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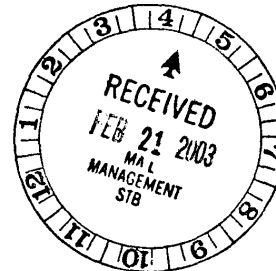
February 21, 2003

FEB 21 2003

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BY HAND

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street NW - Suite 820
Washington, DC 20423



**Re: STB Ex Parte No. 638 - Procedures to Expedite Resolution of
Rail Rate Challenges to be Considered under the Stand-Alone
Cost Methodology**

Dear Secretary Williams:

Pursuant to the Board's Notice in this docket served February 6, 2003, I enclose for filing an original and 10 copies of the Written Testimony of Union Pacific Railroad Company. A certificate of service is attached to the filing.

Please file-stamp the enclosed extra copies of the filing and return them to our messenger. Thank you very much.

Sincerely yours,

Carolyn F. Corwin

Carolyn F. Corwin
Counsel for Union Pacific
Railroad Company

Enclosures

**BEFORE THE
SURFACE TRANSPORTATION BOARD
WASHINGTON, D.C.**

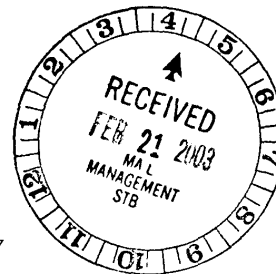
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Procedures to Expedite Resolution
of Rail Rate Challenges to be Considered
Under the Stand-Alone Cost Methodology

STB Ex Parte No. 638



**WRITTEN TESTIMONY OF
UNION PACIFIC RAILROAD COMPANY**

Presented by
J. Michael Hemmer
Vice President - Law

Submitted February 21, 2003

**BEFORE THE
SURFACE TRANSPORTATION BOARD
WASHINGTON, D.C.**

Procedures to Expedite Resolution)
of Rail Rate Challenges to be Considered)
Under the Stand-Alone Cost Methodology)

STB Ex Parte No. 638

**WRITTEN TESTIMONY OF
UNION PACIFIC RAILROAD COMPANY**

Union Pacific Railroad Company ("UP") appreciates this opportunity to present our suggestions for expediting rate challenges using the stand-alone cost ("SAC") methodology. I have been actively involved in defending rate cases on behalf of UP and other railroads for more than 16 years. Since joining UP as Vice President - Law this past September, I have gained a new appreciation of the great significance of rate cases for the railroad.

Each SAC case consumes large quantities of company resources. In order to defend such a case, UP spends millions of dollars on outside counsel and consultants. In addition, UP personnel from virtually every department and in many different locations must devote large amounts of time and effort to comply with discovery requests and to prepare evidence. These cases have always strained the railroad's resources. Due to aggressive downsizing to cut costs, UP no longer has employees with extra time to perform these tasks, so work on rate cases necessarily displaces time spent on the business of running the railroad.

UP has no choice but to make the defense of rate cases a high priority, even though it takes time away from running the railroad and serving shippers. Ultimately, the outcome of these cases can have an enormous impact on our bottom line. If a shipper persuades the Board that it should receive a significantly lower rate, this affects not only the revenue UP earns from that shipper, but also UP's contract negotiations with many other shippers. The Board's decision in the Wisconsin Power & Light case¹ directly affects our negotiations with other Powder River Basin coal customers and even customers receiving coal from other regions. It creates expectations that coal rates will be capped at a comparably low rate. If the Board makes a mistake and sets rates at too low a level in one case, as we believe it did in WPL, UP can never regain the lost revenue.

Rate reductions resulting from rate challenges present a particular problem given UP's persistent inability to achieve revenue adequacy. Over the past 20 years, UP has been unable to earn the rail industry cost of capital for any sustained period. Its cumulative shortfall for the last ten years approaches \$5.5 billion. UP hopes to invest nearly \$1.9 billion during 2003, more than \$1.2 billion of which merely maintains existing track. Yet even this massive investment falls \$400 million to \$500 million short of the amount necessary to preserve and sustain the current UP network. UP is eliminating hundreds of jobs in an effort to squeeze out additional costs and allow necessary investment in the future. These are people who have been working hard and

¹ Wisconsin Power & Light Co. v. Union Pacific R.R., No. 42051 (STB served Sept. 13, 2001), on reconsideration (STB served May 14, 2002), appeals pending, Nos. 02-1198, 02-1225 (D.C. Cir.).

providing support for our services. But at our low rates of return, we cannot afford to perform these tasks. If the Board erroneously orders reductions in UP's rates, the result is to drive UP even further from achieving revenue adequacy, and to push us toward even more aggressive cost reductions. It is costly to litigate SAC cases, but we cannot afford to take these cases lightly.

UP joined the Association of American Railroads' earlier comments and supports the AAR's testimony today. In addition, UP submitted its own reply comments providing its perspectives on several points raised by others and identifying some practical considerations of which the Board should be mindful. We urge the Board to consider all of those submissions carefully.

Today I want to suggest additional steps the Board could take in its effort to expedite the handling of rate cases. These suggestions arise out of UP's experience with major rate cases involving coal and other commodities during the past few years. Consistent with the focus of this proceeding, our suggestions are primarily procedural in nature. I will also comment on difficulties UP has encountered in connection with the now-routine practice of placing rate case filings under seal.

1. Reduce Discovery Burdens

We offer several suggestions for how the Board could reduce the costs and burdens of discovery in rate cases, allowing it not only to save parties money but also to avoid motions practice and move cases along more efficiently. Discovery in rate cases is extremely expensive for railroads. While some shippers have complained about discovery burdens, railroads bear most of the burdens in SAC cases. The railroad possesses data and information about its own operations and costs, which are the chief sources of reliable information for variable and stand-alone cost computations.

We understand that a shipper preparing evidence in a rate case needs many types of information from the defendant railroad. However, UP has repeatedly been faced with cumulative and excessive discovery requests in rate cases. In the FMC case,² the shipper served on UP over 800 interrogatories and document requests (counting subparts separately). Among other things, UP was asked for and produced: several years' worth of detailed train operating statistics for thousands of miles of rail lines; payroll records for thousands of train crew and clerical employees; detailed descriptions of and cost information concerning all facilities, structure, and track in ten western states; confidential contracts between UP and FMC's competitors and customers; dozens of commercially sensitive coal contracts; voluminous car hire records; the location and description of every road crossing from Chicago to Portland; real estate transaction files; hundreds of oversized valuation maps; purchasing department records; and much, much more.

The FMC discovery requests sought vast amounts of computerized data, which required UP to invest in costly and time-consuming efforts to determine which of its systems contained relevant data and to compile the requested records from massive computer databases. In all, UP produced 214 computer disks and cartridges, more than 225,000 pages of documents, and 582 maps.

Discovery requests in rate cases seek incredibly detailed information. In the pending Arizona Electric Power Cooperative case,³ for example, the shipper

² FMC Wyoming Corp. v. Union Pacific R.R., STB Docket No. 42022 (STB filed Oct. 31, 1997).

³ Arizona Electric Power Cooperative, Inc. v. Burlington Northern & Santa Fe Ry. & Union Pacific R.R., STB Docket No. 42058 (STB filed Dec. 29, 2000).

requested, for each \$3,557 end-of-train telemetry device (“EOTD”) used on AEPCO trains, the date of purchase, the original cost, the costs of any additions or betterments, the debt rate as a percent, the financing terms, annual depreciation, annual depreciation rate as a percent, salvage value, and accumulated depreciation. That is just one example.

UP suggests that, in addition to endorsing the narrower discovery standard it has proposed in this proceeding, the Board should rein in discovery in the following ways.

A. Limit the number of discovery requests a party may pose. The federal courts limit discovery, and so should the Board. For example, Fed. R. Civ. P. 33(a) limits a party to 25 written interrogatories, including all discrete subparts, unless the party obtains leave of court or a written stipulation. We suggest that in SAC cases the Board consider imposing on both sides a limit of ten requests for qualitative market dominance, 25 requests for variable costs, and 50 requests for stand-alone costs, with each request limited to no more than four subparts. Such a rule could provide for exceptions where the Board grants leave on the basis of unusual need or the parties stipulate in writing to higher limits.

B. Establish that a party need not produce multiple versions of the same information. UP expects that the Board’s more rigorous discovery standard will discourage requests for multiple versions of what is essentially the same information. For example, application of this standard should avoid the situation in the Northern States Power case,⁴ described in our reply comments, in which UP was required to produce

⁴ Northern States Power Co. Minnesota v. Union Pacific R.R., STB Docket No. 42059 (STB filed Jan. 26, 2001).

archived and redundant train dispatcher sheets, despite the fact that it had already produced train movement files, train delay records, and crew data. Nevertheless, to avoid any ambiguity, the Board should state explicitly that parties need not produce multiple versions of data.

C. Establish standard time periods for which documents and data should be produced. In many instances, parties request documents or data going back many years and up through the current date. In each case, the parties must negotiate more limited time periods and cut-off dates to reduce the burden of discovery and to tailor production to what a party actually needs to prepare its evidence.

UP believes that, for the most part, a shipper needs variable cost information for no more than one year prior to the filing of the complaint and stand-alone cost information for a period beginning no more than two years before the filing of the complaint.⁵ The Board should establish these as standard time periods for discovery, absent agreement by the parties on a different period or grant of leave from the Board. Setting standard time periods would avoid delay resulting from extended negotiations between the parties and reduce motions practice relating to time periods for discovery.

The Board should also provide for a cut-off of discovery no later than the end of the last full calendar quarter prior to filing of initial evidence. Cut-off dates are necessary to avoid repeated searches for the same data. Repeated productions increase costs and complicate the case for both the producing and receiving party. A cut-off date

⁵ A longer period might be appropriate for certain information. For example, it could be appropriate to permit discovery of traffic volumes and revenues for a longer period, to allow a party to develop information on volume and revenue trends.

permits a party to begin and complete document searches promptly in confidence that it will not be required to conduct repetitive searches to supplement its prior production.

D. Dispute resolution conferences before a motion to compel is filed.

Discovery motions consume substantial time, cost a great deal of money, and delay rate cases. UP's reply comments describe the types of difficulties it has encountered in responding to motions to compel filed against it in some rate cases. The Board can take steps to help parties resolve disputes without motions practice.

First, the Board could require parties to present discovery disputes before a Board staff member, who could act as a mediator and facilitate discussion. Second, before such a conference, the party seeking discovery should be required to present to the other party copies of the disputed requests, the responses, all correspondence between the parties relating to the requests, and a specific explanation of why the seeking party cannot prepare its evidence without the requested data. The conference would then be focused and efficient. Then, if the dispute remains unresolved, any motion to compel should include the pertinent history, allowing the objecting party to respond more quickly and ensuring that the Board will have a complete record before it.

2. Limit Evidentiary Submissions

We suggest that the Board could simplify evidentiary presentations in several additional ways, thereby reducing discovery burdens and allowing the Board to decide rate cases more quickly.⁶ Two of these steps relate to computation of variable

⁶ There is precedent for this approach. In 1998, the Board eliminated consideration of product and geographic competition in determining market dominance in rate cases. See Market Dominance Determinations - Product and Geographic Competition, 3 S.T.B. 937 (1998), remanded sub nom. Association of American Railroads v. STB, 237 F.3d 676 (continued...)

costs in determining jurisdictional thresholds, and the other would simplify the stand-alone analysis.

A. In calculating variable costs, the Board should rely more heavily on unadjusted URCS costs. As a matter of law, unadjusted URCS costs must be used to determine variable costs, unless the Board determines that a different approach is preferable. See 49 U.S.C. § 10707(d)(1)(B). For types of costs directly associated with movement of the disputed traffic -- e.g., crew wages or locomotive ownership costs -- data specific to how the railroad handles that traffic should be used to determine variable costs. But for other categories involving indirect or common costs that are not attributable uniquely to transporting the traffic in dispute -- such as the costs of road property or the costs of track maintenance -- the search for supposedly precise, movement-specific costs is an expensive litigation game by both sides that often does not yield a more accurate answer than unadjusted URCS costs and that requires substantial STB resources to review and evaluate.

Parties have expended astonishing amounts of shipper and railroad money on discovery and development of evidence in efforts to adjust URCS costs. The resulting allocations often reflect faulty assumptions and incomplete or mismatched data.⁷ The

(D.C. Cir. 2001), on remand, STB Ex Parte No. 627 (STB served Apr. 6, 2001), petition for review denied sub nom. Association of American Railroads v. STB, 306 F.3d 1108 (D.C. Cir. 2002). The Board took this step in part to simplify rate cases and reduce burdens on the parties. 3 S.T.B. at 946-49.

⁷ In presenting proposed adjustments to URCS costs based on inappropriate data, shippers appear to want to create record-keeping requirements above and beyond the STB's accounting rules. Congress directed that the Board's cost accounting rules be "the most efficient and least burdensome means by which the required information may be developed for regulatory purposes." 49 U.S.C. § 11161. Yet consultants for shippers in rate cases criticize railroads for not maintaining records that better suit their litigation (continued...)

Board in turn must spend extra staff time evaluating the parties' conflicting evidence on such issues. This type of investment is lucrative for consultants and outside counsel but an unreasonable burden on the parties. The Board should instruct the parties to use URCS costs unless the costs are directly attributable to the movement in dispute. This will reduce costs and allow cases to move more quickly.

B. The Board should restrict parties to two evidentiary submissions each on variable costs. In almost every type of litigation and alternative dispute resolution proceeding, a party submits at most two evidentiary filings: an opening and a reply. In SAC cases, however, each side submits three rounds of evidence on variable costs: opening evidence, reply evidence, and rebuttal evidence. These six filings are excessive and unnecessary, and they encourage the parties to "sandbag" their opponents by withholding evidence until later rounds. I have twice asked opposing counsel for a simpler, two-round schedule in rate cases, but without success. UP urges the Board to eliminate the unnecessary third filing on variable costs.

The Board should also consider requiring the parties to meet and confer prior to filing their opening variable cost evidence in an effort to iron out potential differences in basic data (e.g., number of cars, tons, and locomotives). Parties now resolve such nuts and bolts issues through sequential filings with the Board. An opportunity to confer in advance would allow the parties to resolve at least some of these issues before any evidence is filed.

purposes, regardless of what the Board's rules require or whether there is any business purpose that would support the additional effort.

C. The Board should end its practice of attempting to predict traffic volumes and revenues of the stand-alone railroad far into the future. In most recent SAC cases, the Board has attempted to predict rates 20 years into the future. This exercise adds to the complexity of rate cases, while yielding inaccurate results. Parties conduct extensive discovery in order to support favorable rate projections based on detailed analyses of other shippers' contracts, projections of the Rail Cost Adjustment Factor ("RCAF"), evidence of future demand for coal, predictions of export markets for other commodities, speculation about global warming, and a myriad of other factors that may influence the volume of traffic and rates paid for the traffic for 20 years into the future. This effort is unnecessary when evidence of historical trends is available.

The prediction of traffic and revenue levels far into the future is particularly inappropriate because it is so far beyond the Board's transportation-related expertise. In Ex Parte 627, the Board eliminated consideration of product and geographic competition in rate cases in part because it believed that it lacked the expertise to analyze markets for various commodities.⁸ Predictions of future traffic volumes and rates raise even more difficult questions, questions that are at least as far from the core expertise of the Board. We respectfully suggest that the same considerations that led the Board to end consideration of product and geographic consideration in rate cases should lead it to abandon its efforts to predict traffic volumes and rates in a manner that departs from observable historical trends.

⁸ See Market Dominance Determinations, 3 S.T.B. at 947.

With respect, the Board has shown no facility for long-term forecasts. Its predictions have been wrong. As we have explained in briefs we filed on appeal in the WPL case, the Board has projected ever-increasing coal rates, even though its own studies show that coal rates have been declining over the last two decades. The same has been true for the Board's predictions of traffic volumes, where the Board tends to fall back on internal railroad forecasts even when these are shown to be too optimistic.

Rather than attempt to forecast volumes and rates far into the future, the Board should simply identify recent trends and project them into the future. The Board could require parties to produce historical traffic data for an appropriate period for the traffic selected by the shipper for its stand-alone railroad.

Minimizing the number of adjustments to URCS, reducing the number of variable cost filings, and adopting a simplified approach to forecasting of traffic volumes and revenues should reduce the discovery burdens and avoid discovery disputes. These measures (along with the conference prior to filing of variable cost evidence that we recommend) will also help to reduce the burden of preparing evidentiary submissions and standardize the processing of rate cases, allowing the Board to decide these cases more quickly and efficiently. Furthermore, by narrowing the range of issues in dispute, these steps will reduce uncertainty and thereby increase the odds of the parties' reaching negotiated settlements.

3. Litigate in the Sunshine

Finally, UP is deeply troubled by the fact that virtually all evidence and argument in rate cases is filed under seal. While commercially sensitive data must be protected from improper disclosure, overuse of protective orders regularly shields the opinions of experts and the arguments of counsel from scrutiny and comparison. It also

impedes the ability of in-house counsel and fact witnesses to review and respond to evidence. Much of the shielded material is not confidential at all. For example, UP sees no reason to treat the configuration or operating plan of a hypothetical SAC railroad as a secret.

Masking rate case filings deprives the public of the opportunity to see the arguments and evidence the parties present, except to the extent the Board eventually reveals them in its decision. As a result, lawyers sometimes offer arguments that UP cannot expose as inconsistent with prior positions. Consultants can encourage rate litigation by making promises that public filings would show are too optimistic. UP cannot explain to a shipper that arguments the shipper is making in a negotiation are contrary to a position its consultant has taken in a rate case involving another shipper.

The practice of filing everything under seal also prejudices defendant railroads in a very practical way. Most of the issues in a SAC case involve railroad traffic, engineering, operations, and costs, about which railroad employees have unequaled expertise. However, when the shipper designates its evidence as Highly Confidential and files it under seal, under the terms of the standard Board protective order the railroad's outside counsel cannot show any of the evidence to railroad employees (including in-house counsel), even when all of the confidential material came from the railroad. Several days pass before the shipper voluntarily provides or approves a redacted version of the evidence that may be shown to railroad employees. As a result, the railroad loses valuable time evaluating the shipper's evidence and preparing its own evidence. In view of the limited amount of time railroads have to prepare their reply evidence and the very large number of issues they must address, delays in obtaining

redacted evidence that in-house railroad personnel may review impairs the railroads' ability to prepare reply submissions.

UP urges the Board to provide that a party must (a) simultaneously with the filing of any submission under seal, serve on the other party a version of the submission (including hard copy and electronic workpapers) that may be shown to the other party's in-house personnel, and (b) within a reasonable period after making a filing under seal, submit to the Board and serve a public version of its submission. This approach would serve the public interest by allowing the parties to review and respond to evidentiary submissions more promptly and by opening the Board's proceedings to public scrutiny.⁹ The Board should also require that protective orders (a) state that their purpose is to protect the parties' confidential information, not the opinions of experts or the arguments of counsel and (b) state that a party has the right to see its own data or information without the prior approval of opposing counsel.¹⁰

* * *

While UP has other concerns about how rate cases are handled, we can all agree that reducing the burdens of litigating and deciding these cases is a worthwhile goal. UP commends the Board for inviting suggestions on how to improve the process.

⁹ It is feasible to protect confidential information from improper disclosure while providing public access to filings in rate proceedings. UP demonstrated this by voluntarily preparing public versions of much of its own evidence in the FMC rate case.

¹⁰ UP was able to persuade one party to agree to such a provision in a protective order. In the next case, however, the same law firm representing a different shipper resisted a similar provision in that protective order. Board action is required to address such problems.

We believe implementation of the suggestions we have outlined above will help the Board to achieve this goal.

I would be pleased to respond to any questions.

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Written Testimony of Union Pacific Railroad Company was sent on this 21st day of February, 2003, by first-class mail, postage prepaid, to:

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