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SECTION III APPENDIX

3.0 100 % POWDER RIVER BASIN WESTERN SUBITUMINOUS COAL DISCUSSION

3.1 Common Systems

3.1.1 Coal Yard

3.1.1.1 Methodology and Parameters Evaluated

The predicted effects of handling Power River Basin (PRB) coal in the coal yard were developed from an interview with Plant Operations, the Predicted Performance Summary and the Coal Reclaim and Conveyor System Reliability Improvement Study done for IPL by SWEC in 1988.

The focus of the evaluation centered on:

- Stockpile Capacity
- Train Deliveries
- Belt Capacity
- Existing Handling System Problems

3.1.1.2 Stockpile Capacity

The available information indicates that switching to PRB coal will not reduce the existing stockpile capacity to any great extent. SWEC recommends live storage be provided by storage silos of 64 hours duration. The silos would be of the mass flow type providing first in-first out flow. The location of the silos and associated conveying systems will reduce storage to the north and northeast of the existing reclaim hopper.

Dead storage, for emergency use only, is provided in a compacted pile.

This pile must be laid down in shallow lifts and must be heavily compacted with dozers and scrapers. The pile must be monitored with infrared detection devices to discover any thermal hot spots which must be removed, extinguished and recompacted. Live storage is provided for a weekend of 64 hours duration. The handling capacity is designed to operate for two shifts per day six days per week with reclaim on two shifts per day seven days per week.

3.1.1.3 Train Deliveries

Assuming that the units are base loaded, 100 ton 100 railcar unit trains will be required six days a week. Use of the existing unloading system, without any upgrading of equipment, will require 12.5 hours to unload the unit train. This assumption does not allow time for the switching of empty railcars for loaded railcars. Frozen railcar deliveries and use of the car thaw system will increase the unloading time required .

3.1.1.4 Belt Capacity

Use of the existing belt conveyor system, without modifications, will require bunkering for 10.75 hours per day. Load reductions maybe required if an equipment failure occurs and is not easily repaired.

3.1.1.5 Existing Handling System Conditions

The use of PRB coal at Stout Station will require major system modifications, many of them have been identified in our 1988 study.

PRB coal, because of its reactive and dusty nature, requires special handling to avoid spontaneous combustion and dust explosions. The chutes, storage hoppers, silos, storage bunkers, and other coal handling equipment should be designed to be self cleaning with steep valley angles so that the coal will not accumulate. Dust collection must be well designed and maintained.

Much of the existing coal handling system is not suitable to handle PRB coal and requires upgrading. Many chutes and hoppers need redesign, skirting must be extended and maintained, dust collection hoods added, belt scrapers added, belts should have vulcanized splices and washdown troughs and sumps and pumps added. Spillage from belts and other coal handling equipment must be contained and cleaned up immediately. Piles of coal spillage will be a severe fire hazard if not cleaned up daily. Fire protection has to be added with detection devices, sprinkler systems, and fire pumps.

SWEC estimates the cost of adding silos and new conveyors to be approximately $8,000,000-$10,000,000. None of the existing problem modifications are included in the cost estimate.

3.2 Stout Units 5 & 6 Systems

3.2.1 Pulverizer System

3.2.2.1 Methodology and Parameters Evaluated

The effects of switching coal on the coal feed and pulverizer systems are influenced from many parameters. Coal rank, moisture, HHV and Hardgrove grindability index are the most important factors. Conversion to Powder River Basin coal is expected to cause significant impact to the existing capability of the feeder/pulverizer system to meet full load requirements. The four RPS - 613 pulverizers, as configured, will allow approximately 80 % of full boiler operation with this coal, at fineness, with one pulverizer out-of-service for maintenance. The existing air heater will provide approximately 640°F primary air temperature to the pulverizers. This temperature will allow for high moisture coal and still maintain the minimum 140°F pulverizer outlet air temperature, which is considered adequate for adequate coal drying and transport.

To maintain full load capability, without one spare mill available for maintenance, allowing for wear, requires an increase in pulverizer size to model RPS - 723 mills. The scope of modifications, include;

- New RPS - 723 pulverizers (5).
- Exhausters (5) with motor drives.
- Coal feeders (5).
- Air ducts (w/ air control dampers).
- Foundations.
- CO_2 inerting system.
- Electrical breakers upgrade.
- Controls.
- Raw coal piping modifications.
- Isolation gates (Raw coal, burner lines).
- Burner lines (w/ supports).
- New Burners.

Carbon Dioxide (CO_2) has been chosen to provide inerting and fire protection for the pulverizers at this facility. A new low pressure CO_2 system will be connected to all pulverizer units.

The CO_2 is stored under pressure in a liquid form in a refrigerated storage tank at 300 psi and 0°F. When a pulverizer trips, the CO_2 may be discharged to the pulverizer by either an automatic valves from a signal panel or by an operator for manual discharge. Liquid CO_2 is discharged by a master valve, and expands to a gaseous form, to be introduced into the mill through hot air inlets plus other injection points.

A summary of the predicted pulverizer performance and recommended modifications with PRB coal is tabulated in Table A-5. The engineering order-of-magnitude capital cost estimate for these modifications including demolition is $9.6 million.

3.2.2 Boiler Evaluation

3.2.2.1 Methodology and Parameters Evaluated

The predicted effects of converting the boilers to a compliance low sulfur, Subituminous coal were developed from a number of sources. The prediction of impact on boiler performance originated with SWEC and the use of computer programs to estimate combustion constituents quantities, boiler efficiency, and slagging and fouling indices. A summary is presented in Table A-6.

The viability of conversion and the effects of coal switching on boiler operation was also estimated from information gathered in an interview with Plant Operations and experience with this boiler design.

The level of this review is considered sufficient to provide representative performance/operation information. The results later served as the basis for estimating the scope of modifications required, within the tolerance specified, to maintain the boiler MCR. This evaluation, however, does not include a rigorous analysis on the probability of reaching and maintaining full load rating, given the coal property and characteristic variations that could occur with Subituminous coals from the Powder River Basin (PRB). It is not intended to be a final scope of work, as Stone & Webster Engineering Corp. recommends a detailed evaluation and a long term test burn to demonstrate the combined impact of using this coal prior to making a commitment to it.

The focus of the evaluation centered on factors having the potential to result in derating of Unit capacity, and the equipment modifications required to prevent derating. The specific factors, are:

- Burner operation
- Furnace slagging and furnace exit gas temperature
- Convection pass fouling
- Fly ash erosion

3.2.2.2 Burner Operation

The information available indicates that the existing burners will require conversion, possibly to low NO_x type. The likelihood of unacceptable burner operation with this coal is considered high if the burners are

not replaced. The factors related to burner heat input and burner zone heat release, coal V.M. content and ash content are well within the acceptable range to effect a proper replacement.

3.2.2.3 Furnace Performance & Furnace Exit Gas Temperature

The potential for furnace slagging is the same or slightly increased from the Lynnville coal due to the lower furnace emissivity and the Med/High slagging index with the PRB coal. Given the relatively low heat release values, which is consistent with the low ash fusion temperatures of the original design coal, the number of deslaggers installed in this region and the predicted rise in FEGT, initial indications are that furnace control can still be maintained with operating changes without the need for major modifications, but, potentially resulting in a periodic 10 % load derate.

A consequent effect of variations in furnace performance is the impact on steam/metal temperatures and spray attemporator capac ties. The available data suggests that no potential problems related to this exists if furnace conditions are maintained.

3.2.2.4 Convection Pass Fouling

The fouling potential is not increased with this coal. However, the combination of increased slagging resulting from lapses in sootblowing, changes in coal characteristics and the historical tendency to have high temperature ash corrosion on the furnace arch could increase the deposition rate in the high temperature zones of the convection pass. The recommendation is to not add retractable sootblower coverage in the zones exceeding 1500 degrees F at this time.

3.2.2.5 Fly Ash Erosion

Although fly ash erosion is not a threat to performance, it is a factor which could seriously affect long term reliability and maintenance requirements. Erosion is a function of many parameters. However, flue as velocity is considered a key factor as erosion rate is a 2.5 - 3 power function of this parameter. Since the maximum flue gas velocity is predicted to be 3 % higher than with the base coal, the erosion index is the same or slightly, and the overall ash quantity is lower, tube life should not be deleteriously affected with the PRB coal.

3.2.3 Fans

3.2.3.1 Methodology and Parameters Evaluated

Forced Draft Fans

The existing forced draft fans are considered adequate for MCR operation with this coal. This, however, does not consider the possible addition of low NO_x burners, which may require additional static head.

The conversion to Powder River Basin coal results in virtually the same flow and static head requirements that exists with the current high sulfur coals being burned. This, therefore, does not jeopardize exceeding the existing fan margins.

Induced Draft Fans

Similar to the situation with the Forced Draft Fans, the flue gas flow and pressure requirements are expected to be approximately three percent higher than with the high sulfur coal. Refer Table A-6. The flue gas temperature is also expected to rise slightly, which increases the volumetric flow rate by approximately seven percent. Even with this rise, the actual fan performance indicates the fan flow, head and temperature margins are not jeopardized.

3.2.4 Electrostatic Precipitator

3.2.4.1 Methodology and Parameters Evaluated

Please refer to SubSection 1.2.4.1. of Section III, which includes the discussion related to Power River Basin coals.

3.2.5 Ash Handling

3.2.5.1 Methodology and Parameters Evaluated

The fly ash handling system is classified as a wet type, supplied by Allen Sherman Hoff.

The conversion to Powder River Basin coal does not pose a potential problem to reliable operation with ample water supply. The ash has significantly more calcium, which tends to make it more cementatious, however, the quantity is significantly less than with the Lynnville coal.

3.2.5.2 Ash Handling/Pond Effluent

The present system sluices the bottom and fly ash to an ash pond adjacent to the Plant. Changing the coal source will not affect the handling of the bottom ash and the effluent will not likely require additional treatment prior to discharge.

3.3 Stout Unit 7 Systems

3.3.1 Pulverizer System

3.3.1.1 Methodology and Parameters Evaluated

The effects of switching coal on the coal feed and pulverizer systems are influenced from many parameters. Coal rank, moisture, HHV and Hardgrove grindability index are the most important factors. Conversion to Powder River Basin coal is expected to cause significant impact to the existing capability of the feeder/pulverizer system to meet full load requirements. The five RPS - 823 pulverizers, as configured, will allow approximately 75 % of full boiler operation with this coal, at fineness, with one pulverizer out-of-service for maintenance. The existing air heater will provide approximately 650°F primary air temperature to the pulverizers. This temperature will allow for high moisture coal and still maintain the minimum 140°F pulverizer outlet air temperature, which is considered adequate for adequate coal drying and transport.

To maintain full load capability, <u>without</u> one spare mill available for maintenance, allowing for wear, requires an increase in pulverizer size to model RPS - 883 mills. The scope of modifications, include;

- New RPS - 883 pulverizers (5).
- Exhausters (5) with motor drives.
- Coal feeders (5).
- Air ducts (w/ air control dampers).
- Foundations.
- CO_2 inerting system.
- Electrical breakers upgrade.
- Controls.
- Raw coal piping modifications.
- Isolation gates (Raw coal, burner lines).
- Burner lines (w/ supports).
- New Burners.

Carbon Dioxide (CO_2 has been chosen to provide inerting and fire protection for the pulverizers at this facility. A new low pressure CO_2 system will be connected to all pulverizer units.

The CO_2 is stored under pressure in a liquid form in a refrigerated storage tank at 300 psi and 0°F. When a pulverizer trips, the CO_2 may be discharged to the pulverizer by either an automatic valves from

a signal panel or by an operator for manual discharge. Liquid CO_2 is discharged by a master valve, and expands to a gaseous form, to be introduced into the mill through hot air inlets plus other injection points.

A summary of the predicted pulverizer performance and recommended modifications with PRB coal is tabulated in Table A-7. The engineering order-of-magnitude capital cost estimate for these modifications including demolition is $30.5 million.

3.3.2 Boiler Evaluation

3.3.2.1 Methodology and Parameters Evaluated

The predicted effects of converting the boilers to a compliance low sulfur, Subituminous coal were developed from a number of sources. The prediction of impact on boiler performance originated with SWEC and the use of computer programs to estimate combustion constituents quantities, boiler efficiency, and slagging and fouling indices. A summary is presented in Table A-8.

The viability of conversion and the effects of coal switching on boiler operation was also estimated from information gathered in an interview with Plant Operations and experience with this boiler design.

The level of this review is considered sufficient to provide representative performance/operation information. The results later served as the basis for estimating the scope of modifications required, within the tolerance specified, to maintain the boiler MCR. This evaluation, however, does not include a rigorous analysis on the probability of reaching and maintaining full load rating, given the coal property and characteristic variations that could occur with Subituminous coals from the Powder River Basin (PRB). It is not intended to be a final scope of work, as Stone & Webster Engineering Corp. recommends a detailed evaluation and a long term test burn to demonstrate the combined impact of using this coal prior to making a commitment to it.

The focus of the evaluation centered on factors having the potential to result in derating of Unit capacity, and the equipment modifications required to prevent derating. The specific factors, are:

- Burner operation
- Furnace slagging and furnace exit gas temperature
- Convection pass fouling
- Fly ash erosion

3.3.2.2 Burner Operation

The information available indicates that the existing burners will require conversion, possibly to low NO_x type.

The likelihood of unacceptable burner operation with this coal is considered high if the burners are not replaced. The factors related to burner heat input and burner zone heat release, coal V.M. content and ash content are well within the acceptable range to effect a proper replacement.

3.3.2.3 Furnace Performance & Furnace Exit Gas Temperature

The potential for furnace slagging is the same or slightly increased from the base coals due to the lower furnace emissivity and the Med/High slagging index with the PRB coal. Given the relatively low heat release values, which is consistent with the low ash fusion temperatures of the original design coal, the number of deslaggers installed in this region and the predicted rise in FEGT, initial indications are that furnace control can still be maintained with operating changes without the need for major modifications, but, potentially resulting in a periodic 15-20 % load derate.

A consequent effect of variations in furnace performance is the impact on steam/metal temperatures and spray attemporator capacities. The available data suggests that no potential problems related to this exists if furnace conditions are maintained.

3.3.2.4 Convection Pass Fouling

The fouling potential is not increased with this coal. However, the combination of increased slagging resulting from lapses in sootblowing, changes in coal characteristics and the historical tendency to have high temperature ash corrosion on the furnace arch could increase the deposition rate in the high temperature zones of the convection pass. The recommendation is to not add retractable sootblower coverage in the zones exceeding 1500 degrees F at this time.

3.3.2.5 Fly Ash Erosion

Although fly ash erosion is not a threat to performance, it is a factor which could seriously affect long term reliability and maintenance requirements.

Erosion is a function of many parameters. However, flue gas velocity is considered a key factor as erosion rate is a 2.5 - 3 power function of this parameter. Since the maximum flue gas velocity is

predicted to be 3 % higher than with the base coal, the erosion index is the same or slightly, and the overall ash quantity is lower, tube life should not be deleteriously affected with the PRB coal.

3.3.3 Fans

3.3.3.1 Methodology and Parameters Evaluated

Forced Draft Fans

The existing forced draft fans are considered adequate for MCR operation with this coal. This, however, does not consider the possible addition of low NO_x burners, which may require additional static head.

The conversion to Powder River Basin coal results in virtually the same flow and static head requirements that exists with the current high sulfur coals being burned. This, therefore, does not jeopardize exceeding the existing fan margins.

Induced Draft Fans

Similar to the situation with the Forced Draft Fans, the flue gas flow and pressure requirements are expected to be approximately three percent higher than with the high sulfur coal. Refer Table A-8. The flue gas temperature is also expected to rise slightly, which increases the volumetric flow rate by approximately seven percent. Even with this rise, the actual fan performance indicates the fan flow, head and temperature margins are not jeopardized.

3.3.4 Electrostatic Precipitator

3.3.4.1 Methodology and Parameters Evaluated

See SubSection 1.3.4.1 of Section III, which includes the discussion related to Powder River Basin Coal.

3.3.5 Ash Handling

3.3.5.1 Methodology and Parameters Evaluated

The fly ash handling system is classified as a wet type, supplied by Allen Sherman Hoff.

The conversion to Powder River Basin coal does not pose a potential problem to reliable operation with ample water supply. The ash has significantly more calcium, which tends to make it more cementatious, however, the quantity is significantly less than with the Lynnville coal.

3.3.5.2 Ash Handling/Pond Effluent

The present system sluices the bottom and fly ash to an ash pond adjacent to the Plant. Changing the coal source will not affect the handling of the bottom ash and the effluent will not likely require additional treatment prior to discharge.

TABLE A-5
Stout 5 & 6
Comparative Pulverizer Performance and Required Modifications

	Stout 5 & 6	Stout 5 & 6	Stout 5 & 6	Stout 5 & 6
BOILER MANUFACTURER	CE	CE	CE	CE
BOILER SIZE (STEAM FLOW), LB/HR	750,000	750,000	750,000	750,000
COAL TYPE	Lynnville	ILL. BASIN	CENTRAL APP.	POWDER RIVER BASIN
BOILER EFFICIENCY, %	86.66	87.09	88.07	84.06
FIRING RATE @ MCR, LB/HR	92,626	88,151	80,854	118,370
COAL GRINDABILITY, HGI	55	54	45	53
COAL MOISTURE, %	13.00	13.00	7.00	27.20
COAL HEATING VALUE, BTU/LB	11,000	11,500	12,400	8,874
AIR HEATER TEMP., °F	588	588	588	620
EXISTING PULVERIZER SIZE, MODEL NO.	RPS - 613	RPS - 613	RPS - 613	RPS - 613
NUMBER OF PULVERIZERS EXISTING	4	4	4	4
ADJUSTED BASE CAPACITY OF PULVERIZER, LB/HR	32,208	31,877	28,000	31,828
CE CAPACITY ADJUSTMENT FOR WEAR	10.00	10.00	10.00	10.00
NUMBER OF PULVERIZERS REQUIRED ADJUSTED FOR WEAR	3.19	3.07	3.21	4.13
NEW PULVERIZER SIZE, MODEL NO	NA	NA	NA	NA
NEW BASE CAPACITY OF PULVERIZER ADJUSTED FOR 10% WEAR, LB/HR	NA	NA	NA	NA
NEW PULVERIZERS REQ. (ADJUSTED FOR WEAR)	NA	NA	NA	NA
PULVERIZER DESIGN INLET AIR TEMP. REQ. FOR ≈140F MILL OUTLET TEMP.	NA	NA	NA	NA
PULVERIZER PA FLOW PER NEW PULV.	NA	NA	NA	173,600
NEW PULVERIZER MOTOR	NA	NA	NA	YES
NEW HOT/COLD AIR DUCT	NA	NA	NA	YES
AIR TEMPERATURE RESTRICTIONS	NA	NA	NA	YES
SILO REQUIREMENTS	NA	NA	NA	YES
FEEDER REQUIREMENTS	NA	NA	NA	YES
FOUNDATIONS REQUIREMENTS	NA	NA	NA	YES
DEMOLITION REQUIREMENTS	NA	NA	NA	YES
RAW COAL PIPING	NA	NA	NA	YES
ISOLATION VALVES	NA	NA	NA	YES
CO_2 INERTING SYSTEM	NA	NA	NA	YES

	Stout 5 & 6	Stout 5 & 6	Stout 5 & 6	Stout 5 & 6
PIPING				
VALVING				
CONTROLS MODIFICATIONS	NA	NA	NA	YES
ELECTRICAL WIRING	NA	NA	NA	YES

TABLE A-6
Stout 5 & 6
Predicted Boiler Performance Summary

	Stout 5&6	Stout 5&6	Stout 5&6	Stout 5&6
Boiler Load, %	100	100	100	100
Main Steam Flow, lb/hr	750,000	750,000	750,000	750,000
COAL				
Type	Base	Ill. Basin	Central App.	PRB
Fuel HHV, BTU/lb	11,000.0	11,500.0	12,400.0	8,874.0
C, lb/lb	0.6076	0.6326	0.6819	0.5050
H2, lb/lb	0.0436	0.0435	0.0437	0.0360
O2, lb/lb	0.0545	0.0825	0.0809	0.1271
N2, lb/lb	0.0113	0.0130	0.0120	0.0068
S, lb/lb	0.0300	0.0075	0.0102	0.0040
Cl, lb/lb	0.0000	0.0000	0.0009	0.0001
H2O, lb/lb	0.1300	0.1300	0.0700	0.2720
Ash, lb/lb	0.1180	0.0900	0.1004	0.0490
Other, lb/lb	0.0000	0.0000	0.0000	0.0000
HGI	55	54	45	53
Slagging Index	N/A	Low	Low	Med.-High
Fouling Index	N/A	Low-Med	Low	Low-Med
Boiler Eff., %	86.66	87.09	88.07	84.06
Coal Flow, lb/hr	92,626	88,151	80,854	118,370
Total Air, %	121	121	121	121
Comb. Air Flow, lb/hr (no margins)	952,464	913,624	896,805	946,078
Air Temp., deg. F	588	588	588	620
Flue Gas Flow, lb/hr (wet, no margins)	1,033,697	993,762	969,468	1,058,636
Flue Gas Flow, acfm (wet, no margins)	330,482	317,628	308,096	347,600
Gas Temp., deg. F	313	313	313	325
Flue Gas Moist., %wt	5.84	5.78	5.03	7.78
Unburned Fuel, lb/lb	0.0021	0.0022	0.0024	0.0025
Total Ash Flow, lb/hr	11,127	8,129	8,311	6,099

TABLE A-7
Stout 7
Comparative Pulverizer Performance
and Required Modifications

	STOUT 7	STOUT 7	STOUT 7	STOUT 7
BOILER MANUFACTURER	CE	CE	CE	CE
BOILER SIZE (STEAM FLOW), LB/HR	3,145,200	3,145,200	3,145,200	3,145,200
COAL TYPE	Lynnville	ILL. BASIN	CENTRAL APP.	POWDER RIVER BASIN
BOILER EFFICIENCY, %	88.70	89.05	90.00	85.94
FIRING RATE @ MCR, LB/HR	371,893	357,557	328,093	480,120
COAL GRINDABILITY, HGI	55	54	45	53
COAL MOISTURE, %	13.00	13.00	7.00	27.20
COAL HEATING VALUE, BTU/LB	11,000	11,500	12,400	8,874
AIR HEATER TEMP., °F	633	633	633	650
EXISTING PULVERIZER SIZE, MODEL NO.	823 - RS	823 - RS	823 - RS	823 - RS
NUMBER OF PULVERIZERS EXISTING	5	5	5	5
ADJUSTED BASE CAPACITY OF PULVERIZER, LB/HR	91,884	90,659	77,500	90,520
CE CAPACITY ADJUSTMENT FOR WEAR	10.00	10.00	10.00	10.00
NUMBER OF PULVERIZERS REQUIRED ADJUSTED FOR WEAR	4.50	4.38	4.7	5.89
NEW PULVERIZER SIZE, MODEL NO	NA	NA	NA	883 - RS
NEW BASE CAPACITY OF PULVERIZER ADJUSTED FOR 10% WEAR, LB/HR	NA	NA	NA	NA
NEW PULVERIZERS REQ. (ADJUSTED FOR WEAR)	NA	NA	NA	4.89
PULVERIZER DESIGN INLET AIR TEMP. REQ. FOR =140F MILL OUTLET TEMP.	NA	NA	NA	NA
PULVERIZER PA FLOW PER NEW PULV.	NA	NA	NA	173,600
NEW PULVERIZER MOTOR	NA	NA	NA	YES
NEW HOT/COLD AIR DUCT	NA	NA	NA	YES
AIR TEMPERATURE RESTRICTIONS	NA	NA	NA	YES
SILO REQUIREMENTS	NA	NA	NA	YES
FEEDER REQUIREMENTS	NA	NA	NA	YES
FOUNDATIONS REQUIREMENTS	NA	NA	NA	YES
DEMOLITION REQUIREMENTS	NA	NA	NA	YES
RAW COAL PIPING	NA	NA	NA	YES
ISOLATION VALVES	NA	NA	NA	YES
CO, INERTING SYSTEM	NA	NA	NA	YES
PIPING				

	STOUT 7	STOUT 7	STOUT 7	STOUT 7
VALVING				
CONTROLS MODIFICATIONS	NA	NA	NA	YES
ELECTRICAL WIRING	NA	NA	NA	YES

TABLE A-8
Stout 7
Predicted Boiler Performance Summary

	Stout 7	Stout 7	Stout 7	Stout 7
Boiler Load, %	100	100	100	100
Main Steam Flow, lb/hr	3,145,200	3,145,200	3,145,200	3,145,200
COAL				
Type	Base	Ill. Basin	Central App.	PRB
Fuel HHV, BTU/lb	11,100.0	11,500.0	12,400.0	8,874.0
C, lb/lb	0.6130	0.6326	0.6819	0.5050
H2, lb/lb	0.0440	0.0435	0.0437	0.0360
O2, lb/lb	0.0700	0.0825	0.0809	0.1271
N2, lb/lb	0.0130	0.0130	0.0120	0.0068
S, lb/lb	0.0320	0.0075	0.0102	0.0040
Cl, lb/lb	0.0000	0.0000	0.0009	0.0001
H2O, lb/lb	0.1300	0.1300	0.0700	0.2720
Ash, lb/lb	0.0960	0.0900	0.1004	0.0490
Other, lb/lb	0.0000	0.0000	0.0000	0.0000
HGI	55	54	45	53
Slagging Index	N/A	Low	Low	Med.-High
Fouling Index	N/A	Low-Med	Low	Low-Med
Boiler Eff., %	88.70	89.05	90.00	85.94
Coal Flow, lb/hr	371,893	35 ,557	328,093	480,120
Total Air, %	120	12?	120	120
Comb. Air Flow, lb/hr (no margins)	3,800,508	3,675,209	3,609,012	3,805,667
Air Temp., deg. F	633	633	633	650
Flue Gas Flow, lb/hr (wet, no margins)	4,135,956	4,000,264	3,903,869	4,262,214
Flue Gas Flow, acfm (wet, no margins)	1,299,152	1,256,802	1,219,462	1,390,406
Gas Temp., deg. F	300	300	300	320
Flue Gas Moist., %wt	5.89	5.82	5.06	7.84
Unburned Fuel, lb/lb	0.0021	0.0022	0.0024	0.0018
Total Ash Flow, lb/hr	36,500	32,972	33,754	24,375

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Fuels

FP&L Files Appeal Of Orimulsion Verdict

Florida Power & Light Co. (FP&L) recently filed its appeal of the state's rejection of its plan to burn Orimulsion at its Manatee plant. The utility contends that Gov. Lawton Chiles and his cabinet failed to use appropriate findings of fact, to follow proper administrative procedures, and to correctly interpret and apply the state's Power Plant Siting Act (PPSA) in reaching its decision.

FP&L filed its appeal brief July 17 with the First District Court of Appeals in Tallahassee, Fla. and is seeking to overturn the 4-3 verdict issued in April by Chiles and his six-member cabinet, acting as the state's Power Plant Siting Board (CACR 4/22/96, p.3). "The court must reverse the final order and require issuance of an order consistent with the hearing officer's findings of fact as supported by competent substantial evidence, and correct interpretation and application of the Administrative Procedures Act (APA) and PPSA." An *amicus curiae* brief was filed by the Florida Industrial Power Users, the Florida Chamber of Commerce and the Florida Manufacturing and Chemical Council.

The utility contends that the board disregarded a state hearing officer's recommended order as well as a recommendation of conditional approval from the state Department of Environmental Protection (DEP). FP&L's plan was also approved by several state, regional and local groups, including the Public Service Commission, the Tampa Bay Regional Planning Commission and a state hearing officer. FP&L's plans to convert Manatee included the installation of wet scrubbers and electrostatic precipitators, which would cut SO_2 and particulate emissions by 90%. The switch would save the utility roughly $2.6 billion over 20 years. The fuel would be supplied by Bitor America Corp. under a 20-year contract signed in April 1994.

In its brief, FP&L cited three reasons that the verdict should be overturned: the board usurped the role of the hearing officer regarding the facts; refused to specify actions that the utility could take to get project approval, as required by the PPSA; and adopted policies contradicting previous judicial and DEP decisions without adequate explanation.

Being First Is Bad?

Approval of the plan would have made FP&L the first utility in the U.S. to burn Orimulsion, and some sources contend that being the first to use the fuel is an unacceptable risk. The governor did not cite any specifics in rejecting the FP&L plan, and said only that the unquantifiable risks of burning the fuel outweighed any savings to FP&L customers. "Contrary to an express statutory mandate, the siting board refused to specify actions which would secure its approval for the application," the utility stated. According to FP&L, the board also refused to consider appropriate mitigation alternatives "for the adverse environmental and human impacts that were its stated basis for the denial of the project."

For example, said FP&L, the siting board could have adopted a condition of certification restricting NO_x emissions to historical levels, resolving concerns expressed by some groups over possible emissions increases. FP&L has agreed to several conditions regarding the fuel's transport and use. While NO_x emissions would increase as a result of the switch (FP&L expects to increase the plant's capacity factor), its NO_x emissions rate of 0.3 lb. NO_x/mmBtu would be in compliance with state, local and federal standards.

The DEP is not appearing in the appeal in either side of the issue, a source there said. A source in the state attorney general's office called the FP&L brief "interesting," and noted that it "raised some good points." Reply briefs are due today.

IPL Considering Test Of Western Coal At Stout

With Phase II requirements and deregulation's cost-cutting mandates in mind, Indianapolis Power & Light Co. (IPL) is considering test-burning low-sulfur western coal at its Stout generating station this fall. Where the coal will come from hasn't yet been decided, IPL said.

IPL has purchased Indiana coal exclusively since 1990, and three units at Stout currently burn only Indiana coal. Units 5-7 are Phase I-affected, and burn low-sulfur Indiana coal. In 1995, Stout received roughly 1.3 million tons of coal (11,255 Btu/lb., 2.6 lbs. SO_2/mmBtu) in 1995 at an average delivered price of 113.45¢/mmBtu ($25.54/ton).

The utility declined to say what western coal it is looking at, and industry sources differed as to the likely source region. Several predicted that the persistently low prices of PRB coal would win out, while a coal broker in the Midwest said similarities in moisture content and heat value between Colorado/Utah and Indiana coal would favor bituminous Colorado/Utah coals (PRB coals are subbituminous).

Transportation costs alone will likely render PRB coals infeasible as a long-term supply option, insisted a skeptical PRB producer. "Those plants are practically sitting in the middle of the coal fields," he said. "They can truck the coal there." A Colorado/Utah producer disagreed. "I think PRB coal will be very competitive even with a three-line haul, even in competition with trucked Illinois Basin coal," he said. "Just look at the numbers the PRB is getting — unless all of a sudden those [Indiana] mines decide to lower prices, which in the past they haven't had the propensity to do."

IPL-P-00379

Rebuttal Verified Statement of Michael J. Ward

My name is Michael J. Ward. I am currently Executive Vice President-Finance and Chief Financial Officer of CSX Transportation, Inc. (CSX). with headquarters in Jacksonville. Florida.

I have a Bachelor of Science degree from the University of Maryland and a Master of Business Administration degree from the Harvard Business School. I have been employed by CSXT since 1977, when I joined the Baltimore and Ohio Railroad Company (B&O) and the Chesapeake and Ohio Railway Company (C&O), predecessor railroads of CSX that were then commonly referred to as Chessie System Railroads. Although I was initially employed as a Research Analyst in the Finance Department, I have spent the preponderance of my career in the Coal Department, including positions as Vice President of Coal Marketing in Jacksonville, Florida, and General Manager of the C&O Business Unit in Huntington, West Virginia.

As Vice President of Coal Marketing, I was responsible for the pricing and marketing of coal, coke and iron ore transportation. Coal, coke and iron ore the most important commodities transported by CSX in terms of revenue. In 1996, coal, coke and iron ore revenues for CSX totalled $1.6 billion of its $4.8 billion commodity revenues. This represents 33% of CSX's total commodity revenue. In terms of coal train volume, that amounts to over 300 loaded coal trains per day, or 8 million carloads per year. One of every three cars CSX carries is loaded with coal produced from mines in Appalachia, the Midwest, and the South.

The C&O Business Unit is a semi-autonomous unit of CSX, and consists of 1,900 route miles of railroad, headquartered in Huntington, W.V. Although primarily focused on coal transportation, the business unit is also responsible for the operation of all trains in its territory, including merchandise and passenger trains. As General Manager, I was responsible for all train operations, engineering, mechanical, sales, marketing and finance functions.

I returned to the CSX Finance Department in 1995 as Senior Vice President, and assumed my present title in 1996. My present responsibilities include Financial Planning, Cost & Economic Analyses, Treasury, Accounting, Budgets, Joint Facilities, Facilities Administration, Administrative Services, and related duties.

I am also the leader of CSX's Integration Team, which was formed in May 1997 to facilitate the integration of the Conrail assets that are allocated for use by CSX into the existing CSX system. The vast majority of my time is now devoted to the success of this crucial project. I have been asked to present this verified statement to describe the implementation program that CSX expects to follow.

SUMMARY

CSX and the Norfolk Southern Railway (NS) are preparing to integrate the lines and assets of Conrail into our respective rail systems if the Application is approved by the Board. We are also preparing to welcome the current Conrail employees that will be joining us. This task is complex and requires a great deal of thoughtful planning and implementation.

This statement describes our current planning process, and our flexibility to make refinements to those plans as conditions change during the integration process.

LESSONS LEARNED

Based on our own experience and discussions that we have had with Conrail, NS and other companies, both in and out of the railroad industry, that have experienced mergers or acquisitions in recent years, CSX has identified some "lessons learned" that we intend to follow in this Transaction. Among the lessons are:

- Safety is Paramount. The integration of the Conrail lines and assets allocated into the CSX system must be done safety. This message must be constantly conveyed during this entire integration process to both CSX and Conrail employees.
- Integration with Deliberation. This can be accomplished by using a detailed planing process that integrates the necessary changes in a careful and deliberate manner. Effective integration over the long term takes precedence over short term gains.
- Welcome Conrail's Employees and their Expertise. CSX will welcome and value the Conrail employees that are to become CSX employees. Although CSX has carefully studied the Conrail property that will be allocated, and we have had extensive meetings with Conrail employees, we do not have their "hands on" experience of operating it. However, the Conrail employees do,

and we plan to embrace their expertise. This message will be emphasized to the Conrail employees during the integration process.

- Sufficient Resources. CSX believes that some prior mergers have tended to underestimate the number of people and assets that are required to implement the merger. CSX will ensure that we have sufficient people and locomotives to operate all our trains on Day One. With experience, these numbers may be adjusted, but any adjustments will be based upon market conditions, traffic demands and safety.

- Maintain a Staff Command Center. Beginning on Day One and continuing throughout the integration process, we will maintain a staff command center that is manned by business and technology experts. Problems are to be quickly referred to the center. Small and medium problems can be quickly addressed and resolved at this level. Larger problems can be analyzed and forwarded to service management in a timely manner for resolution.

- Ensure the Essential Prerequisites. No amount of planning or management can lead to a successful integration unless certain items have been addressed prior to the start of combined operations. In the case of the Conrail allocation, CSX believes that the following points must be addressed prior to our beginning to operate the Conrail properties that are to be allocated to us:

    - Sufficient Labor Agreements are in Place: Implementing agreements with certain unions are considered essential for a smooth implementation. These agreements are necessary to allow us to make the various changes outlined in the Application, and to split the existing

Conrail workforce between CSX, NS and the Shared Asset Areas of Conrail.

- Sufficient Personnel are Available: This includes both management and agreement-covered employees as are necessary for CSX operations on the Conrail lines to be allocated to CSX and for CSX operations in the Shared Asset Areas.

- Important Capital Improvements are Completed: Various capital projects have been identified by CSX as important to the efficient operation of the integrated CSX and Conrail territories. These improvements should be substantially completed prior to implementation.

- Information Technology is Installed: The merging of information will be essential. Maintaining our principle of keeping change to a minimum, the information technology must coincide with our implementation strategies for all other integration teams.

- Sufficient Locomotives are available and distributed: The operating plan will continue to be refined as additional commercial data becomes available. This operating plan continues to refine the resource requirements necessary, including locomotives.

- Employees are properly trained: The necessary resources must also be trained in new systems and procedures. A dedicated team is charged with determining and prioritizing all training requirements. Until these requirements are met, implementation will not proceed.

- Necessary Issues are Coordinated with NS: NS and CSX meet on a regular basis to make sure our implementation plans are compatible. Both parties understand how critical this issue is for a successful integration.

As a result, CSX is approaching the portion of Conrail which it will operate in a deliberate and methodical manner. Safety is of prime importance and will not be compromised. Conrail's routes, equipment and other assets will be integrated into the CSX system in as seamless and safe a manner as possible to avoid service interruptions to any of

our customers, i.e., both those we currently serve and those CSX will serve once the Conrail transaction has been implemented. Although CSX will begin to operate the allocated Conrail lines on Day One, we recognize that some portions of the implementation will have to be done in stages, particularly with regard to the new operating plan and field transportation systems. CSX clearly intends to retain Conrail's expertise and, if anything, we will allow more than sufficient time for training. Finally, CSX will continue to communicate with all parties, including our employees and customers and public officials, to ensure that CSX's goals and priorities are understood and to receive comments from all interested parties that can assist us in doing an even better job of integrating our systems.

TEAM STRUCTURE

Very early in the process, CSX recognized the need to form a dedicated team to do implementation planning to facilitate the integration of the allocated Conrail assets into the CSX system. Therefore, we formed a team whose sole task was to undertake the implementation planning process. At the outset, it was understood that safety was to be an overriding principle of the process and that this principle would be emphasized on a continuing basis. Our next step was to interview approximately 50 key members of CSX's senior management to ascertain what specific areas or functions should be included in the implementation planning process. These interviews produced a list of over 250 items. These items were then categorized into three groups: 1) tasks which were essential for the long-term successful integration of the allocated portion of Conrail into CSX; 2) tasks which would require a long lead time and 3) tasks that would facilitate the implementation. A

further breakdown of these tasks produced the infrastructure of teams and tasks that we are currently using to complete the implementation planning process.

There are currently 21 core teams involved in the integration planning process. The names of these teams, and the CSX executive in charge of each team, are set forth below:

	Team Name	Team Leader
1)	Day One Operations	Gerry Gates
2)	Safety	Frank Pursley
3)	Headquarters Integration	Chuck Wodehouse
4)	Technology	John Andrews
5)	Commercial	Les Passa
6)	Labor	Ken Peifer
7)	Capital Planning	Tom Schmidt
8)	Asset Division	Dan Miller
9)	Human Resources	Sally Basso
10)	Conveyances/Closing	Mike Giftos
11)	Pro Forma	Fred Favorite
12)	Communications	Marty Fiorentino
13)	Intermodal	Les Passa
14)	Inventory	Everett Eddy
15)	Information Process	Doug Maxwell
16)	Monitoring On-going Conrail Operations	Mike Ward
17)	Corporate Governance	Mike Ward
18)	Concession Process	Bill Hart
19)	Training	Joel Warner
20)	Implementation Planning	Bob Haulter
21)	Future Teams (As Needed)	Mike Ward

Many of these teams have numerous sub-teams, each of which is focused on specific tasks. To make sure all key tasks were included in the process, we matched our team structure against the normal business processes needed to run our railroad. We also matched our teams against our organization structure to make sure each department was represented.

By looking at our integration planning process from both of these perspectives, we feel very comfortable that all key areas are being addressed.

As noted above, a senior executive of the organization has been assigned the leadership function of each team. In most cases, this team leadership role has temporarily become the primary focus of that individual's job. For key teams, a full-time coordinator has been assigned to the team leader to assist in managing the team. These coordinators have been temporarily removed from their normal assignments. They all have many years of experience with CSX.

We have also organized a project management office, from which we manage and organize the day-to-day activities of the integration project. This office is staffed with a full-time Assistant Vice President-Integration Planning. The role of this office is to ensure deadlines are met, project management principles are followed, internal trade-off decisions are made, and that decisions made during the planning process are fully disseminated and understood by each team.

Finally, we have a steering committee composed of myself and all Team Leaders. The role of the steering committee is to set guidelines and policy, resolve questions that arise between various segments of our team, make appropriate decisions as required, and ensure timelines are met. This steering committee meets on a regular basis, averaging approximately two full days per week.

IMPLEMENTATION PLANNING GENERAL PROCESS

Each team has gone through, and will continue to follow, the same general planning process. In early June 1997, the original teams were formed. These teams were selected based either on the amount of lead time necessary to complete the implementation process or due to their extreme criticality to the successful integration process.

The first stage in the process for each team was to define their scope and determine their tasks. The primary commitment to safety was again emphasized to each team at this state. As an example of this "define and determine" stage, the Day One Team was charged to focus on operations for the first 90 days after Day One, or what might be viewed as the critical initial transition process. After the scope and team structure was completed, each team then spent approximately 60 days dissecting and thoroughly understanding Conrail operations in their assigned area. They spent extensive periods of time with key Conrail employees to enable them to understand the operational, administrative, and technical aspects of Conrail's organization. This data gathering process proved to be extremely helpful.

After comparing the current operations of CSX and Conrail, the teams completed a "gap analysis." The gap analysis identified areas where processes are performed differently on the two properties. From this analysis, best practices were identified. Also, this analysis gave us our first thoughts on where training might be needed during the transition process. Even if these best practices are not implemented immediately, we have a database for future reference.

Each team then undertook a "visioning process." During this step, the team identified the desired state of operations post-implementation and dates were identified for reaching the

desired state. The next step was to put together preliminary detailed implementation plans. This is where project management proved very beneficial. We then prioritized the tasks into categories in order of the extent to which the tasks were essential.

The last few months have been spent making sure the individual team plans are compatible within the framework of the overall project. The steering committee reviews the plans for each team, and makes the necessary trade-off decisions to ensure that we achieve a smooth and transparent implementation.

The next major step is to finalize detailed transition plans. In this stage, timelines are firmly established, resource and training needs are finalized, and the implementation process formally begins. During the spring of 1998, we will move towards the building of contingency plans covering key areas where technology, labor or other items may impact our original plans. These contingency plans can then be implemented as required.

RECOGNITION OF THE TASK

CSX's management has long recognized that the integration of Conrail will be the most complex transaction in which our company has participated in recent times. The operations of the Conrail system have to be divided between CSX and the Norfolk Southern Railway (NS). At the same time, Conrail will remain as the operator of certain rail services in the Shared Asset Areas. This approach makes this transaction unique, but one that is fully within the capabilities of CSX (and NS) to handle.

CSX is no stranger to mergers or combinations of railroads. Indeed, CSX was formed in 1986 by the combination of the Chessie System and Seaboard System railroads,

which were themselves the products of a series of successful mergers and combinations. We are also well aware that no amount of planning can guarantee an absolutely safe and smooth integration process. Problems may arise; the problems experienced by UP/SP are only the most recent though clearly they are quite severe. CSX and NS collectively are confident in our ability to successfully allocate the Conrail system between us in a safe and efficient manner and to avoid the problems that were experienced in UP/SP.

For example, there are significant differences between the UP/SP merger and the allocation of Conrail assets. Some of these differences are as follows:

Conrail is very financially sound. For the period from 1990 through 1996, Conrail has maintained a Standard & Poor's credit rating of A. An A rating indicates that that company has a strong capacity to pay interest and repay principal on its outstanding debt. The only U.S. Class I railroad with a higher credit rating than Conrail at the time of this acquisition was NSR. By contrast, during the period from 1990 through 1995 the Standard & Poor's credit rating for SP fluctuated between B+ and BB+. Companies that have ratings of BB or less are generally regarded by Standard & Poor's as having predominately speculative characteristics with respect to capacity to pay interest and repay principal on outstanding debt.

To further contrast the financial strengths of Conrail versus SP, we need look no further than the operating ratios. During the three year period 1994 to 1996, Conrail's operating ratios were 83.6%, 87.6%, and 83.7%. Conversely, SP's were 92.4%, 100.7% and 98.4%. These figures are based on R-1 Schedule 210 data.

In terms of revenue adequacy, Conrail was 8% in 1994, 6.8% in 1995, and 8.4% in 1996. The SP was 7.2% in 1994 and 3% in 1995. The 1996 data is not available due to SP's 1996 merger. By almost any financial measure, Conrail was more financially sound at the time of the acquisition than SP was at the time of its merger with UP.

2. The portion of the Conrail area to be operated by CSX is smaller than SP. Just prior to the UP/SP merger, SP operated 14,404 miles of railroad stretching from Oregon to Louisiana and from California to Illinois. By contrast, the size of Conrail assets to be operated by CSX consists of 4,150 miles of railroad (excluding the Shared Asset Areas), predominately in states in which CSXT already operates. The integration of the allocated portion of Conrail to be operated by CSX will not be as large a physical task as UP faced in merging SP into its system.

3. This is an allocation of Conrail, not a rationalization. Unlike many mergers, there is very little overlapping of the CSX lines and the Conrail lines that are being operated by us. This is a classic "end-to-end" combination. Indeed, of the 4,150 miles of Conrail that are specifically being operated by CSX, only 29 miles are scheduled for abandonment.

THE INTERIM PERIOD: AN OPPORTUNITY TO CONFIRM AND ADJUST

One unique feature of the Conrail acquisition is the interim time period between the date that control actually passes from the voting trustee to both CSX and NS (the Control Date) and the day that the various Conrail lines and assets are allocated and separately operated by CSX and NS as part of their respective rail systems (Day One).

During the period between the Control Date and Day One, Conrail will continue to be operated as a unitary railroad. While the exact length of this interim period is uncertain, it is clear that CSX and NS will continue to have an opportunity to directly observe the continuing Conrail operations and to confirm, adjust, or fine tune the integration plan and the scheduling that have previously been made.

CSX has had numerous meetings and contacts with our counterparts at NS to coordinate our respective implementation planning efforts, particularly with respect to planned operations in the Shared Asset Areas. This coordination will continue during this interim period and may likely increase.

CSX has also had extensive meetings and contact with our counterparts at Conrail from July 1997 to the present. The purpose of these contacts was not to exercise or control any decision making of Conrail. To the contrary, the purpose was to observe and understand the current Conrail methods and procedures for operating their railroad. CSX values the expertise of the Conrail employees and recognizes that they have much to offer. As our integration plan has been developed, we have continued to meet with Conrail employees to gain their feedback regarding the CSX plan. In order to implement the plan in a safe manner, CSX recognizes the importance of "buy in" and acceptance of the plan by the Conrail employees who will continue to operate the Conrail assets that are to be allocated. The presence of this interim period, and our continuing contacts with Conrail employees, will provide us with the opportunity, if any of our assumptions are inaccurate, to make the necessary corrections as soon as possible.

PASSENGER SERVICE

Passenger service is such a critical element of a successful integration program, that it is being given special attention by Paul Reistrup, who is currently Vice President-Passenger Integration for CSX. No one is better qualified for this assignment.

Paul started his railroad career with the B&O in 1957 and held numerous freight and passenger operating positions, culminating as Director of Passenger Services for several years. He served from 1967 through 1975 with the Illinois Central Gulf Railroad at the vice presidential level for freight and passenger operations, and from 1975 through 1978 as President of Amtrak. Since that time, and until his return to CSX earlier this year as Vice President-Passenger Integration, Paul held positions working for other railroads and a railroad consulting firm.

In his capacity as Vice President-Passenger Integration, Paul has conducted numerous meetings with officials of Amtrak and the various commuter agencies which operate passenger trains on the Conrail lines to be allocated to CSXT and has filed as verified statement in this Rebuttal. Those meetings have proven to be beneficial, even where agreement has not yet been reached on all issues. It is my understanding that CSX will honor all existing agreements with respect to passenger service on the Conrail lines that are to be operated by CSX, and will continue to work with the passenger agencies to ensure that the Transaction will benefit the users of both freight and passenger services.

As far as the future is concerned, I understand that any requested changes to passenger service will be considered on a case-by-case basis in accordance with existing

contractual obligations. Due consideration will be given to safety, scheduling, and the need for coordination with CSX freight operations.

FUNCTIONS OF KEY INTEGRATION TEAMS

Set forth below is a description of the role and mission of the key integration teams, along with a brief description of team leader's experience.

1. Day One Operations. CSX recognized the importance of having someone with personal knowledge of current Conrail operations to head the Day One Team. Gerry Gates was selected for this assignment and joined CSX earlier this year as Vice President-Consolidation from his prior position as Conrail's Vice President-Customer Support. He had been with Conrail since 1976, and held increasing senior positions in the engineering, transportation and mechanical departments in Pennsylvania, New Jersey, Ohio, New York and Indiana. The knowledge of Mr. Gates regarding Conrail, plus the knowledge of the other team members regarding CSX, gives us a complete picture of the Day One task that we are facing.

This team has the broadly-defined mission of planning and implementing the actions necessary to prepare for the first day of railroad operations for the enlarged CSX system, and the Shared Asset Areas, and to ensure that present high levels of operations and safety are maintained or improved. The team's core activities include: a) developing all necessary safety-related plans, including comprehensive operating procedures and rules, a training and hiring plan for train crews and dispatchers, and integrated safety rules; b) making sure the necessary infrastructure is in place to support the required operations; c) ensuring that

properly trained employees are available to operate on Day One; d) establishing an operations planning function whose task is to develop an operating plan for Day One; e) creating a customer support team which must be ready to address all customers needs in a seamless fashion from the first day of operations; f) putting in place a team focused on the Chicago area; g) creating a team to work extensively with NSR to address operations in the Shared Asset Areas; and, h) ensuring that a technology team is available to provide the proper support for operations.

On Day One we intend to maintain operations as closely as possible as to how they are done today. The transition process will be done slowly. This is in keeping with CSX's primary goals of protecting the existing rail services and providing a safe environment for our new operating employees and our customers. Implementation of new operating systems will be done in a phased approach, ensuring that one geographical area is sufficiently trained before embarking on another geographical area. A sufficient number of trainers will be available in each area. While this operating system transition is underway, network operations will remain the same as they are today. We will maintain the current dispatching organization and system, the current crew calling network, and the operations control center in Philadelphia (referred to as the "blue room"). These network operations functions will not be consolidated into CSX until the field operating systems transition is complete. We will also seek to minimize the changes to the operating plan during this transition process. The safety program for both properties has been outlined in numerous other documents, but again the central theme will be to keep change to a minimum.

We believe one of the key ingredients necessary for a successful transition is the availability of key resources. One of the sub-teams to Day One Operations is focused solely on the task of personnel. We have undertaken extensive analysis to determine the proper number of train and engine personnel required during the transition process. In order to maintain safety, CSX plans to have a sufficient number of employees, including trainers, available on Day One. CSX anticipates that additional engineers, conductors, and trainmen will enter training early in 1998 so that necessary lead times will be met. This hiring and training is distinct from anticipated post-control hiring and training of current Conrail employees, and is in addition to the normal hiring that would be necessary to offset normal attrition. A sufficient number of employees will be available to serve as pilots to familiarize train crews with new territories. By this means, CSX will assure protection from problems associated with unreasonable employee fatigue and stress. In addition, CSX and NS will discuss with Conrail, to the extent permitted by law, mechanisms to ensure an appropriate pool of train and engine service talent. CSX is making every effort to retain experienced Conrail field operating personnel. By retaining a substantial number of experienced Conrail field personnel, CSX will reduce the burden of training replacements and will retain all of the benefits associated with substantial railroading experience.

The same principle holds true with field management personnel. It is the intent of CSXT to retain in place the vast majority of all field supervisors. This serves many purposes. First, it maintains the operating experience on a specific territory. Second, it reduces the amount of change on operating personnel; they will still be supervised by the

same manager. Third, CSX believes that field supervisors on Conrail are generally a very talented group and wishes to retain this talent.

2. Safety. The Safety team is headed by Frank Pursley, who has worked continually for CSX or its predecessors since 1970. His entire career has been in the field of railroad operations, from Assistant Trainmaster through Superintendent, Vice-President-Transportation to his current position of Vice President-Operations Support and Safety Integration Officer. His responsibilities include operating rules and compliance, derailment investigation, hazardous materials emergency response, crew safety training, environmental protection programs and operations planning. As such, he was the natural choice to lead the Safety team.

Safety is the first of our guiding principles in the Conrail integration process. While it is not my intent to revisit the details of the Safety Implementation Plan that was recently filed by CSX with the Board or Mr. Pursley's verified statement in this Rebuttal, I do wish to emphasize the CSX commitment to the safety of our employees, our customers, and the communities in which we operate in implementing this Integration Plan.

This commitment to safety is apparent in several areas. Our employees will be properly trained. There is only the "safe" way, not a CSX or Conrail way. We will have more than a sufficient number of employees available to operate our system in a safe manner. The best practices of CSX and Conrail will be combined, but only after we are sure that the integration process is proceeding in a successful manner. Until then, we will have the opportunity to study the best safety practices of both CSX and Conrail and to select the best ones for future operations.

It is our intent that the safety rules and training procedures of CSX and Conrail will continue separately through 1998. Because of the operational changes that will occur on Day One (and will continue thereafter), we feel that maintaining separate rules and procedures will assist the implementation of the Day One changes. During this initial period, the importance of compliance with the existing safety rules will be emphasized. In addition, CSX will continue our current review of the operating and safety rules of both CSX and Conrail, with the goal of identifying the best safety practices of both railroads and then combining those practices into one set of safety rules. We plan to implement the combined rules during 1999, but only after proper training of all affected employees has been completed.

3. Headquarters. Chuck Wodehouse is Vice President-Controller of CSX and is in charge of the Headquarters Team. He has been employed by CSX or an affiliated company since 1979 in the fields of accounting, audit and expenditures. He formerly worked the accounting firm of Deloitte Haskins & Sells and is a Certified Public Accountant.

As with the other sections of the Integration Plan, the goal of the Headquarters team is to integrate designated Conrail headquarters personnel into the CSX headquarters, and to provide continued support on Day One to other CSX departments in a manner that is transparent to our customers. While our longer term plans call for centralizing the headquarters operating functions in the Jacksonville, FL area, except for Shared Asset Areas functions, this phase-in will be gradual. On Day One, Conrail headquarters operating support will to continue function at Philadelphia, Pittsburgh and Dearborn, but as part of the CSX headquarters system.

The headquarters section is divided into eleven (11) areas: Finance, Technology, Operations, Intermodal, Customer Service, Sales & Marketing, Supplies & Service Management, Employee Relations, Law, and Non-Employee Expenses. Each section has studied the current Conrail operations and procedures in their area and has developed detailed plans for Conrail integration.

The first phase of the Headquarters Integration will involve centralizing the non-operating functions, and the second stage will involve centralizing the Headquarters operations support areas. Necessary training of affected employees will be completed prior to both stages.

4. Technology. John Andrews has spent his career in the information technology field. Beginning as a Repair Technician with GTE in 1972, he remained with that company until 1993, except a brief period with a consulting firm. John came to CSX Transportation in 1993 as Vice President-Application Systems and is currently Chief Information Officer for CSX. His primary duties in this capacity include the development of new technology systems and the operation of a central data processing center.

The scope of this team is divided into two phases. Phase I includes all system and infrastructure work required to enable planned Day One operations. This includes the general and administrative functions, customer interaction functions, locomotive/asset management functions and dispatch compatibility. Phase II includes all systems and infrastructure work required to enable the phased transition of rail yard and terminal operations.

This team comprises 10 sub-teams: Communications, Data Center Operations, Data Resource Management, Revenue Management, Train Customer Operations, G&A Intermodal, Train Maintenance, Train Control/Signals, and Dispatch. Each of these teams is closely aligned with its respective business partner to ensure that technology requirements match the long-term and transition needs of the various departments. As a result of these duties, the Technology team is also greatly involved with project management.

Within the auspices of this team, the company undertook a tedious, but necessary, process we called the "day in the life." For 4 distinct areas -- train, car, employee and customer -- we brought together a team of over 30 knowledgeable people from various departments to discuss information requirements. These teams discussed what data was necessary to track each of these key resources, how the data flowed through our information systems, and what information would be available during each phase of the transition. These sessions, which sometimes lasted three days, proved to be very beneficial.

CSX has compared the CSX and Conrail information technology systems from the standpoint of a long term integration or substitution. We have concluded that the Conrail system is based upon an older technology. Appropriate "bridges" will be in place on Day One between the CSX and Conrail computer systems to allow for use and direction of the Conrail computer system by CSX. Gradually, the Conrail computer system will be retired and CSX technology will be utilized on the entire system. A sufficient workforce will be available to provide maintenance and repair for the Conrail system until it is retired and to bring it into compliance with year 2000 requirements if it is still in operation as of that date.

5. Commercial. The Commercial team is led by Les Passa. He is currently President and Chief Executive Officer of CSX Intermodal, Inc. Mr. Passa joined CSX in June of this year, as Vice President, Commercial Integration, having spent most of the last ten years with Conrail in a variety of positions, including intermodal planning, customer service, automotive and logistics and corporate planning. CSXT needed someone with extensive Conrail commercial experience to head this team in order to understand and address any differences in CSXT and Conrail commercial operations that may arise during the integration process.

As noted previously, it is CSX's goal to accomplish the integration of Conrail's operations into the CSX system in a manner that makes the process as transparent as possible to Conrail's customers. Because most of Conrail's customers are currently CSX customers, we will already have in place a "customer/server" relationship. Our job will be to demonstrate to our customers that the expanded CSX network is the best provider of their carload and intermodal transportation needs. We plan to do this by retaining the existing Conrail business that is located on lines that are used by us and to grow that business from Day One by competing aggressively with other transportation providers, especially trucks.

For Day One operation, CSX bills of lading, waybills and billing will be in place on the allocated Conrail lines and will be under the control of CSX. Conrail's public price lists, tariffs and exempt pricing circular will remain in effect until Day One. Beginning on Day One, CSX will gradually begin to replace these Conrail publications with those issued by CSX. The end result will be CSX public price documents that will include existing CSX lines and Conrail lines that are operated by us.

Communication with the customers is essential to a smooth integration process. Our customers will be informed when the current CSX commercial structure will be expanded to include the allocated Conrail lines. We will advise them of the expected levels of CSXT service that will be available and emphasize the expanded opportunities that are available to them by using the expanded CSX network.

6. Labor. Ken Peifer heads the Labor team. He began his railroad career with the Chessie System railroads in 1965. His experience includes employment with the Western Pacific, the Rock Island and the Southern Pacific railroads. He returned to CSX as Assistant Vice President-Labor Relations, and is currently Vice President-Labor Relations of CSX. His duties include the negotiation of national labor agreements, the establishment of overall labor strategy, the oversight of the arbitration of significant labor issues and guarantee payments. As such, he is the senior CSX official in the field of labor relations and has filed a joint verified statement with Mr. Robert Spenski in this Rebuttal.

A prerequisite to Day One Operation is the negotiation and execution of necessary implementing agreements with the involved labor organizations. Because the Conrail workforce initially must be allocated into comparable jobs on CSX, NS and Conrail (for its Shared Asset Areas and the System Support Operations facilities), where it is necessary to effect the transaction the parties will jointly negotiate (and if no agreement is reached, will jointly arbitrate to reach an agreement) an implementing agreement to which they will be parties with the representatives for each class or craft on the three rail systems satisfying all labor conditions for this transaction.

7. Capital Planning. The leader of the Capital Planning Team requires someone with both "field" experience as well as planning abilities. Tom Schmidt was chosen for this assignment and will also retain his position as Vice President-Advanced Rail Signaling and Dispatch Technology for CSX. Tom has worked continuously in the railroad industry since 1969, and has been with CSX since 1985. He has an extensive background in engineering, service design, quality management and network operations.

This team is charged with the responsibility of coordinating the capital planning, budgeting and execution of capital improvement projects that are related to the integration of the Conrail lines that are to be operated by CSX. This involves approximately 52 projects with estimated expenditures of approximately $488 million. Some projects are being implemented now, such as the double-tracking of the former B&O line and the construction of various switch connections between CSX and Conrail tracks at numerous locations. Train operations over these connections are subject to the approval of the Transaction by the Board. Various projects in the Chicago area, such as the 59th Street intermodal yard, are also under construction.

8. Asset Division. The Asset Division team is charged with dividing the Conrail operating equipment for use by CSX and NS. Dave Miller, Assistant Vice President Engineering and Mechanical Maintenance Programming and Logistics for CSX, is the team leader. He has been with CSX since 1983, serving in various capacities in purchasing, mechanical operations and planning prior to assuming his present duties.

Conrail's operating equipment will be divided into three classes: 1) locomotives; 2) cars and 3) other equipment, such as maintenance of way equipment and motor vehicles.

Each class is divided into subclasses based, for example, upon the age, status (owned or leased) and condition. There will then be an allocation of each subclass of the equipment on the percentage of Conrail stock ownership, i.e., 42% CSX and 58% NS. An arbitration procedure will be used to resolve any disputes. Once the allocation process has been completed, various pieces of equipment may be swapped between CSX and NS, depending upon their own needs and requirements.

9. Human Resources. Sally Basso is in charge of the Human Resources Team and currently serves as Vice President-Human Resources of CSX. She has been with CSX or its predecessor railroads since 1978, servicing in a variety of positions in human resources, and compensation and benefits.

CSX places a great emphasis on issues that face our employees, and is sensitive to their needs. The task of this team is to ensure that the Conrail employees that begin working for CSX on Day One are highly skilled and motivated to perform their jobs.

To accomplish this task, coordination with NS will be required, and a fair method of employee selection must be developed in accordance with applicable agreements. The team will also be responsible for the management of the Conrail benefit programs that cover all former Conrail employees; i.e., those that transfer to CSX, those that are retired and those that are separated as a result of the transition process.

10. Conveyances/Closings. The Conveyances and Closing team is headed by Mike Giftos, Senior Vice President and General Counsel of CSX Transportation, Inc. Mike joined the Chessie System Railroad upon his graduation from the University of Maryland

School of Law and has been employed by CSX or one of its affiliated companies since that time and is the senior legal officer of CSX.

The Conveyances and Closing Team is split into the following 5 sub-teams: Real Estate, Closing Process, Contract Allocation, FELA Claims and Lawsuits and Liabilities. Each sub-team has its own leader, and the sub-teams are in various stages of development. This team is charged with the responsibility of drafting and executing the necessary documents to separate the rights and obligations of Conrail between CSX and NS, or their designees, as described in the Transaction Agreement on a timely basis.

11. Pro Forma. Fred Favorite is the leader of the Pro-Forma Team. He has worked continuously for CSX or one of its affiliated companies since 1980, and is currently Vice President-Planning and Analysis of CSX. He has held positions in areas of finance, costs and budgets, asset management and economic planning.

This team is responsible for preparing "management-based" Pro-Forma financial reports that reflect the integrated operations of CSX with the Conrail lines and assets that are to be allocated for use by CSX. The reports will include the following: an income statement, balance sheet, cash flow statement, ROIC a projection of capital spending and key operating statistics. Modifications will be made to the reports as required by changes in the key assumptions, and the team will share its findings with other teams.

12. Communications. CSX will be at a disadvantage if the benefits that we foresee resulting from the approval of the Transaction are not properly communicated to our employees, our customers, governmental agencies and the general public. To insure that these points are properly made, Marty Fiorentino, who currently services as Vice President-

Corporate Communications and Public Affairs, was selected as the leader of the Communications Team.

The team will concentrate on communicating the benefits of the Transaction to: 1) CSX and Conrail employees, with a special emphasis on introducing the Conrail employees to CSX and our corporate goals; 2) to our customers, both existing and those now using Conrail; 3) to the communities that we now serve and will serve if the Application is granted and 4) the media and public officials. The team will also report the comments of each of these groups to CSX. These comments are instructive and will be useful in molding our integration process.

13. Intermodal. The integration of that portion of the Conrail intermodal network that is allocated for use by CSX into our enlarged intermodal operations is a crucial element in the success of the Application, and is headed by Mr. Passa. The Intermodal Team will examine the operations of our affiliated intermodal company, CSX Intermodal Inc. (CSXI), and review areas including finance, operations, human resources, sales & marketing and labor. CSXI is also expected to coordinate and review its own planning with the appropriate Integration Team. The various sub-teams include: Finance, Operations, Commercial, and Other Support Functions. Each of these sub-teams are in the process of developing detailed project plans based upon the control of the Council lines to be allocated to CSX.

14. Inventory. The Inventory Team is responsible for monitoring the levels of Conrail inventory items and planning an equitable allocation of those items with NS on or after Day One. Everett Eddy heads this team. He is currently Director, Mechanical Inventory for CSX and has been employed by CSX or is predecessor railroads since 1967.

He has held numerous positions in car distribution, inventory control and mechanical inventory.

The function of this team is similar to that of the Asset Division Team. A methodology for a split of Conrails' inventory on a 42/58 percentage basis must be developed and agreed to with NS. Specifications must be defined and a monitoring system developed for use prior to Day One. Additionally, the team must coordinate with other CSX teams to be sure that sufficient inventory levels are maintained by Conrail on Day One.

15. Information Processes. The Information Processes Team is headed by Doug Maxwell, General Counsel of CSX. Doug joined the CSX Law Department in 1990. He graduated from Harvard Law School in 1975 and spent the next 15 years in the private practice of law before coming to CSX.

This team acts as CSX's single point of contact for all appropriate information requests to Conrail while the Application is pending before the Board. The team is mindful of the prohibitions of requests for confidential information, particularly in commercial areas, and for requests that might reflect premature control of Conrail. The team also coordinates requests with NS in order to avoid duplication and to reduce the administrative time of Conrail in replying to the requests.

16. Monitoring On-going Conrail Operations. I am the leader of this team, the primary function of which is to accurately monitor the performance of Conrail in a lawful manner from the date that the Application was filed, i.e., July 23, 1997, until Day One. This monitoring must necessarily be done in coordination with NS and in a manner that does not unduly burden Conrail.

The focus of the monitoring will shift during this time frame. From the filing date of the Application until the day that it (hopefully) is approved by the Board, i.e., the Control Date, the monitoring will be passive and restrained and in compliance with regulations regarding premature control. During this period, however, we still need to know that Conrail is performing in a manner that is financially sound and that meets the needs of its customers. From the Control Date until Day One, the monitoring will be more proactive and in coordination with NS. As noted previously in this statement, this interim period will be an important time for learning Conrail operations first hand and will be of considerable benefit to CSX on Day One.

17. Corporate Governance. I am also the leader of this team. Our task is to review the corporate organization of Conrail with the objective to ensure that it can be managed in a way that allows CSX to achieve synergies and operating objectives as outlined in the Application. The team will assist, in conjunction with NS, in completing required organization specifications for the Conrail operations that will remain in the long-term.

18. Concession Process. The Concessions team was formed to consider the legitimate concerns of state and local governmental agencies and other railroads which felt that they would be adversely impacted if the Transaction were to be approved. Bill Hart was selected to head this team. He has over 23 years of service with CSX, primarily in the fields of transportation, operations, strategic planning and service design, and is currently Vice President-Corporate Development.

The Concessions teams has an "open door" policy of negotiating issues with the governmental agencies and railroads. The goal is to execute agreements that address

concerns which are a consequence of the Transaction in a manner which does not detract from the benefits. This policy has met with a great deal of success as CSX has executed agreements with numerous railroads (shortlines, regionals and Class Ones) and governmental agencies, which resulted in their public support for the Transaction. We continue to work with a number of entities to settle concerns and gain support.

19. Training. The Training Team is led by Joel Warner, who is currently Assistant Vice President-Human Resource Development for CSX. Joel joined CSX in 1986, has spent his career at CSX in the human resources field, and has a Master of Science degree in Human Resource Development from St. Thomas University.

The importance of this team is readily apparent. Proper training of CSX and Conrail employees is a crucial element in the successful integration of CSX and the allocated Conrail lines. The Conrail employees who are to become CSX employees need to be prepared for this transition in order to understand their responsibilities with CSX. Some training will be required for current CSX employees in order to make the transition easier for all concerned. The team is also responsible for identifying and obtaining the necessary resources that will be required for performing the training.

20. Implementation Planning. The Implementation Planning team is headed by Bob Haulter, who is currently serving as CSXT's Assistant Vice President-Integration Planning. This is a natural selection, as Bob has been involved in the Conrail project since March 1997. He has had a wide range of duties with CSXT since joining a predecessor company in 1973, including Corporate Secretary, Administrative Services, Labor Relations, Human Resources and Performance Improvement.

This team is responsible for the coordination and facilitation of the efforts of all integration teams. It's role is to oversee the project plan for the entire integration process. this includes team definition and scope, project plan development, issue resolution, overall project coordination, the review of key deliverables and providing on-going direction to the process. This team is also responsible for ensuring that all issues that arise between various teams are resolved on a timely basis.

21. Future Teams (As Needed).. There are currently no additional teams. Early in the integration process, however, we realized that it was not critical to initiate implementation planning for each team simultaneously. Some tasks are more critical, and some tasks require a longer period of time for the planning and implementation process. The teams that did not meet either criteria were put on hold until the critical tasks were addressed. Also, we realized that as we progressed the implementation planning process new tasks would be identified.

As future tasks are identified they will either be incorporated into the existing team structure or new teams will be formed. That decision will be made by me in consultation with the steering committee. A recent example is the Inventory team. Due to the nature of the task, as outlined earlier, it was not deemed necessary to initiate this team last summer. The team is now under formation, and coordination is just beginning with NS.

CONCLUSION

CSX has devoted a great deal of employee time and expense to the Conrail integration process and I know that NS has done the same. Although the allocation of Conrail, if

approved by the Board, will be a complex undertaking, I am confident that CSX has an implementation process that is capable of accomplishing that assignment. I am also confident that we have procedures in place to refine this process as the need arises to make any adjustments that may be required. The integration will be done in a safe and prudent manner that will ultimately benefit CSX, our employees, our customers and the general public.

I, Michael J. Ward, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this verified statement. Executed on December 8, 1997.

Michael J. Ward

REBUTTAL VERIFIED STATEMENT

OF

DWIGHT D. WEATHERHOLTZ

My name is Dwight D. Weatherholtz and I am Marketing Manager -- Marketing Services for CSX Transportation, Inc. (CSXT). Among my duties for CSXT is responsibility for the publication and filing of tariffs on various subjects, including switching. I am also required to stay current on tariffs published by other railroads and on practices and procedures generally in the railroad business respecting tariff movements.

The primary purpose of this verified statement is to address certain statements made by Gerald Fauth in support of the Comments, Evidence and Request for Conditions of the Erie-Niagara Rail Steering Committee (ENRS), with respect to switching charges in the Buffalo-Niagara area. Mr. Fauth complains at length about the level of current Conrail switching charges in Buffalo and seeks to show that they "are high by many standards." ENRS-6, Fauth VS at 28.

The main standard he measures Conrail charges against is a $156 per car fee that is one of many charges NS has applied in Buffalo. Mr. Fauth claims that this charge has become "generally established by NS in the Buffalo area." Id. This, however, is a seriously misleading statement.

I have examined NS Switching tariff, NS 8001. The $156 charge so heavily relied upon by Mr. Fauth, per Note 1, Item 1400, NS 8001

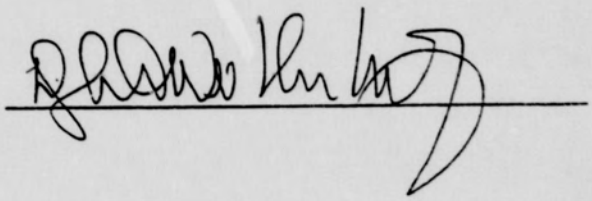
applies only as follows: "NS Motor Vehicle Facility open only on automobiles from Halifax, NS when received from CN-GTE at station 14005". Also, per Note 2, Item 1400, NS 8001, NS will switch for CR at $450 (34th revised page 32, NS 8001), subject to the following: "NS Motor Vehicle Facility open only on automobiles from Edison assembly plant at Metuchen, NJ when received from CR". Thus it cannot be said that $156 is the charge "generally established" in Buffalo.

The secondary purpose of this verified statement is to confirm, as reflected in their published tariffs (CSXT 8100 and NS 8001) that CSXT and NS generally perform switching services for one another at the rate of $250 per car.

CERTIFICATION

I, Dwight D. Weatherholz, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this verified statement.

Executed December 9, 1997.



REBUTTAL VERIFIED STATEMENT

OF CHARLES J. WEHRMEISTER

NS ASSISTANT VICE PRESIDENT

SAFETY AND ENVIRONMENTAL

My name is Charles J. Wehrmeister. I am employed by Norfolk Southern Corporation (NS) as Assistant Vice President, Safety and Environmental, a position I have held for approximately three years. Business functions for which I am responsible include administering NS's grade crossing fund, performing filings for reportable injuries, auditing injury records to determine compliance with corporate procedures, and safety training.

Most of my 28½ year railroad career has been in line management in NS's and its predecessors' Transportation Departments. Before assuming my current job, I held positions as Crossing Watchman, Switchman, Road Brakeman, Yard Conductor, Operations Trainee, Assistant to Trainmaster, Assistant Trainmaster, Terminal Trainmaster, Assistant Superintendent, Superintendent Terminal(s) and Division Superintendent.

I. Introduction

The purpose of this statement is to: (a) describe NS's industry-leading safety record; (b) discuss key features of NS's Safety Integration Plan filed with the Surface Transportation Board (STB) on December 3, 1997; and (c) respond to safety-related contentions of parties other than the U.S. Department of Transportation (DOT) and Federal Railroad Administration (FRA). I believe that with careful planning and execution, the Conrail

transaction can be carried out without compromising safety. In fact, the transaction should have long-run safety benefits.

II. Norfolk Southern's Safety Record

NS is a safety leader of the United States rail industry, having recently won the prestigious E. H. Harriman Memorial Gold Award for employee safety for a record eighth straight year. (Other NS safety and service awards are listed in Volume 6A of the Primary Application, at 122-123.) Safety is so deeply ingrained at NS that it is the first subject at virtually every meeting, including meetings of the Board of Directors, and the first element of our corporate vision: to be the "safest, most customer-focused, and successful transportation company in the world." To ensure our commitment to safety is followed from top to bottom, NS has adopted "Six Tenets of Safety." (See Figure CJW-1.) NS's low number of reportable injuries is proof of our commitment: in 1996 such injuries were a remarkable one-fifth of what they were just eight years before. (See Figure CJW-2.)

Figure CJW-1
Norfolk Southern's Six Tenets of Safety

All injuries can be prevented
All exposures can be safeguarded
Prevention of injuries and accidents is the responsibility of each employee
Training is essential for good safety performance
Safety is a condition of employment
Safety is good business

Figure CJW-1

In comments filed in this proceeding, DOT and FRA characterized NS's operating policies, rules and practices as "provincial" and NS's safety culture as "individualistic."[1]

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[1]Preliminary Comments of the United States Department of Transportation (DOT-3), Verified Statement of Edward R. English, at 15.

NS is uncompromising in its insistence on safety, and we are working to carry that philosophy to carry over to the expanded system. On the other hand, we well understand that a provincial, inward-looking approach could never lead to world-class safety performance. That is why NS regularly has enlisted the most authoritative outside advice on safety available. DuPont, a world leader in safety, has provided expert advice at critical junctures in NS's safety program, and has been retained once again to help us implement the Conrail transaction safely. DuPont will visit Conrail craft employees and officers on three Conrail Divisions and at the Juniata and Hollidaysburg Shops, and will revisit current NS properties. We anticipate receiving DuPont's recommendations by March 1998, in ample time to incorporate their recommendations into the implementation.

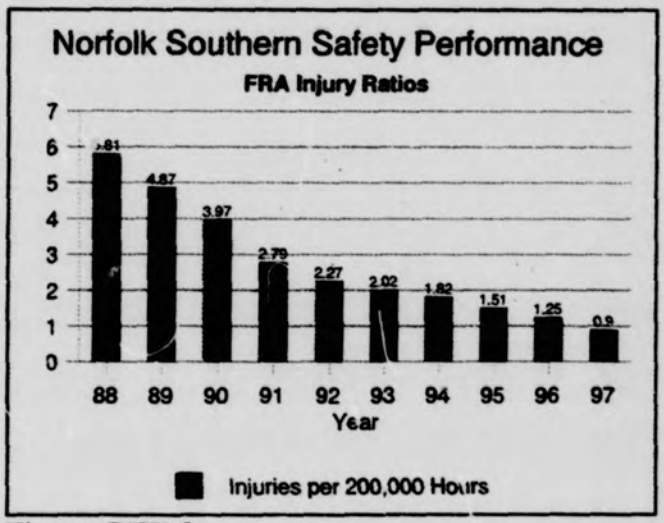

Figure CJW-2
Note: 1997 is a partial year covering 10 months.

III. Preparation of the Safety Integration Plans

In Decision No. 52, the STB required NS and CSX to submit Safety Integration Plans (SIPs) for the proposed expanded CSX and NS rail systems and for the Shared Asset Areas (SAAs). NS and CSX filed the SIPs on December 3, 1997.[2]

NS's SIP identifies and describes measures to ensure compliance with federal safety laws and safe operations as NS integrates into its rail system allocated portions of Conrail. I was among those who worked for the thirty days between issuance of Decision No. 52 and filing of the SIPs, assembling the required information and formulating NS's plan. In many respects, NS's SIP memorializes NS' extensive safety integration effort: evaluating Conrail's safety practices (and in some cases reevaluating our own), becoming more familiar h Conrail's personnel, territory and facilities, and analyzing, with the help of some of the most experienced safety minds in the industry, how to integrate Conrail operations without a hitch. Conrail's safety officers have played a key role in this process. Beginning earlier this year, they have guided NS personnel on Safety Train visits, hi-rail trips and over-the-road-visitations. In recent months, Conrail has escorted NS on tours of Conrail's Pittsburgh,

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[2]DOT has indicated that Applicants and FRA "are committed to continuing the refinement of the SIPs until comments are due on the final EIS" and that the SIPs are "works in progress." See Initial Comments of the United States Department of Transportation on the Safety Integration Plans Filed by CSX Corporation and CSX Transportation, Incorporated, and Norfolk Southern Corporation and Norfolk Southern Railway Company (DOT-4), at 3. NS agrees that continuing dialogue between Applicants and FRA on issues covered in the SIPs is essential. However, NS also believes the SIPs submitted on December 3 are in full compliance with Decision No. 52, and that additional formal filings would be unwarranted. Our personnel and resources must be allowed to focus full-time on the very real and challenging tasks associated with safely implementing the Conrail consolidation.

Indianapolis and Dearborn Divisions. During these trips, we have held numerous joint discussions with employee groups "on division," and made dozens of one-on-one contacts.[3]

In this statement, I will not attempt to replicate NS's SIP, which runs more than 200 pages, but it does seem appropriate to highlight several key features relating to implementation planning and safety:

Training. At the heart of any successful safety program is a well trained workforce. This applies equally to agreement and supervisory personnel. NS has focused heavily on training for the expanded NS system. Excellent training facilities exist on both NS and Conrail properties.

Train and Engine Service Positions. Employees subject to the Hours of Service Act (HSA) have some of the most safety-sensitive jobs in the industry. Unlike other recent mergers, which abolished jobs for HSA-covered employees, the Conrail transaction contemplates an *increase* in locomotive engineer and trainmen positions. NS is hiring and training over 1,000 new train and engine service employees for the NS system post-transaction. Within pre-control constraints, we will be discussing with Conrail mechanisms for maintaining a more than adequate pool of train and engine service talent on Conrail as well.

Dispatching. Dispatching is another area receiving close scrutiny. Again, several factors distinguish the Conrail transaction from other recent mergers. Based on current headcounts, NS does not anticipate eliminating any dispatcher positions, nor will there be near-term changes in dispatching locations likely to cause attrition. Significantly, both Conrail and NS rely on regional dispatching. Because we will retain this system post-transaction, most dispatchers will continue to handle territories with which they are familiar, using the same type of dispatching consoles and equipment they use today.

Track Maintenance. NS has always placed great emphasis on maintaining its track and roadbed for safe operations. Our Operations Division officers already have tested and inspected rail and track structure, including taking measurements by track geometry cars, on Conrail properties to be operated by NS. Completion of this first testing and inspection phase enhances efforts to

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[3]NS's and Conrail's collaboration on safety actually began long before the current proceeding was even instituted, as the two railroads got to know each others' "best practices" through joint ventures like TripleCrown Services®.

plan for the manpower and capital necessary to meet appropriate standards all over the expanded system.

IV. Safety-Related Contentions of Parties other than DOT and FRA

A number of parties to this proceeding other than DOT and FRA have voiced safety-related concerns. These include: Allied Rail Unions (ARU); the American Trucking Associations (ATA); Charles D. Bolam, Vice President, St. Louis Rail Labor Coalition; Cleveland, OH; John F. Collins, New York State Legislative Chairman (on behalf of various parties collectively referred to as "BLE"); International Association of Machinists and Aerospace Workers (IAM); Congressman Dennis J. Kucinich; Congressman Robert Menendez; the Ohio Attorney General, Ohio Rail Development Commission and the Public Utilities Commission of Ohio (collectively the State of Ohio Parties); Shell Oil Company and Shell Chemical Company (Shell); Southeastern Pennsylvania Public Transit Association (SEPTA); Transportation Committees of the Pennsylvania Senate and House of Representatives (Transportation Committees); Transportation Communications International Union (TCU); Transportation Trades Department, AFL-CIO (TTD); United Railway Supervisors Association (URSA); United Transportation Unions (UTU); and West Virginia State Rail Authority.

The above parties' concerns may be grouped as follows:

* Concerns about the experiences of the western rail carriers (particularly UP and SP) in implementing recent STB-approved control transactions;[4]

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[4] E.g., ARU, IAM, John F. Collins, Congressman Menendez, New York State Legislative Board, Shell, TCU, Transportation Committees, TTD, URSA and UTU.

* Concerns about Applicants' planning for safety integration and implementation;[5]

* Concerns about workforce structuring, particularly safety-sensitive occupations;[6]

* Concerns about Applicants' pre-transaction safety records and continuing compliance with federal rail safety laws;[7] and

* Concerns about local safety impacts.[8]

I will address each of these issues in turn.

UP/SP-RELATED CONCERNS

NS is well aware of the public's concern about rail safety in light of recent rail mergers -- particularly UP/SP. However, there are basic differences between the Conrail transaction and UP/SP. SP was in poor financial and operating condition before and at the time of the merger, while UP was still sorting out an earlier transaction with the Chicago and Northwestern. Hence, from the start UP/SP was playing catch-up, particularly with regard to operations over SP lines. Also important is the fact that before the merger UP and SP had the first and second highest accident rates among class I railroads for five of the preceding six years.[9]

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[5] E.g., TCU.

[6] E.g., ARU, John F. Collins, Congressman Kucinich, IAM and TTD.

[7] E.g., Charles D. Bolam, Congressman Kucinich, Congressman Menendez and West Virginia State Rail Authority.

[8] E.g., ATA, Cleveland, OH, the State of Ohio Parties and SEPTA.

[9] For additional details on the differences between the UP/SP merger and this transaction, see Rebuttal Verified Statement of James W. McClellan included as part of this filing.

CONCERNS ABOUT PLANNING

A number of parties have expressed concerns about NS's and CSX's planning process. Some urge measures essentially equivalent to the SIPs Applicants filed on December 3, 1997. As described above, the SIP documents NS's safety plans and processes from virtually every conceivable angle. In addition, the way in which this transaction has evolved over the past year, and the parties' earlier experience with Conrail, have provided ample planning time. There can be no doubt that safety has been looked at more intensively in the Conrail transaction than in any rail merger in history.

CONCERNS ABOUT WORKFORCE STRUCTURING

As discussed above, NS anticipates minimal loss or relocation of experienced personnel, especially in HSA-covered, safety sensitive positions. Total projected job losses as a result of the Conrail transaction are less than the rail industry's average annual attrition rate. By retaining the vast majority of experienced operations personnel, NS should have a more than adequate workforce.

CONCERNS ABOUT PAST SAFETY RECORDS

While there is always room for improvement on the road to zero injuries and incidents, I believe NS's safety record speaks for itself. But don't take my word for it. Shell Oil Company and Shell Chemical Company put it this way:

> NS has always achieved top ratings from Shell and has won numerous railroad industry safety awards. Shell has confidence that NS safety standards and practices will be integrated into the acquired Conrail lines and operations.[10]

As for compliance, it is NS's policy always to obey the law. In this regard, I feel obliged to respond directly to one contention. At no time has NS "refused to participate in the Federal Railroad Administration Safety Assurance and Compliance [SACP] Program."[11] This misapprehension appears to derive from a recent study by the U.S. General Accounting Office (GAO) on FRA's new approach to railroad safety.[12] In fact, NS has participated in the SACP process, and has contacted GAO in an effort to have representations to the contrary retracted.

CONCERNS ABOUT LOCAL SAFETY IMPACTS

At NS no known risk exists in a "safety vacuum." Where appropriate, NS has pursued, and will continue to pursue, measures to avoid potential adverse impacts on safety

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[10]Joint Comments of Shell Oil Company and Shell Chemical Company (SOC-3), at 9.

[11]Letter of October 21, 1997 from Congressman Robert Menendez to the Members of the Surface Transportation Board, at 2. See also Responsive Application (Subnumber 74), filed with the Surface Transportation Board by Congressman Dennis J. Kucinich, at 10.

[12]See U.S. General Accounting Office, Railroad Transportation: Federal Railroad Administration's New Approach to Railroad Safety, July 1997, at 4.

at particular locations. In addition, the STB's Section of Environmental Analysis is scrutinizing local safety effects, and is empowered to require mitigation if necessary.

V. Conclusion

Rail stakeholders and the public have a legitimate right to expect that eastern rail restructuring will be carried out in the safest manner possible. NS's safety record and the concrete steps we have taken to address parties' concerns firmly demonstrate that safety is at the forefront of this proceeding. In the final analysis, I believe the Conrail transaction will be seen not just as having a neutral effect on safety -- frankly, NS would consider that less than an achievement -- but as greatly improving transportation safety in the United States.

VERIFICATION

I, Charles J. Wehrmeister, verify under penalty of perjury that the foregoing statement is true and correct. Further, I certify that I am qualified and authorized to file this statement.

Executed December 8, 1997.

Charles J. Wehrmeister

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB FINANCE DOCKET NO. 33388

CSX CORPORATION AND CSX TRANSPORTATION, INC.
NORFOLK SOUTHERN CORPORATION AND
NORFOLK SOUTHERN RAILWAY COMPANY
-- CONTROL AND OPERATING LEASES/AGREEMENTS --
CONRAIL, INC. AND CONSOLIDATED RAIL CORPORATION

REBUTTAL VERIFIED STATEMENT

OF

WILLIAM W. WHITEHURST, JR.

DATED: December 15, 1997

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REBUTTAL VERIFIED STATEMENT
OF WILLIAM W. WHITEHURST, JR.

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB FINANCE DOCKET NO. 33388

CSX CORPORATION AND CSX TRANSPORTATION, INC.
NORFOLK SOUTHERN CORPORATION AND
NORFOLK SOUTHERN RAILWAY COMPANY
-- CONTROL AND OPERATING LEASES/AGREEMENTS --
CONRAIL, INC. AND CONSOLIDATED RAIL CORPORATION

REBUTTAL VERIFIED STATEMENT

OF

WILLIAM W. WHITEHURST, JR.

My name is William W. Whitehurst, Jr. I am President of W.W. Whitehurst & Associates, Inc., an economic consulting firm specializing in financial analyses, cost accounting, and other economic regulatory issues involving the railroad industry. On behalf of Applicants CSX Corporation and CSX Transportation, Inc. (jointly, "CSX"), I previously submitted a verified statement included in the Railroad Consolidation Application filed June 23, 1997 in this proceeding (CSX/NS-18). A description of my background and professional qualifications was included as Appendix A to that verified statement.

I have been asked by Applicants CSX and NS (Norfolk Southern Corporation and Norfolk Southern Railway Company) to analyze and respond to the testimony submitted on behalf of various shipper interests by Alfred E. Kahn, Frederick C. Dunbar and Thomas D. Crowley relating to the acquisition cost of Consolidated Rail Corporation ("Conrail") and its

potential impact on the Board's revenue adequacy and revenue/variable cost ("r/vc") jurisdictional threshold determinations.[1]

In brief, these shipper witnesses contend that: (1) the purchase price paid for Conrail by CSX and NS exceeds the historic book or market value of Conrail (variously defined) by a large amount and, to that extent, reflects what they characterize as a substantial acquisition "premium"; (2) as a result of the proposed transaction, CSX and NS will have both the increased ability (due to transaction-related increases in market power) and need (in order to pay for Conrail) to impose excessive rate increases, particularly for so-called "captive" shippers; and (3) CSX and NS will, at least to some extent, be able to implement these rate increases free from the Board's scrutiny because inclusion of the acquisition "premium" in the railroads' financial reports for regulatory purposes would raise applicable regulatory rate "ceilings" by both reducing the carriers' rates of return on investment for revenue adequacy purposes and increasing system-average URCS variable costs of service and the applicable 180 percent r/vc jurisdictional threshold for Board rate regulatory jurisdiction (49 U.S.C. § 10707(d)). To prevent the claimed erosion of these rate protections, Kahn/Dunbar and Crowley urge that the Board impose a "mechanical" fix in the form of a condition requiring that the acquisition "premium" be recorded by CSX and NS in an account (Account 80 -- Other Elements of Investment) that is excluded from consideration in revenue adequacy and jurisdictional threshold determinations.[2]

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[1] Messrs. Kahn and Dunbar sponsored a joint verified statement that was submitted separately by Atlantic City Electric Company and Indianapolis Power & Light Company ("ACE, et al.") (ACE, et al.-18) and Consumers Energy Company (CE-05). Mr. Crowley submitted testimony on this and other issues on behalf of ACE, et al (ACE, et al.-18), and substantially similar statements on behalf of Consumers Energy Company (CE-05) and GPU Generation, Inc. (GPU-02). In addition, Centerior Energy Corporation (CEC-05) submitted a statement by Frank S. Harris II (a colleague of Mr. Crowley) containing essentially the same analysis and conclusions. Unless otherwise indicated, citations to this testimony shall refer to the statements included in the ACE, et al.-18 filing.

[2] See ICC Docket No. 40581, Georgia Power Co. v. Southern Railway Co. (served November 8, 1993), Appendix (August 18, 1993 staff memorandum at 13).

My analysis of these claims is addressed below under the following topics:

- Shippers' Characterization of the Acquisition "Premium"
- The Board's Purchase Accounting Rules and Use of Acquisition Cost For Regulatory Purposes
- Projected Financial Impacts of the Acquisition Cost of Conrail on CSX and NS
- Potential Impact of Conrail's Acquisition Cost on Revenue Adequacy and Jurisdictional Threshold Determinations

As explained below, I conclude that: (1) the shipper witnesses have mischaracterized the Conrail purchase price as including an acquisition "premium" to the extent they suggest that it is excessive or does not accurately reflect the current value of Conrail and the anticipated efficiencies and other merger benefits projected to result from the proposed transaction; (2) the Board's accounting rules and decisions require that asset values as recorded for regulatory purposes reflect acquisition cost, not predecessor cost; (3) taking into account transaction-related efficiencies and traffic gains, CSX and NS will be able to finance the acquisition of Conrail and generate net income gains, without raising overall rate levels; and (4) the shippers' claims that the use of Conrail's acquisition cost (rather than its pre-transaction historic net book value) for regulatory purposes would significantly raise applicable rate regulatory "ceilings" are incorrect, primarily because they wholly ignore the impact of anticipated merger efficiencies and other benefits that will result from the proposed transaction.

I have also been asked to analyze and respond to the separate testimony of Mr. Crowley regarding trackage rights compensation, submitted on behalf of Indianapolis

Power & Light Company ("IP&L"). This topic is addressed at the end of my verified statement.

SHIPPERS' CHARACTERIZATION OF THE ACQUISITION "PREMIUM"

The purchase price paid by CSX and NS for Conrail was $9,895 million, plus assumed liabilities and transaction fees. Kahn/Dunbar and Crowley claim that this purchase price reflects a large acquisition "premium," but they use that term inconsistently and indiscriminately. At different places in their testimony, these witnesses refer to the acquisition "premium" as the amount in excess of net book value (Kahn/Dunbar VS at 17), book value of Conrail shares (Crowley VS at 25), historical book value (id. at 26), gross book value (id. at 25; Kahn/Dunbar VS at 16), the market price of Conrail stock immediately prior to the announcement of the proposed CSX acquisition of Conrail (Crowley VS at 25), the market value of Conrail's assets (Kahn/Dunbar VS at 18), and "original cost" (id. at 17). Implicitly, they suggest that the purchase price paid for Conrail is excessive, although they nowhere say so directly.[3]

If these witnesses (and the parties they represent) are suggesting that the purchase price paid by CSX and NS for Conrail is excessive, or does not reflect the actual fair market value of Conrail's business and assets as part of the integrated CSX and NS rail systems, they are wrong: the purchase price reflects no such acquisition "premium." The purchase price for Conrail was established through arms' length bargaining among independent, commercially sophisticated and well-advised parties. Because most railroad services are competitive, and railroads (unlike heavily regulated public utilities) enjoy no guaranteed rates of return, CSX and NS had no reason to pay more than fair value for Conrail. Indeed, the Application includes unchallenged and unrebutted testimony establishing that the financial

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[3] Mr. Crowley does use the term "overstated value" with reference to the acquisition cost of Conrail. Crowley VS at 28.

terms of the proposed transaction (including the purchase price) are fair and reasonable.[4] Kahn/Dunbar and Crowley offer no evidence to suggest that the purchase price paid for Conrail is excessive or otherwise does not reflect the true current value of Conrail's business in the hands of CSX and NS.[5]

COMPARISONS TO PRE-ACQUISITION MARKET PRICE OF STOCK

Of course, as Kahn/Dunbar and Crowley note, the purchase price of Conrail (including assumed liabilities and transaction fees) does substantially exceed, by varying amounts, the pre-transaction market value of Conrail's outstanding publicly traded stock, Conrail's pre-transaction total shareholder equity, and the historic net book value of Conrail's road property and equipment assets (only the latter of which is relevant for regulatory purposes). Crowley VS at 25-29. As a general matter, these facts are neither unusual nor a matter for concern.

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[4] See CSX/NS-18, Vol. 1, Levy VS at 555; CSX/NS-18, Vol. 1, Nolop VS at 460; CSX/NS-18, Vol. 1, Hamilton VS at 569; CSX/NS-18, Vol. 1, Goodwin/Wolf VS at 598.

[5] Kahn/Dunbar suggest that the purchase price might be excessive to the extent it reflects the Applicants' expectation of monopoly profits resulting from transaction-related increases in market power. Kahn/Dunbar VS at 18-19. In my judgment, it is highly dubious to think that CSX and NS would have paid more than the fair value of Conrail in the belief that they could generate increased economic rents. In fact, to the extent that the transaction introduces two-carrier rail service post-acquisition at points served only by one railroad pre-acquisition, competition will be increased -- thus reducing the opportunities for economic rents. If nothing else, this theory assumes that Applicants believed, in setting the purchase price, that the Board would approve an anti-competitive transaction, which is contrary to all recent rail merger decisions (including BNSF and UP/SP), in which the Board and its predecessor have taken care to ensure that any adverse competitive effects would be remedied. In any event, other witnesses for Applicants show that the transaction as proposed will not reduce competition or increase market power. Further, as I discuss below, the fact that anticipated merger efficiencies, traffic and revenue gains, and related benefits more than justified the purchase price of Conrail also demonstrates that the purchase price of Conrail does not reflect anticipated economic rents.

As should be apparent to anyone who has read newspaper accounts of proposed corporate mergers and acquisitions involving publicly traded companies, it is not at all uncommon for the purchase price of such a company to exceed, often by a large amount, the pre-merger market value of the company's publicly traded stock or the company's total shareholder equity. A major reason for this is that substantial synergies may be available to the acquirer in combination with the acquiree that are not available to the acquiree on a stand-alone basis.[6]

More generally, as Professor Kalt discusses in his rebuttal verified statement, the purchase price may be justified by any number of factors, including the purchaser's expectation that the acquired company will be more valuable under its control, as a result of improved management of the acquired company's assets and business, efficiencies related to the combination of the acquired company's assets with those of the purchaser, and similar considerations. In this limited sense, the purchase price may reflect a control "premium," but such a "premium" is merely a portion of the (explicit or implicit) discounted cash flow values of synergies inherent in the combination. This is certainly true in the case of Conrail. The Application documents the substantial efficiencies, service improvements, incremental traffic gains, and other benefits that the proposed Conrail transaction will generate. By attracting new traffic to Conrail's lines, the proposed transaction will revitalize many Conrail assets, and the purchase price reflects this.

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[6] An example recounted in the present Application is the economies of north-south intermodal service, which is attractive for CSX and NS in combination with Conrail, but does not provide the same economies to Conrail as an independent railroad whose long hauls are east-west.

COMPARISONS TO HISTORIC NET BOOK VALUE

It is even less surprising or unusual that the purchase price for Conrail exceeds the historic net book value of Conrail's road property and equipment assets as recorded on its books for regulatory purposes. Under generally accepted accounting principles ("GAAP") and the Board's Uniform System of Accounts for railroads ("USOA"), assets are usually recorded on the company's books at depreciated original (or historic) cost to the owner. Particularly in the case of assets with relatively long service lives (which is the case for a large share of a railroad's investment), historical cost will not reflect -- and often will be significantly less than -- current market values. What it cost a railroad to build a rail line or acquire land for a right-of-way a century ago has little relationship to the current value of these assets.

In the case of Conrail, there is even less reason to presume any relationship between the depreciated historical asset values recorded on Conrail's books and the current market value of those assets. The book value of its assets does not even reflect depreciated original cost, but rather is skewed as a result of the process by which Conrail was created.

Conrail came into being as a government-owned railroad in 1976, designed to operate certain rail properties that were ordered by the government to be conveyed to Conrail by Penn Central and a number of other bankrupt railroads in the Northeast. Pursuant to the Final System Plan developed by the U.S. Railway Association ("USRA"), designated assets of the bankrupt railroads were conveyed to Conrail, and recorded on its books at "acquisition cost" (the amount the U.S. government paid, through Conrail, to the various bankrupt railroad estates for the transferred rail properties). The "acquisition cost" for the various rail lines and other properties conveyed to Conrail was determined initially by USRA through extensive valuation studies based on the net liquidation value of the properties, reflecting the fact that the bankrupt railroads were no longer viable as going concerns. The estates of the bankrupt railroads then contested both the basis of valuation and the amounts in lengthy

proceedings before the Special Court, the railroad reorganization court established by Congress in the Regional Rail Reorganization Act of 1973 (the "3-R Act") to supervise the reorganization of the Northeast rail system and the associated creation of Conrail. In those proceedings, which continued for several years after the creation of Conrail and the conveyance of properties to it on April 1, 1976, the Special Court confirmed USRA's view that the "acquisition cost" of properties conveyed to Conrail should be established based on their net liquidation value, which was the basis used by USRA. The Special Court also held, however, that the particular valuations determined by USRA under the net liquidation value methodology were understated.[7]

Taking the Special Court's various rulings as guidance, the government parties and most of the individual bankrupt estates subsequently negotiated settlements which involved additional payments to the bankrupt estates by the U.S. government for the railroad properties acquired by Conrail. The additional payments by the federal government resulted in retroactive increases in the "acquisition cost" of the rail lines conveyed to Conrail, and the associated asset values recorded on Conrail's books. Hence, the values assigned to assets conveyed to Conrail upon its commencement of operations on April 1, 1976 were adjusted in 1978, 1980, and 1981 to reflect the Special Court proceedings and the settlement agreements. In its Annual Reports to the ICC (Form R-1) for those years, Conrail addressed these conveyance adjustments in the Notes to Financial Statements, and showed the adjustments by individual property account in Schedule 330, "Road and Equipment Property."

As a result of this process, the asset values recorded on Conrail's books do not reflect any reliable or accurate measure of even depreciated original cost, much less provide any coherent barometer of current market value. In many (if not most) instances, the net liquidation value methodology yielded a valuation of the bankrupt railroads' properties that

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See In re Valuation Proceedings Under Sections 303(c) and 306 of the Regional Rail Reorganization Act of 1973, 445 F. Supp. 994 (Special Court, R.R.R.A. 1977), 531 F. Supp. 1191 (Special Court, R.R.R.A. 1981).

was less than those railroads' historic depreciated investment (or net book value) in such properties. In other words, in many instances the "acquisition cost" of the conveyed properties to Conrail was less than the value at which the predecessor railroads carried these properties on their own books and records prior to the mandated conveyance to Conrail. The settlements between the bankrupt estates and the government had the effect of increasing these asset values to some degree, but it remains the case that they were based on net liquidation value, which was less than depreciated original cost in many (if not most) instances.

Thus, book value is not normally a reliable measure of the current value of railroad assets. In view of the peculiar circumstances of its creation, that is especially true with respect to Conrail.

CONCLUSIONS REGARDING CHARACTERIZATION OF SO-CALLED ACQUISITION "PREMIUM"

As this discussion reveals, the references by Kahn/Dunbar and Crowley to the so-called acquisition "premium" paid by CSX and NS for Conrail are misleading, at least insofar as they suggest that the purchase price for Conrail did not reflect fair market value. The purchase price clearly does substantially exceed the pre-transaction net book value of Conrail's road property and equipment assets (the asset values used for regulatory purposes). When these witnesses argue that the acquisition "premium" should be excluded from consideration in revenue adequacy and jurisdictional threshold determinations, it is this amount -- the excess of the purchase price over net book value of road property and equipment assets -- that they have in mind. Accordingly, while the term acquisition "premium" is misused and inconsistently defined by these witnesses, I will use it as a shorthand reference to mean solely the difference between the acquisition cost of Conrail stock and the pre-transaction book value of Conrail's assets for regulatory purposes.

THE BOARD'S PURCHASE ACCOUNTING RULES AND USE OF ACQUISITION COST FOR REGULATORY PURPOSES

Under principles embodied in GAAP and the Board's Uniform System of Accounts for railroads (49 C.F.R. § 1201) ("USOA"), assets are recorded on a company's books at cost. When a railroad (such as Conrail) is acquired through purchase or merger, the value of its assets is reflected on the purchaser's books at acquisition cost, resulting in an adjustment in the pre-transaction book values. These purchase accounting rules have been in place for over 35 years. Although Kahn/Dunbar and Crowley do not expressly contest the applicability or requirements of these accounting rules, at places they suggest that inclusion of the acquisition "premium" in the CSX and NS property accounts for regulatory purposes would be "improper" and that adjusting the Conrail asset values to reflect the acquisition cost of Conrail to CSX and NS is "without regard to correct accounting rules." Crowley VS at 30, 31 n.29. In light of these assertions, it may be helpful to review the Board's accounting rules and how they apply to the proposed Conrail transaction.

PURCHASE ACCOUNTING RULES UNDER THE BOARD'S USOA

The USOA prescribes the accounting rules governing the financial statements that railroads are required to file with the Board as part of their Annual Report Form R-1. The revenues, expenses, and asset values reflected on these financial statements are used for a variety of regulatory purposes, including both the Board's annual revenue adequacy determinations and its development of carrier-specific URCS variable cost formulas used in jurisdictional threshold determinations in individual rate cases.

The Board's accounting rules generally require that assets be recorded on a rail carrier's books for regulatory purposes at historical cost. USOA, Instructions for Property Accounts § 2-1. The regulations also address the proper treatment of asset values in the case

of the merger, consolidation, or purchase of a rail carrier. Section 2-15(a) of the USOA's Instructions for Property Accounts states that:

> (a) When a railway or portion thereof constituting an operating unit or system is acquired by merger or consolidation in a pooling of interests or by purchase the cost of acquisition represented by cash, capital stock or other securities issued or assumed, liabilities assumed, and other consideration, shall be recorded in the accounts in the manner stated hereunder. . . . (Emphasis added.)

Section 2-15(c) of the instructions, which addresses accounting for purchase (as opposed to pooling of interest) transactions, provides that:

> (c) Purchase:
>
> (1) When the acquisition results from a purchase (except from subsidiaries controlled through ownership of the majority share of voting stock) including mergers or consolidations other than pooling of interests, the amount includible in account 731, "Road and Equipment Property," shall be at the cost at the date of acquisition to the purchaser of the transportation property acquired. The cost assigned to the property, as well as other assets acquired, shall be the amount of the cost consideration given. Where property and other assets are acquired for other than cash, including liabilities assumed and shares of stock issued, cost shall be determined by either the fair value of the consideration given or the fair value of the assets acquired, whichever is more clearly evident. In addition to any liabilities assumed, provision shall be made for such estimated liabilities as may be necessary.
>
> (2) When the costs of the individual units or classes of transportation property are not specified in the agreement, the cost assigned such property shall be apportioned among the appropriate primary accounts using the percentage relationship between the fair values for each class of property acquired and the total of such values. (Emphasis added).

Thus, these rules require that, in the case of transactions accounted for as a purchase as opposed to a pooling of interests,[8] the assets of the acquired carrier must be adjusted (up-

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[8] The USOA instructions prescribe different rules for pooling of interests, a narrow category of transactions in which the form, but not the substance, of a carrier's identity is (continued...)

ward or downward) to reflect acquisition cost to the purchaser. Acquisition cost for these purposes means the cash purchase price or, where property is acquired for other than cash (including assumption of liabilities), either the fair value of the consideration given or the fair value of the assets acquired, whichever is more clearly evident. These rules conform precisely to the requirements of GAAP. See Financial Accounting Standards Board, Accounting Standards -- Current Text § B50.125 (1997 Supp.). The required adjustments to a carrier's property accounts to reflect acquisition cost in connection with a purchase transaction are known as purchase accounting adjustments.[9]

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[8](...continued)
altered through an exchange of existing stock. See USOA, Instructions for Property Accounts § 2-15(b); S. Davidson, C. Stickney, & R. Weil, Financial Accounting: An Introduction to Concepts, Methods, and Uses 482-85 (2d ed. 1979); Financial Accounting Standards Board, Accounting Standards -- Current Text §§ B.50.104-.124 (1997 Supp.). It is my understanding that the proposed Conrail acquisition would not qualify as a pooling of interests under the USOA or GAAP.

[9] Mr. Crowley injects an unfortunate amount of confusion into this subject by incorrectly suggesting that the purchase accounting rules governing revenue adequacy determinations are different than those which apply to jurisdictional threshold determinations. Crowley VS at 27-28. In point of fact, both revenue adequacy and jurisdictional threshold (i.e., URCS variable cost) determinations are based on financial statements prepared in accordance with the USOA and submitted in each railroad's Annual Report Form R-1. The purchase accounting rules described in the preceding text thus apply equally to both regulatory functions. In particular, Mr. Crowley is flatly wrong when he claims that revenue adequacy determinations are based on the lesser of purchase price or appraised value of the acquired assets, while carriers can elect for jurisdictional threshold purposes to record the acquired assets at either purchase price or appraised value (even when the latter is greater in amount than the former). As the USOA makes clear, acquisition cost is the governing accounting standard. For assets acquired for cash, cash purchase price represents acquisition cost. For assets acquired other than for cash (such as a combination of cash and assumption of liabilities), acquisition cost is the fair value of the consideration given or the fair value of the assets acquired, whichever is more clearly evident. Thus, appraised value is relevant except when the consideration is limited to cash. Although not entirely clear, it appears that Mr. Crowley's confusion stems from his failure to recognize that purchase price can (as in the case of the Conrail transaction) involve both cash and non-cash (i.e., assumed liabilities) consideration.

The Board's purchase accounting rules have been in place for many years, and the purchase accounting adjustments to property accounts required under these rules are a regular and normal phenomenon in the railroad industry. The required adjustments in property accounts can work in either direction. In some merger, consolidation, and purchase transactions, the acquisition cost has been less than the pre-existing book value of the acquired carrier's road property and equipment (i.e., "predecessor cost"). In that event, the Board's rules require that the acquired assets be written down in value to reflect the lower acquisition cost. This was the situation, for example, in several large rail consolidation transactions discussed by the ICC in its 1990 decision in Ex Parte 483, where the agency reaffirmed the application of its purchase accounting rules and concluded that acquisition cost (rather than predecessor cost) should be used for regulatory purposes even when acquisition cost was less than predecessor cost.[10] It was also true in transactions such as the purchase of Southern Pacific Transportation Company by Rio Grande Industries in the late 1980's.[11]

More recently, as Mr. Crowley notes, a number of railroads have been acquired at a cost that exceeds the acquired carrier's historic net book value (e.g., UP/CNW, BNSF, UP/SP). Crowley VS at 27-28. In these transactions, the Board's purchase accounting rules require that the value of the acquired carrier's assets for regulatory purposes be written up to reflect acquisition cost.

The logic of these purchase accounting rules is that, as a general matter, assets should be recorded on a carrier's books at actual cost to the owner at the time of acquisition. When

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[10] ICC Ex Parte No. 483, Railroad Revenue Adequacy -- 1988 Determination, 6 I.C.C.2d 933 (1990), aff'd sub nom. Association of American Railroads v. ICC, 978 F.2d 737 (D.C. Cir. 1992).

[11] Indeed, as my prior discussion reveals, Conrail's existing book asset values for regulatory purposes reflect a substantial write-down in value at the time Conrail was created and its assets were transferred to it from the predecessor bankrupt railroads. The accounting treatment of Conrail's creation thus simply reflected prevailing purchase accounting rules.

one railroad purchases another, the actual cost is the purchaser's acquisition cost, not the values reflected on the acquired or selling carrier's books.

APPLICATION OF THE BOARD'S PURCHASE ACCOUNTING RULES TO THE CONRAIL TRANSACTION

The proposed acquisition and allocation of Conrail is subject to the Board's purchase accounting rules set forth in the USOA and described in the previous section. Accordingly, in developing the pro forma financial statements included in the Application in this proceeding, Applicants applied these accounting rules and included appropriate purchase accounting adjustments based on 1995 adjusted "base year" results for CSX, NS, and Conrail and a preliminary estimate of the fair market value of Conrail's assets. The results of this analysis are contained in the pro formas included as Appendices C and G of CSX/NS-18.

For purposes of the pro forma financial statements, the pre-transaction net book value of Conrail's road property and equipment assets was $6,693 million. This amount reflects the values shown on Conrail's books at year-end 1995 (the "base year" for purposes of analysis), with adjustments to exclude certain non-recurring items. The total purchase price for Conrail from an accounting view ($9,895 million plus assumed liabilities and transaction fees) substantially exceeded Conrail's pre-transaction book value. As a result, under the Board's purchase accounting rules (and GAAP), a write-up in the value of Conrail's assets was required to reflect the actual acquisition cost.

Because the economic consideration for Conrail included both cash and non-cash items (i.e., assumption of liabilities), the pertinent USOA instructions required that the purchase accounting adjustments be based on the fair value of the consideration given or the fair value of the assets acquired, whichever is more clearly evident. To assist in this assessment of acquisition cost, Applicants relied on the preliminary results of an independent estimate of the fair value of Conrail's road property and equipment assets prepared by Price

Waterhouse.[12] As discussed according to this preliminary estimate, the current fair value of Conrail's road property and equipment assets is $16,243 million. This figure was less than the total purchase price plus assumed liabilities and transaction fees ($17,242 million).[13] Because the preliminary Price Waterhouse estimate focuses on the fair value of Conrail's road property and equipment, Applicants used the lower fair value figure as the basis for the required purchase accounting adjustments to Conrail's road property and equipment assets reflected in the pro formas, assigning the difference to accounts that are excluded from revenue adequacy and jurisdictional threshold determinations.[14] This resulted in an estimated write-up of $9,550 million in the value of Conrail's road property and equipment assets ($16,243 million fair value estimate minus pre-transaction adjusted book value of $6,693 million). As with the other elements of Conrail's financial statements, the pro formas divided the Conrail asset write-up between CSX (42%) and NS (58%) based on their respective percentage ownership interests in Conrail (thus assigning $4,011 million to CSX and $5,539 million to NS). CSX/NS-18, Vol. 1, at 133, 171. This analysis assumed, for purposes of the pro forma financial statements, that CSX and NS would each account for the

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[12] A copy of the preliminary Price Waterhouse fair value estimate, as revised on June 2, 1997, is included as Exhibit WWW-1 to this verified statement.

[13] The difference, estimated to be $999 million based on the preliminary results of the Price Waterhouse fair value estimate, was assigned to "goodwill," which is defined as the amount by which the acquisition cost exceeds the fair value of the acquired assets. The "goodwill" appears within the category "Other Long-Term Assets" in the pro forma balance sheets. CSX/NS-18, Vol. 1, at 133, 171. Amounts assigned to goodwill are not considered as part of the investment base in revenue adequacy and jurisdictional threshold determinations.

[14] Mr. Crowley appears to have this relationship backward, as he suggests that "appraised (fair) value" exceeds "acquisition cost" and that, under the Board's accounting rules, assets may be written up to reflect fair value even when it is greater than acquisition cost. Crowley VS at 27-28. His discussion overlooks the basic point that purchase price (or acquisition cost) includes both cash purchase price of the acquired Conrail stock and assumed liabilities. When assumed liabilities are taken into consideration, the actual purchase price for Conrail exceeded the fair value of the Conrail road property and equipment assets as reflected in the preliminary Price Waterhouse fair value estimate.

entire portion of their ownership interest in Conrail on a consolidated basis together with their separate pre-existing rail operating assets.

The purchase accounting adjustments depicted in the pro forma financial statements are necessarily split between combined CSX/Conrail (Appendix C to CSX/NS-18) and NS/Conrail (Appendix G to CSX/NS-18) presentations. To isolate the purchase accounting adjustments for Conrail as a whole, so that one can see the accounting involved for the entire transaction, I have re-assembled the CSX and NS portions of Conrail and the CSX and NS purchase accounting entries from the "base year" balance sheets to show the total effect on Conrail. The source of this re-assembly is the pro forma balance sheets submitted in the Application. The resulting "base year" pro forma balance sheet before and after the purchase accounting adjustments is presented as Exhibit WWW-2.

As can be seen on Exhibit WWW-2, principal components of the accounting adjustments to reflect the acquisition cost of Conrail to CSX and NS include: (1) a write-up of assets to estimated fair value (from $6,693 million to $16,243 million); (2) addition of acquisition debt to the long-term debt (from $1,911 million to $12,116 million); and (3) elimination of Conrail equity, reflecting CSX and NS ownership of all Conrail shares. In addition, accumulated deferred taxes are adjusted to reflect the fair value asset adjustments. In summary, the purchase of Conrail has been accounted for in accordance with the purchase accounting rules contained in the USOA.

Thus, application of the Board's accounting rules will likely result in a substantial write-up in the value of Conrail's road property and equipment assets to reflect the actual acquisition cost of Conrail. Based on the pro forma analysis, the amount of that write-up is currently estimated to be $9,550 million. The precise amount and presentation of any such adjustment, however, will not be determined until the proposed Conrail transaction is completed and consummated for accounting purposes. For a number of reasons, the final amount of the asset write-up may differ from the amount shown in the pro forma financial statements. For example, the size of the write-up will be based on the final results of the

appraisal of the fair value of Conrail's assets, and on the actual property values reflected on Conrail's books at the time the transaction is consummated for accounting purposes, both of which may well differ from the figures used in the pro forma financial statements. In any event, however, purchase accounting rules will apply.

PROJECTED FINANCIAL IMPACTS OF THE ACQUISITION COST OF CONRAIL ON CSX AND NS

A centerpiece of the arguments presented in the Kahn/Dunbar and Crowley testimony is that CSX and NS will have the ability (through increased market power created as a result of the proposed transaction) and the compelling need (in order to cover the large acquisition "premium" they claim is reflected in the purchase price for Conrail) to raise rates excessively, particularly for so-called "captive" shippers. Other witnesses for Applicants address the issue of the competitive effects of the proposed transaction. It is my purpose here to address the assertion that CSX and NS will be forced to raise rates in order to pay for Conrail.

The short answer to this claim is that CSX and NS simply do not need to raise rates to finance their acquisition of Conrail. To the contrary, as the pro forma financial statements and estimates of public and private transaction-related benefits included in the Application demonstrate, the proposed transaction will generate substantial recurring cost efficiencies and incremental traffic gains that will permit CSX and NS to finance the debt incurred to acquire Conrail -- without any assumed overall rate increases.

The pro forma financial statements reflect the anticipated effects of the proposed acquisition on the Applicant carriers' financial results, using adjusted 1995 results as the "base year" and assuming no increases in rate levels for traffic gains projected to result from the transaction. As previously discussed, the pro formas also reflect the necessary purchase accounting adjustments to incorporate the acquisition cost of Conrail, as well as the debt incurred to finance the transaction.

The pro formas demonstrate that the proposed transaction will have strongly positive impacts on Applicants' financial results. A useful place to look first is the pro forma Statement of Cash Flows for each of the combined CSX/Conrail and NS/Conrail systems. CSX/NS-18, Vol. 1, Appendices E and I. They show that the anticipated merger benefits (cost efficiencies, traffic gains, etc.) are sufficient to: (1) provide cash to pay for the capital expenditures required to achieve merger benefits; (2) service the acquisition debt (both interest payments and principal repayment) in addition to pre-existing CSX, NS, and Conrail debt; (3) generate additional net earnings; and (4) maintain a positive annual net cash flow after both the capital expenditures and debt service. Moreover, the pro forma cash flows assume aggressive debt repayment, at a rate in excess of that required to repay the acquisition debt according to its terms, in order to zero-out incremental net cash increases. If better rate of return opportunities are available, CSX and NS could each scale back their incremental debt pay-down, with resulting positive net cash flow after all acquisition cash requirements are taken into account.

Added indicators of lack of financial pressure to raise rates include a substantial projected increase in net railway operating income ("NROI"), as shown in the pro forma Income Statements, and annual additions to retained earnings, as shown in the pro forma Balance Sheets. CSX/NS-18, Vol. 1, Appendices C, D, G, & H. The NROI for the combined CSX/Conrail system is projected to increase by $270 million annually in the "normal" year (a 23 percent increase), while the projected increase for the combined NS/-Conrail system is $350 million (or 35 percent). CSX/NS-18, Vol. 1, at 150, 181. Retained earnings for CSX/Conrail are projected to increase at a rate of $767 million (or 16 percent) annually, while the corresponding figure for NS/Conrail is $764 million (or 12 percent). Id. at 138, 169.

In sum, anticipated transaction-related efficiencies and incremental traffic gains more than justify the purchase price paid by CSX and NS for Conrail. Even taking into account the debt incurred to finance the transaction, CSX and NS will be able to finance the purchase price, pay down the acquisition debt on an aggressive schedule, make the capital investments

needed to implement the transaction, and achieve net income benefits, without any assumed rate increases. A number of other factors not attributable directly to the proposed transaction -- such as reasonably anticipated traffic growth and additional productivity improvements -- would improve these projected financial results even more. Thus, there is no merit to the suggestion of Kahn/Dunbar and Crowley that CSX and NS will be compelled (even assuming they had the ability) to raise rates overall to pay for Conrail.

POTENTIAL IMPACT OF CONRAIL'S ACQUISITION COST ON REVENUE ADEQUACY AND JURISDICTIONAL THRESHOLD DETERMINATIONS

Kahn/Dunbar and Crowley contend not only that CSX and NS will have the ability (through increased market power) and the need to impose excessive rate increases on shippers following consummation of the proposed Conrail transaction. They also claim that CSX and NS will be able (at least to some extent) to impose these excessive rate increases free from rate reasonableness scrutiny by the Board because application of the Board's normal purchase accounting rules and use of acquisition cost for regulatory accounting purposes will raise significantly the level of regulatory rate "ceilings" under the revenue adequacy and r/vc jurisdictional threshold standards. The implication of this argument is that, by raising the applicable rate "ceilings," the proposed transaction will enable CSX and NS to impose rate increases that would otherwise be found unreasonable.

In support of this argument, Mr. Crowley presents a quantitative analysis purporting to demonstrate that the effect of including the full acquisition cost of Conrail for regulatory purposes (as required under the Board's accounting rules and precedent) would be to: (1) significantly reduce the rate of return of the combined CSX/Conrail and NS/Conrail systems for purposes of the Board's annual revenue adequacy findings; and (2) significantly increase system-average variable costs, and thus the r/vc jurisdictional threshold, for hypothetical coal movements. Crowley VS at 25-39.

As I discuss below, Mr. Crowley's analysis suffers from a number of technical and computational errors, but its principal defect is that it completely ignores -- apparently intentionally -- the anticipated efficiencies, incremental traffic gains, and other beneficial impacts of the proposed Conrail transaction. Mr. Crowley's attempted restatement of CSX and NS revenue adequacy and jurisdictional threshold determinations includes (albeit incorrectly) the effects of the anticipated purchase accounting adjustments and write-up of Conrail's assets (which increase net investment, return on investment, and depreciation expenses), but it entirely omits the effects of merger efficiencies (which reduce operating expenses) and traffic gains (which increase net revenues and net income). As a consequence, Mr. Crowley's prediction that the proposed transaction will significantly increase applicable regulatory rate "ceilings" is invalid.

REVENUE ADEQUACY ERRORS

Mr. Crowley asserts that the effect of including the full acquisition cost of Conrail in CSX and NS financial (Form R-1) reports will be to reduce dramatically the carriers' rates of return for revenue adequacy purposes, and thus to make it more difficult for shippers to qualify for relief from unreasonable rates under the revenue adequacy component of the Board's Constrained Market Pricing rate standards for coal shipments as to which the serving railroad possesses market dominance.[15] Using 1996 as his study year and the purchase accounting adjustments supported by the pro forma financial statements included in the Application (which were based on 1995 data), Mr. Crowley claims to show that, when the combined CSX/Conrail and NS/Conrail financial results for that year are adjusted (as

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[15] See Coal Rate Guidelines, Nationwide, 1 I.C.C.2d 520, 534-37 (1985), aff'd sub nom. Consolidated Rail Corp. v. United States, 812 F.2d 1444 (3d Cir. 1988). The revenue adequacy constraint embodies the principle that railroad revenues should not, in the long run, exceed those necessary to attain a rate of return equal to the nominal pre-tax cost of capital for the industry. The practical significance of this regulatory rate "ceiling" is open to debate. I understand that, since the Board (and its predecessor) commenced annual revenue adequacy determinations about two decades ago, no railroad rate has ever been found unreasonable nor any rate relief awarded on this ground.

required under the Board's accounting rules) to reflect the acquisition cost of Conrail -- by increasing net investment to substitute the acquisition cost for Conrail's pre-transaction book value and by reducing NROI to reflect additional depreciation expense on the increased investment base -- CSX/Conrail's rate of return would drop from 8.8 percent to 6.2 percent, while NS/Conrail's rate of return would fall from 11.6 percent to 7.6 percent. Crowley VS at 33-35 & Exhibit TDC-14.[16] The effect of using acquisition cost for revenue adequacy purposes, he concludes, is to cause the combined CSX/Conrail and NS/Conrail systems to fall farther short of the revenue adequacy level (11.9 percent in 1996 based on the Board's cost of capital findings), thereby limiting otherwise available rate relief.

Mr. Crowley's analysis (which is displayed in his Exhibit TDC-14) contains three fundamental errors -- two that are technical in nature and one that is more fundamental.

First, Mr. Crowley adjusted the figure for "Net Investment in Road and Equipment" (which forms part of the denominator in the rate of return computation) to reflect a required write-up in the value of the Conrail assets to acquisition cost, but he miscalculated the amount of the write-up. Mr. Crowley calculated the amount of the write-up (which he (mis)-

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[16] Even without adjustments to reflect the full acquisition cost of Conrail, CSX and NS rates of return for revenue adequacy purposes will be affected by the proposed transaction simply by virtue of the arithmetical effect of combining CSX and NS with their respective assigned portions of Conrail. Because Conrail's 1996 rate of return (8.4 percent) was less than that of both CSX (8.9 percent) and NS (13.0 percent), including the assigned portions of Conrail in consolidated CSX and NS reports would arithmetically reduce their rates of return. This averaging impact is reflected in Mr. Crowley's Exhibit TDC-14. It shows that, while CSX's rate of return for revenue adequacy purposes was 8.9 percent in 1996, restating its rate of return to include 42 percent of Conrail's financial results would reduce the CSX/Conrail rate of return to 8.8 percent. Similarly, including 58 percent of Conrail's 1996 financial results with NS's results (reflecting NS's ownership share of Conrail) would reduce NS's rate of return for 1996 from 13.0 percent to 11.6 percent -- even assuming no change in Conrail's books to reflect acquisition cost. Kahn/Dunbar and Crowley do not object to this impact of the transaction on CSX and NS rates of return, as it is an unavoidable effect of combining portions of Conrail with CSX and NS. To the contrary, this effect is reflected in Mr. Crowley's portrayal of the accounting procedures he urges the Board to adopt in this case. Crowley VS at 37.

characterizes as the "acquisition premium") by subtracting the pre-transaction book value of Conrail shares ($3,169 million) (by which Mr. Crowley apparently means total shareholder equity) from the cash purchase price paid by CSX and NS for Conrail's shares ($9,895 million), and then adding to this amount his estimate of the value of Conrail's accumulated depreciation and asset disposition charges that would be eliminated by the transaction ($2,387 million). Mr. Crowley treats the result of this computation ($9,113 million) as the amount of the required write-up in the value of Conrail's assets for revenue adequacy purposes. Crowley VS, Exhibit TDC-11.

Mr. Crowley's computations are incorrect. As previously discussed, the amount of the required write-up in the value of the acquired Conrail assets is based on the difference between the acquisition cost of Conrail (here, the estimated fair value of Conrail's assets, which is less than the total purchase price of cash and assumed liabilities) and the pre-existing depreciated book value of Conrail's road property and equipment assets. That figure, based on the pro forma financial statements included in the Application and the preliminary Price Waterhouse fair value estimate, is $9,550 million. Mr. Crowley's convoluted computation involving the cash consideration (excluding assumed liabilities) and the amount of Conrail's shareholder equity does not reflect correct accounting rules, even though his results were not terribly far off from the correct figure.

Second, Mr. Crowley also increased the figure for accumulated deferred taxes by $3,490 million to reflect what he believed would be the impact of the proposed transaction on the combined accumulated deferred taxes for CSX/Conrail and NS/Conrail. Crowley VS, Exhibits TDC-11 & TDC-14. The correct figure, as shown in Exhibit WWW-2, is $3,567 million, and it appears clearly in the pro forma financial statements. CSX/NS-18, Vol. 1, at 133, 171. Rather than use these readily available figures for both CSX and NS, Mr. Crowley derived the total adjustment for accumulated depreciation by dividing the CSX figure by 42 percent (CSX's ownership share of Conrail). The allocation of the accumulated depreciation adjustment between the carriers is not based precisely on the 42%/58%

ownership division. Mr. Crowley's figure is therefore incorrect and off by a relatively small amount.

Third, and **most important**, Mr. Crowley's calculations give no effect whatsoever to the positive projected impacts of the proposed Conrail transaction on operating expenses, revenues, and NROI. Mr. Crowley's computations reflect an assumed increase in operating expenses of $220.01 million, which involve the increased depreciation expense associated with the anticipated write-up in the value of Conrail's assets. Crowley VS, Exhibit TDC-14. But Mr. Crowley simply ignored the offsetting effects on NROI resulting from projected reductions in operating expenses and increases in revenues from transaction-related traffic gains. This omission is significant. The pro forma financial statements included in the Application (which Mr. Crowley has not challenged) show that, as a result of the proposed transaction, the "normal" year NROI of the CSX/Conrail and NS/Conrail systems will increase by a total of $620 million -- even after taking account of the increased depreciation expenses associated with the anticipated write-up in the value of the Conrail assets. CSX/NS-18, Vol. 1, at 150, 181.

This is a fundamental defect in Mr. Crowley's analysis. In effect, his restatement of the CSX and NS rates of return reflect (albeit incorrectly) those features of the proposed transaction that reduce the carriers' rates of return, but leaves out all other features that will increase the rates of return. The very point of the transaction, and the willingness of CSX and NS to incur the price they paid for Conrail, is to achieve merger-related efficiencies, incremental traffic and revenue gains, service improvements, and other benefits. It is seriously misleading for Mr. Crowley to focus solely on the aspects of the proposed transaction that would reduce CSX and NS rates of return while ignoring the other aspects that would have the opposite effect.

Mr. Crowley's attempted restatement of combined CSX/Conrail and NS/Conrail rates of return for revenue adequacy purposes is largely based on the same materials underlying the pro forma financial statements included in the Application. For this reason, they can

readily be adjusted to correct the three errors I have just identified. I have done so both for the year 1995 (which is used in the pro formas and from which much of Mr. Crowley's data were derived) and 1996 (the year used in Mr. Crowley's analysis). For each year, I have restated Mr. Crowley's Exhibit TDC-14 to substitute the correct figures for increased net investment and accumulated deferred taxes and to incorporate the projected net operating income gain of $620 million in the NROI figure. The results of my analysis are contained in Exhibit WWW-3 (for 1995) and Exhibit WWW-4 (for 1996).

My analysis shows that, when Mr. Crowley's rate of return calculations are corrected and the projected merger efficiencies and incremental traffic and revenue gains are taken into account (as they must be), CSX and NS rates of return for revenue adequacy purposes are not significantly reduced as a result of the proposed transaction. To the contrary, the overall impact is to increase the carriers' rates of return for revenue adequacy purposes.

For the year 1995, which is the more pertinent year for purposes of merger-impact analyses, CSX/Conrail's rate of return would increase from 6.6 percent to 7.4 percent, while NS/Conrail's rate of return would hold steady at 10.4 percent. The composite rate of return on investment for all three carriers, taking into account the full acquisition cost of Conrail and merger efficiencies and traffic gains, increases from 8.5 percent to 9.0 percent. The latter figures are most relevant in assessing the overall impact of the proposed transaction on all CSX, NS, and Conrail shippers as a group.

For the year 1996, assuming the projected "normal" year income benefits of the transaction would apply without change from 1995, CSX/Conrail's rate of return would again increase (from 8.8 percent to 9.1 percent), while NS/Conrail's rate of return would fall by a negligible amount (from 11.6 percent to 11.2 percent). For the three carriers as a whole, the composite rate of return would hold constant at 10.2 percent.

These results, it should be added, do not take into account any other factors -- such as normal economic-related traffic growth and additional productivity improvements -- that

could also improve the financial results of the consolidated CSX/Conrail and NS/Conrail systems.

In sum, even when revenue adequacy determinations for CSX and NS are based on the acquisition cost of Conrail, as is clearly required under the Board's accounting rules and precedent, it is unlikely that the carriers' rates of return for revenue adequacy purposes will be adversely affected in any significant way. Indeed, available evidence suggests that they will, in general, be positively affected.

JURISDICTIONAL THRESHOLD ERRORS

Mr. Crowley further claims that, if the acquisition cost of Conrail is used for r/vc jurisdictional threshold purposes, the system-average variable costs and resulting 180 percent r/vc jurisdictional threshold will be increased, thus permitting CSX and NS to increase rates to "captive" shippers without regulatory interference or scrutiny. He purports to quantify this impact by calculating the system-average URCS variable costs and jurisdictional threshold for hypothetical CSX and NS coal traffic movements using both Conrail's predecessor cost (i.e., the net book value of Conrail's road property and equipment before the transaction) and acquisition cost (i.e., reflecting the purchase accounting adjustments displayed in the pro forma financial statements). Crowley VS at 30-33.

Based on 1995 restated URCS formulas for the combined CSX/Conrail and NS/-Conrail systems, Mr. Crowley claims to show that the effect of using acquisition cost rather than predecessor cost in jurisdictional threshold determinations would be to increase the variable costs and jurisdictional threshold for a hypothetical CSX coal movement by 15 percent, and to increase the comparable results for a hypothetical NS coal movement by 24 percent. Crowley VS at 30-33 & Exhibits TDC-12 & TDC-13. These increases result because the purchase accounting adjustments to write up the value of Conrail's assets to reflect acquisition cost increase both the net investment on which the return on investment component of URCS variable costs is calculated and variable depreciation expenses.

Mr. Crowley's jurisdictional threshold computations contain multiple errors, including errors of commission and errors of omission. The errors of commission, largely technical in nature, are reasonably quantifiable and correctable. Correcting the errors of omission -- including Mr. Crowley's complete failure to incorporate in his revised URCS variable cost formulas any of the anticipated merger-related efficiencies that would substantially reduce variable operating expenses[17] -- would, on the other hand, involve entirely rebuilding the base year URCS formulas for the combined CSX/Conrail and NS/Conrail systems and assessing the indirect effects of the proposed transaction on other URCS inputs (such as the industry cost of capital). These tasks could not be completed in the limited time available for this response. Accordingly, I address the errors of commission first, and then enumerate the major errors of omission.

Miscalculation and
Misassignment of the Investment Base

One of the three principal components of URCS variable costs is return on investment, which is computed by multiplying net investment in road property and equipment assets by the industry cost of capital rate. In an attempt to show that the use of acquisition cost for regulatory purposes would increase variable return on investment costs, Mr. Crowley adjusted the pro forma 1995 CSX/Conrail and NS/Conrail URCS formulas to reflect the anticipated write-up in the value of Conrail's assets required under the Board's purchase accounting rules. In doing so, however, Mr. Crowley committed errors both in calculating the amount of the write-up and in the methodology by which the write-up is allocated to individual property accounts.

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[17] I would note here that, in response to Applicants' discovery requests, ACE, et al. have admitted that Mr. Crowley's analysis of post-transaction variable costs and jurisdictional threshold levels for hypothetical traffic movements omitted any consideration of the effects of anticipated merger efficiencies on URCS unit costs. Interrogatory Response, ACE, et al.-20 at 21-22; Interrogatory Response, CD-09 at 12-13.

The correct way to reflect the necessary write-up in asset values required under the Board's purchase accounting rules is displayed in Exhibit WWW-5. Using the preliminary Price Waterhouse estimate of the fair value of Conrail's assets as my guide (consistent with the pro forma financial statements included in the Application), I have distributed the purchase accounting adjustment to net investment in road property and equipment ($9,550 million) to the various property accounts based on the Price Waterhouse preliminary estimated fair values for each property account. Because the preliminary Price Waterhouse analysis includes separate fair value estimates for each property account, the adjustments for each account reflect those specific values. The total $9,550 million adjustment to arrive at a fair market value of $16,243 million is comprised of the elimination of $2,472.8 million in accumulated depreciation and a $7,077.2 million write-up in asset values.

Mr. Crowley's development of the purchase accounting adjustments to reflect the Conrail acquisition cost is displayed in Exhibit WWW-6. This exhibit also compares Mr. Crowley's development to the correct amounts shown on Exhibit WWW-5. Mr. Crowley's computations include the following errors:

First, Mr. Crowley miscalculated the amount of the required write-up in the value of the Conrail assets under the Board's purchase accounting rules. As I have previously discussed, the amount of the purchase accounting adjustment is $9,550 million, based on the preliminary Price Waterhouse fair value estimate and the adjusted pro forma Conrail books for the "base" year 1995. This includes, as just noted, elimination of $2,472.8 million in accumulated depreciation, and an asset write-up of $7,077.2 million. Mr. Crowley, by contrast, attempts to derive the amount of the required adjustment by taking the estimated fair value of the Conrail assets ($16,243 million), and subtracting from that amount the gross book value of Conrail's road property and equipment assets at year-end 1995 ($8,510 million), yielding an amount of $7,733 million. Crowley VS, Exhibit TDC-11. After adding this amount to the URCS investment base, Mr. Crowley then eliminates accumulated depreciation in the amount of $2,472.8 million to derive a total net purchase accounting adjustment (or write-up of Conrail assets) of $10,205.8 million.

As with Mr. Crowley's estimate of the required write-up for revenue adequacy purposes, these calculations are incorrect. They do not conform to the Board's purchase accounting rules (or those of GAAP), which establish the principles governing purchase accounting adjustments reflected on a railroad's R-1 reports and which apply equally to both revenue adequacy and jurisdictional threshold determinations based on those reports. The correct purchase accounting adjustment is $9,550 million. The relationship between the estimated fair value and gross asset book value is not relevant to this computation. Accordingly, Mr. Crowley's jurisdictional threshold calculations reflect an assumed purchase accounting adjustment that is overstated by $655.8 million.

Second, in allocating the preliminary Price Waterhouse estimated fair value of the acquired assets among the individual property accounts, Mr. Crowley included an amount ($400 million) that represents assets of Conrail's corporate parent and assets that are not part of rail operations. This amount is properly included in the SEC Report 10-K for Conrail's parent, but it is not properly included in the operating property accounts submitted in Conrail's Annual Report Form R-1 with the Board.

Third, Mr. Crowley's electronic workpapers depicting his assignment of the purchase accounting adjustments to individual property accounts contain an algebraic error affecting Account 8 (ties). The formula error introduces a double count into the amounts (i.e., the Conrail values are assigned to both CSX and NS, rather than apportioned between them). As a consequence of this one error, the purchase accounting write-up in the value of Conrail's assets is overstated by over $1 billion ($1,177 million to be precise).

Fourth, Mr. Crowley used an incorrect methodology to allocate (or spread) the total amount of the required write-up in asset values to the individual property accounts. He simply allocated the total amount in proportion to the historical 1995 amounts reflected on Conrail's books. This is inappropriate because the preliminary Price Waterhouse fair value estimate -- which is the source of the amount of the required purchase accounting write-up -- identifies estimated fair value amounts for each individual property account. Those

account-specific asset values should be employed, rather than a lump-sum pro rata allocation as used by Mr. Crowley. As a result of this error (which cannot be deemed inadvertent given the availability of the preliminary Price Waterhouse fair value estimate to Mr. Crowley), the required adjustments to most of the primary property accounts are misstated. The effect of this error is to overstate the amount of the write-up (and therefore total net investment) in the equipment accounts (which URCS treats as 100 percent variable) and to understate the amount of the write-up (and therefore total net investment) in the fixed property accounts (which URCS treats as only 50 percent variable). This, in turn, has the effect of overstating the increase in system-average variable costs resulting from the use of Conrail's acquisition cost for jurisdictional threshold purposes.

Taken together, these four computational errors significantly affect Mr. Crowley's jurisdictional threshold calculations. The amount of the purchase accounting write-up contained in Mr. Crowley's analysis is overstated by $1,577 million. Furthermore, because of his misassignment by primary account between road and equipment accounts, the variable cost investment base in his calculations is overstated by $2,179 million (or 26 percent).

Miscalculation and
Misassignment of Depreciation

Another principal category of URCS variable costs is depreciation expense, which is computed as a percentage of gross investment in road property and equipment assets. In an attempt to show that the use of acquisition cost for regulatory purposes would increase variable depreciation expense, Mr. Crowley adjusted the pro forma 1995 CSX/Conrail and NS/Conrail URCS formulas to reflect the impact of the anticipated write-up in the value of Conrail's assets on annual depreciation expense. Here too, however, his calculations contain a number of errors.

The correct procedure for adjusting depreciation expense to reflect the purchase accounting adjustments is displayed in Exhibit WWW-7. The adjustments, which are also

based on the preliminary Price Waterhouse fair value estimate and the 1995 pro forma Conrail results, reflect adjustments to annual depreciation expense for each individual property account based on the required asset value adjustment for that account. Based on these preliminary results, the post-transaction annual depreciation expense for Conrail would be $513 million.

In Exhibit WWW-8, by contrast, I display Mr. Crowley's development of the purchase accounting adjustments to reflect the impact of the transaction on depreciation expenses. This exhibit also compares Mr. Crowley's calculations with the correct figures shown in Exhibit WWW-7. Mr. Crowley's computations contain the following errors:

First, Mr. Crowley started with a total depreciation expense purchase accounting adjustment of $294 million, which in turn generates total depreciation expenses of $584 million. This exceeds the correct amount, as developed in the preliminary Price Waterhouse fair value estimate, $71 million (or 14 percent). In brief, Mr. Crowley ignored the depreciation expense estimates in the preliminary Price Waterhouse analysis, which reflected account-specific estimates of the value of the Conrail assets, their salvage value and remaining service lives, and resulting annual depreciation expense.

Second, as with the allocation of the purchase accounting write-up in investment values, Mr. Crowley misallocated the purchase accounting depreciation expense adjustments to individual property accounts by applying a lump-sum pro rata allocation rather than using the account-specific amounts shown in the preliminary Price Waterhouse fair value estimate. This error has the same effect of over-allocating depreciation expense increases to those property accounts that are highly variable and under-allocating the amounts attributable to less variable accounts.

Taken together, these two errors result in an overstatement of variable depreciation expense by $99 million (or 31 percent).

Errors
of Omission

Mr. Crowley's variable cost and jurisdictional threshold calculations also contain several errors of omission. These are, in fact, far more significant than the errors of commission previously described, but are also not amenable to a straightforward or reliable correction or restatement. In brief, the errors of omission are three in number:

First, as in the case of his revenue adequacy calculations, Mr. Crowley entirely excluded any consideration of the impact of projected merger efficiencies, and operating expense and capital expenditure reductions, on system-average URCS variable costs. As described in the Application's Summary of Benefits Statements and the pro forma financial statements, the proposed Conrail transaction will result in substantial merger efficiencies, including significant reductions in operating expenses and reductions in necessary capital expenditures. These effects would reduce URCS operating expenses (the largest component of URCS variable costs) and, through reduction in capital expenditures, reduce URCS return on investment and depreciation expenses, for particular traffic movements. These variable cost reductions would to some degree offset the increases in system-average variable return on investment and variable depreciation expenses resulting from the purchase accounting adjustments required by the Board's accounting rules.

Second, Mr. Crowley also failed to take into account in his URCS calculations the impact of anticipated changes in traffic volumes as a result of the proposed Conrail transaction. Volumes will change as a consequence of both internal reroutes and incremental traffic gains. Volume changes would affect both the URCS variability percents and resulting URCS unit costs. The amount of the impact of volume changes on post-transaction variable costs is uncertain and difficult to quantify, but the direction of the impact is clear: Mr. Crowley's failure to consider anticipated traffic volume increases resulted in an overstatement of post-transaction unit variable costs and jurisdictional threshold levels associated with the use of acquisition cost.

Third, Mr. Crowley also failed to consider the (indirect) impact of the proposed transaction on the industry cost of capital rate. As noted above, the return on investment component of URCS variable costs is computed by multiplying the carrier's net investment in road property and equipment by the industry cost of capital rate. A lower cost of capital rate for the industry means lower variable costs. Mr. Crowley's calculations utilize the 1995 industry cost of capital rate as determined by the Board. But he ignores the potential effects that the financing arrangements for the proposed Conrail transaction could have on the industry cost of capital rate.

It is beyond the reasonable scope of this testimony to assess quantitatively the impact of the transaction on the industry cost of capital rate, but several factors suggest that the impact would be to reduce it. As part of the proposed transaction, all Conrail common stock has been eliminated, having been purchased by CSX and NS, and thus will not be considered in the Board's annual cost of capital findings. Furthermore, CSX and NS have financed their respective shares of the acquisition through debt financing. Both of these changes will have the effect of changing the capital structure mix for the combined CSX-NS-Conrail, producing a higher proportion of debt and a lower proportion of equity. Because these three railroads, taken together, constitute approximately one-half of the major Class I railroads included in the Board's cost of capital findings, this shift will impact the overall industry capital structure mix. And, since the cost of debt is lower than the cost of common equity, the cost of capital will be reduced as a result of the proposed transaction. This, in turn, would be reflected in reduced URCS variable return on investment costs for particular traffic movements.

As a result of these errors of commission and omission, Mr. Crowley's variable cost and jurisdictional threshold computations tell us nothing reliable about the probable impacts of the proposed transaction (and the use of acquisition cost for regulatory purposes) on future jurisdictional threshold determinations. All of the errors identified suggest that

Mr. Crowley's predicted increase in the jurisdictional threshold levels for hypothetical traffic movements is greatly exaggerated.[18]

IMPROPER WINDFALL RESULTING FROM THE RELIEF REQUESTED BY THE SHIPPERS

A final comment is in order with regard to the specific relief that Kahn/Dunbar, Crowley and the parties they represent have requested with regard to the purchase price of Conrail. These parties seek a condition that would exclude consideration of the so-called acquisition "premium" for Conrail from consideration in either revenue adequacy or jurisdictional threshold determinations. In practical effect, they seek to require CSX and NS to account for the Conrail transaction for regulatory purposes using Conrail's predecessor cost (i.e., pre-transaction net book value of road property and equipment assets) rather than acquisition cost (as required under the USOA and GAAP).

This requested condition would inappropriately bifurcate the effects of the Conrail transaction, and confer on shippers a regulatory rate windfall. The effect of the condition would be to: (1) exclude from consideration the additional costs associated with the full acquisition cost of Conrail (including impacts on return on investment and depreciation expense) in revenue adequacy and jurisdictional threshold proceedings; while (2) at the same time including consideration of all of the offsetting benefits resulting from the transaction (including reductions in operating expenses and capital expenditures and incremental traffic

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[18] The variable cost and jurisdictional threshold calculations in individual rate complaint proceedings, moreover, are often not based on system-average URCS variable costs alone, but reflect numerous movement-specific special study adjustments to the system-average URCS values. Such special study adjustments frequently include movement-specific estimates of road property and equipment ownership costs (return on investment and depreciation expenses), which are the two URCS cost components that Mr. Crowley claims would significantly increase as a result of the use of Conrail's acquisition cost for regulatory purposes. For this reason, Mr. Crowley's estimates of the impact of acquisition cost on system-average URCS variable costs (even if they were otherwise correct) would not necessarily equate to the actual results in specific rate complaint proceedings.

and revenue gains). Thus, CSX and NS rates of return for revenue adequacy purposes would be artificially increased, and jurisdictional threshold levels would be artificially reduced, by incorporating in those determinations only the features of the Conrail transaction that benefit shippers. Shippers would then reap the full advantages of all of the merger efficiencies and benefits the transaction makes possible, but would be exempted from any of the effects of the costs incurred by CSX and NS to make those efficiencies and benefits possible.

Clearly, such a one-sided result cannot reasonably be justified. If the so-called acquisition "premium" is to be excluded from consideration in revenue adequacy and jurisdictional threshold determinations, neither should the offsetting benefits of the transaction on those findings be considered. Because the long-run effects of the proposed transaction are strongly beneficial to shippers, this would be an unfortunate result. The appropriate course of action should be to adhere to the Board's existing precedent and base revenue adequacy and jurisdictional threshold determinations on acquisition cost.

TRACKAGE RIGHTS COMPENSATION

In testimony submitted on behalf of Indianapolis Power & Light Company ("IP&L"), Mr. Crowley proposes "that the STB set trackage rights at [[[ ]]]¢ per car-mile, which equates to [[[ ]]] mills per trailing gross ton-mile for the movement by NS over CSX trackage needed to access Stout and Perry K." IPL-3, Crowley VS at 18. At page 19 of his statement, Mr. Crowley presents a table showing his development of the rate he proposes, using worktable values from an URCS he identifies as "1995 CSX/Conrail Portion URCS."[19]

I have reviewed Mr. Crowley's trackage rights compensation computations, together with the source URCS materials he used in developing them. In summary I find:

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[19] This is the URCS identified in his workpapers as CSXCRCNP files. It represents the base year CSX plus CSX's 42 percent share of the base year Conrail.

1. Mr. Crowley has developed a proposed 4Q97 cost level rate of $[[[ ]]] per car-mile, or $[[[ ]]] per trailing gross ton-mile, using URCS variable costs. He constructed this rate from the "1995 CSX/Conrail Portion URCS" and then escalated those results to 4Q97 using RCAF-A, the RCAF Index which includes a productivity adjustment. At the 1995 cost level used in the Application, these rates are $[[[ ]]] per car mile or $[[[ ]]] per trailing gross ton-mile.

2. The Board ("STB"), and before it the Interstate Commerce Commission ("ICC"), in its SSW Compensation principles calls for trackage rights fees to be computed as a usage-based share of full costs for operations and maintenance, rather than only the tenant's share of the variable portion, plus a usage-based share of a return element based on current fair market value.

3. Mr. Crowley has proposed trackage rights rates using variable costs in at least two recent merger proceedings of which I am aware, and the ICC/STB has rejected his proposals as not meeting the SSW Compensation principles both times.

4. Using full costs, rather than variable costs, the 1995 CSX/Conrail URCS produces a rate at 1995 cost levels of $[[[ ]]] per car-mile, rather than the $[[[ ]]] which Mr. Crowley proposes. Each of these rates uses Conrail (and CSX) historical 1995 investment base amounts for the ROI component of URCS, and neither incorporates the higher current fair market value for URCS ROI which results from incorporating acquisition purchase accounting adjustments to Conrail's assets.

MR. CROWLEY'S RATE
USES VARIABLE COSTS

An interesting feature of Mr. Crowley's discussion of trackage rights compensation is that nowhere in his text does the term "variable" appear in conjunction with the term "costs." Instead, he uses expressions such as "equitable compensation" and "a pro-rata share of the

costs incurred." IP&L witness Weaver and the IP&L legal narrative also studiously avoid any clarification of what level of costs is being proposed, sticking instead to phrases like "CSX's costs."

Fortunately, an examination of the URCS worktable locations referenced in the table at page 19 of Mr. Crowley's testimony reveals all.[20] Ignoring admonitions regarding the appropriate basis for computing trackage rights in the two most recent ICC/STB major merger proceedings, Mr. Crowley has developed the trackage rights rate he proposes using variable costs.

Mr. Crowley has further understated costs to be included in his proposed trackage rights rate by omitting from URCS return on investment for road property the components representing: (a) roadway machines (D1L248); and (b) work equipment (D1L250). These components are part of standard URCS road property return on investment, and represent part of the requirement to maintain track structure.

SSW COMPENSATION PRINCIPLES

In Finance Docket 30,000, the UP/MP/WP control proceeding, and in several sub-dockets to that proceeding, the ICC developed what have come to be referred to as the SSW Compensation principles. These are basic principles for setting trackage rights compensation terms in merger proceedings where the parties have been unable to reach agreement. As recently reaffirmed and summarized in the BNSF and UP/SP merger proceedings, these principles involve the sharing of costs between the landlord railroad and the tenant railroad on a relative shares of usage basis. The "below the wheel" costs to be shared are comprised of a maintenance and operations (M&O) component and an interest rental component. The

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[20] In his deposition, Mr. Crowley confirmed that he was computing variable costs in the table at page 19 of his verified statement. Crowley Dep., December 5, 1997, at 23-24. The complete transcript of Mr. Crowley's deposition is included as Exhibit WWW-10.

M&O costs include both variable costs and fixed costs, and are sometimes entitled "full" or "fully allocated" costs. The interest rental component is calculated by multiplying the current fair market value of the property (rather than book value) by the railroad industry's cost of capital.

These ICC/STB SSW Compensation principles put the tenant railroad in the same economic position as the landlord, first by using full costs rather than variable costs, and second by using the current fair market value of the property rather than pre-merger book value. If the tenant were to pay trackage rights compensation based only on variable costs, he would enjoy a competitive advantage over the landlord, as he would be making no contribution to the landlord's fixed costs -- costs which the landlord has to recover in the long run to remain in business. The problems inherent in this situation can be seen in several ways. First, in terms of bidding for traffic, insofar as the trackage rights component of costs is concerned, the tenant's variable costs and total costs are one and the same. Hence, the tenant can bid at a lower level than the landlord because he has to recover no costs over and above his variable costs while the landlord does have to cover not only variable costs but some portion of fixed costs. A second way to see the economic competitive imbalance is to assume that the tenant handled all of the traffic over the lines of the landlord. If the tenant paid only variable costs, the landlord would be left with a substantial portion of his total costs unreimbursed and no way to recover them. An analogous situation exists with regard to the base for computing return on investment. It is most evident in cases, such as the present proceeding, where there is an actual arm's length transaction that establishes fair market value. In such cases, the actual purchase price represents an expenditure by the landlord and, whether financed by debt, equity, or some combination thereof, the landlord has to recover his cost of capital on the funds.

Mr. Crowley's variable cost computations and proposals have attracted the attention and specific comment of the ICC/STB in both the BNSF merger proceeding and in the UP/SP merger proceedings. In each of these proceedings, his variable cost proposals have been explicitly rejected

COMPENSATION RATE USING
1995 HISTORICAL FULL COSTS

In other testimony on behalf of ACE, et al., Mr. Crowley attempts to incorporate the current fair market value of Conrail into URCS-based variable cost and jurisdictional threshold computations. Here, when addressing a trackage rights rate that forms part of the basis of IP&L's proposed conditions, however, he uses the historical 1995 book value of Conrail. In order to demonstrate the significance of the error he makes in only using variable costs, I also use historical 1995 book value of Conrail even though, as noted above, SSW Compensation requires using the higher current values.

I have computed 1995 CSX/Conrail URCS "below the wheel" costs for line haul trackage rights using the same URCS as contained in Mr. Crowley's workpapers. Using the same method followed by applicants in UP/SP for operating and maintenance costs, but including only 1995 historical costs for investment and depreciation, I have calculated full (or fully allocated) costs (i.e., including both the variable and the fixed portions of unit costs). Components of these costs are presented in Exhibit WWW-9. As shown, the full cost (at 1995 cost levels using 1995 historical Conrail (and CSX) book value for the investment base) for line haul trackage rights is $[[[ ]]] per car-mile, or $[[[ ]]] per gross ton-mile. The rates which Mr. Crowley proposes are less than half the rates that would be computed using fully allocated costs as the Board's precedents require.[21] Hence, Mr. Crowley's analyses offer no reason to depart from the trackage rights rate negotiated by CSX and NS.

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[21] I note that, for rail activities taken as a whole in 1995, variable costs represented approximately 70 percent of total costs for Conrail and CSX. For "below the wheel" costs, however, the variable percent is less since: (a) road property and return on road property are 50 percent variable with volume; and (b) the RMAINT regression equation, which drives a large portion of running maintenance of way costs, produces a variability percent of approximately 60 percent for Conrail and CSX; and (c) the major portion of train control costs are treated as zero percent variable by URCS.

VERIFICATION

I, William W. Whitehurst, Jr., declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this statement.

William W. Whitehurst, Jr.

Executed on: DECEMBER 8, 1997

EXHIBIT WWW-1

Conrail Estimated Asset Fair Values and Annual Depreciation

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PRO FORMA BALANCE SHEET
CONRAIL
(In Millions)

Line No.	Line Item Detail (1)	Conrail Base Year (2)	Purchase Accounting Adjustments CSX (3)	Purchase Accounting Adjustments NS (4)	Purchase Accounting Adjustments Total (5) (3) + (4)	Conrail Base Year Incl Purch Acctng Adj (6) (2) + (5)
	ASSETS					
	CURRENT ASSETS					
1	CASH, CASH EQUIVALENTS, & SHORT-TERM INVESTMENTS	110			0	110
2	ACCOUNTS RECEIVABLE	614			0	614
3	OTHER CURRENT ASSETS	519			0	519
4	TOTAL CURRENT ASSETS	1,243	0	0	0	1,243
5	PROPERTIES-NET	6,693	4,011	5,539	9,550	16,243
6	OTHER LONG-TERM ASSETS	810	764	958	1,722	2,532
7	TOTAL ASSETS	8,746	4,775	6,497	11,272	20,018
	LIABILITIES AND SHAREHOLDERS' EQUITY					
	CURRENT LIABILITIES					
8	SHORT-TERM DEBT	89			0	89
9	CURRENT MATURITIES OF LONG-TERM DEBT	181			0	181
10	ACCOUNTS PAYABLE AND OTHER CURRENT LIABILITIES	900	170	219	389	1,289
11	TOTAL CURRENT LIABILITIES	1,170	170	219	389	1,559
12	LONG-TERM DEBT	1,911	4,277	5,928	10,205	12,116
13	DEFERRED INCOME TAXES	1,523	1,466	2,101	3,567	5,090
14	OTHER LONG-TERM LIABILITIES	973	193	87	280	1,253
15	TOTAL LIABILITIES	5,577	6,106	8,335	14,441	20,018
	SHAREHOLDERS' EQUITY					
16	COMMON STOCK, $1 PAR VALUE	85	(36)	(49)	(85)	0
17	ESOP PREFERED STOCK	282	(118)	(164)	(282)	0
18	OTHER CAPITAL	1,434	(602)	(832)	(1,434)	0
19	RETAINED EARNINGS	1,368	(575)	(793)	(1,368)	0
20	TOTAL SHAREHOLDERS' EQUITY	3,169	(1,331)	(1,838)	(3,169)	0
21	TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	8,746	4,775	6,497	11,272	20,018

1995
IMPACT OF CONRAIL AND CONRAIL "PREMIUM" ON REVENUE ADEQUACY CALCULATIONS

	1995 STB FINDING				CSX & NS With CR				CSX & NS With CR And Acquisition "Premium"		
Railroad (1)	Conrail (2)	CSX (3)	NS (4)	Conrail + CSX + NS (5)	CSX With CR 4/ (6)	NS With CR 4/ (7)	Conrail "Premium" (8)		CSX With CR 5/ (9)	NS With CR 5/ (10)	CSX + NS With CR 5/ (11)
Combined/Consolidated NROI	349,999	425,223	715,471	1,490,693	572,223	918,470	620,000		832,623	1,278,070	2,110,693
+ Interest From Working Cap. Cash	320	7,156	14,704	22,180	7,290	14,890	0		7,290	14,890	22,180
+Inc Tax Non-rail	(2,518)	5,171	24,569	27,222	4,113	23,109	0		4,113	23,109	27,222
-Incremental Depreciation	0			0			0	1/	0	0	0
+Net gain transfers	14,843	18,255	4,409	37,507	24,489	13,018	0		24,489	13,018	37,507
**** Adjusted NROI ****	**362,644**	**455,805**	**759,153**	**1,577,602**	**608,115**	**969,487**	**620,000**		**868,515**	**1,329,087**	**2,197,602**
Comb Net Inv R&E End	6,355,952	8,949,689	8,589,425	23,895,066	11,619,189	12,275,877	9,550,000	2/	15,630,189	17,814,877	33,445,066
Comb Net Inv R&E Start	6,440,455	8,812,775	8,347,025	23,600,255	11,517,766	12,082,489	9,550,000	2/	15,528,766	17,621,489	33,150,255
Comb Net Inv R&E Av	**6,398,204**	**8,881,232**	**8,468,226**	**23,747,661**	**11,568,477**	**12,179,183**	**9,550,000**		**15,579,477**	**17,718,183**	**33,297,661**
OE Inv End	0	0	0	0	0	0	0		0	0	0
OE Inv Start	0	0	0	0	0	0	0		0	0	0
OE Inv Av	**0**	**0**	**0**	**0**	**0**	**0**	**0**		**0**	**0**	**0**
IDC End	0	0	3,197	3,197	0	3,197	0		0	3,197	3,197
IDC Start	0	0	3,251	3,251	0	3,251	0		0	3,251	3,251
IDC Av	**0**	**0**	**3,224**	**3,224**	**0**	**3,224**	**0**		**0**	**3,224**	**3,224**
Net Rail Rel Ass. End	31,919	0	0	31,919	13,406	18,513	0		13,406	18,513	31,919
Net Rail Rel Ass. Start	32,780	0	0	32,780	13,768	19,012	0		13,768	19,012	32,780
Net Rail Rel Ass. Av	**32,350**	**0**	**0**	**32,350**	**13,587**	**18,763**	**0**		**13,587**	**18,763**	**32,350**
Work Cap End	208,202	109,665	268,265	586,132	197,110	389,022	0		197,110	389,022	586,132
Work Cap Start	187,974	116,802	239,399	544,175	195,751	348,424	0		195,751	348,424	544,175
Work Cap Av	**198,088**	**113,234**	**253,832**	**565,154**	**196,430**	**368,723**	**0**		**196,430**	**368,723**	**565,154**
Acc Def Tax End	1,400,411	2,063,544	2,524,852	5,988,807	2,651,717	3,337,090	3,567,000	3/	4,149,857	5,405,950	9,555,807
Acc Def Tax Start	1,211,565	2,004,995	2,400,487	5,617,047	2,513,852	3,103,195	3,567,000	3/	4,011,992	5,172,055	9,184,047
Acc Def Tax Av	**1,305,988**	**2,034,270**	**2,462,670**	**5,802,927**	**2,582,784**	**3,220,143**	**3,567,000**		**4,080,924**	**5,289,003**	**9,369,927**
Tax Adj Net Inv Base End	5,195,662	6,995,810	6,329,641	18,521,113	9,177,988	9,343,125	5,983,000		11,690,848	12,813,265	24,504,113
Tax Adj Net Inv Base Start	5,449,644	6,924,582	6,182,686	18,556,912	9,213,432	9,343,480	5,983,000		11,726,292	12,813,620	24,539,912
* **Tax Adj Net Inv Base** *	**5,322,653**	**6,960,196**	**6,256,164**	**18,539,013**	**9,195,710**	**9,343,302**	**5,983,000**		**11,708,570**	**12,813,442**	**24,522,013**
TAX ADJUSTED ROI	**6.8%**	**6.5%**	**12.1%**	**8.5%**	**6.6%**	**10.4%**	**10.4%**		**7.4%**	**10.4%**	**9.0%**

1996
IMPACT OF CONRAIL AND CONRAIL "PREMIUM" ON REVENUE ADEQUACY CALCULATIONS

Railroad (1)	1996 STB FINDING: Conrail (2)	CSX (3)	NS (4)	Conrail + CSX + NS (5)	CSX & NS With CR: CSX With CR 4/ (6)	NS With CR 4/ (7)	Conrail "Premium" (8)		CSX & NS With CR And Acquisition "Premium": CSX With CR 5/ (9)	NS With CR 5/ (10)	CSX + NS With CR 5/ (11)
Combined/Consolidated NROI	435,305	610,621	787,725	1,833,651	793,449	1,040,202	620,000		1,053,849	1,399,802	2,453,651
+ Interest From Working Cap. Cash	253	8,929	12,835	22,017	9,035	12,982	0		9,035	12,982	22,017
+Inc Tax Non-rail	(6,166)	3,241	23,660	20,735	651	20,084	0		651	20,084	20,735
-Incremental Depreciation	0			0			0	1/	0	0	0
+Net gain transfers	11,014	13,133	16,646	40,793	17,759	23,034	0		17,759	23,034	40,793
** Adjusted NROI **	440,406	635,924	840,866	1,917,196	820,895	1,096,301	620,000		1,081,295	1,456,901	2,537,196
Comb Net Inv R&E End	6,591,515	9,482,069	8,912,338	24,985,922	12,250,505	12,735,417	9,550,000	2/	16,261,505	18,274,417	34,535,922
Comb Net Inv R&E Start	6,355,952	8,949,689	8,589,425	23,895,066	11,619,189	12,275,877	9,550,000	2/	15,630,189	17,814,877	33,445,066
Comb Net Inv R&E Av	6,473,734	9,215,879	8,750,882	24,440,494	11,934,847	12,505,647	9,550,000		15,945,847	18,044,647	33,990,494
OE Inv End	0	0	0	0	0	0	0		0	0	0
OE Inv Start	0	0	0	0	0	0	0		0	0	0
OE Inv Av	0	0	0	0	0	0	0		0	0	0
IDC End	0	0	3,014	3,014	0	3,014	0		0	3,014	3,014
IDC Start	0	0	3,197	3,197	0	3,197	0		0	3,197	3,197
IDC Av	0	0	3,106	3,106	0	3,106	0		0	3,106	3,106
Net Rail Rel Ass. End	23,017	0	0	23,017	9,667	13,350	0		9,667	13,350	23,017
Net Rail Rel Ass. Start	31,919	0	0	31,919	13,406	18,513	0		13,406	18,513	31,919
Net Rail Rel Ass. Av	27,468	0	0	27,468	11,537	15,931	0		11,537	15,931	27,468
Work Cap End	144,679	123,537	267,241	535,457	184,302	351,155	0		184,302	351,155	535,457
Work Cap Start	208,202	109,665	268,265	586,132	197,110	389,022	0		197,110	389,022	586,132
Work Cap Av	176,441	116,601	267,753	560,795	190,706	370,088	0		190,706	370,088	560,795
Acc Def Tax End	1,484,091	2,310,618	2,612,504	6,407,213	2,933,936	3,473,277	3,567,000	3/	4,432,076	5,542,137	9,974,213
Acc Def Tax Start	1,400,411	2,063,544	2,524,852	5,988,807	2,651,717	3,337,090	3,567,000	3/	4,149,857	5,405,950	9,555,807
Acc Def Tax Av	1,442,251	2,187,081	2,568,678	6,198,010	2,792,826	3,405,184	3,567,000		4,290,966	5,474,044	9,765,010
Tax Adj Net Inv Base End	5,275,120	7,294,988	6,564,061	19,134,169	9,510,538	9,623,631	5,983,000		12,023,398	13,093,771	25,117,169
Tax Adj Net Inv Base Start	5,195,662	6,995,810	6,329,641	18,521,113	9,177,988	9,343,125	5,983,000		11,690,848	12,813,265	24,504,113
* Tax Adj Net Inv Base *	5,236,391	7,145,399	6,446,851	18,827,641	9,344,263	9,483,378	5,983,000		11,857,123	12,953,518	24,810,641
TAX ADJUSTED ROI	8.4%	8.9%	13.0%	10.2%	8.8%	11.6%	10.4%		9.1%	11.2%	10.2%

W.W.Whitehurst & Associates, Inc.

Exhibit WWW - 5
Page 1 of 3

CALCULATION OF CONRAIL PURCHASE ACCOUNTING ASSET ADJUSTMENTS BY PROPERTY ACCOUNT
- USING CONRAIL FAIR MARKET VALUE PER PRICE WATERHOUSE
(Dollars In Thousands)

Line No.	ICC	Description	Pre-Acquisition Book Value: Gross (Sch 330) 12/31/95	Pre-Acquisition Book Value: Accum Depr (Sch 335) 12/31/95	Pre-Acquisition Book Value: Net Book Value	Fair Market Value 06/97[2]	Purchase Accounting Asset Adjustment: Decrease in Accum Depr	Purchase Accounting Asset Adjustment: Increase in Asset Value	Post-Acquisition Book Value: Gross (Sch 330) 12/31/95	Post-Acquisition Book Value: Accum Depr (Sch 335) 12/31/95	Post-Acquisition Book Value: Net Book Value
	(1)	(2)	(3)	(4)	(5) (3) - (4)	(6)	(7) - (4)	(8) (6) - (3)	(9) (3) + (8)	(10) (4) + (7)	(11) (9) - (10)
		Road									
1	2	Land for transportation purposes	109,942	0	109,942	1,400,000	0	1,290,058	1,400,000	0	1,400,000
2	3	Grading	209,689	22,811	186,878	3,307,500	(22,811)	3,097,811	3,307,500	0	3,307,500
3	4	Other right-of-way expenditures	2,586	757	1,829	3,000	(757)	414	3,000	0	3,000
4	5	Tunnels and subways	27,688	2,874	24,814	349,500	(2,874)	321,812	349,500	0	349,500
5	6	Bridges, trestles, and culverts	227,358	51,941	175,417	2,777,500	(51,941)	2,550,142	2,777,500	0	2,777,500
6	7	Elevated structures	2,575	2,769	(194)	16,000	(2,769)	13,425	16,000	0	16,000
7	8	Ties	1,294,855	201,778	1,093,077	1,117,500	(201,778)	(177,355)	1,117,500	0	1,117,500
8	9	Rail and other track material	2,503,630	304,233	2,199,397	2,707,500	(304,233)	203,870	2,707,500	0	2,707,500
9	11	Ballast	877,012	(10,865)	887,877	1,687,500	10,865	810,488	1,687,500	0	1,687,500
10	13	Fences, snowsheds, and signs	1,309	543	766	4,000	(543)	2,691	4,000	0	4,000
11	16	Stations and office buildings	183,645	59,494	124,151	292,000	(59,494)	108,355	292,000	0	292,000
12	17	Roadway buildings	11,937	4,574	7,363	5,000	(4,574)	(6,937)	5,000	0	5,000
13	18	Water stations	480	343	137	1,000	(343)	520	1,000	0	1,000
14	19	Fuel stations	33,619	8,964	24,655	30,000	(8,964)	(3,619)	30,000	0	30,000
15	20	Shops and enginehouses	84,747	33,860	50,887	149,500	(33,860)	64,753	149,500	0	149,500
16	22	Storage warehouses	0	0	0	0	0	0	0	0	0
17	23	Wharves and docks	936	58	878	2,000	(58)	1,064	2,000	0	2,000
18	24	Coal and ore wharves	79,151	23,957	55,194	50,000	(23,957)	(29,151)	50,000	0	50,000
19	25	TOFC/COFC terminals	77,212	31,587	45,625	69,500	(31,587)	(7,712)	69,500	0	69,500
20	26	Communication systems	121,275	76,965	44,310	48,000	(76,965)	(73,275)	48,000	0	48,000
21	27	Signals and interlockers	368,989	131,446	237,543	473,000	(131,446)	104,011	473,000	0	473,000
22	29	Power plants	1,140	476	664	2,000	(476)	860	2,000	0	2,000
23	31	Power-transmission systems	8,981	5,293	3,688	7,000	(5,293)	(1,981)	7,000	0	7,000
24	35	Miscellaneous structures	3,868	530	3,338	3,000	(530)	(868)	3,000	0	3,000
25	37	Roadway machines	98,537	73,495	25,042	60,000	(73,495)	(38,537)	60,000	0	60,000
26	39	Public improvements-Construction	43,207	5,225	37,982	30,000	(5,225)	(13,207)	30,000	0	30,000
27	44	Shop machinery	52,041	27,817	24,224	56,000	(27,817)	3,959	56,000	0	56,000
28	45	Power-plant machinery	3,739	3,198	541	8,000	(3,198)	4,261	8,000	0	8,000

P-703

CALCULATION OF CONRAIL PURCHASE ACCOUNTING ASSET ADJUSTMENTS BY PROPERTY ACCOUNT - USING CONRAIL FAIR MARKET VALUE PER PRICE WATERHOUSE

(Dollars In Thousands)

Line No.	ICC	Description	Pre-Acquisition Book Value: Gross (Sch 330) 12/31/95	Pre-Acquisition Book Value: Accum Depr (Sch 335) 12/31/95	Pre-Acquisition Book Value: Net Book Value	Fair Market Value 06/97[2]	Purchase Accounting Asset Adjustment: Decrease in Accum Depr	Purchase Accounting Asset Adjustment: Increase in Asset Value	Post-Acquisition Book Value: Gross (Sch 330) 12/31/95	Post-Acquisition Book Value: Accum Depr (Sch 335) 12/31/95	Post-Acquisition Book Value: Net Book Value
	(1)	(2)	(3)	(4)	(5) (3) - (4)	(6)	(7) - (4)	(8) (6) - (3)	(9) (3) + (8)	(10) (4) + (7)	(11) (9) - (10)
29		Other	0	45,569	(45,569)	0	(45,569)	0	0	0	0
30		Amortization (adjustments)[1]	0	438,536	(438,536)	0	(438,536)	0	0	0	0
31		Total Expenditures for Road	6,430,148	1,548,228	4,881,920	14,656,000	(1,548,228)	8,225,852	14,656,000	0	14,656,000
		Equipment									
32	52	Locomotives	1,138,328	469,155	669,173	650,000	(469,155)	(488,328)	650,000	0	650,000
33	53	Freight-train cars	741,841	313,823	428,018	469,000	(313,823)	(272,841)	469,000	0	469,000
34	54	Passenger-train cars	0	0	0	0	0	0	0	0	0
35	55	Highway revenue equipment	2,790	1,920	870	1,000	(1,920)	(1,790)	1,000	0	1,000
36	56	Floating equipment	0	0	0	0	0	0	0	0	0
37	57	Work equipment	84,682	50,271	34,411	40,000	(50,271)	(44,682)	40,000	0	40,000
38	58	Miscellaneous equipment	31,401	26,735	4,666	6,000	(26,735)	(25,401)	6,000	0	6,000
39	59	Computer systems	79,785	62,374	17,411	21,000	(62,374)	(58,785)	21,000	0	21,000
40		Amortization (adjustments)[1]	0	300	(300)	0	(300)	0	0	0	0
41		Total Expenditures for Equipment	2,078,827	924,578	1,154,249	1,187,000	(924,578)	(891,827)	1,187,000	0	1,187,000
42		Total Road + Equipment	8,508,975	2,472,806	6,036,169	15,843,000	(2,472,806)	7,334,025	15,843,000	0	15,843,000
43		Non-operating & disposition assets[3]	336,825	0	336,825	400,000	0	63,175	400,000	0	400,000
44		Total	8,845,800	2,472,806	6,372,994	16,243,000	(2,472,806)	7,397,200	16,243,000	0	16,243,000
		Assets not considered by Price Waterhouse study:									
45	76	Interest during construction	0	0	0	0	0	0	0	0	0
46	80	Other elements of investment	0	0	0	0	0	0	0	0	0
47	90	Construction in progress	320,006	0	320,006	320,006	0	0	320,006	0	320,006
48		GRAND TOTAL	9,165,806	2,472,806	6,693,000	16,563,006	(2,472,806)	7,397,200	16,563,006	0	16,563,006

W.W.Whitehurst & Associates, Inc.

CALCULATION OF CONRAIL PURCHASE ACCOUNTING ASSET ADJUSTMENTS BY PROPERTY ACCOUNT
- USING CONRAIL FAIR MARKET VALUE PER PRICE WATERHOUSE
(Dollars In Thousands)

Line No.	ICC	Description	Pre-Acquisition Book Value			Fair Market Value	Purchase Accounting Asset Adjustment		Post-Acquisition Book Value		
			Gross (Sch 330) 12/31/95	Accum Depr (Sch 335) 12/31/95	Net Book Value	06/97[2]	Decrease in Accum Depr	Increase in Asset Value	Gross (Sch 330) 12/31/95	Accum Depr (Sch 335) 12/31/95	Net Book Value
	(1)	(2)	(3)	(4)	(5) (3) - (4)	(6)	(7) - (4)	(8) (6) - (3)	(9) (3) + (8)	(10) (4) + (7)	(11) (9) - (10)

[1] Allowance for Disposition of Assets.
[2] Source: NS-20-CO-00103.
[3] Assets of the parent corporation that are not part of the railroad.

CALCULATION OF CONRAIL PURCHASE ACCOUNTING ASSET ADJUSTMENTS BY PROPERTY ACCOUNT - AS CONTAINED IN T.D. CROWLEY WORKPAPER FILES PREM95.WK4 AND NSPREM.WK4

(Dollars In Thousands)

Line No.	ICC (1)	Description (2)	Pre-Acquisition Book Value: Gross (Sch 330) 12/31/95 (3)	Pre-Acquisition Book Value: Accum Depr (Sch 335) 12/31/95 (4)	Pre-Acquisition Book Value: Net Book Value (5) (3) - (4)	Crowley Adjustments: Purchase Accounting Asset Adjustment: Decrease in Accum Depr (6) - (4)	Crowley Adjustments: Purchase Accounting Asset Adjustment: Increase in Asset Value (7)	Assumed Fair Market Value (8) (3) + (7)	Fair Market Value 06/97[2] (9)	TDC Over/ (Under) FMV (10)
		Road								
1	2	Land for transportation purposes	109,942	0	109,942	0	99,929	209,871	1,400,000	(1,190,129)
2	3	Grading	209,689	22,811	186,878	(22,811)	190,592	400,281	3,307,500	(2,907,219)
3	4	Other right-of-way expenditures	2,586	757	1,829	(757)	2,350	4,936	3,000	1,936
4	5	Tunnels and subways	27,688	2,874	24,814	(2,874)	25,166	52,854	349,500	(296,646)
5	6	Bridges, trestles, and culverts	227,358	51,941	175,417	(51,941)	206,652	434,010	2,777,500	(2,343,490)
6	7	Elevated structures	2,575	2,769	(194)	(2,769)	2,340	4,915	16,000	(11,085)
7	8	Ties	1,294,855	201,778	1,093,077	(201,778)	2,353,854	3,648,709	1,117,500	2,531,209
8	9	Rail and other track material	2,503,630	304,233	2,199,397	(304,233)	2,275,613	4,779,243	2,707,500	2,071,743
9	11	Ballast	877,012	(10,865)	887,877	10,865	797,139	1,674,151	1,687,500	(13,349)
10	13	Fences, snowsheds, and signs	1,309	543	766	(543)	1,190	2,499	4,000	(1,501)
11	16	Stations and office buildings	183,645	59,494	124,151	(59,494)	166,920	350,565	292,000	58,565
12	17	Roadway buildings	11,937	4,574	7,363	(4,574)	10,850	22,787	5,000	17,787
13	18	Water stations	480	343	137	(343)	436	916	1,000	(84)
14	19	Fuel stations	33,619	8,964	24,655	(8,964)	30,577	64,196	30,000	34,196
15	20	Shops and enginehouses	84,747	33,860	50,887	(33,860)	77,029	161,776	149,500	12,276
16	22	Storage warehouses	0	0	0	0	0	0	0	0
17	23	Wharves and docks	936	58	878	(58)	851	1,787	2,000	(213)
18	24	Coal and ore wharves	79,151	23,957	55,194	(23,957)	71,942	151,093	50,000	101,093
19	25	TOFC/COFC terminals	77,212	31,587	45,625	(31,587)	70,180	147,392	69,500	77,892
20	26	Communication systems	121,275	76,965	44,310	(76,965)	110,230	231,505	48,000	183,505
21	27	Signals and interlockers	368,989	131,446	237,543	(131,446)	335,384	704,373	473,000	231,373
22	29	Power plants	1,140	476	664	(476)	1,036	2,176	2,000	176
23	31	Power-transmission systems	8,981	5,293	3,688	(5,293)	8,163	17,144	7,000	10,144
24	35	Miscellaneous structures	3,868	530	3,338	(530)	3,516	7,384	3,000	4,384
25	37	Roadway machines	98,537	73,495	25,042	(73,495)	89,563	188,100	60,000	128,100
26	39	Public improvements-Construction	43,207	5,225	37,982	(5,225)	39,272	82,479	30,000	52,479
27	44	Shop machinery	52,041	27,817	24,224	(27,817)	47,301	99,342	56,000	43,342
28	45	Power-plant machinery	3,739	3,198	541	(3,198)	3,398	7,137	8,000	(863)

CALCULATION OF CONRAIL PURCHASE ACCOUNTING ASSET ADJUSTMENTS BY PROPERTY ACCOUNT - AS CONTAINED IN T.D. CROWLEY WORKPAPER FILES PREM95.WK4 AND NSPREM.WK4

(Dollars In Thousands)

Line No.	ICC	Description	Pre-Acquisition Book Value			Crowley Adjustments				
						Purchase Accounting Asset Adjustment				
			Gross (Sch 330) 12/31/95	Accum Depr (Sch 335) 12/31/95	Net Book Value	Decrease in Accum Depr	Increase in Asset Value	Assumed Fair Market Value	Fair Market Value 06/97[2]	TDC Over/ (Under) FMV
	(1)	(2)	(3)	(4)	(5) (3) - (4)	(6) - (4)	(7)	(8) (3) + (7)	(9)	(10)
29		Other	0	45,569	(45,569)	(45,569)	0	0	0	0
30		Amortization (adjustments)[1]	0	438,536	(438,536)	(438,536)	0	0	0	0
31		Total Expenditures for Road	6,430,148	1,548,228	4,881,920	(1,548,228)	7,021,473	13,451,621	14,656,000	(1,204,379)
		Equipment								
32	52	Locomotives	1,138,328	469,155	669,173	(469,155)	1,034,655	2,172,983	650,000	1,522,983
33	53	Freight-train cars	741,841	313,823	428,018	(313,823)	674,278	1,416,119	469,000	947,119
34	54	Passenger-train cars	0	0	0	0	0	0	0	0
35	55	Highway revenue equipment	2,790	1,920	870	(1,920)	2,536	5,326	1,000	4,326
36	56	Floating equipment	0	0	0	0	0	0	0	0
37	57	Work equipment	84,682	50,271	34,411	(50,271)	76,970	161,652	40,000	121,652
38	58	Miscellaneous equipment	31,401	26,735	4,666	(26,735)	28,541	59,942	6,000	53,942
39	59	Computer systems	79,785	62,374	17,411	(62,374)	72,519	152,304	21,000	131,304
40		Amortization (adjustments)[1]	0	300	(300)	(300)	0	0	0	0
41		Total Expenditures for Equipment	2,078,827	924,578	1,154,249	(924,578)	1,889,499	3,968,326	1,187,000	2,781,326
42		Total Road + Equipment	8,508,975	2,472,806	6,036,169	(2,472,806)	8,910,972	17,419,947	15,843,000	1,576,947
43		Non-operating & disposition assets[3]	336,825	0	336,825	0	(336,825)	0	400,000	(400,000)
44		Total	8,845,800	2,472,806	6,372,994	(2,472,806)	8,574,147	17,419,947	16,243,000	1,176,947
		Assets not considered by Price Waterhouse study:								
45	76	Interest during construction	0	0	0	0	0	0	0	0
46	80	Other elements of investment	0	0	0	0	0	0	0	0
47	90	Construction in progress	320,006	0	320,006	0	(320,006)	0	320,006	(320,006)
48		GRAND TOTAL	9,165,806	2,472,806	6,693,000	(2,472,806)	8,254,141	17,419,947	16,563,006	856,941

CALCULATION OF CONRAIL PURCHASE ACCOUNTING ASSET ADJUSTMENTS BY PROPERTY ACCOUNT - AS CONTAINED IN T.D. CROWLEY WORKPAPER FILES PREM95.WK4 AND NSPREM.WK4

(Dollars in Thousands)

Line No.	ICC	Description	Pre-Acquisition Book Value: Gross (Sch 330) 12/31/95	Pre-Acquisition Book Value: Accum Depr (Sch 335) 12/31/95	Pre-Acquisition Book Value: Net Book Value	Crowley Adjustments: Purchase Accounting Asset Adjustment: Decrease in Accum Depr	Crowley Adjustments: Purchase Accounting Asset Adjustment: Increase in Asset Value	Assumed Fair Market Value	Fair Market Value 06/97[2]	TDC Over/ (Under) FMV
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
					(3) - (4)	- (4)		(3) + (7)		

[1] Allowance for Disposition of Assets.

[2] Source: NS-20-CO-00103.

[3] Assets of the Corporation that are not part of the railroad.

CALCULATION OF CONRAIL PURCHASE ACCOUNTING DEPRECIATION ADJUSTMENTS BY PROPERTY ACCOUNT
- USING CONRAIL FAIR MARKET VALUE PER PRICE WATERHOUSE
(Dollars In Thousands)

			Post-Acquisition Conrail Depreciation							Conrail	
Line No.	ICC	Description	Fair Market Value 06/97[1]	Estimated Salvage Value	Net Depreciable Amount	Remaining Years to Depr[1]	Estimated Annual Depr	Re-distrib Shop Mach[2]	Est Annual Depr Incl Shop Mach Re-distrib	1995 Reported R-1 Depr	Increase in CRC Reported Depr
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11) (9) - (10)
		Road							(Sch 412)	(Sch 412)	(Sch 412)
1	2	Land for transportation purposes	1,400,000		1,400,000		0		0	0	0
2	3	Grading	3,307,500		3,307,500	78	42,404		42,404	2,855	39,549
3	4	Other right-of-way expenditures	3,000		3,000	55	55		55	47	8
4	5	Tunnels and subways	349,500		349,500	102	3,426		3,426	448	2,978
5	6	Bridges, trestles, and culverts	2,777,500	3,000	2,774,500	50	55,490		55,490	6,559	48,931
6	7	Elevated structures	16,000		16,000	50	320		320	0	320
7	8	Ties	1,117,500		1,117,500	20	55,875		55,875	36,080	19,795
8	9	Rail and other track material	2,707,500	300,000	2,407,500	34	70,809		70,809	47,100	23,709
9	11	Ballast	1,687,500		1,687,500	20	84,375		84,375	20,386	63,989
10	13	Fences, snowsheds, and signs	4,000		4,000	5	800		800	65	735
11	16	Stations and office buildings	292,000	2,000	290,000	25	11,600		11,600	12,292	(692)
12	17	Roadway buildings	5,000		5,000	11	455		455	334	121
13	18	Water stations	1,000		1,000	15	67		67	5	62
14	19	Fuel stations	30,000		30,000	18	1,667		1,667	1,169	498
15	20	Shops and enginehouses	149,500	400	149,100	20	7,455		7,455	3,343	4,112
16	22	Storage warehouses	0		0		0		0	0	0
17	23	Wharves and docks	2,000		2,000	5	400		400	20	380
18	24	Coal and ore wharves	50,000		50,000	20	2,500		2,500	2,427	73
19	25	TOFC/COFC terminals	69,500		69,500	10	6,950		6,950	4,378	2,572
20	26	Communication systems	48,000	900	47,100	10	4,710		4,710	6,640	(1,930)
21	27	Signals and interlockers	473,000	2,000	471,000	21	22,429		22,429	14,024	8,405
22	29	Power plants	2,000		2,000	15	133		133	42	91
23	31	Power-transmission systems	7,000		7,000	15	467		467	929	(462)
24	35	Miscellaneous structures	3,000		3,000	15	200		200	139	61
25	37	Roadway machines	60,000	1,800	58,200	5	11,640		11,640	1,932	9,708
26	39	Public improvements-Construction	30,000		30,000	50	600		600	821	(221)
27	44	Shop machinery[2]	56,000		56,000	8	7,000	(7,000)	0	0	0

CALCULATION OF CONRAIL PURCHASE ACCOUNTING DEPRECIATION ADJUSTMENTS BY PROPERTY ACCOUNT
- USING CONRAIL FAIR MARKET VALUE PER PRICE WATERHOUSE
(Dollars In Thousands)

Line No.	ICC	Description	Post-Acquisition Conrail Depreciation: Fair Market Value 06/97[1]	Estimated Salvage Value	Net Depreciable Amount	Remaining Years to Depr[1]	Estimated Annual Depr	Re-distrib Shop Mach[2]	Est Annual Depr Incl Shop Mach Re-distrib	Conrail 1995 Reported R-1 Depr	Increase in CRC Reported Depr
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11) (9) - (10)
28	45	Power-plant machinery	8,000		8,000	15	533		533	13	520
29		Total Expenditures for Road	14,656,000	310,100	14,345,900		392,360	(7,000)	385,360	162,048	223,312
		Equipment							(Sch 415)	(Sch 415)	(Sch 415)
30	52	Locomotives	650,000	65,000	585,000	9	65,000		65,000	66,695	(1,695)
		Shop mach - Locomotives						3,834	3,834	1,389	2,445
31	53	Freight-train cars	469,000	100,000	369,000	9	41,000		41,000	39,739	1,261
		Shop mach - Freight cars						2,498	2,498	905	1,593
32	54	Passenger-train cars	0		0				0		
33	55	Highway revenue equipment	1,000		1,000	5	200		200	0	200
34	56	Floating equipment	0		0				0		
35	57	Work equipment	40,000	6,000	34,000	10	3,400		3,400	7,037	(3,637)
36	58	Miscellaneous equipment	6,000	2,000	4,000	4	1,000		1,000		1,000
		Shop mach - Misc equip						668	668	242	426
37	59	Computer systems	21,000	900	20,100	2	10,050		10,050	11,744	(1,694)
38		Total Expenditures for Equipment	1,187,000	173,900	1,013,100		120,650	7,000	127,650	127,751	(101)
39		GRAND TOTAL	15,843,000	484,000	15,359,000		513,010	0	513,010	289,799	223,211
40		Non-operating & disposition assets[3]	400,000		400,000		0		0		
41		FINAL TOTAL	16,243,000	484,000	15,759,000		513,010	0	513,010	289,799	223,211

[1] Source: NS-20-CO-00103.
[2] Distributed to Locomotives, Freight Cars, and Other Equipment based on 1995 Conrail distribution.
[3] Assets of the Corporation that are not part of the railroad.

CALCULATION OF CONRAIL PURCHASE ACCOUNTING DEPRECIATION ADJUSTMENTS
BY PROPERTY ACCOUNT
- AS CONTAINED IN T.D. CROWLEY WORKPAPER FILES PREM95.WK4 AND NSPREM.WK4
(Dollars In Thousands)

Line No.	ICC	Description	1995 Reported Conrail Depr	TD Crowley Adjustments: Increase in CRC Reported Depr	TDC Assumed Total Depr	Depr Using Fair Market Values per Price Waterhouse	TDC Depr Over/(Under) Fair Market Value Depreciation
	(1)	(2)	(3)	(4)	(5) (3) + (4)	(6)	(7) (5) - (6)
		Road	(Sch 412)		(Sch 412)	(Sch 412)	
1	2	Land for transportation purposes	0	0	0	0	0
2	3	Grading	2,855	2,630	5,485	42,404	(36,919)
3	4	Other right-of-way expenditures	47	43	90	55	35
4	5	Tunnels and subways	448	398	846	3,426	(2,580)
5	6	Bridges, trestles, and culverts	6,559	6,200	12,759	55,490	(42,731)
6	7	Elevated structures	0	0	0	320	(320)
7	8	Ties	36,080	37,073	73,153	55,875	17,278
8	9	Rail and other track material	47,100	46,878	93,978	70,809	23,169
9	11	Ballast	20,386	19,291	39,677	84,375	(44,698)
10	13	Fences, snowsheds, and signs	65	87	152	800	(648)
11	16	Stations and office buildings	12,292	12,452	24,744	11,600	13,144
12	17	Roadway buildings	334	375	709	455	254
13	18	Water stations	5	15	20	67	(47)
14	19	Fuel stations	1,169	1,063	2,232	1,667	565
15	20	Shops and enginehouses	3,343	3,081	6,424	7,455	(1,031)
16	22	Storage warehouses	0	0	0	0	0
17	23	Wharves and docks	20	19	39	400	(361)
18	24	Coal and ore wharves	2,427	2,180	4,607	2,500	2,107
19	25	TOFC/COFC terminals	4,378	4,351	8,729	6,950	1,779
20	26	Communication systems	6,640	7,264	13,904	4,710	9,194
21	27	Signals and interlockers	14,024	13,751	27,775	22,429	5,346
22	29	Power plants	42	39	81	133	(52)
23	31	Power-transmission systems	929	845	1,774	467	1,307
24	35	Miscellaneous structures	139	127	266	200	66
25	37	Roadway machines	1,932	8,956	10,888	11,640	(752)
26	39	Public improvements-Construction	821	782	1,603	600	1,003

CALCULATION OF CONRAIL PURCHASE ACCOUNTING DEPRECIATION ADJUSTMENTS BY PROPERTY ACCOUNT
- AS CONTAINED IN T.D. CROWLEY WORKPAPER FILES PREM95.WK4 AND NSPREM.WK4
(Dollars In Thousands)

Line No.	ICC (1)	Description (2)	1995 Reported Conrail Depr (3)	TD Crowley Adjustments: Increase in CRC Reported Depr (4)	TD Crowley Adjustments: TDC Assumed Total Depr (5) (3) + (4)	Depr Using Fair Market Values per Price Waterhouse (6)	TDC Depr Over/(Under) Fair Market Value Depreciation (7) (5) - (6)
27	44	Shop machinery[2]	0	0	0	0	0
28	45	Power-plant machinery	13	22	35	533	(498)
29		Total Expenditures for Road	162,048	167,922	329,970	385,360	(55,390)
		Equipment	(Sch 415)		(Sch 415)	(Sch 415)	
30	52	Locomotives	66,695	61,148	127,843	65,000	62,843
		Shop mach - Locomotives	1,389	1,470	2,859	3,834	(975)
31	53	Freight-train cars	39,739	44,706	84,445	41,000	43,445
		Shop mach - Freight cars	905	1,002	1,907	2,498	(591)
32	54	Passenger-train cars			0	0	0
33	55	Highway revenue equipment	0	0	0	200	(200)
34	56	Floating equipment			0	0	0
35	57	Work equipment	7,037	6,320	13,357	3,400	9,957
36	58	Miscellaneous equipment			0	1,000	(1,000)
		Shop mach - Misc equip	242	247	489	668	(179)
37	59	Computer systems	11,744	11,429	23,173	10,050	13,123
38		Total Expenditures for Equipment	127,751	126,322	254,073	127,650	126,423
39		GRAND TOTAL	289,799	294,244	584,043	513,010	71,033

[1] Source: NS-20-CO-00103.
[2] Distributed to Locomotives, Freight Cars, and Other Equipment based on 1995 Conrail distribution.
[3] Assets of the Corporation that are not part of the railroad.

EXHIBIT WWW-9

CSX-Conrail 1995 Fully Allocated Below the Wheel URCS Costs

Depo of: Thomas D. Crowley In Re: CSX Corp. 12-5-97 Cr67785.0

Page 1 to Page 29

CONDENSED TRANSCRIPT AND CONCORDANCE
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HIGHLY CONFIDENTIAL Page 1

BEFORE THE
SURFACE TRANSPORTATION BOARD

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CSX CORPORATION AND CSX :
TRANSPORTATION INC., : STB Finance Docket
NORFOLK SOUTHERN CORPORATION : No. 33388
AND NORFOLK SOUTHERN RAILWAY :
COMPANY-CONTROL AND OPERATING:
LEASES/AGREEMENTS-CONRAIL :
INC. AND CONSOLIDATED RAIL :
CORPORATION :
----------x

DEPOSITION OF THOMAS D. CROWLEY

Washington, D.C.
Friday, December 5, 1997
REPORTED BY:
SARA A. EDGINGTON

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Deposition of THOMAS D. CROWLEY, called for examination pursuant to notice of deposition, on Friday, December 5, 1997, in Washington, D.C. at the law offices of LeBoeuf, Lamb, Greene and MacRae, 1875 Connecticut Avenue, N.W., Suite 1200, at 9:00 a.m. before SARA A. EDGINGTON, a Notary Public within and for the District of Columbia, when were present on behalf of the respective parties:

PAUL T. DENIS, ESQ.
Arnold & Porter
555 Twelfth Street, N.W.
Washington, D. C. 20004-1202
(202) 942-5858
On behalf of CSX Corporation and
CSX Transportation, Inc.

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APPEARANCES (CONTINUED):
MICHAEL F. McBRIDE, ESQ.
LeBoeuf, Lamb, Greene & MacRae
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Suite 1200
Washington, D. C. 20009
(202) 976-8000
On behalf of American Electric Power Service Corporation,
Atlantic City Electric Company,
and Indiana Power and Light Company

KELVIN J. DOWD, ESQ.
Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, D. C. 20036
(202) 347-7170
On behalf of GPU Generation, Inc.
and Consumers Energy Company
ALSO PRESENT:
ROGER C. PRESCOTT
SEAN D. NOLAN

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PROCEEDINGS
Whereupon,
THOMAS D. CROWLEY
was called as a witness and, having first been duly sworn, was examined and testified as follows:

MR. DOWD: Good morning. We are here today for the deposition of Thomas D. Crowley, president of L. E. Peabody & Associates and a witness who has appeared in this matter on behalf of a number of commenting parties. For the record, also accompanying Mr. Crowley is Roger C. Prescott and Sean Nolan, both of whom are also with L. E. Peabody & Associates.
My name is Kelvin Dowd. I'm counsel for GPU Generation, Incorporated, and Consumers Energy Company, two of the parties that have sponsored Mr. Crowley's testimony. I have signed the confidential and highly confidential undertakings.

MR. MC BRIDE: My name is Michael F. McBride of the law firm Leboeuf, Lamb. I represent American Electric Power Service Corporation, Atlantic City Electric Company, and Indiana Power and Light

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Company, three of the companies who have sponsored testimony by Mr. Crowley. I'm accompanied by my colleagues, Bruce Neeley and Brenda Durham. All of us have signed the confidential and highly confidential undertakings.

MR. DENIS: I would like to confirm that Mr. Prescott and Mr. Nolan have both signed; is that correct?

MR. DOWD: Yes.

MR. MC BRIDE: One more thing. I gather we're going to designate this deposition as highly confidential until the witness can review it and we can determine which portions to keep that designation and which to declassify.

EXAMINATION
BY MR. DENIS:
Q Good morning, Mr. Crowley. I am Paul Denis. I'm with the law firm Arnold & Porter. I represent CSX and CSX Transportation in this proceeding.
I have several questions for you. I would like to direct your attention to your testimony that

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was submitted as part of a document filed as ACE 18 on behalf of Atlantic City Electric and Indiana Power and Light. In your testimony on behalf of ACE –and I will refer simply to ACE to cover both Atlantic City Electric and IP&L as the designator in this proceeding does. In your testimony, you refer to the Conrail and Monongahela merger proceeding before the ICC. Do you recall that portion of your testimony?
A Yes.
Q Do you know when the merger between Conrail and Monongahela Railway took place?
A As I state on page 13 of my statement, the merger was approved and a decision served October 10,
1991.
Q I understand that, Mr. Crowley. My question was whether you knew when the merger itself took place.
A You'll have to clarify that for me. I don't understand the question.
Q Your testimony indicates that the merger was approved and decision served October 10th, 1991;

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is that correct?
A Yes.
Q Do you know when the merger between the two companies that was the subject of that decision took place?
A The merger from a financial reporting standpoint, or merger from an operating standpoint, or merger from some other standpoint? That's the part of the question I didn't understand.
Q Let's start from a financial operating standpoint. Do you know when the merger took place from a financial operating perspective?
A I believe it was in calendar year 1992.
Q Do you know when the merger took place from an operating perspective?
A No, I don't. It would be in that same general time period.
Q Would it matter to the analysis that you did in your verified statement submitted as part of ACE 18 if the merger took place, from a financial operating perspective, in 1993?
A No.

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Q Would it matter for your testimony if the merger, from an operating perspective, took place in 1993?
A No.
Q In your testimony, you indicated that you utilized CWS data for 1992 – excuse me, for 1991 and 1995; is that correct?
A That's correct.
Q Did you at any point perform the same analysis using CWS data for 1992 rather than 1991?
A No.
Q In connection with the study you performed for your testimony in ACE 18, did you analyze the ownership of the Monongahela Railway Corporation?
MR. DOWD: Do you understand the question?
THE WITNESS: No, I didn't.
BY MR. DENIS:
Q Let me try it another way, then. Do you know who the owners of the Monongahela Railway Corporation were at the time of the ICC decision referred to in your testimony?
A I'm sure that I have looked it up, and I'm

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sure at one point I did know that, but as I sit here today, I can't recall.
Q Do you recall if Conrail had any ownership interest in the Monongahela Railway Corporation at the time of the ICC decision referred to in your testimony?
A I don't recall that as I sit here.
Q Do you recall whether there were other owners of the Monongahela – excuse me. Strike that.
Do you recall if there was any other company that was an owner of Monongahela Railway Corporation prior to the decision referenced in your testimony?
A As I sit here today, I don't recall.
Q Would it be relevant to your analysis if, in 1991, Conrail owned 90 percent or more of the Monongahela Railway Corporation?
A No.
Q Would it be relevant to your analysis if Conrail owned 75 percent of Monongahela Railway Corporation throughout 1991?

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A No.
Q Is the percentage ownership in the Monongahela Railway Corporation that would be held by
Conrail in 1991 at all relevant to the analysis in your testimony?
A Not to the analysis that I did, no.
Q Would it be relevant to the analysis that you did in your testimony if Conrail controlled the Monongahela Railway Corporation in 1991?
A Not to the analysis I did, no.
Q In connection with your testimony, did you study whether there were any agreements in place between the Monongahela Railway Corporation and Conrail in 1991?

A We reviewed the documents that the railroads provided related to the Monongahela, and I don't recall seeing any agreements between those carriers, but if there were any in the documents that you provided, we would have reviewed them.

Q Would it be relevant to your analysis if there were any agreements between Conrail and the Monongahela Railway Corporation in 1991?

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A Well, to the extent they impacted our analysis, we would have reviewed it and included them if they were relevant.

Q Do you recall if you included in your analysis any agreements between Monongahela Railway Corporation and Conrail?

MR. DOWD: Asked and answered. You can answer it again.

THE WITNESS: We would have reviewed the agreements to determine if they had an impact on the analysis.

BY MR. DENIS:

Q Why did you choose the year of 1991 for purposes of your analysis in this testimony?

A 1991, as I state in my testimony, was the year of the merger.

Q What is the significance of that to your analysis?

A I was looking for a point in time so I could make a before-and-after comparison, and that was the before part of the analysis.

Q When you say before-and-after analysis,

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before and after what are you looking at?

A The merger.

Q Why is the event of the merger significant to your analysis?

A Well, as I state in my testimony, we were attempting to determine if the pricing behavior changed as a result of the merger between what the MGA was charging versus what Conrail was charging after it absorbed the MGA.

Q Why did you choose the year 1991 for purposes of this analysis?

A It was the latest available.

Q Why is the latest available data significant for purposes of your analysis?

A I was trying to get as current data as possible to show what the changes were from the point in time of the merger to what the impacts are on the markets today, and the latest available would accommodate that decision.

Q Did you perform this analysis at any time using 1994 data?

A No.

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Q Did you perform this analysis at any time using 1993 data?

A No.

Q Did you perform this analysis at any time using 1992 data?

A I think I've already answered that, and the answer is no.

Q Did you understand my question to be asking whether you used those years as alternatives to 1995? I didn't ask the question particularly well.

A I understood your question to mean did I ever do an analysis for that year, and I answered no to all of those years other than '91 and '95.

Q I would like to turn to a series of questions about the testimony you submitted on behalf of Indiana Power and Light in the document labeled IPL-3 of the Service Transportation Board. In the statement of your qualifications submitted with testimony filed in IPL-3, you indicated that you provided evidence on various rail merger proceedings in the past; is that correct?

A And you are referring to what?

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Q Page 4 of your statement of qualifications.

A Yes.

Q Did you provide testimony in the ICC proceeding with respect to the Burlington Northern/Santa Fe transaction?

A I'm sorry. I didn't hear the end of that.

Q The Burlington Northern/Santa Fe transaction?

A Yes, I did.

Q Did your testimony in the Burlington Northern/Santa Fe transaction refer to trackage rights compensation in any way?

A I believe it did, yes.

Q On behalf of which party did you testify in the Burlington Northern/Santa Fe transaction with respect to trackage rights compensation?

A It's something I can look up. I don't recall as I sit here.

Q Did you submit testimony on behalf of Tucson Electric Power Company?

MR. DOWD: I am going to object. The

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record in that case will speak for itself. So if the witness has trouble recalling specifics about that event, perhaps you can just show him an exhibit.

THE WITNESS: I don't recall as I sit here. Tucson is one of our clients, and we possibly did put in testimony in that case.

BY MR. DENIS:

Q In preparing your testimony submitted as part of IP&L-3, did you review the testimony you submitted in the Burlington Northern/Santa Fe proceeding regarding trackage rights compensation?

A No.

Q Are you familiar with the ICC's decision in the Burlington Northern/Santa Fe transaction?

A Yes.

Q Are you familiar with the discussion by the ICC in that decision of trackage rights compensation?
A Generally, yes.
Q Did you review the Burlington Northern/Santa Fe decision of the ICC with respect to trackage rights compensation in connection with the preparation of your testimony on IP&L-3?

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A No.
Q Do you have an understanding of the principles announced by the ICC?
A Yes.
Q What is your understanding of those principles?
A My understanding is that the ICC did not want to adjust the trackage rights compensations the parties agreed to and left what the parties proposed in place.
Q Did the ICC in that Burlington Northern/Santa Fe decision articulate any other principles that should be applied in assessing trackage rights compensation?
A I don't recall.
Q In your opinion, was the Burlington Northern/Santa Fe decision of the ICC correctly decided on the issue of trackage rights compensation?
MR. DOWD: I'm going to object to that as calling for a legal conclusion. You're asking him whether, in his opinion, they got the right answer

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or –
MR. DENIS: I am asking about his opinion, not as a lawyer but as an expert in this proceeding.
MR. DOWD: Can you repeat the question?
BY MR. DENIS:
Q Whether the ICC decision was right concerning trackage rights issues.
A I do not believe they were correct.
Q Are you familiar with the decision of the STB in the Union Pacific/Southern Pacific transaction?
A Yes.
Q Are you familiar with the discussion in the STB's opinion relating to trackage rights compensation?
A Yes.
Q Are you familiar with the STB's analysis of your testimony on behalf of the Western Coal Traffic League on the issue of trackage rights compensation?
A Very familiar, yes.
Q In preparation of your testimony submitted in IP&L-3, did you review the UPSP decision of the

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Surface Transportation Board on the issue of trackage rights compensation?
A No, I did not.
Q What is your understanding of the principals applied by the board in the UPSP decision relating to trackage rights compensation?
A What the STB did in UPSP as it relates to trackage rights compensation is what the STB did in the BN/Santa Fe merger.
Q So would you regard those two decisions as consistent, in your view as an expert?
A Consistent from the government standpoint, yes.
Q Is their analytical methodology consistent?
MR. MC BRIDE: With respect to trackage rights compensation?
BY MR. DENIS:
Q With respect to trackage rights compensation. Thank you.
A I don't think they analyzed them.
Q In your opinion as an expert, was the UPSP

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decision by the board correctly decided on the issue of trackage rights compensation?
MR. DOWD: In what expert capacity are you asking him? Expert on trackage rights? Expert on –
MR. DENIS: He's submitted testimony here on how to analyze trackage rights compensation. I'm asking him if the board's decision in doing the same thing in the UPSP decision was correct or not.
MR. DOWD: In a previous question, he testified, in his view, the board did not analyze trackage rights compensation in that case. So maybe you can rephrase your question.
BY MR. DENIS:
Q Can you answer the question as asked?
A I've lost the question now.
Q Let's go back. Did the board, in the Union Pacific/Southern Pacific transaction, in their opinion transaction, did they analyze the issue of trackage rights compensation?
A No, I don't believe they analyzed trackage rights compensation. They accepted what the carriers proposed.

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Q Did the board review your testimony on the proper calculation of trackage rights compensation?
A The board reviewed my testimony as it related to trackage rights compensation in the merger case, yes.
Q What was the board's opinion of your testimony?
A They didn't like it.
Q Did they indicate in the opinion whether your testimony was correct or incorrect in the proper approach to calculating trackage rights compensation?
A They thought that my approach was incorrect in calculating trackage rights compensation in a merger case.
Q In your opinion, was the board's decision correctly decided on that point?
A I'm sorry?

Q In your opinion, was the board's decision correctly decided on that point?
A In my opinion, the board was not correct.
Q Are you familiar with the ICC decisions that are generally known as the SSW compensation

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decisions?
A Yes.
Q In preparation of your testimony of IP&L-3, did you review the ICC decisions in the SSW compensation proceedings?
A No.
Q What is your understanding of the SSW compensation decisions as they relate to the proper approach to calculating trackage rights compensation?
A It's been a while since I've looked at those decisions. As I sit here today, I wouldn't be able to even speculate.
Q Do you have a view as to whether your testimony in IP&L-3 is consistent with the ICC decisions in SSW compensation?
MR. DOWD: I am going to object. He just testified he's not in a position to even confirm whether he's familiar with the discussion. So I don't see how you can ask him whether it's consistent with his testimony.
MR. DENIS: You and I can make assumptions about how he will answer that question, but he's the

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witness, and I would like him to answer it.
THE WITNESS: In order to answer the question, I would have to go back and review the methodology used in SSW, and I don't recall that methodology as I sit here today.
BY MR. DENIS:
Q I would like to refer you to page 19 of 20 in IPL Exhibit 4 of your testimony on behalf of IP&L.
A I have it.
MR. DENIS: The record will reflect the witness is examining his own copy of that testimony.
MR. DOWD: For the record, the copy the witness is looking at is as filed, and there are no extraneous markings or anything of that nature on it.
BY MR. DENIS:
Q Could you describe for me the steps of your analysis that are summarized in the table on page 19 of your testimony.
A Certainly. The table on page 19 demonstrates compensation on two bases: on a per

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car-mile basis, which would be column 2; and a trailing gross ton mile analogy, which is column 3 of the table.
The elements that are included in the calculation include line 1, which is a combined CSX/Conrail URCS formula for 1995 representing the unit cost for roadway operation depreciation and lease expenses, and the sources out of the 1995 CSX/Conrail portion URCS formula are identified on the bottom of the table. The second line is an index that is used to increase the line 1 expenses from calendar year 1995 to the fourth quarter 1997. Line 3 is simply the multiplication of the unit cost on line 1 by the index on line 2. Line 4 is the unit cost for CSX/Conrail portion of 1995, return on road property, also taken from the URCS formula. Line 5 is the total of lines 3 and 4.
Q Is line 1 on your table, which you indicated is taken from the URCS formula, a measurement of variable cost?
A Yes.
Q Are there other costs included in there

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other than variable costs?
MR. DOWD: Included in line 1 or –
MR. DENIS: No, included in line 1.
THE WITNESS: That would be the variable portion of the cost delineated in the item column.
BY MR. DENIS:
Q In the testimony that you submitted on behalf of the Western Coal Traffic League in the Union Pacific/Southern Pacific transaction, did you adopt a similar approach to calculating trackage rights compensation?
A Similar to the whole table or to line 1?
Q Similar to line 1.
A Well, line 1 is not – is not the trackage rights compensation but a component part of trackage rights compensation that I'm suggesting. Those elements would have been included in the evidence I submitted on behalf of the Western Coal Traffic League merger.
Q Are you familiar with the analysis of trackage rights compensation done by the applicants in the Union Pacific/Southern Pacific transaction?

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And by applicants, I am referring not to the applicants in our proceeding but rather the applicants in that proceeding, Union Pacific and Southern Pacific.
A I'm familiar with the compensation or the trackage rights fee. I'm not familiar with an analysis to develop it. I don't believe I ever saw an analysis. I simply recall seeing a number.
Q Do you recall whether the board, in its decision in the Union Pacific/Southern Pacific transaction, reviewed the applicants' use of URCS data in calculating trackage rights compensation?
MR. MC BRIDE: Whether it did what? I didn't hear the verb. Viewed?
MR. DENIS: Reviewed.
MR. DOWD: I'm going to object to that question as no foundation that the applicants used URCS data in that case in their testimony.

MR. DENIS: I am simply asking whether the board did something.
BY MR. DENIS:
Q You can answer the question if you know.

A I am not familiar with anything other than the number that the UPSP put forward as a trackage rights fee.
Q To your knowledge, has either the ICC or the Surface Transportation Board ever assessed whether it is correct to use the data that you used in line 1 of your table for purposes of calculating trackage rights compensation?
A Let me see if I understand your question. Are you asking me, do they consider these components in analyzing a trackage rights fee?
Q Let's start with that.
A In the last two mergers, to my knowledge, they didn't do any analysis of the fees. They simply accepted what the railroads proposed. In prior mergers, they – when they were more active in setting the compensation, they would have had to consider these kinds of things, because these are the elements that the trackage rights carrier reviews.
Q In preparing your testimony that was submitted as part of IP&L-3, did you attempt to conform your calculation of trackage rights

compensation to the board's opinion in Union Pacific/Southern Pacific?
A As it relates to trackage rights compensation?
Q As it relates to trackage rights compensation.
A In UPSP, the board did nothing but accept their number, and I did not accept the applicant's number in this case. I was not able to conform the two.
MR. DENIS: I have no further questions.
MR. MC BRIDE: Of all of the statements, that's all you have?
MR. DENIS: Yes. Mr. Crowley, thank you very much.
MR. MC BRIDE: For the record, we have no redirect.
(Whereupon, at 9:45 a.m., the deposition was concluded.)

I HEREBY CERTIFY that I have read this transcript of my deposition and that this transcript accurately states the testimony given by me, with the changes or corrections, if any, as noted.

X

Subscribed and sworn to before me this day of , 19 .

X
Notary Public

My commission expires: .

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connection [3]
8:12; 10:11; 15:21
conrail [15]

REBUTTAL VERIFIED STATEMENT

OF

JOHN H. WILLIAMS

I. INTRODUCTION

My name is John H. Williams. I am President of the Woodside Consulting Group Inc., which is located in Menlo Park, California. I submitted a Verified Statement in the Railroad Control Application, Volume 2B of 8 (CSX/NS-19), which described the methodology and results of my Rail Traffic Diversion Study concerning the likely impact of the operation by Norfolk Southern of Conrail's lines on the traffic and revenues of affected railroads. That Verified Statement also described my qualifications and my experience, encompassing almost 35 years in the railroad industry and consulting.

The purpose of this statement is to provide my analysis and rebuttal of certain traffic, revenues, market impacts, and competition statements submitted on October 21, 1997 and October 31, 1997 in this proceeding by the following parties:

- CMA-10: Joint Comments of the Chemical Manufacturers Association and the Society of the Plastics Industry, Inc.;
- W&LE-4: Responsive Application of Wheeling & Lake Erie Railway Company; and
- Ann Arbor-5: Responsive Application and Request for Conditions by Ann Arbor Acquisition Corporation.

My rebuttal is based on my analyses of the comments and statements filed by the parties listed above, on their underlying work papers, on relevant portions of the Norfolk

Southern Rail Traffic Diversion Study that I sponsored and that was previously submitted in this proceeding, and on my knowledge, judgment, and experience.

II. CMA-10: JOINT COMMENTS OF THE CHEMICAL MANUFACTURERS ASSOCIATION AND THE SOCIETY OF THE PLASTICS INDUSTRY, INC.

Attachment 2 to CMA-10 is the Verified Statement of Mr. John J. Grocki, a transportation consultant. His Verified Statement includes, among other things, an Appendix C entitled "Traffic Analysis." This portion of my Statement relates primarily to Mr. Grocki's Verified Statement, including the Appendices thereto.

A. Mr. Grocki's Data Base Is Incomplete and His Methodology is Flawed

Mr. Grocki's use of only a 100 percent Conrail traffic base for his Study too narrowly defined the relevant traffic that would be affected by the Conrail transaction. In order to consider the full effects on chemicals and plastics traffic resulting from the Conrail transaction, it is my opinion that Mr. Grocki should have mirrored the definition of relevant traffic contained in my Rail Traffic Diversion Study to include all three of the following traffic categories:

> "• Norfolk Southern traffic, including all Norfolk Southern-Conrail joint traffic;
>
> • Conrail traffic;
>
> • Non-Norfolk Southern/non-Conrail traffic (also called "non-participatory" or "third party" traffic), which is traffic in which neither Norfolk Southern nor Conrail participated in 1995."
>
> (CSX/NS-19, Williams, Page 73)

The same data base would be used for analysis of the CSXT/Conrail combination, although, for convenience, the traffic records could be re-sorted according to a different hierarchial scheme.

The failure of Mr. Grocki's Study to consider any relevant rail traffic other than that handled by Conrail constitutes a significant flaw that leads to both understating the service and competitive benefits of the Conrail transaction, as well as overemphasizing the importance of the transaction's effects on Conrail traffic only. For example, access by Norfolk Southern to Conrail stations in competition with CSXT (e.g., Philadelphia) will permit Norfolk Southern to extend its haul for single system service to those locations, even though Conrail did not participate in such movements during 1995. Thus, Mr. Grocki understates the conversion of relevant Northeastern Region rail traffic to single system service -- which is a significant benefit of the Conrail transaction -- by leaving it out of his Study.

Just as Mr. Grocki did not consider traffic moved by railroads other than Conrail, his Study also did not consider the extent of rail competition at stations located off the Conrail network. For example, Mr. Grocki's Study did not consider that if traffic being moved by Norfolk Southern to a Conrail destination station to be served by CSXT from an origin station in the Southeast was open to competition from CSXT, then CSXT could convert such movements to single system service. Therefore, Mr. Grocki did not consider the possibility that existing Norfolk Southern-Conrail traffic would become new CSXT/Conrail System single-line traffic where the new CSXT/Conrail System will solely serve the destination station and both CSXT and Norfolk Southern serve the origin station. Similarly, for Union Pacific Southern Pacific System traffic originating in Texas or Louisiana, Mr. Grocki's Study did not consider the availability of competition by other carriers such as Burlington Northern

Santa Fe, Illinois Central or Kansas City Southern, which would affect the available competitive options for such traffic destined to Conrail stations, including the new Norfolk Southern System's ability to extend its length of haul over a different gateway.

As described in his Study, Mr. Grocki obtained a 100 percent traffic tape for Conrail for the year 1995 as the data base for his traffic analysis. Mr. Grocki asserted that "...the 100% traffic sample offered greater accuracy..." than the *Carload Waybill Sample*, for the following reasons:

"The principal advantages of using the 100 percent sample for a database are:

- It includes all traffic originating and terminating in Canada; the Carload Waybill Sample only includes traffic originating in Canada if it terminates on a Class I Railroad in the U.S. It does not include any traffic terminating in Canada.
- The 100 percent sample includes traffic originating and terminating on all railroads, while the Carload Waybill Sample only includes traffic which originates or terminates on a Class I Railroad. This could lead to undercounting chemical and plastics traffic which originates or terminates on a short line.
- Stations with relatively small traffic volumes may tend to be excluded from the Carload Waybill Sample." (Grocki, Appendix C, Page 1)

Mr. Grocki's claimed superiority of the 100 percent Conrail data base over the *Carload Waybill Sample* with respect to Canadian traffic, does not apply to my Rail Traffic Diversion Study because, as I stated in my Verified Statement contained in the *Railroad Control Application:*

"The requirements for carrier reporting of traffic for inclusion in the *Carload Waybill Sample* do not apply to traffic terminating in Canada. In order to rectify that omission, 100% files of Norfolk Southern, Conrail, and CSX Transportation waybill data for Canadian terminations were appended to the *Carload Waybill Sample*, and those few similar traffic movements terminating in Canada for those three carriers that were included in the *Carload Waybill Sample* were removed." (CSX/NS-19, Williams, Page 73)

Clearly, Mr. Grocki's asserted superiority of the 100 percent Conrail data base because it includes Canadian terminating Conrail traffic provides no advantage over the approach used in my Rail Traffic Diversion Study, which included 10[illegible]ercent Canadian terminating traffic data for Conrail, Norfolk Southern, and CSXT.

Mr. Grocki's assertion that the *Carload Waybill Sample* "...only includes traffic which originates or terminates on a Class I railroad..." is also incorrect. According to the *User Guide for the 1995 Surface Transportation Board Waybill Sample*, dated July 15, 1996, potential reporting railroads are those that terminated more than 4,500 carloads in 1995. There were a total of 77 firms that did report to the 1995 *Carload Waybill Sample*, including a number of smaller, non-Class I carriers such as the Chicago, Central and Pacific, Paducah & Louisville, and Wheeling & Lake Erie. On this point, therefore, Mr. Grocki's assertion is simply inaccurate, as the reporting procedures include traffic originating or terminating on non-Class I railroads.

A further deficiency of Mr. Grocki's Study is that the computer logic he used was intended solely to categorize Conrail's traffic, not to model the competitive interplay for that traffic among competing railroads. Accordingly, Mr. Grocki's Study did not model the

marketplace competition for Conrail's traffic with other carriers, nor did it model the competitive struggle for any other traffic, such as were illustrated in my examples. Both the DNS Traffic Diversion Model, which I used in my Rail Traffic Diversion Study, and the ALK Associates Rail Traffic Diversion Model used on behalf of CSXT utilize an intricate set of diversion logic in order to reflect the commercial realities of the marketplace, as known by Norfolk Southern's and CSXT's commercial experts. It is my opinion that, absent the application of a similar set of diversion logic, the foundation underlying Mr. Grocki's Study is incomplete. It is those gaps listed above, among other factors, that cause Mr. Grocki's data analyses and his resulting conclusions with regard to the effects of the Conrail transaction on rail service and competition within the Northeast to be incorrect.

B. <u>Mr. Grocki's Traffic Analysis Is Incorrect</u>

Mr. Grocki used the 100 percent 1995 Conrail traffic data base for chemicals and plastics to conduct his Study, which he described as follows:

> "Using these assumptions, GRA then conducted an analysis for chemical and plastics traffic to identify the service and competitive impacts. This analysis involved approximately 345,700 impacted carloads totaling almost $1 billion in freight revenue. The traffic was divided into nine major categories, depending on the potential impact of the break-up of Conrail on competition and service. The results of this traffic analysis are contained in Figure JG-C-2, in which the nine traffic classes are shown. The note to JG C-2 explains which types of traffic are included in each service/competition category." (Grocki, Appendix C, Page 7.)

Mr. Grocki's Figure JG C-2 shows each of the nine categories of chemical traffic,

with Mr. Grocki's brief summary of his views as to the effects on competition and on service (i.e., "same," "improved," "worse," "worse if gateway shifted," and "unknown") for the traffic assigned to each category. Also shown are notes which summarize the characteristics of the traffic that Mr. Grocki claims to have used in order to assign the traffic to each category.

I describe below the process by which I reviewed and assessed the results of Mr. Grocki's Study. My findings include the following: (1) large blocks of traffic were not assigned by Mr. Grocki to his nine categories in accordance with the criteria that he designed; (2) there was a significant understatement of the positive benefits of newly-created single system service; (3) there was an outright failure to consider the Conrail transaction's cross-territorial boundary service improvements; and (4) for these reasons and others described herein, I disagree with Mr. Grocki's conclusions for many of his categories regarding the impacts of the Conrail transaction on competition and service.

In response to a request by Norfolk Southern, Mr. Grocki provided a copy of the traffic records data underlying his Figure JG C-2. Each record included origin and destination locations and railroads, Conrail's connecting railroads and junctions, STCC, traffic class, Conrail revenue, cars, tons, revenue, and the assigned traffic category in Figure JG C-2. As a result of our analysis, we were able to replicate the categories of traffic and numbers of carloads that Mr. Grocki assigned to each of the nine categories. Accordingly, we know that the traffic records we analyzed for each of Mr. Grocki's traffic categories are the same ones that he used in his Study.

In order to provide a reasonableness test of Mr. Grocki's Study results, I prepared Attachment JHW-CMA-1 from Conrail's 1995 *Annual Report of Freight Commodity Statistics*, for the same commodities that Mr. Grocki's Study used, namely STCC 28

(Chemicals & Allied Products), STCC 29 (Petroleum & Coal Products), and STCC 48 (Hazardous Wastes). In accordance with standard reporting requirements, STCC 49 (Hazardous Materials) is included within the base STCC codes used in the *Annual Report of Freight Commodity Statistics*.

As shown by Attachment JHW-CMA-1, Conrail's Chemicals & Plastics traffic in 1995 consisted of the following proportions:

- Local 32.8%
- Forwarded 18.1%
- Received 44.8%
- Bridge 4.3%

The 345,700 carloads considered in Mr. Grocki's Study approximate the 349,800 total carloads of Chemicals & Plastics traffic reported by Conrail in 1995, as summarized in Attachment JHW-CMA-1. Because two-thirds of Conrail's 1995 Chemicals & Plastics traffic was interchanged with a western or southern rail carrier, my expectation, based on experience, was that Mr. Grocki's Study would show enhanced competition and/or improved service impacts on a majority of that traffic.

Thus, in my initial review, I questioned the validity of Mr. Grocki's Study finding that 50.7% of all Conrail Chemicals & Plastics traffic (Category No. 3 of his Figure JG C-2) would be unaffected by the Conrail transaction, and I also questioned the reasonableness of Mr. Grocki's finding that only an additional 600 carloads, or 0.2% of all Conrail's 1995 Chemicals & Plastics traffic (Category No. 1 of his Figure JG C-2) would experience no degradation in either competition or service as a result of the Conrail transaction. Such findings do not track either with the results of my Rail Traffic Diversion Study or with my general experience, nor are they supported by the details of Mr. Grocki's Study. As I

show, Mr. Grocki's traffic analysis does not provide any reasonable basis for his conclusions concerning the level of service and degree of competition resulting from the Conrail transaction.

1. **Category No. 1: Bridge Traffic**

According to Mr. Grocki's Figure JG C-2, this category consists of 600 carloads, or 0.2% of Conrail's Chemicals & Plastics traffic. The basis for Mr. Grocki's assignment to this traffic Category No. 1 is as follows:

> "Bridge traffic which will now have an additional route choice with the same service and no New Orleans/Memphis diversion potential." (Grocki, Appendix C, Figure JG C-2, Page 9)

Mr. Grocki stated that, in his opinion, competition and service would be "improved" and "same," respectively, for this traffic Category No. 1.

I have reviewed the carload movements assigned by Mr. Grocki to this Category No. 1. Based on my review, I agree with Mr. Grocki's assessment that the Conrail transaction will result in "improved" or "enhanced" competition for this bridge traffic, because an additional route choice will be made available.

However, I do not agree with Mr. Grocki's characterization that service for this category of traffic will be the "same." From my review, 390 carloads of east-west and 66 carloads of north-south traffic, or 77% of the total of 600 carloads in this traffic category, will benefit from the improved service resulting from the Conrail transaction. Such service improvements for cross-territorial traffic now moving via Conrail's western and southern gateways are described in the operating plans filed by the Joint Applicants in this transaction. Further, because of the additional route

choices available to **all** carloads assigned by Mr. Grocki to be included in this Category No. 1, I fully expect that higher quality, improved service will be provided as a result of that intensified competition, in accordance with economic theory and with my own experience. It is my opinion, therefore, that the service provided to the traffic contained in Category No. 1 will be "improved."

2. Category No. 2: Shared Assets Area to Shared Assets Area Traffic

According to Mr. Grocki's Figure JG C-2, he categorized 51,400 carloads, or 14.9 percent of Conrail's Chemicals & Plastics traffic, as this Category No. 2. The basis for Mr. Grocki's assignments to Category No. 2 are as follows:

> "Current Conrail local traffic which will become SAA to SAA traffic; and, Traffic to/from off Conrail origins/destinations which will move to/from SAA's which has no New Orleans/Memphis diversion potential." (Grocki, Appendix C, Figure JG C-2, Page 9)

Mr. Grocki stated that, in his opinion, competition and service would be "improved" and "worse," respectively, for this traffic Category No. 2.

I have reviewed all of the carload movements that Mr. Grocki assigned to Category No. 2. From my review, I determined that Mr. Grocki included about 16,000 carloads in this Category No. 2 that would benefit from single system service as a result of the Conrail transaction. For example, I found [[[ ]]] carloads of traffic originated by Norfolk Southern at [[[ ]]], TN destined to [[[ ]]], PA, that will realize the benefits of single system service on the new Norfolk Southern/Conrail System as a result of the Conrail

transaction. As another example, I found [[[ ]]] carloads of traffic originated by CSXT at [[[ ]]], NC destined to [[[ ]]], NJ in the Northern New Jersey Shared Assets Area that will realize the benefits of single system service on the new CSXT/Conrail System, following the Conrail transaction. In my opinion, a more descriptively consistent grouping of the data than the one used by Mr. Grocki would assign all of the 16,000 carloads which will benefit from the realization of single system service as a result of the Conrail transaction to Category No. 5, in order to accurately analyze this traffic and assess the impact of the Conrail transaction.

Similarly, my review of the movements contained in this Category No. 2 identified 18,361 carloads of east-west and 10,059 carloads of north-south traffic, all of which will benefit from the improved service offered by the Joint Applicants as a result of the Conrail transaction.

I concur, as Mr. Grocki states, that competition will be "improved" for all traffic included in this Category No. 2. I fully expect higher quality, improved service will result from such "enhanced" competition, in accordance with economic theory and my experience, even though Mr. Grocki characterized the service for this Category No. 2 traffic as "worse," presumably because of his contention that all Shared Assets Area traffic would experience poorer service after the transaction. For reasons discussed later in my statement, I anticipate the opposite result. Accordingly, it is my opinion that the service provided the traffic contained in Category No. 2 will be "improved."

3. Category No. 3: Unchanged Traffic

According to Mr. Grocki's Figure JG C-2, Category No. 3 consists of

175,200 carloads, or 50.7% percent of Conrail's Chemicals & Plastics traffic. I entitled this traffic category as "Unchanged" because Mr. Grocki's view was that both competition and service for this traffic category would be the "same," following the Conrail transaction.

The basis for Mr. Grocki's assignment to Category No. 3 follows:

> "Conrail local traffic which becomes NS local or CSX local traffic; Traffic which currently moves via Conrail to/from NS or CSX which becomes NS-CSX interline traffic; Bridge traffic which currently has multiple routing options and will continue to have them after the merger; and, Traffic to/from off Conrail points which currently moves to/from Conrail which will, after merger, originate/terminate on NS or CSX and is not divertable to Memphis or New Orleans." (Grocki, Appendix C, Figure JG C-2, Page 9)

Mr. Grocki stated that, in his opinion, both competition and service would be the "same" for this traffic Category No. 3.

I have reviewed the movements assigned to Category No. 3 by Mr. Grocki. I found that in excess of 28,000 carloads included in Category No. 3 will realize the benefits of single system service as a result of Conrail transaction. For example, [[[ ]]] carloads currently originated by CSXT at [[[ ]]], FL will terminate at [[[ ]]], OH on the new CSXT/Conrail System after the Conrail transaction. As another example, [[[ ]]] carloads originating on Conrail at [[[ ]]], DE now moving via Norfolk Southern to [[[ ]]], OH will benefit from single system service by the new Norfolk Southern/Conrail System as a result of the Conrail transaction. Similarly, [[[ ]]] carloads originating on Norfolk

Southern at [[[ ]]], TN will realize the benefits of the new Norfolk Southern/Conrail System's single line service to [[[ ]]], PA, after the Conrail transaction.

I also found that 53,695 carloads of east-west and 22,331 carloads of north-south traffic, or a total of 76,026 carloads, will realize the service benefits offered by the Joint Applicants, resulting from the Conrail transaction.

From my review, it is apparent that, of the total of 175,200 carloads assigned by Mr. Grocki to this Category No. 3, 104,000 carloads will benefit from improved service. Accordingly, only the remainder, or 71,200 carloads of the 175,200 carload total in this Category No. 3, can be correctly stated to have "same" or "unchanged" service. I do agree with Mr. Grocki's assessment that competition for all traffic in this Category No. 3 will remain the "same," or "unchanged."

4. <u>Category No. 4: To/From Shared Assets Area Traffic</u>

As shown by Figure JG C-2, Mr. Grocki assigned 31,900 carloads, or 9.2% of Conrail's Chemicals & Plastics traffic, to this Category No. 4, which also consists of Shared Assets Area traffic. The basis for Mr. Grocki's assignments to this Category No. 4 follow:

> "Conrail local traffic which becomes NS or CSX traffic to/from an SAA; and, Traffic which moved NS or CSX to/from Conrail which becomes NS or CSX to/from SAA." (Grocki, Appendix C, Figure JG C-2, Page 9)

Mr. Grocki stated that, in his opinion, competition and service would be "same" and "worse," respectively, for this Category No. 4.

I reviewed the movements assigned to this Category No. 4 by Mr. Grocki. The traffic which is included in this Category No. 4 is characterized by either the new Norfolk Southern/Conrail System or the new CSXT/Conrail System "stepping into Conrail's shoes" as a result of the Conrail transaction. Although many of the movements shown by Mr. Grocki can be handled by only one of the two new Systems, there are a substantial number of other movements to or from Shared Assets Areas which also originate or terminate at jointly served locations -- such as Chicago or Toledo or Cincinnati -- which would be subject to enhanced competition from both new Systems, and to the service benefits resulting from such competition even though Mr. Grocki's Study made no effort to determine the amount of such traffic.

For this reason, I do not agree with Mr. Grocki's characterization that this category of traffic will experience no change in its competitive environment. Instead, it is my opinion that both the competition and the service provided after the Conrail transaction by the two new Systems will be at least as good as that provided by Conrail prior to the Conrail transaction. In the absence of data, however, I have stated that both the competition and the service evaluations for this traffic category are "unchanged."

5. **Category No. 5: Single System Traffic**

According to Figure JG C-2, Mr. Grocki assigned only 12,600 carloads, or 3.6% of Conrail's Chemicals & Plastics traffic to this Category No. 5. The basis for Mr. Grocki's assignments to this Category No. 5 follow:

> "Traffic which currently moves Conrail to/from NS or CSX which becomes NS local or CSX local traffic" (Grocki, Appendix C, Figure

Mr. Grocki stated that, in his opinion, competition and service would be "worse" and "improved," respectively, for this traffic Category No. 5.

Mr. Grocki's identification of only 12,600 carloads of single system service is at odds with the 50,000 to 60,000 single system moves shown by my Rail Traffic Diversion Study and by similar studies by CSXT to result from the Conrail transaction; at 50,000 carloads, the single system moves identified by the Applicants would constitute 17.4% of the total chemicals and plastics traffic identified by Mr. Grocki. As stated above, my review of Mr. Grocki's Study indicates that he improperly assigned about 16,000 single system moves to Category No. 2, as well as an additional 28,000 single system moves to Category No. 3. Those improperly assigned 44,000 carloads, in combination with the 12,600 single system movements identified in this Category No. 5 by Mr. Grocki's Study, total 56,600 carloads, which validates the Joint Applicants' findings that 50,000 to 60,000 carloads of Chemicals & Plastics traffic will benefit from "improved" single system service as a result of the Conrail transaction.

As shown by Figure JG C-2, Mr. Grocki characterizes competition for such single system traffic as "worse." His rationale for doing so was provided in a response to a Norfolk Southern interrogatory, as follows:

> "Traffic which is currently interlined between Conrail and NS or CSX which, after the Conrail break-up will become NS or CSX local traffic, currently could be routed via NS/Conrail or CSX/Conrail. In this case, the shipper has the benefit of competition at the origin (or destination) when he can negotiate between the two competing carriers. After the Conrail break-up, whichever

carrier (NS or CSX) controls the local move, will effectively become a monopoly carrier because it can control the service for the route thereby depriving the shipper of one competitive option." (CMA-13/SPI-8, Grocki Response to Interrogatory No. 13)

The characteristics of all of the traffic which will benefit from single system service as a result of the Conrail transaction do not support the blanket application of Mr. Grocki's rationale that competition will be reduced. For example, all of the 16,000 single system moves improperly assigned by Mr. Grocki as Category No. 2 traffic, but which should have been assigned as Category No. 5 traffic, will benefit from improved competition to/from the Shared Assets Areas. Similarly, a portion of those 28,000 carloads which will benefit from single system service that Mr. Grocki had erroneously assigned to Category No. 3 involve movements between origins and destinations that are and will remain open to competition -- some of which have been created by the Conrail transaction, and none of which will experience a reduction in competition because of the Conrail transaction. Still other movements currently originate or terminate at exclusive locations on either Norfolk Southern or CSXT; thus, the Conrail transaction will not lead to a reduction in competition for such traffic.

In total, then, the characteristics of all of the 50,000 to 60,000 carloads that will realize single system service are unknown. However, at least 16,000 carloads will realize enhanced competition, while an unknown remainder will be unaffected by the Conrail transaction or may, in some instances, experience a reduction in competition of the form postulated by Mr. Grocki. On balance, however, it is my judgment that competition for the composite of the single system movements realized

by the Conrail transaction beyond the 16,000 carloads is most fairly characterized as "unchanged."

6. Category No. 6A: Shared Assets Area Traffic Potentially Divertible To The Memphis Or New Orleans Gateways

According to Figure JG C-2, Mr. Grocki assigned 21,200 carloads, or 6.1% of Conrail's Chemicals & Plastics traffic, to this Category No. 6A. The basis for Mr. Grocki's assignment of traffic to this Category No.6A follows:

> "Traffic to/from off Conrail points which currently moves to/from Conrail which will originate/terminate in the Shared Asset Area and is potentially divertable to Memphis or New Orleans." (Grocki, Appendix C, Figure JG C-2, Page 9)

Mr. Grocki stated that, in his opinion, competition and service would be "worse if Gateway shifted" and "worse," respectively, for this traffic Category No. 6A.

I reviewed the detailed traffic records for this traffic category. The records consisted of Conrail forwarded and received traffic to/from Shared Assets Areas, with the other end of each move being on a railroad other than Norfolk Southern or CSXT. As such, all of this traffic will be open to competition between the new Norfolk Southern/Conrail System and the new CSXT/Conrail System for the Conrail end of the move, after the Conrail transaction. Moreover, further analysis revealed that 56% of the carloads originated or terminated at non-Conrail points (i.e., the other end of the move) **exclusively served** by one railroad. Accordingly, Mr. Grocki's conclusion that all of such Shared Assets Areas traffic would be divertible by the new Norfolk Southern/Conrail System, or the new CSXT/Conrail System, in direct competition

with each other on the northern end of the move, to a Memphis or New Orleans Gateway that would shorthaul the western carrier that **exclusively serves** the southern end of the move for 56% of the traffic in this category does not reflect a reasonable assessment of the facts. As the exclusive carrier at one end of a move with two carriers competing for the other end of the move, the western carrier would be in a stronger position to successfully achieve its long haul on the move.

For the remaining traffic in this Category No. 6A which originates or terminates at stations **not exclusively served,** the shipping public will retain two alternative carrier routes at both the origins and destinations. For example, for the [[[ ]]] carloads originating on the Union Pacific Southern Pacific System at [[[ ]]], LA destined to [[[ ]]], NJ in the Shared Assets Area, the alternative carrier at the origin station of [[[ ]]] is Illinois Central. In conjunction with the availability of competing service between the new Norfolk Southern/Conrail System and the CSXT/Conrail System, this would, I believe, preclude the ability of either system to divert this traffic to the Memphis or New Orleans Gateway.

For all the above reasons, I conclude that *none* of the traffic in this Category No. 6A will suffer any adverse impact on competition as a result of the Conrail transaction; instead, competition will be "enhanced." In addition, because all of this traffic currently moves either through the east-west gateways or the north-south gateways, the Conrail transaction will result in "improved" service for all of this traffic.

7. Category No. 6B: Non-Shared Assets Area Traffic Potentially Divertible To The Memphis Or New Orleans Gateway

According to Figure JG C-2, Mr. Grocki assigned 43,400 carloads, or 12.6% of Conrail's total Chemicals & Plastics traffic, to this Category No. 6B. The basis for Mr. Grocki's assignment of traffic to this Category No. 6B follows:

> "Traffic to/from off Conrail points which currently moves to/from Conrail which will originate/terminate on CSX or NS and is potentially divertable to Memphis or New Orleans." (Grocki, Appendix C, Figure JG C-2, Page 9)

Mr. Grocki stated that, in his opinion, competition and service would be "worse if Gateway shifted" and "same," respectively, for this Category No. 6B.

The traffic assigned to this Category No. 6B is similar to that of the preceding traffic Category No. 6A in that Mr. Grocki alleges that this traffic, too, is potentially divertible to the Memphis or New Orleans Gateway.

I reviewed the detailed records in this traffic category. As was true for Category No. 6A, 60% of this Category No. 6B traffic originates or terminates at **exclusively served** non-Conrail points. It is to be expected that Norfolk Southern or CSXT would meet strong resistance from a carrier serving an exclusive point on the southern end of a move to any attempt at shorthauling via the Memphis or New Orleans Gateways. Also, a sizable amount of traffic originates or terminates at non-exclusively served Conrail points, reducing the likelihood that either the new Norfolk Southern/Conrail System or the new CSXT/Conrail System would be able to force routings via the Memphis or New Orleans Gateways. Therefore, I conclude that Mr. Grocki has substantially overstated the potential for such diversions.

For example, I see no possibility that the [[[ ]]] carloads originated by the Union Pacific Southern Pacific System at its **exclusively served** station of [[[ ]]], TX destined to the **exclusively served** Norfolk Southern/Conrail System station of [[[ ]]], DE could be diverted to a longer haul via the Memphis or New Orleans Gateways by the new Norfolk Southern/Conrail System because the latter carrier has no commercial leverage to do so. Similarly, I see no possibility that the [[[ ]]] carloads originated at the Union Pacific Southern Pacific System **exclusively served** station of [[[ ]]], LA and destined to the **exclusively served** Norfolk Southern/Conrail System station of [[[ ]]], WV could be diverted via the Memphis or New Orleans Gateways.

Other traffic contained in this Category No. 6B originates or terminates at **exclusively served** Conrail points, but terminates or originates at **non-exclusively served** points off-Conrail. For example, [[[ ]]] carloads originate on the Union Pacific Southern Pacific System at [[[ ]]], TX (which is also served by the Burlington Northern Santa Fe System) and are destined to [[[ ]]], DE, which will be **exclusively served** by the new Norfolk Southern/Conrail System. I disagree with Mr. Grocki's contention that this movement could be diverted via the Memphis or New Orleans Gateways, thereby shorthauling the originating carrier and, as Mr. Grocki alleges, increasing the rates charged to the shipping public.

Although theoretically the Norfolk Southern/Conrail System could play the Burlington Northern Santa Fe System off against the Union Pacific Southern Pacific System in order to achieve a gateway change, one of those two western carriers would have to concur both in the shorthaul routing and in the reduced revenue division associated with it. Alternatively, the shipper would have to agree to a rate

increase in order to compensate the short-hauled originating carrier, if Mr. Grocki's hypothesis were accepted. Because the shipper controls the routing and, unless both western carriers simultaneously sought such a rate increase, the shipper's preferred alternative would be to continue the existing routing, selecting the western carrier that concurred in the existing routing and would retain the existing rate level. For these reasons, it is my opinion that any such diversions to the Memphis or New Orleans Gateways are highly unlikely to occur as a result of the Conrail transaction.

Because all of the traffic involved flows through east-west or north-south gateways, it is my opinion that service will be "improved" on all of the traffic contained in this Category No. 6B and, further, that competition will be "unchanged," with no diversions to the Memphis or New Orleans Gateways, as a result of the Conrail transaction.

8. **Category No. 7: Joint Line Traffic**

According to Figure JG C-2, this traffic consists of 6,600 carloads, or 1.9% of Conrail's Chemicals & Plastics traffic. The basis for Mr. Grocki's assignment of traffic to this Category No. 7 follows:

> "Conrail local traffic which becomes NS-CSX interline traffic."
>
> (Grocki, Appendix C, Figure JG C-2, Page 9)

Mr. Grocki stated that, in his opinion, competition and service would both be "worse" for this traffic Category No. 7.

I have reviewed all of the movements assigned to Category No. 7 by Mr. Grocki in his current Study. Based on my review, I conclude that Mr. Grocki has overstated by 1,351 carloads the amount of interline traffic that will be created as a

result of the Conrail transaction. Thus, instead of the 6,600 carloads Mr. Grocki indicated would become interline traffic, it is my opinion that the correct number is 5,228 carloads, based on Mr. Grocki's data.

The most frequent error in Mr. Grocki's Study was his failure to recognize that either the existing CSXT System or the existing Norfolk Southern System could access certain stations whether or not the Conrail traffic at that station was "acquired" by either the new Norfolk Southern/Conrail System or the new CSXT/Conrail System. Examples of such stations are La Porte and Terre Haute, IN; Chicago and Kankakee, IL; parts of Baltimore and Pittsburgh; and selected shortlines, including the Finger Lakes and Pittsburgh Industrial Railroad; all such stations can be reached by both new Systems, even if the other end of the move is located at a Conrail station which will be exclusively served by either the new Norfolk Southern/Conrail System or the new CSXT/Conrail System.

Mr. Grocki further alleged:

> "It is GRA's conclusion that because of the limited number of gateways between NS and CSX in Official Territory and the potential for circuitous routing that this traffic will suffer a significant deterioration of service versus the Conrail single line service which it enjoys today...." (Grocki, Appendix C, Page 14)

In order to respond, I summarized the interline traffic by junction from my Conrail N (Penn Lines) and Conrail C (New York Central) split runs, which provided the best available data to test Mr. Grocki's allegation. What I found was that, for all of the interline traffic created, the car miles on Conrail after the Conrail transaction would exceed the car miles on Conrail prior to the Conrail transaction by less than

five percent. I also found that the most significant junction to be used for such interline traffic was Buffalo, which accounted for 60% of the total movements. Except for the junction to be created at Jersey City, all of the other significant junctions which would be used are already operational, and they include major interchanges such as Cincinnati, Cleveland, Columbus, and Toledo.

It is my opinion that the introduction of circuity of less than five percent for the interline traffic, coupled with its concentration at high volume, existing operational interchange points, will prevent any "significant deterioration of service," such as was alleged by Mr. Grocki.

As shown by Figure JG C-2, Mr. Grocki has stated that the effects on competition for this Joint Line traffic category will be "worse." In response to a Norfolk Southern interrogatory for his supporting rationale, Mr. Grocki replied as follows:

> "A shipper which is currently a Conrail local shipper which, after the Conrail break-up, will become an NS-CSX interline shipper will suffer reduction in competition for two reasons:
>
> "(a) Prior to the Conrail break-up, this shipper would negotiate with a single carrier (Conrail). After the Conrail break-up, the shipper will have to negotiate with two (monopoly) carriers for an interline movement. As competitors, CSX and NS have historically been reluctant to make competitive interline rates. In addition, the total cost of the movement will be higher than a Conrail single line haul; therefore, in the absence of conditions imposed by the STB, shippers will likely have to pay a higher rate.
>
> "(b) Both NS and CSX will tend to favor shippers with single line service over

interline movements, particularly within Official Territory. Since many chemical and plastics products are commodity-like in nature (i.e., they are available from a number of sources), customers which, prior to the transaction, had the advantage of Conrail's single line haul, will now find themselves in the position of being an interline move with potential competition from NS and CSX single line hauls. NS and CSX would tend to favor their own single line haul customers versus the CSX-NS interline move after the break-up." (CMA-13/SPI-8, Grocki's Response to Interrogatory No. 13, Page 7)

In rebuttal, I offer the fact that CSXT is currently one of Norfolk Southern's largest interchange partners, and that those two head-to-head competitors make competitive interline rates and interchange traffic on some 200,000 units annually. Because for this traffic there will be no alternative to working together, the new Norfolk Southern/Conrail System in conjunction with the new CSXT/Conrail System will "step into Conrail's shoes" in order to operate and market the 5,200 carloads of interline traffic which results from the Conrail transaction.

Further, I know of no reason why Conrail's rates do not now reflect marketplace conditions, so that Mr. Grocki's assertion that interline movements will require that shippers will have to pay higher rates is simply incorrect. If -- and Mr. Grocki has presented no supporting documentation to his hypothesis -- the total cost of the interline movement increases, but the rate has already been set at its maximum in light of marketplace conditions, then the rate can go no higher and the two carriers will absorb any such cost increases. Moreover, the fact that some 200,000 units

annually are interchanged between the existing Norfolk Southern and CSXT Systems in the ordinary course of business presents strong evidence countering Mr. Grocki's assertion that those shippers requiring interline movements will be treated less than equally compared with the single line customers by the new Norfolk Southern/Conrail System and the new CSXT/Conrail System.

For these reasons, and because the interline partners, the Norfolk Southern Conrail System and the CSXT/Conrail System, will merely "step into Conrail's shoes," it is my opinion that competition for this category of traffic will be "unchanged."

9. Category No. 8: Unknown Traffic

According to Figure JG C-2, this traffic consists of 2,700 carloads, or 0.8% of Conrail's Chemicals & Plastics traffic. The basis for Mr. Grocki's assignment of traffic to this Category No. 8 follows:

> "Traffic which was handled by Conrail in 1995 but now originates or terminates on a short line which has multiple routing options. This traffic could potentially move via another railroad than NS or CSX after the Conrail breakup." (Grocki, Appendix C, Figure JG C-2, Page 9)

Mr. Grocki stated that, in his opinion, both competition and service would be "unknown" for this traffic Category No. 8.

I reviewed the records for all 2,700 carloads assigned to this traffic category. Although there are a number of smaller movements that do not fit the logic by which Mr. Grocki said he assigned traffic to this traffic category, all of the movements in excess of [[[ ]]] carloads each either originate or terminate at East Windsor Hill,

CT, which was a Conrail station in 1995, but is now located on the Connecticut Southern Railroad, a newly formed shortline. Based on my review, I characterize the impact of the Conrail transaction on competition and service for this traffic category as "unchanged," because there will be no effect.

C. Mr. Grocki's Gateway Analysis Is Without Validity

Mr. Grocki states that approximately 63,000 carloads of Chemicals & Plastics traffic will have a reduction in competition after the Conrail transaction. One of the three traffic categories to which he attributes a reduction in competition after the Conrail transaction is:

> "Potentially divertable traffic, i.e., traffic which is currently originating or terminating at locations not on Conrail and which moves to/from a Conrail origin or destination which will be solely served by either CSX or NS after the merger and which will be potentially divertable from its current Conrail Gateway to the Memphis or New Orleans Gateway." (Grocki, Page 5)

In response to a Norfolk Southern Interrogatory, Mr. Grocki confirmed that the above traffic category is included in Figure JG C-2 in accordance with Note 6b and comprised 43,400 carloads. In accordance with the stated hypothesis and the rate increase projected by Mr. Charles N. Marshall, whose Verified Statement appears as Attachment 3 to CMA-10, Mr. Grocki conducted an analysis of the cost impact of diverting such traffic from existing Conrail gateways. From that Gateway Diversion Analysis, Mr. Grocki determined a potential rate increase of 10.75% would be required in order to permit western connecting railroads to maintain their existing revenue through a revised gateway and to permit eastern railroads to retain the same dollar margin they enjoyed via the original gateway.

The results of Mr. Grocki's Gateway Diversion Analysis are contain in his work

papers CMA-HC-0003 through 0005, which I have reproduced as Attachment JHW-CMA-2-HC, and which are referred to as the "Chemical Traffic Diversion Table" in the interrogatory responses below. As shown on Page CMA-HC-0005, Mr. Grocki's Gateway Diversion Analysis effectively rerouted only 22,238 of the total 43,400 carloads included in Figure JG C-2, Note 6b.

In response to a Norfolk Southern Interrogatory, Mr. Grocki explained the difference in these two figures as follows:

> "The methodology used to produce the traffic described in Section 6A and 6b of the Grocki verified statement was different from the methodology used to produce the Chemical Traffic Diversion Table. The former methodology identified all potentially divertable traffic to the New Orleans gateway. The latter methodology only utilized origin-destination pairs which had a net cost savings via the alternate gateway to the railroads involved, and was not sorted by gateway...." (CMA-14, Response to Interrogatory No. 2, Page 3)

Mr. Grocki further explained that:

> "The methodology used to develop the Chemical Traffic Diversion Table identifies the "most profitable" gateway for the railroads involved...." (CMA-14, Response to Interrogatory No. 3, Page 4)

In other words, what Mr. Grocki found, as he conducted his Gateway Diversion Analysis and as he considered the revenue, costs, and profit margins for the movements being analyzed, was that only about one-half of the traffic that he had identified as potentially divertible to the Memphis or New Orleans Gateways in his Figure JG C-2 Note 6b could profitably be diverted by the railroads involved.

My further review of Mr. Grocki's work papers identified such significant errors in his methodology as to make the entire Gateway Diversion Analysis unusable. Attachment JHW-CMA-3-HC was prepared in order to analyze the detail underlying Mr. Grocki's Gateway Analysis, as contained in work papers CMA-HC-005 through 0008.

From my investigation, as can be ascertained from Attachment JHW-CMA-3-HC, I found the following deficiencies in Mr. Grocki's Gateway Diversion Analysis:

- Of 165 state-to-state pairs in Mr. Grocki's Analysis, 65 state-to-state pairs, or 39% of the total, show the Conrail connecting railroad having a negative profit margin, on existing traffic movements and current routings;
- Ten additional records show $0 cost for both Conrail and the connecting railroads;
- Four records show $0 revenue divisions for the connecting railroad;
- Many state-to-state pairs not relevant to Memphis or New Orleans Gateway routings because of circuity are included in Mr. Grocki's Study, such as Wyoming to Indiana and New Jersey to Oregon; and
- In responses to Norfolk Southern interrogatories, Mr. Grocki was not able to identify which gateways he had used for each state-to-state pair, but he admitted that the Chemical Traffic Diversion Table may have included routings via Kansas City or St. Louis. He simply doesn't know. Conceivably, however, **none** of the 22,238 carloads contained in Mr. Grocki's Study were actually diverted via either the Memphis or New Orleans Gateways.

The largest two state-to-state movements shown in Mr. Grocki's Study Analysis are

3,375 carloads originating in Texas destined to New Jersey and 2,421 carloads originating in Texas destined to Pennsylvania. For those movements, I calculated from Mr. Grocki's data that the western railroads' revenue-to cost ratios were at the unrealistically low levels of 1.02 and 1.09, respectively, over their **existing** routes.

As other examples, Mr. Grocki's Analysis showed that [[[ ]]] carloads originating in Wyoming and terminating in Indiana produced a **negative** margin (i.e., a loss) for the western railroads of [[[ ]]] per carload, with a revenue-to-cost ratio of [[[ ]]], for existing routings. Similarly, for [[[ ]]] carloads originating in New Jersey and terminating in Texas, Mr. Grocki's Study found a **negative** margin (i.e., a loss) for the western railroads of [[[ ]]] per carload, with a revenue-to-cost ratio of [[[ ]]].

As shown by Attachment JHW-CMA-2-HC, the bottom line result of Mr. Grocki's cost analysis is that Conrail's western connections generate revenues of $49.9 million and costs of $48.4 million on this traffic over their existing routes. By my calculation, that is a revenue-to-cost ratio of 1.03, which means that, for the western railroads, such Chemicals & Plastics traffic is only marginally profitable. Based on my experience, I do not believe that either the Union Pacific Southern Pacific System or the Burlington Northern Santa Fe System produces such a low, marginal revenue-to-cost ratio on their Chemicals & Plastics traffic.

If Mr. Grocki's Analysis results were correct (which they are not), then the western railroads would not be intensely competing for this Chemicals & Plastics traffic; instead, they would seek the shortest possible haul to the closest gateway in order to minimize either their losses or their marginal contributions. Mr. Grocki slides past the improbable results of his Analysis by his assumption that the western carriers, by reducing their lengths of haul, will reduce their costs, but maintain their existing revenue. The real point of Mr. Grocki's Analysis is that rail rates must be raised so that the western railroads can generate a

reasonable profit margin on their Chemicals & Plastics traffic, and that objective can be further achieved by the western railroads shorthauling themselves!

From my analysis of detailed movement records during the conduct of my Rail Traffic Diversion Study, I know that some Chemicals & Plastics traffic already moves via the Memphis and New Orleans Gateways. If the hypothesis presented by Messrs. Grocki and Marshall were correct, then the Chemicals & Plastics traffic already moving via those gateways should have higher rates than would similar traffic moving via the more commonly used gateways of St. Louis and Chicago.

Attachment JHW-CMA-4 was prepared in order to compare the revenue per ton for Chemicals & Plastics traffic now moving via the Memphis and New Orleans Gateways with that for identical state-to-state pairs moving via the Chicago and St. Louis Gateways. In preparing Attachment JHW-CMA-4, I considered only those state-to-state pairs with the Northeast Region end of the move located in Ohio or more easterly states, because it is those states which would benefit from use of the shorter routes via New Orleans and St. Louis. State-to-state pairs which had no traffic moving via either the Memphis or New Orleans Gateways were not considered because they provided no basis for rate comparisons.

As a review of Attachment JHW-CMA-4 will show, the average revenue per ton for the four gateways was:

- Chicago: $53.77
- Memphis: $54.87
- New Orleans: $51.91
- St. Louis: $57.17
- Average for all four gateways: $56.53

From my comparison of existing Chemicals & Plastics traffic movements via these four gateways, I conclude that there is no factual basis for the hypothesis postulated by Messrs. Grocki and Marshall that rates will be increased if such traffic were diverted to the Memphis or New Orleans Gateways. To the contrary, my comparison from the 1995 *Carload Waybill Sample* demonstrates that rates for such traffic moving via the Memphis and New Orleans Gateways are lower than the average for all four gateways as well as lower than the most heavily used St. Louis Gateway.

Furthermore, because it is based on Mr. Grocki's Gateway Diversion Analysis, which was demonstrated above to be fraught with substantive errors, Mr. Marshall's observation that "the average rate increase for all divertable cars is 10.75%" (Marshall, Page 5) has been shown to be without foundation and should be disregarded.

In response to a question from Mr. Stone, CMA's counsel, during my August 11, 1997 Deposition, I explained why such shorthauls of the Union Pacific and the Burlington Northern Santa Fe Systems via the Memphis or New Orleans Gateways were unlikely to occur:

> "A. Yes. The rationale for that move as I have already testified was the traffic originating or terminating in the Southwestern exclusion territory except for KCS traffic was originated or terminated by either the Union Pacific System or the BN/Santa Fe system.
>
> "And that diversion of that traffic away from the St. Louis area gateways including St. Elmo or Sidney in the case of the new Norfolk Southern gateway or away from the Chicago gateway to a Memphis or a New Orleans gateway would short haul either the Union Pacific or the BN/Santa Fe system. And such short hauls were considered unlikely to occur. In other words, the two

Western carriers were not expected to concur in routing changes that substantially short hauled them.

"Q. Okay. Do you have any prediction based on your experience in the industry of what it would require to induce BN or UP to be short hauled?

"A. Consolidation with either the Norfolk Southern/Conrail system or the CSX/Conrail system." (Williams Deposition, August 11, 1997, Pages 157-158.)

I have not changed my opinion since that date.

D. Mr. Grocki's Service And Competition Allegations Are Inaccurate

From my analysis of Mr. Grocki's Study, I prepared Attachment JHW-CMA-5, which provides my Rebuttal Restatement of Mr. Grocki's Study results contained in his Table JG C-2. As explained earlier in my Statement and as shown by Attachment JHW-CMA-5, using only that Conrail data used in Mr. Grocki's Study, I conclude that as a result of the Conrail transaction, 233,200 carloads, or 67.5% of Conrail's Chemicals & Plastics traffic, will benefit from improved service, and 73,200 carloads, or 21.2% of total Chemicals & Plastics traffic, will benefit from enhanced competition.

1. The Conrail Transaction Will Improve Service For Most Chemicals & Plastics Traffic

As stated in the Norfolk Southern Operating Plan (CSX/NS - 20), Mr. Mohan concluded that both east-west and north-south traffic would be substantially improved as a result of the Conrail transaction. The increased traffic volume would permit both intermediate switching to be reduced and block size to be increased, which would in

turn permit more efficient run-through-type trains, not only on the new Norfolk Southern/Conrail System but on connecting carriers as well. Similar benefits were stated in the CSXT Operating Plan.

The reasons for my conclusion that 233,200 carloads, or 67.5% of total Chemicals & Plastic traffic, will benefit through improved service from the Conrail transaction are shown in Attachment JHW-CMA-5 and summarized as follow:

- Single System Service: 56,600 carloads
- Improved service via east-west and north-south gateways: 140,600 carloads
- Improved Service from Enhanced Competition: 36,000 carloads

I defer to the Norfolk Southern and the CSXT operating witnesses who show that service moving to or from the Shared Assets Areas will not be reduced. However, I would point out that a substantial volume of Shared Assets Area traffic moves across Northeastern Region boundaries via the east-west and north-south gateways and, therefore, will receive improved service for the reasons described in Mr. Mohan's Verified Statement, as a result of the Conrail transaction.

Even though he admitted that his Class I railroad experience does not include any operating experience, Mr. Grocki identified approximately 111,000 carloads of Chemicals & Plastics traffic which he judged would receive "impaired service" as a result of the Conrail transaction. He stated that the "impaired service" would involve either traffic moving to or from a Shared Assets Area or Conrail local traffic which becomes interline traffic after the Conrail transaction. My findings differ significantly from Mr. Grocki's, and I disagree with his conclusions, for all of the reasons discussed in this Verified Statement.

2. The Conrail Transaction Will Enhance Competition For a Substantial Portion of Chemicals & Plastics Traffic

Mr. Grocki identifies about 63,000 carloads of Chemicals & Plastics traffic that he concluded would experience a reduction in competition. According to Mr. Grocki, the following three traffic categories would be involved:

> "1. Current Conrail local traffic which will become NS/CSX interline traffic after the Conrail break-up." (6,600 carloads)
>
> "2. Traffic which is currently interline between Conrail and NS or CSX which, after the Conrail break-up, will become NS or CSX local traffic." (12,600 carloads)
>
> "3. Potentially divertable traffic, i.e., traffic which is currently originating or terminating at locations not on Conrail and which moves to/from a Conrail origin or destination which will be solely served by either CSX or NS after the merger and which will be potentially divertable from its current Conrail Gateway to the Memphis or New Orleans Gateway." (43,400 carloads) (Grocki, Page 5, carloads added)

For the reasons discussed earlier in this Statement, I do not believe that any Chemicals & Plastics traffic will receive reduced competition as a result of the Conrail transaction. As shown by Attachment JHW-CMA-5, it is my opinion that 73,200 carloads, or 21.2% of total Chemicals & Plastics traffic, will receive enhanced competition. Almost all of the traffic which will benefit from enhanced competition between the new Norfolk Southern/Conrail System and the new CSXT/Conrail System will be traffic moving to, from, or between Shared Assets Areas. In addition, a small amount of bridge traffic will benefit from enhanced competition, because the Conrail

transaction will create additional routes, as admitted by Mr. Grocki.

III. W&LE-4: RESPONSIVE APPLICATION OF WHEELING & LAKE ERIE RAILWAY COMPANY

This portion of my Verified Statement evaluates and rebuts portions of the Responsive Application of the Wheeling & Lake Erie Railway Company.

A. W&LE Was Formed In Order To Enrich Its Founders, Not To Preserve Competition with Norfolk Southern/Conrail

The Responsive Application of the W&LE is replete with statements that the W&LE was founded in 1990 in order to preserve competition with a then-to-be formed Norfolk Southern/Conrail combination. The basis for W&LE's claim to this effect is contained in the Verified Statement of Larry R. Parsons, Chairman, CEO and majority shareholder of the W&LE. The following is a typical statement on this subject by Mr. Parsons:

> "I have reason to believe that the recreation of the W&LE in this described territory was NS's response to the Antitrust Division's divestiture demand. This would-be new W&LE, added to the then-viable Pittsburgh & Lake Erie, was supposed to offset the clearly anticompetitive aspects of a Conrail/NS combination in the Pittsburgh/Chicago Corridor." (W&LE-4, Pages 24-25)

Nothing could be further from the truth. Indeed, as I show in my statement, the W&LE was formed with a single objective: to enrich its founders. The preservation of competition in the Pittsburgh/Chicago Corridor was not a consideration.

The bases for founding, operating, and profiting from the W&LE are clearly stated in the *Wheeling Acquisition Corporation's Offering Proposal*, dated November 10, 1988.

Prepared by the W&LE founders and promoters, that document described the W&LE operating properties, discussed the evolution of regional railroads generally, presented a business plan including pro forma financial projections of revenues and expenses, provided projected returns to its investors, and contained resumes of its founders, who later became the W&LE's management team. Within the *WAC Offering Proposal*, there is not a single word nor any other shred of support for Mr. Parsons' unsupported "belief" that the W&LE was created as a prospective competitor of a Conrail/NS combination in the Pittsburgh/Chicago corridor.

The *WAC Offering Proposal* expressed the view that the operating properties comprising the W&LE could be operated together by its management team to produce additional traffic:

> "The Wheeling group believes that the properties can be operated together to produce additional traffic. Norfolk Southern, for several reasons, has not developed the use of the bridge route between the Upper Midwest and mid-Atlantic states...."
>
> "For one, NS owns a competing route and channels traffic over its high density main line. For another, NS ownership of the lines has precluded the use of the lines by competitors, particularly CSX. As an independent, the new railroad would be in a position to work with other carriers..." (*WAC Proposal*, Page 5)

The *WAC Offering Proposal* went on to state:

> "The Wheeling lines of Norfolk Southern carry sufficient density so that they are in no immediate danger of being "torn from the ground." Still, the existence of the lines fits no marketing strategy consistent with the overall

design of Norfolk Southern, which is otherwise the most profitable and well-maintained of the large major railroads..."

"The lines have been operated as strategic orphans since their induction into the NS system in the 1960's. The lines would have provided a link between the East and Midwest, but Norfolk Southern (through predecessor Norfolk & Western) pulled back from a strong foray into Eastern markets, preferring to concentrate on routes serving auto plants and the coal fields. The lines were marked for sale when NS sought to purchase Conrail, by the 1980's the acknowledged power in Eastern markets. When that purchase was denied, NS decided to divest the Wheeling lines as part of an overall plan to trim an estimated 2,500 miles of rail lines from its system..."

"NS' intent, while benign, is not altogether altruistic. NS would still interchange a substantial amount of traffic with the Wheeling and is anxious to preserve its own traffic base...." (*WAC Proposal*, Page 12)

Turning to the benefits and the opportunity for investor profit in the W&LE, the *WAC Offering Proposal* stated:

"It is the hope of the regionals to optimize by realizing the advantages--flexibility and responsiveness--of being small, and also of being sufficiently large to serve diverse markets, to create traffic density and to attract capital...."

"On the latter score, it can be noted that Value Line Investment Survey recently began following MidSouth Corp., a regional railroad formed in 1986. Further, of the three lines involved in the Wheeling transaction, two involve companies with recent or present public capital status. The Pittsburgh &

West Virginia, owner of assets to be sub-leased on a long-term basis, is presently listed on the American Stock Exchange; the Wheeling & Lake Erie, although controlled by stock and by lease by Norfolk Southern, still was listed on the New York Stock Exchange until last year...." (*WAC Proposal*, Page 14)

The *WAC Offering Proposal* then presented its business plan, including pro forma financial projections, which it described as follows:

"The Wheeling group has developed a business plan built around generating sufficient cash flow from railroad operations to pay off in five years a substantial amount of the funds required for the acquisition. Although the Wheeling group is optimistic about applying the economics and marketing efforts of a regional railroad to secure new traffic, the business supporting the pro forma plan is substantially the existing traffic base. The pro formas reflect significant expected gains in productivity as a result of plans to change the methods and organization of work and of compensation...." (*WAC Proposal*, Page 16)

The *WAC Offering Proposal* summarized certain key aspects of the pro formas as follows:

"To summarize, the pro formas indicate that the railroad operations would produce a net cash flow from operations of approximately $13.2 million in the base year on **$43.3 million of revenue**, and would show mild growth in both categories thereafter..."

"Revenues largely reflect actual NS rail movements on the Wheeling lines for the years 1987 and first half 1988. (Later data now being assembled up

through the first half of 1989 will be scrutinized in the due diligence process.) Because the NS base data is recorded on a system basis, the data in many cases had to be pro-rated and assigned to the Wheeling lines; the basis for the split is generally mileage, although other factors may affect special cases..."

"Adjustments were made to the revenues to recognize special assumptions--both up and down. **As an example, the question of how a key Cleveland utility will react to the problem of acid rain after 1992 led to a pro forma downward adjustment in coal revenues. The assumption was that the coal movements would initially be cut by one-third, even though the management has set a high priority on taking steps to avoid that result..."**

"The pro formas do take into consideration the attraction of some new traffic which NS does not carry today. Specifically, the growth would be added by an enhanced use of trackage rights over Hagerstown to points east and south to the Shenandoah Valley..."

"The pro forma revenues in the most likely case grow from nearly $43.3 million in the first year to more than $50.2 million in the year 10--as a result of estimated ICC allowed "general increases" in rates and without regard for efforts to attract additional traffic with local marketing efforts and improved rail economics...." (*WAC Proposal,* Page 16; emphasis added)

In order to show projected returns to its prospective investors, the *WAC Offering Proposal* prepared a leveraged buy-out analysis that it described as follows:

"The leveraged buy-out analysis which follows steps out from the rail revenue/expense pro formas. Again, it should be emphasized that the figures presented do not take into account additional values to be realized from

property not used in rail operations..."

"The first page of that analysis summarizes various assumptions. The offer price is the combination of the $42 million offered to NS for the fixed assets, plus $16.7 million in rolling stock to be received from and financed by Norfolk Southern..."

"The returns to equity investors reflect various assumptions, including the pro forma results, the amount of equity in the capitalization, and the terminal values, among others..."

"The analysis shows coverage of interest, and concludes that 60 per cent of the senior debt would be paid at the end of the fifth year, and that the Wheeling would have repaid substantially all of the senior debt by the end of year seven..."

"The build-up in shareholders' equity is projected...." (*WAC Proposal*, Page 17)

As shown by a review of the projected balance sheet (following Page 17) in the *WAC Offering Proposal*, the WAC founders projected a more than **16-fold increase in shareholders' equity from the beginning pro forma amount of $5.1 million to $83.4 million in 1999.** On that basis, the returns to equity investors (also shown in the detailed projections following Page 17 of the *WAC Offering Proposal*) ranged from a high of 130.4% per annum to a low of 27.3% per annum, according to the relative optimism or pessimism of the assumptions involved. Of course, such substantial annual rates of return to equity investors far exceed those obtainable in the usual financial markets, and it was through the realization of these extraordinary rates of return that the W&LE founders sought to enrich

themselves.

That even greater financial rewards were the true dream of the W&LE founders can be deduced from their reference to the public listing of the MidSouth Corporation in the *WAC Offering Proposal* (Page 14). For, if the W&LE were successful, and it could be publicly traded at a price/earnings ratio comparable to that of MidSouth Corporation, or 14.4 times W&LE net income of $9.8 million in 1999 (as was projected in the *WAC Offering Proposal's* projected income statement following Page 17), then the market value of **W&LE's shareholders equity would have increased to $141.1 million, or more than 28 times the amount of the initial equity investment of $5.1 million.**

From my personal knowledge, I know that providing competition with a combination of a merged Norfolk Southern/Conrail -- a merger which had already been turned down by the U.S. Congress -- never entered the minds of the founders and the investors in the W&LE, who sought instead simply to generate financial returns beyond their wildest dreams.

As described in this Verified Statement, I was actively involved during the formation of the W&LE. For that assignment, I reviewed the *WAC Offering Proposal*, held numerous conversations with the WAC founders, promoters, and investment banker, and interviewed the W&LE's principal customers. Because Mr. Parsons did not assume his position at the Wheeling until March of 1992, according to his Statement, he had no knowledge of the rationale for the founding of the W&LE or of the W&LE promoters' objective to realize such extraordinary financial returns. As a result, his "beliefs" about Norfolk Southern's rationale for its sale, are just that--beliefs, and they have no basis whatsoever in fact. I submit that the *WAC Offering Proposal* demonstrates the lack of any validity to majority shareholder Parsons's stated beliefs and that such beliefs should be wholly disregarded by the

Board.

B. Mr. Parsons' Mis-statements Concerning The Woodside Consulting Group, Inc. Are Misleading And Untrue

In several places in his Statement, Mr. Parsons, W&LE majority shareholder, mis-represents the role of the Woodside Consulting Group, Inc. in the formation of the W&LE with attacks on Woodside which simply have no factual support, and which are both misleading and untrue.

Mr. Parsons' mis-representations include the following:

> "The initial debt problem was partly the result of a faulty consultant study by Woodside Group which erroneously projected for the new W&LE $40 million in operating revenues and five years of coal traffic originations despite the passage of the Clean Air Act. Coal traffic was extraordinarily important for the new W&LE. Its projections accounted for a significant part of the revenues and a very high percentage of the new railroad's margins." (Parsons, Page 5)
>
> "The W&LE was purchased for $42 million (not including any imputed value of a NS equipment lease which was terminated shortly after I arrived at the W&LE). The railroad incurred approximately $42 million of debt based upon a study by Woodside Consulting Group of Menlo Park, Ca. that indicated, among other things, that the W&LE would generate about $40 million in annual revenues and that coal revenues which comprised roughly 25% of W&LE's most profitable traffic would remain for 5 years...." (Parsons, Pages 8-9)

Mr. Parsons' mis-statements are untrue. Further, the multitude of accusations made by Mr. Parsons -- with regard to Woodside's "traffic projections;" Woodside's purported "guarantees" that a fixed amount of coal traffic volume and revenue would continue for five years; Woodside's alleged lack of consideration of the effects of the Clean Air Act on the W&LE coal traffic; and that he as the W&LE President, Chief Executive Officer and majority shareholder relied two and one-half years later on the Woodside Report's supposed assurances that W&LE enjoyed a "guaranteed" stream of future coal revenues -- demonstrate the faultiness of Mr. Parsons' judgment, and cast a pall of doubt on the reminder of his Verified Statement.

In January 1990, the Woodside Consulting Group, Inc. was retained by Wertheim Schroder & Co. Inc. for a consulting assignment which involved the preparation of a *Business Plan* for the W&LE. Our assignment was to work with the founders of the Wheeling Acquisition Corporation to evaluate their planning assumptions for traffic volume and revenue projections, operating costs, capital expenditure plans, and to prepare an estimate of the net liquidation of the W&LE's track and structures. Attachment JHW-WLE-1 contains a complete discussion of Woodside's assignment, our major conclusions, and our findings as to the most significant risks of the W&LE transaction.

Concerning the development of the W&LE's traffic projections, we stated the following:

> "We began our analysis of W&LE's traffic projections using the original WAC Business Plan. Subsequently, WAC revised its traffic projections based largely on the receipt of more complete data from NS. As a result of our review, we have made several additional minor adjustments to WAC's traffic projections, as are discussed later in this Chapter."

"As shown by Table I-1, we project W&LE's Linehaul Revenues at $36.514 million throughout the planning horizon. Table II-1 presents a 'W&LE Traffic Summary By Commodity Group' for this linehaul traffic, based on WAC's revised projections. As shown, **WAC's revised projections for W&LE's traffic volume were 95,100 carloads and $36.5 million of total revenues, annually, or about the same as those in this W&LE Business Plan.**"

(*Business Plan*, Page II-2; emphasis added)

The *Business Plan* discussed each of the Wheeling Acquisition Corporation's revenue and volume projections for each of W&LE's five principal commodity groups.

Our discussion of Coal Traffic in the *Business Plan*, which is reproduced in Attachment JHW-WLE-1, recognized the importance of coal traffic to the W&LE, and discussed the future of the existing coal movements to be assumed by W&LE within the context of the Clean Air Act. It also considered the political pressure which could be exercised by the State of Ohio to ensure that the maximum amount Ohio coal continued to be mined at W&LE's Ohio mines and burned at W&LE's Ohio utility plants, most likely in conjunction with some increased use of blended low sulfur coal. Having reviewed all of the information provided to us by The Wheeling Acquisition Corporation, and having interviewed all of the affected parties, we concluded that, recognizing the risks involved, the financial projections for W&LE's coal movements were reasonably stated.

Subsequent to the issuance of Woodside's *Business Plan*, on April 12, 1990, a representative of Wertheim Schroder & Co. Inc. requested my advice concerning two coal revenue sensitivity scenarios that he was preparing for W&LE's investors and lenders. My advice was that a "disaster" case scenario should call for W&LE to lose **all** of its coal traffic

not later than January 1, 1995. I also advised him that a "worst" case scenario should contemplate the loss of 45% of W&LE's coal traffic in that same time period. That conversation reflected the awareness of all of the parties involved in the W&LE's transaction of the substantial risks associated with the projected future movement of coal by W&LE.

The Woodside Report concluded that all of the business risks of the W&LE transaction were reasonable to assume, subject to the following requirement:

> "Our experience with other regional railroads suggests that, **so long as an effective Management Team is in place,** not only will W&LE's business risks be mitigated, but new opportunities will be recognized and exploited." (*Business Plan*, Page I-11; emphasis added.)

The Woodside Consulting Group has gained substantial experience with many new regional railroads. All of those regional railroads which have been successful have had good railroad managers who adhered to their business plans. For any new railroad, the key ingredient to successful performance is its Management Team. Woodside's experience is that a good Management Team can correct a faulty business plan, but that a poor management team can ruin a good business plan. From our experience with successful regional railroads, we believe that capable railroad managers (such as Ed Moyers, Bill Brodsky, or Ed Burkhardt) would have been able to solve the W&LE's business problems and to execute the W&LE *Business Plan* as it was projected to be achieved.

Based on that Woodside experience and also on those actions subsequently taken by W&LE's Management Team of which we are aware, we believe it is clear that the failure of the W&LE to produce results in accordance with the *Business Plan* resulted both from the loss of Avon Lake coal traffic (without the expected intervention by the State of Ohio to preserve its mining industry) and from the failure of the W&LE Management Team,

compounded by the failure of the W&LE Board of Directors to effectively monitor the W&LE Management Team, in implementing the freight car supply and car hire cost aspects of the operational portion of the W&LE *Business Plan*.

From the perspective of the Wheeling Acquisition Corporation's founders and promoters, its investment banker, and Woodside, the W&LE *Business Plan* was a high risk, as well as a potentially very high reward, transaction. Within the W&LE traffic base, the risk of losing a substantial portion of W&LE's existing high sulfur coal movements was the most significant. What is apparent from a review of the *Business Plan* is that, for a variety of reasons, all of the parties involved -- including the coal producers and users and the Wheeling Acquisition Corporation founders and promoters -- believed that high sulfur coal would continue to flow over the W&LE from Ohio origins. Although Woodside concluded from our investigation that the views of all of those parties were reasonable, we made no assurances and provided no guarantees to any party that W&LE was insulated either from competition from Norfolk Southern or other rail carriers, or from utility scrubber or other equipment decisions, or from any other external events over which W&LE had no control.

C. Mr. Thompson's Traffic Loss Study Is Greatly Overstated

W&LE's Witness Thompson presents a Loss Study in which he projects annual revenue losses of $12.7 million as a result of the Conrail transaction. In contrast, the Norfolk Southern Rail Traffic Diversion Study that I prepared and sponsored projected annual revenue losses to the W&LE of $1.9 million, as a result of the Norfolk Southern portion of the Conrail transaction.

1. **Mr. Thompson's Methodology**

The W&LE traffic study undertaken to quantify the losses which W&LE would incur as a result of the proposed Conrail transaction, sponsored by Mr. Thompson, is summarized as Appendix A (Pages 103-105) to his Verified Statement. According to Mr. Thompson, that analysis was based on fiscal year 1996 (which has been identified elsewhere as July 1, 1995 through June 30, 1996). Applicants selected calendar year 1995 as the base year for purposes of this proceeding, and the use of the twelve month period July 1, 1995 through June 30, 1996 muddles any efforts at consistency, resulting in "apples and oranges" comparisons.

From my review of Mr. Thompson's Appendix A, it appears that his Loss Study was undertaken using work papers other than those placed in the W&LE depository as work papers W&LE-00001 through W&LE-00342. Those work papers consist of the following:

- W&LE-0001 through W&LE-00205: A computer listing, in reverse page number order, of 11,307 records of Wheeling Pitt Steel movements for FY 1996, containing traffic class, STCC, shipper, waybill date and number, car number, and revenue data, but not origin and destination information. It is, therefore, of little value in assessing the validity of Appendix A, for which origin cities, STCC, and destination cities (the latter included for some, but not all, moves) are the principal identifying information.
- W&LE-00229 through W&LE-00245: A computer listing of W&LE forwarded/received traffic for FY 1996, containing origin and destination, STCC, shipper, carloads, and revenue information

summarized for the period, as well as an "N" or "C" notation for many records. Although this information does correspond to the study period identified by Mr. Thompson, it is not sufficient to support all of the data summarized in Appendix A, which also include W&LE local and bridge traffic movements.

- W&LE-00206 through W&LE-00228 and W&LE-00246 through W&LE-00342: Computer listings of W&LE's forwarded/received traffic and, separately by class of traffic and by W&LE customer, both for FY 1997, which does not correspond to the study period identified by Mr. Thompson as the basis of his Appendix A.

Of the work papers provided by W&LE, while clues about local traffic may be gleaned from the FY 1997 listing by customer, only the listing of W&LE FY 1996 forwarded/received traffic might possibly provide any direct support for Mr. Thompson's Appendix A summary. It should be noted that information about routing and other participating carriers is not included in any of W&LE's computer listings. However, even for those origin/destination pairs in Appendix A that clearly represent either forwarded or received moves, there is no clear pattern allowing a match between the FY 1996 work papers and the Appendix A summary. Neither carloads nor revenue figures can be found to correspond for any of the Appendix A movements. Moreover, Mr. Thompson has failed to identify any method that he may have used to estimate diversion percentages where his Appendix A summary includes less than all of the traffic in a specific flow.

In summary, Mr. Thompson's underlying work papers were incomplete as were his movement records used for his study, and they were based on FY 1996 (July

1, 1995 - June 30, 1996) data that does not conform to the 1995 calendar year base year selected by the Board for this proceeding.

Nevertheless, I have reviewed all of the traffic movements shown in Mr. Thompson's Loss Study, as well as all of his work papers and all other traffic data presented by W&LE. As a result of my review and analysis, I have restated Mr. Thompson's Loss Study in order to attempt an "apples to apples" comparison. Although the absence of underlying work papers and use of non-base year data has created difficulty, it is my opinion, based on the FY 1996 Traffic Data used by Mr. Thompson, W&LE's actual annual revenue loss will be $2.0 million, instead of the $12.7 million annual revenue loss claimed by Mr. Thompson in the W&LE Loss Study. Thus, I conclude that Mr. Thompson's Loss Study greatly overstates the W&LE's revenue losses resulting from the Norfolk Southern portion of the Conrail transaction.

The following Table JHW-1 shows my "Restatement of W&LE's Loss Study," the amount of my restatement, and my reasons for restatement:

TABLE JHW-WLE-1

Restatement of W&LE's Loss Study
(Dollars in Millions)

Thompson's W&LE Loss Study	Williams' Restatement of Loss Study	Williams' Reasons for Restatement
$3.6	$0.0	W&LE "Phantom Train"
1.9	0.0	NSCR same as CR; no transaction effect
1.2	0.0	Only W&LE serves origin or destination station
2.1	0.0	W&LE/CSXCR Alliance
0.2	0.2	NSCR Single System Service
0.2	0.1	NSCR vs. W&LE Single System Service
3.5	1.7	NSCR Competition
$12.7	**$2.0**	**Total**

The detail underlying the restatement of Mr. Thompson's Loss Study shown above in Table JHW-WLE-1 is contained in Attachment JHW-WLE-2-HC, which reproduces the detailed movements contained in Mr. Thompson's Appendix A, amplifies those movements by my restatement of the revenue loss, and provides my reasons for restatement for each movement.

2. W&LE's "Phantom Train"

As shown by Attachment JHW-WLE-2-HC, W&LE claims it will lose $3.6 million annually for intermodal traffic moving between Hagerstown, MD and Bellevue, OH, based on FY 1996 data. Mr. Thompson's narrative description of a run through intermodal train service between Bellevue, OH and Hagerstown, MD, to connect with NS indicates that "these trains moved for a period of about six weeks at the beginning of the Conrail control case." This clearly places the traffic movement

in FY 1997 and not relevant to Mr. Thompson's FY 1996 analysis period, let alone the Board's adopted calendar year 1995 period. Furthermore, as shown by the June 25, 1997 letter from Norfolk Southern's Executive Vice President - Operations which was reproduced from W&LE's work papers (see Attachment JHW-WLE-3), the cessation by Norfolk Southern of this train's operation was due to other factors (specifically, W&LE's abysmal on-time performance record) that are not related to the Conrail transaction; accordingly, this move has no place in a table summarizing impacts on W&LE of the Conrail transaction.

Despite those facts, Mr. Thompson has attributed to this traffic movement (STCC "48000") a loss of **$3.6 million in revenue**, as shown in his Loss Study. This $3.6 million revenue loss is clearly far in excess of the revenue ever received by W&LE for this traffic for the six week period when the trains actually ran, and its projected total annual revenue, as stated in W&LE's response to Norfolk Southern's Interrogatory No. 24 (W&LE-6). Thus, cloaked in Mr. Thompson's Loss Study is W&LE's "Phantom Train" that perhaps might have moved, had W&LE's train schedule performance been better, but that actually hardly moved at all! The $3.6 million revenue loss claimed by Mr. Thompson's Loss Study for W&LE's "Phantom Train" should be disregarded in its entirety.

3. NSCR Same As Conrail; No Transaction Effect

Mr. Thompson's Loss Study also claimed annual revenue losses of $1.9 million by attributing certain traffic losses to the Conrail transaction that are, in fact, not related, as summarized by my Table JHW-WLE-1. Where the competitive position of the new Norfolk Southern/Conrail System (NSCR) after the Conrail

transaction will be identical to that of Conrail before the Conrail transaction, then the Conrail transaction will have no effect on W&LE, and it is inappropriate to project that traffic would be diverted from W&LE and to attribute such revenue losses to the Conrail transaction.

The largest movement in this category of traffic is iron ore from Huron, OH to Mingo Junction, OH that, according to Mr. Thompson, will be lost by W&LE in the amount of $1.8 million dollars annually. Mr. Thompson's lament for this traffic follows:

> "W&LE currently has a short-term lease allowing limited access to Lake Erie via Huron Dock at Huron, OH which will expire in less than a year. Wheeling Pittsburgh Steel currently has a contractual ability to ship up to 25% of its ore shipments other than by Conrail. With NS serving Wheeling Pittsburgh Steel in place of Conrail, i.e., succeeding to Conrail's shipping contract, NS control of Huron Dock will open the door for NS to become the sole supplier of ore for Wheeling Pittsburgh Steel. Wheeling Pittsburgh Steel consumes between 2.1 and 2.6 million tons of iron ore per year of which, under the previous Conrail contract, W&LE had the opportunity to handle more than 500,000 tons annually. This important traffic will be foreclosed by the combination of NS's absorption of Conrail's rights, and its exclusive position on Huron Dock." (Thompson, Page 4)

A W&LE work paper (which I have reproduced as Attachment JHW-WLE-4-HC) provided further comments on this movement as follows:

"WE handles [[[ ]]]%. CR now has bal from Penny Dock to Mingo Jct. direct. Amount WE can get rises to [[[ ]]]% by 2000." (WLE-000033 - MKT HC)

From Mr. Thompson's statement and work papers, it is apparent that the current competitive situation is that Conrail handles iron ore from Penny Dock to Mingo Junction directly in competition with W&LE's movements from Huron Dock to Mingo Junction directly. As Mr. Thompson states, W&LE's real objection is to the potential expiration of its 1994 lease from Norfolk Southern for W&LE's use of the Huron Dock. Clearly, it is the potential expiration of W&LE's lease for the Huron Dock -- not the Conrail transaction -- which would cause the loss of W&LE's iron ore traffic. In the absence of the Conrail transaction, the termination of W&LE's Huron Dock lease would cause W&LE's iron ore traffic to be lost, just as subsequent to the Conrail transaction, termination of W&LE's Huron Dock lease would cause the loss of W&LE's iron ore traffic. Thus, the Conrail transaction has no effect on whether or not W&LE's iron ore traffic is lost. What will determine whether or not W&LE retains the iron ore traffic is its ability to negotiate an extension of its Huron Dock lease in a private, marketplace negotiation, but that is not a Conrail transaction effect.

Another example of a W&LE claimed traffic loss that is not related to the Conrail transaction is the movement of corn traffic originating at [[[ ]]], OH destined to [[[ ]]], MD (see Movement No. 4, Attachment JHW-WLE-2-HC). Prior to the Conrail transaction, this traffic was routed ASRY (Plymouth) W&LE to destination; both [[[ ]]] and [[[ ]]] are served by Conrail, which competes for this traffic. After the Conrail transaction, the new

Norfolk Southern/Conrail System will "step into Conrail's shoes," and W&LE's competitive position will be unchanged as the ASRY/W&LE combination will complete against the new Norfolk Southern/Conrail System over the exact same route that Conrail uses today. Accordingly, as shown by Attachment JHW-WLE-2-HC, my reason for rejecting Mr. Thompson's claim that the [[[ ]]] of revenue from this movement will be lost is because the Conrail transaction will have no effect on it.

4. Only W&LE Serves the Origin or Destination Station

As shown by Table JHW-WLE-1, I rejected Mr. Thompson's Loss Study's projected $1.2 million of annual revenue losses whenever the only rail carrier serving the origin or destination station was W&LE. Accordingly, for example, as reference to Attachment JHW-WLE-2-HC will show, Movement Nos. 1 - 3 and 5 - 9 have all been restated to project the loss of no revenue. Since no other rail carriers serve the stations involved -- Rook, PA; Clarksfield, OH; Monroeville, OH; and New Washington, OH -- it is beyond any other carrier's capability to divert such movements. The same rationale applies to other movements in this category, the details of which are shown by Table JHW-WLE-2-HC.

5. A W&LE/CSXCR Alliance Will Be Created

Historically, both CSXT and Norfolk Southern have worked with W&LE to generate rail traffic. As shown by the CSXT System Map (1995), W&LE is categorized as a "regional connection" to CSXT because W&LE serves important stations, such as Canton, OH, that CSXT does not. Following the Conrail transaction, although the Norfolk Southern/Conrail combination will no longer have

need for W&LE as a feeder line to some stations, that will not be true for the new CSXT/Conrail System (CSXCR). Accordingly, as shown by Table JHW-1 and by Attachment JHW-WLE-2-HC, it is my opinion that none of the $2.1 million dollars projected to be lost by Mr. Thompson's Loss Study will in fact be lost when it is commercially advantageous for the new CSXT/Conrail System and W&LE and to enter into such an alliance.

The most important stations affected by such an alliance will include Canton, Mingo Junction, and Steubenville, OH, and Clairton, PA. Following the Conrail transaction, all of these stations will continue to be served by W&LE and by the new Norfolk Southern/Conrail System, but none will be served by the new CSXT/Conrail System. For that reason, it will be in the commercial interests of both W&LE and the new CSXT/Conrail System to create a commercial alliance in order to compete for traffic originating or terminating at these stations, by "stepping into W&LE/Norfolk Southern's shoes." Thus, Mr. Thompson's projected annual losses of $2.1 million are unlikely to occur.

6. Norfolk Southern/Conrail Single System Service

As shown by Table JHW-WLE-1, Mr. Thompson's Loss Study projected that annual revenues of $0.2 million would be lost by W&LE to single system service provided by the Norfolk Southern/Conrail combination. Given the indicated shipper preference for such single system service, I accept Mr. Thompson's finding that $0.2 million will be lost, for the movements shown on Attachment JHW-WLE-2-HC.

7. NSCR vs. W&LE Single System Service

According to Mr. Thompson's Loss Study, any W&LE movement which would be subjected to competition from NSCR single system service after the Conrail transaction would be lost. The largest example of such traffic shown by Attachment JHW-WLE-2-HC is between [[[ ]]], OH, and [[[ ]]], OH, consisting of [[[ ]]] cars of scrap generating [[[ ]]] of revenue annually. Prior to the Conrail transaction, Martins Ferry is served by Conrail, CSXT, and W&LE, while Steubenville is served by Conrail and W&LE. After the Conrail transaction, the Norfolk Southern/Conrail combination will "step into Conrail's shoes," and provide the same single system service in competition with W&LE that was provided by Conrail.

Given two single system service competitors and the fact that W&LE has already captured a share of traffic in these markets, I have judged that W&LE single system service could lose as much as one-half of the traffic to NSCR's single system service. However, W&LE's existing marketplace position in these traffic flows may, in fact, permit W&LE to retain all of its traffic on certain movements, such as the one from Martins Ferry to Steubenville, because the new Norfolk Southern/Conrail System again merely "steps into Conrail's shoes." In order to be conservative, however, I have projected that one-half of the total of $0.2 million projected by Mr. Thompson's Loss Study would be lost.

8. NSCR Competition

Primarily in the Pittsburgh markets, rail competition is being provided by Conrail, CSXT, and the Norfolk Southern/W&LE combination, prior to the Conrail

transaction. Based on the Norfolk Southern Rail Traffic Diversion Study that I prepared, I believe that the Pittsburgh market is split about evenly between the three competitors. Following the combination of Conrail's operations in the Pittsburgh area with the Norfolk Southern, it is my view that the Norfolk Southern/W&LE Pittsburgh market traffic will be redistributed among the two surviving major systems -- namely, the Norfolk Southern/Conrail combination and CSXT.

Accordingly, as a result of Norfolk Southern's portion of the Conrail transaction, it is my judgment that one-half of the $3.5 million W&LE revenue loss claimed by Mr. Thompson's Loss Study, or $1.7 million, will be lost as a result of the competition provided by the Norfolk Southern/Conrail combination. However, the remainder of the W&LE's traffic loss has already been considered by the CSXT Rail Traffic Diversion Study, as is described by CSXT's traffic expert Witness Mr. Howard A. Rosen, which I have reproduced from W&LE's work papers WLE 00005-MKT-HC as Attachment JHW-WLE-5-HC.

D. Mr. Pinkerton's Projections Are Inflated

W&LE's Witness Pinkerton presents an additional set of projections of W&LE's carload, intermodal, and revenue losses, which exceed even those provided by Mr. Thompson's greatly overstated Loss Study. Mr. Pinkerton then uses his own traffic projections in order to show "...the resulting substantial negative impacts upon W&LE's profit, cash flow, and financial position...." (Pinkerton, Page 1)

As I show in this section of my Verified Statement, Mr. Pinkerton's Loss Study does not track either with Mr. Thompson's Loss Study or with the W&LE *Five Year Plan*. In my opinion, Mr. Pinkerton's projections are so overly inflated, with little basis in fact, that they

should be wholly disregarded by the Board.

1. W&LE's Five Year Plan

According to Mr. Pinkerton, W&LE's *Five Year Plan, FY 1997-FY 2001* is contained in Appendix B of his Statement. Mr. Pinkerton described his use of the *Five Year Plan* as follows:

> "The framework for assessing the impact of the proposed NS-CXST-CR transaction upon the W&LE is to compare the performance of W&LE to its most recent Five Year Plan which was developed in October 1996. That plan incorporates all of the restructured financing arrangements negotiated by the new W&LE owner/managers in FY 1994 and it also includes car load projections by commodity based upon the information available one year ago. The complete Five Year Plan is attached as Appendix B." (Pinkerton, Pages 11-12)

The carload and revenue projections by commodity in the *Five Year Plan* referred to by Mr. Pinkerton are contained in Appendix B, Page 36 of Mr. Pinkerton's Statement. Attachment JHW-WLE-6 summarizes W&LE's actual traffic volume and revenue for the years FY 1992 through FY 2001 from that document. As shown by Attachment JHW-WLE-6, W&LE's actual traffic averaged 100, 871 carloads for the years FY 1992 through FY 1996, with a deviation around that average of not more than 15% per year throughout that five-year time period. According to the *Five-Year Plan's* projections, however, W&LE's carloads will increase from that five-year average of 100,871 carloads to 191,780 in FY 2001, an

increase of 90%.

Similarly, as also shown by Attachment JHW-WLE-6, W&LE's net line- haul revenues averaged $32.3 million for the five-year period, FY 1992 through FY 1996, with higher or lower deviations of not more than 10% in any one year. In contrast, W&LE's *Five Year Plan* projects net linehaul revenues of $47.6 million in FY 2001, **an increase of 47% above the five year average for FY 1992 through FY 1996.**

It is my experience that projections such as the carload and revenue projections contained in the W&LE *Five Year Plan* are referred to by railroad planners as "hockey stick" projections, because of their sudden spurt upward from historical performance levels to significantly higher results. It is also my experience that such "hockey stick" projections must be reviewed with great skepticism in order to assess their realism in the marketplace. Despite Norfolk Southern's interrogatories, W&LE has not provided any basis for the carload, intermodal, or net linehaul revenue projections contained in its *Five Year Plan*. One Norfolk Southern interrogatory sought to determine the methodology and sources of data used to develop the *Five Year Plan* projections. W&LE's response, however, merely referred back to the same *Five Year Plan* without further explanation. Not producing documentation to be tested in this proceeding is unresponsive. But to then calculate financial harm to the W&LE based on a set of such undocumented and untested financial projections is not a reasonable approach.

It is noteworthy that W&LE offered a much lower, more realistic set of carload and revenue projections in its May 10, 1994 presentation to its lenders, which I have reproduced as Attachment JHW-WLE-7-HC. As shown, that *1994 Five Year*

Plan projected FY 1999 carloads of 100,600 and revenue of $33.0 million, both of which are more consistent with W&LE's actual average FY 1992 through FY 1996 performance of 100,871 carloads and $32.3 million of revenue than are the October *1996 Five Year Plan* projections used by Mr. Pinkerton. The benefit to Mr. Pinkerton from using the more inflated projections was, of course, a companion inflation of his statement of claimed harm to W&LE resulting from the Conrail transaction. Conversely, if Mr. Pinkerton had used the lower traffic projections contained in W&LE's *1994 Five Year Plan* -- which appears to have provided the basis for its 1994 refinancing agreement -- it is my opinion that Mr. Pinkerton's traffic loss projections would have been reduced accordingly.

2. Mr. Pinkerton's Traffic Loss Projections

According to Mr. Pinkerton, his Traffic Loss Projections are based on the following:

> "The approach taken in my analysis is based upon a micro perspective on the traffic flows of the W&LE before and after the proposed transaction, compared to the macro, waybill sample perspective used in the studies of the applicants. In contrast to other studies submitted and referenced in the applicants' filings regarding traffic diversions and impacts upon other railroads and shippers not involved in the transaction, my car load loss projections for W&LE are based upon analysis of specific customers, commodities, origins, destinations, rate levels, intermediate and short-run costs, and operating plans described by the NS and CSXT in their application...."
>
> "Car load loss projections were developed starting with the analysis performed

by Mr. Reginald Thompson using 1996 data (see Statements by L. Parsons and R. Thompson). The estimates made by Mr. Thompson first were confirmed, and then adjusted to reflect potential growth through FY 2001 for the customers and movements involved. In addition, I performed an independent assessment of the intermodal losses and general merchandise commodities, including the potential for diversion to truck in W&LE's service territory." (Pinkerton, Page 9)

Later in his Statement, Mr. Pinkerton describes his approach somewhat differently as follows:

"Carload loss projections were developed starting with the study prepared by Mr. Reginald Thompson (included and described in detail in Statements of Mr. L. Parsons and R. Thompson). In that study Mr. Thompson examined all of W&LE's existing business in the context of the network changes and operating plans described in the proposed NS-CSXT-CR transaction. Based upon my review of that study and extensive interviews with Mr. Thompson I concur with his conclusions regarding the customer - commodity - origin - destination combinations that will be affected. Further, I concur with his assessment of recent losses that have occurred that, though prior to implementation of the plans described in the applicants' materials, are properly attributed to the impact of the proposed transaction."

"In order to calculate car load losses for FY 1999, FY 2000, and FY 2001 the projections in Mr. Thompson's study were adjusted by the growth shown in the Five Year Plan for each commodity group, starting with FY 1997. The resulting losses are presented in Table 4 and Figure 1 on the following pages.

Car load losses reach 25,243 in FY 2001 out of a planned total of 128,664 or 19.6%...." (Pinkerton, Pages 12 - 13)

I have reviewed all of Mr. Pinkerton's Verified Statement and all of the W&LE work papers and responses to Norfolk Southern's Discovery Requests. Having done so, I found not one shred of evidence to support Mr. Pinkerton's claim that he analyzed "...specific customers, commodities, origins, destinations, rate level...." (Pinkerton, Page 9) in his Traffic Analysis. Indeed, from my review, I believe that Mr. Pinkerton's approach to his traffic analysis simply took Mr. Thompson's greatly overstated Loss Study, adjusted Mr. Thompson's Loss Study for the growth shown in the *Five Year Plan* and then, if he believed it to be desirable, Mr. Pinkerton inflated to even greater traffic volume and revenue losses than had been included in Mr. Thompson's Loss Study or in W&LE's *Five Year Plan*, in order to show a greater adverse impact of the Conrail transaction on the W&LE.

In order to compare the traffic Loss Study presented by Messrs. Thompson and Pinkerton, I prepared Attachment JHW-WLE-8 which identified separately those commodities for which Mr. Thompson's Loss Study projected annual revenue losses of greater than $1.0 million. As shown by Attachment JHW-WLE-8, Mr. Pinkerton's total projected annual losses of 25,243 carloads exceed Mr. Thompson's total projected annual carload losses of 16,444 carloads by 8,799 carloads, or by about 54%. Similarly, having applied his own "methodology," Mr. Pinkerton's projected annual net revenue losses of $15.0 million exceed those of Mr. Thompson's Loss Study of $12.7 million, by an additional $2.3 million.

One of the best illustrations of Mr. Pinkerton's inflation of results is his expansion of Mr. Thompson's claimed revenue losses for the W&LE "Phantom

Train." This is the Norfolk Southern train that was actually operated via the W&LE for only about a six week time period in early 1997, for which Mr. Thompson claimed an annual revenue loss of $3.6 million. As shown by Attachment JHW-WLE-8, Mr. Pinkerton extended such intermodal revenue losses to $4.5 million in FY 2001, an increase of $0.9 million above the $3.6 million loss from the "Phantom Train" projected by Mr. Thompson. At $4.5 million of annual revenue losses, however, Mr. Pinkerton's inflated amount exceeded even the $4.0 million of total net linehaul revenue for all intermodal traffic projected to be achieved by W&LE's *Five Year Plan* (Pinkerton, Page 36). It would seem that each new W&LE analysis results in an ever larger "Phantom Train!"

For the Huron Dock iron ore, Mr. Pinkerton used a similar technique in order to create the "Pinocchio Iron Ore" movements. As shown by Attachment JHW-WLE-8, Mr. Thompson's Loss Study projected annual losses of iron ore traffic of 3,701 carloads and net linehaul revenue of $1.8 million. By the application of his "methodology," Mr. Pinkerton projected annual iron ore traffic losses of 10,000 carloads and $4.0 million of revenue, or annual losses that exceed those shown in Mr. Thompson's Loss Study by 6,299 carloads and revenues of $2.2 million in revenues. In W&LE's *Five Year Plan*, however, total iron ore traffic projected in FY 2001 was 5,116 carloads and revenue of $2.2 million, both of which are only about **one-half** of the iron ore traffic losses of 10,000 carloads and $4.0 million of revenue claimed by Mr. Pinkerton!

Mr. Thompson created and claimed traffic losses from the "Phantom Train" that barely ran -- which Mr. Pinkerton further expanded through his inflated losses to amounts greater than the traffic projections in the W&LE *Five Year Plan*. Similarly,

Mr. Thompson claimed iron ore traffic losses that are not relevant to the Conrail transaction, but which were further inflated by Mr. Pinkerton to "Pinocchio Iron Ore" movements, most of which never moved nor were even projected to be moved in W&LE's *Five Year Plan!*

In short, Mr. Pinkerton's increased traffic loss claims even further inflated the greatly overstated traffic losses contained in Mr. Thompson's Study. As discussed earlier in my Statement, I projected W&LE's annual traffic losses as a result of the Norfolk Southern portion of the Conrail transaction to be $2.0 million based on W&LE's own traffic data for FY 1996. It is that $2.0 million annual impact that the Board should adopt in this proceeding, instead of the greatly overstated $12.7 million annual losses projected by Mr. Thompson's Study, and instead of the even greater $15.0 million annual losses claimed by Mr. Pinkerton.

E. W&LE's Requested Conditions Are Not Related To The Conrail Transaction

Using three different witnesses, W&LE has presented three wish lists of requested conditions, all of which are opportunistic, and none of which are related to the Conrail transaction. Mr. Parsons presents a list of twelve such conditions in his Statement, Mr. Wait presents a list of ten requested conditions in his Statement, while Mr. Thompson presents in his Statement a list of eight requested conditions for which he has quantified gains. The following list of requested conditions is from Mr. Wait's Statement:

1. Access to Chicago
2. Access to Toledo
3. Access to Erie, PA

4. Operation (and lease to own) of the Randall Secondary

5. Operation (and lease to own) of the Huron Branch

6. Trackage rights on CSXT from Benwood to Brooklyn Jct.

7. Use of W&LE Routes to Provide Congestion Relief

8. Stone Traffic - various trackage rights requests

9. Access to Wheeling Pittsburgh Steel at Allenport, PA

10. Trackage rights on CSXT New Castle Subdivision

So far as I have been able to determine from W&LE's work papers, Mr. Thompson made no attempt to quantify conditions requested by Mr. Wait that access to Erie, PA, operation of the Randall Secondary, or the use of W&LE routes to provide congestion relief. Mr. Thompson did, however, suggest as his own condition, which he quantified (but which was not referred to either by Mr. Parsons or by Mr. Wait), that Norfolk Southern should assume the P&WV lease payments. Similarly, Mr. Parsons suggested as conditions trackage rights and commercial access to both Reserve Iron & Metal and to Weirton Steel, and to "reverse joint facility maintenance obligations," none of which were discussed by Mr. Wait or quantified by Mr. Thompson.

None of conditions requested by either of those three W&LE witnesses are related to the Conrail transaction. None are related to a showing of competitive harm that results from the Conrail transaction, and none of the markets affected by the proposed conditions have been shown to experience competitive harm as a result of the Conrail transaction. For example, W&LE does not now have direct access to Chicago or Toledo, but has indirect access via a connecting carrier. Following the Conrail transaction, although the connection itself may change for some traffic, W&LE will continue to have indirect access to those markets via a connecting carrier. Thus, the requested conditions are not related to the

Conrail transaction.

With the sole exception of the Huron Dock, W&LE has no existing access to any of the affected markets. As I discussed earlier in my Statement, it is the potential expiration of W&LE's five-year lease for the Huron Dock -- not the Conrail transaction -- which will determine whether or not W&LE continues to serve that facility. For this reason, I conclude that this requested condition is also not related to or by the Conrail transaction.

F. W&LE Is A Failing Railroad, With or Without The Conrail Transaction

Using W&LE's and Wheeling Corporation audited financial statements for FY 1991 through FY 1997, I have reviewed W&LE's historic earnings performance. Attachment JHW-WLE-9 shows W&LE's operating income/losses and its net income/losses for that seven-year time period. From my review, it is my conclusion that W&LE's poor operating performance, compounded by its highly leveraged capital structure, has produced little net income, which demonstrates that W&LE is a failing railroad, with or without the Conrail transaction.

The Board is aware that W&LE's financial condition is not good, as recognized in its *Decision* of October 29, 1997 in STB Docket No. AB-227 (Sub-No. 10X) which permitted the abandonment of the Massillon Branch:

> "W&LE has requested expedited handling of this petition and requests that the exemption be made effective by November 1, 1997, or soon thereafter. W&LE states that, because its financial condition has deteriorated sharply since last year, the money that it expects to receive from salvage of the track materials is vital to its short-term viability...." (Page 5)

Although W&LE's financial condition may have "deteriorated sharply since last year," W&LE's financial difficulty is not a recent event, as stated by Ernst and Young LLP in W&LE's 1995 *Audited Financial Statements*:

> "Management continues their plans to improve the financial position and results of operations of the Company, which included restructuring its initial credit agreement with the lenders, settling all remaining issues with NS, securing a grant from the State of Ohio, and purchasing certain railway assets by another subsidiary of The Wheeling Corporation. These transactions were completed during the year ended June 30, 1995. In addition, management's plans include ongoing efforts to improve operating revenue, seek additional grants from state and federal sources, and to control operating expenses. **Management expects, although it can not be assured, that cash flows to be generated from operations will be sufficient to meet its financial obligations as they come due.**" (W&LE 1995 *Audited Financial Statements*, Page 7; emphasis added)

It is my opinion that the Conrail transaction will have no significant effect on W&LE. As shown in this Verified Statement, the Norfolk Southern portion of the Conrail transaction will reduce W&LE's annual revenues by not more than $2.0 million, but that loss will be partially offset by the $0.5 million revenue gain from the CSXT portion of the Conrail transaction, which was presented by the CSXT Traffic Study in the *Railroad Control Application (CSX/NS-18, Page 83)*. If W&LE were to lose $1.5 million of its annual revenue stream, that would amount to less than 5% of its total revenue base and is of such small magnitude as to be non-life threatening, as the operating income impacts of such a revenue loss (after considering W&LE's associated cost reductions) will have no material

effect on W&LE's financial viability.

W&LE's recent experience with the Wheeling Pittsburgh Steel strike, as described by Mr. Parsons, should be considered:

> 'To date we remain in compliance with our lenders, despite severe recent losses due to a 10 1/2 month strike by our largest customer Wheeling Pittsburgh Steel. I believe it is a remarkable success story that the W&LE could sustain the loss of **25% of its traffic base** for almost a year and survive while continuing to provide excellent service to its shippers." (Parsons, Page 10; emphasis added)

As I have described, the W&LE was conceived as a high risk/high reward transaction. That W&LE's promoters and investors lost their bet is shown by W&LE's poor earnings performance subsequent to its start up. The W&LE is a failing railroad, but the forum for resolving the future of W&LE should not be that of the Conrail transaction before the Board, for, as I have shown, the impact of the Transaction on the W&LE's financial position will not be life threatening.

IV. ANN ARBOR-5: RESPONSIVE APPLICATION AND REQUEST FOR CONDITIONS BY ANN ARBOR ACQUISITION CORPORATION

A. Conclusions

In support of Ann Arbor's request for conditions, its President, Mr. Evert O. Erickson, estimates annual revenue losses of approximately $2,250,000 that he claims "...will be diverted by NSR and CSXT...." Of this total, Mr. Erickson claims revenue losses of $500,000 from the loss of Yuma Sand traffic destined to Cleveland plus $1,750,00 from the loss of automotive traffic originating at Milan and Toledo.

I have reviewed all of the traffic claimed to be diverted by Mr. Erickson and, in my opinion, **none** of that traffic will be diverted away from Ann Arbor by Norfolk Southern/Conrail or by CSXT/Conrail as a result of the Conrail transaction.

From my review of the "affected" traffic, I believe it is apparent that Ann Arbor has established its commercial position in the marketplace due to several factors: the reduced circuity of its line when compared with lines of Norfolk Southern, CSXT, or Conrail; its superior switching location adjacent to Chrysler's automotive plant in Toledo; and demonstrated shipper preference for its winning price/service bids for traffic. The Conrail transaction, in itself, makes no changes to any of these factors. Accordingly, none of Ann Arbor's claimed revenue losses of $2,250,000 can properly be said to result from the Conrail transaction.

I have also reviewed Mr. Meador's Verified Statement concerning Norfolk Southern's potentially reduced use of its Milan to Toledo trackage rights over Ann Arbor. Although Norfolk Southern projects that some continuing use will be made of these trackage rights, even if all of Ann Arbor's $800,000 annual receipts for Norfolk Southern's use were lost by Ann Arbor (and without considering any of the related costs which Ann Arbor would no longer incur), Ann Arbor's financial viability would not be impaired. Compared with Ann Arbor's 1996 income from railway operations of $1,727,495, the loss of all $800,000 of annual receipts from Norfolk Southern's trackage rights, as offset by my estimated reduction of $640,000 of Ann Arbor's related costs, would not have a material effect on Ann Arbor's financial viability. Therefore, it is my opinion that, in the aggregate, the Conrail transaction will have no significant financial effect on Ann Arbor.

B. Ann Arbor's Yuma Sand Traffic Will Not Be Diverted

According to Mr. Erickson:

> "Ann Arbor currently participates in a three-carrier move of sand originating at Yuma, Michigan and destined to Cleveland, Ohio. The traffic now moves TSBY to Ann Arbor, Ann Arbor to Toledo, and CRC to destination. Ann Arbor generates approximately $500,000 in annual revenues from its participation in this traffic. As a result of the CRC acquisition, CSXT will gain direct access to the shipper at Cleveland. Consequently, after the transaction, the traffic **may** move TSBY to Ann Pere, Michigan and CSXT to Cleveland. Since CSXT will be able to handle this traffic in a two-line move as opposed to the current three-line move, Ann Arbor stands to lose all of its revenues from this traffic." (Erickson, Page 5; emphasis added)

I considered the Yuma Sand traffic record from the 1995 *Carload Waybill Sample* in the Norfolk Southern Rail Traffic Diversion Study that I prepared. I judged none of the Yuma Sand traffic divertible to the combined Norfolk Southern/Conrail System because the TSBY does not connect directly with Conrail at Ann Arbor. The Conrail transaction will not change the position of the two carriers as Norfolk Southern will merely "step into Conrail's shoes," and, therefore, such a diversion cannot be attributed to the Conrail transaction, even if it could physically occur. In fact, following the Conrail transaction, the combined Norfolk Southern/Conrail System will have every commercial incentive to continue to move the Yuma Sand traffic in conjunction with the Ann Arbor to the Cleveland destination, in the face of potential competition from the CSXT/Conrail combination.

It is my opinion that the CSXT/Conrail route following the Conrail transaction will not be successful in attracting the Yuma Sand traffic, because to do so, TSBY, the

originating carrier, would have to accept a shorthaul and because of the relative circuitry of the CSXT/Conrail route via Ann Pere, MI.

The combined CSXT/Conrail route between Howell/Ann Pere, MI and Cleveland is 224 miles, which is 53 miles longer than the competing 171 mile TSBY/Ann Arbor/Conrail route from Howell/Ann Pere to Cleveland. Thus, the 53 mile longer CSXT/Conrail route subsequent to the Conrail transaction will have circuity of thirty-one percent, which disadvantages that route compared with the joint TSBY/Ann Arbor/Conrail route at present. Because the Yuma Sand traffic is low in per carload revenue, the joint CSXT/Conrail route's circuity disadvantage is of considerable economic significance.

Mr. Erickson stated that Yuma Sand traffic "**may**" move via the CSXT/Conrail route to Cleveland after the Conrail transaction. For all of the reasons discussed, it is my opinion that the CSXT/Conrail combination will not divert the Yuma Sand traffic away from the Ann Arbor/Norfolk Southern/Conrail route, as a result of the Conrail transaction.

C. <u>Milan Automotive Traffic Will Not Be Diverted</u>

Mr. Erickson's rationale for the loss of the Milan, MI automotive traffic is as follows:

> "AA also participates in automotive traffic originated by NSR in Milan, Michigan. Some of this traffic is currently switched by NSR to Ann Arbor for movement to Toledo. At Toledo, Ann Arbor interchanges the traffic with either CSXT for movement to Louisville, Kentucky or CRC for movement to Chicago, where it is interchanged for destination to St. Paul, Minnesota. With the acquisition of the CRC line between Toledo and Chicago and given NSR's current route west from Milan, there will be no further need for Ann Arbor's

switching operation. After the CRC acquisition, NSR will also have a single line route to Louisville. Although the NSR route will be more circuitous than the Ann Arbor-CSXT joint-line route, NSR will undoubtedly favor its own route and be unwilling to forward traffic to its arch competitor." (Erickson, Page 6)

At Milan, the automotive facility is located on Norfolk Southern, although it is open to Ann Arbor via switch. The obvious point is that, because Norfolk Southern directly serves that automotive facility now, Norfolk Southern has no "need" for Ann Arbor's switching operation at Milan at this time, prior to the Conrail transaction. Similarly, because the Conrail transaction will have no effect on Ann Arbor's switching operation at Milan, the Norfolk Southern/Conrail combination will have no "need" for Ann Arbor's switching operation at Milan following the Conrail transaction.

Neither Mr. Erickson's Statement nor his work papers provide the amount of revenue associated with his projection of Ann Arbor's traffic losses at Milan. The only work papers provided to us by Ann Arbor that dealt with the Milan traffic are AA-HC-027 through 031, which are reproduced as Appendix JHW-AA-2-HC. The detailed movement records are, based on their revenue date, for the month of September 1997. During September 1997, Ann Arbor moved the [[[ ]]] carloads of automotive parts from Milan to Conrail for the St. Paul, MN destination, and [[[ ]]] carloads from Milan to CSXT for the Louisville, KY destination, or a total of seventeen carloads. Extrapolated to an annual basis, the traffic referred to by Mr. Erickson totals [[[ ]]] carloads and [[[ ]]] of revenue.

Several years ago, Ann Arbor and Conrail made a joint route bid for the Milan to St. Paul traffic which underbid Norfolk Southern direct, as the joint line Ann Arbor/Conrail bid was judged by the shipper in the marketplace to provide a better price/service package.

After the Conrail transaction, Ann Arbor may elect to bid jointly with the CSXT/Conrail combination or with Canadian National in competition with any bid by the Norfolk Southern/Conrail combination, and the Conrail transaction will not preclude either of those Ann Arbor alternatives. Indeed, given Ann Arbor's current success at underbidding Norfolk Southern, and the continued availability of Ann Arbor's switch alternative at Milan, it is my opinion that Ann Arbor will not lose any of this traffic or its associated annual revenue of [[[ ]]] as a result of the Conrail transaction.

For movements from Milan to Louisville, Mr. Erickson states that, following the Conrail transaction, Norfolk Southern will "also have a single line route to Louisville." That is true, but Norfolk Southern already has such a single line route, which involves a slow and high cost switching move via CSXT to the destination plant. For this reason, the shipper prefers the combined Ann Arbor/CSXT joint line route, which generates annual revenue of [[[ ]]]. As a result of competition in the marketplace, the Ann Arbor/CSXT joint route may, in the future, lose traffic to the Norfolk Southern route in conjunction with the CSXT switch move at destination. But because the Conrail transaction has no effect on the competitive positions of Norfolk Southern, CSXT, or Ann Arbor in this corridor, it would be wholly inappropriate to attribute to the Conrail transaction any loss of this automotive traffic by Ann Arbor.

D. Toledo's Automotive Traffic Will Not Be Lost

Concerning Ann Arbor's automotive traffic in Toledo, Mr. Erickson states:

> "A substantial portion of this traffic is switched by Ann Arbor to CRC in Toledo and CRC linehauls the traffic to Chicago for interchange with western railroads. Ann Arbor also switches traffic to NSR for linehaul movements to

Winston Salem, North Carolina and Atlanta, Georgia. NSR currently has no automotive loading facility in the Toledo area. As a result of the CRC transaction, NSR is to acquire CRC's Toledo Automotive Terminal (Airline Yard). Once NSR acquires the Automotive Terminal, NSR will have no need for Ann Arbor's switching service on traffic currently linehauled by NSR. In addition, NSR will acquire the CRC route from Toledo to Chicago and, therefore, will also be able to divert the automotive traffic Ann Arbor currently switches to CRC for movement to or over Chicago. Most, if not all, of this traffic switched by Ann Arbor in Toledo could easily be diverted by NSR once it owns the CRC Automotive Terminal in Toledo and the rail line to Chicago." (Erickson, Pages 5-6)

Ann Arbor estimated the total annual volume of this traffic as [[[ ]]] carloads, but provided no work papers to indicate the specific traffic volumes and revenues which would be lost by destination as a result of the projected loss of all of its automotive switch traffic in Toledo, although Mr. Erickson does refer to "...a substantial portion of this traffic..." as being related Conrail linehauls of traffic to Chicago for interchange with the western railroads. For such traffic, however, as Mr. Erickson states, Conrail already has an automotive terminal at Airline Yard, from which Conrail could directly load the affected traffic for movement to the Chicago Gateway. Therefore, Ann Arbor does not need to participate in this traffic today except that the shipper has elected that Ann Arbor do so, probably because Ann Arbor's automotive loading facility is located adjacent to the shipper's plant, which avoids the cost of draying automobiles several miles to Conrail's facility at Airline Yard. Nothing in the Conrail transaction will change Ann Arbor's position on this traffic and its alternative routes with the CSXT/Conrail combination and Canadian National

will be available.

Similarly, Ann Arbor's role on traffic currently line-hauled by Norfolk Southern to Winston Salem, NC and Atlanta, GA will be determined in the competitive marketplace. At present, prior to the Conrail transaction, either Ann Arbor or Conrail could provide automotive loading services to Norfolk Southern in Toledo. After the Conrail transaction, Ann Arbor could join with CSXT/Conrail to compete for this traffic. Given the shipper's demonstrated preference for the Ann Arbor to perform its switching in Toledo and the continued, future availability of a CSXT/Conrail route in conjunction with Ann Arbor, it is my opinion none of Ann Arbor's traffic will be diverted because of the Conrail transaction.

VERIFICATION

John H. Williams, states under penalty of perjury that he is President of the Woodside Consulting Group, Inc. which is located in Menlo Park, California, that he is authorized to file and verify the foregoing rebuttal verified statement in STB Finance Docket No. 33388 on behalf of the applicants, that he has carefully examined all the statements in the foregoing verified statement, that he has knowledge of the facts and matters stated therein, and that all representations set forth therein are true and correct to the best of his knowledge, information and belief.

John H. Williams

Dated: December 16, 1997

ATTACHMENT JHW-CMA-1

Conrail Chemicals & Plastics Traffic, 1995
(Carloads in Thousands)

Code	Description	Originating		Received		Total
		Terminating	Delivered	Terminating	Delivered	
28	Chemicals & Allied Products	40.6	44.8	134.9	13.8	234.1
29	Petroleum & Coal Products	73.7	15.7	20.7	1.3	111.4
48	Hazardous Wastes	0.5	2.7	1.0	0.1	4.3
	Total	114.8	63.2	156.6	15.2	349.8
	Percent of Total	32.8%	18.1%	44.8%	4.3%	100.0%

Source: Conrail *Annual Report of Freight Commodity Statistics, 1995*

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CMA- HC-0005

Attachment JHW-CMA-3-HC

Analysis of CMA Work Papers CMA-HC-0003 Through -0005

[REDACTED]

P-805

Attachment JHW-CMA-3-HC

Analysis of CMA Work Papers CMA-HC-0003 Through -0005

[REDACTED]

P-806

Attachment JHW-CMA-3-HC
Analysis of CMA Work Papers CMA-HC-0003 Through -0005

[REDACTED]

Attachment JIIW-CMA-3-IIC
Analysis of CMA Work Papers CMA-HC-0003 Through -0005

[REDACTED]