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June 30, 2006

HAND DELIVERY

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

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

Dear Secretary Williams:

Enclosed for filing in the above-referenced proceeding are an original and twenty copies of the Rebuttal Comments of Canadian Pacific Railway Company ("CPR"). A diskette containing an electronic version of the Rebuttal Comments is also enclosed.

Please acknowledge receipt of the enclosed Rebuttal Comments for filing by date-stamping the enclosed extra copies and returning them via our messenger. If you have any questions, please contact the undersigned counsel.

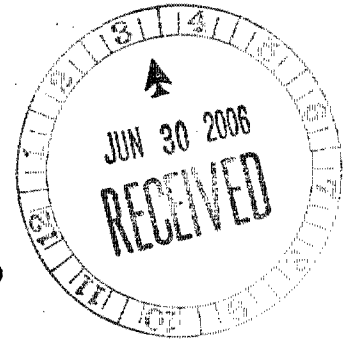
Sincerely,

Terence M. Hynes

Counsel for Canadian Pacific
Railway Company

TMH:aat
Enclosures

**BEFORE THE
SURFACE TRANSPORTATION BOARD**



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

MAJOR ISSUES IN RAIL RATE CASES

**REBUTTAL COMMENTS
OF
CANADIAN PACIFIC RAILWAY COMPANY**

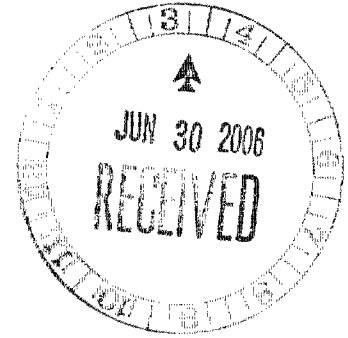
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Attorneys for Canadian Pacific Railway Company

Dated: June 30, 2006

**BEFORE THE
SURFACE TRANSPORTATION BOARD**



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

MAJOR ISSUES IN RAIL RATE CASES

REBUTTAL COMMENTS OF CANADIAN PACIFIC RAILWAY COMPANY

Pursuant to the Notice of Proposed Rulemaking served in the above-captioned proceeding on February 27, 2006 (the “*NPRM Order*”), Canadian Pacific Railway Company and its subsidiaries Soo Line Railroad Company and Delaware and Hudson Railway Company, Inc. (collectively “CPR”) submit these rebuttal comments concerning proposed changes to the Board’s application of the Stand-Alone Cost (“SAC”) methodology in railroad rate cases under *Coal Rate Guidelines, Nationwide*, 1 I.C.C. 2d 520 (1985) (“*Coal Rate Guidelines*”).

I. THE PROPOSED HYBRID INDEX FOR SARR OPERATING COSTS IS NOT SUPPORTED BY THE RECORD, AND SHOULD NOT BE ADOPTED.

The record compiled to date does not support adoption of the “hybrid” index for adjusting a SARR’s operating costs proposed in the *NPRM Order*. To the contrary, comments submitted by carriers and shippers alike demonstrate that the proposed index, under which the RCAF-A would be applied in every case to a SARR’s operating expenses in 5% increments, is entirely arbitrary and unrelated to the level of productivity that a particular SARR might realistically expect to achieve. The proposal is also inconsistent with the Board’s findings in recent SAC cases, which question the suitability of the RCAF-A as an accurate benchmark for a SARR’s productivity. The comments submitted in this proceeding provide no support for a departure from the Board’s existing approach to the issue of SARR productivity. Accordingly, the Board

should not adopt the proposed “hybrid” index, and should continue its practice of determining the appropriate method for adjusting SARR operating expenses on a case-by-case basis.

In each of its recent SAC decisions, the Board has determined the appropriate measure of the SARR’s future productivity for purposes of indexing operating costs on the basis of case-specific evidence. Rather than adopting a mechanical (and arbitrary) estimate of future SARR productivity, the Board has evaluated the competing evidence submitted by the parties, and has applied the index that was best supported by the record in each case. *See, e.g.*, Docket No. 42071, *Otter Tail Power Co. v. BNSF Railway Co.* (served Jan. 27, 2006) (“*Otter Tail*”) at 22 (applying RCAF-U to adjust operating expenses “[b]ecause the record in this case does not support a departure from precedent”); Docket No. 42057, *Public Service Co. of Colorado d/b/a/ Xcel Energy v. BNSF Railway Co.* (served June 8, 2004) (“*Xcel*”) at 34 (applying RCAF-U as “the best index on record”). Recent SAC decisions also confirm the position advanced by CPR and other railroad commenters that the RCAF-A is not a suitable benchmark for measuring the productivity of a SARR. The Board has repeatedly held that a SARR’s ability to achieve significant productivity improvements is far less than that of real world railroads, which have opportunities to enhance productivity by rationalizing their systems, replacing outdated assets, improving operations and implementing new technologies over time. *See, e.g.*, *Otter Tail* at 33; Docket No. 42070, *Duke Energy Corp. v. CSX Transportation, Inc.* (served February 4, 2004) (“*Duke/CSXT*”) at 30; Docket No. 42069, *Duke Energy Corp. v. Norfolk Southern Railway Co.* (served Nov. 6, 2003) (“*Duke/NS*”) at 36-37.

“[T]hose productivity improvements [reflected in the RCAF-A] are driven in part by railroads shifting from older assets to newer technologies – technologies that, for the most part, the [SARR] would start out with – or by railroads abandoning unneeded or antiquated facilities – actions that would be unnecessary for the [SARR] as its system would be optimally designed from the outset for its needs for the SAC analysis period.”

Xcel at 34. Most importantly, the Board has rejected the notion that a SARR could realize significant productivity savings in the early years of the DCF period, finding that a typical SARR could achieve such benefits (if at all) only in the “outward years.” *Otter Tail* at 22. *See also NPRM* at 20 (“use of RCAF-U is imperfect, particularly in the more distant years of the DCF analysis”) (emphasis added); *Duke/CSXT* at 29-30; *Duke/NS* at 37.

The hybrid index proposed in the *NPRM Order*, which would automatically credit the SARR with a portion of the rail industry’s productivity from the very first years of the SAC analysis period, is contrary to the Board’s consistent findings in prior SAC cases. The comments submitted in this proceeding provide no basis upon which the Board might conclude that its prior findings with respect to SARR productivity are incorrect, nor do they support a departure from the Board’s sound case-by-case approach to the issue of SARR productivity.

Indeed, no commenter has expressed unqualified support for the specific indexing methodology proposed in the *NPRM Order*. The railroad parties (including CPR) oppose the automatic application of the RCAF-A, or an arbitrary percentage of that index, in adjusting SARR operating expenses. Consistent with the Board’s findings in recent SAC cases, the carriers have demonstrated that, because a SARR is presumed to be a “least cost, most efficient” railroad from its inception, it cannot obtain the types of structural, technological and labor-related productivity that make up the RCAF-A, particularly during the early years of its existence. CPR Op. Comments at 4-5, Reply Comments at 2-3. *See also CSXT/NS Op.* Comments at 9-11, Reply Comments at 14-15; BNSF Op. Comments at 14 and V. S.

Baranowski, BNSF Reply Comments at 33-40; UP Op. Comments at 31-35, Reply Comments at 24-33. As UP correctly observed, permitting a complainant to posit an optimally efficient SARR at the outset, then giving that SARR credit for the types of productivity that are available only to less than optimal real world railroads, would amount to a “double dip” for productivity in calculating the SARR’s operating expenses. UP Reply Comments at 27.

Several shipper commenters likewise oppose a rule that would indiscriminately apply the same productivity adjustment to the SARR in every case. *See, e.g.,* Albemarle Corp. Op. Comments at 6; Arkansas Electric Cooperative Corporation (“AECC”) Op. Comments at 17-19. As AECC witness Nelson explained, “[u]ltimately, the degree to which the productivity improvements available to the SARR will differ from those available to the incumbent is largely an empirical issue that stems from the design of a particular SARR.” AECC Op. Comments at 18 (emphasis added). The productivity improvements that a SARR might realistically expect to achieve will depend largely upon such variables as the volume and mix of its traffic base, the size and configuration of its physical plant, and the nature of its proposed operating plan. But the hybrid index proposed in the *NPRM Order* reflects “no recognition of the specific productivity that may or may not be available in a particular stand-alone cost proceeding.” Albemarle Corp. Op. Comments at 6. A rule that essentially pre-judges the issue of SARR productivity by applying the same adjustment in every case, regardless of the characteristics of the particular SARR at issue, is both arbitrary and unfair.

The arguments asserted by the Coal Shippers in support of their alternative productivity index – which would automatically credit a SARR with fully 50% of RCAF-A productivity from the outset – are unpersuasive. The Coal Shippers have made no attempt whatsoever to demonstrate (quantitatively or otherwise) any correlation between their proposed index and the

level of productivity likely to be achieved by a SARR at any point during the DCF period. Nevertheless, they suggest that a SARR should be credited with substantial future productivity simply because the rail industry is likely to develop new technologies (such as Positive Train Control) that enhance the productivity of real world railroads. Coal Shippers Op. Comments at 74-82; Reply Comments at 32, 42-44. This argument is without merit. When a new technology becomes available, real world railroads must evaluate the benefits and costs of that technology, as well as competing demands on their limited capital resources, in deciding whether (and when) to adopt it. A rational SARR would need to make the same cost-benefit analysis. Under the Board's current case-by-case approach, complainants may choose to incorporate demonstrable new technologies into their SARR design. Doing so enables the SARR to obtain the productivity benefits associated with such technologies throughout the SAC analysis period. If a particular innovation becomes a reality after a SAC case has been decided, and that innovation would produce productivity savings sufficient to affect the outcome of the SAC analysis, a complainant can petition the Board to reopen the record to consider the impact of that development on SARR operating expenses. However, in considering the effects of future technological advances, the Board would have to take into account the additional costs that the SARR would incur in implementing the new technology. The Coal Shippers' assertion that requiring such a showing would be burdensome (Coal Shippers Reply Comments at 43) ignores the fact that the complainant bears the burden of proof with respect to the issue of SARR productivity. It would violate both sound principles of administrative law and common sense to credit a SARR with 50% or more of the RCAF-A without any evidence regarding the benefits likely to be derived by the SARR from a particular innovation, or the costs that the SARR would incur to implement it.

The Coal Shippers' assertion that it is unnecessary to consider the SARR's cost of acquiring new technologies because such costs "already are factored into the calculation of the RCAF-A" (Coal Shippers Reply Comments at 41) is wrong. The productivity-related costs incorporated into the RCAF-A reflect real expenditures made by real railroads to improve their productivity. But the cost of constructing a SARR in the first instance does not include the additional expenditures that the SARR would have to make if it chose to invest in the same productivity-enhancing assets. Crediting a SARR with all or a portion of future rail industry productivity without also requiring the complainant to account for the cost of obtaining that productivity would result in a significant understatement of SARR operating expenses.

The Coal Shippers' further suggestion that the Board should use an index that credits a SARR with significant future productivity because the SARRs adopted by the Board in recent SAC cases have not been "least cost, most efficient" railroads (Coal Shippers Reply Comments at 34-40) is nonsense. The SAC methodology seeks to determine "the lowest cost at which a hypothetical, optimally efficient carrier could provide the services at issue." *Xcel* at 10. *See also Otter Tail* at 6-7; *Duke/NS* at 11; *Duke/CSXT* at 11. Where a complainant presents an operating plan that is feasible and supported by the evidence, the Board will accept that plan. *See Otter Tail* at 18-19. However, in the Eastern coal rate cases upon which the Coal Shippers rely, the complainants' SARR designs and operating plans were demonstrably infeasible, and failed to provide services consistent with the practices and preferences of the selected shipper group. *See Duke/CSXT* at 24-28; *Duke/NS* at 31-33. In those circumstances, the Board properly rejected the complainants' evidence. The Board's evidentiary rulings in the Eastern coal rate cases do not provide support for a modification of the SAC methodology.

In short, the comments submitted in this proceeding demonstrate that the hybrid index proposed in the *NPRM Order* is inconsistent with well-reasoned Board precedent, and would produce productivity adjustments that are entirely unrelated to the evidence in a particular case. While the Board's concern that the RCAF-U may be "imperfect" (*NPRM Order* at 20) is understandable, its proposed solution would yield results that are likely to be far less accurate in most cases. Given the utter lack of evidentiary support for the proposed hybrid index, adopting that index on the basis of the current record would be arbitrary and capricious. *See, e.g., McGregor Printing Corp. v. Kemp*, 20 F.3d 1188, 1194 (D.C. Cir. 1994) (proposed regulation arbitrary and capricious because there were no facts in rulemaking record to support the rule); *National Treasury Employees v. Horner*, 854 F.2d 490, 499 (D.C. Cir. 1988) (rule held arbitrary and capricious where agency's judgments were not supported by record evidence). Therefore, CPR urges the Board to continue its current approach of determining the appropriate adjustment for future SARR productivity on the basis of case-specific evidence.

As CPR has previously stated (CPR Op. Comments at 5, Reply Comments at 4-5), the Board's rationale for considering a hybrid productivity index – i.e., that applying the RCAF-U throughout a 20-year SAC analysis period may overstate a SARR's operating expenses in the "outward years" of the analysis (*NPRM Order* at 20) – would be rendered moot if the Board shortens the SAC analysis period to ten years. Such a shorter SAC analysis period is endorsed by the vast majority of commenting parties. Adopting a ten-year SAC analysis period, while maintaining the Board's current case-by-case approach to the issue of SARR productivity, will strike an appropriate balance between complainants' interest in obtaining the benefits of future rail industry productivity in the SAC analysis and the requirement that the Board's SAC determinations be based upon credible evidence.

II. THE BOARD SHOULD CONTINUE TO PERMIT PARTIES TO PROPOSE MOVEMENT-SPECIFIC ADJUSTMENTS TO URCS SYSTEM AVERAGE VARIABLE COSTS.

The record does not support adoption of the Board's proposal to disallow movement-specific adjustments to URCS system average variable costs for purposes of determining whether a defendant rail carrier has "market dominance" over the issue traffic, and the "jurisdictional floor" for any rate prescription. *See NPRM Order* at 21-23. Indeed, no party supports a total prohibition on movement-specific adjustments. To the contrary, the comments submitted by carriers and shippers alike demonstrate that case-specific adjustments to URCS system average costs can be essential to the development of reliable and accurate variable cost calculations. Rather, the debate in the parties' comments centers on which adjustments are most important (an issue as to which there is no clear consensus). On the current record, the Board cannot identify a comprehensive list of movement-specific adjustments that ought to be retained or discarded in all cases. Accordingly, it should simply decline to adopt the proposed rule and continue to resolve issues relating to movement-specific adjustments on a case-by-case basis.

CPR is not unsympathetic to the concerns raised by several railroad commenters regarding the burden and expense associated with litigating movement-specific adjustments – and, in particular, the cost of responding to shippers' voluminous requests for discovery related to potential adjustments. *See, e.g.,* UP Reply Comments at 39-41; BNSF Reply Comments at 40-41. As UP notes, a substantial portion of this burden is caused by efforts to re-litigate issues relating to movement-specific adjustments that have been decided in prior SAC cases. UP Reply Comments at 40. The appropriate solution to this problem is not a total ban on movement-specific adjustments in future cases. Rather, in resolving disputes relating to variable cost issues, the Board should provide clear guidance to the parties (and to future litigants) regarding the types of movement-specific adjustments that are permissible. Once issues relating to a specific

adjustment have been decided, the Board should adhere to its precedents and refuse to permit burdensome discovery aimed at relitigating that adjustment. In this way, the scope of legitimate dispute relating to movement-specific adjustments will be narrowed over time, without sacrificing the accuracy of variable cost calculations based upon the actual characteristics of a particular movement.

CSXT/NS have proposed a procedural mechanism that may help to reduce the burden and expense associated with variable cost issues in some SAC cases. In particular, CSXT/NS urge the Board to give parties the option not to submit variable cost evidence at the beginning of a case, where the defendant railroad elects not to challenge the complainant's allegation of market dominance. CSXT/NS Op. Comments at 15-16, Reply Comments at 22-23. Under the CSXT/NS proposal, variable cost evidence could be deferred until after the Board reached its initial SAC determination (and would be filed at that time only if a party decides it is necessary to determine the "jurisdictional floor" for a rate prescription). It would appear that this proposal holds the potential for reducing the cost of SAC cases, by enabling the parties to balance the burden and expense of presenting detailed variable cost evidence against the likely significance of that evidence to the outcome in a particular case.

In summary, the record before the Board in this proceeding does not provide an evidentiary basis for adopting a rule that would disallow all movement-specific adjustments to URCS system average variable costs. *See McGregor Printing Corp. v. Kemp, supra; National Treasury Employees v. Horner, supra.*

III. THE BOARD SHOULD ADOPT THE PROPOSED TEN-YEAR SAC ANALYSIS PERIOD.

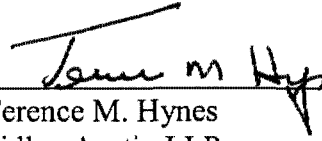
The record contains strong support for the Board's proposal to reduce the SAC analysis period from 20 years to ten years. Both carriers and shippers have expressed varying degrees of

support for that proposal. *See, e.g.*, CPR Reply Comments at 9-10; BNSF Op. Comments at 70-71, Reply Comments at 49-52; UP Op. Comments at 45, Reply Comments at 49-53;; CSXT/NS Op. Comments at 18-19, Reply Comments at 23-25 ; Coal Shippers' Op. Comments at 102-03, Reply Comments at 59-60. As the commenting parties observe, shortening the SAC analysis period will reduce the risks associated with unforeseen changes in economic conditions and operating costs that can render even the most careful long-term projections inaccurate over time. Adopting a shorter DCF period will eliminate much of the uncertainty associated with long range projections, and may also reduce the cost of litigating a SAC case by reducing the scope of the evidence that must be presented. As discussed above, shortening the SAC analysis period would also address the concern underlying the proposed hybrid index for SARR productivity, and render such an index (which itself would create a substantial risk of inaccurate results) unnecessary.

However, the Board should reject the further proposals by the Coal Shippers that a reduction in the SAC analysis period be accompanied by a change in the debt amortization schedule utilized in DCF Table E, and a requirement that rate prescriptions continue in effect even after the expiration of the DCF period unless the defendant carrier can demonstrate a "material change in circumstances" that would support modification or vacatur of the prescribed rate. *See* Coal Shippers' Comments at 102-104. Those proposals were not part of the modified rules noticed in the *NPRM Order*, so they cannot be adopted without further notice and opportunity for parties to comment on them. Moreover, those proposals are entirely unrelated to the issues presented by the proposals that were properly noticed by the Board. Finally, as CPR's Reply Comments demonstrated (at 10), there is no rational basis in law or fact for automatically

extending a rate prescription beyond the term of the SAC analysis that supports the prescribed rate.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Terence M. Hynes", is written over a horizontal line.

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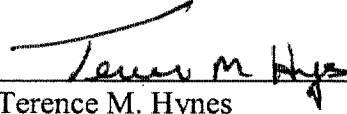
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Attorneys for Canadian Pacific Railway Company

Dated: June 30, 2006

CERTIFICATE OF SERVICE

I hereby certify this 30th day of June 2006 that I have served all parties of record in this proceeding by first class mail, postage prepaid.



Terence M. Hynes