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October 23, 2012

VIA E-FILING

Ms. Cynthia Brown
Chief, Section of Administration
Office of Proceedings
Surface Transportation Board
395 E Street, S.W.
Washington, DC 20423

RE: STB Docket No. EP 715 - Rate Regulation Reforms

Dear Ms. Brown:

Enclosed for e-filing in the above-captioned case, please find the Opening Comments of The Chlorine Institute.

Please feel free to contact the undersigned if you have any questions.

Very truly yours,

Thomas W. Wilcox
Attorney for The Chlorine Institute

Enclosure

cc: Counsel, Parties of Record

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

**STB Docket No. EP 715
RATE REGULATION REFORMS**

OPENING COMMENTS OF THE CHLORINE INSTITUTE

The Chlorine Institute, a Party of Record in this proceeding, hereby files its Opening Comments in response to the Decision and Notice of Proposed Rulemaking (“NOPR”) served in this proceeding on July 25, 2012.

**I.
Identity and Interest of the Chlorine Institute**

The Chlorine Institute is a 200 member trade association comprised primarily of producers, re-packagers and users of chlorine and suppliers to the chlor-alkali industry. Its central focus is on safe production, distribution and use of chlorine and other chlor-alkali chemicals. The essential nature and benefits of chlorine to our economy is well known. A very large percentage of US industry is dependent upon chlorine chemistry and it is a critical element in maintaining public health. It is estimated that 20-25% of chlorine produced in North America is transported by rail. In most cases, transport via rail is the safest overland method of transporting bulk chlorine. It is imperative from both a business and societal perspective that the ability to economically ship chlorine by rail be maintained. However, recent railroad pricing actions, coupled with the continuing railroad actions designed to limit or exclude chlorine from

the interstate rail network, severely threatens the viability of the chlorine industry and threatens the economic welfare of the Nation.

II. Argument

A. **The Full-SAC and Simplified Stand-Alone Cost Rules are Inaccessible to the Majority of Chlorine Rail Shippers to Test the Reasonableness of Their Rates**

In its NOPR, the Board has proposed several changes to its existing rate reasonableness rules. The NOPR proceeds from an assumption that the Board's rate rules currently provide a meaningful regulatory regimen to protect all captive rail shippers from high rail rates. However, the vast majority of chlorine rail shippers do not have access to all of the Board's rules to test the reasonableness of their rail rates. Since 2005, rates for the transportation of chlorine have increased significantly, in some cases approximately 100% in a given year. These increases have been implemented "across the board" by all of the Class I railroads to all of their customers who transport chlorine. Moreover, these large rate increases have not been solely for the purpose of profit maximization, but have been one component of an overall strategy and goal of the Class I railroads to eliminate this traffic from their systems altogether, or in the alternative, reduce what they carry to the minimum amount required by law. Manifestations of this strategy are found in the public comments of the railroads but also in actions they have taken before this Board.¹

¹ Examples of STB proceedings in which the Class I railroads have sought to diminish or eliminate chlorine and other TIH traffic include: Finance Docket 35219, *Union Pacific Railroad Company - Petition for Declaratory Order* (attempt by UP to limit its common carrier obligation to transport chlorine); FD 35504, *Petition for Declaratory Order of Union Pacific Railroad Company* (Legality of UP Tariff Provisions attempting to shift liability onto TIH shippers); and NOR 42131, *Canexus Chemicals Canada, L.P. v. BNSF Railway* (case involving BNSF's refusal

Thus, the large increases in the rail rates for chlorine, and the accompanying decreases in the amount of chlorine shipped by rail over the past seven years, have not only been the result of attempts by railroads to maximize the rates of their captive shippers, which the Board's rate rules are intended to control. In fact, since the railroads' collective goal is to rid this commodity from their respective systems, the rates for chlorine are sometimes set at levels above which would otherwise be "commercially justifiable."² Yet, during this time period only four chlorine rail shippers out of all of the chlorine rail shippers in North America have attempted to obtain relief under the Board's rate reasonableness rules.

The typical chlorine rail shipper cannot utilize the Full-SAC rules to obtain relief. This is because the typical chlorine shipper does not ship chlorine in sufficient volumes and with the regularity and predictability to a single destination or limited destinations that is a necessary prerequisite to a Full-SAC case.³ Rather, many chlorine shipments are in single carload shipments and are transported to various destinations over the tracks of multiple railroads. Carload numbers to particular destinations vary from year to year, making predictions of available relief over a rate prescription period difficult. Accordingly, the huge cost and complexity of a Full-SAC case renders this methodology unusable to the typical chlorine rail

to provide chlorine rates from Vancouver to Kansas City based on a choice to "short-haul" itself and take chlorine only as far as Portland).

² Docket NOR 42100, *E.I. DuPont de Nemours and Co. v. CSXT Transp., Inc.*, (served June 30, 2008) at 11.

³ Docket NOR 42130, *Sunbelt Chlor-Alkali Partnership v. Norfolk Southern Railway Co.*, a Full-SAC case brought by a chlorine shipper and pending before the Board, is a unique case in that the chlorine is transported from a single origin to a single destination, apparently in volumes and at rates sufficiently high enough to justify a Full-SAC case.

shipper. As such, the Chlorine Institute is not providing comments in this proceeding on the NOPR's proposed changes to the treatment of "cross-over" traffic in Full-SAC cases.

Because the Board's Full-SAC rules are not feasible for testing the reasonableness of the rates of the vast majority of chlorine shippers, it is imperative that the Board adopt and administer other rate reasonableness rules such shippers can use, meaning rules that are cost-effective, less complex, and processed in a timely manner. Unfortunately, the same factors that preclude the typical chlorine rail shipper from using the Full-SAC methodology are present with the Board's Simplified Stand Alone Cost ("SSAC") rules promulgated in the Simplified Standards for Rail Cases,⁴ and the lack of flexibility afforded complainants by the SSAC rules can make their use even more problematic. Indeed, despite the SSAC rules being in place for over five years, the Board has never seen any evidence applying its SSAC rules to a real rate dispute. Only one rail shipper has ever even filed a complaint seeking to use the SSAC rules – the Chlorine Institute member, US Magnesium, L.L.C.

The Chlorine Institute believes that the absence of SSAC cases is a strong indication that the Board should be actively pursuing ways to make its rules applicable to rate disputes that cannot feasibly be resolved using the Full-SAC rules less costly, less complex, and more straightforward. Any proposed changes to the SSAC rules that make them *more* complicated and *more* expensive for chlorine shippers are contrary to this objective and contrary to

⁴ Ex Parte No. 646 (Sub-No. 1) *Simplified Standards for Rail Rate Cases* (served September 5, 2007); ("*Simplified Standards*"); *recon. denied* March 19, 2008; *aff'd*, *CSX Transportation, Inc. et al v. Surface Transportation Board*, 568 F.3d 236 (D.C. Cir. 2009).

Congressional intent in enacting 49 U.S.C. §10701(d). As such, while the Chlorine Institute supports the NOPR's proposal to remove the relief cap in SSAC cases, it objects to the Board's proposal to "link" its removal of the relief cap with a requirement that SSAC complainants and their experts prepare a Full-SAC evidentiary presentation on Road Property Investment ("RPI"). Further, there is no reason why the rate prescription period should not also be the 10 years used in Full-SAC cases, and the Board has not articulated one in the NOPR.

B. The Board's Three Benchmark Methodology Rules to Test the Reasonableness of Chlorine Rail Rates Have Arguably Become Unusable for Chlorine Shippers

In the NOPR, the Board has proposed to modify its Three Benchmark Methodology ("3B") rules by increasing the relief limit to \$2,000,000 over a five-year prescription period. No other changes are proposed to the 3B rules. The rationale given for this proposal is that if the NOPR's proposals were adopted the estimated cost of a SSAC case would be approximately \$2,000,000 so the 3B relief limit should be set at that level. NOPR at 15. For the reasons set forth below, this modification would be of little benefit to chlorine shippers, and the relief limit should either be raised substantially higher or, preferably, eliminated altogether. This section's discussion of the NOPR's 3B proposal and the 3B rules is supplemented by the accompanying Opening Verified Statement of Thomas D. Crowley, President of L.E. Peabody & Associates, an economic consulting firm headquartered in Alexandria, Virginia ("Crowley Opening V.S."). Mr. Crowley and his firm presented expert witness written testimony and evidence in the *DuPont* and *Canexus* 3B cases discussed below.

1. Railroad Pricing Behavior Regarding Chlorine has Arguably Eliminated the Availability of the 3B Methodology to Test Chlorine Rates

To date, three complaints have been filed by chlorine shippers that have sought to test the reasonableness of their rates using the 3B methodology: Docket NOR 42100, *E.I. DuPont de Nemours and Co. v. CSX Transportation Inc.*, filed August 21, 2007 (“*DuPont*”); Docket NOR 42114, *US Magnesium, L.L.C. v. Union Pacific Railroad Company*, filed May 4, 2009 (“*USM*”); and Docket NOR 42132, *Canexus Chemicals Canada, L.P. v. BNSF Railway Company*, filed November 14, 2011 (“*Canexus*”). In *DuPont* the Board determined that the challenged rates were unreasonable and initially determined that the maximum reasonable levels produced by the 3B formula in that case for the two movements at issue were R/VC ratios of not more than 287% and 321%, respectively. *DuPont*, (decision served June 30, 2008). However, because the Board subsequently determined there was a flaw in the Revenue Shortfall Allocation Method used in the 3B methodology, it reopened its prior decision for briefing on the issue. *DuPont*, (decision served November 21, 2008). The parties subsequently reached a commercial settlement and the complaint was dismissed. *DuPont*, (decision served September 1, 2009). In *USM*, USM challenged two chlorine rates established by UP at 568% and 422% of UP’s variable cost of providing the service. In a split decision served January 28, 2010, the Board established the maximum reasonable rates for the two movements at 356% and 346%, respectively, and this decision was upheld on appeal to the United States Court of Appeals for the District of Columbia Circuit. In *Canexus*, the parties reached a commercial resolution of their issues after all evidence had been filed in the case and the complaint was dismissed.

While there is somewhat of a track record of chlorine shippers in the past obtaining relief rate relief through the 3B rules, the Chlorine Institute believes these rules may no longer be usable for chlorine shippers, even if the relief limit is increased to \$2,000,000 as the Board has proposed in the NOPR. As explained in greater detail in the accompanying Verified Statement of Mr. Crowley, this is largely due to recent railroad pricing behavior *vis a vis* chlorine and other TIH commodities. Specifically, beginning in 2005, the Class I railroads have engaged in massive, across-the-board rate increases that apply to all of their chlorine and other TIH shippers. Such pricing behavior is not contemplated by the 3B rules, which are designed to correct instances where a shipper is singled out for market abuse by comparing its rates to other similar movements of its commodity. Crowley Opening V.S. at 2-5. As the significant across –the-board rate increases are incorporated into the Board’s Waybill Sample, the R/VC ratios produced by the 3B methodology are ratcheted upward, thereby systematically reducing, if not eliminating altogether, the potential relief available under the 3B test. *Id.* at 4-5 (“the 3BM procedures, as currently structured, will not provide any relief for individual chlorine shippers on a going forward basis.”).

2. The Board Underestimated the Cost and Complexity of a 3B Case in *Simplified Standards*

Increasing the relief limit in 3B cases to \$2,000,000 also has little benefit for chlorine shippers because it is evident from the few 3B cases the Board has seen that the cost and complexity of a 3B case are significantly greater than the Board’s “conservative estimate” of \$250,000 in *Simplified Standards*. *Simplified Standards* at 94. Indeed, the Board anticipated that “the actual cost to litigate a Three-Benchmark case, particularly once a body of precedent is

developed to guide the analysis, should be far less than \$250,000.” *Id.* This has not proven to be the case. This is most evident from the increased efforts of railroad defendants to introduce evidence of “other relevant factors” to either reduce or eliminate rate relief, most recently in the *Canexus* case, where the defendant railroad proposed no fewer than *five* proposed adjustments to the maximum reasonable rates produced by the 3B methodology in that case. Crowley Opening V.S. at 9-11. In addition, the defendant in *Canexus* vigorously pursued the ability to use current revenue and cost data in the 3B analysis, despite the Board rulings that such evidence was not permitted. *Id.* This additional evidence and argument caused the complainant to incur additional expert and legal fees, and internal costs, to rebut BNSF’s arguments.⁵

3. The Board has Not Yet Addressed Shipper Claims that “Bundling” Rate Practices of the Railroads have Deterred Rate Complaints

Still another significant deterrent to chlorine shippers utilizing the 3B rules to challenge rail rates is the railroad pricing practice of “bundling,” by which the railroads force shippers with multiple movements to ship all movements either pursuant to common carrier rates and service terms or pursuant to a contract. Since the 3B rules are designed for smaller disputes and currently have a relief cap of \$1,000,000 over five years, a 3B complaint is necessarily limited to one or two movements which the complainant determines are particularly unreasonably priced. The practice of forcing the shipper to transport all of its chlorine shipments under common

⁵ GKG Law, P.C., one of the undersigned counsel for the Chlorine Institute, was counsel for the complainant in *Canexus*. *Canexus Chemicals Canada, L.P.* is not a Party of Record in this proceeding, but it has authorized the undersigned to represent that the legal, expert witness, and internal costs to *Canexus* to pursue its case against BNSF, which was settled after rebuttal evidence was filed, were in well excess of \$250,000.

carrier rates even though the shipper is willing to enter into a rail transportation contract covering rates it decides not to challenge forces the shipper to either file multiple 3B cases and/or increases the amount the shipper pays for the duration of the 3B case(s) it decides to file. The practice of “bundling” is a significant deterrent to shippers such as chlorine shippers who have dozens of rail movements but cannot feasibly combine all or some of their rail movements into a Full-SAC case or a SSAC case. On September 21, 2011, the Chlorine Institute and the American Chemistry Council submitted a letter to the Board asking it to address the issue of “bundling” rail service rates. The Board has yet to respond to this letter.

4. The Board Should Expand the NOPR to Consider Revisions to the 3B Rules Other than Simply Increasing the Relief Limit to \$2,000,000

Simply increasing the relief limit in 3B cases to \$2,000,000 would therefore be insufficient to address the current deficiencies in the 3B rules as applied to chlorine rail shippers. As an initial step, the Board should eliminate the relief cap for 3B cases altogether. Complainants should be able to choose any of the three maximum rate methodologies based on a cost/benefit analysis rather than an arbitrary relief limit. Crowley Opening V.S. at 12. In addition, the Board should expand the scope of the NOPR to consider other modifications to the 3B rules in light of changes to railroad pricing behavior since their adoption in 2007. Several suggestions entailing the expansion of the comparison group and tempering the R/VC levels produced by the Confidential Waybill Sample data are summarized in the accompanying Opening Verified Statement of Mr. Crowley. The Chlorine Institute believes that such modifications are needed to re-establish the 3B rules as potential means for chlorine and other TIH shippers to effectively challenge rail rates they believe are unreasonable.

III. Conclusion

In summary, the Chlorine Institute supports efforts by the Board to improve its rate reasonableness rules and make them more effective and available to chlorine shippers. However, the proposals in the NOPR will have little impact on the vast majority of chlorine rail shippers because: (1) it is not feasible for them to use the Full-SAC rules now, and the change proposed by the NOPR will not change this; (2) many of the same hurdles of the Full-SAC rules presented to chlorine shippers are also present in the current SSAC rules, and the NOPR's "linked" proposal to eliminate the current relief cap would make such rules even more costly and complex; (3) the continued usefulness and feasibility of the 3B rules to test the reasonableness of chlorine rates is highly questionable, primarily due to railroad pricing behavior in recent years; and (4) the Board significantly underestimated the costs of pursuing a 3B case, so merely increasing the relief limit to \$2,000,000 will have little or no effect on chlorine shippers' willingness to use the 3B rules. Accordingly, the Chlorine Institute urges the Board to consider

making more substantial modifications to its rate rules to make them truly more effective and accessible to all rail shippers.

Respectfully submitted,

Handwritten signature of Paul M. Donovan in blue ink, written over a horizontal line.

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Attorneys for The Chlorine Institute

October 23, 2012

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Docket No. EP 715

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Rate Regulation Reforms

Verified Statement

of

Thomas D. Crowley
President

L. E. Peabody & Associates, Inc.

On Behalf of

The Chlorine Institute

Due Date: October 23, 2012

TABLE OF CONTENTS

PAGE

I. INTRODUCTION1

II. RECENT ACROSS-THE-BOARD RATE INCREASES ON CHLORINE MOVEMENTS MAKE THE THREE-BENCHMARK METHODOLOGY UNUSABLE FOR CHLORINE SHIPPERS2

III. POTENTIAL WAYS TO MAKE THE THREE-BENCHMARK PROCEDURES MORE USABLE FOR CHLORINE (TIH) MOVEMENTS6

A. BROADEN THE COMPARISON GROUP FOR DEFENDANT RAILROAD....6

B. INCLUDE ALL RAILROADS IN THE COMPARISON GROUP7

C. CAP THE ANNUAL CHANGE IN THE R/V C RATIO OF THE COMPARISON GROUP8

IV. THE BOARD HAS UNDERESTIMATED THE COSTS OF A THREE-BENCHMARK PROCEEDING9

V. MONETARY LIMIT ON THE THREE-BENCHMARK METHODOLOGY RATE RELIEF SHOULD BE ELIMINATED12

VI. SUMMARY13

LIST OF EXHIBITS

<u>EXHIBIT NO.</u>	<u>EXHIBIT DESCRIPTION</u>
(1)	(2)
1	T. D. Crowley Qualifications

I. INTRODUCTION

My name is Thomas D. Crowley. I am an economist and President of the economic consulting firm of L. E. Peabody & Associates, Inc. The Firm's offices are located at 1501 Duke Street, Suite 200, Alexandria, VA 22314, 760 E. Pusch View Lane, Suite 150, Tucson, AZ 85737 and 21 Founders Way, Queensbury, NY 12804. A copy of my qualifications and experience is attached to this Verified Statement as Exhibit No. 1.

The Chlorine Institute has asked me to submit comments in *Ex Parte 715 Rate Regulation Reforms* ("EP 715") pursuant to the Surface Transportation Board's ("STB" or "Board") July 25, 2012 decision related to the Three-Benchmark ("3BM") maximum rate methodology.

My Verified Statement describes how the STB's current procedures for the 3BM Methodology are not viable for chlorine shippers and that the STB's proposed modification in EP 715 does not address these problems. The remainder of my Verified Statement is contained under the following headings:

- II. Recent Across-the-Board Rate Increases on Chlorine Movements Make the Three-Benchmark Methodology Unusable for Chlorine Shippers
- III. Potential Ways to Make the Three-Benchmark Methodology Procedures More Usable for Chlorine (TIH) Movements
- IV. The Board Has Underestimated the Costs of a Three-Benchmark Proceeding
- V. Monetary Limit on the Three-Benchmark Methodology Rate Relief Should Be Eliminated
- VI. Summary

II. RECENT ACROSS-THE-BOARD RATE INCREASES ON CHLORINE MOVEMENTS MAKE THE THREE-BENCHMARK METHODOLOGY UNUSABLE FOR CHLORINE SHIPPERS

In the EP 715 Notice of Proposed Rulemaking (“NOPR”), the Board has proposed to modify the 3BM rules by increasing the relief limit to \$2 million over five years. No other changes are proposed. In my opinion, this modification will be of no use to chlorine shippers because recent pricing behavior by the Class I railroads regarding chlorine movements have rendered the 3BM rules unusable for chlorine shippers. This amount is also too low because, as outlined in Section IV below, the Board has significantly underestimated the cost of litigating a 3BM case. Further, Section V of this Verified Statement summarizes the reasons why the relief cap should be eliminated altogether in 3BM cases.

The 3BM Methodology currently relies on a comparison of the revenue / variable cost (“R/VC”) ratio for the issue movement to an R/VC ratio (including several adjustments) of a comparison group made up of “comparable” movements. This methodology is set forth in Ex Parte No. 646 (Sub-No. 1) *Simplified Standards for Rail Rate Cases* (“*Simplified Standards*”). In the three 3BM proceedings involving chlorine movements, the complainants selected comparison groups for each issue movement from STB Confidential Waybill Sample data supplied to the parties that were comprised of all Toxic by Inhalation (“TIH”) movements, not just chlorine movements. The defendant railroads have selected comparison groups comprised of only chlorine movements. In the two 3BM cases involving chlorine movements that have been decided to date, *DuPont*¹ and *USM*,² the STB, for various reasons, selected the complainant’s comparison groups (containing more than just chlorine movements) as superior to

¹ E.I. DuPont de Nemours and Company v. CSX Transportation, Inc., Docket No. 42100 (“*DuPont*”).

² US Magnesium, L.L.C. v. Union Pacific Railroad Company, Docket No. 42114 (“*USM*”).

the railroad's comparison groups.³ In *Canexus*,⁴ the BNSF Railway ("BNSF") and complainant followed this same pattern in filing the three rounds of evidence required for a 3BM proceeding (i.e., BNSF advocated a chlorine-only comparison group while Canexus advocated a comparison group based on TIH movements) but the case was settled prior to a decision from the Board. L.E. Peabody & Associates, Inc. was retained by the complainants in *DuPont* and *Canexus* to present expert written testimony and evidence on the application of the 3BM Methodology to the facts in those cases, and to respond to expert testimony and evidence presented by the railroad defendants.

In *DuPont* and *Canexus*, the railroads presented testimony regarding the systematic increase of all chlorine rates on their respective systems. In *DuPont*, CSX Transportation, Inc. ("CSXT") "acknowledged that it now prices chlorine beyond what would otherwise be commercially justifiable."⁵ CSXT began to systematically increase chlorine rates in response to a 2005 accident involving chlorine that occurred on Norfolk Southern Railway ("NS") rail lines.⁶

In *Canexus*, BNSF provided notice that it had implemented across-the-board rate increases on chlorine and other TIH movements prior to the evidentiary phase of the proceeding.

"... BNSF's pricing of chlorine movements underwent a fundamental change on March 16, 2011... That price change was not limited to specific movements at issue here. BNSF's marketing personnel in its Industrial Products Group fundamentally changed the level and structure of BNSF's rates applicable to chlorine and other toxic-by-inhalation ("TIH") movements managed by the Industrial Products group, both local and interline." [footnote omitted]

And

"...this pricing change was not driven by inflationary cost increases but rather was intended to bring BNSF's rates up to market levels in light of

³ See, *DuPont* June 30, 2008 decision ("*DuPont Decision*"), p. 10; *USM* January 28, 2010 decision ("*USM Decision*"), p. 11.

⁴ *Canexus Chemicals Canada, L.P. v. The BNSF Railway Company* ("*Canexus*").

⁵ See, *DuPont Decision*, p. 9. See also public version of CSXT's February 4, 2008 Opening, pp. 7-10.

⁶ See, public version of CSXT's February 4, 2008 Opening filing, p. 9.

the major changes in the transportation market for TIH products in the preceding two years.” [emphasis added]⁷

In effect, BNSF was inferring that Canexus should not complain about its high rate in its 3BM case because BNSF had not only increased Canexus’ rates, it had implemented similar high rate increases for all of its chlorine shippers. BNSF presented this same theme in its Opening evidentiary filing.⁸

Despite the Board’s February 8, 2012 decision denying BNSF’s petition to use BNSF 2011 traffic data to select the comparison group for the issue movements, BNSF nevertheless included such an analysis in its February 13, 2012 Opening filing.⁹ According to BNSF’s analysis, using the rates based on the across-the-board increase for the rates in the comparison group, the rates for the Canexus issue movements were reasonable. Stated another way, other shippers are paying high rates so Canexus should as well.

BNSF’s position was obviously opposed by Canexus based on the Board’s decision prohibiting the use of data other than the Confidential Waybill Sample data provided to the parties under the 3BM rules, which in that case covered the years 2006-2009. However, even if Canexus had eventually prevailed on this issue, the annual systematic increases of all chlorine rates by the railroads has since rendered 3BM unusable for chlorine shippers because the across-the-board increases beginning in 2010 are being incorporated into the Confidential Waybill Sample each year. 3BM is only viable when there is a difference in the R/VC ratios of the issue movement versus the R/VC ratio of the comparison group. Stated differently, all chlorine movement rates appear reasonable under 3BM even if, as CSXT admitted doing in *DuPont*, the

⁷ BNSF’s Motion to Permit Consideration of 2011 TIH Movements from BNSF Traffic Data in Selecting Comparison Group, filed December 14, 2011, pp. 1-2 (“BNSF Motion to Permit”).

⁸ See, public version of BNSF’s Opening filing dated February 13, 2012, pp. 16-19.

⁹ Id, pp. 30-41.

defendant railroad sets rates for all chlorine movements so high as to be beyond what would otherwise be considered “commercially justifiable” in an attempt to eliminate chlorine from the railroad’s system.

The effect of this pricing on the comparison group prong of the 3BM Methodology is not offset by the other two prongs of the 3BM test, because the other two prongs measure the historical performance of the defendant railroad based on the STB’s RSAM¹⁰ and R/VC_{>180}¹¹ tests. This historical relationship (RSAM ÷ R/VC_{>180}) will not change if different comparison group R/VC’s are considered in an individual proceeding. The result is that the 3BM procedures, as currently structured, will not provide any rate relief for individual chlorine shippers on a going forward basis.

¹⁰ Revenue shortfall allocation methodology (“RSAM”) “measures the average markup that the railroad would need to charge all of its ‘potentially captive’ traffic in order for the railroad to earn adequate revenues” -- STB Docket No. EP 689 (Sub-No. 3), *Simplified Standards for Rail Rate Cases – 2010 RSAM and R/VC₁₈₀ Calculations*, decided February 24, 2012.

¹¹ Revenue-to-Variable cost greater than 180% (“R/VC_{>180}”) measures “the average markup over variable costs earned by defendant railroad on its potentially captive traffic.” -- STB Docket No. EP 689 (Sub-No. 3), *Simplified Standards for Rail Rate Cases – 2010 RSAM and R/VC₁₈₀ Calculations*, decided February 24, 2012.

III. POTENTIAL WAYS TO MAKE THE THREE-BENCHMARK PROCEDURES MORE USABLE FOR CHLORINE (TIH) MOVEMENTS

The STB's decision in *Simplified Standards* specified the procedures to develop the maximum R/VC ratio for the issue movements following 3BM. Those procedures need to be revised in order for 3BM to be usable for chlorine shippers given the massive, across-the-board rate increases described above. Some suggested modifications are described below under the following topics.

- A. Broaden the Comparison Group for Defendant Railroad
- B. Include All Railroads in the Comparison Group
- C. Cap the Annual Change in the R/VC Ratio of the Comparison Group

A. BROADEN THE COMPARISON GROUP FOR DEFENDANT RAILROAD

In *Major Issues*,¹² the STB revised the variable cost procedures for maximum rate complaints. The STB stated that variable costs would be calculated using the STB's Uniform Railroad Costing System ("URCS") Phase III cost program for each railroad¹³ based on nine specific inputs. The following nine inputs are used to calculate variable costs for each issue movement:

1. Railroad;
2. Loaded miles (including loop track miles);
3. Shipment type (Local, originated/delivered, bridge or received/terminated);¹⁴
4. Number of freight cars per shipment;
5. Tons per car;
6. Commodity;
7. Type of movement (single car, multiple cars or unit train);

¹² See, Ex Parte No. 657 (Sub-No. 1) *Major Issues in Rail Rate Cases*, October 30, 2006 ("*Major Issues*").

¹³ For non-Class I railroads, the STB instructed the parties to use regional URCS costs.

¹⁴ In the STB's URCS Phase III cost program, local is shown as "Originate & Terminate," originated delivered is shown as "Originate & Deliver," bridge is shown as "Receive & Deliver" and received terminated is shown as "Receive & Terminate."

8. Car ownership (railroad or private); and
9. Type of car.

As noted above, in previous 3BM cases, the comparison groups have consisted of either groups containing only TIH movements (complainants) or only chlorine movements (railroads). One way to broaden the comparison groups for 3BM proceedings to address the distortions in the Confidential Waybill Sample caused by the defendant railroad's exercise of market power to increase all of the rates of its customers shipping a certain commodity would be to remove the limitation of comparison based on commodity (Standard Transportation Commodity Code ("STCC")) and allow the inclusion of all movements that have similar operating characteristics. In other words, allow inclusion in the comparison group of all movements that have similar operating characteristics such as type of car (i.e., all tanks), shipment type, type of movement, tons per car, etc.

**B. INCLUDE ALL RAILROADS
IN THE COMPARISON GROUP**

Another way to broaden the comparison groups for 3BM proceedings would be to allow the inclusion of all movements that have similar operating characteristics for all railroads, not just the defendant as currently required. In other words, allow all movements that have similar operating characteristics such as type of car (i.e., all tanks), shipment type, type of movement, tons per car, etc. regardless of railroad to be included in the comparison group. Expanding the comparison group parameters might be beneficial, but it could be tempered by the fact that all of the Class I railroads have adopted virtually the same uniform positions concerning their attempts to rid their systems of hauling chlorine and TIH shipments.

**C. CAP THE ANNUAL CHANGE
IN THE R/VC RATIO
OF THE COMPARISON GROUP**

Another potential way of making 3BM more usable for chlorine shippers would be to place a cap on the amount of change allowed in a comparison group R/VC ratio as measured on a year-over-year basis. This could be done by developing an R/VC ratio for a comparison group based on the previous five years of STB Confidential Waybill Sample data and comparing it to the R/VC ratio for a comparison group using only the data for the most current year available. If the previous five-year average R/VC ratio is less than the R/VC ratio for the current year, the previous five-year average R/VC ratio would be used for the maximum rate calculations. This would temper the effect of large, across-the-board rate increases for whole commodity groups.

IV. THE BOARD HAS UNDERESTIMATED THE COSTS OF A THREE-BENCHMARK PROCEEDING

The STB's decision in *Simplified Standards* specified the procedures to develop the maximum R/VC ratio for the issue movements following 3BM. The purpose of 3BM was to provide a more simple, albeit less precise, lower cost option for shippers to obtain maximum reasonable rates from the Board.¹⁵ However, included in the 3BM procedures is a catch-all category referred to as "Other Relevant Factors."¹⁶ "Other relevant factors" allow for the complainant or the defendant railroad to include evidence of additional items that they feel should be considered by the Board when performing the final calculation of the maximum R/VC ratio for the issue traffic. While the Board in *Simplified Standards* attempted to place boundaries around the "other relevant factors" component of the 3BM case,¹⁷ in practice the development and/or rebuttal of "other relevant factors" adds considerably to the complainant's cost of a 3BM proceeding.

In *DuPont*, CSXT included two methods of adjusting the maximum R/VC ratios to adjust the Board's Confidential Waybill Sample data for 2002-2005 to 2007 (current) levels to address the issue of regulatory lag.¹⁸ One method was based on public revenue growth information and the other was based on CSXT 2007 waybill data provided to DuPont in discovery. While the Board rejected both of CSXT's adjustments,¹⁹ DuPont had to spend considerable time and expense to respond to this evidence.

¹⁵ See, *Simplified Standards*, p. 5.

¹⁶ *Id.*, p. 22.

¹⁷ *Id.*

¹⁸ See, public version of CSXT's February 4, 2008 Opening filing, pp. 26 – 29.

¹⁹ See, *DuPont Decision*, pp. 15-17.

While there have only been two 3BM cases since *DuPont*, it should be clear to the Board that its goal of keeping complainant litigation costs down by controlling “other relevant factors” evidence is not being met. This is exemplified in *Canexus*, the most recent 3BM proceeding, which stands as a good example of how defendant railroads can increase a complainant’s cost for a 3BM proceeding. In addition to having to incur the costs of evaluating and responding to BNSF’s Motion to Permit, which was filed before opening evidence was due, the complainant had to incur legal, expert witness, and internal company costs to respond to no fewer than *five* proposed “other relevant factors” adjustments to the rates produced by the 3BM Methodology presented by BNSF – four on Opening and one on Reply. In contrast, *Canexus* did not propose any adjustments for “other relevant factors.” On opening, BNSF included (1) a current rate adjustment (to allegedly combat the issue of regulatory lag); (2) a “historical” Positive Train Control (“PTC”) adjustment; (3) a “liability risk adjustment”; and (4) a “future” PTC adjustment. On Reply, BNSF added a fifth “other relevant factors” proposal: a new adjustment based on current BNSF common carrier rates and URCS variable costs. For good measure, BNSF also included in its Opening Evidence two separate 3BM maximum rate analyses for the Board to consider accepting under the 3BM “final offer” arbitration process; a completely separate “preferred” 3BM analysis based on BNSF 2011 traffic in addition to an “alternative” 3BM analysis of the Board’s 2009 Confidential Waybill Sample.

Canexus did not respond to BNSF’s 2011 “preferred” analysis in the evidence phase of the proceeding because the Board denied BNSF’s petition to use its 2011 traffic in lieu of the Board’s 2006-2009 Confidential Waybill Sample.²⁰ However, *Canexus* incurred substantial costs to review, evaluate and respond to BNSF’s five proposed “other relevant factors”

²⁰ See, *BNSF Motion to Permit* and the STB’s Decision denying BNSF’s Motion dated February 8, 2012.

adjustments, even though three of these adjustments had been rejected by the Board in previous 3BM proceedings.

With regard to BNSF's two PTC-related adjustments, the Board had already addressed PTC costs in *USM*. In rejecting Union Pacific Railroad Company's ("UP") PTC costs in *USM*, the Board stated: "As the PTC investments are made, the costs will flow into our costing model and then into the rate prescription."²¹ This indicates that no other adjustments for PTC need be made. However, Canexus still had to spend considerable time and expense to respond to BNSF's PTC "other relevant factor" evidence, even though it elected to forego for cost reasons a complete analysis and follow-up on all of the data BNSF produced in that proceeding and asked L.E. Peabody & Associates Inc. to limit its evidence and testimony to critiquing the apparent obvious flaws in BNSF's proposals.²²

As the Board has already considered, and rejected, adjustments for regulatory lag (i.e., use of current rates) and PTC investment, railroads should be prohibited from making these same claims in future 3BM proceedings. Further limiting the items that can be classified as "other relevant factors" will help lower the cost of litigating a 3BM proceeding.

²¹ See, *USM Decision*, p. 17, note 20.

²² See, *Canexus*, Complainant's Reply Evidence, Reply Verified Statement of Thomas D. Crowley and Charles A. Stedman, p. 20.

V. MONETARY LIMIT ON THE THREE-BENCHMARK METHODOLOGY RATE RELIEF SHOULD BE ELIMINATED

The STB's decision in *Simplified Standards* specified a limit of \$5 million in rate relief over a five-year period for a Simplified Stand Alone Cost ("Simplified SAC") proceeding and \$1 million in rate relief over a five-year period for a 3BM proceeding with no limit for Full SAC proceedings.²³ In *EP 715*, the Board is proposing to eliminate the rate relief limit for Simplified SAC proceedings (i.e., the same as a Full SAC proceeding) and increase the rate relief limit for 3BM proceedings to \$2 million.²⁴ The Board's justification for increasing the 3BM rate relief limit is the estimated increased cost to litigate a Simplified SAC proceeding.²⁵

The rate relief limit for 3BM proceedings should also be eliminated. First, the \$2 million rate relief limit is arbitrary. The cost to litigate a Simplified SAC is unknown as there have been no Simplified SAC proceedings decided by the STB. Second, and more importantly, a Complainant should be free to choose any of the three maximum rate methodologies based on a cost/benefit analysis rather than an arbitrary monetary relief limit. Each of the three rate relief options carries its own limitations. A full SAC analysis, while very costly and time consuming, offers the greatest potential for relief. The Simplified SAC is presumably less costly and provides more limited relief. The relief associated with the use of 3BM should not be limited by statute as it is already limited by the very nature of the procedure.

In other words, a Complainant should be able to choose a maximum rate methodology based on the difference between the estimated cost to litigate under a specified methodology compared to the estimated rate relief that could be obtained using that methodology.

²³ See, *Simplified Standards*, pp. 27-29.

²⁴ See, *EP 715*, pp. 13, 15.

²⁵ See, *EP 715*, p. 15.

VI. SUMMARY

The 3BM maximum rate procedures are supposed to provide rate relief for small shippers at a reasonable cost. The 3BM maximum rate procedures need to be recalibrated in order to accomplish this objective. As explained above, 3BM procedures can be modified to accomplish the original objective and make 3BM a usable tool at a reasonable cost for small shippers.

A summary of my specific finding and recommendations include:

1. The 3BM maximum rate option in its current form is no longer viable for chlorine shippers due to the recent across-the-board rate increases in chlorine rates;
2. The 3BM Methodology must be modified to make it more usable for chlorine rail shippers and several possible modifications to the 3BM procedures have been summarized in this statement;
3. Modifications to the 3BM procedures are necessary to reduce the costs of litigating a 3BM case;
4. Increasing the arbitrary rate relief limit for 3BM proceedings from \$1 million to \$2 million, and not modifying the 3BM procedures, will not make a 3BM proceeding viable for chlorine shippers; and
5. The arbitrary rate relief limit for 3BM proceedings needs to be eliminated so complainants can determine the best maximum rate procedure based on a cost/benefit analysis.

STATEMENT OF QUALIFICATIONS

My name is Thomas D. Crowley. I am an economist and President of the economic consulting firm of L. E. Peabody & Associates, Inc. The firm's offices are located at 1501 Duke Street, Suite 200, Alexandria, Virginia 22314, 760 E. Pusch View Lane, Suite 150, Tucson, Arizona 85737, and 21 Founders Way, Queensbury, New York 12804.

I am a graduate of the University of Maine from which I obtained a Bachelor of Science degree in Economics. I have also taken graduate courses in transportation at George Washington University in Washington, D.C. I spent three years in the United States Army and since February 1971 have been employed by L. E. Peabody & Associates, Inc.

I am a member of the American Economic Association, the Transportation Research Forum, and the American Railway Engineering and Maintenance-of-Way Association.

The firm of L. E. Peabody & Associates, Inc. specializes in analyzing matters related to the rail transportation of all commodities. As a result of my extensive economic consulting practice since 1971 and my participation in maximum-rate, rail merger, service disputes and rule-making proceedings before various government and private governing bodies, I have become thoroughly familiar with all rail carriers in the United States. This familiarity extends to subjects of railroad service, costs and profitability, cost of capital, railroad capacity, railroad traffic prioritization and the structure and operation of the various contracts and tariffs that historically have governed the movement of traffic by rail.

STATEMENT OF QUALIFICATIONS

As an economic consultant, I have organized and directed economic studies and prepared reports for railroads, freight forwarders and other carriers, for shippers, for associations and for state governments and other public bodies dealing with transportation and related economic problems. Examples of studies I have participated in include organizing and directing traffic, operational and cost analyses in connection with multiple car movements, unit train operations for coal and other commodities, freight forwarder facilities, TOFC/COFC rail facilities, divisions of through rail rates, operating commuter passenger service, and other studies dealing with markets and the transportation by different modes of various commodities from both eastern and western origins to various destinations in the United States. The nature of these studies enabled me to become familiar with the operating practices and accounting procedures utilized by railroads in the normal course of business.

Additionally, I have inspected and studied both railroad terminal and line-haul facilities used in handling various commodities, including unit train coal movements from coal mine origins in the Powder River Basin and in Colorado to various utility destinations in the eastern, mid-western and western portions of the United States and from the Eastern coal fields to various destinations in the Mid-Atlantic, northeastern, southeastern and mid-western portions of the United States. These operational reviews and studies were used as a basis for the determination of the traffic and operating characteristics for specific movements of numerous commodities handled by rail.

STATEMENT OF QUALIFICATIONS

I have frequently been called upon to develop and coordinate economic and operational studies relative to the rail transportation of various commodities. My responsibilities in these undertakings included the analyses of rail routes, rail operations and an assessment of the relative efficiency and costs of railroad operations over those routes. I have also analyzed and made recommendations regarding the acquisition of railcars according to the specific needs of various shippers. The results of these analyses have been employed in order to assist shippers in the development and negotiation of rail transportation contracts which optimize operational efficiency and cost effectiveness.

I have developed property and business valuations of privately held freight and passenger railroads for use in regulatory, litigation and commercial settings. These valuation assignments required me to develop company and/or industry specific costs of debt, preferred equity and common equity, as well as target and actual capital structures. I am also well acquainted with and have used the commonly accepted models for determining a company's cost of common equity, including the Discounted Cash Flow Model ("DCF"), Capital Asset Pricing Model ("CAPM"), and the Farma-French Three Factor Model.

Moreover, I have developed numerous variable cost calculations utilizing the various formulas employed by the Interstate Commerce Commission ("ICC") and the Surface Transportation Board ("STB") for the development of variable costs for common carriers,

STATEMENT OF QUALIFICATIONS

with particular emphasis on the basis and use of the Uniform Railroad Costing System (“URCS”) and its predecessor, Rail Form A. I have utilized URCS/Rail form A costing principles since the beginning of my career with L. E. Peabody & Associates Inc. in 1971.

I have frequently presented both oral and written testimony before the ICC, STB, Federal Energy Regulatory Commission, Railroad Accounting Principles Board, Postal Rate Commission and numerous state regulatory commissions, federal courts and state courts. This testimony was generally related to the development of variable cost of service calculations, rail traffic and operating patterns, fuel supply economics, contract interpretations, economic principles concerning the maximum level of rates, implementation of maximum rate principles, and calculation of reparations or damages, including interest. I presented testimony before the Congress of the United States, Committee on Transportation and Infrastructure on the status of rail competition in the western United States. I have also presented expert testimony in a number of court and arbitration proceedings concerning the level of rates, rate adjustment procedures, service, capacity, costing, rail operating procedures and other economic components of specific contracts.

Since the implementation of the Staggers Rail Act of 1980, which clarified that rail carriers could enter into transportation contracts with shippers, I have been actively

STATEMENT OF QUALIFICATIONS

involved in negotiating transportation contracts on behalf of shippers. Specifically, I have advised shippers concerning transportation rates based on market conditions and carrier competition, movement specific service commitments, specific cost-based rate adjustment provisions, contract reopeners that recognize changes in productivity and cost-based ancillary charges.

I have been actively engaged in negotiating coal supply contracts for various users throughout the United States. In addition, I have analyzed the economic impact of buying out, brokering, and modifying existing coal supply agreements. My coal supply assignments have encompassed analyzing alternative coals to determine the impact on the delivered price of operating and maintenance costs, unloading costs, shrinkage factor and by-product savings.

I have developed different economic analyses regarding rail transportation matters for over sixty (60) electric utility companies located in all parts of the United States, and for major associations, including American Paper Institute, American Petroleum Institute, Chemical Manufacturers Association, Coal Exporters Association, Edison Electric Institute, Mail Order Association of America, National Coal Association, National Industrial Transportation League, North America Freight Car Association, the Fertilizer Institute and Western Coal Traffic League. In addition, I have assisted numerous government agencies, major industries and major railroad companies in solving various transportation-related problems.

STATEMENT OF QUALIFICATIONS

In the two Western rail mergers that resulted in the creation of the present BNSF Railway Company and Union Pacific Railroad Company and in the acquisition of Conrail by Norfolk Southern Railway Company and CSX Transportation, Inc., I reviewed the railroads' applications including their supporting traffic, cost and operating data and provided detailed evidence supporting requests for conditions designed to maintain the competitive rail environment that existed before the proposed mergers and acquisition. In these proceedings, I represented shipper interests, including plastic, chemical, coal, paper and steel shippers.

I have participated in various proceedings involved with the division of through rail rates. For example, I participated in ICC Docket No. 35585, Akron, Canton & Youngstown Railroad Company, et al. v. Aberdeen and Rockfish Railroad Company, et al. which was a complaint filed by the northern and mid-western rail lines to change the primary north-south divisions. I was personally involved in all traffic, operating and cost aspects of this proceeding on behalf of the northern and mid-western rail lines. I was the lead witness on behalf of the Long Island Rail Road in ICC Docket No. 36874, Notice of Intent to File Division Complaint by the Long Island Rail Road Company.

Certificate of Service

I hereby certify that on October 23, 2012, I served a copy of the foregoing Opening Comments of The Chlorine Institute via email and U.S. mail on each of the Parties of Record in this proceeding.

Thomas W. Wilcox

Thomas W. Wilcox

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