154 FERC ¶ 61,070
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Seaway Crude Pipeline Company LLC		Docket No. IS12-226-002

OPINION NO. 546

ORDER ON INITIAL DECISION ON REMAND

(Issued: February 1, 2016)

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Before Commissioners: Norman C. Bay, Chairman;
Cheryl A. LaFleur, Tony Clark,
and Colette D. Honorable.

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1. On May 9, 2014, the Presiding Administrative Law Judge (ALJ or Presiding Judge) issued an Initial Decision on Remand in the above-captioned proceeding.[1] The Initial Decision on Remand followed the issuance of the Commission's Order on Initial Decision and Remand for Further Action,[2] which reversed an earlier Initial Decision by the Presiding Judge[3] and remanded for action consistent with the Order.

2. The Commission reverses, in part, and affirms, in part the Initial Decision on Remand. The Commission finds that the Presiding Judge failed to follow the mandate of the Remand Order concerning Seaway's committed rates. The Presiding Judge also erred in other rulings concerning Seaway's initial rates, as detailed below.

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[1] *Seaway Crude Pipeline Co. LLC*, 147 FERC ¶ 63,009 (2014) ("Initial Decision on Remand").

[2] *Seaway Crude Pipeline Co. LLC*, 146 FERC ¶ 61,151 (2014) ("Remand Order").

[3] *Seaway Crude Pipeline Co. LLC*, 144 FERC ¶ 63,026 (2013) ("Initial Decision").

I. Background

3. On April 13, 2012, Seaway[4] filed FERC Tariff No. 2.0.0 in order to establish initial rates, effective May 14, 2012.[5] Pursuant to 18 C.F.R. § 342.2(b), Seaway filed an affidavit stating that the new rates set forth in Seaway FERC Tariff No. 2.0.0, Item 30, had been agreed to in writing by a non-affiliated shipper who intended to use the service set forth in the tariff.

4. On April 30, 2012, several parties filed motions to intervene in this proceeding, including Cenovus Energy Marketing Services Ltd., Apache Corporation, Chevron Products Company and Noble Energy Inc. ("ACN"), Nexen Energy Marketing U.S.A. Inc.; MEG Energy Corp., the Canadian Association of Petroleum Producers ("CAPP"); Suncor Energy Marketing Inc., Canadian Natural Resources Limited, and Denbury Onshore LLC (hereinafter jointly referred to as "Suncor"); the Independent Petroleum Association of America ("IPAA"); and EnCana Marketing USA. One party, Chesapeake Energy Marketing, Inc., filed a comment in support of the tariff. Pursuant to section 343.3 of the Commission's regulations, five protests were filed by various interested parties.

5. On May 11, 2012, the Commission accepted and suspended Seaway's tariff records, subject to refund and conditions, and established hearing procedures to address all issues raised by the filing.[6] In the Hearing Order, the Commission found that Seaway had complied with the Commission's regulations in establishing initial rates (18 C.F.R. § 342.2(b)). However, the fact that protests had been filed meant that Seaway had to submit cost-of-service data in accordance with Commission Rule 342.2(a), 18 C.F.R. § 342.2(a), and Order No. 561. The Commission concluded that there was insufficient data in Seaway's filing to resolve the issues raised by Seaway's filing. The Commission therefore established a hearing to investigate all issues raised by the filing, including but not limited to, those initially raised by the protesters.

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[4] Seaway is owned fifty percent by Enterprise Products Partners L.P. (Enterprise) and fifty percent by Enbridge Inc. (Enbridge). Enbridge purchased its share of Seaway from ConocoPhillips Company (ConocoPhillips) in November of 2011. Initial Decision on Remand, 147 FERC ¶ 63,009 at P 2.

[5] Seaway Crude Pipeline Company LLC, FERC Oil Tariff, Tariffs – LLC; Rates, Rules, & Regs, FERC No. 2.0.0, 2.0.0.

[6] *Seaway Crude Pipeline Company LLC*, 139 FERC ¶ 61,109 (2012) (Hearing Order).

6. On December 12, 2012, in Docket No. OR13-10-000, Seaway filed a petition for declaratory order ("PDO") requesting the Commission declare that Seaway's committed rates be governed by the pipeline's Transportation Service Agreement ("TSA"). The Commission denied this request on procedural grounds, yet reaffirmed its policy of upholding negotiated rates.[7]

7. On September 13, 2013, following an evidentiary hearing, an Initial Decision issued. Among other rulings, the Initial Decision found that Seaway's committed shipper rates, as established in the pipeline's Transportation Service Agreement ("TSA"), were unjust and unreasonable. On February 28, 2014, the Commission issued its Remand Order,[8] reversing the Initial Decision and remanding it for further action consistent with the Remand Order.

8. On May 9, 2014, the Presiding Judge issued an Initial Decision on Remand. Among other rulings, the Presiding Judge once again found that Seaway's committed raters were unjust and unreasonable. The Presiding Judge also eliminated a substantial portion of Seaway's proposed uncommitted rates associated with the costs of acquiring the Seaway pipeline.

II. <u>Are Seaway's Committed Shipper Rates at Issue?</u>

A. <u>Committed Shipper Rates</u>

9. In the Initial Decision on Remand, the Presiding Judge found that the circumstances of this proceeding merit the Commission's exercising its discretion and modifying Seaway's committed rates because, according to the Presiding Judge, the Commission in the Hearing Order required that all of Seaway's rates be cost-based.[9] The Presiding Judge further stated that Seaway's committed rates were unjust and unreasonable because the committed rates "are not based on cost-of-service data; rather they were determined through an open season process."[10] The Presiding Judge also stated that the committed rates will allow Seaway to "substantially over-recover its cost-

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[7] *Seaway Crude Pipeline Company LLC*, 142 FERC ¶ 61,201 (2013) (Order on PDO).

[8] Remand Order, 146 FERC ¶ 61,151.

[9] Initial Decision on Remand, 147 FERC ¶ 63,009, at P 48.

[10] *Id.* P 49.

of-service" and such an over-recovery is "inconsistent with the concept of just and reasonable rates that are required by the Commission's cost-based rate regulation."[11]

10. The Initial Decision on Remand stated that this proceeding presents a question of first impression as to agency policy when the negotiated rate revenues generated by the committed shipper contracts exceed the pipeline's overall cost of service.[12] The Presiding Judge identified this as involving "an interpretation of a novel question of law."[13] The Presiding Judge disagreed with the Commission's statement in the Remand Order that the committed TSA contract rates were not themselves an issue, but the hearing was intended to examine Seaway's uncommitted rate structure and the fairness of the open season process, arguing that the Hearing Order did not convey such an intention, and no participant understood that to be an intended purpose of the hearing.[14] The Presiding Judge instead argues that the Hearing Order required Seaway's negotiated rates to be cost-based.[15]

11. The Initial Decision on Remand held that while the committed shipper contracts "must be honored," a provision of the contract, Section 6.06, allows for the Commission to modify the committed rates.[16] Section 6.06 provides as follows:

> Government Modifications. Notwithstanding any other provision of this Agreement to the contrary, the Parties acknowledge that the tariff rates payable for all Services are subject to the approval of and modification by the FERC or any other Governmental Authority having jurisdiction.[17]

12. In addition to reiterating her ruling that the committed contract rates, insofar as they were not cost-based, were therefore unjust and unreasonable, the Presiding Judge disagreed with the Commission for issuing its Remand Order. The Presiding Judge argued that the Commission "does not have the authority to order an administrative law

[11] *Id.* P 50.

[12] *Id.* P 41.

[13] *Id.* P 44.

[14] *Id.* P 42.

[15] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 43.

[16] *Id.* PP 46-47.

[17] *Id.* P 46.

judge to change her findings as to the merits of an issue"[18] and is instead contravening the U.S. Supreme Court by "imposing external pressure" on the Presiding Judge to change her independent judgment.[19] The Presiding Judge goes on to state that the Commission's views on its own policies regarding negotiated rates are "baseless and inaccurate"[20] and that the Commission relied on a "post-hoc rationalization" for excluding the committed shipper rates from the Presiding Judge's consideration.[21]

13. In its brief on exceptions, Seaway criticizes the Presiding Judge's rulings concerning the validity of its committed rates and views as to the scope of independence enjoyed by administrative law judges. Seaway first argues that the Initial Decision on Remand erred in holding that the committed shipper rates are subject to a cost-of-service review.[22] Seaway argues that the Initial Decision on Remand failed to acknowledge that not all rates are required to be set on a cost-of-service basis.[23]

14. Seaway rejects the Presiding Judge's argument that issues concerning the open season were not viewed by any participant as being within the scope of this proceeding. Seaway states that it described the open season process in its direct testimony and showed that Seaway's committed rates were offered to all shippers through two well-publicized open seasons.[24] Seaway argues that the validity of Seaway's open season process was not included in the Joint Statement of Issues because no party challenged the validity of the open season in answering testimony or at hearing.[25] Seaway argues that the Statement of Issues was developed at the behest of the Presiding Judge, not the Commission, and therefore it is of no significance in terms of divining what the Hearing Order might have conveyed.[26]

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[18] *Id.* P 40.

[19] *Id.* P 40.

[20] *Id.* P 41.

[21] *Id.* P 42.

[22] Seaway Brief on Exceptions at 28.

[23] *Id.* at 28.

[24] *Id.* at 25, citing Ex. No. SEA-1 at 7-8; *see also* SEA-4 (a copy of the *pro forma* TSA).

[25] Seaway Brief on Exceptions at 25.

[26] *Id.* at 24.

15. Seaway also argues that the Commission has the unequivocal authority to require administrative law judges to issue decisions that comply with applicable law and Commission policy.[27] Seaway then states that the Initial Decision on Remand's reference to "the industry propaganda machine" is "unworthy of a neutral decision maker and fails to exhibit the impartiality required of a Presiding Judge by the Commission's regulations."[28]

16. In its brief on exceptions, Trial Staff states that it no longer maintains its earlier litigation position that the committed shipper rates are at issue.[29] In its Brief Opposing Exceptions, Trial Staff again states that committed rates are not at issue in this proceeding, yet argues that rates for uncommitted shippers should reflect the revenue earned from those committed rates.[30] Despite stating that it no longer calls for the Commission to modify Seaway's committed rates, Trial Staff continues to argue that Seaway's overall revenue is above its costs and therefore its negotiated rates are unjust and unreasonable. Trial Staff states that a failure to modify Seaway's committed rates would be an abandonment of the Commission's "traditional vigilance."[31] Trial Staff argues that because it believes Seaway's committed rates are no longer at issue, a crediting method is required to establish just and reasonable cost-based rates for uncommitted shippers.[32]

17. In its brief opposing exceptions, Suncor states that the most basic tenet of cost-based rate design is that customers should generally only be charged rates that fairly track the costs for which they are ultimately responsible.[33] Suncor argues that committed rates that are not established pursuant to the Commission's Opinion No. 154-B cost-of-service methodology are unjust and unreasonable.[34] Suncor argues throughout its briefs that

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[27] *Id.* at 12.

[28] *Id.* at 14, n.2, citing 18 C.F.R. § 385.504 (a) (2015).

[29] Trial Staff Brief on Exceptions at 4.

[30] Trial Staff Brief Opposing Exceptions at 6.

[31] *Id*. at 7.

[32] *Id.* at 8.

[33] Suncor Brief Opposing Exceptions at 9.

[34] *Id.* at 23.

Seaway's committed rates are the product of market power, and that any rate above a cost-of-service rate is de facto unjust and unreasonable.[35]

18. Suncor argues that it does not appear that the TSAs executed by shipper parties are the product of an open and balanced negotiation.[36] Suncor classifies the TSA rates as "take-it-or-leave-it" rates.[37] Suncor argues that it is "logical to infer" that the disparity in prices between Seaway's origin in Cushing, OK and its destination at the U.S. Gulf Coast created a high demand for Seaway's transportation service, which could allow Seaway to exercise market power.[38] Suncor states that Seaway's own actions provide evidence that its committed rates exceed a competitive level and reflect an exercise of market power.[39]

19. ACN in its brief opposing exceptions argues that it is not possible to calculate an uncommitted rate that does not provide Seaway with excessive returns.[40] ACN states that no shipper can elect to take committed service on Seaway at a cost-based "recourse" rate.[41] ACN also argues that the Presiding Judge enjoys a necessary level of decisional independence from the Commission on matters of fact.[42]

20. In this proceeding, we are presented with a question as to the extent to which the law requires the Commission to owe deference to administrative law judges when a Presiding Judge disagrees with, and therefore does not implement, well-established Commission policy. The Presiding Judge argues that administrative law judges ("ALJs") are independent, and must be completely free from any influence from the Commission.[43] However, as discussed in detail below, the Commission was well within its authority to

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[35] *Id.* at 22.

[36] *Id.* at 11.

[37] *Id.* at 12.

[38] *Id.*

[39] *Id.*

[40] *Id.* at 11.

[41] ACN Brief Opposing Exceptions at 11.

[42] *Id.* at 14.

[43] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 40, citing *Butz v. Economou*, 438 U.S. 478, 513 (1978).

remand the decision back to the Presiding Judge, along with clarification of Commission and legal precedent, with the expectation that the Presiding Judge will follow the law and policy.

1. **The Independence of a Presiding Administrative Law Judge**

21. Administrative law judges, sometimes known as hearing examiners, have a long history within the federal government. Under the Classification Act of 1923,[44] hearing examiners' tenure and status were determined by their particular agency, arguably placing the hearing examiners in a dependent status to the agency.[45] At the time, complaints were raised that these "dependent" hearing examiners were "mere tools of the agency."[46] Beginning in the 1930s, recommendations were made to separate the adjudicatory functions and personnel from investigative and prosecuting personnel in the agencies.[47] In 1941, the Attorney General's Committee on Administrative Procedure recommended that hearing examiners be made *partially* independent of the agency by which they were employed.[48] The Committee found that independence was best ensured by taking decisions regarding tenure and salary away from the Agency head,[49] while at the same time stating that "[c]onclusions, interpretations, law, and policy should, of course, be open to full review (by the Agency)."[50]

22. In 1946, Congress passed the Administrative Procedure Act ("APA").[51] With the APA, Congress intended to make hearing examiners a special class of semi-independent subordinate hearing officers by vesting control of their compensation, promotion and tenure in the Civil Service Commission to a much greater extent than in the case of other

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[44] 5 U.S.C.A. § 661 et seq. (2015).

[45] *Ramspeck v. Federal Trial Examiners Conference*, 345 U.S. 128, 130 (1953).

[46] *Id.* at 131.

[47] *Id*.

[48] ATTORNEY GENERAL'S COMMITTEE ON ADMIN. PROCEDURE (January 22, 1941), cited in *Ramspeck v. Federal Trial Examiners Conference*, 345 U.S. at 131.

[49] ATTORNEY GENERAL'S COMMITTEE ON ADMIN. PROCEDURE, p. 46.

[50] *Id.*, p. 51.

[51] Pub.L. 79–404, 60 Stat. 237 (1946).

federal employees.[52] The decisional independence of an ALJ , as protected by the APA, encompasses issues of tenure, compensation and performance appraisal exemptions.[53] To the extent a larger right of decisional independence exists, such a right would belong to the claimants whose rights are adjudicated by the ALJs rather than to the ALJs themselves.[54] Therefore, contrary to the arguments of the Presiding Judge, administrative law judges do not enjoy unlimited independence in their decision making. ALJs instead have a "qualified" right of decisional independence.[55]

23. There are defined limits to the extent to which ALJs may exercise this qualified right of decisional independence.[56] "An ALJ is a creature of statute and, as such, is subordinate to ((the Commission)) in matters of policy and interpretation of law."[57] Administrative Law Judges "remain entirely subject to the agency on matters of law and policy."[58] As the D.C. Circuit set forth in *Kugelman*:

> The basic concept of the independent administrative law judge requires that s/he conduct the cases over which s/he presides with complete objectivity and independence. In so operating, however, s/he is governed, as in the case of any trial court, by the applicable and controlling precedents. These precedents include the applicable statutes and agency regulations, the agency's policies as laid down in its *published* decisions, and applicable court decisions.
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> [O]nce an agency has ruled on a given matter, [moreover,] it is not open to reargument by the administrative law judge,…although an administrative law judge on occasion may privately disagree with the agency's treatment of a given

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[52] *Ramspeck v. Federal Trial Examiners Conference*, 345 U.S. at 132.

[53] *Nash v. Bowen*, 869 F.2d 675, 678 (2nd Cir. 1989).

[54] *Mahoney v. Donovan*, 824 F.Supp. 2d 49, 66 (D.D.C. 2011), citing *Goodman v. Svahn*, 614 F.Supp. 726, 728 (D.D.C. 1985).

[55] *D'Amico v. Schweiker*, 698 F.2d 903, 907 (7th Cir. 1983).

[56] *Mullen v. Bowen*, 800 F.2d 535, 540 n.5 (6th Cir. 1985).

[57] *Nash v. Bowen*, 869 F.2d 675, 680 (2nd Cir. 1989).

[58] *Mullen v. Bowen*, 800 F.2d at 540 n.5, *see also Iran Air v. Kugelman*, 996 F.2d 1253, 1260 (D.C. Cir. 1993), citing Antonin Scalia, *The ALJ Fiasco – A Reprise*, 47 U.Chi.L.Rev. 57, 62 (1979) (internal quotes omitted).

> problem, it is not his/her proper function to express such disagreement in his/her public rulings or decisions.[59]

When the Commission calls on an ALJ, on remand, to accept the agency's reading of the applicable law, the ALJ is bound to follow that instruction.[60]

24. The Presiding Judge cites to *Butz v. Economou* in support of her argument that the Commission unfairly threatened her judicial independence.[61] The case does not, however, support the argument that the Presiding Judge can ignore Commission policy and precedent. In *Butz*, the issue concerned the personal immunity of federal officials in the executive branch from claims for damages arising from their violations of citizens' constitutional rights.[62] The Supreme Court found that hearing officers enjoyed the same immunity as Article III judges in regards to damages claims.[63] The Court first rejected the argument that all federal officials have absolute immunity from any liability for damages even if in the course of enforcing relevant statutes they infringe on a citizen's constitutional rights, even if such infringement was done knowingly and deliberately.[64] The Court instead ruled that such officers have a qualified immunity.[65] The Court found that as a general rule, which has long prevailed, a federal official may not with impunity ignore the limitations which the controlling law has placed on his or her power.[66] The Court then stated that certain officers have "special functions" that require absolute immunity in certain instances.[67] Once such instance the Court cited was the need for

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[59] *Iran Air v. Kugelman*, 996 F.2d at 1260, citing Joseph Zwerdling, *Reflections on the Role of an Administrative Law Judge*, 25 Admin.L.Rev. 9, 12-13 (1973) (emphasis in original).

[60] *Iran Air v. Kugelman*, 996 F.2d at 1262.

[61] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 40, citing *Butz v. Economou,* 438 U.S. 478, 513 (1978).

[62] *Butz v. Economou*, 438 U.S. at 480 (1978).

[63] *Id.* at 511.

[64] *Id.* at 485.

[65] *Id.* at 486.

[66] *Id.* at 489.

[67] *Id.* at 508.

judges to enjoy absolute immunity from lawsuits claiming that their decisions had been tainted by improper motives.[68] If a civil action could be maintained against a judge by virtue of an allegation of malice, held the Court, judges would lose "that independence without which no judiciary can either be respectful or useful." Thus, judges were held to be immune from civil suit for malice or corruption in their action whilst exercising their judicial functions within the general scope of their jurisdiction.[69]

25. The Initial Decision on Remand focuses on statements in *Butz* that "the process of agency adjudication is currently structured so as to assure that the hearing examiner exercises his independent judgment on the evidence before him, free from pressures by the parties or other officials within the agency."[70] This statement, however, must be viewed in its proper context. The Court stated that prior to the APA, a hearing officer could not be expected to exercise independent judgment when they were required to perform prosecutorial and investigative functions as well as their judicial work, and because they were often subordinate to executive officials within the agency.[71] The Court then explains what procedures were put in place with the APA to guarantee the independence of hearing examiners. The Court ruled that these procedures limit the likelihood that bias will occur, and therefore complete immunity is of limited harm. Most relevant for the present proceeding, the Court found that the possibility of unlawful bias by a hearing examiner/ALJ was limited in the judicial process due in part to "the importance of precedent in resolving controversies" and "the correctability of error on appeal."[72] To do otherwise, held the Court, would be an exhibition of bias.

26. It is this statement that is the most relevant holding of *Butz* concerning the issues before the Commission in this proceeding. The Court held that the likelihood of a hearing examiner exhibiting bias is minimized by the requirement that the hearing examiner follow precedent, and be subject to correction.[73] Instead of supporting the argument that the Presiding Judge enjoys complete decisional independence, the holding in *Butz* further establishes that hearing examiners/ALJs must follow precedent.

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[68] *Id.*

[69] *Id.* at 509.

[70] *Id.* at 513.

[71] *Id.* at 513-14.

[72] *Id*. at 512.

[73] *Id*.

27. Suncor and ACN also present arguments in support of the Presiding Judge's decisional independence that, instead, undercut such claims of untrammeled independence. Suncor states that in *Kugelman* the D.C. Circuit held that an agency may not summarily reverse fact findings by an ALJ, and that agency determinations must be consistent with the ALJ's assessment of the facts of the proceeding.[74] Suncor's reading of the decision, however, is incomplete and inapplicable to the present case. In discussing agency authority to review ALJ findings of fact, the court in *Kugelman* was referring to that specific agency's authority to overturn ALJ findings of fact under section 2412 of the Export Administration Act of 1979. Further, the court held that even within the limits of section 2412 it was appropriate to remand a decision back to the ALJ, who was required to accept the agency's reading of statute as "the law of the case" which the ALJ was bound to follow.[75]

28. ACN cites to several cases, including *Butz v. Economou*, to support its argument that ALJs have decisional independence from the Commission.[76] ACN first cites to *Ramspeck v. Federal Trial Examiners Conference*. However, this case states that ALJs are "semi" independent, and that this independence is achieved not by allowing ALJs to ignore Commission policies, but by vesting control of their compensation, promotion, and tenure in the Civil Service Commission.[77] ACN also cites *Mahoney v. Donovan*, yet that case clearly states that an ALJ's rights are limited to the protection of compensation and tenure, and that any larger right of decisional independence belong to the claimants whose rights are adjudicated by the ALJs and not the ALJs themselves.[78]

29. ACN attempts to characterize the Presiding Judge's rulings on the issue of committed rates as matters of fact, to which ACN claims a higher degree of deference is owed.[79] ACN is incorrect. The Initial Decision on Remand makes clear that the issue of modifying Seaway's TSA committed rates involves "an interpretation of a novel question of law."[80] Indeed, the Presiding Judge stated that the issue "is a question of first

[74] Suncor Brief Opposing Exceptions, p. at 14, citing *Iran Air v. Kugelman*, 996 F.2d at 1262.

[75] *Iran Air v. Kugelman*, 996 F.2d at 1261-62.

[76] ACN Brief Opposing Exceptions at 14.

[77] *Ramspeck v. Federal Trial Examiners Conference*, 345 U.S. at 132.

[78] *Mahoney v. Donovan*, 824 F.Supp. 2d at 66.

[79] ACN Brief Opposing Exceptions at 14.

[80] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 44.

impression as to agency policy."[81] The Commission does not dispute that the revenue from Seaway's committed rates will exceed its overall cost of service. Instead, the Commission disputes the conclusions to be drawn from this fact, primarily whether that fact alone results in committed rates that are unjust and unreasonable.[82]

30. In *California Power Exchange Corp.*,[83] FERC Administrative Law Judge Warren H. Albrecht analyzed whether the determination of a just and reasonable rate is a conclusion of law or fact. Judge Albrecht decisively concluded that:

> The determination of whether rates and charges are just and reasonable must be a conclusion of law. It is the determination of a principle, of a rule of duty. It is not the determination of a fact. These words reflect the ultimate legal conclusion and opinion of the fact-finder and judge (or Commission). They are the ultimate standard to be reached under the Act.[84]

31. The Commission did not remand the instant case to the Presiding Judge with instructions to modify the factual findings of the case. The Commission instead directed the Presiding Judge to properly analyze those facts in accordance with well-established Commission policy. It is the duty of a presiding officer to conduct a fair and impartial hearing and to determine the matters justly under the law.[85] The actions of the presiding officer must be consistent with applicable law and policy.[86]

2. Remand Authority

32. The Presiding Judge states that while the Commission has the authority to reverse an Initial Decision, it does not have the authority to order an administrative law judge to change her findings as to the merits of an issue.[87] While this argument is based primarily on the Presiding Judge's erroneous views regarding the judicial independence of ALJs,

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[81] *Id.* P 41.

[82] *See New Orleans Public Service Inc. v. FERC*, 659 F.2d 509, 513 n.6 (5th Cir. 1981).

[83] 85 FERC ¶ 63,007 (1998).

[84] *Id*. at 65,120.

[85] 18 C.F.R. § 385.504(a)(1) (2015).

[86] 18 C.F.R. § 385.504(b)(20) (2015).

[87] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 40.

discussed *supra*, it also raises the issue of the Commission's authority to remand proceedings generally.

33. The Commission is wholly authorized to remand an initial decision back to the Presiding Judge with instructions to correct errors. Remand is an appropriate remedy for the Commission to employ to allow an ALJ the opportunity to remedy deficiencies and errors in an initial decision.[88] The Commission, consistent with the practices of other federal agencies, will issue an order on remand, whenever appropriate, that states the grounds for the remand and identifies dispositive abuses of discretion, errors of law, problems with conclusions of law and findings of fact, insufficiencies of evidence, and/or policy or procedural issues of concern to the Commission.[89] Procedurally, remand is appropriate when it is issued in accordance with the usual administrative review process, as occurred in this proceeding.[90]

34. In the uncommon instance where it considers a remand, the general rule the Commission follows is that remand is appropriate if enhancement of the record would be useful.[91] When there are sufficient unanswered questions in the record, or outstanding issues that must be resolved before a proper decision can be made, remand is appropriate.[92] Where instead the circumstances are that no useful purpose would be served by further administrative proceedings, or where the record has been fully

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[88] *Benecke v. Barnhart*, 379 F.3d 587, 593 (9th Cir. 2004).

[89] *See Ass'n of Admin. Law Judges, Inc. v. Heckler*, 594 F.Supp. 1132, 1133 (D.D.C. 1984).

[90] *Nash v. Bowen*, 869 F.2d 675, 680 (2nd Cir. 1989). The measure at issue in *Nash* was a "Peer Review Program" that provided mandatory instructions to ALJs concerning the proper length of hearings and opinions, the amount of evidence required in specific cases, and the proper use of expert witnesses.

[91] *See Trunkline Gas Co.*, 87 FERC ¶ 61,146, at 61,603 (1999) ("[T]he Commission cannot reach a reasoned decision of this issue based on the existing record in this proceeding. The Commission, therefore, will remand the proceeding to the ALJ."); *see also Harman v. Apfel*, 211 F.3d 1172, 1178 (9th Cir. 2000). Enhancement is not limited to the reopening of the record, especially when there are sufficient facts in the record to correct the errors in the Initial Decision.

[92] *See id*.

developed, it is appropriate for the Commission to issue an order on initial decision.[93] An additional purpose of a remand, relevant in the present proceeding, is where the Commission identifies an error in analysis or understanding of well-established Commission policy. The desire to ensure a reasonable degree of uniformity among ALJ decisions is not only within the bounds of legitimate agency supervision, but is also encouraged.[94]

35. In this proceeding, the Commission properly reviewed the original Initial Decision. Upon determining that the Initial Decision contained several errors of law, and that several outstanding issues still needed to be resolved, the Commission properly remanded the Initial Decision back to the Presiding Judge. The Commission identified the legal errors and directed the Presiding Judge to provide an analysis consistent with the Commission's policies and precedent. The Commission did not direct the Presiding Judge to change any factual findings, and did not direct the Presiding Judge to deem Seaway's committed rates just and reasonable. The instructions were to follow well-established Commission policy, and to determine whether, in accordance with this policy, the committed rates should stand.

3. <u>Review of Committed Rates</u>

36. As discussed, the Presiding Judge ruled in the Initial Decision on Remand that committed rates, to be just and reasonable, must be cost-based.[95] The Commission reverses the Presiding Judge's determination that Seaway's committed rates must be modified to a cost-of-service level. The arguments set forth in the Initial Decision on Remand as to why the committed rates must be modified were rejected by the Commission in the Remand Order.[96] The Commission adopts this analysis of the Presiding Judge's arguments concerning the negotiated committed rates in the present Order. The Commission will, however, address arguments in the Initial Decision on Remand that either were not raised in the first Initial Decision, or otherwise require additional comment.

37. In ruling that Seaway's negotiated committed rates require modification, the Presiding Judge raises several arguments. The Presiding Judge argues that a committed rate that generates revenue in excess of a pipeline's cost of service is unjust and

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[93] *Benecke v. Barnhart*, 379 F.3d at 593.

[94] *Nash v. Bowen*, 869 F.2d at 680.

[95] Initial Decision on Remand, 147 FERC ¶ 63,009 at PP 49-50.

[96] Remand Order, 146 FERC ¶ 61,151 at PP 13-38.

unreasonable.[97] The Presiding Judge states that the Commission, in the Hearing Order, required that the committed rates be set at cost-of-service levels.[98] Subsequent statements by the Commission explaining that the hearing was to include an examination into the fairness of the open-season process are characterized by the Presiding Judge as nothing more than a "post-hoc rationalization" for excluding the committed shipper rates from the hearing.[99] The Presiding Judge also placed great importance on the belief that Seaway's committed rates raise unprecedented factual and legal circumstances, creating an issue of first impression not addressed in Commission precedent.[100] Finally, the Presiding Judge argued that the committed rate contracts themselves contain provisions that allow for rate modification, and therefore such modifications do in fact honor the contracts.[101]

38. In the Remand Order, the Commission wholly rejected the Presiding Judge's argument that the revenue earned from Seaway's negotiated rates cannot exceed the pipeline's cost of service.[102] The Commission also explicitly stated that the Hearing Order did not require that the committed rates be cost-based.[103] The Commission rejected the Presiding Judge's untenable argument that terms of the committed rate contract that allow for modification provide a justification for lowering Seaway's committed rates to a cost-of-service level solely due to committed rate revenue exceeding Seaway's cost of service.[104] The Commission reaffirms these conclusions and again reverses the Presiding Judge. In addition, the Commission will address new or refined arguments raised subsequent to the Remand Order concerning modification of Seaway's negotiated rates.

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[97] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 50.

[98] *Id.* P 50.

[99] *Id.* P 42.

[100] *Id.* P 41.

[101] *Id.* P 47.

[102] Remand Order, 146 FERC ¶ 61,151 at PP 23-38.

[103] *Id.* P 15 ("While the Hearing Order did require that Seaway provide cost-of-service data to support its tariff filing, it did not require that the committed rates be cost-based.").

[104] *Id.* P 21.

39. In the Initial Decision on Remand, the Presiding Judge states that neither the Hearing Order nor the Order on PDO conveyed that the hearing was intended to explore issues concerning Seaway's rate structure and the open season process.[105] The Presiding Judge also states that the parties did not understand contract formation to be an issue in this case, referencing its absence from the Joint Statement of Issues compiled by the parties.[106] The Presiding Judge claims that the issues of contract formation were therefore not at issue in this proceeding, and reference to such issues is merely a "post-hoc rationalization" by the Commission for excluding committed shipper rates from the Presiding Judge's consideration.[107]

40. The Presiding Judge's arguments concerning the scope of this proceeding are erroneous. The Commission first notes that, contrary to many statements from the participants, the Commission's ruling that the Presiding Judge's arguments for modifying Seaway's committed rates were improper did not result in the committed rates no longer being at issue. A proper review of these rates, including the circumstances involving their formation, remains within the scope of this proceeding. The Hearing Order established a hearing "to address all issues raised by the filing."[108] The Hearing Order specifically references issues normally addressed in the declaratory order process, such as the open season process, and held that these issues were within the scope of the hearing being established.[109] Given this, the Presiding Judge's argument that the open season was outside of the scope of the hearing is incorrect. The Commission did not include an exhaustive list of all issues properly within the scope of the hearing. To include such a list would hamper the fact-finding process, and would not allow unseen but relevant issues from being properly considered. As the Commission has explained:

> The Commission has limited time in which (and a limited record upon which) to make its preliminary analysis of a proposed rate (increase). Given these constraints, the Commission generally is not in a position to enumerate for the benefit of the parties all of the issues that, upon compilation of a more extensive

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[105] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 42.

[106] *Id.* P 42.

[107] *Id.* P 42.

[108] Hearing Order , 139 FERC ¶ 61,109 at P 5.

[109] *Id.* P 25.

> evidentiary record, may be relevant to a determination of the justness and reasonableness of the [proposal].[110]

In any matter set for hearing that involves negotiated contract rates, the formation of those contracts should be considered a relevant issue.

41. Although the Presiding Judge argued that the lack of specific language in the Hearing Order concerning the open-season negotiation process rendered it outside the scope of the hearing, the Presiding Judge found no such limitation concerning the negotiation process involving other aspects of the case, primarily when denying recovery of costs associated with the acquisition of Seaway. Although no explicit mention of arm's length transactions was made in the Hearing Order, the Presiding Judge still found it appropriate to strike hundreds of millions of dollars from Seaway's rate base based on her view of those negotiations. The Presiding Judge fails to explain why the absence of a specific reference in the Hearing Order to the negotiation process prevented an examination of the open season process, yet did not prevent (1) examining whether the transaction for acquiring Seaway was conducted at arm's length, and (2) eliminating hundreds of millions of dollars from Seaway's rate base upon the ruling that it was not. Yet, the Presiding Judge simultaneously found the mere suggestion that the hearing should have included a review of the committed-rate negotiation process as an after-the-fact, inappropriate and biased suggestion from the Commission. Why the Presiding Judge could review arm's length transactions for one issue but not another is not answered in the Initial Decision on Remand.

42. The Presiding Judge states that the parties did not understand contract formation to be an issue in this case, as it was not included in the Joint Statement of Issues. The fact that the Joint Statement of Issues did not reference the negotiation process is not relevant for determining the proper scope of the hearing. That the parties did not include this in the statement simply shows that they had no issue with the negotiation process. The Commission was clear in the Remand Order that the contract formation process was within the scope of this proceeding.[111] Further, ACN explicitly states that it challenged

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[110] *Entergy Serv., Inc.*, 105 FERC ¶ 61,003, at P 8 (2003), quoting *Cincinnati Gas & Elec. Co.*, 59 FERC ¶ 61,072, at 61,291 (1992).

[111] Remand Order, 146 FERC ¶ 61,151 at P 37 ("In setting the matter for hearing, the Commission sought an investigation into the open season and the contract formation process. The question was whether the process was open, transparent, and free of the traditional contract nullifiers such as fraud.").

the open season process in this proceeding, further casting doubt on the Presiding Judge's claim that no party saw the open season as within the scope of the hearing.[112]

43. ACN intimates in its brief opposing exceptions that the Commission's ruling prevents a party from challenging committed rates that conflicted with applicable law, precedent and policy.[113] This is not the case. The Commission has been consistent throughout this proceeding that the committed rates are properly within the scope of this hearing. It is the nature of that inquiry that is at issue. Arguments that go beyond the "applicable law, precedent and policy," were not proper. While ACN is correct in arguing that the Commission has the authority to review negotiated rates,[114] the argument that this authority must result in striking down any negotiated rate that is not cost-based is not accurate. ACN's argument, in essence that anything short of requiring negotiated rates to be set at cost-of-service levels equates to the Commission turning a blind eye to negotiated rates generally, is without merit.

44. In the Initial Decision on Remand, the Presiding Judge rejected the Commission's directive that this proceeding should be decided in accordance with the well-established policies on negotiated rates.[115] Instead, the Presiding Judge argues that this case presents a question of first impression as to agency policy where the revenue from negotiated rates alone exceeds the pipeline's overall cost of service.[116] The Presiding Judge refers to this as an "unprecedented factual circumstance" and finds that the Commission's ruling that she misconstrued long-held Commission policy was "baseless and inaccurate."

45. The Commission rejects the Presiding Judge's argument that this proceeding presents "unprecedented factual circumstances" that render it outside of the Commission's well-established policy on negotiated rates.[117] The Commission was well aware of the factual circumstances of this case when it issued both its Order on Petition for Declaratory Order (PDO) and the Remand Order. These orders, issued with full awareness that revenue from Seaway's committed rates alone exceeded its cost of service, made clear the appropriate law and policy to follow in this case.

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[112] ACN Brief Opposing Exceptions at 30.

[113] *Id.*

[114] ACN Brief Opposing Exceptions at 31-33.

[115] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 46.

[116] *Id*. P 41.

[117] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 41.

46. The Commission also finds little merit in the Presiding Judge's statement that parties could not find a past case where the specific factual situation of committed revenue exceeding the overall revenue requirement existed.[118] It is not surprising that limited case law exists which explicitly mentions committed revenue in relation to a pipeline's overall cost-of-service, for that fact is simply not relevant to the question of whether the rates are just and reasonable. The Presiding Judge's belief in the importance of this fact is predicated on an erroneous understanding of Commission law and policy; an understanding that was rejected in the Remand Order . The Presiding Judge's "unprecedented factual circumstances" would only be relevant if the Commission required a pipeline's overall revenue from its entire portfolio of rates to equal its overall cost of service. The Commission has made clear, however, that there is no such requirement. Thus, the Presiding Judge has failed to establish any relevance to the fact that Seaway's committed revenues exceed its cost of service.

47. While there is no precedent for modifying a contract rate based on the fact that committed revenue alone exceeds a pipeline's revenue requirement, there is extensive precedent that supports the Commission's policy that negotiated rates need not be cost-based, and that a pipeline's entire portfolio of rates can produce revenues that exceed its overall cost of service.[119] Whether through a combination of committed and uncommitted revenue, or through committed revenue alone, it is not at all unique that a pipeline's cost-of-service is exceeded by its revenues. For example, the Commission has authorized rate structures for oil pipelines that allow for up to 90 percent of a pipeline's capacity to be offered at premium rates which exceed the cost-of-service uncommitted rate.[120] In addition, oil pipelines may have settlement rates or market-based rates, either as part of a portfolio or as the sole rate, resulting in revenues exceeding costs. It is a mathematical certainty that any rate structure that includes rates set above cost-of-service levels will generate revenue in excess of the pipeline's costs. As discussed in the Remand Order, the Commission has a well-established policy of allowing rates under certain circumstances that exceed traditional cost-based rates.[121] The Presiding Judge failed to follow this precedent, despite its clear applicability to a proper review of

[118] *Id.*

[119] *See Marathon Oil Co. v. Trailblazer Pipeline Co.*, 111 FERC ¶ 61,236 (2005), cited in Remand Order, 146 FERC ¶ 61,151 at P 29; *see also Sunoco Pipeline L.P.*, 145 FERC ¶ 61,099 (2013) (approving premium service rates above cost-of-service rates).

[120] *See, e.g., Medallion Pipeline Co., LLC*, 150 FERC ¶ 61,156, at P 6 (2015), *Sunoco Pipeline L.P.*, 149 FERC ¶ 61,191, at P 8 (2014).

[121] Remand Order, 146 FERC ¶ 61,151 at P 24.

Seaway's rates. The Initial Decision on Remand is inconsistent with Commission policy on this matter.

48. An additional concern raised by the Presiding Judge's approach is her focus solely on the rate element of the TSAs. No mention is made as to the other provisions of the contracts. Thus, under the rulings of the Initial Decision on Remand, committed shippers would still be bound by their contractual obligations, but must pay the same cost-of-service rate as uncommitted shippers. The Initial Decision on Remand does not address the unjust, unreasonable, and discriminatory outcome of such an approach. The Initial Decision on Remand would create two groups of shippers, committed and uncommitted, paying the same cost-of-service level rate for different types of service. There is no mention in the Initial Decision on Remand of whether the committed rates can be annually adjusted under the Commission's indexing methodology, while uncommitted rates can be indexed. There is no mention whether committed shippers can bring a complaint alleging substantial divergence, as uncommitted shippers can, or whether such a complaint would need to meet a higher burden for contract modification. There is no mention of whether committed shippers must meet volume commitments while paying the same rate as uncommitted shippers without such obligations. ACN recognizes that the Initial Decision on Remand did not do away with any other contract provision associated with committed rates, including take-or-pay provisions.[122] To require that both committed and uncommitted rates be set using the same cost-of-service methodology, yet still require committed shippers and Seaway to follow the remaining terms and conditions of the contracts, would result in rates that are impermissible under the anti-discrimination provisions of the Interstate Commerce Act (ICA).

49. The Commission in the Remand Order provided additional guidance on the issue of the relationship between uncommitted cost-based and committed negotiated rates by analogizing the requirement for oil pipelines to provide a cost-based uncommitted rate to the Commission's requirement for gas pipelines to provide a cost-based recourse rate.[123] In the Remand Order, the Commission addressed the argument that potential market power could render Seaway's negotiated contract rates unjust and unreasonable.[124] The Commission referenced natural gas pipeline recourse rates as an example of how cost-based rates can alleviate market power concerns that may arise when allowing a pipeline without market-based rate authority to charge negotiated rates. The availability of a cost-based uncommitted rate is one requirement that ensures that negotiated rates remain just

[122] ACN Brief Opposing Exceptions at 35.

[123] Remand Order, 146 FERC ¶ 61,151 at P 31.

[124] Remand Order, 146 FERC ¶ 61,151 at P 30.

and reasonable, and further demonstrates why a negotiated rate above cost of service levels can still be just and reasonable.

50. While the Presiding Judge did not directly address the issue of recourse rates, Suncor and ACN argue that Seaway's uncommitted rates, and uncommitted rates generally, are not in fact analogous to natural gas pipeline recourse rates, in that they are not for the exact same service. ACN claims that under the Commission's Alternative Rate Policy Statement, natural gas pipelines may negotiate a rate with a shipper that exceeds a cost-based rate, but that authority is expressly conditioned on the availability of a cost-based 'recourse' rate for the same service. ACN states that natural gas recourse rates allow a shipper who is unable to negotiate what it believes to be a reasonable rate to receive <u>the same service</u> at a cost-based rate.[125] ACN cites to *Paiute Pipeline Co.* for the proposition that negotiated rates must be paired with cost-based rates for the exact same service.[126] ACN argues that shippers should be allowed to use committed service on Seaway at a cost-based recourse rate.[127] ACN and Suncor have essentially used the Commission's reference to natural gas recourse rates in the Remand Order to criticize the propriety of committed negotiated rates generally, arguing that all services provided by oil pipelines must be available at cost-based rates.[128]

51. The Commission first notes that these criticisms from ACN and Suncor, raised well after the hearing in this case concluded, could be considered an improper collateral attack on the Commission's long-standing policy of allowing non-cost based committed rates on oil pipelines, paired with cost-based uncommitted rates. Indeed, ACN's

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[125] ACN Brief Opposing Exceptions at 21, citing Alternative Rate Policy Statement *Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines*; *Regulation of Negotiated Transportation Services of Natural Gas Pipelines*, 74 FERC ¶ 61,076, *order granting clarification*, 74 FERC ¶ 61,194, *order on reh'g*, 75 FERC ¶ 61,024 (1996).

[126] 146 FERC ¶ 61,128 (2014) ("*Paiute*").

[127] ACN Brief Opposing Exceptions at 30. ACN states, incorrectly, that committed shippers are entitled to "special treatment" when shipper demand exceeds Seaway's capacity. As set forth in its tariff, Seaway's pro-rationing policy treats committed shippers and "regular shippers" (any shipper that has actual shipments throughout the base period) equally. Seaway does not offer so-called "premium service" that allows for shipments to avoid pro-rationing.

[128] *Id*.

argument goes beyond Seaway's rates, and instead holds that any negotiated rate that does not provide a cost-based alternative for the exact same service is impermissible. ACN and Suncor's arguments are also flawed on the merits, and not relevant to the issue of Seaway's rate structure or the propriety of modifying Seaway's committed rates.

52. The shippers' argument that Commission policy concerning negotiated rates for natural gas pipelines is directly applicable to oil pipelines is erroneous. Under the Alternative Rate Policy Statement, which sets forth the Commission's policies concerning negotiated rates on natural gas pipelines, negotiated rates are defined as rates derived from the outcome of discussions with individual shippers, i.e., rates available only on a shipper-by-shipper basis.[129] Rates generally available under a natural gas tariff are not negotiated rates.[130] Under the Commission's policies for negotiated rates on oil pipelines, and the common carriage requirements of the ICA, there are no such bi-lateral rates available only on a shipper-by-shipper basis. All rates and services must be made available to all shippers, and must be set forth in the oil pipeline's tariffs. Thus, negotiated rates, as that phrase is defined by the Commission for natural gas pipelines, simply do not exist in the same way for oil pipelines. Consequently, there is no requirement that the Commission's policies for negotiated rates on natural gas pipelines be applied precisely in the same manner on oil pipelines.

53. Given that the Commission's policy on natural gas pipeline negotiated rates and terms have a different statutory and regulatory framework from the Commission's policy with respect to committed rate contracts on oil pipelines, it is clear that ACN's attempt to directly apply the Commission's holding in *Paiute*, and the Commission's natural gas pipeline recourse rate policy generally, to committed rates on oil pipelines is without merit. The Commission has emphasized that the ICA is a distinctly different statute from the Natural Gas Act.[131] The argument that common carriage oil pipelines would be required to offer a cost-based alternative to discount rates associated with long-term volume commitments, or a cost-based alternative to premium service exempt from pro-rationing, raises serious discrimination concerns between differently-situated groups of shippers. For example, the Commission, in addressing premium service, has consistently held that a shipment exempt from pro-rationing must be valued higher than a shipment that is subject to pro-rationing in order to satisfy the anti-discrimination requirements of

[129] *Mississippi Canyon Gas Pipeline, LLC*, 94 FERC ¶ 61,390, at 62,468 (2001).

[130] *Id.*

[131] *See Tapstone Midstream, LLC*, 150 FERC ¶ 61,016, at P 16, n.12 (2015).

the ICA.[132] Adopting the shippers' argument that a cost-based recourse rate for premium service must be available, which does not allow for the value of a pro-rationing exemption to be included in cost-of-service, would arguably violate the anti-discrimination provisions of the ICA.

4. Criticisms of the Commission's Impartiality

54. The Presiding Judge implies that the Commission decision was "tainted" by external influences, primarily the influx of comments from industry actors in response to the original Initial Decision that first raised the prospect of changing the Commission's long-held policies on negotiated committed rates.[133] This charge is without merit. It is not surprising that a decision that calls into question the sanctity of committed rate contracts, which ignores long-held Commission policy, would generate interest from parties outside of the present proceeding. The Commission also does not generally exclude the public's ability to appropriately comment on issues of interest. Further, in its Order on Petition for Declaratory (PDO), issued well before any so-called external pressures arose, the Commission set forth its position on negotiated committed rates in the context of the present proceeding, and the Commission has maintained that position consistently throughout this proceeding.

55. Disagreements over law and policy are bound to occur from time to time between the Commission and Administrative Law Judges. While the Commission may disagree with a Presiding Judge's particular course of action, and expect that all decisions follow the relevant law as well as Commission precedent and policy, such actions are not meant to impugn the professionalism or motives of an individual ALJ.

B. Commission Determination

56. As detailed above, the Presiding Judge's ruling that Seaway's committed rates must be modified to a cost-based level, and the related arguments concerning judicial independence and the Commission's remand authority, are reversed.

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[132] *See Sunoco Pipeline L.P.*, 141 FERC ¶ 61,212 (2012). *Sunoco Pipeline L.P.*, 145 FERC ¶ 61,099 (2013), *Tesoro High Plains Pipeline Co. LLC & Tesoro Logistics Operations, L.L.C.*, 148 FERC ¶ 61,129 (2014)

[133] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 43.

III. What is the Appropriate Rate Period or Periods?

57. Under the Commission's regulations, an oil pipeline's base period must consist of 12 consecutive months of actual experience, adjusted for non-recurring expenses.[134] A test period consists of a base period adjusted for known and measurable changes occurring within 9 months after the last month of available actual experience.[135] A pipeline establishing rates for new service must use a test period based on a 12-month projection of costs and revenues.[136] The Commission may allow reasonable deviations from the prescribed test periods.

58. Seaway proposed a single test period of June 2012 through May 2013.[137] The Initial Decision on Remand affirmed that the test period in this case should be June 2012 through May 2013.[138] However, the Initial Decision on Remand ruled that rates should be based on 135,000 barrels per day (bpd) from June through December 2012 and 295,000 bpd for the post-expansion period of January through May 2013, due to an expansion of the pipeline occurring within the applicable test period.[139]

59. Seaway argues that a single test period should be used to assess the lawfulness of Seaway's initial uncommitted rates, and there is no valid basis to use a second test period to set new rates for periods after the effective date of the initial rates.[140] Seaway states that the Initial Decision on Remand appropriately held that Seaway's rate should be based on 135,000 bpd from June through December 2012 and 295,000 bpd for the post-expansion period of January through May 2013.[141] Seaway states that the record evidence shows that Seaway has not been able to move 400,000 bpd and does not expect to anytime soon.[142]

[134] 18 C.F.R. § 346.2(a)(1)(i) (2015).

[135] 18 C.F.R. § 346.2 (a)(1)(ii) (2015).

[136] 18 C.F.R. § 346.2 (a)(2) (2015).

[137] Seaway Brief on Exceptions at 27.

[138] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 65.

[139] *Id*.

[140] Seaway Brief on Exceptions at 31.

[141] Seaway Brief Opposing Exceptions at 10.

[142] *Id*.

60. Suncor argued that for a carrier that is establishing rates for a new service, the test period should be based on a 12-month projection of costs and revenues.[143] According to Suncor, Commission precedent clearly establishes that the goal in rate design is to set a rate that is most representative of going-forward costs and throughput.[144] As noted by Suncor, during its initial 12-month period, Seaway expanded its capacity from 135,000 bpd to 400,000 bpd in early January 2013.[145] Suncor proposes that Seaway's design capacity of 400,000 bpd be used for setting rates following the January 2013 expansion.[146]

61. ACN disagrees with the Presiding Judge that post-expansion capacity should be set at 295,000.[147] ACN claims that a pipeline that is filing initial rates has no historical throughput data.[148] ACN also states that Seaway does not have any historical volume data for its January 2013 expansion.[149] ACN proposes a "locked-in" period between June 2012 and December 2012 based on the pre-expansion design capacity of 135,000 bpd.[150] Going forward rates, according to ACN, should be based on post-expansion capacity of 400,000 bpd.[151]

62. Trial Staff argues that different rate periods for the pre- and post-expansion periods are necessary to calculate accurate rates, and that rates for the pre-expansion period should reflect costs and volumes from June 2012 through December 2012.[152] Trial Staff argues that post-expansion throughput should be 400,000 bpd, Seaway's

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[143] *Id.* at 24.

[144] *Id.* at 25.

[145] *Id.* at 26.

[146] *Id.* at 31.

[147] ACN Brief on Exceptions at 13.

[148] *Id.* at 15.

[149] *Id.* at 16.

[150] ACN Brief Opposing Exceptions at 37.

[151] *Id.* at 37.

[152] Trial Staff Brief Opposing Exceptions at 10.

annualized design capacity.[153] Trial Staff argues that 295,000 bpd is not representative of future throughput.[154]

A. <u>Commission Determination</u>

63. The Commission affirms the Initial Decision on Remand. Section 346.2(a)(3) of the Commission's regulations reflect the concept that at the time initial rates are filed for a new pipeline that has not become operational, the pipeline must necessarily rely on projected costs, revenues, and throughput. However, once the pipeline has commenced service and has gained operating experience, actual data represents a far better depiction of its costs than mere projections.[155] Commission precedent generally dictates the use of actual design capacity for initial rates on a new pipeline, and the pipeline is placed at risk for the cost of unsubscribed capacity based on actual capacity.[156] However, Commission policy does not support using data that is not likely to be representative of future throughput levels.[157] The Initial Decision on Remand adopted a post-expansion throughput that best represents future throughput levels.

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[153] Trial Staff Brief on Exceptions at 11-12.

[154] *Id.* at 13.

[155] *See, e.g., Transcontinental Gas Pipe Line Corp.*, 11 FPC 94, 106 (1952) (rejecting estimates of costs as based on speculation, and requiring claimed costs to be bottomed on actual costs); *Williston Basin Interstate Pipeline Co.*, 76 FERC ¶ 61,066, at 61,384 (1996) (noting that the Commission has found that actual costs during the test period generally reflect the best evidence of what a company can expect to incur in the future); *High Island Offshore System, L.L.C.*, 110 FERC ¶ 61,043, at P 49 (2005) (noting that the use of actual test period figures is consistent with Commission policy and precedent).

[156] *Enbridge Energy Co. Inc.*, 110 FERC ¶ 61,211, at P 44 (2005).

[157] *SFPP, L.P.*, Opinion No. 511, 134 FERC ¶ 61,121 at P 27, *aff'd on reh'g*, Opinion No. 511-A, 137 FERC ¶ 61,220 (2011).

IV. What Rate Methodology Should be Utilized?

A. Should Seaway's rates be calculated using a depreciated original cost or trended original cost methodology?

64. Seaway's cost of service calculations were based on the Commission's trended original cost ("TOC") methodology. In its reply testimony, Seaway offered an alternative calculation based on the depreciated original cost methodology ("DOC"). The Presiding Judge struck Seaway's reply testimony and exhibits containing the alternative DOC calculations, and they were subsequently submitted as an offer of proof.[158] The Initial Decision on Remand ultimately found that rates should be calculated using the TOC methodology.[159]

65. Suncor states that the Presiding Judge was correct that there was no evidence in the record supporting any method other than the trended original cost methodology.[160] ACN states that the DOC testimony was not proper rebuttal, in that all parties agreed with the TOC methodology.[161]

66. Seaway argues that the Initial Decision on Remand erred in striking Seaway's alternative proposal to justify its uncommitted rates using a depreciated original cost methodology.[162] Seaway states that the use of DOC in Seaway's alternative calculation did not change Seaway's filed uncommitted rates, but "simply justified those rates using an alternative method."[163]

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[158] Ex. ALJ-3 and ALJ-4.

[159] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 70.

[160] Suncor Brief Opposing Exceptions at 30.

[161] ACN Brief Opposing Exceptions at 46.

[162] Seaway Brief on Exceptions at 32.

[163] *Id.* at 34.

1. <u>Commission Determination</u>

67. The Commission affirms the use of the TOC methodology in this proceeding. TOC is the standard cost-of-service methodology for oil pipelines,[164] and was the methodology utilized by Seaway in its initial filing. While the Commission has allowed the use of DOC by oil pipelines,[165] TOC is the methodology that oil pipelines must use absent an express exception granted by the Commission.

B. <u>Should the Purchase Price Related to Enbridge's Acquisition of its Share of Seaway be Included in Rate Base?</u>

68. Enbridge completed its purchase of Seaway for $585 million. This amount, all parties agree, was well above the net book value of $59 million. Enbridge sought to recover the full purchase price of the acquisition, including the acquisition premium above and beyond Seaway's net book value. The Presiding Judge labeled the partnership between Enbridge and Enterprise a scheme orchestrated to override cost-based rate-making designed to prevent utilities buying properties from one another at a price higher than original cost in order to increase the cost of service to the customer.[166] The Presiding Judge stated that the transaction deserved strict scrutiny to ensure it was not a "sham transaction designed to unjustly enrich the partners in a blatant attempt to get what amounts to cost-of-service rates so elevated that they are in effect market-based rates."[167] The Presiding Judge ultimately found that Seaway did not meet its burden of showing that Enbridge's acquisition of Seaway was conducted at arm's-length, and therefore disallowed the acquisition premium.[168] The Presiding Judge raised additional concerns regarding the acquisition premium, finding that it was in fact Enbridge's premium and not Seaway's,[169] and that the acquisition was not for Seaway's assets but for a partial interest to overcome the "veto power" of the previous holder of the interest in Seaway.[170]

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[164] *Williams Pipe Line Co.*, Opinion No. 154-B, 31 FERC ¶ 61,377, at 61,834-35 (1985).

[165] *See TransCanada Keystone Pipeline*, *LP*, 125 FERC ¶ 61,025, at PP 34-38 (2008).

[166] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 109.

[167] *Id.*

[168] *Id.* P 113.

[169] *Id.* P 111.

[170] *Id.* P 112.

69. The Presiding Judge went on to analyze the remaining issues concerning the acquisition premium, yet stated that the analysis would be irrelevant if the Commission agreed with the ruling that the Enbridge purchase was not an arm's length transaction.[171] In determining whether to allow an acquisition premium, assuming the transaction was ruled to have occurred at arm's length, the Presiding Judge asked (1) whether the acquired facility is being put to a new use; and (2) whether the purchaser has demonstrated specific dollar benefits resulting directly from the sale.[172]

70. The Presiding Judge ruled that the reversal of flow of the Seaway pipeline from north to south was a new use.[173] The reversal of Seaway, ruled the Presiding Judge, provided a new transportation alternative that relieves the capacity shortage in Cushing, Oklahoma, and provided service to a larger group of new shippers.[174] The Presiding Judge also ruled that the Seaway reversal satisfied the substantial benefits test.[175] The Presiding Judge found that the cost savings derived from the reversal as compared to constructing a new pipeline, combined with the fact that the reversal occurred much earlier than would have new construction, sufficed to satisfy the Commission's substantial benefits test.[176]

71. In calculating the acquisition premium, the Presiding Judge excluded the goodwill portion of the purchase price from the acquisition adjustment.[177] The Initial Decision on Remand asserted that goodwill should be excluded from the acquisition premium because it is an "intangible value" that does not have a direct relationship to the acquired asset's original cost.[178] The Presiding Judge also found that Seaway failed to remove non-

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[171] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 114.

[172] *Id.* P 125; s*ee also Missouri Public Service Comm'n v. FERC*, 601 F.3d 581, 586 (D.C. Cir. 2010) (internal quotations omitted).

[173] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 127.

[174] *Id.* P 126. The Presiding Judge found that the number of shippers using Seaway increased from 14 to 125 after the reversal. *Id*.

[175] *Id.* P 145.

[176] *Id.* PP 143-44.

[177] *Id.* P 184.

[178] *Id.* P 152.

jurisdictional assets from rate base.[179] The Presiding Judge went on to allocate the Enbridge purchase price to the seven-month initial period as well as the five-month post-expansion period.[180]

72. In its brief on exceptions, Seaway argues that because the Enbridge purchase was responsible for the pipeline being put to a new use and providing substantial benefits to shippers, it meets the Commission's two-part test.[181] Seaway agrees with the Presiding Judge that the pipeline was put to a new use, stating that the Commission does not require a showing that the new use would not have occurred if the assets had not been purchased or that the prior owner could not also have put the asset to a new use if it had elected to do so.[182] Seaway argues that the Commission has held that a pipeline reversal constitutes a new use despite "minor overlap" in pre- and post-reversal shippers.[183]

73. Seaway also agrees with the Presiding Judge that the purchase resulted in substantial benefits to shippers by providing a new outlet for crude oil at Cushing at a significantly lower cost than would have been possible had an entirely new pipeline been built.[184] Seaway states that it recognized that purchasing and reversing Seaway would be less expensive than building a new line.[185] Seaway states that permitting inclusion of the acquisition premium in rate base encourages the efficient re-use of assets at lower cost than greenfield construction.[186] Seaway anticipated it would cost $1.32 billion to build a new 30-inch pipeline from Cushing to the Gulf Coast, which is approximately $150 million greater than the total carrier property in service of $1.17 billion included in Seaway's rate base, which includes (1) the amount that Enbridge paid to acquire its share of the Longhaul 30-inch system; (2) the depreciated original cost value of Enterprise's 50

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[179] *Id.* P 199.

[180] *Id.* P 211.

[181] Seaway Brief on Exceptions at 44.

[182] Seaway Brief Opposing Exceptions at 18.

[183] *Id.* at 21, citing *Enbridge Energy*, 110 FERC ¶ 61,211 at P 30.

[184] Seaway Brief Opposing Exceptions at 24.

[185] Seaway Brief on Exceptions at 37.

[186] Seaway Brief on Exceptions at 47.

percent share of Seaway, and (3) the incremental carrier property additions related to the reversal.[187]

74. Seaway states that shippers benefit by having access to the pipeline much earlier than if a new pipeline were constructed.[188] Seaway agrees with Trial Staff that the risks of delay related to constructing a new pipeline are many, including public opposition, right-of-way issues, and cost overruns.[189]

75. Seaway states that ConocoPhillips was unwilling to support a reversal of Seaway because the pipeline's northbound flow was serving a ConocoPhillips refinery in Oklahoma.[190] Therefore, argues Seaway, the purchase of ConocoPhillips' ownership interest was necessary in order to put the pipeline to a new use that benefitted shippers. As for the transaction, Seaway states that Enbridge had no reason to pay more for the purchase than necessary.[191] Seaway states that the record clearly shows that the parties bargained over the price and Enbridge ultimately paid less than what ConocoPhillips originally sought.[192] Seaway claims that there is no justification for assuming bad faith or improper dealing by a pipeline that seeks to recover its legitimate costs.[193] Seaway states that the Presiding Judge's speculation that Enterprise could have purchased ConocoPhillips' interest at perhaps a lower price is contrary to both the record evidence and basic economic principles.[194]

76. Seaway cites *Rio Grande*, in arguing that the Commission's rejection of an acquisition premium on the sole ground that the seller continued to own a share of the

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[187] Seaway Brief Opposing Exceptions at 24, citing Ex. SEA-26 at 13. With pump upgrades, the difference lowers to $124 million. Seaway Brief Opposing Exceptions at 29.

[188] Seaway Brief Opposing Exceptions at 25.

[189] Seaway Brief Opposing Exceptions at 26, citing Ex. S-1 at 7.

[190] Seaway Brief on Exceptions at 37.

[191] *Id.* at 37.

[192] *Id.* at 38.

[193] *Id.*

[194] *Id.* at 41.

new pipeline made "no sense" and was inconsistent with the two-part test.[195] Seaway argues that, unlike in *Longhorn*,[196] Enterprise was not the seller of the interest Enbridge acquired. The seller was ConocoPhillips, which did not retain any interest after the sale.[197] Seaway, citing *Rio Grande*, explains that the retention of some interest in the acquired facilities (by a prior owner) will reduce the cost basis included in (the pipeline's) rate base, which constitutes a better deal for the rate payer.[198] Seaway states that there is no requirement that an acquisition premium be for a majority interest in the pipeline at issue.[199] Seaway argues that, contrary to the Initial Decision on Remand's suggestion, Opinion No. 525 did not create any new threshold requirement that the purchaser must acquire title to the assets directly rather than acquiring an interest in the company that owns the assets.[200] Seaway states that it does not make economic sense to exclude the purchase price from rate base simply because the new owner purchases an equity interest in the company owning the assets rather than buying the assets directly.[201] Seaway argues that the Commission's two-part test does not depend on whether the purchaser acquires assets directly instead of acquiring the company that owns the assets.[202]

77. Seaway states that it would make no economic sense to permit a purchase price adjustment in rate base where 100 percent of the pipeline asset itself is acquired, but deny the adjustment where ratepayers receive the same benefit through acquisition of an equity interest at a substantially lower cost.[203] Seaway states that it is reasonable to assume that a purchase of a larger interest would have cost more than a smaller interest.[204] Seaway further states that it would be illogical and bad policy to reject a purchase price

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[195] *Id.* at 40, citing *Rio Grande Pipeline Co. v. FERC*, 178 F.3d 533 (D.C. Cir. 1999).

[196] *Longhorn Partners Pipeline*, 82 FERC ¶ 61,146 (1998).

[197] *Id.* at 39.

[198] *Id.* at 40-41.

[199] Seaway Brief on Exceptions at 44.

[200] *Id*. at 46.

[201] *Id.* at 46.

[202] *Id.* at 54-55.

[203] *Id.* at 41.

[204] *Id.*

adjustment that meets the Commission's two-part test simply because of the "magnitude" of the acquisition cost, since this would discourage large pipeline acquisitions and deny shippers the benefits of such projects.[205] Seaway claims that the Commission, in *Enbridge Pipelines (Southern Lights) LLC*, approved a similarly-sized acquisition premium.[206]

78. Seaway argues that well-established court and Commission precedent makes clear that where the Commission's two-part test is met, the pipeline is entitled to recover the full purchase price of an acquired asset, including goodwill, in its cost-of-service computations.[207] Seaway argues that, contrary to the finding of the Initial Decision, Opinion No. 511 did not purport to establish a different standard for inclusion of the goodwill portion of the purchase price in rate base.[208] Seaway explains that the amount assigned by Enbridge to goodwill for accounting purposes represents the difference between the purchase price and the amount attributed by Enbridge to the tangible assets using a depreciated replacement cost analysis that Enbridge developed after the acquisition.[209] Seaway argues that there is no basis to assume the purchase would have occurred at all if Enbridge had offered to pay only the approximately $527 million attributable to the estimated depreciated replacement cost of the identifiable tangible assets.[210] Seaway states that there is no legal basis for Trial Staff's proposal to exclude from rate base the portion of the purchase price attributed to goodwill by Enbridge for accounting purposes.[211]

[205] *Id.* at 43.

[206] *Id.*, citing *Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,310 (2007).

[207] *Id.* at 48, citing *Rio Grande*, 178 F.3d at 542; *Kinder Morgan Pony Express Pipeline LLC*, 141 FERC ¶ 61,180 at P 56, (2012); *Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,310 at P 38 (2007); *Missouri Interstate Gas, LLC*, Opinion No. 525, 142 FERC ¶ 61,195 at PP 1, 56-57 (2013); *Crossroads Pipeline Co.*, 71 FERC ¶ 61,076 at 61,262; (1995); *Natural Gas Pipeline Co. of America*, 29 FERC ¶ 61,073 at 61,150 (1984); *Cities Serv. Gas Co.*, 4 FERC ¶ 61,268 at 61,594 (1978).

[208] Seaway Brief on Exceptions at 54.

[209] *Id.* at 49.

[210] *Id.* at 50.

[211] Seaway Brief Opposing Exceptions at 33.

79. Seaway claims that it appropriately allocated the full purchase price, including goodwill, between the Longhaul 30-inch system and Seaway's other two systems based on economic value of those assets.[212] Seaway states that since only the Longhaul 30-inch system was reversed and put to a new use, there is no basis for the assumption that any portion of the purchase price above net book value should be attributed to the other two systems.[213] Seaway states that based on the relative economic value of the assets, of the total $1.15 billion purchase price, $1.095 billion is properly attributed to the Longhaul 30-inch system, and $55 million is properly attributed to the other two systems that Enbridge acquired from ConocoPhillips.[214] Seaway states that since it is shippers on the newly-reversed Longhaul 30-inch system that receive the benefits of the purchase, it is appropriate that those shippers bear the principle share of the purchase cost.[215] Seaway states it is fair to allocate the full acquisition premium to the Longhaul 30-inch system, while allocating the net book value to the other assets.[216]

80. Suncor states that the Presiding Judge properly held that the acquisition premium was clearly attributable to Enbridge and not Seaway.[217] Suncor states that it is "illogical" and "nonsensical" for Seaway to argue that ConocoPhillips was unwilling itself to reverse the pipeline but would allow Seaway to do it.[218] Suncor further states that the Presiding Judge was accurate in observing that the acquisition premium was not paid for an asset or to acquire a controlling interest in a business that owned the asset; instead, it was paid to acquire a partial interest in Seaway in a complicated arrangement where the acquiring entity (Enbridge) would become a lessee of a portion of Seaway's capacity and benefit from the reversal.[219]

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[212] Seaway Brief on Exceptions at 55.

[213] *Id.* at 55-56.

[214] *Id.* at 59.

[215] *Id.* at 61.

[216] *Id.*

[217] Suncor Brief Opposing Exceptions at 34.

[218] *Id.* at 35.

[219] *Id.* at 34.

81. Suncor claims that it is critical to the analysis of the acquisition premium that Enterprise remained a 50 percent owner of Seaway,[220] and that Enterprise would be unjustly enriched as a result of permitting recovery in rates of the acquisition premium.[221] Suncor claims that Enterprise is getting a favorable capacity lease from Seaway, and that this along with the nonsensical action of ConocoPhillips and the 50 percent ownership by Enterprise results in the entire transaction being a sham.[222] Finally, Suncor argues that goodwill is an intangible asset and therefore should never be included in rate base.[223] Suncor states that goodwill is an accounting adjustment that departs from original cost and should not be permitted to distort rates by being included in a pipeline's asset base.[224]

82. ACN states that removing the acquisition adjustment in this proceeding will reduce Seaway's cost of service from approximately $188.5 million to $40 million.[225] ACN disagrees with the Presiding Judge's finding that Seaway met the benefits test.[226] ACN argues that Seaway already owned the facilities in question, and Enbridge merely bought an interest in an existing corporate entity.[227] ACN characterizes the issue as an increase in the acquired company's rate base (Seaway) to reflect the price paid by the acquiring company (Enbridge).[228] ACN states that Enbridge paid ConocoPhillips to acquire a partnership interest in Seaway, but did not purchase the assets themselves.[229] ACN claims that the only "asset" to which the premium relates is the partnership interest, not the hard assets.[230] ACN states that the Commission has previously held in *Enbridge Pipelines (KPC)* that where an entity does not choose between constructing a new

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[220] *Id.* at 35.

[221] *Id.*

[222] *Id.* at 37.

[223] *Id.* at 37-38.

[224] *Id.* at 39.

[225] ACN Brief Opposing Exceptions at 49, ACN Brief on Exceptions at 25.

[226] ACN Brief on Exceptions at 23.

[227] *Id*. at 27.

[228] ACN Brief Opposing Exceptions at 51.

[229] *Id.* at 52.

[230] *Id.* at 52.

pipeline and acquiring and converting a pipeline to effectuate the service in question, the alleged savings in construction costs are not relevant.[231] ACN argues that because Enbridge only purchased a 50 percent share in Seaway for $1.15 billion, and could have constructed its own pipeline of similar size for $1.3 billion, there were no cost savings to shippers.[232] ACN further states that if the acquisition premium cannot be attributed to Seaway, as the Initial Decision on Remand held, then the reversal cannot be attributed to the acquisition premium.[233]

83. ACN argues that Seaway failed to meet its burden of establishing through clear and convincing evidence that the acquisition provided substantial, quantifiable benefits to ratepayers.[234] ACN criticizes Seaway for not providing credible, substantial record evidence to establish that the pipeline would not have been reversed absent Enbridge's purchase of its interest in Seaway.[235] ACN states that there is no evidence that the reversal would not have happened anyway.[236] ACN also argues that Enbridge's purchase of its interest in Seaway did not result in a new or materially changed service.[237]

84. ACN argues that the substantial benefits test does not apply in this case, citing PP 108-113 of the Initial Decision on Remand.[238] ACN states that applying the substantial benefits test to the purchase of existing facilities represents a "significant and unwarranted expansion of the Commission's case law on acquisition adjustments."[239] ACN argues that the purchase price is properly attributable to Enbridge, as the acquiring company, and not Seaway. Seaway, argues ACN, did not acquire any new facilities,

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[231] ACN Brief on Exceptions at 33, citing *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260, at P 55 (2002), *reh'g denied*, 102 FERC ¶ 61,310 (2003), *affirmed on remand*, 109 FERC ¶ 61,042, at PP 32, 35 (2004).

[232] ACN Brief on Exceptions at 34.

[233] *Id.* at 29.

[234] *Id.* at 32.

[235] *Id.* at 28.

[236] *Id.* at 32.

[237] *Id.* at 28.

[238] ACN Brief Opposing Exceptions at 50.

[239] *Id.* at 51.

assets or interests, which would trigger the application of the two-part substantial benefits test for the purpose of valuing acquired assets in rate base.[240]

85. ACN claims that the Presiding Judge did not make an affirmative determination that Enbridge's purchase was not an arm's length transaction, or was the result of bad faith or improper dealing, but only that Seaway did not meet its burden to show otherwise.[241] ACN implies that because Enbridge will receive an upstream benefit, that is indicative of a non-arm's length transaction.[242] ACN argues that while ConocoPhillips and Enbridge were not "technically" affiliates, Enterprise had an interest in Enbridge paying a high purchase price for its interest in Seaway.[243]

86. ACN argues that even if an acquisition premium is allowed, goodwill should be excluded.[244] ACN states that the goodwill affords Enbridge substantial "future economic benefit" that will accrue to Enbridge alone.[245] ACN argues that the Commission's oil pipeline precedent acknowledges that an acquisition premium and goodwill are two separate and distinct concepts, and are treated as such for accounting and ratemaking purposes.[246] Finally, ACN argues that the purchase price attributable to non-jurisdictional facilities must be excluded from Seaway's rates in this proceeding.[247]

87. Trial Staff disagrees with the Presiding Judge's ruling that Enbridge's purchase of Seaway from ConocoPhillips was not an arm's length transaction.[248] Trial Staff argues that Enbridge bought a 50 percent share of Seaway for valid business reasons according to the evidence presented at the hearing.[249] Trial Staff also disagrees with the Presiding

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[240] *Id.* at 54.

[241] *Id.* at 60.

[242] *Id.* at 61.

[243] *Id.* at 62.

[244] *Id.* at 64.

[245] *Id.* at 67.

[246] *Id.* at 69, citing Opinion No. 511, 134 FERC ¶ 61,121 at PP 153-154.

[247] ACN Brief Opposing Exceptions at 72.

[248] Trial Staff Brief on Exceptions at 7. Trial Staff Brief Opposing Exceptions at 14.

[249] Trial Staff Brief on Exceptions at 8.

Judge's distinction between the purchase of an asset and the purchase of a partnership interest that controls assets.[250] Trial Staff further states that this is not an Enbridge acquisition premium, even if Enbridge will experience ancillary benefits from the reversal of the pipeline.[251]

88. Trial Staff agrees with the Presiding Judge that the transaction satisfied the two-prong test.[252] Trial Staff also agrees with the Presiding Judge that goodwill should be excluded.[253] Trial Staff argues that it is per se inappropriate to include goodwill in rate base.[254] Trial Staff maintains that goodwill departs from original cost and cannot be permitted to distort rates by being included in the pipeline's asset base.[255] Trial Staff argues that $196,059,000 of the acquisition premium should be allocated to non-jurisdictional facilities, and $627,000,000 in goodwill should be excluded.[256]

89. Finally, CAPP argues that the acquisition premium, if allowed, should be allocated between initial shippers and expansion shippers.[257]

1. <u>Commission Determination</u>

90. Generally, when establishing the cost-of-service upon which a pipeline's regulated rates are based, the Commission employs original cost principles, and when a facility is acquired by one regulated entity from another, only the seller's original cost is included in the cost-of-service computations, even though the price paid by the purchaser may exceed that amount.[258] Original cost is defined as "the cost of such property to the person

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[250] *Id.* at 10.

[251] *Id.* at 11.

[252] Trial Staff Brief Opposing Exceptions at 16.

[253] Trial Staff Brief on Exceptions at 6.

[254] Trial Staff Brief Opposing Exceptions at 17.

[255] *Id.* at 22.

[256] *Id.* at 23.

[257] CAPP Brief Opposing Exceptions at 7.

[258] *Missouri Public Service Comm'n v. FERC*, 783 F.3d 310, 313 (D.C. Cir. 2015), citing *Rio Grande Pipeline Co. v. FERC*, 178 F.3d 533, at 536 (D.C. Cir. 1999), *N. Natural Gas*

first devoting it to public service."[259] Under original cost accounting, the acquiring entity can include in its rate base only that portion of the purchase price that represents the depreciated original cost of the property to the original owners, regardless of the acquisition cost.[260] Without the original cost concept, "all that need be done to raise rates and obtain greater income would be to have one company buy utility properties from another at a higher price than original cost and in this very simple way increase the cost of service to consumers."[261]

91. The Commission generally does not allow the inclusion of a facility in the rate base at more than its depreciated original cost.[262] However, where the transfer at a price above book value benefits consumers, it is sometimes appropriate to permit the entire purchase price to go into the rate base.[263]

92. The "substantial benefits" requirement for a pipeline seeking rate-base treatment for an acquisition premium involves a two-prong test. First, the pipeline must show that the facilities will be converted from one public use to a different public use, or that the assets will be placed in FERC-jurisdictional service for the first time. Second, the pipeline must show clear and convincing evidence that its acquisition of the facilities will provide substantial, quantifiable benefits to ratepayers even if the full purchase price, including the portion above depreciated original cost is included in rate base.[264] The

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Co., 35 FERC ¶ 61,114, at 61,236 (1986), *Longhorn Partners Pipeline*, 73 FERC ¶ 61,355, at 62,112 (1995).

[259] *N. Natural Gas Co.*, 35 FERC ¶ 61,114, at 61,236 (1986), quoting 18 C.F.R. Part 201 "Definitions" (1985). Part 201 refers to gas plant. The Commission's definitions under the Interstate Commerce Act do not define "original cost."

[260] *N. Natural Gas Co.*, 35 FERC ¶ 61,114 at 61,236, citing *Montana Power Co. v. FERC*, 599 F.2d 295, 298 (9th Cir. 1979).

[261] *N. Natural Gas Co.*, 35 FERC ¶ 61,114 at 61,236 , quoting *United Gas Pipe Line Co.*, 25 FPC 26, at 64 (1961), *rev'd on other grounds sub nom. Williams Gas & Oil Co. v. FPC*, 299 F.2d 111 (D.C. Cir. 1962).

[262] *Longhorn Partners Pipeline*, 73 FERC ¶ 61,355, at 62,112 (1995).

[263] *Missouri Interstate Gas, LLC*, Opinion No. 525, 142 FERC ¶ 61,195, at P 60 (2013), quoting *Cities Service Gas Co.*, 4 FERC ¶ 61,268, at 61,596 (1978), *Longhorn Partners Pipeline*, 73 FERC ¶ 61,355, at 62,112 (1995).

[264] Opinion No. 525, 142 FERC ¶ 61,195 at P 44.

Commission also considers whether the transaction at issue is an arm's length sale between unaffiliated parties, and whether the purchase price of the asset at issue is less than the cost of constructing a comparable facility.[265] The Commission allows an acquisition premium to be included in a pipeline's rate base when the purchase price is less than the cost of constructing comparable facilities, the facility is converted to a new use, and the transacting parties are unaffiliated.[266]

Arm's Length Transactions

93. Arm's length transactions are characterized as adversarial negotiations between parties that are each pursuing independent interests.[267] The hallmark characteristic of arm's length bargaining is that it is negotiated rigorously, selfishly and with an adequate concern for price.[268] If the negotiating parties have a common economic interest in the outcome of the negotiations, their bargaining is not at arm's length.[269]

94. The Presiding Judge began the analysis by ruling that the purchase of Seaway was not the result of an arm's length transaction.[270] The Commission reverses the Presiding Judge. The negotiations in this proceeding took place between two independent parties, Enbridge and ConocoPhillips. Seaway witness Shamla provided uncontroverted testimony that, after several weeks of negotiations, ConocoPhillips accepted an offer below its original asking price.[271] Witness Shamla also testified that Enbridge entered the

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[265] *Missouri Public Service Comm'n v. FERC*, 601 F.3d 581, 586 (D.C. Cir. 2010) (internal quotations omitted).

[266] *Missouri Public Service Comm'n v. FERC*, 783 F.3d 310, 312 (D.C. Cir. 2015), citing Opinion No. 525, 142 FERC ¶ 61,195 at P 113. *See also Rio Grande Pipeline Co. v. FERC*, 178 F.3d at 536.

[267] *Southwest Power Pool, Inc.*, 149 FERC ¶ 61,048, at P 96 (2014), *see also* Black's Law Dictionary 109 (6th ed. 1991) (defining an arm's length transaction as "a transaction negotiated by unrelated parties, each acting in his or her own self interest ....A transaction in good faith in the ordinary course of business by parties with independent interests").

[268] *Southwest Power Pool, Inc.*, 149 FERC 61,048 at P 96, citing *Jeanes Hosp. v. Sec'y of Health and Human Servs.*, 448 F.App'x 202, 206 (3rd Cir. 2011).

[269] *Southwest Power Pool, Inc.*, 149 FERC ¶ 61,048 at P 97.

[270] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 113.

[271] Ex. SEA-25 at 4.

negotiation with the goal of purchasing and reversing Seaway for an amount less expensive than building a new line, and on a significantly quicker schedule.[272] This goal was attained. Enbridge met its burden to show that the negotiations were conducted at arm's length.

95. There is no evidence to support the contentions of the shippers or the Presiding Judge that the acquisition of Seaway by Enbridge amounted to a sham transaction. Suncor states that it is illogical that ConocoPhillips would refuse to reverse Seaway while it retained an ownership interest, but would then allow a third party to reverse the pipeline.[273] Contrary to Suncor's claim, it is not at all illogical that ConocoPhillips would have no interest in reversing Seaway itself, but would allow Enbridge to purchase its interest in Seaway for the purpose of reversing the pipeline.

96. Both Suncor and the Presiding Judge argue that inclusion of the acquisition premium will result in an unjustified and unreasonable windfall to Enterprise and Enbridge which demonstrates that the transaction was a sham designed to evade the principles of cost-based ratemaking.[274] This is less an argument concerning whether the transaction was conducted at arm's length, and more a criticism of inclusion of acquisition premiums generally. As discussed below, the Commission has established a benefits test to determine when it is appropriate to include an acquisition premium in rate base. The Commission rejects the argument that the mere presence of an acquisition premium indicates a transaction was a sham.

97. It is also not indicative of a sham transaction that benefits from the transaction extend beyond the asset being purchased. Contrary to ACN's claim, the fact that Enbridge will receive upstream benefits does not demonstrate the transaction was not conducted at arm's length. ACN's argument relates more to the allocation of the acquisition premium than the propriety of its inclusion. ACN also failed to support, or demonstrate the relevance of, its argument that Enterprise had an interest in Enbridge's paying a high purchase price to ConocoPhillips.

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[272] *Id.*

[273] Suncor Brief Opposing Exceptions at 35.

[274] Suncor Brief Opposing Exceptions at 36. Initial Decision on Remand, 147 FERC ¶ 63,009 at P 109.

98. In reference to the first prong of the substantial benefits test, the Commission affirms the Presiding Judge's ruling that the reversal of the flow of the Seaway pipeline from north-to-south constitutes a new use.[275] The reversal will allow Seaway to provide a new service unrelated to the transportation service historically provided by Seaway.[276] The reversed pipeline will also service a significantly different, and larger, group of customers with limited overlap with previous shippers that utilized the south-to-north service.[277]

99. The Commission also affirms the Presiding Judge's ruling that the Seaway reversal satisfies the second prong of the substantial benefit test.[278] The Commission has allowed an exception to the original cost rule "only when a purchaser [has] demonstrated that specific dollar benefits resulted directly from the sale."[279] The specific dollar benefits "may include 'decreases in rates, improved services or economies in operation which are clearly related and solely the result of the acquisitions.'"[280] The difference between the acquisition costs and the cost of new construction, for example, has met the specific dollar benefit requirement of the benefits exception.[281] Other benefits, in addition to being less expensive than a "greenfield" project, can include providing more efficient and cost-effective access to products and markets, enhancing supply diversification, limiting the environmental impact of new construction, and permitting the

[275] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 127.

[276] *See Enbridge Energy Co.*, 110 FERC ¶ 61,211 at P 29.

[277] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 126. *See also Enbridge Energy Co.*, 110 FERC ¶ 61,211 at P 30.

[278] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 145.

[279] *N. Natural Gas Co.*, 35 FERC ¶ 61,114 at 61,236, quoting *Mid-Louisiana Gas Co.*, 7 FERC ¶ 61,316, at 61,682, *reh denied*, 8 FERC ¶ 61,227 (1979), *aff'd sub nom. Transcontinental Gas Pipe Line Corp. v. FERC*, 652 F.2d 179 (D.C. Cir. 1981).

[280] *N. Natural Gas Co.*, 35 FERC ¶ 61,114 at 61,236, quoting *Montana-Dakota Utilities Co.*, 23 FERC ¶ 61,151, at 61,335 (1983).

[281] *Tallgrass Pony Express Pipeline LLC*, 147 FERC ¶ 61,266 (2014).

efficient re-use of a currently underutilized infrastructure asset.[282] The benefits must be tangible and non-speculative and must be quantifiable in monetary terms.[283]

100. The Commission has consistently held that the inclusion in rate base of an acquisition premium is appropriate when the costs associated with the acquisition are less than the cost of constructing new facilities.[284] In Opinion No. 525, the Commission found that a variance between new construction and acquisition of approximately $1.4 million was sufficient to meet the benefits test.[285] The Commission found that the variance need not be a particular magnitude or "exorbitant" to meet the benefits test.[286] Including the full purchase price when it is less than constructing new facilities is appropriate because it provides specific benefits to ratepayers, in that the rates will be no higher, if not somewhat lower, than if the pipeline built new facilities. This allows pipelines the appropriate incentives to purchase and utilize existing facilities in lieu of constructing new facilities, thereby avoiding unnecessary construction and the attendant environmental impacts.[287]

101. In this proceeding, Seaway established that its total rate base, which includes the Enbridge purchase price and the other rate base elements, is approximately $150 million less than the cost of constructing a new pipeline.[288] Seaway also stated that the reversal allowed the pipeline to enter north-to-south service more than 18 months earlier than if a new pipeline had been constructed.[289] By offering north-to-south service 18 months earlier, the reversal allows shippers to take advantage of crude oil price differentials between Cushing and the U.S. Gulf Coast, providing significant monetary benefit to

[282] *Enbridge Energy Co., Inc.*, 110 FERC ¶ 61,211, at P 32.

[283] *N. Natural Gas Co.*, 35 FERC ¶ 61,114 at 61,236, citing *Mid-Louisiana Gas Co.*, 7 FERC ¶ 61,316, at 61,684.

[284] Opinion No. 525, 142 FERC ¶ 61,195 at P 61, citing *Natural Gas Pipeline Co. of America*, 29 FERC ¶ 61,073, *Cities Service Gas Co.*, 4 FERC ¶ 61,268, *Crossroads Pipeline Co.*, 71 FERC ¶ 61,076.

[285] Opinion No. 525, 142 FERC ¶ 61,195 at P 110.

[286] *Id.* P 111.

[287] *Id*. P 113.

[288] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 129.

[289] Ex. SEA-25 at 6.

shippers. According to Seaway, this benefit could exceed $1.5 billion over the 18-month period.[290] Further, as argued by Trial Staff, by utilizing existing facilities, the Seaway acquisition eliminates the risk of delays and cost overruns inherent in new construction projects.[291] Accordingly, Seaway has met its burden of demonstrating that the acquisition resulted in substantial benefits as a result of the acquisition.

102. In Opinion No. 525-A, the Commission addressed the question of whether demonstrating specific dollar benefits resulting directly from the sale of an asset required a two-part showing: namely, a showing of specific benefits in addition to a showing that the purchase price was less than the costs to construct comparable facilities.[292] The Commission ruled that because the Commission had issued a certificate of public convenience and necessity to the facilities in question, it had already addressed the initial question as to whether there were benefits to including the cost of the facilities in initial rates. The benefits test was applied to determine the exact level of costs to include in rates by evaluating whether it would cost more to construct new comparable facilities.[293]

103. In reviewing Opinion No. 525-A, the D.C. Circuit focused on the grant of a certificate of public convenience and necessity when it addressed the question of whether the second prong of the benefits test can be met solely by demonstrating a cost differential between acquisition costs and the cost of constructing new comparable facilities. The court stated that "the clearest benefit resulting from the lower acquisition cost of the…project is the likelihood that it will lower costs passed along to ratepayers in using a pipeline *whose construction the Commission determined was required by the public convenience and necessity*."[294] Given the importance of certification in the mind of the D.C. Circuit, it would be improper to apply the rulings of the *MoGas* proceedings[295] in this case without at least recognizing that the Commission has not, and does not, certificate oil pipelines. However, the absence of a non-obtainable certificate

[290] Seaway Brief Opposing Exceptions at 26.

[291] See Exhibit S-1 at 7.

[292] *Missouri Interstate Gas, LLC*, Opinion No. 525-A, 144 FERC ¶ 61,220, at P 50 (2013).

[293] *Id.* P 49.

[294] *Missouri Public Service Comm'n v. FERC*, 783 F.3d 310, 319 (D.C. Cir. 2015), citing Opinion No. 525, 144 FERC ¶ 61,220 at P 113 (emphasis added).

[295] *See Id.*, *see also* Opinion No. 525-A, 144 FERC ¶ 61,220 (Collectively the *MoGas* proceedings).

does not necessarily serve as a per se restriction on an oil pipeline's inclusion of an acquisition premium in appropriate circumstances.[296]

104. The Commission disagrees with ACN's argument that Seaway is not entitled to any acquisition premium. ACN's reliance on *Enbridge Pipelines (KPC)* is misplaced. As the D.C. Circuit held in analyzing *Enbridge Pipelines (KPC),* it is only applicable in situations where no new pipeline use was involved.[297] ACN also errs in its arguments regarding cost savings. The acquisition of Seaway allowed for a now 400,000 bpd pipeline to provide new, north-to-south service. To construct a similar size pipeline would have cost more. Ratepayers benefit by having earlier access to 400,000 bpd of north-to-south service for less than the cost of constructing a new pipeline to provide the same service. That Enbridge bought only a 50-percent share to effectuate this new service is not relevant. Enbridge purchased the percentage of ownership necessary to effectuate the new North-to-South service, and the purchase resulted in the entire capacity, not just fifty percent, being used for the new service. While Enbridge may have owned 100 percent of a newly-constructed pipe, the benefit to shippers would have been the same, but at a higher cost. ACN also attempts to place a seemingly insurmountable burden on Seaway by requiring a showing that the reversal would not have happened but for the purchase. In no other case has the Commission required an affirmative showing that a reversal would not have otherwise happened. ACN also implies that the presence of upstream benefits is indicative of a sham transaction, but failed to elaborate on this argument.[298] ACN does not explain why such benefits go more to allocation than whether the transaction itself was not arm's length.

<u>Partnership and Partial Acquisition Issues</u>

105. The Presiding Judge found it relevant that the acquisition premium in this case was paid not for the pipeline itself, or a controlling interest in the company, but rather for a share of the company.[299] The Presiding Judge also notes that it was Enbridge, not Seaway, that paid the acquisition premium.[300] The Presiding Judge found that it strained

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[296] In this proceeding, for example, we have found that the reversal of Seaway allows for a new service that will service a different and larger group of customers and allow transport out of a constrained origin (Cushing, Oklahoma).

[297] *Missouri Public Serv. Comm'n v. FERC*, 783 F.3d at 319.

[298] ACN Brief Opposing Exceptions at 61.

[299] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 95.

[300] *Id.* P 99.

logic to see how the acquisition premium could be attributed to Seaway.[301] However, the Presiding Judge did not rule that these criticisms should result in the disallowance of the acquisition premium. While it is unclear from the Initial Decision on Remand how these criticisms factored in the Presiding Judge's decision, the Commission will address them.[302] The Commission finds that none of the arguments raised in this proceeding concerning partial acquisition, the retained interest by Enterprise, or that Enbridge purchased an ownership interest and not the assets themselves, are ultimately determinative to whether an acquisition premium is recoverable.

106. In *Rio Grande*, the D.C. Circuit rejected the Commission's attempt to implement a *per se* exclusion to the application of the benefits exception in situations when an asset's seller acquires an interest in the purchaser, finding that such a rule "makes no sense" since such a transaction would reduce the price paid for the asset and therefore result in lower rates.[303] The court stated that the Commission could still ensure that the sale was negotiated at arm's length without needing to resort to a blanket restriction.[304] In this proceeding, Enterprise was not the seller. The true seller, ConocoPhillips, did not retain any ownership interest in Seaway.

107. The Commission sees no reason in this proceeding to differentiate between Enbridge's purchase of an ownership interest in Seaway, and the purchase of the underlying assets. If the arm's length purchase of the paper ownership interest allows a pipeline to be put to a new use, and provide substantial benefits to shippers, the acquisition premium may, absent countervailing circumstances, be allowed in rate base. The Commission also fails to see the relevance of deciding whether the acquisition premium belongs to the acquired or the acquiring company. The acquisition premium goes to the rate base associated with the asset, which in this case happens to be a paper asset conferring rights to the hard asset (the Seaway Longhaul line, which will then factor into rates for transportation service on Seaway.)

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[301] *Id.* P 111.

[302] The Presiding Judge also referenced this argument in her ruling rejecting recovery of goodwill, yet failed to identify why such a fact was relevant in her analysis. *See* Initial Decision on Remand, 147 FERC ¶ 63,009 at P 180.

[303] *Rio Grande Pipeline Co. v. FERC*, 178 F.3d at 542.

[304] *Id.* at 543.

Goodwill

108. The Presiding Judge found that rate base should only include tangible, depreciable property.[305] Goodwill, the Presiding Judge found, is an intangible value that does not have a direct relationship to the acquired asset's original cost.[306] The Presiding Judge further noted that Commission regulations, specifically 18 C.F.R. § 346.2(c)(5), does not include goodwill in the list of costs to be included in rate base.[307] The Presiding Judge also found that the Commission has specifically rejected goodwill from rate base because it would distort the concept of cost-based rate regulation and because it is unrelated to the original cost of the asset.[308] The Presiding Judge states that goodwill represents the expectation of significantly greater revenues from future expansions of Seaway, and is not the focus in the present case on the current value of the acquired assets to current ratepayers.[309]

109. The Commission reverses the Initial Decision on Remand. Goodwill is based upon the difference between acquisition price and the market value of an asset.[310] The Commission's regulations do not preclude full rate recovery of acquisition premiums in appropriate circumstances.[311] Essentially, the Presiding Judge fails to acknowledge Commission precedent that has allowed recovery of goodwill in appropriate circumstances.[312] The Presiding Judge attempts to distinguish one case supporting such recovery, the *Ameren* decision, by stating that the company did not seek to include goodwill in rate base but for purposes of capital structure.[313] While this is true, the case

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[305] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 176.

[306] *Id.*

[307] *Id.*, citing 18 C.F.R. § 346.2(c)(5) (2015).

[308] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 177.

[309] *Id.* P 183.

[310] Opinion No. 511, 134 FERC ¶ 61,121 at P 154.

[311] *Minnesota Power & Light Co.*, 43 FERC ¶ 61,104, at 61,342 (1988), *SFPP, L.P.*, 113 FERC ¶ 61,277, at PP 64-65 (2005).

[312] *See Ameren Corp.*, 140 FERC ¶ 61,034, at P 33 (2012) (*Ameren)* ("Commission policy does not allow for goodwill in rates absent a showing of ratepayer benefits").

[313] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 181.

sets forth the Commission's policy on the recovery of goodwill generally, and is directly on point for purposes of the present proceeding.[314]

110. The Commission further notes that a question was raised in this proceeding of whether goodwill is a part of the acquisition premium, or should be treated separately. In previous orders, the Commission has used language that defines goodwill as an acquisition premium,[315] while in other orders the Commission employed language that differentiated goodwill from acquisition premiums.[316] Furthermore, differences in accounting rules concerning acquisition premiums and goodwill exist between oil vis-à-vis natural gas pipelines and electric utilities. Ultimately, for purposes of determining Seaway's uncommitted rates, whether goodwill is or is not part of the acquisition premium is not pertinent, for the test for the inclusion of goodwill into Seaway's rate base is the same as for an acquisition premium.[317] Goodwill can only be recovered if the acquisition is prudent and provides measurable, demonstrable benefits to ratepayers.[318] As the Commission stated in Opinion No. 511, goodwill is defined by the Financial Accounting Standards Board (FASB) as "an asset representing future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized."[319] It is therefore an asset, something of distinct

[314] The Commission notes that the Presiding Judge cited Order No. 511 in support of her conclusions, a case that also focuses solely on the issue of inclusion of good will in capital structure. Initial Decision on Remand, 147 FERC ¶ 63,009 at P 183, citing Opinion No. 511, 134 FERC ¶ 61,121 at P 179.

[315] *Policy Statement on Hold Harmless Commitments*, 150 FERC ¶ 61,031 (2015) ("This is consistent with our long-standing policy that acquisition premiums, including goodwill, must be excluded from jurisdictional rates absent a filing under FPA section 205 and Commission authorization granting recovery of specific costs.").

[316] *Xcel Energy Southwest Transmission Co., LLC*, 149 FERC ¶ 61,182 (2014) ([T]he Commission requires removal of the effects of acquisition premiums and goodwill from a utility's cost-of-service, including the inputs to formula rates.); *Exelon Corp. and Pepco Holdings, Inc.*, 149 FERC ¶ 61,148 (2014) (Such accounting entries include entries related to transaction costs, merger premiums, acquisition adjustments, goodwill, or any cost related to the Proposed Transaction.).

[317] *See Ameren Corp.*, 147 FERC ¶ 61,225, at P 8 (2014).

[318] *Ameren*, 140 FERC ¶ 61,034 at P 30.

[319] Opinion No. 511, 134 FERC ¶ 61,121 at P 154.

value. Enbridge's acquisition of Seaway satisfies this test in the same manner as discussed above: this was an arm's length transaction that resulted in cost savings and other demonstrable benefits to Seaway's shippers.

Allocation of Acquisition Premiums

111. The Presiding Judge makes several rulings concerning the proper allocation and calculation of any potential acquisition premium. The Presiding Judge found that Seaway did not properly attribute a portion of goodwill to non-jurisdictional assets.[320] The Presiding Judge also found that it would not be appropriate to include an acquisition premium for the portion of the purchase price paid for Enbridge's ability to increase its revenues through future Seaway expansions.[321] The Presiding Judge found that any acquisition premium should be allocated to both the seven-month initial pre-expansion period (June 2012-December 2012) as well as the five-month post-expansion period (January 2013 through May 2013).[322]

112. The Commission reverses the Initial Decision on Remand. The Commission does not require an acquisition premium that has met the benefits test be divided between current rate base and potential future expansions.[323] The benefits test requires that a pipeline demonstrate benefits to current shippers. Once this test is passed, the full purchase price can be included in rate base.[324] As the Commission ruled in Opinion No. 525, if a group of assets are purchased together, there are a number of reasonable ways to allocate the purchase price, including a cost per mile allocation or a fair market value approach.[325]

113. The Commission will require Seaway, in a compliance filing, to properly allocate all costs between jurisdictional and non-jurisdictional assets, and according to the base and test periods adopted in this Order.

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[320] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 178.

[321] *Id*.

[322] *Id.* P 211.

[323] Opinion No. 525, 142 FERC ¶ 61,195 at P 113.

[324] Opinion No. 525, 142 FERC ¶ 61,195 at P 113, citing *Crossroads Pipeline Co.*, 71 FERC ¶ 61,076, at 61,262-263; *Cities Service Gas Co.*, 4 FERC ¶ 61,268, at 61,596; *Natural Gas Pipeline Co. of America*, 29 FERC ¶ 61,073 at 61,150.

[325] Opinion No. 525, 142 FERC ¶ 61,195 at P 78.

V. What are the Appropriate Cost Allowances to be Included in the Cost of Service?

A. AFUDC

114. AFUDC, or allowance for funds used during construction, represents the cost of capital incurred by a pipeline with respect to assets prior to their inclusion in rate base.[326] AFUDC consists of two components. The first is the cost of equity capital. The second is the cost of debt capital known as interest during construction. The Commission permits the capitalization of AFUDC (both interest and equity) into rate base.[327]

115. The Presiding Judge found that Seaway should be permitted to include in its AFUDC (1) $59 million for Enterprise's 50 percent share of Seaway which was removed from service during construction and (2) its incremental carrier property additions required for the pipeline reversal project.[328] The Presiding Judge rejected Seaway's attempt to include costs associated with acquisition as opposed to construction.[329]

116. Seaway argues that the cost of financing the Enbridge acquisition during the period prior to start-up must be included in AFUDC along with the cost of financing other capital investments.[330] Seaway claims that, contrary to the Initial Decision on Remand's assumption, the phrase "during construction" does not mean that AFUDC is limited solely to the financing cost of physical construction activities.[331]

117. ACN argues that AFUDC should only apply to cost of construction, and not acquisition costs.[332] ACN also argues that because the acquisition took place at a time

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[326] *ARCO Pipe Line Co.*, Opinion No. 351, 52 FERC ¶ 61,055, at 61,234, *aff'd in part and modified on other grounds*, Opinion No. 351-A, 53 FERC ¶ 61,398 (1990).

[327] *Id*.

[328] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 221.

[329] *Id*. P 217.

[330] Seaway Brief on Exceptions at 66.

[331] *Id.*at 66.

[332] ACN Brief Opposing Exceptions at 80.

the pipeline was providing service (south-to-north), allowing AFUDC would provide for double recovery.[333] ACN argues that Commission regulations establish that a pipeline can only accrue AFUDC on the costs incurred for construction purposes before the assets are placed into service.[334] ACN further argues that Commission precedent makes clear that AFUDC is only intended to compensate a pipeline for the costs incurred to construct new pipeline facilities during the construction period.[335] According to ACN its proposal would allow for Seaway to accrue AFUDC on (1) its costs to construct the new facilities required to reverse the pipeline, prior to their May 2012 in-service date; and (2) the new facilities required to expand Seaway's capacity to 400,000 barrels per day, prior to their January 2013 in-service date.[336]

1. Commission Determination

118. The Commission affirms the Initial Decision on Remand. The Commission agrees that acquisition costs should not be included in AFUDC. A review of the Commission's rules concerning construction work in progress (CWIP) shows that such costs are more directly associated with construction than acquisition.[337] The Commission concurs with the argument of Trial Staff which stated that in order for expenditures to qualify as CWIP, they must be related to construction of physical property prior to inclusion in rate base.[338] They argue that Enbridge's purchase price is not related to construction. The Commission agrees.

B. The Appropriate Level of Operating Expense

119. The Presiding Judge found that Trial Staff's methodology of annualizing Seaway's actual cost data from June 2012 to September 2012 to determine O&M and A&G expenses conformed to the Commission's stated preference to use actual cost data.[339] The Presiding Judge also excluded Seminole Remediation Expenses as a non-recurring

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[333] *Id.* at 80.

[334] ACN Brief on Exceptions at 38-39.

[335] *Id.* at 39.

[336] *Id.* at 40.

[337] 18 C.F.R. pt. 352, Account 187 (2015).

[338] Trial Staff Brief Opposing Exceptions at 28.

[339] Initial Decision on Remand, 147 FERC ¶ 63,009 at PP 227, 237.

expense,[340] and amortized Fulshear Junction Remediation Expenses over a four-year period.[341] The Presiding Judge also rejected Seaway's projected *ad valorem* taxes for 2013,[342] and required Seaway to increase its fuel and power expenses based on the adopted base and test periods.[343]

120. Seaway argues that even if it were deemed appropriate to use actual data, the Initial Decision erred by inconsistently using only four months of actual data when the record contains nine months of more recent data and therefore is more representative of actual operating expenses.[344] Seaway argues that in regard to initial rates, the Commission's regulations expressly require a carrier to use a 12-month projection of costs and revenues.[345]

121. On exceptions, Trial Staff and ACN argue that the Commission has rejected the "simple average" KN methodology employed by Seaway, and should do likewise here.[346] Seaway argues that there are no grounds to reject its KN approach absent a viable alternative in the record.[347]

1. **<u>Commission Determination</u>**

122. The Commission prefers the use of actual cost data in lieu of projections.[348] In this case, annualized data based on actual costs incurred over the nine-month period from June 2012 through January 2013, corrected for errors as identified in this Order, meets the Commission's preference. The Commission affirms the Presiding Judge's elimination of non-recurring expenses, and amortization of the Fulshear Junction

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[340] *Id.* P 239.

[341] *Id.* P 240.

[342] *Id.* P 241.

[343] *Id.* P 242.

[344] Seaway Brief on Exceptions at 65.

[345] *Id.* at 65.

[346] Trial Staff Brief Opposing Exceptions, p. at 32; ACN Brief on Exceptions at 44.

[347] Seaway Brief Opposing Exceptions at 47.

[348] *See* Opinion No. 511, 134 FERC ¶ 61,121 at PP 28-29.

Remediation Expense.[349] The Commission also reiterates that the so-called "simple average" KN methodology has been rejected, and Seaway must utilize a proper KN method in its compliance filing.[350] The Commission adopts $1.48 million in *ad valorem* taxes, as the record supports this amount as the actual *ad valorem* taxes attributable to the Longhaul 30-inch system for the 2012 tax year.[351]

C. What is the Appropriate Level of Depreciation Expense?

123. Depreciation expenses in a cost of service rate case usually involve two components: the expense for depreciation, including the appropriate average remaining life, and an estimation of the expense for Dismantlement, Removal, and Restoration ("DR&R").[352]

1. What is the Appropriate Average Remaining Life?

124. The annual depreciation percentage or rate is derived by dividing the average remaining life ("ARL") of the jurisdictional facilities into the percentage of the gross plant left to be depreciated.[353] The ARL is derived using survivor curves that predict future plant retirements, and the curves are truncated at the estimated remaining economic life of plant in each plant account.[354]

125. SCN argued the Presiding Judge should accept its proposed ARL of 39.5 years.[355] Seaway and Trial Staff agreed that the appropriate average remaining life for depreciation

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[349] Seaway does not object to amortizing these costs over 4 years. Seaway Brief on Exceptions at 69.

[350] Opinion No. 511, 134 FERC ¶ 61,121 at P 150.

[351] Ex. SEA-39.

[352] Initial Decision on Remand, 147 FERC ¶ 63,009 at 243.

[353] Ex. S-7 at 14:12-13.

[354] *Id.* at 31:1-6.

[355] SCN Brief on Exceptions at 35.

purposes is 28.5 years[356] with an appropriate depreciation rate of 3.51 percent, and the Presiding Judge adopted this in the Initial Decision on Remand.[357]

126. In its brief on exceptions, SCN argues the Presiding Judge erred by rejecting SCN's proposed ARL of 39.5 years for purposes of calculating the appropriate depreciation rate.[358] SCN states its proposed ARL was consistent with the Commission's 1996 letter order approving Seaway's depreciation rates, which are the last depreciation rates approved by the Commission.[359] Additionally, SCN argued its recommended ARL for Seaway is reasonable when viewed in light of Enbridge's long-term capacity lease for a sizable portion of the Seaway capacity.[360] Trial Staff argues the Presiding Judge properly rejected SCN's recommended ARL, stating the 1996 Commission letter order should be given no weight as the order applied to Seaway's predecessor, which operated with flows in a different direction and under differing circumstances of markets and supply than those that now affect Seaway.[361]

127. In its brief opposing exceptions, Seaway argues that there was no basis, as SCN argued, of overturning the Initial Decision's holding that Seaway should use a 28.5-year average remaining life for depreciation purposes.[362] Seaway argues SCN's challenge provided no basis to overturn the Initial Decision's ruling, as Seaway's proposed 28.5-year average remaining life is supported by a recent depreciation study undertaking consistent with the Commission's requirements under 18 C.F.R. Part 347.[363] Seaway states SCN did not conduct a depreciation study, and SCN's average remaining life proposal was generally based on the composite depreciation rate of 2.51 percent included in a 1996 Seaway depreciation order.[364] Seaway argues that SCN's proposal was

[356] *See* Ex. SEA-51.

[357] Initial Decision on Remand, 147 FERC ¶ 63,009 at 245.

[358] SCN Brief on Exceptions at 35.

[359] Ex. Nos. SCN-12 at 11-12; SCN-23 at 3-4.

[360] SCN Brief on Exceptions at 35.

[361] Trial Staff Brief on Exceptions at 35.

[362] Seaway Brief Opposing Exceptions at 42.

[363] Exhibit Nos. SEA-31; SEA-51 (correcting Account 152) Seaway Brief Opposing Exceptions at 42.

[364] Seaway Brief Opposing Exceptions at 42; SCN Br. at 34.

inconsistent with the remaining life assumptions, on which the 1996 order was based. Seaway states a 39.5-year average remaining life may have been valid at the time the 1996 order was issued, but it was not reasonable to assume the pipeline's average remaining life will always be 39.5 years into the future.[365]

Commission Determination

128. The Commission affirms the Presiding Judge's ruling that the ARL for Seaway is 28.5 years, supporting a depreciation rate of 3.51 percent.[366] The Commission's general rule is that the contract life should not be used to establish depreciation rates except where customers are obligated to pay the full cost of the facilities during the contract period[367]—an exception not present in the instant case.

129. Further, ACN's proposed ARL of 39.5 years depends on the leased capacity contract, which is speculative. As Seaway stated, the fact the lease provides the option of renewing for a longer term does not mean either that the lease necessarily will be renewed or that the pipeline will be in operation for an extended length of time.[368]

2. What is the Appropriate Dismantlement, Removal and Restoration Cost?

130. DR&R costs are incurred in the future for dismantlement and removal of facilities and restoration of the removal areas; their inclusion in rates is essentially an early payment by current ratepayers to ensure their fair contribution toward this future expense.[369]

131. The current estimated cost to decommission the pipeline was set forth in the August 2012 decommissioning study conducted for Seaway by TSB Offshore, Inc.[370] After removing figures relating to the Freeport Terminal and the pipeline between Jones

[365] Seaway Brief Opposing Exceptions at 43.

[366] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 256.

[367] *See El Paso Natural Gas Co.*, 145 FERC ¶ 61,040 at P 112 (2013).

[368] Seaway Brief Opposing Exceptions at 44.

[369] S-7 at 37:3-5, 42:20; ID at 243.

[370] Ex. SCN-69.

Creek and Freeport,[371] Seaway and Trial Staff agreed that $25,463,807 relates to the Longhaul 30-inch System and represents the current estimated cost of decommissioning that system.[372]

132. There are two basic methods to calculate a DR&R allowance for an oil pipeline: the accrual method and the annuity method.[373] Both approaches are acceptable, provided they are calculated correctly.[374] Under the accrual approach, the estimated total DR&R cost is divided into equal annual amounts based on the pipeline's remaining life, with the annual amount included in the cost of service.[375] Since an oil pipeline is considered to have the cost-free use of the DR&R collections until they are actually expended for DR&R purposes in the future, the standard ratemaking convention when applying the accrual method is to deduct DR&R collections from rate base.[376]

133. Under the annuity method, the DR&R allowance is calculated based on the assumption that the pipeline will be permitted the opportunity to earn a return on the DR&R collections. In this case, DR&R collections and the amount earned on those collections are required to produce a sufficient amount to cover the ultimate DR&R costs. DR&R collections are therefore not deducted from rate base, as that would prevent the oil pipeline from having the opportunity to earn a return on those funds that ultimately will be needed to cover the final DR&R costs.[377]

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[371] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 260.

[372] *Id.*

[373] *See, e.g., BP Pipelines (Alaska) Inc*., 119 FERC ¶ 63,007, at P 162 (2007) (TAPS Initial Decision).

[374] *See BP Pipelines (Alaska) Inc.*, Opinion No. 502, 123 FERC ¶ 61,287, at P 148 (2008) (annuity method); *Kuparuk Transp. Co.*, 55 FERC ¶ 61,122, at 61,382 (1991) (accrual method).

[375] *TAPS Initial Decision*, 119 FERC ¶ 63,007 at P 162.

[376] *Kuparuk Transp. Co.*, 55 FERC ¶ 61,122 at 61,382-83; Opinion No. 502, 123 FERC ¶ 61,287 at P 148.

[377] *TAPS Initial Decision*, 119 FERC ¶ 63,007 at PP 161-162; Opinion No. 502, 123 FERC ¶ 61,287 at P 148 (ID at 263).

134. In the case at bar, Seaway used the annuity method.[378] SCN witness Arthur also used the annuity method to calculate Seaway's DR&R allowance.[379] Dr. Arthur derived Seaway's DR&R by using Seaway's estimate but relying on a 39.5- year ARL rather than the 30 years that Seaway used, and a composite depreciation rate of 2.51 percent rather than the comparable depreciation rate of 3.51 percent.

135. Trial Staff used an accrual method and originally proposed a DR&R allowance of $332,096.[380] That amount was based on the total DR&R cost estimate for all of Seaway's assets at the present time from a study provided by Seaway.[381] Because not all plant will survive to the end of Seaway's useful life, however, Trial Staff used different survivor curves to adjust that amount downward to reflect the DR&R cost for the amount of plant estimated to still be in service at the time of final abandonment.[382] Staff's proposed DR&R allowance was further reduced after the discovery during the hearing of the need to eliminate costs related to non-jurisdictional assets.

136. Using the resulting $25,463,807, Trial Staff revised its testimony,[383] reducing the proposed annual DR&R expense from $332,096 to $224,336.[384] Seaway also updated the decommissioning costs used in DR&R calculations to reflect the more recent DR&R study as suggested by Trial Staff, but did not make any other adjustments.[385]

137. The Presiding Judge found that Trial Staff's use of the traditional accrual method and its DR&R allowance of $224,336 should be adopted with correction for Staff's admitted failure to address the tax effect of the annual DR&R revenues.[386]

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[378] Ex. SEA-26 at 39.

[379] Ex. SCN-32 at 19, lines 8-10 (assuming DR&R funds would earn Seaway's after-tax weighted nominal cost of capital).

[380] Ex. S-7 at 7:2; Ex. S-9, Schedule 16, line 4.

[381] Ex. S-10 at 4-6.

[382] Ex. S-7 at 40:19-41:6; Ex. S-9, Schedule No. 11.

[383] Exhibit No. S-9, Schedule 16, line 4.

[384] Tr. 479:21-480:23.

[385] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 270.

[386] *Id.* P 279.

138. In its brief on exceptions, Seaway argues that the Initial Decision on Remand did not account for the effect of inflation in determining the cost of the ultimate DR&R liability, and the decision reduced the ultimate DR&R cost used to calculate the DR&R allowance as a result of the Staff's estimate of interim plant retirements.[387] Seaway argues the approach failed to recognize what the true cost of DR&R would be, since the record showed that interim plant retirements will need to be replaced in order for Seaway to continue operations.[388]

139. Seaway states the Initial Decision on Remand erroneously held that inflation should not be factored into the determination of the ultimate DR&R cost, based on the mistaken assumption that the recognition of inflation is a feature of the annuity method rather than the accrual method that the Initial Decision on Remand adopted.[389] Seaway argues that inflation should have been taken into account in calculating the cost of DR&R, but did not take issue with the DR&R cost estimate of $25,463,807, or the Initial Decision's use of the accrual method. Seaway further agrees that, to the extent the accrual method was used, DR&R collections deducted from rate base need to be adjusted for unfunded income taxes.[390] Seaway argues that under either the annuity or accrual method, the DR&R allowance must be sufficient to cover the ultimate DR&R costs, which properly includes inflation.[391]

140. In its brief opposing exceptions, Trial Staff argues that it calculated an appropriate allowance for DR&R. Trial Staff disagrees with Seaway's claim that in adopting Trial Staff's DR&R proposal, subject to tax adjustments, the Initial Decision on Remand erred in failing to consider the effect of inflation and including interim plant retirements in the calculation of DR&R.[392]

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[387] Seaway Brief on Exceptions at 76.

[388] *Id*.

[389] *Id*.

[390] Seaway Brief on Exceptions at 76, i*d*., s*ee* Initial Decision on Remand, 147 FERC ¶ 63,009 at PP 278-279.

[391] Seaway Brief on Exceptions at 77.

[392] Trial Staff Brief Opposing Exceptions at 36; responding to Seaway Brief on Exceptions at 76-77.

141. Trial Staff notes that its witness used the traditional accrual method to calculate the annual DR&R expense of $224,336 approved in the Initial Decision on Remand.[393] Trial Staff notes calculations of pipeline DR&R using the accrual method do not consider inflation and do not include interim plant retirements.[394] Trial Staff states it relied on the use of survivor curves to determine the ARL to use in calculating the amount of annual DR&R expense and did not inflate current estimated costs out to a point in the future.[395]

142. Trial Staff only made one adjustment, dealing with unfunded income taxes,[396] and agrees that the tax effect of the annual DR&R revenues should be corrected by requiring Seaway to follow the Commission's tax normalization rules and annually record the appropriate amount of deferred income taxes in Account 45 and on Seaway's balance sheet.[397]

143. Trial Staff notes that the Commission has refused to adopt the annuity method in a non-settlement context, because of the difficulty in making the necessary assumptions concerning future rates of inflation and costs.[398] Trial Staff states the effect of this approach is to assume that future retirements will be replaced.[399]

144. Trial Staff argues its proposed allowance for DR&R was developed using the traditional accrual method that conforms to Commission policy, and Seaway should be required to place the revenues derived from the DR&R allowance in a subaccount of Account 31 and deduct those revenues from rate base, since Seaway will have the cost-free use of the funds until expended for DR&R purposes.[400]

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[393] Trial Staff Brief Opposing Exceptions at 36.

[394] *Id.*

[395] Tr. 479:21-480:23 (Pewterbaugh); Ex. No. S-9, Schedule No. 16.

[396] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 278.

[397] *Id.*

[398] *Kuparuk Transp. Co.*, 55 FERC ¶ 61,122 at 61,382; Trial Staff Brief Opposing Exceptions at 37.

[399] Trial Staff Brief Opposing Exceptions at 37-38.

[400] *Id.* at 38; Exh. No. S-7 at 42:20-43:9 and 44:12-14; *Kuparuk, Transp. Co.*, 55 FERC ¶ 61,122 at 61,382-83.

Commission Determination

145. The Commission affirms the Initial Decision on Remand. Inflation and negative salvage should not be included in DR&R, since predicting future inflation rates is uncertain and speculative at best. The Initial Decision on Remand at paragraph 276 correctly noted that plant replacement additions are not currently in service and their costs are speculative.[401] Additionally, DR&R is referred to as negative salvage, and the Commission requires the recognition of interim retirements in the calculation of negative salvage.[402] Using the accrual method to calculate DR&R in this instance, avoiding the inclusion of an inflation component, is appropriate. In *Kuparuk Transp. Co.*,[403] the Commission demonstrated a preference for the accrual method, stating that the annuity method "is premised on complex assumptions on the rate of inflation generally" and other speculative and complex elements.[404]

146. The Commission directs Seaway to update its filing using the approved remaining life and survivor curves, and update its depreciation study in Docket No. DO13-4-000, refiling all applicable exhibits. In its updated depreciation study, Seaway must clearly identify its removal cost associated with legal and non-legal retirement obligations and propose appropriate accounting and rate treatment of these obligations. The Commission notes that recalculating DR&R will necessarily cause a recalculation of the cost of service for Seaway, and rates will change.

D. What is the Appropriate Cost of Capital?

1. What is the Appropriate Capital Structure?

147. The primary issues in dispute regarding capital structure are whether the capital structure should be based on the average of the oil pipeline proxy group or the average of Seaway's parents, and whether certain Accumulated Other Comprehensive Income ("AOCI") and non-controlling interests of consolidated entities ("minority interests") should be removed from the equity balances of Enterprise and Enbridge in calculating Seaway's capital structure.[405]

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[401] Ex. No. S-7 at 42:5-7.

[402] *Enbridge Pipelines (KPC*), 100 FERC ¶ 61,260 at P 293), *reh'g denied*, 102 FERC ¶ 61,310 (2003); Trial Staff Brief Opposing Exceptions at 38.

[403] 55 FERC ¶ 61,122 (1991).

[404] *Id*. at 61,382.

[405] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 284.

148. The Commission's guidelines for determining the appropriate capital structure are expressed in Opinion No. 414-A. Under the guidelines, the Commission will use the capital structure of the pipeline itself if the pipeline has its own credit rating, issues its own non-guaranteed debt, and has a reasonable capital structure in relation to those entities in the oil proxy group and to other pipeline capital structures and to other capital structures approved by the Commission in the past.[406]

149. However, the Commission "will utilize an imputed capital structure (most often that of the corporate parent) if the record in a particular case reveals that the pipeline's own common equity ratio is so far outside the range of other equity ratios approved by the Commission and that the range of proxy company equity ratios that it is unreasonable."[407]

150. Seaway contends that, while it does not own rated debt and relies on its parent companies, Enbridge and Enterprise, for debt financing, the Commission policy does not merit using the capital structure of its parent companies because Enbridge's capital structure is anomalous and otherwise inconsistent with the risks of the subject pipeline.[408] Seaway argues that in Opinion No. 435-B the Commission "reviews a pipeline's capital structure to assure that it is not contrived, or that the parent company's capital structure is not unrepresentative of the pipeline's risks."[409] If the standard is not met, a hypothetical capital structure can be used.

151. Seaway states that during the period from December 31, 2011 through September 30, 2012, Enbridge's equity ratio averaged 31 percent, lower than the equity ratio of the individual oil pipeline proxy group members Seaway created, and significantly below the approximately 48-49 percent average equity ratio for the proxy group.[410] Seaway also stated that the Commission indicated in Opinion No. 502 that "45 percent to 55 percent (is the) equity range typically found just and reasonable by the Commission for oil pipelines."[411]

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[406] *Id*. P 286.

[407] *Transcontinental Gas Pipe Line Corporation*, Opinion No. 414-A, 84 FERC ¶ 61,084, at 61,413 (1998) ("*Transcontinental*").

[408] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 288.

[409] *SFPP, L.P.*, Opinion No. 435-B, 96 FERC ¶ 61,281 (2001).

[410] Ex. SEA-45 at 6-7.

[411] Opinion No. 502, 123 FERC ¶ 61,287 at P 176.

152. Seaway further states that Enbridge's capital structure also contained a significant amount of preferred stock,[412] increasing from 3.5 percent in December 31, 2011 to 10 percent in September 30, 2012.[413] Dr. Fairchild argues that Enbridge was anomalous in issuing preferred stock, rendering Enbridge's capital structure anomalous when compared to the oil pipeline proxy group.[414]

153. Finally, Seaway contends that Enbridge's risks were not representative of those of an oil pipeline such as Seaway, because Enbridge's financing reflects that it is a diversified energy company involved not only in oil pipelines, but also in gas distribution, gas pipelines, processing and energy services, and investments in other entities.[415] Seaway argues that Enbridge's equity ratio is so low that even averaging it with Enterprise's more typical equity ratio results in an average equity ratio that is also anomalously low.[416] Seaway stated the average equity ratio as of March 31, 2012 for Enbridge and Enterprise was 38.69 percent, and 37.81 percent as of September 20, 2012.[417]

154. ACN, CAPP, and Trial Staff proposed capital structures based on the average capital structure of Seaway's parents on the grounds that Seaway does not have its own credit ratings or issue its own non-guaranteed debt, and consequently fails two of the three prongs of the test.

155. In calculating Seaway's capital structure, Trial Staff removes the effect of the amount recorded in Account 77(a), Accumulated Other Comprehensive Income (AOCI), from common equity.[418] Trial Staff maintains that the amount recorded in AOCI related to non-cash items, including foreign currency items, actuarial pension liability gain/loss adjustments, unrealized gains and losses on certain investments in debt and equity

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[412] Ex. SEA-45 at 5 (Fairchild).

[413] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 290.

[414] *Id*. P 290.

[415] Ex. SCN-7 at 36, Initial Decision on Remand, 147 FERC ¶ 63,009 at P 291.

[416] Ex. SEA-45 at 7, Initial Decision Remand, 147 FERC ¶ 63,009 at P 292.

[417] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 292.

[418] *Id.* P 296.

securities and cash flow hedges.[419] Trial Staff's argument was that since these items are not available to either Enbridge or Enterprise to finance their business operations, they cannot be considered equity capital.[420]

156. Seaway witness, Dr. Fairchild, states that under GAAP and USOA, "unrealized gains and losses are reflected on a firm's financial statements as part of "comprehensive" income, and the sum of part unrealized gains and losses is reflected as AOCI in a firm's common equity on its balance sheet.[421] Dr. Fairchild stated Trial Staff's proposed "adjustment to remove AOCI from equity prior to calculating capital structure ratios is at odds with GAAP and the Commission's USOA," and he was "unaware of the financial community making similar adjustments to remove AOCI from a firm's equity prior to calculating its capital structure ratios."[422]

157. Seaway notes the Commission added a separate balance sheet account for AOCI to the USOA (Account 77), the express purpose of which was "to record amounts for items of other comprehensive income in stockholders equity."[423] The presence of the separate balance sheet account makes clear that AOCI is properly included in a company's equity balance.

158. Trial Staff proposes to remove the minority interest (non-controlling interest) amount in calculating capital structure.[424] Trial Staff contends that it was not appropriate to include Minority Interest in common equity because the minority interest does not represent equity to the shareholders of Enbridge or Enterprise, because if it did, it would be included in paid-in capital or common share capital, not as a separate line item on either company's balance sheet.[425]

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[419] *Id.*, citing 18 CFR pt. 352, Balance Sheet Accounts 77(a)(2012).

[420] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 296.

[421] Ex. SEA-45 at 11.

[422] *Id.*

[423] Accounting and Reporting of Financial Instruments, Comprehensive Income, Derivatives and Hedging Activities, Order No. 627, FERC Stats. & Regs. ¶ 31,134, at P 36 (2002) (cross-referenced at 101 FERC ¶ 61,032 (2002)) ("Order No. 627").

[424] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 299, citing Ex. S-11(Corrected) at 8-9.

[425] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 299.

159. Seaway's witness, Dr. Fairchild, challenges the merits of the Trial Staff's determination, arguing that under GAAP, a firm that has a controlling interest in another must consolidate that subsidiary into its published financial statements.[426] Further, "in consolidating financial statements, all of the subsidiary's debt is included on the consolidated balance sheet, and the equity of the subsidiary that is not owned by the parent is recorded on the consolidated balance sheet as a minority interest; in this way the consolidated balance sheet reflects 100 percent of the debt of the parent and the subsidiary and 100 percent of the equity of the parent and the subsidiary."[427]

160. The Presiding Judge found the nature of Enbridge's capital structure to be of minimal probative value when considered in isolation,[428] and rejected Seaway's contention that because of Enbridge's capital structure, a deviation from *Transcontinental* is warranted. The Initial Decision on Remand imputed the capital structure of Seaway's parents, Enbridge and Enterprise, to determine the capital structure of Seaway.

161. In the Initial Decision on Remand, the Presiding Judge favored Staff's testimony on AOCI, and Staff's determination to remove the AOCI amount was given credence.[429] The Presiding Judge stated in the Initial Decision on Remand that because the minority interest represents an equity balance not owned by Enbridge or Enbridge, it should not be included in either company's common equity balance utility assets. The Presiding Judge noted that the non-controlling interests of Enterprise and Enbridge,[430] represent third party ownership interests in joint ventures.[431] The Presiding Judge agreed with the Trial Staff's removal of the minority interest, citing precedent in *Morgan Stanley*,[432] and stating that Seaway's contentions are supported only by broadly-referenced GAAP.

162. In its brief on exceptions Seaway argues the Initial Decision on Remand erred in failing to calculate an appropriate capital structure and cost of capital for Seaway. Seaway argues that using data derived from the average of the parent companies of

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[426] Ex. SEA-45 at 12.

[427] *Id.*

[428] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 293.

[429] *Id.*

[430] Ex. S-13 at 10.

[431] Initial Decision on Remand, 147 FERC ¶ 63,009 at 299.

[432] *Morgan Stanley*, 134 FERC ¶ 61,234 (2011).

Seaway's two parents yields anomalous results not representative of the risks of an oil pipeline.[433]

163. Seaway argues there is no justification for removing AOCI or minority interests from the Enterprise and Enbridge equity balances in calculating Seaway's capital structure.[434] Seaway also argues the Initial Decision on Remand's requirement to remove minority interests from the consolidated equity without a corresponding reduction in debt would also produce a mismatch between the remaining debt and equity.[435] Seaway argues the Initial Decision on Remand's proposed equity ratio is understated and its proposed debt ratio is overstated based on this mismatch.[436]

164. ACN argues in its brief opposing exceptions that the Initial Decision on Remand's cost of capital determination is consistent with the Commission's regulations and precedent. ACN advocates that, rather than Seaway's focus on Enbridge's capital structure and its credit rating, the relevant inquiry was "whether the parent companies' average capital structure is anomalous."[437] ACN states that Seaway erroneously argued that Enbridge's risks were not comparable to Seaway's, and merely noting that a company is more diversified than another does not establish that its overall business risk profile is anomalous.[438] ACN argues that if the mere fact that a company is diversified makes its risks anomalous, relative to an oil pipeline, then the proxy group companies' risks are also anomalous.[439] Further, ACN points out that Seaway's argument that Enbridge's financial risk is anomalous, relative to the proxy group companies, is in error because the Commission has ruled that a one-step differential between the subject company's credit rating and the average proxy group credit rating does not support a finding of anomalous financial risks.[440] ACN argues Seaway did not provide substantial

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433 Seaway Brief on Exceptions at 80.

434 *Id.* at 86.

435 SEA-45 at 13, Seaway Brief on Exceptions at 88.

436 Seaway Brief on Exceptions at 88-89.

437 ACN Briefs Opposing Exceptions at 89, citing Initial Decision on Remand, 147 FERC ¶ 63,009 at P 293.

438 ACN Briefs Opposing Exceptions at 89-90.

439 *Id.* at 90.

440 *Id.* at 90, citing *El Paso Natural Gas Company*, 145 FERC ¶ 61,040 at P 691.

evidence to support its argument that its risks were unique when compared to the companies cited in the Initial Decision on Remand, and because of this, it did not overcome the "strong preference…for the use of a parent company's capital structure" in the instant case.[441]

165. CAPP advocates the Initial Decision on Remand properly adopted the use of the parents' average capital structures for the purposes of setting Seaway's rates, and mere reference to other business, including natural gas pipelines, within Enbridge's portfolio do not undermine treatment of Enbridge as a reasonable representative of the business risks of its affiliate, Seaway.[442]

166. Trial Staff argues the Initial Decision on Remand correctly adopted Trial Staff's capital structure, as representative of the risks of an oil pipeline, and Seaway's parents' capital structures were properly used. Trial Staff states it applied the Commission's three-pronged test to determine the pipeline's capital structure, and Seaway failed to satisfy the test.[443] Trial Staff argues that the proposed capital structure of 58.23 percent debt, 5.27 percent preferred equity, and 36.49 percent common equity is similar to the debt and equity ratios approved by the Commission in the past and is reasonable in relation to the oil proxy group.[444] Trial Staff also argues the Presiding Judge appropriately removed the common equity balances of Enterprise and Enbridge, removing AOCI and the minority interests balances.[445]

Commission Determination

167. Opinion No. 502 sets out the use of a hypothetical capital structure based on a proxy group where a parent company capital structure is anomalous or otherwise inconsistent with the risks of a pipeline. Under Opinion No. 502, "if the parents' capital structure is anomalous relative to the capital structures of the publicly-traded proxy companies used in the discount cash flow ("DCF") analysis and capital structures used

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[441] ACN Briefs Opposing Exceptions at 91, citing *Kuparuk*, 55 FERC ¶ 61,122 at 61,372.

[442] CAPP Briefs Opposing Exceptions filed in response to the first Initial Decision at 11-12 (filed November 4, 2013).

[443] Trial Staff Briefs Opposing Exceptions at 40.

[444] Trial Staff Briefs Opposing Exceptions at 42, Referring to *SFPP, L.P.*, Opinion No. 435-B, 96 FERC ¶ 61,281 at 62,065-68, *affirmed in part, vacated in part, BP West Coast Products, LLC v. FERC*, 374 F.3d 1263, at 1284-85 (D.C. Cir. 2004).

[445] Trial Staff Briefs Opposing Exceptions at 43.

for other regulated pipelines, the Commission will use a hypothetical capital structure based on the average capital structure of a group of comparable firms."[446] Additionally, under Opinion No. 435-B, the Commission will "review a pipeline's capital structure to assure that it is not contrived, or that the parent company's capital structure is not unrepresentative of the pipeline's risks."[447] When these two standards are met, the Commission will utilize a hypothetical capital structure.

168. Seaway argued that due to Enbridge's preferred stock, low equity ratio, and diversified business operations, its capital structure is anomalous. The Commission agrees. Here, Enterprise's average capital structure ratios are approximately 54 percent debt and 46 percent equity,[448] which fall well within the ranges of the proposed proxy group.[449] Enbridge's average capital structure ratios from June 30 to September 30, 2012 were 62 percent debt, 7 percent preferred stock, and 31 percent common equity—capital structure ratios that fall outside the ranges of the proposed proxy group.[450]

169. Seaway advocated an updated oil proxy group comprised of Buckeye Partners, Enterprise Product Partners, Sunoco Logistics Partners, Enbridge Energy Partners, and Plains All American Pipeline,[451] with updated figures as of September 30, 2012. The proposed proxy group is comprised of MLPs similar to Seaway.

170. The analysis hinges on whether Enbridge's capital structure is representative of the risks of Seaway. In Opinion No. 502, the Commission made it clear that "45 percent to 55 percent is the equity range typically found just and reasonable by the Commission for oil pipelines."[452] In Opinion No. 502, the Commission allowed the use of a proxy group capital structure to determine the ROE in lieu of two parent companies who had

[446] *BP Pipelines (Alaska) Inc.*, Opinion No. 502, 123 FERC ¶ 61,287 at P 174 (2008).

[447] *SFPP, LP*, 96 FERC ¶ 61,281 at 62,068.

[448] Ex. SEA-45 at 6.

[449] *Id.*; 51.80% debt/48.20% equity.

[450] *Id.*

[451] Ex. SEA-45 at 20-21.

[452] Opinion No. 502, 123 FERC ¶ 61,287 at P 176.

actual equity ratios of 85 percent and 87 percent,[453] and had proposed using an equity ratio of 71 percent.[454]

171. Here, Enbridge's 31 percent equity ratio is nearly 15 percent lower than the lowest the Commission has typically accepted (45 percent). When Enbridge's equity ratio was averaged with Enterprise's more typical equity ratio, the average equity ratio was 36 percent, well below the 45 percent-55 percent range the Commission has determined is typical of oil pipelines, and well below the approximately 41 percent bottom range for oil pipeline proxy groups.[455]

172. The Commission reverses the Initial Decision on Remand in regards to Seaway's capital structure. The Commission finds that a capital structure based on the updated proxy group, with 51.80 percent debt and 48.20 percent equity as of September 30, 2012,[456] is appropriate. Seaway met the burden of demonstrating Enbridge's capital structure was anomalous.

173. The Commission reverses the Initial Decision on Remand as to removing AOCI from the capital structure calculation. AOCI includes accumulated unrealized gains and losses. Under GAAP and USOA, unrealized gains and losses are reflected on a firm's financial statements as part of "comprehensive" income, and the sum of past unrealized gains and losses are reflected as AOCI in a firm's common equity on its balance sheet.[457] The Commission finds that any adjustment to remove AOCI from equity prior to calculating capital structure ratios is at odds with GAAP and the Commission's USOA.

174. The Commission reverses the Presiding Judge's finding to remove minority interests from the capital structure calculation. Under the Federal Accounting Standards Board's FAS 160 and FAS 141r, non-controlling (minority) interest is recorded in the shareholders' equity section of the parents' balance sheet in proportion to percentages in ownership, and the net income must be captured on the consolidated income statement. The *Morgan Stanley* case is not dispositive in this instance. In *Morgan Stanley*, a purchaser was trying to acquire the minority interest of another company, whereas here, Enterprise and Enbridge have third party minority interests on their books. Here, the

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[453] *Id*. P 175.

[454] *Id.* P 176.

[455] Ex. SEA-45 at 9.

[456] Ex. SEA-47.

[457] Ex. SEA-45 at 11, Seaway Brief on Exceptions at 86.

Commission finds that removal of the minority interests from the consolidated equity without a corresponding reduction in debt would produce a mismatch between the remaining debt and equity.

175. The Commission notes that removing AOCI and minority interests from the capital structure calculation is not appropriate regardless of capital structure. The Commission accepts Seaway's proposed capital structure consistent with these findings, using the updated data as of September 30, 2012.

2. <u>What is the Appropriate Cost of Debt?</u>

176. Cost of debt is the interest rate that must be paid from the moment debt is incurred through loans, notes payable, and bonds. The interest rate is contractually agreed upon at the time the debt is issued and may be variable.[458]

177. The proportions of debt and equity used to finance a firm's assets are determined by the level of business risk it faces. A firm engaged in more risky activities typically uses less debt and more equity, and vice versa; the greater the business risk, the less likely there will be sufficient cash flow in each year to meet debt interest and principle payments, so less debt, and more equity, is used to finance the firm.[459]

178. Seaway asserted that the appropriate cost of debt is 5.40 percent, which is the average cost of debt of the oil pipeline proxy group as of September 30, 2012.[460]

179. ACN proposed a 5.01 percent debt cost based on the debt costs of Seaway's parent companies updated as of December 31, 2012,[461] and CAPP recommended a cost of debt of 5.26 percent based on the debt costs of Seaway's parent companies.[462] TrialStaff advocated a 5.31 percent cost of debt for the period ending December 31 and a 5.18 percent cost of debt for the period ending September 30, 2012,[463] based on the debt costs of Seaway's parents.

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[458] Ex. SEA-15 at 4.

[459] *Id*. at 7.

[460] Ex. SEA-18.

[461] Ex. ACN-40.

[462] Ex. CAP-4 at 2.

[463] Ex. S-23 at 5.

180. The Presiding Judge found the cost of debt is 5.31 percent for the period ending December 31, 2011, and the cost of debt is 5.18 percent for the period ending September 30, 2012, adopting the Trial Staff's position.[464]

181. Trial Staff reiterates its argument that the cost of debt should be based on the average debt cost of Seaway's parent companies in its brief on exceptions.[465]

182. ACN in its brief opposing exceptions notes that since the Initial Decision on Remand correctly adopted the use of the average of Seaway's parent companies' capital structures to calculate Seaway's rates, the appropriate average debt cost for Seaway's parent companies was also correctly used.[466]

Commission Determination

183. The Commission reverses the Initial Decision on Remand. As discussed above, the capital structure of Seaway should be based on the proposed revised oil pipeline proxy group. As such, Seaway's proposed cost of debt of 5.40 percent as of September 30, 2012, should be used in the cost of capital determination.

184. The Commission accepts Seaway's cost of debt calculation for the periods ending September 30, 2012 (the end of the test period) and December 31, 2011, using the Moody's average as proposed in Seaway's Answering Testimony.[467]

3. What is the Appropriate Rate of Return on Equity (ROE)?

185. Witnesses for Seaway, ACN, CAPP, and Trial Staff all presented testimony on the appropriate rate of return on equity.[468] Seaway proposed a nominal ROE of 12.36 percent and a real ROE of 10.69 percent, based upon a six-month period ending June

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[464] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 310.

[465] Trial Staff Briefs on Exceptions at 45.

[466] ACN Brief Opposing Exceptions at 91-92; Initial Decision on Remand, 147 FERC ¶ 63,009 at PP 307-310; Seaway Initial Brief at 90 (recognizing that the debt cost calculation must be consistent with the capital structure calculation).

[467] Ex. S-23 page 3.

[468] The following expert witnesses submitted ROE analyses: Dr. Bruce H. Fairchild for Seaway; Ms. Elizabeth H. Crowe for ACN; Mr. David C. Parcell for CAPPs; and Mr. Edward Alvarez III for Trial Staff.

2012.[469] ACN proposed a nominal ROE of 11.28 percent and a real ROE of 9.62 percent for the six-month period ending September 2012.[470] CAPP proposed a nominal ROE of 11.77 percent and a real ROE of 10.11 percent, also for the six-month period ending September 2012.[471] Trial Staff proposed a nominal ROE of 10.68 percent and a real ROE of 8.52 percent for the six-month period ending October 2012.[472] Finally, Seaway provided an updated DCF analysis for the six-month period ending December 2012 that produced a nominal ROE of 10.75 percent and a real ROE of 9.01 percent.[473]

186. The Presiding Judge adopted Trial Staff's determination that Seaway's nominal ROE is 10.68 percent and its real ROE is 8.52 percent, based upon witness Alvarez's discounted cash flow (DCF) analysis for the six month period ending October 2012.[474] The Presiding Judge credited the proxy group criteria developed by Trial Staff and its use of the DCF analysis to develop its nominal and real ROE figures.[475] For AFUDC purposes, the Presiding Judge adopted Trial Staff's determination that Seaway's nominal ROE is 11.16 percent and its real ROE is 8.19 percent.[476]

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[469] *See* Ex. SEA-15 at 5, 13-17; Ex. SEA-18.

[470] *See* Ex. ACN-1 at 21-23; Ex. ACN-18 (Corrected).

[471] *See* Ex. CAP-4 at 3-8, 19-22; Ex. CAP-12.

[472] *See* Ex. S-11 (Corrected) at 20-40; Ex. S-12 at 2; Ex. S-24 at 2.

[473] *See* Ex. SEA-45 at 20-22; Ex. SEA-49.

[474] Initial Decision on Remand, 147 FERC ¶ 63,009 at PP 325, 329.

[475] *Id.* P 326. The Presiding Judge adopted the following six-member proxy group for the DCF analysis: Buckeye Partners, L.P. (Buckeye); Enbridge Energy Partners, L.P. (Enbridge Partners); Enterprise Products Partners, L.P. (Enterprise); Magellan Midstream Partners, L.P. (Magellan); Plains All American Pipeline, L.P. (Plains); and Sunoco Logistics Partners, L.P. (Sunoco). *Id.* P 322; Ex. S-24 at 3.

[476] Initial Decision on Remand, 147 FERC ¶ 63,009 at PP 325, 329. Trial Staff's DCF analysis for AFUDC is based upon a six-month period ending December 2011. *See* Ex. S-24 at 6.

187. The Presiding Judge found that Seaway's DCF analysis relies on an inappropriate proxy group and is calculated incorrectly.[477] Specifically, the Presiding Judge found the following two errors with Seaway's proxy group: (1) it incorrectly includes NuStar Energy, L.P. (NuStar), which was downgraded to a non-investment grade rating; and (2) it incorrectly includes Enterprise because it has an unsustainable growth rate of 22.90 percent.[478] Further, the Presiding Judge found that the dividend yield forward adjustment factor incorrectly used the higher IBES[479] growth rate for "g" rather than the two-stage growth rate in the (1 + 0.5g) calculation.[480] Finally, the Presiding Judge found that ACN's DCF analysis is flawed as well because it accepts Seaway's original proxy group.[481]

188. In its brief on exceptions Seaway states that the Initial Decision on Remand erred in adopting Trial Staff's proposed ROE of 10.68 percent (nominal) and 8.52 percent (real).[482] Seaway contends that the Initial Decision on Remand failed to explain why it adopted Trial Staff's DCF analysis, based upon a six-month period ending October 2012,

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[477] Initial Decision on Remand, 147 FERC ¶ 63,009 at PP 318, 327. Seaway uses the following seven-member proxy group for its original DCF analysis for the six-month period ending June 2012: Buckeye; Enbridge Partners; Enterprise; Magellan; NuStar; Plains; and Sunoco. *See* Ex. SEA-15 at 10 and SEA-18. Witness Fairchild determined that it was appropriate to remove Magellan (due to a negative growth rate) and NuStar (due to a July 2012 debt downgrade to BB+ by Standard & Poor's) for his rebuttal DCF analysis for the six-month period ending December 2012. *See* Ex. SEA-45 at 20-21; Ex. SEA-49.

[478] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 327 (citing Ex. S-11 (Corrected) at 45-46).

[479] International Brokers' Estimate System (IBES) provides estimates for a company's future quarterly and annual performance based on a consensus of Wall Street analyst estimates, including estimates of three-to-five year earnings growth rates.

[480] Initial Decision on Remand , 147 FERC ¶ 63,009 at P 327 (citing Ex. S-11 (Corrected) at 46).

[481] *Id.* P 328; *see* Ex. ACN-1 at 21 and Ex. ACN-18. The Presiding Judge did not make any findings on CAPP's DCF analysis.

[482] Seaway Brief on Exceptions at 90 (citing Ex. SEA-45 at 3; Ex. SEA-49).

when the record contained a more recent DCF analysis from witness Fairchild, based upon a six-month period ending December 2012.[483]

189. Seaway contends that the Initial Decision on Remand found incorrectly that Seaway used an "inappropriate proxy group."[484] Specifically, Seaway argues that the Initial Decision on Remand's findings are related to its proxy group for the period ending June 2012, not for its updated DCF analysis.[485] First, Seaway explains that witness Fairchild's updated DCF analysis, for the period ending December 2012, does remove NuStar from the proxy group subsequent to its credit downgrade, consistent with the Initial Decision on Remand's finding. Second, Seaway points out that Enterprise is a member of Trial Staff's proxy group that the Initial Decision on Remand adopted. Seaway contends that there is no need to exclude Enterprise from its updated DCF analysis because "both Enterprise's growth rate and ROE during the period ending December 2012 were well within the normal range for oil pipelines."[486] Finally, Seaway states that the Initial Decision on Remand provides no justification for failing to use its updated DCF analysis to determine its ROE.

190. Seaway further contends that the Initial Decision on Remand erred when it found that Seaway calculated its DCF "incorrectly," because its DCF analysis used the IBES growth rate, rather than a two-stage growth rate, to calculate the adjusted dividend yield for each member of the proxy group.[487] Witness Fairchild explains that because the adjustment's purpose is to convert a historical dividend yield into a prospective dividend yield for the coming year, "it makes no sense to use a two-stage growth rate that includes long-term growth estimates."[488] Seaway further explains that the Commission's two-

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[483] *Id.* Seaway does not take exception to the Initial Decision on Remand's proposed ROE for AFUDC purposes of 11.16 percent (nominal) and 8.19 percent (real). Seaway proposed a 10.94 percent (nominal) and 7.98 percent (real) ROE for AFUDC purposes, supported by a DCF analysis for a six-month period ending December 2011. *See* Ex. SEA-21.

[484] Seaway Brief on Exceptions at 91.

[485] The Commission notes that Seaway's Brief on Exceptions states incorrectly that its initial proxy group is for a six-month period ending March 2012.

[486] Seaway Brief on Exceptions at 91 (citing Ex. SEA-45 at 23 & n.6; SEA-49).

[487] Seaway Brief on Exceptions at 91-92.

[488] *Id.* (citing Ex. SEA-45 at 23 and Ex. SEA-49, columns (a), (e), and (f)).

stage growth rate, comprised of the short-term growth rate with a two-thirds weight and the long-term growth rate with a one-third weight, has little if anything to do with the growth in dividends that investors expect over the coming year for proxy group companies. Witness Fairchild asserts that "the short-term IBES growth rate is far more representative of the growth investors expect over the coming year than is the two-stage growth rate."[489] Seaway argues that this is especially the case when a proxy group consists entirely of oil pipeline MLPs, since MLPs distribute most available cash to investors and the near-term dividend growth would be expected to track the near-term earnings growth. Finally, Seaway contends that the Initial Decision on Remand's finding is conclusory as it fails to address any of Seaway's arguments supporting the calculation of the adjusted dividend yield.

191. In its brief opposing exceptions, Trial Staff argues that Seaway's arguments are unavailing concerning the Initial Decision's adoption of Trial Staff's DCF analysis for the six-month period ending October 2012.[490] Trial Staff asserts that Seaway's DCF analyses contain several errors that skew its results upwards. First, Trial Staff contends that Seaway's initial proxy group for a six-month period ending June 2012 should exclude Enterprise because its five-year IBES growth results in an unsustainable two-stage growth rate of 16.02 percent.[491] However, Trial Staff agrees with Seaway that Enterprise is properly included in Staff's proxy group for the period ending October 2012.

192. Next, Trial Staff contends that both of Seaway's DCF analyses use five-year IBES growth rates from outside of their respective six-month periods, creating a mismatch in

[489] Seaway Brief on Exceptions at 92-93 (citing Ex. SEA-45 at 23-24).

[490] Trial Staff Brief Opposing Exceptions at 45-46. Trial Staff notes that Seaway does not take exception to the Initial Decision's adoption of Trial Staff's ROE for AFUDC purposes of 11.16 percent (nominal) and 8.19 percent (real) for the period ending December 2011.

[491] Trial Staff Brief Opposing Exceptions at 46 (citing Ex. SEA-18, n. (k); Ex. S-11 (Corrected) at 28-29 and 47; *Southern California Edison Co.*, 131 FERC ¶ 61,020, at P 57 (2010), *remanded on other grounds*, *Southern California Edison Co. v. FERC*, 717 F.3d 177 (2013)). We note that Trial Staff's Brief Opposing Exceptions also states incorrectly that Seaway's initial proxy group is for a six-month period ending March 2012.

data sets.[492] Trial Staff explains that using data from outside of the data period may either overstate or understate the DCF result.[493]

193. Finally, Trial Staff and ACN assert that witness Fairchild errs in calculating the dividend yield adjustment factor in both of his DCF analyses.[494] Trial Staff explains that witness Fairchild skews the DCF results upwards by improperly using the higher IBES short-term growth rate for the "g" in the (1 + 0.5g) calculation rather than the lower, composite two-stage growth rate.[495] ACN asserts that Seaway's contention that the Initial Decision on Remand lacked "any rational basis" to reject Seaway's DCF calculation is unfounded because Seaway's DCF calculation is inconsistent with Commission policy. ACN contends that the Commission's *Generic Rate of Return Proceedings* addressed the issue of the quarterly timing of dividends and settled on the (1 + 0.5g) factor as the proper adjustment, using the same "g" that the Commission prefers for the two-stage, composite growth rate.[496]

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[492] Trial Staff Brief Opposing Exceptions at 46-47. Trial Staff states that Seaway uses IBES growth rate data from July 21, 2012, for its initial DCF analysis and from January 21, 2013, for its updated ROE analysis.

[493] *Id.* (citing Ex. S-11 (Corrected) at 33).

[494] Trial Staff Brief Opposing Exceptions at 46; ACN Brief Opposing Exceptions at 92.

[495] Trial Staff Brief Opposing Exceptions at 46-47 (citing Ex. S-11 (Corrected) at 47; Ex. SEA-18, n. (e)). Trial Staff contends that the proper way to calculate the yield adjustment factor is shown in Ex. S-11 (Corrected) at 48-49; Ex. S-24 at 2 and 6; and *Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, 123 FERC ¶ 61,048 at Appendix A, Table 2, column (5) (2008) (*Proxy Group Policy Statement*).

[496] ACN Brief Opposing Exceptions at 92-94 (citing *Generic Determination of Rate of Return on Common Equity for Public Utilities*, FERC Stats. and Regs. ¶ 30,702 (1986) (*Generic Rate of Return Proceedings*)). ACN states that the Commission's DCF model calculates the proxy group company returns using the formula D/P (1 + 0.5g) + g, where "D" equals the current dividend, "P" equals the company's stock price, and "g" is the composite growth rate that reflects (1) a company-specific, short-term growth rate; and (2) a long-term growth rate equal to the projected growth of the U.S. Gross Domestic Product (GDP). This composite growth rate is also known as the two-stage growth rate.

Commission Determination

194. The Commission reverses the Initial Decision on Remand. Based on the record in this proceeding, the Commission finds that the just and reasonable base ROE for Seaway is 10.75 percent (nominal) and 9.01 percent (real), using Seaway's updated DCF analysis for the six-month period ending December 2012. For AFUDC purposes, the Commission affirms the Initial Decision's determination that Seaway's nominal ROE is 11.16 percent and its real ROE is 8.19 percent.[497]

195. The Commission's long-standing practice in natural gas and oil pipeline cases is to allow an ROE based on the most recent financial data available at the time of the hearing consistent with the due process rights of the participants.[498] Moreover, the Commission finds has adopted this practice for public utility cases.[499] Therefore, the Commission finds it appropriate to base Seaway's ROE upon witness Fairchild's DCF analysis for the six-month period ending December 2012, not upon witness Alvarez's DCF analysis for the earlier six-month period ending October 2012 relied upon in the Initial Decision on Remand.[500]

196. For the six-month period from July 1, 2012 to December 31, 2012, the Commission finds that the appropriate proxy group consists of the following five companies: Buckeye; Enbridge Partners; Enterprise; Plains; and Sunoco.[501] The Commission agrees with Seaway's contention that the Initial Decision on Remand incorrectly found that it used an inappropriate proxy group. Specifically, Seaway is correct that Enterprise's growth rate during the period ending December 2012 was well within the normal range for oil pipelines. The Initial Decision on Remand's criticism of the inclusion of Enterprise is based upon its growth rate for the period ending June 2012; further, the Initial Decision on Remand included Enterprise as a member of its adopted

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[497] We note that no party filed briefs excepting to the AFUDC ROE determination.

[498] *Portland Natural Gas Transmission Sys.*, Opinion No. 510, 134 FERC ¶ 61,129 at PP 242-246 (2011), *order on reh'g*, Opinion No. 510-A, 142 FERC ¶ 61,198 at PP 205-206 (2013).

[499] *Coakley, Mass. Attorney Gen. v. Bangor Hydro-Elec. Co.*, Opinion No. 531, 147 FERC ¶ 61,234 at PP 64, 160, *order on paper hearing*, Opinion No. 531-A, 149 FERC ¶ 61,032 (2014), *reh'g denied*, Opinion No. 531-B, 150 FERC ¶ 61,165 (2015).

[500] Initial Decision on Remand, 147 FERC ¶ 63,009 at PP 325, 329.

[501] *See* Ex. SEA-45 at 20-21; Ex. SEA-49.

proxy group for the period ending October 2012. Similarly, the Initial Decision on Remand's finding regarding NuStar is misplaced because Seaway's updated DCF analysis excludes NuStar from the proxy group.[502] Finally, the Commission finds that witness Fairchild appropriately excluded Magellan in his updated DCF analysis due to its negative IBES and two-stage growth rates in this period, consistent the Commission's policy to remove "illogical" and "anomalous" cost of equity estimates that are inconsistent with the underlying premise of the DCF model.[503]

197. The Commission disagrees with Trial Staff's contention that Seaway's DCF analysis was flawed because its use of five-year IBES growth rates from outside of their respective six-month periods creates a mismatch in data sets. As noted above, the Commission's long-standing policy is to use the most recent financial data available. Moreover, the Commission rejected this very argument when it accepted the five-year IBES growth rate data that the New England Transmission Owners submitted on the 19th day of the month subsequent to the end of the six-month period for stocks prices and dividends.[504] The Commission's acceptance of witness Fairchild's IBES growth rates from January 21, 2013 for his updated DCF analysis is consistent with this policy, as it is within a month of the end of the six-month period ending December 2012.

198. The Commission also agrees with Seaway's contention that the Initial Decision on Remand incorrectly found that its dividend yield forward adjustment factor incorrectly used the "higher" IBES growth rate for "g" rather than the two-stage growth rate in the (1 + 0.5g) calculation.[505] Specifically, the Commission agrees with Seaway's assertion that "the short-term IBES growth rate is far more representative of the growth investors expect over the coming year than is the two-stage growth rate" and that investors would be unlikely to place much weight on a long-term GDP estimate for this purpose.[506] The

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[502] Moreover, there is no valid reason in the record evidence to exclude NuStar from proxy groups for six-month periods ending June 2012 or earlier. In fact, NuStar is a member of Trial Staff's proxy group for the six-month period ending December 2011 that the Initial Decision adopted for the purposes of establishing the base ROE for AFUDC purposes. *See* Ex. S-11 (Corrected) at 25-30; Ex. S-12 at 21; Ex. S-24 at 6.

[503] *See* Ex. SEA-45 at 21 (citing *Proxy Group Policy Statement*, 123 FERC ¶ 61,048 at P 79); *see also* Opinion No. 531, 147 FERC ¶ 61,234 at P 38 & n.64.

[504] Opinion No. 531, 147 FERC ¶ 61,234 at PP 88-89.

[505] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 327.

[506] *See* Seaway Brief on Exceptions at 91-93.

Commission's composite, two-step growth rate serves a different purpose: estimating the growth rate of "an infinite stream of expected dividends" by using the short-term growth rate (weighted at two-thirds) for the first five years and the long-term growth rate (weighted at one-third) for year six and thereafter. In addition, the Commission find unsupported the Initial Decision on Remand's finding that the IBES growth rate for oil pipelines is actually "higher" than the composite growth rate.[507]

199. The Commission finds unpersuasive ACN's reliance upon the Commission's *Generic Rate of Return Proceedings* as evidence that Commission policy and precedent *requires* the "g" value in the dividend yield adjustment factor to be the same "g" value used as the composite growth rate. The Commission developed the two-step DCF methodology for determining ROEs for individual natural gas and oil pipelines in a series of orders dating from the mid-to-late 1990's, long after the Commission established its preferred DCF formula in 1986's *Generic Rate of Return Proceedings*. Specifically, the Commission first required a two-step method for determining constant growth of dividends in natural gas and oil pipeline cases in 1994[508] and first required the use of a long-term GDP growth estimate in 1997.[509] Thus, the Commission could not have contemplated whether it could be appropriate to use only the short-term (IBES) growth rate for the "g" value for the dividend yield adjustment factor back in 1986, and ACN does not provide any specific citation to the *Generic Rate of Return Proceedings* supporting its position. Moreover, the Commission's subsequent allowance for natural gas and oil pipeline proxy groups in a DCF analysis to include MLPs,[510] as well as the requirement that an MLP's long-term growth rate should be one-half the GDP growth estimate,[511] did not occur until 2008.

200. Finally, the Commission disagrees with Trial Staff's arguments that Seaway skews the DCF results upwards by improperly using the higher IBES short-term growth rate

[507] The Commission notes that one reason that the Commission adopted the two-step DCF model for public utilities in the Commission's finding that the three-to-five year growth rate of electric utilities now approximates the projected growth in long-term GDP. Opinion No. 531, 147 FERC ¶ 61,234 at P 40.

[508] *See Ozark Gas Transmission System*, 68 FERC ¶ 61,032 (1994).

[509] *See Northwest Pipeline Corp.*, Opinion No. 396-B, 79 FERC ¶ 61,309 at 62,382-83, *reh'g denied*, Opinion No. 396-C, 81 FERC ¶ 61,036 (1997).

[510] *See Proxy Group Policy Statement*, 123 FERC ¶ 61,048.

[511] *Id.* P 106.

rather than the lower, composite two-stage growth rate. As an initial matter, Trial Staff provides no support for its assertion that the short-term IBES growth rate is inherently higher than the long-term GDP growth rate, which must be true if the IBES short-term growth rate is systematically higher than the composite growth rate. Further, Trial Staff provides no evidence or calculations demonstrating how much higher Seaway's methodology "skews upwards" the ROE results. The analysis shows that the difference between using Seaway's and Trial Staff's methodology appears to be *de minimis*, typically no more than one or two basis points per proxy group company, so we find no basis in the record to reject witness Fairchild's updated DCF analysis based on allegations of upwardly skewed calculations. The Commission acknowledges that Staff correctly points to a sample DCF analysis for oil pipelines in Appendix A in the *Proxy Group Policy Statement* where the "g" value used for the adjusted dividend yield calculation is the composite, two-step growth rate. However, Staff fails to show how Appendix A demonstrates that Commission precedent *requires* the use of the composite growth rate for the adjusted dividend yield calculation.

4. <u>What is the Appropriate Cost of Preferred Stock?</u>

201. Seaway argued that it was not appropriate to include any preferred stock in its capital structure.[512] ACN, CAPP, and SCN took no position.[513] Trial Staff cited to the Commission's Code of Federal Regulations for the proposition that electric utilities, natural gas pipelines, and oil pipelines all require that the weighted cost of preferred equity be shown.[514] Trial Staff asserted the cost of preferred stock is 2.03 percent for the period ending October 31, 2012, and 2.09 percent for the period ending December 31, 2011.[515]

202. The Initial Decision on Remand agreed with Staff's assertion that preferred stock should be included in Seaway's capital structure.[516] Since the Presiding Judge found previously that Seaway's capital structure is based on the average of the capital structures

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[512] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 330.

[513] *Id*. P 332.

[514] 18 C.F.R. § 35.13 (22) (iii) (A) (2012); Initial Decision on Remand, 147 FERC ¶ 63,009 at P 331.

[515] Ex. S-24 at 1, 5, Initial Decision on Remand, 147 FERC ¶ 63,009 at P 333.

[516] Ex. S-11 (corrected) at 11, Initial Decision on Remand, 147 FERC ¶ 63,009 at P 333.

of the parent companies, Enterprise and Enbridge, Enbridge's preferred stock must be reflected in Seaway's capital structure.[517]

203. In its brief on exceptions, Seaway argues that the Initial Decision on Remand erred in adopting Trial Staff's 2.03 percent cost of preferred stock for the period ending October 31, 2012, and 2.09 percent cost of preferred stock for AFUDC purposes for the period ending December 31, 2011,[518] because the capital structure should be based on the average of the oil pipeline proxy group, and none of the proxy group members issues preferred stock. Seaway further argues that, even if it were appropriate to calculate a cost of preferred stock, the Initial Decision on Remand erred by adopting Trial Staff's calculation of 2.03 percent as the cost of preferred stock (by averaging Enbridge's embedded cost of preferred stock of 4.06 percent and averaging it with zero), since Enterprise has no preferred stock.[519] Seaway argues that this result was illogical, since investors would require more than a zero percent return on their investment if Enterprise issued preferred stock.[520]

204. Trial Staff responds in their brief opposing exceptions that, contrary to Seaway's assertion that none of the proxy group members issue preferred stock, Enbridge, one of Seaway's parent companies, does issue preferred stock, and it is included in the proxy group.[521] Trial Staff states Commission regulations and precedent recognize that preferred equity should be treated as a long-term instrument cost used to finance rate base.[522] Trial Staff states they followed these regulations and precedent in calculating Seaway's cost of preferred equity.[523]

205. Trial Staff argues that since Seaway's capital structure should be based on the average of the capital structures of its parents, Enterprise and Enbridge, and Enbridge has

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[517] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 335.

[518] Seaway Brief on Exceptions at 93.

[519] *Id.*

[520] *Id.* 94.

[521] Trial Staff Brief Opposing Exceptions at 47.

[522] *Id.* at 48, citing Ex. No. S-11 (corrected) at 11.

[523] Trial Staff Brief Opposing Exceptions at 48, citing *Transok, Inc.*, 70 FERC ¶ 61,177, at 61,555 (1995) (requiring that rates be designed on actual cost).

preferred stock, Trial Staff reflects that in Seaway's capital structure.[524] Trial Staff states it appropriately averaged the cost of preferred stock of Seaway's parents in determining Seaway's cost of preferred stock, and Seaway cited no Commission precedent supporting its assertion that Trial Staff's calculation of preferred stock is incorrect.[525]

a. Commission Determination

206. The Commission reverses the Initial Decision on Remand. As discussed above, the revised proxy group proposed by Seaway should be used to determine capital structure; therefore, preferred stock should not be included.

207. The Commission notes that Trial Staff has not demonstrated the validity of its approach to calculating the preferred stock. It is not appropriate to take Enbridge's proposed cost of preferred stock and average it with zero, simply because Enbridge does have preferred stock in its capital structure. This results in an artificially reduced average cost of the preferred stock, inasmuch as preferred stock with a zero dividend is highly anomalous. Since the purpose of preferred stock is to provide a dividend that is paid before any common stock dividend, a zero dividend preferred stock is highly unlikely except perhaps in extreme or special circumstances.

E. What is the Appropriate Income Tax Allowance for Seaway?

208. The Presiding Judge found that Seaway was entitled to a full income tax allowance based on a weighted average federal and state income tax rate of 33.7 percent.[526]

209. Suncor argues that the Presiding Judge erred in finding that Seaway is entitled to an income tax allowance without first considering whether it should be applied.[527] ACN argues that Seaway should only be permitted to include 50 percent of its otherwise applicable income tax allowance to account for the fact that only one of its two owners actually incurs an income tax liability.[528]

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[524] Trial Staff Brief Opposing Exceptions at 48.

[525] *Id.*

[526] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 345.

[527] Suncor Brief on Exceptions at 35.

[528] ACN Brief on Exceptions at 47.

210. Seaway states that the Commission has made clear that it is appropriate for a regulated tax pass-through entity, such as an MLP, to include an income tax allowance in its cost of service if an actual or potential income tax liability is incurred on the regulated income generated by the entity.[529]

1. Commission Determination

211. The Commission affirms the Initial Decision on Remand. Seaway calculated its income tax allowance consistent with the established Commission policy and precedent.[530]

F. What is the Appropriate Amount of ADIT?

212. The Presiding Judge ruled that the correct ADIT balance depends primarily on the appropriate (1) rate base, (2) depreciation factor, and (3) weighted average federal and state income tax rate.[531] The Presiding Judge stated that there was no record evidence challenging Seaway's ADIT calculations, and that the final number would be dependent on the resolution of various cost matters.[532]

1. Commission Determination

213. The Commission affirms the Initial Decision on Remand.

VI. What is the Appropriate Rate Design

214. The Presiding Judge stated that the rate design issues in this proceeding are governed by "two irreconcilable principles" the first being that committed rates will be upheld, the second that uncommitted rates must be based on cost-of-service.[533] The Presiding Judge found that Seaway's rate design must employ a true-up mechanism to

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[529] Seaway Brief Opposing Exceptions at 51.

[530] *See Inquiry Regarding Income Tax Allowance*, 111 FERC ¶ 61,139 (2005); *see also SFPP, L.P.*, Opinion No. 511, 134 FERC ¶ 61,121, at PP 218-321 (2011)

[531] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 347.

[532] *Id.* PP 347-348.

[533] *Id.* P 350.

reallocate excess revenue between the pipeline, committed shippers, and uncommitted shippers.[534]

215. The Presiding Judge rejected Seaway's proposed revenue credit methodology because, in her view, all of Seaway's rates must be cost-based.[535] The Presiding Judge also rejected Suncor's proposed methodology because it would result in "significant over-recovery."[536] Finally, the Presiding Judge rejected a system-wide rate proposed by ACN because it did not maintain committed and uncommitted service as separate classes.[537] The Presiding Judge ruled that no party had presented an acceptable rate design that maintained committed and uncommitted rates as two independent classes while preventing over-recovery.[538] The Presiding Judge rejected all of the proposed rate design methods, and criticized the Commission for not re-opening the record to allow the experts to derive a methodology based on her belief that rates must not exceed a cost-of-service level.[539]

216. Seaway states that it will accept the rate design method proposed by SCN based on a system-average approach.[540] Seaway states that the process of setting a cost-based uncommitted rate for Seaway is not dependent on modifying the voluntarily agreed-upon committed rates for the committed shippers.[541]

217. ACN claims that its pre-filed testimony did not differentiate between committed and uncommitted rates, and that the unit rate would apply to both.[542] ACN essentially argues that committed rates must always be used to offset a pipeline's overall revenue

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[534] *Id*.

[535] *Id.* P 351.

[536] *Id.* P 352.

[537] *Id.* P 353.

[538] *Id.* P 354.

[539] Initial Decision on Remand. P 354.

[540] Seaway Brief on Exceptions at 95.

[541] *Id.* at 29.

[542] ACN Brief Opposing Exceptions at 96.

requirement.[543] ACN also states that uncommitted shippers are only responsible for covering the difference between committed rate revenue and overall costs.[544]

218. Trial Staff states that because the Commission is upholding Seaway's committed rates, a crediting method is required to establish just and reasonable cost-based rates for uncommitted shippers.[545]

A. **Commission Determination**

219. The Commission reverses the Initial Decision on Remand. The Presiding Judge's entire argument concerning rate design is built on the fundamentally-flawed premise that the revenue generated from Seaway's committed and uncommitted rates cannot exceed the pipeline's cost-of-service.[546] The so-called "two irreconcilable principles" the Presiding Judge references are not at all irreconcilable, and in fact present no conflict. The Commission reiterates that the Presiding Judge's error in seeing a conflict in these statements is premised on a mistaken belief that the total revenue Seaway derives from both its uncommitted and committed rates cannot exceed Seaway's cost of service. If this were true, then yes, it would be impossible to both uphold the committed rate contracts and realistically calculate a proper uncommitted rate. However, as the Commission has detailed in great length in both the Remand Order and the PDO Order, as well as in the present order, no such requirement exists.

220. The Commission also rules that no true-up mechanism is necessary in Seaway's rate design. The Presiding Judge criticizes the Remand Order for failing to understand that a decision to maintain committed shipper revenue "necessitates the design of as true-up mechanism to reallocate revenues and prevent over-recovery."[547] This argument rests solely on the Presiding Judge's erroneous belief that Seaway's revenues cannot exceed its costs.

221. The Commission rejects the argument that the so-called unique fact that Seaway's committed rate revenue alone exceeds its overall cost of service is relevant in formulating a just and reasonable rate design for Seaway. The Presiding Judge has provided no

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[543] ACN Brief Opposing Exceptions at 25.

[544] *Id.*

[545] Trial Staff Brief Opposing Exceptions at 8.

[546] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 350.

[547] *Id.* P 355.

support for the notion that this factor alone results in unjust and unreasonable committed rates, or prohibits a proper calculation of cost-based uncommitted rates, aside from references to the original Hearing Order which does not support the Presiding Judge's argument. The Commission finds that the Presiding Judge's rationale, if followed, would render ***any*** rate above a cost-of-service level unjust and unreasonable, not merely those committed rates that generate revenue above a pipeline's total revenue requirement. Such an approach is untenable.

222. The Commission allows rate designs that provide for both committed and uncommitted service. Currently there are numerous oil pipelines with rate designs consisting of discount rates set below cost-of-service rates paired with cost-based uncommitted rates. Other pipelines provide premium service rates set above cost-based uncommitted rates, also paired with cost-based uncommitted rates. By definition these rate designs will generate revenue that diverges from a pipeline's overall cost-of-service. The Presiding Judge has failed to support the argument that the divergence in this proceeding, by itself, is a sufficient ground for the Commission to override the sanctity-of-contract principle and modify Seaway's committed rates. For the Commission to allow, for example, discount rates that generate revenue below a pipeline's cost-of-service, but to modify committed contracts that result in revenues above the pipeline's cost-of-service, would be an arbitrary and unjustified exercise of the Commission authority to modify contract rates.

VII. Different Rates for Light Crude and Heavy Crude

223. The Presiding Judge ruled that it is not discriminatory to charge different rates to heavy crude and light crude shippers, as their shipments have different properties and different impacts on oil pipeline operations.[548]

224. ACN also criticizes the Initial Decision on Remand's approval of different rates for heavy and light crude oil shipments without finding a cost-based justification for the magnitude of that proposed differential.[549]

A. Commission Determination

225. The Commission affirms the Initial Decision on Remand. Seaway has fully justified the differences between these two classes of shipper, and the different costs for

[548] Initial Decision on Remand, 147 FERC ¶ 63,009 at P 357.

[549] ACN Brief on Exceptions at 48.

their respective shipments, and therefore is not in violation of the anti-discrimination requirements of the ICA.

VIII. What are the Appropriate Committed and Uncommitted Rates for Seaway?

226. In this proceeding, Seaway's committed rates will be upheld, for the reasons discussed above. Seaway's uncommitted, cost-based rates must be calculated based on the findings of this order and the effects of those findings on Seaway's overall revenue requirement. Given the absence in this proceeding of any rate design element tying the calculation of uncommitted rates to committed rate revenues, the presence of negotiated committed rates, and the revenue derived from such rates, has no impact on the calculation of Seaway's uncommitted rate. The Commission's regulations and precedent provide sufficient guidance in the calculation of an oil pipeline's cost-based rate, and Seaway is required to follow this guidance as well as the rulings in the present order in its compliance filing.

The Commission orders:

(A) The Initial Decision on Remand is affirmed, in part, and reversed in part, as discussed in the body of the Order. To the extent this Order omits discussion of particular exceptions, they have been considered and are denied.

(B) Seaway shall file revised uncommitted rates consistent with this order within 45 day after this order issues. In its compliance filing Seaway must show how it has allocated all costs between jurisdictional and non-jurisdictional assets, and according to the base and test periods adopted in this order. Seaway must also update its filing using the approved remaining life and survivor curves, and to update its depreciation study, refiling all applicable exhibits. Seaway is directed to update its Depreciation Study, as discussed in the body of this order.

(C) Comments on the compliance filing are due 75 days after this order issue and reply comments 90 days after this order issues.

By the Commission.

(SEAL)

Nathaniel J. Davis, Sr.,
Deputy Secretary.