UNITED STATES OF AMERICA

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SURFACE TRANSPORTATION BOARD

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HEARING

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CAROLINA POWER & LIGHT COMPANY,

Complainant,

v

NORFOLK SOUTHERN RAILWAY COMPANY

STB Docket No. 42072

Room 760
Mercury Building
1925 K Street, N.W.
Washington, D.C. 20423

Wednesday,
November 19, 2003

The above-entitled matter came on for hearing pursuant to notice at 10:00 a.m., Roger Nober, Chairman, presiding.

BEFORE:

THE HONORABLE ROGER NOBER, Chairman

APPEARANCES:

On Behalf of the Complainant:

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10:04 a.m.

CHAIRMAN NOBER: There's no need to rise. I apologize for being late. Good morning everyone and thanks for coming. Today we're holding our agency's second oral argument in a large maximum rate case. As many of you know - and I know all the parties here and many of the lawyers were part of our first oral argument which was held in September in the case of Duke Energy versus CSX and we found that argument to be particularly productive.

Now, on the one hand, it confirmed that we properly understood the evidence in certain areas and on the other led us to go back and take a second look at evidence that we thought we understood. In both circumstances, the oral argument allowed our agency to engage in a dialogue with the parties to the case and to ultimately better understand the record in these large and difficult cases.

I also look at that oral argument in conjunction with other recent Board innovations such as the technical conferences which resulted in all technical issues being resolved and the recent discovery conference that we had where all outstanding discovery issues were resolved. The commonality to all of these is that greater involvement by the Board staff with the parties earlier in the case helps us produce a better record and better understand the case.

So as a result, the parties should expect that during my chairmanship there will be more and greater involvement with the Board staff in all rate cases including pending ones. Both in the evidentiary, in the decisional, and the discovery phases will have Board influence and this will increase.

However, while these changes have improved the Board's analysis of these cases, I think we all should recognize it's still not perfect. Just yesterday, the complaining party in the Duke vs NS Case filed the motion for the Board to correct several of what it alleges were technical errors in our recent decision as well as a motion to stay that decision while we review it.

We are currently studying the matters raised in that motion. I just want to assure the parties that if we find there's merit to them we will grant it and review that. It's currently under review. We just got it yesterday afternoon. We are currently looking at it.

Prior to today's argument, I asked the parties to focus on a few core concerns in this case. We heard your admonition last time to try to get you that in advance. So we were able to get that to you on Friday. Hopefully you are able to address these at the hearing today. For the sake of everyone else, let me just identify what those were.

First and most importantly, we asked you to look at whether and to what extent factual issues regarding operating expenses and road property investment in this case should be determined differently from that in Duke vs. NS. Now, I would note that of the issues raised in Duke's motion those were computational and not decisional. They all acknowledge that the Board would make calls in certain ways, but the allegations in that motion are that we simply computed them incorrectly and we will look at that.

Second and to what extent the proposed rerouting of traffic in this case should be permitted in light of our recent decision on setting out standards for rerouting of traffic. Third - and this is something that we spent a lot of time on in the last oral argument - whether and to what extent the operating plans submitted by each party is feasible. Finally, whether the Board should alter its current rate reduction methodology.

Of course, such a discussion would be hypothetical and dependant upon whether the Board finds the challenge rates in this case unreasonable or not. Now, I understand the parties may also raise issues regarding the proper indexing methodology, technically known as the difference between the RCAF-A and the RCAF-U as well as other issues regarding the proper methodology to credit revenue for crossover traffic and of course any other issues that all of you may like to mention.

Procedurally we have given each side 45 minutes. I understand that CP&L will go first and that they are going to reserve some of their time for rebuttal. Again, I will thank you all for being here and look forward to the presentations today. With that, I would just like to note one or two other things.

First, hopefully this is the last argument or matter of any kind that I will have to do by myself. As many of you know, the President nominated two new Board Members just this week. I am hopeful that their nominations will be quickly reviewed and confirmed with any luck before Congress leaves for the session but if not very quickly after they come back. So hopefully when we convene next for our next matter we will have a full Board. I am very cautiously optimistic that's the case.

Secondly, we are working on revising our website. So hopefully by the time we do our next public meeting we'll be able to have the audio for that picked up on our website and streaming audio will be available. For those of you who don't necessarily feel like trudging to the hearing room or are out of town or for whatever reason don't want to come but want to listen to the argument, we will from then on in be able to have them available to everybody over the web.

Not that I don't enjoy seeing folks here, but hopefully those two innovations will make it. They will change the complexion of the arguments here and certainly make it easier to listen to the extent folks want to. With that, again I thank you all for coming and look forward to the presentations for today. Mr. Loftus, are you first?

MR. LOFTUS: I am, Mr. Chairman.

CHAIRMAN NOBER: Please, stand or sit, whatever your preference is.

MR. LOFTUS: I will sit.

CHAIRMAN NOBER: Great.

MR. LOFTUS: Good morning, Chairman Nober and assembled staff. Carolina Power & Light Company welcomes the opportunity to present argument to the Board in this matter. We also appreciate the Board's action in rescheduling this argument until this date. We have of course reviewed in great detail the decision the Board issued recently in the Duke Case.

We want to emphasize at the outset that this is a different case in many respects than the Duke Case. The route miles, for example, of the stand alone railroad you had there were 1,100 miles versus 800 here, track miles 1,300 versus 900, peak year tons were about seven or eight million tons different. There are numerous other differences both factually and in the nature of the evidence presented. We're going to touch upon a number of those as we proceed.

We have reviewed the Board's decision of Friday. I have here in my outline all of the subjects the Board addressed in that decision. Time permitting I will get to all of them. I want to take a moment at the outset to emphasize the extremely high level of the rates that the Board is looking at in this case, the rates for the movement from Central Appalachian origins to the Roxboro and Mayo plants of Carolina Power & Light roughly eight million tons a year.

By CP&L's calculations, those rates range from 370 percent to 525 percent of variable costs. Even by Norfolk Southern's numbers, they range in the 230 to low 400s with many above 350. These rates represent major uniform dollar amount increases on every rate that was involved in what we would call an arbitrary number approximating a 50 percent increase on average on the rates you are dealing with.

We think another very significant reflection of how high these rates are is evidence that CP&L submitted where we ran the revenue to variable cost ratios for all of the other captive coal traffic on the Piedmont Railroad, stand alone railroad in this case, with the exception of the CP&L traffic and the Duke traffic. The revenue to variable cost ratios, the average for all of that other captive traffic is not in the same universe as the rates that are before you in this case.

If you look at that evidence, it's all highly confidential but you will see what we think is a staggering differential. Most importantly of course, we believe the rates exceed the stand alone costs. It's to that subject I now turn.

CHAIRMAN NOBER: Let me just ask one question on that score. The prior rates that you are comparing it to, those are contract rates?

MR. LOFTUS: Yes, sir.

CHAIRMAN NOBER: Were those individual rates for the captive plants, or were those part of a larger bundle?

MR. LOFTUS: They were rates for the captive plants. They were contained in a contract that included rates for other plants.

CHAIRMAN NOBER: Were those captive or competitive plants?

MR. LOFTUS: It included rates for competitive plants.

CHAIRMAN NOBER: So is that a fair comparison to look at individual rates for captive plants on their own versus a bundled contract for a mix of captive and competitive plants?

MR. LOFTUS: We addressed the impact of bundling or debundling in detail in our evidence. We demonstrated that first of all for about 15 years there was no bundling. The first bundling occurred in 1997. It continued that way from then until 2002 when these rates took effect.

If you go back and look at the relationship of the captive plant rates to the competitive plant rates that existed during those earlier time periods and you say let's establish the same relationship today between the competitive plant rates and the rates for Roxboro and Mayo, you would have to reduce these rates by five or six dollars a ton. So if you want to go with a bundled relationship, we would be delighted to see that.

CHAIRMAN NOBER: Well, I guess the point I'm getting at is in the end we look at the rates independently. To what relevance is the fact that there may have been a prior bundled contract rate?

MR. LOFTUS: I don't think it's --

CHAIRMAN NOBER: Why is that? What's the relevance to us for that?

MR. LOFTUS: I don't see any relevance. But to the extent someone does, the bundled relationship would dictate vastly lower rates than the NS has established that are under challenge in this case.

CHAIRMAN NOBER: Go ahead.

MR. LOFTUS: The operating plan is something I want to devote a fair amount of attention to. I'm going to go directly into that. I know the Board and the staff have done a lot of review and analysis of the record so I'm not going to get into the parties and the negotiation background and all of that.

Consistent with the stand alone least cost most efficient concept, the Piedmont Railroad operating plan is designed to serve trainload traffic moving from trainload capable mine origins to trainload capable destinations or interchanges with the Norfolk Southern. Now, NS has a gathering system that serves the Appalachian coal fields.

We have included on the Piedmont Railroad only about a third of the mines that NS serves, all of which are trainload loading capable. We believe it is reasonable to assume that coal producers with those types of loading facilities will want to load trainloads.

CHAIRMAN NOBER: But do all of the parties that are buying the coal want trainload shipments? Isn't the evidence to the contrary?

MR. LOFTUS: What we have in evidence in this case is some conclusory statements by NS about what customer requirements may be. We have testimony from not a single receiver of coal indicating that they would have any problem receiving coal in the manner that we propose to deliver it. I might add that the delivery end is another question.

At the delivery end, we have eight online destinations on our railroad. Seven of those are trainload destinations. They take trainload coal. The eighth takes split deliveries and our operations accommodate that. For the deliveries on the residual NS, the NS can deliver that coal as it deems fit.

But that doesn't mean that it cannot move out of the origin mine areas assembled into trainloads. That is what we have positive. We think it is reasonable to assume that receivers will be interested in receiving that service. I would like to point out to the Board that --

CHAIRMAN NOBER: Well, there are two issues that come to the trainload. One is how do they materialize. NS has alleged that the trains don't get put together and that you just have them all being posited as being loaded in trainloads. But do customers take trainloads of coal from one mine or do they take a mix of coal from different mines?

MR. LOFTUS: The record before you would show that the coal moves from the mines in trainload. That is why you have this phenomenon which has been commented upon in the Duke Case of multiple car shipments assembled into a trainload, some of those leaving on the same day but at different times but perhaps even on different days.

The Board expressed concern about different mines moving different volumes or different receivers. The fact is you are dealing there with a peak period from a base year. The base year is not in the DCF period. The base year basically dictates what your volumes are. We know that the base year that we're dealing with here, 2001, was an anomalous year in terms of purchasing patterns. In fact, NS testified and I quote --

CHAIRMAN NOBER: Well, that would go to volume not to the mix. Doesn't every power plant take a different mix of coal from different mines to create the chemistry that they want not a trainload from one particular mine?

MR. LOFTUS: There's nothing in this record, Chairman Nober, to establish that. I would say that is not, as a general proposition, the case.

CHAIRMAN NOBER: I guess what we have in the record is you have asserted that it's okay and NS has asserted that it isn't, right?

MR. LOFTUS: That's correct.

CHAIRMAN NOBER: That would be the summary of how the evidence has gone on that subject.

MR. LOFTUS: Yes, that would be a very broad summary.

CHAIRMAN NOBER: Go ahead.

MR. LOFTUS: If I might continue that quote from NS, they said "Because unusually tight market conditions existed during 2001, many shippers sourced coal from origin mines they typically do not use." Now, 2001 is the year we got the traffic tapes for, but we do not understand the Board's decision in prior cases to require that the operations here mimic in every respect what happened in a base year.

The NS doesn't even forecast with a few isolated exceptions what its traffic is going to be in the future by individual mine. They forecast by origin clusters. That is because they expect a certain amount of move from groups of mines not necessarily from any specific origin. We think that the methodology CP&L employed here is consistent with that.

CHAIRMAN NOBER: Can you point to a prior case of our last nine rate cases where the Board has accepted that kind of assertion?

MR. LOFTUS: Accepted the assertion that you did not have to mimic in every detail --

CHAIRMAN NOBER: Not in every detail but even in the sort of broad parameters of how they operate and meeting customer needs, where we have accepted such a deviation from current operations. If there is one that you can point us to, I would be happy to go back and look at it. I'm not aware that there is though.

MR. LOFTUS: No, I'm not suggesting that. What I'm suggesting is that the Board's decisions do not require adherence to all of the details of the base year.

CHAIRMAN NOBER: Of course not. Nor should you have to.

MR. LOFTUS: But the only thing we know is in these subsequent years it will not move exactly as it did in the base year in reality or in the stand alone world.

CHAIRMAN NOBER: But it's one thing to say that, that it doesn't have to be a photograph. It can be a painting or even an impressionist painting, but it can't be an abstract one either.

MR. LOFTUS: Well, let me move forward if I may.

CHAIRMAN NOBER: Please.

MR. LOFTUS: We would like to point out if you look at the revenue tapes that were provided in discovery in this case you will find that all of the traffic we're dealing with has been coded as UT which means unit train traffic. They also have a separate code for MC which stands for multiple car traffic. The only exception to what I have just said is traffic moving to Lambert's Point which for reasons not clear to us NS has coded as

LC or lead car. They do not give a unit train or a multiple car designation to it. With that exception, all of the other traffic is coded as UT, unit train traffic, which is how we treated it.

The Board expressed concern about the different tonnages. Over an annual period, each origin will move the exact amount of tonnage forecasted based on the base year and the forecasting. The same is true with regard to destinations. Each destination will receive the base year tonage as adjusted by the forecasting.

With regard to CP&L String Diagram, there has been a lot of evidence about that. I'm not going to spend a lot of time on it. But I do want to say that the model was submitted in full to the Board along with all of the inputs. The Board can manipulate it. So could NS as they took full advantage of it.

There were a number of glitches. Many were corrected. A few remain. But like every computer assisted dispatch system in operation, you have to recognize a human oversight and override capacity which is commonplace for all of the railroads.

We also think that the Board has to consider this fact. We believe that it is likely you will disallow over nine million tons of our traffic group on the basis of rerouting based upon what you did in Duke. That tonage in combination with three million tons differential in the traffic group we posited between opening and rebuttal, there was a double count of some tonage on opening because of confusion about the records that NS provided.

But if you add that up, you are looking at at least 12 million tons coming out of the traffic group which releases any pressure that might be on the capacity. You are dealing with a lot smaller traffic group.

CHAIRMAN NOBER: Do you want to go back to the rerouting later? Do you have more to say about that?

MR. LOFTUS: I don't have a lot more to say about that. No, I don't.

CHAIRMAN NOBER: Because in your case, we set a rule saying that if the distance is shorter we would presume it to be acceptable but if it was longer you would have to come up with some reasons why we should accept it. Now you have some particularly big moves that are pretty close. They are within 40 or 50 miles or something like that.

MR. LOFTUS: We do.

CHAIRMAN NOBER: You are just asserting that those are not --

MR. LOFTUS: No, what we intend to do based on your rulings in Duke is we do intend to assert that there are a number of volumes that should be included. Some are shorter. Some are extremely close in the neighborhood of six miles.

CHAIRMAN NOBER: Yes, I think that there is one six mile.

MR. LOFTUS: Right, and that one we clearly believe should be included. We would note that there's a traditional ability of the originating carrier to get the longer haul where it's between it an the connecting carrier which we think should come into play. But there are some others. We're just saying there's going to be some significant tonage knocked out.

CHAIRMAN NOBER: Regardless.

MR. LOFTUS: When you look at that and you look at the capacity, we think there's ample capacity demonstrated for the tonage moving over the system. I'd like to turn to what NS did with its operating plan. We have provided to the Board a few counsel's exhibits. I'd like to refer to the first one.

CHAIRMAN NOBER: Is that these?

MR. LOFTUS: Yes, sir. I did have a big blow up of this, but then I realized there was highly confidential information on it so we're dealing with it this way. I don't want to spend a lot of time on this because time is precious here. But what I want to explain is that the manner in which NS calculated the movement of less than trainload shipments for mine origins to gathering yards, if you look at line 3B, they established what the average cars per train would be for less than trainload movements.

Based upon that and the tons per car in line 4, they determined the number of tons per less than trainload movement. If you go to line 6, you see in A they have the number of trains moving in trainloads. Then they have the number of trains moving in less than trainload. What that means is they are treating each of these less than trainload movements as a separate train moving from the origin to the destination.

In other words, rather than having a train go out from the gathering yard and stop at several mines and drop off empty cars and pick up loaded cars and go back, in this example you see in 8, round-trip distance is 80 miles from the origin to the destination. They have from each of these origins less than trainload movements moving from the origin to the destination as a train with its own locomotive consist.

Now, that is obviously not a least cost most efficient mode of operation. It is manifestly not as efficient as the existing operations that are in place. And we would suggest it doesn't adhere as well as ours does to the reality of how coal moves from the origin mines to the gathering yards.

CHAIRMAN NOBER: So this is for the one percent of trains that they have moving as less than trainload.

MR. LOFTUS: From this --

CHAIRMAN NOBER: That's line 2B.

MR. LOFTUS: That's from this origin.

CHAIRMAN NOBER: From this origin.

MR. LOFTUS: I might add that is even suspect. If you look at 99 percent of the traffic moves in trainload, you have to wonder whether there's some statistical glitch there and whether it's really one percent moves in less than trainload. But assuming for this one, as you go through the spreadsheet that's listed in note one, you go to that spreadsheet and look at it and for each origin it will show a column where this information appears.

If you go through that column, you will find approximately 2,400 less than trainload shipments. They average somewhere in the vicinity of 30 cars a shipment. So what this generates is a very serious overstatement of locomotive lease, locomotive maintenance, locomotive fuel, locomotive servicing expenses.

CHAIRMAN NOBER: How serious could it be if it's only one percent of the trains coming out of the mines?

MR. LOFTUS: That's only one origin.

CHAIRMAN NOBER: So there's more or less at others.

MR. LOFTUS: This is just a single example, yes. Out of other origins you may find a much higher percentage of less than trainload. Overall, I believe the less than trainload traffic amounts to approximately ten million tons of traffic. I think that may be a little low.

The Board was concerned about the manner in which shipments left the mines in the Duke Case. The next example I have for you, Counsel's Exhibit 2, demonstrates that because NS uses a mathematical, formulaic method of determining the operation between the mines and the gathering yards they have trains leaving at different times. They have trains leaving at different days.

Now, these are trainload shipments we're talking about. Every trainload shipment on CP&L's model departs at the actual departure time. NS has trainloads leaving at different dates and different times because of their mathematical model which the Board has rejected in a couple of prior cases.

NS did not submit its RDCAM model into evidence. As a result, neither CP&L nor the Board can fly spec it the way ours has been. We would also say we do not believe the Board can accept it under applicable law as valid probative evidence where they have withheld the program from you. Even if the Board were to accept NS's operating plan, we would argue it should not accept the inputs to that plan.

Many of them are clearly unreasonable. Crew change times is one example. You can go through those inputs. You can change them. You can change the cycle time that comes out of that program which flows into their traffic characteristics.

CHAIRMAN NOBER: Now, as I understand - and I'm not positive that I do - the way NS put their model in, they said you all were positing trainload movements for as many trains as possible which is virtually all of them. So they tried to model what would the operations then need to be in order to move trainloads. Is that right or am I mistaken on that?

MR. LOFTUS: It seems to me you are mistaken because for example at Devon Yard they added 15 tracks for the gathering. They provided for a gathering operation. They did not move trainloads from the mines as we did.

One other thing I would say if the Board does accept NS's operating plan - and we don't believe you should - that you not accept the roadway investment that they have asserted. One example is on the gathering operation only Kenova, Devon, and Elmore Yards are impacted. They had another 11 tracks at Bluefield, West Roanoke, and Vabrook that are not impacted by the gathering and that are not necessary.

CHAIRMAN NOBER: In Duke vs. NS, we did not accept all of that road property investment, did we?

MR. LOFTUS: I understand, but I believe you did accept the investment of this nature. We're suggesting that you should not. I'd like to turn to indexing.

CHAIRMAN NOBER: Why do you think we should not in this case?

MR. LOFTUS: Because if you accept their operating plan, you should not accept wholesale the associated roadway investments and operating expenses that they have asserted. You should scrutinize each of those separately.

CHAIRMAN NOBER: What should we do differently than we did in Duke vs. NS on that because that's exactly the question that we posed? What road property investment did we accept that we shouldn't accept categorically? Obviously their train operations are different here.

MR. LOFTUS: If I may, I have that a little later in my outline.

CHAIRMAN NOBER: Sure.

MR. LOFTUS: I would like to get to indexing. In Duke, the Board decided to index operating expenses with the RCAF-U. On the record in this case, we believe you should find the operating expenses should be adjusted by the RCAF-A. The reason is that the evidence demonstrates that the Piedmont Railroad will enjoy the benefits of improvements in technology over the 20 year DCF period.

CHAIRMAN NOBER: Okay. Now, the allegation here is that you are a brand new railroad buying all new equipment, right? So you have the latest technology presumably for your operating plan on day one. So what technological innovations would you get over 20 years that you wouldn't have now?

MR. LOFTUS: Okay. I would like to address that. First, I would like to point out that the Board did say in Wisconsin Power & Light "It is not unreasonable to expect that an efficient railroad built today would realize future productivity gains by utilizing new technology as it is developed."

Now, in this case, we have as Counsel's Exhibit 3 some references to the evidence of record in this case. *(disk skip 10:37:39) for a contractor that provides a transportation management system. The materials record explain that the contractor continuously improves and enhances that transportation system on an ongoing basis. It has examples of current upgrades, current enhancements that are in the works.

The IT hardware is replaced every five years. Piedmont Railroad's locomotive fleet is all leased. Those leases are premised on a 12 year term. Those locomotives will be replaced within that period with all new locomotives with all the new bells and whistles and productivity enhancements available as a result of that.

CHAIRMAN NOBER: You have gotten some of those. For example, distributed power is something that the NS doesn't do that is assumed as part of your railroad, right?

MR. LOFTUS: That is correct.

CHAIRMAN NOBER: So some of those are already embedded in. Some you are just positing might happen.

MR. LOFTUS: No, not might, will.

CHAIRMAN NOBER: Does the RCAF-A take only technology or does it also look at labor productivity?

MR. LOFTUS: The RCAF-A is a total factor productivity index I believe.

CHAIRMAN NOBER: So for example if the FRA allowed remote control yards, would you be able to get productivity gains from that do you think?

MR. LOFTUS: Yes.

CHAIRMAN NOBER: Or if they change the number of crew for example.

MR. LOFTUS: Yes.

CHAIRMAN NOBER: You are saying by going with the RCAF-U you don't get to capture that.

MR. LOFTUS: That's correct. One other point, Chairman Nober, is for adjusting revenues, operating revenues --

CHAIRMAN NOBER: I still like to say we, but yes it was me.

MR. LOFTUS: I meant --

CHAIRMAN NOBER: Go ahead.

MR. LOFTUS: I didn't mean you. I meant the Board. The Board decided to adjust operating revenues on the basis of an EIA forecast. We give you a record cite in this exhibit 3 at which EIA explains that is a measure that adjusts for real productivity impacts on railroads.

CHAIRMAN NOBER: If we went to the RCAF-A, given the fact that you have a brand new railroad and all brand new equipment, that would probably overstate productivity. But if you went to an RCAF-U and said no productivity increases, that might understate it because you wouldn't get any labor productivity for example.

So what would we do then if one overstates it and one understates it? Let's say I was sympathetic to your concern about going plainly to the RCAF-U. But going to the RCAF-A would overstate your productivity gains because you do have a brand new railroad and we would need to take account of that. How should we handle that then, other than having to choose one or the other?

MR. LOFTUS: As an advocate, I would say you should go with what you have done before in earlier decisions where you have recognized based on the evidence of record that there is reason to believe there will be productivity gains and you should go with the A. It sounds like where you are heading is some sort of a split. I imagine that you could devise something of that nature.

CHAIRMAN NOBER: Would that be fair to do that?

MR. LOFTUS: Well, let me ask you to look at our exhibit number 4 in trying to respond to that. The problem that you have by adjusting operating revenues by something that reflects the impact of productivity and adjusting expenses with something that doesn't is you get this huge separation. You see the black line here is the project of the RCAF-U.

We used our projection not NS's because they are highly confidential. We plotted out here what the EIA thing does. Now, what you do is where you have that sort of a disparity you create a death spiral for the stand alone railroad. In Duke, for example, in every year from 2005 to 2021, operating expenses are going up significantly more than operating revenues.

CHAIRMAN NOBER: That's true that operating costs continue to go up and coal demand is forecast to be flatter. That is a fair point that you raise that you see in every case not just this one. The costs of operating a railroad continue to get higher but the demand for coal seems to be flatter and in NS's case goes down.

The reality of moving Central Appalachian coal is that it goes down but the cost of running that doesn't go down. How do we fix that as a model? It's always going to cost more to run a railroad over time. Coal demand just isn't forecast to go up by that much.

MR. LOFTUS: But Mr. Chairman, growth and volume is not the only driver of productivity gains.

CHAIRMAN NOBER: Sure.

MR. LOFTUS: There are many other drivers of productivity.

CHAIRMAN NOBER: Well, I see your chart with the RCAF-U. What would it look like with the RCAF-A?

MR. LOFTUS: I'm sorry I don't have that plotted here. I think it would be much more in line with what the operating revenues are doing. The answer is I don't know because I don't have it plotted but I believe it would be much closer.

CHAIRMAN NOBER: So it would be closer to meeting operations. Whether or not the adjustment - we'll deal with that separately - but the fundamental point you raise is that's just a fundamental fact of looking at transporting coal. The cost of doing it goes up and the amount being transported stays relatively flat.

MR. LOFTUS: Well, that doesn't mean --

CHAIRMAN NOBER: You can't generate productivity gains. I understand.

MR. LOFTUS: And it doesn't mean that the rates can't go up either. What you are doing is you are saying what's going to happen to volume. You project it. The question is what's going to happen to rates. You project that as well. If you project that the rates are going to go down, that's illogical with the expenses going up. You ought to assume that the rates are going to go up more or less in line with the expenses in that model.

On rate property investment, Mr. Chairman, we think that there are a number of specific areas where the Board should do something different. I mention specifically on R tracks. We think that should be different. I'm not sure what's happened to our time. I just looked at my watch.

CHAIRMAN NOBER: How are they doing on time?

PARTICIPANT: One minute 59 seconds.

CHAIRMAN NOBER: You have two minutes.

MR. LOFTUS: Let me hit a couple really quickly. On culverts in lieu of bridges, we think that the Board should not accept the bridges that NS posits in lieu of culverts because they accept culverts generally and they did not explain why bridges wouldn't work in the instances where they substituted them.

On retaining wall quantities based on road bed width, we think that the Board should look carefully at the evidence we have submitted there, at the factors that would impact that, and upon consideration of evidence should not accept NS's numbers. In Duke, the Board accepted the shipper's tie spacing on curves over six degrees but accepted NS's mark up of 15 percent on construction costs.

CHAIRMAN NOBER: Go ahead and finish if you have another minute or two.

MR. LOFTUS: Just one more point. On what I was just saying, the tie spacing, here the Board should accept both the tie spacing and the cost based on that tie spacing and should reject the NS's mark up. Finally on NS's bridge unit costs, if the Board doesn't accept anything else, we think it should accept CP&L's unit cost for concrete based on an actual job bid set forth at volume six page 02916. Thank you, Mr. Chairman.

CHAIRMAN NOBER: Just one thing on tunnels because you have different views on the cost of those tunnels, right?

MR. LOFTUS: We do, very different.

CHAIRMAN NOBER: Even though you are basing it on the same Board estimate back in 1982, is it?

MR. LOFTUS: You got me. I don't remember.

CHAIRMAN NOBER: I think so. You could come up with significantly different based on indexing. Now, indexing I know is a big issue in this case. How have we gotten to a point where there's a very large difference on bridges when the base number both parties agree on is the same and it's just the method of inflating it?

MR. LOFTUS: When you say "both parties agree," you are talking about the number of bridges.

CHAIRMAN NOBER: They agree on the base year of costs for bridges in the east, is that right?

MR. LOFTUS: I'm not certain that is right. I have to double check.

CHAIRMAN NOBER: Okay.

MR. MOATES: I think you said tunnels, Mr. Chairman, and then switched to bridges.

CHAIRMAN NOBER: I'm sorry, tunnels, yes. I'm losing my mind here. Tunnels, is that correct?

MR. LOFTUS: I think that is correct.

CHAIRMAN NOBER: I'm sorry. I confused everybody including myself.

MR. LOFTUS: On that note, I would like to move over so that Mr. Moates can --

CHAIRMAN NOBER: You can stay where you are. You don't need to move. He has a microphone right there.

MR. MOATES: I would like for you to be able to see me.

CHAIRMAN NOBER: I can see you wherever you sit.

MR. MOATES: Thank you, Mr. Chairman, Paul Moates for Norfolk Southern. We also welcome very much the opportunity to be able to appear this morning and to have an opportunity to discuss a number of very important matters in this case. We also thank the Board for its very hard work. I know the Board has an awful lot of these cases on its plate. Its efforts are appreciated.

Now, I'm tempted to launch right in to respond to some of the things that you and Mr. Loftus just talked about. Maybe I will on one or two of them, but I actually have a planned presentation that if I can I would like to adhere to because I have a mere 37 of these Power Point slides I would like to get up and show you because I think they are helpful. All of them with maybe one exception or two exceptions touch on what we just talked about.

If it helps, let me just make a general observation. I'm going to give you more specifics here. This whole business about whether the operating plan works or whether it doesn't or whether we put in too many yard tracks at Devon and we goldplated the stand alone railroad, the answer is an emphatic no.The problem is very simply stated. The operating plan that CP&L has proposed is completely infeasible. It bears no relationship to the actual way the traffic moves. You were onto that with Mr. Loftus, and I'm going to give you some specific examples of that.

CHAIRMAN NOBER: Well, he alleged though that in designing the operating plan for moving this that you designed it in a way that's above and beyond your current operations.

MR. MOATES: That's absolutely not true.

CHAIRMAN NOBER: Why do you think it's not true?

MR. MOATES: I can show you a slide like I did last time, if you want to see it, of the relative mills per ten mile operating costs. They are much lower on P&SH as we designed it, not designed it, but as we put it in an operating plan for it. It will demonstrate that the amount of investment in major areas like Devon to Bluefield is much less on the P&SH in our evidence than it is on the real world NS.

The train operating speeds on segments like that are higher than they are in the real NS. We did not replicate that. Did we put in more yard tracks at a place like Devon? Yes, we did. We have five gathering yards in these coal fields. They said they would have one at Devon and they didn't put just a few tracks into it.

Because of the fact that they claim they can run a DP run unit train under retipple (PH) and load it in under four hours and be gone, we know in the real world that's absolutely impossible. I'll show you why. A lot of shippers can't do that. A lot of shippers don't want to do that. Traffic doesn't come out in that way.

They have to have a facility somewhere to gather these less than unit train consignments of cars together and put them into what they call trainload or unit train movements. That is the most efficient way to do it given what they claim to be the selected traffic participants of their railroad.

Let me try to take a step back. I'm going to try to be coherent here. I'm tempted again to jump into all of these things that he talked about. If I don't get to them in my presentation here, I will try to wrap them up.

CHAIRMAN NOBER: Please be sure that you do.

MR. MOATES: I will. This morning I am going to try to give you some specific points illustrated as I said with a number of exhibits to make clear that their SAC evidence is really truly flawed. It really is. It fails in fundamental respects to carry the minimal burden of proof your regulations require.

Mr. Chairman, I'm not making this as a technical argument where you expect the lawyer get up and say failure of proof and throw the case out. These are truly profound failures of proof in all three essential areas of the SAC. It's the traffic and revenues, the construction, and the operating.

They purport to have designed and constructed an efficient all unit train railroad, but nearly one-fifth of that railroad's traffic is demonstrably not unit train in the real world, nearly a fifth, about 18 percent. It proposed on opening that approximately one-half of the traffic on its railroad would be hauled by DP equipped locomotives, which as you observed NS does not have, in run-through service with NS.

But then they come back on rebuttal and change the proposal. They now claim that 98 percent of the P&SH traffic would move in DP equipped unit trains. They also configured their railroad and developed their operating plan using this hopelessly defective String Diagram Model. I do have slides on that. I will try not to dwell on it, but I do think since Mr. Loftus tried to resuscitate it this morning that I have to say a few words about it.

It doesn't work. It is not a real world operating model. At one point, he talked about it as being "like every computer generated dispatch system used to dispatch trains." That thing has never dispatched a train and it never will. It's a creature of a consultant's --

CHAIRMAN NOBER: He alleged though that if you knock out the crossover traffic, all the tonnage for that, that there would be enough capacity and not have the accidents and things that you posited.

MR. MOATES: All right. Let's address that one. First of all, it's the rerouted traffic. I'm surprised to hear him say nine million tons. I think that's a little more than we had identified, but we're all going to have final evidence of that on Monday. The point is that rerouted traffic is all going to be rerouted only between Iaegr, I-A-E-G-R, West Virginia and the Bluefield segment.

Our supplemental evidence will make it clear that's the only segment affected by the rerouting. There would be sound adjustment to the investment on that segment. What about the whole rest of the stand alone railroad?

Frankly, I think that was a very glib assertion. The fact that there's going to be some change of volumes on one specific segment does not in any way undercut our showing of all of the additional investment needed everywhere else on this stand alone railroad. We're going from a piece here to the whole railroad.

This point of they are changing their operating plans so it's all going to be all run by DP locomotives, they used the String Diagram Model. But what they have done is created an operating plan and associated track configuration that are not designed for the correct number of trains needed to handle the real world patterns of the customers whose traffic they selected. That's critical.

That operating plan will not handle the number of trains that they actually have to have to handle the traffic that is specified. Because the number of trains is wrong, very wrong, their evidence by definition doesn't address the issue of whether the P&SH or the Piedmont, as Mr. Loftus calls it, could handle the correct number and size of trains actually needed on the physical plan they proposed.

It's that assertion that it would not need to construct any gathering yards or facilities to consolidate cars and build trains is wholly unsupported. Again, I will show you that in a minute. It's locomotive car and crew counts are all wrong because they are based on the operation of too few trains in the Spring Diagram Model.

In addition, as I will show you shortly, Mr. Chairman, they just like Duke completely changed their construction proposal for the SAR on rebuttal improperly denying Norfolk Southern the opportunity to file evidence that would show the infeasibility and the correct costs of that new proposal. While they give lip service to standing by their opening proposal, check their evidence. In rebuttal, they used the unit costs from their rebuttal construction proposal in their final DCF.

So they say we're going to stand by our opening proposal, but they don't use those costs. Finally, also in the area of traffic and revenues, they projected that they would garner - and this is really amazing to me - tonnage and associated revenues from a variety of sources other than the actual traffic in NS's real world traffic base by claiming that the stand alone railroad would cut rates thereby attracting new business even in the face of objective evidence.

CHAIRMAN NOBER: Did we accept that in the last case? I think one of the questions posed to you was how would this differ. I hope your presentation addresses the four questions we asked about, what we should keep or not keep from the last case, rather than to repeat what we did there because I know what we did there.

MR. MOATES: Okay. But you really have to understand - and I have a slide here for you that I will put up right now - that they have any number of assumptions in this case based on rate cuts. It's number four. There are some of the things that they say disappear because they are assuming there are going to be rate cuts in the stand alone railroad.

They saw shippers are going to ship from the actual origins on the NS to other origins they didn't ship from because they'll do it to get lower rates. They say they are not going to lose market share of foreign coal which our evidence shows we are losing because they are going to cut rates. They say that our course of business traffic projections understate volumes because they are going to attract traffic that doesn't move today because of rate cuts. And on and on and on.

They even say that shippers will accept more sequitous (PH) routes and they will agree to modify train lengths. Why? Rate cuts. Well, that's completely inconsistent with the SAC theory. We're here to test whether Norfolk Southern's existing real world rates are higher than a reasonable maximum. To hypothesize that the stand alone is going to cut those rates as a way to solve a whole variety of problems is inconsistent with the SAC theory.

More to the point, Mr. Chairman, if they are going to even try to convince you that under SAC theory they can do that, you would think they would lower the revenues in the stand alone projection, right? If the rates are going down, then the revenues must go down. Guess what? Not one single dollar of lower revenues.

CHAIRMAN NOBER: In the traffic groups in the last case, did we accept any revenue based on any of these assertions? Did we accept any of the traffic group that you are positing here we shouldn't accept?

MR. MOATES: I'm not sure it's quite the same in this case.

CHAIRMAN NOBER: If this is different, then that's --

MR. MOATES: The rate cutting here is much more pervasive. They cited as a reason to allow many more things I think than Duke did frankly. That's why I'm trying to highlight it. Now, you asked me about the four questions in your order. I'm going to address those. The four questions of last Friday, I'm going to deal with them as I go through my presentation. If you want me to, I will try to give you a real thumbnail answer to all four of them.

CHAIRMAN NOBER: No, go ahead with your presentation.

MR. MOATES: You have an idea where I'm going anyway. The first one was what you just said. Where should things be decided differently based on the facts of this case and the construction and operating areas? We believe the Board got many of the issues in these two important categories correct in Duke, but we respectfully submit that you may have misunderstood the evidence in several important respects.

With your forbearance, I'm going to ask you to look at those again here with me this morning. You asked about the rerouting. Mr. Loftus has indicated he believes it is about nine million tons. I don't have a number like that this morning. I don't think our number is quite that big. We'll file our evidence on Monday, but I can tell you at least until I heard that we didn't believe that the rerouted movements - and there are some that we think you should or will disallow but we don't think they will have any material impact on the outcome of the stand alone presentation.

What about the operating plan? Are the operating plan proposed by them and us feasible? That's easy. No and yes. We think clearly there's isn't for reasons I have diverted to, for reasons you saw in Duke. I'm sorry if I'm a little repetitive, but these are the same consultants. It's the same String Diagram Model. The SAC case is built on it so we have to talk about it.

We believe our operating plan evidence is eminently feasible. It's real world. He says we didn't give you the RDCAM model. That's right. We didn't. We did give it to them. They tried to run it. They reported that after two hours it experienced a numeric overflow and they gave up. They didn't call us or the vendor to try to find out what went wrong with it or whether we could help them.

The fact is that model is used in the real world. It is a proprietary model. It is copyrighted. We cannot just hand that over anymore than if you buy Microsoft Excel that Microsoft is going to give you the code so that you can tear Excel apart and figure out how to use it.

CHAIRMAN NOBER: Yes, I know we are trying to figure it out in a sense. We have an obligation to maintain a record and have that open.

MR. MOATES: That's the problem.

CHAIRMAN NOBER: A proprietary model is one that poses difficulties for us.

MR. MOATES: It's a problem.

CHAIRMAN NOBER: I don't know that we have settled on a solution yet, but we ourselves are mindful of the difficulty there.

MR. MOATES: Well, I would say this very simply, Chairman Nober. If you reject their operating plan - and we believe you will and should for the reasons you found at <u>Duke</u> based on the defective String

Diagram - you have two choices. They fail to carry the burden of proof in a critical element of the SAC case and you can dismiss the case. That would be okay with me.

The other is in the most recent cases, including Duke, what you have done is gone on and accepted the railroad's operating evidence in that instance. You have made in certain respects adjustments where you thought the railroad had proposed something you thought was infeasible. I would submit that's where you should be.

The last question you asked was whether the Board should alter the rate reduction methodology. I didn't really hear Mr. Loftus say much about that. I have quite a bit to say about that, but maybe I won't if that isn't going to be an issue. The first thing I would say - and you alluded to it - it's hypothetical at this point.

If the Board were to conclude that these rates are appropriate under the stand alone cost test, it's a mute issue. I would submit if the Board were to conclude - I hope it doesn't and don't think it will - that these rates generate SAC revenues in excess of cost then frankly very much more than that would be required before you could be justified in even considering changing. I'll find an alternative to the percentage reduction methodology.

CHAIRMAN NOBER: What do you think we need to have to find?

MR. MOATES: That's in the eye of the beholder. I hate to start betting against myself, but I think you would have to find at least the following --

CHAIRMAN NOBER: Well, you said "more" and "very much more." What do you have in mind?

MR. MOATES: Yes, all right. What do I mean by that? I think you would have to find a significant difference between the stand alone revenues and the stand alone costs, not just did the railroad lose by a modest amount, but a huge gap.

CHAIRMAN NOBER: Why would that matter?

MR. MOATES: Because at least tied to the next thing I'm going to say which is you would have to have some other kind of objective evidence that the railroad in fact had set the rate at such a high level that it knew that it was going to lose the SAC test by a large amount and nonetheless it thought it might advantage itself by doing the analydity (PH) by reducing that higher base, I think you have to have those two things. You would have to have the objective evidence, but you would also have to find out that the railroad was right, that it had assumed that it could never win a SAC case. That's not the record in this case.

CHAIRMAN NOBER: Let me just back up. There's been allegations back and forth in the record. Mr. Loftus didn't address this about maliciousness on the part of NS. I don't think that's particularly relevant. The allegation made about the way we do the rate reduction method is that if you find that there are over charges you portion the reduction to everybody which means that no matter how high you set the rate, the way we do the rate reduction, it would only come down a certain amount.

So the higher and higher you set the rate, even if you set it at $100 for example, it wouldn't come down all the way down to what we might consider to be a reasonable level in this case or the other case. It would just come down a certain amount since most of the relief is going to the 85 or 90 percent of the traffic that isn't the Complainant's traffic.

So on the other hand, you could set a rate below the contract rate. If there's enough traffic on the SAC, you could still find that's unreasonable. Either one strikes me you could consider a flaw in the methodology. Why would maliciousness need to be a part of the fact that it is subject to manipulation? That is a fact. Whether or not you did is another issue and maybe even is irrelevant.

MR. MOATES: I agree with you that maliciousness should not be really an issue. Frankly, Norfolk Southern is extremely upset and stunned, as it should be, by the allegation made about its chief coal officer. That's why we have responded to that.

CHAIRMAN NOBER: That's a different issue.

MR. MOATES: I understand. But yes, there is a theoretical issue with that percentage reduction methodology. I am submitting - and I think you would agree - that the facts in this case just don't support any kind of a conclusion that's what's going on here. But you might want to think about a rulemaking at some point to talk about --

CHAIRMAN NOBER: Do we need a rulemaking to do that?

MR. MOATES: Well, it would be cleaner. It would be crisper.

CHAIRMAN NOBER: It wouldn't happen in this --

MR. MOATES: If you have the proper record in front of you, it could be argued that you could do something about it in that case. Again, I just don't think that's this case. I don't want to dwell on it. He said business. I would point out there's only one. By the way, please bear with me. Look at what they write about in their legal arguments versus what the documents and the records say.

The lawyers characterize a lot of this in a very inflammatory way, but the only single piece of documentary evidence that they actually can point to is that one statement that Mr. Knight of CP&L wrote in his final memo. Mr. Fox allegedly said our strategy is to set the rates real high and let the STB reduce them. That's it. Mr. Fox has an affidavit where he flatly denies he ever said that.

CHAIRMAN NOBER: I don't consider the allegations back and forth about a statement to be particularly relevant. They are back and forth. People say things all the time, see you in court, and it doesn't necessarily mean maliciousness. It's just what people say. That having been said, what CP&L has raised about the way the system can be gamed, not that it was gamed here, but that it can be gamed, isn't that legitimate?

MR. MOATES: Yes, I would agree as a theoretical matter.

CHAIRMAN NOBER: Didn't you in your paper agree that it is legitimate?

MR. MOATES: Yes, as a theoretical matter I do agree.

CHAIRMAN NOBER: But you don't think we should change it.

MR. MOATES: I don't think you need to change it. What's to change? First of all, I don't think you are going to get to the percentage reduction methodology. If you do, why would you change it with no supporting facts whatsoever to suggest that's what this railroad did?

CHAIRMAN NOBER: Well, all the time we evolve doctrines when we find that there are problems with them.

MR. MOATES: But you can't find there's a problem, Mr. Chairman. Let me point out to you that what's in this record is consistent evidence that in 1999 or 2000, the last time these two parties successfully negotiated a contract, the railroad told the utility repeatedly our market analyses suggest that a rate increase of five to seven dollars a ton from where the contract rate was at that time was justified. The utility just as consistently said our analysis shows our rates are already too high and we need a reduction.

When it came time to try to negotiate again at the end of 2001 and early 2002 - and this is in the documentary evidence, in the record - Mr. Fox and Mr. Rappold, the negotiators at Norfolk Southern, told Mr. Knight and the other CP&L negotiators the exact same thing. Our analyses show that your rates have been too low for too long. Market would support a much higher rate.

And they said - and this is critical - the STB standards as we understand them and as our advisors tell us would allow a much higher increase. Mr. Knight again was consistent. He said no we believe our analysis of the market says our rates should be lower and that the STB would prescribe the lower rate. This isn't gaming, Mr. Chairman. This is consistent negotiation by two parties who have misread something.

CHAIRMAN NOBER: I'm not saying that it is. I'm just saying that our tests, if you set a rate at $100, not you at NS, but if a railroad set a rate at $100, it wouldn't get reduced down to $15. It would get reduced in proportion and all the other hypothetical --

MR. MOATES: But in a case like this where 87 percent of the traffic of P&SH is crossover traffic, the percentage reduction methodology is frankly much more appropriate than anything else. They are relying upon a huge amount of traffic from shippers other than themselves to get the supposed benefit of this least cost most efficient railroad. If you are going to conclude that the least cost most efficient railroad has revenues that are too high and need to be reduced, you can't give them the benefit of all the participation of those other shippers.

What I think happened here, Mr. Chairman, is one party misread what the market would allow and what this agency would actually allow. That is not gaming. It's serious bargaining and negotiation and circumstances in which one party badly miscalculated what the market and the regulator, you, would allow. That's what's happened here.

Now, I'm going to show you an exhibit where I think gaming is going on. This exhibit graphically demonstrates something sort of like what you saw in the Duke Case, but this is a little different. Down at the bottom -- and again as Mr. Loftus has said this is something we ought to all think about collectively. All the stuff we put in these records is highly confidential which makes some of the arguments we have to make a little elliptical.

Those of you in the know, so to speak, who have seen the evidence will know what CP&L's SAC rate is for the Hyco and Mayo plants. That's depicted by the red box because there's no number there. Those blue boxes above it show you other competitively served plants and the percentage increase of the rates agreed to for those plants above the rate that CP&L says should be prescribed for the big Hyco and Mayo exclusively served plants here.

Now, the Skyland, Brickhaven, and Goldsboro plants are all plants that yes, Mr. Chairman, were bundled previously --

CHAIRMAN NOBER: So you are saying all of those are competitive plants; Skyland, Brickhaven, and Goldsboro.

MR. MOATES: Yes, Skyland is served by motor carriers not another railroad. The other three, Brickhaven, Marshall, and Goldsboro, are all jointly served by Norfolk Southern and CSX. There are physical differences. They are smaller plants than Hyco and Mayo.

CHAIRMAN NOBER: Well, motor carriers, any plant could be motor carriers. That's not a fair comparison.

MR. MOATES: Skyland has received motor carrier deliveries at the same time.

CHAIRMAN NOBER: But anybody could be so every plant is competitive based on that.

MR. MOATES: I understand. But I'm saying it's not could be. It is. It takes truck coal. It's not something that might happen. It's happening. All right. Throw that one out; 43 percent, 48 percent or 58 percent higher. When you look at our SAC evidence and you look at those real world benchmarks and you think about that RSAM (PH) ratio that we put in here again, I would submit that there is absolutely no real world basis to suggest that the --

CHAIRMAN NOBER: And each of those were negotiated contracts; Brickhaven, Marshall, and Goldsboro.

MR. MOATES: They were negotiated when CP&L elected to unbundle them from the contract that included Hyco and Mayo. Those contracts are in existence today, and coal is moving to those plants on Norfolk Southern today. Again, I don't want to mislead you. They are smaller plants. Their tonages are generally less.

CHAIRMAN NOBER: Are they farther away?

MR. MOATES: I know. It's not a perfect match. Some are in different parts of the state. You know about the Marshall one.

CHAIRMAN NOBER: So are these rates per ton or are these based on ton mile? Is there a mileage component to this? Is this a fair comparison?

MR. MOATES: No, there's no milage component.

CHAIRMAN NOBER: So it's just rates per ton.

MR. MOATES: It's just rates per ton. But the Marshall plant you do know about. That's the Duke plant.

CHAIRMAN NOBER: So the Marshall plant could also be 48 percent farther.

MR. MOATES: But it's not. You know where it is. It's in the same service territory as the CP&L plant. It isn't sitting right next door, but it's in the same general area. Now, if I may, I would like to go to these three specific areas of SAC at this time. Just for variety because I think it's more important here, I'm not going to start with operating. I'm going to start with traffic and revenues. I have a point or two here that I know are a little hard to follow. Maybe I talk fast so stop me if I --

CHAIRMAN NOBER: I will.

MR. MOATES: But this is important. Our evidence shows that Piedmont would handle a little over 67 million tons in 2002 which is the base year almost a year ago but that's the way these cases get put together. I said about 87 percent of that traffic is crossover traffic. CP&L claims they would handle roughly five million tons more.

Now, that may not sound like a lot, but given the way I know understand the DCF reports it's critically important. It's the base year so those five million tons are very important. How do they get that higher amount of tonage? To put it the way you would, Mr. Chairman, how can we disagree about what the base year is?

Well, we do because the base year for them gets higher by a gamut that's inconsistent I think with SAC theory - I said that a minute ago - and with the evidence, namely this fiction that they would attract traffic moving from what they call mine clusters - that term that NS uses in its forecast not in the way it serves traffic. They say that they would attract traffic from these mine clusters as opposed to specific mine origins because they are going to lower rates.

So they say traffic didn't move on the NS in 2002 from a mine that we're going to serve in 2002, we the Piedmont, but it's in the general rate area. It's in that area when we cut rates we'll be able to get traffic and they will shift that traffic over to a mine we serve. That's a fiction. There's nothing to support that.

What that means is they count as Piedmont tonage 2002 traffic for mines that their SAR would not serve. That is a critical fundamental point. That isn't permissible I would submit under any reasonable interpretation of what the SAC test is supposed to measure.

CHAIRMAN NOBER: So you are saying that they would, by cutting rates, draw coal from the mines served only by NS onto the railroad for a portion and then back off again.

MR. MOATES: I'm not saying they do it. I'm saying that is their premise and that's how they load up their 2002 numbers. That's where this additional tonage comes from.

CHAIRMAN NOBER: So do you think crossover traffic should only originate from the --

MR. MOATES: This isn't crossover traffic. This is traffic they claim they would originate even though they don't serve the mine. What they are saying is the mine is in the general area of a mine they serve today. We'll cut our rates and that tonage will shift over to a mine that we serve.

CHAIRMAN NOBER: Got it.

MR. MOATES: Again, let me emphasize this point. Even though they say over and over - and I showed you earlier that slide where all the justifications and rate cuts lead to - they never take one single dollar out of their revenue projections anywhere to actually reflect the reality of any rate cuts. That is brazenly inconsistent.

By playing this game, they inflate their first year revenues, the 2002 revenues, by about ten percent overall. By using that and other unsupported assumptions, they inflate volumes by roughly 20 percent over the 20 year DCF.

I don't want to read you all of those things. I apologize to the folks in the audience if you can't see the projector screen. I know a lot of these things are going to be very hard on the TVs but frankly I'm more interested in what the Chairman can see. But this is what happens. Over the 20 year DCF, they overstate traffic by fully 20 percent.

They also distorted revenues in 2002 by making a couple of fairly gross mathematical errors and failing to correct them. We mentioned this in brief, but I want to highlight it now. This is actually just a picture of the footnotes in our brief. They really do take too much tonage and revenue.

They take all the revenue, for example, for moving traffic to Marshall even though they are only entitled to a division of it. They are not going to handle it all the way. There was a traffic anomaly - that's a nice word for a mistake - in the Norfolk Southern traffic tapes for movement to Richburg, Mississippi that used a rate of around 81 or eighty some dollars a ton instead of the correct rate.

We pointed that out to Duke. We pointed that out to CP&L. Duke, to its credit, made the correction in its evidence. But with no explanation, CP&L failed to make that correction here.

CHAIRMAN NOBER: Curiously if these are important enough to be shown overhead, why are they in footnotes?

MR. MOATES: Well, because you have a very severe page limitation on briefs.

CHAIRMAN NOBER: Well, if it's important enough to show, there's probably text you are not showing that ought to be out. I don't like footnotes. I make my staff cut footnotes out. I'm not big on reading them. If it's important enough to say, say it. If it's not, don't count on people reading your footnotes.

MR. MOATES: I think what you have just done is revealed the fact that my judgement when we put the brief together was faulty. I should have had this in the text, and there it is. Now, what about forecasts? We just talked about 2002. What about 2003-2004?

Again, I told you this is a little tedious but both parties did it this way. There's a number for 2002 as a base. We bill to 2003-2004.

Then we think we're going to be shifting over to your good old EIA projections beyond that. So let me go to 2003-2004. The parties' forecasts for those years vary significantly too.

Most important, it's now obvious that we have both significantly overstated what is happening in the real world in 2003. As I said, we know now that you have indicated a strong preference for EIA forecasts. We anticipate that you will probably use the EIA Central Appalachian Forecast for 2005 to 2021. What about 2003-2004?

Well, both parties started with what is called an NS Course of Business Forecast that contained projections for 2002, 2003, and 2004. These are projections put together obviously before 2002. CP&L added in its little 4.2 million phantom tons, again those tons that come from origins not actually served by them. We put in two cases just like in Duke; a base case and an alternative case.

Our base case it turns out is almost 18 percent too high for what's happening in 2003. Our alternative case projects a decline for 2003 of 2.5 percent. So the issue for the Board is which of these projections should you use. We have a quandary. Since the record is closed, we can't file the traffic statistics.

Frankly, we tried to file the fourth quarter 2002 traffic statistics earlier and they were struck. We can't file them. They would show you that in fact the tonages have decreased this year. But you can take official notice of what's reported by that neutral government source EIA.

CHAIRMAN NOBER: No, I recognize that from the first case that we're relying on projections that are several years old by the time we decide the case. We have actual data that --

MR. MOATES: Good because that's what I want to show you. This is from their website for the weekend of November 1, 2003. This is what EIA says has happened to Central Appalachian Coal in the first ten months of 2003, down seven percent.

So it's unarguably the case that we're both wrong. We're both too high. But there is one other thing that we can look at. What did Mr. Dean say, the expert brought in by CP&L to predict growth and tonage, his forecast of tonage? For purposes of this evidence filed on November 27, 2002, he said traffic is going to return to previously expected levels by the fourth quarter 2002 and the first quarter 2003. It would have required a ten and a half percent increase.

Now, the thing on the right is not on the record. I ask you to take official notice of it. This is Mr. Dean's publication, Coal Monthly --

CHAIRMAN NOBER: Coal production for where, Central Appalachian?

MR. MOATES: Central Appalachian, the same period that he says is going to decline 2.5 percent in 2003. There was never any effort to correct the record. They didn't ever tell us anything in brief or otherwise to say that he was wrong, that he had changed his mind if that's what this was.

But the two and a half percent that he says there is exactly the two and a half percent in NS's alternative forecast. They are both again higher than what EIA says is actually happening but we can't look at what is actually happening. I would certainly ask the Board please don't inflate 2003 by 17 percent. There's absolutely no factual justification for doing that.

One last one, and again I cringe as I do this. I'm sorry, yes. I wanted to show you this. If you use that Course of Business work, actually way up there at 17.6, if you use the alternative which is where we and Dean actually say things are, it's 2.5 and EIA is below us. So please don't use anything that's above 2.5 is all my point is there.

You saw this in the last case. I'm sorry that I put up something that's the same. But you know what? They did the same thing here too. This is for the years 2011 to 2021. When you read their evidence, it says they use the formula here on the first slide which will result in a rate forecast of one and a half percent.

If you go and look at the work papers - and we give you the work paper cites there - that's what you really get. You get almost a three percent rate forecast. This reinforces the wisdom of the old adage watch what I do not what I say. So don't just take for face value what they say their forecast is. Go and look at what they did in their work papers.

Now, I would like to turn to construction matters. This may seem a little bit out of order but at some point Mr. Loftus or I ought to show you what this thing looks like or what it is supposed to look like. This is very hard to read. I'm sorry but this is what's in the record. This is the Piedmont Railroad. You'll see that this railroad is very heavily built up in that mountainous Appalachian area that I understand, Mr. Chairman, you know all about.

My point here is a simple one. The Duke Railroad, the ACC, of the portion of its lines and facilities west of Roanoke, it had about 73.9 percent. This railroad has 82.3 percent of its lines and facilities in that terrain west of Roanoke. You would expect, all things being equal, that it would be a more expensive railroad to construct mile for mile because more of it is in that terrain.

I would like to mention to you a couple of real world benchmarks. I know they aren't 800 mile or 1,100 mile railroads because nobody in this country is building railroads like that unless at some point the M&E (PH) gets going and that won't even be that big. There are two benchmarks that are in the record of this case.

One is Norfolk Southern's Keystone Project which has been before this Board and which you have approved the construction project in Pennsylvania. Again, these numbers are highly confidential. I won't say them out loud. If you look at the construction numbers in that application, a real world project, you will find that the per mile construction costs of Norfolk Southern's evidence for the stand alone railroad here is below what the Keystone project costs would be.

Similarly CP&L put in during its market dominance evidence here in opening some evidence about a build-out proposal where this didn't happen. It was looked at where they might build out at the Roxboro plant for CSX to reach that plant several years ago. Those costs also are below the per mile cost that we have in this case.

CHAIRMAN NOBER: So you are trying to argue here that because a higher percentage of this railroad is in the mountainous area that it's per mile cost should be higher than Duke-NS, is that the punchline here?

MR. MOATES: I would say yes. That's the punchline. I would say you shouldn't be surprised. I'm trying to give you something else, a template if you will or something to go and look at, a real world benchmark other than just the evidence in this case. Those are the two things that are in this record, real world benchmarks, to show you that when somebody really was planning to build a piece of railroad, in both cases, not in that cluster of the most mountainous area, one north of there in Pennsylvania and the other down here where the plant is in the North Carolina Piedmont, that those construction costs are higher than the costs we have here.

Before addressing a couple of specific items, we believe the

Board should decide differently here than it did in Duke. I have to point out again very forcefully that they made a number of significant changes to their construction proposal in rebuttal that we didn't have a fair chance to respond to. They changed the equipment, and we're going to talk about that.

Notice these aren't footnotes, Mr. Chairman. They are bullet points so I guess they get more credit. One of them is that on rebuttal they removed 54 bridges from their bridge inventory that we did not challenge on opening. One of your rules on rebuttal, Mr. Chairman, is if the railroad doesn't challenge something they can't change it on rebuttal. Here are two things they did change.

They removed 54 bridges that we didn't take issue with. On opening, they put the Kenova Yard in one place. On rebuttal, they announced they put it in the wrong place and they moved it. We don't think that can be allowed.

CHAIRMAN NOBER: I assume that they moved it because you pointed out the flaws in where it was originally.

MR. MOATES: No, we built that Kenova Yard where they said to build it. They never said why. They just said it was in the wrong place. Here it is now back where the real Kenova Yard is.

CHAIRMAN NOBER: Again, what's the harm of allowing it to be moved?

MR. MOATES: It makes a big difference in terms of the cost.

CHAIRMAN NOBER: But in terms of the sanctity of the SAC process.

MR. MOATES: The sanctity of the SAC process and fundamental fairness. We didn't have a chance to address the costs and the feasibility of having it where they said they were going to put it back. Now, I assume it would be feasible because frankly where they put it back is where our real Kenova Yard is today. But that isn't the area that we got to put evidence into on the cost.

Now, there are two specific things about construction. Please, these are important. We think with all respect you may have gotten these wrong at Duke. We think you did. At least I would like to try to convince you that you did. The first one doesn't sound very sexy. It's clearing and grubbing. There is this issue about how big are the trees that are in the right of way that they are going to have to take down.

Their own evidence, their rebuttal that three F21 and 22 concedes that nearly one-third of the trees on the right of way exceed 12 inches in diameter and this Means cost. We all use this Means manual. There it is, the little blow up for clearing. It Means cost for clearing and grubbing trees up to 24 inches must be used because the equipment wouldn't be there for the larger trees.

The lower costs for clearing trees that are 12 inches or less in diameter is fine for the trees that are 12 inches or less. But they admit that a third of the trees are going to be bigger than that. So by definition, you have to have more costs in there for that.

Now, second are pictures of the Tonka toys as somebody called them the last time. We respectfully submit the Board may have misunderstood - if they did, I think it was partly my fault because of how I did this in the oral argument - our evidence on the appropriate equipment for excavation. Again, remember now, they made this huge change in the rebuttal.

You called our excavator, the thing shown in reply there, the kind of thing more suitable for trenching and for digging trenches. We submit it is not. It is a significant earth moving device. It has a bucket on it that has the same capacity, three cubic yards, as the bucket on the device at the right which is what they specify in rebuttal. I'll show you in a minute that is what they specify in rebuttal not one of these things.

So why do we care? The answer is because ours can maneuver in the narrow terrain or the narrow right of way in the Appalachian Mountains that other monster can't. You can see those monsters if you go over the Wilson Bridge. There are two of them sitting there because what those are used for are fixed location in-site excavations of things like dredging, soft fill, loose rock and that kind of thing. They are not used to move along, like the device in the middle is. Can I have a minute or two more?

CHAIRMAN NOBER: Yes, I want to make sure that you address the RCAF-A and RCAF-U issue that came up.

MR. MOATES: I will. My point here though is this is very significant because without the capacity the thing on the right is much higher than the thing that you would actually have to use in this terrain. You cannot use that monster in the Appalachian Mountains. Do I have ten minutes left or five?

PARTICIPANT: Ten.

MR. MOATES: Thank you. I feel better. He told me five. If I may, let me deal with a few operating things and then I will come back to the RCAF, Mr. Chairman. I have told you what I think happens if you don't accept the evidence based on our RDCAM model. I think you have a failure of proof.

I would like to put up slide 27. I asserted in the beginning that their evidence was based on a lot of traffic that the shippers don't really ship that way. Let me give you some specifics on that. Some of the mines on their stand alone railroad like Luke, Koenig, and Corneliu cannot load unit train quantities. There are smaller shipments that are made at the request of the receiver. Not every receiver wants to get 110 car unit train or a 90 car unit train.

Yes, Chairman Nober, you are right. Customers do demand coal with different characteristics and different mines for all kinds of chemical reasons. They often mix or blend those coals. They bring coals from different locations. What I'm trying to show you here is how they actually built their trains. Mr. Loftus has tried to take us to task because he thought we had one percent of our trains that were less than trainload.

Well, what have they done? How do they get these unit trains or trainload trends? On the third column from the right, there is the record from the actual Norfolk Southern weighbill. That's how many cars are in the real train in the real world. For example, from Pinnacle Creek to Wheelersburg Terminal on March 25, there were 125 cars. In their operating plan, there's only 90 cars. Where did the 35 go?

The next one had 130. They only have 97. Down at the bottom, there was 152 car train going to Ashtabula Harbor on Lake Erie. They have two trains of 100 and 113. How does that happen? Let me show you how it happens. Here is a train they are building from High Power Mountain which is a very important location. It's a very large mine. I think it served Duke as well.

In this case, the coal is going to the Hyco plant. In the real world, that train had 78 cars over there on the far right. This is from their work papers. There is the citation for it. If you look at the bottom, they have taken trains and cars from five different mines on different days to build what I'll show you next. It becomes this one train from High Power

Mountain. It has 111 cars in it. It moves on March 28.

That sounds very efficient. There's a wonderful least cost most efficient operation. But where did it come from? It came by their going in and pulling two cars out of a mine two days earlier at Marrowbone, three cars out of Sidney on the same day. My favorite here is Pevler and Kopperston. They take ten and 18 cars out of trains that moved the next day. In other words, those cars somehow magically appeared in this train on the 28th even though they didn't really go until the 29th.

This is not efficient unit train operation. This is consultants machinations to try to reach into traffic records to hypothesize that there are going to be highly efficient cycling unit trains. That isn't the way the traffic is moving. That isn't the way the shippers are routing the traffic.

Let's skip over this. We have all seen enough of this. Go to 44. You asked me about whether we essentially put in too much investment or goldplated or whatever the right term would be. This is the very important segment between Devon and Bluefield.

Today on Norfolk Southern, it's like you see on the top. It actually has 80 miles of main track, 80 miles of double track, and 18 miles of triple track and passing siding. This is an extremely busy piece of railroad. There's a lot of traffic moving over it today in the real world, not all coal but very heavily coal. Here's, not what CP&L, what Norfolk Southern's evidence shows you we put in as additional investment in this case for the Piedmont Railroad.

We didn't put in all that stuff. We only have 1.66 tracks per mile as opposed to 2.22 in the real world. We don't have the triple tracking and all of that in there. Frankly, Norfolk Southern's operating people think there are darn good reasons to have those in there and I think they are going to have a lot of problems without it. But we did not try to load up investment that wasn't otherwise justified.

There's the comparison for all three of us. They say 1.51. We say 1.66. In the real world, we're 2.22. So we did not overbuild this railroad. We did not go out and replicate the I would say very efficient, but they would argue somehow inefficient existing incumbent Norfolk Southern railway.

Here's a quick one on train speed to show you the same thing for the operating plan. In the real world today, that's how fast Norfolk Southern trains on average cover the Devon to Bluefield segment, about seven miles an hour. I know this sounds crazy but coal trains in the coal fields go very slowly on average. That's an average speed. Bluefield to Roanoke, you start going downhill. It picks up to 18.6. Here's what our operating plan says they will do, 16.2 and 21.9.

CHAIRMAN NOBER: Is that because of changes in equipment? Why do you propose the faster speeds?

MR. MOATES: It's because there are actually fewer trains in the real world. It's because of DP. It's because they aren't meeting as many trains coming the other way as we are and things like that. While they look for this, I'm going to go on and address your question. I want to show you some slides on this DP equipped equipment.

On the issue of the RCAF, first of all, Mr. Loftus I'm sure quoted you correctly from CP&L. But frankly in other cases since then including PPL Montana and TMPA, you have adopted the RCAF-U. The technological innovations that he cites that he wants to get credit for as his railroad gets more productive frankly are all included in consulting costs that he has built into his stand alone operating costs.

He says they are going to have consultants do all of this stuff. Well, the consultants can get the productivity improvements and that's reflected in what they hire them for. The basic point is --

CHAIRMAN NOBER: How does it follow the fact that they pay a consultant that it somehow embeds --

MR. MOATES: Well, if the consultant is getting a new computer, then they don't get the benefit of the new computer. Their proposal isn't to buy the new computer. My point is their proposal is to hire the consultant and they have a fee in there for hiring the consultant.

CHAIRMAN NOBER: That doesn't follow. Just because you hire a consultant means that the railroad that has the consultant gets no productivity gains from what they produce. What they posited here is we have two measures. One gives full productivity gains, the full productivity that railroads currently get now from their current state of equipment forward. Then there's one that has no productivity gains where you inflate the cost at a static level. You heard the discussion before.

MR. MOATES: Right.

CHAIRMAN NOBER: Do you think it's fair to give full productivity gains when they are getting a railroad on the one hand or no productivity gains when they may come from personnel or equipment or operations or things that have nothing to do with equipment?

MR. MOATES: I think it's much more fair to give them no productivity gains because they are claiming they are the least cost most efficient railroad in the world. The moment they go into existence they are going to be around for 20 years. I understand the point.

He said for example the locomotive leases will expire at the end of 12 years and we'll start replacing locomotives and there will be more efficient locomotives. Well, if they are more efficient, presuming the lease costs that are reflected here are going to reflect the likelihood that there will be some additional efficiencies. But they aren't getting the kind of efficiencies that the real world railroads have been able to get out of their inefficient plants and out of their inefficient --

CHAIRMAN NOBER: But most come from personnel and labor matters that aren't technological at all.

MR. MOATES: But they are already least cost most efficient. They have these really efficient, slimmed down, super duper employees that can do all kinds of things because they are non-union and they work across crafts.

CHAIRMAN NOBER: Correct.

MR. MOATES: You tell us that they can work 270 trips a year even though our railroad would go on strike if we tried to pose it to our people. Those are productivity gains that we can't get and they are starting off with them. And you are going to give them more beyond that. I don't think that's appropriate.

CHAIRMAN NOBER: Even if we went to remote control operations for example which wouldn't be embedded in there now. You are saying they couldn't get any of that.

MR. MOATES: I don't think they do much with remote control. They don't have many yards. They have these super efficient unit trains with DP equipment and back and forth they go. As you know, those would be most useful in yard operations. That's where you are going to get your benefits. If you want to give them a nickel to use them at the Devon Yard or something, I don't know.

Again, I'm sorry for being out of order. We had a little trouble with our slides. I do want to make this point about the DP equipped trains. In their opening, they said DP configuration could be used efficiently on mines on these branches, the ones identified. That's 14 or 44 percent of the mines. On rebuttal, after we have already tried to address this, they come back and say almost all of the mines on the Piedmont can clearly benefit from DP, 94 percent of the mines.

Here's what they say actually in their opening evidence. All of the Piedmont Railroad's unit train coal traffic that is interchanged to NS for movement to final destinations or to interchange with another carrier and the overhead grain trains will be handled in run-through service. Each railroad, that means them and Norfolk Southern provides the required number of locomotives which are put into a pool for the specific movements in question.

With respect, we think you may have misunderstood this in Duke. You said that NS's operating plan was adopted and therefore there wouldn't be any NS DP equipped locomotives. They would be cut off. No, they won't be. Their proposal, which we have built our operating plan, is just that one. They will run through. They will be in a pool. They don't have any yards at the interchange point between us and them.

They are not going to take these things off. They couldn't. You can't just cut off the third one at the end. The DP, as you probably know, Chairman Nober, means all three of these locomotives, the two at the head end and the one at the back, have this computer configuration. They have to be able to talk to each other and coordinate what they are doing. You can't just say we crossed the border. NS said we don't have to worry about them anymore. We have to put DP on them.

This is now from our reply. I want to emphasize this. Because they assume that the road power would operate and run through service with us, it is appropriate to charge them the full cost of reequipping our locomotives with the DP capability. We don't have it today. If our locomotives are going to run through with them and they are going to run through with us, which is their plan and our plan, we need to get credit for equipping those locomotives with DP capabilities.

CHAIRMAN NOBER: Is their time up?

MR. MOATES: May I have just a moment?

CHAIRMAN NOBER: If you have just one to finish, go ahead.

MR. MOATES: Let me show you just one other slide. I just want to show you a quick comparison of the operating experts of CP&L and Norfolk Southern. CP&L used Mr. Lyman. I actually knew Mr. Lyman at one time. He's a terrific gentleman. He used to work for the Santa Fe Western Railroad. He doesn't have any eastern railroad experience or none to speak of anyway.

Mr. Kimbrough had 34 years of direct experience in an eastern railroad. He was a superintendent on the Pocahontos Division of the

Norfolk Southern which is right in the heart of the coal fields. Mr. Lyman's own testimony shows he didn't visit 26 of the 32 mines that they say they are going to serve here. Mr. Kimbrough, even in the coldest of weather because he called me a couple of times on his cell phone with the wind howling, went and looked at every one of these branch lines, every mine origin, every destination plant.

There's detailed evidence in this record of all his write ups of everything that happens at each one of those locations. Mr. Lyman made generic assumptions about what is going to happen like every place on the railroad in four hours a DP equipped efficient unit train is going to pull up, it's going to get loaded, and off it goes in four hours. By the way, they didn't even put the four hours in their cost. They say it will take four hours but when they get around to totaling the costs up they left that out.

We have location specific analyses of the actual train sizes, the mine track requirements, the mine loading operations. Mr. Lyman actually even made errors at the few mines he did visit. I'll give you just one example and then I'll be quiet. This one is egregious. Our well oiled machine here is breaking down. I apologize.

The point is that at one of these mines, the Mabley Mine, he didn't even put in the side track and the tipple. So this sufficient unit train I guess would have to come up and switch onto rubber tires or something. Obviously I'm being facetious, but the point is that even on one of the few mines that he went and looked at when he got around to submitting the evidence he forgot to put in the low down of the tipple.

What am I trying to prove here? I am trying to suggest to you what I hope our evidence has already indicated that our operating evidence is much more well supported by a real expert who went out and really looked at everything and did take into account what's involved in the operations to serve these real shippers in the real world. Mr. Chairman, I would like to say more but I think I have probably said all my time would allow. Thank you and your staff.

CHAIRMAN NOBER: Thank you very much. I appreciate it. How much time do you have left?

MR. LOFTUS: Ten minutes.

CHAIRMAN NOBER: Okay.

MR. LOFTUS: I would like to begin addressing the comments regarding the operating plan. With regard to the volume that would come off as I had suggested as a result of rerouting decisions, it is true that the piece that would be most directly affected is Iaegr to Bluefield, but that is also one of the busiest segments of the entire railroad. We would like to point that out.

I think in several points in his argument Mr. Moates misrepresented what CP&L's position has been with regard to "rate cutting." That is that if you find that the stand alone railroad does have a least cost most efficient operation which creates an excess of revenues then the rates will be lower. That is what we were talking about. We're not talking about some systematic program of reducing rates.

CHAIRMAN NOBER: Let me just ask a question just to get a little bit off subject. If we agree that we have an institutional interest in looking at the way we reduce rates, hypothetically of course, what factors should we consider in looking at alternatives?

MR. LOFTUS: That's next on my list. I'll get to it right now. Well, actually I would rather not. May I make one more point on the operating plan?

CHAIRMAN NOBER: Sure.

MR. LOFTUS: I'm afraid I'll forget it if I don't.

CHAIRMAN NOBER: Okay. It happens all the time.

MR. LOFTUS: Mr. Moates said you have two choices on the operating plan. You can either find that they have failed and throw out the case or you can take ours. I disagree with that. For the reasons we have suggested, we would rather you take ours but there is another choice. The essential failing as I see it that you perceived in the Duke decision is the gathering operation and the manner in which that is handled.

I did not see it finding fault with the trainload operations. Another conceivable way to deal with that is to strip out the multi-car shipments and the associated operating expenses and leave it as a trainload railroad. I'm not suggesting that. I am suggesting that there are not just the two options that he mentions. And this is an expert agency. The law is clear in the cases from the Supreme Court on down your duties go beyond calling balls and strikes. You have an expert staff with the capacity to evaluate and seek the best result on the record.

CHAIRMAN NOBER: I agree. One of the frustrations that we often have on the case is that we have a record that's polar with one extreme or another. On the one hand, we have to do more than just call balls and strikes. We have an affirmative duty to determine whether a rate is reasonable or not. I believe strongly in that.

But on the other hand, we can't prove a case for folks. So one of the things I mentioned at the beginning is we are struggling for ways to improve the records we get in the case to make the kind of assertions you are saying there which is to pick and choose and to be able to pick middle ground which I don't think the records currently allow us to do.

So we are looking for ways to try to address that because candidly that is a frustration that I feel when we do have records that are polar. I understand that shippers are not railroads and they do not have the experience in designing railroads that railroads do. They don't have 150 years of history. It's a lot to expect of you on opening.

MR. LOFTUS: Well, you earlier reopened these cases because of the rerouting issue where you wanted more precision as to certain costs and expenses or revenues and expenses.

CHAIRMAN NOBER: I know that's unusual. We haven't done that before in a case, but we did it here because we were looking at the issues and you now see what they were and ways to ensure that the operations and capital plan matched up with the traffic group. That's a chronic problem. We have disputes over what the traffic group are.

But the operating plant needed to move the traffic and the physical plant needed to move the traffic are functions of what the traffic group are. We have different views on what the traffic group are so we have different views of what investment are needed. How to bring them all together is something that we're struggling with candidly. You raise a very fair point and one that in the rate case evaluation we are struggling with so we don't have these extremes.

MR. LOFTUS: Well, I believe from discussions I have had that this staff should have the capability to strip out the tons and the associated expenses in railroad investment. If not, there is the possibility of seeking further detail from the parties in that regard. Now, as to the question you raised about the rate reduction methodology --

CHAIRMAN NOBER: We did that. I will say though that the parties prosecuting the case weren't always happy about the extension of time that meant.

MR. LOFTUS: I understand.

CHAIRMAN NOBER: So there's a balance. It's very important to me to get these resolved and do it within the statutory deadline. By going out for additional information here, the parties were not happy about that as is expressed in their papers as you well know. That's a problem that we faced too.

MR. LOFTUS: Mr. Chairman, the rate reduction methodology. We have testimony by Professor Curtis Grimm which we think does a very good job of explaining the problem. The methodology was adopted explicitly on the assumption that using the existing rate structure would reflect the relative demand elasticities of the traffic movements on the stand alone railroad. That would be consistent with Ramsey (PH) pricing.

The problem is where you have a huge increase in rates such as you have here. That assumption breaks down. You simply do not have a picture using the existing rates on all the other traffic and plugging in these challenged rates. You do not have a fair picture of relative demand elasticities.

That is the point of the analysis we did taking all of the other captive traffic, look at the revenue to variable cost ratio on all of that traffic on average, and then look at what it is here. We're simply not in the same world. As a result, you don't have that assumption fulfilled on the record in this case. It is primarily because of that. You read our paper. It is primarily because of that we say you cannot use the challenged rates for application of the percentage reduction methodology. You should use something else.

We considered whether we should suggest some method other than the percentage reduction methodology as a way to deal with this problem. We couldn't come up with anything frankly. We thought that was too ambitious an undertaking though it seemed to us that since the basic problem was the challenge rates that's the way to deal with it on the record in this case.

CHAIRMAN NOBER: So what would you have us do then? In your papers, you offer some alternatives.

MR. LOFTUS: We do. I would suggest to you that --

CHAIRMAN NOBER: Use the percent rate reduction off the --

MR. LOFTUS: I would suggest to you that the one that makes the most sense --

CHAIRMAN NOBER: Hypothetically.

MR. LOFTUS: The one that makes the most sense is to take the expiring contract rates, to mark them up by ten percent, and we would give you some benchmarks that we think --

CHAIRMAN NOBER: But that expiring contract rate was a bundled rate. That was more than just a one-on-one negotiation between these plants. So how would that be fair?

MR. LOFTUS: Well, Mr. Chairman, as I explained to you earlier - and we have this explained in our evidence in detail - if you want to go with that bundled relationship, you can look at the rates today on those other bundle plants and establish the Roxboro-Mayo rates on the same relationship that existed on that prior contract. The rates we challenge come down five or six dollars a ton. So you are not prejudicing them by that bundled relationship.

CHAIRMAN NOBER: But is it a fair comparison to say that the contract rate for one plant that was part of a bundle of six should be the basis for a one-on-one negotiation for that plant only? That's what you are positing, and is that right? Is that fair?

MR. LOFTUS: I believe it is fair given the facts of what was involved in the earlier contract, given the differences between them. You talk about the rates on these other movements. Cape Fear and Lee - they call them Goldsboro and Brickhaven - they are 80 to 140 miles farther away from the mines.

The trains are ten to 20 cars a train shorter. The lading is typically ten tons per car less. The volumes are only about 750 a year versus eight million a year for Roxboro-Mayo. I think under all the facts it is fair, yes. If I could just very briefly hit a couple of other points.

CHAIRMAN NOBER: Very briefly.

MR. LOFTUS: Mr. Moates introduced some information about tonage decreases in 2003 they would like you to take judicial notice of. I would submit that the record is closed. There are a lot of things we would like to ask you to take judicial notice of too if we're going to get into that. You can't allow cherry picking of that nature on the record. It is what it is.

As to the Dean numbers, what he's referring to is a commercial service that Mr. Dean provides. Mr. Dean in this case would design a specific projection based on individual plants and individual supply. So they are apples and oranges. He said you can look at as a reality check the two cases where something is really happening and gives one of them a CSX number that was worked up in discussions they had with Sandy (PH) Cooper on something. It's not real world at all. As to Mr. Lyman, if you review his credentials, you will find that they are impeccable and he is extremely well qualified in every respect.

CHAIRMAN NOBER: One final thing. I guess I will address this to both of you. As you know in the Duke vs. NS Case, we changed the method for crediting the mileage divisions for crossover traffic. I asked if there are any concerns about that here. Hearing none, I'll just assume that what we did was fine and we'll continue.

MR. LOFTUS: Mr. Chairman, for my part, I will say I felt I had bigger dragons to slay.

CHAIRMAN NOBER: Okay.

MR. MOATES: I remain silent as to your assumptions.

CHAIRMAN NOBER: In the last go around at the end, I had the feeling that ultimately this was a commercial dispute where people were unable to reach one. I still feel that's the case here and wish that the parties were able to sit down and be able to work out a resolution in this matter even in this late date. I'm not going to ask you if you want mediation, but if you wanted it we would certainly appoint a mediator.

But it's still my preference that these matters be resolved at the bargaining table and not in the courtroom or the hearing room or whatever this is. I will say though that it is our job when you can't negotiate to be able to resolve these fairly. Mr. Loftus, you pointed out just the tension that we have which is on the one hand we have each case is individual and we have to decide it on the record before us.

On the other hand, we do have an independent duty to determine whether rates are reasonable. That's a balance that we have to look at with every case as we try to hone the records and be able to make the best judgement we can. We have asked a lot about a prior case that doesn't involve CP&L. That's probably a little bit unfair to hold them to a standard of that earlier case because in the end every case is different.

I did a conference call with some analysts. At the end, they said what do you think that the Duke vs. NS Case is predictive of, and I said nothing. What's the old maxim that they say? Past performance is no guarantee of future results. That's ultimately the matter here which is every case is individual. Every case has to be decided on its facts. You have a record here which is indicative of only the record here.

I would say that the earlier case is its own record and has significant differences than this one. I would not take our decision in that as predictive of what we're going to do in the future other than we did some analytics that were similar and we wanted to try to gage from you what you thought of those and where you thought we ought to make differences.

But in the end, this is a different case. We understand that. This will be decided on its own on its merits. I appreciate your forebearance in us asking for additional evidence. I know that's been an imposition on everyone. And we have given some tight timeframes.

Again, that was a reflection on the one hand of wanting to get the cases done as quickly as possible which I know is what both parties want and on the other hand trying to navigate our way through difficult records and again match up what from our standpoint is the difficulty in these which is differences over the traffic group which produce differences in operations and differences in investment that get more and more extreme as you go on. How to mediate that is something that we are working through.

What I said in my opening was more not less Board involvement in the evidentiary phases of the case is the way to do it. But I certainly think these oral arguments are a help and a step forward to let us probe with you the questions that we have and for you to be able to interact with us some. The more that happens the better.

Unless either of you two have anything else, we appreciate your time and your effort. We will decide this case by the deadline. I think it's December 23. So everybody will have some good reading over the holidays if you will. Again, if there's nothing further, this meeting stands adjourned.

(Whereupon, the above-entitled matter concluded at 11:52 a.m.)