

Mr. Earnest, the Extension deficits are repaid (with interest) in accordance with the Tariff Agreement during its 15-year term.<sup>3</sup>

14. Certain additional features of the Tariff Agreement are worth noting in regards to the objective of achieving a self-sustaining Extension. First, the objective is not just to recover the costs of the Extension from the users, but to stabilize the rate structure of the Extension over time. The main mechanism for achieving this rate stability is the use of a throughput of 340,000 barrels per day to forecast throughput for ratemaking purposes regardless of actual throughput (which is applied even after the Extension achieves self-sufficiency). Thus Extension shippers get the benefit of a relatively high early year billing determinant and more stable rates over time, which is likely to make the Extension more attractive to incremental shippers. Because actual throughput is expected to be lower in the early years and ramp up, this rate stability is likely to result in early year deficits that are offset in later years.
15. The second prominent feature of note in the Agreement is that a state of “self-sufficiency” will be achieved on the Extension. This means that surcharges will terminate and no further deficits will be accumulated when the Extension reaches the defined level of utilization. Rather, future surpluses would be passed on as rate cuts and credited against the cumulative deficiency, should one exist, until it is reduced to zero. This increases the likelihood that the surcharges and surcredits will expire before the end of the Tariff Agreement.
16. Thirdly, the amount in the cumulative account will determine the level of surcharges and surcredits in any year. For example, the surcredit is applied to reduce rates only if the cumulative deficit is greater than or equal to zero. As noted, when a state of “self-sufficiency” is reached, surpluses are used to reduce upstream rates only so long as the cumulative deficit is greater than zero.

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3 A minor exception occurs to the extent a deficit occurs in a year in which the Qualifying Volume on the Lakehead System, as defined in the Offer of Settlement approved by the Commission in the 2006 Settlement Order, exceeds 400,000 bpd. In such a year, the proportionate share of the deficit above the 400,000 bpd level is not subject to repayment. Mr. Douvris’ affidavit (Exhibit 5 to the Joint Petition) shows that this situation is likely to arise only in one year, that the magnitude is relatively small, and that it will be outweighed by other benefits described below. Douvris Aff., Exh. 5 at ¶ 9.

17. Lastly, another major feature is that the stand alone rate on the Extension under the Tariff Agreement is significantly larger than the “implicit rate” under the prior settlement agreement (derived by subtracting the Canadian border-to-Flanagan rate from the proposed border-to-Patoka rate under the prior settlement agreement). This substantial increase in the rate for service on the Extension significantly decreases the “break-even” capacity utilization needed for the Extension to avoid any deficits (and to be able to repay deficits out of later surpluses)
18. These features demonstrate that the surcharge/surcredit methodology achieves the objective of recovering the costs of the Extension through stand alone rates over the term of the Tariff Agreement and thus addresses the Commission’s three concerns about the prior settlement.
19. The Tariff Agreement relies on a “stand alone” rate methodology for the Extension, and does not contemplate the permanent recovery of Extension costs through the Lakehead rates. Therefore, there is no net cost to the Lakehead shippers over the life of the Tariff Agreement and there is no need to quantify specific benefits to offset costs. Moreover, even if there were deemed to be a need to quantify benefits to Lakehead shippers from the Extension, those benefits are described and quantified by Mr. Schrage, Mr. Earnest and Mr. Douvris in greater detail. There is no effective subsidy of the Extension Pipeline by Lakehead shippers as the Extension is not being unduly benefited by the proposed rate arrangement. And, with regards to the matter of the presence of a separate company owning the Extension, the same issues that were identified in the Commission’s prior order on the original settlement are not created by this proposal because the Extension rates are being set on a stand alone basis, rather than a rolled-in basis. The Tariff Agreement effectively caps the revenues of the Extension at the level of its cost of service. Any surplus revenues are used first to pay off prior deficits (with interest) and then to lower the Extension’s stand alone rates. For that reason, there is no legitimate concern here about subsidization of the Extension by Lakehead or its shippers.
20. In terms of the benefits to Lakehead shippers of the Extension, Mr. Schrage discusses those benefits in his Affidavit, including (1) the benefit of having an alternative pipeline

option that enhances the system's flexibility, (2) the additional quality yielded by enhanced crude segregation for light barrels that are transported on the Lakehead and Mustang Systems, (3) the savings in batch pigging costs produced by increased velocity of flow on the upstream lines, (4) the reduction in shipper carrying costs resulting from improved transit times due to faster pipeline flows, and (5) reductions in approved Lakehead surcharges arising from incremental volumes. Mr. Earnest's forecast supports the proposition that there will be substantial incremental volumes generated on the Lakehead System. If some or all of the deliveries to the upstream system are incremental, upstream shipments benefit from reduced carrying costs and pigging charges and under previously approved surcharges even if they themselves do not use the Extension or any other extension. Those incremental volumes will cause an elimination or reduction in previously approved pigging costs charged to shippers, and a reduction in upstream surcharges, while reducing the inventory cost borne by all shippers. Cumulatively, these rate and non-rate benefits easily offset the effect of the surcharge. And they will continue to create ratepayer benefits on the upstream system even after the Extension surcharge/surcredit mechanism has expired at the termination of the Tariff Agreement. The 'security benefit' of alternative pipeline routes to market also continues even after the Extension surcharge/surcredit mechanism has expired.

21. Given that incremental upstream volumes produce reduced pigging costs, lower carrying costs, and lower upstream rates, while reducing quality discounting and providing a security benefit, the surcharge/surcredit mechanism is a reasonable arrangement for the upstream shipper to make to achieve these benefits. The surcharge/surcredit mechanism represents a reasonable balance of the costs and benefits of the Extension to pre-existing and incremental shippers both of whom will benefit from the Tariff Agreement. The shipment to the Extension destination is treated incrementally as far as the Extension is concerned and is expected to pay a stand alone rate for use of the Extension over its lifetime. In addition, the Extension shipment gets the benefit of a stabilized rate, especially in the early years.
22. Conversely, pre-existing shipments on the Lakehead System enjoy the benefits derived from any incremental throughput of reduced pigging costs, reduced carrying costs, and

reduction in previously approved surcharges, as well as benefits relating to reduced quality discounts and a security benefit from alternative routes to market. And when the Extension achieves self-sufficiency, the surcharge/surcredit mechanism will cease, while the security benefit, quality benefit and benefits of incremental volumes will continue beyond the life of the Tariff Agreement.

23. In short, upstream shippers will receive the benefits of a compensatory stand alone rate for the Extension over the life of the Tariff Agreement plus the benefits of incremental volumes upstream. Meanwhile the downstream shipment to the Extension must pay a compensatory stand alone incremental rate for the Extension and must pay a rolled-in rate for the upstream portion of the service, but gets the benefit of both access to new markets and rate stabilization on the Extension.
24. Investors would not bear the risk of any early period losses on the Extension without such a means of passing them on to shippers, so that the project might not be completed without some form of backstopping. And, as noted above, shippers support a mechanism of recovery that takes into consideration the substantial benefits to all customers who benefit from the incremental volumes, even those that do not ship over the Extension.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and accurate.

Executed on October 17, 2007.

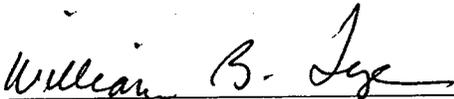
  
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William B. Tye

Exhibit WBT-1

**WILLIAM B. TYE****PRINCIPAL**

Dr. William B. Tye received his B.A. in economics from Emory University and his Ph.D. in economics from Harvard University. Upon leaving Harvard, he became assistant professor of economics and management at the U.S. Air Force Academy, holding the rank of Captain. There he taught quantitative economic theory, econometrics, policy issues in contemporary economics and quantitative decision methods. After leaving the service in 1972, he joined Charles River Associates, a Boston research and consulting firm, as a senior research associate and was promoted to program manager for transportation, and later to vice president and a director of the company. He joined Putnam, Hayes & Bartlett, Inc. in 1980 as a Principal. In August 1990 Dr. Tye and six colleagues founded *The Brattle Group*. *The Brattle Group* is the successor firm resulting from the merger of The Brattle Group, Inc. and Incentives Research, Inc., and was known for a year as Brattle/IRI.

### RECENT ASSIGNMENTS

Dr. Tye, an expert in economic analysis and public policy, has been an economic consultant for over thirty years. He specializes in regulatory and antitrust issues. His clients have included regulatory bodies, firms in regulated industries and law firms. He has authored or co-authored over one hundred papers and publications, including four books. Some consulting assignments include:

- **Antitrust Analysis:** performed studies of competition in silicon, railroading, international telecommunications, petroleum, electric utilities, natural gas, latex and pipelines.
- **Estimating Damages:** provided economic analysis of damages in a case involving claims of alleged fraud in franchising, damage claims from alleged overcharges in the retailing of gasoline, false advertising in infant formulas, and business interruption.
- **Settlement Values and Strategies:** used business decision and planning tools successfully in consultation with attorneys to develop optimal litigation/settlement strategies in several recent cases.
- **Regulatory Economics:** testified on mergers between regulated firms, on the economic aspects of automobile franchise regulation in a case between

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a dealer and an automobile manufacturer, on cost allocation issues involving different petroleum streams on the Trans Alaska Pipeline (TAPS), and on the cost of capital and proper calculation of avoided costs in the electric utility industry.

- **Management:** provided assistance to senior management of a large utility seeking a successful transition to a more competitive business environment.

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“Regulatory Transitions,” in Kenneth J. Button, and David A. Hensher, eds., *Handbook 6: Transport Strategy, Policy and Institutions*, Amsterdam, 2005.

## TESTIMONY

Assisted in preparation of expert testimony before the Postal Rate Commission in 1974 and 1976.

Assisted Professor Franklin Fisher in preparation of expert testimony in antitrust litigation (*CBS v. ASCAP*).

Testimony before the Postal Rate Commission on behalf of United Parcel Service, Docket No. R77-1, filed 14 October 1977.

Direct testimony before the Postal Rate Commission on behalf of United Parcel Service, Docket No. MC78-1, filed 4 April 1979, and supplemental testimony, filed 15 June 1979.

Assisted Professor Stewart C. Myers in the preparation of expert testimony on rate base methodology and rate of return in the oil pipeline industry before the Federal Energy Regulatory Commission, Docket No. OR79-1.

Assisted in the preparation of expert testimony on the subject of profit renegotiation for a government contractor performing trucking services, 1979.

Testimony before the Civil Aeronautics Board on behalf of Eastern Airlines, Miami-London Route Case, Docket No. 36764, 13 December 1979.

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Testimony before the Civil Aeronautics Board on behalf of Eastern Airlines, Florida-Mexico City Route Investigation, Docket No. 32820, 16 July 1980.

Testimony before the Postal Rate Commission on behalf of United Parcel Service, Docket No. R80-1, filed 13 August 1980.

Testimony before the Motor Carrier Ratemaking Study Commission on behalf of Motor Common Carrier Associations, 19 March 1982.

Testimony before the ICC on behalf of the National Coal Association, *Coal Rate Guidelines—Nationwide, Ex Parte* No. 347 (Sub-No. 1), 13 April 1982.

Testimony before the ICC on behalf of The Dayton Power and Light Company (v. Louisville and Nashville Railroad Company), Docket No. 38025, 6 April 1982 (direct) and 7 June 1982 (rebuttal).

Statement prepared for the Motor Carrier Ratemaking Study Commission, "Review of Regulatory Reform and the Trucking Industry: An Evaluation of the Motor Carrier Act of 1980," May 1982.

Testimony before the ICC on behalf of Niagara Mohawk Power Corporation (v. Conrail *et al.*), Docket No. 38336S, 21 July 1982.

Testimony before the ICC on behalf of Commonwealth Edison *et al.* (v. Aberdeen and Rockfish Railroad Company *et al.*), Docket No. 37891 *et al.*, 9 August 1982, 25 October 1982, and 14 February 1983.

Testimony before the ICC on behalf of Consumers Power Company, Docket No. 37854S *et al.*, 6 October 1982, 28 December 1982, and 1 August 1983; in Docket No. 38181S, 15 October 1982, 31 December 1982, and 2 August 1983; in Docket No. 37853S *et al.*, on 12 November 1982, 13 January 1983, and 29 August 1983; and in Docket No. 37857S *et al.*, on 24 January 1983, 25 March 1983, and 10 January 1985.

Statement prepared for the Motor Carrier Ratemaking Study Commission, "The Motor Carrier Market Place Without Collective Ratemaking," 24 November 1982.

Testimony before the ICC on behalf of Delmarva Power and Light Company, Docket Nos. 38329 and 38330, 31 January 1983.

Testimony before the ICC on behalf of Mobil Chemical Company, Docket No. 37850S, 30 March 1983, and 31 May 1983.

Testimony on behalf of Kansas Gas and Electric Company in Civil Action No. 83-1104, United States District Court for the District of Kansas, 19 April 1983.

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Testimony before the ICC on behalf of Consumers Power Company, *Ex Parte* No. 347 (Sub-No. 1), "Coal Rate Guidelines—Nationwide," 28 July 1983.

Testimony before the ICC on behalf of Detroit Edison Company, Docket Nos. 38279S *et al.*, 22 December 1983, 13 February 1984, 14 March 1984, and 5 April 1984.

Testimony before the ICC on behalf of National Coal Association, 14 February 1984, in Finance Docket No. 30300, CSX Corporation—Control—American Commercial Lines, Inc.

Testimony on behalf of MKT Railroad before the ICC, 10 September 1984, 21 November 1984, and 29 May 1985, in Finance Docket No. 30,400 *et al.*, SFSP Merger Proceedings.

Testimony before the ICC, 31 May 1985 and 8 July 1985, *Ex Parte* No. 445 (Sub-No. 1), *Intramodal Rail Competition*.

Testimony on behalf of Presidential Airlines in Docket No. 43825, *Texas Air—Eastern Acquisition Case*, before the Department of Transportation, 13 May 1986.

Panelist in a two-day colloquium on rail costing issues, 18-19 June 1986, before the Railroad Accounting Principles Board.

Deposition in *Farmers Electric Cooperative vs. Arkansas Power and Light Company*, U.S. District Court for the Eastern District of Arkansas, 27 June 1986.

Affidavit before an arbitration panel in the matter of Marilyn Benjamin, Administrator and Traffic Executive Association, Eastern Railroads, 29 May 1986.

Testimony on behalf of Presidential Airlines in Docket No. 44365, *Joint Application of Texas Air Corporation and People Express, Inc.*, merger proceeding before the Department of Transportation, 21 October 1986.

Deposition in *City of Austin et al. v. Decker Coal Company et al.*, No. A-85-CA-104, U.S. District Court, Western District of Texas, 2 April 1987.

Testimony before the ICC on behalf of the Commonwealth of Massachusetts in Docket Nos. 31250 and 31259, Conveyance of B&M Corporation Interests in Conn River Line, 13 June 1988 and Reply Testimony on 13 July 1988.

Testimony before the Illinois Commerce Commission on behalf of Mississippi River Transmission in *Application of Illini Carrier*, 13 May 1988.

Testimony before the ICC on behalf of the Commonwealth of Massachusetts in *Ex Parte* No. 274 (Sub-No. 11A), *Abandonment Regulations—Costing*, 8 July 1988.

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Deposition in *James River Corporation vs. Northwest Pipeline Corporation*, 13-15 March, 12-14 April 1989.

Testimony before the Missouri Public Service Commission, Application of Missouri Pipeline Company, 10 May 1989 and 30 May 1989.

Testimony before the Public Utilities Commission of California, Application No. 88-07-020 *et al.*, 5 January 1990, on behalf of US Sprint.

Testimony before the ICC on behalf of Rio Grande Industries, Inc., *Finance Docket No. 31505, Rio Grande Industries, Inc. et al.*—Purchase and Related Trackage Rights—Soo Line Railroad Company Line Between Kansas City, MO and Chicago, IL, 15 February 1990.

Expert's Report and Deposition, in *Litton Industries et al. v. Chesapeake and Ohio Railway Co. et al.*, Northern District of Ohio, Eastern Division, 11 April 1990.

Testimony before the Michigan Public Service Commission, Application of TNT Holland Motor Express, Inc. for Extension of Operations, 20 July 1990.

*Carolina Power & Light Company, Project No. 432*, before the Federal Energy Regulatory Commission, 15 March 1991.

Expert's Report and Deposition, *NCEMC v. Carolina Power and Light Company*, 11 March 1992.

Testimony before the Federal Energy Regulatory Commission, on behalf of Amerada Hess Pipeline Corporation, 30 March 1992 and Rebuttal Testimony, 10 August 1992.

Deposition in *Richard Lundgren, Inc. v. American Honda Motor Co., Inc.*, Civil Action No. 92-1091, Commonwealth of Massachusetts, February 5, 1993, and Testimony before the Superior Court of Massachusetts, Worcester, Massachusetts, 27 September 1994.

Deposition in *Empresas Puertorriquenas de Desarrollo, Inc. v. F.W. Woolworth Co.*, United States District Court for the District of Puerto Rico, 4 March 1993.

Testimony before the Interstate Commerce Commission, *Seaboard Air Line Railroad Company—Merger—Atlantic Coast Line Railroad Company: Petition to Remove Traffic Conditions*, Finance Docket No. 21215 (Sub-No.5), 29 March 1993.

Testimony before the Postal Rate Commission, *Bulk Small Parcel Service*, Docket No. MC93-1, 16 April 1993.

Testimony before the Commonwealth of Massachusetts Department of Public Utilities, DPU 93-167, *For the Purpose of Establishing Guidelines and Standards for Acquisitions and Mergers Of Utilities*, 16 February 1994.

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Deposition, *Texaco Puerto Rico, Inc., et al., v. Department of Consumer Affairs*, United States District Court for the District of Puerto Rico, 21 April 1994, Expert's Report and Testimony before the Court, 2 August 1994.

"Competition in the Market for Trans-Oceanic Facilities-Based Telecommunications Services," with Hendrik S. Houthakker and Johannes P. Pfeifenberger, before the Federal Communications Commission, June 24, 1994 (also related studies filed October 25, 1996; April 23, 1997 and July 7, 1997).

Prepared Testimony before the Public Utilities Commission of the State of Hawaii, on behalf of Citizens Utilities Company, Kauai Electric Division, 21 July 1994, and oral testimony, 1 May 1995.

Prepared Rebuttal Testimony on behalf of Hawaiian Electric Light Company (Subject: Risks of Purchased Power Contracts), before the Public Utilities Commission of the State of Hawaii, December 1994.

Reply Testimony (with A. Lawrence Kolbe) on Behalf of Edison Electric Institute, Docket No. RM94-7-000, before the Federal Energy Regulatory Commission, 23 January 1995.

"The Economics of Pricing Network Access in the Market for Telecommunications in New Zealand" (with Carlos Lapuerta), prepared for the Minister of Commerce and the Minister of Communications on behalf of Clear Communications, Ltd, 17 February 1995.

Prepared Direct Testimony on behalf of the Designated TAPS Carriers, before the Federal Energy Regulatory Commission and Alaska Public Utilities Commission, Docket Nos. IS94-10-002, *et al.* (Phase II), 14 March 1995.

"Damages from Delay of Essex Government Contract," Expert's Report in *Essex Corp. v. Wackenhut Services, Inc.*, in the United States District Court for the District of New Mexico, March 23, 1995, Deposition, April 25, 1995, and Supplemental Report, January 11, 1996.

Testimony before the I.C.C., Finance Docket No. 32549, *Burlington Northern, Inc. and Burlington Northern Railroad Company—Control and Merger—Santa Fe Pacific Corporation and Atchison, Topeka and Santa Fe Railway Company*, May 10, 1995.

Testimony before the U.S. District Court, Southern District of New York, *New York Urban League v. Metropolitan Transportation Authority*, November 2, 1995.  
"Post Merger 'Character of Rivalry' in the Proposed 'SOP/UP' Railroad Merger," before the Texas Railroad Commission, February 5, 1996.

Testimony before the Surface Transportation Board, Docket No. 32760, *Union Pacific—Southern Pacific* merger proceeding, March 29, 1996.