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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

**COMMENTS
OF
U.S. CLAY PRODUCERS TRAFFIC ASSOCIATION, INC.**

The U.S. Clay Producers Traffic Association, Inc. ("Clay Producers") is a non-profit association of companies involved in the mining and processing of a mineral resource generically called "clay", but more specifically is known as "kaolin clay". Members of the Association ship clay in all modes of transportation, but primarily by rail, from Georgia, South Carolina and Tennessee origins to numerous industries throughout the United States, Canada, Mexico, and the world. The Clay Producers organization has been a historic participant in major proceedings involving transportation related issues subject to regulatory oversight.

The majority of kaolin shipments move via rail from a relatively concise geographic origin and typically the origin is served by a single railroad. Clay Producers take the position that many of their members' movements can be classified as being subject to railroad "market dominance". Given the amount of kaolin which moves at rates above the 180% R/VC threshold,

Clay Producers are concerned that while its members know that maximum rate relief is a theoretically available remedy, the simplified standards (both old and newly proposed) fall short of providing a practice remedy.

1. Kaolin Clay is a Regulation Commodity - Specifically Excluded from the General Commodity Exemption.

Clay Producers participated in Ex Parte No. 346 (Sub-No.24), Rail General Exemption Authority – Miscellaneous Manufactured Commodities, 6 I.C.C. 2d 186, served December 14, 1989, and presented evidence demonstrating the continued need for regulatory oversight for kaolin clay. The Interstate Commerce Commission made specific reference to clay transportation in Appendix A to the report (page 202) and reached the conclusion, based on Clay Producers' evidence, that over 91 percent of clay tonnage moved by rail in 1987. Based on this fact, the Commission concluded that regulation over the transportation of clay classified by specific STCC codes listed in Appendix B of the report should be continued. This exclusion from the Ex Parte No. 346 general commodity exemption is reflected in regulations at 49 C.F.R. ¶ 1039.11 (excluding most commodities in STCC 32-95 from the exemption).

Clay Producers have retained Gerald W. Fauth, III to review the regulatory and rate characteristics of kaolin and hereby attach hereto his Verified Statement ("Fauth Clay Stmt.").

Kaolin traffic generally moves under the following STCC codes:

- STCC 32-952-30, Kaolin, Clay Slurry
- STCC 32-952-31, Kaolin, Not Processed
- STCC 32-952-32, Clay, NEC
- STCC 32-952-34 Clay, Processed.

Fauth Clay Stmt. at p. 7. Clay appears to be the Board's 6th largest regulated commodity group. Fauth Clay Stmt. at p. 6.

Like shippers of many regulated commodities, no kaolin shipper has pursued a formal rate reasonableness complaint before the STB. However, the absence of any formal complaints should not be interpreted as evidence that regulatory oversight of rates is no longer needed. Clay Producers can report that members uniformly report their belief that the numerous uncertainties over standards, procedures, and costs makes the pursuit rate relief unadvisable. The proposed standards fail to address the root problems. A simplified system must be simple, otherwise, no small shipper will be brave enough to be the first the test case.

2. Adding to Litigation Barriers - - Non-Signatory Contracts.

The proposed standards add a new level of complexity to the mix of existing barriers. First, the Board needs to recognize the barriers imposed by the currently prevalent railroad practice of offering non-signatory contracts which for all intents and purposes are non-negotiable, and indistinguishable common carrier published rates. Since some of the kaolin traffic moves under non-signatory contracts which are virtually identical to what would have historically been offered in tariffs, the contract shipper would have to consider whether it has clear standing to pursue a formal complaint. Perhaps, the shipper would have to go to the added burden of requesting a common carrier rate and moving traffic over it before being able to challenge the common carrier rate, with the consideration that in all likelihood, any rate relief would be limited to a prospective basis (not covering any non-signatory contract moves).

The Board should clarify the standing issue for such situations with guidance suggesting that where a railroad offers transportation on a spot basis, with no substantive shipper obligations or concessions exceeding those of a shipper purchasing common rail carriage, the Board will

view the purported rail contract as the functional equivalent of common carriage and consider it to be subject to the Board's rate jurisdiction.

3. Additional Barriers - - Practices versus Rates.

Jurisdictional distinctions run rampant in rail regulation and create uncertainty and complexity which must be cleared-up before shippers feel assured of a prompt hearing focusing on the merits of the dispute at issue rather than procedural classifications and vague jurisdictional theories. In Ex Parte No. 661, Fuel Surcharges, the Board indirectly acknowledged shipper concerns that railroads were extracting excess revenues in the form of non-reflective fuel cost increase surcharges. In comments filed by Clay Producers, it was observed that with respect to one studied move, the fuel surcharge imposed was ten times the estimated increased cost of fuel. Yet in response to the Board's finding that percent-of-revenue based fuel surcharges amounted to an unreasonable practice, one railroad, the Norfolk Southern, reacted by rolling the increased cost of fuel (up to \$60 per barrel) directly into its rates, intending to side-step the Board's jurisdiction. This move illustrates the prevalent railroad industry belief that their rates are safe from regulatory oversight.¹

If excess fuel surcharges are rolled into rates, a shipper seeking to reverse the action could face the above noted non-signatory contract barrier, only to then face litigation over the argument that the Board can only judge the reasonableness of the rate for the entire move, not a distinct component. The bottom line is that a shipper who finds that a railroad has over billed it 10 times for a fuel surcharge may find that although the regulatory agency says the misrepresentation was

¹ Outside the rail industry, if a vendor engaged in misrepresentation on such a systemic level, they would have to worry about either a FTC action or a class action civil suit. However, here, the rail industry can rely on its regulated status as a shield.

wrong, it has no economic recourse to redress that wrong. So long as this perception continues, shippers will be discouraged from realistically expecting relief via STB complaint proceedings.

4. Conclusion.

Clay Producers urge the Board to correct the table set forth in its July 28th decision to reflect the regulated status of rail transportation of kaolin clay, as described in further detail in the attached Verified Statement of Gerald W. Fauth, III ("Fauth Clay Stmt.").

Clay Producers also urge the Board to consider addressing the jurisdictional and classification complexities which many shippers face in evaluating the side issues entailed in a formal rate challenge.

Respectfully submitted,

/s/ Vincent P. Szeligo
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Dated: October 24, 2006

*Attorneys for The U.S. Clay Producers
Traffic Association, Inc.*

BEFORE
THE
SURFACE TRANSPORTATION BOARD
EX PARTE NO. 646 (SUB-NO. 1),
SIMPLIFIED STANDARDS FOR RAIL RATE CASES

OPENING
VERIFIED STATEMENT
OF
GERALD W. FAUTH III

I. INTRODUCTION

My name is Gerald W. Fauth III. I am President of G. W. Fauth & Associates, Inc. (**GWF**), an economic consulting firm with offices at 116 South Royal Street, Alexandria, Virginia 22314. A detailed statement describing my background and experience in attached hereto as **Appendix GWF-1**.

I have been asked by the U. S. Clay Producers Traffic Association, Inc. (**Clay Producers**) to prepare these comments in response to a recent decision by the Surface Transportation Board (**STB or Board**) in Ex Parte No. 646 (Sub-No.1), Simplified Standards for Rail Rate Cases, served July 28, 2006 (**Proposed Simplified Standards**).

In this decision, the Board has proposed and set forth a new, complicated and untested economic procedure which it created and named the “simplified stand-alone cost (**Simplified-SAC**) procedure.” The Board indicates that this new procedure could be applied in so-called “medium size” railroad rate reasonableness cases. The STB has also proposed certain “modifications and refinements” to the existing **Three-Benchmark** approach and has proposed to significantly restrict its use to very small rate disputes.¹ The Board has also proposed new “eligibility presumptions” based on a proposed “maximum value of the case” (**MVC**) approach which would be used to decide which of the STB’s three methodologies, i.e., Stand-Alone Cost (**Full-SAC**), Simplified-SAC or the Three-Benchmark approach, would be used in railroad rate reasonableness proceedings.²

I have been actively involved in the study of railroad rate reasonableness issues for over 25 years. I was actively involved in the ICC and STB proceedings which first established the STB’s current railroad rate reasonableness guidelines and prepared expert economic testimony in the first cases to test the STB’s rate reasonableness guidelines and standards. As a result, I have developed a comprehensive understanding and knowledge of the history, economic development, application, procedures, problems and other issues associated with the STB’s current railroad rate reasonableness guidelines and standards.

¹ See Proposed Simplified Standards, pages 3 and 11

² Specifically, for cases having a MVC greater than \$3.5 million over five (5) years, the current Full-SAC method would be used; for medium size cases with a MVC between \$200,000 and \$3.5 million, the complainant could use either current Full-SAC or proposed Simplified-SAC standards; and for small cases with a MVC less than \$200,000, the Three-Benchmark method could be used. (see Proposed Simplified Standards, pages 33 through 37)

It should be noted that I have also submitted a Opening Verified Statement in this proceeding on behalf of a group of trade associations and other interested parties, referred to herein as the **Interested Parties**.³ In that statement, I fully addressed the problems associated with the Board's proposed new Simplified-SAC procedure, proposed changes to the Three-Benchmark approach, and the eligibility presumptions. I will not repeat those statements here.

The primary purpose of this statement is to address a major omission and error made by the Board in regard to its eligibility estimates set forth in Table 2 of the Board's decision.⁴ Specifically, the Board estimated that all regulated revenue totaled \$7.9 Billion. Based on my review of the 2004 Waybill Sample, I have determined that the Board apparently excluded five major commodity groups and approximately \$3 billion in non-exempt, regulated revenue from their study. These differences can be seen from the following table:

³ These parties are identified in the Joint Written Comments submitted by Counsel Nicholas J. DiMichael and Andrew P. Goldstein in this proceeding on October 24, 2006.

⁴ Proposed Simplified Standards, page 37

Table 1

**Comparison of Unmasked and Masked
2004 Waybill Sample Regulated Revenue**

Description	STCC	STB Table 2		
		2004 Unmasked Regulated Revenue ⁵	2004 Masked Regulated Revenue ⁵	Masked / Unmasked Ratio
Farm Products	01	\$942,701,000	\$1,519,482,235	1.61184
Metallic Ore	10	\$199,375,000	\$295,111,208	1.48018
Coal	11	\$3,168,171,000	\$5,052,980,711	1.59492
Crude Petroleum	13	\$2,403,000	\$475,916	0.19805
Non-Metallic Minerals	14	\$111,508,000	\$226,971,228	2.03547
Ordinance or Accessories	19	\$7,267,000	\$8,036,836	1.10594
Food and Kindred Products	20	\$280,429,000	\$837,788,342	2.98752
Pulp, Paper or Allied Products	26	\$0	\$20,056,960	-----
Chemicals or Allied Products	28	\$2,534,099,000	\$2,686,134,394	1.06000
Petroleum or Coal Products	29	\$516,563,000	\$418,568,345	0.81029
Clay, Glass and Stone Products	32	\$0	\$616,954,951	-----
Machinery, Excl. Electrical	35	\$0	\$7,423,292	-----
Elect. Mach., Equip., or Supplies	36	\$0	\$14,608,788	-----
Transportation Equipment	37	\$23,158,000	\$32,392,561	1.39876
Waste or Scrap	40	\$40,906,000	\$100,691,984	2.46155
Misc. Freight Shipments	41	\$103,195,000	\$120,024,525	1.16308
Misc. Mix (Freight All Kinds)	46	\$7,667,000	\$4,269,636	0.55688
Small Packages, LTC or LTL	47	\$2,375,000	\$2,375,120	1.00005
Hazardous Wastes	48	\$20,895,000	\$38,116,168	1.82418
Hazardous Materials	49	\$0	\$2,211,330,927	-----
Total		\$7,960,712,000	\$14,213,794,127	1.78549
Total Less Traffic Excluded by STB		\$7,960,712,000	\$11,343,419,209	1.42493
Total Class I Operating Revenues		\$40,517,155,000	\$40,517,155,000	
Percent Regulated		19.65%	35.08%	

⁵ Unmasked revenue figures are from Proposed Simplified Standards, page 37, Table 2.
Masked revenue figures were developed from the 2004 Waybill Sample provided by the STB.

As can be seen, there are some significant differences between the Board's Table 2 regulated revenues and the regulated revenues that I have developed. The Board estimated that were **\$7,960,712,000** in total regulated railroad revenue in 2004, whereas I have determined that that the 2004 regulated revenues totaled **\$14,213,794,127**, a difference exceeding **\$6.25 billion**.

A significant portion of this \$6.25 billion difference (perhaps as much as or more than half) results from the Board's use and application of the so-called *masking factors*, which are used to adjust confidential contract revenue information. The revenue data that is included in the 2004 Waybill Sample data that I was provided by the Board is adjusted by these masking factors. For example, for STCC 19, Ordnance or Accessories, the Board (using unmasked revenue data) found that there were \$7,267,000 in regulated revenues, whereas my study (based on the masked revenues) indicates that that there were \$8,036,836 in STCC 19 regulated revenues. I believe that most of this difference between the STCC 19 regulated revenues and other differences result from the Board's use of the unmasked revenue data.⁶

However, my analysis of the masked 2004 Waybill Sample data also indicates that the Board failed to include several STCC groups of regulated traffic and many thousands of computerized records from their study of regulated railroad revenue (i.e., STCC 26, 32, 35, 36 and 49, and other non-exempt traffic within the STCC groups

⁶ It should be noted that Interested Parties requested the work papers used by the Board to develop the Table 2 unmasked regulated revenue figures. However, the STB denied this request. Therefore, the precise difference resulting from the masking factors cannot be determined.

that were studied). These excluded regulated revenues account for approximately \$2.87 billion of masked revenues.⁷

The largest group of traffic excluded by the Board was STCC 49, Hazardous Materials, which may account for approximately \$2.2 billion of the difference. Obviously, Hazardous Materials are not exempt from STB regulation. In fact, with additional regulation from the Federal Railroad Administration (**FRA**), the Department of Homeland Security (**DHS**), and other agencies, Hazardous Materials shipments may be the most heavily regulated segment of railroad traffic. Since this represents an obvious omission by the Board, I believe the omission error resulted from the inadvertent use of the wrong data field in the preparation of the study.⁸

In addition to this obvious omission of STCC 49 regulated revenue, I believe that the Board improperly omitted other regulated traffic from their study. The next largest group of excluded regulated revenues moves under STCC 32, Clay, Glass and Stone Products. My study indicates that the Board excluded **\$616,954,951** in regulated STCC 32 revenue, which would represent the **6th largest group** of STB regulated traffic.

I believe that this omission resulted from a lack of careful reading of the Board's own regulations. The Board's exemptions from regulation of miscellaneous commodities are set forth in 49 CFR § 1039.11. Under this section, STCC 32 is listed as

⁷ The total unmasked revenues associated with the excluded traffic may be lower than \$2.87 billion.

⁸ Specifically, Waybill Field "Commodity Code (STCC)" or "CMD" includes STCC 49 codes, whereas Waybill Field "STCC w/o Hazardous (49) Code" or "STCC" excludes the STCC 49 codes.

exempt from regulation. Therefore, the Board apparently excluded all STCC 32 revenues from its Table 2. However, the regulations also clearly indicate that most of the traffic under the 4-digit STCC 32-95 (non metallic earths or minerals, ground or treated in and other manner) is *excepted* or excluded from this exemption.⁹ It appears that the Board made similar omissions of other excepted commodities that fall under other partially-exempted STCC groups.¹⁰

The member companies of the Clay Producers are actively involved in the mining, processing and shipping of Kaolin Clay products. This Kaolin Clay traffic generally moves under the following STCC codes:

- STCC 32-952-30, Kaolin, Clay Slurry
- STCC 32-952-31, Kaolin, Not Processed
- STCC 32-952-32, Clay, NEC
- STCC 32-952-34 Clay, Processed

The majority of this Kaolin Clay traffic moves by rail from middle Georgia to destinations through North America in bulk, either in a slurry form in private tank cars or a dry form in covered hoppers.¹¹ A earlier study that I performed for the Clay Producers indicated that over 90 percent of Kaolin Clay traffic moves by rail.¹² In

⁹ STCC 32-952-15, Cinders, etc., is specifically excluded from this exception.

¹⁰ For example, it appears that the Board also excluded other "excepted" traffic that moves under STCC's 26, 35 and 36, such as STCC 36-21, Motors or generators.

¹¹ A limited amount of Kaolin Clay traffic also moves in "bagged" shipments in containers and box cars.

¹² The results of my study were adopted by the ICC in Ex Parte No. 346 (Sub-No.24), Rail General Exemption Authority – Miscellaneous Manufactured Commodities, served December 14, 1989 (6 I.C.C. 2d at 202).

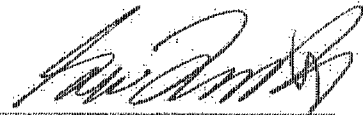
addition to Kaolin Clay, there are other excepted STCC 32-952 clay shipments that move by rail from other areas, such as, Alabama, Arkansas, South Carolina, Tennessee, Wyoming and other States. My study indicates that railroad revenues of non-exempt clay traffic exceed \$1 billion. The majority of this railroad clay traffic (i.e., \$616,954,951), is "regulated" traffic in that it moves at rates which generate a revenue-to-variable cost (R/VC) ratio of 180 percent, which is the STB's jurisdictional threshold.

My review and analysis of the Board's Table 2, the current regulations and the 2004 Waybill Sample data clearly indicates that the Board improperly omitted Clay, Hazardous Materials and other excepted or non-exempt traffic from their Table 2 calculations and results. The Board should make the appropriate corrections to Table 2 and confirm and certify that Kaolin Clay and the other non-exempt commodities remain regulated by the Board.

Commonwealth of Virginia)
) :
City of Alexandria)

ss

Gerald W. Fauth III, being duly sworn, deposes and says that he has read the foregoing document and attachments thereto and knows the contents thereof, and that all matters and things set forth therein are true.



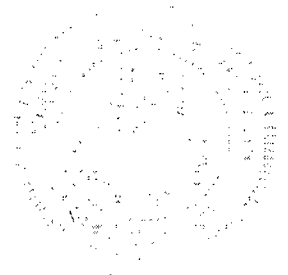
Gerald W. Fauth III

Subscribed and sworn to before me this twenty-third (23) day of October, 2006.



Notary Public

My Commission expires July 31, 2009



**STATEMENT OF QUALIFICATIONS
OF
GERALD W. FAUTH III**

My name is Gerald W. Fauth III. I am President of G. W. Fauth & Associates, Inc. (GWF), an economic consulting firm with offices at 116 S. Royal Street, Alexandria, Virginia 22314. I have over 25 years experience in the private sector and in the Federal government as a recognized expert on transportation issues. The majority of experience has involved economic, regulatory, public policy and legislative issues primarily associated with, or related to, the U. S. railroad industry.

This statement describes my background and experience in general and in more detail in regard to the Surface Transportation Board's (STB) railroad rate reasonableness guidelines and standards, such as the issues involved in the instant STB proceeding, i.e., Ex Parte No. 646 (Sub-No.1), Simplified Standards For Rail Rate Cases.

I am highly experienced in the complex economic and analytical issues associated with the STB's current railroad rate reasonableness guidelines and standards. I have prepared and submitted testimony and evidence in railroad rate reasonableness cases, evaluated testimony and evidence submitted in railroad rate reasonableness cases, and participated in the decision-making process in railroad rate reasonableness cases at the STB. As a result, I have developed a comprehensive understanding and knowledge of the history, economic development, application, procedures, problems and other issues associated with the STB's current railroad rate reasonableness guidelines and standards.

Most of my experience has involved regulatory proceedings, litigations, arbitrations and related projects before, or related to, the STB and its predecessor, the Interstate Commerce Commission (ICC), which was eliminated effective January 1, 1996. The STB is a decisionally independent, bipartisan, adjudicatory body organizationally housed within the U.S. Department of Transportation (DOT), with jurisdiction over certain surface transportation economic regulatory matters. The Three-Member STB Board adjudicates disputes and regulates interstate surface transportation through various laws pertaining to the different modes of surface transportation.

I have submitted expert testimony before ICC, STB, state regulatory commissions, courts and arbitration panels on a wide-variety of issues in numerous proceedings. In addition, I was employed for 3½ years at the STB on the staff of former Board Member Wayne Burkes where I reviewed, analyzed and made recommendations on over 600 written formal decisions that were decided by the entire Board. These proceedings involved all matters of STB jurisdiction and had an impact on the transportation industry and the national economy.

I was actively involved in the initial regulatory proceedings over 20 years ago in which the ICC first proposed and established guidelines which have since evolved into the STB's current railroad rate reasonableness guidelines. I was also actively involved in several of the first cases to test the ICC's proposed guidelines. My work and testimony in those initial proceedings helped shape the STB's current guidelines.

The Board's current simplified rate reasonableness guidelines were initially established by the ICC in Ex Parte No. 347 (Sub-No.2), Rate Guidelines – Non-Coal Proceedings. An ICC complaint proceeding involving railroad switching charges

for empty, one-way movements of railroad cars (i.e. ICC Docket No. 40073, South-West Railroad. Car Parts Co. v. Missouri. Pacific Railroad) was the *first* case to test the ICC's proposed simplified guidelines, which are now known as the STB's Three-Benchmark approach. I was the primary expert witness in ICC Docket No. 40073.

Many of our projects have involved the development of railroad cost analyses based on the application of Uniform Railroad Costing System (URCS) and its predecessor, Rail Form A (RFA). URCS is an integral component of the STB's Full-SAC method, its new proposed Simplified-SAC standard, and the existing and proposed Three-Benchmark approaches. I have an extensive working knowledge of the development and application of URCS and RFA. I have prepared URCS cost analyses for hundreds of individual railroad movements. I also submitted expert testimony in ICC Ex Parte No. 431 (Sub-No.1), Adoption of the Uniform Railroad Costing System as a General Purpose Costing System for Regulatory Costing Purposes.

Another integral component of each of the STB's current and proposed rate reasonableness standards is the STB's Waybill Sample. This database is an expanded sample of carload waybills for terminating shipments which includes over 600,000 records. I am extremely familiar with this database. Over the years, I have performed hundreds of analyses using the STB's Waybill Sample. These analyses have been used as evidence in major merger proceedings and other proceedings before the Board.

I am a 1978 graduate of Hampden-Sydney College in Hampden-Sydney, Virginia where I earned a Bachelor of Arts degree. My major areas of study were history and government. My senior paper in college dealt with the History of Railroad

Deregulation. I am a 1974 graduate of St. Stephen's School for Boys (now St. Stephen's and St. Agnes School), located in Alexandria, Virginia. My senior project and paper in high school dealt with the ICC and the Energy Crisis of 1973. I have also taken and completed post graduate courses in Statistics at George Washington University and Real Estate Principles at Northern Virginia Community College.

I am a member of the Transportation Research Forum and the Association of Transportation Law Professionals.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing COMMENTS OF US CLAY PRODUCERS TRAFFIC ASSOCIATION, INC. and VERIFIED STATEMENT are being served on all parties of record, as they appear on the web-published service list, by first class mail, postage pre-paid, in accordance with the Rules of Practice.

Dated: October 24, 2006

/s/ Vincent P. Szeligo
Vincent P. Szeligo