

Statement of Timothy Strafford
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STB Docket No. 42069

DUKE ENERGY CORPORATION
v.
NORFOLK SOUTHERN RAILWAY COMPANY

STB Docket No. 42070

DUKE ENERGY CORPORATION
v.
CSX TRANSPORTATION, INC.

STB Docket No. 42072

CAROLINA POWER & LIGHT COMPANY
v.
NORFOLK SOUTHERN RAILWAY COMPANY

Good morning Chairman Nober, Vice-Chairman Mulvey, and Commissioner Buttrey.

The draft decision before you addresses petitions for reconsideration of the Board's decisions in three cases assessing challenges to the reasonableness of rail rates under the Board's stand-alone cost (SAC) test. These three proceedings have not been consolidated, as each case involves a separate record and the Board's decision in each of these cases was a product of the particular record in that case. However, because there was considerable overlap in the evidence and arguments presented by the parties in these cases, and because there were many common issues present in the petitions for reconsideration, a single decision was prepared for your consideration.

Under the stand alone cost test, the reasonableness of a defendant's rates is judged against what a hypothetical, optimally efficient stand-alone railroad, as posited by the complainant, would need to charge for providing the service at issue. In these cases, the parties provided extensive evidence on the costs to construct and operate rail lines and facilities in the mountainous areas of the Central Appalachian region. Using this information, the Board in each case estimated the revenues that each stand-alone railroad would need to serve its traffic group. In each case, the Board then compared those revenue requirements to the revenues that the defendant carrier is expected to receive from that traffic.

A significant issue raised in the petitions for reconsideration involves tonnage and revenue forecasts for coal shipments out of the Central Appalachian region. In these three cases, the Board's decisions relied on the 2003 coal forecasts of the Energy Information Agency (EIA) that publishes neutral energy data and forecasts. The EIA's 2003 projections were markedly more optimistic than its 2002 forecasts. Shortly after the Board issued its decisions in these cases, however, the EIA released its 2004 forecasts for the Central Appalachian region which showed that the 2003 forecasts were overly optimistic. The draft decision recognizes that any forecasts will likely be inaccurate to some degree. However, the large disparity between EIA's 2003 and 2004 forecasts for the Central Appalachian region and the reasons for those discrepancies present a new development of such significance that it cannot reasonably be disregarded. Thus, on reconsideration, the draft decision would substitute EIA's 2004 forecasts in the SAC analyses in these three cases. Mr. Awan will discuss the EIA forecasts and the ramifications of this change in more detail shortly.

The draft decision also updates the equity component of the cost-of-capital calculation in all three cases, and in two of the cases, Duke v. NS and CP&L v. NS, we include in the SAC analyses the cost that would be incurred to retrofit locomotives of the “residual” defendant carrier so that they could be used as distributed power locomotives as assumed in the SAC analyses. Because the Stand Alone Railroad in both cases would utilize distributed power and interchange traffic with the residual carriers in run-through service, the mechanics of such service favor the inclusion of such costs, which were omitted in the original analyses. Additionally, the draft decision would make various technical corrections, as discussed in the appendices to the decision.

In all other respects, the draft would deny the petitions for reconsideration. Most significantly, the draft decision declines to reconsider the rejection of complainants’ operating plans in Duke v. NS and Duke v. CSXT. In both cases, Duke proposed a stand-alone railroad that would deliver trainloads from their origin to either their destination or point of interchange with another delivering carrier, without facilities for staging and/or assembling trains. As Duke provided no workable way to deliver the necessary amounts of coal to shippers in the peak week without such facilities, their operating plans were rejected. In its petitions for reconsideration, Duke asserted that, by changing the timing of deliveries, each shipper would receive the correct amount of coal over the course of a year. But such a plan does not comport with the Board’s precedent that requires the complainant to show how any posited changes in service would meet the transportation needs of shippers, nor does it square with the other assertions that Duke has made on the record.

The complainants have also petitioned the Board for reconsideration of the use of the rail

cost adjustment factor that is unadjusted for productivity gains to index inflation over the 20-year period covered by these cases. Instead, the shippers request the use of a rail cost factor that is adjusted for the average change in productivity in the rail industry over the most recent 5-year period. The draft decision denies these requests on the grounds that the Board's previous reasoning has not been shown to be invalid.

I would now like to turn the presentation over to my colleague, Mazhar Ali Awan, from the Section of Economics, to more fully discuss some of the technical issues contained in the draft decision.

The draft decision notes that the SAC test is not the only regulatory constraint on railroad pricing, however, and it may be that abrupt rate increases of the magnitude seen in these cases should be mitigated by the Board's phasing constraint. Accordingly, the draft decision notifies the complainants here that they should advise the Board if they wish to seek relief under the Board's phasing constraint. Should the complainants wish to pursue such claims, the parties will be afforded an opportunity to address whether the magnitude of these rate increases violated the phasing constraint and, if so, what relief should be afforded at this point.

This concludes our statement. We would be happy to answer any questions that you may have.