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ORIGINAL

**UNITED STATES OF AMERICA
BEFORE THE
SURFACE TRANSPORTATION BOARD**

CFI Industries, Inc.
Complainant

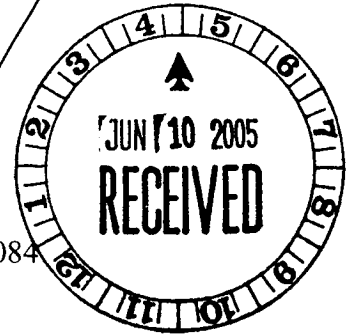
v.

Kaneb Pipe Line Partners, L.P.

and

Kaneb Pipe Line Operating
Partnership, L.P.,
Respondents

Docket No. NOR-42084



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Office of Proceedings

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Public Record

Dyno Nobel, Inc.
Complainant

v.

Kaneb Pipe Line Partners, L.P.

and

Kaneb Pipe Line Operating
Partnership, L.P.,
Respondents

Docket No. NOR-42081

214172

**Reply Brief of Kaneb Pipe Line Partners, L.P.
and Kaneb Pipe Line Operating Partnership, L.P. Supplementing Oral Argument**

Pursuant to the May 20 Order of the Surface Transportation Board (the “Board”),¹ Kaneb Pipe Line Partners, L.P. and Kaneb Pipe Line Operating Partnership, L.P. (collectively, “Kaneb”), submit this Reply Brief Supplementing Oral Argument.

¹ CFI Industries, Inc. v. Kaneb Pipe Line Partners, L.P. and Kaneb Pipe Line Operating Partnership, L.P., Docket No. NOR-42084, and Dyno Nobel Inc. v. Kaneb Pipe Line Partners, L.P., Docket No. NOR-42081, slip op., (May 20, 2005) (“May 20 Order”).

Reply to CF Industries, Inc.

CF Industries, Inc. (“CFI”) knows an attention grabber when it sees one. Thus, both its oral argument and its brief begin with the incendiary charge that “Kaneb paid too much” for the pipeline at issue.² But CFI never substantiates its charge. Other than repetitively beating the “excessive purchase price” drum, CFI does nothing with it.³ CFI nibbles around the edges of the issues but steadfastly avoids addressing them directly. CFI does not explain how it determined that Kaneb paid too much without applying the Board’s Constrained Market Pricing (“CMP”) standards to the facts. CFI does not explain why the Board should abandon almost two decades of uniform application of its CMP standards in favor of CFI’s self-serving variation on original cost valuation (nearly the same amount of time since CFI’s pipeline transportation rates have been increased). CFI does not discuss the holding in Hope,⁴ preferring to discuss only the dicta. CFI sticks its head in the sand when addressing changed circumstances and pretends that unrebutted testimony of Kaneb’s arm’s-length agreement to pay \$140 million for this pipeline is not concrete evidence that circumstances have changed. CFI repeatedly seeks support from cases that fundamentally support Kaneb’s position. In sum, the CFI Brief amounts to an exercise in diversion from the heart of what is at issue in this proceeding. Circumstances have changed since the Board imposed the rate prescription⁵ and, as a result, the Board should vacate the prescription without delay.

² See, e.g., CF Industries, Inc.’s Post-Oral Argument Brief (“CFI Brief”), Docket No. NOR-42084, at 1 (Jun. 3, 2005).

³ The phrase “excessive purchase price,” or a variation thereof, is repeated approximately 12 times in the 13 page brief.

⁴ F.P.C., et al. v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944) (“Hope”).

⁵ CFI Indus., Inc. v. Koch Pipeline Co. (“Koch Decision”), 4 S.T.B. 637 (May 9, 2000), aff’d sub nom CFI Industries, Inc. v. S.T.B., 255 F.3d 816 (D.C. Cir. 2001).

I. CFI Cannot Avoid the Fact That Circumstances Have Changed.

CFI's artful dodging of the issues does not make the issues and the facts disappear. Circumstances have changed, and the significant changes warrant vacating the prescription. The most significant and undeniable change since the prescription was imposed is the increased purchase price. When the prescription was imposed on Koch, Koch had paid approximately \$77 million for the pipeline assets. When Kaneb purchased the pipeline from Koch, it paid \$140 million for substantially the same assets in an arm's-length bargain. While CFI may try to avoid the issue of changed circumstance by pounding the prudence drum, no incessant repetition of "excessive purchase price" can alter the fact that the \$140 million purchase price is a changed circumstance.

No party contests this number. Kaneb has repeatedly identified the \$140 million as a change from the \$77 million purchase price underlying the prescription. The August 12 Order specifically identifies the \$140 million as a potential changed circumstance that may "affect the factual underpinnings of the Koch prescription."⁶ Thus, CFI's suggestion that Kaneb never identified the premises underlying the original rate prescription is merely a ruse, as is CFI's attempt to dodge the issue of the purchase price as a changed circumstance by failing to list it as one of the changed circumstances that Kaneb identified.⁷ Ignoring the purchase price simply cannot make it go away. Kaneb's purchase price is a significant changed circumstance that warrants vacation of the rate prescription.

⁶ August 12 Order, at *8.

⁷ CFI Brief, at 5, 6.

Kaneb has shown that the \$140 million would “lead to a different result,” in the prescription proceeding.⁸ Specifically, Kaneb has shown that the \$140 million purchase price would leave the pipeline revenue inadequate.⁹ Thus, under West Texas (one of the cases relied on by CFI), Kaneb has shown that changed circumstances exist.¹⁰ A showing of changed circumstance is all that is necessary to vacate a rate prescription, and Kaneb has made that showing.

CFI’s charge of imprudence is premature. Any claims of imprudence should be tested and determined in the context of a rate case through the use of CMP. The Board has consistently applied CMP in rate cases to determine the justness and reasonableness of rates, and CMP is the proper way to determine whether Kaneb’s purchase price was prudent – not the untested word of CFI. Nonetheless, CFI asks the Board to accept, without question or analysis, CFI’s conclusion that Kaneb paid too much for the pipeline assets.¹¹

The law requires more. It requires that a party making a claim of imprudence satisfy the initial burden of producing sufficient evidence to establish a reasonable challenge relating to the alleged imprudence.¹² CFI offers no such evidence or any standard for determining the reasonableness of the purchase price, just its word that \$140 million was “excessive.” The Board cannot act on that basis, for such action would not be reasoned decision making. The Board needs a standard to test CFI’s assertions. Economic theory in general, and CMP specifically,

⁸ See West Texas Util. Co. v. Burlington N. & Santa Fe Ry. Co. (“West Texas”), Docket No. NOR-41191, 2003 STB LEXIS 358, at *13 (Jun. 27, 2003) (“The Board has consistently held that the remedy for a party that feels that the factual circumstances underlying a maximum rate case have changed substantially is to . . . show the pattern of changes that would lead to a different result”).

⁹ Kaneb Pipe Line Partners, L.P.’s and Kaneb Pipe Line Operating Partnership, L.P.’s Opening Evidence and Argument, Docket No. NOR-42084, at Exhibit D (Sept. 13, 2004). Other changes also have an impact on the revenue adequacy. See Kaneb’s Initial Brief, at 8-11.

¹⁰ CFI Brief, at 4.

¹¹ CFI Brief, at 1, 2, 3, 8, 10, 12, 13.

¹² Iroquois Gas Transmission System, L.P. v. FERC, 145 F.3d 398 (D.C. Cir. 1998).

provide that standard. The Board has consistently used CMP to verify whether rates are just and reasonable and the components of rates are prudent. But, that test properly occurs in a rate proceeding. The purpose of the instant proceeding is to determine if circumstances have changed. Kaneb has presented 140 million reasons why they have.

II. CFI Cannot Avoid the Fact That Hope Supports the Use of CMP and Purchase Price.

Kaneb has shown the Board that Hope's historic holding is that agencies like the Board have broad discretion in determining what is reasonable as they exercise their statutory authority to set rates or, in this case, vacate a prescription. Once again relying on a case that supports Kaneb's position, CFI avoids Hope's altogether¹³ and instead picks and chooses among dicta to try to assemble a self-serving holding and application of Hope. Carefully crafting dicta, CFI contends that Hope supports the use of Koch's book value. However, Hope's historic holding does no such thing. In fact, it gives the Board broad discretion to choose the appropriate methodology. Using that discretion in Conrail (another of the cases on which CFI relies), the Board rejected the predecessor book value standard that CFI recommends and accepted purchase price.¹⁴ It found that "carriers cannot attract and retain capital unless they are given the opportunity to be compensated for the *real value* of the property, not just the *book value*."¹⁵ Moreover, the Board found that purchase price negotiated at arm's length is a more accurate reflection than book value of the value of property because book value reflects accounting estimates that "may vary significantly from the current economic value of the assets."¹⁶

¹³ See CFI Brief, at 9-13.

¹⁴ CSX Corp. and CSX Transp., Inc., et al. ("Conrail"), 3 S.T.B. 196 (Jul. 20, 1998).

¹⁵ Conrail, 3 S.T.B. at *142 (emphasis added).

¹⁶ Conrail, 3 S.T.B. at *142-143.

Once again, CFI raises the specter of a circularity problem created by the use of the purchase price. As discussed in Kaneb's Initial Brief, CMP defeats any concern of the type of circularity problem raised in Hope.¹⁷ CMP allows the Board to limit a carrier to a return based on the *lesser* of purchase price or the cost that the hypothetical entrant would face (*i.e.*, Stand Alone Costs),¹⁸ destroying the alleged "fatal circularity" problem of employing purchase price.¹⁹ Further, CFI states that calculation of a rate "does not tell the Board whether the value is reasonable, just, prudent, reflects a competitive market, or complies with law, regulation, or policy."²⁰ In fact, there is a calculation that will tell the Board precisely that. The purpose of CMP is to test the justness and reasonableness of rates while emulating what would occur in a competitive market. If CFI would like to test the justness and reasonableness of the rate, the prudence of the purchase price, its reflection of a competitive market, its compliance with law, regulation and policy, CFI should ask the Board to apply CMP in a rate case.

The Board should not be led astray by CFI's artful use of Hope's dicta. Hope encourages the use of the methodology that best determines rate reasonableness. The discretion that Hope gives the Board in choosing the most effective methodology permits the continued use of CMP and purchase price. CMP uses objective, sound economic principles to protect captive shippers while allowing Kaneb's investors the opportunity to earn a reasonable return on their investment. As the Board has consistently determined for almost two decades (or about the same period since CFI has experienced a rate increase), CMP is the proper analysis to determine rate reasonableness within the context of a rate case.

¹⁷ Kaneb Initial Brief, at 8.

¹⁸ As noted in Conrail, at *141, Revenue Adequacy is only one of the constraints that protects captive shippers. "Neither the Board nor the ICC has ever decided a maximum rate case based upon whether the defendant carrier or carriers was or was not revenue adequate. The fact that a carrier is revenue inadequate has never been used as a reason to deny or limit the scope of maximum rate relief."

¹⁹ October 7 Response, at 18; DNI Opposition, at 5.

²⁰ CFI Brief, at n. 22.

III. CFI Cannot Avoid the Board's Regulatory Regime And Consistently Applied Precedent.

CFI continues to show that it lacks an understanding of the Board's regulatory regime. CFI states that "Hope's warnings about avoiding 'circularity' when setting rates for a pipeline may not apply in proceedings where shippers have competitive transportation alternatives . . .,"²¹ and contends that the use of purchase price is appropriate in a situation in which there are no captive shippers, but not otherwise.²² Essentially, CFI wants the Board to apply its regulatory tools, specifically CMP, if there are no captive customers but original cost when captive customers exist. CFI misses the fundamental point that if there are no captive shippers, there is no regulation of rate levels, there is no "setting" of cost-based rates. Neither CMP nor original cost regulation is required. The only time that the Board steps in to establish cost-based rates under CMP is when captive shippers exist.²³

CMP provides a solution that is far superior to the one CFI proposes. To protect the captive shipper, CFI would create a captive pipeline – a pipeline excluded from the market place, a pipeline required to choose between two unattractive alternatives, to serve the market at below market prices or to go out of business. CMP's alternative to that draconian solution is to protect the captive shipper while allowing the pipeline to remain in the marketplace and to have the proper incentives to continue to serve its shippers – both captive and non-captive. The Board has applied CMP consistently for almost two decades precisely for the purpose of determining just and reasonable rates for the protection of captive shippers. Use of purchase price in a revenue adequacy analysis is essential to the proper functioning of CMP. As much as CFI fights against

²¹ CFI Brief, at 3.

²² CFI Brief, at n. 18.

²³ See Market Dominance Determinations – Product and Geographic Competition, 3 S.T.B. 937, *1 (Dec. 21, 1998) ("Market dominance . . . is a prerequisite to our jurisdiction to review the reasonableness of a challenged rail rate"), remanded on other grounds, Assoc. of Am. R.R.s v. S.T.B., et al., 237 F.3d 676 (D.C. Cir. 2001).

the use of CMP, its arguments embrace CMP's economic theory and purchase price as an essential component of CMP.

Reply to Dyno Nobel Inc.

Kaneb has previously stated that there are no material issues of fact to be resolved regarding its own motion for summary disposition. Kaneb has never agreed that there are no material issues of fact to be resolved regarding the motion of Dyno Nobel Inc. ("DNI") for summary disposition. To do so would be to concede that DNI's motion should be granted. In accusing Kaneb of shifting its position regarding DNI's motion, DNI both misstates the facts and demonstrates no understanding of the way in which summary disposition motions work.²⁴

DNI's summary disposition motion must be addressed separately and distinctly from Kaneb's summary disposition motion. Both motions are held to the same standard: to summarily dispose of a proceeding, the Board must "view [the motion] in the light most favorable to the nonmoving party . . . granting summary judgment only if there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law."²⁵ In order to summarily dispose of DNI's motion in DNI's favor, the Board must view the facts in the light most favorable to Kaneb and only grant summary disposition if no genuine issues of material fact exist. The Board must ignore Kaneb's motion. It is totally irrelevant to the issue of whether DNI's motion should be granted or denied.²⁶ For the reasons demonstrated in Kaneb's Initial Brief that will not be repeated here, the Board cannot summarily dispose of the case in DNI's

²⁴ Post-Argument Brief of Dyno Nobel Inc. ("DNI Brief"), Docket No. NOR-42081, at 7-8 (Jun.3, 2005).

²⁵ Breen v. DOT, et al., 282 F.3d 839, 841 (D.C. Cir. 2002).

²⁶ The same is true when the Board is deciding whether to grant Kaneb's motion. In that case, the Board must view the facts in the light most favorable to DNI and ignore DNI's motion.

favor because genuine issues of material fact still exist when the facts are viewed in a light most favorable to Kaneb.²⁷

Further, DNI seems confused as to Kaneb's position regarding the existence of a contract since DNI spends an entire section educating the Board on contract formation. Kaneb does not contest that a contract once existed. However, that contractual period has long since expired. Thus, today, no contract exists. It is as simple as that.

Despite DNI's contentions to the contrary, DNI has made no formal showing that it is a captive shipper. Nor has the Board formally evaluated Kaneb's alleged market dominance as it pertains to DNI in any prior proceeding. There has been no opportunity in the current proceeding for the parties to enter evidence as to the existence or non-existence of market dominance with respect to DNI. DNI cannot now claim proof of market dominance because no such proof has been provided, and Kaneb has not had an opportunity to rebut evidence of market dominance since market dominance is not at issue in this proceeding. As previously discussed in Kaneb's Reply, DNI's discussion of Kaneb's alleged market dominance, as well as the discussion of DNI's past business decisions with respect to transportation and alleged dependence on Kaneb's pipeline in the Barton Verified Statement, are irrelevant to whether the Board should dismiss Count I of DNI's complaint relating to "Violation of the Contract Rate Policy."²⁸ Evidence regarding market dominance is properly reserved for the parties' evidentiary cases with respect to Count III of the complaint regarding rate reasonableness.

²⁷ See Kaneb Initial Brief of Kaneb Pipe Line Partners, L.P. and Kaneb Pipe Line Operating Partnership, L.P. Supplementing Oral Arguments ("Kaneb's Initial Brief"), Docket Nos. NOR-42084 and NOR-42082, at 13-15 (Jun. 3, 1005).

²⁸ Response of Kaneb Pipe Line Partners, L.P. and Kaneb Pipe Line Operating Partnership, L.P. to Reply in Opposition to Motion to Dismiss and Counter-Motion for Summary Disposition, Docket No. NOR-42081, at 10 (Oct. 2, 2003) ("Kaneb's Reply").

Specific Findings Requested

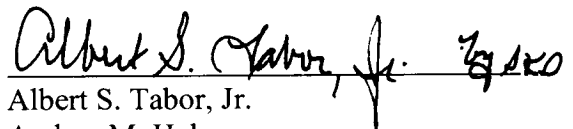
Pursuant to 49 C.F.R. § 1113.18(c), Kaneb respectfully requests the following specific findings:

1. The Board should immediately vacate the rate prescription imposed by the Koch Decision and put CFI and Kaneb back on equal footing.
2. The Board should find that genuine issues of material fact exist such that it may not summarily dismiss Count I in favor of DNI.

Conclusion

WHEREFORE, for the foregoing reasons, Kaneb respectfully requests that the Board vacate the rate prescription imposed in the Koch Decision, based on materially changed circumstances, and restore ratemaking initiative to Kaneb. Further, Kaneb respectfully requests that the Board reject DNI's request for summary dismissal of Count I on the basis that genuine issues of material fact exist with respect to DNI's motion.

Respectfully submitted,



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June 10, 2005

CERTIFICATE OF SERVICE

I certify that I have this day served copies of this document upon all parties of record in these proceedings by hand delivery.

Dated in Washington, D.C this 10th day of June 2005.

A handwritten signature in cursive script, reading "Andrea M. Halverson", written over a horizontal line.

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