

BEFORE THE
SURFACE TRANSPORTATION BOARD

CAROLINA POWER & LIGHT COMPANY,

Complainant,

v.

NORFOLK SOUTHERN RAILWAY COMPANY,

Defendant.



STB Docket No. 42072

ENTERED
Office of Proceedings

FEB - 9 2004

Part of
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DEFENDANT NORFOLK SOUTHERN RAILWAY COMPANY'S
REPLY TO COMPLAINANT'S PETITION FOR RECONSIDERATION

PUBLIC VERSION

James A. Hixon
James A. Squires
George A. Aspatore
Norfolk Southern Corporation
Three Commercial Place
Norfolk, Virginia 23510-2191
(757) 629-2657

G. Paul Moates
Terence M. Hynes
Ronald S. Flagg
Paul A. Hemmersbaugh
Sidley Austin Brown & Wood LLP
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000

Counsel for Defendant Norfolk Southern Railway Company

DATED: February 9, 2004

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Norfolk Southern Railway Company ("NS") submits this reply to the Petition for Reconsideration filed in the above-captioned proceeding on January 20, 2004 by Carolina Power & Light Company ("CP&L") (the "CP&L Petition").

CP&L's Petition calls to mind Sherlock Holmes' reference to the "curious incident" of the dog that didn't bark in the night. *See* A. Conan Doyle, Silver Blaze at 19. CP&L's Petition identifies not a single purported error in the Board's calculation of the costs of constructing and operating the P&SH, or in the traffic volumes (and associated revenues) that the P&SH would attract to its system. Instead, CP&L's Petition focuses solely on two methodological issues that CP&L has repeatedly (and unsuccessfully) addressed throughout these proceedings: the Board's adoption of the RCAF-U to index P&SH operating expenses, and its use of the customary percentage reduction methodology in calculating rate prescriptions. CP&L had ample opportunity to present evidence and argument with respect to those issues (and did so), and the Board's December 23, 2003 Decision (cited herein as "*NS/CP&L*") contained clear and well-supported rulings on both issues. Neither of the rulings as to which CP&L seeks reconsideration involved material error, nor does CP&L's Petition offer any new evidence or changed circumstance that would dictate a different conclusion with respect to either of them. *See* 49 C.F.R. 1115.3(b). Accordingly, CP&L's Petition should be denied.

I. The Board's Use of the RCAF-U To Index the P&SH's Operating Expenses Is Consistent with Board Precedent and the Record Evidence.

CP&L claims that the Board committed material error by using the RCAF-U to index the P&SH's operating expenses. Specifically, CP&L contends that the Board's adoption of the RCAF-U in this case "directly conflicts with prior Board precedent; is economically unsound . . . and fails to apply the agency's expertise in a manner consistent with statutory mandates." CPL Petition at 2. None of these assertions has merit.

CP&L's contention that use of the RCAF-U "directly conflicts" with prior Board precedent is based upon a mischaracterization of the decision in Docket No. 42051, *Wisconsin Power & Light Co. v. Union Pacific R.R.* (decision served September 21, 2001) ("*WP&L*"). According to CP&L, *WP&L* established a "precedent requiring that the measure used to index operating expenses should reflect the impact of productivity." *WP&L* establishes no such requirement, nor does that decision support adoption of some (undefined) alternative index in this case.

WP&L did not adopt or endorse the RCAF-A as the appropriate index for adjusting a SARR's operating expenses. Rather, the Board's indexing of operating expenses in that case was based on a forecast, prepared by defendant UP in the normal course of business, of expected cost increases for moving coal on the UP system. The Board found that the UP forecast, which "relate[d] specifically to coal movements in the [SARR's] traffic group . . . should produce more reliable projections [of future operating costs] than the more broad-based RCAF-U." *WP&L* at 106 (emphasis added). Accordingly, the Board held that the coal-specific UP business forecast constituted the "best evidence of record" for projecting the future cost of handling the SARR's traffic. *Id.*

Thereafter, in Docket No. 42056, *Texas Municipal Power Agency v. Burlington Northern and Santa Fe Railway Company*, (decision served March 21, 2003) at 166-167 ("*TMPA*"), the Board adopted the RCAF-U as the most appropriate index for adjusting SARR operating expenses. *TMPA* argued — as CP&L does here — that the Board should have adopted the RCAF-A, because the SARR "necessarily" would achieve a number of productivity enhancements of the type that are reflected in the RCAF-A. The Board rejected the Complainant's position, finding that:

“The RCAF-A considers productivity adjustments for the railroads based on all of their business operations, but the [SARR] would handle only unit coal trains. We have no evidence, and we find it unrealistic to assume, that projected industry-wide productivity adjustments would result primarily from the transportation of coal.”

Id. 166 (emphasis added). The Board concluded that, “[i]n the absence of any evidence showing specific productivity improvements for unit train operations” (like the UP forecast presented in *WP&L*), the RCAF-U provided the most appropriate index for operating costs. *Id.* 167.

The Board has consistently applied the RCAF-U to index SARR operating expenses in subsequent SAC decisions. See Docket No. 42070, *Duke Energy Corporation v. CSX Transportation, Inc.* (Decision served February 4, 2004) (“*CSXT/Duke Energy*”) at 29-30; Docket No. 42072, *Carolina Power & Light Co. v. Norfolk Southern Railway Co.*, (Decision served December 23, 2003) (“*NS/CP&L*”) at 27-28; Docket No. 42072, *Duke Energy Corporation v. Norfolk Southern Railway Co.*, (Decision served November 6, 2003) (“*NS/Duke Energy*”) at 36-37. In *NS/Duke Energy*, the Board agreed with NS that a SARR would have “less room for productivity improvements” than an existing railroad, because the SARR would be built new and would incorporate the latest technology. *NS/Duke Energy* at 37. Because the record in that case did not contain evidence regarding the impact of “specific likely productivity improvements” on the SARR’s future operating costs, the Board adopted the RCAF-U as the most appropriate cost index. *Id.* In *CSXT/Duke Energy*, the Board acknowledged that a SARR might achieve some productivity improvements that would not be captured by the RCAF-U, but concluded (as it did here) that “the potential impact of such improvements is far less than it would be for existing railroads.” *CSXT/Duke Energy* at 30. Accordingly, the Board again used the RCAF-U to index SARR operating expenses. *Id.*

As the foregoing discussion shows, CP&L’s claim that the Board’s adoption of the RCAF-U in this case conflicts with agency precedent is demonstrably false. Where (as here) the record did not contain evidence of an alternative cost index (such as the UP forecast in *WP&L*) that more specifically reflects the productivity likely to be achieved in conducting a SARR’s coal operations,

the Board has consistently applied the RCAF-U in adjusting SARR operating expenses. CP&L's Petition fails to identify any SAC case in which the Board employed the RCAF-A in calculating future SARR operating costs. Because CP&L did not proffer any alternative measure that would "better reflect the likely expected experience of the P&SH" (*id.* at 28), the Board used the RCAF-U to adjust the P&SH's operating expenses. The Board's decision on this issue is fully consistent with established precedent.

CP&L's contention that "the P&SH would definitely experience productivity improvements over time" (CP&L Petition at 3) is beside the point. The Board accepted the premise that the P&SH might achieve some productivity gains. *NS/CP&L* at 27. However, the Board determined (as it did in *NS/Duke Energy* and *CSXT/Duke Energy*) that the P&SH's potential for productivity improvements would be less than that of the rail industry as a whole. *Id.*¹ For that reason, the Board found that use of the RCAF-A would understate the P&SH's future costs, and that such understatement would be greater than any overstatement of P&SH costs that might result from application of the RCAF-U. *NS/CP&L* at 28. Based upon that finding — and the absence of any alternate cost index supported by record evidence — the Board correctly concluded that the RCAF-U represents the "best evidence" of record with respect to the proper index for calculating future operating expenses.

Moreover, the evidence cited by CP&L in support of its petition fails to demonstrate that any productivity benefits that the P&SH might realize during the 20-year SAC period would justify the use of a different cost index in this case. CP&L claims that an outside contractor employed by the

¹ CP&L questions the "logic" of this finding on the ground that the NS operating plan, which was adopted by the Board (*NS/CP&L* at 26), provides for less-than-trainload movements from origin to destination. CP&L suggests that, because such operations "could be significantly improved" (CP&L Petition at 5), the P&SH would have the ability to attain "early and major productivity improvements" (*id.*). This assertion ignores the Board's unequivocal rejection of CP&L's attempt to combine disparate less-than-trainload movements — many originating at different mines and on different dates — into homogeneous unit trains for the sake of enhancing operating efficiency, without regard to the requirements of the selected shippers. *See NS/CP&L* at 22-26. Any purported "inefficiency" in the handling of such traffic under NS' operating plan results directly from CP&L's selection of substantial volumes of less-than-trainload traffic, and its failure to construct the gathering yards required to handle such traffic as NS does today.

P&SH to operate its transportation management system would “continuously enhance[] its system” and replace the P&SH’s IT hardware every five years (CP&L Petition at 4). But CP&L introduced no evidence showing how or why such changes would reduce the P&SH’s future operating costs (much less quantifying that impact). CP&L likewise failed to quantify any benefits that might result from replacement of P&SH locomotives. As CP&L’s counsel acknowledged (Oral Argument Tr. 31), the P&SH’s locomotive leases had a 12-year term, so that locomotives could, at most, be replaced once during the 20-year SAC analysis period. More importantly, unlike the Complainant in *WP&L*, CP&L proffered no alternative to the RCAF-U index that would more accurately reflect the level of productivity improvements likely to be experienced by the P&SH.

CP&L’s assertion that application of the RCAF-U to determine the P&SH’s future operating costs is “economically unsound” (CP&L Petition at 5) lacks merit. As the Board has repeatedly found, application of the industry-wide RCAF-A index to the operations of a SARR like the P&SH — which would handle predominately a single commodity in a limited geographic area in efficient unit train service — would produce an unrealistically high estimate of its likely future productivity. Contrary to CP&L’s assertions, it would be economically irrational for the Board to ignore that finding and to apply the (demonstrably inappropriate) RCAF-A index. The Board’s decisions (including its decision in this case) articulate the Board’s willingness to consider alternatives to the RCAF-U (such as the UP forecast presented in *WP&L*) that more accurately reflect the specific costs of handling coal traffic in a SARR’s service territory. But CP&L did not proffer such an alternative index in this case, so the Board’s decision to adopt the RCAF-U was both economically sound and legally justified.

Finally, there is no merit to CP&L’s claim that the Board’s failure to create an alternative cost index on its own initiative — without any evidence upon which to base it — violates the National Rail Transportation Policy (CP&L Petition at 6-8). While the Board must consider any alternative methodologies that are presented by the parties, it is not obligated to develop (much less adopt) options that are not supported by the record evidence. *See* Oral Argument Tr. 99 (Chairman Nober: “[w]e can’t prove a case for folks.”) Fourteen months after the close of the evidentiary record,

CP&L's Petition suggests — for the first time — that the Board should fashion a hybrid index based upon both the RCAF-U and the RCAF-A. CP&L Petition at 8. CP&L had ample opportunity in its multiple evidentiary submissions to propose such an alternative, but it did not do so. At oral argument, Chairman Nober expressly solicited CP&L's views as to how such a hybrid index might be developed, but CP&L's counsel offered only that "I imagine that [the Board] could devise something of that nature." (Oral Argument Tr. 34.) CP&L — not NS or the Board — bears the burden of proving that such a hybrid index would be consistent with SAC, and with the record evidence. Because CP&L failed to present such evidence, the Board correctly followed its consistent practice in other SAC cases by adopting the RCAF-U.

II. The Board Did Not Err By Using the Percentage Reduction Methodology to Determine Rate Prescriptions and Reparations.

CP&L devotes the preponderance of its Petition to rehashing an argument that it has made repeatedly since its first filing in this case — namely, that NS set the challenged rates in a manner calculated to "game" the regulatory system and that CP&L had compelling evidence to support that claim. See CP&L Pet. at 8-20. CP&L's Petition offers absolutely nothing new with respect to this argument and, for that reason alone, the Board should adhere to its well-established use of the percentage reduction methodology ("PRM") to determine rate prescriptions in cases in which stand-alone revenues are found to exceed stand-alone costs over the period of the DCF analysis. Even more fundamentally, the results of the Board's SAC analysis — finding the challenged rates unreasonable by only a relatively slim margin — clearly demonstrate that this case simply does not offer the factual predicate that might trigger a legitimate concern about use of the PRM. The Board was therefore under no obligation to consider any alternatives to the PRM in this case at all. The fact that the Board indicated a willingness to do so shows that it more than fully discharged its public interest obligations.

There are several additional compelling reasons that bolster the Board's decision to use the PRM in this case.

First, NS' own Petition for Reconsideration presents a number of well-grounded corrections that should be made to the *NS/CPL* Decision. NS believes that disposition of its Petition will result in a revised Decision finding that the challenged rates are reasonable. In those circumstances, no rate prescription would be warranted, and CP&L's arguments about alternatives to the PRM become moot.

Second, even if the Board were to decide not to make any of the corrections identified in NS' Petition — and NS expects otherwise — CP&L's arguments for discarding the PRM are baseless in the context of this case. This is not a case in which a railroad established its common carrier rates at patently unrealistic levels, such as the \$100 per ton example cited by Chairman Nober (Oral Argument Tr. at 56), with the expectation that the Board would reduce those rates to something well in excess of what could otherwise be justified under a properly conducted SAC analysis. Rather, the Board here found that NS' common carrier rates exceeded a reasonable maximum by very modest amounts (ranging from 6% in 2002 to a high of 16.53% in 2007, and then falling again to less than 2% by the end of the 20-year DCF period). (See *NS/CPL* at 34-35, Tables 3 & 4). Although NS has acknowledged that "gaming" the Board's PRM is a theoretical possibility, the Board's SAC analysis in this case clearly demonstrates that "gaming" has not occurred here.

Third, CP&L's argument suggests that any rate exceeding an expired contract rate by more than 10% is, by definition, set solely for the purpose of "gaming" and would require discarding the PRM, notwithstanding the fact that the Board has now found in all three Eastern cases² that rate increases well in excess of that figure are reasonable. The logic of CP&L's position is that if stand-alone revenues are determined to exceed costs by one dollar, the challenged rate would have to be lowered to the expired contract rate plus 10%, but if stand-alone revenues are found to be equal to stand-alone costs, the challenged rates are deemed reasonable. Put another way, in this case a rate set anywhere between [REDACTED] per ton could never be deemed reasonable as a matter of law,

² In addition to the instant case, the Board has held that increases in rates of comparable percentage amounts are reasonable in both *NS/Duke Energy* and *CSXT/Duke Energy*.

notwithstanding what the Board's SAC analysis demonstrated about its justification under that standard. Such a conclusion obviously cannot be correct, either as a matter of law or logic.

Fourth, CP&L's claim that the "issue rates... bore no meaningful relationship to the rates or the relative demand elasticities for the rest of the SARR traffic group" (CP&L Petition at 11) is both unsupported and incorrect. Because only approximately 10% of the SARR's traffic is that of CP&L itself, CP&L is clearly looking to contributions from the traffic of the other shippers it selected as part of the P&SH's base to justify the rate relief it is seeking. Of that remaining nearly 90% of crossover traffic, approximately 10-15% is traffic moving to plants of Duke Energy under rates comparable to those being challenged by CP&L; approximately 35% is comprised of export and river traffic which generally has a relatively high demand elasticity; and approximately 40-45% consists of other utility coal with varying degrees of elasticity (for example, some moves to solely-served plants and some to plants that are also served by other carriers, some moves under contracts that have been in place for some time, and some moves under contracts established only recently; and some moves to plants where the customers have agreed to provide NS with volume commitments or other types of concessions that warrant lower rates and some to plants where no such concessions have been made). NS has stated since the beginning of this case (and the similar one brought by Duke Energy) that CP&L and Duke are among NS' most demand inelastic customers, and in recognition of that fact NS did not contest market dominance. The fact that CP&L (and Duke Energy) are paying higher rates than other shippers in the traffic group selected by CP&L for the P&SH does not justify jettisoning the PRM.

Fifth, CP&L's claim that the Board erred in failing to find that NS intended to "game" the system (CP&L Petition at 8-10) ignores the plain fact that the Board weighed that evidence, including the expressly conflicting evidence proffered by NS,³ and concluded that it could not make a

³ NS does not wish to burden the record with a detailed recitation of the evidence it submitted in response to CP&L's allegations of intentional "gaming", but refers the Board to the extensive evidence refuting such claims — including the Affidavit of NS' Senior Vice President-Coal Services — that NS filed at all three evidentiary stages. *See, e.g.*, NS Op. I-4 to 5, IV-A to IV-C; NS Reply I-19 to 23, 70-75, App. B; NS Reb. I-6 to 13, IV.

determination that CP&L's claim had merit. (*NS/CPL* at 32). In other words, the Board was not persuaded that the evidence supported a finding of intentional "gaming" on the part of NS.

In short, in light of the Board's SAC analysis and its other findings, there is no factual predicate for CP&L's continued claim that NS engaged in "gaming." Absent that predicate, there is no reason for the Board to consider alternatives to the PRM in this case. Nonetheless, the Board stated its willingness to consider such alternatives, even in the context of this case. (*NS/CPL* at 32). CP&L's real problem is that the Board did examine the alternatives advocated by the utility, found them wanting, and having been presented with nothing better (even after making explicit entreaties at oral argument for CP&L counsel to offer "any feasible alternative" but receiving "no additional suggestions", *id.* at 33), concluded that there was no basis upon which to depart from its well-established precedent.

Finally, CP&L's argument that the Board erred by failing to "implement its own solution to the NS gaming problem" (CP&L Petition at 18) not only falsely states the issue — the Board's Decision makes clear that there is no "NS gaming problem" to be resolved — but it misstates the applicable law. (It also overlooks the Board's express invitation for "proposals for appropriate alternatives to the percentage reduction approach in future cases" (*NS/CPL* at 33) — an entirely appropriate exercise of the Board's broader public interest mandate to deal with the issue in a case in which the facts might justify doing so.) The Board was under no obligation to do more, especially in the face of the concession from CP&L's counsel that after the Complainant and its experts examined the issue, "We couldn't come up with anything frankly" (Oral Argument Tr. at 103).

The cases cited by CP&L in support of its contention that, having rejected CP&L's proposed alternatives to the PRM, the Board had an independent duty to craft a remedy of its own, simply do not stand for that proposition. Rather, each of those cases involved a situation where an agency either ignored evidence that had been placed before it or reached a decision that ran counter to the agency's own findings — neither of which occurred here. The cases do support the rather unremarkable proposition that an agency has an affirmative obligation to see that an adequate record is built about issues that it must decide, but they clearly proceed on the assumption that the information or

alternatives needed for a decision are to be supplied by the parties themselves, not by the agency or its staff. *See, e.g., Aberdeen & Rockfish R.R. Co. v. United States*, 270 F. Supp. 695 (E.D. La. 1967) at 711 (ICC had duty to “see to it that the record is complete” and should “inquire into and consider all relevant facts”). But those cases scarcely support a claim that the Board must itself conduct an independent investigation outside the record, and develop new alternatives to an established precedent like the PRM when it has evaluated all such alternatives presented to it. Moreover, as the Supreme Court recognized in rejecting arguments by opponents of a nuclear power project who claimed an environmental impact statement was defective for failure to consider all conceivable alternatives to building the facility (including energy conservation):

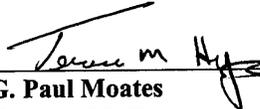
“Common sense also teaches us that the ‘detailed statement of alternatives’ [required by NEPA] cannot be found wanting simply because the agency failed to include every alternative device and thought conceivable by the mind of man. Time and resources are simply too limited to hold that an impact statement fails because the agency failed to ferret out every possible alternative, regardless of how uncommon or unknown that alternative may have been at the time...”
Vermont Yankee Nuclear Power Corp. v. National Resources Defense Council, 435 U.S. 519 at 551 (1978).

Similarly, as the Court observed elsewhere in *Vermont Yankee*, “... administrative proceedings should not be a game or a forum to engage in unjustified obstructionism by making cryptic and obscure references to matters that ‘ought to be’ considered and then, after failing to do more than bring the matter to the agency’s attention, seeking to have that agency determination vacated on the ground that the agency failed to consider matters ‘forcefully presented.’” *Id.* at 551 (quoting *NRDC v. Morton*, 458 F.2d 827, 837-38 (D.C. Cir. 1972)). CP&L “forcefully presented” several (unsound and unworkable) alternatives to the PRM, which the Board rejected with sound justification, and when pressed for any other “feasible alternatives,” CP&L’s response was that it had none. In these circumstances, the Board has amply discharged its duty to the public interest.

CONCLUSION

The Board should deny CP&L's Petition, grant NS' Reconsideration Petition in its entirety, and revise the Decision to find that the challenged rates are not unreasonable.

Respectfully submitted,



G. Paul Moates
Terence M. Hynes
Ronald S. Flagg
Paul A. Hemmersbaugh
Sidley Austin Brown & Wood LLP
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000
(202) 736-8711 (fax)

James A. Hixon
James A. Squires
George A. Aspatore
Norfolk Southern Corporation
Three Commercial Place
Norfolk, Virginia 23510-2191
(757) 629-2657

Counsel for Defendant Norfolk Southern Railway Company

DATED: February 9, 2004

CERTIFICATE OF SERVICE

I hereby certify that, on this 9th day of February, 2004, I served the foregoing
"Defendant Norfolk Southern Railway Company's Reply to Complainant's Petition for
Reconsideration" by causing five (5) copies thereof to be delivered, via hand delivery, to:

C. Michael Loftus
Christopher A. Mills
Frank J. Pergolizzi
Peter A. Pfohl
Daniel M. Jaffe
Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, D.C. 20036



Gabriel S. Meyer