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October 24, 2006

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## HAND DELIVERY

The Honorable Vernon A. Williams  
Secretary  
Surface Transportation Board  
1925 K Street, N.W.  
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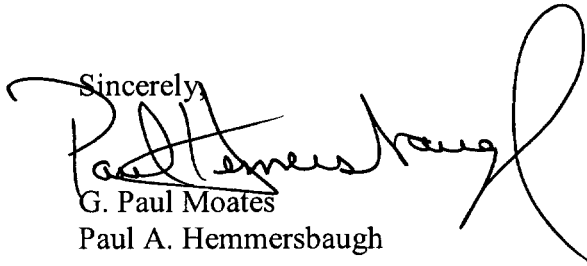
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Re: Ex Parte No. 646 (Sub—No. 1), Simplified Standards for Rail Rate Cases

Dear Secretary Williams:

Enclosed, for filing in the above-referenced proceeding, are an original and ten copies of CSX Transportation Incorporated's and Norfolk Southern Railway Company's Joint Opening Comments in STB Ex Parte No. 646 (Sub—No. 1). A diskette containing an electronic version of that response is also enclosed.

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

Sincerely,  
  
G. Paul Moates  
Paul A. Hemmersbaugh

*Counsel to CSX Transportation, Inc. and  
Norfolk Southern Railway*

Enclosures

**UNITED STATES OF AMERICA  
SURFACE TRANSPORTATION BOARD**

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

***SIMPLIFIED STANDARDS FOR RAIL RATE CASES***

**OPENING COMMENTS OF  
NORFOLK SOUTHERN RAILWAY  
COMPANY AND CSX TRANSPORTATION, INC.**

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**Dated: October 24, 2006**

Norfolk Southern Railway Company (“NS”) and CSX Transportation, Inc. (“CSXT”) (CSXT and NS collectively referred to as “CSXT/NS”) hereby submit their joint initial comments on the Board’s July 26, 2006 Decision in STB Ex Parte No. 646 (Sub-No. 1), *Simplified Standards for Rail Rate Cases* (the “Decision”).

## INTRODUCTION AND OVERVIEW

As the Board has made clear, the first and best methodology to assess the reasonableness of a challenged rate is a full SAC presentation. *See, e.g., Simplified Guidelines* at 8 (1996) (“CMP is the most economically precise procedure available for evaluating the reasonableness of rates and *should be used whenever possible.*”) (emphasis added)<sup>1</sup>; Decision at 9 (“CMP, with its SAC constraint, continues to be our preferred and the most accurate procedure available for determining the reasonableness of rail rates where there is an absence of effective competition”). While CSXT/NS anticipate there will be thousands of pages devoted to the numerous issues that will be raised in connection with the Board’s proposals and the proposals that CSXT/NS and other parties will make in this proceeding, CSXT/NS’s filings will be based upon the following core beliefs:

- Basic economics teaches that when demand exceeds supply, prices rise. Public reports that rail rates are increasing is not an indication that STB rate regulation has failed.
- Increasing rail capacity and improving rail service require increased rail revenues.
- Prices are the heart of any business and are seldom, if ever, simple to determine.
- CSXT/NS agree that not every rate challenge must necessarily be determined through a full stand-alone cost analysis, but CSXT/NS also believe that no rate should be prescribed based on a formula. Mechanical rate formulas may be quick and easy to use but such rate formulas cannot be easy, quick and accurate.

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<sup>1</sup> *Rate Guidelines—Non-Coal Proceedings*, STB Ex Parte No. 347 (Sub-No. 2) Decision at 14 (served Dec. 31, 1996).

- Small cases should be determined by the Board looking at a number of factors and using its expertise to judge the reasonableness of the challenged rate.
- The more revenue that is at stake in an individual case, the closer the results in that case must be to results that would be generated by a full stand-alone cost analysis.
- The more overall rail revenue that is judged by non-SAC procedures, the more important it is that the non-SAC procedures produce SAC-like results.
- Eligibility for the Board's proposals should not be expanded. The present proposal – which would subject two-thirds of regulated rail revenues to challenge under non-SAC tests – may go too far.
- The Board should monitor the effects of any new procedures it adopts in this proceeding, to ensure that results of cases considered under simplified procedures are not materially different from the results that would be generated by a full SAC analysis.
- Rate regulations should not encourage litigation over negotiation. CSXT/NS believe that several of the Board's proposals would in fact foster litigation at the expense of resolution of rate disputes through private negotiation.

CSXT/NS address these broad concerns, as well as a number of specific matters raised by the Decision, in the following sections of these Comments.

## **I. PROPOSED METHODOLOGY FOR “MEDIUM-SIZE” RATE DISPUTES**

As the Board acknowledges, CMP and the SAC constraint are the “preferred and the most accurate procedure available for determining the reasonableness of rates where there is an absence of effective competition.” Decision at 9. Accordingly, any simplified methodology should be designed to achieve the same objectives and similar results as a SAC analysis, in a less-costly manner. *See* Decision at 10-11. The Board has proposed a number of simplifying assumptions and methods for use in a Simplified SAC (“SSAC”) analysis, all in the name of achieving cost savings and reducing complexity. By its nature, any simplification will — to some extent — generate incorrect and inaccurate results. Any potential savings of time and cost must be balanced against the extent to which such a measure (1) departs from economically

sound ratemaking principles and policies, (2) reduces accuracy, or (3) leads to results that diverge from those that would be reached under CMP.<sup>2</sup>

While CSXT/NS recognize that the proposed simplifications are intended to implement the Board's statutory directive to provide a simplified rate reasonableness methodology for lower value cases, they are concerned about the very real possibility that simplified procedures will result in distorted outcomes that do not closely approximate the results of a full SAC analysis. Large amounts of rail revenue will be subject to the SSAC procedures at a time when it is very important to the national interest that railroads continue to have the resources necessary to invest in expanding capacity to meet growing demands for freight transportation. It is therefore essential that accuracy and fidelity to sound economic principles and judicially approved methodologies not be compromised materially in the name of speed and "simplicity."

There is no benefit to a review that is fast, cheap and wrong. Any SSAC methodology the Board adopts must be consistent with the results of a full SAC analysis and include all costs that would be recognized in a SAC analysis. CSXT/NS urge the Board to monitor closely the implementation and application of any simplified methodology it adopts, to ensure that the analysis and results do not diverge materially from those a full SAC analysis would generate.

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<sup>2</sup> The Board states in a footnote (*Decision* at 5, fn. 8) that "A fourth constraint – phasing – can be used to limit the introduction of otherwise-permissible rate increases when necessary for the greater public good" (citing *Coal Rate Guidelines*, 1 I.C.C.2d 520, 546-47) ("*Guidelines*"). Phasing has not been applied to a rate increase in any case since adoption of the *Guidelines*. Nonetheless, it should be emphasized that, as the Board recognized in the *Duke Energy* cases (see *Duke Energy Corp. v. Norfolk Southern Railway Co.*, Docket No. 42069; *Duke Energy Corp. v. CSX Transportation, Inc.*, Docket No. 42070), a complainant wishing to invoke the phasing constraint successfully must demonstrate that the challenged rate increase "would lead to severe dislocation of economic resources." *Duke Energy Corp. v. Norfolk Southern Railway Co.*, *Decision* at 39 (served Nov. 6, 2003). In short, a complainant seeking to invoke phasing bears a heavy burden to demonstrate that the challenged rate increase "could cause significant economic dislocations," *Guidelines*, 1 I.C.C. 2d at 546, and allegations about "the greater public good" would be far from sufficient to meet that burden.

The Board should make clear in any final rules that it adopts that it will carefully monitor the effects of those new rules, including simplifying assumptions and methods, and will make adjustments to those rules as necessary to ensure that results generated by the simplified methodology are not materially different from SAC results.

**A. Proposed Disclosures and Disproportionate Burden and Cost Imposed on Defendant Carriers.**

CSXT/NS support initial disclosures by all parties to a case in which a complainant seeks to avail itself of the SSAC approach. With a few modifications, the initial disclosures proposed in the Decision could promote efficient determination of threshold jurisdictional and eligibility issues, and could facilitate resolution of some cases without further litigation. The proposed “second disclosure,” however, would be fundamentally unfair to rail carriers; would force carriers to bear a disproportionate share of the burden of rate cases; and would encourage rate litigation and regulatory intervention over privately negotiated rates and contracts.<sup>3</sup>

**1. The Proposed Initial Disclosures Are Appropriate and Should Facilitate Effective Determination of Threshold Issues.**

CSXT/NS generally support, with modifications discussed below, the Board’s proposal for initial disclosures by the parties at the outset of a rate challenge in which the complainant seeks to invoke either the medium SSAC or small case methodology. Such initial disclosures would not only allow the Board to make threshold jurisdictional and eligibility determinations,

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<sup>3</sup> While CSXT/NS cannot speak for their short line connections, they expect that producing the proposed level of detail within the time provided would prove burdensome to short lines. Small railroads likely will be increasingly involved in rate cases under the proposed new guidelines. The Board’s experience with high-volume unit train coal cases (where most movements are either local to a single railroad or a joint line movement between two large carriers) is not representative of the extent to which small railroads participate in general merchandise movements. A very large percentage of general merchandise shipments on both CSXT and NS either originate or terminate on a short line railroad. The Board should ensure that whatever rules it adopts do not have a significant adverse effect on small entities.

they would also give the parties an early opportunity to make a preliminary evaluation of the strength of the rate challenge, and may facilitate early resolution of some cases.

CSXT/NS believe the information that a complainant is required to provide in its initial disclosure should also include (1) all correspondence (including emails), studies, and analyses conducted by the shipper (or on its behalf) regarding transportation alternatives for the commodity, origins and destinations at issue; (2) a list of all shipments of the commodity at issue, between the origin(s) and destination(s) at issue, made by the shipper in the preceding two years; and (3) any other quoted rates the shipper has obtained or reviewed for transportation of the commodity between the origin(s) and destination(s) at issue, including quoted rates for non-rail modes such as over-the-road trucking. Information regarding the shipper's transportation alternatives will aid the Board in making the market dominance determination necessary to ascertain whether the Board has jurisdiction over the rate challenge. Data and information regarding all shipments made in the last two years should assist the Board and the parties in evaluating whether a case over which the Board has jurisdiction should be considered under SAC, SSAC, or the small case ("Three Benchmark") methodology.<sup>4</sup>

2.     The Proposed "Second Disclosure" Would Be Fundamentally  
Unfair and Unduly Burdensome to Defendant Carriers, and  
Would Encourage More Litigation.

CSXT/NS are very concerned about the proposed "second disclosure" process and requirements. As outlined in the Decision, the Board's proposal appears to require defendant rail carriers to bear the entire burden and expense of developing and analyzing data and information, and presenting it in a specific format for the complainant to use in its case-in-chief, all in an

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<sup>4</sup> See Decision at 33 ("The annual volume would be based either on *historical traffic patterns* or on the representations of the shipper in its complaint with respect to anticipated future traffic.")(emphasis added).

extraordinarily short period of time. Such an approach would be unfair, unwise, and bad public policy.

The proposal would impose on *defendants* the majority of the costs of gathering and analyzing the information required for *complainants'* case. And, complainants could impose this substantial cost and burden on rail carriers simply by filing a skeletal complaint and paying a \$150 filing fee. Because shippers could obtain this information and have most of their case developed for them by the defendant railroad at very little cost, the proposed second disclosure rule would encourage rate litigation.

Most railroad shippers are sophisticated industrial corporations with knowledgeable logistics and traffic managers who know the transportation industry well. These professionals are skilled negotiators who often have experience in purchasing departments. They know how to use the many tools of contract negotiation, including the regulatory process, to their advantage. It would be naïve to believe that, if given the ability to impose significant burden and cost on the railroad(s) in a negotiation—at no significant cost to themselves—shippers will do anything other than initiate rate cases.

The “second disclosure” proposal would thus work against a fundamental tenet and goal of rail transportation policy since the Staggers Act – to facilitate and promote the establishment of rail rates through private negotiation rather than regulation and litigation.<sup>5</sup> Because, by merely filing a complaint and paying a modest filing fee, a shipper could effectively force rail carriers to gather and package the bulk of the information needed for a rate case, complainants would have every incentive to file a rate case as part of the rate negotiation process. The potential result would be a large volume of rate cases that would impose a heavy burden on both

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<sup>5</sup> See, e.g., 49 U.S.C. § 10101(2).

carriers and the Board. In contrast, if complainants were required to bear the cost of developing their own case, the negotiation process could be more fruitful and the Board's limited resources could be reserved for a far smaller number of fully ripe disputes.

Moreover, the "second disclosure" proposal is contrary to Board policy and the rules in federal and state court litigation. The longstanding policy of the Board (and the ICC before it) regarding document and data production in rate reasonableness cases is that parties are required to produce data and information in their possession, to the extent that production does not impose an undue burden on the producing party. Parties are not required, however, to engage in "special studies" to generate information or data that would not exist in the absence of litigation, or to organize, analyze, manipulate or present data in a form in which it would not otherwise exist. *See, e.g., PPL Montana v. BNSF*, STB Dkt. No. 42054, Decision at 3 (served Nov. 9, 2000) (even in complex SAC cases, discovery rules "require parties to furnish information in their possession, not to prepare special studies"); *Nevada Power*, ICC No. 37038, slip op. at 8-9 (ICC served Oct. 24, 1984).<sup>6</sup> This is a fair and reasonable rule that mirrors the general rule in litigation in federal and state courts.

CSXT/NS are aware of no other context in which one party is effectively required to develop, at its own cost, its adversary's case. The proposed disclosure rules would require a defendant carrier to gather, analyze, and present the majority of the data and information complainants need to present their case-in-chief – whether or not the railroad had captured, recorded, or maintained such information in the first instance. This goes much further than

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<sup>6</sup> CSXT and NS do not maintain data in the format(s) in which it is typically requested in rate cases, and they could not simply "push a button" to generate the specific data the Decision proposes be provided by carriers in their "second disclosure." Rather, generating much of the proposed information and data – to the extent it could be done at all – would require special studies, and substantial carrier time and resources.

general disclosures of the sort required by the Federal Rules of Civil Procedure and analogous state court rules, by effectively requiring a party to develop and give to its opponent that opponent's case-in-chief. Not only is this wholly inconsistent with the adversarial process, it would constitute a regulatory taking and denial of a carrier's right to due process. *See, e.g., Lingle v. Chevron U.S.A.*, 544 U.S. 528 (2005); *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998); *Penn Central Transp. Co. v. City of New York*, 438 U.S. 104 (1978); U.S. Const. amend. V.

If the Board does adopt a "second disclosure" rule similar to that described in the Decision, it should clarify that carriers are not required to perform special studies to generate that information. Instead, consistent with longstanding precedent and practice, carriers' production obligation should be limited to non-privileged data and information generated in the carriers' normal course of business, or as part of carriers' regulatory reporting obligation (*e.g.*, Form R-1 data). The Board should clarify that any new rules it adopts for medium or small cases maintain these longstanding limitations, and that any new disclosure rules do not expand the type of information carriers are required to produce in a rate case.

## **B. Other Procedural and Scheduling Issues**

### **1. Mandatory Mediation**

The Board should adopt a rule mandating mediation in cases filed under the proposed simplified standards and procedures. CSXT/NS believe that mediation may facilitate early resolution of rate disputes in some instances and holds significant potential to reduce the time and expense of litigating such disputes in many other cases. Indeed, in the only case filed under the existing small case guidelines to date, the complainant and NS were able to resolve their dispute in mediation, thereby avoiding the time and expense of litigation. *See B.P. Amoco*

*Chemical Co. v. Norfolk Southern Railway Co.*, Decision STB Dkt. No. 42093 (served June 28, 2005).

The rules should require that, promptly following the filing of the complaint (before the parties make their initial disclosures), the parties must engage in non-binding mediation aimed at resolving the dispute before the parties expend significant resources on litigation. The mediation should be conducted by a neutral non-party selected by the Board (preferably Board staff members, provided that any staff member who serves as a mediator does not participate in the analysis or consideration of the case in the event that it proceeds beyond mediation).<sup>7</sup> The most significant potential benefit of such mediation, of course, would be voluntary resolution of the rate dispute by the parties without expenditure of the significant time and resources required to litigate a rate case.

Although the focus of the mediation should be on the underlying rate dispute, the mediation could also be used to resolve voluntarily issues concerning discovery, procedure and other matters for those cases in which the litigation proceeds. For example, the parties should attempt to reach agreement, through mediation, regarding whether the rate case is eligible for treatment under SSAC. If the parties are able to agree voluntarily that the case qualifies to be evaluated under SSAC, they could effectively eliminate Phase I of the proposed procedural schedule, thereby saving 50 days and avoiding several filings. Similarly, the parties, through mediation, could attempt to resolve the question of the proper route to be used in the SSAC analysis (as discussed below, CSXT/NS oppose the proposal that complainant be allowed to select a route other than the issue traffic's predominant route of actual movement. If the Board

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<sup>7</sup> CSXT/NS also support the proposed "meet-and-confer" and staff conferences requirements as low-cost means of resolving discovery disputes and narrowing the number of such disputes presented to the Board for its resolution. *See* Decision at 17-18.

adopts CSXT/NS' proposed modification, the routing inquiry would not be undertaken in any case). If the parties are able to agree voluntarily on the route, they will be able to avoid the routing inquiry of Phase II, another substantial savings of time and expense for the parties and the Board. Thus mediation can save time and money even when it does not resolve the rate dispute.

2. The Proposed Time Period for Rail Carriers to Prepare the Second Disclosure is Inadequate.

The Board proposes that carriers have only 30 days to gather and develop the "second disclosure" data and information from the time Board staff issues a decision selecting the SSAC route. Decision at 17 (providing for selection of route on Day 140 and second disclosure on Day 170). Thirty days simply would not be sufficient time for either CSXT or NS to develop the required data and information, which comprise the bulk of the evidence upon which the parties would rely to present their cases. Developing such information in 90 days would be a difficult task, and completing the task in 30 days, without diverting substantial resources from carriers' primary job of providing efficient and effective rail transportation service, would be nearly impossible. CSXT/NS therefore urge the Board to adopt a procedural schedule that allows at least 90 days after the selection of a route for carriers to develop and produce second disclosure information.<sup>8</sup>

C. **The Proposed Simplification of Traffic Selection and Road Property Investment Cost Calculation May Achieve Significant Savings Without Undue Loss of Accuracy or Significant Departure from SAC Principles**

Two of the proposed evidentiary modifications appear to hold potential for reducing the cost of litigating medium-sized rate cases without significantly distorting the analysis. If the

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<sup>8</sup> Even ninety days may prove inadequate in the event of a deluge of rate litigation, such as that which may result from the adoption of the proposed rules.

Board takes care to implement those proposals – both in this proceeding and in adjudication of cases evaluated under SSAC – in a manner that does not significantly depart from core principles of CMP and demand-based differential pricing, they could significantly reduce the cost of litigating a “medium-sized” rate case without undermining the existing rate regulatory system.

*First*, the Board’s proposal to include all of the traffic that travels on the selected route over the Test Year<sup>9</sup> and to prohibit “re-routing” of traffic onto the selected route, would reduce the costs to complainants of selecting traffic. It would also eliminate the costs incurred by complainants and defendants in litigating disputes regarding the traffic group. At the same time, this proposed simplification would substantially reduce the potential for gamesmanship through creative, but unrealistic or infeasible, traffic selection. It thus appears that this proposal could improve the accuracy of the SSAC analysis while simultaneously reducing the cost and complexity of SSAC proceedings.

*Second*, the Board’s proposal to simplify the calculation of road property investment (“RPI”) costs in SSAC cases appears to strike a reasonable balance between reducing costs and complexity and reduced accuracy and precision. While the use of average unit costs from the last five SAC decisions for a number of the components of RPI will reduce the accuracy of RPI determinations in each case, such a simplification could save the parties significant time and resources both in discovery and in the development and submission of competing RPI evidence. Moreover, if the Board takes care to account for significant differences in terrain and topography, and retains flexibility to make appropriate adjustments in specific cases for other material differences from RPI in the preceding five SAC cases, the SSAC cost savings should be accomplished without undue distortion of the resulting RPI calculations.

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<sup>9</sup> Capitalized terms that are not otherwise defined herein should be accorded the meaning they are given in the Decision.

#### D. Route Selection

Under the proposed SSAC methodology, a complaining shipper would have the right to select “its preferred route for the challenged movements.” Decision at 12. According to the Decision, “[t]he selected route need not be the route actually used by the railroad for the traffic at issue, but if the selected route has not been used in the prior 12 months for the traffic at issue, the shipper would need to demonstrate that the route selected has sufficient existing capacity to handle the additional traffic.” *Id.* The configuration of the SARR would then consist of the existing facilities along the route selected by the complainant, and the SARR’s traffic group would include the issue traffic and all other movements that traveled over the selected route during the Test Year. *Id.* at 12-13.<sup>10</sup> The Board instead should adopt a rule that the SARR’s configuration must use the predominant route over which the complainant’s traffic actually moved during the Test Year.

The proposal to allow a shipper to build a SARR based on a route of its choosing, rather than the route over which the issue traffic actually moves, should not be adopted, for several reasons. *First*, the proposal to allow complainants to select alternate routes would complicate, rather than simplify, SSAC cases by creating the potential for disputes between the parties with respect to the appropriate route for the SARR. The Decision recognizes the likelihood of such disputes by providing fully 90 days for the parties to submit evidence on the issue of route selection, and for Board staff to decide that issue. Thus, the Board’s proposal would add to the time and expense required to litigate a SSAC case.

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<sup>10</sup> The Board indicates that particular facilities along the selected route would be excluded if the complainant presents “compelling evidence that some facilities along the route have fallen into disuse by the railroad, and thus need not be replicated.” *Id.* at 12. CSXT/NS suggest that further guidance from the Board regarding what would constitute such “compelling evidence” would be valuable.

*Second*, judging the reasonableness of a challenged rate based upon revenues and expenses attributable to a route other than that over which the issue traffic actually moves would be inconsistent with the fundamental purpose of a SAC analysis. “The principal objective of the SAC constraint is to restrain a railroad from . . . charging more than it needs to earn a reasonable return on the replacement cost of *the infrastructure used to serve that shipper*.” Decision at 10 (emphasis added). As the Decision recognizes, the SSAC methodology “should be designed to achieve the same objective, albeit in a less precise manner.” *Id.* But a SSAC analysis based upon the physical configuration, traffic mix and operating characteristics of a route that is not used in the real world to handle the complainant’s traffic would not accurately reflect the cost of the “infrastructure used to serve that shipper.” A regulatory standard that bears no relationship to the real world railroad operations would be arbitrary and capricious and likely would not survive judicial review.<sup>11</sup>

*Third*, the proposal to allow a complainant to base its SARR on a route other than that over which its traffic actually moves creates opportunities for “gaming.” The obvious motive for a complainant to propose an alternate route would be to achieve a more favorable outcome than it could attain based upon analysis of the route over which its traffic actually moves. For example, a complainant might seek to reduce its SARR’s road property investment by selecting an alternate route with less double-tracking and fewer sidings than the route over which its traffic actually moves, even if those additional facilities are needed to meet the complainant’s real

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<sup>11</sup> The proposal that, if a route has been used even once in the past year to handle issue traffic, it becomes fair game for litigation purposes ignores the reasons for occasional variations in routing and rail operations. They may change because a line is out of service due to accident, washout, flood or maintenance. They may change because trains are added or eliminated. They may change because the railroad is trying a change in operating plan to become more efficient. to provide better service, or both. The Board should not adopt a policy that punishes a railroad for decisions designed to react to operating exigencies, or efforts to improve service to customers.

world transportation needs. (Indeed, the Board’s proposed methodology for estimating operating costs in SSAC cases, which would eliminate any consideration of the SARR’s operating plan or the transportation needs of the selected traffic, encourages such a choice.) Likewise, a complainant might select an alternative route to obtain the benefit of greater traffic density (or a higher-rated traffic base) than that associated with the line over which its traffic is handled in the real world. And, the Decision nowhere indicates that a complainant proposing an alternative route would be required to demonstrate that route would adequately meet the requirements of the shippers whose traffic would be re-routed. The Board should not adopt rules that would facilitate (and, in many instances, promote) such “gamesmanship.”<sup>12</sup>

In order to avoid these undesirable results, and to assure that the SSAC analysis accurately measures whether the challenged rate exceeds a reasonable return on the cost of the “infrastructure used to serve that shipper” (Decision at 10), the Board should require that the SARR’s configuration use the route over which the complainant’s traffic actually moved during the Test Year. In those instances in which the complainant’s traffic moved via more than one route on the defendant carrier’s lines during the Test Year, the SARR’s configuration should be based upon the predominant route of movement during the Test Year. This proposed requirement would (1) reduce the complexity of the litigation; (2) eliminate the time and cost to the parties associated with litigating the route; (3) eliminate the time and cost to the Board of

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<sup>12</sup> As a practical matter, the proposed requirement that a complainant seeking to designate a route that has not been used to handle the issue traffic in the prior 12 months demonstrate that the route selected “has sufficient existing capacity” to handle the issue traffic (Decision at 12) would do little to discourage such “gaming.” Given the proposed eligibility threshold for SSAC cases (a MVC of less than \$3.5 million), most SSAC cases are likely to involve relatively low volume single-car or multiple-car shipments rather than frequent trainload movements. Thus, in order to satisfy the proposed capacity requirement, the complainant in most instances would need to show only that existing trains operating over the selected alternate route could accommodate a few more cars per day, rather than that the line in question is capable of handling additional daily train movements.

deciding which route should be used; (4) ensure that the challenged rate is analyzed based on the replacement cost of the infrastructure used to serve the shipper; (5) avoid gaming by the shipper; and (6) free up time in the schedule to allow more time for other steps (e.g. production of documents and information) or to shorten the overall schedule.

## **II. ANY PARTIAL REVOCATION OF AN EXEMPTION SHOULD BE DETERMINED AT THE OUTSET OF ANY MEDIUM OR SMALL RATE CASE.**

If the Board decides to consider partial revocation of a specific commodity exemption for the issue traffic in the context of individual rate case adjudications under either the SSAC medium case rules or the Three Benchmark small case rules, it should decide that issue at the start of the case, before the parties expend resources on discovery and development of evidence. As a matter of fairness to all parties, it is essential that the Board make the threshold determination of whether and to what extent it will revoke an exemption that covers the issue traffic. Deferring a decision on this question would mean that the parties could expend significant time and resources developing a case, only to find that the case will not go forward because the Board has decided against the requested exemption revocation. And it would be wholly inconsistent with the exemption statute to require a railroad to go through the rate regulatory process in the face of a legally-binding exemption order.

## **III. MOVEMENT-SPECIFIC ADJUSTMENTS TO URCS SYSTEM-AVERAGE COSTS**

The Board proposes to use unadjusted URCS system average costs for three purposes: (1) in SSAC cases, estimating operating and equipment costs; (2) in SSAC and Three Benchmark cases, as part of its market dominance analysis, to determine whether the challenged rate produces a revenue-to-variable cost ratio greater than 180 percent for the issue traffic; and (3) in SSAC and Three Benchmark cases, prescribing a rate should the challenged rate be found

unreasonable. While it appears that unadjusted URCS may be adequate for the first two purposes, it should not be used for the third function.

**A. Use of Unadjusted URCS for SSAC Operating and Equipment Costs**

The Board proposes to simplify the process of estimating the operating and equipment costs associated with the SARR's traffic group by eliminating the need for parties to develop detailed operating plans and movement-specific operating statistics. Instead, the defendant carrier's system-average operating expenses for the Test Year, as determined by URCS, would be applied to the SARR's traffic to estimate SARR operating expenses. Decision at 13, App. B. Based upon CSXT/NS' preliminary analyses, it appears that use of unadjusted URCS for this purpose, if done properly, should generate a reasonable approximation of SAC operating and equipment costs. As previously emphasized, the Board should monitor this and other simplifications and procedures adopted in this rulemaking to ensure that SSAC (and small case) results do not deviate materially from SAC results.

**B. Use of Unadjusted URCS for Initial Determination of Market Dominance**

Although CSXT/NS believe that unadjusted URCS cannot be used for all purposes (*see C, infra*), its use in the initial market dominance determination by the Board appears to be a reasonable compromise between the need for accuracy and the goal of simplification. While unadjusted URCS may on occasion contribute to an incorrect finding of market dominance, it appears that such potential for error would be tolerable if the Board modifies its proposal to require mediation early in the process and allows adjustments to URCS before prescribing a rate.

**C. Unadjusted URCS Should Not be Used for Any Final Rate Prescription**

CSXT/NS believe that adjustments to system average URCS costs must be allowed (1) in

SSAC cases when determining the 180 percent R/VC floor below which the Board may not prescribe a rate and (2) in Three Benchmark cases at the end when determining the prescribed rate (*e.g.*, if the Board has determined the revenue-to-variable cost ratio of the challenged move should be 2.5, adjustments (up or down) must be allowed so that the railroad receives 2.5 times the variable costs it actually incurs).

CSXT/NS reiterate their support for the Board's stated objective of reducing the time and expense required to litigate rail rate cases. However, the Board should not sacrifice accuracy on the altar of expediency. For the reasons previously set forth in their comments in Ex Parte No. 657 (Sub.-No. 1), *Major Issues in Rail Rate Cases*, CSXT/NS believe that banning all movement-specific adjustments to URCS in SAC cases would adversely affect the accuracy, integrity, and reliability of SAC analyses and results. *See Ex Parte No. 657*, CSXT/NS Opening Comments at 11-18; Reply Comments at 17-22.<sup>13</sup> The same reasoning applies to SSAC and Three Benchmark cases.

The Board has recognized that certain types of traffic require special handling or other services that add substantially to the variable cost of transporting those shipments. *See, e.g.*, STB Docket No. 42072, *CP&L v. Norfolk Southern*, Decision (served December 23, 2003) at 129-130 (costs of constructing, operating, and maintaining conveyor belt system to move coal from Harris mine mouth to Kopperston loadout were properly included in variable costs of movement).

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<sup>13</sup> The Board, and the ICC before it, have long recognized that movement-specific adjustments result in more accurate variable cost data that better reflect the actual costs of handling specific movements than URCS system-average costs. *See, e.g.*, *Carolina Power & Light v. Norfolk Southern Railway Co.*, STB Doc. No. 42072 (served Dec. 23, 2003); *Pozzolan v. Union Pacific R.R.*, I.C.C. No. 39912, 1989 WL 246868 at \*4; Ex Parte No. 347 (Sub-No. 2), *Rate Guidelines, Non-Coal Proceedings*, (served Dec. 31, 1996) at 28, n.104.

Examples of special moves for which system average URCS costs would fail to reflect true costs include circus trains, certain high-wide movements and movements of spent nuclear fuel. As the Board is aware, railroads will likely be required to comply with additional regulations and new requirements concerning the movement of hazardous materials. The costs of compliance with such new requirements are likely to be substantial. The URCS system average costs would not represent the true costs of any of these moves. Rather than eliminating all movement-specific adjustments to URCS, CSXT/NS urge the Board to adopt three proposals that are consistent with the Board's goal of streamlining the process without undue sacrifice of accurate results.

1. Use of Adjustments to URCS in a SSAC case

The first proposal CSXT/NS make is that the Board provide a procedure under which either party could introduce evidence relating to movement-specific adjustments applicable to the issue traffic prior to a final rate prescription in a SSAC case. Unadjusted URCS would continue to be used at the outset of a proceeding to determine whether the challenged rate exceeds the "jurisdictional threshold" and the SARR's operating and equipment costs would likewise be estimated based upon the defendant carrier's unadjusted URCS system-average costs for the Test Year. If the Board determined either that the challenged rates do not exceed the jurisdictional threshold or, based on the SSAC methodology, those rates do not exceed a maximum reasonable level, the case would conclude without any evidence relating to movement-specific variable costs.

However, if the Board determined that the challenged rate exceeds a reasonable maximum level, then either party would have the option to submit evidence of appropriate movement-specific adjustments to the variable costs of handling the issue traffic; in order to determine with necessary accuracy and precision the jurisdictional floor for any rate prescription.

Only evidence concerning the issue traffic would be permitted (*i.e.*, the parties could not seek to alter the SSAC analysis by proposing movement-specific variable cost adjustments to all of the SARR's traffic group). Each party would be entitled to submit data and analysis supporting its proposed movement-specific adjustments and in opposition to adjustments proposed by the other party. Based on the parties' submissions, the Board would calculate the variable costs and the 180% R/VC ratio(s) for the issue traffic, taking into account any movement-specific adjustments that were supported by the evidence. The Board would then apply the recalculated 180% R/VC floor to its SSAC results and adjust the rate(s) prescribed up or down to the extent necessary in light of the revised jurisdictional floor determination.

This procedure would ensure that any rate prescription imposed by the Board is based upon the specific variable costs of handling the issue traffic (rather than a less precise estimate based solely on URCS system-average costs). Such greater accuracy can be achieved without significantly increasing the cost or complexity of most SSAC cases. Indeed, the procedure would not be applied at all unless the analysis based upon URCS system-average costs resulted in an initial finding of rate unreasonableness. *See, e.g.*, STB Docket Nos. 42069, 42070, 42072, *Duke Energy Corp., et al v. Norfolk Southern Railway Co.*, Decision (served Oct. 20, 2004) (finding challenged rates did not exceed maximum reasonable level). Absent an initial finding that the challenged rate exceeded a maximum reasonable level, the parties would not incur the time and expense required to develop movement-specific adjustments to the defendant carrier's URCS costs. Where the SSAC analysis resulted in a finding of rate unreasonableness, the parties might elect not to pursue adjustments to URCS system-average costs if it was unlikely that such adjustments would materially affect the level of the prescribed rates. In such cases, the parties and the Board would avoid the time and expense of preparing and analyzing movement-specific

variable cost evidence. Even where the procedure is invoked, the parties would be allowed to present evidence relating to movement-specific adjustments only for the issue traffic (which would be only a small fraction of the SARR's overall traffic group). In short, CSXT/NS' proposal would enable the parties to realize most of the cost savings contemplated by the Board's proposal to use URCS costs in SSAC proceedings, while assuring compliance with the Board's statutory obligation not to prescribe rates that would result in a revenue-to-variable cost ratio of less than 180%. See 49 U.S.C. § 10707(d)(1)(A); *West Texas Utilities Co. v. Burlington Northern R.R.*, 1 STB 638, 677 (1996); see generally, Decision, *CP&L v. NS*, STB Docket No. 42072 (Dec. 22, 2003), at 111, n. 63 & 112-143.

2. Use of Adjustment to URCS in a Three Benchmark case

CSXT/NS propose that adjustments to URCS be allowed as part of any final rate prescription in a Three Benchmark case. Just as proposed for SSAC cases, CSXT/NS support the use of unadjusted URCS for most of the Three Benchmark process. It is important to recognize, however, that the Three Benchmark process is designed to produce not a rate, but rather a revenue-to-variable cost ratio that the Board would then apply to the variable costs of the issue movement(s) to determine the maximum reasonable rate for that movement(s). While CSXT/NS agree that unadjusted URCS is an appropriate tool to determine what revenue-to-variable cost ratio should apply, they do not agree that unadjusted URCS costs should then be used when applying the revenue-to-variable cost ratio to calculate the rate(s) prescribed by the Board.

Because parties are entitled to a rate based on the actual costs of serving a particular shipper, they should be allowed to submit evidence on actual costs in a manner similar to that outlined in the preceding section concerning SSAC. Thus any rate prescribed by the Board under the Three Benchmark test should be equal to the revenue-to-variable cost ratio multiplied

by the challenged move's variable costs, as adjusted by the Board to reflect the evidence offered by the parties.

As discussed in section IV, CSXT/NS also believe the procedures proposed for use in a Three Benchmark case should be modified. The proposed modifications would not change the determination the Board makes at the end of its analysis, *i.e.*, an allowable revenue-to-variable cost ratio for the challenged traffic. If the Board adopts the modifications proposed by CSXT/NS for SSAC cases, it should allow the same adjustments to URCS system average variable costs – at the same point and for the same reasons discussed above – in small cases.

3. The Board Should Establish Guidelines for Adjustments to URCS

CSXT/NS propose that the Board provide guidance in this proceeding regarding the types of movement-specific adjustments to URCS system-average costs that it will permit in SSAC cases. CSXT/NS believe that the Board should, at a minimum, permit movement-specific adjustments for fuel costs, equipment ownership, locomotive costs, crew wages, mine loading times, car hire costs, car mileage allowances, and payments to mines or other transportation providers (*e.g.*, payments to short lines, switching charges, payments for coal conveyer belts, etc). <sup>14</sup> *See Joint Opening Comments of CSXT/NS*, Ex Parte No. 657 at 11-18 (May 1, 2006). In Ex Parte No. 657, other railroads and shippers suggested various other categories of costs for which movement-specific adjustments ought to be allowed. Based upon that evidence, and the parties' submissions in this proceeding, the Board should develop and publish a list of those types of movement-specific adjustments that presumptively would be appropriate. And, the

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<sup>14</sup> The proponent of a movement-specific adjustment would, of course, be required to present credible evidence demonstrating that a particular cost is actually incurred in serving the issue traffic, as well as the amount by which that cost differs from the carrier's system-average.

Board should provide for the use of evidence of other movement-specific adjustments, provided they are consistent with simplified rate procedures.

In sum, CSXT/NS believe that the Board's proposal to disallow all movement-specific adjustments to URCS system average costs in SSAC cases could have serious unjust consequences, including the prescription of rates at levels below a properly calculated jurisdictional floor. The alternative proposals set forth above would achieve the Board's objective of reducing the time and expense associated with small and medium-sized rate cases without unnecessarily curtailing the ability of parties to present evidence relating to the actual costs of the movements at issue, costs which could and should materially affect the outcome in a particular case.

#### **IV. PROPOSED METHODOLOGY FOR SMALL RATE DISPUTES – THE THREE-BENCHMARK APPROACH**

CSXT/NS support the Board's efforts to devise alternate methodologies for small cases and propose an approach in which the Board considers a number of factors and uses its expertise and discretion to determine the maximum reasonable rate. The Board faces a difficult challenge in the proposed methodology for small rate cases – how to be consistent with SAC without using SAC or anything that resembles SAC. Attempting to address this problem, the Board has proposed to determine rate reasonableness in small cases using a formula, albeit one that has some discretion built into it in the selection of what constitutes comparable traffic. The Board's proposal has little in common with the one court-approved approach to rate regulation, Constrained Market Pricing.

CSXT/NS understand the Board's desire for simplicity, but they cannot endorse the use of formula to determine what constitutes a maximum reasonable rate. Because rate setting is not simple, determining a reasonable rate cannot be reduced to a simple, mechanical formula. In the

view of CSXT/NS, if costs preclude a procedure that is based on constrained market pricing, the next-best (inexpensive) alternative is one in which the Board considers evidence that is relatively easy to produce and then applies its expertise to that evidence to determine a maximum reasonable rate.

Specifically, the Board should consider any evidence that is relevant and does not turn the inquiry into an expensive, time-consuming battle of the consultants. Such evidence could include the current measures published by the Board – including, RSAM which has a link to revenue adequacy; and RVC<sub>>180</sub> which allows the Board to compare how the mark-up of the challenged rate compares to the average mark-up on the carrier's traffic above 180% of variable cost. CSXT/NS request that the Board continue to publish these figures so that they can be used in small rate case proceedings. It could also consider the revised RSAM and R/VC total measures proposed by the Board in this proceeding (although CSXT/NS believe the original measures are more useful).

Flexibility is the key for handling small rate cases. The Board should avoid imposing limitations on the sort of evidence that can be introduced and reducing small case rate reasonableness analysis to an inflexible or mechanical formula. As the Board recognized when it adopted its current guidelines for small rate cases, application of the benchmark measures should not conclude the analysis, but rather should mark its starting point. *Rate Guidelines—Non-Coal Proceedings*, STB Ex Parte No. 347 (Sub-No. 2), Decision at 14 (Dec. 27, 1996). (“[N]one of the R/VC [benchmark] measures provides a sufficient all-purpose test of rate reasonableness . . . [E]ven in combination, these measures can only provide a starting point for what must become a more particularized analysis.”) (emphasis added). Once that starting point has been established,

the Board should consider all relevant evidence presented by the parties and apply its expertise and judgment to that evidence in order to determine a maximum reasonable rate.

The Board's retention of flexibility would also allow it to consider information that either party may present concerning why the cost of the challenged move is significantly above or below the carrier's system average or why the challenged rate is (or is not) consistent with market conditions. For example, a newly-issued rate for highly hazardous materials shipments may not bear any relation to other existing rates for such transportation, if, for instance, new government security requirements or regulations substantially increase the costs of rail transportation of such materials.

The Board may further reduce the time and money the parties need to spend if it provides some guidance on issues that are likely to arise. One such issue concerns the definition of "comparable" traffic. Particularly in light of the Board's proposal to select one side's proposed comparable traffic group *in toto*, both railroads and shippers would benefit from more guidance on the factors and characteristics the Board will consider in determining what constitutes comparable traffic and the relative importance it proposes to assign to those various parameters.

Another important issue is how to address the fact that the Waybill Sample will necessarily reflect historical data. Because it takes considerable time to prepare the Carload Waybill Sample, the challenged rate will be compared with rates from one-to-three years earlier. In the present economic environment of rising demand, constrained capacity, and accompanying increases in rates, a reasonableness analysis that relies on Waybill Samples data will likely understate current market rates. The Board should consider some type of indexing of waybill sample revenues to increase the usefulness of the Waybill information.

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It is critical that in whatever medium and small rate case methodologies are adopted, the Board be vigilant to ensure that resulting rate reasonableness determinations are consistent with Ramsey pricing and other sound economic principles and regulatory policies. It is also important that the Board make the small rate case procedure available only to those that truly require it. A “rough and imprecise” approach should not be used for any case where a better approach is feasible. *See* Decision at 28. (“[I]mportantly, only a small percentage of a carrier’s traffic would likely be eligible to use the Three Benchmark approach under our proposed eligibility criteria . . .”) CSXT/NS believe that the Board’s proposed eligibility ceiling of \$200,000 is an appropriate limit to ensure that the small rate case procedures are “use[d] only as a last resort.” Decision at 11.

## CONCLUSION

CSXT/NS urge the Board to consider the foregoing comments and look forward to participating in the remaining portions of this proceeding.

**Respectfully Submitted,**

**Dated: October 24, 2006**



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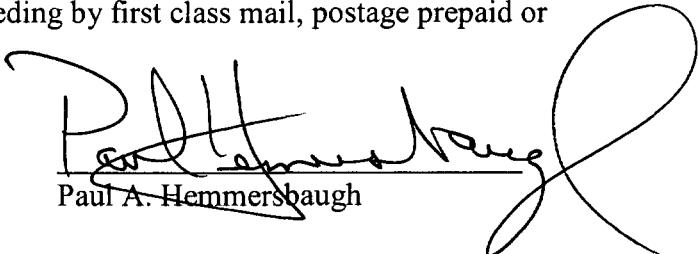
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## **CERTIFICATE OF SERVICE**

I hereby certify that on this 24th day of October 2006 I caused a copy of the foregoing  
**Opening Comments of Norfolk Southern Railway Company and CSX Transportation, Inc.**  
to be served on all parties of record in this proceeding by first class mail, postage prepaid or  
more expeditious method of delivery.



Paul A. Hemmersbaugh