



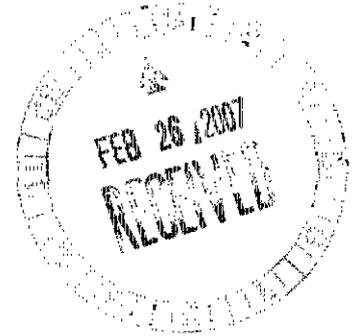
SIDLEY AUSTIN LLP
1501 K STREET, N.W.
WASHINGTON, D.C. 20005
(202) 736 8000
(202) 736 8711 FAX

thynes@sidley.com
(202) 736-8198

BELING GENEVA SAN FRANCISCO
BRUSSELS HONG KONG SHANGHAI
CHICAGO LONDON SINGAPORE
DALLAS LOS ANGELES TOKYO
FRANKFURT NEW YORK WASHINGTON, DC

FOUNDED 1866

218707



February 26, 2007

The Honorable Vernon Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, DC 20423

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

Dear Secretary Williams:

Enclosed for filing in the above-referenced proceeding are an original and twenty copies of the Supplemental Comments of Canadian Pacific Railway Company. A diskette containing an electronic version of the Supplemental Comments is also enclosed.

Please acknowledge receipt of the enclosed Supplemental 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.

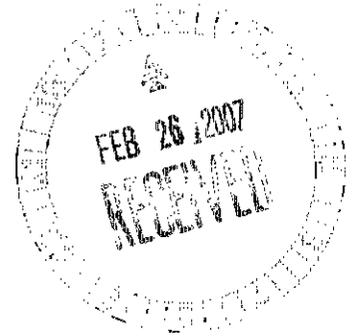
Sincerely,

Terence M. Hynes

TMH:aat
Enclosures

ENTERED
Office of Proceedings
FEB 28 2007
Public Record

**BEFORE THE
SURFACE TRANSPORTATION BOARD**



STB Ex Parte No. 646 (Sub-No. 1)

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

**SUPPLEMENTAL COMMENTS OF
CANADIAN PACIFIC RAILWAY COMPANY**

ENTERED
Office of Proceedings
FEB 27 2007
Part of
Public Record

Paul Guthrie
Vice President - Legal Services
Canadian Pacific Railway Company
401 9th Avenue, S.W.
Gulf Canada Square, Suite 500
Calgary, Alberta T2P 4Z4 Canada

Terence M. Hynes
Sidley Austin LLP
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000
(202) 736-8711 (Fax)

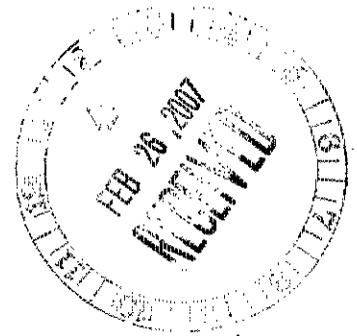
Attorneys for Canadian Pacific Railway Company

Dated: February 26, 2007

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB Ex Parte No. 646 (Sub-No. 1)

SIMPLIFIED STANDARDS FOR RAIL RATE CASES



**SUPPLEMENTAL COMMENTS OF
CANADIAN PACIFIC RAILWAY COMPANY**

Pursuant to the Decision served in the above-captioned proceeding on January 22, 2007 (the "*January 22 Decision*"), Canadian Pacific Railway Company and its U.S. subsidiaries, Soo Line Railroad Company and Delaware and Hudson Railway Company, Inc. (collectively "CPR"), submit these Supplemental Comments regarding the Board's proposal to adopt simplified standards for small and medium sized rail rate cases. CPR's Supplemental Comments address certain issues raised in the *January 22 Decision* and during the course of the hearing held in this proceeding on January 31, 2007 (the "January 31 Hearing").

I. THE BOARD'S AUTHORITY

During the January 31 Hearing, shipper parties questioned the Board's statutory authority to promulgate a three-tiered rate review procedure that would include more than one "simplified" methodology. *See, e.g.* Tr. 50 (Goldstein). Likewise, as the Board noted in the *January 22 Decision* (at 4), "[Joint] Shippers contend that the Congressional directive requires a wholly different [non-CMP based] alternative to SAC." *See, e.g.*, Joint Shippers' Rebuttal at 3-6; Tr. 53-54 (Goldstein). These assertions are wrong.

Section 10701(d)(3) of ICCTA instructed the Board to complete the then-pending *Ex Parte No. 347 (Sub-No. 2)* proceeding, in order to "establish a simplified and expedited method for determining the reasonableness of challenged rail rates in those cases in which a full

stand-alone cost presentation is too costly.” 49 U.S.C. § 10701(d)(3). Nowhere in Section 10701(d)(3) or elsewhere in ICCTA did Congress mandate that all non-SAC cases be handled under a single “simplified” methodology. Indeed, at the time Section 10701(d)(3) was enacted, the Board had under consideration in *Ex Parte No. 347 (Sub-No. 2)* a variety of proposals, including both a “simplified SAC” methodology and a benchmark-based methodology (which was ultimately adopted). Section 10701(d)(3) did not instruct the Board to choose only one of the alternatives before it in *Ex Parte No. 347 (Sub-No. 2)*, nor does that provision otherwise circumscribe the Board’s authority generally to promulgate rules related to the exercise of its rate review jurisdiction. The CMP-based ratemaking standards articulated in *Coal Rate Guidelines, Nationwide*, 1 I.C.C. 2d 520 (1985) (“*Coal Rate Guidelines*”), incorporate multiple approaches to determining rate reasonableness, including the SAC methodology, revenue adequacy, management efficiency and phasing. There is no basis in the statute, or in sound regulatory policy, for the Joint Shippers’ suggestion that the Board may not likewise promulgate more than one “simplified” rate methodology for use in connection with small and medium sized rate disputes.

The Joint Shippers’ further assertion that the simplified rate procedures contemplated by Section 10701(d)(3) need not take into account CMP principles and should, in fact, be based upon a methodology entirely different than SAC is contradicted by both the language and legislative history of that provision. As the Board noted during the January 31 Hearing, Section 10701(d)(3) explicitly refers to simplified procedures to be used where “a full stand-alone cost presentation is too costly....” (Emphasis added). Tr. 115-116 (Mulvey). The legislative history of Section 10701(d)(3) likewise makes clear Congress’ understanding that “the simplified methodology directed to the Board to complete would apply to cases in which the

full stand-alone cost presentation, which encompasses elaborate evidentiary presentations, are impractical.” See S. Rep. 104-176 (1995) at 7 (emphasis added). This language clearly allows for a simplified methodology based upon a truncated SAC analysis. Moreover, in directing the Board to promulgate simplified procedures, Congress explicitly stated that it “[did] not intend to erode the Constrained Market Pricing principles adopted by the ICC for full stand-alone cost presentations.” *Id.* (Emphasis added).

Thus, both the language of Section 10701(d)(3) and its legislative history support the Board’s effort to develop a “simplified SAC” methodology that is less complicated and expensive to implement than a “full” SAC presentation, but which incorporates to the extent possible well-established (and judicially approved) CMP principles. For the reasons discussed in CPR’s prior comments, the Board can – and it should – adopt the SSAC methodology, with the modifications proposed by CPR.

II. ELIGIBILITY CRITERIA

The most hotly contested issue in this proceeding has been the appropriate thresholds for application of simplified rate methodologies. In the *NOPR Decision*, the Board proposed to base eligibility for the SSAC and Three Benchmark (“3B”) methodologies on the “maximum value of the case,” or MVC. The proposed MVC thresholds for the SAC methodology (\$3.5 million) and the SSAC test (\$200,000) are based on the estimated cost to the complainant of litigating a case under each of those methodologies. *NOPR Decision* at 33-34. Under the Board’s proposal, the greatest number of cases would be litigated under a SSAC methodology “designed to achieve the same objective [as the SAC test], albeit in a less precise manner,” while the 3B test would be “reserved for use only as a last resort, once we have exhausted reasonable measures to simplify the SAC analysis.” *NOPR Decision* at 10-11, 37 (Table 2) (emphasis added). The Board’s proposed eligibility thresholds strike an appropriate balance between strict application of CMP-

based rate reasonableness standards and the practical need to provide less costly procedures in smaller rate cases.

The eligibility criteria proposed by shipper parties would strike an entirely different balance. Throughout this proceeding, shippers have insisted that the Board discard the SSAC methodology and “[d]rastically revise upwards” the MVC threshold for application of the 3B test. *Jt. Shippers Reply* at 3-4. At the January 31 Hearing, shippers universally endorsed an MVC threshold of \$10.5 million for application of SSAC (if it is adopted), and \$13.5 million for application of SAC. *Tr.* 25-26, 73, 106-108. The Board should reject these absurdly high MVC thresholds, and retain the thresholds proposed in the *NOPR Order*.

A. Adoption of the Shipper Parties’ Proposed Eligibility Thresholds Would Violate ICCTA.

If the shippers’ proposed eligibility thresholds were adopted, the 3B methodology would govern all but the very largest coal rate cases. As AAR’s Supplemental Comments demonstrate, more than 80% of all regulated traffic would be subject to rate review under the 3B methodology, while only 15.7% of such traffic would be subject to the SAC methodology and less than 4% would be subject to the SSAC test. Such widespread application of the 3B methodology would not merely “erode” the Board’s CMP-based rate reasonableness standards (contrary to Congress’ intent), it would obliterate them.

As CPR’s prior comments showed, the Joint Shippers’ proposal would gut the concept of differential pricing and force rates toward a system-average level. This, in turn, would impair the ability of railroads to invest in facilities and infrastructure at a time when increased capital investment is essential to meet the anticipated demand for rail service.¹ *See CPR Reply* at 13-14;

¹ USDOT shares the railroads’ concern that “repeated use of this [3-B] procedure could tend to lower the mean and reduce all rates to that level. Such an outcome would clearly have a

Rebuttal at 10-11. It would also threaten to reverse the significant progress that railroads have made toward achieving the statutory goal of sustained revenue adequacy. In short, a system of rate regulation under which the 3B methodology became the predominant standard of rate reasonableness would violate the statutory requirement that the Board's ratemaking mechanisms "recogniz[e] the policy of [ICCTA] that rail carriers shall earn adequate revenues." 49 U.S.C. § 10701(d)(2). Such a scheme of rate regulation would also be contrary to the Rail Transportation Policy objectives of "promot[ing] a safe and efficient rail transportation system by allowing carriers to earn adequate revenues" (49 U.S.C. § 10101(3)), "ensur[ing] the development and continuation of a sound rail transportation system" (49 U.S.C. § 10101(4)), and "foster[ing] sound economic conditions in transportation" (49 U.S.C. § 10101(5)).

B. The Shipper Parties' Proposed Eligibility Thresholds Are Not Supported By the Record Evidence.

The record in this proceeding does not support the shipper parties' suggested eligibility thresholds. The proposed threshold of \$13.5 million for application of the SAC methodology is based upon an assumption that the cost (to the complainant) of a SAC presentation would be \$4.5 million. The Joint Shippers assert that this litigation cost estimate must be multiplied by a "risk factor" of three to produce a reasonable MVC threshold for use of the SAC test. Tr. 119-120 (DiMichael). The Joint Shippers' proposed \$10.5 million threshold for the SSAC methodology is likewise predicated upon applying a "risk factor" of three to an assumed cost for litigating a SSAC proceeding of \$3.5 million – the same cost that the Board estimated for a full-SAC presentation. Tr. 65 (Crowley). Neither the assumptions underlying the Joint Shippers' calculations, nor their proposed "risk factor" multiplier, are supported by the record evidence.

detrimental effect on railroad incentives to make capital investments and improve service". See USDOT Comments at 6.

The Joint Shippers' assumed cost of \$4.5 million to litigate a full-SAC case is based upon a statement by Joint Shippers' counsel at the January 31 Hearing that the recent *Otter Tail* coal rate proceeding cost the complainant \$4.5 million. However, as counsel for BNSF (the defendant in *Otter Tail*) pointed out, there was "nothing typical" about the *Otter Tail* case, which involved multiple rounds of supplemental evidence from both parties. Tr. 216-218 (Weicher). Indeed, Joint Shippers' counsel acknowledged that the cost of the *Otter Tail* case was inflated by changes in Board ratemaking precedents that occurred during the course of that proceeding. Tr. 113 (DiMichael). Thus, it is likely that a "typical" SAC case would cost substantially less than the \$4.5 million spent by the shipper in *Otter Tail*. The Board's estimate of \$3.5 million is further supported by the testimony of UP's counsel, who revealed that the cost to UP of the *Wisconsin Power & Light* proceeding was, in fact, \$3.5 million. Tr. 230 (Rinn). These real world examples of expenses actually incurred in recent SAC cases constitute more probative evidence of the cost of litigating a SAC case than the widely divergent estimates proffered by the shippers' "expert" witnesses. Moreover, these costs were incurred in connection with very large coal rate cases that involved amounts in controversy far greater than those likely to be at issue in most medium-sized rate disputes. Where the amounts at stake are smaller, it is likely that the parties will instruct their counsel and consultants to pursue more limited litigation strategies to reduce costs. See Tr. 248 (Rinn). The changes to the Board's SAC procedures promulgated in *Ex Parte No. 657*, if implemented, may also help to reduce the cost of SAC litigation. Thus, the Board's estimate of \$3.5 million as the cost of litigating a full-SAC proceeding is better supported by the record than the Joint Shippers' higher estimate.

The Joint Shippers' assumption that the cost of litigating a SSAC proceeding would approximate the Board's \$3.5 million estimate for a full-SAC case is simply not credible. Such

an assumption ignores the substantial savings (in terms of both time and expense) that will result from various simplifying features of the SSAC methodology. For example, the requirement that the SARR's traffic group consist of those movements actually handled by the defendant carrier over the selected route will eliminate the need for the complainant to analyze and select traffic, as well as the disputes over the propriety of the complainant's traffic selections that are common in SAC cases. Basing the SARR's physical configuration on the defendant carrier's actual facilities will reduce the scope of disputes relating to SARR configuration. Using the defendant carrier's system-average URCS costs to calculate the SARR's operating and equipment expenses will eliminate entirely the need for parties to develop case-specific operating plans and operating expenses. The use of construction unit costs based upon the Board's findings in prior SAC cases will reduce the complexity of SARR construction issues. Notwithstanding the Joint Shippers' unsubstantiated assertions to the contrary, these simplifying measures will make the cost of presenting a SSAC case far lower than the cost of a full SAC analysis. Based upon the record, the Board's proposed MVC of threshold \$200,000 for application of the SSAC methodology is reasonable.

Finally, adopting the eligibility thresholds set forth in the *NOPR Decision* would be consistent with the Board's stated intent that CMP-based rate reasonableness standards be applied wherever it is feasible to do so, and that the 3B methodology be used only as a "last resort." *NOPR Decision* at 9, 11. Accordingly, the Board should retain the MVC thresholds proposed in the *NOPR Decision*. If, upon gaining experience under the simplified rate procedures, it becomes apparent that the cost of litigating SAC or SSAC cases is significantly higher than the Board's estimates, the thresholds for use of the Board's simplified procedures could be modified.

C. The Joint Shippers' "Risk Factor" Proposal Is Unwarranted.

The Joint Shippers' proposal that the Board incorporate into the MVC calculation a "risk factor" that would triple the estimated cost of litigating SSAC and SAC cases is wholly unjustified. As an initial matter, the "risk" associated with a particular rate case is a function of the merits of the parties' respective positions, not the dollar amount at issue. Thus, a risk-driven standard would not be consistent with the requirements of Section 10701(d)(3).

More fundamentally, the Joint Shippers' proposal has little (if anything) to do with the "risk" associated with bringing a particular rate case. Rather, that proposal appears to be addressed primarily to the "cost-benefit" analysis that might be faced by a shipper whose claim is not worth substantially more than the anticipated cost of bringing a rate case. For example, consider a shipper whose claim has an MVC of \$300,000. Under the Board's proposed eligibility criteria, such a shipper would have to decide whether it was worth spending \$200,000 (the estimated cost of a SSAC case) to pursue a recovery that would not exceed (and might be less than) \$300,000. Such a shipper would face a more difficult cost-benefit decision in pursuing a SSAC case than a shipper whose claim was worth \$2 million. However, increasing the MVC threshold for using the SSAC methodology would not affect either shipper's "odds" of winning, nor would it increase the amount of rate relief that either shipper might obtain – both of which are a function of the strength of each shipper's case. Instead, raising the eligibility threshold would serve only to make it possible for other shippers with even larger claims to avail themselves of simpler rate procedures.

In any event, it is not feasible for the Board to identify any single "risk" or "cost-benefit" adjustment that would be appropriate in determining eligibility for simplified rate procedures in all instances. A shipper's decision whether to proceed with a rate complaint can be influenced by a variety of considerations, including cost, case value, strength of the merits, and other

business considerations that are likely to vary from case to case. The Joint Shippers' crude proposal that the Board simply triple the cost of pursuing a case under each rate methodology has no rational nexus to the way in which these myriad factors might affect a shipper's choice in a particular case. Moreover, "risk" and "cost-benefit" issues are present for both parties in connection with any commercial dispute. It would not be appropriate for the Board to adopt eligibility criteria that have the effect of altering the balance of those factors in favor of the complaining shipper. Therefore, the Board should base its eligibility thresholds on the estimated cost of pursuing a case under each methodology, as proposed in the *NOPR Decision*.

D. The Board Should Articulate "Bright-Line" Eligibility Criteria.

The results of the MVC calculation contemplated by the Board's *NOPR Decision* should be deemed "bright-line" eligibility criteria, rather than a rebuttable presumption. In their written comments, the Joint Shippers candidly predicted that, if shippers are free to rebut the results of the MVC calculation, "almost every non-SAC complaint case will begin with a pitched battle involving the shipper's effort to overcome the eligibility presumptions" prescribed by the *NOPR Decision*. *Jt. Shippers Reply* at 12. Such a practice would increase both the time and expense required to litigate rate cases, as shippers sought to expand the application of the 3B methodology. Permitting shippers routinely to challenge the eligibility determination resulting from application of the MVC calculation would thwart the Board's objective of reducing the cost of rate litigation.

At the January 31 Hearing, shippers indicated that a primary reason why they have not invoked the simplified methodology promulgated in *Ex Parte No. 347 (Sub-No. 2)* more frequently is uncertainty regarding which cases are eligible for those procedures. *Tr. 27 (Warfel)*; *Tr. 56 (DiMichael)*. For that reason, shippers repeatedly urged the Board to adopt "bright-line" rules regarding eligibility to use the simplified methodologies under consideration

in this proceeding. Tr. 25 (Warfel); Tr. 56, 70, 73 (DiMichael). In his opening remarks, the Chairman indicated that the Board's objective is to provide greater certainty regarding eligibility for simplified rate procedures. Tr. 5 (Nottingham). CPR urges the Board to adopt "bright-line" standards, rather than "rebuttable presumptions," regarding which cases would be governed by each of the Board's three proposed rate methodologies.

E. The Proposed SSAC and 3B Methodologies Should Not Be Applied In Cases Involving Cross-Border Traffic.

As CPR and other carriers who provide cross-border rail services have shown, the SSAC and 3B methodologies cannot be applied to cases involving a movement between a point in the United States, on the one hand, and a point in Canada or Mexico, on the other hand, because the revenue and cost data required to implement those simplified methodologies do not exist for the foreign portion of a cross-border through shipment. Specifically, the proposed SSAC methodology simplifies the calculation of SARR operating and equipment expenses by using the defendant carrier's system-average URCS. *See NOPR Decision* at 13, App. B. This eliminates the time and expense required to develop case-specific operating and equipment costs in SSAC cases. However, URCS data, which are derived from the annual R-1 Reports filed with the Board, are available only for rail operations conducted in the United States.

The 3B methodology is even more dependent upon data that is not available for the foreign portion of a cross-border through shipment. Like SSAC, the 3B methodology would use URCS to develop variable costs for both the issue traffic and for movements in the comparison group. In addition, the parties would use the Board's Carload Waybill Sample to identify "comparable" movements and to determine the revenues attributable to both the issue traffic and the comparison shipments. However, the Waybill Sample does not include a complete sample of northbound U.S.-Canada rail traffic, nor does it contain complete revenue information even for

southbound cross-border traffic. Thus, the Waybill Sample cannot be used to identify a reliable comparison group or to generate the revenue information needed to apply the 3B methodology in a case involving a cross-border through rate. KCS has demonstrated that similar problems exist with respect to U.S. – Mexico cross-border traffic. KCS Reply at 15; Tr. 330 (Mullins). In short, the essential data sources upon which the Board’s simplified rate procedures are built do not contain the information needed to apply those methodologies to cross-border through shipments.

This problem cannot be overcome by utilizing alternate data sources. There does not exist any regulatory equivalent to URCS for the foreign portion of cross-border movements. Tr. 288 (Hynes). Nor could the Board properly apply the URCS costs of a U.S. carrier participating in a cross-border shipment to the foreign segment of the movement. Each railroad’s URCS system-average costs reflect that carrier’s unique experience – its traffic mix, the type, age and cost of its locomotives and rail cars, the terrain over which it operates, the terms of its labor agreements, the regulatory environment in which it operates and a variety of other factors that directly affect its costs. Attributing a U.S. carrier’s system-average URCS data to the Canadian (or Mexican) segment of a cross-border movement would produce costs, and rate reasonableness determinations, that are utterly inaccurate and arbitrary.

For these reasons, the Board’s final regulations should indicate clearly that the SSAC and 3B tests will not be used where the issue traffic moves between a point in the United States, on the one hand, and a point in Canada or Mexico, on the other hand.² Failing to do so would be

² The unavailability of URCS and Waybill Sample data cannot be circumvented by allowing shippers to challenge only the United States segment of a cross-border through movement. A shipper desiring to challenge the rate on a cross-border through movement must challenge the entire rate between origin and destination. See *Canada Packers, Ltd. v. Atchison, Topeka and*

inconsistent with the Board's stated objectives in this proceeding. The Board's *January 22 Decision* indicates that the "overarching purpose" of the proposed eligibility criteria is to provide "clearer guidance as to who may expect to qualify to use a simplified approach." *January 22 Decision* at 2. Likewise, at the January 31 Hearing, the Chairman stated unequivocally that "[t]hrough this proceeding, we seek to bring some certainty to the questions of who has access to the small rate case process and how a case will be handled by the Board once a complaint is filed." Tr. 5 (Nottingham) (emphasis added). Unless the Board addresses this issue in its final rules, carriers and shippers will face enormous uncertainty regarding whether cross-border rate disputes are eligible for simplified rate methodologies and how, in the absence of essential data, those methodologies might be implemented by the Board.

Making cross-border rate disputes ineligible for the SSAC and 3B methodologies will not create a "regulatory gap" or otherwise adversely affect a significant number of shippers. As CPR has shown, approximately 97% of the coal and 94% of the grain that moves over CPR's U.S. rail lines are domestic shipments that would not be affected by such a rule. CPR Rebuttal at 7. Moreover, 84% of the revenue associated with CPR's cross-border traffic is attributable to movements that are "competitive" rather than "captive." Such traffic is not subject to "market dominance" and the rates for those shipments cannot be challenged before the Board under any rate methodology. 49 U.S.C. § 10707. Of the remaining 16 percent of CPR's cross-border traffic, approximately three-fourths is southbound traffic that originates in Canada. Canadian shippers – and the U.S. shippers who account for the few remaining northbound cross-border through movements – already have access to remedies under Canadian law that are both less

Santa Fe Ry. Co., 385 U.S. 182, 183-84 (1966); *Great Northern Ry. Co. v. Sullivan*, 294 U.S. 458, 475 (1935); *Louisville & No. R.R. Co. v. Sloss-Sheffield Co.*, 269 U.S. 217, 234 (1925).

expensive and more expedited than the Board's rate procedures. Given these facts, it is not surprising that no party has expressed opposition to CPR's proposal.

III. THE PROPOSED THREE-BENCHMARK METHODOLOGY

The *January 22 Decision* (at 5) invited parties to comment on "whether the Board may use the Three Benchmark approach, as modified in the notice, once it has exhausted all reasonable means of simplifying a SAC presentation." CPR's position is that the 3B methodology represents a major substantive departure from CMP-based ratemaking. In particular, the premise underlying the 3B test — *i.e.*, that a rate should not exceed by a significant amount the mean R/VC for a "comparison group" of similar movements — is fundamentally inconsistent with the concept of differential pricing. In short, the 3B methodology is not a "simplification" of the existing CMP-based ratemaking process; rather, it embodies a new substantive standard that sharply conflicts with the Board's longstanding approach to determining rate reasonableness. *See* CPR Comments at 17-18; CPR Reply at 13-14; CPR Rebuttal at 10-11. Widespread application of the 3B methodology (as proposed by the shipper parties) would violate the statutory requirement that the Board's rate regulations be consistent with the policy of ICCTA that rail carriers shall earn adequate revenues. *See* 49 U.S.C. §§ 10701(d)(2); 10101(3).

Accordingly, the 3B methodology may lawfully be utilized only under the following conditions:

First, the Board must adhere to its initial proposal to employ the 3B methodology only as a "last resort" in those relatively few cases in which even a streamlined SSAC analysis would be prohibitively costly. *See* *NOPR Decision* at 11. The eligibility thresholds proposed in the *NOPR Decision* appear to be designed to achieve such a result. By contrast, the absurdly high eligibility thresholds endorsed by the shipper parties would make the crude comparison-based 3B

methodology the predominant standard for rail rate reasonableness. Such a result would clearly be unlawful.

Second, if the Board elects to adopt the comparison-based 3B methodology for the smallest rate cases, it must ensure that the R/VC ratios being compared are accurate – *i.e.*, that those ratios reflect the actual revenues and costs associated with the subject movements. Specifically, the Board must permit the parties to submit evidence relating to movement-specific adjustments to URCS system-average costs in 3B cases. As CPR and other carrier parties have shown, “unadjusted” URCS costs do not account for a variety of unique expenses – including third party payments, special handling requirements and the cost of complying with safety and security regulations in connection with hazardous materials shipments – that constitute a substantial portion of the cost of transporting certain shipments. *See* CPR Rebuttal at 11-12; Tr. 280-284 (Kalick). Failing to take account of those costs in calculating R/VC ratios for the issue traffic and movements in a comparison group would produce “false comparisons,” and prescribing rates on the basis of such false comparisons would be arbitrary and capricious. The Board must take into account the actual costs of handling the issue and comparison traffic in order to generate valid comparisons based upon accurate R/VC ratios.

As CPR demonstrated at the January 31 Hearing, the Board can achieve greater accuracy in calculating R/VC ratios without unduly increasing the cost or complexity of 3B cases. By their nature, 3B cases should involve a relatively small number of “issue” and “comparison” movements. Calculating adjustments for a limited number of movements would not be unduly expensive or time consuming. Moreover, adjustments of the type advocated in this proceeding – such as third party payments and unique costs associated with hazardous shipments – are readily identifiable, and the amount of such adjustments should not be controversial. The Board can

further reduce the scope for disputes involving movement-specific URCS adjustments by providing guidance, either in the final rules issued in this proceeding or on a case-by-case basis, as to the types of adjustments that it will permit.

Third, the Board should not permit the inclusion of contract shipments, or shipments handled by a carrier other than the defendant, in the comparison group. Contract rates are, by definition, not “comparable” to common carrier rates. Rather, contract rates are the product of negotiation between a carrier and shipper, and typically reflect a variety of commercial factors — such as volume commitments, “bundling” of traffic originating at both competitive and exclusively-served origins, and agreements regarding ancillary facilities and services — that have no relevance to shipments that move under tariff rates. Contract shipments may also exhibit very different demand characteristics than tariff movements of the same commodity. *See* CPR Reply at 15. At the January 31 Hearing, USDOT agreed that “[t]he array of terms and the inter-relationship of services, rates and other conditions render contract traffic qualitatively dissimilar to non-contract traffic for comparison purposes.“ Tr. 17 (Smith) (emphasis added).³ The Board should not permit contract shipments to be used as “comparable” movements under the 3B methodology. Nor should it permit comparisons between the issue traffic and shipments handled by a railroad other than the defendant. Each railroad’s rates reflect that carrier’s capacity and the elasticity of demand for its services. Moreover, as discussed above, each carrier’s URCS costs reflect its unique cost structure. Accordingly, the R/VC ratios applicable to one carrier’s shipments are not a reliable benchmark for the reasonableness of a different carrier’s rates, even for seemingly “similar” traffic.

³ Excluding contract shipments from the universe of potential comparison movements under the 3B methodology would essentially moot the troublesome issues presented by the shipper parties’ request for access to the Board’s highly confidential “unmasked” Carload Waybill Sample.

IV. EXEMPT TRAFFIC

In its recent decision in Ex Parte No. 661, *Rail Fuel Surcharges*, (decided January 25, 2007), the Board properly declined to revoke in part previously granted commodity exemptions for the purpose of extending its new rail fuel surcharge regulations to exempt traffic. In doing so, the Board observed that the commodity class exemptions “are based on prior findings that there is a sufficiently competitive market for the transportation involved that regulatory protections are not needed.” *Ex Parte No. 661* at 13. On the basis of the record presented in that proceeding, the Board concluded that:

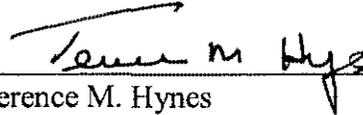
“[there was] no evidence that the marketplace has materially changed for any of the exempted categories of traffic since the findings were made to exempt that traffic from regulation. Without such evidence, we have no basis to reimpose regulation over traffic that has been exempted from regulation for almost two decades.”

Id. The record in this proceeding is likewise devoid of evidence that would justify revocation of any of the Board’s commodity class exemptions.

Accordingly, the Board should not entertain a rate complaint with respect to an exempt commodity movement unless — and until — the complaining shipper has fully satisfied the standards for revocation of the applicable exemption under Section 10502(d). The Board should require the shipper to file a petition for partial revocation, and decide the merits of that petition, before imposing upon a railroad the burden and expense of defending a rate case. In determining whether to grant a petition for partial revocation brought by an individual shipper, the Board must consider “whether regulation or exemption would, on balance, better advance the objectives

of the RTP and the interest of the shipping public overall.” *Ex Parte No. 661* at 12 (citing *Rail Exemption for Misc. Agricultural Commodities*, 8 I.C.C. 2d 674, 682 (1992) (emphasis added)).

Respectfully submitted,



Paul A. Guthrie
Canadian Pacific Railway Company
401 9th Avenue SW
Gulf Canada Square, Suite 500
Calgary, Alberta T2P 4Z4
Canada

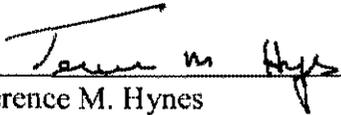
Terence M. Hynes
Sidley Austin LLP
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000
(202) 736-8711 (Fax)

Attorneys for Canadian Pacific Railway Company

Dated: February 26, 2007

CERTIFICATE OF SERVICE

I hereby certify this 26th day of February 2007 that I have served all parties of record in this proceeding by first class mail, postage prepaid.



Terence M. Hynes