



**U.S. Department of  
Transportation**  
Office of the Secretary  
of Transportation

**General Counsel**

**400 Seventh St., S.W.  
Washington, D.C. 20590**

January 11, 2007

218404

Vernon A. Williams, Secretary  
Surface Transportation Board  
Suite 700  
1925 K Street, N.W.  
Washington, D.C. 20423-0001

Re: Simplified Standards for Rail Rate Cases  
Ex Parte No. 646 (Sub-No. 1)

Dear Secretary Williams:

Pursuant to the Decision in the above-referenced docket served December 19, 2006, the United States Department of Transportation hereby gives notice of its intent to participate in the public hearing to be held on January 31, 2007. The undersigned will appear on behalf of the Department, and requests five minutes' time at the hearing.

Respectfully submitted,

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**Before the  
Surface Transportation Board  
Washington, D.C.**

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Simplified Standards for Rail Rate Cases )  
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Ex Parte No. 646 (Sub-No. 1)

**Rebuttal Comments of the  
United States Department of Transportation**

Introduction

The Surface Transportation Board (“STB” or “Board”) in this proceeding is exploring ways to make regulatory relief more widely accessible to shippers who believe railroads are charging them unreasonably high rates. Decision served July 28, 2006 (“Decision”). To this end, the Board has proposed to make the size of the dispute -- measured by “the value of the case” -- determinative of the appropriate method of adjudication. The largest cases would continue to employ the very costly, but theoretically better-grounded Stand-Alone Cost (“SAC”) methodology to assess the reasonableness of rail rates, while simplified rules and accelerated procedures would govern “medium” and “small” disputes.

As noted in its Initial Comments, the U.S. Department of Transportation (“DOT” or “Department”) does not participate in railroad rate adjudications, and therefore lacks practical expertise in many of the issues that arise in a rate case. We accordingly expressed only very preliminary views on a limited number of topics in our Initial

Comments. DOT ventured then that the STB's proposals represented a promising start towards meeting the agency's goals. Review of the pleadings submitted to date indicates that additional refinement is necessary before the Board's proposals offer satisfactory alternatives for use in determining rate reasonableness.

The Board has proposed a Simplified Stand-Alone Cost ("SSAC") method for resolving medium sized disputes, and a revised "Three Benchmark" test for small disputes. Both proposed methods rely upon a variety of simplifying assumptions and exclude certain types of data in order to reduce the cost and the time necessary to determine the reasonableness of rail rates, even though those approaches may occasion some loss of precision compared to the SAC methodology. Decision Served July 28, 2006, Ex Parte No. 646 (Sub-No. 1) at 9-10 and 19-20.

Generally parties have pointed out that resolving detailed questions in individual cases would raise costs, but that not addressing these points could lead to inaccurate results. More specifically, parties either support or oppose the proposed simplifications and exclusions depending on the anticipated effects of the proposed simplifications on the outcomes of rate cases.<sup>1</sup> The problem, of course, is that permitting case-specific adjustments in the interests of precision would also tend to undercut the basic purpose of this proceeding by increasing litigation costs and time.

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<sup>1</sup>/ For example, railroads generally favor use of only the actual or "predominant" route used by the movement in question, while shippers seek to identify the most efficient route possible. Reply Comments, Union Pacific Railroad Co. at 13-15; Joint Written Comments, American Chemistry Council, et al, (Interested Parties) at 29; Crowley, Verified Statement at 54-56. Shippers tend to support reliance upon industry average cost data, while carriers oppose omission of special costs attributable to hazardous materials, payments to third parties, and the like. Interested Parties at 25-28; Reply Submission of Union Pacific Railroad Co. at 21.

The Department cannot assess the extent to which these contrasting views highlight real strengths or weaknesses in the original proposals. Several things are clear, however. The first is that the STB's existing regulatory database of industry costs (the Uniform Rail Costing System, or "URCS") plays a pivotal role in both proposed simplified approaches. The Board should therefore take steps to ensure the accuracy of that database. The second thing that is clear is that there is wholesale uncertainty as to how the SSAC and Three Benchmark proposals would work in the real world, and how closely the results would compare to those in SAC cases. The Department accordingly proposes that the Board provide examples or otherwise demonstrate how it intends that the two procedures would be implemented. One possible approach would be to take relevant information from the record in one or more completed SAC cases and plug that information into the SSAC methodology. Such a demonstration should provide much-needed clarification and would highlight the costs and benefits of such different aspects of the proposed rules as eligibility thresholds and the aggregation rule. The application of the Three Benchmark test could be demonstrated through an example, with shipper identifiers masked. Other approaches could also be used. DOT believes that without a more definitive demonstration, or other clarification, it is less likely that parties will have confidence that either procedure will provide meaningful access and results.

#### Updating URCS

One of the key simplifications proposed by the Board in medium- and small-size disputes is the use of industry wide average costs found in URCS. Decision served July 28 in this Proceeding at 13 and 19. A number of parties have urged that adjustments to

URCS data should be allowed in various circumstances in order to improve the accuracy of the results in individual cases. Reply Submission of Union Pacific Railroad Co. at 21; Reply Comments of CSX Transportation, Inc. and Norfolk Southern Railway Co. at 32-35; Reply Comments of Canadian Pacific Railway Co. at 11-12.

The STB recently decided that it would not permit movement-specific adjustments to URCS costs in cases employing the SAC methodology, which is used to resolve the largest disputes. Decision served October 30, 2006 in Ex Parte 657, (Sub – No. 1) at 60. The Board found that the substantial cost entailed by such modifications outweighed the anticipated improvements in precision. *Id.* at 59 (“With this action alone, we reduce the expense of litigating before the agency by as much as one-third, or over \$1 million per party, per case. We do so by removing an inquiry of questionable value and using instead our URCS model to expedite and reduce the expense of the jurisdictional inquiry.”)

Both SSAC and the Three Benchmark methodologies rely upon URCS data. Assuming the STB reaches the same conclusion here regarding the use of unadjusted URCS costs that it did in Ex Parte 657, ensuring that the URCS database accurately reflects current industry operations and costs becomes all the more important. The Department made much the same point in Ex Parte No. 657.<sup>2</sup>

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<sup>2/</sup> In the Rebuttal Comments of DOT at 14 (filed June 30, 2006) we stated as follows:

Should the Board decide to adopt its proposal and rely solely on URCS average costs, then in a separate proceeding it should reexamine the URCS system. It has been 17 years since the Board adopted URCS as the general purpose costing system for regulatory purposes. Ex Parte No. 431 (Sub-No. 1), served Jan. 26, 1989, Adoption of the Uniform Railroad Costing System As a General Purpose Costing System For All Regulatory Costing Purposes, 5 I.C.C.2d 894 (1989). At that time the methodology included data assembly, the development of regression relationships between railroad activities and expenses, the calculation of unit costs, and procedures for applying those unit costs to the

The accuracy of URCS information is critical to the extent it is employed to simplify rate reasonableness cases of every size. We accordingly again emphasize that current industry costs must be accurately reflected in URCS. The more accurately they are reflected, the more confidence can be placed in determinations of rate reasonableness based on URCS data. The Department once more urges the Board to commence a proceeding aimed at addressing these aspects of URCS, and the Department renews its offer to work with the Board in that effort. If the STB chooses not to pursue this course, it should at the very least undertake an internal examination of URCS to ensure it reflects changes in industry productivity and other significant factors.

#### The Need for Clarity and Comparison with SAC Results

While an overhaul of URCS would be time-consuming, it need not further delay progress toward providing more shippers a realistic opportunity to have their rates reviewed. To that end, the Department agrees with the position of the American Chemistry Council and interested parties that the Board should test its proposed SSAC procedure “against both the results of past SAC cases (to determine if the answer produced by the proposed “simplified” procedure bears any relationship to the answer produced by a Full-SAC analysis) or against a real-life small-case example (to determine how “expedited” and “simplified” the proposed procedures really are).” Interested Parties Reply Comments at 18.

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movement of specific shipments. The rail industry has changed since these equations were derived, and many of the underlying factors that established rail cost relationships may have changed as well.”

More specifically, the STB should draw on the data of record in recent SAC cases and apply that data in hypothetical SSAC proceedings. This would not only inform railroads and shippers as to the intended procedural workings of the SSAC proposal, but would also demonstrate how the results of those cases would compare to the original SAC results. Such an exercise would disclose as well whether SSAC, as proposed, would introduce biases favoring any particular party. Indeed, the STB could conduct a functional sensitivity analysis via separate iterations of hypothetical SSAC cases, each of which might contain a modification favored by one side or the other.<sup>3</sup> Each iteration would then produce a result showing the effect of changing a significant factor in the SSAC process, thereby isolating the cost and benefit of accepting or rejecting that modification.

The Department recognizes that the Three Benchmark procedure relies heavily on “comparable” shipments, and identifying such shipments in a SAC case may well be problematic. If so, DOT suggests that the Board could nonetheless offer valuable guidance on the working of this methodology by using data from the annual Carload Waybill Statistics, properly masked so as not to disclose confidential information about individual shipments and shippers. The agency could select movements of particular distances, explain its selection of an appropriate traffic group with what it considers “comparable” characteristics, and then calculate the confidence interval and other statistics used in the test and determine the rate accordingly. This exercise, too, would

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<sup>3</sup>/ For example, railroads want to use the actual or “predominant” route of movements while shippers wish to be able to specify the most efficient route; railroads favor adjustments to URCS costs for hazardous materials shipments while shippers support the use of unadjusted URCS costs. Reply Submission of Union Pacific Railroad Co. at 16; Joint Written Comments, American Chemistry Council, et al at 29; Reply Submission of Union Pacific Railroad Company at 21; Joint Written Reply Comments, Interested Parties at 25-27.

educate interested parties, reduce the role of uncertainty as a factor preventing use of this option, and produce results that could be compared with SAC.

### Eligibility Thresholds

Railroads and shippers, with few exceptions, have taken markedly contrasting positions on the merits of the SSAC and Three Benchmark proposals. The railroads reject the Three Benchmark approach as inadequately tethered to the bedrock principles of the SAC process, notably differential pricing. Reply Submission of Union Pacific Railroad Co. at 39-41; Reply Comments of Canadian Pacific Railway Co. at 13. Shippers believe the SSAC approach to be worse than the status quo, which provides no useful regulatory access in the first place and thus prompted this proceeding. Joint Reply Comments, Interested Parties at 3-4. The Department's view is more optimistic. The Board's proposals do offer promise, but in order to address remaining uncertainty it is advisable to conduct real-world demonstrations of the proposed procedures, as previously noted.

Beyond the question of the inherent value of these proposals is the issue of the threshold eligibility limits set for each. Here again, shippers and railroads take diametrically opposing views; shippers are concerned that they will be forced into a procedure that is far more expensive than most cases are truly worth, and railroads fear a multitude of cases brought under an inexpensive regime producing invalid results. Joint Reply Comments, Interested Parties at 4. Reply Submission of Union Pacific Railroad Co. at 65; Reply Comments of CSX Transportation, Inc. and Norfolk Southern Railway Co. at 2-3 and 6-7. DOT expressed a preliminary concern that the levels of eligibility

proposed for the simplified procedures might be too low. After reviewing the record we are still left with that impression, although we lack the data to recommend specific levels that might be more appropriate.

This is yet another area as to which real-world demonstrations of the SSAC and Three Benchmark methodologies would shed some light. The accuracy or precision of these proposals is key. To the extent either approach produces results more closely resembling those of SAC cases, concerns about accuracy would be reduced and eligibility levels could and should be raised to provide greater access to shippers without fear of improperly harming railroad financial prospects. Conversely, results that bear no reasonable relationship to those obtained from SAC cases would tend to support lower thresholds, because imprecise approaches should be used less frequently. Results that are wholly divergent from SAC outcomes would counsel against adoption of either simplified procedure.<sup>4</sup>

### Mediation

Truly small disputes (those defined by the proposed “maximum value of the case” as being under \$200,000) would likely generate significantly fewer complaints before the STB. Whenever a relatively small amount is at issue the commencement of a formal legal procedure is unlikely to be seen as worthwhile by a shipper. Mediation by the Board may actually be the best option in these circumstances.

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<sup>4</sup> The SSAC proposal has a greater potential to produce SAC-like results since both SAC and SSAC incorporate the economic principles of Constrained Market Pricing (“CMP”). The Three Benchmark approach, on the other hand, has only “a tenuous connection to CMP.” BNSF Reply Comments at 3.

Like the STB, the Department as a general matter favors negotiation over regulatory adjudication to resolve disputes. Similarly, we would also prefer the less adversarial and more flexible mechanism of mediation as a preliminary step for all rate controversies. Mediation may resolve cases where rates might have been established in error, or where the rates are at such levels as to imperil a shipper's ability to compete. If mediation fails, a shipper always retains the right to pursue a case in any event, and both sides will likely have a clearer understanding of the other's position following attempted mediation. Both the AAR and the Interested Parties support mandatory non-binding mediation. AAR Opening Comments at 9-7, Interested Parties Reply Comments at 32. The Department joins with them in supporting mandatory, non-binding mediation as perhaps the most useful, albeit limited, remedy -- especially for truly small shipments.

#### Aggregation Rule

Once again shippers and railroads are on opposite sides in their views concerning the Board's proposed aggregation rule. The aggregation rule would require that cases from the same shipper would be combined to arrive at the maximum value of the case, which would also then determine which simplified procedure would be available to that shipper. Rail carriers believe aggregation will necessarily limit access to these presumptively less precise options while shippers believe the proposed aggregation rule will unfairly force them into more expensive alternatives (either SSAC or SAC). Joint Reply Comments, Interested Parties at 4; Reply Comments of BNSF Railway Co. at 11; Reply Submission of Union Pacific Railroad Co. at 63-64.

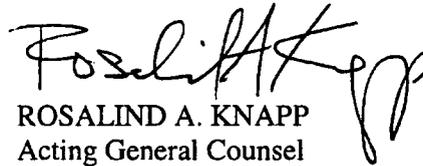
The Department is particularly concerned with the application of the aggregation rule in the context of shippers transporting different types of freight to many customers in different areas. Such circumstances are probably common, particularly for some types of chemical plants. The aggregation rule would, in many cases, force such shippers to select a limited number of shipments for possible rate review in order to avoid a much more expensive procedure. Moreover, the wide range of destinations for such shipments under the aggregation proposal might well make even a regular SAC case more expensive than it is for a shipper whose shipments are concentrated between one or two origins and destinations, such as the coal cases commonly resolved through SAC procedures.

Ultimately, however, DOT believes that the precision of the simplified procedures should govern whether and to what extent the aggregation rule applies. The more a SSAC or Three Benchmark methodology produces SAC-like results, the more unfair it would be to force shippers into a more expensive proceeding by aggregating shipments and the less reason there would be for concern about the financial effects on the railroad industry. On the other hand, if SSAC is more accurate than the Three Benchmark standard, the aggregation rule becomes more appropriate as the size of the amount in dispute increases. As in the case of the eligibility thresholds, pending more information on both the cost and accuracy of the two methods, DOT does not offer a definitive recommendation concerning the aggregation rule. This is yet another issue as to which a real-world demonstration of the pending proposals would be of value.

Conclusion

The Department urges the STB to continue to refine these simplified procedures. The Board's proposals have the potential to offer meaningful relief to shippers. However, the URCS database should be updated, and the Board's proposals need to be more fully explained, refined, and analyzed in order to provide both shippers and railroads with assurances as to how the proposals would work and how the results under the proposals would compare with those achieved in a SAC case.

Respectfully submitted,

  
ROSALIND A. KNAPP  
Acting General Counsel

**CERTIFICATE OF SERVICE**

I hereby certify that on this date I have caused a copy of the Rebuttal Comments of the United States Department of Transportation in Ex Parte No. 646 (Sub-No. 1) to be served by first class mail, postage prepaid, upon all Parties of Record in this proceeding.

  
Paul Samuel Smith

January 11, 2007