121 FERC ¶ 61,310
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Enbridge Pipelines (Southern Lights) LLC Docket No. OR07-15-000

ORDER ON PETITION FOR DECLARATORY ORDER

(Issued December 31, 2007)

1. On July 20, 2007, Enbridge Pipelines (Southern Lights) LLC (Enbridge Southern Lights) filed a petition for a declaratory order. Enbridge Southern Lights asks the Commission to approve the proposed rate structure for the U.S. portion of the planned Southern Lights Pipeline,[1] which will transport light liquid hydrocarbons (diluent) from Chicago, Illinois, to Edmonton, Alberta, for use in transporting heavy crude petroleum produced from Canada's oil sands.

2. Enbridge Southern Lights states that it is targeting a July 1, 2010 in-service date for the Southern Lights Pipeline. According to Enbridge Southern Lights, this construction schedule requires that necessary capital expenditures occur in 2007, accelerating in 2008 and 2009. Enbridge Southern Lights anticipates a ruling on the NEB application in late 2007, and it seeks similar timing from the Commission in this proceeding.

3. The petition is unopposed, and the Commission grants the petition to the extent discussed below.

[1] Enbridge Southern Lights explains that approval of the Canadian portion of the pipeline currently is pending before the National Energy Board of Canada (NEB) in *Enbridge Southern Lights GP Inc*., NEB File No. OF-Fac-Oil-E242-2007-01 01. Enbridge Southern Lights states that it and a Canadian entity, Enbridge Southern Lights LP (Southern Lights Canada), are subsidiaries of Enbridge Pipelines Inc. (Enbridge), a Canadian liquids pipeline company that owns and operates an extensive system in Canada.

Background and Overview of Petition

4. Enbridge Southern Lights emphasizes that Canadian production has been the single largest source of crude oil imported to the United States for a number of years and that the Canadian Association of Petroleum Producers (CAPP) predicts that the Canadian oil sands production will almost double by 2020. However, Enbridge Southern Lights states that, for this production to reach U.S. markets via pipeline, it must be diluted with a less dense, low viscosity material known as diluent. Enbridge Southern Lights further explains that the main source of diluent used in the transportation of Canadian oil sands production has been the condensates produced with natural gas, although the anticipated decline of conventional natural gas production in western Canada means that the associated condensate production also will decline, leaving an unmet demand for diluent, and prompting the Canadian producers to seek other sources of that product. Enbridge Southern Lights also asserts that its market research identified possible U.S. sources for diluent and concluded that the total potential U.S. diluent supply volume for the Southern Lights Pipeline could reach approximately 450,000 bpd without affecting the prices of petroleum products.

5. Enbridge Southern Lights submits that the Southern Lights project offers substantial benefits to the public and to shippers. Enbridge Southern Lights maintains that the increased supply of diluent to western Canada will increase competition for diluent in that market and, in turn, will facilitate economic, efficient production and transportation of oil sands crude. Further, states Enbridge Southern Lights, this will allow synthetic crude oil to be put to higher value uses, such as in existing refineries, which could relieve these refineries from being forced to make substantial investments to meet enhanced product specifications. Enbridge Southern Lights also cites other likely benefits, including increased availability of western Canadian oil sands production to the U.S., which will lessen U.S. reliance on sources from less stable countries, help to offset declining U.S. production levels, and minimize the need for tanker transportation of oil into the U.S.

6. Enbridge Southern Lights explains that the Southern Lights Pipeline will consist of two interconnected pipelines: (1) the U.S. portion, which will be built and operated by Enbridge Southern Lights and will extend from Chicago to the international border near Neche, North Dakota, and (2) the connecting pipeline in Canada, which will be built and operated by Southern Lights Canada and will extend from the international border to Edmonton, Alberta. Enbridge Southern Lights states that the capacity of the Southern Lights Pipeline will be approximately 180,000 barrels per day (bpd).[2]

[2] Enbridge Southern Lights states that the Affidavit of Don Thompson, Director of Light Product Development for Enbridge, which is attached as Exhibit B to its petition,

(continued…)

7. Enbridge Southern Lights further explains that the U.S. portion of the pipeline will consist of two principal components: (1) a new line from Chicago to Clearbrook, Minnesota, which will be approximately 675 miles of 20-inch pipeline following existing right-of-way used by other Enbridge pipelines, and (2) the existing line from the international border to Clearbrook consisting of the 135-mile, 18-inch Line 13 that currently is part of the Lakehead system (owned and operated by Enbridge Energy Limited Partnership (Enbridge LP)). Enbridge Southern Lights states that the line from the international border to Clearbrook is used for the transportation of western Canadian crude oil from the border to Chicago and other midwestern markets.

8. Enbridge Southern Lights states that it will acquire and reverse Line 13 to integrate it into the new Southern Lights Pipeline. However, Enbridge Southern Lights states that, to prevent a reduction in the annual capacity of the Lakehead System, it will construct a new line from Clearbrook to the border to replace Line 13 (the Light Sour Pipeline or LSR) and will make certain improvements to Enbridge LP's Line 2 (together, the Replacement Facilities). Enbridge Southern Lights asserts that the Replacement Facilities will provide a modest increase in annual capacity for the Lakehead system and that each company's rate base will reflect its own expenditures incurred in providing service to its shippers.[3] Enbridge Southern Lights also states that Southern Lights Canada will receive the Canadian portion of Line 13 and, in return, will construct a segment of the new LSR line from Cromer, Manitoba, to the international border.

9. Enbridge Southern Lights explains that Enbridge conducted a widely-publicized open season from May 30 through July 24, 2006. Enbridge Southern Lights describes the materials made available to current and prospective shippers, including the proposed Transportation Services Agreement (TSA),[4] an estimate of capital costs, a pro forma rate

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provides complete details about the origins and nature of the project, the process Enbridge Southern Lights followed to secure supporting commitments, and the potential benefits to shippers and to the public interest. Petition for Declaratory Order of Enbridge Pipelines (Southern Lights) LLC, July 20, 2007 at Ex. B.

[3] Enbridge Southern Lights states that, for an interim period after the like-kind exchange, it will lease Line 13, which will remain in southbound crude oil service. According to Enbridge Southern Lights, this will provide Lakehead shippers an increase in annual capacity of approximately 219,000 bpd. Petition for Declaratory Order of Enbridge Pipelines (Southern Lights) LLC, July 20, 2007 at Ex. B ¶ 21. Enbridge Southern Lights plans to file a separate application for Commission approval to include the cost of the Line 13 lease in its mainline tariff rates during the interim period based on cost parameters agreed to with CAPP. However, Enbridge Southern Lights notes that the relief sought in this petition is not contingent on the separate application.

[4] The *pro forma* TSA is attached to the petition as Exhibit C.

model that explains the development of prospective rates, a market study, draft rules and regulations, a draft commodity specification practice, and a proposed pipeline equalization practice.[5]

10. Enbridge Southern Lights asserts that it has shipper commitments to transport 77,000 bpd during the 15-year TSA term at committed rates that will recover the discounted level of cost for the pipeline.[6] In addition, Enbridge Southern Lights points out that committed shippers will receive a 50-percent discount from the uncommitted rate in addition to other concessions for their long-term volume commitments. For example, continues Enbridge Southern Lights, until the end of the 10th year of the initial 15-year term, committed shippers will have the option to extend the terms of their TSAs for an additional 15 years. Enbridge Southern Lights also emphasizes that the committed shippers agreed to pay an uncommitted tariff rate for volumes transported in excess of their committed volumes (the minimum committed volume is 5,000 bpd).[7]

11. Enbridge Southern Lights summarizes the essential terms of the TSA as follows:

> Committed shippers agree to ship their committed volumes or pay the committed tariff rates for the committed volumes over the 15-year term.
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> Committed shippers have the right, during the first 10 years, to extend the initial TSA term by 15 years at the same or reduced volumes.
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> Committed shippers agree to ship volumes in excess of their minimum commitment at two times the committed rate (uncommitted rate).

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[5] Enbridge Southern Lights explains that the pipeline equalization practice will compensate shippers for differences in the quality of diluent tendered to the pipeline for transportation.

[6] Enbridge Southern Lights states that, following the initial open season, one party exercised its No-Fault Termination Right under the TSA, which gave it the right to terminate the contract by paying its pro-rata share of development costs up to that time. Enbridge Southern Lights explains that Enbridge then allowed the other committed shippers an opportunity to terminate, but none did. Therefore, continues Enbridge Southern Lights, after additional prospective shippers inquired about becoming committed shippers, Enbridge conducted a second open season ending March 28, 2007, although it did not secure any additional commitments.

[7] Enbridge Southern Lights states that, if a committed shipper does not ship the minimum committed volume each month, it will be subject to a deficiency payment.

Committed rates incorporate the following principles:

> Enbridge Southern Lights will set prospective rates annually based on an estimate of its costs.
>
> Capital costs will include costs to transfer Line 13 to Enbridge Southern Lights and to modify it for new use as a diluent pipeline, costs to construct the LSR line, and costs to construct the new diluent line from Chicago to Clearbrook.
>
> The discounted cost-of-service assumes a capital structure of 30 percent equity and 70 percent debt and a base annual equity rate of return (ROE) of 12 percent (adjusted according to the final capital cost of the project in comparison to the estimated capital cost established in September 2006).
>
> Depreciation expense is based on a stipulated depreciation schedule resulting in a more levelized cost-of-service in real terms.
>
> All rates are determined for movements between Chicago and the international border; shorter distance movements (if any) pay the same rate but will be credited with avoided power costs.
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> After the end of each year, Enbridge Southern Lights will refund to or recover from each shipper any rate differential between estimates and actual costs.
>
> Enbridge Southern Lights will credit all uncommitted revenues to the committed and uncommitted shippers up to 90 percent of pipeline annual capacity.
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> Enbridge Southern Lights will retain 25 percent of any incremental revenues associated with volumes above 162,000 bpd (90 percent of annual capacity of 180,000).

12. Finally, Enbridge Southern Lights states that the Commission has recognized the need for new pipeline infrastructure and has expressed its support for such projects,[8] including the following recent statement:

> The Commission has recognized the need for investment in energy transportation infrastructure whether for electric power, natural gas or oil, to meet the nation's growing demand for energy. Further, the Commission also has recognized that certain rate treatments are appropriate to encourage this needed investment in infrastructure.[9]

Notice, Interventions, and Comments

13. Notice of Enbridge Southern Lights' filing was issued on July 27, 2007. Interventions and protests were due August 10, 2007. The Alberta Department of Energy, CAPP, and Statoil North America, Inc. filed motions to intervene.[10] BP Products North America, Inc. filed comments in support of the petition, but did not file a motion to intervene. No one filed a protest.

Discussion

14. Enbridge Southern Lights seeks certain assurances that it contends are necessary to justify the approximately $1.0 billion capital investment required for the U.S. portion of the Southern Lights project.[11] In particular, Enbridge Southern Lights asserts that it

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[8] Enbridge Southern Lights cites, *e.g*., Federal Energy Regulatory Commission Strategic Plan FY2006-FY2011 at 7 (September 2006) ("Goal 1: Energy Infrastructure – Promote the Development of a Strong Energy Infrastructure").

[9] Enbridge Southern Lights cites *Colonial Pipeline Co*., 116 FERC ¶ 61,078, at P 44 (2006) (*Colonial*); *see also Rate Regulation of Certain Natural Gas Storage Facilities*, 115 FERC ¶ 61,343, at P 91 (goal of creating a regulatory environment that will promote infrastructure), *order on reh'g*, 117 FERC ¶ 61,190 (2006). Enbridge Southern Lights adds that the Commission has created incentives to develop needed infrastructure in other industries. *See Promoting Transmission Investment Through Pricing Reform*, Order No. 679, FERC Stats. & Regs. ¶ 31,222 (2006), *reh'g granted in part*, Order No. 679-A, FERC Stats. & Regs. ¶ 31,236, *reh'g denied*, 119 FERC ¶ 61,062 (2007) (issuing rules to promote investment in bulk power transmission system).

[10] Statoil North America, Inc. also provided comments in support of the petition.

[11] Enbridge Southern Lights states that an additional $300 million will be invested by Southern Lights Canada for the Canadian portion of the project.

needs clear assurance the terms of the TSA will control and that the Southern Lights rates will not be subject to the Commission's indexing regulations or subject to challenge on the basis that certain elements of the Schedule B cost-of-service principles depart from standard Commission ratemaking approaches. Enbridge Southern Lights emphasizes that the Commission has recognized the value of providing advance rate guidance for such projects through the declaratory order mechanism.[12] Further, Enbridge Southern Lights maintains that the Commission previously has been flexible in accepting rate provisions:

> The Commission has neither considered nor treated its rate methodologies as limiting its ratemaking approach or constraining it from exploring and adopting other rate approaches that are more fitting in particular circumstances to ensure that a just and reasonable rate results. The Commission has, in fact, used approaches outside its defined methodologies when circumstances have warranted.[13]

A. Rate of Return

15. Enbridge Southern Lights explains that the TSA provides that committed rates will be calculated annually using 77,000 bpd of committed volumes as the throughput level (subject to the revenue credit for uncommitted volumes). Enbridge Southern Lights

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[12] Enbridge Southern Lights cites *Express Pipeline Partnership,* 76 FERC ¶ 61,245, at 62,253 (1996):

> [I]t is better to address these issues [term rate structure and validity of proposed rates] in advance of an actual tariff filing than to defer until the rate filing is made, when the decision-making process would be constrained by the deadlines inherent in the statutory filing procedures. The public interest is better served by a review of the issues presented before a filing to put the rates into effect.

Enbridge Southern Lights adds that, on rehearing, the Commission concluded that "issuing a declaratory order [is] procedurally appropriate for a new oil pipeline entrant, such as Express, because it needs to acquire and guarantee financing in order to begin construction." *Express Pipeline Partnership*, 77 FERC ¶ 61,188, at 61,755 (1996). *See also Colonial Pipeline Co*., 116 FERC ¶ 61,078, at P 9 (2006) (declaratory order prior to $1 billion expansion); *Enbridge Energy Co., Inc*., 110 FERC ¶ 61,211 (2005) (Spearhead Order); *Plantation Pipe Line Co*., 98 FERC ¶ 61,219 (2002).

[13] *Colonial Pipeline Co.,* 119 FERC ¶ 61,183, at P 23 (2007).

acknowledges that, in the Spearhead Order, the Commission suggested that the pipeline should be required to use its initial design capacity to set its first year rate,[14] but Enbridge Southern Lights contends that this requirement should not apply to the proposed Southern Lights line.[15] Enbridge Southern Lights also explains that, in the Spearhead Order, the Commission expressed concern that use of a lower projected throughput figure to set initial rates could permit the pipeline to over-recover its costs.[16] However, Enbridge Southern Lights claims that its proposed rate methodology includes a mechanism to prevent such an over-recovery.

16. Enbridge Southern Lights explains that the TSA provides for adjusting the ROE based on Enbridge Southern Lights' performance in controlling construction costs. Specifically, continues Enbridge Southern Lights, the base ROE is set at a 12-percent nominal level, which will be adjusted depending on whether the project's final capital cost is above or below an agreed capital cost estimate, with an upward ceiling of 14 percent nominal and a downward floor of 10 percent nominal.[17]

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[14] Enbridge Southern Lights cites *Enbridge Energy Co., Inc.*, 110 FERC ¶ 61,211, at P 46 (2005).

[15] Enbridge Southern Lights cites *Calnev Pipe Line LLC*, 120 FERC ¶ 61,073, at P 28 (2007) ("The Commission recognizes that by sizing its expansion pipeline to meet future demands, Calnev is attempting to build its project in a cost effective and efficient manner.") Enbridge Southern Lights points out that the Commission's oil pipeline regulations provide that, when a carrier is establishing rates for a new service, "the test period will be based on a 12-month projection of costs and revenues." 18 C.F.R. § 346.2(a)(3) (2007).

[16] Enbridge Southern Lights cites *Enbridge Energy Co., Inc.*, 110 FERC ¶ 61,211, at P 46 (2005).

[17] Enbridge Southern Lights recognizes that it faces the risk that it may receive an ROE lower than that authorized for other pipelines. Enbridge Southern Lights cites *Texaco Refining and Marketing, Inc. v. SFPP, L.P.*, 117 FERC ¶ 61,285, at P 30 (2006) (approved nominal ROEs of 14.18 percent and 13.63 for two test years). Enbridge Southern Lights also recognizes that it will have the opportunity to earn a higher ROE. It states that, even at the high end, the nominal ROE in the TSA would fall within the zone of reasonableness that the Commission has accepted for other comparably risky projects. Enbridge Southern Lights observes that, in a recent case involving a billion-dollar pipeline expansion, for example, the Commission indicated that the risks of that project merited an ROE at the high end of the zone of reasonableness:

(continued…)

17. *Commission Analysis.* In Opinion No. 154-B, the Commission stated that "the equity rate of return should be determined on a case-specific basis with reference to the risks and corresponding cost of capital associated with the oil pipeline whose rates are in issue."[18] In this case, Enbridge Southern Lights and the committed shippers have agreed to a base nominal ROE of 12 percent, which can be adjusted upward to as much as 14 percent or downward to a potential floor of 10 percent, depending on the final capital costs of the project. This gives Enbridge Southern Lights a strong incentive to control construction costs. However, Enbridge Southern Lights argues that the supply and demand risks of the project warrant a nominal 14-percent ROE for the uncommitted rates, especially as compared to recent Commission decisions relating to less risky Greenfield natural gas pipelines, where the Commission approved similar rates.[19]

18. As 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.

> We believe that a number of factors support Colonial's request for an ROE toward the upper end of the zone of reasonableness. For example, the length and scope of the project will present substantial challenges, even if Colonial is able to site the expansion mainly in the existing right-of-way. The project also requires an enormous investment, and thereby presents the financing challenges not faced by the ordinary upgrade. The size of the investment, the challenges of constructing a multistate project, and the time for completion of the project (four years) all support the request for an ROE toward the upper end of the range of reasonableness. Finally, Colonial has no obligation to expand its system but has voluntarily chosen to build major new facilities, with no guarantee that the throughput would be fully used.

Colonial Pipeline Co., 116 FERC ¶ 61,078, at P 59 (2006).

[18] *Williams Pipe Line Co.,* Opinion No. 154-B, 31 FERC ¶ 61,377, at 61,836 (1985).

[19] Enbridge Southern Lights cites *Corpus Christi LNG, L.P.*, 111 FERC ¶ 61,081 (2005) (accepting 14-percent cost of equity); *Ingleside Energy Center LLC*, 112 FERC ¶ 61,101 (2005).

However, as in *Colonial*, the Commission will not approve a specific ROE in this proceeding.[20] 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.

B. Debt-Equity Ratio

19. Enbridge Southern Lights asks the Commission to authorize a fixed capital structure of 70-percent debt and 30-percent equity for its committed rates, although it acknowledges that it could not obtain this capital structure without the shipper volume commitments. While it expects to achieve the 70-percent debt level of financing, Enbridge Southern Lights maintains that it will calculate the committed shippers' rates on that basis even if it does not reach that level of debt. Enbridge Southern Lights cites the *Colonial* decision, contending that the Commission indicated there that it could approve a capital structure with 71-percent equity if the pipeline could support it.[21]

20. *Commission Analysis*. The Commission will not authorize a specific equity/debt ratio in this order. Enbridge Southern Lights requests a capital structure that is at the high end of the range of capital structures the Commission has authorized in other proceedings. The Commission will defer its decision on the proper capital structure for Enbridge Southern Lights until it is able to determine the justness and reasonableness of a particular capital structure at the time the pipeline files for approval of the actual rates that it will charge.

C. Depreciation

21. Enbridge Southern Lights states that the proposed Southern Lights rate structure employs a stipulated depreciation profile to calculate rates, essentially spreading out the depreciation so that it will produce a more stable rate pattern over time. Enbridge Southern Lights explains that the depreciation schedule specifies a series of differing (i.e., sculpted) depreciation rates that will recover 60 percent of the initial rate base over the first 15 years of the pipeline's life, starting with lower percentages and increasing the percentages during the TSA's initial term. Enbridge Southern Lights further states that the schedule reverts to a straight-line depreciation after the initial 15-year term, at which point the remaining depreciation will be spread using straight-line depreciation. Enbridge Southern Lights contends that this approach prevents front-end rate shock and provides rate stability for shippers by levelizing the rates in real terms. Enbridge Southern Lights contends that this creates an incentive for shippers to begin shipping earlier, versus a straight-line schedule under which early shippers pay the highest rates. Enbridge

[20] *Colonial Pipeline Co.*, 116 FERC ¶ 61,078, at P 59-60 (2006).

[21] *Id*. at P 62.

Southern Lights argues that this will aid the pipeline in obtaining the long-term commitments that will make the project feasible.[22] Enbridge Southern Lights also requests a waiver of the Uniform System of Accounts to permit recording of the sculpted depreciation for Form 6 reporting purposes and in any rate matter that may arise with respect to rates charged during the initial term of the TSA.[23]

22. Enbridge Southern Lights points out that the Commission has not always required oil pipelines to set rates based on straight-line depreciation. For example, Enbridge Southern Lights cites *Kuparuk Transportation Co.,* in which the Commission reversed an Initial Decision that adopted straight-line depreciation over the 27-year useful life of the assets, finding instead that the unit-of-throughput (UOT) method was appropriate.[24] In that case, continues Enbridge Southern Lights, the Commission found that a stipulation adequately established the life of the fields served and the probable future throughput of the pipeline. Enbridge Southern Lights also cites *Georgia Strait Crossing Pipeline LP*, where one shipper negotiated to pay a rate for the entire capacity of the planned pipeline.[25]

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[22] Enbridge Southern Lights cites *Greenbrier Pipeline Co*., 101 FERC ¶ 61,122, at P 115 (2002), *reh'g denied*, 103 FERC ¶ 61,024 (2003) ("Greenbrier indicates it is willing to accept lower rates, and thus, lower return in the early years of its project from customers willing to enter into a long-term agreement in exchange for the certainty and stability provided by the long-term agreements.").

[23] Enbridge Southern Lights cites 18 C.F.R. Part 352, General Instructions 1-8 (2007).

[24] 55 FERC ¶ 61,122, at 61,380-81 (1991). Enbridge Southern Lights states that the Commission also approved levelized rates in *Express Pipeline Partnership*, 76 FERC ¶ 61,245, at 62,257-58 (1996). ("During the first two years of operation, Express' rates generate revenues below what would normally be allowed under traditional cost-based ratemaking . . . ." The Commission approved the rate "because without the rate incentives essential to attract those willing to make term commitments, the project might not be built at all."). *See also Colonial Pipeline Co*., 89 FERC ¶ 61,095 (1999) (levelized initial three-year rate).

[25] 98 FERC ¶ 61,271, at 62,056 (2002). *See also Northwest Pipeline Corp*., 116 FERC ¶ 61,151, at P 28 (2006); *Millenium Pipeline Co., L.L.C.*, 117 FERC ¶ 61,319, at P 131 (2006).

23. Enbridge Southern Lights states that, in *Kern River Gas Transmission Co.*,[26] the Commission described Kern River's depreciation approach as follows: "Generally, under Kern River's levelization methodology, annual depreciation recovery in rates starts very low and increases during the levelization period as the return component of the cost-of-service decreases (in tandem with the declining total rate base) to obtain a constant or 'level' annual cost of service."[27] Further, states Enbridge Southern Lights, the Commission recognized that such a system provides advantages to both the pipeline and the shippers.[28]

24. *Commission Analysis*. Although the Commission has approved a deviation from the straight-line method of depreciation, it has done so only when the pipeline sought to use UOT because its crude oil supply was from a limited reserve area.[29] In this petition, Enbridge Southern Lights has not fully supported its request for sculpted depreciation rates. In particular, it has not explained why sculpted depreciation is necessary to foster investment in the pipeline project or how it will impact the pipeline's rates. Enbridge Southern Lights may renew its proposal for sculpted depreciation at the time it submits its rate filing; however, it must demonstrate that the proposed depreciation method is based on the projected economic or physical life of the project and must analyze the impact of the proposed depreciation method on its proposed initial rates.

D. Rate Design

25. Enbridge Southern Lights maintains that the significant rate design issue in the TSA cost-of-service formula is the provision setting the uncommitted rate at twice the level of the committed rate. According to Enbridge Southern Lights, the purpose of this provision is to distribute the agreed cost-of-service between the committed and uncommitted shippers according to their respective contributions to the initial development and construction of the pipeline. Enbridge Southern Lights reiterates that it is not seeking Commission approval for any specific rate to be charged to the committed or uncommitted shippers in advance of the actual annual tariff filings to be made once the pipeline is in operation, but instead is now seeking approval of the proposed rate design.

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[26] 117 FERC ¶ 61,077 (2006).

[27] *Id*. at P 40.

[28] *Id*. at P 40-41 ("traditional rate design rates start high"). Enbridge Southern Lights further states that the Commission has approved rate levelization in novel circumstances, such as for a pipeline serving an LNG facility. *E.g.*, *Tractebel Calypso Pipeline, LLC*, 106 FERC ¶ 61,273, at P 8 (2004).

[29] *Kuparuk Transportation Co.*, 55 FERC ¶ 61,122, at 61,380-81 (1991).

Accordingly, Enbridge Southern Lights asks the Commission to consider whether it is reasonable, as a matter of regulatory policy, for the uncommitted shippers to bear such a higher proportionate share of the costs on a unit basis.[30]

26. Enbridge Southern Lights emphasizes that the committed shippers have agreed to pay the uncommitted rates for any volumes transported in excess of their minimum monthly commitments. Therefore, reasons Enbridge Southern Lights, the uncommitted rates constitute negotiated rates as contemplated by the Commission's regulations.[31] However, Enbridge Southern Lights also asserts that the uncommitted rates are supported by two other considerations. First, states Enbridge Southern Lights, the revenue-sharing formula for calculating both the committed and the uncommitted rates ensures that the total revenues ultimately collected from committed and uncommitted shippers will not exceed the agreed cost-of-service each year. Second, continues Enbridge Southern Lights, after the annual true-up adjustment, the uncommitted rates will be lower than the benchmark Opinion No. 154-B rates that the uncommitted shippers would be charged under more traditional cost-of-service assumptions and a traditional rate design approach.

27. Enbridge Southern Lights explains that the committed rate will be determined each year as provided in the TSA, and the uncommitted rate then will be set at two times the level of the committed rate. However, Enbridge Southern Lights states that, except in certain limited circumstances, all revenues from uncommitted movements will be credited at the end of the year against both the committed and uncommitted rates, and appropriate refunds will be paid to each group of shippers in proportion to the rates paid, thereby preserving the 50-percent discount. 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 on a unit basis. Enbridge Southern Lights maintains that this reflects the different market risks borne by the committed and uncommitted shippers if the market for transportation of diluent does not develop as expected. Enbridge Southern Lights contends that the Commission previously has accepted the principle that committed shippers are not similarly situated as compared to

[30] Enbridge Southern Lights states that, as with the committed rates, it is essential that the Commission's indexing rules be waived with respect to the uncommitted rates for Southern Lights. Enbridge Southern Lights states that, because the uncommitted rates vary annually based on the committed rates (which in turn are based on annual costs), the uncommitted rates will not necessarily track the general oil pipeline index. Enbridge Southern Lights explains that the intent is that the uncommitted rates will be exempt from indexing (up or down) so long as they are set in conformity with the TSA formula.

[31] 18 C.F.R. § 343.2(b) (2007).

uncommitted shippers and that providing rate discounts to the shippers that made initial financial and volume commitments is nondiscriminatory where, as here, the offer was open to all potential shippers.[32]

28. Enbridge Southern Lights submits that the uncommitted rates calculated pursuant to the TSA (after all adjustments) are lower than the just and reasonable rates that would apply to uncommitted movements under the Commission's standard Opinion No. 154-B rate model, using accepted inputs for cost of capital items and a revenue credit mechanism that takes the discounted rates into account. However, continues Enbridge Southern Lights, if the uncommitted rates were to be challenged, the appropriate framework for evaluating that challenge would be the Commission's Opinion No. 154-B methodology.[33]

29. *Commission Analysis*. Enbridge Southern Lights did not use the pipeline's design capacity to derive the committed rates. Instead, it utilized the volumes committed by shippers during the open season and projected spot volumes,[34] claiming that this constitutes 90 percent of the pipeline's annual capacity. As the Commission stated in the Spearhead Order:

> 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

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[32] Enbridge Southern Lights cites *e.g.*, *Mid-America Pipeline Co., LLC*, 115 FERC ¶ 61,258, at P 16 and n.7 (2006) (acknowledging that "incentive rates have been structured to preserve the rate differential between the incentive rate and the otherwise generally-applicable rate" and that such an agreement "might include a guarantee to [the committed shipper] that its Incentive Program rate would remain below the generally-applicable rate"). Enbridge Southern Lights cites *Enbridge Energy Co., Inc.*, 110 FERC ¶ 61,211, at P 38 (2005) (applying *Express Pipeline Partnership*, 76 FERC ¶ 61,245 (1996)). *See also Plantation Pipe Line Co.*, 98 FERC ¶ 61,219 (2002); *Mid-America Pipeline Co.*, 93 FERC ¶ 61,306, at 62,048-49 (2000).

[33] *Williams Pipe Line Co.*, 31 FERC ¶ 61,377 (1985). Enbridge Southern Lights states that this methodology is codified at 18 C.F.R. Part 346 (2007).

[34] *See* Petition for Declaratory Order of Enbridge Pipelines (Southern Lights) LLC, Ex. D, Statement G of Exhibit Nos. RGV-2 and RGV-3.

> 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.[35]

30. Calculating Enbridge Southern Lights' initial rate for committed volumes on the basis of the pipeline's design capacity (10 percent more volumes than the 90 percent used by Enbridge Southern Lights) would produce a rate lower than under Enbridge Southern Lights' proposed method. However, no one has challenged the proposed method; therefore, the Commission will accept it. Similarly, no one has opposed setting the uncommitted rate. Accordingly, the Commission likewise will accept this aspect of Enbridge Southern Lights' proposal.

31. Enbridge Southern Lights' proposal is fully supported by CAPP and the committed shippers, and no one has protested it. 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. The Commission will, of course, review the actual rates at the time Enbridge Southern Lights files a tariff to implement those rates, to ensure that they are just and reasonable.

E. Costs Included in Rate Base

32. Enbridge Southern Lights asks that it be permitted to include in the rate base the costs associated with the expected benefits of the proposed asset swap in which it would acquire an existing pipeline (Line 13) in exchange for a new line to be constructed for the Lakehead System. Enbridge Southern Lights maintains that the exchange is highly beneficial to Southern Lights shippers when the Canadian portion of the asset is considered because the cost of the LSR line in Canada is substantially lower than the cost of a new line from the international border to Edmonton. Further, continues Enbridge Southern Lights, there is also a benefit to Lakehead's shippers in that the replacement LSR pipeline will increase annual capacity without a corresponding increase in rate base on the Lakehead System.

33. Enbridge Southern Lights contends that, while this asset swap might appear to resemble the type of purchase price adjustment seen in cases such as *Longhorn Partners*

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[35] *Enbridge Energy Company, Inc*., 110 FERC ¶ 61,122, at P 44 (2005) (footnotes omitted). The Commission also noted that Crossroads agreed to file a major section 4 rate proceeding if its annual firm demand level exceeded its rate design level.

Pipeline[36] and *Rio Grande Pipeline Co. v. FERC*[37] (where a purchasing entity seeks to include the purchase price paid for an asset, rather than the seller's depreciated original cost, in the buyer's rate base), it is distinctly different. Enbridge Southern Lights emphasizes that this is not an attempt to write up an asset, but that it is seeking to include in its rate base only the construction costs it will actually incur.

34. Enbridge Southern Lights acknowledges that the concern behind the general rule against purchase price adjustments is that one pipeline company will sell an asset to another pipeline company at an inflated price so that the second company can achieve a higher rate base than it would otherwise, causing that line's shippers to pay twice for the same asset. However, Enbridge Southern Lights contends that this is not the situation here; it seeks only to avoid having the same shippers pay twice. Enbridge Southern Lights explains that, by allowing Lakehead to retain its current rate base, Lakehead's shippers will not be paying higher rates and will not be subsidizing the construction of the new diluent line; rather, once Southern Lights goes into service, the Lakehead rates will be the same as they would have been without the asset swap.

35. Enbridge Southern Lights argues that this asset swap meets the Commission's "benefits exception" test, which permits a purchased asset to "be included in the rate base at the full purchase price if the purchaser can demonstrate that: (1) the acquired facility is being put to new use, and (2) the purchase price is less than the cost of constructing a comparable facility."[38] According to Enbridge Southern Lights, Line 13 will be put to an entirely new use because it will be moving a different product in a different direction to a different market serving different shippers.[39] In addition, continues Enbridge Southern Lights, when the entire transaction on both sides of the border is considered, there is clearly an overall benefit to both the Southern Lights shippers and the Lakehead shippers.

36. *Commission Analysis*. As a result of this proposed asset swap, Enbridge Southern Lights would include in its rate base the following capital costs: (1) construction costs of the new 20-inch diluent pipeline and facilities from Chicago to Clearbrook, Minnesota; (2) construction costs of the Replacement Facilities for Enbridge LP's Lakehead system;

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[36] 82 FERC ¶ 61,146 (1998).

[37] 178 F.3d 533 (D.C. Cir. 1999).

[38] Enbridge Southern Lights cites *Rio Grande Pipeline Co. v. FERC*, 178 F.3d 533, 536-37 (D.C. Cir. 1999).

[39] Enbridge Southern Lights cites *Enbridge Energy Co., Inc.*, 110 FERC ¶ 61,211, at P 27-32 (2005) (upholding use of Spearhead pipeline purchase price as new use where line reversed, new products, and new shippers were involved).

and (3) costs to transfer Line 13 to Enbridge Southern Lights, including reversing the flow and modifying the crude pipeline for use as a diluent pipeline.

37. The Commission finds that Enbridge Southern Lights has demonstrated that this proposal is the most efficient and equitable choice for Southern Lights, Lakehead, and all of their shippers. The potential benefits cited by Enbridge Southern Lights support this decision.

38. The Commission also finds that the proposed asset swap meets the Commission's criteria for such an action. The Commission's "benefits exception" test permits a purchased asset to "be included in the rate base at the full purchase price if the purchase can demonstrate that: (1) the acquired facility is being put to new use, and (2) the purchase price is less than the cost of constructing a comparable facility."[40] Line 13 will be put to new use, moving diluent instead of crude oil, and in a new direction because of the reversal, thereby serving a different market with different shippers. Accordingly, the Commission will allow Enbridge Southern Lights to include the purchase price adjustment in its rate base.[41] This arrangement benefits shippers by assuring they will not pay twice for the same asset and benefits the public interest by providing a means to help transport the vast Canadian oil reserves and increase U.S. refiners' security of supply.

F. Rate from Chicago to International Border

39. Enbridge Southern Lights states that the TSA establishes a single rate for shipments in the U.S. To the extent there may be any short-haul U.S. movements, Enbridge Southern Lights explains that those shippers will pay the applicable Chicago-to-border rate adjusted for any power cost savings associated with the movements. Further, states Enbridge Southern Lights, the power costs savings adjustment will ensure that any shippers who transport diluent from origins other than Chicago will be credited with the variable costs (essentially power and drag reducing agent costs) that are avoided due to the shorter distance of haul. Enbridge Southern Lights submits that the Commission has

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[40] *Rio Grande Pipeline Co. v. FERC*, 178 F.3d 533, 536-37 (D.C. Cir. 1999).

[41] *Natural Gas Pipeline Company of America*, 29 FERC ¶ 61,073, at 61,150 (1984); *see also Rio Grande Pipeline Co.*, 78 FERC ¶ 61,020, at 61,082(1997); *Longhorn Partners Pipeline*, 73 FERC ¶ 61,355, at 61,111 (1995); *Enbridge Energy Co., Inc.*, 110 FERC ¶ 61,211, at P 26-33 (2005).

accepted such rates in other cases and generally has avoided establishing a bright line between cases in which such rates are appropriate and cases in which a distance-based rate is required.[42]

40. Enbridge Southern Lights asks the Commission to accept the single rate it proposes. First, states Enbridge Southern Lights, it is speculative whether any shipper will want to move diluent from an origin point north of Chicago. Enbridge Southern Lights also asserts that the Commission does not require distance-based rates on the basis of speculative shippers.[43] Enbridge Southern Lights also submits that the Commission has been flexible in accepting non-distance based rates, as reflected in its gas pipeline precedents.[44] In the instant case, continues Enbridge Southern Lights, the rate reasonably reflects variations in the cost of providing service because any shipper who chooses to ship over a portion of the pipeline will be credited the savings in power cost not incurred by moving the shorter distance. Because the partial shipper will only pay for the variable power costs it incurred, the rate reasonably accommodates material variations in variable costs.[45] Finally, Enbridge Southern Lights argues that the pipeline was planned, accepted, and launched as a pipeline from Chicago to Edmonton, and it would not have been built on any shorter path. According to Enbridge Southern Lights, because all shippers benefit from the existence of the pipeline, they cannot be heard to argue that they should bear only the cost of a shorter pipeline, one which neither Enbridge Southern Lights nor its committed shippers would have accepted.

41. *Commission Analysis*. The Commission finds this proposal acceptable. Enbridge Southern Lights planned the Southern Lights project and held the associated open season

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[42] Enbridge Southern Lights cites *Greenbrier Pipeline Co*., LLC, 101 FERC ¶ 61,122, at P 77 (2002).

[43] Enbridge Southern Lights cites *Entegra Gas Pipeline Inc*., 113 FERC ¶ 61,327, at P 29 and n.21 (2005).

[44] Enbridge Southern Lights cites *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 436, FERC Stats. & Regs. ¶ 30,665, at 31,538 (1985); *see also Northwest Pipeline Corp*., 82 FERC ¶ 61,158, at 61,578 (1998).

[45] Enbridge Southern Lights cites *Gulf South Pipeline Co., LP*, 111 FERC ¶ 61,463, at P 4 (2005) (allowing pipeline to eliminate fuel charge “on specified transactions posted on its website where, based on Gulf South’s operational experience, no incremental fuel is expected to be consumed in the transaction on an aggregate basis at a matrix of receipt and delivery point pairs”).

on the premise that its diluent shipments would originate in Chicago. By offering a power cost savings to potential future short-haul movements, Enbridge Southern Lights reasonably reduces the rates for such movements.

G. Annual True-Up

42. Enbridge Southern Lights states that the TSA establishes an annual true-up of any differences between estimated and actual revenues and costs, which also will include a credit for any uncommitted revenue received during the year up to 90 percent of the annual capacity of 180,000 bpd (and 75 percent of uncommitted revenues). Enbridge Southern Lights asks the Commission to approve the annual true-up mechanism. If Enbridge Southern Lights finds that it has over-collected, it states that it will issue a refund to each shipper based on the volume transported. Similarly, if Enbridge Southern Lights finds that it has undercollected, it states that it will send an invoice to each affected shipper. Enbridge Southern Lights contends that this annual true-up will benefit shippers because it avoids over-collection by the pipeline, thereby assuring a proper matching of burdens and benefits. Moreover, continues Enbridge Southern Lights, the true-up mechanism is fair as among shippers because the amount of the refund or the adjusted invoice is proportional to their actual volumes during the calendar year for which the true-up is being made.

43. Enbridge Southern Lights cites other Commission orders involving true-ups. For example, Enbridge Southern Lights states that Southern Company has reported to the Commission its annual refunds or surcharges due under its formula rates accepted by the Commission.[46] Additionally, continues Enbridge Southern Lights, the Commission recently accepted a settlement in which Enbridge Pipelines (North Dakota) LLC was permitted to impose a surcharge to support a mainline expansion, subject to an annual true-up of the surcharge.[47] Enbridge Southern Lights also points to a settlement under which an oil pipeline's Hurricane Recovery Surcharge is subject to a true-up that could result in the pipeline issuing refunds to the shippers[48] and a Mid-America Pipeline Company security surcharge true-up that involved the possibility of refunding or invoicing shippers.[49] Enbridge Southern Lights contends that, because the terms of the

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[46] Enbridge Southern Lights cites *Southern Company Services, Inc.*, 105 FERC ¶ 61,019 (2003). *See Southern Company Services, Inc.*, 117 FERC ¶ 61,308, at P 7 n.9 (2006).

[47] Enbridge Southern Lights cites *Enbridge Pipelines (North Dakota) LLC*, 117 FERC ¶ 61,131 (2006).

[48] Enbridge Southern Lights cites *Chevron Pipe Line Co.*, 117 FERC ¶ 61,144 (2006).

true-up will be explicitly set forth in the tariff, using such a prior period adjustment does not violate the filed rate doctrine[50] because any shipper choosing to ship uncommitted volumes will be on notice of the possibility of refunds and charges.[51]

44. Enbridge Southern Lights also points out that the Commission has accepted revenue sharing arrangements similar to the 75/25 revenue sharing proposed here when annual volumes exceed an average of 162,000 bpd.[52] According to Enbridge Southern Lights, where contracts make assumptions about the effective annual capacity of a gas pipeline, the shippers generally cannot challenge those risk allocations after the fact,[53]

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[49] Enbridge Southern Lights cites *Mid-America Pipeline Co., LLC*, 115 FERC ¶ 61,384, at P 5 (2006) ("MAPL states it will refund or invoice its shippers on a pro-rata basis for barrels shipped during the Recovery Period. If this true-up amount is within one percent of the costs incurred, MAPL will not make any additional collections or refunds.").

[50] Enbridge Southern Lights cites *TransColorado Gas Transmission Co*., 112 FERC ¶ 61,135, at P 11 (2005) (in a case involving true-ups of gas quantities, "there is no violation of the filed rate doctrine or the rule against retroactive rate making because the shippers are on notice that the pipeline is entitled to recover these costs"). Enbridge Southern Lights also cites *Canadian Association of Petroleum Producers v. FERC,* 254 F.3d 289, 299 (D.C. Cir. 2001) ("So long as the parties had adequate notice that surcharges might be imposed in the future, imposition of surcharges does not violate the filed rate doctrine."); *Louisiana Public Service Commission v. FERC,* 482 F.3d 510, 520 (D.C. Cir. 2007) (same as for refunds).

[51] Enbridge Southern Lights cites *Public Utilities Commission of California v. FERC,* 254 F.3d 250, 254 & n.3 (D.C. Cir. 2001) (charges under formula rate contained in tariff doe not violate filed rate doctrine). *BP West Coast Products, L.L.C. v. SFPP*, 120 FERC ¶ 61,014, at P 5 (2007).

[52] Enbridge Southern Lights cites *Cheyenne Plains Gas Pipeline Co., L.L.C.,* 108 FERC ¶ 61,052, at P 12 (2004) (clarifying that pipeline could amend agreements to divide revenue 50/50 with negotiated rate shippers); *Entegra Gas Pipeline Inc*., 113 FERC ¶ 61,327, at P 16-17 (2005) (allowing 50/50 split which was included in open season materials, included in pro forma tariff and also in precedent agreement).

[53] Enbridge Southern Lights cites *Mojave Pipeline Co*., 81 FERC ¶ 61,150, at 61,684 (1997) ("As with several of the prior rulings, the Commission finds that the relevant contracts and rates allocated the risk of the Btu gas content between Mojave and its shippers at the beginning of the project. There is no overriding policy reason to interfere with this contractual relationship."). *See also High Island Offshore System*,

(continued…)

and in this case, the division of revenues above 162,000 bpd is the parties' means of allocating the risk that the pipeline's full annual capacity will not be used and making up for some of the discounts to the agreed cost-of-service. However, Enbridge Southern Lights emphasizes that, even with this incentive, it will not recover more than its properly calculated cost-of-service using traditional application of the Opinion No. 154-B methodology.

45. *Commission Analysis*. 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. The Commission thus concludes that this mechanism will result in rates that are just and reasonable.

The Commission orders:

Enbridge Northern Lights' petition for a declaratory order is granted to the extent discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

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66 FERC ¶ 61,378, at 62,268 (1994) (in wake of gas pipeline restructuring, when projections of use of interruptible service were uncertain, Commission required "the pipeline to establish a 90/10 revenue sharing mechanism under which the pipeline is allowed to retain 10 percent of all revenues in excess of allocated costs to give the pipeline an incentive to market interruptible service"); *Discovery Gas Transmission LLC,* 108 FERC ¶ 61,060, at P 13 (2004).