MR. TABOR: May it please the Board, I'm Bert Tabor and I represent Kaneb in this proceeding. On May 11, 1987, CF Industries paid $20.95 to the owner of the pipeline to ship a ton of ammonia from Donaldsonville, Louisiana to Cowden, Illinois. Today, May 11, 2005, 18 years later, CF pays Kaneb precisely that same amount, $20.95, to ship a ton of ammonia from Donaldsonville to Cowden. That rate and every other rate that CF pays today for transportation of ammonia on this pipeline is precisely what it was 18 years ago.

In 1987, the consumer price index for all urban consumers stood at 113.6. Today it is 188.9. A 66% decrease in the value of the dollar. Thus, in real dollars, the rates CF pays have steadily declined over the years and in real dollars, CF is today paying much lower rates than it paid in 1987 or that it paid in 1997.

Let's turn to the efforts of CF, still successful today, I'm sorry to say, to protect its rate reduction. The matters at issue here arise from the Board's August 12, 2004 Order. So that's where I propose we start. In that Order, the Board held that Kaneb cannot increase a prescribed rate until the Board vacates it. The Board then ordered further procedures to address the issue whether Kaneb has demonstrated changed circumstances sufficient to warrant vacating the prescription. The Board described the evidence it needed and it set a schedule for its submission. The Board promised prompt action. Kaneb presented the evidence sought by the Board. That evidence shows that Kaneb purchased the pipeline assets from Koch in November 2002 for approximately $140 million. It shows that they are substantially the same assets the Board examined when it set the rate prescription in *Koch*. It shows that as requested, Kaneb presented the complete asset purchase and sale agreement which contains an itemized evaluation of the assets involved. Kaneb's evidence establishes that the transaction was conducted at arm's length and that Kaneb has no affiliate relationship with *Koch*. It shows that *Koch* and Kaneb were of equal bargaining power throughout the negotiations. It shows that Koch conducted due diligence that included a financial evaluation of the assets prior to making its final bid. And that on the basis of its review, Kaneb believed that the purchase price of $140 million was a fair price to pay for the assets. The valuation, by the way, was confirmed by an independent valuation of $150 million from Corporate Valuation Advisors, Inc., a professional appraisal firm.

Kaneb also presented evidence concerning its operations, establishing that Kaneb has incurred significant increases in operating costs and capital costs and declines in volumes and in revenues.

Finally, Kaneb established that as a result of these changed circumstances, Kaneb's return on investment is significantly lower than the return that underlies the *Koch* prescription, in that it is significantly lower than Kaneb's cost for the capital. In *Koch,* you told us that you stand ready to lift the prescription when it is shown to be necessary. Kaneb has made that showing. Neither CF nor Dyno has submitted any evidence disputing Kaneb's evidence. So if they don't dispute the facts, on what basis do they oppose vacation of the prescription? They oppose vacation by arguing that the Board should dump more than 15 years of ICC and Board precedent, uniformly holding that acquisition costs be used to set investment base when valuating revenue adequacy. They also try to saddle the prescription vacation case with a prudence challenge that properly must be reserved for a rate case.

In short, rather than presenting evidence, CF and Dyno try to change the subject. They resort to clouding the issue with tangential arguments that are irrelevant to our current proceeding.

Let's examine the acquisition cost. In Ex Parte 483, the ICC adopted the use of acquisition cost in valuing a railroad’s investment base. It stated that acquisition costs represent the fair market value of an asset as established by the purchase price. And it found that the use of acquisition cost is consistent with the underlying objectives of revenue adequacy analysis. The ICC further stated that because the acquisition cost reflects a new valuation rate base for the acquired asset, it can either be higher or lower than the previously recorded value. Finally, the ICC noted that in cases where assets are sold for more than book value, the use of predecessor cost would potentially short change investors who paid a premium above the old book.

The use of acquisition cost valuation by the ICC and the Board has been judicially approved, and it has been uniformly applied by both agencies. There have been no instances, and our adversary cite none, in which the Board or the ICC has departed from this policy. For instance, in *Koch* the Board noted that acquisition cost valuation, the amount paid in an arm's length transaction, is consistent with what other business enterprises use for measuring their investments. Despite the fact that your use of acquisition cost has been judicially approved, CF argues that the *Hope* case prohibits you from using Kaneb's acquisition cost, and requires you to use Koch's acquisition cost. That's exactly the opposite of what Hope does. *Kosh* doesn't prohibit, I'm sorry, *Hope* doesn't prohibit, it empowers you. Our adversaries ignore *Hope's* historic holding. *Hope* stands for the proposition that you, the Board, have broad discretion to reach any reasoned decision.

Here's what the Supreme Court said. It said that you are not bound to the use of any single formula or combination of formulas in determining rates. It said you're authorized to make pragmatic adjustments, and when your Order is challenged in the courts, the question is whether the Order viewed in its entirety meets the requirement of the act. Under the statutory standard of just and reasonable, it's the result reached, not the method employed that is controlling. It is not theory, but the impact of the rate Order, which counts.

In *Hope*, neither the Court of Appeals nor the Supreme

Court, addressed today's topic. The propriety of a rate base reflecting a purchase price arrived at as a result of arm's-length bargaining. They were talking about present fair value, a term that included reproduction cost and trended original cost in determining rate base. The Court of Appeals had held that the Federal Power Commission was required to use that present fair value. The Supreme Court disagreed and instead of requiring or prohibiting that formula, or any other formula, gave the regulatory agency broad discretion. The court did indeed note its concern with present fair value as defined by the Court of Appeals, but made no holding on the matter since it was not a matter the court needed to decide.

Well, what's the alternative that our adversaries advocate? The price that Koch paid Gulf Central in 1988, the market price agreed to between a willing buyer and a willing seller in 1988, can't be superior to the market price agreed to between a willing buyer and a willing seller in 2002, for use in setting a 2002 investment base. The cases from other regulatory agencies cited by our adversaries do not support that result. Indeed, they don't provide any support at all for our adversaries' position. Those cases address the original cost to the first person that dedicated the assets to public service. They do not refer to the acquisition cost of an intermediate transfer. Nor is there any principle reason why rates established on the basis of a 2002 market price create the circularity problem alleged by our adversaries, but that rates established on the basis of a 1988 market price do not.

In fact, when we apply the Board's Constrained Market Pricing methodology, the 2002 market price has no circularity problem. To understand why, we need to examine two of the Constrained Market Pricing principles. The revenue adequacy constraint based on acquisition cost ensures that current investors are not getting excessive returns. The stand-alone cost constraint ensures that rate payers are not paying excessive rates. These constraints, working together, protect shippers and avoid any concern over circularity, because if a rate justified by a revenue adequacy calculation exceeds stand-alone cost, the shipper can turn to stand-alone cost to have its rates shipped – its rates set. As I previously noted, in Ex Parte 483, the ICC determined acquisition cost was the best proxy for fair value. The ICC considered historic cost and rejected it. The ICC also looked at replacement cost for revenue adequacy purposes and determined that though theoretically correct, it was too complex. Thus, it adopted acquisition cost. There is no reason to depart from these past decisions adopting acquisition costs.

In short, our adversaries have no principle basis for their position. They are merely trying to preserve CF's sweet deal. A deal Dyno hopes to share. And a sweet deal it is. The rates CF is paying Kaneb today are precisely the same rates that CF has been paying for this service since 1987, 18 years, while inflation has decreased the value of the dollars flowing from CF to the pipeline company by 66%. As matters stand, Kaneb's ability to increase its rates above 1987 levels is indefinitely suspended. It has been required to forego hundreds of thousands of dollars of revenue. The harm it suffers is irreparable. It can never recover the revenues that it's losing today.

Now let's consider the consequences if you vacate the prescription. Vacating the prescription on the other hand, will level the playing field and create an environment for fair negotiation between equals. Without a prescription, if Kaneb increased rates, Koch -- CF could complain and the rates would be subject to reparations. If CF won, it could recover its damages. If Kaneb won, it could keep the revenues from the increased rates.

In the August 11 voting conference, you said that you would get this matter resolved quickly when the new evidence came in. That was nine months ago today. Kaneb is bleeding money. Please vacate the prescription without further delay.

I'm now going to turn for a moment to the *Dyno Nobel* case, and as I turn to that case, I want to be sure to address the policy issue you identified in your April 6 Order, the contract rate issue. But first, I must address the contract issue between Dyno and Kaneb. There is no contract. That's Kaneb's position, that there is no contract. And I believe that Kaneb's position is correct. So whatever contract rate policy you may establish, will not apply to the current relationship between Dyno and Kaneb. Moreover, the *Dyno* case is not right for decision. It's still at an early stage. A complaint and answer have been filed. The answer denies the complaint's allegations. The only other substantive pleadings in this case are cross-dispositive motions on the contract rate issue. Those motions document the existence of a genuine issue of material fact concerning the existence of the contract that precludes summary disposition.

I could give you some quick observations as to why I believe there's no contract, but I don't think that's your real interest today. Besides, if you grant the prescription vacation Kaneb seeks, I believe the contract issue goes away, although Mr. Avery may not agree with me. If it doesn't go away, there will have to be discovery, testimony and briefing before this issue can be right for decision by you.

A word now about Dyno's unreasonable discrimination complaint. Dyno claims to object to an "effective" 68% increase in its rates. What Dyno really objects to is the 7% general increase in its rates and the removal of an industrial rate which previously discriminated in Dyno's favor. Dyno's position is that once the carrier decided that market conditions justified lowering the rates to Dyno's lomo destination, and discriminating in Dyno's favor, Kaneb should never again be allowed to reassess market conditions and eliminate the discrimination. That would be bad law, bad economics, and bad public policy. Carriers must be free to respond to their perception of market conditions. They must be free to act, otherwise they would be discouraged from taking market initiatives in the first place.

Now onto contract rates, keeping in mind that none exist between Dyno and Kaneb. Kaneb likes the concept of contract rates. If all the kinks could be worked out, contract rates would decrease risk for both shipper and carrier, would enhance planning and predictability and would encourage capital investment by both. But before that can happen, everyone needs to understand the rules and I think that's why you put this on the agenda for today.

A contract is an exchange of promises between two or more parties. It appears to me that in the current posture, the Board may be able to enforce a contract rate against one of the parties, the carrier, but may have no authority to enforce it against the other party, the shipper. Something needs to be done about that. The forum addressing a contract must be empowered to address all issues and provide remedies for any party that's the victim of a breach. There are a number of other issues that you should address concerning contract rates. For example, must a carrier publish the contract and the contract rates? Can a carrier charge a shipper a contract rate that's not a published rate? Must a carrier make a contract rate available to the public on a nondiscriminatory basis, that is, to all similarly situated shippers? Must a carrier allocate capacity on a common carrier basis, or can it reserve space long term for the benefit of one shipper to the exclusion of others? If shippers and carriers understand these rules, it will greatly facilitate the use of contracts.

Kaneb applauds your inquiry into this matter, but I'll admit, is a little nervous concerning your choice of our case for your inquiry. Thank you very much.

CHAIR NOBER: Okay. Well, we'll start with Vice Chairman Buttrey. Do you have any questions?

VICE CHAIRMAN BUTTREY: Yes. Mr. Tabor, isn't this all about natural gas prices, basic natural gas prices?

MR. TABOR: Well, I will have to say, Mr. Vice Chairman, that natural gas prices are quite volatile, and, therefore, ammonia prices are quite volatile, but the transportation prices are not. And the transportation prices have stayed steady. We do not buy or sell natural gas. We do not buy or sell ammonia. We are not in the ammonia business. We're an independent carrier. So I'm sure CF's concerns and Dyno's concerns have to be the cost of the product, but that is not something that's involved in this proceeding because that's nothing that Kaneb has any authority over or any ability to affect.

VICE CHAIRMAN BUTTREY: Even given that, you would agree that natural gas prices, basic natural gas prices, and the fact that they've escalated so much, really bears heavily on what's going on here?

MR. TABOR: I suspect that is the case. I don't know that as a fact, but I do know that gas not very long ago was $2.00 per MMBTU and is now $7.00 per MMBTU and that has to have an effect. I've been in and around, well actually, I was in and around the ammonia business 30 some years ago, and left and just recently showed back up. And even back then, as I recall, ammonia prices were horribly volatile. At some point in the three years or so that I messed around with it in the early `70s, prices for anhydrous ammonia went from $25.00 a ton, to several hundred dollars a ton. It's just an amazingly volatile product, and as I say, there's not much that Kaneb can do about that.

VICE CHAIRMAN BUTTREY: Based on your reading of the law on this subject, which I'm sure you've taken a look at,, do you read the law to allow you to reduce your prices below the prescribed rate?

MR. TABOR: Well goodness, I would hope so. But, you know if you say that once you prescribe a rate we can't go -- you've already said we can't go up, and we accept that and that's the premise we're here on. But I don't believe we have, today, thought about whether we could decrease our rates to reflect competition. But I would hope that you would not order that your prescribed rates is that we have to charge precisely what you've told us to. And you've now said no more, but I would hope you wouldn't say no less. I would hope you would give us some flexibility in responding to the marketplace.

VICE CHAIRMAN BUTTREY: When I read the statute, it seemed to indicate to me that that is the case. That you cannot reduce your price, as well as you cannot raise your price. You will charge the rate, that rate, that prescribed rate, and no other rate.

MR. TABOR: Well that is the reason, as you know, I came into this case rather late, and I was not involved in that part of the decision. So I'm not prepared today to give a hearty endorsement to the decision that was made that a prescription binds the carrier for all times. But that's where we are, and that's what we accept, and if in due course we get a chance to talk about that some more, I would love to talk about it.

VICE CHAIRMAN BUTTREY: I believe you said in your documents that you were losing, market share -

MR. TABOR: No. Not losing -

VICE CHAIRMAN BUTTREY: -- because of other competitors -

MR. TABOR: Oh. Oh.

VICE CHAIRMAN BUTTREY: -- or local production or other types of fertilizer that were being used or other modes of transportation, etc.

MR. TABOR: I apologize. Yes. Yes. That -- that was in one of the verified statements that was filed in this case. Is that there has been a loss of market share to other -- other modes of transportation, and that there has been a reduction in demand for anhydrous ammonia.

VICE CHAIRMAN BUTTREY: So if that's the case, wouldn't it be advantageous for you to consider reducing your prices, rather than increasing your prices, if the prescription were lifted?

MR. TABOR: That would sound like a proper response to market conditions, but I am not the marketer, and so I don't know. That sounds right to me, but I just don't know the answer for certain.

VICE CHAIRMAN BUTTREY: We'll have another round, of questions right?

CHAIRMAN NOBER: Yes. Absolutely. Mr. Mulvey?

COMMISSIONER MULVEY: Thank you. You mentioned that the CFI is paying the same nominal rate that it paid 18 years ago. But if we look at other transportation industries railroads, the airlines, trucking in all of those cases, not only are they paying the same rate, very often they're paying a lower rate in both nominaal and real terms. So I don't necessarily think that the fact that the rate is the same necessarily means that just because the PPI or the CPI went up, that therefore the rates should go up. There are productivity factors to consider as well. You note the operating cost, capital cost, etc. have all increased, while volumes have fallen. Can you separate out the amounts of the proposed rate increase attributable to each fact or? In other words, if you vacated this rate, the prescription rate,, how much of it is due to the fall off in volumes, the capital cost increase?

MR. TABOR: Well, Commissioner Mulvey, we have not seen a rate increase at this point, so we haven't gone through that exercise. But the verified statements that we filed with our opening evidence that you saw, it does indicate precisely the amounts that are involved in the operating cost increases, and the volume decreases and revenue decreases. So that evidence is before you, but it really doesn't relate to a rate increase because the rates are what they are, and we can't move them unless and until you vacate the prescription.

COMMISSIONER MULVEY: But if we looked at that evidence, and then came back with another prescribed rate that took into account certain factors, but not other factors, that would be an appropriate response?

MR. TABOR: I don't know the answer to that. I'm sorry.

COMMISSIONER MULVEY: Would you agree that the purpose of an economic regulatory body, such as ours, is to try to replicate the free market solution, in terms of prices and output, if the industry structure had been such that the free market would work –

MR. TABOR: Yes.

COMMISSIONER MULVEY: -- do you see that as a –

MR. TABOR: Yes.

COMMISSIONER MULVEY: Well in other industries, what we rely upon market for is to establish prices and output. What happens to firms that make bad investment decisions? Firms would like to raise their rates, if they make a bad investment decision to offset it. But I'm sure in most cases, competition limits the extent to which they can avail themselves of that option. Wouldn't you agree?

MR. TABOR: Well, I would agree that - that if you make bad investment decisions there are consequences to it. I don't - in the regulated sphere, those bad investment decisions are judged by the prudence standard.

COMMISSIONER MULVEY: Yes.

MR. TABOR: And we have to get through the prudence standard before we make that decision. We have not done that. Kaneb did due diligence. Based on hindsight, things don't look very good, but it is based on hindsight. You, on the other hand, as a regulator, must look at that decision as at the time it was made. So that I don't believe we are in a position today to conclude that this was a "bad investment decision" from a regulatory prudence standpoint. And I think that we have presented evidence that shows what we were looking at, and why it was a prudent decision. CF has attacked that episodically, anecdotally, by selectively referring to some of the evidence we were looking at, ignoring other evidence that we were looking at. So I think it is premature to draw any judgments as to prudence in this case, and indeed I don't believe that your standards have ever before had a prudence case in a prescription vacation case. I think that it is a matter that is properly left to a rate case. And at that point, we'll be glad to slug it out with CF and you all can make your decision, but it's just a little early for that at this point.

CHAIR NOBER: Okay. Well, let me follow up on that. Let's just start with the basics. What is the Board's standard for vacating a rate?

MR. TABOR: AS I understand the Board's standard for vacating a rate and, I just want to get this -

CHAIR NOBER: I'll help you with it.

MR. TABOR: All right.

CHAIR NOBER: If that would help. Because we put it in the August –

MR. TABOR: Yes.

CHAIR NOBER: -- 2004 decision. You have to show whether the factual and legal basis of the prescription remain valid. Okay. Now what do we look to to decide that?

MR. TABOR: Well, you have told us what you wanted to look to and – and we have given you that evidence.

CHAIR NOBER: Well, under the statute we have to show whether there was material error, new evidence, or substantially changed circumstances, under Section 722. Now what's the material error, new evidence, or substantially changed circumstance?

MR. TABOR: Well, the substantially changed circumstances that we have identified for you, is the intervening purchase of the pipeline by Kaneb and the increase in costs and the decrease in volumes and revenue.

CHAIR NOBER: Okay. Now as I understand the way businesses value assets, you look at the sort of present value of the income stream coming in. What led your valuers to assess, to assign such a high purchase price to the asset? You've told -- you just told my colleague that we'd have to look at the prudence -- we have to look at the decision you made at the time you made it. So what led them to believe that the revenue coming in would be as high as they thought it would be?

MR. TABOR: They were influenced by a number of things. Their projections of what the volumes were going to be. Their projections of what their revenues were going to be. Their –

CHAIR NOBER: Well, I'm just asking what do you mean? in the revenues. The revenues are a function of what –

MR. TABOR: Volumes.

CHAIR NOBER: There was a rate prescription. Okay so it was all about volume?

MR. TABOR: Yes. Yes. So if volumes increase, revenues increase and vice versa.

CHAIR NOBER: Okay. Now why is that a change, if the volumes didn't pan out the way that your projections thought they would, why is that a changed circumstance, substantially changed circumstance that would warrant vacating the rate?

MR. TABOR: Well, the volumes have not materialized the way that they were predicted to materialize.

CHAIR NOBER: Now what in our rate regulatory regime, either railroads or pipeline, would lead us to believe that a rosy projection that didn't bear out would constitute a changed circumstance to change the -- enough to say that the value -- that a rate prescription -- that's changed circumstance? Typically, don't we look at investment? I mean what other -- investment, improvements, operating cost, things like that. Not, you know speculative investments, right? Not speculative volume, right?

MR. TABOR: Well you have used the term "rosy projection" and I would like to use the term "prudent projection." And you have the prudence standard, you have to look at the facts, you have to look at what they thought of at the time, and look at it from the moment that they were looking at it. You cannot look back and say oh, with 100% hindsight and say oh they made a mistake, so therefore they were imprudent. The prudence standard requires more and what I'm hearing here is facts are what they are. They guessed wrong. Now the real question is, was that imprudent?

CHAIR NOBER: Well the next sort of questions I would have, have to do with court precedent that look at this very question, as to whether or not a regulatory body should allow the increased asset. You know the stepped up basis if you will, that's how I think of it, of an asset when the price that you pay is a function of the rates that the regulator lets you charge. And there have been a whole series of cases that have looked at that and have tried to draw some distinctions as to when a regulatory body should allow that to occur, and when it shouldn't. And as I understand your argument, since if the projections were prudent and we find the purchase price paid was based upon reasonable assumptions, we should allow it. Is that your argument?

MR. TABOR: Say it again, I'm sorry.

CHAIR NOBER: As I understand your argument, it's if the Board finds that the factors upon which Kaneb relied when it made the purchase were reasonable at the time, or prudent at the time, whatever word you want to use, then we should allow the stepped up basis. Is that your argument?

MR. TABOR: Well, I think you have, again conflated the prudence case with today's case. I think that --

CHAIR NOBER: Let me rephrase the question then. Under what circumstance -- what should we look to to determine whether or not we should allow stepped up, is it solely based upon Kaneb's judgment or should we apply any independent judgment to it at all?

MR. TABOR: Well, remember that this is a two step process, Chairman Nober. Step one is vacation of the prescription. Step two would be either Kaneb will file for, or will publish a rate change or it won't, and then either CF will complain or it won't. So that –

CHAIR NOBER: With all due respect Mr. Tabor –

MR. TABOR: -- the standard that you're talking about, I think is the standard in the rate case. Right now, all we're trying to do is level the playing field so we can get on –

CHAIR NOBER: Well –

MR. TABOR: -- with whatever negotiation or litigation we need to have.

CHAIR NOBER: Well, I think that what we're getting at is what constitutes substantially changed circumstance, and whether or not Kaneb's own analysis of the purchase price, which it then paid, constitutes, you know should meet the standard for substantially changed circumstance. So I would take issue with that. I think that whether or not the price you paid was reasonable or prudent, really is central to the case because that depends on whether or not it meets our standard for whether or not substantially changed circumstance exists, which is what, as these questions began with, you have to show in order to vacate the rate in the first place, right? That's at least the way I look at it. Well anyway I'll follow up with you in a minute. Vice Chairman Buttrey.

VICE CHAIRMAN BUTTREY: Do we have in the record anywhere what the balance sheet shows in terms of the value of the asset?

MR. TABOR: The balance sheet as of what date?

VICE CHAIRMAN BUTTREY: As of now.

MR. TABOR: As of now. I don't believe so. No, sir.

VICE CHAIRMAN BUTTREY: Okay.

MR. TABOR: But we could certainly furnish that, if you'd like.

VICE CHAIRMAN BUTTREY: Do you have any general comments or observations about the price and policies and practices of the competitors, other modes of transportation, other suppliers of anhydrous ammonia in the market we're talking about here?

MR. TABOR: No, I don't.

VICE CHAIRMAN BUTTREY: That's all.

CHAIR NOBER: COMMISSIONER Mulvey.

COMMISSIONER MULVEY: I want to follow up on the prudent management issue again. The prudent management standard has been in the interstate commerce legislation for a long time. The Board and the ICC before it was told to prescribe rates that reflected the cost incurred by a prudent manager. So the issue of whether or not you paid too much for this company, or whether or not your, as the chairman suggested, that it was a rosy scenario, that famous consultant who made the estimate of what it was worth, is it relevant to deciding whether or not we should vacate the prescription. No? Is that not true?

MR. TABOR: Well, I think that, excuse me, as I have said, I think that the prudence of the investment relates to what the new rates should be, if indeed new rates are to be forthcoming. But I don't see how we get to that issue, and really fight about that issue until new rates are prescribed. At this point, we are stuck in 1988, and we can't move from 1988, and there is no, and I emphasize no, intellectual or regulatory justification for setting today's rates on what a buyer and a seller thought these assets were worth in 1988. Seems to me that you as a regulatory agency have two choices. You can either stick with your own standards, which is constrained market pricing and the protection that that gives, or you can go back and be a Federal Energy Regulatory Commission, if that's what you want and you can deal with original cost. But there is no basis just to stop somewhere in the middle as to what two people thought this pipeline was worth in 1988, and say that's what it's always going to be worth.

COMMISSIONER MULVEY: You note at the Board has broad discretion as to what it does in setting a rate, and you agree that, we don't have to accept acquisition cost, nor do we have to accept historic value. We could come up with a cost that was in between the two, or even outside of one or the other.

MR. TABOR: That's what *Hope* tells us. Yes, sir.

COMMISSIONER MULVEY: Okay.

MR. TABOR: Is that you have broad discretion in what you do.

COMMISSIONER MULVEY: You mentioned about –

MR. TABOR: What you have done though is, however, for 15 years, 17 years, you have uniformly accepted acquisition price.

COMMISSIONER MULVEY: You talk about contract rates and the importance of contracts. Do you intend to include escalators in your contracts? And do you have any notion of how long the contract periods would be for?

MR. TABOR: I understand the question. I think the answer to that must be that until we understand the rules, we're not going to know exactly how the contracts will look. And you have to tell us what the rules are, and then we will design our contracts to conform to those rules. But escalators –

COMMISSIONER MULVEY: I guess –

MR. TABOR: -- you know escalators and long term contracts are a fairly common occurrence. So there's no reason to think that they would be off the table in any kind of discussions with the shippers.

COMMISSIONER MULVEY: Okay. That's all the questions I have.

CHAIR NOBER: What are the factors the courts look to in deciding whether or not, let me rephrase the question. Are there boundaries around whether or not we can use acquisition costs, in looking at the value of an asset? Or is that just unfettered discretion, you think on our part.

MR. TABOR: I think that it is, I wouldn't say unfettered discretion, but I would say fettered discretion. It's broad discretion, as long as it's reasoned decision making. Your use of acquisition cost in the past, which has been both acquisition costs that were both greater and less than book value. Those acquisition costs have been accepted by you, they've been explained by you, and that's been accepted by the courts. So that as long as you have reason decision making, I think you're entitled to use acquisition costs. And I think that your constrained market pricing, which is the context within which acquisition cost is used, has been widely approved and in seeing as regulation that reflects today, rather than regulation that affects yesterday.

CHAIR NOBER: What is rationale that the agency has used to rely on acquisition costs, in the past? We've been fairly explicit about why we're doing that.

MR. TABOR: Yes. As, well, as I said, I think that the idea was that within the Constrained Market Pricing theory, that acquisitional cost works, because it is the best proxy for replacement cost, without getting into a complicated calculation. And so therefore, theoretically from an economically theoretical point of view, that it is the best alternative to replacement cost and therefore, it's best into your Constrained Market Pricing theory.

CHAIR NOBER: Now at FERC they don't use acquisition cost. I know that.

MR. TABOR: Right.

CHAIR NOBER: Because I've never had a railroad matter come up when I haven't been reminded of that by shippers.

MR. TABOR: Yes.

CHAIR NOBER: Why don't they use acquisition costs?

MR. TABOR: Well, I will tell you that FERC does not use stand alone cost, either. They do not use Constrained Market Pricing.

CHAIR NOBER: But this is not a stand alone cost case either.

MR. TABOR: They are, FERC continues to regulate on the same basis that it has regulated for the 30 some years that I've been practicing there, and that's in the original cost rate regulation regime. So you know if you go to original cost rate regulation regime, then that's what FERC does, and their basis is for that. But FERC has never found that a Kaneb buying an asset in 2002 should use, as its rate base, a transfer price in 1988, as opposed to the original cost properly calculated that showed up in 1970, or thereabouts, when this pipeline was first dedicated to public service.

CHAIR NOBER: Well the court cases have expressed concern about regulatory agencies like ourselves, adopting acquisition costs because it would create an upward spiral that the rate you've would receive, would be a function of the price you pay, and vice versa. Why is that not a risk here? I mean why isn't this just a textbook example of that?

MR. TABOR: Well, I tried to explain why that is not a risk here, is because of your regulatory regime of Constrained Market Pricing has two alternatives that a shipper has available. He can use stand alone cost, he can use revenue adequacy. If the pipeline company paid too much for the asset, then under the revenue -- it's rates may be too high under the revenue adequacy constraint, but then the shipper can choose the stand - alone cost constraint, and can hold the rates down by use of that tool, rather than the other tool. And that's the reason I think that your system works much better than the alternative system. The one that FERC has used over all these years to emulate what would happen in the market place.

CHAIR NOBER: So your view is that if we were to allow it here and vacate that – find that – your purchase price was changed circumstance, then we would vacate the rate and the shippers would then be free to bring a new rate case, correct?

MR. TABOR: Well –

CHAIR NOBER: Well you have to impose a new rate.

MR. TABOR: Yes.

CHAIR NOBER: And then they'd be free to bring a new rate case.

MR. TABOR: Right.

CHAIR NOBER: And the guard against a spiral would be that they could bring a stand-alone case, rather than a revenue adequacy case. Is that

MR. TABOR: Whatever case they wanted to bring. If they wanted to bring a revenue adequacy case, they could bring that. If they wanted to bring a stand-alone cost case, they could bring that, as I understand it.

CHAIR NOBER: Purchase price is really irrelevant with stand alone case.

MR. TABOR: Right.

CHAIR NOBER: Is that -- it's replacement cost.

MR. TABOR: Exactly.

CHAIR NOBER: So it doesn't matter what you pay.

MR. TABOR: Right.

CHAIR NOBER: Fair enough. Okay. Vice Chairman Buttrey do you have anymore questions? Commissioner Mulvey?

COMMISSIONER MULVEY: No. No further questions.

CHAIR NOBER: Okay. Well thank you very much and we'll move onto our next –