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November 30, 2006

HAND DELIVERY

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

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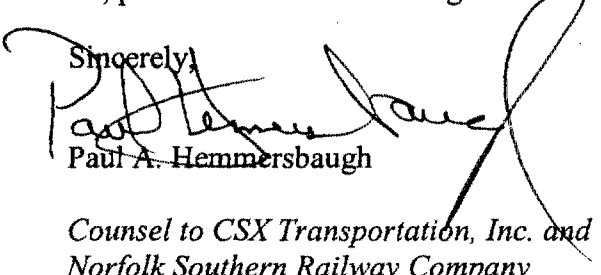
Re: Ex Parte No. 646 (Sub-No. 1), Simplified Standards for Rail Rate Cases

Dear Secretary Williams:

Enclosed, for filing in the above-referenced proceeding, are an original and ten copies of CSX Transportation Incorporated's and Norfolk Southern Railway Company's Reply Comments in the above-captioned proceeding. A diskette containing an electronic version of that response is also enclosed.

Please acknowledge receipt of the enclosed CSXT/NS Reply Comments by date-stamping the enclosed extra copies and returning them via our messenger. Thank you for your assistance in this matter. If you have any questions, please contact the undersigned counsel.

Sincerely,


Paul A. Hemmersbaugh

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

Enclosures

**UNITED STATES OF AMERICA
SURFACE TRANSPORTATION BOARD**

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

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

**REPLY COMMENTS OF
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NORFOLK SOUTHERN RAILWAY COMPANY**

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CSX Transportation, Inc. and Norfolk Southern Railway Company (collectively referred to as "CSXT/NS") respectfully submit their joint Reply Comments in the above-captioned proceeding.

I. INTRODUCTION AND OVERVIEW.

As CSXT/NS noted in their opening comments, their views of the Board's proposed simplified standards for rail rate cases are based upon certain core principles. While the Board's proposals are a constructive starting point for rate regulation when the value of the case does not justify the cost of a full SAC presentation, CSXT/NS believe that the Board must ultimately adopt rules that accord with these core principles to ensure that simplified procedures are both fair and as accurate as possible. The core principles:

- When the demand for rail transportation exceeds the supply of rail transportation, rail rates will rise. This is basic economics, not evidence that rate regulation has failed.
- Increasing rail capacity and improving rail service require increased rail revenues.
- Setting prices is at the heart of any business, and businesses use a myriad of complex factors to set their prices.
- No rate should be prescribed based on a mechanical formula because formulas cannot produce accurate rates.
- Cases too small for a full-SAC or SSAC analysis should be evaluated by the Board using its expertise to weigh all relevant factors.
- Eligibility for SSAC or "Three Benchmark" procedures should not be expanded and eligibility thresholds should not be increased.
- The more revenue that is at stake in an individual case, the closer the results in that case must be to results that would be generated by a full SAC analysis.
- The more overall rail revenue that is judged by non-SAC procedures, the more important it is that the non-SAC procedures produce SAC-like results.
- The Board should monitor carefully the results under any new procedures to ensure that these procedures do not lead to results materially different from those that would be generated by a full SAC analysis.

- Rate regulation should not encourage litigation over negotiation.

Regulations that follow the foregoing principles will allow less complex procedures for smaller cases that continue to recognize that rate-setting is a complex endeavor and that rigorous application of fundamental economic principles and policies (including differential pricing, SAC, and the need for carriers to earn adequate revenues) is essential to maintain and expand the capacity of rail transportation networks upon which so many shippers and their customers depend.

Shippers have made it abundantly clear in their opening comments that what they want is an STB rate review process that is simple, quick, inexpensive and, above all, results in lower rail rates. See, e.g., Joint Written Comments of American Chemistry Council et al, at 5-6 (Oct. 24, 2006) (hereinafter “Joint Shipper Comments at ____”). However, they fail entirely to offer meaningful suggestions for principled simplification of rate reasonableness processes for small cases. In contrast, CSXT/NS seek to build upon and improve the Board’s proposals. In their opening comments CSXT/NS offered a number of constructive proposals for changes that they believe will advance the proper goals of this proceeding while adhering to the core principles enumerated above, including the use of mandatory non-binding mediation to resolve disputes without further litigation and to minimize disputes regarding discovery and other issues. See CSXT/NS Open. Comments at 8-10, 12-24.¹ In response to concerns raised by shippers in their

¹ CSXT/NS emphasize an important caveat to their support for the general idea of using a modified version of the existing *Simplified Guidelines* (Ex Parte 347 (Sub-No. 2)) for the very smallest cases: that methodology must not rely upon a formula or combination of formulas to determine whether a rate is reasonable. CSXT/NS firmly oppose any rate reasonableness test that relies solely on such formulas. As explained in their opening comments and reiterated below, ratemaking is far too complex and multifaceted a process to be evaluated through the mechanical application of formulas. What CSXT/NS support is a methodology that considers R/VC ratios and calculations as a starting point and as relevant considerations in a flexible multi-factor evaluation that considers all relevant evidence. See CSX/NS Open. Comments at 22-24. Thus, CSXT/NS do not support the Three Benchmark test in the form the Board has proposed.

opening comments, CSXT/NS offer in these reply comments the following additional proposals for the Board's consideration.

- Modify the eligibility presumption by allowing a shipper to use a higher threshold than 180 to calculate the maximum value of the case (MVC) as long as that shipper-selected higher threshold becomes the floor for any rate prescription. (*See III.B, infra*);
- Use a "rule of reason" to determine whether aggregation is appropriate for purposes of determining eligibility, rather than an absolute standard for aggregation (*See III.A, infra*);
- Allow SSAC prescriptions to stay in effect beyond one year unless either the shipper or the railroad request that the prescription be updated. (*See IV.E, infra*);
and
- Place the burden of proof on the railroad to show why moves of the same commodity in the same type of service and over similar distances are not comparable. (*See V.C, infra*).

The comments offered by shippers are far more critical than constructive – despite many complaints, they propose few reasonable suggestions for refinement or improvement of the Board's proposals. CSXT/NS respond in detail to shippers' criticisms (and their few proposals) in these Reply Comments, but at the outset they note several fundamental flaws in the shippers' logic and complaints.

- Shippers have shown no reason or justification for the expansive regulatory intervention they seek. Shippers continue to demand more rail services, and under sound economic principles, prices are supposed to rise to when demand exceeds supply. The increased demand for rail transportation services confirms that rail rates are not out of line with the market.
- Shippers have asked for a process that is not grounded in sound economics, and does not recognize railroads' need to earn adequate revenues, which are essential

Rather, they support a more robust "Three Benchmark" approach that eschews formulas and considers the R/VC benchmarks as relevant, but not determinative, factors in the evaluation of the reasonableness of rates in cases whose MVC is less than \$200,000. Where these comments express support for a "Three Benchmark" method or proposal, they are referring to the more robust method described here.

to allow railroads to make investments to improve capacity and thereby increase the supply of rail services.

- Shippers want predictability, but the sort of predictability they seek would hinder private negotiations and favor rate litigation.
- Notwithstanding the theoretical concerns raised by shippers about the cost of simplified procedures, the only time a shipper brought a case under the existing *Simplified Guidelines* (STB Ex Parte 347 (Sub-No. 2)) prior to the initiation of the present proceeding, the matter was resolved quickly and relatively inexpensively.
- Although shippers say they want a simple, inexpensive and fast method for obtaining rate relief, most of the shipper comments would *complicate*, not simplify, the proposed processes, thereby increasing the cost and time required to resolve rate disputes.
- The idea that shippers do not have the resources or bring or maintain rate cases or might be overwhelmed by the railroads is absurd – most of the shippers who would bring rate challenges are among the largest companies in America. As a group, shippers dwarf railroads in virtually every conceivable economic measure.

II. SOUND ECONOMIC AND REGULATORY PRINCIPLES AND IMPORTANT TRANSPORTATION POLICIES ARE THE INDISPENSABLE FOUNDATION FOR ANY RULES ISSUED IN THIS PROCEEDING.

The purpose of this proceeding is to develop simplified methods that reduce the cost and time of resolving rate disputes involving smaller shipments. *See* NPRM at 3-9; 49 USC § 10701(d)(3) (directing the Board to develop a “simplified and expedited method for determining the reasonableness of challenged rail rates”). A related aim of this proceeding is to afford smaller shippers easier access to rate reasonableness evaluations in cases in which they believe their rates are not reasonable. To the greatest extent possible, such procedures should implement the sound and well-established economic principles embodied in Constrained Market Pricing (“CMP”) and Stand Alone Cost (“SAC”) standards, as well as the goals and requirements of the Rail Transportation Policy and other provisions of the Act.

It bears emphasis that it is not a proper goal of this proceeding to subject significant volumes of rail traffic to standards that do not attempt to approximate the results of the

established, economically sound, and court-approved SAC test. Nevertheless, the shipper parties seem interested only in proposals that guarantee a fast rate reduction.² Indeed, they expressly seek a regulatory system untethered to SAC. For example, NGFA expresses an unabashed desire to achieve better results through a simplified test than economically-based SAC would achieve, conceding that “many grain facilities are located on low density rural branch lines or secondary lines and are likely to fail the Board’s internal cross subsidy tests, placing SAC relief beyond their reach.” Nat’l Grain and Feed Ass’n Open. Comments at 15. Similarly, ARC argues that the Board should not seek to develop guidelines “that are as close as possible to its coal rate guidelines.” Supplemental Opening Comments of The Alliance for Rail Competition et al. at 6. Such comments do not seek a sound and reasonable methodology that serves the proper goals of this proceeding, but rather simply advocate an approach calculated to drive down rates.

Commenters seeking such substantial alterations of established policy and standards proceed from the unsupported premise that rail rates are presently too high and that the goal of this proceeding should be to provide shippers with inexpensive and fast rate reductions. There is little evidence, however, that rail rates for small shipments are actually too high given the current supply of, and demand for, rail transportation services. *See generally* U.S. Government Accountability Office Report to Congress: Freight Railroads at 11-16 GAO-07-94 (October 2006). As demand increases relative to supply, prices should rise – the fact that shippers are

² Like all buyers, shippers prefer lower prices for rail transportation services. Despite shippers’ desire to obtain lower rates wherever possible, however, the purpose of this proceeding is *not* to make rate reasonableness standards more favorable to shippers or to guarantee that shippers will obtain rate reductions if they file a rate case. *See, e.g.*, NPRM at 10 (“Any simplified methodology for assessing the reasonableness of rail rates should be designed to achieve the same objective (as SAC), albeit in a less precise manner.”) Rather, the primary purpose of this proceeding is to develop simplified methods that reduce the cost and time of resolving rate disputes involving smaller shipments in a manner that is consistent with existing statutory, regulatory, and economic policy requirements. *See id.* at 3-10.

continuing to purchase the same or more rail services shows that rail rates are not out of line with the market. Certainly, there is no evidence that small shipment rates are uniformly “too high.” At least since the passage of the Staggers Act, an overarching aim of rail transportation policy has been to allow market forces, rather than regulatory intervention, to determine rail rates, and to permit regulation only where necessary to avoid undue exercise of market power. *See, e.g.*, 49 U.S.C. 10101. Consistent with that policy and basic economics, market forces must continue to be the primary determinant of rail rate levels.

Allowing the market to work is essential to the future of railroads. NITL correctly states that this proceeding is about more than “legal rights and the resolution of commercial disputes.” NITL Open. Comments at 2. It is about an effective and efficient national transportation network that requires that the “nation’s rail carriers . . . grow compared to other modes.” *Id.* Increased revenues are essential to rail carriers’ ability to make the investments necessary to improve and expand capacity at a time when such increased capacity is essential to continued economic growth and the vitality of commerce throughout the nation. Thus, the Board must strike a reasonable balance between providing rail customers an open and fair process and allowing railroads to grow.

III. A THREE-TIERED APPROACH AND THE PROPOSED ELIGIBILITY AND AGGREGATION RULES ARE APPROPRIATE.

CSXT/NS continue to believe that the Board’s three-tiered approach generally represents a reasonable balancing of the competing goals of simplicity and cost savings on one hand, and accuracy of results, analytical rigor, and fairness on the other hand. The three-tiered approach also reflects the sound and appropriate principle that the rigor and accuracy of the analysis, and the extent to which it replicates full-SAC analysis and results, should increase as the amount at issue in a rate case increases. *See* NPRM at 28; CSXT/NS Open. Comments at 1-2, 25. Under

the Board's proposal, the least accurate and least-SAC-like approach is reserved for truly small cases, the more accurate SSAC will apply to mid-size cases, and the most accurate full-SAC analysis will apply to large cases.

CSXT/NS believe that the eligibility rules proposed by the Board are appropriate and that the reasoning offered by advocates of higher thresholds is flawed and unpersuasive. The Board developed its eligibility thresholds based in large part upon testimony proffered by shipper groups in an earlier phase of this proceeding and upon expert testimony from an earlier proceeding. *See, e.g.*, NPRM at 35-36 (citing testimony of Joint Shippers in Ex Parte 646). As demonstrated below, shippers offer no criticism that undermines the Board's proposed eligibility thresholds. Moreover, because the Board has made clear that the eligibility thresholds and aggregation rule are rebuttable presumptions that are not intended to be rigidly applied, complainants will have adequate opportunity to demonstrate that specific cases should be considered under a different methodology than the MVC of the case would suggest. Finally, the concern that MVC may overstate the realistic range of a complainant's potential recovery could be addressed by allowing complainants to adjust the MVC downward in a specific rate case by stipulating to a floor on any rate prescription they might obtain in that case.

A. The Board's Aggregation Proposal Is a Rebuttable Presumption and a Rule of Reason Designed to Prevent Manipulation, Not an Rigid Bar to Multiple Cases Involving the Same Origin or Destination.

CSXT/NS agree with the Board that its proposed simplified procedures could be manipulated by complainants bringing serial cases pertaining to movements involving the same or similar rail lines and facilities. *See* NPRM at 34. The proposed aggregation presumptions, applied with reason and vigilance, should discourage such inappropriate manipulation. Some shippers express concern that rigid application of the aggregation presumptions could effectively require a shipper to bring any and all rate claims involving a particular origin or destination in a

single case, regardless of whether the movements in question share common rail routes or facilities. *See, e.g.*, Joint Shipper Comments at 19-22.

This concern appears unfounded. CSXT/NS understand the proposed aggregation presumption not as a rigid and absolute *per se* rule, but rather as a flexible rule of reason. *See, e.g.*, NPRM at 34 (making clear that aggregation is a rebuttable presumption). That is, the Board will evaluate claims involving the same origin(s) or destination(s) that are brought within the same two-year period to determine whether they should have been brought in a single case, and use its expert judgment and discretion to make a case-specific determination in each instance. Complainants who file such multiple cases presumably will be allowed to present evidence and argument that it was not feasible or appropriate to bring later claims at the time of the previous case, and that aggregation of its claims is not necessary to prevent manipulation or distortion of the eligibility thresholds. Where a complainant makes such a showing, the Board would apply its rule of reason to find that the complainant is not required to aggregate its multiple cases for purposes of eligibility determination.³

B. CSXT/NS's Proposed Alternative Option For Determining Eligibility For SSAC Or The Three Benchmark Methodology.

The Joint Shippers assert that eligibility thresholds should be raised because the MVC does not provide a realistic estimate of the likely value of a case. In support of this contention, Witness Crowley asserts that “there is virtually no possibility that the STB will set a rate at the [jurisdictional threshold] level under its proposed SSAC and Three Benchmark approaches . . .”

³ For example, movements that share only the same origin but use entirely different rail lines and facilities to transport commodities to destinations in different directions (say movements originating in Kansas City but moving to destinations in Los Angeles, New York, and Atlanta) would likely not be subject to the aggregation requirement. *Cf.* Joint Shipper Comments at 20-21 (suggesting that shipments originating in a single location and moving to multiple different locations in different directions might be forced from the Three Benchmark test to SSAC, or from SSAC to full SAC as a result of the aggregation presumption).

V.S. Crowley at 31. Shippers conclude that, because no complainant will be able to obtain a rate prescription anywhere near the 180% R/VC jurisdictional threshold, MVC significantly overstates the “actual” value of a small or medium-sized rate case. *See* Joint Shipper Comments at 14-17; V.S. Crowley at 30-36.

To address this concern, CSXT/NS propose that the Board allow complainants the option of reducing the MVC of the case for purposes of eligibility determinations by stipulating that they do not seek a rate prescription that would generate an R/VC ratio below a level they select. Under this proposal, a complainant that believes it has little prospect of obtaining a rate prescription below a certain level could specify an R/VC ratio that would establish the floor for any rate prescription in its case. The Board would then calculate an adjusted MVC of the case based upon the difference between the challenged rate and the rate that would result from the application of the complainant-designated R/VC ratio to the URCS variable costs of the issue movement(s).

The adjusted MVC, in turn, would be used to determine the presumptive eligibility of the case for evaluation under the Three Benchmark, SSAC, or full-SAC methodology. To be eligible for this adjusted MVC, the complainant would be required to stipulate that any rate that might be prescribed in the case could not be lower than a level that would generate the R/VC level the shipper designated for purposes of determining the adjusted MVC. This proposal would allow complainants who believe the MVC overstates the realistic value of the case to reduce that MVC simply by removing from consideration rates below a level that they believe they cannot hope to obtain. This proposal is analogous to the Board’s proposal for addressing traffic volume for purposes of eligibility. *See* NPRM at 34.

C. Alternative Eligibility Thresholds And Calculations Proposed By Other Commenters Are Unsound And Unworkable.

Several commenters have suggested that the presumptive eligibility thresholds proposed in the NPRM should be revised to subject more rate cases to less accurate methodologies. None, however, has proposed an alternative that would be fair, workable in practice, and consistent with fundamental statutory and regulatory requirements and the proper goals of this proceeding.

Most of the comments advocating increases in the presumed eligibility thresholds proceed from at least one of two fundamentally erroneous premises: First, that more rate cases are better than fewer, and that the health and success of rail rate regulation is directly related to the number of cases filed and decided by the Board. Second, that rate litigation should be designed to ensure that shippers' net recovery from any and all rate cases will, at a minimum, cover the cost of litigating those rate cases. These assumptions ignore the risks and uncertainty inherent in any litigation and are fundamentally at odds with more than a quarter century of rail transportation policy and regulation.

For the last three decades, a primary aim of rail rate regulation has been to allow market forces to establish rates by encouraging private negotiations and contracts, and to minimize the setting of rates through government intervention and control. *See, e.g.,* 49 U.S.C. § 10101(1), (2); *Coal Rate Guidelines*, 1 I.C.C. 2d 520, 522, 524 (1985). Rate regulatory proceedings should be reserved for those relatively rare occasions in which a market dominant carrier and a customer are unable to negotiate an agreed rate. *See* 49 U.S.C. §§ 10101, 10701, 10709; *Coal Rate Guidelines*, 1 I.C.C. 2d at 522-24. Contrary to the underlying assumption of several commenting shippers, the filing of more cases and greater reliance on regulatory intervention to set rail transportation rates would be an indication of failure to achieve important goals of modern rail

rate policy. Thus, any proposal that encourages rate litigation over negotiated rates must shoulder heavy burdens of proof and persuasion.

1. Proposals to Change the Basis for Eligibility Thresholds Would Increase Rate Litigation by Effectively Insulating Rail Shippers from the Risks and Uncertainty Inherent in Litigation.

Many commenters seek higher eligibility thresholds based upon the notion that eligibility thresholds should be based upon the likelihood of prevailing in a rate case and other litigation risk factors. This suggestion is a red herring. Eligibility levels should be set without regard to such risk assessments or projections, which in any event could not be generalized in any reasonable or meaningful way over the wide and diverse range of possible specific rate disputes. Neither the Act nor the NPRM provides any support for the notion that the Board should set rate methodology eligibility levels to minimize complainants' litigation risk or to shield them from the litigation risk assessment faced by every other potential litigant. Rather, the proper purpose of this proceeding is to seek to develop sound, simplified and less expensive rate reasonableness tests that allow a potential small case complainant better access to the Board's rate reasonableness procedures. Setting reasonable and appropriate eligibility thresholds is part of that process. Making litigation risk assessments is not.

Most commenters' arguments for raising the eligibility thresholds are predicated on the assumption that those thresholds should be set at levels that make shippers' expected value of a rate prescription (simplified, the likelihood of prevailing times the amount of projected recovery in the event the complainant prevails) greater than or equal to the cost of bringing and litigating the rate case. *See, e.g.,* Joint Shipper Comments at 9-19, App. C at 7-10; USDA Comments at 5-7, 11. Even assuming, *arguendo*, that the necessary parameters (likelihood of prevailing and likely recovery) could be accurately determined at the time of filing of the complaint, this approach would insulate complainants from downside risk. This, in turn, would foster rate

litigation and discourage negotiated rate agreements because shippers would face little downside potential, and significant potential for gain in seeking a rate prescription from the Board.

Moreover, such a proposal seeks to eliminate the risks and uncertainties of litigation and to shield rail shippers from the difficult balancing of potential risks and rewards that is inherent in litigation decision-making. Consideration of such risks and uncertainty is essential to avoid a situation in which the incentives heavily favor the filing of rate cases. Rail carriers must factor such risks into their determination of whether to agree to a rate they believe is too low or to risk rate litigation with its attendant uncertainties. Similarly, potential litigants in every other context have no such effective guarantee that the expected value of their recovery will exceed their litigation costs. No commenter has offered a sufficient reason to establish an exception for shippers who might consider rate litigation.

2. The Parameters Upon Which Commenters Base Their Proposed Higher Eligibility Standards are Unique to Each Case and Cannot Be Generalized For All Potential Cases.

The eligibility thresholds proposed by the Joint Shippers and by USDA depend on subjective evaluation of the merits of a potential rate case, which necessarily depends on its specific facts and circumstances. The Joint Shippers propose that the Board “drastically” increase the eligibility threshold for Three Benchmark cases based upon arbitrary and unsupported assumptions about the assumed level of recovery in a case, and the “litigation risk” (by which they apparently mean the risk that a complainant will not prevail in a rate proceeding). See Joint Shipper Comments at 5, 14, 18-19.⁴ Because the Joint Shippers oppose individualized

⁴ The Joint Shipper Comments do not directly specify a recommended threshold level. However, in support of their comments, they cite testimony filed by most of the same shippers in this docket prior to the institution of this formal rulemaking. See Joint Shipper Comments at 19 (citing joint testimony of numerous shipper groups submitted in 2004, a copy of which is appended as Appendix C to the Joint Shipper Comments). Appendix C advocates a small case eligibility ceiling of \$7.2 million, based upon estimated SAC litigation costs of \$3 million,

eligibility determinations in each case (*id.* at 13), their proposal is apparently that the Board establish a single eligibility threshold based on a general estimate of the cost of a case, the likelihood that a shipper will prevail, and the amount of rate reduction the complainant would receive if it prevailed.⁵

In any specific case, however, it would be impossible to determine – fairly and reliably, and before the submission of any evidence – the likelihood of prevailing and the amount of rate reduction that would be awarded. The specific circumstances of each rate case and the nature and quality of the evidence vary widely. It is simply impossible at the very outset of a case to forecast with any accuracy such fact-specific attributes as probability of success and likely amount of recovery. Any attempt by the Board to do so would amount to prejudging the case. To further stretch such a dubious prognostication to establish a single eligibility threshold for all cases would be a meaningless exercise. Any threshold established through such compound speculation would be entirely arbitrary and capricious.

litigation risk of 3, and an assumed rate reduction of 25%. Appendix C at 8-10. Given that the Joint Shipper Comments advocate elimination of the SSAC approach and application of the Three Benchmark test to all non-SAC cases, it appears that they advocate an eligibility ceiling of at least \$7.2 million for such “small” cases. See Joint Shipper Comments at 23-24, 32; V.S. G. Fauth at 63 (endorsing \$7.2 million eligibility threshold). It may be that the Joint Shippers would advocate a significantly higher eligibility threshold level, because they claim that the cost of a SAC case today is approximately \$4 – 7 million (their 2004 estimate was \$3 million), and the threshold for non-SAC cases should be based on that estimate. *Id.* at 24.

⁵ USDA uses similar hypothetical probabilities and values (unsupported by any evidence that the assumptions are representative of what those parameters might be in an actual medium-sized rate case) to derive its recommended Three Benchmark eligibility ceiling of \$1.6 million. USDA Comments at 6-7. Although USDA posits that recent full-SAC cases have resulted in rate reductions of about 10% in 50% of the cases, there is no reason to assume that future SAC cases (let alone SSAC cases) would generate similar results. The same discussion demonstrates the dependency of the level of the threshold on the input assumptions – when USDA changes the assumed rate reduction by only 10% of the MVC, the resulting threshold declines from \$1.6 million to \$800,000. The USDA proposal is just as arbitrary as that advanced by the Joint Shipper Comments. USDA also advocates a \$15 million eligibility ceiling for most SSAC cases (advocating no ceiling for cases involving “numerous origins, destinations, and commodities”), but offers no explanation of how it arrived that number. See USDA Comments at 11-12.

3. Requests for Higher Eligibility Thresholds Also Overestimate the Costs of Small Cases.

Commenters who advocate higher eligibility thresholds do not adequately consider the fact that costs of litigating SSAC and Three Benchmark cases should be significantly lower than the cost of SAC cases. Because of the proposed elimination of significant time-and-resource-consuming analyses conducted in SAC proceedings, the cost to parties of litigating SSAC cases should be dramatically lower than the cost of SAC proceedings. Similarly, the adoption of rules that clarify or properly simplify the application of the Three Benchmark test should reduce the costs of litigating those cases to amounts less than those projected for a case under the existing *Simplified Guidelines*. See generally, NPRM at 36 (proposed eligibility thresholds for Three Benchmark approach are based upon updating of expert testimony in STB Ex Parte 347(Sub-No. 2) regarding costs of SSAC proceeding).⁶ Thus, even if the actual value approach advocated by shippers for determination of eligibility thresholds were appropriate – and CSXT/NS demonstrate below it is not – estimates of the litigation cost of SSAC and Three Benchmark cases must be adjusted downward to reflect the cost savings that would result from whatever new rules the STB might adopt in this rulemaking.

Moreover, the claims of several commenters that the cost of litigating a Three Benchmark case will be too high to allow small cases to be brought under the Board's proposed eligibility thresholds are belied by a recent complaint under the Board's existing *Simplified Guidelines*. See Complaint, *Williams Olefins v. Grand Trunk Corp.*, STB Dkt. No. 42098 (Nov. 22, 2006). That complaint, filed on behalf of complainant by Snavelly, King, Majoros, O'Connor & Lee (commenters in this proceeding), estimates that complainant's cost of litigating the case "will not

⁶ Costs of full-SAC cases likely would be further reduced if the Board's decision to disallow URCS adjustments in SAC cases is upheld on judicial review. See, e.g., Decision, Ex Parte 657 (Sub-No. 1), *Major Issues in Rail Rate Cases* at 60 (Oct. 30, 2006).

exceed \$50,000.” *Id.* ¶ 6. That estimated cost, in a real case brought under the Board’s existing guidelines (before any additional simplifications and cost savings that might result from rules adopted in this proceeding) is substantially below the \$200,000 MVC ceiling the Board has proposed. Given that Snively, King et al were consultants to the complainant in the only case brought previously under the *Simplified Guidelines* (i.e., *BP Amoco Chem. Co. v. Norfolk S. Ry.*, STB Docket No. 42093 (served June 28, 2005)) they presumably have first-hand knowledge of the likely cost of litigating a small case.

4. The AVC Proposal Is Inappropriate And Unworkable.

The Joint Shippers “alternative” to MVC is unworkable. Although the Joint Shipper Comments assert that eligibility for small case methodologies should be determined based on the Actual Value of the Case (“AVC”) rather than MVC, they offer no explanation or suggestion of how the Board might calculate the AVC of a case. The conclusory “proposal” is unworkable because it is predicated upon knowing what is unknowable – the final outcome of a rate case – at the time of filing of a complaint. In all events, without an explanation of how the AVC would be determined or applied, there is no basis to evaluate – let alone adopt – such an approach.

If the commenters intend that the Board would make a subjective evaluation of the expected value of the case at the outset, and apply that estimate to eligibility thresholds to determine the presumptive methodology, their proposal has the same flaws and is subject to the same criticisms as their proposal for establishing eligibility ceilings. It is arbitrary and inappropriate to assign a probability of success and likely recovery at the very outset of a case, particularly before any case-specific evidence is available. The proposal is also practically unworkable because it is impossible to know the outcome of a specific case at the time it is filed. Such a proposal would have the added flaw of requiring the ultimate decision maker – the Board – to prejudge the merits of the case by forecasting the likelihood the shipper will prevail and

even the prescribed rate level. Thus, to the extent it can be understood as a concrete proposal, the AVC approach would be arbitrary, capricious, and contrary to law.⁷

IV. SSAC IS AN APPROPRIATE PROCEDURE FOR EVALUATING RATE REASONABLENESS.

CSXT/NS continue to support SSAC – the proposal, if carefully implemented and adjusted in light of experience in actual cases, appears to represent an appropriate compromise between accuracy and a faster and cheaper process. As the Board explained, its proposed Simplified SAC methodology necessarily “would be a less precise application of CMP, because it would not identify inefficiencies in the current rail operation.” NPRM at 11. Moreover, shippers’ complaint about reduced precision of SSAC rings hollow in light of their proposal to subject all non-SAC cases to the far less accurate Three Benchmark method. *See id.* (“[W]hile a Simplified SAC method may not fully implement CMP principles [] it more closely tracks CMP than the Three-Benchmark approach . . . [which] should be reserved for use only as a last resort”) (internal citation omitted). As discussed below, however, the Board could further simplify SSAC by adopting CSXT/NS’s proposal that the SARR be required to use the issue traffic’s predominant route of movement. Of course, if in an individual case a shipper is concerned that it might obtain a less satisfactory result under SSAC than under SAC, it is always allowed to present the admittedly more accurate full SAC analysis.

⁷ One commenter offers a hypothetical example intended to demonstrate that the MVC overstates the “AVC” of a case. *See* Joint Shipper Comments at 15-16. What the hypothetical demonstrates, however, is simply that such an analysis and comparison depends entirely on the assumed inputs. The same hypothetical could be used to “demonstrate” results that would be far more favorable to the complainant, simply by changing the assumed rate, variable cost, and comparison group R/VC ratio. Without actual numbers or some showing that the assumptions are representative of the parameters of a real case or movement, the hypothetical has no relevance or value to the question of appropriate eligibility thresholds.

A. The Board Should Require That A SSAC Stand-Alone Railroad Use The Issue Traffic's Predominant Route.

The Board should adopt CSX/NS's proposal to require the use of the issue traffic's predominant route. This is an appropriate simplifying refinement of the Board's proposal that a SSAC Stand-Alone Railroad use the same route and facilities as the issue traffic. The Joint Shippers' proposal to expand the SSAC process by allowing a complainant to designate a route that does not exist in the real world would increase the complexity and cost of a SSAC case.

The Joint Shippers dislike the Board's proposal because they claim that a SARR might use a different route or facilities because better construction equipment would allow an efficient modern railroad to construct lines following more direct routes than those originally established by railroads. *See* Joint Shipper Comments at 30. In the first instance, this criticism ignores the reason for the Board's proposal – to eliminate the substantial cost to parties of developing and defending full road property investment and operating plan presentations.⁸ Further, the shippers' complaint about requiring the SARR to follow the existing route also ignores the reality of actual SAC cases. In the vast majority of cases, complainants choose to construct the SARR over the same routes as the real world railroad.

Moreover, the examples shippers cite in support of their claim that efficient rail carriers starting today would not follow the routes established decades ago actually undermine their argument. *See* Joint Shipper Comments at 30 (citing two public-private partnership projects to rationalize and improve rail routes). The Heartland Corridor and the CREATE projects primarily involve improvements to existing routes and infrastructure (daylighting tunnels, increasing clearances, consolidating run-through tracks, etc.), not building entirely new rail lines over new

⁸ The SSAC proposal would allow complainants to eliminate certain existing carrier facilities from the analysis if they could demonstrate those facilities are not used to serve the SARR traffic. *See* NPRM at 12.

routes. Moreover, those projects were not viable as wholly private investments and would not be undertaken without government assistance necessary to make them viable.⁹

Rather than making the case more complex by adopting the Shippers' proposal to permit any route at all (including a route that does not even exist in the real world), the Board should further simplify the process. As CSXT/NS demonstrated in their opening comments, the Board could substantially reduce the time and cost of SSAC proceedings by requiring that the stand-alone railroad follow the predominant route of movement of the issue traffic in the Test Year. *See* CSXT/NS Open. Comments at 12-15. Other commenters also support a requirement that the SARR in a SSAC case be required to follow the primary route of movement of the issue traffic, and note that such an approach would save significant time and money in SSAC cases. *See* Open. Submission of Union Pacific at 14-19; Comments of Canadian Pacific Railway Company at 8-10.

No shipper comments express support for the proposal to allow complainants to select a route from among those over which its traffic has moved, followed by three rounds of evidentiary submissions regarding the route, eventually leading to a Board staff decision regarding the route three months later.¹⁰ *See* NPRM at 16-17 (describing proposed evidentiary schedule for SSAC proceedings); *cf.* Joint Shipper Comments at 30 (complaining about requirement that SSAC is presumed to use all facilities and required to follow a route used by the

⁹ The proposed CREATE project involves few new routes, but rather the reorganization, expansion, and rationalization of existing infrastructure.

¹⁰ Only one party filed a comment that might be characterized as neutral to mildly supportive of the proposal to allow complainants to advocate alternative existing routes. That comment (filed by a consulting firm on its own behalf and not on behalf of any potential party to a rate case), in its entirety, consisted of a single unsupported sentence claiming that requiring a complainant to demonstrate that an alternative route has sufficient capacity is unduly burdensome. *See* Comments and Recommendations of Snavely King et al at 5. The same commenter opined that the proposed procedural schedules were too long and should be shortened where possible. *Id.* at 4-5.

incumbent railroad, rather than allowing the SARR to hypothesize that it would build along an entirely new physical route that does not exist in the real world). Because the CSXT/NS proposal will better achieve the goals of this proceeding and because there is significant opposition to the Board's alternative route selection proposal and apparently very little support, the Board should adopt CSXT/NS's proposal to require that the SARR follow the predominant route of movement of the issue traffic. This approach would significantly reduce the cost and complexity of a SSAC proceeding while simultaneously eliminating 90 days from the procedural schedule.

B. SSAC's Heavy Burden On Railroads Is Unwarranted Given Shippers' Statement That Placing Such Burden On The Railroads Will Not Reduce Their Costs.

CSXT/NS share the U.S. Department of Transportation's concern "with the apparent disparity in the information burden borne by the railroads in [SSAC] cases." Initial Comments of the U.S. Department of Transportation at 8. DOT correctly notes that the gathering, analysis, and production of case-specific information proposed for every SSAC case could impose a heavy, and potentially costly, burden on the railroads. *Id.* Moreover, DOT further indicates that the potential for such costs in a SSAC proceeding could be used as leverage in rate negotiations. DOT's comments affirm the concerns expressed in CSXT/NS's opening comments: As proposed, the SSAC "second disclosure" process would impose heavy burdens on rail carriers to develop and produce information in a very short period of time and would give shippers incentive to file (or at least threaten to file) medium-sized rate cases as a bargaining tactic. *See* CSXT/NS Open. Comments at 6-7. The Board's proposal would not only impose a substantial new burden on railroads that they do not face in a SAC case, it would require defendant rail carriers to do something defendants are not required to do in any other legal proceeding – build the complainant's case.

Any justification for shifting these burdens to defendant railroads is undermined by the Joint Shipper Comments. Their Witness Crowley, who states that he has been a consultant to a party in every SAC case decided by the Board, avers that “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. . .” V.S. Crowley at 16. As CSXT/NS emphasized in their opening comments, this proposal will impose very substantial new burdens on defendant rail carriers. *See* CSXT/NS Open. Comments at 5-8 (discussing heavy burden of proposed “second disclosure” process on NS and CSXT). If, as the Joint Shippers claim, this shift of burden will not reduce the cost or complexity of SSAC cases for complainants, then there is no justification for imposing the additional burden on rail carriers.

C. Shippers Simultaneously Seek Further Reductions In Cost And Length Of Proceedings And Increased Complexity.

The Joint Shippers’ criticisms are internally contradictory and irreconcilable. On the one hand they object because the Board’s SSAC proposal would not allow them to submit complex efficiency evidence and argument they typically submit in full SAC cases. *See, e.g.,* Joint Shipper Comments at 29-31. Those complex evidentiary submissions and disputes, however, are primary contributors to, and drivers of, the cost and time of full SAC proceedings. Enlarging SSAC proceedings to include such evidence would dramatically *increase* the cost and the time required to conduct those proceedings, which is directly contrary to the purpose of this rulemaking and the statutory mandate it attempts to serve: to “establish a simplified and expedited method for determining” rate reasonableness, “in those cases in which a full [SAC] presentation is too costly, given the value of the case.” NPRM at 3 (quoting 49 U.S.C. § 10701(d)(3)).

On the other hand, they object that SSAC, as proposed by the Board, is already too time-consuming and costly. *See* Joint Shipper Comments at 31-32. The shippers further assert that the “complexities” of the Board’s existing SSAC proposal mean that SSAC cases will not be completed within the proposed time frame. *Id.* at 31. Thus, immediately after asserting that SSAC should be made more complex by adding full-SAC efficiency analyses, the shippers complain that the Board’s proposal – without such efficiency analyses – is too complex and will take too long. At bottom, the Joint Shippers’ criticisms simply ignore the fact that additional complexity would necessarily add cost and time to a SSAC proceeding.

D. Shippers’ Proposal To Subject All Non-SAC Cases to a Three Benchmark Analysis Is Unwise And Inconsistent With Established Economic Principles And Regulatory Policies.

Several commenters advocate elimination of SSAC entirely, and subjecting all non-SAC rate cases to evaluation under the Three Benchmark approach. *See, e.g.* Joint Shipper Comments at 5, 22-32; Supplemental Open. Comments of the Alliance for Rail Competition et al at 14; Open. Comments of Nat’l Grain and Feed Ass’n at 40. Such an approach would subject two-thirds of all non-exempt traffic revenue (assuming the Board’s proposed eligibility thresholds) to the Three Benchmark framework, a rough methodology that makes no attempt to approximate SAC analysis or results, or to follow the fundamental principles of demand-based differential pricing. This would be far too great a sacrifice of accuracy and economic rigor for the sake of simplicity.

As the Board reaffirmed in its Decision, the Three Benchmark method “should be reserved for use only as a last resort, once we have exhausted reasonable measures to simplify the SAC analysis.” NPRM at 11. The roughness of the Three Benchmark approach means that it “must be used as sparingly as possible.” *Id.* (quoting *Simplified Guidelines*, 1 STB 1004, 1021). The proposal to subject all non-SAC challenges to a Three Benchmark method ignores

the undeniable limitations of that last resort methodology by seeking to expand it to cover most of the traffic and revenue within the Board's rate reasonableness jurisdiction. Whatever the shippers' reservations about SSAC, this simply cannot be a reasonable and appropriate result.

Based upon their refusal to offer *any* suggestions for improvements to SSAC and their insistence on "drastically" increased eligibility thresholds, it appears that the large shipper groups have very little interest in the primary goal of this proceeding – to provide shippers of small volumes greater access to the Board's rate reasonableness process.¹¹ *See generally* Joint Shipper Comments. Instead, they seek to facilitate larger shippers' access to an inexpensive, simplified, rough, and inaccurate procedure, and to increase the likelihood that such shippers will obtain lower rates through expansive, low-cost regulatory intervention than they could through marketplace negotiations.

E. Costs of The Proposed True-Ups Can Be Mitigated.

Shippers also contend that the proposed annual true-up will impose undue costs on parties to rate cases. To alleviate that perceived problem, CSXT/NS propose that the Board adopt a presumption that the initial year rate prescription will remain in effect unless a party requests that it be adjusted. Thus, parties would retain the option of seeking an annual true-up, but would only be required to engage in the process if a party determined that the potential adjustment was worth the time and expense of conducting the process.

¹¹ If the cost of a litigating a Three-Benchmark proceeding is really out of reach for a small shipper, as some commenters contend, the logical way to attempt to address that problem would be to identify further simplifications or adjustments designed to reduce the cost of that proceeding and improve those small shippers' access to rate challenge proceedings. Increasing the eligibility thresholds would do nothing for a shipper who cannot afford to bring a rate case under the Three Benchmark test – a challenge that is unaffordable under a \$200,000 eligibility ceiling will remain equally unaffordable regardless of how high the eligibility ceiling is raised.

F. Any Attempt To Apply The Long Cannon Factors In SSAC Cases Would Significantly Increase The Complexity And Cost Of Such Proceedings.

The Joint Shippers criticize the Board for failing to explicitly incorporate the “Long-Cannon factors” in its SSAC proposal. *See, e.g.,* Joint Shipper Comments at 31. The Long Cannon factors concern whether a carrier is moving traffic – anywhere on its network – at rates that do not make a sufficient contribution, and, if so, whether the carrier is taking adequate action to address the situation (*e.g.*, by raising rates on such traffic or attempting to “minimize such traffic”). *See* 49 U.S.C. § 10701(d)(2). As an initial matter, in a time of strained rail capacity accompanied by increasing demand for rail transportation services, it is unlikely that Class I railroads are carrying any significant volume of non-compensatory traffic or traffic that does not maximize the traffic’s revenue contribution. Thus, even an exhaustive Long Cannon analysis likely would not identify potential revenue sufficient to affect materially the challenged rate in a case considered under the SSAC.¹²

More important, the development and submission of evidence concerning application of the Long Cannon factors, and litigation concerning whether some traffic could or should contribute more revenue or should be eliminated, would add substantial complexity, time, and expense to the proposed SSAC approach. Potentially every one of a carrier’s movements, involving thousands of origin-destination pairs, would be subject to review. Alone, the determination of the costs and revenues of myriad movements would rival, and perhaps exceed,

¹² Even assuming, *arguendo*, that a complainant demonstrated that some of a carrier’s movements did not satisfy one or more of the Long Cannon factors, such a showing would not necessarily result in a rate reduction for the issue traffic. The complainant would also be required to demonstrate that its traffic is being charged an unreasonable rate *as a result of* specific non-issue traffic failing to generate sufficient revenues. *See Coal Rate Guidelines*, 1 I.C.C. 2d 520, 541. Moreover, any potential for additional rail carrier revenue or other efficiencies proven in this process would not accrue solely to the issue traffic, but rather would be distributed among all of the carrier’s traffic affected by such a revenue shortfall or inefficiency. *See id.* at 541-42.

the complexity and expense of a full SAC proceeding. And, that would be only the first step. Evaluation of specific movements and submission of competing evidence regarding a movement's appropriate revenues under the Long Cannon factors, and whether any revenue shortfall for specific movements resulted in issue traffic paying an unreasonable rate would be complex and expensive, transforming SSAC into a more lengthy and costly analysis than SAC.

Moreover, shippers have not made any proposal or constructive suggestion as to how the Board's proposed approaches for medium and small cases might be modified to better address the Long Cannon factors. Instead, they simply criticize the Board's proposals as failing to give adequate consideration to those factors, and offer no alternative beyond eliminating the SSAC approach in its entirety. *See* Joint Shipper Comments at 31.¹³ The Shippers' criticism rings hollow in light of the fact that no rate case complainant has explicitly invoked the Long Cannon factors in more than two decades. It appears that their comments accord the Long Cannon factors greater importance in the abstract than shippers themselves have given to those factors when engaged in actual rate cases.¹⁴

The statute does not require the Board to include a mechanism for implementing each of the Long Cannon factors in every rate proceeding. Indeed, even in a full SAC case, those factors are not expressly taken into account. What the statute requires is that the Board give "due consideration" to Long Cannon factors. *See* 49 U.S.C. § 10701(d)(2); *see Public Serv. Co. of Ind. v. Interstate Commerce Comm'n*, 749 F.2d 753, 763 (D.C. Cir. 1984). Here, in discharging

¹³ The Joint Shipper comments also express concern that the Board may not adequately consider the Long Cannon factors in the Three Benchmark proposal. Joint Shipper Comments at 37. Here again, however, they offer no concrete proposal for how the approach the Board has proposed might be modified to address their concerns. *Id.*

¹⁴ The Board has long recognized that there are numerous reasons other than management inefficiency that the profitability of some individual movements may be low. As the Board affirmed in the NPRM, it has "recognized that an R/VC ratio below 100% does not necessarily reflect improper pricing or a money-losing service." NPRM at 7, n. 12.

its statutory duty to develop more simple methodologies for cases in which SAC is not feasible, the decision not to include those factors in the proposed Simplified SAC methodology is an appropriate and reasonable exercise of the Board's discretion. *See* 49 U.S.C. §§ 10701(d)(2), (3).

G. SSAC Conclusion.

In sum, CSXT/NS support the majority of the Board's SSAC proposal as a reasonable balancing of the competing goals of simplicity and cost-reduction on one hand, and accuracy and emulation of SAC results on the other hand. CSXT/NS agree that the SARR in a SSAC case should be required to use the same route and facilities as the issue traffic, and propose that the Board further reduce the time and expense of SSAC proceedings by eliminating the route selection process and requiring the SARR to follow the predominant route of movement of the issue traffic. They remain very concerned about the significant and disparate information and discovery burden the Board's proposal would place on defendant carriers, and ask that the Board reconsider this aspect of the proposal, particularly in light of shippers' statement that the imposition of that burden on rail carriers would not benefit complainants. In order to address commenters' concern about the cost of annual true-ups of rate prescriptions, CSXT/NS propose that such a true-up be conducted only when a party requests it. Finally, as CSXT/NS have explained, any attempt to overlay a Long Cannon factors analysis on the SSAC method would overwhelm all of SSAC's savings of cost and complexity and render it more complex and costly than a full-SAC proceeding.

The crux of the Joint Shippers' complaints about SSAC appears to be that simplification may result in less accurate analysis and results. CSXT/NS recognize that some reduced precision is an unavoidable cost of simplification, and have offered suggestions to minimize the loss of accuracy while maintaining most of the simplifications proposed by the Board. In contrast, the Joint Shippers offer no recommendations for changes to SSAC that might

ameliorate perceived deficiencies. Instead of attempting to grapple with the trade-offs between simplicity and accuracy, or making suggestions to reduce complexity while maintaining greater accuracy, they merely reject SSAC in its entirety and advocate application of the far less accurate Three Benchmark approach to all non-SAC cases. It is neither reasonable nor constructive to complain about the potential inaccuracies of a simplified approach while simultaneously advocating the substitution of a much less accurate approach for a significantly greater volume of traffic.

V. THREE BENCHMARK SPECIFIC COMMENTS.

A. The Board Should Permit Parties To Three Benchmark Proceedings To Submit Evidence Of Individualized Factors Relevant To The Reasonableness Of A Rate.

As CSXT/NS emphasized in their initial comments, it is critical that the Board not apply the Three Benchmark Approach as an inflexible formula. While CSXT/NS recognize that such alternative procedures may be required “as a last resort” for truly small cases inappropriate for SAC or SSAC, mechanical formulas are never an appropriate methodology to set rates. Instead, the Board should use its judgment and experience to weigh all relevant factors and reach a fair result.

CSXT/NS recognize that calculations such as RSAM, R/VC_{COMP} , and R/VC_{total} – while not grounded in constrained market pricing or any economic theory of rate reasonableness – are tools that may be used to assist the Board as it exercises its judgment in a Three Benchmark case. But it would be improper to treat these calculations as inflexible formulas that themselves dictate a rate’s reasonableness. Neither rail carriers nor most businesses set prices by reference to a formula; in any industry, businesses set prices based on a multitude of factors that cannot be reduced to a formula or mechanical calculation. Therefore, no formula or combination of formulas can determine whether the price chosen by a railroad is reasonable. Rather, in those

few cases in which a SAC or SSAC analysis may not be feasible, the Board must use its expertise and judgment to determine rate reasonableness. A Three Benchmark proceeding should be just that – a proceeding that uses *benchmarks* as one among many factors the Board uses to apply its expertise, not a process that substitutes a mechanical calculation for the Board’s exercise of judgment and expertise.¹⁵ Indeed, in *Rate Guidelines – Non-Coal Proceedings*, Ex Parte No. 347 (Sub-No. 2) (“*Simplified Guidelines*”), the Board explicitly rejected a formulaic approach recognizing that “there are limitations in the three R/VC measures, both individually and collectively.” 1 STB 1004, 1023. Those limitations have not changed.

CSXT/NS thus agree with the Joint Shippers that the Board should consider “individualized factors” when determining an appropriate rate and not be bound by any formula. Joint Shipper Comments at 37.¹⁶ Fundamental fairness requires that all parties to small cases be permitted to submit evidence relevant to the reasonableness of a rate. Indeed, in many cases the

¹⁵ To treat R/VC_{COMP} as an automatic formula that alone determines reasonableness effectively would preclude rate increases for small shipments. If the only measure of a rate’s reasonableness is how it compares to the mean of other rates, any increased rate for a small shipment that generates an R/VC above the mean would automatically be deemed unreasonable. Further, evaluating a rate’s reasonableness solely on the basis of its comparability to an average of other rates creates the related problem that “repeated application of a mean figure as the basis for a regulatory ceiling could have a feedback effect that could lower the mean for future cases.” NPRM at 27; see *Burlington N. Ry. Co. v. I.C.C.*, 985 F.2d 589, 597 (D.C. Cir. 1993) (holding that such a feedback effect is a “fundamental conceptual problem” with using a mean figure to evaluate a rate’s reasonableness). The way to eliminate this “fundamental conceptual problem” is for the Board to treat R/VC ratios not as determinative formulas, but rather as a few among many relevant factors and considerations that it will use to guide its expert evaluation of the reasonableness of a challenged rates.

¹⁶ The Joint Shippers’ request that *only complainants* be allowed to submit evidence of “individualized factors” is plainly inappropriate. Joint Shipper Comments at 37. Under the shippers’ proposal, railroads would be precluded from arguing that a rate above the confidence interval of the Board’s formula was reasonable, but shippers would be allowed to submit additional evidence that a rate below that confidence interval was nevertheless unreasonable. *Id.* The shippers do not even make a pretense of arguing that such a double standard would serve the public interest or have any purpose other than advantaging shippers. This skewed “heads-I-win, tails-you-lose” proposal has no merit and should be rejected out of hand.

submission of such evidence will be critical for properly determining a reasonable rate. For example, government requirements (including security regulations) for transporting hazardous materials substantially increase the cost of such transportation. *See, e.g.*, 49 C.F.R. Part 174 (detailing security requirements for rail transportation of hazardous materials). Under any common-sense view, rate regulation should allow a higher rate for transporting a tank car of Toxic Inhalation Hazard (TIH) materials than for transporting a tank car of non-hazardous materials – even if the shipments weigh similar amounts and move a similar distance. The Board should retain the flexibility to consider this sort of individualized evidence to ensure that the Three Benchmark test does not treat such materially different shipments as comparable movements.

B. The Shippers' Request For Access To Unmasked Waybill Sample Data Should Be Rejected.

The Joint Shippers assert that using the masked Waybill Sample to select the initial comparison group is unfair because the railroads will be able to determine the actual value of any masked revenues for movements on their own rail systems. *See* Joint Shipper Comments at 34-36. To solve this purported problem, the Joint Shippers demand access to unmasked waybill sample data *before* the filing of a complaint. This proposal should be flatly rejected, both because the use of masked waybill sample data does not give railroads any advantage in selecting a comparison group and because permitting such unfettered access to unmasked waybill sample data would contravene this Board's longstanding practice of closely guarding the confidentiality of this sensitive contract data.

The Joint Shippers' complaint is another red herring. The Board's proposal makes clear that movements would be considered comparable *not* because they earn comparable revenues, but rather because of *non-rate* factors such as "length of movement, commodity type, [and]

terrain involved.” NPRM at 20. As a result, a railroad’s determination of the actual rates for any masked revenues would not give it an advantage in selecting comparison traffic. As the Board explained, “unmasked revenue information . . . would not be necessary to formulate a reasonable comparison group [because] [t]he comparability of a movement should depend on the characteristics of the movement, not the level of the rate for that movement.” NPRM at 33. Shippers would not be disadvantaged by not having access to data that is irrelevant to the comparability analysis.

Even if revenue were a relevant factor in the comparability analysis (which it is not), the masking of contract data would have little effect on that analysis. Only contract revenues are masked in the Waybill Sample – “common carrier” or tariff revenues are not. *See* 49 C.F.R. § 1244.3(b). As a practical matter, there may be little contract traffic that is potentially comparable to the challenged tariff movement(s). Contract traffic is often subject to considerations that “affect demand characteristics and operating costs” including, for example, volume discounts, or the bundling of multiple origin-destination pairs, or service commitments. *See* NPRM at 20. For any Three Benchmark case, the most comparable traffic is likely to be tariff traffic, whose rates are not masked in the Waybill Sample.

The Joint Shippers also complain that railroads might somehow manipulate their Waybill Sample revenue masking factors to gain an advantage in Three Benchmark proceedings. Joint Shipper Comments at 35. This allegation is completely unwarranted. Regardless, the Board already has the ability to protect against such hypothetical “gaming” through its review of each carrier’s masking factors. *See* 49 C.F.R. § 1244.3(b) (Board must approve of any changes in a carrier’s proprietary masking procedures, and carriers must notify Board of any changes to those procedures).

In all events, the Joint Shippers' request for access to unmasked revenues in the Waybill Sample *prior to filing a case* is wholly unwarranted and inconsistent with the Board's long history of guarding that revenue information very closely. Unmasked waybill revenue data "ha[s] never been made publicly available, not even under a protective order"; on the contrary, it has "been held in the strictest confidence, and, at any time, ha[s] been known only by a few members of the Board's staff." Finance Docket No. 33388, *CSX Corp. and CSX Transportation, Inc., Norfolk Southern Corp. and Norfolk Southern Railway Co.—Control and Operating Leases/Agreements—Conrail Inc. and Consolidated Rail Corp.* (Decision No. 42, served October 3, 1997), at 7. This policy is consistent with the high confidentiality and commercial sensitivity of contract revenues. *See, e.g.,* Ex Parte No. 385 (Sub-No. 4), *Modification of the Carload Waybill Sample and Public Use File* at 3 (served June 16, 2000) ("Our long-standing policy is not to release actual contract revenues reported in the confidential waybill sample because of the potential for commercial harm to both the contracting railroad and shipper."). Indeed, Congress has directed that contract information be protected from unnecessary disclosure. *See* 49 U.S.C. § 11904. The Board should refuse the Joint Shippers' invitation to abandon this longstanding policy.

C. The Board Has The Ability To Control Litigation Costs For The Comparability Determination.

The Joint Shippers speculate that the comparability analysis may be "very time-consuming and costly" because a railroad may submit complex evidence regarding comparability factors such as terrain and operating characteristics. *See* V.S. Crowley at 9-12. These concerns are exaggerated. As their Witness Crowley admits, critical factors such as "commodity type" and "length of movement" can easily be identified by the Waybill Sample, and will not be costly to determine. *Id.* And while evidence about comparability factors such as terrain might be

appropriate in some cases, the submission of such evidence should not unduly complicate Three Benchmark cases. The R/VC_{COMP} benchmark largely turns upon the selection of comparable movements, and if a party proposes a comparable movement that involves materially different commercial considerations, litigants should be permitted to submit evidence of those differences. The Board should retain flexibility to determine what factors affect comparability in accordance with the specific circumstances of particular cases.

Without sacrificing such necessary flexibility, the Board could set some ground rules for the comparability determination and use technical conferences to further control litigation costs. For example, the Board could create a presumption that movements of the same commodity in similar service over a similar distance are comparable, and put the burden of proving otherwise on the defendant rail carrier. A railroad would be able to overcome this presumption by proving by a preponderance of the evidence that the movement is not comparable. This process could be implemented through a technical conference before the parties are required to submit their final comparable movement groups. Such a framework would simplify the evidence necessary for shippers to show that movements are comparable, while preserving the Board's ability to consider evidence of relevant comparability factors other than commodity and distance.¹⁷

D. The Board Should Reject Shippers' Proposal To Expand The Broad Population of Movements from Which Comparable Movements May Be Drawn.

One shipper group recommends that the Board consider "expanding the universe of potential comparables" beyond traffic with the same 2-digit STCC. Joint Shipper Comments at 38. Ostensibly, Joint Shippers are merely asking for more data. CSXT/NS urge the Board to make explicit in any rules it issues in this proceeding that it will flatly reject any argument that

¹⁷ The Board should also control costs by proactively using the mediation process that CSXT/NS have proposed to facilitate the resolution of disputes at an early stage

commodities with the same 2-digit STCC should be regarded as having some inherent comparability. In fact, the transportation and commercial characteristics of the tens of thousands of commodities that move by rail vary widely – commodity by commodity.

The fact that two or more commodities carry the same 2-digit STCC will rarely be relevant to a comparability analysis. For example, STCC 28 (“Chemicals or Allied Compounds”) includes Spent Nuclear Fuel (STCC 28-197-10 Fuel elements, nuclear reactor, irradiated and requiring protective shielding, or irradiated parts or constituents) and the non-hazardous material, Soda Ash (STCC 28-123-22 Sodium carbonate, soda ash, modified, or sodium carbonate, monohydrate). And, even the same four-digit STCC level includes the highly hazardous Chlorine Gas (STCC 28-128-15 Chlorine Gas, liquefied) and non-hazardous soda ash. Data at the 2-digit STCC level will provide shipper litigants with information on far more traffic than will be needed in any simplified proceeding.

Because most commodities with the same two digit STCCs will not be comparable, the Board’s proposed universe of movements from which parties would select comparables is already unnecessarily broad. Joint Shippers’ proposal to further *expand* that selection pool is wholly unnecessary, and would complicate the Three Benchmark process without any potential for identifying traffic that is more comparable to the issue traffic or otherwise improving the accuracy of the analysis. Accordingly, the Board should reject any proposed expansion of the comparable selection universe beyond movements having the same two-digit STCC as the issue traffic.

VI. URCS COST ADJUSTMENTS SHOULD BE RETAINED FOR ANY RATE PRESCRIPTION.

The Joint Shippers endorse the Board’s proposal to disallow all movement-specific adjustments to URCS in the Three Benchmark context. *See* Joint Shipper Comments at 33. This

approach is inconsistent with the positions many of the same shippers took in Ex Parte 657, and would constitute an undue sacrifice of accuracy in exchange for a marginal reduction in complexity.

CSXT/NS strongly disagree with the Board's decision to abandon the use of movement-specific calculations and adjustments to URCS costs in SAC cases. *Compare* CSXT/NS Joint Comments, Ex Parte 657 (Sub-No. 1) at 11-18 (May 1, 2006) *with* Decision, STB Ex Parte 657 (Sub-No. 1), *Major Issues in Rail Rate Cases* at 60 (Oct. 30, 2006). But even if it were appropriate to discontinue movement-specific adjustments in the SAC context, movement-specific adjustments would be essential in cases brought under the Board's proposed Three Benchmark test, where variable costs are a critical component of the Board's final rate prescription. Unlike SAC or SSAC cases (where variable costs may be important in some cases), variable costs will play a central role in all Three Benchmark cases. Thus, accurate, movement-specific variable costs for issue traffic is essential in such cases.

As CSXT/NS explained in their initial comments, the Board must strike a balance between simplicity and accuracy. While it would certainly be "simple" to use unadjusted URCS costs for rate prescriptions (as it would be "simple" to assign a flat lump sum cost for all movements regardless of their characteristics), such simplicity would hardly be accurate in light of the movement-specific factors that affect the actual costs of individual movements and thus the reasonableness of individual rates.¹⁸

¹⁸ It is important to recognize that if a rate were deemed unreasonable under the Three Benchmark approach, the Board must prescribe a reasonable rate. In order to determine the appropriate rate prescription (and to guard against prescribing a rate below the 180% R/VC floor), the Board should apply the adjusted R/VC ratio used to determine the maximum reasonable rate to the *actual* variable costs of the issue movement. Prescribing a rate by using an "upper boundary" around the mean adjusted R/VC for comparison group traffic (whose costs are estimated using unadjusted URCS system average costs) without considering the issue

Indeed, failing to allow the development of movement-specific costs for purposes of determining a rate prescription could result in the Board prescribing rates at a level below the 180% R/VC floor, in violation of statutory requirements and limitations on the Board's jurisdiction. *See* 49 U.S.C. § 10707(d)(1)(A). Congress empowered the Board to make URCS adjustments where necessary or appropriate, and the Board cannot abdicate that responsibility in the name of simplicity when it is prescribing a rate. *See id.* § 10707(d)(1)(B).

Moreover, pursuant to 49 U.S.C. § 10704(a)(1), the Board's jurisdiction only extends to deciding that "a rate charged or collected by a rail carrier for transportation" is unreasonable. If (as the NPRM suggests) the Board failed to use the actual parameters of the movement in question (including its actual costs) in determining the reasonableness of the challenged rate or prescribing a reasonable rate—and instead used unadjusted URCS system average costs—it effectively would be reviewing system averages instead of the actual "rate charged or collected by a rail carrier for transportation," violating § 10704(a)(1)'s jurisdictional mandate.

Here, the Board can create a fair process for movement-specific adjustments that will retain a measure of accuracy without sacrificing its goal of simplicity. *See* CSXT/NS Opening Comments at 20-22. As CSXT/NS proposed in their initial comments, the Board should specify particular movement-specific adjustments that it presumptively will treat as appropriate in small shipper proceedings. At a minimum, the Board should include movement-specific adjustments that are both simple to calculate and potentially outcome-determinative, such as fuel costs, equipment ownership, locomotive costs, crew wages, loading times, car hire costs, private car mileage allowances, and movement-specific payments to others. *Id.* at 21. The Board should also retain the flexibility to allow parties to adjust URCS costs in other contexts, as necessary to

movement's actual specific variable costs is inconsistent with the Board's statutory responsibility and jurisdictional limits.

address extraordinary circumstances. As Union Pacific notes in one example, special circumstances such as the transportation of extremely hazardous materials can lead to costs of training and the cost of increased risk that are undoubtedly factors in the reasonableness of a rate, but that are not represented in unadjusted URCS costs. *See* Union Pacific Open. Comments at 42-43. Prescribing rates without considering these critical factors would lead to arbitrary results and would counter Congress's intent that the Board accurately calculate variable costs in order to ensure that rates that generate a revenue-to-variable cost ratio lower than 180% are not subject to rate challenges.

VII. PARTIAL REVOCATION OF AN EXEMPTION MUST BE EVALUATED UNDER THE SAME STANDARDS AS A PETITION FOR REVOCATION OF AN EXEMPTION OUTSIDE OF THE CONTEXT OF A RATE CASE.

As the Department of Transportation explained, any request for partial revocation of an exemption for purposes of a SSAC or Three Benchmark case must be considered under the same statutory standard and burdens of proof as a petition for revocation of an exemption in any other context. *See* Initial Comments of the U.S. Department of Transportation at 2-3 (DOT opposes "any suggestion that . . . exemptions may be dispensed with on some other basis simply because they arise in the context of rate regulation.").

Thus, in order to demonstrate eligibility for partial revocation of an exemption, a complainant must show that, contrary to the Board's finding in granting the exemption, regulation now *is needed* "to protect shippers from the abuse of market power." *See* 49 U.S.C. § 10502(a)(2)(B). Unless a complainant demonstrates that: (i) a carrier has market power in the relevant market; (ii) the carrier has abused that market power; and (iii) revocation of the exemption in question is necessary to protect shippers from that abuse of market power, an exemption revocation request should be denied. Otherwise, the Board would not be fulfilling its statutory mandate to exempt traffic "to the maximum extent" consistent with ICCTA and to

minimize rail rate regulation. *See id.* §§ 10502(a), 10101(1), (2). And, as CSXT/NS and other carriers argued in their opening comments, the Board should modify its proposal to provide that it will decide any request for partial revocation of an exemption at the very outset of a case, before the parties engage in discovery or disclosures or make any evidentiary filings. *Compare* CSXT/NS Open. Comments at 15 *with* NPRM at 30 (proposing that merits discovery and evidentiary submissions would proceed while the Board is considering a revocation request).

Respectfully Submitted,

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Dated: November 30, 2006

CERTIFICATE OF SERVICE

I hereby certify that on this 30th day of November, 2006, I caused a copy of the foregoing Reply Comments of CSX Transportation, Inc. and Norfolk Southern Railway Company to be served on all parties of record in this proceeding by first class mail, postage prepaid or more expeditious method of delivery.



Matthew J. Warren