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BEFORE THE
SURFACE TRANSPORTATION BOARD

US MAGNESIUM, L.L.C.	)	
Complainant,	)	
v.	)	Docket No. NOR 42114
UNION PACIFIC RAILROAD COMPANY	)	
Defendant.	)	

JOINT REPLY OF AMICI CURIAE, THE FERTILIZER INSTITUTE, AMERICAN CHEMISTRY COUNCIL, AND THE CHLORINE INSTITUTE TO THE OPENING EVIDENCE OF UNION PACIFIC RAILROAD COMPANY

Amici Curiae, The Fertilizer Institute ("TFI"), the American Chemistry Council ("ACC"), and the Chlorine Institute ("CI") (jointly referred to as "Amici") hereby submit this Joint Reply to the Opening Evidence of Union Pacific Railroad Company ("UP"), filed on August 24, 2009. By separate motion, TFI, ACC and CI have asked the Board to accept this Amicus Reply to address an important issue raised by UP with broad implications for all shippers of toxic inhalation hazards ("TIH").

I. Background.

A. Identity of Amici.

TFI, ACC, and CI are trade associations whose members include producers, purchasers and/or shippers of TIH commodities, which are essential to their businesses and to the American economy as a whole. Because TIH commodities cannot always be produced in the same locations where they are used, safe, secure, reliable, and economic transportation is essential.

Rail transportation is the safest and most economic mode by which to transport TIH commodities over land. Therefore, any action taken by this Board that affects the rates for transportation of TIH by rail potentially has significant downstream ramifications for the entire economy.

TFI is the national trade association of the fertilizer industry. TFI, which traces its roots back to 1883, represents virtually every primary plant food producer, as well as secondary and micronutrient manufacturers, fertilizer distributors and retail dealerships, equipment suppliers and engineering construction firms, brokers and traders, and a wide variety of other companies and individuals involved in agriculture. Many members produce and/or consume anhydrous ammonia, which is a TIH that provides essential nutrients to grow our nation's food supply.

ACC's 130 members account for approximately 85 percent of U.S. capacity for the production of basic industrial chemicals and manufacture a wide array of products that are offered for shipment by railroads and other carriers. ACC and its members have a long-standing commitment to the safe and secure transportation of hazardous materials. The business of chemistry depends upon the railroads for the safe, efficient and secure transportation of 176 million tons of chemical products each year, including TIH commodities. The movement of TIH commodities by rail is critical to the well being of our country and our way of life.

The Chlorine Institute, Inc., is a 210-member trade association of chlor-alkali producers worldwide, as well as packagers, distributors, users, and suppliers. The Institute's mission is the promotion of safety and the protection of human health and the environment in the manufacture, distribution and use of chlorine, sodium hydroxide, potassium hydroxide and sodium hypochlorite, plus the distribution and use of hydrogen chloride. The Institute's Producer members account for over 95 percent of total chlorine production capacity in the United States. Virtually all the chlorine shipped by rail in the United States is by a Chlorine Institute member.

B. Statement of Interest.

Complainant, US Magnesium LLC ("USM"), has challenged the reasonableness of rates established by UP for the transportation of chlorine, which is a TIH. USM has elected to bring its challenge pursuant to the Three-Benchmark procedures adopted in STB Ex Parte No. 646 (Sub-No. 1), Simplified Standards for Rail Rate Cases (served Sept. 5, 2007) ("Simplified Standards"). In accordance with the procedures adopted in Simplified Standards, UP and USM submitted Opening Evidence on August 24, 2009 regarding the comparable traffic group that should be used to determine the presumed maximum reasonable rate. UP also submitted evidence of "other relevant factors" that it contends warrant an upward adjustment to the presumed maximum rate. It is this evidence that TFI, ACC, and CI desire to address.

Specifically, UP attempts to increase the maximum reasonable rates for USM's chlorine shipments by including estimated costs to comply with a Congressional mandate that all Class I railroads install positive train control ("PTC"), by December 31, 2015, on mainlines that carry TIH commodities and/or passenger traffic. If the Board were to adopt UP's position, it would have broad rate ramifications for *all* TIH traffic, not just the USM traffic at issue in this case. Therefore, Amici, on behalf of their members, have a very strong and direct interest in this issue.

II. UP'S RATES ARE MORE THAN SUFFICIENT TO RECOVER ITS PTC COSTS WITHOUT FURTHER INCREASES.

Amici are extremely concerned by the skyrocketing levels of rail rates for TIH commodities over the last several years. UP's claim that its TIH rates are based on market conditions are not credible, unless UP means the market conditions of a market dominant monopolist. UP Op. Ev. at 32. But it is precisely those market conditions against which regulation is designed to protect.

The rail industry, including UP, has been very vocal about its desire not to haul TIH traffic at all.[1] Because the common carrier obligation legally prevents railroads from refusing TIH commodities, they are instead engaged in an active campaign to "demarket" by setting rail rates for TIH as high as possible to discourage demand and to maximize revenue on TIH traffic that has no option but to move by rail.[2] Because TIH shippers have little or no choice but to ship by rail under the terms dictated by the railroads, or not ship at all, they are forced to accept these unreasonable terms. Fair and meaningful rate regulation is the only protection that TIH shippers have against this railroad pricing strategy.

In this market environment, it is highly disingenuous for UP to contend that it should be permitted to collect even higher rates in order to recover its PTC investment costs. UP already is earning unreasonably high returns on TIH shipments and PTC costs are not likely to change that. UP is merely trying to justify as high a rate level as it can in order to further its demarketing strategy.

The Board rejected TIH demarketing strategies in STB Docket No. 42100, E.I. DuPont de Nemours and Company v. CSX Transp. Inc., (served June 30, 2008) ("DuPont"). There, the Board acknowledged real concern over carrier efforts to demarket chlorine traffic. Id. at 5. The Board rejected CSXT's all chlorine comparison group in favor of DuPont's all-TIH group, based in part upon CSXT's demarketing strategy for chlorine:

> Moreover, CSXT has acknowledged that it now prices chlorine beyond what would otherwise be commercially justifiable, in an

[1] Written Testimony of UP at 6, in STB Ex Parte No. 677 (Sub-No. 1), *Common Carrier Obligation of Railroads—Transportation of Hazardous Materials* (filed July 15, 2008).

[2] In addition to rates, railroads are attempting to demarket TIH by other means. For example, earlier this year, both UP and RailAmerica published tariffs that shifted liability for TIH incidents to shippers even when the liability is attributable to the railroad's own negligence. Both railroads ultimately withdrew those tariff provisions, but not until confronted with lawsuits filed by ACC and The Chlorine Institute. See American Chemistry Council v. California Northern Railroad, No. 2:09-CV-01410 (USDC N.D. Cal.); Chlorine Institute v. Union Pacific Railway, No. 2:09-CV-00574 (USDC Utah).

> effort to induce shippers to use substitutes for chlorine or source it from nearer locations. Accordingly, a comparison group drawn exclusively from traffic that the railroad concedes is being priced to discourage the traffic would not, in our view, provide a reasonable measure of the share of joint and common costs (and thus the maximum R/VC levels) that should be borne by the issue chlorine movements.

Id. at 9. For similar reasons, the Board should not permit upward adjustments to the presumed maximum rate on grounds that certain costs, such as PTC, are not included in that rate when the challenged rate itself is the product of a demarketing strategy that does not set rates based upon either costs or competitive market conditions.

The height of UP's disingenuousness is its suggestion that USM is an outlier in complaining about TIH rates, because other TIH shippers "have acknowledged that [PTC] is a legitimate consideration in establishing rate and service terms." UP Op. Ev. at 13, 50-51. UP's statement is without any support, and the statement itself does not indicate that TIH shippers concede that UP needs to collect such extremely high rates in order to recover its PTC investment. UP has presented TIH shippers with "take it, or leave it" rates, and interpreted acquiescence to those rates as agreement that they are reasonable. The TIH shippers represented by Amici are extremely concerned with the level of TIH rates and do not agree that current rates, much less even higher rates, are justified by PTC or any other factors.

III. THE RATE PRESCRIPTION PROCESS ALREADY ACCOUNTS FOR REGULATORY LAG.

Because the maximum rate is based upon the R/VC relationship, rather than absolute rate levels, regulatory lag is not an issue. Once the maximum R/VC ratio is determined, that ratio is applied to the most recent Uniform Rail Costing System ("URCS") data available and indexed to the present. Therefore, as UP incurs costs associated with installing PTC, those costs will be captured in the adjusted URCS, which means that revenue will have to increase in order to maintain the prescribed R/VC ratio. Consequently, no "other relevant factor" adjustment is needed in order to capture PTC costs due to regulatory lag.

The Board adopted this method for determining the maximum rate from the prescribed R/VC ratio in a large rate case, STB Docket No. 42111, Oklahoma Gas & Electric Co. v. Union Pac. R.R. Co. (served July 24 2009) ("OGE"), and announced that the method also would apply for all rate cases. Id. at 10, 11.

In STB Docket No. 42088 (Sub-No. 1), Western Fuels Association, Inc. v. BNSF Ry. Co. (served July 27, 2009) ("WFA"), which the Board served only three days later, the Board elaborated on its reasons for this method:

> Expressing the rate prescription as R/VC ratios rather than as predetermined rates provides a flexible rate prescription methodology that allows the actual rates charged for the issue traffic to yield the *same* contribution prescribed by the Board *as costs change.*

Id. at 7 [emphasis added]. The Board added that:

> [W]e express rate limits as R/VC ratios, so that if operating expenses increase or decrease unexpectedly..., the maximum lawful rates will respond *automatically* and *immediately.*

Id. at 8 [emphasis added]. The Board concluded that "there is a need for flexibility in *rate prescriptions* so that they *can be self-adjusting as operating expenses change*, while continuing to provide a reasonable constraint on the pricing of the railroad." Id. [emphasis added].

Thus, the Board itself recognized that the rate prescription process would minimize, if not eliminate, regulatory lag in the prescribed rates. To the extent that UP incurs PTC costs in 2009, those costs will be captured in the URCS data by no later than 2011. And just as important, those PTC costs will be anticipated in the indexed URCS data almost *immediately.* In fact, the Board's quarterly indexing procedures are based on a market basket of price (not cost) indexes that increase at a faster pace than URCS unit costs because the Board's procedures do not include a productivity factor. So long as there is positive productivity in the rail industry, the indexing procedures (based on prices) will impose a *higher* rate of increase than a subsequent true-up based on actual URCS costs when the latter becomes available.

The combination of using the most recent URCS data and indexing that data, according to the Board, "is a simple and unbiased approach." OGE at 10. Although the actual variable costs inevitably may be higher or lower, "there is no reason to conclude that [this] simple approach...will systematically skew the variable cost estimate in favor or either the shipper or the railroad." Id. The Board concluded that:

> this mechanism will provide certainty to the parties, avoid the expense of hiring consultants to perform an annual true-up, minimize ancillary disputes, and, in our judgment, strikes the proper balance between the desire for accuracy and the time, expense, and burden of waiting for more accurate costing data to become available.

Id. at 10-11. UP's proposed "other relevant factor" adjustment for PTC costs injects precisely the type of complexity and expense the Board has sought to avoid. Moreover, it is no more accurate because it relies on estimates and projections from a more biased source (*i.e.*, UP) than the indices relied upon by the Board.

IV. UP'S ADJUSTMENT TO THE PRESUMED MAXIMUM RATE FOR PTC COSTS IS PREMATURE.

Even if an "other relevant factor" adjustment to the presumed maximum rate for PTC costs were appropriate (which it is not), UP's adjustment is premature. UP has not yet made any investment in PTC that it needs to recover. If UP is allowed to adjust the presumed maximum rate to recover its PTC investment costs before it knows what those costs will be and before it actually incurs those costs, the Board will open the door in Three-Benchmark cases for railroads to raise maximum rate levels on the basis of estimated, rather than real, costs. Such costs may never be incurred at the levels anticipated, and in some cases maybe not at all. Furthermore, the issue traffic may never benefit from any of those costs for which it would be required to pay. The Board does not require "captive [] shippers to provide in advance a revenue stream to pay for investments not yet made and assets that are not in place." STB Docket No. 41685, CF Industries, Inc. v. Koch Pipeline Company, L.P., p. 26 (served May 9, 2000).

All that the Board knows from UP's evidence in this case is that UP *estimates* that its total PTC implementation costs will be $1.4 billion and that UP must implement PTC by December 31, 2015. UP Op. Ev. at 6. UP acknowledges that its only firm commitment to install PTC anywhere on its system prior to this deadline is in the Los Angeles Basin by 2012. Id. at 37. Otherwise, the Board does not know when, where, or how much UP will invest in PTC, or how UP intends to fund its PTC investment. The Board *does* know, however, that any rate prescription for USM will expire in March 2014, which is almost two full years *before* the Congressional deadline for installing PTC.

UP argues that it cannot wait until PTC has been installed before seeking to recover its PTC investment costs, because unlike traditional investments, PTC is not a voluntary investment based upon anticipated returns, but is mandated by Congress without any expected return to UP. Therefore, UP contends that it must begin generating revenue to support its PTC investment now. Id. at 52-53. Despite UP's assertions, however, there will be ample opportunity for UP to recover its PTC costs *after* those costs are known and have been incurred.

First, we can quickly dispose of UP's argument that the Board must permit UP to recover PTC costs from current shippers because current market conditions are "favorable" and "there is no guarantee it will be able to recover its costs from future shippers" at future "market" rates. Id. If UP can charge "above-market" rates to TIH shippers today, in an economy that has been widely proclaimed to be the worst since the Great Depression, and call that a "favorable" market, surely it will have no problem recovering PTC costs *after* completing that investment.

Second, as UP actually incurs the costs to install PTC, those costs will be captured by the URCS. As a result, those costs will be encompassed within the R/VC ratios of the comparable traffic group, and the RSAM and $R/VC_{>180}$ benchmarks, and thereby reflected in the presumed maximum rate. UP concedes this very point, UP Op. Ev. at 61-62, but chooses to argue that it still must recover its PTC costs now, even before the amount and timing of its investment is known, because it may not have the opportunity to do so later.

To the extent that there might be a regulatory lag issue, it could only be implicated in the future, if the PTC costs that already have been incurred have not yet shown up in the URCS costs for the comparison group. That scenario is distinguishable from this case, because the costs already would have been incurred and thus would be known. Any adjustment to the presumed maximum rate would be temporary, only until the waybill sample includes years in which the PTC investment is captured by URCS. As demonstrated in Part III, supra, the Board's decisions in WFA and OGE indicate that regulatory lag for small, medium and large rate cases is addressed through the rate prescription process.

V. UP'S PTC ADJUSTMENT IS INCOMPLETE AND, THEREFORE, MUST BE REJECTED.

The Board should reject UP's PTC investment as an "other relevant factor" because UP's proposed adjustment is incomplete, thus rendering a maximum rate based upon that adjustment too high. UP erroneously assumes that PTC is of no benefit to anyone other than TIH shippers (and passenger traffic when applicable). Consequently, UP fails to include countervailing cost savings to offset its estimated cost increases. Because UP has the burden to demonstrate the need for, and to quantify the effect of, its "other relevant factor" adjustments, the Board must reject UP's PTC adjustment. See DuPont at 17; Simplified Standards at 77.

UP implies that it will not benefit from PTC because the overlay form of PTC that UP will install does not provide the same potential benefits as standalone PTC, such as enhancement of track capacity. UP Op. Ev. at 36-37. The comparative costs and benefits of different forms of PTC require evidence and analysis that unduly complicate a Three-Benchmark case, which is supposed to be a simplified standard for determining reasonable rail rates. In Simplified Standards, at 22 and 78, the Board reserved the right to proscribe categories of evidence that would lead to complex or protracted litigation or otherwise significantly increase the expense of a Three-Benchmark case, even if such evidence otherwise might be relevant. Fortunately, it is not necessary to engage in that debate to demonstrate the flaws in UP's argument.

UP concedes that there are safety benefits to PTC, but then ignores those benefits in its quantitative analysis of PTC costs as an "other relevant factor." Id. at 36. UP and other railroads repeatedly have justified their high TIH rates as necessary to account for their greater risk of liability from an accident that involves a release of TIH. See UP Op. Ev. at 6, 12-13. PTC will significantly reduce the potential for such an accident, which in turn will reduce UP's exposure to liability. That reduced liability risk should have a countervailing impact on rates. UP's failure to address and incorporate that countervailing rate reduction into its quantitative analysis renders that analysis incomplete.[3]

Moreover, PTC has the potential to decrease UP's costs beyond just reducing its TIH liability risk. PTC will reduce the risk of accidents for all trains on PTC-equipped track, not just

[3] In fact, UP appears to take a "heads I win, tails you lose" position when it comes to liability risk at pages 44-45 of its Opening Evidence. Immediately after acknowledging that Congress mandated PTC "to *reduce* the risks associated with transporting TIH," UP contends that even *higher* rail rates for TIH are warranted because "PTC cannot eliminate *all* the risk associated with transporting TIH." [emphasis added] Thus, so long as there is *any* risk associated with TIH shipments, UP would argue that higher rates are justified.

those with TIH traffic. That in turn reduces casualty expenses, clean-up costs, costs imposed by operational delays, employee injuries, and potentially a host of other costs. But UP has not even acknowledged those savings, much less attempted to account for them in its "other relevant factor" adjustment. This further exposes the incomplete and one-sided nature of UP's adjustment to the presumed maximum rate for PTC costs.

In addition, many of the costs avoided by PTC that are described above also will accrue to other (*i.e.*, non-TIH) shippers, because their shipments and rail cars will be involved in fewer accidents. Thus, it is not fair to conclude that only TIH shippers will benefit from the installation of PTC.

Accordingly, UP has failed to meet its burden of demonstrating that its proposed "other relevant factor" adjustment for PTC costs is appropriate.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have on this 22nd day of September, 2009, served a copy of the foregoing Joint Reply of Amici Curiae, The Fertilizer Institute, American Chemistry Council, and The Chlorine Institute to The Opening Evidence of Union Pacific Railroad Company on the following by hand to:

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