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February 26, 2007

## VIA E-FILING

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

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

Dear Secretary Williams:

As provided for in previous Surface Transportation Board decisions issued in the above-captioned proceeding, The Kansas City Southern Railway Company hereby submits, via e-filing, its supplemental comments on the issues raised in this proceeding. If there are any questions concerning this e-filing, please contact me by telephone at (202) 663-7823 or by email at [wmullins@bakerandmiller.com](mailto:wmullins@bakerandmiller.com).

Sincerely,



William A. Mullins

Enclosures

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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**EX PARTE NO. 646 (SUB-NO. 1)**

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**SIMPLIFIED STANDARDS FOR RAIL RATE CASES**

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**SUPPLEMENTAL COMMENTS OF THE KANSAS CITY SOUTHERN  
RAILWAY COMPANY**

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**Attorneys for The Kansas City  
Southern Railway Company**

**Dated: February 26, 2007**

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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**EX PARTE NO. 646 (SUB-NO. 1)**

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**SIMPLIFIED STANDARDS FOR RAIL RATE CASES**

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**SUPPLEMENTAL COMMENTS OF THE KANSAS CITY SOUTHERN  
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On January 31, 2007, the Surface Transportation Board ("Board") held a hearing in connection with its proposal to modify to the so-called "Simplified Guidelines" for rail rate cases "in which a full stand-alone cost ("SAC") presentation would be too costly, given the value of the case." July 28, 2006 Decision at 3 (quoting 49 U.S.C. 10701(d)(3)). In announcing this hearing, the Board stated that it would leave the record in this proceeding open until February 26, 2007, so that all interested parties could submit supplemental comments on issues raised in the proceeding and at the hearing. The Kansas City Southern Railway Company ("KCSR") respectfully submits these brief supplemental comments.

As KCSR has shown throughout this proceeding, the proposed Simplified Guidelines would have disproportionate impacts on KCSR and similarly-situated Class II and Class III railroads because the proposed Simplified Guidelines would rely so heavily upon the Uniform Rail Costing System ("URCS"). Both the Simplified-Stand Alone Cost ("SSAC") and the "Three Benchmark" methods depend heavily upon the use of unadjusted URCS. As KCSR's witness explained, however, unadjusted URCS substantially understates KCSR's actual costs.<sup>1</sup>

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<sup>1</sup> KCSR's expert, Mr. George Woodward, working with KCSR personnel, showed that applying unadjusted URCS to a KCSR move could understate KCSR's estimated actual costs by as much as 30%. Mr. Woodward's statement and analysis has not been challenged.

Using unadjusted URCS to determine the 180% revenue/variable cost ("R/VC") threshold for allowing a rate case to go forward thus would mean that KCSR would be exposed improperly to litigation because unadjusted URCS costs would inaccurately determine the variable costs of a KCSR move. Likewise, a challenged rate could incorrectly be found to be unreasonable, leading to a rate prescription at a level below the level that Congress by statute determined to be reasonable. Were the Board to allow that to happen, KCSR's efforts to become revenue adequate would be undermined in violation of the statute.

To resolve this problem, the Board should not apply the Simplified Guidelines to rate complaints involving KCSR and instead continue to rely upon the standards articulated and set forth in Ex Parte No. 347 (Sub-No. 2), Rate Guidelines – Non-Coal Proceeding, 1 S.T.B. 1004 (1996).<sup>2</sup> Alternatively, the Board should allow KCSR to make adjustments to URCS in cases involving KCSR so as to accurately reflect KCSR's costs.

These remedies are more than appropriate, given the shortcomings of URCS. Indeed, it is not seriously disputed that URCS fails accurately to reflect the costs of certain movements. All parties - shippers and railroads alike - agree that the use of URCS system average costs cannot account for all of the actual variable costs of a movement. The Interested Parties only reluctantly accept the use of unadjusted URCS, calling it a "mixed blessing, ultimately acceptable as a reasonable compromise." Reply Comments of Interested Parties at 27. The Association of American Railroads and its members (collectively, "Railroads") assert even more forcefully the inaccuracy of unadjusted URCS in various circumstances. The Railroads request the Board to allow some limited adjustments, with each railroad proposing various allowed

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<sup>2</sup> Despite the political and shipper pressures for the Board to adopt new procedures applicable to non-Stand Alone Cost ("non-SAC") cases, the fact that the two cases thus far brought under the existing Simplified Guidelines have been resolved through mediation, and in relatively short timeframes, belies the claimed "need" for Board action to modify its procedures.

adjustments. Even the Board's predecessor, the Interstate Commerce Commission ("ICC"), recognized that URCS was inaccurate and that parties "should have an opportunity to argue for adjustments [in URCS] due to special circumstances relating to the traffic under complaint."<sup>3</sup> KCSR agrees with the Railroads and the ICC's statement, having in this proceeding demonstrated that such "special circumstances" exist to warrant either not applying the unadjusted URCS rule to KCSR's traffic or, in the alternative allowing KCSR and similarly-situated carriers to continue to make movement specific adjustments to URCS, including application of such a carrier's actual cost of capital rather than an average based upon the four largest Class I railroads.

Despite the widespread, admitted shortcomings of URCS, the Board's October 30, 2006 decision in Ex Parte No. 657 (Sub-No. 1) indicates<sup>4</sup> that the Board is disinclined to allow movement specific adjustments to URCS. In Major Issues, the Board stated that, in its view, allowing movement-specific adjustments was complex and expensive, and provided no more reliable results than did system-average expenses. Neither of these reasons applies to KCSR's situation.

Allowing movement-specific adjustments to URCS for KCSR in the context of the Simplified Guidelines would in fact produce more accurate results and would not overly complicate the issues in the proceeding or substantially add to the cost of litigation. While the Board's experience in SAC cases has been that the differential between the unadjusted URCS costs and the movement-specific adjusted costs was only 1-3%, Major Issues at 53, the Board cannot say that such would be the case with respect to a KCSR movement in the context of

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<sup>3</sup> See Rate Guidelines – Non-Coal Proceeding, ICC Ex Parte No. 347 (Sub-No. 2), slip op. at 4 (ICC served Nov. 6, 1992).

<sup>4</sup> Major Issues In Rail Rate Cases, STB Ex Parte No. 657 (Sub-No. 1) (STB served Oct. 30, 2006) ("Major Issues").

SSAC or Three Benchmark cases. As noted previously, KCSR's expert has determined that URCS can actually understate KCSR's costs by as much as 30%.<sup>5</sup>

The result of such a potential widespread disparity between unadjusted URCS costs and KCSR's costs inappropriately exposes a significant amount of KCSR traffic to a potential complaint under the Simplified Guidelines. While the Board has realized that, by not allowing adjustments to URCS, it is possible that a case could arise where the movement-specific adjustments could be the difference in whether the jurisdictional threshold is triggered, the Board nonetheless indicated that "the possibility of this [happening] does not warrant continuation of a highly burdensome practice that does not appear to produce more accurate results." Major Issues at 53. But in KCSR's case, the "possibility" is a real danger, and allowing adjustments is necessary to produce a substantially more accurate result.

Allowing KCSR and other similarly-situated carriers to make such URCS adjustments would not overly complicate the issues in the proceeding or substantially add to the litigation expense. The complexity and expense in SAC cases comes in large part from the costs associated with developing the stand alone railroad, including the investment base, the appropriate routing, the role of cross-over traffic, and similar issues. Those issues are largely absent under the proposed Simplified Guidelines. Allowing adjustments in URCS as proposed by KCSR and others in the context of SSAC or Three Benchmark would be neither complex nor expensive. Interested Parties' witness Tom Crowley admitted at the Board's January 31 hearing that the complexity and expense of litigating a SAC case did not come from developing

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<sup>5</sup> In part, this is due to the fact that URCS uses a cost of capital figure based upon the average cost of debt and equity for the largest of the Class I's and does not factor in KCSR's cost of capital. In 2005, the STB found the four largest railroads' average cost of capital to be 12.2%. Yet, under that same methodology, KCSR's weighted cost of capital is estimated to be in the 14-16% range. At the very minimum, KCSR and others should be able to substitute their cost of capital into any application of the Simplified Guidelines involving a KCSR move.

movement-specific URCS costs and that such adjustments have “never been a driving cost factor.” Indeed, both Mr. Crowley and Interested Parties’ witness, Mr. Fauth, point to other areas of the Board’s proposed Simplified Guidelines as adding complexity and expense. The Board’s concerns regarding the expense and complexity are simply not applicable in the context of KCSR’s proposal.

Obviously, if the Board is going to heavily rely upon URCS in simplified rate complaint cases, URCS should be as accurate as possible. It isn’t. KCSR and others must be allowed to make adjustments to URCS to account for its inaccuracy. The statute provides the Board with this authority, see 49 U.S.C. 10707(d)(1)(B) (“ . . . with adjustments specified by the Board.”), and the Board should use it in cases involving KCSR and other similarly-situated carriers where application of unadjusted URCS will, in many cases, substantially understate those carrier’s costs.

Depriving KCSR of an opportunity to address the inaccuracies inherent in URCS would be contrary to the goals of the Staggers Act, which directs the Board to “make an adequate and continuing effort to assist [rail] carriers in attaining revenue levels” sufficient to “attract and retain capital in amounts adequate to provide a sound transportation system in the United States.” 49 U.S.C. 10704(a)(2). In doing so, Congress also directed the Board to ensure that KCSR and similarly-situated carriers had an opportunity to earn their cost of capital by allowing market forces to operate to the maximum extent possible and to assess the reasonableness of a rate only if it determined that the carrier had market dominance over a particular rail movement. 49 U.S.C. 10701(d)(1).<sup>6</sup> Applying a rate complaint methodology that does not adequately account

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<sup>6</sup> The Board is precluded from finding a rate unreasonable if it results in an R/VC of less than 180%. 49 U.S.C. 10707(d)(1). Moreover, rates above that level may be reasonable and do not necessarily reflect an exercise of market power. 49 U.S.C. 10707(d)(2).

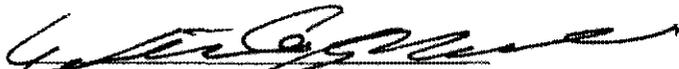
for KCSR's cost of capital, that could understate KCSR's costs by up to 30%, that could subject a large amount of KCSR traffic to a rate complaint based upon an inaccurate calculation of the 180% R/VC threshold, and could result in artificially low rate prescriptions would be contrary to these statutory directives.

It would also be contrary to the goals of the National Rail Transportation Policy ("RTP"), which established that rail rates should be determined by the operation of market forces and that regulation of rail rates should be the exception rather than the norm. The RTP directed the Board "to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates." 49 U.S.C. 10101(1). Similarly, Congress expressed its intention "to minimize the need for Federal regulatory control over the rail transportation system," and directed the Board "to promote a safe and efficient rail transportation system by allowing rail carriers to earn adequate revenues." 49 U.S.C. 10101(2) & (3). Adopting regulatory guidelines that put most of KCSR's rates under an inaccurate regulatory regime would be contrary to these goals and is not in the public interest.

In conclusion, given the inherent inaccuracies with applying URCS to a movement involving KCSR, the Board should not rely upon unadjusted URCS in cases involving KCSR. Doing so would expose KCSR to rate complaints in a manner inconsistent with the Staggers Act and the RTP. To resolve these problems, the Board should consider exempting KCSR from application of the revised Simplified Guidelines and instead apply the existing guidelines that have now been successfully utilized in two cases. Absent an exemption, KCSR and other similarly-situated carriers should be allowed to make movement-specific adjustments to URCS in the context of a SSAC or Three Benchmark proceeding, including, at the very minimum, allowing KCSR to use its cost of capital in any URCS calculation. In adopting these proposals,

the Board would be implementing a policy consistent with the RTP and would ensure that KCSR could continue to achieve revenue adequacy without exposing KCSR to inappropriate litigation.

Respectfully submitted,



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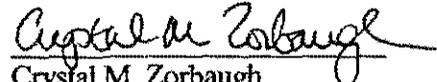
Attorneys for The Kansas City  
Southern Railway Company

February 26, 2007

**CERTIFICATE OF SERVICE**

I have this day served a copy of the foregoing Comments of The Kansas City Southern Railway Company, upon all other parties of record by mail in a properly addressed envelope with adequate first-class postage thereon prepaid, or by other, more expeditious means.

Dated: February 26, 2007

  
Crystal M. Zorbaugh