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May 7, 2007

By e-filing

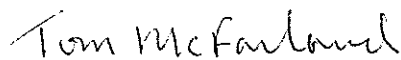
Vernon A. Williams, Secretary
Surface Transportation Board
395 E Street, S.W., Suite 1149
Washington, DC 20024

Re: Docket No. AB-534 (Sub-No. 3X), *Lake State Railway Company -- Abandonment
Exemption -- Rail Line in Otsego County, MI*

Dear Mr. Williams:

Enclosed please find an original and 10 copies of Reply In Opposition To Petition For
Exemption, for filing with the Board in the above referenced matter.

Very truly yours,



Thomas F. McFarland
Attorney for Protestant

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BEFORE THE
SURFACE TRANSPORTATION BOARD

LAKE STATE RAILWAY COMPANY --)
ABANDONMENT EXEMPTION -- RAIL) DOCKET NO. AB-534
LINE IN OTSEGO COUNTY, MI) (SUB-NO. 3X)

**REPLY IN OPPOSITION TO
PETITION FOR EXEMPTION**

NORTHERN ENERGY, INC.
P.O. Box 1237
Gaylord, MI 49734

Protestant

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DATE FILED: May 7, 2007

BEFORE THE
SURFACE TRANSPORTATION BOARD

LAKE STATE RAILWAY COMPANY --	)	
ABANDONMENT EXEMPTION -- RAIL	)	DOCKET NO. AB-534
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**REPLY IN OPPOSITION TO
PETITION FOR EXEMPTION**

Pursuant to the Board's Notice in this proceeding, served April 17, 2007, NORTHERN ENERGY, INC. (NEI) hereby replies in opposition to a Verified Petition for Exemption (Petition) filed by Lake State Railway Company (Lake State) on March 28, 2007.

I. IDENTITY AND INTEREST OF PROTESTANT

NEI is a distributor of commercial and industrial lubricants. Its place of business is located at Gaylord, MI on the rail line proposed to be abandoned. NEI employs 35 persons. NEI receives lubricants by rail, primarily from Louisville, KY, and distributes them throughout the State of Michigan. Over 90 percent of its lubricants are received by rail. NEI receives lubricants by truck only when rail service is impeded or delayed.

Lake States' own evidence shows NEI's consistently increasing use of the involved rail line: 24 carloads in 2004, 37 carloads in 2005 (an increase of 54 percent), and 41 carloads in 2006 (an additional increase of 11 percent). In 2006, NEI constructed a 6,000-square-foot warehouse after having been assured by Lake State that rail service to Gaylord would continue for the foreseeable future. Except for the potential loss of rail service through this abandonment, that warehouse would enable NEI to significantly increase its business, with a corresponding

increase in receipt of lubricants by rail. NEI is on a pace to receive 50 carloads in 2007, an additional increase of 22 percent over its increased 2006 rail traffic volume. Thus, NEI has virtually doubled its rail traffic in only four years. But for the potential abandonment, NEI would continue to increase its rail usage each year.

Because NEI is so rail-dependent, loss of rail service would have a serious adverse effect on its financial viability. The lubricants received by NEI are not susceptible to transloading from railcars to trucks. Consequently, NEI would be required to receive its lubricants by truck. That would result in additional freight charges of 36 cents to 40 cents per gallon. Based on NEI's 2006 receipt of approximately 1.2 million gallons, and using an average increased cost of 38 cents per gallon, the resulting increased freight charges would be \$456,000 per year. It would not be possible for NEI to pass increased costs of that magnitude on to its customers. The requirement that NEI absorb the substantial portion of those increased costs that could not be passed on to customers would result in serious financial harm for NEI. The foregoing facts compel a finding that truck transportation would not be an economically feasible alternative to NEI's receipt of lubricants directly by rail. *See Georgia Public Serv. Comm'n. v. United States*, 704 F.2d 538, 545 (11th Cir. 1983). That factor strongly militates against approval of abandonment. *Busboom Grain Co., Inc. v. ICC*, 856 F.2d 790, 795-796 (7th Cir. 1988).

In sum, NEI is a loyal and substantial rail shipper who would be harmed very seriously if the rail line under consideration were to be abandoned.

II. STANDARDS GOVERNING DISPOSITION OF PETITIONS FOR EXEMPTION OF ABANDONMENT

Prerequisite to the grant of an exemption from any statutory requirement under 49 U.S.C.

§ 10502(a) are two Board findings:

- (1) the application in whole or in part of the statutory requirement is not necessary to carry out the transportation policy of 49 U.S.C. § 10101;
and
- (2) either
 - (a) the transaction or service to be exempted is of limited scope,
or
 - (b) the application in whole or in part of the statutory requirement is not needed to protect shippers from the abuse of market power.

The rail transportation policy most directly implicated by a proposed rail abandonment is 49 U.S.C. § 10101(4), i.e., “to ensure the development and continuation of a sound rail transportation system with effective competition among rail carriers and with other modes, to meet the needs of the public and the national defense.”

In a long line of decisions, the Board (and its predecessor, the ICC) has denied petitions for exemption of abandonment where shippers opposed abandonment, and it was not shown that rail line revenues were minimal compared to the cost of operating the line (i.e., where the record did not support a finding that the filing of a formal abandonment application under 49 U.S.C. § 10903 is not necessary to carry out the rail policy of 49 U.S.C. § 10101(4)):

- (1) *CSX Transp., Inc. -- Aband. Exempt. -- (betw. Memphis and Cordova) in Shelby County, TN*, 2001 STB LEXIS 943 at *7, STB Docket No. AB-55 (Sub-No. 590X), decision served Dec. 12, 2001;
- (2) *The Burlington N. & S.F. Ry. Co. -- Aband. of Chicago Area Trackage in Cook County, IL*, 1999 STB LEXIS 553 at *11-12, STB Docket No. AB-6 (Sub-No. 382X), decision served Sept. 21, 1999;

- (3) *Gauley River Railroad, LLC -- Aband. & Discon. of Serv. -- in Webster and Nicholas Counties, WV*, 1999 STB LEXIS 345 at *14, STB Docket No. AB-559 (Sub-No. 1X), decision served June 16, 1999;
- (4) *Buffalo & Pittsburgh RR, Inc. -- Aband. Exempt. -- in Erie and Cattaraugus Counties, NY*, 1998 STB LEXIS 247 at *13-18, STB Docket No. AB-369 (Sub-No. 3X), decision served Sept. 18, 1998;
- (5) *Central RR Co. of Ind. -- Aband. Exempt. -- in Dearborn, Decatur, Franklin, Ripley and Shelby Counties, IN*, 1998 STB LEXIS 121 at *26-27, STB Docket No. AB-459 (Sub-No. 2X), decision served May 4, 1998;
- (6) *San Joaquin Valley R. Co. -- Aband. Exempt. -- in Kings and Fresno Counties, CA*, 1997 STB LEXIS 114 at *8-9, STB Docket No. AB-398 (Sub-No. 4X), decision served May 23, 1997, *pet. to reopen den.*, 1999 STB LEXIS 76, decision served March 5, 1999;
- (7) *Tulare Valley R. Co. -- Aband. & Discon. Exempt. -- in Tulare and Kern Counties, CA*, 1997 STB LEXIS 37 at *18-19, STB Docket No. AB-397 (Sub-No. 5X), decision served Feb. 21, 1997, *pet. for recons. den.*, 1998 STB LEXIS 76, decision served March 6, 1998;
- (8) *Boston & Maine Corp. -- Aband. Exempt. -- in Hartford and New Haven Counties, CT*, 1996 STB LEXIS 361 at *12-13, STB Docket No. AB-32 (Sub-No. 75X), decision served Dec. 31, 1996;
- (9) *CSX Transp., Inc. -- Aband. Exempt. -- in Grant, Delaware, Henry, Randolph and Wayne Counties, IN*, 1989 ICC LEXIS 297 at *12-16, Docket No. AB-55 (Sub-No. 282X), decision served Oct. 16, 1989.^{1/}

The rationale for that well-established principle is quoted below from *Central R.R. Co. of Ind. -- Aband. Exempt. -- in Dearborn, Decatur, Franklin, Ripley and Shelby Counties, IN*, 1998

^{1/} Petitions for exemption of abandonment are granted where shippers do not contest the abandonment (*see Tulare Valley R. Co. -- Aband. & Discon. Exempt. -- in Tulare and Kern Counties, CA, supra*, 1997 STB LEXIS 37 at *18), and where opponents do not effectively challenge or refute the rail carrier's evidence that continued operation of the rail line would be unduly burdensome (*see Paducah & L. Ry., Inc. -- Aband. Exempt. -- in McCracken County, KY*, 2003 STB LEXIS 344 at *5-6, STB Docket No. AB-468 (Sub-No. 5X), decision served June 20, 2003, and *Minnesota Northern RR, Inc. -- Aband. Exempt. -- betw. Redland Jct. and Fertile, in Polk County, MN*, 1997 STB LEXIS 294 at *25-26, n.17, STB Docket No. AB-497 (Sub-No. 2X), decision served Nov. 14, 1997).

STB LEXIS 121 at *9-10, but it appears in essentially the same form in almost all of the cited decisions:

The petition for exemption procedure for abandonment is primarily intended to be used to expedite decisions and minimize regulatory burdens in uncontested or noncontroversial proceedings. It should not be used in proceedings like the one before us where detailed analysis of revenues and costs is necessary. Detailed revenue and cost analysis is generally reserved for the application process, which provides for a recordbuilding process and for Board analysis by requiring workpapers and other information needed to make an informed decision. This is not a case in which it is clear that revenue from local and overhead traffic is minimal compared to the cost of operating the line. Rather, a detailed analysis of revenue and cost evidence, and the resolution of various issues enumerated above is required to determine the profit/loss of the line
...

It is provided in 49 C.F.R. § 1121.3(a) that a party filing a petition for exemption is required to provide its entire case-in-chief, along with all supporting evidence, workpapers and related documents, at the time that it files its petition. Consequently, any rebuttal evidence or argument filed by a petitioner will be stricken. *Paducah & L. Ry., Inc. -- Aband. Exempt. -- in McCracken County, KY, supra*, 2003 STB LEXIS 344 at *2; *Central Kansas Ry., LLC -- Aband. Exempt. -- in Sedgwick County, KS*, 2001 STB LEXIS 356 at *3, STB Docket No. AB-406 (Sub-No. 14X), decision served April 10, 2001. If a petition for exemption is denied because of an inadequate record, the deficiencies cannot be corrected by means of rebuttal; the rail carrier instead must file a formal abandonment application if it continues to seek abandonment of the rail line. *Central RR Co. of Ind. -- Aband. Exempt. -- in Dearborn, Decatur, Franklin, Ripley and Shelby Counties, IN, supra*, 1998 STB LEXIS 121 at *27. Consequently, Lake State's Reply to Protest of the City of Gaylord, filed April 27, 2007, should be stricken.

III. THE RECORD IS NOT ADEQUATE TO SUPPORT AN EXEMPTION FOR ABANDONMENT

This case falls squarely within the principle requiring denial of exemption where detailed analysis of revenues and costs is required to determine the merits of abandonment. Lake State has submitted the verified statement of its Vice President-Operations Wilford Gamble (VS Gamble), setting forth evidence designed to establish that revenues from traffic on the line are minimal compared to the cost of operating the line. However, there is so much wrong with that evidence that it is difficult to decide where to begin to identify Mr. Gamble's errors.^{2/}

A recurring error that undermines all of Mr. Gamble's evidence is his reliance on historical revenues and costs rather than revenues and costs for a forecast year. Board regulations require use of forecast year revenues and costs in rail abandonment cases. *See Abandonment Regulations - Costing*, 5 I.C.C.2d 123, 130-136 (1988).

1. Revenues

Thus, the traffic and revenues in Mr. Gamble's statement (at 4 and 5) are for historical periods, i.e., 2004, 2005 and 2006. Mr. Gamble's evidence should have included a forecast year, i.e., a 12-month period commencing in the month in which the Petition was filed. That would have taken into account the increased traffic and revenues in 2007 that are attributable to the 6,000-square-foot warehouse that NEI constructed in 2006 (with Lake State's blessing). It also would have taken into account the additional increased traffic and revenues that will result from the unloading facility that Superior Well Service constructed in 2005 (also with Lake State's

^{2/} It has not been shown that Mr. Gamble is qualified to testify on railroad revenues and costs.

blessing). *See* Protest of Otsego County Economic Alliance (OCEA), filed on April 24, 2007, at 5.

2. Off-Branch Costs -- Operating Costs

The operating costs in Mr. Gamble's Statement (at 6-8) appear to be intended to reflect the off-branch costs of Lake State's transportation of traffic between Bay City, MI and the involved rail line. Those costs are even more outdated than the revenues posited by Mr. Gamble. Mr. Gamble's operating costs are based on the 3-day-per-week train operation that existed before Georgia Pacific's plant closed in March, 2006. Current train service is once per week or less (OCEA Protest at 3). Mr. Gamble should have provided forecast year costs based on current train service. It is noteworthy that Lake State is deriving increased revenues from rail line traffic, while having reduced its train-related costs to one-third of their prior level.

Even if the operating costs relied on by Mr. Gamble had not been outdated, those costs are defective for other reasons. It has often been noted in rail abandonment cases that a rail carrier's administrative costs are not avoidable costs of abandonment because they are not reduced as a result of a particular abandonment. Thus, the administrative costs posited by Mr. Gamble (at 7-8) are not avoidable costs of this abandonment.

Neither are the hodge-podge of costs lumped together in Mr. Gamble's Indirect T&E Costs (at 8) avoidable costs of this abandonment. For instance, the number of safety shoes and lanterns used by Lake State's train personnel off the involved rail line would not be reduced as a result of this abandonment.

There is no support in the Petition for Mr. Gamble's testimony (at 6) that off-branch train trips consume 6 hours per trip.^{3/} Mr. Gamble has not identified the permissible train speed off the branch that would be helpful in evaluating the time required for train trips to and from the rail line. In light of the State of Michigan's expenditure of \$12.8 million on the off-branch trackage in the past five years (OCEA Protest, Ex. B), the permissible train speed may enable train trips to and from the rail line in considerably less than 6 hours.

Neither is there any support in the Petition for Mr. Gamble's testimony (at 7) that the Lake State locomotive that provides service to the involved rail line consumes 120 gallons of fuel per trip. It is approximately 116 miles between Bay City and the involved rail line. Thus, a round trip is approximately 232 miles. Mr. Gamble's testimony is that the fuel usage of the Lake State locomotive is approximately 2 miles per gallon ($232 \text{ miles} \div 120 \text{ miles} = 1.93 \text{ miles per gallon}$). The Board should not accept that testimony without any support.

In sum, the off-branch operating costs posited by Mr. Gamble are outdated, unsupported, and in the case of administrative costs, not avoidable costs of abandonment.

3. On-Branch Costs - Maintenance Costs

The maintenance costs in Mr. Gamble's Statement (at 8-10) appear to be intended to constitute the on-branch costs of operating the rail line.

OCEA's Protest at page 3 shows that the cost for snow removal alleged by Mr. Gamble (at 10) is approximately double the actual average cost. There is no support in the Petition for Mr. Gamble's contention (at 10) that snow removal requires 6 hours per day. It also appears that

^{3/} Mr. Gamble's testimony appears to assume that Lake State does not provide service to any shippers off the branch (including the metals company at Gaylord) on days on which service is provided on the branch. That assumption is highly questionable.

Lake State has the ability to reduce its cost of snow removal by taking steps to prevent snowmobile grooming devices from plowing snow onto the rail line (Petition at 9).

There is absolutely no support in the Petition for Mr. Gamble's testimony (at 9) that a maintenance crew requires 2.5 hours per day to inspect and maintain the involved rail line. There is no evidence that Lake State performs any specific maintenance on the rail line. It certainly would not appear to take anywhere near 2½ hours for employees to inspect a 4.16-mile rail line.

In sum, the maintenance costs in Mr. Gamble's Statement are grossly overstated and unsupported.

4. Summary In Regard To Profitability

The OCEA Protest contains a showing (at 5-6) that Lake State's operation of the rail line would result in an operating profit of more than \$100,000 per year. However, no such showing is required of a protestant in a Petition-for-Exemption case. The Petitioner has the burden of proof. It is up to the Petitioner to show that revenues on the rail line are marginal compared to the costs of operating the line. As has been established in the foregoing, Lake State's Petition utterly fails to make such a showing. Consequently, the Petition is required to be denied.

5. Rehabilitation Costs

Lake State's Petition does not establish that there is a single FRA Class I track defect in the rail line, let alone the extensive defects reflected by the rehabilitation costs in the estimate of Armond Cassil Railroad Construction, Inc. (VS Gamble, Attach. WG-3). The purely theoretical nature of the Cassil estimate is shown by its proposed cost to replace 3,000 crossties in the 4.16-mile rail line, or about 700 ties per mile. That corresponds to approximately 25 percent of the roughly 2,800 crossties per mile in a rail line. That crosstie replacement rate of 25 percent

corresponds to the percentage of good ties required to comply with FRA Class I track safety standards. (5 good ties out of 20 ties per rail section = 25 percent). Therefore, Cassil's proposed costs for crosstie replacement assume that there is not a single nondefective crosstie in the entire 4.16-mile rail line! There is not an iota of evidence to support that radical contention. Indeed, there is no evidence in the Cassil estimate or anywhere else in the Petition that defective track conditions of any kind in relation to FRA Class I standards exist in the rail line. That being the case, the theoretical costs of track rehabilitation in the Cassil estimate do not provide support for granting the Petition for Exemption.

6. Opportunity Costs

The opportunity costs posited by Mr. Gamble are unsupported, and appear to be quite excessive. There is no support in the Petition for Mr. Gamble's testimony (at 11) that the 90-pound rail in the line has a value of \$700 per ton. That value is grossly in excess of values for that weight of rail that are commonly seen in other abandonment cases. The value of \$6,000 per switch in Mr. Gamble's testimony (at 11) is also unsupported. There is no evidence in the Petition that Lake State has marketable fee title to any of the land that is included in Mr. Gamble's opportunity cost (at 11). Without proof of marketable fee title, that land is not entitled to inclusion in the calculation of opportunity costs.

Even if Lake State's opportunity costs had been adequately supported, they would not, by themselves, warrant abandonment of a rail line where, as here, continued operation of the line has not been shown to be unprofitable, and abandonment would seriously harm local interests. That was made clear in *Southern Pacific Transp. Co. v. ICC*, 871 F.2d 838 (9th Cir., 1989), where the Court said (at 843):

Southern Pacific contends the ICC's decision is fatally flawed by the Commission's failure to calculate the value of Southern Pacific's opportunity costs. The Commission declined to resolve the discrepancy between the railroad's estimate and that of the County because it concluded that even if Southern Pacific's estimate was accurate, "those costs would not constitute a reason to grant the abandonment" . . . "Other factors, including the profitability of the line, lack of feasible alternative transportation service, and adverse impact on the community," the Commission concluded, "outweighed the opportunity cost . . .

The ICC was not required to resolve a subsidiary issue irrelevant to the ultimate outcome. (footnote omitted). Moreover, by treating Southern Pacific's estimate of opportunity costs as if it were correct, the Commission accorded it as much weight as the Commission could without treating it as dispositive, which the Commission could not do. "Opportunity cost is just one of the factors that must be taken into consideration in determining whether abandonment is justified. Merely because a railroad could earn greater revenue by investing its assets elsewhere does not mean that public convenience and necessity requires abandonment." *Cartersville Elevator, Inc. v. ICC*, 724 F.2d 668, 675 (8th Cir. 1984) (quoting *Burlington N. R.R. Abandonment*, No. AB-6 (Sub-No. 104F) (ICC Jan. 29, 1982)).

CONCLUSION AND REQUESTED RELIEF

WHEREFORE, for all the reasons stated, the Petition for Exemption is required to be denied. Lake State should file a conventional abandonment application if it continues to seek abandonment of the involved rail line.

Respectfully submitted,

NORTHERN ENERGY, INC.
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Protestant

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DATE FILED: May 7, 2007

CERTIFICATE OF SERVICE

I hereby certify that on May 7, 2007, I served the foregoing document, Reply In Opposition To Petition For Exemption, on Kelvin J. Dowd and Andrew B. Kolesar, III, Slover & Loftus, 1224 Seventeenth Street, N.W., Washington, DC 20036, by e-mail to kjd@sloverandloftus.com and abk@sloverandloftus.com, with confirmation by first-class, U.S. mail, postage prepaid.



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