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BEFORE THE
SURFACE TRANSPORTATION BOARD

Docket No. EP 715

RATE REGULATION REFORMS

JOINT REPLY COMMENTS OF CSX TRANSPORTATION, INC. AND NORFOLK SOUTHERN RAILWAY COMPANY

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CSX Transportation, Inc. ("CSXT") and Norfolk Southern Railway Company ("NS") respectfully submit these Reply Comments in the above-captioned proceeding.

I. THE BOARD SHOULD BE GUIDED BY CORE PRINCIPLES.

In evaluating rule changes proposed in this proceeding and comments and proposals of the parties, the Board should be guided by the core principles of fidelity to the statute, sound economics, and the Board's charge to ensure that rail rates are reasonable given all relevant factors—not to insure against rates that are "too high" in the subjective, self-interested view of a particular person or entity. Below, CSXT and NS (sometimes referred to hereinafter collectively as "CSXT/NS") summarize these important core principles. Subsequent sections apply those principles to the Board's proposals and comments submitted regarding those proposals.

A. The First Guiding Principle Should Be Fidelity To Governing Statutes And To Their Animating Policies.

1. The Board Has Authority and Responsibility to Regulate Certain Rail Rates

As an administrative agency, the Board's primary duty is to execute and implement faithfully the statutes and policies Congress has charged it with implementing. Congress has charged the Board with ensuring that any challenged rail rate within the Board's jurisdiction (*i.e.*

rates applying to non-exempt transportation over which the railroad is market dominant), is "reasonable." *See* 49 U.S.C. §§ 10501(b), 10701(d), 10704(a). Carriers have the rate-setting initiative, however, and the rate established by a carrier is presumed to be reasonable unless and until the Board determines otherwise. *See* 49 U.S.C. §§ 10701(c), 10702, 10704. Only when the Board determines, after a full hearing, that a rate charged or collected by a carrier exceeds a maximum reasonable level, may it prescribe a maximum rate. 49 U.S.C. § 10704(a).

Based on these statutory responsibilities, the Board and its predecessor have painstakingly developed a rate regulatory regime to provide standards and methods to evaluate challenged rail rates, most prominently including the Constrained Market Pricing ("CMP") framework first established in *Coal Rate Guidelines—Nationwide,* 1 I.C.C.2d 520 (1985) ("*Coal Rate Guidelines*"). As the ICC, the Board, and the Courts have repeatedly affirmed, CMP—and the Stand-Alone Cost constraint in particular—is the best, most economically rational, and most accurate methodology for evaluating the reasonableness of common carrier rail rates. *See, e.g., Burlington Northern R.R. Co. v. Interstate Commerce Comm'n*, 985 F.2d 589, 596 (D.C. Cir. 1993) ("CMP, with its SAC constraint is the 'preferred and most accurate procedure available for determining the reasonableness' of rates in markets where the rail carrier enjoys market dominance.") (quoting ICC in *McCarty Farms v. Burlington Northern, Inc.*, 3 I.C.C. 2d 822 (1987)); *Simplified Standards for Rail Rate Cases*, STB Ex Parte No. 646 (Sub-No. 1), Decision at 13 (served Sept. 5, 2007) ("*Simplified Standards*") ("CMP, with its SAC constraint is the most accurate procedure available for determining the reasonableness of rail rates where there is an absence of effective competition.").

2. The Board Has Limited Authority To Adopt A Simplified Methodology Where A Stand Alone Cost Presentation Is Too Expensive Given The Value Of The Case.

In the ICC Termination Act, Congress directed the Board to establish a simplified method for evaluating the reasonableness of rail rates in those cases in which a SAC presentation would be too costly in comparison to the value of the case. The governing statutory provision states, in relevant part:

> The Board shall . . . establish a simplified and expedited method for determining the reasonableness of challenged rail rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case.

49 U.S.C. § 10701(d)(3). As CSXT and NS demonstrated in their Opening Comments, the foregoing statutory directive makes clear that application of any rate reasonableness method other than a full-SAC analysis must be guided by three factors: (1) the cost of presenting a SAC case; (2) the value of the case to which the simplified method would be applied; and (3) the relationship between factors (1) and (2). *See* Opening Comments of CSXT/NS at 2-5 ("CSXT/NS"). Another important principle that the Board has long recognized is that, to the fullest extent consistent with the mandate of Section 10701(d)(3), CMP—generally meaning SAC—should be used wherever possible. *See Simplified Standards* at 13, n.17 ("CMP provides the only economically precise measure of rate reasonableness and therefore must be used wherever possible.") (quoting *Rate Guidelines—Non-Coal Proceedings*, 1 S.T.B. 1004 (1996) ("*Simplified Guidelines*")).

In accordance with the statutory command, any simplified method should be available only in those limited instances "in which a full stand-alone cost presentation is too costly, given the value of the case." *See* 49 U.S.C. § 10701(d)(3). Thus, the Board may apply a simplified, less accurate, and less economically rigorous approach only in cases whose value is sufficiently low that a SAC presentation is too costly. When the D.C. Circuit reviewed *Simplified Standards,* it concurred with this reading of the statutory limits, stating that the statute "clearly contemplates a method that may substitute for a full SAC proceeding in *low value cases.*" *CSX Transp., Inc. v. Surface Transp. Bd.,* 568 F.3d 236, 242 (D.C. Cir. 2009) (emphasis added), *vacated on other grounds,* 584 F.3d 1076.[1]

3. The Complainant Has The Burden Of Proof On All Rate Reasonableness Issues.

A rate case complainant—as the party seeking relief—has the burden of proving that a challenged rate is unreasonable. *See, e.g., Duke Energy Corp. v. Norfolk Southern Ry. Co.*, 7 S.T.B. 89, 100 (2003) ("[T]he party with the burden of proof—*i.e.*, the shipper on SAC issues—must present its full case-in-chief in its opening evidence."); *Coal Rate Guidelines,* 1 I.C.C.2d at 547; *Minnesota Power Inc. v. DMIR,* STB Docket No. 42038, Decision at 7, (served March 6, 2000) ("a complainant bears the burden of proof") 49 U.S.C. § 10701; 5 U.S.C. § 556(d); *see also* CSXT/NS at 7-8. Allocation of burden of proof to the complainant is the same regardless of whether the selected methodology is SAC, SSAC, or Three-Benchmark. *See, e.g., E.I. DuPont de Nemours & Co. v. CSX Transp. Inc.*, STB Docket No. 42100, Decision at 2 (served June 30, 2008) (*citing Government of the Territory of Guam v. Sea-Land Serv. Inc., et al.*, STB Docket No. WCC-101, Decision at 6 (served Feb. 2, 2007)).

The Board may not shift the evidentiary burden of proof to the defendant, or force the defendant to present evidence to satisfy the complainant's burden.

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[1] As explained in CSXT/NS Opening Comments, the Board's proposal to eliminate the limit on relief in SSAC cases would violate the statute's limitation of simplified methods to cases in which a full SAC presentation is too costly given the value of the case. *See, e.g.,* CSXT/NS at 1-13.

4. Rail Transportation Policy Goals.

In the Interstate Commerce Act, Congress established national policies to govern the regulation of the railroad industry, including the Rail Transportation Policy ("RTP"). *See* 49 U.S.C. § 10101. One of the important underlying policies is:

> (2) To minimize the need for federal regulatory control over the rail transportation system and to require fair and expeditious regulatory decisions when regulation is required.

49 U.S.C. § 10101(2). The Board's rate regulation policies should result is the need for less federal regulatory control rather than more. Rules and regulations that create unfair negotiating leverage and asymmetric burdens and that offer one party or another free peek at a rate analysis undermine this policy goal. Moreover, the more that parties' expectations about the rate regulatory regime are settled, the fewer rate challenges there should be. Settled expectations about the regulatory regime promote the goal of the RTP because clarity in the regulatory limits promotes negotiated contracts and minimizes the need for federal regulatory control.

B. The Second Guiding Principle Should Be Commitment To Sound Economics.

1. Rail Rate Regulations Must Be Based On Sound Economics.

The experience of the agency has been that attempts to regulate rates that are not based on sound economics, rationally explained and supported, have failed. In *Burlington Northern R.R. Co. v. Interstate Commerce Comm'n*, the defendant railroad argued that the Commission had erred in applying an R/VC-based comparison methodology instead of CMP to adjudicate a rate complaint. 985 F.2d at 595. The R/VC methodology in question deemed a rate reasonable if "its mark-up over variable cost is no greater than the mark-up on 'benchmark' traffic selected as suitable for comparison." *Id.* at 596. The Commission rationalized this approach as somehow achieving "something close to the economic rationality of CMP/SAC analysis while reducing the amount of information needed (and thus the cost of the calculation)." *Id.* The reviewing Court found that the ICC's approach and explanation lacked "supporting principle or intellectual coherence" and the agency "had not intelligibly explained why the trade-off chosen was reasonable." *Id.* at 597. Concluding that "the jettisoning of SAC/CMP cannot pass for reasoned decision making," the Court remanded the case to the ICC. *Id.* at 599.

The agency experienced similar setbacks in other attempts to create rate reasonableness tests that did not comport with sound and rational economics. For example, in *City Pub. Serv. Bd.* ex rel. *San Antonio v. United States*, 631 F.2d 831, 850 (D.C. Cir. 1980), the Court reviewed the ICC's orders prescribing maximum reasonable rates for certain shipments. The ICC had created a rule that a seven percent additive above a carrier's fully allocated costs could be included in a rail rate in order to support a carrier's effort to attain revenue adequacy. But as the Court explained in rejecting the methodology, the ICC "provide[d] no defensible rationale for the inclusion of the seven percent increment." *Id.* at 851. The Court admonished that the agency was obliged to "provide adequate justification for its choice of a particular increment above fully allocated costs." *Id.* at 852.[2]

The ICC also was forced to withdraw other alternative rate regulations when parties pointed out flaws in those non-SAC methodologies. For example, the ICC originally proposed the "ton-mile method" as a maximum rate reasonableness methodology. *Coal Rate Guidelines*, 1 I.C.C.2d at 522. Under the ton-mile method, a "carrier's constant costs would be assigned to particular traffic based upon the tonnage and ton-miles involved." *Id.* at 523. A carrier would then be able to attribute the "fully allocated cost" to that traffic and charge it to the shipper. *Id.*

[2] In *Potomac Elec. Power Co. v. United States*, 584 F.2d 1058 (D.C. Cir. 1978), the Court remanded an ICC rate reasonableness order. The Court explained that it was remanding the case because it was "unable to discern the reasons for certain Commission actions or the policies being pursued." *Id.* at 1064. The Court could not determine why the Commission failed to find unit-train rates unreasonable where, in the same decision, it found that certain trainload rates were unreasonable, and did not compare the two types of rates. *Id.* at 1065.

at 522. The methodology was challenged before the Third Circuit. During the pendency of the appeal, the ICC belatedly determined that the methodology would yield maximum rates that would not adequately reflect demand or contribute adequate revenues. *Id.* at 523, n.7. Given these economic failings, the ICC requested a remand, withdrew the methodology, and began its rulemaking anew. *See id.*

Ultimately, the only rail rate reasonableness methodology that rests on sound economics is CMP and its SAC constraint. *See, e.g., Simplified Standards* at 13 ("The SAC test, which judges the reasonableness of a challenged rate by comparison to the rate that would prevail in a competitive market, rests on a sound economic foundation and has been affirmed by the courts. . . . Any simplified methodology for assessing the reasonableness of rail rates should be designed to achieve the same objective, *albeit in a less precise manner*.") (emphasis added). Properly implemented, SAC is the agency's rate regulation gold standard and lodestar. *See McCarty Farms, et al. v. Burlington Northern Inc.*, 3 I.C.C.2d 822, 840 (1987) (The SAC constraint is the "preferred and most accurate procedure available for determining the reasonableness" of rates.); *Simplified Standards* at 5 (SAC alternatives do not offer "as much precision and degree of confidence as a Full-SAC analysis."). Given the history of failed efforts to develop and apply non-CMP rate reasonableness methods, the Board should proceed with caution when considering proposals to create or expand non-SAC rate reasonableness tests. History teaches that such care is particularly important where, as here, proponents offer no solid economic basis or justification for the proposed changes.

2. Demand-Based Differential Pricing Is Essential For Railroads' Economic Success And Reinvestment.

As the ICC and the Board have recognized since at least the early 1980s, demand-based differential pricing is essential to allow modern railroads an opportunity to earn an adequate return and attract capital. *See, e.g., Coal Rate Guidelines,* 1 I.C.C.2d at 526 (summarizing prior decisions in which ICC had determined that "the cost structure of the railroad industry necessitates differential pricing of rail services"). The theoretically correct way for rail carriers to recover their "unattributable costs" is through Ramsey pricing, whereby a rail carrier would set rates in inverse relation to each customer's elasticity of demand. *See id.* As a practical matter, pure Ramsey pricing would be extremely difficult to implement in the rail industry. *Id.* As a proxy for Ramsey pricing, the Board and its predecessor established a "Constrained Market Pricing" ("CMP") regulatory framework and rate reasonableness test. *Id.* Based on CMP and Ramsey pricing theory, it is now a well-established principle of rail economics and policy that rail carriers should set prices in accordance with observed market demand and elasticity of demand. *See id.* at 527. This means that solely served shippers who often have lower elasticity of demand—and derive the greatest benefit from rail service—must pay more than otherwise similar shippers with more alternative transportation options. As a matter of policy, carriers are expected to engage in such differential pricing because it is essential to allow them to earn adequate revenues and attract necessary capital. *See, e.g., id.* at 521, 526-28; 49 U.S.C. §§ 10101(3), 10704(a)(2). These principles are not only well-established economic doctrine, they form the very foundation of American rail rate regulation and the Constrained Market Pricing framework. *See generally, Coal Rate Guidelines,* 1 I.C.C.2d 520.

3. The Board Must Maintain a Direct Relationship Between the Value of the Case and the Rigor of the Applicable Rate Reasonableness Test.

The Board and courts have recognized there should be a direct relationship between the value of a particular rate case and the rigor of the applicable rate reasonableness test. As a general rule, the more revenue that is at stake in an individual case, the closer the results in that case must be to results that would be generated by a full stand-alone cost analysis. Accordingly, less robust, "simplified" tests should be limited to low-value cases. *See, e.g.*, *Simplified Standards* at 27 ("[A]n overly simplified approach should not be applied to a case when the amount in dispute justifies the use of a more robust and precise approach."); *CSX Transp., Inc. v. Surface Transp. Bd.*, 568 F.3d at 242 (finding that Section 10701(d)(3) "clearly contemplates a method that may substitute for a full SAC proceeding in low-value cases"). Rough, crude, and imprecise measures, such as Three-Benchmark, should be confined to the lowest value cases. *See, e.g.*, *Simplified Standards* at 16 (restricting the Three-Benchmark method to those "shippers who have smaller disputes with a carrier, [for whom] even this Simplified-SAC method would be too expensive, given the smaller value of their cases").

The Board has consistently recognized that full SAC, the only method that simulates a competitive price in a contestable market, is "the most accurate procedure available for determining the reasonableness of rail rates." *Simplified Standards* at 13. It has further emphasized that SAC "provides the only economically precise measure of rate reasonableness and therefore *must be used wherever possible*." *Id.* at 13, n. 17 (quoting *Simplified Guidelines*, 1 S.T.B. at 1021) (emphasis added). Simplified approaches, including the Board's intermediate SSAC approach, which is still simplified and imprecise, but is closer to a full SAC analysis than the rough and imprecise Three-Benchmark approach, should be reserved for cases with values higher than Three-Benchmark cases, but which do not justify use of the full SAC/CMP analysis. *See id.* at 28 ("[B]y placing limits on the relief available, we encourage shippers with larger disputes to pursue relief under the more appropriate methodology . . . . the complainant must evaluate its own claim, decide for itself the expected value of the case, and balance the value against the litigation costs and the potential relief it may receive"); *see also CSX Transp. Inc. v.*

Surface Transp. Bd., 568 F.3d at 240, 242 (finding that the purpose of the relief caps was "[t]o channel larger cases to the more accurate methods," consistent with section 10701(d)(3)).

The greater the amount of rail revenue that the Board seeks to subject to review under non-SAC procedures, the more important it is that the non-SAC procedures produce SAC-like results. In accordance with Section 10701(d)(3) and the Board's repeated admonition that SAC is the only economically accurate method and "must be used wherever possible" (*Simplified Standards* at 13), the Board should endeavor to limit the use of SSAC and Three-Benchmark methods to instances in which the value of the case clearly outweighs the cost of a SAC presentation. Otherwise, rail revenues will be judged by "less precise application[s] of CMP" (*Simplified Standards* at 14) and will produce less accurate determinations of rate reasonableness.

C. The Third Guiding Principle Should Be That Rates Deemed "High" by a Shipper Are Not Necessarily Unreasonable.

Instead of advocating a rigorous, objective methodology, shipper commenters appear interested primarily in an outcome-driven regulatory regime under which the Board would intervene to impose lower rates whenever a shipper deems it appropriate. This stance suggests a fundamental misapprehension of the statute and the rate regulatory regime it establishes. The Board's statutory responsibility is to conduct an economically-sound, objective analysis taking into account statutory requirements and policies to determine if a rate is unreasonable, not simply to reduce rates that a shipper subjectively deems "high" or otherwise objectionable.

Railroads have sole authority to set rates for the transportation services they offer. *See, e.g., BNSF Ry. Co. v. Surface Transp. Bd.*, 403 F.3d 771, 773 (D.C. Cir. 2005) ("a railroad ordinarily may establish any rate it chooses for the transportation it provides."). The railroads' ratemaking initiative is codified in statute, which provides that "a rail carrier providing transportation subject to the jurisdiction of the Board under this part may establish any rate for transportation or other service provided by the rail carrier." 49 U.S.C. § 10701(c). As the Board has recognized, this statutory right means that "a rail carrier is free to establish any common carrier rate it chooses and has the rate freedom to increase its rates without precondition." *AEP Texas North Co. v. BNSF Ry. Co.*, STB Docket No. 41191, (Sub-No. 1), Decision at 2 (served Mar. 19, 2004). Such rates must be "reasonable." 49 U.S.C. § 10702. If a shipper challenges a rate for transportation over which the carrier has market dominance, the Board may apply an objective test that takes into consideration the goals of the Rail Transportation Policy and other provisions of the Interstate Commerce Act and determine if the challenged rate is reasonable. *See, e.g.*, 49 U.S.C. § 10704. Through the Act, Congress has established a balance of carrier rights and limited regulatory oversight. A railroad has the right to set the rates and those railroad-established rates govern unless and until the Board holds that those rates are unreasonable

D. The Fourth Guiding Principle Should Be that Rate Regulations Should Encourage Negotiation Over Litigation and Regulation.

Another guiding principle of rate regulations should be to encourage negotiation and competition over litigation and regulation. The Rail Transportation Policy seeks to maximize the former and minimize the latter. *See* 49 U.S.C. § 10101(1) (policy is to allow "competition and the demand for services to establish reasonable rates"); 49 U.S.C. §10101(2) (policy is "to minimize the need for Federal regulatory control over the rail transportation system"). The statute and federal policy since the Staggers Act strongly encourage private negotiated rate agreements and discourage regulatory determination of rates. *See, e.g.*, *Coal Rate Guidelines*, 1 I.C.C.2d at 522 (Market forces generally constrain rail pricing and an "important source of this constraining influence is the ability shippers now have to enter into contracts for rail service.");

id. at 524 ("[N]egotiated contracts can produce an agreement which is more advantageous both to the railroad and to the shipper than the rate [the ICC] would otherwise prescribe."). When evaluating proposed changes to its rate regulations and methods, the Board must consider whether its proposals are clarifying the regulatory regime and thereby promoting an atmosphere that allows parties to reach negotiated solutions, or whether they are encouraging litigation and regulatory intervention over private sector agreements.

II. APPLICATION OF THESE PRINCIPLES TO THE ISSUES IN THIS PROCEEDING

The foregoing principles provide clear guidance to the appropriate disposition of the six changes included in the Board's Notice of Proposed Rule Making ("NPRM"). *First*, the Board's self-described "centerpiece proposal" of removing the limitation on relief for SSAC cases contravenes the statute and sound economics, and would be certain to lead to the filing of many more rate cases, many of which would be the result of the Board making it far too easy for a shipper to shift the burden of proving a rate is reasonable to the railroads. This is an ill-advised proposal that should be withdrawn. *Second*, there is no sound legal or economic basis for doubling the amount of relief available under the Three-Benchmark methodology, a proposal which if adopted would also be certain to generate more rate litigation rather than resolution of rate negotiations through private contracts, and no party has demonstrated otherwise. *Third*, the Board's proposal to curtail the use—and frequently, misuse—of cross-over traffic in full-SAC cases may be necessary unless the Board revises its cross-over traffic revenue allocation method to use the SARR's costs rather than the defendant's system average URCS costs. And, if the Board decides to adopt its proposed limits on cross-over traffic, it should adopt original ATC as the best alternative the Board has proposed. If the Board does not adopt original ATC it should adopt the alternative approach it has proposed in this proceeding. *Fourth,* enhancing the accuracy of the RPI component of the SSAC test is a sound proposal that is well-grounded in the statute and economics and should be adopted. *Finally*, there is no proper basis for adoption of the Board's proposal to increase the interest rate applied to reparations in rate cases, and adopting that proposal would be arbitrary and capricious.

A. Shippers' Unsupported General Claims that Existing Rate Reasonableness Tests Do Not Reduce Rates as Much as They Would Like Are Not a Rational or Sufficient Basis to Support Their Proposals.

Generally, shipper commenters' apparent definition of "reasonable" rates—rates that they deem sufficiently low based on their own subjective standards and interests—is not based in sound economics, law, or policy. Determining whether a rate is unreasonable requires an economically sound rate reasonableness test applied in an unbiased fashion. Shipper commenters suggest instead that their dissatisfaction with a rate means it is automatically unreasonable. For example, the Alliance for Rail Competition, Montana Wheat & Barley Committee, Colorado Wheat Administrative Committee, Idaho Barley Commission, Idaho Wheat Commission, Montana Farmer Union, Nebraska Wheat Commission, South Dakota Wheat Commission, Texas Wheat Producers Board, and Washington Grain Commission (collectively, "ARC") asserts that proposed adjustments to the SAC test should be rejected because they are "less likely to produce significant relief" for shippers, and argues that the Board should instead change its processes in order to make the rate reasonableness analysis "more likely to provide relief." Opening Comments of Alliance for Rail Competition, *et al.* at 6 ("ARC"). But the purpose of CMP and the SAC constraint is not to provide relief based on subjective allegations of a shipper or the broad-brush, unsupported claims of a shipper organization; it is to determine whether a rate is reasonable. If a rate is found to exceed a maximum reasonable level based on an economically sound, objective test and the factors specified by the statute, then relief is warranted. But ARC seeks to prejudge the outcome, suggesting that if a rate the shipper does not like is found reasonable, the test must be faulty. ARC and others seem to believe the purpose of rate reasonableness proceedings is not to determine the reasonableness of rates, but automatically to transfer funds from carriers to shippers who in their subjective judgment deem their rail rates to be "too high." *See, e.g.*, ARC at 7 (opposing proposed changes to Three-Benchmark approach in the abstract because it claims they will "not make captive shippers whole."); CURE at 16 (calling the Three-Benchmark test "useless" and flawed because it still produces maximum reasonable rates higher than CURE would like.) ARC's and CURE's view rests on the unstated premise that a challenged rate—simply by virtue of having been challenged—is necessarily unreasonable. Although shippers may desire that the Board presume a challenged rate is unreasonable, such a presumption would violate the Interstate Commerce Act, which requires that the Board presume a rate is reasonable, unless and until the Board, after a "full hearing," determines otherwise. *See* 49 U.S.C. §§ 10702, 10704.

ARC again betrays its misunderstanding of the law and the purpose of this proceeding when it states that the Board's proposals would not "make rate relief more accessible." ARC at 7. Instead, the purpose of this proceeding is to ensure that shippers have fair and reasonable access to sound rate review process, not to enhance shippers' chances of obtaining relief in such a process. That process will determine, based on the law and sound economics, whether a particular rate is reasonable. Contrary to some commenters' apparent desire, the Board does not—and may not—seek to create a biased approach whose aim is to transfer funds from carriers to shippers. Just as the Board has found that under the SAC test "a rate may be unreasonable even if the carrier is far short of revenue adequacy," (ARC at 16 (quoting *Simplified Guidelines*, 1 S.T.B. at 1017)), the converse is also true—properly applied SAC analysis may also find a "high" rate is reasonable even if the carrier may be at or near long term revenue adequacy. *Cf. Simplified Standards* at 82-83 (acknowledging that different carriers' rates may generate different R/VC ratios due to differential pricing and the mix of that carrier's traffic).

ARC contends that rates that generate a generic R/VC ratio of 375% should be cause for concern. ARC at 14, n.5. That conclusion cannot be reached in the abstract. Rates are driven by unique factors that do not bear easy comparison. For example, rates that generate relatively high R/VC ratios may be reasonable, depending on the commodity, its shipment characteristics, the infrastructure needed to serve the traffic, and other factors tested in a SAC case. Indeed, the Board and the Courts have properly rejected using R/VC ratios alone to make assumptions about rate reasonableness. *See Rate Guidelines—Non-Coal Proceedings*, 1 S.T.B. at 1022 ("The R/VC benchmarks can only provide the starting point for a rate reasonableness analysis, not the end result"); *id.* at 1023 ("[T]he analysis that we envision would not presume that, simply because a rate produces an R/VC ratio above the average level, it is therefore unreasonable. . . . Rather, what we must consider is whether the resulting markup is within a reasonable range or zone."); *see also Burlington Northern R.R. Co. v. I.C.C.*, 985 F.2d at 597 (rejecting ICC R/VC-comparison-based approach as lacking "any glimmer of supporting principle or intellectual coherence").

Thus, contrary to some shippers' beliefs, low rates are not necessarily the same as reasonable rates, just as "high rates" cannot be presumed (prior to proper analysis) to be unreasonable. However, several shipper groups are not interested in rates that are based on sound economics or objective analysis. Rather, their comments make it clear that, until the Board's regime all but guarantees lower rates and substantial reparations for the shippers in any case they may choose to bring—without significant litigation cost—they will not be satisfied.

B. SSAC Case Proposals

Shippers enthusiastically support elimination of relief caps for SSAC cases, which would be an abrogation of the statutory and economic constraints that underlay the Board's adoption of the $5 million relief cap in *Simplified Procedures*. Commenters who applaud the Board's proposal to eliminate relief caps for SSAC cases conspicuously ignore the very language of the governing statute that led to the adoption of those caps only five years ago. *See e.g.,* Coal Shippers at 74-76; ACC at 24-25. Congress directed the Board "to establish a simplified and expedited method for determining the reasonableness of challenged rail rates <u>in those cases in which a full stand-alone cost presentation is too costly, given the value of the case.</u>" 49 U.S.C. § 10701(d)(3) (emphasis added). Based on that statutory charge, and after considering comments from a wide variety of parties in *Simplified Standards*, the Board established limits of $5 million in maximum relief in SSAC cases and $1 million in Three-Benchmark cases, establishing that "[e]ach limit is based on our estimates of the litigation cost to pursue relief under the next more complicated, and more precise method." *Simplified Standards* at 28. The Board agreed to adjust those limits in the future if it received evidence that litigation costs had changed. *See id.* at 32 ("[P]arties may petition the Board to adjust the limit on relief as needed, assuming they provide detailed litigation cost estimates.").

These commenters offer no explanation for how the Board could eliminate the relief cap without violating the statute. The statute restricts the availability of simplified and less economically-sound tests of rate reasonableness to account for (1) the cost of a full SAC case; (2) the value of the particular case at issue; and (3) a comparison of #1 and #2. There is no evidence at all in this record on #1 and #2 that could justify a change in the relief limit.

The July 25, 2012, NPRM in this proceeding contains not a single reference to any evidence that those litigation cost estimates were erroneous, let alone that they should be completely ignored. Shipper commenters similarly offer nothing of substance. Indeed, all that shippers have offered in support of claims that the litigation cost estimates are too low are unsupported assertions and assumptions—not evidence. *See, e.g.,* ARC at 10-11 ("ARC believes the Board underestimates costs," "issues may drive up litigation costs," and "consultants' fees alone may add up" but providing no evidence); ARC, V.S. of Gerald W. Fauth III, at 13 (making assertions about costs of rate cases with no supporting evidence). Essentially, the Board has proposed to ignore the statute and throw open the door to unlimited rate relief in SSAC cases based on little more than a simplistic and conclusory declaration that "there is no apparent reason to force the shipper to use the more expensive Full-SAC approach over the Simplified-SAC approach in cases where the shipper seeks more than $5 million in relief." NPRM at 14. However, without a complete record addressing possible changes in those litigation cost estimates, the Board may not issue a fiat effectively declaring that the limits it adopted based upon the record compiled in *Simplified Standards* are "no longer operative," and, it may not eliminate them all together without violating the statute.

Further, the Board's proposed elimination of the SSAC relief cap would be an effective repudiation of the statutorily and economically mandated guiding principle that "CMP provides the only economically precise measure of rate reasonableness and therefore must be used wherever possible." *Simplified Standards,* at 13, n. 17 (quoting *Simplified Guidelines*, 1 S.T.B. at 1021). There is no question that CMP/SAC cases require rigorous analysis, including expert economic, operating, and engineering evidence—but that is because of the complexities of modern railroads and rail economics that must be carefully and fairly analyzed and accounted for in accordance with the Board's SAC regulations and jurisprudence. Simply declaring that those SAC evidentiary requirements and procedures are "too complex, too expensive, and too impractical for most shippers" (NPRM at 14) is no justification for lifting the relief caps for SSAC cases, thereby leaving the railroads open to potentially very large rate complaint cases without the safeguards of the full and thorough full-SAC standards and procedures. Lifting the limit on Three-Benchmark relief would obliterate the distinction between the two tests and is contrary to Board precedent and the express mandate of Section 10701(d)(3).

Similarly, the suggestion by some shippers that the Board extend the five-year maximum rate prescription period to ten years (*see* Opening Comments of the Joint Chemical Companies, at 24 ("JCC"); Opening Comments of the Western Coal Traffic League, et al., at 76-77 ("Coal Shippers")) in order to place such periods for SSAC cases on an equal footing with the prescription period in Full-SAC cases are based on no justification other than "more is better." Such suggestions are made without any attempt to offer a legal or economic basis for the change, let alone why the results of a "simplified" procedure—which by definition will generate less accurate results than those resulting from application of the SAC methodology—should be permitted to apply for as long a period of time as those flowing from a Full-SAC case.

Shipper commenters' desire to have no relief limits on SSAC but to retain simplified RPI are inconsistent. *See* NPRM at 14. Objecting to the essential requirement that full replacement costs for road property investment be included in SSAC filings, CURE argues that the development of such evidence is expensive and would not be "simple." *See* Opening Comments of Consumers United for Rail Equity at 3-4 ("CURE").[3] They contend that the Board's proposal

[3] CURE's Comments are particularly remarkable in their liberal use of unsupported references to unidentified, anonymous "experts" as the basis for several of the positions that that organization takes. ("We are advised by experts on both railroad economics and the application of [SAC] that the Full-SAC methodology generally produces a lower R/VC ratio for the challenged rate than does SSAC." CURE at 3. "We understand from experts on this subject that the net effect of these changes would be that most captive shippers would be unable to obtain relief in Full-SAC

to require full RPI evidence is counter to the directive of Congress to establish a simplified and expedited method for determining the reasonableness of challenged rail rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case." CURE at 17. The Section 10701(d)(3) directive that the Board establish a simplified alternative to SAC did not endorse an alternative approach that would generate unreliable results, let alone unreliable results that would form the basis for unlimited relief that would extend over a decade. Indeed, simplified RPI evidence is a simplification, which is based on some average of findings in potentially ancient cases for SARRs bearing no relation to the SARR in a particular SSAC case, from full SAC, which accounts for all infrastructure costs of that particular SARR at current prices. Without the change to RPI, SSAC remains a substantial deviation from full SAC; no party contends that SSAC and SAC are equal. Accordingly, the Board cannot substantially increase the relief limit on SSAC without also adopting the proposed rule that would require full RPI evidence in a SSAC case

Similarly erroneous are shipper arguments that the difference in results between SSAC outcomes with and without full and complete RPI evidence would be inconsequential and not worth the cost and effort to include such evidence. *See, e.g.,* JCC at 25; JCC, V.S. of Thomas Crowley and Robert Mulholland at 56-57. First, until there have been a sufficient number of SSAC decisions to make a valid comparison, any such a conclusion is speculative. And certainly from the perspective of NS and CSXT, the conclusion that "[t]he average RPI cost per track mile has varied less than 10% *in the last five western Full-SAC cases"* (*Simplified Standards,* Appendix A, at 38, quoted in JCC, V.S. of Crowley/Mulholland at 55) (emphasis added) is meaningless. It is well-established that in the Eastern United States, RPI costs generally are

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proceedings." *Id.* at 4.) Such unattributed and unsupported statements are not evidence and should be given no weight by the Board.

appreciably higher because of significant differences in terrain, land costs, and other factors. *See, e.g.,* CSXT/NS at 14 (comparing substantially different RPI conclusions in Eastern and Western rate case decisions using the same base year). In other words, "the East is not the West" and this is one area in which most emphatically "one size does not fit all."

Finally, the Board's proposal to eliminate relief caps for SSAC cases could shift the real burden of proof in most rate cases from shippers to railroads. As explained in detail in the CSXT/NS Opening Comments at 5-12, the required "Second Disclosure" in SSAC cases imposes an unprecedented burden on railroad defendants to develop and provide shipper complainants all of the major components of such cases with virtually no corresponding burden to be borne by the shippers. Such a process would be unfair and contrary to the near-universal allocation of evidentiary burdens, both in Board cases and in American litigation generally.

The proposal to eliminate limits on SSAC relief also would effectively inject regulatory leverage into private rate negotiations—shippers could gain negotiating leverage by threatening to file low-cost, low-risk SSAC cases unless railroads agreed to the shippers' rate demands. In addition, as CSXT/NS explained (CSXT/NS at 11-12), the required "Second Disclosure" would provide shippers with an incentive to file SSAC cases in order to get a virtually no-cost preview of their likelihood of prevailing in such a case. The Board's proposal would open all rate disputes to this sort of unfair negotiating leverage, asymmetric burdens, and a free peek at a rate analysis. Expanding such a procedure to all rate cases would be profoundly unfair to the railroads, who would be required to develop and present the shipper's case for it. And, it would run counter to the Board's oft-repeated policy and goal of encouraging the private resolution of rate disputes. Instead of encouraging private negotiations, the Board's proposal would tip the scales in private negotiations by allowing the specter of regulatory intervention unfairly to influence such negotiations.

C. Proposals For SAC Cases—Crossover Traffic

Several shipper commenters and CSXT/NS appear to be in general agreement that cross-over traffic could be allowed without additional limits, *if* revenue allocations between the SARR and the residual incumbent were done properly. *See, e.g.*, Coal Shippers at 2; JCC at 14. Where they disagree is how to properly allocate those revenues. As CSXT/NS stated in their Opening Comments, they believe that a proper cost-based cross-over revenue allocation methodology would use the SARR's variable costs rather than the carrier's system average URCS costs. This would require additional effort by the parties and the Board, but done properly could form the basis for a more reasonable and coherent allocation of cross-over traffic revenues. If the Board is not willing to engage in that exercise (which would involve "adjustments" to the defendant carrier's URCS costs), then it would be appropriate to impose the sorts of cross-over traffic limits the Board has proposed in this proceeding.

In all events, the Board should prohibit the sort of internal cross-over "Leapfrog" traffic that DuPont proposed in its pending SAC case against NS. As NS explained in its Reply Evidence in that case, if this distorting tactic were allowed, complainants could subvert the entire SAC analysis and render it unreliable by inserting internal cross-over segments to avoid any segments that are costly to build (*e.g.*, bridges or tunnels or lines through expensive urban areas) or otherwise costly or inconvenient for the SARR. Allowing such internal cross-over traffic at all would be a steep, slippery slope that could fatally undermine the SAC analysis and results. Accordingly, the Board should clearly and unequivocally disallow all internal cross-over traffic, and prohibit complainants from using more than one on-SARR cross-over segment for any single movement. *See* CSXT/NS at 18-19.

Additionally, if the Board decides to adopt limitations on cross-over traffic it must apply those rules to all cases. The Board's stated basis for proposing limitations on cross-over traffic was a "disconnect between the hypothetical cost of providing service to [cross-over] movements over the segments replicated by the SARR and the revenue allocated to those movements" resulting (particularly in SARR networks involving significant amounts of carload and multi-car cross-over traffic) in "allocate[ion] of more revenues to the facilities replicated by the SARR than is warranted." NPRM at 16. The concerns that animated the Board to propose limits on cross-over traffic are the same for cases now pending as they are for cases that may be filed in the future. As the Board recently noted:

> The parties should have been, and continue to be, on notice that use and application of cross-over traffic, as well as ATC revenue allocation methodologies, are potential issues in these individual cases, and that parties are entitled to raise and respond to substantive arguments regarding those methodologies within those proceedings. *See, e.g., Ariz. Elec. Power Coop. v. BNSF Ry., NOR 42113* (STB served June 27, 2011) (stating that the Board has concerns with the way cross-over traffic has been costed, and directing the parties to submit new evidence and arguments for how to rectify the identified issue). The Board will address any arguments related to cross-over traffic and cost allocation raised in the pending adjudications, even as it completes its consideration of those issues more broadly in Rate Regulation Reforms.

E.I. DuPont de Nemours & Co. v. Norfolk Southern Ry. Co., STB Docket No. 42125 and *SunBelt Chlor Alkali P'ship v. Norfolk Southern Ry. Co.,* STB Docket No. 42130, Decision at 5 (served Nov. 29, 2012).[4]

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[4] Moreover, no "unfairness" would result from applying ATC to SAC cases filed after the Court of Appeals for the D.C. Circuit rejected "Modified ATC" and remanded *Western Fuels* to the Board, because from that point (May 2010) on, all complainants and potential complainants were on notice that Modified ATC did not apply and that the only properly adopted cross-over revenue allocation method that had survived judicial review was "original" ATC.

If the Board decides to impose the proposed limits on cross-over traffic, it should reaffirm Original ATC as the appropriate revenue allocation method. Original ATC, adopted in *Major Issues,* is the best allocation method the Board has proposed to date and is fairly sound and reasonable.

In *Western Fuels*, the Board was troubled by the ATC allocation to the SARR for a very few low-rated movements. Given that complainants have the sole power to select traffic and designate on-SARR and off-SARR points to maximize density, the Board's concern that low-rated traffic selected by the complainant might not cover the incumbent's URCS variable cost is misplaced and wholly unnecessary.

First, the complainant selects its SARR traffic with its eyes open—it has full knowledge of the applicable revenue allocation methodology and can determine the likely revenue allocation the SARR will receive for any selected movement. If the carrier chooses to select lower rated traffic in order to increase density on a particular line, it makes that choice with full knowledge of the revenue allocation consequences and has no basis to complain about the neutral application of an existing objective methodology to allocate the revenue. The ATC allocations about which the Board expressed concern in *Western Fuels* were not inadvertent flaws in the methodology, they were the natural and appropriate result of objective application of that method to the traffic selected by the complainant in its sole and informed discretion. The complainant already is allowed to select traffic in a manner that most advantages it under the ATC methodology. It does not need the added unfair advantage of a thumb on its side of the revenue allocation scale.

Second, the reason complainants select lower-rated traffic despite knowing that it may cover little or even none of the incumbent's URCS variable costs is that the costs incurred by the optimally efficient SARR will almost certainly be lower than the defendant carrier's real world unadjusted URCS costs. Thus, even if the revenue allocated to the SARR for a cross-over movement is below the incumbent's URCS costs for the on-SARR segment, the SARR likely will generate contribution to fixed costs or net positive revenue.

Thus, if the Board decides to adopt a cross-over revenue allocation approach using the incumbent's unadjusted URCS costs, it should retain Original ATC. The second-best unadjusted-URCS-cost-based alternative to ATC is the variant the Board has proposed in this rulemaking.

In all events, the Board should not adopt the "Modified ATC" it applied in *Western Fuels,* which unfairly biases the revenue allocation in favor of the SARR by disproportionately allocating revenues to higher density lines (generally the on-SARR segments) and thus further distorts the effect of cross-over traffic on the SAC analysis. Original ATC allocates revenues in the manner the Board articulated in *Major Issues,* by attributing more revenues to lower density lines (which have higher average costs) and thereby allocating all cross-over revenues in accordance with corresponding average total costs.[5] Moreover, unlike "Modified ATC," the original ATC method was approved on judicial review.

D. Three-Benchmark Cases

The Board proposes to double the limit on relief in Three-Benchmark cases from $1 million to $2 million. NPRM at 15. Shippers offer three primary arguments regarding the proposed changes to the Three-Benchmark analysis. None is persuasive. *First*, shippers request

[5] To the extent that an off-SARR segment may have higher density than an on-SARR segment, applying a method that would over-allocate cross-over revenues to the off-SARR segment would also violate that intent of ATC. Modified ATC, however, appears to be a one-way ratchet that would only apportion greater revenues than ATC to the on-SARR segment and not to the off-SARR segment.

that the Board take the radical step of eliminating the Three-Benchmark relief limit entirely. *Second*, shippers request that the Board expand the rate prescription period for Three-Benchmark cases from five to ten years. *Third*, shippers make unsupported claims that the Three-Benchmark analysis—which is the least economically-sound test—yields higher reasonable rate results than the Board's other tests. All three comments are unjustified and unsupported, and do not warrant any change in limits on the crude and imprecise Three-Benchmark approach.

1. There is No Evidence to Justify an Increase in the Relief Limit for Three-Benchmark Cases.

The Board proposes to increase the Three-Benchmark limit from the current $1 million[6] to $2 million. The Board's only justification for its proposal is its supposition that proposed alterations to SSAC may increase the costs of litigating a case under that approach. NPRM at 15. As CSXT/NS explained in their Opening Comments, proposed changes to the SSAC methodology alone do not provide reason to increase the Three-Benchmark relief limit. CSXT/NS at 27. The Three-Benchmark approach is already available for use by approximately 45% of all regulated traffic under the current rules, and the Board should not raise relief limits to allow more shippers to utilize this crude methodology to recover as much as $2 million per case. *See Simplified Standards* at 35.

There is no documented evidence in the record that would support a conclusion that SSAC cases would cost twice as much to litigate under the Board's proposed rule changes. The NPRM requested "details" regarding litigation costs so that the Board could evaluate whether to adjust the limitation on Three-Benchmark relief. NPRM at 15. However, no commenter submitted meaningful or probative evidence that would support the proposed increase in the relief limit for Three-Benchmark Cases.

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[6] In current dollars the relief limit is $1.2 million, indexed for inflation.

Some shippers not only seek an increase in the relief limit—without submitting real supporting evidence—but go so far as to request that the Board eliminate the relief limit for Three-Benchmark Cases, without identifying any statutory authority that would allow the Board to subject all challengeable rates to this crude analysis. *See* CURE at 1, 14; Coal Shippers at 76; ARC at 8. 49 U.S.C. § 10701(d)(3) provides that "[t]he Board shall . . . establish a simplified and expedited method for determining the reasonableness of challenged rail rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case." (emphasis added). Eliminating the cap on Three-Benchmark cases would violate this congressional mandate, and subject all carrier rates to a crude Three-Benchmark analysis, without consideration of either the value of the case or the cost of a full SAC presentation. *See Simplified Standards* at 28.[7] This proposal would violate the statutory mandate that simplified methodologies be used solely where full SAC is "too costly" in relation to the value of the case. 49 U.S.C. § 10701(d)(3).

As CSXT/NS explained in their Opening Comments, the mere possibility that other proposed changes may marginally increase a complainant's cost to bring a SSAC case is no reason to increase, much less eliminate, the Three-Benchmark relief cap. Indeed, to the contrary, any increase in the relief limit must first be supported by solid probative evidence showing that the costs of SSAC cases are higher than the Board determined in *Simplified Standards*. *See Simplified Standards* at 32 ("[P]arties may petition the Board to adjust the limit on relief as

[7]Lifting the cap on Three-Benchmark relief would obliterate the distinction between the two tests and is contrary to Board precedent and the express mandate of Section 10701(d)(3). *See Simplified Standards* at 5 (noting that Three-Benchmark exists in addition to SAC and that neither it nor SSAC "offers as much precision and degree of confidence as a Full-SAC analysis"). In expressing its preference for full SAC as "the most accurate procedure available for determining the reasonableness of rail rates," the Board has stated that SAC "provides the only economically precise measure of rate reasonableness and therefore must be used wherever possible." *Id.* at 13 & n. 17 (quoting *Simplified Guidelines*, 1 S.T.B. at 1021).

needed, assuming they provide detailed litigation cost estimates."). No such evidence has yet been presented in this proceeding. Shippers have not justified an increase based upon the Board requirement that any such increase be based upon new evidence of a complainant's cost of a SSAC case. *See Simplified Standards* at 5, 32; *see also* NPRM at 15 (requesting that commenters provide "details regarding litigation costs").

The only "evidence" presented by any commenter on this question is a set of unsubstantiated assumptions presented by witnesses Crowley and Mulholland. *See* JCC at 27. Indeed, Mssrs. Crowley and Mulholland expressly state that they are merely making unsupported assumptions and have no evidence. JCC/V.S. of Crowley/Mulholland at 60 ("we assume legal fees would equal consulting fees and the total cost to bring a case . . . could easily exceed $4 million") (emphasis added); *see also* ARC at 11 (speculating, without support, that consultants fees "may add up to much of the Board's presumed $250,000 litigation budget") (emphasis added); Opening Comments of The Chlorine Institute, V.S. of Crowley, at 12 (arguing for unlimited relief while providing no evidence of the costs to litigate a Three-Benchmark case); CURE at 15-16 (advocating for no cap but failing to provide any evidence regarding the costs to litigate a SSAC case).

Were the Board to eliminate all relief caps on Three-Benchmark cases, it is unlikely that any shipper would ever choose to undertake a full SAC analysis—the universally acknowledged gold standard for rail rate reasonableness analysis. Instead shippers would rely upon the inexpensive Three-Benchmark approach, replacing SAC with a crude, simplistic, and inaccurate approach that is not grounded in sound economics or the goals of the Rail Transportation Policy.

2. The Rate Prescription Period Should Not be Increased.

Suggestions that the Three-Benchmark five-year prescription period be increased should be rejected. Extension of the prescription period would further frustrate the proper, graduated separation between the crude Three-Benchmark approach, the more rigorous SSAC test, and the robust full SAC test. The JCC's suggestion that the Board extend the "five year prescription period...to 10 years," (JCC at 29) seeks to place Three-Benchmark on an equal footing with SAC. Under the statute and the Board's established policies, simplified methods must be limited to lower value cases.

It is not clear whether JCC is proposing to double the total relief limit at the same time it seeks to double the rate prescription period for Three-Benchmark proceedings. If that is what JCC (or any other party) is proposing, then lengthening the prescription period (and increasing the relief cap) would simply be another way of circumventing governing law and policies, by effectively increasing the value of cases subject to the imprecise Three-Benchmark approach.

Any such extension of the prescription period would violate both Section 10701(d)(3) and the corollary proportionality principle established by the Board—that, as the available relief increases, so too must the rigor of the method of analysis. *See, e.g., Simplified Standards* at 28 ("[B]y placing limits on the relief available, we encourage shippers with larger disputes to pursue relief under the more appropriate methodology . . . the complainant must evaluate its own claim . . . and balance the value against the litigation costs and the potential relief it may receive."). Extending the prescription period on Three-Benchmark relief would dilute significantly, if not eliminate, the important relationship between methodological rigor and the value of the case. This would also markedly increase relief available under a methodology that the Board itself has acknowledged is "crude" and lacks the degree of "precision" and "confidence" generated by a full SAC analysis. *Simplified Standards* at 5, 28 (further noting that the Three-Benchmark approach is intended to "fill the gap" in rate reasonableness challenge cost and complexity—not to replace full SAC). The shippers would have their cake and eat it too, by significantly increasing the available relief while incurring no additional costs.

3. Shipper Assumptions that Three-Benchmark Yields Higher Maximum Reasonable Rates than SAC Are Unsupported and Cannot Be Used to Draw Any Meaningful Conclusions.

Speculation that Three-Benchmark yields higher reasonable rates than other tests is unsupported. Based on very limited data and assumptions, ARC and others contend that the Three-Benchmark test always results in a challenged rate being reduced "to a level equivalent to a revenue to variable cost percentage roughly 250%-270%." ARC at 8. If that were the case, then Three-Benchmark would violate *McCarty Farms*, and its repeated application would result in all rates above that range being ratcheted down to the standard R/VC ratio. *See McCarty Farms, et al. v. Burlington Northern Inc.*, 4 I.C.C.2d 262, 278 (1988) (rejecting a requirement that rates above an R/VC standard be lowered to generate a standard ratio, which would in effect require the railroad to charge rates that "are below the level that has been determined constitutes a reasonable maximum"); *Burlington Northern R.R. Co. v. I.C.C.*, 985 F.2d at 597 (explaining that repeated use of a comparison group would drive rates down to the lowest R/VC in the comparison group, and rejecting this R/VC comparison approach as lacking "any glimmer of supporting principle or intellectual coherence").

ARC further asserts that the maximum rates it claims will always be generated in Three-Benchmark cases are higher and afford "far less relief than is available to a captive shipper whose resources and shipments profile make a SAC-based rate case viable." ARC at 8. That assertion is unfounded and unexplained in ARC's comments and cannot be proven. It may be that ARC is attempting to compare R/VCs from Western SAC cases to the jurisdictional floor R/VC ratios it contends are attainable in Three-Benchmark cases. Such reasoning would be fallacious for at least two reasons. *First*, as discussed, neither ARC nor Mr. Fauth has shown that Three-Benchmark R/VC ratios will not go lower than 250-270%.[8] *Second*, the SAC decision R/VC ratios Mr. Fauth uses for comparison are confined to those cases in which the Board found the maximum reasonable rate was the 180% R/VC rate prescription floor. All such cases have been Western unit-train cases, which are not comparable to either Eastern SAC cases, or cases (such as *DuPont de Nemours & Co. v. Norfolk Southern Ry. Co.*, STB Docket No. 42125), involving carload, merchandise, and general freight traffic. There is no basis to assume that all SAC cases should or will yield maximum reasonable rates anywhere close to 180%. Indeed, many substantially higher rates will be found to be reasonable because (1) R/VC ratios do not bear any relation to rate reasonableness; and (2) the proper application of law and economics will yield different results based on factors such as the SARR's density, where the SARR is built, unique construction cost issues to each SARR, unique operations for each SARR, and unique aspects of each SARR's traffic group.

Recent SAC cases have involved significant volumes of carload and multi-car traffic. Such rail operations are significantly more complicated than the operations involved in the coal unit-train SAC cases that have been litigated in the West. Previous SAC cases primarily involving unit trains are not a meaningful benchmark for SAC cases involving carload traffic, such as NS's cases with DuPont and SunBelt or CSX's cases with Total Petrochemicals and M&G Polymers. A SAC case involving carload traffic must posit a SARR that would provide all of the complicated services inherent in carload rail operations. These operations begin with a local train picking up a car at the origin point, followed by a switch at a local serving yard into a block, moving the car in the block to its next classification yard or yards to be classified into

[8] Indeed, although ARC claims this is Mr. Fauth's conclusion, the Fauth statement itself does not make such a broad conclusion. Rather, it simply uses a single example to suggest this might be the case in other instances. *See* ARC, V.S. Fauth at 4-6.

another block (or blocks), moving the car to a local serving yard, and finally delivering the car to its actual destination. This type of operation is far more expensive and complicated than moving unit coal trains. The results of proper SAC analyses of the two different types of networks will be much different from one another. In sum, comparisons of hypothesized Three-Benchmark results with maximum reasonable rate findings in a unit train SAC case are meaningless.

Finally, shipper statements are primarily grounded in a subjective desire for lower rates, not in an economically sound rate reasonableness test objectively applied. For example, JCC complains that Three-Benchmark allows the maximum lawful rate to rise in times when other rail rates are rising. JCC at 28-29. Such an argument is not rooted in sound economics or an objective test neutrally applied at different times and in different economic conditions and circumstances. Rather, it is simply an argument for (or against) a particular outcome. It is doubtful that JCC would argue that the Three-Benchmark test results in rates that are "too low" during times of declining rail rates. This is yet another example of shippers seeking the lowest possible rate without regard for the rational economics and policies that support the application of a rate regulatory regime that strikes a reasonable balance between competing interests.

In conclusion, none of the reasons articulated by the shippers support an increase in the Three-Benchmark relief rate or prescription period. The Three-Benchmark test was developed to "fill a gap" for small value shippers who wish to challenge rail rates but cannot justify the cost of a full SAC presentation. *Simplified Standards* at 5. Were the Board to increase the relief cap or extend the prescription period for Three-Benchmark cases, it could eviscerate the gold standard of rate reasonableness analysis—full SAC. This would not only contradict decades of Board and ICC precedent lauding the merits and benefits of full SAC analysis, it would contravene the clear congressional mandate that simplified procedures only be used where full SAC is "too costly."

49 U.S.C. §10701(d)(3). Shippers' self-serving attacks on Three-Benchmark are unsubstantiated and deserve no weight. The Board should make no changes to its Three-Benchmark approach and limits on that approach.

III. THE BOARD SHOULD NOT ADOPT THE PROPOSAL TO RAISE THE INTEREST RATE ON REPARATIONS TO THE "PRIME" RATE.

The Board has proposed to use the U.S. Prime Rate, as published in *The Wall Street Journal* (the "WSJ Prime Rate"), to calculate interest on reparations awards. NPRM at 18. Although some commenters have supported the Board's proposal, or urged it to go further (*see* Coal Shippers at 77; JCC at 30-31), these comments are not well founded. The use of the WSJ Prime Rate for this purpose would be arbitrary and capricious, and should not be adopted.

The NPRM states that "[i]t is our responsibility to establish an interest rate that encourages compliance with our rules and correlates to market interest rates over a comparable time frame." NPRM at 18. The NPRM states the Board's concern that its current benchmark for interest on reparations (the rate for three-month Treasury bills) "may be insufficient," but it offers no explanation of the source of such "concern." *Id.*; *see* 49 C.F.R. § 1141.1(a). The NPRM also asserts that the WSJ Prime Rate "is the interest rate that the banks charge to their most creditworthy customers," and concludes that the WSJ Prime Rate "may serve as a more appropriate rate for calculating interest owed to shippers for rates found by the Board to be unreasonable." NPRM at 18.

The adoption of the WSJ Prime Rate would be arbitrary, because the WSJ Prime Rate is not "correlate[ed] to market interest rates," and does not purport to measure or reflect actual market interest rates. Rather, the WSJ Prime Rate reflects *base rates* posted by the ten largest U.S. banks as reference points for further negotiations. The actual market interest rate charged may be higher or lower than the bank's stated prime rate, depending on the type of loan and the customer's creditworthiness (among other factors).[9]

The Wall Street Journal itself notes that its publication of the U.S. Prime Rate reflects the "base rate" on corporate loans posted by at least seven of the ten largest U.S. banks, adding that other prime rates "aren't directly comparable," and that actual "lending practices vary widely by location."[10] Similarly, the Federal Reserve's weekly publication of selected interest rates (known as "H.15") confirms that the U.S. prime rate is only "one of several base rates used by banks to price short-term business loans."[11]

The assertion that the WSJ Prime Rate is the rate banks charge "their most creditworthy customers" (NPRM at 18) is often repeated,[12] but is simply incorrect. In fact, the WSJ Prime Rate is based almost entirely on the federal funds target rate established by the Federal Reserve's

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[9] For example, Bank of America states that its prime rate is "based on various factors, including the bank's costs and desired return, general economic conditions and other factors, and is used as a reference point for pricing some loans. *Bank of America may price loans to its customers at, above, or below the prime rate.*" *See* Bank of America *Prime Rate Information* (emphasis added), at: http://newsroom.bankofamerica.com/press-kit/prime-rate-information. Similarly, Wells Fargo emphasizes that "[t]he prime rate is merely a base rate used to make loans to certain borrowers. It is not necessarily the lowest or best rate at which loans are made." *See* Wells Fargo *Credit Card Glossary*, at: https://www.wellsfargo.com/help/credit_cards/glossary; *see also Lum v. Bank of America*, 361 F.3d 217, 227 (3d Cir. 2004), *abrogated in part on other grounds by Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 557 (2007) (noting disclosure by Chase Manhattan Bank stating that WSJ Prime Rate "is merely a pricing index. It is not, and should not be considered by you to represent, the lowest or the best interest rate available to a borrower at any particular bank at any given time.")

[10] *See* Wall Street Journal *Market Data Center*, at: http://online.wsj.com/mdc/public/page/2_3020-moneyrate.html?mod=mdc_h_bndhl.

[11] *See Selected Interest Rates (Weekly) - H.15* (emphasis added), at: http://www.federalreserve.gov/releases/h15/current/#fn9.

[12] *See, e.g., Forman v. Korean Air Lines Co., Ltd.*, 84 F.3d 446, 451 (D.C. Cir. 1996), *quoting In the Matter of Oil Spill by the Amoco Cadiz Off the Coast of France,* 954 F.2d 1279, 1332 (7th Cir. 1992). It should be noted that these cases describe the prime rate as it existed 15 to 20 years ago, and do not reflect current economic conditions and practices in the financial industry.

Federal Open Market Committee ("FOMC"). The WSJ Prime Rate has been set at three percentage points (300 basis points) above the federal funds target rate for many years, and essentially moves in lockstep with the federal funds rate.[13] Indeed, the WSJ Prime Rate has remained unchanged at its current level of three percent for approximately four years.

In short, there is no evidence that the WSJ Prime Rate accurately reflects real market-based interest rates actually paid by business customers. There is also no evidence that complainants in rate cases before the Board typically use borrowed funds to pay rail rates, or that they would pay interest rates approximating the WSJ Prime Rate if they did borrow such funds. Thus, the WSJ Prime Rate does not correlate to any actual interest rates that complainants actually incur during the pendency of rail rate cases. Rather, the WSJ Prime Rate represents an arbitrary benchmark that does not accurately reflect actual market-based interest rates. An arbitrary interest rate benchmark that can never go below three percent is not correlated to market rates, and is not more appropriate than a market-based rate reflecting actual economic conditions (such as the Board's current standard based on three-month Treasury bills).

Moreover, the adoption of a higher interest rate on reparations is not needed to "encourage compliance" with the Board's rules. *See* NPRM at 18. The substantial costs and uncertainty associated with defending rate cases provide ample incentives for railroads to establish rates at reasonable levels. Forcing railroads to pay above-market interest rates on reparations is not necessary to encourage compliance, and amounts to an unjustified penalty that goes beyond the Board's statutory mandate to adjudicate rate reasonableness in appropriate

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[13] *See, e.g.*, https://www.wellsfargo.com/student/rates, (the "prime rate tends to be about 3% above the Federal Funds Rate set by the Federal Reserve, and can go up or down over time"); http://www.capitalone.com/financialeducation/creditcardact/interest_rates.php (prime rate is an "index" that is "currently 3.25 percentage points above the rate for federal funds, set by the Federal Reserve").

cases. The Board should not change its existing regulations governing the interest rates on reparations.

IV. COMMENTS UNRELATED TO THE NOTICED PROPOSALS FOR SAC, SSAC, AND THREE BENCHMARK SHOULD NOT BE CONSIDERED IN THIS PROCEEDING.

The Board commenced this rulemaking to "propose six changes to our rate reasonableness rules." NPRM at 3. In addition to addressing the proposals made by the Board, however, several commenters submitted criticisms and suggestions concerning the entirely unrelated market dominance test adopted in M&G and about revenue adequacy. *See* ARC at 12-19, CURE at 20-21, Opening Comments of the National Grain and Feed Association, at 12. Neither topic is either addressed by the NPRM proposals or a "logical outgrowth" of that Notice.[14] Furthermore, interested shippers submitted comments as *amici* in the M&G proceeding on November 28, 2012. Because neither issue was the subject of any Board proposal or even addressed in the NPRM, and the market dominance test adopted in M&G is being addressed concurrently in a different proceeding, CSXT/NS do not address any of those concerns here.

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[14] Similarly, the Joint Chemical Companies' proposal that the Board should "do more than just raise the interest rates on reparations" by "extend[ing] the rate prescription by a year for every year, or portion thereof, above three years from the filing of the complaint that a case takes to obtain a final appealable decision" (JCC at 31-32) is not a "logical outgrowth" of the NPRM.

Respectfully submitted,

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Dated: December 7, 2012

CERTIFICATE OF SERVICE

I hereby certify that on this 7th day of December 2012, I served a copy of the foregoing Joint Reply Comments of CSX Transportation, Inc. and Norfolk Southern Railway Company by first class mail, postage prepaid, on all parties of record.

Joseph J. Zaleski

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