

SLOVER & LOFTUS

ATTORNEYS AT LAW

1224 SEVENTEENTH STREET, N. W.
WASHINGTON, D. C. 20036-3003

WILLIAM L. SLOVER
C. MICHAEL LOFTUS
DONALD G. AVERY
JOHN H. LE SEUR
KELVIN J. DOWD
ROBERT D. ROSENBERG
CHRISTOPHER A. MILLS
FRANK J. PERGOLIZZI
ANDREW B. KOLESAR III
PETER A. PFOHL
DANIEL M. JAFFE
KENDRA A. ERICSON

2/3707

TELEPHONE:
(202) 347-7170

FAX:
(202) 347-3619

WRITER'S E-MAIL:
kjd@sloverandloftus.com

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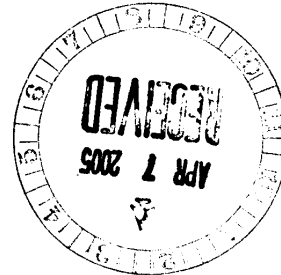
VIA HAND DELIVERY

The Honorable Vernon Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Room 711
Washington, DC 20423

ENTERED
Office of Proceedings

APR - 7 2005

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Public Record



Re: Tennessee Railway Company – Abandonment Exemption – Between
Oneida, Tennessee and Nicks Creek, Tennessee – in Scott County,
Tennessee, Docket No. AB-290 (Sub No. 260X)

Dear Secretary Williams:

Enclosed for filing in the referenced proceeding, please find an original and 10 copies of the Reply of National Coal Corporation to Petition for Exemption, along with a computer disk which contains the filing.

An additional copy of the Petition also is enclosed. Kindly indicate receipt and filing by time-stamping this copy and returning it to the bearer of this letter.

Thank you for your attention to this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "Kelvin J. Dowd".

Kelvin J. Dowd
An Attorney for
National Coal Corporation

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Part of
Public Record

NCC respectfully submits that the Board cannot and should not act affirmatively on the NS Petition without first directing the submission of additional information in accordance with 49 C.F.R. Part 1121.4(c)(1)(i). Specifically, NS should be directed to submit further evidence respecting the future economic viability of the subject

line based upon more accurate and reasonable projections of near-term coal traffic and service demands, as described herein, and the inadequacy of alternative modes of transport to meet those demands.

Independent of the foregoing, NCC further submits that in any disposition of the Petition, the Board should clarify that claims made therein by NS respecting such matters as rehabilitation and repair costs and net salvage values of the subject trackage and related facilities represent the views of NS only, and raise no presumptions for purposes of any further proceedings in connection with the subject line, including proceedings under 49 U.S.C. § 10904.

BACKGROUND

NCC is a public company with offices in Knoxville, Tennessee. Its principal business is the mining and selling of coal sourced in Eastern Tennessee and Southeastern Kentucky.

NCC owns the coal mineral rights to the New River Tract assemblage, which consists of approximately 65,000 acres, and owns and leases another 43,000 acres on properties in Andersen, Campbell and Scott Counties, Tennessee (approximately 25 miles northwest of Knoxville), and Bell, Harlan and Leslie Counties in Southeastern Kentucky.

In July, 2003, NCC commenced mining coal from a surface mine known as Mine No. 2 near Devonia, Tennessee. In 2004, NCC undertook a series of actions which by

year's end had expanded coal operations to include four (4) deep mines and an additional surface mine. Specifically, in April 2004, NCC opened the former U.S. Coal, Inc. Mine No. 9 near Smoky Junction.¹ Thereafter, NCC purchased Mine No. 1 (near Smoky Junction), Mine No. 11 (near Devonia) and Mine No. 7 (a surface mine in the Elk Valley area) from Robert Clear Coal Corporation, and Mine No. 8 on the Straight Creek property in Southeastern Kentucky from Appalachian Fuels, LLC.

Throughout 2004, NCC's coal production volumes averaged 20,000 - 30,000 tons per month as the ramp-up to full operation of the acquired properties progressed. However, January 2005 Tennessee production volumes were approximately 40,000 tons, reflecting a significant increase. An additional 49,000 tons were produced in February, and for March volumes topped 60,000 tons, showing that the new growth is sustained. Moreover, NCC recently secured approval of two new mine permits, and is in the end stages of the approval process for three more. Completion of these projects will increase NCC's coal production output capability to over 1,000,000 tons annually.

The Oneida-Nicks Creek line segment that is the subject of the NS Petition is part of a longer, 42-mile rail line that begins at Oneida and ends at Devonia, Tennessee, where NCC's Mine No. 2 and Mine No. 11 are located. As noted in the NS Petition, the proposed abandonment of the Nicks Creek-Devonia segment is the subject of an exemption noticed by the Board in Docket No. AB-290 (Sub-No. 259X), *Tennessee Railway Company*

¹ NCC purchased U.S. Coal itself in 2002.

– *Abandonment Exemption – In Andersen and Campbell Counties, TN.* NCC already has submitted a notice of its intent to offer to purchase the Nicks Creek-Devonia segment under the financial assistance procedures of 49 U.S.C. § 10904. *See* Petition at 18.² Prior to its acquisition by NCC in 2002, U.S. Coal had negotiated with NS for purchase of the Oneida-Nicks Creek segment, and on information and belief had agreed to terms which included a purchase price of \$250,000.00, among other consideration. A final contract was never concluded, however, and when NCC attempted to revive the transaction following its purchase of U.S. Coal, NS declined to honor its previous offer.³

The Oneida-Nicks Creek line is integral to NCC's direct access to the regional rail transportation network, and as NS notes, NCC represents the principal source of recent and prospective traffic and revenue for the line. *See, e.g.,* Petition at 6, 18. It is not surprising, then, that NS seeks to justify its exemption request almost exclusively by reference to the likelihood that NCC might generate traffic volumes (and, thus, revenues) sufficient to cover NS's estimated cost of maintaining and operating the line, and the impact that abandonment would have on NCC's coal transportation options.

² The Board published a notice of exemption in *Docket No. AB-290 (Sub-No. 259X)* on January 19, 2005. By further Order served February 22, 2005, the Board reopened the proceeding in light of NCC's impending OFA.

³ *See* Petition at 6, n.4. As NS acknowledges, however, the Oneida-Smoky Junction segment remains open for purchase under the OFA procedures of 49 U.S.C. § 10904, and NCC has proffered a request to NS under 49 C.F.R. Part 1152.27 for relevant valuation data that was not submitted with the Petition (*i.e.*, NS's estimate of the value of that portion of the right-of-way that NS owns in fee).

Specifically, NS alleges that at most, the future NCC traffic volumes that could move over the line might only approach 110% of its 2003 “base year” tonnage, and that the added revenue – even if it were “all profit” – would be inadequate to cover claimed avoidable operating losses in the \$350,000.00 range, and alleged rehabilitation expenses of over \$2,000,000.00. *See* Petition at 9-14, 22, 26-27. NS then points to the fact that NCC has been trucking coal to an alternative NS load out at Turley, Tennessee as evidence that abandonment of the Oneida-Nicks Creek line would not deprive NCC of essential transportation services. *Id.* at 6, 12. Finally, NS claims that with a net salvage value of more than \$1,900,000.00, the track and related materials that comprise the subject line could be put to more productive use elsewhere on the NS system. *Id.* at 41. Collectively, these claims provide the underpinning for NS’s case for an exemption under 49 U.S.C. § 10502. *Id.* at 40-45. By the same token, however, material errors in any of these assessments effectively would undermine that case.

DISCUSSION

NCC submits that NS’s Petition dramatically understates the NCC coal production volumes that prospectively could move over the subject line, particularly if – as expected – NCC or another independent entity acquires the Nicks Creek-Devonia segment through the ongoing OFA process. The substitution of more realistic coal traffic projections would completely change the avoidable loss and rehabilitation cost coverage calculations

included in the Petition, and could show that the Oneida-Nicks Creek segment indeed is sustainable. These same higher production forecasts also would tend to contradict NS's claim that truck service offers NCC an effective transportation alternative to rail. In accordance with 49 C.F.R. Part 1121.4, therefore, the Board at a minimum should direct NS to submit additional information addressing these alternative scenarios.

Moreover, and independent of the foregoing, there is reason for skepticism regarding NS's proffered estimates of rehabilitation costs and the net salvage value of track assets for the subject line. The lengths to which NS is going to disavow the terms of its 2002 offer to sell the line to U.S. Coal,⁴ and its stated desire to re-use the track assets elsewhere on its system,⁵ raise the distinct concern that NS may have inflated its asset valuation estimates and understated salvage costs for the line. As noted *supra*, NCC has requested additional valuation data from NS pursuant to 49 C.F.R. Part 1152.27, and in the event that the NS Petition ultimately is granted⁶ NCC or another party may invoke the OFA procedures of 49 U.S.C. § 10904 in order to preserve needed rail service access. In such a circumstance, any examination by the Board of the net liquidation value of the Oneida-Nicks Creek line

⁴ Petition at 6, n.4.

⁵ *See, e.g.*, Petition at 33.

⁶ NCC is not arguing that the Petition must be denied at this time. Rather, it is NCC's position that in light of NS's significant understatement of future coal volumes that potentially would move over the subject line, a reasoned decision on the Petition cannot be made without additional and more accurate information.

must be undertaken *de novo*; no presumptions of authenticity or accuracy should be afforded the estimates contained in the NS Petition.

A. NS Has Significantly Underestimated Prospective Coal Traffic Volumes

The alleged unsustainability of future operations on the Oneida-Nicks Creek line is the central element of NS's case for an abandonment exemption. *See* Petition at 41. That conclusion, in turn, basically rests on two (2) factual assertions: (1) in the Forecast Year (February, 2005 - January, 2006), the line will sustain an avoidable loss – including return on investment – of \$359,652.00 and face rehabilitation costs of \$2,033,832.00;⁷ and (2) prospective traffic growth attributable to the line's principal shipper (NCC) would be insufficient to cover the losses and contribute meaningfully to the rehabilitation burden. *See, e.g.,* Petition at 10-11. The latter claim assumes that at most, NCC's near-term future coal production available for rail transportation over the subject line would be only 110% of its 2003 levels. *Id.* at 9. NCC submits that this assumption seriously understates the actual traffic volumes that could materialize.

As the Board has acknowledged,⁸ NCC is in the process of pursuing acquisition of the Nicks Creek-Devonia line segment under the Board's OFA procedures. With that line

⁷ *See* Petition, V.S. Kirchner, Exhibit 3.

⁸ *Docket No. AB-290 (Sub-259X), supra*, Order served February 22, 2005.

back in service, a large portion of NCC's current production would be directly accessible to rail service over the line that is the subject of the Petition. As noted *supra*, the pace of NCC coal production thus far in 2005 (approximately 50,000 tons per month)⁹ is more than double and could be triple that of 2004, which itself was a higher production year than the 2003 "base year" used by NS. Using a variant of the rule of thumb employed by NS (*see* Petition at 10-11), if one assumes that prospective NCC volume and related rail revenues for the forecast year are 200% of the 2003 figures, and that only one-third of the added revenue was profit, the resulting contribution (\$398,978.00¹⁰) would completely offset NS's claimed avoidable loss (including return on investment). If the higher end of the 2005 production range is used (*i.e.*, 300% of the 2004 monthly average) on the same terms, the available incremental revenue (\$797,955.00) both covers the avoidable loss and makes a 22% single-year contribution to total rehabilitation costs, accepting *arguendo* that those costs are as high as NS claims.

Going beyond the 2005-2006 time frame, the potential for traffic and revenue growth is even more dramatic. As noted *supra*, NCC has five (5) new mine permits that either are already approved or are in the late stages of the approval process. Once operational, these properties could raise NCC's production levels to as much as 100,000 tons

⁹ The production figures cited in this Reply are attested to by NCC Senior Vice-President Charles W. Kite.

¹⁰ 2003 freight revenues from NS Witness Kirchner's Exhibit 3 (\$1,209,023.00) multiplied by .33.

per month, 400-500% of the 2004 volumes. A corresponding, resulting increase in rail freight revenues could completely reverse the dour financial picture shown in NS's *pro forma* income statement for the Oneida-Nicks Creek segment.¹¹

The same is true of NS's argument that the availability of truck transportation to alternative NS load outs means no loss of essential service by NCC if the subject line is abandoned. *See* Petition at 12, 14. As NS correctly points out, in recent months NCC has been using trucks to move modest coal volumes from the Smoky Junction area to an NS load out at Turley, Tennessee, approximately 20 miles away. However, the fact that area highways and local roads can handle those shipments is irrelevant to the question whether the infrastructure and surrounding communities could tolerate the truck traffic that would be associated with NCC's growing production volumes, which already are on a pace to exceed 500,000 tons annually.

Impliedly acknowledging that truck transportation would not present an effective alternative to rail service if coal volumes substantially exceed the 2003 "base year" levels, NS argues that any suggestion of increasing future volumes is "speculative." *See* Petition at 30, n. 22. However, there is nothing speculative about the 50,000 tons that NCC averaged during the first quarter of this year, a pace that continues today. Nor can NS dispute the even greater production and sales volumes that will follow the opening of five

¹¹ Petition, V.S. Kirchner, Exhibit 3.

(5) new prospects that either have been permitted or are in their last stages of permit approval.¹²

In sum, NS's arguments for qualification under the exemption statute (49 U.S.C. § 10502) rest largely on its assessment of the potential for future traffic growth over 2003 "base year" levels. However, the fact is that the current pace of NCC coal production *already* exceeds the *de minimis* 10% increase that is the basis for NS's avoidable loss calculations, and its claims regarding the adequacy of truck transportation as an alternative to rail. Unless the Board determines to deny the Petition outright, NS should be directed to submit additional information addressing the economic viability of continued operations over the Oneida-Nicks Creek line based on more realistic projections of future coal traffic and related revenues.

B. No Presumptions Should Attach to NS's Estimates of Salvage Values and Rehabilitation Costs

If upon consideration of a full record, including the additional information described in the previous section, the Board determines that NS has met the criteria for a Section 10502 exemption, one or more parties may invoke the OFA procedures of 49 U.S.C. § 10904 in an effort to acquire and resume operation of the Oneida-Nicks Creek line

¹² In other contexts, the Board has held that truck transportation does not represent an effective, long-term alternative to rail for large annual coal volumes. *See, e.g., West Texas Utilities Co. v. Burlington Northern Railroad Co.*, 1 S.T.B. 638, 652 (1996).

segment.¹³ Once a financially responsible party (or parties) presents a bona fide offer, the governing statute places responsibility for fixing the purchase price on the Board if NS and the offeror cannot agree. *See* 49 U.S.C. § 10904(e) and (f). Board precedent generally holds that in the case of a rail line abandoned on the basis of its economic non-sustainability, the purchase price will be set at the net liquidation value of the line; *i.e.*, the net salvage value of the track and assets plus the across-the-fence value of that portion of the right-of-way that the selling carrier owns in fee. *See* Docket No. AB-384 (Sub-No. 1X), *Delta Southern Railroad, Inc. – Abandonment Exemption – Between Lake Village, AR and Shelburn, LA*, Decision served January 28, 2005.

The NS Petition includes an Exhibit which the carrier represents as showing the net salvage value of the Oneida-Nicks Creek line segment.¹⁴ *See* Petition, V.S. Kirchner, Exhibit 5. This claimed total value—\$1,936,334.00 or \$71,690.00 per mile—is considerably higher than the price at which NS was willing to sell the line to U.S. Coal in 2002. *Id.* at 6, n.4. Nevertheless, it serves as the basis for NS’s claimed “opportunity cost” of keeping the line in place (*id.* at 39), which NS invokes as further grounds to permit its abandonment.

While NS acknowledges (as it must) that the line will be exposed to the OFA procedures and/or requests for public use conditions if the abandonment exemption is

¹³ As noted *supra*, the OFA process already has begun in connection with the out-of-service line segment between Nicks Creek and Devonia.

¹⁴ The Exhibit breaks the segment into two components: the track between Oneida and Smoky Junction, and the short connecting track between Smoky Junction and Nicks Creek.

granted,¹⁵ it does so begrudgingly,¹⁶ and makes clear its desire to remove the track materials and re-use them elsewhere on the NS system as soon as practicable. *See* Petition at 33-34.

NCC submits that NS's apparent desire to avoid having a sale or other disposition of the line on any terms other than its own, provides ample cause for concern that its claimed asset values may be inflated. Likewise, and particularly given its representations elsewhere regarding the "steep grades" and "significant curves" that supposedly limit train sizes on the line,¹⁷ the roughly \$478,000.00 that NS allocates for removal of the track materials¹⁸ appears to be significantly understated for a 27-mile salvage project conducted over difficult, mountainous terrain.

Whatever the outcome of the Board's deliberations concerning the merits of the Petition itself, the Board should clarify that no presumption of validity or accuracy will attach to NS's estimates of net salvage value and rehabilitation costs for purposes of subsequent proceedings respecting the line, including specifically proceedings under 49 U.S.C. § 10904. Should an OFA be submitted and a Board valuation under Section 10904(e) and (f) eventually become necessary, NCC or any other qualified offeror is entitled

¹⁵ Petition at 32-33.

¹⁶ *Inter alia*, NS makes a rather unusual, pre-emptive request that the Board deny any motions to stay or otherwise postpone the effective date of an exemption, even though no such pleadings have been filed yet.

¹⁷ Petition at 8.

¹⁸ Petition at 102-03.

to a *de novo* review of all relevant valuation evidence, with no pre-conceptions based upon claims made in the instant Petition.

CONCLUSION

For the reasons set forth herein, the Board should direct NS to submit additional information concerning the economic sustainability of the Oneida-Nicks Creek line, based upon future coal traffic projections that are consistent with NCC's current and expected production volumes. Further, in any ruling on the NS Petition, the Board should clarify that the net salvage value and rehabilitation cost estimates included therein shall have no presumptive effect for purposes of any further proceedings.

Respectfully submitted,

NATIONAL COAL CORPORATION

By: Charles W. Kite
Senior Vice President and Corporate Counsel
National Coal Corporation
8815 George Williams Road
Knoxville, Tennessee 37923

Of Counsel:

Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, D.C. 20036

Kelvin J. Dowd
Andrew B. Kolesar, III
Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, D.C. 20036

Dated: April 7, 2005

Attorneys & Practitioners

VERIFICATION

STATE OF TENNESSEE)
)
) ss:
COUNTY OF Fox)

CHARLES W. KITE, being duly sworn, deposes and says that he is Senior Vice-President of National Coal Corporation, that he has read the foregoing Reply, and that the facts asserted therein are true to the best of his knowledge, information and belief.

Dated this 5th day of April, 2005.


Charles W. Kite

SWORN AND SUBSCRIBED
BEFORE ME THIS 5th DAY OF April, 2005

Ramela G. Atchley - Steele
Notary Public

My Commission Expires: June 25, 2005

CERTIFICATE OF SERVICE

I hereby certify that on this 7th day of April, 2005, I caused copies of the foregoing Reply of National Coal Corporation to be served upon all parties of record in this proceeding by first class United States mail, postage prepaid.

A handwritten signature in black ink, appearing to read 'Kelvin J. Dowd', is written over a horizontal line.

Kelvin J. Dowd