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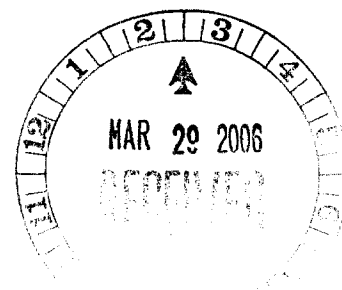
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March 29, 2006

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

216116



Re: STB Ex Parte No. 657 (Sub-No. 1), Major Issues in Rail Rate Cases

Dear Secretary Williams:

Sidley Austin represents the Association of American Railroads in the above-referenced proceeding. Attached, for filing in that proceeding, are an original and ten copies of the Reply of the Association of American Railroads to the Petition of BP Amoco Chemical Company to Clarify Scope of Proceeding, or to Broaden It. Please file the attached Reply, date-stamp the additional copies, and return those copies to our messenger for our files.

If you have any questions concerning this filing, please contact me.

MAILED
MAR 29 2006
U.S. DEPT. OF JUSTICE
OFFICE OF THE SECRETARY
SURFACE TRANSPORTATION BOARD
WASHINGTON, D.C.

Very Truly Yours,

Paul A. Hemmersbaugh

cc: Parties of record

**UNITED STATES OF AMERICA
SURFACE TRANSPORTATION BOARD**

Ex Parte No. 657 (Sub-No. 1)

MAJOR ISSUES IN RAIL RATE CASES



**REPLY OF THE ASSOCIATION OF AMERICAN RAILROADS
TO "PETITION OF BP AMOCO CHEMICAL COMPANY TO
CLARIFY SCOPE OF PROCEEDING, OR TO BROADEN IT"**

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Dated: March 29, 2006

The Association of American Railroads ("AAR"), whose members include all of the Class I railroads as well as other railroads in North America, and is a party of record in this proceeding, hereby submits its Reply in opposition to BP Amoco Chemical Company's "Petition to Clarify Scope of Proceeding, or to Broaden It" (March 27, 2006). The Board convened this rulemaking proceeding to address "issues regarding the proper application of the stand-alone cost (SAC) test in rail rate cases," not separate and distinct issues that may arise under the Board's *Modified Guidelines*, which by definition do not even involve the SAC test. See STB Ex Parte No. 657 (Sub-No. 1). "Major Issues in Rail Rate Cases" at 2 (served Feb. 27, 2006) (the "Decision"). The Board's Decision was entirely clear that the present rulemaking concerns issues arising in SAC cases adjudicated under the *Coal Rate Guidelines*. No modification of that Decision is necessary or appropriate, and the Petition should be denied.

I. THIS RULEMAKING PROCEEDING ADDRESSES ISSUES IN RATE CASES UNDER THE SAC STANDARD OF THE CMP GUIDELINES, WHICH IS ENTIRELY DIFFERENT FROM THE STANDARDS AND ANALYSES APPLIED IN A CASE CONSIDERED UNDER THE MODIFIED GUIDELINES FOR TRULY SMALL CASES.

As the Board is well aware, the standards and analyses for cases considered under the Constrained Market Pricing standards of the *Coal Rate Guidelines* (including the SAC standard that is the subject of this proceeding) are distinct and quite different from the alternative, non-SAC standards the Board has adopted for simplified and expedited consideration of rate cases in which a "stand-alone cost presentation [would be] too costly." Compare *Coal Rate Guidelines, Nationwide*, STB Ex Parte 347 (Sub No. 1), 1 I.C.C.2d 420 (1985) ("*Coal Rate Guidelines*") with *Rate Guidelines – Non-Coal Proceedings*, STB Ex Parte 347 (Sub No. 2) 1 S.T.B. 1004 (1996) ("*Modified Guidelines*"); see 49 U.S.C. §10701(d)(3) (statute requiring separate simplified method to determine rail rate reasonableness challenges where SAC is not feasible).

Indeed, the essential threshold predicate for consideration of a case under the *Modified Guidelines* is a determination that the case is not appropriate for consideration under the CMP framework established by the *Coal Rate Guidelines*. See, e.g., *Modified Guidelines* at 2-3; 49 U.S.C. §10701(d)(3).

It is abundantly clear that the February 27 Decision intended to institute a rulemaking to address issues arising in cases under the *Coal Rate Guidelines* in general, and the SAC constraint in particular. See, e.g., Decision at 3-7 (describing CMP, SAC, and six issues in SAC cases to be addressed in this proceeding). Nowhere in the 39-page, citation-filled Decision does the Board even mention the *Modified Guidelines*, much less suggest that this proceeding might appropriately consider the application of SAC-specific issues to cases brought under non-SAC guidelines. If the Board intended to convene an omnibus rulemaking that would consider both SAC issues *and* issues related to other non-SAC proceedings, it would have so-stated in the Decision. Because the Board did not do so – and BP Amoco’s Petition provides no adequate basis for its proposed expansion of the scope of the proceeding announced by the Board – this proceeding is properly confined to issues in SAC proceedings.

II. BECAUSE THE FUNCTIONS OF VARIABLE COSTS IN SAC PROCEEDINGS ARE MUCH DIFFERENT FROM THEIR FUNCTION IN CASES UNDER THE MODIFIED GUIDELINES, IT IS NOT APPROPRIATE TO CONSIDER THOSE COSTS IN A SAC RULEMAKING.

The Board should reject BP Amoco’s request to broaden this proceeding to address variable cost and indexing issues in rate cases considered under the Modified Guidelines, because the use and functions of such costs are much different in the two analyses. In SAC cases, variable costs are primarily used for two purposes: (i) to aid in determining whether a rail carrier has “market dominance” over the transportation at issue that is required for the Board to exercise its maximum rate reasonableness jurisdiction; and (ii) in the event that a challenged rate

is determined (under a SAC analysis) to exceed a maximum reasonable level, the ratio of revenue to variable costs of the challenged movement is used to establish the statutory floor below which the Board may not prescribe a maximum reasonable rate. See 49 U.S.C. §§ 10701, 10707; Coal Rate Guidelines, 1 I.C.C.2d 520, 521-22. Once jurisdictional thresholds have been determined, however, the primary focus of a SAC case is on the myriad costs and revenues of a hypothetical least-cost, most efficient stand-alone railroad, not a real-world railroad's actual variable costs.

In contrast, variable costs play a very different role in cases considered under the *Modified Guidelines*. Specifically, variable costs are an essential component of each of the three revenue-to-variable cost "benchmark" measures the Board has established as the starting point for its analysis under those guidelines. See *Modified Guidelines*, STB Ex Parte No. 347 (Sub-No. 2) at 14-30 (served Dec. 31, 1996); *B.P. Amoco Chemical Co. v. Norfolk Southern Railway Co.*, STB Doc. No. 42093 at 2, 8-12 (served June 6, 2005) (illustrating the use and importance of variable costs in the only case brought under the *Modified Guidelines* to date).¹ Because of the integral role played by variable costs in a *Modified Guidelines* analysis, it is important that any issues regarding the determination, calculation or application of variable costs for purposes of such proceedings be considered and determined in the proper context – *i.e.* in a proceeding under the *Modified Guidelines*, not as an ill-fitting appendage to a rulemaking proceeding convened to consider SAC issues.

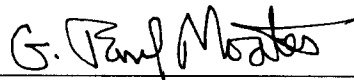
¹ AAR member Norfolk Southern Railway Company ("NS") was the defendant rail carrier in the case brought by B.P. Amoco Chemical. NS does not agree with B.P. Amoco's characterization of the law, the facts, or NS's positions in STB Doc. No. 42093. See B.P. Amoco Petition at 2-7. NS and the other members of AAR are acutely aware of the importance of variable costs to cases brought under the *Modified Guidelines*, and the significant and substantially different role those costs play in such cases and in SAC cases.

CONCLUSION

For the foregoing reasons, the Board should deny the Petition and confirm that this rulemaking proceeding is confined to issues concerning SAC cases brought under the *Coal Rate Guidelines*.

Dated: March 29, 2006

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that on this 29th day of March, 2006, I caused a copy of the foregoing Reply of the Association of American Railroads to the Petition of BP Amoco Chemical Company to Clarify Scope of Proceeding, or to Broaden It, to be served, via first class mail or more expeditious method of delivery, upon all persons who have filed a notice of intent to participate in STB Ex Parte Nol 657 (Sub. No.-1), "Major Issues in Rail Rate Cases."

Catherine Guedi