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June 16, 2005

BY HAND

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

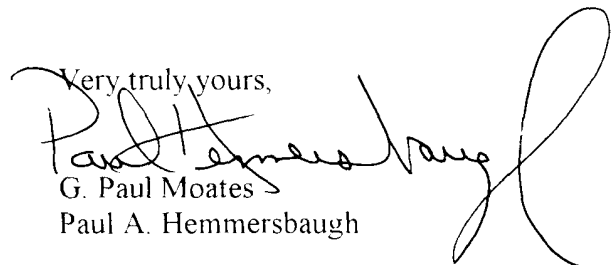


Re: STB Docket No. 42093, BP Amoco Chemical Co. v. Norfolk Southern Railway Co.

Dear Secretary Williams:

Enclosed, for filing in the above-referenced matter, are the original and ten copies of the **Comments of Norfolk Southern Railway Company Regarding Procedures and Standards Announced in June 6, 2006 Decision**. We have enclosed both a Confidential version, which contains confidential, non-public information, and a Public Version that may be made available to the public. Also enclosed are two computer disks containing copies of the Confidential and Public versions of the filing.

Please file-stamp the enclosed copies for our files, and return the stamped copies with our messenger. If you have any questions concerning this filing, please contact one of the undersigned.

Very truly yours,

G. Paul Moates
Paul A. Hemmersbaugh

cc: Michael McBride
George Aspatore

214197
STB Docket No. 42093

BEFORE THE
SURFACE TRANSPORTATION BOARD

Public Hearing

BP AMOCO CHEMICAL COMPANY,

Complainant,

vs.

NORFOLK SOUTHERN RAILWAY COMPANY,

Respondent.

PUBLIC VERSION

STB Docket No. 42093



**COMMENTS OF NORFOLK SOUTHERN RAILWAY COMPANY REGARDING
PROCEDURES AND STANDARDS ANNOUNCED IN JUNE 6, 2005 DECISION**

Norfolk Southern Railway Company ("NS") respectfully submits its comments in response to the Surface Transportation Board's ("STB" or "Board") June 6 Decision in this matter. *See* Decision, *BP Amoco Chemical Co. v. Norfolk Southern Railway Co.*, STB Doc. No. 42093 (served June 6, 2005) (the "*Decision*"). NS is concerned about the new standards and procedures announced in the *Decision*, and believes certain of them are inconsistent with governing law and regulations, prior Board precedent, and sound economic principles. Below, NS identifies some significant issues and ambiguities raised by the approach proposed in the *Decision*, and requests that the Board modify and clarify the *Decision* to address NS' concerns.

I. THE BOARD SHOULD ALLOW SOME ADJUSTMENTS TO PHASE III URCS COSTS

The Board's desire to avoid a lengthy and expensive battle over adjustments to URCS costs in a "simplified proceeding" is understandable in light of its mandate to establish a "simplified and expedited method for determining the reasonableness of challenged rail rates" in

cases in which a full SAC presentation would be too costly. 49 U.S.C. § 10701(d)(3). Indeed, in keeping with those objectives, NS does not intend to oppose BP Amoco's request (should mediation fail to resolve this matter) that this case be considered under the modified guidelines and regulations established by the Board in *Rate Guidelines – Non-Coal Proceedings*, 1 STB 1004 (1996) ("*Guidelines*").¹ However, attempting to advance those objectives by prohibiting all adjustments to URCS goes too far, because such a blanket prohibition can – and in this case would – result in costs that are clearly, materially inaccurate. NS therefore requests that the Board include, as one of the issues to be addressed in Phase I, proposed adjustments to URCS costs. By deciding whether to allow adjustments on a case-by-case basis, the Board can accomplish its objective of limiting delays and costs sometimes associated with some movement-specific costing, without resorting to a prohibition of all adjustments, regardless of their magnitude, materiality, or importance to a fair and objective evaluation of the reasonableness of the challenged rate.

In the present case, a few material variable cost adjustments are essential to an accurate, fair and meaningful evaluation of the reasonableness of the challenged common carrier rate. These costs are readily ascertainable from objective sources, and it should not require significant time or resources for the parties to present their positions regarding them. The following description of significant cost adjustments, which does not purport to be exhaustive, describes three specific, significant adjustments that NS has identified at this early stage of the proceeding

¹ NS' decision not to contest eligibility – which is based upon NS' assessment of the unique circumstances of this case – is for purposes of this case only. NS does *not* concede that this case would be eligible for simplified treatment under the appropriate standards. Rather, NS has decided to forgo an eligibility contest in this case, in order to facilitate the goal of Congress and the Board that, where possible, rate cases be adjudicated expeditiously and inexpensively. Furthermore, NS reserves all of its rights to judicial review, including the right to contest on appeal the lawfulness of the Guidelines and/or the way the Guidelines are applied in this case.

as essential to an accurate statement of the costs of handling the issue traffic, even under a simplified methodology for testing rate reasonableness.

First, it is important that the variable cost calculation include the full cost of the mileage allowances NS pays for the private tank cars used to transport paraxylene. NS' common carrier rate provides for the payment of full mileage allowances, which NS has estimated to be approximately ____ per tank car for this movement. *See* NSRQ 64831; NS Response to Board's May 23 Order at 2 (May 26, 2005). Because the applicable mileage allowance is set by a formula prescribed by the Board, this variable cost is readily ascertainable and objectively verifiable, and there should be no debate about the mileage cost NS pays to the owner of the tanker cars. Determining this cost places no undue burden on BP Amoco, as it knows what cars are used to transport its products.

Moreover, under either party's preliminary estimate of the variable costs of the issue movement, ____ represents a significant, material portion of those costs.² If the Board were to proscribe all adjustments to URCS, this significant, incontestable cost would be excluded, resulting in a very substantial understatement of the movement's variable costs.

Second, a "make whole" adjustment to URCS costs is required. As the Board knows, the costs produced in a Phase III URCS run do not reflect all of a railroad's costs reported in its R-1. In order to account for the full variable costs attributable to the issue traffic, costs that are specific to each railroad must be added in accordance with the formula provided by the Board (*i.e.*, the make whole adjustment).

² Even using BP Amoco's understated variable cost calculations – which NS does not accept – the mileage allowance would account for roughly ____ of the total variable costs of the movement.

Third, the URCS costs from the Costed Waybill Sample are 2003 costs. Since the rate at issue is a current rate, the costs should be adjusted to 2005 costs. Such an adjustment is a fairly straightforward process.

The adjustments described in the preceding paragraph have several common attributes: (1) Each constitutes a significant variable cost of the issue movement that is not adequately captured by Phase III URCS costs; (2) calculation and evaluation of the cost adjustment should cause little additional expense or delay, because each is readily determined and verified by review of objective sources; and (3) failure to include these movement-specific costs in variable cost calculations would result in a substantial, material understatement of those costs. NS believes that such cost adjustments are absolutely essential to a reasonable, accurate, and meaningful calculation of variable costs for the issue movement even under a simplified methodology as contemplated by the *Guidelines*.³

Furthermore, a ban on all URCS adjustments would be inconsistent with well-established principles and the Board's regulations. As the *Decision* acknowledges, the *Rate Guidelines – Non-Coal Proceedings*, 1 STB 1004 (1996) ("*Guidelines*"), expressly hold that "movement-specific costing should be allowed for both the issue traffic and the comparison traffic." *Decision* at 8. The *Guidelines* – regulations representing the culmination of a decade-

³ In order for URCS to perform the role assigned to it under the *Guidelines*, it will be critical to use accurate parameters and inputs to the URCS costing program in order to ensure accurate system average URCS costs for the issue movement. It appears that NS and BP Amoco may disagree about some of the specific parameters of the issue traffic. To the extent there is a dispute between the parties concerning the essential parameters of the movement (for example, the mileage of the movement or the tonnage moved in each tank car), the Board must determine the correct parameters and use those parameters to ensure an accurate URCS result, prior to making any adjustments to that result. Because NS does not consider the use of accurate inputs and parameters to be an "adjustment," but rather an indispensable element of proper URCS costing, it does not further list or discuss those parameters here.

long series of notice-and-comment rulemaking proceedings -- *reject* the use of system average, unadjusted URCS costs in favor of movement-specific, adjusted calculations of variable costs.

The Board's regulations expressly accept and adopt the position of commenters who argued that:

the greater accuracy obtained through movement-specific costing is preferable to reliance on system-average costing. . . . We [the Board] agree that movement-specific costing is preferable and should be allowed for both the issue traffic and the comparison traffic.

Guidelines, 1 STB 1004, 1038 (emphasis added).

Without any prior notice or opportunity for interested parties to comment, the *Decision* would summarily reverse the existing regulations' preference for movement-specific costs and replace it with a new requirement of "strict adherence" to unadjusted system average costs in cases adjudicated under those regulations. *See Decision* at 8-9 ("[U]pon further reflection we believe that the better policy is not to consider any movement specific adjustments."). As a matter of administrative law, and sound public policymaking, such a significant reversal of a basic element of the rate regulatory regime should be implemented, if at all, only through formal notice-and-comment rulemaking, and after careful consideration of the input of all interested parties. *See, e.g., National Family Planning & Reproductive Health Ass'n, Inc. v. Sullivan*, 979 F.2d 227, 241 (D.C. Cir. 1992) (enjoining implementation of an agency rule change for failure to follow notice-and-comment rulemaking requirement, holding that "when an agency adopts a new construction of an old rule that repudiates or substantially amends the effect of the previous rule . . . the agency must adhere to the notice and comment requirements of the Section 553 of the [Administrative Procedure Act]"); *American Federation of Government Employees v. Fed. Labor Relations Auth.*, 777 F.2d 751, 759 (D.C. Cir. 1985) ("[A]n agency seeking to repeal or modify a legislative rule promulgated by means of notice and comment rulemaking is obligated to undertake similar procedures to accomplish such modification or

repeal . . . and to provide a reasoned explanation for the change addressing with some precision any concerns voiced in the comments received.”); *id.* at 760 (“[W]hile an adjudication can overrule an earlier adjudication, the Administrative Procedure Act clearly provides that a rule can only be repealed by rulemaking.”) (Scalia, J., concurring).⁴

The *Decision* sweeps too broadly when it suggests that ICCTA requires the use of system average costs unless the Board specifies adjustments in a particular case. *See Decision* at 8 and n.8. The statutory provision the Board cites expressly applies only to the threshold determination of whether the rail carrier has “market dominance” over the transportation to which the challenged rate applies. *See* 49 U.S.C. 10707. If the Board determines the rail carrier does not have market dominance, the Board lacks jurisdiction to evaluate the reasonableness of the challenged rate. *See, e.g., Coal Exporters Association v. United States*, 745 F.2d 76 (D.C. Cir. 1984). The jurisdictional statute does not govern on-the-merits determinations of variable costs for purposes of evaluating the reasonableness of a rate once the Board determines it has jurisdiction. Moreover, even for purposes of market dominance determinations, the Board’s discretion is not unlimited. Here, as elsewhere, the Board is bound to follow its precedent unless it provides a full and well-reasoned explanation for departure from that precedent. *See, e.g., New York Cross Harbor Railroad v. Surface Transportation Board*, 374 F.3d 1177 (D.C. Cir. 2004).

⁴ While the Board has provided NS and BP Amoco this limited *post hoc* opportunity to provide comments on the Board’s newly announced rules, other interested parties (including other rail carriers and numerous potentially affected rail shippers, many of whom participated in proceedings in *Ex Parte No. 347 (Sub-No. 2)* and *Ex Parte No. 646*) have been afforded no opportunity to comment.

Thus, the Board is not free to make specific adjustments to variable costs in one case and refuse to make the same adjustments in essentially indistinguishable circumstances in another case.⁵

II. THE BOARD SHOULD CLARIFY THAT THE THREE “BENCHMARKS” ARE MERELY THE STARTING POINT FOR THE RATE REASONABLENESS ANALYSIS, AND THAT OTHER FACTORS WILL BE GIVEN FULL CONSIDERATION IN DETERMINING THE REASONABLENESS OF THE CHALLENGED RATE.

While NS does not believe the Board intended to change the role to be played by the benchmarks, NS seeks confirmation of that view because the *Decision*, read in isolation, might be construed to suggest that the Board’s primary criteria for evaluating the reasonableness of the challenged rate are confined to the three revenue-to-variable cost “benchmarks” discussed in the *Decision* (the RSAM, $R/VC > 180$, and R/VC_{COMP}). The *Decision* focuses primarily on discussion of those three benchmarks, and even establishes a separate phase of the proceeding for the determination of the traffic comparison groups for one of those benchmarks. See *Decision* at 2-3, 5-12. Absent from the *Decision* is any specific discussion of the other factors and analyses that the Board must consider in evaluating the reasonableness of a rate challenged under the simplified *Guidelines*.

⁵In the context of SAC proceedings (whose underlying principles and objectives the *Guidelines* seek to emulate), the Board has consistently and repeatedly endorsed the use of movement-specific costs adjustments to adjust URCS system average costs to better reflect the actual costs of providing specific service. See, e.g., *Minnesota Power, Inc. v. Duluth, Missabe and Iron Range Railway Co.*, STB Doc. No. 42038, slip op at 3 (served March 6, 2000) (“Because a carrier’s systemwide average costs are not necessarily representative of the costs of providing a particular service . . . appropriate adjustments are made in individual rate cases to determine as nearly as possible the costs attributable to providing the service at issue.”); *Wisconsin Power & Light Co. v. Union Pacific Railroad Co.*, STB Doc. No. 42051, slip op at 38-39 (served Sept. 13, 2001) (to same effect); *FMC Wyoming Corp. v. Union Pacific Railroad*, STB Doc. No. 42022, slip op at 48 (served May 12, 2000) (same); see also *AEPCO v. BNSF and UP*, STB Doc. No. 42058, slip op at 7 (reiterating Board’s “stated preference for line-specific [variable cost] data, where reliable”). As the Board has recognized, judicious use of reliable movement-specific URCS cost adjustments results in more accurate and better variable cost estimates, which are essential elements of rate reasonableness determinations.

The *Guidelines* make it clear that, far from being conclusive or determinative, the three R/VC benchmarks are merely the initial starting point in a proper rate reasonableness analysis. The Board summarized the role of the benchmarks in evaluating a rate case under the *Guidelines* as follows:

While none of the benchmarks is perfect, we are satisfied that each is instructive for a simplified rate reasonableness analysis. Taken together, they allow us to consider each of the relevant statutory factors. At the same time, each measure serves as a check on the other two. Moreover, as explained above, the three benchmarks are only the starting point for our analysis. They can and should be supplemented, as appropriate with any particularized evidence that would qualify or modify what one or more benchmarks might otherwise indicate.

Guidelines, 1 STB 1004, 1041 (emphasis added). The *Guidelines* repeatedly emphasize the Board's "conclusion that none of the r/vc measures alone provides a sufficient, all-purpose test of rate reasonableness, and that, even in combination, these measures can only provide a starting point for what must become a more particularized analysis." *Id.* at 1020 (emphasis added).

Moreover, in dismissing a challenge to the *Guidelines* as unripe, the United States Court of Appeals for the D.C. Circuit relied in large part upon the Board's assurance in the *Guidelines* that the benchmarks would serve only as a starting point in the Board's rate reasonableness analysis, and that the Board would consider all of the other relevant factors and evidence, and would not rely upon mechanistic application of the benchmarks to determine the reasonableness of a challenged rate. *See Association of American Railroads v. Surface Transportation Board*, 146 F.3d 942, 945, 946-47 (D.C. Cir. 1998).⁶

⁶ Because the DC Circuit has held that judicial review of the *Guidelines* is not appropriate until the Board has applied them to find a rate unreasonable, NS is precluded from seeking judicial review of the *Guidelines* at this juncture. *See id.* at 948. NS does not, by participating in this proceeding, concede that the *Guidelines*, either as written or as they may be applied by the Board, are lawful or enforceable. Rather, NS expressly reserves all of its rights to challenge any

(Footnote continued)

The *Guidelines* list a few illustrative examples of other factors and considerations that must guide the Board's consideration and determination of rate reasonableness beyond those initial starting points:

How a particular carrier's revenue requirements can and should be allocated within its traffic base . . . is affected by such factors as the mix of competitive and captive traffic handled by that carrier, the degree of competition that it faces on its competitive traffic, and the relative density of the routes that it operates. Moreover, the specific markup charged to particular traffic should reflect demand-based differential pricing principles.

Guidelines, 1 STB at 1033-34. Other examples of important factors that the Board should consider in this case are the risks that accompany transportation of a hazardous commodity like paraxylene, and capacity constraints on the lines used by the issue traffic.

NS requests that the Board affirm and clarify what its governing regulations expressly state: that the three benchmarks are merely the starting point for a rate reasonableness analysis, and that the Board expects and will fully consider other relevant evidence and factors in its evaluation of the reasonableness of the challenged rate. Finally, NS asks that the Board clarify when, in the procedural schedule, such non-benchmark evidence should be submitted. It appears to NS that the Board contemplates that such evidence would be submitted in Phase III, along with market dominance evidence and other evidence on "the merits of the case."

aspect of the *Guidelines* issued in Ex Parte 347 (Sub. No. 2), as well as any application of the *Guidelines* to NS in this or in any other case.

CONCLUSION

For the reasons described above, NS requests that the Board make the adjustments, clarifications, and corrections requested in these Comments.

Respectfully Submitted,



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Paul A. Hemmersbaugh

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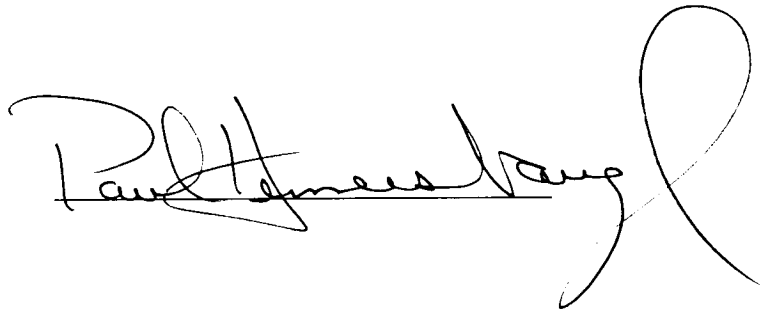
Dated: June 16, 2005

Certificate of Service

I hereby certify that, on this 16th day of June, 2005, I served a copy of the foregoing *Comments of Norfolk Southern Railway Company Regarding Procedures and Standards Announced in June 6, 2005 Decision* by causing it to be delivered by express courier to:

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Counsel to Complainant BP Amoco Chemical Company

A handwritten signature in black ink, appearing to read "Paul H. James", written over a horizontal line. The signature is stylized with a large loop at the end.