

BEFORE THE
SURFACE TRANSPORTATION BOARD

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

RAIL RATE CHALLENGES IN SMALL CASES

COMMENTS OF
CHEVRON PHILLIPS CHEMICAL COMPANY

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

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COMMENTS OF CHEVRON PHILLIPS CHEMICAL COMPANY

Chevron Phillips Chemical Company LP ("Chevron Phillips") hereby submits comments in the above-captioned proceeding. Although Chevron Phillips commends the Board for initiating this proceeding, the Board's proposals fall far short of offering effective and meaningful rail rate regulation standards.

I. STATEMENT OF IDENTITY AND INTEREST.

On July 1, 2000, Chevron Corporation and Phillips Petroleum Company, now ConocoPhillips, combined their worldwide petrochemical businesses (excluding Chevron's Oronite additives business) to form Chevron Phillips. Each company owns 50% of Chevron Phillips.

Chevron Phillips, which is headquartered in The Woodlands, Texas (north of Houston), is one of the world's leading producers of olefins and polyolefins, and a leading supplier of aromatics, alpha olefins, styrenics, specialty chemicals, piping, and proprietary plastics. Chevron Phillips produces chemical products that are essential to the manufacture of over 70,000 consumer and industrial products. Chevron Phillips employs approximately 5150 people at 37 production and research facilities worldwide.

Because Chevron Phillips is highly dependent on rail transportation at reasonable rates, it is essential to have a meaningful regulatory constraint upon the market dominant rail carriers that transport shipments between Chevron Phillips' facilities and its customers. This constraint is woefully inadequate in today's rail markets. On its captive traffic, Chevron Phillips has been presented with "take it, or leave it" rates that eliminate all meaning from the term "negotiation." The idea that the threat of regulation constrains rates on captive traffic is unrealistic, since both parties know that the economics do not justify a rate case even at the exceedingly high levels of

recent rate increases. Moreover, there is no predictability in the current standards that would allow the parties to conduct a cost-benefit risk assessment based on the most predictable outcomes of a rate case. Chevron Phillips urges the Board to rectify this situation.

II. THE IMPORTANCE OF RAIL TRANSPORTATION TO CHEVRON PHILLIPS.

Chevron Phillips owns and operates the following nine rail-served production facilities in North America, of which five are captive to a single carrier and four either are competitively served or are served by a neutral switching carrier:

- Borger, TX – Closed BNSF
- Cedar Bayou, TX — UP-served, open to BNSF
- Marietta, OH – Closed CSXT
- Orange, TX – UP-served, open to BNSF
- Pasadena, TX – PTRAserved, open to BNSF and UP
- Pascagoula, MS – Closed CSXT
- Part Arthur, TX – Pipeline loading to barge, which is transferred to rail at Smiths Bluff, TX – closed KCS
- St. James, LA – Closed UP
- Sweeny, TX – Closed UP

Chevron Phillips ships product by rail annually to over 1800 delivery points. Since a significant portion of these destinations are captive to a single carrier, real competition for these lanes does not exist even from Chevron Phillips’ “open” facilities.

Rail transportation is essential to Chevron Phillips’ supply chain and plant operations. Although Chevron Phillips depends on both inbound and outbound rail transportation, the vast majority of its rail requirements are for outbound shipments of Polyethylene, Polypropylene, Paraxylene, Ethylene, Propylene, Cyclohexane, Styrene, Olefins, and Polystyrene. Total outbound shipments are approximately 41,000 rail cars annually.

Chevron Phillips’ production facilities are configured to load railcars, which are the predominant delivery option for Chevron Phillips’ customers. Very few Chevron Phillips facilities are configured for truck transport, and most of those only for liquids. For plastic resins,

which comprise the largest portion of Chevron Phillips' rail shipments, Chevron Phillips does not have any infrastructure for loading by truck, since the sheer volumes at issue render trucks impractical and cost prohibitive. Consequently, even truck-to-rail transloading is not an option. For those shippers who receive product by truck, Chevron Phillips first must transport the product by rail to a transload facility.

Chevron Phillips has a diverse distribution network to over 1800 destinations, comprised of 4000 origin-destination pairs. Product moves by rail either directly to a customer or to a bulk terminal, where it is trans-loaded to trucks for delivery to the customer. The volumes over any single traffic lane vary significantly. Lanes to gateway points range from 75 cars to 2500 cars annually. Lanes to individual customers can range from a single car to over 400 cars annually. Because Chevron Phillips functions in a highly competitive market, where customers may change suppliers when prices vary by even fractions of a cent, these traffic lanes and volumes can fluctuate frequently.

III. INEFFECTIVENESS OF CURRENT RATE REGULATION.

The STB's current standards and procedures for regulating rail rates have been ineffective for Chevron Phillips. They are too complex, consume too much time, and cost too much money. As such, the current standards are neither practical nor cost-effective, even at the significantly higher rate levels that Chevron Phillips has been quoted recently at its captive facilities.

The Board's preferred regulatory standard, stand-alone cost ("SAC"), is a non-starter for Chevron Phillips on even its highest volume traffic lanes. The cost of prosecuting a SAC case easily exceeds \$4 million and consumes 3-4 years. Many of Chevron Phillips' traffic lanes don't continue for 3-4 years, which allows Chevron Phillips a very small window to recover its

litigation costs before it even would realize any benefit from a rate reduction. Furthermore, Chevron Phillips can ill-afford to pay higher rail rates on top of its litigation costs for 3-4 years knowing that it may not obtain any relief at the end of the process.

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 been less than clear. Eligibility to use the three-benchmark approach has been uncertain. And, these factors have combined to render litigation costs highly speculative. 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.

A rate case 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. That provides 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. Nor does the SAC approach, which is too costly and time-consuming for most captive shippers.

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.

IV. 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, Chevron Phillips 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.

There are many elements in the Board's proposal that concern Chevron Phillips. Due to the complexity of the substantive standards proposed by the Board for the three-benchmark and Simplified-SAC ("SSAC"), Chevron Phillips will only comment briefly on those standards and defer to the more thorough review and assessment that various trade associations have prepared and presented in joint comments.

As a general matter, the Board's proposal to adopt a three-tiered regulatory standard to replace the current two-tiered standard is unnecessary and unjustified. Currently, the Board has adopted the SAC standard for large cases and the three-benchmark standard for all other cases. The Board, however, has proposed to adopt a middle tier for "medium-sized" cases, based on a standard called "Simplified-SAC." The Board also has proposed to modify its three-benchmark standard. While Chevron Phillips commends the Board for its attempt to improve the three-benchmark standard, SSAC does not offer a 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 Chevron Phillips' constantly changing customer and shipping patterns. Any rate process should conclude within no more than 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 proposals.

While the Board claims that SSAC merely sacrifices accuracy for simplicity, it really is mandating a rate higher than SAC for 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 worse.

This raises the question of why there should be an eligibility threshold for SSAC at all. If a complainant truly finds SSAC to be simpler and less costly than Full-SSAC—which Chevron Phillips doubts—and further concludes that this benefit outweighs the higher rate compared to a Full-SAC analysis, then that complainant should have the option to use SSAC at *any* threshold value. There is no reason to deny use of SSAC to any complainant, since there is no risk that the rate will be below SAC, which is the Board's preferred standard.

2. The three-benchmark approach lacks timeliness and predictability.

While the Board's modifications to the three-benchmark approach take some steps in the right direction, Chevron Phillips still has many concerns. First, 9 months for a decision continues to be too long for Chevron Phillips' 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. As Chevron Phillips has stated above, a rate case should be

the exception rather than the rule. 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, the shipper will have no ability whatsoever to make this assessment, since it will not have access to critical data that the Board 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 a significant advantage and an ability to manipulate the regulatory process.

B. The Proposed Eligibility Guidelines Are Flawed.

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

1. MVC is unrelated to actual case value and is prone to railroad 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 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"), which serves as a rate floor. Although MVC represents the "maximum" *potential*

relief that a shipper may obtain, it will almost 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, a prescribed rate 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.

A shipper will not decide whether to bring a rate complaint on the basis of the MVC, which is a fictional number with no significance other than what the Board has arbitrarily assigned to it. Rather, a shipper will try to 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.

The MVC calculation also can be easily manipulated by the railroads 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. At that point, however, it will be quite clear that the shipper is requesting a common carrier rate so that it can 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

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.

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.

2. The proposed eligibility 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 far, far 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 approaches. 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 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 Chevron Phillips to believe that the true cost of an SSAC case is many times greater than the Board assumes.

Moreover, the Board's proposed eligibility thresholds ignore additional 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. In addition, the Board has not included a risk premium in 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 Chevron Phillips would consider in addition to its legal and consulting fees.

The railroads also have every incentive to make rate cases as complex, and therefore costly, as possible. By doing so, they discourage shippers from filing rate cases and destroy the assumptions underlying the MVC thresholds. It is unrealistic for the Board to assume otherwise, because that is precisely what has occurred in Full-SAC cases. Therefore, the MVC thresholds should be several factors greater to reflect much higher litigation costs and to include other costs that the Board has neglected to include in its assumptions.

3. The aggregation requirement conflicts with the statutory emphasis on small cases, not small shippers.

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.

Chevron Phillips’ shipping patterns illustrate this consequence. Chevron Phillips ships by rail to hundreds of destinations from each of its major production facilities. While Chevron Phillips 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 convert these into a Full-SAC case. But the fact that Chevron Phillips would not find a Full-SAC case on these movements to be economically justified today, indicates that a Full-SAC case would be no more justified under the Board’s proposals, since nothing in those proposals changes the Full-SAC approach. Thus, the aggregation rule would leave Chevron Phillips without an effective regulatory remedy for unreasonable rates just as it is today.

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 Chevron Phillips to aggregate their rate challenges over a two-year period when they do not even know all of their customer destinations that far in advance. For example, Chevron Phillips might file a three

benchmark case with an MVC of \$125,000 on a traffic lane in Year 1. In Year 2, Chevron Phillips may want to challenge a rate on a brand new O-D pair from the same origin with an MVC of \$76,000. The aggregation requirement, however, would require Chevron Phillips to use the SSAC approach for the second complaint. But, SSAC would not be justified for either case, individually or collectively, even using the Board's vastly understated litigation cost estimate of \$200,000. Furthermore, "gaming" clearly would not be an issue in this scenario, since Chevron Phillips could not have known of even the potential for the second case when it filed the first.

In contrast, once Chevron Phillips files the first case, the market dominant railroad will know that it has *carte blanche* on pricing to Chevron Phillips from the issue origin facility for two years, until the MVC of the first case no longer is 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 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, Chevron Phillips believes that virtually none will qualify for the three-benchmark approach, especially after application of the aggregation rule. Chevron Phillips finds the Board's eligibility

estimates on page 37, Table 2, to be implausible based on both common sense and Chevron Phillips' 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 likely to be the cost of just 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.

Chevron Phillips has analyzed two movements to illustrate its concerns with the Board's proposed eligibility thresholds. The smaller of the two is a 61 car/year movement of plastic resin from Ohio to Florida. That movement has an R/VC of 233% and an MVC of \$293,051. Despite this relatively small number of rail cars, this movement would not qualify for the three benchmark test. But, even under the unrealistic assumptions that the actual value of the case equals the MVC and that SSAC litigation costs are only \$200,000, the potential gain of only \$93,000 over 5 years would not justify the cost, time, and risk of a rate case.

Moreover, Chevron Phillips has no assurance that this traffic lane will survive 5 years in order to recover its litigation costs. Nor is there a risk factor to account for the possibility that Chevron Phillips could spend \$200,000 only to lose the case. But most importantly, the true value of this case is likely to be less than \$93,000 and the true costs are likely to be many times

greater than \$200,000. Thus, even under the most favorable assumptions for Chevron Phillips, a decision to challenge this rate would be marginal even under the three benchmark approach, much less SSAC, which the Board's proposed threshold would require Chevron Phillips to use.

The second movement analyzed by Chevron Phillips is a 400 car/year joint line movement of methyl mercaptan from Texas to Louisiana. The R/VC is 320% and the MVC would be \$3,606,440. This moderate volume movement with a high R/VC would qualify only to use the Full-SAC approach to challenge the reasonableness of this rate. Yet, the potential gain barely exceeds the Board's own estimated Full-SAC litigation cost of \$3.5 million by a mere \$106,000. This is hardly a risk that Chevron Phillips would take. Although a Full-SAC case clearly would not be economically viable given the actual value of this case, even under the Board's own favorable assumptions, the Board's proposal would not allow Chevron Phillips to use either SSAC or the three benchmark approach.

Although the eligibility thresholds are rebuttable presumptions, that misses the point. Presumptions should be rebuttable to address the exceptional circumstances. The Board's proposals, however, would require almost every shipper to rebut the presumption, which adds even more cost and uncertainty to the process. 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 probably will be worse.

V. Conclusion.

Although Chevron Phillips welcomes this proceeding, it is discouraged by the proposals. The Board should abandon the SSAC concept altogether as too costly, complex and time consuming, which is contrary to the statutory requirement for small rate case standards. Instead, the Board should reform the three-benchmark approach and significantly raise the eligibility

criteria, using an approach other than MVC that is predicated on 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 Chevron Phillips Chemical
Company*

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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 in a cursive style.

Aimee DePew