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PUBLIC VERSION

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

NORFOLK SOUTHERN RAILWAY
COMPANY – CONTROL AND
CONSOLIDATION EXEMPTION –
ALGERS, WINSLOW AND WESTERN
RAILWAY COMPANY

Finance Docket No. 34839

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**REPLY OF PSI ENERGY, INC. TO
APRIL 11, 2006 FILING BY NORFOLK SOUTHERN CORPORATION
AND NORFOLK SOUTHERN RAILWAY COMPANY IN SUPPORT OF
THEIR PETITION FOR EXEMPTION**

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Dated: May 1, 2006

Their Attorneys

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Pursuant to the Board's decision in this docket served April 24, 2006, PSI Energy, Inc. d/b/a Duke Energy Indiana, Inc.¹ ("PSI") replies herein to the April 11, 2006 filing by Norfolk Southern Corporation ("NSC") and Norfolk Southern Railway Company ("NSR") (collectively "NS") in support of their Petition for Exemption to acquire control of the Algiers, Winslow and Western Railway Company ("AWW") and to consolidate the AWW into NSR following the acquisition.

I. Background

NSR presently owns 50% of the stock of the AWW, a 19-mile short line railroad in southern Indiana. The other 50% is owned by American Metals and Coal International, Inc. ("AMCI"), an entity that, until very recently, also owned two coal

¹ PSI's corporate parent, Cinergy Corp., merged with Duke Energy Corporation ("Duke Energy" effective April 3, 2006).

mines served by the AWW. AMCI has agreed to sell its 50% ownership interest in the AWW to NSR, subject to the approval of the Board.

On February 14, 2006, NSR filed a Petition for Exemption from 49 U.S.C. § 11323 *et seq.* to acquire control of the AWW and to consolidate the AWW into NSR (“Petition”). Subsequently, four parties – PSI, the Indiana Southern Railroad, Inc. (“ISRR”), Indianapolis Power and Light Company (“IPL”) and Solar Sources Underground, LLC (“Solar”) – filed replies to the Petition, which was later amended to include NSC. All four parties opposed the Petition unless the Board imposes a condition preserving existing intramodal rail competition by requiring NSR to grant trackage rights to ISRR to enable it to serve the two coal mines presently served by the AWW from a connection between the two carriers at Oakland City Jct., IN. The two mines (known as Pike #1 and Pike #2), which have been closed for several years, have recently been sold to independent coal producers who intend to re-open them. Pike #2 was acquired by Solar in early April of 2006. The facilities at this mine include a loop track and a transloading facility to which coal can be trucked from other nearby small mines, blended, and transferred into railcars for shipment by unit train to electric power plants, including three power plants in Indiana operated by PSI.

As indicated in the initial replies to NSR’s Petition, the proposed control transaction raises substantial and unique competitive issues. In particular, the AWW has been an independent carrier for many years, and the 50% ownership interest in the AWW by the same entity that owned the two AWW-served mines has insured that the AWW

provided rates and service that enabled the movement of coal from these mines to a variety of destinations in Indiana (and elsewhere), regardless of the rail carrier serving the destination. NS's control of AWW and consolidation of its operations into NSR would remove AWW's independence and give NSR complete control over the scheduling and pricing of coal moving from these mines. In all probability, this will result in NSR favoring long-haul, single-line movements to out-of-state destinations that it serves. The transaction, if unconditioned, will have a detrimental effect on the Indiana utility coal market and on the ability of utilities such as PSI to source needed coal from the two AWW-served mines as well as coal from other nearby mines that truck coal to the AWW-served loadout at the Pike #2 mine.

NS addressed the competitive issues raised by other parties for the first time in its April 11, 2006 filing ("April 11 Reply"). As shown below, NS's April 11 Reply mis-characterizes the Indiana utility coal market, and mis-applies Board precedent on the anti-competitive effects of the merger of an originating carrier with a terminating carrier. Proper consideration of these issues warrants denial of NS's Petition absent the imposition of the trackage rights condition requested by the ISRR.

II. This is a Unique End-to-End Consolidation that Presents Significant Competitive Concerns

NS asserts at page 7 of its April 11 Reply that the proposed AWW control transaction "is a garden variety end-to-end consolidation of a small short-line railroad with one of its connecting rail carriers" and that the Board and its predecessor have held that end-to-end rail consolidations "generally present no significant competitive

concerns.” The transaction at issue here is far from a “garden variety” end-to-end rail consolidation, and in fact presents unique competitive issues that the Board has not addressed in other cases. This transaction is unique because the owner of the mines served by the AWW has also owned a 50% interest in the railroad. This has provided it with unique leverage in terms of ensuring that the rates offered by the AWW for movements to the Oakland City Jct. interchange are competitive, thus assuring that as many markets as possible remain economically open to coal produced by these mines. Unlike NSR (if the control transaction is consummated), an independent AWW, 50-percent owned by the owner of the two mines it serves, had no incentive to favor one class of destinations (those served by NSR) over other classes (those served by other railroads including ISRR). The same would be true of any other owner that is independent of another railroad.

NS’s principal legal argument in support of the AWW control transaction is that the Board has “consistently rejected the contention . . . that the consolidation of one railroad having exclusive access to shippers at one end of a rail route with a connecting railroad will harm competition or shippers” (April 11 Reply at 8) and has also held that “merging end-to-end railroads will generally not be inclined to foreclose other connecting carriers from interline movements with the merged railroad or necessarily to favor their own longer single-line routes” (*id.* at 9). NS cites ICC and Board decisions in several Class I rail merger cases, dating mostly from the 1980’s and 1990’s, in support of these propositions.

Most of the cases cited by NS involved the so-called “one lump” theory espoused in rail merger cases such as *Burlington Northern et al. – Merger – Santa Fe Pacific et al.*, 10 I.C.C.2d 661 (1995). However, that theory has been applied only in the context of mergers between independent, long-haul Class I rail carriers, where one of two carriers that served an origin merged with a third carrier that alone served a destination. The one lump theory has no application to (and has never been applied in) a situation such as this one, where a Class I carrier proposes to acquire a 100% ownership interest in a short line Class III carrier that serves two coal mines and is 50% owned by the independent former owner of the mines. The coal producer’s 50% ownership interest in the AWW has ensured that the AWW is truly neutral and willing to participate in competitive joint rates to short-haul destinations regardless of the other carrier(s) involved.² If the coal producer’s interest is acquired by NSR, this neutrality will be lost because NSR will have both the ability and the incentive to favor long-haul, single-line movements. This situation is very different from other end-to-end railroad consolidations that the Board and its predecessor have approved without finding a need for competition-preserving conditions.

² NS witness Doug Evans states that as a result of its stock ownership, NSR has had a “substantial involvement in the management and operations of AWW” and that “[f]or some movements . . . NSR personnel, at AWW’s request, have acted as the marketing agent for both railroads.” Doug Evans V.S. at 1-2. However, PSI’s understanding is that AWW has had a substantial say with respect to the rates offered for interline coal movements.

Moreover, the cases cited by NS are relatively old cases that were decided before rail service began to become a major problem in the aftermath of mergers, and before the Board decided that competition should be encouraged, rather than merely preserved, in rail consolidation cases. *See* Ex Parte No. 582 (Sub-No. 1), *Major Rail Consolidation Procedures*, STB served July 11, 2001, at 9-13. There is now a significant question whether the Board would continue to apply the one lump theory even in the context of a merger by two Class I railroads given these service issues and the pro-competition aspects of the Board's new rail merger policy. *See* 49 C.F.R. § 1180.1 (c)(2)(i) and (iv). Important policy considerations are implicated here, and the Board should not blindly apply old precedent that arose in Class I rail merger cases to the unique facts presented by this case.

NS also asserts that it will not foreclose other connecting carriers from interline movements with the former AWW, or necessarily favor its own longer single-line routes. In this regard, NS points out that it presently participates in interline routes for the movement of Indiana coal, including coal moving to PSI's Gibson Generating Station, and will continue to do so if coal markets for AWW-sourced coal are served by another railroad. April 11 Reply at 9, 11.

As PSI shows below, NS's statements concerning its participation in the interline movement of coal to Gibson Station are facile and incomplete. PSI acknowledges NS's representation that it will not "close" the Oakland City Jct. gateway after it acquires control of AWW, but the fact that a gateway remains open for legal

purposes does not mean that it will remain open economically. The parties to this proceeding have already demonstrated, in their original Replies to the Petition, that NSR will have every incentive to favor its longer single-line hauls by offering rates for movements to the Oakland City Jct. interchange at a level that discourages AWW-originated coal from moving to markets reached via that gateway. NS's continued touting of the benefits of single-line service confirms PSI's concerns in this regard.

Regulation, in the form of denial of NS's petition absent the trackage rights condition requested by ISRR, is necessary to protect shippers from an abuse of market power by NSR, because if NSR acquires the coal producer's ownership interest in the AWW, the AWW's neutrality in arranging for interline transportation of coal from Pike #1 and Pike #2 will be lost, and because of NS's incentive to favor longer single-line hauls.

III. NS's Factual Assertions Concerning the Indiana Utility Coal Market are Inaccurate and do not Support a Conclusion that the Transaction will not Harm Competition or Shippers

NS makes various statements in its April 11 Reply concerning the Indiana utility coal market that are inaccurate, incomplete or misleading, particularly as regards the sourcing and transportation of coal to PSI's three rail-served electric generating stations in Indiana. These statements relate to:

1. The alleged availability of numerous mines from which PSI and other Indiana utilities can source their coal requirements;
2. The alleged availability of numerous coal transportation options, including other truck/rail transloading facilities and even truck transportation itself;

3. NS's participation in interline movements of coal to PSI's Gibson Station; and
4. The alleged benefits of single-line service for coal movements to PSI and Duke Energy.

PSI's three rail-served, coal-fired generating stations in Indiana are described in the Verified Statement of PSI's Vice President of Regulated Fuels, Vincent E. Stroud, which was included in PSI's original Reply to NS's Petition filed on March 16, 2006.³ These generating stations include the Cayuga Station ("Cayuga") which is served by CSX Transportation, Inc. ("CSXT"), the Wabash River Station ("Wabash River") which is now served by the Indiana Rail Road Company ("INRD") as a result of its recent acquisition of CP Rail/Soo Line's facilities and operating rights south of Chicago, and the Gibson Station ("Gibson") which is served by NSR. All three of these stations receive the vast bulk of the coal used as generation fuel by rail, and all of this coal is produced in the Illinois Basin region which includes mines in southern Indiana and, to a lesser extent, southern Illinois. PSI addresses NS's mis-characterizations of the coal production and transportation situation at these power plants below.

A. Alleged Availability of Numerous Mines from which PSI and Other Indiana Utilities Can Source their Coal Requirements

NS's general thesis is that PSI (and other Indiana electric utilities) do not need to purchase coal from the two AWW served mines or use the truck/rail transload facilities at Pike #2 because there are numerous other coal mines in Indiana, including "approximately 60 other coal mines within 100 miles of Pike #1 and Pike #2 [many of

³ Mr. Stroud's statement included a map showing the location of various mines in relation to railroad lines and power plants in southern Indiana. A copy of this map is appended hereto as Exhibit 1 for the Board's convenience.

which] are much closer to the plants than are Pike #1 and Pike #2” and “provide numerous competitive sources of coal for Respondents’ Indiana power stations.” April 11 Reply at 12. These statements reveal a fundamental misunderstanding of the Indiana utility coal market.

There are many coal mines in southern Indiana, but far less than 60 active mines are suitable as sources for the coal consumed at PSI’s generating stations. The active mines have coals of different quality, and coal quality has a large impact on whether the coal can be used in a particular power plant – regardless of the location of any particular mine. In fact, { } active Indiana mines are capable of supplying coal suitable for PSI’s needs.

The coal that has been burned at PSI’s three rail-served generating stations for many years is primarily mid-sulfur coal, ranging from three to four pounds of sulfur dioxide (“SO₂”) per million BTUs (“MMBTU”). Many of the mines that produce such coal { }, and some reserves are being depleted. Thus PSI must constantly look for new coal sources, including new mines.

The Pike #1 and Pike #2 mines have not heretofore been sources of coal for PSI’s power plants because they produce high-sulfur coal, generally containing six to eight pounds of SO₂ per MMBTU, and several of PSI’s plants lack flue gas desulfurization facilities (commonly referred to as scrubbers) which are necessary to enable them to burn high-sulfur coal while still meeting applicable emission requirements. However, in response to increasingly strict governmental air quality and power plant emission standards, as well as the depletion of reserves of low-sulfur Central Appalachian

coal, more eastern and midwestern power plants are installing scrubbers. This enables them to burn high-sulfur coal, and makes coal from Pike #1 and Pike #2 attractive as a future source of generation fuel. Gibson presently has scrubbers at two of its five units, and scrubbers will be installed on the remaining units by 2008. PSI is installing scrubbers at Cayuga, with completion scheduled for 2009 in the case of one of the two Cayuga units and 2010 in the case of the second unit. The coal produced by the new owners of Pike #1 and Pike #2 will be an important new coal source for Cayuga, in particular, and also for Gibson.

Another important consideration for PSI is diversity of coal suppliers. PSI's coal-fired power plants (including its Gallagher Station located on the Ohio River in southeastern Indiana, which receives coal by barge) collectively consume about 16 million tons of coal per year. { } of this coal, or { } percent, presently come from mines operated by a single producer – Peabody Energy. Peabody thus has a very large share of the Indiana coal market. Diversity of suppliers is necessary to ensure price competition for the coal itself, and { }.

In addition to economics, diversity of suppliers is very important for reliability reasons. As Mr. Stroud points out in his Verified Statement attached to PSI's March 16, 2006 Reply to NS's Petition, a constant supply of coal is needed by PSI's baseload power plants to keep them running and avoid disruptions in their ability to produce a continuous supply of electricity to PSI's customers. The availability of

multiple producers increases the likelihood that if any one producer (or area) has a disruption in production or transportation service, others can make up the difference.

Viable sources of coal for PSI's power plants are limited enough {

} . Denial of NS's Petition, if unconditioned, is necessary to protect PSI from abuses of market power that will inhibit needed interline transportation of coal from these mines to PSI power plants.

B. Alleged Availability of Numerous Coal Transportation Options, Including other Truck/Rail Transloading Facilities and Even Truck Transportation Itself

In further support of its thesis that PSI and other Indiana utilities do not need competitively-priced coal from the Pike #1 and Pike #2 mines and the truck/rail transloading facility at Pike #2, NS asserts that these utilities have numerous other transportation options including, in particular, two other transloading facilities served by the ISRR that are closer to PSI's power plants than the Pike #2 transloading facility. April 11 Reply at 12-13 and 21. What NS fails to mention is that neither of these other transloading facilities can be used for unit-train movements of coal to PSI's power plants (these plants receive coal by rail exclusively in unit trains).

NS touts the transload facility served by ISRR at Petersburg, IN, in particular, as an allegedly viable alternative for PSI. However, this facility cannot practicably be used to transload coal from trucks to unit trains. The ISRR yard at Petersburg, where the transload facility is located, consists of several ladder tracks. PSI's understanding is that the coal loading area is limited to one track located adjacent to a

small coal pile, the transloading operation uses front-end loaders to load coal into railcars, and the total coal loading capacity is limited to 30 cars a day. PSI understands that the Petersburg facility is used primarily to transload relatively small quantities of coal (up to 10 cars at a time) for industrial customers. It certainly cannot be used to transload coal into 100-car unit trains for utility customers.

The other transloading facility mentioned briefly by NS is located at Maysville, IN. This facility is located on ISRR's single-track mainline and can load up to 50 cars at a time. It takes seven hours to accomplish this, during which period the ISRR mainline is blocked. PSI has used this transloading facility on a few occasions to ship coal to Gibson, but the operation is very inefficient. After the first 50 cars of a unit train were loaded, ISRR had to move them to Oakland City Jct. and leave them on AWW trackage. The next day 50 additional cars were loaded and taken to Oakland City Jct., where the complete 100-car train was put together for movement to Gibson. The reverse process was used for the empty trains. Not only is this an inefficient operation, but the Maysville facility is presently operating at capacity and could not handle additional coal for PSI in any event.

In contrast, the transloading facility at Pike #2 is located on a loop track than can accommodate up to 105-car unit trains. The loading facility consists of a tipple and loading chute, which enables an entire 100-car train to be loaded efficiently in four hours. The transloading facilities at Petersburg and Maysville are not feasible alternatives to the Pike #2 transloading facility for coal trucked from nearby smaller mines.

}

In short, the truck alternative does not protect PSI from the abuse of market power represented by NS's ability and incentive to economically foreclose interline movements of coal from Pike #1 and Pike #2 if it is permitted to acquire the AWW unconditionally.

C. Interline Movements of coal to Gibson Station

In an attempt to convince the Board that NSR will not act anti-competitively with respect to interline movements from AWW-served mines via the interchange with ISRR (and apparently CSXT for some movements) at Oakland City Jct., NS cites the fact that NSR "participates in several relatively short-haul segments of joint line movements where NSR is the only railroad serving either the origin or the destination, {

}” April 11 Reply at 20. In a similar vein, NS states that {

} *Id.* at 11-12. These statements are misleading, and actually incorrect concerning { }

First, PSI notes that at page 21 of its April 11 Reply, NS reveals for the first time that CSXT has trackage rights over NSR's line between Oakland City and Princeton, IN "for movements of coal from AWW origins to the Southern Indiana Gas & Electric Company's plant at Abee, IN." *See also* Doug Evans V.S. at 2. However, there is no

indication that CSXT can also use these trackage rights for movements of coal from AWW origins to PSI's Cayuga plant, which CSXT serves, or to Gibson.

Gibson receives approximately 10 million tons of coal per year. {

}

NS's statement that NSR presently {

} is incorrect – and in fact, is not supported

by Doug Evans' Verified Statement which states only that {

} which NS has not disputed.

Finally, NS points to the fact that AWW itself has participated in “substantial” interline movements of coal and other products for many years, notwithstanding NS’s 50% ownership interest which “gave NSR a substantial voice and interest in the affairs of AWW” (April 11 Reply at 11). Aside from the fact that the last quoted statement is somewhat inconsistent with NS’s statements elsewhere that AWW has been an “independent” carrier, it is hardly surprising that AWW has participated in interline shipments because it is a 19-mile short line that could only provide rail service by interlining traffic with its connections (ISRR, NS and to a lesser extent CSXT). Moreover, the 50% ownership interest of the entity that also owned the two AWW-served mines assured AWW’s independence, and its willingness to quote rates at economically viable levels regardless of the destination carrier. This neutrality will be lost if NS acquires AWW and consolidates its operations into those of NSR.

D. NS Greatly Overstates the Benefits of Single-Line Service for Coal Movements to PSI and Duke Energy Plants

NS repeatedly touts the benefits of single-line service in its Petition and its April 11 Reply. With respect to PSI, NS asserts that the AWW control transaction “will provide significant benefits to other Cinergy/PSI plants served by NSR at destination by enabling NSR to provide direct single-line service to those plants from AWW origins that could only now be provided by joint AWW-NSR service.” *Id.* at 13, 22. These plants include Gibson and three Duke Energy power plants in North Carolina. NS further asserts that “Cinergy/PSI does not dispute these benefits” (*id.*).

In fact, PSI does not believe that having single-line NSR service available for the movement of coal from the AWW-served mines to Gibson or NS-served Duke

Energy power plants will be of any benefit to it. PSI did not comment on the availability of NS single-line service to Gibson in its March 16, 2006 Reply to NS's Petition because its present rail transportation contract with NS for coal movements to Gibson already contains single-line NS rates from the AWW origins to Gibson. PSI assumed – erroneously, it now appears – that this meant NS could directly serve the AWW mines for movements to Gibson. NS now states that this is not the case, and that AWW actually performs the transportation service between Oakland City Jct. and the mines it serves. April 11 Reply at 13 n.11. However, it remains unclear exactly how AWW would move Gibson coal trains if it were to remain independent, *i.e.* with its own locomotives or using NS locomotives, *etc.* AWW's General manager, Donald Evans, does not address this issue in his verified statement submitted with NS's April 11 Reply. NSR's Doug Evans states only that "all train operations over AWW lines have been performed by AWW employees and usually with AWW equipment." Doug Evans V.S. at 1. Gibson has not previously received coal from the Pike #1 and/or Pike #2 mines, but it is unlikely that AWW has sufficient road locomotives of its own to move the heavy coal trains used by PSI between the mines and Oakland City Jct.

Interline coal trains are usually moved in "run-through" service, which means that the train (including locomotives) stays intact from initial origin to final destination, with only a change of crews at the interchange point. PSI has received interline trains at its Indiana power plants for many years that operate in such run-through service, and it has noted virtually no difference in service between single-line operations and interline operations. PSI is confident that if AWW remained independent of NS and

were in the future to originate coal destined to Gibson or one of the NSR-served Duke Energy power plants, these carriers would have every incentive to work out run-through arrangements that make the interline service indistinguishable from single-line service for all practical purposes.

In short, the additional single-line service espoused by NS will be of no practical benefit to PSI, and certainly does not outweigh the potential loss of viable interline service if NS acquires unconditional control of AWW.

* * * *

In determining whether to grant a petition for exemption involving a consolidation transaction such as this, the Board looks at whether the transaction is likely promote the National Transportation Policy (including the policy of “ensuring effective competition among rail carriers” set forth in 49 U.S.C. § 10101(4)) and whether the transaction is limited in scope. *See* 49 U.S.C. § 10502(a). As NS itself has noted, the essential question is whether the proposed transaction is likely to result in harm to competition or to shippers.

PSI has demonstrated above that NS’s attempt to minimize the anti-competitive nature of its acquisition of control of the AWW is unavailing. The transaction clearly will harm PSI by economically foreclosing its ability to obtain needed coal for its power plants from important new sources, absent a condition granting trackage rights to ISRR to preserve the benefits of previously-existing interline service from the two AWW-served mines. NS’s contentions that PSI has ample other alternatives {

} are plainly wrong – as is its contention that PSI will benefit from additional single-line rail service. The AWW may be a small carrier, but this does not mean the control transaction is limited in scope given the importance of economical interline rail service from the coal mines and transloading facilities it serves.

IV. Conclusion

For the foregoing reasons, PSI requests that the Board deny NS's Petition for Exemption to acquire control of the AWW and to consolidate AWW into NSR following the acquisition, unless the Board imposes the trackage rights condition requested by ISRR permitting ISRR to operate over AWW between Oakland City Jct., IN and the Pike #1 and Pike #2 mines for purposes of enabling it to originate coal at those mines and transport it to destinations reached via ISRR (and other carriers') lines beyond Oakland City Jct.

Respectfully submitted,

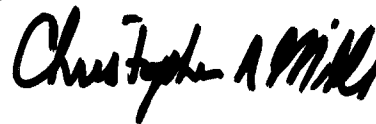
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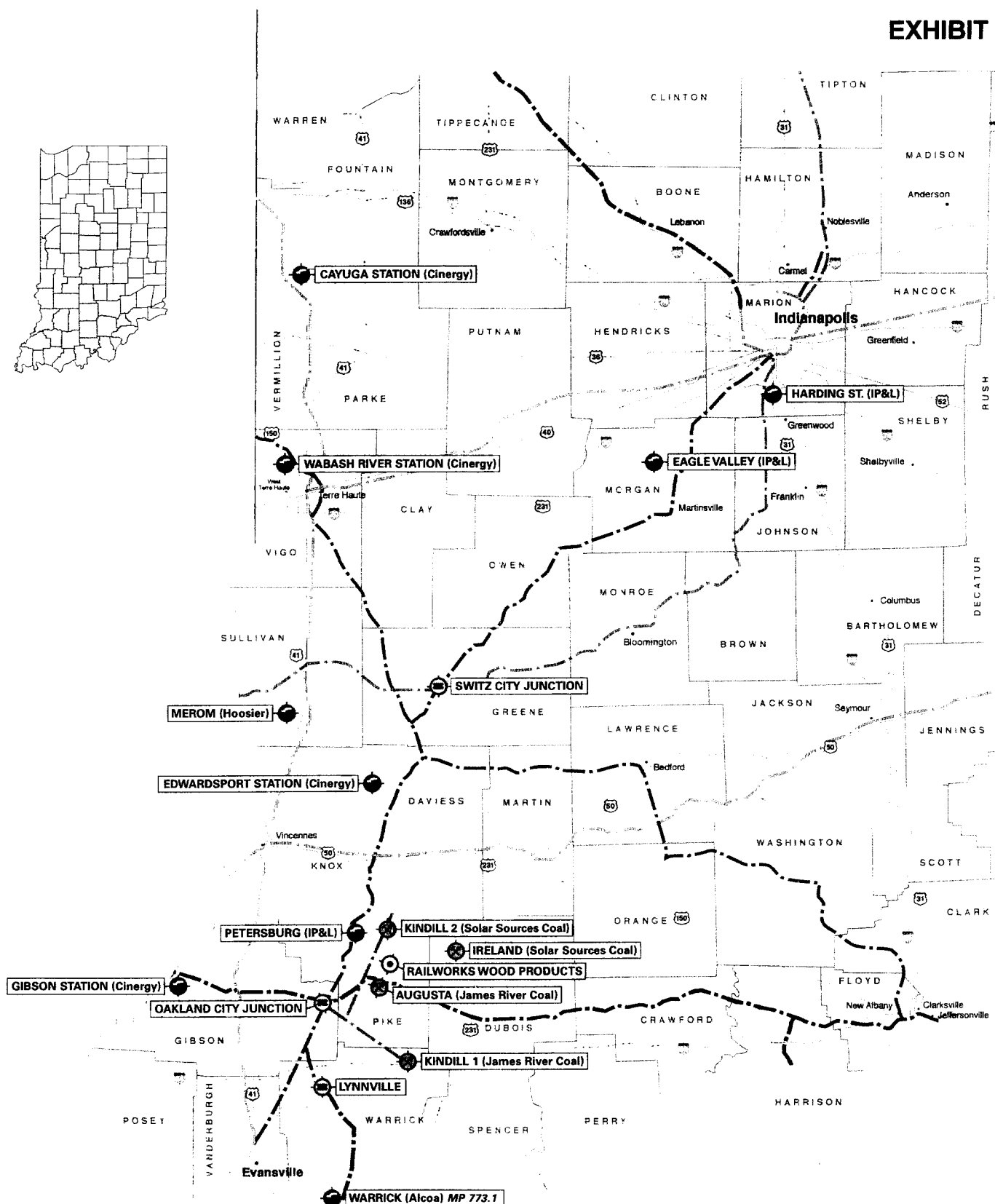
VERIFICATION

I, Vincent M. Stroud, certify under penalty of perjury under the laws of the United States that I am Vice President of Regulated Fuels for PSI Energy, Inc. d/b/a Duke Energy Indiana, Inc. ("PSI"); that I have read the foregoing Reply to NS's April 11, 2006 submission to the STB and know the facts asserted therein with respect to the Indiana utility coal market and PSI's coal supply and transportation options and practices; and that the same are true and correct. Further, I certify that I am qualified and authorized to file this statement.

Executed on: April 28, 2006.

A handwritten signature in black ink, appearing to read "V E Stroud", with a stylized flourish at the end.

Vincent E. Stroud



- | | | | |
|---|---------------------|---|---------------------|
|  | Generating Stations |  | CSX RR |
|  | Coal Mines |  | Norfolk Southern RR |
| | |  | Indiana RR |
| | |  | Indiana Southern RR |
| | |  | Canadian Pacific RR |
| | |  | AWW RR |

CERTIFICATE OF SERVICE

I hereby certify that I have this 1st day of May, 2006, caused copies of the foregoing Reply of PSI Energy, Inc. to be served by hand or United States Mail upon counsel for all parties of record in Finance Docket No. 34839, as follows:

By Hand:

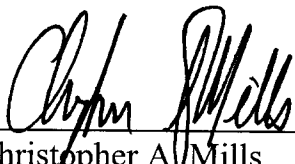
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