

147 FERC ¶ 63,009
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Seaway Crude Pipeline Company LLC

Docket No. IS12-226-000

INITIAL DECISION ON REMAND

(Issued May 9, 2014)

APPEARANCES

Stephen H. Brose, Esq., Steven Reed, Esq., Daniel J. Poynor, Esq., and Geoffrey G. Hengerer, Esq. on behalf of Seaway Crude Pipeline Company LLC.

Katherine B. Edwards, Esq., John Paul Floom, Esq., and Erica L. Rancilio, Esq. on behalf of Apache Corporation, Chevron Products Company, and Noble Energy, Inc.

James H. Holt, Esq. on behalf of Canadian Association of Petroleum Producers.

Frederick G. Jauss, IV, Esq. and Amy Dominick Padgett, Esq. on behalf of Suncor Energy Marketing, Inc. and Canadian Natural Resources Limited.

Marc G. Denkinger, Esq. and Debora E. Lyon, Esq. on behalf of Federal Energy Regulatory Commission Trial Staff.

KAREN V. JOHNSON, Presiding Administrative Law Judge

I. PROCEDURAL HISTORY PRIOR TO ISSUANCE OF THE SEPTEMBER 13, 2013 INITIAL DECISION

1. This matter arises out of the reversal in direction of the crude oil flows on Seaway Crude Pipeline Company, LLC's (Seaway) pipeline to enable it to transport crude oil from Cushing, Oklahoma to the U.S. Gulf Coast. On April 13, 2012, Seaway filed an oil pipeline tariff, FERC No. 2.0.0, proposing initial rates for crude oil transportation on the reversed pipeline for uncommitted shippers (in Item No. 30) of \$3.82 per barrel for light crude and \$4.32 for heavy crude, and proposing for committed shippers (in Item No. 40) various rates based on a contract term of either five or ten years with an additional power charge. Seaway Crude Pipeline Company LLC, FERC Oil Tariff, Tariffs – LLC; Rates, Rules, & Regs, FERC No. 2.0.0, 2.0.0. Seaway provided an effective date of May 14, 2012.
2. Seaway is owned fifty percent by Enterprise Products Partners L.P. (Enterprise) and fifty percent by Enbridge Inc. (Enbridge). Ex. SEA-1 at 3; Ex. SEA-25 at 1-2. Enbridge purchased its fifty percent share of Seaway from ConocoPhillips Company (ConocoPhillips) in November 2011. Ex. SEA-25 at 1-2. Prior to the Enbridge purchase, Seaway provided northbound transportation of crude oil from Jones Creek to Cushing. Ex. SEA-1 at 4.
3. On December 2, 2011, Seaway filed an application to charge market-based rates for the pipeline reversal in Docket No. OR12-4-000. The Commission denied this request. *Enterprise Products Partners L.P.*, 139 ¶ 61,099 (2012).
4. In early 2012, Seaway ceased providing the service of moving crude oil from south to north. Seaway purged the pipeline of existing line fill and made certain modifications to the pipeline to permit crude oil to flow in the opposite direction. Ex. SEA-1 at 5.
5. On April 30, 2012, numerous interventions were filed. Five protests were also filed by various interested parties. On May 11, 2012, the Commission accepted and suspended Seaway's tariff, subject to refund and conditions, and established hearing procedures to address all issues raised by the filing, including those issues raised by the protestors. *Seaway Crude Pipeline Company LLC*, 139 FERC ¶ 61,109 at P 5, 23 (2012) (Hearing Order). The Commission excepted from consideration the limited protest of MEG Energy Corp., which the Commission dismissed as raising solely contractual issues between the parties. *Id.* P 24. The issues the Commission set for hearing specifically included the determination of "whether the proposed rates [in the

tariff] are just and reasonable,” and whether “the prorationing policy as identified in Item 17 of the proposed tariff may result in disparate treatment of similarly situated shippers.” *Id.* P 22-23. The Commission also required Seaway to produce cost-of-service data to aid the Commission in its determination of whether the tariff rates are just and reasonable. *Id.* P 22.

6. On May 18, 2012, the Chief Administrative Law Judge issued an order designating Karen V. Johnson as the Presiding Administrative Law Judge. On May 31, 2012, the Presiding Administrative Law Judge adopted a procedural schedule that set dates for the submission of testimony and for the hearing, among others. On July 3, 2012, Seaway filed a motion to hold this proceeding in abeyance pending a decision by the Commission in the reopened Docket No. OR12-4-000, the proceeding in which Seaway requested to charge market-based rates on the reversed pipeline. The Commission had granted rehearing on its denial of Seaway’s request to charge market-based rates. The Presiding Administrative Law Judge denied Seaway’s request for abeyance after multiple answers in opposition were filed.

7. Pursuant to the original procedural schedule, Seaway filed the Prepared Direct Testimony and supporting exhibits of witnesses William Ordemann, Steven F. Dalhoff, Jeff Brockway, George R. Ganz, Bruce H. Fairchild, Erik G. Wetmore, and Bradley F. Shamla on August 2, 2012. On August 31, 2012, the Presiding Administrative Law Judge granted Seaway’s motion for a protective order, adopting Seaway’s proposed order governing the use of competitively sensitive information.

8. On September 11, 2012, the Chief Administrative Law Judge granted the motion of Suncor Energy Marketing Inc. and Canadian Natural Resources Limited (collectively SCN) and Apache Corporation, Chevron Products Company, and Noble Energy, Inc.,(collectively ACN) to extend all the remaining deadlines in the procedural schedule by approximately six weeks to provide those parties with additional time to evaluate protected information produced in discovery and prepare answering testimony accordingly.

9. Pursuant to the revised procedural schedule, the Answering Testimony and supporting exhibits of intervenor witnesses were filed on October 19, 2012, as follows: (1) SCN Witnesses Steven H. Levine, Daniel S. Arthur, and Matthew P. O’Loughlin; (2) Witnesses Mark Pinney and David C. Parcell for the Canadian Association of Petroleum Producers (CAPP); and (3) ACN Witness Elizabeth H. Crowe. Trial Staff filed the Answering Testimony and supporting exhibits of

Witnesses Kathleen Sherman, Kevin J. Pewterbaugh, Edward Alvarez, III, and Meagan K. McComb on November 30, 2012.

10. Meanwhile, on December 12, 2012, in Docket No. OR13-10-000, Seaway filed a separate petition for declaratory order requesting that the Commission declare the tariff rates for committed shippers on Seaway's reversed pipeline be governed by the contracts entered into by committed shippers during an open season. On January 7, 2013, Trial Staff submitted comments in opposition to the petition, and numerous other parties moved to intervene and filed protests. The Commission denied Seaway's request for declaratory order finding that Seaway failed to follow the Commission's administrative process when it filed its petition for declaratory order, but reiterated its policy of upholding contracts executed between oil pipelines and committed shippers. *Seaway Crude Pipeline Company, LLC*, 142 FERC ¶ 61,201, at P 11-13 (2013). The order required Seaway to produce cost-of-service data to justify its rates. *Id.* P 13.

11. Cross-Answering Testimony and supporting exhibits were filed in this matter on January 9, 2013, by Witness Elizabeth H. Crowe for ACN and on January 10, 2013, by Trial Staff Witnesses Kathleen L. Sherman, Edward Alvarez, III and Meagan K. McComb. Seaway filed the Prepared Rebuttal Testimony and supporting exhibits of Witnesses William Ordemann, George R. Ganz, Bruce H. Fairchild, and Erik G. Wetmore on February 15, 2013. The parties filed a joint statement of issues, a joint witness list and summary of witness testimony, and a joint exhibit list on March 12, 2013.

12. On March 15, 2013, the Presiding Administrative Law Judge granted a motion to strike Exhibit No. SEA-26 on page 55, line 7 through page 57, line 2 (a portion of Erik G. Wetmore's rebuttal testimony) and Exhibit No. SEA-37 (submitted with Erik G. Wetmore's rebuttal testimony) finding these exhibits presented an alternative cost-of-service methodology by Seaway only two weeks before the hearing and that it would be prejudicial to the parties to allow Seaway to make this unforeseen change in methodology at such a late date.

13. The administrative hearing commenced on March 19, 2013, and ended on March 25, 2013.

14. On May 7, 2013, the parties to the proceeding submitted post-hearing initial briefs.

15. On June 4, 2013, the parties to the proceeding submitted post-hearing reply briefs.

16. On August 9, 2013, the Chief Administrative Law Judge issued an Order extending the issuance date of the Initial Decision from August 16, 2013 to September 13, 2013.

17. On September 13, 2013, the Presiding Judge issued the Initial Decision in this proceeding, and on October 9, 2013, an Errata to the Initial Decision was issued to correct erroneous paragraph numbering.

II. PROCEDURAL HISTORY SUBSEQUENT TO ISSUEANCE OF THE SEPTEMBER 13, 2013 INITIAL DECISION

18. On October 15, 2013, the parties to the proceeding submitted briefs on exceptions. Seaway also filed a motion requesting that the Commission give expedited consideration to its review of one issue raised by the Initial Decision concerning committed shipper rates.

19. On October 15, 2013, a flood of untimely motions and procedurally improper pleadings from political entities, oil and gas pipeline industry stakeholders, and various other entities that were not and still are not parties to this proceeding were filed. The bulleted list that follows recapitulates the October 15, 2013 untimely motions and procedurally improper pleadings:

- Continental Resources, Inc. (CLR) filed a comment addressed to Secretary Bose in which it took exception to the Initial Decision's finding as to Issue 1 regarding Seaway's committed shipper rates. CLR was absent from the administrative hearing and had theretofore failed to participate in the proceeding.
- Gas Processors Association (GPA) filed a motion for leave to file brief amicus curiae on exceptions in which it took exception to the Initial Decision's finding as to Issue 1 regarding Seaway's committed shipper rates. GPA was absent from the administrative hearing and had theretofore failed to participate in the proceeding.
- The Association of Oil Pipelines (AOPL) filed a motion for leave to file an amicus curiae brief in which it took exception to the Initial Decision's

finding as to Issue 1 regarding Seaway's committed shipper rates. AOPL had theretofore failed to participate in the proceeding.

- Plains Marketing, L.P. (Plains) filed a motion for leave to intervene out-of-time and to file a brief on exceptions to the limited issue of the Initial Decision's finding as to Issue 1 regarding Seaway's committed shipper rates. Plains was absent from the administrative hearing and had theretofore failed to participate in the proceeding.
- Chesapeake Energy Marketing, Inc. (CEM) filed a brief taking exception to the Initial Decision's finding as to Issue 1 regarding Seaway's committed shipper rates. CEM was absent from the administrative hearing and had theretofore failed to participate in the proceeding.
- Enterprise Crude Oil (Enterprise) filed a motion for leave to intervene out-of-time and limited exceptions to the Initial Decision's finding as to Issue 1 regarding Seaway's committed shipper rates. Enterprise was absent from the administrative hearing and had theretofore failed to participate in the proceeding.

20. On October 16, 2013, Tidal Energy Marketing (Tidal) filed a comment addressed to Secretary Bose in which it took exception to the Initial Decision's finding as to Issue 1 regarding Seaway's committed shipper rates. Tidal was absent from the administrative hearing and had theretofore failed to participate in the proceeding.

21. On October 21, 2013, AOPL, despite its lack of status as an admitted party to this proceeding, filed an answer in support of Seaway's motion for expedited consideration of the committed shipper rate issue.

22. On October 30, 2013, ACN filed an answer in opposition to Seaway's motion for expedited consideration of the committed shipper rate issue. ACN also filed an answer in opposition to the untimely motions and procedurally improper pleadings by entities external to this proceeding.

23. On October 30, 2013, SCN filed an answer in opposition to Seaway's motion for expedited consideration of the committed shipper rate issue. SCN also filed an answer in opposition to the untimely motions and procedurally improper pleadings filed by entities external to this proceeding.

24. On November 14, 2013, the parties to this proceeding filed briefs opposing exceptions.
25. On February 28, 2014, the Federal Energy Regulatory Commission issued the Order on Initial Decision and Remand for Further Action.
26. On March 7, 2014, the Chief Administrative Law Judge issued an order re-designating Karen V. Johnson as the Presiding Administrative Law Judge and establishing a new Initial Decision date of May 9, 2014.
27. On March 28, 2014, the Presiding Administrative Law Judge issued an order to the parties to this proceeding to brief specified issues on remand.
28. On April 1, 2014, Plains renewed its motion to intervene out of time.
29. On April 4, 2014, ACN filed an answer in opposition to plains renewed motion to intervene out of time.
30. On April 8, 2014, SCN filed an answer in opposition to Plains renewed motion to intervene out of time.
31. On April 11, 2014, all of the parties to the proceeding filed briefs on the specified issues on remand.
32. On April 11, 2014, Plains filed a brief on the specified issues on remand, notwithstanding its lack of status as an admitted party to this proceeding and the Presiding Judge's explicit instruction that only designated parties should submit briefing of issues on remand.
33. On April 14, 2014, ACN filed a motion to strike Plains' brief on remand.
34. On April 16, 2014, Plains filed an answer in opposition to ACN's motion to strike its brief on remand.

III. ISSUES

35. On March 12, 2013, Seaway submitted the following Joint Statement of Issues on behalf of all of the parties to this proceeding:

1. Are Seaway's committed shipper rates at issue in this docket?
2. What is the appropriate rate period or periods?
3. What rate base or bases should be used?
 - A. Should Seaway's rates be calculated using a depreciated original cost or trended original cost methodology?
 - B. Should the purchase price related to Enbridge's acquisition of its share of Seaway be included in rate base?
 - 1) Does the Enbridge purchase meet the Commission's standards for inclusion of an acquisition premium in rate base?
 - 2) Should the portion of the purchase price attributable to goodwill be included in rate base?
 - 3) What portion of the purchase price should be attributed to the Longhaul 30-inch System and what portion should be attributed to the other assets?
 - 4) If the purchase price is included in rate base, should a portion of that amount be allocated to the expansion capacity and services of the pipeline?
4. What are the appropriate cost allowances to be included in the cost of service?
 - A. What is the appropriate allowance for funds used during construction ("AFUDC")?
 - B. What is the appropriate level of operating expense?
 - C. What is the appropriate level of depreciation expense?

- 1) What is the appropriate average remaining life for depreciation purposes?
 - 2) What is the appropriate depreciation rate or rates?
 - 3) What is the appropriate dismantlement, removal and restoration (“DR&R”) allowance?
- D. What is the appropriate cost of capital?
- 1) What is the appropriate capital structure?
 - 2) What is the appropriate cost of debt?
 - 3) What is the appropriate rate of return on equity (“ROE”)?
 - 4) What is the appropriate cost of preferred stock?
- E. What is the appropriate income tax allowance for Seaway?
- F. What is the appropriate amount of accumulated deferred income taxes (“ADIT”)?
5. What is the appropriate level of throughput?
 6. What is the appropriate rate design method for calculating rates in this proceeding?
 7. Is the differential between Seaway’s light crude oil and heavy crude oil rates justified?
 8. What is the appropriate level of uncommitted shipper rates?
 9. What is the appropriate level of committed shipper rates?

IV. ANALYSIS

1. Are Seaway's Committed Shipper rates at issue in this Docket?

Positions of the Parties

36. Seaway states that its committed shipper rates are not at issue in this docket because the Commission has an established policy of honoring rates agreed to by shippers who sign contracts in a valid open season. Seaway Initial Br. 7 (citing *Seaway Crude Pipeline Co. LLC*, 142 FERC ¶ 61,201, at PP 12-13 (quoting *Kinder Morgan Pony Express Pipeline LLC & Belle Fourche Pipeline Co.*, 141 FERC ¶ 61,180, at P 21 (2012)) (PDO Order). Seaway maintains that even if the committed shipper rates are deemed to be at issue in this proceeding, there is no basis to change them. Seaway Initial Br. 8 (citing PDO Order, 142 FERC ¶ 61,201 at P 13).

37. Staff contends that Seaway's rates are at issue in this proceeding because the Hearing Order at paragraph 21 required Seaway to produce a cost-of-service justification for its rates in accordance with section 342.2 (a) of the Commission's regulations. Staff Initial Br. 16 (citing Hearing Order at P 23, 25). Furthermore, Staff argues that Seaway's rates are subject to change under the Governmental Modification provision of its contract with committed shippers, Staff Initial Br. 17 (citing Ex. SEA-4 at 13), and should be changed in order to prevent Seaway from substantially over-recovering costs. *Id.*

38. ACN supports the position taken by Staff, while neither SCN nor CAPP takes a position on this issue.

Discussion

39. The Commission's Order on Initial Decision and Remand for Further Action, 146 FERC ¶ 61,151 (2014) (Remand Order), both reversed the Initial Decision in whole and remanded it to "ensure that the entire Initial Decision is consistent with the directions set forth in this order." Remand Order, 146 FERC ¶ 61,151 at P 1. Moreover, the Commission specifically stated in its remand order that it "sees no good cause to re-open the evidentiary record in this proceeding for the purpose of taking additional evidence." Remand Order, 146 FERC ¶ 61,151 at P 43.

40. The effect of these Commission demands is to suggest that the Presiding Judge make a different decision on remand based upon the same factual record that was

before her when she issued the Initial Decision. The Commission has authority to reverse an administrative law judge's Initial Decision; however it does not have the authority to order an administrative law judge to change her findings as to the merits of an issue. The United States Supreme Court has held that, "the process of agency adjudication is currently structured so as to assure that the hearing examiner exercises [her] independent judgment on the evidence before [her], free from pressures by the parties or other officials within the agency" *Butz v. Economou*, 438 U.S. 478, 513 (1978). The instructions in the Remand Order would seemingly contravene that Supreme Court holding by imposing external pressure from the Commission on the Presiding Judge to change her independent judgment on the committed shipper rates despite the fact that the evidence before her remains unchanged since the September 13, 2013 Initial Decision.

41. At issue here is a question of first impression as to agency policy with respect to oil pipeline flow reversal cases when, as here, the negotiated rate revenues generated by the committed shipper contracts exceed the pipeline's overall cost of service. In the Presiding Judge's Order to Brief Issues on Remand, issued March 28, 2014, the parties were specifically asked to cite any cases, either in the oil or gas industry, where this specific factual situation exists. None could cite even one case. Given the unprecedented factual circumstances in this case, the Commission's statement in the Remand Order that the Presiding Judge's findings "misconstrue long-held Commission policy," is baseless and inaccurate. *See* Remand Order 146 FERC ¶ 61,151 at P 13.

42. Moreover there is no support for the Commission's statement in the Remand Order that "the hearing was intended to explore issues concerning Seaway's rate structure, as well as the open season process in which the negotiations took place." *Id.* Neither the Hearing Order nor the PDO Order convey that the hearing was set for that intended purpose. *See generally* PDO Order 141 FERC ¶ 61,180; Hearing Order 139 FERC ¶ 61,109. Nor did any of the parties to this proceeding understand that to be the intended purpose of the hearing, as evidenced by the fact that the Joint Statement of Issues does not include any reference to the open season process in which the negotiations took place. This assertion by the Commission is seemingly nothing more than a post-hoc rationalization for excluding the committed shipper rates from the Presiding Judge's consideration.

43. Given the novel factual situation presented in this case, and the Commission's requirement at Paragraph 21 of the Hearing Order that Seaway is to produce a cost-of-service justification for its rates in accordance with section 342.2 (a) of the

Commission's regulations, both the administrative law judge and the Commission Trial Staff determined that the committed shipper contracts must be disturbed in this case because of the likelihood that overall rates would be unjust and unreasonable. Hearing Order, 139 FERC ¶ 61,109 P 21. It is no surprise that the decision to disturb committed shipper rates was met with great outrage and panic by the oil and gas pipeline industry, which anticipated collecting these excessive and unjustified rates. Numerous untimely motions and procedurally improper pleadings were filed before the Commission by industry stakeholders and political actors. Moreover, much negative press was generated by the industry propaganda machine. Notably, the Presiding Judge's Initial Decision was rendered before the record was tainted by these external influences.

44. The Commission may reverse the Presiding Judge's findings at its discretion, notwithstanding the fact that those findings are based upon substantial factual evidence on the official record and an interpretation of a novel question of law that is supported by the Commission's own Trial Staff. The Presiding Judge, however, is not inclined to change her finding on the Issue 1 committed shipper rates as rendered in the Initial Decision. That finding and the reasoning therefore is reiterated below.

45. In the PDO Order, the Commission, "to remove uncertainty," reiterated its "policy of honoring contracts signed by committed shippers." PDO Order, 142 FERC ¶ 61,201, at PP 12-13 (quoting *Kinder Morgan Pony Express Pipeline LLC & Belle Fourche Pipeline Co.*, 141 FERC ¶ 61,180, at P 21 (2012)). The Commission made clear that its policy applies "in the instant proceeding." *Id.*

46. The Commission's reiteration in the PDO is not dispositive of this issue. As Staff points out, the contracts signed by committed shippers, which must be honored, allow for modification. *See* Staff Initial Br. 17. Section 6.06 of the relevant contract provides as follows:

Governmental Modifications. Notwithstanding any other provision of this Agreement to the contrary, the Parties acknowledge that the tariff rates payable for all Services are subject to the approval of and modification by the FERC or any other Governmental Authority having jurisdiction.

Exhibit No. SEA-4 at 13. Section 6.06 clearly contemplates that the Commission retains authority to approve or modify the rates established by the contract. Seaway contends that Section 6.06 of the TSA is simply the parties' acknowledgment that the Commission has statutory authority to approve or modify the pipeline's rates in

appropriate circumstances; it does not mean or even suggest that the Commission should do so in a manner contrary to its longstanding contract rate policy. Seaway also cites to instances in which the Commission has applied its policy of honoring contract rates to pipelines with provisions similar to Section 6.06. Seaway Reply Br. 18 (citing *Enbridge Pipelines (Southern Lights) LLC*, “Petition for Declaratory Order of Enbridge Pipelines (Southern Lights) LLC,” at Attachment C, Docket No. OR07-15-000 (July 20, 2007) (Section 6.07 is identical to Seaway’s provision here); *Enbridge Pipelines (North Dakota) LLC*, “Petition for Declaratory Order of Enbridge Pipelines (North Dakota) LLC and Enbridge Pipelines (Bakken) L.P.,” at Attachment 1, Docket No. OR10-19-000 (August 26, 2010) (Section 6.08 of this TSA is also substantively the same as Seaway’s provision).

47. The Commission’s policy to honor the contracts signed by committed shippers applies to all provisions within the contract. Provisions that contemplate government modification of rates such as Section 6.06 are not obviated from that policy. Nor is the Commission’s policy to honor committed shipper contracts irreconcilable with Section 6.06. The Commission’s announced policy is to *honor contracts*, not to refrain from *modifying rates*. In this instance, fully honoring the contract, including Section 6.06, allows for the Commission to modify rates at its discretion; however, as Seaway argues, nothing in Section 6.06 *suggests* that the Commission should modify rates. The *Enbridge* cases cited by Seaway are instances in which the Commission’s policy of honoring contracts would have allowed it to modify rates in accordance with the government modification provisions of the contracts, but the Commission chose not to do so. That choice was a matter of discretion rather than policy.

48. The Presiding Judge finds that the circumstances of this proceeding merit the Commission exercising its discretion to modify Seaway’s committed shipper rates. The Hearing Order at paragraph 21 required Seaway to produce a cost-of-service justification for its rates in accordance with section 342.2 (a) of the Commission’s regulations. Staff Initial Br. 16 (citing Hearing Order at P 23, 25). The Hearing Order also directed that the hearing investigate “all issues raised by the filing, including but not limited to, those initially raised by the protestors.” *Id.* The committed shipper rates are indisputably an integral part of Seaway’s filing. Not only do they bind the committed shippers, but they also impact the overall rate design in this proceeding.

49. The overall rate design for this proceeding warrants modifying the committed shipper rates. Seaway’s committed shipper rates do not comply with the Hearing

Order because they are not based on cost-of-service data; rather, they were determined through an open season process.

50. Moreover, the Presiding Judge credits the testimony of Staff witness McComb asserting that any rate design other than one that adjusts downward the committed rate will allow Seaway to substantially over-recover its cost-of-service. Ex. S-14 at 13-16. Cost over-recovery is inconsistent with the concept of just and reasonable rates that are required by the Commission's cost-based rate regulation. The most basic tenet of cost-based rate design is that customers should generally only be charged rates that fairly track the costs for which they are ultimately responsible. *Town of Norwood, v. FERC*, 962 F. 2d 20, 25 (D.C. Cir. 1992); *Union Elec., Co. v. FERC*, 890 F. 2d 1193, 1198 (D.C. Cir. 1989). Seaway argues that the Commission's oil pipeline precedents and regulations explicitly recognize four different methods for establishing just and reasonable rates that do not rely on the Commission's cost-of-service regulations. Seaway Reply Br. 12 (internal citations omitted). That argument, albeit accurate, ignores the fact that the Hearing Order at paragraph 21 in this proceeding explicitly calls for Seaway to produce a cost-of-service justification for its rates.

Conclusion on Remand¹

51. The Presiding Judge reiterates her finding that Seaway's committed rates are at issue in this proceeding.²

2. What is the appropriate rate period or periods?

Positions of the Parties

52. Seaway asserts that the Commission's regulations require that the lawfulness of Seaway's initial uncommitted rates be assessed using a single test period "based on a 12-month projection of costs and revenues." Seaway Initial Br. 10-15 (citing 18 C.F.R. 346.2(a)(3)(2013)).

¹ All conclusions in this Initial Decision on Remand that are included within the scope of remand in the Remand Order will be subtitled "Conclusion on Remand."

² The Presiding Judge notes that further discussion of the reasoning for this conclusion on remand is found under Issue 6 herein.

53. ACN, SCN and Staff recommend establishing one set of rates for an initial period of operations and a second set of rates for the period from January 1, 2013 forward, based on the assumption that Seaway's throughput would increase to approximately 400,000 bpd as a result of certain pump station modifications that went into service in January 2013 that significantly increased Seaway's capacity. See Staff Initial Br. 22-26; SCN Initial Br. 7-12; ACN Br. 6-11. They argue (1) that if the throughput level from the 2012 seven month pre-expansion time period 2012 was the only volume data used to calculate rates Seaway would significantly over-recover its costs during the five month post-expansion period and, (2) using the five month post-expansion 2013 volumes to set rates for the 2012 pre-expansion time period could lead to an under-recovery of costs by the pipeline for the 2012 seven month pre-expansion time period.

Discussion

54. The Commission's regulations provide filing requirements specifying base and test periods for purposes of establishing rates for oil pipelines. For a carrier that is establishing rates for a new service, the test period is based on a twelve-month projection of costs and revenues. 18 C.F.R. 342.2(a)(3)(2012). For a carrier that has less than 12-months' experience, the test period may consist of twelve consecutive months ending not more than one year from the filing date. 18 C.F.R. 346.2(a) (2) (2012). Rates should be based on volumes that are likely to be representative of future throughput. SFPP, L.P., 134 FERC 61,121 at P27 (2011) (explaining that "Commission policy does not support using data that is not likely to be representative of future throughput levels"). Staff argues that its recommendation for a pre-expansion rate period and a post-expansion rate period ensures that representative volumes are used in determining Seaway's rates.

55. Staff's pre-expansion rate period uses the annualized 2012 design capacity of 135,000 barrel per day (bpd) on Seaway. Rates for this period would be in effect from June 2012, when Seaway first delivered barrels, until Seaway's planned expansion was completed in early 2013. Staff's post-expansion rate period uses the annualized design capacity of 400,000 bpd on Seaway, which Staff argues is the expected design capacity on Seaway after its expansion in early 2013. Rates for this period would be in effect from early 2013 and continue on a going forward basis. Ex. No. S-14 at 4:10-20 (McComb).

56. Staff's Initial Brief at pages 26-28 discusses the two rate bases it believes to be necessary to calculate Seaway's pre- and post-expansion period rates using the

method reflected in Staff's Exhibit Nos. 21 and 22 at 6. However, Carrier Property in Service for the Enbridge Acquisition shown in those exhibits was reduced to \$333,351,000. This amount, developed in Exhibit No. ACN-42(a stipulation between Staff and ACN), eliminates non-jurisdictional assets that were discovered during the cross-examination of two of Seaway's witnesses. The resulting test period total carrier property in service for the pre-expansion period of \$410,497,000 (developed in Staff's Initial Brief at page 27) is then be used to calculate the trended original cost rate base for that period using the method shown in Exhibit No. S-21 at 6. Similarly, the resulting test period total carrier property in service for the post-expansion period of \$436,497,000 (Staff's Initial Brief at page 28) is used to calculate the trended original cost rate base for that period using the method shown in Exhibit No. S-22 at 6. Staff Initial Br. 26-28.

57. Seaway asserts that there is no basis in the Commission's regulations for using two separate test periods to assess a single initial rate filing. Seaway also argues that *Lakehead Pipeline Co., L.P.*, 71 FERC 61,338, at 62312-13 (1995), used by SCN witness Arthur is distinguishable because it did not involve initial rates for new service, but instead concerned two separate filings made by an existing pipeline. In *Lakewood*, the Commission assessed each rate using a different test period because the rates at issue were in effect for two different rate periods.

58. Seaway also argues that the "second test period" proposal is based on an incorrect factual premise because while Seaway did make pump station modifications in January 2013, the pipeline did not move 400,000 bpd in January, and is not expected to move that amount of throughput within the first 12 months of operation. Ex. SEA-39 at 3-4; TR. 177-79 (Ordemann). Seaway asserts that the actual volumes for January 2013 were approximately 180,000 bpd, and the actual average daily throughput for the period from June 2012 through January 2013 was approximately 138,000 bpd, which is very close to the 135,000 bpd estimated for the 12 month test period. Ex. SEA-26 at 52; Ex. SEA-39 at 3-4. Seaway asserts that actual volumes for February 2013 were 272,000 bpd . Ex.No. CAN-38 at 12; Tr. 130, 179 (Ordemann). Seaway anticipates that throughput will average approximately 295,000 bpd through May 2013. Ex. SEA-40. Seaway hopes to increase throughput to approximately 335,000 bpd at some point but not within the first twelve months of operations. Ex. SEA-39 at 4.

59. This case is complicated by the fact that Seaway completed an expansion project in early January 2013, virtually in the middle of the test period, that has the potential for increasing throughput during the portion of the test period from January

through May 2013. The expansion project resulted in disparity in throughput between the “locked in” pre-expansion seven month test period, from June 2012 through December 2012, and the five month post expansion test period, from January 2013 through May 2013.

60. There is no disagreement that post-expansion, the potential for a significantly increased throughput exists. However, the actual throughput numbers for January and February 2013 are far less than 400,000 bpd. The Presiding Judge gives credence to Seaway’s anticipation that throughput will average approximately 295,000 bpd through May 2013. Ex. SEA-40.

61. ACN notes that Seaway experienced shutdowns and curtailments in January 2013 that resulted in the lower numbers. ACN Reply Br. 15, n.39. ACN also notes that design capacity and throughput are two distinct measurements, (t)hroughput is the actual volume transported on a pipeline” while design capacity is “the volume that a pipeline is anticipated to be able to transport during a given time period assuming uninterrupted operation as calculated based on fixed assumptions and actual data for a number of variables.” *Id.* at 17 quoting Ex.no. SCN-62.

62. In this instance, however, the design capacity and the actual throughput in January and February are not in sync. The use of design capacity in this case, for the five months from January through May 2013 would result in a gross under recovery by Seaway, and a windfall to shippers. As noted by ACN “Seaway calculated a rate of \$6.91, based on its proposed rate design, cost of service and design capacity of 135,000 barrels per day. *Id.* at 18. “The unit rate (cost of service divided by annual throughput) for Exhibit No. SEA-24 is \$3.83.” *Id.* Using Seaway’s actual throughput for February 2013 of 272,000 bpd, “the \$3.83 unit rate decreases by more than half, to \$1.90”. *Id.* Applying this same methodology, using a throughput of 400,000 bpd would result in the \$1.90 rate decreasing again by almost half to approximately \$1.00.

63. If the actual throughput in January or February had approached 400,000 bpd then the concomitant reduction in the unit rate would be justified. Since that is not in fact the case, use of 400,000 bpd would result in the recovery of an unjust and unreasonably low rate by Seaway. On the other hand, given the change in the design capacity and the rise in throughput in February to 272,000 bpd, the use of 135,000 bpd would result in the recovery of an unjust and unreasonably high rate by Seaway.

64. The factual record shows that Seaway outperformed its pre-expansion capacity of 135,000 bpd in both January and February 2013. The record also shows that the

expansion project completed in early January 2013 increased the capacity of the pipeline to 400,000 bpd. There is no evidence in the record for March through May, 2013. Accordingly, consistent with Commission regulations that a pipeline that does not have operating experience will have to rely on projections, 18 C.F.R. 346.2(a)(2013), the question remaining is what is a fair projection for the five month post-expansion period based upon the evidence of record. The record clearly shows increased capacity post expansion but not up to the 400,000 bpd capacity. Based on the evidence of record, the projection lies somewhere between 135,000 bpd and 400,000 bpd. A number which is within this parameter is one put forward by Seaway: Seaway anticipates that throughput will average approximately 295,000 bpd through May 2013. Ex. SEA-40. While this number is slightly higher than the actuals shown for January and February, it is a number which takes into account that the January actual numbers were likely skewed to the low side because Seaway experienced shutdowns and curtailments in January 2013 that likely resulted in the lower numbers. This number also takes into account the likelihood that Seaway would exceed the 272,000bpd actual throughput in February 2013 in the remaining three months of the test period; March, April and May 2013. As noted by Seaway, Seaway hopes to increase throughput to approximately 335,000 bpd at some point but not within the first twelve months of operations. Ex. SEA-39 at 4.

Conclusion

65. The test period in this case should be June 2012 through May 2013 based upon the Commission's test period regulations requiring Seaway to calculate rates using cost, revenue, and throughput data for a twelve-month test period. 18 C.F.R.

346.2(a)(2013). The rate should be based on 135,000 bpd from June through December 2012 and 295,000 bpd for the post expansion period of January through May 2013.

3. What rate base or bases should be used?

66. In summary, Seaway proposes to allocate the claimed Enbridge Acquisition Cost between the non-jurisdictional and jurisdictional assets, using a revenue-based allocation factor, with the entirety of the jurisdictional costs allocated to its Initial Services, a seven-month period from June 2102 through December, 2012. Staff proposes to allocate the non-goodwill portion of the Enbridge Acquisition Cost between jurisdictional and non-jurisdictional services, and to design rates to recover the jurisdictional costs for two different periods, pre-expansion (135 million bpd) and post-expansion (400 million bpd). ACN proposes to recognize only a portion of the Enbridge Acquisition Cost to jurisdictional services, using a different methodology than

Seaway and excluding costs attributable to good will. SCN proposes adjustments both to the allocation of Enbridge Acquisition Costs to non-jurisdictional services and in the elimination of costs categorized as goodwill. CAPP allocates the Acquisition Costs to the two classes of service, initial and expansion, and derived an allocation factor by multiplying Enbridge's Acquisition cost of \$1,094,918,000 by the quotient of Seaway's initial capacity of 135 million bpd and its expanded capacity of 400 million bpd.

A. Should Seaway's rates be calculated using a depreciated original cost or trended original cost methodology?

Discussion

67. The trended original cost methodology was originally supported by Seaway and currently supported by all other active participants.

68. Seaway's witness Wetmore calculated maximum just and reasonable rates for Seaway using the Commission's established cost-of-service methodology, which employs a trended original cost rate base. None of the other participants takes issue with the use of a trended original cost methodology.

69. Seaway's Mr. Wetmore also performed an alternative rate calculation, using a depreciated original cost rate base, which exhibit was struck along with the related testimony. *Seaway Crude Pipeline Co. LLC*, "Order of Presiding Judge Granting Joint Motion to Strike a Portion of Seaway Crude Pipeline Company LLC's Rebuttal Testimony and Exhibit," Docket No. IS12-226-000 (March 15, 2013). Pursuant to the Presiding Judge's ruling at hearing, Tr. 547-48; *see also* Ex. ALJ-3, Seaway does not address its alternative depreciated original cost proposal in its post-hearing briefs, but reserves its arguments on that issue for briefs to the Commission.

Conclusion

70. As a result of the Presiding Judge's ruling striking Seaway Witness Wetmore's testimony concerning the depreciated original cost methodology, Tr. 547-48, there is no evidence in the record to support use of that methodology. Accordingly, the Presiding Judge finds that Seaway's rates should be calculated using the trended original cost methodology.

B. Should the purchase price related to Enbridge's acquisition of its share of Seaway be included in rate base?

1) Does the Enbridge purchase meet the Commission's standards for inclusion of an acquisition premium in rate base?

71. The following discussion on the Commission's standards for inclusion of an acquisition premium in rate base is subdivided into three parts for organizational clarity. This subdivision is not incorporated into the Joint Statement of Issues.

a. Preliminary challenges to the acquisition premium

Positions of the Parties

72. ACN argues that the purchase price adjustment will allow Enterprise to "earn revenues sufficient to afford it a return of, and on, a \$585 million investment in Seaway," instead of the \$59 million net book value of Enterprise's share of Seaway. ACN Initial Br.15. ACN cites Mr. Wetmore's testimony at hearing where he stated that he did not "know the specifics" of how revenue is allocated among Seaway's owners and was asked by counsel for ACN to "assume" that it was shared equally. ACN Initial Br. 15 (citing Tr. 402, 404 (Wetmore)).

73. Seaway argues that the manner in which Seaway's owners choose to divide the revenue from Seaway's operations is not relevant to the application of the Commission's two-part test or to the setting of rates generally citing to a Supreme Court decision in the analogous context of revenue division agreements between carriers participating in a joint rate, stating that the division of revenue resulting from the joint rate "is no concern of the shipper." *Great N. Ry. Co. v. Sullivan*, 294 U.S. 458, 463 (1935); *Louisville & Nashville R.R. Co. v. Sloss-Sheffield Steel & Iron Co.*, 269 U.S. 217, 234 (1925) (division of revenue among carriers "is a matter which in no way concerns the shipper"). Instead, the "shipper's only interest is that the charge shall be reasonable as a whole." *Great N. Ry.*, 294 U.S. at 463; *Louisville & Nashville R.R.*, 269 U.S. at 234.

74. CAPP takes "no position on the sufficiency of the benefits demonstration," but claims there are "unique factual considerations" that "may or may not support application of the benefits exception test here." CAPP Initial Br. 4, 9. CAPP claims this case is different from other situations in which a purchase price adjustment has been permitted, because "[t]he asset that was acquired by Enbridge was not the pipeline or related physical assets, but rather an interest in the partnership that owned the pipeline." CAPP Initial Br. 5.

75. Seaway responds that in *Enbridge Energy*, 110 FERC ¶ 61,211 at PP 5-6, the Commission approved a purchase price adjustment related to the acquisition of the Spearhead pipeline by Enbridge Energy Company, Inc. (“Enbridge Energy”). There, Enbridge Energy purchased an interest in the partnership that owned Spearhead (CCPS Transportation, L.L.C. (“CCPS”)) from CCPS’s prior owner, BP Pipelines (North America) Inc., rather than buying the Spearhead assets directly.

76. CAPP contends that *Missouri Interstate Gas, LLC*, 142 FERC ¶ 61,195 (2013) (“Opinion No. 525”) “suggests that the [acquisition] premium cannot be paid for an asset that is held by another entity.” CAPP Initial Br. 7. CAPP notes that Opinion No. 525 stated that “an acquisition premium must be reflected on the books of the entity that holds title to the asset to which the acquisition premium relates,” and that “[a]n acquisition premium cannot be transferred between affiliates unless the underlying asset itself is transferred.” Opinion No. 525, 142 FERC ¶ 61,195 at P 78. CAPP suggests that this means that the Enbridge purchase price cannot be included in Seaway’s rate base, because it would require Enbridge to transfer the purchase price from Enbridge’s books to those of its “affiliate” Seaway. CAPP Initial Br. 8-9.

77. Seaway argues that the language in Opinion 525 relates to the appropriate method for allocating an acquisition premium among the different purchased assets.

78. Seaway also argues that contrary to CAPP’s suggestion, Opinion No. 525 also did not create any new “threshold requirement” that the purchaser must acquire “title to the asset[s]” directly rather than acquiring an interest in the company that owns the assets.

79. CAPP argues that *Enbridge Energy* does not apply here, because Enbridge purchased a 50 percent interest instead of a “controlling interest” in Seaway. CAPP Initial Br. 5-6, 9. Seaway argues that there is no requirement, however, that an acquisition premium be for a majority interest in the pipeline at issue where the Commission’s two-part test is met and that Enbridge’s purchase of ConocoPhillips’ 50 percent share of Seaway made the reversal possible. CAPP further claims that the acquisition premium here “warrants careful deliberation,” because “both the seller and the purchaser of the partnership interest were themselves ‘customers’ of the pipeline.” CAPP Initial Br. 9.

80. Seaway argues that CAPP does not point to any record evidence to support this claim and fails to explain how it would be relevant, since the Commission’s two-part test does not turn on who the shippers are.

81. CAPP notes that Seaway's most recent Form 6 does not include the Enbridge purchase price in Seaway's "carrier plant in service." CAPP Initial Br. 9, n.6.

82. Seaway argues that it is entirely appropriate for Seaway to await the Commission's decision in this case before including the acquisition premium in its carrier property accounts for Form No. 6 purposes. *See N. Border Pipeline Co. v. FERC*, 129 F.3d 1315, 1319 (D.C. Cir. 1997) (whether an acquisition premium should be included in rate base is best made in "ratemaking, rather than accounting, proceedings"); *Minnesota Power & Light Co.*, 43 FERC ¶ 61,104, at 61,342 (1988) (explaining that, while the Commission's accounting rules require plant to be recorded at depreciated original cost with any acquisition premium recorded in a separate account, the acquisition premium may be included in rate base "[i]n the event rate recognition of the acquisition adjustment is approved" in a subsequent rate case).

83. ACN claims that the acquisition premium cannot be included in Seaway's rates, because Enterprise was an owner of Seaway both before and after the Enbridge purchase. ACN Br. 14-15.

84. Seaway argues that ACN relies on *Longhorn Partners Pipeline*, 82 FERC ¶ 61,146, at 61,543-44 (1998), in which the Commission denied a purchase price adjustment where the seller retained an interest in the pipeline after the sale, because "the selling entity would in effect be receiving a write-up of an asset which it still owns." Seaway asserts that that case does not apply here, because Enterprise was not the seller of the interest that Enbridge acquired. The seller was ConocoPhillips, which did not retain any interest after the sale. *See Exhibit No. SEA-25 at 4 (Shamla)*. Seaway also argues that the *Longhorn* holding cited by ACN is no longer good law. *Longhorn* was decided by the Commission on the same ground as *Rio Grande Pipeline Co.*, 78 FERC ¶ 61,020 (1997); *reh'g denied*, 82 FERC ¶ 61,147 (1998), which was reversed and remanded by the United States Court of Appeals for the District of Columbia Circuit. *See Rio Grande*, 178 F.3d at 543; *Longhorn Partners Pipeline, L.P.*, 100 FERC ¶ 61,020 (2002).

85. Seaway argues that the *Rio Grande* court held that the Commission's rejection of an acquisition premium on the sole ground that the seller continued to own a share of the new pipeline made "no sense," and was inconsistent with the Commission's two-part test and that the key is "to ensure that the deal was negotiated at arm's length," and was not a "sham transaction[]." *Rio Grande Pipeline Co.*, 178 F.3d at 542-43.

86. Seaway witness Mr. Shamla explained in his initial testimony that the purchase price was the product of "several weeks of negotiations." Ex. SEA-25 at 4.

ConocoPhillips did not retain any interest in the line after the sale and Enbridge, “had no reason to pay more for this purchase than necessary, and [it] negotiated to lower the purchase price that ConocoPhillips originally offered.” *Id.* Seaway argues that no participant challenges Mr. Shamla’s testimony on that issue or the reasonableness of the price paid by Enbridge for the ConocoPhillips interest in Seaway.

87. Seaway argues that the fact that Enterprise remained a fifty percent owner of Seaway does not make the purchase price negotiated between Enbridge and ConocoPhillips something other than an arm’s-length deal. Nor does it provide any other valid basis to exclude the acquisition premium. In fact, as the D.C. Circuit explained, “the retention of some interest in the acquired facilities [by a prior owner] will reduce the cost basis included in [the pipeline’s] rate base,” which constitutes a “better deal for the ratepayer.” *Rio Grande*, 178 F.3d at 542. Since Enterprise was amenable to the reversal, Enbridge only needed to purchase ConocoPhillips’ share in order to reverse the line. *See* Ex. SEA-25 at 3-4. As Mr. Wetmore explained, “[i]t would make no economic sense to permit a purchase price adjustment in rate base where 100 percent of the pipeline asset itself is acquired, but deny the adjustment where ratepayers receive the same benefits [through acquisition of an equity interest] at a substantially lower cost.” Ex. SEA-26 at 21.

88. ACN claims “Mr. Wetmore’s analysis is flawed because it assumes, without establishing, that Enterprise would have sold its 50 percent interest in Seaway to Enbridge in the first place.” ACN Initial Br. 16.

89. Seaway responds that Mr. Wetmore’s argument is based on the same economic logic that the D.C. Circuit relied upon in *Rio Grande*. *See* 178 F.3d at 542. Where a purchase meets the Commission’s two-part test and thus converts an existing pipeline asset to a new use that provides benefits to shippers, it is illogical to disallow the purchase price adjustment on the ground that the purchaser did not acquire 100% of the pipeline, since it is reasonable to assume that a purchase of a larger interest would have cost more than a smaller interest, therefore ACN’s speculation that Enterprise could have purchased ConocoPhillips’ interest at “perhaps a lower price” is contrary to both the record and basic economic principles. Indeed, as Mr. Shamla explained, “other pipeline companies (with which [Enbridge was] competing to build a new pipeline from Cushing to the Gulf) would have willingly paid at least [what Enbridge paid] because of the value of being able to convert the existing pipeline to southbound service quickly and at a lower cost than a new pipeline.” Ex. SEA-25 at 5.

Discussion

90. This case presents a threshold issue of whether Enbridge as a co-owner of a partnership qualifies to record the acquisition premium on its books and, if so, how that translates into carrier property in service for Seaway. At issue is whether the costs incurred by Enbridge in purchasing its one-half interest in the Seaway pipeline should be included in rate base. Interestingly, Staff did not address itself to this preliminary question in either its Initial or Reply brief devoting itself entirely to applying the benefits exception to the rule disallowing acquisition premiums, while CAPP, on the contrary, addressed itself exclusively to this preliminary matter while taking no position on the application of the benefits exception.

91. Seaway asserts that \$1,094,918,269 related to Enbridge's acquisition of its share of Seaway should be included in rate base. That amount represents the full \$1.15 billion purchase price minus the \$55,081,731 attributable to the assets other than the Longhaul 30-inch System that Enbridge acquired from ConocoPhillips. Seaway Br. 17-29.

92. No party disputes that the net book value of Enbridge's 50 percent share of the Seaway assets was approximately \$59 million at the time of the acquisition. As noted by ACN's witness, Ms. Crowe, Seaway's \$1.1 billion acquisition adjustment reflects a 1.755 percent increase over the net book value of Enbridge's 50 percent share of the Seaway pipeline. Ex. ACN-1 at 9:3-9. Removing the proposed \$1.1 billion acquisition adjustment from Seaway's proposed rate base would reduce Seaway's cost of service from approximately \$188.5 million to \$40 million. Ex. ACN-1 at 11:1-10. Enterprise, as a half owner of Seaway, would earn revenues on a \$585 million investment in Seaway due to the fact that Enbridge paid a large sum of money to become Enterprise's co-owner on Seaway. Tr. 402:13-18, 404:5-13 (Wetmore Cross-examination). The sheer magnitude of this this rate base write-up requires close scrutiny.

93. The Commission has held that it is not appropriate to include an acquisition adjustment in a regulated entity's rates when a remaining owner stands to gain an unjustified and unreasonable windfall. Longhorn Partners Pipeline, 82 FERC 61146 at 61543-44 (1998). Seaway's Mr. Wetmore argues that it makes "no economic sense" to deny a purchase price adjustment when a remaining owner stands to benefit from including that purchase price in rates. Ex. SEA-26 at 21:17-22:6 (citing Rio Grande Pipeline Company v. FERC, 178 F.3d 533, 542 (D.C. Cir. 1999)).

94. However, as ACN notes:

Mr. Wetmore's analysis is flawed because it assumes, without establishing, that Enterprise would have sold its 50 percent interest in Seaway to Enbridge in the first place. *Further, it fails to take into account the fact that Enterprise could have acquired Enbridge's same stake in Seaway (in other words, Enterprise could have bought out ConocoPhillips and become Seaway's sole owner), and perhaps at a lower price, if Enterprise did not stand to gain from ConocoPhillips' sale to Enbridge* (emphasis added).

ACN Initial Brief 16-17.

95. The ratemaking treatment of any of the claimed costs in rate base must be harmonized with the principle of cost-based rates, and be consistent with the purposes for which the benefits exception has been recognized. In this case, the asset in issue is the Seaway pipeline; the acquisition premium was paid not for the pipeline or for a controlling interest in the company, but rather for a share of the company. Before the transaction, the pipeline asset belonged to neither of the partners in the Seaway partnership – Conoco and Enterprise – but to the Seaway partnership itself. Partnership agreements do not confer title to any asset held by the partnership to a specific partner. See, e.g., the Enterprise agreement, Ex. SEA-8, page 11: Article 2.8 (“Title to Partnership Assets. Title to Partnership assets, whether real, personal or mixed and whether tangible or intangible, shall be deemed to be owned by the Partnership as an entity, and no Partner or Assignee, individually or collectively, shall have any ownership interest in such Partnership assets or any portion thereof”).

96. As Seaway Witness Mr. Shamla explained, prior to the Enbridge purchase, the pipeline was owned in equal shares by Enterprise and ConocoPhillips Company. Ex. SEA-25 at 3 (Shamla). ConocoPhillips did not want to reverse the line, “because the pipeline was serving a ConocoPhillips refinery in Oklahoma.” *Id.* “Because ConocoPhillips owned a 50 percent interest in Seaway; it had an effective veto over any proposal by Enterprise . . . to make such a reversal.” *Id.* Instead, Enbridge and Enterprise formed a joint venture for the purpose of constructing a new pipeline between Cushing and the U.S. Gulf Coast. *Id.* at 2. That new pipeline project was known as “Project Wrangler.” *Id.* Prior to Project Wrangler, Enbridge had also been “exploring a potential project to construct a new pipeline from Cushing to the Gulf Coast that was referred to at the time as Project Monarch.” Ex. SEA-25 at 2.

97. Seaway asserts that in October 2011, Enbridge learned that ConocoPhillips “which was then in the process of divesting itself of its refinery and other midstream assets” might be willing to sell its 50 percent interest in Seaway. *Id.* at 3-4. Enbridge entered

into commercial discussions with ConocoPhillips, and “[u]ltimately, after several weeks of negotiation, . . . settled on a purchase price of \$1.15 billion for the transfer of ConocoPhillips’ entire interest in Seaway to Enbridge.” *Id.* at 4. The purchase was agreed to and announced in November 2011, and closed on December 20, 2011. *Id.* at 1; Ex. SCN-7 at 35, 39; Ex. SCN-66; Tr. 195-97 (Shamla).

98. Mr. Shamla testified the Enbridge purchase and subsequent reversal of the pipeline allowed Seaway to provide the new north-to-south transportation service “at a savings to shippers when compared with the alternative of constructing a new pipeline from Cushing to the Gulf Coast.” Ex. SEA-25 at 2; *Id.* at 5-6. Mr. Ordemann testified that Seaway currently anticipates it will cost approximately \$1.32 billion to build a new 30-inch line from Cushing to the U.S. Gulf Coast (the “loop” line). Ex. SEA-39 at 5; Ex. SEA-42. The \$1.32 billion estimate for the loop line is approximately \$150 million greater than the total carrier property in service of \$1.17 billion included in Seaway’s rate base, which includes (1) the amount that Enbridge paid to acquire its share of the Longhaul 30-inch System, (2) the depreciated original cost value of Enterprise’s fifty percent share of Seaway; and (3) the incremental carrier property additions related to the reversal. Ex. SEA-26 at 13; Ex. SEA-24, Workpaper 4.

99. Enbridge makes no claim to own the Seaway pipeline or any other partnership asset. In purchasing ConocoPhillips’ interest in the partnership, Enbridge paid the acquisition premium, not Seaway. Thus, Enbridge is the entity that incurred the purchase premium, not Seaway. Moreover, the Seaway partnership held the asset before and after the acquisition premium was paid and there is no transfer of title to which the transfer of the premium can be ascribed. As noted by CAPP;

The “asset,” the pipeline itself, was transferred, if at all, only between the old and new versions of the Seaway partnership. (Exh. SEA-1. at 5, n.2)(Exh. CAP-1 at 9). These two entities may qualify as “affiliates” for purposes of applying the benefits test, but the issue remains as to whether or how the premium transferred from Enbridge to the partnership. (footnote omitted).

CAPP Initial Br. 9.

100. Typically, the assets of a pipeline are valued for rate base purposes at their original cost, which is the cost of construction or acquisition of the assets at the time they were first placed into regulated service, less accumulated depreciation. *Longhorn Partners Pipeline*, 73 FERC ¶ 61,355 at 62,112 (1995). The Commission recognizes an exception

to this general policy in the case of an arm's-length transaction where (1) the purchased asset will be devoted to a new use and (2) the transaction as a whole clearly has demonstrable benefits to customers. *Pub. Serv. Comm'n v. FERC*, 601 F.3d 581 (D.C. Cir. 2010); *Rio Grande Pipeline Co. v. FERC*, 178 F.3d 533 (D.C. Cir. 1999). The nature of this exception and the heavy burden on the pipeline to demonstrate benefits was detailed by the United States Court of Appeals for the District of Columbia:

The benefits exception to the rule disallowing acquisition premiums takes into account (1) whether the acquired facility is being put to a new use, *see Rio Grande Pipeline Co.*, 178 F.3d at 536; *Enbridge Energy Co., Inc.*, 110 F.E.R.C. ¶ 61,211 at 61,796 (2005); *Longhorn Partners Pipeline*, 73 F.E.R.C. ¶ 61,355 at 62,112-13 (1995); and (2) whether “the purchaser has demonstrated specific dollar benefits resulting directly from the sale.” *Kansas Pipeline Co.*, 81 F.E.R.C. at 61,018; *see also Enbridge Energy Co., Inc.*, 110 F.E.R.C. at 61,796. FERC has also considered (3) whether the transaction at issue is an “arm’s length” sale between unaffiliated parties, *see, e.g., Enbridge Energy Co., Inc.*, 110 F.E.R.C. at 61,796; and (4) whether the purchase price of the asset at issue is less than the cost of constructing a comparable facility, *see, e.g., Rio Grande Pipeline Co.*, 178 F.3d at 536-37; *Enbridge Pipelines (Southern Lights) LLC*, 121 F.E.R.C. ¶ 61,310 at 62,688 (2007). FERC has been clear that the pipeline carries the burden of proof of showing a benefits exception to justify the allowance of an acquisition premium. In order to meet this “heavy” burden, a pipeline must prove the existence of benefits to consumers that are “tangible, non-speculative, and quantifiable in monetary terms.” *Kan. Pipeline Co.*, 81 F.E.R.C. at 61,018.

Missouri Pub. Serv. Comm'n v. FERC, 601 F.3d 581, 586 (D.C. Cir. 2010).

101. As CAPP notes, the benefits exception is not an entitlement, but rather a special rule for which shipper benefits, commensurate with the excess amounts paid, are the key component, quoting the D.C. Circuit:

The concept of original cost accounting is a bedrock principle of the Uniform System . . . Absent original cost accounting, “all that pipelines would have to do to raise rates and obtain greater income would be to buy utility properties from another at a price higher than original cost and in this very simple way increase the cost of service to consumers.” *Arkla Energy Resources*, 61 F.E.R.C p 61,004, at 61,038, (1992). A company, however,

is not always prohibited from recovering that amount of the purchase price in excess of depreciated original cost. It can do so by proving that “consumer benefits relative to the excess amount [paid] accrued to rate payers.” *United Gas Pipe Line*, 25 F.P.C. at 63.

CAPP Initial Br. 4 (citing *Northern Border pipeline Co. v. FERC*, 129 F.3d 1315, 1321 (D.C. Cir. 1997) (upholding order denying applications of the benefits test to purchase price of a pipeline segment from another pipeline)).

102. CAPP asserts that the specific facts surrounding the Enbridge Acquisition Costs warrant close scrutiny given the distinctions between this and prior cases in which the benefits test has been employed, and the potential expansion of the policy represented here. The distinguishing facts noted by CAPP are the following:

- The asset that was acquired by Enbridge was not the pipeline or related physical assets, but rather an interest in the partnership that owned the pipeline. Thus, it is different from the *Rio Grande*, *Longhorn*, and *Southern Lights* cases, where the entity seeking approval purchased identified pipeline assets. (fn omitted)
- Enbridge did not purchase the partnership entity itself, but rather a non-controlling (50%) interest in the company. (Ex. SEA-25 at 6). Thus, it is different from the situation in the 2005 *Enbridge* case relied on: there, a single owner (BP Pipelines) sold the entity to a single purchaser (Enbridge). (fn omitted). In such cases, the Commission may reasonably treat the ownership of the asset and the ownership of the company as coextensive.
- Here, both the selling party, Conoco, and the purchasing party, Enbridge, each made (or makes) use of the pipeline. Conoco had used the Seaway system (south to north) to supply its Oklahoma refinery; (footnote omitted). Enbridge will make use of Seaway Capacity (north to south) as part of its integrated system. (citations omitted). The prior cases have presented no such facts for the Commission to evaluate.

CAPP Initial Br. 5-6.

103. CAPP notes that in *Missouri Interstate Gas, LLC*, Opinion No. 525 142 FERC

61195 (2013), the Commission noted that a threshold requirement of the benefits test is that the acquisition must be reflected on the books of the entity that holds title to the asset, and that transfers between affiliates do not qualify for the benefits exception. The Commission in Opinion No 525, Par 78 stated:

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

Opinion No. 525, Par. 78.

104. In this case, the Seaway partnership held title to the asset, but the payment was made for a corporate (partnership) interest. According to CAPP, Opinion No . 525 suggests that the premium cannot be paid for an asset that is held by another entity.

105. CAPP witness Mr. Pinney testified that the unusual factual circumstances would represent an “expansion or special case” of application of the benefits exception because:

The acquisition premium was not paid for an asset, as in the bulk of cases in which it has been applied. It was not paid in order to acquire a controlling interest in a business that itself owned the asset. It was instead paid to acquire a partial interest in a business, in order to overcome a “veto power” held by the predecessor holder of the interest, and in connection with a contemplated arrangement whereby the acquiring entity would itself become a lessee of a portion of the reversed Seaway line. Thus, both the seller and the purchaser of the partnership interest were themselves “customers” of the pipeline, and this aspect also warrants careful deliberation.

CAPP Initial Br 9.

106. Seaway argues that nothing about Opinion No. 525 bars a purchaser from applying an acquisition premium to the appropriate regulated entity, simply because the regulated entity may be held by a subsidiary or other affiliate of the purchaser. Seaway argues that in Opinion No. 525, the purchaser acquired two separate pipeline assets (one regulated and one unregulated) as part of the same transaction. The Initial Decision found that the bulk of the purchase price was attributable to the unregulated pipeline, but nevertheless concluded that it was permissible for the purchaser to apply the acquisition premium to

the regulated pipeline, because there was no requirement “to allocate an acquisition adjustment in any particular way among the subsidiaries of a company whose assets are bought through a stock purchase.” Opinion No. 525, 142 FERC ¶ 61,195 at P 71. The Commission reversed the Initial Decision and found that the acquisition premium related entirely to the regulated assets, not the unregulated assets. *Id.* at PP 75-77. The Commission further explained that when “assets are purchased together there are a number of reasonable ways to allocate the purchase price,” but the purchaser could not simply “allocate the purchase price in any manner it chooses.” *Id.* at P 78. Instead, the Commission held that the acquisition premium must be attributed to the entity that owns “the assets to which the acquisition premium relates,” and cannot simply be transferred to other affiliates that do not own those assets. *Id.*

107. Seaway argues that Opinion No. 525 held that the acquisition premium must be applied to the appropriate company or assets purchased. Thus, for example, if Enbridge had purchased an interest in Seaway and another pipeline company as part of the same transaction, only the portion of the purchase price attributable to Seaway could be recorded on Seaway’s books (*i.e.*, the “entity that holds title to the asset to which the acquisition premium relates”); the portion of the purchase price attributable to the other assets could not be attributed to Seaway unless those other assets were also transferred to Seaway.

Conclusion on Remand

108. The *Rio Grande* court held that the Commission’s rejection of an acquisition premium on the sole ground that the seller continued to own a share of the new pipeline made “no sense,” and was inconsistent with the Commission’s two-part test and that the key is “to ensure that the deal was negotiated at arm’s length,” and was not a “sham transaction[.]” *Rio Grande Pipeline Co.*, 178 F.3d at 542-43.

109. The unique circumstances presented by this partnership arrangement cannot be taken lightly and deserve strict scrutiny in order to determine whether in fact the deal was negotiated at arm’s length and not a sham transaction designed to unjustly enrich the partners in a blatant attempt to get what amounts to cost-of-service rates so elevated that they are in effect market-based rates. At the very least the partnership scheme has overridden cost-based rate-making designed to prevent utilities buying properties from one another at a price higher than original cost in order to increase the cost of service to the customer. Seaway cites *Enbridge Energy* to support its case. However, *Enbridge* involved an agreed-to rate and the Commission found that Enbridge did not support the proposed rate on a cost-of-service basis. *Enbridge Energy*, 110 FERC ¶ 61,211 at P 4.

110. As noted by SCN “Enbridge’s upstream operations stand to significantly benefit from Enbridge’s ownership in Seaway.” SCN brief at 19. Clearly, the pipeline segment at issue here is a small but critical piece of a larger reversal project. Structuring the business transaction in this way appears to allow for maximum recovery to finance a much bigger operation by locking in the highest rates possible without anyone taking a look at the whole picture.

111. Clearly, this is Enbridge’s acquisition premium, not Seaway’s and it strains logic to see how it could be attributable to Seaway. In fact, Seaway’s assertions to the contrary, the reason that the acquisition premium does not appear on Seaway’s form 6 is because it does not belong there.

112. Here the acquisition premium was not paid for an asset or to acquire a controlling interest in a business that owned the asset. It was paid to acquire a partial interest in Seaway, in order to overcome a so-called “veto power” held by the predecessor holder of the interest (Conoco) in a complicated arrangement whereby the acquiring entity (Enbridge) would itself become a lessee of a portion of the reversed Seaway line.

113. The burden is on the pipeline to demonstrate that the Enbridge purchase was an arm’s-length transaction and that the benefits exception should apply. *See Missouri Pub. Serv. Comm’n v. FERC*, 601 F3d. 581, 586 (D.C. Cir. 2010). The Presiding Judge finds that Seaway has not met its burden of showing an arm’s-length transaction and would not allow the acquisition premium based upon the record here presented.³

114. The Presiding Judge will proceed to analyze the remaining issues, with the caveat that they are rendered irrelevant if the Commission agrees with her finding that the Enbridge purchase was not an arms-length transaction.

³ The Initial Decision found that Seaway had not met its burden, and disallowed the acquisition premium based on the record. But the Presiding Judge also recommended that the matter be remanded for additional proceedings. In the Remand Order, the Commission declined to reopen the record, and did not take issue with the Presiding Judge’s conclusion on the merits. Given that the record has not changed, there is no evidentiary basis for the Presiding Judge to modify her ruling in the Initial Decision.

b. New use test

Positions of the Parties

115. Staff argues that Enbridge has met its burden to show that its purchase interest in the pipeline satisfies the Commission's two part test. Staff states that the financial benefit of the Seaway project to the pipeline's customers proceeds from the fact that the estimated \$1.32 billion to construct a new pipeline from Cushing to the Gulf Coast that would duplicate Seaway's service is greater than even Seaway's claimed \$1.17 billion Carrier Property in Service for Seaway. Ex. SEA-26 at 13. Staff further states that additional benefit, which is also apparent but cannot be as readily measured, proceeds from the time-value savings to the customers. Ex. SEA-25 at 2; Ex. S-1 at 7; Ex. S-19 at 7.

116. ACN argues that Seaway is "not providing a new or materially changed service," since Seaway continues to transport crude oil, "just in a different direction." ACN Initial Br. 17.

117. Seaway asserts the argument is directly contrary to *Enbridge Energy*, which held that the reversal of a crude oil pipeline "qualifies as a new use" under the Commission's two-part test even though the pipeline in that case remained in crude oil transportation service after the reversal. 110 FERC ¶ 61,211 at P 29.

118. ACN contends that reversing the direction of a crude oil line is "similar to gas pipelines offering back-haul service, or flexible receipt and delivery points." ACN Initial Br. 17-18 (quoting Ex. ACN-1 at 13 (Crowe)).

119. Seaway asserts that, in the oil pipeline context, transportation in one direction has been found to constitute a distinct service from transportation in the other direction. Citing *ARCO Pipe Line Co.*, 66 FERC ¶ 61,159, at 61,313 (1994) (holding that Commission has no authority to review an oil pipeline's proposal to abandon southbound service while continuing to provide northbound service, since "the services on the northbound and southbound routes are two distinct services"). Unlike natural gas pipelines, oil pipelines are not required to offer back-haul service. *See W. Ref. Pipeline Co.*, 122 FERC ¶ 61,210 (2008), *aff'd on reh'g*, 123 FERC ¶ 61,271 (2008) (rejecting request by shipper to compel pipeline to deliver crude oil in the opposite direction from the service offered by the pipeline). That is because, while the Commission's natural gas regulations explicitly define "transportation" to include "storage, exchange, backhaul, displacement, or other methods of transportation," 18 C.F.R. § 284.1 (2013), the ICA's

definition of transportation contains no comparable language. *See* 49 U.S.C. app. § 1(3) (1988); *see also* *ConocoPhillips Co. v. Enterprise TE Prods. Pipeline LLC*, 134 FERC ¶ 61,174, at P 53 (2011) (explaining that “backhauls” are not included in the ICA’s definition of transportation).

120. ACN further contends that Seaway is not providing a new service, because “ten of Seaway’s fourteen pre-reversal shippers have also shipped on the post-reversal Seaway.” ACN Br. at 18.

121. Seaway argues that this argument ignores the dramatic increase in new shippers since the reversal. *See* Tr. 180-81 (Ordemann) (explaining that approximately 200 shippers nominated volumes for shipment on Seaway as of March 2013 and that it appears the number of shippers “is going to continue to grow”); *see also* Ex. SEA-39 at 2 (Ordemann) (discussing increase in number of shippers post-reversal); Ex. S-31 at 2 (chart showing increase in number of shippers); Ex. ACN-38 (showing approximately 150 shippers in February 2013).

122. Seaway’s Mr. Ordemann testified that there is greater demand for transportation from Cushing to the Gulf Coast than there was for transportation in the opposite direction. *See* Ex. SEA-1 at 5-6. Seaway is also serving a different group of shippers and different markets than it did prior to the reversal. The shippers that used the south-to-north service “moved crude oil from the U.S. Gulf Coast to certain refineries connected to Cushing.” *Id.* at 5-6. After the reversal, the shippers are “(i) producers of crude oil in West Texas/New Mexico, the U.S. Rocky Mountains, North Dakota, the U.S. Mid-Continent and Canada, (ii) owners of refineries on the U.S. Gulf Coast, and (iii) companies that engage in crude oil trading.” *Id.* at 6.

123. ACN claims it is unfair for the ten pre-reversal shippers to “pay rates that reflect a higher depreciation expense, even though the pipeline facilities have not changed.” ACN Initial Br. 18.

124. Seaway argues that the factual premise for ACN’s argument is incorrect, since the pipeline’s facilities and services have changed. Ex. SEA-1 at 4-6 (Ordemann) (describing the changes required to reverse the flow of the line). Furthermore, Seaway argues that the Commission has made clear that a pipeline reversal constitutes a new use despite “minor overlap” in pre- and post-reversal shippers. Citing *Enbridge Energy*, 110 FERC ¶ 61,211 at P 30. Finally, ACN argues that Seaway is not providing a new service, because “only one-half of the pipeline ownership has changed as a result of Enbridge’s acquisition.” ACN Initial Br. 18. Seaway argues that the equity ownership of the

pipeline is irrelevant to determining whether the pipeline has been put to a new use because while Enterprise continues to be a fifty-percent owner of Seaway, the pipeline's *use* – which is the relevant criterion under the first part of the Commission's two-part test – is plainly different.

Discussion

125. The Commission's established standard allows an oil pipeline to include the full purchase price of an acquired asset in its rate base if (1) the asset is put to a new use and (2) the transaction is shown to benefit ratepayers.

126. The reversal of the flow of the Seaway pipeline from north to south is a new use of the pipeline. It provides a new transportation alternative that relieves the pressure from growth since 2009 in the volume of crude oil being delivered into the storage and marketing hub at Cushing, Oklahoma and the demand in the Gulf Coast refining market for increased access to that oil. Ex. SEA-25 at 2. Moreover, the reversal of the pipeline flow provides new access for transportation to a larger group of new customers. During the three years before reversal, there were only fourteen shippers using the Longhaul 30-inch system. By contrast, during the seven months after the reversal, approximately 125 shippers have been using the north-south service. Ex. SEA-39 at 2. As a result of the increase in the number of customers, the reversal permits the transportation of a greater variety of types and origins of crude oil than before the reversal. Instead of transporting oil that was typically imported, it is anticipated that the oil transported by Seaway will be North American sourced oil. Ex. SEA 39 at 2; Ex. SEA-1 at 6.

Conclusion

127. Accordingly, the Presiding Judge finds that the reversal of the flow of the Seaway pipeline from north to south is a new use.

c. Substantial Benefits Test

Positions of the Parties

128. ACN claims that if a new line with a capacity of 400,000 to 450,000 barrels per day costs approximately \$1.3 billion, then Enbridge did not "achieve[] any cost savings by purchasing a 50 percent stake in a smaller pipeline for \$1.1 billion." ACN Initial Br. 20.

129. Seaway argues that Enbridge's alleged failure to achieve "cost savings" is irrelevant. The relevant issue is whether *shippers* are better off as a result of the Enbridge purchase. Seaway asserts that if a new pipeline had been constructed, shippers would have had to pay rates calculated using an approximately \$1.32 billion rate base. Seaway asserts that its total rate base, which includes the Enbridge purchase price and the other rate base elements, is approximately \$150 million less than what the rate base would have been for a new pipeline. Seaway states that the January 2013 pump station upgrades that increased Seaway's capacity cost approximately \$26 million, Ex. SEA-42, still resulting in an approximately \$124 million savings for shippers.

130. Seaway argues that the assertion that Enbridge purchased a smaller pipeline also misses the mark. While Seaway's current capacity of approximately 295,000 barrels per day, Ex. SEA-39 at 4, is not equal to the currently-anticipated capacity of the loop line of 400,000 to 450,000 barrels per day, Ex. SCN-54 at 4; Ex. SCN-68 at 11, the loop line is not yet in service, so its actual capacity is not known at this time and may be less than forecasted. Seaway argues that although it was anticipated that the Seaway line would have a capacity of approximately 400,000 barrels per day after the January 2013 expansion, its actual achieved capacity is significantly less than that. *See* Ex. SEA-39 at 3-4 (Ordemann); Tr. 177-79 (Ordemann); *see also* Ex. ACN-38 at 12 (showing actual deliveries in February 2013 of 272,000 bpd). In addition, Seaway argues that both the current Seaway line and the proposed loop line are 30-inch diameter lines and are thus generally comparable. *See* Ex. SEA-1 at 4; Ex. SEA-39 at 4-5.

131. Seaway argues that the \$1.32 billion estimate for a new Greenfield pipeline could well have exceeded that amount. Staff's witness Kathleen L. Sherman explained, the "risks of delay related to constructing a new pipeline are many, including . . . cost overruns." *See* Ex. S-1 at 7. The Enbridge purchase made the new service available to shippers at a significantly lower cost, while avoiding the risk that the cost of new construction might well exceed the \$1.32 billion estimate.

132. In addition to costing less than new construction, Seaway asserts that the purchase and reversal of the existing pipeline provided substantial benefits to shippers by putting the pipeline in service much earlier than if a new greenfield pipeline had been built. In fact, Mr. Shamla explained that Seaway was placed in southbound service "more than 18 months earlier" than if a new pipeline had been constructed. Ex. SEA-25 at 6. Mr. Wetmore calculated that the value to shippers of having Seaway in service 18 months earlier than new construction was approximately \$1.584 billion. *See* Seaway Br. at 21-22.

133. ACN claims that the monetary benefits to shippers calculated by Mr. Wetmore are not “directly related to the acquisition,” and argues that if all the pipeline had to show was “that its average rate is lower than the price in its destination market, presumably all economically viable pipelines would meet this standard, and [rate base write-ups] would become the rule, rather than the exception.” ACN Initial Br. 20-21 (internal citations and quotation marks omitted).

134. Seaway argues that absent an acquisition that meets the Commission’s two-part test, a pipeline is not permitted to write-up its rate base simply because its shippers are able to obtain a favorable netback from the sale of their volumes and that the shippers have received quantifiable monetary benefits from Seaway providing southbound service 18 months earlier than if new construction had been required.

135. ACN further claims that Mr. Wetmore’s analysis overstates the benefit to shippers because Mr. Wetmore calculates the shippers’ netback using Seaway’s filed rates rather than the maximum just and reasonable rates that Mr. Wetmore calculated Seaway could defend on a cost of service basis. ACN Initial Br. 20.

136. Seaway argues that while it could justify higher uncommitted rates, it has chosen not to charge uncommitted rates at the maximum just and reasonable level. Moreover, the committed rates would remain the same, because they are capped by contract, so the average of the rates that all shippers pay would remain significantly below the maximum just and reasonable uncommitted rate level. Seaway further argues that the differential between crude oil prices at Cushing and the Gulf Coast, which averaged \$15.74 per barrel during the period from June 2012 through January 2013, Ex. SEA-28, is significantly greater than what the average rate would be, whether Seaway’s filed uncommitted rates or maximum just and reasonable uncommitted rates are used. *See* Ex. SEA-3; Ex. SEA-24; Ex. SEA-36.

137. ACN argues that Seaway’s affiliates “own” a certain amount of capacity on the line, such that “any economic benefits associated with service on Seaway will ultimately accrue to Seaway’s owners and affiliates, while the unaffiliated, third-party shippers will pay the price.” ACN Initial Br. 21.

138. Seaway argues that that argument is inconsistent with the facts and fails as a matter of logic. As an initial matter, no shipper “owns” capacity on Seaway, nor does any shipper receive firm service. *See Seaway*, 143 FERC ¶ 61,036 at P 21 n.10.

139. ACN argues that the purchase price adjustment should receive “greater scrutiny” in this case because of the “magnitude” of the price in comparison with the depreciated original cost of the assets. ACN Br. at 13-14. ACN notes that *Enbridge Southern Lights* “did not address the size of the write-up, relative to the net book value of the acquired assets.” ACN Initial Br. 14, n. 53.

140. Seaway asserts that ACN’s argument, which focuses on the percentage increase over net book value, ignores the Commission’s two-part test, which permits the inclusion in rates of a purchase price above net book value where the pipeline is put to a new use and there are benefits to shippers, regardless of whether the purchase price is a penny above net book value or hundreds of millions of dollars above net book value. Seaway argues further that the Commission has previously approved a similarly large rate base adjustment of approximately \$1 billion where the Commission’s two-part test was met. *See Enbridge Southern Lights*, 121 FERC ¶ 61,310 at PP 14, 32-38.

141. ACN further argues that the “significant changes in North American oil and gas markets as a result of recent oil sand and gas shale production developments that have resulted in new flow patterns on existing pipelines should not precipitate or provide cause for new and exorbitant profits to be earned on the transportation network already in place.” ACN Initial Br. 21 (quoting Ex. ACN-1 at 13 (Crowe)) (internal citations and quotation marks omitted).

142. Seaway responds that where an acquisition results in a pipeline being put to a new use that provides benefits to shippers, the purchase price properly is included in rate base and results in the “efficient re-use of . . . currently underutilized infrastructure.” *Enbridge Energy*, 110 FERC ¶ 61,211 at P 32.

Discussion

143. The inability at the present moment to produce an exact dollar amount of savings should not be a factor. The recognition of a significant difference between the two costs without precise dollar quantification is sufficient. *Missouri Interstate Gas, LLC*, Opinion No. 525, 142 FERC ¶ 61,195 at P 61 (2013).

144. Additionally, these savings arise from the much earlier commencement of the level of transportation service from Cushing to the Gulf Coast using the Seaway reversal than would have occurred had the alternative of constructing a new pipeline between the two points been pursued.

Conclusion

145. Accordingly, the Presiding Judge finds that the Seaway reversal satisfies the substantial benefits test.

2) Should the portion of the purchase price attributable to goodwill be included in rate base?

Positions of the Parties

146. Seaway argues that the full purchase price, including goodwill, should be included in rate base because the Commission “has a long-standing policy related to the recovery of acquisition premiums, *including goodwill*, through rates.” *Ameren Corp.*, 140 FERC ¶ 61,034, at P 30 (2012) (emphasis added). Pursuant to that policy, the Commission has explicitly held that, where the applicable standard is met, the “recovery of acquisition premiums *including goodwill* in cost-based rates *is allowed*.” *Id.* (emphasis added).

147. Seaway further argues that established court and Commission precedent makes clear that where the Commission’s two-part test is met, the pipeline is entitled to recover the “*full purchase price* of an acquired asset in its cost-of-service computations.” *Rio Grande*, 178 F.3d at 542 (emphasis added); *Kinder Morgan*, 141 FERC ¶ 61,180 at P 56 (Commission’s two-part test determines “whether to permit a purchased asset to be included in the rate base at the *full purchase price*”) (emphasis added); *Enbridge Southern Lights*, 121 FERC ¶ 61,310 at P 38 (Commission’s two-part test permits the inclusion in rate base of the “*full purchase price*”) (emphasis added) (citations omitted); Opinion No. 525, 142 FERC ¶ 61,195, at P 113 (“Commission has consistently allowed the *full purchase price* in rate base,” where applicable test is satisfied) (emphasis added); *Crossroads Pipeline Co.*, 71 FERC ¶ 61,076, at 61,262 (1995) (approving inclusion of “*entire purchase price*” in rate base) (emphasis added); *Natural Gas Pipeline Co.*, 29 FERC ¶ 61,073, at 61,150 (1984) (permitting pipeline’s share of “*total purchase price*” to be included in rate base) (emphasis added); *Cities Serv. Gas Co.*, 4 FERC ¶ 61,268, at 61,594 (1978) (“appropriate to permit the *entire purchase price* to go into the rate base” (emphasis added)). In short, goodwill may be recovered along with rest of the purchase price where the Commission’s two-part test is met.

148. Staff, ACN, and SCN propose to exclude from rate base the \$627 million portion of the overall purchase price attributed by Enbridge to goodwill for financial accounting

purposes. Staff Br. 32-35.⁴ They claim that the remainder (approximately \$527 million) is the most that is eligible for inclusion in rate base, because, they contend, the \$527 million represents the total “fair market value” of the Seaway assets. Staff Initial Br. 26-27; ACN Initial Br. 22-23; SCN Initial Br. 18.

149. Seaway argues that the “fair market value” of the assets is being confused with the portion of the purchase price attributed by Enbridge to “fair value” for accounting purposes. The \$527 million figure represents Enbridge’s estimate of the “fair value” of the Seaway assets for financial purposes. *See also* Ex. ACN-7 at 1; Ex. ACN-42; Ex. S-3; Ex. SCN-37 at 60-61; Ex. SCN-40 at 4. Enbridge’s \$527 million “fair value” estimate was based on a depreciated replacement cost analysis that Enbridge developed after the acquisition for financial accounting purposes. Ex. SEA-26 at 22-23; Ex. SCN-40 at 12-13; Tr. 375-76; *see also* SCN Initial Br. 18 (acknowledging that the \$527 million figure is “measured as cost of reproduction new less depreciation”). “In other words, Enbridge estimated what it would cost to replace each of the assets in today’s dollars and then depreciated that amount based on the age of the current plant and equipment.” Ex. SEA-26 at 23 (Wetmore); Tr. 365-66 (Wetmore).

150. Seaway witness Mr. Wetmore testified that the depreciated replacement cost of an asset is not necessarily the same as its actual market value. Tr. 445. For example, a homeowner might not be willing to sell if a potential buyer offered to pay only what it would cost to rebuild less depreciation. Tr. 445-46. Seaway argues that the \$527 million attributed by Enbridge to “fair value” for accounting purposes does not represent the full “fair market value” of the assets and that Enbridge would not have been able to purchase the Seaway assets if it had offered to pay only the approximately \$527 million “fair value” depreciated replacement cost estimate. Seaway Witness Mr. Shamlal testified that the \$1.15 billion purchase price was the result of an arm’s-length negotiation between Enbridge and ConocoPhillips, and thus represented the “fair market value” of the interest that Enbridge was acquiring. Ex. SEA-25 at 4. He also testified that, “other pipeline companies (with which [Enbridge was] competing to build a new pipeline from Cushing to the Gulf) would have willingly paid at least [\$1.15 billion] because of the value of being able to convert the existing pipeline to southbound service quickly and at a lower cost than a new pipeline.” *Id.* at 5.

⁴ The \$627 million in goodwill represents the difference between Enbridge’s \$527 million depreciated replacement cost estimate and the “[t]otal acquisition cost” of \$1.164 billion. *See* Exhibit No. SCN-37 at 61. The \$1.164 billion amount includes the \$1.15 billion purchase price plus an adjustment for working capital. *See* Exhibit Nos. SCN-35 at 38; SCN-37.

151. SCN claims that if the full purchase price is included in rate base, “the amount of goodwill passed on in the cost-of-service to ratepayers has no limit, except for the market and the actual purchase price paid.” SCN Br. 16. This speculative allegation ignores the Commission’s two-part test, which permits the full purchase price, including goodwill, to be included in rate base *only if* the acquisition results in a new use and provides benefits to shippers. *See Ameren*, 140 FERC ¶ 61,034 at P 30 (finding “recovery of acquisition premiums including goodwill in cost-based rate is allowed” if the acquisition “provides measurable, demonstrable benefits to ratepayers”); *Id.* at P 33 (“Commission policy does not allow for goodwill in rates absent a showing of ratepayer benefits”). In other words, under the Commission’s two part test, the purchase price and the amount of benefits to shippers set the limit on what can be included in rate base.

152. The portion of the purchase price that may be attributed by the purchaser to goodwill for financial accounting purposes is irrelevant to the Commission’s two-part test, and SCN fails to cite any case in which the Commission has ever considered it as a factor in assessing the adequacy of a purchase price adjustment. Instead, the Commission has made clear that “[a]ccounting does not dictate ratemaking.” *Id.* at P 33 (citations omitted). Since individual company accounting practices can differ based on their own policies and interpretation of accounting guidance, it would not be good policy for the Commission’s two-part test to be dependent on how items are treated for accounting purposes. The Commission’s two-part test therefore appropriately establishes objective and measurable standards for determining whether the purchase price, including goodwill, may be included in rate base.

153. SCN notes that “the presence of goodwill on a utility’s balance sheet does not require that it must or should be included for ratemaking purposes.” SCN Initial Br. 16-17 (quoting *Ameren*, 140 FERC ¶ 61,034 at P 33). That may be true, but it fails to support SCN’s converse position that goodwill must be excluded from the rate base. Rather, the Commission has made clear that where the appropriate standards are met, “recovery of acquisition premiums including goodwill in cost-based rates *is allowed.*” *See Ameren*, 140 FERC ¶ 61,034 at P 30 (emphasis added).

154. SCN further argues that goodwill should be excluded from rate base, because shippers should not have to pay “an intangible cost not directly attributable to an identified asset.” SCN Initial Br. 16. Again, SCN cites no legal support for this claim, which is contrary to Commission precedent that permits the inclusion of the full purchase price, including goodwill, in rate base where the applicable standard is met. *See, e.g., Ameren*, 140 FERC ¶ 61,034 at P 30. Moreover, the reason why it is appropriate to

include the full purchase price, including goodwill, in rate base here is because it benefits shippers. As shown above, if Enbridge had offered to pay only the depreciated replacement cost of the assets and not the full purchase price, the purchase and resulting reversal would not have occurred and shippers would not have obtained the significant benefits provided by the project. Instead, shippers would have had to pay rates based on the cost of new construction, which would have involved significantly higher costs and losses of millions of dollars of revenue through delays in service. The position urged by SCN would therefore be economically inefficient and ultimately harm shippers.

155. SCN argues that the “Commission should not permit the full write up requested by Seaway where Enterprise stands to be unduly advantaged by the write up of an asset at an amount in excess of the fair market value of those assets.” SCN Initial Br. at 18.

156. Seaway argues that it is not attempting to write-up its assets above fair market value, since the full purchase price, including goodwill, represents the fair market value of Enbridge’s share of the assets. Seaway further argues that its rate treatment is conservative in that it values Enterprise’s share at depreciated original cost, rather than as measured by the fair market value of Enbridge’s share.

157. Staff and ACN claim that the Commission has previously held that goodwill may not be included in a pipeline’s rate base. See Staff Br. at 34 (citing *SFPP, L.P.*, 134 FERC ¶ 61,121, at P 179 (2011) (“Opinion No. 511”), *order on reh’g*, 137 FERC ¶ 61,220 (2011) (“Opinion No. 511-A”)); ACN Br. at 22-23 (citing Opinion No. 511, 134 FERC ¶ 61,121 and *Great Plains Energy Inc.*, 121 FERC ¶ 61,069, at P 64 (2007)).

158. Seaway argues that the cases that Staff and ACN rely on, however, simply state the general rule that a purchase price above net book value (including any portion of the purchase price attributable to goodwill) is not permitted to be included in rate base *unless* the Commission’s two-part test is met and that those cases did not purport to establish a different standard for inclusion of the goodwill portion of the purchase price in rate base. Seaway claims that neither of the cited cases involved the question whether any purchase price adjustment should be included in rate base – let alone the portion attributed to goodwill. Opinion No. 511 addressed whether goodwill should be included in calculating the pipeline’s capital structure, with the Commission concluding that the capital structure did not need to be adjusted to remove purchase price adjustments or the portion of the purchase price attributable to goodwill. Opinion No. 511, 134 FERC ¶ 61,121 at PP 150-79. *Great Plains* simply stated the Commission’s normal rules for accounting for asset purchases in the context of its electric utility regulations; it did not involve a request to include a purchase price adjustment in rate base. 121 FERC ¶ 61,069 at PP 48, 59-64.

159. Staff also relies on the Commission's accounting rules, which permit only the cost of tangible property used in carrier service to be included in Account No. 30 ("Carrier property"), while requiring goodwill to be separately recorded in Account No. 40 ("Organization costs and other intangibles").

160. Seaway argues the accounting rules simply set forth the general rule that only the depreciated original cost of pipeline assets be included in rate base. Seaway argues that where the Commission's two-part test is met, a pipeline is permitted to include the full purchase price of the asset, including goodwill, in rate base, notwithstanding Commission accounting policy. *See Minnesota Power & Light*, 43 FERC ¶ 61,104, at 61,342 ("Commission's accounting policy does not preclude full rate recovery [of an] acquisition adjustment," where the applicable test is met).

161. Staff also argues that the Commission's general accounting instructions state that "[t]he excess of the purchase price over amounts includable in the primary carrier property accounts shall be amortized through account 660 'Miscellaneous income charges,' or otherwise disposed of, as the Commission may approve or direct." 18 C.F.R. pt. 352, Instruction 3-11(c)(3)(b) (2013).

162. Seaway argues that instruction simply sets forth the general rules regarding the recordation of purchase price adjustments and that it does not mean that the portion of the purchase price attributable to goodwill cannot be included in rate base or that goodwill only affects "the calculation of income," as Staff suggests. Staff Initial Br. 33. Seaway argues that the instruction makes clear that any acquisition premium may be "disposed of, as the Commission may approve or direct." 18 C.F.R. pt. 352, Instruction 3-11(c)(3)(b).

163. Staff further argues that goodwill is not included in the elements of rate base that a carrier is required to include in a cost-of-service filing. Staff Initial Br. 33 (citing 18 C.F.R. § 346.2(c)(5)).

164. Seaway argues that that regulation simply sets forth the basic rate base elements that a carrier must use to justify cost-of-service rates; it does not prohibit a pipeline from providing additional information or seeking to include an acquisition premium in rate base where the pipeline is able to satisfy the Commission's two-part test. Seaway further argues that Staff fails to reconcile the cases in which the Commission has approved purchase price adjustments with Staff's argument that the Commission's accounting rules only permit the "original cost of jurisdictional assets" to be included in rate base. *See* Staff Br. 33. Staff also claims that it "oppos[es] the inclusion of Goodwill in the

acquisition adjustment,” because, Staff contends, Seaway has not reasonably assigned goodwill between its jurisdictional and non-jurisdictional assets. Staff Initial Br. 34.

165. Seaway argues that it allocated the purchase price, including goodwill, between the Longhaul 30-inch System and Seaway’s two other systems based on the economic value of those assets to Enbridge. Seaway also argues that Staff’s disagreement with Seaway’s allocation method provides no basis for simply excluding the *entire* portion of the purchase price attributable to goodwill from Seaway’s rate base.

166. ACN contends that Seaway did not show that the portion of the purchase price attributable to goodwill “benefits its shippers in any way, nor did it establish that these amounts are related to the provision of jurisdictional service.” ACN Br. 23.

167. Seaway argues that there is overwhelming record evidence demonstrating that the entire purchase price, including the amount attributed by Enbridge to goodwill for accounting purposes, provided substantial benefits to shippers by permitting the reversal of the Seaway pipeline

168. Staff, ACN and SCN further argue that the goodwill portion of the purchase price relates to the economic benefit that Enbridge will derive as a result of future proposed expansions and Seaway’s proposed lease of a portion of its future capacity to Enbridge’s affiliate, Enbridge Pipelines (FSP) LLC (“Enbridge Flanagan South”). ACN Br. 24; Staff Br. 34; SCN Br. 18-21. ACN also speculates that the lease of capacity from Seaway to Enbridge Flanagan South “may unduly discriminate against Seaway’s uncommitted shippers with regard to capacity allocation and other operations.” ACN Initial Br. 24 (emphasis added). ACN provides no record support for this claim, and indeed there is none. In any event, the reasonableness of Seaway’s proposed lease of capacity is not at issue in this case. As the record shows, the capacity lease is not currently in effect, and will not become effective until after the completion of additional construction including the proposed loop line. Tr. 235 (Shamla). In other words, the lease is not expected to take effect until “mid-2014”, *Id.*, which is well beyond the test period in this case.

169. Seaway argues that the entire purchase price should be included in Seaway’s current rate base and no portion should be deferred based on the theory that it relates to solely to future expansions and that there is no basis to exclude the portion of the purchase price attributed by Enbridge to goodwill for accounting purposes as being related solely to future expansions.

170. ACN notes that Opinion No. 511 defined goodwill as “an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized.” ACN Initial Br. 22 (citing Opinion No. 511, 134 FERC ¶ 61,121 at P 154) (internal citations and quotation marks omitted).

171. Seaway argues that it is incorrect to distinguish goodwill from the rest of the purchase price on the ground that goodwill represents *future* economic benefits, while the rest of the purchase price somehow represents only *current* economic benefits. Rather, Seaway argues, the entire purchase price represents the amount that the purchaser paid in anticipation, at the time of the purchase, of receiving future economic benefits. Goodwill is distinguished from the rest of the purchase price, not based on when the economic benefits of the acquired assets are received, but rather because goodwill, instead of being directly assigned to identifiable assets, is not “individually identified and separately recognized.” Opinion No. 511, 134 FERC ¶ 61,121 at P 154 (internal citations and quotation marks omitted); *see also* Ex. SEA-26 at 22 (Wetmore). Seaway argues that, “‘Goodwill’ is an accounting concept [that] represents the excess cost of the acquired company over the sum of the amounts assigned to all identifiable assets acquired and liabilities assumed.” *Ameren*, 140 FERC ¶ 61,034 at n.1. (emphasis added).

172. SCN argues that “*if* the valuation of the goodwill represents incremental revenues from upstream pipelines or other business activities,” then “the inclusion of goodwill amounts [in rate base] would allow Seaway’s owners to recover those benefits twice.” SCN Initial Br. 18-19 (emphasis added).

173. Seaway asserts that SCN’s speculation provides no support for excluding goodwill from Seaway’s rate base because, as Seaway Witness Mr. Wetmore explained, Enbridge’s “determination of how much of the purchase price to attribute to goodwill was not affected by any revenue assumptions, much less assumptions that Seaway would earn revenue from other pipeline projects.” Ex. SEA-26 at 26.

174. SCN claims that “Enbridge’s upstream operations stand to significantly benefit from Enbridge’s ownership in Seaway.” SCN Initial Br. 19.

175. Seaway asserts that the only relevant question is whether Seaway’s *shippers* benefit from the purchase and that the potential for Seaway to benefit other market participants such as upstream pipelines or consumers (*e.g.*, by allowing lower cost crude oil from Cushing to be sold at the Gulf Coast), is irrelevant and provides no reason not to apply the Commission’s two-part test here.

Discussion

176. The inclusion of the Goodwill portion of the purchase price paid by Enbridge is problematic for two reasons. First, as Staff Witness Sherman testified, rate base should only include tangible, depreciable property. The Commission's oil pipeline regulations only permit the inclusion of tangible property costs in the Commission's Uniform System of Accounts Prescribed for Oil Pipelines, Account No. 30, Carrier Property. Since Goodwill is an intangible value attributed subjectively by the purchaser and does not have a direct relationship to the acquired asset's original cost, it is an intangible asset that the Commission requires to be placed only in Account No. 40, Organization costs and other intangibles. The Commission's Instructions for Carrier Property Accounts in its Regulations for Oil Pipelines, 18 C.F. R. § 352, section 3-11(c)(3)(b), *Acquisition by merger, consolidation or purchase, approval of accounting*, provide that, unless otherwise approved or directed by the Commission, the excess of the purchase price over amounts includable in the primary carrier property accounts, such as Goodwill, will be amortized through Account 660, "Miscellaneous income charges." Although accounting does not dictate ratemaking, the treatment for Goodwill required by the Commission's regulations indicates that intangibles, such as Goodwill, should be viewed as only potentially affecting the calculation of income—not rate base.

177. While the annual amortization of an intangible Goodwill amount in Account No. 40 may be included in an oil pipeline's cost-of-service, the Commission has not included Goodwill in the enumeration in 18 C.F.R. § 346.2 (c) (5) of types of costs of depreciable assets included in the calculation of oil pipeline rate bases because it is a non-depreciable intangible. The significance of this difference is that the cost allowance for return is not calculated on a rate base that includes Goodwill. Since Goodwill is unrelated to the original cost of jurisdictional assets, its inclusion in rate base would distort the concept of cost-based rate regulation. The Commission's hearing order indicates that this concept applies in the present proceeding since it required Seaway to justify its proposed rates with cost-of-service data. *Hearing Order* at P 22. As discussed by Staff Witness Sherman, the Commission for this reason has specifically rejected Goodwill from rate base as a type of account adjustments that cannot be permitted for rate making purposes. Ex. S-19 at 10; *SFPP, L.P.*, Opinion No. 511, 134 FERC ¶ 61,121 at P 179, *aff'd on reh'g*, Opinion No. 511-A, 137 FERC ¶ 61,220 (2011) ("These types of accounting adjustments that depart from original cost cannot be permitted to distort rates by being included in the pipeline's asset base").

178. The second reason for opposing the inclusion of Goodwill in the acquisition adjustment is Seaway's attempt to assign the goodwill to its present jurisdictional assets. There is no evidence that Seaway assigned any Goodwill to its non-jurisdictional assets. In addition, while it may be appropriate to include the acquisition adjustment for the fair market value of the jurisdictional assets, it is not appropriate to include an acquisition adjustment for the portion of the purchase price paid for Enbridge's ability to increase its revenues through future Seaway expansions. A portion of the value of the acquisition to Enbridge is associated with its future expansion plans, and it is reasonable to conclude that a portion of the purchase price is likewise associated with those plans. Exh. CAP-1 at 13; Tr. 217:1-219:11.

179. There is no valid basis for Seaway's contention that when the Commission's two-part test is met, the full purchase price, including Goodwill, can be recovered in rates through the inclusion in rate base. Seaway Initial Br. 23. With the exception of *Ameren*, the four decisions that Seaway relies upon do not address Goodwill specifically. *Rio Grande Pipeline Co v. FERC*, 178 F.3rd 533 (1999); *Kinder Morgan Pony Express Pipeline LLC*, 141 FERC ¶ 61,180 (2012); *Ameren Corp.*, 140 FERC ¶ 61,034, *reh'g denied and clarified on other grounds*, 140 FERC ¶ 61,213 (2012); *Enbridge Pipelines (Southern Lights)*, 122 FERC ¶ 61,170 (2008). The decisions in *Rio Grande*, *Kinder Morgan*, and *Enbridge Southern Lights* only provide a generalized rubric of the test for determining whether to give rate treatment for any asset acquisition costs in excess of booked cost and do not specifically address Goodwill as a separate component of acquisition premiums.

180. Moreover, as pointed out in CAPP's Initial Brief at page 5, the *Rio Grande*, *Kinder Morgan* and *Enbridge Southern Lights* decisions are inapplicable here since those cases involved the purchase of an asset and not the purchase of an ownership interest. Enbridge did not purchase an asset owned by another company based on the asset's value in serving customers currently. Rather, it purchased a 50 percent ownership interest in Seaway, paying an amount for Goodwill based on speculation of potential financial rewards in the future that Seaway seeks to have current ratepayers finance.

181. The *Ameren* decision also does not support Seaway's position. *Ameren* does address Goodwill, but only for purposes of capital structure accounting—not for rate base treatment. In the *Ameren* proceeding, Ameren did not include Goodwill in rate base or the cost of service. 140 FERC ¶ 61,034, at PP 25, 32. Moreover, the Commission denied any rate treatment for all acquisition premiums and Goodwill recorded by Ameren that affected Ameren's rates and required its formula rate billings adjusted with refunds as appropriate. *Id.* at PP 39, 40, and Ordering Paragraph B.

182. Seaway asserts that a depreciated replacement cost analysis fails to capture the true cost of the Enbridge purchase because that cost is not necessarily the same as its actual market value. Seaway Initial Br. 24. That assertion is erroneous because the “true cost” of the Enbridge purchase is for the 50 percent interest in Seaway as a company that is part of a network of pipelines that is anticipated to generate revenues in the future, and not limited to the value of assets that Seaway currently uses to serve customers. Further, Seaway’s reference to *actual market value* is inappropriately aligned with its efforts to charge market-based rates that the Commission denied rather than pursuing the establishment of appropriate cost-based rates in the instant proceeding.

183. Enbridge did not invest in Seaway solely for the physical assets that currently benefit Seaway’s customers. The Goodwill represents the more important expectation of significantly greater revenues from future expansions of Seaway and interconnected other projects in which Enbridge has a financial interest. As pointed out in SCN’s Initial Brief at page 19, Enbridge’s other pipelines that deliver crude into Cushing, Oklahoma, in particular the Flanagan South and Gulf Coast Access projects, will be able to proceed as a result of Enbridge’s interest in Seaway. Tr. 208:4-18 (Shamla). The plan by Enbridge and Enterprise since November 16, 2011, has been to loop the Seaway pipeline by mid-2014 to raise its capacity to 850,000 barrels per day and thereby financially benefit from the expansions of the Flanagan South and Gulf Coast Access projects. Tr. 216:22-219-15 (Shamla); Ex. SCN-68 at 11. The Goodwill here is an intangible which represents an expectation of future revenues from future expansions, and not the focus in this cost-based rate case on the current value of the acquired assets to current ratepayers. As discussed in Staff’s Initial Brief at page 34, the Commission regards Goodwill as an accounting adjustment that departs from original cost and should not be permitted to distort rates by being included in a pipeline’s asset base. *SFPP, L.P.*, Opinion No. 511, 134 FERC ¶ 61,121 at P 179, *aff’d on reh’g*, Opinion No. 511-A, 137 FERC ¶ 61,220 (2011). Goodwill in certain cases may be appropriate to reflect in financial accounting reports, but Goodwill should have no place in the instant rate-making proceeding.

Conclusion

184. The goodwill portion of the purchase price represents Enbridge’s calculation of the future value associated with the acquisition, beyond the value of the current assets. As such, it should be excluded from the acquisition adjustment in rate base.

3) What portion of the purchase price should be attributed to the Longhaul 30-inch System and what portion should be attributed to the other assets?

Positions of the Parties

185. Seaway argues that of the total \$1.15 billion purchase price, \$1.095 billion is properly attributed to the Longhaul 30-inch System, and \$55 million is properly attributed to the other two systems that Enbridge acquired from ConocoPhillips, based on the relative economic value of those assets. *See* Seaway Initial Br. 25-26.

186. SCN and ACN first exclude \$627 million from the purchase price related to goodwill. They then propose to allocate the remaining \$527 million among the three Seaway systems based on the “fair value” attributed to each system by Enbridge for accounting purposes. Staff Initial Br. 26-28, 35; ACN Initial Br. 27; SCN Initial Br. 22. Using that approach, Staff and ACN assign approximately \$331 million to the Longhaul 30-inch System and approximately \$196 million to the other two systems. Staff Initial Br. 35; ACN Initial Br. 27; *see also* Ex. ACN-42. SCN divides the assets among the systems somewhat differently and recommends allocating approximately \$349 million to the Longhaul 30-inch System and approximately \$178 million to the other two systems. SCN Initial Br. 22.

187. Seaway argues that in Opinion No. 525, the Commission explained that if various “assets are purchased together,” the purchaser cannot simply “allocate the purchase price in any manner it chooses;” however, “there are a number of reasonable ways to allocate the purchase price, including a cost per mile allocation or a fair market value approach.” 142 FERC ¶ 61,195 at P 78. Here, Seaway allocated the purchase price to the three systems based on their relative economic value. *See* Ex. SEA-26 at 26-27; Ex. SEA-25 at 5; Ex. SCN-43. Seaway asserts that that approach is consistent with a fair market value approach as referenced in Opinion 525 and is otherwise reasonable as discussed below.

188. ACN claims that Opinion No. 525 supports allocating the purchase price based on “fair value.” ACN Br. 27.

189. Seaway asserts that ACN confuses “fair value” and “fair market value.” The “fair value” figures that Enbridge derived for accounting purposes are based on an estimate of the depreciated replacement cost of the assets, which does not represent the true “fair market value” of those assets. Seaway argues that the other participants’ proposal to allocate the purchase price based on “fair value” therefore fails to capture the true

economic value of the three systems and does not attribute the appropriate level of costs to the appropriate shippers. *See* Ex. SEA-26 at 27 (Wetmore).

190. Seaway asserts that the general goal with any type of allocation is to “align cost allocation with cost causation.” Opinion No. 522, 140 FERC ¶ 61,220 at P 100; *see also* Opinion No. 511-A, 137 FERC ¶ 61,220 at P 79. In other words, the Commission “compar[es] the costs assessed against a party to the burdens imposed or benefits drawn by that party.” *Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361, 1368 (D.C. Cir. 2004). Since the primary reason why Enbridge acquired Seaway was to reverse the Longhaul 30-inch System Seaway argues that it is reasonable to attribute \$1.095 billion of the purchase price to the Longhaul 30-inch System, since it was the assets associated with that system on which Enbridge “focused [its] whole attention” during the acquisition. Tr. 232-33.

191. Staff and ACN propose to attribute only 29% of the purchase price to the Longhaul 30-inch System (331 million / 1,150 million = 0.29). *See* Staff Initial Br. at 27, 35; ACN Initial Br. 27. SCN would assign only 30% (349 million / 1,150 million = 0.30). SCN Initial Br. 22.

192. Seaway argues that those proposals are not reasonable, since it was the reversal of the Longhaul 30-inch System that caused Enbridge to incur the costs necessary to purchase its share of Seaway and because those allocation proposals are based on the lower total rate base that these parties advocate because of their proposed disallowance of goodwill. Seaway argues that even if the Commission were to assign the full purchase price to the Longhaul 30-inch System except for the approximately \$178 million or \$196 million that the other participants allocate to the other two systems, *see* SCN Initial Br. at 22; ACN Initial Br. 26; Staff Initial Br. at 27; Ex. ACN-42, (*i.e.*, a total of approximately \$972 million or \$954 million), that would still fail to attribute to the Longhaul 30-inch System the full costs that were necessary to permit the reversal, which provides the significant benefits to the shippers on that system.

193. SCN argues that no “support was provided” for Seaway’s proposed allocation “[o]ther than Mr. Shamla’s opinion and intuition that \$55 million seemed like an appropriate figure.” SCN Initial Br. 23.

194. Seaway argues that the record establishes that Seaway’s purchase price allocation was “[b]ased on an analysis of the revenues projected to be derived from the other [two systems] relative to the overall revenues to be derived from the Seaway assets as a whole.” Ex. SEA-25 at 5. The back-up for that revenue analysis was provided in

discovery and included as an exhibit with SCN's own pre-filed testimony. Ex. SCN-43. At hearing, Mr. Shamla further explained that the allocation was reasonable, since the focus of the purchase was on the Longhaul 30-inch System. Tr. at 323-33 (Shamla).

195. Seaway also argues the reasonableness of the amount of the purchase price attributed by Enbridge to the other assets was confirmed by two studies performed by Seaway witness Mr. Wetmore. See Ex. SEA-26 at 27-29. First, as shown in Exhibit No. SEA-29, Enbridge's share of the other assets had an original cost net book value at the time of the purchase of \$56.6 million, which is virtually identical to the \$55.1 million valuation calculated by Enbridge. As Mr. Wetmore testified:

Since it is the purchase and reversal of the Longhaul 30-inch System that results in the new use and benefits to shippers, it is reasonable that the entire acquisition premium (*i.e.*, the portion of the purchase price above net book value) should be attributed to the Longhaul 30-inch System, and that the portion of the purchase price attributable to the other assets should equal the net book value of Enbridge's share of the other assets.

Ex. SEA-26 at 27-28.

196. Seaway argues that ACN objects to assigning the entire acquisition premium to the Longhaul 30-inch System, Seaway Initial Br. at 25-26, but fails to explain why any portion of the acquisition premium should be attributed to the other systems, when the benefits of the purchase are realized by the shippers on the Longhaul 30-inch System. According to Seaway, ACN would prefer to shift the costs of the acquisition to shippers on the other Seaway systems, but that would be neither fair nor consistent with the rate design goal of aligning cost allocation with cost causation.

197. Seaway also argues that Mr. Wetmore developed a discounted cash flow analysis to assess the maximum economic value that Enbridge could have reasonably attributed to the other assets based on the cost and revenue assumptions related to those assets at the time of the purchase. Ex. SEA-26 at 28-29. In performing that calculation, Mr. Wetmore used the same cost and revenue assumptions contained in the analysis described in Mr. Shamla's testimony. However, instead of calculating the economic value of the other assets as a percentage of the economic value of the purchased assets in total, he analyzed the value of the other assets on a stand-alone basis without making any cost or revenue assumptions related to the Longhaul 30-inch System assets that are at issue in this case. Mr. Wetmore also used an 8.76% discount rate, which is the nominal weighted average cost of capital recommended by Seaway's witness Bruce H. Fairchild. See Ex. SEA-15

at 5. According to Seaway, as shown in Ex. SEA-30, Mr. Wetmore's discounted cash flow analysis establishes that Enbridge could have reasonably attributed a maximum economic value of \$98 million to the other assets on a stand-alone basis. While that analysis calculates an economic value greater than the \$55 million value that Enbridge attributed to the other assets, Mr. Wetmore explained that his analysis "does not reflect any discount that Enbridge may have been able to negotiate with ConocoPhillips for the purchase." Ex. SEA-26 at 28. Seaway argues that the \$98 million therefore is conservative and reflects the *maximum* amount of the purchase price that could reasonably be attributed to the other assets under this alternative analysis. *Id.* at 28-29.

Discussion

198. The only portion of the purchase price paid by Enbridge for its share of Seaway that should be attributed to the Longhaul 30-inch System is in the amount of \$331,351,000 as developed in Ex. ACN-42. The \$1.095 billion attributed by Seaway to the Longhaul 30-inch System should be rejected because it includes Goodwill and non-jurisdictional assets identified in Ex. ACN-42 that should be excluded from rate base.

199. Seaway failed to remove all the non-jurisdictional assets from rate base. The non-jurisdictional assets were included in the total price of \$1.5 billion paid by Enbridge to ConocoPhillips for its interest in Seaway. Ex. SEA-25 at 4:17-19. Seaway's witness Shamla estimated at \$55,081,731 the value of the other assets included in the purchase that are not related to the assets used in Seaway's Longhaul 30-inch System. These other assets include the Freeport System and the Texas City System, which includes facilities serving Galena Park and nearby locations. Ex. SEA-25 at 5:1-7; Ex. SEA-2. These other assets provide only intrastate service and are non-jurisdictional. Tr. 139:2-5 (Ordemann); Tr. 300:3-6 (Wetmore). Mr. Shamla's estimated value of these other assets is based not on booked costs but on an allocation of revenues derived from all the Seaway assets. Ex. SEA-25 at 5:7-12. The portion of Enbridge's purchase that Seaway seeks to include in rate base, \$1,094,918,269, is the result of subtracting Mr. Shamla's estimated value of the other assets of \$55,081,731 from the \$1.15 billion total price paid by Enbridge. *Id.*

200. Seaway admits that allocating only \$55,081,731 to the other non-jurisdictional Seaway assets in which Enbridge acquired an interest is inadequate. Seaway claims in its Initial Brief at page 27 that a calculation by Seaway's Witness Wetmore in Exhibit No. SEA-30 shows that Enbridge could have reasonably attributed \$98 million to the other non-jurisdictional assets on a stand-alone basis.

201. In continuing to insist that the value of the other non-jurisdictional assets is only \$55,081,731, Seaway ignores the testimony on cross-examination of its Witnesses Wetmore and Ordemann. They identified other assets that should have been excluded from the valuation of Enbridge's share of the Longhaul 30-inch pipeline provided by Seaway to Staff and shown in Exhibit Nos. S-3 (Highly Confidential) and ACN-7 (Protected). Tr. 139:2-5 (Ordemann); Tr. 300:3-6 (Wetmore).

202. Based on this testimony, Staff and ACN correctly recalculated the amounts of non-jurisdictional assets that should be deducted from the total Enbridge acquisition cost. The proper amounts for the Texas City System, Freeport System, and Galena Park are shown in the resulting stipulation between Staff and ACN, Ex. ACN-42 at 1, paragraph 1 and total \$196,059,000.

Conclusion

203. The correct amount of Carrier Property in Service necessary to develop the proper amount of rate base is \$196,059,000 and should be deducted from Seaway's fair market value of the Longhaul 30-inch System (excluding Goodwill). The Carrier Property in Service for the Longhaul 30-inch pipeline in the amount of \$331,351,000 should be used to calculate the test period trended original cost rate bases for Seaway's pre- and post-expansion rates.

- 4) If the purchase price is included in rate base, should a portion of that amount be allocated to the expansion capacity and services of the pipeline?**

Positions of the Parties

204. Seaway argues that the full purchase price should be included in Seaway's rate base.

205. CAPP contends that the Enbridge purchase price should be "allocated between the original capacity and the 2013 expansion capacity." CAPP Initial Br. 14 (citing Ex. CAP-1 at 11 (Pinney)); *id.* at 18. In applying that approach, CAPP proposes to allocate the purchase price based on the ratio of Seaway's projected initial capacity of approximately 135,000 bpd to CAPP's witness Mark Pinney's projection of 400,000 bpd capacity after 2012. *Id.* at 18 (citing Ex. CAP-1 at 16 (Pinney)). CAPP therefore proposes to include only approximately 34 percent of Enbridge's purchase price in rate base in calculating Seaway's initial rates. *See* Ex. CAP-2, Workpaper 4, line 6.

206. According to Seaway, CAPP's proposal is inconsistent with the Commission's two-part test and would fail to give Seaway an opportunity to recover its costs. The full purchase price was necessary to permit the reversal that began providing significant benefits to shippers in May 2012. *See* Ex. SEA-25 at 2-6. Indeed, the Longhaul 30-inch System was operating at full capacity during that period. Ex. SEA-39 at 3. The capacity of the line was expanded in January 2013, but additional capital was required to make that expansion possible. *See* Ex. SEA-42, line 1. Seaway argues that the record evidence fully supports inclusion of the entire purchase price in rate base for purposes of calculating initial rates and that 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 to earn a return on its full rate base during the period its assets are in service, as is the case here. *See Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679, 692 (1923) (regulated entity "entitled . . . to earn a return on the value of property which it employs for the convenience of the public").

207. CAPP claims that its approach "alone allocates [the acquisition] costs to the expansion capacity," while suggesting that Seaway's method allocates "the entirety of the [acquisition costs] to the limited capacity of the Seaway line as of the point in time at which the initial reversal was initiated." CAPP Initial Br. 17, 20.

208. Seaway argues that by including the full purchase price in rate base when the reversed Seaway initiated service, Seaway ensures that all shippers that use the new north-to-south service pay their fair share of the capital costs. In other words, there is no need to allocate costs between different periods as CAPP proposes, because the Commission's normal ratemaking procedures already spread the capital costs out (through depreciation and return on any undepreciated rate base) among the various shippers that use a pipeline during the period when the assets are in service. Seaway claims that CAPP's proposal, by contrast, would fail to allow the pipeline to recover its costs, since it would delay recovery of a significant portion of Seaway's rate base, and potentially allow shippers during the initial period to improperly shift costs to shippers in later periods. Indeed, the cost-shifting advocated by CAPP would be particularly inequitable in this case, since the shippers in the initial period benefited from the early start-up of Seaway (relative to a newly built pipeline) to a *greater*, not a lesser, extent than shippers that will use the service later. *See* Ex. SEA-26 at 30-31 (Wetmore).

209. Seaway also argues that the factual premise for CAPP's proposal – that commencing in 2013 the capacity increased to 400,000 bpd – is contrary to record evidence. As Mr. Ordemann explained, even after the completion of the January 2013 expansion, Seaway is not "able to move 400,000 bpd on the Longhaul 30-inch System

and does not expect to be able to achieve that level of throughput anytime in the foreseeable future, given the anticipated mix of light and heavy crude oil.” Ex. SEA-39 at 4; *see also* Ex. ACN-38 at 12; Tr. 130, 179 (Ordemann). Seaway asserts that that further highlights the impracticality and unfairness of using Mr. Pinney’s proposal for ratemaking purposes. Future volume levels cannot be predicted with precision, and expectations of future throughput levels are not always realized. It is not reasonable to deny a pipeline the ability to earn a return on property currently in service for any reason, much less based solely on assumptions regarding future volume levels that turn out to be incorrect.

210. Seaway claims that CAPP’s proposal also fails to address what would happen to the portion of the purchase price that it would exclude from carrier property in service for purposes of calculating the initial rates because the portion of the purchase price not included in carrier property in service would need to be retained in construction work in progress (“CWIP”) and used to calculate AFUDC until the balance is placed in service. *See* Ex. SEA-26 at 30 (Wetmore). Seaway asserts that this “would mean that the shippers that are currently enjoying the benefit of Seaway’s early in-service date would shift the costs they should be bearing onto a later group of shippers that did not pay for service in the initial rate period and therefore did not receive that benefit.” *Id.* Seaway asserts that CAPP’s proposal thus constitutes inappropriate inter-generational cost shifting and fails to align costs with the shippers that benefit from those costs.

Conclusion

211. If the Commission determines to allow the portion of the Enbridge purchase price identified in Exhibit No. ACN-42 that is properly attributable to the Longhaul 30-inch System (\$331,351,000) in the calculation of rates, they should be allocated to both the seven-month initial (135,000bpd), from June 2012 through December 2012 and the five month post-expansion period (295,000bpd), from January 2013 through May 2013. Enbridge explicitly and publicly stated its intention to use the asset for both time periods in connection with its agreement to the purchase price. Moreover, Enbridge intends to make use of the expansion, underscoring the need to allocate an appropriate share of costs to that capacity and the services rendered through the expansion.

- 4. What are the appropriate cost allowances to be included in the cost of service?**
- A. What is the appropriate allowance for funds used during construction (AFUDC)**

Positions of the Parties

212. Seaway calculated AFUDC with respect to the cost of capital associated with three categories of plant prior to it being placed into service: (1) the applicable portion of Enbridge's acquisition costs related to its fifty percent share of Seaway; (2) the depreciated original cost value of Enterprise's fifty percent share of Seaway; and (3) the incremental carrier property additions required for the pipeline reversal project. *See* Ex. SEA-22 at 10; Ex. SEA-26 at 32.

213. ACN contends that Seaway should only be permitted to accrue AFUDC on its "investment in actual new incremental plant under construction." Seaway's proposal to accrue AFUDC on both Enterprise's share of Seaway's existing pipeline facilities, and the proposed \$1.1 billion write-up for Enbridge's purchase of its interest in Seaway, should be rejected. Ex. ACN-1 at 16:19-17:9

214. Staff's contends that AFUDC should include only costs related to construction. Seaway's proposed AFUDC allowance inappropriately includes Enbridge's cost of acquiring an ownership interest in Seaway that does not qualify as a cost that is related to construction. Accordingly, Seaway's proposed allowance should be rejected. The appropriate amounts of AFUDC are shown in Staff Exhibit Nos. S-21 (pre-expansion) and S-22 (post-expansion), page 10.

Discussion

215. AFUDC is transferred to rate base at the same time the associated CWIP balance is transferred to carrier property in service. Ex. SEA-22 at 9:22-10:1.

216. The Commission's *Arco* decision establishes that AFUDC should include only the cost of capital incurred during construction by a pipeline with respect to assets prior to their inclusion in rate base. *ARCO Pipe Line Co.*, 52 FERC ¶ 61,055, at 61,234, *aff'd in part and modified on other grounds*, 53 FERC ¶ 61,398 (1990). Contrary to Mr. Wetmore's contentions in Exhibit No. SEA 26 at 33-34, a close reading of the following excerpt demonstrates that the *Arco* decision contemplates inclusion in AFUDC of the cost

of capital incurred during construction of a pipeline rather than the acquisition cost of acquiring an existing pipeline:

AFUDC or allowance for funds used during construction represents the cost of capital incurred by a pipeline with respect to assets prior to their inclusion in rate base. AFUDC consists of two components. The first is the cost of equity capital. The second is the cost of debt capital known as interest *during construction*. The ICC permitted oil pipelines to capitalize interest *during construction* and add the capitalized amount to rate base. The ICC did not permit the capitalization into rate base of equity used during construction. This Commission permits the capitalization of AFUDC (i.e. both interest and equity) into rate base.

Id. (emphasis added).

217. Enbridge's investment costs during the period prior to start-up are related to acquisition rather than construction. Seaway asserts that Enbridge's acquisition costs were essential in order to effectuate the flow reversal to the benefit of the shippers because the prior fifty percent interest holder (ConocoPhillips) was not amenable to the reversal. Seaway Reply Br. 70; Ex. SEA-25 at 3-5. The purported necessity of Enbridge's acquisition costs for the reversal of the pipeline does not render those acquisition costs tantamount to construction costs. Nor does Seaway's assertion that the acquisition costs were incurred for the benefit of the shippers because the AFUDC associated with the Enbridge purchase is significantly less than what the AFUDC would have been if a greenfield pipeline from Cushing to the Gulf Coast had been constructed, Seaway Reply Br. 71, justify inclusion of acquisition costs in AFUDC.

218. The pipeline reversal required the pipeline to be taken out of service for a few months, during which time Enterprise was not able to earn a return on its invested capital. Ex. SEA-1 at 5 (Ordemann); Tr. 104-05 (Ordemann). In order to recover that investment, Seaway included in its rate base \$59 million in AFUDC related to the limited period in March and April of 2012, when the pipeline was taken out of service to execute the reversal.

219. ACN erroneously asserts that Seaway's proposal to accrue AFUDC would permit it to double-recover AFUDC because Seaway has already recovered AFUDC on, and been compensated for its investment in, the existing pipeline assets through its rates charged for south-to-north service since the pipeline originally went into service. ACN

Initial Br. 30. The Presiding Judge finds persuasive Seaway's response that any AFUDC included in Seaway's rates for the prior south-to-north service would have been for the costs incurred during the original construction period. The reversal constitutes a new service for which a new construction period was required. That new construction period ensued during March and April of 2012. In calculating rates in this case, Seaway "did not include any AFUDC associated with the original pipeline in Seaway's rate base." Ex. SEA-26 at 36. Instead, the AFUDC included in Seaway's rate base with respect to Enterprise's share of Seaway, relates to the limited two-month period in March and April of 2012, when the pipeline was taken out of service to prepare for the reversal and Enterprise consequently was not able to earn a return on its invested capital. Ex. SEA-24, Statement F1 & Workpaper 6; Ex. SEA-1 at 5; Tr. 104-05 (Ordemann).

220. No party to this proceeding contests Seaway's claim that its incremental carrier property additions required for the pipeline reversal project should be included in AFUDC.

Conclusion

221. The Presiding Judge finds that Seaway should be permitted to include in its AFUDC (1) \$59 million for Enterprise's fifty percent share of Seaway which was removed from service during construction and (2) its incremental carrier property additions required for the pipeline reversal project. Seaway should not be permitted to include Enbridge's acquisition costs in AFUDC.

B. What is the Appropriate Level of Operating Expense?

Positions of the Parties

222. Seaway states that the appropriate level of operating expenses, excluding depreciation, for the test period is approximately \$20.3 million. Ex. SEA-24, Statement B, Workpaper 8. According to Seaway, the Commission's regulations provide that a pipeline establishing an initial rate for a new service should use a test period consisting of a twelve-month projection of costs. 18 C.F.R. § 346.2(a)(3).

223. ACN avers that Seaway's proposal to include in rates its cost projections for the period June 2012 through December 2012 is inconsistent with the Commission's test period ratemaking regulations and policies, overly subjective and arbitrary, and overstates Seaway's operation and maintenance expenses (O&M). Moreover, ACN contends that Seaway's allocation of administrative and general (A&G) costs to the 30-Inch Longhaul

System is flawed. Seaway's O&M expenses should reflect objective, actual cost data for a twelve-month period, and its a&G expenses should be allocated among Seaway's jurisdictional and non-jurisdictional services in a manner that is consistent with Commission precedent.

224. Staff contends that the amount of O&M and A&G for the pre- and post-expansion periods contained in Staff's filed testimony is shown on line 19, Statement B, page 3 of Ex. S-21 (\$10,966,000 pre-expansion); Ex. S-22 (\$13,518,000 post-expansion). Staff Witness Sherman calculated the O&M and General Expenses amounts by annualizing the actual O&M and General Expenses for the period June 2012 through September 2012 provided by Seaway. Ex. S-20; Ex. S-21 at 18; Ex. S-22 at 18.

Discussion

225. The Commission has demonstrated a strong preference for using actual cost data, when it is available, in lieu of projections. *See, e.g.*, Opinion No. 511, 134 FERC ¶ 61,121 at PP 28-29; *Transcontinental Gas Pipe Line Corp.*, 11 FPC 94, 106 (1952) (rejecting estimates of costs as based on speculation, and requiring claimed costs to be based on actual costs); *Williston Basin Interstate Pipeline Company*, 76 FERC ¶ 61,066, at 61,384 (1996) (noting that the Commission has found that actual costs during the test period generally reflect the best evidence of what a company can expect to incur in the future).

226. Seaway's proposed \$20.3 million allowance for O&M and A&G expenses erroneously relies on projected costs that had not been adjusted to conform to actual operating experience. Seaway based its O&M and A&G expenses only on budgeted costs that were projections for Seaway's initial operation period from June 2012 through December 2012 made before commencement of actual operations. However, the Commission prefers the use of actual test period data wherever possible. *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260, at P 321 (2002), *reh'g denied*, 102 FERC ¶ 61,310 (2003) ("The Commission prefers to use actual test period data if possible as that method is in keeping with its regulations and precedent").

227. The Presiding Judge finds that Staff's methodology of annualizing Seaway's actual cost data from June 2012 to September 2012 to determine O&M and A&G expenses conforms to the Commission's stated preference in *Enbridge Pipelines*, notwithstanding the specific errors attributed to Staff's calculations in the discussion below. In arriving at this finding, the Presiding Judge gives due consideration to Seaway's recent annualization of actual June 2012 through January 2013 expenses in

Exhibit No. SEA-34, and chooses not to disregard the exhibit as a “moving target” as suggested by Staff. However, Staff identifies several erroneous calculations in Exhibit No. SEA-34 that render it unreliable.

228. Exhibit No. SEA-34 reflects excessive O&M and A&G costs allocated to the Longhaul 30-inch System using plant ratios that are inappropriate. Those ratios are too high because they were calculated erroneously by including the full Enbridge purchase premium including Goodwill, and non-jurisdictional facilities identified in Exhibit No. ACN-42 that should be eliminated. Staff Reply Br. at 18-19; Tr. 410:13-413:1; Ex. ACN-36 at 5. As discussed in Issue 3(B), Seaway’s failure to satisfy its burden to prove that Enbridge’s acquisition was an arms-length transaction which benefits Seaway’s current shippers prohibits recovery of Enbridge’s acquisition premium including good will.

229. Exhibit No. SEA-34 also improperly includes \$1,668.00 of non-recurring Seminole Remediation expenses. Staff Witness Sherman provided specific evidence to support the elimination of that expense in Exhibit No. S-18, page 3, showing that remedial actions at the Seminole site have been completed to the extent practicable: “[r]emediation and Final Closure/Landowner Agreements: Remedial actions to remediate affected groundwater and recover phase-separated Hydrocarbon (PSH) at this crude oil release site (discovered during 2002) have been completed to the extent practicable.” Seaway’s Witness Wetmore disagrees with this decision and attempts to support the inclusion of these costs based on his generalized claim that remediation expenses resulting from oil releases are normal and recurring in the oil pipeline industry. Ex. SEA-26 at 48:13-14. The Presiding Judge finds the testimony of Witness Sherman more credible as to the Seminole Remediation expense because it is supported by evidence on the record. Thus, this non-recurring expense should be eliminated from the cost-of-service.

230. Staff also contends that Exhibit No. SEA-34 erroneously adds \$1.410 million of Fulshear Junction Remediation costs. Staff Reply Br. 19 (citing Ex No. SEA-34, fn.2; Staff Initial Br. 42). Staff proposes to normalize the \$1.344 million of Fulshear Junction Remediation costs actually incurred during the period from June 2012 through September 2012, by amortizing it over the three-year period the project was originally expected to be in effect. *See* Ex. S-17 at 10; Ex. S-21 at 18. Thus, Staff proposes to include \$448,000 in Seaway’s cost of service. *Id.*

231. Seaway does not object to normalizing the costs related to this project; however, as Mr. Wetmore explained, in order to correctly amortize the full costs of the project,

Staff's proposal should be adjusted to include the additional \$1.410 million related to the project expenses that Seaway reported in December 2012. Seaway Reply Br. 79 (citing Ex. SEA-26 at 49; Ex. SEA-35.) Staff suggests that the \$1.410 million "may" be duplicative of the \$1.344 million already included in Staff's calculations. Staff Initial Br. 41. However, Staff's proposal only includes costs actually reported during June 2012 through September 2012. See Ex. SEA-34; Ex. SEA-35. Again, the Presiding Judge gives due consideration to Exhibit Nos. SEA-34 and 35, which make clear that the \$1.410 million reflects an additional amount that was not reported until December 2012. Moreover, Mr. Wetmore testified that the \$1.410 million represents "additional" costs beyond the original \$1.344 million, and set forth the total \$2.754 million amount in Ex. SEA-34.

232. Staff further argues that if the \$1.410 million is included, the costs should be amortized over a four-year period rather than a three-year period. Staff Br. 42 (noting that the project is now expected to take four years). Even if a four-year amortization period were adopted, this would not decrease the Fulshear Junction Remediation expense allowance as Staff suggests at page 42 of its Initial Brief. Instead, if the full \$2.754 million related to the project were amortized over four years, the result would be approximately \$688,000, as opposed to the \$448,000 included by Staff.

233. Per Staff's Brief on Remand, it recommends that Seaway's claimed actual 2012 *ad valorem* property tax expense of \$1.48 million as reflected in Exhibit No. SEA-39 at page 3 be adopted in this case. The 2012 *ad valorem* taxes claimed by Seaway are thus not subject to challenge in this proceeding.

234. Additionally, Staff proposes that its post-expansion allowance for fuel and power costs also should be approved without adjusting for Seaway's projected increase of those costs in 2013. Staff Initial Br. 39. Seaway Witness Ordemann states that the February 2013 through May 2013 fuel and power costs related to the Longhaul 30-inch System are anticipated to be \$5.1 million. Ex. SEA-39 at 5:8-10. This amount would be approximately \$17 million annualized. According to Staff, Mr. Ordemann provided no invoices or other information to justify the use of his projected \$5.1 million for developing rates in this proceeding. Staff Initial Br. 39. Staff further contends that since Mr. Ordemann's testimony was filed before the development of Exhibit No. ACN-42 that identifies non-jurisdictional facilities previously included in the Longhaul 30-inch assets that should be eliminated, the \$5.1 million may not be properly allocated to the operation of only Seaway's jurisdictional facilities.

235. Staff provides a full explanation of the calculation of post-expansion fuel and power allowance of approximately \$3.1 million. Staff’s fuel and power allowance calculation is based on annualizing Seaway’s actual fuel and power expenses during the period from June 2012 through September 2012 (the fuel and power expense for the pre-expansion period rate calculation) increased by multiplying that number by the ratio of the increased post-expansion period capacity to the pre-expansion capacity (400,000/135,000). Ex. S-22 at 3, line 4, n. 1.

236. Staff’s calculation must be adjusted, however, to comply with the Presiding Judge’s finding that Seaway’s post-expansion period rates are to be based on 295,000 bpd capacity. Seaway’s actual fuel and power expenses during the test period should thus be increased by multiplying that number by a ratio of 295,000/135,000. The result of that adjustment is demonstrated in the table below.

Reference
S-22 Workpaper #8, page 18, line 4.

AMOUNTS PERIOD	MULTIPLIER	ANNUALIZED		
4 months of actual				
\$ 349,555.00	3	\$1,048,665.00		
Staff adjustment				In “000’s”
400,000/135,000	2.9630	\$3,107,155.56		\$3,107
ID adjustment				
295,000/135,000	2.1852	\$2,291,527.22		\$2292
			ID difference from Staff	\$815

Conclusion on Remand

237. The Presiding Judge finds appropriate Staff’s method of calculating pre- and post-expansion period operating expenses based on a test period from June 2012 to September 2012.

238. The Presiding Judge finds that Seaway should be prohibited from recovering costs associated with Enbridge's acquisition premium and goodwill.

239. The Presiding Judge finds that Seaway's non-recurring Seminole Remediation Expenses should not be included in operating expenses.

240. The Presiding Judge finds that the Fulshear Junction Remediation Expense equals \$2.754 million amortized over four years resulting in 2013 costs of approximately \$688,000.

241. The Presiding Judge finds Seaway's projected *ad valorem* taxes for 2013 should be rejected.

242. The Presiding Judge finds that Seaway's post-expansion fuel and power allowance should be increased by multiplying Seaway's actual fuel and power expenses for the test period by the ratio of 295,000/135,000.

C. What is the Appropriate Level of Depreciation Expense?

243. The allowance for depreciation expenses in a cost-of-service rate case normally involves two components, the expense for depreciation and the expense for negative salvage, or, in this case, an estimation of the expense for Dismantlement, Removal and Restoration (DR&R). The annual depreciation percentage or rate is derived by dividing the average remaining life (ARL) of the jurisdictional facilities into the percentage of the gross plant left to be depreciated. Ex. S-7 at 14:12-13. The ARL is derived using survivor curves that predict future plant retirements. These curves are truncated at the estimated remaining economic life of plant in each plant account. Ex. S-7 at 31:1-6. DR&R is a cost that will be incurred in the future for dismantlement and removal of facilities and restoration of the removal areas. Its inclusion in rates is essentially an early payment by current ratepayers to ensure their fair contribution toward this future expense. Ex. S-7 at 37:3-5, 42:20.

244. SCN and Seaway disagree on what is the appropriate ARL for Seaway's Longhaul 30-inch pipeline, and, consequently, on the appropriate depreciation rate. SCN, Seaway, and Staff disagree on the appropriate DR&R expense.

1) What is the Appropriate Average Remaining Life for Depreciation Purposes?

Positions of the Parties

245. Seaway and Staff agree that the appropriate average remaining life for depreciation purposes is 28.5 years. Seaway Initial Br. 33; Ex. SEA-51; Staff Remand Br. 6.

246. SCN contends that the appropriate average remaining life for depreciation purposes is 39.5 years. Ex. SCN-12 at 11.

Discussion

247. On February 13, 2013, Seaway submitted a depreciation study to the Commission that was based on a 35-year economic remaining life (*i.e.*, used a May 2047 “truncation date”), which resulted in an average remaining life of 30.0 years. Ex. SEA-31 at 6, 17, 23, 28; *see also* Ex. S-7 at 9 (Pewterbaugh). During discovery, Staff pointed out that the February 13 depreciation study’s use of a remaining life of 78.5 years for Account 152 (“Rights of Way”) was inconsistent with the study’s 35-year truncation date. *See* Tr. 491, 494 (Pewterbaugh). As Mr. Pewterbaugh explained at hearing, “you can’t get 78.5 when you’re truncating at 35.” Tr. 494. Seaway agreed that the remaining life for Account 152 in the February 13 depreciation study was incorrect and provided a revised depreciation study in discovery that fixed the error. Tr. 491. When the composite remaining life for Account 152 is corrected, the total average remaining life for Seaway is 28.5 years. *See* Exhibit No. SEA-51.⁵

248. Seaway maintains that the 28.5 year average remaining life is reasonable and should be used for purposes of setting Seaway’s depreciation rates in this proceeding. Seaway states that the 28.5-year average remaining life is supported by a depreciation study that is consistent with the Commission’s requirements in 18 C.F.R. part 347. *See*

⁵ The active participants stipulated that “if the composite remaining life of 78.5 years for Account 152 (“Rights of Way”), as shown on page 28 of Exhibit No. SEA-31, is changed to a composite remaining life of 32.4 years, the resulting change to the amounts on page 28 of Exhibit No. SEA-31 would be as shown on Exhibit No. SEA-51. *See Seaway Crude Pipeline Company LLC*, “Joint Stipulation,” Docket No. IS12-226-000 (March 28, 2013).

Ex. SEA-31; Ex. SEA-51 (correcting Account 152). Seaway states further that it is also consistent with Commission decisions in other oil pipeline cases. *See, e.g., White Cliffs Pipeline, L.L.C.*, 126 FERC ¶ 61,070, at P 36 (2009) (finding a 25.5-year average remaining life to be reasonable for an oil pipeline). Seaway's proposed 28.5 year average remaining life is also conservative when compared with the 23.3 year average remaining life calculated by FERC Staff witness Pewterbaugh. *See* Exhibit Nos. S-7 at 6, 11; S-9, Schedule No. 13; Tr. 496.

249. In the Initial Decision dated September 13, 2013, the Presiding Judge recommended that the Commission derive the proper ARL from the depreciation study at Exhibit No. S-9; or alternatively, order a compliance filing in which Seaway is directed to provide all information that is necessary for proper vetting all data and inputs used to derive its 28.5 year ARL.

250. In its Brief on Remand, Staff stated that any use of the 23.3-year ARL shown in Exhibit No. S-9 would be inappropriate. Staff Remand Br. 7. Staff explained that Schedule 13 in that exhibit contains illustrative results as of December 31, 2011, and is based on now obsolete data. *Id.* The purpose of the Schedule 13 illustration was to show that Seaway's information could support a lower ARL of 23.3 years (producing a much higher depreciation rate) than the 30-year ARL then being proposed by Seaway. *Id.*

Conclusion on Remand

251. Given that Staff has discredited the data in its sponsored Exhibit S-9 and endorsed an ARL of 28.5 years, the Presiding Judge finds that 28.5 years is the best-supported ARL on the record.

2) What is the Appropriate Depreciation Rate or Rates?

Positions of the Parties

252. Seaway proposes a depreciation rate of 3.51 percent based on an ARL of 28.5 years.

253. SCN proposes a depreciation rate of 2.51 percent based on an ARL of 39.5 years.

254. Staff's endorsement of an ARL of 28.5 years tends to support a depreciation rate of 3.51 percent.

Discussion

255. The depreciation rate is calculated by dividing 1 by the average remaining life. See Exhibit Nos. SEA-24, Workpaper 5, line 4; S-7 at 44; Tr. 501 (Pewterbaugh).

Conclusion on Remand

256. The Presiding Judge finds that the appropriate depreciation rate is 3.51 percent.

3) What is the appropriate dismantlement, removal and restoration?

Positions of the Parties

257. Seaway witness Mr. Wetmore employs the annuity method to calculate that Seaway should collect DR&R expenses of \$980,000. Ex. SEA-22 at 14; SEA-26 at 39.

258. SCN witness Dr. Arthur employs the annuity method to calculate that Seaway should collect DR&R expenses of \$437,000 for the initial 12-month period of operations. Ex. SCN-12 at 12-15 and Figure Nos. 4 and 5 at 27-28.

259. Staff witness Pewterbaugh employs the accrual method to calculate that Seaway should collect DR&R expenses of \$224,336. Staff Initial Br. 51 (citing Tr. 479:21-480:23 (Pewterbaugh)).

Discussion

260. The current estimated cost to decommission the pipeline is set forth in the August 2012 decommissioning study conducted for Seaway by TSB Offshore, Inc. See Ex. SCN-69. As shown in that study, the total cost of decommissioning Seaway is estimated to be \$37,695,319 in today's dollars. Id. at 5. Of that total, \$11,274,943 is associated with the Freeport terminal. Id.; Tr. 304 (Wetmore). An additional \$956,569 is associated with the pipeline between Jones Creek and Freeport. Ex. SCN-69 at 14-15; Tr. 304-06 (Wetmore); Staff Initial Br. 51. Since the Freeport terminal and the pipeline between Jones Creek and Freeport are not part of the Longhaul 30-inch System, see Ex. SEA-1 at 4 & n.1, the DR&R amounts for those assets should be subtracted from the total decommissioning costs shown in the study. Seaway and Staff agree that the remaining \$25,463,807 relates to the Longhaul 30-inch System and represents the current estimated cost of decommissioning that system. Staff Initial Br. 51-57.

261. There are two basic methods to calculate a DR&R allowance for an oil pipeline: the accrual method and the annuity method. See, e.g., BP Pipelines (Alaska) Inc., 119 FERC ¶ 63,007, at P 162 (2007) (“TAPS Initial Decision”). Both approaches are acceptable provided they are calculated correctly. See BP Pipelines (Alaska) Inc., 123 FERC ¶ 61,287, at P 148 (2008) (“Opinion No. 502”) (annuity method); Kuparuk Transp., 55 FERC ¶ 61,122 at 61,382 (accrual method).

262. Under the accrual approach, the estimated total DR&R cost is divided into equal annual amounts based on the pipeline’s remaining life, with the annual amount included in the cost of service. See, e.g., TAPS Initial Decision, 119 FERC ¶ 63,007 at P 162. Since the oil pipeline is considered to have the cost-free use of the DR&R collections until they are actually expended for DR&R purposes in the future, the standard ratemaking convention when applying the accrual method is to deduct DR&R collections from rate base. See Kuparuk Transp., 55 FERC ¶ 61,122 at 61,382-83; Opinion No. 502, 123 FERC ¶ 61,287 at P 148.

263. Under the annuity method, the DR&R allowance is calculated based on the assumption that the pipeline will be permitted the opportunity to earn a return on the DR&R collections. In other words, both the DR&R collections and the amount earned on those collections are required to produce a sufficient amount to cover the ultimate DR&R costs. DR&R collections are therefore not deducted from rate base, as that would prevent the oil pipeline from having the opportunity to earn a return on those funds that ultimately will be needed to cover the final DR&R costs. See TAPS Initial Decision, 119 FERC ¶ 63,007 at PP 161-162; Opinion No. 502, 123 FERC ¶ 61,287 at P 148.

264. In the case at bar, Seaway used the annuity method. See Ex. SEA-26 at 39. Mr. Wetmore therefore did not adjust rate base for DR&R collections. Instead, he assumed that the DR&R amounts collected would have the opportunity to earn Seaway’s after-tax weighted nominal cost of capital and that DR&R collections along with any return earned on those collections together would generate a sufficient amount to cover the ultimate DR&R costs.

265. SCN witness Arthur also used the annuity method to calculate Seaway’s DR&R allowance. See Ex. SCN-32 at 19, lines 8-10 (assuming DR&R funds would earn Seaway’s after-tax weighted nominal cost of capital). Dr. Arthur, however, incorrectly derived Seaway’s DR&R by using Seaway’s estimate but relying on a 39.5- year ARL rather than the 30 years that Seaway used, and a composite depreciation rate of 2.51 percent. The Presiding Judge again has reason to question the reasonableness of

depreciating based on a 39.5 ARL because it is based on an outdated Commission Letter Order. In addition the development of a 2.51 percent depreciation rate would require a remaining economic life of greater than 40 years, which is unreasonable and contrasts starkly with the 30 years used by Seaway and Staff. Staff contends that SCN's annual DR&R should not be adopted because it also flawed in the same respects as Seaway's discussed below. Staff Reply Br. 25.

266. Staff used an accrual method originally proposed a DR&R allowance of \$332,096. Ex. S-7 at 7:2; Ex. S-9, schedule 16, line 4. That amount was based on the total DR&R cost estimate for all of Seaway's assets at the present time from a study provided by Seaway, the Executive Summary of which is provided in Ex. S-10 at 4-6. Because not all plant will survive to the end of Seaway's useful life, however, Staff Witness Pewterbaugh used appropriate survivor curves to adjust that amount downward to reflect the DR&R cost for the amount of plant estimated to still be in service at the time of final abandonment. Ex. S-7 at 40:19-41:6; Ex. S-9, Schedule No. 11.

267. Staff's proposed DR&R allowance, however, was further reduced after the discovery during the hearing of the need to eliminate costs related to non-jurisdictional assets. Seaway Witness Wetmore on cross-examination agreed that the decommissioning estimates included in the total DR&R cost estimate of \$37,695,319 in Exhibit No. S-10, page 5, provided by Seaway should be reduced by eliminating costs associated with Freeport Terminal II and the costs associated with the Jones Creek to Freeport facilities. Tr. 304:10-13; Tr. 305:24-306:1; Exh. No. SCN-69 at 15. After hearing this testimony, Staff Witness Pewterbaugh corrected Exhibit No. S-9 to reflect the reduction in total DR&R costs testified to by Mr. Wetmore. Using the resulting \$25,463,807, Mr. Pewterbaugh corrected Staff's proposed annual DR&R expense in Exhibit No. S-9, Schedule 16, line 4, by reducing it from \$332,096 to \$224,336. Tr. 479:21-480:23.

268. Staff's initial DR&R allowance calculation inputs came from a later version of the same DR&R study that Seaway used in making its DR&R calculations. Therefore, Staff avers, Seaway's DR&R proposal requires similar revision. According to Staff, the appropriate elimination of the additional non-jurisdictional costs would likewise reduce its originally proposed DR&R allowance of \$980,000. Ex. S-10 at 5, table 1; Ex. SEA-24, workpaper 9, line 11.

269. Staff identifies two flaws calling for further revision of Seaway's allowance: (1) Mr. Pewterbaugh opposes inflating current cost estimates to a point 30 years in the future as was done by Mr. Wetmore; and (2) Mr. Pewterbaugh would also require eliminating plant that will be retired before the end of Seaway's useful life without assigning a

negative salvage amount to those retirements. In addition, there should be no adjustment for potential additions to plant as replacements for early retirements. Ex. S-7 at 38:11-42:14.

270. In his rebuttal testimony, Mr. Wetmore updated the decommissioning costs used in his DR&R calculations to reflect the more recent DR&R study as suggested by Mr. Pewterbaugh. However, Mr. Wetmore opposes all other adjustments indicated by Mr. Pewterbaugh. Ex. SEA-26 at 40:5-16.

271. Mr. Wetmore erroneously advocates inflating the current costs which is a feature of the annuity method that he used to calculate his DR&R expense. Under the annuity method all costs, including estimates for inflation and changes in cost factors, are included in the DR&R costs to be amortized, and current rates reflect all those costs, including an allowance for the interest component of the annuity. *Kuparuk Transportation Co.*, 55 FERC ¶ 61,122, at 61,382 (1991).

272. To arrive at his DR&R allowance, Mr. Wetmore inflated the current estimated decommissioning costs in a July 2012 study to a point 30 years in the future. Mr. Pewterbaugh pointed out in his Answering Testimony that this cost inflation is inappropriate. Ex. No. S-7 at 39:1-6. During a 30-year period there will be fluctuations in inflation and changes in costs, but attempting to base rates on such uncertain estimates introduces an inappropriate level of speculation for ratemaking purposes. The more appropriate approach is to base the DR&R allowance on an estimate of current costs and revisit it periodically.

273. Seaway fails to cite to any precedent cases in which the Commission approved DR&R or negative salvage allowances based on costs inflated to a point in the future for pipelines in the more than 20 years that the Commission has allowed such costs. Ex. S-7 at 39:1-9. In fact, rather than supporting Mr. Wetmore's argument, the *Kuparuk* decision that he cites to involves the Commission's rejection of the annuity method for calculating DR&R allowances with its inflation adjustment feature. In *Kuparuk*, the Commission refused to adopt the annuity method because of the potential changes that will occur over a long period of time that cause the necessary assumptions about inflation and costs to be too difficult to make:

Second, the Commission will use the accrual rather than the annuity method to determine the permitted DR&R cost. The annuity method is premised on complex assumptions on the rate of inflation generally, changes in specific factor prices involved in North Slope operations,

uncertain and unsubstantiated changes in productivity, possible joint operations with other companies, changes in the market for surplus materials, and modifications in regulatory policy. Kuparuk's request that this issue be remanded for further litigation simply highlights the speculative and administratively complex nature of this undertaking.

55 FERC ¶ 61,122, at 61,382.

274. The Presiding Judge does not attribute significant weight to other decisions that Mr. Wetmore references in his testimony. They are the initial decision in *Kuparuk* and an initial decision in a case that was resolved without Commission review, and both are non-precedential. Ex. SEA-26 at 41:13-15, 42:7. Consequently, the DR&R allowance should not include an adjustment of the estimated decommissioning costs for inflation as proposed by Mr. Wetmore.

275. Mr. Wetmore, additionally, erroneously opposes Mr. Pewterbaugh's comment that the more appropriate approach to DR&R is to base the DR&R allowance on an estimate of current costs and revisit it periodically. Mr. Wetmore suggests that this approach is administratively inefficient, unnecessary, and likely to result in under-recovery. Ex. SEA-26 at 42:14-16. His proposed alternative however, would require making assumptions about inflation and costs 30 years in the future, which is what the Commission rejected in *Kuparuk* and why Mr. Pewterbaugh opposes inflating the costs. Ex. S-7 at 39:1-5.

276. Mr. Wetmore also opposes including interim plant retirements in the calculation of the DR&R allowance. He argues that retired assets would be replaced, and makes no adjustment in the estimated DR&R costs for the entire pipeline. Ex. SEA-26 at 42:22-43:3. As Mr. Pewterbaugh testifies, however, the future plant replacements would be plant additions that are not currently in service and the costs for which are speculative. Ex. S-7 at 42:5-7. Those anticipated future plant additions are outside of this proceeding and inappropriate to be included in the calculation of the DR&R allowance in the instant case. The Commission has rejected the inclusion of future additions in the calculation of negative salvage. *Tennessee Gas Pipeline Co.*, Opinion No. 240, 32 FERC ¶ 61,086, at 61,220, *reh'g denied*, Opinion No. 240-A, 33 FERC ¶ 61,005 (1985), *vacated in part and remanded on other grounds*, *Pub. Serv. Comm. of New York v. FERC*, 813 F.2d 448 (D.C. Cir. 1987), *vacated in part and remanded on other grounds*, *Tennessee Gas Pipeline Co. v. FERC*, 926 F.2d 1206 (D.C. Cir. 1991).

277. Mr. Wetmore's refusal to make adjustment for interim retirements is inconsistent with his reliance on Exhibit No. SEA-31 to support his depreciation recommendation. The exhibit contains an extensive discussion of survivor curves used to determine interim plant retirements. Ex. SEA-31 at 10-13. The Commission requires the recognition of interim retirements in the calculation of DR&R or negative salvage:

The Commission affirms the ALJ's decisions to reject KPC's proposal to recover \$25,483,050 in negative salvage costs and to accept Staff's proposal of \$9,806,669. The Commission finds, as did the ALJ, that KPC's proposal is unreasonable because it assumes that all of its existing facilities will survive until the end of its economic life. This is unreasonable given the survival rates of facilities as represented in the Iowa survivor curves. It is also unreasonable, as we have held in *Iroquois Gas Transmission System, L.P.*, 84 FERC ¶ 61,086 (1998), to assume that the entire pipeline will be retired at one time.

Enbridge Pipelines (KPC), 100 FERC ¶ 61,260 at P 293 (2002), *reh'g denied*, 102 FERC ¶ 61,310 (2003).

278. Seaway correctly attributes error to Staff witness Pewterbaugh's allowance for omitting the rate base adjustment for "unfunded income taxes." Seaway Initial Br. 38. Staff agrees that its failure to address the tax effect of the annual DR&R revenues should be corrected. Staff maintains that the appropriate way to recognize this tax effect is for Seaway to follow the Commission's tax normalization rules and annually record the appropriate amount of deferred tax assets in Account 45 and Seaway's balance sheet. These annual deferred tax assets will be additions to rate base. Staff Initial Br. 56.

Conclusion

279. The Presiding Judge finds that Staff's use of the traditional accrual method and its DR&R allowance of \$224,336 should be adopted with correction for Staff's admitted failure to address the tax effect of the annual DR&R revenues.

D. What is the appropriate cost of capital?**1) What is the appropriate capital structure?**

280. Seaway witness Dr. Fairchild asserts that the appropriate capital structure for Seaway is 52.17 percent debt and 47.83 percent equity, which is the average capital structure of the oil pipeline proxy group as of March 31, 2012. Ex. SEA-15 at 12; SEA-16; SEA-45 at 2-13 (Fairchild).

281. ACN witness Ms. Crowe developed Seaway's capital structure by averaging the capital structure of Enbridge and Enterprise – Seaway's parent companies. Ex. ACN-1 at 21:3-22. According to ACN, using an actual average capital structure as of the end of the first quarter 2012 produces a debt to equity ratio of 61percent to 39 percent. *Id.*

282. CAPP witness Mr. Parcell proposes a capital structure that reflects the average actual capital structure ratios of Seaway's parent companies. He proposes 42.36 percent equity and 57.65 percent long-term debt.

283. Staff witness Mr. Alvarez develops a capital structure of 58.23 percent debt, 5.27 percent preferred equity, and 36.49 percent common equity for the period ended September 30, 2012. Ex. S-24 at 1-8; Ex. S-21 at 4; Ex. S-22 at 4. For calculating the Allowance for Funds Used During Construction, he calculates a capital structure of 61.13 percent debt, 1.85 percent preferred equity, and 37.05 percent common equity for the period ended December 31, 2011. *Id.* Mr. Alvarez develops his capital structure by averaging the capital structure of Enbridge and Enterprise. Staff Initial Br. 58.

Discussion

284. The primary issues in dispute regarding capital structure are (1) whether the capital structure should be based on the average of the oil pipeline proxy group or the average of Seaway's parents, and (2) whether certain Accumulated Other Comprehensive Income ("AOCI") and Non-Controlling Interests of Consolidated Entities ("Minority Interests") should be removed from the equity balances of Enterprise and Enbridge in calculating Seaway's capital structure.

285. The Commission's guidelines for determining the appropriate capital structure are expressed in Opinion No. 414-A:

Traditionally, the Commission has preferred to utilize the applicant's own

capital structure and will continue to do so if the applicant issues its own non-guaranteed debt and has its own bond rating. But the Commission will utilize an imputed capital structure (most often that of the corporate parent) if the record in a particular case reveals that the pipeline's own common equity ratio is so far outside the range of other equity ratios approved by the Commission and the range of proxy company equity ratios that it is unreasonable.

Transcontinental Gas Pipeline Corporation, 84 FERC ¶ 61,084, at 61,413 (1998) (Opinion No. 414-A). In Opinion No. 502, the Commission stated that the typical range of equity ratios for oil pipelines was 45 percent to 55 percent. *BP Pipelines (Alaska) Inc.*, 123 FERC ¶ 61,287 at P 176 (2008). The highest approved common equity ratio from a litigated rate case in any industry that Staff is aware of is 68.86 percent. *Pacific Gas Transmission Company*, 62 FERC ¶ 61,109 at 61,778-79 (1993).

286. Under these guidelines, the Commission will use the capital structure of the pipeline itself if the pipeline: (1) has its own credit rating; (2) issues its own non-guaranteed debt; and (3) has a reasonable capital structure in relation to those entities in the oil proxy group and to other pipeline capital structures approved by the Commission in the past.

287. Applying this Commission test, ACN, CAPP, and Staff proposed capital structures based on the average capital structure of Seaway's parents on grounds that Seaway does not have its own credit ratings or issue its own non-guaranteed debt and consequently fails two of three prerequisites provided by the Commission in Opinion No. 414-A. Ex. S-11 (Corrected) at 5:6-16 (Alvarez).

288. Seaway stipulates to the fact that it does not own rated debt and instead relies on its parent companies, Enbridge and Enterprise, for debt financing. Seaway Initial Br. 40 (citing Ex. SEA-15 at 8). Seaway contends, however, that Commission policy does not merit using the capital structure of its parent companies because Enbridge's capital structure is anomalous and otherwise inconsistent with the risks of the subject pipeline (Seaway). See Seaway Initial Br. 39-40 (citing Opinion No. 502, 123 FERC ¶ 61,287 at P 174) Opinion No. 502 holds:

[I]f the parents' capital structure is anomalous relative to the capital structures of the publicly-traded proxy companies used in the discounted cash flow (DCF) analysis and capital structures approved for other regulated pipelines, the Commission will use a hypothetical capital

structure based on the average capital structure of a select group of comparable firms. The Commission will also reject the parents' capital structure if it is not representative of the risks of the pipeline.

Id. Similarly, in *SFPP, L.P.*, 96 FERC ¶ 61,281, at 62,068 (2001) (“Opinion No. 435-B”), the Commission explained that it “reviews a pipeline’s capital structure to assure that it is not contrived, or that the parent company’s capital structure is not unrepresentative of the pipeline’s risks.” If this standard is not met, the Commission has made clear that it will generally use a hypothetical capital structure. *Id.*

289. Seaway maintains that Enbridge’s capital structure is anomalous. In its initial brief Seaway demonstrates that during the period from December 31, 2011, through September 30, 2012, Enbridge’s equity ratio averaged 31%, which was lower than the equity ratio of any of the oil pipeline group proxy members and significantly below the approximately 48-49 percent average equity ratio for the proxy group. *See* Seaway Initial Br. 41-42 (citing Ex. SEA-45 at 6-7). Seaway also states that the Commission has indicated that “45 percent to 55 percent [is the] equity range typically found just and reasonable by the Commission for oil pipelines.” Opinion No. 502, 123 FERC ¶ 61,287 at P 176 (emphasis added). Enbridge’s 31 percent common equity ratio is well below the range that the Commission has found to be representative of an oil pipeline.

290. Seaway states further that Enbridge’s capital structure also contains a significant amount of preferred stock. Ex. SEA-45 at 5 (Fairchild) (increasing from 3.5 percent in December 31, 2011, to 10 percent in September 30, 2012). As Dr. Fairchild explained, “none of the firms in the oil pipeline proxy group issues preferred stock, which further renders Enbridge’s capital structure anomalous when compared to the oil pipeline proxy group.” *Id.* at 6.

291. Moreover, Seaway contends that Enbridge’s risks are not representative of those of an oil pipeline such as Seaway. Dr. Fairchild explained that “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.” *Id.* at 7; *see also* Ex. SCN-7 at 36 (noting Enbridge’s involvement in various activities other than oil pipelines, including electric power generation and transmission). As Dr. Fairchild testified, most of the other activities in which Enbridge is engaged are regarded as less risky than oil pipelines. Ex. SEA-45 at 7. Thus, “despite its high financial leverage as reflected in its low common equity ratio, Standard & Poor’s (“S&P[’]”) and Moody’s Investors Service (“Moody’s”) rate Enbridge’s bonds A1 and

Baa1, respectively, while the average bond rating of the oil pipelines in the proxy group is BBB by S&P and Baa by Moody's." *Id.*

292. Seaway goes on to state that Enbridge's equity ratio is so low that even averaging it with Enterprise's more typical equity ratio results in an average equity ratio that is also anomalously low. *See id.* at 8-9. Indeed, based on the data shown above, the average equity ratio for Enterprise and Enbridge was 38.69 percent, as of March 31, 2012, and 37.81 percent, as of September 30, 2012. That is well below both the approximately 48-49 percent average for the oil pipeline proxy group and the 45-55 percent range that the Commission has indicated is typical of oil pipelines.

293. The Presiding Judge finds the nature of Enbridge's capital structure to be of minimal probative value when considered in isolation. ACN astutely identifies the relevant inquiry as whether the parent companies' average capital structure is anomalous, because that is the equity ratio that will be used to calculate Seaway's rates. In this proceeding, Ms. Crowe testified that the average equity ratio for Seaway's parent companies is 39 percent. Ex. ACN-1 at 21:7-22, Ex. ACN-16. In its Initial Brief at 43, Seaway stated that the average equity ratio for the parent companies was 38.69 percent as of March 31, 2012 and 37.81 percent as of September 2012. Seaway did not provide any testimony, support, calculations, or underlying data for these equity ratios.

294. Commission precedent demonstrates approval of capital structures for initial rates that reflect a 40 percent equity ratio. *Ruby Pipeline, L.L.C.*, 128 FERC ¶ 61,224 at P 53 (2009) ("Ruby's ... proposed capital structure of 40 percent equity and 60 percent debt is in line with our recent orders.") (citing *Mid-Atlantic Express, LLC*, 126 FERC ¶ 61,019 at P 31 (2009); *Markwest Pioneer, L.L.C.*, 125 FERC ¶ 61,165 at P 27 (2008); and *Ingelside Energy Center, LLC*, 112 FERC ¶ 61,101, at 61,653 (2005)). Moreover, Staff cites to a case in which the Commission has approved a common equity ratio as low as 35.24 percent. *Allegheny Power*, 106 FERC ¶ 61,241 at PP 25-27 (2004), *vacated in part*, *Allegheny Power v. FERC*, 437 F.3d 1215 (D.C. Cir. 2006). Thus the average equity ratio of Seaway's parent companies is not anomalous.

295. ACN, CAPP, and Staff reject Seaway's contention that Enbridge's risks are not representative of Seaway's risks, because Enbridge 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." Seaway Initial Br. 42-43 (internal quotations omitted). ACN maintains that if that is true, then the proxy group companies' risks are also not representative of Seaway's risks. The record shows that the proxy group companies are also diversified companies with production, transportation,

terminaling, storage, energy services, and international business segments in the natural gas, liquids, crude oil, refined products, ammonia, and asphalt markets. ACN Reply Br. 47-48 (citing Ex. S-24 at 8-15).

296. In calculating Seaway's capital structure, Staff removes the effect of the amount recorded in Account 77(a), Accumulated Other Comprehensive Income, from common equity. Staff maintains that the amount recorded in Accumulated Other Comprehensive Income relates to non-cash items. These include foreign currency items, actuarial pension liability gain/loss adjustments, unrealized gains and losses on certain investments in debt and equity securities, and cash flow hedges. 18 C.F.R., pt. 352, Balance Sheet Accounts 77(a) (2012). These items are not available to either Enbridge or Enterprise to finance their business operations, and therefore cannot be considered equity capital. Consequently, Staff zeroed the effect of these amounts.

297. Seaway witness Dr. Fairchild states that "under Generally Accepted Accounting Principles (GAAP) and the Commission's Uniform System of Accounts (USOA), unrealized gains and losses are reflected on a firm's financial statements as part of 'comprehensive' income, and the sum of past unrealized gains and losses is reflected as AOCI in a firm's common equity on its balance sheet." Ex. SEA-45 at 11. Thus, Dr. Fairchild explains, Staff's proposed "adjustment to remove AOCI from equity prior to calculating capital structure ratios is at odds with GAAP and the Commission's USOA." *Id.* Dr. Fairchild further stated that he was "unaware of the financial community (including bond rating agencies) making similar adjustments to remove AOCI from a firm's equity prior to calculating its capital structure ratios." *Id.*

298. The Presiding Judge notes that Dr. Fairchild refers universally to GAAP and fails to cite any specific provision of the Commission's USOA. Contrarily, Mr. Alvarez cites directly to 18 C.F.R., pt. 352, Balance Sheet Accounts 77(a) (2012) to support Staff's determination to remove AOCI. Alvarez's testimony is thus credited and Staff's determination given credence.

299. Staff also removed the Minority Interest (Non-Controlling Interest) amount. Ex. S-11(Corrected) at 8-9. Staff contends that it is not appropriate to include Minority Interest in common equity because Minority Interest does not represent equity to the shareholders of either Enbridge or Enterprise. If it did, it would be included in paid-in capital or common share capital, not as a separate line item on either company's balance sheet. The non-controlling interests of Enterprise and Enbridge, Ex. S-13 at 10, represent third party ownership interests in joint ventures. The Commission has explained that "when a purchaser of a minority interest in a public utility lacks the ability to influence control

over that acquired public utility, the Commission will not consider the purchase a consolidation of utility assets.” *Morgan Stanley*, 134 FERC ¶ 61,234 at P 16 (2011). Because the Minority Interest represents an equity balance not owned by Enbridge or Enterprise, it should not be included in either company’s common equity balance utility assets.

300. Dr. Fairchild again challenges the merits of Staff’s determination explaining that:

Under GAAP, a firm that has a “controlling interest” in another must consolidate that “subsidiary” into its published financial statements. This consolidation is required even when the subsidiary is a separate entity that issues its own debt for which the “parent” has no responsibility and a portion of the subsidiary’s common equity is publicly traded. In consolidating financial statements, all of the subsidiary’s debt is included on the consolidated balance sheet, and the equity of the subsidiary that is not owned by the parent is recorded on the consolidated balance sheet as a Minority Interest. In this way, the consolidated balance sheet reflects 100% of the debt of the parent and the subsidiary and 100% of the equity of the parent and the subsidiary.

Ex. SEA-45 at 12.

301. Dr. Fairchild’s contentions are again supported only by broadly-referenced GAAP. By contrast, Staff’s removal of the Minority Interest is supported by Commission precedent in *Morgan Stanley*. The Presiding Judge therefore attributes more weight to Staff’s arguments.

Conclusion

302. The Presiding Judge credits the methodologies employed by Staff and finds that the appropriate capital structure is 58.23 percent debt, 5.27 percent preferred equity, and 36.49 percent common equity for the period that ended September 30, 2012. For calculating the AFUDC, the appropriate capital structure is 61.13 percent debt, 1.85 percent preferred equity, and 37.05 percent common equity for the period that ended December 31, 2011.

2) What is the Appropriate Cost of Debt?

Positions of the Parties

303. Seaway asserts that the appropriate cost of debt is 5.46 percent, which is the average cost of debt of the oil pipeline proxy group as of March 31, 2012. Ex. SEA-15 at 5, 12; Ex. SEA-17; Ex. SEA-45 at 2-3, 14-17.

304. ACN proposes a 5.01 percent debt cost based on the debt costs of Seaway's parent companies updated as of December 31, 2012. Ex. ACN-40.

305. CAPP recommends a cost of debt of 5.26 percent based on the debt costs of Seaway's parent companies Ex. CAP-4 at 2.

306. Staff uses the debt costs of Seaway's parent companies to develop a cost of debt of 5.31 percent for the period ending December 31 and 5.18 percent for the period ending September 30, 2012. Ex. S-23 at 5.

Discussion

307. As previously discussed, Staff, ACN, and CAPP all make proper use of the parents' capital structure to determine Seaway's cost of debt. Seaway erroneously uses the average cost of debt for the oil proxy group, thereby rendering its calculation of the cost of debt inapplicable.

308. Seaway's cost of debt should be updated for the most current period available that is within the test period, which is September 30, 2012. Ex. S-11 (Corrected) at 6. Seaway argues that its cost of debt should be based on data that reflects market conditions at the time Seaway's initial rates took effect. However, Seaway concedes that to the extent it is deemed necessary to use more recent data, a cost of debt based on data as of September 30, 2012 should be used. Seaway Initial Br. 44.

309. ACN uses capital structure data that is beyond the test period, having been updated through December 31, 2012, and CAPP uses capital structure data as of December 31, 2011 through June 30, 2012. ACN I.B. at 38; CAPP I.B. at 23. Staff's data used in calculating Seaway's capital structure is superior because Staff's data is the most recent within the parameters of the test period. Ex. S-11 (Corrected) at 6.

Conclusion

310. The Presiding Judge finds the cost of debt is 5.31 percent for the period ended December 31, 2011, and the cost of debt is 5.18 percent for the period ended September 30, 2012.

3) What is the Appropriate Rate of Return on Equity?

Positions of the Parties

311. According to Dr. Fairchild's testimony, the appropriate ROE is 12.36 percent nominal and 10.69 percent real. Ex. SEA-15 at 5, 13-17; Ex. SEA-18; Ex. SEA-45 at 2-3, 18-25.

312. ACN states that Seaway's nominal ROE for the six-month period ending September 2012 is 11.28 percent. Ex. ACN-18 at 1, line "Median Nominal Return on Equity".

313. CAPP witness Parcell computed Seaway's cost of equity at 11.77 percent nominal basis and 10.11 percent real Ex. CAP-4 at 3.

314. Staff calculates a nominal rate of return on equity of 10.68 percent, and a real rate of return on equity of 8.52 percent for the period ended October 31, 2012. Ex. S-24 at 6. According to Staff, for the period ended December 31, 2011, which is used for December 2011 in the calculation of AFUDC, the nominal rate of return on equity is 11.16 percent and the real rate of return on equity is 8.19 percent. Ex. S-11 at 39.

Discussion

315. The Commission's model for estimating the allowed equity rate of return for regulated entities is based on the discounted cash flow methodology. The purpose of a discounted cash flow (DCF) analysis is to determine the rate of return expected by investors. Consequently, the Commission uses a discounted cash flow analysis to determine the appropriate return on equity for a regulated pipeline. *Canadian Association of Petroleum Producers v. FERC*, 308 F.3d 11, 12 (D.C. Cir. 2002).

316. The Commission develops an allowed rate of return on equity for a rate applicant using the results of an analysis performed on a proxy group of companies. Multiple estimates of the cost of equity help to reduce the impact of measurement error that may

occur when developing a rate of return on equity based on a single observation. Furthermore, a proxy group is necessary because Seaway has no publicly traded stock. Without publicly traded stock, it is impossible to directly determine an investor-required return on equity for Seaway. Therefore, it is necessary to select a proxy group of companies to derive a cost of equity for Seaway during the relevant time periods.

317. The primary issues in dispute regarding return of equity involve (1) selection of the appropriate members of the proxy group and (2) proper use of the Commission's DCF analysis.

318. For the reasons discussed in his direct testimony, Dr. Fairchild's original proxy group included the following seven oil pipeline companies: (1) Buckeye Partners, LP ("Buckeye"); (2) EEP; (3) Enterprise; (4) Magellan Midstream Partners, LP ("Magellan"); (5) NuStar Energy, LP ("NuStar"); (6) Plains All American Pipeline, LP ("Plains"); and (7) Sunoco Logistics, LP ("Sunoco"). Exhibit No. SEA-15 at 10. To the extent it is necessary to use more recent data, Dr. Fairchild determined that NuStar and Magellan should not be included in the proxy group for the period ending December 31, 2012. Ex. SEA-45 at 20-21 (explaining that NuStar's debt was downgraded by S&P to a non-investment grade BB+ in July 2012, and Magellan's growth rates were negative during the recent period, which produces illogical and anomalous results).

319. Dr. Fairchild used the Commission's DCF analysis to establish a return on equity of 12.36% nominal, and 10.69% real, based on data for the six-month period ending June 2012. See Ex. SEA-15 at 5, 13-17; Ex. SEA-18; Ex. SEA-45 at 2-3, 18-25. The ROE data from this time period contained in Dr. Fairchild's direct testimony appropriately reflects capital market conditions at the time Seaway's rates took effect. To the extent it is deemed necessary to use more recent data, Dr. Fairchild finds the appropriate return on equity is 10.75percent nominal, and 9.01percent real, based on data for the six-month period ending December 31, 2012, which was the most recent data available at the time the rebuttal testimony was prepared. Exhibit No. SEA-45 at 19.

320. ACN witness Ms. Crowe first accepted the proxy group that Seaway witness Dr. Bruce Fairchild proposed in his direct testimony. Ex. ACN-1 at 22:20-23:8, Ex. ACN-18. In his rebuttal testimony, Dr. Fairchild updated his proxy group companies and excluded Nustar Energy and Magellan Midstream Partners. Taking this update into account does not change the median return on equity shown on Exhibit No. ACN-18.

321. Second, Ms. Crowe used the Commission's preferred DCF model to calculate the proxy group companies' returns. ACN Reply Br. 48-49 (citing Ex. ACN-1). Third, Ms.

Crowe selected the median ROE for the proxy group companies, which is 11.28 percent on a nominal basis, and 9.62 percent in real dollars. *Id.*

322. For the period ended October 31, 2012, Staff uses a proxy group consisting of the following six companies to derive the nominal cost of equity for Seaway: (1) Buckeye Partners, L.P.; (2) Enbridge Energy Partners, L.P.; (3) Enterprise Products Partners, L.P.; (4) Magellan Midstream Partners, L.P.; (5) Plains All American Pipeline, L.P.; and (6) Sunoco Logistics Partners, L.P. (Sunoco). For the period ended December 31, 2011, Staff uses a proxy group consisting of the following six companies to derive the nominal cost of equity for Seaway: (1) Buckeye Partners, L.P.; (2) Enbridge Energy Partners, L.P.; (3) Magellan Midstream Partners, L.P.; (4) NuStar Energy Partners, L.P.; (5) Plains All American Pipeline, L.P.; and (6) Sunoco Logistics Partners, L.P.

323. Staff selected companies for these proxy groups based on the following criteria: (1) they are publicly traded; (2) they have not been involved in merger and acquisition activity during the most recent six-month period used in the discounted cash flow analysis ending October 31, 2012 or December 31, 2011; (3) they have at least 50 percent in company assets or operating income in oil pipeline operations; (4) they have been in operation for at least five years; (5) they are followed by Value Line; (6) they have Institutional Brokers' Estimate System (I/B/E/S) growth estimates; (7) they have investment grade credit ratings; and (8) they have sustainable growth rates.

324. Staff states the following in support of its proxy group selection criteria:

The Commission stated in Order No. 420 that it will exclude companies from a proxy group that do not meet criterion (1) above. The Commission also excluded companies that did not meet criterion (2) in Opinion No. 445. With regard to criteria (3), (4), (5), and (6), the Commission stated in Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity that master limited partnerships may be used as proxy companies if they have 50 percent of company assets or operating income in oil pipelines, have been in operation for at least 5 years, are tracked by Value Line, and have I/B/E/S forecasts available for them.

Regarding criterion (7), the Commission has excluded companies from the proxy group because their financial profile was significantly affected by the lack of an investment grade credit rating. It is important to note that the discounted cash flow model is predicated on the assumption that a company's payout ratio, dividend yield and price to earnings ratio will

remain constant. Often, companies that have credit ratings below investment grade are experiencing financial difficulties that may lead to instability in these ratios. Consequently, the discounted cash flow results for these companies can be distorted, and may not be considered to be reliable estimates of their cost of equity.

Finally, with regard to criterion (8), Staff removes entities from the proxy group whose composite growth rate is equal to, or greater than, 13.3 percent. The Commission initially found this level of growth to be unsustainably high in *ISO New England, Inc.*, where it rejected the discounted cash flow analysis result of PPLCorp. as being an extreme outlier whose inclusion would skew the results of the entire proxy group. More recently, the Commission used 13.2 percent as the growth rate limit in accepting discounted cash flow returns for proxy group companies in Southern California Edison Company.

Staff Initial Br. 64-65 (internal citations omitted).

325. Staff's nominal rate of return on equity is 10.68 percent, and its real rate of return on equity is 8.52 percent for the period ended October 31, 2012. Ex. S-23 at 7. For the period ended December 31, 2011, which is used in the calculation of AFUDC, the nominal rate of return on equity is 11.16 percent and the real rate of return on equity is 8.19 percent. Ex. S-24 at 6.

326. The Presiding Judge credits the proxy group criteria developed by Staff and its use of the DCF analysis to develop its nominal and real return on equity figures.

327. Furthermore, the Presiding Judge finds that Seaway's rate of return on equity relies on an inappropriate proxy group and is calculated incorrectly. NuStar Energy, L.P. is no longer eligible to be included in the proxy group because its credit rating was downgraded to non-investment grade. Ex. S-11 (Corrected) at 45-46. Additionally, Enterprise has an unsustainable growth rate of 22.90 percent, which would skew the results of the entire proxy group. Ex. S-11 (Corrected) at 46. Further, Seaway has an error in its yield adjustment factor (e), in dividing the higher I/B/E/S growth rate (g) by 2 rather than dividing the two-stage growth rate (k) by 2. This error can skew the results of the discounted cash flow analysis upward. Ex. S-11 (Corrected) at 46.

328. ACN accepts Seaway's original proxy group in order to apply its DCF analysis. Thus ACN's determinations as to return of equity are flawed as well.

Conclusion

329. The Presiding Judge adopts Staff's determination that Seaway's nominal rate of return on equity is 10.68 percent, and its real rate of return on equity is 8.52 percent for the period ended October 31, 2012. For the period ended December 31, 2011, which is used in the calculation of AFUDC, Seaway's nominal rate of return on equity is 11.16 percent and the real rate of return on equity is 8.19 percent.

4) What is the Appropriate Cost of Preferred Stock?

Positions of the Parties

330. Seaway avers that it is not appropriate to include any preferred stock in its capital structure.

331. Staff contends that the Commission's Code of Federal Regulations for electric utilities, natural gas pipelines, and oil pipelines all require that the weighted cost of preferred equity be shown. 18 C.F.R. § 35.13 (22) (iii) (A) (2012).

332. ACN, CAPP, and SCN take no position as to this issue.

Discussion

333. Staff asserts that the cost of preferred stock is 2.03 percent for the period ending October 31, 2012. For the period ending December 31, 2011, the cost of preferred stock is 2.09 percent. Ex. S-24 at 1, 5. Preferred stock should be included in Seaway's capital structure. Ex. S-11 (Corrected) at 11.

334. Seaway incorrectly argues that is not appropriate to include any preferred stock in Seaway's capital structure. Commission regulations and precedent recognize that preferred equity should be treated as a long-term instrument cost used to finance rate base. Ex. S-11 (Corrected) at 11. Staff follows these regulations and precedent in calculating Seaway's cost of preferred equity. *See, e.g., Transok, Inc.*, 70 FERC ¶ 61,177, at 61,555 (1995) (requiring that rates be designed on actual cost).

335. Seaway contends that it is not appropriate to include any preferred stock in its capital structure on the false grounds that the capital structure in this case should be based on the average of the oil pipeline proxy group, and none of the proxy group members issue preferred stock. Seaway Initial Br. 46 (citing Ex. SEA-45 at 5-6). As previously discussed, Seaway's capital structure is based on the average of the capital structures of its parent companies, Enterprise and Enbridge. Enbridge has preferred stock that must be reflected in Seaway's capital structure.

336. Staff appropriately averages the cost of preferred stock of Seaway's parents in determining Seaway's cost of preferred stock. Ex. S-11(Corrected) at 11. Enbridge's cost of preferred stock is averaged with Enterprise's cost of preferred stock which is zero. Seaway admits that there is no cost of Enterprise preferred stock because it has none. Seaway Initial Br. at 46.

337. Seaway argues that averaging Enbridge's embedded cost of preferred stock with zero is illogical and produces an incorrect result. There is no cost of Enterprise preferred stock because it has none; however, if Enterprise did have preferred stock, it would plainly cost something. *See* Ex. SEA-45 at 18. Seaway's argument is of minimal probative value, however, because Seaway cites no Commission precedent supporting its assertion that Staff's calculation of preferred stock is incorrect.

Conclusion

338. The Presiding Judge adopts Staff's determination that the cost of preferred stock is 2.03 percent for the period ending October 31, 2012, and the cost of preferred stock is 2.09 percent for the period ending December 31, 2011.

E. What is the Appropriate Income Tax Allowance for Seaway?

Positions of the Parties

339. Seaway avers that it is entitled to a full income tax allowance based on a weighted average federal and state income tax rate of 33.7 percent. *See* Exhibit No. SEA-11 (Ganz). The bases for Seaway's income tax allowance and weighted average income tax rate are set forth in the testimony of Seaway's witness George R. Ganz. Ex. SEA-9; Ex. SEA-43.

340. SCN witness O'Loughlin and ACN witness Crowe contend that Seaway should not receive an income tax allowance in connection with the 50 percent

share of Seaway owned by Enterprise, because Enterprise is an MLP. Ex. ACN-1 at 25; Ex. SCN-35 at 26-33.

341. Staff states that its method for calculating the income tax allowance for the pre-expansion period is shown on page 5 of Exhibit No. S-21 and, for the post-expansion period, on page 5 of Exhibit No. S-22. The amounts shown on line 9 of each page 5, however, should also be adjusted to include the effect of the removal of additional non-jurisdictional assets. As previously discussed, Exhibit No. ACN-42, the stipulation that was entered into between Staff and ACN during the hearing, necessitates the removal of non-jurisdictional assets that were included at the time that Staff filed its prepared testimony. This removal of assets will result in lower tax allowances for the two periods. Ex. S-19:17-18:2.

Discussion

342. Seaway notes that the arguments set forth by witnesses O'Loughlin and Crowe are directly contrary to established Commission policy and precedent. *See Inquiry Regarding Income Tax Allowances*, 111 FERC ¶ 61,139 (2005) ("ITA Policy Statement"); *see also SFPP, L.P.*, 134 FERC ¶ 61,121, at PP 218-321 (2011) ("Opinion No. 511"); *SFPP, L.P.*, 137 FERC ¶ 61,220 (2011) ("Opinion No. 511-A"); *SFPP, L.P.*, 140 FERC ¶ 61,220, at PP 27-345 (2012) ("Opinion No. 522").

343. Witness O'loughlin, in his answering testimony, states that Seaway has calculated its income tax allowance consistent with the Commission's current income tax policy as applied in recent cases. Ex. SCN-35 at 26. Witness O'loughlin contends, however, that the Commission's current policy set forth in its Opinion Nos. 511 and 511-A which entitle MLPs to an income tax allowance are incorrect because they allow MLPs double recovery of investor income. Ex. SCN-35 at 27. Mr. O'loughlin objects to the Commission's reasoning in those opinions, stating that the Commission's Income Tax Allowance policy contradicts the Commission's Return on Equity Policy. Ex. SCN-35 at 30.

344. The Presiding Judge notes that the Commission has previously rejected the proposition that MLPs are not entitled an income tax allowance. Mr. O'loughlin does not identify any circumstances in this proceeding that warrant an exception to the Commission's policy; rather, he challenges the merits of the policy itself. The Presiding Judge gives no credence to Mr. Oloughlin's challenges, noting that the merits of the Commission's income tax allowance policy are not at issue in this

case. Accordingly, the income tax allowance attributed to Seaway shall comply with current Commission policy for the purposes of this Initial Decision.

Conclusion

345. The Presiding Judge finds that Seaway is entitled to a full income tax allowance based on a weighted average federal and state income tax rate of 33.7 percent. The rate bases for the two periods to which that allowance is applied shall be composed in a manner consistent with the findings and conclusions stated in this Initial Decision.

F. What is the appropriate amount of accumulated deferred income taxes (ADIT)?

Positions of the Parties

346. The parties positions on this issue are contingent upon the positions taken on previously discussed issues.

Discussion

347. The correct ADIT balance depends primarily on the appropriate: (1) rate base, (2) depreciation factor, and (3) weighted average federal and state income tax rate. *Id.* Those issues are addressed in other sections. Aside from those matters, there is no record evidence challenging Seaway's ADIT calculations.

Conclusion

348. The Presiding Judge finds that Seaway's ADIT balance shall be determined in the manner consistent with the findings and conclusion as to rate base, depreciation, and income tax allowance stated in this Initial Decision.

5. What is the Appropriate Level of Throughput?

349. The Presiding Judge reiterates the finding stated previously in this Initial Decision that appropriate level of throughput for the pre-expansion period 135,000 bpd, while the appropriate level of throughput for the post-expansion period is 295,000 bpd.

6. What is the Appropriate Rate Design for Calculating Throughput in this Proceeding?

350. The Presiding Judge observes that the rate design in this case is governed by two irreconcilable principles. First, the Commission affirmed in the PDO Order that “agreements executed by . . . committed shippers (including the agreed-to tariff, rate, and priority service structure) would be upheld and applied during the established terms of the agreements between the pipeline and the shippers that made volume commitments during the open season.” PDO Order, 142 FERC ¶ 61,201 at P 13. In the same paragraph of the PDO Order, the Commission states that “if an uncommitted rate is protested, the pipeline must comply with section 342.2(b) of the Commission’s regulations to support its uncommitted rate by filing cost, revenue, and throughput data supporting such rate as required by Part 346 of the Commission’s regulations. *Id.* The Commission stated further that an “uncommitted rate is not unlike a gas pipeline’s recourse rate. It will be available to all shippers who choose not to select [the pipeline’s] negotiated committed rate.” *Id.* The rate design in this proceeding is, however, unlike the rate design of any gas pipeline case known to the Presiding Judge or the parties to this proceeding.⁶ The rate design in this case is distinguished on the fact that the revenues collected through committed shipper contracts exceed Seaway’s total cost of service. That fact means that either the uncommitted shippers must be assigned negative rates (clearly not a viable option), or the rate design must employ some sort of true-up mechanism for reallocating excess revenues between the pipeline, committed shippers, and uncommitted shippers.

351. The Presiding Judge rejects Seaway’s proposed revenue-crediting method because it does not conform to the Hearing Order’s requirement for Seaway to produce cost-of-service justifications for its rates.

352. The Presiding Judge rejects SCN’s averaging method due to the shortcomings of the method admitted by its proponent. Witness O’Loughlin uses an average rate method whereby total post-2012 volumes, both committed and uncommitted, are divided by the cost-of-service to produce an average rate. Ex. SCN-35 at 10-13. Witness O’Loughlin admits, however, that his rates will result in significant over-recovery. He testifies that because “Seaway’s Committed rates

⁶ The Presiding Judge notes again that none of the parties were able to cite to a single case regarding either oil or gas pipelines where the revenues collected through negotiated rates exceeded the pipeline’s total cost of service.

exceed the Average Rate, the revenue yielded by the Committed rates in conjunction with an Uncommitted rate equal to the Average Rate (\$338.4 million) exceeds the cost-of-service (\$201.9 million).” Ex. SCN-35 at 11:11-12.

353. ACN sets forth a system-wide unit rate. The unit rate is calculated by dividing the annual cost of service by the total annual system-wide volumes. Ex. ACN-1 at 27:10-29:2 (arguing that the pipeline’s design capacity is the proper measurement for Seaway’s volumes for the purpose of calculating initial rates in this proceeding). As ACN witness Elizabeth H. Crowe testified, the total system volumes are “not separated between committed and uncommitted volumes.” Ex. ACN-1 at 27:10-20. In ACN’s Brief on Remand, it states that because the unit rate calculation does not distinguish between committed and uncommitted volumes, it assumes that the pipeline will collect the unit rate for every barrel shipped (including the committed volumes). ACN Remand Br. 15-16. Thus, in this sense, using a unit rate calculation to determine Seaway’s uncommitted rates may not be considered “entirely independent of the committed shipper rates.” *Id.*

354. Indeed, no party has offered a true-up mechanism that maintains committed rates and uncommitted rates as two independent rate classes while also preventing Seaway from over-recovering its cost. It is possible that the parties to the proceeding could have worked with their expert witnesses to develop such a mechanism; however that possibility has been foreclosed by the Commission’s instruction that the Presiding Judge not re-open the evidentiary record in this proceeding for the purpose of taking additional evidence. *See* Remand Order, 146 FERC ¶ 61,151 at P 43.⁷ It is not permissible for the Presiding Judge to rely on external sources or otherwise develop an appropriate mechanism that has not been offered on the record and subjected to cross-examination. *See* Administrative Procedure Act, 5 U.S.C. § 556.

355. The Commission’s statement in the Remand Order that “[i]t is unclear from the record whether the Presiding Judge’s error concerning Seaway’s committed rates is a distinct and independent matter from the other issues decided in the Initial Decision,” betrays the author’s failure to understand that a decision to maintain the committed shipper revenues necessitates the design of a true-up mechanism to reallocate revenues and prevent over-recovery. *See* Remand Order,

⁷ If such a true-up mechanism were developed, then perhaps the policy of not disturbing negotiated rates might be applicable in instances, such as this, where the revenues collected through negotiated rates exceed the total cost of service.

146 FERC ¶ 61,151 at P 39. Again, no appropriate mechanism has been offered in this proceeding. Accordingly, the Presiding Judge continues to hold that the committed shipper rates must be disturbed if the rate design is to be found just and reasonable.

356. The Presiding Judge reiterates her finding that cost-based rates for Seaway should be designed using the pre- and post-expansion levels of throughput specified in Issue 5 above and the cost-of-service determinations stated previously in this Initial Decision to calculate committed and uncommitted rates.

7. Is the Differential Between Seaway's Light Crude Oil and Heavy Crude Oil Rates Justified?

357. The Presiding Judge credits Seaway's argument that it is neither discriminatory nor unusual in the oil pipeline industry to charge different rates to light and heavy crude oil shippers. Seaway Initial Br. 52. The two types of crude oil have different properties and have different impacts on pipeline operation, which in turn means the shippers that move those products are not similarly situated. As Mr. Ordemann explained in his direct testimony, heavy crude oil has a higher density and viscosity than light crude oil, and because it is heavier and more viscous, heavy crude oil "moves at a slower rate than light crude oil and reduces the available capacity on the pipeline." Ex. SEA-1 at 6.

358. ACN charges that the differential is not justified because Seaway did not provide adequate evidence to support its proposed differential. ACN's argument fails to rebut the differences between heavy and light crude oil and the effect on pipeline transportation as identified by Mr. Ordemann.

359. The Presiding Judge finds that the differential between Seaway's light crude oil and heavy crude oil rates is fully justified.

8. What is the Appropriate Level of Uncommitted Shipper Rates?

360. The appropriate level of uncommitted shipper rates is contingent upon resolution of all rate design, throughput, and cost-of-service issues previously discussed in this Initial Decision. The record in this proceeding does not resolve all such issues, therefore the Presiding Judge is unable make a precise finding as to the appropriate level of shipper rates.

9. What is the Appropriate Level of Committed Shipper Rates?

361. The appropriate level of committed shipper rates is contingent upon resolution of all rate design, throughput, and cost-of-service issues previously discussed in this Initial Decision. The record in this proceeding does not resolve all such issues, therefore the Presiding Judge is unable make a precise finding as to the appropriate level of shipper rates.

V. ORDER

362. WHEREFORE, based upon due consideration of the evidence presented, it is the determination of the Presiding Judge that Seaway has failed to carry its burden to prove that its proposed committed and uncommitted shipper rates are just and reasonable. The Presiding Judge finds further that Seaway's proposed committed and uncommitted shipper rates should be modified consistent with the findings in this Initial Decision in order to meet the just and reasonable standard set by the Commission. The omission from this Initial Decision of any argument raised by the participants in this proceeding at the hearing or in their briefs does not mean that it has not been considered; rather, it has been evaluated and found to either lack merit or significance such that inclusion would only tend to protract this Initial Decision without altering its substance or effect. Accordingly, all arguments made by the participants in this proceeding which have not been specifically discussed and/or adopted by this decision have been considered and are rejected.

Karen V. Johnson
Presiding Administrative Law Judge