STB DOCKET NO. 41685

CF INDUSTRIES, INC.

v.

KOCH PIPELINE COMPANY, L.P.

Decided May 6, 1997

The Board initiates an investigation to determine whether Koch Pipeline Company, L.P. (Koch's) pipeline rates are unreasonably high or whether the rates are unreasonable discriminate against complainants. In addition, the Board: (1) approves CF Industries (CF's) motion to permit the parties to conduct document discovery and deposition without prior Board's approval; and (2) denies (a) complainants' motions for oral hearing, (b) CF's motion for a Board order requesting 12 months of cost data from Koch, and (c) CF's appeal.

BY THE BOARD:

On March 27, 1996, CF Industries (CF) filed a complaint against Koch Pipeline Company, L.P. (Koch) seeking an order under 49 U.S.C. 15503(a): (1) directing Koch to roll back rate increases on pipeline transportation of anhydrous ammonia\(^1\) on the ground that the rate increases are unreasonable under 49 U.S.C. 15501(a) and discriminatory under 49 U.S.C. 15505; (2) requiring Koch to desist from unfair or destructive competitive practices that assertedly advantage its affiliate, Koch Nitrogen Company; (3) awarding appropriate damages under 49 U.S.C. 15904(b)(2); and (4) granting such other relief as the Board deems just and proper. CF requests an oral hearing to resolve the issues presented.

\(^1\) Anhydrous ammonia is a colorless alkaline compound of nitrogen and hydrogen used in the manufacture of fertilizer.

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BACKGROUND

In General.

Koch acquired the pipeline facilities at issue, which were constructed about 30 years ago, in 1987. The 1,943-mile pipeline runs from ammonia production facilities in southern Louisiana north to Hermann, MO, where the pipeline splits into an eastern and a western leg. The eastern leg serves terminals in Illinois and Indiana. The western leg serves terminals in Missouri, Iowa and Nebraska.

CF and Koch Nitrogen (an affiliate of Koch), two of the principal shippers on the pipeline, are competing ammonia manufacturers. Koch Nitrogen owns a large ammonia manufacturing complex at Sterlington, LA. CF's manufacturing plant is located in Donaldsonville, LA. Most destinations on the pipeline have terminals operated by CF and/or Koch. However, at three Iowa points and one Illinois point, a terminal is also operated by Farmland Industries, Inc.

The rate increases on the eastern leg of the pipeline ranged from 5% on the segment between Sterlington and Wood River, IL, to 53% on the segment between Donaldsonville and Walton, IN. The rate increases on the western leg averaged about 10%. Koch phased in the increases, with 75% of the changes taking effect on April 1, 1996, and the remaining 25% taking effect on July 1, 1996. CF states that the most recent prior rate changes took place in 1987.

CF complains that the rate differential for shipments originating at CF's Donaldsonville facility and Koch Nitrogen's Sterlington plant ranges from $0.50 to $7.10 per ton, a difference not warranted by the difference in distance between the two ammonia production facilities.² CF charges that the rate increases are not balanced across the system, but rather are skewed toward the eastern leg, where CF alleges that it is the largest shipper and there are few competitive transportation alternatives to the pipeline. Smaller increases, it alleges, were assessed on the western leg, where Koch Nitrogen is the largest shipper and where there are more competitive alternatives.³ The smallest

² CF claims that the Donaldsonville and Sterlington plants are 175 miles apart, while Koch contends that they are 240 miles apart.
³ Koch asserts that Koch Nitrogen ships substantially larger volumes than CF on the eastern leg, and that CF ships larger volumes than Koch Nitrogen on the western leg.

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increases were assessed on two routes used almost exclusively by Koch Nitrogen. CF claims that the new rate structure unfairly discriminates against its movement of anhydrous ammonia. Overall, CF claims that damages resulting from the rate structure exceed $2 million per year.

On May 2, 1996, Farmland Industries, Inc. (Farmland) petitioned for leave to intervene as a complainant. Farmland submits that Koch: (1) violated 49 U.S.C. 15701(a) by failing to provide adequate notice of the increases, and (2) violated 49 U.S.C. 15505 by charging and collecting from non-affiliated shippers rates in excess of the costs of service, thereby giving an undue preference and advantage to Koch Nitrogen. Farmland requests a rollback in rates, damages plus interest, payment of attorney fees, and any other further relief that the Board may deem appropriate.

Rate Reasonableness. On May 6, 1996, Koch filed an answer to CF's complaint. On May 8, 1996, Koch filed a motion to establish procedures for an initial market power inquiry, arguing that, absent market power, there is no need for rate regulation. Koch submits that sound regulatory policy and Congressional intent both argue strongly for an initial inquiry into CF's allegations of market power.

In addition, Koch submits that, if the Board finds that it possesses market power with respect to some or all of complainants' movements, the issue of rate reasonableness should be resolved in accordance with the Constrained Market Pricing (CMP) standards, and in particular the stand-alone cost (SAC) test,

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1 Sterlington, LA, to Fort Madison, IA, and Sterlington, LA, to Wood River, IL.
2 Farmland is a regional farm cooperative that is a producer and shipper of anhydrous ammonia.
3 Farmland's intervention was granted by order of the Secretary served July 25, 1996.
4 Other than in the complaint and answer, the issue of unreasonable discrimination has not been extensively discussed by the parties. Therefore, the general focus of this order is on the issue of rate reasonableness. We will, of course, accept, and, as appropriate, rule on evidence on the existence of unreasonable discrimination.
5 Koch points out that the Federal Energy Regulatory Commission's (FERC) regulation of pipelines has specifically recognized that regulatory authority should not be exercised in cases where the market is competitive.
6 SAC is one of the four constraints that comprise CMP, as adopted in Coal Rate Guidelines Nationwide, 11 C.C.A. 520 (1985) (Coal Rate Guidelines), aff'd sub nom. Consolidated Rail Corp. v. United States, 812 F.2d 1444 (3d Cir. 1987). SAC is used to compute the rates an efficient competitor would charge in a contestable market.

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adopted by the Board's predecessor agency the Interstate Commerce Commission (ICC). Citing *Ashley Creek Phosphate Co. v. Chevron Pipe Line Co.*, 5 I.C.C.2d 303 (1989), Koch argues that, while CMP and SAC were adopted by the ICC as the conceptual framework for judging the reasonableness of rates charged by railroads, the approach is also applicable to pipelines. Indeed, Koch notes that Congress, at 49 U.S.C. 15503(a), specifically endorsed SAC as an appropriate test of rate reasonableness for pipelines subject to the Board's jurisdiction. Further, Koch notes that, in *Ashley Creek Phosphate Co. v. Chevron Pipe Line Co.*, No. 40131 (Sub-No. 1) (ICC served March 30, 1992) (*Ashley Creek*), the ICC refused to use a depreciated original cost ratemaking (OCR) method of the type suggested by complainants here, because capital recovery using that procedure results in "front-end loading" of the capital costs.

CF opposes Koch's motion to establish procedures for a market power inquiry. CF states that the presence of "market power" is not a requisite element needed for relief against pricing abuses by pipelines. CF submits that the Board should reject "Koch's attempt to delay this proceeding." Fairland in its reply also requests that the Board find that an initial market power inquiry should be rejected for reasons similar to those that CF presented.

CF also opposes use of SAC to evaluate the reasonableness of the rates at issue because: (1) Koch's proposed replacement cost approach would ignore the criteria of 49 U.S.C. 15503(b), (2) Koch's interpretation of the statute is inconsistent with the ICC's Coal Rate Guidelines and other precedent, and (3) Koch's proposal would allow it to earn excessive returns. More specifically, CF argues that use of a SAC analysis is not warranted because railroad regulation is substantially different from the regulation of an ammonia pipeline.

CF claims that the ICC developed SAC because original cost ratemaking would not always guarantee that shippers would be protected from railroad monopoly abuse. CF states that, under standard original cost ratemaking, the captive rail shippers would have little chance of rate relief because the railroads often generated system-wide revenues well below those commensurate with a reasonable rate of return on investment. It notes that, in addition to the SAC

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10 *Ashley Creek* involved transportation of phosphate slurry through a pipeline between Utah and Wyoming.

11 Under the OCR methodology, it is necessary to calculate the total original investment costs, depreciate the assets, and apply the appropriate rate of return. This gives a return on investment that is added to operating expenses to produce the revenue requirement to be recovered through rates.

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constraint, *Coal Rate Guidelines* contains a revenue adequacy constraint. CF argues that the revenue adequacy constraint is another independent test that may be used to evaluate the reasonableness of a carrier's rates.

Farmland, in its reply, states that there is no basis for selecting any particular method for determining the reasonableness of Koch's rates. Farmland argues that Koch erroneously contends that Congress "specifically endorsed the SAC test for application to pipelines." Farmland states that Congress merely provided that the Board "may" utilize a standard based on SAC. Farmland says that the Board should not prejudge the appropriate standard for determining the reasonableness of Koch's rates until all of the facts and circumstances have been developed.

*Discovery.*

CF has filed interrogatories and document requests with Koch. In response, Koch filed a motion requesting that the Board: (1) stay the response to interrogatories and request for admissions propounded by CF until the Board acts on Koch's motion to establish procedures,\(^\text{12}\) and (2) strike CF's document request on the ground that CF failed to petition the Board for an order requesting production of documents.

CF later filed a motion asking the Board to: (1) establish a procedural schedule providing for an oral hearing, (2) assign the case to an Administrative Law Judge (ALJ) for discovery, (3) permit the parties to conduct limited document discovery and limited depositions without prior Board approval, and (4) order Koch to file detailed documents showing its costs for the most recent twelve months for which data are available. Koch opposed the motion and reiterated its request to stay discovery.

Subsequently, CF moved to compel Koch to respond to discovery. Later correspondence between the parties indicates that they have been unable to resolve issues concerning the scope of discovery and have questions on whether certain discovery requests are too burdensome.

Also unresolved is Koch's request for access to the Board rail waybill data. Koch intends to use the waybill data relating to anhydrous ammonia, ammonia products, and other fertilizer products to analyze issues concerning market

\(^{12}\) If the Board denies its motion, Koch requests that it be given 30 days from the date of the Board order to answer, object or otherwise respond to CF's discovery requests.

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power and competitive alternatives. On January 24, 1997, CF appealed the
Office of Economics, Environmental Analysis, and Administration's (OEEA&A) determinations to release the waybill data, arguing that the data are not relevant
to this proceeding and that the data are available from sources other than the
waybill sample. See, 49 CFR 1244.8(b)(4)(i).

DISCUSSION AND CONCLUSIONS

We have jurisdiction over the Koch interstate pipeline. 49 U.S.C. 15301.
We find that the complaints of both CF and Farmland raise reasonable grounds for
investigation on the issues of rate reasonableness (49 U.S.C. 15501) and
unreasonable discrimination (49 U.S.C. 15505). Accordingly, we will
investigate these issues pursuant to 49 U.S.C. 15901(a).

Complainants' requests for oral hearing, however, are denied. This
investigation will proceed under modified procedure because it appears that
substantially all material issues of fact can be resolved through submission of
written statements, and that efficient disposition of the proceeding can be
15901(c) requires that this investigation be concluded within 3 years after its
initiation, it is critical that this investigation be conducted in an orderly and
timely fashion.

Market Power.

The statutory criteria by which we assess the reasonableness of pipeline
rates are set forth in 49 U.S.C. 15503. Prior to the ICC Termination Act of
1995 (ICCTA), the applicable provisions were found in former 49 U.S.C.
10704(b)(2). Pre-ICCTA law required consideration of the impact of a rate
prescription on the movement of traffic and a carrier's revenue needs. Two new
criteria were added by ICCTA: the provision in section 15503(a) sanctioning use
of SAC to evaluate the reasonableness of pipeline rates, and the provision in
section 15503(b)(3) requiring the Board to consider "the availability of other
economic transportation alternatives" when deciding if a rate prescription is
necessary.

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Our understanding of the (b)(3) provision is that Congress intended that we exercise our rate prescription powers only where a shipper lacks effective competitive alternatives. This interpretation is consistent with the longstanding and similar restrictions on our ability to regulate railroad rates, and with the policy of FERC in its regulation of petroleum pipelines. Indeed, it is generally recognized that sound regulatory policy allows the marketplace to determine the most efficient level of prices where competition is sufficient to prevent the exercise of market power.\(^4\)

If the market is effectively competitive, then agency action can only distort the economically efficient rate(s). Such ill-advised action would contravene the policy to promote adequate, economical and efficient transportation, and to encourage sound economic conditions in transportation.

If the availability of other economic alternatives does indeed act as an effective constraint on a pipeline's rates, there is no need, absent unreasonable discrimination, for the agency to inject itself into the pricing of services. Therefore, as is our practice in the area of railroad rate regulation, we will not exercise our rate prescription authority where effective competitive alternatives prevent a carrier from exercising any unreasonable degree of market power.\(^5\)

In assessing the existence of effective competitive alternatives, we will be guided generally by our railroad market dominance evidentiary guidelines\(^6\) and the precedent developed under those guidelines.

However, while we will not exercise our authority to prescribe a rate to a facility that has effective competitive alternatives, we will not conduct an initial and separate market power inquiry here. Our experience in the rail area has shown that bifurcation of the market power and rate reasonableness phases can


\(^5\) In Ashley Creek (February 15, 1991 decision at 4-5), the ICC declined to "make market dominance a prerequisite for determining the reasonableness of a challenged pipeline rate level." The ICC noted that the law in effect at the time did not require that type of analysis, although it also stated "that this determination does not preclude our examination of market-based ratemaking factors (e.g., market power and competitive factors) and related issues on a case-by-case basis in future proceedings concerning the reasonableness of pipeline rates." In light of the explicit directive of section 15503(b)(3), a market power inquiry is an essential consideration as we exercise our rate review authority.


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unnecessarily prolong a proceeding. Therefore, absent agreement of the parties on the need to bifurcate, this proceeding will take evidence on market power and rate reasonableness concurrently so as to ensure that this investigation can be completed within the 3-year statutory period.\textsuperscript{17}

\textit{Rate Reasonableness Methodology.}

As noted, section 15503(a) provides that, in prescribing a rate, "the Board may utilize rate reasonableness procedures that provide an effective simulation of a market-based price for a stand alone pipeline." Section 15503(b) provides that, in prescribing a rate, "the Board shall consider, among other factors, (1) the effect of the prescribed rate \* \* \* on the movement of traffic \* \* \* , (2) the need for revenues that are sufficient, under honest, economical, and efficient management, to let the carrier provide that transportation or service; and (3) the availability of other economic transportation alternatives.

Farmland argues that the Board should not select any rate methodology until all relevant facts and circumstances have been developed. While we generally agree that a complainant should be allowed to present the type of case it chooses, we will provide some general guidance for the benefit of the parties.

While acknowledging that the principles of CMP are appropriate for evaluating the reasonableness of Koch's rate, the parties disagree over whether the SAC constraint of CMP or a rate methodology based on OCR should be used. In \textit{Ashley Creek}, the ICC concluded that, based on the unique circumstances of the case, a hybrid ratemaking method was most useful for determining rate reasonableness. Because the pipeline in that case was relatively new, the ICC noted that an original cost value for the investment base would approximate the replacement cost value used in SAC. The ICC found that the time pattern of rates and revenues permitted by application of a discounted cash flow (DCF) model under standard SAC procedures was superior to the "front-end loading" of capital costs under OCR.\textsuperscript{18}

\textsuperscript{17} On April 23, 1997, CF filed a document designed to show that its throughput on Koch's pipeline has substantially increased notwithstanding Koch's rate increase, and that hence Koch clearly has market power. CF may present that information as part of its submission during the course of this proceeding.

\textsuperscript{18} March 23, 1992 decision at 12.

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Here, we will not dictate in advance the precise methodology that CF may use to pursue its complaint. Rather, as in our oversight of rail rates, the complainant may choose among several procedures. Although we will permit the complainant to use SAC, which the ICCTA specifically sanctioned for use in pipeline rate cases, we note that CF does not favor use of this procedure to evaluate the reasonableness of Koch's rates. Because the ICCTA, while sanctioning SAC, did not foreclose use of other rate reasonableness procedures, complainants may use any methodology that is consistent with CMP ratemaking principles, which we have found provide "a practical and economically sound method of applying competitive pricing principles to a regulatory framework." Coal Rate Guidelines, 1 I.C.C.2d at 523.

One of the CMP constraints is the so-called revenue adequacy constraint, which evaluates whether a carrier is earning sufficient revenues "over time, to average [a] return on investment equal to its cost of capital." Id. 1 I.C.C.2d at 536. CF has indicated that it "anticipates that this will be an important and relevant rate reasonableness cap in this case."20

Ashley Creek provides guidance as to how either a SAC or a revenue adequacy case should be presented. In determining the reasonableness of the tariff rates in Ashley Creek, a DCF analysis was used to evaluate whether the revenues the pipeline would earn over time would exceed the operating and investment costs (including a reasonable return on investment). Under either a SAC or revenue adequacy approach, a multi-period DCF analysis is most appropriate.

A multi-period DCF analysis best satisfies the goal of both the SAC and revenue adequacy constraints of ensuring that a carrier is given the opportunity to earn adequate revenues over time. Such an analysis recognizes the cyclical nature of the marketplace, and permits an enterprise to earn "excessive" revenues in some years to offset revenue "shortfalls" in others. However, a

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19 We do not share CF's view that use of SAC (as authorized by section 15503(a)) would disregard the criteria of section 15503(b). A basic tenet of statutory interpretation is that one section not be read in such a way as to nullify another section. Moreover, a SAC analysis is not inconsistent with the statutory requirements of subsections (b)(1) and (b)(2) that we consider market power and the effect of the rate prescription on the movement of traffic. And the criterion of subsection (b)(2) is entirely consistent with the principles of SAC, which determines, absent entry and exit barrier costs, the revenues that a fully efficient new entrant would need to charge if it entered the market.


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carrier can recover no more than its total costs over the life of the investment. The revenue adequacy constraint of CMP is not satisfied by a single-period snapshot of a carrier's costs and revenues, but rather "is a long-term concept that calls for a company, over time, to average [a] return on investment equal to its cost of capital." Coal Rate Guidelines, 1 I.C.C.2d at 536. See, Ashley Creek (March 23, 1992 decision at 11) (OCR results in inappropriate "front-end loading" of capital costs; thus, a single-period OCR could lead to an inappropriately low investment base, and regulatory rate level, when the plant is relatively old).

In presenting a multi-period DCF analysis, the parties' evidence, at a minimum, should include: throughput (volume of anhydrous ammonia shipped); pipeline investment; earnings; estimates of cost indices for assets, labor and other input factors; federal and state tax rates or actual historic taxes paid; the pipeline's cost of debt and equity capital and capital structure; and operating expenses.

Because a possible outcome of this proceeding is that we could find varying degrees of market power at different destinations, differential pricing (i.e., differing mark-ups above attributable costs) may be appropriate, and the parties should address the allocation of non-attributable costs between competitive and noncompetitive markets. An examination of the market power Koch possesses at the various locations on the pipeline may also provide insight into whether there has been unreasonable rate discrimination among the shippers. The parties should provide evidence on the pipeline rate structure prior to, and after, the rate increase in order to address the issue of rate discrimination.

Discovery.

Koch's motion to stay discovery is moot, because we have addressed the issues of a market power inquiry and rate reasonableness standards. Our conclusion that market power is an issue that needs to be addressed should eliminate many of the previous discovery objections and allow for significant progress in the discovery phase of this proceeding.21 The parties are directed to

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21 The existence of product and geographic competition is relevant to the market power inquiry. Indeed, both the ICC and FERC have considered such evidence in determining reasonable rates in pipeline cases. See, Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines, Docket No. RM95-6-00, 70 F.E.R.C. P61,139 (February 8, 1995).
proceed with discovery. In particular, Koch should respond to CF’s outstanding discovery requests on or before June 13, 1997.

We also find that Board rail waybill data are generally relevant. CF has alleged that it lacks competitive alternatives, and the waybill sample may cast light on whether rail transportation effectively constrains the pipeline’s rates. Thus, we conclude that the waybill data should be released because the information requested is not available from any other single source. 49 CFR 1244.8(b)(4)(i). Therefore, CF’s appeal of OEEA&A’s determination to release the waybill data is denied.

Pursuant to 49 CFR 1114.21, the parties are permitted to conduct document discovery and depositions without prior Board approval. Moreover, we will waive the requirements of 49 CFR 1114.31(a), which would otherwise require that a motion to compel discovery be filed within 10 days of an answer or objection, because this requirement may inhibit attempts by the parties to reach a negotiated resolution. In addition, pursuant to 49 CFR 1114.21(f), we do not require that copies of interrogatories and requests for admissions of facts or authenticity of documents and the responses thereto be filed with the Board. These documents are not evidence, and the facts established through discovery become evidence only after being submitted by a party.

We will deny CF’s request that we specifically order Koch to file detailed documents showing its costs for the most recent 12 months for which data are available. While this evidence may be relevant to the investigation proceeding, CF should seek to obtain it directly by discovery.

We request that either or both of the parties provide a clear and legible map of the entire pipeline system. The map provided by CF in Exhibit A of the complaint is difficult to read.

Finally, because there are still outstanding discovery disputes, we will refer all existing and future discovery disputes to an ALJ. We are designating Administrative Law Judge Jacob Leventhal as the ALJ in this matter to facilitate the discovery process, to resolve all questions dealing with discovery, and to take such other actions as he deems necessary to resolve discovery disputes. Appeals from rulings of the ALJ are not favored and will be strictly limited to the rigorous standards of 49 CFR 1115.9.

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Procedural Schedule.

We establish the following schedule under modified procedure for the completion of discovery and submission of evidence.23

On Day 120, following service of this decision (May 14, 1997), discovery shall be completed.
On Day 180, opening statements of both parties shall be filed.
On Day 230, reply statements from both parties shall be filed.
On Day 270, rebuttal statements from both parties shall be filed.
Finally, for purposes of expediting the Board's analysis of the record, each party shall file 15 copies of each submission. The parties shall also submit, on diskette, tape or compact disc (CD), three copies of all textual materials, electronic workpapers, data bases, and spreadsheets used to develop quantitative evidence.24 References in the verified statements to tables, exhibits, or workpapers must be specifically identified.

It is ordered:

1. An investigation is initiated to determine whether Koch's pipeline rates are unreasonably high or whether the rates unreasonably discriminate against complainants.
2. Complainants' motions for oral hearing are denied.
3. CF's motion to permit the parties to conduct document discovery and deposition without prior Board approval is granted.
4. Koch shall reply to CF's outstanding discovery requests on or before June 13, 1997.
5. CF's appeal of OEEA&A's determination to release Board waybill data (WB511) is denied.
6. CF's motion for a Board order requesting 12 months of cost data from Koch is denied.
7. The requirement of 49 CFR 1114.31(a) that a motion to compel discovery must be filed within 10 days of an answer or objection is waived.

23 The exact dates under this schedule will be determined under 49 CFR 1152.25(d)(2)-(3), which ordinarily applies in abandonment proceedings but which is adopted for use here.
24 Data must be submitted on 3.5-inch IBM compatible formatted diskettes, QIC-80 tapes (in uncompressed format) or preferably CD. Textual materials must be in WordPerfect 7.0 and electronic spreadsheets must be in Lotus 1-2-3 97 Edition. A copy of each computer diskette, tape or CD submitted to the Board should be provided to any other party requesting a copy.

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8. The procedural schedule set forth in the body of this decision is adopted.
9. This decision is effective on May 14, 1997.
10. Judge Jacob Leventhal is designated as the ALJ in this proceeding to facilitate the discovery process, to resolve all questions dealing with discovery, and to take such other actions as he deems necessary to resolve discovery disputes. A copy of all filings and documents must be sent to Judge Leventhal, FERC, Office of Administrative Law Judges, 888 1st Street, NE, Suite 11F, Washington, D.C. 20426. Judge Leventhal may be reached at 202-219-2538.
11. A copy of this decision shall be served on Judge Leventhal.

By the Board, Chairman Morgan and Vice Chairman Owen.