UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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

REPLY BRIEF OF THE CANADIAN ASSOCIATION OF PETROLEUM PRODUCERS

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 reply brief.

1. The Capital Structure Recommended By Mr. Parcell, Using The Average of Seaway's Corporate Parents, Produces A Result That Is Within the Range Advocated By Seaway Itself, And Is Fully Consistent With Applicable Commission Precedent.

As revealed in the initial briefs, no party advocates that the actual capital structure of Seaway be used to set its rates. This is because, as Seaway's own witness noted, "Seaway does not issue its own rated debt. SEA-45 at 4." Similarly, the nominal capitalization of Seaway of 100 percent equity is unreasonable for purposes of setting its rates, as Mr. Parcell testified: "[I]t is not appropriate to utilize a capital structure containing 100 percent common equity for the purposes of determining the total cost of capital for Seaway." Exh. CAP-4 at 14.

It is thus necessary to use a hypothetical capital structure. The principal issue centers on the choice between two average figures: the average debt-equity

ratios of the pipeline's corporate parents, or the average of the proxy group. CAPP, the Commission Staff (Initial Brief at 57-58), and ACN (Initial Brief at 38) each recommend that the corporate parents' capital structure be employed, relying on Commission precedent that is cited in each of their respective briefs.

In its initial brief, Seaway argues (at 38) that the Commission should instead use a hypothetical capital structure corresponding to the average of the proxy group, specifically, "52.17% debt and 47.83% equity, which is the average capital structure of the oil pipeline proxy group as of March 31, 2012." In the alternative, Seaway proposes the use of updated data that its witness, Dr. Fairchild, computed; "a capital structure of 51.80% debt and 48.20% equity, based on data as of September 30, 2012." (at 39). Seaway thus stands in opposition to the Staff, CAPP, and ACN, each of which sponsor recommendations based on the use of the two corporate parents of the regulated pipeline.

Seaway's argument, however, relies on the same precedent that CAPP and Staff cite. Notably, Seaway wholly fails to acknowledge that the use of the parents' data produces a result that is within the range of proxy-group capital structures computed by its own witness. Moreover, neither the cited precedent nor any other includes any case in which the pipeline had not one but two corporate parents, as is the case here. Seaway's position does not comport with Commission precedent and should be rejected. Thus, Seaway's position – that the opposing proposals do not produce a representative cost – is unsupported both precedentially and factually.

A. The Use of Seaway's Corporate Parents Data To Calculate Seaway's Capital Structure Produces a Result That Is Within The Range of Equity Ratios Computed By Seaway Itself.

Seaway's argument for the use of a proxy-group average capital structure depends on a strained and unsupported application of relevant precedent, as discussed in Section B, below. More to the point, however, the use of its corporate parents' ratios produces a result that is well within each of the alternative range of proxy-group ratios computed by Seaway's own witness, Dr. Fairchild. Offering no rationale for disputing a figure that is within its own range of applicable capital structures, Seaway appears simply to be straining for technical grounds on which to justify a higher equity ratio. Thus, its argument should be dismissed entirely.

The equity ratio resulting from Mr. Parcell's recommendation produces a result within the range identified by Seaway itself. Thus, at page 41 of its initial brief, note 10, Seaway notes the following:

> The equity ratios for the original [Fairchild] proxy group of oil pipelines range from a *low of 40.48% to a high of 56.93%.* Exhibit No. SEA-46. The equity ratios for the updated proxy group range from a *low of 41.29% to a high of 56.93%*. Exhibit No. SEA-47. (emphasis added.)

The CAPP proposal, supported by the recommendation of its expert witness, Mr. Parcell, is for a capital structure incorporating 42.36 percent equity (Exh. CAP-4 at 2, 4, 17) – a figure that is within each of these two ranges of equity ratios for the proxy group sponsored by Seaway's witness. Indeed, it is nearly two percentage

points above the low end of the original Fairchild range. Thus, Seaway is not arguing – it cannot – that the use of its parents' actual capital structures produces a result that is outside the range of the proxy group that it recommends. Instead, it focuses its argument on *one of the two figures* comprising its corporate parents' capital structure, and goes so far as to argue that the Commission is "required" (Seaway Brief at 39) to use the proxy group members. Rather than comparing averages to averages, Seaway thus compares the proxy group average with a specific capital structure, namely, that of Enbridge. This argument distorts the import of the parents' *average* financial data and portrays those data in a misleading way. The result of Seaway's approach would be to determine an equity ratio that is well above the lower end of its own admitted proxy-group range.

The CAPP recommended capital structure represents an equity allowance that is within the proxy-group range, albeit near the lower end. Given that the use of the parents' data is in keeping with precedent (as discussed below), is rational and produces a reasonable result that is consistent with the proxy-group results, there is simply no basis for Seaway's insistence that it is entitled to a higher equity ratio.

CAPP notes that its proposal and that of the Commission Staff[1] differ slightly, even though Staff Witness Alvarez employs the same methodology as CAPP witness Parcell, using the average of the two parent companies of Seaway to calculate an appropriate capital structure. The difference appears to reflect a difference in the time periods underlying the source data – Mr. Parcell using data as of June 30, 2012 (Exh. CAP-4 at 17; CAP-7, CAP-8) and Mr. Alvarez using data as of September 30, 2012 (Exh. S-24 at 1, Note). These differences obviously do not represent any disagreement between Staff and CAPP concerning the use of the corporate parents' financial data, as opposed to those of the proxy group, for purposes of determining the appropriate capital structure for Seaway.

B. The Precedent Seaway Relies On Is Inapplicable, As Seaway Has More Than One Corporate Owner: The Use of the Average Capital Structures Neutralizes Any Claimed "Anomaly"

Conceding that Commission policy establishes that a pipeline that does not issue its own debt is not eligible to have its costs computed to reflect its own capital structure, and that the Commission "generally" uses the corporate-parent ratios in such cases, Seaway nonetheless urges that the Commission precedent "requires" that the proxy group average be used here. (at 39)

> Seaway relies on its parent companies, Enterprise and Enbridge, for debt financing. *Id.* The capital structure of Enbridge, however, is anomalous and

[1] The Staff proposal appears at page 57 of its Initial Brief: "The appropriate capital structure is 58.23 percent debt, 5.27 percent preferred equity, and 36.49 percent common equity for the period ended September 30, 2012."

> not representative of oil pipeline risks. *See id.* at 9-12; Exhibit No. SEA-45 at 4-7 (Fairchild). The Commission therefore should use a hypothetical capital structure based on the oil pipeline proxy group.

Seaway bases its argument on the proposition that one of the two of its corporate parents, Enbridge, Inc., has different risks from Seaway. (SEA-45 at 6). However, neither CAPP nor any other participant argues that Enbridge's capital structure *alone* should be attributed directly to Seaway: rather, Enbridge's capital structure should be reflected as one of the two corporate owners of the pipeline in the composite of its capital structure. In short, because Seaway inaccurately portrays the issue to be whether Enbridge's capital structure can be directly imputed to Seaway, its argument is simply misplaced. If each of the two corporate owners are reasonably representative of the joint venture – as they are – then the average of the two serves as a reasonable basis for setting the hypothetical capital structure of the pipeline.

Because Seaway relies on a comparison of Enbridge to Seaway, and ignores the availability and applicability of financial data for the other corporate parent, Enterprise, the precedent it relies on is simply inapplicable. None of the other cases cited by Seaway involved a pipeline with more than one parent. Thus, the Commission had no alternative to the use of a hypothetical capital structure based on a proxy group, in those instances in which a sole corporate parent has been shown to have a different risk profile from a subsidiary pipeline. That is not

the case here, and the Commission's stated preference for the use of corporate parents' capitalization ratios can reasonably be applied here.

C. The Testimony Relied On Does Not Furnish A Basis For Excluding Enbridge From the Hypothetical Capital Structure

Seaway relies exclusively on the evidence of Mr. Fairchild in seeking to ignore the equity ratio of its own parent, Enbridge. That testimony, however, fails to furnish a sufficient factual foundation for Seaway's argument. In attempting to portray Enbridge as unrepresentative of Seaway, Mr. Fairchild stated:

> Enbridge's financing reflects that it is a diversified energy company involved not only in oil pipelines, but also in gas distribution, gas pipelines, processing and energy services, and investments in other entities. Most of these other activities are regarded as less risky than oil pipelines.

(SEA-45 at 6) This testimony – which furnishes no citation to or discussion of Commission precedent – fails to accurately portray the way in which the Commission has interpreted the relative risks of diversified energy companies such as Enbridge. The Commission has recognized some variability among regulated versus unregulated, and pipeline versus non-pipeline lines of business. *See, e.g., SFPP, L.P., Opinion No. 511-A*, 137 FERC ¶ 61,220, at Par. 302, and note 471; Kern River, *Opinion No. 486-C,* 129 FERC ¶ 61,240 at Pars. 62, 65-69 (explaining why diversified natural gas companies with a large LDC component generally have less risk that an interstate gas pipeline with a transmission function that equals at least 50 percent of its activities.) *Opinion No. 486-B,* 126 FERC ¶ 61,034 (2009) at Pars. 2-22. These decisions make it clear that in evaluating

diversified energy companies, the Commission does not indiscriminately treat all other lines of business as having sufficiently different risks from oil pipelines as to warrant disregard of their relevant financial data. Judge Cianci has aptly summarized these findings as follows:

> [O]pinion No. 486-B only concluded that the risks of the oil pipeline business were closer to those of the natural gas pipeline business than the other product lines of a diversified natural gas company, because the natural gas and oil pipeline businesses involve the regulated transportation of hydrocarbons, and not the more risky unregulated exploration, production, and energy commodity marketing businesses. However, the Commission stated it explicitly recognized that the oil pipeline component of a natural gas company will increase somewhat the firm's overall risk primarily due to the oil pipeline industry's overall greater exposure to competition.

Kern River Gas Transmission Co., *Initial Decision,* 135 FERC ¶ 63,003, Par. 59 (2011)

Mr. Fairchild did not sponsor any evidence to substantiate or quantify the extent of Enbridge's involvement in "less risky" businesses, nor is there any record basis on which to weight those businesses in comparison to each other. Within the spectrum of risks, oil and natural gas pipelines generally share more characteristics than unregulated commodity-based energy activities: Mr. Fairchild's acknowledgement that "gas pipelines" are among the businesses of Enbridge thus furnishes no support for his claim that Enbridge can be definitively distinguished from Seaway, much less that the Commission "must" use the proxy group for purposes of determining Seaway's costs.

Recognizing that oil pipelines may have “somewhat” greater risks than regulated gas pipelines is a far cry from substantiating the claim that Seaway makes here: that Enbridge, which includes both oil and natural gas pipelines among its operations, is not comparable to one of its own oil pipeline subsidiaries. Enbridge “operates, in Canada and the U.S., the world’s longest crude oil and liquids transportation system.” (Exh. CAP-3, Schedule 1, page 1) Seaway itself forms a part of the Enbridge transportation network, as the record makes abundantly clear. It is thus paradoxical for Seaway to portray itself as distinct from one of its parents based solely on a reference to its *other* businesses.

In Opinion No. 486-B, the Commission included in the same DCF proxy group two affiliated (Kinder Morgan) companies (*Opinion No. 486-B,* 126 FERC ¶61,034 at Par. 70), even though their businesses did not precisely overlap, and their credit ratings were different (Id. at Pars. 149-150), a factual scenario close to the one portrayed here. The sole evidence relied on here to distinguish Enbridge – a somewhat higher credit rating – simply does not carry the evidentiary weight that Seaway ascribes to it. That argument should be rejected, and the equity ratios of Enbridge and Enterprise should be averaged to derive an appropriate hypothetical capital structure for Seaway.

2. **The Cost of Debt Of Seaway’s Parents Should Be Used Here: That Figure Is 5.26 Percent As Of August, 2012. CAPP Does Not Oppose the Use of the Updated Data Presented By Commission Staff**

As discussed in CAPP's initial brief, the cost of debt used should correspond to the same entities that serve as the source of the capital structure ratios. Mr. Parcell recommends the use of the average cost of debt of Seaway's two corporate parents, the same source that he recommends be used for purposes of calculating the capital structure ratios. This corresponds with the Commission's directives that the capital structure and debt cost data be consistent. *See,* Opinion No. 502, 123 FERC ¶ 61,287 at P 197. Thus, Mr. Parcell's proposal is in keeping with the Commission's precedents.

> 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.

(CAP-4 at 18) Seaway proposes that the cost of Seaway's debt be calculated on the basis of the average of the proxy group companies, which it calculates as 5.46 percent as of March 31, 2012. (Seaway Initial Brief at 44). Alternatively, Seaway proposes that if updated data are used, the proxy group average cost of debt is 5.40 percent as of September 30, 2012. (*Id.*) Because CAPP opposes the use of the proxy group data for purposes of computing the capital structure of Seaway, it also opposes the use of the proxy group debt costs.

Commission Staff sets forth its position at page 60 of its Initial Brief, as follows:

For the period ending December 31, 2011, the cost of debt is 5.31 percent. For the period ending September 30, 2012, the cost of debt is 5.18 percent.[76] 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. The cost of debt is influenced by the amount of financial risk inherent in the capital structure.[77] Staff averages the cost of debt for Enbridge and Enterprise since they are 50/50 owners in Seaway.[78]

The evidentiary basis for the Staff's debt-cost recommendation includes updated figures for the parents' outstanding debt as of September 30, 2012.

Since the intervenors [testimony] filing, however, Seaway provided updated information in response to data request Staff-6 Seaway-4.12 (Bates Numbers SEA-IS12-226-0004921 and SEA-IS12-226-7 0004927), allowing Staff to calculate the cost of debt for the period ending September 30, 2012 and December 31, 2011.

(S-23 page 3) CAPP does not oppose the use of the Staff's updated debt cost information. Moreover, since Staff witness Alvarez has concurred in the proposals of CAPP and ACN to use the actual debt cost of Enbridge (Exh. S-23 at 3) the Staff and Intervenors appear to be fully in harmony on this issue.

3. Seaway Offers No Rationale For Ignoring the Role of the Expansions in Allocating The Costs of The Enbridge Acquisition

As detailed in CAPP's Initial Brief, the rates computed in this proceeding should accurately reflect the fact that the Enbridge Acquisition Costs were incurred in order to facilitate both the initial and expansion services that are currently furnished by Seaway. In its brief, Seaway argues that the entirety of the Acquisition Costs be allocated to rates for the initial services, with none allocated

to expansion services. It makes three points in its brief in opposition to CAPP's proposal. None of these directly addresses the facts surrounding the issue and none warrants allocating all of the acquisition costs entirely to the initial capacity of the reversed pipeline.

Seaway's first argument is strikingly simple - that the expansion is simply irrelevant to the treatment of the acquisition costs:

> There is no justification for including only a portion of the purchase price in rate base for the purpose of calculating the initial rates simply because the pipeline is expanded after start-up.

For the Commission to adopt this position would represent a willful decision to ignore the facts. The evidence indisputably shows that the reason Enbridge paid what it did for an ownership share in the Seaway pipeline was to enable southbound service at levels that would substantially exceed the initial capacity. If there had only been the prospect that the pipeline would transport the lower, initial capacity, and no evidence of any opportunity to utilize the pipeline to transport more than three times its initial capacity, then the purchase price might have been lower, perhaps even a small fraction of what it was. There is no need for such speculation, however, because the evidence is clear that the price actually paid was directly tied to Enbridge's stated intention to operate the pipeline at a greatly expanded volume.

The language Seaway uses to describe the expansion – "simply because the pipeline is expanded after start up" – portrays the expansion as incidental, a

happenstance that is peripheral to the issue of designing rates. That is not a sensible characterization of the facts, any more than it would be to portray the purchase price paid by Enbridge as exceeding one billion dollars "simply because the pipeline [could be] expanded after start up."

Seaway next argues that Mr. Pinney's approach is inconsistent with Commission precedent and would deprive Seaway of the opportunity to recover its costs. Mr. Pinney, however, took no such position and CAPP makes no such argument.

> By applying his allocation methodology, Mr. Pinney includes only 34 percent of Enbridge's purchase price in rate base. He derives that percentage from the ratio of Seaway's projected initial capacity of approximately 135,000 bpd to Mr. Pinney's projection of 400,000 bpd capacity after 2012. Exhibit No. CAP-2, Workpaper 4.
>
> Mr. Pinney's proposal is inconsistent with the Commission's two-part test and would fail to give Seaway an opportunity to recover its costs.

Mr. Pinney allocated costs to the first of the two planned expansions because it is clear that those services were directly related to the purchase price, were contemplated by Enbridge in agreeing to pay those costs, and thus were incurred in order to furnish those services. Seaway has distorted the proposal to suggest that Seaway could not charge expansion customers for their services. Seaway points to nothing in the CAPP proposal that precludes Seaway from charging expansion customers for the services they receive. As the only rates in issue in this proceeding relate to the initial services, those are the rates that Mr. Pinney addresses.

The third and final point made by Seaway is that Seaway must be permitted an opportunity to earn a return on "its full rate base."

> The capacity of the line was expanded in January 2013, but additional capital was required to make that expansion possible. *See* Exhibit No. SEA-42, line 1. Thus, the evidence of record fully supports inclusion of the entire purchase price in rate base for purposes of calculating initial rates. Indeed, it is not reasonable to deny a pipeline the ability to earn a return on property currently in service; instead, the pipeline must as a matter of law be permitted an opportunity to earn a return on its full rate base during the period those assets are in service, as is the case here.

The issue as framed here, however, is not whether Seaway should be allowed the opportunity to charge both initial and expansion shippers for the costs incurred by Enbridge in acquiring its portion of the partnership – it is already furnishing service through the expansion, which went into service in January, 2013. The issue addressed by the CAPP proposal is whether it is reasonable for Seaway to attribute the entirety of the Enbridge Acquisition Costs to the initial capacity, to wholly ignore the expansion, and to design rates applicable to any uncommitted shipper – original or expansion – on that basis.

As Seaway subtly acknowledges in its brief (at 28), the CAPP proposal addresses the inclusion of "a portion of the purchase price in rate base *for the purpose of calculating the initial rates*." (emphasis added.) Nowhere has Mr. Pinney proposed that the other portion of the Acquisition Cost be excluded from rate base, nor has he proposed that expansion capacity not be allocated a share of the Acquisition Costs. Indeed, Mr. Pinney made clear that a portion of those costs should be recovered in rates for the expansion services; the fact that Seaway has

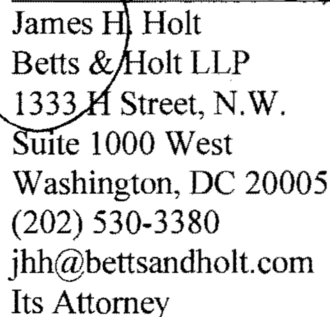
elected not to file separate rates for that service, or rates that incorporate the post-expansion capacity, does not reformulate Mr. Pinney's proposal.

The expansion represents nearly two-thirds of the capacity currently in service as of the close of the evidentiary record. To follow Seaway's proposal, allocating none of the Enbridge Acquisition Costs to the expansion capacity, is patently unreasonable and should be rejected.

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: 

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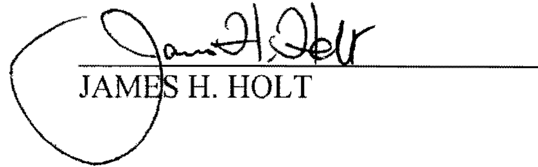
June 4, 2013

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 4th day of June, 2013.



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