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BEFORE THE
SURFACE TRANSPORTATION BOARD

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

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

REPLY SUBMISSION OF UNION PACIFIC RAILROAD COMPANY

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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

REPLY SUBMISSION OF UNION PACIFIC RAILROAD COMPANY

Union Pacific Railroad Company (“UP”) is filing this reply to address the various comments that have been submitted on the proposals for medium-size and small rate cases that the Surface Transportation Board (“Board”) set out in its Notice of Proposed Rulemaking in Ex Parte No. 646 (Sub-No. 1) (STB served July 28, 2006) (“*NPRM*”).

I. INTRODUCTION

In UP’s opening comments, we strongly supported the Board’s effort to establish simplified standards for medium-size and small rate cases (“small cases”). Although shippers have not presented any evidence that abusive rates are a pervasive problem, we agree that the Board should have fair and efficient procedures for addressing shipper complaints. We therefore evaluated the proposed simplified stand-alone cost (“Simplified-SAC”) and Three-Benchmark (“Benchmark”) methods in light of Congress’s directive that the Board “establish a simplified and expedited method of 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).

We concluded that Simplified-SAC is consistent with sound economic principles and the national rail transportation policy. We urged the Board to refine its proposal in ways that

would produce more accurate results at an even lower cost and in an even shorter timeframe by, among other things, establishing strict eligibility criteria and eliminating one full round of evidence. We also urged the Board to apply Simplified-SAC to all cases in which use of a simplified method would be appropriate.

We understand the Board's interest in establishing a separate rate reasonableness method for truly small cases, and we would not oppose an approach that respects basic economic principles and produces reasonably accurate, predictable results. As we explained, however, the Benchmark method is not such an approach. It does not provide any economic principle against which rates can be objectively assessed. Moreover, results would be unpredictable because the concept of comparable traffic is so ill-defined. Because the Benchmark method does not provide any meaningful or predictable standards for railroads to follow in setting rates, it would engender uncertainty about lawful pricing levels and thus increase, rather than reduce, rate disputes between railroads and shippers. Despite our strong objections to the adoption of a formulaic benchmark-based approach, we suggested several modifications to the Board's Benchmark proposal so that the test would at least accomplish the Board's stated objective of comparing revenue-to-variable cost ("r/vc") ratios for truly comparable traffic.

Our review of the comments filed by other participants in this proceeding has not changed our initial conclusions. Shippers generally criticized both simplified methods proposed by the Board and at the same time argued that too few cases would be eligible for simplified treatment.¹ Yet they offered no constructive suggestions for addressing their concerns about

¹ When we discuss positions taken by "shippers," we are usually referring to the views expressed in the Joint Written Comments submitted by American Chemistry Council, et al. ("ACC Op."). Most shippers and shipper groups that filed their own comments in this proceeding also endorsed and/or participated in the Joint Written Comments.

Simplified-SAC. The few changes they suggested to the Benchmark method would complicate that approach rather than resolve their complaints that the method would be too costly and the results too unpredictable. In fact, shipper proposals would leave the Benchmark method largely indistinguishable from the current test under *Simplified Guidelines*² – which shippers have repeatedly criticized as too costly and too unpredictable to afford shippers practical relief.³

Shipper complaints about the Board’s proposals reveal that their objectives are inconsistent with the Board’s. They argue that the Board should abandon any effort to develop a simplified SAC-based approach and instead apply a Benchmark-like test to all cases in which a full SAC presentation would be too costly.⁴ They also argue that the Board should “drastically revise upwards its eligibility thresholds.”⁵ However, applying a Benchmark-like test to most cases would be contrary to the Board’s proposal to use the Benchmark method only as a “last resort” and to retain “CMP with its SAC test” as the “preferred method for assessing the reasonableness of a challenged rate where there is an absence of effective competition.” *NPRM* at 11.

² *Rate Guidelines – Non-Coal Proceedings*, 1 S.T.B. 1004 (1996) (“*Simplified Guidelines*”).

³ See, e.g., Comments submitted by The National Industrial Transportation League (“NITL Op.”) at 2; Joint Written Testimony of the American Chemistry Council, et al., STB Ex Parte No. 646, *Rail Rate Challenges in Small Cases* (July 16, 2004).

⁴ See, e.g., ACC Op. at 5-6; NITL Op. at 6; Supplemental Opening Comments of the Alliance for Rail Competition & PPL Energyplus, LLC (“ARC Op.”) at 11.

⁵ ACC Op. at 5; see also ARC Op. at 14 (calling on the Board “to revise its eligibility standards” in accordance with “the Joint Comments”); Comments of Chevron Phillips Chemical Company (“Chevron Op.”) at 14-15 (“[T]he Board should reform the three-benchmark approach and significantly raise the eligibility criteria”); Comments of The Dow Chemical Company (“Dow Op.”) at 15 (“[T]he Board should reform the three-benchmark approach and significantly raise the eligibility thresholds”).

UP's reply consists of five parts. First, we address shipper claims that "the need for a method to resolve smaller rate disputes is acute."⁶ We explain that rates have been rising recently as a result of market forces but that there is no evidence of any widespread abuse of market power by railroads. We discuss this issue not to downplay the need for simplified standards, but rather to place shipper complaints in an appropriate context.

Second, we address shipper criticisms of Simplified-SAC. We explain that Simplified-SAC is a lawful effort to simplify the full SAC test and that shippers significantly overstate the costs of presenting a case under Simplified-SAC.

Third, we address the comments that parties have filed regarding the Benchmark method. We explain that the opening comments of shippers and other railroads reinforce our fundamental disagreement with the use of any formulaic benchmark-based test, as well as our identification of changes to the Board's Benchmark proposal that would be needed to develop r/vc comparisons for truly comparable traffic.

Fourth, we address shipper criticisms of the proposed eligibility criteria. We demonstrate that shipper objections to the Maximum Value of the Case ("MVC") approach and the "aggregation" rule are unjustified. We also describe how eliminating the aggregation rule would encourage shippers to invoke simplified procedures as a negotiating tactic. We then explain that shipper proposals to increase the eligibility thresholds for small cases would not address concerns about the costs and uncertainties involved in pursuing a small case but would instead expand the use of unprincipled, vaguely defined benchmark-based standards to the vast majority of railroad traffic potentially subject to regulation.

⁶ ACC Op. at 7; *see also* Opening Comments of National Grain & Feed Association, et al. ("NGAF Op.") at 15 (complaining of "sharp hikes in railroad grain rates, particularly recently").

Finally, we briefly discuss issues relating to rate challenges involving exempt traffic and refute shipper arguments that the standards for establishing market dominance in a rate case are similar to those that apply to petitions for partial revocation of an exemption.

II. THE BOARD MUST ALLOW RAIL RATES TO RESPOND TO MARKET FORCES.

Shippers approach the Board's proposals from the false premise that all or most rates for small and medium-size shipments are unreasonably high and reflect an abuse of market power. They claim that the problem is "acute."⁷ In particular, they claim that a growing demand for transportation services in the current capacity-constrained environment is driving up rates and thus driving the need for Board action.⁸ Rate increases in response to market forces of supply and demand, however, do not reflect a failure of regulation or the need for additional regulation. To the contrary, they reflect a working marketplace, consistent with the Government's policy "to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail." 49 U.S.C. § 10101(1).

Moreover, if shippers perceive current rates as too high, it is because they are comparing them with rates that have long been too low to provide railroads with adequate returns on existing capital, and far too low to support the investments in new capacity that these same shippers are now demanding. A recent Government Accountability Office ("GAO") report on

⁷ ACC Op. at 7.

⁸ See, e.g., *id.* at 7 ("Indeed, as rail capacity has decreased, the need for simplified and expedited small cases is greater than ever."); *id.* at 38 ("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 are finding that "resort to the Board's processes is becoming increasingly necessary.").

the freight railroad industry helps put shipper complaints in perspective.⁹ The report shows that “[r]ail rates across the freight railroad industry have generally declined since the enactment of the Staggers Rail Act.”¹⁰ Specifically, the GAO calculated that *nominal rates* decreased by 20 percent between 1985 and 2004.¹¹ *Real rates* – i.e., rates after accounting for the effects of inflation – decreased even more dramatically, as costs rose by nearly 60 percent over that period.¹²

The GAO report also helps demonstrate that recent increases in rates do not reflect railroad abuse of market power. Some shippers suggest that industry consolidation is partly to blame for rising rates.¹³ However, the Board approved the last major consolidation in the rail industry in 1998 – well within the period studied by the GAO.¹⁴ Moreover, the GAO analyzed whether industry consolidation has increased shipper “captivity” and concluded that “captivity is dropping.”¹⁵ The GAO also determined that the amount of traffic moving at rates above the 180 percent r/vc safe harbor has declined: “Since 1985, and as a percentage of all

⁹ See Government Accountability Office, *Freight Railroads: Industry Health Has Improved, But Concerns About Competition And Capacity Should Be Addressed* (Oct. 2006) (“GAO Freight Railroads Report”).

¹⁰ *Id.* at 11.

¹¹ See *id.* The GAO’s figures are consistent with the Board’s analyses. The Board has calculated that *nominal* rates fell by 19.7% and *real* rates fell by 45.3% between 1984 and 2000. See STB Office of Economics, Environmental Analysis & Administration, *Railroad Rates Continue Multi-Year Decline* at 1-2 (Dec. 2000) (“STB Rate Report”).

¹² See *GAO Freight Railroads Report* at 12.

¹³ See, e.g., ARC Op. at 4; NITL Op. at 2.

¹⁴ See *CSX Corp. et al. – Control – Conrail Inc., et al.*, 3 S.T.B. 196 (1998).

¹⁵ *GAO Freight Railroads Report* at 19.

traffic, the amount of potentially captive traffic traveling at rates over 180 percent R/VC and the revenue generated from that traffic have both declined.”¹⁶

Shippers incorrectly claim that GAO data support their arguments that railroads are abusing market power. They point to data showing that “the volume of freight moving at rates with R/VC percentages above 300% has more than doubled.”¹⁷ However, those data say nothing about whether railroads are abusing market power or engaging in lawful differential pricing.¹⁸ Shippers also fail to put the data in perspective by failing to acknowledge that the *percentage* of traffic traveling with r/vc ratios above 300 percent increased by only 2 percent – from 4 to 6 percent – between 1985 and 2004.¹⁹ A 2-percent change over twenty years, resulting in a mere 6 percent of traffic moving at r/vc ratios above 300 percent, is not a widespread pattern of anything, much less a widespread pattern of market power abuse.

Grain shippers also misuse the results of the GAO report. They claim that the report shows that rates have fallen for all commodities except grain.²⁰ However, they are referring to *nominal rates*: the report shows that grain shippers have benefited from substantial reductions in *real rates*.²¹ They also observe that “[t]he greatest increases in the percentage of rail tonnage traveling at rates over 300 percent of revenue/variable costs are occurring in rural

¹⁶ *Id.* at 31.

¹⁷ ACC Op. at 7.

¹⁸ See *GAO Freight Railroads Report* at 3 (“These findings may reflect reasonable economic practices by the railroads in an environment of excess demand, or they may indicate a possible abuse of market power.”).

¹⁹ See *id.* at 32.

²⁰ See NGAF Op. at 15-16.

²¹ See *GAO Freight Railroads Report* at 14, Figure 4. The Board’s data show that “inflation-adjusted prices for corn and wheat have each fallen just over 50 percent since 1984.” *STB Rate Report* at 3.

areas typified by a high incidence of grain originations.”²² However, such r/vc ratios are fully consistent with lawful differential pricing. Indeed, claims that railroads have market power over grain are implausible.²³ Comments in this proceeding by grain shippers and the U.S. Department of Agriculture (“USDA”) confirm that railroads have no market power over grain. USDA has explained that grain is subject to intense product and geographic competition: “Due to their numbers (many), size (small), and the nature of their products (homogeneous with many substitutes), individual agriculture producers of grain and oilseed crops are considered ‘price takers.’”²⁴ Shippers describe how producers can also benefit from direct rail-to-rail competition by transporting their product to elevators served by different railroads because “[v]irtually all agricultural commodities . . . are delivered by the farmer to the first point of sale by truck.”²⁵

We understand that many shippers are facing an unfamiliar situation with respect to their rail rates. Rail rates have been falling in both real and nominal terms in the decades since the passage of the Staggers Rail Act. Market forces are now placing different pressures on rates: “Rail capacity is strained, demand for transportation service is forecast to increase, and railroads must make capital investments to meet that demand.” *NPRM* at 11. Shippers acknowledge the current imbalance between supply and demand. They have observed that “the United States is

²² NGAF Op. at 16.

²³ UP discussed this issue at length in STB Ex Parte No. 665. *See* Union Pacific Railroad Company, Statement of Douglas V. Martin at 10-13, STB Ex Parte No. 655, *Rail Transportation of Grain* (Oct. 30, 2006).

²⁴ Comments of the U.S. Department of Agriculture (“USDA Op.”) at 2; *see also* NGAF Op. at 8 (discussing the “fact that many final or near-final delivery points for commodities have alternative supply sources”).

²⁵ NGAF Op. at 4. Grain shippers argue that most elevators are served by a single carrier and that elevator-to-elevator transshipments are not a viable alternative because of the costs of unloading grain from one elevator and trucking it to another, but they ignore the competition that results from the options available to them when choosing which elevator (and thus which carrier) to use in the first place. *See id.* at 6.

currently experiencing a growing transportation capacity shortage across modes” and that “the share of goods transported by the nation’s rail carriers must *grow* compared to other modes.”²⁶ However, shippers refuse to acknowledge the connection between changes in market forces and changes in rail rates. They fail to recognize that railroads will not be able to expand the supply of capacity to meet market demand if regulation prevents them from setting rates that generate adequate returns on investment.

UP has been consistently revenue inadequate for decades – that is, we have not been earning revenues sufficient to justify reinvesting in all of our existing capacity. We have thus focused our efforts on generating the highest possible returns on the investments we can afford to make.²⁷ If we are not able to increase rates, and thus returns, we cannot justify the investments in new capacity that shippers are demanding. The Board is required by law to protect shippers from abusive pricing if it occurs, but it otherwise must let market forces work. The Board would be acting contrary to law and public policy if it tried to shield shippers from the forces of supply and demand.

III. THE BOARD SHOULD ADOPT SIMPLIFIED-SAC, WITH THE MODIFICATIONS SUGGESTED BY UP.

In UP’s opening comments, we concluded that the Board’s Simplified-SAC proposal established a viable framework for a streamlined application of Constrained Market Pricing (“CMP”). We also suggested several modifications to the Board’s proposed approach that would increase the accuracy and reduce the time and cost of performing an analysis under

²⁶ NITL Op. at 2.

²⁷ The Alliance for Rail Competition argues that railroads should not be permitted to follow such a market-based approach. *See* ARC Op. at 11 n.4 (arguing that railroads should not be “allowed to ration capacity on purely economic grounds”). However, railroads have no option other than to respond to market conditions.

Simplified-SAC.²⁸ Other railroads also endorsed Simplified-SAC and suggested additional modifications and clarifications.²⁹ The U.S. Department of Transportation commented that Simplified-SAC “appears a reasonable, economically acceptable method of ascertaining the reasonableness of rail rates at a lower cost.”³⁰

Most shippers took a sharply different view of Simplified-SAC, urging the Board to withdraw its proposal.³¹ They complain that Simplified-SAC would be too costly for shippers, that results would be inaccurate and biased in favor of railroads, and that the procedural schedule was too lengthy to provide effective relief.³²

Shipper complaints about cost and bias are unjustified. Simplified-SAC would provide a low-cost method of obtaining meaningful access to the Board and produce unbiased results consistent with CMP principles. Shippers cannot reasonably expect that any simplified approach could be both much less costly than SAC and as precise as SAC. The Board cannot fulfill Congress’s directive without making trade-offs between cost and accuracy, and shippers are in a poor position to criticize those trade-offs because they have not offered any concrete suggestions for improving Simplified-SAC. We think that the Board’s proposed approach

²⁸ See Opening Submission of Union Pacific R.R. (“UP Op.”) at 13-46.

²⁹ See Opening Comments of BNSF Ry. (“BNSF Op.”) at 16-36; Opening Comments of Norfolk Southern Ry. & CSX Transportation, Inc. (“NS/CSX Op.”) at 11-15; Comments of Canadian Pacific Ry. (“CP Op.”) at 7-17.

³⁰ Initial Comments of the U.S. Department of Transportation (“USDOT Op.”) at 8.

³¹ See, e.g., ACC Op. at 5; ARC Op. at 14; NITL Op. at 6.

Not all shippers urged the Board to reject Simplified-SAC. In fact, Arkansas Electric Cooperative Corporation urged the Board to allow shippers to apply Simplified-SAC to an even broader range of cases, as did USDA. See Opening Comments of Arkansas Electric Cooperative Corp. (“AECC Op.”) at 6-7; USDA Op. at 9.

³² See, e.g., ACC Op. at 22-32; ARC Op. at 14; Chevron Op. at 5-6; Dow Op. at 5; NITL Op. at 6; Comments of Cargill Inc. (“Cargill Op.”) at 4-5.

strikes nearly the right balance, though it could be improved by incorporating our recommendations.

Shippers also offer no suggestions for addressing their complaints about the procedural schedule. However, the Board could expedite Simplified-SAC cases by accepting our proposals to adopt strict eligibility criteria and to eliminate one round of evidentiary filings, and by committing to decide cases promptly once the parties complete their evidentiary filings.

We discuss these issues in detail below.

A. Simplified-SAC Would Produce Fair Results.

In UP's opening comments, we concluded that Simplified-SAC was consistent with CMP principles. We also suggested several refinements to the Board's proposed approach that would produce even more accurate and more equitable results, including: requiring parties to replicate the predominant route used by the challenged movement, allowing them to account for ongoing capacity investments along the route, providing them the opportunity to rebut presumed costs for road property investment, and allowing them to adjust system-average operating expenses to reflect the special costs of handling hazardous materials.³³

In their comments, shippers assert that Simplified-SAC does not simplify SAC fairly and conflicts with CMP. They argue that the Board's proposal is unfairly skewed toward producing higher maximum rates and is inconsistent with CMP because it would not allow them

³³ See UP Op. at 13-47.

to test for inefficiencies in a defendant's facilities or operations.³⁴ Shippers also object more generally to applying any type of SAC-based, cross-subsidy approach to small rate cases.³⁵

Contrary to shipper claims, Simplified-SAC strikes a reasonable balance between accuracy and simplicity while adhering to the basic principles of CMP, and the Board's proposal is not biased against shippers. As discussed in this section, the Board's Simplified-SAC proposal generally reflects reasonable trade-offs between cost and accuracy. The trade-offs are reasonable because they will affect both railroads and shippers, and they will produce results based on CMP principles using expedited procedures that will be much less costly for shippers than a full SAC test. As for shipper objections to applying SAC-based principles to small rate cases, they effectively concede that most rates would be judged reasonable under the only judicially approved rate reasonableness standard that exists – CMP and the SAC test.

1. Simplified-SAC Is Consistent With CMP Principles And Is Not Biased Against Shippers.

Shippers criticize Simplified-SAC on the grounds that it would be less accurate than SAC and would always produce maximum rates higher than those that would be calculated under the full SAC test. Specifically, they fault the Board's proposal to require a stand-alone railroad ("SARR") to handle all of the defendant's traffic that moves on the issue route and to assume that the SARR would need to replicate all of the incumbent's existing infrastructure on that route.³⁶

³⁴ See ACC Op. at 29-30 & Verified Statement of Thomas D. Crowley ("Crowley VS") at 53-62 & Verified Statement of Gerald W. Fauth III ("Fauth VS") at 14-18, 24-28; ARC Op. at 10; Cargill Op. at 5; Chevron Op. at 6; Dow Op. at 5; NITL Op. at 8.

³⁵ See, e.g., ACC Op., Fauth VS at 19-20; ARC Op. at 8-9; NGAF Op. at 15.

³⁶ See ACC Op. at 29 & Crowley VS at 53-56 & Fauth VS at 33-34.

These criticisms strike at the core of the Board's proposal to simplify the full SAC test, and they fail to recognize that any simplified method must involve some shortcuts and thus will necessarily be less accurate than a full SAC test. As discussed below, the proposal reflects reasoned decision-making, not bias, and would impact both shippers and railroads in a balanced fashion. Perhaps the most telling sign that the Board's proposal is reasonable and unbiased is that shippers offer no suggestions of their own for improving Simplified-SAC.

a) Simplified-SAC would reasonably require a SARR to replicate the defendant's actual routes and facilities.

Shippers criticize Simplified-SAC because it would require a SARR to replicate the defendant's existing infrastructure rather than allow the shipper to posit routes and facilities that are "optimally efficient."³⁷ However, they do not dispute the Board's conclusion that the most time-consuming and expensive elements of the full SAC test stem from shipper efforts to "replicate less than the existing rail infrastructure used to serve the captive shipper." *NPRM* at 10. As the Board explained, shipper efforts to avoid replicating the defendant's infrastructure give rise to disputes about traffic selection and operating plan design, and the time and expense required to resolve these issues "dwarfs those needed to examine the replacement cost of the necessary rail infrastructure." *Id.* at 11.

The Board's proposal to require a SARR to replicate the defendant's actual routes and facilities reflects the Board's accurate understanding that rail carriers generally do not have excess investment in infrastructure. As the Board observed in the *NPRM*, rail carriers "no longer are burdened by substantial excess capacity; rather, the rail industry now faces the opposite situation." *Id.* Moreover, the Board's approach would accommodate claims that the defendant

³⁷ See ACC Op. at 29-30 & Crowley VS at 54-56 & Fauth VS at 15-18.

has excess capacity: “If a shipper presents compelling evidence that some facilities along the route have fallen into disuse by the railroad, and thus need not be replicated, those facilities would be excluded from the SAC analysis.” *Id.* at 12.

Shippers do not contend that the Board’s simplifying assumption is unfair because railroads have substantial excess infrastructure. In fact, they concede that there is a “capacity shortage” and that “the nation’s rail carriers must *grow*.”³⁸ Instead, they speculate that a SARR might be able to reduce costs in some cases by positing a shorter route than the defendant’s route for the challenged movement. They claim that improvements in construction equipment might allow new entrants to build shorter routes over more difficult terrain.³⁹ But such speculation is no basis for rejecting a significant simplification of the SAC test. In fact, in all of UP’s SAC cases, the SARRs have used the existing alignment. Moreover, shippers fail to consider that any cost savings would likely be small in relation to total construction costs and that any savings likely would be offset by the increased costs of using more expensive equipment, or more bridges or tunnels, to traverse more difficult terrain.⁴⁰

³⁸ NITL Op. at 2 (emphasis in original); *see also* National Industrial Transportation League, *Written Testimony of National Industrial Transportation League at Government Accountability Office Rail Regulatory Workshop* (Feb. 27, 2006) (“We have reached a point where demand has exceeded the [rail] industry’s capacity to haul all of the traffic.”).

³⁹ *See* ACC Op. at 30 & Crowley VS at 56 & Fauth VS at 15-18.

⁴⁰ Shippers point to a public-private initiative that they say will reduce the number of route miles between Norfolk, Virginia, and Chicago, Illinois, “by modifying 29 tunnels and 24 bridges and other obstructions.” ACC Op. at 30; *see also id.*, Fauth VS at 16. In fact, that project does not involve the construction of a new route, but rather improvements to an existing route that will allow the movement of double-stack containers over a shorter route. Moreover, the project is receiving public funds because it provides significant public benefits. The project’s existence does not prove that a new entrant would have constructed a route different than the one originally constructed by the incumbent if the new entrant had to bear all of the costs, as would be required under the SAC test.

We believe that the Board's proposal would not disadvantage shippers, but the Board could adopt it even if it would require a SARR to replicate more expensive routes and facilities than an optimally efficient new entrant would construct. The use of shortcuts and the resulting loss of precision are unavoidable aspects of implementing a simplified approach. The important question is whether the Board has struck a reasonable balance between accuracy and simplicity.⁴¹ Moreover, shippers have not suggested any ways in which the Board could modify its proposal to address their concerns, and thus they are in no position to challenge the Board's conclusion that the savings in time and cost would outweigh any loss of precision.

As explained in our opening comments, the Board's proposal that SARRs replicate the defendant's existing infrastructure does have a systematic bias, but one that works against defendants. The Board would allow a shipper to avoid the cost of replicating facilities that have fallen into disuse, but it would not provide defendants with a comparable opportunity to identify infrastructure investments that are in progress on capacity-constrained routes to be replicated by the SARR. We therefore argued that the Board should allow defendants to add new facilities to the existing configuration if they present compelling evidence that they are in the process of making new investments on the route being replicated by the SARR.⁴² We again urge the Board to adopt this proposal.

⁴¹ The Board's approach would be more than a just reasonable shortcut in that the Board would be fulfilling its obligation to assist carriers in attaining revenue adequacy by evaluating challenged rates based on carrier's reasonable investments in infrastructure, rather than the investments that a new, optimally efficient entrant would hypothetically make if it could enter the market today. *See* 49 U.S.C. § 10704(a)(2) ("The Board shall maintain . . . standards and procedures for establishing revenue levels for rail carriers . . . that are adequate, under honest, economical, and efficient management, to cover total operating expenses, including depreciation and obsolescence, plus a reasonable and economic profit or return (or both) on capital employed in the business.").

⁴² *See* UP Op. at 19-21.

b) Simplified-SAC would reasonably require a SARR to handle the defendant's actual traffic.

Shippers criticize Simplified-SAC because it would require a shipper to include all of the traffic that the defendant handles over the challenged movement's route in the SARR traffic group, rather than allow a shipper to posit the "most efficient traffic group."⁴³ However, the Board's proposed approach to the SARR traffic group follows logically from the requirement that a SARR replicate the defendant's infrastructure. Indeed, shippers never argue that the Board should allow them to posit a SARR that would handle only a subset of the defendant's traffic while still replicating the defendant's existing infrastructure.

One likely reason why shippers never argue for the right to posit a SARR that would handle only a subset of the defendant's traffic is because they benefit from an existing simplifying assumption that allows them to obtain all the advantages of grouping issue traffic with non-issue traffic – *i.e.*, the economies of density – without accounting precisely for all costs of handling cross-over traffic. *NPRM* at 13. As UP has demonstrated, the Board's simplified approach to crediting shippers with revenue from cross-over traffic systematically favors shippers.⁴⁴

We believe that the Board's approach to creating the SARR traffic group would not disadvantage shippers, in large part because of the offsetting advantage they obtain from the Board's simplified approach to allocating revenues from cross-over traffic.⁴⁵ However, even if

⁴³ ACC Op., Crowley VS at 54.

⁴⁴ See Opening Submission of Union Pacific Railroad Company at 23-28 & Verified Statement of Kevin Neels at 10-14, *Major Issues in Rail Rate Cases*, STB Ex Parte No. 657 (Sub-No. 1) (May 1, 2006).

⁴⁵ In SAC cases involving UP, other than those challenging rates for coal originating in the Powder River Basin, shippers have consistently posited SARRs that handled all or nearly all of (continued...)

shippers could obtain an advantage in some cases by positing a SARR that would handle only a subset of the defendant's traffic, the Board would be justified in adopting its proposed approach for at least two reasons.

First, the Board's proposal strikes a reasonable balance between accuracy and simplicity. Shipper efforts to posit an idealized traffic group significantly increase the time and resources that parties and the Board must spend on rate cases. The recent *AEPCO* case provides a vivid illustration of the difficulties that arise when shippers attempt to manipulate unfamiliar railroad data to achieve an advantage. As the Board found, the shipper in that case "improperly adjusted the traffic data that it had obtained in discovery to conform to what it viewed as inconsistent train movement data also obtained in discovery."⁴⁶ The improper adjustments were not minor. "Indeed, for some categories of traffic, [the shipper's] traffic figures for the [SARR] exceeded the existing carrier's systemwide traffic levels."⁴⁷ Moreover, the problem was costly to correct. The shipper had to pay its consultants for the flawed initial work; the defendants had to pay their consultants to figure out what the shipper had done and where they had gone wrong; all parties had to pay their counsel to file related pleadings with the Board; and the Board had to address the problem, which it resolved by allowing the parties to submit even more evidence regarding the SARR traffic group.⁴⁸

the available traffic. See *Az. Elec. Power Coop. v. The Burlington N. & S.F. Ry.*, STB Docket No. 42058, slip op. at 4 (STB served Nov. 19, 2003) (observing that the shipper had "intended to include all traffic currently moving over [the incumbents'] lines"); *FMC Wyo. Corp. v. Union Pac. R.R.*, 4 S.T.B. 669, 725 (2000) (describing the traffic selected by the shipper); *Bituminous Coal – Hiawatha, UT to Moapa, NV*, 10 I.C.C.2d 259, 291 (1994) (observing that the stand-alone railroad's traffic "closely mirrors [UP's] own traffic on the involved line segments").

⁴⁶ *Az. Elec. Power*, slip op. at 3.

⁴⁷ *Id.*, slip op. at 4.

⁴⁸ See *id.*

Second, the Board's proposal is conceptually sound because a rail carrier should be allowed to set rates based on the traffic it actually serves. As the Board has recognized, a carrier's correct Ramsey pricing levels are affected by the carrier's traffic base, including "the mix of competitive and captive traffic handled by that carrier, the degree of competition that it faces on its competitive traffic, and the relative density of the routes it operates."⁴⁹ In other words, a carrier's reasonable rates might be made to appear unreasonable by comparing them to rates that a SARR could charge for serving a different traffic group.⁵⁰

c) Simplified-SAC would reasonably base SARR operating costs on the defendant's operating costs calculated using URCS.

Shippers criticize Simplified-SAC because it would base SARR operating costs on the defendant's operating costs rather than the operating costs of an optimally efficient new entrant.⁵¹ However, the Board's proposal would allow parties to simplify significantly the calculation of SARR operating expenses. As the Board observed in the *NPRM*, and as the railroads agreed in their comments, the calculation of SARR operating expenses is an issue that "has been highly contentious and the source of substantial litigation costs and delays."⁵² But if a SARR replicates the defendant's actual facilities and traffic base, those costs and delays can be avoided because "the defendant's operating costs can be used as a proxy for the SARR's operating costs."⁵³

⁴⁹ *Simplified Guidelines*, 1 S.T.B. at 1033-34.

⁵⁰ Shippers should be particularly sensitive to this issue, given their argument that carriers should not be allowed to avoid providing service to high-cost shippers. *See* ARC Op. at 11 n.4.

⁵¹ *See* ACC Op. at 29 & Fauth VS at 24-28.

⁵² BNSF Op. at 26.

⁵³ *Id.* at 27.

Railroads supported the Board's basic approach to calculating SARR operating costs, but several railroads, including UP, argued that the Board should adopt one important modification: it should allow parties the option of making at least some movement-specific adjustments to costs calculated using URCS in order to increase the accuracy of operating cost calculations.⁵⁴

(1) The Board's basic approach to calculating operating costs is sound.

Shippers recognize that the Board's proposed approach "would simplify the development of the SARR operating expenses."⁵⁵ They also acknowledge that the Board's proposal would provide shippers with an advantage by allowing SARRs to benefit from certain economies of scale that otherwise could only be achieved by larger carriers – for example, the fact that "fuel costs per gallon for a Class I carrier may be lower than a SARR could achieve."⁵⁶

However, shippers incorrectly claim that any advantage derived from economies of scale would be offset because the proposal would prevent a SARR from taking advantage of certain efficiencies that would not be available to the incumbent. They claim, for example, that a SARR should have important cost advantages over the incumbent because it could acquire "an entire new fleet" of fuel-efficient locomotives, would not be "burdened with antiquated labor

⁵⁴ See UP Op. at 28-29; CP Op. at 13-14; Comments of Canadian National Ry. ("CN Op.") at 4-5.

⁵⁵ ACC Op., Fauth VS at 25.

⁵⁶ *Id.* at 26.

agreements,” and would have lower maintenance-of-way costs “as the result of hypothetical track replacement.”⁵⁷

In fact, shippers would not lose any significant or valid cost advantages under the proposed approach. For example, the incumbent generally should have the same opportunity as a new entrant to adopt the most current, efficient track replacement strategies. The incumbent’s rates should not be considered abusive merely because they reflect wages paid under agreements negotiated pursuant to the Railway Labor Act. And the Board’s proposal to calculate equipment costs based on historic costs actually appears to favor new entrants, not the incumbents, as discussed in the following paragraph.

Shippers also fail to acknowledge all of the aspects of the Board’s proposal that would work against the interests of defendants by reducing SARR operating costs. For example, the Board’s approach would allow a SARR to benefit from many economies of scale that would not be available to a smaller railroad. Shippers admit that a SARR would benefit with respect to fuel purchases, but they fail to acknowledge that the same type of benefit would extend to the tens of thousands of items that railroads purchase.⁵⁸ As another example – one that the Board described in the *NPRM* – the Board’s approach would understate SARR training and start-up costs. *NPRM* at 50. As yet another example – one that UP and other railroads discussed in their opening comments – the Board’s approach would base SARR equipment costs on historic costs

⁵⁷ *Id.*; see also AECC Op. at 9 (arguing that the Board should not ignore depreciation of the defendant’s equipment because “Simplified-SAC provides no method to credit the SARR with efficiency improvements associated with purchase of new equipment”).

⁵⁸ UP’s operating expense expenditures for purchased materials amounted to approximately \$3 billion in 2005, which was more than UP’s expenditures for labor or purchased services. See UP Annual Report R-1, Schedule 410 (2005).

rather than current costs. Although this appears to be the most practical approach, it would understate the acquisition costs of new equipment for the SARR.⁵⁹

We believe the Board's proposal is reasonable and strikes an appropriate balance between accuracy and simplicity, with a single exception that we discuss below. In any event, shippers have not suggested any ways in which the Board could modify its approach to address their concerns, and thus they are in no position to challenge the Board's conclusion that the savings in time and cost would outweigh any loss of precision.

(2) The Board should improve its proposal by permitting certain movement-specific adjustments to URCS.

UP does not agree entirely with the Board's proposal because it would require parties to use only unadjusted URCS system-average costs to calculate SARR operating costs. In our opening comments, we urged the Board to allow movement-specific adjustments to URCS costs in cases involving movements of hazardous materials. We explained that use of system-average costs would produce flawed results in cases involving challenges to rates for movements of hazardous materials because such movements impose operating costs on railroads that greatly exceed system-average costs by virtue of the extra safety precautions that railroads must take and the inherent risks that they face. We also expressed concern that actual costs may rise even further as a result of new safety rules currently under consideration by the U.S. Department of Homeland Security and the Federal Railroad Administration.⁶⁰

⁵⁹ See UP Op. at 29; BNSF Op. at 28-29.

⁶⁰ See UP Op. at 28-29.

One shipper, Arkansas Electric Cooperative Corporation (“AECC”), also expressed concern about the Board’s proposal to use a defendant’s unadjusted URCS costs to develop SARR operating costs, but the precise nature of AECC’s concern is unclear.⁶¹

Two other railroads expressed concerns similar to UP’s. Canadian Pacific urged the Board to allow movement-specific adjustments to URCS costs, particularly for movements of hazardous commodities, because such movements are subject to special handling and security requirements “that add substantially to the cost of transporting those shipments.”⁶² Canadian National also urged the Board to allow movement-specific adjustments to URCS that reflect the added costs of moving hazardous commodities.⁶³ It suggested that, in the alternative, the Board should institute a proceeding to consider changes to URCS costing to account for the added costs of moving hazardous materials and not apply any new simplified standards to such traffic until that proceeding is completed.⁶⁴

The Canadian railroads’ concerns are consistent with UP’s. Safety and security requirements greatly increase the costs of handling hazardous materials, and those costs can be expected to rise in the future as more stringent regulations are issued. In fact, it is not only the Federal government but also individual states that are imposing new, costly requirements on rail transportation of hazardous materials.⁶⁵ Even shippers recognize that “with additional regulation from the Federal Railroad Administration (FRA), the Department of Homeland Security (DHS),

⁶¹ See AECC Op. at 9-10.

⁶² CP Op. at 13-14.

⁶³ See CN Op. at 4-5.

⁶⁴ See *id.* at 5.

⁶⁵ For example, California enacted new laws regulating railroad safety and local community rail service this past September. See 2006 Cal. Legis. Serv. Ch. 867 (West).

and other agencies, hazardous material shipments may be the most heavily regulated segment of railroad traffic.”⁶⁶

d) Simplified-SAC would reasonably use results from past SAC cases as a basis for road property investment costs.

Shippers criticize Simplified-SAC because SARR road property investment costs would be based on rolling averages calculated from the results of the prior five full SAC cases. Shippers recognize that the “proposed approach is definitely simpler,”⁶⁷ but they complain that the Board should have differentiated between the costs of constructing railroads in the eastern and western U.S. and that the data exhibit too much variation to be treated as reliable, at least without further examination.⁶⁸

UP agrees that these shipper concerns have some validity: the existing data do not justify an irrebuttable presumption that costs from prior SAC cases always should be applied to cases under Simplified-SAC. However, such concerns are not a reason to forego the benefits of Simplified-SAC. Instead, these concerns should be addressed as suggested in our comments: the Board should give parties the option of presenting evidence that different costs should be used in a particular case, but it should accept that evidence only if it meets a very high standard.⁶⁹

⁶⁶ ACC Op., Fauth VS at 53.

⁶⁷ ACC Op., Crowley VS at 57.

⁶⁸ See ACC Op., Crowley VS at 57-62 & Fauth VS at 28-31. Shippers also complain that they were unable to verify the Board’s calculations because they are based on confidential data filed in other cases. See ACC Op., Crowley VS at 61-62. We agree with BNSF that the Board has adequately explained its calculations in the prior cases and that there is no justification for allowing parties to examine information from prior cases in order to re-verify the Board’s calculations. See BNSF Op. at 25-26.

⁶⁹ See UP Op. at 24-28.

Other railroads have taken positions consistent with UP's. BNSF supported the Board's proposal, as long as the Board applies "some flexibility . . . in assessing [road property investment] costs in [Simplified-SAC] cases to account for major differences between the SARRs posited in the prior Full-SAC cases and the SARRs likely to be posited in [Simplified-SAC] cases."⁷⁰ Like UP, BNSF observed that SARRs in Simplified-SAC cases would likely require different facilities and traverse different routes than SARRs in full SAC cases, which are designed primarily to handle coal on predominantly rural coal routes, and thus might require different levels of road property investment.⁷¹

Canadian Pacific also supported the Board's basic proposal, but it observed that the Board's data do not reflect costs from any SAC cases involving a Canadian railroad. It thus urged the Board to "provide an opportunity for Canadian carriers to introduce evidence relating to actual construction costs in Canada" before applying Simplified-SAC to a Canadian railroad for the first time.⁷² UP's opening comments were based on a similar concern that none of the Board's data reflected costs from cases involving UP or the geographic regions that would likely be at issue in Simplified-SAC cases involving UP.⁷³

Finally, Norfolk Southern and CSX agreed with the Board's general approach, so long as "the Board takes care to account for significant differences in terrain and topography, and

⁷⁰ BNSF Op. at 22.

⁷¹ *See id.* at 24-25.

⁷² CP Op. at 11.

⁷³ *See* UP Op. at 25-26.

retains flexibility to make appropriate adjustments in specific cases for other material differences from [road property investment] in the preceding five SAC cases.”⁷⁴

We continue to believe that the Board can address the valid concerns that parties have identified without undermining the value of its proposed approach. If the Board requires parties to meet an appropriately high standard of proof before allowing departures from rolling average costs, parties will offer case-specific evidence only when the evidence is clear and the value of the added precision outweighs the costs of submitting the additional evidence.⁷⁵

2. Shipper Attacks On SAC Theory Should Not Deter The Board From Adopting Simplified-SAC.

In addition to criticizing specific aspects of Simplified-SAC, shippers argue that the Board should abandon its efforts to simplify SAC because any SAC-based approach would be “unworkable for most non-coal shippers and will deprive them of a rate remedy.”⁷⁶ They assert that any SAC-based approach would be unworkable because many shippers “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.”⁷⁷ The Board should not accept such arguments as valid criticisms of Simplified-SAC.

Shipper complaints that application of SAC principles will not result in rate relief put the cart before the horse: they presume that railroads have market power, that railroads are

⁷⁴ NS/CSX Op. at 11.

⁷⁵ See UP Op. at 27.

⁷⁶ ACC Op., Fauth VS at 19; *see also* ARC Op. at 6 (criticizing the Board for “developing modified guidelines that are . . . as close as possible to SAC”).

⁷⁷ NGAF Op. at 15; *see also* ARC Op. at 8 (“Because most captive shippers are not located on high density main lines, this single feature of the Board’s new proposals will render small rate case relief unavailable to most of the captive shippers for whom SAC is prohibitively expensive.”).

abusing that market power, and that the only question is how much rate relief to provide. The Board, however, cannot provide relief without first determining whether the challenged rate is unreasonable, and it cannot make that determination unless it judges the rate against a meaningful standard. CMP and the SAC test provide such a meaningful, court-approved standard. Shippers say that the Board “was not necessarily required to develop a simplified and expedited SAC method,”⁷⁸ but they fail to suggest any standard that would provide a better test of their claims that railroads are abusing market power than a SAC-based standard, which compares the challenged rate against “a simulated competitive price.”⁷⁹

Shippers incorrectly claim that railroads conceded in an earlier proceeding that simplified SAC “was not a suitable approach” for small rate cases.⁸⁰ In that proceeding, the Association of American Railroads actually explained that small-volume shippers are unlikely to prevail because their rates are usually much lower than a simulated competitive price: “[S]mall-volume shippers get the most benefit from the economies of scope and scale of a large rail system, and their rates therefore are the least likely even to approach stand-alone cost.”⁸¹ In other words, claims that shippers cannot prevail in rate cases under SAC-based standards are not indictments of the Board’s standards; they are indictments of the claims that shippers are suffering from abusive pricing.

⁷⁸ ACC Op., Fauth VS at 19.

⁷⁹ *Coal Rate Guidelines, Nationwide*, 1 I.C.C.2d 520, 528 (1985), *aff’d sub nom. Consol. Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987). Moreover, as we discuss below, the Benchmark method, which shippers also criticize, lacks even a tenuous connection to CMP principles unless the SAC test, or a reasonable simplification of the SAC test, applies to most regulated railroad rates. *See* pp. 65-66, *infra*.

⁸⁰ ACC Op., Fauth VS at 20.

⁸¹ Opening Comments of the Association of American Railroads at 29-30, *Rate Guidelines – Non-Coal Proceedings*, STB Ex Parte No. 347 (Sub-No. 2) (Feb. 20, 1996).

Shippers that wish to challenge their rates are entitled to meaningful access to the Board, but their rates must be tested against a meaningful standard. Shippers are not entitled to guarantees that they will win.

B. Shippers Overstate The Costs Of Simplified-SAC.

Shippers argue that Simplified-SAC is impractical for small cases because it would cost shippers much more than the Board's estimate of \$200,000.⁸² They estimate that a Simplified-SAC proceeding would cost a shipper between \$1.75 and \$3.5 million.⁸³

In UP's opening comments, we explained that Simplified-SAC should cost a shipper significantly less than the Board's estimate of \$200,000. We explained that the Board's estimate was based on the costs that a railroad might expect to incur and that the railroad, not the shipper, would bear the vast majority of costs under Simplified-SAC.⁸⁴

Shippers vastly overestimate the costs of Simplified-SAC for at least five reasons. *First*, shippers complain about the costs of analyses that would be performed by the defendant or that would be unnecessary. *Second*, they overestimate their costs for consultants. *Third*, they incorrectly claim that railroads could and would artificially increase the costs of proceedings. *Fourth*, they incorrectly assert that the Board's cost estimate was not based on a procedure comparable to Simplified-SAC. *Finally*, they fail to consider opportunities to reduce even further the already low costs of Simplified-SAC.

⁸² See, e.g., ACC Op. at 23-28; NITL Op. at 7.

⁸³ See ACC Op., Crowley VS at 24; *see also* ACC Op., Fauth VS at 14 (estimating consulting costs between \$500,000 and \$1.25 million).

⁸⁴ See UP Op. at 49-50.

1. Shippers Complain About Costs That Actually Would Be Incurred By Railroads Or That Would Be Unnecessary Under Simplified-SAC.

Shippers claim that their litigation costs under Simplified-SAC would far exceed Board estimates because they would incur significant costs to (i) identify the SARR traffic group; (ii) calculate cross-over revenues; (iii) calculate operating expenses; (iv) consider rerouting the issue traffic; (v) identify road property assets, including facilities that have fallen into disuse; and (vi) perform annual “true ups.”⁸⁵

Those claims are incorrect. The Board’s proposal was designed to minimize or eliminate most of the costs about which shippers complain, and UP has proposed modifications that would eliminate the remaining costs.

Traffic Group. Shippers argue that the Board’s proposal to shift the burden of identifying the SARR’s traffic group to the railroads “will not reduce the shipper’s costs, because the shipper will still need to independently verify the railroad’s data.”⁸⁶ However, the factors that make traffic selection a costly process in a SAC case would not be present under Simplified-SAC.

In a full SAC case, traffic selection can become an expensive, time-consuming process when shippers attempt to use the data they obtain from railroads in discovery to develop their version of an ideal traffic group. As discussed above, the traffic selection process can give rise to significant errors and costly disputes if shippers misunderstand or misuse the data.⁸⁷ However, Simplified-SAC addresses both issues that make traffic selection expensive under SAC: first, there would be no disputes about the composition of the traffic group because the

⁸⁵ See, e.g., ACC Op. at 23-28 & Crowley VS at 16-21 & Fauth VS at 10-12.

⁸⁶ ACC Op., Crowley VS at 16.

⁸⁷ See p. 17, *supra*.

SARR would handle all of the traffic handled by the incumbent; and second, there would be no disputes about whether the complainant accurately identified that traffic because the railroad would be required to provide the traffic data to the shipper. *See NPRM* at 13, 18.

Shippers argue that they would still need to verify the traffic data provided by the defendant, but such verification should be unnecessary because defendants would be obligated to comply with the Board's rules. Moreover, even if a shipper wanted to verify the data, it could do so at a small fraction of the cost of developing the traffic group from railroad data and defending that selection. For example, a shipper could ask the Board to convene a technical conference to address any perceived disparities in the data.

Cross-Over Revenues. Shipper complaints about the costs associated with calculating cross-over revenues ignore the allocation of burdens between the parties under Simplified-SAC.⁸⁸ Shippers argue that “the amount of effort to calculate cross-over revenues will be considerably *higher* in a Simplified-SAC case as compared to a Full-SAC approach, since Simplified-SAC procedures require the inclusion of *all* traffic moving over a route.”⁸⁹ However, under the Board's proposal, the shipper would not be required to calculate cross-over revenues. Instead, the defendant would be required to calculate cross-over revenues and provide the data to the shipper. *See NPRM* at 19. Moreover, calculation of cross-over revenues would be a mechanical process that a shipper readily could verify.⁹⁰ A shipper also could ask the Board to convene a technical conference to address any perceived disparities in the data.

⁸⁸ See ACC Op. at 25 & Crowley VS at 17-18 & Fauth VS at 21-23.

⁸⁹ ACC Op. at 25 (emphasis in original).

⁹⁰ See BNSF Op. at 21 & Opening Verified Statement of John C. Klick (“Klick VS”) at 3-5.

Operating Expenses. Shipper complaints about the costs to shippers associated with calculating operating expenses suffer from the same gap in logic as their complaints about calculating cross-over revenues.⁹¹ Under Simplified-SAC, the defendant would be required to calculate operating expenses using Board-developed URCS cost data and provide the results to the shipper. *See NPRM* at 18. Calculation of operating expenses thus would be another mechanical process that a shipper readily could verify either on its own or with the assistance of a Board-sponsored technical conference.

Rerouting Issue Traffic. Shippers complain about the costs associated with potential rerouting of issue traffic, and they argue that the proposed procedural scheduled would not provide them with the information needed to consider whether to propose rerouting the issue traffic on a timely basis.⁹² The Board could eliminate both complaints by prohibiting shippers from rerouting the issue traffic. As UP and other railroads explained in their opening comments, allowing a shipper to reroute the issue traffic would undermine the basic premise of Simplified-SAC and require the Board to introduce into the Simplified-SAC analysis many of the complicated investment and operational issues that are inherent in a full SAC case, thereby vastly diminishing the benefits of a simplified proceeding.⁹³

Shipper complaints about the time and costs associated with rerouting issues highlight the difficulties that would arise if the Board were to allow shippers to reroute the issue traffic. Their complaints also reaffirm the value of relying on the predominant route of the challenged movement in order to simplify and expedite rate cases.

⁹¹ *See ACC Op.* at 26 & *Fauth VS* at 12.

⁹² *See ACC Op.* at 26-27 & *Crowley VS* at 18-19 & *Fauth VS* at 23-24, 37.

⁹³ *See UP Op.* at 14-19; *BNSF Op.* at 18-19; *CP Op.* at 8-10; *NS/CSX Op.* at 12-15.

Identifying Road Property Investment. Shippers recognize that Simplified-SAC would simplify the costs associated with calculating road property investment, but they argue that the process would still be expensive.⁹⁴ They assert that shippers would need to retain “outside consultants and engineers” to perform a “physical inspection” of the entire route used by the challenged movement to determine whether any facilities have fallen into disuse.⁹⁵

The Board recognized in the *NPRM* that there are certain issues relating to road property investment that cannot be simplified to the same degree as others. *See NPRM* at 40-48. However, the costs of addressing those issues would not be nearly as high as shippers claim. First, shippers could obtain most, if not all, of the information they need about the defendant’s facilities from the defendant through discovery.⁹⁶ Second, the two issues that shippers describe as particularly costly and contentious – estimating quantities of earth work materials when ICC engineering reports are unavailable and calculating the cost of building and/or day-lighting tunnels⁹⁷ – will arise only infrequently. Third, shippers would have no reason to undertake the most costly exercise suggested by their witnesses – physically inspecting the entire route of the challenged movement in search of disused facilities – because they could request the necessary information in discovery. Moreover, shipper concerns that railroads have substantial disused facilities are unwarranted: as shippers recognize, railroads are suffering from a “capacity shortage,” and that “the nation’s rail carriers must *grow*.”⁹⁸

⁹⁴ See ACC Op. at 25-26 & Crowley VS at 18 & Fauth VS at 11-12.

⁹⁵ ACC Op., Crowley VS at 20.

⁹⁶ We encourage the Board to develop standard discovery requests after it gains sufficient experience with Simplified-SAC.

⁹⁷ See ACC Op., Crowley VS at 18.

⁹⁸ NITL Op. at 2 (emphasis in original).

Annual “True Ups.” Shippers complain about the costs associated with updating the Simplified-SAC analysis every year during the five-year prescription period.⁹⁹ However, their concerns are overstated because the Board’s proposal places the primary cost – the cost of updating the calculations – on the railroads. *See NPRM* at 14. Moreover, UP’s experience in rate cases leads us to believe that the parties will be able to negotiate agreements that will minimize the costs of establishing appropriate rate levels during the prescription period.

2. Shippers Rely Upon Vastly Inflated Estimates Of Consultant Costs Under Simplified-SAC.

Shippers vastly overestimate their costs in a Simplified-SAC proceeding, not only because they include costs that would be borne by defendants, but also because they rely on inflated estimates of the amount of work that their consultants would need to perform.

The inflated nature of shipper estimates can be illustrated by considering some examples. The most obvious example is the shipper estimate that consultants would spend 324 to 744 hours – the equivalent of 50 to 93 eight-hour days – calculating variable costs using the Board’s URCS Phase III methodology and repeating those calculations during various phases of the proceeding, even though “calculating variable costs based solely on URCS is a quick and administratively simple process.” *NPRM* at 15.¹⁰⁰

How could consultants spend so much time compiling the few, straightforward pieces of information needed to run the Board’s Phase III model? According to shippers:

⁹⁹ *See ACC Op.* at 26 & *Crowley VS* at 20-21 & *Fauth VS* at 32-33.

¹⁰⁰ Under the Board’s proposal to use the Phase III methodology, variable costs would be calculated based on nine inputs, all of which should in fact require little or no time to develop: (1) the railroad; (2) loaded miles; (3) shipment type; (4) number of freight cars; (5) tons per car; (6) commodity; (7) type of movement; (8) car ownership, and (9) type of car. *See Major Issues in Rail Rate Cases*, STB Ex Parte No. 657 (Sub-No. 1), slip op. at 52 n.166 (STB served Oct. 30, 2006) (“*Major Issues*”).

First, before a shipper decides to file a complaint, a consultant would spend:

- 24 to 80 hours on “data collection, research and evaluation of the issue movement(s)”;
- 24 to 80 hours to “[d]evelop movement characteristics and parameters for the issue movement(s)”;
- 40 to 120 hours costing the issue movement(s) “using the STB’s URCS Phase III methodology”;
- 16 to 24 hours comparing the actual rate to the 180 percent jurisdictional threshold in order to perform an initial “evaluation concerning eligibility”; and
- 40 to 80 hours to prepare a report on the results.¹⁰¹

Second, after a shipper decides to file a complaint, but before it submits any evidence, a consultant would spend:

- 40 to 80 hours to “[u]pdate and refine [the] jurisdictional evaluation of issue movement(s) using the STB’s URCS Phase III methodology”;
- 40 to 80 hours to “[u]pdate and refine [the] evaluation concerning eligibility”; and
- 60 to 120 hours to “[p]repare a verified statement and associated analyses concerning STB jurisdiction and eligibility.”¹⁰²

Finally, a consultant would again spend another 40 to 80 hours during the evidentiary phase of the case to “[d]evelop movement characteristics and parameters for the issue movement(s).”¹⁰³

No one who is familiar with URCS Phase III costing could accept this estimate, and no shipper would pay for such duplicative, unnecessary work. And this is just one example of how shippers derive their overblown cost estimates. Shipper estimates of consultant costs

¹⁰¹ ACC Op., Fauth VS, App. GWF-2 at 1.

¹⁰² *Id.* at 2.

¹⁰³ *Id.* at 3.

with respect to the other parts of a Simplified-SAC case are equally replete with duplicative work and excessive hours.

By way of another example, shippers claim that a consultant would spend 360 to 880 hours developing and analyzing cross-over traffic. What would a consultant be doing for 45 to 110 work days? According to shippers, he or she would spend 120 to 240 hours to “identify” cross-over traffic using the Board’s Public Waybill Sample, then 40 to 160 hours to “develop” estimates of cross-over traffic; another 80 to 240 hours to “identify” cross-over traffic using the Confidential Waybill Sample, and then another 80 to 160 hours to “develop” cross-over traffic from those data.¹⁰⁴ Finally, a consultant would spend 40 to 80 hours analyzing data regarding cross-over traffic and revenues actually provided by the railroad.¹⁰⁵ In other words, the hundreds of hours purportedly devoted to analyzing waybill data would be completely wasted, because the Board’s proposed approach requires the defendant to identify the traffic group, calculate cross-over revenue allocations, and provide the necessary data to the shipper. *NPRM* at 18-19.

The Board has more than enough experience with SAC cases to reject shipper estimates of the time and costs required to conduct an analysis under Simplified-SAC.

3. Shippers Incorrectly Claim That Defendants Will Artificially Increase Shipper Costs To Litigate Cases Under Simplified-SAC.

The Board should not credit shipper claims that railroads will artificially increase the costs to shippers of litigating cases under Simplified-SAC. Shippers say that the “arms race” that has supposedly occurred in SAC cases will be repeated under Simplified-SAC and that they cannot control litigation costs because they “cannot control the level of a railroad’s attack in a

¹⁰⁴ *Id.* at 1.

¹⁰⁵ *Id.* at 3.

case and the number of supplemental rounds of evidence the STB will require.”¹⁰⁶ Shippers are wrong on all counts.

First, shippers are wrong to claim that railroads artificially increase the cost of rate cases – a claim that is demonstrably untrue in SAC cases involving UP. For example, in *Northern States Power*, UP significantly reduced the cost of the case by proposing to the shipper to litigate only the jurisdictional threshold, not stand-alone costs.¹⁰⁷ UP tried to reduce costs even further by proposing that the parties submit only two rounds of variable cost evidence, but the shipper insisted on three rounds. In *AEPCO*, UP’s experience was that the *shipper* increased the costs of the rate case by pursuing far-fetched and ultimately unsuccessful efforts to manipulate the SARR traffic group and route.¹⁰⁸

UP’s experience in *AEPCO* is not unique, as demonstrated by other recent cases in which shipper complaints have been dismissed. BNSF also described in its comments how “shippers themselves have largely been responsible for the high costs of SAC litigation in recent cases,” and how “litigation costs [were] driven by overreaching and unrealistic SARR configurations.”¹⁰⁹

Second, shippers fail to recognize that Simplified-SAC cases would be different from full SAC cases because less money would be at stake. The costs of full SAC cases are high because the stakes are so high. It is rational for parties to spend millions dollars in SAC cases

¹⁰⁶ ACC Op., Crowley VS at 24.

¹⁰⁷ *N. States Power Co. v. Union Pac. R.R.*, STB Docket No. 42059 (STB served Mar. 9, 2001).

¹⁰⁸ *Az. Elec. Power Coop. v. BNSF Ry.*, STB Docket No. 42058 (STB served Mar. 15, 2005), *aff’d sub nom. Az. Elec. Power Coop. v. STB*, 454 F.3d 359 (D.C. Cir. 2006).

¹⁰⁹ BNSF Op. at 9 & n.3.

involving tens of millions of dollars and lengthy rate prescriptions. It would not be rational for parties to devote nearly the same level of resources to the smaller cases that would be decided under Simplified-SAC. Shippers recognize that “[n]o responsible company can justify spending \$4 million to challenge a \$500,000 overcharge.”¹¹⁰ Similarly, no responsible railroad would spend \$4 million to defend a case worth no more than \$500,000.

Third, shippers fail to recognize that Simplified-SAC cases would be different from full SAC cases because the issues that are the most costly and complex to litigate in a full SAC case would not be litigated under Simplified-SAC. The Board’s proposal would eliminate almost all potential disputes regarding construction costs, operating costs, and traffic selection. In other words, even if parties were willing to spend irrational amounts of money on Simplified-SAC cases, there would be nothing for them to spend it on. Moreover, as BNSF observed in its comments, parties’ recent experiences in SAC cases significantly overstate the costs of a case under Simplified-SAC because the final outcome of *Major Issues* will be to resolve “issues that have been the source of contention in the past, such as revenue allocation on cross-over traffic and indexing of operating costs.”¹¹¹

4. Shippers Incorrectly Claim That The Board Relied On A Cost Estimate For A Method That Is Not Comparable To Simplified-SAC.

Shippers wrongly criticize the Board for relying on testimony from an earlier proceeding suggesting that it would be possible to conduct a simplified SAC analysis for between \$25,000 and \$85,000.¹¹² Shippers claim that earlier estimate should not be used to estimate the costs that would be incurred under Simplified-SAC because it was based on “a

¹¹⁰ ARC Op. at 3.

¹¹¹ BNSF Op. at 9.

¹¹² See ACC Op. at 24-25 & Crowley VS at 22.

computer program which produced a calculated answer.”¹¹³ However, the earlier estimate was not based on the cost of running a computer program; it instead reflected the actual experience of a consultant who had performed simplified SAC analyses for clients.¹¹⁴ Moreover, as noted in our opening comments, the earlier estimate included all of the costs involved in obtaining and processing the required data and performing the required analyses, and the defendant, not the shipper, would bear the vast majority of those costs under Simplified-SAC.¹¹⁵

Shippers also complain that the \$25,000 to \$85,000 estimate is outdated and did not include the costs of litigating before the Board.¹¹⁶ However, the Board did not simply adopt that estimate for this proceeding – it more than doubled the upper end of the estimated range by setting the eligibility threshold for Simplified-SAC cases at \$200,000.

5. Shippers Fail To Consider Opportunities To Reduce The Costs Of Simplified-SAC.

Shippers complain about the costs and length of the proceedings required under Simplified-SAC, but they fail to offer any constructive suggestions for addressing their concerns. UP is also concerned about saving time and reducing costs, and we offered several suggestions for improving the process to achieve these goals. We proposed that the Board adopt strict eligibility rules, which would eliminate one round of filings and the delay involved in awaiting a decision regarding eligibility. We also proposed that the Board adopt strict rules regarding route selection, which would eliminate another round of filings and the attendant discovery and

¹¹³ ACC Op. at 24.

¹¹⁴ See Reply Comments of the Association of American Railroads, Reply Verified Statement of Craig F. Rockey & John C. Klick at 21-22, *Rate Guidelines – Non-Coal Proceedings*, STB Ex Parte No. 347 (Sub-No. 2) (Mar. 19, 1996).

¹¹⁵ See UP Op. at 50.

¹¹⁶ See ACC Op. at 25.

litigation costs. Finally, we proposed that the Board eliminate an entire round of SAC-based evidentiary filings, which would reduce costs and shorten the proposed procedural schedule. We believe that the parties will be able to identify additional opportunities to shorten the procedural schedule and reduce costs as they and the Board become more familiar with Simplified-SAC.¹¹⁷

IV. THE BOARD SHOULD NOT ADOPT THE BENCHMARK METHOD.

In UP's opening comments, we opposed the Benchmark method. We explained that the Benchmark method violates fundamental principles of rate regulation and would produce inaccurate and unpredictable results. We urged the Board not to use a formulaic benchmark-based approach for small rate cases but rather to apply Simplified-SAC. Other railroads also criticized the Benchmark method. Although they proposed a range of alternatives that differ from our proposal, their basic criticisms reinforce our concerns about the Benchmark approach.

Shippers also criticized the Benchmark method, describing it as "a major and unnecessary step backward in railroad rate reasonableness regulation."¹¹⁸ After years of complaining about the Board's approach in *Simplified Guidelines*, they actually urge the Board to "retain the existing Three-Benchmark approach, with certain modifications."¹¹⁹ In criticizing the Benchmark method, they express concerns similar to UP's. They say that the method would be "too unpredictable" for parties "to use to make informed decisions" because "a shipper cannot estimate the composition of the final comparison group."¹²⁰ They also say that the Board should not rely on strict formulas but should instead remain open to evidence regarding "individualized

¹¹⁷ One potential opportunity would be to develop standardized discovery requests. See n.96, *supra*.

¹¹⁸ ACC Op., Fauth VS at 3-4.

¹¹⁹ *Id.* at 5.

¹²⁰ ACC Op., Crowley VS at 50, 51.

factors.”¹²¹ However, despite their criticisms, shippers support a Benchmark-like approach.¹²² Moreover, they urge the Board to apply such an approach to all cases that would be eligible for simplified treatment, even though the Board proposed to use the Benchmark method “only as a last resort.” *NPRM* at 11.

We agree with most of the concerns expressed by the other railroads and shippers, but we do not agree with their proposed solutions. We discuss those concerns and proposals below, but we do so in the spirit of making a constructive contribution to the dialogue, not because we believe that it would ever be appropriate for the Board to use a formulaic benchmark-based approach in making rate reasonableness determinations.

A. The Benchmark Method Does Not Provide A Principled Basis For Testing The Reasonableness Of A Challenged Rate.

In UP’s opening comments, we argued that the Benchmark method does not provide a principled basis for determining the reasonableness of challenged rates.¹²³ Not a single party offered a principled justification for the Benchmark method in their comments. Many shippers criticized Simplified-SAC, but they ignored the more serious failings inherent in any benchmark-based approach. In fact, their criticisms actually highlight the fact that Simplified-SAC rests on sound economic principles, while the Benchmark method does not.

Shipper criticisms of Simplified-SAC are more appropriately directed to the Benchmark method. Shippers argue that the Board cannot adopt Simplified-SAC until the

¹²¹ ACC Op. at 37. Not surprisingly, however, their concern is one-sided. Shippers argue that the Board could use a formula to determine that a rate is unreasonable, but if the formula showed that the rate was reasonable, shippers should be allowed to submit evidence regarding “individualized factors that make the rate unreasonable.” *Id.*

¹²² See, e.g., *id.* at 5-6; NITL Op. at 12; Cargill Op. at 13; Chevron Op. at 14; Dow Op. at 15.

¹²³ See UP Op. at 54-57.

proposal has been tested because it is “an exercise with no true economic justification.”¹²⁴ They say that, without testing, “it is simply impossible for the Board to know whether its proposed procedure will in fact result in rates that bear any relationship whatsoever to the results that would accrue from a Full-SAC analysis.”¹²⁵ Thus, according to shippers, “[a]s the record in this proceeding now stands, the Board’s [Simplified-SAC] proposal is simply arbitrary.”¹²⁶

These shipper criticisms of Simplified-SAC are off the mark, but they hit home when applied to the Benchmark method. Simplified-SAC requires no special testing because it is based on CMP and the SAC constraint. The Benchmark method, however, is not grounded in sound economic principles. To the contrary, it is fundamentally inconsistent with the market-based differential pricing principles that railroads must follow and that are endorsed by the national rail transportation policy.¹²⁷ The Board could adopt a simplified approach that is not based on CMP, but only if it were first shown to produce results that are consistent with CMP. The Benchmark method has never been tested against that standard. If it were tested, it would almost certainly fail because, as shippers recognize, outcomes in cases under the Benchmark method depend on criteria for identifying comparable traffic that are so vaguely defined that ultimate outcomes are rendered “unpredictable.”¹²⁸ Shippers say that they are entitled to a

¹²⁴ ACC Op., Crowley VS at 55.

¹²⁵ NITL Op. at 8.

¹²⁶ ACC Op. at 28.

¹²⁷ See 49 U.S.C. § 10101(1).

¹²⁸ ACC Op., Crowley VS at 50; *see also* UP Op. at 51 n.49 (“[R]ate reasonableness findings in past cases would provide little guidance for future cases because, as the Board points out, even with respect to a movement used in a particular comparison group, if the rate for that movement were challenged, that movement’s ‘comparison group would almost certainly be different.’”) (quoting *NPRM* at 27 n.47).

method of rate relief that, though not perfect, is at least “feasibl[y] good.”¹²⁹ However, the Benchmark method has not been shown to meet even this minimal standard.

BNSF’s comments suggest a potential modification of the Benchmark method to mitigate the test’s failure to reflect differential pricing principles. BNSF argues that “the Board should find that a challenged rate is unreasonable only if it is more than one standard deviation from the mean of R/VC_{COMP} .”¹³⁰ It observes that “[s]uch a rule would be much more consistent with the Board’s stated goal of determining whether a given rate is within a range of differential prices.”¹³¹ BNSF’s proposal would improve the Benchmark method in much the same way as would the Board’s proposal to adjust the mean R/VC_{COMP} to address revenue adequacy concerns. Both proposals seek to improve the Benchmark test by incorporating relevant considerations – *i.e.*, differential pricing and revenue adequacy – into the analysis.¹³² However, BNSF’s proposal would not fix the fundamental problems inherent in the Benchmark method any more than would the Board’s proposal to apply “a revenue-need adjustment factor” to the mean R/VC_{COMP} ,¹³³ because the Benchmark test would still determine the reasonableness of a rate by reference to other rates rather than by reference to an ““economic principle”” or ““theoretically definable test”” against which a rate ““can in principle be objectively assessed.””¹³⁴ Moreover, the results

¹²⁹ NGAF Op. at 19.

¹³⁰ BNSF Op. at 48.

¹³¹ *Id.*

¹³² BNSF’s proposal might also help mitigate the Benchmark method’s tendency to reduce rates through iterative applications. *See* UP Op. at 66-67.

¹³³ UP explained why the Board’s use of a “revenue-need adjustment factor” would not remedy the fundamental problems inherent in a r/vc benchmark test in our opening comments. *See id.* at 54-57.

¹³⁴ *Burlington N.R.R. v. ICC*, 985 F.2d 589, 598 (D.C. Cir. 1993) (quoting Verified Statement of Alfred Kahn, Sept. 30, 1987 at 4 in *McCarty Farms, Inc. v. Burlington N., Inc.*).

in each case would still be unpredictable because the criteria for identifying comparable traffic are so ill-defined.

B. The Benchmark Method Could Not Even Be Used To Develop Relevant R/VC Comparisons Without Significant Modifications.

In UP's opening comments, we described several ways in which the Board would need to modify the Benchmark method even if there were any way to judge rate reasonableness on the basis of r/vc comparisons. The comments of shippers and other railroads reinforce our concerns and point to additional problems that the Board would need to address before it could use the Benchmark method to develop relevant r/vc comparisons.

1. The Board Would Have To Give Parties More Flexibility To Address The Cost And Demand Characteristics Of Comparison Group Traffic And Factors Other Than Formulaic Calculations.

UP, other railroads, and shippers all argued in their opening comments that the Board must expand the scope of information it would consider in assessing whether movements are actually comparable. The Board could not make accurate comparisons if movements have dissimilar degrees of demand elasticity or differences in operating costs that are not reflected in the Board's URCS costing system. Moreover, when market conditions are changing rapidly, existing rates might not provide reasonable benchmarks for assessing newly proposed rates.

UP therefore argued that the Board could not limit comparability analysis to consideration of “‘publicly available information [and] (non-rate) information provided in the Waybill Sample.’”¹³⁵ We argued that the Board would have to maintain its current approach under *Simplified Guidelines*, which encourages parties “to present whatever additional information is available that bears on the reasonableness of the pricing of the traffic at issue,”

¹³⁵ UP Op. at 61 (quoting *NPRM* at 20).

including any evidence that “particular traffic is not truly comparable.”¹³⁶ We discussed several examples of the type of information that should be considered in a benchmark-based analysis but that might be ignored under the Board’s proposed approach, including the presence of effective modal competition, differing car supply arrangements, operating costs that differ significantly from system-average variable costs, and use of capacity-constrained lines, terminals, and equipment.¹³⁷

BNSF also argued that the Board should not unduly limit comparability analysis. It expressed concern that the Board’s proposal would prevent the Board from considering “the type of evidence most likely to bear on the issue of similar demand elasticities, such as evidence on the amount of product and geographic competition experienced by the issue traffic, on the one hand, and movements proposed for inclusion in the ‘comparison traffic group,’” on the other.¹³⁸ BNSF stated that if particular traffic is “‘not truly comparable’ to the issue traffic,” then parties should have the same opportunity that exists under *Simplified Guidelines* to “‘bring that to [the Board’s] attention in an individual case.’”¹³⁹

NS and CSX also argued that the Board’s approach must be more flexible. They urged the Board to remain open to “information that either party may present concerning why the cost of the challenged move is significantly above or below the carrier’s system average or why the challenged rate is (or is not) consistent with market conditions.”¹⁴⁰ As an example of a situation in which flexibility would be required to address rapidly changing market conditions,

¹³⁶ *Simplified Guidelines*, 1 S.T.B. at 1022, 1035.

¹³⁷ See UP Op. at 62-66.

¹³⁸ BNSF Op., Klick VS at 6.

¹³⁹ *Id.* at 6-7 (quoting *Simplified Guidelines*, 1 S.T.B. at 1034-35).

¹⁴⁰ NS/CSX Op. at 24.

they observed that “a newly-issued rate for highly hazardous material shipments may not bear any relation to other existing rates for such transportation, if, for instance, new government security requirements or regulations substantially increase the costs of rail transportation of such materials.”¹⁴¹ As discussed above, the prospect of additional, costly regulatory requirements for the transportation of hazardous chemicals is a very real concern.¹⁴²

Shipper comments also highlighted the need for the Board to be sensitive to a variety of factors in applying a benchmark-based test. Shippers warned that “the Board should be very cautious if it is saying that it will permit no evidence whatsoever beyond the formula calculation.”¹⁴³ They argued that “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.”¹⁴⁴ We strongly agree that a strict formulaic approach would be inappropriate. However, departures from such an approach must not be one-sided – both shippers and railroads must have an equal opportunity “to present whatever additional information is available that bears on the reasonableness of the pricing of the traffic at issue.”¹⁴⁵

¹⁴¹ *Id.*

¹⁴² *See* pp. 21-23, *supra*.

¹⁴³ ACC Op. at 37.

¹⁴⁴ *Id.*; *see also* NITL Op. at 13 (“[S]hippers should have the possibility of showing that the Board should evaluate its case differently, or should consider additional factors in determining a maximum reasonable rate.”).

¹⁴⁵ *Simplified Guidelines*, 1 S.T.B. at 1022.

2. The Board Would Have To Exclude Contract Traffic And Non-Defendant Traffic From Comparison Groups.

UP argued in our opening comments that the Board should exclude two types of traffic from comparison groups: contract traffic and non-defendant traffic.¹⁴⁶ The comments of shippers and other railroads regarding these issues reinforce our initial view.

a) Contract traffic and unmasked waybill data

Shippers devote a substantial portion of their comments regarding the Benchmark method to arguments that the Board should grant shippers access to unmasked revenue data from the Waybill Sample before they file a complaint.¹⁴⁷ The issue arises because Board regulations allow railroads to mask the revenues they receive from contract traffic when they submit data for the Waybill Sample “to safeguard the confidentiality of the contract rates.”¹⁴⁸ However, the Board should exclude contract traffic from comparison groups, and even if it were allowed to be included, shippers would have no need for early access to unmasked revenue data.¹⁴⁹

(1) Contract rates are not comparable to common carrier rates.

The Board need not address the issue of shipper access to unmasked revenue data because it should exclude contract traffic from comparison groups. Contract rates will rarely, if

¹⁴⁶ See UP Op. at 59-61, 65.

¹⁴⁷ See ACC Op. at 34-36 & Crowley VS at 42-46 & Fauth VS at 49-54; NITL Op. at 12.

¹⁴⁸ 49 C.F.R. § 1244.3(b).

¹⁴⁹ The U.S. Clay Producers Traffic Association raises a contract-related issue in its comments. It asks the Board to address “the currently prevalent railroad practice of offering ‘non-signatory contracts’” and “clarify” that it “will view the purported rail contract as the fundamental equivalent of common carriage and consider it to be subject to the Board’s rate jurisdiction.” Comments of U.S. Clay Producers Traffic Association, Inc. (“Clay Producers Op.”) at 3-4. The Association also comments on challenges to fuel surcharges. *Id.* at 4-5. We do not address either issue because they are both outside the scope of the *NPRM*. Moreover, a determination of whether a particular price document establishes a contract or a common carrier rate depends on the specific facts of each case and is thus not suited for rulemaking.

ever, be comparable to common carrier rates being challenged by shippers. As we observed in our opening comments, contract rates cannot be compared with common carrier rates – at least not without detailed scrutiny of contract terms and conditions – because contracts typically include terms and conditions that affect the overall economic value of the parties’ arrangements.¹⁵⁰ In addition, contract rates often reflect outdated judgments about market conditions and thus would not provide a valid benchmark for assessing current rates.¹⁵¹ Unlike most common carrier rates, contract rates typically cannot be adjusted on short notice in response to changes in market conditions.

BNSF also opposed the inclusion of contract movements in comparison groups, explaining that “rates negotiated in a contract are directly linked to a host of factors that are not generally present in common carrier movements, such as a binding term, a volume commitment, service requirements, and damage provisions, among other things.”¹⁵²

(2) Shippers have no valid need for early access to unmasked revenue data.

Even if the Board were to allow shippers to include contract movements in comparison groups, shipper arguments for early access to unmasked revenue data do not withstand scrutiny. Indeed, they suggest that shippers misunderstand the mechanics of the Board’s proposal. They also suggest that shippers are seeking opportunities to game the selection of comparison group traffic and highlight the unprincipled nature of the Benchmark method.

¹⁵⁰ See UP Op. at 65.

¹⁵¹ See *id.*

¹⁵² BNSF Op. at 40.

Shipper arguments that railroads could use masking procedures inappropriately to exclude certain movements from comparison groups reveal a misunderstanding of the Board's proposal. Shippers claim that they need access to unmasked data to prevent railroads from establishing masking factors that reduce contract revenues in order to "drop the R/VC for many shipments below the 180 percent [jurisdictional] threshold level, and remove these movements from the comparison group selection process."¹⁵³ However, the Board plainly intends to use unmasked revenue data in developing the list of movements for potential inclusion in the comparison group. *NPRM* at 32-33.¹⁵⁴

Shipper arguments that they need access to unmasked data in order to select the most appropriate comparison group reveal an intent to game the selection of comparison group traffic, while also highlighting the unprincipled nature of the Benchmark method.

Shippers argue that, unless they have access to unmasked revenue data, they will be unable to ensure that their comparison groups include only those movements that support their claim for lower rates.¹⁵⁵ They worry that "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."¹⁵⁶ However, if the Benchmark approach has any validity, parties should be making arguments about comparison group traffic

¹⁵³ ACC Op., Crowley VS at 43.

¹⁵⁴ Shippers also worry that railroads could set the masking factor so high "as to make it appear that the average R/VC for any comparison group would offer little relief [under] the proposed Three Benchmark Procedure." ACC Op., Crowley VS at 43. However, the Waybill Sample contains a flag that denotes contract movements, and thus shippers and consultants would know not to rely on revenue data from those movements.

¹⁵⁵ See ACC Op. at 36 & Crowley VS at 42-44.

¹⁵⁶ ACC Op., Crowley VS at 43.

based on non-rate information: they should be selecting traffic that is most similar to the challenged movement based on factors that “affect demand characteristics and operating costs.” *NPRM* at 20. They should not be trying to justify their selection of traffic based on the result that they seek, as that would amount to inappropriate gaming.

Shippers also argue that revenues and r/vc ratios of other traffic should be relevant factors in selecting comparable traffic, but the Board cannot accept those arguments without undermining the entire Benchmark approach. Shippers say that, without access to unmasked data, they “will not have the necessary revenue information that will enable them to properly evaluate the demand elasticity of potential comparison groups.”¹⁵⁷ They point out that “R/VC ratios have been historically used by the ICC and the Board to evaluate the demand elasticity of railroad traffic.”¹⁵⁸ However, if the Board agrees that r/vc ratios are an appropriate measure of whether traffic is comparable, the Benchmark test becomes pointless because there would be no justification for selecting a comparison group with an average r/vc level that is significantly different from the challenged movement’s r/vc level, in which case application of the Benchmark method would simply affirm that the challenged rate was “reasonable.”¹⁵⁹

b) Non-defendant traffic

In UP’s opening comments, we argued that the Board should not allow traffic moving on carriers other than the defendant to be included in a comparison group because the lawful maximum rate that one carrier could charge for a particular movement would be different

¹⁵⁷ ACC Op., Fauth VS at 49.

¹⁵⁸ *Id.*

¹⁵⁹ As the D.C. Circuit has observed, if the challenged rate produces an r/vc ratio above the mean r/vc ratio for a comparison group, “it seems most probable that the transportation and demand characteristics of the two groups are in fact different.” *Burlington N.R.R. v. ICC*, 985 F.2d at 597.

than the lawful maximum rate that could be charged by a different carrier with different revenue needs, a different cost structure, and a different mix of shippers.¹⁶⁰

Shippers did not address the Board's apparent intent to allow the use of non-defendant traffic. BNSF addressed the issue, and it expressed concerns similar to UP's. BNSF correctly argued that movements on different carriers cannot be considered comparable: a non-defendant carrier "has its own network and cost structure that differs from the network and cost structure of the defendant carrier."¹⁶¹ BNSF also correctly observed that "use of other carrier movements is inconsistent with the practice in Full-SAC cases where parties only use movements for the respondent carrier in the traffic group."¹⁶²

3. The Board Would Have To Address Significant Technical Issues That Presently Would Preclude Accurate Rate Comparisons.

UP observed in our opening comments that the Board could not apply the Benchmark method without addressing the fact that rate data for comparison traffic would often be outdated by the time they appear in the Waybill Sample, and therefore could not appropriately be compared with the challenged rate. Shippers raised another important issue – the fact that revenue data contained in the Waybill Sample might misstate actual revenues. We address both issues below.

a) Time-lag issue

In our opening comments, we pointed out that revenue data in the Waybill Sample will often reflect movements that occurred, and thus market conditions that existed, more than two years before the challenged rate went into effect. We argued that use of outdated revenue

¹⁶⁰ See UP Op. at 59-61.

¹⁶¹ BNSF Op. at 39.

¹⁶² *Id.*

information in r/vc comparisons would be inappropriately backward-looking and could prevent railroads from setting rates in response to conditions currently affecting the transportation market.¹⁶³

Other railroads also identified this same time-lag issue in their comments. BNSF observed that “use of the costed-waybill sample data as the starting point for the identification of a maximum reasonable rate creates a time-lag problem because the costed-waybill data is one to two years older than the rate being challenged.”¹⁶⁴ Norfolk Southern and CSX also observed that the Board would need to address the fact that “[b]ecause it takes considerable time to prepare the Carload Waybill Sample, the challenged rate will [be] compared with rates from one-to-three years earlier.”¹⁶⁵

BNSF, Norfolk Southern, and CSX suggest that the Board might be able to address the issue by using some form of indexing. However, UP is unaware of any index that could reflect market changes at a specific enough commodity level. Moreover, indexing would not address the fact that some rates would not reflect current market conditions because they are governed by long-term contracts.

b) Actual revenue issue

Shippers raised another important issue related to the use of revenue data from the Waybill Sample: the data may not include final revenue settlements that reflect allowances, refunds, or other adjustments.¹⁶⁶ We agree that this is yet another difficulty created by the

¹⁶³ See UP Op. at 58-59.

¹⁶⁴ BNSF Op. at 40.

¹⁶⁵ NS/CSX Op. at 24.

¹⁶⁶ See ACC Op. at 37 & Crowley VS at 47.

Board's proposal to compare r/vc ratios using data from the Waybill Sample. This issue further illustrates the need for sensitivity to factors such as the existence of allowances and refunds when determining whether different movements are truly comparable.

C. The Board Would Have To Develop An Additional Test For Cases In Which No Comparable Traffic Exists.

As UP observed in our opening comments, even if the Board were to adopt the Benchmark method, it would still have to adopt yet another method to address cases in which there is no comparable traffic.¹⁶⁷ Shippers also raised this concern in their comments, noting that “this very problem came up in the first and only case to test the then proposed Three-Benchmark approach” – *South-West Car Parts*.¹⁶⁸ They pointed out that the Board's solution in *South-West Car Parts* – relying on the RSAM and $R/VC_{>180}$ benchmarks – would not be possible under the Board's Benchmark proposal, because “the proposed RSAM and R/VC_{total} ratios are not ‘benchmarks’ in the literal sense of the word.”¹⁶⁹ As the shippers correctly explain, “[t]he proposed RSAM and R/VC_{total} ratios are merely used to mark-up (or down) the R/VC_{COMP} benchmark.”¹⁷⁰

V. THE BOARD'S ELIGIBILITY CRITERIA INCORPORATE APPROPRIATE STANDARDS.

In UP's opening comments, we agreed with the Board's proposal to establish eligibility standards for simplified treatment based on the concept of “Maximum Value of the Case” (“MVC”), and we agreed that the upper threshold for cases under Simplified-SAC should

¹⁶⁷ See UP Op. at 67-68.

¹⁶⁸ ACC Op., Fauth VS at 59 (citing *South-West R.R. Car Parts Co. v. Mo. Pac. R.R.*, STB Docket No. 40073 (STB served Dec. 31, 1996)).

¹⁶⁹ *Id.* at 58.

¹⁷⁰ *Id.* UP made the same point. See UP Op. at 68 (“Without the R/VC_{COMP} benchmark, the reformulated RSAM and R/VC_{TOTAL} benchmarks would provide no guidance, either separately or in combination, for assessing the reasonableness of a challenged rate.”).

be no higher than \$3.5 million.¹⁷¹ We argued that the Board should apply Simplified-SAC to both medium-size and small rate cases, and we explained that shipper costs under Simplified-SAC would be lower than the \$200,000 figure estimated by the Board and not significantly higher than the costs that would be incurred under the Benchmark method.¹⁷² Finally, we observed that the Board’s “aggregation” rule would play a necessary role in preventing shippers from routinely invoking the simplified standards, and thus imposing substantial discovery burdens on railroads, in order to gain leverage in rate negotiations.¹⁷³

Shippers focused most of their opening comments on the eligibility criteria. They disagree with the MVC approach and the aggregation rule, and they argue that the Board should “drastically revise upwards its eligibility thresholds.”¹⁷⁴ They assert that the current thresholds “are wholly unrealistic” because “[m]ost shippers will quickly find themselves presumptively in the Full-SAC category.”¹⁷⁵ They also claim that “[v]irtually no shipper of any size . . . will qualify” to bring a challenge under the Benchmark method.¹⁷⁶

Shipper claims about the effect of the Board’s eligibility criteria are demonstrably incorrect. The Board’s eligibility estimate shows that at least two-thirds of all regulated traffic (as measured by revenue) would be presumed eligible to use a simplified standard. *See NPRM* at

¹⁷¹ See UP Op. at 68-69.

¹⁷² See *id.* at 70.

¹⁷³ See *id.* at 45.

¹⁷⁴ ACC Op. at 5.

¹⁷⁵ *Id.* at 9; see also NITL Op. at 3 (“[M]ost rail rate disputes would fall into the impossibly expensive, lengthy and complex Full-SAC procedure.”).

¹⁷⁶ ACC Op. at 11; see also ARC Op. at 10 (claiming that “the universe of shippers eligible for [the Benchmark] approach under the Board’s new proposal is so small as to be negligible”); NITL Op. at 9 (“No shipper will qualify for a ‘small’ rate case.”).

37.¹⁷⁷ Moreover, the Board's estimate shows that at least 17 percent of regulated traffic would be presumed eligible to use the Benchmark method. *See NPRM* at 37.¹⁷⁸ Such an outcome is consistent with the Board's expressed intent that the Benchmark method "should be reserved for use only as a last resort, once we have exhausted reasonable measures to simplify the SAC analysis, as CMP with its SAC test remains our preferred method for assessing the reasonableness of a challenged rate." *NPRM* at 11.

In the sections below, we respond in more detail to shipper objections to the MVC approach, the eligibility thresholds, and the aggregation rule. We conclude by discussing more generally how those objections actually do not address the ability of shippers with small cases to

¹⁷⁷ Shippers argue that the Board's estimate understates the amount of regulated traffic. *See ACC Op.*, Fauth VS at 52-54; Clay Producers Op. at 2-3. However, if shippers are correct, then the percentage of traffic that would be presumed eligible for simplified treatment would be even higher.

Moreover, the Board's estimate is likely also understated because it excludes certain shorter-term movements. The Board developed its eligibility estimate by calculating the MVC of movements in the 2004 Waybill Sample. That calculation assumed that movements would continue for at least five years. However, as shippers point out, many small and medium-size movements do not continue for five years. *See, e.g.*, NITL Op. at 5; Chevron Op. at 3; Dow Op. at 2. Shippers would be able to bring relatively larger cases with respect to movements that last fewer than five years. For example, under the MVC approach, if a movement continues for at least five years, a shipper could bring a case under Simplified-SAC if the maximum relief that it could attain in any one year would be \$700,000 (excluding discounting). However, if the shipper represents that the movement will last for only two years, the annual maximum would be \$1.75 million.

¹⁷⁸ Shippers purport to demonstrate that the proposed threshold would severely restrict the number of cases that would qualify for the Benchmark method by positing a hypothetical example under which the limit on the number of cars presumed to qualify for "small" case treatment would be 2.3 per month. *See ACC Op.* at 9-10. Even if that example were realistic, it would not undermine the Board's proposed threshold, because a large number of rail shipments would be covered by a 2.3 car per month threshold. For example, Cargill testifies that much of its rail volume "consists of fewer than 20 cars per year moving to a single destination." Cargill Op. at 1. Chevron Phillips reports that shipments "to individual customers can range from a single car to over 400 cars annually." Chevron Op. at 3. Dow discusses a "significant product category" in which "79% of customer destinations received only 1-20 carloads over the course of the year." Dow Op. at 13.

obtain improved access to the Board, but instead relate to the ability of shippers with larger cases to invoke cruder rate reasonableness standards.

A. The Board Should Retain The MVC Approach.

Shippers complain about the Board's MVC approach, but the Board's approach is an appropriate response to Congress's directive that the Board establish simplified and expedited standards for those cases in which a full SAC presentation "is too costly given *the value of the case*." 49 U.S.C. § 10701(d)(3) (emphasis added). Shippers have two complaints. First, they claim that the approach can be manipulated by railroads. Second, they claim that the approach does not accurately reflect the likely actual value of a case. We address each claim in turn below.

1. MVC Does Not Invite Manipulation And Addresses Congress's Directive To Consider "The Value Of The Case."

Shippers argue that the MVC approach "invites manipulation by the railroad to force the shipper to litigate a case under more-expensive procedures."¹⁷⁹ However, just as a

¹⁷⁹ ACC Op. at 18; NITL Op. at 10-11 ("[T]he Board needs to carefully re-evaluate whether the MVC concept is useful as an eligibility standard, since it can be readily manipulated by a potential defendant carrier simply by increasing the challenged rate.").

AECC attempts to illustrate how a railroad could benefit by manipulating MVC. *See* AECC Op. at 4-5. However, AECC's example, as we understand it, is flawed because it does not consider the impact of litigation costs on the railroad.

AECC's point appears to be that if a railroad sets its rate just at the eligibility threshold, the shipper would have no incentive to challenge even an unlawful rate, because it would merely break even after factoring in litigation costs. Of course, no real-world case would have the absolute certainty of costs and results posited by AECC. However, even accepting AECC's assumptions, AECC's conclusion is wrong because it fails to consider the impact of railroad litigation costs. As long as the railroad would incur \$1 of costs, it would be made worse off if the shipper brought the case and won. In other words, a shipper could readily punish a railroad that tried to play the "game" described by AECC. This last point is especially true given that the Board's proposals shift nearly all of the discovery burden to railroads.

UP does agree with one point raised by AECC. AECC suggests that "the Board should provide for adjustment of prescribed rates or other methods that would equalize (or equitably (continued...))

railroad would not intentionally set rates for its tens of thousands of medium-size and small shipments above profit-maximizing levels in order to influence the outcome of potential rate cases, it would not set rates above profit-maximizing levels in order to influence the test that would apply in a potential rate case.¹⁸⁰ The railroad would not only be inviting rate cases, it would be inviting rate cases that would be more costly to defend.¹⁸¹

In addition, shippers do not offer an alternative to MVC that would be more effective in preventing any suspected manipulation. Instead, they argue that eligibility standards should be based on the shipper's annual rail freight bill.¹⁸² However, the size of a shipper's freight bill also would be subject to "manipulation": just as a railroad could, in theory, increase the MVC figure by raising a shipper's rates, it could increase a shipper's annual rail freight bill by raising the shipper's rates.

Moreover, setting eligibility standards based on the size of a shipper's freight bill would be inconsistent with the statute. "The value of the case" does not depend on the size of the shipper's freight bill. Instead, "the value of the case" is determined by the potential value of relief and the costs of pursuing a case. USDA articulates the point clearly in its comments: "The primary issue is not how many cars are being shipped, the amount of freight revenue, or the size of the shipper. Instead, the crux of the issue has always been the benefits a shipper could

distribute) the reasonable and actual cost of the analysis and litigation." *Id.* at 7. In UP's opening comments, we endorsed a rule under which the losing party would pay all costs associated with discovery. *See* UP Op. at 45.

¹⁸⁰ *See* UP Op. at 32.

¹⁸¹ Moreover, if shippers are correct in their claim that railroads would obtain better results under Simplified-SAC than under SAC, then railroad efforts to transform Simplified-SAC cases into full SAC cases would also be self-defeating.

¹⁸² *See, e.g.,* ACC Op., Fauth VS at 5; Cargill Op. at 8 ("A good starting point is the annual freight spend of the shipper on the issue traffic."); Chevron Op. at 9 ("The most obvious starting point is the annual freight spend of the shipper on the issue traffic."); Dow Op. at 8 (same).

reasonably expect from a rate appeal compared with the probable cost of appealing those rates.”¹⁸³

At various points, shippers seem to acknowledge that eligibility standards must focus on the potential value of relief. They say that “any qualification or eligibility test must necessarily involve a comparison of” (i) the “case value,” *i.e.*, “any reparations sought and the present value of any future rate relief,” and (ii) the “SAC cost,” *i.e.*, “[t]he costs associated with preparing and presenting a Full-SAC case before the Board.”¹⁸⁴ That comparison is precisely what the Board accomplishes using MVC.

2. MVC Appropriately Considers “The Value Of The Case.”

Shippers argue that MVC does not correctly calculate the value of a case because it fails to account for the difference between the likely actual value and the maximum value of a case. They say that it is wrong to calculate the value of a case based on the difference between the challenged rate and the jurisdictional threshold when most rates would not be reduced to the jurisdictional threshold level.¹⁸⁵ As explained below, we disagree with the shippers, but we also disagree with the mechanism that is already in place to address their concerns, and we therefore propose an alternative that would better address their concerns and allow the Board to adopt strict eligibility standards, while remaining within the MVC framework.

Shipper complaints about the use of the jurisdictional threshold to calculate MVC are off the mark. The Board has proposed a reasonable approach for implementing Congress’s directive that eligibility for simplified treatment should be based on “the value of the case.” The

¹⁸³ USDA Op. at 5.

¹⁸⁴ ACC Op., Fauth VS at 62.

¹⁸⁵ *See, e.g.*, ACC Op. at 14-17 & Crowley VS at 30-35; AECC Op. at 4; NITL Op. at 9-10.

jurisdictional threshold provides a non-arbitrary yardstick to measure the value of the case. Any other fixed standard would be arbitrary because the actual value of a case cannot be determined until after the case has been litigated.

In addition, shipper claims that most challenged rates would not be reduced to the jurisdictional threshold level are both speculative and most likely wrong – at least with respect to rates challenged under Simplified-SAC. As discussed in our comments in *Major Issues*, we believe that a correct application of SAC to UP rates should not result in any rate reductions, much less reductions to the jurisdictional threshold level.¹⁸⁶ However, the Board’s application of SAC in past cases has reduced UP rates to the jurisdictional threshold, and the Board rejected our proposal to correct one of the most significant flaws in its application of SAC – the method for calculating cross-over revenues – in *Major Issues*.¹⁸⁷ Consequently, at least some shippers should be able to obtain comparable results in cases under Simplified-SAC.¹⁸⁸

Moreover, the Board’s proposal already addresses shipper concerns. The Board would allow shippers to rebut MVC-based eligibility presumptions “based on the likely actual (as opposed to maximum) value of the case.” *NPRM* at 34. However, neither UP nor shippers have embraced that alternative because disputes regarding eligibility would extend proceedings and increase the parties’ costs.¹⁸⁹

¹⁸⁶ See Opening Submission of Union Pacific Railroad Company at 18-19, *Major Issues in Rail Rate Cases*, STB Ex Parte No. 657 (Sub-No. 1) (May 1, 2006).

¹⁸⁷ See *Major Issues*, slip op. at 36-39.

¹⁸⁸ Contrary to shipper claims, complaints filed under the Benchmark method could also result in rate prescriptions at the 180% jurisdictional threshold if those complaints were filed against revenue-adequate carriers.

¹⁸⁹ See, e.g., UP Op. at 69; Dow Op. at 14-15; NGAF Op. at 26-27.

The Board should consider an alternative solution to the “likely” value problem that would address shipper concerns and still permit the application of strict eligibility standards. Under this alternative, the shipper could select an r/vc ratio above the 180 percent jurisdictional threshold that reflects its anticipated value of the case, and the shipper’s relief would be capped at the rate that would produce that r/vc ratio. For example, if a shipper believes the actual value of its case would be to reduce the challenged rate to a rate that would produce an r/vc ratio of 240 percent, MVC would be calculated using a 240 percent r/vc ratio, and any prescription could be no lower than a rate that would produce an r/vc ratio of 240 percent.¹⁹⁰ Such an approach would reduce the time and cost required to complete simplified cases by allowing the Board to enforce strict eligibility limits, and it would allow the MVC calculation to reflect the shipper’s valuation of rate relief.

B. The Board Should Not Increase The Eligibility Thresholds.

Shippers complain that the Board’s eligibility thresholds are too low, but they do not provide any valid justification for increasing the thresholds. In addition to complaints about MVC, which are addressed above, shippers contend that the eligibility thresholds are too low because the Board underestimated the costs of SAC and Simplified-SAC cases and failed to adjust the thresholds to reflect a “risk factor.” However, the Board has likely overestimated rather than underestimated the costs of SAC and Simplified-SAC cases, and it would be inappropriate to adjust the eligibility thresholds to reflect an arbitrary risk factor.

¹⁹⁰ This alternative approach would be consistent with the Board’s approach to the traffic volume component of MVC, which relies on the shipper to state the level of anticipated future traffic and then caps any rate prescription based on “the shipper’s representation of the annual tonnage at issue.” *NPRM* at 34.

1. The Board Has Overestimated, Not Underestimated, The Costs Of SAC And Simplified-SAC Cases.

Shippers argue that one reason why the Board's eligibility thresholds are too low is that the Board underestimated the cost of cases under SAC and Simplified-SAC. They claim that a full SAC case would cost a shipper at least \$4.0 million,¹⁹¹ a Simplified-SAC case would cost between \$1.75 and \$3.5 million,¹⁹² and a Benchmark case would cost between \$100,000 and \$400,000.¹⁹³

The Board should not credit shipper arguments that a full SAC case would cost a shipper at least \$4.0 million. The actual figure in future cases should be significantly lower than \$3.5 million. The Board established the \$3.5 million eligibility threshold based in large part on recent testimony from the same shippers that are now arguing that the costs will be much higher. *NPRM* at 36. Moreover, shippers are plainly incorrect when they assert that their costs in future full SAC proceedings will be substantially more than their costs in past proceedings as a result of the recent Board decision in *Major Issues*. Shippers assert that "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."¹⁹⁴ But none of the Board's decisions in *Major Issues* will increase a shipper's costs in a full SAC case. To the contrary, *Major Issues* will reduce the costs of SAC cases by resolving key issues that have consumed parties' resources in recent cases.

¹⁹¹ See ACC Op. at 7 & Crowley VS at 23.

¹⁹² See ACC Op. at 27 & Crowley VS at 24.

¹⁹³ See ACC Op. at 11 & Crowley VS at 14.

¹⁹⁴ ACC Op., Crowley VS at 23 n.42.

The Board also should not credit shippers' bloated estimates that a case under Simplified-SAC would cost between \$1.75 and \$3.5 million. As discussed above, shippers overestimate the costs of Simplified-SAC because they include the costs of analyses that would be performed by defendants or that would be unnecessary; they overestimate consultant costs; they incorrectly claim that railroads could and would artificially increase the costs of pursuing relief; they incorrectly assert that the Board's estimate was based on a less complicated method; and they fail to consider opportunities to reduce even further the low costs of Simplified-SAC.¹⁹⁵ The Board's estimated cost for Simplified-SAC is overstated, not understated.¹⁹⁶

2. The Eligibility Thresholds Should Not Reflect A Risk Factor.

Shippers and the USDA argue that the Board's eligibility thresholds are also too low because they give "no consideration to the need for recognition of litigation risk."¹⁹⁷ They assert that the Board must adjust the thresholds to reflect a shipper's odds of prevailing in any particular case.

There are at least three flaws in these arguments that the eligibility thresholds should reflect a risk factor.

First, the Board should reasonably expect shippers to bring cases only if they believe they will prevail. In fact, no shipper should bring a case that it does not expect to win. The only reason a shipper would bring a case that it did not expect to win would be to extract a

¹⁹⁵ See pp. 28-38, *supra*.

¹⁹⁶ Shipper-estimated costs for the Benchmark method are also drastically overstated, though we expect the costs would be similar to the costs for Simplified-SAC. See UP Op. at 49-51.

¹⁹⁷ ACC Op. at 18; see also USDA Op. at 5 ("The proposed calculation of the MVC, however, does not consider the probability of prevailing . . ."); NITL Op. at 10 ("[T]he Board must calculate a risk factor in its development of eligibility thresholds."); NGAF Op. at 36 ("The proposed rules are utterly unrealistic to the extent they fail to recognize the need for a 'risk premium.'").

favorable settlement by imposing litigation costs on the railroad – a concern identified in our opening comments.¹⁹⁸ The Board’s rules should not encourage such conduct.

Second, the Board would be engaging in inappropriate speculation if it were to assign a probability of success to small rate cases. Any such speculation would be baseless because there is nothing inherent in the proposed simplified methods that would allow either shippers or railroads to prevail in a predictable portion of cases. Each case would be determined based on the particular facts of that case. Establishing a risk factor based on the outcomes of past full SAC cases, as shippers suggest,¹⁹⁹ would be especially inappropriate and arbitrary because shippers have lost several recent SAC cases due to overreaching tactics that would not be permitted under Simplified-SAC or the Benchmark method.²⁰⁰

Third, increasing the eligibility thresholds by applying a risk factor would not actually address the issue of litigation risk. If shippers are reluctant to bring small rate cases because they are uncertain about whether they will prevail, the solution is not to increase the eligibility threshold, but instead to adopt methods that produce more predictable results. As discussed below, increasing the eligibility thresholds would merely allow shippers with larger rate cases to invoke cruder simplified standards – it would do nothing to make rate complaints more affordable or outcomes more predictable for shippers with small cases.

¹⁹⁸ See UP Op. at 44-45.

¹⁹⁹ See, e.g., ACC Op. at 18.

²⁰⁰ The arbitrary nature of a risk factor based on results of past full SAC cases is illustrated by the fact that shippers would have the Board presume that they would prevail in 33% of cases, while USDA would have the Board presume a 50% chance of success. Compare ACC Op. at 18-19 with USDA Op. at 5.

3. The Board Should Not Allow Shippers To Substitute Simplified-SAC For SAC.

The Board should not adopt the suggestion advanced by several parties that shippers should be allowed to use Simplified-SAC rather than SAC in any case they choose. Several shippers argue that Simplified-SAC would always produce less favorable results for shippers than the full SAC test, so “there is no risk that the rate will be below SAC.”²⁰¹ Similarly, USDA suggests that the Board should allow any shipper to use Simplified-SAC upon “demonstrating that the appealed rates involve numerous origins, destinations, and commodities.”²⁰²

We do not agree that Simplified-SAC would always produce less favorable results for a shipper than the full SAC test. As discussed above, shippers would be using construction costs that might be lower than the costs that would be calculated using SAC, they would be able to take advantage of economies of density associated with handling all of the defendant’s traffic on the issue route, and they would be able to take advantage of operating efficiencies that are enjoyed only by larger railroads.²⁰³

After the Board and parties have gained experience with Simplified-SAC, they may decide that Simplified-SAC or a similar approach would be an adequate substitute for SAC, but such a conclusion is premature. In any event, the Board could not adopt such a proposal in

²⁰¹ Cargill Op. at 5; *see also* AECC Op. at 6 (“The Board should permit shippers to utilize a reasonable variation of the Simplified-SAC procedure in larger cases.”); Chevron Op. at 6 (“There is no need to deny use of [Simplified-SAC] to any complainant, since there is no risk that the rate will be below SAC”); Dow Op. at 5 (“Since [Simplified-SAC] will never produce a rate lower than Full-SAC, the notion that one must qualify to use [Simplified-SAC] is inexplicable.”).

²⁰² USDA Op. at 9.

²⁰³ *See* pp. 16, 20, 23, *supra*.

this proceeding, which was not instituted to replace SAC, but to develop simplified standards for rate cases in which the value of the case does not warrant a full SAC presentation.

C. The Board Should Retain The Aggregation Rule.

Shippers complain about the Board's aggregation rule, which would prevent a shipper from disaggregating a case that should be judged under a more accurate standard into a series of claims that would be assessed under cruder standards. Shippers argue that the rule (i) would be unlawful because it makes eligibility for simplified standards turn on the value of a series of cases rather than "the value of the case,"²⁰⁴ and (ii) would be "likely to eliminate a huge amount of traffic from challenge."²⁰⁵ The rule, however, is a lawful effort to prevent abuse of simplified standards and would not reduce the scope of cases eligible for simplified treatment.

The Board explained its reason for proposing the aggregation rule in the *NPRM*: "Disaggregating claims that could and should be brought in a single complaint to manipulate the MVC calculation [sh]ould not be permitted." *NPRM* at 34. Shippers do not offer an alternative to the aggregation rule. Instead, they actually claim a right to manipulate the rate standard that would apply. They argue that the law "gives the shipper the right to choose the 'case' that he will bring" and that a "shipper should be able to decide whether it makes more sense to 'bundle' the challenge into one complaint . . . or to disaggregate his complaints into many smaller cases."²⁰⁶ However, the aggregation rule reasonably defines which claims should be considered a "case" when identifying "those cases in which a full stand-alone cost presentation is too costly,

²⁰⁴ See ACC Op. at 19-20; *see also* NGAF Op. at 23 (describing the aggregation rule as "unlawful"); NITL Op. at 11 ("[T]he Board's 'aggregation' rule unlawfully transforms a 'Small Case' category into a 'Small Shipper' category.").

²⁰⁵ ACC Op. at 20.

²⁰⁶ *Id.* at 21-22.

given the value of the case.” 49 U.S.C. § 10701(d)(3). The rule is reasonably designed to prevent shippers from undermining the Board’s efforts to ensure that simplified standards are “reserved for only those cases where CMP is not a realistic option.” *NPRM* at 11 (quoting *Simplified Guidelines*, 1 S.T.B. at 1021).

Moreover, as discussed in UP’s opening comments, without the aggregation rule, the Board’s simplified standard proposals would give shippers a source of unfair leverage in rate negotiations. Under the Board’s proposals, a shipper would be able to impose substantial, costly, and one-sided discovery burdens on railroads merely by filing a complaint.²⁰⁷ The aggregation rule is necessary to help ensure that shippers invoke simplified standards only when they believe that a rate actually reflects an abuse of market power, and not as a negotiating tactic. The rule would not reduce the scope of cases that would be eligible for simplified treatment – more than two-thirds of regulated rates would remain open to challenge under simplified standards – but it would appropriately encourage shippers to confine their complaints to meritorious cases.²⁰⁸

²⁰⁷ See UP Op. at 44-45.

²⁰⁸ Some shippers claim that the aggregation rule is flawed because a railroad would have free rein in pricing the shipper’s remaining traffic after the shipper brought enough claims to exceed the eligibility threshold. See, e.g., Dow Op. at 10-11; Chevron Op. at 12. However, shippers would not be precluded from bringing additional claims – they would just have to proceed under more accurate standards.

Moreover, shipper arguments against the aggregation rule presume that individual shippers would be filing multiple challenges against abusive rates. However, as discussed above, shippers provide no evidence that abusive rates are a widespread problem. Indeed, the evidence indicates that abusive rates are not a widespread problem. As discussed above, rates remain far below the levels that existed 25 years ago, and the amount of traffic moving at r/vc ratios over 180% has also declined. See pp. 6-7, *supra*.

In fact, in the past ten years, only two shippers have filed complaints under *Simplified Guidelines*. Shippers often assert that they have not filed cases because of uncertainties in the current guidelines, but those uncertainties did not deter the two companies that filed complaints. Indeed, it strains credulity for entities such as Cargill, Chevron Phillips, and Dow, which have revenues and earnings equivalent to or in excess of UP’s, to suggest that they have a substantial (continued...)

D. The Board Should Not Allow A Benchmark-Like Method To Govern Most Rate Cases.

When shipper criticisms of the eligibility criteria are combined with shipper criticisms of Simplified-SAC, the implication is that the Board should apply a variation of the Benchmark test to the majority of railroad traffic. Shippers urge the Board to consider basing eligibility on a shipper's "freight bill between a single origin-destination pair" and to "drastically revise upwards its eligibility thresholds for the Three-Benchmark Standard."²⁰⁹ They refer to a earlier filing in which shippers advocated an eligibility threshold of \$7.2 million.²¹⁰ However, if the Board were to adopt these proposals, a Benchmark-like test would become the predominant standard in rate reasonableness cases rather than a test of "last resort." *NPRM* at 11.²¹¹ The Board would be abandoning the principle that "CMP with its SAC test," should remain the "preferred method for assessing reasonableness of a challenged rate" that "'must be used whenever possible.'" *NPRM* at 11, 9 n.16 (quoting *Simplified Guidelines*, 1 S.T.B. at 1021).

Furthermore, if the Board were to adopt shipper proposals, it would be destroying the one tenuous connection it has identified that purportedly links results that would be produced

amount of traffic moving under abusive rates when they have not filed a single rate complaint in ten years.

The Board should not discard a reasonable and necessary rule based on unsubstantiated claims that abusive rates are a widespread problem.

²⁰⁹ ACC Op. at 5-6. Dow and Chevron Phillips say that the Board should raise the eligibility thresholds "significantly." See Dow Op. at 15; Chevron Op. at 14.

²¹⁰ ACC Op. at 5-6. USDA also suggests an approach based on a shipper's freight bill, but with a small case ceiling of \$1.6 million. See USDA Op. at 11. Both proposals are flawed not only because they would make most regulated traffic subject to the crudest rate reasonableness standard, but also because they are constructed using arbitrary risk factors and equally arbitrary measures of the value of the case. See ACC Op., App. C at 10 n.13 (describing the derivation of the \$7.2 million figure); USDA Op. at 6-7 (describing the derivation of the \$1.6 million figure).

²¹¹ See also *Simplified Guidelines*, 1 S.T.B. at 1021 ("Because of [its] roughness, however, the [Three-Benchmark method] must be used as sparingly as possible, reserved for only those cases where CMP is not a realistic option.").

by the Benchmark method and results that would be obtained using CMP. In the *NPRM*, the Board explained that “only a small percentage of a carrier’s traffic would likely be eligible to use the [Benchmark] approach,” and thus, “while [the Benchmark] approach would not replicate directly the results of a SAC analysis, it would import that constraint indirectly by comparing the challenged rate against rates for other potentially captive movements that are constrained by some form of the SAC test.” *Id.* at 28. In other words, if the Benchmark method has any connection to a meaningful rate constraint, that connection exists only so long as the method applies to “only a small percentage of a carrier’s traffic.” The Board thus could not expand eligibility for the Benchmark method without undermining its only link to CMP principles.²¹²

The Board should also recognize that the changes to the eligibility criteria being advocated by shippers would not make it any easier for shippers to bring truly small rate cases. Rather, they would allow shippers to bring larger cases under the crudest standards. In fact, shipper proposals for modifying the Benchmark method to expand the universe of traffic that their consultants could scrutinize to select potentially comparable traffic²¹³ and to allow shippers to submit case-specific evidence of unreasonableness²¹⁴ would increase rather than decrease the costs of litigating small cases. Increasing the size of cases that would be eligible for simplified

²¹² In addition, as discussed in UP’s opening comments, the Board could not place greater reliance on a Benchmark-like method without carefully assessing the impact of those standards on the ability of railroads to earn adequate revenues and its statutory obligation to assist rail carriers in attaining adequate revenues. *See* UP Op. at 69 & n.70 (citing *Simplified Guidelines*, 1 S.T.B. at 1008-09) (“[R]eliance on a cruder method would not significantly affect a carrier’s ability to earn adequate revenues, because only a very small portion of rail traffic could be subject to rate reasonableness review using such simplified procedures.”).

²¹³ *See* ACC Op. at 38 & Fauth VS at 56.

²¹⁴ *See* ACC Op. at 37.

treatment and increasing the costs of litigating those cases would do nothing to give shippers with truly small cases improved access to the Board.

The disconnect between shipper complaints and the changes they advocate is striking. For example, Cargill argues that the Board should increase the eligibility thresholds by pointing to five movements, three of which would qualify for the Benchmark method under the Board's proposal because they have MVCs below \$200,000.²¹⁵ Cargill states that it would not challenge the rates for the three movements. It explains that it "would not consider the benefits to outweigh the costs even on the movement with the highest RVC of 426%" because "the true value of that case would be much less than the MVC, rendering this a marginal case despite its extremely high R/VC."²¹⁶ However, Cargill never explains how increasing the eligibility thresholds would make any of the three cases more viable. Indeed, Cargill cannot do so because increasing the eligibility thresholds would make absolutely no difference.²¹⁷

Dow also argues that "the thresholds proposed by the Board are way too low."²¹⁸ However, Dow's filing also demonstrates the disconnect between complaints about the eligibility thresholds and shippers' ability to pursue small cases. In fact, Dow reveals a complete lack of interest in filing truly small rate cases. Dow testifies that for "a significant product category" – one that "represented over 30% of its total U.S. rail shipments" – approximately "79% of the

²¹⁵ See Cargill Op. at 12.

²¹⁶ *Id.* Cargill's statement is significant because it reflects a recognition that R/VCs might be reasonable even if they are in the range of 400%.

²¹⁷ Cargill also complains that Simplified-SAC would be ineffective for the other two movements, which have MVCs of \$1.015 million and \$1.407 million. See *id.* Cargill contends that the MVCs are "very close to what Cargill believes would be its actual litigation costs." *Id.* However, if Cargill's "belief" is incorrect and litigation costs are even close to the Board's estimate of \$200,000, both cases would be extremely viable under Simplified-SAC.

²¹⁸ Dow Op. at 9.

customer destinations received only 1-20 carloads over the course of the year.”²¹⁹ However, Dow says that it “would never contemplate filing a three-benchmark complaint for such a small portion of its total rail volume.”²²⁰ Increasing the eligibility thresholds would not change Dow’s view about the merits of pursuing those small cases.

We do not mean to single out Cargill and Dow – other shippers offer similarly revealing examples that emphasize that increasing the eligibility thresholds would not improve the lot of shippers who wish to pursue small cases.²²¹ The only way to make small cases more viable would be to reduce litigation costs, but neither Cargill nor Dow nor any other shipper offers a single proposal for reducing the costs of small rate cases.

VI. THE BOARD SHOULD REINFORCE THE HIGH STANDARDS THAT APPLY TO PETITIONS FOR PARTIAL REVOCATION OF EXEMPTIONS.

In UP’s opening comments, we disagreed with the Board’s proposed procedures for handling complaints that involve traffic subject to a class exemption. We proposed that the Board address the threshold issue of revocation before requiring defendants to incur the costs of defending the challenged rate.²²² We also urged the Board to reinforce the stringent standards that apply to revocation petitions.²²³ Other railroads made the same arguments.²²⁴ The U.S. Department of Transportation also stressed the importance of exemptions and adherence to

²¹⁹ *Id.* at 13.

²²⁰ *Id.*

²²¹ *See, e.g.,* Chevron Op. at 13-14; *see also* Comments of North Dakota Public Service Commission et al. at 9 (“[E]ven if rates were reduced to the 180% R/VC level, the potential relief would likely be insufficient to encourage any of the eligible shippers for the Three-Benchmark method to pursue a rate complaint . . .”).

²²² *See* UP Op. at 71-72.

²²³ *See id.* at 72-73.

²²⁴ *See* AAR Op. at 13-14; BNSF Op. at 12-16; CP Op. at 18-19; NS/CSX Op. at 15.

statutory standards, stating that it “would oppose any suggestion that these exemptions may be dispensed with on some other basis simply because they arise in the context of rate regulation.”²²⁵

Shippers support the Board’s proposal, but they mischaracterize the standard for evaluating revocation petitions. They assert that it makes sense to consider revocation and rate reasonableness at the same time because “the standards for market dominance under 49 U.S.C. 10701 are similar to the standards that would be required to show that an exemption should be revoked in the case of a specific complaint under 49 U.S.C. 10502(d).”²²⁶ However, as discussed in our opening comments, the standards that apply to petitions for revocation are more stringent and are substantively different as well, because they require the Board to consider additional factors, including the existence of product and geographic competition.²²⁷

Moreover, shipper arguments in favor of the Board’s proposal make clear that shippers are seeking protection from market conditions, not abuse of market power. Shippers argue that, even for exempt traffic, “resort to the Board’s processes is becoming increasingly necessary” because “rail capacity has tightened and the availability of transportation by other modes has declined because of tightening capacity in those modes as well.”²²⁸ In other words, shippers believe that regulation is needed because demand for transportation services is currently outpacing the supply of transportation capacity, and without regard to whether (i) multiple railroads could provide service, (ii) trucks and barges could transport the product, or (iii) rates

²²⁵ USDOT Op. at 2-3.

²²⁶ ACC Op. at 38-39.

²²⁷ See UP Op. at 72-73; see also BNSF Op. at 13-15.

²²⁸ ACC Op. at 38.

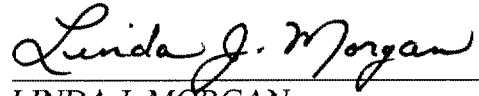
are constrained by the availability of the product in another geographic area or by the availability of substitute products. In short, shippers are complaining about high prices that result from the interplay of supply and demand in a working marketplace. But the ability to raise rates when demand exceeds supply is not a sign of market power over a commodity or market dominance over a particular movement – it is what one expects to see in a working market.

VII. CONCLUSION

We continue to believe that the Board should adopt Simplified-SAC, with the modifications we suggested in our opening comments, as the one and only simplified method for determining rate reasonableness for cases in which a full SAC presentation would be too costly given the value of the case. The comments of other railroads and shippers reinforce our strong initial objections to the Benchmark method, and shipper proposals to regulate the vast majority of rail rates under a Benchmark-like approach would make the problems that we have identified even worse.

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A handwritten signature in cursive script that reads "Linda J. Morgan". The signature is written in black ink and is positioned above a horizontal line.

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November 30, 2006

CERTIFICATE OF SERVICE

I, Michael L. Rosenthal, hereby certify that on this 30th day of November, 2006, I caused a copy of the Reply Submission of Union Pacific Railroad Company to be served by first-class mail or a more expeditious method of delivery upon all persons who have filed a notice of intent to participate in STB Ex Parte No. 646 (Sub-No. 1).

A handwritten signature in black ink, appearing to read "Michael L. Rosenthal", written over a horizontal line.

Michael L. Rosenthal