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 Energy, Limited Partnership   Docket No. OR06-11-000

ORDER ON CONTESTED OFFER OF SETTLEMENT

(Issued December 8, 2006)

1. On September 1, 2006, Enbridge Energy, Limited Partnership (Enbridge) filed an Offer of Settlement (Settlement). Enbridge states that the Settlement is filed under the Facilities Surcharge Framework approved by the Commission on June 30, 2004, in *Enbridge Energy, Limited Partnership*.[1] Citing the support of the Canadian Association of Petroleum Producers (CAPP), Enbridge seeks Commission approval to implement a new surcharge that would allow Enbridge to recover a portion of the costs of a planned pipeline extending from Flanagan, Illinois, to Patoka, Illinois (the Southern Access Mainline Extension or the Extension Pipeline). The Settling Parties are Enbridge and CAPP. [2]

2. Flint Hills Resources, LP (Flint Hills), Mobil Pipe Line Company (Mobil),[3] ConocoPhillips Company (ConocoPhillips), and BP Canada Energy Company (BP)[4] do

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[1] 107 FERC ¶ 61,336 (2004) (Facilities Surcharge order).

[2] Enbridge states that CAPP is an association whose producer members account for more than 95 percent of Canada's oil and gas production. Enbridge further states that approximately 97 percent of the crude petroleum it transports originates in Canada. Enbridge acknowledges that Flint Hills and ConocoPhillips are members of CAPP, but Enbridge emphasizes that the Settlement in this case was reviewed an approved by appropriate committees and the Executive Policy Group of CAPP. Enbridge Energy, Limited Partnership October 2, 2006 Reply Comments in Support of Offer of Settlement at 2.

[3] Mobil filed its motion for leave to file comments on September 22, 2006, one day out of time.

[4] On October 27, 2006, BP filed a provisional motion for leave to intervene out of time and comments.

not oppose construction of the Extension Pipeline; however, they challenge this proposed surcharge that would recover the costs of the Extension Pipeline from all shippers on the Lakehead Pipeline System, which is the U.S. portion of Enbridge's mainline from Canada, even though not all Lakehead Pipeline System shippers will use the Extension Pipeline.

3. As discussed below, the Commission rejects the contested Settlement because it has not been shown that the proposed rates would be just and reasonable.

Description of the Settlement

4. Enbridge states that, in the Facilities Surcharge order, the Commission approved a settlement framework establishing the Facilities Surcharge as a component of Enbridge's U.S. tariff rates. According to Enbridge, the Facilities Surcharge provides it with a flexible mechanism to recover the costs it incurs for enhancing or modifying the pipeline system to permit shipment of a greater variety of crude oil types and facilitate improved shipper access to markets. Enbridge explains that the Facilities Surcharge recovers these costs through incremental surcharges added to its existing base rates and other existing Commission-approved surcharges. Enbridge states that it negotiates with CAPP to determine the projects to be submitted for consideration under the Facilities Surcharge Framework.

5. The instant Settlement contains the sixth agreement submitted under the Facilities Surcharge Framework and relates to the final component -- the Southern Access Mainline Extension -- of the Southern Access Program.[5] The terms of the surcharge are attached to the Settlement as Exhibit I, and a copy of the CAPP letter memorializing the Settlement is attached as Exhibit II.

6. Enbridge states that it operates the Lakehead Pipeline System to provide transportation of Western Canadian oil to the U.S. Midwest, points in Eastern Canada, and New York State. Enbridge further explains that Enbridge Pipelines Inc. (EPI) operates the Canadian portion of the Enbridge System under the jurisdiction of the National Energy Board (NEB). Enbridge describes the Southern Access Program as a coordinated effort to expand capacity and extend facilities to accommodate a projected major increase in production from the oil sands in Western Canada.

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[5] Enbridge states that it submitted the first four agreements contemporaneously with the original Offer of Settlement establishing the Facilities Surcharge framework and that the fifth agreement related to the Southern Access Mainline Expansion, which the Commission approved on March 16, 2006. Enbridge cites *Enbridge Energy, Limited Partnership*, 114 FERC ¶ 61,264 (2006).

7. Enbridge estimates that the total cost of the Extension Pipeline will be approximately $325 million. Enbridge states that the Extension Pipeline involves the construction of 178 miles of 36-inch diameter pipeline from the Lakehead Pipeline System at Flanagan to Patoka. Once completed, asserts Enbridge, the new Extension Pipeline will provide approximately 400,000 barrels per day (bpd) of capacity (based on a 100-percent heavy crude slate) to the Patoka markets.[6] Enbridge states that the Extension Pipeline will be integrated, both operationally and from a tariff rate standpoint, into the Lakehead Pipeline System.

8. Enbridge cites a variety of benefits expected from the Extension Pipeline, including the improved ability to bring Canadian crude oil into U.S. markets. Enbridge argues that these benefits support the proposed surcharge mechanism, which will spread the costs of the Extension Pipeline over the entire Lakehead Pipeline System.

9. Enbridge states that the most direct and quantifiable shipper benefit arising from the Extension Pipeline is a projected systemwide reduction in the tariff rates that would otherwise apply to Lakehead Pipeline System shippers in future years. Enbridge asserts that this rate reduction will occur because the Extension Pipeline will facilitate greater utilization of upstream facilities, thereby reducing the net cost to shippers, even if they do not transport oil to Patoka on the Extension Pipeline itself.[7] Enbridge claims that the key to the rate benefits is that the Extension Pipeline will provide additional take-away capacity at Flanagan, which will be a vital pipeline intersection for Canadian crude oil flowing south through the Lakehead Pipeline System. Enbridge also points to the potential for future expansions to allow as much as 1.2 million bpd of capacity through additional pumping facilities (*i.e.*, without the addition of any new pipe in the ground).[8]

10. Enbridge contends that current pipeline capacity constraints create a large differential between downstream crude prices and the price available for "trapped barrels" that cannot access the most desirable markets. Enbridge predicts that, when these constraints are relieved, the netback price available to the producers will increase.[9]

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[6] Enbridge states that the 400,000 bpd of initial capacity in the Extension Pipeline can be expanded incrementally up to 800,000 bpd through installation of additional pumping capability. Schrage Aff., Exhibit IV, ¶ 9.

[7] *Id*. at ¶ 11.

[8] *Id*. at ¶ 24.

[9] Enbridge states that the "netback price" is essentially the wellhead price of crude oil sold into a distant market where the price is set by market forces. To the extent that market price is a relatively fixed number, the producer ordinarily cannot sell its barrels at the wellhead for more than the distant market price minus the cost of transportation to that market.

Enbridge emphasizes that the market access benefits -- like the rate and operational benefits -- flow across the entire system and not just to the users of the Extension Pipeline. Because the crude market is largely fungible, Enbridge maintains that an increase in the netback price for barrels transported to and beyond Patoka will necessarily raise netback prices for all oil sands producers because they will have the opportunity to seek more valuable markets if the netback in their current market is inadequate.

11. Enbridge contends that, given the substantial systemwide public interest and shipper/producer benefits that will accrue, it is appropriate to recover the costs of the Extension Pipeline through the proposed system-wide surcharge applicable to all Lakehead Pipeline System users. Enbridge maintains that this is consistent with Commission oil pipeline precedent[10] and the Commission's policies favoring the matching of costs and benefits for users of a regulated facility.

12. Enbridge states, however, that for financing reasons, it will not own the Extension Pipeline. Rather, a separate subsidiary with greater access to capital markets will construct and own the line from Flanagan to Patoka. Enbridge emphasizes that the Extension Pipeline will be operationally and financially integrated into the Lakehead Pipeline System so that the financing vehicle will have no impact on shippers.

13. In general, explains Enbridge, it will recover the cost-of-service of the Extension Pipeline through a joint Lakehead-Extension Pipeline tariff and a surcharge, which Enbridge will include in the Facilities Surcharge added to the indexed base rates and other existing surcharges currently in effect for Lakehead. The Extension Pipeline will file a local Flanagan-to-Patoka rate that will be based on the cost-of-service of the Extension Pipeline. The joint Lakehead-Extension Pipeline rates will be discounted joint rates on which Enbridge and CAPP have agreed, and that will be less than the sum of the Lakehead and Extension Pipeline local rates. Enbridge states that it will credit the Extension Pipeline cost-of-service with the joint rate incremental revenue associated with the Flanagan-to-Patoka volumes and will calculate the surcharge to recover the net unrecovered Extension Pipeline cost-of-service. It will true-up the surcharge annually in the same manner as the existing surcharges under the Facilities Surcharge Framework. Enbridge adds that the surcharge will remain in effect for the projected 30-year depreciable life of the new facilities.

14. Enbridge describes the terms of the cost-of-service calculation that are found in Exhibit I of its filing. Specifically, states Enbridge, it and CAPP have stipulated that Enbridge will use the Commission's Opinion No. 154-B methodology with various stipulated inputs. According to Enbridge, the stipulated capital structure will remain

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[10] Enbridge cites *SFPP, L.P.*, 104 FERC ¶ 61,163, at P 10-11 (2003); *Colonial Pipeline Co.*, 116 FERC ¶ 61,078, at P 54 (2006).

fixed at 55-percent equity, 45-percent debt, consistent with the Southern Access Mainline Expansion Surcharge.[11] The stipulated annual depreciation rate will be fixed at 3.33 percent. The stipulated cost of debt for each year will be the weighted average long-term cost of debt of Enbridge Energy Partners, L.P. at the end of the prior calendar year. The stipulated cost of equity will be fixed at a nine-percent real rate of return, plus inflation. The inflation rate used will be the current year CPI-U as determined from time to time in accordance with the Opinion 154-B methodology. The tax allowance component of the cost-of-service will be determined each year in accordance with the Commission's tax allowance policy. According to Enbridge, all incremental operating costs, property or similar taxes, and fuel and power expenses associated with the Southern Access Mainline Extension will be included in the cost-of-service. Further, states Enbridge, the revenue attributable to collection of the rate from Flanagan to Patoka will be credited against the cost-of-service of the Extension Pipeline in calculating the surcharge.[12]

Objections to the Settlement

15. Mobil,[13] ConocoPhillips, Flint Hills, and BP do not dispute that additional pipeline capacity is needed to transport the projected increase in Western Canadian crude oil production. However, they object to the proposal to impose the requested surcharge to recover the costs of the Extension Pipeline on all Lakehead shippers, including those that will not use the Extension Pipeline. Flint Hills, ConocoPhillips, and BP are shippers on the Enbridge System. Flint Hills and BP state that their shipments exit the Lakehead System upstream of Flanagan and that neither will use the Flanagan-to-Patoka extension. ConocoPhillps states that most of its shipments exit in the Chicago area and that it will make only infrequent use of the Extension Pipeline.

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[11] *See Enbridge Energy, Limited Partnership*, 114 FERC ¶ 61,264 (2006).

[12] Enbridge states that an illustration of the surcharge calculation, using the stipulated inputs and estimates for capital and operating costs, is attached to the Douvris Affidavit (Ex. VI to the Settlement) as Attachments A-C. Enbridge explains that it offers this calculation for illustrative purposes only; under the terms of the Settlement, it will base the actual surcharge on the most current estimates when service commences and will true-up the surcharge annually to reflect actual costs and volumes.

[13] Mobil states that its affiliate, Mobil Illinois Pipe Line Company, holds a 70-percent interest in Mustang Pipe Line LLC, which owns a 204-mile, 18-inch diameter pipeline extending from Lockport, Illinois, to Patoka, Illinois. Enbridge Holdings (Mustang) Inc. owns the remaining 30-percent interest in Mustang.

16. The commenters observe that, as the Court of Appeals ruled in *Farmers Union Central Exchange v. FERC*,[14] the Commission must regulate oil pipeline rates on a point-to-point basis, not on a system-wide basis. According to the commenters, the Settlement provides no valid basis for imposing 50-69 percent of the cost of installing and operating the proposed extension on all users of the Lakehead Pipeline System. Moreover, continue the commenters, the calculations of the expected monetary value of improvements in crude oil distribution, quality, and transit time claimed by Enbridge are highly speculative, and there is little indication that shippers at specific destination points would enjoy those benefits.

17. The commenters contend that, instead of seeking an initial rate for a new service under 18 C.F.R. § 342.2, Enbridge treats the proposed extension as an addition to its existing Lakehead Pipeline System. However, they argue that, to recover additional system revenue under the proposed surcharge, Enbridge must show a "substantial divergence" between costs and revenues under its current Lakehead rates, as required by 18 C.F.R. § 342.4(a). In general, the commenters contend that the proposed surcharge violates the Commission's regulations adopted pursuant to Order Nos. 561 and 561-A.[15]

18. The commenters argue that the Facilities Surcharge order involved the expansion and upgrade of an existing service, not the creation of a new or extended service.[16] Further, they emphasize that the original surcharge applied to users of the expanded and upgraded service, and the Commission specifically stated that "acceptance of the Settlement does not constitute acceptance of, or precedent regarding, any principle or issue in this filing."[17]

19. Flint Hills complains that the Settlement would place the risks of underrecovery on all shippers over the entire Lakehead Pipeline System through payment of the surcharge rather than on the pipeline and/or those shippers that will use and receive a direct benefit from the Extension Pipeline. Flint Hills also points out that this case is

[14] 734 F.2d 1486 (D.C. Cir. 1984) ("Because oil pipeline rates are charged on a point-by-point basis, such cost allocation ensures that the costs of providing service over a given territory will be recovered only from the companies that use that particular service." *Id*. at 1528).

[15] *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, Order No. 561, FERC Stats. & Regs. ¶ 30,958 (1993), *order on reh'g*, Order No. 561-A, FERC Stats. & Regs., ¶ 31,100 (1994), *aff'd Assoc. of Oil Pipelines v. FERC*, 83 F.3d 1424 (D.C. Cir. 1996). 18 C.F.R. Part 342 (2006).

[16] *Enbridge Energy, Limited Partnership,* 107 FERC ¶ 61,336 (2004).

[17] *Id*. at P 5.

factually similar to a case involving an extension of the Plantation Pipeline to serve a separate market area in Chattanooga, Tennessee. Flint Hills contends that, in that case, the Commission approved a structure under which a wholly-owned Plantation subsidiary owned and operated the extension, and Plantation recovered all of the extension's costs under a stand-alone local tariff and joint tariff charges applicable only to those shippers that used the Chattanooga extension. Flint Hills emphasizes that Plantation did not impose any surcharge on system-wide shippers to recover the costs of the extension of its pipeline system.[18]

20. Flint Hills adds that the filing demonstrates that the overwhelming majority of the benefits of the proposed Extension Pipeline flow to: (1) Canadian producers, who will gain access to new markets; and (2) refineries tied to the Patoka hub that will gain access to favorably-priced heavy Canadian crude oil. According to Flint Hills, the value of this benefit increases from $786 million to $2.99 billion annually over the period 2010-2020. However, Flint Hills contends that none of the shippers located in Minnesota, such as Flint Hills, will receive any of these massive benefits, even though they will bear all of the risk of underutilization through the proposed surcharge. Rather, emphasizes Flint Hills, the only claimed benefit for these shippers will be improved transit time.

21. Additionally, Flint Hills states that the Commission has substantial evidence on which to decide the proposed surcharge question now under Rule 602(h).[19] Flint Hills contends that the record in this case supports a modification to the Settlement to limit recovery of the costs of the Extension Pipeline to the local and joint tariff rates without a surcharge. Flint Hills asserts that requiring Enbridge to eliminate the proposed surcharge and rely on the local and joint rates will not prevent Enbridge from recovering a just and reasonable return. If that modification is adopted, Flint Hills states that would withdraw its opposition to the Settlement.

22. Flint Hills states that economics indicate that Enbridge is likely to build the Extension Pipeline even if the Commission does not approve the surcharge. According to Flint Hills, the Extension Pipeline will bring the Lakehead Pipeline System into new markets with capacity to refine heavier Canadian crudes. Flint Hills maintains that gaining access to such refinery capacity is essential to the Canadian producers because the refineries currently available on the Enbridge system do not have sufficient capacity to handle the projected increases in heavy Canadian crude production. Flint Hills points out that the current constraint on access to refining capacity has exerted downward pressure on the price of Canadian crude; therefore, making the Patoka refineries accessible will reverse that pressure. Flint Hills also estimates that this access will

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[18] *Plantation Pipe Line Co.*, 98 FERC ¶ 61,219, at p. 61,864 (2002) (*Plantation*).

[19] 18 C.F.R. § 385.602(h) (2006).

increase the value of Canadian crude oil by $756 million in the first year of operation to be shared by the producers of heavy crude oil and the refineries gaining access to the production.

Reply Comments

23. Enbridge argues that the Commission's approval of the Facilities Surcharge mechanism expressly authorized several such surcharges and invited Enbridge, with CAPP's concurrence, to propose other surcharges.[20] Enbridge challenges the claims that the objecting parties will not benefit from the Extension Pipeline.

24. Flint Hills responds that Enbridge includes new information in its reply comments, including announcing ConocoPhillips' plans to build a pipeline from Alberta, Canada, to Patoka, Illinois, attaching new letters in support of the Settlement, and asserting that it is under-recovering its cost-of-service. Flint Hills argues that the announced new system reinforces the concern that the Extension Pipeline will be underutilized. Further, states Flint Hills, the letters supporting the Extension Pipeline do not address the possible impact of the newly-announced line from Hardisty, Alberta, to Patoka. Finally, Flint Hills states that the Form No. 6 data on which Enbridge bases its claim of underrecovery is not relevant to the question of whether the proposed rate design for the Extension Pipeline will result in an overrecovery for that facility.

Commission Analysis

25. The Commission accepted Enbridge's Facilities Surcharge Framework to enable Enbridge to submit for Commission consideration future settlements resulting from agreements with CAPP that recovery of the costs of construction projects through a surcharge is appropriate. The framework was intended by Enbridge to be a means by which it could avoid potential rate disputes with CAPP over these future projects. Enbridge also intended and proposed that each settlement be considered under the Commission's settlement regulations[21] so that the Commission would have the ability to review the terms of the agreement and concerned parties would have the opportunity to comment before any new component would be added to the Facilities Surcharge. This Settlement thus must be considered on the merits as a contested settlement under the Commission's Rule 602. In that regard, we find it necessary to reject the proffered contested Settlement because the Settling Parties have not provided sufficient evidence to demonstrate that their Settlement produces just and reasonable transportation rates.

[20] Enbridge cites *Enbridge Energy, Limited Partnership*, 107 FERC ¶ 61,336, at p. 62,554 (2004).

[21] 18 C.F.R. § 385.602 (2006).

26. Section 1(5) of the Interstate Commerce Act requires that all transportation charges “shall be just and reasonable.”[22] The surcharge proposed here is intended to be recovered from all Lakehead Pipeline System shippers, although there is no dispute that not all Lakehead shippers will use the Extension Pipeline. Flint Hills and BP state that their shipments exit the Lakehead System upstream of Flanagan and that neither will use the Flanagan-to-Patoka extension. ConocoPhillps states that most of its shipments exit in the Chicago area and that it will make only infrequent use of the Extension Pipeline.

27. Mobil, ConocoPhillips, Flint Hills, and BP do not dispute that additional pipeline capacity is needed to transport the projected increase in Western Canadian crude oil production. However, they object to the proposal to impose the requested surcharge to recover the costs of the Extension Pipeline on all Lakehead shippers, including those that will not use the Extension Pipeline. Moreover, the Settlement contemplates that the Extension Pipeline will be constructed and owned by an affiliated company rather than by Enbridge Energy. This heightens the risk that the shippers not using the Extension Pipeline may cross-subsidize those who do.

28. Enbridge contends that the projected benefits to all shippers, even if those shippers do not anticipate using the Extension Pipeline, justify recovery of some of the costs of the Extension Pipeline from those other shippers. However, Enbridge provided no support for its predictions of system-wide benefits, such as improved distribution, improved crude quality, and reduced transit time. Nor do the Settling Parties attempt to quantify any benefits for those other shippers. Lacking adequate evidence of such benefits, we cannot conclude that Enbridge has shown that it would be just and reasonable to charge those other shippers a rate surcharge that would subsidize construction of the Enbridge affiliate's extension pipeline.

The Commission orders:

The Settlement filed September 1, 2006, is rejected, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

[22] 49 App. U.S.C. § 1(5) (1988).