

LEBOEUF, LAMB, GREENE & MACRAE LLP

NEW YORK
WASHINGTON, D.C.
ALBANY
BOSTON
CHICAGO
HARTFORD
HOUSTON
JACKSONVILLE
LOS ANGELES
PITTSBURGH
SAN FRANCISCO

1875 CONNECTICUT AVE., N.W.
SUITE 1200
WASHINGTON, D.C. 20009-5728
(202) 986-8000
FACSIMILE: (202) 986-8102

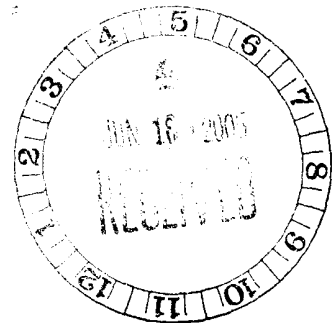
E-MAIL ADDRESS: MICHAEL.MCBRIDE@LLGM.COM
WRITER'S DIRECT DIAL: (202) 986-8050

LONDON
A MULTINATIONAL
PARTNERSHIP
PARIS
BRUSSELS
JOHANNESBURG
(PTY) LTD.
MOSCOW
RIYADH
AFFILIATED OFFICE
BISHKEK
ALMATY
BEIJING

June 16, 2005

VIA HAND DELIVERY

Mr. Vernon A. Williams, Secretary
Surface Transportation Board
1925 K Street, N.W., 7TH Floor
Washington, DC 20423-00001



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

Dear Mr. Williams:

Enclosed for filing are the originals and 10 copies of the "confidential" and "public" versions of "Comments of Complainant BP Amoco Chemical Company on Certain Issues Raised by the Board in Its Decision Served June 6, 2005" in the above-referenced proceeding.

Respectfully submitted,

Michael F. McBride

Michael F. McBride

Attorney for BP Amoco Chemical Company

Enclosure

cc (w/encls.): Mr. Tom O'Connor
Mr. Luis M. Sierra
Mr. Jeffrey Foshee
George A. Aspatore, Esq.
G. Paul Motes, Esq.

214200

Public

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Docket No. 42093

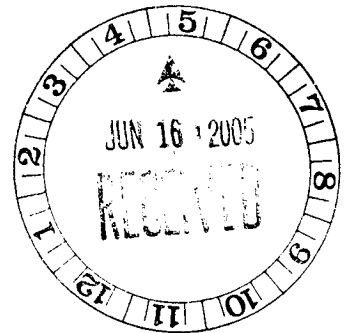
BP AMOCO CHEMICAL COMPANY,
Complainant,

v.

NORFOLK SOUTHERN RAILWAY COMPANY,
Respondent.

ENTERED
Office of Public Access

Part of
Public Record



COMMENTS OF COMPLAINANT BP AMOCO CHEMICAL COMPANY ON
CERTAIN ISSUES RAISED BY THE BOARD IN ITS DECISION SERVED JUNE 6, 2005

Introduction and Summary

Complainant BP Amoco Chemical Company ("BP") hereby submits its Comments on three issues addressed in the Board's Decision served June 6, 2005 ("June 6 Decision"). The three issues concern changes the Board has decided to make to its previous approaches to the same issues in *Rate Guidelines – Non-Coal Proceedings*, 1 S.T.B. 1004 (1996) ("*Rate Guidelines*"), for purposes of this proceeding. The issues on which the Board requested comments are: (1) changes proposed to implement the calculation of variable costs using only unadjusted Uniform Rail Costing System ("URCS") costs, (2) use of the unadjusted "revenue-shortfall allocation methodology" ("RSAM"), and (3) a process for selecting the comparison traffic group.

BP does not challenge the Board's right either to apply its *Rate Guidelines*, or to depart from them in this proceeding, as it deems appropriate. *E.g.*, *SEC v. Chenery Corp.*, 332 U.S. 202-03 (1947). However, in order to justify a departure from its presumptively applicable *Rate Guidelines*, the Board must "cogently explain why it has exercised its discretion in [the] given

manner." *Exxon Corp. v. FERC*, 206 F.3d 47, 54 (D.C. Cir. 2000)(quoting *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 48-49 (1983)).

The Board has provided an appropriate rationale for using unadjusted URCS costs, *for comparative purposes*, for both the issue traffic and the comparison traffic group.¹

However, BP respectfully asserts that the Board has not provided a cogent explanation for departing from the use of the lower end of the "revenue-shortfall allocation methodology" ("RSAM") range. The low-end of the RSAM range reflects adjustments to applicable rate levels for managerial inefficiency, and recognizes the applicability of the "Long-Cannon Amendment" (49 U.S.C. § 10701(d)(2)²), which the statute *requires* the Board to consider. The Board's treatment of the matter would in essence presume that *no* rate NS charges fails to contribute to going concern value, or inadequately contributes to NS's revenues. The Board may not make that assumption without violating the Long-Cannon Amendment.

The Board also has not provided a cogent rationale for departing from use of the entire costed Waybill Sample as the "comparison traffic group." One of the very purposes of the Waybill Sample is to provide a statistically reliable basis for comparison to other comparable traffic in rate reasonableness proceedings; accordingly, BP believes that the Board must rely on it for the

¹ BP reserves the right to present movement-specific cost adjustments if the Board were to adopt a rate-reasonableness standard that is based on *actual* (i.e. *accurate*) costs, rather than one based on a *comparison* of R/VC ratios for traffic for which no movement-specific cost adjustments were made. BP also reserves the right to argue that any cost figure the Board might otherwise rely on is erroneous.

² The Interstate Commerce Commission and its successor agency the STB were charged with protecting individual captive shippers from unreasonably high rate levels. The STB is also directed to ensure that carriers have the opportunity to earn revenues that are adequate to cover costs, allow replacement of needed assets, and provide a fair return. When determining a maximum reasonable rate, the STB was specifically directed to consider three so-called Long-Cannon factors, set forth in 49 U.S.C. § 10701(d)(2). These factors are: (a) the amount of traffic transported at revenues which do not contribute to going concern value and the efforts made to minimize such traffic; (b) the amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic; and (c) the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues.

comparison traffic group. Assuming *arguendo* that the Board has an adequate rationale for not relying on the *entire* costed Waybill Sample, and instead for relying on a smaller comparison group, it has provided no reasoned basis for creating an "either or" approach, *i.e.*, using only one party's comparison group, instead of creating the best comparison group from the available data. If the rationale is that it will take too many staff resources to create its own comparison group, the answer is that the Board should use the *entire* costed Waybill Sample. Consideration of the Long-Cannon factors requires consideration of the entire traffic base.

Argument

I.

THE BOARD MAY USE UNADJUSTED URCS COSTS FOR COMPARISON PURPOSES.

A. Use of Unadjusted URCS Costs for Comparison Purposes. The Board concedes that *Rate Guidelines*, 1 S.T.B. at 1038, contemplate the use of movement-specific adjustments in calculating variable costs.³ However, the Board proposes "not to consider any movement-specific adjustments" in this proceeding. June 6 Decision at 8.⁴ The Board proposes that

³ "Shippers argue that the greater accuracy obtained through movement-specific costing is preferable to reliance on system-average costing. They suggest that, to obtain consistency, the better approach would be to allow movement-specific cost adjustments for the comparison traffic where possible. We agree that movement-specific costing is preferable and should be allowed for both the issue traffic and the comparison traffic." 1 S.T.B. 1037-38 (footnotes omitted). "Indeed, AAR claims that management costing tools are more accurate because they are movement-specific." *Id.* n. 107. Therefore, the Board acknowledges that, at least on an absolute basis, movement-specific adjustments are preferable, because they cause cost determinations to better conform to the facts.

⁴ It is somewhat unclear exactly what the Board means by this statement. BP is under the impression that, despite its language, the Board intends to make certain adjustments, such as those that flow from Ex Parte No. 270 (Sub-No. 4). Moreover, certain "adjustments" to URCS costs are necessary to conform to the facts. For example, URCS would apply a circuitry factor unless it is overridden. Here, the appropriate input is to use 1.0 to override the circuitry URCS would otherwise apply. Also, BP provides the railcars used in the transportation at issue, so NS incurs no car costs. Therefore, it would not be proper to include Car Rental costs from Line 405 of URCS as a cost to NS, nor would it be proper to treat the mileage allowance as a "cost" to NS, when the costs of the cars are borne by BP. Whatever rate methodology the Board uses must conform to the facts. *BP West Coast Products, LLC v. FERC*, 345 F.3d 1263, 1291 (D.C. Cir. 2004) ("under cost-of-service principles, a regulated company is entitled to a rate design

approach for several reasons, including its desire to reduce the burden and expense of these types of proceedings. The Board also noted that, because the revenue/variable cost ("R/VC") ratios for the issue traffic would be *compared* to R/VC ratios for comparison traffic under certain of its *Rate Guidelines*, making adjustments to both the issue traffic and the comparison traffic would likely "cancel each other out," citing *Burlington Northern R.R. v. ICC*, 985 F.2d 589, 601 (D.C. Cir. 1993). The Board's analysis is rational and therefore reasonable, provided that its conclusion applies only to the computation of costs for R/VC *comparison purposes*, and not to any measure of reasonableness based on the *absolute* level of costs.⁵ (We note in passing that consideration of the Long-Cannon factors requires access to the entire STB costed Waybill Sample.)

BP applauds the Board's concern with the amount of transaction costs of proceedings such as this one. In part for that reason, BP does not challenge the Board's policy judgment to rely on unadjusted URCS variable-cost calculations *for comparison purposes* to R/VC ratios for other traffic or groups of traffic. Also, BP agrees with the Board that, relying on the *Burlington Northern R.R.* decision, any adjustments that might be made to the issue traffic would also be made to the traffic in whatever comparison group is used, largely canceling each other out.

to yield sufficient revenue to cover its appropriate cost..."). It would be helpful if the Board were to clarify what types of adjustments, *if any*, it will permit to URCS costs, and what it will not.

⁵ BP would have a right to present evidence on the *actual* variable costs for the issue traffic, if the Board were to apply a guideline or standard herein that determined the maximum reasonable rate as a function of cost (*e.g.*, that all rates over 250% of variable costs are unreasonable). Under those circumstances, the Board would implicitly be representing that its guideline would be based on actual, *i.e.*, accurate, costs. At the present time, there is no indication that the Board intends to follow such an approach in this proceeding. Rather, as BP understands it, the Board intends to use R/VC ratios only for *comparison purposes* to R/VC ratios for similar traffic for the purpose of determining a maximum reasonable rate under 49 U.S.C. § 10701(d)(2). So long as BP's understanding is correct, the Board's approach makes sense, for the reasons stated by the Court of Appeals in *Burlington Northern R.R.*. If at any point, however, the Board decides to determine a maximum reasonable rate by use of actual costs, without comparing R/VC ratios using unadjusted costs for comparative purposes, BP reserves the right to submit movement-specific cost adjustments for the issue traffic. BP must have that right, so that the Board would not be comparing unadjusted URCS costs to presumptively accurate costs. Compare *Burlington Northern R.R.*, 985 F.2d at 600-01.

Accordingly, BP agrees to rely only on URCS average costs for purposes of *comparing* the R/VC cost ratio of the issue traffic with the R/VC ratios for the traffic in the comparison groups.

B. Costs Not Incurred by NS for the Issue Traffic. Nevertheless, in agreeing to the use of URCS unadjusted costs for purposes of determining the variable costs for the issue traffic, it would not be appropriate to assign to the issue traffic any costs that NS does not, in fact, incur in carrying that traffic. *E.g., BP West Coast Products, LLC v. FERC*, 374 F.3d at 1291, citing *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944), and *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486, 1502 (D.C. Cir. 1986). As one example of this, BP owns or leases the railcars used. Therefore, NS incurs *no* car-related costs.

BP assumes that NS and the STB will use the appropriate inputs to URCS to assure that it does not assign car costs to NS for the issue traffic. BP further assumes that, when the Board stated it would use unadjusted URCS costs, it did not intend to refuse to permit the parties to use the appropriate inputs to URCS, or to use the appropriate modifications to URCS if modifications are necessary. A regulatory agency must not be prisoner to its methodologies if they do not produce rational results. *BP West Coast Products, LLC, supra*. It would be irrational if the Board were to assign any car costs to NS, when it does not incur any such costs. Accordingly, URCS must be adjusted if it assigns *any* railcar-related costs to NS.⁶

Moreover, the mileage allowance, which is "built into" the "full mileage" tariff rate NS has imposed on BP's traffic, should not be considered a "cost" to NS. *BP West Coast Products, LLC*, 374 F.3d at 1285-93. In fact it represents a cost borne by BP. The mileage allowance is paid to the entity that provides the cars. The only logical treatment of the mileage allowance is

⁶ One adjustment that would therefore be necessary in this proceeding is to remove Car Rental costs from Line 405 of the URCS costs for the issue traffic, because NS bears no such costs here.

simply to subtract it from the revenues collected by NS to reimburse BP because BP owns or leases the railcars used for this movement. Accordingly, BP did not include the mileage allowance associated with the issue traffic in its cost calculations, both because BP provides its own cars, and because the mileage allowance is not a cost to NS. If NS were to include the mileage allowance as a cost to NS in its R/VC computations, it would be erroneous to do so.

II.

THE BOARD MAY NOT DISREGARD UNADJUSTED RSAM R/VC RATIOS BECAUSE THE LONG-CANNON AMENDMENT REQUIRES IT TO CONSIDER TRAFFIC NOT MAKING AN ADEQUATE CONTRIBUTION TO NS'S REVENUES.

The Board has proposed to use only the upper end of the range published by the Board to "reflect[] the average markup that the railroad would need if it were to replace all of its assets as they wear out." June 6 Decision at 9. The Board stated that "[t]he lower end subtracts out any shortfall related to movements priced below the 100% R/VC level in an attempt to capture managerial inefficiencies." *Id.* The Board stated that an R/VC ratio below 100% "does not necessarily reflect improper pricing or a money-losing service." BP respectfully but emphatically disagrees with this approach.

The failure of the railroads to capture revenue available from lower-rated traffic is at odds with the Board's simultaneous observation that "[t]here is no longer significant excess capacity in the rail industry." June 6 Decision at 10. It simply makes no sense that railroads (including NS) continue voluntarily to carry traffic at rates less than 100% of variable costs, if in fact (as the Board appears to have found in the June 6 Decision at 10, and as NS has pled, May 26, 2005 filing at 3) NS has capacity constraints. The only conceivable logical reason for continuing to charge such "below water" rates is that the railroad has agreed to charge such rates by contract.

But BP had no role in such a decision, and agreeing to charge rates that do not even cover the variable costs of providing the service is the definition of managerial inefficiency, especially in a capacity-constrained environment, because by definition the capacity could be devoted to profitable traffic.⁷ Accordingly, under the Long-Cannon Amendment, the costs not recovered from such shippers are not the responsibility of captive shippers such as BP, whose traffic is carried at R/VC ratios over 180% of variable costs.⁸ The Board is not permitted to disregard the Long-Cannon Amendment, any more than it is permitted to disregard the requirement that it find that there is no effective competition for the issue traffic under 49 U.S.C. § 10701(d)(1).⁹

A practical way for the Board to consider the Long-Cannon Amendment is to continue to consider the low-end of the R/VC ratios in the RSAM tables in determining the maximum reasonable rate(s), the purpose for which those lower R/VC ratios were generated.

⁷ Moreover, as stated in the URCS program (Line 697), the constant-cost markup percentage for NS is 133%. That is, if all traffic on NS paid rates equal to 133% of variable costs, NS would recover all of its fully allocated costs. In a capacity-constrained environment, therefore, NS should attempt to recover additional revenue from the traffic below 133% of variable cost, rather than from traffic already bearing very high R/VC ratios, such as BP's traffic at issue. Whether the lower-rated traffic will bear higher rates or not, NS and its captive shippers would both benefit by raising those rates, so long as NS is capacity-constrained. If the lower-rated traffic will bear higher rates, Long-Cannon is satisfied. If it will not, and uses another mode, capacity is freed up for traffic that will pay higher rates.

⁸ NS stated preliminarily that it believes that BP's traffic, at the current rate level, is at approximately 250% of variable costs. May 26, 2005 NS submission at 3. BP asserts that the actual R/VC ratio is much higher, more than █% under the current common carrier tariff. At the \$█/car full mileage rate now being charged by NS, after deducting the mileage allowance of about \$█/car from the revenues (\$█-\$█ = \$█; \$█ divided by unadjusted URCS costs of about \$█ in multiple-car shipments (*see* Verified Statement of Tom O'Connor, filed May 23, 2005 herein) equals approximately █%.

⁹ In the past, when there was excess capacity on the rail systems, it may have been useful to the railroads and captive shippers to carry traffic at very low R/VC ratios. However, now that the railroads are experiencing capacity constraints (as both the Board and NS have already stated in this proceeding), a continuation of the practice of devoting scarce capacity to low-rated traffic is harmful to the railroad and the shippers whose traffic is charged higher R/VC ratios. This is so both because it devotes scarce capacity to traffic that does not contribute much, if at all, to going concern value, and also because the shippers bearing the higher R/VC ratios must bear costs they do not cause the railroad to incur.

III.

THE BOARD SHOULD USE THE ENTIRE COSTED WAYBILL SAMPLE AS THE COMPARISON TRAFFIC GROUP, OR AT LEAST THE BEST ALTERNATIVE TRAFFIC GROUP, RATHER THAN USE AN "EITHER OR" APPROACH TO THE PARTIES' GROUPS.

The Board proposes to allow each party to select the traffic comparison group as an initial matter.¹⁰ The traffic assigned to that party's comparison group would be contained in that party's final comparison group unless the party thereafter agrees to modify its group. Thereafter, each side would be allowed to comment on the other's group, and allow for winnowing of each other's group in a give-and-take process. Eventually, each side would propose a traffic comparison group, and (unless the parties agree on the comparison group), the record would contain two comparison groups. The Board would select only one of the two comparison groups, apparently without modification.

The Board's approach is flawed. The most appropriate comparison group would be all the traffic in the Waybill Sample. The Waybill Sample is generated for the purpose of use in a proceeding such as this one. *Rate Guidelines, Non-Coal Proceedings*, 1 S.T.B. at 1024; *see generally*, 49 C.F.R. Part 1244, *especially* § 1244.8-9 (Waybill intended for use in STB proceedings). The Waybill Sample is a valid, statistically reliable sample (*see* 49 C.F.R.

¹⁰ In its June 6 Decision (at 5), the Board stated: "In the second phase, each party will tender its proposed comparison groups for use in applying the R/VC_{COMP} benchmark. Staff will then conduct a technical conference to discuss the differences in the proffered comparison groups. If the parties fail to agree on a comparison group, we will select which of the proffered groups to use. The procedures to be followed for the submission of the comparison group are discussed below." BP understands that the Board may choose to use a subset of the Waybill Sample for purposes of its R/VC_{COMP} test. Nevertheless, if the Board does not reconsider its determination not to use the adjusted RSAM percentages, and if it were also to use only, say, NS chemical traffic over 180% of variable costs as its comparison group, it would have excluded consideration altogether of the Long-Cannon factors from the Guidelines it will apply in this proceeding. BP contends that a larger "traffic comparison group" is needed, given the Board's tentative ruling on the adjusted RSAM issue, as well as to satisfy the Long-Cannon Amendment, and for the other reasons provided in text.

§1244.4); use of a portion thereof may not be statistically reliable. Moreover, as BP has stated,¹¹ the Board is required, under the Long-Cannon Amendment, to consider all of the traffic NS is carrying, to determine whether it is imposing a disproportionate revenue burden on its captive traffic, such as that at issue here. The Long-Cannon Amendment states:

"In determining whether a rate established by a rail carrier is reasonable for purposes of this section, the Board *shall* give due consideration to -

"(A) the amount of traffic which is transported at revenues which do not contribute to the going concern value and the efforts made to minimize such traffic;

"(B) the amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic; and

"(C) the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues,

recognizing the policy of this part that rail carriers shall earn adequate revenues, as established by the Board under section 10704(a)(2) of this title."

49 U.S.C. § 10701(d)(2)(emphasis added). Use of a comparison group that did not permit analysis of the three Long-Cannon factors would not be lawful. The Board may no more disregard the Long-Cannon Amendment than it may disregard any other statutory requirement.

The implication of this is that the use of biased comparison traffic groups, rather than the statistically reliable and valid Waybill Sample, runs the grave risk of ignoring (by disregarding) the unprofitable or marginally profitable traffic, if any, that NS is carrying. There is no reason for the Board to incur such a risk, with the Waybill Sample readily available to both parties.¹²

BP is concerned that the Board has signaled, by its determination not to refer to the lower end of the RSAM ratios for NS, to ignore the non-remunerative traffic on NS. If that is the

¹¹ See, e.g., Verified Statement of Tom O'Connor at 10, filed herein on May 23, 2005.

¹² Both BP and NS have requested the entire costed Waybill Sample from the STB.

Board's determination, it suggests that the Board would also be likely to ignore that non-remunerative traffic in determining which traffic comparison group to use. Ignoring non-remunerative traffic on NS for comparison purposes almost certainly would lead to an unreasonably high rate that NS would be allowed to charge BP, by ignoring those aspects of the statute in the Long-Cannon Amendment that were intended to provide balance to the ratemaking process.¹³

In any event, there is no rational reason that the Board needs to adopt an "either-or" approach.¹⁴ Each side's comparison group may have value, but neither may be as good as the Board concludes a combination of the two would be. Or, one comparison group may be superior to the other, but nevertheless contain traffic that the Board does not think belongs, or it may not contain traffic that the Board believes should be included. Why reject the superior comparison group, instead of just removing the traffic determined to be inapplicable, or including the traffic determined to be applicable? The Board should not needlessly tie its hands to choice of one comparison group or the other, when a blend of the two, or a modification of one or the other, may be better still. To deliberately preclude use of the best comparison group, which could be the result of a combination of the two groups proposed by the parties, may be arbitrary and capricious.

BP suggests that the Board use the entire costed Waybill Sample as the best comparison group. Indeed, it seems particularly tailored for this very purpose. If the Board is unwilling to do so, the Board should at most state that it *presumes* it will choose one party's comparison

¹³ The Long-Cannon Amendment was the essential compromise that permitted the Staggers Rail Act of 1980 to be passed by the Senate and thus to be enacted into law.

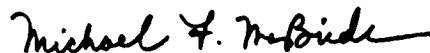
¹⁴ "Of course, no adjudicator would expect to be able to rely entirely on one side's analysis." *Burlington Northern R.R.*, 985 F.2d at 599.

group as better than the comparison group of the other party, but that it will reserve to itself the right to blend the two, or add to either or both, in order to produce the most appropriate comparison group.

Conclusion

The Board should (1) use unadjusted URCS variable costs for purposes of making rate comparisons under its Guidelines for Non-Coal Proceedings, (2) apply both the lower-end as well as the upper-end of the range of R/VC ratios for purposes of its RSAM comparisons, both to comply with the Long-Cannon Amendment and because NS is experiencing capacity constraints, and (3) use (or at least allow) the entire costed Waybill Sample as appropriate for NS for the comparison traffic group or, in the alternative, use the best comparison traffic group it can develop on a statistically reliable basis, including allowing for blending, rather than follow its proposed approach for determining the comparison traffic group by an "either or" process of selecting of one of the two comparison traffic groups submitted by the parties.

Respectfully submitted,



Michael F. McBride
Brian D. O'Neill
LeBoeuf, Lamb, Greene & MacRae, L.L.P.
1875 Connecticut Avenue, N.W.
Suite 1200
Washington, D.C. 20009-5728
(202)986-8000

Attorneys for BP Amoco Chemical Company