

April 20, 2005

BY HAND DELIVERY

The Honorable Vernon L. Williams
Secretary
Surface Transportation Board
Case Control Unit: STB Ex Parte No. 657
1925 K Street, N.W., Room 711
Washington, DC 20423-0001

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Re: Ex Parte No. 657 – Rail Rate Challenges under the Stand-Alone Cost Methodology

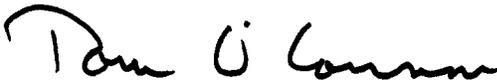
Dear Secretary Williams:

Enclosed for filing for Ex Parte No. 657 – Rail Rate Challenges under the Stand-Alone Cost Methodology are the written comments of Tom O'Connor of Snavely King Majoros O'Connor & Lee, Inc.

Enclosed for filing in the above referenced proceeding are an original and 10 copies of our comments, along with a CD-ROM that contains an electronic copy in Microsoft Word and PDF.

Please indicate receipt of this filing by time-stamping the extra copy and returning it to the courier of this letter.

Sincerely



Tom O'Connor
Vice President

**BEFORE THE
SURFACE TRANSPORTATION BOARD
STB Ex Parte 657
Rail Rate Challenges Under the
Stand Alone Cost Methodology:
A "Win-Win" Alternative Action Plan
For Consideration by the
Surface Transportation Board**

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Comments Of

TOM O'CONNOR

Vice President

Snavelly King Majoros O'Connor & Lee, Inc.

1220 L Street, N.W.

Washington, D.C.

April 20, 2005

Economic and Management Consultants

Response to SAC Rate Challenges: An Alternative

I. Introduction

My name is Tom O'Connor. I am Vice president of Snavely King Majoros O'Connor & Lee, Inc. (Snavely King or SK). Snavely King is an economic and management consulting company focusing on transportation and utilities. Snavely King has been in business for more than 35 years, serving transportation clients including railroads, shippers and government agencies, in the United States, Canada and Europe.

While we prefer negotiations as the more effective pathway to conflict resolution, we are also thoroughly experienced in litigation, including participation as a witness in Stand Alone Cost (SAC) cases. Appendix A of this statement contains a summary of my capabilities and experience.

Others commenting in this proceeding have amply made the point that SAC is a very distressed methodology. SAC holds little promise of help to its limited target audience and SAC is of no help to the vast majority of shippers.

We offer an alternative. Our development of this alternative reflects consideration of a number of key factors including:

- **Chairman Nober's March 31, 2004 statements before Congress and the Chairman's January 12, 2005 presentation to the Midwest Association of Rail Shippers. These confirm that rate reasonableness is an essential part of the mission for the STB and affirm the interest of the STB in solving rate reasonableness challenges.**
- **Statements by other industry observers that SAC is an ineffective regulatory mechanism.**
- **Statements by many others, and our own observation, that SAC has never been accessible to other than a very limited number of shippers, primarily coal shippers.**
- **My experience as a witness in several SAC cases, and my experience in advising in numerous rail rate and service negotiations.**

Comments of Tom O'Connor ■ STB Ex Parte No. 657

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□ **My experience as AVP Economics of the AAR; as part of the railroad team that advocated and helped install rail deregulation. We reflect the importance of the three Long Cannon Factors, an essential part of the deregulation context.**

One of the more important and durable lessons of our experience in negotiations is the importance of structuring the process to facilitate "win-win" outcomes. Unless both parties to a transaction perceive that the agreement is in their interest, its effectiveness is diminished, in some cases sharply diminished.

Conversely, when the parties see that the agreement is designed to protect and advance their interests, the agreement is energized. For example, we frequently find opportunities for increasing efficiency and thereby generating savings, which can benefit both parties.

This "win-win" approach is the foundation of our recommended action plan. The STB recognizes that "...one of the main reasons the Board exists is to provide a regulatory backstop to assess the reasonableness of rates charged to captive shippers when those customers and their railroads are unable to successfully negotiate a contract for the transportation and to redress unreasonable rates."¹

From time to time, SK encounters such situations during the course of rail negotiations. We see a mutually beneficial role for STB mediation in resolving rate reasonableness issues related to such impasses.

¹ Testimony of Roger Nober Chairman of the Surface Transportation Board at House Committee Transportation and Infrastructure Subcommittee on Railroads Hearing on the Status of Railroad Economic Regulation; March 31, 2004

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II. Approach

- Win-win negotiations are usually sufficient to resolve the issues
- Negotiations can be supplemented by mediation if impasse occurs

While SK sees private negotiations as the preferred approach, we also see a need for improving the structure of the rate reasonableness process for small rate cases. Adopting the proven strengths conveyed by a "win-win" approach is the essential design concept.

We believe that involvement of the Surface Transportation Board as a mediator is a significant step in the right direction. This will help establish processes that can transform conflict resolution into productive teamwork and convert friction into momentum.

In today's comments we outline some specifics which implement the "win-win" concept to help both railroads and shippers achieve mutual objectives.

The action plan designs and implements an effective "win-win" strategy to achieve more reasonable rail rates; a strategy both railroad and shipper can endorse, support and implement.

Snavelly King routinely recommends and follows "win-win" strategies in rail negotiations. We see continued reliance on private negotiations as the primary strategy and would turn to the STB only occasionally to resolve impasses in such negotiations. At that point the Action Plan would be applied.

The objective is to use a "win-win" approach to produce more reasonable railroad rates, benefiting both railroads and shippers. Specifically we see the Action Plan addressing rail rates that generate Revenue Cost Ratios (RCR) which:

- Exceed 180% and

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- Exceed at least two of the three RCR benchmarks advanced by the ICC and STB in Ex Parte No. 347 (Sub-No.2) Rate Guidelines – Non Coal Proceedings.²
- Meet the other relevant requirements for access to regulatory rate reasonableness review

Ultimately, resolving such impasse situations benefits both shippers and railroads since such rates present adverse outcomes for all involved parties; railroads, shippers and their mutual customers. We see three sets of issues:

1. Higher rail costs erode the rail shipper's profitability and competitiveness
2. Higher rail costs could lead to adverse outcomes for the shipper such as lost business in its product markets. In some cases the production shifts to overseas markets; a shift difficult to reverse.
3. Lost business such as overseas relocation of production can erode the rail traffic base. While some railroads may see this as easing temporary capacity constraints, loss of profitable rail business can degrade long term rail profitability.

The action plan involves coordinated use of the Surface Transportation Board (STB) approach in the Coal Rate Guidelines, the Non-Coal Rate Guidelines, and techniques proven in negotiations. A key component of the Action Plan is STB assistance with fair and even-handed mediation of the rate discussions. We see such mediation as most effective when it is both voluntary and binding.

² In formulating the Action Plan we consider all three STB RCR and Revenue Shortfall Allocation Method RSAM ratios.

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III. Supporting data

In this section we review some of the data, including evidence from our own experience, showing that impasse in rate negotiations is an important issue warranting remedial action by the STB.

- SK years of experience in rail negotiations and advising on negotiations indicates that if rail is perceived as wielding monopolistic or duopolistic pricing power top management often becomes engaged to find or create an alternative
- Some parties advocate one or more of the numerous bills circulating on the Hill to resolve rail's perceived monopolistic or duopolistic pricing power
- Recent initiatives in North Dakota and Montana indicate efforts are also growing at the State level to constrain perceived rail monopolistic or duopolistic pricing power
- Long-term trends show some chemicals shifted to overseas sourcing with a loss of high profit domestic freight to railroads. More recent data shows some recovery in the balance of trade. Continued recovery will be enhanced by more reasonable rail rates. A generally unappealing alternative is loss of high rated chemical freight with partial substitution of lower rated Intermodal rail on some import freight.

As noted above we see evidence that negotiation situations with conditions leading to impasse are not unusual:

- SK analyses of rail freight of dozens of companies shows numerous situations where rail-to-rail competition has disappeared. The lack of rail to rail-to-rail competition often makes reasonable rates more difficult to attain.
- We frequently see high RCR's on low-volume shipments
- STB waybill sample results show persistently high RCR's for chemicals, coal and some other rail commodities
- STB waybill sample results show persistently low RCR's for food products and some other commodities, which have better alternatives if rail competition is diminished or lost.

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IV. Proposed solution

In this section we present a solution based on:

- Primary reliance on commercial negotiations in the market place
- In the event of a negotiation impasse, access to voluntary binding mediation facilitated by the STB
- Adoption as a basis for mediation and negotiation, RCR benchmarks developed by STB in the Small Shipment proceeding.
- Adoption of reasonable procedures for applying such RCR benchmarks. We suggest that access to mediation facilitated by the STB would be authorized in situations where the existing rates were in excess of any two of the three STB benchmarks (RCR>180, RCR_{comp}, and RSAM)
- We also recommend a cap of \$500,000 on potential rail revenue reductions per lane or small shipment rate case

The recommended solution meets the pressing need for regulatory rate reasonableness review. It also responds to the failure of SAC to assist many coal shippers and virtually all non-coal captive shippers. Such shippers often face negotiation impasses regarding relatively low volume shipments, with revenues at issue that could never justify the cost of a SAC case.

We note further that:

- These individual low-volume lanes often coalesce into durable high-volume flows; creating efficiency for the railroads.
- Many of these origins are unlikely to shift to other locations within the US, thus ensuring the railroads predictable and efficient flows.
- High rail rates can lead to relocation of chemical and other production overseas.

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V. Small Shipment Parameters

For many shippers, the costs of developing and presenting a stand alone cost case are uneconomic given the small size of the traffic volume at issue³. Nevertheless, the volumes are important to the shipper and ultimately to the railroad. The Action Plan addresses this situation to the benefit of both railroad and shipper, facilitated by STB mediation.

Regarding applicability of the Non-Coal Rate Guidelines, we note that large shippers often have lanes with low shipment volumes, lack of rail or other transportation competition and high Revenue Cost Ratios. Such lanes should qualify for the small shipment rate case procedures.

The relevant size for application of the small shipment methodology is determined very simply:

A. Revenue Thresholds

In the evidence submitted in 2003 and 2004 in Ex Parte No. 646 many respondents joined together to recommend a brightline eligibility standard. The Joint Commenters in 2004 recommended \$4,800,000 annual freight bill on a single origin to destination pair as the eligibility standard for small rate cases.⁴ The AAR opposed this eligibility standard.

We recognize the merits of the approach recommended by the Joint Commenters. The approach recognizes that for the overwhelming majority of shippers the costs of a SAC case are vastly greater than would be justified by the revenues at issue. The Joint Commenters approach also addresses the statutory language calling for non-coal rate reasonableness guidelines, which are accessible to shippers in situations where the SAC presentation is too costly given the value of the case. See 49 U.S.C. 10701 (d)(3).

³ The STB's "stand-alone cost" ("SAC") test seeks to determine the lowest cost at which a hypothetical, efficient, "stand-alone railroad" ("SARR") could provide the transportation service needed by a complaining shipper. Under the SAC test, the complaining shipper designs a hypothetical railroad specifically tailored to serve its needs and the needs of other traffic it designates. The costs of building and operating such an efficient SARR are then compared to the revenues that such a system could expect to earn. If the involved shipper demonstrates that the SARR would earn more than necessary to cover all of its costs (including a reasonable return on investment), the shipper is entitled to rate relief

⁴ See 2003 and 2004 Comments of Joint Commenters in Ex Parte 646:

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Building on that approach we suggest two simple modifications to the eligibility standard offered by Joint Commenters:

- First we suggest that the eligibility standard be defined in terms of potential rail revenue reduction, rather than gross rail revenue.
- Second we suggest \$500,000 as a reasonable limit on potential rail revenue reduction for a given small shipment lane.

The potential rail revenue reduction can be estimated by comparing the revenue cost ratio (RCR) on the issue traffic with the proposed RCR rate reasonableness criteria. The following numerical examples illustrate the proposed method.

- Current RCR on issue traffic is 300%
- Proposed RCR criteria is 250%
- Current revenue on issue traffic is \$3,000,000

As shown in the Table A, one fifth of the revenue would be the maximum potential rail revenue reduction in this example.

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Table A		
Rail Cost	RCR	Rail Revenue
Existing situation		
\$ 1,000,000	300%	\$3,000,000
Criteria		
\$ 1,000,000	250%	\$2,500,000
Results		
Potential Rail Revenue Reduction		\$500,000

If either the revenue or the RCR on the existing traffic were to increase, the potential rail revenue reduction would increase. However, as shown in Table B and Table C, the small shipment rate case revenue reduction cap would limit the rail revenue reduction to an agreed amount, for which we suggest \$500,000.

Table B		
Rail Cost	RCR	Rail Revenue
Existing situation		
\$ 2,000,000	300%	\$6,000,000
Criteria		
\$ 2,000,000	250%	\$5,000,000
Potential Rail Revenue Reduction		\$1,000,000
Cap on Rail Revenue Reduction		\$500,000
Results		
Actual Rail Revenue Reduction		\$500,000

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As shown on Table C, the cap would not have an effect on the rate reduction shown in our first example, on Table A.

Table C		
Rail Cost	RCR	Rail Revenue
Existing situation		
\$ 1,000,000	300%	\$3,000,000
Criteria		
\$ 1,000,000	250%	\$2,500,000
Potential Rail Revenue Reduction		\$500,000
Cap on Rail Revenue Reduction		\$500,000
Results		
Actual Rail Revenue Reduction		\$500,000

The recommended approach will be easy to administer and will address concerns such as those raised by the AAR in its August 4, 2003 comments filed in Ex Parte 646.⁵ As shown in Table D, restricting the small shipment rate case procedures to a potential rate reduction of \$500,000 would ensure that there would be little risk to overall railroad revenue levels.

Even in the unlikely event that one hundred such small shipment rate cases were filed and the maximum potential rate reduction of \$500,000 were reached in all 100 cases, the combined rail revenue reduction would be about one tenth of one percent of total rail revenue.

Moreover, any such rail revenue reductions would likely be offset in whole or in part by additional revenue as shippers regain confidence in rail.

⁵ The AAR expressed concern that the small shipment rate reasonableness method should not adversely impact the railroads ability to earn adequate revenues.

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Table D	
Line Item Description	Rail Revenue Amounts
Total Rail Revenue as reported in STB 2002 waybill sample	\$40,880,403,000
Small Shipment Cap on Rail Revenue Reduction	\$500,000
Capped Rail Revenue Reduction on one case as percentage of Total Rail Revenue	0.001%
Capped Rail Revenue Reduction on 100 small shipment cases as a percentage of Total Rail Revenue	0.1%

In fact, the availability of such measures could easily enhance revenue adequacy by leading to net gains in profitable rail traffic.

B. The Small Shipment Issues Have widespread Impact

Over the years, on behalf of dozens of clients, including railroads, shippers and government agencies, SK has analyzed the rail costs and rail revenues of:

- Dozens of commodities, including chemicals, coal, farm products, food products, pulp, paper, petrochemical and others,
- Thousands of individual lanes and
- Hundreds of thousands of carloads

In considering the need for the small shipment rate case procedures, we see a need emerging even at a very modest volume; say one carload per shipper per week. At this very light volume level, we routinely find RCR's well above 180%.

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Some railroad representatives have expressed concern that Small Shipment Rate Cases would become widespread and circumvent the SAC procedures. We see little danger of this outcome. At the outset SAC is not even considered for use by most shippers. Moreover, although we find high RCR's frequently on small shipments, other factors will eliminate most of this traffic from consideration for the small shipment rate case procedures. This is a long-standing situation. For example the ICC concluded in 1995 that only about 18 percent of rail revenue was subject to rate challenges under its jurisdiction.⁶

Factors which could lead to ineligibility to access STB rail rate jurisdiction include the following:

**Under STB regulations (49 U.S.C. 10707(d)(1)),
the reasonableness of a rate
cannot be challenged if any of the following conditions hold:**

1. The revenues generated by that rate are less than 180% of the variable costs associated with handling the issue traffic .
2. In addition, under 49 U.S.C. 10709(c), the reasonableness of a contract rate cannot be challenged.
3. Rates for traffic or services that are exempted from regulation pursuant to 49 U.S.C. 10502 or its predecessor (former 49 U.S.C. 10505) are free from challenge.
4. The qualitative market dominance limitation of 49 U.S.C. 10707(a)-(b) rules out traffic with access to effective transportation competition.
5. Finally the traffic should comport with the grandfather provision of section 229 of the Staggers Act, which conferred regulatory immunity upon the rate levels that were in place at that time if not successfully challenged shortly after enactment of the Staggers Rail Act in 1980

⁶ Data from ICC 1995 Notice of Proposed Rulemaking, as cited in April 2003 filing by US DOT in Ex Parte 646.

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Many have noted that, when effective competition is not present, rail rate levels and rate increases will tend to be significantly higher. In its April 2003 filing in Ex Parte 646 the American Chemistry Council commented that, at that time, 63% of the rail-served chemical production facilities in the US were captive to a single railroad and companies shipping from those facilities pay 15% to 60% more for rail service.⁷

While SK is not suggesting carload volumes as a threshold qualifier for access to small shipment rate case procedures, the RCR results clearly show a need for assistance in resolving small shipment rate reasonableness challenges.

⁷ Comments of American Chemistry Council Before the STB in EP 646, April 16, 2003.

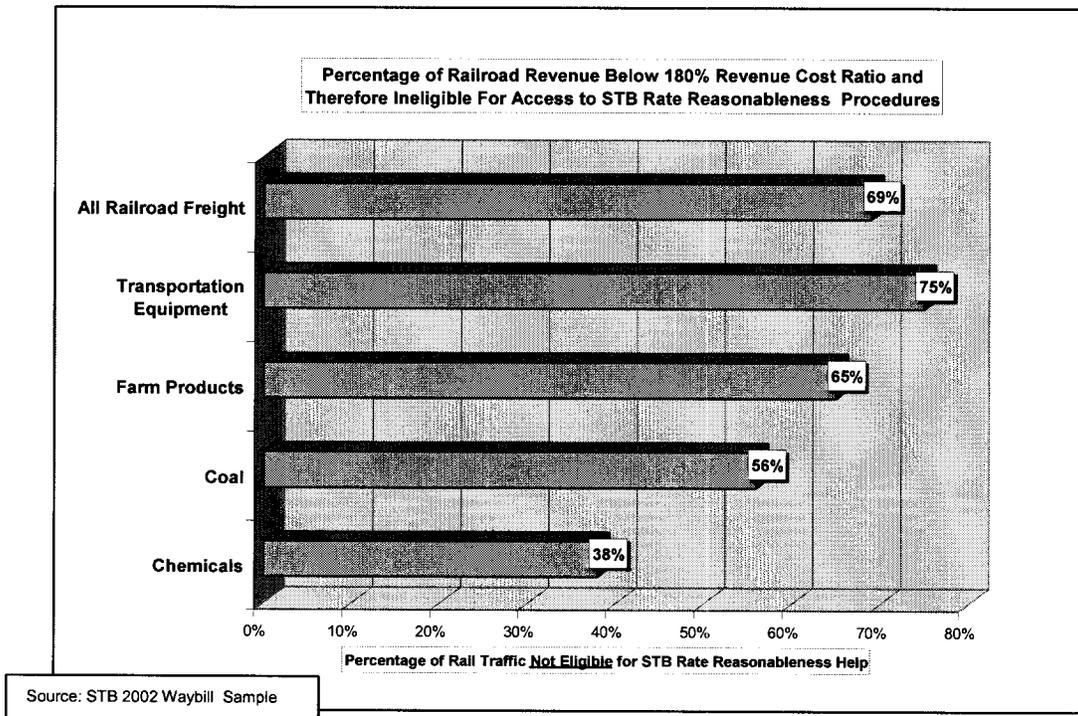
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C. Profitability Metrics

In focusing on the small shipment lanes most in need of mediation assistance we incorporate as criteria some profitability metrics computed by the STB.

□ 180% RCR This criterion eliminates all traffic with an RCR of less than 180%. This eliminates the following percentages of commodity groups based on STB 2002 waybill sample results:

- Chemicals: 38% of freight is eliminated from consideration
- Coal: 56% of freight is eliminated from consideration
- Farm products: 65% of freight is eliminated from consideration
- Transportation Equipment: 75% of freight is eliminated from consideration
- All Railroad Freight: 69% of freight is eliminated from consideration



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□ Revenue Shortfall allocation method (RSAM) Using the 1999 to 2002 4-year averages and the upper end of RSAM, depending on the railroad at issue, this criterion would eliminate all traffic with an RCR of less than 238%. Using the lower end of RSAM, depending on the railroad at issue, would eliminate all traffic with an RCR of less than 191%.

Table I
RSAM Mark-up Percentages 1999 - 2002
 (Range Represents RSAM With & Without Efficiency Adjustment)

Railroad/ Region	4 - Year Average	2002	2001	2000	1999
BNSF	235-316	273-366	258-354	222-296	185-248
GTC		415-497			
KCS	281-340	266-310	302-364	275-339	280-345
SOO	316-407	237-260	328-441	298-361	399-565
NS	191-238	179-216	186-235	208-272	191-227
CSX	222-263	223-259	242-290	217-259	205-245
UP	224-311	196-255	213-299	254-369	231-322
Eastern Region		215-254			
Western Region	229-316	224-297	233-326	243-341	217-298
National		221-280			

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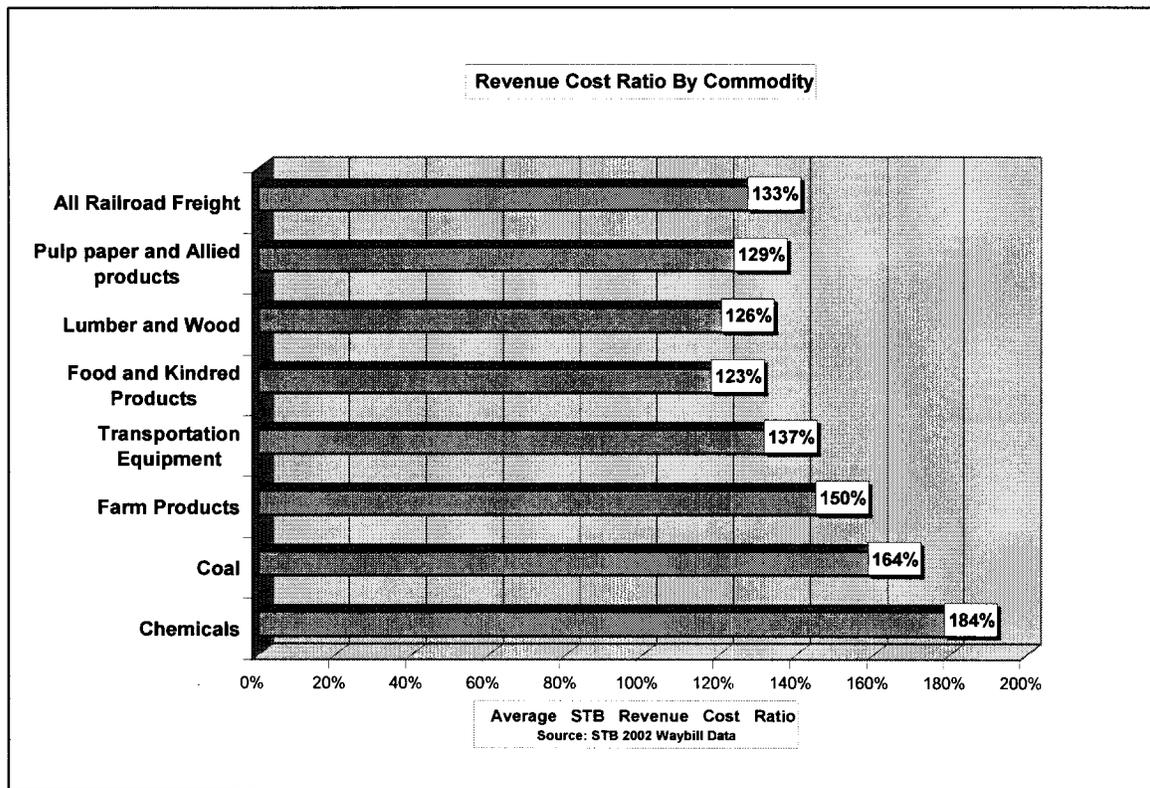
□ RCR >180. Using the 4-year average RCR data on traffic with RCR or RVC greater than 180% as computed by the STB, depending on the railroad at issue, this criterion would eliminate all traffic with RCR below a point ranging from 263% to about 200%, as shown in the following chart:

Table II
RVC>180 Percentages 1999-2002
Actual Average Mark-up Percentages for Traffic Above 180%
RVC

Railroad/ Region	4 - Year Average	2002	2001	2000	1999
BNSF	263	258	266	266	263
GTC		228			
KCS	248	238	263	242	248
SOO	234	205	256	228	246
NS	212	221	219	200	206
CSX	200	207	192	191	210
UP	232	236	234	222	234
Eastern Region		214			
Western Region	246	247	249	242	247
National		234			

The following table shows the average RCR as computed by the STB in its 2002 waybill sample with results aggregated by commodity group.

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Based on these analyses we see relatively limited application for the small shipment rate case procedures. While individual shipment and lane RCR's range to quite high levels, comparison of the RCR benchmarks and the STB average RCR indicates that the application of the recommended procedures would be quite limited. Simply stated, most of the traffic has RCR's below the STB RCR or RSAM benchmarks, or is otherwise ineligible for access to rate reasonableness review.

We recommend allowing access to the small shipment rate procedures only if the issue traffic passes at least two of the three RCR or RSAM benchmarks.

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VI. Recommended Win-Win Action Plan

Our recommended Action Plan relies in the first instance on private negotiations and would turn to the STB for mediation only in the event of impasses in such negotiations.

SK has observed that negotiations impasses can result from a variety of causes. Among the most prominent of these causes is the unavailability of effective transportation alternatives. Here, the STB criteria for access to regulatory rate reasonableness review coincides with the realities of the marketplace.

The Recommended Action Plan approach consists of the following steps:

1. Rely initially and primarily on commercial negotiations in the transportation marketplace.
2. Request STB mediation only in instances where negotiations have reached an impasse. Such mediation would be voluntarily agreed to by the parties and would be binding.
3. Request STB mediation for specific rail lanes for which rail or other modal competition is not available or not economically or commercially practical. This is designed to meet the market dominance prerequisite for Surface Transportation Board (STB) regulatory rate relief.
4. Demonstrate that the rail shipper is eligible to pursue Surface Transportation Board Maximum Rate Relief for the traffic at issue under the STB regulations; e.g. the commodity is not exempt.
5. Demonstrate, based on RSAM and Revenue Cost Ratios (RCR) benchmarks, that the rail rates at issue would likely be found as excessive using the STB small shipment non-coal guidelines.

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6. Apply these RCR findings in mediation facilitated by the STB;

We recommend this synthesized alternative: a step by step solution based on STB small shipper guidelines mediated by the STB.

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VII. Appendix A

Capabilities and Experience of

Tom O'Connor

**Snavely King Majoros O'Connor & Lee
1220 L St. NW
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This section sketches some of the highlights of my background, focusing on experience in the following areas:

- Negotiations
- Litigation and arbitration
- Operations analysis
- Network planning and design
- Analysis of complex operations including mergers

The presentation of capabilities is developed in two parts:

- Part I includes Tom O'Connor's resume, and covers the broad range of assignments.
- Part III sketches Tom O'Connor's litigation experience, including a brief summary of the cases in which he has testified.

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Part I

Resume

Of

**Tom O'Connor
Vice President**

Snavelly King Majoros O'Connor & Lee, Inc.

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Snavely King Majoros O'Connor & Lee, Inc., Washington, DC

- **Vice President (1988-Present)**

Mr. O'Connor has more than twenty-five years experience in business and economic analysis. His experience includes key and increasingly responsible management and policy positions with government agencies and private industry.

Mr. O'Connor has authored a series of guidelines on transportation negotiations and contracting and has conducted transportation negotiations and contracting seminars for a wide range of clients. Mr. O'Connor has also designed and helped lead transportation contract negotiations resulting in tens of millions in cost savings.

Mr. O'Connor has also appeared as an expert witness in successful Stand Alone Cost (SAC) transportation rate litigation, achieving millions of dollars in savings for the client.

He has also created and managed numerous computerized transportation management and regulatory systems to address complex problems and is a widely recognized expert on costing and economics.

He has conducted extensive analyses of truck transportation as well as analyses of tug and barge operations, both inland and off shore, for private sector clients.

Mr. O'Connor has conducted analyses for the Government of Canada used to shape policy for freight transportation and studies for the U.S. Government used to shape Freight and Passenger Transport Policy.

For the Government of Bulgaria, in the Balkans, he developed the Master Plan for Management Information Systems, including telecom and computer facilities designed to operate, measure, manage and monitor both rail freight and rail passenger operations of the Bulgarian State Railways, in Bulgaria and the Balkan Peninsula.

Mr. O'Connor has analyzed more than 45 rail merger scenarios and cases. He has provided expert testimony before state and federal courts and commissions in the U.S. and Canada on economic and policy issues. He has also testified as an expert on computerized transportation analytical systems, rail operations, anti trust issues and transportation economics and costing. Mr. O'Connor has served

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as an impartial and expert monitor of data and processes at issue in litigation on transportation.

Mr. O'Connor has also conducted management audits, focused on identifying the cause and effect relationships underlying claimed cost incidence. The management audits were directed toward testing the cost basis of claims asserted by major railroads.

His experience in telecoms spans the period since 1995. During this period, on a succession of government and commercial projects, Mr. O'Connor directed and participated in the review, design and operation of telecoms systems.

He also designed and developed the business and operations plan for an Eastern European telecoms startup company, BDZCOM. Mr. O'Connor designed and presented the plan and conducted liaison with international commercial, banking and government interests in the United States and Europe.

DNS Associates Inc., Washington, DC

- **Vice President (1982 - 1988)**

Mr. O'Connor directed and participated in numerous projects including merger analyses, transportation infrastructure analyses, plant and network rationalization and feasibility studies.

He designed and implemented mainframe and microcomputerized systems for analyzing rail, truck load, LTL and barge logistics. The computerized cost systems Mr. O'Connor created gained widespread use throughout the United States and Canada.

Mr. O'Connor also advised the U.S. Rail Accounting Principles Board on the costing aspects of regulatory reform policies.

He provided expert testimony on coal rates, computerized data bases and cost systems and rail cost issues before the Interstate Commerce Commission.

Association of American Railroads, Washington, DC

- **Assistant Vice President, Economics (1979 - 1982)**

Managing a large staff of professionals, Mr. O'Connor designed and managed major economic analysis projects. He helped formulate industry economic policy positions culminating in the Staggers Rail Act of 1980. He submitted expert

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testimony on behalf of the railroad industry in numerous cases before the Interstate Commerce Commission and state regulatory commissions. He also appeared regularly in national forums on economic issues.

Mr. O'Connor directed the most significant computerized industry Costing System project in 40 years, URCS, the cost system now used by all major US railroads. He also conducted industry seminars on URCS and related economic issues.

Mr. O'Connor also testified before the Interstate Commerce Commission on the design and application of this pathbreaking rail cost system since adopted by the Commission and the rail industry.

He also directed development and installation of a commercial computerized economic and market analysis system now used by virtually all major US railroads.

Consolidated Rail Corporation, PA

- **Assistant Director, Cost & Economics (1977 - 1979)**

Managing a staff of about 30 professionals, Mr. O'Connor was responsible for all Conrail management and regulatory cost analyses in both freight and passenger areas. He testified before the ICC on the development of subsidy standards now widely used in the US railroad industry.

He also finalized the design, installed and managed Contribution Simulator and Calculator (COSAC), a computerized internal management economic analysis system at Conrail. The COSAC system uses specific management accounting data to develop economic costs. COSAC replaced earlier systems and was used to guide virtually all transportation management decisions, including service design, equipment acquisition, strategic initiatives, line abandonments and service discontinuance.

Mr. O'Connor also participated in cost allocation negotiations between Amtrak and Conrail on cost sharing of joint facilities on the North East corridor. He initiated and directed profit maximization and plant rationalization programs. He also designed and implemented computerization and improvement of a wide range of economic and cost analysis systems used to manage and turn around this multi-billion dollar corporation.

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R.L. Banks & Associates Inc., Washington, DC

- **Consultant (1976 - 1977)**

Mr. O'Connor conducted and directed numerous transportation-related projects in the U.S. and Canada ranging from national logistics analyses to site-specific studies. He specialized in costing systems and appeared as an expert witness on such systems in a precedent setting proceeding before a Canadian Crown Commission.

U.S. Railway Association, Washington, DC

- **Manager, Local Rail Service Planning (1974 - 1976)**

In a project of unprecedented scope and historic implications, Mr. O'Connor developed, computerized, and implemented the light density lines cost analysis system, which defined Conrail. This system was used to reach line service decisions for thousands of miles of track, including service throughout New York. He served as liaison with congressional staffs and shipper groups, as well as federal, state, and local governments, and planning agencies. The system he created was a major element in the design and implementation of the streamlined Midwest-Northeast regional rail system. After leaving USRA, Mr. O'Connor subsequently was called back to appear as an expert witness to present and defend the operation of the USRA costing system.

Interstate Commerce Commission,

- **Economist, Washington, DC (1973-1974)**

Mr. O'Connor served as a staff economist and authored a report analyzing industry investment patterns and ICC regulatory policy, including ICC use of cost evidence.

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□ Education

- University of Massachusetts, Amherst, B.A. Economics
- University of Wisconsin, Graduate Course Work, Economics
- University of Delaware, Graduate Course Work, Business Management
- The American University, Graduate Course Work, Computer Science

□ Professional Organizations

- Transportation Research Board
 - Past Chairman of the Transportation Regulation Committee
- Transportation Research Forum
 - Past President of the Cost Analysis Chapter
- National Defense Transportation Association
 - Past Member of Board of Directors, National Capital Chapter

□ Academic honors

- Phi Kappa Phi academic honors society
- Phi Beta Kappa academic honors society

□ Military

- U.S. Army; Sergeant, Combat Engineers

□ Security Clearance

- Secret

Economic and Management Consultants

Part II
Summary of Expert Testimony

Of

Tom O'Connor
Vice President

Snavely King Majoros O'Connor & Lee, Inc.

1220 L St NW
Washington DC 20005

Comments of Tom O'Connor ■ STB Ex Parte No. 657

1220 L St NW ■ Washington DC 20005 ■ 202 371-9149

Economic and Management Consultants

Tom O'Connor is Vice-President of Snavely King Majoros O'Connor & Lee (Snavely King), an economic and management consulting company. He has been engaged in the business of economic analysis for more than thirty years, beginning in 1973 as an economist with the Interstate Commerce Commission (now the Surface Transportation Board) and later in economic consulting and management positions of increasing responsibility with the United States Railway Association, Conrail, the Association of American Railroads and, from 1982 through 1988 with DNS, Associates and since 1988 with Snavely King Majoros O'Connor & Lee, (Snavely King), an economic and management consulting company focusing on telecommunications and transportation. Mr. O'Connor was Vice President and principal at DNS Associates and has been Vice President and principal of Snavely King since joining the firm in 1988.

He has provided testimony in a number of proceedings before courts and regulatory commissions in the United States and Canada including:

- Interstate Commerce Commission,
- Surface Transportation Board,
- United States Railway Association,
- Regulatory Commission in Indiana,
- Regulatory Commission in New York,
- Regulatory Commission in Pennsylvania,
- State Court in Montana,
- State Court in Virginia,
- Arbitration Panel in New York
- Mediation Panel in Massachusetts
- Canadian Crown Commission.
- US District Court for Eastern District of Virginia,
- US District Court for Arizona

Tom O'Connor's practice centers on transportation with specific focus on litigation, negotiations and infrastructure issues including rationalization and redesign of the railroad infrastructure in the US as well as rebuilding of the railway infrastructure in Eastern Europe.

Mr. O'Connor's work in Eastern Europe focused on both transportation and telecommunications.

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Tom O'Connor Testimony in Federal Regulatory Cases

- **The comparative merits of the Interstate Commerce Commission's Uniform Rail Costing System (URCS) and Cost Center Accounting** submitted to the ICC on behalf of the US Railroad industry in February 1980 in Docket No. 37203.
- **The economics and computer technology of the Light Density Line Methodology used to define Conrail**, submitted to USRA before a special hearing in 1980.
- **Computerized transportation database design and use.** Verified statement was submitted to ICC on behalf of the US Railroad industry in Nov 1980 in Ex Parte No. 385.
- **The comparative merits of two regulatory rail-costing systems, URCS and Rail Form A**, submitted to the ICC on behalf of the US Railroad industry in March 1981, in Ex Parte 399.
- **Testimony on the Preliminary 1979 Rail Cost Study as released by the ICC, calling for adopting and improving URCS.** This was submitted to the ICC on behalf of the US Railroad industry in Docket No. 37203 in February 1982.
- **Rail costing using Rail Form a costs applied to service units generated by a computerized rail network model.** This verified statement was submitted to the ICC on behalf of a shipper located in Nevada in July 1985 in ICC Docket Nos. 37809 and 37815S.
- **Rail costing, also using Rail Form A costs applied to service units generated by computerized network model.** This verified statement was submitted to ICC on behalf of a shipper located in Nevada in November, 1986 in Docket No. 37809, 37815S.
- **Stand Alone Rail Costing, for use in rate reasonableness, using service units developed with a series of computerized network model.** This verified statement was submitted to the ICC on behalf of the Association of American Railroads in September, 1988 in Docket No. 38239S

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- **Rail merger conditions, developed using rail costs and a computerized network model.** This verified statement was submitted to the ICC in March 1994 in Finance Docket No. 21215 (Sub. No. 5)
- **The effects of computerized methods on rail operations and costs.** This verified statement was submitted to the ICC on behalf of Coletto Creek Utility in July 1994 in Docket No. 41242.
- **The cost of rail coal transportation using URCS costs and A Stand Alone Network.** This verified statement was submitted to the ICC on behalf of West Texas Utilities in April 1995 in Docket No. 41191.
- **Further testimony on the cost of rail coal transportation using URCS costs and a Stand Alone Network.** This verified statement was submitted to the ICC on behalf of West Texas Utilities in July 1995 in Docket No. 41191.
- **Oral Argument on the effects of the BN-SF merger on rail costs and service presented before the full Commission** in August, 1995 on behalf of Universal Forest Products in Finance Docket No. 32549.
- **The effects of the UP-SP merger on costs, infrastructure and operations.** Verified statement was submitted to ICC on Behalf of Kansas City Southern Railroad in March 1996 in Finance Docket No. 32760.
- **Competitive truck transportation market.** Joint Verified Statement with James Wells was submitted to Surface Transportation Board (STB) on behalf of TJ MAXX on June 22, 1998 in Docket No. 41192
- **The investment plans of UP-SP to remedy effects of the UP-SP merger.** Verified statement was submitted to STB on Behalf of Kansas City Southern Railroad in June, 1998 in Finance Docket No. 32760 UP-SP Merger Oversight Proceeding
- **The Arkansas and Missouri Railroad Request For Discontinuance Waiver** Filed on Behalf of Kansas City Southern Railroad. Verified

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statement was submitted to Surface Transportation Board (STB) in November 1998 in Finance Docket No. 32670.

- **Further testimony on the competitive truck transportation market.** Joint Verified Statement with James Wells was submitted to Surface Transportation Board (STB) on behalf of TJMAXX in January, 1999 in Docket No. 41192
- **Rail Merger Guidelines to develop new and improved merger analysis processes.** Verified statements were submitted to Surface Transportation Board (STB) on behalf of OxyChem, Oxy Vinyls, BASF and Williams Energy Services in May 2000 in Ex Parte 582.
- **Reply Testimony on Rail Merger Guidelines to develop new and improved merger analysis processes.** Reply Verified statements were submitted to Surface Transportation Board (STB) on behalf of OxyChem, Oxy Vinyls, BASF and Williams Energy Services in June 2000 in Ex Parte 582.
- **Testimony on Rail Costs and Rates.** Verified statement was submitted to Surface Transportation Board (STB) on behalf of Peabody Energy Company June 2003 in Docket 42077.
- **Testimony on Rail Costs and Rates.** Verified statement was submitted to Surface Transportation Board (STB) June 2004 in Ex Parte 646.
- **Testimony on Rail Costs and Rates.** Oral testimony was presented to Surface Transportation Board (STB) July 2004 in Ex Parte 646.

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Tom O'Connor -- State, Regional and Canadian Testimony

- **Expert testimony centering on transportation rates and costs and the implications for antitrust matters.** This testimony involved research and development of computerized cost and rate analyses for rail and truck service to Arizona and surrounding areas. The evidence is focuses on resolving antitrust allegations regarding certain construction materials. This evidence was developed and submitted on behalf of Solcon in May, 2003 with oral testimony at deposition in 2003. The case was under adjudication as Case No. CIV 01 01269 PHX ROS, United States District Court for the District of Arizona and has been settled.

- **Expert testimony centering on commuter railroad operations and costs.** This testimony involved design and development of computerized costing models of commuter rail operations. The evidence was central to arbitration to resolve subsidy disputes between New York and Connecticut. This evidence was developed and submitted on behalf of Metro North Commuter Railroad in August 1996 with oral testimony presented in February 1997. The case was decided successfully in favor of the client.

- **Expert testimony centering on the effects of a series of explosions on transportation operations and costs.** This was submitted on behalf of Washington Construction Company in a damages case filed by Burlington Northern Railroad in state court in Montana, First Judicial District Court, and Cause Number ADV 91-1885. The case went to a jury trial and was decided successfully in favor of the client in September 1993.

- **Expert testimony centering on computerized network models.** This was submitted in an antitrust case filed on behalf of Geoplex in U.S. District Court for the Eastern District of Virginia, Geoplex Corporation v. CACI, Inc. Civil Action No. 89-610-A. This evidence was developed and submitted in November 1989.

- **Expert testimony centering on transportation operations and costs.** This was submitted on behalf of the Canadian provinces of Alberta, Manitoba and Saskatchewan before a Canadian Crown

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Commission in a series of hearings held in Winnipeg, Manitoba and Regina, Saskatchewan in 1976. This led to an historic change in Canadian transportation regulation.

- In addition to these cases Mr. O'Connor has also submitted testimony on rail costs and operations before State regulatory commissions in Indiana, Pennsylvania and New York.

SK Snavely King Majoros O'Connor & Lee

**An Alternative For Some Needs Unmet by SAC:
A Win-Win Approach to
Rail Economic Regulation
For Rate Challenges in Small Rate Cases**

**Presented By
Tom O'Connor
Snavely King Majoros O'Connor & Lee, Inc.
1220 L St NW
Washington, DC 20005**

(202) 371 9149 email SKMOLTom1@aol.com

April 26, 2005

Alternative Remedies for Small Shipments with High RCR's

- Commercial Negotiations
 - Can lead to impasses on captive lanes
- STB Stand Alone Cost (SAC) Rate Case
 - Economically infeasible for small shipments
- STB-Assisted Mediation
 - SK recommends voluntary mediation as a welcome addition to the STB services

Three STB RCR or RSAM Benchmarks

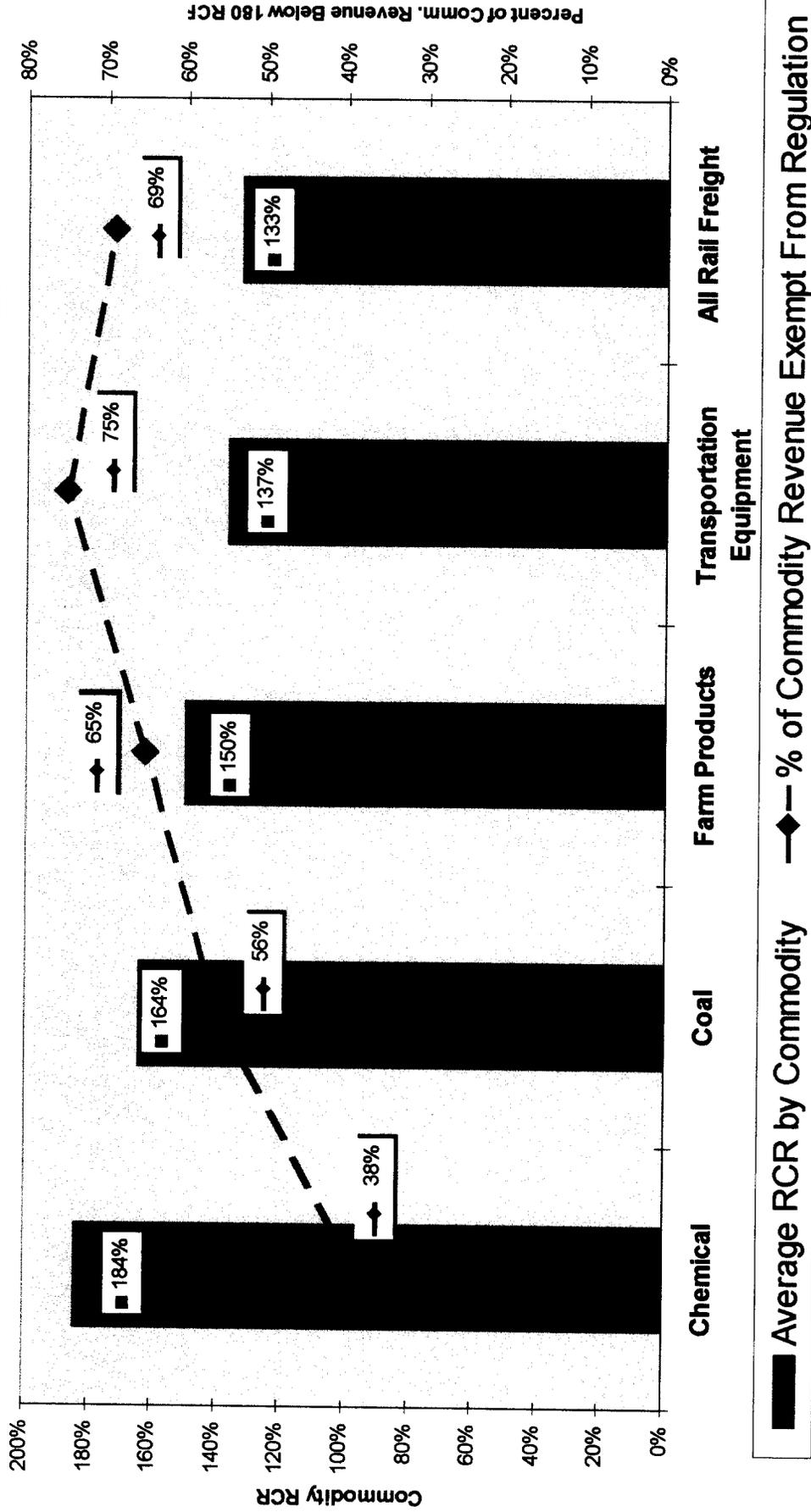
- **RSAM benchmark** reflects the defendant carrier's particular revenue needs (by examining the average markup that the carrier might charge its potentially captive traffic to meet those needs).
- **RVC comp benchmark** reflects demand-based differential pricing principles (by measuring the markups applied to similar traffic).
- **RVC_{>180} benchmark** tests whether the traffic at issue bears a disproportionate share of the carrier's revenues (by examining the markups applied by the carrier to its other potentially captive traffic).

Recommended Action Plan

1. Focus on specific rail lanes with (a) Revenue Cost Ratios greater than the regulatory threshold on lanes where (b) rail or other modal competition is not available or not economically or commercially practical.
2. Demonstrate that small rail shipments are eligible to pursue Surface Transportation Board Maximum Rate Relief under the STB regulations in Ex Parte 347 Sub No. 1. (e.g. traffic is not exempt from regulation)
3. Demonstrate that the small shipment rates at issue would be found as excessive in rate reasonableness analyses using STB Small Shipment RCR or RSAM guidelines in Ex Parte 347, Sub No. 2 and Ex Parte 646
4. The guidelines serve as regulatory access thresholds (Rate > 2 of 3 benchmarks); provide good base for negotiations; and if needed, a base for voluntary mediation.
5. SK recommends a synthesized alternative: a solution based on STB small shipper guidelines with voluntary binding mediation by the STB and Rail Revenue Reduction capped at \$500,000 per small shipment lane.

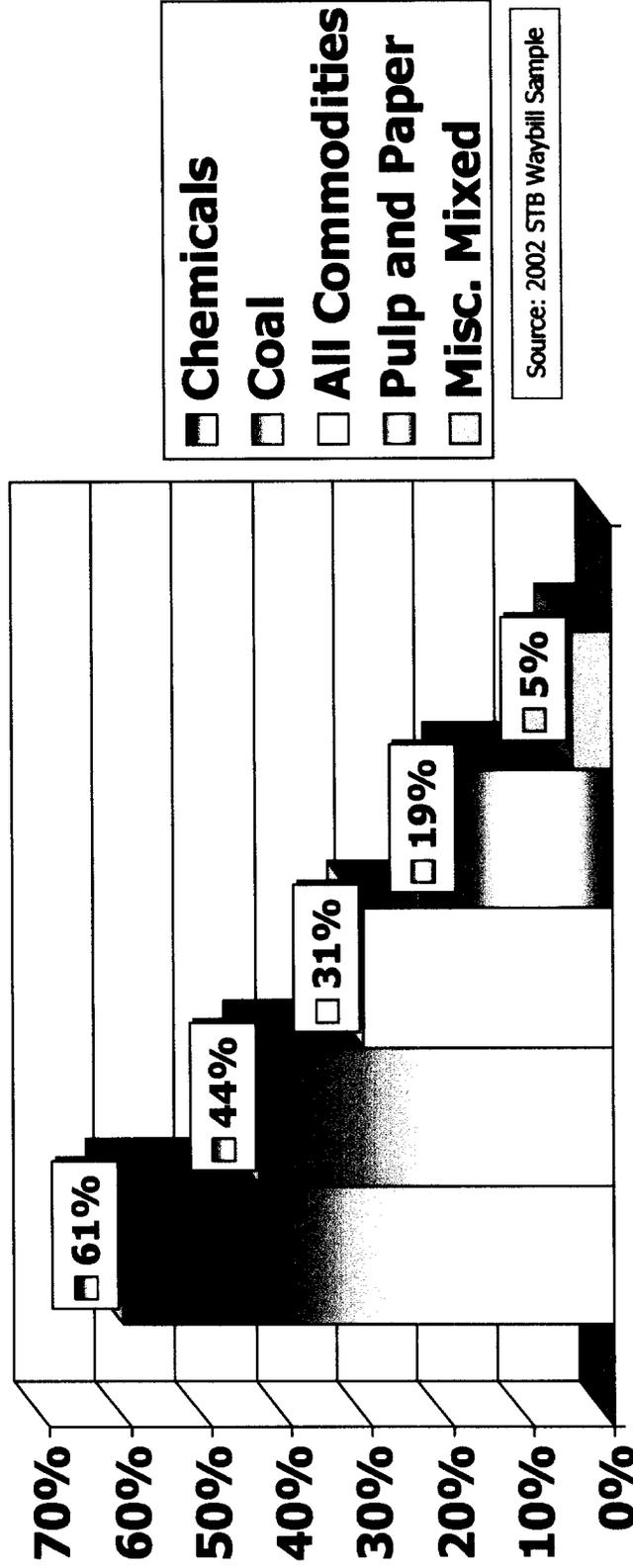
Regulatory Threshold Limits Application of the Recommended Approach

All Commodity Revenue Below RCR 180 Is Exempt From Regulation



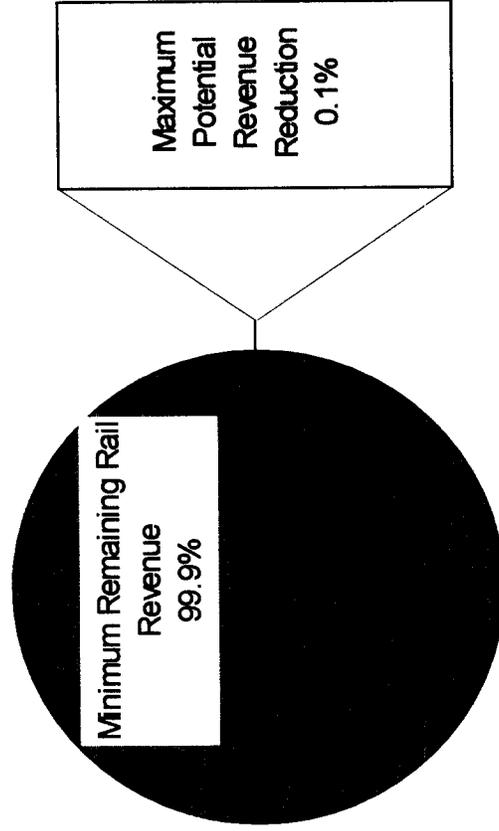
**Even With Limitations on Availability
Many Relatively Low Volume Captive Lanes Will Qualify for
Small Shipment Rate Reasonableness Mediation**

Percentage of Revenue with RCR above 180%



1/ Long-Cannon- 3 Mandates consideration of the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues.

**Estimated Maximum Revenue Impact of
Recommended Small Shipment Rate Approach
Applied to 100 Cases**



**The Potential Rail Revenue Reduction is Small.
100 Cases would cause a Rail Revenue Reduction of
1/10th of 1% of Rail Revenue... or Less**

Recommended Remedy

□ Commercial Negotiations

...with availability as needed to...

□ STB-Assisted Mediation which is..

□ Voluntary and Binding