BEFORE THE
SURFACE TRANSPORTATION BOARD

E.I. DUPONT DE NEMOURS & COMPANY	)	
Complainant	)	
v.	)	Docket No. NOR 42125
NORFOLK SOUTHERN RAILWAY COMPANY	)	
Defendant	)	

REPLY OF
E.I. DUPONT DE NEMOURS & COMPANY TO
NORFOLK SOUTHERN RAILWAY COMPANY'S
PETITION FOR RECONSIDERATION

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I. PREFACE AND SUMMARY OF ARGUMENT

Pursuant to 49 C.F.R. § 1115.3, Complainant, E.I. du Pont de Nemours and Company ("DuPont"), respectfully submits this reply to the Petition for Reconsideration ("NS Pet.") filed by the Respondent, Norfolk Southern Railway Company ("NS"), with the Surface Transportation Board ("Board") on November 12, 2014, seeking reconsideration of the Board's March 24, 2014 decision and October 3, 2014 corrected decision (hereinafter the "Decision" and "Corrected Decision") in the above-captioned proceeding.[1] The NS Petition alleges eleven instances of material error in the Decision, most of which reargue points that NS made previously or misrepresent the record and the Board's Decision. DuPont opposes nine of those claims in their entirety, but agrees, in whole or in part, with the other two issues raised by NS.

First, the Board properly determined that the DuPont Railroad ("DRR") is only required to pay trackage rights fees for its use of the Conrail Shared Assets Areas ("SAA") and the Indiana Harbor Belt Railroad Company ("IHB"), because NS Corporation ("NSC"), not NS, owns those facilities. It would be a barrier to entry to permit NS to earn monopoly rents in the form of returns on investments it never made in the SAA and IHB. Thus, NS's claim that corporate structure is irrelevant to the SAC analysis is incorrect. Moreover, that claim is inconsistent with NS's own position in this case with respect to revenues earned by its intermodal subsidiaries. Finally, even if the Board were to conclude that the DRR should incur ownership costs for the SAA and IHB, the corporate distinction between NS and NSC remains relevant to whether those costs should be replacement costs or acquisition costs. See Part II.A.

[1] Pursuant to decisions served in this docket on June 11 and October 9, 2014, the Board extended the time for filing replies to Petitions for Reconsideration until December 12, 2014 and it extended the page limit to 50 pages.

Second, the Board properly rejected NS's equity flotation cost evidence based upon the Facebook IPO. NS invokes a non-existent "settled rule" that would require the Board to uncritically accept a party's evidence, no matter how unreasonable, if it is the only evidence of record. However, in cases where one party has not submitted evidence of a cost in reliance upon precedent, the Board has not automatically accepted the other party's cost evidence even though the Board has agreed that the cost item is appropriate. Furthermore, contrary to NS's claim, the Facebook IPO was not a "conservative" estimate of an equity flotation fee for the DRR for all the reasons stated in the Decision. See Part II.B.

Third, the Board properly rejected NS's proposed cost for transporting rail over the residual NS to DRR railheads because the NS evidence was unsupported and could result in a double-count. The Board expressly considered the same NS arguments in the Decision and rejected them for a lack of support. See Part II.C.

Fourth, the Board properly rejected NS's proposed lighting costs for nighttime construction as unnecessary and an impermissible barrier to entry. NS's arguments are an attack upon established precedent. DuPont's rebuttal evidence also contradicts the factual basis for NS's argument. Finally, even if NS were correct, the DRR simply could increase the number of road crews to complete the assigned tasks without night work because, whether it takes 10 crews completing 5 miles per day or 20 crews completing 2.5 miles per day, the unit costs are the same. See Part II.D.

Fifth, the Board properly rejected NS's attempts to include a swell factor adjustment in the calculation of earthwork unit costs because there is no evidence that the ICC Engineering Reports measure earthwork quantities in Bank Cubic Yards ("BCY"). Since that is a predicate fact to NS's argument, the application of a swell factor is speculative. See Part II.E.

Sixth, NS's objections to the terminal value correction adopted by the Board are baseless. NS's claim that the Board's correction introduces inconsistent assumptions into the DCF model is wrong because the alleged inconsistencies existed even prior to the Board's terminal value correction, not as a consequence of it. Furthermore, the terminal value correction removes this inconsistency by assuming that the debt to acquire original assets and the debt used to acquire future assets will both be amortized over 20-year periods. Finally, contrary to NS's claim, the Board did not make a mathematical error by overriding scheduled interest payments, but instead reflected the use of an average value over time. See Part II.H.

Seventh, NS's petition as to Positive Train Control ("PTC") is a thinly-disguised attempt to get a second bite at the apple by imposing the costs of two signaling systems upon the DRR. Although DuPont has sought reconsideration of the Board's conclusion that the DRR could not install an RSIA-compliant PTC system in 2009 because that conclusion creates a barrier entry,[2] DuPont agrees that the Board's treatment of PTC costs in the Corrected Decision, by reallocating a portion of the 2009 PTC costs to the 2010 to 2015 time period, produces a result that also could eliminate the PTC-mandate as a barrier to entry. Even though the Board adopted a different approach than either party had advocated, the Board has the authority to devise its own solutions to intractable differences between the parties' evidence. The Board's solution was both reasonable and consistent with constrained market pricing ("CMP") principles that prohibit barriers to entry in the Stand-Alone Cost ("SAC") analysis. If the Board were to nevertheless grant the NS Petition, it should reject NS's preferred solution, which essentially doubles the PTC costs, in favor of its alternative solution of requesting supplemental PTC evidence. See Part II.I.

[2] Petition for Reconsideration of E.I. du Pont de Nemours and Company, pp. 36-38 (filed Nov. 12, 2014) ("Dup. Pet.").

Eighth, the Board correctly applied bonus depreciation to the DRR consistent with SAC principles. NS's Petition on this issue is repetitive of its reply evidence. Although NS contends that the Decision did not identify any specific disadvantages that a stand-alone railroad ("SARR") would face as a result of its accelerated construction period, the Board clearly was referring to the numerous disadvantages presented in DuPont's rebuttal evidence. Finally, NS's proffered correction is itself a barrier to entry because it would deny the DRR the opportunity even to take advantage of bonus depreciation to the same extent as NS did during the SARR's construction period. See Part II.J.

Ninth, the Board adopted the best evidence of record for failed equipment and dragging equipment detectors. Although NS claims that the Board's acceptance of DuPont's evidence based upon 2001 AREMA standards was inappropriate because those were superseded by 2007 AREMA standards, NS has not demonstrated why DuPont's evidence would not also comport with the 2007 standards or that NS's evidence would satisfy those standards. See Part II.K.

Finally, in two instances, DuPont agrees with NS, in whole or in part, that the Board has erred. In Part II.F., DuPont agrees that the Board made a technical error in its calculation of ad valorem taxes, as described by NS, but this error would become moot if the Board grants DuPont's Petition for Reconsideration of the Board's acceptance of NS's new methodology for calculating ad valorem taxes in the first instance. See Dup. Pet. at 40-42. In Part II.G., DuPont agrees with NS as to the treatment of moveable bridge approach spans.

II. ARGUMENT

This section addresses each error alleged by NS in the order in which it is presented in the NS Petition.

A. The Board Properly Determined that the DRR Need Not Account for Ownership Costs of Certain Partially-Owned Facilities.

The Board concluded that the DRR must incur replacement costs for joint facilities that are partially-owned by NS Rail ("NS") (i.e., the Belt Railway of Chicago ("BRC") and the Terminal Railroad Association of St. Louis ("TRRA")), but not for those that are partially-owned by NS Corporation ("NSC") (i.e., the Conrail Shared Asset Areas ("SAA") and the Indiana Harbor Belt Railroad Company ("IHB")). Decision at 47-49. NS has sought reconsideration of the latter conclusion on grounds that the distinction in corporate entities is irrelevant to the SAC analysis. The Board's distinction is relevant and supported by precedent.

When the defendant in a rate case has acquired its rail lines through prior historical acquisitions of stock, the Board has required the SAC analysis to reflect replacement costs rather than the defendant's acquisition costs. AEPCO, slip op. at 10. However, where the defendant operates over trackage rights on non-defendant railroads without incurring ownership costs, the Board only has required the SAC analysis to include the trackage rights fees – not replacement costs. Id. Although the Board adhered to this precedent, the NS Petition seeks to apply replacement costs to trackage rights facilities that the defendant, NS, does not own. Instead, NS attempts to attribute the ownership interest of its non-defendant parent company, NSC, in two non-defendant railroads, the SAA and IHB, to NS, which would result in a barrier to entry and is contrary to Board precedent.

NS makes four points, none of which constitute material error. An examination of these points shows that NS's relationship with the SAA and IHB is solely as a purchaser of services;

NS has no ownership interest in the SAA or IHB; payments made by NS to the SAA and IHB are intended to fully compensate the SAA and IHB for services provided; and NS's payments to the SAA and IHB are the best representation of the costs for services that the SAA and IHB provide to the DRR.

1. **Conrail and IHB do not appear in NS's Annual Report Form R-1**

NS contends that the Board inaccurately claims that the SAA and IHB do not appear in NS's R-1 . NS Pet. at 6. This is a misrepresentation of what the Board said and of the DuPont evidence upon which the Board's decision was based. While the NS R-1 discusses the SAA and the IHB in terms of NSC's corporate structure, it does not include SAA and IHB assets or equity in NS's consolidated financial data.[3]

The Board observed, "as DuPont notes, the SAA and IHB are not listed in NS's R-1 data." Decision at 49 [underline added]. In Rebuttal, the point that DuPont made, and thus to which the Board referred, was that the SAA and IHB are not listed in NS's R-1 as assets or equity positions (i.e., do not appear in Schedule 310). Dup. Reb. at III-F-150-51. DuPont made this point because NS itself had cited to Schedule 310 as proof that it owned the BRC and TRRA, and thus the absence of the SAA and IHB provided complementary proof that NS did not own those entities. The fact that the acronyms SAA and IHB appear in different contexts elsewhere in the NS R-1 is a red herring.

Moreover, NS incorrectly asserts that its "R-1 also explains that NS's operating rights over Conrail lines are a function of its ownership interest.". NS Pet. at 6. NS does not have any ownership interest in the Conrail lines (i.e., SAA and IHB) as clearly indicated in the NS R-1;

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[3] There is a clear distinction between the expenses that NS incurs while operating over SAA and the IHB and the expenses of the SAA and IHB. The former reflects the NS's costs of operations and are included in the R-1 data, while the latter are not incurred by the NS and are not included in the R-1.

the Conrail ownership instead lies with NSC. As NS itself explains in its Annual Report Form R-1, "Through a limited liability company, [NSC] and CSX Corporation (CSX) jointly own Conrail Inc. (Conrail), whose primary subsidiary is Consolidated Rail Corporation (CRC)."[4]

NS further argues that BRC and TRRA have no impact on the R-1 data because their assets are not consolidated with NS's assets. NS Pet. at 6. Therefore, NS claims that, even if the SAA and IHB were owned by the NS and not NSC, and the entities were included in Schedule 310, there would be no material difference because their assets would not be in the R-1 in any event. This argument is erroneous. Schedule 310 lists the stock, bond, other investments and advances made by the consolidated railroad company to affiliated companies. In the case of NS's Schedule 310, it includes NS's stock ownership in the BRC and the TRRA (and other rail and non-rail related companies). But at any point in time, the value of stock ownership is simply the amount that would be due to stockholders after discharge of all senior claims such as secured and unsecured debt. While the TRRA and the BRC's gross assets are not included in the NS's financial statements, the amount of assets represented by NS's stock holdings are included.

Contrary to NS's claim, the financial results of the companies listed in Schedule 310 do have a direct impact on the NS's financial statements. For example, Schedule 310A of NS's 2010 R-1 states that equity in the undistributed earnings for the BRC, and for other affiliated companies, was credited to NS's operating expenses. This means that NS's operating expenses, which impact its URCS variable costs and return on investment calculation, were impacted by many of the companies listed in Schedule 310. NS's claim that the affiliated companies have no impact on the NS's R-1 data thus is false.

[4] See NS 2009 R-1, at 9.

In the case of BRC and TRRA, NS is an equity owner of, and makes a capital contribution to, the affiliated companies. Therefore, the trackage rights fees paid to those affiliates reflect that capital contribution. Because NS does not own or contribute to the SAA and IHB, the trackage rights fees paid do not reflect any capital contribution and therefore are representative of what an unaffiliated party pays. The Board must treat the SAA and IHB as non-defendants when applying its precedent on the use of trackage rights in the SAC analysis.

2. **Corporate structure is relevant in a SAC case.**

Next, NS claims that its corporate structure is irrelevant to the SAC analysis because the Board's ruling "allow[s] the DRR to operate on the SAA and IHB lines without paying 'the full stand-alone costs of providing and maintaining the line.'" NS Pet. at 5, citing AEPCO 2005 at 11. NS's argument that the DRR must account for the ownership interest of its parent company, NSC, in the SAA and the IHB is based on logic that directly contradicts NS's argument in this very case with respect to intermodal revenues.[5] NS's argument also contradicts Board precedent and the explicit corporate structure established by NS.

In its Petition, at 5, NS recognizes that the Board did require the DRR to account for construction costs for portions of the BRC and the TRRA, networks that are partially owned by NS. NS also recognizes that the Board's rationale for treating the SAA and the IHB differently was not arbitrary. Rather, it was based on the entity that holds ownership interest in the various systems as reported in NS and NSC's books. NS simply doesn't like the Board's decision and argues that "[t]he Board's rationale for why the BRC and TRRA assets should be treated differently than the SAA and the assets of the IHB is not reasonable in the context of a SAC case." Id.

[5] See Decision at 51-54. DuPont has sought reconsideration of that issue on other grounds. Dup. Pet. at 27-33.

> The *Decision*'s concerns that recognizing the ownership costs of the SAA and IHB would require 'ignoring [NS's corporate] structure' and that 'the data used in the SAC analysis' needs to 'accurately reflect[] the underlying corporate structure' are misplaced. *Decision* at 49. <u>NS's corporate structure is not relevant to a SAC case</u>—<u>the only question is whether the DRR is fully accounting for all the stand alone costs of its service</u>.
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> Not only is the Board's decision on partially-owned lines erroneous, it also would create bad precedent in SAC cases. <u>The Board's form-over-substance finding that the positioning of assets within a railroad's corporate family tree determines the treatment of those assets in a SAC case may lead to unintended results when carried to its logical extreme</u>. If, for example, a SARR were to replicate a defendant railroad's operations through a rail terminal owned by the defendant railroad's corporate parent, the Board's holding on partially-owned lines would imply that the SARR would not need to build the rail terminal, <u>but would instead only need to pay to use the terminal in the manner in which the defendant railroad compensates its corporate parent for such use</u>."

<u>Id.</u> at 6-7 [emphasis added].

This argument directly contradicts NS's position with respect to revenues earned by its intermodal subsidiaries, Triple Crown Services ("TCS") and Thoroughbred Direct Intermodal Services ("TDIS").[6] There, NS has argued that the DRR may step into the shoes of only NS, and none of the subsidiaries to which it is a parent, which would entitle the DRR only to revenue on TCS/TDIS shipments <u>in the manner in which NS's subsidiaries compensate their parent, NS</u>. In other words, NS argued that, with respect to revenues, the Board <u>must</u> ignore the substance of the railroad's ownership structure in favor of the form of such ownership. In fact, NS argued that basing the DRR intermodal revenues from services marketed by its subsidiaries on the total net revenues earned on those shipments (and reported in the NS R-1 data) would distort the SAC analysis. Connecting the dots, NS argues that the lines between parent and subsidiary should

[6] NS Reply at III-A-61-62.

only be observed in one direction by requiring the Board to ignore corporate boundaries on the cost side, but observe them on the revenue side, of the equation. This is a clear example of arguing based on outcome rather than theory.[7]

The Board's decision to treat the SAA and IHB as independent operating entities, separate and distinct from NS, is also consistent with NSC's corporate structuring. At the time of their joint acquisition of Conrail, Inc. ("Conrail") and Conrail's railroad operating company Consolidated Rail Corporation ("CRC"), NSC and CSX Corporation ("CSXC"), the non-railroad parent holding companies of NS and CSX Transportation, Inc. ("CSXT"), respectively, chose to maintain Conrail and CRC as separate corporations jointly owned by NSC and CSXC.[8] The two non-railroad parent companies decided to spin off the majority of CRC rail lines to their railroad subsidiaries, but specifically retained the SAA and the IHB ownership as part of Conrail and CRC. As stated in NSC/CSXC's April 8, 1997 Letter Agreement ('Letter Agreement"), "Shared Assets [SAA] will remain assets of [Conrail] or a subsidiary of [Conrail]."[9] Similarly, the Letter

[7] The Board's logic with respect to the treatment of the SAA and IHB should not preclude it from properly crediting the DRR with revenues earned by NS's TCS and TDIS subsidiaries. The Board ruled that, because the SAA and the IHB are not listed in NS's R-1 data, the DRR should not be required to construct those assets. Decision at 49. In contrast, TCS and TDIS are listed in NS's R-1 data, and all revenues earned on all TCS/TDIS shipments are included in the intermodal revenues reported in NS's R-1 data. See also, Dup. Pet. at 27-33.

[8] To facilitate their joint acquisition, NSC and CSXC established CRR Holdings LLC in which each own 50 percent of the voting shares. Green Acquisition Corp is a wholly owned subsidiary of CRR Holding LLC, and, subsequently, is the parent company of Conrail Inc. Conrail Inc. is the former publicly traded holding company for Consolidated Rail Corporation, which operated as a Class I railroad throughout the Northeastern U.S. See Distribution Agreement, dated July 26, 2004, by and among CSX Corporation, CSX Transportation, Inc., CSX Rail Holding Corporation, CSX Northeast Holdings Corporation, Norfolk Southern Corporation, Norfolk Southern Railway Company, CRR Holdings LLC, Green Acquisition Corp., Conrail Inc., Consolidated Rail Corporation, New York Central Lines LLC, Pennsylvania Lines LLC, NYC Newco, Inc., and PRR Newco, Inc., as contained in Exhibit 2.1 to Norfolk Southern Corporation's Form 8-K, filed on September 2, 2004.

[9] See Letter Agreement, at page 7. A copy of the Letter Agreement can found on the SEC website at http://www.sec.gov/Archives/edgar/data/702165/0000950123-97-003099-index.html.

Agreement states that it was NSC's and CSXC's intention to keep the IHB ownership in [Conrail].[10] The Board confirmed this separate corporate structure in its November 10, 1997 decision in the NSC and CSXC Conrail acquisition.

A presentation by NS's Controller on February 28, 2003 includes the following statement: "the structure of the Conrail transaction is heavily influenced by taxes." The deal was structured specifically to achieve deferred tax benefits associated with the acquisition. The Conrail control application[11] filed with the Board describes the deal as follows:

> In terms of structure, for various reasons, including tax reasons, the Conrail assets allocated to NS [Corp] and CSX will not be transferred directly to them but will be transferred to newly created subsidiaries of Consolidated Rail Corporation (CRC), which I will refer to as PRR and NYC. Use of those properties will be provided by PRR and NYC to NS and CSX respectively, which will operate the properties under operating agreements.[12]

Maintaining the SAA in a Conrail that is jointly owned by two non-railroad holding companies provides NS benefits that would not be available to the DRR if it were required to build the SAA and IHB infrastructure. First and foremost, NS did not incur the costs to acquire the SAA and Conrail's ownership stake in IHB. Those acquisition costs instead were borne by NSC, NS's corporate parent, and retained at the holding company level. This is clearly demonstrated by the absence of Conrail and CRC in the list of consolidated companies included in NS's Annual Report Form R-1 section on Voting Powers and Elections or in Schedule 310.

The Board clearly explained in its WTU decision that a railroad in a SAC case is precluded from earning monopoly rents in the form of returns on investments it never actually

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[10] See Letter Agreement, at Exhibit A, page 11.

[11] STB Docket No. FD 33388, CSX Corp. and CSX Transp., Inc., Norfolk Southern Corp. and Norfolk Southern Ry. Co.—Control and Operating Leases/Agreements—Conrail, Inc. and Consolidated Rail Corp. filed June 23, 1997 ("Conrail").

[12] See STB Docket No. FD 33388, Volume CSX/NS-18, p. 7, and Volume CSX/NS-25, p. 46.

made.[13] NS did not invest in Conrail, its parent company did; therefore, the Conrail investments in the SAA and IHB are not included in NS's investment figures reflected by its Annual Report Form R-1 data. As a replacement carrier for the NS, the DRR can be expected to incur the same costs as the incumbent NS. The SAA and IHB charge NS fees for services and trackage rights. These fees, along with fees charged to other customers, go to the recovery of costs incurred by the SAA and IHB for providing such services. Thus, NS's relationship with the SAA and IHB is that of a customer. The Board correctly included the DRR's payments for the proportional share of the SAA's operating and maintenance expenses, and the DRR's trackage rights fees on the IHB, but also correctly excluded any investment costs related to these assets because NS did not directly incur these costs. Requiring the DRR to incur costs associated with NSC's investment in the SAA would provide NS a return on an investment it never made, which is a clear barrier to entry.

NS also asserts that it relies upon NSC to provide employees for certain administrative functions and for office space in NSC's headquarters buildings. NS Pet. at 6-7. Because of this, NS implies that there is no true corporate separation between NS and NSC and that what NSC owns is also owned by NS. The implicit assumption underlying NS's argument is that NSC provides its employees and office space at no cost to NS, and thus there is no distinction between NS and NSC. This is incorrect. NS pays substantial fees for outsourcing these administrative and housing functions to its corporate parent. NS's 2010 R-1 reports that NS paid NSC $732 million in 2009 and $744 million in 2010 for what NS terms "a fee for management services it performs for NS Rail."[14] Included in these fees were $45 million and $49 million, respectively, for markups above NSC's costs, indicating that these were not simply "pass through" costs, but

[13] West Tex. Utilities Co. v. Burlington Northern R.R. Co., 1 S.T.B. 638, 670 (1996) ("WTU")..

[14] See NS 2010 Annual Report Form R-1, at 9.

costs that included an additional return to NSC.[15] If NS and NSC were just one single entity, there would be no need for such costs, and especially no need for a markup on the costs.

Board precedent also contradicts NS's claim that corporate structure is irrelevant to a SAC case. In Docket No. 41295, Pennsylvania Power & Light Company vs. Consolidated Rail Corporation, CSX Transportation Inc. and Norfolk Southern Railway Company, served February 7, 1997 ("PPL"), the Board held that NSC was incorrectly joined as a defendant in that SAC proceeding, dismissed NSC from case, and substituted NS in the proceeding. If corporate structure was irrelevant in a SAC case, the Board would have retained NSC as a defendant because, by NS's logic, it would not matter if NS or NSC were the defendant. The Board's action in PPL clearly indicates that corporate structure is a relevant factor.

NS's Petition also overstates Board precedent because it would require a SARR to account for the stand-alone cost of all lines over which it operates via trackage rights. The Board, however, has never imposed such a requirement, which is a fact that even NS has recognized in this proceeding.[16] The precedent cited by NS has distinguished the SARR's use of trackage rights over the defendant's own lines versus the lines of non-defendant carriers.[17] The Decision properly concludes that rail lines owned by related railroad companies are not the defendant's own lines, but rather they are the lines of non-defendant carriers. Therefore, a SARR need not account for the replacement costs of those lines.

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[15] Id. NSC also charges NS a revenue-based licensing fee (which totaled $139 million in 2010 and $114 million in 2009) for use of certain intangible assets owned by NSC.

[16] See NS Reply at III-F-306 ("In the case of trackage rights over third-party non-defendants, a trackage rights fee alone can account for the full costs to the defendant, because in that case the trackage rights fee is the only cost that the defendant incurs for operations over the third party's line.").

[17] Id. at III-F-305-06.

3. **NS has not carried its burden of proof.**

NS claims that it did carry its burden "to demonstrate the relationship of the [SAA and IHB] and the costs and revenue realized by the [NS] as a result of that relationship." Decision at 49; NS Pet. at 7. But NS's reply evidence blurred the distinction between itself and NSC when it claimed that "[t]he operating rights that NS possesses over these lines plainly are not 'trackage rights,' but rather operating rights that NS possesses as an incident of its ownership." NS Reply at III-F-309. NS does not possess these rights as an incident of "its" ownership, but rather as an incident of NSC's ownership, and it is that fact that makes all the difference. NSC elected to make the SAA and IHB its subsidiaries, rather than NS subsidiaries, with all of the benefits and consequences attendant to that decision.[18]

NS claims that the SAA and IHB operating agreements were not mere trackage rights agreements, but rather agreements among co-owners to establish their rights and responsibilities on a joint facility. NS Pet. at 7. These factors, according to NS, indicate it met its burden of proof. In actuality, NS did not meet its burden because it never proved that it purchased or caused to be purchased, the ownership stakes in the SAA and the IHB. As NS acknowledges in its Petition, NSC acquired the ownership interest in these assets, not NS. NSC could have assigned NS ownership of the SAA just as it assigned NS ownership of the Pennsylvania Lines LLC,[19] but it made the conscious decision not to do so. Instead, NSC and CSX decided to retain their ownership in the SAA through their joint ownership in Conrail, and not push these assets

[18] As noted in the preceding subpart, NSC structured its acquisition of the SAA and IHB for tax benefits, which would not be realized by the DRR.

[19] After NSC and CSX acquired Conrail, the two companies agreed to split the CRC railroad assets into three separate companies. Pennsylvania Lines LLC was created to encompass the former CRC lines which would be conveyed to NS. New York Central Lines LLC was created to encompass the former CRC lines which would be conveyed to CSXT. The remaining lines generally constituted the rail lines in the SAA and remained with CRC.

down to their respective railroad operating companies. NS cannot demonstrate it realized any costs to acquire the SAA and IHB, because it was NSC that acquired these assets. NS has shown, and the Board included in its analyses, the costs NS incurs for operating on these lines, but NS has not demonstrated it incurred any costs to acquire the lines.

4. **The Decision does not create bad precedent.**

Finally, NS claims that the Decision also creates bad precedent. NS Pet. at 7-8. Specifically, NS argues that the Board's decision is not only erroneous, it also creates bad precedent in SAC cases by looking at "form-over-substance" that could lead to unintended results. But form is critical in SAC cases, and for the Board's role as the economic regulator of the railroad industry. As noted above, NS went to great lengths in this case to argue that the DRR was only entitled to revenue on TCS/TDIS intermodal shipments in the manner in which NS's subsidiaries compensate the defendant railroad. NS argued that, with respect to revenues, the Board must ignore the substance of the railroad's ownership structure in favor of the form of such ownership.

To support the contradictory form-over-substance argument NS presented in its Petition, NS presumes that, if a SARR were to replicate a defendant railroad's operations through a rail terminal owned by the defendant's corporate parent, the Board's holding would imply that the SARR would not need to build the terminal, but would only need to pay what the defendant pays its corporate parent for use of the terminal. NS's example completely avoids the question of what cost the incumbent actually incurred to build or buy the terminal. If the defendant incurred no costs, then, under contestable market theory, the SARR should not incur such costs. NS's argument would have the SARR construct the terminal, even when the defendant railroad never expended a dollar for the terminal's acquisition. The fundamental issue that must be resolved in this situation is whether or not the railroad defendant expended funds to build or acquire the property in question. The question is not whether the defendant railroad's parent corporation expended the funds, since the parent is not the defendant in the case; it is whether the defendant railroad that issued the challenged rate and provides the service expended the funds. If the answer to this question is "no," then the SARR replacing the railroad also does not need to expend the funds.

Railroad holding companies, including NSC, structure their organizations into multiple corporate entities for many reasons. In many cases they will create new subsidiary companies to minimize their tax liabilities or maximize their revenue potential. They will create complex corporate structures to protect different parts of their business in the case of bankruptcy. In many cases, they will create a specific corporate structure to avoid or minimize regulatory issues. NS effectively is claiming all of the benefits afforded by these complex corporate structures, but none of the associated costs. For example, the railroads have strenuously argued over the years that non-railroad related revenues should be excluded from the Board's revenue adequacy determinations because they do not reflect the returns generated by the railroad operating companies. This has allowed the railroads to claim that they have not yet reached revenue adequacy, as defined by the Board, while simultaneously showcasing their record returns to Wall Street. This dichotomy between appearing revenue inadequate from a regulatory perspective while securing access to capital from Wall Street is due almost exclusively to the railroads' corporate structures, which afford them the ability to segregate costs and revenues as desired for different purposes.

* * *

Ultimately, even if the Board were to conclude that the DRR should incur ownership costs for the SAA and IHB, the corporate distinction between NS and NSC remains relevant to whether those costs should be replacement costs or acquisition costs. In the Decision, the Board required the DRR to replicate lines of the BRC and TRRA because, "[i]n SAC cases, RPI costs are developed by replacement costs, and not the cost the incumbent railroad paid for the line when it was acquired." Decision at 48 [underline added]. Unlike the BRC and TRRA, the incumbent railroad, NS, did not pay anything to acquire an ownership share in the SAA or IHB; rather, its parent NSC did. The most that NS has argued in this case is that it would not possess trackage rights over the SAA and IHB but for NSC's purchase of those entities. Therefore, NSC's purchase cost is the most that the DRR potentially would need to pay. As DuPont demonstrated in rebuttal, the DRR's pro rata share of that cost is only a fraction of the replacement costs that NS would impose. Dup. Reb. at III-F-156-58.

B. **The Board Properly Rejected NS's Equity Flotation Costs.**

NS contends that it was material error for the Board to reject the 2.1% equity flotation fee added by NS to the DRR's stand-alone costs. NS Pet. at 8-10. In support of its contention, NS makes two separate, and equally flawed, arguments. First, NS contends that its equity flotation cost must be accepted because it was the only evidence of record on the issue of what the equity flotation fee should be. Id. at 8. But, the Board does not automatically accept the only evidence of record, especially when one party's evidence is a deviation from precedent, for which that party has the burden of proof, and the other party relied upon that precedent in not submitting its own evidence. Second, NS claims that the Board's rejection of NS's proposed 2.1% fee "ignores the fact that the DRR's equity flotation costs would almost certainly be higher than 2.1%." Id. at 14-15 [underline in original]. The Board, however, rationally explained why NS's evidence was insufficient and NS has not shown that explanation to be material error.

1. There is no "settled rule" that requires the Board to uncritically accept the only evidence of record.

In support of its first contention, NS inaccurately invokes an alleged "settled rule" that, where only one party submits evidence on an issue and the Board agrees that the issue is appropriate for inclusion in the SAC analysis, then the Board always accepts the evidence submitted by that party. Id. at 3 (n. 3) and 8. The Board does not uncritically accept one party's evidence just because it is the only evidence of record. The Board also considers whether that party's evidence is reasonable and adequately supported.

In AEPCO, defendants BNSF and UP included costs for undercutting during SARR construction. The complainant omitted such costs. The Board determined that undercutting was an appropriate SAC cost category, stating that "defendants have shown that some undercutting was done on portions of the lines that the ANR would replicate." Arizona Elec. Power Coop., Inc. v. BNSF Ry. Co. and Union Pac. R.R. Co., Docket No. NOR 42113, slip op at 85 (served Nov. 22, 2011) ("AEPCO"). Nonetheless, the Board omitted the cost because defendants' evidence was insufficient to justify the particular dollar figure that they advocated. Id.

In Pub. Serv. Co. of Colo. d/b/a Xcel Energy v. The Burlington Northern and Santa Fe Ry. Co., 7 S.T.B. 589 (2004) ("PSCo/Xcel I"), the complainant Xcel proposed several alternative methods for indexing SARR operating expenses to account for railroad productivity. The defendant BNSF rejected all methods of ascribing productivity to the SARR and refused to offer any such evidence even when expressly requested to do so by the Board. Id. at 619. Although the Board agreed with Xcel that it was appropriate to credit the SARR with productivity, id., it nonetheless refused to accept any of the methods proposed by Xcel, and instead applied the RCAF-U, which did not account for any productivity. Id. at 619-620; see also, Otter Tail Power Co. v. BNSY Ry. Co., Docket No. 42071, slip op. at 21-22 (served Jan. 27, 2006) ("Otter Tail").

Multiple other examples similarly indicate that the Board does not blindly accept a single party's evidence just because it is the only evidence of record, but also subjects such evidence to a "reasonableness" test. See, e.g., PSCo/Xcel I, 7 S.T.B. at 649 (where Xcel did not mention or address BNSF's inclusion of certain G&A employees, the Board included them "[b]ecause BNSF's argument is reasonable"), 656 (adopting BNSF's evidence of travel expenses "as it appears reasonable and is the only evidence of record"); AEPCO at 34 (accepting defendant's PTC costs, when complainant omitted such costs, "because those costs have been reasonably quantified by defendants").[20]

Even if the alleged "settled rule" were to exist, such a rule does not and should not apply where the issue or cost category is a new item that deviates from precedent. Equity flotation costs were regularly rejected prior to the filing of evidence by DuPont in this case.[21] In other words, DuPont did not ignore an accepted cost category; instead, DuPont's omission of an equity flotation fee was in line with precedent. It was NS that sought a departure from precedent, and the burden was on NS to submit and support the new cost that it included.[22] The PSCo/Xcel I decision is particularly relevant to the NS Petition because, in both that case and this one, the

[20] Indeed, the Board sometimes selects a cost figure that neither party submitted into evidence, which also constitutes ignoring the only evidence of record. In the Otter Tail case, BNSF included per diem costs of $75 during employee training while Otter Tail did not include any such costs. The Board found that per diem costs were appropriate. Otter Tail at C-16. Following NS's allegedly "settled rule," the Board should have included $75 per day for such costs, but the Board did not do this. Instead, the Board included costs of only $35 per day. Id.

[21] See, AEPCO at 138 (there is a "longstanding precedent" of rejecting equity flotation costs). The lone exception is a case where both parties agreed to include an equity flotation fee. Id. at 137 ("In AEP Texas II – the only case to date in which the Board accepted equity flotation costs – both parties had agreed that an equity-flotation fee should be included").

[22] See, e.g., AEPCO at 33 ("Where…a complainant has followed established agency precedent, defendants carry the burden to justify a departure from that methodology."); PSCo/Xcel I at 671 ("It is incumbent upon the proponent of a new cost to demonstrate that such a cost would need to be incurred by a SARR."); Western Fuels Assoc., Inc. v. BNSF Ry. Co., Docket No. 42088, slip op. at 68-69 (served Sept. 10, 2007) ("WFA/Basin I"); Otter Tail at 4.

party who presented the only evidence of record also was advocating a departure from precedent, and thus it had the burden of proof. Even though the Board agreed that a change was appropriate in both cases, it nevertheless rejected the only evidence submitted, thereby indicating that the party had not carried its burden merely by submitting the only evidence of record.

2. NS's evidence of an equity flotation fee was not conservative.

The second reason asserted by NS in support of its equity flotation cost is that the Board's rejection of the 2.1% fee advanced by NS "ignores the fact that the DRR's equity flotation costs would almost certainly be higher than 2.1%." NS Pet. at 9 [underline in original]. NS's position is baseless because the Board rationally explained why NS's evidence was insufficient.

The Decision made clear that NS did not adequately show why the Facebook example was a proper benchmark for the DRR. Decision at 274-75. The only evidence of similarity in NS's Reply was that the Facebook offering was "recent" and of similar "magnitude." NS Reply at III-G-5. The Decision made clear that the Board was looking for better evidence of similarity, such as another transportation company, or at least an effort to address credit ratings, risk profiles, or the capital-intensive nature of the railroad business. Decision at 274-75. NS did not provide such evidence.

NS nevertheless claims that its 2.1% fee is a conservative estimate of the gross spread on the DRR's equity issuance, and that the STB ignored the fact that the DRR's equity flotation costs would be higher than 2.1% in the real world. As support for its claim, NS states that equity flotation costs usually range between 2 and 7 percent of the amount raised, and that the most recent railroad common equity issuance equaled 3.9%. NS Pet. at 9. Based on these few data points, NS concludes that its 2.1% fee is a conservative estimate.

There are several problems with NS's presumptive conclusion. First, NS's support for higher flotation costs is dated and more current research shows that equity flotation costs are falling. Second, the prior BNSF equity flotation cost is an inappropriate benchmark for the DRR because of dramatic differences in the sizes of the equity issues. Third, the recent Facebook IPO is also an improper cost benchmark because of significant fundamental differences between a technology IPO and a railroad IPO.

To start, NS's claim that gross spreads on equity issuances usually range between 2 and 7 percent relies upon outdated data.[23] The academic paper NS heavily relied upon for these figures was published nearly twenty years ago, and the data included in the paper is even older, with dates ranging from 1990 to 1994.[24] More recent academic research has found that equity flotation costs have fallen since NS's supporting work paper was issued in 1996. For example, in their 2008 paper "Competition in IPO Underwriting: Time Series Evidence," Bajaj, Chen and Mazumdar found that average gross spreads have fallen over time while keeping issuance size constant.[25] Additionally, Loughran and Ritter found evidence in their 2004 research that investment banking firms were lowering gross spreads over time to increase profits in other parts of the banker's business.[26] NS has not shown that the gross spreads included in its supporting work papers are still indicative of the equity flotation costs that would be incurred in the 2007 to 2009 time period.

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[23] "Gross spread" is the difference between the offering price of public offered securities and the proceeds paid the issuer of the securities by the underwriter. The securities underwriters and selling group earn the gross spread as compensation and to cover expenses.

[24] See NS Reply work paper "III-G Cost of Raising Capital.pdf," at page 59.

[25] See Mukesh Bajaj, Andrew H. Chen and Sumon C. Mazumdar, "Competition in IPO Underwriting: Time Series Evidence," *Research in Finance*, Volume 24, 2008, pages 1-25 at page 12.

[26] See Tim Laughran and Jay Ritter, "Why Has IPO Underpricing Changed Over Time?", *Financial Management, Autumn* 2004, pages 5–37.

Next, NS states that the most recent railroad common stock issuance, Burlington Northern Inc.'s ("BN") 1991 common stock issue, incurred flotation costs of 3.9%, and thus a 2.1% flotation cost is extremely conservative for the DRR. There are several flaws in NS's argument. First, NS does not take into consideration the relative size differences between BN's 1991 common stock issue and the DRR's common equity requirement. Security and Exchange Commission ("SEC") data indicate that BN issued 10.35 million shares of common equity at a principle amount of $345 million.[27] In contrast, the STB's work papers indicate that the DRR would issue approximately $29.5 billion in common equity, taking into consideration initial construction investments and interest during construction.[28] In other words, the DRR's common equity issuance would be nearly 85 times the size of the BN's 1991 issuance. NS has acknowledged that gross spreads are based, in part, on the amount of the common stock issued. However, NS has provided no evidence that an issuance that is 85 times the size of the BN would incur just a 180 basis point difference in flotation costs.

Second, BN did not pay 3.9% in banker's fees and costs in its issuance as NS claims, but rather a 3% gross spread and banking fees. The 3.9% figure cited by NS reflects the total costs to BN, including a 0.9% stock dilution impact.[29] Since the DRR would not have any shares to dilute, the appropriate flotation cost for comparison is 3.0%, not the 3.9% figure that includes both flotation costs and equity dilution. This fact shows that NS's claim that a 2.1% flotation fee is a conservative estimate is wildly off-base. If equity flotation costs decline as the size of the offering increases as NS contends, the DRR would pay significantly less than what BN paid.

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[27] See "SEC News Digest," Issue 91-190, October 1, 1991 at page 6.

[28] See STB e- work paper "D42125 Exhibit III-H-1 STB No3 Corrected STB.xlm," worksheet "Interest."

[29] See Railroad Cost of Capital – 1991, 8 I.C.C. 2d 402, 404, 415 (n. 14) (1992).

This is supported by one of the dated academic papers NS relies upon to support high equity floatation costs, which shows that the cost difference in equity flotation costs and fees between an equity offering raising \$19.9 million and an offering raising \$499.9 million was approximately 510 basis points, or 5.1 percentage points.[30] In other words, a \$480 million difference in the amount of common equity issued reflected a 5.1 percentage point difference in flotation costs. Yet NS asserts that a \$29.1 billion difference between BN's 1991 equity issuance and the DRR's issuance would only see a 90 basis point, or 0.9 percentage point, difference in equity flotation fees when the true cost of BN's 1991 issuance is measured.[31] If there are truly economies of scale in equity flotation, as NS believes, the costs to issue DRR equity would be significantly lower than the 2.1% advocated by NS for the DRR.

NS attempts to support its claim that the 2.1% flotation fee is conservative by also pointing towards the relatively recent Facebook IPO. NS acknowledges that the Facebook IPO would be different from the DRR's capital raising activities and that they operate in different industries with different economics, but contends that the only relevant differences are ones that would lead to lower equity flotation costs for Facebook than would be faced by the DRR. These other factors include high demand for Facebook stock which led to investment bankers lowering their fees for the business, and the idea that Facebook, being an established firm, would face lower fees than a "greenfield" stand-alone railroad. NS grossly oversimplifies the IPO pricing picture, and fails to take into consideration the numerous factors that dictate IPO pricing, besides expected demand for the common stock and the size of the issuance. These factors include, but

[30] See NS Reply work paper "III-G Costs of Raising Capital.pdf," at page 62. The costs for an offering between \$10 million and \$19.9 million was 11.63 percent and \$200 million and \$499.9 million was 6.53 percent.

[31] BN's 1991 equity flotation fees, excluding the stock dilution costs, was 3.0 percent. Subtracting NS's proposed DRR equity flotation costs of 2.1 percent leaves a 0.9 percent difference.

are not limited to, issuing company risk, issuing company industry, litigation risk, underwriter reputation, venture capital backing, estimated proceeds from the issue, firm age, and estimated return volatility to name just a few.[32] To assert that Facebook would pay a lower spread simply because it is an established firm with a popular name ignores the considerable research that shows equity pricing takes into consideration many relevant factors.

Given the clear lack of an acceptable and viable way to calculate the equity flotation costs for the issue size and nature of the DRR, the only course of action for the Board was to exclude those costs from the SAC evidence.

C. The Board Properly Rejected NS's Cost Evidence For Transportation Over The Residual NS As Unsupported And A Double-Count.

The Board rejected NS's proposed cost for transporting rail over the residual NS to the DRR railheads because the NS reply evidence was unsupported . Decision at 201. NS's petition for reconsideration engages in a revisionist characterization of the evidence without addressing the fundamental flaw in its evidence identified by the Board. NS Pet. at 10-12.

NS wrongly asserts that it offered the only evidence of record that accounted for transportation over the residual NS. Id. at 11. DuPont's unit cost (which NS accepted) was based on the price in NS's 2009 R-1 Report, which includes the cost of transportation over foreign railroads. Because the residual NS would be a foreign railroad as to the DRR, DuPont relied upon the inclusion of foreign rail transportation costs as representative of the cost that the DRR would incur over the residual NS. Thus, DuPont did offer separate evidence to account for this cost.

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[32] See Grace Qing Hao, "Securities Litigation, Withdrawal Risk and Initial Public Offerings," *Journal of Corporate Finance*, V. 17 (2011), 438-456 at page 451. The author in the article summarizes results from other peer-reviewed studies that examined the various determinants in gross-spreads in IPO literature, and notes that these other researchers found numerous statistically significant issues that impact pricing and fees.

On Reply, NS argued that its R-1 costs cannot be a fair representation of the DRR's foreign rail transportation costs over the residual NS because NS "obtains substantial amounts of rail from suppliers located on and near its lines," and thus does not incur significant foreign railroad transportation costs. NS Reply at III-F-139. But NS did not provide any support for its statement.[33] Furthermore, NS's addition of foreign line transportation costs to the unit costs based upon NS's R-1 report could result in a possible double count. Dup. Reb. at III-F-82.

NS's inaccurate contention that its evidence is the only evidence of record misrepresents the record in an attempt to force the Board into accepting NS's evidence. Thus, the Board should deny the NS Petition.

D. **The Board Properly Rejected NS's Lighting Costs for Construction.**

The Board rejected NS's attempt to impose lighting costs upon the DRR for night construction . Decision at 172-73. The Board's Decision is correct. Furthermore, NS's evidence is contradicted by evidence that DuPont submitted in rebuttal.

The lighting cost NS imposes upon the DRR is an impermissible barrier to entry. The "compressed time schedule" referenced by NS has existed in all previous SAC proceedings and is based on the time needed to construct the most difficult project on the SARR.[34] To construct the other components of the SARR during this time period, complainants, defendants and the Board all have assumed unlimited resources, consistent with SAC theory. Flouting this precedent, NS now argues that the DRR should be charged with the "costs of lighting that would be necessary to complete construction of the DRR on the compressed time scheduled [sic] posited by DuPont ." NS Pet. 13.

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[33] What little support NS did offer was in the form of impermissible new evidence in its Final Brief, at 145-47, which the Board properly discounted.

[34] WTU, 1 S.T.B. at 674.

But the Board rejected a near-identical argument in Arizona Public Service Co. v. Atchison, Topeka & Santa Fe Ry., 2 S.T.B. 367, 385-386 (1997) ("APS"), stating, "[u]nder that approach, there would be essentially no barriers to entry into the railroad industry…."[35] Of particular similarity to NS's argument, the defendant in that case argued that preliminary engineering costs would be greater for the SARR because of the increased effort necessary to meet the tight schedule assumed for construction. The Board rejected that argument because there was no evidence that the defendant also incurred additional costs of this nature. Id. at 386-87. Underlying the prohibition on barriers to entry is the notion that the incumbent should not benefit from entering the market in a piecemeal process over an extended period during which it earned income over the operating portions of its system. APS, 2 S.T.B. at 385; Coal Trading, 6 I.C.C.2d at 413. Thus, the proper question when assessing a potential barrier to entry is whether it involves "sunk costs that were not incurred by the incumbent." APS at 386. Here, NS has not shown that it incurred the lighting expenses that it assigns to the DRR.

Furthermore, NS never revealed its assumptions for concluding that the DRR even would need night work. Although NS assumed only 25 working days per month, it did not state how many working daylight hours it assumed.[36] NS Reply at III-F-116. Consequently, NS's lighting costs are unsupported. Neither did NS explain why it assumed only 25 working days per month when a typical month is 30 or 31 days long. To the extent that there would be only 25 working

[35] See also, Coal Trading Corp. v. Balt. & Ohio R.R., 6 I.C.C.2d 361, 413 (1990) ("Defendants' argument that they too would face these costs if they entered the market today is irrelevant to the question of whether entry barriers exist for this market.") ("Coal Trading").

[36] In Docket No. 42130, NS made an identical argument predicated upon 10 hours of daylight. See, Docket No. 42130, "Final Brief of Norfolk Southern Railway Company," p. 38, n. 50 (filed July 26, 2013). If NS used that same assumption in this case, DuPont presented evidence that, on the shortest days of the year, the time between the beginning and end of civil twilight (where the sun illuminates brightly enough for outdoor activities without the aid of lighting) was over 10.5 hours. Dup. Reb. at III-F-69. That time period would be even longer throughout the rest of the year.

days per month due to factors such as weather, the Board properly determined that the costs for nighttime work would be covered by the contingency factor. Decision at 173.

Finally, NS's position seems to be that the allotted number of crews cannot complete the assigned tasks without working into the night. If the DRR determines that this is the case, the DRR simply increases the number of crews. Because roadbed preparation costs are based on units, and not the number of personnel, increasing the number of crews does not increase the costs. Stated differently, whether it takes 10 crews completing 5 miles per day or 20 crews completing 2.5 miles per day, the costs are the same because they are based on units, e.g., cubic yards. NS ignores this basic fact.

E. **The Board Properly Rejected NS's Swell Factor Adjustment.**

The Board properly rejected NS's attempts to include a swell factor adjustment in the calculation of earthwork unit cost. Decision at 184-85. NS presents a convoluted and factually incorrect argument for reconsidering that decision. NS Pet. at 14-16.

In its evidence, NS claimed that a swell conversion factor is necessary because earthwork quantities are measured in Bank Cubic Yards ("BCY") by the ICC Engineering Reports,[37] while R.S. Means expresses hauling costs in Loose Cubic Yards ("LCY").[38] The Board, however, rejected NS's claim that the ICC Engineering Reports state earthwork quantities in BCY, noting that NS had not presented any support for this assertion, nor was the assertion self-evident. Decision at 185. Since the Engineering Reports do not specify bank cubic yards, loose cubic yards, or any other type of cubic yards, any application of a swell factor is speculative.

NS's Petition now backs away from NS's own evidence, claiming that the unit of measure in the Engineering Reports is not directly relevant to this issue. NS Pet. at 15 (n. 17).

[37] NS Reply at III-F-85; NS Final Br. at 140.

[38] NS Reply at III-F-86; NS Final Br. at 140.

But it has everything to do with this issue because, according to NS's own evidence, a conversion factor is required precisely because of this alleged difference in units.

Finally, NS claims that, "[i]n rejecting NS's evidence, the Board erroneously relied on an unsupported, broad-brush claim presented by DuPont for the first time in rebuttal that some unidentified contractors take additional hauling due to swell into account when they make bids for excavation." NS Pet. at 15, citing Dup. Reb. at III-F-50. Although NS claims that DuPont's statement is unsupported, NS itself agreed with that statement. NS Final Br. at 141. Ultimately, the point made by the Board is that, because Means reflects work being done and standard industry practice is to bid on earthwork in its compacted state, the Means earthwork costs already account for swell. Decision at 185. NS has not demonstrated anything improper about that conclusion.

F. **Ad Valorem Taxes.**

DuPont does not contest the presence of the error identified by NS in the Board's calculation of ad valorem taxes. However, because DuPont has sought reconsideration of the Board's adoption of NS's new methodology for calculating ad valorem taxes (see Dup. Pet. at 40-42), this error would become moot if the Board grants DuPont's Petition.

G. **Moveable Bridge Approach Spans.**

DuPont does not contest the error identified by NS.

H. **The Board's Terminal Value Correction Is Not Flawed.**

The Board accepted DuPont's evidence that the Discounted Cash Flow ("DCF") model contained an internal inconsistency between its cost of capital assumption that the DRR's capital structure would remain constant into perpetuity, and its terminal value calculation that assumed the SARR would be 100 percent equity financed during the period after year 20 and before the first assets are replaced in the replacement level of the model. Corrected Decision at 20-22.[39] To remedy this inconsistency, the Board accepted DuPont's adjustment to the DCF model's terminal value calculation to reflect the cost of capital assumption that the SARR's level of debt would remain constant into perpetuity, and that interest tax shields, consistent with this constant level of debt, are accounted for in the cash flow calculation.

NS objects to the terminal value adjustment accepted by the Board, stating that it contains two flaws. First, NS claims the Board made a conceptual error by introducing a new inconsistency into the DCF model by applying different financial assumptions between debt used for assets acquired during the construction period and debt used to acquire replacement assets. NS Pet. at 20. Second, NS asserts the STB made a mathematical error by overriding the interest payments in years 11 to 20 of the DCF model and instead using the average interest payments. Id. at 20-21. Both of NS's assertions are incorrect and should be ignored.

As to the alleged conceptual error, NS claims that, before the correction to the terminal value calculation, the DCF model was configured to assume that both debt used to acquire assets during the initial construction period and debt used to acquire replacement assets would be amortized over 20 years. Id. at 20. NS claims that, after the terminal value correction, the debt amortization assumptions are now different. Specifically, NS alleges that debt used to acquire the original assets is still amortized over 20 years, but there will be no amortization of debt used for the acquisition of assets in subsequent replacement cycles. Id. NS's claim that the terminal value adjustment introduces inconsistent assumptions is wrong for two primary reasons.

[39] The Corrected Decision, however, rejected the interest rates in DuPont's terminal value correction to reflect the holding that DuPont must pay down the principal on its capital investments. Corrected Decision at 21. DuPont has sought reconsideration of that holding. Dup. Pet at 34-36.

First, contrary to NS's statement, the Board's DCF model did not assume both debt associated with original assets and debt used for replacement assets would have a 20-year amortization period, but instead the DCF model assumed debt associated with replacement assets would be amortized over the lesser of the service life of the asset, or 20 years.[40] In the case of Public Improvement assets, debt used to acquire replacement assets would be amortized over 13 years, not 20 years as alleged by NS. This means that the conflicting assumption identified by NS in the DCF model, regarding debt associated with original and replacement assets, existed even prior to the terminal value correction accepted by the Board, not as a consequence of that correction.

Second, the terminal value correction will account for amortization of debt used to acquire future assets in the same manner as original DRR debt. NS states that there will be no amortization of debt for assets in subsequent asset replacement cycles. This ignores the fact that the debt reflected in the terminal value calculation is there to perpetually replace future assets (as well as to account for other corporate needs as debt is used by real-world railroads). Stated differently, the correction assumes that the debt to acquire the original assets and the debt used to acquire future assets will both be amortized over 20-year periods. If anything, the terminal value correction adopted by the Board removes an inconsistency that was already present in the DCF model.

As to the alleged mathematical error, NS claims that the Board overstated the amount of interest the DRR would pay in years 11 through 20. NS Pet. at 20-21. NS claims that, because interest payments are lower than average in the later years of the amortization period, the use of average interest payments over this period overstates the interest expense. Id. at 20. However,

[40] See STB electronic work paper "D42125 Exhibit III-H-1 STB No3 Corrected STB.xlsm," worksheet "Replacement," cell V19.

NS's claim fails to consider that, while the interest payments in the second half of the 20-year amortization period are lower than the average interest payment, the interest payments in the first half of the amortization period are higher. In other words, the use of an average interest payment within the perpetuity calculation already takes into consideration the lower interest payments that occur in the second half of the amortization period just as it takes into consideration the higher interest payments in the first half of the period.

Neither of NS's claims about the terminal value correction warrants reconsideration of the Board's Decision. Far from introducing another inconsistency to the DCF model, the correction made by the Board removes a current inconsistency in how debt issued for original investments and future investments was amortized. The Board's correction also does not lead to a mathematical error by overriding scheduled interest payments, but instead simply reflects the use of an average value over time. The Board should reject NS's petition and retain the terminal value approach applied in the Decision.

I. The Board's Treatment of PTC Costs Properly Eliminates the PTC-Mandate As A Barrier To Market Entry.

The Board agreed with DuPont that the DRR could implement PTC in 2009, but it agreed with NS that the DRR would need to incur costs to upgrade that initial system to be RSIA-compliant[41] between 2009 and 2015. Decision at 228-30. NS contends that the Board's hybrid resolution of this issue is arbitrary because the parties' evidence does not allow for such an approach. NS Pet. at 21-25. The NS Petition, however, is principally an attempt at another chance to pile more costs upon the DRR by re-arguing NS's position that PTC could not be installed by the DRR in 2009. While NS seemingly accepts the Board's holding that the DRR

[41] Rail Safety Improvement Act of 2008 § 104, Public Law 110-432, 122 Stat. 4854 (Oct. 16, 2008), codified at 49 U.S.C. § 20157.

could install a PTC system in 2009, NS still would duplicate nearly every cost component in 2015 to install an RSIA-compliant system.[42] In other words, NS is claiming that, even if the DRR does not have to build a CTC system in 2009 followed by a PTC system in 2015, it still must build two PTC systems, one in 2009 followed by a different PTC system in 2015. But this was not the Board's conclusion and it would defeat the purpose of installing a PTC system from the outset of the DRR's operations.

DuPont separately has sought reconsideration of the Board's determination that the DRR must incur upgrade costs from 2010-2015 to implement an RSIA-compliant PTC system by the end of 2015. Dup. Pet. at 36-38. Specifically, DuPont contends that such a requirement creates a barrier to entry by imposing two sets of PTC costs upon the DRR within the same period in which NS itself would incur only a single set of costs to accomplish the same objective. Since this would impose a risk upon the DRR's investors that is not faced by NS's investors over this same time period, the imposition of upgrade costs is an impermissible barrier to entry.[43] In order to remove this barrier to entry under the unique circumstances of the PTC mandate, the Board should assume that the DRR will construct an RSIA-compliant PTC system, regardless of whether such a system could have been constructed in 2009. If the Board agrees with DuPont, NS's reconsideration argument will be moot.

Regardless, even if the Board continues to require that the DRR incur PTC upgrade costs, NS's Petition is without merit because the Board's treatment of PTC costs in the Corrected

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[42] See NS Pet. at 24 (n. 30) ("NS believes that only the antennas and towers installed in 2011 [sic] would likely not require replacement in order to upgrade the initial PTC system to RSIA 2015 standards.").

[43] See, PPL Montana, LLC v. The Burlington Northern and Santa Fe Ry. Co., 5 S.T.B. 1105, 1111-12 (2001) (holding that "a SARR should not be assumed to bear costs that are not faced by the defendant railroad [including]...costs associated with risks not faced by the defendant railroad's investor.").

Decision, by reallocating a portion of the 2009 PTC costs to the 2010 to 2015 time period, can produce a result that also properly eliminates the PTC-mandate as a barrier to entry. Much of NS's complaint as to how the Board would implement its hybrid approach was addressed in the Corrected Decision. The Board moved certain PTC development costs from the 2009 time period to the 2010 to 2015 period, without increasing the total PTC cost. In contrast, NS would add upgrade costs to the 2009 costs, thereby increasing the total PTC costs for the DRR. The Board's solution was appropriate because, otherwise, the DRR would incur more costs than NS itself to implement a fully interoperable, RSIA-compliant PTC system, because the DRR's costs are based upon NS's costs to implement such a PTC system. Thus, regardless of whether the Board assumes a fully interoperable, RSIA-compliant PTC system in 2009 as DuPont advocates, or imposes an upgrade requirement for 2015 as NS advocates, the Board must limit the total expense to the 2009 costs developed by the parties.

Although neither DuPont nor NS advocated this particular solution, the Board has authority to devise its own solutions to intractable differences between the parties' evidence. PSCo/Xcel I at 33 (holding that the Board "has broad discretion to apply any appropriate analytical tool to the evidence, on its own motion or otherwise."). In PSCo/Xcel I, the Board exercised its discretion in a significant way that departed from the evidence presented by either party. The parties had submitted operating plans based upon different traffic volumes. The Board, however, selected the complainant's volumes but the defendant's operating plan, which was based on the defendant's volumes. Because "reopening the record for supplemental evidence would be neither simple nor desirable," the Board itself "developed an approach for addressing this issue." Id. at 29. The Board has taken a similar practical approach with PTC in this proceeding.

In order to implement its decision, the Board first determined which party's cost evidence to accept for the various PTC system components. It then identified certain costs that the DRR would incur in the Base Year to initiate service with a basic PTC system. The Board also identified interoperability and upgrade costs that the DRR would incur between 2010 and 2015 and spread those costs over this time period.[44] NS's Petition essentially challenges those cost allocations by attempting to assign all of the costs to 2009 and then duplicate most of those costs again from 2010 to 2015. Clearly that is not what the Board intended.

NS offers two alternative solutions to the problem that it perceives with the Decision. The first proposal, which NS prefers, essentially would impose the same PTC costs upon the DRR twice. NS Pet. at 23-24. It also contains numerous other errors.[45] The second proposal would re-open this proceeding for the submission of supplemental PTC evidence. Id. at 24-25. For the reasons set forth herein, DuPont opposes both proposals; however, if the Board grants the NS Petition (which it should not), it should do so by requesting supplemental evidence under the second proposal.

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[44] In the Corrected Decision, the Board denied the DRR any bonus depreciation on the PTC upgrade costs. DuPont has sought reconsideration of that determination if the Board rejects DuPont's request to reconsider the imposition of PTC upgrade costs at all. Dup. Pet. at 38-39.

[45] NS's proposed first solution contains multiple errors. First, NS fails to implement the technical correction for tax depreciation shields to which it has agreed in the "Joint Supplemental Petition for Technical Corrections of Norfolk Southern Railway Company and E.I. DuPont de Nemours & Company," filed on November 12, 2014. Second, NS has calculated tax depreciation for the 2010 to 2015 PTC investment using a 7-year Modified Accelerated Cost Recovery System schedule for assets placed in service in the second quarter of the year. However, because the 2010 to 2015 PTC investments are annual figures, Board precedent calls for assuming the assets are placed in service in the first quarter of the year. Third, NS did not include any salvage percentage in its replacement calculations, which is inconsistent with the Board's treatment of the PTC investment installed prior to 2010 when the Board included a 5 percent salvage value. See STB DCF model worksheet "Replacement ," cell O38.

J. The Board Correctly Applied Bonus Depreciation to the DRR Consistent With SAC Principles.

NS asserts that the Board erred in permitting the DRR to rely on bonus depreciation available to it under laws that applied at the time of construction. NS Pet. at 25-27. NS contends that bonus depreciation "would place the DRR at a distinct and unfair financial advantage over the real-world NS." Id. at 25. The advantage would be unfair, according to NS, because it exists "solely as a byproduct of the artificially short construction period assumption," and thus acts as a "reverse barrier to entry" because it confers "a large benefit on the SARR that was not available to the incumbent." Id. at 25-26. These arguments, which merely rehash the same arguments that NS made in its reply evidence, fail to demonstrate any material error in the Board's rejection of those arguments.

The Board rejected NS's arguments against bonus depreciation because "NS's approach would require the DRR to bear any disadvantages of its construction timing while denying it the tax advantages available during that timing. The fact that the SARR's construction is assumed to occur during a limited time frame, which may result in efficiencies unavailable to the incumbent, does not make it a reverse barrier to entry as NS argues." Decision at 278 [emphasis added]. NS challenges the Board's logic on grounds that the Board did not identify any disadvantages that a SARR would face as a result of construction timing and suggests that is because there are no such disadvantages. NS Pet. at 26 (n. 31). NS is incorrect.

A SARR is exposed to numerous disadvantages from the short construction time frame. The SARR must pay current market prices for land, materials and labor, regardless of what the incumbent may have paid (unless the incumbent paid nothing, in which case the SARR also pays nothing). These prices could be elevated during the brief period of SARR construction, thus forcing the SARR to expend far more than under normal conditions. The viability of a SARR can also be negatively impacted by prevailing debt interest rates. The cost of capital utilized by the Board in the DCF model includes both an equity component and a debt component.[46] The debt component is based upon the average railroad industry cost of debt during the SARR construction period.[47] If the SARR construction period coincides with a period of high interest rates for debt, the SARR would be saddled with extra debt costs as a direct consequence of the "artificially short construction period assumption." NS Pet. at 26. Compared to the SARR, the defendant would have incurred low to moderate levels of debt over many decades of financing, thus smoothing out any period of high interest rates. Indeed, to the extent that NS ever issued debt during periods of high interest, it would have refinanced that debt at the earliest opportunity once interest rates declined, which is not an option available to a SARR in the SAC analysis.

Conceptually, NS's proffered solution also is faulty. NS concedes that the DRR is entitled to some bonus depreciation, but only to the same extent that NS itself took advantage of bonus depreciation during the DRR construction period. NS Pet. at 26-27.[48] However, this gives an unfair advantage to NS in at least two different ways.

First, because NS was not constructing brand new rail lines, it did not have as many construction projects as the DRR during the SARR construction period. Thus, even absent the assumption of unconstrained resources, the DRR would and could have taken greater advantage of bonus depreciation than NS itself was able to do. Yet, NS not only would restrict the DRR to NS's real-world bonus depreciation levels but it would further restrict the DRR to a mileage

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[46] See, e.g., Railroad Cost of Capital - 2013, STB Ex Parte No. 558 (Sub-No. 17) (served July 31, 2014).

[47] See, e.g., AEP Tex. North Co. v. BNSF Ry. Co., Docket No. 41191 (Sub-No. 1), slip op. at 107 (served Sept 10, 2007).

[48] See also, NS Reply at III-H-6 (filed Nov. 30, 2012).

prorated subset of NS's actual bonus depreciation. NS Reply at III-H-6. The Board properly rejected this attempt to impose a barrier to entry upon the DRR.

Second, because NS constructed its real-world rail lines over the course of the past century, it had multiple opportunities to take advantage of tax advantageous programs like bonus depreciation in other time periods that are not available to the DRR. These include, but are not limited to:

- The Revenue Act of 1962 that enacted an investment tax credit ("ITC") equal to 7 percent of qualified investment property;
- The Tax Reform Act of 1969 that established rapid depreciation of railroad rolling stock;
- The Revenue Reform Act of 1971 which updated the ITC and allowed a 3-year carryback and 7-year carry forward of the credits which could not be used in current years because of tax liability limitations;
- The Tax Reduction Act of 1975 that increased the ITC to 10 percent for all taxpayers and increased the tax liability limitations for railroad companies;
- The Tax Reform Act of 1976 that extended the 10 percent ITC through December 31, 1980;
- The Revenue Act of 1978 which permanently increased the ITC to 10 percent instead of reverting to a 7 percent ITC beginning in 1981, and extended the ITC to certain qualified rehabilitation expenditures;
- The Economic Recovery Act of 1981 which allowed for more generous ITC amounts, the enactment of safe-harbor leasing laws and increases in the credits available for qualified rehabilitation projects;
- The Job Creation and Worker Assistance Act of 2002 which enacted a 30 percent bonus depreciation rate for the years 2002 to 2004; and
- The Jobs Growth and Tax Reconciliation Act of 2003 that increased the bonus depreciation to 50 percent and extended its use to 2005.[49]

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[49] NS's 2005 SEC Form 10-K discusses NS's use of bonus depreciation during the 2002 to 2005 time period. See NS 2005 SEC Form 10-K, at page K-21.

Because these investment incentives were not available to the DRR during its short construction period, NS's claim of unfairness works both ways. The Board properly applied existing law to the DRR just as NS and its predecessors made use of existing law during development of the rail lines replicated by the DRR.

NS also makes the claim that, since the Board has previously decided in its WTU decision that a SARR is a replacement, and not a competitor, for the segment of the incumbent's rail system the SARR would serve, the SARR should not be able to enjoy any benefits not fully available to the incumbent railroad. NS Pet. at 27. NS therefore argues that, since it was unable to enjoy the full benefits of the limited-time bonus depreciation, the SARR's bonus depreciation should be similarly restricted. The logical extension of NS's argument, however, is that the SARR must be constructed and operated in the same manner as the incumbent if the SARR is stepping into the incumbent's shoes. But, the Board consistently has rejected this line of logic. The stand-alone replacement, in fact, does not even need to be another railroad.[50]

Furthermore, the WTU decision recognized the trade-off in benefits between the SARR and the incumbent. The STB stated that, while a SARR may find benefits accruing from the fact that it has a shorter construction period than the incumbent, the incumbent benefited from building its system in a sequential manner, allowing it to earn returns on individual line segments before the incumbent's entire system was complete.[51] Therefore, while the SARR may benefit in some way from its compressed construction schedule, any benefits are counterbalanced by the benefits the incumbent received from generating returns from its network while still under

[50] See Coal Rate Guidelines, Nationwide, 1 I.C.C.2d 520, 543 (1985). See also, Western Fuels Assoc., Inc. v. BNSF Ry. Co., Docket No. 42088, slip op. at 14 (served Feb. 18, 2009) ("Finally, using the densities of the hypothetical SARR makes no sense, as under SAC the hypothetical competitor to BNSF does not even need to be a railroad at all.).”

[51] See WTU at 671-72.

construction. Indeed, elimination of barriers to entry in the SAC analysis requires that the incumbent not benefit from entering the market in a piecemeal process over an extended period. APS, 2 S.T.B. at 385; Coal Trading, 6 I.C.C.2d at 413.

NS's claim that the DRR's application of bonus depreciation under available tax law creates a reverse barrier to entry is a red herring. NS significantly benefited from the same bonus depreciation that the DRR seeks to use, while simultaneously benefiting from prior year tax laws and regulations to obtain tax benefits not available to the DRR. In addition, NS's claim that, as a replacement carrier, the DRR cannot achieve benefits above and beyond those received by the NS is contrary to Board precedent and ignores the point that the DRR must pay current market prices for its investment and lose the benefits of building its network in a sequential manner as NS built its network. Finally, NS's proffered alternative would be a clear barrier to entry by denying the SARR even the ability to take advantage of bonus depreciation to the same extent as NS did during the DRR's construction period. Given the limitations placed upon the DRR, the STB must continue to allow the DRR to claim the bonus depreciation allowed under applicable tax law.

K. The Board Adopted the Best Evidence of Record for Failed Equipment and Dragging Equipment Detectors.

NS's claim that DuPont's quantities of Failed Equipment Detectors ("FEDs") and Dragging Equipment Detectors ("DEDs") do not meet current AREMA standards is disingenuous. NS asserts that, because the 2007 AREMA Manual supersedes the detector spacing guidelines in the 2001 AREMA Manual, which DuPont used to derive its FED and DED quantities, DuPont's detector quantities are inconsistent with current industry standards. NS Pet. at 27-28. NS's assertion proceeds from the illogical assumption that detector spacing based on the 2001 AREMA Manual cannot satisfy the 2007 standards. But NS has not explained how DuPont's spacing conflicts with the 2007 AREMA Manual.

Unlike the objective standard in the 2001 AREMA Manual used by DuPont, the 2007 AREMA Manual identifies a multitude of subjective factors. NS Reply at III-F-247. NS has not demonstrated that the 2001 objective standard is inconsistent with the 2007 subjective standard. Rather, NS baldly claims that its current spacing of 15 miles is based on the 2007 AREMA standard and thus represents the best evidence. Id. But NS has not attempted to apply the multitude of 2007 AREMA factors to the DRR either to justify its detector spacing or to criticize DuPont's spacing. Because DuPont's evidence is based upon an objective and supported industry measure, whereas NS's evidence is based upon the unsupported assertion that the DRR must do what NS does, the Board rationally accepted DuPont's evidence.

III. **CONCLUSION.**

For all of the foregoing reasons, DuPont requests that the Board deny the NS Petition for Reconsideration of the Decision and Corrected Decision, except to the extent that DuPont has concurred with NS on specific matters.

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CERTIFICATE OF SERVICE

I hereby certify that this 12th day of December 2014, I served a copy of the foregoing via e-mail and first class mail upon:

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