

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 646 (Sub-No. 1)

RAIL RATE CHALLENGES IN SMALL CASES

**COMMENTS OF
THE DOW CHEMICAL COMPANY**

Jeffrey O. Moreno
Thompson Hine LLP
1920 N Street N.W., Suite 800
Washington, D.C. 20036
(202) 263-4107

Dated: October 24, 2006

COMMENTS OF THE DOW CHEMICAL COMPANY

The Dow Chemical Company LLC ("Dow") hereby submits comments in the above-captioned proceeding. Dow commends the Board for initiating this proceeding, which is long overdue. However, the Board's proposals fall far short of offering effective and meaningful rail rate regulation and indeed are likely to create a worse situation than exists under the current standards.

I. STATEMENT OF IDENTITY AND INTEREST.

Dow, headquartered in Midland, Michigan, is a manufacturer of chemicals, plastics and agricultural products. Dow, including its subsidiaries and affiliates, operates numerous production facilities throughout the continental United States. The largest of these facilities are located near Freeport, Texas; Plaquemine, Louisiana; Taft, Louisiana; and Midland, Michigan.

Dow relies extensively upon rail transportation to move products to, from, and between its U.S. and other North American facilities. Rail historically has been the most cost-effective mode for transporting large volumes of Dow's chemical and plastic traffic long distances over land. In addition, Dow relies heavily upon rail transportation for the safe movement of hazardous chemicals.

Dow tenders over 90,000 car loads annually of chemicals and plastics for transportation by rail from over 25 facilities across the United States. Since more than 45% of this traffic is captive to one railroad, Dow has a very strong interest in ensuring that regulation is an effective constraint on its rail rates. Because rail is the most efficient form of transportation for Dow's commodities, and is the safest form of transport for its hazardous materials, Dow's infrastructure is designed predominantly for rail service as opposed to other transportation modes.

Dow's high level of dependence on rail transportation requires a meaningful regulatory constraint upon the rates of market dominant rail carriers that transport shipments between Dow's facilities and to Dow's customers. Dow is extremely concerned by the unprecedented rate increases that the railroads are imposing. Dow is captive on much of its rail traffic, and needs effective regulation to protect it from unreasonably high rates. But the existing regulatory regime has proven to be ineffective because the economics and the uncertainty do not justify a rate case even at exceedingly high rate levels. Dow strongly urges the Board to rectify this situation by adopting simplified standards and expedited procedures that are available to all captive shippers.

II. INEFFECTIVENESS OF CURRENT RATE REGULATION.

The STB's current standards and procedures for regulating rail rates are ineffective for the vast majority of captive shippers, including Dow. They are too complex, consume too much time, and cost too much money. As such, the current standards are neither practical nor cost-effective from a business perspective, even at the significantly higher rate levels that Dow recently has been quoted on its captive traffic.

The Board's preferred regulatory standard, stand-alone cost ("SAC"), has not been an option for Dow since the standard was first adopted over 20 years ago. Since then, the cost of prosecuting a SAC case increased to \$4 million and the process has expanded to take 3-4 years. Dow's traffic lanes do not have a case value that would justify such significant litigation costs, due to the volume and/or duration of the traffic lanes. Many of these traffic lanes don't continue for 3-4 years, which allows Dow a very small window to recover its litigation costs before it even would realize any benefit from a rate reduction. Indeed, Dow has a 30% turnover in its annual rail volume (*i.e.* 30% represents new O-D pairs). Dow must make current business

decisions based on its current costs, not on whether it might or might not be entitled to reparations in 3-4 years.

The Board's "Bottleneck Decisions" have further alienated most captive shippers from the SAC standard. Although many shippers like Dow do not move sufficient volumes between O-D pairs to justify a SAC case, they may move such volumes over an origin-to-interchange bottleneck, before that traffic fans out to many different destinations. But, because the Board has prohibited shippers from challenging the reasonableness of just the bottleneck rate, the Board itself has rendered its preferred SAC standard unusable by most captive shippers. Therefore, the Board should develop a meaningful alternative for those shippers that is workable.

Although the Board has had small case guidelines (the "three-benchmark approach") in place for over a decade, those too have proven to be ineffective. The standards have lacked both clarity and predictability; there also has been no clear procedure or timeline; and these uncertainties have combined to render litigation costs highly speculative. Furthermore, before a shipper even can get to the point where the Board would apply the three-benchmark approach, the shipper must demonstrate its eligibility to use that approach under criteria that have never been clearly defined. This state of uncertainty has discouraged cases under the three-benchmark approach and rendered that approach ineffective as a constraint on rail pricing by market dominant carriers.

If regulatory standards are consistent and predictable, rate cases should be the exception rather than the rule. When there are meaningful standards that are applied consistently, shippers and carriers can predict at least a narrow range of probable outcomes from a rate case. This would provide incentives for them to reach a negotiated commercial agreement based upon that

range, their anticipated litigation costs, and various risk factors. Because the three-benchmark approach offers none of this consistency and predictability, it does not constrain rail rates.

Any modifications that the STB makes to its rate standards must address these flaws in the current standards that have deprived the vast majority of captive shippers of regulatory protection since the Staggers Act. The STB's efforts are wasted if it merely replaces one ineffective regulatory regime with another equally ineffective regime.

III. THE BOARD'S PROPOSALS FALL FAR SHORT OF OFFERING EFFECTIVE REGULATORY OPTIONS.

The Board's proposed guidelines fall far short of establishing meaningful and effective regulatory standards that address the complexity, cost and timing issues that exist in the current guidelines. Indeed, Dow believes that the Board has proposed a regulatory regime that will leave captive shippers in a worse position than they are today.

A. There Are Substantial Problems With Both The SSAC And Three-Benchmark Proposals.

Dow is very concerned that the Board's proposals remain too complex and ineffective. Due to the complexity of the Board's three-benchmark and Simplified-SAC ("SSAC") proposals, Dow will only comment briefly on those proposals here and defer to the more thorough review and analysis that various trade associations, including the American Chemistry Council, have prepared and presented in joint comments.

In general, the Board's proposal to adopt a three-tiered regulatory approach to replace the current two-tiered approach is unnecessary and unjustified. The current SAC and Three-Benchmark standards can be modified to address most shipper concerns. Rather than complicate matters with a third approach, the SSAC, which is both complex and untested and would only propagate the uncertainty that has crippled the three-benchmark approach for the past decade, the Board should focus its efforts on providing more guidance and clarity as to how it will apply the

three-benchmark approach and how it will determine eligibility. In the process, the Board should assure that no captive shipper is left without an economical remedy. While Dow commends the Board for its attempt to improve the three-benchmark approach, the SSAC approach does not offer any meaningful and effective regulatory constraint.

1. SSAC is too complex, costly, and time consuming.

SSAC appears to be anything but simple, timely and inexpensive. To begin with, 18 months is way too long, given Dow's constantly changing customer and shipping patterns. Any rate process should conclude within six months in order to be effective. Furthermore, because SSAC requires annual "true-up" calculations, there is a substantial likelihood of having to relitigate many issues each year throughout the 5-year rate prescription period, consuming more time and more money that the Board has failed to factor into its proposal.

Although the Board claims that SSAC merely sacrifices accuracy for simplicity, it really is mandating a rate higher than SAC for a dubious claim of simplicity. By depriving the complainant in an SSAC case of the ability to optimize the stand-alone railroad, the traffic on the SSAC will make less of a revenue contribution than Full-SAC traffic to the same fixed investment and operating costs. Also, because the SSAC costs are not adjusted for operating inefficiencies, costs are likely to be greater than a Full-SAC analysis. Therefore, at best, SSAC will produce a result equal to Full-SAC, but in all probability much higher. On top of that, there are still many complexities in the SSAC approach that render it ineffective and meaningless to most captive shippers.

Since SSAC will never produce a rate lower than Full-SAC, the notion that one must qualify to use SSAC is inexplicable. If a complainant truly finds SSAC to be simpler and less costly than Full-SAC—which Dow doubts—and further concludes that this benefit outweighs

the higher rate compared to a Full-SAC analysis, then why should that complainant be precluded from using SSAC at all, since there is no risk that the rate will be below SAC, which is the Board's preferred standard?

2. The three-benchmark standard still lacks timeliness and predictability.

While the Board's modifications to the three-benchmark approach take some steps in the right direction, Dow still harbors many concerns. First, nine months for a decision continues to be too long for Dow's practical business needs. A proper time frame, at the outside, should be 180 days.

Second, The Board's decision to deny complainants access to the unmasked Waybill data until the end of a case undermines the principal objective of reasonable predictability and is fundamentally unfair to the shipper. If a standard is meaningful and predictable, carriers and shippers alike will be able to negotiate contract rates around that standard without resorting to the Board at all. But, without access to the unmasked Waybill data, shippers will have no ability whatsoever to make this assessment, since they will not have access to essential data that the Board itself would use to determine a reasonable rate. The carrier, on the other hand, will have full access to that data from the start, giving it the ability to manipulate critical parts of the regulatory process to its advantage.

B. The Proposed Eligibility Standards Are Flawed.

It does not matter how effective a substantive standard the Board adopts if no one qualifies to use that standard. Dow believes that the Board's eligibility thresholds are unrealistically low and that its methodology for determining eligibility is prone to manipulation by the railroads. Consequently, the Board's proposed eligibility standards would continue to leave most captive shippers without regulatory protection from monopoly rates.

1. MVC is inconsistent with the statute and is prone to carrier manipulation.

The Board has proposed to determine eligibility to use the SSAC and three-benchmark approaches based on the “Maximum Value of the Case,” or “MVC.” This proposal stems from the statutory mandate that the Board “establish a simplified and expedited method for determining the reasonableness of challenged rail rates in those cases in which a full-stand-alone cost presentation is too costly, *given the value of the case.*” 49 U.S.C. §10701(d)(3) [emphasis added]. But, MVC does not measure the value of the case, as required by the statute. Rather, it substantially overstates the actual value of the case to the complainant and is subject to manipulation by the railroads.

MVC measures the difference between the challenged rate and 180% of revenue/variable cost (“R/VC”), based on the statutory prohibition against prescribing a rate below that level. While this is the “maximum” *potential* relief that any complainant may obtain, it almost certainly will never be the “actual” value of a case, since it is highly unlikely that any of the potentially applicable rate standards will prescribe a rate at or even near 180% R/VC.

Furthermore, prescribed rates may exceed 180% R/VC by widely divergent margins depending on the commodities at issue, thereby offering regulatory protection to some captive shippers, but not others. Dow is one of those shippers who could be left without a remedy, since chemical traffic has some of the highest R/VC ratios. As such, the MVC on Dow traffic will substantially overstate the actual case value, since a prescribed rate still is likely to be well above 180% R/VC. Yet, the MVC could force Dow into an SSAC or, more likely, a Full-SAC case, which Dow has never found to be economically justified.

Dow would not evaluate whether to file a rate complaint on the basis of the MVC. That is a fictional number with no significance other than what the Board has arbitrarily assigned to it.

Rather, Dow would estimate the actual value of the case based on a prediction of the probable outcome.¹ Because MVC lacks any connection to the actual value of a case, it does not comply with the statutory requirement for eligibility to use small case standards.

Railroads also can easily manipulate the MVC calculation simply by setting the tariff rate at a level that exceeds the designated thresholds. If contract negotiations between a shipper and carrier break down over rate levels, the shipper must request common carrier rates in order to challenge them as unreasonable before the Board. Any request for a common carrier rate will signal the shipper's intent to file a rate complaint. The railroad will have both the ability and the incentive to set the tariff rate sufficiently high to force the shipper into a Full-SAC case, even if the contract rate offered by the railroad would have qualified for a lesser standard.

Under this scenario, the actual value of the case in reality will be the difference between the contract offer (rather than the tariff rate) and the prescribed rate. But, the shipper's eligibility to use a lesser standard would be based on the fictional MVC measure that the railroad has artificially inflated by quoting a higher tariff rate. Thus, even though a Full-SAC case would be too costly given the actual value of the case, the shipper will not qualify to use a lesser standard because of the inflated MVC.

The Board should abandon the MVC concept altogether and focus on criteria that bears a more rational connection to the actual value of a case to the shipper. The most obvious starting point is the annual freight spend of the shipper on the issue traffic. Whatever methodology the Board ultimately adopts, however, it must include all of the cost factors, including a risk premium.

¹ The Board's refusal to grant complainants access to the unmasked waybill data, however, makes it extremely difficult for a shipper make this assessment with any degree of confidence.

2. The proposed thresholds are unrealistically low.

Even if MVC were a suitable proxy for the actual value of a case, the thresholds proposed by the Board are way too low. This is because the Board uses unreasonable assumptions and ignores several important cost and risk factors.

The proposed thresholds are based upon unrealistic assumptions of the litigation costs associated with each of the three proposed standards. For Full-SAC cases, the Board assumes a \$3.5 million estimated litigation cost based upon a figure that is two years old, and the Board assumes unrealistically that this cost will decline based upon changes that it has proposed in Ex Parte No. 657 (Sub-No. 1). But, experience shows that the complexity of SAC cases continues to increase as the analysis becomes more sophisticated and new issues continue to surface. Even if the STB's proposals in Ex Parte No. 657 simplify *some* past complexities, there is no reason to believe that new issues will not continue to arise as SAC presentations evolve.

The Board also unreasonably assumes that an SSAC case will cost only \$200,000 to prosecute. The Board bases this assumption upon an untested estimate of \$25,000 to \$85,000 submitted by railroad witnesses over 10 years ago. The shipping community has never accepted the railroad estimates. Moreover, there is no evidence that the SSAC proposal submitted back then, which was a computer model that calculated a final answer, bears any resemblance to the SSAC approach proposed by the Board, which requires substantial litigation to resolve disputes over the evidence submitted by the parties. The level of complexity that still exists in the SSAC standard leads Dow to believe that the true cost of an SSAC case is many times greater than the Board assumes.

In addition, the Board's proposed eligibility thresholds ignore other costs incurred by the complainant beyond its fees for counsel and consultants. These include both out-of-pocket costs,

such as discovery compliance and travel, and internal costs, such as management time. The Board also has omitted a risk premium from its litigation cost assumptions. The potential return from a rate case must recover more than just litigation costs; it must recover a factor sufficient to compensate for the risk that the case will be unsuccessful and for the opportunity cost associated with the time, money, and resources dedicated to a rate case. These are real costs that Dow would consider in addition to its legal and consulting fees.

The railroads also have every incentive to make rate cases as complex and costly as possible in order to discourage shippers from challenging rates. It is unrealistic for the Board to assume otherwise, because that is precisely what has occurred in Full-SAC cases. The MVC gives the railroads an additional incentive, because higher costs would undermine the Board's assumptions underlying the MVC thresholds. Therefore, the MVC thresholds should be several factors greater to reflect much higher litigation costs and to reflect other costs that the Board has neglected to include in its assumptions.

3. The aggregation requirement would disqualify most shippers from using less than Full-SAC.

The Board further constrains the value and effectiveness of any small case standard by requiring complainants to aggregate multiple O-D pairs when calculating the MVC. This will require many cases that might qualify for a lesser approach to be filed as either SSAC or Full-SAC cases. Large shippers with many potential small value cases would be ineligible to use the simplified rate procedures for all but a few movements. Consequently, the aggregation rule constitutes an "end-run" around the statutory requirement that the Board develop alternatives to SAC for small cases, not small shippers.

Dow is a perfect example of how the aggregation requirement would convert the statute's small case standard into a small shipper standard. Dow ships by rail to hundreds of destinations

from each of its major production facilities. While Dow may have a few movements that qualify for the three benchmark approach and others that qualify for SSAC, aggregating only a handful of these cases quickly would thrust Dow into a Full-SAC case. If a Full-SAC case were economically justified, Dow would have brought one already. Nothing in the Board's proposals would change that assessment.

According to the Board, the aggregation rule is necessary to prevent "gaming" by shippers. But the Board fails to explain how challenges to rates assessed on individual traffic lanes constitutes gaming. Each challenged rate presents a distinct and individual case with its own characteristics and value. The statute expressly requires the Board to adopt simplified procedures for those cases in which Full-SAC is too costly, "given the value of the case." The aggregation rule, however, turns this requirement on its head by defining a case in terms of the collective value of multiple cases. The statute simply does not permit this.

Furthermore, it is impractical and unfair to require shippers like Dow to aggregate their rate challenges over a two-year period when they do not even know all of their O-D pairs that far in advance. For example, Dow might file a three benchmark case with an MVC of \$150,000 on a traffic lane in Year 1. In Year 2, Dow may want to challenge a rate on a brand new O-D pair from the same origin with an MVC of \$100,000. The aggregation requirement, however, would require Dow to use the SSAC approach, which would not be justified even using the Board's vastly understated litigation cost of \$200,000. In this case, clearly there would be no "gaming" by Dow, since Dow could not have known of even the potential for the second case when it filed the first. Indeed, once Dow files the first case, the railroads will know that they have *carte blanche* on their pricing to Dow for two years, until the first case no longer will be included in the aggregation measure.

While the Board justifies the aggregation rule as necessary to preclude “gaming” by shippers, it is in fact the railroads who have both the ability and incentive “game” the system. As described above, the railroads can dictate the precise level of the MVC through their control over the tariff rate. Shippers, on the other hand, must incur additional time, expense and effort to pursue separate rate cases for speculative gains. The Board has expended way too much effort trying to prevent gaming by shippers that would not in fact be gaming at all under the statute, while ignoring the unquestionable ability of railroads to “game” the MVC in a way that would thwart the intent of the statute.

4. The proposed thresholds will continue to leave most captive shippers without effective regulatory rate constraints.

The proposed eligibility thresholds still would deprive most captive shippers of a cost-effective regulatory constraint on rail rates. While many movements may qualify for SSAC, Dow believes that very few will qualify for the three-benchmark approach. The Board’s eligibility estimates on page 37, Table 2, are implausible based on both common sense and Dow’s own experience. However, because the Board has refused to provide the workpapers underlying this Table, there is no way for anyone to verify or challenge these estimates.

Common sense demonstrates that, at the proposed eligibility cap of \$200,000, the three-benchmark standard will never be used by any shipper. Very few shippers will ever qualify to use this standard, and those that do qualify would never expend the time, money and effort to pursue a case. An MVC threshold of \$200,000 over 5 years would permit only the very occasional shipper to use the three-benchmark standard. But \$200,000 is a reasonable estimate of just the cost of litigation. Under this set of facts, it would be impossible for a complainant to do better than break-even, and then only if the MVC truly equals the actual case value.

Moreover, even if one generously assumes that litigation costs are as low as \$50,000, the

potential financial gain hardly justifies the time, effort, expense, and risks associated with prosecuting a three-benchmark case.

Dow's own experience demonstrates that the Board's proposals would not extend effective rate regulation to Dow. For example, in 2005, Dow's rail shipments for a significant product category represented over 30% of its total U.S. rail shipments. Approximately 79% of the customer destinations received only 1-20 carloads over the course of the year, while still accounting for 20% of the total carloads of this product. But, at an average of less than 5 cars per destination, each individual destination accounted for less than 0.01% of Dow's total volume of this significant product category. While these individual movements *might* qualify for the three-benchmark approach, Dow would never contemplate filing a three-benchmark complaint for such a small portion of its total rail volume. Moreover, the proposed aggregation rule would require that these rates be challenged under the SSAC approach, if Dow were to challenge even a small group of these rates within a two year period.

Another 11% of destinations received just 21-50 carloads annually, accounting for 18% of total rail shipments; 6% of destinations received 51-100 carloads annually, accounting for 21% of total shipments; and 3% of destinations received 101-250 carloads annually, accounting for 22% of total shipments. Some of the smaller volume movements might be three-benchmark cases, but the larger volume moves most likely would be SSAC cases and, after applying the aggregation rule, most would be Full-SAC cases. Yet, none of these are truly large volume movements with attributes similar to the coal movements that justify Full-SAC cases.

Finally, the remaining 1% of destinations received more than 251 carloads annually, accounting for 19% of total shipments. Many of these likely would be Full-SAC cases under the proposed eligibility standards. Since Dow does not consider these movements to justify Full-

SAC cases today, there is no reason why it would consider otherwise under the new proposals. In other words, the new proposals do not offer Dow any options that are different than the ineffective options that already exist.

Dow has analyzed several chemical and plastic movements to illustrate these points based on actual movements. For example, a 29 car movement between Ohio and North Carolina, with an R/VC of 307% would qualify for the three benchmark approach with an MVC of \$129,256. A mere 57 car movement from Texas to Arkansas, with an R/VC of 249%, would fall under SSAC with an MVC of \$200,536. Because neither example includes the fuel surcharge, they understate both the true R/VC and MVC calculations. Even so, the MVC clearly overstates the actual value of both cases, since very little, if any, chemical and plastic moves at or near 180% R/VC. In neither case would Dow find the time and expense worth the potential benefits of even a three benchmark rate case.

Dow also evaluated a much larger movement for both MVC and comparable movement R/VCs. A movement of 300 cars per year from West Virginia to Michigan, with an R/VC of 388%, would require a Full-SAC analysis with an MVC of \$3,659,824. In order to estimate an actual value for this case, Dow applied very narrow criteria to identify comparable movements from the Waybill sample and determined that the comparable group's average R/VC would be 224%. This clearly illustrates that the actual value of this case would be nowhere near the MVC. Although Dow believes that this rate is exceptionally unreasonable, it never would consider a SAC challenge to this rate to be justified. Nor would Dow file an SSAC based on its understanding of that proposed approach.

Although the eligibility thresholds are rebuttable presumptions, that misses the point. Presumptions should be rebuttable to address exceptional circumstances. The Board's proposals,

however, would require almost every shipper to rebut the presumption. This in turn would increase litigation costs for most shippers, further undermining the cost assumptions underlying the proposed MVC thresholds. Moreover, this would leave shippers with precisely the same uncertainty they face as to their eligibility to use the current three-benchmark standard. Thus, nothing will have improved over the current situation, and Dow believes it would be worse.

IV. Conclusion.

Although Dow welcomes this proceeding, it is discouraged by the Board's proposals. Dow urges the Board to abandon the SSAC concept altogether as too costly, complex and time consuming, and therefore, as contrary to the statutory standard for small rate case standards. Instead, the Board should reform the three-benchmark approach and significantly raise the eligibility thresholds, using an approach other than MVC that is more closely linked to the actual case value. The Board must ensure that *all* captive shippers for whom a SAC presentation is too costly given the actual value of the case are eligible to use the three-benchmark approach. Without such assurances, this rulemaking will accomplish nothing other than to confirm the irrelevance of regulatory rate protections to the vast majority of captive shippers.

Respectfully submitted,



Jeffrey O. Moreno
Thompson Hine LLP
1920 N Street, N.W.
Suite 800
Washington, DC 20036
202-263-4107

Attorney for The Dow Chemical Company

October 24, 2006

CERTIFICATE OF SERVICE

I hereby certify that I have on this 24th day of October, 2006, served a copy of the foregoing Comments on all parties of record, by first-class mail, postage prepaid.

A handwritten signature in black ink, appearing to read 'Aimee DePew', written over a horizontal line.

Aimee DePew