

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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SUNBELT CHLOR ALKALI PARTNERSHIP )

Complainant )

v. )

NORFOLK SOUTHERN RAILWAY COMPANY )

Defendant )

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) Docket No. NOR 42130

) 234584

) ENTERED

) Office of Proceedings

) July 26, 2013

) Part of

) Public Record

**FINAL BRIEF OF  
SUNBELT CHLOR ALKALI PARTNERSHIP**

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## ACRONYMS

This table defines the acronyms used in this Brief.

ATC	Average Total Cost
CAGR	Compound Annual Growth Rate
CTC	Central Traffic Control
DCF	Discounted Cash Flow
G&A	General and Administrative
I&I	Intertrain and Intratrain
LRP	Long Range Plan
MMM	Maximum Markup Methodology
MOW	Maintenance of Way
NS	Norfolk Southern Railway Company
PTC	Positive Train Control
RMI	A GE Transportation Company
RTC	Rail Traffic Controller Model
SAC	Stand-Alone Cost
SARR	Stand-Alone Railroad
SBRR	SunBelt Railroad
STB	Surface Transportation Board
T&E	Train and Engine
TCS	Triple Crown Services
TDIS	Thoroughbred Direct Intermodal Service
TIH	Toxic Inhalation Hazard
UP	Union Pacific Railroad
URCS	Uniform Railroad Costing System

## CASE GLOSSARY

This table defines the abbreviated case names found in this Brief.

<u>AEP Texas</u>	<u>AEP Tex. N. Co. v. BNSF Ry.</u> , STB Docket No. 41191 (Sub-No. 1), slip op. (served Sept. 10, 2007).
<u>AEPCO</u>	<u>Ariz. Elec. Power Coop. v. BNSF Ry.</u> , STB Docket No. NOR 2113, slip op. (served Nov. 22, 2011).
<u>APS</u>	<u>Ariz. Pub. Serv. Co. v. Atchison, Topeka &amp; Santa Fe Ry.</u> , 2 S.T.B. 367 (1997).
<u>Coal Trading</u>	<u>Coal Trading Corp. v. Baltimore &amp; Ohio R.R.</u> , 6 I.C.C.2d 361, 413 (1990).
<u>CP&amp;L</u>	<u>Carolina Power &amp; Light Co. v. Norfolk S. Ry.</u> , 7 S.T.B. 235 (2003).
<u>Duke/CSXT</u>	<u>Duke Energy Corp. v. CSX Transp. Inc.</u> , 7 S.T.B. 402 (2004).
<u>Duke/NS</u>	<u>Duke Energy Corp. v. Norfolk S. Ry.</u> , 7 S.T.B. 89 (2003).
<u>EP 715 NPR</u>	<u>Rate Regulation Reforms</u> , STB Docket No. EP 715, slip op. (served July 25, 2012).
<u>EP 715 Rule</u>	<u>Rate Regulation Reforms</u> , STB Docket No. EP 715, slip op. (served July 18, 2013).
<u>FMC</u>	<u>FMC Wyo. Corp. v. Union Pac. R.R.</u> , 4 S.T.B. 699 (2000).
<u>Major Issues</u>	<u>Major Issues in Rail Rate Cases</u> , STB Ex Parte No. 657 (Sub-No. 1), slip op. (Oct. 30, 2006).
<u>McCarty Farms</u>	<u>McCarty Farms, Inc. v. Burlington N., Inc.</u> , 2 S.T.B. 460 (1997).
<u>Otter Tail</u>	<u>Otter Tail Power Co. v. BNSF Ry.</u> , STB Docket No. 42071, slip op. (served Jan. 27, 2006).
<u>TMPA</u>	<u>Tex. Mun. Power Agency v. Burlington N. &amp; Santa Fe Ry.</u> , 6 S.T.B. 573 (2003).
<u>West Texas</u>	<u>W. Tex. Utils. Co. v. Burlington N. R.R.</u> , 1 S.T.B. 638 (1996).
<u>Western Fuels I</u>	<u>W. Fuels Ass'n v. BNSF Ry.</u> , STB Docket No. 42088, slip op. (served Sept. 10, 2007).
<u>Western Fuels II</u>	<u>W. Fuels Ass'n v. BNSF Ry.</u> , STB Docket No. 42088, slip op. (served June 15, 2012).

Wisconsin

Wis. Power & Light Co. v. Union Pac. R.R., 5 S.T.B. 955 (2001).

Xcel

Pub. Serv. Co. of Colo. v. Burlington N. & Santa Fe Ry., 7 S.T.B. 589 (2004).

Xcel II

Pub. Serv. Co. of Colo. v. Burlington N. & Santa Fe Ry., STB Docket No. 42057, slip op. (served Jan 19, 2005).

Pursuant to the procedural schedule served by the Surface Transportation Board (“Board” or “STB”) in this docket on March 8, 2013, Complainant, SunBelt Chlor Alkali Partnership (“SunBelt”), hereby submits this Final Brief in support of its Complaint, as amended, against Defendant, Norfolk Southern Railway Company (“NS”). Because NS has not contested its market dominance over the issue movement, SunBelt has established the Board’s jurisdiction to determine whether the challenged rate is unreasonable. Thus, all of the contested issues in this case concern the proper application of the stand-alone cost (“SAC”) analysis. SunBelt has presented a SAC analysis, based upon well-settled principles, to establish the unreasonableness of the NS proportional rate for transporting chlorine from McIntosh, AL to New Orleans, LA.

Part I of this Brief dispels NS’s attempts to justify changes to the SAC analysis solely because the issue commodity is a Toxic Inhalation Hazard (“TIH”) material. That is a pretext for making result-oriented changes to address matters that either already are adequately addressed by, or are not appropriate for, a SAC analysis. SunBelt addresses the merits of the specific changes urged by NS in Parts IV.C and VI.E below

Part II addresses the core dispute in this case over the operating plan for the stand-alone railroad, which is called the SunBelt Railroad (“SBRR”). Subpart A explains why SunBelt’s operating plan is realistic, feasible and supported. Subpart B explains why NS’s operating plan is not, and also contrasts both plans to highlight the deficiencies in the NS approach. SunBelt developed its operating plan in accordance with the same methodology used by both parties in prior cases. SunBelt used NS train-event data to identify all of the trains that NS uses to serve the SBRR’s traffic group over the constructed facilities and then modeled those trains in its RTC simulation, essentially operating the same trains in the same manner as the real-world NS. NS, however, has contended that its train-event data is unsuitable for that purpose and has caused

SunBelt to develop a “fatally deficient and infeasible” operating plan. But NS does not explain how SunBelt’s operating plan, which is based upon the very same trains that NS operates today, is infeasible. Nevertheless, NS has chosen to completely discard the SunBelt operating plan and has introduced a new and expensive computer program, called MultiRail, in order to build brand new trains from the ground up. NS’s use of MultiRail to develop a new operating plan from scratch is a completely unnecessary task that divorces the SBRR’s operations from the real-world, adds new levels of complexity and cost to the SAC analysis, and results in substantial deviations from SAC principles.

Part III addresses the two major differences between the parties’ revenue calculations for the SBRR. These differences are attributed to SunBelt’s use of Modified Average Total Cost (“ATC”) versus NS’s use of Original ATC, and to accounting gimmicks that NS uses to deprive the SBRR of substantial intermodal revenue. In addition, SunBelt explains why its application of a compound annual growth rate based upon multiple years of data is superior to NS’s reliance upon a single year to forecast the SBRR’s traffic volumes. Lastly, SunBelt explains why cross-over traffic restrictions are not appropriate.

Part IV addresses differences over operating expenses. Most of those differences can be attributed to the parties’ different operating plans, and how those plans affect the amount of infrastructure, equipment and operating personnel required. There also are myriad unit cost differences that are not addressed in this Brief. SunBelt does address two major expenses categories that are not contingent upon the operating plan, General & Administrative (“G&A”) and Maintenance of Way (“MOW”) costs. In both instances, NS has improperly attempted to burden the SBRR with costs based upon NS’s larger and more diverse traffic base and its much older infrastructure. Finally, SunBelt explains why NS’s attempt to add an unprecedented new

operating expense that it calls “Excess Risk” is inappropriate, unnecessary, and flawed.

In Part V, SunBelt addresses the more significant road property investment disputes. As a general matter, NS has proposed many costs that the Board has repeatedly rejected in past cases and should reject again in this proceeding. NS also has used a deeply flawed methodology to inflate land values. But perhaps the most significant dispute concerns the use of Means Handbook unit costs for earthwork. Although the Board has used Means Handbook costs in the absence of better evidence from real world construction projects, SunBelt has presented evidence of such costs based upon the real-world Trestle Hollow project to demonstrate that the SBRR can obtain better prices than the Means Handbook estimates. Finally, SunBelt and NS strongly disagree whether the SBRR can construct an all-Positive Train Control (“PTC”) signaling system or whether it must first construct a CTC system that it would have to overlay with PTC just four years later.

Part VI addresses multiple disputes over how the Board should perform the Discounted Cash Flow (“DCF”) and Maximum Markup Methodology (“MMM”) analyses. SunBelt has advocated for two modifications of existing procedure whereas NS has advocated for three.

SunBelt seeks to modify the SBRR’s capital structure and the current methodology for calculating the present value of future interest payments in the terminal value calculation. The former is intended to accurately reflect real-world railroad capital structures, including that of NS. The latter fixes a flaw in the current methodology. NS does not contest the existence of the flaw, but simply seeks to justify it based on precedent.

In contrast, NS proposes three result-oriented modifications. First, NS injects equity flotation costs into the cost of capital despite the Board’s consistent rejection of similar attempts in prior cases. Second, NS attempts to deprive the SBRR of the full benefits of bonus

depreciation in violation of SAC principles. Third, NS attempts to modify the MMM analysis to allocate certain costs solely to TIH traffic. Apart from being unnecessary and inappropriate, this latter modification violates the Board's rules against movement-specific Uniform Rail Costing System ("URCS") adjustments and would be an impermissible modification by adjudication of a rule that originally was adopted through notice-and-comment rulemaking procedures.

Finally, Part VII addresses NS allegations of a cross-subsidy on the SBRR. Apart from the obvious fact that NS claim is based upon its SAC analysis, which is meaningless because the entire Stand-Alone Railroad ("SARR") fails under the NS analysis, NS has not provided proper templates for performing the cross-subsidy tests in accordance with Board precedent.

**I. THE SAC ANALYSIS DOES NOT NEED TO BE MODIFIED FOR TIH TRAFFIC.**

NS inappropriately seeks multiple modifications to the SAC analysis based upon allegations that the analysis does not recognize the unique costs and risks of transporting chlorine. NS Reply, at I-15 to -28. Specifically, NS uses these allegations as a pretext for creating a fictional operating cost that it calls "Excess Risk" and assigning that cost solely to TIH traffic, segregating and allocating insurance costs solely to TIH traffic, assigning 90 percent of PTC costs solely to TIH traffic, and modifying how the MMM analysis is applied. The NS argument is convoluted, inherently contradictory, and simply wrong. See SunBelt Reb. at I-5 to -20.

First, NS asserts broad public policy arguments as to the risks that the common carrier obligation forces NS to assume by requiring the transportation of TIH materials. But, as SunBelt has demonstrated, the issue movement exposes the hypocrisy of this argument because NS repeatedly has rejected SunBelt's requests for an alternative route that would shrink the total distance from 570 miles to 386 miles, and the NS portion from 570 miles to just 40 miles.

SunBelt Reb. at I-8 to -10. The fact of the matter is that the issue movement is too lucrative, despite all the alleged risks that NS supposedly would rather not bear, for NS to abandon its long-haul for a much shorter route.

Second, NS wrongly asserts that the risks it incurs when transporting TIH materials either are not included in the SAC analysis or should be included. NS Reply, at I-25 to -28. Those risks, which NS refers to as “negative externalities,” fall into two categories: those that fall upon NS and those that fall upon society. The SAC analysis, however, imposes upon the SARR every cost that NS itself incurs, such as special handling and security measures, PTC, liability insurance, and risk of catastrophic liability. SunBelt Reb. at I-13 to -14. In the case of catastrophic liability, NS incorrectly argues that the SARR may not respond to such liability the same as NS, by exiting the market through bankruptcy. Such a restriction would be an impermissible barrier to exit, which would violate the SAC requirement of a contestable market. With respect to societal externalities, it would not be appropriate to include those in the SAC analysis because those are not costs that NS incurs. *Id.* at I-14. The transportation of chlorine has both positive and negative externalities for society and, because it is the purview of Congress, not the Board, to balance those competing interests, the Board may not use the SAC analysis for this purpose. *Id.* at I-14 to -16.

Third, NS wrongly claims that non-TIH shippers are subsidizing the unique costs of TIH traffic. The costs that NS attempts to assign solely to TIH traffic are “Excess Risk,” a portion of its insurance costs, and PTC costs. SunBelt explains why NS is incorrect with respect to each of these cost categories in greater detail in Parts VI.C, 0, and VI.E, below.

Finally, NS attempts to address all of these allegedly unique TIH transportation costs through impermissible modifications to the MMM analysis. As NS itself has argued extensively

in its reply evidence, a legislative rule that an agency has adopted through a notice-and-comment rulemaking may not be amended or modified except through another such rulemaking proceeding. NS Reply Ex. III-A-4. NS's attempt to modify the MMM analysis through this adjudication is particularly hypocritical because the Board adopted the MMM procedures in the very same rulemaking proceeding in which it adopted the ATC procedures that NS claims the Board can only modify through another rulemaking.

## **II. SUNBELT DEVELOPED A FEASIBLE OPERATING PLAN FOR THE SBRR, CONSISTENT WITH BOARD PRECEDENT**

SunBelt developed the SBRR's operating plan in the same manner as the parties have done in every SAC case decided by the Board over the past decade. Those operating plans were based on the waybill, car-event, and train-event data produced by the railroads in discovery. As in past cases, the waybill and car-event data have been used to select the SARR traffic and to calculate revenue divisions. Also as in past cases, train-event data have been used to model the SARR's operations and to develop the operating plan. In other words, SunBelt developed its operating plan by operating the same trains as NS, in the same fashion, and with identical consists and routes, effectively adopting NS's real-world trip plans, car-blocking plans, and train-service plans for the SBRR.

SunBelt's task, however, was made all the more difficult by multiple flaws and deficiencies in NS's traffic data. Those difficulties are well-chronicled in SunBelt Opening Exhibits III-A-2, III-A-3, and III-C-1, and in Rebuttal Exhibit III-C-1. Although NS does not deny the existence of those flaws and deficiencies, it focuses upon each one individually in an attempt to diminish the real magnitude of the challenges faced by SunBelt. But NS's critique vastly understates the problem: not only were there flaws in each data set, but the flaws in the data sets were not consistent, thus creating enormous complications and contradictions. They

placed SunBelt in the position of having to make judgment calls regarding which data set was “more correct” than the other when the data contained in them did not agree. Now NS seeks to exploit those complications and contradictions by alleging that SunBelt’s use of NS’s own flawed and deficient data has resulted in a fatally flawed operating plan. NS may not do that.<sup>1</sup>

Although NS spends pages upon pages of its Reply explaining how SunBelt allegedly could have compensated for these data deficiencies (largely by developing surrogate data) or could have found the missing data in other sources, NS does not attempt to “correct” or “supplement” SunBelt’s operating plan for the SBRR by following its own advice to SunBelt. Instead, NS proposes an entirely new operating plan based upon a proprietary software program, MultiRail, that is a complete departure from the tried and true methodology of prior SAC cases. Whereas the parties in previous SAC cases have modeled the SARR’s operations based upon real-world trains identified from the defendant’s train-event data, NS disregards actual train- and car-event data in favor of aggregated waybill data for individual movements (data that is essentially devoid of routing information identifying intermediate stations through which the traffic moved in the real world). NS then proceeds to create new car blocks, uses those blocks to build new trains that operate over different routes, and finally models the operation of those trains that NS’s experts have completely divorced from NS’s real-world operations. In other words, NS rejected its own existing operations, which are based upon the experience of NS’s own operating personnel, in favor of a brand new, made-for-litigation operating plan.

Although SunBelt rejects the vast majority of NS’s criticisms, it has accepted some legitimate claims and modified its operating plan accordingly. The Board, therefore, should

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<sup>1</sup> See W. Fuels Ass’n v. BNSF Ry. (Western Fuels I), STB Docket No. 42088, slip op. at 101-02 (served Sept. 10, 2007) (rejecting defendant’s attempt to discredit complainant’s reliance on inaccurate evidence, because complainant selected between equally valid sources of evidence with no information from the railroad indicating which was more appropriate).

adopt SunBelt’s Rebuttal operating plan, based upon real-world NS operations, over NS’s unsupported and unrealistic attempt to create a new operating plan from scratch using MultiRail.

**A. SunBelt’s Operating Plan Is Sufficient to Serve the SBRR Traffic, Based on NS’s Real-World Operations**

As the parties in previous SAC cases have done, SunBelt used NS train-event data to identify all of the trains that NS uses to serve the SBRR’s traffic group over the constructed facilities. SunBelt then modeled those trains in its RTC simulation. According to NS, its train-event data is not an appropriate source for developing the SBRR’s operating plan because it does not contain critical information.<sup>2</sup> Indeed, NS goes to great lengths to discredit the reliability of its own train-event data—for the first time—in Reply. But if the train-event data is truly as unreliable and inadequate as NS describes it, the production of such data without disclosing its deficiencies and errors is a textbook case of “sand-bagging.”

The Board has long recognized that the “defendant’s traffic tapes are a critical component of the Board’s SAC analysis . . . .”<sup>3</sup> Furthermore, the Board repeatedly has held that “the parties are entitled to reasonably rely on evidence the other side supplied in discovery, and that defendants cannot impeach . . . evidence with information defendants failed to produce in discovery.”<sup>4</sup> Therefore, if a defendant fails to identify flawed, deficient, or incomplete traffic data during discovery, it cannot subsequently cite to those problems to criticize the

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<sup>2</sup> E.g., NS Reply, at III-C-27.

<sup>3</sup> Duke Energy Corp. v. CSX Transp. Inc. (Duke/CSXT), 7 S.T.B. 402, 451 (2004).

<sup>4</sup> Ariz. Elec. Power Coop. v. BNSF Ry. (AEP/CO), STB Docket No. NOR 42113, slip op. at 103 (served Nov. 22, 2011); see also AEP Tex. N. Co. v. BNSF Ry. (AEP Texas), STB Docket No. 41191 (Sub-No. 1), slip op. at 80-81, 83 (served Sept. 10, 2007); Pub. Serv. Co. of Colo. v. Burlington N. & Santa Fe Ry. (Xcel), 7 S.T.B. 589, 630-31, 683 (2004); Western Fuels I, slip op. at 101-02.

complainant's use of that data.<sup>5</sup> Even when a complainant might have discovered the problem based upon inconsistencies with other information produced by the defendant, the complainant is not obligated to verify that all materials produced in discovery are in agreement, or to verify that the data is correct and supported.<sup>6</sup> Therefore, SunBelt reasonably relied upon the NS traffic and event data to develop a feasible, realistic, and supported operating plan based upon the best information provided by NS in discovery.

**1. SunBelt has modeled all of the trains that NS's own data indicates are needed to handle the SARR traffic.**

According to NS, one of the most serious deficiencies in SunBelt's operating plan is the failure to capture 1,756 trains that NS alleges are needed to provide complete origin to destination service for the SBRR's traffic group.<sup>7</sup> But SunBelt did not "fail" to capture these trains. Rather, the NS train-event data does not indicate that those trains actually move over the SBRR and/or handle the SBRR's traffic group. Of the 1,756 allegedly missing trains, 1,316, or 76%, were excluded by SunBelt, even though they appear in the NS train-event data, because the data showed only a single train event on the lines replicated by the SBRR.<sup>8</sup> Another 210 allegedly missing trains do not appear in the train-event data at all.<sup>9</sup>

NS claims that, despite what its train-event data shows, the trains omitted by SunBelt are

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<sup>5</sup> Cf. Duke/CSXT, 7 S.T.B. at 450-51 (because defendant identified a problem with its traffic data during discovery and provided supplemental information to address the problem, complainant could not ignore the matter); Wis. Power & Light Co. v. Union Pac. R.R. (Wisconsin), 5 S.T.B. 955, 975 (2001) (rejecting defendant's additional adjustments to traffic data after discovery); FMC Wyo. Corp. v. Union Pac. R.R. (FMC), 4 S.T.B. 699, 726-27 (2000) (same).

<sup>6</sup> See Western Fuels I, slip op. at 102, 111 n.395.

<sup>7</sup> NS Reply, at III-C-14; SunBelt Reb., at III-C-25, note 54..

<sup>8</sup> SunBelt Reb., at III-C-27 to 28.

<sup>9</sup> SunBelt Reb., at III-C-28 to 29.

needed to complete transportation for the SBRR's traffic group. First, NS belatedly explains that, although the train-event data for many local trains indicate that the trains touch the SARR at only one location, these trains actually move over the SARR.<sup>10</sup> This explanation is an improper attempt by NS to impeach its own data produced in discovery and reasonably relied upon by SunBelt with information not previously provided to SunBelt.<sup>11</sup> Second, NS claims that, if SunBelt had only used the car-event data instead of the train-event data, it would have identified most of the missing trains.<sup>12</sup> This also is an improper attempt by NS to impeach its train-event data. More importantly, the car-event data is not granular enough to be used to determine the routing of individual trains because the reporting of events is so infrequent (and the miles between reported events is often so great) that car-event data is often deficient for purposes of determining on-SARR train routing.

NS fails to explain why SunBelt should have known that it could not rely upon the train-event data to identify trains that travel over the SARR, even though this is precisely what both parties in past cases have done. Nor does NS offer any justification for failing to disclose this alleged data deficiency during discovery. It is incumbent upon NS, not SunBelt, to ensure the reliability of its own data and to disclose known errors, flaws and deficiencies in that data.

Nevertheless, based upon NS's explanation of the idiosyncrasies in its coding of train-

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<sup>10</sup> NS Reply, at III-C-25 (“ . . . [L]ocal trains frequently work in and around a single operating station (which, for consistency, is identified in the NS train event data by a single milepost designation) and travel only a few miles.”)

<sup>11</sup> See AEP Texas, at 80-81 (“AEP Texas reasonably relied on the information it received from BNSF in developing its evidence, and BNSF may not impeach that evidence with information it failed to produce during discovery.”)

<sup>12</sup> NS Reply, at III-C-26. Specifically, NS refers to the “SunBelt Car/Train Database,” which was extracted from the car-event data. Elsewhere, NS incorrectly asserts that the “SunBelt Car/Train Database” links NS waybill, train-event, and car-event data. Id. at 15; NS Reply Ex. III-C-8, at 12. In fact, the database does not link train-event data. SunBelt Reb. Ex. III-C-1, at 7.

event and car-event data, SunBelt conservatively added 1,031 of the allegedly missing trains on Rebuttal.<sup>13</sup> Those trains touch the SARR at only one location according to the train-event data, which typically indicates that those trains do not move over the SARR. But SunBelt concluded that the NS explanation that those are local trains was plausible, because their location is not near a junction with the residual NS. SunBelt has not added the remaining allegedly missing trains because they do operate near junctions with the residual NS, which means they just as easily could have moved to off-SARR points on the residual NS rather than the SBRR.

**2. SunBelt has properly accounted for reciprocal obligations with connecting carriers.**

NS argues that SunBelt's operating plan does not account for the SBRR's reciprocal obligations to connecting carriers consistent with NS's joint use and interline agreements with those carriers. Specifically, NS claims that SunBelt's operating plan: (1) does not provide for reciprocal blocking of cars being interchanged with its connecting partners; (2) assumes all interchange agreements provide for run-through power;<sup>14</sup> (3) allocates responsibility for fueling in a manner inconsistent with inter-carrier agreements and real-world practice; and (4) makes no provision for running repairs to foreign railcars. In some instances, SunBelt has agreed with NS. But most of NS's criticisms are simply wrong.

SunBelt has agreed that its opening evidence operating plan did not account for the classification of rail cars in many of the SBRR's yards. In rebuttal, SunBelt has accepted the NS methodology for classification car counts, but has rejected the actual NS car counts because they are based on unsupported data generated through the MultiRail software. Furthermore, the

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<sup>13</sup> SunBelt Reb., at III-C-29.

<sup>14</sup> SunBelt agrees that some interchange agreements prohibit run-through power. These prohibitions, however, do not apply to any trains during the peak period. SunBelt Reb., at III-C-32 to -33.

various sources that NS has provided in response to SunBelt's requests for supporting data contain three inconsistent sets of car counts. Therefore, SunBelt has developed classification car counts using the same methodology described by NS for its car counts, but SunBelt applied the methodology to the car event data provided by NS in discovery.<sup>15</sup>

NS wrongly claims that SunBelt has assumed that locomotive fueling in interline service would always be the responsibility of connecting carriers. All SBRR locomotives on originating trains will be fully fueled and serviced before departing the originating yard.<sup>16</sup> Moreover, SunBelt's calculation of operating expenses does not assume that foreign railroads will bear any fuel expense for locomotive operations on the SBRR—it includes the cost associated with fuel required to power all locomotives on the SBRR.<sup>17</sup>

SunBelt has rejected NS's assertion that SunBelt fails to provide car repair facilities in order to make running repairs on foreign cars in compliance with the AAR interchange rules. First, SunBelt provides nearly the same total miles of car-shop and car-repair tracks as NS, but at more yards.<sup>18</sup> Second, SunBelt has increased the personnel to make running repairs to the level that NS provided in its reply.<sup>19</sup> Third, the AAR interchange rules require the car owner to pay for the repairs, and thus, it is improper to impose the costs of car repair facilities on the SBRR without also including the corresponding revenue.<sup>20</sup>

### **3. SunBelt's operating plan properly handles TIH shipments.**

NS poses three criticisms of how the SunBelt operating plan handles TIH shipments.

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<sup>15</sup> SunBelt Reb., at III-C-31 to -32, -96 to -103.

<sup>16</sup> SunBelt Reb., at III-C-33.

<sup>17</sup> Id.

<sup>18</sup> Id. at -34.

<sup>19</sup> Id.

<sup>20</sup> Id. at 34 to -35, III-F-125 to -126.

SunBelt accepts the NS criticism that TIH trains must be limited to 50 mph and has made that adjustment to its rebuttal RTC simulation.<sup>21</sup> SunBelt, however, rejects the NS criticisms that the SBRR cannot track TIH shipments and does not provide the personnel needed to comply with regulations and best practices. The SBRR can track and trace TIH shipments both through its PTC communications system and RMI Transportation Management System.<sup>22</sup> The SBRR's Manager – Environmental, aided by regional transportation officers and managers are responsible for compliance with TIH rules.<sup>23</sup> NS has unnecessarily attempted to duplicate personnel by creating a separate department for these functions.<sup>24</sup>

Although NS claims that its MultiRail-based operating plan created trip plans that enable the SBRR to track the movement of TIH cars and comply with federal regulations governing their movement, this is not accurate. NS does not distinguish between TIH and non-TIH traffic in blocking cars or assigning blocks to trains in MultiRail.<sup>25</sup> Also, the MultiRail trip plans that NS provided do not correspond to individual carloads, but to traffic flows, which can include both TIH and non-TIH cars.<sup>26</sup> This failure to distinguish between TIH and non-TIH traffic undercuts NS's claims that its operating plan adequately addresses TIH shipments.<sup>27</sup> By basing its operating plan upon real-world NS trains, SunBelt's operating plan implicitly accounts for TIH requirements and avoids these problems.

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<sup>21</sup> Id. at III-C-36.

<sup>22</sup> Id. at III-C-35 to -36.

<sup>23</sup> Id. at III-C-36 to -37.

<sup>24</sup> Id. at III-C-37.

<sup>25</sup> Id. at III-C-77 to -78.

<sup>26</sup> Id. at III-C-78.

<sup>27</sup> See NS Reply, at III-C-77 to -85.

#### **4. The SBRR's yards are properly designed and sized.**

NS is particularly critical of the SBRR's yard and network configuration, claiming that "the location, sizing, and configuration of the SBRR yards posited by SunBelt were untethered to the workload that the SBRR actually would have to perform at each facility."<sup>28</sup> NS has criticized SunBelt for not providing a "hump" yard at Birmingham and positing medium-size yards that are too small.<sup>29</sup> SunBelt has accepted NS's claim that SunBelt omitted classification switching for carload traffic moving through the operating yards, and corrected that omission in its rebuttal yard sizes, but SunBelt rejects the classification car counts used by NS.<sup>30</sup> SunBelt rejects all of NS's other criticisms of its yard designs and capacity.

SunBelt rejects NS's inclusion of a "hump" yard on the SBRR.<sup>31</sup> Based upon its rebuttal car classification counts for the SBRR, SunBelt has determined that, in the Base Year, the Birmingham yard will exceed NS's own proposed threshold of 900 cars to justify a hump yard only just barely. Thus, instead of building a hump yard, SunBelt has added yard crew assignments on rebuttal.<sup>32</sup> Although car classification counts will increase over the ten year DCF period, it still would not be proper to build hump yards in the base year. Nor would it be proper to build hump yards later in the DCF model because that would overstate the SBRR's costs. Specifically, the model would double-count expenditures by adding the hump yard capital investment when warranted by the volume of cars, without reducing yard crew assignments to reflect the operational savings. Therefore, SunBelt has opted to provide adequate yard crews to

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<sup>28</sup> NS Reply, at III-B-7.

<sup>29</sup> Id. at III-B-7, III-C-30 to -37.

<sup>30</sup> SunBelt Reb., at III-C-96 to -99.

<sup>31</sup> Id. at III-C-99, -101 to -103.

<sup>32</sup> Id. at III-C-102.

handle classification in all yards on the SBRR, without the use of hump yards, and grow these crews to provide classification service over the life of the DCF model.<sup>33</sup>

**5. The NS criticisms of SunBelt’s RTC Model are minor or inaccurate.**

Although NS has criticized various aspects of SunBelt’s RTC simulation, most of those criticisms are minor or inaccurate. SunBelt acknowledges the grade errors identified by NS and corrected them on rebuttal, but notes that the errors were so minor that they caused only 2 of 523 trains to stall, which was easily resolved by adding power to those trains.<sup>34</sup> Moreover, most of the grade errors were from erroneous NS RTC models that NS itself produced in discovery.<sup>35</sup> SunBelt also agrees that it understated the number of track outages, and included additional outages on rebuttal.<sup>36</sup> SunBelt, however, disagrees with 34 outages that NS asserted, most of which were nonsensical outages that NS used to block access to the McIntosh yard for 36% of the peak period.<sup>37</sup> Also, SunBelt accepts the inclusion of the at-grade crossings that NS claimed were missing, although they have little bearing on the Simulation.<sup>38</sup> In response to NS’s criticism concerning consist changes, SunBelt has modeled consist changes along train routes and, as a result, also modeled light-engine movements.<sup>39</sup>

SunBelt, however, rejects the following two NS criticisms of the RTC Model. First, there is no need to separately model hi-rail movements on the SBRR. Hi-rail vehicles are accounted

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<sup>33</sup> Id. at III-C-102 to -103. NS used a “trapezoid” flat yard layout for its hump yard that significantly overstates the classification track miles required. This design is unrealistic and infeasible for use with the hump yard NS has proposed. Id. at III-C-99 to -100.

<sup>34</sup> Id. at III-C-39 to -40.

<sup>35</sup> Id. at III-C-40.

<sup>36</sup> Id. at III-C-41 to -42.

<sup>37</sup> Id.

<sup>38</sup> Id. at III-C-44.

<sup>39</sup> Id. at III-C-44 to -45.

for in the maintenance outages that SunBelt included in the RTC simulation where the hi-rail movements were due to track maintenance.<sup>40</sup> Where hi-rail movements are not part of a maintenance outage, it is common industry practice for the hi-rail vehicle to trail an operating train using that train's clearance or warrant.<sup>41</sup> Furthermore, unlike maintenance outages, railroads time and perform their inspections to follow the prevailing traffic.<sup>42</sup>

Second, SunBelt rejects the inclusion of randomly-generated foreign trains in the RTC Model as an inappropriate and inaccurate method to simulate delays encountered by foreign trains.<sup>43</sup> Because NS's own evidence indicates when and where delays caused by foreign trains actually occurred in the real world, SunBelt used those delays in the RTC Model rather than randomly-generated imaginary trains.<sup>44</sup> NS compounds this error by giving the foreign trains priority over most SBRR trains.<sup>45</sup>

**B. NS's MultiRail-Based Operating Plan Is Unsupported, Infeasible, Unrealistic, Unnecessary, And Violates Fundamental SAC Principles.**

The parties in prior SAC cases have developed their operating plans by identifying the necessary trains from the defendant's train-event data and modeling those trains in a rail-network simulation (*e.g.*, the RTC Model). That is precisely what SunBelt has done in this proceeding, NS has disavowed its own train-event data and claimed that SunBelt's reliance on that data was misplaced. Instead, NS has taken a brand new and untested approach to developing an operating plan by building all-new trains to handle the SBRR's traffic group using the MultiRail software

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<sup>40</sup> Id. at III-C-45.

<sup>41</sup> Id.

<sup>42</sup> Id. at III-C-45 to -46.

<sup>43</sup> Id. at III-C-42.

<sup>44</sup> Id. at III-C-43. On opening, a query error caused SunBelt to understate the number of outages attributed to foreign railroads. SunBelt corrected this on rebuttal. Id. at III-C-42.

<sup>45</sup> Id. at III-C-43.

program. Unlike the tried and accepted methodology used by SunBelt, the NS approach is completely disconnected from reality. In addition, NS's MultiRail evidence is unsupported, infeasible, unrealistic, and violates SAC principles. Furthermore, NS's use of MultiRail adds unnecessary cost and complexity to the SAC analysis while not providing any advantage over the established methodology used by SunBelt.

**1. NS's MultiRail-based operating plan is unsupported.**

The Board should reject NS's operating plan evidence as unsupported, because: (a) NS developed the foundation of its operating plan using the MultiRail computer program; (b) NS has not submitted MultiRail as part of its evidence; and (c) without the MultiRail program, identifying all of the NS assumptions, modifications, and program overrides that influence the MultiRail outputs is not possible. Thus, by presenting its operating evidence without the MultiRail program or any significant documentation on its algorithms or iterations, NS has made it impossible for SunBelt or the Board both to verify that NS's operating plan evidence is supported and to restate the evidence.

First, the NS operating plan is unsupported because NS has not submitted the MultiRail software as part of its evidence. Although NS offered to provide the Board with a temporary copy of a fully functional, read-write version of MultiRail preinstalled on a laptop, the Board stated that it was unable to accept this offer.<sup>46</sup> Furthermore, SunBelt objected to that NS offer on the grounds that provision of MultiRail to the Board would constitute an impermissible *ex parte* communication because NS refused to provide the same version of MultiRail to SunBelt under the same terms.<sup>47</sup> Because NS had a proper means available to it for providing MultiRail to the Board, which would be to include the software in its evidentiary submission, as parties in prior

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<sup>46</sup> See Letter from Rachel D. Campbell, STB, to G. Paul Moates, NS Counsel (Feb. 11, 2013).

<sup>47</sup> See Complainants' Joint Reply to Def.'s Pet. for Clarification.

cases have done, NS has no legitimate excuse for failing to support its MultiRail evidence.<sup>48</sup>

Second, the Board cannot identify the assumptions underlying the MultiRail-based evidence and verify the evidence. For example, the user can adjust the standard algorithms in MultiRail by adding flow constraints and control parameters. The user can influence how MultiRail assigns cars to blocks by inputting penalties on the use of yards, yard activities, and routes.<sup>49</sup> The user can adjust dwell times.<sup>50</sup> But without the MultiRail program, which NS has not provided, the Board cannot identify any adjustments and assumptions that NS baked into its MultiRail-generated model of the SBRR. The MultiRail program provides the only interface through which any NS adjustments can be identified because the MultiRail data files that NS provided do not contain linking conventions that identify the adjustments and the parameters and data elements to which they relate.

Third, NS fails to provide any explanation of how it derived the MultiRail-generated evidence, including how it balanced competing inputs. There are multiple user inputs that influence how MultiRail assigns railcars to blocks and processes data.<sup>51</sup> NS, however, does not explain how these inputs were chosen or how they influenced the MultiRail model. In addition, without the read-write version of the MultiRail program, neither SunBelt nor the Board can adjust NS's inputs to determine how they affect the MultiRail outputs and downstream analyses, and gain insight into how NS derived its evidence or how NS could have achieved greater

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<sup>48</sup> Tex. Mun. Power Agency v. Burlington N. & Santa Fe Ry. (TMPA), 6 S.T.B. 573, 646 (2003) (rejecting computer model to evaluate SARR's main-line track configuration because defendant did not provide the computer program); Western Fuels I, slip op. at 37 (rejecting fuel consumption study as unsupported because defendant did not provide the computer program used to perform the study).

<sup>49</sup> Id. at III-C-60 to -61.

<sup>50</sup> Id. at III-C-61 to -62.

<sup>51</sup> Id. at III-C-60 to -61.

operating efficiencies than that reflected in its Reply case.

Finally, NS's failure to submit MultiRail as evidence prevents SunBelt and the Board from restating the MultiRail outputs, if necessary. In SAC cases, the Board is not limited to the role of a passive arbiter in carrying out its duty to determine if the challenged rate is reasonable based on a well-developed evidentiary record. Pub. Serv. Co. of Colo. v. Burlington N. & Santa Fe Ry., STB Docket No. 42057, slip op. at 3-4 (served Jan. 19, 2005). As a guardian of the public interest, the Board must ensure that the record is sufficient for it to determine the reasonableness of the rate. Id. at 4-5. Thus, when the Board finds defects in evidence submitted in rate cases, it may substitute new data into the spreadsheets and models underlying the evidence.<sup>52</sup> See Tex. Mun. Power Agency v. Burlington N. & Santa Fe Ry., STB Docket No. 42056, slip op. at 2 n.3 (Feb. 6, 2002) (recognizing that the Board often restates evidence). But such restatement is impossible if the substituted data does not cascade through the SAC analysis. For this reason, the Board has stated that it must be able to manipulate the data that a party submits and have the ability to re-run a party's calculations on such data. Duke/CSXT, 7 S.T.B. at 449-50 (criticizing defendant for submitting hard-coded work papers); Gen. Procedures for Presenting Evidence in Stand-Alone Cost Rate Cases, 5 S.T.B 441, 444-45 (2001); Texas, STB Docket No. 42056, slip op. at 2 n.3 (Feb. 6, 2002); see also 49 C.F.R. § 1104.3(b)(2) ("In order to fully evaluate evidence, all spreadsheets must be fully accessible and manipulable."). But, by

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<sup>52</sup> E.g., AEPCO, slip op. at 41 (accepting the railroad's operating plan, but adjusting its operating statistics); Western Fuels I, slip op. at 15 (using the shipper's operating plan, with modifications); Otter Tail Power Co. v. BNSF Ry. (Otter Tail), STB Docket No. 42071, slip op. at C-6 (served Jan. 27, 2006) (using the shipper's operating plan, but restating the number of personnel required); TMPA, 6 S.T.B. at 606 (using the railroad's operating plan, but the Board's own time estimates for train loading, servicing and fueling, interchanging, and unloading); Wisconsin, 5 S.T.B. at 980 (using the railroad's operating plan, with adjustments); FMC, 4 S.T.B. at 738 (using an adjusted version of the railroad's operating plan "to address certain concerns expressed by [the shipper] on rebuttal and to exclude certain overstatements [] discovered in reviewing [the railroad's] evidence.").

choosing to present evidence based on MultiRail without also including the MultiRail program as part of its submission to the Board, NS has made the Board a prisoner to NS's submissions. See Pub. Serv. Co. of Colo. v. Burlington N. & Santa Fe Ry. (Xcel II), STB Docket No. 42057, slip op. at 4 (served Jan 19, 2005).

**2. The MultiRail approach is untethered from reality and contrary to SAC principles.**

The Board has repeatedly held that:

A core SAC principle is that the SARR must meet the transportation needs of the traffic it would serve. Thus, the proponent of a SARR may not assume a changed level of service to suit its proposed configuration and operating plan, unless it also presents evidence showing that the affected shippers, connecting carriers, and receivers would not object.<sup>53</sup>

Despite this clear warning, this is exactly what the NS operating plan does. The NS operating plan provides a completely different level of service through the creation of new trains with new consists and routes that have no connection to real-world operations. Yet, NS presents no evidence that the affected shippers, connecting carriers, and receivers would not object. Nor does NS demonstrate that its operating plan provides service that is equivalent to NS real-world operations. In contrast, because SunBelt's operating plan is built around existing NS trains, consists and routes, SunBelt is able to demonstrate that its operating plan provides the same level of service, as measured by a comparison of SunBelt's Rebuttal RTC transit times with the abridged transit times included by NS in its Reply.<sup>54</sup>

The MultiRail process unavoidably distances its output from NS's real-world operations.

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<sup>53</sup> Carolina Power & Light Co. v. Norfolk S. Ry. (CP&L), 7 S.T.B. 235, 255 (2003) (citing W. Tex. Utils. Co. v. Burlington N. R.R. (West Texas), 1 S.T.B. 638, 667 (1996)); accord FMC, 4 S.T.B. at 736; McCarty Farms, Inc. v. Burlington N., Inc. (McCarty Farms), 2 S.T.B. 460, 476 (1997).

<sup>54</sup> SunBelt Reb., at III-C-49 to -52.

First, although NS begins with the same carload traffic from the same waybill file as SunBelt, it must convert that data into a format required by MultiRail to function properly. This conversion required NS to alter the interchange location for 12,575 Waybill records, which began the process of divorcing the MultiRail operating plan from NS's real-world operations.<sup>55</sup> Second, it is not clear whether NS even inputs its real-world blocking data into MultiRail. On page III-C-24 of NS's reply, NS asserts that it populated MultiRail with blocks that are based on its real-world blocks. But, on page 7 of NS reply workpaper "Modeling Operating Plan in MultiRail for the SunBelt Rate Case.docx," NS states that it used a blocking plan that it developed from scratch through an iterative process. This ambiguity casts doubt on any purported connection between NS's real-world blocking plan and the blocking plan it developed for the SBRR.<sup>56</sup> Third, MultiRail assigns daily average carloads to the foregoing traffic blocks, which have no relation to real-world block assignments.<sup>57</sup> Finally, NS must manually assign each car block to a train.<sup>58</sup> Although NS uses real-world train schedules as a starting point, there is no link between the blocks that NS assigns to each train and the blocks that actually move in those trains.<sup>59</sup>

The average cars per train and transit times in NS's proposed operating plan are prime examples of how NS's use of MultiRail results in a disconnect from real-world operations and creates unnecessary inefficiencies and costs for the SBRR. For example, because NS directed MultiRail to release no more than 2 cars at any one time,<sup>60</sup> this decreased the average cars per

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<sup>55</sup> Id. at III-C-80 to -81.

<sup>56</sup> Id. at III-C-81 to -82.

<sup>57</sup> Id. at III-C-82.

<sup>58</sup> Id. at III-C-85.

<sup>59</sup> Id.

<sup>60</sup> Id. at III-C-75.

train below real-world levels for all types of SBRR traffic.<sup>61</sup> It also systematically delayed SBRR traffic, causing transit times to increase by up to 6 hours, well above real-world levels.<sup>62</sup>

Another example of the disconnect between the MultiRail operating plan and real-world operations is how NS handles (or does not handle) TIH traffic in MultiRail. As discussed in Part II.A.3 above, the MultiRail analysis fails to distinguish between TIH and non-TIH traffic, which undercuts NS's claims that its operating plan adequately addresses TIH shipments.<sup>63</sup>

Ultimately, MultiRail is an unnecessary tool that only serves to further complicate an already inherently complicated SAC process by creating one-off, made-for-litigation data where actual data already exists. This fundamental flaw in NS's operating plan flies directly in the face of Board precedent that abjures litigants to base their operating plan on real-world operations. For example, in FMC, the agency rejected a shipper's operating plan because it did not utilize actual railroad practices regarding the length of trains, and consolidated multiple car shipments into unit train shipments.<sup>64</sup> Similarly, in Duke/CSXT, the Board rejected the shipper's operating plan that was "different from how CSXT conducts its coal-hauling operations in the Central Appalachian Region . . ." and because it did not provide the same level of service that the incumbent provided to its customers.<sup>65</sup> For the reasons exhaustively set out in SunBelt's Rebuttal, the exact same situation exists with respect to NS's MultiRail-based operating plan.<sup>66</sup>

Finally, by untethering the operating plan for the SBRR from NS's own operations, NS has made it impossible for the Board to benchmark that operating plan against real-world

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<sup>61</sup> Id. at III-C-75 to -76.

<sup>62</sup> Id. at III-C-75.

<sup>63</sup> See NS Reply, at III-C-77 to -85.

<sup>64</sup> FMC, 4 S.T.B. at 736-737.

<sup>65</sup> Duke/CSXT, 4 S.T.B. at 426.

<sup>66</sup> SunBelt Reb., at III-C-52 to -87.

conditions. If the Board accepts NS's gambit, which is directly contrary to the Board's consistent precedent, it will become a prisoner of evidence developed by computer software and dueling experts, that is "untethered" from real-world railway operations, and thus without any objective means to assess what is or is not realistic.

### **3. MultiRail produces infeasible and unrealistic SAC results.**

The acceptability of computer model evidence turns not only on the use of an acceptable program, but also the manner in which a party uses it. NS has not used MultiRail in a manner that produces a feasible or realistic operating plan. Moreover, the NS operating plan's substantial deviation from NS's own operations has caused the NS evidence to run afoul of basic SAC principles. Because NS developed the SBRR trip plans, car blocking plans, and train plans from scratch, it inevitably created substantial disconnects between the SBRR's operations and those of the residual NS and connecting carriers. Those disconnects occur in five ways.

First, by only relying upon routing from waybill data, without regard for different real-world routes, NS created impermissible and distorting off-SARR ("external") reroutes that require the SBRR to interchange traffic with connecting carriers at points that are not on the real-world route of movement.<sup>67</sup> In TMPA, 6 S.T.B. at 594-95, the Board held that, when rerouting non-issue traffic, the SAC analysis "must either take responsibility for the entire movement from origin to destination or fully account for the ramifications of requiring the residual carrier to alter its handling of the traffic." Logically, this rule also must apply to connecting carriers that would have to alter how they handle the rerouted traffic on their lines.

Second, NS only modeled carload traffic on MultiRail without giving any consideration

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<sup>67</sup> Id. at III-C-62 to -67, 69-70.

to the impacts by, and upon, unit trains that also operate over the SBRR.<sup>68</sup> Consequently, NS failed to account for the requirements of that traffic in developing its routing and operating plans for the carload traffic using MultiRail.

Third, the MultiRail exercise ignores the requirements of the real-world NS traffic that SunBelt did not select for the SBRR traffic group, and simply assumes away any interference that the MultiRail operating plan may impose upon that traffic.<sup>69</sup>

Fourth, a feasible operating plan must provide complete transportation for the entire traffic group. But NS's MultiRail evidence reveals that traffic was not assigned to blocks and blocks were not assigned to trains, effectively stranding multiple carloads of SBRR traffic.<sup>70</sup> Also, NS's own MultiRail evidence indicates that over 10% of the carloads in MultiRail could be reassigned to alternate car blocks to increase efficiency by reducing the number of intermediate handling events required.<sup>71</sup> This proves that the NS operating plan does not provide either the complete or efficient service that NS claims makes its operating plan superior to SunBelt's. Instead, NS has used MultiRail to include significant inefficiencies in its operating plan in order to artificially inflate the SBRR's operating and investment costs.

Finally, MultiRail contains significant limits that are inconsistent with use in a SAC analysis. The most significant limit is that MultiRail models operations on an average basis, whereas the SAC analysis requires the parties to model peak operations.<sup>72</sup> Because actual railroad operations are highly variable over the course of a year, MultiRail cannot accurately

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<sup>68</sup> Id. at III-C-70.

<sup>69</sup> Id. at III-C-71.

<sup>70</sup> Id. at III-C-72.

<sup>71</sup> Id. at III-C-84.

<sup>72</sup> See Id. at III-C-59, -87.

model peak period operations. In contrast, SunBelt's operating plan is based on the actual trains and operations that vary considerably from day to day. This difference ultimately is manifested in the very different peak period train lists using the SunBelt and NS methodologies.

MultiRail is a tool, and like all tools, the person wielding it has more to do with its efficacy than the tool itself. In this proceeding, NS has wielded MultiRail as a tool for inflating the SBRR's expenses beyond those of an optimally efficient rail carrier. Although SunBelt was able to identify a large number of errors and inefficiencies in NS's MultiRail-based operating plan, NS attempted to ensure that the inefficiencies in its operating plan were unassailable by providing SunBelt with only a limited-functionality version of MultiRail that does not even allow SunBelt to ascertain the level of those inefficiencies, much less eliminate them and properly restate the NS analysis. Because the Board also lacks full access to MultiRail, it is in no better position to analyze and adjust NS's model.

In contrast, SunBelt's operating plan, which is based on actual NS train movements, is based upon the years of experience that NS operating personnel have fine tuning those operations. By severing the SBRR's operations from actual NS operations through the use of MultiRail, NS is leading the Board down a path whereby it will become impossible for the Board ever to determine the feasibility of a SARR operating plan by comparing that plan to reality.

**4. NS's criticisms of SunBelt are a smokescreen to conceal the deficiencies in its own traffic data and to justify its unprecedented MultiRail-based approach to developing the SBRR operating plan.**

NS has not offered a cogent explanation as to why it deviated from the methodology used by previous SAC parties to develop operating plans and, instead, chose to use MultiRail. After claiming that SunBelt used the wrong data source and asserting that every one of the trains that

SunBelt missed could be found in the car-event data,<sup>73</sup> along with all of the other information needed to model local-train service,<sup>74</sup> NS should have had all the information it needed to correct the alleged deficiencies in SunBelt’s operating plan. Since SunBelt’s operating plan was based upon NS’s real-world operations, if NS believed that the SunBelt plan failed to provide the service that NS provides in the real world, it could have fixed the alleged flaws without resorting to an operating plan utterly divorced from NS’s own operations. By adding all of the alleged missing trains and modeling local-train service in accordance with its own critique, NS should have been able to develop a “corrected” operating plan using the same established methodology that SunBelt used. Instead, “NS developed a brand new operating plan from the ground up.”<sup>75</sup>

NS does not explain why SunBelt’s operating plan was so “fatally deficient”<sup>76</sup> that it needed to build an operating plan from scratch. Although NS generally argues that SunBelt cannot model a carload railroad using train-event data, this is just another smokescreen in NS’s attempt to avoid the use of its own train-event data and to persuade the Board to use its MultiRail-based operating plan. If all the trains are captured in the NS traffic data, then so must all the individual cars that moved in those trains (i.e., the NS train-event data are also “built from the ground up”). Nevertheless, NS creates the false impression that a carload operating plan requires the preparation and development of individual trip plans, car-blocking plans, and train-service plans from the ground up, and that SunBelt’s failure to do so was fatal. But, the fact that SunBelt modeled trains from the NS train-event data means that the SBRR has adopted the same

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<sup>73</sup> NS Reply, at III-C-26 to -27.

<sup>74</sup> Id. at III-C-27 to -28, -29 to -30, -47,-50, -51 n.96.

<sup>75</sup> Id. at III-C-119.

<sup>76</sup> Id. at III-C-118.

trip plans, the same car-blocking plans, and the same train-service plans as the real-world NS.<sup>77</sup>

NS's attempt to create new plans is an unnecessary reinvention of the wheel that removes the NS operating plan several steps from reality.

NS also suggests that a trip plan is essential in order to satisfy customer requirements.<sup>78</sup> This claim is a red herring, however, because the mere preparation of a trip plan says absolutely nothing about whether the plan satisfies the customer's requirements. That assessment still requires some benchmark comparison with real-world service. This is why actual train and traffic data is used in SAC analyses rather than trip plans and train schedules. In the real world, things don't always go according to plan. The SunBelt operating plan reflects this reality while the NS plan does not. By operating the same trains as the real-world NS, SunBelt can compare the SBRR's average train speeds against NS reported average train speeds to determine if the SBRR provides an equivalent level of service.<sup>79</sup> NS cannot make a similar comparison, because it has completely untethered its operating plan from the real world.<sup>80</sup>

Even though NS failed to explain why it rejected the only proven methodology for developing operating plans in favor of its new and untested MultiRail-based methodology, several explanations are quite obvious. First, as described above, all of the allegedly missing trains could not in fact be found in the car-event data, and there were significant conflicts between the train- and car-event data that could not be reconciled. Consequently, if NS had tried to rely upon that data, it would have had to concede that its data is flawed and incomplete and its criticism of SunBelt would be exposed for the smokescreen that it is. Second, NS could not get

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<sup>77</sup> SunBelt Reb., at III-C-9 to -10, -57.

<sup>78</sup> NS Reply, at III-C-42, -45.

<sup>79</sup> SunBelt Reb., at III-C-51.

<sup>80</sup> See Id. at III-C-86.

the SAC answer it wanted, *i.e.* the stand-alone cost greater than stand-alone revenues, simply by correcting for SunBelt's alleged errors. Therefore, in order to increase its train count to desired levels, NS needed to untether the SBRR traffic from NS's real-world trains, which it could only do by completely starting over. In summary, NS used the overhyped deficiencies in the SunBelt operating plan both as a smokescreen to conceal the inadequacies in its own data production to SunBelt and as an excuse to discard SunBelt's operating plan altogether in order to start fresh with a process that enabled it to better manipulate the final answer.<sup>81</sup> Regardless of NS's motivations, SunBelt's operating plan satisfies the Board's requirements and should be accepted as realistic, feasible, and supported.

**5. The NS RTC Model contains numerous flaws.**

For the reasons stated in the preceding sections, the NS RTC simulation is fatally flawed from the outset because it relies upon unsupported, infeasible and unrealistic output from the MultiRail software to generate the trains and other inputs to the RTC Model. Another fatal flaw is NS's decision to model an average week rather than the required peak period, because MultiRail is incapable of generating peak period statistics for the RTC simulation.<sup>82</sup> SunBelt also has identified additional errors that render NS's RTC simulation useless to test the configuration of the SBRR.

First, NS incorrectly modeled foreign trains that cross SBRR lines. Instead of using actual data on the number of foreign train crossings over the real-world NS system, NS concocted greatly inflated surrogate numbers based upon outdated FRA data for highway, not rail, crossings and that expressly may not be used in litigation proceedings.<sup>83</sup> Compounding this

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<sup>81</sup> Id. at III-C-53 to -54.

<sup>82</sup> Id. at III-C-87.

<sup>83</sup> Id. at III-C-87 to -88.

error, NS gave foreign trains a higher priority than SBRR trains in every single instance, which has an enormous impact upon operating and investment costs.<sup>84</sup>

Second, due to the inability of MultiRail to identify highly inefficient “turn” movements and NS’s failure to make simple network adjustments to prevent unnecessary “turn” moves in the RTC Model, the NS RTC simulation requires the SBRR to make unnecessary “turn” movements during the modeled period.<sup>85</sup> Each unnecessary “turn” move increases cycle times, locomotive hours, locomotive miles, car miles, car hours, crew hours, and fuel consumption, places unnecessary burdens on network congestion, and potentially slows down other trains that might encounter the turning train. This system-wide error universally increases the costs associated with operating NS’s SBRR, creating a gross overstatement of the SBRR’s operating costs.

### **III. NS UNDERSTATES THE SBRR’S STAND-ALONE REVENUE AND VOLUME.**

The parties disagree over both the proper method of forecasting the SBRR’s traffic volumes from 2017 through 2021, and the calculation of SBRR revenues. SunBelt has used a compound annual growth rate (“CAGR”) based upon multiple years of historical and forecasted data, whereas NS has used a single year, to forecast future volumes. The primary differences between the parties in their calculation of the SBRR’s revenue fall into two main categories. First, NS is highly critical of SunBelt’s use of Modified-ATC to calculate cross-over revenue divisions. Second, NS understates intermodal revenue from its Thoroughbred Direct Intermodal Service (“TDIS”) subsidiary. Finally, NS has asked the Board to restrict SunBelt’s use of cross-over traffic. NS is wrong on each issue for the reasons discussed below.

#### **A. SunBelt’s Forecasted Volumes Are Based On Past Precedent And Procedures.**

SunBelt has used a CAGR, based upon NS actual and forecasted data from 2010-2016, to

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<sup>84</sup> Id. at III-C-43.

<sup>85</sup> Id. at III-C-90 to -93.

project the volumes of all commodities moving over the SBRR from 2017 through 2021.<sup>86</sup> NS has rejected that approach in favor of using the growth rate for the very *last* year (2015-2016) of its internal forecast.<sup>87</sup> SunBelt’s CAGR, which averages multiple years of data, is supported by Board precedent, while the NS approach of using a single year of historical data to forecast volume in future years has been rejected.

In AEP Texas, the Board stated that “AEP Texas has not provided a sufficient justification for us to depart from the Board practice of using an average over a recent historical time period (usually all years dating back to the SARR’s construction start date).”<sup>88</sup> The Board further declared, “[a]s explained in West Texas, using data for a single year increases the risk that the single year is an aberration.”<sup>89</sup>

In FMC, both the complainant and defendant, UP, presented a CAGR, which the Board accepted, to forecast both volumes and revenues. For “Traffic Volumes Generally,” the defendant “estimate[d] traffic growth beyond 2001 (or 2002)” using “the average (geometric mean) of the annual percentage change in traffic volumes contained in LRPs from 1997 to that time.”<sup>90</sup> The Board decided to “use the traffic forecasts in the LRPs for the years 1997 through 2001 (or 2002, as applicable) and [to] use [the complainant’s] procedures for carrying those forecasts forward through 2017.”<sup>91</sup> With respect to the Soda Ash volumes presented by UP and

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<sup>86</sup> Id. at III-A-5 to -7.

<sup>87</sup> NS Reply, at III-A-8. On Rebuttal, SunBelt did change the baseline year for the CAGR from 2009 to 2011 in response to NS criticism that 2009 was the bottom of the recession. SunBelt Reb., at III-A-5 to -6.

<sup>88</sup> AEP Texas North Co. v. BNSF Railway Co., STB Docket No. 41191 (Sub-No.1), slip op. at 107 (served Sept. 10, 2007).

<sup>89</sup> Id.

<sup>90</sup> FMC, 4 S.T.B. at 730.

<sup>91</sup> Id. at 731. “LRPs” are “Long Range Plans”

accepted by the Board, “UP used the compound average growth rate from 1999 through 2007. . . to develop its growth rate for soda ash for the period 2008-2017.”<sup>92</sup> The Board even took upon itself to use a CAGR for rate forecasts when it was dissatisfied with the evidence presented by both parties.<sup>93</sup>

Therefore, the Board should accept SunBelt’s use of the CAGR as presented. The use of “averages” based on historical and forecasted data applied to future years has been a tool used by shippers, defendants, and the Board for years. The CAGR in this case uses NS provided data, based on the appropriate time periods as referenced by NS and defined by the Board, and serves as a more accurate predictor of NS’s business for the forecasted years.

**B. The Board Should Use Modified ATC for Cross-Over Traffic Revenue Divisions.**

In both its Opening and Rebuttal Evidence, SunBelt allocated cross-over revenue using Modified-ATC as adopted by the Board in Western Fuels I,<sup>94</sup> recently reconfirmed on remand in Western Fuels II,<sup>95</sup> and described as the Board’s “current Modified-ATC approach” in Rate Regulation Reforms (EP 715 NPR), STB Docket No. EP 715, slip op. at 18 (served July 25, 2012). Despite the foregoing Board affirmations of Modified ATC as the current approach for pending rate cases, NS argues on procedural grounds that Original ATC is the only lawful approach that the Board may use. In the alternative, NS has suggested that the Board apply Alternate ATC, which the Board has proposed, and just a week ago adopted, as a replacement for

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<sup>92</sup> Id. at 732.

<sup>93</sup> Id. at 735 (“We find the evidentiary submission of both sides on this issue to be seriously flawed... (t)hus, to estimate the growth in rates for the period beyond 2001 (or 2002) for all commodities (including coal and soda ash), we apply the geometric mean of the annual percentage change in rates contained in the LRPs for the years 1997 to 2001 (or 2002).”).

<sup>94</sup> Western Fuels I, slip op. at 14.

<sup>95</sup> W. Fuels Ass’n v. BNSF Ry. (Western Fuels II), STB Docket No. 42088, slip op. at 2 (served June 15, 2012).

Modified ATC in Rate Regulation Reforms (EP 715 Rule), STB Docket No. EP 715 (served July 18, 2013). SunBelt has demonstrated that, as a matter of both law and economics, Modified ATC is superior to both Original ATC and the Alternate ATC.<sup>96</sup>

NS contends that, as a matter of law, the Board improperly adopted Modified ATC in an adjudicatory proceeding. The adoption of Modified ATC in Western Fuels I did not require a public rulemaking proceeding, because Modified ATC was a refinement of Original ATC necessitated by the objectives of both ATC and Coal Rate Guidelines, Nationwide, 1 I.C.C.2d 520 (1985). Because agencies are permitted, via adjudication, to refine their application of so-called “legislative” or “substantive” rules adopted in rulemaking proceedings, there was nothing improper about the Board’s adoption of Modified ATC in Western Fuels I.<sup>97</sup> The Board’s action in Western Fuels I was a reasonable clarification of an existing rule to accomplish the stated goals and intent of ATC; hence, it was a permissible interpretive rule.

Furthermore, the application of Original ATC to this proceeding would be arbitrary and capricious. The Board has never applied Original ATC in any proceeding because, in the very first attempted application of Original ATC in a specific case, the Board encountered a set of facts that it had not contemplated in the original rulemaking that produced “an illogical and unintended result.” Western Fuels I, slip op. at 14. According to the Board, “[s]uch a result would plainly conflict with our express purpose to find a non-biased, cost-based method.” Id. (citing Major Issues in Rail Rate Cases (Major Issues), STB Ex Parte No. 657 (Sub-No. 1), slip op. at 32 (Oct. 30, 2006)). Thus, even if NS has correctly identified a procedural defect in the adoption of Modified ATC, it nevertheless would be arbitrary and capricious for the Board to

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<sup>96</sup> SunBelt Reb., at I-26 to -32, III-A-10 to -23.

<sup>97</sup> 5 U.S.C. § 552(b)(3)(A); PPL Mont., LLC v. STB, 437 F.3d 1240, 1247 (“notice is not required before every clarification or extension of an agency’s principles to novel scenarios”).

resort to the discredited Original ATC as a replacement.

Although SunBelt continues to believe that, as a matter of economics, Modified ATC is superior to Alternate ATC, it recognizes that the Board concluded otherwise just a week ago, in EP 715 Rule, served July 18, 2013.<sup>98</sup> Because Original ATC clearly is inappropriate, the Board should apply Alternate ATC if it elects not to apply Modified ATC in this proceeding. But SunBelt continues to support the use of Modified ATC both because it is economically superior and because SunBelt has relied upon Modified ATC as the Board's methodology for allocating cross-over revenue throughout the entire evidentiary phase of this proceeding.

**C. NS Uses Accounting Gimmicks To Understate Intermodal Revenue.**

NS has used accounting gimmicks to deny the SBRR intermodal revenue from TDIS activities that NS itself reports as rail revenues to the Securities and Exchange Commission, the STB, and its shareholders.<sup>99</sup> Because the NS revenue waybill data does not include all rail-related revenues associated with the movement of intermodal traffic via TDIS, an NS subsidiary, SunBelt was forced to develop accurate intermodal revenue from other sources provided by NS in discovery. SunBelt calculated what it reasonably assumed to be net rail revenue for Triple Crown Services ("TCS") / TDIS shipments, excluding revenue associated with non-rail activities, such as trucking and lift service. NS criticized these revenue adjustments as inadequate and reduced intermodal revenue to include only the line-haul and train starts revenue that TCS/TDIS transfer directly to NS to cover NS operating costs associated with intermodal shipments, while denying the SBRR any revenue above this cost recovery device.<sup>100</sup>

Contrary to NS claims, SunBelt did not ignore the construction of facilities necessary to

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<sup>98</sup> SunBelt Reb., at III-A-10 to -23.

<sup>99</sup> Id. at III-A-23 to -29.

<sup>100</sup> NS Reply, at III-A-9 to -14.

serve this traffic. SunBelt included only the revenues attributable to the ramp-to-ramp rail portion of the moves over the NS system by backing out all TDIS payments to third party (*i.e.*, non-NS) service providers. The remaining revenues are those associated with the ramp-to-ramp rail movement of the traffic over NS, to which the SBRR is entitled.

SunBelt has accepted NS's critique to the extent SunBelt erroneously included revenue for non-rail services or non-NS rail segments, but SunBelt rejects NS's attempt to eliminate the lion's share of TDIS revenues that NS reports as rail revenue on its own books every year. In its reply, NS has understated TDIS intermodal revenue by 22% solely based on an accounting device designed to deny the SBRR revenue that NS itself claims as rail operating revenue.<sup>101</sup> The Board should include this revenue in the SAC analysis.

**D. SunBelt Has Not Abused Cross-Over Traffic.**

NS has asked the Board to restrict SunBelt's use of cross-over traffic in this case by applying the limitations that the Board proposed in EP 715 NPR, regardless of whether the Board had completed that rulemaking, or whether it ultimately adopted any such measures in that proceeding.<sup>102</sup> This is a non-issue. First, in EP 715 NPR, the Board unequivocally stated that it would not apply any of the proposed restrictions to pending rate cases, including this one. Second, the Board recently served its final decision in that rulemaking on July 18, 2013 in which it decided not to adopt restrictions on cross-over traffic. EP 715 Rule, at 28. Although the Board invited parties in future proceedings to advocate in their individual cases ways to address the handling of cross-over traffic (*e.g.*, costing adjustments in the Board's URCS, ATC and/or MMM models), NS did not propose any alternate ways to address the issue apart from applying the EP 715 NPR restrictions that the Board expressly has decided not to impose.

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<sup>101</sup> SunBelt Reb., at III-A-29.

<sup>102</sup> See NS Reply, at III-A-35.

Furthermore, SunBelt’s traffic group contains only a very small amount of the type of cross-over traffic about which the Board expressed concern in EP 715 NPR. The Board explained that its concern with cross-over traffic has arisen due to a shift in recent cases from cross-over traffic that is predominantly trainload service to cross-over traffic that includes large amounts of carload and multi-carload movements. The Board, however, is not concerned with all carload and multi-carload cross-over traffic. Rather, the Board is concerned with SARRs that construct a short segment over a high-density line and primarily serve as a bridge carrier that handles most of its traffic (a significant portion of which is single car and multiple car traffic) in so-called “hook-and-haul” overhead trainload service, leaving the residual incumbent to perform more costly terminal activities.<sup>103</sup> That is not the SBRR.

The SBRR includes mostly overhead cross-over traffic for which it performs I&I switching, thereby incurring comparable costs to those incurred by NS for intermediate handling.<sup>104</sup> SunBelt cross-over traffic is not predominantly hook-and-haul overhead movements that are originated/terminated by the residual incumbent. In all, less than 1% of the SBRR’s traffic constitutes the type of “hook-and-haul trainload” traffic about which the Board expressed concern.<sup>105</sup> Thus, SunBelt has not abused cross-over traffic, as NS alleges. Rather, SunBelt has employed such traffic as a tool to make the SAC analysis manageable, as the Board intended.<sup>106</sup>

Finally, SunBelt would be severely prejudiced if the Board were to restrict the use of cross-over traffic in this proceeding.<sup>107</sup> The use of cross-over traffic in the SAC analysis has

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<sup>103</sup> SunBelt Reb. Ex. III-A-1, at 23-25.

<sup>104</sup> Id. at 18, 24.

<sup>105</sup> Id.

<sup>106</sup> Id. at 20-23.

<sup>107</sup> Id. at 4-11.

been well-established for nearly 20 years. Indeed, the Board has described the device as “an indispensable part of administering a workable test,” Western Fuels I, slip op. at 11, without which “captive shippers might be deprived of a practicable means by which to present their rate complaints to the agency.” Xcel II, slip op. at 16. The first sign that the Board might back away from this precedent came in EP 715 NPR, which was served exactly one week before SunBelt filed its opening evidence in this proceeding. Thus, SunBelt relied extensively on the Board’s prior proclamations by expending an enormous amount of time and money to construct its entire SARR around a traffic group that included a substantial volume of cross-over traffic.

#### **IV. SUNBELT’S OPERATING EXPENSES ARE REASONABLE.**

The vast majority of the difference in operating expenses between SunBelt and NS is attributable to their different operating plans, which SunBelt has addressed in Part II, above. But significant differences also exist in two areas that are largely independent of the operating plan: G&A and MOW expenses. In both instances, NS has improperly attempted to burden the SBRR with costs based upon NS’s larger and more diverse traffic base and its much older infrastructure. In addition, NS includes an unprecedented and inappropriate new operating expense that it calls “Excess Risk.” The Board should reject NS’s improper attempts to inflate G&A and MOW costs, and to create a new “Excess Risk” cost category for the reasons presented below.

##### **A. SunBelt’s G&A Expenses Are Appropriate for the SBRR’s Size and Traffic.**

SunBelt’s G&A expenses are adequate for the SBRR. Yet, in its Reply Evidence, NS proposes to more than quintuple the G&A staffing level that SunBelt proposed on Opening, thereby nearly tripling SunBelt’s G&A cost estimate. In Rebuttal Exhibit III-D-1, SunBelt carefully and exhaustively confronts and discusses why, in virtually all cases, NS’s evidence is wrong and should be rejected by the Board.

In addition to the details discussed minutely in SunBelt’s Rebuttal, there are certain broad issues that the Board should keep in mind in its examination of NS’s G&A proposals. First, a small railroad does not need an army to satisfy the G&A requirements of typical railroads, and in many cases, the SBRR can consolidate those functions or requirements among existing forces without the additional staffing posited by NS. Second, NS’s evidence is flawed because the G&A “benchmarks” that it uses—its own G&A costs, those of certain Class II railroads, and third party studies—are inappropriate due to substantial differences between the SBRR and existing carriers. The closest peer to the SBRR among existing railroads is Montana Rail Link, whose G&A staffing compares favorably to SunBelt’s evidence.<sup>108</sup> Third, when the SBRR’s G&A costs are “benchmarked” against more relevant comparisons—similar-sized SARRs from past SAC decisions, such as the Western Fuels and Xcel decisions—the reasonableness of SunBelt’s evidence and the enormous inflation in the NS evidence is evident.<sup>109</sup> In light of these considerations, the Board should reject NS’s inflated G&A costs.

**B. SunBelt’s MOW Plan Is Designed for a Newly-Constructed Railroad, Whereas NS Assumes a Legacy Railroad Constructed Over Many Decades.**

SunBelt’s MOW plan reflects the reduced tasks and costs associated with a newly constructed railroad operation. To do so, it factors in the use of new materials, considers the projected annual tonnage, separates the tasks and costs of capital projects performed by contractors, and considers the ten-year life of the SBRR. The details are addressed in SunBelt Opening Exhibit III-D-3 and Rebuttal Exhibit III-D-2. In contrast, NS has designed a MOW plan based on the needs of NS’s existing system, which is larger than the SBRR and comprises older infrastructure constructed to lower standards; has been subjected to phases of deferred

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<sup>108</sup> SunBelt Reb. Ex. III-D-1, at 10-11.

<sup>109</sup> SunBelt Reb., at III-D-39 to -40.

maintenance, roadbed and track-joint pumping, and archaic construction techniques; and has existing defects and age-related maintenance needs. A realistic MOW plan must recognize the real physical condition of the brand new SBRR infrastructure and the substantially reduced maintenance needs of such infrastructure during the 10-year life of the SBRR covered by the DCF model. The Board should reject the NS MOW plan for its failure to do so.

**C. The Board Should Reject NS’s Unprecedented Inclusion Of “Excess Risk” Costs As Unnecessary And Fundamentally At Odds With Basic SAC Principles.**

NS adds an “excess risk” operating cost factor, which it contrived for the purpose of providing adequate funds to cover the SBRR’s liability for damages from a TIH release that exceeds \$1 billion of insurance coverage.<sup>110</sup> This cost is improper because it denies the SBRR the ability to exit the market in the event of catastrophic liability, which constitutes a barrier to exit that would violate the theory of contestable markets.<sup>111</sup> If the real-world NS incurs catastrophic liability above its insurance coverage limits, then it must pay those costs itself to the extent it is able or exit the market by declaring bankruptcy. NS’s position impermissibly denies the SBRR the latter option. Furthermore, because NS itself does not set aside any portion of its TIH revenue to cover uninsured catastrophic costs from a TIH release, it would be an impermissible barrier to require the SBRR to do so.<sup>112</sup>

Also, the “excess risk” that NS attempts to include as an operating cost already is reflected in the railroad industry’s cost of capital.<sup>113</sup> To the extent that investors believe they face a greater risk that their investment will be lost from a catastrophic TIH release on a railroad, they require a higher return on their investment. Consequently, NS’s attempt to add “excess risk” to

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<sup>110</sup> NS Reply, at III-D-224 to -242.

<sup>111</sup> SunBelt Reb., at III-D-53.

<sup>112</sup> Id. at III-D-54

<sup>113</sup> Id. at I-13 to -14; III-D-54 to -55.

the SBRR's operating costs would be a double count of a cost already included in the SBRR's cost of capital.

Finally, NS's attempt to quantify "excess risk" on a per car basis is arbitrary and flawed.<sup>114</sup> The NS methodology is predicated upon historical accident data, which fails to reflect the safety advances that are built into the SBRR's system, such as PTC, and safety advances made by the industry over the 50-year data period. NS also irrationally claims that the SBRR's risk of a catastrophic TIH incident is higher than that of any other railroad because of the SBRR's higher proportion of TIH traffic relative to total traffic, even though other railroads handle a higher overall amount of TIH traffic over much greater distances. NS's "excess risk" factor not only violates a basic SAC principle, but it is seriously flawed as applied, and the Board should disregard it.

**V. SUNBELT'S ROAD PROPERTY INVESTMENT FOR THE SBRR IS REALISTIC, FEASIBLE, AND CONSISTENT WITH PRECEDENT.**

NS argues that SunBelt's road property investment costs are greatly understated, and proposes total road property investment costs that are over 71% higher than those presented by SunBelt in its Rebuttal Evidence. There are numerous differences between the SunBelt and NS road property investment costs that account for this wide disparity, the full details of which are addressed in Part III.F of SunBelt's Rebuttal Evidence. But there is at least one consistent pattern: on issue after issue, NS ignores or flouts consistent Board precedent governing many elements of road property investment costs, such as the following:

- NS proposes stripping costs that are inconsistent with the agency's recent decisions in Xcel, 7 S.T.B. at 671, AEP Texas, slip op. at 79, and AEPCO, slip op. at 84-85. See SunBelt Reb. III-F-41 to -42.
- NS advocates a final grading additive that has been rejected in at least four past agency decisions, in AEP Texas, slip op. at 82-83; Duke Energy Corp. v. Norfolk

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<sup>114</sup> Id. at III-D-55 to -57.

S. Ry. (Duke/NS), 7 S.T.B. 89, 176 (2003); McCarty Farms, 2 S.T.B. at 480; and CP&L, 7 S.T.B. at 313-314. See SunBelt Reb. III-F-48 to -49.

- NS includes an adjustment for “swell” that was rejected in AEPCO, slip op at 92. See SunBelt Reb. III-F-49 to -50.
- NS supports an increase in retaining wall quantities that was specifically rejected in the Board’s recent decisions in AEPCO, slip op. at 84 and AEP Texas, slip op. at 84. See SunBelt Reb. III-F-62.
- NS includes nearly \$18 million for lighting costs for night time work, an additive rejected by the Board in Otter Tail, slip op. at D-18. See SunBelt Reb. III-F-71 to -72.
- NS added over \$8 million in mobilization costs for land, ignoring STB consistent precedent that holds that a mobilization factor should only be applied to construction costs. AEPCO, slip op. at 132; FMC, 4 S.T.B. at 818; Ariz. Pub. Serv. Co. v. Atchison, Topeka & Santa Fe Ry. (APS), 2 S.T.B. 367, 401 (1997). SunBelt Reb. III-F-140 to -142.
- NS added costs to account for alleged lost production due to rainfall. But this additive flies in the face of Board precedent in Otter Tail, where the Board rejected a similar added cost for winter construction (in a far more challenging weather zone), slip op. at D-18, and in McCarty Farms, 2 S.T.B. at 484, n.52. SunBelt Reb. III-F-143 to -144.

As discussed in SunBelt’s Rebuttal, NS did not carry its burden of proof to show that the Board should depart from its clear precedent. In this Brief, however, SunBelt focuses upon four matters, which are among the most consequential to the SAC analysis: (a) land values; (b) earthwork unit costs; (c) undercutting; and (d) PTC.

**A. NS Has Used Deeply Flawed Methodologies To Inflate Land Values.**

Most of the difference between the SunBelt and NS land values is attributable to a seriously flawed appraisal by NS. The errors and distortions committed by the NS appraiser are too numerous to discuss them all in this Brief. SunBelt’s appraisers present a thorough critique of the NS methodology and a full defense of their own methodology in Rebuttal Exhibit III-F-2.<sup>115</sup>

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<sup>115</sup> SunBelt’s appraisers have presented a summary of their review of the NS appraisal, with page references to their more detailed analysis, at pages 14-21 of Rebuttal Exhibit III-F-2. In addition, they also have summarized their responses to NS’s critique, also with page references to the more detailed discussion, at pages 22-24 of Rebuttal Exhibit III-F-2.

The most egregious NS errors are discussed below.

As a preliminary matter, NS attempts to discredit SunBelt's land appraisal by disingenuously accusing SunBelt of using 2011 real estate values for land that the SBRR would acquire in 2009.<sup>116</sup> Although the appraisal valuation date is July 31, 2011, SunBelt adjusted the 2011 valuation back to the SBRR construction period beginning in 2009.<sup>117</sup> This methodology has been used by shippers and railroads alike in past cases.<sup>118</sup>

The first error in the NS appraisal is the use of an arithmetic mean rather than a weighted average mean, resulting in overstated land values.<sup>119</sup> As a general rule, the larger the parcel, the lower the unit price. Consequently, producing an average value using an arithmetic mean, which gives equal weight to large and small parcels, will tend to overstate the land value that is applied to a wide variety of parcel sizes. SunBelt measured the impact of this error by testing the same 38 sales data sets used by NS. In 95% of the cases, the NS average land value overstated the actual sales prices of the 38 sets of comparable sales, and 76% of the overstatements were by more than 25 percent, and 34% of the overstatements more than doubled the actual sales price.<sup>120</sup> Finally, in a blatantly misleading attempt to discredit SunBelt's appraisers, NS quoted the Appraisal Institute's book, "The Appraisal of Real Estate," completely out of context to give the false impression that the Institute has rejected the weighted average mean in favor of the

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<sup>116</sup> NS Reply, at III-F-4.

<sup>117</sup> See SunBelt Op. Ex. III-H-1, Table C (showing that the July 2011 appraisal values were adjusted back in time to \$179.2 million as of July 30, 2009). At page III-H-2 of its Reply, NS acknowledges that "SunBelt's land valuation witness estimated 2011 land values and discounted those values back to the SBRR construction period...."

<sup>118</sup> SunBelt Reb., at I-72

<sup>119</sup> SunBelt Reb. Ex. III-F-2, at 28-37.

<sup>120</sup> Id. at 38.

arithmetic average.<sup>121</sup>

Next, NS compounded the above error by arbitrarily excluding high-end sales prices as outliers, but not low-end prices.<sup>122</sup> There is no logic to this approach or support in general appraisal practice. Furthermore, there is no explanation or apparent pattern in how NS identified these outliers. By starting with the arithmetic mean (which favors higher unit-price sales), and then excluding a varying proportion of higher unit-price sales, NS produced a land value conclusion that was disconnected from the sales data, which means that any resulting value conclusions are unsupported and unreliable.<sup>123</sup> While both have their place in the appraisal process, the weighted average mean is a far more accurate and reliable form of averaging when attempting to determine a reasonable value for a large number of widely varying properties.<sup>124</sup>

NS also inflated land values by using average land values for the entire route when faced with few or no sales for a county.<sup>125</sup> Because most routes include at least one urban area, where sales data typically is available, this methodology effectively transfers urban land values to rural communities.<sup>126</sup>

NS, for its part, has proffered unfair criticisms of SunBelt's appraisal. The most overstated criticism is that SunBelt's physical inspections were deficient and that NS's were superior because NS spent more time inspecting the SBRR route. This is a red-herring. Through advanced preparation and the use of powerful tools, SunBelt made better use of its time in the field, inspecting more urban areas on the SBRR route than NS, and better documented its

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<sup>121</sup> Id. at 38-39.

<sup>122</sup> Id. a 48.

<sup>123</sup> Id. at 46.

<sup>124</sup> Id. at 40-41.

<sup>125</sup> Id. at 48.

<sup>126</sup> Id. at 49.

inspections.<sup>127</sup> In fact, SunBelt’s appraisers spent twice as much time in the office preparing for its physical inspections as they spent in the field.<sup>128</sup> While in the field, they had very powerful tools at their disposal that enhanced their efficiency and productivity.<sup>129</sup> A simple comparison of time spent in the field simply is not a reliable indicator of the accuracy of an appraisal.

NS also maligns SunBelt’s use of powerful computer tools, such as Google Earth aerial imaging and other online tools, as a “desktop appraisal.” Such criticism is nonsense because it is the responsibility of an appraiser to use all available tools and techniques to improve the accuracy of the appraisal.<sup>130</sup> Moreover, considering that the railroad right-of-way often is difficult to access without trespassing on private property or is in remote areas, computer imaging actually provides better access than driving around in a car.

Beyond its appraisal errors and distortions, NS attempts to add over \$8 million in extra mobilization costs to cover asserted “real estate acquisition costs,” such as title work, negotiations, expert appraisals, recording fees, and numerous other added costs.<sup>131</sup> The Board, however, consistently has held that mobilization only applies to construction costs.<sup>132</sup> The justification provided by NS for this departure from established precedent is that the SBRR

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<sup>127</sup> Id. at 79-80.

<sup>128</sup> Id. at 80.

<sup>129</sup> Id. at 81.

<sup>130</sup> Id. at 81-82.

<sup>131</sup> NS Reply, at III-F-268 to -272.

<sup>132</sup> See AEPCO, at 132 (“Mobilization involves the marshaling and movement of people, equipment, and supplies to the various construction sites and other pre-construction coordination and activities”); FMC, at 818 (“Mobilization costs reflect the cost of assembling equipment, personnel and facilities at designated places so that construction may commence”); APS, 2 S.T.B. at 401 (“Mobilization costs cover expenses associated with moving personnel, materials, supplies, and equipment to job sites and the establishment of offices and other facilities prior to commencement of a construction project.”)

cannot purchase 7,300 acres of land in seven months without engaging contractors.<sup>133</sup> But, as stated by the ICC, “any restriction in the supply of resources necessary to construct the SARRs in the minimum time dictated by technological feasibility represents a barrier to entry.”<sup>134</sup> This also is a classic barrier to entry because NS has not shown, or even attempted to show, that it actually incurred these types of costs when it (or its predecessors) originally acquired the right-of-way that the SBRR must purchase.<sup>135</sup>

Finally, NS has rejected SunBelt’s land inflation index, which adheres to established precedent, in favor of a made-for-litigation forecast prepared by NS’s appraisers.<sup>136</sup> Instead of relying upon Board precedent for estimating future land values, NS relied on the unsupported position of its real estate consultant that rural and urban land values would increase only at the general rate of inflation. With respect to rural land values, SunBelt shows that the basis for NS’s position, that declining farm income will lead to declining farm land values, is not supported by recent studies.<sup>137</sup> For example, current USDA research has shown little correlation between farm

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<sup>133</sup> See NS Reply, at III-F-269. This argument is reminiscent of the effort of past defendants to include an assemblage factor in real estate acquisition – an effort that has been rejected by the Board unless the defendant can show that it paid such a cost. See Duke/NS, at 169 n. 97 (assemblage factor is an impermissible barrier to entry unless the defendant railroad can show that it incurred such costs for the rail line at issue); see also West Texas, at 672-673 (“the cost of needed permits, licenses and environmental compliance also must be considered as a barrier when that cost was not incurred by the incumbent.”).

<sup>134</sup> See Coal Trading Corp. v. Baltimore & Ohio R.R. (Coal Trading), 6 I.C.C.2d 361, 413 (1990); see also West Texas, at 471 (rejecting assertion of inflated costs because “[e]xisting railroads were built on a piecemeal basis, and were not saddled with a need to marshal, in such a short period of time, the resources required to construct a 1,400-mile rail system.”)

<sup>135</sup> See McCarty Farms, at 506 (“Only when the incumbent carrier has incurred a sunk cost should that cost be included in the SAC analysis.”); Coal Trading, at 413 (“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. The entry process actually faced by the incumbent was quite different from that hypothesized for the new entrant.”).

<sup>136</sup> See SunBelt Reb., at III-G-7 to -10; SunBelt Reb. Ex. III-G-1.

<sup>137</sup> SunBelt Reb. Ex. III-G-1, at 2-5.

values and farm income, and nonagricultural factors (such as the possibility of farmland development) are a much greater influence on farmland value than they have been historically. Similarly, with respect to urban land values, SunBelt shows that NS's projections are based on the use of data with a limited timespan; that the data is misused; and that the data that NS used was neither final nor representative of the values claimed.<sup>138</sup>

**B. The Trestle Hollow Project Is Superior To The Means Handbook For Earthwork Unit Costs.**

Major differences impacting road property investment costs in this case are the construction unit costs, particularly those for earthwork. SunBelt has used actual costs from the recent Trestle Hollow project in Tennessee, which is more representative of the costs that the SBRR would incur.<sup>139</sup> NS, instead, has relied upon the Means Handbook, which has been used in prior SAC cases in the absence of actual real-world construction costs.

The use of actual costs is preferable to Means Handbook costs because Means does not, and cannot, recognize the economies of scale of large railroad projects such as the SBRR.<sup>140</sup> Indeed, Means itself recognizes that “[e]conomies of scale can reduce costs for large projects.”<sup>141</sup> The SBRR clearly would be larger than any project contemplated by the Means Handbook, with economies of scale resulting in lower costs than those in Means. The recent Western Fuels I and AEPCO decisions reinforce the notion that actual earthwork costs bid by contractors for actual projects are in fact lower than average costs from the Means Handbook.<sup>142</sup>

NS attempts to avoid this fact by disparaging the Trestle Hollow project as “tiny in size

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<sup>138</sup> Id. at 6-11.

<sup>139</sup> SunBelt Reb., at III-F-15 to -29.

<sup>140</sup> Id. at III-F-16.

<sup>141</sup> See id. at III-F-16.

<sup>142</sup> AEPCO, slip op. at 86-88; Western Fuels I, slip op. at 86.

and scope in comparison to the SBRR.”<sup>143</sup> But any real-world project would be tiny in comparison to the 578-mile SBRR. Moreover, NS’s argument actually undermines its reliance upon Means because Means does not capture the economies of scale that can reduce costs for such large projects. This acknowledgement by Means also suggests that the relatively smaller size of Trestle Hollow overstates the true costs that the SBRR would incur for its much larger scale construction project.

NS also suggests that, because the Trestle Hollow project was a shortline project, it is substandard or not relevant to the SBRR.<sup>144</sup> This is nonsense. The costs and challenges of building a railroad are not dependent upon the size of the railroad doing the building. The Trestle Hollow project involved construction of a complicated, new alignment for the South Central Tennessee Railroad in difficult conditions, including steep terrain requiring deep cuts and high fills. The hilly terrain, ridges, and valleys along the alignment, and the fact that much of the land had not been accessed for decades, presented difficult challenges. The elevation change of the project from end to end was well over 100 feet. The contractor used scrapers, assisted by bulldozers, and large excavators with trucks to perform the earthwork. In fact, the Trestle Hollow project involved terrain that was more difficult than most of the terrain that the SBRR would encounter.

SunBelt used the Trestle Hollow Project unit costs because they are a supportable, feasible, and superior real-world substitute for the Means Handbook costs for common earthwork. The Trestle Hollow Project unit costs reflect the use of actual earthwork costs from a contractor’s bid in the same way that actual costs were substituted for Means Handbook costs in Western Fuels I and AEPCO. As shown in both of those cases and this proceeding, actual bids

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<sup>143</sup> NS Reply, at III-F-35.

<sup>144</sup> NS Reply, at III-F-36.

from contractors are lower than Means Handbook costs. Because of this fact, the Board should use SunBelt's earthwork cost figures.

**C. Undercutting Is An Unnecessary Expense.**

NS has attempted to inject a completely unnecessary added expense into the SBRR's roadbed preparation costs. Specifically, NS includes undercutting costs, an item repeatedly rejected by the Board.<sup>145</sup> NS Reply, at III-F-70 to -80. NS attempts to distinguish this precedent on the assertion that the SBRR traverses more wetlands, where there is a greater need for undercutting. But as SunBelt has demonstrated, to the extent that undercutting is necessary, it is already included in the ICC Engineering Reports. SunBelt Reb. at III-F-44 to -46.

All excavation quantities shown in the ICC Engineering Reports have been included by both parties in their calculation of the cubic yards of excavation per mile by valuation section for the SBRR, Because the Engineering Reports are based in part on observations of physical characteristics of topography or structures that were readily observable parts of the roadbed construction effort, if the area surrounding an embankment showed signs of unsuitable material and/or warranted grubbing, the quantities would have been included in the Reports. Thus, the addition of undercutting quantities would result in a double-count.

If undercutting were necessary, NS presumably would have examples where the original roadbed construction of SBRR-replicated lines had to be replaced, or the subgrade adjusted, because undercutting was not performed during the original construction. NS also should be able to show that these lines currently have two-feet of rip rap underlying the roadbed. But NS has not made either showing. Because the ICC Engineering Reports do not indicate that any quantities of rip rap or other material have been used for the replacement of unsuitable material, this indicates

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<sup>145</sup> See Western Fuels I, slip op. at 83, AEP Texas, slip op. at 79, Duke/NS, 7 S.T.B. at 176, CP&L, 7 S.T.B. at 313.

that any unsuitable material was simply removed and replaced with excavated material from adjacent sections.

Finally, NS has not supported its undercutting quantities. It has only speculated and generalized about a 2-foot undercutting depth. The NS assumption that every instance of wetland excavation will occur at a fill location with an average height of eight feet would grossly overstate undercutting quantities because eight feet is the average fill height for the entire 578-mile SBRR, not just the so-called wetland excavation areas. Finally, the NS justification for requiring swamp mats is a classic barrier to entry because it is based upon the need “[t]o sustain the aggressive construction production rate proposed for the” SBRR. NS Reply, at III-F-79.

**D. The SBRR Can And Will Install PTC in 2011.**

There is a significant difference between the SunBelt and NS cost for signals and communications because SunBelt installs PTC at the beginning of SBRR operations in 2011, whereas NS installs Central Traffic Control (“CTC”) in 2011 and then installs an overlay PTC system in 2015. SunBelt’s proposal is what a least-cost, optimally efficient rail carrier would do, because it would be irrational to install a CTC system for new construction that would be obsolete in just four years.<sup>146</sup> NS does not contest that logic, but instead argues that the technology to install PTC did not exist in 2011 and that the market could not supply the required systems because of simultaneous demand from all railroads. NS is wrong.

NS has confused the ability to install PTC on a new railroad with the requirement to install PTC as an overlay to an existing CTC system that is interoperable with other railroads. The latter is technologically more complex and expensive. SunBelt has shown that not only did PTC technology exist in 2011, but also railroads in the U.S. and around the world were using

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<sup>146</sup> Id. at III-F-109.

PTC in various forms well before then.<sup>147</sup> The challenges and the costs are much greater for installing an overlay system, in the midst of on-going rail operations, that must be interoperable with other railroads. Nevertheless, because there are costs associated with making PTC interoperable across railroads by 2016, SunBelt has included such costs in addition to the SBRR's original PTC installation costs in 2011.<sup>148</sup>

SunBelt's evidence on PTC is very similar to the PTC evidence filed by DuPont in Docket No. 42125. NS, in its Final Brief in that case, alleged that DuPont would face two insuperable obstacles to its PTC deployment plan. First, DuPont could not rely upon NS's PTC system costs because the NS PTC system did not exist, and second, DuPont did not explain how the technology that existed at the time could be adapted, brought to scale, and implemented for DuPont's 7,300 mile SARR.<sup>149</sup> Presumably, NS will raise similar arguments on brief in this case, even though the SBRR is a much smaller SARR. The Board should reject the NS arguments.

NS doesn't seem to be sure whether it should argue that the SBRR system could not have met 2015 standards in 2011 (which is irrelevant) or that the SBRR's PTC system would need to have been continually upgraded through 2015 and beyond to meet federal standards (which is rendered moot by the fact that the required upgrades are accounted for in SunBelt's use of NS costs, which reflect development of a fully compliant system). Whether the SBRR's PTC system could meet 2015 standards in 2011 is irrelevant because it did not need to do so. For example, the SBRR's PTC system would not need to be interoperable with other railroads until 2016. The SBRR's PTC system only would need to be operable, scalable, and expandable, so that

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<sup>147</sup> Id. at III-F-110.

<sup>148</sup> Id. at III-F-113, -119.

<sup>149</sup> Final Brief of Norfolk Southern Railway Company, E.I. du Pont de Nemours & Co. v. Norfolk S. Ry., STB Docket No. 42125, at 153 (filed June 14, 2013) ("NS/DuPont Brief").

investment at the level reflected in the SunBelt model would bring it up to applicable standards by 2015. Moreover, because SunBelt assumed that the SBRR would incur the cost of a fully compliant PTC system from the start of operations, even though the system might not be able to meet all 2015 standards in 2011 (*i.e.*, PTC was installed in 2011, and continually expanded and improved to meet federal standards by 2015), the SBRR's costs are conservatively *overstated* for all years prior to 2015. Those costs also are conservatively *overstated* in general because many of the difficulties that NS has encountered, and the consequent costs, are due to the NS need to install an overlay PTC system in a short time period, on an operating railroad, with limited resources.<sup>150</sup> In contrast, the SBRR will install most of its PTC system prior to beginning operations (unlike NS which will be overlaying PTC while continuing to operate as normal), will upgrade that system to 2015 standards over time (which is the same time period applicable to NS), and will not be subject to the same resource constraints (although the NS costs used by SunBelt still conservatively reflect those constraints). This PTC investment and installation approach is the same basic Board-approved approach used for overall SARR investment whereby the peak year's track infrastructure requirements are installed at the commencement of SARR operations even though the peak operating period is typically 10-years in the future.

NS appears to have perceived the weakness of its argument in the DuPont case, when it acknowledged in its brief that a limited function (*i.e.*, noncompliant by 2015 standards) system could have been installed by the SARR, and that if a "PTC-lite" system were installed before

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<sup>150</sup> Federal Railroad Administration, Report to Congress on Positive Train Control Implementation Status, Issues, and Impacts 29 (2012) ("The limited resources available, along with the 2015 deadline have forced the railroads to develop and install PTC technology in a less efficient way than would otherwise be the case.") (included as NS Reply WP "2012 FRA PTC Report").

2015, then “numerous and significant upgrades” would be needed by 2015.<sup>151</sup> NS implied that this is problematic, but it is not. The limited function system would have cost less to install than the advanced NS system upon which SunBelt based the SBRR’s PTC costs, while meeting the SBRR’s signaling needs. By using the NS costs reflecting a fully compliant system to develop the SBRR’s PTC costs in 2011, SunBelt ensured sufficient funding for continual upgrades and improvements over time.

NS attempts to avoid this fact by requiring the SBRR to build the complete NS system in 2011 if it is also going to use NS costs. This creates a “lose-lose” scenario for the SBRR that places it at a distinct disadvantage to NS, which violates SAC principles. By requiring SunBelt to match a specific PTC technology with the costs for the SBRR’s PTC system in 2011, NS is imposing an impossible burden upon SunBelt. The most complete set of PTC costs to which SunBelt has access are those produced in discovery by NS for its PTC deployment. SunBelt cannot simply ask a vendor to design a customized PTC system and quote costs for a completely hypothetical railroad. But this does not mean that the technology was unavailable in 2011 or could not be adapted over four years to comply with 2015 standards. NS itself concedes that functioning PTC technology did exist in 2011 and that the Congressional PTC mandate was a technology forcing event.<sup>152</sup> Therefore, it is reasonable and necessary to presume that the SBRR could install existing PTC technology in 2011 and that the same Congressional mandate would force the technology needed to upgrade that system to 2015 standards. To hold otherwise would constitute an impermissible barrier to entry.

The important facts are that the existence of PTC technology in 2011, along with the

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<sup>151</sup> NS/DuPont Brief 156.

<sup>152</sup> NS/DuPont Brief 153-54 (acknowledging that the NS’s PTC technology did not exist in 2009), 155 (referring to “technology-forcing U.S. law”), 155-56 (referring to PTC technology that existed in 2009).

ability to upgrade that technology by 2015, demonstrate the feasibility of SunBelt's approach. A rational new entrant would not incur the cost of a CTC system knowing that it will have just four years to recoup its investment before it must install PTC. NS, by contrast, has had decades to recoup its CTC investment. Rather, a new entrant would start with available PTC technology and upgrade it as necessary to comply with 2015 standards. The feasibility of this strategy is evident because even NS no longer seems to claim that PTC technology was unavailable, only that the technology for its particular PTC system was not yet fully developed. NS's attempt to overcome this fact by requiring the SBRR's PTC costs to precisely match the NS technology would constitute a barrier to entry. Furthermore, SunBelt's use of NS costs for PTC development conservatively overstates the actual costs that the SBRR would incur because the SBRR would not be under the same time and resource constraints as NS. Therefore, SunBelt has posed feasible and realistic PTC costs for the SBRR.

Finally, the NS position is incongruous. Although NS claims that the SBRR must install PTC by the Congressional 2015 deadline, both NS and FRA have publicly acknowledged that is not possible.<sup>153</sup> Indeed, NS has testified that it will not be able to implement a compliant PTC system until the 2018-2020 time frame. If NS itself will be unable to meet the 2015 deadline, the SBRR cannot be required to meet that deadline either.

## **VI. SUNBELT HAS PERFORMED THE DCF AND MMM ANALYSES CONSISTENT WITH BOARD PRECEDENT AND REAL-WORLD PRACTICE.**

This Brief addresses five major areas of difference between NS and SunBelt in their performance of the DCF and MMM analyses. These are equity flotation costs, the SBRR's debt capital structure, bonus depreciation, the present value of future interest payments, and TIH-related modifications to the MMM analysis. With respect to the debt capital structure and future

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<sup>153</sup> SunBelt Reb. at III-F-111.

interest payments, SunBelt has advocated modifications to the practice in prior cases based upon real-world practice and a newly-identified flaw, respectively. In contrast, NS has engaged in result-oriented deviations from Board precedent that has consistently rejected equity flotation costs, barriers to entry that deny the SARR the ability to pay the same market prices as the defendant, and MMM variable cost adjustments.

**A. NS Improperly Adds Equity Flotation Costs To The SBRR's Cost Of Capital.**

Although the Board has consistently rejected railroad attempts to include equity flotation costs in the SARR's cost of capital, NS claims that the Board "changed its approach" in AEP Texas.<sup>154</sup> NS's characterization is incorrect.

The Board's inclusion of equity flotation costs in AEP Texas is easily distinguished from all of its other decisions rejecting such costs. In AEP Texas, the complainant agreed to an equity flotation cost as part of its plan to have the SARR restructure its initial investment soon after the construction was completed.<sup>155</sup> Thus, there was no dispute for the Board to resolve. Furthermore, the equity flotation fee was only 0.13%, which stands in stark contrast to the 2.1% fee proposed by NS based on an inappropriate comparison with the Facebook IPO.

In cases after AEP Texas, the Board has continued to reject equity flotation costs. Indeed, the Board explicitly rejected the very same argument that NS has made in this proceeding—that the Board "changed its approach" in AEP Texas.<sup>156</sup> In AEPCO, slip op. at 138, the Board specifically stated that its "longstanding precedent" required rejecting the equity flotation fee proposed by BNSF and UP. That "longstanding precedent" recognized that, if the Board were to use a flotation fee as requested by NS, then the Board would also have to replace the railroad

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<sup>154</sup> NS Reply, at III-G-3 to -4.

<sup>155</sup> SunBelt Reb., at III-G-3.

<sup>156</sup> AEPCO, slip op. at 138,

industry cost-of-capital in the DCF model:

A serious argument that an equity flotation cost should be included for a stand-alone railroad would require a re-examination of the use of the general rail industry cost-of-capital rate in the DCF model. Because of the complexities associated with such an endeavor, the parties to SAC cases have found it preferable to use the rail industry's cost-of-capital rate as a surrogate for that of the stand-alone railroad.<sup>157</sup>

NS has not proposed any replacement for the rail industry cost-of-capital in the DCF model and, consequently, the Board should reject the inclusion of an equity flotation cost.

**B. The SBRR's Debt Capital Structure Is The Same As Real-World Railroads.**

SunBelt has set a target capital structure for the SBRR and maintained that structure throughout the DCF model, consistent with STB precedent. The SBRR would make coupon payments on its debt consisting solely of fixed interest payments. To reflect this steady capital structure, the SBRR would reissue debt as older debt is retired, which results in consistent interest payments as reflected in the DCF model. Although this is different from past cases in which the SARR has issued debt similar to a typical home mortgage loan, SunBelt has designed the SBRR's capital structure in the same manner as real-world railroads, including NS, and other large corporations.<sup>158</sup> This capital structure also is consistent with the Board's DCF model, which assumes the capital structure does not change over time and that interest rates on future debt will equal the interest rate for debt issued during the SARR's construction.

**C. The SBRR Is Entitled To Bonus Depreciation.**

Consistent with Board precedent and contestable market theory, the SBRR must be permitted to take advantage of the "bonus" depreciation provisions enacted in 2008 and 2009,

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<sup>157</sup> Wisconsin, 5 S.T.B at 1040 n.200.

<sup>158</sup> SunBelt Reb., at III-H-2 to -4.

and continued in 2010.<sup>159</sup> Although NS acknowledges that the SARR is entitled to some bonus depreciation benefit, it attempts to limit that benefit based upon the extent to which NS itself has benefited from those provisions.<sup>160</sup> But that would impose an impermissible barrier to entry in violation of contestable market theory.

The NS argument attempts to turn contestable market theory on its head by claiming that bonus depreciation should be restricted because it places the SBRR at an advantage relative to NS. The fact that the SBRR might have an advantage relative to NS is a red-herring. By virtue of being a least-cost, optimally efficient new entrant, a SARR necessarily will have many advantages over the incumbent. If the objective of a SAC analysis were to establish parity between the defendant and the SARR, then a SARR would be required to use the same production techniques that the defendant used to build the original rail lines a century ago, rather than more efficient modern techniques.<sup>161</sup>

The SAC analysis requires the SARR to pay current prices at the time of construction regardless what the defendant may have paid. This is because “[t]he crucial feature of a contestable market is its vulnerability to hit-and-run entry,”<sup>162</sup> which means that the SARR must be able to enter the market within the minimum amount of time dictated by technological feasibility for the most complex and time-consuming project on the SARR, and pay current market prices for construction, without regard for resource constraints.<sup>163</sup> That means a SARR must pay market rates for land, material, and labor, which are sometimes higher than the

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<sup>159</sup> Id. at II-H-5 to -9.

<sup>160</sup> NS Reply, at III-H-5.

<sup>161</sup> SunBelt Reb., at III-H-6.

<sup>162</sup> William J. Baumol, Contestable Markets: An Uprising in the Theory of Industry Structure, Am. Econ. Rev., March 1982, at 1, 4.

<sup>163</sup> SunBelt Reb., at III-H-7.

defendant paid and at other times lower. Tax depreciation is a temporal cost factor just like these other costs that the SARR incurs. It would be arbitrary to deny the SBRR the benefit of “current market prices” for just this one factor simply because this factor reduces the SBRR’s costs.<sup>164</sup>

**D. SunBelt Has Corrected A Flaw In The Calculation Of The Present Value Of Future Interest Payments In The Terminal Value Calculation.**

SunBelt has identified and corrected a flaw in the current methodology for calculating the present value of future interest payments in the terminal value calculation.<sup>165</sup> Because the DCF model explicitly assumes that the SARR’s capital structure will remain constant into perpetuity, the amounts of common equity and debt carried on the SARR’s financial statements will remain the same forever. However, the DCF model assumes that, after year 20 and until the first assets are replaced in the replacement level of the DCF model, the railroad has no debt and no tax shielding interest payments. This creates an irreconcilable mismatch between the SARR’s cost of capital and its cash flows. The cost of capital assumes that the SARR is carrying debt, and its associated interest payments, but the cash flows reflect no benefits from the interest tax shields.

Although NS recognized that such a disconnect exists, it refused to accept that a correction is needed because the disconnect is allegedly a “mainstay of the Board’s DCF model since Coal Trading and McCarty Farms.”<sup>166</sup> NS did not provide any citations to these two cases, so it is not entirely clear why NS mentioned them. In Coal Trading, the ICC allowed the debt-equity mix to change over time as debt was paid off;<sup>167</sup> conversely, McCarty Farms involved use of a constant capital structure.<sup>168</sup> Neither case included a statement by the agency approving, let

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<sup>164</sup> Id. at III-H-8.

<sup>165</sup> Id. at III-H-10 to -14.

<sup>166</sup> See NS Reply, at III-H-9.

<sup>167</sup> See Coal Trading, 6 I.C.C.2d at 379-380.

<sup>168</sup> See McCarty Farms, 2 S.T.B. at 522, n.123.

alone recognizing, the existence of the disconnect that SunBelt has identified. NS also incorrectly claims that the Board “affirmed” this disconnect in the Major Issues proceeding.<sup>169</sup> The Board, however, did not even address tax shielding interest payments or the SARR’s debt-equity mix beyond Year 20, which is at the heart of the disconnect described by SunBelt. Finally, the simple fact that an error has existed for several years is not a legitimate justification for its continued existence. An error, regardless of how long it has existed, should be corrected.

**E. The Board Should Reject NS’s Radical Modifications To The MMM Analysis.**

SunBelt has applied the Board’s MMM analysis consistent with the Major Issues decision, in which the Board adopted MMM. In contrast, NS has proposed a radical departure from Major Issues purportedly to “properly allocate the unique variable costs of TIH transportation solely to the SBRR’s TIH movements.”<sup>170</sup> Specifically, NS attempts to assign unique costs to TIH traffic for PTC installation, insurance, and “excess risk.” The Board should reject the NS modifications to MMM both as a matter of fact and law.

NS inaccurately describes PTC costs as unique to TIH transportation. There are three independent problems with this assertion.<sup>171</sup> First, because PTC is the only signal system used by the SBRR, as opposed to a PTC/CTC overlay, PTC unequivocally is used by all of the SBRR’s traffic, not just TIH traffic. Second, because the Rail Safety Improvement Act of 2008 does not require PTC to be installed on a rail line unless there is both (a) the presence of TIH traffic and (b) at least 5,000,000 gross tons of total traffic, it is inaccurate for NS to contend that TIH traffic is the *only* cause, because without substantial non-TIH traffic, PTC would not be required. Third, even if the presence of TIH traffic were the sole basis for requiring PTC, the benefits of PTC are

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<sup>169</sup> See NS Reply, at III-H-9.

<sup>170</sup> NS Reply, at III-H-21 to -28.

<sup>171</sup> SunBelt Reb., at III-H-28 to -30.

not limited to just TIH traffic. Thus, this factual predicate for NS's MMM modifications is erroneous.

Additionally, NS attributes extra insurance costs to TIH traffic based upon the irrational claim that "the SBRR will have a markedly higher risk of a catastrophic TIH release than other railroads" simply because it carries a higher percentage of TIH traffic relative to total traffic than other railroads.<sup>172</sup> Such a comparison is meaningless. The SBRR, with only a fraction of the total TIH carloads and TIH car-miles of NS, clearly has a lower risk profile, which is further reduced by the SBRR's installation of PTC on all of its lines from the first day of operations.<sup>173</sup> NS also wrongly asserts that TIH traffic would be solely responsible for the need to purchase insurance in excess of \$200 million.<sup>174</sup>

Moreover, as discussed in Part IV.C above, NS's attribution of excess risk cost to TIH traffic is an attempt to game the MMM analysis by double-counting excess risk costs and creating an impermissible barrier to exit.<sup>175</sup>

Finally, as a matter of law, the NS modifications to MMM constitute movement-specific adjustments to URCS, which are prohibited by Board precedent and are inconsistent with the purpose of MMM.<sup>176</sup> Also, according to NS's own legal argument, its modifications to MMM must be rejected as an impermissible attempt to modify, via adjudication, a legislative rule adopted through notice and comment rulemaking.<sup>177</sup>

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<sup>172</sup> NS Reply, at III-D-206

<sup>173</sup> SunBelt Reb., at III-D-48 to -50, III-H-30 to -31.

<sup>174</sup> Id. at III-D-49.

<sup>175</sup> Id. at III-H-31 to -32.

<sup>176</sup> SunBelt Reb., at III-H-24 to -27.

<sup>177</sup> Id. at III-H-24.

## VII. NS HAS NOT CONDUCTED A PROPER CROSS-SUBSIDY ANALYSIS.

NS asserts that, if the Board finds that SBRR revenues exceed its cost, the Board must conduct cross-subsidy analyses on the Burstall, AL to McIntosh, AL line segment using the templates that NS provided.<sup>178</sup> The Board should reject these templates as nothing more than weighted dice.

NS has designed the templates to maximize the likelihood that the Board will find an impermissible cross-subsidy on the Burstall-McIntosh segment. First, NS taints them with the same overstatements, misapplications, and double-counts in its SAC evidence so that the templates will understate the revenues and overstate the costs of the Burstall-McIntosh Segment.<sup>179</sup> Second, NS's claim that the templates develop indirect operating expenses consistent with the Otter Tail decision is incorrect. In fact, the templates include in their indirect operating expense calculations two additional expenses—Ad Valorem taxes and operating materials and supplies.<sup>180</sup> Third, Ad Valorem taxes do not need to be calculated indirectly because they can be calculated directly using a simple straight mileage proration, and their zero variability in URCS makes them well-suited for a mileage prorate.<sup>181</sup> Likewise, because materials and supplies are a direct function of the line segment's T&E personnel, which NS was able to identify, they also should be calculated directly.<sup>182</sup> These flaws render the NS templates incorrigible.

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<sup>178</sup> NS Reply, at III-H-16 to -20.

<sup>179</sup> SunBelt Reb., at III-H-22.

<sup>180</sup> Id.

<sup>181</sup> Id. at III-H-22 to -23.

<sup>182</sup> Id. at III-H-23

## VIII. CONCLUSION.

For the foregoing reasons, the Board should order NS to establish and maintain rates for the issue movement that are no higher than those shown by SunBelt's Rebuttal Evidence for each of the years from July 30, 2011 through July 29, 2021, and to pay SunBelt reparations equal to the difference between the maximum prescribed rate levels and the freight charges actually paid by SunBelt on all shipments from July 30, 2011 through the date of NS's compliance with the Board's order, together with compensatory interest.

Respectfully submitted,



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July 26, 2013

**CERTIFICATE OF SERVICE**

I hereby certify that this 26th day of July 2013, I served a copy of the Final Brief of SunBelt Chlor Alkali Partnership upon Defendant via hand delivery at the address below:

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