

BEFORE THE
SURFACE TRANSPORTATION BOARD

241171

ENTERED
Office of Proceedings
July 26, 2016
Part of
Public Record

CONSUMERS ENERGY COMPANY)

Complainant,)

v.)

CSX TRANSPORTATION, INC.)

Defendant.)

Docket No. NOR 42142

**REPLY TO COMPLAINANT’S PETITION FOR LEAVE TO FILE
SUPPLEMENTAL EVIDENCE OF EQUITY FLOTATION COSTS**

Consumers’ Petition for Leave to File Supplemental Evidence of Equity Flotation Costs (“Petition”) rests on two false premises. The first is that the Board’s June 29 decision in *Sunbelt Chlor Alkali Partnership v. Norfolk Southern Railway Company* “reversed prior precedent” about the need to account for equity flotation costs in the SAC analysis.¹ It did not. Before Consumers filed its evidence, the Board had made clear in both *SunBelt I* and *DuPont* that “it would be unreasonable to assume that the SARR would raise . . . [the necessary capital] without paying some form of equity flotation fee.” *SunBelt I* at 184.² While *Sunbelt II* reconsidered the Board’s initial rejection of the specific evidence of flotation costs offered in that

¹ The Board’s June 18, 2014 decision in *Sunbelt Chlor Alkali Partnership v. Norfolk Southern Railway Co.*, NOR 42130, is referred to as *Sunbelt I*, and its June 29, 2016 decision partially granting and partially denying petitions for reconsideration is referred to as *Sunbelt II*.

² See also *E.I. du Pont de Nemours & Co. v. Norfolk Southern Ry. Co.*, at 274, STB Docket No. NOR 42125 (served Mar. 24, 2014) (“*DuPont*”) (same).

proceeding, the Board did not change its *Sunbelt I* recognition that it is “unreasonable” to think that a SARR would not have to pay “some form of equity flotation fee.” Consumers nevertheless made the unreasonable choice to assume no equity flotation fees, and it has no excuse for waiting until now to try to change course.

The Petition’s second false premise is that a party ought to be allowed to alter its evidence if an intervening decision causes the party to rethink its evidentiary choices. But supplemental evidence is only permitted in rare circumstances where the Board has made a substantial methodological change or where the Board itself needs additional information to complete the SAC analysis. The Board did not change any rule or methodology here. On the contrary, the *Sunbelt I* rule that a SARR must pay “some form of equity flotation fee” was unchanged by *Sunbelt II*. Allowing supplemental evidence in situations like this one would make it impossible for the Board to comply with Congress’s clear directive to streamline the handling of rate cases. Consumers is not entitled to a “do over” on this issue, and its Petition should be denied.

I. Consumers Had Ample Notice of the Need to Address Equity Flotation Costs in Its Opening Evidence.

The story Consumers tells in its Petition is one in which a complainant relied on a well-established “prevailing rule” that equity flotation costs “should be excluded entirely” from the SAC analysis, only to be blindsided when that precedent was unexpectedly changed. Petition at 2. That is simply not an accurate account of the procedural history of this issue.

When Consumers filed its Opening Evidence on November 2, 2015, the Board had established in both *DuPont* and *Sunbelt I* that equity flotation costs were not included in the railroad industry cost of capital and that a flotation cost is a fee that a SARR would incur when raising capital to construct the SARR network. See *Sunbelt I* at 184; *DuPont* at 274. Indeed, the Board went so far as to say “it would be unreasonable” to assume that a SARR could raise capital “without paying some form of equity flotation fee.” *Id.* The Board held in both decisions, however, that the railroad had not provided sufficient evidence to support its proposed flotation fee.

Consumers nevertheless chose not to include an equity flotation fee in its opening evidence. Consumers acknowledged the decision in *Sunbelt I*, but argued that the “complexity” of determining equity flotation costs and the alleged lack of “reasonable surrogates” for the SARR justified its decision to include no such costs. Open. at III-G-5. CSXT’s Reply Evidence showed that reasonable surrogates were available if one chooses to look. CSXT presented a detailed expert analysis of equity flotation costs for similarly-sized offerings, which demonstrated that the average underwriting spread of 535 IPOs of \$100 million or more in all industries that came to market over the past decade was 6.3%. See Reply at III-G-1 through III-G-5.

On Rebuttal, Consumers admitted that *Sunbelt I* was “contrary” to prior cases on flotation costs and floated an improper new argument that *Sunbelt I* failed to appropriately explain the Board’s conclusion that it would be unreasonable to exclude equity flotation costs from the SAC analysis.³ Consumers then made an extensive new argument about how the SARR could use a private placement process

³ Rebuttal at III-G-2; see Motion to Strike at 13.

to obtain equity at a potentially lower cost than a public placement.⁴ Consumers' new argument did not, however, include any calculations of the equity flotation fees for such a private placement.

This procedural history cannot be squared with the assertions in Consumers' Petition. It is not true that at the time Consumers filed its Opening Evidence the "prevailing rule" was that equity flotation costs "should be excluded entirely." Pet. at 2. Both *Sunbelt I* and *DuPont* disprove that claim.⁵ And it is not true that Consumers never had "a fair chance to present probative evidence as to what that cost reasonably should be." *Id.* at 4. It had two chances. One was on opening, when it had an opportunity to present the sort of equity flotation cost evidence contemplated by *SunBelt I* and *DuPont*. And the second was on Rebuttal, when it had the right to present evidence arguing that CSXT's equity flotation cost evidence was "unsupported, infeasible or unrealistic" and to present its own calculations.⁶

In short, before Consumers filed its Opening Evidence the Board made clear that SARRs would incur equity flotation costs; Consumers was well aware of that precedent; and it nevertheless made the strategic decision to question CSXT's evidence without presenting any alternative calculations. "A party that does not put forward its best case as to all elements of its case assumes the risk of that strategic

⁴ This new argument is also improper rebuttal. *See id.* at 24-26.

⁵ Moreover, Consumers' Rebuttal attacks on *Sunbelt I* belie any claim that it was unaware of *Sunbelt I*'s holding that equity flotation costs are appropriate in a SAC analysis.

⁶ *Duke Energy Corp. v. Norfolk Southern Ry. Co.*, 7 S.T.B. 89, 101 (2003) ("*Duke/NS*").

choice,”⁷ and the fact that Consumers now is having second thoughts about its strategy does not justify supplemental evidence.⁸

II. Supplemental Evidence Is Only Appropriate When The Board Has Made a Methodological Change That Could Have a Significant Impact on a Party’s SAC Presentation.

Consumers’ Petition cites two cases where the Board allowed supplemental evidence that Consumers asserts are “[c]learly” analogous to this case. Petition at 3 (citing *Western Fuels* and *Otter Tail*). But examination of these cases only illustrates how inappropriate supplemental evidence would be here. In each case, the Board was faced with a situation in which an unexpected change to substantive standards made it unfair to not allow a party to change its presentation. Neither case can justify allowing supplemental evidence where Consumers had every opportunity to submit the sort of equity flotation cost evidence called for by *Sunbelt I* and simply made a strategic decision not to do so.⁹

⁷ *PPL Montana, LLC v. BNSF Ry. Co.*, at 2, STB Docket No. 42054 (served June 30, 2003).

⁸ Indeed, a decision in *Total Petrochemicals USA, Inc. v. CSX Transportation, Inc.* is scheduled to be issued before this case is decided, and many issues in that case likely will have some relevance to issues that are disputed here. Will Consumers then be asking again to revise some of its evidence?

⁹ The Board sometimes makes a *sua sponte* request for supplemental evidence that it believes is necessary to complete its analysis of a case. *See, e.g., Total Petrochemicals USA, Inc. v. CSX Transportation, Inc.*, STB Docket No. 42121 (served July 24, 2015). Such requests are categorically different from instances like the Petition where a party asks for permission to file supplemental evidence to revise an earlier submission.

*Western Fuels Association*¹⁰ is a good example of the extraordinary circumstances that are typically necessary to permit supplemental evidence. There the parties initially submitted three rounds of evidence in 2005. *See WFA I* at 4. The Board then held the proceeding in abeyance while it considered changing certain SAC methodologies in Ex Parte 657, including the revenue allocation methodology for cross-over traffic.¹¹

After the final Ex Parte 657 rule was adopted in October 2006,¹² the Board ordered the *WFA* parties to file supplemental evidence “to reflect the methodological changes adopted in *Major Issues*,” *WFA I* at 3, and it proceeded to issue a decision that applied the *Major Issues* methodological changes to *WFA*’s initial SAC presentation. But the Board acknowledged that *WFA* “had designed its case under one standard, only to have it judged under another,” and specifically that *WFA*’s traffic selection likely would have been far different if had known that the new *Major Issues* revenue allocation standards would be applied to its evidence. *WFA II* at 9; *see WFA I* at 3. The Board cautioned that “it is not the Board’s practice to permit complainants to redesign their case in light of subsequent Board decisions,” but that it would depart from this practice because the intervening rule change “would affect the basic design of a SAC case.” *WFA I* at 20.

¹⁰ *Western Fuels Ass’n, Inc. v. BNSF Ry. Co.*, STB Docket No. 42088 (served Sept. 10, 2007) (“*WFA I*”); *Western Fuels Ass’n, Inc. v. BNSF Ry. Co.*, STB Docket No. 42088 (served Feb. 18, 2009) (“*WFA II*”).

¹¹ *See Major Issues in Rail Rate Cases*, STB Ex Parte 657 (Sub-No. 1) (served Feb. 27, 2006) (Notice of Proposed Rulemaking).

¹² *See Major Issues in Rail Rate Cases*, STB Ex Parte 657 (Sub-No. 1) (served Oct. 30, 2006) (final rule).

Otter Tail similarly allowed supplemental evidence only after a change in the Board's revenue allocation methodology. Specifically, after *Otter Tail* filed its opening evidence, the Board decided *Duke/NS*, 7 S.T.B. at 110, in which the Board adopted a "Modified Straight-Mileage Prorate" method for revenue allocation. *Otter Tail* then asked to revise its opening evidence, arguing that it should be allowed "to adjust its data to conform with the Board's method for allocating cross-over revenues."¹³ The Board agreed to the request for supplemental evidence because "it will provide the Board with more relevant evidence and allow it to apply recent precedent."¹⁴

These decisions to allow supplemental evidence after significant changes to revenue allocation methodologies are not remotely analogous to the situation here, where Consumers simply chose not to present equity flotation cost evidence despite two Board decisions indicating that it was unreasonable to ignore those costs. A change to a revenue allocation methodology implicates traffic selection and the fundamental design of a SARR. The proper amount of equity flotation costs does not. And where a party has already had two opportunities to present its own

¹³ *Otter Tail Power Co. v. BNSF Ry. Co.*, STB Docket No. 42071, at 1 (served Nov. 21, 2003).

¹⁴ *Id.* Consumers' citation of *Hatch v. FERC*, 654 F.2d 825, 835 (D.C. Cir. 1981), is similarly inapposite, for this case is plainly not one where the Board "change[d] a controlling standard of law" and did not provide "actual notice of the operative standard." The operative standard was announced in *Sunbelt I* and *DuPont*, and Consumers has no one but itself to blame for its decision not to present evidence to meet that standard.

calculation of equity flotation costs, there is no reason to grant that party yet another round of evidence. The Petition should be denied.¹⁵

CONCLUSION

For the foregoing reasons, Consumers' Petition for Leave to File Supplemental Evidence of Equity Flotation Costs should be denied.

Respectfully submitted,



Peter J. Shudtz
Paul R. Hitchcock
John P. Patelli
CSX Transportation, Inc.
500 Water Street
Jacksonville, FL 32202

Raymond A. Atkins
G. Paul Moates
Matthew J. Warren
Terence M. Hynes
Hanna M. Chouest
Marc A. Korman
Sidley Austin LLP
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000
(202) 736-8711 (fax)

Counsel to CSX Transportation, Inc.

Dated: July 26, 2016

¹⁵ CSXT also notes that Consumers proposes a grossly unfair schedule in which it would give itself triple the amount of time to prepare supplemental evidence as it would allocate to CSXT. *See* Petition at 4 (proposing thirty total days for Consumer evidence (20 for opening plus 10 for Rebuttal) and only ten for CSXT Reply Evidence). Even in a case where supplemental evidence might be appropriate, it would never be fair and reasonable to adopt such a one-sided schedule.

CERTIFICATE OF SERVICE

I hereby certify that on this 26th day of July, 2016, I caused a copy of the foregoing Reply to Petition for Leave to File Supplemental Evidence of Equity Flotation Costs to be served by hand delivery or more expeditious means upon:

Kelvin J. Dowd
Slover & Loftus LLP
1224 Seventeenth Street, N.W.
Washington, D.C. 20036


Alec J. Weingart