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May 1, 2006

HAND DELIVERY

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

Re: Ex Parte No. 657 (Sub-No. 1), Major Issues in Rail Rate Cases

Dear Secretary Williams:

Enclosed for filing in the above-referenced proceeding are an original and twenty copies of the Joint Comments of Norfolk Southern Corporation and CSX Transportation, Inc., in the above-referenced proceeding. A diskette containing an electronic version of the Joint Comments is also enclosed.

Please acknowledge receipt of the enclosed Joint Comments for filing by date-stamping the enclosed extra copies and returning them via our messenger. If you have any questions, please contact the undersigned counsel.

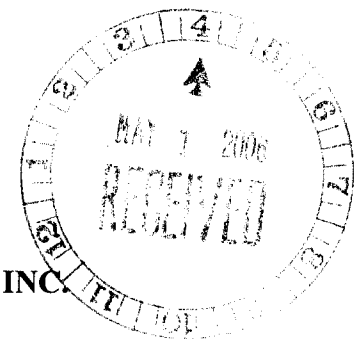
Sincerely,

G. Paul Moates
Paul A. Hemmersbaugh

Counsel to Norfolk Southern Corporation and CSX Transportation, Inc.

Enclosures

UNITED STATES OF AMERICA
SURFACE TRANSPORTATION BOARD



STB Ex Parte No. 657 (Sub-No. 1)

MAJOR ISSUES IN RAIL RATE CASES

JOINT COMMENTS OF NORFOLK SOUTHERN RAILWAY COMPANY AND CSX TRANSPORTATION, INC.

Docket No. 41191
WEST TEXAS UTILITIES COMPANY
v.
BNSF RAILWAY COMPANY

216464

STB Docket No. 41191 (Sub-No. 1)
AEP TEXAS NORTH COMPANY
v.
BNSF RAILWAY COMPANY

STB Docket No. 42088
WESTERN FUELS ASSOCIATION, INC.,
&
BASIN ELECTRIC POWER COOPERATIVE
v.
BNSF RAILWAY COMPANY

STB Docket No. 42095
KANSAS CITY POWER AND LIGHT COMPANY
v.
UNION PACIFIC RAILROAD COMPANY

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Counsel to CSXT and NS

Dated: May 1, 2006

CSX Transportation, Inc. ("CSXT") and Norfolk Southern Railway Company ("NS") (NS and CSXT collectively referred to hereinafter as "CSXT/NS") are pleased to submit their joint opening comments on the Board's proposals regarding issues in rate cases considered under the Stand-Alone Cost constraint of the Constrained Market Pricing principles adopted by the *Coal Rate Guidelines*. *See* Decision in STB Ex Parte 657 (Sub-No. 1), *Major Issues in Rail Rate Cases* (served Feb. 27, 2006) ("*Notice*"). NS' and CSXT's recent direct experience in rate cases under the *Coal Rate Guidelines* is limited to three cases, filed in 2001 and 2002, and decided after reconsideration in October 2004. In all three of those cases (*Duke Energy Corp. v. Norfolk Southern Railway Co.*, STB Dkt. No. 42069; *Duke Energy Corp. v. CSX Transportation, Inc.*, STB Dkt. 42070; and *Carolina Power & Light v. Norfolk Southern Railway Co.* STB Dkt. No. 42072), the Board found the challenged rates did not exceed a maximum reasonable level, and that no rate prescription was appropriate. *See Duke Energy Corp. et al v. Norfolk Southern Railway Co. et al*, STB Dkt. Nos. 42069, 42070, 42072 (Oct. 20, 2004).[1]

CSXT/NS expects that other interested parties may have additional views on the proposals described in the *Notice*. CSXT/NS will review other parties' submissions carefully and will respond to those comments and proposals as appropriate in their Reply Comments.

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[1] The recent experiences of CSXT and NS in SAC cases have been very similar. In late 2001, Duke Energy Corporation filed rate reasonableness complaints against both NS and CSXT. Although the complaints and SAC proceedings against the two Eastern railroads were separate, they both involved rail transportation of coal from Central Appalachian origin mines to Duke Energy power generation plants in the Carolinas, similar Stand-Alone Railroads, and similar issues and allegations. Shortly after Duke filed its two complaints, another utility operating in the Carolinas – Carolina Power & Light Company – filed a similar complaint (involving the same coal-producing regions, and very similar traffic, allegations, and issues) against NS. The Board established similar, serial procedural schedules in the three cases, and the cases proceeded on parallel tracks. Strong testament to the similarity of the three cases is the fact that the Board's final substantive decision in the three cases was a single consolidated decision addressing all three cases. *See Duke Energy Corp. et al v. Norfolk Southern Railway Co. et al*, STB Dkt. Nos. 42069, 42070, 42072 (Oct. 20, 2004) (consolidated decision, separately finding the challenged rates in each of the three cases to be below a maximum reasonable level). Because of the similarity of NS' and CSXT's recent SAC case experience, and to avoid burdening the Board with two similar sets of comments, NS and CSXT have decided to submit this single, joint set of comments on issues and proposals set forth in the *Notice*.

I. MAXIMUM RATE DETERMINATION: THE PROPOSALS TO REPLACE THE PERCENT REDUCTION METHODOLOGY ARE IMPERFECT SOLUTIONS IN SEARCH OF A PROBLEM

The first issue discussed in the Notice is the percent reduction methodology ("PRM") long embraced by the Board and its predecessor for allocating any excess revenues that the SAC analysis may conclude a particular SARR would earn in each year of the DCF period. *Notice* at 7-16. The Board begins by acknowledging the sound rationale for the historical use of the PRM, namely that "allocating the SAC costs among the traffic group in proportion to the existing rate structure would implicitly reflect the varying demand elasticities within the SAC traffic group." *Id.* at 7 (footnote citations omitted). This fundamental underpinning of the PRM is critical, because it is clearly wedded to the essential principle of Ramsey pricing, namely that each movement on a SARR pays a rate that reflects its relative "need" for the railroad's services – that is, that the rates are based on the elasticity of demand that each shipper faces for the transportation of its freight.

However, the Board expresses concern about a potential latent "flaw within the rate prescription method used in the past," namely that either a railroad or a shipper (or both) might manipulate the PRM, either by setting the challenged rate "at a much higher level than it expects to sustain" in the case of the former, or "by grouping its traffic with other traffic charged higher rates" in the case of the latter. *Id.* at 8. But the Board cites no actual example of a case in which such alleged "gaming" of the PRM actually occurred, referring instead to the rate reasonableness case brought against Norfolk Southern by Carolina Power & Light Company in STB Docket No. 42072 and the utility's allegation there that " the railroad could 'lose the battle' over the reasonableness of the challenged rate but 'win the war' with respect to the rate level that it can charge." *Id.* But the fact is that Norfolk Southern "won the battle *and* the war" in that case when the Board found the challenged rates to be reasonable. *See Carolina Power & Light Co. v.*

Norfolk Southern Ry. Co., STB Docket No. 42072 (served October 20, 2004).[2] By definition, Norfolk Southern could not have been "gaming" the PRM by establishing a rate that the Board's SAC analysis found reasonable – the PRM does not apply to rates found reasonable.

In other words, there is simply no evidence that the hypothetical concern addressed by the Board's proposed alternatives to the PRM – the same *theoretical concern* that Norfolk Southern acknowledged in the *CP&L* case – is a real problem that requires abandonment of the fundamentally sound approach that the PRM takes to allocating excess revenues across the users of a stand-alone railroad system. This is especially true so long as the Board remains vigilant to the concern and allows parties to submit whatever evidence and arguments they may believe appropriate to address the "gaming" issue in a specific case. Indeed, CSXT/NS respectfully suggest that complainants' rhetoric regarding gaming in recent Eastern rate cases has been primarily a litigation tactic.

In response to this purely hypothetical problem and perceived theoretical deficiencies in the PRM, the Board has proposed two alternative approaches for calculating the maximum contribution from each movement in a SARR traffic group, both of which the Board suggests would result in "the total contribution from the traffic group [equaling] the total SAC costs, and with no movement assigned a contribution higher than the rate charged for that movement." *Notice* at 9. Although the Board should always strive to improve its application of constrained market pricing principles, its suggested alternatives of a "Maximum Contribution Methodology" ("MCM") and a "Maximum Markup Methodology" ("MMM") simply do not accomplish that

[2] In each of the three recent Eastern cases, the complainant alleged that the rates in question had been set unreasonably high and were "outrageous," "punitive," and "confiscatory." In each of those cases, the defendant railroad presented evidence that refuted complainants' suggestions and allegations that the challenged rates constituted attempts to "game" the Board's rate prescription methods. *See, e.g.*, NS Reply Evid. at I-52 to I-76, App. B, *CP&L v. NS*, STB Dkt No. 42072 (Oct. 11, 2002). More fundamentally, however, the Board found the challenged rates reasonable in each of the three cases. *See Duke Energy Corp. et al v. Norfolk Southern Railway Co. et al*, STB Dkt. Nos. 42069, 42070, 42072 (Oct. 20, 2004). By definition, rates found to be below a maximum reasonable level cannot be said to have "gamed" the rate prescription system, because there is no occasion to apply a rate prescription process in such a case.

goal as effectively as the PRM itself.[3] In addition, the advantages that the Board claims that MCM would have over the PRM are overstated. First, as noted above, the "gaming" concern, avoidance of which the Board cites as the first advantage, is not a demonstrably real (as opposed to theoretical) problem, and certainly is not sufficiently concrete to justify scrapping the otherwise sound PRM.

And the suggestion that "use of the MCM approach should facilitate rate case settlements and private negotiations" (*id.* at 12) is speculative and wholly unsupported. Unless both parties know the design of the SARR and the traffic it will handle, it is hard to imagine how MMM/MCM would encourage settlement. It should be recognized that a railroad "acting strategically" (*Notice* at 8) -- that is, allegedly establishing a rate at an unrealistically high level in the belief that it will end up with a higher rate at the end of the PRM process than it would if the rate was set in a manner reflecting market forces -- will not know when it establishes its common carrier rate what configuration and traffic group the shipper will ultimately designate for its SARR. It is therefore not correct to assume that the railroad will know in advance of an actual rate challenge what the revenues and costs of the non-issue traffic of the complaining shipper's SARR will be – in other words, the railroad will not know when it sets the shipper's rate what the values will be in any of the lines of Table 1 of the Board's Notice, save for the issue traffic tons and revenues.

In fact, based on the examples provided by the Board in its Table 3 showing the comparison between prescription outcomes using the PRM versus the MCM, the hypothetical complainant sees the promise of a rate that is more than $3 per ton lower under the proposed MCM approach – a result that would only encourage such a prospective complainant to forgo private negotiated resolution in order to seek a litigated resolution of its rate dispute. Such

[3] The Board "acknowledge[s] that MCM would not reflect pure Ramsey pricing" (*Notice* at 12), and because MMM is in the Board's own words "a variant of the MCM approach" (*id.* at 13), it suffers from the same deficiency.

results would be directly contrary to the Board's policy of promoting the public interest by encouraging private, negotiated resolutions of such matters. *See, e.g. Coal Rate Guidelines,* 1 I.C.C.2d at 524.

The fundamental flaw in the Board's MCM proposal is that if stand-alone revenues are found to exceed stand-alone costs, application of MCM leaves rates at the lower end of the revenue per ton-mile spectrum unaffected and drives rates at the higher end of the spectrum to an identical, fully-allocated revenue per ton-mile. This would destroy the existing rate relationships, which, as the Board has repeatedly recognized, presumptively reflect the effects of the different demand elasticities exhibited by the movements in the stand-alone traffic group. As a result, an MCM-based SAC outcome would be divorced from the demand-based differential pricing principle that the *Guidelines* emphasize constitutes the fundamental underpinning of constrained market pricing and the SAC test. *See Coal Rate Guidelines,* 1 I.C.C.2d at 526-28.

Furthermore, the fact that MCM assumes that all rates at the higher end of the revenue per ton-mile spectrum can be set at the same revenue per ton-mile level flies in the face of prior findings by the Board and its predecessor that all movements of such traffic cannot be deemed to have the same elasticity of demand. *See, e.g., Coal Rate Guidelines,* 1 I.C.C.2d at 523-29, 558-560. As a matter of economics, if the market for rail services is contestable – as the SAC test assumes in evaluating the forward-looking cost level at which an efficient competitor would enter the market – a lower overall revenue requirement would, consistent with Ramsey Pricing principles, translate into lower rates for *all* movements in the stand-alone traffic group, whether those movements exhibited relatively low, or relatively high, revenues per ton-mile. If the stand-alone entity did not price in this way, a competitor could enter the market and profitably displace the stand-alone railroad by pricing consistent with Ramsey principles.

Moreover, the MCM proposal is inconsistent with Ramsey pricing principles because it awards all of the benefits of excess SARR revenue to higher rated traffic. Effectively, MCM would transfer benefits that, under Ramsey pricing principles, should inure to middle- and lower-

rated traffic to higher rated traffic. This revenue transfer essentially would cause lower-rated traffic to subsidize higher-rated issue traffic, thereby generating the sort of cross-subsidization that Ramsey pricing and the Board's CMP regulations are designed to avoid.

The MMM "variant" to MCM suffers from the same deficiencies, as well as the significant drawback acknowledged by the Board of requiring the parties "to estimate the variable cost in the base year of every movement in the traffic group and project this forward to encompass every year in the DCF analysis period." *Notice* at 16. Such a task would be quite difficult, highly time-consuming, and in stark contrast to recent Board efforts to expedite rate cases. *See, e.g.*, *Decision,* STB Ex Parte No. 638, *Procedures to Expedite Resolution of Rail Rate Challenges to Be Considered Under the Stand-Alone Cost Methodology* (served April 3, 2003). It also inevitably would lead to disputes about the appropriate technique to project such costs over an entire DCF period. (The Board is well aware of the complexities of projecting and forecasting a SARR's volumes and revenues that parties have battled over in recent SAC cases.) Adoption of this approach would be inconsistent with the Board's efforts to achieve accuracy in SAC cases while simultaneously seeking ways to reduce the cost and complexity of such proceedings.

There is no sound reason for the Board to depart from use of the PRM as the appropriate methodology for determining rate prescriptions in SAC cases in which the Board finds that the SARR's revenues exceed its costs. Remaining vigilant to the possibility that a railroad or shipper might try to manipulate the PRM in a specific case, as well as making it clear that parties will be permitted to offer specific evidence in a particular case about such alleged efforts at gaming, will provide all the protection necessary to maintain the integrity of the Board's prescription processes.

II. REVENUE ALLOCATION FOR CROSS-OVER TRAFFIC

CSXT/NS agrees with the Board that the current method for allocating "cross-over traffic" revenue between the SARR and the residual incumbent distorts the SAC test in favor of the complainant. CSXT/NS believes that approaches applied in past cases, including the "Modified Straight-Mileage Prorate" approach, allocate too little revenue to the residual incumbent and do not adequately account for the full costs to the residual incumbent of serving crossover traffic, particularly on the low-density residual lines that the complainant chooses not to include in its SARR. As a corollary of the underallocation of revenue to the residual incumbent, MSP overallocates crossover traffic revenue to the SARR. This revenue allocation imbalance has resulted in excessive reliance on cross-over traffic by complainants, producing distorted SARR revenue projections. The existing revenue allocation further results in the residual incumbent cross-subsidizing the SARR – if the Board is to continue to allow widespread use of crossover traffic in SAC cases, it must apply a revenue allocation method that does not permit such cross-subsidies.

In this context, CSXT/NS views the Board's proposed Average Total Cost ("ATC") approach as an improvement. While less than ideal, the proposed approach appears designed to allocate crossover traffic revenue in a manner that attempts to better reflect the relative costs of serving crossover traffic. The utility of this approach would depend on how it is implemented and adjusted to account for factors and issues that inevitably will arise in particular cases. Based on CSXT/NS' (limited) recent experience, the ATC approach appears to be a step in the direction of fairer allocation of revenue from cross-over traffic.

III. INDEXING OPERATING COSTS

The Board has expressed concern in recent rate cases that the RCAF-U cost indexing factor may understate the productivity gains a SARR might realize, particularly in the later years of the SAC analysis period. At the same time, the Board has recognized that the RCAF-A, the alternative cost index that takes into account industry-wide productivity gains, would

substantially overstate the productivity gains that would be available to the SARR, which is assumed to be the least-cost, most efficient possible rail carrier at its inception.

As the Board recognizes, the potential for some productivity improvements becomes somewhat more realistic in the later years of the SAC analysis period. The long lives of most rail capital assets mean that most potential increases in productivity would not be available to the SARR until the final years of the 20-year analysis period. Thus, if the Board adopts a shorter SAC analysis period, as it has proposed in this proceeding, that shorter period would obviate the perceived need to adjust the operating cost index to adjust for productivity improvements that would be available to the SARR, if at all, only after the end of the shorter SAC analysis period.

The hypothetical SARR is assumed to be the least-cost, optimally efficient railroad. *See, e.g.*, Decision, *Duke Energy et al v. Norfolk Southern et al,* STB Dkt. Nos. 42069, 42070, 42072 (Oct. 20, 2004), at 3. Thus, unlike real-world railroads, the SARR is presumed to have so optimized its operations that, in the short-to-medium term, no further productivity improvement is possible.[4] *See id.* at 17-18 (explaining that SARR could not expect reduced operating expenses from purchase of locomotives, because it is assumed to have equipped itself with new locomotives at the outset). Because the SARR is optimally efficient at its inception, and would replace very few significant capital assets in its initial decade of operation, no productivity adjustment to the RCAF-U is necessary or appropriate during the first 10 years.[5] *See generally,*

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[4] Although real world rail carriers have realized significant employee productivity improvements over the last few decades, it is extremely unlikely that the SARR could generate significant gains in labor productivity. Complainants are allowed to hypothesize a hyper-efficient, non-union, cross-trained work force, whose super-employees reliably perform multiple jobs and tasks simultaneously. Given the assumption of super-optimal workers at the SARR's inception – and absent evolutionary changes that radically change human capabilities – there is no realistic potential for significant improvements in SARR employee productivity.

[5] The SAC analysis generally assumes that the SARR replaces certain information technology ("IT") equipment after five years. It is unlikely, however, that a SARR would replace any of its IT systems in the first ten years of its operation. And, contrasted with the significant IT requirements associated with a real-world Class I railroad's handling of a wide range of commodities and the specialized services they require over the CSXT and NS systems, the SARR's IT needs are from the outset much more limited, due to its provision of trainload service

Otter Tail Power Co. v. BNSF Railway Co., STB Dkt. No. 42071 (served Jan. 27, 2006), at 22 (noting that potential theoretical productivity gains might be available to the SARR, but only in the "outward years" of the 20-year SAC analysis period).

If the Board retains a 20-year SAC analysis period, it is possible that, in the second decade, the SARR could achieve some limited productivity improvements. *See id.* For example, it is possible that a complainant could demonstrate that asset replacement and technological advances in years 11 through 20 could result in some increased productivity in the performance of certain maintenance-of-way functions. To the extent potential productivity gains would be available to the SARR, they likely would be confined to certain specific operating expense categories and accounts, and probably would be greater in some of those accounts than others. Therefore, to avoid arbitrary changes to operating expense indexing, any proposed adjustments and their amounts, should be tied to those specific operating expense items that are likely to achieve ascertainable productivity improvements. Because the SARR already benefits from optimal efficiency and productivity assumptions, the burden should be on the complainant to demonstrate the timing, functions, and amount of any projected productivity improvement.

CSXT/NS accordingly propose that the Board use the RCAF-U to index operating expenses for the first 10 years, and that it apply a rebuttable presumption that the RCAF-U is the

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of fewer bulk commodities on a more limited geographical network. Moreover, even for its relatively simple and limited operations, a SARR starts out with a streamlined network and cutting edge IT systems for tracking car movements, facilitating crew calling, tracking accounting expenditures and a host of other activities, taking full advantage of automation and minimizing the SARR workforce. Thus, at its inception, the SARR is assumed to have realized virtually all of the productivity gains associated with IT equipment that real world rail carriers have obtained over a period of many years, as well as the lion's share of potential gains for the foreseeable future. Further, the cost of IT equipment represents only a tiny fraction of SARR operating expenses, and its replacement would not have any significant effect on overall operating costs. For the foregoing reasons, replacement of IT equipment – whether in five, ten, or twenty years – simply does not warrant any adjustment to the RCAF-U index for operating expenses.

appropriate index for operating expenses in the second ten years of the SAC analysis period.[6] If a complainant can demonstrate, with reasonable specificity, that certain operating expense accounts are likely to experience productivity gains at a certain time in the second ten years, and if it can present evidence supporting a specific amount by which the affected accounts should be adjusted, then the Board could adjust those accounts accordingly. For SARR operating expenses that the complainant does not demonstrate would likely experience productivity improvements, the Board should apply the baseline RCAF-U index. This approach would avoid the award of a windfall to the SARR based on an arbitrary, general assumption that it could achieve some productivity gains at some unspecified time, while allowing the SARR to obtain the benefit of productivity improvements that complainant could demonstrate are reasonably likely to be achieved.

IV. MOVEMENT-SPECIFIC ADJUSTMENTS TO URCS

CSXT/NS understands the Board's concern that allowing movement-specific adjustments to URCS system average costs may, in some instances, result in substantial expenditure of time and resources by the parties without sufficient net adjustments to those costs to justify the effort and expense. The Board's proposed solution, however, would throw out the baby with the bath water – and sacrifice the accuracy that is essential to accurate jurisdictional determinations by refusing to consider <u>any</u> adjustments to URCS costs, even those movement-specific costs that vary substantially from the URCS system average. CSXT/NS urge the Board to reconsider its proposal to prohibit all movement-specific adjustments to URCS, because such an approach could significantly affect the accuracy, integrity, and reliability of SAC analyses and results.[7]

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[6] If the Board decides to limit the SAC analysis period to 10 years, then it should apply the RCAF-U to index operating expenses, because no productivity adjustment would be appropriate for the first 10-years of the optimally efficient SARR.

[7] CSXT and NS fully reserve the right to submit further comments, argument, and evidence regarding movement-specific adjustments to URCS variable costs. Moreover, if the Board adopts a rule or practice prohibiting or unduly limiting such variable cost evidence or

As the Board, and the ICC before it, have long recognized, movement-specific variable cost adjustments result in more accurate variable cost data that better reflect the actual costs of those specific movements than URCS system-average costs. *See, e.g.*, *Carolina Power & Light v. Norfolk Southern Railway Co.*, STB Doc. No. 42072 (Dec. 23, 2003)[8]; *Pozzolanic v. Union Pacific RR*, I.C.C. No. 39912, 1989 WL 246868 at *4 ("The Commission normally finds individual cost study data to reflect more accurately actual costs than regional or aggregated data."). As the Board summarized when adopting modified guidelines for smaller cases,

> It is well established practice to allow movement specific cost adjustments in rate cases for purposes of determining whether the 180% jurisdictional floor is exceeded. Such adjustments – to reflect the actual cars used, actual lading weights, and actual train equipment, crew, and operations involved are possible and appropriate where such information is known and differs from the carrier's system average data.

Ex Parte No. 347 (Sub-No. 2), Rate Guidelines, Non-Coal Proceedings, at 28, n.104 (served Dec. 31, 1996) (internal citation omitted).[9] Because movement-specific adjustments result in more accurate variable cost data and analyses for traffic at issue in rate cases – including important jurisdictional calculations and determinations – the agency has consistently preferred to make such adjustments where possible. *See, e.g.*, *Wisconsin Power & Light v. Union Pacific R.R. Co.*,

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adjustments in SAC cases (or in other rate reasonableness proceedings), CSXT and NS reserve the right to contest or oppose such a rule or practice in any future rate cases or proceedings.

[8] *Accord* STB Docket No. 42057, *Pub. Serv. Co. of Colo. d/b/a XCel Energy v. BNSF Ry. Co.*, 2004 WL 1428724, at *77 (June 7, 2004); STB Docket No. 42056, *Texas Municipal Power Agency v. BNSF Ry. Co.*, 2003 WL 1523335, at *19 (Mar. 21, 2003); STB Docket No. 42051, *Wisconsin Power & Light Co. v. Union Pacific R.R. Co.*, 2001 WL 1075821, at *18 (Sept. 13, 2001); STB Ex Parte No. 346 (Sub-No. 29A), *FMC Wyoming Corp. & FMC Corp. v. Union Pacific R.R. Co.*, 2000 WL 33527851, at *25 (May 12, 2000).

[9] *But see* Decision, *BP Amoco Chemical Company v. Norfolk Southern Railway Co.*, STB Dkt. No. 42093 (June 6, 2005), at 8-9 (proposing, in a specific case brought under the *Simplified Guidelines*, to expedite the case by prohibiting URCS variable cost adjustments like those allowed by the Board in SAC cases). Both NS and BP Amoco Chemical filed comments opposing the Board's proposal to prohibit all movement-specific adjustments to URCS variable costs. *See, e.g.*, "Comments of Norfolk Southern Regarding Procedures and Standards Announced in June 6, 2005 Decision," *BP Amoco Chemical*, STB Doc. No. 42093 (June 16, 2005); "Comments of BP Amoco Chemical Company on Certain Issues Raised by the Board in its Decision Served June 6, 2005, *BP Amoco Chemical*, STB Doc. No. 42093 (June 16, 2005).

STB Dkt. No. 42051, 2001 WL 1075821 at *18 (Sept. 13, 2001).[10] Reversing this sound precedent in favor of a blanket prohibition on evidence supporting variable cost adjustments would significantly undermine the accuracy and fairness of rate case analysis and results.

For example, in *CP&L v. Norfolk Southern Railway,* STB Dkt. No. 42072, NS demonstrated that the costs associated with constructing, operating, and maintaining a conveyor belt system used to move coal from the Harris coal mine mouth to the Kopperston loadout were properly considered variable costs of the movement of coal from the Harris mine to CP&L's Hyco plant. *See* Rebuttal Evidence and Argument of Norfolk Southern Railway Company at II-A-60, STB Dkt. No. 42072 (Nov. 27, 2002). Because NS' investment for the conveyer belt system – while substantial – is a relatively small proportion of NS' systemwide roadway investment, allocation of that cost equally across the entire NS system would have resulted in an URCS system-average variable cost increase of less than 1/3 of one cent per ton. But, because the belt costs are associated with only one mine, NS showed that, for purposes of variable cost analysis, the full cost of the belt should be allocated to the coal tonnage originating from that mine. *See id.* The Board agreed that a movement-specific adjustment to variable costs for the Kopperston-Hyco movement was appropriate, finding that "because this expense is part of NS' actual cost of handling the Kopperston-Hyco movement, [the full amount of that cost] is properly included in calculating NS' variable costs of serving that movement." *CP&L v. Norfolk Southern*, STB Dkt. No. 42072, Decision at 130 (Dec. 23, 2003). As a result of this adjustment, the Board found that the variable costs of the Kopperston-Hyco movement were $4.41 per ton, as compared with $ 3.97 per ton without that movement-specific adjustment. *Id.* at 112, 138. Had the analysis used URCS system average costs, the exclusion of this single movement-specific

[10] *Accord* STB Docket No. 42057, *Pub. Serv. Co. of Colo. d/b/a XCel Energy v. BNSF Ry. Co.*, 2004 WL 1428724, at *77 (June 7, 2004); STB Docket No. 42056, *Texas Municipal Power Agency v. BNSF Ry. Co.*, 2003 WL 1523335, at *19 (Mar. 21, 2003); STB Docket No. 42051; STB Ex Parte No. 346 (Sub-No. 29A), *FMC Wyoming Corp. v. Union Pacific R.R. Co.*, 2000 WL 33527851, at *25 (May 12, 2000).

adjustment alone would have resulted in a 10% understatement of the movement's variable costs. Stand Alone Cost cases can determine rates for millions of tons of coal for up to twenty years. A significant understatement of costs – even of less than one dollar per ton – could mean the railroad receives tens or even hundreds of millions of dollars less than it is entitled to receive.[11]

Another recurring example of the need for movement-specific variable cost adjustments is payments made by rail carriers to short lines (or other carriers) for haulage or trackage rights necessary to transport coal or other freight from origin to destination. *See, e.g.,* NS Reb. Evid. at II-A-59, *CP&L v. Norfolk Southern*, STB Docket No. 42072 (evidence regarding trackage rights agreement and payments, on a per-ton basis, to Vaughn Railroad Company). Such payments are often significant components of the costs of affected movements, and they must be included in the calculation of the variable costs of those movements in order to develop accurate estimates of their variable costs. *See, e.g., id.; CP&L v. Norfolk Southern*, STB Docket No. 42072, Decision at 129-30 (approving movement-specific adjustment to variable costs to account for trackage rights payments to Vaughn Railroad).

As the foregoing examples show, movement-specific adjustments to variable costs, individually and collectively, can have significant effects on the accuracy and results of a variable costs analysis, and on the calculation of R/VC ratios. Therefore, rather than eliminating variable cost adjustments entirely, CSXT/NS believes there may be intermediate approaches that would improve the efficiency of variable cost analyses while continuing to allow significant variable cost adjustments that are necessary to ensure the accuracy and integrity of essential rate case calculations and analyses. Below, CSXT/NS propose two possible alternatives to the

[11] In cases brought under the *Simplified Guidelines*, the potential effect of prohibiting movement-specific variable costs adjustments is even greater, both because a given dollar amount cost adjustment will generally represent a larger proportion of the costs in a smaller case, and because variable costs are such an important component of the three R/VC benchmarks used by the *Simplified Guidelines*. *See Rate Guidelines – Non-Coal Proceedings*, STB Ex Parte 347 (Sub-No. 2) (served Dec. 31, 1996).

Board's proposal, each of which would afford parties a significant opportunity to avoid much of the expense of variable cost presentations.

CSXT/NS' first proposal is that the Board allow defendant rail carriers to elect, at the outset of a SAC case (well before the opening round of evidence), whether they will contest quantitative market dominance as a threshold matter. If the rail carrier elects not to contest quantitative market dominance at the beginning of the case, the parties would conduct discovery and present evidence regarding only a Stand Alone Cost analysis. If, based on the parties' SAC presentations, the Board concludes the challenged rates do not exceed a maximum reasonable level, the case would conclude without presentation of any variable cost evidence whatsoever. In such circumstances, the parties will have avoided the entire expense of submission of variable cost evidence, including but by no means limited to the expense of presenting evidence regarding movement-specific adjustments to URCS costs.

If the Board's SAC analysis determines that challenged rates exceed a maximum reasonable level, either party would be allowed to elect whether to contest URCS system-average variable costs. If a party elects to pursue this option, the parties would present variable cost evidence, including data and analysis supporting movement-specific adjustments to URCS costs. Based on the parties' submissions, the Board would determine movement-specific variable costs, and the 180% revenue-to-variable cost ratio for issue traffic. Finally, the Board would apply the 180% R/VC floor to its SAC results in order to ensure that any prescribed rate generates a R/VC ratio at or above the jurisdictional minimum.

If implemented, this proposal would eliminate entirely the need for variable cost presentations in many cases. *See, e.g.*, Decision, *Duke Energy Corporation et al v. Norfolk Southern Railway Co., et al*, STB Doc. Nos. 42069, 42070, 42072 (served Oct. 20, 2004) (final decisions concluding the challenged rates in three separate cases did not exceed a maximum reasonable level, vitiating the need for further variable cost analysis). In such cases, the Board and the parties would realize a substantial savings of time and expense that would otherwise

have been devoted to unnecessary variable cost evidence and analysis. Similarly, in cases in which the Board determines a challenged rate is not reasonable, and the stand-alone cost analysis results in a prescribed rate that would generate R/VC ratios that substantially exceed 180%, parties may elect not to contest URCS system average variable costs, because of the low likelihood that movement-specific adjustments would change the prescribed rate(s). In such cases, the parties and the Board again would avoid the time and expense of preparing and analyzing movement-specific variable cost evidence.

Finally, in cases in which a party elects to pursue a variable cost analysis, the expense to the parties would be no greater than they would have been had they developed and submitted variable cost evidence at an earlier stage of the proceeding. This proposed approach would thus expedite many SAC proceedings, while still adhering to the Board's statutory obligation not to prescribe rates that would result in a revenue-to-variable cost ratio – whose proper determination depends on accurate calculation of the actual variable costs of the specific movements at issue of less than 180%. *See* 49 U.S.C. § 10707(d)(1)(A); *West Texas Utility Co. v. Burlington Northern R.R.*, 1 STB 638, 677 (1996); *see generally,* Decision, *CP&L v. NS*, STB Docket No. 42072 (Dec. 22, 2003), at 111, n. 63 & 112-143.

Some parties may be concerned that such a tiered approach would result in unnecessary delay of the rendering of a final decision regarding an appropriate rate prescription or relief. Because the overall time necessary to develop and present SAC evidence and variable cost evidence should be approximately the same regardless of the order in which such evidence is presented, the Board may be able to address timing concerns by adjusting the schedule for presentation of SAC evidence. In addition, the Board might consider requiring the rail carrier to collect only the maximum reasonable rate prescribed by its SAC analysis during the pendency of the follow-on variable cost proceeding, subject to true-up payments (including interest) based on the final maximum rate level determined after the conclusion of the variable cost phase.

A second possibility that the Board might consider is limitation of the categories of costs for which it will consider movement-specific evidence. The Board could identify a limited number of cost categories that, in its experience, vary most substantially from URCS system costs, and allow the parties to submit movement-specific evidence for those categories only. NS and CSXT believe those cost categories should include fuel costs, equipment ownership, crew wages, mine loading times, car mileage allowances, and payments to mines or other transportation providers (*e.g.*, payments to short lines, payments for coal conveyer belts, etc). In order to avoid unfairness or inaccurate results in specific cases and circumstances, the Board could also allow parties to present arguments for presentation of evidence regarding other specific costs, if the proponent can demonstrate that movement-specific costs for those items are likely to be substantially different from system average costs.

This approach would place a reasonable limit on the cost categories with respect to which parties would submit evidence, thereby reducing the time and expense of presenting and analyzing variable costs evidence. At the same time, such an approach would allow parties to present evidence regarding the costs that vary most substantially from URCS system average costs, thereby allowing significant adjustments to cost calculations. Properly applied, such an approach would achieve the important goals of maintaining accuracy that is essential to proper determinations of market dominance and jurisdictional thresholds, while reducing the complexity and burden of variable cost presentations and analysis.

In sum, CSXT/NS believe the Board's proposal to disallow all movement-specific adjustments to URCS system average costs is ill-advised and could have unfair and material adverse effects on SAC analyses and results in particular cases, including but not limited to prescription of rates at levels below the properly calculated jurisdictional floor. CSXT/NS have proposed two alternatives that could achieve the Board's goal of reducing the expense of presenting variable cost evidence, without the potential distortion of the process inherent in the Board's proposal. In all events, NS and CSXT urge the Board not to adopt the proposal

described in the *Notice*, which would unwisely sacrifice accuracy and fairness in an effort to reduce the costs of one component of the multi-faceted, complex SAC analysis.

V. STAND ALONE COST ANALYSIS PERIOD

Based on their recent rate case experience, CSXT/NS have found that the use of a 20-year SAC analysis period requires projections of traffic volumes, rates, costs, and other parameters over a longer period than normally can be predicted with a reasonable degree of accuracy. In the dynamic North American and world economies, markets and the myriad factors and unknowns that affect them are constantly changing and evolving, often in unpredictable ways and directions. Because the transportation industry serves many other industries, it is affected by changes in the many different markets and sectors in which its customers operate. The result of such compound uncertainty is that the accuracy and reliability of forecasts and projections for the future vary inversely with the length of the period – the longer the period, the less likely that projections will be accurate.

For example, accurate projection of coal traffic volumes becomes increasingly difficult as the projection period lengthens. Everything else being equal, projections of volumes of coal a railroad (or stand-alone railroad) will haul in the immediately following year are likely to be far more accurate than projections for the volume the same railroad may haul twenty years later. Some of the many variables affecting future coal volumes include electric power demand and the numerous factors affecting that demand; local and regional changes in coal reserves and supplies; the relative prices of coal mined in different regions or under different conditions; prices of other fuels and methods of electric power generation; requirements of various environmental laws, including air pollution control laws regarding several different byproducts of the burning of coal, and generators' installation of pollution control devices and technologies to meet such regulatory requirements; price and availability of other modes of transportation of coal; and available rail transportation capacity relative to demand. As a result of these and many

other variables, it is nearly impossible to project coal traffic volume with consistent accuracy over a period of 20 years.

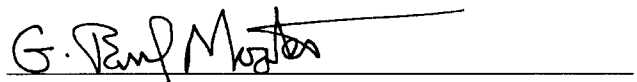
Moreover, the great difficulty of making accurate future projections of material variables reduces the utility and viability of 20-year rate prescriptions. As the Board noted, the near-inevitability of material changes in circumstances over 20 years means that one party or another will likely be allowed to re-open a SAC proceeding well before the expiration of the 20-year rate prescription period. *See Notice* at 29. If, as the Board suggests, "rate prescriptions [will] tend[] to endure no longer than 10 years," the additional cost and effort required to project SAC results for a second decade may not be justified by the benefits of that additional analysis.

At the same time, however, there are benefits of a longer SAC analysis period. For example, a longer period may perform a "smoothing" function by reducing the likelihood that short-term changes in costs, revenues, or other central SAC assumptions will cause the overall SAC analysis and results to be materially erroneous over time. In addition, the twenty-year period is more consistent with the useful lives of many railroad assets. Other than replacement of certain information technology assets and automobiles, very few assets have lives of less than 10 years.

On balance, CSXT/NS 's preliminary view is that a shorter DCF period may make sense. If properly implemented, such an approach has potential to simplify and reduce the costs of SAC cases, while reducing the compound uncertainty and speculation inherent in the 20-year analysis period, thereby facilitating more accurate analysis and results. CSXT/NS suggest that the Board implement any reduction in the length of the SAC analysis period with care that such a change does not disproportionately affect other components of the analysis, or cause SAC analysis and results to diverge from the fundamental economic principles underlying the *Coal Rate Guidelines*. CSXT/NS further suggest that the Board establish only a presumptive length of the SAC analysis period, and allow parties to present evidence and argument demonstrating that a different (longer or shorter) period may be more appropriate for the specific circumstances and

conditions of a given case. As with other Board proposals, CSXT/NS request that the Board remain flexible in its implementation of any changes it adopts, and make it clear that such new rules and approaches are subject to adjustment and revision based on circumstances and experience in actual cases.

Respectfully Submitted,



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Dated: May 1, 2006

Certificate of Service

I hereby certify that on this 1st day of May 2006, I caused a copy of the foregoing **"Joint Comments of Norfolk Southern Railway Company and CSX Transportation, Inc."** to be served upon all parties on the service list for this proceeding by first class mail or more expeditious method of delivery.

Catherine Gealis

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