233411

BEFORE THE

SURFACE TRANSPORTATION BOARD

DOCKET NO. NOR 42123

M&G POLYMERS USA, LLC

v.

CSX TRANSPORTATION, INC.

MOTION TO PARTICIPATE AS AMICI CURIAE OF

ALLIANCE FOR RAIL COMPETITION
MONTANA WHEAT & BARLEY COMMITTEE
COLORADO WHEAT ADMINISTRATIVE COMMITTEE
IDAHO BARLEY COMMISSION
IDAHO WHEAT COMMISSION
MONTANA FARMERS UNION
NEBRASKA WHEAT BOARD
OKLAHOMA WHEAT COMMISSION
SOUTH DAKOTA WHEAT COMMISSION
TEXAS WHEAT PRODUCERS BOARD
WASHINGTON GRAIN COMMISSION

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Dated: November 28, 2012

Alliance for Rail Competition and the other captive shipper interests listed on the cover (hereafter "ARC, et al.") hereby request leave to participate in this proceeding as amici curiae, for the limited purpose of commenting on the refined qualitative market dominance methodology proposed in the Board's decision served September 27, 2012 in this proceeding. ARC, et al. do not seek to intervene in this case or to broaden the issues, or to address the merits of the rate challenge brought by Complainant M&G Polymers USA, LLC ("M&G").

In its decision served October 25, 2012, the Board provided for amicus filings by non-parties like ARC, et al. Because of the potential importance of the Board's proposal for market dominance determinations in rate cases other than M&G's, and because ARC, et al. have direct and representative interests in the issues raised by the Board's new proposal, the requested leave should be granted.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this 28th day of November, 2012, caused copies of the foregoing document to be served on all parties of record by first class mail.

John M. Cutler, Jr.

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BEFORE THE

SURFACE TRANSPORTATION BOARD

DOCKET NO. NOR 42123

M&G POLYMERS USA, LLC

v.

CSX TRANSPORTATION, INC.

COMMENTS AS AMICI CURIAE OF

ALLIANCE FOR RAIL COMPETITION
MONTANA WHEAT & BARLEY COMMITTEE
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I. INTRODUCTION

Alliance for Rail Competition ("ARC") and the other shipper interests identified on the cover of these comments (hereafter "ARC, et al."), appreciate the opportunity to comment as amici curiae on the refined qualitative market dominance methodology proposed by the Board in its Decision served September 27, 2012 in this proceeding. ARC, et al. discussed that Decision in comments filed October 23, 2012 in Ex Parte No. 715, Rate Regulation Reforms.[1] However, the Board's proposed new approach to market dominance determinations was not identified as an issue in that proceeding, even though it is plainly relevant to STB rail rate cases.[2]

It is clear from the Board's September 27 Decision in this proceeding that the Board's "refined" or "limit price" approach is being considered not just for use in this proceeding, but also for possible application in other rate cases. Accordingly, consideration of comments of entities other than Complainant M&G and Defendant CSXT is warranted, even if the Board restricts ARC, et al. and other commenters to amicus status.

II. INTEREST OF ARC, ET AL.

ARC is an association of shippers of freight, most of which are captive to a railroad for most if not all of their transportation requirements. ARC members include large utility coal shippers (PPL, Western Fuels and Otter Tail), shippers of sand (including sand for hydraulic fracturing) and glass, and shippers and producers of agricultural commodities, mostly located in the West. Montana Wheat & Barley Committee and the other wheat, grain, barley and farmer groups filing jointly with ARC represent producer and farmer interests as to a broad range of is-

[1] A copy of those comments, including the Verified Statement of G.W. Fauth, is attached as an Appendix.

[2] ARC et al. also requested access to waybill sample data in connection with Ex Parte No. 715, and in an October 25, 2012 letter denying that request, the Board's Office of Economics stated that the "refined approach" is not at issue in Ex Parte No. 715.

sues, including but not limited to rail transportation issues. ARC, et al. have filed comments in many recent STB rulemaking proceedings affecting the interests of captive shippers by rail.

ARC, et al. recognize the importance of a healthy, financially sound, competitive railroad industry, and the importance of rail transportation of coal, sand, grain, corn, soybeans, barley and other bulk commodities, especially for large volume bulk shipments over long distances. However, as major railroads achieve or approach revenue adequacy, and demonstrate that they can earn revenues from competitive shippers, it becomes increasingly important to ensure that railroads do not abuse their market power over captive shippers.

III. ARGUMENT

A. Strong Legal and Policy Considerations Weigh Heavily Against Excessively Restrictive Limits on Regulatory Recourse

In its September 27, 2012 Decision in this proceeding, the Board offers as a rationale for its refined proposal its belief that more objective market dominance standards are needed as a consequence of Board efforts "to make its rate review process more broadly available to shippers other than large utilities." Decision at 3. However, the changes in market dominance procedures proposed by the Board would have the opposite effect. The statutory quantitative threshold of STB jurisdiction, 180% of variable cost, below which market dominance is presumed not to exist, would be supplemented by a qualitative market dominance test whose effect could be to raise the jurisdictional threshold to RSAM levels. Captive shippers challenging rate below RSAM would see their rates deregulated unless they could prove that there are no feasible transportation alternatives, or that any such alternatives are priced well above RSAM-equivalent levels.

It is as if the Board were concerned that it has done too much to facilitate rate challenges by shippers previously excluded from recourse to remedies for excessive rail rates, and that the floodgates have been opened to a deluge of rate cases by shippers that are not really captive, necessitating measures to deter complaints by such shippers.

To ARC, et al., and to most captive rail shippers, any such reasoning is wrong on almost every count. It is true that, for many years, shippers other than large utility coal shippers were largely excluded from rate reasonableness remedies. Such shippers typically cannot afford Full SAC cases, and yet, under the ICC's decision in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines, Nationwide, 1 I.C.C. 2d 520 (1985), there was no other limit on the rail rates of market dominant railroads. Constraints under "Constrained Market Pricing" other than SAC were unusable. It was not until eleven years later, in Ex Parte No. 347 (Sub-No. 2), Rate Guidelines – Non-Coal Proceedings, 1 S.T.B. 1004 (1996) (sixteen years after enactment of the Staggers Rail Act), that a test of reasonableness aimed at other captive shippers was approved. The resulting methodology – essentially the Three Benchmark test – was adopted because Congress gave the agency a deadline for adoption of an alternative to SAC in 49 U.S.C. § 10701(d)(3), added by the ICC Termination Act of 1995. Ten more years went by with essentially no rate litigation other than SAC. Meanwhile, rail rates for captive shippers of all commodities rose significantly.

In 2007 (27 years after the Staggers Act became law), the Board once again addressed the shortcomings of rail rate regulation for shippers other than those able to bring SAC cases, this time in Ex Parte No. 646 (Sub-No. 1), Simplified Standards for Rail Rate Cases, decision served September 5, 2007. In that decision the Board adopted modifications in its Three Benchmark test, adopted the Simplified SAC (SSAC) test for "medium-size" rate cases, and adopted relief caps that have recently been recognized as excessively low. No shipper has used the SSAC approach. And while Three Benchmark cases have been litigated, the relief awarded has been far more limited than that obtained in successful SAC cases, in which maximum lawful rates have been prescribed at no more than 180% of variable cost. In contrast, rates were found unlawful only to the extent they exceeded roughly 350% of variable cost in Docket No. NOR 42114, U.S. Magnesium, LLC v. Union Pacific R. Co., decision served January 28, 2010.

More recently, in Ex Parte No. 715, the Board proposed to increase the relief cap in Three Benchmark cases, and proposed to eliminate the relief cap as to SSAC cases, though it also proposed technical revisions as to Full SAC and SSAC that, in the view of ARC, et al. and many other shippers, will make SSAC even less likely to work for any captive shipper unable to afford a Full SAC rate case.

While this history hardly suggests a regulatory regime in which it is too easy for captive shippers to obtain rate prescriptions reducing excessive rail rates, other factors make the situation even more challenging for shippers, and even less threatening for market dominant railroads.

For example, railroads that charge excessive rates face no penalty. At worst, they must return amounts collected in excess of maximum lawful levels, plus interest. However, other damages, such as profits lost because shippers' products were made uncompetitive due to excessive rail rates, cannot be recovered. Railroads also refuse to enter contracts with many shippers. Shippers who enter contracts often do so on a take-it-or-leave-it basis, and can challenge their rates before the STB only after their contracts expire, facing punishing rate increases while rate cases are in litigation, if the price demanded for contract renewal is excessive.

Litigation costs are high, and tend to be driven up by railroad defendants seeking to deter rate litigation. STB reasonableness standards have often been ineffective, or vulnerable to gaming, as well as to barriers like the Bottleneck decision,[3] the segment cross-subsidy test, and the Board's insistence that revenue adequacy has yet to be achieved by most railroads. The Three Benchmark test is vulnerable to being neutralized by a railroad's ability to raise rates for comparison group shippers.

Not all of these obstacles to relief result from action by the Board, but many do, and railroads continue to push for additional limits on their exposure to rate regulation. See, e.g., the recent filing in Ex Parte No. 717 of the AAR's petition for a rulemaking to reintroduce consideration of product and geographic competition in coal rate cases.[4] These and other obstacles threaten irreparable harm to captive shippers not just by eliminating their ability to protect themselves, but also by leading many captive shippers to conclude that invoking legal remedies against monopoly railroads is a hopeless endeavor.

It is against this background that the Board proposes its "refined" or "limit price" approach to making market dominance decisions. While any shipper satisfying this test should certainly be regarded as truly captive, the Board must not assume that shippers failing to meet the test are protected against excessive rail rates by the presence of effective competition. Such a presumption would further stack the deck against captive rail shippers for whom STB rail regulation is already more theoretical than real. It would also increase the need for many shippers to engage in substantial threshold litigation as a prerequisite to any possible challenge to high rail

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[3] Central Power & Light Co. v. Southern Pacific, et al., 1 S.T.B. 1059 (1996), aff'd sub nom. MidAmerican Energy Co. v. STB, 169 F.3d 1099 (8th Cir. 1999).

[4] Rail to rail competition, which might otherwise make rate cases unnecessary, has been undermined by mergers, paper barriers, the Midtec decision (Midtec Paper Corp. v. Chicago & N.W. Transp. Co., 3 I.C.C. 2d 171 (1986), aff'd sub nom. Midtec Paper Corp. v. United States, 857 F2d 1487 (D.C. Cir. 1988)), railroad antitrust immunity, etc., as well as the documented refusal of railroads that could compete to do so.

rates, undermining the Rail Transportation Policy of ensuring rate reasonableness where effective competition is absent.

B. The "Limit Price" Approach May Identify the Most Severely Captive Shippers But Cannot Identify All Captive Shippers

As with any excessively restrictive test, there is not likely to be a significant problem with false positives under the Board's proposed limit price approach. That is, if the limit price approach indicates an absence of effective competition, the rail carrier is likely to have market dominance over the transportation in question, and the challenged rate is therefore required to be reasonable under 49 U.S.C. § 10701(d)(1).

However, there is a significant danger, approaching a certainty in some cases, that the test will produce false negatives, indicating the presence of competition that is effective in preventing excessive rail rates when such competition actually does not exist or is not effective within the meaning of the statute.

The seriousness of the danger of false negatives is exacerbated by the fact that erroneous market dominance findings have asymmetrical impacts on shippers and railroads. A railroad erroneously found to have market dominance may nevertheless prevail in showing its rate to be reasonable. In fact, this is likely if the competition overlooked at the market dominance phase is effective. By definition, effective competition keeps rates reasonable. This same consideration also makes it highly unlikely for shippers to make false or far-fetched allegations of captivity. Shippers have nothing to gain and much to lose if they challenge the reasonableness of rates that are not excessive.

However, if the Board erroneously finds an absence of market dominance, not only is the shipper precluded from attempting to prove that the challenged rates are unreasonable, but the

Board's erroneous finding will often enable the railroad to raise the rates the shipper sought to challenge as excessive, further penalizing the shipper.

In light of this asymmetry, railroads have powerful incentives to contest shipper claims of market dominance, particularly where their rates might be found unreasonable under applicable standards. "However, the market dominance requirement should not be used as a litigation weapon, and Congress certainly does not intend for it to be used to chill pursuit of legitimate rate relief as envisioned under the statute." See Market Dominance Determinations – Product and Geographic Competition, 3 S.T.B. 937 (1998), aff'd. AAR v. STB, 306 F.3d 1108 (D.C. Cir. 2002).

Unfortunately, a test which could produce false negatives will strengthen the ability of railroad defendants to shield high rail rates from reasonableness scrutiny by persuading the Board that effective competition makes regulation unnecessary.[5] STB rail rate regulation is weak enough without adopting new market dominance tests that favor railroad defendants.

C. Railroads that Decline to Compete with Each Other Would be Rewarded by the Board's Proposal

It is not difficult to provide examples of situations in which the limit price approach could produce a false negative, indicating a lack of market dominance despite the absence of effective competition. Consider the example of a utility operating a coal-fired generating station that is captive to a single railroad. By filing a rate case, the utility could expect a significant rate reduction under the SAC test, possibly leading to a rate prescription capping rates at 180% of variable cost.

[5] ARC, et al. are aware of the D.C. Circuit's suggestion that some shippers might "consider regulators' hands to be friendlier than invisible ones." AAR v. STB, supra, 306 F.3d at 1111. It is doubtful that the court of appeals would have made this statement if it knew more about STB rail rate regulation.

Now assume that the utility is captive to BNSF (with an RSAM of 253%), and that the utility spends millions of dollars to build out to UP (with an RSAM of 258%).[6] Assume further that the two railroads decline to compete for the shipper's business, with neither railroad offering lower rail rates or higher service quality than the other.

The Board's proposed limit price approach would make it appear that UP and BNSF would be providing effective competition for each other, and no market dominance could be found, precluding a rate reasonableness challenge by the shipper, so long as the rates charged by the two railroads were set at or near their RSAM levels.

Even if the stand-alone cost of service to the utility could be shown definitively to be far below the two railroads' RSAM levels, no rate reasonableness challenge would be entertained. In fact, RSAM would replace 180% as the threshold of STB jurisdiction and a floor under which rate reasonableness could not be challenged. ARC, et al. submit that his result would be a clear violation of 49 U.S.C. § 10707(d)(2), which provides that a finding of an R/VC percentage above 180 does not establish a presumption that market dominance is absent or that the challenged rate is reasonable.

Build-outs are not the only situations in which railroads could be rewarded by the limit price approach for refusing to compete with each other. If the Board were to reverse its Midtec decision and Bottleneck decisions, as a way of increasing the effectiveness of its rail rate regulation, the result could be no gain for captive shippers due to a presumption of effective competition from second rail carriers newly accessible to captive shippers. Any access remedies result-

[6] See the attached V.S. of G.W. Fauth at 8, citing the decision served February 27, 2012 in Ex Parte No. 689 (Sub-No. 3), Simplified Standards for Rail Rate Cases – 2010 RSAM and R/VC > 180 Calculations.

ing from whatever the Board ultimately does in Ex Parte No. 711 could be similarly neutralized by the proposed limit price approach to market dominance determinations.

Of particular concern for smaller shippers represented by ARC, et al., including shippers of agricultural commodities, is the adverse impact of the proposed limit price approach on the long-awaited revenue adequacy constraint. For such shippers, the best hope for protection against excessive rail rates is the possibility that, upon achieving long term revenue adequacy, railroads seeking increased revenue will no longer find it so easy to achieve that result through further differential pricing on captive traffic. See Coal Rate Guidelines, Nationwide, supra, 1 I.C.C. 2d at 536 ("A railroad seeking to earn revenues that would provide it, over the long term, a return on investment above the cost of capital would have to demonstrate with particularity: (1) a need for higher revenues; (2) the harm it would suffer if it could not collect; and (3) why captive shippers should provide them").

The prospect of limits on further differential pricing above today's high rates is extremely appealing to captive shippers. These are the shippers who have, for over 30 years, made disproportionate contributions to the railroads' attainment of revenue adequacy, which appears likely in the near future even under the Board's excessively pro-railroad revenue adequacy standards.

An effective revenue adequacy constraint is especially important for captive shippers who cannot afford to bring Full-SAC or SSAC cases, but who can expect little or no relief from the Three Benchmark approach, given the shortcomings of that methodology. However, the proposed limit price approach to market dominance determinations appears likely to prevent many shippers from invoking the revenue adequacy constraint, even if that constraint would support the proposition that competition is "effective" within the meaning of the statute only if it prevents rail rates from rising above levels deemed reasonable under the revenue adequacy constraint. So long as RSAM levels were higher than existing rates, rate increase to RSAM levels might be permitted (and encouraged) on market dominance grounds, even if such increases would violate the revenue adequacy constraint.

D. Exaggerated Railroad Claims of Effective Intermodal Competition Would Also Result from Adoption of the Limit Price Approach

For many shippers, including many shippers of agricultural commodities in the western United States represented by ARC, et al., service by a second railroad does not exist now and is unlikely to exist even if current barriers to competition among railroads (Midtec, paper barriers, etc.) are removed or relaxed.

Such shippers must be concerned about claims of intermodal competition in market dominance determinations, and for many such shippers, the most likely argument by railroad defendants seeking dismissal of complaints based on claims of effective competition will be that their high rail rates are constrained by truck competition.

No doubt there will be shippers – particularly shippers of unit train or trainload volumes of grain, coal, fertilizer, sand and other commodities – for whom trucking is infeasible. Such shippers may have limited vulnerability under the proposed limit price approach, although it is hard to see how they will benefit. Showing the infeasibility of intermodal competition is already done in rail rate cases under current procedures.

However, smaller shippers, including carload and multiple car shippers, face the "false negative" danger that effective competition will be found under the proposed limit price approach when it does not exist.

The Board must bear in mind that the railroads have always sought to focus primarily on whether competition might exist, in theory if not in practice. They traditionally focus less on whether such actual or hypothetical competition is effective within the meaning of the statute, i.e., whether it keeps rail rates at or below maximum lawful levels.

Unfortunately, for too many years, the ICC and STB rewarded this narrow focus by dismissing complaints based on a presumption that, if a second carrier was or might be accessible, effective competition would surely exist. This presumption was consistent neither with the statute, since it ignored high rate levels, nor with reality, since it is clear that railroads able to compete as to price and service often decline to do so.

See, e.g., the comments filed in Ex Parte No. 705 by shippers who found that expensive build-outs produced little or no benefit. It appears that additional attempts by the railroads to shift the focus from the effectiveness of competition to whether it does or might theoretically be possible can be anticipated based on the AAR's filing in Ex Parte No. 717, seeking a rulemaking aimed at identifying "cases where effective indirect competition can safely be presumed to exist and there is accordingly no warrant for a full rate reasonableness analysis." AAR filing dated November 19, 2012 at page 11, emphasis added).[7]

The Board's proposal to use RSAM levels as a way to test the effectiveness of alleged competition is an improvement on simply presuming that competition is effective if it exists or could exist. However, as the court held in Arizona Public Service Co. v. United States, 742 F.2d 644, 651 (D.C. Cir. 1984):

> [T]he mere existence of some alternative does not in itself constrain the railroads from charging rates far in excess of the just and

[7] ARC, et al. underscore the word "presumed" in the AAR filing to emphasize that the railroads seek not to return to procedures under which they had the burden of proof as to effective product and geographic competition, as adopted in Market Dominance II. See Market Dominance Determinations – Product and Geographic Competition, supra, 3 S.T.B. at 941. Rather, the railroads evidently want the Board to presume that natural gas for power generation constrains rail rates on coal because some utilities have substituted gas for coal as a boiler fuel.

> reasonable rates that Congress thought the existence of competitive pressures would ensure.

As discussed above, one problem with the limit price test proposed by the Board is that it evidently equates RSAM levels with the just and reasonable levels that Congress thought the existence of effective competition would ensure, even though RSAM levels may exceed SAC, SSAC, revenue adequacy constrained levels and possibly even Three Benchmark rate case outcomes.

Another problem with the proposed limit price approach is that it is vulnerable to railroad gaming. Gaming by railroad defendants seeking to avoid a rate challenge can take several forms, and new ploys are likely if the Board adopts its new test as proposed. One form of gaming involves the fact that there are thousands of small, struggling "trucking companies," in the U.S., many of which consist of a driver and a single truck (frequently leased).

For many years, it has been thought that truck service is far more expensive on a unit cost basis than rail service, due to the greater volumes typically transported by rail. However, rail rates on captive traffic may be (or exceed) double the 180% of variable cost that Congress set as the jurisdictional threshold, and a desperate trucker who is barely avoiding bankruptcy may agree to provide service for a price at or near the motor carrier's cost of service.

Such motor carriers, if they survive at all, are likely to be poor prospects for captive rail shippers to depend on. Their use also raises liability exposure issues. Is the motor carrier adequately capitalized? Is it adequately insured? Does it comply with applicable safety and other legal requirements as to its operations, equipment and personnel? If not and if there is a highway accident, the shipper is likely to be sued along with the motor carrier.[8] Defendant railroads

[8] See, e.g., Schramm v. Foster, 341 F. Supp. 536 (D. Md. 2004) and Puckrein v. ATI Transit, 897 A.2d 1034 (N.J. 2006), recognizing potential tort liability under a negligent hiring theory for brokers and shippers, respectively.

in STB rate cases will have no incentive to limit themselves to FedEx, UPS or other solid, well-established trucking companies in seeking to avoid a market dominance finding. Indeed, such motor carriers may charge freight rates exceeding railroad RSAM levels, giving the railroads an incentive to look for the lowest price trucking company around, and to solicit a verified statement from such a trucker to the effect that it will work for less than the limit price applicable to the case.

And yet there is no correlation between truck costs, which are usually a function of distance, and RSAM levels, which are based on the average markup over variable cost that would produce revenue adequacy (under the current, flawed STB standards), if applied to all rates set at or above 180% of variable cost. Truck rates make no distinction between those shippers that are subject to STB rail rate jurisdiction and those shippers that are not.

Alternatively, railroads might raise their rates to truck competitive levels to avoid being found market dominant. This would be anomalous, and another form of gaming for a railroad named as a defendant in an STB rate case, since the ability to raise rates should be limited if the railroad faces effective competition. Railroads should not be allowed to "price themselves out of qualitative market dominance" through rate increases, and market dominant railroads should not have a free hand to charge high rates and impose rate increases, free of regulatory scrutiny, solely because they have not yet been found revenue adequate.

Another concern for captive rail shippers involves motor carrier capacity. It is highly unlikely that there are enough motor carriers serving Montana to be able to transport Montana's annual wheat production to the Pacific Northwest. However, as ARC, et al. understand the proposed limit price test, that fact would render truck competition infeasible only in a rate case brought by many if not most Montana grain shippers jointly. The result could be to require McCarty Farms-type class actions.

If a single grain shipper challenged BNSF wheat rates as unreasonably high, BNSF's burden would be relatively simple. It would merely need to locate a trucking company willing to say that it would transport that single shipper's wheat for a price at or near 253% of BNSF's variable cost of service (BNSF's current RSAM level). The grain shipper seeking relief would then have to try to rebut BNSF's claim of having satisfied the limit price test, or else accept BNSF rail rates at 253% of variable cost as immune from challenge. The ability of a single shipper to bring a test case would be made much harder.

As noted above, this problem is most likely for lower volume shipments. However, in State of Montana v. BNSF, STB Docket No. NOR 42124, BNSF has argued that it has the authority to impose shipment size limits, and that its prerogative includes charging single-car rates and offering no multi-car rates at all. See Transcript of November 30, 2010 oral argument at page 8. BNSF went on (id. at p. 12) to argue that the Board may regulate BNSF's rate levels, but may not regulate BNSF shipment size or volume limits. Shippers of wheat, corn, soybeans and barley, as well as other commodities, could be vulnerable, whether or not they are able to ship in trainload volumes.

ARC, et al. have used Montana in the foregoing example because BNSF controls over 90% of rail freight in the state, but similar concerns arise as to Washington, Idaho, Kansas, North and South Dakota, Nebraska, Colorado, Oklahoma, Texas and many other states across the U.S. where railroads can be expected to resist STB rate challenges through motions to dismiss based on the Board's proposed limit price approach. Though the Board may think the test would facilitate shipper access, the fact is that it would mainly facilitate railroad defenses against rate challenges.

Shippers suffering extreme captivity might be able to reduce the costs and burdens of persuading the STB of an absence of effective competition for the railroad charging the challenged rates. However, for many more shippers, the costs and burdens of establishing market dominance would go up, and for many railroad defendants seeking to avoid scrutiny of excessive rate levels, their costs and burdens would go down. Deprived of regulatory recourse for rates at or near RSAM levels, shippers who are considered captive today would lose the only negotiating leverage they have.

IV. CONCLUSION

For the foregoing reasons, ARC, et al. believe the Board's proposed limit price approach should not be adopted as a new test in STB market dominance determinations due to the virtual certainty of false negatives unreasonably and unlawfully depriving many captive shippers of the only defense they have against abuses of railroad market power. As noted, this does not mean that the Board erred in finding market dominance by Defendant CSX in this case, and there may be others in which the infeasibility of any transportation alternative, or extremely high rail rates, can support expedited findings of an absence of effective competition. However, where the limit price test is not met, the Board should apply existing tests of market dominance.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this 28th day of November, 2012, caused copies of this document to be served on all parties of record by first-class mail.

John M. Cutler, Jr.

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BEFORE THE

SURFACE TRANSPORTATION BOARD

EX PARTE NO. 715

RATE REGULATION REFORMS

OPENING COMMENTS OF

ALLIANCE FOR RAIL COMPETITION
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Dated: October 23, 2012

I. INTRODUCTION

Alliance for Rail Competition, Montana Wheat & Barley Committee and the other shipper organizations identified on the cover (hereafter, ARC, et al.), submit these Opening Comments pursuant to the Board Decision served July 25, 2012 in this proceeding.

In these Opening Comments, ARC, et al. will focus on the Board's proposed modification of its Three Benchmark procedures. This proposal is inadequate if the Board truly seeks to "provide shippers a more accessible forum to bring rate disputes" (Decision at 1), and enforce the directive of Congress that, where a railroad has market dominance, "its transportation rates for common carrier service must be reasonable" (Decision at 3, citing 49 U.S.C. § 10701(d)(1)).

ARC, et al. will also comment on changes in the definition of "effective competition" recently proposed by the Board in its decision served September 27, 2012 in Docket NOR 42123, M&G Polymers USA, LLC v. CSX Transportation, Inc. ("M&G Polymers"). The harm this proposal will cause to the goals of an accessible forum for rate disputes and reasonable rail rates for captive shippers will far outweigh any modest benefits that might result from the proposals in Rate Regulation Reforms.

In addition, ARC, et al. will comment briefly on the Board's proposal to modify the interest rate used for reparation payments as described at page 18 of its Decision in this proceeding, and on the proposed Simplified SAC and Full SAC changes. See the attached Opening Verified Statement of G.W. Fauth III (hereafter Fauth V.S.). ARC, et al. will leave to other shippers and shipper groups the task of analyzing in more depth the four proposals which we discuss only briefly. ARC, et al. generally support, as to those issues, the comments being filed by Western Coal Traffic League and Concerned Captive Coal Shippers.

ARC, et al. includes among its members captive shippers, including Executive Board members PPL, Western Fuels and Otter Tail Power Company, that have employed the Full SAC approach to challenged high rail rates as unlawful. In addition, other ARC members may consider rate challenges under the Board's two more complex and costly SAC-based rate reasonableness methodologies. However, we are confident that other parties, including WCTL and CCCS, will devote considerable resources to analyzing the technical and legal details of the Board's proposals as to Full SAC and SSAC. ARC's resources will therefore be concentrated on issues less likely to be addressed by WCTL and CCCS.

II. BACKGROUND OF THIS PROCEEDING

As the Board's July 25 Decision explains, this proceeding is an outgrowth of Ex Parte No. 705, Competition in the Railroad Industry. Another successor to that proceeding is evidently Ex Parte No. 711, Petition for Rulemaking to Adopt Revised Competitive Switching Rules, Notice served July 25, 2012. Based on comments filed in Ex Parte No. 705, the Board apparently recognizes the possibility that more may need to be done on two fronts to enhance protections for captive rail shippers.

To the extent that railroad competition does not exist, access remedies may enable shippers served by a single railroad to obtain service by a second railroad. This concept appears to underlie Ex Parte No. 711. To the extent that railroad competition is impracticable even with access remedies, or to the extent that shippers have access to more than one railroad but competition is ineffective, access remedies may do little or nothing to help. Such situations call for improved rate regulation, which appears to be the goal in Ex Parte No. 715.

ARC, et al. strongly agree that STB rail regulation needs to be made more effective even if the Board eventually revisits and overturns past decisions limiting rail competition, such as

Midtec Paper Corp. v. Chicago & N.W. Transp. Co., 3 I.C.C. 2d 171 (1986), aff'd sub nom. Midtec Paper Corp. v. United States, 857 F.2d 1487 (D.C. Cir. 1988).[1] We remind the Board that for most shippers, their captivity resulted not from fault or inaction by the shipper but rather from actions by railroads approved by the ICC and STB, including mergers, acquisitions and line sales subject to paper barriers. The Board has a responsibility to protect captive shippers vulnerable to abuses of railroad market power, and to promote effective railroad competition where feasible.

As ARC, et al. explained in comments filed in Ex Parte No. 705, increased competition between Class I railroads and among Class I and short line railroads is an important goal, particularly if railroads made able to compete actually do so. ARC, et al. support measures to increase railroad competition. However, there are also thousands of captive shippers in the U.S. that are unlikely to see any benefit from access remedies or other measures intended to foster effective competition. The STB must recognize this reality and craft appropriate remedies.

There are several problems with access remedies. First, many shippers, and in particular, many smaller and more isolated shippers of agricultural and mineral commodities including many represented by ARC, et al., are simply too far from a second railroad to be able to benefit from access remedies. Either the mileage is too great for a second railroad to reach shippers, or the volumes are too low, or the access fees are too high, or some combination of these. This fact should not subject them to monopoly pricing or poor service.

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1 In its July 25, 2012 decision in Ex Parte No. 711, the Board did not propose to revisit Midtec. Rather, it posed a series of questions that will take a great deal of time and cost a great deal of money to answer, with no certainty of any increase in competition anytime soon, if ever. See also the discussion of M&G Polymers, below, which is likely to eliminate most rail rate reductions that increased competition might otherwise produce.

In Montana, for example, most shippers of agricultural, mineral and resource commodities are hundreds of miles from any railroad other than BNSF. As a consequence, BNSF controls over 95% of Montana rail freight volumes. Other states, such as North and South Dakota, may have two railroads serving the state as a whole, but for most shippers in most areas of those states, the nearest second railroad may still be hundreds of miles away.

Another problem with access remedies is that shipper access to a second railroad does not necessarily or even often translate into competition by the railroads in question to maximize service quality and minimize costs. In Ex Parte No. 705, large coal shippers such as Ameren commented that they had spent millions of dollars to build out to a second railroad from a coal fired power plant, only to find that the second railroad was unwilling to provide better service or charge lower rates than the incumbent railroad. If this is the result with large shippers moving millions of tons of coal per year, members of ARC, et al. are understandably concerned that, even if access were feasible and affordable, nothing would change due to the unwillingness of railroads to compete.

Accordingly, while ARC, et al, are generally supportive of improved access remedies and other initiatives to promote more competition among railroads, our Ex Parte No. 705 comments emphasized that the Board must not ignore the needs of shippers that will remain captive despite such initiatives. For such shippers, the Board needs to improve the effectiveness of its regulation of unreasonable rail rates, charges and practices. Regulatory oversight must minimize the competitive disadvantages these shippers face as compared with non-captive farms, elevators and businesses.

THERE SHOULD BE NO CAP ON THREE BENCHMARK RELIEF, AND THE BOARD'S SAC CHANGES ARE MISGUIDED

ARC, et al. and other captive shipper interests made many recommendations for regulatory improvements in Ex Parte 705, and ARC's comments in that proceeding are incorporated herein by reference.[2]

In this proceeding, the Board has proposed six changes in its rate case procedures. As set forth in the attached Fauth V.S., ARC, et al. are concerned on behalf of their large coal shipper members about changes the Board has proposed as to Full SAC and SSAC cases. At a time when the Board should have less concern than ever about the revenue adequacy of major railroads and should have more concern than ever about excessive rail rates, the proposed changes make Full SAC cases more expensive and less likely to produce significant relief, and make SSAC cases almost as costly as Full SAC cases. These are steps in the wrong direction.

Full SAC and SSAC cases are now and will remain extremely costly, time consuming and demanding unless the Board adopts changes other than those at issue in this proceeding. The SAC-based rate case options will therefore be available, as a practical matter, only to very large shippers shipping enormous volumes. The Board needs to improve SAC-based remedies to make them less costly and more likely to provide relief. Fauth V.S. at 9-14

In contrast, the Three Benchmark approach can be employed by smaller and more isolated shippers for whom SAC-based remedies are prohibitively expensive or otherwise unworkable. In addition, Three Benchmark can potentially be a remedy for larger shippers that have too little at stake, or too many origin-destination pairs, for Full SAC or SSAC to be viable. Though Three

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2 ARC, et al. filed comments on April 12, 2011 in Ex Parte No. 705 and also filed separately as part of a larger shipper group including American Chemistry Council and others ("Interested Parties"). In addition, ARC, et al. filed reply comments on May 27, 2011, and participated in the Board's June 22, 2011 hearing in Ex Parte No. 705.

Benchmark is the only option for small shippers, who can't afford SAC-based approaches, Three Benchmark can also be important for large shippers with small cases. Otherwise, railroads could inflict multiple smaller abuses on captive shippers with immunity from regulatory recourse.

Although ARC, et al. identified numerous shortcomings with respect to the Three Benchmark approach in Ex Parte No. 705, the Board in this proceeding addresses only one shipper concern: the $1 million (over 5 years) relief cap.[3] And the Board's proposal is simply to raise the relief cap to $2 million (over 5 years).

ARC, et al. certainly do not oppose this change, but it does not go far enough to make the Three Benchmark approach fully meet the requirements of 49 U.S.C. § 10701(d), or to make rate relief more accessible.

The first problem is that, even with a maximum of $2 million relief over five years, the Three Benchmark process will generally not make captive shippers whole, or deter abuses of market power by monopoly railroads.

A relief cap is inherently arbitrary, and arbitrary in a way that can harm only the shipper, not the railroad. If the cap applies at all, that will mean the shipper was otherwise entitled to rate relief that the cap prevented the shipper from obtaining, and the railroad is left in possession of revenues extracted from the captive shipper that the railroad would not otherwise be entitled to keep. The only effect of a regulatory relief cap is to penalize small shippers and shippers with smaller rate disputes.

In contrast, if the shipper demonstrates that it is entitled to less than $2 million in relief over five years, that lower amount is the most the shipper can receive. In other words, the bene-

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3 As the Board notes at page 12, n. 9 of its July 25 decision, inflation adjustments since 2008 have raised the original $1 million cap to $1.118 million.

fit of the cap goes entirely to the monopoly railroad and the detriment is borne entirely by the captive shipper. Heads, the railroad wins; tails the shipper loses.

This problem exists regardless of where the relief cap is set. The same harm to a captive shipper and benefit to a monopoly railroad could occur with a $3 million or $5 million relief cap. Therefore, ARC, et al. strongly urge the Board to eliminate any relief cap in the Three Benchmark cases, as it proposes to do in SSAC rate cases.

Other compelling reasons exist for eliminating this relief cap. One is that the relief available in Three Benchmark cases is already severely limited by the formula underlying Three Benchmark. As detailed in the accompanying Fauth V.S., a successful Three Benchmark complainant will, at best, reduce its rate to a level equivalent to a revenue to variable cost percentage of roughly 250%-270%, depending on the railroad defendant. V.S. at 4-6. This is far less relief than is available to a captive shipper whose resources and shipment profile make a SAC-based rate case viable. And yet it is highly likely that if the Three Benchmark complainant could afford to bring a SAC case, it would obtain far more relief. Fauth V.S. at 7.

In other words, the rail rates challenged in a Three Benchmark case may be just as excessive and unlawful as in a SAC case, warranting a reduction to 180% of variable cost for 10 years. However, even with no relief cap, the rates of a shipper bringing a meritorious complaint could be reduced only to around 250% of variable cost, and only for five years.

This fact puts captive shippers with smaller bank accounts or smaller cases at a disadvantage, which is compounded by imposition of a relief cap. The Three Benchmark shipper, even if successful, cannot get as much relief as a SAC shipper, and the relief otherwise available may be further reduced by the relief cap.

In contrast, these factors constitute an advantage for a market dominant railroad defendant, despite its having been found to have imposed an unlawful rate. Having charged, possibly for years, rates which exceed the upper limit under the Three Benchmark formula, and which are therefore virtually guaranteed to exceed the stand-alone cost of the service, the railroad gets to keep the amounts it charged above SAC, i.e., amounts for which there is no justification under STB and court-approved economic theory, but below the Benchmark maximum. And, if the unlawful rail rates exceed $2 million over five years, the defendant railroad gets to keep that excess as well.

It is unfortunate that railroads who break the law by charging unreasonable rates are not subject to penalties that might deter other violations. The Board is able, at best, to make such railroads return excessive amounts they have collected, with interest, during the limitations period, making the wronged shipper more or less whole. Given how few rate cases are brought, this slight risk cannot serve to deter abuses of railroad monopoly power. But the Three Benchmark approach combines a relief cap (even if raised to $2 million), and limits on relief under Three Benchmark even aside from the relief cap, and the ability of railroads to raise rates even before the five year period expires, once the Board's (doubly) limited relief is recovered. The result is a system that rewards railroads for charging excessive rates. A railroad that charges $2 million too much may have to return the shipper's overpayments, if a successful Three Benchmark challenge is brought. A railroad that charges $5 million too much comes out ahead even if a successful Three Benchmark challenge has been brought. This makes no sense. The Board is not providing the regulatory oversight Congress called for where "a full stand-alone cost presentation is too costly, given the value of the case." 49 U.S.C. § 10701(d)(3).

The Board indicates that a relief cap of $2 million for Three Benchmark cases is appropriate because it now estimates that SSAC cases will cost $2.75 million to litigate. As explained by Witness Fauth (V.S. at 13), the Board has significantly underestimated the costs shippers face under SSAC, with the revisions proposed in the Board's July 15 Notice. In any event, the suggestion that shippers facing more than $2 million in overcharges over 5 years should file SSAC cases assumes that such shippers can afford to pay $2.75 million or more in hopes of obtaining relief. Few shippers of agricultural commodities have such deep pockets.

ARC, et al. also believes the Board underestimates the cost of litigating a Three Benchmark case. Assuming there have ever been shippers who could spend no more than $250,000 and hope for success in a Three Benchmark case, that cost never covered all smaller shippers and is likely to cover few, if any, now.

Consider the example of a state like Montana, in which BNSF controls more than 90% of rail freight. (Other states may be less captive when considered as a whole, but there are certainly large parts of states which a single railroad dominates to the same degree that BNSF dominates Montana, and in some western states, these areas are larger than many eastern states.)[4] Under the Three Benchmark procedures as developed by the Board in Ex Parte No. 646 (Sub-No. 1), Simplified Standards for Rail Rate Cases, decision served September 5, 2007, and in subsequent Three Benchmark rate cases, identifying a comparison group is difficult, time consuming and expensive.

The shipper must identify similarly situated shippers using the Board's specified criteria, including "length of movement, commodity type, traffic densities and likely routes involved, and demand elasticity." For a Montana shipper challenging BNSF grain rates, for example, this may

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[4] See, e.g., the Christensen, GAO and USDA studies cited in the Ex Parte No. 705 comments of ARC, et al.

necessitate identifying shippers outside Montana for the comparison group, because BNSF is not likely to treat any subset of captive Montana grain shippers to markedly lower rates than it imposed on any other subset of Montana grain shippers. See the attached Fauth V.S. at 5-6.

The requirement that shippers account for the "confidence internal" and "other relevant factors" issues may drive up litigation costs even more. It must also be understood that the Board has warned captive shipper complainants that any failure to assert every argument as comprehensively as possible may be fatal. See, e.g., PPL Montana LLC v. BNSF, Docket No. 42054, decision served June 27, 2003: "A party that does not put forward its best case as to all elements of its case assumes the risk of that strategic choice," even if the evidence omitted would have supported relief the Board cannot or will not award. The Board can no longer assume that Three Benchmark rate cases will cost no more than $250,000.

Cost consultants' fees alone may add up to much of the Board's presumed $250,000 litigation budget for the complainant shipper. Litigation costs for the railroad should be lower, because of its readier access to data. Even if railroad litigation costs were the same, however, railroads charging high enough rates can afford to allocate to litigation costs the amounts of their excessive rail rates that even a successful complainant shipper cannot recover due to the relief cap and other factors discussed above.

Assuming a shipper were able to bring a successful Three Benchmark case despite the forgoing considerations, all the railroad has to do to prevent a second successful challenge is to raise rates for comparison group traffic to more closely resemble the challenged rates on the issue traffic. Three Benchmark relief will often be easy to neutralize, and once it is, any relief a shipper obtained can be recovered by the railroad through subsequent and no longer challengeable rate increases.

Captive shippers understand that the deck is stacked against them. That is one reason there have been few Three Benchmark cases filed, and most that have been filed were not brought by small shippers of agricultural commodities. If the Board truly wants to make recourse more effective for captive shippers unable to afford SAC-based approaches, raising the relief cap to $2 million does not go nearly far enough. At a minimum, the Board should eliminate the Three Benchmark relief cap, but the Board must also strengthen Three Benchmark to reduce the shortcomings discussed above, or provide alternatives such as a functioning revenue adequacy constraint. Otherwise, Three Benchmark will become increasingly irrelevant as a methodology to remedy unreasonable rail rates.

Finally, as for the Board's proposal on interest rates, ARC, et al. support it, as far as it goes. It is another minimal step in the right direction, as noted by Witness Fauth in the attached V.S. at 14-15.

III. THE BOARD SHOULD NOT MODIFY ITS MARKET DOMINANCE STANDARDS AS PROPOSED IN M&G POLYMERS

Though not mentioned in the Board's July 25, 2012 Notice initiating this proceeding, the Board's September 27, 2012 M&G Polymers decision is highly relevant to the Rate Regulation Reforms under consideration here. If the Board were to adopt and apply its M&G Polymers decision in other rate cases, the result would immunize rail rates and rate increases from shipper challenge to a degree that would dwarf the best conceivable outcomes from Ex Parte No. 715.

The Board appears not to have invited comments in the M&G Polymers decision from anyone other than the parties to that proceeding. ARC, et al. therefore raise their concerns about the Board's proposed new definition of effective competition here.

It would be difficult to imagine a policy less likely to "provide shippers a more accessible forum to bring rate disputes" than the change in market dominance determinations proposed in

M&G Polymers. As for assisting Board efforts "to make its rate review process more widely available to shippers other than large utilities," cited as a goal at page 3 of the M&G Polymers decision, the Board's new proposals will be hugely counterproductive. Thousands of smaller shippers will find recourse to the Board for rate relief foreclosed, even if their R/VC percentages are well above 180%. In addition, railroads will be given a simple way of deregulating their own rates by raising them – a dream come true for any monopoly.

The M&G Polymers policy further isolates and disadvantages the smaller shippers and smaller cases that cannot be brought under Full SAC or SSAC. Just as such shippers are relegated to a rate reasonableness methodology – Three Benchmark – that precludes relief for rates exceeding stand-alone cost, substituting maximum reasonable rate at or near RSAM levels, M&G Polymers would apparently make RSAM levels the new jurisdictional threshold for such shippers, based on the Board's proposed new approach to market dominance determinations. See Fauth V.S. at 7-8.

In M&G Polymers, the message from the Board appears to be that if rates challenged by M&G are subject to quantitative market dominance because the R/VC exceeds 180%, the Board will proceed to qualitative market dominance but will find captivity only if the cost of all transportation alternatives is far above RSAM levels (293% for CSX, the defendant in the case). It is difficult to see how the Board reconciles this proposal with its own recognition (M&G Polymers at 5) that:

> At the core of the "effective competition" standard is the idea that there are competitive, market pressures on the railroads deterring them from charging monopoly prices for transporting goods. McCarty Farms, 3 I.C.C. 2d at 832 quoting Ariz. Pub. Serv. Co. v. United States (Ariz. Pub Serv.), 742 F.2d 644, 650-51 (D.C. Cir. 1984).

While a significant amount of differential pricing immune from challenge was built into the statutory jurisdictional threshold by Congress, a decision effectively raising the threshold for CSX by 113 percentage points is bad policy and bad law. Shippers need more recourse today, not less, and 49 U.S.C. § 10707(d)(2) prohibits a presumption that a railroad lacks market dominance because the R/VC exceeds 180 percent.

Here again, the Board appears to be rewarding railroads that choose to set rates well above SAC levels. In fact, a captive coal shipper like Ameren, having spent millions to build out to a second railroad only to find that the second railroad declines to compete, would appear to have no hope of initiating a rate case so long as both railroads' coal rates approximate RSAM.

Instead of facing the possibility of an expensive rate case that might reduce coal rates to 180% of variable cost, the railroads could simply argue that qualitative market dominance is absent. Any bargaining leverage Ameren might have by virtue of SAC-based remedies would be foreclosed unless R/VCs rise to 350%, or perhaps to the 500% of variable cost that the Board cites as indicating the need for investigation. M&G Polymers at 4.[5] It appears that the Board sees the need to deter rate cases by small shippers which theoretically might have sound transportation alternatives as more important than the need to remedy monopoly pricing by railroads (which it cannot deter). In the experience of ARC, et al., captive shippers file rate cases as a last resort, and there is no reason to fear false claims of captivity.

Shippers of millions of tons coal over long distances may not need to worry about claims of effective competition from trucks, though build-outs and access remedies may disqualify such shippers from filing a rate case forever or until revenue adequacy is achieved. Adoption of an

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[5] Notably, under the Board's Hypothetical I in M&G Polymers, rail rates at 375% of variable cost would be no cause for concern unless the R/VC equivalent for the alternative was 425% or higher, and even then, the Board would want to make sure there were no "intangible factors" warranting dismissal of the rate case for lack of market dominance.

effective revenue adequacy constraint on differential pricing might do no good for such shippers if they are erroneously deemed protected by "effective competition" under M&G Polymers.

However, truck competition, real or imagined, will certainly be claimed by railroads seeking to head off rate challenges by smaller shippers, including shippers of agricultural commodities represented by ARC, et al.

Unlike coal moving in weekly or daily unit train volumes, grain shipments from country elevators will often be subject to theoretical competition from trucks. The truck capacity to move all of the wheat grown in Montana, North Dakota or other states represented by ARC, et al. may not exist, but rate cases tend not be filed as class actions. An individual shipper would be a far more likely complainant.

Consider a hypothetical shipper paying BNSF or UP rail rates at 275% of variable cost, who wanted to file a Three Benchmark case, possibly as a test case observed by similarly situated shippers. Aside from the obstacles discussed in earlier sections of these comments, the hypothetical shipper might now face the need to address the Board's new definition of effective competition.

As we read M&G Polymers, nothing would prevent the railroad defendant from calculating the RSAM-equivalent cost, and soliciting bids from trucking companies for service at such rates. There are several hundred thousand trucking companies registered with DOT, many of which consist of a driver with an owned or leased truck, operating on a shoestring. If the defendant railroad were able to secure an affirmative response to its bid, the Board would apparently conclude that the challenged rail rates were adequately constrained by truck alternatives, and rate reasonableness issues would never be reached.

It gets worse. Assume, in the foregoing hypothetical, that the alternative truck cost were 25 percentage points above the challenged rail rate, and therefore arguably not a constraint on rate levels. By raising its rate, the railroad could apparently price itself out of market dominance, insulating itself from rate challenges. Moreover, the STB has held that "a rate may be unreasonable even if the carrier is far short of revenue adequacy" Rate Guidelines – Non-Coal Proceedings, 1 S.T.B. 1004, 1017 (1996). For shippers unable to afford SAC – based rate cases, this may no longer be true.

It is as if, in an antitrust case where the market definition was so narrow as to produce liability exposure (e.g., toasters costing $50 or less), the law permitted potential defendants to double their prices, creating apparent competition with toaster ovens and making their market share appear too small for concern. Of course, this would not work in the toaster market because toaster buyers are not captive. However, many small shippers of agricultural commodities and many small farmers are decidedly captive, and have no commercial means of defending themselves against rail rate increases up to truck-competitive levels. Under M&G Polymers, it would appear that their regulatory remedies would also be foreclosed.

ARC, et al. emphatically do not mean to suggest that the Board's finding of CSX market dominance as to most of the rates challenged by the complainant in M&G Polymers was erroneous. If a lack of effective competition is found under such a strongly pro-railroad standard, market dominance by CSX surely exists.

However, the new test of effective competition proposed in M&G Polymers threatens to deregulate rail rates and rail rate increases for many thousands of other shippers who currently regard themselves as captive to a single railroad. Whatever further steps it takes in Docket No.

42123, the Board should not adopt its new approach to market dominance as to any other shippers without further consideration of the threat that approach poses to STB rail rate regulation.

ARC, et al. recognize that the statute calls on the STB to promote railroad revenue adequacy, in addition to guarding against unreasonable rates and practices. However, we also believe that, but for the Board's overly conservative revenue adequacy standards, most if not all Class I railroads would have been found long-term revenue adequate years ago. Certainly, BNSF's access to ample capital is now beyond dispute. STB market dominance standards are critical to any hope shippers may have of challenging high rail rates, and therefore to any bargaining leverage shippers may have in negotiations with rail carriers. For the Board to adopt the flawed M&G Polymers approach while continuing to apply flawed revenue adequacy standards would severely harm the interests of non-utility shippers the Board says it wants to help.

IV. THE BOARD SHOULD EXPLORE OTHER WAYS OF ADDRESSING CAPTIVE SHIPPERS' CONCERNS

ARC, et al. welcome the Board's decision to initiate its proceedings in Ex Parte No. 715 and Ex Parte No. 711, even if the proposals in the former do not go far enough (and are counterproductive in many ways), and even though there are no proposals in the latter. ARC, et al. also welcome the opportunity to address BNSF acquisition premium issues and related issues in response to the Board's decision served October 9, 2012 in Docket No. 35506, Western Coal Traffic League – Petition for Declaratory Order. Without such proceedings, prospects for improved regulation and increased competition are poor.

However, there are other initiatives the Board should consider. As just pointed out, revenue adequacy is here or imminent even under excessively conservative STB standards. The Berkshire Hathaway vote of confidence aside, BNSF would have been revenue adequate for

2011 but for the Board's misguided treatment of the acquisition premium, which was said by BNSF's auditors to be $8 billion.

In 1985, the ICC expressed the view that the ability of railroads to overcharge captive shippers through differential pricing, subject only to rate regulation by this agency, could not remain business as usual once revenue adequacy is achieved. See Coal Rate Guidelines, Nationwide, 1 I.C.C. 2d 520, 534-37 (1985), aff'd. Consolidated Rail Corp. v. United States, 812 F.2d 1444 (3rd Cir. 1987). In Coal Rate Guidelines, the Commission adopted its revenue adequacy constraint, and the ICC sand STB have consistently listed that constraint as an option in rate case decisions ever since, but for almost 30 years, the revenue adequacy constraint has failed to help a single rail shipper.

Coal Rate Guidelines contains indications about how rail rate regulation might change for railroads that meet or exceed long-term revenue adequacy, and the end of presumptively unlimited differential pricing could be of tremendous benefit to shippers that have for decades made disproportionate contributions to railroad revenues.[6]

The Board can and should consider how to implement its revenue adequacy constraint. Not only will the issue arise soon in a rate case, but it could offer more hope to smaller shippers and large shippers with smaller disputes than the approaches that are the subject of Ex Parte No. 715.

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6 Though the Long-Cannon Amendment, codified at 49 U.S.C. § 10701(d)(2), provides a basis for preventing "one commodity" from contributing an unreasonable share of a railroad's revenues, it does not prohibit one shipper or even a group of shippers from being forced to contribute an unreasonable share. In any event, the ICC held many years ago that "a disproportionate share is not necessarily an unreasonable share." See Public Service Co. of Indiana v. I.C.C., 749 F.2d 753, 765 (D.C. Cir. 1984).

ARC, et al. suggested such a focus on revenue adequacy in our comments in Ex Parte No. 705.[7] We also called on the Board to consider tests for determining when ancillary railroad charges, as opposed to freight rates, are excessive. (Id. at 5-7.) Many shippers have been hit with multiple new charges that appear far higher than any conceivable cost of the underlying service. If railroad charges are now profit centers, there should be a methodology for assessing their reasonableness, but SAC, SSAC and Three Benchmark cannot satisfy this need. The Board's decision on fuel surcharges in Ex Parte No. 661, Rail Fuel Surcharges, decision served January 26, 2007, was welcome, as was the Board's July 29, 2008 decision denying UP's motion to dismiss in Docket No. 42105, Dairyland Power Coop v. Union Pacific R. Co. However, more general guidance as to maximum reasonable railroad charges should be forthcoming.

The Board may have had such smaller disputes in mind in attempting to facilitate mediation and arbitration in Ex Parte No. 699, Assessment of Mediation and Arbitration Procedures. Here again, the Board deserves commendation for its efforts. Unfortunately, railroad reluctance to agree to arbitration may limit the value of alternative dispute resolution.

There were other recommendations made by shippers in Ex Parte No 705 that warrant attention and development. STB rail rate regulation and competition policies have not been optimized.

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[7] See the May 27, 2011 Reply Comments of ARC, et al. at 1-4.

V. CONCLUSION

For the foregoing reasons, ARC, et al. urge the STB to eliminate any relief cap in Three Benchmark rate cases, to rethink the changes proposed in M&G Polymers, and to broaden its focus to include new initiatives to address rates, charges and practices by market dominant railroads that are challenged as unreasonable.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this 23rd day of October, 2012, served copies of the foregoing document on all parties listed on the STB service list by first-class mail, postage prepaid.

John M. Cutler, Jr.

BEFORE THE

SURFACE TRANSPORTATION BOARD

STB DOCKET EX PARTE NO. 715

RATE REGULATION REFORMS

VERIFIED STATEMENT

OF

GERALD W. FAUTH III

My name is Gerald W. Fauth III. I am President of G. W. Fauth & Associates, Inc., an economic consulting firm with offices at 116 South Royal Street, Alexandria, Virginia 22314. A statement describing my background, experience and qualifications is attached hereto as Appendix GWF-1.

This Surface Transportation Board (STB or Board) proceeding concerns proposals by the Board to modify its railroad rate reasonableness rules and guidelines. The STB currently has three rate reasonableness tests: Stand-Alone Cost (SAC or Full-SAC), Simplified-SAC and Three-Benchmark. In a decision served July 25, 2012 in this proceeding, the Board proposed six changes to its existing rate reasonableness rules.

I have been asked by the Alliance for Rail Competition, Montana Wheat & Barley Committee, Colorado Wheat Administrative Committee, Idaho Barley Commission, Idaho Wheat Commission, Montana Farmers Union, Nebraska Wheat Board, Oklahoma Wheat Commission, South Dakota Wheat Commission, Texas Wheat Producer Board, and Washington Grain Commission (hereinafter referred to as ARC et al.) to submit these comments concerning the Board's proposed changes to railroad rate reasonableness rules and guidelines.

The "*centerpiece*" of the STB's decision is to remove the limitation on relief for cases brought under the Simplified-SAC test, which is currently set at $5 million over 5 years.[1] The STB's stated goal for the proposed removal of the rate relief limit in Simplified-SAC cases is "to encourage shippers to use a simplified alternative to a Full-SAC analysis that is economically sound, yet provides a less complicated and less expensive way to challenge freight rates by discarding the requirement that shippers design a hypothetical railroad to judge a railroad's real world rates."[2] The proposed removal of the rate relief limitation in Simplified-SAC cases would be a positive step towards the STB's goal of making Simplified-SAC more accessible for captive shippers. However, the STB has also proposed "*some technical changes,*" which would have the opposite effect and would make it much more expensive and more difficult for captive shippers to obtain relief under Simplified-SAC.

The STB has also proposed to double the relief available under the Three Benchmark method from approximately $1 million to $2 million over 5 years.[3] This is also a positive step, however, the Board's rationale is misplaced since it ties the Three-Benchmark relief limit to an unsupported and understated cost estimate to present a Simplified-SAC case (with proposed changes) of "less than $2.75 million."[4] Moreover, the current and proposed limits ignore the fact the Three-Benchmark test is a very different economic approach under which (unlike Full-SAC or Simplified-SAC) the maximum rate levels in a successful case can never be set at 180 percent (which has occurred often in Full-SAC cases) and, indeed, are likely to be significantly higher than 180 percent. The Three-Benchmark relief limit should be eliminated.

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1 STB Ex Parte No. 715, Rate Regulation Reforms, served July 25, 2012, page 3.
2 *Ibid.* page 3.
3 *Ibid.* page 15. The monetary limit is indexed annually for inflation.
4 STB Ex Parte No. 715, page15.

In addition to the proposed changes to the Simplified-SAC and Three Benchmark relief levels, the Board has proposed "some technical changes" which include: curtailing the use of cross-over traffic in Full-SAC cases; modifying the approach used to allocate revenue from cross-over traffic in Full-SAC and Simplified-SAC cases; "improving the accuracy" of the Road Property Investment (RPI) component of the Simplified-SAC test; and raising the interest rate that the railroads must pay to complainants for, inter alia, reparations when the railroad has collected unreasonable rates.[5]

Essentially, the STB's proposed technical changes significantly raise the Full-SAC and Simplified-SAC rate reasonableness bars. Without question, the proposed curtailing of the use of cross-over traffic in Full-SAC cases will result in higher Full-SAC results (i.e., higher maximum reasonable rates) and the proposed changes to the RPI component of Simplified-SAC will make it much more expensive and more difficult for captive shippers to obtain relief under Simplified-SAC.

The Proposed \$2 Million Limitation on
<u>Relief for Three-Benchmark Cases</u>

The STB has proposed doubling the relief available under the Three-Benchmark method from approximately \$1 million to \$2 million over 5 years. The Board's rationale ties the Three-Benchmark relief limit to an unsupported and understated cost estimate to present a Simplified-SAC case (with proposed changes) of "less than \$2.75 million." As indicated herein, the Board's proposal to eliminate the RPI simplification component of Simplified-SAC will significantly increase the cost to present a Simplified-SAC case. Essentially, the Board has proposed eliminating the "Simplified" from Simplified-SAC. As a result, the cost of a Simplified-SAC

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[5] *Ibid.* page 1 and page 3.

case will be much closer to the cost to present a Full-SAC, which the Board has estimated to cost about $5 million.

Although the Three-Benchmark test, like Simplified-SAC and Full-SAC, ensures that the defendant railroad(s) earn adequate revenues, it employs a completely different rate reasonableness approach from the SAC tests. Simplified-SAC and Full-SAC are based on replacement cost methodologies, whereas the Three-Benchmark test employs rate comparisons (i.e., R/VC_{COMP}), which are, in most cases, adjusted upward based on system-wide benchmarks (i.e., $R/VC_{RSAM} / R/VC_{\geq 180\%}$). The Board's current and proposed relief limits ignore the fact that complainants utilizing the Three-Benchmark test have an inherent disadvantage in that, if the complainant is successful, the resulting maximum reasonable rates levels can never be set at 180 percent (which has been the case in previous Full-SAC cases) and, indeed, are likely to be significantly higher than 180 percent.

Under the R/VC_{COMP} component of the Three-Benchmark test, the R/VC percentages of the issue traffic are compared to the R/VC percentages for the defendant's similarly situated captive shippers. Comparability is determined by reviewing a variety of factors, such as length of movement, commodity type, traffic densities of the likely routes involved, and demand elasticity. For example, the R/VC percentage for a 750 mile BNSF grain movements may be compared to other BNSF grain movements with R/VC percentages equal to or exceeding 180% and moving a similar distance (e.g., 600 to 800 miles).

It has been my experience that the Class I railroads (especially BNSF, which is the largest grain hauler) pay close attention to the R/VC percentages associated with captive traffic which could be subject to STB rate regulation. The railroads know that they can push captive rates up to a R/VC percentage level of approximately 250% or higher with little or no risk of STB intervention.

In order to demonstrate this fact, I have developed the R/VC percentage associated with BNSF's current export wheat rates for shuttle trains (110 cars per train) from Shelby, Montana to River Gate, Oregon. Shelby, which is 778 miles from River Gate, is the closest shuttle facility to the PNW export terminals. Based on the STB's unadjusted URCS approach, BNSF's current freight charges of $3,584 per car generate a R/VC percentage of **257%**.[6] If BNSF's rate from Shelby, Montana were challenged using the Three-Benchmark test, it is doubtful that the shipper would obtain any meaningful relief from the STB.

For example, assume that it was determined that the BNSF had comparable shuttle train export wheat movements moving a similar distance which generated a R/VC of 225%. The comparable R/VC percentage would by marked up BNSF's R/VC_{RSAM} (253%) / $R/VC_{\geq 180\%}$ (223%) mark-up ratio (1.13453).[7] For example, if the R/VC_{COMP} percentage is established at 225%, it would be marked-up to 255 percent (225% x 1.13453).

Although Montana is one of the most captive states, it would, in reality, be difficult to find a comparison group of BNSF shuttle train export wheat movements which would generate R/VC percentages below 225%. According to the U.S. Department of Agriculture's (USDA) Crop Reports, the largest wheat producing states in 2011 were: Kansas (276,500,000 bushels), North Dakota (199,858,000 bushels), Montana (174,970,000 bushels), Washington (167,880,000 bushels), Idaho (115,979,000 bushels) and South Dakota (104,796,000 bushels). Although BNSF serve these states, the distances to the Pacific Northwest (PNW) export terminals are different. For example, the distances from Washington to the PNW are much shorter and the distances from North Dakota are much longer.

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6 BNSF rates per carload taken from BNSF 4022-M, Item 43808, Col.4, effective October 6, 2012. BNSF's current fuel surcharges are included in the freight charges. URCS costs were developed using the STB URCS 2010 BNSF data, indexed to a current level.

7 See STB Ex Parte No. 689 (Sub-No.3), Simplified Standards For Rail Rate Cases - 2010 RSAM and R/VC>180 Calculations, served February 27, 2012, page 3.

Export wheat shuttle train movements from Montana to the PNW could be compared to export wheat shuttle train movements from BNSF shuttle train origins in Kansas moving to export terminals in Texas. As indicated in the following table, however, the R/VC percentages associated with shuttle movements from Kansas to Houston moving plus or minus 50 miles of the distance from Shelby (778 miles) are in the same range:

Table 1

R/VC Percentages Associated With BNSF 110-Car Export Wheat Movements From Kansas Shuttle Origins to Houston, TX Moving 728 to 828 Miles [8]

BNSF Kansas 110-Car Shuttle Origin	BNSF Miles to Houston	BNSF Freight Charges Per Car	BNSF R/VC
Abilene	738	$3,784	262%
Salina	761	$3,801	256%
Hugoton	787	$3,984	260%
Concordia	793	$3,825	247%
Wright	799	$3,995	257%
Dodge City	807	$3,992	254%
Ensign	822	$3,998	250%

As can be seen, the Kansas to Texas R/VC percentages range from 247% to 262%, which are in the same range as the Montana to PNW R/VC percentages. As a result, captive Montana wheat shippers would receive no relief by using the R/VC percentages of the Kansas to Texas wheat traffic as a comparison group. Nor would Kansas wheat shippers have much chance of developing a successful case using a comparison group based on Shelby, Montana shipments. The fundamental problem is that the Three Benchmark approach can be and is rendered

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[8] BNSF rates per carload taken from BNSF 4022-M, Item 46307, Col.4, effective July 19, 2012. BNSF's current fuel surcharges are included in the freight charges. URCS costs were developed using the STB URCS 2010 BNSF data, indexed to a current level.

ineffective if market dominant railroads raise rates to similar levels for all similarly situated captive shippers. The occasional outlier might qualify for relief but most small shippers are not helped by Three Benchmark and cannot bring SAC based rate cases.

Under Full-SAC or Simplified-SAC, it is possible that the rates from Shelby could be set at 180 percent, especially since Shelby is on BNSF's high-density "Hi-Line." However, the potential rate relief would not pay for the cost to present a Simplified-SAC or Full-SAC case. For example, CHS estimates that Shelby loads approximately 1.5 shuttles per month, which equates to 1,980 carloads per year.[9] If we assume that all of the Shelby traffic moved to River Gate and the rates were set at 180 percent, the rate reduction per car would be approximately $1,080 per car or $2.14 million per year, which is $600,000 less than STB's estimate to present a Simplified-SAC case (i.e., $2.75 million in current dollars), an estimate I believe is too low.

A recent STB decision in STB Docket No. NOR 42123, M&G Polymers USA, LLC v. CSX Transportation, Inc., served September 27, 2012, (M&G Polymers), may further reduce the potential relief in Three-Benchmark cases. In M&G Polymers the STB concluded that CSXT possesses market dominance with respect to only 36 of the 42 challenged R/VC>180% rates. The STB appears to have adopted a new market dominance standard which it calls "limit price R/VC ratio."[10] The STB stated:

> ". . . We will refer to the ratio of the limit price over variable costs as the "limit price R/VC ratio." If the limit price R/VC ratio exceeds CSXT's most recent RSAM figure, we preliminarily conclude that the alternative cannot exert competitive sufficient to constrain rates effectively. If, in contrast, the limit price R/VC ratio falls below this RSAM figure, we

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9 http://www.chsmontana.com/index.cfm?show=10&mid=6 (110 cars per shuttle x 1.5 shuttles per month x12 months)

10 M&G Polymers, served September 27, 2012, page 14 (quotations included).

will preliminary conclude that the competitive alternative effectively constrains that rate at issue."[11]

The following table lists the most current RSAM percentages published by the STB:[12]

Table 2

STB's Current RSAM Percentages (4-Year Average)

Railroad	RSAM
BNSF	253%
CSXT	293%
CN (GTC)	309%
KCS	327%
NS	265%
CP (SOO)	301%
UP	258%

As can be seen, each of these RSAM percentages exceeds 250%. If the STB were to adopt this "Limit Price R/VC Ratio" or R/VC_{RSAM} approach, the potential for rate relief under the Three-Benchmark test may be even more limited. If BNSF could find a trucking company with costs comparable to 253% of BNSF's variable cost of service, it could argue that market dominance is absent, and move for dismissal of any rate complaint. Lacking any regulatory recourse, the shippers would have little or no negotiating leverage with BNSF.

And if railroads are allowed to use RSAM levels instead of 180% in market dominance determinations, effectively rising the jurisdictional threshold, they might then argue for RSAM as a rate reasonableness standard. Even if limited to use in market dominance determinations as proposed in M&G Polymers, RSAM would eliminate regulatory recourse for thousands of shippers paying rates well above 180% of variable cost. And thousands of shippers paying rates with R/VCs above 180% but below RSAM could be vulnerable to unchallengeable rail rate

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11 *Ibid.*

12 See STB Docket No. EP 689 (Sub-No. 3), Simplified Standards For Rail Rate Cases - 2010 RSAM and R/VC>180 Calculations, served February 27, 2012, page 3.

increases up to RSAM levels. The main beneficiaries of this change would plainly be railroads that the Board continues to find revenue inadequate, even though they are enjoying record revenues and are having no difficulty attracting capital.

The Board's goal of facilitating rate cases and preventing excessive rail rates and rate increases would be better served if the Board adopted more accurate revenue adequacy standards and a functioning revenue adequacy constraint.

Proposed Elimination of RPI Simplification

The STB formally adopted Simplified-SAC in a decision served September 5, 2007 in Ex Parte No. 646 (Sub-No.1), Simplified Standards for Rail Rate Cases (Simplified Standards). I submitted expert testimony in that proceeding for a group referred to as "Interested Parties" and my testimony was cited by the Board.[13] As a result, I am very familiar with the Board's Simplified-SAC approach.

In Simplified Standards, the Board significantly restricted the evidence parties can submit on certain issues. The STB stated that the "*core analysis*" in a Simplified-SAC proceeding will address the "replacement cost of the existing facilities used to serve the captive shipper and the

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[13] Interested Parties included: American Chemistry Council, American Forest and Paper Association, American Soybean Association, Colorado Wheat Administrative Committee, Fertilizer Institute, Glass Producers Transportation Council, Idaho Barley Commission, Idaho Wheat Commission, Institute Of Scrap Recycling Industries Inc, Montana Wheat & Barley Committee, National Association Of Wheat Growers, National Barley Growers Association, National Corn Growers Association, National Council Of Farmer Cooperatives, National Farmers Union, National Grain And Feed Association (NGFA), National Industrial Transportation League, National Oilseed Processors Association, National Petrochemical And Refiners Association, Nebraska Wheat Board, North American Millers' Association, North Dakota Grain Dealers Association, North Dakota Public Service Commission, North Dakota Wheat Commission, Oklahoma Wheat Commission, Paper & Forest Industry Transportation Committee, PPL Energyplus, South Dakota Wheat Commission, Texas Wheat Producers Board, Washington Wheat Commission, Alliance For Rail Competition, Consumers United For Rail Equity, National Sorghum Producers, USA Rice Federation, and the Honorable Brian Schweitzer, Governor, State of Montana. I also submitted testimony on behalf of the U.S. Clay Producers Traffic Association, Inc.

return on investment a hypothetical SARR would require to replicate those facilities."[14] Specifically, the Board established simplified procedures for determining road property investment (RPI) based on the findings in prior Full-SAC cases. The Simplified-SAC test utilizes a rolling average from prior cases, such that as new Full-SAC cases are issued by the Board, older cases are dropped from the comparison in subsequent proceedings.

Appendix A of the Board's decision in Simplified Standards describes the development of the simplified RPI components and could be described as the "core analysis" of Simplified-SAC.[15] Although the RPI simplification process set forth in Simplified Standards is the core of Simplified-SAC test, one of the Board's proposed "technical changes" in this proceeding calls for the removal or elimination of RPI simplification. The Board's rationale for this proposed change is shown below:

> The current Simplified-SAC test simplifies the RPI component by relying on findings from prior Full-SAC cases. Simplified Standards, slip op. at 15. We also seek public input on whether, if we remove the limitation on relief as discussed above, we should remove the RPI simplification. Complainants would be required to submit detailed expert testimony on the replacement costs of the facilities used to serve the complainant.
>
> Our rationale is that we cannot retain the RPI simplification if we are going to remove the rate-relief cap under this approach. We understand that removing this simplification feature of the approach will raise costs and may require extending the procedural schedule. We propose to consider extensions of the procedural schedule on a case-by-case basis. As for costs, we believe that a Simplified-SAC case, even without the RPI simplification, will remain far less expensive to litigate than a Full-SAC case. Nevertheless, because there will be some increased cost, we also propose to raise the monetary limit on relief for a Three-Benchmark case to allow all rate complainants who cannot justify using the Simplified-SAC approach to have a cost-effective option for rate relief.[16]

In these two paragraphs, the Board proposes a "technical change" which would essentially *gut* the core analysis (i.e., RPI simplification) of Simplified-SAC. Under the STB's

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14 Simplified Standards, page 15.
15 *Ibid.* pages 38 through 48.
16 STB Ex Parte No. 715, pages 14 and 15.

new proposal, the complainants "would be required to submit detailed expert testimony on the replacement cost of the facilities."[17] If this proposed change is adopted, the litigation costs associated with Simplified-SAC cases will significantly increase. As acknowledged by the Board, the development of RPI evidence is "expensive."[18]

In Simplified Standards, The STB developed the following simplified approach for use in the development of RPI costs in Simplified-SAC cases:[19]

1. **Land** - Land costs per acre by category (agricultural, residential, industrial and commercial) (Table A-2);

2. **Roadbed Preparation** - Earthwork costs per cubic yard (common, loose, solid, borrow and fine grading) (Table A-3) and other earthwork cost per route mile (Table A-4);

3. **Track** - Track construction cost per track mile (Table A-5);

4. **Tunnels** – Not simplified due to the lack of data.

5. **Bridges and Culverts** - Bridge construction cost per linear foot per track (eastern and western costs by bridge type) (Tables A6, A-7 and A-8) and culvert construction costs per square inch and foot (corrugated metal pipe, reinforced concrete box and structural steel plate) (Table A-9);

6. **Signals and Communication** - Signaling and communications costs (with CTC) per route mile (Table A-10);

7. **Building and Facilities** - Building and facilities costs per ton of total traffic (Table A-11);

8. **Public Improvements** - Public improvement costs per route mile (without grade separations) (Table A-12) and grade separation cost per separation (Table A-13).

9. **Mobilization, Engineering, and Contingencies** - Mobilization is fixed at 3.5% of the cost of road preparation, track, tunnels, bridges and culverts, signals and communications, buildings and facilities, and public improvements. Engineering is fixed at 10% of the same RPI expense categories. Contingencies are fixed at 10% of road preparation, track, tunnels, bridges and culverts, signals and communications, buildings and facilities, public improvements, mobilization, and engineering.

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17 See Ex Parte No. 715, page 14 and 15

18 *Ibid.* page 15.

19 See STB's decision in Ex Parte No. 646 (Sub-No. 1), served August 14, 2009, for the most current rolling RPI averages.

RPI costs represent the core of SAC cases. For example, as shown in the following table, in the most recent Full-SAC case decided by the Board, i.e., STB Docket No. 42113, Arizona Electric Power Cooperative, Inc. v. BNSF Railway Company And Union Pacific Railroad Company, served November 22, 2011, (AEPCO), the Board adopted RPI values which amounted to nearly $7 billion:

Table 3

RPI Values in STB Docket No. 42113

Item	AEPCO	BNSF/UP	STB
Land	$217,127,324	$217,127,324	$217,127,324
Roadbed Preparation	$1,274,203,409	$2,088,221,496	$1,279,698,628
Track	$2,771,918,869	$2,976,497,975	$2,798,024,510
Tunnels	$54,456,954	$74,178,992	$74,179,521
Bridges	$736,200,000	$736,217,899	$736,217,899
Signals & Communications	$305,786,000	$383,888,175	$372,814,461
Building & Facilities	$175,652,366	$225,372,345	$190,832,590
Public Improvements	$59,753,863	$59,882,262	$59,738,638
Mobilization	$58,329,605	$123,035,566	$65,123,562
Engineering	$537,797,146	$649,816,876	$551,150,625
Contingencies	$619,122,554	$748,814,852	$634,490,776
TOTAL	**$6,810,348,090**	**$8,283,053,762**	**$6,979,398,533**

These RPI costs were developed based on numerous studies and analyses and hundreds of pages of testimony prepared by several prominent economists, economic consultants, engineers and other witnesses retained by the complainant (AEPCO) and the defendant railroads (BNSF and UP). The combined expert and legal fees associated with the RPI development likely costs hundreds of thousands, if not millions, of dollars.

Conversely, under Simplified-SAC a single economic analyst could develop the RPI costs in a few days using the RPI simplification process. For example, Table 3 shows that the largest RPI cost element in AEPCO was Track costs ($2.8 billion as determined by the STB). Under the STB's current RPI simplification process, parties merely have to determine the number of track miles and multiply by the developed track cost per mile (STB Table A-5).

The Board states that it cannot retain the RPI simplification if it removes the rate-relief cap under this approach. I believe that the Board's rationale is misplaced. Essentially, the Board is eliminating the "*Simplified*" from Simplified-SAC. The Board states that "the cost to bring a Simplified-SAC case, even without the RPI simplification, should be significantly less than 50% of the cost to bring a Full-SAC case (i.e., less than $2.75 million dollars). I respectfully disagree. There is no evidence to show that Simplified-SAC without RPI simplification will be any less expensive than a Full-SAC case. Perhaps the Board should also consider changing the name from "Simplified-SAC" to "Almost Full-SAC" or "Full-SAC Lite", since the remaining simplifications included in Simplified-SAC are minimal in comparison to the RPI simplification process.

Proposed Cross-Over Traffic Changes

Another "technical change" that the Board has proposed involves the use of cross-over traffic in Full-SAC and Simplified SAC cases. Cross-over traffic refers to movements, such as interchange traffic, which would be routed over the hypothetical stand-alone railroad (SARR) for "only a part of their trip from origin to destination."[20] The Board maintains that it must "address the use of cross-over traffic in Full-SAC cases in order to correct a "bias" in the current cross-over traffic approach "created by the disconnect between the revenue allocation and the costs of

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[20] Ex Parte No. 715, page 6.

providing service." Accordingly, the Board has proposed two options for Full-SAC cases: (1) restricting the use of cross-over traffic to movements for which the SARR would either originate or terminate the rail portion of the movement, or (2) restricting the use of cross-over traffic to movements where the entire service provided by the defendant railroad in the real world is in trainload service.[21] The Board has also proposed to modify the Average Total Cost (ATC) method which is used to allocate revenues from cross-over traffic in Full-SAC and Simplified-SAC cases.

There is no question that the Board's proposals concerning limitations on cross-over traffic will raise Full-SAC maximum reasonable rate levels. The Board's first proposal which restricts cross-over traffic to movements which would either originate or terminate on the SARR and thus exclude potential "bridge" cross-over traffic, and the second proposal would exclude potential non-trainload traffic. All railroads carry bridge traffic and non-trainload traffic, but the hypothetical SARR would not be allowed to carry this traffic under the Board's proposals. Less cross-over traffic will result in higher Full-SAC rates.

Proposed Changes to The Interest Rate on Rate Overcharges

The Board has proposed to change the interest rate used in rate cases from the T-Bill rate (currently at 0.10%) to the U.S. Prime Rate, as published in The Wall Street Journal (currently at 3.25%)[22]. The Board states that the Prime rate is "the interest rate that the banks charge to their most creditworthy customers, and may serve as a more appropriate rate for calculating interest owed to shippers for rates found by the Board to be unreasonable."[23] This is a positive step, but it should be noted that under the Board's proposed changes, reimbursements under Full-SAC

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[21] *Ibid.* pages 16 and 17.
[22] *Ibid.* page 18.
[23] *Ibid.*

will be significantly lower with the proposed restrictions on cross-over traffic and thus the interest component of shippers' relief will be significantly lower. Moreover, the costs associated with the Simplified-SAC test will be significantly higher with the proposed elimination of RPI simplifications. As a result, any higher interest payments will be more than off-set by the higher Simplified-SAC litigation costs.

Summary

The "*centerpiece*" of the STB's decision is to remove the limitation on relief for cases brought under the Simplified-SAC test. Without the proposed "technical changes" this would be a positive step and likely achieve the Board's "overarching goal" to "ensure that the Board's simplified and expedited tests for resolving rate disputes are more accessible to parties."[24] With the proposed elimination of RPI simplification, however, the Board has effectively taken "Simplified" out of Simplified-SAC. It has proposed to make Simplified-SAC less "simplified and expedited" and less "accessible to parties."

The STB's proposal to double the relief available under the Three Benchmark method from approximately $1 million to $2 million over 5 years is a small step in the right direction. However, the Board's rationale is misplaced since it ties the Three-Benchmark relief limit to an unsupported and understated cost estimate to present a Simplified-SAC case (with proposed changes) of "less than $2.75 million." Moreover, the current and proposed limits ignore the fact the Three-Benchmark test is a very different economic approach under which (unlike Full-SAC or Simplified-SAC) the resulting maximum rate levels can never be set at 180 percent (which has been the case in previous Full-SAC cases) and, indeed, are likely to be significantly higher than 180 percent. The Three-Benchmark relief limit should be eliminated.

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[24] Ex Parte No. 715, page 1.