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September 22, 2009

BY HAND

The Honorable Anne K. Quinlan
Acting Secretary
Surface Transportation Board
395 E Street, SW
Washington, DC 20423

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Re: Docket No. 42114, *US Magnesium, L.L.C. v. Union Pacific Railroad Company*

Dear Secretary Quinlan:

Enclosed for filing *under seal* in the above-reference matter are the original and ten copies of the Highly Confidential version of Union Pacific's Reply Evidence, three compact discs containing an electronic copy of the Highly Confidential version, and three compact discs containing Union Pacific's Highly Confidential electronic workpapers.

We have separately enclosed for filing in the Board's *public docket* the original and ten copies of a Redacted version of Union Pacific's Reply Evidence, and three compact discs containing an electronic copy of the Redacted version.

Additional paper copies of this filing are also enclosed. Please return date-stamped copies to our messenger.

Thank you for your attention to this matter.

Sincerely,

Michael L. Rosenthal

Enclosures

225762

REDACTED – TO BE PLACED ON THE PUBLIC FILE

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

US MAGNESIUM, L.L.C.,)
)
Complainant,)
)
v.)
)
UNION PACIFIC RAILROAD COMPANY,)
)
Defendant.)



Docket No. 42114

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REPLY EVIDENCE OF UNION PACIFIC RAILROAD COMPANY

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September 22, 2009

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to address the “other relevant factors” discussed in UP’s Opening Evidence. Finally, Part VI summarizes UP’s conclusion that the challenged rates are reasonable.

UP’s Reply Evidence is supported by a Verified Statement from Robert G. Worrell, Senior Assistant Vice President - Chemicals for UP, who refutes USM’s allegations that UP has adopted a strategy to “de-market” chlorine and other TIH materials and that UP engaged in “gaming” when it established the challenged rates. *See* Appendix A. UP’s Reply Evidence is also supported by a Verified Statement from Dr. Marius Schwartz, Professor of Economics at Georgetown University, who analyzes the economic basis for USM’s “de-marketing” claims and concludes that the data do not support those claims. *See* Appendix B. Finally, UP’s Reply Evidence regarding railroad costing issues, the identification of the comparison groups, and the calculation of the maximum reasonable rates in this proceeding is verified by Benton V. Fisher, a Senior Managing Director at FTI Consulting, Inc. *See* Appendix C.

I. INTRODUCTION

UP’s Opening Evidence explained that rates negotiated between UP and most chlorine shippers have increased significantly since 2004, that USM’s rates had fallen below the rates paid by other shippers, and that this dispute arose because UP wanted to bring USM’s rates up to market levels. *See* UP Op. at 12-15. USM confirms each of these points in its own opening evidence. Specifically, USM acknowledges that UP has been “significantly ramping up chlorine and TIH commodity rates,” that “chlorine producers with whom USM competed in some markets were above USM in profitability,” and that UP’s “pricing strategy” with regard to USM reflected an effort to “shrink or eliminate that gap.” USM Op., O’Connor V.S. at 6, 7.

Although USM acknowledges that its rates were below market levels, it claims that UP has manipulated the market by adopting “a pricing strategy that called for significantly ramping up chlorine and other TIH commodity rates to maximize profits.” *Id.* at 7. However,

there is nothing manipulative about setting rates to maximize profits – particularly for a railroad consistently found to be revenue inadequate. UP readily admits that it sets rates to maximize profits; it follows that strategy not only for chlorine and other TIH materials, but for all of the commodities that it handles.

USM also claims that UP’s approach to pricing chlorine and other TIH materials is part of a “de-marketing” strategy. *Id.* at 4. According to USM, UP has been “de-marketing” TIH by “setting rates at levels designed to be so high as to discourage the traffic from moving.” *Id.* However, USM’s de-marketing claim is inconsistent with its recognition that UP has been raising rates on chlorine and other TIH materials to maximize profits and that UP has succeeded in “significantly increasing the revenue contributed by these movements.” *Id.* at 6.

USM’s claim that UP has been de-marketing TIH is also inconsistent with its acknowledgement that, until recently, USM and UP had “reached agreements for contract rates after mutual negotiations, that were generally reasonable and fair to USM.” USM Op., Kaplan V.S. at 6. Indeed, USM claims that “UP adopted and began implementing” a de-marketing strategy “in the 2005 timeframe,” USM Op. at 13, but neglects to mention that USM chlorine volume increased by { } percent from 2005 to 2008, *see* Worrell Reply V.S. at 6. USM’s de-marketing claim is also inconsistent with UP’s recent success in negotiating new contracts with each of its top chlorine shippers, except USM. *See* UP Op. at 50; Worrell Reply V.S. at 9.

Dr. Marius Schwartz of Georgetown University explains in his accompanying reply verified statement that raising rates, while accepting some reduction in volume, is consistent with efforts to maximize profits. He concludes that an examination of UP data regarding TIH volume, revenue, and variable cost in recent years confirms that UP’s pricing

behavior is consistent with the pursuit of greater profit and does not support USM's claim that UP has been seeking to de-market TIH. *See* Schwartz Reply V.S. at 4-7.

UP is legitimately and seriously concerned about the risks associated with transporting chlorine and other TIH materials. *See* UP Op. at 9-12. However, UP is not attempting to address its concerns by making these commodities too costly to transport by rail. As described in the accompanying verified statement by Robert G. Worrell, UP's Senior Assistant Vice President - Chemicals, UP is addressing its concerns by, among other things, improving its safety and security processes, instituting procedures to ensure that customers comply with those processes, working with customers and other partners within the industry to develop and implement new rail tank car designs, and encouraging shippers to eliminate unnecessary movements of TIH by engaging in product substitution, on-site production, and product swaps as an alternative to long-distance transportation. *See* Worrell Reply V.S. at 4-5.

Ultimately, USM's allegations of market manipulation and de-marketing appear designed to draw attention from the serious problems with USM's Opening Evidence; namely, USM's flawed proposal to calculate the R/VC_{COMP} benchmark using comparison groups that are not similar to the issue traffic; its flawed proposal to create a narrowly-tailored "TIH $R/VC_{>180}$ " benchmark to ratchet down the already-low rates produced by its faulty comparison groups; and its baseless claims of "gaming" to justify increasing the limit on relief in this proceeding.

USM has not selected appropriate comparison groups. USM has not selected appropriate comparison groups for purposes of calculating the R/VC_{COMP} benchmark. USM is challenging UP's rates for transporting chlorine, but it included almost no chlorine traffic in its proposed comparison groups.

Even though UP ships more chlorine than any other TIH commodity, and chlorine accounts for more than 38 percent of UP's movements of TIH, USM's comparison groups consist almost entirely of movements of anhydrous ammonia and other TIH commodities:

- USM's proposed comparison group for the challenged Sahuarita rate consists of 162 movements: 143 anhydrous ammonia, 9 hydrogen fluoride, 8 ethylene oxide, and 2 chlorine. Chlorine therefore accounts for only 1 percent of the proposed comparison group. *See* USM Op., Hillenbrand V.S., Exhibit_(KNH-4).
- USM's proposed comparison group for the challenged Eloy rate consists of 89 movements: 70 anhydrous ammonia, 8 ethylene oxide, 7 hydrogen fluoride, and 4 chlorine. Chlorine therefore accounts for only 4 percent of the proposed comparison group. *See id.*, Exhibit_(KNH-5).

Chlorine is in a very different product market than anhydrous ammonia and the other commodities that USM included in its proposed comparison groups. *See* UP Op. at 26-27. Using an R/VC_{COMP} benchmark developed from movements of commodities in different product markets to set maximum rates for chlorine would defeat the reason for using the R/VC_{COMP} benchmark in the first place – that is, to serve as the best available measure of demand elasticity and ensure that regulated rates reflect demand-based differential pricing principles. *See id.* at 23-26.

Moreover, chlorine is among the most toxic of TIH materials in industrial use. *See id.* at 6-8. Government studies show that chlorine poses materially greater transportation risks than anhydrous ammonia, which comprises the vast majority of the traffic in USM's proposed comparison groups. *See id.* at 8-9.

UP's proposed comparison groups consist solely of movements of chlorine. For this and other reasons that are discussed in Part II, UP's comparison groups are "most similar in aggregate to the issue movements." *Simplified Standards* at 18.

USM has not justified any downward adjustment to the presumed maximum lawful rates based on "other relevant factors." USM compounds its error of creating a flawed

R/VC_{COMP} benchmark by proposing to substitute a special “TIH R/VC_{>180}” benchmark for the Board’s R/VC_{>180} benchmark. USM asks the Board to leap from the premise that UP’s “potentially captive” TIH traffic has a higher average markup than UP’s other “potentially captive” traffic to the conclusion that a downward adjustment is required to comply with the principle that one commodity should not be “paying an unreasonable share of the carrier’s overall revenues.” USM Op. at 20 (quoting 49 U.S.C. § 10701(d)(2)(C)).

USM’s proposal is flawed in many respects. At the most basic level, USM’s proposal flouts the Board’s determination in *Simplified Standards* that “R/VC_{>180} will not be more narrowly tailored to focus on a subset of the railroad’s traffic, as that is the role of the R/VC_{COMP} benchmark.” *Simplified Standards* at 82. USM also fails to consider that some commodities will necessarily move at above-average markups; thus, it never tries to explain why UP’s average markup on TIH should be considered “unreasonable.” These and other problems with USM’s proposed adjustment are discussed in Part III.

USM has not offered any valid reason to increase the limit on relief in this proceeding. USM argues that the Board should increase the \$1 million limit on relief in this case because UP raised its rates to USM “with the specific intent of gaming USM’s access to the *Simplified Standards*.” USM Op. at 24. This outrageous and false accusation is belied by USM’s admission that its rates had fallen below rates paid by its competitors and that UP was seeking simply to “shrink or eliminate that gap.” USM Op., O’Connor V.S. at 6. USM also claims that UP’s decision to establish common carrier rates that were { } percent above its contract rate proposal constituted “gaming.” See USM Op., Kaplan V.S. at 8. However, as UP showed in its Opening Evidence, the { } percent differential is less than the typical difference

between contract rates and common carrier rates. See UP Op. at 63-64. UP further addresses and refutes USM's arguments for increasing the limit on relief in Part IV.

II. "FINAL OFFER" COMPARISON GROUPS

The development of an appropriate comparison group is the foundation of the Three-Benchmark method. The Three-Benchmark analysis is a meaningless mathematical exercise unless comparison group traffic provides a valid basis for assessing the markup over variable costs being paid by the issue traffic.

Ideally, comparison group traffic should have the same demand and cost characteristics as the issue traffic. However, it is far more critical that comparison group traffic and the issue traffic have similar demand characteristics than similar cost characteristics. As the Board has explained, the Three-Benchmark method is about "comparing mark-ups over variable costs," which means that "movements with different cost characteristics may be included in the comparison group." *Simplified Standards* at 17; see also *South-West Railroad Car Parts Co. v. Missouri Pac. R.R.*, ICC Docket No. 40073 (ICC served Dec. 12, 1988) at 8 ("Differences in transportation shipment characteristics . . . are not critical.").

The Board has recognized that the best way to guarantee that comparison group traffic and the issue traffic have similar demand characteristics is to ensure that the comparison group traffic and the issue traffic involve commodities in the same or a similar product market. See *Rate Guidelines – Non-Coal Proceedings*, 1 S.T.B. 1004, 1035 n.90 (1996). In other words, the traffic should involve commodities that are the same or that are substitutes for each other. See *South-West Railroad Car Parts, supra*, at 6; *South-West Railroad Car Parts Co. v. Missouri Pac. R.R.*, STB Docket No. 40073 (STB served Dec. 31, 1996) at 7; cf. U.S. Department of Justice & Federal Trade Commission, *Horizontal Merger Guidelines* § 1.1 (1997) (explaining that two commodities are in the same product market if they are substitutes).

UP and USM agree upon many of the relevant cost characteristics of comparison group traffic, but they differ dramatically with respect to the crucial issue of demand characteristics: UP's proposed comparison groups consist entirely of movements of chlorine, while USM's comparison groups consist almost entirely of movements of anhydrous ammonia. This important difference means that UP's proposed comparison groups are "most similar in aggregate to the issue movements." *Simplified Standards* at 18.

In addition, UP and USM agree that comparison group traffic should exclude "non-defendant traffic" – that is, movements for which R/VC ratios developed from Waybill Sample data do not reflect UP's actual revenues and variable costs because all or a portion of the line-haul movement was handled by another carrier – but USM's comparison groups actually include a significant number of movements that suffer from this problem.

In section A, we discuss the most significant difference between the parties' proposed comparison groups: USM's proposal to include movements of any TIH in its comparison groups, which results in proposed comparison groups that contain almost no chlorine. In section B, we describe four comparability factors on which the parties agree. In section C, we discuss comparability factors that were identified by one party but not the other. In section D, we discuss two comparability factors that the parties agree are relevant, but that they have applied differently. Finally, section E summarizes UP's "final offer" selection criteria.

A. USM Did Not Select "Like Commodities."

The most significant difference between USM's and UP's criteria for selecting comparison group traffic is the criterion used to select comparable commodities. UP limited potentially comparable movements to movements of chlorine, whereas USM considered the universe of potentially comparable movements to include movements of any TIH.

Adopting USM's approach would have dramatic consequences for this case: USM's approach produces comparison groups that contain almost no chlorine traffic. Instead, USM's proposed comparison groups consist almost entirely of anhydrous ammonia and other TIH commodities. Chlorine accounts for only 1 percent of the traffic in USM's proposed comparison group for the challenged rate to Sahuarita; chlorine accounts for only 4 percent of the traffic in USM's proposed comparison group for the challenged rate to Eloy. This near absence of chlorine from USM's comparison groups is all the more remarkable because Waybill Sample data from 2004 through 2007 show that chlorine actually accounted for more than 38 percent of UP's movements of TIH.¹

Table 1 further illustrates the consequence of adopting USM's proposed comparison groups: the challenged rates would be evaluated using comparison groups that contain almost no chlorine, either in absolute or percentage terms.

**TABLE 1
COMPOSITION OF USM'S PROPOSED COMPARISON GROUPS**

Commodity	Sahuarita		Eloy	
	Number of Records	% of Comp. Group	Number of Records	% of Comp Group
Anhydrous Ammonia	143	88%	70	79%
Hydrogen Fluoride	9	6%	7	8%
Ethylene Oxide	8	5%	8	9%
Total, Non-Chlorine	160	99%	85	96%
Chlorine	2	1%	4	4%

¹ By comparison, anhydrous ammonia accounted for approximately 31% of UP's movements of TIH, based on Waybill Sample data from 2004 through 2007. See UP Reply Highly Confidential electronic workpaper "UP TIH CWS 2004 2007 - Reply.xls."

The theory underlying the Board's reliance on the R/V_{COMP} benchmark requires that the comparison groups in this case consist of movements of chlorine, or at least movements of other commodities that are in the same product market as chlorine. *See* UP Op. at 22-26. USM notes that the commodities in its proposed comparison groups are all "TIH commodities." USM Op. at 17. However, the TIH designation relates to the commodities' extremely hazardous nature; it does not mean that they are in the same product market or otherwise have similar demand characteristics. The TIH designation suggests that the commodities may have similar cost characteristics, but that is only one of the two considerations when developing a comparison group, and it is the less important of the two. *See supra*, pp. 7-8.²

As UP discussed in its Opening Evidence, chlorine is in a very different product market than anhydrous ammonia and the other TIH materials in USM's proposed comparison groups, and thus chlorine can be expected to have very different demand characteristics. *See* UP Op. at 26-27. Because USM's proposed comparison groups consist almost entirely of anhydrous ammonia, and USM therefore is effectively proposing that the Board set maximum reasonable rates for movements of chlorine based on movements of anhydrous ammonia, it is worth focusing in particular on the differences in the product markets for chlorine and anhydrous ammonia.

Chlorine and anhydrous ammonia are used in very different markets, and thus the demand for each commodity, and the related demand for transportation of each commodity, are subject to very different market forces. Chlorine is used primarily in the manufacture of plastics

² Moreover, as discussed extensively in UP's Opening Evidence, although chlorine and anhydrous ammonia are both TIH materials, chlorine's toxicity and dispersion properties make chlorine a far riskier material to transport than anhydrous ammonia. *See* UP Op. at 6-9.

and for other industrial uses. *See id.* at 26. By contrast, anhydrous ammonia is primarily used in agriculture, as a fertilizer, or in manufacturing other fertilizers. *See id.* Chlorine and anhydrous ammonia plainly are not substitutes for each other. Plastics are not manufactured using anhydrous ammonia, and crops are not fertilized with chlorine. *See id.*³

Shippers also have more modal alternatives for transporting anhydrous ammonia than for transporting chlorine. Approximately 85 percent of long-distance delivery of chlorine takes place by railroad tank car. *See id.* at 27 (citing figures from The Chlorine Institute). By contrast, less than half of the anhydrous ammonia used in this country moves by rail. *See id.* at 27-28 (citing figures from The Fertilizer Institute).

Shippers also have more product alternatives for anhydrous ammonia than for chlorine. According to The Chlorine Institute, for 95 percent of chlorine's uses, there is no ready substitute for chlorine. *See id.* at 26. By contrast, there are other fertilizers that could be substituted for anhydrous ammonia and that are less hazardous to transport than anhydrous ammonia. *See id.* at 28.

In addition, although chlorine and anhydrous ammonia are both classified as TIH, chlorine is far more toxic than anhydrous ammonia, and chlorine's toxicity, combined with its dispersion properties, make chlorine far more risky to transport than anhydrous ammonia – a fact confirmed by an extensive study sponsored by the U.S. Department of Energy. *See id.* at 8-9.

UP recognizes the many differences between chlorine and anhydrous ammonia in its own marketing activities. Within UP's Chemicals group, anhydrous ammonia is marketed by

³ UP's Opening Evidence also explained why chlorine is not in the same product market as hydrogen fluoride and ethylene oxide – the two other TIH commodities that appear in USM's proposed comparison groups. *See* UP Op. at 27.

the team responsible for fertilizers, while chlorine is marketed by the team responsible for industrial chemicals, and the two teams report to different assistant vice presidents. *See id.* at 27.

USM's only justification for including all TIH commodities in its proposed comparison groups is that the Board adopted all-TIH comparison groups in *E.I. DuPont de Nemours & Co. v. CSX Transp. Inc.*, STB Docket No. 42100 (STB served June 30, 2008) ("*DuPont*"). *See* USM Op. at 17. However, the situation in this case is different from the one that the Board faced in *DuPont*. The Board's decision in *DuPont* reflected CSX's admission that its chlorine pricing was "driven primarily by risk avoidance and mitigation considerations, not profit maximization considerations," and that it was pricing chlorine "beyond what would otherwise be commercially justifiable." *DuPont* at 8, 9. As the Board observed, if the rates in the Waybill Sample data do not reflect the carrier's assessment of a commodity's demand characteristics, then "a broader comparison group" may be necessary to "provide a more reasonable guide for the contribution to joint and common costs that the movements at issue should bear." *Id.* at 9.

In this case, UP's chlorine rates reflect UP's assessment of market-level rates for chlorine. *See* Worrell Reply V.S. at 10-11. USM itself recognizes that UP's pricing reflects a strategy "to maximize profits." USM Op., O'Connor V.S. at 7. As discussed below in more detail, Dr. Schwartz confirms in his verified statement that the data indicate that UP's pricing reflects efforts to increase profits, not an effort to de-market chlorine and other TIH materials. *See* Schwartz Reply V.S. at 4-7.

Because chlorine and other TIH materials are in different product markets and chlorine and other TIH materials have different risk profiles, there is no reason to believe that UP's markups on movements of other TIH materials provide a "reasonable guide for the

contribution to joint and common costs that the movements at issue should bear.” *DuPont* at 9. Accordingly, there is no justification for including movements of other TIH materials in comparison groups that will be used to determine the maximum rates that UP can charge for movements of chlorine.

B. USM And UP Agree On The Application Of Four Comparability Factors.

UP and USM agree upon four of the remaining seven comparability criteria identified by USM in its opening evidence:

First, they agree that potentially comparable movements should be limited to movements generating R/VC ratios above 180 percent. *See* UP Op. at 21; USM Op. at 17.⁴

Second, they agree that potentially comparable movements should be limited to movements in private cars. *See* UP Op. at 22; USM Op. at 16.

Third, they agree that potentially comparable movements should not include issue traffic. *See* UP Op. at 29; USM Op. at 16.⁵

Fourth, they agree that potentially comparable movements will necessarily include traffic that moved under contract rates rather than common carrier rates. *See* UP Op. at 29 n.44; USM Op. at 17-18. However, UP has proposed an adjustment to the presumed

⁴ USM states that it limited comparison group movements to those “with an R/VC of 180% or higher.” USM Op. at 17. However, the Board’s rules say that comparison group movements should be priced “above the 180% level.” *Simplified Standards* at 17 (emphasis added). USM might have worded the standard incorrectly out of concern that UP would contest the inclusion in the comparison groups of several movements with R/VC ratios that round to 180%. For purposes of this proceeding, however, UP is not contesting whether R/VC ratios that round down to 180% are properly considered to be “above the 180% level.”

⁵ In fact, no issue traffic appeared in the Waybill Sample data released by the Board. *See* UP Op. at 29.

maximum lawful rates to account for the difference between common carrier rates and contract rates as an “other relevant factor.” *See* UP Op. at 63-64.

C. USM And UP Each Addressed One Comparability Factor That The Other Party Did Not Address.

UP and USM each addressed one comparability factor that the other party did not address in its opening evidence, but that should be immaterial to the composition of the final comparison group for this case: USM addressed cross-border movements; UP addressed tank car capacity.

1. Cross-Border Movements

USM states that it excluded “cross border movements” from the universe of potentially comparable movements. *See* USM Op. at 17. In fact, USM’s opening evidence and workpapers do not indicate that USM actually applied any specific filter to the Waybill Sample data to exclude “cross border movements,” so it is impossible to determine what USM considers to be “cross border movements.”⁶ USM may have been trying to address the concern that URCS might not accurately develop costs for the Canadian or Mexican portions of cross-border movements when those movements are billed on an international through basis rather than being rebilled at the border. *See Simplified Standards* at 99-100. As UP understands the issue, movements that are billed on an international through basis would appear in the Waybill Sample as originating or terminating in Canada or Mexico. UP believes that, all other things being equal, it would be preferable to exclude international movements that are not rebilled at the

⁶ Although USM claims that it excluded “cross border movements,” that factor is not addressed in USM’s expert’s summary of USM’s “Comparison Group Selection Factors” or in USM’s expert’s workpaper setting forth USM’s comparison group selection methodology. *See* USM Op., Hillenbrand V.S. at 11, Table V; *id.*, Hillenbrand electronic workpaper “Methodology Write up.doc.”

border from potentially comparable movements. In addition to the issues associated with using URCS to develop variable costs for the portions of movements that occur in Canada or Mexico, the Waybill Sample's mileage-block methodology will likely misstate the defendant carrier's actual share of revenue for the portion of the movement in the United States – as it will for any interline traffic that is billed on a through basis rather than being rebilled. *See infra*, pp. 18-20. Thus, R/VC ratios calculated from such movements would not provide a “useful indicia of the lawful contribution to fixed and common costs.” *See Simplified Standards* at 83. However, this criterion should be irrelevant in this proceeding because UP's proposed comparison groups do not include any movements that are shown in the Waybill Sample as originating or terminating in Canada or Mexico.

2. Tank Car Capacity

UP limited potentially comparable movements to movements that are shown in the Waybill Sample as moving in tank cars that transport less than 22,000 gallons of product – the same type of tank cars used to move the issue traffic. *See UP Op.* at 21-22. USM did not explicitly address this issue in its opening evidence, and USM included movements in tank cars without regard to car capacity. *See USM Op.* at 16. UP believes that, all other things being equal, potentially comparable movements should be limited to movements in the same type of equipment as the issue traffic, at least when URCS distinguishes between the equipment types, as it does with regard to tank car capacity. *See UP Op.* at 21-22. Thus, USM's decision to include in its comparison groups certain traffic moving in tank cars that transport 22,000 gallons or more of product is another reason the Board should adopt the comparison groups proposed by UP.

Even if the Board concludes that the car capacity distinction should not be used to limit potentially comparable movements, that would be no reason to favor the comparison groups proposed by USM. All of the chlorine movements in the Waybill Sample moved in tank cars

that transport less than 22,000 gallons of product. Thus, UP did not actually exclude any movements from its proposed comparison groups based solely on this criterion.

D. USM And UP Disagree On The Application Of Two Comparability Factors.

UP and USM agree that potentially comparable movements should have a similar length of movement to the issue traffic, and should exclude movements of “non-defendant traffic.” However, the parties disagree on the application of these criteria. In addition, USM’s comparison groups include a significant number of movements of “non-defendant traffic” that USM apparently intended to exclude.

1. Movements Of Similar Distances

UP and USM agree that potentially comparable movements should have a similar length of movement to the issue traffic, but whereas UP limited the universe of potentially comparable movements to movements with loaded miles that were within 400 miles of the issue movements’ loaded miles, USM used a 200-mile range. *Compare* UP Op. at 22, *with* USM Op. at 17.⁷

USM does not explain why it used a 200-mile range, but it references the *DuPont* case, in which the parties agreed upon a 150-mile range. *See* USM Op. at 17 (citing *DuPont* at 8 n.25). USM may have adopted a 200-mile range rather than a 150-mile range in this case because a 150-mile range would have required it to exclude a significant number of low-R/VC anhydrous ammonia movements that it included in its comparison groups. *See* USM Op., Hillenbrand V.S., Exhibit_(KNH-4) & Exhibit_(KNH-5).

⁷ UP and USM also disagreed about the number of loaded miles the issue traffic travels to Sahuarita and Eloy. To avoid a dispute, UP has adopted USM’s calculations of loaded miles to both destinations. UP’s adoption of USM’s calculations of loaded miles does not alter the composition of the comparison groups developed by UP.

UP believes that the appropriate mileage range for each case must reflect a balancing of two important considerations: the mileage range should be large enough to include a sufficiently representative sample of comparable movements, but small enough to avoid the feedback effect described by the Board in *Simplified Standards*. See UP Op. at 23 (citing *Simplified Standards* at 73).

In fact, UP would have produced more favorable results for itself in most cases had it adopted the 200-mile range proposed by USM, or even a 300-mile range, rather than the 433 percent presumed maximum lawful R/VC ratio that is produced using a 400-mile range:

- If UP had adopted USM's proposed 200-mile range, its Sahuarita comparison group would have consisted of 11 chlorine movements and produced a presumed maximum lawful R/VC ratio of 496 percent; its Eloy comparison group would have consisted of 6 chlorine movements and produced a presumed maximum lawful R/VC ratio of 356 percent.⁸
- If UP had adopted a 300-mile range, its Sahuarita comparison group would have consisted of 19 chlorine movements and produced a presumed maximum lawful R/VC ratio of 450 percent; its Eloy comparison group would have consisted of 21 chlorine movements and produced a presumed maximum lawful R/VC ratio of 437 percent.⁹

However, UP adopted a larger mileage range because it believed that a larger comparison group would reflect a more acceptable sample size, without creating an undue risk of a feedback effect. Moreover, UP submits that it is more appropriate, and more consistent with the Three-Benchmark method, as well as the Board's specific instructions in *Simplified Standards*, to expand the comparison group by increasing the mileage range than by including commodities in different product markets. See *supra*, pp. 7-8; see also *Simplified Standards* at

⁸ See UP Reply Highly Confidential electronic workpaper "UP Comparison Group at 300 and 200 Miles - Reply.xls."

⁹ See *id.*

17 (“Moreover, we are comparing mark-ups over variable cost to determine the reasonable level of contribution to joint and common costs for a particular movement. This means that movements with different cost characteristics may be included in the comparison group.”).

2. Movements Shown As Originating And Terminating On UP

UP and USM agree that comparison groups should not include “non-defendant traffic.” *See Simplified Standards* at 82. UP implemented this restriction by limiting the universe of potentially comparable movements to movements shown in the Waybill Sample as originating and terminating on UP. *See UP Op.* at 21. However, USM imposed an additional, unnecessary restriction by excluding rebilled movements from its comparison groups. *See USM Op.* at 16. As discussed below, rebilled movements are not “non-defendant traffic.”¹⁰

Moreover, USM’s decision to include movements of all TIH commodities in its comparison groups created a “non-defendant traffic” issue that USM failed to address in its opening evidence: the need to exclude movements that are shown in the Waybill Sample as originating and terminating on UP, but that actually are moved by a short-line for a portion of the line-haul. UP had no need to address this point in its Opening Evidence because none of the chlorine movements in its comparison groups presented a similar issue. As discussed below, however, these movements create the same problem as “non-defendant traffic” – that is, the R/VC ratios developed from Waybill Sample data do not reflect UP’s actual revenue and variable costs for these movements, and thus they do not provide a “useful indicia of the lawful contribution to [UP’s] fixed and common costs.” *See Simplified Standards* at 83. In fact, the

¹⁰ USM’s opening evidence refers to “Rule 11 and rebilled movements.” *USM Op.* at 16. AAR accounting Rule 11 articulates the accounting principle that applies to rebilled movements – that is, each railroad will separately bill the shipper for its portion of the movement. Movements that are rebilled are generally described as “Rule 11 movements.”

Board expressly ruled that such a situation should be treated as an interline movement, at least for variable costing purposes, in *Kansas City Power & Light Co. v. Union Pacific Railroad Co.*, STB Docket No. 42095 (STB served May 19, 2008) (“*KCPL*”).

a) Rebilled Movements

USM explained that it limited the universe of potentially comparable movements to movements that are shown in the Waybill Sample as originating and terminating on UP in accordance with the Board’s direction that “non-defendant traffic” be excluded from the analysis. *See* USM Op. at 16 (citing *Simplified Standards* at 82). However, it offered no justification for also excluding rebilled movements. *See id.*

UP agrees that excluding movements that are shown in the Waybill Sample as originating or terminating on a carrier other than UP is a corollary of the Board’s decision to “exclude non-defendant traffic from the comparison group.” *Simplified Standards* at 82. When the Waybill Sample shows that a movement was handled by UP, but originated, terminated, or bridged by a carrier other than UP, the “UP revenue” that appears in the Waybill Sample is actually a mileage-based allocation of the total revenue collected for the interline movement.¹¹ In other words, the Waybill Sample will not necessarily reflect the rate charged by UP for its portion of the interline movement – it will potentially reflect the rates charged by other carriers in the route. Thus, an R/VC ratio developed from the Waybill Sample revenue data will not necessarily provide a “useful indicia of the lawful contribution to [UP’s] fixed and common costs.” *Simplified Standards* at 83; *see also* UP Op. at 21.

¹¹ *See* Railinc, *Reference Guide for the 2007 Surface Transportation Board Carload Waybill Sample* at 60, Item 102 (July 31, 2008) (explaining the calculation of revenue splits among railroads shown as participating in a route).

However, UP disagrees with USM's decision to exclude movements that were rebilled by UP. When a rail carrier rebills an interline movement, it issues the shipper a separate bill reflecting its rate for its portion of the interline movement, and thus the carrier's revenue that appears in the Waybill Sample reflects only the rate charged to the shipper by that carrier. In other words, movements that were rebilled by UP are not subject to the same mileage-based allocation of revenue among UP and other carriers that handled the traffic before or after UP. Because movements that were rebilled by UP are not subject to the concerns that led the Board to exclude "non-defendant traffic" from comparison groups, UP did not exclude rebilled traffic from its comparison groups. *See* UP Op. at 21.

b) Short-line Movements

USM states that it intended to limit potentially comparable movements to those that originated or terminated on UP. *See* USM Op. at 16. However, USM's comparison groups actually include a significant amount of anhydrous ammonia traffic that is moved by, and terminates on, San Pedro Railroad – the short line that serves Curtiss, Arizona. USM's Sahuarita and Eloy comparison groups both include 52 movements of anhydrous ammonia from Enid, Oklahoma, to Curtiss, 5 movements from Chaison, Texas, to Curtiss, and 1 movement from Donaldsonville, Louisiana, to Curtiss.¹²

UP does not serve any receivers at Curtiss, Arizona – a fact that should have been apparent to USM.¹³ In 1994, Southern Pacific Transportation Company sold its line from

¹² *See* USM Op., Hillenbrand V.S., Exhibit_(KNH-4) & Exhibit_(KNH-5).

¹³ USM could have determined from publicly available data that UP does not serve Curtiss. UP's system map, which is available on the Internet, does not show a line from Benson to Curtiss. *See* <http://www.uprr.com/aboutup/maps/sysmap.shtml>. UP's density charts, which UP produced to USM in discovery, also do not contain any information regarding the line from (continued...)

Benson, Arizona, to and beyond Curtiss to SWKR Operating Company, Inc. (“SWKR”). *See SWKR Operating Co. – Acquisition & Operating Exemption – Southern Pac. Transp. Co.*, ICC Finance Docket No. 32620 (ICC served Dec. 23, 1994). In 2003, SWKR sold the line to its current owner, San Pedro Railroad Operating Company, LLC (“SPROC”). *See San Pedro R.R. Operating Co., LLC – Acquisition & Operation Exemption – SWKR Operating Co.*, STB Finance Docket No. 34430 (STB served Nov. 21, 2003).

The Waybill Sample shows the movements to Curtiss as originating and terminating on UP because SPROC acts as a handling carrier for UP between Benson and Curtiss. The handling carrier arrangement means that UP sets the line-haul rate and pays a handling fee to SPROC, and SPROC does not appear in the route. *See, e.g., Arkansas Midland R.R. – Alternative Rail Service – Line of Delta Southern R.R.*, STB Finance Docket No. 34479 (STB served Mar. 11, 2004) at 6 (describing a handling carrier relationship).

The handling carrier arrangement creates the same problem that led the Board to rule that “non-defendant traffic” should not be included in comparison groups – that is, it produces R/VC ratios that are not useful for purposes of the Three-Benchmark method. In fact, Board precedent provides that handling carrier arrangements should be treated as interline movements for costing purposes, *see* KCPL at 8, and USM agrees that interline movements are “non-defendant traffic” and thus should be excluded from the universe of potentially comparable traffic, *see* USM Op. at 16.

The R/VC ratios calculated for movements that include handling carrier arrangements are problematic because the variable cost portion is based on the incorrect

Benson to Curtiss. A search of Board decisions using the search term “Curtiss” would have quickly revealed the history and current ownership of the line.

presumption that the reporting carrier handled the movement from origin to destination. In this case, the Waybill Sample shows the Enid to Curtiss traffic as moving over the entire route on UP, and thus the variable costs were calculated using UP's system-average costs for the entire route. However, UP's URCS variable costs are not an accurate measure of the costs that UP incurred for the portion of the movement between Benson and Curtiss. UP believes that the most accurate measure would be the handling fee it pays SPROC. Board precedent suggests that the costs should be calculated using Western Region URCS. *See KCPL* at 8. Either way, R/VC ratios developed from the Waybill Sample data do not reflect a proper measure of the variable costs or UP's actual markups over variable costs, and thus they do not provide a "useful indicia of the lawful contribution to [UP's] fixed and common costs" for these movements to Curtiss. *Simplified Standards* at 83.

E. Summary Of UP's Final Offer Comparison Groups

UP's selection criteria produce comparison groups that are far superior to USM's comparison groups in providing "evidence as to the reasonable level of contribution to joint and common costs for the issue movement[s]." *Simplified Standards* at 18. Most significantly, the issue movements in this case are movements of chlorine, and UP's selection criteria produce comparison groups that consist entirely of chlorine movements, whereas USM's comparison groups contain almost no chlorine movements. In addition, USM included "non-defendant traffic" in its comparison groups because it failed to recognize that certain traffic is actually moved by a short-line carrier for a portion of the line-haul.

UP's "final offer" comparison groups for the Sahuarita and Eloy movements consist of the same 24 movements as the comparison groups presented in UP's Opening Evidence. UP has made one change to its comparability criteria after reviewing USM's opening evidence – it has accepted USM's calculation of the number of loaded miles that the issue traffic

travels to Sahuarita and Eloy – but that change does not affect the composition of either of UP’s comparison groups. UP’s “final offer” comparison group traffic is presented in Appendix D.

III. “OTHER RELEVANT FACTORS”

The Board should reject USM’s proposal to replace the Board’s $R/VC_{>180}$ benchmark with a special “TIH $R/VC_{>180}$ ” benchmark that would be used to adjust the presumed maximum lawful rates downward. *See* USM Op. at 20-21. As UP showed in its Opening Evidence, the presumed maximum lawful rates should be adjusted upward to reflect UP’s costs to install Positive Train Control (“PTC”) and the differential between the contract rates and common carrier rates. *See* UP Op. at 31-65.

USM observes that UP’s “potentially captive” TIH traffic has a higher average markup than UP’s other “potentially captive” traffic, and, based on that observation, it argues that a downward adjustment is required because “UP’s overall TIH pricing strategy” has created a situation in which “one commodity is paying an unreasonable share of the carrier’s overall revenues.” USM Op. at 20 (quoting 49 U.S.C. § 10701(d)(2)(C)). USM proposes to implement that downward adjustment by replacing the Board’s $R/VC_{>180}$ benchmark with a “TIH $R/VC_{>180}$ ” benchmark when calculating the $RSAM \div R/VC_{>180}$ ratio. Because USM’s proposed “TIH $R/VC_{>180}$ ” benchmark is a larger number than the Board’s $R/VC_{>180}$ benchmark, the substitution would reduce the $RSAM \div R/VC_{>180}$ ratio. The reduction to the $RSAM - R/VC_{>180}$ ratio would, in turn, reduce the R/VC_{COMP} benchmark, and thus the maximum lawful rates. *See* USM Op. at 20; *id.*, Hillenbrand V.S. at 17.

USM’s proposal to replace the Board’s $R/VC_{>180}$ benchmark (i) conflicts with the Board’s decision in *Simplified Standards*, (ii) reflects a misapplication of Long-Cannon principles, and (iii) relies on unjustified complaints about UP’s “pricing strategy.” We discuss

the conflict with *Simplified Standards* in section A, the misapplication of Long-Cannon principles in section B, and the unjustified complaints about UP's "pricing strategy" in section C.

A. USM's Proposed Adjustment Was Rejected In *Simplified Standards*.

The most fundamental problem with USM's proposal to replace the Board's $R/VC_{>180}$ benchmark with a "TIH $R/VC_{>180}$ " benchmark is that the Board rejected the use of such narrowly-tailored measures of $R/VC_{>180}$ in *Simplified Standards*. In *Rate Guidelines – Non-Coal Proceedings*, 1 S.T.B. 1004 (1996), the Board had observed that "the $R/VC_{>180}$ measure can be refined to focus on specific subsets of a carrier's traffic" and had encouraged parties to "suggest more appropriate uses of the underlying data." *Id.* at 1038. In *Simplified Standards*, however, the Board revisited the issue and reversed course. The Board concluded that " $R/VC_{>180}$ will not be more narrowly tailored to focus on a subset of the railroad's traffic, as that is the role of the R/VC_{COMP} benchmark." *Simplified Standards* at 82.

UP's Opening Evidence proposed an alternative $RSAM \div R/VC_{>180}$ adjustment as one possible way to account for UP's cost to install PTC. However, UP did not propose merely to calculate elements of the $RSAM \div R/VC_{>180}$ ratio using a more narrowly-tailored subset of its traffic that it believed was comparable to the issue traffic. Instead, UP proposed a broader adjustment designed to account for a significant change in market conditions that was not reflected in traffic data in the 2004-2007 Waybill Samples, and thus was "not reflected in the comparison group of the average $RSAM$ and $R/VC_{>180}$ benchmarks." *Simplified Standards* at 85. Specifically, UP proposed a modified $RSAM$ benchmark to reflect its costs to install PTC that are attributable to TIH traffic, which it used, together with a modified $R/VC_{>180}$ benchmark,

to calculate the full degree of differential pricing that should be permitted on the issue traffic. *See* UP Op. at 58-59.¹⁴

By contrast, USM's proposal simply replaces the Board's $R/VC_{>180}$ benchmark with a version that, in this one particular case, would produce a more favorable result for USM.¹⁵ But, if the Board decides to replace the $R/VC_{>180}$ benchmark when comparison group traffic has above-average markups, it must replace this benchmark in every case based on the subset of traffic at issue, or else the adjustment would have a one-way, downward ratchet effect on rates. USM apparently recognizes that it is effectively advocating a general change in the method of calculating the $R/VC_{>180}$ benchmark, rather than a specific adjustment to account for "other relevant factors." It argues that "[s]ince the $RSAM \div R/VC_{>180}$ relationship is a revenue need adjustment factor that is applied to the R/VC_{COMP} group, the $R/VC_{>180}$ Benchmark should be adjusted to reflect traffic with similar characteristics." USM Op., Hillenbrand V.S. at 15.

¹⁴ Thus, USM's and UP's $R/VC_{>180}$ calculations are not the same. USM's "TIH $R/VC_{>180}$ " calculation addresses only TIH traffic that meets all of USM's selection criteria, except its mileage limitation. *See* USM Op., Hillenbrand V.S. at 15. UP's modified $R/VC_{>180}$ benchmark addressed all TIH traffic with an R/VC ratio greater than 180% that was handled by UP, not a case-specific subset of TIH traffic.

UP also proposed an alternative approach to accounting for its costs to install PTC that did not involve any adjustments to the $RSAM$ or $R/VC_{>180}$ benchmarks. *See* UP Op. at 59-60.

¹⁵ USM's calculation works in USM's favor only because USM eliminated its mileage criteria when selecting the subset of traffic it used to calculate the "TIH $R/VC_{>180}$ " benchmark. USM never explains why it "used the same selection criteria that were used in selecting [USM's] R/VC_{COMP} Benchmark in this case with [that] one exception." USM Op., Hillenbrand V.S. at 15. However, the answer is clear. If USM had used all of the same selection criteria, its "TIH $R/VC_{>180}$ " calculations would have been the same as the average R/VC ratios in its comparison groups, or 215% for Eloy and 211% for Sahuarita. *See id.*, Exhibit_(KNH-4) & Exhibit_(KNH-5). Indeed, USM's "TIH $R/VC_{>180}$ " benchmarks would have been *lower* than UP's actual $R/VC_{>180}$ benchmark of 231%. *See Simplified Standards for Rail Rate Cases – 2007 RSAM and R/VC_{>180} Calculations*, STB Ex Parte No. 689 (STB served May 12, 2009), Table II. Thus, instead of reducing the $RSAM \div R/VC_{>180}$ ratio from 1.41 to { }, USM's proposal, if carried through to its logical conclusion, would actually require increasing the $RSAM \div R/VC_{>180}$ ratio to 1.52 for Eloy and 1.55 for Sahuarita.

However, the Board expressly rejected such adjustments when it ruled that “R/VC_{>180} will not be more narrowly tailored to focus on a subset of the railroad’s traffic, as that is the role of the R/VC_{COMP} benchmark.” *Simplified Standards* at 82.

B. USM’s Proposed Adjustment Reflects A Misapplication Of Long-Cannon Principles.

USM’s invocation of the third Long-Cannon factor is severely flawed. USM’s evidence that UP’s “potentially captive” TIH traffic – that is, UP’s TIH movements with R/VC ratios above 180 percent – has a higher average markup than UP’s other “potentially captive” traffic is plainly insufficient to justify a downward adjustment based on the Long-Cannon principle that “one commodity” should not be “paying an unreasonable share of the carrier’s overall revenues.” 49 U.S.C. § 10701(d)(2)(C)).

USM ignores the fact that TIH is not one “commodity” but several different commodities, and thus its argument never gets out of the starting block.

USM’s argument also fails because USM never explains why a carrier’s “above-average markups” on some category of traffic, as measured using system-average URCS costs, necessarily means that the traffic is paying an “unreasonable” share of the carrier’s overall revenues under section 10701(d)(2)(C).

Unless a railroad charges equal markups on all of its traffic, some commodities will necessarily have above-average markups. That some commodities have above-average markups cannot be considered *per se* “unreasonable” because railroads are expected to use differential pricing – that is, they are expected to set markups that vary in accordance with demand. *See Coal Rate Guidelines, Nationwide*, 1 I.C.C. 520, 526 (1985). Board precedent thus makes clear that “a disproportionate share is not necessarily an unreasonable share of revenue

needs.” *Arkansas Power & Light Co. v. Burlington N.R.R.*, 3 I.C.C.2d 757, 769 (1987); *accord Coal Rate Guidelines*, 1 I.C.C. at 541.¹⁶

Moreover, to the extent that a comparison of markups might be relevant, USM fails to consider that UP’s markups on TIH traffic might appear higher than its markups on other traffic because system-average URCS costs do not reflect the true costs to railroads – both the operating costs and the costs associated with the potential risks and liability – of transporting TIH materials in general, and chlorine in particular. *See* UP Op. at 9-12; *see generally, Class I Railroad Accounting and Financial Reporting – Transportation of Hazardous Materials*, STB Ex Parte No. 681 (STB served Jan. 5, 2009); *Comments of Union Pacific Railroad Company, Class I Railroad Accounting and Financial Reporting – Transportation of Hazardous Materials*, STB Ex Parte No. 681 (Feb. 4, 2009). Thus, even if a comparison of markups were relevant, the fact that the Board uses unadjusted, system-average URCS costs to expedite Three-Benchmark cases would not justify treating TIH traffic as though it were system-average traffic for purposes of applying the Long-Cannon factors.

Apart from showing that a subset of UP’s TIH traffic has an above-average markup (as measured using system-average URCS), USM offers no support for its claim that TIH traffic is paying an unreasonable share of UP’s overall revenues. By contrast, UP has presented many reasons why its rates for TIH movements in general, and chlorine movements in particular, should be among the highest on the railroad. Specifically, UP has addressed the extraordinary costs and risks associated with transporting chlorine and other TIH materials. *See*

¹⁶ In fact, the legislative history of the Staggers Act reveals that the Conference Committee affirmatively changed the standard from “disproportionate” to “unreasonable.” *See* H.R. Rep. No. 96-1430, at 95 (1980) (“In the third consideration, the word ‘disproportionate’ is changed to ‘unreasonable.’”).

UP Op. at 9-12, 18-20. Moreover, USM's evidence was based on 2004-2007 Waybill Sample data, but UP's costs to carry TIH have grown even higher as the result of the new, approximately \$1.4 billion mandate to install PTC by the end of 2015. *See id.* at 35-41.

Because USM analyzed all TIH rather than a particular commodity and merely presumed that above-average markups, as measured using system-average URCS, are unreasonable, USM has not shown that one commodity is paying an unreasonable share of UP's overall revenues, and thus it has not demonstrated that its proposed downward adjustment is justified under Long-Cannon principles.

C. USM's Proposed Adjustment Relies On Unjustified Complaints About UP's "Pricing Strategy."

USM does not state clearly whether it believes that its complaints about "UP's overall TIH pricing strategy" provide an independent basis for a downward adjustment to the presumed maximum lawful rates – that is, whether USM thinks UP's "pricing strategy" constitutes an "other relevant factor," despite its failed effort to show a violation of Long-Cannon principles. For the sake of completeness we address those complaints in this section, as well as in Part IV.

USM claims that UP's "pricing strategy" for TIH materials is to "de-market" these commodities – that is, UP has "sought to drive these commodities off [its] system[] by making the cost to ship them prohibitively expensive." USM Op. at 13. USM claims that "UP adopted and began implementing such a strategy in the 2005 timeframe." *Id.*

USM's complaints about "UP's overall TIH pricing strategy" do not provide any basis for a downward adjustment to the presumed maximum lawful rates. As discussed in the sections that follow, UP's data, and USM's own analysis of those data, show that UP's pricing reflects a legitimate effort to maximize profits. In addition, USM's own description of its

negotiating experiences with UP is inconsistent with its de-marketing claims. Finally, UP's recent, successful contract negotiations with other chlorine shippers are inconsistent with USM's claims that UP is de-marketing TIH.

1. UP's Data, And USM's Own Analysis, Indicate That UP Is Maximizing Profits, Not De-Marketing TIH.

USM's de-marketing claim is not true. UP would prefer not to transport chlorine and other TIH materials because of the risks they pose to UP, its employees, and the communities it serves. However, UP is not attempting to address its concerns by making TIH too costly to ship. As described in Robert Worrell's accompanying verified statement, UP is addressing those concerns by, among other things, improving its safety and security processes, instituting procedures to ensure that customers comply with those processes, working with customers and other stakeholders within the industry to develop and implement new rail tank car designs, and encouraging shippers to eliminate unnecessary movements of TIH by engaging in product substitution, on-site production, and product swaps as an alternative to long-distance transportation. *See Worrell Reply V.S. at 4-5.*

USM's real complaint about UP's "pricing strategy" is that rates for transporting chlorine have been rising, that USM had been enjoying an advantage over its competitors, and that UP has been trying to bring USM's rates up to market levels. USM acknowledges all of these points in its opening evidence through the testimony of its expert witness, Tom O'Connor. Based on his review of UP documents produced in discovery, Mr. O'Connor reports that UP has been "significantly ramping up chlorine and TIH commodity rates," that "chlorine producers with whom USM competed in some markets were above USM in profitability," and that UP's "pricing strategy" with regard to USM reflected an effort to "shrink or eliminate that gap." USM Op., O'Connor V.S. at 6, 7.

Mr. O'Connor's testimony does not support his conclusion that UP's "pricing strategy" involves de-marketing chlorine or other TIH materials. Mr. O'Connor reports that UP's documents show that the railroad has been engaged in an effort "to raise chlorine rates and profitability." *Id.* at 6. He further reports that UP has set internal profitability goals and rate targets as part of a "pricing strategy that called for significantly ramping up chlorine and TIH commodity rates to maximize profits." *Id.* at 7. At some points, Mr. O'Connor contradicts himself, claiming that UP appears indifferent "as to whether a given [chlorine] supplier could survive" at UP's target rates, *id.* at 7, but those claims are inconsistent with his recognition that UP is seeking "to maximize profits," *id.*

Moreover, despite occasionally invoking the specter of "de-marketing," Mr. O'Connor's testimony that UP has succeeded in increasing its total contribution from TIH suggests that UP is *not* pricing chlorine and other TIH commodities at levels "beyond what would otherwise be commercially justifiable." *DuPont* at 9. Mr. O'Connor reports, based on his study of documents produced in discovery by UP, that the effect of UP's pricing strategy has been "to dramatically increase the net revenue produced for UP by its chlorine and other TIH shipments." *USM Op., O'Connor V.S.* at 4. He reports that UP's strategy "has resulted in UP handling less chlorine and other TIH commodities, but significantly increasing the revenue contributed by these movements." *Id.* at 6; *see also id.* at 7 (UP is "transporting less TIH commodities but increasing the revenues from this general traffic group").

Dr. Marius Schwartz confirms in his accompanying reply verified statement that Mr. O'Connor's observations and Waybill Sample data regarding UP's TIH shipments, revenue, and variable cost do not support USM's claim that UP is "de-marketing" TIH or that UP is

pricing chlorine and other TIH commodities at levels “beyond what would otherwise be commercially justifiable.” *DuPont* at 9.

Dr. Schwartz explains that Mr. O’Connor’s observation of increasing rates and decreasing volumes does not indicate “de-marketing”: “Raising rates and accepting a reduction in volume is entirely consistent with efforts to increase profit.” Schwartz Reply V.S. at 1. Dr. Schwartz observes that “Mr. O’Connor’s own submission contradicts the ‘de-marketing’ claim and concludes that UP’s pricing has served to increase its profit.” *Id.* at 2. Dr. Schwartz then analyzes the pattern of volume, revenue, and variable cost changes for UP’s TIH shipments and concludes that “UP’s price increases for TIH traffic are entirely consistent with a desire to increase its profit (or contribution to fixed costs),” and that there “is nothing in the data to suggest that UP was engaged in ‘de-marketing.’” *Id.* at 7.

In short, Dr. Schwartz concludes that “UP’s pricing is consistent with pursuit of greater profit rather than driving away TIH traffic.” *Id.* at 4.

2. USM’s Description Of Its Own Negotiating Experiences With UP Is Inconsistent With Claims That UP Is De-Marketing TIH.

USM’s claim that UP is de-marketing chlorine and other TIH materials is also inconsistent with the testimony provided by Dr. Howard I. Kaplan, USM’s Vice President, Chemicals and By-Products, about USM’s own negotiating experiences with UP. Specifically, Dr. Kaplan’s testimony is inconsistent with USM’s claim that UP has been trying to drive TIH commodities “off [its] system[] by making the cost to ship them prohibitively expensive” and that it “adopted and began implementing such a strategy in the 2005 timeframe.” USM Op. at 13. Dr. Kaplan contradicts USM’s claims when he relates his own experience in negotiating with UP after 2005 – that is, after UP supposedly adopted a “de-marketing strategy.” Dr. Kaplan testifies: “Historically, relations between the UP and USM have been good, and prior to 2008,

we have reached agreements for contract rates after mutual negotiations, that were generally reasonable and fair to USM and we believe generated significant profits for the UP.” USM Op., Kaplan V.S. at 6.

USM never attempts to reconcile its allegations that UP began a de-marketing campaign in 2005 with Dr. Kaplan’s admission that, “prior to 2008,” the parties “reached agreements” that USM regarded as “generally reasonable and fair.” *Id.* In fact, USM’s volume of chlorine shipments has increased from { } carloads in 2005 to { } carloads in 2008, an increase of more than { } percent. *See* Worrell Reply V.S. at 6.¹⁷ Dr. Kaplan does allege that UP told him in 2009 that it “was pricing chlorine freight rates in order to de-market chlorine.” USM Op., Kaplan V.S. at 7. However, UP emphatically denies that it was engaged in such a strategy and that any of its employees made the alleged statement to Dr. Kaplan. *See* Worrell Reply V.S. at 6. UP would prefer not to carry chlorine and has made such statements to USM, and Dr. Kaplan’s de-marketing allegation may reflect an unwarranted assumption based on those statements and USM’s dissatisfaction with UP’s proposal to increase USM’s rates significantly to bring them up to market levels. *See id.* However, as discussed in more detail in response to USM’s “gaming” claims, UP’s pricing to USM reflected an effort to bring USM’s rates up to market levels and close the gap that had opened between USM and its competitors, not any effort to “de-market” TIH. *See id.* at 10; *see also infra*, pp. 36-37.¹⁸

¹⁷ USM shipped { } carloads in 2007, but its internal marketing presentations appear to indicate that the { } between 2007 and 2008 was due to { }. *See* Appendix E (USM discovery document USM00347).

¹⁸ Dr. Kaplan’s emails to other individuals within USM regarding his conversations with UP do not mention any UP statements about “de-marketing.” Rather, they show that UP representatives told him that UP planned to increase USM’s rates in 2009 because USM was { } *See* Appendix E (USM discovery document USM00468).

3. UP's Recent, Successful Contract Negotiations With Other Chlorine Shippers Are Inconsistent With Claims That UP Is De-Marketing TIH.

USM's claim that UP has been engaged in a de-marketing effort since 2005 is also inconsistent with UP's recent success in negotiating new contracts with each of its top chlorine shippers, except USM. *See* UP Op. at 50. UP entered into new contracts with {

} . *See* Worrell Reply V.S. at 9.¹⁹ These companies accounted for { } percent of UP's chlorine business in 2008. *See id.* USM's claim that UP is pricing chlorine freight rates at unreasonable levels to drive chlorine off its system is flatly inconsistent with UP's recent, successful contract negotiations with the shippers responsible for the vast majority of UP's chlorine traffic.

USM's claim that UP has been engaged in a de-marketing effort since 2005 is also inconsistent with UP's long-term success in negotiating contracts with chlorine shippers: almost all of UP's chlorine transportation since 2005 has occurred under contract rates, rather than common carrier rates. Indeed, in the 2004-2007 Waybill Sample data, there are only 11 records showing chlorine moving under a common carrier rate, compared with more than 550 records showing chlorine moving under contract rates.²⁰ USM is currently the only shipper for which UP is carrying chlorine under common carrier rates. *See* Worrell Reply V.S. at 9.

USM points the Board to a few emails in which UP engaged in internal discussions about how to respond to requests from shippers with competitive options for

¹⁹ {

} . *See id.* at 9 n.13.

²⁰ *See* UP Opening Highly Confidential electronic workpaper "Common Carrier Adjustment.xls."

transporting chlorine and other TIH materials, but those documents do not support USM's claim that UP is seeking "to drive these commodities off [its] system[]." USM Op. at 13.

As Mr. Worrell explains in his accompanying verified statement, those documents reflect UP's efforts to deal with the very difficult question of how to develop appropriate rates for chlorine and other TIH materials at a time when UP was dealing with two significant events. *First*, UP was addressing the record-setting levels of demand that were stressing its system and causing network performance to deteriorate. *See* Worrell Reply V.S. at 6-7. As UP has acknowledged in other Board proceedings, UP took steps "to limit the growth in new traffic seeking to use [its] constrained corridors, as a way of improving service," and UP's marketing department "employed a variety of measures, including at-times-substantial rate increases, to encourage shippers to moderate their demand for our services, or to channel that demand in ways that reduce stress on congested parts of the system." Opening Submission of Union Pacific Railroad Company, Verified Statement of Thomas C. Haley at 3, *Major Issues In Rail Rate Cases*, STB Ex Parte No. 657 (Sub-No. 1) (May 1, 2006).²¹ *Second*, UP was faced with renewed questions about how to address the extreme risks associated with transporting chlorine and other TIH materials in the wake of the Graniteville accident, which had occurred in January 2005. *See* Worrell Reply V.S. at 7.

²¹ Even as UP began to recover from its service problems, it recognized that the high-demand environment required it to be more selective in accepting new business and more aggressive in its pricing. UP was no longer in a position of pursuing low-return traffic to fill spare capacity. *See* Worrell Reply V.S. at 7 n.9. As UP explained to its customers, UP had to ensure that it was handling traffic that produced "revenue sufficient to justify reinvestment in its infrastructure." Letter from Jack Koraleski, UP's Executive Vice President - Marketing and Sales, to UP Customers (Jan. 11, 2005). *Available at* <http://www.uprr.com/customers/updates/2005/011105.shtml>.

As Mr. Worrell explains, UP's response to those two events included a focus on traffic that could be handled by a rail carrier other than UP, and a special focus on TIH traffic that was moving at low rates and that could be handled by a carrier other than UP. *See id.* Risky, low-rated, competitive TIH traffic was particularly unattractive business to be handling, especially when shippers without competitive options were demanding more and better service. *Id.* With rare exceptions, UP did not refuse to quote rates for competitive TIH traffic, but it made certain that the rates it proposed were commercially justifiable – that is, UP made certain that the rates it quoted were in line with the rates it was charging customers that did not have the same competitive options, so that the traffic would not displace other, more profitable traffic. *Id.* at 8.

In any event, USM's allegations about UP's responses to rate requests from customers with access to rail competition should have no bearing on this case for at least three reasons. *First*, the Three-Benchmark method is designed to compare rates of shippers without access to rail competition. UP rates to shippers that have access to rail competition should have no bearing on this proceeding. *Second*, the Three-Benchmark method is based on rates for movements that are captured by the Waybill Sample. If any UP rates were actually set so high that they discouraged traffic from moving, they would not be reflected in the Waybill Sample data and thus could not appear in the comparison groups. *Third*, all of the movements in UP's proposed comparison groups occurred under contracts, and thus they reflect rates that were negotiated between UP and the shipper. The Board has no basis for assuming that those negotiated rates did not reflect then-existing market conditions, and thus no basis for making a downward adjustment to the presumed maximum lawful rates in this case.

IV. LIMIT ON RELIEF

The Board should reject USM’s proposal to increase the limit on relief in this proceeding to \$2 million over five years. *See* USM Op. at 22-25. USM advances two arguments for increasing the limit on relief, both premised on outrageous and false claims that UP has somehow “gamed” the Three-Benchmark method. In Section A, we refute USM’s claim that UP “gamed” the Three-Benchmark method when it established the challenged rates. In Section B, we refute USM’s claim that UP “gamed” the Three-Benchmark method through its “overall TIH pricing strategy.”

A. UP Did Not “Game” The Challenged Rates.

USM falsely claims that UP “intentionally established the common carrier rates for Eloy and Sahuarita at levels high enough to try to discourage USM [sic] pursuing relief for these two movements via the Three Benchmark methodology.” USM Op. at 24. The UP document that USM cites as the primary support for its “gaming” claim – indeed, the very language quoted by USM – shows that UP recognized the potential for litigation but did nothing more than hold firm to its pre-existing plan to bring USM’s rates into line with the rates that UP was charging other chlorine shippers. Moreover, USM’s own expert witness recognized that “chlorine producers with whom USM competed in some markets were above USM in profitability,” and that UP’s “pricing strategy” with regard to USM reflected an effort to “shrink or eliminate that gap.” USM Op., O’Connor V.S. at 6.

USM’s first “gaming” claim is based almost entirely on a UP “Contract Review” document that discusses options for its 2009 contract negotiations with USM. The document does not contain any suggestion that UP decided to establish rates that would discourage USM from pursuing a Three-Benchmark case. The document shows that UP considered three options:

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USM also suggests that UP “gamed” the challenged rates by responding to USM’s request for common carrier rates with rates that were { } percent higher than its proposed contract rates. *See* USM Op. at 11; *id.*, Kaplan V.S. at 8. However, as UP explained in its Opening Evidence, there are well-established reasons why contract rates are typically lower than common carrier rates, and UP’s Opening Evidence shows that its average differential in this case was actually lower than UP’s average differential between contract rates and common carrier rates. *See* UP Op. at 63-64.²³

Finally, USM suggests that UP “gamed” the challenged rates because the difference in rates for movements to Eloy and Sahuarata does not reflect the difference in the number of miles that movements travel to reach each destination. *See* USM Op. at 25. However, USM does not and cannot allege any facts suggesting that UP implemented the rate difference to affect the outcome of this case. Indeed, USM’s Dr. Kaplan acknowledges that the rate difference pre-dated this case, and that the same percentage difference existed in USM’s 2008 contract with UP.²⁴

USM complains that UP has not explained the difference to USM’s satisfaction, USM Op. at 25. However, UP has explained, both in response to discovery and in its Opening Evidence, that the difference in rates for movements to Eloy and Sahuarita reflects the

²³ UP’s Opening Evidence showed that common carrier rates produce R/VC ratios that are approximately { } higher than R/VC ratios for contract rates. *See* UP Op. at 64. UP’s common carrier rate to Eloy produces an R/VC ratio of 516%. *See* USM Op. at 19. UP offered USM a contract rate of { }. *See id.*, Kaplan V.S. at 7. That rate would have produced an R/VC ratio of { }. Thus, the R/VC ratio produced by the common carrier rate is only { } percent higher than the R/VC ratio that would have been produced by the contract rate.

²⁴ Dr. Kaplan testifies that “the 2008 per car rates to Eloy and Sahuarita were { } and { }, respectively” – in other words, the Eloy rate was { } higher than the Sahuarita rate. USM Op., Kaplan V.S. at 6. Under UP’s common carrier rates, the Eloy rate is 29% higher than the Sahuarita rate.

significantly higher operating costs that UP incurs to transport USM's chlorine to Eloy due to the additional switching and local service that is required. *See* UP Op. at 16-17; *id.* at 18 n.29; *see also* USM Op., Counsel's Exhibit No. 3 (UP response to USM Interrogatory No. 6).

Mr. Worrell confirms in his accompanying verified statement that UP did not engage in any "gaming" in anticipation of this litigation when it established common carrier rates for USM. *See* Worrell Reply V.S. at 10-11.

B. UP Did Not "Game" The Three-Benchmark Method Though Its "Overall TIH Pricing Strategy"

USM's claim that UP has "gamed" the Three-Benchmark method by charging unjustifiably high rates for all of its movements of chlorine and other TIH commodities is false, and it is not, in any event, the type of claim that could justify an increase in the limit on rate relief under *Simplified Standards*. *See Simplified Standards* at 33. In fact, USM's arguments actually highlight the "regulatory lag" problem inherent in the Three-Benchmark method and the need to address it through an upward adjustment to the presumed maximum lawful rates.

UP has already refuted in detail USM's claim that UP is "de-marketing" chlorine and other TIH materials by "setting rates at levels designed to be so high as to discourage the traffic from moving." USM Op., O'Connor V.S. at 4. UP has explained that USM's own analysis of UP documents and data show that its pricing reflects a legitimate effort to maximize profits. *See supra*, pp. 29-30. UP has also explained that USM's own description of its past rate negotiations with UP is inconsistent with its de-marketing claims. *See supra*, pp. 31-32. Finally, UP has explained that its recent, successful contract negotiations with other chlorine shippers are inconsistent with USM's claims that UP is de-marketing chlorine and other TIH materials. *See supra*, p. 33. In short, UP has shown that it is setting rates for chlorine and other TIH materials

based on profit maximization considerations and *not* at levels “beyond what would otherwise be commercially justifiable.” *DuPont* at 9.

Moreover, there is no merit to USM’s argument that the Three-Benchmark method loses its effectiveness in an environment characterized by rising rates unless the Board increases the limit on relief. *See* USM Op. at 24-25. That is, even if USM were correct in its claim that UP had an “overall TIH pricing strategy” of “ratcheting [rates] upwards based on a uniform de-marketing pricing policy,” USM Op., O’Connor V.S. at 8, such a strategy would not have the effect of undermining the Board’s decision to establish a \$1 million limit on relief under the Three-Benchmark method.

Under the Three-Benchmark method, the amount of relief available to a complainant is not affected by the absolute level of the rates charged for the complaint traffic; it is affected by the difference between the rates charged for the complaint traffic and the rates charged for traffic in the comparable group. Thus, contrary to USM’s claims, a railroad’s decision to raise rates uniformly for a commodity (or a group of similar commodities) would not “cause the \$1,000,000 relief cap to be used up more quickly,” USM Op. at 25, or “drain[] away the effectiveness of the Three-Benchmark rate reasonableness process,” *id.*, O’Connor V.S. at 8.²⁵

²⁵ USM’s expert suggests that the effect of a rail carrier’s decision to raise rates to a particular subset of traffic is “a flaw in the [Three-Benchmark] process that the Board perhaps did not anticipate.” USM Op., O’Connor V.S. at 8. We suspect that the Board recognized that the Three-Benchmark method could not be manipulated in the manner suggested by USM.

In fact, to the extent that a general price increase could affect the Three-Benchmark method, the Board addressed the issue by indexing the \$1 million limit on relief using the Producer Price Index. *See Simplified Standards* at 28 n.36.

USM's argument does highlight one important aspect of this case: the substantial difference between the challenged rates and the "presumed maximum lawful rates" that would be produced by using the comparison groups proposed by USM. However, in the absence of any evidence that UP "gamed" the particular challenged rates, and in light of the abundant evidence that UP's rates for chlorine have increased significantly in recent years, the two most logical reasons for that difference are: (i) USM has proposed inappropriate comparison groups, and (ii) the difference between comparison group rates and the rates UP established for USM reflects the effect of "regulatory lag."

UP submits that both factors are at play in this case. UP's evidence shows that the "presumed maximum lawful rates" produced using appropriate comparison groups are much closer to the challenged rates; indeed, UP's evidence shows that the presumed maximum lawful rate for Sahuarita should be even higher than the challenged rate. UP's evidence also shows that Waybill Sample data do not reflect the increased rates UP has recently negotiated with chlorine shippers other than USM. Accordingly, the Board should adopt UP's proposed comparison groups and also make the upward adjustments to the presumed maximum lawful rates that UP described in its Opening Evidence.

V. CALCULATION OF MAXIMUM REASONABLE RATES AND R/VC RATIOS

Based on its review of USM's opening evidence, UP has adjusted its variable cost calculations for the issue movements to reflect USM's evidence regarding the number of miles that the issue traffic travels from Rowley to Eloy and Sahuarita. Accordingly, Table 2 below presents UP's revised calculations of: (i) actual First Quarter 2009 ("1Q09") rates and R/VC ratios for the issue traffic; (ii) the presumed maximum lawful 1Q09 rates and R/VC ratios for the

issue traffic; and (iii) the presumed maximum lawful 1Q09 rates and R/VC ratios, adjusted to account for UP's costs to install PTC and a common carrier rate adjustment.²⁶

**TABLE 2
MAXIMUM REASONABLE RATES AND R/VC RATIOS
AFTER ADJUSTING FOR COSTS TO INSTALL PTC AND
APPLYING THE COMMON CARRIER RATE ADJUSTMENT²⁷**

	Sahuarita	Eloy
1Q09 Per Car Rate (R/VC ratio)	\$10,410 (416%)	\$13,396 (514%)
"Presumed Maximum Lawful Rate" (R/VC ratio)	\$10,829 (433%)	\$11,275 (433%)
Maximum Rate, Adjusted to Reflect Revenue Need and Common Carrier Adjustment (R/VC ratio)	{ } { }	{ } { }
Maximum Rate, Adjusted to Reflect Revenue Supplement and Common Carrier Adjustment (R/VC ratio)	{ } { }	{ } { }

²⁶ UP's variable cost calculations remain slightly different from USM's because USM failed to include UP's return-on-investment costs as one of the components in developing its composite index. As UP adopts USM's mileage calculations, UP and USM agree on the base year URCS variable costs, which are developed using UP 2007 URCS. However, the URCS variable costs to be indexed include not only UP's operating expenses listed in Schedule 410 to UP Annual Report Form R-1, but also UP's return-on-investment costs, and thus UP's return-on-investment costs must be included in developing the composite index. See UP Reply Highly Confidential electronic workpaper "STB Index UP 2007 URCS - Reply.xls."

²⁷ See UP Reply Highly Confidential electronic workpaper "UP PTC RSAM Revenue Adj Calculations - Reply.xlsx."

VI. CONCLUSION

UP's evidence demonstrates that when all relevant factors are considered, the challenged rates are reasonable. Accordingly, the Board should dismiss USM's complaint.

Respectfully submitted,



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September 22, 2009

CERTIFICATE OF SERVICE

I, Michael L. Rosenthal, certify that on this 22nd day of September, 2009, I caused copies of the Highly Confidential and Public versions of the Reply Evidence of Union Pacific Railroad Company to be served by hand on:

Thomas W. Wilcox
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Michael L. Rosenthal

A

REPLY VERIFIED STATEMENT

OF

ROBERT G. WORRELL

My name is Robert G. Worrell. I am Senior Assistant Vice President - Chemicals for Union Pacific Railroad Company (“UP”). I have been employed by UP since 1978. I began my career as a management trainee, and have held positions in UP’s Finance and Strategic Planning departments, and in the Chemicals, Intermodal, and Agricultural Products groups in UP’s Marketing and Sales Department. I was promoted to my current position in January 2007. Prior my most recent promotion, I had been Senior Assistant Vice President - Field Sales in the Chemicals group, since August 2006, and I had been Assistant Vice President - Field Sales in the Chemicals group, from January 2002 until August 2006.

In my current role, I have full marketing and sales responsibility for UP’s Plastics and Industrial Chemicals businesses; this means, among other things, that I have responsibility for UP’s overall business relationship with US Magnesium, L.L.C. (“USM”). At UP, “Industrial Chemicals” include all Toxic Inhalation Hazard (“TIH”) materials we currently carry, with the exception of anhydrous ammonia. As part of my current role, I have been closely involved in UP’s efforts to promote the safe and secure transportation of TIH materials and to comply with government regulations regarding the transportation of TIH materials.

I am submitting this verified statement to address two inaccurate claims that USM made in its Opening Evidence. First, I address USM’s claim that UP has adopted a strategy to “de-market” chlorine and other TIH materials “by making the cost to ship them prohibitively expensive.” USM Op. at 13. Second, I address USM’s claim that UP engaged in “gaming” by “intentionally establish[ing] the common carrier rates for Eloy and Sahuarita at levels high

enough to try to discourage USM from pursuing relief for these two movements via the Three Benchmark methodology.” USM Op. at 24.

I. UP IS NOT “DE-MARKETING” CHLORINE AND OTHER TIH MATERIALS.

USM is wrong when it claims that UP has adopted a pricing strategy designed to “de-market” chlorine and other TIH materials. UP prices and negotiates rates for transporting chlorine and other TIH materials based on an assessment of the costs of transporting those commodities, including the costs associated with the risks and extra handling associated exclusively with transporting TIH, and the demand for transportation of those commodities, within an overall, company-wide framework that focuses on maximizing contribution towards the railroad’s fixed costs. The overall objective of maximizing contribution has two important consequences. First, we may not always pursue business if the highest price a shipper is willing to pay would be less than the costs we would incur by handling that traffic. Second, we may not pursue business for which revenues exceed the costs of handling that business if it would displace other business that would provide a higher contribution. The process of negotiating rates is always challenging, and particularly so with regard to chlorine and other TIH materials due to the risk profiles of these commodities; but UP is *not* trying to “de-market” these commodities “by making the cost to ship them prohibitively expensive.” USM Op. at 13. Our objective is to price chlorine at levels that are compensatory to, and reflective of, the risks and operating costs associated with handling the product.

A key element of our Marketing and Sales activity involves understanding the markets that our customers and their products are involved with; specifically, we focus on understanding the dynamics and the details of the market demand for the products in question, what the shipper’s transportation alternatives are, and what other market- and business environment-related influences are and how they factor into the viability of a customer’s product

within its markets. With such information and knowledge, we then establish pricing that we believe reflects product and transportation market conditions. Often, a challenging aspect of negotiating a rate contract with a customer involves pricing the customer's portfolio at a level that is commensurate with the rest of the market within which that customer, and its commodity(ies), are involved. Our objective is not to "make" or "break" a market with transportation rates, nor to determine or influence who the "winners" and most prominent participants in a market are, but rather to cover our costs of handling the business, and then earn a reasonable return. And with regard to chlorine and other TIH commodities, the costs associated with safely and efficiently handling the business exceed the costs associated with handling non-TIH commodities.

Further, and in the context of the principles referenced above, when we negotiate rates for chlorine or other TIH materials, we face an additional challenge: the full array of unusual and extraordinary costs – including both every-day operating costs and the potential costs associated with the risk of an accidental release – associated with transporting TIH commodities cannot be easily calculated. One issue is that our operating and capital investment costs continue to change and grow as we implement new safety measures, including the new requirement to install Positive Train Control.¹ And, an even more vexing dilemma is that no comprehensive assessment of TIH handling costs can be made without considering the potentially staggering risk and liability exposure that is inherent to TIH, especially for chlorine.²

¹ See generally Written Testimony of Union Pacific Railroad Company at 16-17, *Common Carrier Obligation of Railroads – Transportation of Hazardous Materials*, STB Ex Parte No. 677 (Sub-No. 1) (July 10, 2008).

² See *id.* at 10-11. Chlorine is more risky to carry than almost other TIH commodities because it is fatal at lower concentrations and has dispersion properties that increase the risk of exposure in the event of an accidental release.

Despite these challenges and risks, UP recognizes and accepts its common carrier obligation to transport chlorine and other TIH materials – an obligation the Board emphatically re-enforced in a recent proceeding involving UP and USM.³ UP also recognizes that the law places limits on the maximum rates that railroads can charge for the transportation of chlorine and other TIH materials (though the Board’s rules do not allow railroads to reflect the true costs of transporting TIH).⁴

Given all this, UP is not seeking to address our concerns about carrying TIH by raising rates to levels that make these commodities prohibitively expensive to ship. Instead, we are pursuing a variety of different strategies designed to reduce and/or mitigate the risks associated with carrying TIH. For example, we are directly addressing transportation risks by adjusting and improving our safety practices, policies and procedures and by instituting charges to ensure that customers comply with those policies and practices.⁵ We are also working with customers and other stakeholders within the industry to develop and implement new, safer and

³ See *Petition of Union Pac. R.R. for a Declaratory Order*, STB Finance Docket No. 35219 (STB served June 11, 2009). Thus, when USM asked us to quote rates to transport chlorine under circumstances that we believed exceeded our obligations under the common carrier requirement, we did not respond by quoting unrealistically high rates in order to try to avoid the issue. Instead, we made the straightforward decision to ask the Board to issue a declaratory order to address the extent of our common carrier obligation with respect to 4 of the 35 destinations to which USM requested rates. When the Board held that we were obligated to quote the requested rates, we established rates that were consistent with the other common carrier rates that we had previously established for USM.

⁴ See generally *Comments of Union Pacific Railroad Company, Class I Railroad Accounting and Financial Reporting – Transportation of Hazardous Materials*, STB Ex Parte No. 681 (Feb. 4, 2009); *Simplified Standards for Rail Rate Cases*, STB Ex Parte No. 646 (Sub.-No. 1) (STB served Sept. 5, 2007) at 84 (“[W]e conclude that simplified guidelines can only be achieved by adhering strictly to the URCS model to calculate variable costs.”).

⁵ See *Written Testimony of Union Pacific Railroad Company* at 12-16, 21-23, *Common Carrier Obligation of Railroads – Transportation of Hazardous Materials*, *supra*, note 1.

more efficient rail tank car designs.⁶ We are also seeking to reduce the amount of TIH that we carry by supporting policies that promote product substitution and on-consumption-site production, encouraging producers to consider selling to closer customers, encouraging producers to consider product swaps as an alternative to long-distance transportation; and we have tried to make sure that our rates are consistent in reflecting our assessment of costs and demand, so that we do not inadvertently encourage unnecessary transportation of TIH.⁷ In short, we set our rates for chlorine and other TIH commodities based on our best understanding of market conditions, and with a keen eye on covering all the known and foreseeable handling costs and risks associated with transporting TIH.

UP's rates for chlorine and other TIH commodities have increased significantly in recent years. We have been aggressive in trying to ensure that we price TIH commodities in accordance with the thinking and principles outlined above. We have explained our pricing practices and rationale to all our TIH customers and, while price increases are not generally praised, and certainly not requested, most of our customers are aware of the environment we are operating in and have accepted our pricing reasoning and practices. Our experience is that there have been profound changes in the market for transporting chlorine and other TIH products and that shippers understand these changes and recognize that our rates and pricing practices fairly reflect market conditions.

I have reviewed USM's opening evidence and am surprised and somewhat confused by what appear to be contrasting, if not contradictory, statements by USM and Dr. Kaplan, USM's Vice President, Chemicals and By-Products. While, on the one hand, USM

⁶ See *id.* at 20-21.

⁷ See *id.* at 6-10.

asserts that UP has engaged in a “de-marketing” campaign since at least 2005 to rid itself of TIH business (USM Op. at 13), on the other hand, Dr. Kaplan states that “relations between the UP and USM have been good, and prior to 2008, we have reached agreements for contract rates after mutual negotiations, that were generally reasonable and fair to USM” (USM Op., Kaplan V.S. at 6). The business backdrop to these comments is the fact that USM’s volume of chlorine shipments have increased from { } carloads in 2005 to { } carloads in 2008. This increase is inconsistent with the notion of “de-marketing.”

I am also puzzled by Dr. Kaplan’s claim that in 2009 he was told by someone at UP that UP “was pricing chlorine freight rates in order to de-market chlorine.” *Id.* at 7. I never made that statement to Dr. Kaplan, and, to my knowledge, nor did any other UP employee; that statement would contradict both our policies and our practices. Dr. Kaplan’s claim may reflect an incorrect assumption based on some of UP’s general statements that, in today’s environment of risk and potentially limitless liability associated with handling TIH, we would prefer not to carry chlorine if we had the choice.

I note that USM claims that a few pieces of e-mail it has selectively culled from the tremendous volume of discovery documentation produced by UP prove that UP has engaged in a broad strategy to “de-market” TIH that began “in the 2005 timeframe.” USM Op. at 13.⁸ The documents do not support USM’s claim that UP has adopted a broad “de-marketing” strategy; they simply reflect a few snapshots of ongoing dialogue, internally at UP, that is a part

⁸ UP produced more than 115,000 separately-numbered pages of documents, and thousands of multi-page electronic documents, in response to USM’s discovery requests in this case.

of one aspect of our ongoing efforts to establish and maintain appropriate rates for transporting TIH commodities.

The issue of establishing appropriate, market-based rates for chlorine and other TIH business was receiving special focus in 2005, as UP was dealing with several significant situations and events that had influence on each other, as well as on more strategic questions as to how best, most safely, and most efficiently to run our overall railroad. First, UP was addressing record-setting levels of demand for our services that were stressing our railroad and causing our overall levels of service performance and individual customer service to deteriorate. As part of solving our congestion and service deterioration issues, we sought to identify business that was consuming the railroad's resources without providing sufficient contribution (with "sufficient contribution" being defined in the context of what the commodity in question was), with a particular focus on business that could be handled by other railroads. Second, UP was dealing with renewed questions and internal debate about the risks associated with transporting chlorine and other TIH products in the wake of the January, 2005 Graniteville accident. These events led us to focus special and specific attention on chlorine and other TIH business that was moving at low rates and/or that could be handled by other rail carriers. High-risk, low-rated, competitive TIH movements were never attractive for us to handle under any circumstances, but were even less attractive in an environment where other shippers, without competitive options and with non-TIH business, were demanding more and better service from UP.⁹

⁹ Even as we began to recover from our service problems, we recognized that the high-demand environment that we faced (before the recent economic downturn) required us to be more selective in accepting new business and allowed us to be more aggressive in our pricing.
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(continued...)

Thus, the e-mails that USM has focused on have three important points in common. First, they all involved situations in which the customer was paying rates that were below UP's view of the then-current market rates for movements of the particular TIH commodity in question. Second, they involved situations where the customer had an active and viable rail alternative to UP service. Third, although the e-mails do discuss whether or not to bid on certain traffic, UP in fact did not refuse to bid, but made certain that its proposed rates were commercially justifiable; that is, UP took steps to ensure that the rates quoted were in line with rates being charged to customers that did not have the same competitive options, so that the business in question would not displace other, more profitable movements and would not disrupt or distort market equilibriums.¹⁰

I believe that UP's strategy with respect to chlorine and other TIH products has been successful, at least from a marketing perspective. UP's overall volume of chlorine and other TIH materials has declined somewhat between our record-high volumes in 2004 and our volumes in 2008, but those declines have been modest, especially when compared with the dramatic increase in our contribution to fixed costs from that business.¹¹ The declines in volume have been more impacted by recessive economic conditions and decisions by producers who have told us that they are curtailing or adjusting their flows of TIH products in response to their

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} See UP-USMAG3B-0024589.

¹¹ I do not believe that our 2009 volumes are relevant because they are obviously being affected by the current economic situation. Our 2008 volumes also reflect the effects of the economic slowdown, but not to the same extent as 2009 volumes.

own liability concerns than by UP's pricing decisions and actions. The volume and contribution data show that we have not used price to drive TIH business from our railroad.

Ultimately, I believe the best evidence that UP has been charging, and is continuing to charge, commercially reasonable rates, rather than rates designed to "de-market" chlorine and other TIH, is our success in negotiating contracts with chlorine shippers. With the exception of this current dispute with USM, all chlorine transported by UP has moved under contract rates, rather than common carrier rates.¹² Said in another way, we have always reached negotiated agreements with our chlorine shippers on chlorine rates. Indeed, USM's Dr. Kaplan concedes that, at least before this current dispute, UP's rates have been "generally reasonable and fair to USM." USM Op., Kaplan V.S. at 6.

Moreover, UP has recently entered into new contracts with each of its top chlorine shippers, with the exception of USM. UP entered into new contracts with {

}.¹³ These companies accounted for { } percent of UP's total chlorine movements in 2008. USM is UP's only chlorine shipper moving chlorine under common carrier rates. Our success in reaching negotiated agreements with all our chlorine shippers except USM seemingly disproves USM's claim that we are engaged in a broad strategy to "de-market" TIH.

¹² The only exception would be the rare case when a shipper asked to move chlorine to a location that was not covered by its contract, and the traffic moved before we amended the contract. In such instances, we have sometimes established a tariff rate to govern the movement.

¹³ {
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II. UP DID NOT “GAME” THE RATES IT ESTABLISHED FOR USM

USM also erroneously claims that UP engaged in “gaming” by “intentionally establish[ing] the common carrier rates for Eloy and Sahuarita at levels high enough to try to discourage USM pursuing relief for these two movements via the Three Benchmark methodology.” USM Op. at 24. The rates that UP offered USM as part of USM’s contract negotiations were consistent with the rates that UP is charging other chlorine shippers. The slightly higher rates that UP established in response to USM’s demand for common carrier rates are consistent with the differential between contract rates and common carrier rates that is typically observed in the market.

I am particularly surprised by USM’s “gaming” claim because documents that UP produced to USM in discovery – documents that USM quotes in its opening evidence – show that there was no such “gaming.” {

} We set USM’s rates at levels that were aligned with the market, using the pricing and cost analysis methodologies and principles described earlier in this statement.

As documents produced in discovery show, USM’s 2008 contract rates were significantly below the rates that UP was charging other chlorine customers. The contracts rates that UP offered to USM in 2009 were designed to bring USM’s rates up to market levels. We were concerned that if we continued to charge below-market rates to USM, USM’s competitors

would be at a commercial disadvantage, which would undermine our ability to maintain rates at what we believed to be the market levels. We also recognized the risk that USM's below-market rates would be used in rate litigation by other chlorine shippers as a way to ratchet down their rates to below-market levels. Thus, we held firm to our view of the appropriate market-level rates.

Lastly, USM is again in error when suggesting that the difference between UP's rate for movements to Eloy and the rate for movements to Sahuarita is indicative of "gaming" because the rate difference cannot be explained by the difference in the number of miles that movements travel to reach each destination. *See* USM Op. at 25. {

} . While the difference in rates between the two points may appear large relative to the difference in mileage, the difference in rates reflects the significantly higher operating costs per car that are incurred when transporting USM's chlorine to Eloy; the Eloy move requires substantially more switching, handling and local service than that required to deliver traffic to Sahuarita.

Again, USM's "gaming" claims are simply not true.

STATE OF NEBRASKA)
)
COUNTY OF DOUGLAS)

VERIFICATION

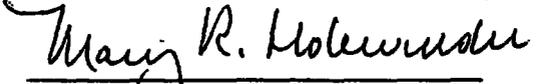
I, Robert G. Worrell, declare under penalty of perjury that the foregoing Statement is true and correct to the best of my knowledge. I further certify that I am qualified and authorized to file this Statement.

Executed on September 21, 2009.

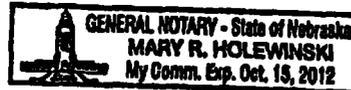


Robert G. Worrell

Subscribed and sworn to before me on this 21st day of September, 2009.



Notary Public



My Commission Expires: October 15, 2012

B

REPLY VERIFIED STATEMENT

OF

MARIUS SCHWARTZ

1. Introduction and Overview of Conclusions

My name is Marius Schwartz. In connection with the opening round of evidence filed in this proceeding by Union Pacific Railroad Company (UP), I submitted a Verified Statement in which I addressed the appropriate recovery of costs that UP and other railroads will incur to install Positive Train Control systems on lines that carry passengers or Toxic Inhalation Hazard (TIH) materials.¹ That Statement describes my qualifications and includes a copy of my curriculum vitae.

In this reply round, UP has asked me to analyze the economic basis for allegations made by US Magnesium, L.L.C. (USM), and, especially, its expert Tom O'Connor, that UP has engaged in a strategy of "de-marketing" the shipment of TIH materials. Specifically, USM and Mr. O'Connor allege that, starting in 2005, UP has raised rates for shipping TIH materials to prohibitive levels so as to drive such shipments off of its rail network.²

Raising rates and accepting a reduction in volume is entirely consistent with efforts to increase profit — the difference between a firm's revenue and all its costs — or to increase the contribution to fixed cost (a similar measure reported later in Table 1).³ I construe USM's "de-marketing" allegations to mean that UP's pricing has been inconsistent with such a goal, that is,

¹ See Opening Evidence of Union Pacific Railroad Company, Appendix B (Aug. 24, 2009).

² See Complainant's Opening Evidence (USM Op.), pp. 12-13 & Verified Statement of Tom O'Connor (O'Connor V.S.), pp. 3-7 (Aug. 24, 2009).

³ "Contribution" is defined as total revenue minus total variable cost, whereas profit is net of all costs, including fixed costs. The price and quantity combination that will maximize contribution will also maximize profit. However, positive contribution does not indicate abnormal profit because of the need to cover fixed cost.

UP's pricing behavior could not be explained as an attempt to increase profit but, rather, reflects an attempt simply to curtail transportation of TIH traffic. In other words, as I understand USM's claims, "de-marketing" entails sacrificing profit by raising price so as to drive TIH volume below the level that would maximize profit.

I reach two main conclusions. First, Mr. O'Connor's own submission contradicts the "de-marketing" claim and concludes that UP's pricing has served to increase its profit. Second, an examination of UP's aggregate data on TIH shipments, revenue, and variable cost in recent years confirms that UP's pricing behavior is consistent with pursuing greater profit, and thus the data do not support USM's "de-marketing" claims.

2. Contradictory Allegations

At times, Mr. O'Connor appears to argue that UP's TIH pricing policy is driven by goals other than profit. At one point, Mr. O'Connor claims that UP's TIH pricing involves arbitrary discrimination among shippers. He asserts that, through selective rate increases and other actions, UP "targets individual shippers ... to achieve its corporate goals."⁴ At other points, Mr. O'Connor more specifically asserts that UP has adopted a "de-marketing strategy" for TIH commodities in that UP supposedly seeks to choke off TIH shipments for reasons unrelated to costs⁵ and that UP has been raising rates without regard to whether shippers could pay the higher rates.⁶ However, Mr. O'Connor proceeds to contradict these claims.

⁴ O'Connor V.S., p. 3.

⁵ "UP and other Class I railroads have in recent years publicly stated their objections to continuing to transport TIH commodities. The reasons cited by UP and other railroads tend to focus on the possibility of increased costs; risks and potential liabilities. I have shown in prior testimony that higher casualties, insurance and loss and damage costs are not borne out in the record." O'Connor V.S., p. 3, footnote omitted.

⁶ See O'Connor V.S., p. 7.

Regarding alleged discrimination among shippers, Mr. O'Connor states that UP documents show that its pricing policy resulted both in "raising the profitability and making it more uniform among chlorine suppliers."⁷ This does not support a claim of arbitrary discrimination among shippers.

Regarding Mr. O'Connor's more specific claims about de-marketing of TIH traffic, Mr. O'Connor says that UP is "setting rates at levels designed to be so high as to discourage the traffic from moving at all."⁸ However, he goes on to say that rate increases to TIH shippers raised profit and, hence, could be explained entirely on this basis: "In summary, UP adopted a pricing strategy that called for significantly ramping up chlorine and TIH commodity rates to maximize profits, along with and nominally justified by a de-marketing strategy. This has resulted in UP transporting less TIH commodities but increasing the revenues received from this general traffic group."⁹ In other words, Mr. O'Connor ultimately appears to acknowledge that UP is not sacrificing profit to rid itself of TIH traffic, but instead is engaged in a strategy to increase profits.

⁷ O'Connor V.S., p. 6. He adds: "In some cases pursuit of the UP pricing strategy meant accelerating the rate increases for some shippers. The typical target of such accelerated rates would be a shipper in the position USM occupied in 2004 in Workpaper UP-USM3B-0001551. Other chlorine producers with whom USM competed in some markets were above USM in profitability [to UP] as measured by the PI index. To shrink or eliminate that gap, UP could be expected to increase the pressure on USM to take larger and faster rate increases."

⁸ O'Connor V.S., p. 4.

⁹ O'Connor V.S., p. 7. Earlier, he notes: "The combined effect of the UP policies and the pricing practices ... is to dramatically increase the net revenue produced for UP by its chlorine and other TIH shipments." O'Connor V.S., pp. 3-4.

3. UP's Data on TIH Shipments

An examination of UP's aggregate data on TIH shipments supports the conclusion that UP's pricing is consistent with pursuit of greater profit rather than driving away TIH traffic.

Table 1 below summarizes the aggregate data for UP movements of TIH traffic that are shown in the STB's "Waybill Sample" data as originating and terminating on UP. My understanding is that the revenue shown in the Waybill Sample data for such traffic includes only UP-reported revenue and, hence, reflects the actual revenue earned by UP.¹⁰

The data represent an aggregation of numerous movements with potentially different revenue and cost. Nevertheless, examining the aggregate data is a useful starting point for investigating the qualitative patterns associated with UP's pricing on average.

Table 1: UP TIH Traffic from 2004-2007 Waybill Sample Data

	2004	2005	2006	2007
Carloads	17,876	17,676	16,024	16,564
UP total Revenue (\$)	41,490,012	43,801,844	49,013,076	59,400,768
UP total Variable Costs (\$)	{ }	{ }	{ }	{ }
Contribution to Fixed Costs (\$)	{ }	{ }	{ }	{ }
Average Revenue (\$/carload)	2,321	2,478	3,059	3,586
Average Variable Cost (\$/carload)	{ }	{ }	{ }	{ }

Source: UP opening electronic work paper "UP TIH CWS 2004 2007.xls"

¹⁰ By contrast, for traffic that is shown in the Waybill Sample as originating on one railroad and terminating on another, the terminating carrier reports the total revenue to the STB, and the STB allocates the revenue between the railroads based on a formula. Thus, the revenue attributed to UP in the Waybill Sample data for such traffic may not reflect the actual division of revenue between the carriers.

According to the Waybill Sample data, from 2004 to 2006, Average Revenue rose, the number of Carloads fell, and total Revenue rose. Assuming for the moment that demand and cost conditions did not change — an assumption revisited shortly — this pattern is consistent with pricing by a firm that faces a downward-sloping demand for its product and is raising price towards the profit-maximizing level. The fact that raising the price — as proxied by the average revenue — caused carload volume to decline yet total revenue to rise, shows that such a move necessarily raised profit. This conclusion follows because, all else equal, a reduction in volume will decrease the total variable cost, i.e., will yield some cost savings, which reinforces the effect of the increase in revenue on profit.¹¹ Therefore, an increase in total revenue coupled with a reduction in volume, as occurred from 2004 to 2006, indicates that price is being raised to increase profit (rather than to curtail TIH traffic) if cost and demand conditions are stationary.

From 2006 to 2007, the data suggest that demand conditions did change, specifically, that demand from TIH shippers increased. (This inference can be made because average revenue and carload volume both rose from 2006 to 2007. If demand had not increased, then a rise in average revenue, our proxy for price, should have caused a fall in volume.) The increase in demand from 2006 to 2007 suggested by the data likely provides further reason for UP to raise price in order to increase profit.¹²

Changes in UP's variable cost conditions from 2004 through 2007 reinforce the conclusion that UP's pricing is consistent with a strategy of pursuing greater profits and that the

¹¹ The fact that total variable cost in fact rose while volume fell from 2004 to 2006 indicates that the total variable cost curve shifted up, as discussed below.

¹² A natural effect of an increase in demand is to raise a firm's profit-maximizing price rather than to lower it. A sufficient but not necessary condition for the profit-maximizing price to rise following a demand increase (and assuming marginal cost is non-decreasing) is that, at any price, the new demand curve is not flatter than the old one. For example, the firm's optimal price increases if the demand curve shifts out in a parallel fashion.

data offer no support for USM's claim that UP's pricing reflects a "de-marketing" strategy. For expositional purposes, the above discussion assumed that variable cost conditions remained stationary, that is, that UP's marginal and average variable cost curves did not shift. However, the data suggest that UP's total variable cost curve did shift up, at least between 2004 and 2006 (and likely also from 2006 to 2007) — variable cost became higher at any given volume of shipments.¹³ Such a shift could be due to increases in input prices, the imposition of tighter regulations, changes in other variables that affect the variable cost of carrying traffic, or some combination.¹⁴ Where an upward shift in the total variable cost curve also reflects an upward shift in the *marginal* cost curve, the firm's profit-maximizing price will rise. This fundamental and widely-accepted principle of economics provides an additional reason for UP to raise price.

The above analysis can be summarized as follows. (1) The increase in both average revenue and total revenue from 2004 to 2006, accompanied by a decrease in volume would suggest a move by UP to raise price in the direction of the profit-maximizing level, if there were no exogenous shifts in the demand or variable cost conditions facing UP. (2) The fact that UP's total variable cost curve did seem to shift up over this period (and likely also from 2006 to 2007) would push the profit-maximizing price higher, meaning that if UP's price was too low in 2004, it would have had even more reason to raise it than if costs and demand had remained stationary. (3) The suggested increase in demand from 2006 to 2007 would likely operate in the same direction, that is, it also would provide an economic justification for raising prices. Thus, the

¹³ This shift is implied because carload volume from 2004 to 2006 fell (from 17,876 to 16,024) whereas total Variable Costs rose (from { } to { }). If cost conditions were stationary, a fall in volume would have reduced *total* variable costs, since a decrease in volume generates some savings. Thus, the observed pattern implies an upward shift in the total variable cost curve.

¹⁴ From 2006 to 2007, volume rose, so the increase in total variable costs does not by itself establish that the total variable cost curve shifted up. Nevertheless, an upward shift in the variable cost curve is suggested because *average* variable cost increased between 2006 and 2007 (from { } to { }).

inferred shifts in variable costs and demand make it even easier to explain why UP would wish to raise price in order to increase its profit.

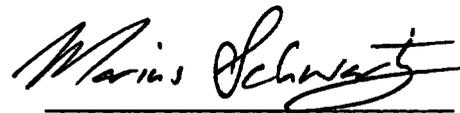
4. Conclusion

Mr. O'Connor's claims that UP is engaged in a strategy of "de-marketing" TIH materials are internally contradictory and find no support in the data. The overall picture suggested by the data in Table 1 is that UP's price increases for TIH traffic are entirely consistent with a desire to increase its profit (or contribution to fixed costs). There is nothing in the data to suggest that UP was engaging in "de-marketing" — raising price and reducing TIH volume while sacrificing profit in doing so.

VERIFICATION

I, Marius Schwartz, declare under penalty of perjury that the foregoing Statement is true and correct to the best of my knowledge. I further certify that I am qualified and authorized to file this Statement.

Executed on September 22, 2009

A handwritten signature in black ink that reads "Marius Schwartz". The signature is written in a cursive style with a horizontal line underneath the name.

Marius Schwartz

C

WITNESS QUALIFICATIONS AND VERIFICATION

Benton V. Fisher

Benton V. Fisher is a Senior Managing Director at FTI Consulting, Inc., an economic and financial consulting firm with offices located at 1101 K Street, NW, Washington, DC 20005. Mr. Fisher has been involved in various aspects of transportation consulting, including economic studies involving costs and revenues, traffic and operating analyses, and work with performance measures and financial reporting systems.

Mr. Fisher holds a Bachelor of Science in Engineering degree from Princeton University. In 1990, he served as the Deputy Controller for the Bill Bradley for U.S. Senate Campaign. In 1991, he joined Klick, Kent & Allen, Inc., which was acquired by FTI Consulting in 1998. While with the firm, Mr. Fisher has performed numerous analyses for and assisted in the preparation of expert testimony related to merger applications, rate reasonableness proceedings, contract disputes, and other regulatory costing issues before the Interstate Commerce Committee, Surface Transportation Board, Federal Energy Regulatory Commission, Postal Rate Commission, federal courts, and state utility commissions.

On opening, Mr. Fisher sponsored evidence relating to Phase III URCS costing of the issue traffic movements, the identification of traffic in the proposed comparison groups, the calculation of the “presumed maximum lawful rate,” and the calculation of proposed adjustments to the “presumed maximum lawful rate.” He sponsors similar evidence in this reply. A copy of Mr. Fisher’s verification is attached hereto.

DISTRICT OF COLUMBIA)

VERIFICATION

Benton V. Fisher, being duly sworn, deposes and says that he has read the Reply Evidence that he has sponsored, as described in the foregoing Statement of Qualifications, and that the contents thereof are true and correct to the best of his knowledge and belief.

Benton V. Fisher
Benton V. Fisher

Subscribed and sworn to before me on this 21 day of September, 2009.

Elizabeth B. Steiner
Notary Public

My Commission expires: _____
ELIZABETH B. STEINER
NOTARY PUBLIC DISTRICT OF COLUMBIA
My Commission Expires: 09/15/2011

D

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