminate against any shipper as all shippers have the ability to sign up for the volume discounts through long-term agreements with Mid-America. *Id.* at p. 183 (*citing Mid-America Pipeline Co., LLC,* 116 FERC ¶ 61,040 at P 23 (2006). Finally, it asserted, cancellation of the ethane incentive rate simply means that ethane will be moved at the same rate as the other components of the demethanized mix under Mid-America's local rate, which is not above the indexed ceiling. *Id.* (*citing* Exhibit No. M-43). In sum, Mid-America asserted that the cancellation of the ethane incentive rates is lawful and within Commission regulation. *Id.* (*citing* 18 C.F.R. § 342.3(a) (2007); *Mid-America Pipeline Co., LLC,* 115 FERC ¶ 61,258 at P 17 (2006)).[590]

B. WILLIAMS

1216. In contrast with Mid-America, Williams argued that Mid-America's cancellation of the lower ethane incentive rate for Group 100 and increase in the joint rate for ethane and its subsequent reinstatement of an ethane discount, which was not received by all shippers, constitute discriminatory conduct in violation of the Interstate Commerce Act. Williams Initial Brief at p. 59 (*citing* 49 U.S.C. app. § 15(1)). According to Williams, it was the only shipper affected by the cancellation of the incentive rate because Mid-America canceled the discount in FERC Tariff No. 45, but reinstated it in FERC Tariff No. 47 for shippers who had signed long-term incentive agreements with Mid-America.[591] *Id.* (*citing* Transcript at pp. 898-99). Further, Williams opined,

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[588] The Propane Group did not address this issue. Propane Group Initial Brief at p. 189; Propane Group Reply Brief at p. 184.

[589] In support, Mid-America also cited *Dome Pipeline Corp.*, 117 FERC ¶ 61,364 at P 11 (2006), *aff'd on reh'g*, 118 FERC ¶ 61,132 (2007); *Shell Pipeline Co.*, 100 FERC ¶ 61,139 at P 6, *aff'd on reh'g*, 100 FERC ¶ 61,330 (2002).

[590] Mid-America offered nothing new in its Reply Brief. *See* Mid-America Reply Brief at pp. 150-52.

[591] Which Williams, the only one of all the shippers on the system for the previous five years, chose not to do. Transcript at p. 899.

Mid-America's "business judgment" justification was clearly a pretext for discrimination against Williams for agreeing to ship its Group 100 barrels on a new natural gas liquids pipeline, Overland Pass Pipeline, upon its starting operation in 2008, even though Williams will continue to ship on Mid-America's Rocky Mountain System and Seminole Pipeline despite its agreement with the new pipeline. *Id.* at p. 60 (*citing* Transcript at pp. 890, 899, 973).

1217. In any event, Williams contended that, even had Mid-America demonstrated that it lawfully offered a lower discriminatory incentive rate, it could not increase any rate on the Rocky Mountain System because revenues exceeded costs. *Id.* at p. 61 (*citing* Exhibit Nos. M-24 at p. 39; WIL-18). Moreover, at the hearing, Mid-America witness Ganz testified that Rocky Mountain System revenues exceeded costs of service in all of his calculations. *Id.* (*citing* Transcript at p. 2351). Thus, Williams submitted that the ethane discount rates should be reinstated for the period September 18, 2006, through January 17, 2007, and refunds with interest should be ordered for that period. *Id.*

1218. In reply, Williams reiterated that neither Mid-America nor Staff noted that, under FERC Tariff No. 47, Mid-America reinstated an ethane rate discount which did not apply to Williams, despite it being in the top two shippers of ethane on the Rocky Mountain System. Williams Reply Brief at pp. 62-63. Also, Williams insisted that, in *Express Pipeline LLC,* 99 FERC ¶ 61,236, relied upon by Mid-America, it was suggested that the Commission or other trier of fact has an express duty to determine whether cancellation of a rate discount is in the public interest. Williams Reply Brief at p. 63. Moreover, Williams claimed that the Commission acknowledged its request to suspend the elimination of the lower ethane incentive rate and corresponding increase in the joint rate and concluded that, in FERC Tariff No. 45, Mid-America proposes changes to rates that are already at issue in the consolidated proceedings to which Williams is already a party. *Id.* (*citing Mid-America Pipeline Co., LLC,* 116 FERC ¶ 61,249 at P 13). Consequently, Williams submitted, consistent with *Express Pipeline*, the cancellation of the ethane incentive rate was placed squarely within the scope of this proceeding, and because no testimony was submitted regarding this matter, the cancellation of the ethane incentive rate cannot be found to be just and reasonable. *Id.* at p. 64.

C. COMMISSION TRIAL STAFF

1219. Staff does not argue one way or the other as to whether the cancellation of the ethane incentive rates was just and reasonable. Rather, Staff stated that, because Mid-America's request for rehearing is still pending, the order dated October 19, 2006, controls the disposition of FERC Tariff No. 45 in this proceeding. *Id.* at p. 126. Specifically, Staff continued, the order states, "There does not appear to be any disagreement as to whether Mid-America's Rocky Mountain System rates are before me.

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Clearly, they are not." *Id.*[592] Accordingly, it stated, no testimony regarding this issue was submitted in this proceeding. *Id.*[593]

Discussion and Ruling

1220. The issue is whether Mid-America's cancellation of the ethane incentive rates under FERC Tariff No. 45 is just and reasonable. According to Mid-America, the ethane incentive rate is a discount rate, which it is not required to offer at all, and therefore, there is no reason to prohibit the cancellation of the rate. Mid-America Initial Brief at p. 182. Further, it maintained that its reasons for cancelling the rate stemmed from its business realities and does not discriminate against any shipper, since all shippers had the ability to sign up for the volume discounts through long-term agreements with it, and Williams simply chose not to do so. *Id.* at p. 183.

1221. Contrary to Mid-America's position, Williams argued that the cancellation of the lower ethane incentive rate for Group 100 and increase in the joint rate for ethane and the subsequent reinstatement of the ethane discount, which was not received by all shippers, constituted discriminatory conduct in violation of the Interstate Commerce Act. Williams Initial Brief at p. 59. According to Williams, it was the only shipper affected by the cancellation of the incentive rate because Mid-America canceled the discount in FERC Tariff No. 45, but reinstated it in FERC Tariff No. 47 for shippers who had signed long-term incentive agreements with Mid-America, which did not include Williams. *Id.* Claiming that the Commission acknowledged its request to suspend the elimination of the lower ethane incentive rate and corresponding increase in the joint rate, Williams argued that the cancellation of the ethane incentive rate was placed squarely within the scope of this proceeding and, because no testimony was submitted regarding the matter, the cancellation of the ethane incentive rate cannot be found just and reasonable. Williams Reply Brief at p. 64.

1222. Taking no position regarding this issue, Staff asserted that, because Mid-America's request for rehearing is still pending, the order dated October 19, 2006, controlled the disposition of FERC Tariff No. 45 in this proceeding. Staff Initial Brief at p. 126. Specifically, Staff insisted that this order stated that the Rocky Mountain System rates were not an issue in this proceeding. *Id.*

1223. On September 15, 2006, the Commission issued an order consolidating Docket No. IS06-520-000 with the matters already before me. *Mid-America Pipeline Co.*, 116 FERC ¶ 61,249. Subsequently, I held a prehearing conference to assess the impact of that Order on the proceeding at which the parties focused on the question of whether I needed

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[592] *Mid-America Pipeline Co., LLC,* 117 FERC ¶ 63,013, at P 18 (2006).

[593] Staff added nothing new in its Reply Brief. Staff Reply Brief at p. 101.

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to investigate Mid-America's Rocky Mountain rates in order to determine whether its joint rate with Seminole was just and reasonable. *See Mid-America Pipeline Co., LLC*, 117 FERC ¶ 63,013 at P 2 (2006). After giving the parties an opportunity to submit briefs, I held that the parties did not disagree on the fact that the Rocky Mountain rates were not before me and that it was implicit in the Commission's September 15, 2006, Order that the Rocky Mountain rates were just and reasonable. *Id.* at P 18 and n.3. I further held that "insofar as concerns the [Rocky Mountain/Seminole] joint rate, the scope of the hearing is limited to the question of the justness and reasonableness of the Seminole rate and the justness and reasonableness of the sum of that rate and the Rocky Mountain System rate." *Id.* at P 25. There is nothing in the instant record which gives me any cause to alter those rulings.

1224. Consequently, the question of whether the cancellation of the incentive rates for the transportation of the ethane component of demethanized mix in FERC Tariff No. 45 is just and reasonable and otherwise lawful is not before me. Moreover, in its argument, Williams implied the FERC Tariff No. 47 may be before me. If, indeed, that is what it was attempting to indicate, I could not say in stronger terms that it erred.

II. SEMINOLE ISSUES – SUMMARY OF THE EVIDENCE

A. CHARLES E. OLSON

1225. To begin, Olson testified that, in December 2004, Seminole Pipeline Company, a common carrier which is located entirely in the State of Texas and that transports refined natural gas liquids, filed an initial rate of 95.85 cents for service between Hobbs, Texas, and Mont Belvieu, Texas. Exhibit No. WIL-2 at pp. 5-7. According to him, Enterprise Products Partners, LLC owns 90% of Seminole. *Id.* at p. 6. Additionally, he claimed that Seminole pays no significant taxes outside of Texas.[594] *Id.*

1226. Olson determined a cost-based rate for Seminole after receiving information from the company for the base period ending January 31, 2006, and the test period ending October 31, 2006. *Id.* at p. 7. Seminole provided the following amounts, and Olson admitted they were accepted: operating expenses of $28,636,000; depreciation expense of $7,036,000; and amortization of $140,000. *Id.* at pp. 7-8. With these figures, Olson said, he calculated the return on rate base, $14,357,000, and the income tax allowance, $5,778,000, using the Enterprise Products Partners capital structure, debt cost, and return on equity developed by Mid-America witness Williamson. *Id.* at p. 8.[595] Therefore, he

[594] It is a Delaware corporation and pays taxes in that state related to this status, according to Olson, and Delaware is the only state other than Texas in which it pays taxes. Exhibit No. WIL-2 at p. 6.

[595] *See also* Exhibit Nos. M-19, M-21, M-22.

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suggested that a revenue requirement of $55,947,000 for Seminole is appropriate. *Id.* at pp. 7-8.[596]

1227. According to him, he used an original cost rate base of $150,364,000. *Id.* at p. 8.[597] In addition, Olson explained, he adopted the 13.21% nominal return calculated by Williamson and used the 52.02% common equity ratio determined by Williamson. *Id.* at p. 9.[598] Furthermore, Olson testified, Williamson's embedded cost of capital of 5.78% was used. Exhibit No. WIL-2 at p. 9; *see also* Exhibit No. M-22 at p. 22. Next, Olson stated, he calculated a weighted cost of capital of 9.80% from this information. Exhibit No. WIL-2 at p. 9. Because Seminole's Texas franchise tax was 0.25% of its net taxable capital, Olson claimed that he did not have to calculate a state tax gross-up. *Id.* However, unlike Williamson, who used a trended original cost methodology, Olson stated, he opted for an original cost methodology. *Id.* at p. 8.

1228. Because all of Seminole's active input origins and outlets are in Texas, Olson claimed that the pipeline should not be subject to the Commission's jurisdiction. *Id.* at pp. 9-10. He contended that its rates should be determined by the Texas Railroad Commission. *Id.* at p. 10. Olsen suggested that, should the Commission find that Seminole's rate from Hobbs, Texas, to Mont Belvieu, Texas, is jurisdictional, it should recognize that "Seminole has only recently attempted to become a [Commission] regulated pipeline." *Id.* He continued that, in his view, because no shipments have been made pursuant to FERC Tariff No. 3, which did not go into effect until 2005,[599] and because Texas state rates under which it did do business were computed using an original cost methodology, use of a trended original cost methodology is inappropriate. *Id.*

1229. Using data provided by Seminole, Olson calculated the three-year (2004-06) average of interstate barrels from Hobbs to Mont Belvieu to be 68,575,415. *Id.* at pp. 11-12.[600] Then, he continued, using the previously calculated revenue requirement of $55,947,000 and this barrel average, he determined that the appropriate rate was 81.58 cents per barrel. Exhibit No. WIL-2 at p. 12. Therefore, in Olson's opinion, the FERC Tariff No. 3 rate of 98.85 cents per barrel, which exceeds Olson's rate by more than

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[596] *See also* Exhibit No. WIL-44.

[597] *See also* Exhibit No. WIL-4.

[598] *See also* Exhibit Nos. M-19, M-21 at p. 7.

[599] Although Seminole went into operation 23 years earlier. Exhibit No. WIL-2 at p. 10.

[600] *See also* Exhibit No. WIL-6.

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twenty percent, is not just and reasonable. *Id*. He further suggested that this rate exceeds the revenue requirement derived rate from the Seminole cost-of-service study[601] of $59,686,000, or 87.04 cents. *Id.*

1230. On direct examination, at the hearing, Olson testified that the parties stipulated to a return on equity of 11.25%. Transcript at pp. 3027-28. Consequently, he continued, his cost of capital dropped from 9.80% to 8.74%; the return on rate base dropped from $14,357,000 to $13,141,812; and the income tax allowance decreased from $5,778,000 to $4,918,000. *Id.* at p. 3028. After the parties' stipulation, he explained, Ganz's revised cost of service became $58,321,000, and Ganz's rate became 85.05 cents. *Id.* at p. 3030.

1231. Under cross-examination, when asked whether Seminole was an intrastate pipeline, Olson reiterated his previous testimony by answering in the affirmative. *Id.* at p. 3032. Olson noted, again, that Seminole pays taxes only in Texas, with one exception, and that all of the barrels shipped originated in Texas. *Id.* at p. 3033-36.[602] The vast majority of the barrels Seminole received, agreed Olson, were from connecting carriers regulated by the Commission and, despite his previous claim that all of the barrels shipped on Seminole were of a Texas origin, he admitted that, approximately, two-thirds of the barrels are shipped interstate. *Id.* at pp. 3036-37.

1232. Under further cross-examination, when asked to describe a "fair value state," Olson explained that it was a state in which the rate base is determined using what is known as a fair value rather than original cost. *Id.* at p. 3038. Fair value, explained Olson, is a judgmental blending of original cost and reproduction cost. *Id.* at p. 3038. Being further questioned, Olson stated that Texas is not a fair value state at present; it uses original cost. *Id.* at p. 3038. Because Texas currently uses the original cost method, Olson recommended its use. *Id.* at p. 3039.

1233. Olson agreed, when asked during additional cross-examination, that he used an interstate barrel average of the three-year period 2004-06 in computing Seminole's rates without providing any reason for doing so, which resulted in a 68.6 million average. *Id.* at p. 3052. He also agreed that, had he used a four-year average, adding in the quantum of 2003 interstate barrels (63.8 million), his average would have been reduced. *Id.* at p. 3053. Olson admitted that, while he used a volume figure of 68.6 million barrels, the actual volume number during the base period was 65.9 million barrels. *Id.* at p. 3054. The fuel and power expense, he went on to say, is the largest component of Seminole's total expense. *Id.* at p. 3057.

1234. On re-direct examination, Olson stated that, during the period 2003 to 2006, the Rocky Mountain volumes increased. *Id.* at p. 3066. The base period volumes, which

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[601] *See* Exhibit No. WIL-3.

[602] S*ee also* Exhibit No. S-77.

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Ganz used, in Olsen's view, did not reflect the increasing volumes that occurred during the test period beyond the base period. *Id.* at pp. 3066-67. According to Olson, intrastate revenues increased for Seminole beginning in 1993. *Id.* at p. 3068.

B. KATHLEEN L. SHERMAN

1235. In response to Williams witness Olson, Sherman addressed the contention that Seminole may not seek rate treatment according to the Commission's trended original costs methodology. Exhibit No. S-52 at pp. 2-3. She stated that, under the trended original cost methodology, a nominal rate of return on equity including inflation is calculated. *Id*. at pp. 3-4. Then the inflation portion of the rate is deducted, she said, resulting in a real rate of return. *Id*. Further, Sherman stated, the real rate of return multiplied by the equity share of the rate base is the annually permitted equity return. *Id*. at p. 4. She added that the inflation factor multiplied by the equity rate base is the equity rate base deferred return that is amortized over the life of the property. *Id*. Sherman testified that the deferred return is equivalent to deferred equity return that is not recovered until it is amortized and included in future periods in the cost of service. *Id.*

1236. Sherman stated that a net deferred return of $34,298,000 was included in Seminole's trended original cost rate base, resulting in a total end-of-Test Period net trended original cost rate base of $184,662,000. *Id*. She claimed that to conduct a cost-of-service study, Seminole used an average net trended original cost rate base of $187,963,000, and Olson used Seminole's original cost rate base of $150,364,000.[603] *Id*.

1237. All new pipeline assets, Sherman said, are added to the rate base at original cost and their equity portions are trended. *Id.* at p. 5. Further, she contended that, but for existing assets previously valued under another method, the Commission only permits a one-time adjustment to determine the rate base to be trended in the future. *Id*.

1238. Sherman testified that, to calculate its cost of service, Seminole used the trended original cost methodology, while Olson used an original cost methodology because he contended that Seminole was not an interstate pipeline and failed to produce a valuation rate base from the Commission's Oil Pipeline Board.[604] *Id*. at pp. 5-6. She claimed that Seminole admitted it was not issued a FERC Oil Pipeline Board valuation report.[605] *Id.* at p. 6. However, Sherman stated that, since Seminole is not claiming a starting rate base

[603] *See also* Exhibit No. WIL-4 at p. 4.

[604] *See also* Exhibit No. WIL-2.

[605] *See* Exhibit No. S-54.

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write-up,[606] it does not need a valuation report in order to calculate its rate base using a trended original cost model. *Id*. at pp. 6-7.

1239. To develop her cost-of-service analysis, Sherman relied on a cost-of-service for the Base Period performed by Seminole, as well as other information provided by Seminole through data requests. *Id*. at p. 8. She stated that it was not necessary to allocate common costs between Mid-America and Seminole because the latter is directly charged for common general and administrative expenses under a service agreement between the companies.[607] *Id*. Sherman testified that she used the common equity ratios for 1985 through 2005, as calculated by Staff witness Green. *Id.* at p. 9. According to Sherman, Staff determined an original cost rate base of $149,813,000 and used the end-of-test-period net trended original cost rate base of $183,610,000. *Id*. She declared that she made no adjustments to Seminole's proposed operating expenses. *Id*. According to her, this resulted in a net deferred return of $32,204,000 and a cost-of-service for the Test Period, ending October 31, 2006, of $57,656,000.[608] *Id*. at pp. 9-10.

1240. On cross examination, Sherman testified that, despite the parties stipulation as to cost of service, hers did not agree with Ganz' because he "made another adjustment . . . that included an adjustment to general and administrative expenses, and he also added some additional numbers for a test period, which included some additional depreciation." Transcript at p. 3090. She added that she thought that Staff and Ganz also disagreed on the capital structure. *Id.* However, she agreed that the difference was less than "a million dollars." *Id.* at p. 3091.

C. DOUGLAS M. GREEN

1241. Green testified that his proposed return on capital for the Test Period ended October 31, 2006, for Mid-America is applicable to Seminole. Exhibit No. S-50 at p. 1-2. Additionally, Green believed that the capital structures he derived for Mid-America are also applicable to Seminole for the purposes of determining the deferred equity component.[609] *Id*. at p. 2. He also stated that "Seminole's ownership history dating back to 1985 mirrors that of Mid-America," and opined that, because of this, using the most recent capital structure of Enterprise Products Partners, L.P., is most appropriate.[610] *Id.*

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[606] *See* Exhibit No. S-55.

[607] *See also* Exhibit No. S-56.

[608] *See also* Exhibit No. S-53.

[609] *See also* Exhibit No. S-2, Schedule No. 3.

[610] *See also* Exhibit No. S-51.

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Green summarized his proposed cost of capital as follows:

		Test Period ended 10/31/2006	
Type of Capital	Ratio	Cost	Weighted Cost
Long Term Debt	44.97%	5.73%	2.58%
Common Equity	55.03%	8.02%	4.41%
Total	100.00%		6.99%

Exhibit S-50 at p. 2.

1242. Under cross-examination, at the hearing, Green stated that the ultimate owner of 10% of Seminole is a British chemical company called Ineos USA, LLC.[611] Transcript at p. 3083. On re-direct examination, he claimed that incorporating the capital structure of Ineos in his analysis would not have had a significant effect on his determination of the capital structure for Seminole. *Id.* at p. 3084.

D. BONNIE J. PRIDE

1243. Pride described Seminole as a 1,281-mile pipeline that moves natural gas liquids from the Hobbs interconnection with Mid-America to a loop including Clemens, Stratton Ridge, and Mont Belvieu, Texas (the Group 950 destinations). Exhibit No. S-57 at p. 3. She added that Seminole and Mid-America participate in joint rates from origin points on the Rocky Mountain System to the Group 950 destination points under a joint tariff filed by Mid-America. *Id.*

1244. Pride disagreed with Williams witness Olson's contention that Seminole is an intrastate pipeline that provides only limited interstate through service with its affiliate, instead asserting that Seminole is an interstate common carrier that provides jurisdictional interstate transportation service. *Id.* at pp. 2-3. As such, she suggested, Seminole is subject to Commission regulation. *Id.* Pride testified that, since Seminole filed annual reports describing interstate operations with the Commission since 1982, and concurrently, has been involved in joint rate movements with Mid-America, it has been an interstate common carrier since 1982. *Id.* Pride enumerated six points she believes prove Seminole is an interstate common carrier: (1) transportation along Seminole falls under the definition of interstate commerce as defined by the Commission; (2) when shipping volumes under the joint rates, shippers intend to transport the volumes in interstate commerce; (3) in its complaint, Williams stated that it ships interstate volumes under the joint rates; (4) Seminole has participated with Mid-America in this joint rate tariff for approximately twenty-five years; (5) Seminole has filed Form 6 annual reports with FERC that report interstate operations for the last twenty-five years; and

[611] *See also* Exhibit Nos. S-51 at p. 3; SPL-1 at p. 3.

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(6) information provided by Seminole shows that volumes for which rates are being set in this proceeding move non-stop in interstate commerce. *Id*. at p. 4.

1245. Also according to Pride, by participating in a joint rate, Mid-America and Seminole recognize that they are providing interstate transportation. *Id*. at pp. 4-5. She stated that, despite Seminole being located entirely within the State of Texas, it is not an intrastate pipeline because a pipeline is an interstate common carrier when it transports a product which moves in interstate commerce, and, in Seminole's case, Pride stated, shipments originate in the Rocky Mountain region and are transferred to Seminole at Hobbs for further interstate transport.[612] *Id.* at pp. 5-6. Therefore, she asserted, Seminole is an interstate common carrier subject to Commission jurisdiction.[613] *Id*. at p. 6.

1246. Seminole filed its first local interstate tariff, FERC Tariff No. 3, with the Commission on December 17, 2004, which created an initial local interstate rate of 98.85 cents per barrel, Pride said.[614] *Id*. at p. 9. She added that, even though Seminole took 23 years to file an interstate rate in its own name, it was still an interstate common carrier because it participated in Mid-America's tariff, and is therefore entitled to the use of a trended original cost methodology as suggested by Staff witness Sherman. *Id*.

1247. With regard to her calculation of rates using test year data, Pride stated:

> Exhibit No. S-61 reflects the Seminole rate I calculated using Staff Witness Sherman's cost of service and Williams Witness Olson's recommended throughput volumes. Since there is only one local rate on file, it is not necessary to separate the costs into distance and non-distance related costs. Accordingly, the volumes are simply divided by the cost of service to arrive at a cost justified rate of 84.08 cents per barrel. Staff's proposed rate is

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[612] Pride conceded that many pipelines regulated by the Commission also have intrastate shipments. Exhibit No. S-57 at p. 7. She asserted, however, "that does not negate the fact that the pipelines are jurisdictional common carriers with respect to their interstate volumes." *Id.*

[613] Pride also noted that "Seminole has a concurrence filed with the Office of the Secretary of this Commission[,] dated August 20, 1982, which states that it will participate in joint tariffs with Mid-America that apply" to products shipped in interstate commerce. Exhibit No. S-57 at p. 7. *See also* Exhibit Nos. S-58, S-60.

[614] Moreover, according to Pride, Seminole has been filing a Form 6 with the Commission since 1982. Exhibit No. S-57 at p. 8; s*ee also* Exhibit No. S-59. She suggested that this indicates that "for the past 25 years Seminole has recognized that it is an interstate common carrier subject to the [Interstate Commerce Act] and this Commission's jurisdiction." *Id.*

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> considerably lower than Seminole's existing rate of 98.85 cents per barrel. It is my recommendation that Staff's proposed rate of 84.08 cents per barrel be adopted as the just and reasonable rate in this proceeding.

Id. at p. 10; *see also* Transcript at pp. 3106-07.

1248. During cross examination, Pride stated that there could not be any shipments pursuant to FERC Tariff No. 3 except under the Mid-America and Seminole local rates. Transcript at p. 3095. She added that, absent a connecting carrier, a shipper could not make interstate movement on Seminole under FERC Tariff No. 3. *Id.* at p. 3096.

E. JAMES M. COLLINGSWORTH

1249. To start with, Collingsworth explained that Seminole began operating in 1981 as a 634-mile pipeline (also known as the Seminole Blue Line), extending from Hobbs-Gaines, Texas, and the Permian Basin to the Texas Gulf Coast at Mont Belvieu, Texas. Exhibit No. SPL-1 at p. 2. Furthermore, according to him, Seminole primarily transports demethanized mix and ethane/propane mix to Mont Belvieu for use in fractionators and chemical processing facilities on the Gulf Coast. *Id.*

1250. Originally, continued Collingsworth, Seminole was incorporated under the name MAPCO Texas Pipeline Company and had its name changed to Seminole Pipeline Company on November 18, 1980, with MAPCO, Inc., its parent, remaining the majority owner of the pipeline. *Id.* Subsequently, in 1998, the Williams Companies bought MAPCO, Inc., including its interest in Seminole Pipeline Company, Collingsworth noted, and on July 31, 2002, Enterprise Products Partners, L.P. purchased Williams' interest in Seminole. *Id.* Enterprise Products Partners, L.P. began operating Seminole in February 2003, Collingsworth said. *Id.*

1251. Collingsworth testified that Williams challenged the rate contained in Seminole's FERC Tariff No. 3, which contains a local interstate rate of 98.85 cents per barrel for product received by Seminole at its origin at Hobbs-Gaines, Texas, for delivery to the Group 950 destinations in the Mont Belvieu area. *Id.* at p. 3. FERC Tariff No. 3, he contended, has remained in effect unchanged since it was filed on December 17, 2004.[615] *Id.*

1252. In addressing the interstate versus intrastate nature of Seminole, Collingsworth asserted that most of the barrels that move on Seminole originate outside the state of Texas. *Id.* at p. 4. Moreover, most of the barrels nominated from a Mid-America origin to a Seminole destination at Mont Belvieu, stated Collingsworth, flow continuously

[615] Collingsworth claimed no interstate barrels have been shipped pursuant to FERC Tariff No. 3. Transcript at p. 3134.

without interruption or processing at Hobbs-Gaines or any other intermediate point. *Id.* Seminole, in his opinion, was not acting opportunistically (as Olson claimed) by filing FERC Tariff No. 3, and Seminole did not previously fail to make its jurisdictional status clear. *Id.* at p. 5. With respect to FERC Tariff No. 3, Seminole filed it, according to Collingsworth, not to clarify its jurisdictional status, but to ensure that there was an appropriate benchmark in place to measure the justness and reasonableness of the joint rates with Mid-America. *Id.*

1253. Regarding the actual base period volumes, Collingsworth argued that they are within the normal range of Seminole interstate volumes over the past years, and are likely to be representative of future volumes as well. *Id.* at p. 6. He claimed, therefore, that Olson's three-year average of the 2004, 2005, and 2006 interstate barrels was inappropriate. *Id.* at pp. 5-6.

1254. At Hobbs, explained Collingsworth, Mid-America connects to a pipeline owned by Seminole, where demethanized mix is then moved to Mont Belvieu. Exhibit No. M-42 at p. 2. In addition, he testified, Mid-America maintains a joint tariff with Seminole, so shippers only have to provide one nomination, pay one rate, and deal with one carrier. *Id.* FERC Tariff No. 45,[616] continued Collingsworth, increased the joint rate for movements from four Mid-America origination points, Groups 100, 101, 102, and 104, to the Mont Belvieu region, Group 950. *Id.* Originally, he pointed out, the joint rates were set out in FERC Tariff No. 42 and its Supplement No. 5.[617] *Id.* According to Collingsworth, FERC Tariff No. 45 eliminated the ethane component discount rate programs contained in FERC Tariff No. 42. *Id.* at p. 3. This cancellation was appropriate, he said, because a carrier is not obligated to offer a discounted rate. *Id.* at p. 6. Additionally, Collingsworth explained, the discounted rate is still offered to shippers that have entered into certain Dedication Agreements. *Id.* Because the company did not change its Rocky Mountain System local general commodity rate for demethanized mix movements or the Seminole local rate, he asserted, the ceiling for the joint rates did not change. *Id.*

1255. FERC Tariff No. 45, Collingsworth testified, also established the following joint rates for movement of all demethanized mix to Group 950 for all shippers without a long-term Dedication Agreement: Group 100: 435.39 cents per barrel, Group 101: 374.44 cents per barrel, Group 102: 353.07 cents per barrel, and Group 104: 300.47 cents per barrel. *Id.* at p. 3. Under FERC Tariff No. 45, claimed Collingsworth, each joint rate is now equal to the sum of the underlying local rates for the same total movement. *Id.* at pp. 3-4. Essentially, he argued, FERC Tariff No. 45 did not change any of the underlying local rates. *Id.* at p. 4.

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[616] *See* also Exhibit No. M-43.

[617] *See also* Exhibit No. M-44.

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1256. Under cross-examination, at the hearing, Collingsworth testified that Seminole Blue and Seminole South are the same line, and that Seminole Red and Seminole North are the same line. Transcript at p. 3127. He explained that the capacity per day on the Seminole Blue Line varies by product: approximately 110,000 barrels per day of natural gasoline, 120,000 barrels per day of normal butane, and 134,000 barrels per day of ethane/propane mix. *Id.* Furthermore, only demethanized mix, he claimed, is shipped on Seminole Red. *Id.* at p. 3128. The Seminole Blue Line, according to Collingsworth, has batching on it. *Id.*

1257. Under further cross-examination, Collingsworth stated that Seminole is adding a second pump station at the Patricia, Texas, site, which is the first pump station east of Gaines and will add approximately 4-6,000 barrels a day of capacity on the Seminole Red line. *Id.* at p. 3129. Collingsworth acknowledged that Seminole is incapable of transporting all of the barrels that shippers move on the Mid-America Pipeline and desire to transport down to Seminole. *Id.* at p. 3130. He also testified that the West Texas Pipeline, Chaparral Pipeline, and the Louis Dreyfus line are utilized to move volumes from Mid-America that come into Hobbs down to Mont Belvieu. *Id.* at p. 3131. The Chaparral Pipeline, explained Collingsworth, is owned by TEPPCO Partners, L.P. *Id*. Besides Mid-America, Collingsworth noted, Seminole, located in the State of Texas, can acquire barrels from the Chevron/West Texas Pipeline, which is located in the State of New Mexico. *Id.* at p. 3140.

1258. When asked what products Seminole receives from Mid-America originating within the State of Texas, Collingsworth answered that Seminole receives 12,000 barrels a day of Y-Grade (demethanized mix). *Id.* at p. 3132. Asked to elaborate on the oil tanks referred to on page 3 of Exhibit No. WIL-49, Collingsworth indicated that Seminole owns an ethane/propane mix cavern at Gaines, one demethanized mix cavern at Stratton Ridge, and an ethane/propane mix cavern at Stratton Ridge. Transcript at p. 3144. He added that the ethane/propane mix stored at Gaines is intended to move down Seminole to a final destination, and while it is in the storage cavern, it is under the custody of Seminole. *Id.* at p. 3145.

1259. Next, Collingsworth claimed that Chevron Phillips Petrochemical Company ships product, which originates and ends in the State of Texas, on Seminole. *Id.* at p. 3156. Furthermore, Chevron Phillips Petrochemical Company, testified Collingsworth, shipped on the joint tariff between Mid-America and Seminole prior to the filing of FERC Tariff No. 3. *Id.* at pp. 3157-58. Collingsworth also explained that the Ineos fractionator has been in operation for years at Hobbs, and barrels coming from the Rocky Mountain System get fractionated at it. *Id.* at p. 3162. Its capacity, according to him, ranges between 25,000 and 50,000 barrels per day. *Id.*.

1260. Being further questioned on volume increases, Collingsworth admitted volumes on

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Seminole are currently higher than they were in 2004. *Id.* at p. 3167. The position that Seminole has on the joint rate for the demethanized mix, he stated, is lower than some of the proposed rates that have been submitted by the experts for Seminole in this proceeding. *Id.* at p. 3177.

1261. Finally, on redirect examination, Collingsworth affirmed that there is a joint tariff between the West Texas LPG pipeline and Seminole on which shipments can move. *Id.* at pp. 3143, 3194.

F. MICHAEL J. KNESEK

1262. The following information, testified Knesek, was provided to the Regulatory Economics Group and Ganz: (1) current property and fixed asset subledgers; (2) property pages from Form 6 reports; (3) various detailed Seminole revenue information and pipeline mileage data; (4) basis for the allocation of overhead expenses to Seminole; and (5) account listing used to convert financial records to the FERC's Uniform System of Accounts for Form 6 reporting purposes. Exhibit No. SPL-3 at p. 2. Additionally, the above data, according to him, were extracted from Seminole's books and records, which were maintained in the ordinary course of business. *Id.* The data provided to the Regulatory Economics Group and Ganz, noted Knesek, was extracted from Seminole's books and records and was the same as that used in their preparation of the 2005 and 2006 Form 6. *Id.* at p. 3. Finally, he continued, Seminole is charged directly for General and Administrative overhead expenses pursuant to a service agreement with Mid-America, and the amount of overhead expense that would otherwise be allocated to Seminole from its parent companies absent the agreement is included in Mid-America's operating expenses. *Id.*

G. J. PETER WILLIAMSON

1263. Williamson stated that the cost of capital for Seminole is the same as that for Mid-America. Exhibit No. SPL-4 at p. 2. Because Seminole is almost entirely owned by the same parent as Mid-America, and Seminole's interstate throughput all originates on Mid-America's Rocky Mountain System, Williamson reasoned, the same cost of equity calculation that he performed for Mid-America would apply equally to Seminole, for the same periods. *Id.* Similarly, as with Mid-America, Williamson claimed that Enterprise Products Partners has been responsible for Seminole's debt since Enterprise acquired the lines in 2002. *Id.* Thus, he claimed that for the same reasons that he recommended using the parent capital structure for Mid-America starting with its acquisition by Enterprise, he believed the same would be true for Seminole. *Id.* at pp. 2-3.

H. GEORGE R. GANZ

1264. Initially, Ganz stated that he applied the same methodology in his Seminole Direct

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Testimony as in his Mid-America Direct Testimony. Exhibit No. SPL-5 at p. 2.[618] However, because Seminole is a Subchapter C Corporation, he asserted, the tax allowance issues associated with the fact that Mid-America is a limited liability company owned by a master limited partnership do not apply to Seminole. *Id.* at p. 2. Moreover, Ganz explained, both Williams and Staff accepted the underlying Seminole operating expense and property numbers as well as the accumulated deferred income tax and income tax allowance numbers contained in Exhibit No. SPL-6. Exhibit No. SPL-5 at p. 3. Conversely, because Williams and Staff used different volume numbers, Ganz testified, their interstate percentages were different from each other and from his percentages. *Id.* Significantly, he disagreed with the positions of Williams and Staff in failing to make adjustments for known and measurable changes in cost in the test period. *Id.* at p. 3. Importantly, after determining that test period additions to carrier property were unnecessary, and that the actual expenses in 2006 did not meet the Commission's known and measurable standard for test period adjustments contained in 18 CFR § 346.2(a)(ii), he argued that the actual costs for the Base Year of February 2005 through January 2006 were representative of the costs for the Test Period. Exhibit No. SPL-5 at p. 4.

1265. According to Ganz, Olson eliminated deferred earnings based on the belief that Seminole is or was engaged solely in intrastate service. *Id.* Nevertheless, in his view, based upon the information contained in Collingsworth's testimony, Seminole is and always has been engaged in interstate service. *Id.* Additionally, because Seminole's FERC Tariff No. 3 was the first local tariff Seminole filed with the Commission, he claimed, calculating deferred earnings at this point is inappropriate. *Id.* Interestingly, Ganz continued, a shipper could have filed a complaint against Seminole's rate at any time from the start of operations in 1983 to the current period; if such a complaint had been filed, Seminole's rates would have been analyzed under the trended original cost methodology. *Id.* at p. 5. Similarly, Ganz explained, Seminole's rates should be analyzed under that methodology. *Id.* Olson's elimination of deferred earnings, he opined, is contrary to the proper application of the trended original cost methodology. *Id.*

1266. Next, with respect to return on equity and historical capital structure, Ganz testified that he used the figures recommended by fellow Seminole witness Williamson and used by Williams witness Olson. *Id.* On the other hand, he stated, Staff witness Sherman used numbers recommended by Green. *Id.* In addition, he claimed, there is a further difference between his cost-of-service calculations and the costs of service proposed by Olson and Sherman. *Id.* Although his use of an average rate base founded on the average of Base and Test periods achieved a similar result to the one achieved by Sherman's use of the end-of-Base Period numbers, in Ganz's opinion, his approach employed a Test Period, which was consistent with the calculations that all parties, including Staff, employed in Mid-America. *Id.* at p. 6. The Test Period cost of service

[618] *See also* Exhibit No. M-24 at pp. 5-9.

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for Seminole, continued Ganz, equaled approximately $59 million.[619] *Id*.

1267. Seminole only has one origin and one destination for interstate movements, asserted Ganz, and consequently, developing an interstate rate is simply a matter of dividing the cost-of-service by the interstate volumes. *Id.* at p. 8. However, Ganz disagreed with Williams' and Staff's use of a three-year average (being higher than the actual volumes) to develop their volume numbers, reasoning that: (1) some costs, such as power, vary with volumes; (2) Williams and Staff used the actual operating costs Seminole incurred during the Base Period but did not adjust the costs to reflect the higher volumes derived by the three-year average; and (3) hypothetical volumes were inappropriate. *Id.* at pp. 8-9. The use of hypothetical volumes, opined Ganz, is inappropriate, because unless good cause can be shown, the Commission's regulations require a cost-of-service to be calculated based on 12 months of actual experience. *Id.* at p. 9. In conclusion, the appropriate volume to use for all purposes in this proceeding, in Ganz's opinion, is the actual volume moved during the base period — 65,892,000 barrels. *Id.* Dividing the interstate cost-of-service by the interstate volume, explained Ganz, generates a rate of 89 cents, which is below the rate of 98 cents filed in Seminole's FERC Tariff No. 3. *Id.* at p. 10.[620]

1268. At the hearing, Ganz argued that, had Olson accepted his cost of service, the only difference between his calculated rate and Olson's rate would be based on which volumes were used. Transcript at p. 3208. The costs of the Gaines and Stratton Ridge storage facilities, continued Ganz, were included in the rate base for Seminole. *Id.* at p. 3213. Specifically, the storage costs were included on an original cost basis and not a market based equivalent, according to him, because Seminole owned those assets. *Id.*

1269. Ganz testified that the operating revenues represent the revenues that Seminole received for movements of interstate barrels during the base period and without any test period adjustments. *Id.* at p. 3225. He added that the Test Period number would be the same. *Id.*

1270. The Base Year for the Seminole analysis, he noted, was the February 2005 to January 2006 period, and the Test Period, could have reflected known and measurable changes that became effective within nine months of the end of the Base Period, October 2006. *Id.* at p. 3240. Additionally, the actual calendar year 2006 expenses were higher than the Base Period expenses, asserted Ganz. *Id.* at pp. 3239-40.

SUMMARIES OF THE PARTIES' ARGUMENTS AND RULINGS

[619] Ganz stated that his calculations are contained in Exhibit No. SPL-6. Exhibit No. SPL-5 at p. 6.

[620] *See also* Exhibit No. SPL-6, Statement A.

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ISSUE NO. 10: IS SEMINOLE A FERC JURISDICTIONAL PIPELINE?

A. WILLIAMS

1271. In its Initial Brief, with respect to whether the Commission has jurisdiction over Seminole, Williams suggested that "all interstate movements are jurisdictional unless the facts show a sufficient break in the continuity of transportation so that shippers moving product . . . do not have a fixed intent to move product interstate." Williams Initial Brief at p. 63 (*quoting Texaco Refining and Marketing, Inc. v. SFPP, L.P.*, 80 FERC ¶ 61,200 at p. 61,805 (1997)). Ultimately, declared Williams, the jurisdictional status of the Seminole Pipeline System is a "question of law resolved by specific facts." *Id.*

1272. In supporting its assertion that the Commission does not have interstate jurisdiction over the movements of Seminole Pipeline, Williams enumerated the following, which it claimed to be, uncontested facts:

(a) The Seminole System is located entirely within the State of Texas;

(b) The Seminole System consists of two pipelines: a "Blue" or south line and a "Red" or north line;

(c) The Red Line transports only demethanized mix, while the Blue line transports multiple products which are batched;

(d) Most of the volumes that move on the Seminole System originate outside the State of Texas;

(e) No barrels have ever been shipped on the Seminole System under FERC Tariff No. 3;

(f) With respect to the non-affiliated shipper that signed the "affidavit" in support of Seminole FERC Tariff No. 3, any transportation of product for that shipper on the Seminole System would occur solely within the State of Texas;

(g) Seminole has intrastate transportation tariffs on file with the Texas Railroad Commission;

(h) There is no interstate transportation or movement on the Seminole Pipeline System absent a connecting carrier;

(i) Seminole owns several "caverns" for underground storage of

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ethane/propane mix and other products waiting to be batched on the Red Line;[621]

(j) At the Enterprise Hobbs and Ineos fractionators, demethanized mix is converted into different products; and

(k) Following fractionation,[622] the movements on the Seminole System are solely within the State of Texas.

Id. at pp. 64-65.[623]

1273. Next, Williams claimed that FERC Tariff No. 3 is invalid as no barrels have ever been shipped pursuant to it and because it was (and is) based on transportation for a Texas shipper who has yet to move a single barrel under that Tariff.[624] *Id.* at pp. 66-67. A shipper sponsoring an initial rate by affidavit, argued Williams, must be able to transport product in interstate commerce. *Id.* at p. 67. In other words, it stated, a shipper must "intend" to use the service, and any other understanding would nullify the "intent" provision of Section 342.2(b).[625] *Id.*

1274. Because the origin and destination points of the Seminole Red and Blue Lines lie wholly within the State of Texas, Williams asserted, for a movement on Seminole to be jurisdictional, it must originate outside the State of Texas and be transferred to Seminole at Hobbs-Gaines, Texas. *Id.* at pp. 67-68 (*citing* Exhibit Nos. SPL-1 at p.4; WIL-2 at pp. 5, 9; WIL-9 at p. 5; Transcript at pp. 3125, 3127). Consequently, argued Williams, absent a connecting carrier, such as Mid-America, moving product to the Seminole System at Hobbs, transporting product in interstate commerce on the Seminole System is

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[621] Seminole noted that "batching" only occurs on the Blue Line. Seminole Reply Brief at p. 156 (*citing* Transcript at p. 3128).

[622] "[F]ractionation allows the natural gas liquids to be separated into their constituent components, such as propane, butane, ethane and natural gasoline, and transported in isolated batches in that form. These separated components are commonly referred to as 'purity products'." Exhibit No. M-1 at p. 4.

[623] In support, Williams cited Exhibit Nos. SPL-4 at p. 4; WIL-2 at pp. 4-5, 7, 9-10; WIL-9 at p. 5; WIL-11; WIL-57; and Transcript at pp. 3095-96, 3125, 3127-28, 3133-34, 3144-45, 3156-57, 3162, 3165, 3184.

[624] The shipper, according to Williams, failed to ship any interstate barrels on Seminole Pipeline even before FERC Tariff No. 3 was filed with the Commission. Williams Initial Brief at p. 66 (*citing* Transcript at pp. 3157-58).

[625] 18 C.F.R. § 342.2(b).

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physically impossible, and thus, Seminole cannot be a jurisdictional pipeline. *Id.* at p. 68 (*citing* Transcript at pp. 3096-97).

1275. Also, Williams argued that, even had the Commission jurisdiction over a shipment moving in interstate commerce, that jurisdiction ends if there is a break in continuity of the transportation, *i.e.*, interstate barrels of products are limited to those which continue without interruption, and in their same form as originally tendered to the interstate pipeline carrier connecting to Seminole at Hobbs-Gaines, Texas, such as the demethanized mix product barrels which are "tight-lined"[626] at the Hobbs station right from Mid-America Pipeline to the Seminole System Red Line. *Id.* at pp. 68-69 (*citing* Transcript at p. 3128). According to Williams, the Commission has long held that a break in the continuity of transportation negates Commission jurisdiction over an otherwise jurisdictional pipeline. *Id.* at p. 71. For example, Williams noted, in *Ultramar, Inc. v. Gaviota Terminal Co.,* 80 FERC ¶ 61,201 at p. 61,810 (1997), the Commission denied jurisdiction, reasoning:

> At Ultramar's refinery the crude oil is transferred into different products which are then marketed, at least to some extent, in other states. The refining of the oil, however, causes a break in transportation that result in any subsequent transportation of refined product being a separate movement. Even if that subsequent movement from the refinery is interstate, it has no bearing on the nature of the first movement from offshore. Thus, the shipment of the crude oil and the refined products are distinct movements, not a continuous movement across state lines that would establish jurisdiction.

William's Initial Brief at pp. 71-72. Analogously, suggested Williams, like the Ultramar refinery, the fractionation of natural gas liquids at the Hobbs and Ineos facilities transforms the liquids into different products.[627] *Id.* at p. 72. Therefore, insisted Williams, the fractionation causes a break in transportation, resulting in the subsequent transportation being a separate movement. *Id.* Consequently, it added, the Commission is divested of jurisdiction over those barrels. *Id.*

1276. In its Reply Brief, Williams attacked Seminole's and Staff's positions, claiming they missed the single most compelling fact abrogating Commission jurisdiction: transporting natural gas liquids in interstate commerce on Seminole under FERC Tariff No. 3 is physically impossible. Williams Reply Brief at p. 66. Williams emphasized that

[626] According to Mid-America, "tight-line" implies direct movement without interruption. Mid-America Initial Brief at p. 185 (*citing* Transcript at p. 3128).

[627] And, claimed Williams, as admitted by Seminole witness Collingsworth. Williams Initial Brief at p. 72 (*citing* Transcript at pp. 3162-63).

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Seminole witness Collingsworth testified that no barrels have ever been shipped under FERC Tariff No. 3 and that any movement for the shipper that signed the "affidavit" in support of the Tariff would occur entirely within the State of Texas. *Id.* (*citing* Transcript at p. 3165). Thus, Williams argued that FERC Tariff No. 3 permits an interstate service that is physically impossible to provide and consequently submitted that FERC Tariff No. 3 did not and cannot ever provide Commission jurisdiction. *Id.* at pp. 66-67.

1277. Williams also disagreed with Seminole's assertion that the Commission has already rejected its position that conducting interstate commerce under FERC Tariff No. 3 is physically impossible. *Id.* at p. 67. It contended that, while the Commission rejected the claim that Seminole did not properly determine its initial rate in FERC Tariff No. 3, the Commission did not consider the claim that transporting natural gas liquids under the tariff was physically impossible rendering it invalid. *Id.* at p. 67. Rather, Williams added, the Commission simply found that "Seminole properly filed its FERC Tariff No. 3 consistent with the requirements of section 342.2(b)." *Id.* (*quoting Williams Energy Services, LLC and Williams Power Co., Inc. v. Mid-America Pipeline Co., LLC and Seminole Pipeline Co.*, 116 FERC ¶ 61,175 at P 38).

1278. Finally, Williams maintained that all parties agreed that fractionation of natural gas liquids at the Hobbs and Ineos facilities interrupts the continuity of transportation, and that the only jurisdictional interstate barrels on Seminole are those that originate on Mid-America or another interstate pipeline outside the State of Texas and move to Seminole at Hobbs without a break in the continuity of transportation or alteration of the product initially tendered to Mid-America or another pipeline. *Id.* at pp. 69-70 (*citing* Seminole Initial Brief at pp. 184, 186; Staff Initial Brief at pp. 129-30).

B. COMMISSION TRIAL STAFF

1279. Staff, in its Initial Brief, insisted that the Seminole System is subject to the Commission's jurisdiction under the Interstate Commerce Act. Staff Initial Brief at pp. 126-27 (*citing* 49 U.S.C. § 1 *et seq.* (1988)). Determining whether an oil pipeline shipment is interstate or intrastate, explained Staff, "depends on the essential character" of the shipment. *Id.* at p. 128. Specifically, Staff asserted: "[S]o long as the shipper intends to ship to a specific, known destination in another state at the time of shipment, any intrastate sections of pipeline between the point of origination of the shipment and the final intended destination are considered interstate, and are subject to Commission jurisdiction." *Id.* (*citing Baltimore & Ohio Southwestern Railroad Co. v. Settle*, 260 U.S. at p. 173-74). According to Staff, courts have found the following factors indicative of an interstate shipment: (1) through billing across different pipeline sections to the final destination; (2) uninterrupted movement of the shipment through terminals connecting different pipelines; (3) continuous possession by the carrier; and (4) unbroken bulk of the shipment. *Id.* at p. 129 (*citing Baltimore & Ohio Southwestern Railroad Co. v. Settle*, 260 U.S at p. 171).

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1280. Staff claimed that many facts support Williams' intention to ship to another state at the time of shipment: First, Williams' product when tendered in Wyoming (Group 100), like most others shipped on Mid-America's Rocky Mountain System, is nominated to move on Seminole for delivery to Mont Belvieu; Second, most, if not all, of Williams' shipments flow continuously onto Seminole's system through Hobbs without interruption for either refining or storage;[628] third, Williams pays only once for shipments nominated for Mont Belvieu from Group 100, instead of making two separate payments for shipment from Group 100 to Hobbs and then from Hobbs to Mont Belvieu; and fourth, Williams' product remains in the custody of the pipeline companies at all times between Group 100 and Mont Belvieu.[629] *Id.* at pp. 130-34 (*citing* Exhibit Nos. SPL-1 at p. 4; S-57 at p. 5; M-37 at p. 39; WIL-54 at p. 2; Transcript at p. 3128).

1281. Conversely, emphasized Staff, the Commission has found a break in continuity at a terminal between two pipelines where:

> (1) at the time of shipment, there is no specific order being filled for a specific quantity of a given product to be moved through to a specific destination beyond the terminal storage;
>
> (2) the terminal storage is a distribution point or local marketing facility from which specific amounts of the product are sold or allocated; and
>
> (3) transportation in the furtherance of this distribution within the single state is specifically arranged only after sale or allocation from terminal storage.

Id. at p. 129 (*citing Hydrocarbon Trading and Transport Co. v. Texas Eastern Transmission Corp.*, 26 FERC at p. 61,471). None of these factors, claimed Staff, are found in Williams' shipments. *Id.* at p. 135. Additionally, it asserted, there is no evidence that indicates that any Williams product is ever sold or allocated to any other destination once it reaches Hobbs. *Id.* at p. 136. Finally, Staff pointed out, prior to

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[628] Staff admitted that any of Williams' shipments from Group 100 which are fractionated at Hobbs (those not tight-lined) and then transported to Mont Belvieu on Seminole's pipeline may be considered intrastate shipments. Staff Initial Brief at p. 133.

[629] Staff claimed that witness testimony revealed that Williams' demethanized mix, once placed on Mid-America at Group 100, is moved directly through the Hobbs terminal to Seminole without delay, put in temporary operational storage which is under the control of Mid-America, or temporarily held in the Hobbs fractionator (without being fractionated) before moving onto Seminole. Staff Initial Brief at pp. 134-35 (*citing* Transcript at pp. 1346, 3099, 3102, 3162-63).

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shipment, Williams knows specifically how much quantity is being shipped and that it is bound for particular destinations on the Mont Belvieu loop. *Id.* (*citing* Transcript at pp. 3193-94).

1282. In reply, Staff insisted that the Seminole pipeline system is within the Commission's jurisdiction and insisted that no statute, regulation, or precedent support Williams' claim that Seminole FERC Tariff No. 3 is invalid. Staff Reply Brief at p. 102. Indeed, Staff asserted that it could not find, and Williams did not provide, any statute, regulation, appellate court decision, or prior Commission decision requiring a consenting shipper to move product under the consented-to tariff, or even to be capable of shipping product under such tariff. *Id.* at p. 103. In contrast, Staff declared that Commission precedent strongly supports the validity of FERC Tariff No. 3, as its prior decisions have clearly indicated that in a Section 342.2(b) filing, a carrier establishes a tariff as valid if the carrier supplies the required affidavit and no entity challenges the filing during the appropriate time frame. *Id.*[630] Staff contended that this is the case here, that Commission decisions in this docket[631] have held that, because Seminole filed its FERC Tariff No. 3 pursuant to the requirements of Section 342.2(b), and because Williams knew of that filing and failed to protest, Seminole validly established FERC Tariff No. 3. *Id.* at pp. 103-04.

1283. Further, while Staff agreed with Williams that the Commission's jurisdiction over Mid-America's shipments on Seminole is limited to shipments made under the Mid-America/Seminole joint rate, it did not agree that this jurisdiction is further limited to those shipments which are tight-lined from the Mid-America system through the Hobbs terminal onto Seminole.[632] *Id.* at p. 105. Instead, Staff submitted that Commission jurisdiction includes every Williams joint rate shipment which is not fractionated at either of the Hobbs fractionators and those joint rate shipments to Mont Belvieu which are stored at Hobbs during transition from Mid-America to Seminole. *Id.* According to Staff, Commission precedent holds that, so long as storage of a shipment at a terminal facility occurs during the course of an otherwise interstate movement, the

[630] In support Staff cited *Rio Grande Pipeline Co.,* 78 FERC ¶ 61,020 at p. 61,082 (1997), *reh'g denied,* 82 FERC ¶ 61,147 (1998), *rev'd on other grounds sub nom.*, *Rio Grande Pipeline Co. v. FERC,* 178 F.3d 533 (D.C. Cir. 1999); *Dome Pipeline Corp.,* 117 FERC at p. 62,815; *Sinclair Oil Corp. v. BP Pipelines*, 106 FERC ¶ 63,025 (2004).

[631] In Support, Staff cited *Williams Energy Servs., LLC v. Mid-America Pipeline Co., LLC,* 116 FERC at pp. 61,749-50; *Mid-America Pipeline Co., LLC,* 116 FERC ¶ 1,040 at p. 61,158 (2006).

[632] Staff did agree with Williams that volumes of demethanized mix which are tight-lined from the Mid-America system through the Hobbs terminal onto Seminole are jurisdictional. Staff Reply Brief at p. 106 (*citing* Williams Initial Brief at p. 69).

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shipment remains interstate. *Id.* at p. 107 (*citing Southern Pacific Terminal Co. v. ICC,* 219 U.S. 498, 526-27 (1911)). It further declared that, as Williams' shipments of product originating at Group 100 are specifically intended to be delivered to Mont Belvieu, any part of those shipments that are stored at Hobbs during the transportation to Mont Belvieu remain interstate in nature. *Id.*

1284. Next, Staff distinguished this case from the two cases — *Interstate Energy Co.*[633] and *Northville Dock Pipe Line Corp.*,[634] cited by Williams in support of its position on storage. *Id.* at pp. 107-09. In those two cases, according to Staff, an intrastate shipment was found where a shipper moved a bulk quantity of product to a terminal for storage pending sale or transfer of a specific quantity of that shipment to a specifically known party within the same state as the terminal and where the quantity and/or the party were undetermined at the time of initial shipment. *Id.* at p. 108. Conversely, here, Staff asserted that, before tendering its product to Mid-America for shipment, Williams intended to ship a specific, known quantity of its product to Mont Belvieu. *Id.* Therefore, Staff argued that these movements are interstate. *Id.* at p. 109.

1285. Finally, Staff admitted that any portion of Williams' shipments that are fractionated at Hobbs become intrastate in character and should be shipped to Mont Belvieu under intrastate tariffs on file with the Texas Railroad Commission, with two caveats: (1) the record does not indicate that any Williams shipments were among those Rocky Mountain System shipments fractionated at Hobbs; and (2) any of Williams' shipments held in the Hobbs fractionators without being fractionated and then shipped on Seminole remain interstate in character. *Id.* at pp. 109-10.

C. SEMINOLE PIPELINE

1286. Agreeing with Staff, Seminole claimed that the Seminole System is an interstate common carrier pipeline within the Commission's jurisdiction. Seminole Initial Brief at p. 184. It insisted that the Commission already has rejected Williams' contention that Seminole's FERC Tariff No. 3 was for intrastate service and not properly filed with it. *Id*. (*citing Williams Energy Services v. Mid-America Pipeline Co., LLC*, 116 FERC ¶ 61,175 at P 35-38; *Mid-America Pipeline Co., LLC*, 116 FERC ¶ 61,040 at P 25). According to Seminole: "The 'essential character' of the commerce determines whether it is interstate or intrastate. . . . The most important factor in determining the 'essential character' of the movement is the 'fixed and persisting transportation intent of the shipper at the time of the shipment'." *Id.* (*citing Atlantic Coast Line Railroad Co. v. Standard Oil Co.*, 275 U.S. 257, 268 (1927); *Texaco Refining and Marketing, Inc. v. SFPP, L.P.*, 80 FERC at p. 61,805).

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[633] 32 FERC at p. 61,690.

[634] 14 FERC at p. 61,207.

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1287. Further, Seminole insisted that it is within the Commission's Interstate Commerce Act jurisdiction even though it is located entirely within the State of Texas because most of the product that moves on it does so under the joint interstate tariff with Mid-America and originates outside of Texas (Wyoming, Utah, Colorado, New Mexico, and Oklahoma) and terminates in the Belvieu, Texas, area. *Id.* at p. 185 (*citing* Exhibit Nos. S-57 at pp. 2-3, 6; SPL-17; S-58). Moreover, in support of its contention, Seminole emphasized that it moves substantial volumes in interstate commerce without interruption. *Id.* Specifically, it claimed, demethanized mix moves directly (*i.e.,* is tight-lined) from Mid-America to the Seminole Red Line without interruption. *Id.* (*citing* Transcript at p. 3128). In addition, Seminole asserted that the placement of volumes of demethanized mix in operational storage at Hobbs does not interrupt the continuous flow of transportation of product in interstate commerce because the demethanized mix that awaits batching is not processed in storage and the shipper intends continuous transportation of its product from the Mid-America origin to the Seminole destination. *Id. (citing Texaco Refining & Marketing, Inc. v. SFPP, L.P.,* 80 FERC at p. 61,806; *Northville Dock Pipe Line Corp. & Consol. Petroleum Terminal, Inc.,* 14 FERC at p. 61,207).

1288. Responding to Williams' witness Olson's testimony claiming that it should not be considered jurisdictional, Seminole offered the following "facts":

- Admitting that all of its origin points are in Texas, Seminole claimed, two-thirds of the barrels that move on it are interstate volumes. *Id.* at p. 187 (*citing* Transcript at p. 3037; Exhibit No. SPL-9). It also noted that Williams admitted that it ships products from Wyoming and New Mexico to the Mont Belvieu, Texas, area pursuant to the Mid-America/Seminole joint tariff. *Id.* (*citing* Exhibit No. S-57 at p.6).

- Admitting that some volumes shipped on it are intrastate, Seminole asserted that this does not cause the Commission to lose jurisdiction. *Id.* (*citing Amoco Pipeline Co.*, 62 FERC at p. 61,803). It also noted that Olson admitted that a state rate and a Commission-approved rate for shipments on the same pipeline may coexist. *Id.* at pp. 187-88 (*citing* Transcript p. 3072; *BP Pipelines (Alaska) Inc.*, 109 FERC ¶ 61,376 (2004).

- Seminole agreed that it pays most of its taxes to the State of Texas, but claimed that is irrelevant in determining whether a particular movement is within the Commission's jurisdiction. *Id.* at p. 188.[635]

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[635] Seminole noted that the Trans Alaska Pipeline also pays most of its taxes to one state, but remains jurisdictional. Seminole Initial Brief at p. 188 (*citing* Exhibit S-78 at p. 2; Transcript at p. 3025).

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· Continuing, Seminole rejected Olson's suggestion that Seminole's owners deliberately chose to incorporate it as a company separate from Mid-America to shield it from the Commission's jurisdiction. *Id.* Seminole suggested that it was incorporated separately from Mid-America for reasons other than jurisdictional status, and that whether the pipeline provides interstate transportation service as a common carrier is more important than its corporate identity. *Id.* at pp. 188-89.

· Finally, Seminole maintained that the Commission in this case has previously rejected the argument that FERC Tariff No. 3 is not jurisdictional because no barrels can actually be shipped on this tariff. *Id.* at p. 189 (*citing Williams Energy Servs., LLC v. Mid-America Pipeline Co., LLC,* 116 FERC ¶ 61,175 at P 35-38). Additionally, it noted that Staff witness Pride testified at the hearing that, if a shipper nominated movements on the combination of Seminole's FERC Tariff No. 3 and the local Commission-approved rate of another connecting carrier, interstate barrels could be shipped pursuant to FERC Tariff No. 3. *Id.* (*citing* Transcript at pp. 3095-96).

1289. In its Reply Brief, Seminole claimed that the Commission has previously found that Mid-America filed its FERC Tariff No. 3 consistent with the requirements of Section 342.2(b). Seminole Reply Brief at p. 154 (*citing Williams Energy Servs., LLC v. Mid-America Pipeline Co., LLC,* 116 FERC ¶ 61,175 at P 38). Although Williams suggested Mid-America's filing was a "chimera" because the nonaffiliated shipper that signed the affidavit under Section 342.2(b) could not have shipped, and did not ship, pursuant to FERC Tariff No. 3, Seminole asserted that, for the reasons previously explained, it is incorrect that the non-affiliated shipper could not ship volumes pursuant to FERC Tariff No. 3. *Id.*[636] Indeed, Seminole pointed out that Seminole witness Collingsworth testified that the nonaffiliated shipper can and did in fact move product under the Mid-America/Seminole joint tariff. *Id.* at pp. 154-55 (*citing* Transcript at p. 3158).

1290. Lastly, although Williams admitted that the barrels of demethanized mix that are tight-lined at the Hobbs Station directly from Mid-America to Seminole's Red Line are interstate in nature, Seminole submitted that, contrary to Williams' claim, the demethanized mix barrels that are placed in breakout storage while awaiting batching on the Blue Line remain in interstate commerce. *Id.* at pp. 155-56. In any event, Seminole claimed that Williams' arguments on this issue are irrelevant, as Williams admitted that the line has interstate movements and does not argue for any change in the proposed

[636] Seminole noted further that the record does not reflect why the shipper did not ship any product pursuant to FERC Tariff No. 3, nor did Williams present any evidence that it never intended to do so. Seminole Reply Brief at p. 155.

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volume figures it uses to set rates. *Id.* at p. 156.

DISCUSSION AND RULING

1291. While at first glance the jurisdictional question of a pipeline lying entirely within one state may seem easy to dispel, only a perfunctory examination of such pipeline would lead to the conclusion that movements occurring on such pipeline are merely intrastate in nature. Ultimately, the issue becomes whether movement of product on a pipeline located entirely within one state constitutes a link in an interstate chain of movements. *Hydrocarbon Trading & Transp*ort *Co., Inc., v. Texas Eastern Transmission Corp.*, 26 FERC at p. 61,470. To the extent that it does, the movement is subject to the Commission's jurisdiction. *Id.*

1292. Determining whether an oil pipeline movement is interstate or intrastate "depends on the essential character" of the movement and the fixed and persisting intent with which the shipment is made. *Baltimore & Ohio Southwestern Railroad Co. v. Settle,* 260 U.S. at p. 170. Reviewing courts have found the following factors indicative of an interstate shipment: (1) the presence of through billing across different pipeline sections to the final destination; (2) uninterrupted movement of product; (3)continuous possession of the shipment by the carrier; and (4) unbroken bulk of the shipment. *Id.* at p. 171.

1293. Conversely, while a movement beginning and ending in one state may constitute a link in a jurisdictional interstate chain of movements, a "sufficient break in the continuity of transportation" demonstrating the lack of intent by the shipper to move product interstate may remove federal jurisdiction. *See, e.g.*, *Texaco Refining & Marketing, Inc. v. SFPP, L.P.*, 80 FERC p. 61,805. Specifically, the following factors have been found to constitute a sufficient break in the continuity of transportation and the termination of an interstate journey: (1) at the time of shipment, no specific order of a specific quantity of a given product is being filled for a particular destination beyond the terminal storage; (2) the terminal storage is a distribution point or local marketing facility from which specific amounts of the product are sold or allocated; and (3) transportation in the furtherance of this distribution within the single state is specifically arranged only after sale or allocation from terminal storage. *Hydrocarbon Trading & Transp*ort *Co., Inc., v. Texas Eastern Transmission Corp.*, 26 FERC at p. 61,471.

1294. Essentially, Williams argued that, because the origin and destination points of the Seminole Red and Blue Lines lie entirely within the State of Texas, any interstate movement on the Seminole System must originate outside the State of Texas and subsequently be transferred to Seminole at Hobbs-Gaines, Texas. Williams Initial Brief at pp. 67-68. Consequently, Williams continued, absent a connecting carrier, such as Mid-America, transferring product to the Seminole System at Hobbs, interstate service on Seminole pursuant to FERC Tariff No. 3 is physically impossible. *Id.* at p. 68. Finally, Williams asserted that FERC Tariff No. 3 is invalid since no shipment has moved, or can

move, on the Seminole System under that Tariff. *Id.* (*citing* Transcript at pp. 3096-97).

1295. In response to Williams, Seminole and Staff submitted that FERC Tariff No. 3 is a valid tariff as the Commission previously decided that Seminole complied with the requirements of Section 342.2(b)[637] of the Commission's regulations by providing the required affidavit, which was not challenged by any party. Seminole Reply Brief at p. 154 (*citing Williams Energy Servs., LLC v. Mid-America Pipeline Co., LLC,* 116 FERC 61,175 at P 38); Staff Reply Brief at pp. 103-04 (*citing Williams Energy Services, LLC and Williams Power Co., Inc. v. Mid-America Pipeline Co., LLC,* 116 FERC ¶ 61,175 at P 38; *Mid-America Pipeline Co., LLC,* 116 FERC ¶ 61,040 at p. 61,158). Moreover, Staff claimed that it cannot find, and Williams did not cite, any statute, regulation, appellate court decision, or prior decision requiring a consenting shipper to move, or be capable of moving, product under the consented-to tariff. Staff Reply Brief at p. 103. Seminole added that Staff witness Pride testified at the hearing that product could move pursuant to FERC Tariff No. 3 under a combination of FERC Tariff No. 3 and the local Commission-approved rate of another carrier, such as Mid-America.[638] Seminole Initial Brief at p. 189. In any event, Seminole pointed out that Collingsworth testified that the nonaffiliated shipper can and did in fact move product under the Mid-America/Seminole joint tariff.[639] Seminole Reply Brief at pp. 154-55.

1296. Based on the instant record, it is clear that, before the tender of product at Mid-America's pipeline in Wyoming and the other origin points,[640] Williams' product is nominated to move on Seminole's pipeline for delivery to Mont Belvieu, Texas. Exhibit No. SPL-1 at p. 4. Also, most, if not all, of Williams' shipments flow continuously onto Seminole's system through Hobbs without interruption. Exhibit Nos. WIL-54 at p. 2; SPL-1 at p. 4; Transcript at p. 3128. In addition, Williams pays only once for shipments nominated for Mont Belvieu from Wyoming, instead of making two separate payments for shipment from Wyoming to Hobbs and then from Hobbs to Mont Belvieu. Exhibit Nos. SPL-1 at p. 4; M-37 at p. 39. Moreover, Williams' shipments remain, at all times, in the custody of the pipeline companies between Wyoming and Mont Belvieu. Exhibit No. WIL-54 at p. 2; Transcript at pp. 3099, 3102, 3162-63.

1297. Furthermore, it does not appear that Williams' shipments reflect a sufficient break

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[637] 18 C.F.R. § 342.2(b).

[638] Transcript at pp. 3095-96.

[639] Transcript at p. 3158.

[640] The majority of product that moves on Seminole originates outside of Texas at origins in Wyoming, Utah, Colorado, New Mexico, and Oklahoma. Exhibit Nos. SPL-17; S-58.

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in the continuity of transportation terminating Commission jurisdiction. While demethanized mix delivered from Mid-America to Seminole may be stored at Hobbs while batching, this is operational storage which does not serve to break the flowing of the product in interstate commerce. *Texas Refining and Marketing, Inc. v. SFPP, L.P.,* 80 FERC at p. 61,806; *Northville Dock Pipe Line Corp. and Consolidated Petroleum Terminal, Inc.*, 14 FERC at p. 61,207; *Hydrocarbon Trading & Transp*ort *Co., Inc., v. Texas Eastern Transmission Corp.,* 26 FERC at pp. 61,470-71.

1298. I agree with Staff and Mid-America that the Commission previously has determined that Mid-America filed its tariff consistent with the requirements of the Commission's Regulations. 18 C.F.R. §342.2(b); *Williams Energy Services, LLC and Williams Power Co., Inc. v. Mid-America Pipeline Co., LLC,* 116 FERC ¶ 61,175 at P 35-38. Specifically, the Commission's regulations require that a carrier justify an initial rate by "filing a sworn affidavit that the rate is agreed to by at least one non-affiliated person who intends to use the service in question, *provided* that if a protest to the initial rate is filed, the carrier must [file a cost-of-service justification for the rate]." 18 C.F.R. § 342.2(b). Indeed, the Commission held:

> Seminole filed a local interstate rate in FERC Tariff No. 3 on December 17, 2004, to be effective January 17, 2005, providing for the transportation of NGLs from the Hobbs-Gains origin to Group 950 (Mont Belvieu, Texas). Prior to that time, Seminole did not have a local rate on file with the Commission for this movement . . . .
>
> Although Seminole was at the time providing a joint interstate service with MAPL and continues to do so, the initial rate proposed by Seminole was for an entirely new local service to be provided solely by Seminole. . . . Further, Williams was shipping NGLs on the MAPL/Seminole systems under a joint rate and was aware that Seminole filed an initial local rate. Williams could have protested Seminole's filing, which then would have required Seminole to make a cost-of-service filing pursuant to section 342.2(a) of the Commission's regulations. However, Williams failed to protest the filing, and accordingly, the Commission will not nullify Seminole's FERC Tariff No. 3 on the basis of an allegation that the rate was not established properly.

Williams Energy Services, LLC and Williams Power Co., Inc. v. Mid-America Pipeline Co., LLC, 116 FERC ¶ 61,175 at P 35-38.

1299. Equally unavailing is Williams' argument that FERC Tariff No. 3 is invalid because no barrels of natural gas liquids have moved on the Seminole System under that Tariff. The fact that no product may have moved pursuant to FERC Tariff No. 3 is irrelevant to the question at issue as FERC Tariff No. 3 has been determined to be validly

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established, shippers have the opportunity to ship on the Seminole System pursuant to it, and Williams presented no evidence that the consenting shipper did not intend to make such shipments. Further, similar to Staff, I cannot find, nor has Williams cited, any statute, regulation, appellate court decision, or prior Commission decision requiring a consenting shipper to move product under the consented-to tariff. In any event, Seminole witness Collingsworth testified that the non-affiliated shipper can and did indeed move product under the Mid-America/Seminole joint tariff prior to the filing of FERC Tariff No. 3. Transcript at pp. 3157-58. Williams' contention that interstate service under FERC Tariff No. 3 is physically impossible misses the mark. While any movement for a shipper that signed the affidavit in support of FERC Tariff No. 3 would occur entirely within the State of Texas, a shipper may elect to ship on the combination of Seminole's FERC Tariff No. 3 and the local Commission-approved tariff of another connecting carrier. *See* Transcript at pp. 3095-96.

1300. After dismissing Williams' argument that FERC Tariff No. 3 is invalid since physical movement on Seminole is impossible, a conclusion that the Commission has jurisdiction over it follows quite easily. The evidence clearly establishes that, while Seminole lies entirely within the State of Texas, most of the volumes that move on the Seminole System originate outside the State of Texas. Exhibit Nos. S-57 at pp. 2-3, 6; S-58; SPL-17. Commission precedent extends its jurisdiction over a pipeline that lies entirely within a single state if the pipeline forms a component of a continuous movement from one state to another. *Texaco Refining & Marketing, Inc. v. SFPP, L.P.*, 80 FERC at p. 61,805. Accordingly, I conclude that to the extent that barrels of product originate on Mid-America or another interstate pipeline outside the State of Texas and move to Seminole at Hobbs (and then move to Mont Belvieu) without a sufficient break in the continuity of transportation, federal jurisdiction exists.

1301. I further find that Commission jurisdiction includes every Williams joint rate shipment to Mont Belvieu which is tight-lined through the Hobbs terminal or stored at Hobbs during transition from the interstate pipeline to the Seminole System. Staff and Seminole correctly noted that operational storage does not interrupt the continuous flow of transportation of product in interstate commerce, as the shipper intends continuous transportation of its product. *See id.* at p. 61.

ISSUE NO. 11: WHAT ARE THE APPROPRIATE VOLUMES TO USE FOR RATE DESIGN?

A. WILLIAMS

1302. In its Initial Brief, Williams argued that the appropriate volumes to use for rate design should be the three-year average of actual volumes moved on the Seminole Pipeline System in 2004, 2005, and 2006. Williams Initial Brief at p. 72. Referring to its witness Olson's testimony, it reasoned that the application of an average of the annual

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volumes offers a more representative figure than a single actual figure in the face of increasing volumes on the Seminole System.[641] *Id.* at pp. 72-73 (*citing* Exhibit Nos. WIL-2 at p. 11; WIL-9 at pp. 5-6; Transcript at p. 3052). According to Williams, Olson's calculations produced, using the three-year average, an average of 68.575 million barrels as compared with the 65.892 million barrels calculated by Seminole witness Ganz. *Id.* at pp. 73-75 (*citing* Exhibit Nos. WIL-2 at p. 12; SPL-5 at p. 9; Transcript at pp. 3053-54).

1303. Williams noted that Staff witness Pride adopted Olson's position and claimed that its three-year average evidenced that Seminole's use of the actual volumes was less reflective of volumes during the period when the filed rate was intended to be applicable. *Id.* at p. 74. It noted that, although Olson, Pride, and Ganz all used the same methodology to calculate a Seminole rate (*i.e.*, revenue divided by volume), the lower volume used as a divisor by Ganz resulted in a higher rate. *Id.* at p. 75 (*citing* Transcript at p. 3201). According to Williams, as confirmed by Seminole witness Collingsworth, "[t]he actual 2004 volumes and the annualized 2006 volumes were higher than Mr. Ganz's base-year volumes." *Id.* (*citing* Exhibit No. WIL-9 at p. 6; Transcript at pp. 3140, 3166-68).

1304. Rejecting Seminole's contention that the increase in volume used by Olson in calculating the three-year average was not known and measurable, Williams noted that Seminole witnesses Ganz and Collingsworth testified that the increase in volumes over the Base Year was "known." *Id.* at pp. 76-77 (*citing* Transcript at pp. 3199, 3202, 3236). It also asserted that, on numerous occasions, the Commission has accepted volumetric adjustments to test year results. *Id.* at p. 77 (*citing Williston Basin Interstate Pipeline Co.,* 52 FERC at pp. 61,648-49).

1305. In its Reply Brief, Williams maintained that the appropriate volume to use for rate design is the three-year average of 68.575 million barrels per year transported on the Seminole System for 2004, 2005, and 2006, because it is more representative of future volume levels than Seminole's base period volumes of 65.892 million barrels. Williams Reply Brief at pp. 70-71. According to it, the Commission requires a representative level of throughput in determining rates. *Id.* at p. 71 (*citing Natural Gas Pipeline Co. of America,* 105 FERC ¶ 61,383 at p. 62,713 (2003); *Viking Gas Transmission Co.,* 64 FERC ¶ 61,072 at p. 61,644 (1993)). Because Seminole's volumes increased over the three-year period that Williams used, Williams argued, its three-year average is more representative of a typical year of operation than Seminole's base period throughput, which was lower than Seminole's actual volumes in 2004, 2005, and 2006 (both annualized and actual). *Id.*

1306. Further, Williams objected to Seminole's recent suggestion that, if its three-year

[641] In other words, Williams insisted that volumes should be adjusted when they are non-representative. Williams Initial Brief at p. 73 (*citing* Exhibit No. WIL-9 at p. 6).

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average is used for Seminole's volume, the fuel and power costs, and thus Seminole's cost-of-service, need to be increased by at least $600,000. *Id.* at p. 73. Williams asserted that the "adverse inference" rule applies here: "The party with access to information has the burden of 'bringing it forward and will suffer the consequences of the adverse inference if it does not do so'." *Id.* at pp. 74-75 (*quoting Town of Highlands,* 37 FERC ¶ 61,149 at p. 61,357 (1986)). Thus, Williams declared, Seminole had the burden to demonstrate that power and fuel costs did in fact increase with the increased volumes transported over Seminole during the three-year period used by Williams. *Id.*

B. COMMISSION TRIAL STAFF

1307. Staff agreed with Williams that the appropriate volume to use for rate design purposes is 68.575 million barrels per year. Staff Initial Brief at p. 136. It claimed that Williams' three-year average annual volumes are more representative of future volumes than Seminole's base period volumes. *Id.* Essentially, reasoned Staff, reasonable deviation from the prescribed test period volumes is appropriate under special circumstances, as is the case here. *Id.* at p. 137 (*citing Town of Highlands, N.C. v. Nantahala Power & Light Co.,* 37 FERC ¶ 61,149 at p. 61,357 (1986)). Moreover, Staff declared, the Commission, in requiring a representative level of throughput in determining rates, has recognized averages of throughput where they are representative of future levels. *Id.* at pp. 137-38 (*citing Natural Gas Pipeline Co. of America*, 105 FERC ¶ 61,383 at p. 62,713 (2003); *Viking Gas Transmission Co.*, 64 FERC ¶ 61,072 at p. 61,644 (1993)). Furthermore, it asserted, a comparison of the average throughput calculated by Williams witness Olson with Seminole's actual throughput proves that Olson's figure is more representative of a typical year of operation than Seminole's base period throughput.[642] *Id.* at p. 138. In Staff's opinion, the Commission, comparing average throughput with actual throughput, would find that Olson's three-year average "is more representative of a typical year of operation than Seminole's base period throughput." *Id.* at p. 138.

1308. In its Reply Brief, Staff claimed that Seminole misinterprets the Commission's regulations in asserting that they mandate the use of actual base period volumes unless there are known and measurable changes or if the base period volume level is non-recurring such that it requires normalization. *Id.* at pp. 111-12. Staff insisted that the regulations must be read along with Commission precedent and that, when read together, the Commission allows deviations from base period volumes when the average throughput level is more representative of future volumes than a single year. *Id.* at

[642] Staff also noted that Seminole's base period volume of 65,892,000 barrels per year is lower than the 2004 actual volume (68,906,952 barrels), the 2005 actual volume (66,715,919 barrels), and the annualized 2006 volume (70,103,372 barrels). Staff Initial Brief at p. 139 (*citing* Exhibit Nos. WIL-2 at pp. 11-12; WIL-9 at p. 5).

pp. 112-13 (*citing Iroquois Gas Transmission System,* 84 FERC at p. 61,471).[643] Through a multi-year analysis of Seminole's volumes, Staff suggested, its actual base period volumes are unreasonably low and, from this, argued that there is no reason to believe that Seminole's volume levels will remain that low in the future. *Id.* at p. 113.

C. SEMINOLE PIPELINE

1309. Seminole claimed that the appropriate volumes to use for designing Seminole's rates are the actual Base Period[644] volumes (65.892 million barrels). Mid-America Initial Brief at p. 190. According to Seminole, the regulations stipulate the use of actual Base Period volumes except where known and measurable changes exist, or the base period volume level was non-recurring such that it requires normalization. *Id*. (*citing* 18 C.F.R. § 346.2 (2007)). It argued that neither condition exists in this case, and that, even if they did, Williams' adjustment is arbitrary and unfair. *Id.*

1310. With respect to whether there were known and measurable changes, Seminole contended that, while volumes increased during the nine months following the base period, those volume fluctuations were not known and measurable as of the end of the base period. *Id.* It noted that its witness, Collingsworth, testified that it was "difficult to forecast future volume levels" and that "the base period volumes are within the 'normal range' of Seminole's operations." *Id.* (*citing* Exhibit No. SPL-1 at p. 6).[645]

1311. Next, although admitting that actual base period volumes were lower than the 2004, 2005, and annualized 2006 volumes, Seminole asserted that this fact does not lead to the conclusion that the base period volumes were non-recurring or abnormal. *Id.* at p. 191. Indeed, according to it, the actual Base Period volumes are only four percent lower than Williams' average. *Id.* at p. 191 (*citing* Exhibit No. WIL-2 at pp. 11-12).

1312. Seminole claimed, assuming arguendo that an adjustment to the Base Period volumes is appropriate, Williams' proposed three-year average is not more representative

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[643] Staff also cited *Natural Gas Pipeline Co. of America*, 105 FERC at p. 62,713; *Viking Gas Transmission Co.*, 64 FERC at p. 61,644.

[644] The Base Period consists of the period February 2005 through January 2006. Exhibit No. SPL-9 at p. 1.

[645] Seminole also theorized that price differences "*might*" cause demethanized mix to be diverted from Mont Belvieu to Conway, or that "outages at gas processing plants and reduced availability of purity products . . . *might* also affect Seminole's volume levels." Mid-America Initial Brief at p. 191 (emphasis added). In support for these hypotheses, Seminole cited only to Collingsworth testimony (Transcript at p. 3166) which, on this point at least, lacks any real substance. As a consequence, Seminole's theory lacks support in the record and will not be further discussed.

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of normal future volume levels. *Id.* at p. 192. In fact, it submitted, Williams witness Olson admitted at the hearing that he had not provided any explanation for why the three-year average was more representative than any other normalization period. *Id.* (*citing* Transcript at p. 3052). Seminole also noted that, had Olson included 2003 volumes in his average, the resulting average would have been even lower and closer to the base period volumes.[646] *Id.*

1313. Williams' adoption of a higher volume level without its concomitant increase in costs, Seminole declared, results in an inappropriately low rate. *Id.* at p. 193. Certainly, opined Seminole, a four percent increase in volumes, the difference between Williams' three-year average and Mid-America's base period volumes, would increase Seminole's cost of service by approximately $600,000 through a proportionate four percent increase in fuel and power costs.[647] *Id.*

1314. In reply, Seminole attacked Williams' claim that a known and measurable change was present. It maintained that the actual Test Period volumes were neither known nor measurable as of the end of the Base Period, and also asserted that Williams fails to allege that its three-year average corresponds to any actual 12-month period, let alone represents a known and measurable change occurring within nine months of the Base Period. Seminole Reply Brief at p. 157.

1315. Next, addressing Williams' and Staff's arguments that the volume levels should be normalized to be more representative, Seminole submitted that neither of the parties

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[646] According to Seminole, the inclusion of 2003 volumes in a four-year (2003, 2004, 2005, and 2006) average results in a difference of only 2.2% between the actual base period volumes and the average. Mid-America Initial Brief at p. 192 (*citing* Transcript at pp. 3052-53).

[647] In support, Seminole cited Transcript at pp. 3057-58; Exhibit No. WIL-12 at p. 3. The latter exhibit, a Seminole response to a Williams' data request, in pertinent part, contains a statement from a Seminole employee named Steve Breckon who explained that, although one could not accurately determine what power costs would be at higher volume levels, the following was clear:

> [A]ssuming constant fuel prices, increased volumes always result in higher fuel costs. Indeed, as volumes increase, the incremental cost to move each additional barrel generally becomes higher, because as volumes increase, more pumps are required to move the product and, because friction increases at higher pumping rates, the number of pumps required as well as the cost to operate them also increases.

Exhibit No. WIL-12 at pp. 2-3.

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demonstrated that the Base Period volumes used by Seminole were at non-recurring levels, and neither showed that normalization was necessary, as the actual base period volumes were very similar to the proposed normalized average. *Id.* at p. 158. Moreover, Seminole opined that, although the 2006 and 2007 volumes were higher than 2005, this did not necessarily mean that volumes will remain at the 2007 level. *Id.*

DISCUSSION AND RULING

1316. Seminole and Williams/Staff proposed competing alternatives regarding the appropriate throughput volume to be used for ratemaking purposes. The issue, therefore, is whether one alternative is *more* representative of Seminole's future throughput levels than the other.

1317. In *Iroquois Gas Transmissions System, L.P.,* the Commission explained that the purpose of using a limited historical base period and a forward looking test period is "to capture recent, actual or known and measurable throughput levels that provide the *best evidence* of what throughput can be expected following the close of the test period and record."[648] 84 FERC ¶ 61,086 at p. 61,471 (1998) (emphasis added). The Commission's regulations require an oil pipeline in filing for an initial rate or change in an existing rate to use a base and test period as defined below:

> (a) *Base and test periods defined.* (1) For a carrier which has been in operation for at least 12 months:
>
> (i) A base period must consist of 12 consecutive months of actual experience. The 12 months of experience must be adjusted to eliminate nonrecurring items (except minor accounts). The filing carrier may include appropriate normalizing adjustments in lieu of nonrecurring items.
>
> (ii) A test period must consist of a base period adjusted for changes in revenues and costs which are known and are measurable with reasonable accuracy at the time of filing and which will become effective within nine months after the last month of available actual experience utilized in the filing. For good cause shown, the Commission *may allow reasonable deviation from the prescribed test period.*

18 C.F.R. § 346.2(a)(1) (2007) (emphasis added). "*Generally speaking,* the rate filing and the data supplied at the time of the filing according to the rules should provide the basis for the hearing and the decision." *Michigan Wisconsin Pipe Line Co.,* 21 FPC 306 at

[648] While, in making this statement, the Commission was referring to the base and test periods in the natural gas context, I find it equally applicable to the base and test periods in the oil context.

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p. 316 (emphasis in original). "The fact that [a company's] throughput projection reflected in its filed rates was reasonable when made only means that it complied with the filing regulations; it does not preclude the Commission from considering updated data in deciding the ultimate question of what rates should be found just and reasonable for the relevant periods." *Williston Basin Interstate Pipeline Co.,* 72 FERC ¶ 61,074 at p. 61,382 (1995).[649]

1318. Williams, with the support of Staff, submitted that the appropriate volumes to use for rate design derive from the three-year average of actual volumes moved on the Seminole Pipeline System in 2004, 2005, and 2006 — 68.575 million barrels. Williams Initial Brief at pp. 72-73; Staff Initial Brief at p. 136. Essentially, Williams contended that the application of an average of the annual volumes offers a more representative figure than Seminole's single, actual figure in the face of increasing volumes on the Seminole System. Williams Initial Brief at pp. 72-73. In addition, it argued that "the Commission has repeatedly accepted volumetric adjustments to test year results." *Id.* at p. 77 (*citing e.g.*, *Williston Basin Interstate Pipeline Co.,* 52 FERC ¶ at pp. 61,648-49).

1319. Similarly, Staff maintained that deviation from the prescribed test period volumes is appropriate under special circumstances, as it claimed is the case here. Staff Initial Brief at p. 137. It added that the Commission, although requiring a representative level of throughput in determining rates, has recognized averages of throughput where they are more representative of future volume levels. *Id.* at pp. 137-38 (*citing Natural Gas Pipeline Co. of America,* 105 FERC at p. 62,713; *Viking Gas Transmission Co.,* 64 FERC at p. 61,644). According to Staff, a comparison of Williams' average throughput with Seminole's actual throughput illustrates that Williams' figure is more representative of a typical year of operation than Seminole's Base Period throughput because Seminole's Base Period volumes of 65.892 million barrels per year are lower than the 2004 actual volumes (68.906 million barrels), 2005 actual volumes (66.715 million barrels), and annualized 2006 volumes (70.103 million barrels). *Id.* at pp. 138-39.

1320. Contrary to both Williams and Staff, Seminole declared that the appropriate volumes to use in designing Seminole's rates are the actual February 2005 through January 2006 Base Period volumes — 65.892 million barrels. Mid-America Initial Brief at p. 190. Seminole insisted that the Commission regulations require the use of actual base period volumes except where (1) known and measurable changes exist, or (2) the base period volume level is nonrecurring such that normalization is required. *Id.* at p. 190 (*citing* 18 C.F.R. § 346.2 (2007)). Because Seminole identified the existence of neither condition in this case, it argued that there is no reason to deviate from the prescribed base and test period volumes. *Id.* Moreover, Seminole maintained that, even

[649] Here too, although, in making this assertion, the Commission was referring to 18 C.F.R. § 154.63 (e)(2)(i) (1994) involving filings under the Natural Gas Act, I find it equally applicable to oil pipeline cost-of-service filings.

if the actual base period volumes were lower than the 2004, 2005, and annualized 2006 volumes, the base period volumes are not necessarily, or even impliedly, abnormal or non-recurring. *Id.* at p. 191. Indeed, according to Seminole, the actual base period volumes are only four percent lower than Williams' three-year average. *Id.*

1321. Further, Seminole insisted that, assuming arguendo, an adjustment to the base period volumes is appropriate, Williams' proposed three-year average is not more representative of normal future volume levels. *Id.* at p. 192. Seminole pointed to Williams witness Olson's admission, at the hearing, that he did not provide any explanation for why the three-year average was more representative than any other normalization period.[650] *Id.* (*citing* Transcript at p. 3052). Moreover, Seminole added, had Williams included 2003 volumes, the resulting four-year average would have been even lower and closer to the base period volumes — indeed, only a 2.2% difference. *Id.*

1322. Neither Williams nor Staff has provided sufficient justification for deviating from Seminole's Base Period volumes — 65.892 million barrels. Thus, I find that Seminole's actual Base Period volumes are the best representative of its future throughput levels found in the instant record. Moreover, I cannot find good cause for adjusting or deviating from the Base Period volumes.[651] Further, although actual Base Period volumes were lower than the 2004, 2005, and annualized 2006 volumes, I am not convinced by this fact alone that the Base Period volumes are nonrecurring or abnormal. Indeed, as Seminole pointed out, actual Base Period volumes are lower than Williams' average by only four percent.[652] Even more significant is the fact that, if the year 2003 volumes are included

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[650] An indication, perhaps, that Williams' rationale supporting use of the three-year average may not be well reasoned.

[651] Although I may have preferred using Seminole's end-of-Test Period actual throughput, surprisingly in view of the Commission's preference for it, no party proffered that figure into evidence. In view of this, I am compelled to find the Base Period actual throughput data tendered by Seminole as the next best evidence. *See Williston Basin Interstate Pipeline Co.,* 67 FERC at p. 61,364 n.51; *Williston Basin Interstate Pipeline Co.*, 71 FERC ¶ 61,019 at p. 61,084 (1995).

[652] It might even be said that this small difference is de minimis. *See Eastern Natural Gas Co.*, 61 FERC ¶ 61,179 (1992). Additionally, the difference between the actual base period volumes and the 2004 and 2006 volume levels is also quite small, as the 2004 volumes are only 4.5% greater than the base period volumes, and the 2006 volumes are only 6.3% greater than the base period volumes. Exhibit No. WIL-2 at pp. 11-12. Indeed, I find persuasive Seminole's suggestion that Williams' proposal may not even be directionally more representative, as Seminole witness Collingsworth testified that traffic on the Seminole System may not return to current levels until 2011 or 2012. *See* Transcript at pp. 3166-67.

to comprise a four-year average, a difference of only 2.2% between the actual Base Period volumes and the average results. Consequently, I see no reason to deviate from Seminole's base period volumes.

1323. Moreover, the cases[653] cited by Williams and Staff in support of their positions that the "Commission has repeatedly accepted volumetric adjustments to test year results" and "has accepted averages of throughput where they are representative" do not persuade me to deviate from Seminole's actual base period volumes. First, in *Williston Basin Interstate Pipeline Co.,* 52 FERC ¶ 61,170, the Commission accepted the presiding judge's decision to use the actual volumes for only the last 12-months of the 21-month test period specified in 18 C.F.R. § 154.63(e)(2)(i). *Williston Basin Interstate Pipeline Co.,* 52 FERC at pp. 61,647-48. The facts in the instant case are not analogous. Specifically, while in *Williston*, the Commission did not use the data from the *entire* prescribed test period, it still limited its use of data to that which fell *within* the prescribed test period and comprised the most currently available actual volumetric data. *Id*. Here, Williams and Staff proposed to use an average of three years of actual experience, and their average goes well beyond the time frame of the base and test period.

1324. Next, in *Viking Gas Transmission Co.*, the Commission accepted a seven-month average of volumes as more representative of future throughput than a one-month actual volume level. *Viking Gas Transmission Co.*, 64 FERC at p. 61,644. This is not the case here. Specifically, in *Viking,* the Commission did not deviate from a base or test period, as Williams proposed here. *Id.* Furthermore, in *Viking,* only seven months of available relevant actual data existed, and the proposed one-month actual volume level was abnormally low when compared to the other six months. *Id.* Here, there exists available data of 12 consecutive months of actual experience, and the actual Base Period volumes are not abnormally low when compared to actual volume levels of the three years (2004, 2005, and 2006) used in Williams' three-year average.

1325. Lastly, also in *Natural Gas Pipeline of America*, the Commission did not deviate from a base or test period. In fact, it found that the last 12 months of available data should be used to establish a representative level of throughput rather than a 24-month average of throughput. *Natural Gas Pipeline of America*, 105 FERC at p. 62,713. As stated above, Williams proposed to deviate from the base and test period in this proceeding and use a three-year average of throughput.

1326. In sum, I do not find these cases persuasive or analogous to this proceeding as they do not support a deviation from the base or test period volumes.

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[653] *Williston Basin Interstate Pipeline Co.,* 52 FERC at pp. 61,648-49; *Natural Gas Pipeline of America,* 105 FERC at p. 62,713; *Viking Gas Transmission Co.,* 64 FERC at p. 61,644.

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1327. Having decided that Seminole's position on throughput is appropriate, there is no need for me to address the question of whether, had I accepted the increased throughput suggested by Williams and Staff, to increase Seminole's expenses to accommodate the increased throughput. However, I note that, had I accepted the increased throughput suggested by Staff and Williams, I also would have increased Seminole's expenses concomitantly.

ISSUE NO. 12: IS THE CURRENTLY EFFECTIVE TARIFF NO. 3 RATE JUST AND REASONABLE, AND IF NOT, WHAT IS THE APPROPRIATE RATE?

A. WILLIAMS

1328. Williams claimed, in its Initial Brief, that no party, including Seminole, supported the currently effective rate of 98.85 cents per barrel authorized by FERC Tariff No. 3. Williams Initial Brief at p. 78. It noted that Seminole witness Ganz testified, at the hearing, that his cost-of-service analysis did not support the 98.85 cent rate; rather it supported approximately a 90 cent per barrel rate for the base year, later reduced to 85.05 cents. *Id.* at p. 79 (*citing* Transcript at pp. 3208-09, 3210-11; Exhibit No. SPL-5 at p. 10). According to Williams, Seminole could not support the currently effective FERC Tariff No. 3 rate, and thus, it argued that the rate is not just and reasonable.[654] *Id.* at p. 80. Consequently, Williams recommended that the appropriate rate be set at 78.56 cents per barrel, determined by using Williams witness Olson's original cost methodology.[655] *Id.* at p. 82. Alternatively, Williams noted, if Williams' recommended rate is rejected, it would support a rate of 85.05 cents per barrel, which is calculated using Seminole's methodology with Williams' volumes. *Id.*

1329. In its Reply Brief, Williams still insisted that the effective FERC Tariff No. 3 rate, 98.85 cents per barrel, is not just and reasonable. Williams Reply Brief at p. 75. It

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[654] Williams asserted that Seminole failed to offer a witness to provide an explanation or justification for the filed rate and only speculated as to whether the analysis and calculations were performed by internal or external personnel. Williams Initial Brief at p. 80.

[655] Williams chose not to explain Olson's "methodology" in its brief. Rather it referred to Olson's testimony (Exhibit No. WIL-2 at pp. 10-11) in which Olson indicated that his rate is based not only on acceptance of his three-year throughput average which I already have rejected (*see supra* Issue No. 11), but also on his "original cost methodology." However, on brief, Williams did not explain what the latter methodology entails, nor did Olson, in his testimony, except to indicate that, here, he rejects application of the methodology adopted by the Commission in *Williams Pipe Line Co.*, 31 FERC ¶ 61,377.

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maintained that the appropriate maximum should be 78.56 cents per barrel and opposed Seminole's new proposed rate of 88.51 cents per barrel for the period February 2005 through January 2006 (subject to indexing). *Id.* at pp. 75-76.

1330. Williams claimed that questions regarding Seminole's new proposed FERC Tariff No. 3 rate subject to indexing were never raised and no witness ever testified that any proposed rate would, or even should, be increased by indexing after the period February 2005 through January 2006 (or any other subsequent time period). *Id.* at p. 77. Additionally, Williams argued that approval of this proposed retroactive indexing effectively recognized increases in Seminole's costs since January 2006 without a corresponding increase in volumes in those and subsequent years. *Id.* at pp. 77-78. Here again, Williams invoked the "adverse inference" principle, stating that Seminole lacked evidence supporting the costs inferred by respective annual index increases, and hence, its proposed cost of service reflected its maximum rate through at least 2008. *Id.* at pp. 78-79. Thus, Williams opined, Seminole's indexing proposal for the substitute Seminole interstate rate should be rejected outright. *Id.*

1331. With respect to its recommendation of 78.56 cents per barrel, Williams added that its suggested rate is higher than (1) the "continuation rate" of 70.36 cents in 2006 provided for in Seminole Tariff TRRC No. 16 filed with the Texas Railroad Commission for the intrastate transportation of demethanized mix originating at Mid-America Rocky Mountain System Group 100 and moved from Hobbs to Mont Belvieu, Texas, after being stopped in transit due to having been delivered to the Hobbs fractionator; (2) the division of rate Seminole receives from the joint movements originating on the Rocky Mountain System and ending at Seminole Destination 950 (Mont Belvieu, Texas); and (3) the rates that the West Texas LPG Pipeline and Chaparral Pipeline realize, respectively, for shipping Mid-America origin barrels from Hobbs to Mont Belvieu, Texas, in the event that space is not available on Seminole. *Id.* at pp. 80-81 (*citing* Exhibit Nos. WIL-56 at p. 2; WIL-57 at p. 8; Transcript at pp. 3168-71, 3177-79).

B. COMMISSION TRIAL STAFF

1332. In its Initial Brief, Staff recommended a rate of 84.08 cents per barrel as the just and reasonable rate for FERC Tariff No. 3, based on Staff's cost-of-service which differs from Seminole's with regard to rate base, capital structure, and volumes.[656] Staff Initial Brief at p. 139 (*citing* Exhibit No. SPL-13 at p. 70). It asserted that the Commission has adopted net depreciated trended original cost as the model for calculating rate bases for oil pipelines. *Id.* at p. 140 (*citing Williams Pipe Line Co.*, 31 FERC at p. 61,833). Thus, although Staff used Seminole's trended original cost methodology, it noted that it used a

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[656] As noted above, I already have rejected the Williams/Staff position on throughput volumes. *See* Issue No. 11, *supra*.

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net trended original cost rate base rather than the average net trended original cost rate base as did Seminole.[657] *Id.* at pp. 139-40. Staff claimed that Seminole's average rate base derived from the average of the base and test periods does not comply with the Commission's prescribed test period, and furthermore, Seminole's average rate base of $182,799,000 overstates the appropriate end-of-Test Year amount of $179,707,000 by $3,092,000. *Id.* at p. 140 (*citing* Exhibit No. SPL-6 at p. 8).

1333. With respect to capital structure, Staff contended that the most recent capital structure of Seminole's current parent, Enterprise Products Partners, should be used because Seminole's ownership history mirrors that of Mid-America. *Id.* at p. 141. According to Staff, Enterprise Products Partners' capital structure includes 44.97% debt and 55.03% equity. *Id.* Continuing, Staff maintained that the small percentage of ownership by INEOS, a privately held company located in the United Kingdom, does not affect Seminole's capital structure. *Id.* at pp. 141-42 (*citing* Transcript at pp. 3082-83). Staff claimed: "There would have to be a 10% difference in equity between INEOS and Enterprise to change Seminole's capital structure by 1%. However, a difference in equity of as much as 10% from that experience by Enterprise would be unrepresentative of pipeline operations. . . . These factors indicate that INEOS should not affect Seminole's capital structure." *Id.* at p. 142.

1334. In its Reply Brief, Staff asserted that, while Seminole uses an average of the end-of-Base Period and end-of-Test Period rate bases, it should have used the end-of-Test Period year amount of $179,707,000 for its rate base, as that figure represents the most recent and reliable data available.[658] Staff Reply Brief at p. 115 (*citing* Exhibit No. SPL-6 at p. 8). According to Staff, the Commission's regulations require the use of a base period adjusted for test period changes. *Id.* at p. 116 (*citing* 18 C.F.R. § 346.2 (2007)). In addition, Staff contended that Seminole has not provided any basis for deviating from the Commission's regulations. *Id.* Simply put, Staff declared that Seminole uses an average rate base because its rate base is declining — an average of the end-of-base period and end-of-test period rate bases results in a higher rate base for the pipeline and overstates the appropriate end-of-test year amount by over $3 million. *Id.* (*citing* Exhibit No. SPL-6 at p. 8).

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[657] According to Staff, Williams used original cost rather than a trended original cost because it believed Seminole was not a jurisdictional pipeline. Staff Initial Brief at p. 140. It should be noted, however, that I already have determined that Seminole is jurisdictional. *See* Issue No. 10, *supra*.

[658] Staff clarified, in its Reply Brief, that it used end-of-Base Period numbers in its testimony because that was the only data available at the time, but it now uses the end-of-Test Period data, which subsequently became available. Staff Reply Brief at p. 115 (*citing* Exhibit No. SPL-6 at p. 8).

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C. SEMINOLE PIPELINE

1335. According to Seminole, the just and reasonable rate for service on the Seminole System is 88.51 cents per barrel adjusted for indexing. Seminole Initial Brief at p. 194. Adjusting that rate for indexing,[659] Seminole claimed it calculated a ceiling rate of 93.95 cents per barrel to account for the July 1, 2006 indexing increase, and 98.01 cents per barrel to account for the July 1, 2007 indexing increase.[660] *Id.*

1336. Seminole asserted that it disagreed with Williams in two areas: (1) volumes;[661] and (2) the proper ratemaking methodology. As for the proper ratemaking methodology, Seminole claimed that the Opinion 154-B methodology (*Williams Pipe Line Co.,* 31 FERC ¶ 61,377) is the proper methodology in this case because the Commission has applied it in all interstate oil pipeline cost-of-service cases since 1985,[662] and it is the equivalent of a formal rule.[663] *Id.* at pp. 195-96.

1337. Disclaiming as frivolous Williams' suggestion that the depreciated original cost is appropriate because Seminole attempted to conceal its jurisdictional status, Seminole noted that it has held itself out as a jurisdictional pipeline for more than 25 years. *Id.* at p. 197 (*citing e.g.,* Exhibit Nos. SPL-12; SPL-13; SPL-14; SPL-15; SPL-16; SPL-18; S-58; WIL-9; Transcript at pp. 3042-49). Moreover, Seminole argued that, even if Seminole's interstate local rate was filed relatively recently, in 2004, the Commission's holding in *Lakehead Pipe Line Co.*, 75 FERC at p. 61,591, still mandates the use of the

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[659] In support, Seminole cited: *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992,* 115 FERC ¶ 61,295 (2007); *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992,* 119 FERC ¶ 61,155 (2007).

[660] Multiplying the 88.51 cents per barrel base period rate by 1.061485 and 1.043186 yields 93.95 and 98.01 cents per barrel, respectively. Seminole Initial Brief at p. 194 n.91; *see also infra* note 685. Seminole noted that the 98.01 cents per barrel rate most likely will need to be adjusted for future indexing increases that occur between July 1, 2007, and the date the Commission orders a new rate to take effect. *Id.* at p. 194.

[661] In deciding Issue No. 11, *supra*, I adopted Seminole's position on throughput volume.

[662] Seminole cited *ARCO Pipe Line Co.,* 52 FERC ¶ 61,055; *ARCO Pipeline Co.,* 53 FERC ¶ 61,398 (1990); *Lakehead Pipe Line Co., L.P.,* 71 FERC ¶ 61,338; *Lakehead Pipe Line Co., L.P.,* 75 FERC ¶ 61,181 (1996); *SFPP, L.P.,* 86 FERC ¶ 61,022; *SFPP, L.P.,* 91 FERC ¶ 61,135; *SFPP, L.P.,* 96 FERC ¶ 61,281 (2001).

[663] In support, Seminole cited Order No. 571, III FERC Stats. & Regs. ¶ 31,006 at p. 31,167 (1994).

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Opinion 154-B methodology in setting rates in this case. *Id.* at p. 198. Specifically, according to it, the Commission explained:

> The appropriate starting point for trending an oil pipeline's rate base under [the Opinion 154-B trended original cost methodology] was when the new methodology became effective for oil pipelines. . . Lakehead did not have to file for new rates under [trended original cost] to activate the new methodology. If a shipper had filed a complaint from that point on, Lakehead's rates would have been analyzed under [trended original cost] and not under the previous valuation methodology.

Id. (*quoting Lakehead Pipe Line Co.,* 75 FERC at p. 61,591).

1338. In addressing the appropriate historical capital structure, Seminole asserted that there is no basis for Staff's assumption that Mid-America's capital structure applies to Seminole for deriving the deferred equity component of the rate base. *Id.* at p. 199. Claiming Staff witness Green's statement that "Seminole's ownership history dating back to 1985 mirrors that of Mid-America" is incorrect, Seminole pointed out that, first, the owners of Mid-America and Seminole are different: Mid-America is wholly owned by Enterprise Products Partners, and ten percent of Seminole is owned by a privately held company, INEOS. *Id.* (*citing* Exhibit No. S-50 at p. 2). Second, it argued that the 1987 SEC Form 10-K for MAPCO reveals that, at that time, MAPCO solely owned Mid-America, but owned only 45% of Seminole. *Id.* (*citing* Exhibit Nos. M-164 at pp. 10-11; SPL-18 at pp. 12-13).

1339. Lastly, Seminole contended that the average of the end-of-base period and end-of-test period rate bases should be used. *Id.* Seminole maintained that neither an end-of-base period nor an end-of-test period number alone encompasses the rate base level in effect *during* the applicable period. *Id.* at p. 200.

1340. In reply, Seminole claimed that the currently effective FERC Tariff No. 3 rate is just and reasonable and would not need to be lowered prospectively if the Tariff rate is below the rate calculated under the Commission's Opinion 154-B methodology using the February 2005 through January 2006 base period as indexed forward to the date the Commission issues its ruling. Seminole Reply Brief at p. 160 (*citing* Exhibit No. SPL-6 at p. 2; Transcript at p. 3208). On the other hand, if FERC Tariff No. 3 were above the indexed ceiling, Seminole insisted, it would need to be lowered going forward. *Id.* In short, Seminole recommended, using the Opinion 154-B methodology, a base period rate of 88.51 cents per barrel. *Id.*

1341. According to Seminole, it filed FERC Tariff No. 3 consistent with Section 342.2(b) of the Commission's regulations, 18 C.F.R. § 342.2 (2007), as it supported its

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rate filing with the agreement of a non-affiliated shipper subject to no protest.[664] *Id.* at pp. 160-61. Thus, Seminole asserted that Williams' argument that the current rate is "neither sponsored nor supported" is inaccurate and irrelevant to the proceeding here, and the properly posed question is whether the existing FERC Tariff No. 3 rate is just and reasonable. *Id.*

DISCUSSION AND RULING

1342. As I do not adopt any party's position with respect to the appropriate ratemaking methodology and cost of service, I find none of the parties' FERC Tariff No. 3 rate proposals acceptable. The issue to be decided is whether the rate calculated pursuant to the ratemaking methodology and cost-of-service I adopt is higher than the current FERC Tariff No. 3 rate, rendering that Tariff just and reasonable.[665] Consequently, to answer that question, the following sub-issues must be decided: (1) What is the appropriate ratemaking methodology?; (2) What is the appropriate level of throughput?; (3) What is the appropriate rate base?; and (4) What is the appropriate capital structure to be used?

1. Ratemaking Methodology

1343. In *Williams Pipe Line Co*., the Commission adopted net depreciated trended original cost as the model for calculating rate bases for oil pipelines, and therefore, revenue requirements. *Williams Pipe Line Co.,* 31 FERC at p. 61,833. Since then, the Commission has applied that methodology in all interstate oil pipeline cost-of-service cases.[666] Williams asserted that the appropriate rate is 78.56 cents per barrel, which was

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[664] Seminole acknowledged Williams claim that it did not protest the filing because Seminole would have challenged its standing and argued that such a possibility did not prevent Williams from protesting other rates. Seminole Reply Brief at p. 161 n.103 (*citing Mid-America Pipeline Co.*, 111 FERC ¶ 61,128 at P 21, 23). While Williams did assert such a claim here, Williams Initial Brief at pp. 80-81, it is specious.

[665] The rate calculated pursuant to the ratemaking methodology and the cost of service I adopt will need to be indexed forward to the date the Commission issues a ruling before it can be compared to the FERC Tariff No. 3 rate. *See Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992,* 115 FERC ¶ 61,295 (2007) (directing pipelines in computing their index ceiling levels for the period July 1, 2006, through June 30, 2007, to multiply their July 1, 2005, through June 30, 2006 index ceiling levels by 1.061485); *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992,* 119 FERC ¶ 61,155 (2007) (directing pipelines in computing their index ceiling levels for the period July 1, 2007, through June 30, 2008, to multiply their July 1, 2006, through June 30, 2007 index ceiling levels by 1.043186).

[666] *See e.g., ARCO Pipe Line Co.,* 52 FERC ¶ 61,055; *ARCO Pipeline Co.,* 53

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determined by Williams witness Olson's proposed original cost methodology. Williams Initial Brief at p. 82 (*citing* Exhibit No. WIL-2 at pp. 10-11). In short, because Williams doubts the jurisdictional status of Seminole, it opined that a trended original cost methodology is not required in this case. Exhibit No. WIL-2 at pp. 9-11.

1344. In contrast, both Staff and Seminole proposed a trended original cost methodology. Seminole Initial Brief at p. 195; Staff Initial Brief at pp. 139-40. Claiming that it is a jurisdictional pipeline, Seminole submitted that the proper ratemaking methodology to be used in evaluating the justness and reasonableness of Seminole's local interstate rate should be the trended original cost method, or what it calls the "Opinion 154-B methodology." Seminole Initial Brief at p. 196. According to Seminole, this methodology was adopted by the Commission in 1985[667] and has become well established in the oil pipeline context. *Id.* at pp. 195-96. Similarly, Staff maintained that the Commission has adopted and continues to use net depreciated trended original cost as the model for calculating rate bases for oil pipelines. Staff Initial Brief at p. 140 (*Williams Pipe Line Co.,* 31 FERC at p. 61,833). However, because the two parties use a different rate base, Staff recommended that the appropriate rate be 84.08 cents per barrel, while Seminole submitted that the appropriate rate be 88.51, subject to indexing. Staff Initial Brief at p. 139; Seminole Initial Brief at p. 194.

1345. Having already determined, in Issue No. 10, *supra*, that Seminole is subject to the Commission's jurisdiction, I agree with Seminole and Staff that the appropriate ratemaking methodology to be applied in this proceeding is the trended original cost method. "For oil pipelines . . . the Commission adopts net depreciated trended original cost (TOC) as the model for calculating rate bases, and therefore, determining revenue requirements." *Williams Pipe Line Co.,* 31 FERC at p. 61,833.

2. Cost of Service

(a) Appropriate Volumes

1346. In Issue No. 11, *supra*, I determined that Seminole's proposed actual base period volumes — 65,892,291 barrels – is appropriate.

(b) Appropriate Rate Base

1347. The Commission's regulations require an oil pipeline, in filing for an initial rate or change in an existing rate, to provide certain statements, workpapers, and schedules based on an appropriate test period. Specifically:

FERC ¶ 61,398; *Lakehead Pipe Line Co., L.P.,* 75 FERC ¶ 61,181; *SFPP, L.P.,* 86 FERC ¶ 61,022; *SFPP, L.P.,* 91 FERC ¶ 61,135; *SFPP, L.P.,* 96 FERC ¶ 61,281.

[667] Citing *Williams Pipe Line Co.,* 31 FERC at p. 61,833.

> A carrier that files for rates . . . or a carrier . . . that files to establish or change rates by filing cost, revenue, and throughput data supporting such rates, other than pursuant to a Commission-approved settlement, must file the following statements, schedules, and supporting workpapers. The statement, schedules, and workpapers must be based upon an appropriate test period.
>
> (a) *Base and test periods defined.* (1) For a carrier which has been in operation for at least 12 months:
>
> (i) A base period must consist of 12 consecutive months of actual experience. The 12 months of experience must be adjusted to eliminate nonrecurring items (except minor accounts). The filing carrier may include appropriate normalizing adjustments in lieu of nonrecurring items.
>
> (ii) A test period must consist of a base period adjusted for changes in revenues and costs which are known and are measurable with reasonable accuracy at the time of filing and which will become effective within nine months after the last month of available actual experience utilized in the filing. For good cause shown, the Commission may allow reasonable deviation from the prescribed test period.

18 C.F.R. § 346.2(a)(1) (2007).

1348. With respect to rate base, Staff argued that the appropriate rate base is the end-of-Test Year amount of $179,707,000, as that figure represents the most recent and reliable data available. Staff Reply Brief at p. 115 (*citing* Exhibit No. SPL-6 at p. 8). According to Staff, the Commission's regulations mandate the use of a base period adjusted for test period changes, and Seminole has suggested no reason for deviating from the Commission's regulations. *Id.* at p. 116 (citing 18 C.F.R. § 346.2(a)(1) (2007)).

1349. In contrast to Staff, Seminole recommended that the appropriate rate base be the average of the end-of-Base Period and end-of-Test Period rate bases. Seminole Reply Brief at p. 162 (*citing* Exhibit No. SPL-5 at p. 6). Seminole argued that Staff, in support of its position, simply referred to the Commission's general test period definition and suggested that nothing in that regulation renders Seminole's averaging method inappropriate. *Id.* at pp. 162-63. Lastly, Seminole contended that its average more accurately and fairly accounts for the rate base in effect during the base and test periods. Seminole Initial Brief at p. 200.

1350. While I agree with Seminole that Staff simply stated the Commission's general test period definition required for an appropriate initial rate filing, I find that the

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appropriate rate base is the end-of-Test Year amount of $179,707,000,[668] as that figure represents the most recent and reliable data available. The trended original cost rate base should be based upon an appropriate Test Period as defined under Section 346.2 of the Commission's regulations, 18 C.F.R. § 346.2(a)(1)(ii).

1351. Although the Commission's regulations do not expressly reject the use of an average or require the use of test year data except in an initial filing, I am not persuaded by Seminole's rationale that using an average rather than the end-of-test year data will create a just and reasonable rate. Indeed, Seminole does not provide, and I cannot find, any Commission precedent supporting Seminole's averaging of rate bases. Additionally, Seminole's argument can be encompassed in one unconvincing statement: "[T]he use of an average more accurately and fairly accounts for the rate base" because it "captures the rate base level in effect *during* the applicable period." Seminole Initial Brief at p. 200. Nevertheless, the Commission's prescribed test period assists the general ratemaking purpose to capture the most recent and reliable data available.[669] Accepting the end-of-test year rate base will accomplish the Commission's ratemaking goal because it represents the most recent and reliable data available. Indeed, Seminole's average results in an amount of $182,799,000, which overstates the end-of-test year amount by more than $3 million.[670] I find persuasive Staff's argument that Seminole uses an average rate base because its rate base is declining, and an average of the end-of-base period and end-of-test period rate bases results in a higher rate base for the pipeline.[671] Consequently, I accept Staff's end-of-Test Year rate base.

(c) Appropriate Capital Structure

(1) Historical Capital Structure

1352. As an initial matter, both Staff and Seminole agreed that the capital structure analysis for Mid-America applies to Seminole. Staff Reply Brief at p. 117 (*compare* Exhibit No. S-50 at p. 2 *with* Exhibit No. SPL-4 at pp. 1-3). Accordingly, Staff submitted that, because "Seminole's ownership history dating back to 1985 mirrors that of

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[668] *See* Exhibit No. SPL-6 at p. 8.

[669] *See Iroquois Gas Transmissions System, L.P.,* 84 FERC at p. 61,471 (stating that the purpose of using a limited historical base period and a forward looking test period is to capture recent, actual or known and measurable data levels that provide the best evidence of what can be expected following the close of the test period and record). While this was a natural gas case, I find the rationale equally applicable to the base and test periods in the oil context.

[670] *See* Exhibit No. SPL-6 at p. 8.

[671] *See* Staff Reply Brief at p. 116 (*citing* Exhibit No. SPL-6 at p. 8).

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Mid-America . . . [the] historical capital structures for deriving the deferred equity component of the rate base are shown in Schedule No. 3 of Exhibit No. S-2 . . . and the most recent capital structure of Enterprise, Seminole's parent, should be used for Seminole's present capital structure." Staff Initial Brief at pp. 141.

1353. Conversely, Seminole claimed that Staff's "cursory discussion" of this issue is inadequate in supporting a conclusion that Seminole's parent company's capital structure should be used as Seminole's historical capital structure. Mid-America Initial Brief at p. 199. Specifically, Seminole rejected Staff's assertion that "Seminole's ownership history dating back to 1985 mirrors that of Mid-America." *Id.* According to Seminole, Mid-America is wholly owned by Enterprise Products Partners while 10 percent of Seminole is owned by INEOS, a private company in the United Kingdom. *Id.* (*citing* Exhibit Nos. M-6; S-50 at p. 2). In addition, Seminole pointed out that the 1987 SEC Form 10-K for MAPCO shows that at that time, Mid-America was wholly owned by MAPCO, while MAPCO owned only 45% of Seminole. *Id.* (*citing* Exhibit Nos. M-164 at pp. 10-11; SPL-18 at pp. 12-13).

1354. In response to Seminole's position that the owners of Mid-America and Seminole are not the same, Staff insisted that those ownership factors do not affect Staff's or Seminole's capital structure analyses. Staff Reply Brief at p. 117 (*citing* Exhibit No. SPL-4 at pp. 1-3). Indeed, Staff supported its witness Green's testimony at the hearing:

> To give you an idea, as I stated, that ultimate owner has a 10 percent stake in Seminole. If it had a 10 percentage point difference in equity percentage from Enterprise, it would have had a 1 percent overall impact on the composite capital structure for Seminole. In fact, if you go a little beyond that, it would have been so unrepresentative of the financing of pipeline operations, that it could have been challenged and not included for that reason.

Id. at p. 118 (*citing* Transcript at pp. 3082-83).

1355. I find that the capital structure analysis for Mid-America also applies to Seminole. *See* Issue No. 4.A.(1), *supra*. Notwithstanding the facts that (1) Seminole is now owned ten percent by INEOS, a private company in the United Kingdom; and (2) in 1987 Mid-America was wholly owned by MAPCO, while MAPCO owned only 45% of Seminole, I conclude that the same capital structure used for Mid-America can be imported into Seminole's cost of service, as these two factors do not affect the analysis for Seminole's capital structure. *See* Transcript at pp. 3082-84.

(2) Current Capital Structure

1356. I find, because Enterprise Products Partners has been the guarantor of

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Mid-America's debt since 2002, the capital structure of Enterprise Products Partners should be used to calculate Seminole's current capital structure.[672] Staff advocated, and Seminole does not contest, the use of the most recent capital structure of Seminole's current parent, Enterprise Products Partners. Staff Initial Brief at p. 141. Accordingly, consistent with my decision regarding the appropriate current capital structure for Mid-America under Issue No. 4.B.(1), I adopt the capital structure of Enterprise Products Partners as of September 30, 2006: an equity ratio of 57.33% and a debt percentage of 42.67%.[673]

1357. For the foregoing reasons, I conclude that, to calculate a just and reasonable rate, the proper ratemaking methodology to be used in this proceeding is the trended original cost method; with respect to cost of service, I find appropriate Seminole's actual base period volumes as discussed under Issue No. 11; additionally, I reject Seminole's average of end-of-base period and end-of-test period rate bases and accept as appropriate Staff's end-of-test year rate base; finally, I accept the capital structure of Seminole's parent company to be used for Seminole's historical capital structure and the most recent capital structure of Enterprise Products Partners, Seminole's parent company, to be used for Seminole's present capital structure.

1358. In view of the above, I find that, should the rate calculated by using the formula I set out here be less than the rate set forth in FERC Tariff No. 3, the rate set forth in FERC Tariff No. 3 is unjust and unreasonable.

ISSUE NO. 13: IF THE FERC TARIFF NO. 3 RATE IS UNJUST AND UNREASONABLE, WHAT REPARATIONS OR REFUNDS, IF ANY, DOES SEMINOLE OWE SHIPPERS?

A. WILLIAMS

1359. Williams stated that the standard governing reparations under the Interstate

[672] *See* Exhibit No. SPL-4 at pp. 2-3 where Seminole witness Williamson stated that "[j]ust as with Mid-America, Enterprise [Products Partners, L.P.] has been responsible for Seminole's debt since Enterprise acquired the lines in 2002. Therefore, for the same reasons that I recommend using the parent capital structure for Mid-America starting with its acquisition by Enterprise, I believe the same would be true for Seminole."

[673] As of September 30, 2006, Enterprise Products Partners' long-term debt equaled $4,884,261,000, and its stockholders equity equaled $6,563,514,000, totaling $11,447,775,000. Exhibit No. S-3 at p. 62. Thus, the stockholders equity, divided by the total, yields an equity percentage of 57.33%. *Id.* Similarly, the long-term debt divided by the total, yields a debt percentage of 42.67%. *Id.*

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Commerce Act is as follows:

> If the Commission determines that the pipeline rates are not "just and reasonable," shippers who file complaints — and only those shippers — are entitled to the difference between the rates they paid and the rates the Commission retroactively determines to be just and reasonable. The period for potential reparations generally includes two years prior to the filing date of the complaint.

Williams Initial Brief at p. 83 (*quoting ExxonMobil v. FERC,* 487 F.3d 945, 962 (D.C. Cir. 2007)). Accordingly, assuming the just and reasonable rate is determined to be Williams' suggested rate of 78.56 cents per barrel, Williams claimed that Seminole owes it 20.29 cents plus interest for each barrel shipped on the Seminole Pipeline System from January 17, 2005 (the effective date of the FERC Tariff No. 3 rate — 98.85 cents), to the present. *Id.* at pp. 83-84.

1360. In reply, responding to Staff and Seminole, Williams asserted that, assuming the Mid-America/Seminole joint tariff is currently set at the maximum rate, to the extent the Seminole FERC Tariff No. 3 rate is unjust and unreasonable, the rate authorized by the Mid-America/Seminole joint tariff is necessarily unjust and unreasonable because Seminole FERC Tariff No. 3 was and is a rate component of the Mid-America/Seminole joint rate. Williams Reply Brief at p. 82. Thus, Williams submitted that shippers moving natural gas liquids under the joint tariff are entitled to refunds and it, as the only complainant, is owed reparations. *Id.*

1361. To conclude, Williams maintained that this proceeding will not determine a new, prospective rate; rather, it will establish, for the first time, a valid tariff and just and reasonable rate. *Id.* at pp. 83-84.

B. COMMISSION TRIAL STAFF

1362. Unlike Williams, Staff contended Seminole owes no reparations to Williams because no shipper has moved product under Seminole's FERC Tariff No. 3. Staff Initial Brief at p. 143. In fact, Staff asserted that shipping product under FERC Tariff No. 3 alone is technically impossible because it is an interstate tariff applicable to a pipeline system located wholly within the State of Texas. *Id.* at p. 144. Specifically, Staff claimed that FERC Tariff No. 3 establishes a rate as the Seminole component in the joint tariff with Mid-America, wherein any shipment originating on Mid-America that travels on Seminole's system to Mont Belvieu, Texas, is charged pursuant to that joint rate. *Id.* On the other hand, any shipment originating and terminating entirely on Seminole's line is charged Seminole's intrastate rates filed with the Texas Railroad Commission. *Id.* Consequently, no shipper has been charged under FERC Tariff No. 3. *Id.* at p. 145 (*citing* Transcript at p. 3134). Moreover, Staff insisted, Seminole owes no refunds

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because FERC Tariff No. 3 is currently in effect without suspension or refund obligation. *Id.* (*citing Williams Energy Servs., LLC v. Mid-America Pipeline Co., LLC,* 116 FERC ¶ 61,175 at PP 35-36 (2006)).

1363. In reply, Staff reasserted that, even were FERC Tariff No. 3 found to be unjust and unreasonable, Seminole will not owe any reparations or refunds to Williams or any other shipper because reparations must be determined by rates actually charged, and no shipper has ever shipped product pursuant to the FERC Tariff No. 3 rate. Staff Reply Brief at p. 118. It pointed out: "If the Commission determines that pipeline rates are not 'just and reasonable,' shippers who file complaints — and only those shippers — are entitled to the difference between *the rate they paid* and the rates the Commission retrospectively determines to be just and reasonable." *Id.* (*quoting ExxonMobil Oil Corp. v. FERC,* 487 F.3d at p. 962) (emphasis added by Staff)). Finally, Staff insisted that the rate which the Commission finds to be just and reasonable only applies prospectively, and reparations for prior charges may not be based on this prospective rate. *Id.* (*citing Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Railway Co.,* 284 U.S. at pp. 387-90).

C. SEMINOLE PIPELINE

1364. Similar to Staff, Seminole's argument is simple: it owes no refunds even if FERC Tariff No. 3 is found to be unreasonably high because no shipments have moved pursuant to the FERC Tariff No. 3 rate. Seminole Initial Brief at p. 201 (*citing* Exhibit No. WIL-2 at p. 10; Transcript at p. 3134). Furthermore, Seminole asserted, even had shipments moved under the tariff, any rate change resulting from this complaint would be prospective only. *Id.* at p. 201.[674]

1365. Seminole, in its Reply Brief, maintained that interstate movement is possible under FERC Tariff No. 3. Seminole Reply Brief at p. 164 n.104. Consequently, Seminole acknowledged that, were Williams to move product under FERC Tariff No. 3 prior to the Commission's institution of a new local rate (and assuming the Commission were to find the current rate to be too high), Williams would be owed reparations on those shipments. *Id.*

[674] In support, Seminole cited Interstate Commerce Act § 15(1), 49 U.S.C. app. § 15(1) (1998); *Arizona Grocery v. Atchison, Topeka & Santa Fe Railway Co.,* 284 U.S. at pp. 387-89.

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DISCUSSION AND RULING[675]

1366. Recently, the Circuit Court for the District of Columbia Circuit noted that the Interstate Commerce Act allowed the Commission to award reparations:

> The ICA permits reparations for successful challenges to the justness and reasonableness of existing rates . . . . If the Commission determines that the pipeline rates are not "just and reasonable," shippers who file complaints — and only those shippers — are entitled to the difference between the rates they paid and the rates the Commission retrospectively determines to be just and reasonable. The period for potential reparations generally includes two years prior to the filing date of the complaint.

ExxonMobil Oil Corp. v. FERC, 487 F.3d at p. 962.

1367. Not surprisingly, Williams argued that it is owed reparations from Seminole for each barrel shipped on the Seminole System from the effective date of the FERC Tariff No. 3, January 17, 2005,[676] to the present. Williams Initial Brief at p. 83. Noting that FERC Tariff No. 3 was, and is, a component of the Mid-America/Seminole joint rate, Williams claimed that, assuming the Mid-America/Seminole joint tariff is currently set at the maximum rate, to the extent the rate authorized by Seminole FERC Tariff No. 3 is unjust and unreasonable, the rate authorized by the Mid-America/Seminole joint tariff is necessarily unjust and unreasonable. Williams Reply Brief at p. 82. Thus, Williams continued, if the joint rate authorized by the Mid-America/Seminole joint tariff is unjust and unreasonable, shippers transporting natural gas liquids under the joint tariff are entitled to refunds, and Williams, as the only complainant, is owed reparations. *Id.* at pp. 82-83.

1368. Unlike Williams, Staff and Seminole contended that Seminole owes no reparations to Williams even were Seminole's FERC Tariff No. 3 found to be unreasonably high because no shipper, not even Williams, has moved product under that Tariff. Staff Initial

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[675] It must be noted that this issue deals solely with the question of whether Williams is entitled to reparations as a result of a finding that the FERC Tariff No. 3 rate is unjust or unreasonable. That it was unjust and unreasonable is discussed in Issue No. 12, *supra*. Nothing in the discussion of this Issue relates to the question of whether Williams is entitled to reparations should the joint Mid-America/Seminole tariff be determined to be unjust or unreasonable. That discussion is left for Issue No. 14, *infra*.

[676] Williams filed the complaint challenging the justness and reasonableness of the Seminole FERC Tariff No. 3 rate on March 6, 2006. Williams Initial Brief at p. 83. The date the FERC Tariff No. 3 rate became effective, January 17, 2005, falls within two years prior to the filing date, which is generally the period for potential reparations. *Id.*

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Brief at p. 143; Mid-America Initial Brief at p. 201. In fact, Staff declared that shipping product under FERC Tariff No. 3 alone is technically impossible because it is an interstate tariff applicable to a pipeline system located wholly within the State of Texas, as shipments originating on Mid-America which travel on Seminole's system to Mont Belvieu, Texas, move under a Mid-America/Seminole joint rate, and shipments originating and terminating entirely on Seminole's line move under the intrastate tariff which Seminole filed with the Texas Railroad Commission. Staff Initial Brief at p. 144. Contrary to Staff's assertion, Seminole acknowledged that shipments can move interstate under FERC Tariff No. 3 (as it explained under Issue No. 10). Mid-America Reply Brief at p. 164 n.104.

1369. As noted by the Court of Appeals for the District of Columbia Circuit, the Commission is permitted to award reparations to shippers that file a complaint against a rate and prove successful in their challenge in the amount of "the difference between *the rates they paid* and the rates the Commission retrospectively determines to be just and reasonable." *ExxonMobil Oil Corp. v. FERC,* 487 F.3d at p. 962 (*citing* 49 U.S.C. app. §16(3) (1988)). Upon being asked whether interstate barrels had been tendered under FERC Tariff No. 3, Seminole witness Collingsworth replied, "I know barrels haven't been moved on that rate." Transcript at p. 3134. More significantly, even Williams witness Olson testified that "FERC Tariff No. 3 went into effect in 2005 . . . . [and n]o barrels have been shipped on this tariff." Exhibit No. WIL-2 at p. 10.

1370. There does not seem to be any real dispute as to whether any product was shipped by Williams or any other shipper *solely* pursuant to FERC Tariff No. 3. Clearly, there was none. Accordingly, even though I have determined that FERC Tariff No. 3 may be unjust or unreasonable, no reparations can be awarded as a result of this finding. However, that begs the question as the more significant inquiry is whether reparations should be awarded should the Mid-America/Seminole joint tariff be determined to be unjust or unreasonable. That discussion is left for Issue No. 14, *infra*.

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ISSUE NO. 14: IF THE TARIFF NO. 3 RATE IS UNJUST AND UNREASONABLE, HOW SHOULD THE MID-AMERICA/SEMINOLE JOINT RATES[677] TO GROUP 950 DESTINATIONS BE ADJUSTED?

A. WILLIAMS

1371. According to Williams, the Mid-America/Seminole joint tariff rate to Group 950 should be decreased by 20.29 cents per barrel. Williams Initial Brief at p. 84. Essentially, Williams explained, the difference between the current Seminole rate of 98.85 cents per barrel and Williams' recommended just and reasonable rate of 78.56 cents per barrel yields 20.29 cents per barrel. *Id.* As a result, Williams argued that the Mid-America/Seminole joint tariff rate should be decreased to 429.63 cents per barrel (the sum of the Mid-America local rate and the 78.56 Seminole local rate). *Id.* Finally, Williams added that it should be awarded the difference with interest in the joint rate back to March 6, 2004. *Id.*

1372. In its Reply Brief, Williams argued that because FERC Tariff No. 3 was never valid, and thus, in effect, never existed,[678] the determination of a valid tariff authorizing a joint and reasonable rate in this proceeding is not prospective rate relief. Williams Reply Brief at p. 85. Williams explained that Seminole took a contrary position; specifically, that "[t]o the extent any of the Mid-America joint rates exceed the sum of the Seminole local rate (as so revised) and the Mid-America local rates, Mid-America would be required to lower those joint rates prospectively, . . . and [these joint rates] remain just and reasonable until they exceed the sum of the local rates which will only occur, if at all, only when the Commission directs Seminole to lower its local rate prospectively." *Id.* at

[677] Unlike Issue No. 13 which solely addressed the question of whether reparations should be awarded as a consequence of a finding that FERC Tariff No. 3 was unjust or unreasonable, this issue addresses the question of whether reparations should be awarded as a consequence of a finding that the Mid-America/Seminole joint rate is unjust or unreasonable. According to Seminole, the only Mid-America joint rates that are currently equal to the sum of Mid-America's and Seminole's local rates and are likely to be affected if the Seminole local rate were required to be lowered are the joint rates for movements from Groups 100-104 on the Rocky Mountain System to the Mont Belvieu, Texas, area destination on Seminole (Group 950). Mid-America Initial Brief at p. 202. The joint rates for those movements were established by Mid-America's FERC Tariff No. 45. *Id*.

[678] Williams' argument in this regard already has been rejected by the Commission and need not be discussed here any further. *See Williams Energy Services, LLC and Williams Power Co., Inc. v. Mid-America Pipeline Co., LLC and Seminole Pipeline Co.*, 116 FERC ¶ 61,175 at P 37.

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pp. 84-85 (*quoting* Mid-America Initial Brief at p. 202). Williams submitted that, Seminole's position, in effect, allows it to submit an invalid tariff and an admittedly unreasonable rate that, when challenged, would allow it to reject refund of the admittedly unreasonable rate on the basis that any rate relief would be prospective. *Id.* at pp. 85-86. Thus, Williams recommended, because the Interstate Commerce Act and due process do not countenance such a scheme, that the Mid-America/Seminole joint rates to Group 950 should be reduced by 20.29 cents per barrel. *Id.* at p. 86.

1373. Next, Williams asserted that reparations are proper. *Id.* In response to Seminole's claim that "no reparations are due because Williams filed a protest rather than complaint against the joint rates," Williams insisted that it indeed filed a "Complaint" challenging the Mid-America/Seminole joint rates, as well as the underlying local rates. *Id.* at pp. 86-87 (*citing Williams Energy Servs., LLC and Williams Power Co., Inc. v. Mid-America Pipeline Co., LLC and Seminole Pipeline Co.,* 116 FERC ¶ 61,175 at P 2)). Continuing, Williams added that, while several of its allegations were dismissed by the Commission, the Commission did not dismiss or otherwise rule upon the Williams challenge to the joint rate. *Id.* at p. 87.

B. COMMISSION TRIAL STAFF

1374. Staff maintained that a just and reasonable joint rate must be less than or equal to the sum of the local interstate rates currently effective for that route. Staff Initial Brief at p. 145.[679] Thus, Staff asserted that Mid-America must adjust its joint rates only to the extent that the Commission establishes a new, lower Seminole rate, and only if the sum of the new rate and the local Mid-America rates is lower than the currently effective joint rate. *Id.* at p. 146.

1375. Moreover, even in the event that the Commission ultimately directs Mid-America to lower the joint rate under its joint rate policy, according to Staff, Williams should not be given reparations under the joint rate. *Id.* at p. 147. In determining whether Williams is owed reparations, Staff argued, the Commission would need to decide that the Mid-America/Seminole joint tariff as a whole is unjust and unreasonable.[680] *Id.* Because the record does not contain this information, Staff argued that there can be no finding that the joint tariff is unjust and unreasonable. *Id.* at pp. 147-48.

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[679] In support, Staff cited *Mid-America Pipeline Co., LLC,* 111 FERC ¶ 61,128 at P 23; *Big West Oil Co. v. Frontier Pipeline Co.,* 94 FERC ¶ 61,339 at p. 62,259 (2001); *Express Pipeline, LLC,* 104 FERC ¶ 61,207 at P 8; *Chevron Pipe Line Co.,* 115 FERC ¶ 61,173 at P 6 (2006).

[680] In support, Staff cited *Patterson v. Louisville & Nashville Railroad Co.*, 269 U.S. 1, 10 n.2 (1925).

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1376. In reply, Staff maintained that all parties to this proceeding agree Mid-America must adjust its joint rates with Seminole to the extent the joint rates exceed the sum of the local Mid-America rates and the FERC Tariff No. 3 rate determined to be just and reasonable in this proceeding. Staff Reply Brief at p. 120.

1377. With respect to refunds, Staff concurred with Seminole and asserted that the Commission can only lower the FERC Tariff No. 3 rate prospectively in this proceeding, and consequently, Mid-America can only adjust its joint rate prospectively to reflect the new local Seminole rate. *Id.* at p. 121. It asserted, therefore, that Mid-America will owe no refunds associated with the joint rates. *Id.*

1378. Similarly, with respect to reparations, Staff declared that Williams is owed no reparations associated with the Mid-America joint rates. *Id.* at p. 122. Specifically, it claimed that, because the Commission's Order, dated August 24, 2006, dismissed Williams' complaint against Mid-America's local and joint rates and set for hearing only the lawfulness of the FERC Tariff No. 3 rate,[681] Williams does not have a complaint proceeding that would provide a legal basis for reparations attributable to the Mid-America joint rates under the Interstate Commerce Act. *Id*.

C. SEMINOLE PIPELINE

1379. Seminole declared that it agreed with Staff, stating that Mid-America will be required to lower its joint rates prospectively only to the extent that any of the Mid-America joint rates exceed the sum of the Seminole local rate and the Mid-America local rates. Seminole Initial Brief at p. 202.[682] According to Seminole, the Commission suspended the new joint rates in FERC Tariff No. 45,[683] subject to refund, on September 15, 2006. *Id.* at p. 203.[684] Yet opined Seminole, even if the Seminole local rate is

[681] In support, Staff cited *Williams Energy Services, LLC v. Mid-America Pipeline Co., LLC,* 116 FERC ¶ 61,175 at P 23, 39.

[682] In support, Seminole cited: *Texas Pipeline, Inc.*, 72 FERC ¶ 61,313 (1995); *Express Pipeline, LLC*, 104 FERC ¶ 61,207 at pp. 61,717-18 (2003); *Williams Energy Services, LLC v. Mid-America Pipeline Co., LLC*, 116 FERC ¶61,175 at P 18; *Mid-America Pipeline Co., LLC*, 117 FERC ¶ 63,013 (2006).

[683] FERC Tariff No. 45 established the Mid-America joint rates for movements from Groups 100-104 on the Rocky Mountain System to Group 950 — Mont Belvieu area. Seminole Initial Brief at p. 202. Seminole contended that this would be the only Mid-America joint rate that would be affected if the Seminole local rate were required to be lowered. *Id.* at pp. 202-03.

[684] In support, Seminole cited *Mid-America Pipeline Co.,* 116 FERC ¶ 61,249.

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required to be reduced and the joint rates with Mid-America are reduced, Mid-America will not be required to pay refunds because the Seminole local rate may be lowered only prospectively (as it argued under Issue No. 13). *Id.* In any event, claimed Seminole, Mid-America owes no reparations because Williams filed a protest, not a complaint, against the joint rates. *Id.*[685]

DISCUSSION AND RULING

1380. To the extent that FERC Tariff No. 3 is unjust or unreasonable, the issue becomes whether the sum of the new, just and reasonable rate and the local Mid-America rates is lower than the currently effective joint rate — Mid-America's FERC Tariff No. 45.[686]

1381. "The Commission's policy has been that a joint rate is just and reasonable if it is less than or equal to the sum of the individual tariff rates for that movement currently on file with the Commission." *Mid-America Pipeline Co., LLC,* 111 FERC ¶ 61,128 at P 23; *see also Big West Oil Co. v. Frontier Pipeline Co.,* 94 FERC ¶ 61,339 at p. 62,259 (2001); *Express Pipeline, LLC,* 104 FERC ¶ 61,207 at P 8; *Chevron Pipe Line Co.,* 115 FERC ¶ 61,173 at P 6. It follows from this that, should one rate component of the joint rate be lowered by Commission decision, the joint rate too must be lowered if the sum of the new rate and the other effective rate components is lower than the currently effective joint rate.

1382. According to Williams, the Mid-America/Seminole joint tariff rate to Group 950 should be decreased by 20.29 cents per barrel (the difference between the current Seminole rate of 98.85 cents per barrel and Williams' recommended just and reasonable rate of 78.56 cents per barrel). Williams Initial Brief at p. 84. Finally, Williams argued that it is owed reparations and rejected Seminole's claim that it did not file a complaint against the joint rates. *Id.* at pp. 86-87.

1383. Seminole and Staff agreed that the just and reasonable joint rate must be less than or equal to the sum of the local interstate rates currently effective for that route. Staff Initial Brief at p. 145; Mid-America Initial Brief at p. 202. Thus, they both asserted,

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[685] In support, Seminole cited *Mid-America Pipeline Co.,* 116 FERC ¶ 61,249 at P 5.

[686] According to Seminole, the only Mid-America joint rates that are currently equal to the sum of Mid-America's and Seminole's local rates and are likely to be affected if the Seminole local rate were required to be lowered are the joint rates for movements from points on the Rocky Mountain System (Groups 100-104) to the Mont Belvieu, Texas, area destinations on Seminole (Group 950). Mid-America Initial Brief at p. 202. The joint rates for those movements were established in Mid-America's FERC Tariff No. 45. *Id.*

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Mid-America must lower its joint rates only to the extent that the Commission establishes a new, lower Seminole rate, and the sum of the new rate and the local Mid-America rates is lower than the currently effective joint rate. Staff Initial Brief at p. 146; Mid-America Initial Brief at p. 202.

1384. With respect to reparations, Seminole contended, and Staff concurred, that Mid-America owes Williams no reparations because Williams allegedly filed a protest, not a complaint, against the joint rates. Mid-America Initial Brief at p. 203 (*citing Mid-America Pipeline Co.,* 116 FERC ¶ 61,249 at P 5).

1385. With respect to refunds, Staff and Seminole agreed that, while the Commission suspended the new joint rates in FERC Tariff No. 45, subject to refund, Mid-America will not be required to pay refunds. Staff Reply Brief at p. 121; Mid-America Initial Brief at p. 203. Specifically, Seminole maintained that the joint rates remain just and reasonable until they exceed the sum of the local rates, which will occur, if at all, only when the Commission directs Seminole to lower its local rate prospectively (as it argued under Issue No. 13). Mid-America Initial Reply Brief at p. 165. Consequently, Seminole insisted that no refunds are available against the joint rate unless and until the local rate is lowered. *Id.*

1386. The first question which must be addressed is whether Williams filed a "complaint" or a "protest." In fact, it filed both. The Commission, in its August 24, 2006, order reported as follows: "On March 6, 2006, Williams . . . filed a complaint . . . ." *Williams Energy Services, LLC and Williams Power Co., Inc. v. Mid-America Pipeline Co., LLC and Seminole Pipeline Co.*, 116 FERC ¶ 61,175 at P 1. Furthermore, the Commission stated that "Williams alleges that [Mid-America's and Seminole's] joint rates, as well as the underlying local rates are unjust, unreasonable, unduly discriminatory, or otherwise unlawful." *Id.* at P 2. It also noted that, *inter alia*, the following issue specifically was stated by Williams: "Whether the joint rates charged by [Mid-America] and Seminole for transportation from Groups 100, 105, and 110 to Group 950 are unjust and unreasonable." *Id.* at P 11. More significantly, the Commission stated:

> Although Seminole's local rate was properly established . . . , the justness and reasonableness of Seminole's local rate has not been determined. Seminole's local rate is not grandfathered pursuant to the provisions of the EPAct and may be challenged by a complaint based on "reasonable grounds" for believing that the rate is unlawful. *Because Seminole's local rate is one underlying component of [Mid-America's] joint rate, the level of the Seminole local rate is relevant to determining the appropriate level of [Mid-America's] joint rate.* The Commission finds that Williams has stated reasonable grounds for believing that Seminole's local rate is unlawful. Accordingly, the Commission will set Seminole's FERC

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> Tariff No. 3 for hearing and will consolidate it with the ongoing proceeding in Docket No. IS05-216-000, *et al.* At the hearing, Complainant Williams will bear the burden of showing that the rate is not just and reasonable.

Id. at P 39 (footnote omitted; emphasis supplied).[687] Thus, it is quite clear that Williams did file a complaint,[688] that the Mid-America/Seminole joint rate is at issue here,[689] and that, should Williams carry its burden of proof, it is entitled to reparations. The Seminole/Staff argument that Williams is not a complainant and is not entitled to reparations because it did not file a complaint is, in fact, so totally without merit as to be ludicrous.

1387. Having made that determination, the next question is whether Williams is entitled to reparations. In deciding Issue No. 12, I established a formula which I determined will result in a just and reasonable Seminole local rate. Should the compliance filing, which Mid-America and Seminole will be required to make after this Order becomes final, result in an actual joint rate which is less than the rate which Williams has been charged for the period beginning January 17, 2005,[690] and ending September 18, 2006,[691] then it follows that the joint rate established by FERC Tariff No. 42 also is unjust and unreasonable. Therefore, should that be the case, Williams is entitled to reparations in the amount of the difference between the FERC Tariff No. 42 rate and the just and reasonable rate calculated pursuant to the formula set out in Issue No. 12 multiplied by the number of barrels it shipped during that period. *ExxonMobil Oil Corp. v. FERC,* 487

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[687] For Staff and Seminole to ignore this Commission order addressing Williams' complaint and to focus on Williams' protests is, at best, shortsighted.

[688] In addition to filing its complaint, Williams did protest against Mid-America's March 31, 2005, May 20, 2005, March 31, 2006, and August 18, 2006, tariff filings. *See Mid-America Pipeline Co., LLC*, 111 FERC ¶ 61,128; *Mid-America Pipeline Co., LLC*, 111 FERC ¶ 61,483 (2005); *Mid-America Pipeline Co., LLC*, 115 FERC ¶ 61,124; *Mid-America Pipeline Co., LLC*, 116 FERC ¶ 61,249.

[689] That FERC Tariff No. 45 replaced FERC Tariff No. 42 (*Mid-America Pipeline Co.*, 116 FERC ¶ 61,249) is irrelevant to this question.

[690] Williams filed its complaint on March 6, 2006, and would be entitled to reparations for two years before that date. *Williams Energy Services, LLC and Williams Power Co., Inc. v. Mid-America Pipeline Co., LLC and Seminole Pipeline Co.*, 116 FERC ¶ 61,175 at P 1. However, the joint rate did not become effective until January 17, 2005. Exhibit No. SPL-1 at p. 3.

[691] The effective date of FERC Tariff No. 45. *See Mid-America Pipeline Co.*, 116 FERC ¶ 61,249 at P 1.

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F.3d at p. 962.

1388. Moreover, as the period to which Williams is entitled to reparations terminated on the date when FERC Tariff No. 45 replaced FERC Tariff No. 42 pursuant to the September 18, 2006, Commission's September 15, 2006, Order, Williams is entitled to refunds from that date forward. *Mid-America Pipeline Co., LLC*, 116 FERC ¶ 61,249 at P 14.

ORDER

1389. IT IS ORDERED, subject to review by the Commission on exceptions or on its own motion, as provided by the Commission's Rules of Practice and Procedure, that within thirty (30) days of the issuance of the final order of the Commission in this proceeding, Mid-America Pipeline Company, LLC, and Seminole Pipeline Company shall file revised Tariff sheets in accordance with the findings and conclusions of this Initial Decision, as adopted or modified by the Commission;

1390. IT IS FURTHER ORDERED, subject to review by the Commission on exceptions or on its own motion, as provided by the Commission's Rules of Practice and Procedure, that within thirty (30) days of the issuance of the final order of the Commission in this proceeding, Mid-America Pipeline Company, LLC, and Seminole Pipeline Company shall calculate and distribute reparations and refunds in accordance with the findings and conclusions of this Initial Decision, as adopted or modified by the Commission

EDWARD M. SILVERSTEIN
Presiding Administrative Law Judge

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