BEFORE THE

SURFACE TRANSPORTATION BOARD

Ex Parte No. 715

RATE REGULATION REFORMS

Joint Reply Comments of

The American Chemistry Council, The Fertilizer Institute, The National Industrial Transportation League, Arkema, Inc., The Dow Chemical Company, Olin Corporation, and Westlake Chemical Corporation

Jeffrey O. Moreno
Thompson Hine LLP
1919 M Street, N.W., Suite 700
Washington, DC 20036
202-331-8800

December 7, 2012

Table of Contents

BEFORE THE

SURFACE TRANSPORTATION BOARD

Ex Parte No. 715

RATE REGULATION REFORMS

Joint Reply Comments of
The American Chemistry Council, The Fertilizer Institute,
The National Industrial Transportation League, Arkema, Inc., The Dow Chemical Company, Olin Corporation, and Westlake Chemical Corporation

The American Chemistry Council, The Fertilizer Institute, The National Industrial Transportation League, Arkema, Inc., The Dow Chemical Company, Olin Corporation, and Westlake Chemical Corporation (collectively "Joint Chemical Companies") hereby submit these Joint Reply Comments in response to the Board's Notice of Proposed Rulemaking in this proceeding served on July 25, 2012 ("Notice").

Various Class I railroad interests filed opening comments in this proceeding regarding the six proposals in the Board's Notice. As a general matter, they took similar positions on virtually all of the proposals. First, they supported the Board's proposal to restrict the use of cross-over traffic in Stand-Alone Cost ("Full-SAC") cases (although some urged the Board to prohibit the use of cross-over traffic altogether). Second, they supported the adoption of Alternate-ATC (although some urged a return to Original-ATC). Third, they supported the development of detailed road property investment ("RPI") costs in Simplified-SAC cases. Fourth, they objected to removing the relief cap in Simplified-SAC cases even if the Board requires detailed RPI costs. Fifth, they objected to increasing the relief cap in Three-Benchmark cases (although BNSF Railway would support a modest increase under specific circumstances). Last, they objected to substituting the Prime Rate for the T-Bill rate for the interest rate on reparations.

The railroad interests have said very little that has not already been addressed in the opening comments of the Joint Chemical Companies. Rather than repeat their opening comments here, the Joint Chemical Companies will limit this reply to selected railroad comments that have not been previously addressed in the opening comments, and to highlight key fundamental differences between the Joint Chemical Companies and the railroads.

I. CROSS-OVER TRAFFIC.

As discussed at pages 9-16 of the Joint Chemical Companies' opening comments, the rationale that the Board provided in the Notice for restricting cross-over traffic did not make sense. Other shipper groups have expressed similar confusion.[1] The opening comments of other interested parties, including the railroads, also fail to offer logical support for the Board's rationale. The essence of the Board's rationale is that, with respect to single and multi-car cross-over traffic, the on-SARR segments are allocated too much revenue when the stand-alone railroad ("SARR") does not originate or terminate the traffic, but instead handles the traffic in so-called "hook-and-haul" overhead trainload service. Notice at 16. The Board's rationale, which the railroads parrot without corroboration, suffers from three fundamental flaws.

First, the Average Total Cost ("ATC") revenue allocation methodology is designed to reflect the incumbent's cost of providing service over the on-SARR and off-SARR segments. Therefore, the SARR's operations and costs are irrelevant to the amount of revenue allocated to the on-SARR segment. The basic question should then be whether the formula equitably allocates revenues to each segment based on the incumbent's relative costs over the segments. Neither the Board nor any railroad has alleged that the formula fails to do so. If the Board intends to align ATC (and revenue divisions generally) with the SARR's operations and relative

[1] WCTL et al. at 14-22.

costs, rather than the incumbent's operations and costs, it must provide a reasoned explanation for this reversal of precedent. Moreover, the Board's rationale is improperly focused on a single operational element affecting SARR variable costs (line-haul train operations) and fails to account for other items that also affect SARR fixed and variable costs (e.g., SARR densities). To date, neither the Board nor the railroads have acknowledged that the Notice is a fundamental deviation from precedent, much less offered reasonable justification for such deviation or properly defined the scope of the proposed change(s).

No matter the scope of the proposed change, the ATC methodology, as presently constructed and applied, properly reflects the incumbent's costs; therefore no deviation from precedent is warranted. Because the purpose of the SAC analysis is to determine whether the incumbent is earning excess revenue (above its costs) from the traffic group handled by the SARR, it is appropriate to use the incumbent's costs to allocate cross-over revenue. Allocating revenue on the basis of the SARR's costs would shield the incumbent's excess revenue from the SAC analysis by shifting that revenue to the off-SARR segments.

Second, both the Notice and the railroads' comments erroneously assert that ATC allocates revenue to the SARR for services that the SARR does not perform. BNSF makes this assertion most succinctly at page 11 of its opening comments:

> As explained above, to establish the SARR's revenue on cross-over traffic, through revenue is allocated between the SARR and the residual incumbent based on the relative costs of the on-SARR and off-SARR portions of the movement. The costs for both on-SARR and off-SARR segments are based on the defendant's URCS costs. <u>For non-trainload traffic, the defendant's URCS costs include the gathering, switching, assembly and delivery costs described above, which are spread across both the SARR and non-SARR segments.</u> Thus, under a cost-based revenue allocation methodology, the SARR is allocated revenues to cover such costs, even though the complainant has posited a SARR that does not incur those costs. [underline added]

The foregoing description is misleading at best, especially the underlined text. When the residual incumbent (or the SARR) interchanges, originates, or terminates cross-over traffic, URCS assigns a substantial premium for the gathering, switching, assembly and delivery activities performed at the interchange or terminal location. Contrary to the Board and railroad assertions emphasized above, URCS does not spread those costs across the both the on-SARR and off-SARR segments. Specifically, URCS assigns costs associated with terminal and interchange switching (including clerical and overhead costs) to the railroad that performs those operations. Only the costs associated with inter- and intra-train ("I&I") switching, which does not occur at the origin or termination points, is allocated on a per-mile basis. I&I switching costs make up a very small portion of the line-haul costs, regardless of the traffic type. Furthermore, it is likely that I&I switching activities occur on both the on-SARR and off-SARR segments, which substantially reduces the potential for a consistent bias in favor of just one party. Neither the Notice nor the railroad comments acknowledge these facts, nor do they attempt to explain why the terminal and interchange switching premium allocated to the terminal and interchange carriers is understated, or the relatively small I&I switching costs allocated on a per-mile basis is overstated. Thus, the bias allegedly created by single and multi-car cross-over traffic handled in "hook-and-haul" service is not demonstrated, and to the extent any bias exists, it is severely overstated and cannot not justify the Board's proposal to eliminate the use of cross-over traffic in the SAC analysis.

Third, the Board and the railroads focus on a single scenario—a SARR that operates almost exclusively as a "hook-and-haul" overhead carrier that originates/terminates or switches very little traffic--as the basis to make broad and inaccurate presumptions about the nature of SARR systems generally. The Board presumes that the residual incumbent will always be under-allocated, and the SARR always over-allocated, revenues even though the operations of the SARR and the residual incumbent may well be reversed (*i.e.*, in one case the SARR may be the overhead carrier, but in another the residual incumbent may be the overhead carrier on the same movement). An example of this is the so-called "leap-frog" cross-over traffic that Norfolk Southern urges the Board to prohibit altogether.[2] Under the leap frog scenario, the SARR absorbs terminal and interchange switching costs, and the residual incumbent is allocated revenue to cover I&I switching costs it may or may not perform. Furthermore, as noted above, it is just as likely that all I&I switching activities occur on the segments replicated by the SARR. Therefore, to presume that the off-SARR segment is always allocated too little revenue for the services performed on it because of the way URCS allocates I&I costs is incorrect.

Although the Notice and the railroad comments repeat the same refrain of a "disconnect" with how URCS assigns costs and ATC allocates revenues on cross-over traffic, neither the Notice nor any comments that followed have identified, explained, documented, or quantified that "disconnect" or the resulting "bias." Nor have they acknowledged that the focus upon the SARR's costs instead of the incumbent's costs would be a deviation from precedent, or attempted to justify that deviation. The entire proposal to restrict cross-over traffic is built upon a house of cards, and should be abandoned.

II. ALTERNATE-ATC.

The Joint Chemical Companies, at pages 21-24 of their opening comments, opposed the adoption of Alternate-ATC and supported the continued use of Modified-ATC. The railroad

---

[2] Several railroads refer to the use of "leap frog" trains in Docket No. 42130, E.I. du Pont de Nemours and Company v. Norfolk Southern Railway Company, and ask the Board to prohibit this type of cross-over traffic. AAR at 19; NS/CSXT at 18-19; UP at 9 (n. 8). The Board should not address that issue in this proceeding. This is a highly fact-based issue that should be evaluated within the context of the evidence and argument presented by DuPont and NS in their case. No commenter in this proceeding has demonstrated why this cross-over traffic is improper, nor do they have access to the facts presented by DuPont and NS.

commenters uniformly oppose the retention of Modified-ATC, although some support Alternate-ATC and others urge a return to Original-ATC. The Joint Chemical Companies have little to add to their opening comments on this subject, which effectively demonstrate several fundamental flaws with Original and Alternate-ATC that do not exist with Modified-ATC.

The Joint Chemical Companies, however, will reply to assertions by multiple railroad commenters that ATC is being manipulated by shippers. UP alleges that "shippers can and do bias the result by carefully selecting the cross-over traffic to include in their SARRs." UP at 9. What the railroads refer to as "manipulation" is none other than the "grouping" of traffic that is essential to the SAC analysis. Coal Rate Guidelines – Nationwide, 1 I.C.C.2d 520, 544 (1985) ("Without grouping, SAC would not be a very useful test...."). Even if the parties had perfect information to allocate cross-over revenue, they still would make their traffic selection based in part upon those revenue allocations. Those same considerations apply when selecting non-cross-over traffic as well. While Modified-ATC may not be the "perfect" solution for allocating cross-over revenue[3], it is a reasonable approach. UP itself concedes that ATC is "formulaic." Hence, it cannot be manipulated. The fact that shippers select traffic for a SARR based in part on the revenue associated with that traffic resulting from the standard revenue allocation formula is not manipulation; rather, it is a normal part of the traffic selection process required for grouping.[4]

UP goes even further than the other railroad commenters by urging the Board to replace ATC with efficient component pricing ("ECP"). UP has advocated for ECP dating back to the very first case to use cross-over traffic, and has been rebuffed by the Board every time.[5] UP

[3] Due to the uncertainty inherent in any cost-allocation methodology, there can never be a perfect model.

[4] UP's criticism that "ATC is a method for approximating 'something that doesn't exist'" is a red-herring, because the entire SAC analysis approximates something that doesn't exist, the stand-alone railroad. UP at 7.

[5] Bituminous Coal—Hiawatha, Utah to Moapa, Nevada, 10 I.C.C.2d 259, 265-67 (1994); Major Issues in Rail Rate Cases, EP 657 (Sub-No. 1), slip. op. at 36 (served Oct. 30, 2006).

argues that ECP is superior because it is less subject to railroad manipulation than ATC is subject to shipper manipulation. UP at 12-13. First, as discussed above, shippers are not manipulating ATC when they consider the cross-over revenue allocation in their grouping decisions. Second, the core concern with ECP is not that it is subject to manipulation, but that the concept itself is fundamentally biased in favor of the railroad and is inconsistent with the SAC analysis in which the SARR is a replacement for, not a competitor of, the defendant.

III. **SIMPLIFIED-SAC.**

The position of the railroad commenters on the Board's two Simplified-SAC proposals is diametrically opposite of the Joint Chemical Companies' position. Whereas the Joint Chemical Companies oppose the development of full RPI evidence and support removal of the relief caps, the railroads support the RPI proposal and oppose the removal of the relief caps. The Joint Chemical Companies reply to two railroad arguments.

First, nearly every railroad argues that, due to the discovery and evidentiary burdens imposed on railroads, Simplified-SAC is susceptible to abuse by shippers who might bring unmeritorious Simplified-SAC claims, or threaten to bring such claims, simply to gain an unjustified advantage in commercial negotiations.[6] They contend that this potential would be magnified by the Board's proposals. This reprises a similar argument that the railroads made when the Board first adopted Simplified-SAC. In the five years since then, there is no evidence that any such abuse has occurred. The railroads ask the Board to conduct this rulemaking on the basis of a non-existent problem.

---

[6] BNSF at 15-16; NS/CSXT at 5-12; UP at 17-18.

Second, the railroads incorrectly argue that removal of the relief cap would violate the statute.[7] Specifically, the railroads contend that the relief cap is essential to conform to the statutory directive to "establish a simplified and expedited method for determining the reasonableness of challenged rail rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case." 49 U.S.C. 10701(d)(3) [underline added]. According to the railroads, if the Board removes the relief cap, there is no longer a link between the cost of Full-SAC litigation and the case value. That simply is not true.

As the Joint Chemical Companies demonstrated in their opening comments, at pages 25 and 28-29, the simplifications in both the Simplified-SAC and Three-Benchmark methodologies inevitably produce higher rate prescriptions than a Full-SAC case. Because those simplifications reduce the value of a shipper's case, the shipper has ample incentive to select the Full-SAC methodology when the value of its case warrants the additional cost.

IV. **THREE-BENCHMARK.**

The Board's only proposal for Three-Benchmark cases was to increase the relief cap to $2 million to reflect the higher litigation cost if it adopts the Simplified-SAC proposal to require the full development of RPI costs. NS/CSXT strongly oppose this proposal and actually urge the Board to reduce the relief cap in order to minimize the number of cases that potentially might be filed using the Three-Benchmark approach, even though there have been very few Three-Benchmark cases filed in the five years since the Simplified Standards decision. NS/CSXT at 22-25. The Joint Chemical Companies refer the Board to their opening comments, at pages 27-29, wherein they urge the Board to remove the Three-Benchmark relief cap altogether because the simplifications that make that methodology more crude and conservative inevitably produce

[7] AAR at 12-13; NS/CSXT at 2-5.

higher prescribed rates. Therefore, the NS/CSXT concern about that approach causing rates to ratchet downward is not plausible.

V. INTEREST RATE.

The railroad commenters uniformly oppose the Board's proposal to change the interest rate on reparations from the T-Bill to the Prime Rate. Their principal argument is that the T-Bill rate is the most appropriate for "risk-free" investments.[8] This predicate that a rate case is "risk-free" for the shipper is absolutely wrong.

As complainants in past and pending rate cases have repeated on multiple occasions, they typically must pay the defendant railroad a rate premium just for the opportunity to pursue a regulatory rate remedy. The rate premium is the difference between the tariff rate that is paid while the case is pending and the best contract offer from the railroad that the complainant turned down in order to pursue a reasonable rate. The longer it takes to litigate a rate case, the greater the premium paid. If the shipper loses the rate case, the entire tariff premium is kept by the railroad. In contrast, the only cost to the railroad is its out-of-pocket litigation cost.

The Joint Chemical Companies agree with UP's comment, at page 19, that the interest rate "should reflect the rate of return the shipper lost because it did not have the funds available." They also agree with UP that a reasonable proxy is needed because "it would be impractical to determine the appropriate rate of return on a shipper-by-shipper basis." The point of disagreement, as mentioned above, is the assumption that the appropriate rate of return should be based upon a risk-free investment. As the Joint Chemical Companies observed in their opening comments, even the Prime Rate understates the true opportunity cost for the shipper.

---

[8] AAR at 24-25; BNSF at 18; KCS at 11-13; UP at 18-19.

Respectfully submitted,

Jeffrey O. Moreno
Thompson Hine LLP
1919 M Street, N.W., Suite 700
Washington, DC 20036
202-331-8800

December 7, 2012

CERTIFICATE OF SERVICE

I hereby certify that this 7th day of December 2012, I served a copy of the foregoing to the following parties by first class mail:

Louis P. Warchot Association of American Railroads 425 Third Street, S.W., Suite 1000 Washington, DC 20024	Andrew B. Kolesar III Slover & Loftus LLP 1224 Seventeenth Street, N.W. Washington, D.C. 20036
John H. LeSeur Slover & Loftus LLP 1224 Seventeenth Street, N.W. Washington, DC 20036	Robert D. Rosenberg Slover & Loftus LLP 1224 Seventh Street, N.W. Washington, DC 20036-3003
James W. Wochner Kansas City Southern Railway Company P.O. Box 219335 Kansas City, MO 64121-9335	Thomas W. Wilcox GKG Law, P.C. Canal Square 1054 31st Street, N.W. Suite 200 Washington, DC 20007
John O'leary Arkema Inc. 900 First Avenue King of Prussia, PA 19406	Gregory Leitner Husch Blackwell LLP 736 Georgia Avenue, Suite 300 Chattanooga, TN 37402
Christopher S. Perry U.S. Department of Transportation 1200 New Jersey Avenue, S.E. Washington, DC 20590	Paul M. Donovan LaRoe, Winn, Moerman & Donovan 1250 Connecticut Avenue, N.W. Suite 200 Washington, DC 20036
Scott A. King 5005 LBJ Freeway, Suite 2200 Dallas, TX 75244	Paul A. Hemmersbaugh Sidley Austin LLP 1501 K Street, N.W. Washington, DC 20005
Eric Von Salzen McLeod, Watkinson & Miller One Massachusetts Avenue, N.W. Suite 800 Washington, DC 20001	Emily S. Fisher 701 Pennsylvania Avenue, N.W. Washington, DC 20004

John M. Cutler, Jr. McCarthy, Sweeney & Harkaway, P.C. 1825 K Street, N.W. Suite 700 Washington, DC 20006	J. Bruce Blanton Director Transportation Services Division U.S. Department of Agriculture 1400 Independence Avenue, S.W. Room 4450-South Building Washington, DC 20250
Scott N. Stone 9100 Glenbrook Road Fairfax, VA 22031	Myles L. Tobin Fletcher & Sippel LLC 29 North Wacker Driver Suite 920 Chicago, Illinois 60606-2832
Gordon P. MacDougall 1025 Connecticut Avenue, N.W. Suite 919 Washington DC 20036-5444	Samuel M. Sipe, Jr. Steptoe & Johnson LLP 1330 Connecticut Avenue, N.W. Washington, DC 20035-1795
William A. Mullins, Esq. Baker & Miller PLLC 2401 Pennsylvania Avenue, N.W. Suite 300 Washington, DC 20037	David C. Reeves Baker & Miller PLLC 2401 Pennsylvania Avenue, N.W. Suite 300 Washington, DC 20037
Michael L. Rosenthal Covington & Burling LLP 1201 Pennsylvania Avenue, N.W. Washington, DC 20004-2401	Patrick E. Groomes Fulbright & Jaworski, LLP 801 Pennsylvania Avenue, N.W. Washington, DC 20004-2623
Michael F. McBride Van Ness Feldman, PC 1050 Thomas Jefferson Street, N.W. Suite 700 Washington, DC 20007-3877	

Jeffrey O. Moreno