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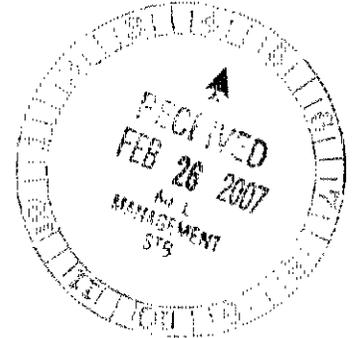
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Via HAND DELIVERY

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

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

Dear Secretary Williams:

Enclosed for filing in the above-referenced proceeding are an original and twenty copies of BNSF Railway Company's Supplemental Comments. Please date stamp the extra copy of this letter and return it with our messenger.

Sincerely,

Anthony J. LaRocca
Counsel for BNSF Railway Company

Enclosures

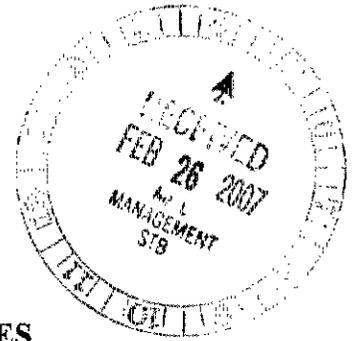
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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

**SUPPLEMENTAL COMMENTS OF
BNSF RAILWAY COMPANY**



I. INTRODUCTION

BNSF Railway Company (“BNSF”) submits these Supplemental Comments in Ex Parte No. 646 (Sub-No.1), *Simplified Standards for Rail Rate Cases (“EP 646 NPRM”)*, pursuant to the Surface Transportation Board’s January 22, 2007 Order (“January 22 Order”). In its January 22 Order the Board identified certain issues that the parties were requested to address at the January 31, 2007 hearing in this proceeding and announced that it would keep the record open until February 26, 2007 to allow the submission of supplemental comments on those and any other issues raised in the public hearing. BNSF filed Opening Comments in this proceeding on October 24, 2006, Reply Comments on November 30, 2006, and Rebuttal Comments on January 11, 2007. BNSF concurs in and adopts the Supplemental Comments being filed by the Association of American Railroads (AAR) and provides the following additional comments on certain issues raised by the Board in its January 22 Order.

II. ELIGIBILITY

A. Small Claims Approach

In its EP 646 NPRM, the Board proposed eligibility criteria for use of its two alternative rate reasonableness standards based on estimates of the costs to litigate Full-SAC cases and Simplified SAC (“SSAC”) cases. Under the Board’s proposal, if the Maximum Value of the Case (“MVC”) – the maximum rate relief that could be obtained over a five-year period –

exceeds the cost of litigating a Full-SAC case, then the case should be brought under the SAC standard. If the MVC does not justify litigation under the SAC standard, then the case must be brought under the SSAC standard unless the MVC is less than the estimated cost to litigate a SSAC case, in which case the Three Benchmark standard could be used.

The shippers objected to the Board's use of the MVC, arguing that in many cases the actual value of the case ("AVC") would be less than the MVC. In such a case, a shipper that was entitled to rate relief would not bring a case if the cost to litigate the case were projected to exceed the amount that the shipper could expect from the litigation even though the MVC exceeds expected litigation costs. BNSF, AAR and other railroads acknowledged this concern and proposed that the Board retain the basic litigation cost approach to eligibility but substitute for the MVC standard an AVC standard that would be based on a shipper's good faith estimate of the actual value of a case. The shipper's estimated AVC would then define the maximum relief that could be obtained.

In its January 22 Order, the Board invited parties to consider a modification to the original EP 646 eligibility proposal, whereby a complainant would be free to select the methodology (SAC, SSAC or Three Benchmark) for determining the reasonableness of a challenged rate. The amount of relief available under each standard would be limited, presumably based on the estimated litigation costs of Full-SAC and SSAC cases (e.g., if the complainant chose the SSAC standard, it could obtain a maximum rate reduction worth \$3.5 over five years).

BNSF continues to support the AVC approach. The AVC approach was not conceived to give shippers a choice of the standard to apply in a given case. There is no reason to allow a shipper to choose the applicable rate reasonableness standard. The purpose of the AVC approach is to ensure that shippers with valid claims are not precluded from pursuing those

claims because of litigation costs. The AVC approach recognizes that there may be shippers that could not afford to pursue rate litigation under the MVC standard but they could afford to pursue the claim if the eligibility standard was linked to the AVC. Take the example of a small shipper with a claim having an MVC of \$300,000. If the AVC of that claim is \$180,000, the shipper may be precluded from bringing that claim under the MVC standard because the shipper could incur litigation costs of \$200,000 that exceed the actual value of the case. On the other hand, if the eligibility criteria was linked to AVC, the shipper would be able to bring the claim under the Three Benchmark standard.

The AVC approach also assumes that the shipper will make a good faith estimate of the value of the case, thus limiting the possibility that a shipper's rate reasonableness challenge will be litigated under a standard that is not appropriate given the size of the case. For example, under the railroads' proposed AVC approach, it would not be reasonable for a large coal shipper with several million dollars a year in coal transportation expenses to litigate the reasonableness of a challenged coal transportation rate under the Three Benchmark or SSAC standard (and potentially obtain a rate cap for five years) simply by choosing an AVC that is obviously disproportionate to the total revenues for the movement. Large coal rate cases should be considered under the SAC standard. The Board's proposed small claims approach contains no limit on the ability of a complainant to choose among the three standards for tactical litigation reasons, and therefore it presents opportunities for abuse.

BNSF is also concerned with the Board's proposal to allow a complainant to change its selection of a rate reasonableness standard under the small claims approach at any time up to the filing of evidence. The Board's proposal would prejudice railroad defendants who could be forced to redirect their defense of a case just before the filing of evidence to consider a new standard without sufficient time to prepare the defense. If the Board were to adopt the small

claims approach, it should require that a complainant wishing to change the standard used to assess the reasonableness of the challenged rate must dismiss its complaint voluntarily and bring a new case.

B. Risk Multipliers and the AECC Proposal

BNSF addressed in its prior comments the shippers' proposal that eligibility thresholds for the alternative rate reasonableness standards be based on estimated litigation costs multiplied by a risk factor. As BNSF explained, litigation risk is an inherently subjective factor that should have no place in determining the proper rate reasonableness standard to be applied in different cases. BNSF also explained that the use of a risk multiplier would not help the small shippers who are the focus of this proceeding. Small shippers with litigation uncertainty would face the same risk that their litigation costs would not be recovered even if the Board raised the eligibility standards with a risk multiplier. The only effect of a risk multiplier would be to increase the size of cases that could potentially be brought under less accurate standards. AAR shows in its supplemental comments that under the eligibility criteria proposed by shippers based, in part, on application of their risk multiplier, 80 percent of the railroads' traffic potentially subject to rate regulation would be assessed under the most crude Three Benchmark standard.

The AECC proposal is little more than a dressed-up version of the shippers' risk multiplier approach. AECC argues that eligibility should be based on the economic value of a case, which AECC claims would be the costs to both railroads and shippers to litigate the case. It is not necessary to address the premise of AECC's claim that the economic value of a case in the abstract is the total litigation cost associated with the claim because the abstract economic value of a rate case is not relevant to the Board's efforts here. This proceeding is intended to adopt standards that will ensure that shippers with small and medium-sized claims will have

meaningful access to the Board's regulatory processes without abandoning the economic principles underlying the Board's regulation of rail rates. Such access can be enhanced by allowing a shipper to use more crude rate reasonableness standards when the amount of rate relief available to the shipper is less than the cost *to the shipper* to litigate under a more accurate approach. The abstract economic value of a case is irrelevant, as are the railroad's estimated litigation costs.

C. Full-SAC Litigation Costs

The Board seeks comments on "whether it has overstated the costs to litigate a Full-SAC case in light of reforms adopted in Ex Parte No. 657 (Sub-No. 1)." BNSF believes that \$3.5 million is a conservative estimate of a complainant's Full-SAC litigation costs that likely overstates future litigation costs in light of changes that have been made to the SAC standard in Ex Parte No. 657 and experience that the Board has gained through recent SAC litigation.

The changes brought about by Ex Parte No. 657 will clearly reduce litigation costs. It is beyond any serious dispute that the Board's elimination of litigation over purported movement-specific adjustments to URCS will substantially reduce discovery and litigation costs. This simplification measure will eliminate two rounds of evidence by each party addressing the other party's proposed movement-specific adjustments, as well as the technical conferences that have often been required to resolve those issues.

The Board's adoption of the Average Total Cost ("ATC") methodology for allocating revenues between on-SARR and off-SARR segments of a cross-over movement will also substantially reduce litigation expenses. The suggestion of the shippers' witness Mr. Crowley at the hearing that the use of ATC may actually increase litigation costs is patently without merit. The actual calculations under ATC may be somewhat more involved than the application of arbitrary MMP factors, but the source of high litigation costs in the allocation of revenue on

cross-over traffic was not associated with the calculations but with disputes over the methodology to be used in making the calculations and the extensive use of consultants and expert witnesses to develop and defend the proposed methodologies. For example, in *AEP Texas*, complainant used four expert witnesses in preparing its revenue evidence, including evidence relating to the allocation of revenue on cross-over traffic. In *Xcel*, each party employed two experts to address cross-over revenue allocation. The adoption of ATC will substantially reduce future litigation expenses on this issue.

The reduction of future SAC litigation costs will also result from the extensive experience that the Board has gained in the recent SAC cases. The Board's experience with the string program used in early SAC cases is a good example of why future SAC litigation costs can be expected to come down. Substantial litigation costs in the *PPL*, *TMPA*, *Xcel* and *Otter Tail* SAC cases resulted from the complainants' use of a flawed and easily manipulated string program to determine SARR capacity and operating parameters. Over time, the complainants realized that a simpler and more straightforward model is available for those purposes, the Rail Traffic Controller ("RTC") model, and complainants in *AEP Texas* and *WFA/Basin Electric* decided to use the RTC model from the start. While there has been some dispute about the inputs that should be used in that model, the common use of the RTC model by both parties has substantially reduced litigation costs and delays associated with contention over the parties' capacity modeling.

Shippers' counsel at the January 31, 2007 hearing claimed that the cost of SAC litigation has increased recently to as much as \$4.5 million, and they cite the shipper's costs in the *Otter Tail* case as representative of the cost of a typical Full-SAC case. But as BNSF explained at the hearing, the *Otter Tail* case was far from a typical case. In *Otter Tail*, the complainant presented *four* SAC cases, each of which was controversial and resulted in extensive delays of the

procedural schedule. Otter Tail's Opening Evidence presented an initial SARR configuration and operating plan based on the string program (Case No. 1). A month later it filed an Errata to correct problems with the string program, resulting in a new SARR configuration with a significant addition of track miles (Case No. 2, which Otter Tail subsequently referred to as its "Primary Case"). One month after BNSF filed its Reply Evidence, Otter Tail sought leave to file Supplemental Evidence with yet another SARR configuration based on a new string program and a different traffic group (Case No. 3, referred to by Otter Tail as its "Alternative Case"). After extensive delays attributable to Otter Tail's new filing, the Board then ordered both parties to submit Supplemental Evidence on specific issues, and it instructed Otter Tail to make changes to its SARR configuration using the computerized Rail Traffic Controller ("RTC") model rather than the string program. Thus, Otter Tail submitted its fourth iteration of the SARR (Case No. 4), followed a week later by another Errata.

The experience in *Otter Tail* indicates that it is possible for shippers to spend extraordinary amounts litigating SAC cases, but SAC litigation does not need to be as expensive and drawn out as it was in that case. Indeed, the issues that produced most of the lengthy delays and the presentation of multiple rounds of evidence – e.g., use of the string program, disputes over the allocation of revenue on cross-over traffic, and the application of a cross-subsidy test – have largely been resolved. Future SAC litigation can be expected to cost much less than it cost to litigate the *Otter Tail* case.

D. SSAC Litigation Costs

It is more difficult to assess a shipper's litigation costs under the proposed SSAC standard than under the Full-SAC standard because there is no experience with SSAC litigation. However, the Board's estimate of \$200,000 is a reasonable estimate drawn from expert testimony in the original rulemaking in Ex Parte No. 347 (Sub-No. 2) that estimated the

consultants' cost to prepare a Simplified SAC presentation being considered at that time (using similar simplifications to those adopted by the Board in this proceeding) at between \$25,000 and \$85,000. *EP 646 NPRM* at 36. The Board added a cost for counsel to litigate the case and indexed the costs to arrive at its \$200,000 estimate. *Id.*

The estimate of shippers' witness Mr. Crowley at the January 31, 2007 hearing that SSAC litigation costs would be half the costs to litigate a Full-SAC case is greatly exaggerated. The shippers ignore the fact that most of the work needed to present SSAC evidence must be carried out by the railroad defendant. Some effort must be done by shippers' consultants to check the railroads' data, but there is no basis for assuming, as the shippers do, that the shipper will need essentially to replicate the defendants' work. It is certainly possible that a shipper could seek to complicate SSAC litigation and drive up litigation costs, but the Board should base its litigation cost estimates on reasonable litigation expenses. While BNSF would accept modest changes in the proposed \$200,000 threshold, there would be no justification for increasing the threshold beyond \$400,000-\$500,000.

E. The Aggregation Rule

BNSF agrees with AAR that the Board should not abandon the proposed aggregation rule and consider aggregation on a case-by-case basis. Such an approach would inevitably produce substantial litigation costs and undermine the objectives of simplification and reduction of litigation cost that are the focus of this proceeding. It is clear that some form of aggregation rule is needed to avoid the fragmentation of rate claims by complainants simply to take advantage of less accurate simplified standards. While a hard and fast rule of the type originally proposed by the Board would be the simplest and least expensive rule to administer, BNSF would not object to formulating the rule as a rebuttable presumption.

III. SIMPLIFIED SAC

A. Three Tier Approach

The shippers have argued that the statute precludes the adoption of a three tier approach to assessing the reasonableness of rates in small, medium and large rate cases and requires instead the establishment of only one alternative to the Full-SAC standard. The statute directs that “[t]he Board shall, within one year after the effective date of this paragraph, complete the pending Interstate Commerce Commission non-coal rate guidelines proceeding 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, given the value of the case.” 49 U.S.C. § 10701(d)(3). The shippers focus on the statute’s reference to “a simplified and expedited method” to suggest that a single alternative to Full-SAC is required. The shippers read far too much into the statute.

There is no reason to believe that Congress intended to limit the options available to the Board in resolving what had already dragged on for more than a decade. “A simplified and expedited method” could certainly involve a method such as the approach proposed by the Board where cases not amenable to litigation under the Full-SAC standard would be divided into two groups – small and medium-sized cases – and subjected to different standards based on the amount at stake in each case. Congress’ clear intent was to require the Board to conclude the pending non-coal rate proceeding, not to dictate a particular result or a particular methodology.

In any event, if the shippers were correct, then the SSAC standard would be the only appropriate alternative to the Full-SAC standard. While Congress did not instruct the Board on the substance of the standards to be applied in small and medium-sized cases, it did make clear that it did “not intend to erode the Constrained Market Pricing principles adopted by the ICC for

full stand-alone cost presentations.”¹ As BNSF has explained at length in prior comments in this proceeding, the Three Benchmark standard bears only the most tenuous relation to CMP while the SSAC standard attempts to implement CMP principles using simplified assumptions. If only one alternative to Full-SAC were permissible, which BNSF does not accept, that alternative should be SSAC.

B. Rerouting of Issue Traffic

The Board also asked for comments on whether a prohibition on the rerouting of issue traffic represents a valid tradeoff between simplification and accuracy. BNSF believes that such a limitation is strongly justified.

First, the benefits of such a limitation in terms of simplifying and reducing the costs of litigation are clear and substantial. Complainants’ efforts to reroute traffic in recent SAC cases have been the source of much contention and litigation cost. In both the *Xcel* and *Otter Tail* cases, complainants’ rerouting of traffic were major issues that complicated the SAC litigation. The Board can easily conclude based on prior experience that the efforts that would be involved in proving that alternative routes are more efficient than existing routes and that they have the capacity to handle additional traffic would add significantly to the costs of litigating a SSAC case, possibly raising disputes over capacity modeling that were very costly to deal with in prior SAC cases. A limitation on rerouting would simplify SSAC litigation.

On the other hand, such a limitation on the rerouting of traffic would not likely have any adverse impact on the accuracy of results. Shippers have argued that disallowing the rerouting of issue traffic violates the shippers’ right to select the most efficient route for the SARR. But as DOT’s representative noted at the hearing, there is no reason to assume that a railroad’s existing routing of traffic is inefficient. It is reasonable to assume that the incumbent has already chosen

¹ S. Rep. No. 176, 104th Cong., 1st Sess. 8 (1995).

the most efficient route for the issue traffic. Moreover, allowing the complainant to reroute issue traffic would not ensure that the SAC analysis is based on the most efficient configuration of a SARR. Indeed, the complainant's incentive in rerouting traffic would not be to maximize the efficiency of the SARR but rather to route traffic over the highest density lines of the incumbent whether or not the alternative route was more efficient. There is no reason to believe that the accuracy of results would be improved at all by allowing the complainant to reroute issue traffic, while it is clear that rerouting of traffic would lead to costly disputes over the reasonableness of the chosen route.

IV. THREE BENCHMARK APPROACH

A. Ratcheting

BNSF agrees with the AAR that the downward ratcheting effect that would result from the Board's proposed methodology is the same basic problem that led the D.C. Circuit to reject the rate reasonableness methodology at issue in the *McCarty Farms* case. This ratcheting effect is produced by any methodology that drives rates down to the average rate for a group of traffic. By definition, an average rate is based on rates that are above and below the average. But rate cases will not result in below-average rates being brought up to an average level. Therefore, reducing a challenged rate to the average simply reduces the average level for the next application. Successive application of a standard based on the average of the comparable group would relentlessly drive the rates in the comparable group down toward the lowest value in the group.

BNSF explained on opening, however, that this ratcheting effect can be mitigated by evaluating a challenged rate not by reference to a single average of comparable rates but by reference to a range of reasonable rates defined statistically by the first standard deviation from the average. If a challenged rate falls within that range, it should not be found to be

unreasonable. If the challenged rate lies outside the reasonable range of rates, it should be brought within that range, but not forced down to the average of the comparable rates. The purpose of using a standard deviation approach is to identify rates that are outside the zone of reasonableness. It also preserves differential pricing by recognizing that differences in demand characteristics will lead to some variation in rates within the zone of reasonableness.

B. Access to Unmasked Waybill Sample

BNSF opposes complainants' access to unmasked waybill data, pre-complaint or otherwise. There is no reason for complainants to have access to unmasked waybill data because those data relate exclusively to contract movements that should not be included in any comparable traffic group. There is a real difference between contract rates and rates for common carriage service. Contract rates reflect negotiations between the parties with respect to service commitments, volume commitments, and other economic aspects of the transportation service for the contract movements that do not apply to movements under common carriage rates. If contract movements are excluded from comparable traffic groups, as they should be, then there is no reason to produce unmasked revenue from the waybill sample at any time.

C. RSAM

BNSF agrees with the AAR that the Board should use the former calculation of RSAM.

D. Mediation

BNSF also agrees with the AAR that the Board should mandate non-binding mediation as a means of giving the parties an incentive to pursue negotiated resolutions of their differences.

Respectfully submitted,

A handwritten signature in black ink, appearing to be "Samuel M. Sipe, Jr.", written over a horizontal line.

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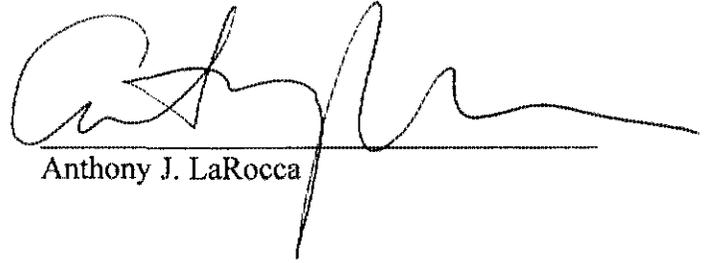
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February 26, 2007

ATTORNEYS FOR
BNSF RAILWAY COMPANY

CERTIFICATE OF SERVICE

I, Anthony J. LaRocca, hereby certify that on February 26, 2007, I caused a copy of BNSF Railway Company's Supplemental Comments to be served by first-class mail or a more expeditious method of delivery upon all persons who have filed a notice of intent to participate in STB Ex Parte No. 646 (Sub-No. 1).



Anthony J. LaRocca