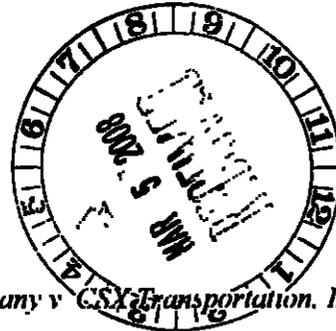


March 5, 2008

The Honorable Anne K. Quinlan  
Acting Secretary  
Surface Transportation Board  
395 E Street, SW  
Washington, DC 20423



RE Docket No. NOR 42100, *E I du Pont de Nemours and Company v. CSX Transportation, Inc.*

Dear Secretary Quinlan:

Please find enclosed for filing in the above referenced matter, an original and ten (10) copies of E I du Pont de Nemours and Company's Reply Evidence - **PUBLIC VERSION**. Also enclosed is a compact disk containing written text in pdf format.

An extra copy of this filing is enclosed for stamping and returning to our offices.

If you have any questions, please do not hesitate to contact the undersigned.

Sincerely,

Nicholas J. DiMichael  
Jeffrey O. Moreno

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**PUBLIC VERSION**

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

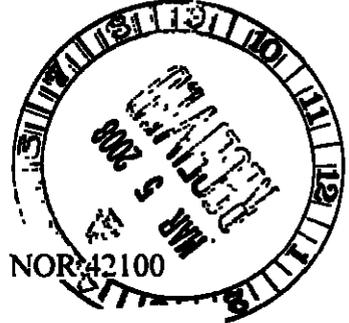
E I DUPONT DE NEMOURS AND COMPANY )

Complainant, )

v )

CSX TRANSPORTATION, INC , )

Defendant. )



Docket No NOR 42100

**COMPLAINANT'S REPLY EVIDENCE**

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Public Record**

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March 5, 2008

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**Part II – Reply Verified Statements**

- 1) Reply Verified Statement of Michelle Moore, an Executive Buyer of raw materials for E I du Pont de Nemours and Company
- 2) Reply Verified Statement of Thomas D Crowley, President, L E. Peabody and Associates, Inc , Alexandria, Virginia

**Part III – Reply Exhibits**

Exhibit A – DuPont Contract Fact Sheet

Exhibit B – Bear Stearns 2007 Rail Volume Analysis



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**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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E I DUPONT DE NEMOURS AND COMPANY		)	
	Complainant,	)	
		)	
v		)	Docket No NOR 42100
		)	
CSX TRANSPORTATION, INC.,		)	
		)	
	Defendant	)	
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**PART I — ARGUMENT**

DuPont has challenged the reasonableness of CSXT's rail transportation rates in this small rate case, and two others, under the Three-Benchmark approach adopted by the Board in *Simplified Standards for Rail Rate Cases*. Ex Parte No 646 (Sub-No 1), decision served September 7, 2007 (petition for reconsideration pending) ("*Simplified Standards*") In this proceeding, DuPont has challenged CSXT's rates for three movements of chlorine, STCC 2812815, from Niagara Falls, NY to New Johnsonville, TN ("Niagara Falls Movement"), from Natrium, WV to New Johnsonville, TN ("Natrium Movement"), and from Niagara Falls, NY to Carneys Point, NJ ("Carneys Point Movement")

Pursuant to the procedures adopted in *Simplified Standards*, DuPont and CSXT simultaneously presented Opening Evidence on February 4, 2008 In their opening evidence, each party identified its initial group of comparable traffic from the Board's Confidential Waybill Sample for the years 2002-2005, applied the Board's formula for adjusting the average revenue to variable cost ("R/VC") ratio of the comparable traffic group, and presented evidence of "other relevant factors" to make further adjustments to the R/VC ratio of the comparable traffic group

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In addition, DuPont also presented its evidence of CSXT's market dominance over the issue movements, including evidence regarding the variable cost of the movement in order to satisfy the "jurisdictional threshold" requirement of 49 U.S.C. 10707(d)

According to *Simplified Standards*, in Reply Evidence, each party must select its "final offer" comparison group. A party may select its final comparison group only from movements contained in either party's opening evidence comparison groups. Furthermore, any movement that was in both parties' opening evidence comparison group must be included in each party's final comparison group. *Simplified Standards*, p. 18. The Board then will select the comparison group "that it concludes is most similar in the aggregate to the issue movements," as the foundation for determining a maximum reasonable rate for the issue movements. *Id.*

DuPont presents this Reply Evidence and Argument in eight parts. Part I responds to CSXT's charge that this case is not appropriate for resolution under the Three-Benchmark approach. Part II answers CSXT's attacks on the Three-Benchmark approach itself. Part III addresses the differences between the parties' variable cost calculations for the issue movements. Part IV responds to CSXT's arguments that chlorine should be treated differently from all other commodities. Part V identifies the factors that DuPont applied to determine its "final offer" comparison group and responds to those factors that CSXT applied in its opening evidence. Part VI responds to CSXT's evidence of "other relevant factors."<sup>1</sup> Part VII presents the maximum R/VC ratios for the issue movements based on the DuPont "final offer" comparison group, as adjusted by the "other relevant factors" presented in the DuPont Opening Evidence. Finally, Part VIII summarizes the relief that DuPont requests.

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<sup>1</sup> DuPont is discussing CSXT's adjustments to the RSAM calculation and its "market-based" adjustments of the comparable traffic group R/VC ratios to 2007 levels under the rubric of "other relevant factors," although CSXT has not identified them as such.

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**I. THIS CASE IS APPROPRIATE FOR DECISION UNDER THE THREE-BENCHMARK APPROACH**

CSXT's Opening Evidence is charged with rhetoric and innuendo that has absolutely no bearing upon the Board's resolution of this proceeding, or any of the other two small rate cases filed by DuPont, pursuant to the Three-Benchmark approach adopted in *Simplified Standards*. CSXT's assertions are nothing more than an attempt to put a new spin on arguments that the Board considered and rejected in *Simplified Standards* regarding the proper use of the Three-Benchmark approach.

First, CSXT continues to argue that simplified rate standards should apply only to small shippers, not small cases. Although CSXT states that it does not seek to prevent any of the three small rate cases filed by DuPont from going forward, CSXT asserts that "they hardly constitute a 'truly small case' for a 'small shipper'." CSXT Op. Ev. at 4. CSXT seems to believe that, because DuPont is one of CSXT's largest customers and ships thousands of carloads in hundreds of traffic lanes annually, DuPont should not be permitted to file a small rate case. *Id.* at 2. But, as the Board correctly observed in *Simplified Standards*, p. 5, note 5, "under the statute eligibility must be based on the value of the case, not the size of the shipper."

CSXT, however, would define the value of this case as the value of the total business DuPont conducts with CSXT, not the value of the case actually presented to the Board. Specifically, CSXT argues that "[t]he traffic covered by this Complaint and its two companions are simply small component parts of a far larger dispute between the parties regarding hundreds of lanes of traffic long governed by a complex, integrated Master Contract." CSXT Op. Ev. at 3. But if the size of DuPont and its total traffic volume on CSXT are the criteria for determining eligibility to use the Three-Benchmark approach, then DuPont would be deprived of any practical form of relief from unreasonably high rates. The statute does not require an "all or

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nothing" approach – a shipper with a number of movements on a carrier may choose to challenge all of them, many of them, or just a few

DuPont would much prefer to enter into a new master contract with CSXT for all of its traffic at reasonable rate levels. But a contract is supposed to be the result of negotiations in a competitive market. Here, no such market exists. CSXT has abused its market dominance over much of the DuPont traffic to demand unreasonably high rates. For example, as to the chlorine movements at issue in this case, CSXT has declared from the outset that those rates are "non-negotiable." *Pileggi Op. V S* at ¶12

DuPont does not take issue with every single rate that CSXT has established for its traffic. But CSXT is offering only a package contract that forces DuPont to pay unreasonable rates on many traffic lanes in order to receive reasonable rates on some. CSXT's approach runs counter to the statutory requirement that *each and every* rate charged by a market dominant carrier must be "reasonable." 49 U.S.C. 10701(d) ("If the Board determines that a rail carrier has market dominance over the transportation to which a *particular rate* applies, *the rate established* by such carrier must be reasonable.") DuPont stands ready to negotiate a new master contract with CSXT as soon as CSXT is prepared to offer reasonable rates for DuPont traffic.

Under *Simplified Standards*, DuPont is entitled to challenge the reasonableness of individual rates for individual movements, as it has done in the three small rate cases it filed against CSXT. DuPont is not required to challenge every single rate that CSXT has published for it. Nevertheless, DuPont is mindful of the Board's concern that a shipper not attempt "to divide a large dispute into multiple smaller disputes." *Simplified Standards* at 32. But DuPont has not even come close to crossing that line.

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For all of the rhetoric in its opening evidence, CSXT does not actually accuse DuPont of impermissibly dividing its claims. That is because DuPont has not sought to manipulate the Board's process in its three small rate complaints. Each of the seven movements at issue is sufficiently discrete and has sufficiently low annual volume so as to make a Full Stand-Alone Cost ("Full-SAC") presentation too costly given the value of each case individually or combined. In *Simplified Guidelines*, p. 32, the Board noted that a Full-SAC case costs approximately \$5 million. This estimate is based upon cases involving the presentation of mostly single-commodity stand-alone railroads where the issue traffic moves between a single origin-destination pair. A multi-commodity stand-alone railroad with multiple origins and destinations spread across a wide geographic area could require an even more costly Full-SAC presentation. The seven movements of four different commodities in the three DuPont small rate cases are spread across origins and destinations in eight states: New York, New Jersey, Michigan, Mississippi, Virginia, West Virginia, North Carolina and Tennessee. There is little to no overlap in their routes and the distances involved would require DuPont to create a stand-alone railroad that replicates a very sizeable portion of CSXT's entire rail network. Moreover, based upon 2006 traffic volumes for the issue movements, even without the \$1 million rate relief cap imposed upon each of the three complaints filed by DuPont, the total relief calculated by DuPont in its Opening Evidence would not exceed the Board's \$5 million cost estimate for a Full-SAC case.

DuPont has filed only three rate cases, involving a total of seven geographically dispersed movements and four commodities. Until DuPont does significantly more than that, CSXT cannot reasonably argue for aggregation. Indeed, CSXT has limited itself to empty rhetoric—it has not raised any aggregation objections to the three pending DuPont small rate cases. The Board cannot make any aggregation determination based on speculation about cases that have

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not been, and may never be, filed. Accordingly, the Board should disregard CSXT's rhetoric and apply the Three-Benchmark approach in accordance with *Simplified Standards*.

Finally, CSXT makes a baffling assertion, without any explanation, that "it is fundamentally inappropriate for it to have to defend the rates on three separate movements in this single Complaint, and that DuPont has stepped outside the bounds of the purposes behind the Three Benchmark methodology by filing three Complaints covering a total of seven different sets of movements, all of which are simply disaggregated component parts of a larger dispute." CSXT Op. Ev. at 5. But DuPont just as easily could have filed seven separate complaints for each of the seven issue movements, in which case CSXT could have no such objection. Had DuPont done so, CSXT would have been required to defend, and present evidence in, seven different proceedings instead of only three. The evidence would not have been any different, just more repetitive and more voluminous.

DuPont combined its claims into three cases based upon whether the commodities transported were a toxic-by-inhalation ("TIH") hazardous material, a non-TIH hazardous material, or a non-hazardous material, because DuPont viewed this approach as the most efficient way to litigate the common issues in these cases for both the parties and the Board. As proof that no good deed goes unpunished, the Board held that the Three Benchmark \$1 million relief cap would apply to each case rather than each movement. Decision served Jan. 22, 2008, p. 3. Thus, CSXT already has benefited from the aggregation of seven movements into only three complaints. The Board should treat CSXT's assertions as what they are: hollow posturing.

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II. **CSXT's CHALLENGES TO THE THREE-BENCHMARK METHODOLOGY ARE INCORRECT**

At pages 12-16 of its Opening Evidence, CSXT re-ploughs ground that CSXT has trod many times before, in the *Simplified Standards* proceeding, by challenging a number of aspects of the Three-Benchmark methodology itself. Indeed, as noted below, some of CSXT's challenges attempt to unsettle law decided a decade ago.

CSXT's challenges to the Three Benchmark approach are wrong as a matter of policy and law, and were correctly rejected by the Board in *Simplified Standards*. Although CSXT and several other (but not all) rail carriers have appealed the *Simplified Standards* decision to the U.S. Court of Appeals for the District of Columbia Circuit, DuPont asserts that the railroads' challenges to the Three-Benchmark approach are meritless, and will be so found by the Court.

**Eligibility Limits.** CSXT objects to the Board's decision in *Simplified Standards* to set the eligibility limits in Three-Benchmark cases at \$1 million. CSXT argues that the \$1 million eligibility limit "subjects far too much traffic" to the Three-Benchmark methodology. But the statutory test for eligibility is not whether "too much traffic" (in the railroad's eyes) is encompassed by the Three-Benchmark procedure. Rather, it is whether the Three Benchmark methodology fulfills the statutory command for a "simplified and expedited" procedure, by effectively enabling a party to challenge the reasonableness of a rail rate in cases where a full stand-alone cost presentation is "too costly, given the value of the case." 49 U.S.C. 10701(d)(3).

In light of that statutory requirement, the \$1 million eligibility threshold is clearly *too low*. In establishing that requirement, the Board assumed that a Three-Benchmark case would cost only \$250,000 to litigate. The \$1 million eligibility limit was chosen to provide a potential complainant with a proper "risk factor." *See, Simplified Standard* at 31-32. But the litigation tactics employed by CSXT in this case – which has involved a CSXT Motion to Dismiss, a

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CSXT Motion to Hold in Abeyance, a CSXT Motion for Clarification, and the need for DuPont to file a Motion to Compel – suggests that the Board's estimate of the cost of a Three-Benchmark case may be significantly understated. DuPont notes that a number of entities have asked the Board to revise the eligibility limits upward. See, Petition for Reconsideration filed by Interested Parties on October 12, 2007 in Ex Parte 646 (Sub-No 1), pp 2-12

**The Three-Benchmark "Presumption."** CSXT objects to the Three-Benchmark "presumption" that an adjusted R/VC ratio derived from a group of comparable movements establishes a maximum reasonable rate. CSXT characterizes the Board's *Simplified Standards* decision in this respect as a "mechanical application" of a formula. CSXT is wrong. The Board's decision in *Simplified Standards* makes clear that, if the challenged rate is above a reasonable confidence interval around the estimate of the mean for the adjusted comparison group, it will be "presumed unreasonable." In such cases, the maximum rate will be prescribed at that boundary level, but only "absent any 'other relevant factors.'" *Simplified Standards* at 21 [emphasis added]. Thus, the Board's decision in *Simplified Standards* makes clear that the presumption will apply only where there is no other evidence of reasonableness. The Board's decision does not indicate that "other relevant factors" will be considered on something other than an "equal footing" with the evidence on comparability, as CSXT incorrectly charges. CSXT Op Ev , p 15. The Board's requirement that "other relevant factors" be quantifiable is a reasonable one, and not challenged by CSXT. See, *Simplified Standards* at 22.

**Movement-Specific Adjustments to URCS.** CSXT reiterates the railroad industry's oft-expressed objection to the Board's decision to permit no movement-specific adjustments to URCS variable costs. While DuPont strongly believes that the actual variable costs of the issue movements are far *below* the costs produced by URCS, DuPont also believes

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that the Board's decision to allow no movement-specific adjustments is particularly appropriate in Three-Benchmark cases CSXT is flatly incorrect in arguing that many movement-specific adjustments "can be made with little litigation expense " CSXT Op Ev at 15. As the Board has found, allowing such adjustments would drive the cost of these cases up to patently unacceptable levels See, *Simplified Standards* at 84

Moreover, CSXT's critique in its Opening Evidence, p. 15, makes no mention of the fact that, if movement-specific adjustments were made to the cost of the issue movement, then movement-specific adjustments *also* would have to be made to the cost of the comparable movements, so as not to distort the comparison But as the Board correctly pointed out in *Simplified Standards*, if the movements were similar, "they would likely get similar adjustments, which could cancel these adjustments out " *Simplified Standards* at 84 [citation omitted]

**Product and Geographic Competition.** CSXT's objection to the Board's refusal to consider evidence of product and geographic competition attempts to resurrect an issue that was settled a decade ago in *Market Dominance Determinations - Product and Geographic Competition*, 3 S T B 937, 949 (1998), *aff'd Assoc of Amer R R v STB*, 306 F 3d 1008 (D.C Cir 2002) ("*P&G Competition*") The Board concluded that the statute does not require it to consider product and geographic competition, *id* at 946, and that to do so would impose substantial burdens on both the parties and the Board, *id* at 947. Indeed, the Board noted that consideration of product and geographic competition imposes burdens on the Board "that extend the processing of rate cases," *id*, a consequence that is anathema to the statutory requirement of a simplified and expedited method for determining the reasonableness of challenged rail rates 49 U S C § 10701(d)(3)

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The Board also expressed concern that consideration of product and geographic competition requires it "to address complex non-transportation issues , thus significantly complicating and prolonging an analysis of the record," and requiring it "to 'second guess' shipper management" about issues beyond the Board's expertise. *P&G Competition*, at 947 The Board expressly cited examples of prior cases in which it was required to determine whether a paper manufacturer could alter its production process to use a different type of wood and whether the end users of aluminum containers could switch to plastic or glass *Id*

The Board also noted that the minimal harm to railroads of excluding evidence of product and geographic competition was outweighed by the harm it would cause to shippers

When effective product and geographic competition is present but difficult to demonstrate, the carrier will be no worse off if the effectiveness of this competition is determined by a complicated antitrust-type market dominance analysis or confirmed by the rate reasonableness analysis Conversely, if there is not effective competition, then a protracted examination of product and geographic competition, followed by an expensive and time-consuming rate analysis, works to the detriment of all parties Only if the prospect of such an onerous regulatory process deters the filing of a rate complaint would the railroads benefit However, the market dominance requirement should not be used as a litigation weapon, and Congress certainly does not intend for it to be used to chill pursuit of legitimate rate relief as envisioned under the statute

*Id* , note 60 In addition, the Board noted that, "if there are product and geographic competitive alternatives that are obviously effective, a shipper would be unlikely to pursue a regulatory rate challenge " *Id* at 948

The evidence in this case also is that product and geographic competition has had little to no effect upon CSXT's pricing of DuPont traffic Exhibit A, titled "DuPont Contract Fact Sheet," is an internal CSXT document prepared after the breakdown in contract negotiations with DuPont The last bullet on the third page (CSX-ALLIIC-005746) states, [REDACTED]

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[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]<sup>2</sup>

Finally, tremendous consolidation in the rail industry has rendered product and geographic competition much less effective than it may once have been. Since there is effectively a railroad duopoly in the eastern and western halves of the country, the odds are quite high that a potential source of product or geographic competition also is served by the same railroad. Moreover, as long as the issue commodity or the substitute commodity must move by rail to or from a point served by the defendant railroad, such product or geographic competition cannot be described as "effective."<sup>3</sup>

**Alleged Regulatory Lag.** CSXT argues that the Board has failed to adequately address the alleged "inherent bias" caused by using rates from 2002-2005 to judge the reasonableness of a rate in 2007-2008. CSXT is wrong. *See infra* at pp. 39-41. In *Simplified Standards*, the Board correctly noted that an adjustment to rail costs is not necessary, since, because the Three-Benchmark approach focuses on R/VC ratios where price levels are reflected in both the numerator and denominator, the effect of price shifts associated with inflationary

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<sup>2</sup> All shaded text is CONFIDENTIAL and HIGHLY CONFIDENTIAL information that has been redacted from the public version of this pleading.

<sup>1</sup> For example, [REDACTED]

[REDACTED] The fact that DuPont may obtain a lower transportation cost due to the shorter distance is a factor attributable to CSXT's lower cost, not to competition. CSXT can charge a lower rate and still earn the same or even a greater R/VC ratio on the alternate movement.

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increases is largely offset *Simplified Standards* at 85 And, the Board also correctly ruled that a revenue adjustment is not appropriate *Id*

Moreover, it would not be proper to adjust the maximum rate to account for an alleged lag, without *also* recalculating the RSAM and R/VC>180 ratios, to account for the same lag This is because alleged revenue increases by a carrier in any intervening time period would, all other factors being equal, shrink the shortfall to revenue adequacy, thereby decreasing the RSAM The R/VC>180 may increase as well, if the carrier has raised rates on traffic with a revenue to cost ratio of more than 180 percent A decrease in the RSAM (whether or not accompanied by an increase in the R/VC>180) would reduce the "expansion ratio" (the ratio of the RSAM to the R/VC>180), thereby in turn reducing the presumed maximum reasonable rate CSXT's attempt to "fully reflect[] current market rates" without currently reflecting *all* the factors that go into the maximum reasonable rate calculation, is simply an attempt to "pick and choose" those parts of the process that are – at this moment in time – most favorable to it

Finally, the Board has consistently and correctly determined in prior cases that the use of a four-year average was desirable "given the cyclical nature of railroad traffic," the need to "smooth out annual variations," and to "minimize the impact of any year that may have been aberrational for that carrier"<sup>4</sup> CSXT's methodology has the effect of elevating the importance of the current year's rates in a five-year rate prescription, no matter where the current year is in the rail economic cycle

**Sources of Information.** Finally, CSXT objects to the Board's ruling that parties to Three-Benchmark cases must base their selection of a comparison group and any advocacy for a

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<sup>4</sup> See *McCarty Farms v Burlington Northern Inc*, 4 I C C 2d 262 (1988), *rev'd on other grounds, Burlington Northern R R Co v ICC*, 985 F 2d 589 (D C Cir 1993), *South-West R R Car Parts Co v Missouri Pac R R Co*, Docket No 40073, 1988 ICC LEXIS 370, \*14 (Dec 1, 1988), *Rate Guidelines—Non-Coal Proceedings*, 1 S T B 1004, 1032-33 (1996)

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particular comparison group solely on Waybill Sample data released to the parties or other publicly available information. The Board's restriction is an eminently reasonable limitation to prevent Three-Benchmark cases from drowning in discovery, a result that would be contrary to the Congressional requirement for a "simplified and expedited" method for determining the reasonableness of rates when a full stand-alone cost presentation would be too costly, given the value of the case.

### **III. CSXT HAS NOT FOLLOWED THE BOARD-MANDATED PROCEDURES FOR CALCULATING VARIABLE COSTS**

In its Opening Evidence, DuPont calculated the variable costs of the issue movements using the Board's Uniform Railroad Costing System ("URCS") Phase III cost program without adjustments, as required by the Board's October 30, 2006 decision in Ex Parte No. 657 (Sub-No 1), *Major Issues in Rail Rate Cases*. CSXT followed the same procedures with two exceptions that produce slight differences from the variable costs calculated by DuPont:

The two differences are in the loaded miles and STCC commodity inputs to URCS. First, whereas CSXT used loaded miles from its internal records, DuPont used the loaded miles generated from the PC\*Miler|Rail program (version 10), which is from the same database used in the Waybill Sample. Crowley Reply V S at 5-6. Second, whereas CSXT used a 4-digit STCC of 2812 to identify loss and damage costs, DuPont used a 3-digit STCC of 281. DuPont consistently used a 3-digit STCC in all three of its pending small rate cases, in contrast to CSXT's decision to use a 4-digit STCC in this case and a 3-digit STCC in the other two cases. *Id.* at 6.

Because DuPont has followed the procedures mandated by the Board, the Board should use the DuPont variable cost calculations. *Simplified Standards* at 84 ("simplified guidelines can only be achieved by adhering strictly to the URCS model to calculate variable costs")

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**IV. CSXT'S "DEMARKETING" OF CHLORINE TRAFFIC VIOLATES ITS COMMON CARRIER OBLIGATION AND CONTRAVENES THE PUBLIC INTEREST IN THE SAFE TRANSPORTATION OF CHLORINE**

CSXT inappropriately argues that the greater risks associated with chlorine, compared with most other commodities, outweighs all of the marketplace considerations and traditional transportation characteristics relevant to identifying comparable movements. According to CSXT, transportation characteristics that are not related to risk "fade to near irrelevance" when it comes to moving chlorine. CSXT Op. Ev. at 6. Thus, "[a]t CSXT, chlorine transportation pricing is driven primarily by risk avoidance and mitigation considerations, not by profit maximization considerations." *Id.* at 7. What CSXT describes as a "paradigm shift in CSXT's pricing philosophy" for GHs, *id.* at 10, is in fact an attempt to "demarket" the transportation of those commodities, which is inconsistent with CSXT's common carrier obligation and is detrimental to public health and safety.<sup>5</sup>

Risk is an inherent factor in many industries and the rail industry is not alone in having to address the risks posed by chlorine. However, the rail industry is the only one responding to that risk with a "demarketing" strategy. Companies that manufacture chlorine and those which, like DuPont, use it every day face risks similar to, and in some cases greater than, CSXT's risk in transporting chlorine. Indeed, many of them, including DuPont, deal with chlorine in far larger quantities than CSXT, and operate plants that produce or use chlorine near large population centers. Yet none of those companies price their chlorine, or their chlorine-based products, the way that CSXT has chosen to price its transportation of chlorine. Whereas those companies manage their risks, CSXT is trying to avoid them altogether, regardless of the public interest.

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<sup>5</sup>

See DuPont Op. Ev. at 11-12 and Exs. A and B

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It makes no difference that CSXT is a common carrier obligated to transport chlorine. When CSXT chose to be in the common carrier business, it chose to accept all of the associated benefits and obligations. CSXT cannot selectively attempt to avoid certain obligations through unchecked pricing. Yet unchecked pricing is precisely the result if the Board accepts CSXT's claim that no rate can compensate it for the risk of transporting chlorine.

CSXT claims that its new pricing philosophy discourages long-haul movements of chlorine and creates incentives for chlorine users, who "insist on shipping the product," to obtain their supplies from closer sources. CSX I Op Ev at 7. CSX I then rationalizes the high rates for the issue movements by accusing DuPont of "prefer[ring] to have the lowest possible rail rates available so it can purchase product from the cheapest source, regardless of length of haul, number of yard handlings, or the number of High Threat Urban Areas that must be traversed to transport the product to its destination." *Id.* at 8. But, CSXT does not identify what closer chlorine sources DuPont could use for the issue movements. In fact, CSXT admits that "[t]he overwhelming majority of [chlorine] movements originate in Niagara Falls, New York, or Natrum, West Virginia, the two origins for the issue movements." *Id.* at 7. Therefore, by CSXT's own admission, it appears that DuPont is sourcing its chlorine from the nearest sources for the volumes DuPont requires in its production processes. This exposes CSXT's claim that its pricing encourages shorter over longer haul movements to be empty rhetoric.

According to Michelle Moore, who is responsible for purchasing raw materials, including chlorine, for the products manufactured by DuPont at its New Johnsonville and Carneys Point facilities, transportation risk is a major factor in deciding where to source chlorine. Moore Reply V S at ¶¶1. 7. DuPont conducts transportation risk assessments and typically requires a supplier to source from the point with the shortest route, if sufficient material is available from that

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supply point *Id* ¶4 DuPont also structures its supply contracts with its suppliers to minimize transportation distances *Id* However, in order to ensure a regular and uninterrupted supply of chlorine, DuPont requires multiple sources for each production facility and each source must be certified for quality and specifications *Id* ¶¶2-3. It is misleading and disingenuous for CSXT to accuse DuPont of sacrificing safety in order to obtain chlorine from the cheapest source

CSXT's attempt to "demarket" TIH commodities is like the behavior of a child who, when required to perform an undesirable chore, is determined to protest so loudly and frequently that the parent will find someone else to do the chore in the future But, in the case of transporting chlorine, there often is no one else to do it Yet it has to be done because, as DuPont demonstrated in its Opening Evidence, pp 7-8 and Ex A, so much that we take for granted in our daily lives depends upon chlorine and rail most often is the safest mode of available transport

The rail industry has managed its TIH transportation risks, including chlorine, successfully for many decades Such risks have been managed through safety rules and operating practices, employee training, and equipment design, to name just a few risk management tools As a last line of defense, there is insurance for accidents that may occur despite all the other steps taken All of these measures have costs and it is appropriate to consider those costs in pricing decisions. Moreover, those costs are likely to be reflected in the rates of comparable traffic, such as all TIH commodities It is not appropriate, however, for CSXT to set rates at the highest level it thinks it can get away with simply because it wants to eliminate *all* risk exposure The Board must check this pricing behavior, in order to protect the *public interest* in the safe transportation of chlorine, and not just the narrow interests of the rail carriers that it regulates

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CSXT's candid admissions as to how it prices chlorine, and other TIH movements, raises serious questions as to whether the Three Benchmark approach can be an effective means to determine the reasonableness of rail rates for chlorine and other TIH movements over the long run. CSXT's decision to price chlorine transportation, since 2005, primarily according to risk avoidance, and without regard to market conditions or even cost characteristics, is an admission that it is pricing completely outside any legitimate economic model. Consequently, over the course of just four more years, all chlorine movements in the Waybill Sample will reflect that unlawful pricing model. The Three Benchmark approach will only perpetuate that model. In order to break this cycle, the Board will need to devise an alternative simplified rate case methodology for chlorine and other TIH movements.

The above concern is not present in this case, since the parties are using Waybill data from 2002-2005, which mostly precedes the time that CSXT altered its pricing strategy. However, CSXT urges the Board to consider this "paradigm shift in CSXT's pricing philosophy" in evaluating the reasonableness of the issue chlorine movements. CSXT Op Ev at 10. DuPont submits that the Board must do just the *opposite*, because CSXT's paradigm shift towards "demarketing" all TIH movements fundamentally violates its common carrier obligation and is contrary to the public interest in transporting chlorine by the safest available mode.

### **V. "FINAL OFFER" COMPARISON GROUP**

Although DuPont and CSXT have agreed upon several relevant factors in selecting their initial comparison groups, there are several fundamental differences. The common factors applied by both parties are tank car movements, private car ownership, CSXT originated and terminated movements, and movements with an R/VC > 180. After carefully considering the other factors applied by CSXT, DuPont believes that, with two minor modifications noted in this

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Reply Evidence below, its initial comparison groups for each of the issue movements are the "most similar in the aggregate to the issue movements " *Simplified Standards* at 18.

DuPont witness Crowley compares the initial comparison groups of DuPont and CSXT for each of the three issue movements See Crowley Reply V S at 10-11 and Exs TDC-10, 11 and 12 He then reviews and critiques each of the criteria applied by CSXT to select its initial comparison group *Id* at 12-23 Finally, Mr Crowley explains the modifications that DuPont has made to its "final offer" comparison groups and presents each group in Exhibits TDC-16, 17 and 18 *Id* at 24-25

As discussed in detail below, the DuPont "final offer" comparison groups for the three chlorine lanes consist of the following

- 1 The DuPont initial comparison group for each lane,
- 2 plus certain chlorine movements from CSXT's initial comparison group that satisfy all of the criteria for inclusion in the DuPont initial comparison group in each lane, except that the Waybill Sample did not identify them as a STCC "49" hazardous material,
- 3 less the issue movements for each lane, as identified by CSXT,
- 4 less the movements originated or terminated by a short-line or switching carrier based on the Freight Station Accounting Code ("FSAC") information reported in the Costed Waybill Sample

**A. CSXT Factors Accepted by DuPont**

In its "final offer" comparison groups, DuPont has accepted three factors applied by CSXT These factors concern the identification of hazardous commodities, the identification of issue traffic, and the exclusion of movements that are originated or terminated by a switching or short-line carrier

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1. **DuPont has added to its "final offer" comparison groups chlorine movements that are not identified in the Waybill Sample by STCC "49"**

In its Opening Evidence, DuPont excluded all movements that did not include a "49" STCC, which indicates that the commodity is a hazardous material. After reviewing CSXT's comparison group, however, DuPont realized that apparent coding errors in the Waybill Sample resulted in several chlorine movements not receiving a "49" STCC, even though chlorine clearly is a hazardous material. Therefore, DuPont has added those movements to its "final offer" comparison groups, provided those movements also satisfy the other selection criteria adopted by DuPont. Crowley Reply V S at 14.

2. **DuPont has accepted CSXT's criteria for identifying the issue movements for exclusion from its "final offer" comparison group**

Although both DuPont and CSXT excluded the issue traffic from their initial comparison groups, they employed different methods to identify the issue traffic from the Waybill Sample. CSXT identified traffic as "issue traffic" based on origin, destination and STCC code. DuPont identified "issue traffic" as movements in DuPont (DUPX) cars. Upon review of CSXT's evidence, DuPont accepts CSXT's identification of issue movements and has omitted these movements from its comparison groups. *Id.* at 13. However, DuPont disagrees with CSXT's methodology for exclusion of the issue movements from the comparison groups. *Id.* Proper application of that methodology, as discussed below, excludes fewer movements from each DuPont comparison group than CSXT would exclude.

CSXT's error lies in the use of a *single* comparison group for *all three* of the issue movements, whereas DuPont used a more refined set of factors to identify *separate* comparison groups for *each* issue movement. *Id.* For example, the DuPont comparison group for the Natrium Movement excludes only the Natrium Movements as issue traffic. In contrast, CSXT's

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single comparison group for all three issue movements also excludes the Niagara Falls and Carneys Point Movements as issue traffic for the Natrium Movement. Consequently, CSXT would omit 16 movements from the DuPont comparison group for the Natrium Movement when only one of those movements in fact is the Natrium Movement, and the other 15 are the Carneys Point Movement. Thus, for the Natrium Movement, DuPont has excluded as issue traffic only other Natrium movements, and for the Niagara Falls Movement, DuPont has excluded as issue traffic only other Niagara Falls movements, and for the Carneys Point Movement, DuPont has excluded as issue traffic only other Carneys Point movements. *Id.* at 14.

CSXT concedes that "[i]t makes little sense to 'compare' the current rates charged on issue traffic with historical rates on that same traffic, as the overarching purpose of the Three Benchmark approach is to compare the issue rates with rates charged for *other* similar traffic." CSXT Op. Ev. at 22 [underline added; italics in original]. But CSXT's methodology violates its own principles: with respect to the Natrium Movement, the Carneys Point Movement is not the "same traffic," but is "other similar traffic."

3. **Although DuPont disagrees with CSXT's rationale, it has excluded from its "final offer" comparison group movements that are originated or terminated by a switching or short-line carrier**

CSXT has not offered a proper justification for excluding movements that were originated or terminated by a short-line or switching carrier, even though they are reported in the Waybill Sample as "CSXT Local" movements. Unlike joint line movements, these movements are priced by CSXT, and they are costed from origin to destination as CSXT movements. Thus, for purposes of identifying comparable movements from the Costed Waybill Samples, there is no difference between these movements and those that are originated or terminated by CSXT.

Nevertheless, CSXT claims that the use of its system-average URCS variable costs for the portion of the movement served by the short-line does not produce a R/VC reflective of

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CSXT's experience, and thus does not provide a comparable basis for evaluating the challenged rates. CSXT Op Ev at 20-21. DuPont disagrees with CSXT's exclusion of these movements for the following reasons:

First, CSXT claims that it can identify movements in the Waybill Sample that originate or terminate on a switching carrier or short-line by whether the FSAC begins with a "6." DuPont has been unable to corroborate this claim. Crowley Reply V S at 21.

Second, because CSXT has pricing authority from the switching or short-line carrier, it sets rates for the entire origin-destination movement as if it were a single line movement. Indeed, CSXT often has an ownership in these carriers, such as Conrail. Furthermore, many of these types of movements are subject to paper barriers that allow CSXT to set rates as if they were single-line movements.

Third, if the Board considered these movements other than CSXT local, it would apply regional unit costs to the non-CSXT portion of the movement and CSXT unit costs to the CSXT portion, and classify the movement as interline. These costs would clearly be greater than the costs for a local move because of the introduction of interchange costs for both railroads and the resulting R/VC ratio would be lower. *Id.* at 21-22. Thus, by accepting the Waybill Sample's determination that these movements are "CSXT local," DuPont has been conservative in its approach.

Despite its disagreement with CSXT's exclusion of movements that originate or terminate on a switching or short-line carrier, DuPont has excluded those movements from its "final offer" comparison group because their exclusion has a minimal effect upon this case. DuPont only had two such movements in its initial comparison group, and both of those movements were in the Niagara Falls to New Johnsonville lane. *Id.* at 21.

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**B. CSXT Factors Rejected by DuPont**

**1. DuPont has adopted far more reasonable distance parameters than CSXT**

Although CSXT and DuPont both applied a distance criteria in their initial selection of comparable movements, DuPont has applied a far more reasonable standard to identify movements most similar in the aggregate to the issue movements. DuPont rounded the issue movement mileage to the nearest 50 miles and selected movements that fell within a range of 150 miles on either side of that number. Crowley Reply V S at 22. DuPont performed this analysis for *each* of the three issue movements in order to obtain the most comparable traffic based upon distance for *each* movement. In contrast, CSXT included every movement with a distance greater than 200 miles. It is only through this methodology that CSXT is able to select a single comparison group for all three of the issue movements.

CSXT's much broader mileage range includes many movements that clearly are not comparable to the issue movements. For example, although the Niagara Falls Movement travels 880.7 loaded miles, CSXT includes movements with as few as 210.8 miles, or less than 25% of this distance. *Id.*

CSXT's assertion that "the most significant effects of length of movement on variable costs and revenues are found in the difference between relatively short hauls, on the one hand, and medium and longer distance movements, on the other hand," CSXT Op. Ev. at 21, is unsupported by the facts. DuPont witness Crowley illustrates the impact of distance upon costs in his Verified Statement at Ex. TDC-15, which plots the variable cost per ton-mile in 50-mile increments for a common comparable movement selected by both CSXT and DuPont. Crowley Reply V S at 22-23. By extending its mileage boundaries around the issue movements by

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several hundred miles beyond those chosen by DuPont, CSXT has included a much greater variation in the costs of providing service *Id* at 23

At the 200 mile threshold selected by CSX I, the cost curve is still very steep. For example, a 1¢ drop in the cost per ton-mile occurs between 200 and 350 miles, a span of only 150 miles. But the next 1¢ drop in the cost per ton-mile occurs between 350 and approximately 1350 miles, a span of 1000 miles. The much narrower DuPont mileage range for selecting comparable movements is on this relatively flat part of the cost curve. For example, Exhibit TDC-15 shows that CSXT's variable cost range is from \$0.04072 to \$0.01983 per ton-mile, whereas the DuPont range is from \$0.02500 to \$0.02238 per ton-mile. *Id*. This shows that, holding all other factors constant, shorter haul movements will have higher rates (measured on a mills per ton-mile basis) than longer haul movements. *Id*.

There also does not appear to be any correlation between revenues and distance at 200 miles. Witness Crowley has prepared charts that compare all the movements in the DuPont and CSXT initial comparison groups for each of the three issue movements. Crowley Reply V S at 10-11, Exs. TDC-10, 11 and 12. These charts identify all the movements included in each party's initial comparison groups, color code the common movements in both party's comparison groups, and categorize the reasons why each party has excluded the remaining movements of the other party from their comparison groups. With very few exceptions, a review of CSXT's initial comparison group in this case reveals that the highest R/VC ratios are most prevalent for movements shorter than 450 miles. This fact seriously undermines CSXT's claim that all traffic that moves over 200 miles is comparable based upon length of haul.

By including only movements that are 150 miles longer or shorter than each issue movement, DuPont has identified traffic that is far more similar in distance to the issue

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movements than CSXT has identified. Therefore, DuPont continues to adhere to the distance criteria in its opening evidence.

### 2. CSXT improperly limits comparable traffic to just chlorine

DuPont has included all TIH commodities in its initial comparison group, whereas, CSXT has included only chlorine. Although CSXT concedes that "'toxic-by-inhalation' commodities are a particularly dangerous group of extremely hazardous materials, with their own unique transportation characteristics, and special safety, handling, and security requirements," it claims that non-chlorine TIH commodities "are not useful for purposes of a comparable movement analysis because they come from many different and disparate origins sources and travel on a variety of routes (with varying density and capacity) to a variety of different destinations." CSXT Op. Ev. at 23 and note 18. This logic is inconsistent with other positions that CSXT has taken in this case, and with CSXT positions taken in the other two DuPont small rate cases.

First, CSXT previously claimed that all of the other "non-risk" factors that supposedly render other TIH commodities non-comparable with chlorine "fade to near irrelevance when it comes to moving" chlorine. *Id.* at 6. If risk is in fact the primary factor in determining comparability, and all TIH commodities share similar risk characteristics, then all TIH commodities should be similar.

Second, in Docket Nos. 42099 and 42100, CSXT does not seem to have any problem comparing multiple commodities despite their different origins, routes, and destinations. CSXT has not explained why these differences should be a concern in this case but not in the other two cases.

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Although CSXT disposes of all other TIH commodities in a footnote, it offers a lengthier, albeit no more persuasive, justification for excluding anhydrous ammonia movements from its initial comparison group. CSXT claims that, before risk management became its primary focus for chlorine traffic, its pricing did reflect primarily market considerations, and that the markets for chlorine and anhydrous ammonia are very different. CSXT Op Ev at 23. For example, CSXT claims that anhydrous ammonia is subject to greater intermodal competition, has a more global market, and passes through fewer major cities. All of these statements are wrong.

In *CF Industries, Inc v Koch Pipeline Co., L.P.*, 4 S T B 637, 643 (2000), the Board held that Koch Pipeline possessed market dominance over the transportation of anhydrous ammonia to virtually every destination at issue. Although Koch presented evidence that Midwestern retailers received almost as much anhydrous ammonia by barge as by pipeline, and also significant tonnage by rail, the Board found that neither barge nor rail provided effective intermodal competition. *Id.* at 644-45. With respect to rail, even before adding in equipment and storage costs, the Board concluded that rail rates were not cost competitive at nearly three times the pipeline rate.<sup>6</sup> *Id.* at 645-46. In essence, because rail has no chance of competing with pipelines, or barges, rail transportation of anhydrous ammonia realistically is restricted to areas beyond the reach of those two modes. This is precisely the same situation for rail transportation of chlorine, which will always move by barge when that is an option.<sup>7</sup> The Board also considered and rejected product and geographic competition for anhydrous ammonia shipments. *Id.* at 641-42, 652-55. Thus, CSXT's unsupported assertion that the transportation markets for chlorine and anhydrous ammonia are very different simply is not credible.

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<sup>6</sup> Based upon CSXT's strategy to "demarket" TIHs, it is safe to presume that CSXT has not decreased rail rates for transporting anhydrous ammonia since 2000, and probably has increased them significantly.

<sup>7</sup> See DuPont Op Ev at 13-14 (DuPont will always ship chlorine by barge, whenever capacity is available, even if rail is an option.)

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Nor is CSXT's unsupported claim that anhydrous ammonia passes through fewer High Threat Urban Areas ("HTUAs") and other major cities very credible. DuPont witness Crowley has analyzed the routes for anhydrous ammonia and other TIH commodities in the DuPont comparison groups and observes that the number of HTUAs and other major cities passed through "is simply a function of the origin, destination and route of the movement and not the commodity " Crowley Reply V S at 15 For example, although the Niagara Falls Movement travels through more HTUAs and other major cities than most of the comparable movements of all TIH commodities, the Natrium Movement travels through fewer HTUAs and other major cities and the Carneys Point Movement travels through about the same number of HTUAs and other major cities as the other comparable movements of all TIH commodities. *Id* at 16 Thus, the risk of transporting anhydrous ammonia and other TIH commodities through HTUAs and other major cities is not demonstrably less than the same risk for chlorine

In summary, the DuPont "final offer" comparison group continues to include all TIH commodities in the Waybill Samples that also satisfy the other DuPont selection criteria

3. **CSXT has inappropriately excluded movements on the unsupported assumption that fuel costs were not recovered**

CSXT has excluded all movements with no charges in the "Miscellaneous Charges" field of the Waybill Sample on the unsupported assumption that this indicates that fuel costs were not recovered DuPont believes that this is an inappropriate exclusion of otherwise comparable movements for several different reasons

First, the absence of a value in the "Miscellaneous Charges" field does not necessarily mean that CSXT did not receive a fuel adjustment on that movement CSXT has not presented any evidence that it reports fuel surcharges in this field or that fuel surcharges are the only monies recorded in this field Crowley Reply V S. at 17

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Second, fuel costs can be accounted for in different ways. But, CSXT creates the impression that it was not compensated for increasing fuel prices if there is no value in the "Miscellaneous Charges" field of the Waybill Sample. For example, because tariff rates can be increased on 20 days notice, changing fuel costs can be captured in the line-haul rate without a fuel surcharge. In addition, many rates are adjusted by the Rail Cost Adjustment Factor, or some variation, that includes changes in fuel costs. *Id.* at 18. Exhibit IDC-13 shows that the fuel component of the RCAF increased at a faster rate than EIA's U.S. No. 2 Diesel price from 1Q02 to 1Q08. Thus, even if there was no separate fuel surcharge, a rate adjustment mechanism, such as the RCAF, would have captured the increase in CSXT's fuel costs. *Id.* at 18.

Third, even if CSXT did not assess a fuel surcharge on a particular movement, that was a market-based decision by CSXT, and thus is properly included in the comparison group. The same would be true of any other market-based decision and CSXT has not offered any rationale for treating fuel differently.

Fourth, CSXT claims that traffic without a fuel surcharge from 2002-2005 was under-recovering fuel costs relative to other traffic. However, by CSXT's own admission, during that period it was *over*-recovering fuel costs on traffic subject to a fuel surcharge based upon a methodology that the Board subsequently declared to be an unreasonable practice. *Rail Fuel Surcharges*, STB Ex Parte No. 661, (served Jan. 26, 2007). As noted in that Board decision, CSXT admitted that "its fuel surcharge program 'is designed to recoup CSXT's increased overall fuel expenses to ensure adequate revenues.'" *Id.* at 6, quoting CSXT Comment at 18 [emphasis added]. But the Board rejected CSXT's rationale, stating,

the fact that a railroad may not be able to recover its increased fuel costs from some of its traffic. does not provide a reasonable basis for shifting those costs onto other traffic in this manner. We believe that imposing rate increases in this manner, when there is

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no real correlation between the rate increase and the increase in fuel costs for that particular movement to which the surcharge is applied, is a misleading and ultimately unreasonable practice.

*Id.* at 7 Thus, by CSXT's own admission, traffic assessed a fuel surcharge from 2002-2005 was overcharged for changes in the cost of fuel to account for traffic that did not pay a fuel surcharge. Since it is not practical to exclude both types of traffic from a comparison group, a fair and reasonable response is to include both types of traffic, allowing the conceded over-recovery of fuel on the one type of movement to offset the alleged under-recovery on the other. The average RVC ratio of this comparison group then should be similar to what it would have been if fuel were properly accounted for in both types of movements.

#### 4. CSXT has not offered any rationale for excluding multiple car movements

In *Simplified Standards*, p. 17, the Board observed that, because it is "comparing mark-ups over variable cost to determine the reasonable level of contribution to joint and common costs for a particular movement [i.e., movements with different cost characteristics may be included in the comparison group." By way of example, the Board noted that "there is no reason, *a priori*, to presume that the RVC ratios should be different" between single car, multiple car, and unit train movements. Despite this presumption of comparability between such movements, CSXT has included only single car movements in its comparison group.

In contrast, DuPont included multiple car movements in its initial comparison group based upon the Board's *a priori* presumption. CSXT, however, has not offered any evidence to rebut the Board's presumption despite being given fore-knowledge of that presumption in *Simplified Standards*. Any CSXT attempt to offer such evidence in its Reply or Rebuttal evidence in this case would constitute inappropriate "sandbagging," since DuPont would not have the opportunity to adjust its "final offer" comparison group to account for any CSXT

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argument that DuPont might consider valid. Therefore, the Board should accept the inclusion of multiple car movements as being most similar to the issue movements.

### 5. CSXT inappropriately excludes other CSXT movements that originate or terminate in Canada

CSXT wrongly concludes that movements that originate or terminate in Canada are not comparable due to differing laws, regulatory requirements and costs in Canada. CSXT does not attempt to identify or explain the magnitude of those differences or their impact upon its revenues and costs. DuPont submits that CSXT's movements for only very short distances into and out of Canada do not create the apples-to-oranges comparison problems that CSXT insinuates.

First, CSXT does not have extensive operations in Canada. Any cross-border movements that originate or terminate in Canada travel in Canada for only a very short portion of the total origin to destination route. The longest move in Canada from any of the three DuPont "final offer" comparison groups in this case is 42.4 miles and accounts for no more than 8.3% of the total length of movement. Crowley Reply V.S. at 19 and Ex. TDC-14. The vast majority of such movements in the DuPont "final offer" groups move only 10.7 miles in Canada and are less than 2% of the total length of haul. *Id.* Thus, to the extent there is any difference between CSXT's costs in Canada versus the United States, those differences will be very small relative to the total movement costs.

Second, it is inappropriate to exclude these Canadian movements because the Board includes them in the Waybill Sample and in its calculation of the RSAM and  $R/VC > 180$  benchmarks. *Id.* at 19. The variable costs in the Waybill Sample cover the movement from origin to destination, even if those points are in Canada, and the revenues are for the entire movement. *Id.* For purposes of the RSAM and  $R/VC > 180$  calculations, the Board treats these

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movements as domestic U S movements *Id* Thus, in order to maintain consistency between all three benchmarks, they must be based upon the same universe of traffic

Therefore, DuPont has retained traffic that originates or terminates in Canada as part of its "final offer" comparison group

### **C. The DuPont "Final Offer" Comparison Groups Have Comparable Density Ranges to the Issue Movements**

Neither DuPont nor CSXT included density as a factor in the selection of their initial comparison groups due to the uncertainty of whether they could use the density maps produced by CSXT in discovery Now that the Board has clarified that the parties may use that data, DuPont has conducted a density analysis of the movements contained in its "final offer" comparison groups DuPont witness Crowley has calculated the weighted average density for each issue movement and for each movement in the "final offer" comparison groups and presented the results in Exhibits IDC-16, 17 and 18 Crowley Reply V S at 27-28 These analyses demonstrate that the DuPont "final offer" comparison groups are comparable in density with each of the issue movements

As shown in Ex IDC-16, the weighted average density of the Niagara Falls Movement is 72.3 million gross tons per mile ("MGT/mile") The comparison group movements have a range of weighted average density from 29.9 to 74.9 MGT/mile Furthermore, the movements at the high and low ends of this range also were included in CSXT's initial comparison group, which means they must be included in both party's "final offer" groups Therefore, the DuPont "final offer" comparison group will have at least the same range of density as CSXT's group.

As shown in Ex IDC-17, the weighted average density of the Natrium Movement is 33.3 MGT/mile The comparison group movements have a range of weighted average density from 19.3 to 114.7 MGT/mile The movements at the low end of this range also were included in

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CSXT's initial comparison group, which means they must be included in both party's "final offer" groups. Excluding two movements at 114.7 MGT/mile, the next highest density movement is 91.2 MGT/mile, which also was included in CSXT's initial comparison group.<sup>8</sup> Therefore, with the exception of two movements out of a group of 99, the DuPont "final offer" comparison group will have at least the same range of density as CSXT's group.

As shown in Ex. TDC-18, the weighted average density of the Carneys Point Movement is 78.5 MGT/mile. The comparison group movements have a range of weighted average density from 29.9 to 120.2 MGT/mile. Furthermore, the movements at the high and low ends of this range also were included in CSXT's initial comparison group, which means they must be included in both party's "final offer" groups. Therefore, the DuPont "final offer" comparison group will have at least the same range of density as CSXT's group and may ultimately be narrower.

All of the above density ranges reflect comparable movements based upon density thresholds used by the Board. When evaluating track and traffic conditions in Annual Report Form R-1, Schedule 720, the Board requires each Class I railroad to group these characteristics by density category. Track category A (the most densely traveled rail lines) groups together all lines with 20 MGT/mile or higher. Crowley Reply V S at 28. Additionally, in Schedule 416, the Board also requires that Class I railroads calculate road property depreciation rates by the same density category. *Id.* at 28-29. With the exception of a few movements with a weighted average density of 19.3 MGT/mile, which were included in the both parties' initial comparison groups and therefore must be included in their "final offer" groups, every DuPont comparable movement falls within the highest density category used by the Board. *Id.* at 29.

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<sup>8</sup> As noted in the following discussion of the densities for the Carneys Point Movement, both parties included a movement with a weighted average density of 120.2 MGT/mile, which indicates that 114.7 MGT/mile is not outside the representative density range.

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**VI. "OTHER RELEVANT FACTORS"**

CSXT has made two adjustments to the maximum R/VC ratios produced by applying the Board's formula to CSXT's initial comparison group. One adjustment is to correct an alleged error in the Board's RSAM calculation and the other is to adjust the R/VC ratios of the comparable traffic to 2007 "market" levels. Although CSXT does not consider these adjustments to be "other relevant factors," it concedes that its evidence might be considered under that label. CSXT Op. Ev. at 31. Because DuPont agrees with CSXT's statement that the quantified effects of its adjustments would be the same regardless of when in the process they are applied, *id.*, the issue of whether or not these adjustments constitute "other relevant factors" is moot. For the purpose of responding to CSXT, however, DuPont is addressing both adjustments as "other relevant factors."

**A. The Board Should Reject CSXT's RSAM Adjustment**

CSXT has identified an alleged "flaw" in the Board's RSAM calculation that it attempts to correct. Specifically, CSXT claims that, because the RSAM revenue shortfall is calculated after all taxes have been paid, the revenues needed to make up that shortfall also must be calculated after taxes in order for CSXT to achieve revenue adequacy. CSXT Op. Ev. at 19-21. DuPont witness Crowley identifies two fundamental problems with CSXT's adjustment. First, CSXT erroneously applies its statutory tax rate to adjust the revenue shortfall for taxes. Crowley Reply V.S. at 34-35. Second, because the variable costs used to calculate the RSAM and R/VC >180 ratios include an over recovery of income taxes, they in fact understate the size of the R/VC >180 traffic and artificially increase the revenue adequacy adjustment factor. *Id.* at 36-37. Finally, this case is an improper proceeding to make changes to the RSAM calculation.

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### 1. CSXT does not pay the statutory tax rate

CSXT's adjustment of the RSAM for taxes wrongly assumes that CSXT pays the statutory tax rate, when its effective tax rate is much lower. This error causes a substantial and unjustified increase in the expansion ratio (the factor resulting from dividing the RSAM by the R/VC >180) from 1.24 to 1.38. CSXT Op. Ev. at 26. Thus, CSXT has vastly overstated the impact of the alleged flaw.

The effective tax rate is the amount of tax paid when all other government tax offsets or payments are applied, divided by the tax base. Factors such as deferred income taxes, tax-loss carry-forwards and carry-backs, and governmental tax credits can drive the effective tax rate well below the statutory rate. Crowley Reply V S at 34. CSXT is no exception. DuPont witness Crowley shows that CSXT's effective tax rates were well below its statutory rates from 2002 through 2005. *Id.*

Ideally, the proper tax rate to apply is neither the effective nor the statutory rate, but CSXT's marginal tax rate, which is likely to be somewhere between the effective and statutory rates. However, the Board would need a complete set of CSXT's income tax returns from 2002 through 2005 to determine CSXT's marginal tax rate for that time period. *Id.* at 35. Since CSXT, which is the sole source of that information, has chosen not to place it in evidence, the Board should apply CSXT's effective tax rate, if it elects to make any adjustment at all. Since all taxpayers strive to minimize their tax liability, it also is reasonable to presume that CSXT's marginal tax rate is much closer to its effective than its statutory tax rate.

The selection of the tax rate has a substantial impact upon the Board's expansion ratio of 1.24 for CSXT without any adjustments. Whereas the statutory tax rate produces a sizeable increase in the expansion ratio up to 1.38, CSXT's effective tax rate would increase the expansion ratio only modestly to 1.26. *Id.*, Ex. TDC-19. Although DuPont does not believe that

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any adjustment is necessary or appropriate for the reasons given in the next two sections, if the Board decides to make any adjustment, it should rely upon CSXT's effective tax rate, not its statutory tax rate

### 2. URCS overstates the necessary recovery of taxes to achieve revenue adequacy

DuPont believes that no adjustment to RSAM is necessary because URCS overstates the tax component in variable costs by using the statutory tax rate. URCS includes a variable return on investment ("ROI") component calculated using a pre-tax weighted-average cost of capital ("WACC") based on the federal statutory tax rate of 35 percent, which explicitly adds variable costs to each movement to cover the railroad's hypothetical tax burden. Crowley Reply V S at 36. However, as explained above, actual tax expenses are much lower than the statutory rate due to offsets and credits.

For example, as demonstrated in the preceding section, CSXT's effective tax rate is much lower than its statutory tax rate. Taking 2005 as an example, Mr. Crowley shows that CSXT booked \$220 million in federal taxes, but URCS implicitly included \$748 million to cover taxes inherent in the variable return on investment calculation. *Id.*, 1:10 TDC-20. In other words, URCS included taxes that were more than three times CSXT's actual income tax expense.

This impacts the RSAM revenue adequacy adjustment factor because the Board uses URCS variable costs, along with revenue statistics, to identify movements to include in the R/VC >180 sample group and the resulting Revenue >180 calculation. By overstating variable costs, URCS effectively excludes movements from the R/VC >180 sample group, which lowers the Revenue >180 figure. Correcting the URCS variable costs for this tax recovery overstatement, by using CSXT's effective tax rate, would increase the number of movements in the R/VC >180

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sample group, and thereby increase the total Revenue<sup>>180</sup> *Id* at 36-37 This would produce a more accurate revenue adequacy adjustment factor

### **3. This proceeding is an inappropriate forum to change the RSAM**

The Board revised the RSAM in *Simplified Standards*, after an extensive period for public notice and comment During four rounds of comments and a public hearing, neither CSXT nor any other party identified the alleged flaw that CSXT urges the Board to correct in this proceeding It would be inappropriate for the Board to use this proceeding between just CSXT and DuPont to change the RSAM methodology that was thoroughly vetted in a notice and comment rulemaking proceeding

As DuPont has demonstrated above, there are a multitude of countervailing factors that must be considered before declaring the existence of a flaw in the RSAM methodology and precisely how to fix such a flaw DuPont believes there is no flaw, because there is in fact no under-recovery of actual taxes If anything, DuPont believes there is an overstatement of taxes, and the resulting revenue shortfall Moreover, even if there is a flaw, the fix is to use the effective, not the statutory, tax rate The Board, however, should not determine the existence of a flaw within the narrow confines of this proceeding Rather, the Board should apply the RSAM that it adopted after extensive public notice and comment and direct CSXT to raise the alleged flaw in a petition to reopen *Simplified Standards*

### **B. CSXT's "Market" Adjustment Is Neither Necessary Nor Appropriate**

CSXT alleges that the cost and revenue data associated with movements from the 2002-2005 Waybill Samples "does not provide a comparable basis for evaluating the R/VC ratios of the challenged rates, which were established in mid-2007 . ." CSXT Op Ev at 26 Therefore, CSXT attempts to adjust the revenues and costs of every comparable movement to 2007 levels in order to "account for the significant market changes and dynamics and railroad cost inflation for

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the shipment of chemicals traffic that have occurred throughout the last five-plus years " *Id* at

26-27 These adjustments are neither necessary nor appropriate

CSXT's "market" adjustment to the maximum R/VC ratios of the comparable movements should be rejected for three reasons First, it undermines a fundamental objective of the Three Benchmark approach to smooth out the impact of market fluctuations over time when comparing the R/VC ratios of the issue traffic with a comparison group. Second, CSXT has not presented its evidence objectively as required by *Simplified Standards* Third, CSXT has not demonstrated that the adjustments are necessary to reflect changes in the market

1. **CSXT's "market" adjustment undermines a fundamental objective of the Three Benchmark approach**

CSXT's fundamental error lies in its assumption that the Board should evaluate rate reasonableness based upon a static period in time, i.e., a specific calendar year But from the very earliest permutations of the Three Benchmark methodology, the Board has strived to follow a multi-year approach that smooths out market fluctuations over time.

In *McCarty Farms v Burlington Northern Inc*, 4 I C C 2d 262 (1988), *rev'd on other grounds, Burlington Northern R R Co v ICC*, 985 F 2d 589 (D.C. Cir 1993),<sup>9</sup> the ICC reversed an earlier decision that made tentative findings based upon comparable traffic from only a single year of waybill data

We agree that one year of data should not be used to establish a standard which will have application to movements of traffic for many years The risk that data for any one year could be non-representative of the long-term trend outweighs any benefit, in

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<sup>9</sup> As a result of the *McCarty Farms* remand, the ICC abandoned R/VC comp as the *sole* determinant of reasonableness, but proposed to continue using it in combination with RSAM and R/VC > 180 in Ex Parte No 347 (Sub No 2), *Rate Guidelines—Non-Coal Proceedings*, 1995 ICC LEXIS 301, \*11, \*23-24 (served Dec 1995) Even after the court remand in *McCarty Farms*, the ICC cited to that decision as the example of how to apply the R/VC comp benchmark as part of the newly-proposed three benchmark approach *Id* at \*30-31, n 32 Thus, *McCarty Farms* clearly remained a viable precedent for that purpose both then and now

## PUBLIC VERSION

terms of simplicity in developing a rate reasonableness standard, to be derived from the use of a single year of data

*Id* at 277 For the purpose of prescribing future rates, the ICC declared

We believe that the best approach to establishing a standard that can be used to determine the reasonableness of rates for any year, including periods when data are not available, is to use an average of several years' of data. Evaluation of R/VC ratios over several years tends to balance out cyclical fluctuations and provide a better estimate of maximum reasonableness from a long run perspective

*Id* See also *South-West R R Car Parts Co v Missouri Pac R R Co*, Docket No 40073, 1988 ICC LEXIS 370, \*14 (Dec 1, 1988) (The ICC combined 5 years of data "to smooth out cyclical fluctuations")

This precedent refutes CSXT's assertion that the cost and revenue data associated with movements from the 2002-2005 Waybill Samples "does not provide a comparable basis for evaluating the R/VC ratios of the challenged rates, which were established in mid-2007" CSXT Op Ev at 26 Precisely because of changes and fluctuations in market conditions over time, the ICC concluded that a multi-year average of comparable rates was necessary to make the best determination of a maximum reasonable rate over the long run Because any rate prescription will be for a 5 year period, it is important to prescribe a rate that is based neither upon the peak nor the trough of the business cycle

When the ICC formally proposed the three benchmark approach in Ex Parte No 347 (Sub-No 2), *Rate Guidelines—Non-Coal Proceedings*, 1995 ICC LEXIS 301 (Nov 22, 1995), it added the RSAM and R/VC > 180 benchmarks in response to criticism of using the R/VC comp benchmark alone Consistent with its decisions in *McCarty Farms* and *South-West Car Parts* to draw comparable traffic from multiple years of waybill data, the ICC decided to use a 4-year average of the RSAM and R/VC >180 benchmarks "so as to smooth out annual variations and

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minimize the impact of any year that may have been aberrational for that carrier” *Rate Guidelines—Non-Coal Proceedings*, 1 S T.B. 1004, 1032-33 (1996)

CSXT’s market adjustment would undermine the Board’s carefully considered decision to use a 4-year average of all three benchmarks, by attempting to mark-up the R/VC ratios of the comparable traffic to market conditions in a single year. The rationale given by the Board in its earlier decisions – to use a 4-year average of the RSAM, the R/VC>180 and the R/VC comp figures in order to prevent the possibility that data from any one year could be “non-representative,” to “balance out cyclical fluctuations and provide a better estimate of maximum reasonableness from a long run perspective” and to “smooth out cyclical fluctuations” and “aberrations” – is just as valid now as it was then. CSXT notes that it has experienced increased demand for rail services in recent years. Yet, traffic data for 2007 shows that total volume for all Class I railroads was down for the year 2.3 percent, and that CSXT volumes are down even more, declining 3.4% for the year compared to 2006 (see Exhibit B). Moreover, there is widespread concern that the U.S. economy is heading into a recession, which could put further downward pressure on prices. Thus, CSXT’s so-called “market” adjustment to 2007 R/VC levels could have the effect of “locking in” rates at their very peak for the next 5 years.

### 2. CSXT’s “market” adjustments are not objective

In *Simplified Standards*, p. 77, the Board required a party introducing evidence of “other relevant factors” to provide the Board with “an objective, transparent means of adjusting the maximum lawful rate upwards or downwards.” The burden is upon the party requesting the adjustment. By ostensibly indexing only the revenues and variable costs of the comparable

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group movements to 2007 levels, CSXT has hardly presented an objective means of adjusting the maximum lawful rate<sup>10</sup> .

CSXI's adjustment to the revenues and variable costs of only the comparable group creates a mismatch among the three benchmarks Crowley Reply V S at 39 Although the Three-Benchmark approach relies upon historic variable costs and revenues to calculate all three benchmarks, CSXT fails to account for the impact of its indexing upon the RSAM and R/VC>180 benchmarks What we are left with after CSXI's indexing are comparison movement R/VC ratios that nominally have been indexed to 2007 price levels, and RSAM and Revenue >180 ratios based on averages of 2002 to 2005 historic rates and costs. *Id* Consequently, while CSXT purports to adjust the comparison group R/VC ratios to 2007 levels, it still applies the "expansion ratio" (the factor resulting from dividing the RSAM by the R/VC >180) based upon an average of the actual 2002-2005 cost and revenue data, even though higher R/VC ratios indexed to 2007 levels would produce a lower expansion ratio that would require an offsetting reduction to the maximum R/VC ratios for the issue movements This comparison of apples and oranges would allow CSXT to apply a much higher R/VC ratio to DuPont than would be proper Because CSXT has made adjustments that only benefit itself, without considering the countervailing effects of applying its adjustments consistently to all three benchmarks, these adjustments can hardly be considered an objective and transparent approach.

Furthermore, the inevitable offsetting effect is one of the reasons the Board rejected as unnecessary and inappropriate a nearly identical proposal by BNSF to address the same regulatory lag concerns expressed by CSXT *Simplified Standards*, pp 84-85 "Because the

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<sup>10</sup> Although CSXT claims that its "market" adjustment is not an "other relevant factor," that clearly is not the case See *Simplified Standards*, p 85 (In order to account for regulatory lag, "parties may present (as 'other relevant factors') evidence that the presumed maximum lawful rate should be higher, or lower, due to market changes not reflected in the comparison group or the average RSAM and R/VC >180 benchmarks ")

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Three Benchmark approach focuses on R/VC ratios (where price levels are reflected both in the numerator and denominator)," the Board concluded that "the effects of price shifts associated with an inflationary increase in costs should be largely offset, leaving the R/VC ratios unaffected " *Id* at 85. Nor did the Board believe that a revenue adjustment was appropriate, because the RSAM – R/VC >180 ratio also would change, potentially creating an offsetting effect to any rate increases or decreases attributable to regulatory lag. *Id*

### 3. CSXT has not demonstrated that its "market" adjustment is necessary to reflect changes in the market

Although the Board rejected adjustments to rail costs and revenues as unnecessary and inappropriate, *Simplified Standards* at 85, it nevertheless recognized at least the potential for a regulatory lag effect, and thus permitted the parties to "present (as 'other relevant factors') evidence that the presumed maximum lawful rate should be higher, or lower, *due to market changes not reflected in the comparison group or the average RSAM and R/VC >180 benchmarks* " [emphasis added] CSXT, however, has proposed the same methodology previously rejected by the Board precisely because the changes that methodology sought to account for already were reflected in the three benchmarks CSXT has not demonstrated any other market changes that are not reflected in the three benchmarks

Although CSXT shows that total revenues for the chemical group as a whole have increased from 2002 to 2007, it has not demonstrated the cause of those increases or whether the increased revenues are attributable to all, or just a portion, of chemical traffic CSXT's reliance upon public data on changes in revenues per unit for general chemical traffic falls far short of the transparency required by the Board to demonstrate "other relevant factors " *Crowley Reply V S* at 41

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Both of CSXT's proposed indexing methods rely upon changes in revenues for an entire business group rather than for the specific commodity or movements at issue. There is no evidence that CSXT's chemical business as a whole reflects changes in the comparable group. For example, CSXT's website lists 29 major chemical groups within its chemical group business, with multiple sub-categories within each macro group. *Id.* at 42. Although CSXT may categorize all these commodities as chemicals, the actual products are not nearly as homogenous. They cover a wide range of commodities, including sand, plastics, petroleum coke, LPG and soda ash, that have absolutely nothing in common other than being included in CSXT's chemical business group. *Id.* In addition, CSXT's chemical business group includes T1H hazardous materials, non-T1H hazardous materials, and non-hazardous materials. If these commodities were as homogenous as CSXT treats them in its analysis, they would have to be considered as similar commodities for the purpose of identifying comparable traffic, which neither CSXT nor DuPont has advocated in this case.

CSXT also has not shown that its revenue increases are due entirely to market changes. Although market changes may account for some of CSXT's increased revenue, a primary driver in higher 2007 chemical business revenues clearly has been increases in assessed fuel surcharges. *Id.* at 43. It is not possible to determine from the evidence submitted by CSXT what portion of its increased revenues in 2007 are driven by market changes that are not already reflected in the three benchmarks and other factors such as fuel surcharge revenue that is independent of the chemical transportation market. *Id.* at 44.

**PUBLIC VERSION**

**VII. CALCULATION OF MAXIMUM R/VC RATIOS**

DuPont has calculated the maximum R/VC ratio for each issue movement in three ways. First, DuPont has applied the formula in *Simplified Standards* to each of its three "final offer" comparison groups. Second, Dupont has adjusted the result of the Board's formula, as described in its opening evidence, to account for the "Long-Cannon" factors in the statute 49 U S C. 10701(d)(2)(A)-(C) Third, DuPont has recalculated the RSAM and R/VC > 180 benchmarks, as described in its opening evidence, to apply the Board's most current and accurate methodology for calculating the cost of capital DuPont has summarized these results in the chart below

<b>Maximum R/VC Ratios Based Upon DuPont "Final Offer" Comparison Groups</b>			
	<b>Niagara Falls Movement</b>	<b>Natrium Movement</b>	<b>Carneys Point Movement</b>
Maximum R/VC Ratio Based Upon <i>Simplified Standards</i> without "other relevant factors" <sup>11</sup>	290%	330%	333%
Maximum R/VC Ratio Based Upon RSAM with efficiency adjustment <sup>12</sup>	272%	309%	306%
Maximum R/VC Ratio Based Upon New Cost of Capital Methodology <sup>13</sup>	269%	306%	303%

<sup>11</sup> Crowley Reply V S at 31, Table 5

<sup>12</sup> Crowley Reply V S at 46, Table 6

<sup>13</sup> Crowley Reply V S at 48, Table 7

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**VIII. CONCLUSION**

DuPont respectfully requests the Board to

- (1) find that the CSXT's common carrier rates applicable to the transportation of the commodity between the origins and destinations named in the Complaint are unreasonable,
- (2) prescribe just and reasonable rates for the future applicable to the rail transportation of DuPont's traffic, pursuant to 49 U S C §§ 10704(a)(1) and 11701(a), and,
- (3) award DuPont reparations, plus applicable interest, in accordance with 49 U S C § 11704 for unlawful rates set by CSXT for the period beginning June 16, 2007 to the effective date of a decision by the Board prescribing just and reasonable rates

Respectfully submitted,



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*Attorneys for E I du Pont de Nemours and  
Company*

March 5, 2008

**PUBLIC VERSION**

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

<hr/>		)	
E I DUPONT DE NEMOURS AND COMPANY		)	
	Complainant,	)	
		)	
	v	)	Docket No NOR 42100
		)	
CSX TRANSPORTATION, INC ,		)	
		)	
	Defendant	)	
<hr/>		)	

**PART II – REPLY VERIFIED STATEMENTS**

- 1) Reply Verified Statement of Michelle Moore, an Executive Buyer of raw materials for E I du Pont de Nemours and Company
- 2) Reply Verified Statement of Thomas D Crowley, President, L E Peabody and Associates, Inc . Alexandria, Virginia

**PUBLIC VERSION**

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

_____		)	
E I DUPONT DE NEMOURS AND COMPANY		)	
	Complainant.	)	
		)	
v		)	Docket No. 42100
		)	
CSX TRANSPORTATION, INC		)	
	Defendant.	)	
_____		)	

**REPLY VERIFIED STATEMENT OF MICHELLE MOORE  
E I DUPONT DE NEMOURS AND COMPANY**

1. My name is Michelle Moore. I am an Executive Buyer for E.I. du Pont de Nemours and Company ("DuPont") in Wilmington, DE. I have been an employee of DuPont since 1988. In my current position, I am responsible for purchasing Chloralkali raw materials that DuPont uses in the production of titanium dioxide and other products. This includes the purchasing of chlorine for the DuPont production facilities at New Johnsonville, TN and Carney's Point, NJ. I am submitting this Verified Statement in response to claims made by CSX Transportation, Inc. ("CSXT") that "DuPont prefers to have the lowest possible rail rates available so it can purchase product from the cheapest source, regardless of length of haul, number of yard handlings, or the number of High Threat Urban Areas that must be traversed to transport the product to destination." CSX Op. Ev. at 8. That statement simply is not true.

2. Chlorine is the basic raw material in Chloralkali commodities. No alternative is available. Therefore, it is essential for DuPont to have a reliable and steady source of chlorine.

3. DuPont cannot purchase its chlorine from just any source. Each DuPont production facility must certify the chlorine for quality and specifications before the chlorine can

be accepted in the manufacturing process. Furthermore, in order to avoid production shutdowns due to a lack of raw material and because a single source often cannot supply DuPont with all the chlorine it needs, DuPont requires that there be at least two sources of chlorine for a production facility.

4

[REDACTED]  
[REDACTED]  
[REDACTED]<sup>1</sup> This includes consideration of the closest source of chlorine for each DuPont facility, which usually, but not always, has the most cost effective freight rates.

Furthermore, DuPont requires route risk assessments for all TIII transportation. DuPont requires the shorter transportation route, if the material is available from the supplier. However, sometimes a supplier has production problems that compel DuPont to obtain chlorine from a source further away [REDACTED]  
[REDACTED]  
[REDACTED]

[REDACTED] the suppliers have every incentive to provide chlorine to DuPont from the nearest production source. Ultimately, however, the supplier's production schedule, not DuPont, determines the supply point for chlorine.

5

[REDACTED]  
[REDACTED] DuPont does not purchase chlorine for Carney's Point from PPG Industries at Natrium, WV, because PPG's chlorine has not been qualified for use at Carney's Point.

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<sup>1</sup> All shaded text is CONFIDENTIAL or HIGHLY CONFIDENTIAL information that has been redacted from the public version of this pleading.

6 At New Johnsonville, TN, DuPont primarily receives chlorine by barge from Natrium, WV, because that is considered the safest mode of transport. However, DuPont also receives chlorine by rail from both Natrium and Niagara Falls because there is insufficient barge capacity to supply all of that facility's chlorine needs and because PPG's Natrium production plant cannot supply all of the chlorine consumed at New Johnsonville

7 Transportation risks are a major factor in the supply sourcing decisions made by DuPont CSXT's assertion that DuPont sources its chlorine from the cheapest source regardless of risk simply is untrue



**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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**E. I. duPont de Nemours and Company** )

**Complainant** )

**v.** )

**CSX Transportation, Inc.** )

**Defendant** )

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**Docket No. NOR 42100**

Reply  
Verified Statement

of

Thomas D Crowley  
President  
I E Peabody & Associates, Inc

**Due Date: March 5, 2008**

**PUBLIC VERSION**

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**LIST OF EXHIBITS**

<b><u>EXHIBIT NO.</u></b>	<b><u>DESCRIPTION</u></b>
TDC-9	Comparison of DuPont and CSXT URCS Phase III Inputs, Variable Costs, Rates and R/VC Ratios for the III Movements – 3Q07
TDC-10	Comparison of DuPont and CSXT Opening Evidence Comparable Groups for the Niagara Falls Movement
TDC-11	Comparison of DuPont and CSXT Opening Evidence Comparable Groups for the Natrium Movement
TDC-12	Comparison of DuPont and CSXT Opening Evidence Comparable Groups for the Carneys Point Movement
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TDC-17	Final Comparable Group and Maximum R/VC Ratio for the Natrium Movement

IDC-18	Final Comparable Group and Maximum R/VC Ratio for the Carneys Point Movement
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## **I. INTRODUCTION**

My name is Thomas D. Crowley. I am the same Thomas D. Crowley who filed a verified statement in this proceeding on February 4, 2008 ("Opening VS") on behalf of E. I. duPont de Nemours and Company ("DuPont"). My qualifications and experience are attached to my Opening VS as Exhibit\_1(DC-1).

DuPont is requesting that the Surface Transportation Board ("STB") prescribe reasonable rates, service terms and reparations associated with the transportation of chlorine via CSX Transportation, Inc. ("CSXT") for the following three (3) movements:

1. Niagara Falls, NY to New Johnsonville, TN ("Niagara Falls Movement"),
2. Natrium, WV to New Johnsonville, TN ("Natrium Movement"), and
3. Niagara Falls, NY to Carneys Point, NJ ("Carneys Point Movement")

In my Opening VS, I applied the STB's procedures for the Three-Benchmark Methodology specified in the STB's September 5, 2007 decision in Ex Parte No. 646 (Sub-No. 1) Simplified Standards for Rail Rate Cases ("Simplified Standards") and provided the following information in support of DuPont's request:

1. The revenue / variable cost ("R/VC") ratio for each of the issue movements,
2. The selection of comparable CSX1 movements from the STB's Unmasked Confidential Waybill Sample ("Waybill Sample") for CSX1 for each year 2002 through 2005,
3. The upper boundary of the R/VC ratio for the comparable group (referred to as the "Maximum R/VC Ratio") for each of the issue movements following the STB's procedures specified in Simplified Standards.

- 4 The identification and quantification of other relevant factors, and
- 5 The relief to which DuPont is entitled for each issue movement

Simultaneous with the filing of DuPont's Opening evidence on February 4, 2008, CSXT filed its Opening evidence in this proceeding. In this Reply statement, I critique and respond to CSXT's Opening evidence and incorporate some revisions to the analyses included in my Opening VS

My Reply verified statement ( "Reply VS " ) summarizes the analyses I have performed and my results are summarized under the following headings and in the accompanying Exhibits

- II Revenue/Variable Cost Ratios for the Issue Movements
- III DuPont's Final Maximum Revenue/Variable Cost Ratios for the Issue Movements
- IV Other Relevant Factors
- V Relief for DuPont

## **II. REVENUE / VARIABLE COST RATIOS FOR THE ISSUE MOVEMENTS**

The first step in the STB's Three-Benchmark analysis is to calculate the R/VC ratio for the issue movements. To develop a R/VC ratio, the rates and variable costs for each movement need to be developed. These three components were included in my Opening VS for each issue movement and remain unchanged in this Reply filing. CSXT included these same components in its Opening evidence. Exhibit (TDC-9)<sup>1</sup> compares DuPont's and CSXT's calculations of variable costs, rates and R/VC ratios for the issue movements. My critique of CSXT's Opening evidence as it relates to rates, variable costs and R/VC ratios for the issue movements is discussed below under the following topics:

- A. Rates for the Issue Movements
- B. Variable Costs for the Issue Movements
- C. R/VC Ratios for the Issue Movements

### **A. RATES FOR THE ISSUE MOVEMENTS**

DuPont's 3Q07 rates (including the July 2007 fuel surcharge) for the issue movements are shown in Table 1 below.

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<sup>1</sup> Exhibit (TDC-1) through Exhibit (TDC-8) were included with my Opening VS.

<u>Item</u> (1)	<u>Niagra Falls - New Johnsonville</u> (2)	<u>Natium - New Johnsonville</u> (3)	<u>Niagra Falls - Carneys Point</u> (4)
1 Total Rate Per Car - 3Q07 <sup>1</sup>	\$9 173 17	\$5 993 75	\$4 896 66

<sup>1</sup> Opening VS Table 1

CSXT agrees with DuPont's rate calculations for the issue movements<sup>2</sup>

## **B. VARIABLE COSTS FOR THE ISSUE MOVEMENTS**

In the STB's October 30, 2006 decision in Ex Parte No. 657 (Sub-No. 1) Major Issues in Rail Rate Cases ("Major Issues"), the STB revised the variable cost procedures for rate complaints, deciding that variable costs would be calculated using the STB's Uniform Railroad Costing System ("URCS") Phase III cost program without adjustments. The STB also identified the nine inputs to calculate unadjusted variable costs for an issue movement. In my Opening VS, I followed the STB's procedures in calculating the issue movement variable costs.

CSXT followed the same procedures in calculating the issue movement variable costs in Opening. Table 2 below shows the two inputs where DuPont and CSXT used different values

<sup>2</sup> CSXT's electronic workpapers show two different rate calculations for the Natium and Carneys Point movements. One rate calculation uses DuPont's miles to calculate the fuel surcharge for the issue movements and that calculation agrees with DuPont's rate calculation. The other rate calculation uses CSXT's miles to calculate the fuel surcharge for the issue movement and this creates a minor difference in the rates as shown on Exhibit\_(IDC-9). As discussed in the next section, the use of CSXT's miles for costing the issue movements is improper.

<u>Item</u> (1)	<u>Niagra Falls - New Johnsonville</u> (2)	<u>Natrium - New Johnsonville</u> (3)	<u>Niagra Falls - Carney Point</u> (4)
<b>1</b> Loaded Miles			
a DuPont	880.7	722.8	588.3
b CSXT	<u>880.7</u>	<u>747.6</u>	<u>579.0</u>
c CSXT over (under) DuPont	0.0	24.8	(9.3)
<b>2</b> Commodity (3-digit STCC)			
a DuPont	281	281	281
b CSXT	2812	2812	2812
<hr/>			
Source: Exhibit (TDC-9)			

As shown in Table 2 above, DuPont and CSXT differ on the loaded miles for two of the issue movements and the STCC level used to calculate the loss and damage portion of variable costs for all three issue movements.

CSXT's loaded miles for the Natrium and Carneys Point movements (Columns (3) and (4)) are not based on the STB's procedures. CSXT relied on internal data which the STB expressly rejected in Simplified Standards at pages 83-84.

DuPont relied on the miles generated from the PC\*MillerRail program (Version 10) available from AIK Technologies ("AIK"). AIK is the contractor used by the STB to add the movement miles to the Waybill Sample that are used by the STB to calculate variable costs for the movements in the Waybill Sample using the URCS Phase III costing program. The miles used by AIK in the

Waybill Sample are from the same data base underlying the PC\*Miler/Rail program<sup>3</sup>. Stated differently, the miles for all the comparable movements taken from the Waybill Sample are based on PC\*Miler/Rail and the issue movement miles need to be from the same source.

The second input difference is the STCC code used in the URCS Phase III cost program to identify loss and damage costs. DuPont used a 3-digit STCC of 281 while CSX I used a 4-digit STCC of 2812. The URCS Phase III cost program produces slightly higher variable cost results for loss and damage when the 4-digit STCC 2812 is used. DuPont used a 3-digit level to develop the issue movement variable costs in this proceeding and the two other concurrently filed proceedings<sup>4</sup> while CSX I used a 4-digit STCC only in this proceeding and a 3-digit STCC in the two other proceedings.

Table 3 below compares the 3Q07 variable costs presented by DuPont and CSX I for each of the three issue movements and shows the difference in variable costs caused by the differences in inputs described above.

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<sup>3</sup> This can be confirmed by reviewing the miles contained in the Waybill Sample for the issue movement records eliminated by CSX I from the comparable group. For example, DuPont used 588.3 miles to develop the variable costs for the Carneys Point Movement. As shown on Exhibit 4 (TDC-12), all ten (10) movements marked with a "3" in Column (1) that moved between Niagara Falls (FSAC 17780 in Column (4)) and Carneys Point (FSAC 39880 in Column (6)) are records from the Waybill Sample that CSX I identified as issue movements. Each of these movements has 588.3 loaded miles (Column (13)) i.e. the same miles used by DuPont.

<sup>4</sup> STB Docket Nos. 42099 and 42101.

**Table 3**  
**Comparison of DuPont's and CSXT's Calculation**  
**of URCS Phase III Cost Program Variable Costs Per Car**

Item	Niagra Falls - New Johnsonville	Natruium - New Johnsonville	Niagra Falls - Carneys Point
(1)	(2)	(3)	(4)
1 3Q07 Variable Cost Per Car - DuPont <sup>1</sup>	\$1 993 25	\$1 712 52	\$1 472 65
2 3Q07 Variable Cost Per Car - CSXT -	<u>\$1 994 54</u>	<u>\$1 758 01</u>	<u>\$1 458 48</u>
3 CSXT over (under) DuPont <sup>2</sup>	\$1 29	\$45 52	(\$14 17)

<sup>1</sup> Exhibit (TDC-9)

Table 3 demonstrates the amount that CSXT overstated its 3Q07 variable costs for the Niagara Falls and Natruim Movements and the amount it understated the 3Q07 variable costs for the Carneys Point Movement

**C. R/V C RATIOS FOR**  
**THE ISSUE MOVEMENTS**

Table 4 below shows the R/V C ratios for each issue movement as calculated by DuPont and CSXT

**Table 4**  
**Comparison of DuPont and CSXT R/V C Ratios for the Issue Movements**

Item	Niagra Falls - New Johnsonville	Natruium - New Johnsonville	Niagra Falls - Carneys Point
(1)	(2)	(3)	(4)
1 R/V C Ratio - DuPont <sup>1</sup>	460%	350%	333%
2 R/V C Ratio - CSXT <sup>1</sup>	460%	341%	336%

<sup>1</sup> Exhibit (TDC-9)

As shown in Table 4 above, CSX's and DuPont's R/VC ratios for the Niagara Falls Movement are the same. CSX's R/VC ratios for the Natrium and Carneys Point Movements are different from those calculated by DuPont because of CSX's improper calculation of variable costs. Both DuPont and CSX agree that the R/VC ratios for the three issue movements are significantly higher than the STB's jurisdictional threshold of 180%.

### **III. DUPONT'S FINAL MAXIMUM REVENUE / VARIABLE COST RATIOS FOR THE ISSUE MOVEMENTS**

The SIB's decision in Simplified Standards specified the procedures to develop the Maximum R/VC Ratio for the issue movements using the Three Benchmark Methodology. In my Opening VS, I presented the results of my initial analyses following the SIB procedures. I have reviewed CSXT's Opening evidence and based on that review have revised my opening evidence. My revised analyses are summarized below under the following topics:

A. Selection of Comparable Movements

B. DuPont's Final Maximum R/VC Ratios for the Issue Movements

#### **A. SELECTION OF COMPARABLE MOVEMENTS**

In my Opening VS, at pages 8 through 10, I explained how I selected the comparable movements from the SIB's Waybill Samples for 2002 through 2005 to develop comparable groups for each of the three issue movements. At pages 18 through 24 of its Opening filing, CSXI explained how it selected the single comparable group that it applied to all three movements at issue. My discussion of the comparable movement selection process is contained under the following headings:

1. Comparison of DuPont's Three Comparable Groups to CSXI's Single Comparable Group
2. Review of CSXI's Comparable Group
3. DuPont's Final Comparable Groups

**1. Comparison of DuPont's  
Three Comparable Groups to  
CSXT's Single Comparable Group**

In my Opening VS I included three separate comparable groups, one for each issue movement CSXI included only one comparable group and used it for all three issue movements. I have developed a comparison of CSXI's single comparable group to each of the three comparable groups from my Opening VS.

Exhibit\_(TDC-10) compares my initial comparable group for the Niagara Falls Movement to the initial comparable group presented by CSXI. Exhibit\_(TDC-10) is broken into two sections. The first section lists the movements in my Opening VS comparable group ("DuPont Section"). *These movements are color-coded to identify whether or not they were included in CSXT's comparable group.* Movements shaded in blue were included in CSXI's opening comparable group and must be included in the final comparable group (discussed later in my testimony). Movements shaded in yellow were not included in CSXI's comparable group. For the yellow-shaded movements, I identified one or more of the following reasons as to why that particular movement was not included in CSXI's comparable group based on CSXT's opening description of its selection criteria:

1. The STCC was other than 2812815.
2. The miscellaneous charges were zero.
3. It was identified as an issue movement.
4. The origin or destination is in Canada,
5. A short line or switching railroad is involved in the movement, and/or
6. The movement represents either a multiple car or unit train shipment.

The applicable reason(s) for exclusion from CSXT's comparable group is/are identified by numbers 1 through 6 (corresponding to the above six reasons) which numbers were placed to the left of each yellow-shaded movement on Exhibit\_(TDC-10)

The second section of Exhibit\_(TDC-10) lists the movements in CSXI's comparable group and compares them to the comparable group I submitted for the Niagara Falls Movement ("CSXI Section 1). CSXI's movements are color-coded to identify whether or not they were included in my opening comparable group. Movements shaded in blue were included in my opening comparable group and must be included in the final comparable group.<sup>2</sup> Movements shaded in green were not included in my opening comparable group. For the green-shaded movements, I identified one or more of the following reasons as to why that particular movement was not included in my opening comparable group:

1. The miles for the movement fell outside of the mileage range specified in my opening selection criteria, i.e., outside +/- 150 miles of the miles for the issue movement rounded to the nearest 50-mile increment.
2. The movement did not have a hazardous SICC, and/or
3. The movement had a rebill code other than zero.

Exhibit\_(TDC-11) contains the same comparisons for the Natrum Movement. Exhibit\_(TDC-12) contains the same comparisons for the Carneys Point Movement. My discussion of the reasons for the differences between CSXI's single comparable group and my three comparable groups is contained in the following section:

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<sup>2</sup> These are the same movements shaded in blue in the DuPont Section of Exhibit\_(TDC-10)

## **2. Review of CSXT's Comparable Group**

My review and critique of CSXT's comparable group, and how it relates to the comparable groups I included in my Opening VS, are included below under the following topics

- a Use of a Single Comparable Group
- b Identification of Issue Movements
- c Movements without a Hazardous SICC
- d Comparable STCC's
- e Miscellaneous Charges
- f Canadian Movements
- g *Multiple Car Movements*
- h Short Line Railroad Movements
- i Length of Haul

### **a. Use of a Single Comparable Group**

In my Opening VS I included three separate comparable groups one for each issue movement CSXT included only one comparable group and used it for all three issue movements CSXT's application of single comparable group to three separate and distinct issue movements is contrary to Simplified Standards

In the discussion of the Three-Benchmark Methodology in Simplified Standards, the STB makes several references to "issue movement", "comparable group" and "challenged rate" in the singular.<sup>6</sup>

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<sup>6</sup> See for example Simplified Standards at 6 16 17 18 and 21

Simplified Standards is clear that there must be a comparable group applicable to each issue movement or "challenged rate." As DuPont has challenged three separate issue movements, each with its own rate, a separate and distinct comparable group is required for each issue movement. CSXT has not followed the STB's procedures.

**b. Identification of Issue Movements**

Simplified Standards requires that issue movements be excluded from the comparable group. In my Opening VS, I identified issue movements in the Waybill Sample as any movement from the issue movement origin to the issue movement destination with the issue movement STCC and traveling in a DUPX car. These movements were excluded from my comparable groups.

In CSXT's opening, CSXT identified issue movements in the Waybill Sample, and excluded them from the comparable group, using the same criteria I did with the one exception. CSXT excluded more than movements in DUPX cars.

I agree with the issue movements that were identified by CSXT.<sup>2</sup> However, I take exception to how CSXT excluded the issue movements.

As CSXT used a single comparable group for all three issue movements, CSXT excluded from its comparable group all Waybill Sample movements for all three issue movements. As noted above, Simplified Standards requires a comparable group for each separate issue movement and challenged rate and CSXT did not meet this requirement.

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<sup>2</sup> DuPont comparable movements that were identified as issue movements by CSXT are identified with a "3" in the DuPont Section of Exhibit (TDC-10), Exhibit (TDC-11) and Exhibit (TDC-12).

In Reply I have excluded the issue movements identified by CSXT but have done so separately for each issue movement. Stated differently, in my final comparable group for the Niagara Falls Movement included with this Reply, I have excluded all Niagara Falls to New Johnsonville movements from the comparable group but have included any movements between Natrium and New Johnsonville or Niagara Falls to Carneys Point as these two latter movements are not issue movements for purposes of the Niagara Falls Movement. I excluded the issue movements for the Natrium Movement and the Carneys Point Movement in the same manner.

**c. Movements without a Hazardous STCC**

As stated in my Opening VS at page 8, one of the selection criteria was that the movement had to be classified as a hazardous commodity in the Waybill Sample. A review of CSXT's comparable group identified several movements that would have met my selection criteria for either the Natrium Movement or the Carneys Point Movement except that the movement did not have a hazardous STCC in the Waybill Sample.<sup>3</sup> In Reply, I have added the movements from CSXT's comparable group that meet the selection criteria of the Natrium Movement and Carney's Point Movement to my final comparable group for each issue movement.

**d. Comparable STCC's**

One of the comparable group selection criteria identified at page 8 in my Opening VS was that the commodity had to be classified as a PHH because the issue movements of chlorine are classified

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<sup>3</sup> CSXT comparable movements that do not have a hazardous STCC are identified with a "2" in the CSXT Section of Exhibit\_(TDC-10) Exhibit\_(TDC-11) and Exhibit\_(TDC-12)

as III. This criteria was based on the special handling requirements for FII commodities when moved by railroad.

In Opening, CSXI restricted its comparable group to a single FII commodity, i.e., chlorine. STCC 2812815. At pages 23-24, CSXT presents two explanations as to why anhydrous ammonia movements and other FII movements are not comparable to the issue chlorine movements. Neither of CSXT's explanations has any merit.

First, CSXT presents information comparing the amount of chlorine and anhydrous ammonia that are shipped by rail and attempts to draw a distinction between the markets for each commodity. CSXI's figures are unsupported and irrelevant. CSXI has presented no evidence that the rates for these commodities are developed in a different manner. The guiding principle is that both commodities are classified as FII and are handled in the same manner when moved by CSXT which makes them comparable.

Second, CSXT claims that many anhydrous ammonia movements pass through fewer major cities than chlorine movements but provided no support. In response to CSXT's assertion, DuPont identified the High Threat Urban Areas ("HTUA")<sup>2</sup> and other major cities through which each of the issue movements travel and compared them to the HTUA and other major cities through which the movements in DuPont's comparable groups travel.<sup>3</sup> This analysis shows that the number of HTUA and other major cities for each movement is simply a function of the origin, destination and route of the movement and not the commodity.

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<sup>2</sup> See CSXT discovery documents CSX-12100C-000155 and 000156 included in my electronic workpapers.

<sup>3</sup> See my electronic workpapers for this analysis.

For example, the Niagara Falls Movement travels through four HTUA and two other major cities which is simply a function of the origin, destination and route of the issue movement. Many of the comparable movements, both chlorine and other TII commodities, travel through fewer HTUA and other major cities. However, a review of the routes for the chlorine and the anhydrous ammonia movements included in the comparable group show similarity in the number of HTUA and other major cities for those movements.

Continuing this comparison, the Sodium Movement travels through only two HTUA and one other major city. Virtually all of the comparable movements traveled through more HTUA and major cities.

Finally, the Carneys Point movement travels through three HTUA and no other major city. The majority of the comparable movements travel through three or more HTUA as well as other major cities.

In summary, CSXT's contentions that anhydrous ammonia and other TII movements are not comparable to the issue chlorine movements because the rates are calculated differently or there are fewer HTUA's or other major cities on the route are without merit.

My final comparable group for each issue movement includes all TII movements from the Waybill Sample that meet the specified selection criteria for each particular issue movement.

**e. Miscellaneous Charges**

Miscellaneous Charges is a field in the Waybill Sample that is separate from the freight revenue field. In calculating the RSAM and R/VC<sub>rate</sub> ratios, the STB calculates the revenue for each movement in the Waybill Sample by adding miscellaneous charges to the freight revenue. In

calculating the RVC ratio for the movements in each comparable group, I followed the same procedure

CSX I also followed this procedure for the comparable movements it selected. However, CSXT used Miscellaneous Charges as a comparable movement selection criteria. Specifically, in Opening at page 21 CSX I states that it "excluded from its comparison groups any shipments to which a fuel surcharge did not apply. As the Waybill Sample does not have a field titled "fuel surcharge," CSXT excluded all movements where the miscellaneous charges were zero.<sup>11</sup> CSXT's exclusion of movements with no miscellaneous charges is improper for at least three reasons:

First, CSXT provides no evidence of a link between fuel surcharges and miscellaneous charges reported in the Waybill Sample. The Waybill Sample User Guide provided by the STB along with the Waybill Sample defines Miscellaneous Charges as "The total of all miscellaneous charges, excluding transit and freight revenue charges, shown in dollars." The definition clearly makes no reference to fuel surcharges.

Second, CSXT does not provide any evidence that it reports fuel charges separately in the miscellaneous charges field of the Waybill Sample or that fuel surcharges are the only monies reported in the miscellaneous charges field.

Lastly, CSX I attempts to justify its exclusion of movements with no miscellaneous charges, which CSXT equates to fuel surcharges, by stating that fuel prices have nearly tripled from January 2002 to January 2008 and more than doubled from January 2002 to December 2005, the time period covered by the Waybill Sample.<sup>12</sup> CSX I gives the impression that it was not compensated for

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<sup>11</sup> DuPont comparable movements with zero miscellaneous charges that were excluded by CSXT are identified with a "2" in the DuPont Section of Exhibit\_(TDC-10), Exhibit\_(TDC-11) and Exhibit\_(TDC-12)

<sup>12</sup> See footnote 17 on page 21 of CSX I's Opening evidence.

increasing fuel prices if there was no fuel surcharge shown for a movement. Even assuming that the miscellaneous charges did reflect fuel surcharges, the lack of miscellaneous charges does not mean that CSXT was not compensated for increasing fuel prices.

Rates for rail traffic and therefore rates for the comparable movements, are adjusted by the Rail Cost Adjustment Factor ("RCAF") or some variation, whether they are tariff moves or contract moves. A major component of the RCAF is fuel prices. Exhibit\_(TDC-13) contains a comparison of the increase in the EIA U.S. No. 2 Diesel fuel price cited by CSXT and the fuel component of the RCAF. As shown in Exhibit\_(TDC-13), the fuel component of the RCAF increased at a faster rate than EIA U.S. No. 2 Diesel price. Specifically, the fuel component of the RCAF nearly quadrupled from 1Q02 to 1Q08 and more than tripled from 1Q02 to 4Q05. Even if there was no separate fuel charge, the rate adjustment mechanism, e.g., the RCAF, was capturing the increase in CSXT's fuel prices.

On a final note, CSXT's exclusion of movements with zero miscellaneous charges improperly increases the R/VC ratio for the comparable group as movements with miscellaneous charges have higher R/VC ratios than movements with zero miscellaneous charges. CSXT's selection process results in the highest possible R/VC ratios for the comparable group.

For the above reasons, CSXT's exclusion of comparable movements simply on the basis of zero miscellaneous charges is improper.

#### **f. Canadian Movements**

In my Opening VS, I did not use a Canadian origin or destination as a comparable movement selection criteria. CSXT states at page 21 of its Opening, that movements with an origin or

destination in Canada were excluded from the comparable group because the STB does not collect cost and revenue data for movements in Canada by Canadian carriers

CSX is correct in its characterization of how the STB collects cost and revenue data for *Canadian* carriers. The problem with CSX's logic is that it excluded movements handled by a U.S. carrier, namely CSX.

All of the movements included in my Opening VS comparable groups are movements that are originated and terminated by CSX and no Canadian carriers are involved in the movement of that traffic.<sup>12</sup> In fact, if a Canadian carrier was involved in a movement, the movement would not be a local CSX movement and would not be selected.

I treated these movements in the same manner as the STB treats them in the Waybill Sample and in the calculation of the RSAM and R/VC<sub>100</sub> ratios. These movements travel only a few miles in Canada.<sup>13</sup> The variable costs in the Waybill Sample cover the movement from origin to destination.<sup>14</sup> The revenues reflect the revenues for the entire movement. For purposes of the RSAM and R/VC<sub>100</sub> calculations, the STB treats these movements as domestic U.S. movements.<sup>15</sup>

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<sup>12</sup> DuPont comparable movements that were identified as Canadian movements by CSX are identified with a "4" in the DuPont Section of Exhibit\_(TDC-10), Exhibit\_(TDC-11) and Exhibit\_(TDC-12)

<sup>13</sup> See Exhibit\_(TDC-14) for a listing of the Canadian movements included in the final comparable groups for the issue movements, the miles in Canada and the percentage of total movement miles in Canada. As shown on Exhibit\_(TDC-14) the longest movement in Canada equaled 42.4 miles and the highest percentage of total movement miles in Canada equaled 8.3%. Many of the movements traveled only 10.7 miles in Canada or less than 2% of the total miles.

<sup>14</sup> This can be verified by costing the Canadian movements in the Waybill Sample as CSX local movements using the U.S. Phase III cost program and the movement characteristics included in the Waybill Sample. The loaded miles shown for the Canadian movements in the Waybill Sample can be verified as the miles for the entire movement including the miles in Canada by using PC\*Miler - Rail.

<sup>15</sup> This information was provided to L. Peabody & Associates, Inc. by the STB staff at a January 29, 2008 meeting in the STB offices, also attended by CSX.

Based on the above, CSXI's exclusion from the comparable group of CSXT local movements originating or terminating in Canada is erroneous

**g. Multiple Car Movements**

In my Opening VS, I included a multiple car movement in my comparable groups if the movement met all of the selection criteria<sup>12</sup> CSXI excluded all movements that were not single car movements

Simplified Standards explicitly allows the inclusion of movements with different cost characteristics as the STB stated, at page 17 "that movements with different cost characteristics may be included in the comparison group" and "there is no reason to presume that the R/VC ratios should be different

CSXT's exclusion of comparable movements simply because they have more cars than the issue movements is unsupported. I have included one multiple car movement in the final comparable group for the Niagara Falls Movement, two multiple car movements in the final comparable group for the Natium Movement and six multiple car movements in the final comparable group for the Carneys Point Movement

**h. Short Line Railroad Movements**

CSXI stated on Opening, at pages 20-21, that it excluded all movements that "were originated or terminated by a short-line or switching carrier based on the Freight Station Accounting Code

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<sup>12</sup> DuPont comparable movements that are multiple car movements are identified with a "6" in the DuPont Section of Exhibit (TDC-10) Exhibit (TDC-11) and Exhibit (TDC-12)

( F-SAC ) information reported in the CWS " CSXT identified these movements as movements with an origin or destination FSAC beginning with a "6"

I did not exclude these movements from my comparable groups in my Opening VS as the FSAC was not one of my selection criteria <sup>18</sup> I could not verify CSX I's claim that F-SAC's beginning with a "6" were short-line or switching carriers. In order to eliminate this area of dispute, I have accepted CSX I's position and eliminated two such movements from the comparable group for the Niagara Falls Movement. There were no such movements in my Opening VS comparable groups for the Natrium Movement or the Carneys Point Movement.

By eliminating these movements, I am not agreeing with CSXT's position on short line railroad movements. In the Waybill Sample, the STB treats these as CSXT local movements and applies CSX I's unit cost to the entire movement when calculating the variable costs. This demonstrates that these movements originate and terminate on CSX I and are controlled by CSX I.

If the STB considered these movements other than CSX I local, they would apply regional unit costs to the non-CSX I portion of the movement and CSX I unit costs to the CSXT portion and classify the movement as interline. For example, a joint short line eastern railroad plus CSX I movement would be considered as an interline forwarded movement on the short line railroad and an interline received movement on CSXT. From a cost of service perspective, the shortline Phase III costs would be based on Eastern Region unit costs and include an origin terminal cost, applicable line haul costs and interchange costs. The CSXT portion of the movement (the interline received portion) would include interchange costs, applicable line haul costs and a destination terminal cost.

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<sup>18</sup> DuPont comparable movements that were identified as movements involving a short-line or switching carrier are identified with a "5" in the DuPont Section of Exhibit (TDC-10) Exhibit\_(TDC-11) and Exhibit\_(TDC-12)

These costs would clearly be greater than the costs for a local move because of the introduction of interchange costs for both railroads and the resulting R/VC ratio would be lower

**1. Length of Haul**

In my Opening VS at page 9, I explained that one of my selection criteria for comparable movements was loaded miles within a range of plus or minus 150 miles of the issue movement loaded miles rounded to the nearest 50 miles. This resulted in mileage ranges of 750 to 1,050 miles for the Niagara Falls Movement, 550-850 miles for the Natrium Movement and 450-750 miles for the Carneys Point Movement

In Opening, CSXT's selection criteria was much broader, i.e., CSXT included movements in the comparable group with mileages as low as 211 miles and as high as 1,576 miles. The difference in length of haul for the comparable movements is the main reason why DuPont did not include many of the movements selected by CSXT<sup>19</sup>

CSXT's broad mileage range includes many movements that are not comparable to the issue movements. For example, the Niagara Falls Movement travels 880.7 miles in the loaded direction. CSXT has included movements with loaded miles as low as 210.8 miles, less than 25% of the length of the Niagara Falls Movement

To demonstrate the problem with CSXT's mileage range, I performed an analysis of URCS Phase III variable costs for a movement that was included in both my comparable group and CSXT's comparable group. I developed the variable costs for the example movement changing only the

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<sup>19</sup> CSXT comparable movements that are outside the mileage range used by DuPont are identified with a "1" in the CSXT Section of Exhibit (TDC-10), Exhibit (TDC-11) and Exhibit (TDC-12)

miles traveled by the movement and leaving the other characteristics the same. I started with the assumption that the movement traveled 50 miles and increased the miles in increments of 50. I then plotted the variable cost per ton-mile results for each distance to develop the trend line shown on Exhibit\_(TDC-15). I then identified the point on the cost per ton-mile curve that corresponded to the lower and upper mileage boundaries in the comparable movements for both DuPont and CSXT. As seen on Exhibit\_(TDC-15), the range in cost per ton-mile for CSXT's mileage boundaries is much greater than the range for DuPont's mileage boundaries. In other words, by extending the mileage boundaries to several hundred miles shorter or longer than the issue movement, CSXT has included a much greater variation in costs of providing service. On Exhibit\_(TDC-15), CSXT's range in variable costs is from \$0.04067 per ton-mile to \$0.02123 per ton-mile. DuPont's range is from \$0.02438 per ton-mile to \$0.02268 per ton-mile.

The reason the change in variable costs is significant is that variable cost sets the floor for rate making purposes. The contribution made by captive traffic (the differential between the rate and the variable cost) is approximately the same, as the SIB's maximum rate procedures produce the rate ceiling. With those two facts in mind, movements of shorter haul captive traffic will command higher rates (measured on a mills per ton-mile basis) than movements of longer haul captive traffic. Stated differently, shorter haul captive movements will have higher rates (measured on a mills per ton-mile basis) than longer haul captive movements, all other things held constant. By beginning its comparable group at the 200-mile range and ending over 1,500 miles, CSXT has included moves that are not comparable because of the differences in the length of haul. By comparison, DuPont's narrow mileage range results in the selection of similar movements.

### **3. DuPont's Final Comparable Groups**

DuPont's final comparable groups for each movement at issue are discussed under the following topics

- a Modification to Opening Comparable Groups
- b Density Criteria

#### **a. Modification to Opening Comparable Groups**

Modifications to DuPont's Opening comparable groups and development of the final comparable groups are discussed below for each issue movement

##### **(1) Niagara Falls Movement**

Based on my review of CSX1's opening evidence, I have made two modifications to my opening comparable group of 31 movements for the Niagara Falls Movement. The first modification is the elimination of one issue traffic movement. The second modification is the elimination of two short-line railroad movements.

*Exhibit (TDC-16) contains my final comparable group of 28 movements for the Niagara Falls Movement. The movements shaded in blue are movements that were included in CSXT's opening comparable group and based on Simplified Standards must be included in the final comparable group. The movements shaded in yellow were not included in CSXT's opening comparable group.*

**(2) Natrium Movement**

Based on my review of CSXT's opening evidence I have made two modifications to my opening comparable group of 88 movements for the Natrium Movement. The first modification is the elimination of one issue movement. The second modification is the addition of twelve movements from CSXI's comparable group that met my selection criteria as they are hazardous movements even though they do not have a hazardous STCC in the Waybill Sample.

Exhibit\_(IDC-17) contains my final comparable group of 99 movements for the Natrium Movement. The movements shaded in blue are movements that were included in CSXT's opening comparable group and based on Simplified Standards must be included in the final comparable group. The movements shaded in yellow were not included in CSXT's opening comparable group. The movements shaded in green were added from CSXT's opening comparable group.

**(3) Carneys Point Movement**

Based on my review of CSXI's opening evidence, I have made two modifications to my opening comparable group of 164 movements for the Carneys Point Movement. The first modification is the elimination of ten issue movements. The second modification is the addition of fifteen movements from CSXT's comparable group that met my selection criteria as they are hazardous movements even though they do not have a hazardous STCC in the Waybill Sample.

Exhibit\_(IDC-18) contains my final comparable group of 169 movements for the Carneys Point Movement. The movements shaded in blue are movements that were included in CSXT's opening comparable group and based on Simplified Guidelines must be included in the final comparable

group. The movements shaded in yellow were not included in CSXI's opening comparable group. The movements shaded in green were added from CSXT's opening comparable group.

**b. Density Criteria**

In Simplified Standards, at page 17, the STB listed a number of factors relating to the determination of comparable movements. One of these factors was "traffic densities of the likely routes involved."

In order to assess the "traffic densities of the likely routes involved" density information is needed from the railroad as accurate density information is not publicly available. In discovery, DuPont requested and CSXT provided CSXT system-wide density maps for 2002 through 2006.

In its January 15, 2008 decision in this proceeding, at page 3, the STB stated "Neither the carrier nor the shipper is permitted to use information from the carrier's files to advocate for a particular comparison group." Based on the STB's decision, this prevented DuPont from using the CSXT density charts produced in discovery.

In its January 31, 2008 decision in this proceeding, the STB reversed itself, stating, at page 4, "The parties may each rely on the traffic density maps provided during discovery to support their comparison group." Unfortunately, there was only one working day between the date this decision was issued and the date opening evidence was due. Consequently, neither party included any analysis of density in opening.

As the STB has now allowed the use of CSXT's density maps, I conducted a density analysis of the movements contained in each of my three final comparable groups. Using PC\*Miler[Rail], I obtained the routes and mileages for each of the movements and applied the line segment densities

obtained from the CSXT 2006 density map produced in discovery to calculate the weighted average density in million gross tons per mile ("MG T/mile") for each movement and the simple average density for the comparable group as a whole <sup>20</sup>

Exhibit\_(TDC-16) Column (14), contains the results of my analysis for the Niagara Falls Movement. As shown on Exhibit\_(TDC-16), the weighted average density for the issue movement is 72.3 MG T/mile. The simple average density for the comparable group is 64.9 MG T/mile. The weighted average density for the individual movements ranges from 29.9 MG T/Mile to 74.9 MG T/mile. The weighted average density range for the individual movements shaded in blue, i.e., the movements that were included by both parties and must be included in the final comparable group, is the same as the range for the entire group. All the movements included in my comparable group that are not included in CSXT's opening comparable group (the movements shaded in yellow) fall within the density range of comparable movements selected by both parties.

Exhibit\_(TDC-17), Column (14), contains the results of my analysis for the Natrium Movement. As shown on Exhibit\_(TDC-17), the weighted average density for the issue movement is 33.3 MG T/mile. The simple average density for the comparable group is 54.6 MG T/mile. The weighted average density for the individual movements ranges from 19.3 MG T/Mile to 114.7 MG T/mile. The weighted average density range for the individual movements shaded in blue, i.e., the movements that were included by both parties and must be included in the final comparable group, is from 19.3 MG T/mile to 91.2 MG T/mile. All but two of the movements included in my comparable group that

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<sup>20</sup> The density analysis is included in my electronic workpapers.

are not included in CSXT's opening comparable group (the movements shaded in yellow) fall within the density range of comparable movements selected by both parties<sup>21</sup>.

Exhibit (FDC-18) Column (14), contains the results of my analysis for the Carneys Point Movement. As shown on Exhibit (FDC-18), the weighted average density for the issue movement is 78.5 MGT/mile. The simple average density for the comparable group is 58.5 MGT/mile. The weighted average density for the individual movements ranges from 19.3 MGT/Mile to 120.2 MGT/mile. The weighted average density range for the individual movements shaded in blue, i.e., the movements that were included by both parties and must be included in the final comparable group is the same as the range for the entire group. Stated differently, all the movements included in my comparable group that are not included in CSX's opening comparable group (the movements shaded in yellow) fall within the density range of comparable movements selected by both parties.

The density ranges shown above reflect comparable movements based on the density threshold used by the STB. When evaluating track and traffic conditions, the STB requires each Class I railroad to group these characteristics by density category<sup>22</sup>. Track category A (the most densely traveled rail lines) groups rail lines with 20 MGT/mile or higher.

Additionally, the STB requires that the Class I railroad calculate road property depreciation rates by density category in Schedule 416 of Annual Report Form R-1. The same basic density

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<sup>21</sup> The two movements that fall outside the range of densities for the blue-shaded movements have a weighted average density of 114.7 MGT/mile. As noted in the following discussion of the densities for the Carneys Point Movement, both parties included a movement with a weighted average density of 120.2 MGT/mile which indicates that 114.7 MGT/mile is not outside the representative density range.

<sup>22</sup> Annual Report Form R-1 Schedule 720. For purposes of Schedule 720, average density is determined based on track-miles and not route miles. For purposes of my density analysis, I used route miles because track-miles were not available for each route.

categories used for track characteristics discussed above, are used to calculate road property depreciation rates

With the exception of a few movements with a weighted average density of 19.3 MGT/mile, many of which were included by both parties and must be part of the final comparable group, the comparable movements I selected fall into the top density category used by the STB

In summary, I have considered density in my analysis and it supports my final comparable group for each issue movement

#### **B. DUPONT'S FINAL MAXIMUM R/VC RATIOS FOR THE ISSUE MOVEMENTS**

To develop the Maximum R/VC Ratio for each issue movement, I followed the procedures set forth in Simplified Standards. First, I selected the comparable group for each issue movement. Next, I multiplied the R/VC ratio for each comparable movement by the ratio of the CSXT RSAM and R/VC<sub>180</sub> four-year average contained in the STB's December 20, 2007 decision in Ex Parte No. 347 (Sub-No. 2) Rate Guidelines - Non-Coal Proceedings ("Non-Coal Guidelines"). I then calculated the mean and standard deviation for the adjusted R/VC ratios for the comparable group. Next, using the mean and standard deviation, I calculated the 90% confidence interval around the estimate of the mean to determine the upper boundary of the mean for the comparable group which becomes the threshold for determining if a rate is unreasonable.

CSXT followed the same procedures with one major exception. CSXT deviated from the STB's specified procedures by applying an annual adjustment ratio (RSAM to R/VC<sub>180</sub>) to the R/VC ratio of each movement in its comparable group, depending on the year of the movement, rather than

the STB's specified 4-year average adjustment ratio. Simplified Standards makes it very clear that the 4-year average adjustment ratio should be applied. The STB states, at page 20, in the section titled "Method to Calculate RSAM and R/VC" <sup>22</sup> "In a rate case, we will not rely on the figures for a single year but will use a 4-year average where possible." Clearly a 4-year average is possible in this proceeding as the STB published the 2002-2005 RSAM and R/VC > 180 ratios in its December 20, 2007 decision in Non-Coal Guidelines.

Table 5 below compares my calculations of the issue movements' R/VC ratios to the Maximum R/VC Ratios calculated using the final comparable groups and following the STB's procedures <sup>23</sup>

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<sup>22</sup> The calculation of the final Maximum R/VC Ratio for each issue movement is shown in Exhibit\_(TDC-16) through Exhibit\_(TDC-18)

Table 5				
<u>Maximum Rate for Issue Movements Using SIB's RSAM and R/VC&gt;180</u>				
(1)	Niagra Falls - New Johnsonville (2)	Natruium - New Johnsonville (3)	Niagra Falls - Carneys Point (3)	
1	3Q07 Rate per Car (Including Fuel Surcharge) -	\$9,173.17	\$5,993.75	\$4,896.66
2	3Q07 Variable Cost per Car -	\$1,993.25	\$1,712.52	\$1,472.65
3	R/VC Ratio -	460%	350%	333%
4	Maximum R/VC Ratio <sup>2</sup>	290%	330%	326%
5	Maximum Rate per Car <sup>2</sup>	\$5,780.43	\$5,651.32	\$4,800.84
6	Amount CSXT Rate per Car Exceeds Maximum Rate per Car <sup>2</sup>	\$3,392.74	\$342.43	\$95.82

- Table above  
 = Table 3 above  
 - Line 1 - Line 2 x 100  
 - Exhibit (IDC-16) Exhibit (IDC-17) and Exhibit (IDC-18)  
 - Line 2 x Line 4  
 - Line 1 - Line 5

As shown in Table 5 above, CSXT's rate for each of the issue movements (Line 1) exceeds the rate based on the Maximum R/VC Ratio (Line 5) for the comparable group by an amount ranging from \$95.82 per car to \$3,392.74 per car.

#### **IV. OTHER RELEVANT FACTORS**

In this section of my Reply VS, I first review and critique the other relevant factors included by CSXT in its opening evidence. Then I quantify and apply DuPont's other relevant factors to the issue movements based upon DuPont's "final offer" comparable groups. The results of my other relevant factor analyses are summarized below under the following headings:

- A. CSXT's Other Relevant Factors
- B. Application of DuPont's Other Relevant Factors

##### **A. CSXT'S OTHER RELEVANT FACTORS**

My discussion of CSXT's other relevant factors addresses the two factors developed by CSXT in opening, i.e. (1) an adjustment to RSAM Ratio, and (2) indexing of Waybill Sample variable costs and revenues.

###### **1. Adjustment to RSAM Ratio**

In December 2007, the STB published the results of its RSAM and R/VC<sub>180</sub> calculations for CSXT.<sup>24</sup> Based on the STB's RSAM and R/VC<sub>180</sub> ratio calculations for 2002 to 2005, the average mark-up factor developed by dividing the RSAM ratio by the R/VC<sub>180</sub> ratio equals 1.24. This mark-up factor is applied to movements in the comparable group.

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<sup>24</sup> See Non-Coal Guidelines, served December 11, 2007 and corrected December 20, 2007.

CSXT states that it used the STB's RSAM and R/VC<sub>TR</sub> figures to calculate the required mark-up ratios but made an adjustment to its calculations to account for an alleged flaw in the STB's methodology.<sup>25</sup> CSXT asserts that the STB's Simplified Standards procedures should have adjusted the REV<sub>after-tax</sub> component of the RSAM ratio to account for income taxes attributable to the additional revenue needed for CSXT to be deemed revenue adequate. Specifically, CSXT believes the correct procedure for developing the mark-up factor is to divide the difference between the RSAM and R/VC<sub>TR</sub> ratios by one less the railroad's statutory federal and state income tax rates, and add the resultant quotient to the R/VC<sub>TR</sub> ratio.<sup>26</sup> According to CSXT, this would produce a tax-adjusted RSAM ratio, and a resultant tax-adjusted mark-up factor.

There are two primary problems with CSXT's RSAM adjustment. First, CSXT assumes that the additional revenue from the REV<sub>after-tax</sub> calculation would be taxed at CSXT's statutory tax rates without any support for its assumption. Second, the variable costs used to calculate the RSAM and R/VC<sub>TR</sub> ratios are already overstated due to an over recovery of income taxes, which understates the size of the R/VC<sub>TR</sub> traffic and artificially increases the revenue adequacy adjustment factor. I address these two issues below.

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<sup>25</sup> See CSXT Opening Evidence at 24.

<sup>26</sup> CSXT's logic is that the REV<sub>after-tax</sub> component in the RSAM ratio is calculated based on after-tax earnings, and a straight application of the component to the R/VC<sub>TR</sub> ratio, which is based on pre-tax revenues, would leave a railroad below a revenue adequate level.

**a. Statutory Tax Rates  
Versus Effective Tax Rates**

CSXI's assertion that parties should adjust the  $REV_{short-term}$  component of the RSAM ratio at CSXI's statutory federal and state tax rates ignores the fact that CSXI's income tax expenses do not reflect a straight application of the statutory tax rates. Simply stated, CSXI's effective tax rate is significantly different than the statutory tax rate.

The effective tax rate is the amount of tax an individual or firm pays when all other government tax offsets or payments are applied, divided by the tax base. CSXI's Annual Report Form R-1 data clearly shows that the railroad's effective tax rate does not equal combined federal and state statutory rates as assumed by CSXI. One can distinctly see this fact in looking at CSXI's Form R-1 data. In 2003, CSXI recorded \$297 million in income from continuing operations before taxes, but booked a tax benefit, not a tax expense, of \$50 million.<sup>27</sup> In other words, CSXI's net railway operating income increased due to tax benefits. This was not an isolated situation. CSXI booked a tax benefit of \$21.5 million in 2002 while generating nearly \$500 million in income from continuing operations.<sup>28</sup> In sum, between 2002 and 2005, CSXI's effective tax rates were well below the statutory standards in each year.

There are a number of factors that can drive a firm's effective tax rate well below its statutory tax rate. These include, but are not limited to, the impact of deferred income taxes, tax-loss carryforwards and carrybacks and governmental tax credits. CSXI's Form R-1 data for 2003 does not indicate the reason for the large tax credit booked by CSXI, but the simple fact is that it illustrates clearly that CSXI is not paying taxes at a statutory level.

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<sup>27</sup> See CSXI 2003 Form R-1 Schedule 210, Lines 46 and 63.

<sup>28</sup> See CSXI 2002 Form R-1 Schedule 210, Lines 46 and 63.

While it is clear that CSXT's average effective tax rate is below the statutory level, it is unclear that CSXT's marginal tax rate is also below the statutory level, since it is not possible to verify CSXT's effective marginal tax rate with the available information. A marginal tax rate is the tax rate that applies to the last dollar of the tax base, and often applied to the change in tax obligations as income rises. In this instance, the  $REV_{\text{short-term}}$  dollars added to the Revenue<sub>180</sub> while holding all other operating expenses constant would be considered marginal revenue. CSXT assumes that this revenue would be taxed at the statutory rate. However, it is not possible to calculate the actual impact of taxes on this additional revenue with data in the record, or with publicly available CSXT financial data. Rather, to effectively calculate the impact of the additional revenue would require a complete set of CSXT income tax returns for the 2002 to 2005 time period. Without this data, one cannot truly determine the tax impact, if any, of the additional revenue.

CSXT simplistically assumes that the additional revenue contributed by the  $RFV_{\text{short-term}}$  figure would be taxed at a statutory level. CSXT has clearly provided no support for this assumption in the record of this case. If the STB were to accept CSXT's argument that the  $REV_{\text{short-term}}$  component of the RSAM ratio required a tax adjustment, the only logical tax rate to use for the adjustment is CSXT's effective tax rate for each year. The use of CSXT's effective tax rate reflects the fact that CSXT does not incur tax expenses at the statutory rate, and would therefore provide an adjustment consistent with CSXT's actual tax position. Exhibit\_(TDC-19) contains a restatement of CSXT's mark-up factor calculated using CSXT's effective tax rates. As shown in Exhibit\_(TDC-19), the corrected mark-up factor equals 1.26, rather than CSXT's overstated factor of 1.38.

**b. URCS Overstates the  
Required Tax Recovery**

The STB's URCS model includes a variable return on investment ("ROI") component calculated using a pre-tax weighted-average cost of capital ("WACC") based on the federal statutory tax rate of 35 percent. The use of the pre-tax WACC in the variable ROI, which adjusts the cost of equity to allow for a return to common equity holders from after-tax earnings, explicitly adds additional variable costs to each movement to cover the railroad's hypothetical tax burden. However, as explained above, railroads seldom pay taxes at the statutory rate due to offsets and credits, and their actual tax expenses are much lower than implied by the statutory rate. Therefore, using a statutory tax rate in the URCS model leads to an overstatement in each movement's variable costs.

Exhibit\_(IDC-20) illustrates the impact of the overstatement of tax recovery inherent in URCS. As shown in Exhibit\_(IDC-20), actual federal taxes booked by CSXT in 2005 equaled \$220 million based on R-1 Schedule 210, Line 47. In contrast, the STB's 2005 URCS implicitly included \$748 million to cover the taxes inherent in the URCS variable ROI calculation. In other words, the URCS model included over three times the amount of costs necessary to cover CSXT's actual income tax expense.

The effect of the tax overstatement in URCS has a direct impact on the calculation of the RSAM revenue adequacy adjustment factor. At a base level, the STB uses URCS variable costs along with revenue statistics, to identify the movements to include in the R/VC<sub>1M</sub> sample group, and the subsequent Revenue<sub>1M</sub>. The problem lies in that the STB has effectively excluded movements from the R/VC<sub>1M</sub> sample group, and lowered its Revenue<sub>1M</sub> figure, by overstating tax recovery in its URCS variable cost calculations. For example, assume a movement has an R/VC ratio of 179

percent based on the STB's URCS variable costs as presently calculated. Removing the tax recovery overstatement from the URCS variable costs would reduce the denominator in the R/VC ratio calculation and increase the R/VC ratio for the movement above the 180% threshold for inclusion in the R/VC<sub>180</sub> sample group. It is likely that correcting the URCS variable costs for this tax recovery overstatement would increase the number of movements in the R/VC<sub>180</sub> sample group, and thereby increase the total Revenue<sub>180</sub>.

Any change in the Revenue<sub>180</sub> has a direct impact on the STB's revenue adequacy adjustment factor since, in its simplest form, the adjustment factor is equal to 1 plus the  $RFV_{short\ run}$  divided by the Revenue<sub>180</sub>.<sup>22</sup> If the STB were to calculate CSXT's URCS variable costs using a pre-tax WACC taking into consideration CSXT's effective tax rate, instead of a statutory tax rate, the size of the R/VC<sub>180</sub> traffic group would be larger and produce a more accurate revenue adequacy adjustment factor.

## **2. Indexing of Waybill Sample Variable Costs and Revenues**

CSXT asserts that the 2002 to 2005 revenue and variable cost data for the comparable group provides an inconsistent comparison for evaluating the R/VC ratios of the challenged rates, which were established in 2007 due to inflation in rail rates and railroad operating costs.<sup>20</sup> To address this alleged inconsistency, CSXT proposed three indexing methods – two related to indexing revenues and one for indexing variable costs – to adjust the comparable group's R/VC ratios. CSXT's first proposed method for indexing prior year revenues to 2007 levels relied upon average chemical

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<sup>22</sup>  $1 + (RFV_{short\ run} - Revenue_{180})$   
<sup>20</sup> See CSXT Opening Evidence at 26.

revenue per unit as reported in CSXT's publicly available financial reports for the 2002 to 2007 period. The second revenue indexing method used a combination of the publicly available changes in revenue developed in CSXI's first proposal and revenue data extracted from CSXI's confidential traffic files. Finally, CSXT proposed to adjust the comparable group's variable cost calculations based on publicly available railroad cost factors.

As a threshold matter, Simplified Standards explicitly rejected as unnecessary the very type of indexing proposed by CSXI.<sup>11</sup> The STB also stated that if any party wished to present additional evidence of indexing of revenues and/or costs, the additional evidence would be evaluated as "other relevant factors."<sup>12</sup> The STB warned, though, that the party submitting such additional evidence would bear the burden of proof of the necessity of the proposed change and require that the proposing party quantify the evidence in an objective, transparent manner.<sup>13</sup>

With the STB's instructions in mind, it is clear that CSXT did not meet its burden because CSXI did not show that the adjustments are necessary. First, CSXT's evidence was not presented objectively since CSXT failed to adjust all relevant revenue and cost data, and instead focused only on the data that would increase the comparable group's R/VC ratios. Second, CSXT's indexing leads to a double count of the revenue necessary for CSXI to reach revenue adequacy. Third, CSXT has failed to provide thorough and reliable proof that the adjustments were necessary to reflect changes in the market. I discuss my reasons for CSXI's failures below.

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<sup>11</sup> See Simplified Standards at 84-85. "We do not believe that any adjustment to rail costs is necessary," and "Nor do we believe a revenue adjustment is appropriate."

<sup>12</sup> See Simplified Standards at 85.

<sup>13</sup> See Simplified Standards at 77.

**a. CSXT's Indexing  
is Unobjective  
and Unnecessary**

CSXT stated that it indexed the comparable group's revenues and variable costs to account for the timing differences between the revenue and cost figures of the movements in the comparable group and those of the issue traffic. According to CSXT, indexing the comparable group's revenues and variable costs places the outdated comparable group R/VC calculations at the same price level as that of the issue traffic. The problem with CSXT's adjustments is that they were far from objective because CSXT only included adjustments that benefited itself, and ignored adjustments that potentially would lower the comparable group's adjusted R/VC ratios.

CSXT ostensibly adjusted the revenue and costs figures for the comparable group from 2002-2005 to 2007 levels in order to place them at the same levels as the issue traffic. However, the comparable group's revenues and variable costs are not the only historic revenue and cost statistics used in the STB's Three Benchmark Methodology. Namely, the STB's Three Benchmark Methodology also calls for the use of historic revenue and variable cost data in the calculation of the RSAM and R/VC<sub>180</sub> ratios. Failure to adjust all variable costs and revenues leads to a glaring inconsistency in the application of the data. What we are left with after CSXT's indexing are comparable group R/VC ratios nominally indexed to 2007 price levels, and RSAM and Revenue<sub>180</sub> ratios based on averages of 2002 to 2005 rates and costs. The mismatch in levels between the comparable group R/VC's and the RSAM and R/VC<sub>180</sub> ratios obviously leaves an unknown and unexplored outcome to the maximum rate process. CSXT failed to explore these issues, and left the STB with a process that clearly does not produce a transparent outcome.

The question then becomes why did CSXT not index the data included in the RSAM and R/VC<sup>180</sup> ratios when indexing the other revenues and variable costs? Any truly objective analysis would have adjusted all revenues and costs to the same levels including the RSAM and R/VC<sup>180</sup> figures

**b. CSXT's Indexing  
is Redundant**

In addition to being unobjective and one-sided, the indexing of the sample group's revenue and variable cost figures is redundant due to the presence of the RSAM revenue adequacy adjustment factor. As the STB explained in Simplified Standards, the RSAM revenue adequacy adjustment factor is designed to provide a ratio to adjust the rates in the comparison movements to reflect the maximum lawful rates the carrier can charge captive traffic taking into consideration the railroad's need for adequate revenues.<sup>181</sup> In other words, the Three Benchmark Methodology already adjusts rates in the comparable group in an effort for a railroad to achieve and maintain revenue adequacy.

By indexing the revenue component of the comparable group to higher 2007 levels in order to reflect rate increases, CSXT's proposal to reach revenue adequacy, while also applying a RSAM revenue adjustment factor designed to adjust rates to a revenue adequate level, would push the *comparable group's revenues beyond that necessary for revenue adequacy*. Simply stated, CSXT cannot double count its efforts to reach a revenue adequate rate levels.

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<sup>181</sup> See Simplified Standards at 81.

The STB provided an example of CSXT's unnecessary index adjustments<sup>14</sup> The STB provides an example of a revenue adequate railroad heaping an index adjustment on top of revenues that already placed the railroad in a revenue adequate position. As the STB noted, indexing would only place the railroad further above the revenue adequacy level. The STB's logic also holds true for a railroad that is not currently revenue adequate, but is raising its rates to reach revenue adequacy. Stacking an adjustment for helping a carrier to become revenue adequate on top of an adjustment to reflect a railroad's increasing rates to reach revenue adequacy is clearly unnecessary and would result in rates reflective of a position well beyond revenue adequacy.

**c. CSXT Has Not Proven  
the Market Has Shifted  
in a Transparent Manner**

CSXT states that it indexed the revenues in the comparable group to account for the significant market changes and dynamics that have occurred in the chemical market between 2007 and the 2002 and 2005 time period from which the comparable group was extracted<sup>15</sup>. There is no denying that CSXT's total revenues for the chemical group have increased between 2002 and 2007. However, CSXT has not provided clear evidence of the cause of the increased revenues, or if the increased revenues was attributable to all chemical traffic. CSXT's use of publicly available changes in revenues per unit for general chemical traffic falls far short of the transparency needed to pass the STB's "other relevant factors" standard to adjust the comparable group R/VC ratios. Additionally, much of this increase in revenues has not come from a shift in the markets and dynamics, but from CSXT's collection of fuel surcharges.

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<sup>14</sup> See Simplified Standards at 85

<sup>15</sup> See CSXT Opening at 27

As indicated above, CSXI's two revenue indexing processes rely upon changes in average revenue per unit for CSXT's entire chemical business group. CSXT's first method indexes the comparable group's revenues based wholly upon historic changes in the chemical business group's average revenue per unit. CSXT's second proposed indexing method uses a combination of the chemical business group data developed in its first method and confidential revenue data developed from its internal traffic files. The problem with both approaches is that they rely in whole or in part upon *changes in revenues for an entire business group, and not changes in revenues for the specific commodity or movements at issue*. CSXT has failed to meet its burden of proof that the publicly available pricing data for CSXI's chemical business as a whole reflects changes in the movements included in the comparable group.

CSXI's website lists 29 different major chemical groups in its chemical business group, with *multiple sub-categories within each macro group*.<sup>2</sup> While CSXT may categorize all these commodities as "chemicals," the actual products are not nearly as homogenous and cover a wide range of commodities including sand, plastics, petroleum coke, LPG and soda ash. Each of these different commodities is driven by different market factors and conditions that may have absolutely nothing in common other than being included in CSXT's chemical business group. CSXI has presented no evidence that the changes in revenue and revenue per unit for its total chemical business group has the same rate of changes for the commodities included in the comparable group. CSXT carries the burden to show that these changes are necessary to reflect changes in the market for the specific commodities. CSXT has fallen well short of this mark.

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<sup>2</sup> See [http://www.csx.com/?fuseaction=customers\\_pricing\\_lists-detail&bu=CH&bun=Chemicals#CSXI3700](http://www.csx.com/?fuseaction=customers_pricing_lists-detail&bu=CH&bun=Chemicals#CSXI3700) accessed on February 27, 2008.

The STB stated that parties may present additional "other relevant factor" evidence for indexing to show "market changes not reflected in the comparison group" <sup>18</sup> In this instance, CSX has not shown that the changes in both its publicly published revenue statistics and its internal confidential revenue data was due entirely to market changes

CSX shows its revenue indexing in terms of stronger pricing due to changes in market conditions stating that indexing is necessary to account for "significant market changes and dynamics" for the shipments of chemical traffic <sup>19</sup> While changing market conditions may account for some increases in revenues, a primary driver in higher 2007 chemical business revenues has also been increases in assessed fuel surcharges CSX's Fourth Quarter, 2007 Quarterly Financial Report made this point crystal clear indicating the change in chemical revenues was due to several factors, including higher fuel surcharges

Chemicals - Revenue and revenue per unit increases were driven primarily by improved pricing and a higher fuel surcharge rate <sup>20</sup>

In other words, both market and non-market issues have impacted CSX's revenues in some unknown combination

The STB's decision in Ex Parte 661, Rail Fuel Surcharges, served January 26, 2007 ("Ex Parte 661") de-linked railroad fuel surcharges from base transportation rates, and instead linked railroad fuel surcharges to actual operations <sup>21</sup> The STB stated

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<sup>18</sup> See Simplified Standards at 85

<sup>19</sup> See CSX Opening at 27

<sup>20</sup> CSX Quarterly Financial Report, Fourth Quarter, 2007, page 10

<sup>21</sup> In fact, the STB took CSX to task in its Ex Parte 661 decision for attempting to argue that a fuel surcharge was a revenue enhancement tool rooted in differential pricing, and not just a means for recovering higher fuel costs. See Ex Parte 661 at 6

Because railroads rely on differential pricing, under which rates are dependent upon factors other than costs, a surcharge that is tied to the level of the base rate, rather than to fuel consumption for the movement to which the surcharge is applied, cannot fairly be described as a cost recovery mechanism.

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The railroads will have a 90-day transition period to adjust their fuel surcharge programs.<sup>42</sup>

As mandated by the SIB, CSX I changed its fuel surcharge program from one based on a percentage of base rates to one based on a link to operations.

CSX I clearly had increased revenues in 2007, but it is not possible from publicly available data to discern what portion of the change was driven by changes in the transportation market and what was driven by increases in fuel surcharge revenues which are independent of the chemical transportation market.<sup>43</sup> CSX I carries the burden of showing that the increases in chemical revenues were due to changes in markets in a transparent manner. CSX I has not met this burden.

#### **B. APPLICATION OF DUPONT'S OTHER RELEVANT FACTORS**

In my Opening VS, I included two other relevant factors and quantified their application to the calculation of the Maximum R/VC Ratio for the issue movements. The procedures described and the analyses contained in my Opening VS remain unchanged. However, because the

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<sup>42</sup> See Ex Parte 661 at 6.

<sup>43</sup> CSX I may try to argue that increases in fuel surcharge revenue were due to changes in the fuel market, and therefore linked to changes in "markets." This would be a red herring. CSX I clearly states that it was looking at changes in the chemical transportation market, and not the fuel market, in advocating its adjustment.

comparable groups and the Maximum R/VC Ratios have changed from my Opening VS, I have revised the calculations showing the application of DuPont's other relevant factors

These revisions are contained below under the following topics

- 1 STB's RSAM Ratio Adjusted for Efficiency
- 2 STB's RSAM and R/VC Ratios Adjusted for the STB's New Cost of Capital Methodology

**1. STB's RSAM Ratio  
Adjusted for Efficiency**

At pages 11-12 of my Opening VS, I described the methodology I used to adjust the STB's RSAM for efficiency. I have not changed that methodology or its results in Reply

The results from using the STB's RSAM adjusted for efficiency to calculate the Maximum R/VC Ratio for the final comparable groups are summarized in Table 6 below

**Table 6**

**Maximum Rate for Issue Movements Using Efficiency RSAM and R/VC > 180**

<u>Item</u> (1)	<u>Niagra Falls - New Johnsonville</u> (2)	<u>Natium - New Johnsonville</u> (3)	<u>Niagra Falls - Carneys Point</u> (4)
1 3Q07 Rate per Car (Including Fuel Surcharge) <sup>1</sup>	\$9,173.17	\$5,993.75	\$4,896.66
2 3Q07 Variable Cost per Car <sup>2</sup>	\$1,993.25	\$1,712.52	\$1,472.65
3 R/VC Ratio -	460%	350%	333%
4 Maximum R/VC Ratio with RSAM Adjusted for Efficiency <sup>3</sup>	272%	309%	306%
5 Maximum Rate per Car <sup>4</sup>	\$5,421.64	\$5,291.69	\$4,506.31
6 Amount CSX 1 Rate per Car Exceeds Maximum Rate per Car <sup>5</sup>	\$3,751.53	\$702.06	\$390.35

<sup>1</sup> Table 1 above  
<sup>2</sup> Table 3 above  
<sup>3</sup> Line 1 - Line 2 x 100  
<sup>4</sup> Electronic workpapers  
<sup>5</sup> Line 2 x Line 4  
<sup>6</sup> Line 1 - Line 5

As shown in Table 6 above, CSXT's rate for each of the issue movements (Line 1) exceeds the rate based on the Maximum R/VC Ratio using the RSAM adjusted for efficiency (Line 5) for the comparable group by an amount ranging from \$390.35 per car to \$3,751.53 per car

**2. STB's RSAM and R/VC<sub>>180</sub>  
Ratios Adjusted for the STB's  
New Cost of Capital Methodology**

At pages 13-15 of my Opening VS, I described the methodology I used to incorporate the STB's January 17 2008 decision in Ex Parte No 664 Methodology to be Employed in Determining the Railroad Industry's Cost of Capital ("Cost of Capital") to replace its single-stage Discounted Cash Flow ("DCF") model with a Capital Asset Pricing Model ("CAPM") to determine the cost of equity component in the cost of capital calculation. I have not changed that methodology or its results in Reply.

The results from incorporating the CAPM cost of capital methodology to calculate the Maximum R/VC Ratio for the final comparable groups are summarized in Table 7 below.

Table 7

**Maximum Rate for Issue Movements Using CAPM RSAM and R/VC>180**

Item (1)	Niagra Falls- New Johnsonville (2)	Natrium - New Johnsonville (3)	Niagra Falls - Carneys Point (4)
1 2007 Rate per Car (Including Fuel Surcharge) <sup>1</sup>	\$9,173.17	\$5,993.75	\$4,896.66
2 2007 Variable Cost per Car =	\$1,993.25	\$1,712.52	\$1,472.65
3 R/VC Ratio -	460%	350%	333%
4 Maximum R/VC Ratio with RSAM Adjusted for CAPM <sup>2</sup>	269%	306%	303%
5 Maximum Rate per Car <sup>3</sup>	\$5,361.84	\$5,240.31	\$4,462.13
6 Amount CSXT Rate per Car Exceeds Maximum Rate per Car	\$3,811.33	\$753.44	\$434.53

<sup>1</sup> Table 1 above  
<sup>2</sup> Table 3 above  
 - Line 1 - Line 2 x 100  
<sup>3</sup> Electronic workpapers  
 - Line 2 x Line 4  
 = Line 1 - Line 5

As shown in Table 7 above, CSXT's rate for each of the issue movements (Line 1) exceeds the rate based on the Maximum R/VC Ratio using the RSAM and R/VC ratios adjusted for the CAPM cost of capital (Line 5) for the comparable group by an amount ranging from \$434.53 per car to \$3,811.33 per car.

**V. RELIEF FOR DUPONT**

In this section of my Reply VS I present the relief that DuPont is entitled to for the issue movements based on the analyses and methodologies described above. The results of my analyses are shown in Table 8 below.

Movement (1)	Based on		
	STB's RSAM and R/VC > 180 (2)	Efficient RSAM and R/VC > 180 (3)	CAPM RSAM and R/VC > 180 (4)
1. Niagra Falls, NY - New Johnsonville, TN	\$713	\$788	\$800
2. Natrium, WV - New Johnsonville, TN	\$142	\$291	\$313
3. Niagra Falls, NY - Carneys Point, NJ	<u>\$157</u>	<u>\$640</u>	<u>\$713</u>
4. Total	\$1,012	\$1,719	\$1,826

As shown in Table 8 above, DuPont is entitled to relief totaling \$1.01 million using the STB's RSAM and R/VC<sub>180</sub> ratios subject to the appropriate cap in three-Benchmark cases. The relief increases to \$1.72 million using the RSAM and R/VC<sub>180</sub> ratios adjusted for efficiency and to \$1.83 million using the RSAM and R/VC<sub>180</sub> ratios adjusted only for the CAPM cost of capital (i.e., unadjusted for efficiency)<sup>44</sup>, again subject to the appropriate cap.

<sup>44</sup> See electronic workpapers, file "TIIH Relief Summary Reply.xls" for the detailed calculations.



**REDACTED**

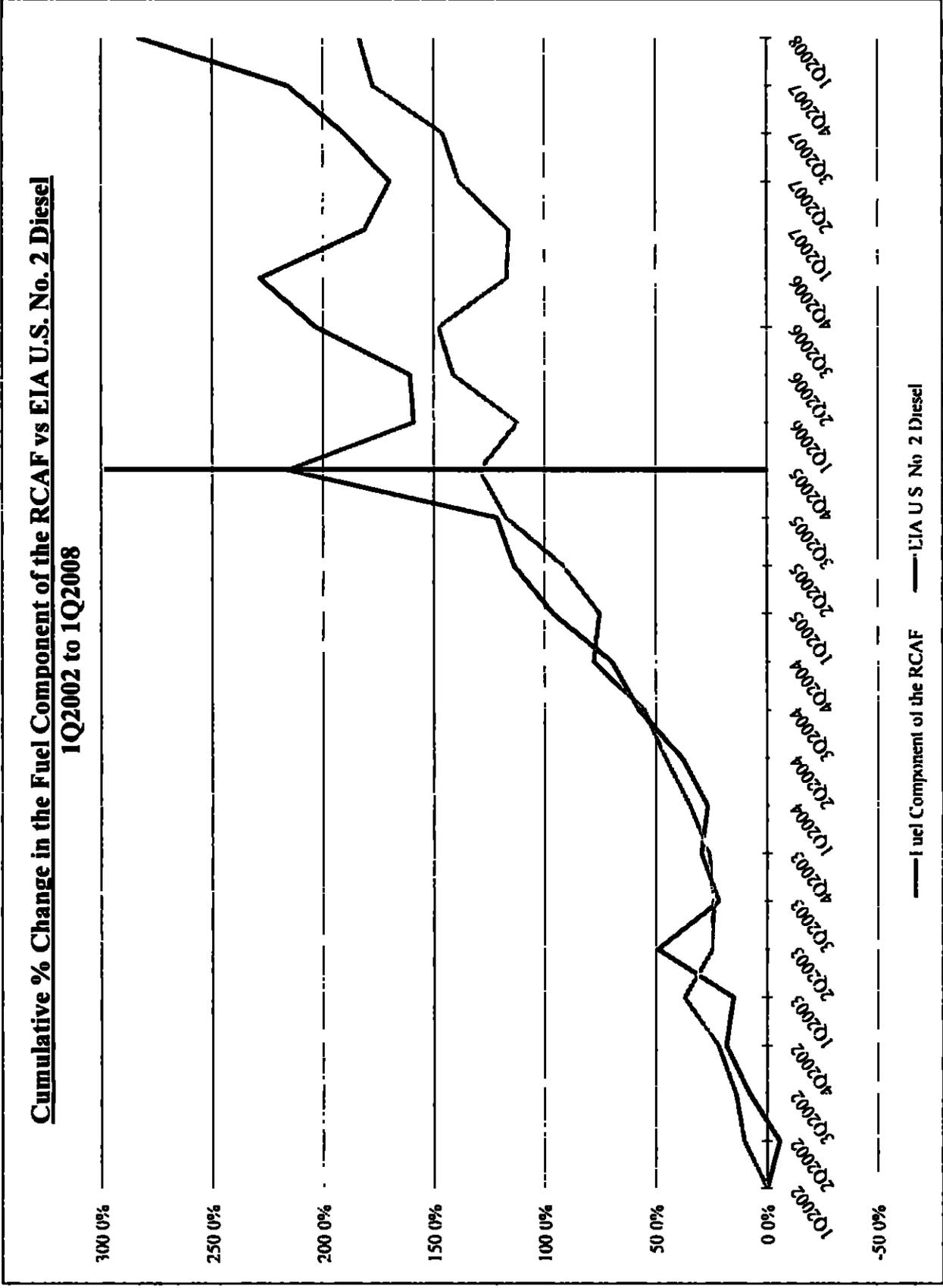
REDACTED

REDACTED

REDACTED

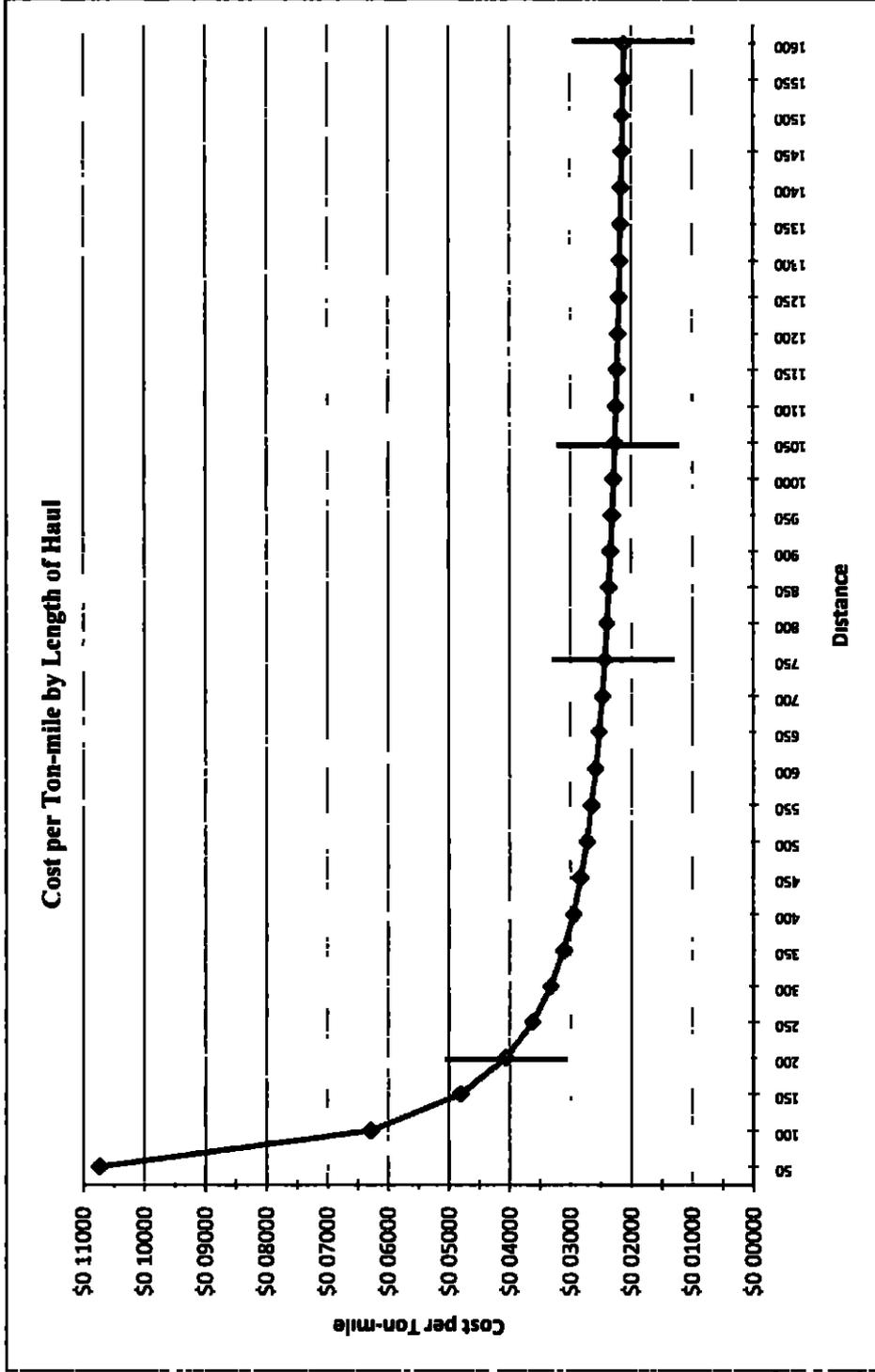
**Comparison of the Change in the Fuel Component  
of the RCAF to the EIA's U.S. No. 2 Diesel**

<u>Quarter</u>	<u>Fuel Component of the RCAF</u>	<u>Cumulative % Change</u>	<u>EIA U S No 2 Diesel</u>	<u>Cumulative % Change</u>
(1)	(2)	(3)	(4)	(5)
1 1Q2002	87.4	0.0%	117.8	0.0%
2 2Q2002	82.5	-5.6%	130.0	10.3%
3 3Q2002	94.4	8.0%	134.6	14.2%
4 4Q2002	103.5	18.4%	143.7	21.9%
5 1Q2003	100.7	15.2%	161.7	37.2%
6 2Q2003	130.4	49.2%	146.9	24.7%
7 3Q2003	106.3	21.6%	146.3	24.1%
8 4Q2003	113.3	29.6%	148.4	26.0%
9 1Q2004	110.8	26.8%	158.7	34.7%
10 2Q2004	120.8	38.2%	171.7	45.7%
11 3Q2004	137.7	57.6%	182.9	55.3%
12 4Q2004	148.3	69.7%	209.7	78.0%
13 1Q2005	171.5	96.2%	206.6	75.4%
14 2Q2005	186.9	113.8%	226.0	91.8%
15 3Q2005	193.6	121.5%	256.4	117.6%
16 4Q2005	276.2	216.0%	270.4	129.5%
17 1Q2006	226.4	159.0%	250.0	112.2%
18 2Q2006	227.9	160.8%	284.1	141.1%
19 3Q2006	265.2	203.4%	292.1	147.9%
20 4Q2006	287.0	228.4%	255.8	117.1%
21 1Q2007	245.9	181.4%	254.7	116.1%
22 2Q2007	235.9	169.9%	281.3	138.7%
23 3Q2007	253.9	190.5%	289.7	145.9%
24 4Q2007	276.4	216.2%	327.0	177.6%
25 1Q2008	334.8	283.1%	334.2	183.7%



REDACTED

TIH Commodity - Lane 1



CSXT Mileage Range for Comparable Moves  
DuPont Mileage Range for Comparable Moves

REDACTED

REDACTED

REDACTED

**Corrected RSAM Adjustment Calculation**

<u>Item</u> (1)	<u>Source</u> (2)	<u>2002</u> (3)	<u>2003</u> (4)	<u>2004</u> (5)	<u>2005</u> (6)	<u>Four-Year Average 1/</u> (7)	
<b><u>STB's Calculations</u></b>							
1	Board RSAM Ratio	Ex Parte 347 (Sub-No 2)	286%	292%	292%	300%	292.5%
2	Board R/VC >180	Ex Parte 347 (Sub-No 2)	238%	239%	231%	236%	236.0%
3	STB RSAM Mark-Up	Line 1 - Line 2	1.20	1.22	1.26	1.27	1.24
<b><u>CSXT's RSAM Adjustment</u></b>							
4	Shortfall (After -Tax)	Line 1 - Line 2	48%	53%	61%	64%	57%
5	CSXT Shortfall Calculation	Line 4 - (1 - 38.5%) <u>2/</u>	78%	86%	99%	104%	92%
6	CSXT Adjusted RSAM	Line 2 + Line 5	316%	325%	330%	340%	327.8%
7	CSXT Adjusted RSAM Mark-Up	Line 6 - Line 2	1.33	1.36	1.43	1.44	1.39
<b><u>Corrected RSAM Adjustment</u></b>							
8	Income (Loss) from continuing operations (before inc. taxes)	Sch 210, Ln 46	479,373	296,642	511,043	963,736	562,699
9	Income Taxes On Ordinary Income	Sch 210, Ln 63	(21,562)	(50,403)	15,220	249,418	48,168
10	Effective Tax Rate	Line 8 - Line 7	-4.5%	-17.0%	3.0%	25.9%	1.8%
11	Corrected Shortfall Calculation	Line 4 - (1 - Line 10)	46%	45%	63%	86%	60.1%
12	Corrected Adjusted RSAM	Line 2 + Line 11	284%	284%	294%	322%	296.1%
13	Corrected Adjusted RSAM Mark-Up	Line 12 - Line 2	1.19	1.19	1.27	1.37	1.26

---

1/ Simple average of Columns (3) to (6)

2/ CSXI calculated an effective tax rate of 38.5%, including state taxes.

**Federal Income Tax Provision Included In URCS By STB**

<u>Item</u> (1)	<u>Source</u> (2)	<b>2005 CSXT</b> <u>Amount</u> (3)
1 CSX URCS Total Return On Investment @17.9%	URCS D8P1L135	\$2,348,502
2 CSX URCS Total Return On Investment @12.2%	URCS D8P1L135 1/	<u>\$1,600,655</u>
3 Provision For Federal Income Tax Included In URCS By STB	Line 1 - Line 2	\$747,847
4 Actual Federal Taxes	CSX R-1 Sch 210 Line 47	\$220,345
5 Tax Provision Included In URCS By STB In Excess Of Actual Taxes Paid	Line 3 - Line 4	\$527,502
<hr/> 1/ URCS developed without provision of federal income tax		

**PUBLIC VERSION**

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

<hr/>		)	
E I DUPONT DE NEMOURS AND COMPANY		)	
	Complainant,	)	
		)	
	v	)	Docket No NOR 42100
		)	
CSX TRANSPORTATION, INC .		)	
	Defendant	)	
<hr/>		)	

**PART III – REPLY EXHIBITS**

- Exhibit A     DuPont Contract Fact Sheet
- Exhibit B     Bear Stearns 2007 Rail Volume Analysis

**EXHIBIT A**

**REDACTED**

# **EXHIBIT B**

**Moreno, Jeffrey**

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**Subject:** FW Week 52 Rail Volumes Rail Volumes Deteriorate Further During Volatile Christmas Week

**Attachments:** Week 52-07.xls, Disclaimer.txt

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**From:** Wolfe, Edward [mailto:ewolfe@bear.com]

**Sent:** Thursday, January 03, 2008 11:22 AM

**To:** Wolfe, Ed (Exchange)

**Subject:** Week 52 Rail Volumes: Rail Volumes Deteriorate Further During Volatile Christmas Week

Pasted below, we have included brief comments on Week 52 rail volumes and service metrics. We have also attached an Excel file with company and segment data.

Our more in depth *On Track* note will be available tomorrow morning.



**BEAR  
STEARNS**

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**DISCLOSURES & REG AC BELOW**

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## **Week 52: Rail Volumes Deteriorate Further During Volatile Christmas Week**

**VOLS DETERIORATE.** Total Week 52 vols declined 6.0% y-o-y, deteriorated vs. -2.8% and -3.2% in the prior 2 weeks and -2.3% for the full year. In 4Q rails vols declined 1.0%, improved vs. -2.4% last quarter and -2.8% in 1H:07. Vols for the Canadian rails declined -3.1% y-o-y and vols for the Big 4 U.S. rails were down 6.6% y-o-y. In 4Q vols for the Canadian rails were up 4.4%, improved vs. +0.2% last quarter and vols for the Big 4 U.S. rails were down 2.1%, improved vs. -3.0% last quarter.

**TIMING OF CHRISTMAS LIKELY A LARGE DRAG.** Christmas occurred on a Tuesday this year, impacting two full work days (Monday, Christmas Eve and Tuesday) whereas last year Christmas occurred on a Monday, impacting just one full work day, with Christmas Eve occurring on a Sunday (Sunday is typically a slower freight day). We expect the rails to make up that vol. during 1Q although the first week could see similar effects with New Years Day this year on a Tuesday vs. Monday a year ago. Continued weak demand as well as the lingering effects of harsh weather conditions across the western U.S. and Canada also contributed to the decline in vols.

**BROAD BASED WEAKNESS.** Vols declined y-o-y in 6 of 8 segments, led by declines in autos (-21%), intermodal (-8%) and paper/lumber (-22%). Coal vols declined 4% and grain vols declined 3%. Minerals/stone vols also declined 4%. On the positive side, chemicals vols were flattish and metals were up a solid 5%.

**NSC AND CNI LESS WORSE AMONG THE CLASS I's.** Harsh weather conditions in the Midwest continued to impact BNI and UNP, with vols down 6% and 7%, respectively. NSC was the least worst among the U.S. rails this week, with vols down 5%, while CSX's vols were down 9%. In Canada, CNI's vols were down 2% and CP's vols were down 5%.

3/4/2008

**MIXED SERVICE METRICS.** 3 of the 4 U.S. Class 1 rails reported faster train speeds while 3 reported deteriorated dwell times BNI reported the best y-o-y improvement in train speeds while NSC reported the best y-o-y improvement in dwell times In Canada, CNI's y-o-y train speeds declined and y-o-y dwell times deteriorated. We note that complete service metrics for CP are not available yet

See the attached spreadsheets and tomorrow's On Track note for more detail by company and by segment.

Have a great day!

Ed



Looking for our latest models or research? A fast way to access notes, reports and models is by clicking on Bear's Research Library Click [here](#) to access research by company or analyst

Equity Research Analyst	Phone	Email	Sector	Rating
<u>Edward Wolfe</u>	212-272-7048	ewolfe@bear.com	Airfreight & Surface Transportation - Railroads	Market Weight
<u>Scott Group</u>	212-272-0692	sgroup@bear.com		

### Companies Analyzed

Company Name	Ticker/Price Chart	Yesterday's Closing Price	Rating	Target Price	Risk (If target is included)	Methodology (If target is included)
Union Pacific	<u>UNP</u>	124.24	Peer Perform			
Norfolk Southern	<u>NSC</u>	49.41	Outperform			
CSX Corporation	<u>CSX</u>	43.45	Peer Perform			
Canadian Pacific Railway (Canada)	<u>CP CN</u>	64.45	Peer Perform			
Canadian Pacific Railway (US)	<u>CP</u>	64.45	Peer Perform			
Canadian National (Canada)	<u>CNR CN</u>	46.40	Peer Perform			
Canadian National (US)	<u>CNI</u>	46.40	Peer Perform			
Burlington Northern Santa Fe	<u>BNI</u>	82.93	Peer Perform			

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Edward Wolfe

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**Ratings for Sectors (vs. regional broader market index). Market Overweight (MO)** - Expect the industry to perform better than the primary market index for the region (S&P 500 in the US) over the next 12 months. **Market Weight (MW)** - Expect the industry to perform approximately in line with the primary market index for the region (S&P 500 in the US) over the next 12 months. **Market Underweight (MU)** - Expect the industry to underperform the primary market index for the region (S&P 500 in the US) over the next 12 months.

**Edward Wolfe, Airfreight & Surface Transportation - Railroads**

Union Pacific, Pacer International Inc., Norfolk Southern, CSX Corporation, Canadian Pacific Railway (Canada), Canadian Pacific Railway (US), Canadian National (Canada), Canadian National (US), Burlington Northern Santa Fe

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**Underperform (Sell)** 7 / 65

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### EASTERN RAILROADS

	CSX				NSC			
	F07 Week 52	6 wk rolling	QTD	YTD	F07 Week 52	6 wk rolling	QTD	YTD
Intermodal	-10.9%	-3.0%	-4.2%	-3.4%	-4.5%	-2.5%	-4.2%	-4.2%
Automotive	-10.1%	-9.4%	-3.5%	-5.1%	-32.4%	-4.0%	2.1%	-5.0%
Coal	-12.5%	2.9%	2.2%	-1.8%	-2.0%	-6.5%	-5.2%	-3.1%
Grain	2.4%	3.6%	-1.1%	-3.1%	-9.5%	-1.7%	1.8%	0.0%
Chemicals	1.8%	7.1%	5.8%	2.6%	5.2%	2.3%	4.2%	3.3%
Paper/Lumber	-14.0%	-12.6%	-14.1%	-12.6%	-12.2%	-9.8%	-9.3%	-8.9%
Metals	0.8%	0.3%	-3.3%	-2.2%	9.2%	3.9%	3.2%	-7.0%
Minerals/Stone	-10.7%	-8.2%	-6.8%	-7.6%	-8.3%	-6.4%	-3.7%	-4.1%
<b>Total Carloads</b>	<b>-8.6%</b>	<b>-2.5%</b>	<b>-3.1%</b>	<b>-3.4%</b>	<b>-4.7%</b>	<b>-3.4%</b>	<b>-3.0%</b>	<b>-3.9%</b>

### WESTERN RAILROADS

	BNI				UNP			
	F07 Week 52	6 wk rolling	QTD	YTD	F07 Week 52	6 wk rolling	QTD	YTD
Intermodal	-11.8%	-7.5%	-8.9%	-6.6%	-9.0%	-1.4%	-0.9%	0.5%
Automotive	-17.9%	-8.6%	-4.0%	-3.1%	-20.5%	-5.3%	-3.2%	-4.2%
Coal	-1.6%	-0.9%	0.3%	0.3%	-4.1%	-0.1%	3.0%	0.5%
Grain	6.0%	10.5%	12.8%	3.3%	1.0%	1.9%	5.0%	-4.8%
Chemicals	0.9%	7.9%	7.3%	11.5%	1.0%	3.7%	5.5%	3.3%
Paper/Lumber	-28.1%	-17.8%	-17.3%	-18.6%	-22.4%	-13.9%	-13.0%	-15.8%
Metals	-6.3%	2.1%	2.5%	0.1%	1.7%	0.6%	-0.5%	-4.0%
Minerals/Stone	9.6%	17.6%	7.6%	-1.1%	1.9%	5.5%	3.7%	-6.9%
<b>Total Carloads</b>	<b>-6.3%</b>	<b>-2.6%</b>	<b>-3.0%</b>	<b>-3.1%</b>	<b>-6.9%</b>	<b>-1.2%</b>	<b>0.1%</b>	<b>-1.3%</b>

### CANADIAN RAILROADS

	CN				CP			
	F07 Week 52	6 wk rolling	QTD	YTD	F07 Week 52	6 wk rolling	QTD	YTD
Intermodal	5.3%	4.5%	4.2%	0.1%	2.9%	7.0%	6.9%	6.7%
Automotive	-28.5%	-6.6%	6.5%	4.1%	-11.4%	-2.9%	6.3%	2.4%
Coal	7.9%	-3.8%	-4.8%	-10.9%	-6.4%	-2.2%	-5.7%	-4.1%
Grain	-13.5%	-5.5%	-1.2%	-2.0%	-24.5%	-2.3%	-4.7%	-0.2%
Chemicals	0.2%	2.6%	5.0%	4.4%	-11.5%	3.7%	5.1%	12.2%
Paper/Lumber	-29.1%	-15.7%	-13.1%	-12.7%	-29.3%	-14.0%	-12.3%	-16.3%
Metals	27.3%	15.7%	14.1%	6.2%	14.4%	16.8%	12.0%	-3.8%
Minerals/Stone	-2.8%	4.9%	2.0%	-4.8%	-13.7%	-6.3%	-3.3%	-3.2%
<b>Total Carloads</b>	<b>-1.9%</b>	<b>5.0%</b>	<b>5.3%</b>	<b>-1.1%</b>	<b>-5.3%</b>	<b>2.6%</b>	<b>2.7%</b>	<b>2.8%</b>

### SMALL CAP RAILROADS

	KCSM (Mexico only)				KCS (U.S. only)			
	F07 Week 52	6 wk rolling	QTD	YTD	F07 Week 52	6 wk rolling	QTD	YTD
Intermodal	34.4%	14.9%	16.3%	14.1%	-59.8%	-49.0%	-34.3%	-19.0%
Automotive	-47.5%	-1.0%	-1.2%	2.7%	-31.5%	29.7%	44.5%	32.2%
Coal	0.0%	507.5%	1194.9%	552.0%	-18.9%	-0.6%	-1.7%	3.0%
Grain	-29.5%	-19.9%	-13.0%	0.2%	-15.8%	-2.4%	-2.2%	-0.8%
Chemicals	-21.4%	-15.6%	-12.5%	-6.8%	19.6%	16.1%	12.8%	5.4%
Paper/Lumber	-33.5%	-23.5%	-25.7%	-18.1%	-3.9%	-9.2%	-8.5%	-8.6%
Metals	-8.3%	-4.2%	-9.7%	-14.3%	12.4%	7.1%	11.1%	-5.5%
Minerals/Stone	10.1%	14.6%	15.0%	8.0%	44.6%	1.9%	8.1%	2.6%
<b>Total Carloads</b>	<b>-7.6%</b>	<b>-1.6%</b>	<b>-0.3%</b>	<b>0.3%</b>	<b>-21.4%</b>	<b>-13.4%</b>	<b>-9.6%</b>	<b>-5.0%</b>

Certificate of Service

I hereby certify that I have on this 5th day of March 2008, served a copy of the foregoing Complainant's Reply Evidence on Paul Moates and Paul Hemmersbaugh, Sidley and Austin, 1501 K Street, NW, Washington, D C 20005, via hand delivery and email

  
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Jeffrey O Moreno