

BEFORE THE
SURFACE TRANSPORTATION BOARD

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

RAIL RATE CHALLENGES IN SMALL CASES

Joint Written Comments

submitted by

American Chemistry Council, American Forest and Paper Association, American Soybean Association, Colorado Wheat Administrative Committee, The Fertilizer Institute, Glass Producers Transportation Council, Idaho Barley Commission, Idaho Wheat Commission, Institute of Scrap Recycling Industries, Montana Wheat and Barley Committee, National Association of Wheat Growers, National Barley Growers Association, National Corn Growers Association, National Council of Farmers Cooperatives, National Farmers Union, National Grain and Feed Association, National Sorghum Producers, The National Industrial Transportation League, National Oilseed Processors Association, National Petrochemical & Refiners Association, Nebraska Wheat Board, North American Millers Association, North Dakota Grain Dealers Association, North Dakota Public Service Commission, North Dakota Wheat Commission, Oklahoma Wheat Commission, Paper and Forest Industry Transportation Committee, PPL EnergyPlus, LLC, South Dakota Wheat Commission, Texas Wheat Producers Board, USA Rice Federation, Washington Wheat Commission, Alliance for Rail Competition, Consumers United for Rail Equity

By their attorneys:

Nicholas J. DiMichael
Laurence W. Prange
Thompson Hine LLP
1920 N St. N.W.
Suite 800
Washington, D.C. 20036
(202) 263-4103

Andrew P. Goldstein
John M. Cutler, Jr.
McCarthy, Sweeney & Harkaway, P.C.
2175 K St. N.W.
Suite 600
Washington, D.C. 20006
(202) 775-5560

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I. INTRODUCTION AND SUMMARY OF POSITION

In accordance with the Board's decision served July 28, 2006 in this proceeding ("Decision"), the above-listed parties ("Interested Parties") submit these Joint Written Comments. In its Decision, the Board proposed major changes to the handling of cases challenging the reasonableness of rail rates that fall within the provisions of 49 U.S.C. 10701(d)(3), namely, those cases in which a "full stand-alone cost presentation is too costly, given the value of the case." For such cases, Congress has ordered the Board to establish "a

simplified and expedited method for determining the reasonableness of challenged rail rates. . . .”

Id. The Board’s proposal set forth in its Decision is in three major parts:

- a) A simplified stand-alone cost (Simplified-SAC) procedure to use in “medium size rate disputes” for which a full stand-alone cost (Full-SAC) presentation¹ would be too costly, given the value of the case;
- b) Retention of the “Three Benchmark” method presented in *Rate Guidelines – Non-Coal Proceedings*, 1 S.T.B. 1004 (1996) (*Simplified Guidelines*), for “small rate disputes” for which even a Simplified-SAC presentation would be too costly, given the value of the case; and,
- c) Establishment of “eligibility presumptions” based on the “maximum value of the case” (MVC) to distinguish between large, medium, and small rate disputes.

These Joint Written Comments discuss each of these parts of the Board’s proposal.

These Joint Written Comments are in four parts:

- a) Overall comments on the Board’s proposals, including a legal analysis and detailed comments regarding the costs, feasibility, and other aspects of the proposal, and a summary and discussion of the expert evidence submitted;
- b) A Verified Statement by Thomas D. Crowley, President, L.E. Peabody and Associates, Inc. (Appendix A)
- c) A Verified Statement by Gerald W. Fauth, III, G.W. Fauth & Associates, Inc. (Appendix B)
- d) A copy of the Joint Written Testimony submitted by many of these same Interested Parties on July 16, 2004, in a prior phase of this long-considered proceeding. (Appendix C)

For many years, shippers and shipper groups, including many of these Interested Parties have sought Board action to provide more guidance and better procedures to parties who may be interested in bringing challenges to unreasonably high rail rates in cases that cannot justify the huge time and expense of a Full-SAC presentation. The Board has, in various settings,

¹ The Full-SAC standard for “large” cases was set forth in the Interstate Commerce Commission’s decision in *Coal Rate Guidelines, Nationwide*, 1 I.C.C. 2d 520 (1985), (*Guidelines*), *aff’d sub nom. Consolidated Rail Corporation v. United States*, 812 F.2d 1444 (3d. Cir. 1987).

acknowledged the problems with the *Simplified Guidelines*, and has indicated that action would soon be forthcoming to cure them.²

These Interested parties are very pleased that the Board has initiated this proceeding, and commends the Board for deciding to take action to improve its small rate case procedures. However, particularly in light of their strong desire to see expedited, simple, clear and cost-effective rules for cases that cannot practicably utilize Full-SAC procedures, these Interested Parties have the painful duty to tell the Board that the primary proposals in its Decision are not a solution. Indeed, adoption of the primary features of the Board's proposal would make a currently poor situation much worse, and would effectively foreclose all possible small case rate challenges in the future.

Although the Board may be correct in proposing a rebuttable standard for determining eligibility for cases in which a Full-SAC presentation is not practicable, the Board's specific eligibility proposals as offered are completely unrealistic and inconsistent with the statute. Indeed, even under the unrealistic assumptions underlying the Board's eligibility standards, most shippers would fall under the large case, Full-SAC procedures, particularly in view of the Board's "aggregation" rule. Indeed, the "aggregation rule" effectively turns what is required to be a "small case" category of complaints (regardless of the size of the shipper) under 40 U.S.C. 10701(d)(3) into an unlawful "small shipper" complaint category.

The Board's proposed Simplified-SAC procedures for "medium" size cases are unclear, unfair, unworkable and unlawful. The Board's cost assumptions for bringing a Simplified-SAC case are far understated, by many multiples. The time proposed to decide a Simplified-SAC case

² See, *E.g.*, testimony of Roger Nober to the Subcommittee on Railroads of the House Committee on Transportation and Infrastructure, May 20, 2003, p. 9 ("shippers who feel they have been charged an unreasonable rate have a right to have that complaint heard by the Board in a fair, impartial, expeditious and economical manner.

– which in all likelihood is also significantly understated – would render the procedure useless as a business matter. Moreover, the substance of the proposed procedure is arbitrarily skewed to result in rates significantly higher than would result from a Full-SAC case, in violation both of the statute and the principles set forth under *Guidelines*. Despite the Board’s 20-pages of fine-print appendices needed to describe three aspects of a “simplified” stand-alone cost procedure, there are uncertainties in the Board’s proposed Simplified-SAC procedures that would require years of litigation to resolve – litigation that will never take place because those very uncertainties, and the cost and time that would be required to resolve them, would terminally chill shippers’ use of the Board’s alternatives to Full-SAC procedures.

Some parts of the Board’s revised Three-Benchmark procedures hold some promise. However, significant changes need to be made for a fair and workable system. As currently described, the proposed Three-Benchmark procedures are subject to both legal infirmities and substantive and procedural inequities.

Finally, the Board is correct is providing for specific procedures for the revocation of exemptions in the context of individual complaint proceedings.

In summary, these Interested Parties urge the following:

- 1) The Board should withdraw its Simplified-SAC proposal for “medium” cases in its entirety.
- 2) The Board should drastically revise upwards its eligibility thresholds for the Three-Benchmark Standard and the Full-SAC standard. In addition, instead of a “maximum value of the case,” which can be determined by the defendant carrier, these Interested Parties commend to the Board the simpler and more objective measurement of a shippers’ freight bill

That is part of our fundamental charge from the Congress. That is not the case now, and our agency can and will offer some solutions to that problem.” (“Nober Testimony”).

between a single origin-destination pair, as described in Appendix C to these Joint Written Comments.

3) The Board should eliminate the “aggregation” rule.

4) Although some of the proposed changes to the Three-Benchmark standard show improvement over some of the current benchmarks in *Simplified Guidelines*, other parts of the proposed Three-Benchmark standard need significant revision. The Board should utilize the revised Three-Benchmark factors to determine the basic level of rate reasonableness for small cases, but should permit parties to supplement the Three-Benchmark factors with other relevant evidence, including evidence of inefficiencies required to be considered by the Board under the statutory Long-Cannon provision. The Board cannot dismiss the Long-Cannon requirements under either the Simplified-SAC standard or the revised Three-Benchmark standard simply by incorrectly declaring that inefficiencies no longer exist in the rail industry.

5) The Board should eliminate the “confidence interval” requirement under the Three-Benchmark standard.

6) The Board should revise the procedural requirements proposed for the Three-Benchmark standard to provide shippers with access to data needed for a proceeding before a complaint is filed, and to adopt procedures that will permit the determination of a complaint within 180 days.

II. SHIPPERS NEED EFFECTIVE SMALL CASE STANDARDS AND PROCEDURES

As set forth in Appendix C, shippers need a balanced, simple, clear, quick and inexpensive process for deciding small cases in accord with the intent of Congress that a “simplified and expedited” methodology be made available as an alternative when the Full-SAC process is “too costly, given the value of the case.” What was true in the comments of certain

Interested Parties in July 2004 is still true. Indeed, as rail capacity has decreased, the need for simplified and expedited small case standards is greater than ever. As the Government Accountability Office found recently in Report GAO-07-94, the volume of freight moving at rates with R/VC percentages above 300% has more than doubled. Earlier GAO reports have confirmed that many shippers regard STB procedures as a barrier to reasonable rail rates.

While the need for a method to resolve smaller rate disputes is acute, fewer shippers have access to Full-SAC procedures than ever before. Just three and a half years ago, Chairman Nober testified to the Congress that a complainant's spending in a Full-SAC case was likely to be about \$2 to \$3 million. Nober Testimony, p. 7. But the Board's Decision indicates that the cost of bringing a SAC case is now more than \$3.5 million.³ Thus, even the Board's own estimate suggests that the cost of a Full-SAC presentation has increased by about twenty percent (on the low end of the increase) to seventy-five percent (on the high end) in just three years. Moreover, these Interested Parties believe that the Board's number of \$3.5 million is very conservative. As noted by Witness Crowley, Full-SAC cases now cost at least \$4.0 million, Crowley V.S., p. 23. Thus, if Chairman Nober was correct in 2003 and the "midrange" cost for a Full-SAC case was \$2.5 million in early 2003, the cost of bringing a Full-SAC case now has increased by at least sixty percent in just three and a half years. Given the time, cost, uncertainty and expense, only the smallest handful of shippers can use Full-SAC procedures.

More importantly, as discussed below, Full-SAC procedures are simply unusable for most potential non-coal complainants, who ship their goods radially from one or more plants to

³ Contrary to the Board's assertion, the Board's proceeding in Ex Parte 657 is not likely to reduce the cost of a Full-SAC much if at all, especially since new standards recently imposed by the Board will drive this cost even higher. See, e.g., *Otter Tail Power Company v. BNSF Railway Company*, decision served January 27, 2006 (cross-subsidy test); *PPL Montana LLC v. Burlington Northern & S.F. Ry.*, STB Docket No. 42054 (served August 20, 2002, *aff'd sub nom PPL Montana, LLC v. STB*, 437 F.3d 1240 (D.C. Cir. 2006), both of which substantially raised the bar to western coal shippers on medium- and light-density lines. See Crowley V.S., p. 22.

numerous, shifting locations across the country, unlike the transportation of coal moving from one or a few mines to a single electric generating station.

At the same time, shippers have not used the Board's current *Simplified Guidelines*. As discussed in detail in Appendix C, pages 7-11, eligibility standards under the current *Simplified Guidelines* are unclear, a situation which seriously impedes shippers' use of the Board's procedures. Moreover, as discussed at pages 12-13 of Appendix C, it has not been clear how the Board would apply its current small case standards, which further chills shippers' use of the process. To remedy these problems, in July 2004 certain Interested Parties suggested a "bright line" test for eligibility and further guidance on the Three-Benchmark test. See Appendix C. Those Interested Parties also indicated certain technical problems with the Revenue Shortfall Allocation Method (RSAM) benchmark.

But, instead of adopting the relatively narrow suggestions in the July 2004 Comments of the Interested Parties, the Board in its recent Decision has proposed a brand-new, untested, extremely complex, expensive, unclear, unworkable and unlawful standard for "medium size" cases, as well as eligibility standards for "small," "medium" and "large" cases that are completely unrealistic. Both of these developments are strongly opposed by these Interested Parties for the reasons set forth in the next two sections of these Comments.

III. THE BOARD'S ELIGIBILITY PROPOSALS ARE UNREALISTIC AND INCONSISTENT WITH THE STATUTE, AND NEED COMPLETE REVISION

Under the Board's Decision, eligibility criteria would be based on the concept of the Maximum Value of the Case (MVC), which would be the "maximum relief the shipper could attain over 5 years if the challenged rates were reduced to the jurisdictional floor (i.e., the level at which the R/VC ratio equals 180%)." Decision, p. 33. To compute the MVC, the Board would "multiply the difference between the challenged rate and the rate floor by the annual volume of

the traffic at issue,” using the rail industry’s most recent cost-of-capital figure as the discount factor to obtain the net present value. *Id.* If the complaint challenged multiple rates covering different origins and destinations, the Board would aggregate the MVC for each set of movements covered by the complaint. *Id.*

If the MVC exceeds \$3.5 million, the Board would presume that the complainant would present a Full-SAC analysis. If the MVC was between \$200,000 and \$3.5 million, the complainant could use either the Full-SAC or the Simplified-SAC method, but the Board would presume that the complainant could not use the Three-Benchmark method. *Id.* Finally, if the MVC was less than \$200,000, the complainant could use the Three-Benchmark method. Rate relief would be limited to five (5) years, and rate prescriptions would be capped at the shipper’s representation of the annual tonnage at issue. *Id.*

A. Even Using the Board’s Own Incorrect Assumptions, the Board’s Proposed Eligibility Standards Are Completely Unrealistic

Simple examples reveal that the Board’s eligibility standards are wholly unrealistic for virtually all shippers, even using the Board’s own far-understated assumptions. Most shippers will quickly find themselves presumptively in the Full-SAC category.

Take, for example, a hypothetical, but quite realistic movement of chemicals from a point at “Origin, Louisiana” to a destination at “Captive, Georgia.” Assume that the rate for this market-dominant movement is \$3,250 per car, with a variable cost of \$1,000.⁴ This assumed rate and cost produces a revenue to variable cost (R/VC) ratio of 325%, an R/VC ratio above the average R/VC level needed by any of the four major U.S. Class I carriers for revenue adequacy

⁴ This example is a realistic one, since the average revenue per car for major carriers for chemicals is approaching \$2500 per car, a figure that counts both market-dominant and competitive movements.

in 2004 for all that railroad's traffic,⁵ and an R/VC ratio even above the R/VC level needed by any of the four major U.S. Class I rail carriers for revenue adequacy in 2004 from just that railroad's captive (+180% traffic).⁶ A shipper might reason that such a rate might be a candidate for challenge.⁷ It would then have to calculate whether a challenge would be brought under the "small," "medium" or "large" procedures, given the level of traffic between the two points. The calculation would be as follows, omitting the effects of the discount factor for simplicity:

Rate (assumed)	\$3,250 per car
Variable Cost (assumed)	\$1,000 per car
R/VC ratio of challenged rate	325%
Rate Floor (180% of variable cost)	\$1,800 per car
Unadjusted MVC per year (rate minus rate floor)	\$1,450 per car
Limit on the number of cars presumed to qualify for "small" case treatment (\$200,000 divided by \$1,450)⁸	137 cars over five years, or shipment of just 2.3 cars per month
Limit on cars presumed to qualify for "medium" case treatment (\$3.5 million divided by \$1,450)⁸	2,413 cars over five years, or 40 cars per month, or a little over 1.3 car per day
Number of cars presumed to qualify for large case treatment⁸	Over 1.32 cars per day

⁵ See Decision, p. 25. The Board's proposed revised RSAM essentially calculates the average revenue to variable cost ratio that a carrier would need from all of its traffic to achieve revenue adequacy. In 2004, BNSF's RSAM was 139%; CSXT's was 137%; NS' was 135%; and UP's was 124%. An R/VC of 325%, then, is two and a half times the rate that the carrier would need, on average, from all of its traffic to achieve revenue adequacy.

⁶ The current RSAM calculates the revenue to cost ratio that a carrier would need from all of its captive traffic in order to achieve revenue adequacy. In 2004, BNSF's RSAM was 266%; CSXT's was 292%, NS' was 226%, and UP's was 306%. An R/VC of 325%, then, means that, even within the universe of captive traffic, shipments from Origin, LA to Captive, GA move at rates higher than average for captive traffic, though not at the very highest level of captive rates.

⁷ A recent Government Accountability Office Study would put this rate into the highest six percent of all rates charged by rail carriers. See. GAO Report GAO-07-94, at 33.

⁸ A precise answer would adjust the limit by the cost of capital discount factor.

Several points must be noted. First, a case involving shipments of only 2.3 cars a month is not a “small” case – it is a “microscopic” case. Virtually no shipper of any size in the country will qualify for a “small” case, especially in view of the Board’s “aggregation” rule, discussed further below. And, a movement of about 1.5 cars per day between an origin and a destination (even without considering the “aggregation” rule”) can hardly be considered, in any realistic commercial sense, a “large” movement. On their face, then, using a realistic example, the Board’s eligibility standards simply do not conform to commercial reality.⁹

Moreover, under the example above, shipping 135 cars over the full five-year period (a level below which the shipper would be presumed to qualify for a “medium” case), or a little over two cars a month, the unadjusted maximum value of the case would be \$195,750, or about \$158,000 taking the discount factor into account.¹⁰ But as noted below, the likely actual value of the case will be far lower than the maximum value of the case – so much so that it is very likely that the complaining shipper in a “small” case will not even cover its direct expense of litigation.¹¹ It is significant that the Board’s proposal never estimates the direct cost of litigating a “small” case. However, Witness Crowley estimates that the total litigation costs of a “small” case will be between \$100,000 and \$400,000, and Witness Fauth estimates that consultant costs alone would range from \$115,000 to \$225,000. Crowley V.S., p. 14; Fauth V.S., p. 46¹² Thus,

⁹ Other examples which produce similar results are readily available. See, e.g., Fauth V.S., p. 63-64.

¹⁰ Based on the agency’s most recent cost of capital, the discount factor would be 1.242.

¹¹ Since the expense of litigation is incurred at the beginning of the period, it must be measured against the MVC, which is discounted back to the present.

¹² As the Board well knows, the State of North Dakota appropriated nearly a million dollars to litigate a Three-Benchmark “test” case. Even assuming that the cost of a “test” case will be several times higher than the cost of subsequent Three-Benchmark litigation, and even assuming that the proposed revised Three-Benchmark approach would require lower litigation costs than the current Three Benchmark approach, the North Dakota experience certainly indicates that the cost of litigating a Three-Benchmark case, even under the proposed revised procedures, is significant. The Interested Parties believe that the cost of litigating even the revised Three-Benchmark case will

these Interested Parties believe the likely cost of litigating a “small” case will certainly exceed the actual value of a case even near the threshold between a “small” and “medium” case, and will likely exceed even the maximum value of a case at that threshold.

The same analysis holds true for a so-called “medium” case. In the example above, assume that the number of cars moving between the origin and destination is 275 cars over the five year period, or above the cutoff for qualifying as a “small” case. In such a case, the unadjusted MVC is \$398,750, or about \$321,000 taking the discount factor into account. But the Board’s proposed eligibility threshold fails to calculate for the actual value (as opposed to the maximum value) of the case, any litigation risk, or the large possibility (discussed further below) that the actual cost of litigating a Simplified SAC case will be many multiples higher than the \$200,000 estimated by the Board. The overwhelming likelihood is that even a “successful” complainant in a “medium” case – even a “medium” case well above the \$200,000 cutoff for a “small” case -- will not cover its direct cost of litigation and or even the MVC.

The same is true for the eligibility criterion for most “large” cases, other than the traditional coal cases involving the shipment of millions of tons of coal between a single origin and a single destination. In the example above, assume that the number of cars moving between the origin and destination is 730 cars per year (or 2.0 cars per day between an origin and a destination), which results in an unadjusted MVC of \$5.3 million, or \$4.2 million after considering the discount factor, well over the \$3.5 million MVC cutoff for a “medium” case. While this is not a “large” movement by any means in the commercial sense, it would be presumed to be such under the Board’s eligibility rules. In such a case, the Board estimates that the cost of litigating a Full-SAC case would be \$3.5 million – a figure which is in all likelihood

virtually always exceed the Board’s assumed cost of litigation, considering likely challenges to eligibility, market dominance, the necessity for expert evidence to select a comparison group, etc. See *Crowley V.S.*, pp. 7-12.

understated. Yet the maximum value of the case (even assuming that the Board's litigation cost estimate is correct) is not substantially over the Board's understated estimate of the cost of bringing a Full-SAC case. This figure would never compensate the shipper at the actual level of the rate that is likely to be prescribed under the Board's current Full-SAC standards, or for any litigation risk.

Witness Crowley estimates the cost of a Full-SAC case as at least \$4.0 million, a direct litigation cost at the low end virtually equal to the maximum value of the case in the example. Crowley V.S., p. 23. In fact, it is highly likely that not even a "successful" complaining shipper will cover its cost of litigation, unless the number of cars between an origin and a destination is far higher than the presumed large case "threshold" posited by the Board. And, as discussed in the following subsections and in Section IV below, most of the Board's assumptions regarding the cost and time for a case are drastically understated, particularly in view of the "aggregation" rule.

It is no answer to say that the Board's presumptions are "rebuttable," and therefore a shipper will be able to argue to the Board that it should qualify for smaller-case treatment. What the Board has effectively proposed is to force the shipper to make, in virtually all cases, an individualized determination of eligibility, at significant additional time and expense. As the July 2004 Interested Parties comments indicated, it is just this need for an individualized determination which has discouraged shippers from filing challenges under the Board's current procedures. Instead of developing eligibility procedures that reasonably cover the large majority of complainants and leave only the "difficult" cases for individualized determination, the Board's proposed procedures will require individualized determinations for all or almost all cases.

Indeed, the Board's proposal has made a bad situation even worse by positing a "presumed" level at which a shipper would qualify for "small," "medium" and "large" case treatment. Thus, a shipper seeking to qualify for any treatment less than a Full-SAC treatment would not only face an individualized eligibility determination, since in the very large majority of cases the direct litigation costs will probably equal or exceed the actual value of the case, but would have to face that dispute with an adverse "presumption" that the shipper would have to overcome. Instead of ameliorating the "chilling effect" of the uncertainty under the current rules, the Board's proposal -- though intended to provide some guidance as to eligibility -- has increased the "chill" even more.

B. The Board's Proposed Eligibility Standards Fail to Take Into Account the Substantial Difference Between the Likely Actual Value and the Maximum Value of a Case in Determining Eligibility

The Board's eligibility presumptions are linked to the Maximum Value of the Case, which in turn is linked to the "jurisdictional threshold" (180% of the variable cost of the movement), below which the Board has no jurisdiction over a rate. The jurisdictional threshold is therefore the maximum level theoretically achievable by any complainant. The Board's proposal appears to proceed on the basis that, as long as the MVC exceeds the cost of the case, then the shipper will go forward with the case and equity is served.

But the fact of the matter is that the MVC is irrelevant to a shipper's decision as to whether or not to challenge a rate. A complainant's question is "what are my chances for success at all, and if I win, what rate reduction am I likely to achieve?" In other words, a complainant wants to know the likely actual value of the case -- here termed the "AVC" -- before determining whether or not to bring a rate challenge.

The Board's proposal does not even attempt to estimate what the actual value of a case brought under either the Simplified-SAC or the Three-Benchmark standard is likely to be.

However, Witness Crowley explains in his attached Verified Statement why it will be virtually impossible under either the Simplified-SAC or the Three-Benchmark methodology for the AVC to even approach the MVC. Crowley V.S., pp. 30-35. Indeed, witness Crowley notes that, in the case of a Full-SAC analysis, even in three recent cases where the STB determined that the challenged rate was below the SAC level, the shippers' AVC averaged 65% below the MVC. Crowley V.S., pp. 35-36.

Moreover, the Simplified-SAC method proposed by the Board will always achieve a less favorable result for the shipper than a Full-SAC analysis, since the Board will not permit a shipper in a Simplified SAC case to obtain the benefit of efficiencies or densities that are permitted in the Full-SAC analysis. See Crowley V.S., pp. 31-33. It should be noted that the results of the proposed Simplified-SAC procedures could be tested by applying the procedures to the facts of a recent Full-SAC case. However, the Board has refused to release any workpapers by which it could be determined if the Board's staff has already tested its procedures, as it did in testing the AAR's "black box" SAC in 1993, and the results of any such tests.

Additionally, as detailed by Witness Crowley, the Three-Benchmark approach will also always result in an AVC far lower than the MVC. This is because the key factor in the equation – the comparison with similar movements with revenue to cost ratios over 180%, at a confidence interval of 90% around the adjusted mean of the comparison group -- will result in maximum rate levels much higher than the jurisdictional threshold. Crowley V.S., pp. 33-35, 37

For example, assume, based on the example given on page 10 of these Comments, that the movement from Origin, LA to Captive, GA is on the Norfolk Southern (the most favorable assumption for the shipper, since NS is the only Class I railroad with a ratio of the RSAM to the R/VCtotal less than one). Decision, p. 25. Assume that the shipment is small enough to

presumptively qualify for the Three-Benchmark approach, and that the average of the adjusted comparison group traffic's rates produces a 250% R/VC ratio. Application of the Board's Three-Benchmark formula (Decision, p. 25) would result in a revenue to variable cost ratio for the maximum reasonable rate at 245%.¹³ The difference between the MVC and the AVC would be as follows:

Rate (assumed)	\$3,250 per car
Variable Cost (assumed)	\$1,000 per car
Rate floor (180% of variable cost)	\$1,800 per car
Unadjusted MVC per year (Rate minus rate floor)	\$1,450 per car
Prescribed maximum rate (Variable Cost x 245%)	\$2,450 per car
AVC per year (Rate minus prescribed rate)	\$800 per car

Thus, under these very conservative assumptions, the AVC in this Three-Benchmark case is well below the unadjusted MVC.

The analysis presented by Witness Crowley, based on the recent Government Accountability Office report discussed above, grounds the assertions based on this example even more firmly. According to the GAO figures using the STB unmasked Waybill Sample, 25% of rail traffic moves at rates with an R/VC ratio between 180 and 300 percent, and 6 percent moves at rates in excess of 300%. With these figures in hand, a straightforward calculation reveals that the AVC for typical Three-Benchmark challenge would be nearly 70 percent below the MVC of that movement. Crowley V.S. p. 37.

¹³ 250% times .98. Decision, p. 25.

Even ignoring the fact that the Board has drastically underestimated the cost of a Three-Benchmark and Simplified-SAC case (discussed below), it is very likely that even a “successful” shipper’s recovery (i.e., the AVC) will be below its direct litigation cost. In the above example for a “small” case as proposed by the Board, assume a shipper transports 137 cars over five years, a level that would result in an unadjusted MVC of \$198,650, or \$159,944 after accounting for the discount factor, or under the presumed limit for using the Three-Benchmark procedures. But since the AVC will be in all likelihood at or even well below 50% of the MVC, the shipper’s actual recovery will be less than \$80,000 – a level that will not even cover direct litigation costs even under extremely favorable assumptions and circumstances for using the Three-Benchmark procedures.¹⁴

C. The Board Ignores A Number of Litigation Costs In Addition to the Cost of Developing the Economic Evidence

The Board’s proposals seem to assume that most of the cost of litigation is in the economic evidence to be submitted and the legal principles surrounding that economic evidence. But there are other costs ignored by the Board. The Board presumes, for example, that the defendant carrier will not challenge market dominance, and that the defendant carrier will not file any other procedural or substantive motions in the case. But as Witness Crowley notes, motions to dismiss and multiple rounds of evidence have become standard features of rate litigation before the Board. Crowley V.S., pp.12, 21-22, 23 fn. 41. The Board also ignores the complainant’s indirect costs – time and money spent by the complainant’s own personnel in preparing for the case and in responding to issues in the case.

¹⁴ If the small shipper transports even fewer cars by rail –say 100 cars over five years rather than 137 cars over five years -- the actual value of its case will be about \$60,000 or less, certainly less than the direct cost of litigation, even under extremely favorable assumptions as to litigation cost.

D. The Board's Use of the MVC Allows a Defendant Railroad to Determine the Eligibility of the Shipper

Because the MVC is forward-looking and based upon the challenged rate, the MVC invites manipulation by the railroad to force the shipper to litigate a case under more-expensive procedures. A railroad which believes that a captive shipper may be close to filing a rate challenge will have both the incentive and (in all likelihood) the ability to raise the rate to an even higher level and thereby push the MVC calculation above the level presumed to qualify for a lower-cost procedure. The shipper will then, at the very least, have to spend time and resources to convince the Board that it should qualify for a less expensive type of case. As shown by witness Crowley, because the variable cost for a particular movement remains the same regardless of the level of the rate, the MVC increases much faster than increases in the rate. Crowley V.S., pp. 28-29.

E. The Board Fails to Consider the Need for a Risk Factor in Determining Eligibility

The Board's eligibility standards clearly give no consideration to the need for recognition of litigation risk. Clearly, maximum reasonable rate challenges of all types are subject to very substantial litigation risk, and particularly cases that would be brought under the Three-Benchmark or Simplified SAC approaches, given the lack of precedent and uncertainty. Indeed, as witness Crowley has shown, in the past seven Full-SAC cases, there have been only two in which the shipper has achieved any rate reduction at all. The remaining five cases have been complete defeats for the shipper-complainant.

The blunt fact of the matter is that no rational shipper will bring a rate challenge if it would recover merely the cost of the litigation, or even a little more, and thus, an eligibility standard must take into account a litigation risk factor. The comments of the Interested Parties in July 2004 and in July 2003 recommended a litigation risk factor of three, that is, the eligibility

standard should be set taking into account that a shipper should have the possibility of a return three times the cost of litigation. See Appendix C, pp. 8-9. The Interested Parties here believe that level is the minimum necessary in developing a eligibility standard.

F. The Board's "Aggregation" Rule Unlawfully Transforms What Should Be a "Small Case" Category Into a "Small Shipper" Category

Under the Board's proposal, all claims brought within a 2-year period (the statute of limitations period under 49 U.S.C. 11705(c)) that involve the same defendant railroad and the same captive origin or destination would be "aggregated." This means that if a shipper were to file a complaint against one railroad, challenging the movement from its captive plant to Destination 1, and the MVC of that complaint was \$100,000, the shipper would be eligible to use the Three-Benchmark approach. But if within two years the same shipper filed a second complaint against the same defendant, challenging a movement from the same captive plant to Destination 2, and the MVC of the second complaint was \$150,000, the shipper would be presumed eligible to use the Simplified-SAC procedures, but not the Three-Benchmark approach.

The proposed "aggregation rule" is nonsensical and unlawful.

First, as discussed by witness Crowley, the "aggregation rule" does not take into account the routing of a movement, and thus will produce absurd results. As the Board has proposed it, the rule will apply whenever the same origin or the same destination is involved in two potential complaints. Thus, for example, the aggregation rule will apply when one movement travels east from a captive origin and a second travels west from the same origin, even though the eastward and the westward movements would be over completely different routes. In such a case, evidence in a Full-SAC or a Simplified-SAC case for the eastward movement would be completely different from evidence for the westward movement, and virtually none of the cost

and time devoted to presenting evidence for the eastward movement could be applied to the work needed for presenting evidence for the westward movement. As noted by witness Crowley, a shipper, for example, located in Denver, CO served by BNSF, and shipping three railcars a week to customers located in Seattle, Los Angeles, Chicago, and Houston, each of whose movements qualify for the Three-Benchmark approach, under the aggregation rule would have to develop a “Simplified” SAC that would have to replicate a majority of BNSF’s entire system. The cost for such a “simplified” undertaking would be enormous – all for three railcars a week to four destinations. Crowley V.S., pp. 24-28.

Witness Fauth has developed an analysis that demonstrates that the aggregation rule is likely to eliminate a huge amount of traffic from challenge, and that Table 2 of the Board's decision, which clearly does not take the effect of the aggregation rule into account, is simply wrong and misleading. Witness Fauth determined the MVC for forty-two individual movements of STCC 28-211-42 from the same captive origin in Louisiana. An examination of these individual movements, without considering the aggregation rule, suggests that 32 of these movements would qualify for Simplified-SAC procedures, 9 would qualify for the Three-Benchmark approach, and 2 would be forced to use the Full-SAC standard, all under the far-understated assumptions posited by the Board. But since all of these movements are from the same origin served by a single carrier, even aggregating these movements based on the destination railroad would mean that 33 of the 42 movements whose destinations are located in the service areas of seven Class I rail carriers across the nation would exceed the presumptive floor and be forced to use the Full-SAC analysis.¹⁵ Fauth V.S., pp. 63-66.¹⁶ That Full-SAC

¹⁵ The Board states that the aggregation rule should be applied to different shipments “that involve the same defendant railroad.” Decision, p. 34. Thus, it is not clear that aggregation would not apply, for example, to both joint UP/NS and UP/CSX movements, since in both cases the same “defendant railroad” (the UP) is involved.

presentation would need to replicate a good portion of the entire U.S. railroad system. The alternative would be for the shipper to forego rate relief on many of the movements, except piecemeal by filing complaints every two years, over a decade or more.

Moreover, the aggregation rule is unlawful. The statute simply says that the Board must develop a simplified and expedited “method” for challenging 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]. The statute gives the shipper the right to choose the “case” that he will bring, and if the cost of using the full SAC is too great “given the value of the case,” the shipper should have the right to bring the case using the less-costly “method,” regardless of any other “case” that the shipper may have brought from some other origin to the same destination, or from some other destination from the same origin.

The aggregation rule unlawfully transforms what the statute requires to be a “small case” rule (“too costly given the value of the case”) into a “small shipper” rule. After all, it is only the very, very small shipper – one who is transporting from a very small plant from a single origin to one destination, or very few clustered destinations -- who will not be affected by the “aggregation” rule. Any larger shipper, who may be shipping from multiple plants to one destination, or shipping from a large plant to multiple (maybe even hundreds) of destinations, will be affected.

The Board’s concern about “manipulation of the eligibility standards” is misplaced. If a shipper chooses to bring two complaints from a single origin to several destinations, the shipper will have to bear the cost of each separate litigation. The shipper should be able to decide whether it makes more sense to “bundle” the challenge into one complaint, which may force the

¹⁶ See also *Fauth V.S.*, p. 22, which notes that movements of STCC 28-211-42 are destined for 22 different

shipper to utilize a Full-SAC analysis, or to disaggregate his complaints into many smaller complaints, for which he will have to bear multiple litigation costs.

The proposed “aggregation” rule should be eliminated.

G. The Board’s Eligibility Estimates Are Unreliable

The STB’s decision includes an analysis of the amount of regulated traffic that would be presumed eligible to use the Full-SAC, the Simplified-SAC, and the Three-Benchmark approaches. Based on the 2004 Waybill Sample, the Board estimates that 34 percent of all regulated traffic would use the Full-SAC standard, 50 percent would be eligible to use the Simplified-SAC procedure, and 17 percent would be eligible to use the proposed Three-Benchmark approach. Decision, p. 37, Table 2. But the agency’s analysis is flawed. See *Fauth V.S.* at p. 49-54 and *Crowley V.S.* at pp. 44-46. Moreover, as noted above, the entire table is utterly unreliable because it does not take into account the Board’s aggregation rule.

IV. THE BOARD’S PROPOSED SIMPLIFIED SAC PROCEDURES FOR A “MEDIUM” CASE ARE UNWORKABLE AND INCONSISTENT WITH THE STATUTE

The Board has long recognized that Full-SAC procedures are only workable when traffic moves over a predetermined route in large quantities for long periods of time. The Board has also recognized that virtually all non-coal movements do not exhibit these characteristics: they involve constantly-changing destinations, with varying tonnage and carload count levels. Non-coal movements spread out radially from an origin, rather than moving from a single origin over one or a few well-defined routes, such as occurs in western PRB coal movements. Indeed, it is significant that recent Board decisions involving eastern coal movements – which typically are from a variety of mines in different locations being transported over a variety of routes to gathering points (an arrangement that is somewhat more similar to non-coal movements in either

states from California to Massachusetts, and from Wisconsin to Mississippi.

the east or the west compared to western coal movements) -- have resulted in total losses for shippers even where a huge increase in the rates was being challenged.¹⁷ The Board's decision notes that its SAC procedures "assume[] that . . . the SARR would continue to operate into the indefinite future, . . .", an assumption that is contrary to the facts of most non-coal movements. See, Decision, p. 6.

The Board has drastically underestimated the cost of litigating a Simplified-SAC case. Moreover, when other factors that will arise in all typical non-coal rate challenges are taken into account -- matters such the increased complexity of calculating revenues and costs for cross-over traffic in a non-coal case, the cost of calculating investment needed in highly complex, urban parts of a carrier's system, the "radial" nature of a SAC from a large non-coal manufacturing facility, etc. -- the cost of certain aspects of a Simplified-SAC analysis will be even greater than the corresponding analyses in a Full-SAC case. Finally, the Board has ignored certain costs altogether. The cost of a Simplified-SAC analysis will be many times higher than the \$200,000 figure posited by the Board.

A. The Cost of a Simplified-SAC Procedure Will Be Many Multiples Higher Than the Cost Estimated by the Board

In its Decision, the Board estimates that the cost of a Simplified SAC will be \$200,000. Decision, p. 36. The estimate is absurdly low. The Board's estimate apparently starts from three premises, all of which are wrong. The first seems to be that a reasonable cost of a Full-SAC case should be estimated at \$3.5 million. The second is that AAR's experts testified correctly in the early 1990s when they claimed that it would be possible to conduct a simplified stand-alone cost using procedures that the AAR developed (but which the Board rejected) for \$25,000 to \$85,000. The third is the Board's belief that the AAR's procedures that were rejected in 1996 are

¹⁷ See, e.g., *Duke Energy Corp. v. CSX Transportation, Inc.*, STB Docket No. 42070, served February 4,

comparable to the Simplified SAC procedures outlined by the Board in its Decision. In addition to these incorrect assumptions, the Board vastly underestimates the time and cost of litigating under its proposed Simplified-SAC procedures.

The cost of a Full-SAC case is now significantly higher, these Interested Parties believe (and the Board seems to acknowledge), than \$3.5 million. These Interested Parties believe that the figure is over \$4.0 million now, and trending upward. As Witness Crowley notes, the Board need only consult the evidentiary “arms race” that has occurred in Full-SAC cases by comparing the records developed Docket No. 41191, *West Texas Utilities Company v. Burlington Northern Railroad Company* served April 25, 1996 (“WTU”) to the publicly-available evidence in Docket No. 41191 (Sub-No. 1), *AEP Texas North Company v. BNSF Railway Company* (“AEP North Texas”) to see the huge increase in cost and complexity in Full-SAC cases. Crowley V.S., pp. 11-12. This “arms race” is not likely to abate with the Board’s decision in Ex Parte 657, both because that case will itself only generate more litigable issues, and also because still other Board decisions, such as in the case of *Otter Tail Power Company v. BNSF Railway Company*, are likely to drive costs even higher. As witness Crowley notes, an estimate of \$4.0 to \$7.0 million for SAC cases should be used by the Board if the Board desires to develop a rational eligibility standard for Full-SAC and “other than Full-SAC” cases. Crowley V.S., pp. 23.

Additionally, the Board’s assumption that the simplified SAC procedure advocated by the AAR in the late 1990s would be between \$25,000 and \$85,000 is completely untested and clearly incorrect, especially given the fact that the figure was offered nearly fifteen years ago. More importantly, the Board is simply wrong that the AAR’s 1993 simplified stand-alone cost procedure and the Simplified-SAC procedure now proposed by the Board are comparable. They are not. The first was a computer program which produced a calculated answer (though that

2004; *Duke Energy Corp. v. Norfolk Southern Ry. Co.*, STB Docket No. 42069, served November 5, 2003.

answer was incorrect). The Board's proposed procedure, in contrast, is not a computerized program at all, and does not produce any answer until a huge number of analyses are made, a large amount of evidence is presented, and the Board decides between the litigated positions of the two parties. Moreover, the cost of litigation beyond the cost of consultants under the Simplified-SAC procedure will be far higher than the extremely modest amount assumed by the Board in its \$200,000 estimate.

The Board's proposed Simplified-SAC procedures ignore requirements so numerous that the Board's total cost for a Simplified-SAC case of \$200,000 will fall far short over covering consultants' fees alone, much less full litigation costs. See, *Crowley V.S.*, pp. 14-21. For example, the STB's proposal to shift the burden of identifying the SARR's traffic group and of developing the SARR's revenues will not reduce the shipper's cost, because the shipper will still need to verify the railroad's data. *Id.* at 15-16. In addition, the amount of effort to calculate cross-over revenues will be considerably higher in a Simplified-SAC case as compared to the Full-SAC approach, since the Simplified-SAC procedures require the inclusion of all traffic moving over a route, whereas the Full SAC allows the shipper to choose a subset of the actual traffic. *Id.* at 16. As Mr. Crowley notes, a movement hypothesized by the Board on page 14 of the Decision might mean that there are literally thousands of cross-over movements on the shipment's route. *Id.* Moreover, several Road Property Investment categories will require substantial evidentiary development. *Id.* at 17; *Fauth V.S.*, p. 11-12.

In reality, the proposed "simplified" SAC procedures are extremely complex. For example, witness Fauth notes that although the STB's approach for Road Property Investment may simplify the valuation process, the complainant in a Simplified SAC proceeding would still be responsible for the time-consuming identification of the SARR assets, such as land, track,

bridges, etc., which is usually the most time-consuming process involved in the Full SAC standard. See, *Fauth V.S.*, p. 12. It is ironic that the Board required 20-plus pages of single-space text just to outline some of the proposed “simplified” procedures – text which still leaves many questions unanswered. Identification of cross-over traffic revenues, calculation of operating expenses, and many other components will all be required of a Simplified-SAC complainant, and the development of these components will require many hundreds of hours of work. *Fauth V.S.*, p. 12. The process will be far more complicated than is assumed by the Board.

In particular, the identification of cross-over traffic is likely to be far more complex in a non-coal case, because regulated non-coal movements involve thousands of origins and destinations. Witness *Fauth* estimates, for example, that regulated movements of plastics were transported from 318 different origins in 2004 to 1,104 different destinations, or potentially several hundred thousand origin-destination pairs. The origins and destinations of this regulated plastics traffic are spread throughout the United States. *Fauth V.S.*, pp. 21-22. Thus, cross-over traffic identification in a Simplified SAC case is likely to be much more difficult than cross-over traffic identification in a coal case using the Full-SAC approach. *Id.* at 23.

Indeed, the Board’s Decision seems to completely ignore the cost of several significant litigation expenses in making its \$200,000 estimate for a Simplified-SAC case. For example, the cost of the yearly “true up” – which is likely to be substantial – has apparently been completely ignored by the Board. See, *Crowley V.S.*, pp. 20-21; *Fauth V.S.*, p. 32-33. The Board dismisses with a sentence the complicating effects of the *PPL Montana/Otter Tail* cross-subsidy test, the evidentiary burden of production and persuasion of which would be placed on the railroad. But the shipper’s affirmative case will need to consider the requirements of the *PPL Montana/Otter*

Tail cross-subsidy test, which will likely require the re-routing of the issue traffic in order to maximize the economies of density for any movement traversing even a limited number of less-dense line segments. See *Crowley V.S.*, pp. 18-19. Moreover, once the railroad comes forward with such evidence, the shipper will need to respond. And, as noted above, the Board has given no mention to even the possibility (and cost) of discovery disputes; the likely necessity to respond to procedural matters such as motions by the defendant railroad to dismiss the shipper's case (which have been a routine part of recent Full SAC cases); or challenges to market dominance, which have not been a significant issue in recent coal cases but which well might become a part of non-coal rate challenges.

Indeed, there are major areas of uncertainties in the Simplified SAC procedures proposed by the Board, all of which will need to be litigated in order to be resolved. As noted by Witness Fauth, during the STB's hearings in 2003, former STB Chairman Linda Morgan voiced just this concern, that the use of a Simplified-SAC procedure would mean "that would start a whole new process again . . ." leading to substantial uncertainties that would have to be litigated. *Fauth V.S.*, p. 10.

In short, the Board's "Simplified SAC" procedures even as painted by the Board are certain to cost far more than the \$200,000 estimated by the Board. Witness Crowley estimates that the total cost of a Simplified-SAC case will be between \$1 to \$2 million for economic consulting costs. *Crowley V.S.*, p. 24. Witness Fauth's estimates are also far higher than the \$200,000 in total costs estimated by the Board: consulting costs alone during the original litigation will conservatively run between \$500,000 and \$1.25 million. *Fauth V.S.*, p. 13-14. Attorneys' fees and other costs would need to be added on top of consulting costs. Even averaging the ranges between Witness Fauth and Witness Crowley's estimates would result in an

estimate of consulting costs alone for a Simplified-SAC case at \$750,000 to \$1.6 million.

Attorneys and other fees will add to those figures. Moreover, Simplified-SAC procedures are likely to morph into even more complex and expensive procedures, as Full-SAC cases have done. The effect of both complexities in the Board's current proposal and likely future complexities as cases develop means that the proposed "Simplified-SAC" procedures fails to meet the broad statutory standard requiring a "simplified and expedited method" of resolving non-coal rate challenges.

B. The Board Has Failed To Disclose Whether It Has Tested Its Simplified-SAC Procedure, and Therefore It Is Not Possible to Determine If It Has Fairly Traded Accuracy for Simplicity

Any legal deference which the Board may claim in trading accuracy for simplicity in the development of a Simplified-SAC procedure must be rooted in a rational inquiry by the Board as to how much accuracy has been lost, how much simplicity and cost savings have been gained, and whether the trade-off is reasonable. In 1993, the Board rigorously tested a simplified-SAC procedure advanced by the AAR. See *Fauth V.S.*, pp. 34-36. But the Board has not applied its own standards to itself, as it has not disclosed whether it has tested the Simplified-SAC procedure, by applying the procedure to any past Full-SAC case and to any credible non-coal example, and if it has tested the procedure, what were the results of such tests. As Witness Fauth points out, testing cannot be done by private parties, as they do not have access to required information. *Id.* at 36 Unless its proposed Simplified-SAC procedure has been tested, the Board cannot support any assertion that it has fulfilled the statutory mandate to develop a "simplified and expedited" method of processing non-Full-SAC cases. As the record in this proceeding now stands, the Board's proposal is simply arbitrary.

C. The Board's Proposed Simplified-SAC Procedures Are Unfairly and Unlawfully Skewed Toward a Higher Maximum Rate

The Board's Simplified-SAC procedures do not fairly simplify the Full-SAC analysis. Instead of sacrificing accuracy for simplicity while maintaining neutrality toward the outcome, the Board's proposal consistently sacrifices a lower SAC rate for a higher Simplified-SAC rate. In effect, it is not a trade of accuracy for simplicity, but a trade of simplicity for higher maximum rates. The Board's proposed procedures are inconsistent both with fundamental fairness and with the underlying premises of *Guidelines*.

As the ICC explained in *Guidelines*, the Full-SAC constraint is based on two overlapping and interacting theories, that of differential pricing and the contestability of markets. *Guidelines*, at 525. The first permits a carrier to charge rates in excess of the average cost for it to attain revenue adequacy, while the second places as a limit the full economic cost, including a normal profit, that needs to be met for an efficient producer to provide service to an identified set of shippers. But as noted by Witness Crowley, who has participated in every Full-SAC case since the standard was adopted, the proposed Simplified-SAC procedures remove any SARR efficiencies by mandating the use of existing infrastructure along the route of movement, by including all traffic in the traffic group, and by using the incumbent railroad's system average operating costs. Each of these adjustments will increase the cost of the SARR in a Simplified-SAC in comparison to the SARR in a Full-SAC case. Crowley V.S, pp. 53-56; see also, Fauth V.S., pp. 24-28.

None of the simplifying procedures proposed by the Board will have the opposite effect.

By definition, then, Simplified-SAC procedures will always result in a maximum rate higher than the rate calculated under the Full-SAC procedures. See, Crowley V.S., pp. 53-56; Fauth V.S., p. 33-34. What is unknown is: how much higher a rate will the Simplified-SAC

procedures produce? This question can only be answered by Board staff, who have access to the data in past Full-SAC cases and presumably have a more detailed knowledge of how the Simplified-SAC procedures will work. However, unlike the agency's treatment of the AAR's "simplified" stand-alone cost procedures in 1993, the Board has failed to disclose whether it has its proposed Simplified-SAC procedures, and if so, the results of such tests. Thus, it is unknown whether the Board's proposed procedures will in fact produce an answer that is reasonably related to the answer that would be produced by the Full-SAC analysis.

The Board states that requiring these procedures is justified because "railroads are not burdened by substantial excess capacity; rather, the rail industry now faces the opposite situation." Decision, p. 11. In other words, the Board appears to be saying that, because there is little or no excess rail capacity, rail carriers are currently optimally "efficient." But the Board itself noted in *Simplified Guidelines*, an optimally efficient carrier entering the market would not in all likelihood replicate the existing rail network, even if it was assumed to carry the same traffic. *Simplified Guidelines*, at 1015; see also *Crowley V.S.*, pp. 53-56. As Witness Fauth points out, many existing railroad lines were built over a hundred years ago over routes that would not be selected today. For example, circuitous routes were often selected in order to avoid difficult terrain before the advent of modern construction equipment. *Fauth V.S.*, pp. 15-16. Indeed, the Board's assertions are belied in the real world: Norfolk Southern, for example, recently received \$95 million in Federal Funding for a \$311 million public-private initiative known as the Heartland Corridor project which will cut 233 miles off its existing route between Norfolk, VA and Chicago, IL by modifying 29 tunnels and 24 bridges and other obstructions. *Fauth V.S.*, p. 16. And the CREATE project in Chicago, an even larger initiative, is being built precisely because the current rail configuration is inefficient. *Fauth V.S.*, p. 16.

The Board's unwillingness to permit more than a limited inquiry into a carrier's inefficiencies (and then only under a "compelling evidence" standard) is contrary to the statute, which requires the Board to consider the Long-Cannon factors set forth in 49 U.S.C. 10701, and contrary to the underlying theory of *Guidelines*. See *Crowley V.S.*, p. 53-54.

C. The Board's Proposed Simplified-SAC Procedures Will Take Far Too Long, and Are Inconsistent with the Statutory Requirement for an "Expedited" Process

In its Decision, the Board has proposed a schedule for its Simplified-SAC procedures that would produce a decision in eighteen months, or 545 days. Ironically, the Board's own rules for Full-SAC proceedings indicate that, absent a specific order by the Board, all discovery and evidence will be filed in just 210 days, 49 C.F.R. 1118. The statute gives the Board an additional 270 days to issue a decision after the record is closed – or a total of 480 days. In other words, the Board has proposed in this proceeding a period for a Simplified-SAC proceeding that is even longer than the Board's own rules for a Full-SAC proceeding. Of course, the Board has never processed a Full-SAC proceeding according to the timelines in its own rules, and the procedures that the Board has required for Full-SAC cases in fact make it impossible to do so. Despite the 480-day period contained in the rules and the statute, Full-SAC proceedings have taken three to four years to process and decide – a time period two to three times as long as the Full-SAC rules contemplate in the absence of a special procedural schedule.

There is no reason to believe that the Simplified-SAC procedures outlined by the Board will be accomplished in the eighteen month period set forth in the decision. The complexities and uncertainties in the procedures will make it virtually impossible to do so, even if both parties had every incentive to process the case quickly.

But even if it could be assumed that a Simplified-SAC case would be processed in the time period proposed in the Decision, the procedure would hardly be "expedited," as the statute

requires. More importantly, the time required for the “Simplified SAC” procedure is simply inconsistent with the transportation needs of American business, and especially non-coal shippers. As noted above, the volumes in non-coal movements change much more frequently than the volumes involved in movements of coal. The Board’s proposed rules limit a shipper’s relief to the amount of traffic identified in the Complaint at the outset. Decision, p. 36. Thus, if the amount of a complaining shipper’s traffic increases over the term covered by the relief allowed under the complaint, relief is not available for the additional traffic. And, if the amount of traffic decreases, any decision reducing the carrier’s rate is moot.

Thus, even ignoring all the other considerations surrounding the Board’s proposed Simplified-SAC procedures, the Simplified-SAC proposal should be withdrawn because it fails to result in “expedited” procedures that meet ordinary commercial needs.

V. THE REVISED THREE-BENCHMARK PROCEDURE HOLDS PROMISE, BUT SUBSTANTIAL CHANGES NEED TO BE MADE IN CERTAIN AREAS

A. Some Parts of the Revised Three-Benchmark Approach Hold Promise

In its Decision, the Board has made significant revisions to the “Three-Benchmark” approach set forth in *Simplified Guidelines*. While some of these are helpful, there are other aspects of the Three-Benchmark proposal that require modification. A fundamental problem, of course, is that no real-world shipper will be able to utilize the Three-Benchmark approach under the Board’s Decision, and thus any extended discussion of the approach is of limited utility unless the eligibility standards are radically changed.

In its Decision, the Board has proposed to revise the method for calculating the RSAM. The Board’s proposed revision is useful, since it calculates a carrier’s “revenue shortfall” by including revenue from traffic priced at a revenue to variable cost level of less than 180%, and

not just “captive” traffic carried at levels above the jurisdictional threshold. The same is true of the revised $R/VC > 180$, which is to be renamed the “ R/VC_{total} .”

Second, these Interested Parties believe that the Board’s use of unadjusted URCS for costing under the Three-Benchmark approach is generally acceptable. However, there will be questions as to exactly how to define “unadjusted” URCS costs, and the Board should carefully review this matter in light of the comments in this proceeding and experience in individual cases.

Third, the process that the Board has outlined for “winnowing” the comparison group appears to make sense (as long as both parties obtain access to information necessary to make an informed decision about the group, as discussed below), but this process will need to be carefully overseen. The Board should, as cases are processed and experience is gained, be willing to make adjustments to the process in the interests of justice and fairness.

Fourth, the discovery process and staff conferences proposed by the Board are generally acceptable. However, the Board should reduce the 270-day procedural schedule set forth in the Decision.¹⁸ In this respect, a better eligibility standard would materially assist in expediting the process, since fifty (50) days of the Board’s proposed schedule is consumed by the need to determine eligibility. These Interested Parties believe that the schedule suggested by the Interested Parties in July 2004, which would produce a decision within approximately 180 days, is reasonable. See Appendix C, p. 16-17.

However, the Board needs to make significant changes (in addition to the radical changes in its eligibility standard for a Three-Benchmark case as noted above) in order to provide for a useful and lawful small rate case process.

¹⁸ The Board’s Decision is somewhat unclear as to the schedule for processing Three-Benchmark cases. At one point, the Board indicates that a final decision on the merits would be issued within “1 year of the date of the complaint,” Decision, p. 19, but the procedural schedule outlined by the Board appears to provide for a decision in 270 days. Decision, p. 29-30.

B. The Board's Proposal to Utilize a Confidence Interval Unfairly Skews the Three-Benchmark Rate Comparison Upward

The Board proposes to develop a 90 percent one-sided confidence interval around the comparison group's adjusted R/VC ratio, and to use the upper bound of the calculated confidence interval as the measure of rate reasonableness. The use of the proposed confidence interval is incorrect, and arbitrarily skews the results of the Three-Benchmark comparison upward. As discussed by Witness Crowley, the construction of a confidence interval implies that the sample to which it is applied was drawn randomly from the respective population. However, the Three-Benchmark approach is far from being a random process, and in fact it is the antithesis of random: the group will be purposefully selected by the parties to the litigation. Thus, there is no statistical basis for the use of a confidence interval, and the process serves no purpose other than to artificially raise the reasonableness standard of a rate. Crowley V.S., p. 48-49.

C. The Board Must Revise Its Procedures to Permit Access, Under Standard Confidentiality Orders, to Unmasked Waybill Data Prior to the Filing of a Case

Under the proposed Three-Benchmark procedures, upon determination of eligibility to use the Three-Benchmark approach, the agency will release to the shipper the STB's most recent "masked" Waybill Sample. At that point, the shipper and railroad will identify their initial evidence of an appropriate comparison group. The agency will then convene a technical conference, and each party will then tender its "final offer" group of comparative movements. The STB would then select the comparison group from one of the two final positions. Only then, after certain further technical adjustments, will the STB unmask the revenues for the movements in the selected comparison group. But it should be noted that the shipper will only have access to the "masked" Waybill Sample throughout the selection process, and will not have access to the unmasked data, because allegedly the unmasked information would not be necessary to

formulate a comparison group. But the agency's suggested procedures are unfair and the agency's reasoning incorrect.

Under Board procedures involving the Waybill Sample, rail carriers have been allowed to alter the revenues for contract traffic through the use of "masking factors." The masking factors are selected by individual carriers and thus are different from carrier to carrier. These masking factors can be different for different commodities or commodity groups carried by each carrier; and can be either positive or negative. Railroads apply masking factors to the revenue appearing on the Waybill Sample and provide these masking factors to the Board. It should be noted that individual railroads set the masking factors and can set them in a way that eliminates or compromises any potential comparable group. The Board has no published guidelines on how carriers may set the masking factors.

The Board has admitted that the masking factors render the Board's Waybill Sample inaccurate for a variety of purposes. Indeed, the Board has for many years regularly warned parties obtaining access to masked data that use of revenue data from the Carload Waybill Sample in any type of comparison could lead to wrong or misleading results. See e.g., STB letter dated June 6, 2005 in response to WB456-1. Ironically, under its Decision the Board is permitting only unmasked Waybill Sample revenues to be revealed to the shipper-complainant precisely to develop a reasonable "comparison" group.

The Board in its Decision proposes to deny shippers access to the unmasked Waybill data, even under confidentiality orders. This is fundamentally unfair, because the comparison must be made to an "unmasked" rate -- the challenged rate -- and the defendant carrier will have access to the most important "unmasked" data -- movements on its own system.

Railroads are the originators of the data in the Waybill Sample, and therefore have access to the unmasked revenue data for any potential comparison group. As noted by Witness Crowley, a railroad entering into a Three-Benchmark adjudication will be able to use the unmasked revenue data to identify movements to include in its comparison group that will drive a higher average R/VC ratio when the STB ultimately reveals the actual revenue data at the end of the process. Knowing the most beneficial movements to include in the comparison group beforehand will allow the defendant railroad to spend the time and effort to justify the inclusion of these movements in the final comparison group. The complaining shipper, in contrast, will not have this information, and will be at a clear disadvantage. *Crowley V.S.*, pp. 42-44. It is arbitrary and capricious for the Board to institute procedures that give one party to litigation access to information denied to the other party, especially when the “unmasked” information will determine the reasonable rate under the Three-Benchmark procedures.¹⁹ The Board should permit access to the unmasked revenue data before the filing of a complaint, under the Board's standard confidentiality restrictions that would limit the unmasked revenue data to outside counsel and consultants (as in done in a wide variety of Board proceedings), upon certification that the information is being used in the development of a potential rate complaint under the Board's rules.

D. The Board Must Permit the Introduction of Evidence That Would Fall Within the Long-Cannon Factors, and the Board Should Permit Evidence of Special Factors To Be Submitted In a Case

In its Decision, the Board indicates in a footnote that it is a permissible and appropriate simplifying measure to deem a rate unreasonable in a small rate dispute if it is above a

¹⁹ It is very clear from the data released in this case that there are significant differences between the masked and unmasked revenue data. *Id.*, pp. 41-42; see also, *Fauth V.S.*, pp. 53-56.. Moreover, because the Board will not release the masked revenue data until after the comparison group is selected, the shipper will not be able to determine the correct degree of demand elasticity for that type of traffic. *Fauth V.S.*, p. 51.

reasonable confidence interval around the adjusted mean of the comparison group. The Board seems to indicate in the previous sentence of the Decision that it was reconsidering the need for "individualized evidence beyond that described herein." Decision, p. 28 and fn.49

It is unclear exactly what the Board means by these statements. If the Board is saying that if the challenged rate is above the calculated formula level, it would permit no other evidence by the carrier to show that the rate is reasonable, these Interested Parties would agree. However, the Board should be very cautious if it is saying that it will permit no evidence whatsoever beyond the formula calculation. The statute requires the Board to consider the Long-Cannon Factors, and the Three-Benchmark test that the Board has advanced in its Decision appears to make no room for the consideration of such factors. In addition, shippers should be able to show that there are individualized factors that make the rate unreasonable even if the rate is below the level that would be produced by the formula.

E. The Board Should Revise Certain Technical Aspects of the Comparison Group

As noted by Witness Crowley, the Board's Waybill Sample does not include final revenue settlements, an omission that biases the sample upward. The Board should take steps to insure that the Waybill Sample consists of settled revenues reflecting all allowances and refunds. Crowley V.S., p. 47.

In addition, the Board appears to indicate that public Waybill Sample data would be used to determine the comparison groups during the final offer process, though the Board is not entirely clear on this. See Decision, p. 20, *but compare*, Decision, p. 32; see also Fauth V.S., p. 55. Assuming that public Waybill Sample data is being used, it should be noted that such data excludes information required to accurately evaluate the characteristics of possible comparison groups. See Fauth V.S., pp. 55-56. Moreover, and more importantly, it appears that the Board

has proposed to limit comparison traffic group selection to traffic which has the same 2-digit STCC code as the issue movement. But different commodities could have similar transportation, demand, and market characteristics. Fauth V.S., p. 56. The Board should strongly consider expanding the universe of potential comparisons.

VI. THE BOARD IS CORRECT IN PROVIDING FOR REVOCATION OF EXEMPTIONS IN THE CONTEXT OF AN INDIVIDUAL RATE PROCEEDING

In its Decision, the Board notes that if the traffic at issue is part of the class of traffic that has been exempted from Board regulation pursuant to 49 U.S.C. 10502(a), the complainant could include with its complaint a separate request for a partial revocation of the pertinent class exemption for the traffic at issue pursuant to 49 U.S.C. 10502(d). The railroad would file with its answer a separate response to that request, but evidence would continue to be submitted under the schedules required for non-Full-SAC rate cases while the Board considered the request.

These Interested Parties strongly agree with this aspect of the Board's decision. As rail capacity has tightened and the availability of transportation by other modes has declined because of tightening capacity in those modes as well, shippers of exempt commodities are increasingly finding themselves without effective transportation options. In such cases, resort to the Board's processes is becoming increasingly necessary. Thus, the Board is completely correct in providing for coordinated treatment of an exemption revocation request with a challenge to the rate being charged by a rail carrier.

There is nothing inconsistent with the proposed procedure and the requirements of 49 U.S.C. 10502(d). Rather, the proposed procedure simply insures that the processing of revocation request and the processing of the rate complaint will be accomplished at the same time, rather than consecutively. The standards of each can be met. Moreover, there is no need for consecutive treatment since the standards for market dominance under 49 U.S.C. 10701 are

similar to the standards that would be required to show that the exemption should be revoked in the case of a specific complainant under 49 U.S.C. 10502(d). The Board should adopt is proposed processing of rate complaints involving exempt commodities.

VII. CONCLUSION

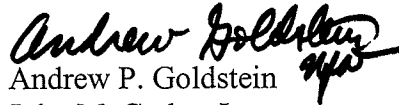
The Board should revise its Proposal to conform to the suggestions by these Interested Parties.

Respectfully Submitted,

By the attorneys of the Interested Parties



Nicholas J. DiMichael
Laurence W. Prange
Thompson Hine LLP
1920 N St. N.W.
Suite 800
Washington, D.C. 20036
(202) 263-4103



Andrew P. Goldstein
John M. Cutler, Jr.
McCarthy, Sweeney & Harkaway, P.C.
2175 K St. N.W.
Suite 600
Washington, D.C. 20006
(202) 775-5560

Dated: October 24, 2006

CERTIFICATE OF SERVICE

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

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

Aimee DePew

APPENDIX A

***BEFORE
THE
SURFACE TRANSPORTATION BOARD***

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

**SIMPLIFIED STANDARDS
FOR RAIL RATE CASES**

Verified Statement
of
Thomas D. Crowley
President

**L. E. PEABODY & ASSOCIATES, INC.
ECONOMIC CONSULTANTS**

Due Date: October 24, 2006

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LIST OF EXHIBITS

EXHIBIT	
<u>NO.</u>	<u>TITLE</u>
(1)	(2)
1	Statement of Qualifications
2	Comparison of Full SAC and Simplified SAC Analyses
3	Application of the STB's Proposed Three Benchmark Method
4	STB Eligibility Estimates, Eligibility Estimates Based on 2004 Masked Waybill Sample Data, Eligibility Estimates Based on 2005 Masked Waybill Sample Data, Methodology Used To Aggregate 2004 and 2005 Waybill Sample Revenues
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I. INTRODUCTION

My name is Thomas D. Crowley. I am an economist and the President of L. E. Peabody & Associates, Inc., an economic consulting firm that specializes in solving economic, transportation, marketing, and fuel supply problems. I have spent most of my consulting career of over thirty-five (35) years evaluating fuel supply issues and railroad operations, including railroad costs, prices, financing, capacity and equipment planning issues. My assignments in these matters were commissioned by railroads, producers, and shippers of different commodities. A copy of my credentials is included as Exhibit No. 1 to this verified statement.

I have been requested by Counsel for various Interested Parties to address certain issues arising from the Surface Transportation Board's ("STB") decision in Ex Parte No. 646 (Sub-No. 1), *Simplified Standards For Rail Rate Cases*, served July 26, 2006 ("Ex Parte 646"). Specifically, Counsel for the Interested Parties have requested that I address the following issues: (1) the Maximum Value of the Case ("MVC") determinates proposed by the STB and the determinants' impact on the available rate reduction procedures; (2) the theoretical bases and the application of the STB's proposed Three Benchmark Methodology ("Three Benchmark"); and (3) the theoretical bases and the application of the STB's proposed Simplified Stand-Alone Cost Procedures ("SSAC").

My testimony is discussed further below under the following topical headings:

- II. Determination and Application of the MVC
- III. Application of the Three Benchmark Methodology
- IV. Application of the Proposed SSAC Methodology

II. DETERMINATION AND APPLICATION OF THE MVC

The STB instituted these Ex Parte 646 proceedings in an attempt to remedy the shortcomings of the procedures originally adopted pursuant to the STB's decision in Ex Parte No. 347 (Sub-No. 2), *Rate Guidelines - Non-Coal Proceedings*, Served December 31, 1996 ("Ex Parte 347"). To examine why the shipper community failed to utilize the Ex Parte 347 procedures, the STB held public hearings in 2003 and 2004 to gather input regarding the limitations of the Ex Parte 347 procedures. The STB found that shippers perceived the Ex Parte 347 procedures as too vague to use as an effective tool in the regulatory and negotiating processes. In addition, shippers felt that the proposed Ex Parte 347 procedures would open them to prolonged litigation over whether the shippers would even qualify to use the proposed simplified guidelines.^{1/}

To address the shippers' concerns around the vagueness of its Ex Parte 347 procedures, the STB now proposes to utilize three procedures to address rate complaints under the stand-alone cost ("SAC") constraint. First, the STB proposes to retain its current stand-alone cost ("Full SAC") procedures for use in certain "large" rate cases that reflect great value to the shipper. Second, the STB proposes to create a scaled-down SSAC procedure to use in what the STB terms "medium size" rate disputes, for which a Full SAC analysis may be too costly. And third, the STB proposes to retain the Three Benchmark methodology, with certain modifications, for use in small rate disputes when even a SSAC approach would be prohibitive to the shipper.

^{1/} See Ex Parte 646 at 3.

In addition to initial concerns surrounding the vagueness of the Ex Parte 347 procedures, shipper groups urged that the STB to adopt a “bright-line test” for shipper eligibility to use the simplified guidelines.^{2/} This bright-line test would address shippers’ concerns around extended litigation of a shipper’s eligibility to bring a case under the small shipper procedures. In response to the shippers’ proposal, the Association of American Railroads (“AAR”) did not oppose a bright-line test for eligibility in small rate cases, but sought to include only “truly small cases” as measured by a shipper’s size.^{3/} The evidence provided by the various parties persuaded the STB that it needed to provide further guidance as to who may use its simplified guidelines.

Based on input from the shippers and the railroads, the STB has now developed proposed eligibility tests. While the STB’s proposed eligibility standards are a start, I believe the STB’s proposed eligibility standards contain many flaws, both of conception and application, that make the standards unworkable in the real world and would preclude shippers from using the STB’s proposed new rate reasonableness methodologies. These problems are outlined below under the following topical headings:

- A. STB Proposed Eligibility Standards
- B. Flaws in the STB’s proposed Eligibility Standards

**A. STB PROPOSED
ELIGIBILITY STANDARDS**

The STB has proposed to meet the shippers’ “bright-line test” by developing specific eligibility standards as to when a shipper may pursue a case using the STB’s proposed Ex Parte 646

^{2/} See Ex Parte 646 at 9.

^{3/} See Ex Parte 646 at 35.

procedures, and what procedures it may use in pursuing a maximum reasonable rate case. The STB proposes to base eligibility on what it terms the maximum value of the case ("MVC"). According to the STB, the MVC equals the maximum relief that a shipper may obtain over five (5) years, assuming a rate reduction to the 180 percent jurisdictional threshold ("JT") rate level. The STB proposes to calculate the MVC by multiplying the difference between the issue rate and the JT rate level by prospective five-year traffic volumes, and discounting the annual cash flows by the most recent railroad industry cost of capital.^{4/} Mathematically, one may present the STB's proposed MVC calculation as follows:^{5/}

$$\text{MVC} = \sum_{n=0}^4 \{[(\text{Rate} - 1.8 \times \text{VC}) \times \text{Vol}] \div (1+i)^n\}$$

Where:	"Rate" =	The issue rate
	"VC" =	The issue movement's variable cost
	"Vol" =	Historic or forecasted traffic volumes
	"i" =	The most current railroad industry cost of capital
	"n" =	The number of years

The STB proposes to base eligibility for its various maximum reasonable rate methodologies upon the calculation of the MVC. If the aggregate MVC is less than \$200,000, then the shipper may presumptively use the STB's proposed Three Benchmark methodology for determining a maximum

^{4/} See Ex Parte 646 at 33.

^{5/} The STB's Ex Parte 646 decision does not provide a detailed mathematical equation for the MVC calculation. However, in a subsequent decision in the Ex Parte 646 proceedings served September 25, 2006, the STB provided the equation it claimed it used to develop the asserted MVC of unregulated shipments included in the STB's 2004 Waybill Sample, and included in the STB's July 26, 2006 decision at Table 2. The STB denied a request seeking its workpapers underlying the MVC calculations so I am unable to confirm the STB's calculations. However, I assume that the equation used by the STB to calculate the MVC in its Table 2 reflects the STB's proposed procedure for calculating the MVC in other cases.

reasonable rate.^{6/} If the aggregate MVC is greater than \$200,000, but less than \$3.5 million, then the shipper may presumptively use the SSAC approach. Finally, if the MVC is greater than \$3.5 million, then the shipper will presumptively utilize a Full SAC analysis.

To guard against what it terms “manipulation of its eligibility standards,” the STB proposes to impose several restrictions and rebuttal presumptions on the MVC calculations.^{7/} These limitations would include limiting rate relief to five (5) years, curtailing the scope of the rate relief to the volume of traffic included in the MVC calculation, and limiting all claims brought within a two (2) year period that involve the same defendant railroad and same captive origin or destination.^{8/} The STB proposes to allow shippers to rebut these eligibility presumptions based on the likely actual value of the case (“AVC”) instead of the MVC.

The STB bases its proposed eligibility thresholds purportedly on evidence filed by shippers in Full SAC cases and the original rulemaking in Ex Parte No. 347. The STB assertedly based its \$3.5 million eligibility presumption on shipper claims that the cost to bring a Full SAC analysis exceeds \$3.5 million and continues to rise.^{9/} The STB also asserts that prior testimony in Ex Parte 347 has indicated that consulting costs to bring a SSAC case would range between \$25,000 to \$85,000 excluding attorney fees. The STB believes that when attorney fees are added to these proposed

^{6/} The threshold MVC levels serve as rebuttable presumptive thresholds for use of a particular rate reasonableness approach, and do not preclude a shipper from bringing a maximum reasonable rate case using a more sophisticated approach. In other words, a shipper that is eligible to use the STB’s proposed Three Benchmark approach may use the STB’s proposed SSAC approach or a Full Stand-Alone Cost approach. See Ex Parte 646 at 33.

^{7/} See Ex Parte 646 at 36.

^{8/} See Ex Parte 646 at 34.

^{9/} The STB also states that it will hold the \$3.5 million threshold level even in the face of raising costs because it believes that its proposed modifications to Full SAC procedures addressed in Ex Parte No. 657 (Sub-No.1), *Major Issues in Rail Rate Cases*, Served February 27, 2006 will reduce the expense of bringing any type of maximum reasonable rate proceeding.

consulting fees, the total cost of a SSAC approach would equal \$200,000. As support for its eligibility requirements, the STB examined its 2004 Waybill sample to estimate the number of movements that would be presumed eligible to use the SSAC and Three Benchmark Approaches.^{10/} The STB asserts that 17% of regulated shipments would be able to use the Three Benchmark Approach, while 50% of regulated shipments would be able to use the SSAC approach.

**B. FLAWS IN THE STB'S
PROPOSED ELIGIBILITY STANDARDS**

The STB believes that its proposed eligibility standards for determining which rate reduction methodology that a shipper may presumptively use addresses the concerns brought by the shippers about the existing Ex Parte 347 approaches. I believe, though, that the STB's proposed MVC calculations and eligibility thresholds contain numerous flaws and biases that will preclude their use by the shipping community. Specifically, I have found that the threshold MVC levels are unrealistically low based on the complexity and stipulations mandated by the STB in its proposed SSAC and Three Benchmark approaches. Also, the MVC calculation as proposed by the STB is open to manipulation by the railroads, and effectively removes the decision of which rate reduction methodology should be employed from the hands of the shippers. Third, the MVC has no bearing on the AVC of the case, and it is the AVC which dictates whether or not a shipper will initiate a case. And finally, the MVC calculation unfairly biases the calculation against shippers by artificially raising the value of a case. I explain each of these flaws below under the following topical headings:

1. Threshold MVC Levels Are Unrealistically Low
2. The STB's Proposed Aggregation Rules Are Unrealistic

^{10/} See Ex Parte 646 at 37, Table 2.

3. The MVC Is Subject To Manipulation By The Railroad
4. The MVC Has No Relation To The AVC

**1. The Threshold MVC
Levels Are Unrealistically Low**

The STB claims that its threshold MVC levels of \$200,000 for the presumptive right to use the Three Benchmark approach and \$3.5 million for the presumptive right to use the SSAC approach fairly reflect the upper bound of the costs to bring a maximum reasonable rate case under the respective methods.^{11/} I believe based on my past experiences in presenting evidence in every Full SAC case filed since the adoption of the modern SAC procedures in Ex Parte 347 (Sub-No. 1), *Coal Rate Guidelines, Nationwide*, Served August 8, 1985 ("Coal Rate Guidelines"), and based on the railroad's response to that evidence, that the STB has dramatically underestimated the costs to produce evidence under the Three Benchmark and SSAC approaches. I explain the reasons for my beliefs below.

**a. The Costs To Bring A Case For A Single Movement Under
The Three Benchmark Approach May Exceed \$200,000**

The STB believes that the simplifying approaches it proposes in its Three Benchmark methodology will allow small shippers to pursue rate relief where the MVC of the case does not exceed \$200,000.^{12/} These simplifications include: 1) limiting the breadth and depth of discovery;^{13/} 2) limiting evidence on the comparability of comparison group movements to publicly available information and to non-rate data provided in the STB's Waybill Sample;^{14/} 3) requiring simultaneous

^{11/} See Ex Parte 646 at 36.

^{12/} See Ex Parte 646 at 36.

^{13/} See Ex Parte 646 at 31.

^{14/} See Ex Parte 646 at 20.

tendering of evidence on an appropriate comparison group;^{15/} and 4) eliminating movement specific adjustments in the calculation of a movement's variable cost.^{16/}

While the STB may think that its procedures will result in extremely low litigation costs under the Three Benchmark approach, I believe that this is not correct, and the cost of litigation will make the approach cost prohibitive for many smallshippers, given the extremely low \$200,000 MVC limit the STB proposes for its Three Benchmark approach.

**i. The Cost To Justify Inclusion of
Movements In The Comparison Group
Will Be Much Higher Than The STB Assumes**

I believe the STB has dramatically underestimated the true costs to justify inclusion of movements in the comparison group. The STB proposes that after each party submits its final offer comparison group to the STB and justifies its selections, the STB will then select the comparison group that it concludes is most similar in aggregate to the issue movement.^{17/} The STB indicates that it will determine comparability by reviewing a variety of factors presented by the parties, including such factors as length of movement, commodity type, terrain involved, and "other factors which could affect demand characteristics and operating costs."^{18/}

While a shipper may easily identify length of haul and commodity type from data contained in the STB's Waybill Sample, identifying the other comparative factors can make the comparison group identification process very time consuming and costly. Take for example a comparison of the terrain involved in the issue and comparison movements. While the STB may envision that the parties to a

^{15/} See Ex Parte 646 at 20.

^{16/} See Ex Parte 646 at 28.

^{17/} See Ex Parte 646 at 20.

^{18/} See Ex Parte 646 at 20.

Three Benchmark case will attempt to justify including a movement in their comparison group based upon broad generalizations about the terrain along the route, e.g., the issue and the comparison movement both move from North Dakota to Minnesota, the reality will most likely be far different. Based on my experiences in Full SAC analyses, I fully expect that the railroads will present in-depth, detailed evidence challenging the shipper's comparison group, while using equally detailed evidence justifying its own comparison group. Such detailed evidence could include detailed topographical data about the route.

I also believe that terrain is not the only comparative category where the expense to present evidence could dramatically rise. The same can occur in developing train characteristics and other factors impacting operating costs. For example, the issue movement may originate at a location that requires an extensive amount of switching or extra locomotive power. The defendant railroad may present evidence based on direct observation that the shipper's comparison group movements do not have the extensive switching or locomotive requirements as the issue movement, and should therefore be excluded from the comparison group calculation. The shipper would then either have to perform its own study of the comparison group movements to determine if the operating characteristics are similar, or run the risk of having the STB select the defendant railroad's comparison group because it was better supported.

The STB will attempt to hold down such extensive use of evidence by limiting the amount of discovery in Three Benchmark cases. In fact, limiting the amount of data available through discovery will potentially increase the cost of justification by forcing shippers to find alternative sources of data. For example, information that a shipper may easily discern from track charts or train lists may be unavailable due to the discovery limitation proposed by the STB. Such a limitation will force the

shipper either to obtain the required data from another source, such as through direct observation on a field trip, or risk not justifying to the STB's satisfaction, the shipper's choices in its comparison group. In contrast, the rail carrier will have access to this information, and there are no limitations on the rail carrier's use of its own data. Thus the STB's proposal imposes a severe disadvantage on shippers while conferring a clear advantage on the defendant railroad.

Some may reject as hyperbole these concerns about ever-increasing complexity in comparison group selection, but one need only look at the evidentiary "arms race" that has occurred in Full SAC cases to see where this can lead. A perfect example of this phenomenon can be seen by comparing the STB's decision in Docket No. 41191, *West Texas Utilities Company v. Burlington Northern Railroad Company*, Served May 3, 1996 ("WTU") to the publicly available evidence in Docket No. 41191 (Sub-No. 1), *AEP Texas North Company v. BNSF Railway Company* ("AEP Texas"). Both cases involve challenging unreasonable rail rates from the Powder River Basin ("PRB") to the Oklahoma Generating Station through the use of the STB's Full SAC constraint, but the level of detail presented in AEP Texas dwarfs that presented by the parties in WTU. The parties in WTU based their evidence primarily on operating and investment data provided in discovery and on system average railroad statistics. In AEP Texas, both parties based their evidence on a multitude of sources presented by dozens of experts. With regard to the stand-alone railroad's operating plan, the railroad based its operating plan in WTU on its historical average cycle time data and shipper specific average train sizes. In AEP Texas, the parties relied upon computer simulation models that incorporated a multitude of operating factors never explicitly raised in WTU.^{19/}

^{19/} The STB's recommended railroad simulation model, the Rail Traffic Controller, incorporates such factors as track geometry, terrain, locomotive characteristics, signaling and communication and segment specific track outages and slow orders.

The differences between WTU and AEP Texas did not come about from modifications to the Full SAC constraint, but from incremental changes to the complexity of evidence filed by the parties in each succeeding Full SAC case. At every turn, the parties to maximum reasonable rate cases subsequent to WTU produced greater levels of information to justify their own evidence, and/or to refute that of the other party. I believe the same rush to complexity will also occur in the justification of the comparison groups in the STB's proposed Three Benchmark approach. I expect initial cases brought under the proposed Three Benchmark methodology will be more complicated than the STB envisions.

**ii. The Railroads Will Actively Contest
Every Piece Of Shipper Evidence**

The railroads have not only raised the cost of filing a Full SAC analysis by making the evidence more complex, they have also raised the expense to shippers by contesting every evidentiary submission made by shippers. I fully expect the railroads to utilize the same tactic in the STB's proposed simplified procedures to discourage filings of maximum rate cases.

It has become the common practice for railroads to contest every round of evidence in Full SAC cases by filing motions to dismiss and/or strike evidence after every shipper evidentiary filing. For example, in Docket NO. 42057, *Public Service Company of Colorado D/B/A Xcel Energy v. Burlington Northern and Santa Fe Railway Company*, ("Xcel"), the defendant railroad, Burlington Northern and Santa Fe Railway Company ("BNSF"), filed motions to strike the shipper's evidence, to supplement its own evidentiary record and to "clarify" the record after Xcel's opening evidence, after Xcel's rebuttal evidence, after the STB's decision in another rate case and after Xcel's post oral hearing brief. In each case, Xcel was forced to respond to each of the railroad's filings and incur even

greater expense than anticipated. The railroads employed similar tactics of filing additional motions and requests in every subsequent Full SAC case since Xcel.^{20/}

I have every expectation that a railroad faced with contesting a maximum reasonable rate case under the Three Benchmark approach will employ the same tactics. In fact, I believe that post-evidentiary filings would become even more common under the Three Benchmark approach due to the small threshold value of the case. A railroad has every incentive to increase the costs to the shipper of filing a rate case. If the railroad can force the shipper to incur even greater costs by filing numerous extraneous motions, it puts itself in a position to drive the costs above the MVC of the case to the shipper, and discourage similar filings in the future.

**iii. The Estimated Costs to
Present A Three Benchmark Case**

The STB presumes that costs under the Three Benchmark approach will remain low for several reasons. First, the STB believes that a great deal of the preliminary work before a case is filed would be performed by the shipper and not performed by external consultants and attorneys.^{21/} Second, the STB anticipates that its use of unmodified URCS variable costs and limitations on discovery will hold expenses in check.^{22/} Third, the STB expects its comparison group final offer selection process will lead to prompt, expedited resolution to the comparison group selection.^{23/} I do not agree with the STB's rationale. Shippers will ask consultants and attorneys knowledgeable about these procedures to provide an opinion prior to filing a case. The discovery process is an incremental process and the

^{20/} See the public filings in STB Docket No. 42071, *Otter Tail Power Company v. The Burlington Northern and Santa Fe Railway Company* ('Otter Tail'), in AEP Texas, and STB Docket No. 42088, *Western Fuels Association, Inc., and Basin Electric Power Cooperative, Inc. v. BNSF Railway Company* ("WFA/Basin").

^{21/} See Ex Parte 646 at 35.

^{22/} See Ex Parte 646 at 29.

^{23/} See Ex Parte 646 at 20-21.

bulk of the costs will be associated with the comparison group. Whether or not the STB promptly decides the comparison group selection is totally within their purview and will not impact the cost of presenting a case.

The STB draws its \$200,000 presumptive threshold ceiling for a Three Benchmark analysis from testimony presented in its Ex Parte 347 rulemaking.^{24/} By implementing this ceiling, the STB assumes preparing and presenting a Three Benchmark case will cost shippers less than the \$200,000 threshold level. I believe the STB has dramatically underestimated the average costs to prepare and present a case under the STB's proposed Three Benchmark procedures. In actuality, based on my past experience in preparing evidence for maximum reasonable rate cases and other proceedings before the ICC/STB that rely upon Uniform Rail Costing System ("URCS") and Waybill Sample data, I estimate the minimum costs to bring a case using the proposed Three Benchmark approach would equal \$100,000 and could range as high as \$400,000, including consulting and legal fees.

**b. The STB Underestimates The
Cost To Present A SSAC Case**

The STB has set its eligibility threshold for the cost of a SSAC analysis based on its expectations of the future costs to present a Full SAC case. Specifically, the STB believes that shippers may litigate future Full SAC cases for approximately \$3.5 million.^{25/} Therefore, it has set the bounds for use of its proposed SSAC procedures at the expected cost to file a case using the proposed SSAC approach (\$200,000) and the expected cost to litigate a Full SAC case (\$3.5 million).

^{24/} See Ex Parte 646 at 36.

^{25/} See Ex Parte 646 at 36.

I believe that, like its estimates of the cost to present a maximum reasonable rate under the Three Benchmark approach, the STB has very seriously underestimated the cost to a shipper of litigating a case using its proposed SSAC methodology. I hold this view for two reasons. First, the steps involved in the STB's proposed SSAC approach are not nearly as straight-forward as the STB suspects. Second, there are large areas of uncertainty that the STB has not accounted for, which will drive up the cost of cases. And, as is currently happening with Full SAC cases, the railroads will take every opportunity to increase the cost of the case through the filing of repeated motions and petitions.

The STB asserts that its SSAC procedures will differ from a Full SAC analysis by eliminating or restricting the evidence parties may submit on certain issues.^{26/} Specifically, the STB proposes to modify the process as follows:

- *Route* - The shipper will have the right to identify its preferred route. If the shipper chooses a route not currently used by the issue movement, the shipper will need to demonstrate that the selected route has the capacity to handle the additional traffic.
- *Configuration* - The SARR's facilities will replicate the defendant railroad's existing facilities. The shipper will have the opportunity to prove that facilities along the route have fallen into disuse, and thus exclude them from the analysis.
- *Test Year*- The parties will investigate the rates based on a one-year analysis.
- *Traffic Group* - The traffic group will consist of all traffic moving over the selected route. A shipper will not be allowed to reroute non-issue traffic.
- *Cross-Over Traffic* - Cross-over traffic revenues will be allocated using the same method as in a Full SAC analysis.
- *Road Property Investment* - Road property investment ("RPI") will be based on a combination of averages from prior Full SAC cases and actual data.
- *Operating Expenses* - The parties will base operating expenses on modified URCS variable costs for the involved railroad(s).

^{26/} See Ex Parte 646 at 12.

- *Discounted Cash Flow* - Because the SSAC approach will only use a one-year test period, the netting process from the existing discounted cash flow (“DCF”) model can be eliminated.
- *Maximum Reasonable Rate* - The parties will utilize the same rate reduction approach as used in Full SAC analyses as determined by the STB in its Ex Parte 657 proceedings.

In addition to “simplifying” the rate reasonableness tests, the STB also proposes to stream-line the process by altering the discovery process to place a greater initial burden on the defendant railroad. Instead of the railroad providing raw traffic and operating information to the shipper for the shipper to identify and construct traffic groups, traffic revenues and operating costs, the railroad (as part of the railroad’s second disclosure in the SSAC process): 1) will identify all the traffic that moved over the routes replicated by the SARR; 2) will develop total operating and equipment costs for each of the movements included in the traffic group; 3) and create the revenue allocations for the on-SARR portion of each cross-over movement.

While the STB contends that its proposed methodology will stream-line existing Full SAC procedures, and thus eliminate a large portion of the expense associated with a Full SAC analysis, I believe that the STB has not fully considered the ramifications and intricacies of its proposal, and that the amount of work required for various elements in a SSAC case could approach, or even exceed, the cost and complexity of presenting the elements of a Full SAC case.

First, the STB’s proposal to shift the burden of identifying the SARR’s traffic group and developing SARR revenues to the railroad will not reduce the shipper’s cost because the shipper will still need to independently verify the railroad’s data. As it currently occurs in a Full SAC analysis, a shipper receives traffic data from the railroad, identifies a subset of the available traffic for its traffic group, and determines the SARR revenue for the traffic group and develops operating expenses for

the traffic group. Subsequently, after receiving the shipper's opening evidence, the defendant railroad independently verifies the data presented by the shipper by going back to the base supporting data and reproducing the shipper's traffic data and operating expense data looking for any errors of omission or calculation. Under the STB's proposed SSAC approach, the methodology will be reversed with the railroad producing the initial data and the shipper verifying the information. The shipper will still use the same steps as if it was producing the data only in reverse order, meaning that it will face no net decline in expense for this portion of the process. If the shipper does not verify the railroad's traffic and operating expense data, it runs the extreme risk of using an incomplete traffic group, incorrectly calculated revenues or incorrectly calculated operating costs. It will be therefore imperative for the shipper to go through the time and expense to reproduce the railroad's data.

Second, the amount of effort to calculate cross-over revenues will be considerably higher under the SSAC approach compared to a Full SAC analysis. Full SAC procedures allow a shipper to identify a traffic group that maximizes SARR revenues while minimizing operating expenses and RPI.^{27/} This usually entails including in the SARR's traffic group a subset of the actual traffic moving over the replicated route. The SSAC approach will require the inclusion of all traffic moving over the route, which could be several multiples above the amount of effort required in a Full SAC case. For example, on a movement like one the one hypothesized by the STB on page 14 of its Ex Parte 646 decision, which envisions moving grain from the Upper Midwest to the West Coast for export, the number of individual movements included on the route could reach into the thousands. Such a task becomes especially burdensome if the STB adopts its Average Total Cost ("ATC") revenue methodology as proposed in the STB's Ex Parte 657 proceeding, which requires the development

^{27/} See Coal Rate Guidelines at 543.

of the variable cost of movement for both the on-SARR and off-SARR portions of each cross-over move.

Third, several RPI categories, including grading and tunnel investment, still require a shipper presenting a SSAC case to produce independent evidence of actual costs. For example, the STB proposes to have parties use Interstate Commerce Commission ("ICC") engineering reports as the basis for determining the underlying quantities of earth work materials where the ICC developed the information. Where the ICC did not produce this information, the parties will need to present evidence of grading quantities from other sources. As the STB well knows, one of the greatest points of contention in recent Full SAC cases has been grading quantities developed where the ICC did not produce engineering reports. Similar squabbles have also occurred over the costs of building and/or day lighting tunnels. The STB should not expect the parties to see a decline in litigation costs associated with these RPI categories.

Fourth, the STB's decision to retain internal cross-subsidy analyses will force shippers on low-density rail lines to spend considerable sums of money justifying the rerouting of their traffic. The STB proposes to retain the internal cross-subsidy tests set forth in STB Docket No. 42054, *PPL Montana, LLC v. The Burlington Northern and Santa Fe Railway Company*, served August 20, 2002 ("PPL") and Otter Tail as an affirmative defense for the defendant railroad. These tests, which act as a threshold hurdle to presenting a Full SAC case (in the case of the PPL cross-subsidy analysis), and as a limitation on rate reductions (in the case of the Otter Tail cross-subsidy analysis), are especially detrimental to shippers with facilities on low-density, under-utilized rail lines.

Shippers in past Full SAC cases have attempted to overcome this cross-subsidy burden by rerouting the issue traffic, rerouting non-issue traffic or a combination of both.^{28/} As I indicated above, the STB's proposed SSAC procedures would not allow the rerouting of non-issue traffic.^{29/} This will force shippers on light-density rail lines who bring a maximum reasonable rate case under the proposed SSAC approach to attempt to reroute the issue traffic to higher-density segments. However, to reroute the issue traffic under the proposed SSAC approach, a shipper will need to demonstrate that the route selected has sufficient existing capacity to handle the additional traffic.^{30/} The currently accepted norm for demonstrating rail line capacity in maximum reasonable rate cases is the use of a rail simulation model such as the Rail Traffic Controller ("RTC") model.^{31/} Therefore, a shipper that attempts to reroute its issue traffic will almost assuredly be required to perform a simulation to demonstrate that the new route possesses the available capacity. It is this sort of demonstration that the STB acknowledges drives up the cost of Full SAC presentations.^{32/} The STB's proposed SSAC approach will also drive this expense in medium size cases as well. Shippers who do not undertake these costly efforts will lose any chance of relief no matter how captive, and many isolated shippers may have no way of satisfying the segment cross-subsidy test under any circumstances.

^{28/} See, for example, Otter Tail where the shipper rerouted the issue traffic, Xcel where the shipper rerouted non-issue traffic and STB Docket No. 42056, *Texas Municipal Power Agency v. The Burlington Northern and Santa Fe Railway Company*, served March 24, 2003 ("TMPA") where the shipper rerouted both the issue and non-issue traffic.

^{29/} As I will discuss below, the STB has effectively gutted Constrained Market Pricing ("CMP") through its proposed simplifications, including eliminating the bedrock SAC principle of maximizing traffic densities on a SARR. See Coal Rate Guidelines at 543.

^{30/} See Ex Parte 646 at 12.

^{31/} See Xcel at 27 and Otter Tail at 18.

^{32/} See Ex Parte 646 at 11.

Fifth, a shipper can expect to spend considerable funds proving facilities along the route of movement have fallen into disuse. The shipper using the proposed SSAC approach must construct a hypothetical SARR that consists of the existing facilities (including all track, sidings, and yards) along the selected route.^{33/} The STB has indicated though that a shipper may exclude facilities along the route that have fallen into disuse by the railroad if the shipper provides “compelling evidence.”^{34/} It is unclear from the Ex Parte 646 decision what evidence the STB would consider “compelling,” but based on prior STB decisions, I believe the STB would accept nothing less than documentation produced by the railroad that the railroad no longer uses a particular facility, or demonstrations of physical evidence such as photographs and field report summaries proving the subject facilities have fallen into disuse. It is highly unlikely, based on my experiences in Fall SAC proceedings, that a defendant railroad will willingly provide the necessary evidence through the discovery process to prove that it no longer uses a facility.^{35/} Therefore, the shipper attempting to prove a facility had fallen into disuse will most likely rely upon physical inspection and observation to prove that a railroad no longer uses a particular facility. This will entail the shipper retaining outside consultants and engineers to perform the physical inspections and observations, thus once again increasing the cost and the complexity of the SSAC approach.

Sixth, under the STB’s proposed SSAC procedures, even if a shipper does prevail and the STB determines the rate unreasonable, the shipper will still have to prepare and present evidence each year for an additional four (4) years. The STB proposes to only test a rate for reasonableness during a

^{33/} See Ex Parte 646 at 12.

^{34/} See Ex Parte 646 at 12.

^{35/} The STB and the ICC have long noted the railroads’ propensity for withholding critical data from discovery. See, for example, ICC Docket No. 37038, *Bituminous Coal - Hiawatha, Utah to Moapa, Nevada*, 10 ICC 2d 259 (263) (“Nevada Power II”) and STB Docket No. 42022, *FMC Wyoming Corporation and FMC Corporation v. Union Pacific Railroad Company*, Served May 10, 2000 (“FMC”) at 31.

one-year test period analysis.^{36/} If the STB finds the rate unreasonable for the test year, it will prescribe rates only for that year. Each subsequent year, the shipper and the railroad will have to then “update” their traffic and operating cost analyses to reflect any changes.^{37/} This updating will require each party to completely redevelop the traffic group volumes and revenues and recalculate operating expenses.^{38/} As I indicated above, developing SARR traffic revenues can be expected to be one of the most complex and costly portions of the proposed SSAC procedures, especially if the STB adopts the proposed ATC revenue methodology. Under the STB’s proposal, not only would a shipper have to absorb this expense during the initial round of evidence, but absorb this expense every year for an additional four years after a decision is rendered.

**i. The Railroads Will Take Every Opportunity
To Raise The Expense Of A SSAC Presentation**

As I indicated above, the railroads have taken every step possible in recent cases to increase the cost of filing a maximum reasonable rate case, and I have every expectation that a railroad faced with contesting a maximum reasonable rate case under the STB’s proposed SSAC approach will employ the same tactics. In fact, for the same reasons I cited above for the proposed Three Benchmark approach, I believe that post evidentiary filings would become even more common under the SSAC approach due to the smaller threshold value of the case relative to that of a Full SAC analysis. A railroad has every incentive to increase the costs to the shipper of filing a rate case. If the railroad can force the shipper to incur even greater costs by filing numerous extraneous motions, it puts itself

^{36/} See Ex Parte 646 at 14.

^{37/} Under the STB’s proposal, RPI cost will remain unchanged. See Ex Parte 646 at 56.

^{38/} As I indicated earlier, it is completely unrealistic to simply adopt the railroad’s traffic, revenues and operating costs calculations without thoroughly examining and vetting the analyses. A shipper will ultimately be forced to reproduce the railroad’s results to confirm their accuracy.

in a position to drive the costs above the MVC of the case to the shipper, and discourage similar filings in the future.

**ii. The Estimated Costs
To Present A SSAC Case**

As I indicated above, the STB states in its Ex Parte 646 decision that it expects the minimum cost to bring a small shipper rate case using the SSAC approach would range between \$25,000 to \$85,000, excluding attorney fees, based on testimony received during the Ex Parte 347 proceedings.^{39/} These cost levels, which were presented by two railroad witnesses, reflect the costs to bring a maximum reasonable rate case using the AAR's proprietary simplified SAC procedure presented in the Ex Parte 347 hearings. The STB believes it will require approximately the same level of effort to develop a rate case under the STB's proposed SSAC as under the AAR's Ex Parte 347 proprietary procedures because both methods used system-wide figures to estimate operating costs, and investment expenses from prior Full SAC cases.

I disagree with the STB's contention that the cost to present a case using the AAR's Ex Parte 347 simplified SAC procedure should be similar to the costs to prepare and present a case using the STB's proposed SSAC. While the AAR's Ex Parte 347 approach and the STB's proposed SSAC method both arguably use railroad average operating and investment costs, the SSAC procedures as proposed by the STB have so many options and so many unresolved questions that the cost will most assuredly be far higher than \$200,00 and in some cases exceed the \$3.5 million threshold for a Full SAC case.

^{39/} See Ex Parte 646 at 36.

As a threshold matter, I believe the STB has understated the costs to accurately and effectively present a Full SAC analysis as well as a SSAC analysis. The cost to present a Full SAC analysis is relevant to the application of the SSAC method because the STB defines the eligibility to use the SSAC approach, in part, by the expected costs to present a Full SAC analysis. Therefore, to address the SSAC issue, I must first address the issue of the cost to present a Full SAC analysis. The STB holds that a shipper can expect to reasonably spend approximately \$3.5 million to present a Full SAC analysis, including consulting and legal fees, taking into consideration the STB's proposed Ex Parte 657 procedures on the cost of evidence preparation and presentation.^{40/} Based on my experiences in developing evidence in prior Full SAC cases and in analyzing the STB's proposed Ex Parte 657 procedures, I conclude the STB has underestimated the costs for a Full SAC case. I estimate the minimum consulting fees to present a Full SAC analysis would equal \$2.25 million, and could run upwards of \$4.0 million depending upon the complexity of the case and the number of rounds of evidence required.^{41/} I base these figures on the costs incurred in prior SAC proceedings and on the level of effort involved in the STB's Ex Parte 657 procedures.^{42/} If we assume legal fees are 75 percent of the total consulting fees, then the costs to present a Full SAC analysis will run between approximately \$4 and \$7 million.^{43/}

^{40/} See Ex Parte 646 at 36.

^{41/} While three rounds of evidence are required by the STB's regulations, the nine most recently decided maximum rate cases had between 3 and 7 rounds of evidence.

^{42/} The STB presumably believes the costs to present a Full SAC case under its proposed Ex Parte 657 procedures will decline due to the elimination of movement specific adjustments in the calculation of variable costs. However, the effort to calculate movement specific variable costs is minor compared to the effort to develop the SAC for a case. I believe any cost reductions from using unadjusted URCS Phase III costs instead of movement specific costs will be more than offset by the increase in the costs to develop SAC under the proposed Ex Parte 657 procedures.

^{43/} I must also note that these are only external consultant and legal fees, and do not include the internal company costs to the shipper to bring a maximum reasonable rate case.

Given that the STB plans to utilize many of the same Ex Parte 657 procedures in its SSAC analysis as it plans on using in a Full SAC analysis, I believe the cost to prepare a SSAC analysis will be much, much higher than the \$200,000 figure estimated by the STB. I estimate, based on the expected analyses required, that the minimum consulting fees to present a SSAC analysis will be approximately \$1 million and could run as high as \$2 million. The full extent of the fees is really out of the hands of the shipper and in the hands of the railroad and the STB. Shippers cannot control the level of a railroad's attack in a case and the number of supplemental rounds of evidence the STB will require. It is the level of the railroad's attack and the number of rounds of evidence required by the STB that drive up many of the costs.^{44/} Since consulting fees for a SSAC analysis will range from \$1 to \$2 million and assuming legal fees will equal approximately 75 percent of consulting fees, I estimate the total external costs of a SSAC analysis will run between \$1.75 to \$3.5 million.^{45/}

2. The STB's Proposed Aggregation Rules Are Unrealistic

As I indicated above, the STB proposes to impose several restrictions and rebuttable presumptions on the MVC calculations to guard against what it terms "manipulation of its eligibility standards."^{46/} These restrictions would include limiting rate relief to five (5) years, curtailing the scope of the rate relief to the volume of traffic included in the MVC calculation, and limiting all claims brought within a two (2) year period that involve the same defendant railroad and the same captive origin or destination. If the shipper brought one or more rate cases within two (2) years for

^{44/} The railroads, or their surrogates, will argue that shippers could lower their costs in presenting a maximum reasonable rate by producing and presenting "better" evidence. This is a hollow argument. In recent Full SAC cases where shippers have presented operating and traffic evidence that the railroads have accepted the majority of, the railroads have developed new arguments and attacks that drive up the cost even further.

^{45/} As before, these only reflect external costs to the shipper and do not take into consideration internal company costs to bring a maximum reasonable rate case.

^{46/} See Ex Parte 646 at 36.

movements from the same captive origin or the same captive destination against the same defendant railroad, the STB would aggregate the MVC from these movements in determining the eligibility of use of a rail rate standard.

The aggregation rule proposed by the STB would effectively force even the smallest of shippers to use the more complex SSAC analysis, or spend the time and money justifying its reasons to use the less complex Three Benchmark approach. This is because the STB's flawed eligibility criteria do not take into consideration the route of the effective shipments, only the origins and destinations. Without explicitly taking into consideration the routing of the movements, the eligibility criteria proposed by the STB will produce absurd results.

I have developed the following hypothetical example to demonstrate the faults with the STB's proposed aggregation requirement. Assume a small manufacturing company located in Denver, CO and served exclusively by the BNSF ships a total of three (3) railcars per week or 156 cars per year. The manufacturer's customers are located in Seattle, WA, Los Angeles, CA, Chicago, IL and Houston, TX, and each customer receives 39 cars per year ($156 \text{ cars} \div 4 \text{ destinations}$), or approximately one (1) car every 10 days ($156 \text{ cars} \div 39 \text{ cars}$). Now also assume, for simplicity sake, that the proposed rates and variable costs for each origin destination pair equal \$1,920 and \$600 per car, respectively.^{47/} As Table 1 below shows, the MVC for each individual origin/destination pair is well below the \$200,000 threshold eligibility level for the use of the STB's proposed Three

^{47/} This assumption that the shipments would face similar rates and costs is realistic because the mileages between the origin and the various destinations are fairly close. However, I have set the average rate per car purposely low to demonstrate the impact on the eligibility level. If the rate in the hypothetical example were set at \$2,500 per car, rates which are common amongst chemical and agricultural shipments, the number of annual carloads shipped to surpass the base eligibility level would dramatically fall.

Benchmark approach.^{48/} However, when I aggregate the movements as required by the STB's proposed eligibility standards, the MVC raises to almost two and one-half times the eligibility threshold.

^{48/} Since the individual movements have the same rates and variable costs, the MVC is the same for each movement.

Table 1
Hypothetical Example of Impact Of
The STB's Proposed Aggregation Requirements

Item (1)	Individual Movements (2)	Aggregate Movements (3)
1. Aggregate Five Year Revenues At The Issue Rate ^{1/}	\$374,400	\$1,497,600
2. Aggregate Five Year Revenues At The JT Rate ^{2/}	\$210,600	\$842,400
3. Aggregate Difference in Issue and JT Revenues ^{3/}	\$163,800	\$655,200
4. Five Year Discount Factor at 12.2 Percent ^{4/}	1.242	1.242
5. Maximum Value of the Case ("MVC") ^{5/}	\$131,884	\$527,536

^{1/} Column(2): \$1,920 per car x 39 cars per year x 5 years. Column (3): \$1,920 per car x 156 cars per year x 5 years.

^{2/} Column (2): \$600 per car x 180% x 39 cars per year x 5 years. Column (3): \$600 per car x 180% x 156 cars per year x 5 years.

^{3/} Line 1 - Line 2.

^{4/} Discount factor assuming a 12.2% annual cost of capital and cash flows occur at the beginning of each year.

^{5/} Line 3 ÷ Line 4.

As Table 1 above demonstrates, the STB's proposed aggregation rules would require this small shipper to either use the more complex and costly SSAC methodology, or present evidence as to why the STB should allow it to use the Three Benchmark methodology.

Moreover, the use of a SSAC analysis for the hypothetical example would be completely unrealistic. Because the shipper ships railcars to four distinct corners of the BNSF's system (Los Angeles, Seattle, Chicago and Houston), the STB's proposed SSAC approach would require the shipper to reproduce the infrastructure along a majority of the BNSF's major routes. This would require the determination of cross-over revenues for a gigantic amount of BNSF's traffic base and could easily entail sending teams of consultants and engineers over nearly two-thirds of the

continental U.S. reviewing the infrastructure along the rights-of-way for each aggregated movement. The costs to inspect the track alone would be enormous. When the costs to verify the traffic for this mega-SARR is included, the costs would certainly be prohibitive, considering the shipper only moves three cars per week.

3. The MVC Is Subject To Manipulation By The Railroad

The STB goes to great lengths to guard against a shipper “manipulating” the STB’s proposed eligibility requirements. The STB’s proposed eligibility requirements, however, take little or no action to guard against the railroads manipulating MVC calculations by setting extremely high issue rates and forcing shippers into a more complex rate analysis.

The STB’s proposed MVC calculation requires four (4) inputs: 1) the movement’s rate; 2) the movement’s variable cost; 3) the movement’s historic or prospective volumes; and 4) the railroad industry cost of capital. Of the four inputs, two are completely outside of the shipper’s control (the movement’s rate and the railroad industry cost of capital), one is slightly impacted by the shipper (the variable costs) and one is completely under the shipper’s control (annual shipment volumes).^{49/} The STB’s proposed eligibility standards limit how much a shipper may adjust traffic volumes in the MVC calculation through the standard’s aggregation requirements. However, the STB places no limits on the one factor, the issue rate level, that is completely under the control of the railroad. A railroad can easily push the MVC well above the threshold eligibility level by setting the rate high enough. I demonstrate this fact in Table 2 below.

^{49/} I believe the variable cost of a movement is slightly impacted by the shipper’s ability to use either railroad provided railcars or provide its own railcars. The vast majority of the other variable cost factors are out of the shipper’s control.

Table 2
**Hypothetical Example Of The Impact
Of Different Rate Levels On The MVC**

Item (1)	MVC at \$1500 Per Railcar (2)	MVC at \$3,000 Per Railcar (3)
1. Aggregate Five Year Revenues At The Issue Rate ^{1/}	\$390,000	\$780,000
2. Aggregate Five Year Revenues At The JT Rate ^{2/}	\$280,800	\$280,800
3. Aggregate Difference in Issue and JT Revenues ^{3/}	\$109,200	\$499,200
4. Five Year Discount Factor at 12.2 Percent ^{4/}	1.242	1.242
5. Maximum Value of the Case ("MVC") ^{5/}	\$87,922	\$401,932

^{1/} Column(2): \$1,500 per car x 52 cars per year x 5 years. Column (3): \$3,000 per car x 52 cars per year x 5 years.

^{2/} Columns (2) and (3): \$600 per car x 180% x 52 cars per year x 5 years (same cost level as Table 1 example).

^{3/} Line 1 - Line 2.

^{4/} Discount factor assuming a 12.2% annual cost of capital and cash flows occur at the beginning of each year.

^{5/} Line 3 ÷ Line 4.

As Table 2 above shows, setting the rate level for a hypothetical move at \$1,500 per car and assuming a variable cost of \$600 per car and 52 cars shipped per year produces a MVC of \$87,992, which is well below the eligibility threshold for the use of the Three Benchmark approach. If, however, the railroad sets the issue rate at \$3,000 per car instead of \$1,500 per car, the MVC increases to over twice the Three Benchmark eligibility level of \$200,000.^{50/}

Some will argue that the STB's proposed eligibility standards protect shippers from such manipulation by the railroads by providing the shipper the opportunity to rebut the eligibility

^{50/} The reason the MVC increases by a over a factor of four (4) while the issue rate only increases by a factor of two (2) is due to the variable cost for the movement being held constant. Stated differently, the \$1,500 per car differences between the two rates accrues directly to the bottom line of the MVC calculation.

presumption. I believe this is an invalid argument because it ignores the costs associated with developing and presenting evidence to overcome the presumptive eligibility. The STB states it has proposed these simplified guidelines to meet the statutory goal of providing shippers meaningful access to regulatory remedies for unreasonable rail rates.^{51/} Leaving the threshold key to such relief in the hands of a defendant railroad and foisting upon the shipper the costs associated with rebutting the railroad actions does nothing to meet the statutory goal, and in fact places another obstacle in the way of meeting this goal.

**4. The MVC Has No
Relation To The AVC**

The STB proposes to base threshold eligibility levels for its different rate reasonableness standards upon the MVC.^{52/} As a fundamental issue, the STB's proposed approach for estimating the MVC presumes the rate reasonableness standards proposed by the STB will produce rates at the JT rate level. However, I contend that there is almost no possibility of a rate prescription at the JT level under any of the proposed maximum rate approaches as currently proposed or employed by the STB. This fact leads to a complete disconnect between the value the STB's expects a shipper to receive and the value the shipper will actually receive. This difference in values will effectively preclude shippers from using the STB's proposed standards. Indeed, the actual value of a case ("AVC") in all likelihood will be far lower than the MVC.

**a. Neither The Three Benchmark Nor The SSAC Approaches
Can Be Expected To Produce Rates At The JT Rate Level**

^{51/} See Ex Parte 646 at 3.

^{52/} See Ex Parte 646 at 33.

The STB's proposed MVC estimates rest upon the fundamental assumption that the STB will set the challenged rate at the JT rate level.^{53/} I believe that there is virtually no possibility that the STB will set a rate at the JT level under its proposed SSAC and Three Benchmark approaches, or under the existing Full SAC procedures as current applied by the STB. I base my contentions upon the results of recent STB decisions in Full SAC cases and upon the limitations and restrictions the STB proposes to place on SSAC and Three Benchmark calculations.

**i. JT Rate Levels In SAC
And SSAC Proceedings**

Prior to its decision in TMPA, the STB, and its predecessor the ICC, exhibited no clear trend in prescribing rates under the SAC constraint. For example, the STB/ICC found the issue rates in Nevada Power II and STB Docket No. 37809, *McCarty Farms, Inc., Et Al v. Burlington Northern Inc.*, served August 20, 1997 ("McCarty") to be reasonable under the SAC constraint. However, in WTU and STB Docket No. 42051, *Wisconsin Power and Light v. Union Pacific Railroad Company*, served September 3, 2001 ("WPL") not only did the STB determine the issue rates to be unreasonable, but determined that the SAC rates were below the movement's JT rate levels. Finally, in FMC and STB Docket No. 41185, *Arizona Public Service Company and PacifiCorp v. The Atchinson, Topeka and Santa Fe Railway Company*, served July 9, 1997 ("APS"), the STB found the issue rates to be unreasonable, but that the SAC rates exceeded the JT rate level.

Since its decision in WPL, the STB has entered what it euphemistically calls its "sophisticated" era of SAC analysis, whereby the STB has determined no SAC rate to be below the JT rate level.^{54/}

^{53/} In reality, the rate reasonableness test only establishes the rate. A secondary test determines whether the rate produced is at or below the JT rate level.

^{54/} See Ex Parte 646 at 40.

During this time span, the STB has found only the rates in Xcel and TMPA to be unreasonable, and in both of those cases, the SAC rates were well above the JT rate levels. .

The fact that it is very unlikely that a Full SAC analysis will produce a rate below the JT rate level given current conditions, indicates to me that there is virtually no possibility that a rate adjudicated under the STB's proposed SSAC approach will produce a rate at the JT rate level. I base this contention on the STB's own admission that the SSAC process will produce less precise results than a Full SAC analysis, and will exclude the assumed efficiencies of the Full SAC procedures.^{55/} These limitations of the SSAC approach will necessarily dictate that a rate analysis undertaken using the SSAC process will, at best, produce results equal to a Full SAC analysis, and, in the vast majority of cases, produce rates above that of a Full SAC analysis. Exhibit No. 2 to this verified statement details the reasons for this conclusion. Overall, I believe it unlikely under current STB conditions and rulings that a Full SAC analysis will show a contested rate is below the JT rate level. It therefore goes without saying that a rate adjudicated under the proposed SSAC approach will not lead to a rate prescribed at the JT rate level.

^{55/} See Ex Parte 646 at 11.

ii. **JT Rate Levels In Three
Benchmark Proceedings**

It is mathematically impossible for the STB's proposed Three Benchmark methodology of rate reasonableness to produce a prescribed rate at or below the JT rate level when the movement is wholly on a railroad that is revenue inadequate as defined by the STB. Moreover, it is highly improbable that a rate on a revenue adequate railroad will be at or below the JT rate level.

The STB's proposed Three Benchmark methodology bases its rate reasonableness standard and its rate prescription process primarily on the determination of an average Revenue to Variable Cost ratio ("R/VC") for a comparison group of movements. Specifically, the STB will calculate the average R/VC ratio for a comparison group of traffic, and adjust this average R/VC by factors to account for a railroad's level of revenue adequacy and to account for statistical variation within the sample set.

As the STB describes in its Ex Parte 646 decision, the members of the comparison group will include, at a minimum, shipments that have the same 2-digit STCC code as the issue movement and have an R/VC above 180 percent.^{56/} The STB will also adjust the average R/VC ratio for the comparison group by the ratio of the defendant railroad's RSAM to R/VC_{total} . The STB included this adjustment to address the railroads' alleged revenue inadequate status. If the defendant railroad is revenue inadequate, then the RSAM to R/VC_{total} ratio will always be greater than one (1).^{57/}

^{56/} See Ex Parte 646 at 33. This is not to infer that these are the only criteria for selection of a comparison group. Other factors can include mileage, car ownership, origin and destination regions or a multitude of other factors.

^{57/} The STB defines R/VC_{total} as total railroad revenue divided by total railroad variable costs ($REV_{total} \div VC_{total}$), and defines RSAM as total railroad revenue plus total railroad revenue shortfall or overage divided by total railroad variable cost $[(REV_{total} + REV_{short/overage}) \div VC_{total}]$. The railroad revenue shortfall or overage factor is determined as part of the annual railroad adequacy determination, and is a positive figure if there is a shortfall, or a negative figure if there is an overage. If the railroad is revenue inadequate, the numerator of the ratio (RSAM) will be greater than the denominator (R/VC_{total}) leading to an adjustment factor greater than one (1).

These two constraints to the Three Benchmark methodology preclude a prescribed rate, for any railroad deemed revenue inadequate, above the 180 percent JT rate level. This is because the movements in the comparison group must by definition have R/VC greater than 180 percent and the revenue adequacy adjustment factor must be greater than one (1) for a revenue inadequate railroad. Page 1 of Exhibit No. 3 to this verified statement demonstrates the impact of the two constraints. As Page 1 of Exhibit No. 3 shows, even if the average R/VC is at the 180 percent threshold and the railroad is revenue inadequate under current STB revenue adequacy regulations, the resulting prescribed rate by definition must be above the 180 percent JT rate level. The STB's Three Benchmark constraints provide no other alternative.

For the Three Benchmark method to produce a prescribed rate below the JT rate level i.e., less than 180 percent, several unique conditions must occur. First, the railroad must be revenue adequate under STB guidelines. A revenue adequate railroad will have a RSAM less than R/VC_{total} and produce an adjustment factor of less than one (1). Application of this lower reduction factor has the potential to reduce the comparison group's average R/VC below the 180 percent JT threshold level. I demonstrate this occurrence on Page 2 of Exhibit No. 3.

Second, the R/VC of the comparison group must be relatively close to the 180 percent JT threshold rate level, or else the reduction applied by the RSAM to R/VC_{total} will not counteract the increase in the movement's R/VC ratio. In general, assuming all members of the comparison group have the same R/VC, for every 0.01 decline in the railroad's RSAM to R/VC_{total} ratio, the R/VC of the comparison group can increase by 1.8% and retain the same average R/VC ratio. For example,

If the railroad has unitary revenue adequacy, i.e., the revenue shortfall or overage is zero (0), then the RSAM and R/VC_{total} will equal and the adjustment factor will equal one (1).

as shown in Page 2 of Exhibit No. 3, while the R/VC for the shipments in the comparison group have increased by 1.8% above the JT threshold level, the prescribed rate would produce a R/VC at the JT level due to the mitigating influence of the RSAM to R/VC_{total} ratio.

Third, there must be very little variance in the R/VC for the shipments in the comparison group. If not, the confidence interval adjustment factor will increase the R/VC for the prescribed rate above the JT threshold level. Page 3 of Exhibit No. 3 shows the impact of increasing the R/VC on half the shipments by only 3%. Even this small variance pushes the R/VC for the prescribed rate above the 180 percent JT threshold level.

In sum, if the STB determines a railroad is revenue inadequate, there is no mathematical possibility that a rate prescribed under the Three Benchmark approach will be below the JT rate level. In addition, many factors must be perfectly aligned before STB's proposed Three Benchmark method will produce a prescribed rate at or below the JT rate level for a revenue adequate railroad. It is for this reason that I believe that there is very little chance a rate developed using the STB's Three Benchmark approach will produce a rate at the JT rate level.

**b. The Disconnect Between The MVC And The AVC
Will Preclude The Use Of The Proposed Procedures**

The fact that the MVC of a case has no relationship to the AVC will preclude many shippers from utilizing the STB's proposed procedures. One can most accurately see the disconnected relationship between these two factors by reviewing the MVC and AVC from prior Full SAC cases. Table 3 below displays the MVC and AVC from the STB's seven (7) most recently decided SAC cases.

Table 3
The MVC And AVC Of Historic Full SAC Cases

<u>SAC Case</u> (1)	<u>MVC</u> (2)	<u>AVC</u> (3)	<u>% Difference</u> ^{1/} (4)
1. Otter Tail ^{2/}	\$15,892,081	\$7,484,387	52.9%
2. Xcel	\$27,956,470	\$11,139,532	60.2%
3. Duke/NS ^{3/}	\$284,823,356	\$0	<u>6/</u>
4. Duke/CSX ^{4/}	\$33,478,269	\$0	<u>6/</u>
5. CP&L ^{5/}	\$188,917,973	\$0	<u>6/</u>
6. PPL	\$6,578,284	\$0	<u>6/</u>
7. TMPA	\$17,366,771	\$3,187,143	81.6%

^{1/} [Column (3) ÷ Column (2)] - 1.

^{2/} Based on the SAC rate before application of the STB's cross-subsidy analyses tests.

^{3/} STB Docket No. 42069, *Duke Energy Corporation v. Norfolk Southern Railway Company*, served November 6, 2003 9 ("Duke/NS").

^{4/} STB Docket No. 42070, *Duke Energy Corporation v. CSX Transportation, Inc.*, served February 4, 2004 ("Duke/CSX").

^{5/} STB Docket No. 42072, *Carolina Power & Light Company v. Norfolk Southern Railway Company*, served October 20, 2004 ("CPL").

^{6/} STB found the challenged rate to be reasonable and therefore there is no AVC.

As Table 3 above demonstrates, even in Full SAC analyses where history indicates that a shipper may receive a rate prescription at the JT rate level, the AVC of more recent Full SAC cases have been dramatically below the MVC.

Extrapolating this precedent to the current situation, I believe that it is plausible that the difference between AVC and MVC for cases brought under the SSAC and Three Benchmark approaches will be greater than the differences identified in Table 3 for Full SAC cases. I base my conclusion on the limitations of the proposed procedures discussed above and information provided by the United States Government Accountability Office ("GAO").

First, by definition a SSAC result will produce a less precise and more adverse answer from a shipper's perspective than a Full SAC analysis. Moreover, based on Table 3 above, the simple average AVC in a Full SAC case when SARR revenues exceeds SAC is approximately 64.9 percent of the MVC.^{58/} From this I would expect SSAC would produce a greater difference between AVC and MVC than produced in Table 3 on Full SAC cases.

I would expect similar results from the Three Benchmark approach based on evidence from a recent GAO study. In a recently published study "Freight Railroads: Industry Health Has Improved, but Concerns about Competition and Capacity Should be Addressed," the GAO found that, based on the STB's unmasked Waybill Sample, 25 percent of tons move at rates with R/VC between 180 and 300 percent, while 6 percent of railroad tonnage moves at rates with R/VC greater than 300 percent.^{59/} Assuming a uniform distribution of rates in the 180 to 300 percent band of shipments indicates the average R/VC is approximately 240 percent.^{60/} Moreover, a shipper will only bring a rate case under the Three Benchmark Analysis if initial results indicate that the issue rate is above the expected average R/VC. This would indicate that a rate, on average, must be above 240 percent for a shipper to bring a rate case. Since I have assumed a uniform distribution, I would estimate that an average issue rate would have an R/VC midway between the average and the 300 percent maximum, or an average R/VC of 270 percent.

^{58/} $(59.9\% + 60.2\% + 81.6\%) \div 3 = 64.9\%$

^{59/} See GAO Report GAO-07-94 at 33. Because the proposed Three Benchmark approach only considers rates above the 180 percent JT threshold level, I am only concerned with the 31 percent of the STB's Waybill Sample with R/VC greater than 180 percent.

^{60/} This result is consistent with my analysis of BNSF's shipments in the 2004 and 2005 Waybill Samples with R/VC of greater than 180 percent, which found the average BNSF R/VC to equal 242 percent and 247 percent in 2004 and 2005, respectively.

Assuming these factors, the AVC of the case would be based on the difference between the issue R/VC of 270 percent and the average R/VC of 240 percent, or 30 percent of the variable cost. In contrast, the MVC would be based on the difference between the issue R/VC of 270 percent and the JT R/VC of 180 percent or 90 percent of the variable cost. Dividing the AVC of 30 percent of variable cost by the MVC of 90 percent of the variable cost produces a difference of 66.6 percent, slightly higher than the average difference from prior Full SAC cases.

**5. The STB's MVC Formula
Overstates The Discounted Cash Flows**

As I indicated above, the STB did not provide a detailed mathematical formula for its MVC calculation in its July 26, 2006 Ex Parte 646 decision, but did provide an MVC equation in its September 25, 2006 decision in the proceeding denying a workpaper requests seeking the support behind the STB's July 26, 2006 Table 2 calculations. I presume that the MVC equation included in the STB's September 25, 2006 decision reflects the STB's proposed procedures for calculating the MVC in other cases. If my presumption is correct and the STB will utilize its September 25, 2006 equation in determining the MVC, then the STB's proposed method of calculating will unfairly overstate the MVC and push shippers into higher eligibility classes.

The MVC equation proposed by the STB would discount the difference between the annual revenues based on the issue rate and the annual revenues based on the 180 percent JT rate level over a 5 year period. The STB's proposed MVC formula begins the discounting in Year 0, and continues the discounting through Year 4. Discounting cashflows in such a manner implicitly assumes that the shipper receives its cashflows on the first day of each analysis year. Stated differently, the STB's proposed MVC calculation assumes that all of the shipper's movements will occur on the first day

of each year of the 5 year period. This is clearly a nonsensical position, since most non-agricultural shippers will ship products evenly through out the year.^{61/}

The impact of assuming a beginning of the year discount convention is to artificially raise the calculated MVC due to the time value of money. Simply stated, a dollar received today has more value than a dollar received one year from now. Similarly, assuming a shipper receives all of its cash at the beginning of the year will create a higher MVC than if the cash was received at the end of the year. Since shippers would not receive their cash on the first day of the year, but would theoretically receive their cash through out the year as they make their shipments, the MVC should not assume to the contrary.^{62/} A more accurate and fair MVC calculation would assume a mid-year convention, which implicitly assumes that the shipper receives half of the cash in the first half of the year and the remainder in the second half. Mathematically, the STB can achieve this result by beginning its discount period at Year 0.5 instead of Year 0, and continuing in annual increments to Year 4.5.

^{61/} Even agricultural shippers, who ship based on the growing seasons, do not ordinarily ship all of their product on a single day of the year and will spread their shipments over several weeks or months.

^{62/} I term the cash received as "theoretical" since the shipper will not receive a check from the railroad for the difference between the revenues based on the issue rate and the revenues based on the JT rate each time it makes a shipment. However, from a discounted cash flow standpoint, this is what is presumed to occur.

III. APPLICATION OF THE PROPOSED THREE BENCHMARK APPROACH

Under the STB's proposed Three Benchmark methodology, the STB will determine the reasonableness of the rate by comparing the challenged rate's R/VC ratio to the adjusted average R/VC ratios for a comparison group of traffic. Specifically, the STB proposes to use the following methodology:

1. Upon determination of eligibility to use the Three Benchmark approach and the enactment of the necessary confidentiality agreements, the STB will release to the shipper and the railroad all movements in the STB's most recent masked Waybill Sample that have the same 2-digit STCC code as the issue movement and have an R/VC above 180%.
2. Using data from the masked Waybill Sample, the shipper and the railroad will identify their initial evidence of an appropriate comparison group.
3. After receipt of the initial evidence, the STB will convene a technical conference in an attempt to resolve any disputes between the parties as to the appropriateness of movements in the comparison groups.
4. Each party will then tender its "final offer" group of movements it believes should comprise the comparison group. Only movements previously submitted by one of the parties will be allowed to be included in a party's final offer group, and any movement set forth in both parties' initial tender will be required to be included in each side's final tender, unless both parties agree to exclude the movement.
5. After submission of the final offer comparison groups, each party will have an opportunity to challenge the other party's comparison group and support its own comparison group in simultaneous rebuttal filings. The STB will then select the comparison group that it concludes possess the most similarities, in aggregate, to the issue movements.
6. The STB will then adjust the R/VC for each movement in the comparison group by the ratio of the RSAM to R/VC_{total} and calculate the mean and standard deviation of the R/VC ratios, weighted in accordance with the proper sampling factors.
7. Using the mean and standard deviation of the adjusted R/VC ratios for the comparison group, the STB will calculate a 90 percent confidence interval around the adjusted mean R/VC ratio.

8. If the STB determines the R/VC for the issue movement exceeds the upper bound of the 90 percent confidence interval of the adjusted mean R/VC of the comparison group, the STB will deem the rate unreasonable, and set the prescribed rate at the average adjusted R/VC for the comparison group.
9. Only at the end of the proceedings, would the STB unmask the revenues for the movements included in the comparison group. The parties could then examine the underlying data used to determine the reasonableness of the issue rate.

The STB contends that the above approach will provide captive shippers with small disputes a practical means for challenging the reasonableness of a rail rate.^{63/}

While the STB may contend that its proposed Three Benchmark approach will provide access to rate relief for small shippers, I believe that several flaws and biases endemic to the approach will preclude its use by shippers in its current form. Specifically, the selection of the comparison group from the STB's Confidential Waybill Sample is inherently biased in favor of the railroads. Second, the use of any Waybill Sample data, whether masked or unmasked, is biased because the Waybill Sample does not account for all allowances and rebates given by railroads. Third, the development of the confidence interval only serves to increase the maximum reasonable rate, and, in addition, is unreliable because the movements in the comparison group are not randomly generated. Fourth, there is too much uncertainty surrounding outcomes from the Three Benchmark approach to allow shippers to gauge their prospective results. I address each of these issues below under the following topical headings:

- A. The Selection Of The Comparison Group Is Biased In Favor of the Railroads
- B. The Waybill Sample's Revenues Are Biased

^{63/} See Ex Parte 646 at 28.

- C. The Procedures For Developing Confidence Intervals Are Unnecessary And Unreliable
- D. The Three Benchmark Approach Is Too Uncertain As Proposed

**A. THE SELECTION OF THE COMPARISON
GROUP IS BIASED IN FAVOR OF THE RAILROADS**

The STB proposes that the parties to a Three Benchmark rate case select comparison movements from data contained in the STB's confidential Waybill Sample.^{64/} The Waybill Sample consists of a sample of carload waybills for terminating shipments by all rail carriers that terminate at least 4,500 carloads, or 5 percent of the carloads in any one state. The Waybill Sample identifies the originating and terminating freight stations, the names of the railroads included in the movement, the interchange points, the number of cars, the car types, the weight in tons, the commodity type, and the freight revenue. To protect confidential contract revenue information, the STB allows the carriers when submitting waybill revenue data to mask the revenue information to safeguard confidentiality, but requires the railroads to provide it with information to "unmask" the confidential revenue data.

The fact that the railroads are the originators of the data included in the Waybill Sample, and therefore have access to the unmasked revenue data for any potential comparison group on their individual railroads, creates an information bias that favors the railroad and places the shipper at a clear disadvantage in a case. A railroad entering into a Three Benchmark adjudication may use the unmasked revenue data to identify movements to include in its comparison group that will drive a higher average R/VC ratio when the STB ultimately reveals the actual revenue data at the end of the process. Knowing the most beneficial movements to include in a comparison group beforehand will

^{64/} See Ex Parte 646 at 20.

allow a defendant railroad to spend the time and effort to justify the inclusion of these movements in the final comparison group.

Moreover, the fact that the railroads can select and develop revenue masking factors themselves can lead to a gross manipulation of the Three Benchmark process, if the STB allows. Federal regulations currently permit railroads to use proprietary masking procedures when submitting Waybill Sample revenue data to the STB, with the prior approval of the STB.^{65/} A railroad could, if it so chooses and the STB permitted it, set the masking factor at such low levels that Waybill Sample revenues would be so low as to drop the R/VC for many shipments below the 180 percent JT threshold level, and remove these movements from the comparison group selection process. The shipper attempting to use the STB's proposed Three Benchmark would be faced with a situation whereby there could be little or not identifiable comparable movements in the STB supplied masked Waybill Sample data from which to choose due to the number of movements below the 180 percent JT threshold level. Similarly, a railroad could set its masking factor at such a high level as to artificially raise R/VC levels as to make it appear that the average R/VC for any comparison group would offer little relief from the proposed Three Benchmark procedures.

Shippers on the other hand will not have access to the unmasked revenue information, which will place them in a disadvantageous position. Simply stated, a shipper may end-up fighting for the inclusion of a movement in the final comparison group that could be to its detriment when the STB ultimately unmask revenue and provides the true revenue information.

^{65/} See 49 CFR 1244.3 (b)(2)-(3)

The impact of having *a priori* knowledge of revenue data may be inferred by comparing Table 2 in the STB's Ex Parte 646 decision, which the STB produced using unmasked revenues, to a comparable table prepared using the STB's procedures and masked revenue data from the STB's Waybill Sample. I prepared Exhibit No. 4 using the same procedures as the STB used in developing its Ex Parte 646 Table 2, but utilized masked revenue data contained in the STB's 2004 and 2005 Waybill Sample.^{66/} Table 4 below demonstrates that the use of masked revenue data can lead to dramatically different inferences and conclusions using the unmasked revenue data.

^{66/} Exhibit No. 4 also contains the procedures I used to mimic the development of the STB's Table 2.

<u>Description</u> (1)	<u>Unmasked STB Table 2</u>		<u>Masked 2004 Waybill Sample</u>		<u>Masked 2005 Waybill Sample</u>	
	<u>Large Disputes</u> (2)	<u>Small Disputes</u> (3)	<u>Large Disputes</u> (4)	<u>Small Disputes</u> (5)	<u>Large Disputes</u> (6)	<u>Small Dispute</u> (7)
1. Farm Products	15%	85%	15%	85%	15%	85%
2. Metallic Ore	66%	34%	77%	23%	0%	100%
3. Coal	61%	39%	75%	25%	69%	31%
4. Crude Petroleum	0%	100%	0%	100%	74%	26%
5. Non-Met. Minerals	14%	86%	32%	68%	0%	100%
6. Ordnance	39%	61%	34%	66%	29%	71%
7. Food Products	8%	92%	20%	80%	11%	89%
8. Chemicals	11%	89%	23%	77%	24%	76%
9. Petroleum Products	21%	79%	26%	74%	23%	77%
10. Transp. Equipment	40%	60%	30%	70%	23%	77%
11. Waste or Scrap	14%	86%	0%	100%	27%	73%
12. Miscellaneous Freight	36%	64%	0%	100%	55%	45%
13. Miscellaneous Mixed Shipments	56%	44%	49%	51%	57%	43%
14. Small Package Freight	0%	100%	0%	100%	96%	4%
15. Hazardous Wastes	0%	100%	16%	84%	12%	87%
16. Total	34%	66%	43%	57%	44%	56%
Source: Exhibit No. 4						

As Table 4 above demonstrates, the use of masked revenue data will produce a dramatically different conclusion than using unmasked revenue data. For example, in the STB's Table 2, 11% of chemical shipments (line 8) would be considered eligible for large dispute rate resolutions. Using masked waybill data, the amount of shipments would increase to 23 percent in 2004 and 24 percent in 2005 based on masked revenue data. This increase infers that the revenues in the 2004 and 2005 waybill samples are considerably higher than the unmasked data using waybill data with this much disparity lead to faulty conclusions.

To compare and verify the results from my analysis of the 2004 masked STB Waybill Sample, I replicated the STB's Table 2 again using data from the 2005 masked STB Waybill Sample. I display the results in Table 5 below.

Description (1)	Unmasked STB Table 2		Masked 2004 Waybill Sample		Masked 2005 Waybill Sample	
	Large	Small	Large	Small	Large	Small
	Disputes (2)	Disputes (3)	Disputes (4)	Disputes (5)	Disputes (6)	Dispute (7)
1. Farm Products	15%	85%	15%	85%	15%	85%
2. Metallic Ore	66%	34%	77%	23%	0%	100%
3. Coal	61%	39%	75%	25%	69%	31%
4. Crude Petroleum	0%	100%	0%	100%	74%	26%
5. Non-Met. Minerals	14%	86%	32%	68%	0%	100%
6. Ordnance	39%	61%	34%	66%	29%	71%
7. Food Products	8%	92%	20%	80%	11%	89%
8. Chemicals	11%	89%	23%	77%	24%	76%
9. Petroleum Products	21%	79%	26%	74%	23%	77%
10. Transp. Equipment	40%	60%	30%	70%	23%	77%
11. Waste or Scrap	14%	86%	0%	100%	27%	73%
12. Miscellaneous Freight	36%	64%	0%	100%	55%	45%
13. Miscellaneous Mixed Shipments	56%	44%	49%	51%	57%	43%
14. Small Package Freight	0%	100%	0%	100%	96%	4%
15. Hazardous Wastes	0%	100%	16%	84%	12%	87%
16. Total	34%	66%	43%	57%	44%	56%

Source: Exhibit No. 4

In sum, allowing one party to the proceeding to have additional access to critical data, in this case unmasked revenue information, creates an information asymmetry that creates a natural bias in the end results. The STB cannot allow such a bias to exist in a regulatory proceeding.

**B. THE WAYBILL SAMPLE'S
REVENUES ARE BIASED**

The key calculation of the Three Benchmark approach is the determination of the comparison group's average R/VC ratio. Not only is the comparison group's average R/VC ratio instrumental in the determination of the upper bound of the 90 percent confidence interval which determines the reasonableness of a rate, but the STB prescribes a rate equal to the adjusted average R/VC for the comparison group if it finds the issue rate unreasonable. Anything that would bias the calculation of the comparison group's average R/VC will in the final analysis bias the prescribed rate.

According to STB publications describing the Waybill Sample and the GAO's October 2006 Freight Railroad Report, the railroads do not always include final revenue settlements in the Waybill Sample data they supply to the STB.^{67/} This indicates that the revenue data contained in the Waybill Sample would not necessarily be reflective of the actual rate due to the exclusion of any allowances or rebates provided to the shipper that are settled at a latter date. The fact that the railroads do not include all allowances and rebates in the Waybill Sample data provided to the STB indicates that the unmasked revenue data included in Waybill Sample are most likely overstated. This overstatement will translate to higher comparison group R/VC ratios, and subsequently higher prescribed rates. If the STB wishes to use Waybill Sample data to produce regulatory rates, it must insist that the Waybill Sample data provided by the railroads consist of settled revenues reflecting all allowances and refunds.

^{67/} See "The Carload Waybill Statistics: A Content Analysis" in the User Guide For The 1992 ICC Waybill Sample, AAR, July 30, 1993 and GAO Report GAO-07-94 at 17.

C. THE PROCEDURES FOR DEVELOPING CONFIDENCE INTERVALS ARE UNNECESSARY AND UNRELIABLE

The STB proposes to develop a 90 percent one-sided confidence interval around the comparison group's adjusted average R/VC ratio, and to use the upper-bound of the calculated confidence interval as the measure of rate reasonableness.^{68/} The STB would develop its confidence interval using the average and standard deviation of the adjusted comparison group and a parameter drawn from the Student's t-distribution based on the number of movements in the comparison group.

I believe it is unnecessary to develop a confidence interval around the comparison group's average R/VC since, statistically, it would have no true meaning. The construction of the confidence interval implies that the sample was drawn randomly from the respective population.^{69/} The STB's proposed Three Benchmark approach is far from being a random process, and is in fact the antitheses of randomness due to the direct selection of the comparison group movements by the parties to the case and the final offer selection by the STB. The creation of a confidence interval serves no purpose other than to artificially raise the reasonableness standard of a rate.

If the STB does intend to use a confidence interval, notwithstanding the lack of statistical reasoning for its use, the STB should not construct the confidence interval using a Student's t-distribution as proposed. The use of the Student's t-distribution requires the population from which the sample is drawn to be normally distributed.^{70/} The distribution of the adjusted R/VC ratios cannot be assumed, *a priori*, to be normally distributed. If the population is not normal, then the proposed use of the Student's t- distribution will not produce a 90% confidence interval.

^{68/} See Ex Parte 646 at 26.

^{69/} See James H. Stock and Mark W. Watson, Introduction to Econometrics (Pearson Education, 2003) at 71.

^{70/} See William H. Green, Econometric Analysis (Prentice Hall, 5th ed. 2003) at 852. This source is an updated version of the econometric test cited by the STB in Ex Parte 646 at 26.

Instead of relying upon a the Student's t-distribution to construct the confidence interval, I recommend that the STB use a larger sample size in its comparison group (greater than 30), which would allow for an assumption of normality due to the Central Limit Theorem ("CLT").^{71/} The use of the CLT does not require any assumption about the normality of the underlying population, except that no variable costs equal zero (0).^{72/} In addition to avoiding the requirement of normality of the R/VC ratios, larger sample sizes will reduce the random variability (variance) of the estimate of the mean of adjusted R/VC ratios. When these estimates are used to "fairly reflect the maximum lawful rates the carrier could charge those potentially captive movements" the reduced variability will provide more consistent results in the disposition of small rail rate disputes.^{73/}

**D. THE THREE BENCHMARK APPROACH
IS TOO UNCERTAIN AS PROPOSED**

Shippers indicated that they did not use STB's existing simplified guidelines in part due to a lack of predictability of outcomes. In responding to the STB's initial 2003 call for input into eligibility requirements and simplified procedures for small rate cases, shippers stated that one key aspect of any revised methodology would be predictability of the case outcome.^{74/} Shippers reiterated their calls for predictability of outcomes in follow-up hearings in 2004. The STB acknowledges that its existing simplified procedures do not provide the predictability and other aspects of rate relief sought by shippers, and instituted this proceeding in an attempt to correct this issue.

^{71/} The CLT holds whatever the underlying distribution (provided that standard deviation is finite), as the number of samples becomes large, the distribution tends to the standard normal. The CLT has a substantial impact on the practice of statistics. Many practical problems involve sums or averages or random variables, and in these situations, by virtue of the CLT, the normal distribution provides a satisfactory approximation to the true distribution.

^{72/} See William H. Green, Econometric Analysis (Prentice Hall, 5th ed. 2003) at 909-911.

^{73/} See Ex Parte 646 at 27.

^{74/} See Ex Parte 646 at 9.

The STB now states that its Three Benchmark approach (along with its SSAC approach) addresses many of the concerns raised about the existing simplified guidelines, including providing shippers meaningful access to regulatory relief and protecting even small shippers from unreasonable rates.^{75/} However, the STB still has not addressed the predictability issue in the Three Benchmark method. I believe this continued lack of predictability could doom the STB's proposed revised procedures.

Litigation, by its very nature, is unpredictable. But the lack of even rudimentary predictability in a regulatory setting provides a complete disservice to the parties to the regulatory case. Without some predictability in outcomes before the STB, shippers will not use the regulatory tools available and leave the shippers in an untenable negotiating position with the railroads. The ICC clearly understood this when it implemented its Coal Rate Guidelines decision. Specifically, the ICC stated: ^{76/}

“Thus a benefit of these guidelines is to enable both the shipper and the railroad to estimate the maximum rate we would prescribe if the matter were brought to us for adjudication. We believe that will encourage contract solutions which (as shown below) may often be more efficient and more beneficial to both parties than a prescribed rate.”

The Three Benchmark approach, as proposed by the STB, is just too unpredictable for shippers to use to make informed decisions. This unpredictability stems primarily from ambiguity around the composition of the comparison group and from the masked revenues contained in the Waybill

^{75/} See Ex Parte 646 at 37.

^{76/} See Coal Rate Guidelines at 524.

Sample. The fact that a shipper cannot estimate the composition of the final comparison group precludes the shipper from predicting with any sort of confidence what the STB would consider a reasonable rate. Similarly, shippers cannot predict the outcome of the case because they do not have access to unmasked Waybill Sample revenue data. As I demonstrated above in Tables 4 and 5, there is a significant difference between the masked and unmasked Waybill Sample revenue data. The fact that an entire case presentation will be made with unknown and unverifiable data sets will prevent a shipper from using the Three Benchmark approach, unless it has at least some sense beforehand of the likely outcome.

IV. APPLICATION OF THE PROPOSED SSAC METHODOLOGY

According to the STB, a Full SAC analysis has two primary objectives. First, to restrain a railroad from exploiting market power over a captive shipper by charging more than needed to obtain a reasonable return on the infrastructure needed to serve the shipper. Second, the SAC test detects and eliminates the costs associated with a railroad's inefficiencies.^{77/} The STB asserts that this second objective of a Full SAC inquiry, the detection and elimination of inefficiencies, drives the intricacy and expense of a SAC analysis.^{78/} To simplify, i.e., reduce the expense, of a Full SAC analysis, the STB proposes to use an alternative SSAC that only addresses the first objective, whether the shipper is being forced to cross-subsidize other part's of the railroad's network, while ignoring the second objective, the elimination of a railroad's inefficiencies.

As I described in detail above, the SSAC approach as proposed by the STB is not as "simplified" as the STB presumes, with several aspects of the approach being as complicated, if not more so, than a Full SAC analysis. In addition, I believe the STB's proposed SSAC approach possesses several theoretical and practical flaws that bias the approach in favor of the railroads. First, the SSAC approach proposed by the STB conflicts with CMP by eliminating the efficiencies intrinsic to CMP. Second, the SSAC's use of investment unit costs from prior Full SAC cases is unsupported and unreflective of true costs. I discuss both flaws in greater detail below under the following topical headings:

^{77/} See Ex Parte 646 at 10.

^{78/} See Ex Parte 646 at 11.

- A. The Proposed SSAC Conflicts With CMP
- B. The STB's Proposed SSAC RPI Costs Are Unsupported And Unverifiable

**A. THE PROPOSED SSAC
CONFLICTS WITH CMP**

The STB states that eliminating the inefficiency objective of the SAC constraint from the SSAC analysis will do away with a majority of the expense incurred in a Full SAC analysis. The STB acknowledges that its approach would produce a “less precise” application of CMP because it would not identify inefficiencies in current rail operations, but the STB claims that its proposed adjustments will allow it to determine whether an illegal cross-subsidy exists.^{79/} However, as the ICC explained in its Coal Rate Guidelines decision, the SAC constraint of CMP is based on the two overlapping and interacting objectives. In other words, the STB's attempt to only pursue one objective of the SAC constraint, elimination of cross-subsidies, while ignoring the efficiency object of the constraint effectively voids the regulatory basis of CMP.

The STB explained in Coal Rate Guidelines that CMP rests upon two economic theories - differential pricing and the contestability of markets.^{80/} These theories provide the analytical basis for determining the costs for which a shipper may properly be charged and the extent to which the shipper should bear the appropriate costs of service. To gauge whether a railroad has forced a shipper to bear costs for which the shipper receives no benefits, the ICC implemented the use of the SAC test. The ICC described the SAC test as a method that “approximate[s] the full economic costs, including a normal profit, that need to be met for an efficient producer to provide service to the

^{79/} See Ex Parte 646 at 11.

^{80/} See Coal Rate Guidelines at 525.

shipper(s) identified. This cost calculation produces a simulated competitive price standard against which actual rates can be compared.”^{81/} An intrinsic component of the CMP, as manifested by the SAC test, is the hypothetical SARR’s efficiency. It is not possible to produce an economically efficient and reasonable rail rate under CMP principles if the SAC process does not directly account for potential efficiencies.

The STB’s proposed SSAC removes any SARR efficiencies by mandating the use of existing infrastructure along the route of movement, by including all traffic in the SARR traffic group, and by using the incumbent railroad’s system average operating costs in lieu of the more efficient stand-alone operating costs. The fundamental purpose of the SAC constraint of CMP is to determine the least cost at which an efficient competitor could provide the service.^{82/} To accommodate this purpose, the type and size of the stand-alone facility can vary substantially to provide the least cost service as mandated by CMP principles. Requiring the SARR to reproduce the defendant railroad’s existing facilities frustrates this fundamental purpose, and makes the rate reasonableness analysis moot.

The same can be said of the proposed approach of including all traffic along the route of movement in the SARR’s traffic group. The ICC called the ability to group traffic in a SAC analysis “essential to the theory of contestability.”^{83/} By including all traffic over a defined segment of track in a SSAC analysis eliminates the ability of the shipper to define the most efficient traffic group. In addition, requiring the use of the incumbent’s system average operating costs redefines the analysis from CMP to simple replacement pricing, which is neither economically rational nor sustainable in

^{81/} See Coal Rate Guidelines at 529, emphasis added.

^{82/} See Coal Rate Guidelines at 543.

^{83/} See Coal Rate Guidelines at 544.

a contestable market. Simply stated, if the STB wishes to continue to use CMP as its economic foundation for rail rate regulation, it must consider both the efficiency and the cross-subsidy objectives of SAC. Elimination of one objective turns the test into an exercise with no true economic justification.

The STB attempts to justify its elimination of efficiencies from its proposed SSAC procedures on the premise that the railroads have allegedly eliminated excess capacity, and have therefore presumably become as efficient as possible.^{84/} The STB has incorrectly transposed the causality function between railroad efficiency and capacity. Productive efficiency can be defined as using the least amount of resources to produce a given good or service or as output is being produced at the lowest possible unit cost. This will occur when the average cost of production is at the lowest point on the average cost curve, and indicates that production is achieved at the lowest cost possible where the organization is maximizing its output given its level of inputs. Relative to a railroad's operation, a rail line's capacity is a function of how efficiently the railroad operates over the line. Simply stated, capacity is a function of efficiency.

The STB would flip this causal relationship and assert that efficiency is a function of capacity. This is nonsensical. A rail line's efficiency simply is not defined by its capacity. For example, assume a line segment on a railroad can handle 25 trains a day with up to 100 cars per train. If the railroad ran 25 trains a day but only included 50 cars on each train, the line segment could be said to be at "capacity" because it could not handle any additional trains, but the system is not efficient because

^{84/} See Ex Parte 646 at 11, "But times have changed. Railroads no longer are burdened by substantial excess capacity; rather, the rail industry now faces the opposite situation. Rail capacity is strained, demand for transportation service is forecast to increase, and railroads must make capital investments to meet that demand."

it is only transporting 50% of the potential carloads. The STB clearly recognized this distinction between capacity and efficiency in its original Ex Parte 347 proceedings.^{85/} To now claim that railroads can ignore efficiency because certain line segments are allegedly at their capacity ignores the relationship between the two factors.

The other problem with the STB's efficiency and capacity juxtaposition is that capacity in the current rail network is as much a function of the sunk costs as efficiency. Much of the existing U.S. rail network's capacity is based on investment decisions made long ago, and are sunk in nature. If a railroad were to enter the market today, it is highly probable that it would not replicate the existing infrastructure, but would construct a more efficient facility based on current market conditions. This is a basic principle of CMP, which is to determine the cost of an optimally efficient system.^{86/} This is the opportunity invested in a Full SAC analysis, and disallowed under the proposed SSAC procedures.

**B. THE STB'S PROPOSED SSAC RPI COSTS
ARE UNSUPPORTED AND UNVERIFIABLE**

Instead of developing RPI costs specific to the SARR under consideration in a SSAC analysis, the STB proposes to utilize average RPI unit costs based on evidence submitted in prior Full SAC analyses.^{87/} Specifically, the STB proposes to use rolling average costs from past cases to develop average RPI unit costs for major RPI categories. The STB proposes to use costs developed in the six most recent SAC cases - Otter Tail, Duke/NS, Duke/CSX, CPL, Xcel and TMPA - in which the

^{85/} See Ex Parte 347 at 10, note 33.

^{86/} See Ex Parte 347 at 10.

^{87/} See Ex Parte 646 at 13.

STB ruled on each party's RPI evidence.^{88/} As the STB issues decisions in new Full SAC cases, it indicates it will update its rolling average RPI costs for use in SSAC analysis. The STB asserts that its proposed approach will simplify the preparation of a SSAC case, and thus reduce the overall expense.

While the STB's proposed approach is definitely simpler, I believe it contains several flaws that make it too unreliable for use for rate regulation. First, in developing average RPI unit costs, the STB failed to account for the differences in constructing railroads in the eastern U.S. versus the western U.S. Second, there appears to be too much variation in some investment categories on which to effectively determine representative "average" investment unit costs. Third, the STB has apparently failed to support or verify several investment statistics making their use dubious at best. I explain each one of the flaws below.

1. The STB Fails To Differentiate Regional Costs

The STB proposes to develop its rolling average RPI costs using the six most recent Full SAC decisions. Three of those decisions, Otter Tail, Xcel and TMPA, involved SARRs built from the PRB of Wyoming and Montana to generating stations in South Dakota, Colorado and Texas. The other three decisions, Duke/NS, Duke/CSX and CPL, involved SARRs extending from Central Appalachia to generating stations in North Carolina and South Carolina. The STB acknowledged in its Duke/NS decision that constructing railroads east of the Mississippi River is more costly than building railroads in the western portion of the U.S.^{89/} The STB even recognizes the impact of location on RPI costs

^{88/} See Ex Parte 646 at 40. The STB states that it excluded RPI evidence from PPL since it did not thoroughly weigh the railroad's RPI evidence in the case.

^{89/} See Duke/NS at 8, "The relative expense to build transportation projects in the mountainous areas of the Eastern United States compared to projects located primarily in less mountainous areas of the West may have been a factor in this case."

in its Ex Parte 646 decision.^{20/} Nevertheless, the STB still proposes to use average RPI expenses from across all regions to develop RPI expenses in SSAC analyses.

I believe that average RPI investment unit costs may be a useful surrogate for actual unit costs if the STB's investment information could be separated into additional or different categorical groupings. For example, earth work unit costs in the coastal plains east of the Appalachian Mountains may exhibit similarities to earth work unit costs to the plains east of the PRB. However, I was unable to thoroughly investigate additional potential RPI groupings due to the STB's refusal to make its work papers underlying its RPI unit costs available for inspection. It goes without saying though that since the STB has previously recognized the regional nature of railroad investment, its proposal to use interregional RPI unit costs is highly questionable.

2. Some Investment Categories Exhibit Too Much Variation

The STB's proposal to rely upon average RPI unit costs rests upon the implicit assumption that the averages calculated by the STB are the best indicator of the true investment expense for the hypothetical SARR. However, in most cases, the STB ignores the dispersion of its RPI unit costs estimates which provides an indication how close the true mean lies to the sample.^{21/} Exploring a measure of central tendency, in this case the average RPI unit costs, without exploring a measure of dispersion for the sample group can lead to erroneous and biased conclusions.

^{20/} See Ex Parte 646 at 39.

^{21/} The STB does recognize the level of dispersion in its estimation of grade separation unit costs when it seeks comments on the potential exclusion of the Duke/NS unit costs due to it being a potential outlier. See Ex Parte 646 at 48.

Theoretically, the STB's proposed approach is based upon probability statistics, in which the rolling average is the same as an expected value. The expected value of a given unit cost represents the probability-weighted average of its possible values. The rolling average, or the "mean" also represents a "central tendency" in that one typically will predict that an actual value of a unit cost will be closer to rather than farther away from the average.

However, the ability of an average or, equivalently, the expected value to predict the actual value of a unit cost is influenced by the dispersion of the associated data. One way to measure the dispersion of data is to measure the average absolute deviation ("AAD"). The AAD measures the extent to which the values in a given data set differ from the average of the set. For example, if one averaged the numbers 4 and 8, the average would be 6, while the mean absolute deviation would be 2. This is equivalent to $|8 - 6| = 2$ and $|4 - 6| = 2$. In terms of probability, the average absolute deviation measures the extent to which the expected value predicts actual values. In other words, it predicts the errors, how far the typical value will "miss" the predicted value. If the average absolute deviation is, say 5% of the average, any given value will miss the expected value by only 5%.^{22/}

I have calculated the AAD to test whether rolling average RPI unit costs from the past six SAC cases are good predictors of RPI unit costs in a Simplified-SAC case. I show the results of this analysis in Exhibit No. 5. As Exhibit No. 5 shows, the rolling averages appear to reasonably predict some unit costs. For example, the cost per track mile of track construction is consistent, such that the typical value from the past six cases differs only 4% from the average value. Unfortunately, the

^{22/} For a complete discussion of statistical dispersion, see the National Institute of Standards and Technology's Engineering Statistics Handbook at NIST/SEMATECH e-Handbook of Statistical Methods, <http://www.itl.nist.gov/div898/handbook/>, October, 2006.

same cannot be said for many of the other rolling averages proposed by the STB. The typical land cost per acre from the past six SAC cases differs from the average by 49% for commercial properties to 58% for residential properties. The cost per foot of Type 1 bridges for the last six SAC cases differs from the average by 45%. The costs of public improvements without grade separation differ from the average by 57%, while the grade separations differ by 50%. These results suggest that there is little validity in using these unit costs as proxies for unit costs in SSAC cases, since they have little predictive value in determining the unit costs of any given case. The unique attributes of each SARR cause the unit costs to differ dramatically.

The existence of such large deviations in several of the investment categories should give the STB pause about its calculated average RPI unit costs. These large deviations may be caused by outliers within each case's RPI unit costs. This is a standard concern when developing the average of averages as the STB proposes in this case. This can be resolved by a detailed examination of the underlying unit costs for each Full SAC case. But once again, this is not possible due to the STB's refusal to make its workpapers available for examination. Without a close examination of the underlying data, the STB is asking shippers to rely upon blind faith in the preparation of a SSAC analysis.

3. The STB Is Relying Upon Unverified Data

The STB would have the parties using a SSAC analysis rely upon average unit costs from prior Full SAC cases. The implicit assumption to the STB's proposal is that the STB has already vetted the investment costs from the Full SAC cases, and the resulting costs are truly reflective of the actual

costs incurred. However, the STB has already indicated that this assumption is not true in all cases, and should cause one to reflect on the accuracy of the STB's figures.

The STB proposes for parties performing a SSAC analysis to use historic culvert construction costs from prior Full SAC cases to develop culvert costs in the SSAC analysis.^{93/} Unlike other RPI categories where the STB has estimated RPI unit costs in each case, the STB would have the parties calculate culvert expense using a series of linear equations that the STB claims were developed in prior Full SAC analyses. Just as one can run statistical tests to draw inferences around an average (as the STB proposes in its Three Benchmark Approach around the adjusted average R/VC of the comparison group), one may also run statistical tests around the results of linear regressions to test the robustness of the results. Most practitioners report the results of these statistical tests when reporting the results of their regression equation.^{94/}

Counsel for the Interested Parties requested via a workpaper requests to the STB that the STB provide the basis for the its culvert expense regression equations, including the statistics for the regression results. In its September 25, 2006 decision in this proceeding, the STB indicated that it was unable to provide the output statistics since, according to the STB, the data was not provided to it by the parties to the underlying cases. The STB's response to the workpaper requests raises two large concerns. First, if the parties to the original Full SAC cases did not provide the output statistics to their regression analysis, then how did the STB fully evaluate the evidence in those cases? Second, and of larger concern to this proceeding, the STB now proposes to use investment data for future

^{93/} See Ex Parte 646 at 44.

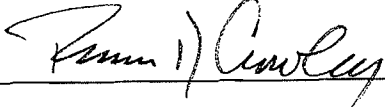
^{94/} The most common statistics included when reporting regression results include the coefficient of determination which explains the proportion of variability of the dependent variable explained by the linear relationship with the independent variable, the standard error of the coefficient of determination, the standard error of the regression coefficients and the p-values of the regression coefficients.

SSAC analysis for which it has no supporting documentation and no basis to determine the robustness of the data. One must question the ability of the STB to establish a reasonable rate based on unsupported and unverifiable information.

VERIFICATION

COMMONWEALTH OF VIRGINIA)
)
CITY OF ALEXANDRIA)

I, THOMAS D. CROWLEY, verify under penalty of perjury that I have read the foregoing Verified Statement of Thomas D. Crowley, that I know the contents thereof, and that the same are true and correct. Further, I certify that I am qualified and authorized to file this statement.



Thomas D. Crowley

Sworn to and subscribed
before me this day of October 24, 2006



Anthony V. Evanshaw III
Notary Public for the State of Virginia

My Commission expires: September 30, 2007

STATEMENT OF QUALIFICATIONS

My name is Thomas D. Crowley. I am an economist and President of the economic consulting firm of L. E. Peabody & Associates, Inc. The firm's offices are located at 1501 Duke Street, Suite 200, Alexandria, Virginia 22314 and 5901 N. Cicero Avenue, Suite 504, Chicago, Illinois 60646.

I am a graduate of the University of Maine from which I obtained a Bachelor of Science degree in Economics. I have also taken graduate courses in transportation at George Washington University in Washington, D.C. I spent three years in the United States Army and since February 1971 have been employed by L. E. Peabody & Associates, Inc.

I am a member of the American Economic Association, the Transportation Research Forum, and the American Railway Engineering and Maintenance-of-Way Association.

The firm of L. E. Peabody & Associates, Inc. specializes in solving economic, marketing and transportation problems. As an economic consultant, I have organized and directed economic studies and prepared reports for railroads, freight forwarders and other carriers, for shippers, for associations and for state governments and other public bodies dealing with transportation and related economic problems. Examples of studies I have participated in include organizing and directing traffic, operational and cost analyses in connection with multiple car movements, unit train operations for coal and other commodities, freight forwarder facilities, TOFC/COFC rail facilities, divisions of through rail rates, operating commuter passenger service, and other studies dealing with markets and the transportation by different modes of various commodities from both eastern and western origins to various destinations in the United States. The nature of these studies enabled me to become

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familiar with the operating practices and accounting procedures utilized by railroads in the normal course of business.

Additionally, I have inspected and studied both railroad terminal and line-haul facilities used in handling various commodities, and in particular unit train coal movements from the Powder River Basin to various utility destinations in the midwestern and western portions of the United States and from the Eastern Coal Fields to various destinations in the Mid-Atlantic, northeastern and southeastern portions of the United States. These operational reviews and studies were used as a basis for the determination of the traffic and operating characteristics for specific movements of coal and numerous other commodities handled by rail.

I have frequently been called upon to develop and coordinate economic and operational studies relative to the acquisition of coal and the rail transportation of coal on behalf of electric utility companies. My responsibilities in these undertakings included the analyses of rail routes, rail operations and an assessment of the relative efficiency and costs of railroad operations over those routes. I have also analyzed and made recommendations regarding the acquisition of railcars according to the specific needs of various coal shippers. The results of these analyses have been employed in order to assist shippers in the development and negotiation of rail transportation contracts which optimize operational efficiency and cost effectiveness.

Moreover, I have developed numerous variable cost calculations utilizing the various formulas employed by the Interstate Commerce Commission ("ICC") and the Surface Transportation Board ("STB") for the development of variable costs for common carriers, with particular emphasis on the

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basis and use of Rail Form A and its replacement costing formula the Uniform Railroad Costing System ("URCS"). I have utilized Rail Form A/URCS costing principles since the beginning of my career with L. E. Peabody & Associates Inc. in 1971.

I have frequently presented both oral and written testimony before the ICC, STB, Federal Energy Regulatory Commission, Railroad Accounting Principles Board, Postal Rate Commission and numerous state regulatory commissions, federal courts and state courts. This testimony was generally related to the development of variable cost of service calculations, rail traffic and operating patterns, fuel supply economics, contract interpretations, economic principles concerning the maximum level of rates, implementation of maximum rate principles, and calculation of reparations or damages, including interest. I presented testimony before the Congress of the United States, Committee on Transportation and Infrastructure on the status of rail competition in the western United States. I have also presented testimony in a number of court and arbitration proceedings concerning the level of rates, rate adjustment procedures, rail operating procedures and other economic components of specific contracts.

Since the implementation of the Staggers Rail Act of 1980, which clarified that rail carriers could enter into transportation contracts with shippers, I have been actively involved in negotiating transportation contracts on behalf of coal shippers. Specifically, I have advised utilities concerning coal transportation rates based on market conditions and carrier competition, movement specific service commitments, specific cost-based rate adjustment provisions, contract reopeners that recognize changes in productivity and cost-based ancillary charges.

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I have been actively engaged in negotiating coal supply contracts for various users throughout the United States. In addition, I have analyzed the economic impact of buying out, brokering, and modifying existing coal supply agreements. My coal supply assignments have encompassed analyzing alternative coals to determine the impact on the delivered price of operating and maintenance costs, unloading costs, shrinkage factor and by-product savings.

I have developed different economic analyses for over sixty (60) electric utility companies located in all parts of the United States, and for major associations, including American Paper Institute, American Petroleum Institute, Chemical Manufacturers Association, Coal Exporters Association, Edison Electric Institute, Mail Order Association of America, National Coal Association, National Industrial Transportation League, North America Freight Car Association, the Fertilizer Institute and Western Coal Traffic League. In addition, I have assisted numerous government agencies, major industries and major railroad companies in solving various economic problems.

In the two Western rail mergers that resulted in the creation of BNSF Railway Company and Union Pacific Railroad Company and in the acquisition of Conrail by Norfolk Southern Railroad Company and CSXT, I reviewed the railroads' applications including their supporting traffic, cost and operating data and provided detailed evidence supporting requests for conditions designed to maintain the competitive rail environment that existed before the proposed mergers and acquisition. In these proceedings, I represented shipper interests, including plastic, chemical, coal, paper and steel shippers.

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I have participated in various proceedings involved with the division of through rail rates. For example, I participated in ICC Docket No. 35585, Akron, Canton & Youngstown Railroad Company, et al. v. Aberdeen and Rockfish Railroad Company, et al. which was a complaint filed by the northern and midwestern rail lines to change the primary north-south divisions. I was personally involved in all traffic, operating and cost aspects of this proceeding on behalf of the northern and midwestern rail lines. I was the lead witness on behalf of the Long Island Rail Road in ICC Docket No. 36874, Notice of Intent to File Division Complaint by the Long Island Rail Road Company.

As a result of my extensive economic consulting practice since 1971 and my participating in maximum-rate, rail merger, and rule-making proceedings before various government and private governing bodies, I have become thoroughly familiar with the operations, practices and costs of the rail carriers that move coal over the major coal routes in the United States.

Comparison of Full SAC and Simplified SAC Analyses

Coal Rate Guidelines define a stand-alone railroad ("SARR") as a system in which the plant size and traffic base are designed to maximize efficiencies and production economies.^{1/} The fact that a SARR is designed to maximize efficiencies and production economies infers that the designer of a SARR will set out to create an optimal system that balances two factors, revenues and costs. From an optimization perspective, an optimal SARR can be created in two ways. First, the designer may maximize the revenue from a system given a fixed and variable set of costs. Or, second, the designer can minimize fixed costs and variable operating costs given a static revenue base.^{2/} Mathematically, these expressions can be represented as follows:

1) $\text{MAX (Revenue)} \Rightarrow \text{Investment} + \text{Fixed Oper. Cost} + \text{Variable Oper. Cost}$

2) $\text{MIN (Investment} + \text{Fixed Oper. Cost} + \text{Variable Oper. Cost)} \Rightarrow \text{Revenue}$

Lets assume that the designer of a SARR in a Full SAC wishes to maximize revenue over a certain section of a railroad's network that is operating at less than full capacity. Assuming the designer reproduces the current infrastructure, the network could be maximized his network by shifting traffic from other parts of the railroad to this portion of the network. Therefore, the new revenue for this section of the network would be greater than the existing revenue, while the variable operating costs will also be greater than the existing operating costs (ignoring for the moment efficiency gains in variable operating costs). Assuming these conditions, then:

3) $\text{Revenue}_{\text{New}} > \text{Revenue}_{\text{Current}}$

4) $\text{Variable Operating Cost}_{\text{New}} > \text{Variable Operating Cost}_{\text{Current}}$

^{1/} See Coal Rate Guidelines at 544.

^{2/} The ICC made this point in Coal Rate Guidelines. "The plant should be designed to minimize construction (or acquisition) and operating costs and/or maximize the carriage of profitable traffic." Coal Rate Guidelines at 543.

Comparison of Full SAC and Simplified SAC Analyses

5) $\text{Revenue}_{\text{New}} > \text{Variable Operating Cost}_{\text{New}}$

Then the system is optimizing its structure because the new traffic is making a greater contribution to the fixed investment and operating costs while maximizing physical plant utilization.

In a simplified stand-alone cost analysis ("SSAC"), the designer is precluded from optimizing the network due to a limitation on rerouting non-issue traffic, and requirements to continue to utilize the same operating plant.^{3/} Therefore in a SSAC analysis under the same considerations:

6) $\text{Investment}_{\text{Full SAC}} = \text{Investment}_{\text{SSAC}}$

7) $\text{Fixed Operating Costs}_{\text{Full SAC}} = \text{Fixed Operating Cost}_{\text{SSAC}}$

8) $\text{Revenue}_{\text{Full SAC}} \geq \text{Revenue}_{\text{SSAC}}$

9) $\text{Variable Operating Cost}_{\text{Full SAC}} \geq \text{Variable Operating Cost}_{\text{SSAC}}$

Given that the traffic will be making less of a contribution to the same fixed investment and operating costs, the results of the SSAC analysis will fall below that of a Full SAC analysis. In other words, a Full SAC analysis will by definition produce an answer no worse than a SSAC analysis and in almost all cases better.^{4/}

The same analysis can be performed if the designer sets out to minimize expenses instead of maximizing revenues. If the designer of a Full SAC analysis holds revenues for his network constant relative to the incumbent railroad, he will attempt to minimize all costs such that:

^{3/} See Ex Parte 646 at 13.

^{4/} A Full SAC analysis will produce the same results as a SSAC analysis if there are no inefficiencies in current railroad's system and its network is operating at capacity.

Comparison of Full SAC and Simplified SAC Analyses

- 10) $\text{Investment}_{\text{Full SAC}} < \text{Investment}_{\text{Current}}$
- 11) $\text{Fixed Operating Costs}_{\text{Full SAC}} < \text{Fixed Operating Costs}_{\text{Current}}$
- 12) $\text{Variable Operating Costs}_{\text{Full SAC}} < \text{Variable Operating Costs}_{\text{Current}}$

In a SSAC analysis, because costs are not adjusted for efficiencies, costs are greater than in a Full SAC analysis. Therefore:

- 13) $\text{Investment}_{\text{SSAC}} \geq \text{Investment}_{\text{Full SAC}}$
- 14) $\text{Fixed Operating Costs}_{\text{SSAC}} \geq \text{Fixed Operating Costs}_{\text{Full SAC}}$
- 15) $\text{Variable Operating Costs}_{\text{SSAC}} \geq \text{Variable Operating Costs}_{\text{Full SAC}}$

Because the SSAC will have a cost structure that, at best, is no better than a Full SAC analysis, and is much more likely to have a higher cost structure due to the inability to shed inefficiencies in the incumbent's current operations, the best a SSAC analysis can do is equal a Full SAC analysis and will most assuredly produce a worse result.

As indicated above, a SSAC analysis will produce the same results as a Full SAC analysis only if the incumbent railroad is fully utilizing its plant and is fully maximizing efficiencies. Since this is clearly not happening with current railroad operations, it is safe to assume that a SSAC analysis will always produce a worse result than a Full SAC analysis.

**Application of the STB's Proposed Three
Benchmark Method On a Revenue Inadequate Railroad**

	<u>Movement</u>	<u>Revenue to Variable Cost Ratio 1/</u>	<u>RSAM to R/VC_{Total} Ratio 2/</u>	<u>Adjusted Revenue to Variable Cost Ratio 3/</u>
	(1)	(2)	(3)	(3)
1.	A	180.001%	1.001	180.2%
2.	B	180.001%	1.001	180.2%
3.	C	180.001%	1.001	180.2%
4.	D	180.001%	1.001	180.2%
5.	E	180.001%	1.001	180.2%
6.	F	180.001%	1.001	180.2%
7.	G	180.001%	1.001	180.2%
8.	G	180.001%	1.001	180.2%
9.	I	180.001%	1.001	180.2%
10.	J	180.001%	1.001	180.2%
11.	K	180.001%	1.001	180.2%
12.	L	180.001%	1.001	180.2%
13.	M	180.001%	1.001	180.2%
14.	N	180.001%	1.001	180.2%
15.	O	180.001%	1.001	180.2%
16.	P	180.001%	1.001	180.2%
17.	Q	180.001%	1.001	180.2%
18.	R	180.001%	1.001	180.2%
19.	S	180.001%	1.001	180.2%
20.	T	180.001%	1.001	180.2%
21.	Mean of the Adjusted R/VC Ratio 4/			180.2%
22.	Standard Deviation of the Adjusted R/VC Ratio 5/			0%
23.	Upper Bound of a 90% Confidence Interval 6/			180.2%

- 1/ Only moves with R/VC of greater than 180% can be included in the comparison group.
- 2/ A RSAM to R/VC_{total} ratio of greater than one (1) indicates the railroad is not revenue adequate under current STB revenue adequacy definitions.
- 3/ Column (2) x Column (3)
- 4/ Average of Column (4), Lines 1 to 20
- 5/ The standard deviation of Column (4), Lines 1 to 20. Because all unadjusted R/VC are the same in this example, the standard deviation of the sample is zero (0).
- 6/ Because the standard deviation of the sample equals (0), the upper bound of the 90 percent confidence interval equals the adjusted R/VC of the sample group.

**Application of the STB's Proposed Three
Benchmark Method On a Revenue Adequate Railroad**

	<u>Movement</u>	<u>Revenue to Variable Cost Ratio 1/</u>	<u>RSAM to R/VC_{Total} Ratio 2/</u>	<u>Adjusted Revenue to Variable Cost Ratio 3/</u>
	(1)	(2)	(3)	(3)
1.	A	181.8%	0.99	180.0%
2.	B	181.8%	0.99	180.0%
3.	C	181.8%	0.99	180.0%
4.	D	181.8%	0.99	180.0%
5.	E	181.8%	0.99	180.0%
6.	F	181.8%	0.99	180.0%
7.	G	181.8%	0.99	180.0%
8.	G	181.8%	0.99	180.0%
9.	I	181.8%	0.99	180.0%
10.	J	181.8%	0.99	180.0%
11.	K	181.8%	0.99	180.0%
12.	L	181.8%	0.99	180.0%
13.	M	181.8%	0.99	180.0%
14.	N	181.8%	0.99	180.0%
15.	O	181.8%	0.99	180.0%
16.	P	181.8%	0.99	180.0%
17.	Q	181.8%	0.99	180.0%
18.	R	181.8%	0.99	180.0%
19.	S	181.8%	0.99	180.0%
20.	T	181.8%	0.99	180.0%
21.	Mean of the Adjusted R/VC Ratio 4/			180.0%
22.	Standard Deviation of the Adjusted R/VC Ratio 5/			0%
23.	Upper Bound of a 90% Confidence Interval 6/			180.0%

- 1/ Only moves with R/VC of greater than 180% can be included in the comparison group.
- 2/ A RSAM to R/VC_{total} ratio of less than one (1) indicates the railroad is revenue adequate under current STB revenue adequacy definitions.
- 3/ Column (2) x Column (3)
- 4/ Average of Column (4), Lines 1 to 20
- 5/ The standard deviation of Column (4), Lines 1 to 20. Because all unadjusted R/VC are the same in this example, the standard deviation of the sample is zero (0).
- 6/ Because the standard deviation of the sample equals (0), the upper bound of the 90 percent confidence interval equals the adjusted R/VC of the sample group.

**Application of the STB's Proposed Three
Benchmark Method On a Revenue Adequate Railroad**

	<u>Movement</u>	<u>Revenue to Variable Cost Ratio 1/</u>	<u>RSAM to R/VC_{Total} Ratio 2/</u>	<u>Adjusted Revenue to Variable Cost Ratio 3/</u>
	(1)	(2)	(3)	(3)
1.	A	183.000%	0.99	181.2%
2.	B	183.000%	0.99	181.2%
3.	C	183.000%	0.99	181.2%
4.	D	183.000%	0.99	181.2%
5.	E	183.000%	0.99	181.2%
6.	F	183.000%	0.99	181.2%
7.	G	183.000%	0.99	181.2%
8.	G	183.000%	0.99	181.2%
9.	I	183.000%	0.99	181.2%
10.	J	183.000%	0.99	181.2%
11.	K	180.001%	0.99	178.2%
12.	L	180.001%	0.99	178.2%
13.	M	180.001%	0.99	178.2%
14.	N	180.001%	0.99	178.2%
15.	O	180.001%	0.99	178.2%
16.	P	180.001%	0.99	178.2%
17.	Q	180.001%	0.99	178.2%
18.	R	180.001%	0.99	178.2%
19.	S	180.001%	0.99	178.2%
20.	T	180.001%	0.99	178.2%
21.	Mean of the Adjusted R/VC Ratio 4/			179.7%
22.	Standard Deviation of the Adjusted R/VC Ratio 5/			2%
23.	Upper Bound of a 90% Confidence Interval 6/			180.1%

- 1/ Only moves with R/VC of greater than 180% can be included in the comparison group.
2/ A RSAM to R/VC_{total} ratio of less than one (1) indicates the railroad is revenue adequate under current STB revenue adequacy definitions.
3/ Column (2) x Column (3)
4/ Average of Column (4), Lines 1 to 20
5/ The standard deviation of Column (4), Lines 1 to 20.
6/ Line 21 + {1.328 x [Line 22 ÷ (20-1)^{1/2}]}, where 1.328 equals the student's-t parameter for a 10% confidence interval with 20-1 degrees of freedom.

STB Eligibility Estimates

Commodity (1)	Total Regulated (2)	Large Disputes		Medium Disputes		Small Disputes	
		Revenues (3)	% of Total (4)	Revenues (5)	% of Total (6)	Revenues (7)	% of Total (8)
1. Farm Products	\$942,701,000	\$140,960,000	15%	\$589,934,000	63%	\$211,807,000	22%
2. Metallic Ore	199,375,000	131,922,000	66%	59,997,000	30%	7,456,000	4%
3. Coal	3,168,171,000	1,937,001,000	61%	1,058,386,000	33%	172,784,000	5%
4. Crude Petroleum	2,403,000	0	0%	993,000	41%	1,410,000	59%
5. Non-Met. Minerals	111,508,000	16,135,000	14%	65,984,000	59%	29,389,000	26%
6. Ordinance	7,267,000	2,858,000	39%	3,979,000	55%	430,000	6%
7. Food Products	280,429,000	23,591,000	8%	156,673,000	56%	100,165,000	36%
8. Chemicals	2,534,099,000	267,842,000	11%	1,627,608,000	64%	638,649,000	25%
9. Petroleum Products	516,563,000	107,579,000	21%	260,906,000	51%	148,078,000	29%
10. Transportation Equipment	23,158,000	9,327,000	40%	8,817,000	38%	5,014,000	22%
11. Waste or Scrap	40,906,000	5,884,000	14%	30,732,000	75%	4,290,000	10%
12. Miscellaneous Freight	103,195,000	37,262,000	36%	62,894,000	61%	3,039,000	3%
13. Miscellaneous Mixed Shipments	7,667,000	4,309,000	56%	2,948,000	38%	410,000	5%
14. Small Package Freight	2,375,000	0	0%	2,375,000	100%	0	0%
15. Hazardous Waste	20,895,000	0	0%	13,064,000	63%	7,831,000	37%
16. Totals	\$7,960,712,000	\$2,684,670,000	34%	\$3,945,290,000	50%	\$1,330,752,000	17%

Source: Ex Parte 646 Table 2

Eligibility Estimates Based On 2004 Masked Waybill Sample Data

Commodity (1)	Total Regulated (2)	Large Disputes		Medium Disputes		Small Disputes	
		Revenues (3)	% of Total (4)	Revenues (5)	% of Total (6)	Revenues (7)	% of Total (8)
1. Farm Products	\$1,476,472,260	\$220,941,524	15%	\$1,016,809,518	69%	\$238,721,218	16%
2. Metallic Ore	311,568,384	239,667,970	77%	61,491,447	20%	10,408,967	3%
3. Coal	4,902,114,656	3,659,507,696	75%	1,152,061,806	24%	90,545,154	2%
4. Crude Petroleum	12,069,872	0	0%	9,495,712	79%	2,574,160	21%
5. Non-Met. Minerals	274,027,984	88,204,006	32%	151,428,346	55%	34,395,632	13%
6. Ordinance	8,340,516	2,858,280	34%	5,052,072	61%	430,164	5%
7. Food Products	884,606,480	174,953,220	20%	516,944,638	58%	192,708,622	22%
8. Chemicals	4,177,154,234	946,675,185	23%	2,613,530,357	63%	616,948,692	15%
9. Petroleum Products	874,327,187	224,689,937	26%	492,561,937	56%	157,075,313	18%
10. Transportation Equipment	31,337,997	9,555,688	30%	12,823,738	41%	8,958,571	29%
11. Waste or Scrap	196,960	0	0%	196,960	100%	0	0%
12. Miscellaneous Freight	1,583,588	0	0%	874,780	55%	708,808	45%
13. Miscellaneous Mixed Shipments	7,494,636	3,705,396	49%	3,379,560	45%	409,680	5%
14. Small Package Freight	2,375,120	0	0%	2,375,120	100%	0	0%
15. Hazardous Waste	38,533,128	6,324,800	16%	26,702,488	69%	5,505,840	14%
16. Totals	\$13,002,203,002	\$5,577,083,702	43%	\$6,065,728,479	47%	\$1,359,390,821	10%

Source: 2004 STB Waybill Sample and L. E. Peabody & Associates, Inc. analysis.

Eligibility Estimates Based On 2005 Masked Waybill Sample Data

Commodity (1)	Total Regulated (2)	Large Disputes		Medium Disputes		Small Disputes	
		Revenues (3)	% of Total (4)	Revenues (5)	% of Total (6)	Revenues (7)	% of Total (8)
1. Farm Products	\$1,628,767,693	\$250,325,947	15%	\$1,099,305,876	67%	\$279,135,870	17%
2. Metallic Ore	1,061,160	0	0%	896,040	84%	165,120	16%
3. Coal	411,765,661	283,211,959	69%	117,773,377	29%	10,780,325	3%
4. Crude Petroleum	5,574,011,253	4,148,032,766	74%	1,338,723,965	24%	87,254,522	2%
5. Non-Met. Minerals	8,175,880	0	0%	6,071,080	74%	2,104,800	26%
6. Ordinance	290,096,114	84,130,260	29%	169,557,405	58%	36,408,449	13%
7. Food Products	9,829,900	1,082,284	11%	8,159,376	83%	588,240	6%
8. Chemicals	907,197,885	220,523,556	24%	513,251,054	57%	173,423,275	19%
9. Petroleum Products	4,299,862,489	976,476,478	23%	2,716,398,761	63%	606,987,250	14%
10. Transportation Equipment	928,381,705	211,602,046	23%	554,288,829	60%	162,490,830	18%
11. Waste or Scrap	43,390,872	11,612,312	27%	20,326,980	47%	11,451,580	26%
12. Miscellaneous Freight	128,595,824	71,060,072	55%	50,910,180	40%	6,625,572	5%
13. Miscellaneous Mixed Shipments	73,200,491	41,972,401	57%	29,281,718	40%	1,946,372	3%
14. Small Package Freight	43,919,720	42,175,240	96%	1,494,560	3%	249,920	1%
15. Hazardous Waste	50,793,100	6,731,480	13%	40,015,220	79%	4,046,400	8%
16. Totals	\$14,399,049,747	\$6,348,936,801	44%	\$6,666,454,421	46%	\$1,383,658,525	10%

Source: 2005 STB Waybill Sample and L. E. Peabody & Associates, Inc. analysis.

Methodology Used To Aggregate 2004 And 2005 Waybill Sample Revenues

1. Identify shipment moves in the STB's Waybill Sample based on same movement characteristics:
 - a. Same 7 digit STCC ^{1/}
 - b. Same origin and destination FSAC
 - c. Same railroad
 - d. Same routing
2. Delete all exempt traffic as identified by use of the exempt flag field in the Waybill Sample file and by car type, i.e, box cars, TOFC and COFC. ^{2/}
3. Aggregate URCS costs and masked revenues for each identified movement.
4. Calculate R/VC for the aggregated movements.
5. For each movement with a R/VC ratio of greater than 180 percent, determine the MVC over a five year period using the STB's 2004 railroad industry average cost of capital. ^{3/}
6. Stratify movements by the MVC into three categories: MVC less than \$200,000, MVC between \$200,000 and \$3.5 million and MVC of greater than \$3.5 million.
7. Aggregate revenues by 2 digit STCC based on stratification.

^{1/} Movements with the hazardous materials flags were aggregated at the base 7 digit STCC level due to the STB's Table 2 Methodologies' silence on the handling of hazardous materials and due to the fact that hazardous materials are not in themselves an exempt commodity.

^{2/} The STB's Table 2 Methodologies delete exempt traffic after aggregating revenues and costs and determination of MVC. However, aggregating the data before deleting exempted traffic would lead to including some exempted car types in aggregated data. Therefore, in preparing this exhibit, I deleted exempt traffic and car types prior to aggregating revenue and cost information.

^{3/} I used the 2004 railroad industry cost of capital for consistency with the STB's Table 2, even though the STB has recently issued its 2005 railroad industry cost of capital decision.

Analysis of Land, Earthwork, Bridge Unit Costs from Full Stand-Alone Cost Cases

Item (1)	Land Cost per Acre 1/				Earthwork Cost per Cubic Yard 2/				Bridge Cost per Foot 3/		
	Agricultural (2)	Residential (3)	Industrial (4)	Commercial (5)	Common (6)	Loose (7)	Solid (8)	Borrow (9)	Type 1 (10)	Type 2 (11)	Type 3 (12)
1. Otter Tail	\$533	\$13,006	\$14,844	\$32,423	\$3.90	\$6.57	\$9.22	\$12.35	\$2,315	\$2,552	\$4,300
2. Duke/NS	4,088	3,853	76,611	204,849	3.32	8.75	9.09	9.84	6,044	3,405	3,813
3. Duke/CSXT	4,141	6,982	39,842	94,656	3.29	8.67	9.09	9.81	4,892	3,924	3,993
4. CP&L	3,932	4,913	83,253	130,900	3.34	8.81	9.20	9.89	5,790	3,967	3,701
5. Xcel	446	22,157	13,797	42,549	3.43	8.00	9.57	12.26	1,793	2,690	4,427
6. <u>TMPA</u>	<u>4,932</u>	<u>24,709</u>	<u>47,234</u>	<u>74,344</u>	<u>3.19</u>	<u>4.51</u>	<u>7.15</u>	<u>10.46</u>	<u>2,225</u>	<u>3,862</u>	<u>4,409</u>
7. Mean (Expected Value) <u>4/</u>	\$3,012	\$12,603	\$45,930	\$96,620	\$3.41	\$7.55	\$8.89	\$10.77	\$3,843	\$3,400	\$4,107
8. Maximum Value <u>5/</u>	\$4,932	\$24,709	\$83,253	\$204,849	\$3.90	\$8.81	\$9.57	\$12.35	\$6,044	\$3,967	\$4,427
9. Minimum Value <u>6/</u>	\$446	\$3,853	\$13,797	\$32,423	\$3	\$5	\$7	\$10	\$1,793	\$2,552	\$3,701
10. Percent Difference - Max to Min <u>7/</u>	1006%	541%	503%	532%	22%	95%	34%	26%	237%	55%	20%
11. Average Absolute Deviation <u>8/</u>	\$1,682	\$7,354	\$23,103	\$47,503	\$0.17	\$1.34	\$0.58	\$1.02	\$1,732	\$519	\$272
12. Ratio Avg. Abs. Dev./Mean <u>9/</u>	56%	58%	50%	49%	5%	18%	7%	10%	45%	15%	7%

1/ Ex Parte 646 Table A-2

2/ Ex Parte 646 Table A-3

3/ Ex Parte 646 Table A-6

4/ Average, Lines 1 - 6

5/ Maximum Value, Lines 1 - 6

6/ Minimum Value, Lines 1 - 6

7/ (Line 8 - Line 9) ÷ Line 9

8/ (Σ[Line 7 - i]) ÷ 6 where i = Line 1 through Line 6

9/ Line 11 ÷ Line 7

Analysis of Other Road Property Investment Unit Costs from Full Stand-Alone Cost Cases

<u>Item</u> (1)	<u>Cost per Track Mile</u>		<u>Cost Per Route Mile</u>		<u>Cost per Grade Separation 5/</u> (6)
	<u>Construction 1/</u> (2)	<u>Other Earthwork 2/</u> (3)	<u>Signaling & Communication 3/ (w/o Grade Separation) 4/</u> (4)	<u>Public Improvement</u> (5)	
1. Otter Tail	\$550,664	\$36,260	\$168,669	\$24,391	\$561,877
2. Duke/NS	563,401	82,643	139,689	15,575	2,117,957
3. Duke/CSXT	549,626	78,399	156,914	3,549	469,857
4. CP&L	531,706	96,555	169,578	9,313	554,317
5. Xcel	588,465	59,027	209,142	33,597	539,225
6. <u>TMPA</u>	<u>602,974</u>	<u>33,303</u>	<u>81,883</u>	<u>46,521</u>	<u>832,437</u>
7. Mean (Expected Value) <u>6/</u>	\$564,473	\$64,365	\$154,313	\$22,158	\$845,945
8. Maximum Value <u>7/</u>	\$602,974	\$96,555	\$209,142	\$46,521	\$2,117,957
9. Minimum Value <u>8/</u>	\$531,706	\$33,303	\$81,883	\$3,549	\$469,857
10. Percent Difference - Max to Min <u>9/</u>	13%	190%	155%	1211%	351%
11. Average Absolute Deviation <u>10/</u>	\$20,831	\$21,501	\$29,018	\$12,679	\$424,004
12. Ratio Avg. Abs. Dev./Mean <u>11/</u>	4%	33%	19%	57%	50%
<u>1/</u> Ex Parte 646 Table A-4					
<u>2/</u> Ex Parte 646 Table A-5					
<u>3/</u> Ex Parte 646 Table A-8					
<u>4/</u> Ex Parte 646 Table A-10					
<u>5/</u> Ex Parte 646 Table A-11					
<u>6/</u> Average, Lines 1 - 6					
<u>7/</u> Maximum Value, Lines 1 - 6					
<u>8/</u> Minimum Value, Lines 1 - 6					
<u>9/</u> (Line 8 - Line 9) ÷ Line 9					
<u>10/</u> (Σ Line 7 - i) ÷ 6 where i = Line 1 through Line 6					
<u>11/</u> Line 11 ÷ Line 7					

APPENDIX B

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

DATED: OCTOBER 24, 2006

**Verified Statement of
Gerald W. Fauth III**

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**Verified Statement of
Gerald W. Fauth III**

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**Verified Statement of
Gerald W. Fauth III**

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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 is attached hereto as **Appendix GWF-1**.

I have been asked by Counsel for a group of trade associations and other interested parties, referred to herein as the **Interested Parties**,¹ 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,” which it indicates could be applied in so-called “*medium size rate disputes*.”² 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.³

In addition, the Board has 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**),

¹ 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.

² Proposed Simplified Standards, page 3

³ *Ibid.*, pages 3 and 11.

Simplified-SAC or the Three-Benchmark approach would be used in railroad rate reasonableness proceedings.⁴

I have been actively involved in the study of railroad rate reasonableness issues for over 25 years. I was actively involved in the Interstate Commerce Commission (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.

The Board's current rate reasonableness guidelines were initially established by the ICC in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines – Nationwide 1 I.C.C. 2d 520 (1985) (Coal Rate Guidelines). This 1985 ICC decision provides the regulatory framework, known as Constrained Market Pricing (CMP), now used by the STB for analyzing rail rate challenges. The CMP approach has been successfully applied in a number of ICC and STB cases, most often using a Full-SAC analysis, which has proved to be a time-consuming and extremely costly process.

The ICC struggled for nearly a decade to find an appropriate approach for smaller cases. In 1995, Congress abolished the ICC and directed the newly-created STB

⁴ 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)

“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.”⁵ The following year, in its December 27, 1996 decision in Ex Parte No. 347 (Sub-No. 2), Rate Guidelines – Non-Coal Proceedings (Simplified Guidelines), the STB formally adopted the established simplified standards known as the Three-Benchmark approach.

Now, more than 20 years after the CMP framework and the Full-SAC standard were formally adopted by the ICC and nearly a decade after the STB formally adopted the Three-Benchmark approach, the STB has created and introduced a complicated new economic procedure, i.e., Simplified-SAC, and has proposed several major and significant changes to its existing and established railroad rate reasonableness guidelines and standards.

This statement evaluates and describes: the complexity and problems associated with the STB’s proposed new Simplified-SAC procedure; problems associated with the STB’s proposed modifications to the Three-Benchmark approach; issues associated with the STB’s proposed new eligibility standards; and other problems associated with the Board’s proposals.

Based on my experience, my review of the Board’s proposals and various analyses that I have performed, I believe that the Board’s proposed new Simplified-SAC procedure for medium size disputes and its proposed modifications to the existing Three-Benchmark approach represent a major and unnecessary step backward in railroad rate

⁵ ICC Termination Act of 1995, 49 U.S.C. 10701(d)(3) (emphasis added)

reasonableness regulation. There are serious problems and numerous uncertainties associated with the Board's proposals which will take years to work through and straighten out in future railroad rate complaint proceedings, rulemaking proceedings and court appeals.

The Board has the authority to modify its established methods and, if it wishes, develop and propose new simplified procedures. However, the proposed new Simplified-SAC procedure is not the panacea for the problem that the Board purports it to be. In summary:

- Simplified-SAC is not a "simplified and expedited" method;
- Simplified-SAC does not replicate the Full-SAC standard;
- A SAC procedure, whether Simplified-SAC or Full-SAC, is unworkable for most non-coal shippers;
- Simplified-SAC will undoubtedly result in higher rates than Full-SAC; and
- The STB has not provided the results of any testing to certify that its proposed new Simplified-SAC procedure will produce realistic results and protect captive shippers from paying unnecessarily high rates.

The proposed Simplified-SAC procedure is complex and contains numerous uncertainties. It would involve thousands of hours of work associated with: research of factors and data necessary to meet the Simplified-SAC requirements, traffic analyses, economic analyses and other work to utilize and apply the proposed new procedure. The uncertainties associated with the proposed procedure could add hundreds

of more hours to the process. The Board's proposed 18 month procedural schedule does not represent an expedited schedule.

STB's proposed Simplified-SAC procedure also include major departures from a basic premise of the STB's well-established CMP framework in that the resulting maximum reasonable rates under the Simplified-SAC procedures would reflect inefficiencies associated with the existing movements and thus would result in rates which are significantly elevated over those that would apply in an optimally efficient system.

The Board maintains that departures from the Full-SAC standard are necessary in order to develop a simplified approach. However, it is evident that the proposed departures and procedures will result in higher maximum reasonable rates. The STB has not provided the results of any testing of its proposed Simplified-SAC procedures which could be used to evaluate the reasonableness of this trade-off.

It is clear that the STB's proposed new eligibility presumptions are far too low. Contrary to the Board's estimates, under the proposed new eligibility presumptions very little traffic would qualify to use the proposed new Simplified-SAC procedure. Most shippers would be forced to use the expensive and time-consuming Full-SAC standard and the Three-Benchmark approach would probably never be used.

The Board should withdraw the proposed new Simplified-SAC procedure and retain the existing Three-Benchmark approach, with certain modifications. The Board should also consider increasing the eligibility presumptions to a reasonable level, such as the \$7.2 million level previously advocated by the Interested Parties.

II. SUMMARY OF FINDINGS

- **Major Regulatory Step Backward** - A brand new and untested economic standard was not required or necessary to resolve the issues. The problems associated with the Board's existing Three-Benchmark approach primarily concerned eligibility for, and uncertainties associated with, the application of the established approach. These problems could have been addressed without the introduction of a complicated new and untested economic procedure. The problems and issues associated with the proposed new procedure will take many years to resolve.
- **Simplified-SAC is Not a "Simplified and Expedited" Method**. Simplified-SAC is a misnomer. It is anything but a simple test and the Board's proposed 18-month procedural schedule does not represent an expedited schedule. As such, it does not represent a "simplified and expedited" method for the determination of rate reasonableness as mandated by Congress. The Board's proposed Simplified-SAC procedure would take thousands of hours to develop. Moreover, there are many inherent uncertainties associated with the proposed standard which would take hundreds of more hours and days to resolve. I estimate that economic consulting fees alone in a Simplified-SAC case could range from approximately \$500,000 to \$1.25 million compared to an estimated range of \$115,000 to \$225,000 for a case involving the proposed Three-Benchmark approach..
- **Simplified-SAC versus Full-SAC** - SAC, whether Simplified-SAC or Full-SAC, is unworkable for most non-coal shippers. Simplified-SAC represents a major departure from a basic premise of the STB's well-established CMP framework, i.e., Full-SAC is based on hypothetical and *optimally efficient* stand-alone transportation system, whereas, Simplified-SAC is based on the replacement of *existing* facilities. The Board has also proposed the use of Class I system average URCS costs to determine the operating expenses associated with the Stand Alone railroad (SARR), which would not reflect the optimally efficient operating characteristics of the SARR. For these and other reasons discussed herein, the proposed Simplified-SAC approach would necessarily generate *higher rates* than the accepted Full-SAC approach.

- **Simplified-SAC Testing Required** - The STB must make certain and assure the public that the proposed new Simplified-SAC procedure produces realistic results and protects captive shippers from paying unnecessarily high rates. The STB has not provided the results of any evaluations or testing that it may have performed on its proposals. The STB should have performed such evaluations and testing *before* it proposed such major changes to its rate reasonableness guidelines. It is difficult for outside experts to independently test the STB's proposals. The ICC provided public testing of a previously considered Simplified-SAC procedure and the STB subsequently rejected the approach, in part, because of the inordinately high results of these public tests.
- **Most Shippers Would Be Forced to Use Full-SAC** - Contrary to the Board's estimates, under the proposed new eligibility presumptions very little traffic would qualify to use the proposed new Simplified-SAC procedure. The proposed \$3.5 million MVC boundary is far too low. Based on this proposed standard and the Board's aggregation proposal, most "middle-size" shippers would be forced to use the costly Full-SAC standard. Only an extremely small group of traffic would qualify for the Three-Benchmark approach and that traffic would be unlikely to use it because no one would want to start a rate litigation involving only a few cars per year. In fact, the Board's proposed \$200,000 MVC standard for small disputes will result in the *de facto* abandonment of the established Three-Benchmark approach.
- **Withdraw Simplified-SAC - Retain and Fix Three-Benchmark** - The Board should withdraw proposed Simplified-SAC procedure and retain, with certain minor modifications, the existing Three-Benchmark approach.

III. STB'S PROPOSED NEW SIMPLIFIED-SAC PROCEDURE

1. Brief Description of STB's Proposed New Procedure

Like the Full-SAC standard, the Board's proposed new Simplified-SAC procedure is based on a complicated replacement cost methodology. The STB's proposed procedure has most of the same elements as the existing Full-SAC approach. However, there are several key differences between Full-SAC and the proposed new procedures. The STB's proposed Simplified-SAC procedure is primarily based on the replacement cost of the railroad's *existing facilities*, whereas the existing Full-SAC standard is based on the replacement cost of a *hypothetical and optimally efficient* stand-alone transportation system designed to maximize efficiencies and production economies.⁶ The STB has attempted to modify the Full-SAC standard by shifting to this "existing facilities" approach and by "eliminating or restricting the evidence parties can submit on certain issues."⁷

2. Major Regulatory Step Backward

The STB has proposed these changes in an attempt to correct what it perceives as basic problem with the existing Three-Benchmark approach, i.e., "a decade has passed . . . without any shipper presenting a case that has been decided under

⁶ See Proposed Simplified Standards, page 12. See also Coal Rate Guidelines, e.g., page 27: "The purpose of a SAC analysis is to determine the least cost at which an efficient competitor could provide the service . . ." (emphasis included).

⁷ Proposed Simplified Standards, page 12

Simplified Guidelines.”⁸ The Ex Parte No. 646 proceeding was initiated in an effort to determine why no cases have been brought under the 1996 rules and to solicit suggestions on how to improve them.

There are two problems areas associated with the Board’s existing Three-Benchmark approach that were identified in the STB’s 2003 and 2004 hearings: issues relating to eligibility for small case status; and issues related to uncertainties associated with the approach. The problems associated with the Board’s established Three-Benchmark approach are not complicated and should not be difficult to resolve. Rather than focusing on these issues, however, the Board has essentially decided to *throw the baby out with the bathwater* by creating and proposing a new, complicated and untested Simplified-SAC procedure and by proposing to restrict the use of the established Three-Benchmark approach. In doing so, the Board has taken a major regulatory step backward and has essentially started the rulemaking process all over again.

Based on history, it could take another decade of STB proceedings and court appeals to work through and straighten out the new proposals set forth by the Board in its most recent decision. During the STB hearings in 2003, former STB Chairman Linda Morgan voiced this concern:

⁸ *Ibid.*, page 3

COMMISSIONER MORGAN: You talked about what I guess I would term simplified SAC as another approach to handling these cases, and of course, we had that conversation originally in the record that resulted in the guidelines that we have today. **My only concern with that would be that that would start a whole new process again.** In other words, we have these three guidelines in place. There's discussion of how to make that work better. If we were to pursue some new option, simplified SAC, for example, obviously there's more meat that has to be put on those bones and that's going to require some time.⁹

Here, the Board has decided to "start a whole new process again."

However, there are serious problems with the Board's proposed new Simplified-SAC procedure and it appears that it was prematurely proposed since the Board has not provided any testing which would show that that it produces realistic results and protects captive shippers from paying unnecessarily high rates.

**3. STB's Proposed New Simplified-SAC Procedure
Is Neither a Simplified or Expedited Method**

The name of the STB's proposed new rate reasonableness standard, i.e., Simplified-SAC, is a misnomer. It is anything but a simple test. The Board's proposed 18-month procedural schedule cannot be called expedited. Thus, it does not represent a "simplified and expedited" method for the determination of rate reasonableness as mandated by Congress.

As indicated in the Board's Appendices A, B and C, the proposed Simplified-SAC procedure would involve numerous complicated components and steps. Like the Full-SAC method, the proposed new Simplified-SAC procedure is based on a

⁹ April 22, 2003 Hearing on Simplified Procedures for Small Rate Cases, STB Ex Parte No. 646 (emphasis added).

complicated replacement cost methodology which has most of the same elements as the Full-SAC standard. Both tests require a substantial amount of time-consuming work.

For example, both the Full-SAC and Simplified-SAC procedures require detailed analyses of the required Road Property Investment (**RPI**) for the selected SARR. As indicated in Appendix A of the Board's decision, it rejected a simplified approach for determining RPI based on a "cost per mile" because it "could sacrifice too much accuracy for simplicity."¹⁰ Instead, the Board has proposed to apply investment values from prior Full-SAC cases to the existing assets that have been identified and determined to be required for the SARR in a Simplified-SAC case.

The STB's proposed approach may simplify the *valuation* process (i.e. valuing the assets), but the complainant in such proceedings would still be responsible for the time-consuming *identification* of the SARR assets, such as land, track, bridges, tunnels, etc., which is usually the most time-consuming process associated with the Full-SAC standard. This detailed and time-consuming asset identification process would involve obtaining and reviewing of ICC Engineering Reports, track charts and other information, some of which can only be obtained through discovery.¹¹ This asset identification process alone usually involves hundreds of man hours of work.

¹⁰ Proposed Simplified Standards, page 39

¹¹ Although ICC Engineering Reports carry the name ICC, they are no longer maintained by the STB. Most of the original reports are available through the National Archives, however, most of these reports have not been updated in many years. Moreover, these reports are not available for all railroad lines (Proposed Simplified Standards, page 41).

For example, in order to determine the land value, a complainant in a Simplified-SAC case (after the route has been established) would be required to determine the acreage required for the SARR and determine zoning or land use (i.e., agricultural, residential, industrial or commercial) for each of the identified line segments. This can involve retaining a local land use expert(s) and careful and time-consuming reviews of railroad track charts, deeds, local zoning records and other information. After the required land assets are identified and evaluated, the STB's proposed land values would be applied to determine the land cost.

In addition to determining the RPI, the STB's proposed Simplified-SAC procedure would involve the development of: the Traffic Group; Cross-Over Traffic; Total SARR Operating Expenses; a Discounted Cash Flow (**DCF**) analyses; and many other analyses. In addition, if, as proposed, a defendant railroad raises an internal cross-subsidy defense, many of these developments will be revised and additional analyses will be required. As discussed in more detail herein, the development of these components would involve and require thousands of hours of work.

In contrast to the Board's Full-SAC standard and the proposed Simplified-SAC procedure, a Three-Benchmark approach can developed and structured to represent as a *simplified and expedited* method. Although problems and uncertainties remain with the approach, it involves a limited number of steps:

- (1) Determine the variable cost and the resulting revenue-to-variable ratio(s) for the issue movement(s) using the STB's URCS Phase III costing system;
- (2) Determine average revenue-to-variable cost ratios for comparable groups using the STB's Waybill Sample (i.e., the R/VC_{COMP} test); and
- (3) Adjust and compare the results from steps one and two using the RSAM and $R/VC_{>180}$ ratios published by the STB.

In addition to requiring fewer steps and economic analyses, the Three-Benchmark approach is based on data and information which are maintained by the STB (i.e., the Waybill Sample and URCS) which is relatively easy to obtain and process in regulatory proceedings. In contrast, the proposed Simplified-SAC procedure requires the time-consuming process of obtaining and analyzing data and information that are maintained by the railroads.

4. Estimated Economic Consulting Fees Associated with Simplified-SAC

The Board's proposed Simplified-SAC procedure would take thousands of man-hours to develop, even if the required data and information was readily available. Moreover, there are many inherent uncertainties associated with the proposed procedure which would take hundreds of additional hours and days to resolve. I have prepared a summary of the work and steps that would be required in a Simplified-SAC case, which is attached hereto as **Appendix GWF-2**. This estimate assumes that the Board's proposed Simplified-SAC procedure is a viable and workable approach (which it is not) and that it would produce reasonable and realistic results (which has not been

demonstrated by the STB). I estimate that the consulting fees in a Simplified-SAC case could range from approximately \$500,000 to \$1.25 million which excludes attorney fees and other consulting fees that may be required.

5. Existing versus Optimally Efficient Facilities

The STB has proposed to discard a key element of the well-established CMP framework that is reflected in a Full-SAC presentation, i.e., the Full-SAC constraint that protects a captive shipper from bearing the *cost of inefficiencies* associated with the defendant's current operations. As previously stated, the STB's proposed Simplified-SAC procedure is primarily based on the replacement cost associated with the railroad's *existing* facilities rather than the most *optimally efficient* facilities.

The STB attempts to justify this dramatic change in its position by stating that "times have changed" (in the last ten years) and that the railroads are "no longer burdened by substantial excess capacity." The STB does admit, however, that the proposed new standard "may not fully implement CMP principles"¹² In fact, the elimination of efficiency considerations is a major and fundamental problem and flaw associated with the STB's proposed new Simplified-SAC procedure. While it is true that the railroad industry has become more efficient in recent years, the industry is far from being considered as an *optimally efficient* industry.

It is very unlikely that the existing facilities associated with any existing railroad movement would represent the most optimally efficient facilities. As a result,

¹² Proposed Simplified Standards, page 11

the route, assets, operating expenses, and other factors associated with the hypothetical and optimally efficient SARR systems in Full-SAC cases would be very different from those required for SARR systems based on existing facilities in Simplified-SAC cases. In fact, a hypothetical and optimally efficient stand-alone transportation system may not even be a railroad system at all. For example, a complainant in a Full-SAC case could design a hypothetical pipeline to replace its existing rail service.

There are many examples which can be used to demonstrate the problems associated with the use of existing facilities. First, many existing railroad lines were built over a hundred years ago over routes that would not be selected today. Circuitous routes were often selected, such as following rivers to avoid difficult terrain, which was difficult to overcome in the days before modern construction equipment and engineering techniques. There were also political and other factors involved in route selection. Recent railroad mergers have also had a significant impact on existing railroad routing.

As a result, existing railroad routes are not always the most direct or efficient. For example, the New York Central, now part of the NS as a result of the Conrail transaction, was known as the "Water Level Route" as its main line from Buffalo to New York City was routed circuitously along the picturesque Hudson River. It is doubtful that such a circuitous route along valuable waterfront property would be selected today.

Dimensional clearance and weight restriction problems persist over many existing railroad routes as a result of obsolete tunnels, bridges and track design. In fact, these problems have probably intensified in recent years as railroads have sought to improve productivity and profitability by acquiring and utilizing double-stack cars, larger

hopper and tank cars and higher boxcars and auto-rack cars. Attached hereto as **Appendix GWF-3** is a map of the U.S. railroad main line systems produced by the Railway Industrial Clearance Association of North America. As indicated by this map, many existing railroad main line routes have clearance restriction problems.

Although NS is revenue adequate, it continues to make investments to improve the efficiency of its system. For example, NS recently received \$95 million in Federal funding for a \$311 million public-private initiative known as the Heartland Corridor project which will cut 233 miles off its existing route between Norfolk, Virginia and Chicago, Illinois by modifying 29 tunnels and 24 bridges and other overhead obstructions.¹³

Chicago, which is the largest and busiest railroad gateway in North America, provides another example of the railroads improving the efficiency associated with existing facilities. The Chicago Region Environmental and Transportation Efficiency Program (**CREATE**) is an even larger public-private initiative between the State of Illinois, City of Chicago, Metra and the nation's railroads. CREATE will invest \$1.5 billion in critically needed rail infrastructure improvements in the Chicago area which will eliminate 25 grade crossings and greatly improve the efficiency of railroad traffic moving through Chicago.¹⁴ There would be no need for these major improvements in Chicago if the railroads' existing facilities were optimally efficient.

¹³ <http://www.nscorp.com>

¹⁴ <http://www.createprogram.org>

In some cases, even the shortest route may not be the most optimally efficient route under the existing Full-SAC standard. This was emphasized by the ICC in

Coal Rate Guidelines:

The parties will have broad flexibility to develop the least costly, most efficient plant. The plant should be designed to minimize construction (or acquisition) and operating costs and/or maximize the carriage of profitable traffic. In selecting the route of a SAC railroad, for instance, an overriding factor may be the effort to lower costs by taking advantage of economies of density. Generally, a stand-alone railroad would attempt to fully utilize plant capacity, adding other profitable traffic in order to reduce the average cost of operation. Thus, the stand-alone railroad may not represent the shortest route for the captive shipper, but the one with the highest traffic densities. The factors to be considered depend upon individual circumstances. Hence the optimal size and placement of the physical plant must be determined on a case-by-case basis.¹⁵

As a consequence of the STB's proposal to use existing facilities in the Simplified-SAC procedure, the railroad rates resulting from the application of the procedure would necessarily be *higher* than rates produced by the STB's Full-SAC standard. This was the primary reason why the ICC and the STB rejected a previously proposed Simplified-SAC approach presented to the ICC by the Association of American Railroads (AAR) in 1992:

¹⁵ Coal Rate Guidelines, pages 28 and 29.

First, whereas the purpose of CMP-SAC is to estimate the cost of a hypothetical and optimally efficient stand-alone transportation system designed to maximize efficiencies and production economies, the AAR-SSAC model is *restricted to segments of the existing rail system*. Moreover, all lines in the rail network are valued at full replacement cost, even though *not all existing railroad assets should, or ever would, be replaced*. Because it is doubtful that an optimally efficient carrier entering the market would use the same technology and same assets as the existing carrier, AAR-SSAC is not based on a fully efficient system.³³ Thus, the program fails one of the basic purposes of CMP-SAC, which is to determine the cost of an optimally efficient system. As a result, the model appears biased in the railroad's favor by using costs that are higher than those used by CMP-SAC.¹⁶

As previously stated, the Board maintains that the railroads are “no longer burdened by substantial excess capacity.” The fact that railroads have been “shedding track capacity” and are “increasingly operating in a capacity-constrained environment” does not mean that the railroads are “no longer burdened by substantial excess capacity.”¹⁷

As indicated by the Board in Simplified Guidelines “not all existing railroad assets should, or ever would, be replaced.” Despite any industry-wide capacity constraints that may exist, it is very unlikely that any existing individual railroad movement would represent an optimally efficient movement as represented in a Full-SAC analysis.

¹⁶ Simplified Guidelines, page. 10 (emphasis added).

¹⁷ It may well be that, to a greater or lesser extent, what is commonly called a “capacity” shortage today may not represent a literal shortage of capacity, but instead the result of the railroads reallocating their resources, such as allocating more capacity to intermodal or other select traffic, and that there may be more capacity available if certain types of traffic did not receive preferred handling.

6. **Full-SAC and Simplified-SAC Are
Unworkable For Most Non-Coal Shippers**

The Board was required by Congress to develop a “simplified and expedited method” which could be used to establish maximum reasonable rates when Full-SAC is too costly. The Board was not necessarily required to develop a simplified and expedited SAC method.¹⁸ In fact, a SAC approach, albeit Full-SAC or Simplified-SAC, is unworkable for most non-coal shippers and will deprive them of a rate remedy absent an accessible and effective alternative.

The Full-SAC standard was expressly designed for coal shippers, specifically western coal shippers.¹⁹ In the development and application of SAC, the three most important elements are: *density, density and density*. Consequently, the SAC approach generally only works for repetitive, high volume movements, such as coal. In fact, the Full-SAC standard has only been applied in two non-coal railroad rate cases (the most recent of which was filed with the STB in 1997).²⁰

Even the largest non-coal shippers cannot match the densities associated with most coal movements. For example, the 2004 Waybill Sample indicates that nearly 400 million tons of coal (STCC 11) moved at rates which exceeded the Board’s

¹⁸ It should be noted that the STB was required to develop a “simplified and expedited *method*” and not “*methods*,” as it has proposed here. The fact that the Board has proposed to have two simplified and expedited methods in place rather than a single method further complicates the process.

¹⁹ See ICC Ex Parte No. 347, Western Coal Investigations – Guidelines for Railroad Rate Structure.

²⁰ See STB Docket No. 37809, McCarty Farms, Inc. et al. v. Burlington Northern, served August 20, 1997 and STB Docket No. 42022, EMC Wyoming Corporation, et al. v. Union Pacific Railroad Company, served May 12, 2000.

jurisdictional R/VC threshold of 180 percent. The largest commodity group that was identified by the Board as being potentially eligible for the Simplified-SAC procedure was Chemicals (**STCC 28**). The 2004 Waybill Sample indicates that only 24 million tons of Chemicals moved at rates which exceeded 180 percent.

The AAR ultimately conceded that a Simplified-SAC approach was not a suitable approach and eventually abandoned the approach in favor of an alternative Shipper Specific Market Pricing or SSMP approach, which was also later rejected by the STB:

Even with such modifications, however, AAR now concedes that AAR-SSAC would not provide a useful rate reasonableness test for the type of traffic for which simplified procedures are needed.³⁸ According to AAR, that is because the low-volume shipper is least likely to be cross-subsidizing other traffic; to the contrary, the low-volume shipper benefits most from the economies of scale, scope, and density that characterize the rail industry.³⁹ Thus, even with grouping, AAR concedes that a SAC-type procedure would not offer rate relief to a low-volume shipper. (Footnote 38 and 39 references included)²¹

7. Identification of SARR Traffic

An example of the unworkable and time-consuming nature of the Board's proposed Simplified-SAC procedure is in the development of the existing traffic and potential Cross-Over Traffic over the hypothetical SARR.²²

²¹ Simplified Guidelines, page. 12

²² The STB defines cross-over traffic as follows: "Cross-over" traffic refers to movements for which the SARR would not replicate all of the defendant railroad's current movement, but would instead interchange the traffic with the residual portion of the railroad's system. (Proposed Simplified Standards, page 13, footnote 21)

In Full-SAC cases, this traffic identification process usually involves the identification of other similar, high-volume, predictable and profitable coal traffic which generally moves from the same concentrated geographic areas (such as the Powder River Basin in Wyoming or the Allegheny coal region in Kentucky and West Virginia), to a relatively limited number of destinations (such as the issue and other nearby utility plants). For example, publicly available data from Federal Energy Regulatory Commission's (FERC) Form 423, Monthly Cost and Quality of Fuels for Electric Plants, can be used in coal rate cases to help identify potential cross-over coal traffic.

Although the SARR traffic identification process in Full-SAC cases generally involves similar and predictable coal traffic, it is still a time-consuming and complicated process. However, it would not be nearly as simple in non-coal rate cases, whether using the Full-SAC standard or the proposed Simplified-SAC procedure. The traffic pools in most non-coal cases would involve a greater percentage of non-coal movements, such as intermodal or chemical traffic, which involve thousands of origins and destinations and multiple routings which would be more difficult to identify and evaluate.

For example, the 2004 Waybill Sample indicates that regulated movements of plastics (STCC 28-211), which is one of the largest groups of captive shippers, moved from 318 different origins and to 1,104 individual destinations, which would equate to 351,072 potential origin and destination pairs. The origins and destinations for regulated STCC 28-211 rail traffic are spread throughout the United States and generally are not located in major coal producing areas as illustrated in the following table:

Table 1

**Major Origin and Destination States for
Regulated STCC-28-211 Railroad Movements**

<u>STCC 28-211 Origins</u>		<u>STCC 28-211 Destinations</u>	
<u>State</u>	<u>Number</u>	<u>State</u>	<u>Number</u>
Texas	48	Ohio	80
Ohio	24	California	67
Illinois	20	Pennsylvania	63
North Carolina	17	Illinois	55
South Carolina	17	North Carolina	56
Louisiana	15	New Jersey	45
Michigan	13	Indiana	44
Georgia	13	Virginia	37
Mississippi	11	New York	34
New Jersey	11	Wisconsin	34
Pennsylvania	11	Massachusetts	21

Since most of the STCC 28-211 origins and destinations are not in the major coal producing areas, a hypothetical SARR for such movements would unlikely be able to adequately benefit from profitable high-volume and easily identifiable coal traffic. It is likely that some of these destinations could be close to coal destinations, i.e. coal fired electric generating facilities. However, any such potential traffic would be difficult to identify and would likely only involve a limited portion of the SARR.

Such movements could involve other non-coal main lines with high-volumes of general commodity traffic. For example, the Board states that a captive farmer or grain elevator in the Upper Mid-West could include certain "bridge traffic" of "large volumes of intermodal and other traffic that neither originates nor terminates in

that region, but flows over the rail network to other destinations.”²³ There would be many differences between the economies associated with high-volume intermodal traffic and high-density coal traffic. Intermodal traffic (which is exempt from STB regulation) moves to thousands of facilities and generally moves at less profitable rate levels. As a result, any such profitable traffic may be limited and difficult and time-consuming to identify.

As a consequence, the traffic identification process in a Simplified-SAC case could easily be much *more difficult* than the traffic identification process in coal cases using the Full-SAC standard. Moreover, the results are likely to yield higher SAC rates.

8. Internal Cross-Subsidy Inquiry

The Board has proposed that the so-called “internal cross-subsidy test” applied in two recent coal rate cases employing the Full-SAC standard could be used by the railroad defendants’ in Simplified-SAC cases as an “affirmative defense.”²⁴ The acceptance of this cross-subsidy test will make it impossible for small shippers on lighter-density lines to obtain relief and will complicate and certainly will not simplify the process. Moreover, the Board’s proposed restrictions concerning the use of existing facilities and its proposed acceptance of the use the cross-subsidy test will essentially limit the traffic for the hypothetical SARR in Simplified-SAC cases to portions of the

²³ Proposed Simplified Standards, page 14

²⁴ *Ibid.*, page 13

existing bridge traffic over the line. These limitations will result in higher SAC costs and rates.

**9. Use of Adjusted Class I URCS
System Average Operating Expenses**

In an effort to “*dramatically simplify*” the Full-SAC approach, the Board has proposed to change the method in which the SARR operating expenses are calculated by using URCS system-average operating expenses.²⁵ The Board maintains:

We can use system-average URCS costs because the traffic that would share the SARR facilities *should reflect* a mix of traffic with some combinations of unit train traffic, intermodal traffic, and general merchandise traffic. Some traffic may use more than the system-average number of locomotives, for example, while other traffic may use fewer than the system average number of locomotives. But the combined operating expenses of the traffic *should be close to* the system-average. Thus, the system-average operating characteristics *should provide a reasonable surrogate for* calculating the operating expenses for all the traffic traveling over the SARR.²⁶

The Board asserts that this system-average approach *should* reflect, be close to, and provide a reasonable surrogate for the determination of the SARR operating expenses. However, the Board makes these assumptions without providing any testing or comparative analyses.

²⁵ *Ibid*, page 49

²⁶ *Ibid.*, page 50 (emphasis added).

The Board lists the following cost categories that would be developed using adjusted URCS system-average operating expenses:²⁷

Train and Engine Personnel;
Locomotive Lease Expense;
Locomotive Maintenance Expense;
Locomotive Operating Expense;
Railcar Lease Expense;
Material and Supply Operating;
Ad Valorem Taxes;
Joint Facilities;
Operating Managers;
General and Administrative;
IT Systems and Communications;
Loss and Damage;
Insurance; and
Maintenance-of-Way.

While I agree that this proposed approach would simplify the development of the SARR operating expenses, it is clear that this proposed change would also *dramatically increase* the SARR's operating expenses and the resulting rates. The operating expenses for an optimally efficient SARR would obviously be substantially lower than the operating expenses for any existing Class I carrier, both on an aggregate or per-unit basis. Most hypothetical SARR's would involve only segments of the Class I carriers and operate and Class II or Class III carriers. For example, in Otter Tail the

²⁷ Ibid., page 49, footnote 62, lists 15 different cost categories. On page 50, the Board indicates that one category, i.e., training and start-up, would be understated using URCS and, therefore, actual training expenses would be used.

Board found that the Train and Engine Personnel expense for the OTRR SARR was \$46.0 million.²⁸ In contrast, the Engine and Train Crew cost for BNSF was \$1.2 billion in 2005.²⁹

The large Class I carriers would enjoy some economies of scale. For example, fuel costs per gallon for a Class I carrier may be lower than a SARR could achieve because of its buying power and ability to hedge fuel. However, a SARR would have equipment, facilities and operations which are optimally efficient, thus its unit costs would necessarily be lower than the Class I average unit costs. For example, a SARR may lease or purchase an entire new fleet of locomotives which would be more fuel-efficient and more efficiently managed and maintained. The SARR could also operate with more efficient crew allocations, whereas Class I carriers are burdened with antiquated labor agreements. Maintenance of way costs would be lower as the result of hypothetical track replacement.

These efficiencies usually more than offset any additional costs that the SARR would incur. A real example of the differences between the operating expenses of an efficient new competitor (such as an SARR) with an old established industry (such as the railroad industry) can be found by comparing the profits associated with the North American operations of the Japanese automotive companies (i.e., Toyota Motor Corporation, Nissan Motor Company, and Honda Motor Company) with the profits generated by the Big Three automakers (i.e., General Motors Corporation, Ford Motor

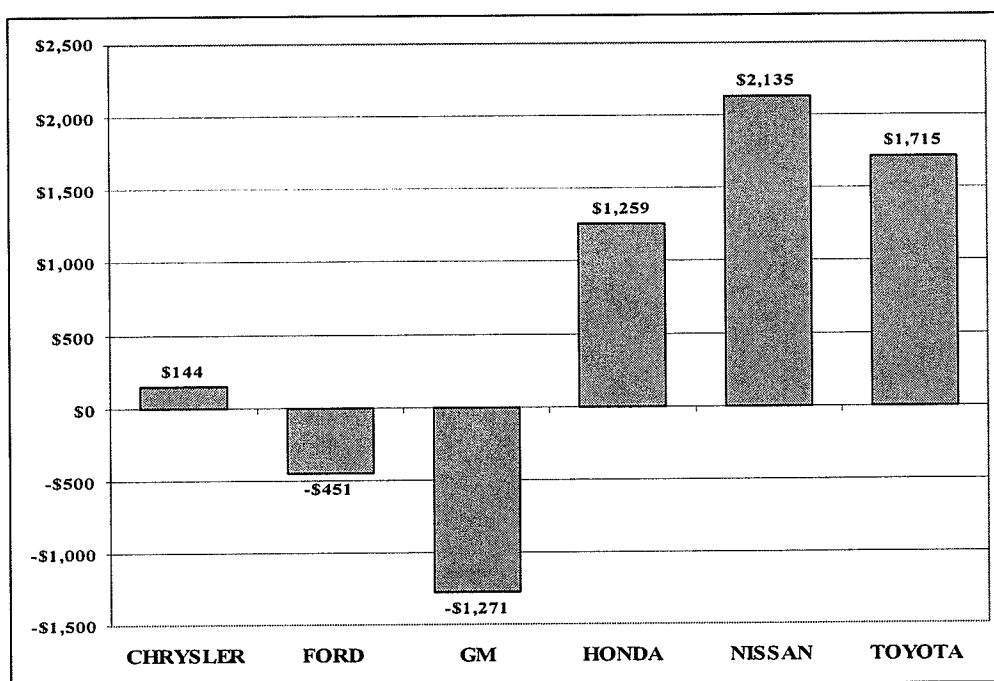
²⁸ STB Docket No. 42071, served March 28, 2006, page 3

²⁹ BNSF 2005 R-1 Schedule 410, Lines 402 and 403.

Company and the Chrysler Group of DaimlerChrysler Corporation). The 2005 profits per vehicle are summarized in the following chart:

Chart 1

**Comparison of 2005 North America
Profits Per Vehicle For the Automotive Industry³⁰**



As can be seen, the profits per vehicle for the Japanese automakers are substantially higher than the profits and losses of the Big 3 U.S. automakers. These differences are a result of several factors. The Japanese automakers have invested billions of dollars to build new efficient plants and facilities in North America. For

³⁰ Source: October 2006 Report titled: Automotive Competitive Challenges, Going Beyond Lean, by The Harbour-Felax Group, Royal Oak, Michigan. Based on 2005 Corporate Annual Reports. Note: Profit data before tax and write-offs.

example, Toyota has invested \$16.3 billion in new plants and facilities in North America and employs over 38,000 people in its North America operations.³¹ The Japanese have built new efficient plants with greater manufacturing flexibility. The Japanese automakers are also not burdened by antiquated labor agreements and so-called “legacy costs” associated with health care and pensions for a large group of retired workers. As a result, the Japanese automakers’ North American plants and operations have much lower labor and operating costs.³²

As efficient new competitors, the Japanese automakers have operating expenses which are substantially lower than the Big 3 automakers. There would be a similar difference between the hypothetical operating expenses of the optimally efficient SARR and the revenue inadequate U.S. railroad industry. Consequently, the use of URCS system average operating expenses would overstate the operating cost of the SARR and the resulting maximum reasonable rate(s) in cases which utilized the proposed Simplified-SAC procedure.

10. Use of Rolling Averages From Prior Coal Cases

The Board has proposed to use “rolling-average” costs from prior coal rate cases to determine the RPI of the SARR in Simplified-SAC proceedings. These RPI costs include:

³¹ Toyota.com, Investor Fact Sheet.

³² Harbour-Felax Report

- (1) Land,
- (2) Roadbed Preparation,
- (3) Track,
- (4) Tunnels,
- (5) Bridges and Culverts,
- (6) Signals and Communications,
- (7) Buildings and Facilities,
- (8) Public Improvements,
- (9) Mobilization,
- (10) Engineering, and
- (11) Contingencies

The Board recognizes that cost differences exist but maintains that using its proposed rolling-average approach is justified because of the “high cost” associated with a more accurate development of these costs.³³ The Board presents various comparisons of land costs, earthwork costs, track costs, etc. from findings in previous cases which used the Full-SAC standard.³⁴ However, these Tables only serve to demonstrate the problems associated with the proposed “rolling-average” approach. For example, the following chart shows that differences in RPI costs in prior cases:

³³ Proposed Simplified Standards, page 41

³⁴ *Ibid.*, see Tables A-2 through A-11, pages 40 through 48.

Table 2
Comparison of RPI Unit Costs
From Prior STB Full-SAC Cases

<u>Cost Item</u>	<u>STB Table</u>	<u>Unit Cost Range</u>		<u>Average</u>
		<u>Low</u>	<u>High</u>	
Agricultural Land Cost Per Acre	A-2	\$446	\$4,932	\$3,012
Residential Land Cost Per Acre	A-2	\$3,853	\$24,709	\$12,603
Industrial Land Cost Per Acre	A-2	\$13,797	\$83,253	\$45,930
Commercial Land Cost Per Acre	A-2	\$42,549	\$204,849	\$96,620
Common Earthwork Cost Per Cubic Yard	A-3	\$3.19	\$3.90	\$3.41
Loose Earthwork Cost Per Cubic Yard	A-3	\$4.51	\$8.81	\$7.55
Solid Earthwork Cost Per Cubic Yard	A-3	\$7.15	\$9.57	\$7.55
Borrow Earthwork Cost Per Cubic Yard	A-3	\$9.81	\$12.35	\$10.77
Other Earthwork Cost Per Mile	A-4	\$33,303	\$96,555	\$64,365
Track Construction Cost Per Mile	A-5	\$531,706	\$602,974	\$564,469
Bridge Type 1 Cost Per Foot	A-6	\$1,793	\$6,044	\$3,843
Bridge Type 2 Cost Per Foot.	A-6	\$2,552	\$3,924	\$3,862
Bridge Type 3 Cost Per Foot	A-6	\$3,701	\$4,427	\$4,107
Signaling & Communications Cost Per Mile	A-8	\$81,883	\$209,142	\$154,313
Buildings & Facilities Cost Per Ton	A-9	\$0.234	\$0.591	\$0.423
Public Improvement Cost Per Mile	A-10	\$3,549	\$46,521	\$22,158
Grade Separation Cost Per Separation	A-11	\$469,857	\$2,117,957	\$845,945

As can be seen, there are significant differences between the RPI unit costs in prior cases which used the Full-SAC standard. In many cases, the average cost is more than double the low value and less than half of the high value. Therefore, the use of rolling averages can dramatically affect the results. The following table demonstrates the potential impact of using average land values:

Table 3

**Example of Potential Differences in Land Values
Using The STB's Rolling Average Approach**

<u>Ln.</u>	<u>Item</u>	<u>Amount</u>
1	Assumed Length of SARR (Miles)	500
2	Assumed Width of Right of Way (Ft)	50
3	Feet Per Mile	5,280
4	Total Square Ft of Area (L.1xL.2xL.3)	132,000,000
5	Square Ft. Per Acre	43,560
6	Total Acres (L.4/L.5)	3,030.30
7	Agricultural Acres (50% Assumed)	1515.15
8	Residential Acres (30% Assumed)	909.09
9	Industrial (10% Assumed)	303.03
10	Commercial (10% Assumed)	303.03
11	Low Agricultural Land Cost	\$675,757
12	Low Residential Land Cost	\$3,502,724
13	Low Industrial Land Cost	\$4,180,905
14	Low Commercial Land Cost	<u>\$12,893,623</u>
15	Low Total Land Cost	\$21,253,010
16	High Agricultural Land Cost	\$7,472,720
17	High Residential Land Cost	\$22,462,705
18	High Industrial Land Cost	\$25,228,157
19	High Commercial Land Cost	<u>\$62,075,392</u>
20	High Total Land Cost	\$117,238,974
21	Average Agricultural Land Cost	\$4,563,632
22	Average Residential Land Cost	\$11,457,261
23	Average Industrial Land Cost	\$13,918,168
24	Average Commercial Land Cost	<u>\$29,278,759</u>
25	Average Land Cost	\$59,217,820

As can be seen, the use of rolling averages can dramatically skew the results. This is especially true for land values which, as the Board admits are “affected by location.”³⁵ However, as Table 2 shows, there are significant differences between the other costs as well.

³⁵ Proposed Simplified Standards, page 41

**11. Use of a Test Year With 5-Year True Up
Approach versus the 20-Year DCF Model**

The Board has proposed to change from the current 20-year Discounted Cash Flow (DCF) model to a single “Test Year” approach. Under this Test Year approach, the “operating expenses of the SARR would be estimated only for the Test Year.”³⁶ After the results are determined for the Test Year, the Board proposes that “the parties would be instructed to apply the same method to determine the maximum lawful rate for the other years, but for not more than a 5-year period (inclusive of any reparation periods).”³⁷

The Board has proposed that the railroad and shipper parties involved would “confer annually” and “re-calculate the maximum lawful rate for that year to reflect the actual changes in traffic volumes, revenues, and URCS costs.”³⁸ In other words, rather than having STB-established maximum reasonable rates in place the establishment of maximum rates for the other four (4) years would involve the re-application of the time-consuming and costly Simplified-SAC procedures.

For example, assume that the problems associated with the proposed Simplified-SAC procedures can be and have been resolved and suppose that a complainant successfully applies the proposed Simplified-SAC procedures and that the Board establishes a reasonable rate using 2006 as the Test Year. If the complainant is entitled to two (2) years of reparations, say 2004 and 2005, the complainant would be

³⁶ Proposed Simplified Standards, page 56

³⁷ *Ibid.*, page 14

³⁸ *Ibid*

required to re-apply the approved Simplified-SAC procedures to those reparation years and then again for the next two years, say 2007 and 2008, to establish rates for those years. Therefore, in this example, the 5-year period would be: 2004, 2005, 2006, 2007 and 2008. After the 5th year (or after 2008 in this example), the complainant would be required to file a new complaint with the STB which would involve a costly reassessment and reevaluation of the established Simplified-SAC procedures.

The Board's establishment of the acceptable Simplified-SAC procedures could serve as a useful guideline for establishing rates for the limited 5-year period. However, the establishment of rates for each of the other four (4) years would likely involve differences between the parties concerning the updating of the procedures which would need to be resolved, for example actual changes in traffic volumes, revenues, etc.

Having STB-established rates in place, whether for 5, 10 or 20 years, would greatly simplify the process. Requiring annual reapplications of the Simplified-SAC procedures and limiting these reapplications to a 5 year period would add layers of unneeded, time-consuming and costly work.

**12. STB's Proposed Simplified-SAC
Procedure will Result in Higher Rates**

The proposed Simplified-SAC procedures, if adopted by the Board, will result in higher rate rates. The STB recognized that "any simpler method will necessarily be cruder than CMP. Accuracy must be sacrificed for simplicity."³⁹ However, nearly every procedure and adjustment proposed by the Board to "simplify" the process will

³⁹ Simplified Guidelines, page 5

result in higher costs. The proposed use of existing facilities, URCS system average costs and rolling averages combined with the lack of high-density traffic will result in higher rates for most non-coal shippers who may be eligible to use the proposed procedures. How high is up is anyone's guess.

13. STB Simplified-SAC Testing Required

The STB has previously emphasized that railroad rate reasonableness guidelines must "protect captive shippers from paying unnecessarily high rates."⁴⁰ The STB has also recognized that simplified procedures "must produce realistic measurements."⁴¹ However, here the STB has developed and proposed new procedures which represents a major departure from the CMP framework, yet it has produced no studies to demonstrate that its proposed new Simplified-SAC procedure protects shippers from paying unnecessarily high rates or produces realistic results.

AAR proposed a Simplified-SAC approach to the ICC in 1992. Like the STB's proposed Simplified-SAC procedure, the AAR's proposed Simplified-SAC approach was primarily based on the replacement of the existing facilities rather than use of a hypothetical and optimally efficient stand-alone transportation system. The ICC sought public comment on the AAR's proposed test and held two public workshops in 1993 to test the proposed approach. The ICC's testing of the AAR's Simplified-SAC approach produced inordinately high numbers under which a rate producing revenue-to-

⁴⁰ *Ibid.*, page 43

⁴¹ *Ibid.*, page 6

variable cost ratio levels of 5,000% would be considered reasonable. As a result of the tests performed by the ICC and other factors, AAR's proposed Simplified-SAC approach was rejected by the ICC and later by the STB in its 1996 decision in Simplified Guidelines. The Board stated:

... Allowing that result would give carriers earning less than our measure of revenue adequacy *carte blanche* to charge unreasonably high rates, contrary to the statute. As the ICC observed, under the statute, a rate may be unreasonable even if charged by a carrier that is far short of revenue adequacy.⁴²

The STB could have tested its proposed Simplified-SAC procedures against the results from several previous Full-SAC cases referenced by the Board and used to simplify the valuation process.⁴³ The same sample movements which were used by the ICC in its 1993 public workshops to test the AAR's proposed Simplified-SAC approach could also be used by the STB to test its proposed Simplified-SAC procedure.

The reasons for adequate testing of the STB's proposed new Simplified SAC standard are obvious. The STB's proposals represent major changes to its rate reasonableness standards, which will have a significant impact on railroad traffic subject to its jurisdiction. Presumably and logically, the STB would have performed such evaluations and testing *before* it proposed such major changes to its rate reasonableness guidelines. However, the STB has not provided the results of any such evaluations or testing of its proposed new Simplified-SAC procedure.

⁴² Simplified Guidelines, page 11

⁴³ Otter Tail, Xcel, TMPA, PPL, Duke, CP&L and WPL, see, for example, Proposed Simplified Standards, page 39.

It would be very difficult for any independent party to perform such testing from publicly available information. The STB's proposed new Simplified-SAC procedure would require line specific information and data, much of which can only be obtained through the discovery process. GWF and other consulting firms may possess detailed information relating to certain specific railroad movements and lines, but the use of such data is can be restricted by confidentiality agreements to individual proceedings. Since there is no discovery allowed in this proceeding, it would be difficult for any outside independent consulting firm without access to internal railroad information and data to apply and test the STB's proposed new Simplified-SAC procedure against sample movements in a way that would yield accurate results.

The STB has also proposed several "significant adjustments" to the URCS methodology and values. The decision proposes that "Board staff perform all these adjustments to URCS by adjusting the data files used by URCS." The STB's decision indicates that these URCS data modifications "would be made available to the public."⁴⁴ Since these URCS modifications have not yet been released by the STB, it would be difficult to accurately apply the STB's Simplified-SAC procedure to sampled movements.

The STB should perform and/or make available for evaluation testing of its proposed new Simplified-SAC procedure before theses procedures are adopted by the Board.

⁴⁴ Proposed Simplified Standards, pages 50 to 53

14. Discovery After Route Selection Process

The Board has proposed a procedural schedule which would restrict a complainant's ability to properly and accurately analyze and evaluate the selected route before it is determined by the Board. The Board has proposed that a staff decision concerning the selected route would be made on Day 140.⁴⁵ However, the "Railroad's Second Disclosure," which would contain most of the information required for the route selection process, would not be released until Day 170. This Second Disclosure includes vital information such as: the identification of all traffic over the selected SARR routes; movement information, operating and cost calculations, revenue data and other essential information.⁴⁶ Essentially, the Board is proposing that shippers go into the route selection process blindfolded.

**15. STB's Proposed 18-Month
Procedural Schedule is Not Expedited**

The has proposed what it terms as a "*tight*" procedural schedule for cases using the Simplified-SAC procedures. The Board has proposed a 18-month procedural schedule which would be divided into the following Phases:⁴⁷

- Phase 1 - Eligibility Phase (Day 0 to Day 50)
- Phase 2 - Discovery Phase (Day 50 to Day 180)
- Phase 3 - Evidence Phase (Day 180 to Day 360)
- Phase 4 - Board Decision Phase (Day 360 plus 6 Months)

⁴⁵ *Ibid.*, page 16

⁴⁶ *Ibid.*, pages 18 and 19.

⁴⁷ *Ibid.*, pages 16 and 17

This proposed 18-month procedural schedule may be shorter than the procedural schedule for cases using the Full-SAC standard, but it does not represent an “expedited” schedule. A true simplified and expedited method should be able to be developed and applied in a matter of a few months, not a year and a half.

Eligibility for the simplified standards should be clear and straightforward and not require 50 days to resolve. The information and evidence required for the simplified standards should be easily accessible and not require 130 days of discovery. The evidence phase should also be straightforward and simple. It should not involve the time-consuming and costly procedures associated with the proposed Simplified-SAC approach. Finally, any disputed issues associated with simplified standards should not take the Board six months to resolve. The Board’s proposed time-table for simplified cases does not have the hallmarks of an “expedited” schedule.

**16. Conclusions Regarding STB’s
Proposed Simplified-SAC Procedure**

The STB’s proposed Simplified-SAC procedure is not a “simplified and expedited” method. There are numerous problems associated with the Board’s proposed new procedure. It is an unworkable procedure which, if adopted by the Board, will result in higher railroad rates. As a result, the Board should withdraw the proposed Simplified-SAC procedures.

IV. STB'S PROPOSED CHANGES TO THE THREE-BENCHMARK APPROACH

1. Brief Description of STB's Proposed Changes to the Three-Benchmark Approach

The STB's Three-Benchmark approach took over 10 years to develop and has been in place for another 10 years. With the proposed \$200,000 MVC eligibility standard which equates to approximately only \$40,000 per year, the Board is effectively discarding the approach in favor of the proposed new Simplified-SAC procedure. The STB indicates that the Three-Benchmark approach "should be reserved for use only as a last resort."⁴⁸ Although the Three-Benchmark approach will rarely, if ever, be used again under the Board's proposals, the STB has proposed major modifications to the established Three-Benchmark approach. These proposed changes are significant and will impact the way the benchmarks are calculated and applied, if and when they are used.

The STB's current Three-Benchmark approach includes three components:

- **R/VC_{COMP}** - The R/VC_{COMP} benchmark compares the R/VC ratios generated by the issue traffic with R/VC ratios for traffic which generates R/VC ratios greater than 180 percent and involves "similar commodities moving under similar transportation conditions."⁴⁹
- **RSAM** - The RSAM benchmark measures the uniform mark-up or R/VC ratio that would be needed from captive shippers to cover all of a carrier's URCS fixed cost.
- **R/VC_{>180}** - The R/VC_{>180} benchmark represents the average R/VC ratio on captive traffic, i.e., traffic with R/VC ratios in excess of 180 percent.

⁴⁸ Proposed Simplified Standards, page 11

⁴⁹ Simplified Guidelines, page 25

Under the current Three-Benchmark approach, a complainant would generate R/VC_{COMP} benchmark comparisons using the Waybill Sample and compare the generated R/VC ratios with RSAM and $R/VC_{>180}$ ratios generated by the STB. The STB's 2004 RSAM and $R/VC_{>180}$ benchmark ratios for the four largest Class I carriers are summarized in the following table:⁵⁰

Table 4

STB's Current RSAM and $R/VC_{>180}$ Benchmarks

<u>Railroad</u>	<u>RSAM</u>	<u>$R/VC_{>180}$</u>
BNSF	215% - 266%	234%
CSXT	254% - 292%	197%
NS	197% - 226%	212%
UP	245% - 306%	210%

In Simplified Guidelines, the STB concluded that benchmarks can be used as “multiple indicators that together provide a landscape of the relevant pricing considerations, without assigning preset weight to each figure” (Landscape approach) or combined “into a predetermined formula that produces a single starting point for our reasonableness assessment” (Formula approach)⁵¹ The Board indicated that “Under either approach, each of the benchmarks will be introduced and can be subjected to scrutiny. Moreover, under either approach, the benchmarks serve merely as the starting point of an analysis that should be further developed and tailored to the individual case.”⁵²

⁵⁰ Proposed Simplified Standards, Table 1, page 25

⁵¹ Simplified Guidelines, pages 30 and 31

⁵² *Ibid.*, page 34

The following table provides an example of one application of the current Three-Benchmark approach:

Table 5
Example of the Application of
The Three-Benchmark Approach

<u>Item</u>	<u>R/VC</u>
R/VC Ratio for NS Movement	300%
R/VC _{COMP} Benchmark	250%
RSAM Benchmark Range for NS	197% to 226%
R/VC _{>180} Benchmark for NS	212%
Landscape Approach ⁵³	197% to 250%
Formula Approach ⁵⁴	233% to 268%

In the above example, using the three individual benchmarks as “*multiple indicators*” under the Landscape approach or by applying the Formula approach, the 300 percent R/VC for the NS movement would appear to be unreasonable in comparison with the other benchmarks.

The STB has proposed to change the way that the RSAM and R/VC_{>180} benchmarks are calculated and has proposed to change the name of the R/VC_{>180} benchmark to R/VC_{total}. The STB’s proposed RSAM and R/VC_{total} ratios for the four largest Class I carriers are summarized in the following table:

⁵³ Range of R/VC_{COMP}, RSAM and R/VC_{>180} benchmarks

⁵⁴ R/VC_{COMP} times RSAM / R/VC_{>180} ratios of 0.93 and 1.07.

Table 6

STB's Proposed RSAM and R/VC_{total} Ratios⁵⁵

<u>Railroad</u>	<u>RSAM</u>	<u>R/VC_{total}</u>
BNSF	139%	130%
CSX	137%	124%
NS	132%	135%
UP	136%	124%

As can be seen, these proposed new ratios are substantially lower than the current benchmarks (see Table 4). For example, the RSAM benchmark for NS would change from a range of 197 percent to 226 percent to a single ratio of 132 percent and the R/VC_{>180} benchmark for NS of 212 percent would change to an R/VC_{total} ratio of 135 percent.

The STB's proposed calculations are based on total reported revenues and URCS costs for the individual carriers. The current R/VC_{>180} benchmark measures the average R/VC ratio on captive traffic for each Class I railroad based on the Waybill Sample, whereas the proposed R/VC_{total} benchmark represents a Class I carrier's overall average R/VC ratio for all traffic. The proposed RSAM benchmark essentially represents an adjustment to the proposed R/VC_{total} benchmark to account for revenue shortages or overages associated with a carrier's revenue adequacy needs.⁵⁶

The Board has proposed to develop R/VC_{COMP} mark-up ratios from the difference between the proposed new RSAM ratios and the new R/VC_{total}.

⁵⁵ Proposed Simplified Standards, page 25

⁵⁶ *Ibid.*, pages 23 through 25.

For example, STB has determined that NS's proposed RSAM/R/VC_{total} ratio would be 0.98 (132/135), which compares to a range of 0.93 to 1.07 under the current approach.⁵⁷ This RSAM/R/VC_{total} ratio (e.g., 0.98) would then be applied to R/VC of the selected comparison group.

**2. STB's Perceived Flaw With The
Existing Three-Benchmark Approach**

The Board has proposed changes in the way that RSAM and R/VC_{>180} benchmarks are calculated to "address a flaw in the existing method".⁵⁸ The STB contends that it is not possible for the RSAM benchmarks to be lower than the R/VC_{>180} benchmark if the carrier is found to be "revenue inadequate." It cites as an example that NS's 2002 unadjusted RSAM benchmark was lower than NS's R/VC_{>180} benchmarks (216% versus 221%) and NS was not found to be revenue adequate that year.⁵⁹

The STB's perceived flaw with the current RSAM and R/VC_{>180} benchmarks is based on a misplaced comparison and linking of the Board's rate reasonableness standards with the Board's revenue adequacy standards. The Board addressed issues related to differences between the RSAM and R/VC_{>180} benchmarks in depth in Simplified Guidelines.⁶⁰ It recognized that the benchmark calculations differ from the Board's revenue adequacy calculations.

⁵⁷ Proposed Simplified Standards, page 25, Table 1.

⁵⁸ *Ibid.*, page 22

⁵⁹ *Ibid.*, page 23

⁶⁰ Simplified Guidelines, pages 31 through 33.

We recognize that neither of these carriers was revenue adequate, according to our annual calculations, for the full 4-year period. That is because the unadjusted RSAM measure differs somewhat from our annual revenue adequacy calculation. For example, the unadjusted RSAM measure excludes costs that are not associated with ongoing rail operations and thus should not be borne by captive shippers through differential pricing.⁶¹

The Board also recognized that there may be problems associated with the use of a single year's benchmark (such as 2002 used by the Board) and adopted 4-year averaging:

As Table I shows, a carrier's RSAM figures fluctuate from year to year within certain general parameters. This is not surprising given the cyclical nature of railroad traffic,⁶² and the effect can be minimized by applying a multi-year average (we use a 4-year averaging period), so as to smooth out annual variations and minimize the impact of any year that may have been aberrational for that carrier. (footnote included)⁶²

From the above, it is clear that the calculation of the Board's revenue adequacy calculations and methodology are very different from the calculation of the current Three-Benchmark guidelines. The STB's revenue adequacy standards compare a carrier's return on investment (**ROI**) with the railroad industry's cost of capital. For example, the Board's finding that NS was revenue adequate was based on a comparison of NS's ROI of 11.64 percent to the railroad industry's cost of capital rate of 10.1 percent. The Board's ROI calculations are based on information contained in each railroad's Railroad Annual Report Form R-1, Schedule No. 250.⁶³

⁶¹ *Ibid.*, page 32

⁶² *Ibid.*, pages 23 and 24

⁶³ *Ibid.*, page 1

In contrast, the Board's current RSAM and $R/VC_{>180}$ benchmarks are R/VC ratios (rather than ROI ratios) that are developed from STB analyses of the Waybill Sample and applied URCS system-average costing. Therefore, the STB's revenue adequacy and rate reasonableness standards are based on different measures of profitability and are developed from different data sources.

The STB's revenue adequacy standards are primarily based on actual reported R-1, Schedule No. 250 information. The STB's Waybill Sample is a statistical and stratified sample of carload waybills for terminated shipments by railroad carriers. Currently, the data base includes approximately 600,000 waybill records. These records are expanded to represent the total railroad traffic. The R/VC ratios for each expanded record are calculated using estimated revenue divisions and URCS system average cost. In Simplified Guidelines, The Board recognized that there were problems associated with the Waybill Sample:

We also recognize that there are limitations in the Waybill Sample data currently provided to us, including instances of incomplete or inaccurate information regarding some of the sampled movements. . . .⁶⁴

Since the Waybill Sample data is based on an expanded sample and reflects estimated revenues and expenses, any relationship between the Waybill Sample data and R-1, Schedule No. 250 data would be a fluke. Therefore, there is no demonstrated "flaw" associated with the Board's current RSAM and $R/VC_{>180}$ benchmarks. The Board fully addressed these issues when it established the Three-Benchmark approach.

⁶⁴ Simplified Guidelines, page 17.

3. **Estimated Economic Consulting Fees
Associated with the Three-Benchmark Approach**

The Board's proposed Three-Benchmark approach, although much simpler than its proposed Simplified-SAC procedure, would also take a number of hours to develop. Moreover, there are a number of inherent uncertainties associated with the proposed approach. I have prepared a summary of the work and steps that would be required in a case utilizing the Three-Benchmark approach, which is attached hereto as **Appendix GWF-4**. This estimate assumes that the proposed Three-Benchmark approach has been established and is a viable and workable approach which can produce reasonable and realistic results. I estimate that the economic consulting fees in a Three-Benchmark case could range from **\$115,000 to \$225,000**, which excludes attorney fees and other consulting fees that may be required.

4. **Public Use "No Rate" Waybill Sample
Comparison Group Final Offer Approach**

The Board has proposed to adopt a so-called "final offer" approach under which each party would tender its initial and reply "final offer" comparison group of movements which it believes should be used as the comparison group for the R/VC_{COMP} test. The Board would then select one of the two submitted groups as the most reasonable comparison group. The Board maintains that this approach should "enable a prompt, expedited resolution of the comparison group selection."⁶⁵

⁶⁵ Proposed Simplified Standards, pages 20 and 21

The Board's "final offer" concept may have merit in that it has been my experience that the comparison group selection process can be contentious and time-consuming. However, the Board has also proposed a public data "*no rate*" approach based on public data which would restrict the revenue and other information that is required to properly evaluate and determine reasonable comparison groups. In summary, the Board is proposing that the parties develop the R/VC_{COMP} comparison groups without having the ability to evaluate the R/VC's of the groups. In other words, they are proposing to take the R/VC out of the R/VC_{COMP} test.

Under the Board's proposal, after a complaint has been filed and then after the Board has made a finding concerning eligibility, the Board would provide for the release of certain *masked* public Waybill Sample data to the parties for the development of evidence regarding the appropriate comparison group for the R/VC_{COMP} test. The Board indicates that it would provide for the "automatic release of certain (masked) Waybill Sample data" after a finding has been made that the complainant is eligible to use the Three-Benchmark method.⁶⁶ The Board indicates that these records would include "all movements which have the same 2-digit STCC code as the issue movement and an R/VC ratio above 180%"⁶⁷ The Board states:

⁶⁶ *Ibid.*, page 20

⁶⁷ *Ibid.*, page 33

. . . Comparability would be determined by reviewing a variety of factors, such as length of movement, commodity type, terrain involved, and other factors which could affect demand characteristics and operating costs. See Simplified Guidelines, I S.T.B. at 1035 n.90 (a properly selected comparison traffic will have a similar degree of demand elasticity). However, **the analysis and arguments must rest on publicly available information or on (no-rate) information provided in the Waybill Sample.**⁶⁸

However, under the Board's proposed public data "no rate" approach, the R/VC's for the comparison groups could not be accurately determined and evaluated before they are submitted by the parties and selected by the Board. The Board has proposed to only provide unmasked revenue information for the comparison group selected by the Board at the end of the proceeding. The Board states:

. . . Litigants would not, however, have broader or earlier access to unmasked revenue information, as that highly confidential information would not be necessary to formulate a reasonable comparison group. The comparability of a movement should depend on the characteristics of the movement, not the level of the rate for that movement.⁶⁹

The Board has essentially proposed to limit the evaluation of comparability to the route miles, commodity type and other movement parameters. Revenues and R/VC ratios have been taken out of the equation. The R/VC ratio(s) for the comparable group, and thus resulting maximum reasonable rate(s) would not be known until the end of the proceeding. There are several problems associated with this proposed public data "no rate" approach.

⁶⁸ Proposed Simplified Standards, page 20 (emphasis added)..

⁶⁹ Ibid., page 33

5. Accurate Rate and R/VC Ratio Information is Required at the Front-End of the Litigation Process

The Board cites Simplified Guidelines in that “properly selected comparison traffic will have a similar degree of demand elasticity.” However, by restricting the data to the masked public Waybill Sample, shippers, will not have the necessary revenue information that will enable them to properly evaluate the demand elasticity of potential comparison groups.

Revenue-to-variable cost or R/VC ratios have been historically used by the ICC and the Board to evaluate the demand elasticity of railroad traffic. For example, a R/VC ratio of, say, 125 percent may be indicative of a competitive rate, whereas a R/VC in excess of 180 percent has been historically used as an indicator of market dominance. In fact, the whole purpose of the R/VC_{COMP} test was to use R/VC ratios as an “indication of the relative degree of demand elasticity for that type of traffic.”⁷⁰ Although the data set provided by the Board will all have R/VC ratios in excess of 180 percent, the amount in excess, or the degree of elasticity, will not be known. For example, the masked 2004 Waybill Sample indicates that regulated STCC 28-211 traffic has R/VC ratios ranging from 180 percent to 2,741 percent. In contrast, railroads are likely to know most if not all of the unmasked data, giving them a major advantage over shippers.

The Board’s current guidelines allow railroads to encrypt or mask revenue information associated with contract shipments to protect the confidentiality of the

⁷⁰ Simplified Guidelines, page 25.

contract rates.⁷¹ Since the majority of railroad traffic is exempt or moves under contract, this *masking* of contract rate information significantly impacts the quality of the Waybill Sample revenue data. These differences can be seen from the following table which compares the total railroad regulated revenues that were developed by the Board using the unmasked 2004 Waybill Sample revenue data with total railroad regulated revenues developed by using masked 2004 Waybill Sample revenues:

⁷¹ *Ibid.* page 32 and see 49 CFR 1244.9

Table 7

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

<u>Description</u>	<u>STCC</u>	STB Table 2 2004 Unmasked Regulated ⁷² Revenue	GWF 2004 Masked Regulated ⁷¹ Revenue	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
Ordnance 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	<u>\$2,211,330,927</u>	-----
Total 2004 Regulated Revenue		\$7,960,712,000	\$14,213,794,127	1.78549
Revenue Excluded by STB		-----	\$2,870,374,918	
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%	

⁷² 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**.⁷³

A significant portion of this \$6.25 billion difference (perhaps as much as or more than half or around \$3 billion) results from the Board's use and application of the so-called masking factors that are used to adjust confidential contract revenue information. The Board's Table 2 revenues were based on the unmasked revenue data, whereas my analysis is based on the 2004 Waybill Sample data that I was provided by the Board which 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 (i.e., \$7,267,000 versus \$8,036,836) and other identified differences result from the Board's use of the unmasked revenue data.⁷⁴

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

⁷³ These differences are also described in my Opening Verified Statement submitted in this proceeding on behalf of the U.S. Clay Producers Traffic Association, Inc.

⁷⁴ 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 in decisions served September 26, 2006 and October 20, 2006. Therefore, the precise differences resulting from the use of masking factors cannot be determined.

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 that were studied). These excluded regulated revenues account for approximately \$2.87 billion of masked revenues.⁷⁵

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.⁷⁶

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.

⁷⁵ The total unmasked revenues associated with the excluded traffic may be lower than \$2.87 billion.

⁷⁶ 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.

I believe that the Board's omission of the STCC 32 and other regulated traffic 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 *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.⁷⁷ It appears that the Board made similar omissions of other excepted commodities that fall under other partially-exempted STCC groups.⁷⁸

This table serves to demonstrate that accurate revenue and R/VC ratio information is required in the front-end on the litigation process in order to properly evaluate the issue rates and properly apply the R/VC_{COMP} test. Under the Board's proposals, shippers will have no idea as to the reasonableness of the issue rates until the end of the litigation process. Early access to accurate rate information could greatly expedite the process. For example, with accurate rate information, the parties may be able to agree on a reasonable rate before going through the remainder of the litigation process and waiting for a Board decision.

⁷⁷ STCC 32-952-15, Cinders, etc., is specifically excluded from this exception.

⁷⁸ 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.

6. **Other Non-Public Waybill Sample Data is Required**

The Board indicates that the public Waybill Sample data would be used to determine the comparison groups during the Final Offer process. In addition to lacking accurate rate information, the Public Waybill Sample data excludes other information that is required to accurately evaluate the characteristics of possible comparison groups.⁷⁹

For example, the public use Waybill Sample includes 5-digit STCC information, whereas the so-called confidential Waybill Sample includes the more accurate 7-digit STCC information.⁸⁰ There can be significant differences between the characteristic of traffic within STCC groups. For example, Kaolin Clay moves under the 5-digit STCC 32-952. However, the characteristics of Kaolin Clay can vary significantly on a 7-digit STCC basis. Kaolin Clay moves in a slurry form in private tank cars under STCC 32-952-30 and moves in railroad and private covered hoppers in dry form under STCC 32-952-31.

⁷⁹ On page 20 of the decision, which describes the proposed Comparison Group selection process, the Board clearly states that "However, the analysis and arguments must rest on publicly available information or on (no rate) information," which I interpret to mean the Public Use Waybill Sample. On page 32, the Board states that "once we find that a complainant is eligible to use the Three-Benchmark" (i.e. after Day 50 which is before the Comparison group process), it would release "all movements that have the same 2-digit STCC code as the issue movement and an R/VC ratio above 180%." Since the Board indicates that confidentiality agreements would be required, one could assume that some non-public data fields would be released. However, the Board is not clear on this point. The fact that confidentiality agreements are required does not mean that confidential information will be released. Since the Board clearly states that only "publicly" available information must be used, the Board could merely intend to identify and release the Public Waybill Sample records that meet the criteria (i.e. same 2-digit STCC > 180%). These identified Public Waybill Sample records, however, may not contain all the data fields that are contained in the Confidential Waybill Sample (such as 7 digit STCC codes, origin and destination SPLC codes, railroads, etc.).

⁸⁰ 2004 Public Use Waybill File 247-byte Record Data Element Descriptions

The public Waybill Sample also does include the Standard Point Location Codes (**SPLC**) nor does it identify the originating and terminating railroads which are required identify and evaluate the characteristics of the origins and destinations. The public Waybill Sample merely provides Business Economic Areas (**BEA**).⁸¹ This is obviously important information in the evaluation of comparison groups. Movements within BEA's can have significantly different characteristics. For example, one origin within a BEA may be served by only one railroad whereas another may have service from two carriers.

As previously stated, the Board has proposed to limit comparison traffic group selection to traffic which has the same 2-digit STCC code as the issue movement. Comparison groups should not be limited to the same 2-digit STCC codes. Different commodities could have similar transportation, demand and market characteristics. For example, private tank car movements of Petroleum Products (STCC 29) could be similar to tank car movements of Chemicals (STCC 28).

Consultants and lawyers should have access to the full confidential Waybill Sample data as soon as, if not before, a complaint has been filed. The railroads have access to the information for the traffic on their systems. Without access to the confidential Waybill Sample, however, shippers will be required go into the process blindfolded.

⁸¹ *Ibid.*

7. **STB's Confidence Interval Adjustment**

The Board has proposed to make a “confidence interval” adjustment to the R/VC_{COMP} results which would increase the results in an attempt to quantify the “uncertainty in the measurement of the comparison group.” The adjustment looks at the “range of values within which one can be 90% or 95% sure that the true measurement lies.” The proposed confidence interval adjustment will only find a rate unreasonable if it is above this confidence interval.⁸² Therefore, this represents an upward adjustment of the resulting maximum reasonable rate level. Witness Thomas D. Crowley describes the problems associated with this proposed adjustment in more detail.

8. **Benchmarks versus Adjustment Ratios**

There are merits to the Board's proposed new RSAM and R/VC_{TOTAL} ratios. The ratios are relatively simple to calculate and may more accurately reflect railroads' revenue adequacy needs based on the Board's current standards. However, the Board should also consider retaining the current RSAM and $R/VC_{>180}$ benchmarks and the continued annual publication of these figures.

Under the current Three-Benchmark approach, shippers evaluate their rates by comparing their R/VC ratios with three (3) benchmarks: the published RSAM and $R/VC_{>180}$ benchmarks and the developed R/VC_{COMP} benchmark. Such comparisons can be useful in deciding whether to proceed with a complaint case.

⁸² Proposed Simplified Standards, page 19

Unlike the current STB-published RSAM and $R/VC_{>180}$ benchmarks, the proposed RSAM and R/VC_{total} ratios are not “*benchmarks*” in the literal sense of the word. The proposed RSAM and R/VC_{total} ratios are merely used to mark-up (or down) the R/VC_{COMP} benchmark. The new ratios cannot be used as “multiple indicators” of rate reasonableness. In fact, the name “Three-Benchmark” for the proposed approach may also be a misnomer. Under the proposed approach, however, to the shipper's rate is effectively determined by a single indicator of rate reasonableness, i.e., the adjusted R/VC_{COMP} benchmark.

In Simplified Guidelines, the Board recognized that there may be cases in which the R/VC_{COMP} benchmark cannot be used and, therefore, the RSAM and $R/VC_{>180}$ would be used:

There may well be some cases in which there is no readily identifiable traffic that is truly comparable.⁹² In those instances, we may have to forgo what the R/VC_{COMP} benchmark would add to the analysis if it were available, and be guided only by the other two benchmarks--the RSAM measure and the fairness of how the carrier is pricing that commodity in relation to other commodities that it handles (the $R/VC_{>180}$ measure, discussed more fully below). But we should not forgo an otherwise useful benchmark in all cases simply because it might be unavailable in some cases.

⁹² There may well be cases in which the R/VC_{COMP} benchmark cannot be included in the analysis for lack of appropriate comparison traffic. As the ICC noted, captive rail traffic moving in small or isolated shipments can be such unusual traffic that it may be difficult to obtain a sufficient data base of similar traffic to use for comparison.⁸³

⁸³ Simplified Guidelines, pages 26 and 27.

It should be noted that this very problem came up in the first and only case to test the then proposed Three-Benchmark approach, i.e., ICC Docket No. 40073, South-West Railroad Car Parts v. Missouri Pacific Railroad (Car Parts). I was the primary economic witness in the Car Parts proceeding and, thus, I am very familiar with the issues. The case involved railroad rates on one-way movements of empty railroad cars to a scrap and recycling facility. A group of comparable traffic could not be found in the Waybill Sample for R/VC_{COMP} benchmark and both sides challenged the comparison group that had been used by the ICC.

The Board should consider retaining RSAM and $R/VC_{>180}$ benchmarks. These benchmarks can serve as indicators to evaluate rates before complaints are filed and are useful in cases such as Car Parts in which the R/VC_{COMP} benchmark cannot be used due a lack of traffic having similar commodities moving under similar transportation conditions.

9. Conclusions Regarding STB's Proposed Changes to the Three-Benchmark Approach

The Board's proposed restrictions and limitations on the use of, and access to, the unmasked confidential Waybill Sample data should be reconsidered by the Board. Access to the unmasked confidential Waybill Sample in the front-end of the litigation process is required to properly evaluate the issue rates, would help expedite the process and would yield more accurate results. The Board's proposed new ratios, i.e., the modified RSAM and the new R/VC_{TOTAL} , are useful, but the Board should consider the continued publication of the current RSAM and $R/VC_{>180}$ ratios.

V. STB'S PROPOSED ELIGIBILITY PRESUMPTIONS

1. Brief Description of STB's Proposed Eligibility Presumptions

The STB has proposed new “eligibility presumptions” based on a proposed MVC approach which would be used decide which of the STB’s three methodologies would be used in rate reasonableness proceedings. For cases having a MVC greater than \$3.5 million, 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 the Full-SAC or Simplified-SAC methods. For small cases with a MVC less than \$200,000, the Three-Benchmark method could be used.⁸⁴

2. STB's Table 2 Eligibility Estimates

The STB’s decision includes an analysis of the amount of regulated traffic that would be presumed eligible to use the Full-SAC, Simplified-SAC or Three-Benchmark approaches. Based on the 2004 Waybill Sample, the STB estimates that 34 percent of all regulated traffic would use the Full-SAC standard, 50 percent would be eligible to use the proposed Simplified-SAC procedure, and 17 percent would be eligible to use the proposed Three-Benchmark approach.⁸⁵ There are several problems with the STB’s proposed new “eligibility presumptions.”

⁸⁴ *Ibid.*, pages 33 and 34

⁸⁵ See Proposed Simplified Standards, page 37, Table 2

The STB estimates that 67 percent of all traffic would be eligible to use proposed standards (50% Simplified-SAC plus 17% Three-Benchmark). I believe that the STB's analysis is flawed and, in contrast to its findings, the majority of railroad traffic subject to its jurisdiction would be unable to use either of the proposed simplified procedures.

3. Application of Eligibility Presumptions

The following table provides an example of URCS variable cost associated with a 500-mile movement of farm products in the East based on an average load of 100 tons per car. Based on a rate per car which generates a revenue-to-variable cost ratio of 300 percent, the MVC threshold for Small Disputes would be reached at only **27 cars per year** and only **467 cars per year** for Medium disputes:

Table 8

**Example of the Application of
The STB's Eligibility Presumptions**

<u>Ln.</u>	<u>Item</u>	<u>Small Disputes</u>	<u>Medium Disputes</u>
1	URCS Variable Cost Per Ton (500 mi., 100 tons/car)	\$15.50	\$15.50
2	Rate Per Ton at 180% R/VC (L.1 x 1.80)	\$27.90	\$27.90
3	Rate Per Ton at 300% R/VC (L.1 x 3.00)	\$46.50	\$46.50
4	Rate Per Ton Above 180% (L.3 minus L.2)	\$18.60	\$18.60
5	Estimated 5 year tonnage	13,354.86	233,709.70
6	Total Difference (L.4 x L.5)	\$248,400	\$4,347,000
7	Five Year Discount Factor Based on 12.2% Cost of Capital	1.242	1.242
8	Maximum Value of the Case (L.6 / L.7)	\$200,000	\$3,500,000
9	Average Maximum Tons Per Year (L.5 / 5 yrs)	2,671	46,742
10	Average Maximum Cars Per Year (L.9 / 100 tons per car)	27	467

Based on the proposed \$200,000 MVC level, very little traffic (only movements with less than 27 cars per year in the above example) would qualify for or could economically justify the use of the Three-Benchmark approach. As a result, the STB's proposal represents a *de facto* abandonment of the STB's established Three-Benchmark approach in favor of the proposed new Simplified-SAC procedures.

The proposed \$3.5 million MVC for medium size disputes will also significantly limit the number of cases that would be eligible for the proposed Simplified-SAC procedures. Based on the above example, the \$3.5 million MVC threshold would be reached at only 467 cars per year.

4. **STB's MVC Approach**

The statute states that "simplified and expedited method" should be used in "those cases in which a full stand-alone cost presentation is too costly, given the value of the case." (49 § 10701(d)(3)) Therefore, any qualification or eligibility test must necessarily involve a *comparison* of:

- (1) **Case Value** - The total potential value of the case, i.e., any reparations sought and the present value of any future rate relief; and
- (2) **SAC Cost** - The costs associated with preparing and presenting a Full-SAC case before the Board, such as attorney and consulting fees.

The eligibility presumption of \$3.5 million proposed by the Board represents the Board's estimate regarding the cost associated with a Full-SAC and the \$200,000 level represents the Board's estimate to present a Simplified-SAC case.

I believe the latter value is far too low, and the former value is understated as well. I estimate that the consulting fees alone in a Simplified-SAC case would range from \$500,000 to \$1.25 million.

Notwithstanding any differences between the estimated cost of a Full-SAC or Simplified-SAC case, the Board's proposed MVC approach is flawed in that it is based on the maximum potential rate relief at 180 percent. Based on the problems associated with the STB's proposed Simplified-SAC procedure (such as reflecting existing carrier inefficiencies), it is extremely unlikely that any shipper would be able to obtain the MVC relief.

The total costs and risks associated with presenting a case must be accounted for in the determination of the case value. For example, if the MVC is \$3.5 million and the consulting and legal fees are \$3.5 million, there would be little incentive to spend \$3.5 million in an effort to achieve maximum savings of \$3.5 million. Indeed, this is what the Interested Parties' previous recommendation for a "bright-line" test of \$7.2 million in annual freight charges between an origin and a destination was, based upon the estimated cost of a SAC case of \$3 million and a litigation risk factor of three.

5. STB's Aggregation Proposal

The Board's proposed eligibility presumptions include an aggregation provision under which would aggregate the MVC for each set of movements covered by the complaint and potential future movements:

. . . If a complaint challenges multiple rates covering different origins and destinations, **the Board would aggregate the MVC for each set of movements covered by the complaint.** In this fashion, the MVC would equal the net present value, as of the time of the filing of the complaint, of the maximum relief that the shipper could obtain.⁸⁶

* * * *

To avoid any incentive to understate the MVC, the MVC calculation would serve to limit any prospective rate relief available under either a Simplified-SAC or Three-Benchmark presentation. Rate prescriptions would be capped at the shipper's representation of the annual tonnage at issue. For example, if a shipper represented in its complaint that the volume of traffic at issue was 100,000 tons per year, the prescription would set the maximum rate the carrier could charge for the first 100,000 tons of traffic in a particular year; the challenged rate could continue to be charged for any additional tonnage in that year. Additionally, any rate relief – whether in the form of reparations for past shipments or rate prescription for future shipments – would be limited to 5 years.

Disaggregating claims that could and should be brought in a single complaint to manipulate the MVC calculation would not be permitted. To discourage a shipper from manipulating the MVC of a case, all claims brought within a 2-year period (the statute of limitations period under 49 U.S.C. 11705(c)) that involve the same defendant railroad and the same captive origin or destination would be aggregated.

This aggregation approach would further limit the amount of traffic that would be eligible for simplified procedures. In an effort to demonstrate this impact of this aggregation proposal, I have determined the MVC for forty-two (42) individual movements of the same commodity (STCC 28-211-42) which are from the same captive origin in Louisiana. The results of this study are shown in the following table:

⁸⁶ Proposed Simplified Standards, page 33 and 34 (emphasis added)

Table 9

**MVC Calculations
For 42 Representative STCC 28-211-42
Movements From A Single Louisiana Origin**

<u>Origin State</u>	<u>Movement Number</u>	<u>Origin Railroad</u>	<u>Destination Railroad</u>	<u>5 Year MVC</u>
LA	1	UP	BNSF	\$978,454
LA	2	UP	BNSF	\$1,293,390
LA	3	UP	BNSF	\$241,010
TOTAL (3 Movements)		UP	BNSF	\$2,512,854
LA	4	UP	CN	\$394,819
LA	5	UP	CN	\$640,737
LA	6	UP	CN	\$756,916
TOTAL (3 Movements)		UP	CN	\$1,792,472
LA	7	UP	CP	\$402,162
TOTAL (1 Movement)		UP	CP	\$402,162
LA	8	UP	CSX	\$740,411
LA	9	UP	CSX	\$68,337
LA	10	UP	CSX	\$1,071,083
LA	11	UP	CSX	\$530,628
LA	12	UP	CSX	\$1,631,767
LA	13	UP	CSX	\$365,225
LA	14	UP	CSX	\$1,638,756
LA	15	UP	CSX	\$1,669,275
LA	16	UP	CSX	\$387,742
TOTAL (9 Movements)		UP	CSX	\$8,103,224
LA	17	UP	KCS	\$754,622
LA	18	UP	KCS	\$287,556
TOTAL (2 Movements)		UP	KCS	\$1,042,178
LA	19	UP	NS	\$1,361,381
LA	20	UP	NS	\$665,056
LA	21	UP	NS	\$1,474,638
LA	22	UP	NS	\$6,729,239
LA	23	UP	NS	\$549,026
LA	24	UP	NS	\$561,638
LA	25	UP	NS	\$4,332,222
LA	26	UP	NS	\$1,596,530
LA	27	UP	NS	\$960,471
LA	28	UP	NS	\$1,773,394
TOTAL (10 Movements)		UP	NS	\$20,003,595
LA	29	UP	UP	\$943,502
LA	30	UP	UP	\$336,208
LA	31	UP	UP	\$127,613
LA	32	UP	UP	\$714,666
LA	33	UP	UP	\$448,800
LA	34	UP	UP	\$659,948
LA	35	UP	UP	\$114,151
LA	36	UP	UP	\$4,267
LA	37	UP	UP	\$768,849
LA	38	UP	UP	\$77,963
LA	39	UP	UP	\$88,277
LA	40	UP	UP	\$82,633
LA	41	UP	UP	\$198,313
LA	42	UP	UP	\$198,160
TOTAL (14 Movements)		UP	UP	\$4,763,350
TOTAL (42 Movements)				\$38,619,835

As can be seen, if all of these movements of the same commodity from the same captive origin are aggregated, the total MVC would be \$38,619,835, which is well above the Board's proposed \$3.5 million MVC level for Simplified-SAC cases. Therefore, if these 42 movements are aggregated, the complainant would be forced to use the Full-SAC approach, even if it is "too costly" to use.

On an individual movement basis, 32 movements would qualify for the Simplified-SAC procedures, 9 would qualify for the Three-Benchmark approach and 2 would be forced to use the Full-SAC standard. However, if these movements are aggregated based on the destination railroad (which is a logical aggregation since pricing would be based on the railroads involved in the movements), the 33 movements via UP-CSX, UP-NS and UP-Direct movements would exceed the \$3.5 million MVC level and thus not qualify for the proposed Simplified-SAC procedures, with MVC levels of \$8,103,224, \$20,003,595 and \$4,763,350, respectively.

In the above example, it would be possible to aggregate some movements. For example, the 3 movements via UP-BNSF could be aggregated since the total MVC of these 3 movements is \$2,512,854. However, in doing so, the complainant would be effectively precluded from challenging the other rate levels.

The Board's aggregation proposal will significantly limit the amount of traffic which is eligible to use the proposed simplified procedures. The Board's eligibility estimates did not account for the potential impact of aggregation and thus overstate the amount of traffic which would be eligible for the proposed Simplified-SAC procedures and the proposed Three-Benchmark approach.

**6. Conclusions Regarding the
Proposed Eligibility Presumptions**

The Board has significantly overstated the amount of traffic which would be eligible for the its proposed new Simplified-SAC procedure and the modified Three-Benchmark approach. The Board's \$3.5 million and \$200,000 eligibility presumptions are too low. These low levels combined with the proposed MVC aggregation approach will significantly limit the amount of traffic that is eligible for the simplified standards.

VI. CONCLUSION

The Board should consider withdrawing the proposed Simplified-SAC procedure and the proposed modifications to the Three-Benchmark approach. As demonstrated herein, there are numerous problems associated with the Board's proposals. At minimum, the STB should perform and provide adequate testing of the proposed standards before they are adopted.

SS

[Signature]

Handwritten Signature

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.

ESTIMATED CONSULTING WORK AND COSTS ASSOCIATED WITH STB'S PROPOSED SIMPLIFIED -SAC PROCEDURE

(Assumes that the Complaint is eligible for established STB's Simplified-SAC procedures and that Simplified-SAC is a viable and workable procedure which can produce reasonable and realistic results)

Description	Hours	
	From	To
PHASE I - Initial Rate Evaluation(s) for STB Jurisdiction and Eligibility for Simplified-SAC Procedures		
Initial meetings, conversations and communications with client representatives and lawyers regarding evaluation of issue movement(s)	8	16
Initial data collection, research and evaluation of issue movement(s).	24	80
Develop movement characteristics and parameters for the issue movement(s) (tons/car, tare weight, cars/train, miles, etc.).	24	80
Initial movement costing and jurisdictional evaluation of issue movement(s) using the STB's URCS Phase III methodology.	40	120
Initial evaluation concerning eligibility for the Simplified-SAC procedures.	16	24
Prepare report for client regarding the results of initial rate evaluation, STB jurisdiction, and eligibility for Simplified-SAC procedures.	40	80
Meeting, conversations and communications with client representative and/or lawyers regarding results and recommendations for Phase II.	8	16
Phase I - Total Estimated Hours	160	416
Phase I - Total Estimated Cost *	\$28,000	\$72,800
PHASE II - Pre-Complaint Rate Evaluation(s) Using Estimates of the Application of the STB's Simplified-SAC Procedures		
Simplified-SAC data collection, research and evaluation of issue movement(s) using STB adjusted URCS data and Public Waybill Sample.	120	180
On-the-ground inspection and studies of existing railroad operations, facilities and identified routes.	24	40
Identify and analyze existing and potential routes of movement(s) for Simplified-SAC procedures.	40	160
Identify and analyze existing traffic and potential cross over traffic for identified routes of movement(s) using Public Waybill Sample.	120	240
Develop initial configuration of SARR for Simplified-SAC procedures.	40	80
Develop initial estimates of traffic group and cross over traffic for SARR	40	160
Develop initial estimates of Road Property Investment for identified SARR (using estimated values in lieu of actual railroad data)	80	160
Develop initial estimates of Operating Expenses for identified SARR.	40	200
Identify and evaluate potential problems associated with the Simplified-SAC procedures (e.g. Internal Cross-Subsidy Inquiry)	20	40
Develop estimates of the results a potential Simplified-SAC analysis.	40	80
Prepare report concerning estimated Simplified-SAC results and potential for STB relief	60	80
Meeting, conversations and communications with client representative and/or lawyers regarding results and recommendations for Phase III.	8	16
Phase II - Total Estimated Hours	632	1,436
Phase II - Total Estimated Cost *	\$110,600	\$251,300

**ESTIMATED CONSULTING WORK AND COSTS ASSOCIATED
WITH STB'S PROPOSED SIMPLIFIED - SAC PROCEDURE**

(Assumes that the Complaint is eligible for established STB's Simplified-SAC procedures and that Simplified-SAC is a viable and workable procedure which can produce reasonable and realistic results)

	Hours	
	From	To
PHASE III - STB Complaint Process - Eligibility (STB Phase 1)		
Update and refine jurisdictional evaluation of issue movement(s) using the STB's URCS Phase III methodology.		
Update and refine evaluation concerning eligibility for the Simplified-SAC procedures.		
Assist lawyers in drafting complaint	40	80
Prepare verified statement and associated analyses concerning STB jurisdiction and eligibility for Simplified-SAC.	40	80
Assist in the preparation on initial disclosure due with complaint (Day 0).	24	40
Finalize and submit STB complaint (including evidence and argument on eligibility) and Initial Disclosure (Day 0)	60	120
Review and analyze railroad answer to complaint, reply to eligibility and initial disclosure (Day 20).	24	40
Prepare rebuttal testimony and evidence on eligibility (Day 30).	16	24
Review and analyze STB's Decision of eligibility (Day 50).	24	40
Phase III - Total Estimated Hours	40	80
Phase III - Total Estimated Cost *	8	24
	276	528
	\$48,300	\$92,400
PHASE IV - STB Complaint Process - Discovery (STB Phase 2)		
Assist lawyers in the development and submission of discovery requests (Day 50).	24	40
Prepare for and participate in "meet and confer" meetings on discovery issues (Day 57)	24	36
Prepare for and participate in STB staff discovery conferences	24	36
Prepare and submit opening evidence concerning selected route (Day 80)	80	160
Review and analyze railroad reply evidence on selected route (Day 100)	40	160
Prepare and submit rebuttal evidence concerning selected route (Day 110)	60	120
Review and analyze STB decision on selected route (Day 140).	24	40
Review and analyze railroads second disclosure regarding discovery issues (Day 170).	40	80
Assist lawyers remaining discovery matters, such as Motions to Compel (Day 180).	40	80
Phase IV - Total Estimated Hours	356	752
Phase IV - Total Estimated Cost *	\$62,300	\$131,600

ESTIMATED CONSULTING WORK AND COSTS ASSOCIATED WITH STB'S PROPOSED SIMPLIFIED -SAC PROCEDURE

(Assumes that the Complaint is eligible for established STB's Simplified-SAC procedures and that Simplified-SAC is a viable and workable procedure which can produce reasonable and realistic results)

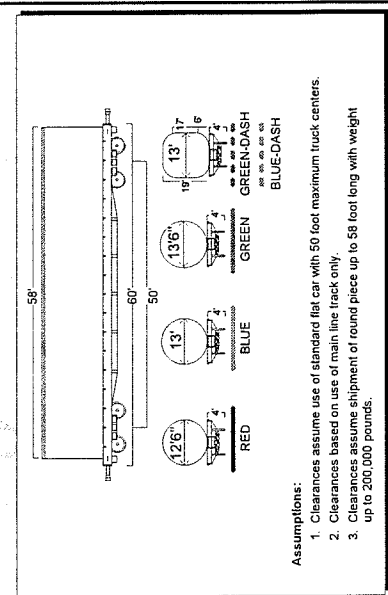
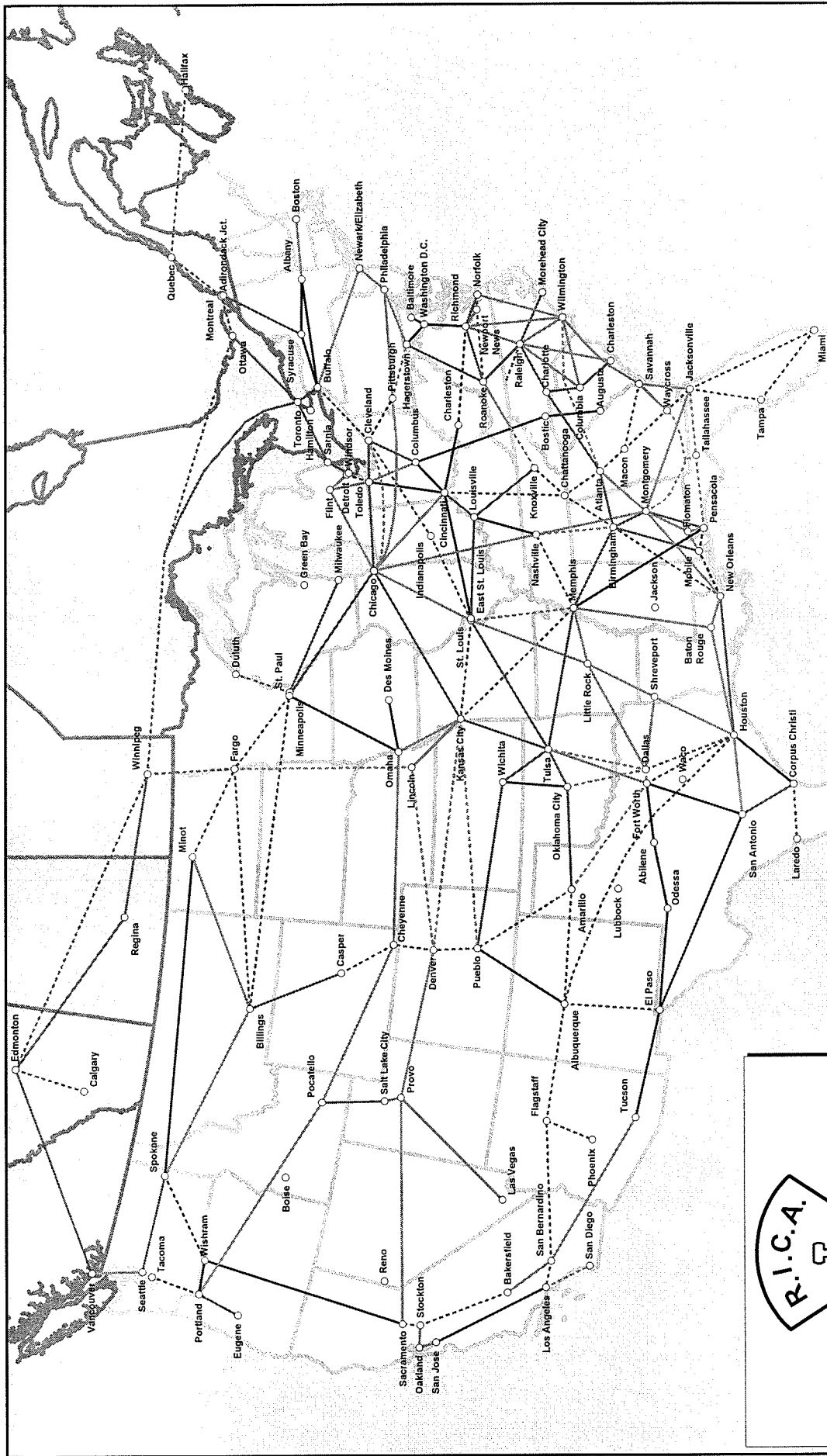
	Hours	
	From	To
PHASE V - STB Complaint Process - Evidence (STB Phase 3)		
Review and analyze railroad's discovery and other relevant information concerning selected route(s).	40	80
Additional on-the-ground inspections and studies of railroad operations, and facilities of selected route(s).	24	40
Develop movement characteristics and parameters for the issue movement(s) and route (tons/car, tare weight, cars/train, miles, etc.)	40	80
Identify and analyze existing traffic and potential cross over traffic for identified routes of movement(s) using Confidential Waybill Sample.	80	240
Develop final configuration of SARR for Simplified-SAC procedures.	40	80
Develop existing traffic group and cross over traffic for SARR	80	160
Develop Road Property Investment for identified SARR using ICC Engineering Reports and other railroad information	240	600
Develop Operating Expenses for identified SARR.	60	160
Identify and evaluate potential problems associated with the Simplified-SAC procedures (e.g. Internal Cross-Subsidy Inquiry)	40	60
Develop results of Simplified-SAC analysis.	40	60
Prepare and submit Opening Evidence with results of Simplified-SAC analysis and estimated STB relief (Day 250).	160	240
Review and analyze railroad's Opening Evidence (Day 250).	40	80
Revise Simplified-SAC analyses in response to railroad's Opening Evidence.	40	80
Prepare and submit Reply Evidence with results of revised Simplified-SAC analysis and estimated STB relief (Day 310).	80	160
Review and analyze railroad's Reply Evidence (Day 310).	40	80
Revise Simplified-SAC analyses in response to railroad's Reply Evidence.	40	60
Prepare and submit Rebuttal Evidence with results of revised Simplified-SAC analysis and estimated STB relief (Day 340).	80	160
Prepare evidence and presentations for STB Technical Conference (Market Dominance and Merits (Day 350)	40	160
Assist lawyers in preparation of Final Briefs (Day 360)	24	60
Review and analyze railroads Final brief (Day 360)	16	24
Phase V - Total Estimated Hours	1,244	2,664
Phase V - Total Estimated Cost *	\$217,700	\$466,200

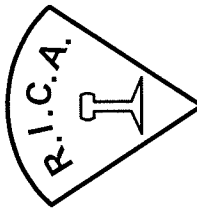
ESTIMATED CONSULTING WORK AND COSTS ASSOCIATED WITH STB'S PROPOSED SIMPLIFIED - SAC PROCEDURE

(Assumes that the Complaint is eligible for established STB's Simplified-SAC procedures and that Simplified-SAC is a viable and workable procedure which can produce reasonable and realistic results)

	Hours	
	From	To
PHASE VI - Post STB Decision		
Review and analyze STB decision (6 months after Day 360)	16	24
Meetings, conversations and communications with client representatives and/or lawyers regarding STB decision and recommendations.	8	24
Assist client and lawyers in negotiations with the railroad.	0	40
Assist lawyers in appeal of STB decision.	0	240
Update approved Simplified-SAC procedures for non-Test Years (4 additional applications for reparation and future years)	480	1,240
Phase VI - Total Estimated Hours	504	1,568
Phase VI - Total Estimated Cost *	\$88,200	\$274,400
TOTAL ESTIMATED HOURS	3,172	7,364
TOTAL ESTIMATED COST	\$555,100	\$1,288,700

* Estimated cost is based on a blended rate of \$175.00 per hour for consulting services.





**The Railway Industrial Clearance
Association of North America**

13'6"

13'0"

12'6"

13'6"

13'0"

12'6"

13'6"

13'0"

12'6"

Note: Map is NOT to be used as authorization for movement but only as a guideline. Contact the respective railroad for clearance information.

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Prepared by DeskMap Systems, Inc. Austin, Texas (512) 346-9330

ESTIMATED CONSULTING WORK AND COSTS ASSOCIATED WITH STB'S PROPOSED THREE - BENCHMARK APPROACH

*(Assumes that the Complaint is eligible for established STB's Three-Benchmark Approach and that
Three-Benchmark is a viable and workable procedure which can produce reasonable and realistic results)*

Description	Hours	
	From	To
PHASE I - Initial Rate Evaluation(s) for STB Jurisdiction and Eligibility for and Initial Application of the Three-Benchmark Approach		
Initial meetings, conversations and communications with client representatives and lawyers regarding evaluation of issue movement(s)	4	8
Initial data collection, research and evaluation of issue movement(s)	16	24
Develop movement characteristics and parameters for the issue movement(s) (tons/car, tare weight, cars/train, miles, etc.)	16	24
Initial movement costing and jurisdictional evaluation of issue movement(s) using the STB's URCS Phase III methodology.	16	24
Initial evaluation concerning eligibility for the Three-Benchmark approach.	8	14
Prepare initial evaluations of possible comparison traffic groups using the STB's Public Waybill Sample.	24	80
Develop and evaluate estimated R/V/C ratios of potential comparison groups using adjusted masked rates and URCS Phase III methods.	40	80
Obtain from STB or develop RSAM and R/V/C _{TOTAL} ratios for this railroads involved in issue movement(s).	1	16
Calculate confidence interval adjustment.	8	16
Adjust R/V/C's of potential comparison group to reflect RSAM / R/V/C _{TOTAL} ratio and confidence interval adjustment.	4	16
Develop estimates of the results a potential Three-Benchmark analysis.	16	24
Prepare report concerning estimated Three-Benchmark results and potential for STB relief.	16	24
Meeting, conversations and communications with client representatives and lawyers regarding results and recommendations for Phase II.	4	8
Phase I - Total Estimated Hours	173	358
Phase I - Total Estimated Cost *	\$30,275	\$62,650

PHASE II - STB Complaint Process - Eligibility (STB Phase I)		
Meetings, conversations and communications with client representatives and lawyers regarding required work for complaint process.	4	8
Update and refine jurisdictional evaluation of issue movement(s) using the STB's URCS Phase III methodology.	8	24
Update and refine evaluation concerning eligibility for the Three-Benchmark approach.	4	24
Assist lawyers in drafting complaint	8	16
Prepare verified statement and associated analyses concerning STB jurisdiction and eligibility for Three-Benchmark approach.	40	80
Assist in the preparation on initial disclosure due with complaint (Day 0).	8	16
Finalize and submit STB complaint (including evidence and argument on eligibility) and Initial Disclosure (Day 0)	8	16
Review and analyze railroad answer to complaint, reply to eligibility and initial disclosure (Day 20).	24	40
Prepare rebuttal testimony and evidence on eligibility (Day 30).	40	60
Review and analyze STB's Decision of eligibility (Day 50).	4	8
Phase II - Total Estimated Hours	148	292
Phase II - Total Estimated Cost *	\$25,900	\$51,100

ESTIMATED CONSULTING WORK AND COSTS ASSOCIATED WITH STB'S PROPOSED THREE - BENCHMARK APPROACH

*(Assumes that the Complaint is eligible for established STB's Three-Benchmark Approach and that
Three-Benchmark is a viable and workable procedure which can produce reasonable and realistic results)*

	Hours	
	From	To
PHASE III - STB Complaint Process - Discovery (STB Phase 2)		
Obtain and analyze 2-digit STCC Waybill Sample records of movements with an R/V/C ratio over 180%.	24	60
Assist lawyers in the development and submission of discovery requests (Day 50).	8	24
Review and analyze railroad's discovery and other relevant information.	24	40
Assist lawyers remaining discovery matters, such as Motions to Compel (Day 100).	8	24
Phase III - Total Estimated Hours	64	148
Phase III - Total Estimated Cost *	\$11,200	\$25,900
PHASE IV - STB Complaint Process - Evidence (STB Phase 3)		
Prepare additional evaluations of possible comparison traffic groups using the STB's supplied 2-digit Waybill Sample data.	24	40
Develop and evaluate estimated of R/V/C ratios of potential comparison groups using adjusted masked rates and URCS Phase III methods.	32	60
Adjust R/V/C's of identified comparison group to reflect RSAM / R/V/C _{TOTAL} ratio and confidence interval adjustment.	8	16
Develop estimates of the results a potential Three-Benchmark analysis.	8	16
Prepare and submit Opening Evidence with initial tender of Comparison Group and Market Dominance testimony (Day 120).	40	60
Review and analyze railroad's Opening Evidence with initial tender of Comparison Group and Market Dominance testimony (Day 120).	16	24
Prepare for and attend STB Technical Conference meeting(s) concerning selection of the Comparison Group.	8	16
Prepare and submit Reply Evidence with Final Tender of Comparison Group and Market Dominance testimony (Day 150).	40	60
Review and analyze railroad's Reply Evidence with Final Tender of Comparison Group and Market Dominance testimony (Day 150).	16	24
Prepare and submit Rebuttal Evidence with Final Tender of Comparison Group and Market Dominance testimony (Day 180).	40	60
Review and analyze railroad's Rebuttal Evidence with Final Tender of Comparison Group and Market Dominance testimony (Day 180).	16	24
Assist lawyers in preparation of Final Brief (if necessary and allowed)	0	20
Review and analyze railroads Final Brief (if necessary and allowed)	0	20
Phase IV - Total Estimated Hours	248	440
Phase IV - Total Estimated Cost *	\$43,400	\$77,000

**ESTIMATED CONSULTING WORK AND COSTS ASSOCIATED
WITH STB'S PROPOSED THREE - BENCHMARK APPROACH**

*(Assumes that the Complaint is eligible for established STB's Three-Benchmark Approach and that
Three-Benchmark is a viable and workable procedure which can produce reasonable and realistic results)*

	Hours	
	From	To
PHASE V - Post STB Decision		
Review and analyze STB decision (3 months after Day 180)	10	16
Meetings, conversations and communications with client representatives and/or lawyers regarding STB decision and recommendations.	8	10
Assist client and lawyers in negotiations with the railroad.	8	16
Assist lawyers in appeal of STB decision.	0	10
Phase V - Total Estimated Hours	26	52
Phase V - Total Estimated Cost *	\$4,550	\$9,100
TOTAL ESTIMATED HOURS	659	1,290
TOTAL ESTIMATED COST	\$115,325	\$225,750

* Estimated cost is based on a blended rate of \$175.00 per hour for consulting services.

APPENDIX C

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 646

RAIL RATE CHALLENGES IN SMALL CASES

Joint Written Testimony of the

American Chemistry Council, American Farm Bureau Federation, American Soybean Association, Colorado Wheat Administrative Committee, The Fertilizer Institute, Idaho Barley Commission, Idaho Wheat Commission, Kansas Wheat Commission, Montana Wheat & Barley Committee, National Association of Wheat Growers, National Barley Growers Association, National Council of Farmer Cooperatives, National Farmers Union, National Grain and Feed Association, National Grain Sorghum Producers, The National Industrial Transportation League, North Dakota Grain Dealers Association, North Dakota Public Service Commission, the North Dakota Wheat Commission, South Dakota Wheat Commission, Texas Wheat Producers Board, Washington Barley Commission, Washington Wheat Commission, Alliance for Rail Competition, Consumers United for Rail Equity

I. INTRODUCTION AND BACKGROUND

In accordance with the Notice of Public Hearing served June 29, 2004 in this proceeding, the above-listed parties ("Interested Parties") submit this Joint Written Testimony to be included in the record of the public hearing scheduled for July 21, 2004. That hearing is intended to provide a forum for the expression of views regarding rail rate challenges in small cases to be considered by the Board. The hearing is also intended to offer an opportunity to discuss proposals for handling small cases involving a challenge to the reasonableness of rates charged by a rail carrier and the discussion of views as to how "small rate cases" should be defined or identified. Notice of Public Hearing, p. 2. In its 1996 decision in Ex Parte 347 (Sub-No. 2), *Rate Guidelines – Non-Coal Proceedings [1996 Decision]*, served December 27, 1996, the Board

set out “simplified evidentiary guidelines” to be used in proceedings to determine the reasonableness of challenged rail rates charged on captive traffic where the agency’s Constrained Market Pricing guidelines¹ cannot practicably be applied.

One year ago, on July 11, 2003, seventeen separate organizations,² each of which is also joining in this Joint Written Testimony, submitted Joint Comments in this proceeding (“2003 Joint Comments”), after Chairman Nober, at a hearing held in this case on April 22, 2003, asked shipper interests to identify common ground and, where possible, to present the Board with more specific proposals addressing their concerns.³ The 2003 Joint Comments were the product of intensive discussions and comprehensive agreement among the seventeen named shipper groups in response to Chairman Nober’s request.⁴

Observing that no case had ever been filed under the *1996 Decision* because of its many uncertainties, the 2003 Joint Comments set forth several fundamental principles that should

¹ See, Ex Parte 347 (Sub-No. 1), *Coal Rate Guidelines Nationwide*, 1 I.C.C.2d 520 (1985) [*Coal Rate Guidelines*]

² The American Chemistry Council; the Colorado Wheat Administrative Committee; The Fertilizer Institute; Idaho Barley Commission; the Idaho Wheat Commission; the Kansas Wheat Commission; the Montana Wheat & Barley Committee; the National Grain and Feed Association; the National Industrial Transportation League; the North Dakota Public Service Commission; the North Dakota Grain Dealers Association; the North Dakota Wheat Commission; the South Dakota Wheat Commission; the Washington Barley Commission, the Washington Wheat Commission; the Alliance for Rail Competition; and Consumers United For Rail Equity

³ The Board initiated this proceeding on March 26, 2003, in a notice soliciting the views of interested persons regarding all aspects of rail rate challenges in small cases. In response, various shipper, carrier, labor and government interests submitted written testimony on April 16, 2003, and presented oral testimony at a hearing held on April 22, 2003.

⁴ The 2003 Joint Comments supplemented the written testimony of individual parties submitted on April 16, 2003. The document was not intended to supplant the individual comments filed by the organizations named in the 2003 Joint Comments, and the 2003 Joint Comments specifically urged the Board to review the individual comments as well as the Joint Comments. 2003 Joint Comments, p. 2, fn 1.

guide the Board in revising its small rate case procedures. 2003 Joint Comments, pp. 3-5. The 2003 Joint Comments also proposed a “bright-line test” to determine the eligibility of a shipper to use the small case guidelines (2003 Joint Comments pp. 5-7), and requested the Board to clarify how it would determine the reasonableness of rates in small rate cases (2003 Joint Comments pp. 9-12). The 2003 Joint Comments lastly set forth detailed suggestions for simplifying and expediting procedures for small rate cases, with the goal of obtaining an initial decision from an Administrative Law Judge within at most five to six months from the date of the filing of the complaint, and a decision on appeal to the Board within at most nine months.

Finally, on August 21, 2003, the seventeen 2003 Joint Commenters sent a letter to the Chairman responding to a letter sent by counsel for the Association of American Railroads that discussed several of the proposals discussed in the 2003 Joint Comments.

Since the 2003 Joint Comments were submitted on July 11, 2003, additional parties⁵ have determined to participate in this proceeding along with the parties submitting the 2003 Joint Comments. These organizations represent an extremely broad spectrum of users of the nation’s rail system, including a variety of agricultural interests, chemical producers, industrial producers, fertilizer shippers, coal shippers, and others.

These Interested Parties here adopt and incorporate the 2003 Joint Comments, which are attached to this submittal in their entirety for the convenience of the Board. These Interested Parties also supplement those 2003 Joint Comments as set forth in this Joint Written Testimony.

⁵ The American Farm Bureau Federation; American Soybean Association; National Association of Wheat Growers; National Barley Growers Association; National Council of Farmer Cooperatives; National Farmers Union; National Grain Sorghum Producers; and the Texas Wheat Producers Board.

II. THE BOARD'S SMALL RATE CASE RULES MUST PROVIDE FOR A BALANCED, CLEAR, QUICK AND INEXPENSIVE PROCESS FOR ADJUDICATING SMALL RATE CASE DISPUTES

As discussed in more detail in the 2003 Joint Comments, the goal of the small rate case process must be to provide a balanced, simple, clear, quick, and inexpensive process for deciding such cases in accord with the intent of Congress that a “simplified and expedited” methodology be made available as an alternative to a “full stand-alone cost presentation” when such a process is “too costly, given the value of the case.” The rules, processes and standards that currently exist for small rate cases do not meet these goals, and these Interested Parties applaud the Board for initiating a process designed to lead to substantial changes.

Simplicity is crucial. Complexity and undue uncertainty drive up the cost of any litigation, including litigation before the Board, and given the smaller amounts at stake by definition in a “small rate case,” complexity and cost will terminally chill the exercise of the statutory right to reasonable rates for the very large majority of captive users of rail services. In this regard, the Board’s experience in Stand-Alone Cost cases is an object lesson in what should not happen in small rate case proceedings. Since the Interstate Commerce Commission decided the first Stand-Alone Cost case eighteen years ago,⁶ the complexity, size and cost of a SAC case before the agency has increased astronomically. But instead of guarding against complexity in small rate cases, the Board’s current small rate case rules invite complexity at the very outset: they define little, rule nothing out, and identify virtually no standards for decision.

While this gives the Board maximum flexibility and discretion, it makes it impossible for potential complainants to know whether small rate case procedures will be used; what evidence

⁶ *Omaha Public Power District v. Burlington Northern, Inc.*, 3 I.C.C.2d 123 (1986).

will be considered; how long the case will take; and what the case will cost. These problems, formidable in the best of cases, become insurmountable when combined with defendants' litigation incentives to make small rate cases long, complex and expensive in order to discourage future complaints. The issue was summed up by Chairman Nober in recent Congressional testimony: the uncertainty of the small rate case procedures "appears to be a major reason why no cases have been brought using the small-case process."⁷

Clarity is similarly important. If parties are going to avail themselves of the rate complaint process, they need the assurance of a system featuring relatively straightforward eligibility and substantive standards, so that they can predict to some reasonable degree what cases qualify for small rate case procedures and which rates are likely to be found unreasonable. This does not mean that the outcome of small rate case litigation must be perfectly and entirely predictable. It does mean that the eligibility for small rate cases should be clearer and that processes for determining eligibility should be defined. It also means that the substantive inquiry should be sufficiently transparent to allow exercise of reasonable, though necessarily imperfect, judgment.

Most importantly, clarity and predictability will enhance the potential of private settlements, since both parties will be able to make more accurate assessment of their risks. Where there is good reason to conclude that rates are reasonable, neither side has an incentive to litigate. Where rates appear unreasonable, regulatory uncertainty should not protect the status quo. And where cases fall between these points, clarity promotes negotiated solutions. In short,

⁷ Testimony of Roger Nober, Chairman of the Surface Transportation Board, House Committee Transportation and Infrastructure Subcommittee on Railroads, Hearing on the Status of Railroad Economic Regulation, March 31, 2004, p. 9.

if the small rate case process becomes clearer, it is even more likely that customers and suppliers will conduct balanced negotiations leading to private resolutions rather than Board-ordered relief.

Finally, it is most important for the Board's rules on small rate cases to establish a process under which a complainant can be assured of expeditious action. Unlike coal movements that generally continue for years and even decades, small rate cases are likely to involve movements that may last for only a few years. The need to spend two years litigating rates for a movement that may last only three to five years would discourage most if not all potential complainants. Moreover, increased litigation time usually means increased litigation cost.

The Board's current small rate case standards do not appropriately balance the rights of shippers and carriers. The complexity, uncertainty and cost that are inherent in the current small case procedures and standards, combined with the astronomical cost, time and uncertainty of a Stand-Alone Cost case, make it virtually impossible for any captive shippers, other than the largest coal shippers, to exercise their right to a reasonable rate under the ICC Termination Act. As Chairman Nober testified before Subcommittee on Railroads of the House Committee on Transportation and Infrastructure on May 20, 2003, "shippers who feel they have been charged an unreasonable rate have a right to have that complaint heard by the Board in a fair, impartial, expeditious and economical manner. That is part of our fundamental charge from the Congress. *That is not the case now*, and our agency can and will offer some solutions to that problem." Nober Testimony, May 20, 2003, p. 9 [emphasis added].⁸

⁸ Chairman Nober's statement echoes an earlier conclusion by the General Accounting Office, which, in 1999, found that, of 700 rail shippers surveyed, 75% reported paying rates that they

III. THE BOARD SHOULD ADOPT A “BRIGHT-LINE” TEST TO DETERMINE A SHIPPER’S ELIGIBILITY TO USE THE SMALL CASE GUIDELINES, WHICH SHOULD BE BASED UPON THE COMPLAINANT’S ANNUAL FREIGHT BILL FOR TRANSPORTING A COMMODITY BETWEEN AN ORIGIN-DESTINATION PAIR

Under the statute, the Board is required “to 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).

The agency’s current rules provide no guidance to potential complainants as to how the Board will decide whether a shipper will qualify for small rate case procedures or not. 2003 Joint Comments, p. 6. The 2003 Joint Commenters strongly believed that there must be a less onerous and greatly simplified bright-line standard of eligibility, and strongly urged the Board to adopt a bright-line small case eligibility standard utilizing the shipper’s annual rail freight bill between each origin-destination pair. The Board was correct in concluding that eligibility for the simplified standard must turn on the dimensions of the “case” and not the size of the shipper bringing the case, in order to accurately reflect the Congressional intent behind the “small rate case” provisions.⁹

The 2003 Joint Comments argued that where a dispute involved an annual freight bill of \$4.8 million per commodity for a single origin-destination pair, a full stand-alone cost complaint would clearly be “too costly, given the value of the case.” Such cases would therefore plainly

regarded as excessive, but felt that they had no regulatory recourse. Shippers cited the time, cost, and complexity of rate cases, poor prospects for relief, and concerns about retaliation. See, Report GAO/RCED-99-46, Railroad Regulation: Current Issues Associated with the Rate Relief Process, February 26, 1999.

⁹ See, Ex Parte No. 646, Notice of March 27, 2003, focusing the proceeding on small rate “cases” as opposed to “small shippers.”

qualify for the small case procedures. The calculation of this bright line was directly linked to the cost of bringing a full stand-alone case and reasonable assumptions as to the value of a potential complainant's case.

Specifically, the 2003 Joint Comments began with a conservative estimate of the cost of a typical SAC rate case of \$2 million, and then made three additional very conservative assumptions, namely a multiplier of three to compensate for litigation risk; a potential 25% rate reduction; and a five-year recovery period. Combining these four factors led to a mathematical calculation that the shipper's annual freight bill from the complained-of rates would need to be at least \$4.8 million to justify a SAC case, and therefore any freight bill lower than that between a single origin-destination pair should automatically qualify for small rate case treatment.¹⁰ See 2003 Joint Comments, pp. 6-7.

The Interested Parties endorse the methodology set out in the 2003 Joint Comments, but wish to supplement that analysis with a few additional points.

First, in the year since the 2003 Joint Comments were filed, it has become very clear that the complexity and cost of bringing a SAC case has increased. The 2003 Joint Comments indicated that the cost of a typical large rate case for a complainant was \$2 to \$3 million for legal fees, consultants and other expenses.¹¹ The calculation of the \$4.8 million eligibility figure was predicated on a cost for a SAC case at \$2 million, the low end of this range. However, more

¹⁰ \$2 million cost of a SAC case times a litigation risk factor of 3 = \$6 million. \$6 million divided by 5 year recovery period = \$1.2 million per year. \$1.2 million divided by 25% potential rate reduction = \$4.8 million annual freight bill.

¹¹ As Chairman Nober testified on May 20, 2003 to the Railroad Subcommittee of the House Committee on Transportation and Infrastructure, railroads have been known to spend \$5 million on each rate case, while a shipper's spending on the same case is more likely to be only \$2-3 million. (Nober Testimony, p. 7)

recent experience with SAC cases indicates that \$2 million is no longer even close to the actual amount for bringing a SAC case, which now exceeds \$3 million, and is heading upward.

The Interested Parties understand that the Board has a difficult time balancing the need for predictability in SAC cases with the need to be responsive to the evidence submitted by the parties. Yet, the Board must understand the “downstream” consequences of its own actions on both SAC cases and on the “value of the case” standard for determining eligibility for small rate cases. For example, in the recent *Xcel Energy* case (STB Docket No. 42057, *Public Service Company of Colorado D/B/A/ Xcel Energy v. The Burlington Northern and Santa Fe Railway Company*, decision served June 7, 2004), the Board made a number of changes to its rulings in prior cases. The nature of SAC cases and the Board’s rulings tend to lead to greater cost and complexity. But as the cost of bringing a SAC case rises, any threshold for determining eligibility for small rate case procedures must also rise, given the statutory “value of the case” standard.

Using a multiplier of three as a necessary margin between the expected costs and expected recovery in a rate case in order to justify the risk; an assumption that the relief sought is a 25% rate reduction; and that the period of potential relief is five years,¹² the shipper’s annual freight bill between each origin-destination pair would now have to be at least \$7.2 million to justify a SAC case, simply using the SAC cost of \$3 million rather than a SAC cost of \$2

¹² Unlike coal movements, which may extend for many years under long-term coal supply contracts, non-coal movements are rarely governed by long-term supply arrangements. Markets change frequently. These Interested Parties believe that a five year assumption is reasonable, and indeed generous, inasmuch as shipping patterns may change in less than five years. It should be noted that the Board itself has implicitly recognized that non-coal movements are typically of much shorter duration than coal movements, since the Board’s rules provide that a small rate case shipper must specify “the duration of any rate prescription” sought. 49 C.F.R. §1111.1(a)(8).

million.¹³ Thus, these Interested Parties believe that a \$7.2 million annual freight bill from a single origin-destination pair should be the eligibility threshold for small case status, under which a shipper is automatically entitled to utilize the small case procedures to challenge the rate.¹⁴

Second, these Interested Parties believe that the Board's eligibility rules should provide for the possibility that, in a particular case, a movement whose yearly freight bill is larger than that set forth above might still qualify for small case treatment. Thus, although a movement with a freight bill below \$7.2 million should automatically qualify for small case treatment, a movement above that level might also qualify, but only after a specific showing of eligibility by the shipper. The \$7.2 million threshold was predicated, for example, on an assumed potential rate relief of 25% -- a very high figure. However, a particular complainant might allege, at the outset in its complaint, that it is seeking a 15% rate reduction, or a rate reduction for fewer than five years. In that case, the "value of the [complainant's] case" is even lower than the figure used to calculate the threshold, and the complainant should be given the opportunity to show that it should be able to qualify for small case treatment even if its freight bill for the movement is somewhat in excess of the threshold. In other words, where a case does not qualify for small rate case procedures under the bright-line test, the Board should not, at this early stage, assume that SAC litigation is feasible.

¹³ \$3 million for the cost of a SAC case, times a multiplier of 3 to represent the risk premium = \$9 million; \$9 million divided by a 5 year recovery period = \$1.8 million per year. \$1.8 million divided by 25% = \$7.2 million annual freight bill.

¹⁴ See, 49 C.F.R. §1111.1(8). As noted, the \$7.2 million threshold assumes that the shipper desires and the Board will prescribe a rate under the small case guidelines for five years. In the event that the shipper would seek a rate prescription for a longer period of time, the shipper would still be bound by the \$7.2 million threshold, and would have to show that the total relief sought would be less than the \$7.2 million amount over the longer time period.

Finally, these Interested Parties strongly oppose the position of the AAR that the Board should identify a “sub-class of cases brought by truly small shippers.” See Letter from the Association of American Railroads, August 4, 2003. The AAR’s letter takes issue with the premise that SAC cases typically cost \$2 million. However, there is no support for the AAR’s suggestion that non-coal cases under CMP would be less costly than coal cases. Experience and logic show otherwise. There have been two non-coal cases litigated under the SAC standard, and both at least equaled or exceeded the cost of coal cases.¹⁵ Non-coal shippers typically transport multiple commodities to many destinations that change every few years, if not more frequently. Thus, a non-coal SAC is likely to involve a larger stand-alone system, to more destinations, with more complex rail operations. This suggests that non-coal SAC case costs would at least be equal to, but certainly not lower than, coal rate cases.

The AAR’s suggestion is contrary to the statute, which recognizes only two categories of complaints: those litigated under the Stand-Alone Cost standard, and “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). There is no provision in the statute for special eligibility rules for the “truly small shipper” as a third category of complainant. The AAR’s argument in favor of rules applicable to the “truly small shipper” is inconsistent with the statute’s focus on the “value of the case,” not the size of the shipper. In sum, the Board should develop rules that attempt to fairly and reasonably identify the universe of possible cases which qualify for small rate case treatment under the statutory

¹⁵ The *McCarty Farms* case took seventeen years to resolve and the State of Montana and various farm producers spent \$3.2 million in costs, excluding attorney’s fees (the case was taken on contingency). The *FMC Wyoming* case involved all of the same procedures, issues, and evidence that is submitted in coal rate cases.

“value of the case” standard, leaving a degree of flexibility to account for individual or unusual circumstances.

IV. THE BOARD SHOULD CLARIFY HOW IT WILL DETERMINE THE REASONABLENESS OF RATES IN SMALL RATE CASES.

In the 2003 Joint Comments, the commenters indicated that the existing small rate case guidelines do not provide a clear standard that complainants know they must satisfy in order to obtain relief. The Joint Commenters noted that the Board adopted three benchmarks only as a “starting point,” without any guidance as to how those benchmarks will be applied, and with the expectation that complainants will augment these benchmarks with additional, vaguely identified, evidence. *1996 Decision*, at 1045. The Joint Commenters sought clarification from the Board as to how it will apply these benchmarks as a standard of reasonableness in small rate cases, and how various types of additional evidence might alter the benchmark results.

Specifically, the 2003 Joint Comments asked the Board to:

- Clarify what type of “individualized pricing considerations” might be relevant in a particular case (2003 Joint Comments, p. 10)
- Clarify the types of efficiency considerations that might be significant in resolving the issue of whether or not to use the efficiency –adjusted RSAM (2003 Joint Comments, p. 11);
- Clarify the application of the $R/VC > 180$ benchmark when the complainant’s R/VC ratio is less than the average published by the Board (2003 Joint Comments, p. 11)
- Grant complainants’ access to the confidential waybill sample for purposes of evaluating a potential rate complaint (2003 Joint Comments, p. 11)
- Clarify what should be considered “similar” traffic for purposes of the $R/VC[Comp]$ benchmark (2003 Joint Comments, p. 11)
- Clarify how the Board is thinking of weighing the three factors by preparing responses to eight hypothetical examples applying various combinations to the three benchmarks (2003 Joint Comments, p. 12)

The Interested Parties in this respect adopt the 2003 Joint Comments in their entirety, and urge the Board to implement the suggestions therein.

In this regard, the Board has sought suggestions on substantively revising the small case standards, and has indicated that no party has yet come forward with any such revisions.¹⁶ However, the Interested Parties are painfully aware that it took the ICC and the Board ten years – from 1986 to 1996 -- and a Congressional directive to the agency in the 1995 ICC Termination Act (49 U.S.C. 10709(d)(3)), to come up with the benchmark approach set forth in the *1996 Decision*. Before embarking on a wholesale new path, the Interested Parties believe that the sounder approach would be for the Board to better define what the 1996 standards mean and how they will be applied, as requested in the 2003 Joint Comments.

V. **THE BOARD SHOULD REVISE ITS METHODOLOGY FOR CALCULATING THE REVENUE SHORTFALL ALLOCATION METHOD (RSAM)**

Among the three benchmarks developed by the agency to assess the reasonableness of a rate under the simplified procedures is the Revenue Shortfall Allocation Method, or RSAM. The Board has stated in its *1996 Decision* that the RSAM benchmark measures the uniform markup above variable cost that would be needed from every shipper of potentially captive traffic (i.e., the >180 traffic group) in order for the carrier to recover all of its fixed costs. *1996 Decision*, 1 S.T.B. at 1027. The Board noted in its *1996 Decision* that RSAM supplies a “key component” of a simplified rate reasonableness analysis “because it accounts for a railroad’s need to earn adequate revenues, as required by 49 U.S.C. 10704(a)(2).”

¹⁶ Testimony of Roger Nober, Chairman, Surface Transportation Board, before the House Committee Transportation and Infrastructure, Subcommittee on Railroads, March 31, 2004, p. 11.

Assuming that Board's small rate case standards should include a factor assessing a railroad's "shortfall" from revenue adequacy, it appears that the methodology by which the Board calculates the RSAM is flawed. Indeed, it appears that the RSAM, as calculated by the Board, does not in fact measure the carrier's existing "shortfall" from revenue adequacy. In fact, under the Board's existing methodology, a carrier's revenue might equal or exceed the level for "adequacy" found by the Board in its yearly determinations of revenue adequacy, and yet the RSAM could still show the existence of a substantial "shortfall."

The reason for this anomaly appears to lie in the technicalities of the RSAM calculation, technicalities that are not apparent from the Board's *1996 Decision*. A short summary of our understanding of the RSAM calculation is in order:

Step 1: The Board first calculates a carrier's total variable cost from the Waybill File, and the carrier's total freight revenues from the Waybill File and the R-1.

Step 2: The Board inflates to carrier's total variable cost by a "markup" in order to develop the carrier's Fully Allocated Costs.

Step 3: The Board subtracts from the Fully Allocated Cost figure the carrier's total variable cost (obtained in Step 1) and any non-line haul revenues (such as switching, demurrage, and joint facility revenues), to obtain a figure for the carrier's "Unattributable Costs."

Step 4: The Board subtracts the variable costs of the non-competitive (i.e., traffic with a revenue to variable cost ratio of less than 180%) from the revenue of the non-competitive traffic, to obtain the "revenue contribution" of the non-competitive traffic.

Step 5: The Board then subtracts the revenue contribution of the non-competitive traffic from the "Unattributable Costs" developed in Step 3, to obtain "residual" unattributable costs.

Step 6: The Board calculates the RSAM by dividing the residual unattributable costs by the variable cost of the captive (i.e., greater than 180% r/vc ratio) traffic.

A quick review of these steps reveals that the revenue being obtained from captive traffic never figures in to the calculation of a revenue "shortfall." Particularly in view of the Board's ruling

that the RSAM is intended to account “for a railroad’s need to earn adequate revenues,” the implications of this methodology are anomalous:

1) Because revenue from existing captive traffic never figures in to the calculation of the RSAM under the Board’s current methodology, a carrier can be revenue adequate, or even have revenues that exceed revenue adequacy, and still have a high “revenue shortfall” denoted by a very high RSAM, as long as a significant portion of its revenues is obtained from the carrier’s captive shippers.

2) A carrier that over time increases revenues from its captive traffic and decreases revenues from its non-captive traffic will have a higher and higher “shortfall” and thus a higher and higher RSAM. Under the Board’s existing small case guidelines, all other things being equal, a higher RSAM will apparently permit a carrier to increase revenues on its captive traffic still further, since the RSAM is one of three factors that the Board will consult in determining the reasonableness of a captive shipper’s rail rate.¹⁷

3) Two carriers can have precisely the same total revenue and precisely the same relationship to revenue adequacy, yet one carrier’s RSAM can be very different from the other, if one carrier is obtaining a larger proportion of its revenue from captive traffic, compared to the other carrier that is maximizing revenues from its non-captive traffic. Oddly enough, the carrier with the higher RSAM will be the carrier obtaining a greater proportion of its revenue from

¹⁷ The Board’s methodology in calculating the RSAM appears to create a perverse incentive for carriers not to maximize revenues from traffic that contributes only marginally to fixed costs, and instead to maximize revenues from captive traffic. Such an incentive could be argued to be at odds with the statutory command in 49 U.S.C. §10701(d)(2)(B), which requires the agency, in determining rate reasonableness, to give consideration to the amount of traffic which contributes only marginally to fixed costs and the extent to which rates on such traffic can be changed to maximize the revenues from such traffic.

captive traffic – thus permitting that carrier to obtain even more revenue from captive traffic, since that carrier's RSAM will be higher than the RSAM of the carrier maximizing revenues from all of its traffic.

The Interested Parties submit that the Board should, in any rulemaking, seek comments from the public on the appropriate way to calculate the RSAM. The Interested Parties submit that the methodology for calculating the RSAM utilized by the Board appears to incorrectly increase the level of the RSAM, create inappropriate incentives for rail carriers, and establish unlawful considerations for the Board in determining whether a particular rate is reasonable.

VI. THE BOARD SHOULD DEVELOP NEW PROCEDURES FOR SMALL RATE CASES.

The 2003 Joint Comments set forth a detailed discussion of procedures that the Board should adopt to expedite small rate cases. These suggestions included:

- Active management of a small rate case by an Administrative Law Judge, with high standards for interlocutory appeals;
- Standardized discovery to expedite the initial processing of a case, and limited additional discovery in specified areas;
- Expedited determinations of small case eligibility by the ALJ;
- Access to the confidential waybill sample upon certification by a potential complainant that information will be used to evaluate a possible small rate case complaint;
- Expedited processing of motions to compel;
- Expedited time frames for the submission of evidence, with briefs filed at the same time as the evidence
- A specified time for decision by the ALJ, within 5 to 6 months after the filing of the complaint;
- Expedited appeals to the full Board, with a specified time frame for decision.

These Interested Parties adopt in their entirety the suggestions on these matters set forth in the 2003 Joint Comments, and urge the Board to implement them in refining its small rate case guidelines.

VII. CONCLUSION

The undersigned organizations respectfully request the Board to review the suggestions in these Comments and to take steps to adopt these suggestions as revisions to the Board's rules.

Respectfully submitted,

**American Chemistry Council
American Farm Bureau Federation
American Soybean Association
Colorado Wheat Administrative Committee
The Fertilizer Institute
Idaho Barley Commission
Idaho Wheat Commission
Kansas Wheat Commission
Montana Wheat & Barley Committee
National Association of Wheat Growers,
National Barley Growers Association
National Council of Farmer Cooperatives
National Farmers Union
National Grain and Feed Association
National Grain Sorghum Producers
The National Industrial Transportation League
North Dakota Grain Dealers Association
North Dakota Public Service Commission
North Dakota Wheat Commission
South Dakota Wheat Commission
Texas Wheat Producers Board
Washington Barley Commission
Washington Wheat Commission
Alliance for Rail Competition
Consumers United for Rail Equity**

By: Nicholas J. DiMichael
Thompson Hine LLP
1920 N St. N.W., Suite 800
Washington, D.C. 20036
Representative of the Interested Parties

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