

**OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE MINNESOTA PUBLIC UTILITIES COMMISSION**

In the Matter of Application of Enbridge Energy)	
Limited Partnership and Enbridge Pipelines)	
(Southern Lights) LLC for a Certificate)	OAH No. 8-2500-19094-2
Of Need for the Alberta Clipper Pipeline Project)	MPUC Dkt. No. CN-07-465
And the Southern Lights Diluent Project)	
)	

**Direct Testimony of
John T. Durkin, Jr.**

**On Behalf of
Minnesota Center for Environmental Advocacy**

Table of Contents

1. INTRODUCTION.....1

**2. THE EFFECT OF THE ALBERTA CLIPPER PROJECT
ON LOCAL AND REGIONAL SUPPLY2**

**3. THE BENEFITS OF THE ALBERTA CLIPPER
PROJECT RELATIVE TO ITS COSTS5**

List of Exhibits

- Exhibit MCEA-1:** Curriculum Vitae of John T. Durkin, Jr., Ph.D.
- Exhibit MCEA-2:** Graph, Minnesota and Regional weekly average retail gasoline prices
- Exhibit MCEA-3:** Graph, Regional and National weekly average retail gasoline prices

1. INTRODUCTION

Q. What is your name, position and business address?

A. My name is John T. Durkin, Jr. I am a Vice President with Chicago Partners. My address is Suite 1500, 140 S. Dearborn, Chicago, IL 60603.

Q. Please describe your education and professional experience.

A. I received a PhD. in economics from the University of Chicago in 1991. For the last 6 years, I have been employed by Chicago Partners, an economics consulting firm that specializes in the application of economic theory to a variety of legal and regulatory issues. I am also a lecturer at the Harris Graduate School of Public Policy Studies at the University of Chicago.

Q. Have you included a current copy of your Curriculum Vitae as an exhibit?

A. Yes. A current copy of my CV is included as Exhibit MCEA-1.

Q. Have you previously submitted testimony to a regulatory agency on the economic impact of a proposed pipeline expansion?

A. Yes. I submitted testimony before the Illinois Commerce Commission.

Q. What is the purpose of your testimony?

A. I have been asked by the Minnesota Center for Environmental Advocacy to examine the likely impact of Enbridge's proposed Alberta Clipper pipeline on the local and regional supply of refined petroleum products. In addition, I have been asked to consider whether the analysis presented by the Minnesota Department of Commerce experts, Adam J. Heinen and Bryan J. Minder, establish that the benefits of the Alberta Clipper project exceed the costs of the project.

Q. What is your understanding of the Alberta Clipper project?

A. I understand that Enbridge proposes to construct and operate a new 36 inch diameter pipeline running from Cromer, Manitoba through Minnesota to Superior, Wisconsin to carry Canadian tar sands crude oil. Enbridge claims that the new pipeline would carry 450,000 barrels per day of heavy crude.

Q. What opinions have you formed as a result of your analysis?

A. I have formed three main opinions

- The Alberta Clipper will have no impact on the local or regional supply of refined petroleum and no impact on local or regional prices.
- The analysis by the Department of Commerce (“DOC”) experts provides no basis to support their claim that the project is needed or that benefits of the project exceed its costs. In particular, the accuracy of their predictions regarding increasing demand is unreliable.
- My analysis suggests that the benefits are less than the cost for the people of Minnesota.

2. THE EFFECT OF THE ALBERTA CLIPPER PROJECT ON LOCAL AND REGIONAL SUPPLY

Q. Is there any basis for the claim that the Alberta Clipper project would lead to an increase in local or regional crude oil supplies?

A. No. As Mr. Heinen admits, Enbridge makes no claim that the increased crude supplies are destined for the Minnesota market.¹ Indeed, Enbridge’s recent announcement of plans to extend its pipeline system down to the Gulf² suggests that a large portion of its capacity is destined for refiners outside of the Midwest. Local refineries have access to crude supplies from sources other than the Enbridge pipeline.³ Moreover, Mr. Minder claims that local refineries are already operating at or near their capacity,⁴ so even if local crude supplies did increase, there would be no impact on local refined supplies.

¹ Direct testimony and Exhibits of Adam J. Heinen, Minnesota Public Utilities Commission, Docket No. PL9/CN-07-465, page 32.

² *The Globe and Mail*, ‘Enbridge, Exxon move ahead on pipeline bid’, December 19, 2007.

³ Direct testimony and Exhibits of Adam J. Heinen, Minnesota Public Utilities Commission, Docket No. PL9/CN-07-465, Exhibit AJH-3.

⁴ Direct testimony and Exhibits of Bryan J. Minder, Minnesota Public Utilities Commission, Docket No. PL9/CN-07-465, page 24.

Q. Is there any basis for the claim that the Alberta Clipper project would lead to a reduction in local crude prices?

A. No. Basic economic theory suggests that there is no basis for this claim. Crude suppliers sell to the refineries willing to pay the highest price. Enbridge's pipeline system allows suppliers to sell to refineries in multiple locations, and local refineries can buy crude from multiple sources. If crude prices were higher in Chicago or the Gulf than in the local market, then suppliers would ship the crude further down through the Enbridge pipeline. Similarly, if local prices of Canadian tar sands crude were higher than crude prices in Chicago, then local supplies from the Gulf or other locations would increase. This means that local, regional and Gulf refineries all pay essentially the same prices.

The only way the pipeline expansion could impact local crude prices would be if it impacted national or international prices by impacting the national or international supply of crude, but this pipeline expansion has no impact on the national or international supply of crude. There are several ways for Canadian tar sands crude to get to refineries in the US and internationally other than the Enbridge pipeline system, so while the Alberta Clipper project will impact who gets paid to supply the crude, it has no impact on the total national or international supply of crude.

Q. Is there any basis for the claim that the Alberta Clipper project would impact local or regional refined petroleum supplies or prices?

A. No. Again, basic economics indicates that there is no basis for this claim. For commodities like refined petroleum products with relatively low transport costs, local prices are determined primarily by national and international supply and demand factors. If prices differed significantly across regions, then suppliers would have an incentive to ship their product to the higher price areas. Moreover, a significant fraction of local consumption of refined products is provided by refineries outside of Minnesota, and significant fraction of regional refined products is provided by refineries outside of the

Midwest.⁵ MCEA Exhibit 2 plots Minnesota and Regional weekly average retail gasoline prices. MCEA Exhibit 3 plots weekly regional and national prices. Changes in Minnesota prices are highly correlated with changes in regional and national prices. Therefore, even if the Alberta Clipper project did impact local crude supplies or prices, it would not impact local refined supplies or prices.

Q. Is there any basis for the claim that the Alberta Clipper would insulate MN refineries or consumers from supply disruptions in other markets?

A. No. The same intuition suggests that because markets are interrelated supply shortages in one market affect prices in all markets. If the shipments of crude to Chicago from the Gulf were cut off, crude that otherwise would have gone to the MN refineries either through the Enbridge system or other sources would be sold in Chicago. This would raise local crude prices. The Alberta Clipper project has no impact on these economic forces.

Q. Is there any basis to the claim that the project will induce local refineries to expand capacity?

A. No. Economic theory indicates that the decision to expand refining capacity depends more on the expected prices of refined petroleum products relative to the costs of refining crude. Thus, expansion decisions are largely based on national and international factors that impact the prices of crude and refined petroleum products as well as technological innovations that impact refining costs. Moreover, while both Mr. Minder and Mr. Heinen note that local refineries are expanding capacity,⁶ they present no evidence indicating that those decisions are necessarily a response to the particular proposed Alberta Clipper project. Economics suggests that those expansion plans are more likely related to the high price of refined petroleum products than the Alberta Clipper project. Indeed, the

⁵ Direct testimony and Exhibits of Adam J. Heinen, Minnesota Public Utilities Commission, Docket No. PL9/CN-07-465, page 13.

⁶ Direct testimony and Exhibits of Bryan J. Minder, Minnesota Public Utilities Commission, Docket No. PL9/CN-07-465, page 24.

expansions of the Koch Pine Bend and Marathon/Ashland refineries are unrelated to the Alberta Clipper project as they have already occurred.

3. THE BENEFITS OF THE ALBERTA CLIPPER PROJECT RELATIVE TO ITS COSTS

Q. Do the Department of Commerce experts provide any basis for concluding that the benefits to the Alberta Clipper project exceed its costs?

A. No. They identify potential benefits and costs, but they conduct no analysis that calculates the benefits or the cost to either the people of Minnesota or to society.

Q. How do they justify their claim that the benefits exceed the costs?

A. The central component of their argument is that local demand for refined petroleum will rise over time. They claim that because local refineries are currently operating at capacity this implies that there is a need for more local supply, and this implies that the benefits exceed the costs.

Q. How do they justify their claim that local demand for refined petroleum will rise over time?

A. Mr. Heinen relies heavily on the Annual Energy Outlook (AEO) 2007 from the Energy Information Agency (EIA) as well as estimates of local population growth, and Mr. Minder relies on Mr. Heinen's conclusion.

Q. Do you consider the estimates of future demand growth reliable?

A. No. The EIA models energy consumption as a function of three main factors: aggregate income, energy intensity and price. Therefore, the accuracy of the AEO predictions regarding future consumption of petroleum products depends on the reliability of their predictions regarding economic growth, changes in technology that impact energy intensity, and changes in price. It also depends on whether they have reliably estimated the effect of these factors on petroleum product consumption.

The AEO's estimates of future changes in aggregate income, energy intensity and price are based on the assumption that the future will not be too different from the past. In

other words, they assume that aggregate income, energy intensity and price will change at rates similar to their historical average rates of change.

The AEO also presents estimates based on the assumption that these factors change at rates that deviate from their historical averages. For example, the AEO contains an estimate of future consumption if prices rise faster than the historical average. However, it does not present estimates when all or even two of the factors change at rates that deviate from their historical averages. This is particularly important because of the interactions between these factors. For example, if price growth is higher than its historical average, then it is likely that economic growth will be lower than its historical average. Similarly, a low rate of economic growth could induce a higher rate of technology adoption.

In conclusion, estimates of future demand growth based on the assumption that the future will be similar to the past are inherently unreliable, and there are several reasons to believe that the future may be different from the past. For example, recent legislation at the national level is giving large incentives to bio-fuels and requiring increased fuel efficiency in automobiles. Similarly, states, including Minnesota, are moving toward adopting California clean car standards that will result in even greater efficiencies. Finally, the recent run up in crude prices suggests that prices can rise at more than their historical average.

Q. Do the benefits, if any, of the Alberta Clipper project even depend on whether future demand will rise?

A. No. Again, simple economics indicates that the project would only yield benefits for Minnesota consumers and local refineries if it brought about an increase in supply. This is true independent of whether future demand is higher.

Q. Is there any basis for the claim that there will be substantial additional benefits in the form of Enbridge's investment, higher profits for local refineries, increased local employment and higher local tax revenues?

A. No. There are several problems with these claims. First, Enbridge's investment brings no direct benefits to the people of Minnesota. There could be benefits from the investment if

it led to higher profits, higher employment or increased tax revenue; however, Mr. Minder's claim that there is an independent benefit from Enbridge's investment is essentially double counting. Second, the Alberta Clipper project could lead to additional local refinery profits only if it increased the local supply of crude, and, as argued above, the project will have no impact on the local supply of crude. Finally, while the project could lead to an increase in employment and tax revenue, even Mr. Minder claims those increases will be relatively modest.⁷

Q. What does your analysis suggest about the benefits relative to the costs?

A. My analysis suggests that the Alberta Clipper would have no impact on local refined prices, so there would be no benefits to consumers of refined petroleum in Minnesota. Since there will be no increase in local crude supply, there will be no benefits to Minnesota refineries. Since, according to the DOC's own testimony, there will be environmental costs; this implies that the benefits are less than the cost for Minnesota consumers and refiners. Moreover, since the potential benefits in the form of increased employment and tax revenue are modest, it is likely that the environmental costs exceed these small benefits. This implies that for the people of Minnesota the benefits of the Alberta Clipper project are less than its costs.

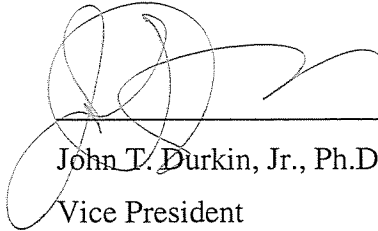
Q. Does this mean that there no benefits to society from the Alberta Clipper project.

A. No. Enbridge benefits because it gets to transport crude to refiners that would otherwise have been transported by another company. In addition, Canadian crude oil suppliers may benefit because it reduces their costs of reaching some refiners.

⁷ Direct testimony and Exhibits of Bryan J. Minder, Minnesota Public Utilities Commission, Docket No. PL9/CN-07-465, pages 21-22.

Dated: March 12, 2008

Respectfully submitted,



John T. Durkin, Jr., Ph.D.

Vice President

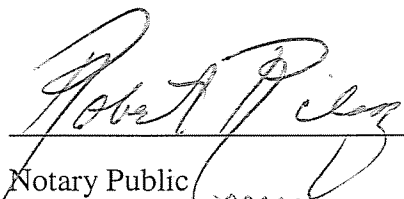
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Subscribed and sworn to before me

this 12 day of March, 2008



Notary Public

