UNITED STATES OF AMERICA

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OFFICE OF CONGRESSIONAL AND PUBLIC SERVICES
SURFACE TRANSPORTATION BOARD

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ORAL ARGUMENT

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DUKE ENERGY CORPORATION, Complainant, v. CSX TRANSPORTATION, INC., Defendant.	STB Docket No. 42070

Wednesday,
September 10, 2003

Washington, D.C.

The oral argument came to order in the Board's Hearing Room, 7th Floor, 1925 K Street, N.W., at 10:00 a.m., Roger Nober, Chairman, presiding.

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C-O-N-T-E-N-T-S

P-R-O-C-E-E-D-I-N-G-S

(10:02 a.m.)

CHAIRMAN NOBER: Well, good morning everyone, and thank you all for being here. As all of you know, today we're having an oral argument in the rate reasonableness case of Duke vs. CSX. Now in this case, Duke requested that the Board hold an oral argument, and this is, I think, the first time that the Board has taken this tact and held an oral argument in this case, in a rate case like this.

Now it's been my policy to promote an open process here, and this argument in this rate case is another step in that direction. Now I could see by the folks who are in the audience here that parties with other rate reasonableness cases before the Board are watching it closely. And after seeing this, you'll all have to decide whether or not you think asking for such an argument in this case is a good idea or a bad idea. Personally, I think it's a good idea, and I think it has been very helpful, but again, all of you will need to see.

Now I appreciate that the parties have

submitted briefs in the case, and summaries of their arguments, and they have a number of issues that they would like to raise today. I've had a chance to read those briefs and your summaries, and I look forward to the issues that you raise. And likewise, I have some issues that I hope that all of you will address today, as well.

Now I recognize that the Stand-Alone cost method is our court- approved method for determining the reasonableness of a challenged rate. And SAC cases are complex matters with hundreds of pieces, and I think all of you in the audience today will come to see that fairly quickly.

Now some pieces are large, like determining the appropriate operating plan for this hypothetical railroad, and others are small, like determining the cost of a single railroad tie or personal computer. But each piece fits into a whole that leads to a conclusion about whether the challenge rate is reasonable. And if not, what the maximum reasonable rate should be.

Now the cost to build the hypothetical

railroad are large, as demonstrated by past cases in which the SAC method has been used, but all of those cases were in the western and midwestern United States, where I think it's safe to say, it's easier and cheaper to build their than in the east.

Now from my days of working on Capitol Hill and on highway projects, I know what it costs to build transportation assets in Appalachia. My former boss built a thing or two in that part of the world, and Chairman Nick Rahall, who is also on the committee, built a thing or two in the very region that we're dealing with here. And I can tell you first-hand, it's expensive. And we'll have to see whether the SAC analysis in the east, in this expensive part of the world works, given the high cost of construction there. So that's sort of an over-arching question which I have, and one which we'll, I think, need to explore today a little bit.

Now in this case, I am interested in whether the operating plan submitted by Duke would meet the needs of the customers it wants its railroad to serve. Now I understand the shipper is entitled to submit an operating plan for its hypothetical railroad that is different than the way a common carrier operates. Railroads have been working for 150 years to find the most efficient ways to serve their customers. And although it's possible to be more efficient than they are, I think it's a difficult task, and a high burden to meet.

Now similarly, I think it's unrealistic for a railroad to submit as its evidence an operating plan for the hypothetical railroad that is less efficient, and isn't at all related to the operating plan of its own operations. After all, the premise of a SAC test is that the rate being charged is higher than would be charged by a hypothetical, efficient new carrier, and our agency's burden is to try to figure out just what that is.

I also just want to take note about the equities here. We have to ask whether a regulatory regime should permit a railroad to increase the rates that it charges a single customer as high as CSX has done here. The difference between the contract rate that CSX charged Duke under a recently expired contract and the challenge rate here is over 50 percent. And certainly, while a tariff rate is higher than negotiated rate, we have to look at whether it's fair for the railroad's customers to bear that increase overnight.

Similarly, we have to ask whether or not it's fair for the shipper to be asking for a rate that is lower than is being charged to a competitively served plant, and whether or not under any sort of analysis of railroad economics, we would award a rate that is actually below what a similar plant owned by that company pays at a competitively served plant. Again, these are difficult questions, and not ones that I profess to have every answer to.

Finally, the shippers have raised, and I've taken notice of allegations that CSX promised in its earlier Conrail transaction not to raise rates for captive shippers. Now this is a very difficult question, because that certainly didn't mean that Conrail could never raise its rates on the one hand, but on the other hand, how does that promise apply in this case? It's one that certainly is -- we are looking at, and one that I hope that the parties can address here today.

That having been said, this is just -- I can tell you certainly, I have not made up my - the royal "we" - I have not made up my mind in this case. It's one that we have several months before it needs to be decided, and we may well have new Board Members, who are not me, also looking at it.

The goal of this hearing is to help us sort of highlight some of the issues that I think I've tried to raise for you from the evidence, and also hear your own presentations. I think just a moment now on procedure, and then we'll turn to the hearing. We've allocated 45 minutes per side, and I think it's -- we've allowed the shippers, the proponents of the case, to reserve some time for rebuttal, which I understand that you want to do.

Again, I look forward to your presentations and won't hesitate to ask questions when I have them. I can assure you of that. But again, think about some of the things that we've raised here, and I appreciate your briefs and your summaries in this case. And with that, I think we'll turn to you and begin. Thank you very much.

MR. SLOVER: May it please the Board, my name is William Slover, and I'm appearing here this morning on behalf of the Complainant, the Duke Energy Corporation. On behalf of Duke, we appreciate the opportunity to appear before the Board this morning, and supplement the written arguments that we've already submitted.

In my remarks this morning, I would like to cover a few subjects. One, I would like to very briefly describe who Duke is, and how we got here this morning. I'd like to then talk to two unique legal issues in this proceeding, and then I would like to conclude with a brief discussion of the evidence under the guidelines, which are the controlling precedent in this case. As permitted by the Board's order, I've reserved 20 minutes of my time for rebuttal.

Duke Energy is a national energy company which has a franchise power division, which serves a 22,000 square mile area in the States of North and South Carolina. We serve about 2.2 million customers, and we generate about half of our power from coal. We operate eight coal-fired stations, seven of which are captive to either the Norfolk-Southern or CSXT. The proceedings here this morning involve three stations which are captive to the CSXT Transportation Company, two in North Carolina, and one in South Carolina.

Now the Duke story begins basically in 1999. Prior to 1999, Duke and CSX engaged in business according to private transportation contracts. During this period, Duke felt that it was paying top dollar, but as a captive shipper, it recognized that under the scheme of things, captive shippers were going to pay a substantial premium for their coal transportation service.

However, in 1998, following the approval of the Conrail merger, CSX came to Duke and sought a 10 percent increase in Duke's rates. Obviously, Duke was not happy. It felt that it was already paying probably too much, but as a captive shipper, it had no choice. It acceded to the increase, but it did, thereafter, undertake a review of its rates pursuant to the Board's Rate Guidelines. As a captive shipper, of course, its only leverage is the guidelines, and so it decided to review its rates under the guidelines.

CHAIRMAN NOBER: Well, let me just stop you right there for a minute.

MR. SLOVER: Sure.

CHAIRMAN NOBER: You have seven plants, you have eight plants, if I understand it.

MR. SLOVER: That's correct.

CHAIRMAN NOBER: One is competitive, and then you have three served by CSX, and then four served by NS singly.

MR. SLOVER: Right.

CHAIRMAN NOBER: So you have basically four plants that CSX can serve in one way -- of which one is competitive.

MR. SLOVER: That's correct.

CHAIRMAN NOBER: So your view is you have no leverage with CSX?

MR. SLOVER: I don't believe we did, no. The three captive stations pretty much control the traffic. They are base-load stations, and they have to run regardless. They are always running, always burning coal. They can't be turned up or down within much of a degree.

CHAIRMAN NOBER: But in terms of volumes, isn't the competitive plant the biggest of the four?

MR. SLOVER: Yes, the competitive station is the biggest of the three plants, but I don't --

CHAIRMAN NOBER: But that gave you no leverage with CSX?

MR. SLOVER: Well, if we had it, it didn't work. Let's put it that way, because we wouldn't be here today, as you pointed out. Our rates went up about 50 percent, so if we had leverage, we didn't appreciate it. But as I say, when the rates were raised, we reviewed our prices under the guidelines, and at that point, CSX came in, and they were interested in not only not reducing the rates, they were seeking further increases. So we had a situation by 2001, where CSX was seeking further increases, and we were unhappy with the increases that had been imposed upon us.

Now I've assembled a couple of charts here. As you know, all of these numbers are sort of shrouded with confidentiality, but I did want to give the Board an idea of the numbers we're dealing with. And so what I've tried to show in terms of the ultimate rates that were published to our stations, I've put in this first column, this is the average rate ceiling which the Board has imposed in its prior maximum rate cases. This is the average that coal moves in the east according to the Board's study in 2001, and these are the assailed rates up here.

As you can see, we're paying roughly twice what coal moves in the east, and very considerably more than the past ceiling, so this red column is what brings us here today. Nearly, 50 mils a ton mile for coal transportation.

Now the two points that I'd like to begin with, one of which Your Honor mentioned, and that's the interface between these proceedings and Docket number 33388, the Conrail case. As the Board is aware, CSX and NS engaged in a bidding war for Conrail, where ultimately they paid $10 billion for Conrail, which was about $6 billion higher than its book value. And the major shipper organizations appeared before the Board. They expressed concern that CSX and NS would not be able to carry this debt, and they specifically said that if in the event the projections that the railroads had given the Board failed to come to pass, the burden would fall on the captive shippers. And further in the transactions, the Board accepted the revenue cash flow projections of CSX, but it also accepted CSX' promise not to raise the rates of captive shippers in the event that the projections did not come to pass. And as we all --

CHAIRMAN NOBER: Is your view that CSX could never raise their rates to a captive shipper? What is your view of what they could do?

MR. SLOVER: I certainly don't think that they can raise their rates in the context of the -- what we show in the evidence as their $3 billion shortfall in meeting this Conrail burden. Something way down the road, I'm not sure, I don't think they should be raising this captive rates. But certainly, I don't believe that they can fund the shortfall in Conrail off of captive traffic. I think that Condition 19 in the Conrail case, where they promise not to raise the rates, I think they now have to be held accountable, and that's a very important issue too.

CHAIRMAN NOBER: Let's just assume for the sake of argument that what you're saying is right, how would we ever know if that's what CSX is doing? I mean, rates can go up. How do we know that the rate increase here, as you've asserted, is to fund -- pay off the Conrail transaction, and not just to reflect the fact that railroads aren't revenue adequate, and need to raise rates? And we have a lot of rate cases when people don't like that.

MR. SLOVER: I -- obviously, you can't connect it directly up to the debt, but we certainly feel that the failure of CSX to realize the cash flow and the immediate increase in our rates in this magnitude, we think is a strong inference that they're making up their shortfall from captive traffic.

CHAIRMAN NOBER: So it's not the fact that they're raising rates. It's the magnitude of it. I mean, how do we know the difference between just a rate increase because fuel went up, and a rate increase that's paying off -- that's because the Conrail transaction didn't materialize? I mean, that's -- how would we know the difference? That's what I --

MR. SLOVER: Well, I think in --

CHAIRMAN NOBER: Other than the fact that rates just went up.

MR. SLOVER: In baby steps, you might not. And if they were baby steps, we wouldn't be here. But when you get these -- in the aggregate, Duke takes 15 million tons of coal, so when you talk about 5 and 10 percent on 15 and 16 dollar rates, you're talking about real money. And so we think those are profit-oriented, and not recovering any fuel or any government increased costs.

CHAIRMAN NOBER: I mean, the magnitude is a different question. We'll spend some time on that later with CSX, but just in terms of at the outset, I mean, how would we know the difference? You've raised it and asserted it, but how could we tell? How would we look at a -- even if we were concerned about that, how would we know when one is raising it because of violating their promise, and on the other hand a rate increase, which we see across the railroad industry?

MR. SLOVER: I don't -- you know, I have not read every word of this evidence. I read about 95 percent of it.

CHAIRMAN NOBER: Neither have I.

MR. SLOVER: I don't think CSX is professing to be recovering costs of fuel or anything. I think they want more revenue, more money.

The other general point that I wanted to raise at the outset relates to our contention that in putting this rate up at this astronomical level, CSX has really set about to game the Board's Stand-Alone cost methodology. The Board has, in its recent decisions, pursued the so-called Percentage Reduction methodology to establish the Stand-Alone ceiling. And under that method, the Stand-Alone revenues are compared with the Stand-Alone costs, where the revenues exceed the cost, as compared to percentage, and the percentage is taken against the complaining shipper's rate, and it's reduced. And while that may be well and good in a normal situation, where the railroad knows in advance that it's headed to this room, it's able to pre-ordain the outcome of the case, more or less, by setting the rate at a level that when it loses, it ends up where it wanted to be in the beginning. And so if there's going to be some integrity to these guidelines, the critical part of the guideline for Stand-Alone cost is this rate, and you don't control it, and we can't affect it. They have the statutory right to set it. And we have seen zero in this record that tells us where this number came from. We know why they think it's an okay number today, but we have seen zero as to how they set this rate. And so we're convinced that it was set to game the methodology.

CHAIRMAN NOBER: Well, let me just ask you about that for a moment.

MR. SLOVER: Sure.

CHAIRMAN NOBER: I mean, again, let's just assume for the sake of argument that what you're saying is true, and that somebody at CSX said well, you know, we're going to have to litigate this, so let's raise the rate a certain amount, figuring that if it gets reduced, we'll be where we want to be. Absent a memo to that effect, how would we ever know that? I mean, how would we -- gaming the system, I read your allegations. I talked to our economist about it, but how would we ever know if that was happening? I mean, what should we look for, other than it's high, it's red, you know, so therefore, it's -- you're gaming the system. How would we know it?

MR. SLOVER: I think you would apply the common sense rule. You'd go in and you'd look in their evidence, and expect them to tell you how they did set this rate. This is a monopoly market. They call all the shots. You would think that there would be some method shown whereby they came up with 46 mils per ton-mile. There isn't anything in this entire record that tells you where this number came from. And so from that, we come to the conclusion they set it up real high, so if it got knocked down, they'd end up where they wanted to be.

CHAIRMAN NOBER: I mean, in the end, isn't their burden to show that their rate is reasonable or unreasonable, as the case may be. I mean, do they have to prove -- has any railroad ever had to prove where it -- why it set its tariff rate where it did, other than to defend that it's reasonable or unreasonable?

MR. SLOVER: Well, I think that that's why I say this is a unique issue to this case. I don't think in the prior maximum rate cases that there has been such an enormous disparity between the rate that people are happy under, and the rate that they're complaining to you about.

CHAIRMAN NOBER: I have to say, I have not, in my year on the job, met a single shipper who has been handed a tariff who liked it, and said, you know, where the heck did this rate come from, and why am I being charged this? I mean, that is common to every shipper, at least anyone that's ever spoken to me.

MR. SLOVER: Well, I would say that most of the tariffs are at least faintly related to the prior contracts; whereas, this thing is in a different dimension.

CHAIRMAN NOBER: It's just the magnitude.

MR. SLOVER: The magnitude, right. Now in the time remaining, I would like to briefly discuss the evidence.

CHAIRMAN NOBER: Let me just ask one more --

MR. SLOVER: Sure.

CHAIRMAN NOBER: Now this is the increase at your captive plants. What happened at your competitive plant?

MR. SLOVER: Well, that's their story. I'd be glad to get into it. We have one competitive plant.

CHAIRMAN NOBER: Uh-huh.

MR. SLOVER: At the time frame involved here, there was no competition. As the record reveals, Duke Energy asked Norfolk & Southern, and CSX to file, or to put prices out for this traffic, and these folks refused. They wrote a letter and said we're not going to bid on this traffic unless it's part of this whole package, and so you're not getting a number from us.

CHAIRMAN NOBER: For the Marshall plant.

MR. SLOVER: For the Marshall plant. And the only person that showed up at the party was the Norfolk & Southern. Duke had to accept that price. They made us coal arrangements with one bid on the table, and then after the dust died down and weeks and months passed, these people came in with a number too little, too late.

CHAIRMAN NOBER: But how much did the competitive plant go up, when the dust settled, without -- I mean, just magnitude-wise? I mean, it's a confidential --

MR. SLOVER: The competitive plant went up. I don't know exactly -- there's been several more prices. I'm not precisely sure. I know that the Duke so-called competitive plant, as we point out in the evidence, pays about twice as much as everybody else's competitive plant, and that does not make us very happy either.

CHAIRMAN NOBER: But, I mean, that's the --

MR. SLOVER: The competitive -- the so-called competitive rates are -- well, the one that

Norfolk & Southern published lies less than this number.

CHAIRMAN NOBER: But in terms of the -- I mean, if we kind of, you know, in probing it a little bit said the kind of inference of gaming and the inference of violating the Conrail representations as to the magnitude of the increase, yet at a competitive plant, you also had a similar increase, what would that say about the inferences?

MR. SLOVER: Well, we -- I'm sort of amazed that we're back to Contract rates here. I mean, the railroad spent years exercising comparable rates from the list of --

CHAIRMAN NOBER: No, I'm just looking at the magnitude. I'm just -- without getting into the individual numbers. And if they went up everywhere, that's -- you know, that again is a factor, and wouldn't you agree that's a factor in --

MR. SLOVER: Well, I don't -- I see the Marshall -- we see the Marshall situation as a very complicated situation. These people were trying to price Marshall in the midst of a rate case. One person didn't file a price. The prices have changed since this record was closed. No, I -- and I don't see Marshall at all as relevant, personally, and the Board has -- I mean, the shippers came to the Board and said let's make competitive rates a standard for Stand-Alone, the Board said no, that comparable rates to competitive plants have no probity when it comes --

CHAIRMAN NOBER: And I wasn't suggesting that it would factor into the SAC analysis, but you've alleged two extra SAC factors; the gaming of the system, and the Conrail transaction, which have to be viewed through inference. So one way to view the -- you know, to sort of compare that rate is to look at what happened at the competitive plant, and try to factor that into the inference. That's what I was getting at with that.

MR. SLOVER: Right.

CHAIRMAN NOBER: Because I was trying to look at -- as I asked in the question, how do we make sense, and how would we know if those things are happening. Because, you know, they're fair allegations, and they're -- you know, they certainly would concern me if they were true. But how would we ever figure out if they were true? And my question was whether or not the competitive plant would help give us a window into that.

MR. SLOVER: Well, my answer to that would be no. The basic standards, as we know under the guidelines, are variable costs and Stand-Alone cost. Now the railroad's brief doesn't mention variable costs, and in their remarks this morning they don't mention variable costs. And the reason is obvious, their own evidence shows that the revenue cost ratios on this traffic are 280 percent. And, of course, the Congress specified 180 as sort of a level where the red flags go up, and the Board is supposed to examine captive traffic. Their own figures show 280.

Now, of course, Duke's numbers show that the variable costs are closer to 400 percent. And there again, I don't want to digress too much because my time is short, but we have a very serious problem with the data on our variable cost. They're very vanilla costs. We couldn't get much information to make the specific adjustments that have been made in these past maximum rate cases. And, for example, this so-called adjustment for specific roadway return, which computes return under variable costs viable route of the coal trains, we couldn't do that because they wouldn't give us the data. If we could have gotten the data, Your Honor, we could have thrown the Conrail numbers out, because we don't use any of the Conrail routes. So if we had a fair shot at variable cost, I think the revenue cost ratio of these rates is in the neighborhood of 500 percent.

CHAIRMAN NOBER: They were individual lines and --

MR. SLOVER: Pardon?

CHAIRMAN NOBER: They were individual lines that were close to 600.

MR. SLOVER: That's correct. And, I guess, my point is that I think there's a strong presumption of unlawfulness for anything where you can earn four times the cost. You can't do that in the legal business that I'm aware of. And so we feel that the variable cost evidence provides a very strong presumption of unlawfulness.

Now in the few minutes that I have left, I am reliably informed that this record contains 709,000 pages. And, obviously, in the few minutes that I have left, I'm going to do --

CHAIRMAN NOBER: I hope there's no one who's actually read all 709,000.

MR. SLOVER: I'm going to try to fly over this stuff at about 10,000 feet, but I think I can do it in a way that will show you why these rates are unlawful.

Now what I've got here in my first chart is the top compares the two Stand-Alone costs. We come in around five, they come in around thirty-five. And down here I show the components that make up Stand-Alone cost; construction of the railroad, the operating expenses and so on, and what they contribute to this difference. So as the chart shows, the roadway, the construction of the railroad through Appalachia, as you describe, accounts for 41 percent of this difference.

Now for the rest of my discussion on Stand-Alone cost, I sort of take my cue from the TMPA case and the remarks of your predecessor, who noted that at one point, the Board had nothing under the guidelines, that they have worked diligently, have assembled a very respectable body of authority, that rules and principles are the rules of the road, so to speak. And they're out there to help people find their way down the Stand-Alone road.

The first item, and the most costly item is the construction cost. So what I've shown here are the construction costs in the past Stand-Alone railroads as computed by the Board. And I'm doing it on a track-mile basis because track-miles are the figures in most of the cases. So the average cost to construct a railroad in all prior Stand-Alone cases, $1.3 million a track- mile. Eastern cases, same territory, same lines, Appalachia, $1.2 million a track-mile.

Now Duke's evidence in this case, highest Stand-Alone cost construction ever, $1.8 million. I submit consistent with the rules of the road. And then over here, we have CSX' claim that it costs $3-1/2 million a track-mile to build this railroad.

And I submit that there's no support for a number like this in anything in the entire rules of the road. And the same picture emerges --

CHAIRMAN NOBER: Well, you spent a lot of time looking at the various components of this.

MR. SLOVER: Sure.

CHAIRMAN NOBER: What in the -- is there any part of CSX' costs that you think are an over-statement?

MR. SLOVER: Well --

CHAIRMAN NOBER: I tell you, if you could actually build a track-mile in Appalachia for $3.6 million dollars a mile, you're hired.

MR. SLOVER: There's two things. One --

CHAIRMAN NOBER: Well, for $1.8 million a mile, you're definitely hired.

MR. SLOVER: Well, the basic problem that I would have if I were you, Mr. Chairman, is that if we were the people in this case that you needed to know something about, Duke Energy, we would come and tell you what it costs to build power plants. We build them. We know what they cost.

These people build railroads. They build spurs, they build tracks. They know what these costs are. We asked for the AFE's, the construction costs in the discovery. They won't give them to us, so the best evidence they have, and that's the actual cost to do this. And there's nothing in the record, because they haven't produced it, so this number represents the best number that our best experts could come up with. And as I say, it's consistent with what the Board has found. Now the same picture -- how am I doing on time?

CHAIRMAN NOBER: Go ahead.

MR. SLOVER: Okay. The last chart I have here is -- shows you the same picture for operating costs. And here, in all of the prior Stand-Alone cases that the Board has decided, it has found that it costs roughly 5 mils a ton-mile to operate a Stand-Alone Railroad. And these railroads all are basically coal-hauling railroads, going from point to point loading the trains.

Here, Duke is at the same level that the universe of prior railroads, and over here we have the

CSX figure, 19 mils a ton- mile, four times higher than the average of all prior Stand-Alone Railroads. And this number is so high, that to buy into this number, you have to believe that it costs more to operate the Stand-Alone Railroad, an imaginary efficient railroad, than it costs to operate the CSX itself. And, obviously, that can't be. So in conclusion, what I'm trying to say is that all of CSX' numbers have one basic flaw. They do not seek to develop a least cost --

CHAIRMAN NOBER: We'll give you a chance to finish.

MR. SLOVER: Sure.

CHAIRMAN NOBER: How did you all put together your operating plan? I mean, CSX in their brief alleged a lot of concerns about it. But if it's based on, you know, points and not on actual trains, that it didn't account for gathering of trains together, the trains materialized at different places. I mean, how did you put that together, and is that, you know, a realistic appraisal, even in a hypothetical world, of how a railroad could operate?

MR. SLOVER: Well, we, first of all, got the best experts we could find in the railroad business, one of whom was their former Vice President of Operations, who is today President of the Shortline Railroad. And we asked them to design the railroad and to design the operations to serve the captive shipper population, the traffic that we had. And they took the trains, the number of trains, the number of daily trains, the number of crews, and then because those expert efforts had, in our view, foundered in the FMC case, and in the McCarty Farms case, where the Board said well, we see what you're saying, but we're not sure it'll work. We created this controversial String Program. And it's a simple model. It's open architecture, and we applied these inputs that these experts gave us to determine whether the operation was, in fact, feasible. And we submit that it is, and that's why we think this number confirms it.

And the point that I was going to make, and I'm out of time, is that the reason that CSX is always up on these red charts is because it doesn't engage in least cost efforts. What it is attempting to do is to justify that big number that it starts with, the 46 mils per ton-mile. And when you have to cover that big number, then you're going to end up with a most cost railroad. Thank you.

CHAIRMAN NOBER: Okay. Thank you very much.

MR. MOATES: Chairman Nober, may it please the Board, before the secretary starts my clock, would you mind if I just moved over so I can get my Power Point here.

CHAIRMAN NOBER: Absolutely.

MR. MOATES: Let me get the projector turned on.

CHAIRMAN NOBER: Okay. You've gone hi-tech.

MR. MOATES: Not really, because I'm doing this.

Again, Chairman Nober, if I may, I'd prefer to remain seated because of the devices we're going to use, but good morning. I am Paul Moates. I'm representing CSX. I greet the Staff this morning, as well, because we are well aware of who has to do a lot of the hard work in these cases. And let me say on behalf, I'm sure, of the Complainant and ourselves, we do appreciate the hard work that goes into these cases. We know we have a couple of others here in the same time frame.

I'm going to, I think, disabuse you of the accuracy of some of the graphs that Mr. Slover just put up there, so don't get too vetted in on those numbers. But just think for a moment about his 46 cents a ton-mile and, you know, how outrageous he says that is. To put that in context, what that really means is that by the way, we think the number is much too high, and I'm going to tell you why in a minute. But that would mean, even if he was right, that we're charging less than 5 cents a ton to haul coal through Appalachia. I don't think on the face of it, that shouldn't really shock anybody's sensibilities.

Maybe the best way for me to start, Mr. Chairman, is to try very quickly to sort of respond to some of the questions you asked here, and then I'd like to come back to my sort of prepared remarks. And I do have some slides that I think will be helpful and interesting. Some will probably be a little bit boring, but they're important. They deal almost entirely with Stand-Alone costs, and I'm constrained to note that Mr. Slover took a substantial amount of time here, and didn't talk about Stand- Alone costs until the last five minutes of his presentation. Which I would submit is significant, it follows the pattern we've seen in their filings. And I think this case, and I hope you do too, is about the correct way to calculate Stand-Alone costs, because that's your standard -- let me just go through a few of those questions quickly, and then I'll expand on them either now, as you prefer, or when I get to various subjects in my preparation.

Does the SAC analysis work in the ECSV? Absolutely. It worked in this case. It worked in the export coal cases. It worked in the Dayton Power & Light case. Would Duke's operating plan work for shippers, real world shippers? Duke's operating plan doesn't work at all, and it certainly does work for Duke or the shippers it proposes to serve, and I'll show you why it doesn't work. It's really -- it falls apart. It's a sham.

Should our operating plan provide for an operation that's less efficient and costs more than real world CSX operations? No, it shouldn't, and it doesn't, and these comparisons are bogus. There's no other way to say it, they're bogus, and I'll show you why in a minute.

CHAIRMAN NOBER: So you think your operating plan reflects how CSX actually operates?

MR. MOATES: I think our operating plan does not reflect exactly how CSX operates. I think our operating plan reflects how a coal-hauling railroad in Appalachia, even more efficient than CSX, would operate, recognizing the least cost, most efficient principles that motivate the SAC guidelines. It certainly does not suggest that we are more efficient than SAC. I am going to suggest to you that we're not nearly as inefficient as he is suggesting.

Can the regulatory regime permit increases in the range of 50 percent plus? We take issue with the 50 percent plus. We respectfully submit they have not calculated those increases correctly. They even say in the afterword of their brief that we increased their rates again after the record closed. That simply isn't true. I mean, we've been escalating the common carrier rates in accordance with their terms throughout these proceedings; that is, with the RCAF adjusted escalator.

They have been getting those notices, you know, throughout the case, and they decided for some reason to make a big issue about it when they filed the brief on this latest notification. There's nothing other going on there, other than the fact that the tariff is being escalated. I'll say tariff from time to time. We know I mean the common carrier rate. The tariff was being escalated by its terms.

CHAIRMAN NOBER: So you've just -- your position is that your rate has just gone up by our adjustment factor?

MR. MOATES: Correct. It's gone up by the factor --

CHAIRMAN NOBER: And nothing more.

MR. MOATES: -- the adjustment factor, which is incorporated expressly in the terms of the common carrier rates.

CHAIRMAN NOBER: So just by RCAF, which is a couple of percent a year.

MR. MOATES: If that, yes.

CHAIRMAN NOBER: But then how did it go up -- where does the 50 percent allegation come from then?

MR. MOATES: I'm talking about during the case. The 50 percent allegation --

CHAIRMAN NOBER: From the contract.

MR. MOATES: -- is how much it went in from when the contract expired. It didn't -- our evidence, we believe, shows it didn't go up that much. It went up a lot. It went up more than a third. Why? A couple of the reasons; for the last number of years, and Mr. Slover suggested this, Duke has insisted - it hasn't been the railroad's position - Duke has insisted on negotiating these contracts using the Marshall rate, which is not some peripheral plant, as I think your Chairman understands. The Marshall plant is the largest plant in the Duke system. It takes over 5-1/2 million tons a year of coal. That's much more than all three of the plants that are at issue in this case combined.

It is a huge plant. They have bundled that consciously in the contract negotiations with the railroads, both CSX and Norfolk- Southern. They have insisted that the railroads bid on the Marshall tonnage at the same time they bid rates for these captive plants.

Duke elected to cancel the contract at issue here. They didn't have to bring this case, and they did. It was their choice. They cancelled the contract. They told the railroads they wanted separate bids on the captive plants. The railroads weren't that stupid. They knew what was going on. They knew that the rate cases were being prepared for these captive plants, so they weren't going to bid on Marshall separately, as though they had in the past, like they were bundled. They said no, CSX said no. So they established common carrier rates, as required by law, for these three plants. They continued to negotiate for the Marshall tonnage.

No Marshall tonnage has ever stopped

moving since the beginning of these negotiations. That plant is humming along just fine, and has a very high level of productivity. In fact --

CHAIRMAN NOBER: That's served by NS, not CSX.

MR. MOATES: Correct. And during the pendency of these two cases, Duke has again flipped the majority of the tonnage between these two railroads. They actually shifted it over, as they always have. They play that plant back and forth between the two railroads to get the best rates.

You ask about the rate of the Marshall. I'm not going to read it, but I do refer you, and I think you've seen this, to the chart on page 6 in CSX' brief. I'll just tell you order of magnitude that shows that the Marshall rate is somewhat above the expired contract rate, not that much, but it's well above what Duke claims to be the proper SAC rate, which is not that $3 number you put up there, by the way. It's something much more than that. That relationship, as I'm going to talk about here in a minute, we think is very, very significant.

You also asked, Mr. Chairman, should the customers bear this kind of an increase overnight, if it's 30 percent, or 50 percent, or whatever it is. Should they? In this case, the answer is an unequivocal yes, they can, and they have, without any undue problem.

Your guidelines, as you know, include the so-called phasing constraint, which frankly, we anticipated Duke might invoke, and that's why in our opening evidence, we do put in a lot of evidence about the impact, or the minimal impact on Duke rate- payers and the like, and pay these increases. They never have invoked it, and for good reason. Because while they have been paying these rates, Duke has been running its plants, its coal- fired plants at record levels. Duke has had huge profits. They made so much money in South Carolina this last year, especially off their coal-fired plants, they over-earned the amount that the South Carolina PSC allows on the return on equity, and they have a problem with that. Now they've got to deal with that.

CHAIRMAN NOBER: Well, let me ask -- I

mean, you're saying 30 or 50 percent. Is there any overnight rate increase that you agree would be too much?

MR. MOATES: Not as a, sort of a philosophical matter. If the Stand-Alone cost test failed, it would be too much. I could imagine an increase that would be appropriate under the Stand-Alone guidelines, but which might be all at one time too much, and would have to be phased-in. And that is why you have that constraint. This shipper has not --

CHAIRMAN NOBER: In other words, your view of the Stand-Alone case, you know, going to your chart on page 6, which I promise you I did read and spent some time looking at, you could go 60 percent above where you are now in your view, and that that would be all right.

MR. MOATES: We could, but there's something else in there you can't see. It's the market. CSX didn't set that rate willy- nilly, as they suggest.

CHAIRMAN NOBER: But in your view, the market is even higher, that you could go up to 28.

MR. MOATES: Our view of the permissible amount under SAC or Ramsey. But the view, not my view, the view of the CSX marketing officials, who actually has established these rates in the marketplace, and worry about when they're going to lose tonnage, cause them to set the rate where it is.

For years and years, Duke had said to CSX in negotiations, not only is Marshall very competitive and you won't get your share of Marshall tonnage if you don't give us a good rate for these three plants, they said with electricity deregulation, we have all kinds of options. And you better be careful with your rates, because we'll start buying more power off the grid. You know, we have coal-fired -- I mean, excuse me - we have gas-fired combined cycle plants. We could use those more. Those kind of factors are real. I realize we're not allowed to argue them any more in terms of market dominance, but they're really real in the bargaining, and that's what CSX has heard for years. And frankly, they believe that. And it may even be that they believed it a little bit too long, and when they woke up and realized in deregulation of electric utilities, that that really wasn't happening, they realized they had a lot more headroom to move those rates up, they did.

CHAIRMAN NOBER: Now Duke argues that you set that rate by gaming the system, that you set it a higher rate than you otherwise would, thinking that well, if the Board knocks it down, you've got a margin for error, and you still get a nice increase. If we were concerned about that, again, how would we ever prevent you from doing that?

MR. MOATES: I think there's a clear answer to that one, Mr. Chairman. The first clear answer is, the evidence doesn't support gaming here. In fact, our evidence shows, as you just pointed out, that the rates could be much higher than they are, that they were set reasonably according to the assessment of CSX of the marketplace. But if a shipper like Duke actually believed that, it had discovery. It could have asked us questions about that in discovery. It could have asked for the deposition of the coal marketing officers who set these rates, and they could have explored that. They never did it. They never did it.

It's a lawyer's creation. It's an interesting argument. I would say that theoretically, it could be of some concern to the Board in a case of which the facts supported the inference that that kind of thing may have gone on. I respectfully submit there is not one scintilla of evidence of that in this case.

We put in extensive evidence on the basis on which we set rates. There's a whole big section in our opening testimony about that. And the most critical thing --

CHAIRMAN NOBER: They profess that the rate you set here is the highest rate ever set for a coal movement.

MR. MOATES: Well, that just isn't true either. Look back at the export coal rates. The export coal rates were litigated 23 years ago, and were higher than these rates. And you know what, the ICC found them to be reasonable, so that just isn't true.

Now what about this broken --

CHAIRMAN NOBER: Well, it's an example.

MR. MOATES: Well, it's an example. To talk about the broken promise of Conrail. How does it apply? Well, it's not a broken promise. It's been four years since the Conrail transaction was implemented, almost six years since this agency authorized it. CSX has not gone out and raised the rates of captive shippers across the board.

It is, and will continue to look for every opportunity it can to raise rates on customers who can afford to pay higher rates, and who should under your differential pricing principles be required to pay higher rates, because a customer like Duke is actually at the high end of the pyramid of those who get the greatest value from CSX' transportation services.

Economic theory, the theory upon which your CMP guidelines are based, doesn't just teach that that's permissible. It teaches that the railroad has to charge a customer like Duke those highest rates. And if it doesn't, it's not being fair to other customers on the system. And more the point, it will never have any reasonable prospect of achieving revenue adequacy.

CHAIRMAN NOBER: Well, let me just stop you right there for a minute. I mean, how would we ever know the difference? I mean, under your theory, anything you wanted to charge would be okay, because CSX hasn't achieved revenue adequacy.

MR. MOATES: No, no.

CHAIRMAN NOBER: Why aren't they revenue adequate?

MR. MOATES: That isn't my theory. We do not argue --

CHAIRMAN NOBER: Well, you said that you need to charge under constrained market pricing --

MR. MOATES: As a general --

CHAIRMAN NOBER: -- what the traffic will bear to meet revenue adequacy. Now why is CSX not revenue adequate?

MR. MOATES: Because we have not been able to charge all the market might allow in some places, and because the market is so strong in other places, that we can't charge enough to cover all those costs. There are no revenue --

CHAIRMAN NOBER: And the shippers allege that, you know, your debt load from Conrail is a factor in that.

MR. MOATES: The debt load from Conrail is certainly a factor for CSX and Norfolk-Southern as a general matter. You can't deny that it's there. The debt load of UP's acquisition of SP is a factor. The debt load of BNSF's acquisition of Sante Fe is a factor, but that doesn't mean that those -- without a direct link, which doesn't exist in this record, between efforts to pay for that debt, as opposed to the system's revenue shortfall overall, that there's something wrong with the way these rates were set.

CHAIRMAN NOBER: Well, again, how would we ever take that into account? I mean, how would we ever know the difference between you're charging more to pay off your debt, versus you're charging more just because you need to charge more?

MR. MOATES: I think there has to be a record established by the Complainant, and that's what discovery is for. And that effort wasn't even made here, much less put in the --

CHAIRMAN NOBER: So what is your view then of what the -- the allegations made? And I can read what John Snow said, or what the Board said, which I think you already know, and the condition that you would abide by that. How would that translate then into -- I mean, how would you interpret that condition? What does it mean?

MR. MOATES: I think it means that the -- CSX in this case committed that it would not go out, as sort of a campaign or in a conscious massive effort raise rates on captive shippers, regardless of what market conditions might permit. I don't think it can possibly and reasonably be interpreted as a promise that CSX would never raise the rates of any captive shipper anywhere. If he had made that kind of commitment I think, frankly, it would have been, you know, a serious on his part as Chairman of the Board, because --

CHAIRMAN NOBER: No, I don't agree it means that either. It can't mean you could never raise rates on the one-hand. But the question is what is -- you know, they've said such a big rate increase overnight should be taken as that. And I'm asking you, how would you interpret the statements and the conditions in light of what you did here?

MR. MOATES: The best I can say is I interpret them according to the facts in this record, which is there's nothing in this record to suggest that that had anything whatsoever to do with CSX' motivation for increasing Duke's rates. What motivated CSX to increase Duke's rates was Duke's decision to unbundle Marshall, and to demand that rates be set independently for these so-called captive plants. And what motivated it was the recognition by CSXT's marketing officers that they had actually been keeping those rates too low, in the belief that what Duke had told them was right, that in the utility deregulation era, that they couldn't raise the rates very much without losing the business to some other, you know, source of electricity. And that's not true, and it's been proven not to be true by what's happened while these rates have been in effect.

As I said, Duke's plants, their coal-fired plants that run over the last year and a half or two years, hit near record levels, and they're making their record profits. That isn't what you would expect to see if, you know, these rates were really causing problems for them, and they had to cut back the dispatch at these plants. They haven't done that.

I've got a lot of SAC stuff to cover, Mr. Chairman, and I would like to try to get into it now, if I could. Let me see if I could just - since we've talked about some of the things here at the beginning, I will spare you my spontaneous from the Coal Rate Guidelines on the importance of Ramsey pricing, but I know that you know how important that is.

We certainly don't, as Mr. Slover alleges, ask the Board -- he says that we ask the Board to ignore SAC and the CMP guidelines and things like that, and we do not. We embrace those guidelines. We believe that a fair and reasonable analysis of the parties' respective SAC Commissions will lead to only one conclusion; that is, that our's is not better, just vastly better than that of Duke. And the reason we put in these comparisons of our rates to the Ramsey rates, or the CSX RSAM rate to the Marshall rates, all of which they complain. And he says oh, rate comparisons are out the window. We're not offering the Marshall rate as a basis of rate reasonableness. It's not a rate comparison. It's a sanity check on the SAC presentations. Compare the results of their SAC presentation to all of those factors and compare our's, I'm willing to go with our's.

Now the four primary drivers of Stand-Alone costs that I wish to discuss, and I hope I can do this without --

CHAIRMAN NOBER: But under your presentation, for example, I think if we accepted all of what you said as true, in some minds, you'd get up to 1,800 percent of revenue variable costs being reasonable. If we accepted in some of the highest minds.

MR. MOATES: I don't recall anything like 1,800 percent, but --

CHAIRMAN NOBER: If we accepted all of your evidence, in some of the highest minds, you'd wind up with an RVC, under your presentation, you know, that's what you put on your chart on page 6, the highest minds would get up to as high as 1,800 percent, or even more.

MR. MOATES: Oh, I see what you're saying. If that were translated --

CHAIRMAN NOBER: And that that's still reasonable. And you're saying yeah.

MR. MOATES: Yeah, as a matter of theory, you're never going to see a rate like that.

CHAIRMAN NOBER: That's not theory. This is what you put in this case, and what you --

MR. MOATES: As a matter of economic theory, that's what these calculations would permit to be charged. And I'm telling you, you will never, ever see a rate like that from CSX or any other railroad, because we cannot charge a rate that high. That's why the rate is actually down where it is, not up at the higher end of that chart.

Yes, I understand what you're saying. Yes, the SAC evidence properly assessed, would permit us to charge under the regulatory regime in a few cases, rates that were actually that high. It's never going to happen.

CHAIRMAN NOBER: But is that -- I mean, from our agency's standpoint, where our job is to try to evaluate what's reasonable, how would we -- I mean, is that something that -- I mean, should we accept that? Should we live with that saying that, you know, you can get up to 1,800 percent RVCs and have that be reasonable. And our check on it is saying well, you just can't charge that much. That's equivalent to no regulation, isn't it?

MR. MOATES: I understand the quandary and, you know, the reality is for the vast preponderance of the traffic, and importantly, the minds that actually move traffic to Duke, the RVC ratios aren't anywhere near that. They're in the 200s, maybe a few in the low 300s. Those are --

CHAIRMAN NOBER: That's the reality.

MR. MOATES: That's the reality.

CHAIRMAN NOBER: If we accepted your evidence, which you say is superior and that we should accept, you wind up in some of those cases with those kinds of numbers.

MR. MOATES: I didn't recall an 1,800

percent, but I understand what you're saying. Some very high ratios that --

CHAIRMAN NOBER: That's the back of the' envelope. I don't have -- you know, we haven't decided it yet, but I think that's -- you get somewhere in that ball park.

MR. MOATES: Just as if you accept their evidence, you're going to come up with some very big minds that take traffic to them, and have ridiculously low ratios properly calculated.

Now, Mr. Chairman, the four primary drivers of SAC that I wish to discuss, and I hope I can without sounding like the Fed Ex salesman, are the configuration and capacity of the ACW. That's the name of the Stand-Alone railroad here. That is what lines and facilities would be needed to handle the traffic that Duke has selected for the railroad, the construction costs that we've averted to, what would it cost to feasibly design and construct this railroad in the rugged terrain of the Appalachian Mountains, the operating cost - what would it actually cost to operate the ACW in that territory, and the traffic and revenue projections that tell us what this railroad would realistically handle over the 20 year DCF period the parties analyzed, and what were the revenues that would go along with that.

Now let's look at the ACW, if you want to put our first slide up here, a 1,200 mile railroad designed to haul coal from the Appalachia coal fields of Duke's three plants. It's easier to see, actually, on this big thing over here, but the three plants are here at Lee or Pelzer, Cliffside, Riverbend, and by the way, there's Marshall on the same branch line as Riverbend, actually a little farther up the line. It's not sitting way out here somewhere. It's right there. Logically, it could have been part of this case. We know why it wasn't. They knew they couldn't prove market dominance because it's a competitive plant.

As become the standard modus operandi of SAC cases, Duke has designed a railroad that is dependent upon the fiction that it would be able to rely upon a residual incumbent, here CSX, to operate all the remaining main and branch lines, so you can see all these blue lines here in the middle of their railroad, here, over here, here, here on this branch, over here, over here. These things exist throughout this railroad, and their fiction is that CSX is going to actually maintain branch line operations for their account in all these places that will continue to operate and maintain that railroad.

Duke's evidence on the central SAC issues of the configuration of the ACW and the resulting capacity of this railroad are fatally flawed because they are critically dependent upon the String Diagram Model created by Duke's consultants solely for litigation purposes, and with which the Board and the Staff are by now quite familiar. And notwithstanding numerous efforts to supposedly fix this model, efforts which by rebuttal Duke realized were falling apart, it continues to suffer from two fundamental flaws that render Duke's evidence worthless, and I do mean worthless. I mean this is a failure of proof.

First, the operating assumptions fed into the model, things like train size, time required to complete train inspections, interchanges and so on are wholly unrealistic. I'll discuss those in a minute here when I talk about operating issues. But most importantly, this model doesn't work. It simply doesn't work. It suffers from numerous programming and coding errors that cause it to generate nonsensical results. And, Mr. Chairman, the output of this model is absolutely central to Duke's entire SAC case. And when it collapses, because it demonstrably does, and I'll shortly highlight Duke's case collapses, Duke has the fundamental burden of proof on configuration and capacity, and on the operations of the ACW.

The failure of the SDM Model means that Duke has no evidence on these issues, and that failure of proof means the Board can and should dismiss the complaint. I know that sounds Draconian, but if burden of proof means anything, this is a case where you should actually seriously consider dismissing this complaint.

CHAIRMAN NOBER: Well, we have several responsibilities, one of which is to evaluate the case and the record, but the other is to evaluate whether the rate is reasonable. And one question that I have, and I raised in my opening, is whether or not, given the String Model on the one hand and your operating plan on the other, we can evaluate whether the rate is reasonable, whether either one allows us to look at the operations of an efficient railroad. So yes, on the one hand the Complainant bears the burden of proof. On the other hand, don't you think you all have the burden to bear the responsibility also to show how an efficient -- how you would operate?

MR. MOATES: Yes, no, but -- yes, they bear the burden of proof. And if they fail to carry it, I mean that's tough. This is the tough noogies rule. If you don't carry your burden --

CHAIRMAN NOBER: Is that our agency's responsibility?

MR. MOATES: -- proof in litigation --

CHAIRMAN NOBER: Well, wait a minute. Is that our agency's responsibility under the statute? Is it to say tough noogies to the shipper, to the Complainant, or is just try to determine whether the rate is reasonable? What is your view of our job?

MR. MOATES: My view is to evaluate the evidence that the parties presented. I don't think the Board has to do an independent fact-finding to determine whether a rate is reasonable. The way the law works is that they challenge our rate, and you have rules and regulations as to how they do that. And if they fail to carry their burden of proof, they fail to carry the burden of proof, and the rate has not been proven to be unreasonable.

CHAIRMAN NOBER: Do you think we have an independent --

MR. MOATES: Now I believe we have a responsibility, I do. And I believe we have discharged that responsibility very well here, and I'll show you that when we get to operating costs. And I think -- and I know you why you wouldn't understand or be reluctant to dismiss the complaint, even though as a litigator I think you ought to do it. But when you get there, you probably won't have to do that, but you do have to adopt our operating costs, and I'll show you why. And I'll show that they're not unreasonable, and they're not nearly as high as they claim they are.

Now on rebuttal, they acknowledge there were problems with this model, and they said they fixed them. Guess what, they didn't. Using their own testimony and work papers, let's go up here to this first point. This modified String Diagram Model of their's, first of all, fails to even purport to evaluate 292 miles of the branch lines of this railroad. That's nearly 25 percent of the entire Stand-Alone railroad. There is no modeling. That's a failure of proof.

It also failed to detect 72 head-on train collisions during the peak week of operations. This is after he's fixed everything, as well as 141 instances in which multiple trains attempted to occupy the same siting. I mean, these are not small problems. Trains are hitting each other. There are trains hanging out of sidings. The trains hang out of sidings because this model treats a train as a single point, rather than a moving object a mile or more long. Duke says well, that doesn't matter. All the points are moving at the same time. It sure does matter, and the results prove it.

This model even as fixed fails to recognize track speed limits. Running the model reveals 1,462 times which these trains exceed the track speed limits. It doesn't apply braking to any of the empty trains. It appears in some cases to calculate braking and acceleration, but then fails to apply the values when it actually simulates the train movements.

Despite the modifications that their witness, Mr. Crowley, made, it still doesn't account accurately for grade and curvature, and it doesn't even purport to take into account numerous factors that affect trains in the real world; things like the time that cars or locomotives spending waiting in our mines, loading operations, for maintenance requirements, even for random failures. And by the way, yes, random failures can happen even to a least cost most efficient railroad. That is the real world out there. And you'll hear about some of these random failures, Mr. Chairman, in the video that we submitted with our reply testimony here, which I hope you've seen. If you haven't, I urge you to try to take a look at it. I have a few still shots from it. But there is some interesting testimony in there from some of the officers, or the officials who actually operate the railroad out there.

Even Mr. Crowley conceded that his modified program still permitted train collision, so he went in after all of this and manually overrode the results produced by the model of the peak day for 38 separate trains. Now I submit that completely invalidates the model. He's fiddled with this thing throughout the case. There's still all the problems I just indicated to you there, and yet he still has to go in manually and fool around with 38 trains, adjust them so that they work on that peak day. That model is rendered a nullity when you do that kind of thing to it. It isn't a model any more. It's a gerrymandered result.

CHAIRMAN NOBER: I think you've --

MR. MOATES: Made my point?

CHAIRMAN NOBER: You've made that point.

MR. MOATES: All right. Let me say --

CHAIRMAN NOBER: To be honest, really where I have the questions about the model that you put in - I mean, I understand what the shippers put in, and --

MR. MOATES: Okay. I'm coming to that one.

CHAIRMAN NOBER: Okay.

MR. MOATES: But let me just say one thing about consistency here, if I could. On rebuttal, they claim that we didn't really use this model to do all this. They knew they had a problem. They said our operating witnesses conceived the ACW, kind of sprung, you know, whole cloth in their minds like Roman gods or something. You know, they thought of this railroad, and they only used the model to confirm a few things. Well, what did their evidence actually say? Let's go to this slide.

Their evidence said on rebuttal, "The String Program was used to verify the ACW's capacity. The String analysis did indicate that some adjustments were needed, and those adjustments were incorporated." They also said with respect to their

-- let's go to the next slide. They also said for Duke's calculations - this is our operating costs - items such as the number of operating statistics, the number of locomotives, rail cars, train crew members, they were driven by the String Program because they are dependent on the String analysis. In its rebuttal, Duke discusses them, and so on. That's not the witnesses dreamed this thing up and just used the model a little bit to confirm. That is the model did what we say it did. It was critical to their whole case, and it collapses.

All right. You say you understand that so let's go to your next concern. Now the Board is left with the alternative of dismissing the complaint, which you're obviously reluctant to do, or it must use the evidence on capacity and operating statistics provided by CSX. Now Duke argues in a brief that our own operating evidence is based on this RTC model, since we didn't buy it for them or for the Board, our capacity and operating evidence must be rejected too.

CHAIRMAN NOBER: Now did you submit your model to us?

MR. MOATES: No. We submitted to you the inputs and the outputs of the model. We submitted the same to them. We told them that that model was used by us under a proprietary license, given to us by Berkeley Simulation Software. It's available to any member of the public. It's like a Microsoft program or something like that.

CHAIRMAN NOBER: So how do we know that what you've put in is more reasonable than their model? Is it --

MR. MOATES: Here's the difference. We have challenged and shown clearly that their model just flatly doesn't work. They have not challenged --

CHAIRMAN NOBER: Yeah, I understand that.

MR. MOATES: They have not challenged the workability of this model. They say the supposedly well-accepted RTC model. It's very well accepted. That's what was used to model the Alameida Corridor Project. It's what is being used to model the Chicago Terminal Project. Railroads use this for all kinds of -- it's a tool commonly used. It's just like a Microsoft program.

Now it costs 40 or 45,000 dollars to buy the lease. We understand that. We told them who to call, and where they could buy it.

CHAIRMAN NOBER: Beyond the model itself, the question I have is really about how you're operating the railroad. Is it how CSX currently operates? Do you gather -- I mean, you've cited a number of infirmities in the way the proponent's operating plant would work, that the trains materialize, that they go in unit trains, they're longer than can even be handled by the residual CSX.

MR. MOATES: Right.

CHAIRMAN NOBER: Did you, in your model, redo that and show well, here's how CSX actually operates. We gather trains, we put them together, you know, you need to have different mixes of mines to get the right chemistry of the burn, or did you just say here's what --

MR. MOATES: We did what they did. We adhered to some of their basic assumptions, like they say they're going to operate with distributed power. We explained why that doesn't make sense. We don't use distributed power. Norfolk-Southern doesn't use it. We wouldn't accept the trains, but we put distributed power on there. We designed the operations in that manner.

We did not replicate the CSX operation, although we went in numerous instances and said the real world CSX operation today, it operates like this, it operates like this for the convenience of the customers --

CHAIRMAN NOBER: No. In other SAC cases, is that how the railroads have presented it, or is this different than that?

MR. MOATES: Yes. No, it's not.

CHAIRMAN NOBER: So they've always done exactly what you've done in this case?

MR. MOATES: My understanding, the cases we've been involved in, yes. We're not trying to impose the inefficiencies of CSX on them inappropriately, but we sure as heck are calling them and requiring them to make the recognition cost-wise of the portions of our operations that they ignore, and that they pretend you don't need; like gathering from mines, like switching the cars at mines, taking the time, not a four hour average, but in many cases 12, 14, 16, 20 hours to build those trains at the mines, to bring them back to gathering yards. They didn't do any of that stuff.

CHAIRMAN NOBER: Your suggestion is also that it takes 2-1/2 hours for a crew change. I mean, when I rode a train, the crew change took 5 minutes.

MR. MOATES: It depends on the kind of train and where it is.

CHAIRMAN NOBER: I mean, the guys got off. They took their cooler off. They brought a new one on. We even took a couple of pictures, because I was on the train, and they were in and out in 5 minutes. But anyway, putting that aside --

MR. MOATES: My colleague tells me I've got an awful lot of good slides I'm not getting to.

CHAIRMAN NOBER: Okay.

MR. MOATES: I'm going to try to move along here a little bit. Our RTC model - I hate to leave that out but I guess I'll have to. Basically, what they say about our use of the RTC model, is absolutely inconsistent between what they say on brief, and what they say in rebuttal.

CHAIRMAN NOBER: Well, they've alleged, and frankly, I'm concerned about this. If we accept your model, then it's above what CSX' own costs are. I mean, it produces a number that's more expensive than it currently costs to operate CSX itself.

MR. MOATES: Here's what they say on brief. "All of our CSX operating cost positions flow from outputs of our model." Put up the next part of the slide. Here's what they say on rebuttal. "The other operating statistics were developed outside the model." That little footnote down there says, "It bears repeating that CSX used the RTC model only to determine train cycle times. It did not use the model to develop any other parameters, such as the operating statistics for the ACW."

This is really important. This is really important, Mr. Chairman. What they're conceding, and they're right on the right hand part of the slide. They're actually wrong on the left. We used that model only to develop the cycle times. We have witnesses with spreadsheet analyses that have developed all the operating statistics for the railroad. You can rely on that. They haven't been able to attack that.

The only thing that those operating statistics - excuse me - that the RTC model was used for was to develop the cars and the crew times, and everything else we have backup for in spreadsheet analysis.

CHAIRMAN NOBER: Again, I don't want to belabor this, but our job is to evaluate whether a hypothetically efficient railroad could operate more efficiently than CSX. The plan that you've put in is less efficient than the existing CSX.

MR. MOATES: No. Absolutely not, Mr. Chairman. That's absolutely incorrect. The plan that we put in is for a railroad that is significantly more efficient than CSX. Let me get to that. Yeah, let's go to slide 21 real quick. We're out of order here but I see this is bothering you, so let's try to clear this up.

All right. They say our own operating

costs are 13 mils per ton-mile, and that's the way he builds this thing. Let's see about that. What are CSX' own operating costs? You can go calculate this. This is from the R-1. It's on file right here. The 2000 operating costs were $27.1 mils per ton-mile, 2001 - 27.2. We don't know how they did this calculation. They drop a footnote, but it doesn't make any sense.

I think what they've done is they've used their way of calculating operating costs for CSX to a few of the mines in this case. That's not the real honest to God CSX system operating cost.

CHAIRMAN NOBER: That's system average.

MR. MOATES: That's system average, and that's what they're claiming this is. That's what they claim.

CHAIRMAN NOBER: So you're saying 27.1 and 27.2 are system average costs.

MR. MOATES: Those are the right numbers. If you took depreciation out, it would drop maybe 2 cents, but those are the comparative numbers. So I want to say this one more time. We absolutely did not design a Stand-Alone railroad that is less efficient than CSX. That's just not true.

They designed a Stand-Alone railroad that is ridiculous. It's a fantasy railroad. It doesn't work. It doesn't take into account all kinds of real world demands of the customers in the coal fields, and how to operate a railroad; like, how you gather those cars, how you load the cars, how you have to have a crew and a train at the mine while the cars are loaded. They just disappear and come back a day or two later.

CHAIRMAN NOBER: And did your's take into account all of the -- did you provide a gathering yard in, for example?

MR. MOATES: We absolutely did. We put that in there. We put in all kinds of detailed information about the loading at the mines. Let me show you just one --

CHAIRMAN NOBER: Are you sure about that, that you put in gathering yards, and that you --

MR. MOATES: I'm sorry. We did not put gathering yards. I'm thinking what we did was, we went and did all the mine loading operations though that they didn't do. Remember, they --

CHAIRMAN NOBER: So you just ran unit trains from the individual mines, rather than gathering them together and moving them down. Right? And that requires having triple tracks in places and, you know, a lot more expense for property investment.

MR. MOATES: The trains on those busy lines up there that, you know -- this area up in here, these areas over there, there's a lot of traffic in there. Those trains are meeting. They don't model that, as I said before, at all. Twenty-five percent of the railroad they don't bother modeling --

CHAIRMAN NOBER: No, I understand what they didn't do. I'm asking what you did.

MR. MOATES: Yeah, that is what we did. In fact, I'll show you. This is right out of our rebuttal evidence. We showed you where they needed all the additional investment to deal with all the things they left out. That's all the stuff that you need at a minimum by way of additional investment to do the kind of operation they say they're going to do.

CHAIRMAN NOBER: But not to do the kind of --

MR. MOATES: There's no --

CHAIRMAN NOBER: Not to do the kind of operation CSX currently does.

MR. MOATES: There's no double and triple tracking. You can't do that in this territory. It's physically impossible. The video shows you why, and some of the shots I have here actually - -

CHAIRMAN NOBER: As I said, I've been there. I understand the difficulty of the terrain.

MR. MOATES: Let me talk about the difficulty of the terrain and construction cost. It's more than a $3 billion difference in the parties' respective projections of the cost of designing and building the ACW. Now a significant part of this flows from their failure to build the whole railroad. That's what this chart is all about. And more than $1 billion of the difference derives from their failure to propose a feasible construction plan, basing their unit cost for earthwork on a belated, ill- conceived proposal offered for the first time on rebuttal - and I want to emphasize that - when we have no opportunity to respond.

They're using equipment and procedures that simply wouldn't work. Stated plainly, no prior SAC complainant ever suggested that a railroad could be built using the equipment and techniques they first identify in rebuttal, for the simple reason that it can't be done. It should be rejected out of hand. It's infeasible.

Now you've already addressed a significant portion of the $1 billion, when you struck their improper effort on rebuttal to move that Fayette yard, which the evidence shows would cost about $200 million. Of the remaining $800 million, more than half relates to differences in the parties' evidence as to the cost for preparation of the roadway; that is, excavation and removal of rock, earth, clearing and grading the soil. So how do we get to this point of this huge disagreement?

Well, in their opening submission, what you have recognized as their case in chief, they're supposed to come clean and put in all of their evidence, not hold back, Duke included that the methodology requires a construction proposal. And on reply, we directed responded to that proposal, and convincingly demonstrated that the evidence failed -- their evidence failed completely to recognize the fundamental fact that this railroad would be built in some of the most rugged terrain in the Eastern U.S. We could look at a few of these slides real quick. Number 7, please.

Now again, these are from the CSX video. It's a reply exhibit. You smiled when I mentioned it before. I don't know if that's because whether you've seen it or not, but I do urge that you and the Staff look at it, if you haven't. It really does have a lot of, you know, real world indications of what this is like.

This is the kind of terrain we're talking about, you know. Here's one of the many tunnels that the coal train is coming out of. I'm just going to run through these real quickly. The next one, you know, a lot of single track territory, lot of shale and rock.

CHAIRMAN NOBER: How old are these CSX lines?

MR. MOATES: Excuse me?

CHAIRMAN NOBER: How old are these CSX lines?

MR. MOATES: I believe that a lot of these lines that were the former Clinchfield Railroad date back to the latter part of the 19th Century, early part of the 20th Century.

CHAIRMAN NOBER: So these are 100 years old, plus.

MR. MOATES: Yeah. Now, obviously, this railroad has been rebuilt a couple of times.

CHAIRMAN NOBER: Now the way that the analysis would have to go here, they'd have to take 100 year old lines built under, you know, totally different construction methods and replicate it.

MR. MOATES: Well, they get to replicate them using modern techniques. That's the way your Stand-Alone theory works. They have, and we recognize that.

Now Duke proposed to -- well, let's just see these other pictures real quick, some of the other -- you know, there are big gorges you've got to go across. There are mountains you've got to tunnel through. You run along rivers. This is from one of the opening scenes in the video.

CHAIRMAN NOBER: Fine. I think, you know, we could stipulate, it's expensive to build in Appalachia.

MR. MOATES: All right. Good. I'll accept that stipulation.

CHAIRMAN NOBER: But that's --

MR. MOATES: Duke proposed to construct the railroad and this train without equipment of the right type. They use equipment on their opening of the type that you have seen, and they have submitted, their consultants have submitted, in Powder River Basin cases like this. This is the main excavating, scraping and excavating machine they were going to use in opening. This thing is sometimes called a "paddle pad."

CHAIRMAN NOBER: Now they said in their open -- Mr. Slover said before that the reason that they put in the projections they put in, was that they didn't get discovery from you, particularly the AFEs. Is that true?

MR. MOATES: That's not true. We produced a lot of AFEs. Did we produce an AFE for a 1,200 mile railroad? Absolutely not.

CHAIRMAN NOBER: Okay. Did they ask for it?

MR. MOATES: Because nobody is building 1,200 mile railroads. We gave them what we had for, you know, branch lines and sidings, and so forth.

CHAIRMAN NOBER: So your position is that you turned over everything they asked for?

MR. MOATES: With respect to -- yes. With respect to everything, including with respect to construction. This didn't hold them up on construction. They didn't need that. They used their own consultants, as we did, engineering experts to come in with this testimony.

Let me show you what they came back with as an excavator on rebuttal. Now these are counsel's exhibits. I'm offering these to you. We've gone to, you know, spec sheets for manufacturers to find the equipment that matches up with the specifications in their testimony of that type. Obviously, the one on the right, and I'll show you here in a minute, would have clam shell bucket that we're working in earthwork territory, but that isn't going to work in the Appalachia coal fields, any more than that thing would, because it can't deal with rock.

What is the right piece of equipment here? Well, it's that, and that's what was in our reply evidence. That's not something they used in 1900, Mr. Chairman. We are using modern construction practices. This is the right way to do it, or the theory, but we are using the kind of equipment that is feasible, and that would have the best productive capacity to get this job done.

CHAIRMAN NOBER: But given how expensive it is to build in Appalachia, is your ultimate view then the SAC rate produces a rate that's, you know, at the high end of the chart, as you have on your page 6. And that anything that doesn't cause the utility to switch to natural gas is reasonable?

MR. MOATES: No.

CHAIRMAN NOBER: Anything under that? I mean, what is too much?

MR. MOATES: When you --

CHAIRMAN NOBER: I mean, it's expensive to build in the east, and it's a different kind of analysis than you have in the west.

MR. MOATES: When you come under the SAC rate that we think the evidence shows is permissible, the maximum SAC rate -- the maximum SAC rate isn't the rate that you're going to proscribe, or that we're going to run out and put in. The rate is the rate that you see in that chart, and I'm almost afraid to say even the common carrier rate I can, is that 16.46 rate. It's way, way below what we --

CHAIRMAN NOBER: That's what you charge, but what would be reasonable under --

MR. MOATES: That's what we have to charge because of the market constraints.

CHAIRMAN NOBER: But under the analysis you put in, you know, a lot more than that would be reasonable.

MR. MOATES: Ten dollars more. That's correct. We believe that. But we didn't put that kind of a rate in, because we don't think the market justifies it. We do have to deal in the real world with all these things that we can't talk about on market. We know what -- we think we have a pretty good idea of what the market will allow.

CHAIRMAN NOBER: And do you think that what our agency should find is that you could charge anything up to 26 bucks, and that would be all right?

MR. MOATES: Yes. And that's what you did in the export coal case. If you go back and look at the tables for what was deemed to be a reasonable rate there, they were far in excess of the challenged rates that were in the range of 16, 17, 18 dollars a ton. The rates there that were found to be reasonable were up into the 20s.

CHAIRMAN NOBER: So you think that's what we should find, that something all the -- that high is --

MR. MOATES: Respectfully, I think that's what you --

CHAIRMAN NOBER: -- is reasonable.

MR. MOATES: -- have to find, based on our evidence.

CHAIRMAN NOBER: But is your -- again, I don't want to come back to this for the umpteenth time, but is the operating plan you put in, what a hypothetical efficient -- is that an efficient operation? I'm troubled by that.

MR. MOATES: I think it's a very efficient operation. Again, I mean, our evidence shows very clearly that, you know, they left out 25 percent of the railroad in terms of how they actually modeled it in the investment. They did the same kind of thing with the operations. That String Diagram shows you, it just collapses. It doesn't work. We came back and showed how it actually would work feasibly, and it doesn't work -- we didn't replicate CSX, but we took account of CSX' real world operations which exist for a darned good reason; namely, the demands of the customers and of other railroads, and of --

CHAIRMAN NOBER: So do you think what you modeled is more or less efficient than what you do today?

MR. MOATES: I think what we modeled is more efficient than what we do today in many respects. I would --

CHAIRMAN NOBER: Overall?

MR. MOATES: Yes.

CHAIRMAN NOBER: So why isn't CSX just adopting it? Why aren't they running unit trains?

MR. MOATES: Because we have to run that entire railroad. We have to serve all those people. Just because they decided not to serve those branch lines, we have to.

CHAIRMAN NOBER: So if you were just serving the ACW, you would run exactly as your operating plan is.

MR. MOATES: Their ACW has a higher velocity than the real world CSX, and it has lower operating costs than the real world CSX. Let me show you a slide on that. I assume I'm out of time, but I've really got some things here I'd like to get up, if I could. Let's go to slide --

CHAIRMAN NOBER: To Mr. Slover I'll let you make up your time in rebuttal to that.

MR. MOATES: Go to Slide 18, please. On brief, for the first time, he had a chart here this morning like this. For the first time on brief, they put in a chart like this that purported to show how ridiculously high the cost per track mile for CSX was compared with all the other cases. That's what it looked like.

What they failed to disclose, and let's look at the next chart, is that those year-one figures for the DCF and the decisions that they listed, those were the year-one figures, rather. They were not the figures for 2001, the year in which Duke and CSX analysis are based on here. When the current figures, which are right there in the very same DCF tables, and the Staff can go back and check this, are put in the chart, this is what you actually get.

And by the way, the DCF in these three eastern cases over here, the CEA cases, they ended in 1998. Those cases are so old that the 20-year DCF ended in 1998, so you can mentally add five more years of escalations beyond that.

That's why I've been saying throughout this argument, and it's what we've said in our briefs, the east is not the west. There are dramatic differences, and the Chairman has recognized them here this morning. They have done this with their operating costs, as well. And I'm not going to have an opportunity, unfortunately, to talk about the many deficiencies in the specifics of their operating plan, but --

CHAIRMAN NOBER: Did the Board ever adopt the coal export analysis that you're suggesting, you're citing as precedent here? Was that a --

MR. MOATES: Sure.

CHAIRMAN NOBER: Not the Board, but the ICC.

MR. MOATES: The ICC.

CHAIRMAN NOBER: Was it the full commission or the staff?

MR. MOATES: Yes, I thought -- I helped try that case, but it's been a long time. It is a full commission decision.

CHAIRMAN NOBER: Yeah. I won't tell you

where I was in 1978.

(Laughter.)

MR. MOATES: Well, I regret to say that I was one of the lawyers for the Norfolk & Western in that case. And yes, that is a commission decision.

CHAIRMAN NOBER: And to the extent I can even remember.

MR. MOATES: Now this is the similar chart for the operating cost. This is the chart they put in their brief. Now you may notice, there are quite a few fewer bars here than there were on the construction chart. Where did all those other cases go? Well, let's find out where they went.

They left out the eastern cases, and why? Well, because when you put the eastern cases, those are the numbers you would have gotten. And when you bring those numbers to current values, there's where you are. Very misleading presentations they're making out of these things, and that's why you shouldn't be so worried about these costs being so out of whack. They are not out of whack. They are consistent with what you've seen and what you have found, you or your predecessor have found in other eastern cases.

Yeah, and lower than -- you asked me if we're less efficient than CSX. No, there are the CSX average system expenses up there on the top. All of these hypothetical least cost most efficient railroads are below the real world CSX cost.

May I have two minutes on traffic and revenues? It's just one more, and I'll go very fast on this.

CHAIRMAN NOBER: Sure.

MR. MOATES: There is about a $3 billion difference between the parties here too, over the whole 20-year DCF, when you add up all the differences in traffic and revenue for each of those 20 years. Well, I can give you a very quick summary of where those differences come from.

First, and this is number 25, please. First, they overstated their own traffic. Now think about this - Duke overstated its own traffic for last year to these plants by 40 percent. Forty percent, and it never advised the Board of that fact. I respectfully request that Mr. Slover on his rebuttal address that fundamental error that's carried forward throughout the DCF analysis. This isn't a small point. This is the traffic that caused him to come here and file this complaint.

Second, they also overstated export coal traffic in 2002, by projecting only an 8 percent decline, when it actually fell by 20 percent.

Third, for the first time on rebuttal, when they realized they had some problems here, they claimed oh, not to worry. The ACW will cut its rates, and that's why we'll get future traffic. Well, one, I submit that's inconsistent with SAC theory. But two, they didn't even reduce their revenues to recognize that fact. Go look at the revenues they project. They didn't show any cut rates.

Fourth, they ignored the fact that you have made it very clear in your prior cases that independent traffic forecasts are to be relied upon, and they made the completely unsupported assumption that traffic on this thing would be flat for 17 years of the DCF, in the face of multiple independent forecasts that we submitted, including those of the

EIA that you've used in many recent cases. They diverted over 2 million tons annually of traffic to longer, less efficient routes. They took it in the real world today and put it on a longer route so they could get more revenue in their hypothetical world.

Sixth, they used a very distorted application of the modified mileage prorate. I'm not going to go through these other slides on that. We had a number of them. I'll show you some examples of where they were hauling traffic literally seven miles, and taking 40 percent of the revenue, leaving 150 miles for CSX, and giving us, you know, 50 or 60 percent of the revenue, very distorted methodology.

And lastly, and I just -- well, there's an example of some of those. But lastly, they did something on rebuttal that I can only describe as a slight of hand, an arithmetic slight of hand when they thought we wouldn't have a chance to respond to it. That is, when they escalated the rates in the DCF - go ahead and go to that guy - when they escalated the rates in the DCF for the period 2011-2020 to show how those rates had increased, this is what they said in their evidence that they would do. They would take the average change in rates for the period of 2002-2010 over the change in the RCAF over that period, multiply it by the projected RCAF for the 2011-2020, and that would give you the rate forecast. So that's what they said they did, you know. One percent divided by 2 percent, times 3 percent will give you a forecast of 1-1/2 percent.

We had to go dig into their work papers. They didn't acknowledge this. They didn't reveal it to you or to us. Here's what you find they actually did. They put a -- they added a one to the numerator and the denominator in this calculation both times, and so here's what you actually end up with, and here's what they use as their forecast. It's almost double what they claim they were doing. That is nothing but an arithmetic slight of hand. It's unjustified. It's unrevealed and, frankly, it ought not to be countenanced.

Mr. Chairman, I believe our SAC evidence is demonstratively superior to that of Duke. It's demonstrable, both because of the numerous fundamental deficiencies we detailed in our evidence on brief and here today. And because our evidence clearly shows the rates generated by Duke's analysis bear no reasonable relationship to the Ramsey rate, to CSX RSAM ratio, or to the rates that they've agreed to to that big jointly-served Marshall plant, we submit that there is every indicia that our SAC analysis is much closer to a credible determination of a reasonable rate than is their's.

We thank the Board for the opportunity to appear this morning, and for your commitment to a fair and complete evaluation of the evidence. And again, we thank the Staff for their hard work. I'm sorry I didn't get to share more of these slides with you, but with the time --

CHAIRMAN NOBER: Thank you. No, that's okay. I interrupted you, so I'll bear the burden of that.

MR. MOATES: If the Chairman would like, we have copies of these slides. We have them on a disk and we could leave those, if you'd like that.

CHAIRMAN NOBER: Mr. Slover, take the time you need to finish up your presentation. I know you ended more or less on time in the beginning.

MR. SLOVER: Mr. Moates started off talking about the market, and how his people analyzed the market to set these rates. Our position here is that there is no market where you're a monopolist, and that's the fundamental reason that we're here with you today.

Mr. Moates also makes a big point that we never asked him a lot of things in discovery, and how CSX set these numbers. On page three of our brief, I said that the CSX set the rates on the basis of cost and profitability, that they never explained it. We wrote them a letter and said how did you do it, and they never answered, so I don't agree that we could have asked this stuff, and found out. We did, and I'm back to where I began. I don't think they had any basis for this rate but to gain the Board's methodology.

Now there's a lot of talk about revenue adequacy too. And I recognize that it's your job to balance our needs as captive shippers, and their need for adequate revenues. But what I see going on here is a double dip. The Stand-Alone rules were their idea. The railroad industry, Professors Baumol and Willig, they were the architects of Stand-Alone costing. And Stand-Alone costing satisfied their revenue adequacy requirements, so inherent in a Stand-Alone costing is the revenue adequacy consideration. And I don't see how you can then come back again in a Stand-Alone case, and put in thousands of pages of stuff about revenue adequacy. They've had their bite, and it's Stand- Alone costing.

Now there's a lot of talk about how bad our railroad is, and how misconfigured it is. I think the fact of the matter is that Duke's railroad on opening was 1236.6 miles. Their railroad is 1239.9 miles. We're dealing with the same railroad here. Our railroad has a few fewer sidings, I think, but basically, both parties have built the same railroad. There isn't any big issue on the configuration of this railroad. It's the same railroad.

They simply contend that it costs this staggering amount to build it, and I certainly don't want to come over here and argue with the Chairman, but some of these construction in the west is significantly more difficult, or at least as difficult as construction in the east. When you come out of Denver on that route, and you get up on Pike's Peak and Palmer Pass, and 8,000 feet in the Rockies, and rock, and the Nevada Power, they were going through Utah, Nevada.

Each of these cases you're moving so much common earth, so much loose rock, and so much hard rock. And probably in the western cases, they moved more hard rock than they moved in this case. Just in proportion, it's not as great, so I certainly don't believe the evidence supports any inference that it is staggeringly high to build railroads in Appalachia, versus other regions of the country. And a great deal of this railroad, Your Honor, is running through these wonderful flat alluvial plains of North Carolina, so I think you have to really look at the evidence.

CHAIRMAN NOBER: Fair enough.

MR. SLOVER: I'm bedazzled with these new pieces of equipment and everything. I don't know about it. Our construction equipment package is the package that moved earth at Pike's Peak. It's the one that moved earth and rock in the west, and we figure it's important.

One of the things that Mr. Moates didn't mention was that they put this 100 percent additive into their construction costs for moving earth in the east, and they justified it on this Means manual for estimating costs, and they put "West Virginia and Virginia" out of Means. But that's not in Means. They made it up. There is no justification to charge 100 percent extra for moving earth in the east, and construction progress. You're working on a right-of-way, and there's no basis at all, so one of the biggest bumps in these construction costs they made up.

Now this attack on the String Model is interesting. As you have intimated, a lot of their criticisms come from what we consider to be a black box, some model that they have not put into evidence, they have not put the inputs. We haven't any idea how it works. But one thing that I think you need to understand --

CHAIRMAN NOBER: They have alleged a lot of infirmities in it. I mean, do you dispute those? That it doesn't take into account train length, it provides for -- you know, it has trains -- putting aside, you know, FRA inspection and other regulatory matters, just that trains collide, that they appear, that there aren't sufficient sidings. I mean, how --

MR. SLOVER: Wrong, wrong, wrong, wrong that stuff. If you look in the record, they have 72 crashes. Well, in our view, the model shows one train is on the main line, one is on a siding. We don't buy into all that, but there's one common sense thing that transcends all this.

This railroad is run by human beings, dispatchers. The model does not run the railroad. Duke Stand-Alone Railroad was built to serve the highest use for a two-week period in the 20-year life of the railroad. And the rest of the entire life of the railroad, it is hugely over-capacity. So if, in fact - and I don't believe it is the fact - the sidings do hold the trains, the sidings are 7,000 feet. There's 600 extra feet for the trains that Duke is running. Each one of these little points on their thing is not supported in the evidence. But the fact of the matter is, that even if there were some glitches in this model, it's not perfect. They said well, it's made for litigation. All of this stuff is made for litigation. We don't get a lot of information from them. You've got the DCF as a model, the SFGT as a model.

CHAIRMAN NOBER: Has the Board ever accepted - I mean, this was long before my time - ever accepted the String Model as an operating plan?

MR. SLOVER: With plaudits to Your Honor, we're now getting a little more vision as to what goes on, and from the best that I can determine, the Board and the parties are using this much maligned String Model in the PPL case today. And I'm able to sort of figure that out from the openness that has come during your tenure.

As I said, the model we designed to try to show that the railroad that the experts designed, and designed the operations, is feasible, but the model does not run the railroad. And I submit that a railroad that has a huge over-capacity for the entire, virtually the entire life of its 20-year cash flow is more than able to handle the operations, to handle the coal, and to handle the 90 or so trains that move on a peak day.

Mr. Moates, I guess, was troubled by our charts in the brief, and those charts were taken from evidence. As a matter of fact, I have the sources of those charts here, but they come from the cases. And the reason we didn't show as many operating costs as we showed construction costs, is the Board didn't figure them out. We only put items on that chart that the Board actually computed in the cases.

Now with this new evidence they have come in this morning to show these lines go up, not knowing what they specifically did, but guessing what they're up to, they probably took them, and they escalated them by the RCAF-U, and that way you get the cost to go up. You don't have productivity. I think the Board's own study, which was put out by the Board's Department of Economics shows that cost, coal rates, et cetera, have been either flat or trending downward, so trying to pump those costs up to make their's look more reasonable, is a new idea. Where he got his 27 mils, I have no idea. That's not in the record.

And finally, I do want to say that we did ask for the AFEs on construction. They didn't give them to us. And if Mr. Moates if of the view that they've told us how much it costs to construct and build railroads in Appalachia, and we didn't use it, that's incorrect. Thank you.

CHAIRMAN NOBER: Well, before you conclude, let me just again - - I mean, you had raised the issues in your brief about -- both about the gaming of the common carrier rate, tariff rate, whatever you want to call.

MR. SLOVER: Right.

CHAIRMAN NOBER: And about, you know, how the CSX promises in Conrail figured into this. You heard Mr. Moates' reply. What would you -- how would you respond to those?

MR. SLOVER: Well, I heard his reply, but I -- he said we never asked him how he set the rate.

We could have gotten it in discovery, wrote him a letter and asked him. He told me how he set the rate in his brief on page 8. He says, "The evidence shows that CSXT developed the rates through good-faith application of regulatory and economic principles to relevant business conditions and requirements." It doesn't mean anything to me. How you take those words and get 16 and 17 dollars a ton for 300 mile movements, I don't know. So my position is that there's not one shred of evidence in this record as to how they set these rates.

There's 700,000 pages as to why after-the-fact they look good, but they didn't have any Ramsey analysis. They didn't even have any data when they set these rates. One of their complaints is that they had to hire a whole lot of computer experts and do all this burdensome work to meet the guidelines, so Mr. Moates and I are in disagreement as to what the record shows. And our view is that there is no basis for the rates, and that's why we claim they were set to game the guidelines.

CHAIRMAN NOBER: And in your view then,

how would we take that into account? I mean, if you were telling the Board how you wanted us to take that into account, how would we do that?

MR. SLOVER: I think you have to, at least in this case, use another methodology to establish Stand-Alone costs. I don't think you can do percent reduction. If you do, I think you have to use --

CHAIRMAN NOBER: That's on the gaming part of it.

MR. SLOVER: There's evidence about what the pre-existing contract rate was. There's evidence in the record about what the going rate structure is in this territory, and it's considerably below. There's, I think, in our evidence, we've got three or four ideas as to how you could undermine what we contend is the gaming of the methodology.

CHAIRMAN NOBER: And then on the Conrail piece, your view isn't that -- how would we take that into account?

MR. SLOVER: Well, I've got my story, and I'm sticking to it.

CHAIRMAN NOBER: Which is?

MR. SLOVER: In this very room in front of the former Chairman, she said you've heard all these captive shippers come in and say you're going to put this thing on their backs if it fails, and they stated it's not going to happen. And we submit, here it is, so can we connect it up mathematically? No. But where they said revenues were going up, costs were going down, cash flow was going up, they would not have to increase captive rates, and they have a cumulative deficit in cash flow of $3 billion at the time this record was made. And they have picked out our captive traffic to get well. That's our position.

CHAIRMAN NOBER: But their argument is not that they raised it because of Conrail. What Mr. Moates said is, you got into a dispute about how you were going to bundle Marshall with the other plants, and maybe emotions got out of hand. But essentially, they set the rate because of, you know, everyone was trying to get more business out of Marshall, is what I heard. Is that --

MR. SLOVER: The story here in terms of evidence of record, there's no support that they designed this rate to somehow compensate or over-compensate for Marshall. There's no correlation. I don't understand their position on the record that these rates were set somehow because of Marshall. They were coming in for increases before they even knew that Duke was going to unbundle. They raised the rates when Marshall was part of the package. They were looking for further increases before they knew Marshall was going to be separate. So if their story now is that the 16, 17, 18 - these rates keep going up because they keep escalating them for the --

CHAIRMAN NOBER: Yeah.

MR. SLOVER: If that's their story, I don't believe it.

CHAIRMAN NOBER: But let me ask you again, how would we take it into account? What would you say to the Board, this is what I think you ought to do if you agree with me that I'm right? What would we do?

MR. SLOVER: On the --

CHAIRMAN NOBER: On the Conrail piece of it.

MR. SLOVER: I would reject the increases, hold them accountable.

CHAIRMAN NOBER: Have we ever done that? So that's not a SAC - - that wouldn't be a SAC methodology. That would just be a different equitable argument, just say no.

MR. SLOVER: Well, where the chief executive comes in and promises you he's not going to raise the rates if his numbers go bad, and his numbers go down the drain, and he raises the rates, I don't -- that's about as good as it gets. And I think you have to say we have to hold you accountable. You, the railroad, gave us these numbers. We acted on these numbers. We asked you whether you were going to raise captive rates if the numbers went bad. You say no. The numbers went bad. You've raised the --

CHAIRMAN NOBER: And you think we have the power to do that?

MR. SLOVER: I certainly do, absolutely.

CHAIRMAN NOBER: Mr. Moates, do you agree with that?

MR. MOATES: No.

MR. SLOVER: We cited --

MR. MOATES: I'd also like to point out --

CHAIRMAN NOBER: Again, I'm just trying to probe these arguments.

MR. SLOVER: We have some -- we cited cases where we believe that the conditions in Conrail can be enforced outside of the context of Conrail.

MR. MOATES: May I say just one thing on that? There was never any promise made in the Conrail record, including what esteemed counsel is saying, that CSX would never raise rates. I mean, I think you and I agree that that would be ludicrous if had been made. Mr. Snow didn't say that, and it should be noted --

CHAIRMAN NOBER: Well, I mean, you wouldn't say that either, that they could never raise rates of the captive customer.

MR. MOATES: No.

CHAIRMAN NOBER: No one would agree with that.

MR. MOATES: And, you know, they've never -- this company has never shown up at any of the Conrail oversight hearings. If they really thought there was a problem because of Conrail, I would suggest that's some place they could have gone, and they've never gone there.

MR. SLOVER: If we had shown up in Conrail, Your Honor, you know very well they would have told us -- they would have had 50 reasons why we should have brought a rate case. We thought about going on Conrail. We're paying these enormous rates. That's why we've shoved this case through. That's why we have avoided a lot of discovery we could have gotten, because at the end of the day, Duke Energy doesn't pay these rates. We're a surrogate for the light customer. They're the people that are paying the hundreds of millions of dollars that are collectively involved in these cases. And we were not about to go into the Conrail case, get met with 10 million motions, et cetera, when we should have been in a rate case. That's our answer. Thank you.

MR. MOATES: Well, could I clarify one fact point? You know, I said two different things, and I don't think we're really -- I may have misspoke slightly. This is on the AFE point. It may not be the most important, but he essentially said I didn't tell you the truth. My colleagues have reminded me, what happened was, when they asked for the AFEs in discovery, we gave them a list of all of the AFEs. They said they're in Jacksonville. You're welcome to come look at them. They decided not to do that. That was in my mind as we gave them AFEs. We gave them access. They elected not to come and see them.

CHAIRMAN NOBER: Well, again, I thank both of you very much for your presentation and bearing through my questions. I would just like to say before we close that, you know, this -- obviously, we still have three or four months before this case is going to be decided. And we're not done with our analysis, and I don't know how this case is going to come out.

I will say that from a sort of 30,000 foot level, you were at the 10,000 foot level - I guess we fly a little higher here - that there are some difficult issues that you posed. On the one hand, you know, the difficulties with the operating plan that you all have put in, that the shippers have brought on too. And also, what I would think are some unrealistic assumptions in your operating plan, and whether or not that allows us to really evaluate whether the rate is reasonable, given sort of the polar extremes of this, which at least I think at first blush, is a little more extreme than we've had in other rate cases, and that's something that's difficult for us.

But secondly, and there have been several sort of other equitable arguments raised, which I just tried to probe a little bit, because there isn't a lot of evidence on them, and I don't know what we can do with them, or what we should do with them. Nor do I know if it's even appropriate to do anything, but there are just things that have been raised and, you know, again create difficult questions. There obviously is a point at which they come into play, and then there's a point at which can we ever prove them, or can they ever be proved, and should they ever be proved? Again, they're very difficult.

But in the end, I think the one thing you both agreed on in the beginning is that this is fundamentally a commercial dispute. There was a dispute between the parties over how to negotiate for the package of plants, and it fell apart. And I know you spent a lot of money in litigation but, you know, I don't know how this case is going to come out, nor should anybody know how this case is going to come out. And litigation is never the best way to resolve this. Can you work this out?

I mean, would a period of time to negotiate or even mediate - I'll appoint a mediator for you, if you want - that would run concurrent with the case. It wouldn't delay it - would that help? Is there any chance of coming to a settlement? If the answer is no, just say so. We'll decide it. Do you want a few minutes to talk about it? We'll recess for a few minutes. I think both of your companies are here, right?

MR. SLOVER: I would --

CHAIRMAN NOBER: Do you want 15 minutes to discuss it?

MR. MOATES: We can. I don't want to be, to quote a former vice president, a nattering naybob of negativism, but I am pessimistic because many efforts preceded the filing of the case, and there have certainly been discussions, I think, at least without the lawyers during the case. But it's a good question, it's a fair question, and we ought to caucus.

CHAIRMAN NOBER: Because in the end, when you put aside the arguments, you know, it's really a commercial dispute - how are we going to bundle Marshall? How are the rates going to be done? You all did -- took actions on your behalf. You all took actions on your behalf, and here we are. But is that really how this case should be decided? If it is, we'll do it. We'll look -- you know, we'll do our best job to evaluate everything that's been said here. I think that there are some -- as I said, it's a difficult case for us, an we'll have to evaluate it.

Well, why don't we recess for 15 minutes and give you all a chance to talk.

MR. SLOVER: Thank you.

CHAIRMAN NOBER: If you need a room or need separate rooms, we'll provide them.

(Whereupon, the proceedings in the

above-entitled matter went off the record at 11:46:40 a.m. and went back on the record at 12:05:09 p.m.)

CHAIRMAN NOBER: Please come to order. Gentlemen.

MR. MOATES: If I may, Mr. Chairman, on behalf of CSX, and having conferred with the client, putting some of the people who would be involved in the kinds of efforts you're suggesting - first of all, let me say, and you make your point when you say this has been a commercial dispute - that Duke has long been and remains a very important and valued customer of CSX. You know, we all don't like these situations where lawyers get hired for the obvious reasons when you read the evidence, you say you know how we got here, and these things do happen. But Duke and CSX are going to be living together for a long, long time. They have in the past, and they're going to going forward, and we do value them as a customer. We regret we are where we are.

In that regard, I think it's important to remind you and the Staff in Section 4(b) of our opening evidence, there is a lot of explanation there of how we did get here, and about how those negotiations did go, and then ultimately, how they didn't go.

Having said that, because, you know, they are a good customer, and frankly, we do talk to them all the time about a variety of matters, everything from daily operating issues, to commercial matters, we would welcome the opportunity to meet with them again. I think what makes sense here is for the commercial people, not the lawyers, to meet and to talk about what you've suggested. And if it appears that mediation would be useful, I think we can very promptly at that point advise the Board. I think this meeting ought to take place in the fairly near future. I'm not going to try to speak at calendars of, you know, important business people who have to do that, but hopefully within weeks. And make a serious effort to sit down and kind of hopefully calmly review how we got to where we are, and see if they can't go back and pick that thread up. And if it turns out that a mediator would be helpful in that regard, I think they can advise the lawyers, and we'll advise you.

CHAIRMAN NOBER: Mr. Slover.

MR. SLOVER: Duke would join in all of those sentiments.

CHAIRMAN NOBER: Well, again, I understand the importance to the -- I appreciate that, as you know, on both of your parts. I know your companies are here, so CSX, I thank you, and Duke, I thank you.

You know, obviously, we do -- I understand the importance to the parties of getting this resolved, and the due date on this case isn't for a couple of -- three more months or so, so I don't think any of these efforts would delay the case, nor would we let it. We will continue our analysis and work toward a decision, but I think concurrent with that, if you all are able to sit down and talk, and how much is a reasonable time? Fourteen days to get back to us, is that too much, or is that enough time?

MR. SLOVER: Yes.

MR. MOATES: That's fine.

CHAIRMAN NOBER: Okay. Well, why don't we do that. Why don't you all, each side report back in 14 days whether appointing a mediator would be helpful. It would be somewhat a new procedure. I will have to figure out exactly how we would do it, but I think we'll manage that. And if you both -- and I don't think we would try -- I wouldn't try to do this over your objections. But if you take 14 days to talk about it and think it would be helpful, we will do what we can to facilitate that, so I appreciate both of your cooperation and all of your time, and energy, and effort in putting together the very, very informative presentations today. So thank you all very much, and the meeting stands adjourned.

MR. SLOVER: Thank you.

MR. MOATES: Thank you.

(Whereupon, the proceedings in the above-entitled matter went off the record at 12:08:26 p.m.)

CERTIFICATE

This is to certify that the foregoing transcript in the matter of: STB Docket No. 42070

Before: Surface Transportation Board

Date: September 10, 2003

Place: Washington, DC

represents the full and complete proceedings of the aforementioned matter, as reported and reduced to typewriting.