

BEFORE THE
SURFACE TRANSPORTATION BOARD

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March 7, 2016
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Public Record

CONSUMERS ENERGY COMPANY)
)
)
)
 Complainant,)
)
 v.)
)
 CSX TRANSPORTATION, INC.)
)
)
 Defendant.)

Docket No. NOR 42142

REPLY EVIDENCE OF CSX TRANSPORTATION, INC.

I. COUNSEL'S ARGUMENT AND SUMMARY OF EVIDENCE

(Volume 1 of 4)

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

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

Counsel to CSX Transportation, Inc.

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SHORT FORMS FOR FREQUENTLY CITED CASES

The following short form case citations are used herein:

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| <i>AEPCO 2002</i> | <i>Arizona Electric Power Cooperative, Inc. v. Burlington Northern & Santa Fe Railroad Co. & Union Pacific Railroad Co., 6 S.T.B. 322 (2002)</i> |
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| <i>SAC Procedures</i> | <i>General Procedures for Presenting Evidence in Stand-Alone Cost Rate Cases</i> , 5 S.T.B. 441 (2001) |
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| <i>SunBelt</i> | <i>SunBelt Chlor Alkali Partnership v. Norfolk Southern Railway Co.</i> , STB Docket No. 42130 (served June 20, 2014) |
| <i>SSW (1985)</i> | <i>St. Louis Southwestern Railway Company – Trackage Rights Over Missouri Pacific Railroad Company – Kansas City To St. Louis</i> , 1 I.C.C.2d 776 (1985) |
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| <i>TMPA II</i> | <i>Texas Municipal Power Agency v. Burlington Northern & Santa Fe Railway Co.</i> , 7 S.T.B. 803 (2004) |

TPI Market Dominance

Total Petrochemicals & Refining USA, Inc. v. CSX Transportation, Inc., STB Docket No. 42121 (served May 31, 2013)

West Texas

West Texas Util. Co. v. Burlington Northern Railroad Co., 1 S.T.B. 638 (1996).

WFA I

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WFA II

Western Fuels Ass'n, Inc. v. BNSF Railway, STB Docket No. 42088 (served Feb. 17, 2009)

WP&L

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

Xcel

Public Service Co. of Colorado d/b/a Xcel Energy v. Burlington Northern & Santa Fe Railway Co., 7 S.T.B. 589 (2004)

ACRONYMS

| | |
|-------|---|
| AAR | Association of American Railroads |
| AC | Alternating Current |
| AEI | Automatic Equipment Identification |
| AEO | Annual Energy Outlook |
| AFE | Authorizations for Expenditure |
| AMLO | Assistant Manager Locomotive Operations |
| AMTO | Assistant Manager Train Operations |
| APA | Administrative Procedure Act |
| AREMA | American Railway Engineering and Maintenance-of-Way Association |
| ARRA | American Recovery and Reinvestment Act |
| ATC | Average Total Cost |
| AVP | Assistant Vice President |
| BEA | Bureau of Economic Analysis |
| BNSF | Burlington Northern Santa Fe Railway Company |
| BRC | Belt Railway of Chicago |
| B&V | Black & Veatch |
| CAGR | Compound Annual Growth Rate |
| CERR | Consumers Energy Railroad |
| CFS | Commodity Flow Survey |
| CMA | Chemical Manufacturers Association |
| CMP | Aluminized Corrugated Metal Pipe |
| CN | Canadian National Railway Company |
| CNW | Chicago & North Western Railway Company |

| | |
|--------|--|
| CP | Canadian Pacific Railway |
| CREATE | Chicago Region Environmental and Transportation Efficiency Program |
| CSX | CSX Corporation |
| CSXIT | CSX Intermodal Terminals |
| CSXT | CSX Transportation, Inc. |
| CTC | Centralized Traffic Control |
| CTCO | Chicago Transportation Coordination Office |
| CWA | Clean Water Act |
| CWR | Continuous Welded Rail |
| CY | Cubic Yards |
| DCF | Discounted Cash Flow |
| DOT | Department of Transportation |
| DTL | Direct-to-Locomotive |
| ECY | Embankment Cubic Yard |
| EIA | Energy Information Administration |
| EPA | Environmental Protection Agency |
| ERM | Environmental Resources Management |
| ETMS | Electronic Train Management System |
| EVA | Energy Ventures Analysis, Inc. |
| FAS | Financial Accounting Standards |
| FASB | Federal Accounting Standards Board |
| FCC | Federal Communications Commission |
| FED | Failed Equipment Detector |
| FHWA | Federal Highway Administration |

| | |
|------|--|
| FRA | Federal Railroad Administration |
| FSC | Fuel Surcharges |
| G&A | General & Administrative |
| GAO | Government Accountability Office |
| GDP | Gross Domestic Product |
| GE | General Electric |
| GIS | Geographic Information System |
| GPS | Global Positioning System |
| HSL | Hours of Service Law (49 U.S.C. Ch. 211) |
| HVAC | Heating, Ventilation, and Air Conditioning |
| ICC | Interstate Commerce Commission |
| IHB | Indiana Harbor Belt Railway |
| INRD | Indiana Rail Road Company |
| ISA | Intercarrier Service Agreement |
| ISS | Interline Settlement System |
| IT | Information Technology |
| KCBX | KCBX Terminals, Inc. |
| KCS | Kansas City Southern Railway |
| LCY | Loose Cubic Yard |
| LUM | Locomotive Unit Mile |
| MDOT | Michigan Department of Transportation |
| MERC | Midwest Energy Resources Company |
| MGT | Million Gross Ton |
| MLO | Manager Locomotive Operations |

| | |
|-------|---|
| MMBtu | million British Thermal Units |
| MMM | Maximum Markup Methodology |
| MOW | Maintenance-of-Way |
| MP | Mile Post |
| MPSC | Michigan Public Service Commission |
| MSA | Managed Services Agreement |
| MSP | Modified Straight-Mileage Prorate |
| MSRR | Michigan Shore Railroad |
| MTO | Manager Train Operations |
| NPRM | Notice of Proposed Rule Making |
| NROI | Net Railway Operating Income |
| NS | Norfolk Southern Railway Company |
| NYMEX | New York Mercantile Exchange |
| NYSW | New York, Susquehanna & Western Railway |
| OSHA | Occupational Safety and Health Administration |
| P&L | Paducah & Louisville Railway |
| PRB | Powder River Basin |
| PTC | Positive Train Control |
| P&W | Providence and Worcester Railroad |
| R/VC | Revenue to Variable Cost |
| RCAF | Rail Coal Adjustment Factor |
| RCP | Reinforced Concrete Pipe |
| RCRA | Resource Conservation and Recovery Act |
| RIP | Repair In Place |

| | |
|-------|---|
| ROW | Right-of-Way |
| RPMS | Real Property Management System |
| RSAM | Revenue Shortfall Allocation Method |
| RSC | Rail Security Coordinator |
| RSIA | Rail Safety Improvement Act of 2008 |
| RTC | Rail Traffic Controller |
| SAC | Stand-Alone Cost |
| SARR | Stand-Alone Railroad |
| SCTG | Standard Classification of Transportation Goods |
| SFAS | Statement of Financial Accounting Standards |
| SFC | Specific Fuel Consumption |
| SOX | Sarbanes-Oxley Act |
| SP | Southern Pacific Railroad |
| STB | Surface Transportation Board |
| STCC | Standard Transportation Commodity Code |
| T&E | Train & Engine |
| TIH | Toxic-by-Inhalation Hazard |
| UP | Union Pacific Railroad Company |
| URCS | Uniform Rail Costing System |
| USDOT | U.S. Department of Transportation |
| WTI | West Texas Intermediate |

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EXECUTIVE SUMMARY

“It is certainly plausible that some shippers would consider regulators’ hands to be friendlier than invisible ones.”

United States Court of Appeals
for the District of Columbia¹

Consumers is gambling that the visible hand of the STB will be more friendly than the invisible hand of real-world competition. The Consumers plant to which the issue traffic moves is located on the shores of Lake Michigan. A vibrant water transportation industry has served the Great Lakes for over a century. Over 20 million tons of coal moved by vessel in 2011 to twenty-eight facilities on the Great Lakes. Between 2011 and 2015, over 60 million tons were delivered by water to coal-fired utility plants in Michigan. Indeed, Consumers owns three other coal-fired plants on the Great Lakes that receive coal by water. With a dock, any plant can enjoy these competitive market rates for coal by water. Consumers is instead hoping for a better rate from the Board.

The success of Consumers’ bet to find a more friendly regulatory forum depends on the STB accepting Consumers’ attempt to ignore the real world in favor of wishful thinking in four respects.

First, Consumers ignores the fact that Chicago is the single most complex railroad terminal in North America. Freight train operations through this congested

¹ See *AAR v. STB*, 306 F.3d 1108, 1111 (D.C. Cir. 2002).

gateway are arduous and unpredictable, in part because of the need to coordinate with seven Class I carriers, multiple terminal carriers, local commuter operations, and Amtrak across a spaghetti-like tangle of tracks. Some of the most notoriously congested Chicago lines are at issue in this case, such as the 75th Street interlocking that the Amtrak Chicago Gateway Blue Ribbon Panel described as the “most congested rail chokepoint in the Chicago area, and perhaps in the entire United States.”² Under the best of conditions, operations in Chicago are characterized by agonizingly slow transit times and high operating costs. Under the harsh winter conditions that are all too common, Chicago casts rippling waves of congestion that slow the entire American freight rail network.

But Consumers ignores all that. It proposes that its hypothetical railroad could operate in Chicago unburdened by the congestion that plagues real-world railroads. Consumers’ trains zoom through Chicago at miraculous speed, with transit times less than half those of the actual CSXT trains Consumers purports to replicate. Has Consumers proposed to elevate the entire railway, permitting the new entrant to operate above the fray and shrug off the tortuous journey through Chicago? It has not. Has Consumers discovered the key to unlocking the Chicago solution by proposing new operating efficiencies that have escaped all others? It has not. Consumers simply ignores these operating realities in favor of a fantasy

² Report of the Amtrak Chicago Gateway Blue Ribbon Panel, at 25 (Oct. 2015), *available at* <https://www.amtrak.com/ccurl/873/180/Chicago-Gateway-Amtrak-Blue-Ribbon-Panel-Final-Report.pdf> (hereinafter, the “Blue Ribbon Panel Report”).

railroad that can simply wish away all the delays and costs that CSXT actually must face to transport slow, long unit coal trains through the Chicago gauntlet.

Second, Consumers misleads the Board about its very own forecast demand for the J.H. Campbell plant. The issue traffic comprises 43% of Consumers' Opening traffic group, a significant difference from most past rate cases where the issue traffic is a small fraction of the traffic group. Accurate volume projections for the issue traffic are therefore critical to the integrity of the SAC analysis, and all that information lies in Consumers' hands. Yet on Opening, Consumers materially overestimates the forecast coal requirements at Campbell. CSXT discovered that a month before filing, Consumers submitted completely different (and materially lower) forecasts to the Michigan Public Utility Commission. Consumers did not disclose this updated forecast to the STB (or CSXT). This is not a mathematical mistake or minor oversight—it knowingly and materially results in overstated volumes for a large segment of the CERR traffic group, and overstates the revenue that CSXT is projected to earn from Consumers over the 10-year analysis period by \$55.3 million. The Board should not condone transforming the Stand-Alone Cost (SAC) process into a game of “catch me if you can.”

Third, Consumers asks the Board to disregard overwhelming evidence—including numerous internal studies conducted by Consumers—about feasible transportation alternatives to CSXT's service to its Campbell plant. The issue movement is received by CSXT in Chicago and transported to the Campbell plant in Port Sheldon, Michigan. As the name of its location suggests, Campbell has direct

evidence pales in comparison to the stark findings by the STB showing a \$33.5 billion shortfall for CSXT.

Once stripped of its illusions, flawed assumptions, and fanciful view of real-world railroad operations, Consumers' gamble fails. CSXT shows in this Reply Evidence the true nature of the healthy market for water transportation over the Great Lakes; the extraordinary challenges of operating in Chicago; and the reality of its revenue inadequacy. This evidence demonstrates that (1) CSXT does not have market dominance over the traffic at issue; (2) CSXT's rate to haul coal trains through the heart of the most congested gateway in America is reasonable; and (3) Consumers' revenue adequacy allegations must be dismissed. The true costs to construct and operate a hypothetical stand-alone railroad through the congested Chicago terminal exceed the revenues from the selected traffic group by \$414 million on a net present value basis (over the 10-year analysis period). The challenged rate is therefore reasonable and this case should be dismissed.

CSXT summarizes its Reply evidence below.

A. VESSEL SERVICE ON THE GREAT LAKES CONSTITUTES AN EFFECTIVE COMPETITIVE ALTERNATIVE TO CSXT'S RAIL SERVICE.

The Board does not need to reach the complex SAC issues in this case—and indeed it does not have jurisdiction to reach them. For Congress has instructed the Board that it may not even consider whether a rail rate is reasonable unless the complaining shipper first proves a lack of effective competition for the service to which the challenged rate applies. Here, CSXT's movement of coal from Chicago to Campbell is subject to highly effective competition from water transportation—

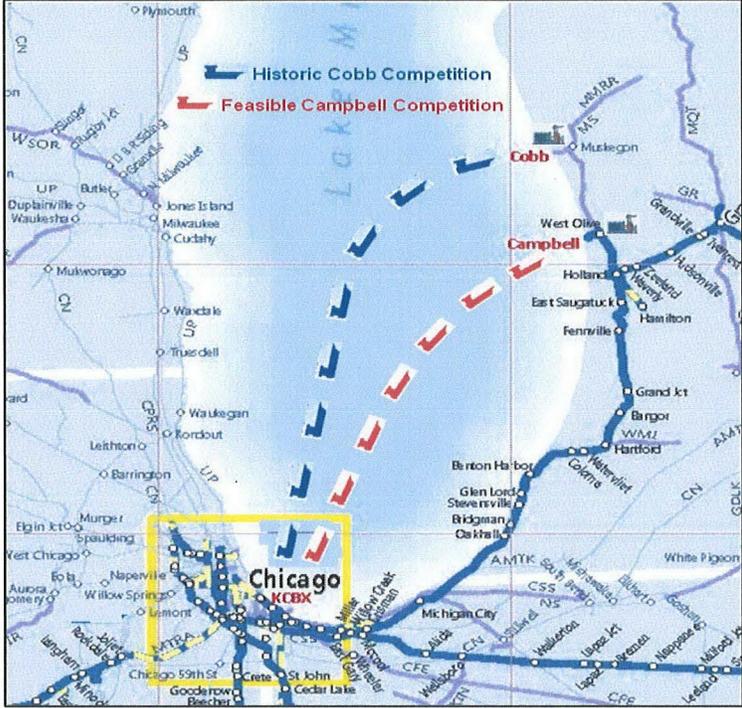
competition whose effectiveness has been conclusively proven by the fact that Consumers exclusively used water transportation at a plant nearly identically situated to Campbell.

Specifically, Consumers' B.C. Cobb plant is located on Lake Muskegon, a small inlet on the shores of Lake Michigan, just 25 miles north of Campbell. The Cobb plant historically received its coal exclusively via water transportation, primarily from the KCBX terminal in Chicago in vessels moving across Lake Michigan. This reliance on water transportation is not because of a lack of access to rail. The main line of the Michigan Shore Railroad runs literally adjacent to the Cobb plant. But water was such an effective competitive option that Consumers historically chose to use water transportation exclusively for coal deliveries to Cobb.

Like Cobb, the Campbell facility is located on a small inlet on the shores of Lake Michigan known as Pigeon Lake. Like Lake Muskegon, Pigeon Lake is navigable and has been used for barge deliveries to the Campbell plant.³ Unlike at Cobb, where Consumers chose a water delivery option, at Campbell Consumers has chosen to rely on rail transportation. But that choice is the only material transportation difference between Cobb and Campbell, which have virtually equal access to the Great Lakes marine transportation network.

³ These barge deliveries of equipment for use at the Campbell plant were reported in newspaper articles that CSXT has attached as workpapers "2011 Environmental Equipment Delivery," "2013 Barge Deliveries to Campbell," and "2014 Barge Deliveries to Campbell."

Figure I-1
Water Competition at Cobb and Campbell



CSXT and Consumers have operated within this real-world competitive landscape over the past quarter-century. It is a landscape where Consumers' ability to convert Campbell coal transportation from rail to water has consistently colored the parties' commercial relationship. Over the years, Consumers has made abundantly clear to CSXT that it had viable commercial alternatives to CSXT service. Indeed, {

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Despite the availability of water transportation, Consumers chose to file this rate case. But this meant that it needed to impeach its own pre-litigation studies. Even though “some shippers . . . consider regulators’ hands to be friendlier than invisible ones,”⁶ Congress has made clear that a shipper with an effective competitive option is required to rely on the market to constrain railroad rates and has no legal right to a regulatory rate reduction.⁷

So Consumers hired a new litigation witness to attack its old experts. This new witness (Mr. Barbaro) argues that the multiple independent consultants hired

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⁶ See *AAR v. STB*, 306 F.3d 1108, 1111 (D.C. Cir. 2002).

⁷ See H. Rep. 96-1430, 96th Cong., 2d Sess. at 89 (1980) (where competition is effective “such competition should continue to function as the regulator of the rate”); *Consolidated Papers, Inc. v. Chicago & N.W. Transp. Co.*, 7 I.C.C. 2d 330, 336 (1991) (“Congress has decided that, to the greatest extent possible, railroad rates should be governed by competitive forces.”); *Potomac Elec. Power Co. v. Consolidated Rail Corp.*, 367 I.C.C. 532, 536 (1983) (Congress “intended to allow[] the forces of the marketplace to regulate railroad rates whenever possible”).

by Consumers in the ordinary course of business both misjudged the feasibility of the alternatives they were studying and massively underestimated the costs of those alternatives. But it is Mr. Barbaro who is mistaken. He piles assumption upon assumption in an attempt to make alternatives to rail transportation seem impossibly expensive and impractical. Where Consumers' prior consultants estimated { } to construct a dock alternative, Mr. Barbaro claims that the capital costs for a similar alternative could exceed {{ }}⁸ Where Consumers internally estimated operating costs of {{ }} for a water alternative, Mr. Barbaro claims the alternative would actually cost {{

}}⁹ Such astronomical made-for-litigation estimates are inherently incredible—not just because they contradict the careful and well-supported analysis that CSXT presents here—but because they are irreconcilable with the analyses that Consumers and its experts performed before initiating this litigation.

Indeed, most of Mr. Barbaro's arguments claiming that water transportation is infeasible and too expensive stem from a single, wildly incorrect assumption: that any effective competitive option would have to handle 100% of the issue volume and thus would require massive storage facilities for winter months when Lake

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Michigan is not navigable. That assumption and others like it are flatly contrary to Board precedent and basic economics, and when they are corrected, the obstacles Mr. Barbaro has conjured up vanish.

As demonstrated by Section II-B of this Reply Evidence and Consumers' own studies, there are two undeniably feasible transportation alternatives to move coal from Chicago to Campbell. The "Direct Water Option" involves vessel shipments from the KCBX dock in Chicago direct to the Campbell plant. The Direct Water Option would thus mirror how coal historically has been transported to Cobb. The Direct Water Option requires Consumers to construct a dock at Campbell similar to the dock that Consumers constructed at Cobb, but the cost of that dock amounts to just {{ }} per ton when using generous calculations that incorporate Consumers' claimed cost of capital and provide for interest during construction.

The alternative "Cobb-Rail Option" involves Consumers shipping coal by vessel to the existing Cobb dock. From Cobb, that coal could be shipped to Campbell via the Michigan Shore Railroad—whose tracks literally adjoin the Cobb plant. Only minor rail infrastructure upgrades at Cobb and at Campbell would be necessary for Consumers to avail itself of this option. {

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The only genuine question left is whether these feasible and cost-competitive options constitute effective competition. “At the core of the ‘effective competition’ standard is the idea that there are competitive, market pressures on the railroads deterring them from charging monopoly prices for transporting goods.”¹¹ The Board has observed that in some circumstances a feasible alternative may only impose an “outer limit” on the rate a carrier can charge: “In other words, there is a competitive constraint, even though there is not effective competition.”¹²

The Board has tried to distinguish between a “competitive constraint” and “effective competition” with its Limit Price Test.¹³ If the competitive constraint falls above the carrier’s most recent RSAM benchmark, then the Board will presume there is no effective competition. The Board justified this new approach because of the fear that “at some point even a monopolist could price its services so high that patently ridiculous transportation alternatives would eventually serve to constrain rates.”¹⁴ But the Board has “strongly encouraged” parties to provide “a better general approach” to the question of whether feasible alternatives exert effective

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¹¹ *TPI Market Dominance*, STB Docket No. 42121, 5, quoting *McCarty Farms*, 3 I.C.C.2d at 832.

¹² *FMC*, 4 S.T.B. at 718.

¹³ See *TPI Market Dominance*, STB Docket No. 42121, at 4.

¹⁴ *Id.* at 16.

competitive pressure on a carrier's pricing or "a superior benchmark that can be used to guide this inquiry."¹⁵

This case shatters the illusion that the Limit Price Test can distinguish between a "competitive constraint" and "effective competition." CSXT and other parties and economists have long argued that this approach lacks any economic validity. That proof is simple: does the Board's new test conclude that rail has market dominance over the transportation of coal from Chicago *to Cobb*? We know that a reliable test would conclude that it did not, because the direct water alternative dominated that market.¹⁶ Yet the Limit Price Test would generate a false positive—labeling the direct water alternative ineffective and presuming market dominance where none exists.

CSXT is providing the Board a vastly superior general approach to dealing with this "central issue." For here, a virtually identical water movement to Cobb was such effective competition that it wholly displaced rail transportation to that plant. There can be no better measure of the effectiveness of competition than a historical example of how that competition worked in the real world. History shows that vessel transportation of coal to Cobb was competitively potent enough to win 100% of that market, and that history teaches that similar water transportation of coal to Campbell would be effective competition. Professor Kevin Murphy, the George J. Stigler Distinguished Professor of Economics at the University of

¹⁵ *Id.* at 26 n.78 (quoting *M&G*, STB Docket No. 42123, at 5).

¹⁶ See CSXT Reply WP "Coal Shipments to Michigan.xls" (showing that 100% of coal transported to Cobb was transported via water).

Chicago's Booth School of Business, has reviewed the evidence here and concluded that the actual historic competition at Cobb is compelling evidence that a similar water movement to Campbell provides an effective competitive constraint on the pricing of CSXT's rail service.¹⁷

This real-world example of effective competition is a far superior means of addressing the concerns voiced by the Board in *M&G*. CSXT respectfully submits that the Limit Price Test is legally unfounded and economically flawed and that it should be rejected in its entirety. And here, the real-world example of Cobb water transportation is a strong benchmark of effective competition that the Board can rely upon to assure itself that the feasible and cost-competitive alternatives Consumers has for coal transportation to Campbell constitute effective competition.

B. THE CHALLENGED RATE IS REASONABLE UNDER THE SAC CONSTRAINT.

In any event, the challenged rate is reasonable under a proper application of the SAC test. Consumers would have the Board believe that this case is a simple one because its hypothetical SARR (the Consumers Energy Railroad, or "CERR") is smaller than those in recent cases like *DuPont* and *TPI*.¹⁸ This is true. What Consumers ignores, however, is that all of the selected traffic group, including the issue traffic, moves through the most operationally complex railroad terminal in North America, if not the world.

¹⁷ See CSXT Reply Ex. II-B-2 (Murphy Verified Statement).

¹⁸ Consumers Op. I-28.

Consumers submits a SAC analysis that uses deeply flawed assumptions in each of the three key legs of the SAC analysis: traffic group, operating plan, and road property investment. CSXT will not summarize in this Executive Summary all the errors, unsupported assumptions, and departures from agency precedent in Consumers' Opening that are addressed and corrected in CSXT's Reply. Instead, CSXT here highlights the most significant of those flaws.

1. **Consumers is gaming the SAC results by selecting merchandise traffic in an indefensible way, claiming revenues for services the CERR would not provide, and knowingly using an outdated estimate of its own coal volumes.**

All SAC cases begin with the traffic selection. In this case, Consumers seeks to maximize economies of density and minimize operating costs by designing a hypothetical railroad that would only provide trainload service through Chicago. Consumers therefore selected a variety of intermodal customers and unit train customers who ship coal, crude oil, ethanol, wheat, and other bulk commodities through Chicago. Apparently unsatisfied with the results, Consumers turned its attention to merchandise customers whose carload shipments also traverse these same Chicago facilities.

But in incorporating merchandise carload traffic, Consumers was unwilling to relinquish its trainload model for the CERR. To avoid the need to build any classification yards, and avoid the expense of switching or train building activities, Consumers selected only merchandise trains where—on that given day—the train had no railcars that required any switching within the Chicago terminal. This way,

Consumers maintained its trainload model, but by proposing a hypothetical railroad that would serve only a subset of a given merchandise customer's business.

Consumers thus proposes to shoehorn a new “overhead” railroad into the heart of the most congested gateway in America. Yet it eschews the cooperation and coordination among carriers that is paramount to smooth operations through Chicago and skims for itself only merchandise shipments that traverse Chicago as trainloads to and from the residual CSXT and its connecting partners. Consumers refuses to replicate the services provided by CSXT to its customers, or even a subset of those customers. Rather, it assumes that the hypothetical railroad would be able to somehow identify and divert to its lines—on a real time basis—only merchandise trains that require no switching in Chicago and, even beyond that, only those merchandise trains not carrying any TIH shipments. It would shun traffic *from the same customer* to the same destination if it is delivered by a connecting carrier on a train that required any switching within Chicago.

No real world customer would contract with a railroad on such restrictive terms. Imagine a hypothetical merchandise customer of the CERR. On Monday, the customer tenders a railcar that is handled by the CERR through Chicago. On Tuesday, the customer tenders another railcar with the same commodity destined for the same ultimate destination—but the CERR rejects that railcar because it arrives at the point of interchange on a train with a TIH tank car. On Wednesday, another identical railcar from the same customer arrives at interchange, and this time it is again accepted by the CERR. Yet on Thursday, the doors are closed—the

CERR refuses to handle the customer's shipment because this time it arrives on a merchandise train that requires switching somewhere in Chicago. What would the contract between the customer and the CERR look like for such erratic service? Would it provide that "CERR will handle customer's shipment unless those shipments require too much work?" It surely would not remotely resemble the existing contract with CSXT into whose shoes the CERR purports to step, yet without offering service as good as that provided by CSXT.

This is a tortured and inappropriate application of grouping principles under *Coal Rate Guidelines*. A complainant may seek to maximize economies of density by selecting an optimal group of customers to serve. The SAC test "is used to compute the rate a competitor in the market-place would need to charge in serving a captive shipper *or a group of shippers* who benefit from sharing joint and common costs." *Coal Rate Guidelines*, 1 I.C.C.2d at 528 (emphasis added). The ICC made it clear that "[t]he ability to group traffic *of different shippers* is essential to theory of contestability." *Id.* at 544 (emphasis added). It allows complainants to identify areas where production economies define an efficient subsystem or alternative system whose traffic is divertible to a hypothetical competitor. Thus, the SAC evidence will usually be based on a rail plant of optimal size, and "potential users of a stand-alone facility can be identified by referring to the railroad's *existing customer list*." *Id.* at 543 (emphasis added). The theme of selecting a "group of shippers" from the "existing customer list" permeates *Coal Rate Guidelines*.

But Consumers is proposing a hypothetical railroad that will not serve all merchandise customers, or even a subset of those customers. Unlike past applications of the Board's grouping principles that focused on a single commodity (*e.g. Coal Trading*), maximized economies of density (*e.g., DuPont*) or maximized contribution (*e.g., Western Fuels*), here Consumers groups traffic based on the amount of relative effort required to move the traffic through Chicago, leaving the more onerous handlings to the residual CSXT. Not only does this novel grouping approach run afoul of practicality and fairness, it takes advantage of a revenue allocation mechanism that is insensitive to the relative effort undertaken by the SARR and by the incumbent.

Indeed, Consumers' grouping approach undermines the essence of the ATC revenue allocation, which distributes revenues over the residual incumbent assuming that all necessary services required to move each shipment will be performed on a pro-rata basis over the incumbent's system. By selecting only merchandise traffic that has had all of its necessary switching and blocking work performed outside of the route replicated by the SARR, Consumers is gaming the revenue allocation process. Under its view, Consumers is conceptually maximizing its economies of density by serving a fraction of a customer's total traffic, because it deems providing the infrastructure and crews needed to serve the remainder to be too expensive. This may indeed be the most "efficient" way to maximize economies of density, to carve up a customer's business to prune expensive, unwanted demand. But it makes a mockery of the customer relationship and is a meaningless way to

gauge the reasonableness of rates where no real-world railroad could unilaterally dictate to its customers in that fashion. The Board should remove these merchandise trains from the SAC analysis.

Consumers is also seeking revenue for service the CERR would not provide. First, Consumers ignores the Board's serious and very public concerns that including merchandise cross-over traffic exclusively in hook and haul service biases the SAC analysis. The STB proposed to sharply limit this kind of cross-over traffic, or eliminate it entirely, in Ex Parte 715, but decided to let parties address those concerns in individual cases, by (for example) adjusting how ATC allocates revenues.¹⁹ Consumers stands mute on this issue, however. It proposes no solution to fix the bias introduced by its decision to include merchandise cross-over traffic in pure hook-and-haul service. CSXT should not be obligated to solve a problem of Consumers' own creation. The Board should penalize Consumers for shunning its concerns and throw out all the merchandise traffic from the traffic group. Nonetheless, because CSXT recognizes the Board's reluctance in past proceedings to eliminate traffic from the SARR traffic group, it proposes in Section III-A of this Reply a second-best solution to adjust the revenue allocation (and the allocation under MMM) to correct the bias.

Second, Consumers is grossly manipulating the revenue allocation for the intermodal traffic. Consumers constructed its hypothetical railroad to run right up

¹⁹ See *Rate Regulation Reforms*, STB Docket No. EP 715, at 27 ("We continue to have reservations about the growing use of carload and multi-carload cross-over traffic in Full-SAC cases.").

to the steps of the 59th Street intermodal facility, *and then stop*. The residual railroad is left to provide all the complicated and expensive services to terminate and originate those intermodal customers at the 59th Street facility while charging the CERR only 30% of the lift costs. Yet Consumers then assumed a massive revenue allocation that reflects all those services that its hypothetical railroad would not perform. This approach implicates the “troubling” and “serious” questions raised in *McCarty Farms* about a complainant isolating facilities from the remainder of the CSXT network.²⁰ This also creates a multi-million dollar discrepancy between the services performed by the CERR and the revenues provided by the ATC methodology.

And last, but not least of all, Consumers misleads the Board about its very own forecast for coal demand at Campbell. The issue traffic comprises 43% of Consumers’ Opening traffic group, unlike most past rate cases where the issue traffic has comprised a small fraction of the traffic group. Accurate volume projections for the issue traffic are therefore critical to the integrity of the SAC outcome, and all that information lies in Consumers’ hands. Yet on Opening, Consumers materially overestimated the forecast coal requirements at Campbell. A month before its filing of Opening Evidence with the STB, Consumers submitted completely different (and materially lower) forecasts to its state regulator. Consumers did not disclose this updated forecast to the STB (or CSXT). This is not a mathematical mistake or minor oversight—it materially overstates 43% of the

²⁰ *McCarty Farms*, 2 S.T.B. at 468.

traffic group, and overstates the revenue CSXT will earn from Consumers over the 10-year analysis period by \$55.3 million. The Board should not condone such a blatant instance of saying one thing to the STB and another to a different regulator.

2. Consumers' operating plan and expenses for this hypothetical railroad ignore the realities of operating in Chicago.

Consumers' strained revenue and tonnage assumptions foreshadow the profound flaws in its hypothetical operating plan. Chicago is one of the nation's most important rail hubs.²¹ One "third of all rail freight traffic in the United States, and approximately 60% of all rail intermodal traffic"²² moves through the Chicago gateway, with 500 freight trains operated in the terminal and 50,000 freight cars heading for Chicago every day.²³ On the passenger side, Chicago is "the most important hub in Amtrak's national network" and Chicago's Metra commuter rail service has the second largest ridership in North America.²⁴ Together, Metra and Amtrak operate 800 passenger trains every weekday in Chicago.²⁵

But the terminal is plagued by congestion due to the need to coordinate so many different freight and passenger train operations that frequently crisscross

²¹ Blue Ribbon Panel Report at 8; *Doing the Locomotion*, THE ECONOMIST (Feb. 13, 2016), available at <http://www.economist.com/news/business/21692867-second-golden-age-american-railroads-drawing-close-consolidation-may> (noting that Chicago still has "pressing congestion problems" and is "a bottleneck through which much of America's freight is rammed").

²² Blue Ribbon Panel Report at 14.

²³ Fred W. Frailey, *Fixing Chicago: Are railroads ready and willing to repair the nation's rail hub?* TRAINS, at 31 (July 2015) ("*Fixing Chicago*").

²⁴ Blue Ribbon Panel Report at 10-12. Chicago's Metra carries more than 83 million passengers a year and its ridership is second only to New York City. *See id.*

²⁵ *Fixing Chicago* at 31.

each other. Multiple Class I railroads operate in and through Chicago. The Belt Railway of Chicago and the Indiana Harbor Belt Railroad Company conduct extensive switching and transfer operations in the Chicago terminal area. Short-line carriers such as the Chicago, Fort Wayne & Eastern Railroad and the Iowa Interstate Railroad also operate in and around Chicago. Passenger and commuter service is provided by Amtrak and Metra.

The result of these 1,200 daily train movements is a terminal that is highly congested, resulting in a bottleneck for the 600 million tons of freight that move through Chicago on a yearly basis. It takes an average of 30 hours to cross Chicago—“about the same amount of time it takes the same train to travel from Chicago to the East Coast.”²⁶ At one interchange alone—75th Street—“90 freight trains operated by four different carriers, 30 Metra trains and two Amtrak routes each converge daily on a four-square-mile area.”²⁷ Slightly further down the line, at the 80th Street interlocking at Forest Hill Junction, it can take a freight train 15 to 20 minutes to travel two miles. *Id.* A train approaches these diamonds approximately once every 15 minutes.²⁸ And these delays do not impact the Chicago region alone. As Scott Haas, Vice President for UPS, has explained “[a] lone train

²⁶ Blue Ribbon Panel Report at 35.

²⁷ Greg Hinz, *What will it take to unclog Chicago's creaky rail network?*, CRAIN'S CHICAGO BUSINESS (Oct. 2, 2015), <http://www.chicagobusiness.com/article/20151002/BLOGS02/151009961/what-will-it-take-to-unclog-chicagos-creaky-rail-network>.

²⁸ *Fixing Chicago* at 29.

stopped in Chicago can force other trains to stop or slow as far away as Los Angeles or Baltimore. It's a ripple effect—everything in my system backs up.”²⁹

Consumers submits a hypothetical railroad that flies through this gateway at stunning speeds. It may claim that the reason for the quick train speeds is its decision to handle fewer of CSXT's trains, and eschewing those that require any switching within the Chicago gateway. But the operating complexity of Chicago is not the result of an excessive number of CSXT's own trains. Rather, the estimated 30 hours needed to cross the worst rail bottlenecks in the country is attributable to conflicts between CSXT trains and those operated by other railroads. In particular, CSXT (and the CERR) must cross a series of rail “interlockings” that are controlled by foreign line dispatches (*not* by CSXT).³⁰ Consumers' SARR is so much faster than what can be achieved in reality that its operating plan is implausible on its face.

How does Consumers achieve its astonishing train speeds? As shown in CSXT's Reply submission, Consumers' operating plan rests on two ludicrous assumptions. First, Consumers ignores the true delay from other railroads in Chicago, which control and dispatch the real-world crossings with CSXT (and the CERR). It does not use the real-world delays experienced by each train included in its traffic group. Rather, it sprinkles just 22 delays over chosen trains in an attempt to minimize the impact, and arranges for many of those delay events to occur in the

²⁹ Blue Ribbon Panel Report at 36.

³⁰ *Id.* at 8.

Barr Yard rather than having to deal with the train sitting at a red light on the mainline.

Second, Consumers ignores the cascading effect that is the true congestion devil in Chicago. When a train is stopped at an interchange with a foreign railroad, trains behind it also experience delay. A simple, uncontroversial proposition. But Consumers modeled its hypothetical trains so that if one CERR train is stopped at a crossing with foreign trains, other CERR trains can whistle merrily by. That assumption is nonsense. Imagine a model of commuter traffic congestion that assumed that only the lead automobile would be stopped by a red-light, with the others zooming by at the speed limit. The average commuter speeds produced by such a silly assumption plainly would be inflated and worthless. But that is exactly what Consumers has done here by assuming that an incident that delays one train would not also delay the trains behind it. As a direct result, the CERR would have no crew changes anywhere in Chicago—indeed, Consumers posits that virtually all CERR crews could pilot *two* trains through the Chicago terminal gauntlet during a single 12-hour shift!

CSXT has submitted an operating plan that is designed—to the extent possible—to capture a taste of what CSXT deals with on a day-to-day basis in Chicago. CSXT posits a SARR that is maximally but realistically efficient—one that must deal with the realities of railroading in Chicago and the real costs and delays that entails.

Other flaws in Consumers' operating plan and expenses are also corrected in this Reply. As is typical, the opening presentation understates locomotive costs, crew counts, general and administrative expenses, and maintenance of way expenses.

3. Consumers seeks to use “reciprocal” trackage rights over the NS corridor—the most congested rail line in Chicago—without providing the same compensation paid by CSXT.

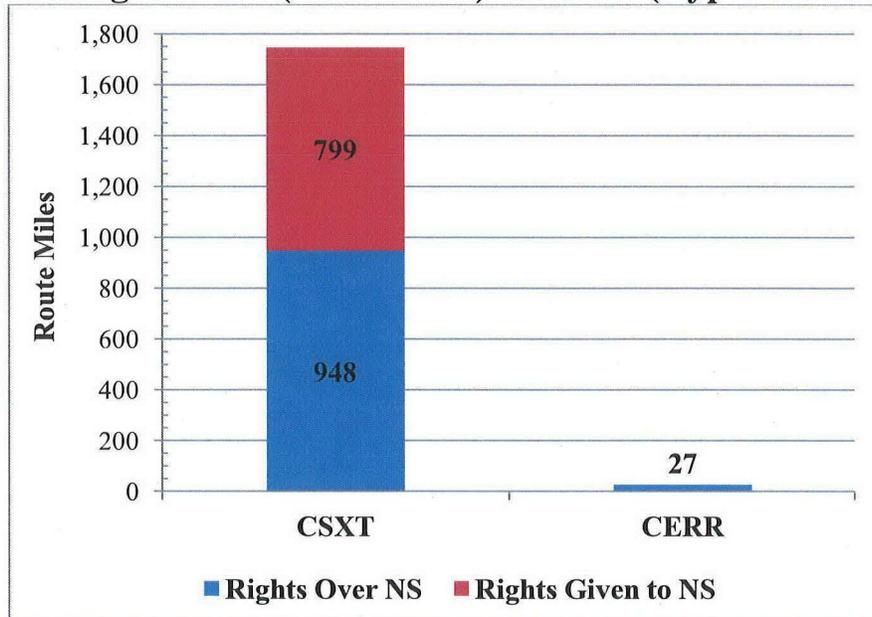
The stand-alone railroad designed by Consumers relies on 29 miles of trackage rights over the Norfolk Southern Railway (“NS”) through downtown Chicago. This is permissible under established SAC theory because CSXT uses those same congested trackage rights over NS to haul coal trains to Campbell. In *Coal Rate Guidelines*, the railroad community asked the Board to ban the use of trackage rights in SAC cases “because existing trackage rights fees do not reflect the true economic cost to a railroad of leasing its facilities.” I.C.C.2d at 543 n.60. The ICC disagreed, but cautioned that: “A proponent may include trackage rights over another carrier's lines (to which it would gain access by constructing, hypothetically, a connector line) *if* it can demonstrate what constitutes a reasonable charge for the trackage rights.” *Id.* (emphasis in original).

The charge proposed by Consumers for its hypothetical railroad to access these congested NS trackage rights in downtown Chicago is far too low. Consumers relies on the existing contract between CSXT and NS, claiming the right to “step into the shoes” of CSXT and enjoy the rock-bottom rate of { } per car-mile. But this is not the total compensation CSXT paid to NS for those trackage rights; it

paid, and continues to pay, far more than this paltry fee for the right to traverse this congested corridor. As compensation, CSXT granted NS reciprocal access in multiple locations to over 948 miles of CSXT's network outside of Chicago, for the same low reciprocal fee. Indeed, this contract between CSXT and NS is part of an umbrella reciprocal agreement negotiated as part of the Conrail joint acquisition consolidation case, an agreement that covers more than 1,500 total miles of track.

The CERR could not offer the same reciprocity to NS that CSXT does. It would utilize just 28 miles over the NS system without providing NS access to any facilities of its own. The disparity in the reciprocal operations offered between NS/CSXT and the purported agreement between NS/CERR is illustrated in the following table:

Table I-2
Reciprocal Agreement (Real World) v. CERR (Hypothetical World)



By the very words of the contract, the rate structure is “reciprocal.” Because each railroad makes extensive use of trackage rights over the other’s lines on routes across their respective systems, having a standard reciprocal rate simplifies billing for both railroads. The rate reflects the fact that each railroad has an extensive system with broad reach and that there are benefits to each carrier in having the right to operate over the other system in a variety of geographic areas. The reciprocal charge is implemented in a range of states from Illinois, to Ohio, Michigan and New York, and south through Virginia, Tennessee, and Georgia among others.

The contract thus reflects negotiations between two large carriers that saw the benefit in foregoing income on individual track segments in exchange for the right to operate over similar segments in other parts of the country. The broad

reach and reciprocal nature of the agreement make it unique. By its nature, the agreement does not represent the full costs of the trackage rights segments—it certainly does not contain any rental component inherent in conventional trackage rights agreements. Nor does it represent the cost that would be agreed upon in an arms-length transaction of the sort that a railroad of limited geographic scope would be required to negotiate with a third-party carrier.

In this context, no third party—NS included—would be willing to agree to such a low trackage rights fee to traverse such a congested corridor where there were no opportunities to offset the below market rate. As illustrated in CSXT's Reply evidence, the reciprocal { } per car mile rate is grossly below that which would be—by the Board's own methodology—negotiated in an arms-length transaction, where the charge would typically encompass the variable costs incurred by the owning carrier; the tenant carrier's share of maintenance and operations expenses; and a rental component.³¹

CSXT is not asking the Board to deny Consumers the ability to use these trackage rights over NS, or to dismiss the case. Rather, it urges the Board to set aside the reciprocal rate as not capturing the full consideration paid by CSXT for the right to traverse that congested corridor in downtown Chicago. Instead, it should use the well-established *SSW Methodology* for setting reasonable trackage rights fees, which would include a rental component that NS would rightly demand. Using that approach, a reasonable fee for access to this 29 mile congested corridor—

³¹ *SSW 1987*, 4 I.C.C.2d at 668.

where the railroad was incapable of offering valuable reciprocal rights over 948 miles of its own track—would be \$1.47 per car mile.

4. Building a railroad through downtown Chicago would be much more expensive than claimed by Consumers.

Consumers also fails to account for the road property investment challenges of construction in the difficult Chicago landscape. Like its operating plan, its engineering plan assumes a railroad being built in a rural setting rather than through a major metropolis.

For example, Consumers builds highway bridges that do not provide adequate clearance for the people and cars that must pass beneath them. Some Consumers highway bridges have long diagonal spill slopes under the span that would overrun sidewalks and roadways; others literally would drop piers in the middle of highway lanes. CSXT replaces these plainly inadequate bridges with bridges that would provide the same under-bridge space that CSXT's bridges provide today.

Consumers has similar willful blindness about the other railroads that its SARR would have to build across. In the real world the CSXT lines that the CERR is replicating have 20 crossing diamonds where CSXT crosses the lines of one of the many other railroads operating in Chicago. Consumers' Opening only includes one of these crossings, and thus effectively assumes that other carriers would bear the costs of every single other one. While Consumers alleges that other crossings may have been built by different carriers, in fact these crossings appear in the ICC

Engineering Reports for CSXT's predecessor. CSXT has added the costs of these crossing diamonds.

In the same vein, Consumers creates two new interchanges with CSXT. The manner in which Consumers proposes to construct these interchange facilities would block grade crossings and interfere with other carrier's lines. The issues are particularly severe at the Dolton interchange, where Consumers proposes to build an interchange track through the middle of a co-owned UP/CSXT joint facility. At the same point Consumers proposes another track that would block the intersections of Lincoln and Park Avenue and Cottage Grove Avenue for 30 minutes every time a train is interchanged. CSXT's engineers designed solutions to avoid these issues.

These are just a few examples of the many issues with Consumers' road property investment evidence, which are addressed in detail in Section III-F.

* * *

In sum, Consumers has hypothesized a host of unrealistic assumptions about its ability to cherry-pick traffic without providing the necessary service and support (yards and switching) in Chicago, and it assumes that it would be able to operate with minimal interference from other freight railroads, commuter operators, and Amtrak in the most complex and operationally challenging terminal area in the country. CSXT's Reply Evidence addresses each of these infirmities in Consumers' Opening Evidence, as well as a number of other errors of the more "traditional" sort found in SAC cases. When the appropriate corrections have been made to that

evidence, the costs to construct, operate and maintain the CERR exceed the revenues properly attributable to it. The challenged rate is thus reasonable under the SAC test.

C. THE REVENUE ADEQUACY CLAIM SHOULD BE DISMISSED.

Consumers argues that CSXT is “revenue adequate” and that the challenged rate is therefore unreasonable under the Revenue Adequacy Constraint adopted in *Coal Rate Guidelines, Nationwide*, 1 I.C.C.2d 520 (1985), *aff’d sub nom. Consolidated Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987). But the constraint in *Guidelines* is irrational and must be abandoned. The test is using the wrong measure—it fails to follow the wise advice of over 50 leading economists to use the current value of assets. And a test of “system-wide revenue need” (even if properly measured) “provides no guidance on the rates [a shipper] should be charged for the particular facilities and services [the shipper] uses.”³²

The Board need not reach these issues, however. Rather, it should dismiss this allegation for two simple reasons. First, granting relief under the revenue adequacy constraint where none is justified under the SAC constraint would create an impermissible cross-subsidy in violation of the basic tenets of *Guidelines*. Second, CSXT has not been revenue adequate for 29 consecutive years, with a cumulative shortfall of \$33.5 billion since 1999. Either reason offers ample basis to summarily dismiss the revenue adequacy claim.

³² *BNSF 2006*, 453 F.3d at 481.

1. Consumers cannot simultaneously seek relief under both the SAC constraint and the Revenue Adequacy constraint.

A centerpiece of the STB's rate regulations is the prohibition against cross-subsidies. The ICC long ago declared that "a captive shipper should not bear the costs of any facilities or services from which it derives no benefit."³³ A corollary "core economic underpinning of CMP is the principle that a shipper must cover its own attributable costs and only unattributable costs are to be allocated among the traffic group. Indeed, this theme permeates *Guidelines*."³⁴

The Board's final SAC analysis will show the full cost of the facilities and services used to serve Consumers in the congested Chicago terminal area and the light-density line up the shore of Lake Michigan to the Campbell plant, and the proper portion of those costs that CSXT can lawfully recover from Consumers through differential pricing.

But Consumers cannot "shift responsibility for paying for facilities it uses to other shippers who do not benefit from those facilities."³⁵ As the Board has explained, it would "turn the CMP principle against cross-subsidization on its head to protect a captive shipper from subsidizing other traffic, while at the same time allowing that shipper's rates to be subsidized by other traffic."³⁶ The D.C. Circuit, in affirming the Board's interpretation of *Coal Rate Guidelines*, observed that "it is

³³ *Coal Rate Guidelines*, 1 I.C.C.2d at 523.

³⁴ *Otter Tail*, Docket No. 42071, at 24.

³⁵ *PPL Montana 2003*, 6 S.T.B. at 757-58 & n.21; see also *PPL Montana 2002*, 6 S.T.B. at 286.

³⁶ *PPL Montana 2003*, 6 S.T.B. at 757.

difficult to steal from a penniless Peter to pay Paul.”³⁷ And the STB recognized that it could improperly *exacerbate* an internal cross-subsidy by ordering the defendant to lower the challenged rate where the complainant was not covering its own attributable costs.³⁸ Accordingly, the Board has cautioned that its *PPL* cross-subsidy analysis “serves as both a threshold inquiry and a limit on potential rate relief.”³⁹

This centerpiece of the STB’s rate regulations—the prohibition of cross-subsidies—prevents any complainant from seeking relief under both the SAC and the Revenue Adequacy constraint. Stated simply, if the challenged rate passes muster under the Board’s final SAC analysis, then by definition the costs to construct, operate, and maintain the portion of the CSXT rail system used by Consumers exceed the properly attributable revenues. Accordingly, any relief accorded Consumers under the Revenue Adequacy constraint would necessarily demand a cross-subsidy from the remaining “revenue adequate” portions of the CSXT system. The Board’s final SAC analysis will show the costs attributable to serving Consumers, including both the expense of the highly congested Chicago gateway and the lighter density line the runs up the Michigan shoreline. No relief can be granted below those costs without tearing apart the basic fabric of CMP and the prohibition against cross subsidies.

³⁷ *PPL Montana, LLC v. Surface Transp. Bd.*, 437 F.3d 1240, 1246 (D.C. Cir. 2006).

³⁸ *See PPL Montana 2002*, 6 S.T.B. at 295, n.17.

³⁹ *Otter Tail*, S.T.B. Docket No. 42071, at 11.

The ICC permitted a complainant to present evidence under both constraints long ago.⁴⁰ And it stated that “the various constraints contained in CMP may be used individually or in combination to analyze whether the rate at issue is unreasonable.”⁴¹ But the ICC also said that “[a]lthough we have described the constraints in CMP separately, they are necessarily interrelated. *They represent different means of approach to that same basic issue*, i.e., the extent of unattributable costs to be covered through differential pricing and the portion that can be charged to the shipper involved.”⁴² The ICC never grappled with the prospect of stealing from a penniless Peter to pay Paul by granting rate relief when the Board’s final SAC analysis showed the challenged rate fell below the costs attributable to serving the complaining shipper.⁴³

The STB cannot prescribe relief under the revenue adequacy constraint below the level determined by its final SAC analysis without creating an impermissible cross-subsidy from the rest of CSXT’s 21,000 mile network, in violation of the heart of the Board’s rate regulation standards. Consumers must pick one horse to ride for this race—either the SAC constraint or the Revenue Adequacy constraint. And having chosen SAC, its claim must rise or fall on that evidence.

⁴⁰ See *Bituminous Coal*, 6 I.C.C. 2d at 1; *Ark. Power*, 3 I.C.C. 2d at 757.

⁴¹ *Coal Rate Guidelines*, 1 I.C.C.2d at 548.

⁴² *Id.* at 547 (emphasis added).

⁴³ The same holds true if a complainant prevails under the SAC test. The STB would create an impermissible cross-subsidy by prescribing rates below the level justified by its final SAC analysis. *Otter Tail*, Docket No. 42071, at 11.

2. CSXT has never been found “Revenue Adequate” for even a single year.

For as long as the ICC has measured revenue adequacy for CSXT, CSXT has been found revenue inadequate. For each year since 1986 (the first year for which the ICC published a finding for CSXT) the ICC and the Board have found that CSXT’s ROI is below the industry cost of capital—the agency’s standard for measuring revenue adequacy.⁴⁴ Indeed, according to the Board’s annual findings, CSXT has fallen more than \$33.5 billion short of “revenue adequacy” on a cumulative present value basis since 1999.⁴⁵

Consumers attempts to sidestep this overwhelming body of agency findings by (1) ignoring the single ROI standard, (2) arguing the methodology for calculating the cost of capital is flawed or the Board should replace the industry average with an internal estimate of CSXT’s cost of capital, and (3) introducing a collection of “other probative evidence.” Although it cites financial data, analysts’ reports, numerous “financial ratios,” and CSXT’s “cash flow,” this evidence falls woefully short of overcoming the fact that CSXT has been found to have fallen \$33.5 billion short of revenue adequacy over the last 15 years.

Wall Street Reports: The ICC recognized almost 30 years ago that security analysts’ reports are an unreliable indicator of revenue adequacy, because the perspectives of the agency are different from those of Wall Street analysts. As the ICC stated, “Our concerns center on the long-term viability and capability of the

⁴⁴ See *infra* at Section IV Table IV-1.

⁴⁵ See *infra* at Section IV Table IV-2.

railroads to provide essential rail service,” whereas “security analysts are interested not only in long-term viability but also in the potential profits for the short term. Indeed, sometimes the potential to make a short term profit may far outweigh their interest in the long term health and earnings capacity of the railroad.”⁴⁶ Thus, the analyses described by Consumers are neither relevant nor competent evidence of revenue adequacy.

Alternative Metrics: Consumers also attempts to establish that CSXT has attained revenue adequacy by citing various financial ratios. The ICC properly rejected these same financial ratios long ago as “inappropriate as indicators of long-term revenue adequacy.”⁴⁷ Because the ratios are “misleading,” the ICC “decided that these financial ratios should not be used in revenue adequacy determinations. We believe firmly that the rate of return standard is correct, and will base our determinations on it.”⁴⁸ Consumers has offered no basis to now find compelling the same hodgepodge of metrics that ICC deemed “misleading” and “inappropriate.”

Different Cost of Capital: Finally, Consumers launches yet another impermissible collateral attack on the Board’s annual cost of capital findings. “[I]t is hornbook administrative law that an agency need not—indeed, should not—entertain a challenge to a regulation, adopted pursuant to notice and comment, in

⁴⁶ *Standards II*, 3 I.C.C.2d at 267-68.

⁴⁷ *Standards I*, 364 I.C.C. at 808.

⁴⁸ *Id.*, 364 I.C.C. at 817.

an adjudication or licensing proceeding.”⁴⁹ Moreover, the agency has long followed the advice of the Railroad Accounting Principles Board (“RAPB”)⁵⁰ and used an industry-wide, rather than a carrier-specific, cost of capital to determine if a carrier is revenue adequate. The ICC, STB, and RAPB reasoned that an industry-wide figure is more reliable and promotes incentives for efficient management. Finally, Consumers tells the STB one thing, and its own regulators the opposite. Before its own regulators, Consumers extols the virtues of using multiple models, cautions against the use of Capital Asset Pricing Model (CAPM) in these times of depressed interest rates, and advocates for the same market risk premium used by the STB. Yet in this case, Consumers takes the polar opposite position. The STB should not countenance this kind of gamesmanship.

Consumers’ alternative universe where CSXT is revenue adequate is thus farfetched and cannot support placing a system-wide rate freeze on CSXT, particularly where the SAC analysis shows that the challenged rate is reasonable. As the Board recognized, “[t]he very purpose of the SAC test is to determine what [the defendant] needs to charge to earn ‘adequate’ revenues on the portion of its

⁴⁹ *Tribune Co. v. FCC*, 133 F.3d 61, 68 (D.C. Cir. 1998). See also *New Jersey Dept. of Env. Protection v. USNRC*, 561 F.3d 132, 143 (3d Cir. 2009) (quoting *Tribune Co v. FCC*).

⁵⁰ The RAPB was established by Congress to evaluate issues associated with rail costing and to propose principles to govern the estimation of such costs. See former 49 U.S.C. 11161-63 (1995). Pursuant to the statute, the ICC gave great weight to the recommendations of the RAPB. See former 49 U.S.C. 11163 (1995). While former sections 11161-63 are no longer in the governing statute and the RAPB no longer exists, the STB continues to accord great weight to the recommendations of the RAPB.

system that is included in the system of the SARR.”⁵¹ This targeted constraint is therefore the preferred procedure for gauging the reasonableness of a particular rate.⁵² SAC fulfills Congress’s mandate to consider revenue adequacy in the rate reasonableness process in a rigorous way that focuses only on the portion of CSXT’s network used to serve Consumers. Where, as here, that test shows the rate is reasonable, the matter is over and the case must be dismissed.

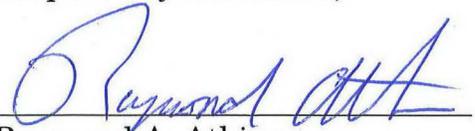
CONCLUSION

For the reasons summarized above and detailed in the following Reply Narrative, Exhibits, and Workpapers, the Board should find that Consumers has failed to demonstrate that CSXT possesses market dominance over the issue traffic, and the complaint should be dismissed for lack of jurisdiction. Moreover, Consumers’ SAC presentation fails to demonstrate that the challenged rates are unreasonable. As CSXT’s Reply Evidence demonstrates, when the errors and unsupported and unrealistic assumptions in Consumers’ evidence are corrected, the CERR’s stand-alone costs well exceed its revenues. Each of the challenged rates is therefore below maximum reasonable levels under the SAC test, and Consumers is entitled to no relief whatsoever. In addition, Consumers is not entitled to any relief under a revenue adequacy constraint.

⁵¹ *Xcel Reconsideration*, S.T.B. Docket No. 42057 at 6; *BNSF 2006*, 453 F.3d at 480 (“the SAC test is designed to take into account the railroad’s need for revenue adequacy on the portion of its system that is included in the system of the [SARR]”).

⁵² *Burlington Northern R.R. Co. v. Interstate Commerce Comm’n*, 985 F.2d 589, 596 (D.C. Cir. 1993) (“CMP, with its SAC constraint is the ‘preferred and most accurate procedure available for determining the reasonableness’ of rates in markets where the rail carrier enjoys market dominance.”) (quoting *McCarty Farms*, 3 I.C.C. 2d at 822).

Respectfully submitted,



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

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

Counsel to CSX Transportation, Inc.

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CERTIFICATE OF SERVICE

I hereby certify that on this 7th day of March, 2016, I caused a copy of the foregoing Reply Evidence of CSX Transportation, Inc., including Narrative, Exhibits, and electronic workpapers, to be served by hand delivery upon:

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



Jake Thorn