

BEFORE THE
SURFACE TRANSPORTATION BOARD

DUKE ENERGY CORPORATION,

Complainant,

v.

CSX TRANSPORTATION, INC.

Defendant.

Docket No. 42070



210395

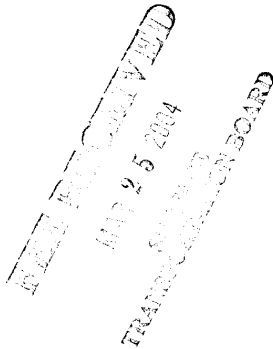
PETITION FOR RECONSIDERATION

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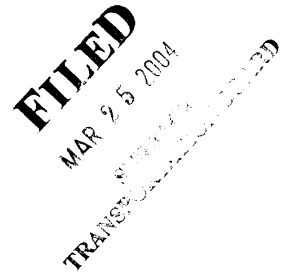
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PETITION FOR RECONSIDERATION

Pursuant to 49 C.F.R. § 1115.3, Duke Energy Corporation (“Duke”) petitions the Board to reconsider several material errors in its Decision served February 4, 2004 (the “Decision”) and in support thereof shows:

I. Preface and Summary of Argument

This is the third decision in the eastern coal rate case trilogy.¹ In the first two decisions, the Board found that rates charged by Norfolk Southern for movements of coal to captive southern utilities were unreasonably high. In this case, where Duke challenged the nearly identical rates of defendant CSX Transportation, Inc. (“CSXT”), the Board reached the opposite finding; namely, that CSXT’s rates were reasonable by a wide margin. See Decision at 31.

The Board’s approval of CSXT’s rates was based upon its findings under the stand alone cost constraint (SAC) of the Coal Rate Guidelines. SAC limits rail rates in monopoly markets to the levels which a hypothetical, efficient railroad (SARR) would need to charge the captive shipper in order to cover its operating costs and earn a reasonable return on its investment. Specifically, the Board approved CSXT’s rates on Duke’s traffic because it found that a SARR earning the same revenues that CSXT will earn under the challenged rates would lose \$1.45 billion over a 20-year time span.² Where a SARR would lose money charging the challenged rates, they are considered reasonable under the SAC constraint.

The basic reason why the SARR serving Duke was found to be so unprofitable is the Board’s conclusion that its annual operating costs would be very high – over \$300 million. In

¹ See also Docket No. 42069, Duke Energy Corp. v. Norfolk Southern Ry. (STB served Nov. 6, 2003 and Feb. 3, 2004) (“Duke/NS”); and Docket No. 42072, Carolina Power & Light Co. v. Norfolk Southern Ry. (STB served Dec. 23, 2003) (“CPL/NS”).

² This margin will shrink dramatically when the Decision is corrected for its numerous computational errors favoring CSXT. See Duke’s “Petition to Correct Technical and Computational Errors,” filed March 16, 2004.

reaching this finding the Board relied upon evidence presented by CSXT.³ Had the Board accepted Duke's operating cost evidence instead (\$105 million annually), the SARR would have been enormously profitable and the Board would have been compelled to conclude that CSXT's rates were well in excess of the levels permissible under the SAC rate constraint. Hence, the outcome of Duke's complaint case turned on which version of SARR operating costs was correct.

In the argument which follows, Duke will demonstrate with clarity, specificity and most importantly, with uncontroverted facts from the evidentiary record that both the Board's rejection of Duke's SARR operating evidence as "fatally flawed" and its acceptance of CSXT's evidence without any analysis as "realistic" are findings which abound with material error. Duke also identifies other material errors in the Board's Decision, but these other errors pale in their consequence to those made by the Board in its treatment of SARR operating costs.

II. The Board Erred in Rejecting Duke's SARR Operating Plan and Costs and Compounded its Error by Unreservedly Accepting CSXT's Operating Evidence

A. Overview

To secure rate relief under the SAC rate constraint, a captive railroad customer must demonstrate how an efficient railroad supplying its transportation needs would be designed, constructed and operated profitably. The challenge in such an undertaking for firms in other industries is self-evident. The daunting task is made especially difficult by the fact that the party possessing much of the crucial information; namely, the defendant railroad obfuscates and withholds immense amounts of important information in its effort to mystify the process and

³ The Board's acceptance of CSXT's SARR operating plan also caused a dramatic increase in the SARR's annual capital costs as CSXT's operating plan implicated a more costly SARR configuration. See Decision at 38. Thus the adoption of CSXT's evidence by the Board resulted in a "double-whammy" against Duke.

obstruct its opponents. See Duke Op. at I-8; Duke Reb. at I-4. In these circumstances, the independent regulatory agency plays an important role:

‘A regulatory body such as the Interstate Commerce Commission cannot properly discharge its duty if it remains ignorant of relevant facts simply because they were not introduced in evidence. The Commission should itself supply deficiencies in the record. It should bring to light material which the parties have either overlooked or have wilfully failed to call to its attention. It should aid those parties who through lack of resources are unable adequately to present their cases. It should make full use of the expert knowledge of commissioners and staff, and of the mass of transportation information that it has accumulated through the years.’^[4]

In reaching its findings and conclusions on SARR operating costs, the Board failed to make full use of its expertise. In the Board’s defense is the fact that it was misinformed by CSXT. It is clear from the events at the oral argument held in this proceeding that the Board had sincere misgivings concerning the efficiency of CSXT’s SARR operating plan. See Transcript of Sept. 10, 2003 Oral Argument (“Tr.”) at 7, 71. However, it was assured repeatedly by CSXT that: “The plan that we put in is for a railroad that is significantly more efficient than CSX.” Id. at 72; see also id. at 37. As the discussion which follows will prove, the CSXT operating plan which the Board accepted was, in fact, far less efficient than CSXT’s real world operations. No amount of obfuscation by CSXT changes the operating cost numbers. Under CSXT’s plan as adopted by the Board, the direct operating costs of the SARR are 16.8 mills per ton mile. The cost equivalent of the real-world CSXT is 12.9 mills per ton mile.⁵ This deviant relationship which

⁴ See Baltimore & Ohio R.R. v. United States, 386 U.S. 372, 430 n.23 (1967) (Brennan, J., concurring) (quoting H.R. Doc. No. 678, Practices and Procedures of Governmental Control of Transportation, 78th Cong., 2d Sess., p. 70 (1944)).

⁵ The variable costs for the Bluegrass No. 4 to Cliffside move, less return and depreciation on road property, equal \$400.27 per car (see Duke Reb. Exh. II-A-127, p. 2). The net ton-miles equal 42,028 ({ } tons per car x { } loaded miles – see Duke Reb. Exh. II-A-126, p. 1). The variable costs per net ton-mile (9.5 mills) were multiplied by CSXT’s fully allocated

attributes higher costs to the SARR than to CSXT mathematically confirms that the Board's findings on SARR operating costs are wrong. They can be corrected only by a reconsideration of these costs and their restatement at a greatly reduced level.

B. Each of the Decision's Three Reasons for its Rejection of Duke's SARR Operating Plan is Invalid

The Board's decisional SARR operating cost syllogism consists of two (2) premises. The first premise is that Duke's operating plan and its costs are flawed, and the second is that CSXT's counter-plan is "realistic." The Decision identifies only three flaws in Duke's plan:

1. The trains on Duke's SARR are too long to meet the contractual requirements of its customers and the operating requirements of the residual CSXT, its connecting carrier ("Train Size");
2. Duke's SARR lacks essential gathering yard facilities necessary to form trains ("Inadequate Facilities"); and
3. Duke's SARR operating plan requires its customers to involuntarily switch the sources of their coal purchases ("Involuntary Coal Resourcing").

If these three reasons were meritorious, they might support the Board's action, but each is contrary to fact.

1. Train Size

The defining feature of Duke's modern efficient SARR operating plan is its trainload-only service from origin to destination or interchange. See Decision at 24. Unlike CSXT, all of the SARR's direct origins and destinations can load and unload trainloads. See

ratio of 1.3595 shown in the URCS formula at D8L617C1. Note also the operating costs which the Board calculated for other coal-carrying SARR's are well below 16.8 mills per ton-mile. See Duke's April 15, 2003 Post-Evidentiary Brief at 20.

Duke Op. at III-C-6 to 7; Duke Reb. at III-C-6 n.3.⁶

In its evidence, CSXT claimed that some of the trains on Duke's SARR were too long. Duke's train sizes were generally similar to those of CSXT except some had as many as 115 cars. As told by CSXT: "[m]ost southern utilities served by CSXT today receive their coal shipments under contracts that specify a maximum train size in the range [of 90-95 cars]." (emphasis added). See CSXT Reply at III-C-7. Additionally, CSXT argued that its rail network "south of Spartanburg [SC] is designed to handle coal trains of 90-95 cars." Id. Solely on the basis of these two CSXT claims, the Board agreed with CSXT that the Duke trains which exceeded 95 cars did not meet the needs of the customer or the connecting carrier and because of this, Duke's SARR operating plan violated a "core" SAC principle that SARRs must meet the needs of shippers and connecting carriers.⁷ The problem with the Board's analysis of preferred train lengths is that it is lifted directly from CSXT's presentation where it is unsupported by facts. Compare Decision at 25 with CSXT Reply at III-C-7. Moreover, the evidence which is in the record directly refutes CSXT's claims and the Board's finding predicated thereon.

CSXT's contention that "most southern utilities" served by CSXT today have contracts specifying maximum train sizes of 90-95 cars is untrue with respect to the utilities whose coal traffic would be handled by Duke's SARR. In its Rebuttal evidence, which the Board appeared to have ignored, Duke provided proof that CSXT's claim was wrong. Duke noted, for example, that {

⁶ In contrast, CSXT serves many mines which cannot load trainloads. Their smaller shipments must be assembled by CSXT into trains at CSXT's gathering yards.

⁷ See Decision at 25 (citing McCarty Farms, Inc. v. Burlington N., Inc., 2 S.T.B. 460, 476 (1997 ("McCarty Farms")); Docket No. 42022, FMC Wyo. Corp. v. Union Pac. R.R. (STB served May 12, 2000) ("FMC"); West Texas Utilities Co. v. Burlington N. R.R., 1 S.T.B. 638, 667 (1996) ("West Texas"))).

} See Duke Reb. at III-C-15. {

} See Duke Op. Workpapers Vol. 4, p. 1280 through Vol. 9, p. 4522. {

}.⁸ Similarly, CSXT's Tariff 8200, which is referenced in many of CSXT's utility contracts, lists 150 car trains as a "standard size." See Tariff CSXT 8200-G, Item 5020 ("Trainload/Unit Train Sizes"). The Board's finding that SARR shippers cannot receive trains with more than 95 cars is disproved by the undisputed evidence of record and is incorrect.⁹

Similarly, there is no evidentiary support for the Board's finding that Duke's larger trains would be inconsistent with the requirements of the residual CSXT – i.e., the SARR's connecting carrier. To be sure, CSXT claimed that its system "is designed to handle coal trains of 90-95 cars" (see Decision at 24), but again it offered no proof in support of this contention. See CSXT Reply at III-C-7. Here, again, the only probative evidence in the record directly refuted CSXT's 90-95 car claim. As Duke demonstrated on Rebuttal (Duke Reb. at III-C-15 n.15), {

⁸ See, e.g., Duke Op. Workpapers Vol. 8, p. 3702 ({
}); id. at Vol. 4, p. 1328 ({

⁹ CSXT's claim about the train size preferences of southern utilities should have been viewed by the Board with skepticism as southern utilities in the other eastern cases were found by the Board to prefer train sizes well in excess of 95 cars. See Duke/NS at 31.

}.¹⁰

The Board's mistaken finding on train length preferences and requirements was pivotal to its decision to torpedo Duke's trainload-only operating plan. There is no evidence to support the Board's finding on preferred train sizes and the only evidence of record refutes it. Under these circumstances, the Board erred. See, e.g., Lakeland Bus Lines, Inc. v. NLRB, 347 F.2d 955, 962 (D.C. Cir. 2003).

2. Inadequate Facilities

If it were not for the fact that the bizarre discussion in the Decision on the SARR's lack of gathering yards (id. at 25) provides one-third of the support given by the Board for its hugely consequential rejection of Duke's SARR operating plan, this absurd finding would not merit mention in this petition because it is so clearly misguided and irrelevant.

At several junctures, the Decision correctly observes that Duke's SARR operating plan features only trainload service from origin to destination and, therefore, it does not build trains in the old-fashioned way with cars from disparate origins in gathering yards. See Decision at 24. However, when the Decision strains for reasons to reject Duke's operating plan, it incredulously states that a "defining characteristic" of Duke's SARR plan is its creation of trains from cars from different mines. Id. at 25. After thus misdescribing Duke's SARR operating plan, the Decision finds the plan as misdescribed is "unworkable" because Duke's SARR configuration fails to provide for gathering facilities for assembling trains.

Under the aforescribed circumstances, it was more than simple error for the Board to reject Duke's SARR operating plan on account of its failure to provide facilities for operations it doesn't perform and doesn't hold itself out to perform and which the Board knew it

¹⁰ See CSXT's Reply electronic workpaper "2001 Cars Data Calculations.xls," level "train size."

didn't perform. The Board's rejection of Duke's SARR operating plan because it lacks gathering facilities must be eliminated from the Decision.¹¹

3. Involuntary Supply Source Change

The third reason upon which the Board bases its conclusion that Duke's SARR operating plan is infeasible is its completely mistaken belief that Duke's trainload-only operating plan somehow forces SARR customers to change their coal suppliers. According to the Decision, eastern coal buyers would be unwilling to accept high sulfur coal when they had purchased low sulfur coal. Nor would sellers who sold coal be happy to lose their sales solely as a consequence of SARR operations. After ascribing these dire shortcomings to Duke's SARR operating plan, the Decision concludes that they make the plan "fatally flawed," referencing WTU, McCarty Farms and FMC. See Decision at 25-28.¹²

While the Decision may be correct in its speculation that a SARR operating plan which delivered coals to its customers different from those which its customers purchased would be unacceptable, Duke's SARR does nothing of the sort. As Duke stressed in its direct evidence and as its traffic evidence demonstrated, its SARR delivers each customer's annual coal purchases in compliance with applicable contractual service requirements. See Duke Op. at III-C-1, III-B-2 & n.1. Over the course of the year, every single customer served by the SARR receives the exact amount of coal it purchased from the exact mine from which it was purchased. See Duke Reb. at Exh. III-A-4.

There is no evidence in the record that Duke's SARR fails to deliver 100 percent

¹¹ The identical text on gathering yards appears in the other eastern cases and may have been inserted into the Decision in this case by mistake.

¹² None of these cases deals with a SARR which forced its customers to change their sources of supply.

of each customer's coal purchases or that it delivers coals different than those the customer purchased; nor did CSXT ever make such a claim.¹³ The Decision's finding that Duke's SARR requires its customers to involuntarily change the sources of their coal purchases is a fiction which the Board went out of its way to create.¹⁴

How could the Board reach the errant finding that Duke's SARR would force its customers to change their supply sources? It did so through its misuse of certain coal shipping data which Duke presented for the sole purpose of demonstrating the SARR's operational capacity to meet the highest anticipated customer weekly demand for its coal transportation services. In past cases, the Board has held that SARRs must be shown by their proponents to be operationally capable of meeting their "peak period" demand. See FMC at 38. During its peak week, the SARR here would be required to deliver 2,744,321 tons of coal to its customers.¹⁵ Duke's required peak week evidentiary analysis demonstrated how its SARR could easily meet this level of customer demand. See Duke Reb. at III-C-63 to 65. Naturally, as a trainload-only railroad, the precise timing of the SARR's originations of coal from its 62 origins differs from that of the real world CSXT which serves the origins with a range of different services. See Duke Reb. at III-C-6 n.3. Thus, for example, the SARR may originate 100 cars on a Monday from a particular mine and transport them directly to destination, whereas the real-world CSXT might originate the same 100 cars in increments over the course of several days or weeks and

¹³ There is no evidence in the record on the "re-sourcing" of coal purchases as CSXT never faulted the SARR operating plan for such a defect. While CSXT alleged many defects in Duke's SARR operating plan, involuntary resourcing of coal purchases was not amongst them.

¹⁴ There is no evidence in the record on coal supply agreements, coal qualities, coal prices, etc. The Board's discussion of this subject to bolster its finding on resourcing is based entirely upon facts not in evidence. See Decision at 26.

¹⁵ See Duke's electronic version of Reb. Exh. III-C-5.

take them to gathering yards for formation into trains. Each rail system (CSXT and the SARR) provides the exact same quantity of transportation services, but the timing of the services differs. Timing is not a factor in the transportation of coal. See, e.g., Duke Reb. at III-B-18.

The Decision focuses upon the differences in the timing of originations between the SARR and CSXT in its Table 2 (see Decision at 27) and incorrectly concludes from the differences shown there that SARR customers are forced to resource their coal purchases. Thus, the Decision correctly notes that during the peak week, the SARR would originate 25 percent more Bates Branch coal and 50 percent less Burke Station coal than CSXT originates during the peak week. However, it then seriously errs when it takes these peak week service differences between the SARR and CSXT and extrapolates them to an annual basis, and concludes that for the entire year the SARR originated 25 percent more coal from the Bates Branch mine than its customers purchased or 50 percent less from the Burke Station mine than its customers purchased, resulting in forced supply source changes; namely, the switch to Bates Branch coal from Burke Station coal. Nothing of this sort happens. Obviously, in the next week, or the previous week, the SARR transported more Burke Station coal and less Bates Branch coal as the evidence is very clear that over the course of the year (coal is customarily purchased on a yearly or multi-yearly basis) each customer receives its exact coal purchases. See Duke Reb. at III-C-64. In concluding to the contrary from a one week snapshot of SARR operations, presented for another purpose, the Board erred. The finding that the SARR forces its customers to change suppliers, a defect in its operating plan which was never raised by CSXT, is unsupported by both logic and evidence and is contradicted by the evidence which shows that the SARR provides each of its customers with the precise quantity of transportation services which it requires to deliver its coal purchases.

erred when it adopted CSXT's evidence as its own findings and conclusions on SARR operating costs. To do so was clear material error.¹⁷

2. CSXT's Evidence Contravenes Least-Cost Principles

The Board proceeds to compound its error in giving dispositive weight to CSXT's computer model evidence by simply endorsing CSXT's SARR operating plan evidence as "realistic" without even looking at it. Had the Board reviewed CSXT's evidence as it reviewed Duke's, it would have easily discerned at least two obvious and unacceptable artifices employed by CSXT to generate the huge inflation in the locomotive and crew components of SARR operating costs. Each artifice contravenes least cost SAC principles.

a. The Mini-Train

The first artifice used by CSXT to inflate SARR operating costs is its "mini-train" operating plan. A significant portion of the SARR's locomotive- and crew-related operating expense (see Decision at 52, Table C-1) is a direct function of train size. Duke's SARR runs trains with as many as 115 cars and the real-world CSXT moves coal trains ranging from 75 to 150 cars. Astoundingly, however, CSXT's version of the SARR – as accepted by the Board – operates hundreds of trains in road service with consists of only 2 to 15 cars in each trainload.¹⁸

inputs, the program and all outputs prior to trial.”).

¹⁷ CSXT, having generated the most crucial element in its SARR operating plan (i.e., cycle time) with its computer model, subsequently attempted to divorce its evidence from the missing model. See Oral Arg. Tr. at 72. In a last gasp effort to try and rehabilitate its operating cost case, it divulged the model more than thirteen months after the evidentiary record on SARR operating costs was closed. See Supplemental Evidence of Defendants CSX Transportation, Inc., filed January 5, 2004, at 11 (“The workpapers submitted with this Supplemental Evidence include . . . an executable copy of the RTC Model . . .”).

¹⁸ See STB electronic workpaper “STB-LUMs and Carmiles (CSX) v4 (modified Off Jct) v.3.xls,” level “LUMs and Carmiles,” sum of column H where column AI is less than 16.

Where one or more locomotives hauls so few cars over long distances in road haul service, locomotive costs per ton soar! The mini-train is the driving force of CSXT's ultra-high cost SARR operating plan. Its pervasive use refutes CSXT's assurances to the Board that its SARR operating plan was "efficient."

If we again examine movements over the Spartanburg gateway, we see that CSXT's SARR handled over 340 trainloads through the gateway with fewer than 50 cars.¹⁹ Indeed, 197 of its mini-trains had 15 or fewer cars. At the nearby Mt. Holly, North Carolina gateway, CSXT's SARR delivered over 200 trains of 12 cars or less. Fifty-five of these mini-trains had only 4 cars and thirty-four had only 2 cars.²⁰ Through its mini-train SARR operating plan, CSXT generated a huge inflation in locomotive crew, maintenance, capital, etc. costs which is directly reflected in the Board's cost findings. See Decision at 52, Table C-1. Had the Board used its expertise in reviewing CSXT's operating plan, it would have seen for itself the totally inefficient employment by CSXT of hundreds of very short trains in its SARR operating plan.²¹

b. Excess Motive Power

CSXT's second SARR operating cost artifice inflated costs by egregiously overpowering the SARR. Specifically, CSXT claims that the SARR would have to own a fleet

¹⁹ See STB electronic workpaper "STB-LUMs and Carmiles (CSX) v4 (modified Off Jct) v3.xls," level "LUMs and Carmiles," sum of H where column G equals "Spartanburg" and column AI is less than 50.

²⁰ Hundreds of similar mini-trains similarly traverse every single gateway on CSXT's SARR. See STB electronic workpaper "STB-LUMs and Carmiles (CSX) v4 (modified Off Jct) v3.xls."

²¹ Even NS readily concedes the inefficiency of operating short trains from origin to destination. See Docket No. 42069, Norfolk Southern Railway Company's Reply to Petition for Reconsideration, filed March 15, 2004, at 19 ("Nor would it have been efficient for NS to operate small trains . . . directly from the mine to destination.").

of { } road locomotives in order to handle the traffic volumes projected for the SARR's peak day in 2004. CSXT's workpapers, relied upon the Board,²² reveal that this huge number of locomotives was derived by {

} that CSXT claims the SARR would have to operate on the peak day, and then adding MOW locomotives, helpers, and a 5 percent spare margin for a total of { } locomotives.²³ In other words, CSXT's "efficient" operating plan would have the SARR acquire so many new AC4000-CW locomotives that it would be able to dedicate three AC4000CWs to each and every train it operates on its peak day, regardless of how briefly any such train might be on the SARR. Under CSXT's plan, the SARR would then retain those { } road locomotives, with many of them idle for the balance of that peak day and for the rest of the peak year.²⁴

Of course, no real-world railroad, let alone an optimally efficient SARR, would invest in such an enormous amount of excess locomotive capacity. In the first place, as CSXT elsewhere acknowledged (CSXT Reply at III-C-8), the SARR, like any rational railroad operator, could be expected to enter into locomotive run-through/pooling arrangements with its connecting carriers to cover many interline movements such as those posited for the SARR. Under such arrangements, of course, each carrier's contribution to the pool typically reflects the relative amount of time the interline trains are on its system. Thus, even if each of the assumed {

²² See STB electronic workpaper "STB-switch and helper crews (Modified).xls," tab "Road locomotives."

²³ It is unclear just how CSXT derived the { } train figure; its workpapers (see the previous footnote and CSXT Reply at III-C-9) indicate that it was derived from CSXT's application of its RTC model, but as CSXT did not file the model with its Reply evidence, we are simply left to accept CSXT's crucial representation on faith.

²⁴ As the peak day represents the maximum number of locomotives required, by definition, there will be locomotives needed only on that one day of the year.

}, the residual CSXT as connecting carrier would supply a substantial portion of the pool. See Duke Reb. at III-C-18. Thus, CSXT's calculation of locomotive requirements for the SARR is vastly overstated, even for the peak day.

In the second place, the notion that the SARR would deliberately maintain a permanent locomotive fleet so large that many locomotives would sit idle 364 days per year is ludicrous.²⁵ Rather, an efficient SARR would endeavor to adjust the size of its locomotive fleet to reflect changes in traffic volumes, leasing additional units only when needed to handle increased volumes and allowing leases to expire when traffic levels fall; indeed, the Board implicitly recognized this flexibility when it indexed the peak year fleet size down to reflect lower SARR traffic volumes in the base year.²⁶

The extent of CSXT's overstatement of SARR locomotive requirements becomes clear when it is seen that it results in an average of just { } locomotive unit-miles ("LUM's") per locomotive for the entire year,²⁷ in contrast to CSXT's system-wide average of { } LUM's per locomotive (CSXT Reply at III-C-9). In other words, CSXT's operating plan for the optimally efficient SARR, designed from the ground up to handle high-volume bulk commodities in trainload service and using new and efficient AC locomotives, would result in a locomotive utilization rate { } percent lower than that achieved by real-world CSXT! Plainly,

²⁵ Even CSXT admitted that no rational railroad would design its system to handle once-a-year traffic volumes without delays. See CSXT Reply at III-B-10.

²⁶ The proper and theoretically correct developments of SARR locomotive requirements is thus quite different from the Board-accepted treatment of fixed plant requirements, which are typically sized from the beginning to handle peak period traffic volumes.

²⁷ Working from CSXT's data, the STB found that the { }-locomotive fleet would generate only { } LUM's in the peak year (see STB electronic workpaper "STB-Equipment Counts (Modified Off Jct) v3.xls"), for a dismal average of just { } LUM's per locomotive. The CSXT version of this spreadsheet showed { } LUM's per locomotive.

CSXT's calculation of SARR locomotive requirements fails the very "sanity check" it urged the Board to apply to Duke's operating plan. The Board's acceptance of CSXT's calculations resulted in another vast overstatement of an important component of SARR operating costs in the peak year, and in every other year of the SARR's projected operations.

D. Conclusion

The Board's findings and conclusions on SARR operating costs, which caused the adverse outcome of Duke's complaint, are revealed to be unsupported by substantial evidence. Nor has the Board employed its own expertise which would have alerted it to the fact that something was wrong with a SARR whose operating costs were greater than those of CSXT, the nation's most inefficient major railroad. See Duke Reply Workpapers, p. 187.²⁸ Finally, the Board should have given some affirmative recognition to the interests of the electric consumers. While CSXT has repeatedly attacked Duke as rich, greedy, and more than able to pay its charges (see, e.g., CSXT Op. at I-1, I-9, and IV-C), the real parties in interest who will bear the enormous increases which the Board has erroneously approved are the citizens of the Carolinas. Their interests were ignored by the Board.

III. It Was Error for the Board to Refuse to Enforce its Conrail Condition

On June 1, 1999, CSXT consummated its purchase of a portion of Conrail for which it paid a premium price exceeding both the book and market value of the acquired assets. During the course of the acquisition proceedings before the Board numerous captive shippers and major national shipper associations representing captive shippers appeared to register their opposition to the acquisition and to present evidence regarding the dubious economics of

²⁸ Elsewhere, in treating relatively trivial issues such as divisions on cross-over traffic and re-routes, the Board went out of its way and beyond the record to employ its expertise to CSXT's benefit. See Decision at 16-22.

CSXT's acquisition proposal. These parties argued that CSXT's projections of robust traffic and revenue gains without rate increases, upon which the financial success of the proposed acquisition was predicated, were speculative, improbable and inaccurate, and that if CSXT failed to realize the improved revenues and profits as they believed the case would be, CSXT would inevitably seek to make up any cash and revenue shortfalls from customers over which it enjoyed market dominance – the captive shippers. See Duke Op. at I-17 to 20.

In approving CSXT's purchase of Conrail, the Board acknowledged the possibility of the situation which the captive customers feared, but it was deemed as "not true" because the Board was persuaded by CSXT's economic predictions that the merged enterprise would achieve the revenues and profits which CSXT forecast and which would be needed to carry its enormous new debt.²⁹ Nonetheless, the Board extracted assurances from CSXT that there would be no exploitation of captive shippers in the event of any missteps with the merger and the merger's approval was expressly conditioned on said assurances by CSXT. In this fashion, CSXT and the Board appeased major and outspoken opponents of the merger.³⁰

As the phrase goes, now the rest of the story is well known. CSXT failed to realize the financial targets which it presented to the Board and, in fact, encountered numerous unanticipated operating problems with Conrail which caused it to suffer huge shortfalls in revenues, profits, and cash flow from those upon which the Board predicated its approval of the acquisition. The unexpected problems encountered by CSXT in its assimilation of Conrail have been well-chronicled by the financial community and were underscored in Duke's evidence. See

²⁹ See CSX Corp. – Control – Conrail Inc., 3 S.T.B. 196, 261-62 (1998) ("Conrail").

³⁰ See F.D. No. 33388, CSX Corp. – Control – Conrail Inc., Comments and Requests for Conditions of the National Industrial Transportation League, U.S. Clay Producers Traffic Ass'n, Inc., and the Fertilizer Institute, Oct. 21, 1997, at 23

Duke Reply at I-17 to 18 & Reply Workpapers at 187. More pointedly, they were articulated in depth before the Board in the evidence of Duke's Witness Whitehurst, an acknowledged expert in merger finances. Witness Whitehurst presented compelling data demonstrating that CSXT's post-Conrail cash flow was less than one-half of what CSXT had represented it would be to the Board. As a consequence, by the end of 2001 it had experienced a cash shortfall of over \$3 billion from that upon which the Board approved the merger. See Duke Reply Exh. II-B-1 at 6.

To shore up to its collapsing finances, Witness Whitehurst explained how CSXT embarked upon a rate increase program notwithstanding the fact CSXT's revenue projections to the Board did not contemplate rate increases. Id. at 6-8. He documented how CSXT itself confirmed his position in its 2001 Annual Report to its shareholders wherein CSXT recounted how it had been successful in imposing significant "rate increases" in a market of "weak demand." Id. at 7. Naturally the rate increases were imposed upon captive shippers generally and on Duke in particular, as CSXT has repeatedly stressed that its competitive traffic cannot absorb rate increases and that rate increases must come from "demand-inelastic shippers" such as Duke. See CSXT Op. at I-3, I-13.

In declining to enforce the Conrail condition which precluded CSXT from exploiting captive traffic to compensate for Conrail shortfalls, the Board relies upon two stated grounds:³¹

1. Duke failed to support its allegation that CSXT's collapsed finances caused it to raise Duke's rates; and
2. The Board's Conrail condition was not meant to freeze CSXT's rates "indefinitely."

Both of these reasons are wrong and both fail to measure up to the decisional standards for an

³¹ To its credit, the Board does not deny it imposed such a condition in Conrail.

administrative decision. See, e.g., Lakeland v. NLRB, supra.

The Board could have concluded that Duke had failed to support its Conrail allegation only by ignoring Duke's evidence (which is not referenced in the Decision). It is difficult to imagine more compelling evidentiary proof than CSXT's own statements to its shareholders that it is raising its rates, coupled with its repeated statements on this very record that captive shippers are its only source of increased revenues. See CSXT Op. at I-3, I-40. The record contained extensive evidence that CSXT's bungled acquisition of Conrail had wreaked havoc with its operations, finances, stock prices, etc. and that to solve its crisis, CSXT was increasing its rates on Duke's traffic and in its refusal to acknowledge these proven facts, the Board erred.

The Board's refusal to enforce its Conrail condition on the grounds of "indefiniteness" makes no sense given the facts associated with CSXT's Duke rate increases. The merger was consummated on June 1, 1999. In that same year, a year in which rail costs declined by 2.8 percent, CSXT raised Duke's rates by 10 percent. In 2001, after rail costs had fallen further, CSXT proposed additional increases in Duke's rates of 11 percent which were raised to 50 percent when it filed the common carrier increases hereunder attack.

The Board clearly erred when it excused CSXT's increases as being non-violative of the Conrail prohibition because they were too "indefinite" in time. On the contrary, the large and precise increases were imposed at or near the commencement of the definite term – five years – during which the Board obligated itself in response to shipper concerns to monitor its Conrail conditions and during which time it expressly promised to oversee the interplay between CSXT's finances and its captive rates. See Conrail at 385 n.262. The time has arrived for the Board to honor the commitments which it made in Conrail by rejecting CSXT's 50+ percent rate increases on Duke's traffic.

**IV. The Board Further Overstated SARR
Operating Costs by Indexing them by the RCAFU**

In justifying its use of the RCAFU to index SARR operating costs, the Board used the exact same text as it used in the Duke/NS decision. Therefore, in the interests of administrative efficiency, Duke hereby adopts by reference its position on that issue as presented in its petition for reconsideration in that proceeding, which it appends hereto as Attachment 1.³²

**V. The Board Erred in Failing to
Update the SARR's Cost of Capital**

Here as to the issue, as well, Duke adopts by reference, its argument presented in the Duke/NS case which is appended hereto as Attachment 2.

VI. Conclusion

The assailed Decision enables CSXT to charge a captive customer 50 mills per ton-mile for coal transportation on trainload service. This charge is twice as high as the average charge for all coal traffic moving in the east.³³ Something is wrong with a “simulated competitive price” that is twice the amount of real-world prices. That something is the material error which is identified in this petition and which the Board must now reconsider.

³² There is one difference between Duke/CSXT and Duke/NS. In Duke/CSXT, the Board places no reliance on its decision in TMPA.

³³ The Board has found that all coal, single car, multiple car, and trainload moves at an average rate in the east of 26 mills per ton mile. See Duke Op. at I-7.

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CERTIFICATE OF SERVICE

I hereby certify that on March 25, 2004, I caused copies of the foregoing Petition for Reconsideration of Complainant Duke Energy Corporation to be served by hand upon the following counsel for Defendant CSX Transportation, Inc.:

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BEFORE THE
SURFACE TRANSPORTATION BOARD

DUKE ENERGY CORPORATION,

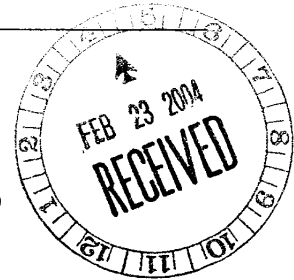
Complainant,

v.

NORFOLK SOUTHERN RAILWAY
COMPANY,

Defendant.

Docket No. 42069



PETITION FOR RECONSIDERATION

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2. **The Board Erred in Using the RCAF-U to Reduce Duke's Rate Relief**

The Decision gives only cursory treatment to a finding of very substantial consequence to the outcome of this case; namely, its use of the RCAF-U as the proper index for forecasting future changes in SARR operating expenses. See Decision at 32. The Board bases its finding on this issue on two points presented by NS. One of NS's points is that because the SARR's traffic will decline in the future, there will be no productivity from "increasing traffic volume." However, this premise is completely contradicted by Table 1 in the corrected decision, which shows SARR traffic increasing from 79+ million in the first year (2002) to over 88 million tons by 2008, an increase of over 10 percent.⁴ NS's declining traffic contention, which the Board found to be "well taken," is flatly wrong according to the Board's own findings.

NS's second point is that the SARR's productivity growth would not be as great as that of the rail industry generally because the SARR is a brand new railroad. The Decision's reliance on this NS point is especially disappointing because the Board had very recently considered the exact same claim by a railroad (Union Pacific) and had rejected it (along with use of the RCAF-U) in Docket No. 42051, Wisconsin Power & Light Co. v. Union Pacific R. Co. (STB served Sept. 12, 2001) at 106 ("Wisconsin"). There, the Board found that "[i]t is not unreasonable to expect that an efficient railroad built today would realize future productivity gains by utilizing new technology as it is developed." The Board further found that a SARR would experience the same productivity increase that Union Pacific projected for its own coal operations, and it specifically rejected Union Pacific's proposed use of the RCAF-U on the

⁴ In contrast, the product of the annual increases in rail output shown in Table B of Ex Parte No. 290 (Sub-No. 4), Railroad Cost Recovery Procedures – Productivity Adjustment (STB served Jan. 12, 2004), yields a six-year (1997-2002) traffic increase of just under 5 percent.

grounds that the Union Pacific productivity-reflecting index “should produce more reliable projections than the more broad-based RCAF-U.” Id.

In its evidence in this proceeding, Duke specifically relied upon the Board’s findings in Wisconsin in keeping with the Board’s admonition in Ex Parte No. 347 (Sub-No. 3), General Procedures for Presenting Evidence in Stand-Alone Cost Rate Cases (STB served March 12, 2001), at 6, that parties should not re-litigate previously resolved issues. See Duke Reb. at III-G-3 to 4. Unlike Union Pacific in Wisconsin, NS did not produce a forecast of its costs for either its coal segment or its operations generally as Duke had requested, and so Duke, consistent with Wisconsin, utilized the RCAF-A, which was the only index reflecting a productivity adjustment that was available to Duke. Under the recited circumstances, the Board’s action in the Decision to reverse field and adopt the previously-rejected RCAF-U based on the absence of evidence from Duke on “specific likely productivity improvements” (see Decision at 37) is especially arbitrary and capricious because of the Board’s express directive not to “re-litigate” decided points. The Decision’s erroneous use of the RCAF-U for SARR costs is compounded by the circumstance that the Board used an adjustment mechanism (the EIA projection) for future SARR revenues that includes an explicit productivity adjustment. This mismatch, alone, wrongly guarantees a bleak financial future for the SARR.

The Board’s passing reference to Docket No. 42056, Texas Municipal Power Agency v. The Burlington N. and S.F. Ry. (STB served March 21, 2003) (“TMPA”), is also unavailing as that case was decided after the close of the evidentiary record in this proceeding. Duke cannot be faulted for failing to address precedent which did not exist during the hearing and which conflicts with the precedents which were then in existence. See, e.g., Consolidated

Edison Co. of New York v. FERC, 315 F.3d 316, 323 (D.C. Cir. 2003) (“A new rule may be applied retroactively to the parties in an ongoing adjudication, so long as the parties before the agency are given notice and an opportunity to offer evidence bearing on the new standard . . .”).⁵ The gravamen of the Board’s reasoning on this issue in TMPA was its skepticism that a railroad handling “only unit trains” could expect to participate in industry-wide productivity adjustments.⁶ In rejecting Duke’s SARR trainload plan and instead adopting NS’s inefficient plan, the Board burdened Duke’s SARR with operations far more inefficient than those of the real-world NS. Therefore, the SARR’s opportunities for future productivity improvements in this case should be greater than the industry average.

Moreover, there is a sound basis to conclude that the SARR’s productivity growth will exceed the industry average. The RCAF productivity adjustment is not limited to productivity advances, but instead measures “total factor productivity,” meaning all changes in productivity, both positive and negative. See Railroad Cost Recovery Procedures - Productivity Adjustment, 5 I.C.C.2d 434, 465 (1989). Accordingly, the productivity average takes into account all the errors and mistakes that real-world railroads make (e.g., merger problems, failure to hire sufficient personnel, etc.). These are problems that a SARR avoids because it is a least-cost, most-efficient carrier. The agency found that “it would appear that calculations limited to

⁵ Citing Hatch v. FERC, 654 F.2d 825, 835 (D.C. Cir. 1981) (“Courts have uniformly held that for an agency to meet [its obligation under 5 U.S.C. § 554(b)(3)] where it seeks to change a controlling standard of law and apply it retroactively in an adjudicatory setting, the party before the agency must be given notice and an opportunity to introduce new evidence bearing on the standard.”).

⁶ At best, Board’s logic in TMPA might justify a refusal to allow the SARR to experience as much productivity growth as the Class I average, but it does not justify the refusal to allow the SARR any productivity gains.

technological productivity would produce larger adjustments to the inflation index since other components of total factor productivity appear to have fallen during the period under consideration.” Id. at 466. The SARR, which starts with technology akin to that in present use, and then regularly replaces its assets, is thus well-positioned, as the Board found in Wisconsin, to match the industry “upside” and avoid its “downside.” The SARR should thus be able to match, if not exceed, industry average productivity growth.

Duke notes that it is particularly punitive to reduce the rate relief that would otherwise be available in the early years of the DCF analysis, notwithstanding use of the RCAF-U in those years, on the basis of the negative results that mushroom in later years due to the use of the RCAF-U. The Board’s approach reduces the rate relief that is otherwise warranted by 76% (in Table 3, the \$117.7 million cumulative present value of the overrecovery in 2011 is reduced to \$27.9 million by 2021) on the basis of long-term projections, which the Board has implicitly acknowledged are inherently more prone to error.

Accordingly, if the Board remains wedded to the improper use of the RCAF-U to adjust SARR operating expenses, it should at least truncate the DCF analysis to exclude the negative and highly speculative out-years that result from its use of the RCAF-U particularly since, as the Board has recognized, nothing mandates use of a 20-year DCF analysis in the first place.

3. **The Cost of Capital Should be Updated in the DCF Analysis**

The Decision’s DCF analysis reflects the use of an average of the 1999-2001 Class I railroad industry cost of capital of 10.53%, weighted according to the timing of the SARR’s expenditures during the construction period. On the other hand, the revenues for the

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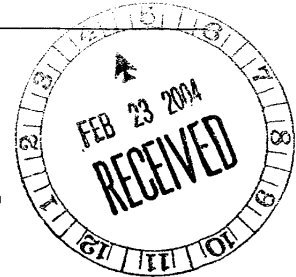
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DCF are adjusted based on the EIA 2003. Thus, the DCF analysis includes an internal mismatch in that it uses capital costs from one period and a revenue adjustor from another. The mismatch is no small thing. In Ex Parte No. 558 (Sub-No. 6), Railroad Cost of Capital-2002 (STB served June 19, 2003), the Board found that the industry cost of capital declined to 9.8% in 2002.⁷

The Decision's use of a cost of capital that correlates unfavorably with the DCF revenues places the SARR, and the shippers it serves, at a financial disadvantage. The disparity between the SARR's cost of capital and that of the industry average represents an impermissible entry barrier since a least-cost, most-efficient carrier should certainly be able to take advantage of the capital refinancing opportunities available to the Class I industry. In past cases such as Bituminous Coal – Hiawatha, Utah to Moapa, Nevada, 6 I.C.C.2d 1, 71-73 (1989), the standard practice of the agency was to have the SARR lock-in interest rates on debt during the construction period, but to base the capital cost of equity on an average that expanded to include post-construction changes, generally through the date of the decision. Significantly, this approach was developed and applied by the agency in periods of generally increasing inflation and costs of capital so as to favor the carriers. In periods of diminishing inflation and costs of capital, especially given the great flexibility of current debt markets, which reflect frequent refinancing, floating interest rates, and lines of credit, a SARR should have at least the same ability as real-world railroads to benefit from diminished investor expectations. Duke further

⁷ The 2002 cost of capital decision was served after evidence was submitted, but before the due date for the decision.

notes that the STB has not in any recent cases given any explanation for apparently departing from its prior practice of updating the cost of SARR equity through the date of the decision.⁸

4. The Board Erred in Rejecting Duke's SARR Operating Plan and Compounded its Error by Summarily Accepting NS's Plan

It was material error for the Board to reject Duke's modern, efficient, least-cost SARR operating plan and to accept NS's "worse-than-reality" operating plan. This action, alone, increased annual SARR operating costs by \$75 million and added an additional \$120+ million to the SARR's roadway investment expense. The Board's error results in the anomaly where an optimally efficient, least-cost railroad has higher operating costs than the inefficient NS itself.⁹

A. The Board's Criticisms of Duke's SARR Operating Plan are Unsupported by Probative Evidence

The Decision provides three reasons for its rejection of Duke's operating plan:

1. Duke's operating plan fails to provide SARR customers with the quality and quantity of the rail service which they require (Customer Service);
2. Duke's operating plan requires the staging of trainloads made up of cars from different mines, but its SARR

⁸ Duke's electronic workpapers, submitted under seal herewith, show the effect on the corrected Decision's DCF analysis of updating the cost of analysis under different scenarios. "DCF_2002Equity.123" calculates the cost of equity in accordance with the agency's prior practice. "DCF_2002Debt.123" calculates the cost of equity in accordance with "DCF_2002Equity.123," but assumes that the SARR refinances all of its debt in 2002 at the prevailing cost of debt. "DCF_2002CostofCapital.123" calculates the cost of capital according to the Class I average, i.e., SARR equity and debt investors are treated as if they have invested in a Class I railroad in 2002 (and the debt-equity ratio is weighted accordingly). All three approaches improve the SARR's financial results.

⁹ The operating costs of the SARR are 15.2 mills per ton-mile whereas NS's variable costs (which, unlike SARR operating costs, include a significant return on investment) are 11.2 mills per ton-mile (as calculated by Duke) and 13.0 mills per ton-mile (as calculated by the Board in CP&L).

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