

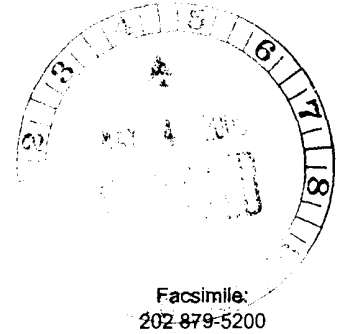
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May 4, 2005

213923

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, DC 20423-0001

OFFICE OF
FEDERAL
REGULATION

Re: *CF Industries, Inc. v. Kaneb Pipe Line Partners, L.P.*, Docket No. 42084

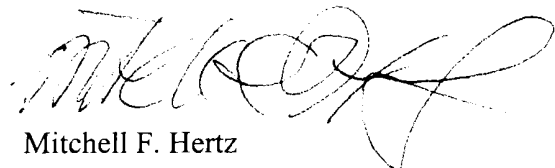
Dear Secretary Williams:

In compliance with the Surface Transportation Board's ("Board") April 6, 2005 order in this proceeding, CF Industries, Inc. ("CFI") hereby notifies the Board that **Mitchell F. Hertz**, outside counsel for CFI, will be its speaker at the May 11, 2005 oral argument.

In addition, attached is CFI's written summary of the evidence and argument that it intends to present at the oral argument. Please note that certain of the material is classified as "confidential," and this material has been redacted from the public version of the written summary. An original and ten copies of both the public and confidential versions are included.

Please date stamp the extra copies of this cover letter and the filing and return them to our messenger. Thank you for your assistance in this matter.

Sincerely,



Mitchell F. Hertz

cc: Mr. Albert S. Tabor, Jr., Counsel for Kaneb Pipe Line Partners, L.P.
Mr. Donald G. Avery, Counsel for Dyno Nobel Inc.

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UNITED STATES OF AMERICA
BEFORE THE
SURFACE TRANSPORT

ORIGINAL
+10 RD



CF INDUSTRIES, INC.,
Complainant,

v.

KANEB PIPE LINE PARTNERS, L.P.

and

KANEB PIPE LINE OPERATING
PARTNERSHIP, L.P.,
Defendants.

Docket No. NOR 42084

213923

Office of the
Master
of the Court
U.S. District Court
District of Columbia

SUMMARY OF ARGUMENT OF CF INDUSTRIES, INC.

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Counsel for CF INDUSTRIES, INC.

Dated: May 4, 2005

SUMMARY OF ARGUMENT OF CF INDUSTRIES, INC.

This case is about Kaneb Pipeline Partners, L.P.'s ("Kaneb") attempt to leverage its market dominance to force captive shippers to pay for a bad investment decision. Kaneb purchased its ammonia pipeline at almost three times book value on the assumption that volumes would increase by nearly []% – despite Kaneb's due diligence indicating that such increases were unlikely in the near term. Not surprisingly, the projected volumes failed to materialize. The Surface Transportation Board ("Board") should reject Kaneb's attempt to force captive shippers to backstop its unsuccessful gamble.

The Board's decision in *CF Industries, Inc. v. Koch Pipeline Co., L.P.* prescribed rates from two origin points to numerous destination points on Kaneb's pipeline. In reaching its prescription decision, the Board made two core findings about the pipeline: (1) the pipeline was market dominant and (2) the pipeline was revenue adequate.

In 2002, Kaneb purchased the pipeline for \$140 million dollars – almost three times book value. The evidence shows that Kaneb was expecting volumes to increase by approximately []%, and that with such increases, it could expect returns of []% per year. Thus, Kaneb had little margin for error. In other words, the pipeline would be worth considerably less (or returns would be lower) if the volumes did not materialize. The evidence also shows that Kaneb was aware that [

], and Kaneb's internal studies suggested that [

].

Notwithstanding the then-current volume data, Kaneb went forward and paid an excessive purchase price. When the volumes did not materialize, Kaneb raised CF Industries, Inc.'s ("CFI") rates above the maximum prescribed rates. CFI challenged the rate increases on the grounds that increasing prescribed rates required Board approval. The Board agreed, but

offered Kaneb the opportunity to demonstrate that changed circumstances justify lifting the rate prescription.

Lifting the rate prescription requires Kaneb to make an affirmative showing that one of the two pillars of the rate prescription – market dominance or revenue adequacy – is no longer valid. Kaneb fails on both counts.

Kaneb does not challenge the Board's market dominance finding. Hence, Kaneb's case rests entirely on showing that the Board's revenue adequacy determination is no longer valid. Kaneb argues that *pieces of* the revenue adequacy determination have changed. For example, Kaneb argues that operating costs, revenues, and volumes have changed. While these changes may have taken place, they are only relevant to the extent that they alter the results of the revenue adequacy analysis. Operating costs, revenues, and volumes constantly change and relying upon such changes without evaluating the impact on revenue adequacy would undermine any protective value of rate prescriptions. This is particularly the case here because Kaneb was aware of such changes when it overpaid for the pipeline.

Even taking these changes into account, however, the pipeline would still be earning adequate returns if the purchase price had accurately reflected Kaneb's due diligence regarding volumes. Thus, the Board faces the fundamental question of which party – the pipeline or its captive shipper – is responsible for Kaneb's decision to overpay.

Using Kaneb's inflated purchase price to determine revenue adequacy and lift the rate prescription is improper in this case because it would allow Kaneb to pass along the risks associated with its poor investment decision to captive customers. Thus, in cases such as this where the pipeline is market dominant, the Board should set the investment base for a revenue adequacy determination using the lower of book costs or investment costs. Prior ICC decisions

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reserve for the Board the flexibility to establish such a rule in particular cases if it deems appropriate. When using book costs to establish the investment base, Kaneb's pipeline remains revenue adequate.

This approach complies with decades of rate regulation precedent. The Supreme Court's decision in *FPC v. Hope Natural Gas Co.* noted that the value of a pipeline ultimately depends on the rates themselves, and thus setting rates (or, in this case, lifting a rate prescription) based on a determination of the value of the pipeline (*e.g.*, the purchase price) produces erroneous results. In other words, setting rates based on Kaneb's "valuation" of the pipeline merely builds that valuation into the rates without independently verifying whether it is reasonable. Ignoring *Hope* in this case would inject the very circularity into the Board's decision-making that the Court in *Hope* directed agencies to avoid.

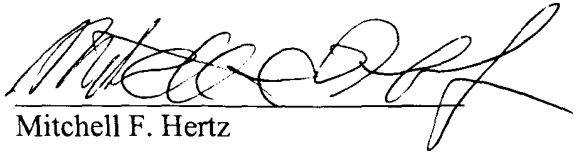
The Board has recognized the importance of *Hope* by adopting the revenue adequacy test – which incorporates the *Hope* teaching that carriers are entitled to an opportunity to earn a return commensurate with the risks they face. An important component of *Hope*, however, is that carriers are not *guaranteed* such a return. When they make a bad investment decision and squander the opportunity provided by *Hope*, they cannot shift the consequences to captive shippers. *Hope* and its progeny bind the Board's decision in this case.

Finally, using book costs to test revenue adequacy does not impact other parties' contracts. Existing contractual rates are built into the revenue adequacy analysis by accepting Kaneb's actual revenue figures.

CERTIFICATE OF SERVICE

I certify that I have this day served copies of the Summary of Argument of CF Industries, Inc. on all parties in this proceeding by hand delivery.

Dated at Washington, D.C., this 4th of May, 2005



Mitchell F. Hertz