



National Energy
Board

Office national
de l'énergie

Reasons for Decision

(Issued as a Letter Decision on 9 August
2001)

**Murphy Oil Company Ltd.
(now Plains Marketing
Canada, L.P.)**

**Concerning Tolls for the
Milk River Pipeline**

August 2001

Toll Complaint

ERRATA
NATIONAL ENERGY BOARD

REASONS FOR DECISION

Concerning Tolls for the Milk River Pipeline

August 2001

Page 14

Under “9. Cost of Service”, replace “for the fourth quarter of 2000” with “for the period 1 September to 31 December 2000”.

Under “9. Cost of Service”, replace “in the final quarter” with “in that period”.

Page 17

In footnote 1 at the bottom of the page, replace “for the fourth quarter of 2000” with “for the period 1 September to 31 December 2000”.

Page 18

Under “13. Adjustment of Interim Tolls”, replace “approximately \$1.0 million” with “approximately \$1.2 million”.



File: 4775-M23-1-2
9 August 2001

Mr. Frank R. Foran
Borden Ladner Gervais LLP
1000 Canterra Tower
400 Third Avenue SW
Calgary AB
T2P 4H2
Facsimile: 266-1395

Dear Mr. Foran:

**Murphy Oil Company Ltd. (now Plains Marketing Canada, L.P. [Plains])
Complaint dated 25 August 2000 by PanCanadian Petroleum Limited, Alberta
Energy Company Ltd., Gulf Canada (previously Crestar Energy Inc.) and EOTT
Energy Canada Limited Partnership, collectively known as the Bow River South
Group (BRS), Concerning Tolls Charged on the Milk River Pipeline**

Reasons for Decision

The National Energy Board has completed its examination of submissions received from Murphy (now Plains), BRS and Mobil Oil Canada in the above matter and is issuing the attached Reasons for Decision and Order TO-4-2001 establishing final tolls on the Milk River Pipeline effective 1 September 2000.

Plains is required to serve a copy of this letter and attachments on its shippers and interested parties.

Yours truly,

Original signed by Robert LeMay

Michel L. Mantha
Secretary

Attachments: Reasons for Decision and Order TO-4-2001

cc: Mr. John Kers, Plains Marketing Canada, L.P., facsimile: 294-8834
Mr. Loyola Keough, Bennett Jones LLP, facsimile: 265-7219
Mr. Paul Kahler, PanCanadian Petroleum Limited, facsimile 268-6563
Mr. Pat Greenaway, Tidal Energy Marketing Inc., facsimile: 205-8490
Mr. Bill Jack, Alberta Energy Company Ltd., facsimile 691-8832
Mr. Bruce Greenbank, EOTT Energy Canada Limited Partnership, facsimile 265-7634
Mr. Brian Woods, Mobil Canada Products Ltd., facsimile 260-7118

444 Seventh Avenue SW
Calgary, Alberta T2P 0X8

444 Septième Avenue S.-O.
Calgary (Alberta) T2P 0X8

Canada

Telephone/Téléphone : (403) 292-4800
Facsimile/Télécopieur : (403) 292-5503
<http://www.neb.gc.ca>

National Energy Board

Reasons for Decision

In the Matter of

**Murphy Oil Company Ltd.
(now Plains Marketing
Canada, L.P.)**

Complaint dated 25 August 2000 by PanCanadian Petroleum Limited, Alberta Energy Company Ltd., Gulf Canada (previously Crestar Energy Inc.) and EOTT Energy Canada Limited Partnership, collectively known as the Bow River South Group (BRS), Concerning Tolls Charged on the Milk River Pipeline

August 2001

© Her Majesty the Queen in Right of Canada 2001 as represented by the National Energy Board

Cat. No. NE22-1/2001-5E
ISBN 0-662-30996-0

This report is published separately in both official languages.

Copies are available on request from:

The Publications Office
National Energy Board
444 Seventh Avenue SW
Calgary, Alberta, T2P 0X8
E-Mail: publications@neb-one.gc.ca
Fax: (403) 292-5576
Phone: (403) 299-3562
1-800-899-1265

For pick-up at the NEB office:

Library
Ground Floor

Printed in Canada

© Sa Majesté la Reine du Chef du Canada 2001 représentée par l'Office national de l'énergie

N° de cat. NE22-1/2001-5F
ISBN 0-662-86193-0

Ce rapport est publié séparément dans les deux langues officielles.

Exemplaires disponibles sur demande auprès du:

Bureau des publications
Office national de l'énergie
444, Septième Avenue S.-O.
Calgary (Alberta), T2P 0X8
Courrier électronique: publications@neb-one.gc.ca
Télécopieur: (403) 292-5576
Téléphone: (403) 299-3562
1-800-899-1265

En personne, au bureau de l'Office:

Bibliothèque
Rez-de-chaussée

Imprimé au Canada

Table of Contents

| | | |
|------------|---|-----------|
| 1. | Background | 1 |
| 2. | Toll Proceeding | 2 |
| 3. | Legitimacy of BRS Interest | 3 |
| 4. | Competition | 4 |
| 5. | Operating, Maintenance, General Administration | 6 |
| 5.1 | Repair and Maintenance Expenses | 6 |
| 5.2 | Contract Other | 6 |
| 5.3 | Power Costs | 7 |
| 5.4 | Oil Losses and Gains | 8 |
| 6. | Income Taxes | 9 |
| 7. | Rate Base | 10 |
| 8. | Cost of Capital | 12 |
| 8.1 | Capital Structure | 12 |
| 8.2 | Cost of Debt | 12 |
| 8.3 | Return on Common Equity | 13 |
| 9. | Cost of Service for 2000 | 14 |
| 10. | Cost of service for 2001 | 15 |
| 11. | Toll Structure | 16 |
| 12. | Final Tolls | 17 |
| 13. | Adjustment of Interim Tolls | 18 |
| 14. | Method of Regulation | 19 |
| 15. | Disposition | 20 |

List of Tables

| | | |
|---|---|----|
| 1 | Calculation of Net Rate Bases (Dollars) | 11 |
| 2 | 2000 Cost of Service (Dollars) | 14 |
| 3 | 2001 Cost of Service (Dollars) | 15 |
| 4 | Approved Tolls for Transportation to U.S. Border (\$/m ³) | 17 |

List of Appendices

| | | |
|----|---|----|
| I | Milk River Pipeline and Related Systems | 21 |
| II | Order TO-4-2001 | 22 |

Chapter 1

Background

On 25 August 2000, the Bow River South Group (BRS) consisting of producers and shippers of crude oil transported on the Milk River Pipeline (i.e., PanCanadian Petroleum Limited, Alberta Energy Company Ltd., Crestar Energy Inc. [now Gulf Canada] and EOTT Energy Canada Limited Partnership) filed a complaint concerning the level of tolls charged for the Milk River Pipeline. BRS requested that the Board initiate a proceeding to examine the justness and reasonableness of these tolls. Tolls for the Milk River Pipeline are regulated on a complaint basis pursuant to the *Memorandum of Guidance for the Regulation of Group 2 Companies*, updated 6 December 1995.

The Milk River Pipeline system consists of three parallel pipelines with diameters of 16.8, 27.3 and 32.4 cm (6, 10 and 12 inches) located in southeastern Alberta. The pipelines extend 16.4 km from a truck terminal at Milk River, Alberta to the U.S. border with a 7.6 cm (3 inch) lateral from the TRUAX 10-22 oil battery. The 16.8 cm pipeline transports light sour crude oil while the other two pipelines transport medium crude oil. The system has a capacity of 20 000 m³ per day with upstream connections to the Bow River and Manyberries pipelines and a downstream connection to the Cenex Pipeline. A map of the system and related pipelines is shown in the Appendix.

At the beginning of this proceeding, the Milk River Pipeline was owned by Murphy Oil Company Ltd. (Murphy). On 4 May 2001, Murphy sold the pipeline to Plains Marketing Canada, L.P. (Plains) for \$18,300,000. This sale was approved by Board Order MO-7-2001. For ease of reference, Murphy is used in this decision to also refer to Plains.

Chapter 2

Toll Proceeding

On 31 August 2000, the Board issued Order TOI-1-2000 to allow existing tolls on the pipeline to be charged on an interim basis effective 1 September 2000 and established a procedure to examine the pipeline's tolls.

On 21 September 2000, Mobil Oil Canada (Mobil) filed an intervention with respect to this proceeding and otherwise made no further submissions.

On 22 September 2000, Murphy requested an extension of the deadline for filing its submission. On 26 September 2000, the Board extended this deadline to 4 October 2000. On 4 October 2000, Murphy filed its Direct Written Evidence and on 13 October 2000, provided a list of shippers and interested parties which had been served with information concerning the complaint.

On 27 October 2000, BRS requested the Board to compel Murphy to provide more complete responses to BRS's letter of 17 October 2000. On 1 November 2000, the Board suspended the schedule for the proceeding and established a procedure to examine BRS's request. After examining submissions from Murphy and BRS, the Board decided on 21 November 2000 to compel Murphy to provide its financial statements. On 19 December 2000, BRS provided its Direct Evidence.

On 20 December 2000, the Board required Murphy to file information in accordance with Part X of the Board's *Guidelines for Filing Requirements*. On 9 January 2001, Murphy requested an extension of the deadline for filing this information from 24 January 2001 to 7 February 2001 and a clarification with respect to the process. On 12 January 2001, the Board granted the requested extension and clarified that the effect of the BRS complaint had been to initiate a toll proceeding in which Murphy was the applicant.

On 20 February 2001, the Board sent an information request to Murphy and set out the schedule for the remainder of the proceeding. In its response Murphy advised that it had entered into an agreement with Plains to sell the pipeline. On 27 March 2001, BRS submitted Additional Written Evidence. On 20 April 2001, Murphy filed its Reply Evidence followed by its Final Argument on 27 April 2001. On 11 May 2001, BRS provided Final Argument. On 18 May 2001, Plains, as the new owner of the pipeline, adopted all of Murphy's previous evidence and submitted Reply Argument.

Chapter 3

Legitimacy of BRS Interest

Murphy argued that the Board should dismiss the BRS complaint on the basis that none of its members bear the cost of transportation service on the Milk River Pipeline. While Murphy acknowledged that BRS represents producers served by the pipeline and confirmed that members of BRS are the shippers of record for 4% to 5% of the volumes transported on the Milk River Pipeline, it submitted that since the Billings (Montana) refineries are shippers of record for 81% of the throughput, they, and not the producers, bear the impact of tolls on the pipeline.

BRS submitted that collectively, it accounts for approximately 35% of the volumes shipped on the Milk River Pipeline. BRS stated that, as shippers and producers served by the Milk River Pipeline, they are impacted by the tolls on the pipeline and that Murphy's contention that the Billings refineries bear the impact of tolls is over-simplistic and fails to recognize or fully explain the market dynamics that can influence crude oil pricing at any point in time. BRS argued that, under a variety of market conditions, netback conditions will exist under which producers (i.e., BRS) will absorb the impact of changes in transportation costs. BRS contended that as the Billings refiners pay a market-based price for crude oil delivered at Billings, a reduction in the toll would translate into higher field netbacks for producers.

Views of the Board

The evidence demonstrates that the members of BRS produce approximately 35% of the throughput transported on the Milk River Pipeline and are the shippers of record for 4% to 5% of its total throughput. The Board considers that the net value received by producers for their production is the delivered price adjusted for quality and transportation and, to some extent, market conditions. Therefore, whether the payment of tolls is made by shippers, producers or refiners, the netback received by producers is impacted by the tolls on the Milk River Pipeline. As BRS consists of both shippers and producers, the Board is of the view that it has a legitimate interest in ensuring just and reasonable tolls on the pipeline.

Chapter 4

Competition

Murphy stated that the Milk River Pipeline is one component of the interconnected system made up of the Bow River, Conoco Glacier and Cenex Front Range pipelines. (See the Appendix.) This system moves crude from southern Alberta to refineries around Great Falls and Billings, Montana (the Billings refiners). According to Murphy, the Milk River Pipeline faces competition from pipelines which access markets directly served by it, e.g., Rangeland and U.S. pipelines, and from pipelines which provide access for intra-Alberta crude oil to other markets, e.g., Enbridge and Express. Murphy argued that shippers on the Milk River Pipeline have the ability to choose competitive alternatives at reasonable prices and that it is not in a position to exercise market power. Murphy stated that competitive forces act to constrain tolls for service as exemplified by the Northern Pipeline bypass proposal in 1992 which led to a reduction in tolls for the Milk River Pipeline and placed it at significant risk of losing volumes to other pipeline systems and to other markets. Murphy argued that in such a competitive environment, a cost of service methodology should not be used to set tolls or as a benchmark for gauging their reasonableness.

BRS stated that the evidence does not support Murphy's claims that competitive forces act to constrain the tolls or that these competitive forces place the pipeline at significant risk of losing volumes to other pipelines and markets. The pipeline's tolls have remained constant for many years, notwithstanding significant increases in throughput and theoretical reductions in rate base. No changes in rates charged have appeared to be necessary in order to respond to competitive options. Further, it contended that there is no economically competitive alternative for volumes which must flow south to Montana. BRS suggested that Murphy has been able to extract excessive rates of return and charge unreasonable tolls to customers over an extended period of time. In its view, these excessive earnings would not have been maintained over such a lengthy period of time if the Milk River Pipeline operated in a true competitive environment.

Views of the Board

As noted by both Murphy and BRS, economic regulation is designed to prevent the potential abuse of market power by a company operating in a monopolistic environment or in one with limited competition. Regulation ensures that such a company charges rates which are fair to customers and provides the company with a reasonable opportunity to earn a fair return on its capital investment. The Board agrees with Murphy that effective competition exists when customers of a service have the ability to obtain comparable services at reasonable prices from alternative suppliers and market participants are not in a position to exercise market power.

The evidence demonstrates that competing pipelines cannot access 30% to 40% of the volumes available to the Milk River Pipeline. The volumes transported on the Manyberries Pipeline system or the lateral from the TRUAX 10-22 battery or that are trucked to the Milk River truck terminal have no economic alternative but to use the Milk River Pipeline. Furthermore, the evidence shows that between 22% and 33% of the total Bow River volume transported on the Milk River Pipeline was from the

Fincastle “locked-south” area (crude oil delivered into the Bow River Pipeline at Fincastle and points south) which has no option but to travel south into the Milk River Pipeline.

According to Murphy’s calculations, the Milk River Pipeline’s after tax earnings from 1996 to 1999 have ranged from 16.7% to 18.5% of net capital employed. These are significantly in excess of returns allowed Group 1 Companies under the RH-2-94 decision. Despite the construction in 1997 of the Express Pipeline as a competitor, the Board notes that the Milk River Pipeline’s throughput and earnings have increased while tolls have remained the same.

The evidence suggests that the Milk River Pipeline operates in a limited competitive environment and that it exercises some level of market power. As a result, the Board has decided that an examination of the justness and reasonableness of its tolls is warranted. This examination will focus on the appropriate costs to be reflected in tolls. These costs, as proposed by Murphy and challenged by BRS, are discussed below under the main headings: operating, maintenance, general and administration, rate base, income taxes and cost of capital.

Chapter 5

Operating, Maintenance, General Administration

Murphy's operating, maintenance, general and administration expenses were forecast to increase over threefold from \$854,266 in 2000 to \$2,602,624 in 2001. These expenses are examined under four primary areas: repair and maintenance expenses, contract other, power costs, and oil losses and gains.

5.1 Repair and Maintenance Expenses

Repair and maintenance expenses were forecast to increase \$159,689 in 2001 over 2000 amounts because of additional work. Murphy budgeted \$100,000 of this increase for anticipated repairs to its pumps and motors and another \$50,000 for cleaning a tank in preparation for the installation of a new floating roof. Murphy acknowledged that pump wear and repair work were difficult to predict with certainty.

BRS suggested that some of this increase in repair and maintenance expenditures was for items which should be capitalized and depreciated or, at least, amortized over several years. It suggested that the cost of service could be significantly reduced if these expenses were amortized over five years. BRS did not want the entire amount of one-time expenses to be built into a benchmark level for tolls that would apply over many years.

Views of the Board

The Board finds that the proposed increase in repair and maintenance expenses is somewhat unusual and that much of this work is of a contingency nature. However, there is no evidence to suggest that this work will not be undertaken in the test year and the Board agrees with Murphy that annual repair and maintenance work should be expensed as incurred. Therefore, the Board accepts Murphy's estimate of maintenance expenses.

5.2 Contract Other

Murphy estimated that this toll proceeding would cost \$250,000 in outside legal and consultant fees which it proposed to recover as a one-time charge in 2001. Murphy was concerned that amortizing this expense over several years would require additional carrying costs which would increase costs borne by toll-payers and put it at risk with respect to recovery.

BRS suggested that these costs should be amortized over five years and expressed concern about one-time expenses distorting the determination of just and reasonable tolls.

Views of the Board

In considering how to treat the costs for this toll proceeding it is necessary, in the Board's view, to consider the regulatory context of the dispute in this case. Group 2 companies are only required to file their annual financial statements and the tolls they charge, and are not required to undergo rate hearings in the normal course of their regulation. Shippers have the right to file a complaint if they are not satisfied with the tolls. Group 2 pipeline companies benefit from a lower level of scrutiny in respect of tolls, such as being relieved of many of the costs associated with the filing requirements of Group 1 companies.

The key to the success of this form of light handed regulation is successful negotiation between pipeline companies and their shippers. As companies and their shippers are usually able to reach agreement on just and reasonable tolls, regulatory intervention is rarely required. Hearing costs in relation to tolling matters for Group 2 companies and their shippers are therefore minimized. Often it is largely within the company's power to resolve toll disputes with its shippers through negotiation and thereby avoid the filing of complaints and the associated costs in having them resolved. Thus, if a complaint is upheld and the Board determines that changes to the tolls are required to make them just and reasonable, it may not be reasonable to allow the pipeline company to recover its hearing costs from its shippers through tolls. Where a complaint is not upheld by the Board, this indicates that the tolls being charged by the company are just and reasonable. In those circumstances, it would often be reasonable for the pipeline company to recover its associated hearing costs through its tolls, as these costs would have been beyond its control.

The Board has determined that a significant reduction in tolls on the Milk River Pipeline is required. (See section 12, Table 4.) Given the circumstances of this case, the opportunity for Murphy to resolve the dispute with BRS through negotiation and the reduction in tolls, it would not be appropriate, in the Board's view, to require BRS and the other shippers to bear the burden of paying for Murphy's hearing costs through their recovery in tolls. Therefore, the costs of this proceeding have not been included in calculating the tolls of the Milk River Pipeline.

5.3 Power Costs

Murphy forecast its power costs to increase from \$510,589 in 2000 to \$1,334,400 in 2001 as the result of deregulation of the Alberta electric industry. Murphy based its estimate on the advice of an independent consultant who addressed the "critical conditions" of the western Canada power market.

BRS estimated Murphy's power costs at \$969,600 based on current forecasts. In its view, power costs in Alberta would also decrease in subsequent years. BRS stated that, if Murphy's earnings and tolls were set at reasonable levels, it could accept a temporary toll increase to accommodate increased power costs.

Views of the Board

The Board is satisfied that power costs are beyond Murphy's control or ability to forecast accurately at this time. However, the Board also notes that the Government of Alberta has established significant rebates to ease a period of transition in the electricity industry. In this instance, power costs are material and the Board considers that a deferral account is warranted to protect Murphy and its shippers from significant risk.

The Board approves Murphy's estimated power costs of \$1,334,400 for the test year and directs Murphy to establish a deferral account for the difference between this amount and its actual power costs, net of any Government of Alberta rebates. The amount so-deferred shall be subject to an appropriate toll adjustment by Murphy in 2002. Within 120 days after year-end, Murphy shall provide the Board and its shippers with details of its actual expenditures and rebates.

5.4 Oil Losses and Gains

Murphy acknowledged that it had experienced significant oil gains in previous years, but contended that it had pursued this matter with Cenex Pipeline who had undertaken a cleaning of its meter prover to resolve the problem. On this basis, Murphy forecast an oil loss equivalent to 0.015% of throughput which it considered low compared to the 0.05% charged by Enbridge Pipelines Inc. Murphy estimated oil losses of \$138,948 in 2001 compared to a net oil gain of \$484,191 in 2000. BRS made no submission on this item.

Views of the Board

The Board recognizes Murphy's recent efforts to remedy the oil gains from which it has benefitted over several years, but is not satisfied that Murphy will experience any significant oil loss in the test year. Therefore, the Board disallows Murphy's estimated oil loss.

Chapter 6

Income Taxes

Murphy calculated an income tax provision of \$540,337 for the test year under a normalized methodology and using a tax rate of 43.5%. Murphy estimated that the actual tax rate applicable to the Milk River Pipeline was 42.1% and argued that the impact of using this lower tax rate would be negligible. It also estimated its deferred taxes at \$115,049 for 2001.

BRS suggested that a tax rate of 40% would be more appropriate based upon Murphy's actual corporate tax rate.

Views of the Board

The Board believes that the tax provision should be calculated using the more accurate tax rate of 42.1%. Further, the Board notes that, although Murphy used a normalized tax methodology, it made no allowance for deferred taxes in either its rate base or capital structure. This is required under the normalized methodology to recognize deferred taxes as a zero cost source of financing. Therefore, the Board will calculate the tax provision using a 42.1% tax rate and deduct deferred taxes from the rate base in determining the cost of capital.

Chapter 7

Rate Base

The methodology to be used to determine rate base was a key point of contention in how costs should be reflected in tolls. Murphy calculated tolls for 2001 based upon a semi-depreciated rate base of \$10,025,966. Murphy proposed the use of a semi-depreciated rate base to demonstrate the reasonableness of its tolls. Under its semi-depreciated rate base, the “net” plant amount was derived from the average of the original cost of assets and the depreciated value of those assets, such that only half the amount of average accumulated depreciation is actually deducted from the rate base. Therefore, the “net” amount on which the return is calculated would never be less than one-half the original cost of those assets. In support of this approach, Murphy cited the Board’s 1980 decision for Cochin Pipelines Ltd. and its use by some provincially-regulated pipelines. Murphy thereby derived a rate base of \$10,025,966.

BRS rejected Murphy’s use of a semi-depreciated rate base. However, it was not proposing that the Milk River Pipeline be regulated on a rate base/cost of service basis but rather that the results of a rate base/cost of service analysis be used to establish a benchmark level for the pipeline’s tolls. BRS estimated Murphy’s rate base at \$8,012,714.

Views of the Board

Under Murphy’s proposed semi-depreciated methodology, it would earn an after tax return on its net plant and working capital plus one-half the cost of assets which had already been recovered through depreciation. In addition, interest expense would be charged to finance another one-half of net plant. As a result, this methodology double-counts a large portion of plant costs for purposes of deriving a “reasonable” return on equity and then recounts half the net depreciated cost of assets in the calculation of a deemed interest expense.

The Board’s accepted regulatory standard for the determination of just and reasonable tolls is based on a depreciated original cost rate base. However, the Board conditionally accepted the use of a semi-depreciated rate base for toll-setting in the 1980 Cochin decision based upon an unopposed agreement among the shipper-owners. In that instance, this methodology was intended to provide for an initial period of lower tolls and revenue for the newly constructed pipeline. The circumstances of the Cochin case were very different from this case. Therefore, the Board is not persuaded that Murphy has made a valid case for a departure from the regulatory standard and has applied a fully depreciated, original cost rate base methodology to determine an appropriate rate base. Under this approach, the rate base for the Milk River Pipeline is based upon the 13-month average of net plant plus an allowance for working capital. The Board’s determination of net rate bases for 2000 and 2001 is shown in Table 1.

Table 1
Calculation of Net Rate Bases (Dollars)

| Item | 2000 | 2001 |
|----------------------------------|----------------|----------------|
| Average Gross Plant | 11,709,568.00 | 11,844,485.00 |
| Average Accumulated Depreciation | (3,588,276.00) | (4,026,504.00) |
| Working Capital | 154,048.00 | 1,814,591.00 |
| Deferred Taxes | (81,828.00) | (115,049.00) |
| Net Rate Base | 8,193,512.00 | 7,884,391.00 |

1 \$188,308 per the application has been reduced by \$6,849 as a result of the disallowance of \$250,000 in toll proceeding costs. See section 5.2.

Chapter 8

Cost of Capital

Murphy calculated a return on its investment using a 7% return after tax on 100% of a semi-depreciated rate base plus deemed interest expense at 7.25% on 50% of the depreciated original cost rate base. Murphy's proposed return on its investment was \$985,453, made up of a return on common equity (ROE) of \$701,818 and a deemed interest expense of \$283,635. The determination of an appropriate cost of capital requires decisions with respect to capital structure, cost of debt and ROE, each of which is discussed below.

8.1 Capital Structure

Murphy contended that the Milk River Pipeline is totally financed by equity. It pointed out that in the RH-2-94 proceeding, the Board approved a deemed equity ratio of 45% for Trans Mountain Pipe Line Company. In Murphy's view, Trans Mountain has no direct competition at Kamloops and Burnaby, with the latter constituting about 69% of its total deliveries while the Milk River Pipeline faces competitive threats from Express and other pipelines. According to Murphy, a capital structure that includes an incremental five percentage points for equity beyond that awarded to Trans Mountain was therefore justified.

BRS did not offer any evidence on appropriate capital structure but suggested that a capital structure with a 50% equity component would be appropriate.

Views of the Board

The business risks of the Milk River Pipeline may be somewhat higher than that of Trans Mountain. This is because the Milk River Pipeline is relatively smaller with more limited supply and markets. In the specific circumstance of this case, the Board considers a common equity ratio of 50% to be reasonable. Therefore, the Board deems the capital structure for the pipeline to be composed of 50% debt and 50% common equity.

8.2 Cost of Debt

Murphy took the view that the interest rate applicable to the Milk River Pipeline should reflect the cost of financing a relatively small pipeline bearing significant risk from operating in a competitive marketplace. In its financial calculations, Murphy used an interest rate of 7.25%. Murphy suggested that this rate was not significantly different from Enbridge's debt yield of 7%. BRS did not challenge Murphy's proposed cost of debt.

Views of the Board

While the Board is of a view that the Milk River Pipeline operates in a limited competitive environment, it accepts that an interest rate of 7.25% is reasonable in this case.

8.3 Return on Common Equity

Murphy argued that a higher ROE than that derived using the RH-2-94 methodology would be appropriate since the pipelines subject to RH-2-94 are of a large capacity and carry relatively high volumes of oil or gas into large market areas. According to Murphy, these major pipelines have recently earned higher returns under multi-year toll settlements. Further, Murphy claims that the competitive risk faced by the Milk River Pipeline is higher than that faced by pipelines subject to RH-2-94. The Milk River Pipeline is a small pipeline and part of a system of pipelines that serves one relatively small and confined refinery area. The Express Pipeline will soon complete an interconnection to the Billings market. With that, Murphy argues that the Milk River Pipeline will face additional competition in its limited market.

BRS did not offer any evidence on appropriate ROE but suggested a rate of 12% as being appropriate on a 50% equity component.

Views of the Board

The business risk of the Milk River Pipeline which includes sales volatility, quality of its market and limited access to supply, is likely higher than the Group 1 pipelines subject to RH-2-94. The Board also considers the Milk River Pipeline to be exposed to higher financial risk than those of a benchmark pipeline referred to in the RH-2-94 decision. On this basis, the use of a higher ROE than that derived from using the RH-2-94 methodology is justifiable for purposes of setting tolls in this case. Thus, the Board finds that an ROE of 13% is reasonable in the current circumstances of the Milk River Pipeline.

Chapter 9

Cost of Service for 2000

Tolls have been charged on an interim basis since 1 September 2000 pursuant to Order TOI-1-2000. In order to set final tolls for the fourth quarter of 2000, the Board must determine a cost of service for the year. Since conditions in the final quarter were not materially different from those forecast for the test year, the Board finds that its decisions with respect to income taxes, interest and ROE for the test year are appropriate for setting these tolls. In summary, the approved cost of service for 2000 will be derived on the following basis:

1. Murphy's recorded actual operating, maintenance, general and administration and depreciation expenses are accepted.
2. Income taxes are computed at a 42.1% tax rate.
3. The net rate base has been derived from the 13-month average of net plant plus an allowance for working capital minus deferred taxes.
4. A capital structure for net rate base has been derived based upon 50% debt and 50% common equity.
5. Interest expense has been calculated at a rate of 7.25%.
6. The ROE has been computed at 13%.

A summary of Murphy's proposed amounts¹ and the approved cost of service for 2000 is given in the following Table 2.

Table 2
2000 Cost of Service (Dollars)

| Item | Proposed | Adjustments | Approved |
|----------------------|-----------|-------------|-----------|
| Repair & Maintenance | 30,319 | 0 | 30,319 |
| Contract Other | 4,027 | 0 | 4,027 |
| Power Costs | 510,689 | 0 | 510,689 |
| Oil Losses/Gains | (484,191) | 0 | (484,191) |
| Miscellaneous | 793,427 | 0 | 793,427 |
| Depreciation | 439,056 | 0 | 439,056 |
| Income Taxes | 544,206 | (156,960) | 387,246 |
| Interest | 295,421 | 1,594 | 297,015 |
| ROE | 706,842 | (174,264) | 532,578 |
| TOTAL | 2,839,796 | (329,630) | 2,510,166 |

¹ Murphy's actual revenue in the year 2000 was \$4,814,495.

Chapter 10

Cost of service for 2001

A summary of Murphy's proposed costs, Board adjustments and the approved cost of service for 2001 is presented below in Table 3. In total, Board adjustments reduce Murphy's proposed test year cost of service by 16.0%.

Table 3
2001 Cost of Service (Dollars)

| Item | Proposed | Board Adjustments | Approved |
|----------------------|------------------|------------------------------|------------------|
| Repair & Maintenance | 190,008 | 0 | 190,008 |
| Contract Other | 254,107 | (250,000) | 4,107 |
| Power Costs | 1,334,400 | 0 | 1,334,400 |
| Oil Losses/Gains | 138,948 | (138,948) | 0 |
| Miscellaneous | 769,161 | 0 | 769,161 |
| Depreciation | 437,402 | 0 | 437,402 |
| Income Taxes | 540,337 | (167,701) | 372,636 |
| Interest | 283,635 | 2,174 | 285,809 |
| ROE | 701,818 | (189,333) | 512,485 |
| TOTAL | 4,649,816 | (743,808) | 3,906,008 |

Chapter 11

Toll Structure

For the past decade, Murphy has charged a 53.6% premium on light crude oil received from the Manyberries Pipeline versus medium and heavy crude oils received from the Bow River Pipeline. However, there was no differential charged for light crude oil received from trucks. Murphy was unable to provide any cost information to support this toll structure, but considered this toll differential to be reflective of economies of scale related to the fact that the light crude oil is transported in a smaller diameter pipeline than medium and heavy crude oils. As for the uniform toll charged trucked volumes, Murphy explained that these volumes represent only 6% of pipeline throughput and that the toll originates from the time when all types of crude oil were transported in the same pipeline. BRS made no submission on this matter.

Views of the Board

The Board notes that light crude oil can be transported in any of the Milk River pipelines and that the decision concerning which pipeline is used is simply an operational preference by Murphy unrelated to the particular requirements of light crude oil. The Board is aware of no other pipeline that charges a premium for the transportation of light versus medium or heavy crude oils. Rather, medium and heavy crude oils are generally charged premiums over light crude oil as is the case on both the Express and Enbridge systems. Murphy has not demonstrated that there is any significant difference in required facilities, services or costs, to justify any toll differential being applied to light crude oil. This unusual toll structure could be interpreted as further evidence of market power. Therefore, the Board is not satisfied that any premium for the transportation of light crude oil is warranted and has decided that tolls for light crude oil should be set at the same level as those for medium and heavy crude oils.

Chapter 12

Final Tolls

Based on the foregoing costs of service and Murphy's throughput information, the Board has determined final tolls to be effective 1 September 2000 and 1 January 2001 as follows:

Table 4
Approved Tolls for Transportation to U.S. Border (\$/m3)

| Origin/Crude Oil Type | Interim Tolls | Effective 1 September 2000¹ | Effective 1 January 2001 |
|---|--------------------------|---|---|
| Milk River Truck Terminal/ Light, Medium & Heavy | 1.57 | 0.845 | 1.342 |
| Milk River Pump Station/Light | 1.26 | 0.441 | 0.701 |
| Milk River Pump Station/ Medium & Heavy | 0.82 | 0.441 | 0.701 |
| TRUAX 10-22 Battery/Light | 1.26 | 0.441 | 0.701 |
| TRUAX 10-22 Battery/ Medium & Heavy | 0.82 | 0.441 | 0.701 |

1 These tolls are only in effect for the fourth quarter of 2000 and reflect the Board's reduction of Murphy's cost of service for the year.

Chapter 13

Adjustment of Interim Tolls

Tolls have been charged on an interim basis subject to refund since 1 September 2000. Based upon its determination of final tolls, the Board estimates the refund on volumes shipped from 1 September 2000 to 1 August 2001 to be approximately \$1.0 million. The Board directs Murphy to recalculate its billings to shippers during the interim period and to refund the amount of the difference plus interest at 7.25%.

Chapter 14

Method of Regulation

Tolls for the Milk River Pipeline have been regulated on a complaint basis since 1985. The Board notes that both Murphy and BRS sought continuation of this method of regulation. With the expectation that Plains will cooperate in providing its shippers and interested parties with sufficient information to support the justness and reasonableness of tolls, the Board will continue to regulate the Milk River Pipeline on a complaint basis pursuant to the *Memorandum of Guidance for the Regulation of Group 2 Companies* as updated 6 December 1995.

Chapter 15

Disposition

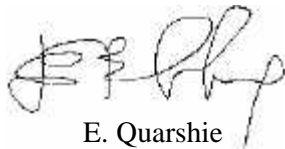
The foregoing constitutes our Reasons for Decision in this matter.



C. Dybwad
Presiding Member



J.-P. Théorêt
Member

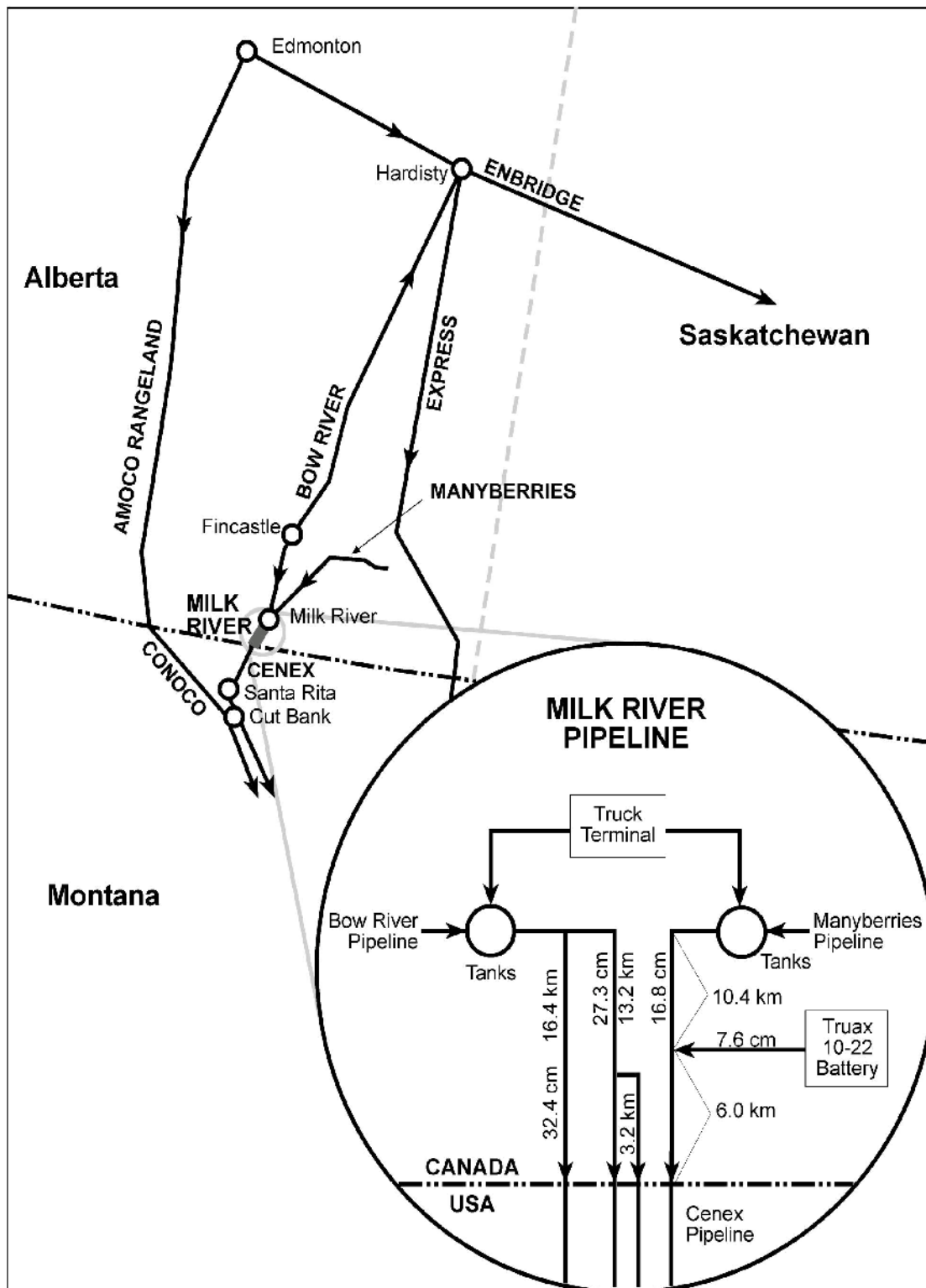


E. Quarshie
Member

Calgary, Alberta
August 2001

Appendix I

Milk River Pipeline and Related Systems



Appendix II

Order TO-4-2001

IN THE MATTER OF the *National Energy Board Act* (the Act) and the regulations made thereunder; and

IN THE MATTER OF a complaint filed with the National Energy Board (the Board) pursuant to sections 20, 59, 60, 62, 64, 65 and 66 of the Act on 25 August 2000 by Bow River South Group consisting of PanCanadian Petroleum Limited, Alberta Energy Company Ltd., Crestar Energy Inc. (now Gulf Canada) and EOTT Energy Canada Limited Partnership, concerning the level of tolls charged by Murphy Oil Company Ltd. (Murphy) for transportation on the Milk River Pipeline, under file 4775-M23-1-2;

BEFORE the Board on 1 August 2001.

WHEREAS on 31 August 2000, the Board initiated a written proceeding to examine the tolls on the Milk River Pipeline and issued Order TOI-1-2000 to allow the existing tolls to be charged on an interim basis effective 1 September 2000 pending the determination of final tolls;

AND WHEREAS during the course of the proceeding, Plains Marketing Canada, LP (Plains) purchased the Milk River Pipeline from Murphy and adopted all of the evidence previously filed by Murphy in this proceeding;

AND WHEREAS the Board has considered the submissions of the parties to the proceeding in its examination of the tolls on the Milk River Pipeline;

AND WHEREAS the Board has issued its Reasons for Decision dated August 2001 in this matter and has determined just and reasonable tolls for the Milk River Pipeline as set out in Schedule “A” attached to and forming part of this order;

IT IS ORDERED that pursuant to sections 59 and 64 of the Act:

1. The tolls contained in Schedule “A” are approved as final tolls for the Milk River Pipeline to be effective 1 September 2000 and 1 January 2001, respectively.
2. Plains shall refund to the shippers on the Milk River Pipeline, the difference between tolls charged on an interim basis pursuant to Order TOI-1-2000 and the final tolls set out in Schedule “A”, together with interest at a rate of 7.25%.
3. Plains shall establish a deferral account to record any difference between the approved amount of \$1,334,400 for power costs in 2001 and the actual amount of these costs net of any rebates from the Government of Alberta.

4. Any balance in the deferral account referred to in clause 3 of this order, shall accrue interest at an annual rate of 7.25% and be reflected by Plains in an appropriate adjustment to the year 2002 tolls for the Milk River Pipeline.
5. Plains shall, no later than 120 days after its 2001 year end, file with the Board and provide to its shippers, details of the actual expenditures and rebates referred to in clause 3 of this order.

NATIONAL ENERGY BOARD

Original signed by Robert LeMay

Michel L. Mantha
Secretary

Schedule "A"

Final Tolls for the Milk River Pipeline (Dollars per cubic metre)

| Origin/Crude Oil Type | Effective 1 September 2000 | Effective 1 January 2001 |
|-------------------------------------|-------------------------------|-----------------------------|
| Milk River Truck Terminal/All Types | 0.845 | 1.342 |
| Milk River Pump Station/All Types | 0.441 | 0.701 |
| TRUAX 10-22 Battery/All Types | 0.441 | 0.701 |