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UNITED STATES OF AMERICA 139 FERC ¶ 63,015
FEDERAL ENERGY REGULATORY COMMISSION

Enbridge Pipelines (Southern Lights) LLC Docket Nos. IS10-399-003
IS11-146-000

INITIAL DECISION

(Issued June 5, 2012)

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BOBBIE J. McCARTNEY, Deputy Chief Administrative Law Judge.

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BACKGROUND AND PROCEDURAL HISTORY

1. This proceeding addresses two rate filings made by Enbridge Pipelines (Southern Lights) LLC (ESL) in Docket Nos. IS10-399-000 and IS11-146-000. In Docket No. IS10-399-000, ESL seeks to establish initial rates for the United States portion of a 1,582-mile pipeline it owns and constructed from Manhattan, Illinois to Edmonton, Alberta.[1] The pipeline, which began commercial operations on July 1, 2010, transports diluent to Alberta.[2] Diluent consists of low density, low viscosity hydrocarbons used to dilute heavy oil and bitumen, thus making them transportable by pipeline.[3]

2. ESL proposes rates based on its Transportation Services Agreements (TSAs). Under the TSAs, the pipeline provides two categories of service. Committed shippers[4] agree to ship or pay for the transportation of a specified volume of diluent over an initial fifteen-year contract term and pay the committed rate for their annual volume commitments.[5] Uncommitted shippers, and committed shippers who ship volumes in excess of their annual committed volumes, pay the uncommitted rate. The TSAs establish as “an over-arching principle” that the ratio of the uncommitted rate to the committed rate be 2:1.[6] In its tariff filing, ESL proposed an uncommitted rate of $10.0526 per barrel and a committed rate of $5.0263 per barrel.[7]

3. Two companies – BP Products North America Inc. (BP) and Statoil North America, Inc. (Statoil) – have entered into TSAs as committed shippers. Together, their

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[1] *See* Exh. ESL-1 at 3-4 (Jervis). Mr. Jervis refers to the entire Manhattan-to-Edmonton pipeline project as the “Southern Lights Pipeline” and to “Enbridge Southern Lights” as the company that owns the portion of the project located in the United States. *Id.* at 2. However, in the discussion of risk in determining an appropriate rate of return below, Commission Trial Staff (“Trial Staff”) uses the term “Southern Lights Pipeline” to refer only to the United States portion of the entire pipeline project, since that is the only portion over which the Commission has rate jurisdiction and for which an appropriate rate of return is at issue. This usage also parallels the usage by the National Energy Board of Canada (NEB). *See* Staff I.B. at 7-8.

[2] *Id.* at 3-4.

[3] *Enbridge Pipelines (Southern Lights) LLC*, 131 FERC ¶ 61,288, at P 1 n.1 (2010).

[4] ESL’s Committed Shippers are BP Products North America Inc. (“BP”) and Statoil North America, Inc. (“Statoil”). Exh. ESL-1 at 8.

[5] Exh. ESL-1 at 12 (Jervis).

[6] Exh. ESL-9 at 42 n.1 (Webb) (Southern Lights Diluent Pipeline Transportation Services Agreement, *pro forma* U.S. version).

[7] Exh. ESL-4 at 2 (Jervis) (Enbridge Pipelines (Southern Lights) LLC, FERC ICA Oil Tariff, FERC No. 2).

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commitments equal 77,000 barrels a day, or approximately 43%, of the pipeline's total daily capacity of 180,000 barrels.[8]

4. Prior to making its tariff filing in Docket No. IS10-399-000, ESL filed a petition for a declaratory order, which the Commission approved in 2007, seeking approval of the rate terms of the TSAs. Among other things, the TSAs provide for rates based on: (1) a capital structure of 30% equity and 70% debt; (2) a return on equity of between 10% and 14%, depending on the project's final capital cost; (3) a depreciation rate schedule, which specifies rates that yield depreciation expenses more levelized than those derived from depreciation rates using a straight-line basis; (4) the crediting of all uncommitted revenues to both committed and uncommitted shippers up to 90% of the pipeline's annual capacity, and a 25% pipeline - 75% shippers sharing of incremental revenues associated with volumes above that level; and (5) an annual projection of costs and volumes, with an annual true-up mechanism that provides refunds to, or recovery from, shippers after the end of each year.[9]

5. In the rehearing order in 2008, the Commission clarified that the agreed-upon terms of the TSAs would govern the determination of the committed shippers' rates, and that it was upholding the rate design embodied in the TSAs, with one condition.[10] In the event that the uncommitted rate was protested, the Commission held that it would require ESL to support the uncommitted rate by filing cost, revenue, and throughput data, as required by Part 346 of its oil pipeline regulations.[11] The Commission added that when a just and reasonable uncommitted rate was determined in this manner, the pipeline could derive the committed rate by applying the agreed-upon terms of the TSAs.[12]

6. When ESL filed actual tariff rates based on the TSAs in 2010 in Docket No. IS10-399-000, Imperial Oil and ExxonMobil Oil Corporation (jointly, the Indicated Shippers) protested the proposed uncommitted rate.[13] In accordance with the 2008 clarification order, the Commission required the pipeline to provide cost justification for the uncommitted rate under Part 346 of its regulations.[14] It set the filing for hearing, holding the hearing in abeyance pending the outcome of settlement judge procedures.[15]

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[8] Exh. S-15 at 3-4 (McComb).

[9] *Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,310, at P 11 (2007); Exh. ESL-9 at 40-41, 44, 62-63 (Webb).

[10] *Enbridge Pipelines (Southern Lights) LLC*, 122 FERC ¶ 61,170, at P 13 (2008).

[11] *Id.*

[12] *Id.*

[13] *Enbridge Pipelines (Southern Lights) LLC*, 131 FERC ¶ 61,288, at P 5, 15 (2010).

[14] *Id.* at P 15.

[15] *Id.*

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7. Settlement judge procedures were unsuccessful, and on January 19, 2011, the Chief Administrative Law Judge terminated the settlement procedures and designated Judge Charlotte J. Hardnett to preside at the hearing.[16]

8. While Docket No. IS10-399-003 was pending before Judge Hardnett, the Commission consolidated a new ESL rate case with the ongoing hearing.[17] Pursuant to the TSAs, the pipeline had made its first annual recalculation of the tariff rates on December 28, 2010. In Docket No. IS11-146-000, it proposed to increase the uncommitted rate to $10.9744 per barrel and the committed rate to $5.4872 per barrel, subject to the TSA true-up mechanism.[18] The Commission suspended the new rates to be effective February 1, 2011, subject to refund.[19] Therefore, the order locked-in the period in which the rates at issue in Docket No. IS10-399-003 were in effect to the seven months of July 2010 through January 2011.

9. On March 15, 2011, at the request of the participants, Judge Hardnett heard oral argument on the scope of the consolidated proceedings. After the filing of briefs, she ruled that the sole issue before her was whether the uncommitted rates proposed by ESL were just and reasonable.[20] On April 20, 2011, the Chief Administrative Law Judge issued an order substituting Deputy Chief Administrative Law Judge Bobbie J. McCartney as Presiding Judge.[21]

10. On November 30, 2011, in Docket No. IS12-63-000, ESL filed its second annual recalculation of tariff rates under the TSAs.[22] It proposed to increase the uncommitted rate to $11.8434 per barrel and the committed rate to $5.9127 per barrel, again subject to true-up.[23] The Commission suspended the tariff filing to be effective January 1, 2012, subject to refund.[24] It did not consolidate the new docket with the ongoing hearing

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[16] *Enbridge Pipelines (Southern Lights) LLC*, "Order of Chief Judge Terminating Settlement Judge Procedures, Designating Presiding Administrative Law Judge, and Establishing Track III Procedural Time Standards," (Jan. 19, 2011).

[17] *Enbridge Pipelines (Southern Lights) LLC*, 134 FERC ¶ 61,067 (2011).

[18] *Id.* at P 3; Exh. ESL-6 at 2 (Jervis) (Enbridge Southern Lights, FERC ICA Oil Tariff, FERC No. 4.3.0).

[19] *Enbridge Pipelines (Southern Lights) LLC*, 134 FERC ¶ 61,067, at P 13 (2011).

[20] *Enbridge Pipelines (Southern Lights) LLC*, "Order on Scope of Issues Set for Hearing and Denying Motion for Certification to the Commission," April 5, 2011.

[21] *Enbridge Pipelines (Southern Lights) LLC*, "Order of Chief Judge Making Substitute Designation of Presiding Administrative Law Judge, Modifying Track III Procedural Schedule, and Waiving Period for Answers," April 20, 2011.

[22] *Enbridge Pipelines (Southern Lights) LLC*, 137 FERC ¶ 61,256, at P 1-2 (2011).

[23] Enbridge Southern Lights, FERC ICA Oil Tariff, FERC No. 4.5.0, at 2.

[24] *Enbridge Pipelines (Southern Lights) LLC*, 137 FERC ¶ 61,256, at P 1 (2011).

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procedures, but instead held proceedings in the new docket in abeyance pending the outcome of the hearing.[25] This order locked-in the period in which the rates at issue in Docket No. IS11-146-000 were in effect to the eleven months of February through December 2011.

11. The undersigned conducted a hearing on ESL's proposed uncommitted rates in Docket Nos. IS10-399-033 and IS11-146-000 on January 10 and 11, 2012. At the hearing, ESL, the Indicated Shippers, and Trial Staff sponsored a total of twelve witnesses and 131 exhibits. Pursuant to the procedural schedule, initial briefs were due by February 28, 2012 and reply briefs were due by March 27, 2012.

12. On March 9, 2012, ESL filed a Motion to Strike the Offer of Proof submitted with the Indicated Shippers' Initial Post-Hearing Brief ("I.B."). In the Offer of Proof, the Indicated Shippers presented five issues[26] relating to ESL's rate structure that they wanted the Commission to examine in this proceeding. On March 29, 2012, an Order was issued granting the Motion to Strike on grounds that the Offer of Proof is procedurally and substantively flawed.[27]

ISSUES

13. On December 20, 2011, the parties submitted a Joint Statement of Issues, noting the following questions in the calculation of a just and reasonable uncommitted rate in Docket Nos. IS10-399-003 and IS11-146-000:

- Does the TSA apply to the uncommitted rate and if so how, and in what respects?
- What is the appropriate base and test period?
- What is the appropriate total cost-of-service?
- What is the appropriate rate base?
- What is the appropriate overall return?
- What is the appropriate capital structure?
- What is the appropriate cost of debt?

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[25] *Id.*

[26] *See* Indicated Shippers I.B. at 51. The issues include: (1) the lawfulness of the rebate mechanism in the Transportation Services Agreements (TSAs) and pipeline tariff; (2) alleged discriminatory, preferential, and anticompetitive impacts of the TSAs and their rate structures on uncommitted shippers; (3) the lawfulness of the rights of first offer (ROFO) in the TSAs; (4) the lawfulness of the alleged subordination of the Enbridge Southern Lights' FERC tariff to the pipeline project's Canadian tariff; and (5) the lawfulness of the 2:1 ratio between the uncommitted and committed rates.

[27] *See* Order Granting Motion to Strike, *Enbridge Pipelines (Southern Lights) LLC*, Docket Nos. IS10-399-003 and IS11-146-000 (March 29, 2012).

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- What is the appropriate cost of equity?
- What is the appropriate income tax allowance?
- What is the appropriate level of operating expenses?
- What is the appropriate depreciation expense?
- What capital structure and rate of return apply to the calculation of AFUDC?
- What is the appropriate level of amortization of AFUDC?
- What is the appropriate level of deferred return?
- What is the appropriate level of throughput/billing determinants?
- What is the appropriate rate design?
- What is the just and reasonable uncommitted rate for the period in question?

Issue #1: Does the TSA apply to the uncommitted rate and if so how, and in what respects?

A. ESL

14. On February 28, 2012, ESL filed its Initial Post-Hearing Brief, explaining that aspects of the TSA that were approved by the Commission, and therefore became part of the existing tariff structure of ESL, must be taken into account when assessing the Uncommitted Rate for both 2010 and 2011. ESL noted that it is not the TSA itself, but rather the Commission's prior rulings with respect to the TSA, that constitute the framework within which this case must be decided.[28]

15. ESL dismissed the argument that Indicated Shippers cannot be bound by the TSA because Indicated Shippers did not agree to it.[29] ESL observed that the Indicated Shippers had notice and an opportunity to participate in the Declaratory Order process, but chose not to do so. ESL argued that Indicated Shippers cannot now collaterally attack the result of that process, as the Commission has repeatedly confirmed.[30]

16. ESL explained that the Commission found that the 2-to-1 ratio was non-discriminatory in the Declaratory Order and confirmed this in the Clarification Order.[31] ESL observed that the Commission again confirmed that the 2-to-1 ratio was just and reasonable and non-discriminatory in the Order on Complaint.[32]

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[28] ESL witness, Dr. Webb, discussed the application of the Commission's prior orders in detail. *See* Exh. ESL-7 at 8-18; Exh. ESL-44 at 4-8.

[29] *See* Exh IS-33 at 20-23.

[30] *See* Order on Complaint at P 9 ("[T]he Indicated Shippers' complaint against Southern Lights Pipeline's rate structure and methodology is an impermissible collateral attack on the declaratory order proceeding.").

[31] *See* Declaratory Order at P 31; Clarification Order at P 13.

[32] *See* Order on Complaint at P 16.

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17. ESL noted that their witness, Dr. Jaffe, addressed the economic significance of ESL's Commission-approved tariff structure.[33] Since the TSA obligates the Committed Shippers to pay ESL's Discounted Costs whether or not they ship their committed volumes, Dr. Jaffe explained that it is the Committed Shippers who primarily bear the risk related to diluent demand, as well as the other project risks identified in the Declaratory Order.[34] Furthermore, Dr. Jaffe explained that the transfer of risk from ESL to the Committed Shippers is directly related to the tariff structure that treats the Committed Shippers as a class of shippers separate from the Uncommitted Shippers.[35]

18. ESL stated that the Uncommitted Shippers bear no risk under the TSA and benefit from the flexibility to ship when they choose. Dr. Jaffe explained that this optionality has economic value to the Uncommitted Shippers whether or not they ship any volumes.[36] Therefore, ESL argued that the appropriate rate design must incorporate the concept that the Uncommitted Shippers should pay an Uncommitted Rate that compensates those who do bear the project risk for the cost of doing so. ESL contended that is exactly what the TSA does, both through the 2-to-1 rate design and the year-end refund mechanism.[37] ESL argued that if the Uncommitted Rate were based on a cost-of-service assuming a low-risk environment, as the Indicated Shippers seek, then Uncommitted Shippers would obtain an unwarranted free ride by having the option to ship whenever they want at a low-cost rate without having taken any of the risks of supporting the project.[38]

19. ESL observed Trial Staff's concurrence that the Commission has approved certain key provisions of the TSA and that those rulings apply to the determination of the Uncommitted Rate. For example, Trial Staff witnesses recognized that in the Declaratory Order, the Commission approved the calculation of the Committed Rates in accordance with the TSA, the requirement that the Uncommitted Rate be set at two times the Committed Rate, and the implementation of the refund mechanism.[39] ESL noted Trial Staff witness McComb's explanation that the Commission-approved 2-to-1 ratio, as set forth in the TSA, must be maintained when calculating the Uncommitted Rate.[40]

20. ESL disagreed with the Indicated Shippers' approach, which assumes that the Commission-approved aspects of the TSA do not apply to the Uncommitted Rate. ESL observed that the Indicated Shippers are attempting to relitigate the 2-to-1 ratio already approved by the Commission.

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[33] *See* Exh. ESL-27 at 5-14.

[34] *Id.*; Tr. at 91:18-20 (Jaffe).

[35] *See* Exh. ESL-27 at 5-8.

[36] *See* Exh. ESL-27 at 10-11; Tr. at 82:7-15.

[37] *See* Exh. ESL-27 at 11.

[38] *Id.*

[39] *See* Exh. S-15 at 2:20-3:4, 16; Exh. S-10 at 21, 25; *see also* Tr. at 287:12-17.

[40] *See* Tr. at 281:23-282:2.

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21. ESL contended that they and Trial Staff have properly reflected the Commission's prior rulings on the TSA in their rate presentations. ESL explained that their proposed rate design, which incorporates the *Keystone/Laclede* methodology,[41] takes into account the two classes of shippers and assures that the Uncommitted Shippers do not pay more than their fair share of the cost-of-service.

22. In accordance with the *Keystone/Laclede* methodology, ESL explained that the Opinion No. 154-B cost-of-service is allocated between the Committed and Uncommitted Shippers by first deducting the revenue provided by the Committed Shippers and then allocating the remainder over the volumes transported by the Uncommitted Shippers, assuming there are any such volumes.[42] ESL argued that its tariff structure results in just and reasonable cost-based rates for the Uncommitted Shippers, since the rates designed in this manner always exceed the effective (post-refund) rates paid by Uncommitted Shippers at the corresponding volume level.[43]

23. ESL explained that Trial Staff uses a different methodology to confirm that the effective Uncommitted Rates for 2010 and 2011 are just and reasonable at all potential volume levels.[44] ESL noted that Trial Staff's approach uses a cost-of-service that reflects the shifting of risk from the pipeline to the Committed Shippers under the TSAs, but then applies the Commission-approved 2-to-1 ratio to that cost-of-service to derive the maximum Uncommitted Rate.[45]

24. On March 27, 2012, ESL filed its Post-Hearing Reply Brief. ESL noted that many of the Indicated Shippers' arguments hinge on the novel idea that, once they filed a protest, all of the Commission's prior rulings ceased to apply. ESL explained that nothing in the Commission's prior orders suggests that the Indicated Shippers start on a "blank slate" once a protest is filed. ESL stated that the Clarification Order requires that, if a protest is filed, ESL is required to justify the Uncommitted Rate on a cost-of-service

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[41] *See TransCanada Keystone Pipeline, LP*, 125 FERC ¶ 61,025 (2008); *Laclede Pipeline Co.*, 114 FERC ¶ 61,335 (2006); *see* ESL-7 at 57-58, 64 (noting that the Commission determined that a revenue crediting approach (*i.e.*, crediting the revenue from discounted shipments) was an appropriate method to calculate a rate for undiscounted service. The Commission followed this approach in *Keystone* (in a situation involving committed and uncommitted shippers, as here), and granted the pipeline's request that the uncommitted rate be calculated on a revenue crediting mechanism which resulted in uncommitted shippers bearing a higher share of the pipeline's costs on a per-unit basis).

[42] *See* Exh. ESL-7 at 64; *see also Keystone*, 125 FERC ¶ 61,025, at P 25.

[43] *See* Exh. ESL-7 at 66-67; Exh. ESL-56, Workpaper 9.

[44] *See* Exh. S-19.

[45] *See* Exh. S-15 at 9, 11.

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basis under Opinion No. 154-B.[46] ESL argued that the Clarification Order does not state that the Uncommitted Rate calculation must disregard the approved tariff structure, and in fact, the Commission has repeatedly stated that the approved tariff structure is not undermined by requiring a cost-of-service showing with respect to the Uncommitted Rate.[47]

25. ESL further explained that the Commission did not impose the specific cost-of-service elements in the TSA on the Uncommitted Shippers, but rather required calculation of those elements in accordance with the Opinion No. 154-B methodology embodied in Part 346 of the oil pipeline regulations.[48]

26. ESL noted that, as a practical matter, the Indicated Shippers' blank slate approach would be unworkable since the calculation of the allowable just and reasonable Uncommitted Rate must be consistent with the Commission's prior final rulings on the ESL tariff structure both to preserve the finality of Commission decision making and to protect the reliance interests of those parties. In particular, ESL pointed out that the Commission held the year-end refund mechanism to be just and reasonable in the Declaratory Order and recently reaffirmed that ruling in the Order on Complaint.[49] Similarly, ESL noted that the 2-to-1 rate design method has also been approved by the Commission as both non-discriminatory and just and reasonable.[50] ESL agreed with

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[46] *See* Clarification Order at P 13 (stating that "if the uncommitted rate is protested, Enbridge Southern Lights must comply with section 342.2(b) to support its uncommitted rate by filing cost, revenue, and throughput data supporting such rate as required by part 346 of the Commission's regulations").

[47] *Id.* ("Therefore, the Commission clarifies that the agreed-upon terms of the TSA will govern the determination of the committed shippers' rates over the term of the TSA, and that the rate design embodied in the TSA used to determine both the committed and uncommitted rates will be upheld . . . ."); *see* 2010 Suspension Order at P 16 ("The fact that the Commission is setting the initial rates for hearing does not undermine the approval of the rate structure in the declaratory order or the fact that the Commission approved committed rates that would be 50 percent of the uncommitted rates.").

[48] *See* Order on Complaint at P 17 ("interests of the Indicated Shippers are adequately protected in the ongoing hearing on the Uncommitted Rate, in that they can challenge the reasonableness of any cost proposed to be included in the Uncommitted Rate"); *see also* Staff I.B. at 13 ("Trial Staff concludes from these observations that in its hearing and declaratory orders, the Commission was simply pointing out that it could not accept the TSAs' specified cost components and formula on their face, and that the pipeline would need to justify the uncommitted tariff rate at hearing. Indeed, the Commission expressly found, that in all other respects, the TSA rate structure applied").

[49] *See* Declaratory Order at P 45; Order on Complaint at PP 11-13.

[50] *See* Declaratory Order at P 31; Clarification Order at P 13; Order on Complaint at P 16.

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Trial Staff's observation that principle is not repealed merely because a protest has been filed.

27. ESL addressed Indicated Shippers' reliance on various "recourse rate" rulings pursuant to the *Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines* policy statement to conclude that the approved features of the TSAs do not apply to the determination of a just and reasonable Uncommitted Rate. While the Clarification Order did reference the "recourse rate" concept, ESL noted that the Commission did not suggest that the 1996 Natural Gas Policy Statement dictates how to apply the Opinion No. 154-B methodology for purposes of demonstrating the justness and reasonableness of the posted 2010 and 2011 Uncommitted Rates; rather, the Commission stated only that "if the uncommitted rate is protested it must be supported by filing cost, revenue, and throughput data, similar to the requirement that gas pipelines must offer a cost-of-service based recourse rate."[51] ESL argued that this is precisely what it did in this case.

28. ESL mentioned that the Clarification Order did not state that the TSA structure approved in the Declaratory Order proceeding should be disregarded if a party protests ESL's Uncommitted Rate. To the contrary, ESL noted the Commission's clarification that "the rate design embodied in the TSA used to determine both the committed and uncommitted rates will be upheld and applied during the term of the TSA."[52] ESL explained that the ruling was subject only to the condition that, if the Uncommitted Rate was protested, ESL must support the rate "by filing cost, revenue, and throughput data supporting such rate as required by part 346 of the Commission's regulations."[53] Finally, ESL argued that in the Order on Complaint, the Commission removed any doubt as to the applicability of the TSA rate structure, stating that it had "reviewed the TSA and the rate structure in the declaratory order proceeding and determined that the proposed rate design was just and reasonable and not unduly discriminatory because all potential shippers had the opportunity to become Committed Shippers."[54]

29. ESL contended that the TSAs resulted from valid open seasons and not the type of individually-negotiated contracts addressed in the 1996 Natural Gas Policy Statement. ESL disagreed with Indicated Shippers that the process leading up to the TSAs was "private," "secret," or "individualized" and as ESL witness Jervis described, the TSAs were the outcome of an entirely transparent process consisting of two open seasons. ESL cited the Commission's summary of the process: "In 2006, in order to determine the financial viability of its proposed Southern Lights Pipeline, Enbridge held a widely publicized open season. Imperial and ExxonMobil were among the potential shippers

[51] Clarification Order at P 14.
[52] Clarification Order at P 13.
[53] Clarification Order at P 13.
[54] Order on Complaint at P 16.

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who received notices and attended meetings. Neither of the Indicated Shippers became a Committed Shipper on the proposed pipeline."[55] Therefore, ESL argued that the TSA rate structure was developed through a fully transparent process in which the Indicated Shippers and any other prospective shippers were provided two opportunities to become Committed Shippers. Accordingly, ESL believed that the 1996 Natural Gas Policy Statement's concern about pipelines using negotiated rates to impose unilateral demands is not applicable in this case.

30. ESL explained that another feature setting this case apart from the gas pipeline negotiated rate regime is that ESL sought and obtained pre-approval of the TSA rate structure through the Commission's well-established declaratory order process. ESL noted that in contrast to the process envisioned under the 1996 Natural Gas Policy Statement, the Commission has encouraged oil pipelines to file declaratory order petitions concerning their proposed rate structures as a means of obtaining regulatory certainty in advance of constructing major new infrastructure projects, and as the Commission has repeatedly held, "a declaratory order [is] procedurally appropriate for a new oil pipeline entrant . . . because it needs to acquire and guarantee financing in order to begin construction."[56]

31. Regarding Indicated Shippers' allegation that using the TSA rate structure to set the Uncommitted Rate will result in the type of undue discrimination prohibited under the ICA, ESL stated that the Commission expressly and unambiguously found to the contrary.[57] ESL argued that even if the TSA rate structure were deemed to be the product of negotiations between ESL and the Committed Shippers, the resulting Uncommitted

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[55] Order on Complaint at P 9.

[56] *Express Pipeline Partnership*, 77 FERC ¶ 61,188, at 61,755 (1996); *see also Colonial Pipeline Co.*, 116 FERC ¶ 61,078, at P 45 (2006) ("it is useful to remove uncertainty regarding rate methodology issues prior to construction of a project and prior to the filing of proposed rates because the assurances facilitate financing and other investment decisions."). ESL noted that the list of new or expanded pipelines that have obtained declaratory orders in this fashion also includes *Enbridge Pipelines (North Dakota) LLC*, 133 FERC ¶ 61,167 (2010); *White Cliffs Pipeline, L.L.C.*, 126 FERC ¶ 61,070 (2009); *CCPS Transportation, LLC*, 121 FERC ¶ 61,253 (2007); *Calnev Pipe Line LLC*, 120 FERC ¶ 61,073 (2007); *Caesar Oil Pipeline, LLC*, 102 FERC ¶ 61,339 (2003); *Proteus Oil Pipeline Co.*, 102 FERC ¶ 61,333 (2003); *Plantation Pipe Line Co.*, 98 FERC ¶ 61,219 (2002).

[57] Declaratory Order at P 16 (holding that "the [ESL] proposed rate structure does not violate the antidiscrimination or undue preference provisions of the Interstate Commerce Act (ICA) because the rate discount was made available to all interested shippers and reflects the differences in service between firm and non-firm shippers"); *see* 2010 Suspension Order at P 16 ("[s]ince all potential shippers had the opportunity to sign up for the committed rates, there is no issue of discrimination").

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Rate would not violate the ICA. ESL explained that the ICA does not preclude rates set by contract – it requires only that the same contract rates be offered to similarly situated shippers.[58] ESL also noted that neither they nor the Trial Staff contends that the TSAs "trump" the Commission's oil pipeline regulations.

32. ESL noted that while the Indicated Shippers stress a policy adopted for gas pipelines, they wholly ignore the Commission's policy for oil pipelines that was adopted in orders issued after the 1996 Natural Gas Policy Statement. ESL cited to *Express Pipeline Partners*[59], where the Commission held that it was appropriate for oil pipelines to establish differential rates for different classes of shippers, such as committed shippers and uncommitted shippers. ESL stated that the principle discussed in *Express* has been repeatedly reaffirmed, including in the *Keystone* case,[60] where the pipeline explained to the Commission that its proposed rate structure "results in uncommitted shippers bearing a higher proportionate share of the pipeline's costs on a unit basis, that is, 'walk-up' shippers pay more per barrel of transportation."[61] ESL pointed out that the Commission never mentioned any of its gas pipeline rulings when it approved the approach adopted in *Express* and followed in *Keystone*.

33. ESL argued that the Indicated Shippers do not consistently apply their own blank slate position – arguing that the Uncommitted Rate should be determined without regard to any aspect of the TSAs[62] while seeking to benefit from the long-term contractual commitments undertaken by the Committed Shippers. ESL believed that the Indicated Shippers want the benefits of ESL's project financing (*e.g.*, highly leveraged capital structure, low cost of debt) without having undertaken the obligations that made those benefits possible. ESL noted that the Indicated Shippers seem to seek an Uncommitted Rate that would confer upon them the right to free-ride on the contractual commitments of the Committed Shippers while bearing none of the corresponding obligations that made the Southern Lights Pipeline project possible. ESL cited Dr. Jaffe's opinion that

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[58] *See Sea-land Service, Inc. v. ICC*, 738 F.2d 1311, 1316 (D.C. Cir. 1984) ("the [ICC] has held that contract rates are not inherently discriminatory, provided that the carrier offering them makes them available to all similarly situated shippers of like commodities").

[59] *See* 76 FERC ¶ 61,245 (1996).

[60] *See, e.g., White Cliffs Pipeline, L.L.C.,* 126 FERC ¶ 61,070, at P 28 (2009); *TransCanada Keystone Pipeline, LP*, 125 FERC ¶ 61,025, at P 25 (2008); *Enbridge (U.S.) Inc. and ExxonMobil Pipeline Co.,* 124 FERC ¶ 61,199, at P 29 (2008); *Enbridge Energy Company, Inc.,* 110 FERC ¶ 61,211, at P 38 (2005); *Plantation Pipe Line Co.*, 98 FERC ¶ 61,219, at 61,866 (2002); *Mid-America Pipeline Co.*, 93 FERC ¶ 61,306, at 62,048-49 (2000).

[61] *TransCanada Keystone Pipeline, LP*, 125 FERC ¶ 61,025 at P 23 (2008).

[62] *See* Indicated Shippers I.B. at 6-13.

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allowing parties to change the rules in this type of ex-post fashion can only discourage investment and encourage regulatory gamesmanship.[63]

B. Committed Shippers

34. On February 28, 2012, Committed Shippers filed its Initial Post-Hearing Brief, stating that the TSA applies to the Uncommitted Rate as it fixes the relationship between the Uncommitted Rate and the Committed Rate at a 2-to-1 ratio.[64] Committed Shippers also noted that Staff witness McComb demonstrated that the Committed Rate and the Uncommitted Rate are fundamentally interrelated for rate making purposes.[65]

35. Committed Shippers explained that prior Commission orders approved the Refund Mechanism set forth in the TSA.[66] Committed Shippers argued that the TSA Refund Mechanism, in conjunction with the Commission-approved relationship between the Uncommitted and Committed Rate of 2:1, is why Indicated Shippers' proposal to calculate an "Uncommitted Rate" based on the total design capacity of the Southern Lights Pipeline system is contrary to Commission policy and the Commission's prior orders concerning the Southern Lights Pipeline.

36. On March 27, 2012, Committed Shippers filed its Post-Hearing Reply Brief, noting that Indicated Shippers' attempts to avoid prior Commission rulings are unpersuasive. Committed Shippers believed that the Commission's orders are clear that the 2:1 Rate Design Ratio and the associated refund mechanism will apply to the calculation of a just and reasonable uncommitted rate.[67] Committed Shippers stated that the Indicated Shippers' contention that the Commission's negotiated rate policy applicable to interstate natural gas pipelines must guide the development of the

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[63] *See* ESL-27 at 6.

[64] *See* Exh. ESL-7 at 26:16-19 (Webb); Exh. ESL-44 at 5:13-16, 10:6-10, 11:1-14, 48:1-8 (Webb); Exh. S-15 at 15:1-7 (McComb); *see Imperial Oil and ExxonMobil Oil Corp. v. Enbridge Pipelines (Southern Lights) LLC,* 136 FERC ¶ 61,115 at P 17 (2011); *Enbridge Pipelines (Southern Lights) LLC*, 134 FERC ¶ 61,067 at P 12 (2011); *Enbridge Pipelines (Southern Lights) LLC*, 131 FERC ¶ 61,288 at P 16 (2010); *Enbridge Pipelines (Southern Lights) LLC*, 122 FERC ¶ 61,170 at P 11 (2008); *Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,310 at P 31 (2007).

[65] *See* Tr. 291:17–292:9; Exh. S-21 (McComb).

[66] *Order on Complaint*, *Imperial Oil and ExxonMobil Oil Corp. v. Enbridge Pipelines (Southern Lights) LLC*, 136 FERC ¶ 61,115 at P 11 (2011) (noting that "[t]he Commission finds that the Indicated Shippers' argument on the refund mechanism is deficient on both procedural and substantive grounds. The annual refund mechanism was part of the TSA available to all potential shippers, was discussed by Enbridge in its petition for declaratory order and was approved by the Commission").

[67] Order on Complaint at P 11.

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Uncommitted Rates in this case is misguided as there are significant differences underlying the statutory and regulatory regimes applicable to natural gas and oil pipelines.

C. Indicated Shippers

37. On February 28, 2012, Indicated Shippers filed its Initial Post-Hearing Brief, which was corrected on February 29, 2012. Indicated Shippers noted that the TSA does not apply to the uncommitted rate in this proceeding because the Commission conditioned its approval of the Enbridge Southern Lights project on the absence of a protest.[68]

38. Indicated Shippers mentioned that the Commission expressly stated in the Clarification Order that the committed rate agreed to by ESL and its Committed Shippers was a "negotiated rate," and that the uncommitted rate would function as a recourse rate akin to a natural gas pipeline's cost-based recourse rate, which must be available to shippers who choose not to negotiate a rate.[69] Indicated Shippers witness Crowe elaborated on the parallels between recourse rates and the uncommitted rate in this case, noting that it is essential for the Commission to approve rates for uncommitted shippers that are directly comparable to cost-based, "recourse" rates for shippers on natural gas pipelines so that the Commission can prevent both the pipeline and its committed shippers from exercising market power over the transportation of diluent by pipeline between Chicago and Edmonton.[70]

39. Indicated Shippers observed that Staff witness McComb conceded during cross examination at the hearing that for rate design purposes, the Commission usually requires a pipeline to treat negotiated rate contracts as if they were maximum recourse rate contracts.[71] Indicated Shippers argued that for a shipper to have recourse to an

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[68] *See* Clarification Order at P 13 (stating that the Commission clarifies that the agreed-upon terms of the TSA will govern the determination of the committed shippers' rates over the term of the TSA, and that the rate design embodied in the TSA used to determine both the committed and uncommitted rates will be upheld and applied during the term of the TSA, but with one condition. That is, if the uncommitted rate is protested, Enbridge Southern Lights must comply with section 342.2(b) to support its uncommitted rate by filing cost, revenue, and throughput data supporting such rate as required by part 346 of the Commission's regulations).

[69] *See* Clarification Order at P 14 *citing Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines*, 74 FERC ¶ 61,076, at 61,240-41 (1996) (hereinafter "1996 Natural Gas Policy Statement").

[70] *See* Exh. IS-33 at 27-28.

[71] Tr. 296-97; *see also Tennessee Gas Pipeline Co*., 135 FERC ¶ 61,208, at P 203 (2011) (noting that in the absence of protective provisions designed to avoid unjust cost-

alternative cost-based rate, that rate must not be increased as a result of the special deal negotiated by the pipeline with the committed shippers.[72] Indicated Shippers explained that the Clarification Order makes clear that the Commission had these principles in mind for purposes of calculating ESL's uncommitted rate in the event of a protest, and that the uncommitted rate must be calculated first without regard to the special deal negotiated with the Committed Shippers.

40. Therefore, Indicated Shippers disagreed with ESL and Staff witnesses that it does not matter which rate is derived first or that the rate must be "weighted" to take into account the two-to-one ratio between the uncommitted and committed rates. Indicated Shippers summarized that while it is undisputed that the appropriate framework for evaluating a challenge to the uncommitted rate is the Commission's Opinion No. 154-B methodology,[73] ESL and Staff witnesses inherently assumed that the special deal with the negotiated rate shippers necessarily impacts the rates to be paid by non-negotiated rate shippers. Indicated Shippers argued that this is at odds with the Commission's treatment of negotiated rates for natural gas pipelines.

41. Indicated Shippers stated that Staff witness McComb's proposed approach in Docket No. IS10-399-003, where she multiplies the cost-based rate by two to derive an uncommitted rate, and her proposed approach in Docket No. IS11-146-000, where she "weights" uncommitted volumes by two to calculate the uncommitted rate, are also inappropriate as these methods improperly apply the TSA to the calculation of the uncommitted rate.

42. Indicated Shippers explained how it is well established that private negotiations cannot trump the Commission's regulations under the Interstate Commerce Act ("ICA").[74] In the present case, Indicated Shippers noted that any provision in the TSA as to the derivation of the uncommitted rate has been superseded and negated by the Commission's establishment of this rate proceeding.[75]

43. Indicated Shippers argued that the approaches taken by ESL and Staff witness McComb ignore this key principle and under their approaches, an uncommitted shipper may never be able successfully to challenge on a cost basis the rate it would pay. Indicated Shippers believed that it would be inconceivable that the Commission would

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shifting to recourse ratepayers, the pipeline's rates should "be designed based on the assumption that all its negotiated rates were at the maximum recourse rate" (citing *Wyoming Interstate Company, Ltd.*, 117 FERC ¶ 61,150 (2006)).

[72] *See* 1996 Natural Gas Policy Statement at 61,242.

[73] *See* Clarification Order at P 12.

[74] *United States v. Baltimore & Ohio Ry. Co.*, 333 U.S. 169, 175 (1948) (holding that private contracts cannot frustrate the purposes of the ICA).

[75] Exh. IS-33 at 19.

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assure uncommitted shippers of a cost-based, recourse rate available to those who did not negotiate a special deal, but yet would preclude the possibility of that outcome by forcing the uncommitted rates to be governed by the agreement negotiated between Committed Shippers and ESL.

44. Indicated Shippers explained that absent a showing of "substantial divergence," a pipeline may not substitute a cost-of-service methodology for indexing, and in ESL's Docket No. IS11-146-000 tariff filing, ESL did not assert that there was a substantial divergence, and it has not made a showing of substantial divergence in its evidence presented at the hearing. Therefore, Indicated Shippers argued that the rate change ESL has proposed in Docket No IS11-146-000 as to the uncommitted rate based on a cost-of-service rate-making methodology is invalid as to the uncommitted rate and should be rejected.

45. On March 27, 2012, Indicated Shippers filed its Post-Hearing Reply Brief, noting that, contrary to ESL's position, Indicated Shippers' evidentiary presentations in this proceeding have not sought to relitigate the two-to-one ratio. Indicated Shippers stated their disagreement with ESL and Staff on how and when the two-to-one ratio should be applied – Indicated Shippers position is that it should be applied to reduce the committed rate rather than to increase the uncommitted rate.

46. Indicated Shippers disagreed with ESL's position that "[T]he order of calculation between the Committed Rate and the Uncommitted Rate is irrelevant"[76] and Indicated Shippers cited to the Clarification Order to show that the Commission has held that the uncommitted rate is to be calculated first.[77]

47. Indicated Shippers stated that this rate case is a proceeding under Section 15 of the Interstate Commerce Act ("ICA") where ESL has for the first time filed actual rates for common carriage service and the Commission has set the proceeding for investigation pursuant to Sections 15(1) and 15(7) of the ICA.[78] Under the governing statute, Indicated Shippers noted that ESL has the burden of proof in this proceeding to show that the uncommitted rate is just and reasonable, and Indicated Shippers are subject to no burden of proof here. Rather, Indicated Shippers stated that they are fully within their statutory

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[76] ESL I.B. at 50.

[77] *See* Clarification Order at P 13 ("When a just and reasonable uncommitted rate is determined in this manner, Enbridge Southern Lights may derive its committed rate by applying the agreed-upon terms of the TSA."); Complaint Order at P 5 ("Committed Shippers would receive the discounted rates agreed to in the TSA after the Uncommitted Rate was derived").

[78] *Enbridge Pipelines (Southern Lights) LLC*, 131 FERC ¶ 61,288, at Ordering Paragraph B (2010); *Enbridge Pipelines (Southern Lights) LLC,* 134 FERC ¶ 61,067, at Ordering Paragraph B (2011).

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rights to challenge the rates ESL is proposing, and there is no other forum in which Indicated Shippers can exercise their statutory right to challenge the rates they will be charged.

48. Committed Shippers dismissed ESL witness Jaffe's notions of "free-riding" and "option value" as nothing but economic doublespeak with no bearing on common carriage transportation under the ICA. Committed Shippers believed that there is nothing unfair about requiring ESL to live with the economic consequences of its choices, and such a result is required by the Commission's negotiated rates policy and the just and reasonable requirement of Section 1(5) of the ICA.

49. Indicated Shippers disagreed with ESL's argument that Indicated Shippers "ignore the distinction between Committed and Uncommitted Shippers by creating a single cost-of-service and dividing it by the design capacity of the pipeline, which effectively assumes that all barrels on the system are uncommitted barrels."[79] On the contrary, Indicated Shippers noted that they do not make any such assumption, and witness Crowe's rate design has made no assumption regarding any particular volumes by using design capacity for rate design throughput for purposes of developing a just and reasonable, uncommitted, cost-based recourse rate.[80]

50. Indicated Shippers argued that ESL bears a heavy burden of proof to demonstrate that it merits a discount-type adjustment of the rate treatment of ESL's negotiated arrangement with Committed Shippers; this burden includes a showing that ESL's use of a negotiated rate does not adversely impact the uncommitted rate, and Committed Shippers believed that ESL has not met this burden.

51. Indicated Shippers noted that ESL's attempt to portray the negotiated rates as discounted rates is incorrect as the current case involves an entirely different situation than a straightforward discounted rate scenario. Indicated Shippers pointed out that ESL itself believed that it was seeking approval for negotiated rates as its request for clarification or, in the alternative, rehearing of the Declaratory Order characterized the TSA rates as negotiated rates.[81]

52. Indicated Shippers argued that the Commission's general rate design approach regarding discounted rates is distinct from its general rate design approach regarding negotiated and recourse rates, and this distinction is central to the understanding of the

[79] *See* ESL I.B. at 51.

[80] Exh. IS-1 at 7, 12, 20 (citing *White Cliffs Pipeline, L.L.C.*, 126 FERC ¶ 61,070 at P 31 (2009); *Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,310 at P 29 (2007)); Exh. IS-4 (Updated) at 1, line 8.

[81] *See* Clarification Order at P 6-7 ("Enbridge Southern Lights states that . . . it intends to file both the committed and uncommitted rates as negotiated rates . . . .").

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participants' different respective positions on the issue of how the TSA applies to the uncommitted rate in this case. Indicated Shippers stated that in contrast to a situation in which a pipeline seeks a discount adjustment in the context of a discounted rate to a non-affiliate, a pipeline bears a heavy burden to justify a discount-type adjustment in the context of negotiated rates. Indicated Shippers explained that the Commission has stated that for a pipeline to receive a discount-type adjustment, the pipeline must ensure that its use of negotiated rates would not result in any improper cost-shifting to those shippers who pay the recourse rate.[82] Furthermore, Indicated Shippers stated that instances in which the Commission has authorized "discount-type adjustments" in the context of negotiated rates have been relatively rare.[83]

53. Indicated Shippers asserted that ESL, Committed Shippers, and Staff have not recognized, much less tried to demonstrate, that ESL has met this heavy burden to support a discount-type adjustment in this case. In addition, Indicated Shippers stated that the Commission's approval of the two-to-one ratio in the declaratory order proceeding does not relieve ESL of this burden.

54. Indicated Shippers noted that ESL has not shown that Committed Shippers have a greater price sensitivity – or a greater demand elasticity – than uncommitted shippers, and ESL's "discount" was offered so that ESL could obtain long-term volume commitments and to insulate itself from risk – not so that it could capture volumes that it otherwise would not have been able to ship at a non-discounted rate.

55. Indicated Shippers also dismissed ESL's argument that without the two-to-one ratio offered to Committed Shippers, ESL would not have been able to construct the pipeline. Indicated Shippers conceded that uncommitted shippers may be "better off" in the sense that the ESL pipeline exists and they have the ability to ship over the pipeline if they so choose, but Indicated Shippers asserted that this is the nature of any common carriage oil pipeline.

56. Indicated Shippers argued that the *Laclede/Keystone* approach and the rate design proposed by Staff violate the central tenet of the relationship between recourse rates and negotiated rates: that customers who take service under the recourse rates are not to be adversely affected by the use of negotiated rates.[84] Indicated Shippers stated that under this improper cost-shifting and cross-subsidization, ESL and Staff's models do not derive a cost-based uncommitted rate that is just and reasonable under *Hope*.

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[82] *Wyoming Interstate*, 129 FERC ¶ 61,022, at P 11

[83] *See Tennessee Gas*, 135 FERC ¶ 61,208, at P 193.

[84] *See* 1996 Policy Statement on Negotiated Rates, 74 FERC ¶ 61,076, at 61,242; *Hope Natural Gas*, 320 U.S. at 602.

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57. Indicated Shippers noted that ESL and Staff have confused the negotiated/recourse rate principles that apply here under the Commission's directive with discounted/non-discounted rate principles that do not apply here. Therefore, Indicated Shippers argue that ESL and Staff's rate design models are flawed. Indicated Shippers asserted that the Commission precedent relied upon by ESL Witness Webb and Staff pertain to the Commission's discounted rate policy, not its policy regarding negotiated and recourse rates.[85]

58. Indicated Shippers have explained in their Initial Brief that the uncommitted rate must be a cost-based, just and reasonable rate.[86] Indicated Shippers noted that Staff, in Docket No. IS10-399-003, started with a cost-based committed rate and multiplied this rate by two.[87] In Indicated Shippers' view, Staff has improperly calculated an uncommitted rate that is not cost-based and is not just and reasonable.[88] Indicated Shippers argued that a multiple of a cost-based rate cannot itself be cost-based.

59. Given that ESL has not met its burden to justify a discount-type adjustment, Indicated Shippers argued that the fact that Witness Crowe's rate design does not meet a "revenue check" has no merit. Indicated Shippers asserted that a revenue check is not a requirement of cost-of-service rates, especially not initial rates, and this is because the Commission does not always guarantee that a pipeline will recover its full cost-of-service. Indicated Shippers also dismissed ESL, Committed Shippers, and Staff's concern about ESL not receiving enough revenue as exaggerated, misplaced, and illusory since a pipeline can always charge less than its cost-of-service. Indicated Shippers noted that under the TSA, ESL receives substantial guaranteed revenues from the Committed Shippers for 15 years, including an annual true-up between revenue and actual costs.[89] Indicated Shippers stated that given these guaranteed revenues, it is unlikely ESL will under-recover its cost-of-service.

D. Trial Staff

60. Trial Staff asserted that the TSAs apply to the design of the uncommitted rate in this proceeding, and stated that in its 2008 clarification order, the Commission noted that if someone protested the uncommitted rates, the appropriate framework for evaluating the challenge would be the Opinion No. 154-B methodology.[90] Furthermore, in setting Docket No. IS10-399-033 for hearing, Trial Staff stated that the Commission required

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[85] *See e.g., Tennessee Gas*, 135 FERC ¶ 61,208, at P 186-89.

[86] IS I.B. at 37-38 (citing Clarification Order at P 13).

[87] Staff I.B. at 75-77; Exh. S-15 at 9-10; Exh. S-17 at 1, lines 3-4.

[88] *See, e.g.,* IS I.B. at 36-38; Exh. IS-33 at 17; Exh. IS-40 at 5-6; *Hope Natural Gas*, 320 U.S. at 602.

[89] Exh. ESL-9 at 1, 38-47.

[90] *Enbridge Pipelines (Southern Lights) LLC*, 122 FERC ¶ 61,170, at P 12 (2008).

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ESL to support the protested uncommitted rate "with cost, revenue and throughput data in accordance with Part 346 of the Commission's regulations."[91]

61. Trial Staff observed that these orders direct the Presiding Judge and participants to use conventional cost-of-service ratemaking for oil pipelines in assessing the reasonableness of the uncommitted rate proposed by ESL, but the orders do not require them to disregard the Commission's rulings on the TSAs with respect to anything other than the cost-of-service underlying the proposed uncommitted rate.

62. Trial Staff explained that pursuant to the Commission's orders, the TSA rate formula and specific values no longer automatically apply to the calculation of the uncommitted rate, and instead, each cost component must be individually justified. Trial Staff noted that the Commission's orders set up the data requirements of Part 346 of the regulations and Opinion No. 154-B as the framework for this analysis, but except for the derivation of rate base, neither the Part 346 regulations nor Opinion No. 154-B actually specifies a method for deriving the cost components. Trial Staff concluded from these observations that in its hearing and declaratory orders, the Commission was simply pointing out that it could not accept the TSAs' specified cost components and formula on their face, and that the pipeline would need to justify the uncommitted tariff rate at hearing. Trial Staff pointed out that the Commission expressly found that in all other respects, the TSA rate structure applied.[92]

63. Based on the cited language of the Commission's orders and the language of Part 346 and Opinion No. 154-B, Trial Staff contended that all aspects of the TSAs apply to the calculation of the uncommitted rate, except for the automatic application of the individual cost components specified in Schedule B of the TSAs. Accordingly, Trial Staff asked the Presiding Judge to take the TSAs into account not only for assessing rate structure and rate design, but even in the determination of individual cost elements in situations where Part 346 and Opinion No. 154-B do not prohibit it.

64. Trial Staff noted that they differ with ESL on the application of the TSAs to specific elements in the calculation of an appropriate uncommitted rate, and in particular, on whether the TSAs should be taken into account in (1) assessing the risk of ESL in determining the cost of equity, and (2) calculating throughput for rate design.

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[91] *Enbridge Pipelines (Southern Lights) LLC*, 131 FERC ¶ 61,288, at P 15 (2010).

[92] *Enbridge Pipelines (Southern Lights) LLC*, 131 FERC ¶ 61,288, at P 16 (2010) (holding that "[t]he fact that the Commission is setting the initial rates for hearing does not undermine the approval of the rate structure in the declaratory order or the fact the Commission approved committed rates that would be 50 percent of the uncommitted rates").

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65. Trial Staff observed that the Indicated Shippers' approach derives an uncommitted rate solely in reference to Opinion No. 154-B and Part 346 of the Commission's regulations and that "[n]o aspect of Enbridge Southern Lights' TSAs with its committed shippers will be applicable to rates for uncommitted shipper service."[93] Trial Staff noted two problems with the Indicated Shippers' approach: (1) it ignores the Commission's holding in the hearing order that in setting the uncommitted rate for hearing, it was not undermining the rate structure or the 2:1 ratio of the TSAs, and (2) use of an Opinion No. 154-B methodology and the data filed under Part 346 of the regulations, with the exception of rate base, do not dictate a particular method for calculating the costs and throughput underlying the rates at issue here.

66. On March 27, 2012, Trial Staff submitted their Post-Hearing Reply Brief, noting that the Indicated Shippers claim that the committed rates are negotiated rates that should function as recourse rates to shippers like themselves who choose not to negotiate a rate with the pipeline.[94] Trial Staff explained that Indicated Shippers point to the Commission's statement in the 2008 clarification order that the uncommitted rate is not unlike a gas pipeline's recourse rate, which is a cost-of-service based rate, and therefore, the Indicated Shippers conclude that the uncommitted rate must be calculated without regard to the agreed-upon terms of the TSAs.[95] Trial Staff argued that witness McComb did exactly that by calculating uncommitted rates based on the cost-of-service developed by Trial Staff witness Ms. Sherman, which used the traditional cost-of-service elements for oil pipelines, rather than the cost elements specified in the TSAs. However, Trial Staff noted that the Indicated Shippers conveniently ignored the Commission's ruling in its two orders that in setting ESL's rates for hearing, it was not undermining the approval of the rate structure in the declaratory order. In other words, Trial Staff explained that this is purely a cost-of-service proceeding and adopting the Indicated Shippers' position would require undermining the rate structure of the TSAs.

Findings and Conclusions

67. As previously explained, this proceeding addresses two rate filings made by ESL in Docket Nos. IS10-399-000 and IS11-146-000. In Docket No. IS10-399-000, ESL seeks to establish initial rates for the United States portion of a 1,582-mile pipeline it owns and constructed from Manhattan, Illinois to Edmonton, Alberta.[96] ESL proposes

[93] *See* Exh. IS-1 at 7, 16 (Crowe).

[94] *See* IS I.B. at 7.

[95] *Id.*

[96] *See* Exh. ESL-1 at 3-4 (Jervis). Mr. Jervis refers to the entire Manhattan-to-Edmonton pipeline project as the "Southern Lights Pipeline" and to "Enbridge Southern Lights" as the company that owns the portion of the project located in the United States. *Id.* at 2. However, in the discussion of risk in determining an appropriate rate of return below, Commission Trial Staff ("Trial Staff") uses the term

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rates based on its TSAs. Under the TSAs, the pipeline provides two categories of service. Committed shippers[97] agree to ship or pay for the transportation of a specified volume of diluent over an initial fifteen-year contract term and pay the committed rate for their annual volume commitments.[98] Uncommitted shippers, and committed shippers who ship volumes in excess of their annual committed volumes, pay the uncommitted rate. The TSAs establish as "an over-arching principle" that the ratio of the uncommitted rate to the committed rate be 2:1.[99] In its tariff filing, ESL proposed an uncommitted rate of $10.0526 per barrel and a committed rate of $5.0263 per barrel.[100]

68. Pursuant to the TSAs, the pipeline had made its first annual recalculation of the tariff rates on December 28, 2010. In Docket No. IS11-146-000, it proposed to increase the uncommitted rate to $10.9744 per barrel and the committed rate to $5.4872 per barrel, subject to the TSA true-up mechanism.[101] The Commission suspended the new rates to be effective February 1, 2011, subject to refund, resulting in a locked-in period of July 2010 through January 2011 in which the rates at issue in Docket No. IS10-399-003 were in effect, and consolidating Docket No. IS11-146-000 with this proceeding.[102] On November 30, 2011, in Docket No. IS12-63-000, ESL filed its second annual recalculation of tariff rates under the TSAs.[103] It proposed to increase the uncommitted rate to $11.8434 per barrel and the committed rate to $5.9127 per barrel, again subject to true-up.[104] The Commission suspended the tariff filing to be effective January 1, 2012, subject to refund, resulting in a locked-in the period of February through December 2011 for the rates at issue in Docket No. IS11-146-000.[105] It did not consolidate the new

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"Southern Lights Pipeline" to refer only to the United States portion of the entire pipeline project, since that is the only portion over which the Commission has rate jurisdiction and for which an appropriate rate of return is at issue. This usage also parallels the usage by the National Energy Board of Canada (NEB). *See* Staff I.B. at 7-8.

[97] ESL's Committed Shippers are BP Products North America Inc. ("BP") and Statoil North America, Inc. ("Statoil"). Exh. ESL-1 at 8.

[98] Exh. ESL-1 at 12 (Jervis).

[99] Exh. ESL-9 at 42 n.1 (Webb) (Southern Lights Diluent Pipeline Transportation Services Agreement, *pro forma* U.S. version).

[100] Exh. ESL-4 at 2 (Jervis) (Enbridge Pipelines (Southern Lights) LLC, FERC ICA Oil Tariff, FERC No. 2).

[101] *Id.* at P 3; Exh. ESL-6 at 2 (Jervis) (Enbridge Southern Lights, FERC ICA Oil Tariff, FERC No. 4.3.0).

[102] *Enbridge Pipelines (Southern Lights) LLC*, 134 FERC ¶ 61,067, at P 13 (2011).

[103] *Enbridge Pipelines (Southern Lights) LLC*, 137 FERC ¶ 61,256, at P 1-2 (2011).

[104] Enbridge Southern Lights, FERC ICA Oil Tariff, FERC No. 4.5.0, at 2.

[105] *Enbridge Pipelines (Southern Lights) LLC*, 137 FERC ¶ 61,256, at P 1 (2011).

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docket with the ongoing hearing procedures, but instead held proceedings in the new docket in abeyance pending the outcome of the hearing.[106]

69. Prior to making its tariff filing in Docket No. IS10-399-000, ESL filed a petition for a declaratory order seeking approval of the rate terms of the TSAs which the Commission approved in 2007. In the rehearing order in 2008, the Commission clarified that the agreed-upon terms of the TSAs would govern the determination of the committed shippers' rates, and that it was upholding the rate design embodied in the TSAs, with one condition.[107] In the event that the uncommitted rate was protested, the Commission held that it would require ESL to support the uncommitted rate by filing cost, revenue, and throughput data, as required by Part 346 of its oil pipeline regulations.[108] Furthermore, in setting Docket No. IS10-399-033 for hearing, the Commission specifically required ESL to support the protested uncommitted rate "with cost, revenue and throughput data in accordance with Part 346 of the Commission's regulations."[109]

70. Thus, as directed by the Commission's orders, the appropriate framework for evaluating a protest of the uncommitted rates in this proceeding will be the Commission's Part 346 oil pipeline regulations as applied in the Commission's Opinion No. 154-B methodology. However, in setting the justness and reasonableness of the uncommitted rates for hearing in these dockets, the Commission did not rule that the participants were free to ignore its prior rulings approving other aspects of the TSAs. To the contrary, the Commission expressly ruled that setting the uncommitted rates for hearing did not undermine its approval of the rate structure or the 2:1 ratio between the uncommitted and committed rates in the TSAs.

71. In determining the justness and reasonableness of the uncommitted rates set for hearing in this proceeding, the approach advanced by the Indicated Shippers must be rejected because it derives an uncommitted rate solely in reference to Opinion No. 154-B and Part 346 of the Commission's regulations without regard to the Commission's prior rulings and is predicated on the argument that "[n]o aspect of Enbridge Southern Lights' TSAs with its committed shippers will be applicable to rates for uncommitted shipper service."[110] As noted by ESL and Trial Staff, this approach ignores the Commission's prior rulings holding that in setting the uncommitted rate for hearing it was not undermining the rate structure or the 2:1 ratio of the TSAs and fails to address the fact that use of an Opinion No. 154-B methodology and the data filed under Part 346 of the

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[106] *Id.*

[107] *Enbridge Pipelines (Southern Lights) LLC*, 122 FERC ¶ 61,170, at P 13 (2008).

[108] *Id.*

[109] *Enbridge Pipelines (Southern Lights) LLC*, 131 FERC ¶ 61,288, at P 15 (2010).

[110] *See* Exh. IS-1 at 7, 16 (Crowe).

regulations, with the exception of rate base, do not dictate a particular method for calculating the costs and throughput underlying the rates at issue here.

72. Based on the cited language of the Commission's orders and the language of Part 346 and Opinion No. 154-B, the undersigned concurs with and hereby adopts the position advocated by Trial Staff that all aspects of the TSAs apply to the calculation of the uncommitted rate, except for the automatic application of the individual cost components specified in Schedule B of the TSAs which will be determined by the Commission's traditional cost-of-service methodology for oil pipelines. Accordingly, the TSAs must be taken into account for assessing rate structure and rate design and should be taken into account in the determination of individual cost elements in situations where Part 346 and Opinion No. 154-B do not prohibit it.

73. Among other things, the TSAs provide for rates based on: (1) a capital structure of 30% equity and 70% debt; (2) a return on equity of between 10% and 14%, depending on the project's final capital cost; (3) a depreciation rate schedule, which specifies rates that yield depreciation expenses more levelized than those derived from depreciation rates using a straight-line basis; (4) the crediting of all uncommitted revenues to both committed and uncommitted shippers up to 90% of the pipeline's annual capacity, and a 25% pipeline - 75% shippers sharing of incremental revenues associated with volumes above that level; and (5) an annual projection of costs and volumes, with an annual true-up mechanism that provides refunds to, or recovery from, shippers after the end of each year.[111] Trial Staff noted that while they do not contest ESL's application of the TSAs to the calculation of an appropriate uncommitted rate in most respects, they differ with ESL regarding the specific elements of assessing the risk of ESL in determining the cost of equity and calculating throughput for rate design. These issues will be addressed separately below.

<u>Issue #2: What is the appropriate base and test period?</u>

A. ESL

74. ESL argued that the issue of the just and reasonable 2010 Uncommitted Rate is now moot, as is the appropriate base and test period for that rate. ESL noted that it is undisputed that no Uncommitted Shipper transported diluent under the 2010 Uncommitted Rate during the seven-month period during which it was in effect.[112] ESL explained that to the extent the Committed Shippers transported any volumes during the seven-month period and paid the Uncommitted Rate, they have been refunded the difference between the Committed and Uncommitted Rates through the Commission-

[111] *Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,310, at P 11 (2007); Exh. ESL-9 at 40-41, 44, 62-63 (Webb).

[112] ESL-7 at 33:1-5; *see also* 2011 Suspension Order at P 9.

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approved Committed Shipper Credit.[113] Therefore, ESL asserted that the justness and reasonableness of the 2010 Uncommitted Rate – including the appropriate corresponding base and test period – is entirely academic, since no refunds or other relief would result from a ruling on the issue.[114]

75. ESL addressed the Indicated Shippers' argument that an Uncommitted Rate should be set for 2010 and then indexed forward.[115] ESL believed the argument that indexing applies to the 2010 Uncommitted Rate or any other Uncommitted Rate is without merit. According to ESL, their Petition for Declaratory Order clearly explained that the Committed and Uncommitted Rates would not be subject to indexing, and that the tariff structure set forth in the TSA, including the true-up to actual costs, would apply instead.[116] ESL noted that the Commission expressly approved the annual true-up mechanism,[117] and both the Declaratory Order and the Clarification Order expressly established that ESL could set its Uncommitted Rates as provided in the TSA, and if those annual Uncommitted Rates were challenged, they would be judged under an Opinion No. 154-B cost-of-service test.[118] ESL explained that there is no suggestion in either the Declaratory Order or the Clarification Order that indexing would apply in any way to ESL's tariff rates during the term of the TSAs.[119]

76. ESL noted that the Commission has now accepted two consecutive filings of the Uncommitted Rates since the initial rate was filed in 2010 and no party asserted that those filings violated the Commission's indexing rules, and there is no mention of indexing in the Commission's 2011 or 2012 Suspension Orders.[120] ESL believed that the theory that indexing governs the Uncommitted Rate on this pipeline, notwithstanding the Commission's prior orders, is simply an after-thought by the Indicated Shippers in a further effort to overturn the existing approved tariff structure.

77. ESL stated that the issue of the just and reasonable 2011 Uncommitted Rate is arguably moot for the same reasons that apply to the 2010 rate, but ESL does not object to a determination of the maximum just and reasonable 2011 Uncommitted Rate so that the Commission can provide appropriate guidance to the parties regarding this recurring

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[113] ESL-7 at 32:21-33:2; in any event, the Committed Shippers have not challenged the Uncommitted Rate.

[114] *See* ESL-7 at 33:7-8.

[115] *See* IS-1 at 7:16-21.

[116] ESL-44 at 33:1-35:11; Tr. at 247:1-18.

[117] *See* Declaratory Order at P 45.

[118] *See* ESL-44 at 33:11-17; Declaratory Order at P 28; Clarification Order at P 12.

[119] *See* ESL-44 at 33-34.

[120] *See* 2011 Suspension Order; *Enbridge Pipelines (Southern Lights) LLC*, 137 FERC ¶ 61,256 (2011) ("2012 Suspension Order"); ESL-44 at 33-34.

issue. ESL observed that although the 2011 Uncommitted Rate is no longer in effect and was not used by any Uncommitted Shipper, the 2012 Suspension Order made clear that the Commission expects this case to provide guidance for the 2012 rate proceeding, and presumably future potential rate challenges as well.[121] ESL explained that the 2011 docket is the most appropriate means of providing that guidance because it concerns a full year test period and the most recent actual data in the record, and thus, ESL does not object to using the 2011 Uncommitted Rate as the basis to provide guidance on the appropriate determination of the just and reasonable Uncommitted Rates going forward.

78. ESL assumed that if the 2010 rate is not moot, a locked-in period approach should be used in regard to the 2010 Uncommitted Rate. ESL explained that the initial rate here was not in effect for the full 12 months as it was only in effect until January 31, 2011, creating a seven-month locked-in period.[122] ESL noted that in such situations involving locked-in rate periods, the Commission generally relies on actual costs and volumes because the actual costs are already known and will have no effect on rates going forward.[123] Moreover, ESL added that a further reason to use a test period based on volumes that were actually moved was because no volumes were transported during 2010 that ultimately paid the Uncommitted Rate.[124]

79. Assuming the 2011 Uncommitted Rate is not determined to be moot, ESL, Staff, and the Indicated Shippers agree that the most appropriate test period in the record for the 2011 Uncommitted Rate is the initial twelve months of operations of ESL – July 1, 2010, through June 30, 2011.[125] ESL believed that reliance on the most recent twelve months of actual data at the time the testimony was filed is appropriate under the governing regulation, which requires that a change to an existing rate be based on a 12-month base period of actual data.[126]

80. ESL's Post-Hearing Reply Brief noted disagreement with Indicated Shippers about details of the base and test periods but stated that their more fundamental divergence is over two basic issues: indexing and design capacity. ESL asserted that the

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[121] *See* 2012 Suspension Order at P 11.

[122] ESL-7 at 32:4-33:8; S-1 at 9:1-11.

[123] *See Williams Natural Gas Co.,* 80 FERC ¶ 61,158, 61,678-79 (1997); *Arkansas-Louisiana Gas Co.,* 22 FERC ¶ 61,125, at 61,198-99 (1983); *Ozark Gas Transmission System,* 39 FERC ¶ 61,142, at 61,506, *reh'g den.*, 41 FERC ¶ 61,207 (1987), *rev'd on other grnds sub nom.*, *Public Service Comm'n of New York v. FERC*, 866 F.2d 487 (D.C. Cir. 1989); *Alabama-Tennessee Natural Gas Co.,* 25 FERC ¶ 61,151, at 61,424-25 (1983); *Southwestern Public Service Co.,* 60 FERC ¶ 61,052, at 61,189 (1992); *see also* ESL-7 at 32:15-18; S-1 at 9:9-11.

[124] ESL-7 at 33:1-5.

[125] ESL-7 at 37:1-15; S-1 at 9:16-10:20; IS-1 at 11:15-12:1.

[126] 18 C.F.R. § 346.2(a)(1).

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Indicated Shippers' arguments regarding indexing rely on their faulty premise that the approved terms of the TSA do not apply to the Uncommitted Rate, despite the Commission's prior orders holding otherwise.[127]

81. As Dr. Webb testified, ESL's Petition for Declaratory Order explained that the Committed and Uncommitted Rates would not be subject to indexing and that the tariff structure set forth in the TSA, including the true-up to actual costs, would apply instead.[128] In response, the Commission expressly approved the annual true-up mechanism[129] and both the Declaratory Order and the Clarification Order established that ESL could set its Uncommitted Rates as provided in the TSA; if those annual Uncommitted Rates were challenged, they would be judged under an Opinion No. 154-B cost-of-service test.[130]

82. ESL noted that the Indicated Shippers have not cited a single Commission order suggesting that indexing applies here, and there is no suggestion in either the Clarification Order or the Declaratory Order that indexing would apply to ESL's tariff rates during the term of the TSAs.[131] ESL reiterated that the Clarification Order does not say that a protest of the Uncommitted Rate would somehow "divorce" it from the approved provisions of the TSA, and in fact, the order is directly to the contrary.[132] ESL also observed that the Commission did not give any indication in either Suspension Order that it believed the rate filings were limited by indexing or the substantial divergence standard, or that indexing would be an issue in the subsequent rate hearings.[133]

83. ESL summarized the Indicated Shippers' argument that a locked-in period approach is inappropriate with regard to the 2010 and 2011 Uncommitted Rates because ESL did not utilize the Commission's indexing methodology in filing its 2011 and 2012

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[127] *See* IS I.B. at 14 ("[B]ecause the TSA does not apply to the uncommitted rate, absent an express waiver, ESL may only change its initial rate . . . by the Commission's indexing methodology . . . or by filing under an alternative methodology pursuant to 18 C.F.R. § 342.4.").

[128] ESL-44 at 33:1-35:11; Tr. at 247:1-18.

[129] *See* Declaratory Order at P 45.

[130] *See* ESL-44 at 33:11-17; Declaratory Order at P 28; Clarification Order at P 12.

[131] *See* ESL-44 at 33-34.

[132] *See* Clarification Order at P 13 ("[T]he Commission clarifies that . . . the rate design embodied in the TSA used to determine both the committed and uncommitted rates will be upheld and applied during the term of the TSA").

[133] *See Enbridge Pipelines (Southern Lights) LLC*, 134 FERC ¶ 61,067 (2011) ("2011 Suspension Order"); *Enbridge Pipelines (Southern Lights) LLC*, 137 FERC ¶ 61,256 (2011) ("2012 Suspension Order").

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rates.[134] ESL explained that this argument fails because indexing does not apply to ESL's tariff rates during the term of the TSAs, and even assuming the Indicated Shippers had a basis for their claim, the time for the Indicated Shippers to object to the 2011 and 2012 tariff filings on the basis of indexing was at the time of filing, not at this late date in the proceeding.

84. ESL stated that Indicated Shippers did not specifically object to the 2011 and 2012 tariff filings on the basis that they did not comply with indexing; instead, Indicated Shippers only commented that the filings were not based on indexing but rather that their "sole basis" was under the TSA mechanism.[135] Therefore, ESL argued that Indicated Shippers waived the indexing issue by not making it a direct ground of their protests.[136] ESL concluded that the Uncommitted Rates are locked-in, as supported by both ESL[137] and Trial Staff,[138] and the Indicated Shippers' argument that the initial rate "continues to have forward-looking effects," is without support.[139]

B. Committed Shippers

85. Committed Shippers noted their support for Dr. Webb's approach. For the 2010 period, Dr. Webb explained that it is appropriate to use the locked-in period of July 1, 2010 to January 31, 2011, subject to annualization, instead of a test period approach. Committed Shippers explained that in the case of a locked-in period, the Commission generally relies on actual cost data and billing determinants.[140] For the 2011 period, Committed Shippers stated that the appropriate test period is the initial twelve months Enbridge was in operation (July 1, 2010 to June 30, 2011) as required under section 346.2 of the Commission's rules.[141] Committed Shippers noted that Staff also treated the 2010 period as a locked-in period that was annualized; however, Staff used a slightly different approach for the 2011 period, but one that ultimately results in a finding that Enbridge's

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[134] *See* IS I.B. at 14.

[135] 2011 Protest at 6-7; 2012 Protest at 12-13.

[136] *See* 18 C.F.R. § 343.3(c) (2011) ("Commission action, including any hearings or other proceedings, on a protest will be limited to the issues raised in such protest.")

[137] *See* ESL I.B. at 16-20.

[138] *See* Staff I.B. at 17-21.

[139] *See* IS I.B. at 14.

[140] *See Williams Natural Gas Co.,* 80 FERC ¶ 61,158, at 61,678-79 (1997); *Sw. Pub. Serv. Co*., 60 FERC ¶ 61,052, at 61,189 (1992); *Ark. La. Gas Co.,* 22 FERC ¶ 61,125, at 61,199 (1983).

[141] 18 C.F.R. § 346.2 (2012). This consists of ten months of actual data and two months of projections.

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filed rates are just and reasonable.[142] For the 2011 period, Committed Shippers observed that Staff used actual volume data for the twelve months ending June 30, 2011.[143]

86. For the 2010 period, Committed Shippers continued to support the approach put forward by Enbridge and Trial Staff. Committed Shippers disagreed with Indicated Shippers' use of projections, estimates, and actual cost information at the time the pipeline was placed in service (July 2010).[144] While Indicated Shippers witness Crowe's approach may be appropriate when a pipeline makes an initial rate filing at start-up, Committed Shippers asserted that her approach is contrary to Commission policy when the rates are locked in and no longer forward-looking.[145] Committed Shippers concluded with their view that the test period for the 2010 Uncommitted Rate is July 1, 2010 to January 31, 2011.

87. For the 2011 period, Committed Shippers again agreed with Enbridge and Trial Staff that using actual data for the pipeline's first twelve months of operation (July 1, 2010 - June 30, 2011) is the appropriate test period, as required under section 346.2 of the Commission's rules and policy.[146] Committed Shippers noted that the Indicated Shippers maintain that any increase to the 2010 Uncommitted Rate should be done via indexing or pursuant to a full cost-of-service review pursuant to section 342.3(a).[147] According to the Committed Shippers, the Indicated Shippers reach this conclusion based entirely on their erroneous conclusion that the principles in the TSA does not apply to the calculation of the Uncommitted Rates, and therefore, Indicated Shippers' argument that the indexing regulations must govern changes to the Uncommitted Rate is fundamentally flawed.[148] Committed Shippers concluded that July 1, 2010 to June 30, 2011 should be the appropriate test period for the 2011 period.

C. Indicated Shippers

88. Indicated Shippers disagreed with the approach of ESL witness Webb and Staff witness McComb of treating the 2010 initial rate as a locked-in-period rate and relying on ESL's actual costs and throughput data from July 1, 2010, through January 31, 2011. Indicated Shippers explained that because the TSA does not apply to the uncommitted

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[142] *See* Exh. S-15 at 6:14-15.

[143] *See* Exh. S-15 at 10:16-17.

[144] *See* IS I.B. at 13-14.

[145] 18 C.F.R. § 342.2; In the case of a locked-in period, the Commission generally relies on actual cost data and billing determinants. *See Williams Natural Gas Co.,* 80 FERC ¶ 61,158 at 61,678-79 (1997); *Sw. Pub. Serv. Co*., 60 FERC ¶ 61,052 at 61,189 (1992); *Ark. La. Gas Co.,* 22 FERC ¶ 61,125 at 61,199 (1983).

[146] 18 C.F.R. § 346.2 (2012).

[147] *See* Exh. IS-1 at 7, 22 (Crowe).

[148] *See* IS I.B. at 40.

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rate, absent an express waiver, ESL may only change its initial rate established in Docket No. IS10-399-003 by the Commission's indexing methodology for oil pipelines or by filing under an alternative methodology pursuant to 18 C.F.R. § 342.4.[149] According to Indicated Shippers, since ESL did not follow either approach in its tariff filing in Docket No. IS11-146-000, that docket is inapplicable to the uncommitted rate. Indicated Shippers argued that the initial docket, Docket No. IS10-399-003, continues to have forward-looking effects and there is no locked-in period.

89. Indicated Shippers' Post-Hearing Brief reiterated its support for using a twelve-month projection rather than the actual figures from seven months of usage of the pipeline in 2010. Indicated Shippers dismissed ESL's claims that "the fact that no volumes were transported during 2010 that ultimately paid the Uncommitted Rate is a further reason to use a test period based on volumes that were actually moved."[150] Indicated Shipped argued that this observation simply establishes that the seven-month period was probably not representative of the pipeline's future usage, particularly once the controversy over uncommitted rates is resolved.

90. Indicated Shippers underscored that neither Staff nor ESL has presented anything tending to show that actual volumes for the seven-month period are the "best evidence" of the volumes that will be shipped in the future, as required by the cases Staff cites.[151] Furthermore, Indicated Shippers noted that the seven-month period may very well have been a poor representation of the actual future use of the pipeline, since no uncommitted shipments were moved at all.

91. Indicated Shippers disagreed with Trial Staff's allegation that there is inconsistency in Indicated Shippers witness Crowe's testimony respecting the use of design capacity for throughput despite recommending use of the twelve-month projection as a test period.[152] Indicated Shippers noted that Trial Staff ignores that "Commission precedent generally dictates the use of actual design capacity for initial rates on a new pipeline . . ."[153] Further, Indicated Shippers contended that since ESL's proposed uncommitted rate has been protested, the Clarification Order makes clear that in

[149] *See* Exh. IS-1 at 7.

[150] *See* ESL I.B. at 20.

[151] *See* Staff I.B. at 18; *see Williston Basin Interstate Pipeline Co.*, 76 FERC ¶ 61,066, at 61,384 (1996).

[152] *See* Staff I.B. at 19-20.

[153] Declaratory Order at P 29 (citing *Enbridge Energy Company, Inc.*, 110 FERC ¶ 61,211, at P 44 (2005)); Clarification Order at P 10 (citing *Enbridge Energy Company, Inc.*, 110 FERC ¶ 61,211; *Great Lakes Gas Transmission Limited Partnership*, 66 FERC ¶ 61,118 (1994); *Equitrans, Inc.*, 63 FERC ¶ 61,070 (1993); *Arkansas Western Pipeline Co.*, 63 FERC ¶ 61,006 (1993).

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accordance with the Commission's precedent and regulations, ESL's actual design capacity must be used to derive ESL's initial uncommitted rate.[154]

92. Regarding the appropriate base and test period for Docket IS11-146-000, Indicated Shippers reiterate its position for Docket No. IS10-399-003, namely that indexing should be applied to the initial 2010 rate in the absence of express approval of a different methodology under 18 C.F.R. § 342.4. Nevertheless, if indexing is rejected, Indicated Shippers have accepted the use of the base and test period of July 2010 to June 2011 as an alternative position.[155]

D. Trial Staff

93. Trial Staff explained that at the time of filing of initial rates for a new pipeline that has not become operational, the pipeline must necessarily rely on projections of costs, revenues, and throughput. Trial Staff cited to Section 346.2(a)(3) of the regulations to reflect this concept. However, Trial Staff noted that once the pipeline has commenced service and has gained operating experience, actual data represents a far better depiction of its costs than mere projections. Trial Staff stated that over the years, the Commission has repeatedly shown a preference for the use of test period actual data over projections in rate cases,[156] and this is especially true when the rates have been "locked-in", and are thus no longer forward looking.[157] Accordingly, Trial Staff's evidence showed that the appropriate test period to determine a just and reasonable uncommitted rate in Docket No. IS10-399-003 is the seven months of July 2010 through January 2011, annualized to create a twelve-month test period (the 2010 rate period).[158]

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[154] *See* Clarification Order at P 9-13; IS I.B. at 30-31.

[155] *See* IS I.B. at 41; *see also* ESL IB at 20; Staff IB at 83-84.

[156] *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).

[157] *See, e.g., Williams Natural Gas Co.*, 80 FERC ¶ 61,158, at 61,678-79 (1997) (approving the use of actual cost figures "particularly since the rates in this case are locked-in by the filing of a new rate case"); and *Arkansas-Louisiana Gas Co.*, 22 FERC ¶ 61,125, at 61,198-99 (1983) (noting that the Commission would not discourage the submission of actuals for a locked-in period, "as has often been done in the past"); Exh. S-1 (rev. Jan. 11, 2102) at 9 (Sherman).

[158] Exh. S-1 (rev. Jan. 11, 2012) at 8-9 (Sherman).

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94. Trial Staff noted that ESL witness Dr. Michael Webb agrees with Trial Staff's approach to this locked-in period, but the Indicated Shippers' witness, Elizabeth Crowe, advocates the use of projections, or "actual cost information available at the time Enbridge Southern Lights was placed into service in July 2010."[159] Trial Staff stated that Ms. Crowe bases her analysis on ESL's twelve-month estimate of its costs from a September 13, 2010 filing rather than the known costs actually incurred by the pipeline during the locked-in period,[160] but with respect to throughput, Ms. Crowe abandons this approach and recommends that the Commission base the uncommitted rate on the design capacity of Enbridge Southern Lights' pipeline – 180,000 barrels per day.[161]

95. According to Trial Staff, Ms. Crowe's testimony that "in accordance with the Commission's regulations, system capacity should be use to derive initial rates for service on Enbridge Southern Lights"[162] is false. Trial Staff states that Ms. Crowe does not point to any regulations to support her assertion,[163] nor can she as the Commission has none.

96. Trial Staff's Post-Hearing Reply Brief agreed with ESL that the uncommitted rate for the 2010 rate period is moot in the sense that ESL did not transport any uncommitted volumes during that period, and therefore no refunds are due. Nevertheless, Trial Staff requested a ruling on the uncommitted rate at issue in Docket No. IS10-399-003 for several reasons. Trial Staff explained that in ESL's latest annual rate filing in Docket No. IS12-63-000, the Commission held that docket "in abeyance pending the outcome of the hearing in Docket No. IS10-399-000*, et al.*",[164] and ruled that "to the extent broad methods and principles will be resolved in the ongoing hearing in Docket No. IS10-399-000, *et al.*, any challenges to future filings should be limited to material issues concerning specific inputs to the rates . . ."[165] Trial Staff noted that in so doing, the Commission made no distinction between the two separate rate periods at issue in the hearing – it simply referred to the consolidated proceedings as a whole.

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[159] Exh. IS-1 at 16 (Crowe).

[160] *Id.* at 19-20.

[161] *Id.* at 20.

[162] Exh. IS-33 at 16 (Crowe). *See also* Exh. IS-1 at 7 (Crowe) (use of design capacity is consistent with the Commission's regulations); *id*. at 20 (use of full capacity is consistent with Commission regulations and policy).

[163] *See* Exh. ESL-46 (Webb) (in response to a data request asking Ms. Crowe to cite the Commission regulations to which she refers, she responds with cites to cases only).

[164] *Enbridge Pipelines (Southern Lights) LLC*, 137 FERC ¶ 61,256, at P 11 (2011).

[165] *Id.*

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97. At a minimum, Trial Staff requested the Presiding Judge to rule on the appropriate levels of rate base, depreciation expense, and deferred return for the 2010 rate period, since these values carry forward and will affect subsequent rate periods, including the 2011 rate period and the current rate period established in Docket No. IS12-63-000. Finally, should either the Presiding Judge or the Commission agree with the Indicated Shippers that Enbridge Southern Lights should establish an initial rate in Docket No. IS10-399-003, which would then be subject to indexing in the future, Trial Staff stated that a decision on the merits of the uncommitted rate for the 2010 rate period would be necessary.

Findings and Conclusions

98. ESL argues that the justness and reasonableness of the 2010 Uncommitted Rate - including the appropriate corresponding base and test period for that rate – is now moot since no Uncommitted Shippers transported diluent during the relevant time period and no refunds or other relief would result from a ruling on the issue as to the Committed Shippers.[166] ESL explained that to the extent the Committed Shippers transported any volumes during the seven-month period and paid the Uncommitted Rate, they have been refunded the difference between the Committed and Uncommitted Rates through the Commission-approved Committed Shipper Credit.[167]

99. As previously noted, Trial Staff's Post-Hearing Reply Brief agreed with ESL that the uncommitted rate for the 2010 rate period is moot in the sense that no refunds are due; however, Trial Staff points out that, among other things, the values pertaining to several elements of the Uncommitted Rate for the 2010 rate period, such as the appropriate levels of rate base, depreciation expense, and deferred return for the 2010 rate period, will carry forward and will affect subsequent rate periods, including the 2011 rate period and the current rate period established in Docket No. IS12-63-000. Trial Staff's arguments are persuasive and support the need for a ruling on the justness and reasonableness of the 2010 Uncommitted Rate – including the appropriate corresponding base and test period for that rate.

100. 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 projections of 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. Over the years, the Commission has repeatedly shown a preference for the use of test period actual data over

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[166] ESL-7 at 33:1-5; *see also* 2011 Suspension Order at P 9.

[167] ESL-7 at 32:21-33:2; in any event, the Committed Shippers have not challenged the Uncommitted Rate.

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projections in rate cases,[168] and this is especially true when the rates have been "locked-in", and are thus no longer forward looking.[169] ESL, Committed Shippers, and Trial Staff all agree to this "locked-in" approach.

101. By contrast, Indicated Shippers believed that ESL should establish an initial rate in Docket No. IS10-399-003, which would then be subject to future indexing. Indicated Shippers' position is based on their conclusion that the principles in the TSA do not apply to the calculation of the Uncommitted Rates. As discussed in Issue 1, *supra*, Indicated Shippers are incorrect as all aspects of the TSAs apply to the calculation of the uncommitted rate, except for the automatic application of the individual cost components specified in Schedule B of the TSAs which will be determined by the Commission's traditional cost-of-service methodology for oil pipelines. Therefore, Indicated Shippers' argument here that the indexing regulations must govern changes to the Uncommitted Rate is fundamentally flawed and not supportable by prior Commission precedent. Accordingly, Indicated Shippers' approach must be rejected.

102. For the foregoing reasons offered by Trial Staff, the appropriate test period to determine a just and reasonable Uncommitted Rate in Docket No. IS10-399-003 is the seven months of July 2010 through January 2011, annualized to create a twelve-month test period (the 2010 rate period). The appropriate test period for the 2011 Uncommitted Rate is the initial twelve months of operation of ESL from July 1, 2010 to June 30, 2011 (the 2011 period).

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[168] *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).

[169] *See, e.g., Williams Natural Gas Co.*, 80 FERC ¶ 61,158, at 61,678-79 (1997) (approving the use of actual cost figures "particularly since the rates in this case are locked-in by the filing of a new rate case"); and *Arkansas-Louisiana Gas Co.*, 22 FERC ¶ 61,125, at 61,198-99 (1983) (noting that the Commission would not discourage the submission of actuals for a locked-in period, "as has often been done in the past"); Exh. S-1 (rev. Jan. 11, 2102) at 9 (Sherman).

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Issue #3: What is the appropriate total cost-of-service?

A. ESL

103. ESL provided a chart detailing the parties' respective positions on total cost-of-service ("COS").

Party	*Witness*	*Source*	*2010*	*2011*
ESL	Dr. Webb	ESL-55 and 56, Stmt A	$267.1 million	$280.4 million
Trial Staff	Ms. Sherman	S-2 and 3, Stmt A	$167.1 million	$178.8 million
Indicated Shippers	Ms. Crowe	IS-4 (Updated) and IS-3A Supp., Stmt A	$161.2 million	$153.4 million

B. Committed Shippers

104. Committed Shippers took no position on this issue and noted that for both the 2010 period and the 2011 period, both Enbridge's and Staff's total cost-of-service, when applied to proper throughput determinants and Opinion No. 154-B methodology, result in a finding that Enbridge's filed 2010 and 2011 rates are just and reasonable.

C. Indicated Shippers

105. Indicated Shippers stated that the appropriate total COS is $161,248,000, [170] which was calculated using the model in Ms. Crowe's Exhibit IS-4 (Updated). Indicated Shippers noted that the amount of Ms. Crowe's COS is similar in magnitude to the COS of $167,079,000 calculated by Staff witness Sherman.[171] For Docket No. IS11-146-000, Indicated Shippers proposed a total cost-of-service of $153,407,000.[172]

D. Trial Staff

106. Trial Staff noted that in its 2008 clarification order, the Commission agreed with ESL that the appropriate framework for evaluating any challenge to the uncommitted rate would be the Commission's Opinion No. 154-B methodology.[173] Accordingly, Trial

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[170] Exh. IS-4(Updated) at 1, line 7; Exh. IS-1 at 22.

[171] *See* Exh. IS-4(Updated) at 1, line 7; Exh. S-2 at 2, line 7.

[172] Exh. IS-3A (Supp.) at 1, line 7.

[173] *Enbridge Pipelines (Southern Lights) LLC*, 122 FERC ¶ 61,170, at P 12 (2008).

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Staff asserted that their witness, Ms. Sherman, followed this methodology to determine Trial Staff's proposed cost-of-service.[174]

107. Trial Staff stated that the Commission set out the methodology in its opinions in *Williams Pipe Line Company*,[175] Opinion Nos. 154-B and 154-C, and *ARCO Pipe Line Company*,[176] Opinion Nos. 351 and 351-A,[177] where the Commission adopted a net depreciated "trended original cost" method as the model for calculating rate bases for oil pipelines.[178]

108. Under the trended original cost method, Trial Staff explained that the Commission first extracts the inflation component from the nominal return on equity, leaving the real rate of equity return to be applied to rate base in determining the pipeline's current revenue requirement.[179] Trial Staff continued that the inflation component of the equity return is then added to the pipeline's rate base. According to Trial Staff, the Opinion No. 154-B methodology thus "trends" the pipeline's rate base, deferring recovery of the inflation component of equity return to the later years of the pipeline's life.[180]

109. Trial Staff explained that the Commission adopted this methodology to address its concern about the ability of newer pipelines to compete with older ones, and the trended original cost methodology helps to alleviate this problem by eliminating the front-end load associated with net depreciated original cost rate base by reducing the equity return in the cost-of-service in the pipeline's early years.[181] In most other respects, Trial Staff noted that the Opinion No. 154-B methodology is similar to the Commission's traditional cost-of-service rate making.[182]

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[174] Exh. S-1 (rev. Jan. 11, 2012) at 5 (Sherman).

[175] *Williams Pipe Line Co.*, 31 FERC ¶ 61,377 (1985), *reh'g,* 33 FERC ¶ 61,327 (1985).

[176] *ARCO Pipe Line Co.*, 52 FERC ¶ 61,055 (1990), *reh'g,* 53 FERC ¶ 61,398 (1990).

[177] *Cost-of-Service Reporting and Filing Requirements for Oil Pipelines*, 59 Fed. Reg. 59,137 (Nov. 16, 1994), FERC Stats. & Regs., Regulation Preambles January 1991-June 1996 ¶ 31,006, at 31,164 n.6 (1994).

[178] Exh. S-1 (rev. Jan. 11, 2012) at 8 (Sherman); *Williams Pipe Line Co.*, 31 FERC at 61,833.

[179] *Williams Pipe Line Co.*, 31 FERC at 61,835.

[180] *Id*. at 61,834-35.

[181] *ARCO Pipe Line Co.*, 52 FERC ¶ 61,055, at 61,235 (1990).

[182] *See Williams Pipe Line Co.*, Opinion No. 154-C, 33 FERC ¶ 61,327, at 61,639 (1985) (summarizing the Commission's holdings in Opinion No. 154-B). In Opinion No. 154-B, the Commission also adopted the concept of a starting, or transition, rate base for oil pipelines, to account for the switch from the valuation method used by the Interstate Commerce Commission (ICC) to the new trended original cost method. *Williams Pipe*

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110. As shown on page 2 of Exhibit No. S-2, under the Opinion No. 154-B methodology, Trial Staff asked the Presiding Judge to adopt an uncommitted rate for the 2010 rate period based on an annual cost-of-service of $167,079,000.[183] For Docket No. IS11-146-000, Trial Staff explained that as shown on page 2 of Exhibit No. S-3, the uncommitted rate for the 2011 rate period should be based on an annual cost-of-service of $178,752,000.[184] Trial Staff explained that Ms. Sherman's calculation of this amount reflects, among other things, use of Trial Staff's proposed capital structure, cost of equity, cost of debt, and the stipulated depreciation rate of 3.01%.[185]

Findings and Conclusions

111. ESL claims the appropriate total cost-of-service for the 2010 rate period is $267,100,000,[186] the Indicated Shippers that it is $161,428,000,[187] and Trial Staff that it is $167,079,000.[188] The Committed Shippers take no position.[189] Of course, rulings on the individual components of the cost-of-service will determine the appropriate total cost-of-service; however, it is helpful to note that Trial Staff's differences with ESL regarding the overall cost-of-service primarily concern return and associated income taxes while Trial Staff's principal differences with Indicated Shippers on cost-of-service relate to return and associated income taxes, and operating expenses.

112. As observed by ESL, the numerical differences between the parties regarding associated income taxes appear to arise solely from differences in equity return. ESL argued that ROE from the top of the cost of equity range for the oil pipeline proxy group should be used based on higher overall risks. The Indicated Shippers supported use of the median ROE, but only if design capacity was used for the throughput volume of the pipeline. In contrast, Trial Staff asserts that ESL has a very low cost of equity because there is no dispute among the participants that the existence of the TSAs shifts most of the risk of the Southern Lights Pipeline project from ESL to the Committed Shippers.

Line Co., 31 FERC ¶ 61,377, at 61,835-36. However, the starting rate base concept does not apply to Enbridge Southern Lights since it is a new pipeline, and was never subject to ICC regulation. *See, e.g.,* Exh. S-2 (rev. Jan. 11, 2012) at 6, Statement E1, line 12 (Sherman) (listing as not applicable (N/A) the write-up of starting rate base (SRB)); Exh. ESL-7 at 38 n.14 (Webb) (the starting rate base concept applies only to pipelines in operation before 1985).

[183] Exh. S-2 (rev. Jan. 11, 2012) at 2, Statement A, line 7 (Sherman).

[184] Exh. S-3 (rev. Jan. 11, 2012) at 2, Statement A, line 7 (Sherman).

[185] Exh. Nos. S-1 (rev. Jan. 11, 2012) at 12; S-2 at 10, line 5 (Sherman).

[186] ESL I.B. at 21.

[187] Indicated Shippers I.B. at 14.

[188] Trial Staff I.B. at 23.

[189] Committed Shippers I.B. at 8.

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This issue will be addressed more fully in the discussion of overall return ***infra*** (Issue #5).

113. Regarding operating expenses, consistent with their approach of using cost projections for a new pipeline, the Indicated Shippers propose operating expenses based on pipeline estimates made at a time close to when it went into service.[190] Both Trial Staff and ESL based operating expenses on annualized expenses actually incurred by the pipeline during the locked-in period. Trial Staff and Enbridge Southern Lights agree on the level of all operating expenses except power costs, which vary depending on throughput.[191] Consistent with Commission precedent and policy, the level of operating expenses should be based on annualized expenses actually incurred by the pipeline during the locked-in period. Power costs will be determined based on the throughput calculations adopted for the relevant period as set forth in the discussion of the appropriate level of operating expenses under Issue 10 ***infra.***

Issue #4: What is the appropriate rate base?

A. ESL

114. ESL provided a chart detailing the parties' respective positions on rate base:

Party	*Witness*	*Source*	*2010*	*2011*
ESL	Dr. Webb	ESL-55 and 56, Stmt E1	$1.58 billion	$1.59 billion
Trial Staff	Ms. Sherman	S-2 and 3, Stmt E1	$1.50 billion	$1.52 billion
Indicated Shippers	Ms. Crowe	IS-4 (Updated), Stmt E1 and IS-3A Supp., Stmt C	$1.43 billion	$1.43 billion

115. ESL stated that their position is appropriate because the figures that Dr. Webb present reflect the carrier property in service ("CPIS"), accumulated depreciation, allowance for funds used during construction ("AFUDC"), deferred taxes and deferred return as of the end of the 2010 and 2011 periods, respectively.[192] Although Ms. Crowe claims the Indicated Shippers' 2010 rate base figure is based on the CPIS as of April 30,

[190] Exh. ESL-1 at 19 (Crowe) (it is appropriate to use the pipeline's own estimates of operating expenses, at or near the time it was placed in service).

[191] Exh. ESL-7 at 64 n.28 (Webb).

[192] ESL-7 at 46:13-21; ESL-44 at 42:2-3; *see also* S-1 at 10:12-20.

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2011,[193] ESL noted Dr. Webb's explanation that it appears to actually be as of December 31, 2010.[194]

116. ESL explained that the remaining differences in the respective parties' rate base calculations arise principally from differences in their calculations of AFUDC and deferred return, which are discussed *infra*.

B. Committed Shippers

117. Committed Shippers took no position on this issue, and stated that for both the 2010 period and the 2011 period, both Enbridge's and Staff's rate base, when applied to proper throughput determinants and Opinion No. 154-B methodology, result in a finding that Enbridge's filed 2010 and 2011 rates are just and reasonable.

C. Indicated Shippers

118. Indicated Shippers held that the appropriate rate base is $1,425,203,000 for the 2010 rate period,[195] and Indicated Shippers proposed a rate base of $1,432,004,000 for the 2011 rate period.[196] Indicated Shippers explained that witness Crowe used the actual carrier property in service as of April 30, 2011, the latest date as of which she possessed actual data at the time of her Answering Testimony and she excluded ESL witness Webb's speculative plant additions of $10.5 million.[197] However, Indicated Shippers noted that they would accept the use of data available as of June 30, 2011, in a compliance filing.

119. Indicated Shippers disagreed with the contention in Trial Staff's initial brief that Ms. Crowe "contradicts" her own position that initial rates should be based on twelve-month projections of costs by using actual carrier property in service (CPIS) as of July 2010 in calculating her rate base.[198] Indicated Shippers took issue with Staff's assertion for two reasons. First, as Ms. Crowe explained in her testimony, the twelve-month cost projections upon which Ms. Crowe relied were filed by ESL on July 29, 2010, and September 13, 2010.[199] Indicated Shippers noted that both dates were after the pipeline went into service, so the actual July 1, 2010, cost of plant should have been known with certainty as of both those dates, in particular in the September filing upon which Ms. Crowe chiefly relied. Second, Indicated Shippers asserted that rate base values are

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[193] *See* Exh. IS-1 at 11.
[194] *See* Exh. ESL-44 at 43:10-44:2.
[195] *See* Exh. IS-4(Updated) at 3, line 18 ("Net Trended Original Cost Rate Base").
[196] *See* Exh. IS-3A (Supp.) at 3, line 18.
[197] *See* Exh. IS-1 at 12-13.
[198] *See* Staff I.B. at 27.
[199] *See* Exh. IS-1 at 19, line 16 through 20, line 2.

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always "point in time" values, not projections over any number of months, so a specific date had to be selected for setting the value for carrier property in service, and Ms. Crowe chose to use the July 1, 2010, value for reasons explained in her testimony.[200]

120. Indicated Shippers argued that ESL's initial brief mistakenly suggests that Ms. Crowe claimed to base her proposed rates for 2010 on CPIS as of April, 2011.[201] Indicated Shippers explained that in the referenced section of Ms. Crowe's testimony, she was responding solely to Dr. Webb's calculation of rates for 2011 to compare "apples to apples," when she used rate base amounts as of June 20, 2011 – not April, 2011.[202] The resulting rates, contained in Exh. IS-3, were not the rates proposed by Indicated Shippers as Indicated Shippers' proposed rates for 2010 are contained in Exh. IS-4 and IS-4 (Updated).

D. Trial Staff

121. As shown on page 6 of Exhibit No. S-2, Trial Staff explained that the appropriate net trended original cost rate base for the 2010 rate period is $1,503,754,000.[203] Ms. Sherman based this amount on ESL's carrier property in service as of January 31, 2011, the end of the period in which the Docket No. IS10-399-003 rates were in effect.[204] Trial Staff noted that this conforms to the Commission's general policy of using a pipeline's rate base as of the end of the test period[205] and Page 6 of Exhibit No. S-2 shows the various adjustments Ms. Sherman made to carrier property in service to arrive at an appropriate rate base for the 2010 period.

122. Trial Staff explained that ESL proposes a net trended original cost rate base of $1,580,491,000.[206] Like Trial Staff, the pipeline uses carrier property in service as of January 31, 2011 as the starting point for the calculation of rate base for the 2010 rate period.[207] However, Trial Staff stated that ESL ends up with a higher trended original cost rate base than Trial Staff due to the calculation of AFUDC (Allowance for Funds Used During Construction) and deferred return, both of which are dependent on the level of return used in the calculation.[208] Trial Staff noted that under the Opinion No. 154-B

[200] *See id.*

[201] *See* ESL I.B. at 21-22.

[202] Exh. IS-1, p. 12, lines 7-9.

[203] Exh. S-2 (rev. Jan. 11, 2012) at 6, Statement E1, line 13 (Sherman).

[204] Exh. S-1 (rev. Jan. 11, 2012) at 10 (Sherman).

[205] *Iroquois Gas Transmission System, L.P.*, 84 FERC ¶ 61,086, at 61,443 (1998).

[206] Exh. ESL-55 (rev. Dec. 27, 2011), Statement C, line 18 (Webb).

[207] *See* Exh. ESL-19 (showing carrier property in service (CPIS) of $1,423,146,575 as of January 31, 2011). Ms. Sherman uses the identical level of CPIS in her calculation. Exh. S-2 (rev. Jan. 11, 2012) at 6, Statement E1, line 1 (Sherman).

[208] *Compare* Exh. ESL-55 (rev. Dec. 27, 2011), Statement E1 (Webb) *with* Exh.

methodology, these two cost items are added to rate base.[209] Trial Staff pointed out that ESL proposes a higher return, and therefore, ESL's proposed amortization of AFUDC and deferred return are correspondingly higher, resulting in a higher rate base.

123. Trial Staff stated that Indicated Shippers propose a net trended original cost rate base of $1,425,203,000.[210] Trial Staff observed that, consistent with her approach of using projections as of the beginning of the pipeline's operations, rather than actual data as of the end of the test period, Ms. Crowe used carrier property placed in service as of July 2010 in determining the net trended original cost rate base.[211] Trial Staff explained that Indicated Shippers propose a different return than Trial Staff and ESL and a different level of carrier property in service. Accordingly, Trial Staff noted that Indicated Shippers' level of AFUDC and deferred return differs from Trial Staff's and ESL's values, and thus so does Indicated Shippers' resulting net trended original cost rate bases.

124. Trial Staff asked the Presiding Judge to adopt the use of the pipeline's carrier property in service as of January 31, 2011 as the starting point in calculating rate base, as proposed by both Trial Staff and ESL. Trial Staff explained that this approach best conforms to the Commission's policy of using the pipeline's rate base as of the end of the test period, since the rates in Docket No. IS10-399-003 were superseded on this date. Trial Staff advocated for rejecting Indicated Shippers' recommendation to use ESL's actual carrier property in service as of July 2010 for determining rate base. Trial Staff noted that this position not only contravenes Commission policy, but also contradicts the Indicated Shippers' own position that a new pipeline should base its rates on cost-of-service determinants in accordance with section 346.2(a)(3) of the Commission's regulations.[212] Trial Staff explained that regulation requires the use of twelve-month projections, and the pipeline's actual carrier property in service as of July 2010 is not a projection, let alone a twelve-month projection.

125. For Docket No. IS11-146-000, Trial Staff's proposed net trended original cost rate base for the 2011 rate period is $1,516,563,000.[213] In determining the appropriate rate base, Ms. Sherman intended to use Enbridge Southern Lights' carrier property in service as of June 30, 2011, the end of Trial Staff's test period for Docket No. IS11-146-000

S-2 (rev. Jan. 11, 2012), Statement E1 (Sherman) (showing different values for accumulated AFUDC and deferred return and associated deferred income taxes).

[209] *Williams Pipe Line Co.*, 31 FERC ¶ 61,377, at 61,834 (oil pipelines can amortize equity "write-up", or deferred return, over the life of their property) and 61,839 n.38 (oil pipelines may add AFUDC to rate base).

[210] Exh. IS-4 (Updated) at 3, Statement C, line 1 (Crowe).

[211] Exh. IS-1 at 19 (Crowe).

[212] *Id.* at 16 (recommending an Opinion No. 154-B cost-based rate for uncommitted service under section 346.2[a](3) of the Commission's regulations).

[213] Exh. S-3 (rev. Jan. 11, 2012) at 4, Statement C, line 18 (Sherman).

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rates.[214] Trial Staff noted that Ms. Sherman testified that this end of the test period balance appropriately represents the cumulative amount of carrier property in service from the past year, ending on the last day of the test period, and takes into account any additions and retirements of property during the year.[215] Trial Staff explained that, in her rate base calculation, Ms. Sherman inadvertently used the pipeline's carrier property in service as of September 30, 2011, rather than as of June 30, 2011, as she intended. Trial Staff stated that their proposed rate base level should be adjusted accordingly,[216] and that Page 6 of Exhibit No. S-3 shows the various adjustments Ms. Sherman made to carrier property in service to arrive at an appropriate rate base for the 2011 period.

126. Trial Staff noted that ESL proposes a net trended original cost rate base of $1,592,745,000[217] and uses carrier property in service as of September 30, 2011 as the starting point for the calculation of rate base for the 2011 rate period.[218] Trial Staff explained that ESL ends up with a higher trended original cost rate base than Trial Staff due to the calculation of AFUDC and deferred return, both of which are dependent on the level of return used in their calculation.[219] Under the Opinion No. 154-B methodology, Trial Staff explained that these two cost items are added to rate base.[220] Trial Staff asserted that ESL proposes a higher return than Trial Staff, and therefore its proposed amortization of AFUDC and deferred return are correspondingly higher, resulting in a higher rate base. In addition, Dr. Webb erroneously uses the September 30, 2011 carrier property in service for his calculation.

127. Trial Staff observed that Ms. Crowe proposes a net trended original cost rate base of $1,432,004,000,[221] based on actual carrier property in service as of April 30, 2011.[222] As previously noted by Trial Staff, use of the end of test period (i.e., the June 30, 2011) balance for carrier property in service is consistent with Commission practice and Ms.

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[214] Exh. S-1 (rev. Jan. 11, 2012) at 10 (Sherman).

[215] *Id.*

[216] Because no participant used carrier property in service as of June 30, 2011 in its calculations, this figure apparently is not in evidence.

[217] Exh. ESL-56 (rev. Dec. 27, 2011), Statement C, line 18 (Webb).

[218] *See* Exh. ESL-19 (Brown) (showing carrier property in service of $1,434,974,534 as of Sept. 30, 2011); and Exh. ESL-56 (rev. Dec. 27, 2011), Statement E1, line 1 (Webb) (showing use of the same figure).

[219] *Compare* Exh. ESL-56 (rev. Dec. 27, 2011), Statement E1 (Webb) *with* Exh. S-3 (rev. Jan. 11, 2012) at 6, Statement E1 (Sherman) (showing different values for accumulated AFUDC, deferred return, and associated deferred income taxes).

[220] *Williams Pipe Line Co.*, 31 FERC ¶ 61,377, at 61,834 (oil pipelines can amortize equity "write-up", or deferred return, over the life of their property) and 61,839 n.38 (oil pipelines may add AFUDC to rate base) (1985).

[221] Exh. IS-3A (Supplement) at 3, Statement C, line 18 (Crow).

[222] Exh. IS-1 at 13 (Crowe).

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Sherman's proposal. According to Trial Staff, because the Indicated Shippers propose a different return than Trial Staff and ESL, and a different level of carrier property in service, their level of AFUDC and deferred return differs from Trial Staff's and ESL's values, and so does their resulting net trended original cost rate base.

128. Trial Staff argued that their proposed rate base for the 2011 rate period is consistent with the Commission's practice of using end of test period balances to develop rate base. Trial Staff also asked for the adoption of their position of using carrier property in service as of June 30, 2011 in determining rate base. Trial Staff noted that this finding would require a revision to the values in Trial Staff's exhibits since Trial Staff inadvertently used the September 30, 2011 carrier property in service balance, and the June 30, 2011 balance is not in record evidence since no participant actually used it in testimony. Trial Staff asserted that ESL could be directed to provide the number in its compliance filing.

Findings and Conclusions

129. ESL and Trial Staff are correct in noting that the pipeline's carrier property in service as of January 31, 2011 is the starting point in calculating rate base for the 2010 rates as this approach best conforms to the Commission's policy of using the pipeline's rate base as of the end of the test period. For the reasons discussed *supra*, Indicated Shippers is mistaken by using projections as of the beginning of the pipeline's operations, rather than actual data as of the end of the test period. For the 2011 period, Trial Staff is correct in noting that the end of the test period balance appropriately represents the cumulative amount of CPIS from the past year, ending on the last day of the test period, and takes into account any additions and retirements of property during the year.

130. ESL and Trial Staff do not argue for the same rate base figures due to their differing calculations of AFUDC and deferred return, both of which are dependent on the level of return. As discussed *infra*, I agree with Trial Staff's methodology regarding these factors.

Issue #5: What is the appropriate overall return?

A. ESL

131. ESL submitted a table detailing the parties' positions on overall return:

Party	*Witness*	*Source*	*2010*	*2011*
ESL	Dr. Webb	ESL-55 and 56, Stmt C	$127.2 million	$128.2 million
Trial Staff	Ms. Sherman	S-2 and 3, Stmt C	$75.8 million	$76.4 million
Indicated Shippers	Ms. Crowe	IS-4 (Updated), Stmt C and IS-3A Supp., Stmt C	$61.7 million	$61.2 million

132. ESL explained that the major driver of the differences among the parties with respect to the overall return is their assessment of the relevant risks of the pipeline.[223] ESL noted that Dr. Webb determined the rate of return that corresponds to the full risk of the Southern Lights Pipeline, and that was necessary because Dr. Webb undertook to determine directly the cost-based ceiling rate for Uncommitted Shippers that do not bear any of the pipeline's market and commercial risks through contractual commitments like those made by the Committed Shippers.[224]

133. According to ESL, Trial Staff followed an alternative approach acknowledging that some of the risks of the Southern Lights Pipeline had been shifted to the Committed Shippers, but taking into account the contractual commitments of the Committed Shippers through application of the Commission-approved 2-to-1 rate design in calculating the appropriate ceiling rate for Uncommitted Shippers.[225]

134. On the other hand, ESL stated that the Indicated Shippers simply ignored the risks borne by the Committed Shippers. Instead, ESL explained that Indicated Shippers seek to benefit from the shifting of those risks through the TSAs, even though the Indicated Shippers bear none of the burdens of the TSAs entered into by other parties through the open season process. ESL argued that as a matter of policy, that approach constitutes "free riding" that should be rejected.[226]

135. ESL noted Dr. Jaffe's explanation that the tariff rate level for uncommitted shipments will not have a significant impact on the pipeline because of the refund mechanism.[227] Rather, ESL stated that the primary economic impact of reducing the Uncommitted Rate is to reduce the effective cost of shipping for the Uncommitted Shippers while raising it for the Committed Shippers, thus rewarding the parties that

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[223] The parties' differences with respect to the specific elements of the overall return are discussed in Sections VIII-X below.

[224] *See* ESL-7 at 51.

[225] *See* S-15 at 9-10; ESL-27 at 18.

[226] *See* ESL-27 at 19.

[227] *Id*. at 20.

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declined to make the commitments necessary to finance the pipeline at the expense of those parties that assumed that risk.[228] ESL explained that the likely economic effect of rewarding such behavior is that in the future, parties will be unwilling to make the kind of commitments that made the project possible.[229]

136. ESL argued that the overall risks of the Southern Lights Pipeline are not comparable to those of the average oil pipeline, and in fact, in the Declaratory Order, the Commission found the Southern Lights Pipeline to be a risky project that warranted an equity rate of return from the high end of the range of reasonableness.[230] As ESL witness Earnest explained, the current risks of the pipeline are extremely high, as demonstrated by the failure of the pipeline to attract even the volumes for which the Committed Shippers are obligated to pay – much less any sustained incremental volume above that level.[231] ESL stated that the Indicated Shippers' argument that the Southern Lights Pipeline is a low-risk project assumes that at some future, indeterminate time, the pipeline will no longer face the kinds of risks that have limited its throughput to date.

137. ESL argued that the future risk of variability of demand for diluent in Alberta is substantial, however, as described in detail by Mr. Earnest. As an initial matter, ESL asserted that the demand for diluent transportation on the Southern Lights Pipeline over the longer-term remains closely linked to Canadian heavy oil production, which remains difficult to accurately forecast.[232] Further, ESL noted that Canadian heavy crude producers can use synthetic crude as a blending material, thus enabling the heavy oil to be transportable by pipeline, which reduces the demand for diluent at any level of crude production.[233] ESL also pointed out that supply may be hindered by higher royalties or other taxes, tougher environmental regulations, and limits or fees associated with greenhouse gas emissions.[234]

138. ESL explained that the future risk from competing alternative modes of transportation is also substantial.[235] ESL cited to Mr. Earnest's explanation that both

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[228] *Id.*

[229] *Id.*; ESL-7 at 25:14-27:17.

[230] Declaratory Order at P 18.

[231] *See* ESL-30 at 3-4; *see also* NEB Decision at 30 ("The Board notes that the Southern Lights Pipeline was underutilized in 2010. The Board also notes that Committed Shippers did not ship their full committed volumes, despite the fact that the marginal cost to do so would have been zero.").

[232] ESL-24 at 6-9.

[233] *Id.* at 10-11.

[234] *Id.* at 11-12.

[235] As the NEB explained, "[t]he Board is . . . of the view that there are other means than the Southern Lights Pipeline to obtain diluent for the Alberta market. . . . [T]he Board is not persuaded that ESL is a monopoly pipeline exerting monopoly power

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Provident Energy Ltd. and Keyera Facilities Income Fund operate diluent rail-unloading facilities in the Edmonton, Alberta, area with capacities of 80,000 bpd and 50,000 bpd, respectively, and Canadian National Railway indicates that since 2006 it has been shipping a steadily increasing amount of diluent into Alberta from various U.S. origins.[236] ESL also cited to Mr. Earnest's explanation that rail is extensively used to transport North Dakota Bakken crude to market today, and that the experience in North Dakota is illustrative of the potential volumes of Canadian heavy oil volumes that may be transported by rail. [237]

139. ESL dismissed Indicated Shippers witness Safir's contention that rail is not competitive with ESL. According to ESL, Dr. Safir severely underestimates the degree and nature of the competitive threat from rail by assuming that rail competition would only take place on the Chicago-to-Edmonton route.[238] ESL noted that Mr. Earnest has stated that rail has far more flexibility than the Southern Lights Pipeline in regard to origination points, thus enabling rail users to source their diluent from whatever point in North America provides the lowest delivered cost to Edmonton.[239] ESL explained that Dr. Safir's contentions are directly contradicted by evidence provided by Mr. Henry Roman, the rail expert that Imperial Oil engaged to provide evidence at the National Energy Board of Canada ("NEB"), which Dr. Safir attached to his Answering Testimony.[240]

140. According to ESL, Mr. Earnest explained that Mr. Roman estimated the rail cost to transport diluent from Chicago to Edmonton to be $6.52 per barrel for single car movements, and approximately 17-20% lower for unit train movements.[241] Thus, Mr. Earnest explained, Dr. Safir's own evidence indicates that using a unit train between Chicago and Edmonton is less costly for a potential uncommitted shipper until the Southern Lights Pipeline reaches a total throughput of about 155,000 bpd, or 86% of capacity.[242]

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in the diluent market. In the Board's view, a competitive market for diluent is operating in western Canada at the present time." NEB Decision at 30.

[236] *Id*. at 15; *see also* ESL-38.

[237] *Id*. at 16; specifically, Mr. Earnest notes that outbound rail transportation capacity for crude oil in North Dakota is expected to increase to a total of 255,000 bpd by 2012. If crude producers started shipping 255,000 bpd of heavy oil by rail in Canada, diluent demand in Canada would drop by approximately 70,000 bpd.

[238] ESL-30 at 19-20.

[239] *Id*.

[240] *Id*. at 20.

[241] *Id*.

[242] *Id*. at 20-21; ESL-39.

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141. ESL noted that Mr. Earnest also described a study concerning the Keystone XL pipeline recently released by the U.S. Department of State, which incorporated an extensive analysis of the oil industry's transportation alternatives in the event that the Keystone XL pipeline is not built.[243] According to ESL, that study found that both the U.S. and Canadian rail systems have significant spare capacity that can be used to transport crude oil or diluents.[244] ESL asserted that the study also found that rail companies claim that shipping undiluted bitumen with heating is competitive with shipping via pipeline, and is even cheaper if there is the option to back haul diluent, and that rail could accommodate 1,250,000 bpd of Canadian crude exports by 2030.[245]

142. ESL explained how Mr. Earnest also testified that the diluent pipeline portion of the Northern Gateway project will be a direct competitor to the Southern Lights Pipeline, as it is designed to transport diluent to Edmonton from Kitimat, a seaport with access to tankers loaded at multiple locations.[246] ESL stated Dr. Safir's contention that Northern Gateway will not be a competitor because both Northern Gateway and ESL are owned by Enbridge and because it will not be in operation until 2016 at the earliest.[247] However, ESL argued that Dr. Safir ignores the fact that both the Southern Lights Pipeline and Northern Gateway are common carriers; therefore, it will be the shippers, not Enbridge, that choose which route and regulated service to use.[248] Further, ESL stated that Northern Gateway will be a competitor post-2016, and given the current low utilization of the Southern Lights Pipeline, if Northern Gateway were in operation today, ESL's risk level would be even higher.[249]

143. According to ESL, the unusual riskiness of the pipeline was anticipated at the time it was being built. As discussed in the Affidavit of Don Thompson that was attached to ESL's Petition for Declaratory Order, if ESL had built the project without shipper support, it would have faced substantial risk associated with heavy oil production in Western Canada, the refinery market in the U.S. Midwest, the natural gasoline market in the U.S. Gulf Coast, and the imported worldwide naphtha market.[250] ESL noted Dr. Jaffe's explanation that ESL was unable to get commitments when the differential between the Committed and Uncommitted Rates was initially set at 1.5-to-1. Instead, ESL explained that it was compelled to raise the offered differential to 2-to-1 in order to

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[243] ESL-30 at 22.
[244] *Id.*
[245] *Id.* at 23.
[246] *Id.* at 25.
[247] *Id.*
[248] *Id.*
[249] *Id.*
[250] *See* ESL-1 at 9.

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attract committed volumes to support the pipeline, which suggests shippers were aware of the inherent riskiness of the project.[251]

144. ESL asserted that, after the initial open season, one Committed Shipper exercised its right to terminate its commitment, reducing the Committed Volume to 77,000 bpd.[252] ESL explained that it then conducted a second opportunity to commit, on essentially the same terms as the first, yet no additional shippers signed up, including the remaining Committed Shippers, who could have, but did not, commit to additional volumes at that point.[253] Thus, ESL pointed out that despite two open seasons, it was unable to attract more than 77,000 bpd of committed throughput.[254] According to Dr. Jaffe, surely the Indicated Shippers, and other economically-sophisticated parties, would have signed up when the opportunity was presented to them if the Southern Lights Pipeline were in fact such a low-risk pipeline.[255]

145. ESL argued that the Indicated Shippers' response to ESL's showing on the issue of risk is unpersuasive as the Indicated Shippers focus on long-term risk and essentially ignore the current risk of the pipeline during the 2010-2011 period at issue here.[256] ESL cited to Mr. Earnest's explanation that Dr. Safir's analysis is also deeply flawed. According to ESL, Dr. Safir incorrectly calculates the future extent and variability of demand by confusing total Canadian oil sands production with the volume of heavy crude that must be blended with a diluent before it can be transported by pipeline. ESL noted that as a result, Dr. Safir's estimate of the volume of heavy crude in 2020 that will require diluent addition is in error by over 1.0 million bpd.[257] As ESL previously asserted, Dr. Safir further disregards substantial evidence of current and potential rail competition, including testimony of Imperial Oil's own expert witness, Mr. Roman, before the NEB.[258]

146. According to ESL, Dr. Safir's dismissal of the competition that the Southern Lights Pipeline faces from synthetic crude is also overly simplistic.[259] For example, Dr. Safir contends that synthetic crude is less desirable than traditional diluents because

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[251] *See* ESL-27 at 13; Tr. at 93:19-24; NEB Decision at 23 (as the NEB explains, "the Board is of the view that the Committed Shippers took on substantial underutilization risk and did so based on all aspects of the toll principles, including the 2 to 1 Toll Ratio").

[252] ESL-1 at 10.

[253] *Id.* at 11.

[254] *Id.*

[255] ESL-27 at 13.

[256] *See* IS-8 at 11-15; ESL-30 at 2-4.

[257] ESL-30 at 7-8.

[258] *Id.* at 19-24.

[259] *Id.* at 11-13.

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of its higher blend ratio.[260] ESL noted Mr. Earnest's explanation that not only is synthetic crude clearly already being used to dilute heavy crude, but the determination of whether diluent or synthetic crude is the optimal blendstock for the Canadian heavy crude producer actually relies on a number of factors including the pricing relationship between the resulting blended stocks, dilbit and synbit, and the pricing relationship between diluent and synthetic crude.[261] Depending on those factors, ESL stated that either of the two blendstocks may in fact be more desirable in a specific situation.[262]

147. Lastly, ESL argues that Dr. Safir overstates the linkage between the volume of Canadian heavy crude runs in PADD II and the volume of diluent available for return to Canada via the Southern Lights Pipeline.[263] According to ESL, Mr. Earnest explained that much of Dr. Safir's testimony in regard to diluent supply risk is predicated on the erroneous notion that diluent supplies will be concentrated in PADD II.[264] ESL noted that the U.S. Gulf Coast – not PADD II – is actually the largest potential source of diluent due to its large number of refineries and NGL fractionators in the region.[265] ESL dismissed Dr. Safir's suggestion that crude oil netbacks at Edmonton are higher for PADD II delivery as unsupported. ESL cited to Mr. Earnest explanation that Canadian heavy crude producers do not have the ability to price differentiate between buyers, meaning, to charge different prices at Edmonton to different crude buyers. Rather, for a given grade of crude, ESL stated that there is only one price at Edmonton, irrespective of the ultimate processing location.[266]

148. ESL believed that the record is clear that the Southern Lights Pipeline is an unusually risky enterprise that warrants a correspondingly high equity ratio and high equity return in determining the just and reasonable Uncommitted Rate, so that the Uncommitted Shippers pay their fair share of the overall economic cost of the pipeline when they choose to ship. ESL argued that this is not an issue of either over-compensating or under-compensating ESL; because of the year-end refunds, ESL does not gain or lose from the return used to set the maximum Uncommitted Rate at current and foreseeable volume levels, and does so to only a small extent if volumes were to exceed 162,000 bpd in the future. ESL asserted that the overall return must reflect the fact that the Committed Shippers have borne most of the risk of the pipeline to date, while the Indicated Shippers elected not to take on the contractual obligation to bear that risk, by not signing TSAs during the two open seasons that were offered. As a policy

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[260] *See* IS-8 at 30.

[261] ESL-30 at 12.

[262] *Id*.

[263] *Id*. at 13-18; *See* ESL-35 (PADD II consists of fifteen states in the mid-section of the U.S. as defined by the Energy Information Administration).

[264] *Id*. at 14.

[265] *Id*. at 15.

[266] *Id*. at 17-18.

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matter, ESL noted that giving the Indicated Shippers the benefits of the reduced risks to ESL produced by the TSAs without requiring the Indicated Shippers to bear the same burdens that the Committed Shippers have borne would be fundamentally wrong and should not be the basis for determining the Uncommitted Rates in this case.

149. ESL's Post-Hearing Reply Brief addressed the Indicated Shippers' contention that Southern Lights is an "average risk" pipeline is without merit.[267] ESL cited to the Declaratory Order, where the Commission found the Southern Lights Pipeline to be a risky project that warranted an equity rate of return from the high end of the range of reasonableness.[268] ESL explained that, in that Order, the Commission described with specificity the factors that made the Southern Lights Pipeline such a risky endeavor, including "the size and scope of the multistate and international project, the approximately $1.3 billion investment requirement, and the length of time necessary to complete the project."[269] Additionally, ESL pointed out the Commission's explanation that "Enbridge Southern Lights has elected to build major new facilities with no guarantee that the projected throughput will be achieved."[270]

150. ESL noted Mr. Earnest's discussion regarding the fact that the pipeline has failed to attract even the volumes for which the Committed Shippers are obligated to pay – much less sustained incremental volume above that level.[271] As Mr. Earnest explained, the current business and market risks associated with the pipeline are extremely high.[272] Moreover, ESL explained that the future business and commercial risk of the pipeline will remain high, due to the uncertainty concerning the volume of locally-produced diluent in Western Canada itself and the level of competition from rail and other diluent pipelines.[273]

151. ESL dismissed Indicated Shippers' contention that the assessment of risk should only focus on ESL as meritless.[274] ESL noted Dr. Fairchild's explanation in paragraphs 17 and 18 of the Declaratory Order, where the Commission addressed rate of return with respect to "the total project . . . the total Southern Lights Pipeline, which includes the Committed Shippers as well as Enbridge Southern Lights."[275] ESL argued that the Indicated Shippers are ignoring the risks borne by the Committed Shippers, and instead seek to benefit from the shifting of those risks through the TSAs, even though the

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[267] *See* IS I.B. at 26.
[268] Declaratory Order at P 18.
[269] *Id.*
[270] *Id.*
[271] *See* ESL I.B. at 23-24; ESL-30 at 3-4.
[272] *See* ESL-30 at 2-4.
[273] *See* ESL I.B. at 24-27.[273]
[274] *See* IS I.B. at 26.
[275] Tr. at 197:1-4.

Indicated Shippers bear none of the burdens of the TSAs. ESL cited to Dr. Jaffe's explanation that the "fact that the TSA transfers much of the throughput risk from Enbridge Southern Lights to the Committed Shippers does not make that risk go away."[276]

152. ESL noted Trial Staff's statement that the Indicated Shippers' argument is completely "inconsistent with their initial position that the TSAs should not be taken into account. If the TSAs did not exist, the risk of the Southern Lights Pipeline would not have been shifted to the committed shippers . . . ."[277] ESL argued that this is yet another example of the Indicated Shippers' attempts to benefit from the long-term contractual commitments undertaken by the Committed Shippers.

B. Committed Shippers

153. Committed Shippers take no position on this issue, and note that for both the 2010 period and the 2011 period, both Enbridge's and Staff's overall return, when applied to proper throughput determinants and Opinion No. 154-B methodology, result in a finding that Enbridge's filed 2010 and 2011 rates are just and reasonable.

C. Indicated Shippers

154. Indicated Shippers' stated their position that the appropriate overall return is $61,747,000.[278] For Docket No. IS11-146-000, Indicated Shippers proposed an overall return of $61,249,000.[279]

155. Indicated Shippers' Post-Hearing Reply Brief explained that ESL's central argument is that "[t]he overall risks of the Southern Lights Pipeline are not comparable to those of the average oil pipeline" and that for this reason "a nominal ROE from the top of the cost of equity range for the oil pipeline proxy group" is appropriate.[280] However, Indicated Shippers argued that ESL both overstates the extent of risk that ESL faces and mistakes just and reasonable ratemaking with respect to a common carriage pipeline for what ESL characterizes as "free riding.[281]

156. Indicated Shippers noted ESL's argument that its proposed rate of return should reflect "full risks of the project" including the risks borne by ESL and the risks borne by

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[276] *See* ESL-27 at 11; ESL I.B. at 23.
[277] Staff I.B. at 48-49.
[278] Exh. IS-4 (Updated) at 1, line 1, and at 3, line 16.
[279] Exh. IS-3A (Supp.) at 1, line 1; *id.* at 3, line 16.
[280] ESL I.B. at 23, 34.
[281] *See* ESL I.B. at 4, 13, 23.

the Committed Shippers.[282] As explained in Indicated Shippers' Initial Brief, it is the risk to the regulated entity, not the pipeline "project," that is taken into account for purposes of determining a just and reasonable return on equity and overall return.[283] Indicated Shippers stated that ESL's own witnesses have conceded that this is true as a "general proposition," although the witnesses assert that various special circumstances excuse ESL from the usual procedures here.[284] Indicated Shippers pointed out that Staff's assessment also assumes that the risks transferred to the Committed Shippers are not to be included in the risks ESL itself faces.[285]

157. Indicated Shippers argued that ESL attempts to ride two horses at the same time with respect to the risk-shifting effect of the Committed Shippers' TSAs. First, ESL argues that, "The overall return must reflect the fact that the Committed Shippers have borne most of the risk of the pipeline to date . . . ."[286] Yet, Indicated Shippers stated that those agreements shift risk away from ESL and onto parties – the Committed Shippers – who voluntarily agreed to take it by contracting to pay for a certain level of volumes regardless of the total volumes shipped.[287] Indicated Shippers asserted that ESL nevertheless claims that it should be awarded an ROE at the high end of the range for the very same reason – to reflect the risks Committed Shippers took on.[288] Indicated Shippers argued that Enbridge's position with respect to its overall return is unprecedented in the history of FERC ratemaking, as acknowledged by its witnesses on cross-examination.[289] According to Indicated Shippers, with the exception of *Colonial Pipeline Company*,[290] neither ESL nor its witnesses could cite to any precedent whatsoever to support ESL's proposal to use the risk profile of the Committed Shippers or their corporate parents.[291] It is the pipeline's costs and risks, not its shippers' or its shippers' parents' costs and risks that must be considered in cost-based ratemaking.

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[282] *See* ESL I.B. at 4, 22-30.

[283] *See* IS I.B. at 26-27.

[284] Tr. 193, 197 (testimony of Fairchild); Tr. 259-60 (Testimony of Webb).

[285] *See* Exh. S-10 at 21 (testimony of Alvarez); Staff IB at 36-37 (noting in Staff's discussion of capital structure that ESL's proposal to include the risks borne by Committed Shippers is "not supportable").

[286] ESL I.B. at 30.

[287] ESL I.B. at 23-24; *see also id.* at 31 (acknowledging that "the Committed Shippers [are] bearing a majority of the risks of the Southern Lights Pipeline through and during the term of the TSAs . . . .")

[288] *See* ESL IB at 30.

[289] Tr. 260 (Testimony of Webb).

[290] 116 FERC ¶ 61,078 (2006)

[291] *See* IS I.B. at 21-22; Staff IB 35-36; Tr. 260 (ESL witness Webb raised *Express Pipeline Partnership*, 76 FERC 61,245 (1996) when requested to name Commission precedent supporting the use of one class of shippers' risks in setting rates for another class of shippers. However, that case did not even discuss a higher ROE

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158. Indicated Shippers stated that ESL's assertion that "the Commission found the Southern Lights Pipeline to be a risky project that warranted an equity rate of return at the high end of the range of reasonableness" is erroneous and disingenuous.[292] Indicated Shippers argued that the Commission made no finding as to the riskiness of ESL in the Declaratory Order, and rather, ESL was directed to justify whatever ROE it claimed was necessary in this very rate proceeding where it proposes the rates.[293] Indicated Shippers noted that ESL witness Webb acknowledged this under cross.[294]

159. Indicated Shippers pointed out that ESL also cites the Complaint order for the proposition that the Commission has "found" the two-to-one ratio just and reasonable. However, Indicated Shippers argued that that the Complaint Order, to the extent it was merely reaffirming the Declaratory Order, actually misstated the Declaratory Order. Indicated Shippers noted that the Declaratory Order found only that the two-to-one ratio was not unduly discriminatory,[295] and the Declaratory Order did not find that the two-to-one ratio was "just and reasonable"; that language does not appear in the order with respect to the ratio, as conceded by ESL witness Webb.[296] To the extent that the Complaint order was ruling anew, Indicated Shippers stated that there was no basis in substantial evidence in the complaint proceeding for a new "ruling" that the two-to-one ratio was just and reasonable. Accordingly, Indicated Shippers believed that ESL's reliance on the Commission's misstatement is unwarranted.

160. Indicated Shippers noted that based on the testimony of ESL witness Earnest, ESL argues that the record is "clear that the Southern Lights Pipeline is an unusually risky enterprise that warrants a correspondingly high equity ratio and high equity return in determining the just and reasonable Uncommitted Rate."[297] However, according to Indicated Shippers, ESL completely ignores the cross-examination of ESL witness Jervis, which contradicted the testimony of ESL witness Earnest on several points during cross-examination.[298] Similarly, Indicated Shippers pointed out that ESL's argument that Indicated Shippers assume that "at some future, indeterminate time, the pipeline will no longer face the kinds of risks that have limited its throughput to date," ignores ESL

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component to reflect Committed Shippers' risks).

[292] ESL I.B. at 23 (emphasis added); *see also* IS I.B. at 24.

[293] Declaratory Order at P 18 ("as in *Colonial*, the Commission will not approve a specific ROE in this proceeding").

[294] Tr. 220, 244-45.

[295] Declaratory Order at P 31.

[296] Tr. at 222.

[297] ESL I.B. at 29.

[298] *See* Tr. 112-13 (forecasted need for pipeline expansion); 116 (increased actual volumes shipped since pipeline opened); 121 (use of Chicago as a "good hub for sources of diluent"); 132 (pipeline expected to operate continuously).

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witness Jervis' confirmation that the proposition is true.[299] Indicated Shippers also noted witness Jervis' statement that the company's expectations are that the pipeline will be full in 2014, that ESL was already considering expanding the pipeline by 33%, and that expansion might be "required."[300] According to Indicated Shippers, the testimony of the company witness necessarily trumps the conflicting testimony of the hired expert theorist.

161. Indicated Shippers argue that ESL attempts to magnify the perceived risk faced by the pipeline by taking issue with Dr. Safir's conclusion that rail is not a viable competitive alternative to Enbridge Southern Lights.[301] However, Indicated Shippers asserted that ESL's criticism of Dr. Safir is belied by ESL's own internal analysis that the cost of rail is approximately $11.50-$12.50 per barrel, so that the cost of rail would exceed that of the ESL pipeline once 90,000 bpd (only 13,000 bpd of uncommitted volumes) are shipped.[302] Indicated Shippers noted that Statoil similarly estimated even higher costs for rail transport of diluent to Edmonton, Alberta, Canada,[303] and therefore, ESL's discussion of rail competition is contradicted by the evidence.

162. Indicated Shippers argued that even if ESL's various arguments that the pipeline is "unusually risky" were supported by evidence, ESL's own acknowledgement that "Committed Shippers have borne most of the risk of the pipeline to date,"[304] completely undermines its argument that ESL itself actually faces these unusual risks.

163. Indicated Shippers argue that ESL's policy arguments[305] confuse "free-riding" with taking common carriage service. Indicated Shippers noted the Commission's recognition that uncommitted shippers are entitled to a cost-based recourse rate that is "available to all shippers who choose not to select Enbridge Southern Lights' negotiated committed rate."[306] Moreover, Indicated Shippers believed that all conceivable uncommitted shippers who come along now or in the future should not be penalized for "not signing TSAs during the two open seasons that were offered," as ESL appears to recommend, by paying for risks ESL has already contracted away.[307]

164. Indicated Shippers argued that, in contrast to ESL's claims, as a matter of policy, the "likely economic effect" and desired ultimate result of a successful challenge here by

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[299] ESL I.B. at 24.

[300] *See* Tr. 113, 131-32; *see also* IS IB at 25-26.

[301] ESL I.B. at 24-26.

[302] Exh. IS-48 at 3 (chart comparing cost of rail with combined U.S. and Canada committed and uncommitted tolls).

[303] *See* Exh. IS-49.

[304] ESL I.B. at 30.

[305] ESL I.B. at 13.

[306] *See* Clarification Order at P 14.

[307] *See* ESL I.B. at 30.

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Indicated Shippers is that the Commission would scrutinize proposals such as ESL's much more closely in the future so that pipelines are not permitted to sneak through special deals and agreements that violate the ICA and have significant anticompetitive ramifications merely because of the lack of protest. Indicated Shippers pointed out that the Commission has a duty whether or not there is a protest to evaluate proposals as to whether they pass muster under the ICA,[308] and the Commission also has a duty to evaluate the anticompetitive ramifications of its decisions.[309]

D. Trial Staff

165. As shown on page 2 of Exhibit No. S-2, Trial Staff noted that the appropriate overall return on rate base for Enbridge Southern Lights for the 2010 rate period is $75,796,000.[310] Trial Staff explained that Ms. Sherman derived this figure by multiplying Trial Staff's recommended weighted cost of capital of 5.040%[311] by the trended original cost rate base of $1,503,754,000.[312] As shown on page 2 of Exhibit No. S-3, Trial Staff noted that the appropriate overall return for ESL for the 2011 rate period is $76,442,000.[313] Trial Staff's witness, Ms. Sherman, derived this figure by multiplying Trial Staff's recommended weighted cost of capital of 5.040% by the trended original cost rate base of $1,516,563,000.[314]

166. Trial Staff noted that their witness, Edward Alvarez III, developed the components for the weighted cost of capital,[315] and these components – capital structure, cost of debt, and cost of equity – are discussed separately, *infra*. Trial Staff explained that Ms. Sherman adjusted Mr. Alvarez' debt and equity ratios to account for deferred return on equity under the trended original cost methodology of Opinion No. 154-B,[316] and this

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[308] *See, e.g.*, *Magellan Pipeline Co., L.P.*, 138 FERC ¶ 61, 177, at PP 11, 18 (2012) (rejecting declaratory order in the absence of a protest where the proposed rate structure provided firm service at the same rate as the uncommitted rate).

[309] *Gulf States Utilities Co. v. FPC*, 411 U.S. 747, 758-59 (1973) (requiring the Commission to "consider, in appropriate circumstances, the anticompetitive effects of regulated aspects of interstate utility operations"); *accord New York Independent System Operator, Inc.*, 127 FERC ¶ 61,136, at P 6 (2009).

[310] Exh. S-2 (rev. Jan. 11, 2012) at 2, Statement A, line 1 (Sherman).

[311] *Id.* at 4, Statement C, lines 10-14.

[312] *Id.* at lines 14-18.

[313] Exh. S-3 (rev. Jan. 11, 2012) at 2, Statement A, line 1 (Sherman).

[314] *Id.* at 4, Statement C, lines 14-16.

[315] Exh. S-10 at 23 (Alvarez).

[316] Exh. S-1 (rev. Jan. 11, 2012) at 12 (Sherman); Exh. S-2 (rev. Jan. 11, 2012) at 4, Statement C, lines 4-11 (Sherman).

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adjustment increases the equity ratio, resulting in a slightly higher overall weighted cost of capital than that set out in Mr. Alvarez' testimony.[317]

167. Trial Staff advocated for the level of overall return for ESL and Indicated Shippers to be rejected. Trial Staff stated that ESL's return is based on carrier property in service as of September 30, 2011, a date beyond the end of the test period, and it is also based on unreasonably high components. For similar reasons, Trial Staff asked that the Indicated Shippers' return be rejected as it too fails to base the overall return on the end of test period carrier property in service, and for the reasons given in the discussion of the 2010 rate period, the components of return proposed by the Indicated Shippers are suspect.

Findings and Conclusions

168. The rulings, *infra*, on the individual components of return determine the overall return.

Issue #6: What is the appropriate capital structure?

A. ESL

169. ESL asserted that the appropriate capital structure is 70% equity and 30% debt, which Dr. Fairchild explained reflects the total risks of the Southern Lights Pipeline and approximates those of the Committed Shippers' parent companies.[318] ESL noted that Dr. Fairchild's analysis showed that his recommended 70% equity and 30% debt capital structure ratios best correspond to and reflect the total risks of the Southern Lights Pipeline and are comparable to those associated with the Committed Shippers' parent companies.[319] ESL explained that not only are the Committed Shippers bearing a majority of the risks of the Southern Lights Pipeline through and during the term of the TSAs, but many of the risks faced by the Southern Lights Pipeline are also similar to the risks associated with producing heavy oil.[320] Moreover, ESL stated that the 70/30 ratio is not outside the range of ratios the Commission has previously indicated that it could accept for a risky pipeline.[321] ESL asserted that in a situation not unlike the instant proceeding, the Commission addressed a proposed major expansion of an existing

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[317] T he adjustment for deferred return results in an overall cost of capital of 5.04% (Exh. S-2 (rev. Jan.11, 2012) at 4, Statement C, line 14) (Sherman), compared to the 5.03% calculated by Mr. Alvarez (Exh. S-10 at 23) (Alvarez).

[318] ESL-20 at 19; Tr. at 185:16-20 (Fairchild) ("The 70/30 was the approximate capital structure and I used it because it approximated the risk of the Southern Lights Pipeline, in my opinion in the absence of the TSA as a stand-alone pipeline.").

[319] ESL-20 at 17-19.

[320] *Id*. at 17.

[321] *Id*. at 18-19.

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pipeline that was facing a variety of physical and financial challenges and indicated that it would be prepared to accept a capital structure consisting of 71% equity.[322]

170. However, if the 70% equity structure recommended by Dr. Fairchild is not used, ESL argued that the next best alternative would be the actual capital structure of Enbridge Pipelines Inc. ("EPI"), as proposed by the Trial Staff.[323] According to ESL, Trial Staff correctly points out that EPI is the first company in the ownership chain of ESL that has long-term debt with its own bond rating – a necessary requirement for a reliable, market-tested capital structure.[324] Nonetheless, ESL believed that the use of EPI's capital structure is less justified in the instant situation than use of Dr. Fairchild's proposed 70% equity capital structure for at least two reasons: first, more than 35% of EPI's long-term debt is consolidated upwards from ESL itself and reflects the financing of ESL that was made possible only because of the Committed Shippers' contractual commitments.[325] Second, it is difficult to calculate EPI's relevant debt/equity ratio due to the presence of a large quantity of inter-company loans on EPI's balance sheet that could properly be viewed as equity, or at least as canceling each other out.[326] Nonetheless, while ESL argued that it is less appropriate than the 70% equity capital structure proposed by Dr. Fairchild, the EPI capital structure, particularly as adjusted to eliminate the effects of inter-company loans, would be a better reflection of the overall risks of the Southern Lights Pipeline than the other two alternatives discussed here – *i.e.*, the capital structure of ESL or the average capital structure of the proxy group.[327]

171. ESL explained that it is inappropriate to use ESL's capital structure of 70.35% debt and 29.65% equity for at least two reasons. First, ESL's capital structure ratios do not reflect the total risks of the Southern Lights Pipeline.[328] Although ESL has been able to finance the Southern Lights Pipeline with a large amount of non-recourse debt, that is only because of the assurances provided by the Committed Shippers through the TSAs.[329] Further, the Committed Shippers have effectively assured the payment of interest and principal on the Southern Lights Pipeline's debt with the creditworthiness of their parent

[322] *See Colonial Pipeline Co.*, 116 FERC ¶ 61,078, at P 59 (2006); ESL-20 at 18-19; Tr. at 177:3-178:18.

[323] Exh. S-10 at 4.

[324] *See id.*

[325] ESL-20 at 12-13 (thus, as described below in regard to ESL's own capital structure ratios, EPI's capital structure ratios do not reflect the total risks of the Southern Lights Pipeline).

[326] *Id.*

[327] ESL-29 at 28 (as explained by Dr. Fairchild, if the inter-company loans were netted, EPI's capital structure as of March 31, 2011 would be 46.67% debt and 53.33% equity).

[328] ESL-20 at 11.

[329] *Id.*

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companies.[330] Second, as previously noted, the Commission's usual practice is to base capital structure ratios on the first entity in the ownership chain having debt rated by a major bond rating agency, and ESL's debt is not rated.[331]

172. According to ESL, Dr. Fairchild also explained that it is inappropriate to use the average of the capital structures from the proxy group, as the Southern Lights Pipeline is more risky than the typical oil pipeline.[332] ESL cited Mr. Earnest, who testified that the Southern Lights Pipeline has unusual market risks at both ends of the pipeline, including: (1) variability and uncertainty concerning both the short- and long-term demand for diluent in Canada; (2) competition in supplying diluents in the Alberta market; and (3) variability and uncertainty surrounding diluent supply in the U.S. Midwest.[333] ESL noted that both Dr. Fairchild and Mr. Jervis testified that the risks of the pipeline are so much greater than that of the typical oil pipeline that the contractual assurances of shippers through their TSAs were necessary before ESL would even undertake the Southern Lights Pipeline.[334]

173. ESL's Post-Hearing Reply Brief addressed the Indicated Shippers' claim that ESL's recommended capital structure is inappropriate because the business risks and risk profile of ESL are "entirely different" from those of the Committed Shippers' parent companies.[335] The Indicated Shippers further contended that Dr. Fairchild's position is unsupported by relevant Commission precedent.[336] ESL argued that the first and most glaring flaw in the Indicated Shippers' position is that they are focused on the wrong risks – despite their repeated assertions that the TSAs should be disregarded in determining the cost-of-service of the Uncommitted Rate,[337] the Indicated Shippers want to take full advantage of the transfer of a substantial portion of the risk of the Southern Lights Pipeline from ESL to the Committed Shippers under the TSAs. ESL stated that Indicated Shippers reach that result by arguing that only the risks retained by ESL should matter, and not the risks borne by the Committed Shippers.[338] ESL explained that the Committed Shippers benefit under the TSAs because they undertook the obligation to

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[330] *Id.*; Tr. at 186:14-187:1.

[331] *See Transcontinental Gas Pipe Line Corp.*, 84 FERC ¶ 61,084 at 61,413, *reh'g denied*, 85 FERC ¶ 61,323 (1998), *petition for review denied*, *North Carolina Utilities Commission v. FERC*, 203 F.3d 53 (D.C. Cir. 2000) (per curiam); *see* ESL-20 at 11-12 (as noted above, ESL's immediate parent company, EECI, has no debt issued in its own name, while EPI (which owns 100% of EECI) has long-term debt rated by S&P).

[332] Exh. ESL-20 at 14-16.

[333] *Id.* at 15.

[334] Exh. ESL-20 at 16; Exh. ESL-1 at 9.

[335] IS I.B. at 20-21.

[336] IS I.B. at 21-22.

[337] IS I.B. at 11, 13

[338] *See* IS I.B. at 20, 23-24.

support the pipeline's cost-of-service during the open season, and for the Uncommitted Shippers to claim essentially the same benefits without bearing the same risks would be the essence of free-riding and should not be permitted.[339]

174. When the overall risks of the Southern Lights Pipeline are properly considered, it is evident that the pipeline faces substantial risks, and many of those risks are akin to the risks associated with producing heavy oil.[340] Thus, ESL argued that the pipeline can be viewed as an extension of heavy oil production and subject to many of the risks associated with the oil production activities in which the Committed Shippers are engaged.[341] Dr. Fairchild further explained that his proposed capital structure is supported by *Colonial Pipeline Co.*,[342] where the Commission indicated it would be prepared to accept a capital structure of 71% equity for a similarly risky pipeline.[343]

175. ESL turned to Trial Staff's proposed use of the EPI actual capital structure and noted that the Indicated Shippers argue against Trial Staff witness Alvarez's adherence to the Commission's three-pronged test set forth in *Transcontinental Gas Pipeline Corporation*.[344] ESL stated that under the *Transco* test, the Commission will use the actual capital structure of a filing company only if: (1) the debt issued by the company is non-guaranteed; (2) the company has its own separate bond rating; and (3) the company's common equity ratio is reasonable, given the equity ratios approved by the Commission in the past.[345] ESL noted how Mr. Alvarez explained that ESL's capital structure would at most meet only one of those three tests.[346] Nevertheless, ESL noted that the Indicated Shippers contend that the actual capital structure of ESL should be used and that the factor of whether or not a pipeline's long-term debt is rated should be regarded as merely a "secondary consideration" in determining the appropriate capital structure for a regulated oil pipeline.[347]

176. ESL stated that the Indicated Shippers' arguments regarding Trial Staff's recommended use of EPI's capital structure are unavailing. As explained by Trial Staff,

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[339] *See* Exh. ESL-27 at 11:5-15.

[340] *See* Exh. ESL-20 at 17.

[341] *See* ESL-24 at 7:3-8:9; ESL-30 at 10:4-10:10; Tr. at 181 (Fairchild).

[342] 116 FERC ¶ 61,078 (2006).

[343] *See* 116 FERC ¶ 61,078, at P 59; ESL-20 at 18-19; Tr. at 177:3-178:18; *See* IS I.B. at 21-22 (as discussed below, the Indicated Shippers mischaracterize Dr. Fairchild's testimony with respect to the *Colonial* decision).

[344] 84 FERC ¶ 61,084, at 61,413 (1998) ("*Transco*"). *See* IS I.B. at 16.

[345] *See* Staff I.B. at 30.

[346] *See* S-10 at 4-5, 27; Staff I.B. at 30-31 (ESL's debt is not guaranteed by its parent company although it is supported by the revenue stream assured by the Committed Shippers and their parent companies).

[347] IS I.B. at 16.

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use of the actual capital structure of ESL is inappropriate because it fails two of the three criteria established by the Commission in *Transco*.[348] ESL explained that Trial Staff further noted that the absence of a bond rating is not a "secondary consideration."[349] Thus, as Trial Staff explained, it used the capital structure of ESL's corporate parent (EPI), which passes the test set forth in *Transco*.[350]

177. ESL argued that using ESL's own capital structure is inappropriate because ESL lacks an independent debt rating.[351] ESL noted the explanation by Dr. Fairchild and Trial Staff, that the Commission usually determines the appropriate capital structure ratio by identifying the first entity in the pipeline's ownership chain to have its own bond rating – and as noted above, the latter is not a "secondary consideration" in determining which entity's capital structure should be utilized.[352] According to ESL, the fact that ESL's debt was offered and sold in an arms-length transaction in the open market does not constitute a "rating" by the marketplace that is equivalent to a formal bond rating.[353]

178. ESL explained that both Trial Staff and Dr. Webb noted that the capital structure proposed by Ms. Crowe is also well outside the range the Commission has ever approved for an oil pipeline.[354] Further, ESL stated that its actual capital structure bears no relationship to the risk of the Southern Lights Pipeline, as it could not have been obtained

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[348] Staff I.B. at 30-31 ("First, it does not have its own bond rating. Second, its common equity ratio, rather than being too high, is under 30%, which is lower than the lowest common equity ratio that Mr. Alvarez is aware of in a litigated case.").

[349] *See id*. at 38 ("[T]he Commission has never stated that the bond-rating criterion can be dropped in such a cavalier fashion. Indeed, in [*Transco*], the Commission specifically stated the opposite").

[350] *See id*. at 31. ESL does note that, if the EPI capital structure is used, it should be adjusted to remove the effects of inter-company debt for the reasons explained by Dr. Fairchild. *See* ESL-20 at 12-13; ESL I.B. at 32-33. The resulting EPI capital structure would be 46.67% debt and 53.33% equity. ESL I.B. at 32 and n.23. Trial Staff further notes that "[s]uch a change, other things being equal, would marginally increase Trial Staff's calculation of the Opinion No. 154-B uncommitted rate, but would not change Trial Staff's conclusion that this rate is above the TSAs' uncommitted rate." Staff I.B. at 31-32 & n.105.

[351] *See* ESL-20 at 11-12.

[352] *See id.; see also* Trial Staff I.B. at 38; *Transco*, 80 FERC ¶ 61,157, at 61,665.

[353] *See* ESL-29 at 18:19-22 ("That argument is simply another attempt to circumvent the Commission's policy. Enbridge Southern Lights' debt has not been rated by a major bond rating agency, as Commission policy requires, and the private placement of debt tells us nothing about the quality of that debt (*e.g.*, whether it is investment grade).").

[354] *See* ESL-44 at 37; ESL-51; Staff I.B. at 30-31.

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without the TSAs.[355] ESL cited Dr. Fairchild's that ESL's capital structure contains project-financed debt that was only possible because the Committed Shippers guaranteed a long-term stream of revenues through their TSAs.[356] In other words, the lenders were only willing to provide this level of debt because the Committed Shippers entered into TSAs that obligated them to ship or pay for shipment of volumes totaling 77,000 bpd for 15 years.[357] Thus, ESL argued that the suggested 70% debt capital structure is simply another example of the Indicated Shippers free-riding on the TSAs while maintaining that Commission-approved aspects of the TSAs do not apply.

179. ESL asserted that the Indicated Shippers' arguments against ESL's proffered capital structure consist primarily of mischaracterizations of the positions of ESL and of its witnesses, and are without merit. For example, the Indicated Shippers incorrectly claim that their witness Safir was "unrebutted" with respect to his testimony that "the business risks and risk profile of the parents of the Committed Shippers are entirely different than those of ESL."[358] However, ESL noted that Dr. Fairchild's reply testimony directly responded to the passage that the Indicated Shippers cite. [359] ESL noted that the Indicated Shippers also criticize Dr. Fairchild's position because he was unaware of the percentage of business that the Committed Shippers derive from heavy oil production versus that of oil pipeline transportation.[360] Yet, ESL stated that the Indicated Shippers offer no explanation as to why that knowledge would be relevant to Dr. Fairchild's position. According to ESL, Dr. Fairchild never attempted to draw a distinction between

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[355] *See* ESL-20 at 11-12; Staff I.B. at 37 ("[Indicated Shippers'] approach is self-serving and fails to conform to their own position that the TSAs should not be taken into account when determining the Opinion No. 154-B uncommitted rate. Clearly, Enbridge Southern Lights would not have been able to support the financing of the Southern Lights Pipeline with 70% debt without the guarantees provided by the TSAs.").

[356] *See* ESL-29 at 15:1-13, 22:7-23:7.

[357] *See* Tr. at 186:14-187:1.

[358] IS I.B. at 20 (citing Exhibit IS-8 at 38).

[359] *See* ESL-29 at 16:14-17 ("In fact, the extensive geographic diversification and vertical integration of BP and Statoil noted by Dr. Safir arguably result in their having less overall business risk than the Southern Lights Pipeline, which has but a single purpose and market."). Dr. Fairchild further explained: "While I agree that BP and Statoil are not suitable proxies for typical oil pipelines, the Southern Lights Pipeline is anything but typical. Indeed, the unique risks and contractual arrangements surrounding the Southern Lights Pipeline are exactly why the capital structure ratios of Enbridge Southern Lights, its parent, or a proxy group of oil pipelines are not suitable for determining the rate of return to be used in calculating the Uncommitted Rate." *See id*. at 16:23-17:4.

[360] IS I.B. at 20-21.

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oil production and transportation; in fact, quite the opposite – he explained that the risks of the Southern Lights Pipeline were similar to those of producing heavy oil.[361]

180. ESL stated that the Indicated Shippers claim Dr. Fairchild's reliance on the *Colonial* decision is flawed – the Indicated Shippers noted the 71% equity ratio in *Colonial* did not come from Colonial Pipeline's shippers, but rather was derived from the weighted capital structure of the pipeline's parent group.[362] ESL argued that distinction is of no relevance to Dr. Fairchild's position, as he never suggested that the *Colonial* decision required the use of the Committed Shippers' parents' capital structure or that he derived his proposed capital structure by relying on the methodology utilized in that decision. Rather, ESL explained that Dr. Fairchild cited the ratio the Commission indicated it would be prepared to accept in the *Colonial* decision as a data point that supported his proposed capital structure. As clearly denoted in his Prepared Initial and Rebuttal Testimony, ESL asserted that Dr. Fairchild relied on his own knowledge, as well as the testimony of Mr. Earnest, to support the derivation of his recommended debt-equity ratio.[363]

181. According to ESL, the Indicated Shippers similarly note that "in *Colonial*, the Commission did not actually approve a capital structure of 71% equity and 29% debt," but rather "stated that it would 'impute the parents' capital structure if it is shown to be reasonable . . . in light of the unique circumstances of Colonial's capital structure and Commission precedent.'"[364] ESL stated that Dr. Fairchild never claimed otherwise, and rather, he stated that the Commission indicated it would be willing to accept a capital structure consisting of 71% equity if it was shown to be reasonable when challenged.[365]

182. ESL asserted that the Indicated Shippers also claim that Dr. Fairchild's proposed capital structure is undermined because he was "unaware of any recent Commission decision other than *Colonial* approving capital structures for oil pipelines with an equity ratio as high as 70%."[366] However, ESL noted that the Indicated Shippers conveniently disregard Dr. Fairchild's qualifying statement – that "neither [was he] aware of any situation that involves the same circumstances [as] in this case where you have a risky

[361] *See* ESL-20 at 17 ("Because many of the risks faced by the Southern Lights Pipeline, and discussed by Mr. Earnest, are akin to the risks associated with producing heavy oil, the Southern Lights Pipeline can be viewed in many respects as essentially an extension of heavy oil production activities.").

[362] IS I.B. at 21.

[363] *See* ESL-20 at 9:10-19:14; ESL-29 at 11:17-22:6.

[364] IS I.B. at 21.

[365] *See* ESL-20 at 18:14-17 ("[In *Colonial*] the Commission . . . *indicated that it would be prepared* to accept a capital structure consisting of 71% equity . . . .") (emphasis added); ESL-29 at 22:1-3 (same).

[366] IS I.B. at 22 (citing Tr. at 179).

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pipeline and . . . the specific terms of the TSA in terms of how the risks are borne between the owner of the pipeline and its Committed Shippers."[367] According to ESL, the Indicated Shippers similarly note that Dr. Fairchild "stated that he was not aware of any Commission precedent in which the Commission had approved the use of the capital structure ratios of an oil pipeline's unaffiliated shippers to calculate the rate of return for the filing oil pipeline."[368] Yet, ESL explained that Dr. Fairchild stated that he was aware of "the Kuparuk case where they use[d] the capital structure of the owning pipeline – the owners of a pipeline which were integrated oil companies and which were also shipping on that pipeline."[369]

183. ESL noted that the Indicated Shippers assert that Dr. Fairchild's characterization regarding the long-term revenue stream provided by the TSAs[370] is an "overstatement."[371] According to ESL, Dr. Fairchild acknowledged that the Committed Shippers did not legally guarantee ESL's debt,[372] but Dr. Fairchild explained that the assurances made by the Committed Shippers through their TSAs effectively accomplish the same result.[373] ESL stated that Dr. Fairchild further explained his conversations with the individuals involved in drafting the guarantee portions of the TSAs confirmed his position.[374]

B. Committed Shippers

184. Committed Shippers took no position on this issue, and noted that for both the 2010 period and the 2011 period, both Enbridge's and Staff's capital structure, when applied to proper throughput determinants and Opinion No. 154-B methodology, result in a finding that Enbridge's filed 2010 and 2011 rates are just and reasonable.

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[367] Tr. at 179.

[368] IS I.B. at 22 (citing Tr. at 179-180).

[369] *Kuparuk Transportation Co.*, 55 FERC ¶ 61,122 (1991); Tr. at 180.

[370] This means that the Committed Shippers effectively guarantee ESL's debt payments through their TSAs.

[371] IS I.B. at 22.

[372] *See* Tr. at 189-91.

[373] ESL-29 at 17:22-24; Tr. at 187:4-5, 12-14.

[374] Tr. at 186:14-187:1 ("What those guarantees do is obligate or guarantee the payment obligations under the TSAs, which include interest and principal on the debt of Enbridge Southern Lights. When I talked to the treasury people who went through negotiations with the underwriters and the bankers, they said the support for this debt came from the TSAs and the guarantees that were provided in those TSAs, so I think my statement here that says the assurances under the TSA effectively accomplish [the] same end result in terms of guaranteeing the debt is accurate.").

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C. Indicated Shippers

185. Indicated Shippers stated that the appropriate capital structure for ESL is 70.4% debt and 29.6% equity – this ratio is based on ESL's actual capital structure in 2010, consistent with Opinion No. 154-B.[375]

186. In Opinion No. 154-B,[376] the Commission stated that, "[T]he Commission shall use a pipeline's or its parent's actual capital structure but will allow participants on a case-specific basis to urge the use of some other capital structure."[377] The Commission reiterated its preference later in the order that for a pipeline that issues its own long-term debt not guaranteed by its parent, the Commission should use the pipeline's actual capital structure to determine its allowed return.[378]

187. Indicated Shippers noted that ESL has issued its own long-term, non-recourse debt to outside investors.[379] As Indicated Shippers witness Crowe has explained, ESL's long-term debt is project-financed, and the debt is not backed or guaranteed by any other entity in ESL's ownership chain.[380] Indicated Shippers stated that this meets the standard of Opinion 154-B.

188. Indicated Shippers asserted that, in contrast, Staff witness Alvarez recommended that the Commission use the capital structure of ESL's parent, Enbridge Pipelines Inc., rather than that of ESL, to calculate ESL's return.[381] Indicated Shippers explained that he based his recommendation on Opinion No. 414-A,[382] which has three factors for

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[375] Exh. IS-4 (Updated) at 3, lines 10-11; Exh. IS-1 at 6-7; *see also* Exh. IS-8 at 6, 39-40.

[376] *Williams Pipe Line Company*, Opinion No. 154-B, 31 FERC ¶ 61,377 (1985).

[377] *Id.* at 61,833.

[378] *Id.* at 61,836 (noting that "[t]he Commission must decide on the appropriate capital structure to use to determine a pipeline's starting rate base and to thereafter compute the pipeline's allowed return. The Commission recently expressed for gas pipelines a general policy of using actual capital structures rather than hypothetical capital structures. The Commission believes that this approach is appropriate for oil pipelines. The actual capital structure could be the actual capital structure of either the pipeline or its parent. The Commission concludes that a pipeline which has issued no long-term debt or which issues long-term debt to its parent or which issues long-term debt guaranteed by its parent to outside investors should use its parent's actual capital structure. However, a pipeline which issues long-term debt to outside investors without any parent guarantee should use its (the pipeline's) own capital structure.").

[379] Exh. IS-1 at 16; *see also* Exh. IS-34.

[380] *Id.*

[381] *See* Exh. S-10 at 4.

[382] *Transcontinental Gas Pipeline Corporation*, Opinion No. 414-A, 84 FERC ¶

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determining whether to use a pipelines' own capital structure: whether the pipeline a) issues its own non-guaranteed debt, b) has its own bond rating, and c) has a common equity ratio that falls within the range of common equity ratios approved by the Commission in other cases.[383]

189. Indicated Shippers noted that witness Alvarez acknowledged that ESL issues its own non-guaranteed debt, but he recommended the use of Enbridge Pipeline Inc.'s capital structure and cost of debt in calculating ESL's return because ESL does not have its own bond rating.[384] Indicated Shippers disagreed with this recommendation, and taking the position to the extreme, it would imply that a pipeline could elect whether to use its own capital structure or that of its parent by strategically choosing whether or not to obtain a bond rating. Further, Indicated Shippers witness Crowe explained that it is not appropriate to use Enbridge's Pipeline Inc.'s capital structure and cost of debt in this case,[385] as ESL's own capital structure and cost of debt should be used because this is the only way properly to align cost causation with cost responsibility.

190. Indicated Shippers witness Safir, explained that using the capital structure of ESL itself better reflects the actual business risks faced by ESL.[386] According to Indicated Shippers, it is undisputed that, as Dr. Safir noted, ESL is in an unusual situation of having transferred much of its business risk to the Committed Shippers through the TSA.[387] As a result, Indicated Shippers explained that ESL was able to raise a substantial amount of debt even without a formal credit rating.[388] Thus, Dr. Safir concluded that ESL's capital structure represents a more economically accurate measure of a market-based debt-to-equity ratio for ESL than does the ratio of its parent Enbridge Pipelines Inc., whose capital structure includes risk elements not faced by ESL.[389] As an example, Indicated Shippers cited Dr. Safir's testimony that Enbridge Pipelines Inc. has invested over $1 billion in renewable energy projects in Ontario in 2010 for the provision of electric power.[390] Indicated Shippers explained that electric generation has a much different

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61,084, at 61,413 (1998) (hereinafter "Opinion No. 414-A"); *see* Exh. S-10 at 4.

[383] Opinion No. 414-A, 84 FERC ¶ 61,084, at 61,413; *see also* Exh. S-10 at 4; Exh. IS-33 at 3-4.

[384] Exh. S-10 at 4; *see also* Exh. IS-33 at 3.

[385] Exh. IS-33 at 3 ("While . . . the Commission prefers to use a company's capital structure where the long-term debt is independently rated, the Commission's long-standing and overarching principle and policy in setting pipeline rates is to use actual costs for the entity whose rates are being determined in order to ensure just and reasonable rates for transportation service on regulated oil and gas pipelines.").

[386] Exh. IS-40 at 8; *see also* Exh. IS-8 at 6, 36-37.

[387] Exh. IS-40 at 8.

[388] *Id.*

[389] *Id.*

[390] *Id.* at 8, n.6; *see also* Exh. IS-42.

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business risk profile than does a liquids pipeline such as ESL,[391] and that Dr. Safir's testimony in this regard stands unrebutted.

191. Indicated Shippers noted witness Crowe explained that whether or not a pipeline's long-term debt is "rated" is a secondary consideration in determining the most appropriate capital structure for a regulated oil pipeline.[392] Indicated Shippers stated that in Opinion No. 404, the principles of which were affirmed by Opinion No. 414-A, the Commission indicated that the key factor in determining whether to use a jurisdictional pipeline's own capital structure was whether the pipeline "does its own financing."[393] Indicated Shippers asserted that it is undisputed here that ESL does its own financing.[394] Witness Crowe noted that ESL's debt was offered and sold in the financial marketplace and that the credit agreement was entered into between ESL and several independent financial institutions.[395]

192. According to Indicated Shippers Witness Crowe, a specific credit agreement was entered into and used to construct the ESL pipeline and that the costs associated with this credit agreement are known and measurable.[396] Witness Crowe also noted that ESL's parent company, Enbridge Pipelines Inc., separately lists the debt specifically attributable to ESL in a line entitled "Southern Lights Project Financing" and separately calculates the cost of that long-term debt.[397] Indicated Shippers stated that Staff witness Alvarez agreed that this "Southern Lights Project Financing" does refer to the long-term debt specifically issued and used to construct ESL pipeline.[398] Indicated Shippers also stated that witness Crowe's unrebutted testimony indicates that no other debt was used to finance the ESL pipeline system.[399] Therefore, according to Indicated Shippers, it is inappropriate to use the cost of other long-term debt, or the capital structure reflected in that other long-term debt, to set rates on ESL.[400]

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[391] Exh. IS-40 at 8, n.6; *see also* Exh. IS-42.

[392] Exh. IS-1 at 16-17.

[393] *See Panhandle Eastern Pipeline Co.,* Opinion No. 404, 74 FERC ¶ 61,109, at 61,359-60 (1996).

[394] *See, e.g.*, Exh. IS-1 at 16; Exh. IS-33 at 4; Exh. IS-34 at 4-7; Exh. IS-35.

[395] *See also* Exh. IS-34 at 4-7; Exh. IS-33 at 4 (explaining that "The fact that it was an arms-length transaction in the open market constitutes a "rating" by the marketplace that is essentially equivalent to the process reflected in the evaluation of a debt instrument made by a bond rating agency").

[396] *Id.* at 4-5.

[397] *See* Exh. S-12 at 28; *see also* Exh. IS-33 at 5.

[398] Exh. IS-35; *see also* Exh. IS-33 at 5.

[399] Exh. IS-33 at 5.

[400] *Id.*

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193. Indicated Shippers stated that the specific long-term debt attributable to ESL is less than one quarter of its parent Enbridge Pipelines Inc.'s total long-term debt as of March 31, 2011.[401] Ms. Crowe explained that the vast majority of Enbridge Pipeline Inc.'s long-term debt is completely unrelated to ESL and ESL's costs, and is instead associated with the vast network of Enbridge crude and liquids pipelines and other investments, which are primarily located in Canada.[402] Accordingly, she concluded that the different business profiles and regulatory regimes applicable to these operations should not be reflected in Enbridge Southern Lights' cost-of-service, particularly when the portion of the debt (and its cost) specifically attributable to Enbridge Southern Lights is separately identified and distinguishable.[403]

194. Indicated Shippers dismissed ESL's position that the Presiding Judge and the Commission should look to the capital structures of the parents of the Committed Shippers as entirely unprecedented, highly inappropriate, and contrary to the Commission's longstanding policy which favors the use of the actual capital structure of the regulated enterprise. Indicated Shippers stated that ESL witness Fairchild used neither ESL's actual capital structure, nor Enbridge Pipeline Inc.'s capital structure.[404] According to Indicated Shippers, Witness Fairchild also does not derive a hypothetical capital structure based on the average capital structures of an oil proxy group,[405] but instead, Witness Fairchild derives a capital structure of 30% debt and 70% equity to calculate ESL's return based on the averages of the capital structures of BP p.l.c. and Statoil ASA, the respective corporate parents of the Committed Shippers.[406]

195. Indicated Shippers asserted that Witness Fairchild's rationale suffers from several fatal flaws and was contradicted on cross-examination. First, he noted that the Committed Shippers have "effectively guaranteed" the payment of ESL's debt through the TSAs and that they bear the associated risks.[407] Second, Witness Fairchild asserted that the sole purpose of the Southern Lights pipeline is to ship diluent from the United States to Canada so that it can be mixed with heavy oil to ship by pipeline to market.[408] Thus, according to Indicated Shippers, he concluded that, "Because many of the risks faced by the Southern Lights Pipeline . . . are akin to the risks associated with producing heavy oil, the Southern Lights Pipeline can be viewed in many respects as essentially an extension of heavy oil production activities."[409]

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[401] *Id.*
[402] *Id.*
[403] *Id.* at 5-6.
[404] Exh. ESL-20 at 11-13.
[405] *Id.* at 13-16.
[406] *Id.* at 6, 17-18.
[407] Exh. ESL-29 at 14, 17, 22.
[408] Exh. ESL-20 at 17.
[409] *Id.*

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196. Indicated Shippers characterized Witness Fairchild's proposal as unprecedented and inappropriate.[410] As Indicated Shippers witness Crowe explained, "It is Enbridge Southern Lights' own financial risk that has direct bearing on the issue of an appropriate capital structure to use for setting its rates."[411] Moreover, Indicated Shippers stated that even when the Commission determines that a hypothetical capital structure is appropriate, this structure "is almost always based on the capital structures of entities deemed to have similar business profiles and thus business risk."[412]

197. Indicated Shippers asserted that Witness Safir's testimony is unrebutted and demonstrates the business risks and risk profile of the parents of the Committed Shippers are entirely different than those of ESL.[413] Indicated Shippers noted that during cross-examination, Witness Fairchild conceded that he was not aware of what percentage of the business conducted by Committed Shippers involves heavy oil production,[414] nor did he know what percentage of the business conducted by Committed Shippers involves oil pipeline transportation.[415] Indicated Shippers argued that Witness Fairchild's lack of knowledge of the fundamental business of the companies demonstrates that his assertion that ESL's risks are comparable to the risks faced by the parents of the Committed Shippers is simply without foundation in fact.

198. According to Indicated Shippers, the alleged legal basis for Witness Fairchild's position is similarly without foundation. Witness Fairchild relied upon the Commission's decision in *Colonial Pipeline Company*[416] to support his proposal in this case to use a capital structure consisting of 70% equity to calculate ESL's return.[417] Indicated Shippers pointed out that witness Fairchild asserted that in *Colonial*, the Commission "indicated that it would be prepared to accept a capital structure consisting of 71% equity

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[410] *See, e.g.*, Exh. IS-1 at 17; Exh. IS-8 at 36.

[411] Exh. IS-1 at 17.

[412] *Id.*

[413] *See also* Exh. IS-30, Exh. IS-31; Exh. IS-8 at 38 (stating that "[t]hese firms are both international companies engaged in all aspects of the energy industry, including exploration, production, refining, marketing, and transportation of crude oil and refined petroleum products. Pipeline transportation in North America accounts for none of Statoil's business operations, while it is only a relatively small segment of BP's business activities. It is unlikely that the market risks faced by companies such as BP and Statoil – involved in highly risky activities such as exploration and development – are at all similar to those of an oil products pipeline").

[414] Tr. 181.

[415] *Id.*

[416] *Colonial Pipeline Company*, 116 FERC ¶ 61,078 (2006).

[417] *See* Exh. ESL-20 at 18-19; Exh. ESL-29 at 20, 22.

in calculating the cost-of-service for that expansion."[418] Indicated Shippers stated that on cross-examination, witness Fairchild acknowledged that the 71% equity ratio in *Colonial* did not come from Colonial Pipeline's shippers,[419] and rather, this capital structure was the weighted capital structure of the pipeline's parent group.[420] Witness Fairchild also acknowledged on cross-examination that the 71% equity "ratio is at the extreme of what [the Commission] ha[s] approved in the past."[421]

199. Indicated Shippers further noted that witness Fairchild conceded on cross-examination that in *Colonial*, the Commission did not actually approve a capital structure of 71% equity and 29% debt.[422] Rather, Indicated Shippers pointed out the Commission's statement that it would "impute the parents' capital structure if it is shown to be reasonable at [the time of the rate case] in light of the unique circumstances of Colonial's capital structure and Commission precedent."[423]

200. Indicated Shippers noted that witness Fairchild acknowledged that he was unaware of any recent Commission decision other than *Colonial* approving capital structures for oil pipelines with an equity ratio as high as 70%.[424] He also stated that he was not aware of any Commission precedent in which the Commission had approved the use of the capital structure ratios of an oil pipeline's unaffiliated shippers to calculate the rate of return for the filing oil pipeline.[425] Thus, according to Indicated Shippers, witness Fairchild conceded that his proposal to use the capital structures of the corporate parents of the Committed Shippers to calculate ESL's return is unprecedented.

201. According to Indicated Shippers, on cross-examination, witness Fairchild's claim in his rebuttal testimony[426] that under the TSA, Committed Shippers "effectively guaranteed" payment of ESL's debt was shown to be an overstatement. Indicated Shippers noted that witness Fairchild agreed that it would be more accurate to say that under the TSA, the Committed Shippers have guaranteed to provide ESL with long-term revenues.[427] Indicated Shippers pointed out that the Committed Shippers have agreed to provide substantial revenues to ESL for fifteen years, but witness Fairchild admitted that it is his understanding that Committed Shippers would not have to cover ESL's debt to

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[418] Exh. ESL-20 at 18; *see also* Exh. ESL-29 at 22.
[419] Tr. 175-76; *see also Colonial*, 116 FERC ¶ 61,078, at P 37, 62.
[420] Tr. 176; *see also Colonial*, 116 FERC ¶ 61,078, at P 37, 62.
[421] Tr. 176; *see also Colonial*, 116 FERC ¶ 61,078, at P 62.
[422] Tr. 176; *see also Colonial*, 116 FERC ¶ 61,078, at 62.
[423] *Colonial*, 116 FERC ¶ 61,078, at P 62; *see also* Tr. 176.
[424] Tr. 179.
[425] Tr. 179-80.
[426] Exh. ESL-29 at 14, 17, 22.
[427] Tr. 187.

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ESL's creditors if ESL were to default on its debt.[428] Indicated Shippers cited witness Fairchild's view that the only guarantor is Enbridge Southern Lights, and it is nonrecourse debt.[429] Accordingly, Indicated Shippers classified ESL's debt as not "guaranteed." Indicated Shippers asked that the Presiding Judge and the Commission use ESL's own capital structure, consistent with the Commission's Opinion No. 154-B methodology.

202. For Docket No. IS11-146-000, for the same reasons stated *supra* for Docket No. IS10-399-003, Indicated Shippers believed that is appropriate to use ESL's actual capitalization of 71.5% debt and 28.5% equity.[430]

203. Indicated Shippers' Post-Hearing Reply Brief, noted ESL's persistance in its contention that the Commission should adopt a figure amalgamated from Committed Shippers' parent companies' capital structures to reflect the "total risks of the Southern Lights Pipeline."[431] Indicated Shippers agreed with Staff's assertion that "[i]t is common knowledge that risk is a very slippery notion, and its measurement is fraught with difficulties of one kind or another. Therefore, Enbridge Southern Lights' determination that the business risk of the Southern Lights Pipeline is comparable to that of the committed shippers is conclusory and not supported by any persuasive study – possibly because the task is simply too formidable."[432]

204. Indicated Shippers noted that ESL appears to recognize the weakness in its own argument by adopting the same position as Staff – favoring ESL's parent Enbridge Pipelines Inc.'s capital structure – as an alternative argument.[433] Indicated Shippers observed that Staff's position seems to be that whatever portion of "total risk" is embodied in the TSAs is irrelevant for determining the appropriate capital structure.[434] However, Indicated Shippers argued that Staff turned around 180 degrees and took into account the risks borne by Committed Shippers subsequently in its analysis of Indicated Shippers' position.

205. Indicated Shippers noted that they were charged with "self-serving" inconsistency when Staff claimed that, "Without the TSAs, it is likely that the high risk of the Southern Lights Pipeline project would have precluded Enbridge Southern Lights from access to

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[428] Tr. 189.
[429] Tr. 191.
[430] Exh. IS-3A (Supp.) at 3, lines 4-5; Exh. IS-5; Exh. ESL-21; Exh. IS-1 at 12.
[431] *See* ESL I.B. at 31.
[432] Staff I.B. at 36-37.
[433] *See* ESL I.B. at 31-32.
[434] *See* Staff I.B. at 34 (characterizing ESL's approach of taking "total risk" into account for purposes of capital structure, as "academic" and "at odds with Commission policy").

the capital markets entirely without the financial support of its parent."[435] Indicated Shippers stated that Staff appears confused as to whether the "total risk" concept aggregating ESL and Committed Shippers' exposures to risk is relevant or not, criticizing the analysis of ESL witness Dr. Fairchild and then quoting him at length to contradict Indicated Shippers' position.[436] Indicated Shippers argued that if the risks shifted to the Committed Shippers through the TSAs cannot be accounted for in ESL's capital structure, then it is nonsensical to conclude that the very same risk-shifting makes ESL's own capital structure illusory, so that ESL "cannot reasonably be considered as an independent financing entity."[437]

206. Contrary to Staff's interpretation, Indicated Shippers believed that the TSAs should not be taken into account for purposes of capital structure.[438] Instead, Indicated Shippers advocated that ESL's own actual capital structure should be used, regardless of the risk-shifting properties of the TSAs. According to Indicated Shippers, whether risks were shifted is irrelevant for purposes of capital structure, as Staff itself has recognized. Indicated Shippers pointed out that Staff cited Opinion No. 414 for the proposition that for purposes of capital structure, "the Commission will not examine the pipeline's relative riskiness. That issue will be addressed only in determining whether the pipeline's return on equity will be set at the high, mid, or low point of the range of returns on equity."[439] Thus, Staff's assertion that Indicated Shippers have been inconsistent was dismissed by Indicated Shippers as meritless.[440]

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[435] Staff I.B. at 39.

[436] *Compare* Staff I.B. at 35-36, *with id.* at 37-38.

[437] *Id.*

[438] *See id.* at 37.

[439] Staff I.B. at 36 (quoting *Transcontinental Gas Pipeline Corp.*, Opinion No. 414, 80 FERC ¶ 61,157, at 61,666 (1997)).

[440] Indicated Shippers noted that, in contrast, ESL attempts to ride two horses in its Initial Brief – ESL has requested that the Presiding Judge and Commission take official notice of the recent Canadian National Energy Board ("NEB") decision, *Reasons for Decision in Enbridge Southern Lights GP Inc.*, RH-1-2011 (Feb. 2012). ESL I.B. at 2, n.2. According to Indicated Shippers, only a year ago, ESL argued the opposite position, but ESL now suggests that this decision is instructive to the outcome of this proceeding, and references to it and quotes from it throughout its initial brief. Yet, Indicated Shippers pointed out that ESL previously argued in this proceeding that an earlier NEB order in that same NEB docket was not relevant. *See* Answer . . . In Opposition to the Motion of Indicated Shippers to Certify Questions to the Commission" at 3-4 (filed March 11, 2011) (stating that "…the Indicated Shippers are wrong in suggesting that the recent order issued by the National Energy Board of Canada ("NEB") is relevant to the scope of the issues in this proceeding. . . . [T]he Commission has recognized that the scope of NEB proceedings may vary from the scope of Commission proceedings, even if the matters are related, and that issues pending before the NEB are

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207. Indicated Shippers characterized Staff's assertion that "the pipeline project would have been viewed by the capital markets as a speculative venture that could only be financed by debt at an exorbitantly high interest rate that would unduly burden ratepayers" as pure conjecture.[441] Contrary to ESL's assertions,[442] Indicated Shippers noted that the Commission has never made a finding that ESL is a high-risk pipeline,[443] and there is ample evidence in the record showing that ESL is not especially risky.[444]

208. As Indicated Shippers previously mentioned, ESL's laundry list of threats to the pipeline's future in its Initial Brief,[445] is belied by ESL's prior assessment that the pipeline will be full and in need of expansion by 2014.[446] Consequently, Indicated Shippers noted that it would be speculative to assume that "the capital markets" would have treated ESL one way or another.

209. Indicated Shippers asserted that there is nothing "cavalier" in its analysis of ESL under the three-factor test of Opinion No. 414.[447] Indicated Shippers stated that it is undisputed that ESL issues its own non-guaranteed debt.[448] According to Indicated Shippers, Staff's claim that ESL's common equity ratio is "lower than the lowest common equity ratio that Mr. Alvarez is aware of in a litigated case,"[449] overlooks cases in which the Commission has indeed approved equity ratios as low as 30%.[450] As for the third factor, Indicated Shippers acknowledged in their Initial Brief that ESL's debt is not rated.[451] However, Indicated Shippers disputed whether a single factor of analysis under the sole control of the pipeline itself should be allowed to defeat the underlying policy favoring the use of the pipeline's own capital structure announced in *Kentucky West*,[452] reiterated in Opinion No. 154-B,[453] and reaffirmed in *Transco*, Opinion No. 414-A.[454]

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not determinative of what is appropriate for consideration by this Commission).

[441] *See* Staff I.B. at 39.

[442] ESL I.B. at 35.

[443] *See* Declaratory Order at P 18.

[444] *See* Tr. 113, 131-32; IS I.B. at 25-26.

[445] *See* ESL I.B. at 23-27, 33.

[446] *See* Tr. 112-13, 130-31; Staff I.B. at 37 (noting that ESL's risk assessment is "not supported by any persuasive study").

[447] *See* Staff I.B. at 38 (citing *Transco*, Opinion No. 414, 80 FERC at 61,665).

[448] ESL I.B. at 32 (acknowledging that "ESL has been able to finance the Southern Lights Pipeline with a large amount of non-recourse debt").

[449] Staff I.B. at 30-31.

[450] *See Kern River Gas Transmission Co.*, 117 FERC ¶ 61, 077, at P 49 & n.90 (2006); *Mojave Pipeline Co.*, 58 FERC ¶ 61,074, at 61,248 (1992) ("[T]he Commission is now approving a 70/30 debt equity ratio for Mojave.").

[451] *See* IS I.B. at 17.

[452] *Kentucky West Virginia Gas Co.* (*Kentucky West*), 2 FERC ¶ 61,139, at 61,325

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210. According to Indicated Shippers, the Commission explained that the three-factor test was designed to discourage potential manipulation of subsidiaries' capital structures by the parent company to produce higher rates.[455] Indicated Shippers explained that those concerns are obviously not present here, and in fact, in a case like this one, the test allows for the opposite kind of manipulation. As discussed in the Initial Brief, Indicated Shippers stated that a pipeline could simply choose not to obtain a rating in order to ensure that its parent's capital structure was used where this would favor it.[456]

211. Indicated Shippers noted that Staff objects to what it perceives as a failure, essentially, to check a box required by the three-factor test.[457] However, Indicated Shippers stated that Opinion 414-A modified *Kentucky West* in part to avoid just such a "mechanistic" and "absolute" approach to the Commission's ultimate obligations to "produce just and reasonable rates."[458] According to Indicated Shippers, while Staff may be unswayed that successful capital market financing obviates the need for a bond rating, Staff does not dispute that the same function of a bond rating was served. Indicated Shippers believed that, as a practical matter, the Commission's policy of using a bond rating as a factor of analysis has therefore been satisfied. Accordingly, Indicated Shippers believed that the Presiding Judge and the Commission should follow the general policy to use ESL's actual capital structure of 70.4% debt and 29.6% equity.

D. Trial Staff

212. Trial Staff noted that while the Commission historically has preferred to make use of a filing company's actual capital structure,[459] it has found that it may be more appropriate to use either the capital structure of the filing company's parent or a hypothetical capital structure.[460]

(1978).

[453] *Williams Pipe Line Co.*, Opinion No. 154-B, 33 FERC ¶ 61,327 (1985).

[454] *Transco*, Opinion No. 414-A, 84 FERC ¶ 61,084 (1998).

[455] *Transco*, Opinion No. 414, 80 FERC at 61,664.

[456] IS I.B. at 16.

[457] *See* Staff I.B. at 38.

[458] *Id.* at 61,414-61,415.

[459] *See*, *e.g.*, *Kentucky West Virginia Gas Co.* (*Kentucky West*), 2 FERC ¶ 61,139, at 61,325 (1978) ("The first choice is to use the actual capital structure of the firm being regulated.")

[460] *Id.* at 61,326-27.

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213. Trial Staff explained that the Commission has set forth a three-prong test for determining when it will use the actual capital structure of a filing company.[461] Specifically, Trial Staff noted that the Commission will use a filing company's actual capital structure: (1) if the debt issued by the company is non-guaranteed, (2) if the company has its own separate bond rating, and (3) if the company's common equity ratio is reasonable, given the equity ratios approved by the Commission in the past.[462] If these three criteria are not satisfied, the Commission will use an imputed capital structure.

214. Trial Staff asserted that ESL fails the three-prong test in two ways in the current case – it does not have its own bond rating and its common equity ratio, rather than being too high, is under 30%, which is lower than the lowest common equity ratio that Mr. Alvarez is aware of in a litigated case.[463] Under these circumstances, when it is not appropriate to use the filing company's actual capital structure, Trial Staff stated that the Commission will normally employ the capital structure of the pipeline's corporate parent if it is reasonable to do so.[464]

215. Trial Staff followed this approach, and Mr. Alvarez determined that the capital structure of Enbridge Pipelines Inc., the parent of ESL, issues its own non-guaranteed debt, has its own bond rating, and has an equity ratio within the historical range approved by the Commission.[465] With the parent company having satisfied the Commission's three-prong test, Staff explained that Mr. Alvarez used Enbridge Pipelines Inc.'s capital structure of 55.29% debt and 44.71% equity as of March 31, 2011[466] – the latest available information as of the date of his answering testimony.[467]

216. Trial Staff noted that both ESL and the Indicated Shippers take a different approach than Trial Staff, and their analyses end up at opposite ends of the capital structure spectrum, with Enbridge Southern Lights proposing the use of a hypothetical

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[461] While Trial Staff uses the term "three-prong test" (because there are three criteria), the Commission has sometimes used the term "two-prong test" by combining the first two criteria.

[462] Exh. S-10 at 4 (Alvarez), quoting *Transco*, 84 FERC at 61,413.

[463] *Id.* at 27.

[464] *Transco*, 84 FERC at 61,413.

[465] Exh. S-10 at 5 (Alvarez).

[466] *Id.* at 23. In rebuttal testimony, Enbridge Southern Lights raises some "technical problems" with Trial Staff's calculation of the capital structure ratios of the parent, Enbridge Pipelines, Inc. Exh. ESL-29 at 23-28 (Fairchild). The issues raised by Enbridge Southern Lights would change Trial Staff's equity ratio from 44.71% to 53.33%. *Id.* at 28. Such a change, other things being equal, would marginally increase Trial Staff's calculation of the Opinion No. 154-B uncommitted rate, but would not change Trial Staff's conclusion that this rate is above the TSAs' uncommitted rate.

[467] Exh. S-10 at 5 (Alvarez).

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capital structure with a very high equity ratio and the Indicated Shippers proposing the use of the actual capital structure of ESL with its very low equity ratio. Trial Staff explained that while ESL asserts that this is a unique case that justifies a departure from Commission policy, the Indicated Shippers erroneously suggest that its approach is consistent with Commission policy.

217. Unlike Trial Staff or the Indicated Shippers, ESL focuses on the total risk of Southern Lights Pipeline, which includes the risk transferred to the committed shippers by the TSAs. Trial Staff explains ESL's rationale is that such an approach is required in determining the Opinion No. 154-B uncommitted rate to reflect the full economic cost of the Southern Lights Pipeline project – otherwise, according to ESL, the traditional approach employed by Trial Staff and the Commission would require the committed shippers to unfairly subsidize the uncommitted shippers that did not contribute in any way to the financing of the Southern Lights Pipeline project.[468]

218. However, Trial Staff notes that their traditional approach derives an uncommitted rate that is two times the rate that will be charged to the committed shippers. For this reason, Mr. Alvarez testified that he does not understand how Trial Staff's approach subsidizes the uncommitted shippers when they will be paying twice the rate charged to the committed shippers.[469] Indeed, in its rebuttal testimony, ESL acknowledges that Trial Staff's rate design position effectively cures the subsidy issue it raised.[470]

219. Trial Staff stated that, consistent with ESL's position that the focus in this case should be on the total risk of the Southern Lights Pipeline, ESL rejected the use of both the actual capital structure of the filing company and the capital structure of its parent, Enbridge Pipelines Inc., as well as the capital structures of the proxy companies. Instead, Trial Staff notes that ESL argues that these other entities are not comparable in risk to the Southern Lights Pipeline and that the use of a hypothetical capital structure is thereby justified.[471] Ultimately, Trial Staff observed that ESL chose to use the average capital structure of the two committed shippers, BP and Statoil, claiming that the risks of these international oil-producing companies are most comparable in risk to the Southern Lights Pipeline.[472]

220. According to Trial Staff, while the capital structure approach taken by Enbridge Southern Lights may be consistent with its overall methodology for determining the Opinion No. 154-B uncommitted rate, its approach is nonetheless at odds with

[468] Exh. ESL-20 at 8-9 (Fairchild) and ESL-29 at 3 (Fairchild); *see also* Exhibit S-12 at 10-15 (Alvarez).

[469] Exh. S-10 at 21-22 (Alvarez).

[470] *See*, *e.g.*, Exh. ESL-29 at 29 (Fairchild).

[471] Exh. ESL-20 at 9-17 (Fairchild).

[472] *Id.* at 18-19.

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Commission policy. Trial Staff agreed with Enbridge Southern Lights that a company's capital structure, from a strictly academic standpoint, should reflect its level of business risk, *i.e.*, less risk- more debt versus more risk-less debt. However, apart from whether or not the capital structure proposed by Enbridge Southern Lights truly reflects the Southern Lights Pipeline's business risk, Trial Staff explained that the Commission's capital structure policy has evolved over the years, and its current policy is not to engage in a strict relative risk analysis, but rather to apply the three-prong test instead.

221. Trial Staff specifically noted that the Commission in 1997 modified its longstanding *Kentucky West* policy on capital structures, which permitted the use of a filing company's capital structure if the company issued non-guaranteed debt and had its own bond rating. Trial Staff explained that the modification added a third prong that required that the filing company's equity ratio also be within the range of the equity ratios of the proxy companies used in the DCF (Discounted Cash Flow) analysis.[473] Trial Staff noted that in *Transco*'s first order on rehearing, the Commission opted for additional flexibility and expanded the third prong by allowing a filing company to show the reasonableness of its equity ratio by reference to the equity ratios approved by the Commission in other recent cases and stated that it "will not be bound by the proxy company range."[474]

222. In this regard, Trial Staff witness Alvarez testified that the capital structure proposed by ESL with its 70% equity ratio "is outside the range that the Commission has considered appropriate" because it is above the highest equity ratio approved by the Commission in a litigated case.[475] Trial Staff observed that ESL supports the reasonableness of the 70% equity ratio by referring to a declaratory order involving the Colonial oil pipeline where the Commission indicated that it was prepared to accept a 71% equity ratio.[476]

223. However, Trial Staff explained that the Commission rejected a similar argument in another case when a party tried to use the same *Colonial* order to support the use of a 71% equity ratio. In that case, the Commission agreed with the presiding judge that it did not approve a 71% equity ratio in the *Colonial* case, "but stated it would review the proposal upon completion of the project."[477] Therefore, Trial Staff stated that ESL's attempt to expand the range of equity ratios approved by the Commission by relying on this *Colonial* case to buttress its position is unavailing.

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[473] *Transco,* Opinion No. 414, 80 FERC at 61,665.

[474] *Transco,* Opinion No. 414-A, 84 FERC at 61,414-15.

[475] Exh. S-10 at 26-27 (Alvarez).

[476] Exh. Nos. ESL-20 at 18-19 (Fairchild), citing *Colonial Pipeline Co.*, 116 FERC ¶ 61,078 (2006), and ESL-29 at 22 (Fairchild).

[477] *BP Pipelines (Alaska) Inc.*, 123 FERC ¶ 61,287, at P 176 (2008).

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224. Moreover, in modifying its capital structure policy, Trial Staff noted that the Commission eliminated what had been a part of the *Kentucky West* analysis. As the Commission stated:

> In this part of the analysis the Commission will not examine the pipeline's relative riskiness. That issue will be addressed only in determining whether the pipeline's return on equity will be set at the high, mid, or low point of the range of returns on equity for the proxy companies under the policy enunciated in Opinion No. 396-B.[478]

225. In contrast to the Commission's decision to back away from risk analyses in its determination of the appropriate capital structure, Trial Staff observed that ESL relies almost entirely on a risk analysis in its own assessment of an appropriate capital structure. From a purely technical standpoint, Trial Staff argued that ESL's analysis is not supportable as it is common knowledge that risk is a very slippery notion, and its measurement is fraught with difficulties of one kind or another.[479] Therefore, Trial Staff stated that ESL's determination that the business risk of the Southern Lights Pipeline is comparable to that of the committed shippers is conclusory and not supported by any persuasive study – possibly because the task is simply too formidable.

226. Given the history and evolution of the capital structure issue, Trial Staff concluded that ESL's capital structure analysis does not comply with current Commission policy and, in any event, is too speculative and unreliable.

227. Trial Staff noted that by contrast, while the Indicated Shippers properly focus on the capital structure, cost of debt, and cost of equity of Enbridge Southern Lights, their capital structure approach also violates the Commission's policy. Perhaps more fundamentally, though, Trial Staff stated that Indicated Shippers' approach is self-serving and fails to conform to their own position that the TSAs should not be taken into account when determining the Opinion No. 154-B uncommitted rate.[480] Clearly, ESL would not

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[478] *Transco*, 80 FERC at 61,666 (footnote omitted); *see also Transco*, Opinion No. 414-A, 84 FERC at 61,413 ("The Commission further announced that this portion of the capital structure analysis no longer would include an evaluation of the pipeline's relative risk, as it formerly did under the second prong of the *Kentucky West Virginia* test").

[479] *See, e.g.*, the discussion on pages 45-46 below, citing *Northwest Pipeline Corp.*, 92 FERC ¶ 61,287, at 62,006 (2000).

[480] *See*, *e.g.*, Exh. IS-1 at 6 (Crowe) ("No aspect of Enbridge Southern Lights' TSAs with its committed shippers will be applicable to rates for uncommitted service"). As it turns out, the Indicated Shippers seem to move back and forth between ignoring the TSAs and relying on them. For example, they rely on the TSAs for purposes of recommending the bottom end of the range of reasonableness, *see*, *e.g.*, Exh. IS-8 at 42

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have been able to support the financing of the Southern Lights Pipeline with 70% debt without the guarantees provided by the TSAs. Trial Staff agreed with ESL witness Dr. Fairchild's following statement:

> It is only because most of the risks associated with the Southern Lights Pipeline have been transferred to the Committed Shippers through the TSAs that Enbridge Southern Lights has been able to finance its investment in the Southern Lights Pipeline using considerably more debt than if it were a stand-alone pipeline and Enbridge Southern Lights were bearing all of the risks itself. The ability of Enbridge Southern Lights to finance its investment in the Southern Lights Pipeline with 70 percent non-recourse debt is a direct result of the contractual assurances provided by the Committed Shippers, together with the regulatory assurances provided by the Commission. Through the TSAs, the Committed Shippers effectively guaranteed the payment of the interest and principal on the Southern Lights Pipeline's debt and are bearing the associated risks.[481]

228. According to Trial Staff, the convenient argument put forth by the Indicated Shippers that the absence of a bond rating is a "secondary consideration" because it is offset by the fact that ESL successfully financed the Southern Lights Pipeline in the capital markets is not credible. Trial Staff asserted that the Commission has never stated that the bond-rating criterion can be dropped in such a cavalier fashion, and indeed, in discussing its modification of the *Kentucky West* test, the Commission specifically stated the opposite.[482] Furthermore, Trial Staff explained that the successful financing of the project, as noted above, is due to the support provided by the committed shippers in the TSAs.

229. Trial Staff believed that the importance of the TSAs in this regard is vividly demonstrated by the unusually low cost of debt that ESL was able to obtain. Without the TSAs, Trial Staff opined that it is likely that the high risk of the Southern Lights Pipeline

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(Safir) ("Another factor that cannot be overlooked is the existence of Enbridge Southern Lights' TSAs."), but ignore them when recommending the median of the range – as long as rates are based on the pipeline's design capacity. Indeed, in its rebuttal testimony, Enbridge Southern Lights discusses the inherent contradictions between the Indicated Shippers' answering testimony and cross-answering testimony. Exh. ESL-44 at 38-39 (Webb).

[481] *See*, *e.g.*, Exh. ESL-29 at 13-14 (Fairchild).

[482] *Transco*, 80 FERC at 61,665 (stating that "[i]n discharging [its] consumer protection obligation in cases such as this, the Commission believes that it remains important to examine whether a pipeline issues its own non-guaranteed debt and has its own bond rating. These aspects of the *Kentucky West Virginia* analysis will be retained").

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project would have precluded ESL from access to the capital markets entirely without the financial support of its parent. Trial Staff asserted that the alternative is that the pipeline project would have been viewed by the capital markets as a speculative venture that could only be financed by debt at an exorbitantly high interest rate that would unduly burden ratepayers, and therefore, because ESL cannot reasonably be considered as an independent financing entity, its actual capital structure cannot be used for rate of return purposes under existing Commission policy.[483]

230. Trial Staff's Post-Hearing Reply Brief reiterated its position that the appropriate capital structure to use in this case for both dockets is the capital structure of Enbridge Pipelines Inc., the parent of ESL.[484] Trial Staff addressed the Indicated Shippers' argument that the capital structure of ESL should be used regardless of the fact that it lacks a bond rating. Trial Staff noted that ESL's rationale is that if such a position is not adopted, a pipeline could choose whether its capital structure or its parent's is used "by the simple expedient of strategically choosing whether or not to obtain a bond rating."[485] Trial Staff concluded that there is no merit to this argument as a company's purpose in obtaining a bond rating is to facilitate its financing activities by expanding the pool of potential buyers in the capital markets and thereby lowering the cost of financing.

231. Trial Staff stated that many potential buyers, such as banks and insurance companies, are prohibited from investing in companies unless they have a bond rating at or above a specific level. Trial Staff further noted that to refrain purposely from obtaining a bond rating so as to influence which capital structure is used in an infrequently occurring rate case would undercut a company's financing activities and would not be a sensible strategy for a prudent management. Trial Staff pointed out that the Commission stated in the *Transco* proceeding that "the intervenors acknowledge that the Commission previously has found a separate bond rating to be characteristic of financial independence."[486] In this case, Trial Staff explained that there was no need for ESL to obtain a bond rating because rather than relying on its own credit standing to finance the Southern Lights Pipeline, it relied on the credit standing of the Committed Shippers, which is why it cannot qualify as an independent financing entity.

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[483] Trial Staff's analyses and conclusions regarding the appropriate capital structure, cost of debt, and cost of equity apply equally to both the 2010 rate (Docket No. IS10-399-003) and the 2011 rate (Docket No. IS11-146-000).

[484] Trial Staff I.B. at 29-31, citing *Transcontinental Gas Pipe Line Corp.* ("*Transco*"), Opinion No. 414, 80 FERC ¶ 61,157 (1997); Opinion No. 414-A, *order on reh'g*, 84 FERC ¶ 61,084 (1998); Opinion No. 414-B, *order on reh'g*, 85 FERC ¶ 61,323 (1998).

[485] *See* IS I.B. at 16.

[486] *Transco*, 80 FERC at 61,660 (footnote omitted).

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232. Trial Staff noted that it is particularly significant that their position on this matter is the Commission's position,[487] and if the Indicated Shippers want the Commission to change its policy, they should argue directly for that outcome rather than implying that the requirement of a bond rating is Trial Staff's idea.[488]

233. As Trial Staff previously discussed, the Commission's requirement of a bond rating is just one part of a three-part showing that is designed to establish a company as an independent financing entity. Trial Staff's Initial Brief notes that this is a showing that ESL fails to satisfy on two counts – not only because it lacks a bond rating, but also because its debt ratio and equity ratio is outside the historical range approved by the Commission,[489] and could not be sustained without the financial guarantees provided by the Committed Shippers in the TSAs.

234. In addition, Trial Staff asserted that the Indicated Shippers' other argument that the use of Enbridge Southern Lights' own capital structure and cost of debt "is the only way properly to align cost causation with cost responsibility"[490] fails to recognize that the more recent Commission capital structure policy is consistent with the cost causation principle because it addresses the appropriateness of using actual costs. In other words, the mere incurrence of costs, be they operating costs or capital costs, does not ensure that those costs will be used to develop rates. Trial Staff explained that the purpose of the Commission's capital structure policy is to obtain a cost of capital that reflects the costs that would be incurred by a stand-alone, independent financing entity; such costs would be market-tested and would effectively adhere to the cost causation principle.

235. According to Trial Staff, ESL is not an independent financing entity for the reasons discussed *supra* and in Trial Staff's Initial Brief.[491] Both its capital structure and cost of debt were only possible because of the financial support provided by the Committed Shippers in the TSAs, and as a result, ESL's actual capital costs do not comply with the cost causation principle because these costs were not "caused" by ESL, but rather by the Committed Shippers. Trial Staff noted that it is just in such instances that the Commission's capital structure policy dictates the use of a capital structure and cost of debt other than that of the filing, jurisdictional pipeline company. Trial Staff stated that the Indicated Shippers' witness, Dr. Safir, makes the same error as ESL's witness, Dr. Fairchild, by attempting to justify the capital structure of ESL by use of a

[487] Trial Staff I.B. at 38, quoting *Transco*, 80 FERC at 61,665.

[488] Indicated Shippers I.B. at 16.

[489] Trial Staff I.B. at 30-33; as the Commission stated in the *Transco* proceeding, it "continues to prefer to examine objective, concrete considerations, such as whether the applicant issues its own non-guaranteed debt and has its own bond rating separate from that of its corporate parent." *Transco,* 84 FERC at 61,414.

[490] Indicated Shippers I.B. at 16-17.

[491] Trial Staff I.B. at 37-39.

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relative risk analysis – while ignoring the fact that its capital structure does not pass the Commission's three-prong test. As Trial Staff pointed out in its Initial Brief, the Commission's capital structure policy has not included a relative risk analysis for many years.[492] Moreover, Trial Staff noted that it is difficult to fathom Dr. Safir's argument that ESL's capital structure "represents a more economically accurate measure of a market-based debt to equity ratio for ESL than does the ratio of its parent Enbridge Pipelines Inc. . . ."[493]

236. According to Trial Staff, it is clear is that ESL's actual capital structure and actual cost of debt are artificial because of the risk-shifting and risk-reducing impacts of the TSAs – they do not represent what would obtain in the absence of the TSAs by an independent financing entity because ESL under those circumstances would face all of the risks attendant to the Southern Lights Pipeline project. While Dr. Safir acknowledges the impact of the TSAs for rate of return purposes,[494] Trial Staff noted that he conveniently and inconsistently ignores their impact for capital structure purposes.

237. Trial Staff noted that the Indicated Shippers end their discussion of the capital structure issue in their Initial Brief with a straw man argument[495] by quarreling with Dr. Fairchild's contention that the Committed Shippers "effectively guaranteed" the payment of Enbridge Southern Lights' debt, asserting that this characterization "was shown to be an overstatement."[496] Trial Staff explained that Indicated Shippers' point is that there is no legal guarantee that the Committed Shippers have to pay the debt costs of ESL in the event of a default, thereby making ESL's debt non-guaranteed.

238. Nonetheless, Trial Staff asserted that the Committed Shippers in the TSAs contractually guaranteed the payment of revenues for fifteen years that would cover ESL's entire cost-of-service, including the cost of debt and equity. Therefore, Trial Staff noted Indicated Shippers' contention that ESL does its own financing is highly misleading,[497] given that ESL had to rely on the credit standing of the Committed Shippers because of its failure to qualify as an independent financing entity. As a result, Trial Staff believed that Dr. Fairchild's statement that the Committed Shippers

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[492] *Id.* at 34-37; *see also Transco*, 84 FERC at 61,421 ("However, as the Commission determined in Opinion No. 414, it is unnecessary to examine a pipeline's risk in establishing the appropriate capital structure in ratemaking. It is adequate to address a pipeline's risk only once, which will occur in the process of establishing the allowed ROE [return on equity])."

[493] Enbridge Southern Lights I.B. at 17.

[494] *See*, *e.g.*, Exh. IS-40 at 8-9 (Safir).

[495] Indicated Shippers I.B. at 22.

[496] *Id.*

[497] *Id.* at 17.

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"effectively guaranteed" the payment of Enbridge Southern Lights' debt did not represent an overstatement.

239. According to Trial Staff, more important is the fact that nobody disagrees that the project-financed debt of ESL is non-guaranteed – at least in a legal sense. Trial Staff explained that fact only establishes that ESL satisfies the first prong of the Commission's three-prong test, and for purposes of evaluating what the appropriate capital structure should be, the Indicated Shippers' point is a distinction without a difference because, as discussed above, it does not change the fact that the capital structure of Enbridge Southern Lights does not satisfy the Commission's three-prong test.

Findings and Conclusions

240. While the Commission historically has preferred to make use of a filing company's actual capital structure,[498] it has found that it may be more appropriate to use either the capital structure of the filing company's parent or a hypothetical capital structure.[499]

241. The Commission has set forth a three-prong test for determining when it will use the actual capital structure of a filing company.[500] Specifically, as Trial Staff noted, the Commission will use a filing company's actual capital structure: (1) if the debt issued by the company is non-guaranteed, (2) if the company has its own separate bond rating, and (3) if the company's common equity ratio is reasonable, given the equity ratios approved by the Commission in the past.[501] If these three criteria are not satisfied, the Commission will use an imputed capital structure.

242. ESL fails the three-prong test in two ways as it does not have its own bond rating and its common equity ratio, rather than being too high, is under 30%, which is lower than the lowest common equity ratio that Trial Staff witness Alvarez is aware of in a litigated case.[502] Since it is not appropriate to use ESL's actual capital structure in the present case, Trial Staff stated that the Commission will normally employ the capital structure of the pipeline's corporate parent if it is reasonable to do so.[503]

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[498] *See*, *e.g.*, *Kentucky West Virginia Gas Co.* (*Kentucky West*), 2 FERC ¶ 61,139, at 61,325 (1978) ("The first choice is to use the actual capital structure of the firm being regulated.")

[499] *Id.* at 61,326-27.

[500] While Trial Staff uses the term "three-prong test" (because there are three criteria), the Commission has sometimes used the term "two-prong test" by combining the first two criteria.

[501] Exh. S-10 at 4 (Alvarez), quoting *Transco*, 84 FERC at 61,413.

[502] *Id.* at 27.

[503] *Transco*, 84 FERC at 61,413.

243. Mr. Alvarez noted that Enbridge Pipelines Inc., the parent of ESL, issues its own non-guaranteed debt, has its own bond rating, and has an equity ratio within the historical range approved by the Commission.[504] Since ESL's parent company satisfies the Commission's three-prong test, Mr. Alvarez is correct in using Enbridge Pipelines Inc.'s capital structure of 55.29% debt and 44.71% equity as of March 31, 2011[505] – the latest available information as of the date of his answering testimony.[506] Neither ESL nor Indicated Shippers' position on capital structure complies with Commission policy.

Issue #7: What is the appropriate cost of debt?

A. ESL

244. ESL noted that Dr. Fairchild recommends a cost of debt of 4.31%, which is EPI's average embedded cost of non-affiliated, or third-party, debt for 2010.[507] As explained by Dr. Fairchild, the Commission usually looks to the pipeline or its parent, depending on where rated debt is located, to determine the cost of debt.[508] In the instant case, ESL stated that it is appropriate to use EPI's third-party debt as the cost of debt because ESL does not have any rated debt, and its immediate parent company, EECI, has no debt issued in its own name.[509] ESL explained that Trial Staff proposes a similar cost of debt of 4.58%, based on the cost of both third-party and affiliate debt for EPI as of March 31, 2011.[510]

245. In contrast to ESL and Trial Staff, ESL observed that the Indicated Shippers' position is that the cost of ESL's debt as of March 31, 2011 (2.37%) should be used.[511] However, ESL stated that Dr. Fairchild explained how the Indicated Shippers' use of

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[504] Exh. S-10 at 5 (Alvarez).

[505] *Id.* at 23. In rebuttal testimony, ESL raises some "technical problems" with Trial Staff's calculation of the capital structure ratios of the parent, Enbridge Pipelines, Inc. Exh. ESL-29 at 23-28 (Fairchild). The issues raised by Enbridge Southern Lights would change Trial Staff's equity ratio from 44.71% to 53.33%. *Id.* at 28. Such a change, other things being equal, would marginally increase Trial Staff's calculation of the Opinion No. 154-B uncommitted rate, but would not change Trial Staff's conclusion that this rate is above the TSAs' uncommitted rate. For purposes of recalculating a cost-of-service uncommitted rate, this decision adopts Trial Staff's figures.

[506] Exh. S-10 at 5 (Alvarez).

[507] *See* Exh. ESL-29 at 23:7.

[508] Exh. ESL-20 at 19:18-19.

[509] ESL-20 at 19-20, ESL-22, ESL-29 at 22-23.

[510] *See* S-10 at 6; S-12 at 28.

[511] *See* IS-1 at 13:1-2.

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ESL's project-financed debt for the cost of debt calculation is flawed.[512] As previously discussed, ESL has been able to secure low-cost debt financing based on the assurances provided by the Committed Shippers through their TSAs. ESL asserted that adopting the Indicated Shippers' proposed cost of debt would effectively provide the benefit of ESL's project financing to the Uncommitted Shippers, without them having to bear any of the risks and costs required to achieve it.[513] ESL explained that Ms. Crowe's recommendation would thus be unfair to the Committed Shippers, who would be subsidizing the Uncommitted Shippers through a low cost of debt included in the Uncommitted Rate.[514]

246. ESL noted their agreement with Trial Staff that EPI is the appropriate entity from which to derive the cost of debt in this proceeding.[515] ESL explained that Trial Staff proposes a similar cost of debt of 4.58%, which reflects all of EPI's long-term debt – *i.e.*, both third-party and affiliate.[516]

247. ESL stated Indicated Shippers' argument that the appropriate cost of debt is that of ESL as of March 31, 2011 (2.37%).[517] The Indicated Shippers contend it is appropriate to use ESL's cost of debt, despite the fact that low-cost financing was only available because of the assurances made by the Committed Shipper through their TSAs, because the project-financed debt used to construct the Southern Lights Pipeline carries its own specific cost, and is "solely attributable" to the pipeline.[518] ESL noted the Indicated Shippers' argument that ESL's cost of debt should be used because the debt attributable to ESL is less than one quarter of EPI's total long-term debt as of March 31, 2011.[519] According to ESL, the Indicated Shippers' position is unsustainable.

248. As explained by both ESL and Trial Staff, ESL's project-financing cost of debt could not have been achieved without the assurances provided by the Committed Shippers through their TSAs.[520] Mr. Jervis confirmed that without the assurances

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[512] ESL-29 at 22.

[513] ESL-29 at 22-23.

[514] *Id.*

[515] *See* ESL I.B. at 33-34; Staff I.B. at 39-40.

[516] Staff I.B. at 40.[516]

[517] *See* IS I.B. at 22-23.

[518] *See* IS I.B. at 23.

[519] *Id.* at 18.

[520] *See* Staff I.B. at 41 (explaining that the Indicated Shippers "use Enbridge Southern Lights' unusually low cost of debt even though it is abundantly clear that such a rate would not have been possible without the guarantees provided by the committed shippers"); *see also* Tr. at 186:20-23 (Fairchild) ("When I talked to the treasury people who went through negotiations with the underwriters and the bankers, they said the support for this debt came from the TSAs and the guarantees that were provided in those

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provided by the Committed Shippers through their TSAs, the Southern Lights Project might well have not been built at all – much less at such a low cost of capital.[521]

249. ESL argued that the Indicated Shippers' focus on the "specific" debt used to finance the pipeline conveniently disregards the factors that allowed that financing to proceed in the first place. Trial Staff agreed, stating that "the use of [ESL's] actual cost of debt is again in conflict with the Indicated Shippers' position that the TSAs should not be taken into account."[522] ESL pointed out Trial Staff's argument that the unreasonableness of using ESL's cost of debt of 2.37% is also "evidenced by the fact that it is more than 75 basis points *lower* than the current yield on 30-year U.S. Treasury bonds."[523] ESL stated that attempting to benefit from the lower debt costs attributable to the financial commitments that the Committed Shippers made under the TSAs is another example of how the Indicated Shippers seek to free-ride on those commitments, despite having taken on none of the same risks.[524]

B. Committed Shippers

250. Committed Shippers took no position on this issue, and noted that for both the 2010 period and the 2011 period, both Enbridge's and Staff's cost of debt, when applied to proper throughput determinants and Opinion No. 154-B methodology, result in a finding that Enbridge's filed 2010 and 2011 rates are just and reasonable.

C. Indicated Shippers

251. Indicated Shippers argue that the appropriate cost of debt is 2.37%, which represents the cost of the long-term debt incurred to finance ESL's system.[525] As Indicated Shippers witness Crowe explained, even if the Commission determines that Enbridge Pipelines Inc. is the appropriate entity to use for capital structure purposes, the Commission should still use ESL's own cost of debt.[526] Witness Crowe noted that ESL has its own project-financed debt that was used entirely and solely to construct the ESL pipeline system,[527] and she also noted that ESL's debt "carries its own specific, known and measurable cost," which "is specifically, entirely, and solely attributable to the

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TSAs . . .").

[521] *See* ESL-1 at 9.

[522] *See* Staff I.B. at 41.

[523] *See* Staff I.B. at 43 (citing ESL-44 at 38) (emphasis in original).

[524] *See* ESL-27 at 11 (Jaffe); ESL-29 at 22-23 (Fairchild).

[525] Exh. IS-4(Updated) at 3, line 12; Exh. ESL-22; Exh. IS-1 at 6, 18.

[526] *See* Exh. IS-33 at 6-7.

[527] *Id.* at 6.

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financing of the Enbridge Southern Lights system and therefore is the only appropriate cost of debt that should be used to establish rates charged for service on that pipeline."[528]

252. For Docket No. IS11-146-000, Indicated Shippers took the position that it is appropriate to use the actual average cost of debt for ESL's long-term debt financing, which was 2.37% at the end of the first quarter of 2011.[529]

253. Indicated Shippers reply brief noted that ESL and Staff fail to explain why additional costs unrelated to the Southern Lights project, but included in the cost of debt of ESL's parent company Enbridge Pipelines Inc., should be substituted for the actual cost of debt ESL incurred. Indicated Shippers argued that this needless, but persistent, deviation from ESL's actual costs to finance the pipeline only reinforces Indicated Shippers' position that ESL's actual capital structure should be used in this ratemaking.

254. Indicated Shippers noted that even if ESL's parent's capital structure is used, this is no justification for ignoring the reality that ESL's actual total cost of debt is easily identified and measured independently from its parent's.[530]

255. According to Indicated Shippers, both ESL and Staff reiterate that ESL achieved its low cost of debt in part because of the guarantees it secured from Committed Shippers.[531] Indicated Shippers noted that neither ESL nor Staff, explains why this is relevant to calculating a just and reasonable cost-based rate. As discussed above, Staff's understanding of Indicated Shippers' position is flawed: Indicated Shippers asserted that the Commission should set a cost-based rate by taking ESL's costs as they actually exist, regardless of why or how they got that way. According to Indicated Shippers, this is not a selective application of the Committed Shippers' TSAs, and in fact, there are many reasons why ESL's cost of debt may have been lower than usual, including a weak market and the type and term of the debt. Indicated Shippers asserted that Staff's offhand comparison to U.S. Treasury Bonds is meaningless without a comparative analysis of Treasury Bond yields of various terms in comparison to the term of ESL's debt.[532]

256. Indicated Shippers stated that Staff's argument that ESL's actual cost of debt cannot be used if the parent's capital structure is used is illogical.[533] In particular, Staff's citation to *SFPP, L.P.*, 134 FERC ¶ 61,121, at P 192 (2011), which rejected "dollar tracing" to segregate actual project debt costs from parent debt costs, is inapposite where all of the project debt costs are already segregated and separately held by the

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[528] *Id.* at 6-7; *see also* Exh. IS-34 at 2-3; Exh. IS-36.
[529] Exh. IS-3A (Supp.) at 3, line 12; Exh. IS-5; Exh. ESL-22; Exh. IS-1 at 13.
[530] *See* Exh. IS-33 at 6-7.
[531] *See* ESL I.B. at 34; Staff I.B. at 41.
[532] *See* Staff I.B. at 43.
[533] *See* Staff I.B. at 40.

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subsidiary.[534] Finally, Indicated Shippers argued that Commission precedent does not support the view that actual debt costs should be rejected simply because they are "too low." For Docket No. IS11-146-000, Indicated Shippers took the position that the actual average cost of debt for ESL's long-term debt financing, 2.37%, is appropriate.[535]

D. Trial Staff

257. Trial Staff asserted that when using a parent's capital structure in a rate of return analysis, the Commission has found that it is also appropriate to use the parent's cost of debt.[536] While it is true that ESL's parent did not provide the financing for the Southern Lights Pipeline project, Trial Staff argued that it would be illogical, inconsistent, and an obvious mismatch not to also use the parent's cost of debt if, in fact, the parent's capital structure is being used.[537]

258. Although Trial Staff and ESL differ on whether certain debt of the parent, Enbridge Pipelines Inc., should be included in the calculation of the cost of debt, the quantitative impact of this disagreement is very small. As with the differences regarding the parent's capital structure ratios, it would not change Trial Staff's conclusion that the Opinion No. 154-B uncommitted rate is above the TSAs' uncommitted rate.[538] Moreover, as Trial Staff previously discussed, the parent's capital structure is used by Staff witness Alvarez because it reflects the Commission's longstanding capital structure policy, and as a result, Mr. Alvarez uses the 4.58% cost of debt for Enbridge Pipelines Inc, which reflects all of the parent's long-term debt.[539]

259. Trial Staff explained that Indicated Shippers use the actual capital structure of ESL despite its failure to satisfy the Commission's three-prong test. According to Trial Staff, the relevant point is that in conjunction with that erroneous decision, Indicated Shippers follow through and use ESL's unusually low cost of debt even though it is clear that such a rate would not have been possible without the guarantees provided by the committed

[534] *See id.* at 40, n.125.

[535] *See* IS I.B. at 41-42; Exh. IS-3A(Supp.) at 3, line 12; Exh. IS-1 at 12-13.

[536] *See*, *e.g.*, *SFPP, L.P.*, 134 FERC ¶ 61,121 n.300 (2011) ("When a subsidiary uses its parent company's capital structure, as all parties agree SFPP should do here, the use of the parent's cost of debt necessarily follows . . . .")

[537] *See, e.g., BP Pipelines (Alaska) Inc.*, 123 FERC ¶ 61,287, at P 197-98 (2008).

[538] In any event, a recent ruling by the Commission supports Trial Staff's position that all long-term debt should be considered in the calculation of the cost of debt. *See SFPP*, *L.P.*, 134 FERC ¶ 61,121, at P 192 (2011) ("The Commission concludes that 'dollar tracing' of debt to particular expenses is impossible," citing *Kern River Gas Transmission Co.* (*Kern River*), Opinion No. 486, 117 FERC ¶ 61,077 at P 195 (2006), *reh'g*, 137 FERC ¶ 61,220 (2011)).

[539] Exh. Nos. S-10 at 6 (Alvarez) and S-12 at 28 (Alvarez).

shippers.[540] That being the case, Trial Staff stated that the use of ESL's actual cost of debt is again in conflict with the Indicated Shippers' position that the TSAs should not be taken into account.

260. Although the Indicated Shippers' witness, Ms. Crowe, acknowledges that the use of the parent's long-term debt "would normally be the appropriate determination" if the parent's capital structure is used, she points out that "Enbridge Southern Lights has its own project-financed debt that was used entirely and solely to construct the Enbridge Southern Lights pipeline system" and "[t]hat debt carries its own specific, known and measurable cost."[541] Trial Staff noted that her argument may be superficially appealing, but it does not trump the fact that this position is inconsistent with the Commission's capital structure policy.

261. Trial Staff noted that Ms. Crowe attempts to support her argument by analogizing this case to the *Kern River* case cited by Trial Staff witness Alvarez.[542] In particular, she noted that Kern River was "a project-financed pipeline that issued its own debt specifically to finance the pipeline" and that "[t]he Commission in *Kern River* used only the long-term debt issued to finance the Kern River system in setting the debt cost in that proceeding."[543] Trial Staff asserted that Indicated Shippers' reliance on *Kern River* is inapposite as Ms. Crowe did not discuss how the *Kern River* case involved levelized rates where the Commission approved of Kern River's use of the Ozark methodology to develop the cost-of-service, rather than a traditional cost-of-service.[544]

262. According to Trial Staff, while this proceeding involves the application of the Opinion No. 154-B trended original cost methodology, this particular approach is based on the traditional cost-of-service approach that applies an overall, weighted cost of debt and equity to the rate base,[545] albeit a real rate of return on a trended original cost rate base. In addition, Trial Staff explained that the capital structure used in the *Kern River* case was an average over the levelization period, rather than the actual capital structure at

[540] *See* Exh. ESL-29 at 13-14 (Fairchild).

[541] Exh. IS-33 at 8 (Crowe).

[542] *Kern River*, 117 FERC ¶ 61,077 (2006).

[543] Exh. IS-33 at 8-9 (Crowe) (emphasis in original).

[544] *Kern River*, 117 FERC at P 111 (as the Commission explained: "The Ozark method differs from the traditional cost-of-service model in that it assumes that all debt was raised to finance rate base. Thus in establishing the capitalization for the model, all outstanding debt is subtracted from the total rate base and the remainder is assumed to be financed by equity. In contrast, the traditional cost-of-service model applies an overall, weighted cost of book debt and equity (rate of return) to the entire rate base to determine an appropriate return allowance, thus assuming that both debt and equity are used to finance rate base proportionally throughout the term of the project").

[545] *See*, *e.g.*, Exh. S-10 at 23 (Alvarez).

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a particular moment in time.[546] Finally, Trial Staff asserted that the particulars of the levelized approach in the *Kern River* case did not raise the issue of the Commission's three-prong test, but the fact is that Kern River would have satisfied that test – it issued non-guaranteed debt, had a bond rating, [547] and its equity ratio, whether using an average or an end of period ratio, was within the historical range approved by the Commission.[548] Therefore, Trial Staff noted that unlike ESL, Kern River was able to qualify as an independent financing entity.

263. Trial Staff stated that it proposes the same cost of debt for Enbridge Southern Lights in both dockets.

Findings and Conclusions

264. When using a parent's capital structure in a rate of return analysis, the Commission has found that it is also appropriate to use the parent's cost of debt.[549] Trial Staff recommended a cost of debt of 4.58%, representing all the long-term debt of ESL's parent, Enbridge Pipelines Inc. ESL also recommended the use of the parent's cost of debt, but calculates that cost at 4.31% by excluding affiliate debt.

265. Trial Staff witness Alvarez noted that the credit rating agencies look at all of the debt outstanding in their credit rating assessment for Enbridge Pipelines Inc., so excluding this debt from the cost of debt calculation would not reflect all of the risks associated with the issuer credit rating.[550] This explanation is persuasive, and in addition, the Commission recently reaffirmed its view that "dollar tracing" of debt to particular expenses is impossible.[551]

266. Accordingly, Trial Staff's recommendation of 4.58% as the appropriate cost of debt, which represents all the long-term debt of ESL's parent, Enbridge Pipelines Inc, is hereby adopted.

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[546] *Kern River*, 117 FERC at P 107.

[547] *Id.* at P 177 ("Kern River's credit rating is somewhat above the average for natural gas pipelines").

[548] *Id.* at P 107.

[549] *See, e.g., SFPP, L.P.*, 134 FERC ¶ 61,121 n.300 (2011) ("When a subsidiary uses its parent company's capital structure, as all parties agree SFPP should do here, the use of the parent's cost of debt necessarily follows . . . .")

[550] *See* Staff R.B. at 24.

[551] *See SFPP, L.P.*, 134 FERC ¶ 61,121, at P 192 (2011) ("The Commission concludes that 'dollar tracing' of debt to particular expenses is impossible," citing *Kern River Gas Transmission Co.* (*Kern River*), Opinion No. 486, 117 FERC ¶ 61,077 at P 195 (2006), *reh'g*, 137 FERC ¶ 61,220 (2011)).

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Issue #8: What is the appropriate cost of equity?

A. ESL

267. According to ESL, due to the relatively high market risks of the Southern Lights Pipeline, Dr. Fairchild testified that a nominal ROE from the top of the cost of equity range for the oil pipeline proxy group (11.13%), should be used.[552] Dr. Fairchild's ROE range used a test period ending December 2010.[553] When the ROE range was updated by Trial Staff witness Alvarez for a test period ending June 30, 2011, the high end of the cost of equity range was 12.92%.[554] Dr. Fairchild explained that the median cost of equity estimate is too low, because it reflects investors' required rate of return from established crude oil and refined products pipelines, which have typical and normal risks.[555] According to ESL, as recognized in the Declaratory Order, the Southern Lights Pipeline is more risky than the oil pipeline proxy group.[556] ESL further stated that as detailed by Mr. Earnest, the market and commercial risks associated with the Southern Lights Pipeline are high, thus warranting an ROE at the top of the range.[557]

268. ESL stated that, on cross-examination, Dr. Fairchild explained that the Commission recognized that "several factors . . . support Enbridge Southern Lights's request for an ROE at the upper end of the range," including "the size [of the project] and the fact that it was a multistate international project, its investment, [the] length of time necessary to complete it and the uncertainty of throughput."[558] Dr. Fairchild further explained that the Commission was addressing the risks of "the total project, . . . the total Southern Lights Pipeline, which includes the Committed Shippers as well as Enbridge Southern Lights."[559]

269. According to ESL, the Indicated Shippers support use of the median ROE, but only if design capacity is used for the throughput volume of the pipeline.[560] However, ESL argued that the proposed condition on use of the median ROE is inapplicable here because, as discussed *infra*, design capacity is not the appropriate measure of throughput in this case. In any event, ESL argued that whether design capacity or actual throughput is used to determine the maximum Uncommitted Rate, the risks of the Southern Lights

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[552] ESL-20 at 24-26.
[553] ESL-20 at 24:5-7.
[554] S-10 at 20:19-21:2.
[555] ESL-20 at 24:14-25:4.
[556] Declaratory Order at P 18; ESL-20 at 24-26*;* ESL-29 at 5-11.
[557] ESL-24 at 3-23.
[558] Tr. at 196:16-21.
[559] Tr. at 197:1-4; *see also* Tr. at 244:23-245:8 (Webb).
[560] *See* Exh. IS-1 at 18.

Pipeline are still far in excess of even an average oil pipeline, much less a low-risk pipeline that would fall below the median of the proxy group.[561]

270. ESL notes that Trial Staff uses a low-risk ROE because its presentation reflects the shifting of risk from ESL to the Committed Shippers by using the Commission-approved 2-to-1 rate design ratio to set the Uncommitted Rate.[562] Even in that context, ESL believes the use of a low-risk ROE has not been supported, because ESL has not been shown to have risks below those of an average pipeline.[563] However, ESL stated that the use of the low-risk ROE outside the context of the Trial Staff's rate design approach would clearly be inappropriate for the reasons described above.

271. ESL's Post-Hearing Reply Brief argued that Indicated Shippers' argument that the Commission has never made any finding that ESL is a high-risk pipeline is without merit.[564] ESL stated that in the Declaratory Order, the Commission did not adopt a specific ROE because it could not determine at that time (*i.e.*, 2007) what the proxy group range would be today; rather, the Commission noted, ESL should "propose and support the ROE or the range it believes is necessary when it files to implement its actual initial rates."[565] However, ESL explained that the Commission clearly found the circumstances of ESL created an unusually risky pipeline that warranted an ROE from the high end of the range.[566]

272. ESL explained that Indicated Shippers further claim that the Commission "did not explicitly consider the fact that ESL had transferred the risk of underrcovery to the Committed Shippers through the TSA, thus significantly reducing the pipeline's risk."[567] ESL argued that contention is baseless, and in fact, ESL clearly presented that issue in its Petition for Declaratory Order.[568]

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[561] *See* Exh. ESL-29 at 7-8, 29.

[562] *See* Exh. S-15 at 9-10.

[563] *See* Exh. ESL-20 at 24-26.

[564] *See* IS I.B. at 23-24.

[565] Declaratory Order at P 18.

[566] Declaratory Order at P 18 (stating that "[a]s it did in Colonial, *the Commission finds here* that several factors support Enbridge Southern Lights' request for an ROE at the upper end of the range of reasonableness, including the size and scope of the multistate and international project, the approximately $1.3 billion investment requirement, and the length of time necessary to complete the project. Additionally, Enbridge Southern Lights has elected to build major new facilities with no guarantee that the projected throughput will be achieved") (emphasis added).

[567] *See* IS I.B. at 25.

[568] *See* Petition at Exhibit D, ¶ 8 (Verified Statement of Robert G. Van Hoecke) ("Under the rate structure agreed upon with the Committed Shippers, those shippers have undertaken to bear virtually all of the throughput risk during the first 15 years of the

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273. Even if the Commission had not ruled on this issue in the Declaratory Order, ESL stated that the risks of the Southern Lights Pipeline would warrant an ROE from the upper end of the range of reasonableness. As noted above, ESL recounted Mr. Earnest's discussion of risks the Southern Lights Pipelines faces from (1) competition such as rail transportation of diluent from various sources (not just Chicago) to Alberta and of undiluted bitumen from Alberta (thus reducing the need for diluent); (2) the diluent portion of the Northern Gateway Project which when built will provide an alternative pipeline source to bring imported diluent to Alberta; and (3) diluent produced locally in Western Canada which competes with all sources of imported diluent.[569] ESL asserted that Mr. Earnest further discussed diluent supply risks[570] and uncertainties and risks of diluent demand.[571]

274. According to ESL, Mr. Earnest also clearly delineated the various errors and mischaracterizations contained in Dr. Safir's risk analysis, thus discrediting the Indicated Shippers' assertions that the Southern Lights Pipeline is a monopoly[572] or that "ESL has average risk."[573]

275. Indicated Shippers asserted that ESL should not have considered the risks of the Southern Lights Pipeline project as a whole, but instead should have focused solely on the regulated pipeline entity (*i.e.*, ESL) in addressing the issue of ROE.[574] ESL disagreed and noted that it is not only appropriate but necessary to consider the risks of the Southern Lights Pipeline, versus those of ESL only, because the Uncommitted Shippers did not provide the volume commitments that the Committed Shippers provided. According to ESL, by not signing a TSA, the Uncommitted Shippers avoided the substantial risk the Committed Shippers incurred of supporting the cost of the pipeline whether or not there was adequate demand for its services. ESL argued that if the Uncommitted Rate is now set without regard to those risks, the Uncommitted Shippers would avoid both the risk and the cost arising from that risk entirely, and only the Committed Shippers would incur that burden. ESL noted that such an approach would penalize the very parties that supported the building of the pipeline in the first place and result in a free ride for the Uncommitted Shippers at the Committed Shippers' expense.[575]

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operation of Southern Lights.").

[569] *See* ESL-24 at 12-16.

[570] *See id*. at 17-23.

[571] *See id*. at 6-12.

[572] *See* IS I.B. at 25.

[573] IS I.B. at 26). *See* ESL I.B. at 25-29.

[574] IS I.B. at 26-27

[575] *See* ESL-27 at 11; ESL-7 at 23-24; ESL-20 at 9; Tr. at 197:1-4 (Fairchild); *see also* Tr. at 244:23-245:8 (Webb).

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276. ESL argued that Indicated Shippers' arguments against ESL's proffered ROE consist primarily of mischaracterizations of the positions of ESL and of its witnesses, and are without merit. For example, the Indicated Shippers argue that because the pipeline has already been constructed, "[w]ith respect to the risk of the pipeline not being built, as ESL witness Jaffe agrees, no party currently bears that risk."[576] ESL countered by noting how Dr. Jaffe explained that the phrase "currently bear is not relevant to that question since the project has been completed,"[577] but also discussed in detail in his prepared rebuttal testimony the fallacies of using *ex-post* analysis to justify reducing the returns on investments made in good faith based on *ex-ante* expectations of the rules.[578] According to ESL, Dr. Jaffe explained that regulators must reject attempts by parties, such as the Indicated Shippers, to change the rules in an *ex-post* fashion.[579]

277. The Indicated Shippers also claim that ESL witness "Mr. Jervis confirmed a number of facts that flatly contradict the testimony of ESL's outside expert Mr. Earnest with regard to the level of competition and risk faced by ESL."[580] ESL noted that Indicated Shippers argue that Mr. Jervis acknowledged that the Southern Lights Pipeline is the "only pipeline bringing diluent from the U.S. to Alberta," and his agreement that Chicago is a "very good hub" for diluent somehow support Indicated Shippers' position that "ESL is a monopoly pipeline not subject to significant or meaningful competition."[581] ESL categorized Mr. Jervis' statements as simply straightforward statements of fact that are well-known to anyone familiar with the North American oil industry and in no way undermine or contradict Mr. Earnest's conclusions.

278. ESL argued that Indicated Shippers' suggestion that Mr. Earnest, a recognized oil industry expert, was unaware that the Southern Lights Pipeline was the only pipeline bringing diluent from the U.S. into Alberta is without substance. ESL noted Mr. Earnest's explanation that simply because the Southern Lights Pipeline is the only pipeline transporting diluent into Alberta does not mean that it has no competition, and rather, he discussed in detail the significant competitive pressure for the Southern Lights Pipeline that arises from diluent transportation by rail, the blending of heavy crude with

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[576] IS I.B. at 24-25 (citing Tr. at 90).

[577] Tr. at 90.

[578] *See* ESL-27 at 7:11-8:8.

[579] *Id.* at 8:2-8 (noting that "[o]nce a pipeline is built, the investment costs are sunk and irreversible. Therefore, there is always an incentive for shippers to try to change the economic terms under which the pipeline was constructed, in an attempt to reduce their costs at the expense of the party or parties that undertook the risks of the irreversible investment. Part of the job of regulators is to protect against any possibility that the regulatory process might be exploited to engage in such "hold-up" behavior).

[580] IS I.B. at 25.

[581] IS I.B. at 25 (citing Tr. at 116, 121).

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light synthetic crude, potential new diluent import pipelines, and diluent produced from local natural gas production in Western Canada that does not need to be transported.[582]

279. ESL stated that Mr. Earnest has never denied, as implied by the Indicated Shippers, that Chicago is not a good hub for diluent; rather, Mr. Earnest emphasized that, while Chicago is the only origin location for diluent shipped via the Southern Lights Pipeline, rail competition has a myriad of potential origination locations.[583]

280. According to ESL, Indicated Shippers also claim that Mr. Jervis contradicted ESL's testimony on the risk of underutilization of the Southern Lights Pipeline because he acknowledged that ESL management had produced a forecast showing that ESL could be fully utilized by 2014 and has considered expanding the pipeline.[584] However, ESL asserted how Mr. Jervis explained that a similar management forecast had previously predicted that the Southern Lights Pipeline would be fully utilized by 2010.[585] ESL pointed out that the pipeline was only about 25% utilized in 2010,[586] even with the ship-or-pay obligations of the Committed Shippers under which they paid for transportation of volumes in excess of those that actually moved.

B. Committed Shippers

281. Committed Shippers took no position on this issue, and noted that for both the 2010 period and the 2011 period, both Enbridge's and Staff's cost of equity, when applied to proper throughput determinants and Opinion No. 154-B methodology, result in a finding that Enbridge's filed 2010 and 2011 rates are just and reasonable.

C. Indicated Shippers

282. Indicated Shippers asserted that the appropriate ROE for ESL is 9.00% real ROE and 10.5% nominal ROE, as demonstrated by the testimony of Ms. Crowe.[587]

283. Indicated Shippers noted that similar to the Commission's policy on capital structure, Commission policy and precedent with respect to ROE requires the use of a

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[582] *See* ESL-24 at 12-16.

[583] *See* ESL-30 at 19-20.

[584] *See* IS I.B. at 25.

[585] *See* Tr. at 127:18-21 ("Again, if you look at the forecast that we showed, it was indicated that basically by 2014, if you look at the forecast before, it was supposed to be 2010. Things change frequently.").

[586] Movements in 2010 averaged about 47,000 bpd, out of a total capacity of 180,000 bpd. Tr. at 170:21-22 (Jervis).

[587] Exh. IS-4(Updated) at 3, line 13, and at 7, lines 3-4; Exh. IS-6; Exh. IS-1 at 7.

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ROE that reflects the risk of the regulated enterprise.[588] Accordingly, a proxy group of oil pipeline surrogates similar in business risk is used to determine a range of ROE, and unless compelling circumstances are shown, the Commission will typically use the median ROE in the range.

284. In this proceeding, Indicated Shippers argued that it is undisputed that ESL's business risk has been shifted elsewhere, thereby reducing the pipeline's risk. According to Indicated Shippers, this fact is in striking contrast to ESL's erroneous claim to the contrary that ESL is a very high risk pipeline and therefore should be afforded a ROE at the top end of the range.

285. Indicated Shippers asserted that ESL has failed to meet its burden of proof to show by compelling evidence that the pipeline's risk merits any other placement than at the median of the range of the proxy group. For purposes of establishing an initial uncommitted rate for ESL, Indicated Shippers believed that ESL should be placed at the median of the range of oil pipelines in the proxy group if capacity is used for rate design, and at the low end if design capacity is not used. Indicated Shippers explained that use of the median reflects the fact that ESL has a business risk comparable to the mid-range of reasonably similar liquids pipelines, under the circumstances where rates for uncommitted service are derived using design capacity.[589]

286. Despite ESL's repeated claims to the contrary, Indicated Shippers argued that the Commission has never made any finding that ESL is a "high risk" pipeline, and ESL has failed to sustain its burden of proof to show that any deviation from the median ROE is warranted.

287. Indicated Shippers noted that in the Declaratory Order proceeding, it is true that the Commission stated that it "finds here that several factors support Enbridge Southern Lights' request for an ROE at the upper end of the range of reasonableness . . ."[590] However, Indicated Shippers explained that the Commission also specifically held that it would "not approve a specific ROE in this proceeding. Instead, Enbridge Southern Lights must propose and support the ROE or the range it believes is necessary when it files to implement its actual initial rates."[591] Thus, despite ESL's and its witnesses' repeated claims to the contrary, Indicated Shippers argued that the Commission has never made any finding that ESL is a "high risk" pipeline, and there is no Commission finding or ruling that controls the determination here of the appropriate ROE for ESL.

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[588] *Williams Pipe Line Company*, Opinion No. 154-B, 31 FERC ¶ 61,377, at 61,834.

[589] Exh. IS-8 at 44.

[590] Declaratory Order at P 18.

[591] *Id.* (footnote omitted) (citing *Colonial Pipeline Co.*, 116 FERC ¶ 61,078, at PP 59-60 (2006)).

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288. According to Indicated Shippers, ROE is a forward-looking concept, and therefore, the assessment of risk must also be forward looking. Indicated Shippers pointed out that the pipeline has already been constructed, and with respect to the risk of the pipeline not being built, as ESL witness Jaffe agrees, no party currently bears that risk.[592] Indicated Shippers noted that the only regulatory risk faced by ESL is the possibility that its proposed rates will be reduced to just and reasonable levels by the Commission.

289. Indicated Shippers stated that in the Declaratory Order, the Commission did not explicitly consider the fact that ESL had transferred the risk of underrecovery to the Committed Shippers through the TSA, thus significantly reducing the pipeline's risk. Indicated Shippers noted that ESL witness Jaffe has acknowledged that the vast majority of the risks listed in the Declaratory Order are borne by the Committed Shippers and not ESL.[593]

290. According to Indicated Shippers, the facts indicate that ESL is a monopoly pipeline not subject to significant or meaningful competition. Indicated Shippers asserted that the only company witness in the case, Mr. Jervis, confirmed a number of facts that flatly contradict the testimony of ESL's outside expert Earnest with regard to the level of competition and risk faced by ESL. Some of these facts include that ESL is the only pipeline bringing diluent from the United States into Alberta, Canada,[594] contrary to Earnest's position that ESL faces significant competition, and Mr. Jervis also stated that Chicago, the origin point of ESL, is a very good hub for diluent,[595] contradicting Earnest's position denying that Chicago is a good hub and therefore that the supply risk is high.

291. As to the risk of underutilization and underrecovery, Indicated Shippers explained that Mr. Jervis admitted that ESL's management forecast in 2010 was that ESL could be full by 2014[596] and that management is therefore presently considering expanding the pipeline by a significant amount, 33%.[597] Indicated Shippers noted that Mr. Jervis stated that an expansion of ESL "might be required."[598]

292. According to Indicated Shippers, Mr. Jervis also contradicted ESL's expert Earnest with respect to operational risk; he stated that while the pipeline does not now

[592] Tr. 90.
[593] Tr. 91.
[594] Tr. 116
[595] Tr. 121
[596] Tr. 127
[597] Tr. 113; Exh. IS-45.
[598] Tr. 131.

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operate continuously because it cannot presently meet the minimum flow requirements for such operation, it operates on a start/stop basis which assures that daily deliveries flow as required by operating continuously for a period of time such as twelve hours or two days and then by stopping for a period of time to get the daily flow desired.[599] Indicated Shippers asserted that Mr. Jervis flatly contradicted ESL's expert's written testimony that ESL "never will" deliver on a continuous basis, stating, "No, that's not a true statement."[600]

293. According to Indicated Shippers, cross-examination of ESL witness Earnest elicited admissions that support the position of Indicated Shippers witness Dr. Safir that ESL has average risk. Indicated Shippers noted Mr. Earnest's statement that he does not dispute that there are now or will be ample supplies of diluent available in PADD 2, as of today and it should not change in 2014.[601] Indicated Shippers pointed out Mr. Earnest's agreement that the largest Canadian heavy crude oil deliveries in the United States, a major source of diluent supply, are to PADD 2.[602] According to Indicated Shippers, Mr. Earnest ultimately acknowledged that, "As you move through time, it's my judgment that the need — the market need for a diluent transmission pipeline like the Southern Lights facility will likely increase."[603]

294. Indicated Shippers stated that the focus of the ROE determination should be on the risk faced by ESL, the regulated enterprise, but ESL witnesses Jaffe, Fairchild, and Webb state that the focus should be on the riskiness of the pipeline "project."[604] Consistent with Commission policy and precedent, Indicated Shippers argued that the uncommitted rate must be based on only the current risk faced by the pipeline, and to take into account other risks would result in providing additional value beyond the valuable consideration already received by the Committed Shippers under the TSAs. Indicated Shippers noted Dr. Fairchild's agreement that, as general proposition, it is a precept of ratemaking that a pipeline's rate of return should be a function of the risk that is borne by the pipeline itself, although he asserted that this particular case is different.[605] In fact, Indicated Shippers stated that Dr. Fairchild admitted that he is not aware of any Commission precedent involving other oil pipelines where the Commission's determination of a reasonable rate of return for the pipeline included the consideration of risks not borne by the filing pipeline.[606]

[599] Tr. 131-32.
[600] Tr. 132.
[601] Tr. 150-51.
[602] Tr. 148.
[603] Tr. 141-42.
[604] *See, e.g.*, Tr. 95, 243; Exh. IS-20 at 9.
[605] Tr. 193.
[606] Tr. 197.

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295. Similarly, Indicated Shippers cited to Dr. Webb's statement that he was not aware of a circumstance in which the Commission has taken into account the profits of one shipper in setting the rates for another set of shippers.[607] Nor was Dr. Webb able to provide any precedent where the Commission has taken into account the risks of other shippers when setting the rates to be charged another set of shippers.[608]

296. In sum, Indicated Shippers argue that ESL has failed to meet its burden of proof to show that ESL is a high-risk pipeline. Indeed, Indicated Shippers believed that the deliberate transfer of risk to the Committed Shippers under the TSAs shows that ESL is in several significant respects less risky than the average oil pipeline in the proxy group. Indicated Shippers stated that ESL wants to choose selectively the elements of the TSAs that ESL would apply to the determination of the uncommitted rate. Indicated Shippers noted that ESL desires that the two-to-one ratio of the TSA apply to the determination in the first instance of the uncommitted rate, yet ESL does not want the transfer of risk under the TSAs to be reflected in the ROE. To be consistent, therefore, Indicated Shippers called for the transfer of risk under the TSAs to be recognized and applied. However, Indicated Shippers took the position that the TSA does not apply to the derivation of the uncommitted rate, and, therefore, to be consistent, although there is ample evidence showing that ESL is less risky, Indicated Shippers accept the use of the median of the range of ROE, even though that is more favorable to the pipeline, provided that design capacity is also used for ESL's throughput.

297. For the same reasons regarding Docket No. IS10-399-003, Indicated Shippers' position for Docket No. IS11-146-000 is that the appropriate cost of equity is 9.00% real and 10.5% nominal.[609]

D. Trial Staff

298. According to Trial Staff, witness Alvarez presents a comprehensive analysis of the appropriate cost of equity in his answering testimony.[610] Trial Staff asserted that neither ESL nor the Indicated Shippers seriously challenged the technical details of his analysis, presumably because the more important issues involved the placement of the rate of return on equity within the range of reasonableness and which entity should be the focus of the analysis. In this regard, Trial Staff noted that a seminal issue bearing directly on the appropriate cost of equity is whether the Commission-approved TSAs should be taken into account in determining the Opinion No. 154-B uncommitted rate and, if so, to what extent. As discussed earlier in this brief, Trial Staff's position is that the TSA provisions should be fully taken into account to the extent they are not inconsistent with Opinion

[607] Tr. 259.

[608] Tr. 259-60.

[609] Exh. IS-3A (Supp.) at 3, line 13, Exh. IS-6; Exh. IS-1 at 7.

[610] Exh. S-10 at 6-23 (Alvarez).

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No. 154-B and Part 346 of the Commission's regulations. Mr. Alvarez's analysis reflects this position by recognizing the risk-shifting and risk-reducing features of the TSAs.

299. Trial Staff asserted that there is no dispute among the participants in this proceeding that the existence of the TSAs shifts most of the risk of the Southern Lights Pipeline project from ESL to the Committed Shippers.[611] Trial Staff believed that it follows that ESL, the jurisdictional pipeline company whose rates are at issue in this proceeding, has a very low cost of equity. As a result, after deriving the range of reasonableness for the cost of equity, Mr. Alvarez concluded that ESL's very low risk made it appropriate to place its cost of equity at the bottom end of the range.[612]

300. Trial Staff explained that Mr. Alvarez employed the DCF approach, the Commission's preferred methodology, in deriving the range of reasonableness for ESL's cost of equity.[613] In accordance with the Commission's traditional practice, he first selected a group of six proxy companies that satisfied various criteria specified by the Commission in past decisions.[614] In the process, he also excluded three companies from consideration because they failed to meet these criteria.[615]

301. Trial Staff noted that after Mr. Alvarez selected a proxy group of six companies, he applied the Commission's DCF model to each of the proxy group companies to develop a range of reasonableness of 9.15% to 12.92% using data for the six months ending June 30, 2011.[616] As noted above, most of ESL's risk associated with the Southern Lights Pipeline project was shifted to the committed shippers by the terms of the TSAs, which eliminate the risk that ESL will under collect its cost-of-service for fifteen years. As a result, Trial Staff stated Mr. Alvarez's conclusion that ESL was "much less risky" than the pipelines in his proxy group.[617] Therefore, Mr. Alvarez recommended that the nominal cost of equity for ESL should be 9.15% – the bottom end of his range of reasonableness.[618]

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[611] *See, e.g.,* Exh. Nos. IS-1 at 13 (Crowe), IS-33 at 10 (Crowe), IS-8 at 33 (Safir), IS-40 at 8-9 (Safir), ESL-20 at 8 (Fairchild), and ESL-29 at 3 (Fairchild).

[612] Exh. S-10 at 21 (Alvarez).

[613] *Id.* at 9.

[614] *Id.* at 10-12.

[615] *Id.* at 13.

[616] *Id.* at 14-20 (Alvarez). Enbridge Southern Lights relies on a somewhat different proxy group of companies and obtains a range of reasonableness of 9.10% to 11.13% (Exh. ESL-20 at 24) (Fairchild), and the Indicated Shippers rely on Enbridge Southern Lights' proxy group of companies and update the data to obtain an 8.76% rate of return on equity for the bottom end of the ranges (Exh. IS-1 at 13) (Crowe).

[617] Exh. S-10 at 21 (Alvarez).

[618] *Id.*

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302. Trial Staff explained the Commission's longstanding policy on the placement of the allowed rate of return on equity within a range of reasonableness is to assume, unless demonstrated otherwise, that the risks of pipelines fall within the "broad middle range" such that the selection of the median rate of return on equity is justified. That justification is grounded in the Commission's recognition the available risk tools are not precise enough to enable it to make "carefully calibrated adjustments . . . to reflect the generally subtle differences in risk among pipelines."[619] Therefore, unless "a very persuasive case" is made, Trial Staff noted that "the Commission will set the pipeline's return at the median of the range of reasonable returns."[620] In this case, however, Trial Staff's position is that the risk-reducing and risk-shifting features of the TSAs persuasively establish that the cost of equity (allowed rate of return on equity) for ESL should be set at the bottom end of Trial Staff's range of reasonableness because most of its business risk has been shifted to the Committed Shippers by the TSAs.

303. According to Trial Staff, under the trended original cost methodology applicable to oil pipelines, it is the real rate of return on equity (nominal less inflation) that is applied to the equity rate base to determine the revenue requirement. As a result, Mr. Alvarez derived a real cost of equity of 5.59% by subtracting the annual inflation rate of 3.56% for the year ending June 2011 from the 9.15% nominal cost of equity.[621]

304. With respect to the cost of equity, there is not much disagreement between Trial Staff and the Indicated Shippers since both generally conclude that the cost of equity should be set at the bottom end of the range of reasonableness to reflect Enbridge Southern Lights' low risk.[622] However, Trial Staff noted that the Indicated Shippers' conclusion in this respect is inconsistent with their initial position that the TSAs should not be taken into account. If the TSAs did not exist, the risk of the Southern Lights Pipeline project would not have been shifted to the Committed Shippers, and the risk of ESL would have been such that selecting a cost of equity at the bottom end of the range of reasonableness would have been unreasonable. Indeed, Trial Staff noted ESL's statement that it would have been too risky to finance the pipeline project without the support of the TSAs.[623]

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[619] *Northwest Pipeline Corp.*, 92 FERC ¶ 61,287, at 62,006 (2000).

[620] *Id.*

[621] Exh. S-10 at 20-21; Exh. S-11 at 1 (Alvarez). In deriving the real rate of return on equity, both Enbridge Southern Lights and the Indicated Shippers used an inflation factor of 1.5%. However, it appears as if that rate is based on 2010 data (*see, e.g.*, Exh. Nos. ESL-13, Statement E2 (Webb) and IS-3 (Updated) at 12, Workpaper 10 (Crowe)), while Trial Staff witness Alvarez' inflation rate of 3.56% is based on the year ending June 2011 (Exh. S-10 at 22-23 (Alvarez)).

[622] *See*, *e.g.,* Exh. IS-40 at 8-9 (Safir).

[623] *See, e.g.,* Exh. ESL-10 at 7-8 and ESL-11 at 6 (Webb).

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305. Trial Staff noted that the Indicated Shippers presented testimony that the Southern Lights Pipeline has "minimal market risks" and could be operating at full capacity in a few years and that this prospect places ESL in a low risk category.[624] However, in its rebuttal testimony, Trial Staff explained that ESL comes to the opposite conclusion and explains that one cannot reasonably assume that the throughput for ESL will reach the maximum capacity of the pipeline in the near term.[625] As a result, because such an assumption appears unreasonable, Trial Staff disagreed with Indicated Shippers' position that the initial rate for the uncommitted shippers should be based on a cost of equity for ESL at the median of the range of reasonableness as long as the throughput is set at maximum capacity.[626]

306. Trial Staff proposes the same cost of equity for Enbridge Southern Lights in both dockets. Therefore, its discussion of the issue under Docket No. IS10-399-003, above, applies to Docket No. IS11-146-000 as well.

307. Trial Staff's Post-Hearing Reply Brief noted that ESL engaged in a different kind of rate of return analysis than either Trial Staff or the Indicated Shippers and concluded that the cost of equity should be at the high end of the range of reasonableness. Specifically, rather than focusing on the risk of the jurisdictional pipeline company, as is uniformly done in a rate case, Trial Staff pointed out that ESL focused on the risk of the Southern Lights Pipeline project, which reflects the risks of both ESL and the Committed Shippers, BP and Statoil. As a result, Trial Staff believed that it is a matter of apples versus oranges to compare Trial Staff's analysis with the analysis done by ESL. Indeed, the two analyses need to be considered in their own particular context. In other words, Trial Staff used the Commission-approved 2:1 ratio between uncommitted and Committed Shippers for its rate design, while ESL employed a different rate design. According to Trial Staff, the end result, as noted in Trial Staff's Initial Brief at 48, is that both Trial Staff and ESL both conclude that the Opinion No. 154-B uncommitted rate is above that of the TSAs' uncommitted rate.

308. Trial Staff offered a few observations regarding ESL's rate of return approach, stating that Dr. Fairchild's view is an *ex-post facto* interpretation of what the Commission actually said in the declaratory order. While the Commission refers, among other things, to "the size and scope of the multistate and international project," it does not refer specifically to the Southern Lights Pipeline.[627] Instead, it refers only to ESL, the filing, jurisdictional pipeline company.

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[624] Exh. IS-8 at 23 (Safir) and IS-33 at 24 (Crowe).

[625] *See, e.g.*, Exh. ESL-30 at 2-4 (Earnest).

[626] For purposes of this recommendation, which relies on the unreasonable throughput assumption, it appears as if the Indicated Shippers are not taking the TSAs into account.

[627] *Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,310, at P 18

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309. Trial Staff stated that even though the Commission approved the TSAs in the declaratory order, the Commission's discussion does not take cognizance of the risk-reducing and risk-shifting provisions of the TSAs – something that no participant in this proceeding questions. In addition, while the Commission bases its discussion on what it said in the *Colonial* case,[628] it appears as if the risk-related facts in that case are different from those in this proceeding. Specifically, Trial Staff argued that it does not appear as if the shippers in the *Colonial* case had entered into an arrangement similar to the TSAs in this proceeding.[629] In any event, Trial Staff noted that Dr. Fairchild did not know whether that was the case or not.[630]

310. In Trial Staff's view, regardless of the Commission's meaning by its comments in the Declaratory Order, it would not be reasonable to conclude that the Commission had endorsed ESL's novel rate of return approach in this proceeding. At that early stage, Trial Staff explained that the Commission would not have known what particular approach ESL was going to pursue in a future rate case.

311. According to Trial Staff, while ESL takes the TSAs into account in parts of its overall analysis of the uncommitted rate, its approach of looking at the total risks of the Southern Lights Pipeline removes the relevance of the TSAs in this part of its analysis. Significantly, ESL's analysis does not result in an estimate of the cost of equity to ESL, the filing, jurisdictional pipeline company. As a result, ESL's witness finds that the Southern Lights Pipeline, which reflects the risks borne by both ESL and the Committed Shippers, is a very risky enterprise and thus warrants a cost of equity at the high end of the range of reasonableness.[631]

312. By contrast, Trial Staff witness, Mr. Alvarez, took the traditional route and focused on ESL, the filing, jurisdictional pipeline company. As Trial Staff noted in its Initial Brief, there is no dispute among the participants that the existence of the TSAs shifts most of the risk of the Southern Lights Pipeline project that ESL would otherwise assume to the Committed Shippers.[632] Indeed, the TSAs eliminate the risk that ESL will under collect its cost-of-service for fifteen years. In consideration of these facts, Trial Staff noted that Mr. Alvarez reasonably concluded that ESL was "much less risky" than

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(2007); *Order granting clarification and denying rehearing*, 122 FERC ¶ 61,170 (2008).

[628] *Id.*; *see also Colonial Pipeline Co.*, 116 FERC ¶ 61,078, at P 59 (2006); *Order denying reh'g*, 119 FERC ¶ 61,183 (2007).

[629] Tr. 194-95 (Fairchild).

[630] *Id.*

[631] ESL I.B. at 34-36.

[632] Trial Staff I.B. at 44 and 45 n.138.

the pipelines in his proxy group and recommended that the nominal cost of equity be set at 9.15% – the bottom end of his range of reasonableness.[633]

313. Nonetheless, while acknowledging Trial Staff's use of the Commission-approved 2:1 rate design ratio to set the uncommitted rate, Trial Staff noted that ESL still takes issue with Trial Staff's placement of the cost of equity at the bottom end of the range of reasonableness. In its view, ESL "has not been shown to have risks below those of an average pipeline."[634] However, Trial Staff explained that Commission's policy is to begin its risk analysis "with the assumption that pipelines generally fall into a broad range of average risk, absent highly unusual circumstances that indicate an anomalously high or low risk compared to other pipelines."[635] According to Trial Staff, the Commission later expanded on this theme by stating that "[i]n the instances where the Commission has deviated from the median to allow a return on equity adjustment, it has done so based on perceived forward-looking risk factors unique to the regulated entity and/or shortcomings in available proxy companies."[636]

314. Trial Staff noted that ESL's own witness, Dr. Webb, has referred to "the unique economic circumstances of the Southern Lights Pipeline . . ."[637] Trial Staff agreed with this assessment because the Commission-approved TSAs constitute a "game-changer" and make this case unique. Indeed, Trial Staff observed that no participant in this proceeding disagrees with the fact that the TSAs have shifted most of ESL's risk to the Committed Shippers for fifteen years. Trial Staff argued that this fact becomes even more compelling when one considers that the Southern Lights Pipeline represents ESL's sole asset. Because of these "unusual" and "unique" circumstances, Staff witness Alvarez, as noted above, concluded that ESL was "much less risky" than the pipelines in his proxy group. As a result, Trial Staff submitted that there is ample justification for deviating from the median and placing ESL's cost of equity at the bottom end of the range of reasonableness.

315. Trial Staff noted that the Indicated Shippers make two recommendations for the cost of equity. One is to set the cost of equity at the bottom end of the range of reasonableness if design capacity is not used to calculate rates, presumably because of the TSAs[638] – despite its original posture that no aspect of the TSAs should be taken into

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[633] Exh. S-10 at 21 (Alvarez).

[634] ESL I.B. at 36.

[635] *Transcontinental Gas Pipe Line Corp.*, 90 FERC ¶ 61,279, at 61,937 (2000) (footnote omitted).

[636] *BP Pipelines (Alaska) Inc.*, 123 FERC ¶ 61,287, at P 195 (2008) (footnote omitted).

[637] Enbridge Southern Lights Exh. ESL-44 at 1 (Webb).

[638] Indicated Shippers I.B. at 24; *see also* Exh. IS-8 at 42 ("Another factor that cannot be overlooked is the existence of Enbridge Southern Lights' TSAs.").

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account.[639] Trial Staff explained that Indicated Shippers' other position is to "accept" a cost of equity at the median of the range of reasonableness as long as the pipeline's design capacity is used in the calculation of rates.[640] However, as Trial Staff explained in its Initial Brief, this latter position is not supportable because it is dependent on an entirely unreasonable assumption – that rates should be calculated based on throughput at maximum capacity.[641] Moreover, Trial Staff also explained in its Initial Brief why the Indicated Shippers' five policy arguments for using design capacity to calculate rates are all without merit.[642]

Findings and Conclusions

316. The Commission's preferred methodology in deriving the range of reasonableness for the cost of equity is the DCF approach, which Trial Staff witness Alvarez used. Trial Staff noted that Mr. Alvarez applied the Commission's DCF model to each of the proxy group companies he selected and developed a range of reasonableness of 9.15% to 12.92% using data for the six months ending June 30, 2011.

317. Indicated Shippers believes that ESL should be placed at the median of the proxy group range if capacity is used for rate design and at the low end if design capacity is not used. ESL argued for using the high end of the proxy group range. Trial Staff asserts that ESL should be set at the bottom end of the proxy group range.

318. Trial Staff explained that Commission's policy is to begin its risk analysis "with the assumption that pipelines generally fall into a broad range of average risk, absent highly unusual circumstances that indicate an anomalously high or low risk compared to other pipelines."[643] According to Trial Staff, the Commission later expanded on this theme by stating that "[i]n the instances where the Commission has deviated from the median to allow a return on equity adjustment, it has done so based on perceived forward-looking risk factors unique to the regulated entity and/or shortcomings in available proxy companies."[644] The question to be addressed here then is whether the evidence of record in this proceeding supports a deviation from the median and, if so, to what extent.

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[639] *See*, *e.g.*, Exh. IS-1 at 6 ("No aspect of Enbridge Southern Lights' TSAs with its committed shippers will be applicable to rates for uncommitted service.").

[640] Indicated Shippers I.B. at 24.

[641] Trial Staff I.B. at 49-50.

[642] *Id.* at 68-75.

[643] *Transcontinental Gas Pipe Line Corp.*, 90 FERC ¶ 61,279, at 61,937 (2000) (footnote omitted).

[644] *BP Pipelines (Alaska) Inc.*, 123 FERC ¶ 61,287, at P 195 (2008) (footnote omitted) citing

319. The Indicated Shippers make two recommendations for the cost of equity. One is to set the cost of equity at the bottom end of the range of reasonableness if design capacity is not used to calculate rates, presumably because of the lower risk to ESL associated with the TSAs – despite its otherwise consistent position that no aspect of the TSAs should be taken into account. Their other recommendation is to "accept" a cost of equity at the median of the range of reasonableness but only if the pipeline's design capacity is used in the calculation of rates. However, as Trial Staff explained in its Initial Brief, this latter position is not supportable because it is dependent on an entirely unreasonable assumption – that rates should be calculated based on throughput at maximum capacity. Moreover, Trial Staff has also persuasively explained in its Initial Brief why the Indicated Shippers' five policy arguments for using design capacity to calculate rates are all without merit.

320. ESL argues that the Declaratory Order has already determined that the Southern Lights Pipeline is "high risk" and warrants an ROE from the high end of the range. This argument is not supportable. The Commission's Declaratory Order does state that it "finds here that several factors support Enbridge Southern Lights' request for an ROE at the upper end of the range of reasonableness . . ."[645] However, as noted by Trial Staff and the Indicated Shippers, the Commission also specifically held that it would "not approve a specific ROE in this proceeding. Instead, Enbridge Southern Lights must propose and support the ROE or the range it believes is necessary when it files to implement its actual initial rates."[646] Accordingly, there is no prior Commission finding or ruling that controls the determination of the appropriate ROE in this proceeding as advanced by ESL. Rather, consistent with Commission policy, it will be assumed that ESL falls into a broad range of average risk "… absent highly unusual circumstances that indicate an anomalously high or low risk compared to other pipelines."[647]

321. While ESL has provided persuasive support for its contention that it would have been too risky to finance the pipeline project without the TSAs,[648] it can not be denied that once having been secured the TSAs eliminated the risk that ESL will under collect its cost-of-service for fifteen years, thereby shifting most of ESL's business risk to the Committed Shippers. Indeed, rather than focusing on the risk of the jurisdictional pipeline company, as is uniformly done in a rate case, ESL focused on the risk of the Southern Lights Pipeline *project*, which reflects the risks of both ESL and the Committed

[645] Declaratory Order at P 18.

[646] *Id.* (footnote omitted) (citing *Colonial Pipeline Co.*, 116 FERC ¶ 61,078, at PP 59-60 (2006)).

[647] *Transcontinental Gas Pipe Line Corp.*, 90 FERC ¶ 61,279, at 61,937 (2000) (footnote omitted).

[648] *See, e.g.,* Exh. Nos. ESL-10 at 7-8 and ESL-11 at 6 (Webb).

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Shippers, acknowledging that, "The overall return must reflect the fact that the Committed Shippers have borne most of the risk of the pipeline to date . . ."[649]

322. Given the lower forward-looking risk for ESL's jurisdictional operations due to the TSAs, which provide that the Committed Shippers will be bearing the responsibility for ensuring the pipeline's collection of its cost-of-service, I must concur with Trial Staff's position that ESL's business risk is much less than the pipelines in the proxy group it was compared to in the DCF analysis; therefore, I concur that the nominal cost of equity should be set at 9.15% – the bottom end of the range of reasonableness.

Issue #9: What is the appropriate income tax allowance?

A. ESL

323. ESL noted that the parties' positions on income tax allowance are set forth in the table below, and that the numerical differences regarding income tax allowance arise solely from differences in equity return, which are addressed, *supra*.

Party	*Witness*	*Source*	*2010*	*2011*
ESL	Dr. Webb	ESL-55 and 56, Stmt D	$75.0 million	$76.3 million
Trial Staff	Ms. Sherman	S-2 and S-3, Stmt D	$27.5 million	$27.7 million
Indicated Shippers	Ms. Crowe	IS-4 (Updated), Stmt D and IS-3A Supp., Stmt D	$26.3 million	$25.8 million

B. Committed Shippers

324. Committed Shippers took no position on this issue, and for both the 2010 period and the 2011 period, both Enbridge's and Staff's income tax allowance, when applied to proper throughput determinants and Opinion No. 154-B methodology, result in a finding that Enbridge's filed 2010 and 2011 rates are just and reasonable.

C. Indicated Shippers

325. Based upon Indicated Shippers witness Crowe's cost-of-service, the appropriate amount of income tax allowance is $26,347,000.[650] Indicated Shippers noted that they have not contested the federal income and state income tax rates in Ex. ESL-55

[649] ESL I.B. at 30.
[650] Exh. IS-4(Updated) at 1, line 2.

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(Statement D), an attached exhibit to the Rebuttal Testimony of ESL witness Webb. However, Ms. Crowe has applied them to her cost-of-service model.

326. For Docket No. IS11-146-000, Indicated Shippers propose an income tax allowance of $25,787,000.[651] Indicated Shippers do not contest the federal income and state income tax rates in Ex. ESL-56 (Statement D), an attached exhibit to the Rebuttal Testimony of ESL witness Webb. However, Ms. Crowe applies them to her cost-of-service model.

D. Trial Staff

327. According to Trial Staff, the appropriate income tax allowance for ESL for the 2010 rate period is $27,460,000,[652] and Statement D in Exhibit No. S-2 shows how Ms. Sherman derived this figure.[653] Trial Staff noted that the income tax allowance is primarily a function of Trial Staff's recommended return on equity and federal and state income tax rates.[654] Ms. Sherman used the marginal federal corporate income tax rate of 35.00% and a state income tax rate of 8.87% (resulting in a composite income tax rate of 40.77%).[655]

328. Trial Staff explained that the differing levels of equity return proposed by the three participants account for most of the difference among them on the income tax allowance issue, and the remaining difference relates to the state income tax rate. Trial Staff accepted the 8.52% state income tax rate developed by ESL for the 2010 rate period. Trial Staff mistakenly used the 8.87% rate developed by the pipeline for the 2011 rate period,[656] rather than the 8.52% rate, for the 2010 rate period. Furthermore, Trial Staff noted that while the Indicated Shippers also used the 8.87% state income tax rate for the 2010 rate period, they indicated in the Joint Statement of Issues, filed on December 20, 2011, that they would not contest the income tax rates used in Dr. Webb's Exhibit No. ESL-55, Statement D.[657]

329. For Docket No. IS11-146-000, Trial Staff explained that the appropriate income tax allowance for ESL for the 2011 rate period is $27,693,000.[658] Statement D in Exhibit No. S-3 shows how Ms. Sherman derived this figure.[659] The income tax allowance is

[651] Exh. IS-3A (Supp.) at 1, line 2.
[652] Exh. S-2 (rev. Jan. 11, 2012) at 2, Statement A, line 2 (Sherman).
[653] *Id.,* at 5, Statement D.
[654] *Id.* at lines 3, 9, and 10.
[655] *Id.* at lines 9-11.
[656] Exh. ESL-56 (rev. Dec. 27, 2011), Statement D, line 10 (Webb).
[657] Joint Statement of Issues, at 9 (Dec. 20, 2011).
[658] Exh. S-3 (rev. Jan. 11, 2012) at 2, Statement A, line 2 (Sherman).
[659] *Id.* at 5, Statement D.

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primarily a function of Trial Staff's recommended return on equity and federal and state income tax rates.[660] Ms. Sherman used the marginal federal corporate income tax rate of 35.00% and a state income tax rate of 8.87% (resulting in a composite income tax rate of 40.77%).[661]

330. Trial Staff noted that ESL proposes an income tax allowance of $76,308,000 for the 2011 rate period.[662] It bases the allowance on its proposed return on equity, and the same federal income tax rate of 35%, and state income tax rate of 8.87% (resulting in a composite income tax rate of 40.77%) as Trial Staff.[663]

331. According to Trial Staff, in response to Dr. Webb's testimony, the Indicated Shippers proposed an income tax allowance of $25,787,000.[664] Trial Staff noted that Indicated Shippers also based this allowance on their proposed return on equity, and the same federal income tax rate of 35%, and state income tax rate of 8.87%, resulting in a composite income tax rate of 40.77%.[665]

Findings and Conclusions

332. Trial Staff and ESL correctly noted that the parties' differences regarding income tax allowance arise solely from differences in equity return and its associated components.

Issue #10: What is the appropriate level of operating expenses?

A. ESL

333. ESL submitted a table setting forth the parties' positions on the level of operating expenses:

[660] *Id.* at lines 3, 9, and 10.
[661] *Id.* at lines 9-11.
[662] Exh. ESL-56 (rev. Dec. 27, 2011), Statement A, line 2 (Webb).
[663] *Id.* at Statement D, lines 9-11.
[664] Exh. IS-3A (Supplement) at 1, Statement A, line 2 (Crowe).
[665] *Id.* at 4, Statement D, lines 9-11.

Party	*Witness*	*Source*	*2010*	*2011*
ESL	Dr. Webb	ESL-55 and ESL-56, Stmt B	$19.0 million	$29.6 million
Trial Staff	Ms. Sherman	S-2 and S-3, Stmt B	$19.1 million	$29.5 million
Indicated Shippers	Ms. Crowe	IS-4 (Updated), Stmt B and IS-3A Supp., Stmt B	$29.9 million	$22.9 million

334. According to ESL, because the 2010 period at issue is locked-in, the appropriate basis for operating expenses is actual costs, as recognized by both ESL and Trial Staff. ESL noted that Trial Staff's calculation reflects slightly higher power costs due to their throughput assumption of 77,000 bpd in the locked-in period rather than the actual throughput transported.[666] By contrast, ESL explained that the Indicated Shippers' proposed level of operating expenses is based on projected costs. Although the projected cost figure used by the Indicated Shippers would increase the overall cost-of-service for that period, ESL nonetheless believes that it is conceptually more appropriate to use actual costs for the locked-in 2010 period. ESL stated that the higher projected costs were for a 12-month period, five months of which fell outside of the locked-in period, and to the extent the projected costs did not fully materialize in the locked-in period, there is no reason to include them in the Uncommitted Rate for that period. Moreover, ESL argued that the actual costs also tie to the actual throughput in the 2010 locked-in period, which is appropriate because ESL would not have attracted any greater throughput during that period even if the tariff rates had been lower.[667]

335. For 2011, ESL asserted that Dr. Webb accepts Ms. Sherman's operating expense figures, which make certain test period adjustments. According to ESL, Indicated Shippers propose a level of operating expenses that is far too low. Despite the fact that the Indicated Shippers were provided updated costs through June and that Commission regulations clearly require the use of normalizing and test year adjustments to actual data where appropriate,[668] Ms. Crowe used actual costs through April without any test-period adjustments.[669] According to ESL, agreement between ESL and Trial Staff on the normalizing and test-year adjustments for 2011 confirms that those adjustments are reasonable and should be applied here.

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[666] S-2 at Statement B.

[667] *See* ESL-27 at 13.

[668] *See* 18 C.F.R. § 346.2(a).

[669] *See* IS-1 at 12.

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336. With respect to litigation costs, ESL and Trial Staff stipulated to the use of actual litigation costs for 2011.[670] ESL stated that the resulting litigation cost figure of $1.41 million is less than the estimated total costs amortized over three years as calculated by Dr. Webb, and is therefore a conservative figure.[671] ESL argued that 2011 is now a locked-in period, so it is appropriate to use the actual costs for the period. According to ESL, the Indicated Shippers' proposal to amortize the litigation costs incurred in one year over a multi-year period not only seriously understates the litigation costs recoverable in this case, but also conflicts with the Commission's relevant ruling in Opinion No. 511.[672]

B. Committed Shippers

337. Committed Shippers took no position on this issue, and note that Enbridge and Staff have stipulated to operating expenses of the 2011 period. Committed Shippers explained that for both the 2010 period and the 2011 period, both Enbridge's and Staff's operating expenses, when applied to proper throughput determinants and Opinion No. 154-B methodology, result in a finding that Enbridge's filed 2010 and 2011 rates are just and reasonable.

C. Indicated Shippers

338. Indicated Shippers noted that the appropriate level of operating expenses is $29,867,000,[673] and this figure is based on ESL's revised September 2010 estimated operating costs.[674] Indicated Shippers argued that, consistent with their approach throughout this case, this figure is derived from ESL projections contemporaneous to the commencement of service. Indicated Shippers noted that this approach is required by the Commission's regulations,[675] and, as described *supra*, avoids the risk of using an aberrant figure for future indexing calculations. Indicated Shippers also mentioned that ESL's assertion that "actual costs also tie to actual throughput,"[676] overstates the effect of throughput variations on operating costs, when the throughput level is in fact only related to the costs of fuel and power, which only constitute about 1% of the total cost-of-service.[677]

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[670] *See* ESL-44 at 57.

[671] *Id.*

[672] *SFPP, L.P.*, 134 FERC ¶ 61,121, at PP 35-37 (2011) ("Opinion No. 511"); ESL-44 at 58.

[673] Exh. IS-4(Updated) at 1, line 3; and 2, line 17; Exh. IS-1 at 7.

[674] Exh. IS-1 at 7.

[675] 18 C.F.R. § 346.2(a)(3)

[676] *See* ESL I.B. at 37.

[677] Exh. IS-4(Updated) at 12, line 78.

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339. For Docket No. IS11-146-000, Indicated Shippers witness Crowe calculated a level of operating expenses of $22,939,000 using the actual data available as of April 30, 2011, the latest date as of which she possessed actual data at the time of her Answering Testimony.[678] However, Indicated Shippers noted that they would accept the use of actual data through June 30, 2011, in a compliance filing, with no further "test period" adjustments. According to Indicated Shippers, if speculative future "normalizing" cost increases are permitted to be made to rates which are then changed again in January 2012, ESL will almost certainly over-collect, and only Committed Shippers will benefit from any refund or rebate.

340. Indicated Shippers stood by the testimony of witness Crowe to the effect that litigation expenses should be amortized over a five-year period, notwithstanding Staff's criticism.[679] Indicated Shippers asserted that Commission policy supports amortization of litigation expenses over some time frame, as Staff appears to recognize or at least does not dispute.[680] Indicated Shippers noted that the portion of Ms. Crowe's testimony that does not call for amortization involved a rebuttal of ESL witness Dr. Webb's approach on an apples-to-apples basis, substituting Ms. Crowe's figures to demonstrate a disparity.[681] Indicated Shippers clarified that Ms. Crowe was not adopting or proposing a conflicting methodology and that Staff mistakes Ms. Crowe's testimony.

D. Trial Staff

341. Trial Staff stated that the appropriate level of operating expenses, less depreciation expense, which is addressed separately, for ESL for the 2010 rate period is $19,095,000.[682] As explained by Ms. Sherman, Trial Staff based the level of operating expenses on ESL's actual expenses for the seven-month locked-in period in Docket No. IS10-399-003, annualized to make a twelve-month test period.[683]

342. Trial Staff noted agreement with ESL on the level of all operating expenses except power costs. Trial Staff explained that the pipeline's power costs vary depending on throughput.[684]

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[678] *See* IS I.B. at 42; Exh. IS-3A(Supp.) at 1, line 3.

[679] *See* Staff I.B. at 95.

[680] *See id.*; *see also* Exh. IS-33 12-13 (citing *Kern River Gas Transmission Co.*, Opinion No. 486, 117 FERC ¶ 61,077, at PP 277-280 (2006); Portland Natural Gas Transmission System, Opinion No. 510, 134 FERC ¶ 61,129, at PP 101-111 (2011)).

[681] Exh. IS-1 at 13 ("[T]his rate is only derived for comparative purposes.").

[682] Exh. S-2 (rev. Jan. 11, 2012) at 3, Statement B, line 17 (Sherman).

[683] Exh. S-1 (rev. Jan. 11, 2012) at 9 (Sherman).

[684] Exh. ESL-7 at 64 n.28 (Webb).

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343. Trial Staff witness McComb adjusted the pipeline's power costs to $2,054,000, calculated with a recommended throughput of 77,000 barrels per day, annualized to 28,105,000 barrels per year [685] Witness McComb based this amount on the pipeline's schedule of power costs for her recommended level of throughput.[686] ESL witness Webb, on the other hand, recommends use of throughput of only 41,561 barrels per day, or approximately 15,170,000 barrels per year.[687] Trial Staff noted that witness Webb therefore proposes a correspondingly lower level of powers costs – $1,943,000.[688]

344. According to Trial Staff, the Presiding Judge should adopt the level of operating expenses advocated by both Trial Staff and ESL based on annualized expenses actually incurred by the pipeline during the locked-in period, and the appropriate level of power costs depends on the throughput the Presiding Judge finds appropriate for the period. Trial Staff advocated for the adoption of witness McComb's recommended rate design throughput of 77,000 barrels per day, the TSA commitment of the two committed shippers.

345. Consistent with Commission precedent and policy, Trial Staff asked the Presiding Judge to reject the level of operating expenses proposed by the Indicated Shippers. As previously noted, the Commission has stated its preference for the use of actual test period data over projections, especially for locked-in periods.[689]

346. For Docket No. IS11-146-000, Trial Staff stated that the appropriate level of operating expenses (less depreciation expense, addressed below) for ESL for the 2011 rate period is $29,527,000.[690] As explained by Ms. Sherman, Trial Staff based the level of operating expenses on ESL's actual expenses for the test period of July 1, 2010 through June 30, 2011,[691] and she made adjustments to the pipeline's claimed expenses for: (1) administrative and operations support services; (2) property taxes; (3) pipeline integrity costs; and (4) regulatory litigation expenses.[692]

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[685] Exh. S-18, line 2 (McComb); *see* Exh. S-1 at 28; and Exh. S-2 at 3, Statement B, line 4 (Sherman).

[686] *See* Exh. ESL-13, Workpaper 8, line 1 (Webb).

[687] Exh. ESL-7 at 61 (Webb).

[688] Exh. ESL-55 (rev. Dec. 27, 2011), Statement B, line 4 (Webb).

[689] *Williams Natural Gas Co.*, 80 FERC ¶ 61,158, at 61,678-79 (1997) (approving the use of actual data "particularly since the rates in this case are locked-in by the filing of a new rate case"); *Arkansas-Louisiana Gas Co.*, 22 FERC ¶ 61,125, at 61,198-99 (1983) (the Commission noted it would not discourage the submission of actuals for a locked-in period, noting that such submissions "ha[ve] often been done in the past").

[690] Exh. S-3 at 2, Statement A, line 3 (Sherman).

[691] Exh. S-1 (rev. Jan. 11, 2012) at 13-14 (Sherman).

[692] *Id.* at 14-27.

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347. Trial Staff explained that Indicated Shippers' operating expense proposal of $22,939,000[693] is inappropriate because it is based on only ten months of actual expenses, annualized,[694] when all twelve months of expenses are known.

348. According to Trial Staff, in her cross-answering testimony, Ms. Crowe takes issue with Trial Staff's use of actual test period regulatory litigation expenses of $1.41 million for the 2011 rate period,[695] and she proposes the pipeline amortize this expense over a five-year period, consistent with Commission policy and precedent.[696] Trial Staff explained that this position contradicts Ms. Crowe's position in her answering testimony where, in response to Dr. Webb's 2011 rate period expense, she proposes using ten months of operating expense, annualized, without any amortization of litigation expense.[697] Trial Staff explained that she relies on the TSA true-up mechanism to explain why she proposes no adjustment to any operating expenses: "Enbridge Southern Lights is required under its TSAs with committed shippers to true up actual costs to estimated costs each annual period. Thus, no adjustments beyond annualization of the 10 months of actual data are warranted."[698]

349. Trial Staff noted that Ms. Sherman makes the same argument specifically with respect to litigation expense – that with the true-up mechanism, ESL will be able to collect its actual regulatory litigation expense over time.[699] Trial Staff argued that Ms. Crowe offers no explanation for her contradictory positions.

Findings and Conclusions

350. Indicated Shippers' proposal regarding the appropriate level of operating expenses, which uses projected costs, is inconsistent with established Commission precedent and therefore must be rejected.[700]

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[693] Exh. IS-3A (Supplement) at 1, Statement A, line 3 (Crowe).
[694] Exh. IS-1 at 12 (Crowe).
[695] Exh. IS-33 at 11-14 (Crowe).
[696] *Id.* at 12.
[697] Exh. IS-1 at 12 (Crowe).
[698] *Id.* In addressing her primary case, Ms. Crowe explains that it is not clear if any litigation expenses are included in the pipeline's projections that she relies on. Therefore, she states her recommendation to amortize the litigation expenses applies only to the 2011 rate period. *Id.* at 13.
[699] Exh. S-1 at 27 (Sherman).
[700] *Williams Natural Gas Co.*, 80 FERC ¶ 61,158, at 61,678-79 (1997) (approving the use of actual data "particularly since the rates in this case are locked-in by the filing of a new rate case"); *Arkansas-Louisiana Gas Co.*, 22 FERC ¶ 61,125, at 61,198-99 (1983) (the Commission noted it would not discourage the submission of actuals for a locked-in period, noting that such submissions "ha[ve] often been done in the past").

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351. For 2010, Trial Staff proposed operating expenses of $19.1 million while ESL proposed $19.0 million. For 2011, Trial Staff proposed operating expenses of $29.5 million while ESL proposed $29.6 million. Both Trial Staff and ESL advocate for the adoption of operating expenses based on annualized expenses actually incurred by the pipeline during the locked-in periods; however, Trial Staff explained that the appropriate level of power costs, and therefore the operating expenses, depends on the appropriate throughput for the period. Trial Staff urges adoption of witness McComb's recommended rate design throughput based on the 77,000 barrels per day actually compensated for by the two Committed Shippers under the TSAs during the seven-month, locked-in period. ESL witness Webb, on the other hand, recommends use of throughput of 41,561 barrels per day, the average barrels per day physically moving through the pipeline during the seven-month, locked-in period.

352. Committed Shippers entered into TSAs that obligated them to ship or pay for shipment of volumes totaling 77,000 barrels per day for 15 years.[701] Given the TSAs' requirements that Committed Shippers make payments based on a minimum throughput level of 77,000 barrels per day, whether they shipped that amount or not,[702] Trial Staff is correct in asserting that the appropriate level of power costs should be based on the committed throughput volume of 77,000 barrels per day actually compensated for by the Committed Shippers during the seven-month, locked-in period; accordingly, Trial Staff's proposed level of operating expenses will be adopted here.

<u>Issue #11: What is the appropriate depreciation expense?</u>

A. ESL

353. ESL provided the parties' positions on the level of depreciation expense set forth in the table below:

Party	*Witness*	*Source*	*2010*	*2011*
ESL	Dr. Webb	ESL-55 and ESL-56, WP 1	$42.5 million	$42.9 million
Trial Staff	Ms. Sherman	S-2 and S-3, WP 1	$42.5 million	$42.9 million
Indicated Shippers	Ms. Crowe	IS-4 (Updated) and IS-3A Supp., WP 1	$42.4 million	$42.5 million

[701] *See* Tr. at 186:14-187:1.

[702] Exh. S-15 at 8-9 (McComb). *See* Exh. ESL-1 at 10-11 (Jervis) (BP and Statoil have made commitments totaling 77,000 barrels per day); and Exh. ESL-9 at 7 (Webb) (TSA Article 3.01, requiring committed shippers to ship or pay for their committed volumes).

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354. ESL noted that all parties relied on the stipulated 3.01% depreciation rate,[703] and thus, any differences in depreciation balances relate solely to the differences in the underlying rate base figures, and those differences are discussed under the individual headings herein.

B. Committed Shippers

355. Committed Shippers took no position on this issue, and noted that Enbridge and Staff have stipulated to a depreciation rate of 3.01% for both periods.[704] Committed Shippers noted that this depreciation rate, when applied to proper throughput determinants and Opinion No. 154-B methodology, results in a finding that Enbridge's filed 2010 and 2011 rates are just and reasonable.

C. Indicated Shippers

356. Based upon witness Crowe's calculations, Indicated Shippers stated that the appropriate depreciation expense is $42,443,000.[705] Indicated Shippers do not contest the depreciation rate of 3.01% listed in Exh. ESL-43, the attached exhibit to the Rebuttal Testimony of ESL witness Spanos, which reflects an agreed upon stipulation between ESL and Staff as to the depreciation rate. Indicated Shippers explained that the stipulated rate is applied to Ms. Crowe's cost-of-service model.

357. For Docket No. IS11-146-000, Indicated Shippers proposed a depreciation expense of $42,507,000.[706] Indicated Shippers did not contest the depreciation rate of 3.01% listed in Ex. ESL-43, the attached exhibited to the Rebuttal Testimony of ESL witness Spanos, which reflects an agreed upon stipulation between ESL and Staff as to the depreciation rate. Indicated Shippers explained that the stipulated rate is applied to Ms. Crowe's cost-of-service model.

358. Indicated Shippers argued in their Post-Hearing Reply Brief that their depreciation calculations are not inconsistent, as alleged by Staff.[707] Indicated Shippers noted that witness Crowe used CPIS and land value as of December, 31, 2010 from Exhibit No. ESL-19. Furthermore, Indicated Shippers disagreed that initial rates for service should be established using "end of test period plant balances" alleged by Staff. As previously

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[703] *See Enbridge Pipelines (Southern Lights) LLC*, Stipulation of Enbridge Southern Lights and FERC Trial Staff, Docket No. IS11-146-000, *et al*. (Nov. 1, 2011).

[704] Exh. ESL-44 at 56:4-7.

[705] Exh. IS-4(Updated) at 1, line 4.

[706] Exh. IS-3A (Supp.) at 1, line 4, and at 9, line 5.

[707] *See* Staff I.B. at 56.

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discussed, Indicated Shippers asserted that Commission regulations require initial rates for service to be established on the basis of projections, not traditional test period data.[708]

D. Trial Staff

359. On November 1, 2011, Trial Staff and ESL filed a stipulation on depreciation rates based on a truncation date of 2045, or 35 years into the future, for certain of the pipeline's plant accounts. According to Trial Staff, ESL witness John Spanos sponsored Exhibit No. ESL-43, which summarizes the stipulation and shows the resulting overall depreciation rate of 3.01%.[709]

360. Trial Staff witness Sherman calculated the appropriate level of depreciation expense for the 2010 rate period at $42,524,000.[710] She based this expense on depreciable carrier property in service of $1,412,770,000 and the stipulated depreciation rate of 3.01%.[711]

361. Trial Staff explained that both ESL and the Indicated Shippers agree on the use of the stipulated depreciation rate of 3.01%.[712] However, ESL uses depreciable carrier property in service at $1,410,849,000 to obtain a depreciation expense of $42,467,000,[713] while the Indicated Shippers use depreciable carrier property in service of $1,410,080,000 to obtain a depreciation expense of $42,443,000.[714]

362. Trial Staff agreed with ESL that $42,467,000 is the appropriate level of depreciation expense for the 2010 rate period. Trial Staff inadvertently used the pipeline's land value as of September 30, 2011, rather than January 31, 2011, the end of the rate period, in its calculation.[715] Using the January 31, 2011 land value, Trial Staff and ESL obtain the same depreciation expense. Trial Staff explained that the Indicated Shippers used carrier property in service as of July 1, 2010, the start of pipeline

[708] 18 C.F.R. § 346.2(a)(3) (2012).

[709] Exh. ESL-42, at 1-2, and Exh. No. ESL-43 (Spanos).

[710] Exh. S-2 (rev. Jan. 11, 2012) at 2, Statement A, line 4, and at 10, Workpaper 1, line 6 (Sherman).

[711] *Id*. at 10, Workpaper 1, lines 4 and 5 (Sherman).

[712] *See* Exh. ESL-55 (rev. Dec. 27, 2011), Workpaper 1, line 5 (Webb); Exh. IS-4 (Updated) at 9, Workpaper 1, line 5 (Crowe).

[713] Exh. ESL-55 (rev. Dec. 27, 2011), Workpaper 1, lines 4 and 6 (Webb).

[714] Exh. IS-4 (Updated) at 9, Workpaper 1, lines 4 and 6 (Crowe).

[715] *Compare* Exh. S-2 (rev. Jan.11, 2012) at 10, Workpaper 1, line 2 (Sherman) (specifying a land value of $10,377,000) *with* Exh. ESL-19 (Brown) (indicating a land value of $12,297,480 as of December 31, 2010). Apparently, this record evidence only reflects the pipeline's land balance as of December 31, 2010, without any updated data through January 31, 2011.

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operations, but land value as of December 31, 2010, in their depreciation expense calculation.[716] Aside from this inconsistency, Trial Staff asked that the Presiding Judge reject Indicated Shippers' proposal since it is does not conform to Commission policy of using end of test period plant balances.

363. As set out in Trial Staff witness Sherman's Exhibit No. S-3, the appropriate level of depreciation expense for the 2011 rate period, Docket No. IS11-146-000, is $42,880,000.[717] Trial Staff explained that Ms. Sherman based this expense on a level of depreciable carrier property in service of $1,424,597,000 and the stipulated depreciation rate of 3.01%.[718]

Findings and Conclusions

364. As ESL noted, all parties relied on the stipulated 3.01% depreciation rate,[719] and thus, any differences in depreciation balances relate solely to the differences in the underlying rate base figures. Since Indicated Shippers' methodology used projections to determine initial rates for service, their position must be rejected as it does not conform to Commission policy of using end of test period plant balances. Accordingly, Trial Staff and ESL's methodology for calculating the level of depreciation expense is correct.

Issue #12: What capital structure and rate of return apply to the calculation of AFUDC?

A. ESL

365. ESL submitted a table of the parties' positions on capital structure for Allowance for Funds Used During Construction ("AFUDC"):

[716] Exh. IS-4 (Updated) at 9, Workpaper 1, line 1 (Crowe) (showing starting carrier property in service balance as of July 1, 2010 of $1,422,377,000) and line 2 (showing land balance of $12,297,000); Exh. ESL-19 (showing December 31, 2010 land balance) (Brown). Because land is not depreciable, these calculations must subtract land value from carrier property in service to obtain depreciable carrier property in service.

[717] Exh. S-3 (rev. Jan. 11, 2012) at 2, Statement A, line 4 and at 10, Workpaper 1 (Sherman).

[718] *Id.* at 10, Workpaper 1, lines 4 and 5 (Sherman).

[719] *See Enbridge Pipelines (Southern Lights) LLC*, Stipulation of Enbridge Southern Lights and FERC Trial Staff, Docket No. IS11-146-000, *et al*. (Nov. 1, 2011).

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	ESL (ESL-20 at 26)		Trial Staff (S-10 at 24)		Indicated Shippers (IS-4 (Updated) and IS-3A Supp. Stmt. F1)	
	Equity	Debt	Equity	Debt	Equity	Debt
2006	70%	30%	48.98%	51.02%	1.70%	98.30%
2007	70%	30%	49.04%	50.96%	1.70%	98.30%
2008	70%	30%	37.69%	63.31%	2.70%	97.30%
2009	70%	30%	41.45%	58.55%	20.10%	79.90%
2010	70%	30%	44.39%	55.61%	29.60%	70.40%

366. ESL stated that to the extent the 70% equity ratio recommended by Dr. Fairchild is not used, Trial Staff's use of EPI's debt/equity ratio is the next best alternative.[720] However, for the reasons discussed *supra*, ESL argued that the 70% equity ratio is more appropriate.

367. ESL argued that Indicated Shippers' witness Crowe uses debt ratios ranging up to 98.3% for the period 2006-2010, which she has failed to justify.[721] According to ESL, for two of those years, those high debt ratios reflect short-term, not long-term, construction debt, as her own exhibits show.[722] ESL asserted that Ms. Crowe also failed to address the question of whether those extremely high short-term debt ratios were guaranteed by the parent company and therefore should not be used for purposes of AFUDC. Overall, ESL argued that Indicated Shippers have cited no precedent for such extraordinarily high debt ratios and their AFUDC calculations should be disregarded.[723]

368. ESL set forth in a table the parties' positions on allowed rate of return on equity for AFUDC:

[720] Further, adjusting those ratios to eliminate EPI's inter-company debt would yield ratios of 30.36% debt and 69.64% equity for the year ended December 31, 2006; 25.67% debt and 74.33% equity for the year ended December 31, 2007; 44.85% debt and 55.15% equity for the year ended December 31, 2008; 46.68% debt and 53.32% equity for the year ended December 31, 2009; 42.42% debt and 57.58% equity for the year ended December 31, 2010; and 41.91% debt and 58.09% equity for the quarter ended March 31, 2011. *See* S-12 at 28.

[721] *See* Exh. IS-4 (Updated) and IS-3A Supp. at Statement F1.

[722] *See* Exh. IS-5 (showing "short-term debt" for 2007 and 2008 and "long-term debt" for later years).

[723] Moreover, Ms. Crowe's exhibits (IS-4 (Updated) and IS-3A Supp.) claim to derive the capital structure from ESL-21. However, Ms. Crowe's debt/equity ratios are actually taken from her own exhibit (IS-5).

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	ESL (ESL-20 at 27)	Trial Staff (S-10 at 25)	Indicated Shippers (IS-4 (Updated) and IS-3A Supp. Stmt. F1)
2006	12.61%	12.61%	10.50%
2007	11.17%	11.17%	10.50%
2008	16.28%	11.53%	10.50%
2009	13.44%	10.30%	10.50%
2010	11.13%	9.10%	10.50%

369. ESL explained that Dr. Fairchild calculated ROEs for each year using the high end of the proxy group range, consistent with the Commission's finding in the Declaratory Order.[724] ESL noted that Trial Staff witness Alvarez calculated similar ROEs at the high end of the range for 2006 and 2007, but then switched to the low end of the range for 2008-2010.[725] ESL previously explained why they believe that approach is incorrect.

370. According to ESL, Indicated Shippers' witness Crowe used a constant nominal ROE of 10.5%, the median of the proxy group, for all years.[726] ESL's previous arguments also explain why that ROE is also too low, and moreover, as Mr. Alvarez showed, the median nominal ROE for the years at issue was not constant, but varied within a range of 9.71% to 14.46%.[727]

371. ESL stated that Commission precedent supports calculating the rate of return for prior years' AFUDC purposes using contemporaneous factors for capital structure, ROE and debt cost.[728] Thus, ESL believed that Ms. Crowe's calculation fails to adjust for differing market conditions in the prior years when the AFUDC was accrued, and therefore, should be disregarded.

372. ESL listed the parties' positions on cost of debt rates for AFUDC in the table below:

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[724] *See* Exh. ESL-20 at 27.

[725] *See* Exh. S-10 at 25.

[726] *See* IS-4 (Updated) and IS-3A Supp. at Statement F1.

[727] *See* Exh. S-10 at 24; S-12 at 39-43.

[728] *See, e.g.*, *Kuparuk Trans. Co.*, 55 FERC ¶ 61,122, at 61,380 (1991); *ARCO Pipe Line Co.*, 52 FERC ¶ 61,055, at 61,244-45 (1990).

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	ESL (ESL-29 at 23)	Trial Staff (S-10 at 25)	Indicated Shippers (IS-4 (Updated) and IS-3A Supp. Stmt. F1)
2006	6.36%	6.63%	2.37%
2007	6.15%	6.20%	2.37%
2008	5.46%	6.03%	2.37%
2009	3.43%	3.54%	2.37%
2010	4.31%	4.57%	2.37%

373. According to ESL, although Dr. Fairchild's and Mr. Alvarez's recommended debt costs for AFUDC are quite similar, Dr. Fairchild's calculation is more appropriate because it excludes the effects of affiliate debt and looks only at third-party debt. By contrast, ESL argued that Indicated Shippers' witness Ms. Crowe used ESL's 2.37% cost of debt as of March 31, 2011 for each of the prior years,[729] a figure that is far too low for the reasons previously discussed. In any event, ESL stated that Ms. Crowe's cost of debt is not adjusted to reflect even the actual cost of debt of ESL in each of the prior years as shown on Ms. Crowe's own exhibit.[730]

B. Committed Shippers

374. Committed Shippers took no position on this issue, and noted that for both the 2010 period and the 2011 period, both Enbridge's and Staff's calculation of AFUDC, when applied to proper throughput determinants and Opinion No. 154-B methodology, result in a finding that Enbridge's filed 2010 and 2011 rates are just and reasonable.

C. Indicated Shippers

375. Indicated Shippers noted that the calculation of AFUDC is based on ESL's actual capital structures for each year of the construction period. In keeping with Commission policy, Indicated Shippers explained that the cost of capital is updated to the most recent period available. Thus, assuming rates are designed using system capacity, the nominal ROE is 10.50%, which is the updated median ROE produced under the Commission's DCF methodology for oil pipelines. Indicated Shippers explained that the cost of debt is 2.37%.[731] Indicated Shippers put forth the same argument for Docket No. IS11-146-000.

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[729] *See* IS-4 (Updated) and IS-3A Supp. at Statement F1.

[730] As shown in Ms. Crowe's Exhibit IS-5, the cost of ESL's debt varied from 5.44% (as of December 31, 2007) to 2.37% (as of March 31, 2011). *See* IS-5. However, in the workpaper accompanying Ms. Crowe's cost-of-service exhibits, she uses a constant cost of debt of 2.37%. IS-4 (Updated) and IS-3A Supp. at workpaper 10.

[731] Exh. IS-4(Updated) at 7, lines 1-6; Exh. IS-1 at 6, 18.

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376. In Indicated Shippers' Post-Hearing Reply Brief, they noted that ESL takes issue with all three components of Indicated Shippers' AFUDC calculation, capital structure, ROE, and cost of debt.[732]

377. As to the capital structure issue, Indicated Shippers stated that witness Crowe used ESL's own capital structure as described in ESL's own data; there should be no need to "justify" the numbers ESL provided. Similarly, Indicated Shippers stated that ESL's contention that Indicated Shippers failed to address whether ESL's construction period debt was guaranteed by ESL's parent calls for speculation on a detail ESL itself could have testified to but did not.[733]

D. Trial Staff

378. Trial Staff explained that AFUDC represents the cost of capital incurred by a pipeline with respect to assets prior to their inclusion in rate base.[734] AFUDC consists of two components: the cost of equity capital and the cost of debt capital, or interest, during construction.[735] Trial Staff observed that in Opinion No. 154-B, the Commission allowed oil pipelines to include AFUDC in their rate bases using their nominal cost of capital.[736]

379. According to Trial Staff, to calculate the AFUDC component of rate base, it is first necessary to calculate the AFUDC rates over the period of construction, which reflect the capital structures, costs of debt, and costs of equity over that time period. Trial Staff witness Alvarez sets forth the capital structures he adopted for the five-year period from 2006 to 2010 in his answering testimony,[737] and cites to his attached calculations for their

[732] *See* ESL I.B. at 39-42.

[733] *See id.* at 40.

[734] *ARCO Pipe Line Co.*, 52 FERC ¶ 61,055, at 61,234 (1990).

[735] *Id.*

[736] *Williams Pipe Line Co.*, 31 FERC ¶ 61,377, at 61,839 n.38. The Commission has specified how to calculate AFUDC, which includes both debt and equity costs, for natural gas pipelines and electric utilities in the Uniform System of Accounts. Gas Plant Instructions, 3(17), 18 C.F.R. pt. 201 (2011); Electric Plant Instructions, 3(17), 18 C.F.R. pt. 101 (2011). However, the comparable instructions for oil pipelines in the Uniform System of Accounts are a relic from the days of ICC regulation, and only provide for recovery of interest, and not equity capital, used during construction. Instructions for Carrier Property Accounts, 3-3(11), 18 C.F.R. pt. 352 (2011). Opinion No. 154-B superseded these instructions by permitting an AFUDC that includes both debt and equity for oil pipelines. *See ARCO Pipe Line Co.*, 43 FERC ¶ 63,033, at 65,372-73 (1988) (Benkin, ALJ) (explaining the FERC's new regulatory regime for oil pipelines under Opinion No. 154-B, including a complete AFUDC).

[737] Exh. S-10 at 24 (Alvarez).

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derivation,[738] and to his work papers for the source data.[739] Consistent with his prior rate of return analysis, Trial Staff explained that Mr. Alvarez relies on the capital structures and costs of debt of the parent, Enbridge Pipelines Inc.

380. In his answering testimony, Trial Staff explained that Mr. Alvarez also sets forth his recommended costs of debt and equity for the same five-year period,[740] and he explains that he accepted the cost of debt figures provided in a data response by ESL's witness, Dr. Fairchild.[741] According to Trial Staff, Mr. Alvarez also explains that he accepted Dr. Fairchild's range of costs of equity for purposes of determining the rates of return on equity in calculating the AFUDC rates.[742]

381. As discussed above, Trial Staff explained that their approach to determining the Opinion No. 154-B uncommitted rate reflects the risk-shifting and risk-reducing features of the TSAs, which were approved by the Commission in a Declaratory Order in December 2007,[743] and which transfer most of ESL's risk to the committed shippers.

382. Therefore, for purposes of deriving the AFUDC rates for the three years from 2008 to 2010, Trial Staff asserted that Mr. Alvarez proposed the use of the costs of equity at the bottom end of the range of reasonableness in recognition of the unusually low risk character of ESL.[744] However, for 2006 and 2007, before the Commission approved the TSAs, ESL still faced the regulatory and financial risks attendant to the Southern Lights Pipeline project, and as a result, Mr. Alvarez recommended the use of the high end of the range of reasonableness for those two years.[745]

383. Trial Staff disagreed with the AFUDC rates calculated by ESL for the same general reasons Trial Staff explains above in the discussion regarding capital structure, cost of debt, and cost of equity. Trial Staff also disagreed with the Indicated Shippers' position that the cost of equity for 2006 and 2007 should be set at the bottom end of the range of reasonableness since the TSAs were signed in August 2006, and Enbridge Southern Lights' risk presumably was reduced as of that date.[746]

384. According to Trial Staff, the Commission's approval of the TSAs in the Declaratory Order at the end of 2007 provided the regulatory assurances that the capital

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[738] Exh. S-11 at 17 (Alvarez).
[739] Exh. S-12 at 28, 34-36 (Alvarez).
[740] Exh. S-10 at 25 (Alvarez).
[741] *Id.* at 24, Exh. S-12 at 28 (Alvarez).
[742] Exh. S-10 at 24 (Alvarez); *see also* Exh. S-12 at 39-43 (Alvarez).
[743] *Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,310 (2007).
[744] Exh. S-10 at 25 (Alvarez).
[745] *Id.*
[746] Exh. IS-33 at 10 (Crowe).

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markets needed to reassess the risk of ESL – not the mere signing of the documents, which would not be worth much if the Commission had not subsequently approved the TSAs.

385. Trial Staff proposed the same capital structures and rates of return for the calculation of AFUDC in both dockets, and therefore, its discussion of the issue under Docket No. IS10-399-003, above, also applies to Docket No. IS11-146-000.

386. With respect to the Indicated Shippers' discussion of this issue,[747] Trial Staff fully supports the criticisms set forth by ESL in its Initial Brief.[748] Among other things, Trial Staff argued that the Indicated Shippers erroneously apply current debt and equity costs to past construction periods, presumably based on their misunderstanding as to how AFUDC is to be calculated. According to Trial Staff, aside from the use of the wrong data, that misunderstanding also leads Indicated Shippers to inappropriately mix current debt and equity costs with past capital structures. Trial Staff agreed with ESL[749] that the AFUDC rate needs to be based on data that is contemporaneous with the period of construction – 2006 to 2010 in this case.

Findings and Conclusions

387. Trial Staff explained that AFUDC consists of two components: the cost of equity capital and the cost of debt capital, or interest, during construction. Indicated Shippers erroneously apply current debt and equity costs to past construction periods, and accordingly, their calculations must be rejected.[750]

388. Consistent with his prior rate of return analysis, Trial Staff witness Alvarez correctly uses the capital structures and costs of debt of the parent, Enbridge Pipelines Inc. For 2006 and 2007, before the Commission approved the TSAs, ESL still faced the regulatory and financial risks attendant to the Southern Lights Pipeline project, and as a result, Mr. Alvarez correctly used the high end of the range of reasonableness for those two years. For the three years from 2008 to 2010, Trial Staff asserted that Mr. Alvarez proposed the use of the costs of equity at the bottom end of the range of reasonableness in recognition of what he believes to be the unusually low risk character of ESL resulting from the protections afforded to ESL by the TSAs.[751] As discussed *supra*, Trial Staff is correct in using the low range ROE for these years.

[747] Indicated Shippers I.B. at 28.
[748] ESL I.B. at 39-42.
[749] *Id.* at 41-42.
[750] *See* ESL I.B. at 39-42.
[751] Exh. S-10 at 25 (Alvarez).

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Issue #13: What is the appropriate level of amortization of AFUDC?

A. ESL

389. ESL noted that the parties' positions on the level of amortization of AFUDC are as follows:

Party	*Witness*	*Source*	*2010*	*2011*
ESL	Dr. Webb	ESL-55 and ESL-56, Stmt A	$3.1 million	$3.1 million
Trial Staff	Ms. Sherman	S-2 and S-3, Stmt A	$1.8 million	$1.8 million
Indicated Shippers	Ms. Crowe	IS-4 (Updated), Stmt A and IS-3A Supp., Stmt A	$0.8 million	$0.8 million

390. ESL explained that the differences in the parties' proposals regarding the amortization of AFUDC are largely driven by their differing proposals on capital structure and cost of capital.

B. Committed Shippers

391. Committed Shippers took no position on this issue, and noted that for both the 2010 period and the 2011 period, both Enbridge's and Staff's calculation of the amortization of AFUDC, when applied to proper throughput determinants and Opinion No. 154-B methodology, result in a finding that Enbridge's filed 2010 and 2011 rates are just and reasonable.

C. Indicated Shippers

Indicated Shippers believed that the appropriate level of amortization of AFUDC for both dockets is $844,000, and variations among the Parties and Staff on this figure are due to disagreements on component figures discussed above.[752]

D. Trial Staff

392. According to Trial Staff, Ms. Sherman explained that the appropriate level of amortization of AFUDC for ESL for the 2010 rate period is $1,840,000.[753] As noted above, in Opinion No. 154-B, the Commission permitted oil pipelines to add AFUDC to

[752] Exh. IS-4(Updated) at 1, line 5, and at 8, lines 4, 10.
[753] Exh. S-2 (rev. Jan. 11, 2012) at 2, Statement A, line 5 (Sherman).

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their rate bases.[754] Trial Staff stated that a pipeline takes the calculated amount of AFUDC and amortizes it over the life of its property.

393. Trial Staff's total comprises $1,213,000 attributable to amortization of equity AFUDC and $627,000 attributable to amortization of debt AFUDC.[755] Trial Staff notes that Ms. Sherman bases her determination on the AFUDC amounts for equity and debt transferred to rate base, as shown in Statement F1,[756] and uses the stipulated depreciation rate of 3.01% for the amortization rate.

Findings and Conclusions

394. Trial Staff explained that all three participants use the same 3.01% depreciation rate as the amortization rate for AFUDC, and all three use the same construction costs in their AFUDC calculations.[757] The differences in the three AFUDC amortization amounts are from the various proposals for the capital structure, cost of equity, and cost of debt applicable during the construction period. As discussed in Issue #6, Trial Staff was correct to use the capital structure of Enbridge Pipelines Inc., the parent of ESL, and as noted in Issue #7, Trial Staff properly used the debt of ESL's parent, Enbridge Pipelines Inc, for the cost of debt. In Issue #8, the low range ROE was held to be controlling in the calculation of cost of equity. Accordingly, these inputs should be used to calculate the appropriate level of AFUDC amortization.

Issue #14: What is the appropriate level of deferred return?

A. ESL

395. ESL noted that the parties' positions on the level of deferred return are set forth in the table below:

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[754] *Williams Pipe Line Co.*, 31 FERC at 61,839 n.38.

[755] Exh. S-2 (rev. Jan. 11, 2012) at 9, Statement F2, lines 4 and 10 (Sherman).

[756] *Id.* at 8, Statement F1.

[757] *See* Exh. S-2 (rev. Jan. 11, 2012) at 8, Statement F1 (Sherman); Exh. ESL-55 (rev. Dec. 27, 2011), Statement F1 (Webb); Exh. IS-4 (Updated) at 7, Statement F1 (Crowe).

Party	*Witness*	*Source*	*2010*	*2011*
ESL	Dr. Webb	ESL-55 and ESL-56, Stmt C	$16.4 million	$16.5 million
Trial Staff	Ms. Sherman	S-2 and S-3, Stmt C	$23.8 million	$24.2 million
Indicated Shippers	Ms. Crowe	IS-4 (Updated), Stmt C and IS-3A Supp., Stmt C	$0.0 million	$5.3 million

396. ESL stated that their position on the level of deferred return is appropriate because it provides for recovery of the proper amount of deferred return for each period. ESL argued that Indicated Shippers use the flawed approach of not including any deferred return for 2010.[758] According to ESL, Ms. Crowe claims that the deferred return should be based on the prior year's ending rate base.[759] However, Dr. Webb discussed that Ms. Crowe's approach of failing to include deferred return in the first year of operations has no basis in Commission precedent, and would result in a deferred return that is theoretically unrecoverable.[760]

397. ESL explained that deferred earnings are a central element of Opinion No. 154-B.[761] ESL stated that an end-of-period calculation of rate base necessarily includes earnings deferred during the period in question, and Ms. Crowe provided no justification for excluding deferred earnings in this instance, particularly when she did deduct depreciation and deferred taxes for the initial year.[762]

398. ESL argued that for 2011, Indicated Shippers' calculation of deferred return is grossly understated. ESL noted that Ms. Crowe calculates deferred return using a substantially understated CPIS base, as her own exhibits show.[763] According to ESL, Ms. Crowe omitted more than $208 million from the CPIS base used to calculate deferred return because she picked up the wrong figure from her own exhibits.[764] ESL argued that

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[758] Exh. IS-4 (Updated).

[759] Exh. IS-1 at 10.

[760] ESL-44 at 41-42; Under Ms. Crowe's approach, if the Southern Lights Pipeline's useful life were to expire in 2045, ESL would be left with a remaining deferred return balance, yet no means of recovering that unamortized balance.

[761] *See Williams Pipe Line Co.*, 31 FERC ¶ 61,377, at 61,839 n.20 (1985) (stating that a pipeline is entitled to collect deferred earnings); ESL-44 at 41:18-19.

[762] Exh. ESL-44 at 41-42.

[763] *See id.*

[764] *See* IS-3A Supp. at Statement E2; The correct amount that should appear in the first column on line 1 of Statement E2 is the $1,422.3 million that Ms. Crowe shows on the comparable line of IS-4 (Updated).

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Ms. Crowe's understated CPIS for 2011 is unexplained and unjustified.[765] ESL noted that Ms. Crowe further calculated deferred return using an unduly low equity ratio of 30%, when she should have used a ratio of 70% as recommended by Dr. Fairchild, or at least the appropriate EPI capital structure for the reasons addressed, *supra*.

B. Committed Shippers

399. Committed Shippers took no position on this issue, and noted that for both the 2010 period and the 2011 period, both Enbridge's and Staff's calculation of deferred return, when applied to proper throughput determinants and Opinion No. 154-B methodology, result in a finding that Enbridge's filed 2010 and 2011 rates are just and reasonable.

C. Indicated Shippers

400. Indicated Shippers stated that the appropriate level of deferred return is $0.[766] Indicated Shippers noted that the deferred return should be based on the prior year's ending rate base,[767] and that the calculation of the deferred return should not be accelerated in rate base by basing each year's deferred return on the same year's ending rate base.[768]

401. For the same reasons stated for Docket No. IS10-399-003, Indicated Shippers' position for Docket No. IS11-146-000 is that the appropriate level of deferred return is $81,000.[769]

402. In Indicated Shippers' Post-Hearing Reply Brief, they argued that Staff's discussion of *SFPP, L.P.*, 129 FERC ¶ 63,020, at P 619 (2009) misinterprets and overemphasizes an ambiguous sentence that was not central to the ruling in question. Indicated Shippers asserted that the decision in *SFPP* had nothing to do with initial ratemaking and the question in this case of whether there can be deferred return for a new pipeline with no prior years' rate base on which to base calculations. Indicated Shippers noted that Staff cites no other Commission precedent for the practice it recommends.

403. For the reasons stated in the discussion of Docket No. IS10-399-003 and in Indicated Shippers' Initial Brief, Indicated Shippers' position for Docket No. IS11-146-000 is that the appropriate level of deferred return is $5,391,000,[770] and the appropriate

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[765] *See* Exh. ESL-44 at 43:10-44:2.
[766] Exh. IS-4(Updated) at 1, line 6 and at 6, lines 10-18.
[767] *See* Exh. IS-1 at 10.
[768] *Id.*
[769] Exh. IS-3A (Supp.) at 1, line 6.
[770] *See* IS IB at 43; Exh. IS-3A (Supp.) at 6, line 13.

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amortization of deferred return is $81,000.[771] Indicated Shippers were puzzled by ESL's assertion that Ms. Crowe "omitted more than $208 million from the CPIS base used to calculate deferred return,"[772] since Ms. Crowe used values for June 30, 2010 supplied by ESL in discovery.

D. Trial Staff

404. Trial Staff noted that Ms. Sherman shows in Exhibit No. S-2 that the appropriate level of net deferred return is $23,834,000, and the appropriate level of amortization of deferred return for inclusion as a cost item in the calculation of the uncommitted rate for the 2010 rate period is $364,000.[773] According to Trial Staff, the Commission noted in Opinion No. 154-B that under the trended original cost methodology, the inflation factor included in the nominal rate of return on equity is extracted and multiplied by the pipeline's equity rate base. Trial Staff explained that the resulting equity rate base "write-up," or deferred return, is then amortized over the life of the property.[774]

405. Trial Staff stated that Ms. Sherman shows this calculation in Statement E2 on page 7 of Exhibit No. S-2. According to Trial Staff, the calculation includes first deriving the equity rate base, multiplying that rate base by Trial Staff's inflation factor of 3.56% to obtain the deferred return of $24,201,000, and then amortizing the deferred return by the stipulated depreciation rate of 3.01%.[775] Trial Staff noted that the resulting value of $364,000 is a relatively small accumulated deferred return for an oil pipeline, since ESL only began commercial operations on July 1, 2011, and this docket represents the first rate case in which a portion of its equity return is deferred. Trial Staff explained that subtracting the amortization of deferred return for the 2010 rate period from the accumulated deferred return yields a net deferred return of $23,834,000.[776]

406. Trial Staff asserted that Indicated Shippers' approach contravenes the Opinion No. 154-B methodology since the Commission adopted deferred return, the hallmark of the methodology, in order to make new pipelines more competitive in their early years of operation.[777] Trial Staff explained that deferred return provides for lower rates in the early years by reducing the cost of equity embedded in current rates and amortizing the

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[771] Exh. IS-3A (Supp.) at 6, line 15; Indicated Shippers' Initial Brief mistakenly stated the figure for amortization of deferred return, $81,000, in place of the figure for deferred return, $5,391,000. *See* IS I.B. at 43.

[772] ESL I.B. at 44.

[773] Exh. S-2 (rev. Jan.11, 2012) at 7, Statement E2, lines 18 and 15 (Sherman); *id.* at 2, Statement A, line 6 (Sherman).

[774] *Williams Pipe Line Co.*, 31 FERC ¶ 61,377, at 61,834 (1985).

[775] Exh. S-2 (rev. Jan. 11, 2012) at 7, Statement E2 (Sherman).

[776] *Id.* at line 18.

[777] *Williams Pipe Line Co.*, 31 FERC ¶ 61,377, at 61,834-35 (1985).

deferred equity return over the life of the pipeline.[778] According to Trial Staff, the Indicated Shippers' proposal frustrates that purpose.

407. Trial Staff noted that a recent initial decision by Judge Cianci clearly articulates how to calculate deferred return under the Opinion No. 154-B methodology: "deferred return is calculated each year by multiplying the inflation factor from the year in question by the equity portion of the pipeline's rate base *from that same year*."[779] Trial Staff asserted that no party took exception to this ruling, and in Opinion No. 511, the Commission generally affirmed the initial decision without discussion of this issue.[780]

408. For Docket No. IS11-146-000, Ms. Sherman shows in Exhibit No. S-3 that the appropriate level of net deferred return is $24,226,000, and the appropriate level of amortization of deferred return as a cost item in the calculation of the uncommitted rate for the 2011 rate period is $370,000.[781] Ms. Sherman shows this calculation in Statement E2 on page 7 of Exhibit No. S-3, and Trial Staff noted that the calculation includes first deriving the equity rate base, multiplying that rate base by Trial Staff's inflation factor of 3.56% to obtain the deferred return of $24,596,000, and then amortizing the deferred return by the stipulated depreciation rate of 3.01%.[782] According to Trial Staff, the resulting value of $370,000 is a relatively small accumulated deferred return for an oil pipeline since Enbridge Southern Lights only began commercial operations on July 1, 2010, and this docket represents the second rate case in which a portion of its equity return is deferred. Trial Staff explained that subtracting the amortization of deferred return for the 2011 rate period from deferred return yields a net deferred return of $24,226,000.[783]

Findings and Conclusions

409. As Trial Staff explained, deferring return is intended to provide for lower rates in the early years of a pipeline by reducing the cost of equity embedded in current rates and amortizing the deferred equity return over the life of the pipeline.[784] I agree with Trial Staff that the Indicated Shippers' proposal frustrates this purpose, and therefore, their position must be rejected.

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[778] *Id.*

[779] *SFPP, L.P.*, 129 FERC ¶ 63,020, at P 619 (2009) (Cianci, ALJ) (emphasis added).

[780] *SFPP, L.P.*, 134 FERC ¶ 61,121, Opinion No. 511 (2011), *reh'g,* 137 FERC ¶ 61,220, Opinion No. 511-A (2011).

[781] Exh. S-3 (rev. Jan.11, 2012) at 7, Statement E2, lines 18 and 15; and at 2, Statement A, line 6 (Sherman).

[782] Exh. S-3 (rev. Jan. 11, 2012) at 7, Statement E2 (Sherman).

[783] *Id.* at line 18.

[784] *Id.*

410. Under the Opinion No. 154-B methodology, "deferred return is calculated each year by multiplying the inflation factor from the year in question by the equity portion of the pipeline's rate base from that same year."[785] These separate components are discussed, *supra*. Accordingly, Trial Staff's inflation factor and equity rate base should be used with the Opinion No. 154-B methodology to calculate the net deferred return.

Issue #15: What is the appropriate level of throughput/billing determinants?

A. ESL

411. ESL stated that for 2010, Dr. Webb testified that the appropriate level of billing determinants is 15.17 million barrels per year.[786] As discussed above, the 2010 rate was in effect for a locked-in period. However, no Uncommitted Shipper volumes were transported in 2010; thus, the maximum Uncommitted Rate would be infinite if the cost-of-service were divided by actual Uncommitted Volumes.[787] To the extent an Uncommitted Rate needs to be calculated for 2010, ESL noted that the best proxy would be the actual throughput that moved, that is, 15.17 million barrels. As Dr. Jaffe explained, that volume is almost certainly greater than the volume that would have moved without the Committed Shippers' contractual ship-or-pay obligation in place, but it is clear that no greater volume than that would have moved at any tariff rate during the period in question. Thus, the 15.17 million barrels of actual throughput for 2010 is a conservative figure to use to derive the maximum Uncommitted Rate for that period.[788]

412. ESL argued that Indicated Shippers' proposal to use the design capacity of the system (180,000 bpd) for 2010 is flawed. ESL noted that in the Declaratory Order, the Commission indicated that design capacity is frequently appropriate for initial rates on a new pipeline, but explained that recognized exceptions to that general policy apply.[789] ESL noted Dr. Webb's explanation that ESL clearly qualifies for those exceptions.[790]

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[785] *SFPP, L.P.*, 129 FERC ¶ 63,020, at P 619 (2009) (Cianci, ALJ) (emphasis added).

[786] *See* Exh. ESL-55 at Statement A.

[787] Tr. at 99:19-100:2 (Jaffe).

[788] According to ESL, the other alternative would be to assume that some Uncommitted Volume moved over and above the 77,000 bpd of Committed Volume, and to apply the *Keystone/Laclede* rate design approach to that amount of Uncommitted Volume. ESL noted that Dr. Webb shows the effective Uncommitted Rate would be just and reasonable under that approach at all volume levels; however, it is unnecessary to apply that approach for 2010 since the actual volumes are known for the locked-in period.

[789] Declaratory Order at P 29; ESL explained that principle is not reflected in the tariff filing regulations for oil pipelines, which state that the initial rates of a new pipeline

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413. ESL cited to *Crossroads Pipeline Co.*, 73 FERC ¶ 61,138 (1995), where the Commission recognized that an exception to the design capacity policy exists where pipelines have an automatic true-up or rate review mechanism in their tariffs.[791] As noted above, ESL has a true-up mechanism that prevents it from over-recovering.[792] ESL noted that over-earning cannot be a relevant consideration for the locked-in period of 2010 because no Uncommitted Volumes moved during that period, and accordingly, the use of design capacity in regard to 2010 is completely unwarranted.

414. As explained by Dr. Webb, the use of design capacity is based in part on a concern that pipelines should bear the risk of "oversizing."[793] However, according to ESL, the Commission recognized in *Crossroads* that an exception exists where the pipeline is redeploying an existing asset, as ESL has done here, because there is no risk of "oversizing" the asset.[794] Indicated Shippers allege that this exception is inapplicable because "[i]t is clear from the [Clarification] Order that the Commission contemplated the use of actual design capacity to derive ESL's initial uncommitted rate" in accordance with the Commission's regulations.[795] However, ESL stated that the Commission never mandated the use of design capacity in the Clarification Order; rather it found that in the event of a protest, ESL must "support its uncommitted rate by filing cost, revenue, and throughput data supporting such rate as required by Part 346 of the Commission's regulations."[796]

415. ESL explained that for 2011, Dr. Webb testifies that the appropriate level of billing determinants is 19.835 million barrels per year, or 56,000 bpd.[797] As Dr. Jaffe testified, because the Committed Shippers averaged 56,000 bpd during the test period – despite the fact that their effective economic cost of shipping up to 77,000 bpd is equal to variable operating costs – market demand for shipments at any price above variable

should be established on projected throughput for the first 12 months of operation. 18 C.F.R. § 346.2(a)(ii)(3).

[790] *See* Exh. ESL-7 at 34.

[791] *See Crossroads,* 73 FERC ¶ 61,138, at 61,396; *see also TransCanada Keystone Pipeline*, 125 FERC ¶ 61,025, at P 30 (2008) ("*Keystone"*); ESL-7 at 34.

[792] ESL-44 at 18-19.

[793] *See* ESL-7 at 34.

[794] ESL I.B. at 46; *Crossroads*, 73 FERC ¶ 61,138, at 61,396.

[795] IS I.B. at 33 (citing Clarification Order at PP 9-13).

[796] Clarification Order at P 13; *see also* Staff I.B. at 68 ("[Ms. Crowe] claims that her approach is consistent with Commission regulations and policy. . . . Ms. Crowe is mistaken about the Commission's regulations. They are silent on rate design methodology.").

[797] *See* Exh. ESL-56 at Statement A.

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operating cost must be less than 56,000 bpd.[798] Dr. Webb also explained how the *Keystone/Laclede* approach methodology is appropriately utilized at higher throughput levels, should they appear.[799]

416. ESL argued that Indicated Shippers' proposal to use the design capacity of the system (180,000 bpd) for 2011 is unsupported as the design capacity principle cited by Ms. Crowe only applies, if at all, to the initial rate for a new pipeline. However, according to ESL, the 2011 rate is not an initial rate, which makes that principle inapplicable from the outset for 2011.[800]

417. ESL stated that the five reasons presented by Ms. Crowe as support for using design capacity for 2011 are also without merit. First, the 2011 rates will not be in place for an indefinite period, as she claims. The TSA requires ESL to reset rates every year for the duration of the term and the 2012 rate has now gone into effect, superseding the 2011 rate.[801] Second, a rate set on design capacity will not promote efficient utilization of the asset because, as described above, additional volume would not have moved in 2011 at any conceivable tariff rate.[802] Third, the Commission precedent cited by Ms. Crowe as support for her proposition does not apply here, because those cases involve initial rates of oil pipelines or natural gas certificate cases, which also involve initial rates.[803] Fourth, as noted above, the year-end refund mechanism will prevent ESL from over-recovering.[804] Lastly, Ms. Crowe's assertion that ESL will not under-recover because of the TSAs is at odds with her assertion that no aspect of the TSA will be applicable to the Uncommitted Rate.[805] ESL noted that in any event, as witness McComb explained at hearing, the fact that there is a true-up under the TSA does not support setting a rate that itself will not recover the cost-of-service.[806]

418. Contrary to the Indicated Shippers' assertions, ESL stated that it did not "represent" in its Petition that it would use 90% of design capacity to establish the

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[798] *See* Exh. ESL-27 at 17.

[799] *See* Exh. ESL-7 at 63.

[800] *See* Exh. ESL-44 at 22-23.

[801] *Id*. at 24.

[802] *Id*. at 24-25.

[803] *Id*. at 25-26; Ms. Crowe cites *Enbridge Pipelines (Southern Lights) LLC*, 122 FERC ¶ 61,170, at P 10 (2008) (citing *Enbridge Energy Company, Inc.*, 110 FERC ¶ 61,211 (2005)); *Great Lakes Gas Transmission Limited Partnership*, 66 FERC ¶ 61,118 (1994); *Equitrans, Inc*., 63 FERC ¶ 61,070 (1993); *Arkansas Western Pipeline Co*., 63 FERC ¶ 61,006 (1993).

[804] *Id*. at 26.

[805] *Id*. at 26-27.

[806] *See* Tr. at 296:16-18.

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Uncommitted Rate.[807] ESL noted that Statement G of the Petition was clearly labeled as "illustrative" and designed to show how the *Laclede* method would apply at a hypothetical volume level.[808] ESL explained that the purpose of the Van Hoecke Affidavit was to show that Uncommitted Rates were just and reasonable at all potential volume levels – not to establish 90% of design capacity as a presumption.

419. Further, ESL asserted that relevant precedent following the Declaratory Order confirms that design capacity is not required for new oil pipelines. According to ESL, in *Keystone*, the Commission addressed Keystone's request to justify its uncommitted rates using the approach set forth in *Laclede*. ESL noted that the Commission specifically granted Keystone's request based on its true-up mechanism that assured no over-recovery.[809] Here, ESL argued that the Commission has already determined that ESL's true-up mechanism is non-discriminatory, just and reasonable, and similarly assures that no over-recovery will occur.[810]

420. ESL stated that in any event, even if the Commission were to use 180,000 bpd (or 162,000 bpd) as the level of billing determinants for 2010 or 2011, it would have to compare the resulting rate to the effective rate at that particular throughput level – not the posted rate. As shown by ESL and Trial Staff, ESL's Uncommitted Rates are just and reasonable at all volume levels up to and including 180,000 bpd when the year-end refunds applicable at each volume level are properly taken into account.[811] ESL stated that Indicated Shippers' advocacy of the design capacity approach is ultimately unavailing.[812]

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[807] *See* IS I.B. at 32.

[808] *See* Exhibit D ("Van Hoecke Affidavit") at P 17 (describing the three exhibits as "(1) an *illustrative* cost-of-service and rate calculation under the TSA methodology . . . and (2) two *illustrative* cost-of-service calculations using the Opinion No. 154-B methodology. . . . *These exhibits are presented simply for comparison purposes*.") (emphasis added).

[809] *See Keystone*, 125 FERC ¶ 61,025, at P 30.

[810] *See* Declaratory Order at P 45; Order on Complaint at PP 11-14.

[811] *See* ESL-48 and ESL-50; S-15 at 17.

[812] Trial Staff's use of the Committed Volumes (77,000 bpd) is appropriate only if the Commission is also applying the 2-to-1 rate design, as the Trial Staff proposes. *See* Staff I.B. at 76. If the Commission were disregarding the TSAs, as the Indicated Shippers seek, the 77,000 bpd throughput level would have no relevance. In that scenario, the maximum amount of volume that would have moved through the Southern Lights Pipeline is the volume the Committed Shippers actually moved – and there is good reason to think even that volume level would be overstated without the TSAs. *See* ESL-27 at 17.

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B. Committed Shippers

421. Committed Shippers noted that the appropriate levels of throughput for the 2010 and 2011 rates should be based on actual throughput during the relevant periods. Therefore, Committed Shippers supported the calculations of ESL witness Webb, who testified that the appropriate level of throughput to calculate the Uncommitted Rate is 15.17 million bpy for the 2010 period.[813] Committed Shippers explained that this number was calculated by annualizing the actual volumes for the 2010 period, which ran from July 1, 2010 to January 31, 2011.[814] According to Committed Shippers, the appropriate level of throughput for the 2011 period is 19.835 million bpy,[815] and this figure shows the actual volumes that flowed on ESL during the 2011 period.[816] Committed Shippers argued that these numbers are appropriate because they represent what actually occurred on the pipeline during the rate periods.

422. Committed Shippers noted that it is unwarranted and unsound to base Southern Light's rates on its design capacity. According to Committed Shippers, prior Commission oil pipeline orders adopting the use of design capacity for initial rates cite policy goals: (i) to minimize the opportunity for a pipeline to over-recover its costs; and (ii) to incentivize a pipeline to correctly size its pipe.[817] Committed Shippers stated that neither of those concerns is present here.

423. Committed Shippers explained that there is no possibility of over-recovery in this case because ESL's tariff contains an annual true-up mechanism.[818] Committed Shippers explained that the true-up is structured to compare the actual revenues received by Enbridge from both committed and uncommitted shippers in a calendar year to the actual cost-of-service in that year. Committed Shippers stated that if the actual revenue exceeds

[813] *See* Exh. ESL-55, Statement A, Line 9.

[814] *Id.*

[815] *See* Exh. ESL-56, Statement A, Line 8.

[816] *Id.*

[817] *See, e.g.*, *White Cliffs Pipeline, LLC*, 126 FERC ¶ 61,070 at PP 31-32 (2009); *TransCanada Keystone Pipeline, LP*, 125 FERC ¶ 61,025 at PP 30-32 (2008); *Crossroads Pipeline Co.*, 73 FERC ¶ 61,138 at 61,396-97 (1995).

[818] Southern Lights FERC Tariff No. 2, Exh. ESL-4, at p. 2 n.1 (noting that the true-up provides that "[t]o the extent the actual revenue, net of committed shipper volume credits, for a full calendar year exceeds the true-up revenue requirement for the same calendar year, Carrier shall refund to each Shipper its share of the difference based on such Shipper's proportionate contribution to the actual revenue for the same calendar year as detailed in the TSA as amended. To the extent the actual revenue for the Base Period is less than the true-up revenue requirement for the calendar year, Carrier shall recover from each Shipper its share of the difference based on such Shipper's proportionate contribution to the actual revenue for the said calendar year").

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the cost-of-service, meaning an over-collection, or is less than the cost-of-service, meaning an under-collection, Enbridge will, respectively, issue refunds to or collect the difference from both committed and uncommitted shippers based on their proportionate share of the revenues contributed to the pipeline during the year so as to maintain the 2:1 Rate Design Ratio.[819]

424. Committed Shippers asserted that this case is on all fours with *Crossroads Pipeline Co.*, 73 FERC ¶ 61,138 (1995), and subsequent cases that did not require the use of design capacity to calculate rates. Committed Shippers explained that in *Crossroads*, the pipeline converted an oil pipeline to natural gas service and proposed that it be able to base its initial rates on throughput rather than design capacity, which represented a larger volume. Crossroads, in a request for rehearing of the order granting it authority, argued that its initial rates should not be calculated using the pipeline's design capacity, pointing out that there was no question of building an oversized pipeline because the pipeline already existed. Committed Shippers stated that the Commission accepted this argument, and moreover, the Commission determined that it would not require the use of design capacity in designing initial rates because the pipeline implemented sufficient safeguards against over-recovery—the pipeline had committed to file a section 4 rate proceeding if its annual firm demand level exceeded its rate design level.[820]

425. Committed Shippers asserted that the Commission recently reaffirmed its reasoning in *Crossroads* in *White Cliffs Pipeline, LLC*, 126 FERC ¶ 61,070 (2009), and *TransCanada Keystone Pipeline, LP*, 125 FERC ¶ 61,025 (2008). Committed Shippers explained that White Cliffs held a two-phase open season for a new oil pipeline, offering discounted prices for five-year term commitments; in addition to the lower Committed Rates, White Cliffs sought approval to use test period billing determinants, which were based only on the level of committed throughput at the time the system was placed into service plus a reasonable projection of uncommitted volume. According to Committed Shippers, White Cliffs' proposed throughput was less than the design capacity. Unlike Southern Lights, White Cliffs failed to offer a mechanism to protect against over-recovery, and the Commission rejected White Cliffs' proposal, explaining that in calculating Uncommitted Rates, it will permit the use of throughput that is less than design capacity when the pipeline puts into place an effective safeguard against cost over-recovery.[821]

426. In contrast, Committed Shippers explained that in *TransCanada Keystone Pipeline, LP*, 125 FERC ¶ 61,025 (2008), the pipeline provided a mechanism to

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[819] *See* Exh. ESL-7 at 16-17 (Webb). Committed Shippers noted that when volume on the pipeline exceeds 162,000 bpd, ESL may retain 25% of revenues from the uncommitted volumes above 162,000 bpd.

[820] *Crossroads Pipeline Co.*, 73 FERC ¶ 61,138 at 61,396 (1995).

[821] *See White Cliffs* at PP 31-32.

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safeguard against over-recoveries. Committed term shippers on Keystone had a rate that had two components: a fixed component, which represented the shipper's contribution to the capital costs of the pipeline, and a variable component, which recovered non-capital costs in the project. Committed Shippers noted that the Uncommitted Rate was a one-part rate that was higher than the total Committed Rate, and Keystone also had a mechanism whereby non-capital costs were allocated among committed and non-committed volumes and then trued-up by crediting committed shippers the difference between their estimated and actual non-capital costs. According to Committed Shippers, in this way, the pipeline could not over-recover its costs in any given year. Committed Shippers explained that the Commission determined that the true-up protection was sufficient to allow it to use projected throughput,[822] and the Commission further noted that all potential shippers had the opportunity through an open season to become a committed shipper.[823]

427. In this case, Committed Shippers stated that there is no possibility that Enbridge will over-recover its costs, and the safeguards required by the Commission are present here. Committed Shippers asserted that the Commission "approved Enbridge Southern Lights' proposed true-up provision, finding that it will ensure that the pipeline will not over-recover its costs."[824]

428. According to Committed Shippers, the Commission has already recognized the significance of a true-up mechanism in preventing over-recovery on Southern Lights. Committed Shippers explained that Enbridge's use of actual throughput with a true-up mechanism provides an increased level of protection against over-recovery for both committed and uncommitted shippers. Committed Shippers stated that the Commission, as recognized above, does not mandate the use of design capacity if a pipeline provides an alternative to minimize the likelihood of over-recovery.

429. Finally, Committed Shippers asserted that this project was not a greenfield project, and as such, use of design capacity is unwarranted. Committed Shippers stated that ESL reversed and redeployed a pre-existing crude oil pipeline, Line 13 of the Enbridge/Lakehead mainline system, to avoid costly new construction from Clearbrook, Minnesota to Edmonton, Alberta.[825] Retooling an existing pipeline to meet current market needs is an efficient use of resources, minimizes or eliminates new environmental

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[822] *See Keystone* at P 30.

[823] *Id.* at P 31.

[824] February 22 Order at P 5; *see also* Order on Petition at P 45 ("The Commission finds that this proposed mechanism will guarantee that Enbridge Southern Lights will not be over-recovering its costs and at the same time will ensure that Enbridge Southern Lights is appropriately compensated for its capital investment and its associated risk.").

[825] *See* Exh. ESL-1 at 5-7 (Jervis).

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impacts, and is encouraged by the Commission, and in fact, redeploying the old pipeline is estimated to have saved shippers more than $1 billion in additional construction costs.[826] Therefore, as in *Crossroads*, Committed Shippers explained that the Commission's historical concern that new pipelines be correctly sized does not arise here.[827] Accordingly, Committed Shippers stated that ESL should not be required to base its cost-of-service calculations on the pipeline's design capacity.

430. Committed Shippers' Post-Hearing Reply Brief addressed Docket No. IS10-399-003 and Indicated Shippers' argument that the design capacity of the pipeline must be used to calculate rates for both the 2010 period (initial rates) and the 2011 period. Committed Shippers noted Indicated Shippers' assertion that, in the Declaratory Order,[828] the Commission recognized that the rate methodology using Committed Volumes and projected Uncommitted Volumes was inconsistent with Commission precedent and "[i]n the Clarification Order, the Commission applied its prior precedent and indicated that [Enbridge's] actual design capacity must be used to calculate [Enbridge's] initial uncommitted rate."[829] Committed Shippers noted that the Commission did no such thing.

431. According to Committed Shippers, in the Declaratory Order, the Commission found that while use of design capacity is generally the norm when setting initial rates for new pipelines,[830] Enbridge's alternative proposal to use projected throughput was justified under the circumstances and did not violate the antidiscrimination or undue preference provision of the ICA.[831]

432. Specifically, Committed Shippers asserted that the Commission determined that Enbridge's proposed rate design was entirely justified on the grounds that all potential shippers had an opportunity during both open seasons to avail themselves of the TSA, the entire rate design was fully supported by the Committed Shippers and the Canadian Association of Petroleum Producers, no one had challenged the use of projections rather than design capacity, and no one had opposed the method of setting the Uncommitted Rate.[832] According to Committed Shippers, the Commission also noted that in the

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[826] *Id.* at 8.

[827] *See also Cimarron River Pipeline, LLC*, 124 FERC ¶ 61,069, at P 50 (2008) (declining to impose design capacity based rates); *Missouri Interstate Gas, LLC*, 122 FERC ¶ 61,136, at PP 62-63 (2008) (same).

[828] *Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,130 (2007) ("Declaratory Order").

[829] IS I.B. at 31.

[830] Declaratory Order at P 29 (quoting *Enbridge Energy Company, Inc.*, 110 FERC ¶ 61,211 at P 44 (2005) ("Spearhead Order").

[831] *Id.* at PP 29-31; Clarification Order at P 11.

[832] Declaratory Order at PP 29-31; *see also* Order on Complaint at PP 3-4.

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Spearhead Order, it found that projected throughput was appropriate when safeguards against over-recovery are put into place, as is the case with Enbridge.[833]

433. In the Clarification Order, the Commission recognized that some party in the future might challenge the Uncommitted Rate.[834] Committed Shippers stated that in the case where the Uncommitted Rate is challenged, the Commission could have plainly stated that Enbridge must use the design capacity of the Southern Lights Pipeline, and the Commission also could have plainly stated that, if the Uncommitted Rate was protested, that Enbridge must use 90% of design capacity, which is Indicated Shippers' alternative to full design capacity.[835] However, Committed Shippers explained that the Commission did neither of those things. Rather, the Commission only required that Enbridge provide and use throughput data that would support its cost-of-service rate, which is exactly what Enbridge has done.

434. Because no Uncommitted Volumes moved during the locked-in 2010 period, Committed Shippers noted that one must come up with a proxy, and the best approach is to use the volumes that actually moved during the period. Committed Shippers explained that Dr. Webb testified that the appropriate level of throughput for the 2010 period is 15.17 million bpy.[836] Committed Shippers asserted that this volume is also appropriate because the 2010 period is a locked-in period with no future price effects.[837]

435. Committed Shippers noted that separate and apart from the fact that the Commission did not require Enbridge to use design capacity to calculate the Uncommitted Rate whether or not the Uncommitted Rate was challenged, there are two exceptions to the general norm of using design capacity for new pipelines as set forth and discussed in *Crossroads*, *White Cliffs*, and *Keystone*.[838] These exceptions are: (1) when

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[833] Declaratory Order at P 29 & n.35 (quoting Spearhead Order at P 44).

[834] Clarification Order at P 13 (noting that "if the uncommitted rate is protested, Enbridge Southern Lights must comply with section 342.2(b) to support its uncommitted rate by filing cost, revenue, *and throughput data supporting such rate* as required by part 346 of the Commission's regulations. When a just and reasonable uncommitted rate is determined in this manner, Enbridge Southern Lights may derive its committed rate by applying the agreed-upon terms of the TSA.") (emphasis added).

[835] *See* IS I.B. at 32.

[836] *See* Exh. ESL-55, Statement A, Line 9 (Webb); Committed Shippers argued that an acceptable alternative to Dr. Webb's approach is that of Staff witness McComb, who divided cost-of-service by the Committed Shippers' committed volumes of 77,000 bpd or, on an annualized basis, 28.105 million barrels to arrive at a Committed Rate, which is then multiplied by two to derive the Uncommitted Rate. Exh. ESL-15 at 8:21 (McComb).

[837] *Id.*; Exh. ESL-7 at 61 (Webb).

[838] *See* IS I.B. at 32-33.

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the pipeline has converted an existing pipeline for use as an oil pipeline; and (2) when the pipeline has in place a cost-of-service true-up mechanism.[839]

436. According to Committed Shippers, Indicated Shippers do not dispute that the first exemption applies in this case – Enbridge reversed and redeployed a pre-existing crude oil pipeline, Line 13 of the Enbridge/Lakehead mainline system, to avoid costly new construction from Clearbrook, Minnesota to Edmonton, Alberta.[840]

437. However, Committed Shippers note Indicated Shippers' argument that "neither the refund mechanism of the TSA, nor any of the TSA's other aspects applies to the uncommitted rate."[841] According to Committed Shippers, Indicated Shippers conclude from this that the TSA refund mechanism does not "protect" Uncommitted Shippers because, in their view, the TSA does not apply to the Uncommitted Rate.[842] Committed Shippers stated that it is unclear what Indicated Shippers mean by "protect" with respect to the refund mechanism, and they do not explain; however, it is clear that Indicated Shippers misunderstand why the true-up mechanism exception applies. The Commission's concern is that a pipeline will over-recover its costs if it uses throughput that is less than design capacity when it derives its initial rates. However, when there is some form of true-up mechanism, or even a rate review mechanism, this concern is significantly reduced or eliminated. Committed Shippers asserted that in such cases, all shippers are protected from the pipeline's over-recovery. Committed Shippers stated that Enbridge's true-up mechanism meets this standard, and Enbridge cannot over-recover its costs.[843] According to Committed Shippers, both Committed and Uncommitted Shippers are protected from over-recovery and the *Crossroads* exception applies.[844]

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[839] *See id.; see also White Cliffs Pipeline, LLC*, 126 FERC ¶ 61,070 at PP 31-32 (2009); *TransCanada Keystone Pipeline, LP*, 125 FERC ¶ 61,025 at PP 30-32 (2008); *Crossroads Pipeline Co.*, 73 FERC ¶ 61,138 at 61,396-97 (1995).

[840] *See* Exh. ESL-1 at 5-7 (Jervis).

[841] IS I.B. at 33.

[842] *Id.*

[843] Southern Lights FERC Tariff No. 2, Exh. ESL-4 at p. 2 n.1 (noting that the true-up provision provides that "[t]o the extent the actual revenue, net of committed shipper volume credits, for a full calendar year exceeds the true-up revenue requirement for the same calendar year, Carrier shall refund to each Shipper its share of the difference based on such Shipper's proportionate contribution to the actual revenue for the same calendar year as detailed in the TSA as amended. To the extent the actual revenue for the Base Period is less than the true-up revenue requirement for the calendar year, Carrier shall recover from each Shipper its share of the difference based on such Shipper's proportionate contribution to the actual revenue for the said calendar year").

[844] At page 34 of its brief, Indicated Shippers end the block quotation without providing the key explanatory sentence: "The general policy is also intended to prevent overrecovery of costs, which could occur even where an oversized existing pipeline was

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438. Committed Shippers noted Indicated Shippers' argument that Enbridge's use of actual volumes is simply too low as compared to the percentage of design capacity that was approved in *Crossroads*.[845] However, Committed Shippers explained that the pipeline in *Crossroads* was not dealing with a locked-in period as Enbridge is. In *Crossroads*, the pipeline had to make an estimate; here, Enbridge does not need to estimate because actual throughput is known for the locked-in rate period. Moreover, as Committed Shippers discussed above, in the case of a challenge to the Uncommitted Rate, the Commission did not direct Enbridge to use any particular percentage of design capacity when it easily could have done so. Instead, Committed Shippers asserted that the Commission opted to wait for the facts to develop and to allow Enbridge the opportunity to present and justify throughput volumes that support a cost-of-service calculation in conformity with Opinion No. 154-B. According to Committed Shippers, that is precisely was Enbridge has done.

439. Committed Shippers noted Indicated Shippers' argument that the rates for the 2011 period should be treated as initial rates, and from this assertion, conclude that either full design capacity or 90% of design capacity should be used to calculate the Uncommitted Rate for the 2011 period.[846] Committed Shippers argued that the rates for the 2011 period cannot be considered initial rates – the rates for the 2010 period were Enbridge's initial rates. Committed Shippers asserted that Enbridge must attempt to calculate its rates based on test period throughput, which is based on historical movements. According to Committed Shippers, the appropriate level of throughput for the 2011 period is 19.835 million bpy[847] and this figure represents twelve months of actual data.[848] Committed Shippers stated that this number is the appropriate throughput because it represents what actually occurred on the pipeline during the test period.

440. According to Committed Shippers, the five reasons Indicated Shippers witness Crowe presented in support of using the design capacity of the system for 2011, which would result in an artificially low Uncommitted Rate that has no relation to actual movements, are unpersuasive.[849] Because Committed Shippers did not fully transport their contract commitments of 77,000 bpd when the Committed Shippers had to pay the full cost to transport those barrels anyway, it is clear that an artificially low Uncommitted Rate based on total design capacity would not have resulted in any additional movements

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purchased." *Crossroads Pipeline Co.*, 73 FERC ¶ 61,138 at 61,396 (1995). As discussed above, Enbridge's annual true-up mechanism protects all shippers from over-recovery.

[845] *See* IS I.B. at 34.

[846] IS I.B. at 43-44.

[847] *See* Exh. ESL-56, Statement A, Line 8.

[848] *Id.*

[849] *See* Initial Post-Hearing Brief of Enbridge Pipelines (Southern Lights) LLC at 47-48 (filed Feb. 28, 2012); *see also* IS Br. at 43-44.

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by either Committed or Uncommitted Shippers. Thus, an artificially low rate, such as that calculated by witness Crowe, would only have served to keep Enbridge from realizing its cost-of-service. Contrary to witness Crowe's position, Committed Shippers argued that it is economically efficient and the foundation of regulatory ratemaking to set rates at levels designed to allow a pipeline to recover its costs.[850] Committed Shippers stated that Witness Crowe's approach fails to do that,[851] and accordingly, Enbridge should not be required to base its cost-of-service calculations on the pipeline's design capacity.

C. Indicated Shippers

441. Indicated Shippers argued that the appropriate level of throughput to be used to calculate initial rates for uncommitted service on ESL is the full design capacity of the system, which is 180,000 bpd (65,700,000 barrels per year).[852] As Indicated Shippers witness Crowe stated in her Cross-Answering Testimony, "[I]t is the Commission's general policy and precedent to place a new pipeline at risk for unsubscribed capacity by designing rates based on system capacity."[853] Indicated Shippers explained that in the Declaratory Order, the Commission acknowledged this general precedent as well as an exception to the general precedent.[854] Further, in the Clarification Order, the Commission reiterated almost verbatim that "Commission precedent generally dictates

[850] *See, e.g.*, Exh. ESL-44 at 16-17 (Webb); Tr. 293:8-13, 294:22-296:1, 296:17-18 (McComb).

[851] *See id.*

[852] Exh. IS-4(Updated) at 1, line 8; Exh. IS-1 at 7.

[853] Exh. IS-33 at 25 (citing Clarification Order at P 10 (citing *Enbridge Energy Company, Inc.*, 110 FERC ¶ 61,211 (2005); *Great Lakes Gas Transmission Limited Partnership*, 66 FERC ¶ 61,118 (1994); *Equitrans, Inc.*, 63 FERC ¶ 61,070 (1993); *Arkansas Western Pipeline Co.*, 63 FERC ¶ 61,006 (1993))).

[854] Declaratory Order at P 29 (quoting *Enbridge Energy Company, Inc.*, 110 FERC ¶ 61,211, at P 44 (2005) (footnotes omitted) (stating that "Commission precedent generally dictates the use of actual design capacity for initial rates on a new pipeline, and a pipeline is placed at risk for the costs of unsubscribed capacity based on actual capacity. The Commission made an exception to this policy in the case of *Crossroads Pipeline Co.* (*Crossroads*), in which the pipeline filed an application to acquire an oil pipeline and convert it to a gas pipeline for transportation of gas in the interstate market. In that case, the Commission concluded that it was appropriate to use projected throughput in light of safeguards implemented by Crossroads to prevent over-recovery"). The Commission also noted that Crossroads had agreed to file a major section 4 rate proceeding if its annual firm demand level exceeded its rate design level. *See Crossroads Pipeline Co.*, 73 FERC ¶ 61,138, at 61,396 (1995).

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the use of actual design capacity for initial rates on a new pipeline, and a pipeline is placed at risk for the costs of unsubscribed capacity based on actual design capacity."[855]

442. Indicated Shippers argued that read together, the Declaratory Order and Clarification Order make clear that ESL's design capacity must be used to derive its initial uncommitted rates.

443. Indicated Shippers pointed out that in the Declaratory Order, the Commission noted that in deriving the illustrative committed rates in that proceeding, ESL had not followed the Commission's general precedent to use the pipeline's design capacity to calculate initial rates.[856] The Commission explained that instead, ESL had utilized the volumes committed by shippers during the open season and projected spot volumes, claiming that the sum of committed volumes and projected spot volumes constituted 90% of the pipeline's annual capacity.[857] However, the Commission also noted that no one had challenged ESL's proposed method to derive the committed rates using 90% of capacity, and the Commission therefore accepted the proposed method.[858] Similarly, the Commission noted that no one had opposed setting the uncommitted rate, and accepted that aspect of ESL's proposal as well.[859]

444. According to Indicated Shippers, in the Clarification Order, the Commission applied its prior precedent and indicated that ESL's actual design capacity must be used to calculate ESL's initial uncommitted rate.[860] In the Clarification Order, the Commission noted that in the Declaratory Order, it had found that ESL's proposed method of calculating the initial rate for ESL's Committed Shippers "did not comply with section 342.2(a) of the Commission's regulations."[861] The Commission again noted that ESL's proposal to rely on committed volumes and projected spot volumes to derive ESL's committed rate was "not consistent with that precedent and the Commission's regulations" to use actual design capacity for initial rates on a new pipeline.[862]

445. Indicated Shippers also noted that in the Clarification Order, the Commission explained that, while it had found in the Declaratory Order that ESL's proposed rate structure does not violate the antidiscrimination or undue preference provisions of the

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[855] Clarification Order at P 10 (internal citations omitted).

[856] Declaratory Order at P 29-30; *see also* Clarification Order at P 10.

[857] Declaratory Order at P 29 (citing Petition for Declaratory Order of Enbridge Pipelines (Southern Lights) LLC, Exh. D, Statement G of Exhibit Nos. RGV-2 and RGV-3).

[858] Declaratory Order at P 30.

[859] *Id.*

[860] *See* Clarification Order at PP 9-14.

[861] Clarification Order at P 10.

[862] *Id.*

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ICA,[863] it was "concerned" regarding the calculation of a just and reasonable uncommitted rate.[864] The Commission explained that because ESL's proposed rate design set the uncommitted rate at twice the level of the committed rate, and because ESL's proposed committed rate was not supported by cost-of-service data and determined in accordance with the Commission's Opinion No. 154-B rate methodology, "[T]he uncommitted rate likewise is unsupported."[865] Therefore, as discussed above, the Commission held that, "if the uncommitted rate is protested, Enbridge Southern Lights must comply with section 342.2(b) to support its uncommitted rate by filing cost, revenue, and throughput data supporting such rate as required by part 346 of the Commission's regulations."[866]

446. According to Indicated Shippers, since ESL's proposed uncommitted rate has been protested, the Clarification Order makes clear that in accordance with the Commission's precedent and regulations, ESL's actual design capacity must be used to derive ESL's initial uncommitted rate. In the alternative, Indicated Shippers proposed that 90% of ESL's design capacity be used to derive ESL's initial uncommitted rate. Committed Shippers stated that, as discussed above in ESL's Petition for Declaratory Order, ESL represented that its projected throughput amounted to 90% of its design capacity.[867]

447. Indicated Shippers argued that the *Crossroads* exceptions to the Commission's general precedent do not apply in this case. Indicated Shippers noted that in his direct and rebuttal testimony, ESL witness Webb cited *Crossroads* for the proposition that there are two exceptions to the Commission's general policy for setting initial rates of new pipelines based on actual design capacity, and he asserted that both of them apply in this case.[868] Regarding the first exception, witness Webb asserted that the Commission's requirement to use actual design capacity to set initial rates is in part based on a concern that a pipeline bears the risk of "oversizing," or building a bigger pipeline than is needed for the market being served.[869] According to witness Webb, the first exception applies when the pipeline converts an existing asset with preexisting capacity to a new use.[870]

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[863] *Id.* at P 11.

[864] *Id.* at P 12.

[865] *Id.* at P 12.

[866] *Id.* at P 13.

[867] Declaratory Order at P 29 (citing Petition for Declaratory Order of Enbridge Pipelines (Southern Lights) LLC, Exh. D, Statement G of Exhibit Nos. RGV-2 and RGV-3).

[868] Exh. ESL-7 at 33-36; Exh. ESL-44 at 20-22 (also citing *Missouri Interstate Gas, LLC*, 122 FERC ¶ 61,136, at P 62 (2008), *reh'g denied*, 127 FERC ¶ 61,011 (2009); *Cimarron River Pipeline, LLC*, 124 FERC ¶ 61,069, at P 50 (2008)).

[869] Exh. ESL-7 at 34-35; Exh. ESL-44 at 20-22.

[870] *Id.*

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Witness Webb asserted that in this situation, the Commission has recognized that the Commission's concern of "oversizing" the pipeline does not exist.[871]

448. Witness Webb claimed that the second exception to the Commission's general policy applies when the pipeline establishes an automatic true-up or rate review mechanism in its tariff.[872] Citing *Crossroads* and the Commission's decision in *Keystone*,[873] witness Webb explained that such a mechanism would prevent overrecovery by the pipeline. Witness Webb asserted that because ESL involves the reversal and redeployment of a preexisting crude oil pipeline – Line 13 of the Enbridge/Lakehead mainline system – and because the tariff contains a refund mechanism that provides for a refund of all of the uncommitted revenue up to 162,000 bpd, both exceptions apply to ESL.[874]

449. According to Indicated Shippers, despite ESL witness Webb's erroneous assertions to the contrary, the two exceptions do not apply to the instant case. As a threshold matter, Indicated Shippers noted that, in the Clarification Order, the Commission explained that the calculation of the uncommitted rate must be in accordance with Commission regulations.[875] Indicated Shippers asserted that it is clear from the Order that the Commission contemplated the use of actual design capacity to derive ESL's initial uncommitted rate.[876]

450. Furthermore, as noted *supra*, it is Indicated Shippers' position that neither the refund mechanism of the TSA, nor any of the TSA's other aspects applies to the uncommitted rate. Thus, unlike the true-up mechanism in *Keystone*, Indicated Shippers argued that the TSA's refund mechanism does not serve to protect uncommitted shippers. In fact, Indicated Shippers believed that the *Keystone* case actually supports the proposition that the Commission intended for ESL to design its uncommitted rates using the full design capacity of the pipeline.[877]

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[871] *Id.*

[872] Exh. ESL-7 at 35-36; Exh. ESL-44 at 18-19.

[873] *TransCanada Keystone Pipeline*, 125 FERC ¶ 61,025 (2008) ("*Keystone*").

[874] *See* Exh. ESL-7 at 34-36; Exh. ESL-44 at 18-22.

[875] *See* Clarification Order at PP 9-13.

[876] *Id.*

[877] *Keystone*, 125 FERC ¶ 61,025, at P 30 (noting that "[t]he Commission will approve Keystone's request to calculate the uncommitted rate based on projected throughput. While the Commission recognizes it previously stated in several recent cases that pipelines should base uncommitted rates on design capacity rather than on projected throughput as proposed here, there are a number of factors here supporting the use of projected throughput. The major concern in the *Spearhead* and *Southern Lights* cases cited by Keystone as requiring design capacity for uncommitted rates was the potential for the over- recovery of costs").

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451. According to Indicated Shippers, there is also a key difference between the instant case and the *Crossroads* decision: the ratios in each case of throughput used to support a cost-based initial rate to actual design capacity are vastly different. Indicated Shippers explained that in *Crossroads*, the actual design capacity was 250,000 Mcf/d, while the projected throughput, which the Commission allowed Crossroads to use to calculate its initial rate, was 225,000 Mcf/d, or 90% of Crossroads' actual design capacity.[878]

452. Indicated Shippers noted that in contrast, in the instant case, although ESL had included throughput projections of approximately 90% of actual design capacity in its Petition for Declaratory Order, ESL witness Webb used a throughput level of only 41,561 bpd, based on the actual volumes shipped by ESL's Committed Shippers, to calculate what he considered to be a cost-based uncommitted rate.[879] Indicated Shippers asserted that this figure is less than 25% of the pipeline's actual design capacity, and obviously, this much lower percentage increases the resulting rate dramatically. Indicated Shippers argued that the two cases are not at all analogous, and that it is erroneous to claim that the Commission's allowance of 90% of Crossroads' actual design capacity to calculate an initial rate supports the proposition here that the Commission should permit less than one quarter of ESL's design capacity to calculate an initial cost-based uncommitted rate.[880]

453. For Docket No. IS11-146-000, Indicated Shippers noted that the appropriate level of throughput is the full design capacity of the system, which is 180,000 bpd (65,700,000 barrels per year).[881] In her Cross-Answering Testimony, Indicated Shippers witness Crowe listed five reasons why design capacity should be used.[882] One reason she advanced is that calculating an uncommitted rate based on design capacity "will promote efficient utilization of pipeline capacity by maximizing throughput."[883] Noting that no uncommitted shipper has as yet shipped diluent on ESL, witness Crowe explained that if uncommitted rates are calculated on the basis of only ESL's committed volumes, 77,000

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[878] 73 FERC ¶ 61,138, at 61,396.

[879] Exh. ESL-7 at 61.

[880] Indicated Shippers witness Crowe pointed out that the Commission held in *Crossroads*: "We agree with Crossroads that deterring the oversizing of facilities proposed for construction is not present in this case. However, we note, that where purchases of facilities are involved, the Commission would expect that the size of the facilities bear a reasonable relationship to the anticipated market. In any event, we disagree that the Commission's general policy of requiring rates to be designed based on actual capacity should not apply to the purchase of existing facilities or to oil pipeline conversions." *Crossroads*, 73 FERC ¶ 61,138, at 61,396; *see also* Exh. IS-1 at 20-21.

[881] Exh. IS-3A (Supp.) at 1, line 8; Exh. IS-33 at 23.

[882] Exh. IS-33 at 24-26.

[883] *Id.* at 24.

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bpd, which represent only 43% of ESL's full capacity, these rates could discourage the utilization of the pipeline and hinder economic efficiency.[884]

454. Witness Crowe also explained that an uncommitted rate based on ESL's design capacity would benefit Committed Shippers.[885] She stated that such a rate would attract additional revenue much sooner than otherwise.[886] Therefore, an uncommitted rate based on design capacity would defray the costs the Committed Shippers must otherwise bear under the TSA's cost-of-service.[887]

455. Indicated Shippers acknowledged that it is the Commission's general precedent to require oil pipelines who seek to change their rates based on a cost-of-service methodology to use actual throughput.[888] However, Indicated Shippers argued that the instant case is unique, as there have been thus far zero actual uncommitted volumes (not subject to the Committed Volume Credit)[889] on ESL. Thus, Indicated Shippers noted that a rate calculated in Docket No. IS11-146-000, assuming that indexing of the Docket No. IS10-399-003 uncommitted rate does not apply, may still properly be considered as an initial rate for uncommitted service. Accordingly, for the same reasons as stated in Docket No. IS10-399-003, Indicated Shippers' position on this issue is that the appropriate level of throughput is the full design capacity of the system.

456. In the alternative, Indicated Shippers proposed that 90% of ESL's design capacity be used to derive ESL's uncommitted rate. As Indicated Shippers discussed in Docket No. IS10-399-003, in ESL's Petition for Declaratory Order, ESL had claimed that 90% of its design capacity was its projected throughput.[890]

457. Indicated Shippers' Post-Hearing Reply Brief noted Staff's conclusion that the regulations in Part 346 are merely "filing requirements" and that Indicated Shippers witness Crowe is "mistaken about the Commission's regulations."[891] Indicated Shippers

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[884] *Id.* at 25.

[885] *Id.* at 26.

[886] *Id.*

[887] *Id.*

[888] *See* 18 C.F.R. § 346.2(a); *see also* Exh. ESL-44 at 22-23.

[889] The Committed Volume Credit is set forth in Paragraph 16 of Schedule B to the TSA. Exh. ESL-9 at 44; *see also* Exh. ESL-7 at 13. Indicated Shippers explained that this credit assures that a Committed Shipper does not have to pay the uncommitted rate for the committed shipper's committed volumes, even if the Committed Shipper does not ship its committed volumes in equal increments each month. Exh. ESL-7 at 13.

[890] Declaratory Order at P 29 (citing Petition for Declaratory Order of Enbridge Pipelines (Southern Lights) LLC, Exh. D, Statement G of Exhibit Nos. RGV-2 and RGV-3).

[891] Staff I.B. at 68-69; *see also id.* at 17-18.

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pointed to the Clarification Order, and how the Commission noted that it was "concerned" in part by the effects of ESL's failure to comply with precisely the regulations Staff characterizes as inconsequential filing requirements.[892] Indicated Shippers stated that the Commission found ESL's proposed rate structure had been approved "despite" its failures to comply with the regulations.[893] According to Indicated Shippers, the Commission went on to condition that approval on ESL's eventual compliance with Part 346 in the event of a protest, including the use of design capacity to derive a cost-based uncommitted rate.[894]

458. Indicated Shippers stated that although the Commission has already announced that its policy favors the use of design capacity in this case, Trial Staff devotes seven pages of its Initial Brief attempting to refute Indicated Shippers witness Crowe's additional policy justifications.[895]

459. According to Indicated Shippers, Trial Staff asserts that "Lowering the rates by basing them on design capacity will not lead to greater utilization here" in response to Ms. Crowe's argument "that use of design capacity in deriving the uncommitted rate will promote efficient utilization of pipeline capacity by maximizing throughput."[896] Indicated Shippers noted that a fundamental principle of economics is that, as the price or rate falls, other things being equal, the amount that will be shipped will increase. Yet, Indicated Shippers explained Trial Staff's assertion that this rule will be broken in this case, based on only the demand of Committed Shippers. Indicated Shippers stated that this protest concerns the uncommitted shippers' rate, and uncommitted shippers, who shipped no volume in 2010, certainly may have been induced to ship on ESL if the posted rates had been cost-based, and thus just and reasonable. Indicated Shippers asserted that Trial Staff does not even address this hole in its analysis of demand for the pipeline.

460. Indicated Shippers noted Trial Staff's statement that the "general policy and precedent for placing a pipeline at risk for unsubscribed capacity by designing rates based on system capacity" cannot apply here because "the pipeline has no incentive to

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[892] Clarification Order at P 10, 12.

[893] *Id.* at P 11.

[894] *See id.* at 13 ("[I]f the uncommitted rate is protested, Enbridge Southern Lights must comply with section 342.2(b) to support its uncommitted rate by filing cost, revenue, and throughput data supporting such rate as required by part 346 of the Commission's regulations."); *id.* at 10 ("Commission precedent generally dictates the use of actual design capacity for initial rates on a new pipeline . . . . Enbridge Southern Lights' reliance on committed volumes and projected spot volumes is not consistent with that precedent and the Commission's regulations.").

[895] *See* Staff I.B. at 69-75.

[896] *Id.* at 71.

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maximize throughput based on the level of the uncommitted rates."[897] Indicated Shippers stated that, as previously described, the Commission has already indicated its concern over ESL avoiding the "general policy and precedent for placing a pipeline at risk for unsubscribed capacity." According to Indicated Shippers, Trial Staff's reasoning that the policy should not be applied here because it would not effectively motivate ESL given its contractual arrangements is beside the point. Indicated Shippers stated that, if ESL lacks incentive to provide reasonable, cost-based rates to uncommitted shippers, the Commission is not relieved of its duty to determine just and reasonable rates.[898]

461. Indicated Shippers noted Staff's determination that "since the pipeline can never keep revenues in excess of its cost-of-service, its rates can never become excessive."[899] According to Indicated Shippers, although the TSAs will generally prevent ESL from keeping revenues in excess of its cost-of-service, this does not by itself determine anything about the reasonableness of the rate charged to uncommitted shippers.[900] Further, this does not benefit the uncommitted shippers, who are neither protected nor obligated by the terms of the TSAs. Indicated Shippers stated that the Commission indicated in the Clarification Order that the purpose of this proceeding is to ensure that the uncommitted rate is in fact cost-based, just, and reasonable – the TSAs do not accomplish this for the uncommitted shippers.

462. Indicated Shippers took issue with Trial Staff's contradictory and irrelevant arguments about under-recovery, agreeing "that in all circumstances Enbridge Southern Lights faces no risk of under-recovery due to the TSAs for the first fifteen years under the TSAs" yet worrying "if an uncommitted unit rate is derived on design capacity, to the extent the pipeline transports even one barrel for a committed shipper it would not be able to collect its full cost-of-service."[901] Indicated Shippers argued that the risk of under-recovery is a red herring, and in fact, the provisions of the TSAs guarantee that ESL will always recover its cost-of-service. Indicated Shippers stated that Trial Staff's first statement is correct – yet, as Indicated Shippers have explained, the terms of the TSAs do not apply to the establishment of the uncommitted rates and cannot alter the Commission's duty to set a just and reasonable cost-based rate. Thus, Indicated Shippers argued that the mechanism by which the TSAs shift revenues between ESL and the Committed Shippers should be of no relevance or concern in establishing the cost-based, just and reasonable, uncommitted rate.

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[897] *Id.* at 72.

[898] *Farmers Union Central Exchange v. FERC*, 734 F.2d 1486, 1507, 1508 (D.C. Cir.), *cert. denied sub nom. Williams Pipe Line Co. v. Farmers Union Central Exchange*, 469 U.S. 1084 (1984).

[899] *Id.* at 73.

[900] Further, if volumes exceed 162,000 bpd, ESL will over-recover its costs despite the TSAs' refund mechanism.

[901] *Id.* at 73.

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463. Indicated Shippers noted ESL's claim that "Indicated Shippers' proposal to use the design capacity of the system (180,000 bpd) for 2011 is utterly unsupported" because "[t]he design capacity principle cited by Ms. Crowe only applies (if at all) to the initial rate for a new pipeline."[902] However, as Indicated Shippers argued in their Initial Brief, the 2011 rate may still be considered an initial rate because no uncommitted volumes ever shipped in 2010.[903] According to Indicated Shippers, if ESL is allowed to set a new rate for 2011 without indexing, as required by 18 C.F.R. § 342.3, or making a showing that a different methodology is warranted under § 342.4, then the 2010 "initial rate" is nothing more than a fiction. Indicated Shippers argued that this would undermine Commission policy for initial rates by allowing ESL to avoid the policy of "placing a pipeline at risk for unsubscribed capacity by designing rates based on system capacity,"[904] by never actually offering an initial rate as contemplated by that policy.

D. Trial Staff

464. As described by Trial Staff witness McComb in her answering testimony, the appropriate level of throughput/billing determinants for the 2010 rate period is 28,105,000 barrels.[905] Trial Staff noted that during the seven-month, locked-in period in Docket No. IS10-399-000, ESL transported a total of 8,935,661 barrels, or an average of 41,561 barrels per day, for the 215-day period,[906] and only the Committed Shippers shipped diluent during this period.[907] With respect to the appropriate cost-of-service for the 2010 rate period, Trial Staff took the position that actual data represent the best basis for determining rates for a locked-in period. However, in this, case the locked-in period's actual daily average of 41,561 barrels is well below the TSAs' requirements that Committed Shippers make payments based on a minimum throughput level of 77,000 barrels per day, whether they ship that amount or not.[908] Therefore, Trial Staff stated that during the 2010 rate period, ESL received revenues from the Committed Shippers based on a throughput level of 77,000 barrels per day, and for this reason, Ms. McComb testified that the uncommitted rate for the 2010 rate period should be based on this minimum level of throughput.[909]

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[902] ESL I.B. at 47.

[903] *See* IS I.B. at 44.

[904] Staff I.B. at 72.

[905] Exh. S-15 at 8-9 (McComb).

[906] Exh. ESL-6 (Jervis).

[907] Exh. ESL-1 at 13 (Jervis); Exh. S-15 at 7 (McComb).

[908] Exh. S-15 at 8-9 (McComb). *See* Exh. ESL-1 at 10-11 (Jervis) (BP and Statoil have made commitments totaling 77,000 barrels per day); and Exh. ESL-9 at 7 (Webb) (TSA Article 3.01, requiring committed shippers to ship or pay for their committed volumes).

[909] Exh. S-15 at 8-9 (McComb).

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465. Trial Staff asked the Presiding Judge to reject Dr. Webb's proposed throughput because it fails to account for the minimum volumes that the Committed Shippers must either ship or pay for. As Trial Staff witness McComb notes, Dr. Webb appears to ignore the minimum throughput condition imposed on the Committed Shippers.[910] According to Trial Staff, if ESL requires these shippers to pay rates based on a total commitment of 77,000 barrels per day, or 28,105,000 barrels per year, and ESL receives shipper revenues based on these commitments, then it should appropriately design its transportation rates on this level.

466. Trial Staff argued that this idea is somewhat akin to the design of demand charges on natural gas pipelines, where the Commission's practice is to design demand rates based on the level of the firm shippers' contract entitlements, or demand, rather than their actual usage.[911] According to Trial Staff, since the natural gas shippers have contracted to pay for specific capacity on the pipeline, whether they use the capacity or not, they pay rates based on their contract volumes. In the case of ESL, Trial Staff noted that the Committed Shippers have agreed to pay the pipeline rates based on their commitments, whether they actually ship their committed volumes or not. Accordingly, the pipeline's rate design should account for these minimum commitments in cases where actual shipments fall below the contract amounts.

467. Trial Staff asserted that Ms. Crowe's answering and cross-answering testimony provides several reasons for using pipeline capacity to determine throughput, and none of these reasons has merit in these circumstances. Ms. Crowe claims that her approach is consistent with Commission regulations and policy,[912] but as Trial Staff noted *supra*, Ms. Crowe is mistaken about the Commission's regulations. According to Trial Staff, they are silent on rate design methodology, and the filing requirements simply direct the pipeline to file a schedule of throughput for the test period, without specifying how that data should be used.[913]

468. Trial Staff explained that Ms. Crowe gives five policy reasons for the use of pipeline capacity for rate design. Ms. Crowe argued that the rate for uncommitted service could be in effect for an indefinite period of time and that, according to forecasts, demand for diluent may exceed the pipeline's capacity in the future.[914] Ms. Crowe bases this argument on the idea that the uncommitted rate in Docket No. IS10-399-003 is an initial

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[910] Exh. S-15 at 8 (McComb).

[911] *See, e.g., Texas Eastern Transmission Corp.*, 30 FERC ¶ 61,144, at 61,258 (1985) (fixed costs in the demand component are generally recovered from pipeline customers on the basis of contractual peak day volumes-contract demands).

[912] Exh. IS-1 at 20 (Crowe).

[913] 18 C.F.R. § 346.2(b)(2) (2011).

[914] Exh. IS-33 at 24 (Crowe).

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rate, subject to change only if ESL files for a change under the indexing provisions[915] or the general cost-of-service provisions[916] of the Commission's oil pipeline regulations.[917]

469. According to Trial Staff, Ms. Crowe's assertion that the uncommitted rate in Docket No. IS10-399-003 will be effective only until changed by one of these methods is belied by the Commission's acceptance of ESL's rate change filings in Docket Nos. IS11-146-000[918] and IS12-63-000.[919] Trial Staff noted that in these two orders, the Commission accepted the pipeline's proposed changes, subject to refund and the hearing. Trial Staff observed that the orders make no finding that the pipeline improperly filed for these rate changes, or that it should have filed under the indexing or some other Commission regulations, which would have been grounds for rejection of the filings. Indeed, Trial Staff explained that the Commission found the substantive issue presented in the filings was solely whether the proposed uncommitted rates were just and reasonable, listing various cost-of-service issues.[920]

470. Trial Staff also argued that the Indicated Shippers untimely raise this issue at this stage in the proceeding; if ESL improperly filed its tariff in Docket No. IS11-146-000, the appropriate forum to seek redress by intervenors is before the Commission, not with the Presiding Judge after a hearing. Trial Staff asserted that the Commission has already accepted for filing two proposed changes in the uncommitted rate, subject to hearing, and has thereby already locked-in two rate periods. Trial Staff explained that the Commission did not identify as a hearing issue the lawfulness of the rate changes under its regulations, and therefore, since the uncommitted rates proposed in both Docket Nos. IS10-399-003 and IS11-146-000 were in effect for only a discrete period of time, they could never remain in effect indefinitely, as claimed by Ms. Crowe.

471. Trial Staff noted Ms. Crowe's claim that using design capacity in deriving the uncommitted rate will promote efficient utilization of pipeline capacity by maximizing throughput.[921] According to Trial Staff, as a general matter, if transportation rates are lower, because they are designed on a higher level of throughput, one would expect shipments to increase and the pipeline to more fully utilize its capacity. However, Trial

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[915] 18 C.F.R. § 342.3

[916] 18 C.F.R. § 342.4(a)

[917] Exh. IS-1 at 22 (Crowe).

[918] *Enbridge Pipelines (Southern Lights) LLC*, 134 FERC ¶ 61,067, at P 1 (2011).

[919] *Enbridge Pipelines (Southern Lights) LLC*, 137 FERC ¶ 61,256, at P 1 (2011).

[920] *Enbridge Pipelines (Southern Lights) LLC*, 134 FERC ¶ 61,067, at P 12 (2011) (the substantive issue in Docket No. IS10-399-003 and this proceeding is the justness and reasonableness of the uncommitted rates); *Enbridge Pipelines (Southern Lights) LLC*, 137 FERC ¶ 61,256, at P 13 (2011) (citing Trial Staff brief stating that the only matter set for hearing is the justness and reasonableness of the uncommitted rates).

[921] Exh. IS-33 at 24-25 (Crowe).

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Staff asserted that experience has shown this not to be the case for ESL – due to the lack of demand for diluent, the Committed Shippers are currently not fully utilizing the capacity they are required to pay for under their TSAs. Trial Staff explained that the chart on page 3 and the graph on page 4 of Exhibit No. IS-46 illustrate deficiency volumes for the Committed Shippers in virtually every month of the pipeline's history from July 2010 through December 2011. Trial Staff noted this means that even though these shippers are paying for capacity of 77,000 barrels per day, they are shipping far less – on average only 41,561 barrels per day in the 2010 rate period.[922] Yet, Trial Staff stated that the incremental cost to these shippers to ship additional barrels is close to zero.[923] Therefore, Trial Staff asserted that it is not the pipeline's rates that are impeding greater utilization of its capacity, but the lack of demand for the product itself,[924] and lowering the rates by basing them on design capacity will not lead to greater utilization here.

472. Trial Staff noted that Ms. Crowe refers to the Commission's general policy and precedent for placing a pipeline at risk for unsubscribed capacity by designing rates based on system capacity.[925] Trial Staff stated that it is true that the Commission has long imposed minimum throughput conditions on new pipelines in order to protect consumers and to ensure full utilization of pipelines[926] and in fact, the Commission referred to this policy in its 2007 declaratory order and the 2008 clarification order in this proceeding.[927]

473. However, Trial Staff explained that this concept does not apply to this case. Trial Staff noted that ESL's TSAs with the Committed Shippers allow it to recover its costs for fifteen years regardless of the volume of diluent shipped, and these commitments remain in effect however the uncommitted rate is designed. Therefore, the pipeline has no incentive to maximize throughput based on the level of the uncommitted rates, because in the end it will recover all of its costs from the committed shippers. Furthermore, Trial Staff argued that the revenue sharing provision of the TSAs, which allows the pipeline to

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[922] Exh. ESL-7 at 61 (Webb).

[923] Tr. at 141 (Earnest).

[924] *Id.* (no demand for Enbridge Southern Lights in 2010 as evidenced by the volume shipped by committed shippers, who have an incremental cost of transportation close to zero).

[925] Exh. IS-33 at 25 (Crowe).

[926] *See, e.g., Ozark Gas Transmission System*, 16 FERC ¶ 61,099, at 61,199 (1981) (the purpose of a throughput condition – 90% of design capacity in Ozark's case – is to protect consumers from a pipeline's overly optimistic projections of volumes, and to ensure that the pipeline's authorized rate of return depends upon the set level of utilization of the facilities).

[927] *Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,310, at P 29 (2007); and *Enbridge Pipelines (Southern Lights) LLC*, 122 FERC ¶ 61,170, at P 10 (2008).

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retain 25% of all revenues attributable to uncommitted volumes in situations where throughput exceeds 162,000 barrels per day,[928] already provides it with an incentive to fill the pipeline to capacity.

474. Trial Staff noted Ms. Crowe's argument that if system capacity is not used to design rates, as soon as demand for diluent grows, the resulting rates will become excessive.[929] Ms. Crowe referred to the Commission's general policy of basing rates for new pipelines on design capacity.[930] Trial Staff asserted that Ms. Crowe correctly states the policy and the Commission's concern about over-recovery,[931] but the Commission disposed of her argument in its 2007 Declaratory Order. There, the Commission found that the TSAs' true-up and refund mechanism "will guarantee that Enbridge Southern Lights will not be over-recovering its costs . . ."[932] Trial Staff explained that the TSA true-up mechanism, which is also included in the pipeline's tariff,[933] prevents ESL from collecting in rates anything above its cost-of-service, with an average annual throughput of up to 162,000 barrels per day.

475. Trial Staff disputed that the true-up mechanism does not apply to uncommitted rates, as claimed by Ms. Crowe.[934] But, even if it does not, Trial Staff argued that it still applies to committed rates.[935] The mechanism accounts for all revenues received by ESL, from both committed and uncommitted shippers; since the pipeline can never keep revenues in excess of its cost-of-service,[936] its rates can never become "excessive."

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[928] Exh. ESL-9 at 43-44 (*pro forma* TSA, Schedule B, paras. 14 and 15) (Webb).

[929] Exh. IS-33 at 25-26 (Crowe).

[930] Exh. IS-1 at 20-21 (Crowe).

[931] *See Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,130, at P 29 (2007) (Commission precedent generally dictates the use of actual design capacity for initial rates on a new pipeline).

[932] *Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,130, at P 45 (2007).

[933] Exh. ESL-5 at 2 n.1 (Jervis).

[934] Exh. IS-1 at 21 (Crowe) (the TSAs do not apply to the rates paid by uncommitted shippers, and thus the true-up mechanism is irrelevant to the issue of a just and reasonable uncommitted rate).

[935] Even Ms. Crowe concedes this. Exh. IS-33 at 26 (Crowe) (by means of the refund mechanism, uncommitted shipper revenue defrays the costs the committed shippers must bear).

[936] The TSAs do provide an exception when annual pipeline volumes exceed an average of 162,000 barrels per day. In this case, Enbridge Southern Lights may retain 25% of the revenues attributable to such volumes. Exh. ESL-9 at 44*, pro forma* TSA, Schedule B, para. 15 (Webb).

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476. According to Trial Staff, Ms. Crowe asserted that designing rates for uncommitted rates on design capacity would create no risk of cost under-recovery, given the pipeline's TSAs with the committed shippers.[937] Trial Staff agreed that in all circumstances, ESL faces no risk of under-recovery due to the TSAs for the first fifteen years under the TSAs. However, Trial Staff asserted that this fact alone does not dictate the use of design capacity, or any other particular level of throughput, in designing rates.

477. Trial Staff noted that if the Presiding Judge were to adopt the Indicated Shippers' rate design based on full capacity and at the same time ignore the existence of the TSAs, ESL would indeed face the risk of under-recovery. As more fully discussed *infra*, if an uncommitted unit rate is derived on design capacity, to the extent the pipeline transports even one barrel for a committed shipper, it would not be able to collect its full cost-of-service. According to Trial Staff, this is because under the Commission-approved TSAs, the committed rate must be 50% of the uncommitted rate. Yet, Trial Staff noted that Ms. Crowe's proposed rate design assumes all throughput, up to pipeline capacity, flows under the higher uncommitted rate – her design does not account for volumes flowing at a lower rate.

478. For Docket No. IS11-146-000, Trial Staff does not propose a specific level of throughput or billing determinants for the 2011 rate period. Instead, its witness McComb developed rates at various levels of throughput to test the reasonableness of ESL's proposed uncommitted rate.[938] Using a total annual cost-of-service of $167,898,000,[939] she calculated an uncommitted rate at eleven different throughput levels, ranging from 77,000 barrels per day, or 28,105,000 barrels per year (the committed shippers' minimum ship or pay for level) to 180,000 barrels per day, or 65,700,000 per year (the design capacity of the pipeline).[940] Ms. McComb also adjusted the cost-of-service at the various throughput levels to account for power costs.[941]

479. Trial Staff explained that Ms. McComb then compared her resulting uncommitted rates with the effective uncommitted rates under the TSAs.[942] The effective uncommitted rates take into account the TSA refund mechanism, which lowers the actual rates that

[937] Exh. IS-33 at 26 (Crowe).

[938] Exh. S-15 at 15 (McComb).

[939] Ms. McComb did not update her calculation to reflect Trial Staff's revised cost-of-service of $178,752,000 for the 2011 rate period. This proved unnecessary, because, as explained below, at every level of throughput, Trial Staff's cost-based, Opinion No. 154-B uncommitted rate was higher than the pipeline's effective proposed tariff rate. Using a higher cost-of-service in the calculation would have only resulted in higher uncommitted rates, and thus only further justified the tariff rate.

[940] Exh. S-19, Workpaper 1 (McComb).

[941] Exh. S-15 at 15 (McComb).

[942] Exh. S-15 at 15-16 (McComb).

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shippers pay to move uncommitted volumes by providing refunds attributable to the revenues from the uncommitted volumes.[943] As shown in Exhibit No. S-19, at all levels of throughput, Trial Staff's Opinion No. 154-B uncommitted rates exceed the TSAs' effective rates.

480. Trial Staff argued that this approach has merit because at the time Ms. McComb submitted her testimony, the rates in Docket No. IS11-146-000 were still open-ended and forward-looking, having not yet been locked-in by ESL's filing in Docket No. ISI2-63-000. Therefore, Trial Staff noted that it was still uncertain if the pipeline would transport diluent under the uncommitted rate for any shippers; at the time of the testimony, it had never done so, thus providing no basis to establish an appropriate level of uncommitted throughput.

481. Trial Staff asserted that 28,105,000 barrels should be the minimum acceptable throughput since, as explained by Ms. McComb, this is the level at which the TSAs require the committed shippers to ship or pay. Even at the lower level of the 19,835,000 barrels per year proposed by ESL, Trial Staff argued that their effective uncommitted rate remains above the tariff rate.[944] Therefore, Trial Staff concluded that it does not matter what throughput level is used to determine the uncommitted rate for the 2011 rate period.

482. Trial Staff's Post-Hearing Reply Brief noted the Indicated Shippers incorrectly claim that in the 2008 clarification order, the Commission indicated that ESL must use its actual design capacity to calculate the initial uncommitted rate.[945] Trial Staff explained that, in that order, the Commission actually held that ESL's reliance on committed volumes and projected spot volumes was not inconsistent with Commission precedent that generally dictates use of actual design capacity for initial rates on a new pipeline.[946] Committed volumes plus spot volumes, which proved to be zero based on experience, is exactly the throughput that Trial Staff advocated for use in determining rates for the 2010 rate period.

483. According to Trial Staff, even if the Commission had intended that ESL use design capacity in determining its initial rates, the orders do not explain why the policy

[943] *Id.*

[944] Using Ms. McComb's methodology in Exhibit S-19, and given that there are no uncommitted volumes in Enbridge Southern Lights' proposed actual throughput number, the uncommitted rate at this level would be $16.844 per barrel ($167,898,000 divided by 19,835,000 barrels yields a committed rate of $8.4647 per barrel, doubled to $16.9295 per barrel to produce the uncommitted rate). The resulting uncommitted rate still remains well above the tariff rate of $10.9744 per barrel for the 2011 rate period.

[945] Indicated Shippers I.B. at 31.

[946] *Enbridge Pipelines (Southern Lights) LLC*, 122 FERC ¶ 61,170, at P 10 (2008).

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should apply in this case. Trial Staff noted that, in the 2008 clarification order, the Commission stated: "Commission precedent generally dictates the use of actual design capacity for initial rates on a new pipeline, and a pipeline is placed at risk for the costs of unsubscribed capacity based on actual design capacity."[947] The Commission then cited four cases in which it either placed a pipeline at risk for underutilization of new capacity, or considered doing so.[948] However, Trial Staff explained that in each of these four cases, the pipeline did not have in place a true-up mechanism like that in ESL's TSAs. Thus, to the extent these pipelines based their rates on projected volumes, rather than design capacity, Trial Staff stated that it would have been the shippers, and not the pipeline, that would have borne the cost responsibility for under utilization of the new facilities – that is, the pipeline would have been able to recover the cost of the entire capacity of the facilities over its projected volumes, rather than the design capacity.

484. Trial Staff argued that the Commission's concern about over-recovery does not apply to ESL. In the declaratory order, the Commission found that the true-up mechanism in the TSAs guarantees that ESL will not over-recover its costs,[949] and under the true-up mechanism, the pipeline can neither over- or under-recover its costs, regardless of the level of throughput used to design rates. Thus, Trial Staff asserted that the Indicated Shippers' position on using design capacity lacks merit.

Findings and Conclusions

485. During the seven-month, locked-in period in Docket No. IS10-399-000, ESL transported a total of 8,935,661 barrels, or an average of 41,561 barrels per day, for the 215-day period,[950] and only the Committed Shippers shipped diluent during this period.[951] With respect to the appropriate cost-of-service for the 2010 rate period, Trial Staff took

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[947] *Id.* (footnote omitted).

[948] *Enbridge Energy Co., Inc.*, 110 FERC ¶ 61,211 (2005) (noting that the pipeline proposes no safeguards that would prevent the over recoveries that could result from using projected rather than design volumes) *id.* at P 46; *Great Lakes Transmission L.P.*, 66 FERC ¶ 61,118 (1994) (requiring the pipeline to bear the risk of under-recovery of the costs associated with the excess capacity of its proposed expansion facilities) *id.* at 61,210; *Equitrans, Inc.*, 63 FERC ¶ 61,070 (1993) (placing the pipeline at risk for under-recovery of costs associated with the excess capacity of new facilities) *id.* at 61,304; and *Arkansas Western Pipeline Co.*, 63 FERC ¶ 61,006 (1993) (placing the pipeline at risk for the recovery of the costs of the unsubscribed capacity of its facilities) *id.* at 61,027.

[949] *Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,310, at P 45 (2007). However, under its tariff and the TSAs, Enbridge Southern Lights can retain 25% of the uncommitted revenues for volumes over an annual average of 162,000 barrels per day.

[950] Exh. ESL-6 (Jervis).

[951] Exh. ESL-1 at 13 (Jervis); Exh. S-15 at 7 (McComb).

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the position that actual data represent the best basis for determining rates for a locked-in period. However, in this case, the locked-in period's actual daily average of 41,561 barrels is well below the TSAs' requirements that Committed Shippers make payments based on a minimum throughput level of 77,000 barrels per day, whether they ship that amount or not.[952] Therefore, Trial Staff explained that ESL received revenues from the Committed Shippers based on a throughput level of 77,000 barrels per day during the 2010 rate period, and accordingly, Trial Staff is correct in noting that the uncommitted rate for the 2010 rate period should be based on this minimum level of throughput.[953]

486. Indicated Shippers argued that if system capacity is not used to design rates, as soon as demand for diluent grows, the resulting rates will become excessive.[954] As Trial Staff asserted, Indicated Shippers' witness Crowe correctly stated the Commission's general policy of basing rates for new pipelines on design capacity[955] and the Commission's concern about over-recovery.[956] However, Trial Staff pointed out that the Commission disposed of Ms. Crowe's argument in its 2007 Declaratory Order, where the Commission found that the TSAs' true-up and refund mechanism "will guarantee that Enbridge Southern Lights will not be over-recovering its costs . . ."[957] The TSA true-up mechanism, which is also included in the pipeline's tariff,[958] prevents ESL from collecting in rates anything above its cost-of-service.

487. Indicated Shippers incorrectly claim that the 2008 clarification order indicated that ESL must use its actual design capacity to calculate the initial uncommitted rate.[959] In that order, the Commission actually held that ESL's reliance on committed volumes and projected spot volumes was not inconsistent with Commission precedent that generally dictates use of actual design capacity for initial rates on a new pipeline.[960] According to Trial Staff, committed volumes plus spot volumes, which proved to be zero based on

[952] Exh. S-15 at 8-9 (McComb); *see* Exh. ESL-1 at 10-11 (Jervis) (BP and Statoil have made commitments totaling 77,000 barrels per day); Exh. ESL-9 at 7 (Webb) (TSA Article 3.01, requiring committed shippers to ship or pay for their committed volumes).

[953] Exh. S-15 at 8-9 (McComb).

[954] Exh. IS-33 at 25-26 (Crowe).

[955] Exh. IS-1 at 20-21 (Crowe).

[956] *See Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,130, at P 29 (2007) (Commission precedent generally dictates the use of actual design capacity for initial rates on a new pipeline).

[957] *Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,130, at P 45 (2007).

[958] Exh. ESL-5 at 2 n.1 (Jervis).

[959] Indicated Shippers I.B. at 31.

[960] *Enbridge Pipelines (Southern Lights) LLC*, 122 FERC ¶ 61,170, at P 10 (2008).

experience, is exactly the throughput that Trial Staff advocated for use in determining rates for the 2010 rate period. Indicated Shippers' arguments must be dismissed.

488. For Docket No. IS11-146-000, Trial Staff asserted that 28,105,000 barrels should be the minimum acceptable throughput since this is the level at which the TSAs require the Committed Shippers to ship or pay. Consistent with the previously explained reasoning, this is the correct level of throughput to use for the 2011 rate period.[961]

Issue #16: What is the appropriate rate design?

A. ESL

489. ESL noted that Dr. Webb explained the appropriate rate design is one that appropriately allocates the cost-of-service between the Committed and Uncommitted Shippers in a way that ensures the appropriate group of shippers pays for the services they receive.[962] ESL asserted that setting differential rates for the Committed and Uncommitted Shippers is consistent with Commission precedent and the Commission's prior rulings for ESL.[963] The Commission first recognized this principle in *Express Pipeline Partners*,[964] and has repeatedly confirmed it.[965] In the instant proceeding, the Commission acknowledged this point when it determined that the 2-to-1 ratio does not result in undue discrimination,[966] and is just and reasonable.[967]

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[961] Overall, Trial Staff concluded that it does not matter what throughput level is used to determine the uncommitted rate for the 2011 rate period because their effective uncommitted rate designed using the Commission's 154-B methodology remains above the proposed tariff rate, even at the lower level of the 19,835,000 barrels per year proposed by ESL. Using Ms. McComb's methodology in Exhibit S-19, and given that there are no uncommitted volumes in Enbridge Southern Lights' proposed actual throughput number, the uncommitted rate at this level would be $16.844 per barrel ($167,898,000 divided by 19,835,000 barrels yields a committed rate of $8.4647 per barrel, doubled to $16.9295 per barrel to produce the uncommitted rate). The resulting uncommitted rate still remains well above the tariff rate of $10.9744 per barrel for the 2011 rate period.

[962] ESL-7 at 9:11-14; 23:19-24:14, 25-27, 54-67; ESL-44 at 13-30.

[963] *See* ESL-7 at 26, 55-56; ESL-44 at 14-15; Tr. at 260:9-16.

[964] *Express Pipeline Partners*, 76 FERC ¶ 61,245 (1996).

[965] *See, e.g.*, *White Cliffs Pipeline, L.L.C.,* 126 FERC ¶ 61,070, at P 28 (2009); *TransCanada Keystone Pipeline, LP*, 125 FERC ¶ 61,025, at P 25 (2008); *Enbridge (U.S.) Inc. and ExxonMobil Pipeline Co.,* 124 FERC ¶ 61,199, at P 29 (2008); *Enbridge Energy Company, Inc.,* 110 FERC ¶ 61,211, at P 38 (2005); *Plantation Pipe Line Co.*, 98 FERC ¶ 61,219, at 61,866 (2002); *Mid-America Pipeline Co.*, 93 FERC ¶ 61,306, at 62,048-49 (2000).

[966] *See* Declaratory Order at PP 25-31; Exh. ESL-7 at 26.

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490. ESL argued that the Commission-approved *Keystone/Laclede* revenue-crediting methodology is appropriately used to test such differential rates.[968] As Dr. Webb explained, in *Laclede*, the Commission determined that a revenue crediting approach, that is, crediting the revenue from discounted shipments, was an appropriate method to calculate a rate for non-discounted service.[969] The Commission followed this approach in *Keystone* in a situation quite similar to the instant proceeding because it involved committed and uncommitted rates established through an open season, and granted the pipeline's request that the uncommitted rate be calculated through a revenue crediting mechanism which resulted in uncommitted shippers bearing a higher share of the pipeline's cost on a per-unit basis.[970] ESL believed that the *Keystone/Laclede* methodology is consistent with principles of sound regulatory theory. As Dr. Webb explained, if a pipeline cannot differentiate between the rates for different classes of shippers, it may lose volume from shippers with better alternatives – thus raising rates for all shippers.[971] In the instant case, although it was necessary for ESL to offer lower rates to the Committed Shippers based on the Discounted Costs to obtain their commitments in the open season process, even the Uncommitted Shippers are better off, because they have a pipeline available that ESL otherwise would not have been able to build.[972]

491. ESL stated that their rate design and the rate design supported by Trial Staff are mutually complementary.[973] At a conceptual level, the core tenets of the approaches are the same: the TSA governs the Committed Rate[974]; there are two classes of shippers[975]; and the 2-to-1 ratio is maintained.[976]

492. ESL noted that Dr. Webb directly calculates the Uncommitted Rate by estimating the cost-of-service that the Uncommitted Shippers would have incurred if the Committed Shippers had not taken on much of the risk of the project. Trial Staff calculates the cost-of-service for ESL, taking into account the shifting of much of the risk from ESL to

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[967] Order on Complaint at P 16; ESL-44 at 51; *see also* National Energy Board Decision at 24 ("Taking into account all the factors above . . . the Board is of the view that a 2 to 1 Toll Ratio is just and reasonable.").
[968] ESL-7 at 56-59.
[969] *Laclede*, 114 FERC ¶ 61,335, at n.4.
[970] *Keystone*, 125 FERC ¶ 61,025, at P 25.
[971] Exh. ESL-7 at 58.
[972] Exh. ESL-1 at 9-10; Exh. ESL-7 at 56.
[973] Exh. ESL-44 at 48; Exh. ESL-27 at 17.
[974] T r. at 287:12-17; 289:3.
[975] Exh. S-15 at 3-4; Tr. at 294:22-295:1.
[976] Tr. at 281:24-282:2; 284:24-285:5; 292:5-9; 294:12-16.

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the Committed Shippers, and then allocates that cost-of-service between the Committed and Uncommitted Shippers in accordance with the Commission-approved 2-to-1 ratio.[977]

493. ESL stated that Dr. Webb, Dr. Jaffe, and Ms. McComb state that the order of calculation between the Committed Rate and the Uncommitted Rate is irrelevant.[978] Rather, the key point is that the Commission approved a rate design under which the Uncommitted Shippers bear twice as much of the cost-of-service, on a per-barrel basis, as the Committed Shippers. As Ms. McComb explained on the stand, that is precisely what her approach accomplishes.[979]

494. According to ESL, the rate design set forth by the Indicated Shippers is inherently flawed. As explained by Drs. Webb and Jaffe, the Indicated Shippers' approach ignores the Commission's prior decisions in this proceeding, as well as the unique history and background of the pipeline. ESL also argued that Indicated Shippers ignore the distinction between Committed and Uncommitted Shippers by creating a single cost-of-service and dividing it by the design capacity of the pipeline, which effectively assumes that all barrels on the system are uncommitted barrels.[980] ESL asserted that Indicated Shippers also assume away the refund mechanism, except when it benefits their argument, and believe that the shifting of the commercial risk to the Committed Shippers justifies setting the Uncommitted Rate using unreasonably low costs of capital.[981] ESL noted that Ms. Crowe's rate design implies revenues far below her revenue requirement, which suggests that ESL is not entitled to recover its cost-of-service.[982]

495. ESL's Post-Hearing Reply Brief stated that Indicated Shippers' argument that *Keystone/Laclede* does not apply because these are "negotiated rates" is incorrect.[983] ESL explained that the Committed Rates are discounted, but not negotiated within the

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[977] Tr. at 279:12-18; 286:2-5.

[978] Tr. at 96:19-25 (Jaffe); 229:23-230:6(Webb); 279:15-17 (McComb); 285:1-5 (McComb); 286:2-5 (McComb); 292:5-9 (McComb).

[979] *See* Tr. at 293:8-13 ("The fact is . . . when you take the cost-of-service and you accept this 2-to-1 principle, you have to weight your volumes so that you would get your end result rates and multiply them by throughput, you get the same cost-of-service that you're trying to calculate."); Exh. S-21.

[980] *See* ESL-44 at 4; ESL asserted that at hearing, Indicated Shippers introduced Exhibit IS-56, which was apparently developed to address this issue. However, that exhibit is flawed because it still uses design capacity, and because, as Ms. McComb testified at hearing, it fails the revenue test – that is, if the proposed rates were applied to the actual volumes transported, they would not cover the cost-of-service. *See* Tr. at 295-96.

[981] *Id*. at 5-6.

[982] *Id*. at 15.

[983] *See* IS I.B. at 47.

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meaning of the Commission's gas discounting policy, for the reasons discussed, *supra*.[984] The Committed Rates in this case are therefore directly comparable to the discounted committed rates in *Keystone*, where the Commission did apply the *Laclede* methodology.[985]

496. According to ESL, Indicated Shippers contend that in this case, the *Laclede/Keystone* approach is both "circular . . . [and] internally inconsistent."[986] In making that argument, Indicated Shippers rely on a portion of Trial Staff witness McComb's testimony.[987] As Dr. Webb explained, however, the circularity argument is grounded in a misconception of the issue in this case, which is not the just and reasonable Committed Rate, but rather the just and reasonable Uncommitted Rate. ESL noted that Dr. Webb applied the Commission's *Keystone/Laclede* revenue crediting approach to test the justness and reasonableness of his proposed 2011 Uncommitted Rate at various throughput levels.[988] In order to do that, Dr. Webb calculated the "effective" Committed Rate at a variety of throughput levels. Those "effective" rates arise when the revenue from Uncommitted Volumes at the posted Uncommitted Rate is refunded to the Committed and Uncommitted Shippers using the Commission-approved refund mechanism.[989] ESL noted that the effective Committed Rate is the amount the Committed Shippers would effectively have paid after receiving their share of the refunds. Dr. Webb then deducted the revenues earned from the effective Committed Rate at representative throughput levels from his total Opinion No. 154-B cost-of-service to derive an "allowed," or just and reasonable, Uncommitted Rate ceiling at each of those

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[984] ESL acknowledges that the Committed Rates were referred to as "negotiated rates" in places in the Declaratory Order. *E.g.,* Declaratory Order at P 26. However, it is important to note the specific context. That reference specifically characterizes the Committed Rates as negotiated rates under the Commission's oil pipeline regulations, not under the Commission's 1996 Natural Gas Policy Statement. *Id.* at P 26 & n. 31. The applicable oil pipeline rule involves a rate that has been "agreed to by at least one non-affiliated person who intends to use the service in question," 18 C.F.R. §342.2(b), which is quite different from the concept of a negotiated rate under the 1996 Natural Gas Policy Statement. In any event, the Declaratory Order specifically characterizes the Committed Rates as discounted rates in other contexts. *E.g.*, Declaratory Order at P 31 ("the rate discount was made available to all interested shippers and reflects the differences in service between firm and non-firm shippers").

[985] *See Keystone*, 125 FERC ¶ 61,025, at P 30.

[986] IS I.B. at 46.

[987] *Id.* (citing S-15 at 13); Trial Staff also notes in its brief that it did not use the *Keystone/Laclede* methodology because of "circularity" concerns. Trial Staff I.B. at 112-13.

[988] *See* Exh. ESL-7 at 56-59, 63-67.

[989] *See id*. at 17-18.

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levels.[990] In the final step, mathematically illustrated in ESL-13, Workpaper 9, Dr. Webb compared the "effective" Uncommitted Rate to the "allowed" Uncommitted Rate at throughput levels ranging from 90,000 bpd to 180,000 bpd to show that the effective 2011 Uncommitted Rate is always lower than the corresponding just and reasonable ceiling rate for 2011.

497. As ESL previously noted, the Indicated Shippers argue that Dr. Webb's application of the *Keystone/Laclede* analysis to validate the 2011 Uncommitted Rate is "circular."[991] Under this view, the alleged circularity arises because Dr. Webb must first determine the Committed Rate at various throughput levels before he can determine the effective rates at those throughput levels.[992] According to this argument, "if the committed rate is to be determined only after the appropriate uncommitted rate is determined, one cannot take into account committed revenues (which are based on the committed rate) in calculating the uncommitted rate."[993]

498. ESL explained that this concern about alleged circularity appears to have stemmed from a perception that the Commission intended this proceeding to be used to set just and reasonable Committed Rates as well as just and reasonable Uncommitted Rates. However, subsequent to the filing of the Trial Staff testimony on which the Indicated Shippers rely, the Commission issued its Order on Complaint, which expressly rejected the Indicated Shippers' contention that the Committed Rates must be reviewed in this proceeding.[994] ESL noted that the Commission went on to rule that "Indicated Shippers' argument that the Committed Rates cannot be decoupled from the Uncommitted Rate is effectively an attempt to overturn the rate structure approved by the Commission in the declaratory order proceeding, and is an impermissible collateral attack on the Commission's prior orders."[995]

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[990] *Id*. Note that Dr. Webb was not calculating the actual Uncommitted Rate in this step – the posted Uncommitted Rate already exists in the tariff and the effective Uncommitted Rate would be derived from the year-end refund mechanism. The "allowed" Uncommitted Rate, by contrast, allocates the appropriate cost-of-service to the Uncommitted Shippers and represents the rate level they could theoretically have been charged under Opinion 154-B and the *Keystone/Laclede* line of cases.

[991] IS I.B. at 46; *see also* Staff I.B. at 112.

[992] *Id*. at 112-13.

[993] Exh. S-15 at 14 (McComb).

[994] Order on Complaint at P 16 (noting that "The Commission rejects Indicated Shippers' argument that the Commission has failed to appropriately review the Committed Rates pursuant to the Interstate Commerce Act. The Commission reviewed the TSA and the rate structure in the declaratory order proceeding and determined that the proposed rate design was just and reasonable and not unduly discriminatory because all potential shippers had the opportunity to become Committed Shippers.").

[995] *Id*. at P 17.

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499. According to ESL, the Order on Complaint makes clear that it was entirely appropriate for Dr. Webb to perform his *Keystone*/*Laclede* analysis by starting with the Committed Rates calculated in accordance with the Commission-approved TSA rate structure. With that component in place, there is nothing circular about Dr. Webb's calculation of the effective Uncommitted Rate to confirm that the posted 2011 Uncommitted Rates will be lower than the Opinion No. 154-B Uncommitted Rates at all throughput volumes.

500. ESL noted that as an alternative to their proposed rate design, Trial Staff's rate design approach, which as noted above, first calculates an Opinion No. 154-B cost-of-service and then apportions that cost-of-service using the Commission-approved 2-to-1 ratio, is also appropriate.[996] Contrary to Indicated Shippers' assertions, this methodology does not create an unjust and unreasonable rate.[997] The effect of the approach utilized by Ms. McComb is to apportion proportionately more of the total cost-of-service to the Uncommitted Volumes than the Committed Volumes, and that is exactly what the Commission approved in the Declaratory Order, where the 2-to-1 ratio is expressly described as a cost allocation mechanism within the tariff structure of ESL.[998] ESL stated that differential rates for committed and uncommitted shippers based on differing cost allocations have been accepted at least since the *Express* order.[999]

501. According to ESL, the Uncommitted Rates of ESL can be upheld as just and reasonable under either of two reasonable rate design approaches. On the one hand, the cost-of-service can be allocated between the Committed and Uncommitted Shippers

[996] *See* Staff I.B. at 75-78, 107-10.

[997] *See* IS I.B. at 47-48.

[998] *See* Tr. at 260:9-15 (Webb); *see* Declaratory Order at P 27 ("According to Enbridge Southern Lights, while the committed and uncommitted shippers will share in paying the agreed cost-of-service of the pipeline, after revenue sharing is implemented, the *uncommitted shippers will pay a higher proportion of the costs of on a unit basis*.") (emphasis added); *see also id.* at P 31 ("Moreover, all potential shippers had an opportunity during the open season to commit volumes and establish a 50-percent tariff rate discount. Accordingly, the Commission finds that the proposed rate structure does not violate the antidiscrimination or undue preference provisions of the Interstate Commerce Act (ICA) because the rate discount was made available to all interested shippers and *reflects the differences in service between firm and non-firm shippers*.") (emphasis added).

[999] As noted above, Dr. Webb explained that "in the *Express* case the Commission specifically noted what they call there the term shippers, who are Committed Shippers, had taken on the risk of committing [to] this pipeline and allowing the pipeline to be built and therefore, it was appropriate that the term shippers should get a lower rate and that the nonterm shippers should pay an above average rate . . . ." Tr. at 260:9-15.

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using the well-established *Keystone/Laclede* methodology, as Dr. Webb did, or the cost-of-service can be allocated using the 2-to-1 rate design method specifically approved by the Commission in the Declaratory Order and subsequent orders. By contrast, the Indicated Shippers' rate design disregards the existence of Committed and Uncommitted Shippers entirely and simply sets an across-the-board rate using the design capacity of the pipeline. Nothing in the Commission's prior orders is consistent with that approach, and it would fail to produce a just and reasonable Uncommitted Rate in this case.

B. Committed Shippers

502. Committed Shippers explained that the cost-of-service should be allocated between Committed Shippers and Uncommitted Shippers according to the 2:1 Rate Design in the TSA, which as discussed above, has been approved by the Commission and is in accordance with precedent.[1000] Actual throughput, rather than design capacity, should be the underlying basis to determine the rates, for the reasons addressed, *supra*. The Committed Shippers supported the method of calculation performed by Enbridge witness Dr. Webb.

503. According to Committed Shippers, Staff's method of calculation, while different in some respects from that of Dr. Webb, relies on the same base principles, namely that the 2:1 Rate Design in the TSA must apply and that actual throughput on the pipeline should be used for throughput levels greater than the committed volume of 77,000 bpd. As such, Staff provides an alternative but complimentary method that ultimately yields the same determination that Enbridge's filed rates are just and reasonable and also provides an additional check on Dr. Webb's work.

504. Committed Shippers explained that Staff witness McComb definitively demonstrated that the question of whether one calculates the Committed Rate first and then the Uncommitted Rate, or vice versa, is a red herring.[1001] If proper cost-based rate design is employed, the order of the computation does not matter. To perform a revenue check, for each class of shipper, one multiplies the rate to be tested by the associated volume in the model to calculate annual revenue for that class. The aggregate of revenues from all classes of shippers should equal the total cost-of-service. Indicated Shippers' approach—to calculate an Uncommitted Rate using the design capacity of the pipeline as the throughput determinant and then divide by two for the Committed Rate—will not pass a revenue check.[1002] As Staff witness McComb observed: "why would you set an initial rate that you know isn't going to collect the cost-of-service?"[1003]

[1000] *Laclede Pipeline Co.*, 114 FERC ¶ 61,335 (2006), and *TransCanada Keystone Pipeline, LP*, 125 FERC ¶ 61,025 (2008).

[1001] *See* Tr. 291:17–292:9; Exh. S-21.

[1002] Tr. 294:17–296:1.

[1003] Tr. 296:17-18.

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505. Committed Shippers' Post-Hearing Reply Brief for Docket No. IS10-399-003 noted that Indicated Shippers' position fails to take into account settled ratemaking principles established in Commission orders.[1004] According to Committed Shippers, Indicated Shippers' failure to incorporate the principles set forth in these proceedings and in the complaint proceeding also undercuts Indicated Shippers' arguments with respect to Staff witness McComb.[1005] Committed Shippers argued that the foundation of Indicated Shippers' criticism of witness McComb is that the ratemaking principles approved by the Commission should not apply, but once that notion is discarded, nothing remains of Indicated Shippers' argument.

506. For Docket No. IS11-146-000, Committed Shippers believed that Indicated Shippers' argument that the 2011 rate should be indexed against the 2010 rate should be rejected.[1006] According to Committed Shippers, the Commission has approved the mechanism whereby Enbridge files new Committed and Uncommitted Rates annually based on cost-of-service.[1007] Committed Shippers asserted that decision is final and is not the subject of these proceedings.

507. According to Committed Shippers, Indicated Shippers criticize Dr. Webb's *Laclede/Keystone* approach to testing the Uncommitted Rate on grounds that it is a "circular" calculation,[1008] but Committed Shippers argued that this is untrue. Dr. Webb has demonstrated that the *Laclede/Keystone* calculation is solvable because there is only ever one unknown variable, both when one calculates the Uncommitted Rate only or both the Committed and Uncommitted Rates.[1009]

[1004] *See* Exh. ESL-44 at 4-5; Declaratory Order at PP 11, 25-31, 42-45; Clarification Order at PP 9-14; Order on Complaint at PP 11-12, 16-17 (noting that these principles are:

1. There are two distinct classes of shippers, Committed and Uncommitted.
2. The Committed Shippers have an obligation to pay the cost-of-service whether or not they ship.
3. The pipeline must refund to all shippers 100% of the revenue generated by the Uncommitted Volumes up to 162,000 bpd and 75% of revenues above 162,000 bpd.
4. The pipeline has an annual true-up mechanism to reflect actual costs.
5. The Commission has reviewed and approved the 2:1 Rate Design Ratio between Committed and Uncommitted Rates as being just and reasonable.
6. The Commission has determined that Enbridge is engaged in a risky enterprise.").

[1005] *See* IS I.B. at 36-38.

[1006] *See* IS I.B. at 45.

[1007] *See* Declaratory Order at P 11.

[1008] IS I.B. at 46.

[1009] *See* Exh. ESL-44 at 48-50.

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508. Committed Shippers explained that Enbridge has filed its 2012 rates to be effective January 1, 2012. There were no volumes shipped by Uncommitted Shippers during the test period ending June 30, 2011 or during the 2011 period—February 1, 2011 to December 31, 2011. Thus, the 2011 period is also a locked-in period with no volumes shipped by Uncommitted Shippers. Nevertheless, for purposes of designing a forward-looking rate, the costs borne by Uncommitted Shippers must reflect the fact that they bear no risk as compared to the Committed Shippers. If a pipeline cannot differentiate between different classes of shippers, it may lose shippers to better alternatives.[1010]

509. According to Committed Shippers, the *Laclede/Keystone* methodology appropriately distinguishes among classes of shippers, appropriately allocates cost-of-service between Committed and Uncommitted Shippers, and is the appropriate way to test an Uncommitted Rate. Applying this methodology, Dr. Webb calculates the revenue produced from the Committed Shippers and subtracts this from Enbridge's cost-of-service. He then allocates the remainder of the cost-of-service over various Uncommitted Volumes and applies the TSA refund mechanism.[1011] In all cases for 2011, the result is that the effective Uncommitted Rate, after refunds, is always less than an Uncommitted Rate properly derived with Opinion No. 154-B methodology that recognizes the 2-to-1 rate differential at all Uncommitted Volumes. Therefore, Committed Shippers argued that the Enbridge tariff mechanism is just and reasonable.

510. As was the case with the 2010 rate, Committed Shippers stated that Indicated Shippers' criticism of Staff's 2011 rate methodology fails to consider the difference between Committed and Uncommitted Shippers and the concomitant 2:1 Rate Design Ratio.[1012] As did Dr. Webb, for the 2011 rate, Staff witness McComb also tested for different levels of potential Uncommitted Volumes. Staff used the Committed throughput of 77,000 bpd and then assumed various hypothetical levels of Uncommitted throughput at double their original volume to account for the 2-to-1 ratio. Doing this assures that the 2-to-1 ratio between the rates is maintained. Staff then compared its calculated Uncommitted Rates to the effective Uncommitted Rate that would ultimately obtain under the TSA due to the Refund Mechanism, which operates to credit both Committed and Uncommitted Shippers whenever any Uncommitted Volumes flow.[1013] For the reasons set forth above, application of the 2:1 Rate Design Ratio is required under the Commission's orders and, as such, Ms. McComb's approach is complimentary to that of Dr. Webb.

[1010] *See* Exh. ESL-7 at 58.
[1011] *See* Exh. ESL-7 at 64-66.
[1012] *See* IS I.B.. at 47-48.
[1013] *See* Exh. ESL-15 at 15-16.

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C. Indicated Shippers

511. Indicated Shippers explained that the initial rate is derived by adding the components of the cost-of-service and dividing the total cost-of-service by design capacity.[1014] As directed by the Commission, Indicated Shippers stated that witness Crowe derived an initial rate for uncommitted service that is cost-based without regard to the special deal ESL negotiated with the Committed Shippers. According to Indicated Shippers, this rate comports both with the Commission's Opinion No. 154-B methodology for oil pipelines and Section 346.2 of the Commission's regulations governing the determination of initial rates for service on new oil pipelines.[1015] The initial rates for uncommitted service proposed in witness Crowe's testimony do not relate to, and are not governed by, the committed rates negotiated in the TSAs between Enbridge Southern Lights and its Committed Shippers.[1016] Indicated Shippers argued that neither the true-up or refund mechanism nor any other provision of ESL's TSAs with its Committed Shippers impact the initial rates established here for uncommitted service.[1017]

512. Indicated Shippers asserted that Witness Webb calculated an initial uncommitted rate using a similar general methodology as that used by Indicated Shippers witness Crowe: each took his or her respective cost-of-service and divided this amount by his or her respective throughput/billing determinant value.[1018] Despite a similar approach to rate design, at least for the calculation of an initial rate, ESL witness Webb and Indicated Shippers witness Crowe arrived at dramatically different initial uncommitted rates because they used different inputs in the rate design formula: witness Crowe's calculated cost-of-service is much lower than that calculated by witness Webb and much closer in magnitude to that of Staff, and her throughput recommendation of actual design capacity is much higher.[1019] According to Indicated Shippers, with a lower numerator and a higher denominator, witness Crowe recommended a much lower rate, $2.45/bbl, than the rate witness Webb calculated as a cost-based initial uncommitted rate. Indicated Shippers also explained that Ms. Crowe's calculated rate is also much lower than the $10.0526 per barrel rate that ESL filed in Docket No. IS10-399.

513. Although Staff's COS of $167,079,000 is similar in magnitude to Ms. Crowe's COS of $161,248,000, Indicated Shippers asserted that Staff witness McComb employed a different rate design than either ESL witness Webb or Indicated Shippers witness Crowe. First, similar to the approaches of witness Webb and witness Crowe, witness

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[1014] Exh. IS-1 at 22.

[1015] Exh. IS-1 at 22.

[1016] *Id.*

[1017] *See, e.g.*, Exh. IS-1 at 5, 7, 16, 22.

[1018] *See* Exh. IS-7 at 22; Exh. ESL-7 at 61.

[1019] *See* Exh. IS-4 (Updated) at 1, lines 7-9; Exh. ESL-12 at Statement A, lines 8-10.

McComb calculated a cost-based rate by dividing Staff's recommended COS, prepared by Staff witness Sherman, by Ms. McComb's recommended throughput/billing determinants, consisting of Committed Shippers' committed volume levels.[1020] However, Indicated Shippers stated that witness McComb then took an erroneous, additional step.[1021] To calculate the uncommitted rate, she multiplied the cost-based committed rate she calculated by two.[1022]

514. Indicated Shippers noted Ms. McComb's confirmed on cross-examination that she felt compelled to do this because of the TSA.[1023] However, Indicated Shippers asserted that Ms. McComb's approach fails to recognize that, like a natural gas recourse rate, the cost-based uncommitted rate must not be increased as a result of the special deal negotiated by ESL with the Committed Shippers. Thus, Indicated Shippers took the position that the TSA's two-to-one ratio between uncommitted rate and the committed rate does not apply to the initial calculation of an uncommitted rate, and multiplying the cost-based rate she calculates by two to derive the uncommitted rate is erroneous. Further, as Indicated Shippers witnesses Crowe and Safir make clear in their Cross-Answering testimony, multiplying any cost-based rate by two cannot result in a cost-based rate.[1024]

515. Indicated Shippers argued that if the two-to-one ratio in the TSA is used to derive either the committed rate or the uncommitted rate, at least one of the two rates cannot be considered cost-based in any meaningful sense. When uncommitted volumes are shipped on ESL, ESL will be transporting both committed and uncommitted volumes from Manhattan, Illinois, to Alberta, Canada. Indicated Shippers stated that ESL has not established that the costs ESL incurs of transporting uncommitted volumes are twice the costs of transporting committed volumes on a per barrel basis, nor can it. Therefore, when applying the two-to-one ratio in this case, only one of the rates can be cost-justified. If a cost-based uncommitted rate is derived first — as Indicated Shippers have done based on the Commission's directives — and this rate is divided by two to derive the committed rate, the committed rate will not be cost-based. Similarly, if the committed rate is derived first — as it is under Staff witness McComb's approach — and this rate is multiplied by two to derive the uncommitted rate, the uncommitted rate will not be cost-based.

[1020] Exh. S-15 at 9; Exh. S-17 at 1, line 3.

[1021] *See* Exh. S-15 at 10; Exh. S-17 at 1, line 4; *see also* Exh. IS-33 at 14; Exh. IS-40 at 2.

[1022] Exh. S-15 at 10; Exh. S-17 at 1, line 4; Exh. IS-38; *see also* Exh. IS-33 at 14.

[1023] Tr. 286-87.

[1024] *See, e.g.*, Exh. IS-1 at 9; Exh. IS-33 at 17, 19; Exh. IS-40 at 5, 6.

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516. Indicated Shippers argued that according to the Commission's orders, only one of the two rates must be cost-justified: the uncommitted rate,[1025] and the committed rate, as a negotiated rate between the pipeline and two of its shippers, need not be.

D. Trial Staff

517. Trial Staff stated that rate design is the process of deriving unit rates from a cost-of-service.[1026] For the 2010 rate period, Trial Staff witness McComb used a simple rate design. She first took Trial Staff's Opinion No. 154-B annual cost-of-service for ESL, as calculated by Ms. Sherman, and divided it by the annualized minimum throughput volumes of the Committed Shippers.[1027] This calculation, $159,099,000 divided by 28,105,000 barrels, yields a unit rate of $5.66 per barrel.[1028]

518. Trial Staff noted Ms. McComb's explanation that ESL transported only committed volumes during the 2010 rate period.[1029] Therefore, Ms. McComb's unit rate of $5.66 per barrel applies only to committed volumes. To derive the uncommitted rate, she multiplied the committed rate by two.[1030] This results in a rate of $11.32 per barrel.[1031]

519. Ms. McComb multiplied the committed rate by two because the Commission required that the 2:1 uncommitted to committed rate ratio be maintained in ESL's rate design.[1032] Since the pipeline transported only committed volumes during this locked-in

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[1025] *See, e.g.*, Clarification Order at P 13.

[1026] *Texas Eastern Transmission Corp.*, 30 FERC ¶ 61,144, at 61,258 (1985) (rate design is used to permit the jurisdictional cost-of-service to be recovered through unit charges).

[1027] Exh. S-15 at 9 (McComb); Exh. S-17 (McComb).

[1028] Exh. S-15 at 9 (McComb); Exh. S-17 (McComb). Ms. McComb used a total annual cost-of-service of $159 million in her calculation, based on Trial Staff's answering testimony as originally filed. *See* Exh. S-2 at 2, Statement A, line 7 (August 16, 2011) (Sherman answering testimony). Trial Staff subsequently corrected its cost-of-service to $167 million. *See* Exh. S-2 (rev. Jan. 11, 2012) (Sherman). The use of the updated, higher cost-of-service would not change Ms. McComb's or Trial Staff's ultimate conclusion, since its use would only produce a higher Opinion No. 154-B uncommitted rate, and thus only further justify Enbridge Southern Lights' lower TSA tariff rate.

[1029] Exh. S-15 at 9 (McComb); Tr. at 279 (McComb).

[1030] Exh. S-15 at 10 (McComb).

[1031] *Id.*; Exh. S-17 (McComb).

[1032] Exh. S-15 at 9-10 (McComb); Tr. at 279 (McComb). *See Enbridge Pipelines (Southern Lights) LLC*, 131 FERC ¶ 61,288, at P 16 (2010) (the fact that the Commission is setting Docket No. IS10-399-000 for hearing does not undermine the approval of the rate structure in the declaratory order or the fact that the Commission approved

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period, Ms. McComb chose to derive a committed rate first, and then the uncommitted rate from the committed rate.[1033] She had no basis for projecting any uncommitted volumes for the period. As she explained, because the Commission required that the 2:1 ratio be maintained in the design of ESL's rates, it makes no difference whether one first derives the committed rate and then the uncommitted rate from that rate, or derives the uncommitted rate directly.[1034]

520. Trial Staff explains that Exhibit No. S-21 makes this point. There, Ms. McComb used 2011 rate period costs and volumes, rather than those of the 2010 rate period, for illustration, but the principle illustrated applies equally to both periods. Trial Staff notes that the exhibit conclusively demonstrates that, because of the underlying 2:1 principle, one can derive an identical uncommitted rate regardless of whether one first calculates the committed rate or the uncommitted rate. The top eleven lines of the exhibit show the derivation of a committed rate at various levels of pipeline throughput, and then the corresponding uncommitted rates that result by doubling the committed rates.[1035] The eleven lines at the bottom of the exhibit show the derivation of the uncommitted rates first, and then the committed rates derived from them by multiplying by 0.50.[1036] Trial Staff stated that both approaches produce the same rates.[1037]

521. Accordingly, Trial Staff's asserted that their evidence shows the appropriate rate design for determining an uncommitted rate for Enbridge Southern Lights for the 2010 rate period based on an Opinion No. 154-B cost-of-service. Ms. McComb demonstrated that the uncommitted rate can be calculated simply by taking the Opinion No. 154-B cost-of-service and dividing it by the minimum throughput levels of the committed shippers to first yield a committed rate, and then multiplying the committed rate by two to obtain the uncommitted rate.

522. Trial Staff explained that ESL proposes a rate design similar to Trial Staff's for the 2010 rate period. Dr. Webb divided his annualized cost-of-service by his annualized

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committed rates that would be 50% of the uncommitted rates). *See also Imperial Oil and ExxonMobil Oil Corp. v. Enbridge Pipelines (Southern Lights) LLC*, 136 FERC ¶ 61,115, at P 13 (2011) (affirming the TSA refund mechanism which "preserve[s] the 2-to-1 ratio").

[1033] Tr. at 279 (McComb).

[1034] Tr. at 279, 291-92 (McComb).

[1035] Exh. S-21, lines 9 and 10 (McComb).

[1036] *Id.*

[1037] This is due to the fact that if one is to calculate the uncommitted rates first, based on committed throughput only, one must weight the committed volumes by 50% to achieve the proper 2:1 ratio. *See* Exh. S-21, line 6 (bottom half) (McComb) (showing the application of appropriate 0.50 weighting).

throughput to yield a rate of $18.02 per barrel.[1038] Unlike Ms. McComb, however, he does not multiply this result by two to obtain the uncommitted rate. For this reason, Trial Staff asserted that his rate design is flawed.

523. Trial Staff stated that Dr. Webb calculates an undifferentiated cost-based unit rate of $18.02 per barrel, but he does not discuss whether this rate applies both to committed and uncommitted volumes, or just one of these classes. Trial Staff explained that during the locked-in period, ESL transported only committed volumes,[1039] and it is these committed volumes that provide the throughput he uses in his rate design. Thus, arguably, Dr. Webb developed a rate for committed volumes only. In order to maintain the 2:1 rate ratio approved by the Commission, Trial Staff asserted that Dr. Webb should have doubled his proposed cost-based rate to arrive at an uncommitted rate. In any event, the resulting rate would be higher than the pipeline's proposed uncommitted tariff rate.

524. Trial Staff discussed how Indicated Shippers' rate design likewise uses an annual cost-of-service divided by throughput to obtain an undifferentiated unit rate. In this case, Ms. Crowe takes her recommended cost-of-service of $161,248,000 and divides this by the pipeline's annual capacity of 65,700,000 barrels to yield a rate of $2.45 per barrel.[1040] According to Trial Staff, Ms. Crowe's rate design is also fatally flawed because it fails to account for the Commission-approved 2:1 ratio; it requires the pipeline to transport all volumes – both committed and uncommitted – at the $2.45 per barrel rate in order to recover its cost-of-service.

525. According to Trial Staff, because Ms. Crowe used the capacity of the pipeline to design rates, ESL would need to fill its pipeline with 65,700,000 barrels of diluent per year to receive the $161,248,000 in cost-of-service revenues proposed by the Indicated Shippers. If it were to transport even one barrel for a committed shipper at a rate equal to one half of the $2.45 per barrel rate, it would fall short of making its revenue requirement.[1041] Therefore, under Ms. Crowe's rate design, ESL could never achieve its revenue requirement unless it transported uncommitted volumes only. Furthermore, Trial Staff argued that record evidence shows that through December 2011, the pipeline has yet to transport a single barrel of diluent for an uncommitted shipper.[1042]

[1038] Exh. ESL-7 at 61 (Webb).

[1039] *Id.*

[1040] Exh. Nos. IS-4 (Updated) at 1, Statement A, lines 7-9; and IS-1 at 21-22 (Crowe).

[1041] *See* Tr. at 294-95 (McComb) (the problem with Indicated Shippers' rate design is that it assumes there is only one class of volumes – uncommitted volumes); and Tr. at 295-96 (McComb) (unless the design volumes are weighted to reflect the 2:1 ratio, the pipeline's revenue will not equal its cost-of-service).

[1042] Exh. IS-46 at 3 (Jervis).

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526. Trial Staff explained that all three participants advocate a basic rate design of dividing the annual cost-of-service by annual throughput. Where Trial Staff parts company with the other participants relates to application of the 2:1 rate principle of the TSAs. According to Trial Staff, they apply this principle in rate design, but the other participants do not. The Commission held that in setting the initial rates in this docket for hearing, it was not undermining the fact that the Commission-approved committed rates would be 50% of the uncommitted rates.[1043] Trial Staff argued that the rate designs proposed by ESL and Indicated Shippers undermine the 2:1 principle by ignoring it.

527. Trial Staff noted that ESL proposes two different rate designs for the 2011 rate period. Initially, ESL's witness, Dr. Webb, employs a conventional rate design based on an annual cost-of-service and twelve months of throughput.[1044] Exhibit No. ESL-56 shows this calculation using an updated cost-of-service.[1045] Since the pipeline did not transport any volumes for uncommitted shippers during this period, Dr. Webb concludes that there is no need to distinguish between the two classes of customers.[1046] His rate design results in a unit rate of $14.14 per barrel, by dividing the cost-of-service by throughput.[1047] Under this approach, Dr. Webb gives no consideration to the provisions of the TSAs, and simply seeks to obtain an uncommitted rate that would permit the pipeline to recover its Opinion No. 154-B cost-of-service.[1048]

528. Trial Staff explained that Dr. Webb also presents a second rate design. To address the situation where pipeline throughput exceeds the committed shippers' annual average of 77,000 barrels per day commitment and includes volumes from uncommitted shippers, he proposes what he terms the "*Laclede/Keystone*" approach. He names the approach after the Commission decisions in *Laclede Pipeline Company*[1049] and *TransCanada Keystone Pipeline, LP*.[1050] In essence, the method subtracts revenues attributable to a "discount" class of shippers from the total cost-of-service, and then derives rates for other shippers based on the remaining of cost-of-service. In this proceeding, the committed shippers represent the discount class and the uncommitted shippers the other class. Specifically, Dr. Webb first determines revenues from the committed shippers, who he considers discount shippers under the TSAs. He calculates the revenues at the effective

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[1043] *Enbridge Pipelines (Southern Lights) LLC*, 131 FERC ¶ 61,288, at P 16 (2010).

[1044] Exh. ESL-7 at 62 (Webb).

[1045] Exh. ESL-56, Statement A, lines 7-9 (Webb).

[1046] Exh. ESL-7 at 62-63 (Webb).

[1047] Exh. ESL-56, Statement A, lines 7-9 (Webb).

[1048] Exh. ESL-7 at 62 (Webb).

[1049] *Laclede Pipeline Co.*, 114 FERC ¶ 61,335 (2006). *See* Exh. S-15 at 7 (McComb) (summarizing the Commission order).

[1050] *TransCanada Keystone Pipeline, LP*, 125 FERC ¶ 61,025 (2008). *See* Exh. S-15 at 7-8 (McComb) (summarizing the Commission order).

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rates charged them, taking into consideration the TSA refund mechanism. He then subtracts that revenue from his Opinion No. 154-B cost-of-service. Finally, he divides the remaining costs by hypothetical test period uncommitted volumes to obtain cost-based uncommitted rates at various levels of throughput.[1051]

529. Trial Staff argued that these two rate design proposals are flawed. With respect to the first approach, Ms. McComb raises the same concerns that she had with Dr. Webb's calculation for the uncommitted rate for the 2010 rate period. Specifically, she points out that Dr. Webb uses the actual volumes shipped by the committed shippers for the period, instead of the minimum volumes for which they must pay.[1052] Ms. McComb's Exhibit No. S-16 shows that use of the contractually committed volumes of 28,105,000 barrels per year results in a rate of $10.33, rather than $16.16, per barrel, using Dr. Webb's cost-of-service.[1053] Doubling these rates to determine the uncommitted rates results in rates of $20.66 per barrel and $32.32 per barrel, respectively, based on throughput of 28,105,000 barrels per year.

530. Trial Staff explained that Ms. McComb also points out flaws in Dr. Webb's *Laclede/Keystone* approach. In particular, Trial Staff argued that the method uses circular logic.[1054] In employing the method, Dr. Webb must determine the amount of revenue attributable to the committed shippers at various levels of throughput. In so doing, however, he uses the same TSA tariff rate of $10.9744 per barrel to calculate the revenues at the various throughput levels, instead of the effective rates that these shippers would actually pay at these levels.[1055] As discussed above, the TSA refund mechanism acts to reduce the rates paid by shippers as throughput increases. Therefore, Ms. McComb shows that in calculating the revenue from the committed shippers in the process of determining cost-based uncommitted rates, Dr. Webb has implicitly assumed that the appropriate rates to use are the proposed TSA rates. However, it is exactly these rates that are at issue here, the purpose being to determine whether these rates are just and reasonable.[1056]

531. According to Trial Staff, ESL's *Laclede/Keystone* method contains a further flaw. If the committed rate is to be determined only after the appropriate uncommitted rate is determined, one cannot take into account committed revenues, which are based on the committed rate, in calculating the uncommitted rate.[1057]

[1051] Exh. ESL-7 at 64 (Webb).
[1052] Exh. S-15 at 11 (McComb).
[1053] *Id.*; Exh. S-16, Workpaper 2, line 9 (McComb).
[1054] Exh. S-15 at 13 (McComb).
[1055] *Id.*
[1056] *Id.*
[1057] *Id.* at 14.

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532. Trial Staff has previously addressed the problems with the Indicated Shippers' rate design proposal in connection with the 2010 rate period. That discussion applies equally here. The only difference between their rate designs for the 2010 and 2011 periods is the cost-of-service. Furthermore, Trial Staff has already addressed the problem the Indicated Shippers have with Ms. McComb's procedure of doubling the committed rate to obtain the uncommitted rate. Trial Staff asserted that Exhibit No. S-21 justifies the procedure and shows the same results pertain if the uncommitted rate is derived directly.

Findings and Conclusions

533. The rate design should appropriately allocate the cost-of-service between the Committed and Uncommitted Shippers in a way that ensures the appropriate group of shippers pays for the services they receive.[1058] All three participants advocate a basic rate design of dividing the annual cost-of-service by annual throughput. However, Trial Staff parts company with the other participants in relation to the application of the 2:1 rate principle of the TSAs.

534. Setting differential rates for the Committed and Uncommitted Shippers is consistent with Commission precedent and the Commission's prior rulings for ESL,[1059] and the Commission acknowledged this point when it determined that the 2-to-1 ratio does not result in undue discrimination,[1060] and is just and reasonable.[1061]

535. The Indicated Shippers' rate design disregards the existence of Committed and Uncommitted Shippers entirely and simply sets an across-the-board rate using the design capacity of the pipeline as the throughput in the rate calculation. In addition, the Indicated Shippers' method would design a rate that would not permit ESL to collect its cost-of-service, a result which is inconsistent with the Commission's Declaratory Order, creating an unjust and unreasonable result.[1062] Nothing in the Commission's prior orders for ESL is consistent with that approach, and it would fail to produce a just and reasonable Uncommitted Rate in this case in addition to ignoring the Commission-approved 2:1 ratio.

536. ESL's proposed rate design is similar to Trial Staff's for the 2010 rate period - ESL witness Webb divided his annualized cost-of-service by his annualized throughput

[1058] ESL-7 at 9:11-14; 23:19-24:14, 25-27, 54-67; ESL-44 at 13-30.

[1059] *See* ESL-7 at 26, 55-56; ESL-44 at 14-15; Tr. at 260:9-16.

[1060] *See* Declaratory Order at PP 25-31; Exh. ESL-7 at 26.

[1061] Order on Complaint at P 16; ESL-44 at 51; *see also* National Energy Board Decision at 24 ("Taking into account all the factors above . . . the Board is of the view that a 2 to 1 Toll Ratio is just and reasonable.").

[1062] Tr. 296:17-18.

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to yield a rate of $18.02 per barrel,[1063] but his design is flawed as he does not multiply this result by two to obtain the uncommitted rate. ESL's two proposed rate designs for the 2011 rate period are also flawed. The first approach gives no consideration to the provisions of the TSAs and simply seeks to obtain an uncommitted rate that would permit the pipeline to recover its Opinion No. 154-B cost-of-service. In ESL's second proposal, the *Laclede/Keystone* approach, the amount of revenue attributable to the committed shippers at various levels of throughput is determined.[1064] However, in doing so, the same TSA tariff rate of $10.9744 per barrel is used to calculate the revenues at the various throughput levels, instead of the effective rates that these shippers would actually pay at these levels.[1065] As discussed *supra*, the TSA refund mechanism acts to reduce the rates paid by shippers as throughput increases. ESL's approach here implicitly assumes that the appropriate rates to use are the proposed TSA rates while it is exactly these rates that are at issue here. Accordingly, ESL and Indicated Shippers' rate design must be rejected, and the 2:1 Rate Design in the TSA should be used to allocate the cost-of-service between Committed Shippers and Uncommitted Shippers.

537. To determine the 2010 rate design, the Opinion No. 154-B annual cost-of-service for ESL, as calculated using the various components determined in this Initial Decision, should be divided by the annualized minimum throughput volumes of the Committed Shippers, or 28,105,000 barrels.[1066] This determines the Committed Rate, which is multiplied by two, for the reasons explained *supra*, to determine the Uncommitted Rate.[1067] The same methodology should be used to calculate the 2011 rate design.

538. Furthermore, the question of whether one calculates the Committed Rate first and then the Uncommitted Rate, or vice versa, is inconsequential.[1068] As ESL noted, the Commission has ruled that "Indicated Shippers' argument that the Committed Rates cannot be decoupled from the Uncommitted Rate is effectively an attempt to overturn the rate structure approved by the Commission in the declaratory order proceeding, and is an impermissible collateral attack on the Commission's prior orders."[1069]

[1063] Exh. ESL-7 at 61 (Webb).
[1064] Exh. S-15 at 13 (McComb).
[1065] *Id.*
[1066] Exh. S-15 at 9 (McComb); Exh. S-17 (McComb).
[1067] ESL transported only committed volumes during the 2010 rate period.
[1068] *See* Tr. 291:17–292:9; Exh. S-21.
[1069] Order on Complaint at P 17.

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Issue #17: What is the just and reasonable uncommitted rate for the period in question?

A. ESL

539. ESL explained that Dr. Webb and Trial Staff witness Ms. McComb conclude that the 2010 Uncommitted Rate of $10.0526/bbl and the 2011 Uncommitted Rate of $10.9744/bbl were just and reasonable for those periods.[1070] As noted, *supra*, Dr. Webb reached that result by using relatively high cost-of-capital parameters to directly calculate the maximum Uncommitted Rate, which he shows to be higher than the filed rate.[1071] ESL noted that Trial Staff reached that result by calculating the COS for ESL and then allocating that COS in accordance with the Commission-approved 2-to-1 rate ratio.[1072] As with ESL, Trial Staff shows that its maximum Uncommitted Rate exceeds the filed rate.[1073]

540. According to ESL, Indicated Shippers argue that the Uncommitted Rate for 2010 should be $2.45/bbl,[1074] and that the Uncommitted Rate for 2011 should be $2.33/bbl,[1075] both of which are inappropriately low. As stated in Dr. Webb's testimony, Ms. Crowe and Dr. Safir wrongly approached this case as though the task were to set a COS rate for a hypothetical pipeline that is coming before the Commission for the first time to set rates for a single class of shippers that will bear the entire cost of the pipeline.[1076] ESL asserted that approach has no relevance to the real goal of setting the just and reasonable Uncommitted Rate for the actual pipeline that exists.[1077]

541. Moreover, ESL noted that the unreasonableness of Indicated Shippers' Uncommitted Rates can be examined by comparing them to the rates the Committed Shippers actually paid in 2010 and 2011. As explained by Dr. Webb, the Indicated Shippers' proposal implies that Uncommitted Shippers should pay rates that are less than half the rates that the Committed Shippers actually paid in 2010 ($5.025) and in 2011 ($5.4872).[1078] ESL stated that Indicated Shippers have made no effort to explain how that is fair or appropriate, either for the Committed Shippers who bore the risks of the Southern Lights Pipeline throughout this period, or for the Uncommitted Shippers, who avoided those risks and chose not to ship at all in 2010 and 2011.

[1070] Exh. ESL-7 at 64; Exh. S-15 at 16.
[1071] Exh. ESL-44 at 9:2-15.
[1072] Exh. S-15 at 9-10.
[1073] *See id.* at 9-10, 16-17.
[1074] Exh. IS-4 (Updated) at 1:9.
[1075] Exh. IS-3A Supp. at 1:9.
[1076] Exh. ESL-44 at 11:18-12:18; *see also* Tr. at 257:13 - 258:5.
[1077] *See id.*
[1078] Exh. ESL-44 at 7:1-9.

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B. Committed Shippers

542. Committed Shippers supported the position of Enbridge and FERC Staff that the filed rates for 2010 and 2011 should be approved. Committed Shippers explained that Enbridge witness Dr. Webb's 154-B approach yields a rate of $17.61/bbl for the 2010 period and a rate of $14.14/bbl for the 2011 period.[1079] These rates far exceed the rates filed by Enbridge for the 2010 and 2011 periods, $10.0526/bbl and $10.9744/bbl, respectively. Moreover, Enbridge witness Dr. Webb demonstrated that under its filed rates, Enbridge's achieved ROE for 2010 and 2011 much lower than that recommended by Dr. Fairchild, reinforcing the conclusion that Enbridge's filed rates are just and reasonable.[1080]

543. Committed Shippers noted that FERC Staff reaches the same conclusion using an alternative method. As noted above, for the 2010 period, Staff divided Staff's locked-in cost-of-service of $159 million by the Committed Shippers' committed volume of 28.105 million barrels to arrive at a Committed Rate of $5.66/bbl and an Uncommitted Rate of $11.32/bbl.[1081] Committed Shippers explained that Staff compared $11.32 to Enbridge's filed rate of $10.0526 and concluded that Enbridge's 2010 rate is just and reasonable.[1082] For the 2011 period, Staff compared the effective TSA Uncommitted Rate for each of its hypothetical uncommitted volumes against the Opinion No. 154-B rate and determined that the former was lower than the latter in every instance, thereby showing the former was just and reasonable.[1083]

544. According to Committed Shippers, under either approach, Enbridge's filed Committed and Uncommitted Rates are less than properly calculated Opinion No. 154-B rates, and are therefore just and reasonable.

C. Indicated Shippers

545. Indicated Shippers argued that a just and reasonable uncommitted rate for the period in question is $2.45/bbl.[1084] For Docket No. IS11-146-000, Indicated Shippers proposed an uncommitted rate of $2.33/bbl.[1085]

[1079] Exh. ESL-55, Statement A, line 10 (2010 rate); Exh. ESL-56, Statement A, line 9 (2011 rate).

[1080] *See* Exh. ESL-7 at 60–62.

[1081] Exh. ESL-15 at 9–10.

[1082] *Id.*

[1083] Exh. S-15 at 15:18–16:14; Exh. S-19 at Workpapers 1 & 2.

[1084] Exh. IS-4 (Updated) at 1, line 9; Exh. IS-1 at 22.

[1085] Exh. IS-3A (Supp.) at 1, line 9.

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546. Indicated Shippers noted ESL's argument that this rate is *per se* unreasonable because it is less than half the rate that Committed Shippers actually paid in 2010 ($5.025).[1086] Indicated Shippers argued that this is neither a logical nor procedurally fair comparison. As discussed *supra*, the committed rates are to be derived once the uncommitted rates have been determined. Moreover, Indicated Shippers asserted that the committed rates were also made subject to refund when the Commission accepted and suspended the tariffs subject to refund, so if they turn out to have been too high, presumably Committed Shippers will be entitled to refunds of the difference from inception of the service.

D. Trial Staff

547. Trial Staff noted that witness McComb presented evidence demonstrating that ESL's proposed tariff rate of $10.0526 per barrel for the 2010 rate period is a just and reasonable uncommitted rate.[1087]

548. According to Trial Staff, as shown in Exhibit No. S-17, and as described above, Ms. McComb derived a committed rate by first dividing Trial Staff's annualized Opinion No. 154-B cost-of-service of $159,099,000 by the annual committed throughput of 28,105,000 barrels,[1088] resulting in a committed rate of $5.66 per barrel.[1089] Because Ms. McComb used only committed volumes to derive this rate, she multiplied the rate times two, for the reasons discussed above, to determine an uncommitted rate of $11.32 per barrel.[1090] Since ESL's TSA uncommitted tariff rate of $10.0526 per barrel is lower than Trial Staff's Opinion No. 154-B, cost-based rate of $11.32 per barrel, Trial Staff concludes that the tariff rate is cost justified.

549. For Docket No. IS11-146-000, Trial Staff noted that Ms. McComb presented evidence demonstrating that the just and reasonable uncommitted rate for the 2011 rate

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[1086] ESL I.B. at 52 (citing Exh. ESL-44 at 7); ESL makes a similar comparison between the rate Indicated Shippers have proposed for the Docket No. IS11-146-000 case (assuming that indexing does not apply) and the rate Committed Shippers paid in 2011.

[1087] Exh. S-15 at 9-10 (McComb).

[1088] Exh. S-17 (McComb). Ms. McComb used a total annual cost-of-service of $159 million in her calculation, based on Trial Staff's answering testimony as originally filed. *See* Exh. S-2 (August 16, 2011) at 2, Statement A, line 7 (Sherman). Trial Staff subsequently corrected its cost-of-service to $167 million. *See* Exh. S-2 (rev. Jan. 11, 2012) at 2, Statement A, line 7 (Sherman). The use of the updated, higher cost-of-service would not change Ms. McComb's or Trial Staff's ultimate conclusion, since its use would only produce a higher Opinion No. 154-B uncommitted rate, and thus only further justify Enbridge Southern Lights' lower tariff rate.

[1089] Exh. S-17 (McComb).

[1090] Exh. S-15 at 10 (McComb).

period is ESL's proposed TSA tariff rate of $10.9744 per barrel.[1091] As shown in Exhibit No. S-19, and as described above, Ms. McComb derived a series of uncommitted rates by first dividing Trial Staff's cost-of-service of $167,898,000 by the sum of the annual committed throughput of 28,105,000 barrels plus various levels of uncommitted throughput from zero to 37,595,000 barrels, up to a total equal to system capacity of 65,700,000 barrels.[1092] Trial Staff asserted that this results in a series of committed rates at various throughput levels.[1093] Because Ms. McComb used only committed volumes to derive this rate, she multiplied the resulting committed rates times two for the reasons discussed above to determine corresponding uncommitted rates.[1094]

550. Since ESL's effective uncommitted tariff rates are lower than Trial Staff's Opinion No. 154-B, cost-based uncommitted rates at any level of throughput, Trial Staff concludes the proposed TSA tariff rate of $10.9744 per barrel is cost justified.

Findings and Conclusions

551. Indicated Shippers argued that the Uncommitted Rate for 2010 should be $2.45/bbl,[1095] and that the Uncommitted Rate for 2011 should be $2.33/bbl,[1096] implying that Uncommitted Shippers should pay rates that are less than half the rates that the Committed Shippers actually paid in 2010 ($5.025/bbl) and in 2011 ($5.4872/bbl).[1097] Indicated Shippers made no effort to explain how that is fair or appropriate, either for the Committed Shippers who bore the risks of the Southern Lights Pipeline throughout this period, or for the Uncommitted Shippers, who avoided those risks and chose not to ship at all in 2010 and 2011. Accordingly, their position must be rejected.

552. ESL and Trial Staff concluded that the 2010 Uncommitted Rate of $10.0526/bbl and the 2011 Uncommitted Rate of $10.9744/bbl were just and reasonable for those periods.[1098] As noted *supra*, ESL reached its result by using relatively high cost-of-

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[1091] Exh. S-15 at 15-16 (McComb).

[1092] Exh. S-19 (McComb). Ms. McComb used a total annual cost-of-service of $167,898,000 in her calculation based on an earlier version of Trial Staff's answering testimony. Trial Staff subsequently corrected its cost-of-service to $178,752,000. *See* Exh. S-3 at 2 (rev. Jan. 11, 2012) (Sherman). The use of the updated, higher cost-of-service would not change Ms. McComb's or Trial Staff's ultimate conclusion, since its use would only produce higher uncommitted rates, and thus only further justify Enbridge Southern Lights' lower tariff rate.

[1093] Exh. S-19, line 9 (McComb).

[1094] Exh. S-15 at 10 (McComb).

[1095] Exh. IS-4 (Updated) at 1:9.

[1096] Exh. IS-3A Supp. at 1:9.

[1097] Exh. ESL-44 at 7:1-9.

[1098] Exh. ESL-7 at 64; Exh. S-15 at 16.

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capital parameters to directly calculate the maximum Uncommitted Rate, which was shown to be higher than the filed rate.[1099] Trial Staff reached its result by calculating the cost-of-service for ESL and then allocating that cost-of-service in accordance with the Commission-approved 2-to-1 rate ratio.[1100]

553. Since ESL's proposed TSA uncommitted tariff rate of $10.0526 per barrel is lower than Trial Staff's Opinion No. 154-B cost-based rate of $11.32 per barrel, the 2010 tariff rate is cost justified. For the 2011 period, Trial Staff calculated a series of committed rates at various throughput levels[1101] that were all lower than Trial Staff's Opinion No. 154-B, cost-based uncommitted rates at any level of throughput. Accordingly, the proposed 2011 TSA uncommitted tariff rate of $10.9744 per barrel is cost justified.

SUMMARY AND CONCLUSION

The 2010 and 2011 rate periods are "locked-in" for seven months and eleven months, respectively, with no volumes shipped by Uncommitted Shippers.

554. In Docket No. IS10-399-000, ESL seeks to establish initial rates for Southern Lights Pipeline, the United States portion of a 1,582-mile pipeline it owns and constructed from Manhattan, Illinois to Edmonton, Alberta. The pipeline, which began commercial operations on July 1, 2010, transports diluent to Alberta.[1102] As previously explained, in its initial tariff filing, ESL proposed an uncommitted rate of $10.0526 per barrel and a committed rate of $5.0263 per barrel[1103] based on its Transportation Services Agreements, or TSAs, which establish as "an over-arching principle" that the ratio of the uncommitted rate to the committed rate be 2:1.[1104]

[1099] Exh. ESL-44 at 9:2-15.

[1100] Exh. S-15 at 9-10.

[1101] Exh. S-19, line 9 (McComb).

[1102] The U.S. portion of the Southern Lights Pipeline is owned and operated by ESL and the Canadian portion is owned and operated by Enbridge Southern Lights LP (an affiliated company in Canada). The project involved the reversal of an existing crude oil pipeline (Line 13 of the Enbridge-Lakehead mainline system) between Clearbrook, Minnesota and Edmonton, Alberta and construction of a new 20-inch pipeline from Chicago to Clearbrook. *See Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,310, at PP 6-8 (2007) ("Declaratory Order"). The term "Southern Lights Pipeline" as used in this proceeding is intended to refer only to the United States portion of the entire pipeline project, since that is the only portion over which the Commission has rate jurisdiction and for which an appropriate rate of return is at issue.

[1103] Exh. ESL-4 at 2 (Jervis) (Enbridge Pipelines (Southern Lights) LLC, FERC ICA Oil Tariff, FERC No. 2).

[1104] Exh. ESL-9 at 42 n.1 (Webb) (Southern Lights Diluent Pipeline Transportation Services Agreement, *pro forma* U.S. version).

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555. ESL made its first annual recalculation of the tariff rates for Southern Lights Pipeline on December 28, 2010, proposing to increase the uncommitted rate to $10.9744 per barrel and the committed rate to $5.4872 per barrel, subject to the TSA true-up mechanism.[1105] In Docket No. IS11-146-000, the Commission suspended the new rates to be effective February 1, 2011, subject to refund, and consolidated that rate case with the ongoing hearing.[1106] Thus, the rates in Docket No. IS10-399-003 were only in effect for a seven-month period (the 2010 rate period), when they were superseded by the rates in Docket No. IS11-146-000.

556. ESL asserts that the uncommitted rate at issue in Docket No. IS10-399-003 is moot because no one shipped uncommitted volumes during the period that rate was in effect, and the rate period is now locked-in. While it may be true that no one shipped uncommitted volumes during the 2010 rate period, the levels of rate base, accumulated depreciation, and deferred return established in Docket No. IS10-399-003 carry forward and affect subsequent rate periods. Therefore, it is appropriate that rulings on the cost-of-service issues presented in Docket No. IS10-399-003 be made in this proceeding as the Commission has directed in setting this matter for hearing.

557. The rates in Docket No. IS11-146-00 were in effect for an eleven-month period (the 2011 rate period), when they were superseded by ESL's second annual rate filing on November 30, 2011, in Docket No. IS12-63-000.[1107] The Commission suspended the tariff filing to be effective January 1, 2012, subject to refund, but did not consolidate the new docket with the ongoing hearing procedures. Instead, the proceedings in that docket have been held in abeyance pending the outcome of this proceeding.[1108] Committed Shippers have explained that there were no volumes shipped by Uncommitted Shippers during the test period ending June 30, 2011 or during the 2011 period—February 1, 2011 to December 31, 2011. Thus, the 2011 period is also a locked-in period with no volumes shipped by Uncommitted Shippers.

The TSA-derived uncommitted rates for the 2010 and 2011 rate periods are just and reasonable.

558. Perhaps the most significant and contentious issues pending adjudication in this proceeding pertain to the Commission's prior rulings with respect to the TSAs. The issue of whether the TSAs apply to the uncommitted rate, and if so, how and in what respects,

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[1105] *Id.* at P 3; Exh. ESL-6 at 2 (Jervis) (Enbridge Southern Lights, FERC ICA Oil Tariff, FERC No. 4.3.0).

[1106] *Enbridge Pipelines (Southern Lights) LLC*, 134 FERC ¶ 61,067 (2011).

[1107] *Enbridge Pipelines (Southern Lights) LLC*, 137 FERC ¶ 61,256, at P 1-2 (2011).

[1108] *Enbridge Pipelines (Southern Lights) LLC*, 137 FERC ¶ 61,256, at P 1 (2011).

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must be addressed first to provide the appropriate analytical framework within which the remaining issues in this case are to be decided.[1109]

559. Prior to making its tariff filing in Docket No. IS10-399-000, ESL filed a petition for a declaratory order, which the Commission approved in 2007, seeking approval of the rate terms of the TSAs. Among other things, the TSAs provide for rates based on: (1) a capital structure of 30% equity and 70% debt; (2) a return on equity of between 10% and 14%, depending on the project's final capital cost; (3) a depreciation rate schedule, which specifies rates that yield depreciation expenses more levelized than those derived from depreciation rates using a straight-line basis; (4) the crediting of all uncommitted revenues to both committed and uncommitted shippers up to 90% of the pipeline's annual capacity, and a 25% pipeline-75% shippers sharing of incremental revenues associated with volumes above that level; and (5) an annual projection of costs and volumes, with an annual true-up mechanism that provides refunds to, or recovery from, shippers after the end of each year.[1110]

560. In the rehearing order in 2008, the Commission clarified that the agreed-upon terms of the TSAs would govern the determination of the committed shippers' rates, and that it was upholding the rate design embodied in the TSAs, with one condition.[1111] In the event that the uncommitted rate was protested, the Commission held that it would require ESL to support the uncommitted rate by filing cost, revenue, and throughput data, as required by Part 346 of its oil pipeline regulations.[1112] The Commission added that when a just and reasonable uncommitted rate was determined in this manner, the pipeline could derive the committed rate by applying the agreed-upon terms of the TSAs.[1113]

561. Based on the cited language of the Commission's orders and the language of Part 346 and Opinion No. 154-B, the undersigned concurs with and hereby adopts the position advocated by Trial Staff that all aspects of the TSAs apply to the calculation of the uncommitted rate, except for the automatic application of the individual cost components specified in Schedule B of the TSAs which must be determined by the Commission's traditional cost-of-service methodology for oil pipelines. Accordingly, the TSAs must be taken into account for assessing rate structure and rate design and should be taken into account in the determination of individual cost elements in situations where Part 346 and Opinion No. 154-B do not prohibit it.

[1109] *See* full discussion *supra,* "Issue #1: Does the TSA apply to the uncommitted rate and if so how, and in what respects?"

[1110] *Enbridge Pipelines (Southern Lights) LLC*, 121 FERC ¶ 61,310, at P 11 (2007); Exh. ESL-9 at 40-41, 44, 62-63 (Webb).

[1111] *Enbridge Pipelines (Southern Lights) LLC*, 122 FERC ¶ 61,170, at P 13 (2008).

[1112] *Id.*

[1113] *Id.*

562. The position advocated by Indicated Shippers that "[n]o aspect of Enbridge Southern Lights' TSAs with its committed shippers will be applicable to rates for uncommitted shipper service "[1114] is simply not supportable and must be rejected as inconsistent with the Commission's prior rulings with respect to the TSAs. Further, the uncommitted rate design model advocated by the Indicated Shippers' is flawed and can not be adopted for use in this proceeding because it derives solely in reference to Opinion No. 154-B and Part 346 of the Commission's regulations, steadfastly rejecting any application of the TSAs to the rates for uncommitted shipper service despite the Commission's prior rulings to the contrary.[1115]

563. While ESL and Trial Staff were in substantial agreement as to many of the various components of the cost-of-service, those components of the cost-of-service where the parties were in disagreement must be addressed within the framework of the Commission's Opinion No. 154-B methodology. Trial Staff noted that, in particular, they differed with ESL on whether the TSAs should be taken into account in (1) assessing the risk of ESL in determining the cost of equity, and (2) calculating throughput for rate design. For the reasons discussed more fully *supra,* I have adopted the position advocated by Trial Staff regarding both of these issues.[1116]

564. Committed Shippers concur that the TSAs must be taken into account for assessing rate structure and rate design but took no position on the various components of the cost-of-service where ESL and Trial Staff were in disagreement, correctly noting that both ESL's and Trial Staff's cost-of-service components, when applied to proper throughput determinants and Opinion No. 154-B methodology, result in a finding that ESL's filed 2010 and 2011 rates are just and reasonable.

565. Trial Staff calculated an annual cost-of-service for the 2010 rate period of $167,079,000. It primarily used annualized costs actually incurred by the pipeline. Trial Staff also based its cost-of-service on a rate base derived using the trended original cost methodology adopted by the Commission in Opinion No. 154-B, on its own analysis of ESL's cost of capital, and on a stipulated depreciation rate. In its rate design, Trial Staff used an annual level of throughput of 28,105,000 barrels. This represents the annual level that the committed shippers are obligated to pay for under the TSAs, whether they ship that level or not. As previously discussed, I concur with Trial Staff's position on this disputed issue. In any event, Trial Staff's calculated uncommitted rate exceeded the proposed TSA tariff rate of $10.0526 per barrel for the 2010 rate period confirming that the pipeline's proposed tariff rate for the 2010 rate period is cost-justified.

[1114] *See* Exh. IS-1 at 7, 16 (Crowe).

[1115] *See* Exh. IS-1 at 7, 16 (Crowe).

[1116] (*See* "Issue #8: What is the appropriate cost of equity?" and "Issue #15: What is the appropriate level of throughput/billing determinants?").

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566. For the 2011 rate period, Trial Staff developed an annual cost-of-service of $178,752,000. It based this amount primarily on actual costs incurred by ESL during its first of year of operations, with some adjustments. As in the analysis for the 2010 rate period, Trial Staff based its cost-of-service on a rate base derived using the trended original cost methodology adopted by the Commission in Opinion No. 154-B, on its own analysis of ESL's cost of capital, and on a stipulated depreciation rate. For the 2011 rate period, Trial Staff did not propose any specific level of throughput, but instead calculated uncommitted rates over a range of throughput. In these calculations, it specifically took into account the TSA rate structure and the 2:1 (uncommitted to committed rate) ratio that the Commission approved. At every level, Trial Staff's uncommitted rates exceeded the pipeline's effective uncommitted rates for the 2011 rate period confirming that the pipeline's proposed uncommitted tariff rate for the 2011 rate period is cost-justified.

567. Trial Staff has supported its position that its calculations for the total cost-of-service follow the Commission's Opinion No. 154-B methodology while giving appropriate deference to the TSAs in accordance with prior Commission rulings;[1117] accordingly, for the reasons discussed more fully herein above, I adopt Trial Staff's overall calculation of an annual cost-of-service of $167,079,000 for 2010 and an annual cost-of-service of $178,752,000 for 2011. Further, I concur with and hereby adopt Trial Staff's determination that the TSA tariff rates proposed by ESL for uncommitted service in Docket Nos. IS10-399-003 and IS11-146-000 are just and reasonable. Trial Staff reached this conclusion by comparing these tariff rates with the uncommitted rates it calculated using a methodology consistent with Opinion No. 154-B and by using data provided by the pipeline in accordance with Part 346 of the Commission's oil pipeline regulations. In all cases, ESL's proposed uncommitted tariff rates were lower than the effective uncommitted rates calculated by Trial Staff. Further, this conclusion is consistent with and supported by record evidence in this proceeding which justifies the cost basis for the uncommitted rates proposed by ESL in Docket Nos. IS10-399-000 and IS11-146-000. Accordingly, I find that the TSA-derived uncommitted rates for the 2010 and 2011 rate periods are just and reasonable.

ORDER

568. The omission from this Initial Decision of any argument raised by the Participants at the hearing or in their briefs does not mean that it has not been considered; rather, it has been evaluated and found to either lack merit or significance such that inclusion would only tend to lengthen this Initial Decision without altering its substance or effect. Accordingly, all arguments made by the Participants which have not been specifically discussed and/or adopted by this decision have been considered and are rejected.

[1117] *Enbridge Pipelines (Southern Lights) LLC*, 122 FERC ¶ 61,170, at P 12 (2008).

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569. IT IS ORDERED, subject to review by the Commission on exceptions or on its own motion, as provided by the Commission's Rules of Practice and Procedure, that within sixty (60) days of the issuance of the Final Order in this proceeding, all parties shall take appropriate action to implement all the rulings in this decision including, as necessary and appropriate, a compliance filing by ESL with supporting documentation reflecting the determinations in this decision.

Bobbie J. McCartney
Deputy Chief Administrative Law Judge

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