UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

	)	
Seaway Crude Pipeline Company, LP	)	Docket No. IS12-226-000
	)	

INITIAL BRIEF OF THE CANADIAN ASSOCIATION OF PETROLEUM PRODUCERS

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May 7, 2013

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Pursuant to Rule 706 of the Commission's Rules of Practice and Procedure, and in accordance with the governing procedural schedule, The Canadian Association of Petroleum Producers ("CAPP") hereby submits its initial brief. This brief addresses the following issues from the List of Issues:[1]

- Issue No. 3.B.4., Allocation of the Enbridge Purchase Price To Both Initial And Expansion Capacity and Services
- Issue Nos. 4.D.1., 2. And 3. Costs of Debt and Equity Capital and Capital Structure
- Issue No. 6. Rate Design, Including the Use of Revenue Credits
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I. The Enbridge Purchase Price: If It Is included In Rate Base, Should a Portion Of That Amount Be Allocated To the Expansion Capacity and Services of the Pipeline? (List of Issues: No. 3.B.4.)

[1] In light of its detailed nature, CAPP endorses the parties' Joint Statement of Issues as a concise statement of the case for purposes of Rule 706(b)(1)(a).

The rates filed by Seaway that initiated this proceeding were calculated using three categories of carrier property in service, the largest comprising an amount that Seaway witness Wetmore described as "the applicable amount Enbridge incurred to acquire its fifty percent share of Seaway from Conoco Phillips Company:" $1,094,918,000. (Exh. SEA-22 at p. 6, ll, 10-14; Exh SEA-24, workpaper 4) This amount, referred to in the remainder of this brief as "The Enbridge Acquisition Costs," represents roughly 93% of the total amount of $1,174,264,000 claimed by Seaway as carrier property in service for the Test Period. The other two categories of carrier plant in service are identified in Enbridge's filed case as Enterprise's Retained Ownership with an amount of $59,020,000 and Incremental Additions Prior to Initial Service with an amount of $12,426,000. Test Period Additions total $7,900,000.

The issues presented in this case that relate to the largest share of the pipeline's claimed rate base are twofold: one, whether the costs incurred by Enbridge in purchasing its one-half interest in the Seaway pipeline should be included in rate base at all, and two, if the costs are allowed in rate base, how they should they be allocated to the rates that are in issue in this proceeding.

The first issue corresponds to those comprising Issue 3.B. of the Issues List; the second, Issue 3.B.4. As discussed below, this case presents certain novel features that call into question the applicability of the "benefits" test relied on by Seaway, and the Commission should carefully scrutinize the proposed treatment of Enbridge's claimed costs in order to ascertain whether inclusion of those costs in rate base fits the Commission's policy formulated in prior cases. If so, in light of the special circumstances presented here, the Commission should ensure that the policy as applied produces just and reasonable rate results.

With regard to this critical second question – how to allocate the Enbridge Acquisition Costs in designing the rates that are here in issue – it is abundantly clear that, if the Commission determines to allow those costs in rate base, they should be allocated to both the initial (135,000 barrels per day) and the 2013 expansion (to 400,00 barrels per day) capacities and services. Enbridge explicitly and publicly stated its intention to use the asset for both services, in connection with its agreement to the purchase price. Moreover, Enbridge itself intends to make use of the expansion, underscoring the need to allocate an appropriate share of costs to that capacity and the services rendered through the expansion. Thus, as set forth in the Joint Statement of Issues, CAPP's position on the Enbridge acquisition payments is that the rates designed for Seaway's services should reflect the commercial reasons for which Enbridge agreed to pay the price it did.

A. The Commission Should Carefully Scrutinize the Facts To Ascertain Whether the Purposes of the Benefits Exception Would Be Served By Recognition of the Enbridge Acquisition Costs, Or Any Portion Thereof, As An Element of Seaway's Rate Base

Seaway argues that the costs of the Enbridge Acquisition qualify for inclusion in the rate base of Seaway, relying on Commission precedent that includes:

Enbridge Pipelines (Southern Lights) LLC, 121 FERC ¶ 61,310, at PP 36-38

(2007); *Enbridge Energy Company, Inc.*, 110 FERC ¶ 61,211, at P 28 (2005); *Rio Grande Pipeline Co.*, 78 FERC ¶ 61,020 at 61,082(1997); *Longhorn Partners Pipeline*, 73 FERC ¶61,355 at 62,112 (1995). (SEA-22 at 6-7, n.4) In each of these cases, the Commission applied the benefits test to ascertain whether an acquisition premium could be included in the rate base of an entity that had purchased a pipeline asset or control over an asset.

These precedents, however, make clear that the benefits exception is not an entitlement, but rather a special rule for which shipper benefits, commensurate with the excess amounts paid, are the key component. As the D.C. Circuit has noted:

> The concept of original cost accounting is a bedrock principle of the Uniform System. …Absent original cost accounting, "all that pipelines would have to do to raise rates and obtain greater income would be to buy utility properties from another at a price higher than original cost and in this very simple way increase the cost of service to consumers." *Arkla Energy Resources*, 61 F.E.R.C. p 61,004, at 61,038, (1992). A company, however, is not always prohibited from recovering that amount of the purchase price in excess of depreciated original cost. It can do so by proving that "consumer benefits relative to the excess amount [paid] accrued to rate payers." *United Gas Pipe Line*, 25 F.P.C. at 63.

Northern Border Pipeline Co. v. FERC, 129 F.3d 1315, 1321 (D.C. Cir. 1997) (upholding order denying application of the benefits test to purchase price of a pipeline segment from another pipeline)

CAPP has taken no position on the sufficiency of the benefits demonstration here, or the reasonableness of the Enbridge Acquisition Costs:

CAPP urges, however, that the ratemaking treatment of any of the claimed costs in rate base be harmonized with the principle of cost-based rates, and be made consistent with the purposes for which the benefits exception has been recognized. (Exh. CAP-1 at 2-5, 16-18) Thus, to the extent that any costs are found eligible by reason of the benefits conferred, those costs should be reasonably assigned to the benefitted parties in the ratemaking process.

The specific facts surrounding the Enbridge Acquisition Costs warrant close scrutiny here, given the distinctions between this and prior cases in which the benefits test has been employed, and the potential expansion of the policy that the proposal here represents. Among the distinguishing facts here are:

- The asset that was acquired by Enbridge was not the pipeline or related physical assets, but rather an interest in the partnership that owned the pipeline. Thus, it is different from the *Rio Grande, Longhorn,* and *Southern Lights* cases, where the entity seeking approval purchased identified pipeline assets.[2]
- Enbridge did not purchase the partnership entity itself, but rather a non-controlling (50%) interest in the company. (Exh. SEA-25 at 6)

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[2] In *Rio Grande*, the pipeline "purchased 194 miles of an existing refined products pipeline…" *Rio Grande Pipeline v. FERC,* 178 F.3d 533 (D.C. Cir. 1999). In *Longhorn Partners,* a newly formed partnership proposed "to include the full purchase price of a crude oil pipeline system it proposed to purchase…in any cost of service computations regarding the rates to be charged" by the partnership. *Longhorn Partners Pipeline,* 73 FERC ¶61,355 at 62,110 (1995). In *Enbridge Southern Lights,* the partnership entity proposed to "acquire and reverse Line 13," a 135-mile crude oil pipeline segment. *Enbridge Pipelines (Southern Lights) LLC,* 121 FERC ¶ 61,310 At Pars. 7,8

Thus, it is different from the situation in the 2005 *Enbridge* case relied on: there, a single owner (BP Pipelines) sold the entity to a single purchaser (Enbridge).[3] In such cases, the Commission may reasonably treat the ownership of the asset and the ownership of the company as coextensive.

- Here, both the selling party, Conoco, and the purchasing party, Enbridge, each made (or makes) use of the pipeline. Conoco had used the Seaway system (south to north) to supply its Oklahoma refinery;[4] Enbridge will make use of Seaway capacity (north to south) as a part of its integrated system. (Exh. CAP-1 at 14-15) (Exh. SEA-4 at 2; through "capacity release or other means…exclusive access to a portion of the Seaway Expansion"). The prior cases have presented no such facts for the Commission to evaluate.

[3] *Enbridge Energy Company, Inc.*, 110 FERC ¶ 61,211, at Pars. 5, 6 (2005) (90% interest acquired with option on remaining 10%).

[4] Prior to Conoco's sale of its one-half partnership interest in Seaway, "it became clear that ConocoPhillips had no interest in reversing Seaway, because the pipeline was serving a ConocoPhillips refinery in Oklahoma. Because ConocoPhillips owned a 50 percent interest in Seaway, it had an effective veto over any proposal by Enterprise (the other 50 percent owner) to make such a reversal." (Exh. SEA-25 at 3).

In *Missouri Interstate Gas, LLC, Opinion No. 525* 142 FERC ¶ 61,195 (2013), the Commission recently ruled on proposed rates that were designed in part to incorporate an acquisition premium paid for certain natural gas pipeline assets. The Commission noted that a threshold requirement of the benefits test is that the acquisition must be reflected on the books of the entity that holds title to the asset, and that transfers between affiliates do not qualify for the benefits exception.

> [U]nder the [Uniform System of Accounts], an acquisition premium must be reflected on the books of the entity that holds title to the asset to which the acquisition premium relates. An acquisition premium cannot be transferred between affiliates unless the underlying asset itself is transferred.

Opinion No. 525, Par. 78. Seaway here presents an issue that differs from prior cases, wherein a premium was paid by a regulated pipeline for an asset, i.e., in which the payor of the premium acquired "title to the asset." (See the cases cited in footnote 1, *infra*, and the *Northern Border* opinion, excerpted above) Here, the Seaway partnership held title to the asset, but the payment was made for a corporate (partnership) interest. The language from Opinion No. 525 suggests that the premium cannot be paid for an asset that is held by another entity.

Here, the asset in issue is the Seaway pipeline; the acquisition premium, however, was paid not for the pipeline or for a controlling interest in the company, but rather for a share of the company. The pipeline has been employed for some years in transportation service from south Texas northerly to Oklahoma. Following the identified financial transactions, the pipeline was reversed to furnish north to south service. Prior to the transaction, the pipeline asset belonged to neither of the partners in the Seaway partnership – Conoco and Enterprise – but to the Seaway partnership itself.[5]

In purchasing Conoco's interest in the partnership, Enbridge paid the acquisition premium, not Seaway. Thus, Enbridge is the entity that incurred the purchase premium, not Seaway, and the description of the Uniform System of Accounts quoted above in Opinion No. 525 does not apply here. This presents a threshold issue of whether Enbridge as a co-owner of the partnership qualifies to record the acquisition premium on its books and, if so, how that translates into carrier property in service for Seaway.

A second aspect of the language quoted above is that the acquisition premium "cannot be transferred between affiliates unless the underlying asset itself is transferred." Here, the Seaway partnership held the asset prior to and after the acquisition premium was paid. Thus, there is no transfer of title to which the transfer of the premium can be ascribed. The "asset," the pipeline itself, was transferred, if at all, only between the old and new versions of the Seaway partnership. (Exh. SEA-1, at 5, n.2) (Exh. CAP-1 at 9) These two entities may

[5] Partnership agreements typically do not confer title to any asset held by the partnership to a specific partner. (See, e.g., the Enterprise agreement, Exh. SEA-8, page 11: Article 2.8 "Title to Partnership Assets. Title to Partnership assets, whether real, personal or mixed and whether tangible or intangible, shall be deemed to be owned by the Partnership as an entity, and no Partner or Assignee, individually or collectively, shall have any ownership interest in such Partnership assets or any portion thereof.") Enbridge makes no claim to own the Seaway pipeline or any other partnership asset.

qualify as "affiliates" for purposes of applying the benefits test, but the issue remains as to whether or how the premium transferred from Enbridge to the partnership.[6]

As Mr. Pinney characterized the unusual factual circumstances presented here, the application of the benefits exception would represent an "expansion or special case" of the policy. (Exh. CAP-1 at 6) The acquisition premium was not paid for an asset, as in the bulk of cases in which it has been applied. It was not paid in order to acquire a controlling interest in a business that itself owned the asset. It was instead paid to acquire a partial interest in a business, in order to overcome a "veto power" held by the predecessor holder of the interest, and in connection with a contemplated arrangement whereby the acquiring entity would itself become a lessee of a portion of the reversed Seaway line. Thus, both the seller and the purchaser of the partnership interest were themselves "customers" of the pipeline, and this aspect also warrants careful deliberation.

As Mr. Pinney noted, these unique factual considerations may or may not support application of the benefits exception test here. If any portion of the Enbridge Acquisition Costs is allowed rate-based treatment, however, Mr. Pinney

[6] Seaway maintains its books in accordance with the Uniform System of Accounts (Exh. SEA-5 at 1,2). Its most recently filed Form 6, however, appears not to reflect the Enbridge Acquisition Costs in carrier plant in service, as is reflected in the proposed rates sponsored by Seaway here. (See, Seaway Crude Pipeline Co., Form 6, FERC Accession Submittal No. 20130418-8051, April 18, 2013)

urged that the purposes of the exception be held firmly in mind in designing rates for the reversed Seaway transportation services.

B. The Governing Standards: If The Enbridge Acquisition Costs Are Included In Rate Base, They Must Be Allocated Reasonably, Fairly Reflect the Principle Of Cost-Causation, And Ensure That Shipper Benefits Are Aligned With Rate Responsibility

Given that the threshold qualification for inclusion of any portion of the Enbridge Acquisition Costs in rate base is the "benefits to shippers" test, the central question in designing rates to recover those costs is, "benefits to which shippers?" Here, the answer is clear, that the benefits accrue, if at all, to initial shippers and expansion shippers. Notably, among the latter category is Enbridge itself. As Mr. Pinney testified, this makes it especially critical that the costs of the acquisition premium be allocated in a way that produces just and reasonable results.

The allocation of the costs of the Enbridge purchase premium is not subject to the unfettered discretion of the Seaway partnership, nor of Enbridge. There may be any number of ways to reasonably allocate the purchase price, and the Commission should ensure that the result is reasonable. The Commission explicitly addressed this question in Opinion No. 525, in ruling on the disposition of a purchase price premium,

> Finally, the Presiding Judge's finding that a purchaser of an asset can allocate the purchase price in any manner it chooses is not entirely correct. As explained by the Staff witness in this proceeding, if a group of assets are purchased together there are a number of reasonable ways to allocate the

> purchase price, including a cost per mile allocation or a fair market value approach.[107]

Opinion No. 525 at Par. 78. In ascertaining the appropriate allocation of costs, the Commission selects from among those methodologies contained in the record, none of which may hold claim to being the exclusive or definitive allocation methodology. This standard was recently reiterated by the Commission in another oil pipeline proceeding, *SFPP, L.P., Opinion No. 522*, 140 FERC ¶ 61,220 (2012)

> In deciding which cost allocation methodology to apply, the Commission must choose from the cost allocation alternatives available on the record.[151] Thus, the Commission "must sometimes conclude which is the more reasonable of the several [cost allocation] alternatives." [Fn.] To make the decision, the Commission considers which methodology most closely conforms to the Commission's long standing practice of trying to align cost allocation with cost causation.[Fn.]
>
> [151] *See Michigan Gas Storage Co.*, 89 FERC ¶ 61,131, at 61,376 (1999) (stating that where the record presents the Commission with three flawed approaches from which to choose, it must choose from the alternatives available on the record).

Opinion No. 522 at Par. 100. Thus, the Commission chooses from among the cost allocation methodologies presented. In this case, the cost allocation methodologies presented encompass several variables and produce a range of results. These are discussed and compared in Section I. C, below.

In selecting a methodology for allocating costs, the bedrock principle of designing rates is the cost-causation standard:

> [A]ll approved rates [must] reflect to some degree the *costs actually caused by the customer who must pay them.* Not surprisingly, we evaluate compliance with this unremarkable principle by comparing the costs

> assessed against a party to the burdens imposed or benefits drawn by that party.

Illinois Commerce Comm'n v. FERC, 576 F.3d 470, 476 (7th Cir. 2009) (citing *KN Energy, Inc. v. FERC*, 968 F.2d 1295, 1300 (D.C. Cir. 1992); *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 708 (D.C. Cir. 2000); *Pacific Gas & Elec.Co. v. FERC,* No. 03-1025, 373 F.3d 1315, 1320-21 (D.C. Cir. 2004). As noted by the courts in applying this principle, "Not surprisingly, we evaluate compliance with this unremarkable principle by comparing the costs assessed against a party to the burdens imposed or benefits drawn by that party." *Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361, 1368 (D.C. Cir. 2004)

Thus, in choosing among the various ratemaking approaches proposed in this case, the test is whether the result properly assigns costs to the customers who caused them to be incurred, and whether the costs assessed to a ratepayer are fairly comparable to the burdens or benefits accruing to those parties.

C. The CAPP Proposal Best Reflects and Embodies Principles Of Cost-Causation: The Enbridge Costs Were Not Incurred Exclusively To Furnish Reversed Service To Initial Shippers, But Also To Furnish Reversed Service To Expansion Shippers As Well

The CAPP proposal best conforms to the cost-causation principles outlined above. In agreeing to purchase a one-half interest in the Seaway pipeline, Enbridge explicitly envisioned using its interest in the reconfigured company to reverse the line, expand the line, and make use of the expanded line for its purposes, which included furnishing transportation services using leased capacity on the line. Because the Seaway proposal imposes the entirety of the acquisition costs on rates for initial shippers only, it fails to comport with the principle of cost-causation.

Testifying on behalf of CAPP, Mr. Mark Pinney succinctly addressed the appropriate treatment of the Enbridge Acquisition costs. Should the Commission find that the specific facts surrounding the transfer of Conoco's interests in the Seaway pipeline to Enbridge qualify for the benefits exception, Mr. Pinney noted that the basis on which those costs were generated is the starting point of analysis for purposes of designing rates in this case.

> Q: If the [benefits] policy is to be applied, how should it be applied here?
> A: At a minimum, the rates for Seaway's services should be designed to ensure that there is a correspondence between the purposes for which Enbridge incurred the Enbridge Acquisition Costs and the services for which rates are being established to include those costs. Put differently, the benefits exception should be calibrated to the benefits.
>
> In this regard, it is clear that the price Enbridge paid for the Seaway assets was a function of the commercial potential for the reversed Seaway over a period of time that will include the expanded capacity of system, and not merely the capacity at the point in time when the initial southbound services were implemented, in May, 2012. Specifically, the change in ownership, the reversal of the pipeline, the change in corporate form, and the commencement of additional measures to expand the system, were all related. This relationship should be given due recognition in the design of rates for Seaway's services.

(Exh. CAP-1 at 10-11). Mr. Pinney went on to identify the most central factual consideration in applying the cost-causation principle to the circumstances of this case.

> As I noted earlier, Enbridge's acquisition of the Seaway interests was motivated by more than simply the preexisting northbound services, and included both the reversal and the two expansions that are anticipated to be undertaken – the 2013 expansion to 400,000 b/d and the 2014 expansion to a total capacity of 850,000 b/d. The Commission should ensure that the correct capacity figure is used in translating the Enbridge Acquisition Costs into rates for specific shippers.

(Exh. CAP-1 at 11) Noting that each of the three tranches of capacity were envisioned, Mr. Pinney's specific proposal for allocating costs and designing rates incorporated other, practical and sound considerations.

> Q: Why are you not proposing that the Enbridge Acquisition Costs be allocated to the 2014 expansion as well?
> A: When sufficient cost data becomes available for that expansion, I would anticipate that such an allocation should be considered in designing rates for those services as well. My proposal is conservative, in the sense that I am not proposing an allocation of costs to the 2014 expansion, although it might be justified.

(Exh. CAP-1 at 12) Accordingly, Mr. Pinney allocated the Enbridge Acquisition Costs to the initial and expansion services, but not to the contemplated 2014 expansion.

> Q: How do you propose that the Commission accomplish this [ratemaking] objective?
> A: My recommendation is that the Enbridge Acquisition Cost be allocated between the original capacity and the 2013 expansion capacity. I have performed such an allocation, which appears on my

> Exhibit CAP-2, Work paper 4. I made the allocation based on the respective capacities. This is consistent with the use of initial capacity as the basis for the design of rates, as proposed by Seaway.

(Exh. CAP-1 at 11)

> It is clear that a portion of the Enbridge Acquisition Costs are reasonably attributable to the 2013 expansion and thus it would be unreasonable to compute rates for the pre-expansion services on the presumption that the entirety of those costs are attributable to services rendered through the pre-expansion capacity.

(Exh. CAP-1 at 12)

The relevant facts surrounding the actual payment of the Enbridge Acquisition Costs demonstrate conclusively that the purchase price was determined in anticipation of both the reversal and the expansions. These facts are not in dispute. The key facts as outlined by Mr. Pinney and other evidence in the record are:

- The Seaway acquisition was integral to Enbridge's overall strategy of enhancing its markets for southbound flows of incremental crude oil supplies over time. (Exh. SEA-25, pages 2 – 7) (Exh. CAP-1 at 13);

- The pre-reversal Seaway line, as originally put into southbound service, had a capacity that is a mere fraction of the volumes anticipated to require access to the Gulf Coast via Enbridge's facilities over the near term. The volumes and timing of this strategy make it abundantly clear that the two expansions were inseparable from the pre-expansion capacity in Enbridge's deliberations and negotiations for the purchase of Conoco's Seaway interest. (Exh. CAP-1 at 13)

- The purchase price reflected Enbridge's appreciation that the Seaway Pipeline was a "strategic asset," and a key fit with Enbridge's existing pipeline system, as confirmed in a contemporaneous press release by Enbridge's President. (Exh. CAP-1 at 13) (Exh. CAP-3) ;

- Enbridge intended to make use of expanded Seaway capacity as a component of its Gulf Coast Access project, including the so-called Flanagan South project intended for service beginning in 2014. (Exh. SEA-4);

- Enbridge made arrangements in connection with the Seaway acquisition to obtain exclusive use of portions of the Seaway expansion for additional. volumes of southbound crude transportation, the so-called Cushing South project. (Exh. SEA-4 at 2) (Exh. CAP-1 at 14-15);

- Neither the Seaway Expansion nor the Cushing South projects were intended to be physically separate from the Seaway Pipeline. (Exh. SEA-4 at 2, 7-8)

As noted, these facts are not in dispute. Indeed, the factual evidence furnished by Mr. Pinney and the testimony of Enbridge witness Mr. Shamla are entirely harmonious; each reinforces the other. As Mr. Shamla testified, the 2013 expansion was anticipated in connection with Enbridge's acquisition of the Seaway interest, and in January, 2013, that expansion in fact went into service. Tr. (Tr. 194; Tr. 197-200; See also, Tr. 314) Enbridge itself anticipated becoming a shipper via release/lease or other arrangement (Exh. SEA-4 at 2) by a date anticipated to be "mid-2013" (Exh. SEA-4 at 11). Thus, the expectations on which Enbridge based its financial investment – that additional volumes would flow on the reversed Seaway following the 2013 expansion, with added capacity up to 400,000 bpd, with some portion of capacity reserved for the exclusive use of Enbridge – aligned perfectly with the actual facts as shown on the record. Enbridge and Seaway acknowledge that the expansion and initial capacities are not physically distinct. (Exh. SEA-4 at 2, 7-8) To design rates without taking these facts into account would be inconsistent with the evidentiary record and wholly unreasonable.

Turning from the facts to the design of rates, it is wholly implausible that the entirety of the Enbridge Acquisition Costs can be attributed to the limited capacity of the Seaway line as of the point in time at which the initial reversal was initiated. Yet that is the position of Seaway. Seaway's response to Mr. Pinney's proposal consists of the following statement by Seaway witness Wetmore: "There is no justification for including only a portion of the purchase price in rate base simply because the pipeline is expanded after start-up." (Exh. SEA-26 at 30). Mr. Wetmore wholly fails to address the more logical question: why should an acquisition cost that was plainly based on both initial and expansion capacity of the purchased asset be borne entirely by shippers making use of the initial capacity, merely because the start-up preceded the expansion by a few months? Conventional ratemaking principles demand that costs be aligned with benefits. Application of the benefits exclusion, if it is applied, makes it all the more critical that these principles be used in the design of rates.

Mr. Pinney derived a rate for Enbridge's uncommitted southbound transportation service employing a reasonable, capacity-based methodology. In allocating the Acquisition Costs to the two classes of service, initial and expansion, he derived the allocation factor by multiplying Enbridge's Acquisition cost of $1,094,918,000 by the quotient of Seaway's initial capacity of 135 mbpd and its expanded capacity of 400 mbpd. (Exh. CAP-1 at 16) This is an entirely sound approach and should be adopted here.

In this case, the CAPP proposal is the best of those presented from the standpoint of conforming to the applicable principles of rate design. None of the other methodologies proposed for the allocation of costs to services captures as directly the fact that the price Enbridge agreed to pay for its share of the Seaway partnership reflected a vision of an expanded pipeline, over a near term that in fact has transpired as expected. The costs were incurred to serve two classes of customers. Neither initial nor expansion shippers should be omitted from the calculation of rates. Seaway's proposal effectively does so, as Mr. Pinney testified:

> I would reiterate, however, that if all of these costs were attributed to the pre-expansion capacity of Seaway, as reflected in Seaway's proposal, then the purchase price would be facially unreasonable, for the reasons I have discussed, and the resulting rates would be unreasonable.

(Exh. CAP-1 at 16)

The shipper and staff proposals span a range of alternative approaches, each of which has flaws and merits. However, as the Commission stated in *SFPP, Opinion No. 522,* quoted above, the Commission in such circumstances seeks to identify "which methodology most closely conforms to the Commission's long standing practice of trying to align cost allocation with cost causation." (distinguishing between two proposals: a "multi-tiered" and an "all-in" methodology). Here, aligning costs paid by Enbridge in order to furnish both the initial and 2013 expansion services is reasonable. To fail do so would produce unreasonable results: "It is unreasonable to isolate the expansions from the allocation of acquisition costs in the design of rates for the initial capacity of the reversed Seaway system." (Exh. CAP-1 at 16)

As concerns the Enbridge Acquisition Costs, by far the largest category of costs proposed to be included in rate base, the proposals include:

Seaway proposes to allocate the claimed Enbridge Acquisition Cost between the non-jurisdictional and jurisdictional assets, using a revenue-based allocation factor, with the entirety of the jurisdictional costs allocated to its Initial Services.

Staff proposes to allocate the non-goodwill portion of the Enbridge Acquisition Cost between jurisdictional and non-jurisdictional services, and to design rates to recover the jurisdictional costs for two different periods, pre-expansion and post-expansion.

ACN proposes to recognize only a portion of the Enbridge Acquisition Cost to jurisdictional services, using a somewhat different methodology than Seaway and also excluding costs attributable to good will.

SCN proposes adjustments both to the allocation of Enbridge Acquisition Costs to non-jurisdictional services and in the elimination of costs categorized as goodwill.

As discussed above, no cost allocation methodology can lay claim to perfection. On balance, however, Mr. Pinney's proposal holds significant advantages over the Staff and Seaway approaches. A significant advantage of Mr. Pinney's proposal is that it alone allocates costs to the expansion capacity, thereby aligning the claimed "shipper benefits" as quantified by Seaway with the services that bear the costs of the Enbridge Acquisition Costs. Thus, Seaway attributes a portion of the claimed benefits to volumes flowing *after* the 2013 expansion was placed into service, in January, 2013. (Exh. SEA-28, at 1 of 2, line 10; showing estimated Barrels Per Day increasing to 295 MBD, more than the original capacity of 135 MBD but less than the installed expansion capacity of 400 MBD.) Tr. 198. If, as Seaway explicitly claims, shipper benefits include expansion volumes, then so too should the allocation of costs to services encompass the expansion capacity. Mr. Pinney's methodology accomplishes this; others do not.

Second, as Mr. Pinney noted, Enbridge itself will make use of the expansion capacity, as discussed above. (Exh. CAP-1 at 14-15) (Exh. SEA-4 at 2) Thus, his methodology equitably gives recognition to the fact that Enbridge, in agreeing to a purchase price, had in mind making use of the Seaway expansion capacity itself, as an integral, "strategic" element of its system. In the context of the "shipper benefits" test, Enbridge itself occupies the shoes of shippers who derived a benefit from the efficiencies inherent in the reversal of the Seaway line. Allocating the entirety of the Enbridge Acquisition Costs to the initial capacity, as under Seaway's proposal (and to some extent the Staff proposal), would effectuate a subsidy of Enbridge's own uses by other shippers. The "benefits" test, if it is applied here, should be accompanied by a rate design that aligns those benefits with costs.

Another advantage of Mr. Pinney's proposal is that it can be adopted irrespective of the level of costs that may or may not be authorized for inclusion in rate base under the benefits exception criteria. Thus, he did not explicitly endorse any specific dollar figure Enbridge Acquisition Cost, and explicitly tailored his proposal to apply to whatever level and composition of costs, if any, that the Commission may choose to accept, up to the claimed level of $369 million (Exh. CAP-1 at 16) Thus, Mr. Pinney's cost allocation can be harmonized with the outcome of the issues raised by Staff, ACN, and SCN, regarding the categorization of jurisdictional versus non-jurisdictional (the "Texas City" and other assets; [Issue No. 3.B.3]; and good will versus "hard asset" costs [Issue No. 3.B.2].

Whatever the level of acquisition costs found eligible for rate-base treatment under the benefits test, those costs can and should be treated as proposed under the Pinney methodology.

Finally, a further advantage of the CAPP proposal is that, as noted above, it leaves open a design of rates for the 2014 expansion at such time, and with such additional data as is necessary, as subsequent developments warrant. Unlike the Staff proposal, the CAPP proposal does not rely on any subsequent proceeding or computations to ensure a just and reasonable outcome.

II. Cost of Capital: Capital Structure, Cost of Debt and Equity

CAPP witness David Parcell submitted expert testimony on cost of capital that comprised recommendations on capital structure, cost of debt and cost of equity.

A. Capital Structure:

Mr. Parcell addressed capital structure as follows:

> My proposed capital structure, in contrast [to Seaway witness Fairchild], reflects the average actual capital structure ratios of Seaway's parent companies – Enbridge Inc. and Enterprise Products Partners L.P. These are 42.36 percent equity and 57.65 percent long-term debt. …[M]y approach is consistent with Commission precedent in cases where a pipeline does not issue its own debt without parent guidelines.

(Exh. CAP-4 at 2) Mr. Parcell identified the source data underlying his proposed recommendation. "Exhibit No. CAP-7 shows the capital structures of Enbridge

Inc. as of December 31, 2011 and June 30, 3012. Exhibit No. CAP-8 shows the capital structures for the same dates for Enterprise Products Partners, L.P." (*Id.*)

Mr. Parcell justified his methodology by reference to precedent, in which "the Commission has expressed a preference for using the actual capital structure of a regulated pipeline for ratemaking purposes." Mr. Parcell noted the three-prong test used by the Commission to determine those instances in which the parents' capital structure is preferred: 1. the pipeline issues its own debt without parent guarantees; 2. the pipeline has its own bond rating, separate from its parent; and, 3. the pipeline has an equity ratio that is reasonably consistent with other equity ratios approved by the Commission and those of the proxy companies. (Exh. CAP-4 at 15) Finding these criteria applicable to Seaway, he noted that its parents' capital structures are comparable to those of the proxy group:

> As I noted previously, Seaway does not issue its own debt but rather has all of its capital provided by its parent companies. In addition, as I indicate below, the capital structure ratios of Seaway's parent companies have an average equity ratio of 42.36 percent. This is consistent with the equity ratios recently adopted by the Commission for other oil pipelines, and presents no apparent anomaly. For example, in Opinion No. 502, the Commission adopted the most recent (2006 – 42 %) equity ratio of BP Pipeline's parent. In addition, in Opinion No. 511, the Commission utilized the parent's most recent (2007 – 46.94%) common equity ratio of SFPP's parent. Both of these are consistent with the 42.36 percent equity ratio I am proposing in this proceeding for Seaway.

(Exh. CAP-4 at 16; *citing BP Pipelines, Opinion No. 502*, 123 FERC ¶ 61,287 (2008); *SFPP, L.P., Opinion No. 511*, 134 FERC ¶ 61,121 (2011)) Further, as Mr. Parcell testified, the credit ratings of Seaway's parent companies are "consistent with the respective credit ratings of the proxy companies." (*Id.*) As a result, "it is apparent that Seaway's parent companies' perceived risk (as measured by the level of credit ratings) is similar to that of the pipeline." (*Id.*)

B. Cost of Debt

Mr. Parcell recommended a cost of debt of 5.26% (Exh. No. CAP-4 at 2). He computed this figure using the debt costs of the same two corporate parents used to calculate his recommended capital structure:

> **Q. HAVE YOU CALCULATED THE COSTS OF DEBT FOR ENBRIDGE INC. AND ENTERPRISE PRODUCTS PARTNERS, L.P.?**
> A. Yes, I have. Exhibit No. CAP-9 shows the cost of long-term debt for Enbridge Inc. as of December 31, 2011 (date of most current annual report). This indicates a cost of long term debt of 4.85 percent. Exhibit No. CAP-10 shows the cost of debt for Enterprise Products Partners, L.P. This exhibit begins with the cost of debt as of December 31, 2011 and "updates" the debt issues through August 2012 to reflect two debt retirements and two debt issuances. This indicates a current cost of debt of 5.68 percent. I have utilized the average of these two cost rates. This indicates an average cost of debt of 5.26 percent. I use this as the cost of long-term debt for Seaway.

(Exh. CAP-4 at 18) As Mr. Parcell noted, Commission precedent indicates "that when a parent company's capital structure is used, the use of the parent company's cost of debt necessarily follows." (*Id*.)

C. Cost of Equity

In CAPP's answering case, CAPP witness Parcell computed an appropriate cost of equity of 11.77 percent (nominal basis) and 10.11 percent (real basis.) (Exh. CAP-4 at 3) Among the four cost of capital witnesses, the differences are attributable in part to differences in the DCF proxy groups adopted. Mr. Parcell's recommendation incorporated six of the seven companies appearing in the DCF proxy group proposed in the direct evidence of Seaway's cost of capital witness, Mr. Fairchild :

Buckeye Partners, LP
Enbridge Energy Partners, LP
Magellan Midstream Partners, LP
NuStar Energy, LP
All American Pipeline, LP
Sunoco Logistics Partners, LP

(Exh. CAP-4 at 20) Mr. Parcell excluded one company, Enterprise Products Partners, LP, on the basis of his evaluation of its percentage of business operations: Enterprise Products, he found, "has a much lower percentage of operating income and assets attributed to its oil pipeline segment than do the other six entities. In fact, the relative percentages for this entity are well below 10 percent, while the other six entities each have either operating income or assets over 40 percent." (*Id.*)

III. Rate Design: Revenue Crediting From "Discounted" Contracts And The Differential Between Light and Heavy Crudes (Issues No. 6 and 7)

A. Use Of The Revenue Credit Methodology, As Opposed To An Average Rate Methodology, Is Misplaced Here, As the Tariff Rates Have Not Been Established

In its direct case, Seaway computed proposed rates using a so-called revenue credit methodology to account for revenues from certain contracts for transportation service. Under this methodology, the revenues are deducted from the overall cost of service prior to designing rates for other, nominally "undiscounted" services. In support of this methodology, Seaway witness Mr. Wetmore referred in his testimony to the contracts as "discounted," and cited Commission precedent in which natural gas pipelines have designed rates for non-discounted ("recourse" rates in the parlance of the natural gas pipeline regime at the Commission) rates using the revenue credit methodology.

The revenue credit methodology thus presumes that certain revenues are derived from "discounted" contracts. In his answering testimony, Mr. Pinney pointed out that, in the specific circumstances of this case, there is no preexisting tariff rate, and therefore no basis for determining that the revenues in issues are attributable to "discounts." Mr. Pinney noted that the cited gas pipeline cases presume that there are identifiable discounts on which to conduct the revenue crediting methodology. In the absence of such a framework he proposed that rates be designed using full costs and full billing determinants. (Exh. CAP-1 at 17-20)

If Seaway's filed rates were ultimately adopted, then the contracts from which Mr. Wetmore derived his projected revenues and associated credit to cost of service might credibly be termed discounted. In the event, however, that lower rates – perhaps substantially or even dramatically lower – are adopted as a result of the Commission's determinations in this case, then the "discounted" contracts will not in fact constitute a discount from any tariff rate, and the use of the revenue credit methodology would have to stand, if at all, on a different conceptual footing. (Indeed, it is conceivable that the cumulative revenues could exceed the cost of service, presenting a ratemaking conundrum.) In these circumstances, where there is no pre-existing tariff rate by which to ascertain whether committed rates are in fact discounted, the Commission should determine what rationale, if any, would support the use of a revenue credit to design tariff rates.

Seaway appears to concur with CAPP's position to at least some extent. In his rebuttal testimony, Mr. Wetmore recognized the potential outcome of this proceeding, that the Commission may require Seaway to lower its uncommitted rate below the committed rate (Exh. SEA-26, at 6). He further noted that the Commission has previously held that the committed rates may exceed uncommitted rates (*Id.,* at lines 18-20). As Mr. Wetmore also testified in his rebuttal evidence: "I agree that the revenue credit approach only works if the committed rates are below the average rate. If the committed rates were above the average rate, then the revenue credit approach could not be used and the uncommitted rates would be assessed based on the average rate." (Exh. SEA-26 at 58) Given this concession, it is appropriate to use the approach taken by Mr. Pinney, which is to calculate rates using the total allocated cost of service and the total throughput, i.e., an average rate approach. (Exh. CAP-1 at 19) It cannot be presumed that the committed rates are "discounted" unless and until the tariff rates for uncommitted service are established.

B. Mr. Pinney Appropriately Designed Illustrative Rates To Preserve the Percentage Differential Between Light and Heavy Crudes Proposed By Seaway

Mr. Pinney designed illustrative rates incorporating his recommendations, as well as the cost of capital evidence of Mr. Parcell. In doing so, he computed rates for light and heavy crude volumes, preserving the same percentage premium between heavy and light crudes that Seaway itself proposed in its filing.

> I calculate this rate for heavy volumes to be $1.80 per barrel and for light volumes to be $1.59 per barrel. In calculating these rates I maintained the 13% premium that Seaway is proposing to charge uncommitted shippers for transporting heavy crude oil versus what they are proposing to charge uncommitted shippers for transporting light crude oil.

(Exh. CAP-1 at 20) This is a reasonable approach, and should be adopted in connection with CAPP's other recommendations.

WHEREFORE, for the foregoing reasons, CAPP respectfully requests that each of the issues addressed in this brief be resolved in accordance with the foregoing positions and recommendations.

Respectfully submitted,

THE CANADIAN ASSOCIATION OF PETROLEUM PRODUCERS

By: [signature]

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May 7, 2013

PROPOSED FINDINGS AND CONCLUSIONS

Pursuant to Rule 706(b), CAPP submits the following proposed findings of fact and conclusions of law.

1. The purchase price paid by Enbridge for its interest in the Seaway pipeline reflects both the expectation and intent by Enbridge to provide services to both initial and expansion shippers. See the discussion at pages 3-33, *infra.*
2. Seaway and Enbridge entered into arrangements whereby Enbridge would make use of the expansion services contemplated by both parties. (*Id.*)
3. Accordingly, since rates are intended to assign costs to the shippers who benefit, it is unreasonable for Seaway's initial shippers to bear the acquisition costs exclusively. (*Id.*)
4. The CAPP proposal addresses these considerations reasonably and in a balanced way, by allocating costs to rates for initial services and expansion services in proportion to their respective capacities. (*Id.*)
5. A reasonable cost of capital in deriving the overall costs of service for Seaway is arrived at by assigning the following costs:
    a. A return on equity allowance of 11.77 percent (nominal)/10.11 (real).
    b. A cost of debt of 5.26%. See pages 23-24, *infra*.
    c. A capital structure of 42.36 percent equity and 57.65 percent long-term debt.

    (See the discussion at pages 22-25, *infra*.)

6. An appropriate rate design uses an average-rate methodology, rather than a revenue credit approach. There being no established tariff rate, it is not possible to determine whether committed rates are "discounted." See the discussion at pages 25-27, *infra*.
7. It is appropriate to design rates using the same percentage differential between light and heavy crudes as reflected in the filed rates. See pages 27-28 *infra*.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, DC this 7th day of May, 2013.

JAMES H. HOLT