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

Re: STB Ex Parte No. 665 (Sub-No. 2) – *Expanding Access to Rate Relief*

Dear Ms. Brown:

Pursuant to the Advance Notice of Proposed Rulemaking served on August 31, 2016 in the above docketed proceeding, Norfolk Southern Railway Company respectfully submits the enclosed comments.

Sincerely,

A handwritten signature in black ink, appearing to read "Aarthy S. Thamodaran". The signature is fluid and cursive, with a large initial "A" and "S".

Aarthy S. Thamodaran
Counsel for Norfolk Southern Railway Co.

Enclosures

**UNITED STATES OF AMERICA
SURFACE TRANSPORTATION BOARD**

STB Ex Parte No. 665 (Sub-No. 2)

EXPANDING ACCESS TO RATE RELIEF

**COMMENTS OF
NORFOLK SOUTHERN RAILWAY COMPANY**

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Dated: November 14, 2016

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB Ex Parte No. 665 (Sub-No. 2)

EXPANDING ACCESS TO RATE RELIEF

**COMMENTS OF
NORFOLK SOUTHERN RAILWAY COMPANY**

Norfolk Southern Railway Company (“NS”) provides these comments in response to the Advance Notice of Proposed Rulemaking served by the Surface Transportation Board (“STB” or “Board”) on August 31, 2016 in this proceeding (“ANPR”). NS also joins in support of the comments filed in this proceeding by the Association of American Railroads.

Based on its careful review of STB precedent as well as the conclusions and recommendations of the report prepared by InterVISTAS Consulting Inc. for the STB, *An Examination of the STB’s Approach to Freight Rail Rate Regulation and Options for Simplification*, dated September 14, 2016 (“InterVISTAS Report”), NS urges the STB to reject the fourth rate reasonableness methodology proposed in the ANPR.

As recognized by the STB and confirmed in the InterVISTAS Report, the STB must maintain the sound economic principles of its rate regulatory regime, namely, Constrained Market Pricing (“CMP”) and its core tenet of demand-based differential pricing. The STB’s Stand-Alone Cost Test (“SAC”) and, to a lesser degree, its Simplified-SAC Test (“SSAC”) are rooted in these sound economic principles; and, the STB’s Three-Benchmark Test (“3-B”), while admittedly crude, retains the minimum necessary ties to these principles. With these three rate

reasonableness methodologies, the STB's existing rate regulatory regime is accessible to and cost-effective for shippers of all sizes. The fact that only a few rate cases have been filed with the agency in recent years does not alter this conclusion.

Further substantive simplifications to the STB's existing rate regulatory regime would only move "away from the bedrock CMP principles, undermine the reliability of the tests, and would not necessarily incentivize shippers to use those tests."¹ In particular, the STB's proposed fourth rate reasonableness methodology would erode carriers' ability to engage in lawful and necessary differential pricing, thus compromising the financial health of the rail industry and minimizing the overall welfare of rail shippers.

I. STB MUST MAINTAIN THE SOUND ECONOMIC PRINCIPLES OF ITS RATE REGULATORY REGIME.

The STB's rate regulatory regime is founded on the principles of CMP.² The regime currently consists of three rate reasonableness methodologies: (1) SAC, which represents the strictest adherence to the principles of CMP;³ (2) SSAC, which represents a "less precise application of CMP;"⁴ and (3) 3-B, which represents a "crude" approximation of CMP.⁵

¹ InterVISTAS Report at xvii.

² See generally *Coal Rate Guidelines, Nationwide*, Ex Parte No. 347 (Sub-No. 1), 1985 ICC LEXIS 254 (served Aug. 8, 1985), *aff'd sub nom. Consolidated Rail Corp. v. U.S.*, 812 F.2d 1444 (3rd Cir. 1987) ("*Coal Rate Guidelines*").

³ See, e.g., InterVISTAS Report at 22, 39. See also *Total Petrochemicals & Refining USA, Inc. v. CSX Transp., Inc.*, Docket No. 42121, 2016 STB LEXIS 271, at *100 (served Sept. 14, 2016) (Begeman, dissenting in part) (acknowledging "economists' views that [SAC] is the 'gold standard'").

⁴ *Simplified Standards for Rail Rate Cases*, Ex Parte No. 646 (Sub-No. 1), 2007 STB LEXIS 516, at *29 (served Sept. 5, 2007) ("*Simplified Standards*").

⁵ *Simplified Standards* at *108. See also *id.* at *29 (noting that SSAC is more precise than 3-B); InterVISTAS Report at ix (noting that 3-B has been "criticized on several grounds, including claims that it lacks theoretical support [and] is too simple to take into account the unique demand characteristics of each movement").

The STB has attested that “CMP provides the only economically precise measure of rate reasonableness and therefore must be used wherever possible.”⁶ Similarly, the InterVISTAS Report concludes that its extensive “research has not pointed to a simpler methodology than the three CMP methods that assess rate reasonableness consistent with the statutory requirement to take into account carrier revenue adequacy and encourage achievement of the highest possible level of economic efficiency/economic welfare.”⁷ And most importantly, Congress has repeatedly directed the agency to maintain a rate regulatory regime consistent with the sound economic principles of CMP.⁸

A. Economies of Scope and Density in the Rail Industry Require Continued Use of Constrained Market Pricing and Demand-Based Differential Pricing.

CMP recognizes that demand-based differential pricing is required in the rail industry due to the industry’s economies of scope and density.⁹ These economies “arise in the railroad industry because of the presence of joint and common costs.”¹⁰ As acknowledged by the STB

⁶ *Rate Guidelines – Non-Coal Proceedings*, Ex Parte No. 347 (Sub-No. 2), 1996 STB LEXIS 360, at *1021 (served Dec. 31, 1996) (“*Non-Coal Proceedings*”).

⁷ InterVISTAS Report at 130.

⁸ See S. REP. NO. 114-52 at 14 (2015) (requiring the STB to report on potential alternative rate reasonableness methodologies, but clarifying that any “alternative methodologies must to [*sic*] be consistent with sound economic principles”); S. REP. NO. 104-176 at 5 (1995) (directing the agency to establish a simplified rate reasonableness methodology, but clarifying that “the Committee does not intend to erode the Constrained Marketing Pricing principles”).

⁹ See, e.g., *Coal Rate Guidelines* at *14; InterVISTAS Report at vii, 21.

¹⁰ InterVISTAS Report at 21. See also *Coal Rate Guidelines* at *14. Joint and common costs exist because “railroads use the same tracks and other infrastructure to serve different shipments by various shippers of a range of commodities These common costs are not directly attributable to individual shipments, or even particular commodities.” InterVISTAS Report at 21.

and the InterVISTAS Report, carriers need to engage in demand-based differential pricing to recover these costs.¹¹

Congress understood that if railroads charged the same price per ton-mile to all shippers, this average price would give some shippers an incentive to choose another less expensive transportation mode. With fewer shippers remaining, they would have to pay higher rates in order to cover the fixed and common costs of the railroad. This higher rate could force additional shippers out of the market, leaving even fewer shippers to cover fixed and common costs. Differential pricing would allow railroads to design pricing strategies, based on market forces which would enable them to cover their total costs. . . . Those shippers with the fewest alternatives were expected to bear a higher share of the costs to ensure revenue adequacy. Differential pricing effectively provided new tools for railroads to maximize the use of rail transport, and the resulting higher traffic volumes allowed lower rates for shippers overall than if fixed pricing (i.e., average cost pricing) had been used.¹²

In short, differential pricing balances the dual goals of carrier revenue adequacy and overall shipper welfare by “generating the needed revenue to cover costs and a reasonable return but with the minimum traffic or economic efficiency loss.”¹³

¹¹ See *Coal Rate Guidelines* at *14-20; InterVISTAS Report at 21.

¹² InterVISTAS Report at 11-12. See also *Coal Rate Guidelines* at *14-15 (“This is because non-demand-based cost apportionment methods do not necessarily reflect the carrier’s ability (or inability) to impose the assigned allocations and cover its costs. Thus, they frequently ‘over-assign’ or ‘under-assign’ the carrier’s unattributable costs to particular services. If a carrier sought to apply the formula price to all of its traffic, it would lose that traffic for which the demand could not support the price assigned. In that event, the remaining shippers might be required to pay a larger portion of the carrier’s unattributable costs because they would lose the benefit of sharing these costs with the lost traffic.”); H.R. REP. NO. 96-1035 at 39-40 (1980) (same).

¹³ InterVISTAS Report at 121. See also *Coal Rate Guidelines* at *17 (“Applied to the railroad industry, [differential] pricing would permit an efficient carrier to cover all of its costs (including the cost of capital) and thus become revenue adequate. Moreover, the attainment of revenue adequacy would benefit shippers because the industry then would be able to attract all the capital needed to provide and maintain high-quality rail service.”).

Accordingly, the InterVISTAS Report finds no reason to depart from the sound economic principles of CMP and differential pricing.¹⁴ Nor should the STB.

B. Number of Rate Cases Filed Does Not Justify Further Reforms.

In the ANPR, the STB notes as relevant that “[s]ince Simplified Standards, only a few Three-Benchmark cases have been decided by the Board, while no complaint has been litigated to completion under the Simplified-SAC alternative.”¹⁵ However, as repeatedly recognized by the agency and various stakeholders, the fact that only a few rate cases have been filed with the agency in recent years does not evidence a need for further regulatory reforms.

In *Coal Rate Guidelines*, the agency itself predicted an accelerating decline in the number of rate cases filed, largely due to: (1) its statutorily circumscribed jurisdiction regarding rate review, “which in turn reflects the relatively limited nature of the problem to which the guidelines are directed;” (2) constraining market forces; and (3) the ability of shippers to enter into contracts for rail service.¹⁶ And, the agency’s prediction is consistent with market realities. Although some shippers have alleged that 3-B is problematic because the comparable rates are similar to those of the contested traffic,¹⁷ the InterVISTAS Report concludes that this “may also be an indication that the contested rate is consistent with market outcomes.”¹⁸

¹⁴ InterVISTAS Report at 121.

¹⁵ ANPR at 6 (emphasis in original).

¹⁶ *Coal Rate Guidelines* at *5. And of course, *Coal Rate Guidelines* applies to all commodities—not just coal. *E.g.*, *US Department of Energy and US Department of Defense v. Baltimore & Ohio Railroad Co. et al.*, 1990 ICC LEXIS 14, at *1-2 (served Jan. 2, 1990) (noting that “the Commission has ‘since endorsed the application of Coal Rate Guidelines to non-coal shipments’”) (internal citations omitted). Even in the ANPR, the STB rejects the notion that grain, or any other commodity, deserves special treatment under its rate regulatory regime. *See, e.g.*, ANPR at 11-12.

¹⁷ *See, e.g.*, ANPR at 7.

¹⁸ InterVISTAS Report at 129.

In fact, the STB's existing rate regulatory regime encourages rate-setting consistent with efficient market outcomes. As NS has previously explained, "[w]hen rate regulations are certain, railroads are able to conform their pricing decisions thereto; and, shippers also understand their regulatory options, with the advice of outside counsel and consultants, and negotiate accordingly."¹⁹ Various shipper-side groups agree that this is the "principal reason" for the recent decline in rate cases filed: "shippers and carriers can and do make reasonably accurate assessments of their positions, and likely case outcomes, using the SAC rules and precedents in place today."²⁰

Thus, a well-functioning regulatory environment should result in relatively few rates cases filed and litigated to completion, especially given the STB's mandates under the Rail Transportation Policy.²¹ Seven 3-B cases and two SSAC cases have been filed with the STB to date; and, the STB reached a decision as to rate reasonableness in at least four of these cases.²²

¹⁹ *Opening Comments of NS*, Ex Parte No. 733, at 4 (filed Aug. 1, 2016). *See also* *Petition of Norfolk Southern Ry. Co. & CSX Transp. Inc. To Institute a Rulemaking Proceeding To Exempt Railroads from Filing Agricultural Transp. Contract Summaries*, Ex Parte No. 725 (served Aug. 11, 2014) (V.C. Miller, concurring) ("My view is that when shippers have more information they can make better decisions and, as a consequence, fewer disputes will arise.").

²⁰ *Opening Comments of Coal Shippers*, Ex Parte No. 733, at 57-58 (filed Aug. 1, 2016).

²¹ *See* 49 U.S.C. § 10101(1) (STB must "allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail"); *id.* at § 10101(2) (STB must "minimize the need for Federal regulatory control over the rail transportation system").

²² *See Rail Rate Cases at the STB*, SURFACE TRANSPORTATION BOARD, https://www.stb.gov/stb/industry/Rate_Cases.htm (where "Simplified" cases used the 3-B outlined in *Non-Coal Proceedings*); *E.I. du Pont de Nemours and Co. v. CSX Transp., Inc.*, Dockets No. 42099, 42100, 42101, 2009 STB LEXIS 252, at *1 (served June 12, 2009) (noting that the STB previously found that the challenged rates were unreasonably high, although the parties ultimately reached a settlement).

C. Existing Rate Regulatory Regime Is Accessible To and Cost-Effective for Shippers of All Sizes.

In the ANPR, the STB also claims that its three existing rate reasonableness methodologies “present accessibility challenges for . . . small shippers of any commodity. The Board also recognizes that for small rate disputes, regardless of commodity, the litigation costs required to bring a case under the Board’s existing rate reasonableness methodologies can quickly exceed the value of the case.”²³ These claims are simply false.

It is true that a SAC presentation entails “significant complexity and costs of preparing and litigating a case.”²⁴ This complexity flows from the economic “precis[ion]”²⁵ of SAC and the structure of the rail industry.²⁶ As the InterVISTAS Report explains, “[b]ecause the rail industry is a network industry, when trying to determine the reasonableness of rates charged to captive shippers, an accurate cost analysis is necessarily a complex undertaking.”²⁷ Accordingly, the InterVISTAS Report concludes that “SAC has stood the test of time as a maximum rate reasonableness methodology” and must be preserved within the STB’s regulatory regime.²⁸

However, the complexity of SAC does not mean that rate relief is only available to the largest shippers. The InterVISTAS Report recommends that if “shippers want a simpler, faster

²³ ANPR at 3.

²⁴ InterVISTAS Report at 39.

²⁵ InterVISTAS Report at viii.

²⁶ *See, e.g.*, InterVISTAS Report at 129 (“SAC is the only methodology “that allows shippers to avoid cross-subsidization [and] benefit from the economies of scope in the [rail] network.”). Based on its review of past SAC cases, the InterVISTAS Report further concludes that “some of the complexity can also be attributed to the effort of the shippers to develop increasingly complex [stand-alone railroads] that maximize cross-over traffic and associated economies of scope.” InterVISTAS Report at 44.

²⁷ InterVISTAS Report at 40. *See also id.* at 44 (noting that the “complexity of [SAC] is a necessary exercise for those who want to estimate an economically efficient rate for the traffic in a network industry”).

²⁸ InterVISTAS Report at xviii.

and less expensive procedure,” they can use SSAC and 3-B.²⁹ In fact, the InterVISTAS Report posits that in many cases, “there is reason to believe that [shippers] can achieve similar results to Full SAC under these less-costly alternatives. . . . These results support the choice that the STB currently offers the shipper between full SAC, Simplified SAC or Three-Benchmark, with the shipper deciding whether full SAC is worth the cost.”³⁰

The InterVISTAS Report emphasizes that 3-B, in particular, represents a highly simplified and cost-effective avenue for shippers with smaller claims to seek rate relief:

Shippers and the railroad only need to compute one of these benchmark measures. . . . In practice, the only quantitative analysis required is the selection of comparable traffic. . . . The cost of such an exercise is likely to be below the \$4 million relief limit the shipper can seek over a 5-years period.³¹

Thus, the STB’s existing rate regulatory regime allows shippers *of all sizes* to seek cost-effective rate relief. As discussed above, shippers are not precluded from filing rate cases by the STB’s three existing rate reasonableness methodologies but rather by the fact that most rates are already consistent with efficient market outcomes.

Accordingly, there is no need to modify the STB’s existing rate regulatory regime. The STB’s regime must remain grounded in sound economic principles, consistent with Congress’s repeated directives to the agency.

²⁹ InterVISTAS Report at 44. *See also* InterVISTAS Report at 129 (noting that if shippers “believe that other nuances concerning their shipments need to be captured to get a more precise result,” SAC should be used).

³⁰ InterVISTAS Report at 127-28. This conclusion was based on the application of SSAC and 3-B to two prior SAC cases involving the same western carrier. *See generally* InterVISTAS Report at 58-74.

³¹ InterVISTAS Report at 128-29.

II. PROPOSED SIMPLIFICATIONS TO THE STB'S EXISTING RATE REGULATORY REGIME WOULD DEPART FROM SOUND ECONOMIC PRINCIPLES AND MUST BE REJECTED.

In the ANPR, the STB proposes a fourth rate reasonableness methodology which is essentially a further simplification of 3-B. But, in the STB's own words, 3-B is itself a "crude" rate reasonableness methodology, less rooted in sound economic principles than SSAC and SAC.³² The InterVISTAS Report explains that each benchmark only "represents a simplified component of the CMP principles, and the combination of the three can be linked to the theoretical basis of CMP."³³

While the Three-Benchmark approach is not supported mathematically by equations similar to Ramsey pricing, the approach does conform to the two key tenets of Constrained Market Pricing: the carrier should have a reasonable opportunity to earn adequate revenues from captive traffic, but no more; and greater economic efficiency is achieved if the carrier uses differential pricing.³⁴

Given the extensive simplifications already inherent in 3-B, the InterVISTAS Report cautions that "[a]ny additional simplification would, in our opinion, deviate further from these characteristics of CMP and would compromise the nature of the test and its adherence to the CMP principles."³⁵ The STB similarly has cautioned that "[b]ecause of their roughness, . . . the simplified procedures[, SSAC and 3-B,] must be used as sparingly as possible."³⁶ As noted

³² *Simplified Standards* at *108.

³³ InterVISTAS Report at 45.

³⁴ InterVISTAS Report at 52.

³⁵ InterVISTAS Report at 129.

³⁶ *Non-Coal Proceedings* at *32. See also *Simplified Standards* at *164 (promising to "reassess the advisability" of 3-B if "an avalanche of rate cases [using 3-B were] brought to the agency"); *Burlington Northern R.R. Co. v. ICC*, 985 F.2d 589, 597 (D.C. Cir. 1993) (warning that if an R/VC comparison approach "is employed regularly and repeatedly," it could essentially create a rate ceiling set at 180% R/VC).

above, these simplified procedures have been used “as sparingly as possible” with seven 3-B cases and two SSAC cases filed to date.³⁷ And as described above, the number of rate cases filed with the agency does not represent a problem but rather is consistent with a well-functioning regulatory system. Yet now, the STB illogically proposes a fourth rate reasonableness methodology that is *even rougher* than 3-B with the intent that the new methodology will be used *substantially more* than just sparingly.

A. The STB’s Proposed Comparison Group Would Erode Differential Pricing, Harming Industry Financial Health and Overall Shipper Welfare.

The STB’s proposed methodology would significantly depart from sound economic principles—particularly, CMP’s key tenet of differential pricing—and must be rejected.

In 3-B, the R/VC_{comp} benchmark “measures the demand-based differential pricing of other comparable movements charged by the same railroad.”³⁸ While crude, this benchmark is at least derived from the basic premise that “Ramsey pricing principles would indicate that traffic with *identical conditions and a common price elasticity (price sensitivity)* would pay similar markups on variable cost.”³⁹ As such, in any rate reasonableness test that proposes to compare the challenged rates against a comparison group, it is critical to use a comparison group consisting of “rates that are truly comparable.”⁴⁰

As the STB has admitted, 3-B “fairly reflect[s] the maximum lawful rates the carrier could charge those potentially captive movements” *only where* “the comparison group has been drawn properly from other captive traffic with similar characteristics.”⁴¹ The InterVISTAS

³⁷ See *supra* note 22.

³⁸ InterVISTAS Report at 49.

³⁹ InterVISTAS Report at 49 (emphasis added).

⁴⁰ InterVISTAS Report at 53.

⁴¹ *Simplified Standards* at *161-62.

Report similarly emphasizes that “[t]he comparable group used to estimate the benchmark should reflect as much as possible the characteristics of the traffic at issue because ‘markups applied to a similar commodity moving under similar transportation conditions can provide some rough indication of the relative degree of demand elasticity for that type of traffic.’”⁴²

The practical import of using “truly comparable” rates cannot be overstated. As most recently explained in the InterVISTAS Report:

If the comparison is not done right, it could in effect result in the ratcheting down of rates to some inappropriate “lowest common denominator” simply because someone elsewhere is paying less for a shipment which is not truly comparable. Such an approach could threaten railroad viability. If every shipment with a low price elasticity of demand were granted rates closer to LRMC on the basis of some other, somewhat comparable, group enjoying lower rates, there would be a shortfall of revenue to cover all the common/fixed costs.⁴³

In *Simplified Standards*, the STB also “acknowledge[d] the concern . . . about a feedback effect that could act to lower the mean for future cases.”⁴⁴ Thus, an accurate comparison group is critical to preserving the necessary tether to differential pricing that even a crude rate reasonableness methodology requires.

In the ANPR, the STB proposes to fully abandon the underlying economic principles of the R/VC_{comp} benchmark by assembling an initial comparison group composed of traffic with vastly different conditions and price sensitivities. In particular, the STB seeks comment on the use of certain “default parameters for selecting the initial comparison group:” (1) non-defendant carrier traffic, in addition to defendant carrier traffic; (2) contract traffic, in addition to common

⁴² InterVISTAS Report at 49 (citing *Non-Coal Proceedings* at *58-59).

⁴³ InterVISTAS Report at 53.

⁴⁴ *Simplified Standards* at *163. See also *Burlington Northern*, 985 F.2d at 597 (warning that if an R/VC comparison approach “is employed regularly and repeatedly,” it could essentially create a rate ceiling set at 180% R/VC).

carrier traffic; (3) traffic below 180% R/VC, in addition to traffic at or above 180% R/VC; and (4) traffic with similar shipping characteristics, defined as movements (a) within a 15% mileage band around the actual miles travelled by the challenged traffic, (b) of the same shipment type (e.g., unit train or non-unit train), and (c) classified under the same five-digit Standard Transportation Commodity Code (“STCC”).⁴⁵ As discussed in turn below, each of these proposed default parameters would undermine the true comparability of the comparison group.

1. Non-Defendant Carrier Traffic

The initial comparison group must consist only of defendant carrier traffic.⁴⁶ As the STB explained in *Simplified Standards*:

We will exclude non-defendant traffic from the comparison group because R/VC ratios of one carrier cannot fairly be compared with the R/VC ratios charged by another railroad. The reasonable level of contribution to joint and common costs (reflected by the R/VC ratio) is first and foremost a function of the amount of joint and common costs that need to be recovered. This will vary between carriers, creating inevitable and proper differences in R/VC ratios. Moreover, the reasonable degree of differential pricing one carrier can exercise is also a function of the mix of traffic; for example, a carrier with little revenue from competitive traffic will need to recover a larger share of joint and common costs from its potentially captive traffic.⁴⁷

And, the STB’s statements in *Simplified Standards* remain valid because they represent the fundamental economic structure of the rail industry.⁴⁸

Furthermore, R/VC ratios of one carrier cannot fairly be compared with ratios of another carrier even within the confines of the “same URCS region,” as the STB proposes.⁴⁹ For

⁴⁵ See ANPR at 13-15.

⁴⁶ If the STB imprudently proceeds with its proposal to include non-defendant carrier traffic in the comparison group, it must apply an appropriately calculated adjustment to account for the varying RSAMs of the defendant carrier and non-defendant carrier(s).

⁴⁷ *Simplified Standards* at *188-89.

⁴⁸ See, e.g., InterVISTAS Report at 21.

example although NSR and CSX Transportation, Inc. are in the same URCS region, their RSAMs varied by approximately 4.5% in 2014.⁵⁰ As explained above, R/VC ratios are based on the joint and common costs incurred by a railroad for its particular *network*—not its particular URCS region. Put slightly differently by the STB, the best comparison group “provides the best evidence as to the reasonable level of contribution to joint and common costs *for the issue movement.*”⁵¹ This best evidence lies solely within the experience of the defendant carrier.

And contrary to the STB’s proposal, insufficient waybill samples do not justify a departure from sound economic principles.⁵² NS respectfully notes that insufficient waybill samples are a problem of the STB’s own creation, as the STB rejected a Notice of Proposed Rulemaking to expand the waybill sample (at least with respect to traffic designated as a Toxic Inhalation Hazard).⁵³ As a means of helping to correct this problem, NS applauds the Board’s stated intent to propose modifications to the waybill sampling rate.⁵⁴

2. *Contract Traffic*

The comparison group must consist only of common carrier traffic.⁵⁵ In *Simplified Standards*, the STB recognized that contract traffic is not truly comparable to common carrier

⁴⁹ See ANPR at 14.

⁵⁰ See *Simplified Standards for Rail Rate Cases – 2014 RSAM and R/VC_{>180} Calculations*, Ex Parte No. 689 (Sub-No. 7) (served Feb. 26, 2016). The STB does not publish an RSAM for Canadian National Railway, the other carrier in the same URCS region.

⁵¹ *Simplified Standards* at *39.

⁵² See ANPR at 15.

⁵³ See, e.g., *Waybill Data Reporting for Toxic Inhalation Hazards*, Ex Parte No. 385 (Sub-No. 7) (served July 27, 2016).

⁵⁴ See ANPR at 15 n14.

⁵⁵ If the STB imprudently proceeds with its proposal to include contract traffic in the comparison group, it must apply an appropriately calculated common carrier adjustment to resolve any “disparity in rates between contract and tariff movements” resulting from diverging costs, certainty levels, and other distinguishing factors across the two categories of movements. See

traffic.⁵⁶ And, the STB's conclusion in *Simplified Standards* remains valid because it acknowledges the critical difference between contract rates and common carrier rates. Contracts represent negotiated agreements with various trade-offs between the parties. For example, in exchange for receiving a lower rate, a shipper may agree to provide the carrier with consideration in the form of a longer duration, volume commitments, more favorable liability provisions, etc. Accordingly, contract rates are not an appropriate basis of comparison for common carrier rates as the latter lack any form of contractual consideration flowing to the carrier. Again, insufficient waybill samples do not justify a departure from sound economic principles.⁵⁷

Furthermore, Congress specifically amended the Staggers Rail Act of 1980 "to encourage carriers and customers to make widespread use" of contracts.⁵⁸ Allowing contract traffic into the comparison group would have the adverse unintended consequence of dis-incentivizing private parties from contracting, as acknowledged by the STB in *U.S. Magnesium, L.L.C. v. Union Pacific Railroad Co.*:

Providing a prescribed tariff rate at contract levels could discourage railroads from offering lower rates, for fear those lower contract rates would be used in rate cases without adequate consideration. Similarly, it could discourage certain parties from pursuing good faith negotiations, hoping instead to receive the lower contract rate as part of a tariff rate case.⁵⁹

U.S. Magnesium, L.L.C. v. Union Pacific Railroad Co., Docket No. 42114, 2010 STB LEXIS 34, at *42-43 (served Jan. 28, 2010).

⁵⁶ *Simplified Standards* at *190 ("[H]olding everything else constant, a comparison group that consists of just common carrier traffic will be selected over a group that includes contract traffic.").

⁵⁷ See ANPR at 14.

⁵⁸ See *Interpretation of the Term "Contract" in 49 USC 10709*, Ex Parte No. 669, 2007 STB LEXIS 138, at *4 (citing H.R. REP. NO. 96-1035 (1980) and S. REP. NO. 96-470 (1979)). See also 49 U.S.C. § 10101(1), (2); InterVISTAS Report at 119 ("The deregulated regime generally allows carriers and shippers to reach mutually agreed rates without any need for regulatory oversight.").

⁵⁹ 2010 STB LEXIS 34, at *43-44.

And, the STB's statements in *U.S. Magnesium* remain valid because they capture the universal concerns and motivations at play when parties negotiate.

3. Traffic Below 180% R/VC

The comparison group must consist only of traffic priced at an R/VC level of at least 180%. In *Simplified Standards*, the STB itself acknowledged that “rates available to traffic with competitive alternatives would provide little evidence on the degree of permissible demand-based differential pricing needed to provide a reasonable return on the investment.”⁶⁰ And, the STB's conclusion in *Simplified Standards* remains economically sound. As noted in the InterVISTAS Report, differential pricing is based on the fact that “some traffic is very price sensitive (the below 180% R/VC traffic) and [] other traffic is able to pay higher mark-ups and may need to pay higher markups in order for the railroad to be revenue adequate.”⁶¹

4. Traffic with Similar Shipping Characteristics

The comparison group must consist only of traffic with similar shipping characteristics, as determined pursuant to a nuanced and multi-factored inquiry. The InterVISTAS Report emphasizes that there is a “need to have *all* the service characteristics comparable (distance, volume, whether or not there are guarantees regarding volume, shipper vs. railroad owned cars, service level, type of line used, time of year, handling characteristics, etc.).”⁶² Accordingly, the sum of the STB's proposed three factors—15% mileage band, shipment type, and STCC—would overlook a host of other factors bearing on comparability and yield a flawed comparison group.

More specifically, the STB's proposed three factors are themselves flawed. First, the STB offers no justification to support its assumption that traffic movements are comparable

⁶⁰ *Simplified Standards* at *38.

⁶¹ InterVISTAS Report at 47.

⁶² InterVISTAS Report at 53 (emphasis added).

within a 15% mileage band of the issue traffic's actual miles travelled.⁶³ For example, some movements within this band may still traverse different types of line, a relevant service characteristic identified by the InterVISTAS Report and ignored by the STB. Similarly, the STB's offers no justification to support its binary definition of "shipment type." For example, not all unit train shipments carry the same volumes of commodity or have associated volume guarantees, relevant service characteristics identified by the InterVISTAS Report and again ignored by the STB. Third, the STB proposes to use the five-digit STCC (or even a higher level generality of STCC); but again, insufficient waybill samples do not justify a departure from sound economic principles.⁶⁴ As the STB recognized in *U.S. Magnesium*, the most specific STCC should be used to assemble the comparison group.⁶⁵

To recap, the STB's proposed default parameters for the initial comparison group would impermissibly interfere with the calculus of differential pricing by assembling a comparison group composed of traffic with vastly different conditions and price sensitivities. As such, these parameters must be rejected. Although the STB notes that parties would still be able to "present arguments regarding the appropriateness of the initial comparison group,"⁶⁶ the STB's proposed parameters are fundamentally inconsistent with sound economic principles. Parties should not have to eliminate or adjust these flawed parameters on a case-by-case basis, particularly if the STB wants to create a streamlined and expedited rate reasonableness methodology.

⁶³ See ANPR at 13.

⁶⁴ See ANPR at 13-14.

⁶⁵ 2010 STB LEXIS 34, at *2-3 (noting that the ideal comparison group for challenged movements of chlorine would consist of chlorine-only traffic). See also InterVISTAS Report at 53 (describing the different insurance costs and risk profiles between commodities).

⁶⁶ ANPR at 12.

3-B is already the crudest approximation of CMP principles within the STB's existing rate regulatory regime. Accordingly, it is undeniable that further substantive simplifications to 3-B, as proposed in the ANPR, would only create a rate reasonableness methodology lacking a sufficient tether to sound economic principles.

III. CONCLUSION

For the foregoing reasons, NS urges the STB to reject the fourth rate reasonableness methodology proposed in the ANPR. The proposed methodology would represent a significant departure from the bedrock principles of CMP and differential pricing, thus threatening the financial health of the rail industry and minimizing the overall welfare of rail shippers. While NS acknowledges that some *procedural* changes could be implemented to streamline and expedite rate cases, as described in more detail in NS's comments filed in Ex Parte No. 733, *Expediting Rate Cases*, no *substantive* changes are necessary or appropriate.

The STB's existing rate regulatory regime encourages private rate-setting consistent with efficient market outcomes and allows shippers of all sizes to seek adequate and cost-effective rate relief. In fact, the number of rate cases filed is consistent with a well-functioning regulatory system. Most importantly, as required by Congress, the STB's existing rate regulatory regime conforms to sound economic principles—albeit most strictly with SAC, less strictly with SSAC, and most tenuously with 3-B. The STB must not use the current proceeding to disrupt this rate regulatory regime, which strikes the appropriate balance for all stakeholders.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'J. A. Hixon', written in a cursive style.

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