

Reply Testimony of

**John T. Durkin, Jr.**

in the matter of

**ILLINOIS COMMERCE COMMISSION**

**DOCKET NO. 07-0446**

CHICAGO PARTNERS  
A LIMITED LIABILITY COMPANY

140 South Dearborn Street  
Chicago, Illinois 60603

1 **Q1: Please state your name, business and address.**

2

3 A1: My name is John T. Durkin, Jr. My address is Chicago Partners, Suite 1500, 140  
4 S. Dearborn, Chicago, IL 60603.

5

6 **Q2: Did you previously submit direct testimony in Illinois Commerce**  
7 **Commission Docket No. 07-0446?**

8

9 A2: Yes.

10

11 **Q3: What is the purpose of your reply testimony?**

12

13 A3: I am responding to the reply testimonies of Dr. Peter F. Colwell and Dr. Charles J.  
14 Cicchetti.

15

16 **Q4: Has anything in the reply testimony of Dr. Colwell caused you to change the**  
17 **opinions you expressed in your direct testimony?**

18

19 A4: No. In my direct testimony, I argued that Dr. Colwell had failed to establish in his  
20 direct testimony that Enbridge faces a holdout problem. In addition, I argued that even if  
21 Enbridge does face a holdout problem granting Eminent Domain (ED) authority would be  
22 inefficient because it would lead to a transfer of land or easement rights from landowners  
23 to pipeline operators even though the land or easement rights are more valuable to  
24 landowners than to Enbridge. Dr. Colwell's reply testimony fails to establish that  
25 Enbridge faces a holdout problem and continues to ignore the inefficiency caused by ED.

26

27 **Q5: Has anything in the reply testimony of Dr. Cicchetti caused you to change the**  
28 **opinions you expressed in your direct testimony?**

29

30 A5: No. In my direct testimony, I argued that local prices were determined primarily  
31 by national and international supply and demand factors rather than local supply

32 conditions. I also argued that Dr. Cicchetti’s analysis in his direct testimony had failed to  
33 provide any evidence that local refined prices would be impacted by local crude supplies  
34 or that the extension would have any affect on local, national or international crude  
35 supply and, therefore, his analysis failed to establish that the extension project would  
36 have any impact on local refined prices. Dr. Cicchetti’s reply testimony contains no  
37 evidence of the relationship between local crude supply and local refined prices or  
38 evidence of the relationship between the extension project and local, national or  
39 international crude supply.

40

41 **Q6: Are there any particular areas of their reply testimonies that you would,**  
42 **nonetheless, like to address.**

43

44 A6: Yes. I would like to address Dr. Colwell’s comparison of the paths of Enbridge’s  
45 pipelines with and without Eminent Domain, my quote from Dr. Colwell’s earlier  
46 publication and the issue of the public good nature of the proposed pipeline.

47

48 **Q7: What is your response to Dr. Colwell’s discussion of Exhibits 1 and 2 in his**  
49 **reply testimony?**

50

51 A7: Dr. Colwell highlights the difference between what he describes as the  
52 “convoluted” path of the Lakehead Line 14 pipeline which Enbridge had to build without  
53 ED and the straight path of the Guardian pipeline that Enbridge built with ED. He argues  
54 that this difference is “the clearest way to see the consequences of unfettered holdouts”  
55 and that the “zigzagging could only be considered an excessive allocation of land  
56 resources.”<sup>1</sup>

57

58 Dr. Colwell’s analysis is flawed for several reasons. First, deviations from the least cost  
59 path do not necessarily imply that the hold out problem exists. If landowner differences  
60 in reservation prices are large relative to the additional costs of deviating from the least

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<sup>1</sup> Reply Testimony of Peter F. Colwell, Ph.D., Illinois Commerce Commission Docket No. 07-00446, page 5.

61 cost path, then deviations from the least cost path would be the equilibrium outcome even  
62 in the absence of a hold out problem.

63

64 Second, the path of a pipeline tells us nothing about whether resources have been  
65 allocated efficiently. Economist typically define an efficient resource allocation as one  
66 that maximizes the sum of producer and consumer (landowner) surplus. A straight line  
67 path maximizes producer surplus if it is the least cost path<sup>2</sup>, but does not necessarily  
68 maximize total surplus. If landowner differences in reservation prices were large relative  
69 to the additional costs of deviating from the straight line, then a straight line path would  
70 necessarily be inefficient. When Colwell argues that the straight line path is an efficient  
71 allocation of land resources, he is ignoring landowner surplus.

72

73 **Q8: What is your response to Dr. Colwell's claim that you misquoted his**  
74 **published statements?**

75

76 A8: Dr. Colwell's publication<sup>3</sup> that I quote in my direct testimony proposes a method  
77 for inducing property owners to reveal their reservation prices. He argues that his  
78 proposed method of self assessment would "increase efficiency and equity". The quote in  
79 my direct testimony is his description of why his proposed method would reduce the  
80 efficiency losses caused by ED. My purpose of including the quote was simply to point  
81 out that Dr. Colwell himself recognizes the inherent inefficiency of ED, so there is no  
82 sense in which I took his quote out of context.

83

84 In his reply testimony, Dr. Colwell argues that the disclaimers in his publication  
85 somehow invalidate his conclusion regarding the efficiency losses of ED. However, those  
86 disclaimers say nothing out the inefficiency of ED. The disclaimers simply suggest that  
87 his proposed method might not be politically acceptable even if it is efficiency enhancing.

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<sup>2</sup> In general, geographic features could imply that a straight line path is not the least cost path.

<sup>3</sup> Colwell, Peter F. "Privatization of Assessment, Zoning and Eminent Domain." *ORER Letter*, Spring 1990.

89 Finally, in his reply testimony, Dr. Colwell argues that the proposed method in his  
90 publication would only work for total takings and not partial takings. Again, this is a red  
91 herring that is unrelated to his conclusion regarding ED. In his publication, he recognizes  
92 that granting ED for easements also leads to “more control of land than is socially  
93 optimal”.<sup>4</sup>

94

95 **Q9: What is your response to the discussion regarding public goods and**  
96 **externalities in their reply testimonies?**

97

98 A9: In his direct testimony, Dr. Colwell argues that roads and pipelines are “similarly  
99 deserving of the power of ED”,<sup>5</sup> but his testimony was not clear as to why they were  
100 similarly deserving of ED. In my direct testimony, I conjectured that Dr. Colwell might  
101 be making one of two possible arguments. First, I suggested that he might have been  
102 arguing they are similarly deserving of ED because both roads and pipelines need to be  
103 connected. Second, I suggested that he might have been arguing that they both have  
104 characteristics of public goods in which case a private provider would not be able to  
105 cover the cost of providing the socially optimal level of output. If so, he might have been  
106 arguing that Enbridge was deserving of a subsidy in the form of ED independent of  
107 whether there is a hold out problem.

108

109 In his reply testimony, Colwell clarifies that he believes pipelines are like roads for the  
110 purposes of considering ED status because they both need to be connected.<sup>6</sup> Thus, my  
111 discussion of public goods, externalities and ED and Dr. Colwell’s and Dr. Cicchetti’s  
112 criticism of that discussion are largely irrelevant.

113

114 However, their criticism does not change my conclusion that in the absence of a holdout  
115 problem Enbridge can capture the benefits it provides and, therefore, can cover the cost  
116 of providing the socially optimal level of production without ED. This is true independent

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<sup>4</sup> Op. Cit, Colwell, page 3.

<sup>5</sup> Testimony of Peter F. Colwell, Ph.D., Illinois Commerce Commission Docket No. 07-00446, page 8.

<sup>6</sup> Reply Testimony of Peter F. Colwell, Ph.D., Illinois Commerce Commission Docket No. 07-00446, page 4.

117 of whether pipelines are more like public goods than roads and independent whether  
118 Enbridge's pipelines are common carrier pipelines subject to FERC rate regulation. Thus,  
119 it would be inefficient to provide a subsidy in the form of ED to Enbridge if there is no  
120 hold out problem.

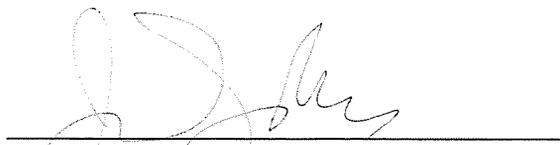
121 **RESPECTFULLY SUBMITTED THIS SEVENTH DAY OF APRIL, 2008**

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125

A handwritten signature in black ink, appearing to read "John T. Durkin, Jr.", is written over a solid horizontal line. The signature is cursive and somewhat stylized.

126 John T. Durkin, Jr., PhD.

127 Vice President

128 CHICAGO PARTNERS, LLC

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