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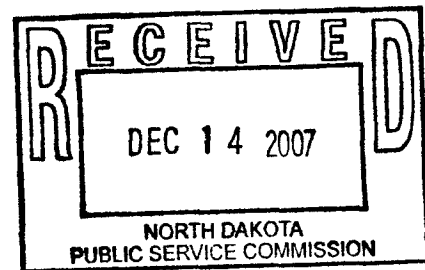
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December 14, 2007

MS ILLONA A JEFFCOAT-SACCO
EXECUTIVE SECRETARY
PUBLIC SERVICE COMMISSION
600 EAST BOULEVARD, DEPT 408
BISMARCK ND 58505-0480

HAND DELIVERED



Re: TransCanada - Keystone Pipeline Project
Case No: PU-06-421
OAH File No. 20070181
Our File No. 11815

Dear Ms. Jeffcoat-Sacco:

As indicated in my letter dated November 27, 2007, Keystone, within the ten day period allowed by the November 7, 2007 Notice of Intent to Consider Information Not Presented at a Hearing, had requested to submit a written response regarding the April 30, 2007 PHMSA Special Permit information, item no. 203, that was received by the Public Service Commission in this case. This letter is intended to be Keystone's written response regarding the PHMSA Special Permit that was issued to Keystone.

Overview

Pursuant to Section 60118 of the Pipeline Safety Act, TransCanada Keystone Pipeline (Keystone) applied to the Pipeline Hazardous Materials and Safety Administration (PHMSA) for a waiver of the regulations of the Office of Pipeline Safety (OPS) in 49 C.F.R. § 195.106 so as to permit Keystone to design, construct and operate the Keystone pipeline at hoop stresses up to 80 percent of the specified minimum yield strength (SMYS), for mainline pipe.

Keystone will design, construct and operate the Keystone pipeline in accordance with 49 C.F.R. § 195.106 at hoop stresses up to 72 percent of the specified minimum yield strength (SMYS) in the following areas:

- Pipeline segments operating in high consequence areas (HCAs) described as commercially navigable waterways in 49 CFR 195.450;



- Pipeline segments operating in HCAs described as high population areas in 49 CFR 195.450;
- Pipeline segments operating at highway, railroad and road crossings; and
- Piping located within pump stations, mainline valve assemblies, pigging facilities and measurement facilities.

Technical Basis of Request

TransCanada and other pipeline operators in Canada have designed, constructed, operated, and maintained both natural gas and liquid transmission pipelines utilizing a 0.8 design factor since the early nineteen seventies. Canadian pipeline standards began to reflect the 0.8 design factor in the 1973 edition of Z184, the gas pipeline standard. This allowed adoption of a Maximum Allowable Operating Pressure (MAOP) corresponding to 80% SMYS, based on hydrostatic testing at a minimum of 1.25 times the intended MAOP. Testing above 100% SMYS was facilitated by the introduction of a more liberal volume strain criterion. Initially, the design factors themselves were not changed, but parallel “hydrostatic test factors” could be used to determine MAOP. This led to the somewhat anomalous situation that the MAOP could, and often did, exceed the design pressure. This anomaly was removed in the 1990 edition of Z183 (oil) and the 1992 edition of Z184 (gas), when a single design factor of 0.80 was adopted, in conjunction with maximum “location factors” that varied from 1.000 for Class 1 to 0.550 for Class 4¹. Since 1994, this approach has been maintained in CSA Z662, which replaced Z183 and Z184 and is the current standard for oil and gas pipeline systems. CSA-Z662 is the Canadian equivalent (covering both gas and liquid pipelines) to 49 C.F.R. §192 and §195.

The Canadian pipeline industry has an outstanding track record for safety over the 33 years since implementation of the use of a 0.8 design factor for the design and operation of both gas and oil pipelines. Keystone, in its petition for waiver, provided specific and more detailed background on the CSA’s determination of the applicability of the 0.8 design factor, a comparison of requirements in CSA Z662 to those of 49 C.F.R. Part 195, and a summary of the operational history of pipelines designed and operated to a 0.8 design factor. In addition, a total of approximately 2500 miles of gas transmission pipelines have been granted the Petition for Waiver to design, construct and/or operate at 0.8 design factor in the U.S in 2006.

Economic Basis of Request

There is a demonstrated need for the Keystone Pipeline Project to move crude from the Canadian producing basins to the US Midwest. According to the Canadian Association of Petroleum Producers forecast of crude production based on approved / planned projects, the total Alberta production volume will exceed existing pipeline export capacity by 2009 if major expansion or new pipeline systems are not built. Keystone’s analysis of this same date supports this conclusion and has lead Keystone to target completion of the pipeline by Q4 2009.

Design, construction, and operation of the Keystone Pipeline at a higher design factor will allow Keystone to build a more economical pipeline in two primary ways:

¹ The class location definitions in CSA Z662 are based on population and other land-use issues, and are similar to those in ASME B31.8. The design formula in Canadian standards is based on nominal wall and outside diameter

- a. reducing steel costs for the pipeline project; and
- b. increasing the throughput capacity of the pipeline

Evaluation & Findings

PHMSA has performed a rigorous evaluation and conducted a public comment period of the Keystone application to ensure that the design, construction and operation of the Keystone pipeline will meet or exceed existing pipeline regulations. Upon conclusion of its analysis, PHMSA reached two findings:

1. The operation of the Keystone pipeline at hoop stress of up to 80 percent SMYS is not inconsistent with pipeline safety
2. The operation of the Keystone pipeline at hoop stress of up to 80 percent SMYS will provide a level of safety equal to, or greater than, that which would be provided if the pipeline were operated under existing regulations.

PHMSA reached these findings through the review of public comments and the analysis of Keystone's application which described actions for the life cycle of the proposed pipeline addressing pipe and material quality, construction quality control, pre-in service strength testing, the Supervisory Control and Data Acquisition (SCADA) system inclusive of leak detection, operations and maintenance and integrity management.

The aggregate affect of Keystone's actions and PHMSA's 51 conditions provide for more inspections and oversight than would occur on pipelines installed under existing regulation.

Compliance

Keystone is required to comply with the terms and conditions of the PHMSA Special Permit.

Pre-emption

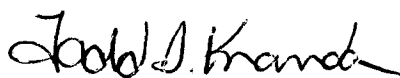
Based on the legal analysis outlined in the attached Memorandum, any state regulation of the design of the Keystone pipeline that conflict with the pipeline design specifications of the federal Pipeline and Hazardous Materials Safety Administration (PHMSA) is not allowed. Pursuant to delegation by Congress to the Secretary of Transportation and re-delegation to PHMSA, it is PHMSA that enforces the detailed regulations pertaining to the "design" of interstate pipelines carrying petroleum and petroleum products. The regulations in 49 C.F.R. Sections 195.100-195.134 regarding "Design Requirements" prescribe minimum design requirements for new pipeline systems constructed with steel pipe. Specifically, Section 195.106(d) of PHMSA's regulations establishes the "minimum wall thickness of the pipe that may be used. A state permit condition requiring Keystone to adopt a different specification would conflict with existing federal regulation for interstate petroleum pipelines and would therefore be subject to preemption. Accordingly, any attempt by a state agency to regulate the safety and design conditions of an interstate hazardous liquid pipeline is preempted by federal law.

I am enclosing an original Certificate of Service which indicates that this correspondence has been provided to legal counsel for the various parties, namely Attorney Erik R. Johnson and Attorneys Pat Madsen and John

Dingess who are legal counsel of record for Fargo, Attorney Matt Shimanek and Attorney Jana Linderman who are legal counsel of record for the Intervenors of Dakota Resource Council et al as well as to Intervenors John and Janie Capp.

If you have any questions, please feel free to contact Thomas D. Kelsch or me.

Sincerely,

A handwritten signature in black ink that reads "Todd D. Kranda". The signature is written in a cursive style with a long horizontal flourish at the end.

Todd D. Kranda

TK:ls
Enc

MEMORANDUM

I. FEDERAL LAW PREEMPTS STATE REGULATION OF HAZARDOUS LIQUID PIPELINE SAFETY

The Supremacy Clause of Article VI of the United States Constitution grants Congress the power to preempt state or local law. U.S. Const. art. VI, § 2; *Northwest Cent. Pipeline Corp. v. State Corp. Comm'n of Kan.*, 489 U.S. 493, 509 (1989); *Fletcher v. Burlington N. & Santa Fe Ry. Co.*, 474 F.3d 1121, 1125-26 (8th Cir. 2007). Under the doctrine of preemption, a federal law can displace state law through express preemption, field preemption, or conflict preemption.¹ See, e.g., *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 299-300 (1988) (describing these three “circumstances in which federal law preempts state regulation” as “familiar”); *Cal. Fed. Sav. & Loan Ass'n v. Guerra*, 479 U.S. 272, 280-81 (1987) (similar).

A. The Federal Statutory Scheme Expressly Preempts State Regulation of Pipeline Safety

To determine whether a federal law preempts state or local regulation, one begins with the statutory text. See *Schneidewind*, 485 U.S. at 299. The federal statutes applicable here are the Pipeline Safety Improvement Act of 2002, as amended by the Pipeline Inspection, Protection, Enforcement, and Safety Act of 2006, and various earlier pipeline safety statutes which are

¹ Express preemption exists where Congress enacts an explicit statutory command that state law be displaced. See *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 383 (1992) (holding that Airline Deregulation Act “expressly preempts the States” from enacting or enforcing guidelines regarding airline fare advertising). Field preemption exists “where the scheme of federal regulation is sufficiently comprehensive to make reasonable the inference that Congress left no room for supplementary state regulation.” *Moldo v. Matsco, Inc. (In re Cybernetic Servs., Inc.)*, 252 F.3d 1039, 1045-46 (9th Cir. 2001) (internal quotation marks omitted); see *Napier v. Atl. Coast Line R.R. Co.*, 272 U.S. 605, 607 (1926) (the main question “is whether the . . . Act has occupied the field . . . so as to preclude State legislation”). Conflict preemption is found “where compliance with both federal and state regulations is a physical impossibility,” *Fla. Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963), or where state law “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.” *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

currently codified at 49 U.S.C. § 60101 *et seq.* (collectively, the “PSA”).² The purpose of the PSA is to “provide adequate protection against risks to life and property posed by pipeline transportation and pipeline facilities by improving the regulatory and enforcement authority of the Secretary of Transportation.” 49 U.S.C. § 60102(a)(1). Federal legislation in this area seeks to provide “a national hazardous liquid pipeline safety program with nationally uniform minimal standards and with enforcement administered through a Federal-State partnership.” 49 C.F.R. pt. 195, app. A (“Delineation Between Federal and State Jurisdiction — Statement of Agency Policy and Interpretation”).

The PSA defines “hazardous liquid” to mean either “petroleum or a petroleum product” or “a substance the Secretary of Transportation decides may pose an unreasonable risk to life or property when transported by a hazardous liquid pipeline facility in a liquid state (except for liquefied natural gas).” 49 U.S.C. § 60101(a)(4). The PSA defines “hazardous liquid pipeline facility” to include “a pipeline, a right of way, a facility, a building, or equipment used or intended to be used in transporting hazardous liquid.” *Id.* § 60101(a)(5). The PSA contains a separate set of definitions and terms applicable to gas pipelines.³

² Before their recodification as Subtitle VIII of Title 49 of the U.S. Code in 1994, *see* Pub. L. No. 103-272, 108 Stat. 1301 (1994), two separate statutes provided the framework for the federal regulation of pipeline safety. The Natural Gas Pipeline Safety Act of 1968 (“NGPSA”) authorized the DOT to regulate pipeline transportation of natural gas and other gases as well as the transportation and storage of liquefied natural gas. Pub. L. No. 90-481, 82 Stat. 1003 (1968) (formerly 49 U.S.C. § 1671 *et seq.*). The Hazardous Liquid Pipeline Safety Act of 1979 (“HLPESA”), Pub. L. No. 96-129, 93 Stat. 1003 (1979) (formerly 49 U.S.C. §§ 2001-2014), was modeled largely on the NGPSA, and authorized the DOT to regulate pipeline transportation of hazardous liquids. In 1994, Congress combined and recodified the two existing pipeline safety statutes at 49 U.S.C. § 60101 *et seq.* *See* Pub. L. No. 103-272, 108 Stat. 1301 (1994).

³ *See* 49 U.S.C. § 60101(a)(2) (defining “gas” to mean “natural gas, flammable gas, or toxic or corrosive gas”); *id.* at § 60101(a)(3) (defining “gas pipeline facility” as “a pipeline, a right of way, a facility, a building, or equipment used in transporting gas or treating gas during its transportation”); *id.* at § 60101(a)(6) (defining “interstate gas pipeline facility” as “a gas pipeline facility — (A) used to transport gas; and (B) subject to the jurisdiction of the Commission under

The PSA differentiates between the regulation of interstate⁴ and intrastate⁵ hazardous liquid pipelines.⁶ In a provision entitled “Preemption,” the Act expressly preempts State and local authorities from regulating the safety of interstate pipelines. For interstate pipelines, “a State authority may not adopt or continue in force safety standards for interstate pipeline facilities or interstate pipeline transportation.” 49 U.S.C. § 60104(c).

There are two narrow exceptions to this prohibition, by which a State authority may participate in investigating compliance, neither of which is applicable here. First, a State authority may enter into a certification and pipeline safety agreement with the DOT, through which the DOT authorizes the State authority “to participate in the oversight of interstate pipeline facilities.” *Id.* § 60106(b). “Each such agreement shall include a plan for the State authority to participate in special investigations involving incidents or new construction and allow the State authority to participate in other activities overseeing interstate pipeline transportation or to assume additional inspection or investigatory duties.” *Id.* This narrow exception, however, on its face pertains to inspection and investigatory duties and does not provide a role for the State in imposing safety standards for an interstate pipeline. Indeed, the same statutory section states: “Nothing in this section modifies section 60104(c) [the preemption provision] or authorizes the Secretary to delegate the enforcement of safety standards for

the Natural Gas Act (15 U.S.C. § 717 *et seq.*)).”

⁴ An “interstate hazardous liquid pipeline facility” is “a hazardous liquid pipeline facility used to transport hazardous liquid in interstate or foreign commerce.” 49 U.S.C. § 60101(a)(7). “Interstate or foreign commerce” is defined in relevant part as commerce between “a place in a State and a place outside that State” or “places in the same State through a place outside the State.” *Id.* § 60101(a)(8)(B).

⁵ An “intrastate hazardous liquid pipeline facility” is “a hazardous liquid pipeline facility that is not an interstate hazardous liquid pipeline facility.” *Id.* § 60101(a)(10).

⁶ A “hazardous liquid pipeline facility” is a “pipeline, a right of way, a facility, a building, or equipment used or intended to be used in transporting hazardous liquid.” *Id.* § 60101(a)(5).

interstate pipeline facilities prescribed under this chapter to a State authority.” *Id.* Second, the DOT may designate an agent with delegated authority to conduct inspections of pipeline operators and facilities to ensure compliance with federal safety standards on behalf of the DOT. *Id.* § 60117(c). However, “[f]ederal preemption of the regulation of interstate pipeline safety in any other manner [than these two narrow exceptions] is manifest in the language of the PSA provision entitled Preemption.” *Olympic Pipe Line Co. v. City of Seattle*, 437 F.3d 872, 878 (9th Cir. 2006), citing 49 U.S.C. § 60104(c).⁷

Regarding intrastate pipelines, the PSA provides:

A State authority that has submitted a current certification under section 60105(a) of this title may adopt additional or more stringent safety standards for intrastate pipeline facilities and intrastate pipeline transportation only if those standards are compatible with the minimum standards prescribed under this chapter.

Id. § 60104(c). Thus, a State authority may regulate *intrastate* pipelines and impose safety requirements in addition to the federal standards only if: 1) the State authority applies and is approved by the DOT through an annual certification process pursuant to § 60105; and 2) the standards are compatible with the federal standards. *Id.* § 60104(c). Alternatively, a State authority may receive authorization from the DOT to inspect an intrastate pipeline under a pipeline safety agreement pursuant to § 60106(a) or through the designation of an agent under § 60117(c).

The foregoing analysis of the PSA demonstrates that it expressly preempts state or local pipeline safety regulation of an interstate pipeline such as Keystone. The imposition of pipeline

⁷ Similarly, the DOT reached the same conclusion regarding the PSA’s predecessor statute (the HLPSA): “The HLPSA leaves to exclusive Federal regulation and enforcement the ‘interstate pipeline facilities,’ those used for the pipeline transportation of hazardous liquids in interstate or foreign commerce.” 49 C.F.R. pt. 195, app. A. (2006).

safety conditions by the Public Utilities Commission is, therefore, expressly preempted by the PSA. *See* 49 U.S.C. § 60104(c); *Olympic Pipe Line Co.*, 437 F.3d at 879-881 (holding that “the PSA expressly preempts Seattle’s attempted safety regulation of [Olympic’s] Seattle Lateral”).

The conclusion that the PSA preempts any attempt by the Commission to impose safety measures on Keystone’s operations also is consistent with and supported by precedents under the prior two statutes, the NGPSA and the HLPSA, that were combined and recodified (*see* discussion, *supra*, note 2) as the present federal pipeline safety statutes at 49 U.S.C. § 60101 *et seq.*⁸ Indeed, the language in the current preemption provision codified at 49 U.S.C. § 60104(c) pertaining to interstate pipelines is virtually identical to the HLPSA preemption provision previously codified at 49 U.S.C. § 2002(d),⁹ thus supporting reliance on prior HLPSA preemption cases. *See Olympic Pipeline Co.*, 437 F.3d at 881 n.24 (relying on prior HLPSA and

⁸ *See, e.g., Kinley Corp. v. Iowa Utils. Bd.*, 999 F.2d 354, 358 (8th Cir. 1993) (holding that the HLPSA expressly preempts an Iowa state statute that established a state program to supervise interstate hazardous liquid pipelines); *id.* at 360 (“the hearing, permit and inspection provisions of [the Iowa statute] are so related to federal safety regulations that they are preempted” and the “environmental and damage remedies provisions are not severable . . . and thus are preempted as well”); *ANR Pipeline Co. v. Iowa State Commerce Comm’n*, 828 F.2d 465 (8th Cir. 1987) (holding same Iowa code section preempted under the NGPSA with respect to natural gas pipelines); *Nat’l Fuel Gas Supply Corp. v. Pub. Serv. Comm’n of New York*, 894 F.2d 571, 578 (2d Cir. 1990) (NGPSA “governs safety requirements for interstate gas transmission lines and expressly preempts more stringent regulation of such lines by State agencies”), *cert. denied*, 497 U.S. 1004 (1990). *Natural Gas Pipeline Co. of Am. v. R.R. Comm’n*, 679 F.2d 51, 52 (5th Cir. 1982) (holding that the NGPSA expressly preempts the application to interstate gas pipelines of a Texas Railroad Commission rule requiring natural gas companies to provide procedures and safeguards to protect the public from accidental releases of gases from their facilities); *Williams PipeLine Co. v. City of Mounds View*, 651 F. Supp. 551, 566 (D. Minn. 1987) (holding that the HLPSA expressly preempts city and county efforts to regulate hazardous liquid pipeline safety because the Act “clearly expresses Congressional intent to preempt state efforts to establish safety standards for hazardous liquid pipelines”).

⁹ The current statutory preemption provision states in relevant part: “A State authority may not adopt or continue in force safety standards for interstate pipeline facilities or interstate transportation.” 49 U.S.C. § 60104(c). The prior HLPSA preemption provision stated: “No state agency may adopt or continue in force any safety standards applicable to interstate pipeline facilities or the transportation of hazardous liquids associated with such facilities.” *Kinley Corp.*, 999 F.2d at 358 (quoting former 49 U.S.C. § 2002(d)).

NGPSA preemption cases as further support for the conclusion that the current preemption provisions expressly preempt State safety regulation of interstate hazardous liquid pipelines).

Further, while the express language of section 60104(c) is alone sufficient to demonstrate Congress' intent to preempt State safety regulation of interstate hazardous liquid pipelines, the legislative history of the HLPSA further demonstrates Congress' intent. As the Eighth Circuit has held, "[i]n enacting the HLPSA, Congress intended to 'establish a statutory framework similar to the NGPSA to regulate the transportation of hazardous liquids by pipeline.'" *Kinley Corp. v. Iowa Utils. Bd.*, 999 F.2d 354, 358 (8th Cir. 1993) (quoting S. Rep. No. 182, 96th Cong., 1st Sess., reprinted in 1979 U.S.C.C.A.N. 1971, 1975). Further, the NGPSA's express preemption provision¹⁰ was virtually identical to the HLPSA's and that currently found at 49 U.S.C. § 60104(c), causing the Eighth Circuit to hold that its prior NGPSA preemption decision constituted controlling authority for its conclusion that Congress similarly intended to preempt State safety regulation of hazardous liquid interstate pipelines. *Id.* at 358-59.

For the foregoing reasons, the Eighth Circuit's conclusion in *Kinley Corp.* as to the preemptive sweep of the HLPSA is equally applicable and controlling in this case:

Here, Congress granted exclusive authority to regulate the safety of construction and operation of interstate hazardous liquid pipelines to the Secretary of the Department of Transportation. This Congressional grant of exclusive federal regulatory authority precludes state decision-making in this area altogether and leaves no regulatory room for the state to either establish its own safety standards or supplement the federal safety standards.

Kinley Corp., 999 F.2d at 359 (citing *ANR Pipeline Co.*, 828 F.2d at 472, and *Pacific Gas & Electric Co. v. State Energy Res. Conservation & Dev. Comm'n*, 461 U.S. 190, 212 (1983)).

¹⁰ The NGPSA's express preemption provision provided that "[n]o State agency may adopt or continue in force any such standards [referring to State safety standards for intrastate pipelines] applicable to interstate transmission facilities." *Kinley Corp.*, 999 F.2d at 359 (quoting former 49 U.S.C. App. § 1672(a)(1)).

B. State Regulation of Pipeline Safety Conflicts With Existing Federal Pipeline Safety Regulations and Arises in a Field that Congress Sought to Occupy.

Congress' express command that "a State may not adopt or continue in force safety standards for interstate pipeline facilities," 49 U.S.C. § 60104(c), by itself clearly preempts the State/local regulations proposed here. Nonetheless, while that express ban alone is sufficient, it is worth noting that State regulation of the design of the Keystone pipeline would conflict with the pipeline design specifications of the federal Pipeline and Hazardous Materials Safety Administration (PHMSA). Pursuant to the powers delegated by Congress to the Secretary of Transportation and redelegated to PHMSA, that agency enforces detailed regulations pertaining to the "design" of interstate pipelines carrying petroleum and petroleum products. *See* 49 C.F.R. §§ 195.100-195.134 ("Design Requirements"). These regulations "prescribe[] minimum design requirements for new pipeline systems constructed with steel pipe and for relocating, replacing or otherwise changing existing systems constructed with steel pipe." *Id.* § 195.100. In particular, the Administration's regulations establish the "minimum wall thickness of the pipe" that may be used. *Id.* § 195.106(d). A state permit condition requiring Keystone to adopt a different specification would conflict with existing federal regulation, and with the federal goal of establishing uniform minimum national safety standards for interstate petroleum pipelines. It is therefore subject to conflict preemption, as well as express preemption.

Further, it is apparent from the federal pipeline safety statutes and the detailed regulatory regime they commanded the Secretary of Transportation to create that Congress sought to leave no room for State or local safety regulation of interstate petroleum pipelines.¹¹ The extensive regulatory regime authorized by Congress covers approximately 130 regulatory sections, *see* 49

¹¹ *See Schneidewind*, 485 U.S. at 308-09 (holding that Michigan statute regulating natural gas pipelines' issuance of securities "impinges on a field that the federal regulatory scheme has occupied" under the Natural Gas Act ("NGA")).

C.F.R. §§ 195.0-195.589, and addresses, *inter alia*, “Design Requirements,” “Construction,” “Pressure Testing,” “Operation and Maintenance,” “Qualification of Pipeline Personnel,” “Corrosion Control,” and “Annual, Accident, and Safety Related Condition Reporting.” The regulatory scheme leaves no room for State regulation of pipeline safety.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF NORTH DAKOTA

TRANSCANADA KEYSTONE PIPELINE, LP)
30-INCH CRUDE OIL PIPELINE/CAVALIER TO)
SARGENT COUNTIES SITING APPLICATION)

CASE NO. PU-06-421
OAH NO. 20070181

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on the 14th day of December, 2007, the undersigned deposited in the United States Post Office at Mandan, North Dakota, a true and correct copy of the following document(s) in the above-captioned action:

Letter with written response regarding the PHMSA Special Permit - item no. 203

That a copy of the above document(s) was securely enclosed in an envelope with postage duly prepaid, and addressed as follows:

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