BILL LOCKYER, Attorney General
of the State of California
RICHARD M. FRANK
Chief Deputy Attorney General
J. THOMAS GREENE
Chief Assistant Attorney General
KATHLEEN E. FOOTE
Senior Assistant Attorney General
MARGARET E. SPENCER
State Bar No. 62870
Deputy Attorney General
455 Golden Gate Avenue, Suite 11000
San Francisco, California 94102-7004
Attorneys for the Plaintiff, State of California

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

THE STATE OF CALIFORNIA, Plaintiff, v. VALERO L.P., a limited partnership, VALERO ENERGY CORPORATION, a Delaware Corporation, and KANEB PIPE LINE PARTNERS, L.P., a limited partnership, and KANEB SERVICES LLC, a limited liability corporation, Defendants.	Case No. **COMPLAINT FOR EQUITABLE RELIEF FOR VIOLATIONS OF THE SHERMAN ACT AND SUPPLEMENTAL STATE CLAIMS**

Plaintiff, State of California, on its own behalf and as *parens patriae* on behalf of its citizens, by and through its Attorney General, Bill Lockyer, brings this civil action to obtain equitable and other relief against the Defendants named herein for violations of the antitrust laws of the United States and of the unfair competition laws of the State of California, and complains and alleges as follows:

I.

JURISDICTION AND VENUE

1. This complaint is filed and this action is instituted under Section 16 of the Clayton Act (15 U.S.C. § 26) to prevent and restrain the violation by Defendants, as hereinafter alleged, of Section 7 of the Clayton Act (15 U.S.C. § 18). This Court has jurisdiction over this action pursuant to 28 U.S.C. § 1337.

2. This complaint is filed and the action is also instituted under Section 1 of the Sherman Act (15 U.S.C. § 1) to prevent and restrain the violation by Defendants, as hereinafter alleged, of Section 1 of the Sherman Act. This Court has jurisdiction over this action pursuant to 28 U.S.C. § 1337.

3. This Court has supplemental jurisdiction over the claims of Plaintiff arising out of the California Unfair Competition Act, California Bus. & Prof. Code § 17200 et seq. The California Attorney General has jurisdiction to bring such claims pursuant to California Bus. & Prof. Code §§ 17204 and 17206.

4. Venue is proper in the Northern District of California under Section 12 of the Clayton Act, 15 U.S.C. § 22, and under 28 U.S.C. section 1391(b) inasmuch as at least one of the Defendants either transacts business, maintains an office, has an agent or is found within this district. Each Defendant is within the jurisdiction of this Court for service of this complaint.

5. The violations alleged herein have a substantial effect on interstate commerce.

II.

PLAINTIFF

6. The Attorney General of the State of California is the chief law enforcement officer of the state and as such is empowered to bring this suit on behalf of the State and on behalf of its general economy and natural persons residing in the state.

III.

DEFENDANTS VALERO L.P. AND VALERO ENERGY CORPORATION

A. VALERO L.P.

7. Defendant Valero L.P. is a publicly-traded limited partnership organized, existing, and doing business under and by virtue of the laws of the state of Delaware, with its office and principal place of business located at One Valero Place, San Antonio, TX 78212. Defendant Valero L.P. has conducted, at all times material hereto, and does now conduct business within the Northern District, State of California.

8. Defendant Valero L.P. is, and at all times relevant herein has been, a diversified transportation and terminaling company engaged, either directly or through affiliates, in the transportation and terminaling of crude oil, intermediate refinery feed stocks, finished petroleum product blend components, gasoline, diesel fuel, and aviation fuel; and other related businesses.

9. Valero GP, LLC is the general partner of Valero L.P., and manages the operations and employs the full-time personnel of Valero L.P. Riverwalk Logistics, L.P. owns Valero GP, LLC's two percent interest in Valero L.P. and at all times relevant herein has been a wholly owned subsidiary of Valero L.P. Energy Corporation.

10. Defendant Valero is, and at all times relevant herein has been, engaged in commerce as "commerce" is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12.

B. VALERO ENERGY CORPORATION

11. Defendant Valero Energy Corporation ("VEC") is a corporation organized, existing, and doing business under and by virtue of the laws of the state of Delaware, with its office and principal place of business located at One Valero Place, San Antonio, TX 78212. VEC has conducted, at all times material hereto, and does now conduct business within the Northern District, State of California.

12. Defendant VEC is, and at all times relevant herein has been, a diversified energy company engaged, either directly or through affiliates, in the refining of crude oil into refined petroleum products, including gasoline, aviation fuel, and other light petroleum products; the transportation, terminaling, and marketing of gasoline, diesel fuel, and aviation fuel; and other related businesses.

13. Defendant VEC is, and at all times relevant herein has been, engaged in commerce as “commerce” is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12.

//

14. Defendants Valero L.P. and VEC are, from time to time, hereinafter jointly referred to as “Valero.”

IV.

DEFENDANTS KANEB PIPE LINE PARTNERS, L.P. AND KANEB SERVICES, LLC

A. KANEB PIPE LINE PARTNERS, L.P.

15. Defendant Kaneb Pipe Line Partners, L.P. (“KPP”) is a publicly-traded limited partnership organized, existing, and doing business under and by virtue of the laws of the state of Delaware, with its office and principal place of business located at 2435 North Central Expressway, Richardson, TX 75080. KPP has conducted, at all times material hereto, and does now conduct business within the Northern District, State of California.

16. Defendant KPP is, and at all times relevant herein has been, a diversified transportation and terminaling company engaged, either directly or through affiliates, in the transportation and terminaling of crude oil, intermediate refinery feed stocks, finished petroleum product blend components, gasoline, diesel fuel, and aviation fuel; and other related businesses.

17. Defendant KPP is, and at all times relevant herein has been, engaged in commerce as “commerce” is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12.

B. KANEB SERVICES, LLC

18. Defendant Kaneb Services LLC (“KSL”) is a publicly-traded limited liability company organized, existing, and doing business under and by virtue of the laws of the state of Delaware, with its office and principal place of business located at 2435 North Central Expressway, Richardson, TX 75080. Defendant KSL has conducted, at all times material hereto, and does now conduct business within the Northern District, State of California.

19. Defendant KSL is, and at all times relevant herein has been, a company that manages and operates a refined petroleum products and anhydrous ammonia pipeline business

and a terminaling of petroleum products and specialty liquids business through the general partner interest owned by one of its subsidiaries in KPP, a Delaware limited partnership, which in turn owns those systems and facilities through its subsidiaries, and other related businesses.

20. Defendant KSL is, and at all times relevant herein has been, engaged in commerce as “commerce” is defined in Section 1 of the Clayton Act, as amended, 15 U.S.C. § 12.

21. Defendants KPP and KSL are, from time to time, hereinafter jointly referred to as “Kaneb.”

V.

VALERO/KANEB MERGER

22. Pursuant to an agreement and plan of merger dated October 31, 2004, Valero L.P. intends to acquire all of the outstanding voting securities of Kaneb in exchange for cash, stock of Valero L.P., or a combination of cash and stock of Valero L.P.. The value of the transaction at the time of the agreement was approximately $2.8 billion. The surviving entity is to be called Valero L.P.

VI.

TRADE AND COMMERCE

A. RELEVANT PRODUCT MARKETS

23. A line of commerce in which to analyze the effect of the proposed merger is the provision of terminaling services for light petroleum products, fuel blending components, intermediate feed stocks for refinery units, and crude oil.

24. A line of commerce in which to analyze the effect of the proposed merger is the pipeline transportation of light petroleum products.

25. A line of commerce in which to analyze the effect of the proposed transaction is the bulk supply of light petroleum products.

26. Light petroleum product terminals are specialized facilities with large storage tanks used to receive light petroleum products by pipeline, by water, or direct from refinery production; for storage; and for redistribution by pipeline, water carrier, or local distribution by truck.

27. Terminaling services consist of a cluster of services related to the storage and throughput of petroleum products. Terminals receive, store, and handle bulk quantities of light petroleum products for redelivery by pipeline, into water vessels, or across truck racks in tankwagon quantities. They also perform value-added services, such as handling and injection of motor fuel additives (including ethanol) as light petroleum products are redelivered across the truck rack. Terminals also receive, store, and redeliver bulk quantities of crude oil, refinery feedstocks, and other blending components for finished fuels.

28. Light petroleum products include motor gasoline, distillates, and jet fuel.

29. Motor gasoline is produced in various grades and types, including conventional unleaded gasoline, reformulated gasoline, CARB gasoline, and others. Reformulated gasoline is gasoline formulated for use in motor vehicles, the composition and properties of which meet the requirements of the reformulated gasoline regulations promulgated by the U.S. Environmental Protection Agency under Section 211K of the Clean Air Act. Reformulated gasoline also includes oxygenated fuels program reformulated gasoline. CARB gasoline is gasoline meeting the specifications of the California Air Resources Board, and which also meet or exceed U.S. Environmental Protection Agency gasoline specifications for the areas in which they are used. There is no substitute for gasoline as a fuel for automobiles and other vehicles that are designed to use gasoline.

30. Diesel fuel is a petroleum distillate with the referenced sulfur specification to meet on-road, off-road, or home heating uses. There is no substitute for the appropriate diesel fuel as a fuel for trucks, railroad engines, farm equipment, other vehicles and equipment designed to burn diesel fuel. Jet fuel is a kerosene product meeting the specifications for use in turbojet and turboprop engines. Military jet fuel meets the specifications for kerosene products designated for military use (JP-8 and JP-5).

31. Blendstocks are petroleum products and other chemicals blended with unfinished gasoline to produce finished gasoline. Examples of common blend components include CARBOB, reformate, alkylate, MTBE, and ethanol. Ethanol is an anhydrous denatured aliphatic alcohol. The use of ethanol as a gasoline blending component and oxygenate has

become increasingly prevalent in some parts of the country, especially as some states, (*e.g.*, California, New York) have recently prohibited the use of oxygenates such as MTBE.

32. Crude oil is the primary feedstock distilled and further refined to produce finished fuel products and other refined products. Intermediate feedstocks are semi-refined petroleum products used as feedstocks to blend into finished petroleum products.

B. RELEVANT GEOGRAPHIC MARKETS

1. Northern California Terminaling Market

33. Valero and Kaneb are direct horizontal competitors in the provision of terminaling services for bulk suppliers of refining components, most blending components, and light petroleum products in Northern California. The other participants are Tesoro, ConocoPhillips, Shell, and Chevron. BP and IMTT also participate in this market. However, these terminals have constrained access to the Kinder Morgan pipeline system.

34. Kaneb is an independent commercial terminal operator. Kaneb does not own or sell any light petroleum products to wholesale or commercial customers. Thus, Kaneb derives its revenue solely from the provision of terminaling services, including receipt of bulk supplies.

35. Kinder Morgan owns the only common carrier pipeline that serves the interior of Northern California. This pipeline provides the only economic means of distributing light petroleum products to Northern California terminals outside of the East Bay.

36. Bulk supply of light petroleum products in Northern California comes from two sources: (1) domestic production by integrated refiner/terminal operators in Northern California and (2) imports via marine vessel by petroleum product traders, largely on behalf of, or for the integrated refiner/marketers in California.

37. Kaneb owns three terminals that participate in this market: Martinez, Richmond, and Selby. All three of the terminals are both accessible to the Kinder Morgan pipeline system and capable of receiving deepwater marine vessels.

38. VEC owns a refinery at Benicia and associated storage tanks. The refinery and associated tanks are used by Valero for its own terminaling and bulk supply needs. Valero

L.P. controls crude storage facilities.

39. Post-transaction, Valero and Kaneb will control a significant share of bulk supply and terminaling services for light petroleum products in Northern California. The proposed transaction would significantly increase market concentration, and post-merger the market would be highly concentrated.

40. After the transaction, the combined firm could more effectively coordinate with others to raise prices in the market for bulk supply of and terminaling services for refining components, blending components, and light petroleum products in Northern California.

41. The Kaneb terminals are the only independent marine-accessible terminals with unconstrained access to the Kinder Morgan pipeline system. The Kaneb terminals are therefore the only terminals through which a products trader and other marketers can import and distribute light petroleum products throughout Northern California. Wholesale bulk prices in Northern California would likely increase without access to the Kaneb terminals. In addition, Kaneb provides storage to some Northern California refiners for blending components and feedstocks. Loss of access to this storage would likely result in reduced production at these refineries.

<u>2.</u> **<u>Northern California Bulk Ethanol Terminaling</u>**

42. The U.S. Environmental Protection Agency and the California Air Resources Board have mandated the use of oxygenates at various times and in various places in California. Federal regulations require oxygenated gasoline year round in the counties of Los Angeles, Ventura, San Bernadino (partial), Riverside (partial), San Diego, Sacramento, Yolo, El Dorado (partial), Placer (partial), Solano (partial), and Sutter (partial). California regulations require oxygenated gasoline year round in the counties listed above and in Imperial County from November 1 through February 2.

43. California has prohibited the use of oxygenates such as methyl tert butyl ether (“MTBE”). Ethanol is the oxygenate of choice in areas where oxygenated gasoline is required by the U.S. Environmental Protection Agency.

44. Ethanol requires its own storage and cannot be commingled with other light

petroleum products. Ethanol can be shipped in bulk quantities from production facilities into California only by rail or by marine vessel. Ethanol cannot be brought into the state by pipeline. Once bulk ethanol shipments have been placed in storage, tank trucks transport ethanol to outlying terminals, where it can be placed in smaller storage tanks pending final blending with pre-oxygenated gasoline (“CARBOB”) at the truck rack.

45. Kaneb’s Richmond, Selby, and Stockton terminals are the only terminals in Northern California not associated with refineries capable of receiving and distributing bulk volumes of ethanol. Northern California terminals could not be economically supplied with ethanol trucked from Southern California or other locations.

46. Because satellite terminals must receive ethanol supplies by truck, trucking economics strongly influence which bulk ethanol terminal will supply ethanol to finished gasoline terminals.

47. VEC is a significant user and supplier of ethanol for its own finished gasoline sales.

48. After the proposed transaction, Valero could increase prices for or deny access to bulk ethanol terminaling services, causing increased prices for, or reduced supply of, ethanol or finished CARB gasoline.

3. Entry

49. Entry into the relevant markets would be difficult and would not be likely, timely, or sufficient to prevent the anticompetitive effects that are likely to result from the proposed transaction.

VII.

FIRST CLAIM FOR RELIEF

50. Plaintiff repeats and realleges paragraphs 1 through 49 hereof.

51. Valero and Kaneb are competitors in terminaling services for bulk suppliers of refining components, blending components, and light petroleum products in Northern California.

52. The effect of the proposed transaction, if consummated, may be substantially to

lessen competition in the provision of terminaling services for crude oil, light petroleum products, blend components, and intermediate refinery feedstocks, and the bulk supply of light petroleum products and blend components (including ethanol) in Northern California, in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, in the following ways, among others:

a. by eliminating direct competition between Valero and Kaneb in the provision of terminaling services for bulk suppliers of crude oil, refining components, light petroleum products, blend components, and intermediate refinery feedstocks;

b. by increasing the likelihood of, or facilitating, collusion or coordinated interaction between the combination of Valero and Kaneb and their competitors in the provision of terminaling services for bulk suppliers; and

c. by increasing the likelihood of, or facilitating, collusion or coordinated interaction between Valero and the other bulk suppliers of light petroleum products; each of which increases the likelihood that wholesale prices of light petroleum products will increase in the relevant section of the country.

VIII.

SECOND CLAIM FOR RELIEF

53. Plaintiff repeats and realleges paragraphs 1 through 49 hereof.

54. Kaneb provides services in the upstream market for terminaling for bulk ethanol in Northern California through its terminals at Selby and Stockton. No other independent terminals in Northern California can economically receive and distribute bulk supplies of ethanol.

55. Valero Energy is a significant user of ethanol for the oxygenation of gasoline and a significant seller in the downstream market for CARB gasoline in Northern California.

56. Valero has an incentive to raise ethanol storage costs to benefit downstream wholesale ethanol and gasoline sales.

57. The effect of the proposed merger, if consummated, may be substantially to lessen competition in the terminaling of bulk ethanol in Northern California, in violation of Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and in the following ways, among others:

a. by eliminating Kaneb's incentive to maximize bulk ethanol storage at current prices in Northern California;

b. by increasing the likelihood that the combination of Valero and Kaneb will unilaterally exercise market power to increase the price of ethanol and the price of finished oxygenated CARB gasoline in Northern California; prices of CARB gasoline in the relevant section of the country; each of which increases that likelihood that wholesale prices of light petroleum products will increase in the relevant section of that country.

//

//

IX.

THIRD CLAIM FOR RELIEF

58. Plaintiff repeats and realleges paragraphs 1 through 49, 51 through 52, and 54 through 57.

59. Such conduct constitutes a contract, combination or conspiracy in restraint of trade in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.

X

FOURTH CLAIM FOR RELIEF

60. Plaintiff repeats and realleges paragraphs 1 through 49, 51 through 52, 54 through 57, and 59.

61. By performing the acts alleged above, Defendants and each of them have engaged in and will continue to engage in unfair and unlawful trade practices in violation of the California Unfair Competition Act, California Bus. & Prof. Code § 17200 et seq.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff prays judgment as follows:

A. That pending the final adjudication of the merits of this complaint, a temporary restraining order and a preliminary injunction be issued against the Defendants preventing and restraining each of them, and all persons acting on their behalf, from taking any action, either directly or indirectly, in furtherance of the proposed merger and requiring the parties to maintain their companies as separate and independent business entities pending the final adjudication of this matter;

B. That the Valero/Kaneb merger be adjudged to be in violation of Section 7 of the Clayton Act and Section 1 of the Sherman Act and § 17200 et seq. of the California Business and Profession Code;

C. That a permanent injunction be issued against the Defendants ordering divestiture and such other relief as necessary to prevent irreparable harm to the State of California and its consumers;

D. That Plaintiff be awarded its costs of suit, including reasonable attorneys' fees; and

E. That Plaintiff have such other and further relief as the Court deems just and proper.

DATED this 15th day of June, 2005.

BILL LOCKYER, Attorney General
of the State of California
RICHARD M. FRANK
Chief Assistant Attorney General
J. THOMAS GREENE
Chief Assistant Attorney General
KATHLEEN E. FOOTE
Senior Assistant Attorney General
MARGARET E. SPENCER
Deputy Attorney General

By: ______________________________
MARGARET E. SPENCER
Deputy Attorney General
Attorney for the Plaintiff, State of California