

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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Docket No. EP 715

RATE REGULATION REFORMS

OPENING COMMENTS OF UNION PACIFIC RAILROAD COMPANY

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Union Pacific Railroad Company (“UP”) is filing these comments to address the Board’s proposals in *Rate Regulation Reforms*, EP 715 (STB served July 25, 2012). In these comments, UP focuses on the Board’s proposals for restricting the use of cross-over traffic in rate disputes under the Full-SAC test and briefly addresses each of the Board’s other proposals.¹

Part I of UP’s comments addresses the Board’s proposals for restricting the use of cross-over traffic. UP supports the proposals, but it also encourages the Board to consider more far-reaching methods of reducing the distorting effect that cross-over traffic causes in Full-SAC cases. In Part II, UP supports the Board’s proposed modification of its Average Total Cost (“ATC”) method of allocating revenue from cross-over traffic. In Parts III through V, UP addresses the Board’s other proposals.

I. The Board should restrict the use of cross-over traffic in Full-SAC cases.

The Board never should have allowed the use of cross-over traffic in rate cases. Much of what is wrong with proceedings under today’s Full-SAC test – their length, cost, and complexity – can be traced back to that initial wrong turn. The use of cross-over traffic – that is, movements

¹ UP endorses the comments filed by the Association of American Railroads.

in a traffic group that would be routed over the stand-alone railroad (“SARR”) for only part of their trip from origin to destination – is fundamentally inconsistent with a test that is designed to simulate rates that would be charged by a hypothetical railroad that “stands alone.” As a result, when the test is applied in individual cases, it fails to accomplish its objective of determining whether the defendant railroad is charging a shipper more than it needs to earn a reasonable return on the replacement cost of the infrastructure used to serve that shipper.

Because the use of cross-over traffic is fundamentally inconsistent with the design of the stand-alone cost test, UP supports the Board’s proposals to limit the use of cross-over traffic in Full-SAC cases. However, UP strongly encourages the Board to undertake a more substantial reevaluation of the use of cross-over traffic. The Board has long considered the use of cross-over traffic to be a helpful shortcut, but that shortcut has led the Full-SAC test far off course. The Full-SAC test as currently applied says nothing about the reasonableness of the challenged rates; instead, the results depend on arbitrary allocations of revenue from cross-over traffic. Manipulation of cross-over traffic and revenue has become *the* critical issue in every case.

We reached this state of affairs through a series of choices. The Board should reconsider those choices now that it has seen their consequences. If the Board is unwilling to prohibit the use of cross-over traffic entirely, it should reexamine other alternatives for reducing cross-over traffic’s distorting effect on Full-SAC cases, including rules that would (i) preclude complainants from increasing the amount of cross-over traffic on their SARRs when they reroute issue or non-issue traffic, and (ii) allocate cross-over revenue using efficient component pricing principles (“ECP”).

A. The use of cross-over traffic biases outcomes in Full-SAC cases.

The basic problem with using cross-over traffic in the Full-SAC test is that there is no economically valid way to allocate cross-over revenue between the incumbent carrier and the

SARR, and even the use of a facially neutral allocation method can introduce bias when applied. As UP and other parties have discussed in prior proceedings, the Board's ATC method relies on arbitrary allocations of a defendant railroad's revenue to portions of through movements, which undermines any basis for placing confidence in the results of a Full-SAC test.² The allocations are necessarily arbitrary because there are no actual rates for portions of through movements and no observed demand for transportation over portions of through movements. Consequently, as the Board acknowledges, the only way to know whether use of ATC approximates the outcome of a true Full-SAC analysis would be to perform an analysis using a SARR that actually provides origin-to-destination service for the entire traffic group, but that would defeat the whole purpose of using cross-over traffic in the first place. *See Rate Regulation Reforms* at 6-7; *Major Issues in Rail Rate Cases*, EP 657 (Sub-No. 1), slip op. at 24 (STB served Oct. 30, 2006). Nonetheless, the Board adopted ATC because it refused to revisit its decisions permitting the use of cross-over traffic, and it mistakenly believed that ATC would produce results that were "unbiased." *Major Issues in Rail Rate Cases*, slip op. at 36 n.92.

What the Board failed to appreciate when it adopted ATC is that a method that appears unbiased in principle can be biased in practice. The Board believed that ATC's neutral principle of allocating revenue in relation to the average total costs of providing service over the parts of the network in question would not systematically favor either railroads or shippers. However, the Board overlooked shippers' ability to manipulate ATC's results through their selection of the cross-over traffic that moves over their SARRs. Shippers can and do manipulate ATC's results

² *See, e.g.*, Opening Submission of Union Pacific Railroad Company, Verified Statement of Kevin Neels at 3-4, *Major Issues in Rail Rate Cases*, EP 657 (Sub-No. 1) (May 1, 2006); Comments of BNSF Railway Company, Verified Statement of Joseph P. Kalt at 34-35, *Major Issues in Rail Rate Cases*, EP 657 (Sub-No. 1) (May 1, 2006).

by selecting for their SARRs only those movements that produce favorable divisions of SARR revenue, and they also manipulate ATC's results by extending their SARRs and rerouting issue traffic to tap into additional sources of cross-over revenue. This is precisely what shippers are doing when they describe the traffic selection process as an "iterative" process.³ The Board's reliance on ATC as an "unbiased" revenue allocation methodology is badly misplaced because shippers bias ATC's results by selecting the traffic to which ATC is applied.⁴

If the Board wants confirmation that the use of cross-over traffic has overwhelmed and undermined the Full-SAC test, it need look no further than its November 16, 2011, decision in *Arizona Electric Power Cooperative v. BNSF Railway*, NOR 42113 ("*AEPCO*").⁵ In *AEPCO*, cross-over traffic generated more than 90% of SARR revenue. The shipper did not achieve that result by following the unbiased approach of taking an ATC-based revenue division from all the traffic that shared facilities with the issue traffic. Instead, the shipper dramatically expanded the universe of potential cross-over traffic and available revenues by ignoring the defendant carriers'

³ See, e.g., Complainant Seminole Electric Cooperative, Inc.'s Unopposed Second Petition to Revise Procedural Schedule at 3, *Seminole Elec. Coop. v. CSX Transp., Inc.*, NOR 42110 (June 30, 2009) ("The process now required to develop a SAC analysis under the *Major Issues* procedures is more iterative than linear, as the identification of traffic that may be appropriate for inclusion in the traffic group must be followed by application of the ATC procedure ... to determine the revenues available to the SARR from such traffic and, thus, whether it is optimally efficient to include it."); Complainant Arizona Electric Power Cooperative, Inc.'s Second Unopposed Motion to Extend Procedural Schedule at 3, *Arizona Elec. Power Coop. v. BNSF Ry.*, NOR 42113 (Oct. 30, 2009) (explaining that, as a result of a dispute over production of pricing documents, complainant did not have "any time to complete the iterative process leading to the finalization of the SARR system and operating plan").

⁴ The Board's view of ATC as "unbiased" is more accurate in the context of the Simplified SAC test because a shipper must use the defendant's predominant route of movement and include all of the traffic that moves over that route in their analysis.

⁵ UP's petition for review of the *AEPCO* decision is pending in the U.S. Court of Appeals for the District of Columbia Circuit. In these comments, UP is not addressing whether the Board had a valid legal basis for its decisions affecting the use of cross-over traffic in *AEPCO*. Rather, in these comments, UP is urging the Board to re-evaluate its approach as a matter of policy.

interchange points and extending the SARR by rerouting issue traffic hundreds of miles beyond its real-world routes over corridors carrying large volumes of intermodal traffic. The shipper then selected traffic from that broader universe to take advantage of favorable revenue divisions created by ATC. By the time the shipper was done, its Full-SAC analysis implied that the defendants' rates should be *below their variable costs of handling the issue traffic*.⁶ In fact, the shipper's SARR, coupled with the Board's method of allocating cross-over revenue to the SARR, indicated that cross-over revenue alone was sufficient to cover the stand-alone cost of the proposed SARR – that is, *the defendants could have set the challenged rates at zero and the SARR still could have covered its stand-alone costs*. This result is enough to undermine any confidence in the Full-SAC test as a meaningful test of rate reasonableness, at least when the lion's share of SARR revenues are developed using ATC.

B. The Board's proposals address some of the bias created by the use of cross-over traffic, but they do not go far enough.

To the Board's credit, the two proposals in this proceeding for restricting the use of cross-over traffic appear to reflect concern with the result in *AEPCO*. Implementation of either limit would improve the status quo because each would restrict the use of cross-over traffic and thus reduce the potential for bias in the application of ATC. Moreover, both limits would help address the specific concern the Board identified, namely, ATC's over-allocation of revenue to SARRs that provide only "hook and haul" service to carload and multi-carload cross-over traffic. *Rate Regulation Reforms* at 16. Accordingly, if the Board goes no further in reexamining the use

⁶ In a remarkable example of understatement, even the shipper admitted that the result appeared "counterintuitive." Opening Evidence of Complainant Arizona Electric Power Cooperative, Inc. at III-H-14, *Arizona Elec. Power Coop. v. BNSF Ry.*, NOR 42113 (Jan. 25, 2010).

of cross-over traffic in Full-SAC cases, UP suggests a complainant should be allowed to choose which of the two limits would apply in its case, but that one or the other should apply.

However, UP encourages the Board to consider more substantial changes to its rules regarding the use of cross-over traffic in Full-SAC cases. As long as the outcomes of Full-SAC cases are determined by allocations of cross-over revenue using ATC, shippers will continue to exploit their control of the traffic selection process to bias the results. The underlying problem cannot be resolved by refining ATC because there is *no* method of accurately allocating through revenues to a specific portion of through movements. See *Major Issues in Rail Rate Cases*, slip op. at 24 (“Even if the Board knew the total replacement costs of the off-SARR segments used by cross-over movements, it would have no method for allocating a share of those investment costs only to the cross-over movements.”). As one scholar has explained, ATC is a method for approximating “something that doesn’t exist.”⁷ Moreover, even if ATC did provide an acceptable shortcut in some cases, no one would ever know whether it actually worked in any particular case without performing a true Full-SAC test. See *Rate Regulation Reforms* at 6-7; *Major Issues in Rail Rate Cases*, slip op. at 24. The Board has acknowledged that the use of cross-over traffic “introduces some imprecision into the SAC analysis.” *Pub. Serv. Co. of Colo. v. Burlington N. & Santa Fe Ry.*, NOR 42057, slip op. at 7 (STB served Jan. 19, 2005). But the full truth is that the Board has no idea how much “imprecision” the use of cross-over traffic introduces into the SAC analysis, and given the control shippers have over SARR design and traffic selection, it has no basis for believing the answer is anything but “a lot of imprecision.” The Board should not allow results of Full-SAC cases to be driven by ATC-based allocations of

⁷ Comments of BNSF Railway Company, Verified Statement of Joseph P. Kalt at 35, *Major Issues in Rail Rate Cases*, EP 657 (Sub-No. 1) (May 1, 2006).

cross-over revenue when it cannot have any confidence that the results say anything about the reasonableness of challenged rates.

UP suggests that the Board consider at least three methods of reducing the bias created by the use of cross-over traffic. First, it should consider prohibiting the use of cross-over traffic in Full-SAC cases. Second, it should consider imposing rules that limit shippers' ability to add cross-over traffic to their SARRs by rerouting issue and non-issue traffic. Third, it should consider replacing ATC with ECP as its method of allocating cross-over revenue.

1. The Board should consider prohibiting the use of cross-over traffic in Full-SAC cases.

The Board should reconsider its previous refusal even to reevaluate the use of cross-over traffic as a shortcut in Full-SAC cases. *See, e.g., Major Issues in Rail Rate Cases*, slip op. at 36. The Board has recognized that “[t]o achieve the benefits of simplification of the SAC analysis that cross-over traffic allows, we must find a reasonable way to allocate the revenues from that traffic.” *Id.* In *Major Issues in Rail Rate Cases*, the Board suggested ATC would provide that “reasonable way to allocate the revenues” and “ensure that the result” of a SAC analysis using cross-over traffic “closely aligns with what a larger, more cumbersome SAC analysis would show.” *Id.* However, experience has shown that the use of cross-over traffic and ATC are neither simplifying Full-SAC cases nor ensuring that results closely align with what an analysis without cross-over traffic would show.

The use of cross-over traffic has complicated rather than simplified the Full-SAC test. As discussed above, ATC is subject to manipulation because shippers control the SARR design and traffic selection process. Shippers now expend substantial time and energy to test multiple SARR design and traffic selection alternatives before they even begin to compile their evidence in Full-SAC cases; railroads must expend substantial time and energy to understand, evaluate,

and then address the implications of SARRs that do not reflect their real-world costs and revenues; and then the Board must expend substantial time and energy to evaluate the conflicting evidence and arguments. Each new case seems to raise new issues regarding the use of cross-over traffic, whether in the form of disputes about refining ATC, or enforcing limits on SARR design and re-routing of traffic, or applying tests for cross-subsidies.⁸ The use of cross-over traffic has given rise to a host of complexities that would not be presented if cross-over traffic were prohibited.

In addition, ATC provides no assurance that the results of a SAC analysis using cross-over traffic closely align with what an analysis without cross-over traffic would show. ATC uses a formulaic approach to revenue allocation, but shippers can and do bias the results by carefully selecting the cross-over traffic to include in their SARRs. The Board cannot genuinely have confidence that the result in a case in which the vast majority of SARR revenue comes from cross-over traffic “closely aligns with what a larger, more cumbersome SAC analysis would show.” *Major Issues in Rail Rate Cases*, slip op. at 36.

There is no reason shippers could not pursue Full-SAC cases without using cross-over traffic. The Interstate Commerce Commission did not contemplate the use of cross-over traffic when it adopted the SAC test in *Coal Rate Guidelines, Nationwide*, 1 I.C.C.2d 520 (1985). See *Major Issues in Rail Rate Cases*, slip op. at 31. The Board should consider the benefits of returning to basics, rather than continuing its efforts to “refine” ATC and other facets of the SAC test in a futile attempt to accommodate the use of cross-over traffic.

⁸ The most recent example is the issue of “Leapfrog trains,” that is, cross-over traffic the SARR would interchange with the residual defendant multiple times between the traffic’s origin and destination. See Norfolk Southern Railway Company’s Motion to Hold Case in Abeyance Pending Completion of Rulemaking at 7-11, *E.I. du Pont de Nemours & Co. v. Norfolk S. Ry.*, NOR 42125 (Aug. 6, 2012).

2. The Board should consider imposing new limits on rerouting of issue and non-issue traffic.

If the Board continues to allow shippers to use cross-over traffic in Full-SAC cases, it should consider imposing new limits on shippers' ability to increase the amount of cross-over revenue in SAC analyses by rerouting issue and non-issue traffic. Such new limits could help prevent the impact of arbitrary, biased revenue divisions from undermining the Full-SAC test.

In many recent Full-SAC cases, the Board has allowed shippers to increase the amount of cross-over revenue in their SAC analyses by positing SARRs that reroute issue traffic and (non-issue) cross-over traffic. *See, e.g., AEPCO, supra; AEP Tex. N. Co. v. BNSF Ry.*, STB Docket No. 41191 (Sub-No. 1) (STB served Sept. 10, 2007) ("*AEP Texas*"); *Duke Energy Corp. v. CSX Transp., Inc.*, 7 S.T.B. 402 (2004) ("*Duke/CSXT*"); *Carolina Power & Light Co. v. Norfolk S. Ry.*, 7 S.T.B. 235 (2003) ("*CP&L*"); *Texas Mun. Power Agency v. The Burlington N. & Santa Fe Ry.*, 6 S.T.B. 573 (2003) ("*TMPA*"). However, the more cross-over revenue is allowed into the Full-SAC test, the more opportunities shippers have to bias the results, and the less confidence the Board can have that the results align with what a true Full-SAC analysis would show.

With regard to rerouting of cross-over traffic, the Board has developed a test under which rerouting is allowed if the shipper can show "that the combined operations of the SARR and the residual carrier would be at least as efficient as the existing operations." *Duke/CSXT*, 7 S.T.B. at 418.⁹ The test adds another layer of complexity to Full-SAC cases, and, more importantly, it

⁹ However, the Board prohibits rerouting of cross-over traffic "that would not, under its customary routing, use any lines included in the SARR," unless the shipper provides "a compelling justification that the defendant carrier should itself be routing the traffic in this manner and that it is inefficient for it not to do so." *Id.*

provides shippers an additional opportunity to use cross-over traffic to bias the Full-SAC test.¹⁰

The Board should consider adopting a different rule: a shipper may not shift non-issue traffic from its actual route unless the SARR's operation would be at least as efficient as the existing operation *and the SARR would handle the traffic from origin to destination.*¹¹ In other words, the SARR could not handle the rerouted traffic as cross-over traffic. Under the new rule, a shipper would retain the flexibility in designing and locating the SARR and grouping traffic that was contemplated in *Coal Rate Guidelines*, but it could not use cross-over traffic as a shortcut.

The Board should consider adopting a similar rule for cases involving rerouting of issue traffic. The *AEPCO* case illustrates how shippers have been allowed to increase the impact of cross-over traffic by rerouting the issue traffic. In *AEPCO*, instead of rerouting non-issue traffic over lines used by the issue traffic, the shipper rerouted the issue traffic over lines used to move huge volumes of non-issue traffic. UP and BNSF Railway have challenged the Board's decision permitting the specific reroutes in that case, but regardless of the outcome of that challenge, the Board should consider adopting a rule requiring a shipper that reroutes the issue traffic to design its SARR to handle any non-issue traffic on the new route from origin-to-destination. In other words, the SARR could not handle any non-issue traffic on the new route as cross-over traffic. Like UP's proposed rule involving rerouted non-issue traffic, this rule for rerouted issue traffic would maintain a shipper's flexibility to make SARR design and traffic selection decisions, as contemplated by *Coal Rate Guidelines*, while reducing the bias and uncertainty introduced in Full-SAC cases when cross-over traffic is used as a shortcut.

¹⁰ Shippers have taken advantage of this test to increase the amount of cross-over traffic handled by the SARR in several recent cases, including *Duke/CSXT*, *CP&L*, *AEP Texas*, and *AEPCO*.

¹¹ UP recognizes that shifting of non-issue traffic may be allowed in certain circumstances because the SARR is not required to follow the defendant railroad's existing routes.

UP's proposals reflect a simple principle: the use of cross-over traffic is a shortcut that benefits shippers that bring Full-SAC cases. Shippers are not required to use cross-over traffic in their SAC analyses – they are free to posit a SARR that would handle the issue traffic and non-issue traffic from origin to destination. Because the use of cross-over traffic is a shortcut that benefits shippers, it is fair to impose limits on that shortcut, especially when its overuse undermines confidence in the results of the SAC analysis.

3. The Board should consider replacing ATC with ECP.

If the Board continues to allow shippers to use cross-over traffic in Full-SAC cases, it should also reconsider its refusal to adopt ECP as its method of allocating cross-over revenue. *See Major Issues in Rail Rate Cases*, slip op. at 36. Under ECP, the SARR would be allocated revenue equal to the incumbent's variable costs of providing service over the on-SARR portion of the cross-over movement. In *Major Issues in Rail Rate Cases*, the Board rejected ECP after concluding that ECP was not a sound method of determining how much cross-over revenue should be allocated to the SARR and that it was biased in favor of railroads. *See id.* at 36-39. Both criticisms reflect misunderstandings of ECP, and, more importantly, neither criticism of ECP provides a reason for preferring ATC over ECP.

With regard to the Board's first criticism of ECP, ECP's proponents never claimed ECP is superior to ATC because it is a more accurate method of allocating cross-over revenue to a SARR. As discussed above, there is *no* method of accurately allocating cross-over revenue to a SARR. *See page 7, supra* (citing *Major Issues in Rail Rate Cases*, slip op. at 24). Any choice between ATC and ECP must be made on a different basis.

With regard to the Board's second criticism of ECP, that criticism reflected a failure to recognize that bias is actually a much greater problem with ATC than with ECP. As discussed above, ATC is subject to manipulation by shippers because they control the SARR design and

traffic selection process. By contrast, ECP is not subject to manipulation by railroads. In fact, under ECP, shippers still decide how much cross-over traffic to include in their SARRs. The crucial difference between ECP and ATC is that ECP reduces a shipper's ability to bias SAC results through the use of cross-over traffic and arbitrary revenue allocations. ECP helps reduce bias because it allocates to the SARR the incumbent's avoided costs of handling that traffic, but not an arbitrary share of the incumbent's contribution from that traffic. The SARR would not lose money by handling cross-over traffic (unless it proposed operations less efficient than the incumbent's operations), and it would earn some contribution if it is more efficient than the incumbent, but it could not earn excessive contribution by exploiting the arbitrary nature of ATC. In *Major Issues in Rail Rate Cases*, the Board suggested that ECP creates a bias in favor of railroads because it does not allocate any of the incumbent's contribution to the SARR, but ECP does not prevent shippers from capturing the incumbent's full contribution: a shipper can capture the incumbent's full contribution by designing the SARR to handle the movement from origin to destination. By contrast, a railroad that believes ATC is providing a shipper with too much contribution for a particular cross-over movement cannot require the shipper to design its SARR to handle the movement from origin to destination. In short, ECP contains a built-in mechanism to protect against bias favoring railroads, while ATC lacks a similar mechanism to protect against bias favoring shippers.

UP believes ECP is a more theoretically sound basis for allocating revenue from cross-over traffic than ATC because ECP is consistent with contestable market principles,¹² but as a

¹² See Opening Submission of Union Pacific Railroad Company, Verified Statement of Kevin Neels at 16-17, *Major Issues in Rail Rate Cases*, EP 657 (Sub-No. 1) (May 1, 2006); Comments of BNSF Railway Company, Verified Statement of Joseph P. Kalt at 37-46, *Major Issues in Rail Rate Cases*, EP 657 (Sub-No. 1) (May 1, 2006); Rebuttal Submission of Union Pacific Railroad (continued...)

practical matter, ECP has at least two clear advantages over ATC: (1) ECP focuses the SAC analysis on the economics of the issue traffic because the issue traffic's revenues play a larger role in the analysis than revenues from cross-over traffic, and (2) ECP is less susceptible to manipulation and bias for the reasons already described. These advantages would translate into greater confidence in the integrity of the SAC analysis.

C. The Board should apply its proposals for restricting the use of cross-over traffic to pending cases.

If the Board concludes that its proposals for restricting the use of cross-over traffic improve the fairness and accuracy of the SAC analysis, it should apply its proposals to pending cases. When the Board previously undertook a similar reform effort, it held pending cases in abeyance so it could apply the new rules to those cases. *See Major Issues in Rail Rate Cases*, slip op. at 2 (STB served Feb. 27, 2006). While the Board recognized that its approach might delay those cases, the Board explained that it had to “balance the concern for expedition against the public interest in ensuring that both the SAC test and the jurisdictional floor for rate relief are applied fairly and in conformity with our statutory responsibilities.” *Major Issues in Rail Rate Cases*, slip op. at 4 (STB served April 14, 2006). The test should be no different here, and, particularly when a pending proceeding is in an early stage, concern for expedition should give way to the public interest in a fair and reliable SAC analysis.

Applying any new restrictions on the use of cross-over traffic to pending cases would be consistent with federal administrative law and with Board precedent. A new rule may apply to parties in pending cases “so long as [the parties] are given notice and an opportunity to offer

Company, Rebuttal Verified Statement of Kevin Neels at 4-10, *Major Issues in Rail Rate Cases*, EP 657 (Sub-No. 1) (June 30, 2006); Rebuttal Comments of BNSF Railway Company, Rebuttal Verified Statement of Joseph P. Kalt at 23-28, *Major Issues in Rail Rate Cases*, EP 657 (Sub-No. 1) (June 30, 2006).

evidence bearing on the new standard, and . . . have not detrimentally relied on the established legal regime.” *BNSF Ry. v. STB*, 526 F.3d 770, 784 (D.C. Cir. 2008) (citing *Consol. Edison Co. v. FERC*, 315 F.3d 316, 323 (D.C. Cir. 2003)).

The Board has provided parties to pending cases with notice of the new rules by instituting this rulemaking and permitting parties to comment on their scope and application. Like when the Board implemented the changes in *Major Issues in Rail Rate Cases*, providing parties in pending cases with “an opportunity to introduce evidence bearing on the new” rule, *Hatch v. FERC*, 654 F.2d 825, 835 (D.C. Cir. 1981), is a straightforward step – particularly in proceedings that are still at an early stage.

Moreover, applying new restrictions on the use of cross-over traffic to pending cases would not upset any legitimate reliance interest of the parties in pending proceedings. In its Notice of Proposed Rulemaking, the Board assumed that it would be “unfair” to complainants to apply the limitations to pending cases because complainants had “relied” on the old rules so far in their litigation. *Rate Regulation Reforms*, slip op. at 17 n.11. However, in one pending case, *Intermountain Power Agency v. Union Pacific Railroad*, NOR 42136, UP had not even provided the complainant with the data required to begin selecting traffic for its SARR when the Board issued its Notice of Proposed Rulemaking. Shortly after the Board announced the rulemaking, UP asked the Board to hold the case in abeyance.¹³ Under the circumstances in that case, Intermountain Power Agency has no legitimate reliance interest in the old rules.

Even in cases that have been pending for much longer, the Board’s assumption does not reflect notions of detrimental reliance, as courts apply that concept in determining whether an

¹³ See Motion to Hold Proceeding in Abeyance, *Intermountain Power Agency v. Union Pac. R.R.*, NOR 42136 (Aug. 14, 2012).

agency may apply a new rule to pending cases. Detrimental reliance would prevent application of a new rule only if the new rule were “an abrupt departure from well-established practice.” *Retail, Wholesale & Dep’t Store Union v. NLRB*, 466 F.2d 380, 390 (DC Cir. 1972); *see also Clark-Cowlitz Joint Operating Agency v. FERC*, 826 F.2d 1074, 1082 (DC Cir. 1987) (noting that in evaluating a party’s detrimental reliance interest, the court is required “to gauge the unexpectedness of a rule”). Parties to ongoing Board proceedings have been well aware that restrictions on the use of cross-over traffic have been in flux for years and new restrictions could have been applied in their individual cases. *See Rate Regulation Reforms*, slip op. at 16, n.10; *Major Issues in Rail Rate Cases*, slip op. at 75 (STB served Oct. 27, 2007). The Board’s proposals do not constitute an “abrupt departure from well-established practice.”

Consistent with its past practice and principles of administrative law, the Board should apply new restrictions on the use of cross-over traffic to pending cases, if it concludes that its proposals are in the public interest and would improve the reliability of the SAC analysis.

II. The Board should modify the ATC method.

UP supports the Board’s proposed modification to its ATC method of allocating revenue from cross-over traffic, assuming the Board continues to allow the use of cross-over traffic and to apply some variation on its ATC method of allocating cross-over revenue.

UP believes the Board should eliminate the need for ATC, or at least replace ATC with a revenue allocation that is not subject to bias or manipulation by shippers. But if one starts with ATC’s basic logic that allocations of cross-over revenue should reflect the economies of density, the Board’s proposal seems preferable to the “modified ATC” approach the Board applied in *Western Fuels Association v. BNSF Railway*, NOR 42088 (STB served Sept. 10, 2007). As the Board acknowledges in *Rate Regulation Reforms*, its “modified ATC” approach did not give nearly the same weight to economies of density as did its original ATC approach. *See Rate*

Regulation Reforms at 8. If the Board's objective in modifying ATC was to account for the limited "problem" that the Board identified in *Western Fuels* – i.e., that some cross-over movements might be assigned revenues amounting to less than 100% of their variable costs for the on-SARR portion – the Board's "modified ATC" was an over-correction. The Board's current proposal is a more measured response to the limited "problem" identified in *Western Fuels*.¹⁴

III. The Board should not modify the limits for relief under Simplified-SAC.

UP opposes the Board's proposal to remove all limits for relief in Simplified-SAC cases. The proposal assumes that if the Board also removes the simplification of the Road Property Investment ("RPI") component of the Simplified-SAC test, railroads would always prefer to defend against a Simplified-SAC case rather than a Full-SAC case. That is not the case. If a shipper is going to pursue large claims for relief, it should pursue those claims under the Full-SAC test, not some less-accurate, simplified approach.

UP is also concerned that removing the limits for relief in Simplified-SAC cases will lead to gamesmanship on the part of shippers. The Simplified-SAC rules require the railroad defendant to perform a large portion of the work necessary to prepare the shipper's case. *See Simplified Standards for Rail Rate Cases*, EP 646 (Sub-No. 1), slip op. at 25-26 (STB served Sept. 5, 2007). Under the Board's proposal, shippers that plan to pursue large claims for relief

¹⁴ UP does not necessarily agree that the result in *Western Fuels* suggested a problem with "original ATC." If ATC's purpose is to allocate revenues to SARR line segments in some relation to the cost of the services the SARR provides over those segments, as the Board has suggested in its proposals to restrict the use of cross-over traffic, it would not be surprising if, in some cases, the SARR would be entitled to revenues that amounted to something less than the defendant's variable costs of operating over SARR segments as measured by the defendant's system-average URCS costs. Moreover, even in such instances, a SARR can receive some contribution from that cross-over traffic if it is more efficient than the defendant.

could obtain a free evaluation of the most complex parts of their case largely at the railroad's cost by invoking the Simplified-SAC rules, and then they could use the information to decide whether to pursue a Full-SAC case.

The Board acknowledged and attempted to address a similar gamesmanship problem when it adopted Simplified-SAC. At that time, the Board addressed railroads' concerns about disproportionate discovery and disclosure burdens by establishing a meaningful filing fee for Simplified-SAC cases. *See id.* at 68, 70 (filing fee of \$10,600). More recently, however, the Board reduced the filing fee to \$350. *Regulations Governing Fees for Services*, EP 542 (Sub-No. 18) (STB served July 7, 2011). Before the Board considers altering the limits for relief in Simplified-SAC cases, it should adopt rules to prevent shippers from gaming the discovery and disclosure process. Among the possibilities the Board should consider are increased filing fees, rules under which the loser would pay the defendant railroad's discovery and disclosure costs, and rules that preclude shippers from withdrawing Simplified-SAC claims after discovery and filing Full-SAC complaints on the same movements.

IV. The Board should not modify the limits for relief under the Three-Benchmark test.

Because the Board's proposal to raise the limits for relief under the Three-Benchmark test is predicated on the Board's plan to change the Simplified-SAC test in ways that UP opposes, UP also opposes the Board's proposed change to the Three-Benchmark test.

V. The Board should not modify the interest rate on overcharges.

UP opposes the Board's proposal to change the standard used to calculate interest owed to shippers in rate reasonableness cases. UP strongly disagrees with the Board's premise that the interest rate on overcharges should be used as a tool to punish railroads for setting rates that are later found to be unreasonable. *See Rate Regulation Reforms* at 18 (suggesting that the interest rate should be set at a level that "encourages compliance with our rules"). If it were easy to

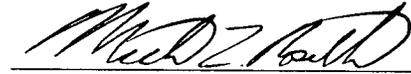
determine whether rates were unreasonable, the Full-SAC test would not be so complex.¹⁵ In addition, the Full-SAC test has been in a constant state of flux since the time it was adopted, which makes results even more difficult to predict. The *Western Fuels* case provides a stark example of how changing rules can dramatically influence the outcome in a case. An interest rate designed to penalize railroads for setting rates too high when the standards are so uncertain would be grossly unfair and would have a chilling effect on market-based rate setting, a result that would be contrary to the rail transportation policy. *See, e.g.*, 49 U.S.C. § 10101(1) (policy “to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail”); *id.* § 10101(3) (policy “to promote a safe and efficient rail transportation system by allowing rail carriers to earn adequate revenues”).

The Board’s current rules appropriately use the T-Bill rate to calculate interest on overcharges. The interest rate on overcharges should reflect the rate of return the shipper lost because it did not have the funds available. However, a proxy for that figure is required because it would be impractical to determine the appropriate rate of return on a shipper-by-shipper basis. The T-Bill rate is an appropriate proxy. The T-Bill rate reflects the level of return that a shipper could obtain from a risk-free investment. Interest on a reparation award is equivalent to a risk-free investment for the shipper because the Board would order the railroad to pay the shipper interest at the specified rate on any overcharges. Accordingly, the Board should not change its method for calculating interest on overcharges.

¹⁵ For example, Intermountain Power Agency (“IPA”) apparently believes that it can construct a SARR that will show that a UP rate from Provo, Utah, to IPA’s generating plant is unreasonable, even though IPA failed in its attempt to show that the same rate was unreasonable when the rate was tested using a SARR designed to challenge rates from two additional origin points. If IPA prevails in its second challenge, it would show only that, under the Full-SAC test, as currently applied, the “reasonableness” depends more on a shipper’s creativity in manipulating the Full-SAC test than on the actual level of the rate.

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CERTIFICATE OF SERVICE

I hereby certify that on this 23rd day of October, 2012, I caused a copy of the Opening Comments of Union Pacific Railroad Company to be served by first-class mail, postage prepaid, on all parties of record in this proceeding.



Michael L. Rosenthal