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October 22, 2009

**VIA E-FILING**

The Honorable Anne K. Quinlan  
Acting Secretary  
Surface Transportation Board  
395 E Street, SW  
Washington, DC 20423

Office of Proceedings  
ENTERED  
OCT 22 2009  
Part of  
Public Record

**Re: STB Docket NOR 42114, U.S. Magnesium, LLC v. Union Pacific Railroad Company**

Dear Ms. Quinlan:

Enclosed for e-filing in the above-captioned case please find the Rebuttal Evidence of U.S. Magnesium, LLC ("USM"). USM is e-filing both a Confidential and Public Version of its Rebuttal Evidence. Highly Confidential and Confidential Information is redacted from the Public Version and is denoted with brackets { } in the Highly Confidential Version. Pursuant to the Board's e-filing procedures USM is filing the Highly Confidential version under seal.

USM is also hand delivering to the STB today three (3) compact disks to accompany this filing, which contain the electronic workpapers of USM's witnesses Mr. Kim Hillenbrand and Mr. Tom O'Connor.

Please feel free to contact me with any questions.

Sincerely,

*Thomas W. Wilcox*  
Thomas W. Wilcox

Enclosure

cc: Michael L. Rosenthal, Esq. (counsel for Defendant)

**PUBLIC VERSION**

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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US MAGNESIUM, L.L.C.	)	
	)	
	)	
Complainant,	)	
	)	
v.	)	Docket No. NOR 42114
	)	
UNION PACIFIC RAILROAD COMPANY	)	
	)	
	)	
Defendant.	)	

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**COMPLAINANT'S REBUTTAL EVIDENCE**

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October 22, 2009

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**Rebuttal Verified Statement, Mr. O'Connor rebuts certain factual allegations made by UP and its witnesses concerning the negotiating history of the parties, USM's operations, and UP's pricing strategy for Toxic by Inhalation Hazardous ("TIH") commodities and its effect on USM.**

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

US MAGNESIUM, L.L.C.	)	
	)	
	)	
Complainant,	)	
	)	
v.	)	Docket No. NOR 42114
	)	
UNION PACIFIC RAILROAD COMPANY	)	
	)	
	)	
Defendant.	)	

**PART I – COUNSEL’S ARGUMENT**

**I. INTRODUCTION**

U.S. Magnesium. LLC (“USM”), a relatively small shipper of chlorine captive to Union Pacific Railroad Company (“UP”) for rail service, has challenged the reasonableness of two common carrier rates established by UP for the transportation of chlorine from USM’s Rowley, Utah facility to receivers in Eloy, AZ and Sahaurita, AZ. The challenged rates are 526% and 419%, respectively, of UP’s URCS Phase III variable costs of providing this service.<sup>1</sup> They are approximately double the rates UP charged for this service in 2008 and thus represent a sudden and dramatic increase in rates, which USM maintains was driven by UP’s desire to discourage shipments of chlorine and other Toxic by Inhalation Hazardous (“TIH”) commodities on its system. USM has requested the Board review the reasonableness of the issue rates under the Three-Benchmark

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<sup>1</sup> See Hillenbrand Reply V.S. at 5-7; Hillenbrand Rebuttal V.S. at 5.

Methodology adopted by the Board in Ex Parte No. 646 (Sub-No.1) *Simplified Standards for Rail Rate Cases* (Served September 5, 2007) (“*Simplified Standards*”); *recon. denied* March 19, 2008; *aff’d*, *CSX Transportation Inc., et al v. Surface Transportation Board*, 568 F.3d 236 (D.C. Cir. 2009).

In accordance with *Simplified Standards* and the Board’s recent decisions in Docket No. 42100, *E. I. DuPont De Nemours and Co. v. CSX Transportation, Inc.* (served June 30, 2008) (“*DuPont*”), USM has submitted comparison groups for use in the R/VC<sub>COMP</sub> part of the Three-Benchmark Methodology that provide the Board with the best evidence to estimate the appropriate demand-based differential pricing for the issue movements. These comparison groups, selected from the unmasked STB Carload Waybill Sample provided to the parties by the Board in May, 2009, contain UP single line, origin to destination movements of chlorine and other TIH commodities of comparable length and operating characteristics to the issue movements. Using USM’s comparison groups for the R/VC<sub>COMP</sub> test, combined with the other two prongs of the Three-Benchmark Methodology (RSAM and R/VC>180), produces presumed maximum reasonable rates, expressed as an R/VC ratio, of 311% for the Eloy movement, and 302% for the Sahaurita movement.

USM has also submitted evidence to show that the presumed maximum reasonable rates should be reduced under the “other relevant factors” component of the Three-Benchmark Methodology because it can be demonstrated that chlorine and other TIH commodities produce a disproportionately high contribution to UP’s revenues. As such, the maximum reasonable rates calculated in this proceeding using a comparison

group of chlorine and other TIH commodities still produces a unreasonable level of contribution to joint and common costs for the issue movements.

Finally, USM has asked the Board to increase the damages cap from \$1,000,000 to \$2,000,000 in this case, due in part because UP established the challenged common carrier rates at issue in this case with knowledge that USM was highly likely to challenge them, and USM maintains UP established them at levels designed to discourage use of the Three-Benchmark Methodology. The damages cap should also be raised in this case because the challenged rate levels reflect UP's desire to cease transporting chlorine and other TIH commodities, and therefore inherently distort the underlying assumptions and purposes of the Three-Benchmark Methodology for USM and other TIH shippers. Such pricing behavior constitutes either explicit or implicit "gaming" of the Three-Benchmark Methodology and should be addressed by raising the damage cap in this case.

UP has responded to USM's complaint and evidence in this proceeding by, among other things, (1) proposing a single comparison group consisting only of 24 UP chlorine movements in the Waybill Sample of widely varying lengths and operating characteristics, despite the Board's clear rejection of a chlorine-only group in *DuPont* and at the expense of nearly all key comparability factors in *Simplified Standards*; (2) basing its chlorine-only group in large part on an attempt to resurrect an outdated, discredited, and abandoned application of an early version of R/V<sub>COMP</sub> test by the Interstate Commerce Commission ("ICC") that emphasized the end use of commodities over all other comparability factors; (3) engaging in semantics over whether UP's publicly stated desire to push chlorine and other TIH commodities off the UP system -- and the associated predatory and monopolistic pricing behavior designed to fulfill that desire -- is

“de-marketing” or “profit maximization;” and (4) proposing that the Board should approve, based on a claim that it falls within the definition of an “other relevant factor,” UP’s assessment on USM and all other UP TIH customers, in advance, the amounts UP currently estimates it will have to pay to install Positive Train Control (“PTC”) technology on its entire system by December 31, 2015.<sup>2</sup>

In the following Section II, USM rebuts UP’s unfounded criticisms of USM’s comparison groups and confirms why USM’s Final Offer comparison groups -- which are consistent with the Board’s rules and precedents -- are much more appropriate and correct than UP’s single Final Offer comparison group, which largely ignores the Board’s rules and its decision in *DuPont*. In Section III, USM rebuts UP’s unfounded criticisms of USM’s proposal that the presumptive maximum reasonable rates should be reduced. In Section IV, USM summarizes the maximum reasonable rates and R/VC ratios produced by a proper application of the Three-Benchmark Methodology. Finally, in Section V, USM rebuts UP’s arguments that the damage cap should be increased.

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<sup>2</sup> UP has made its broad policy proposal regarding PTC costs despite the fact that the actual amount UP may have to pay is not presently known, and the implementation date for such systems is nearly two years after the end of the prescription period in this case. USM has responded extensively to UP’s flawed and erroneous proposal in USM’s Reply Evidence. USM reserves the right to seek leave to respond to any new evidence or argument on this proposal UP includes in its rebuttal evidence. In the meantime, USM calls to the Board’s attention that the public funding of PTC has garnered increased attention since the parties filed their reply evidence on September 22, 2009. See attached Counsel’s Rebuttal Exhibit 1, which is a letter dated October 2, 2009 from 20 members of Congress to several of their colleagues urging the retention of \$50 million in pending FY2010 transportation and related agencies appropriations legislation (H.R. 3288) to fund the Rail Safety Technology Grant Program, which was created under Section 105 of the Rail Safety Improvement Act. This provision of the Act contemplates up to \$250,000,000 for such grants, which are anticipated to be used primarily to fund PTC and are available to freight and passenger railroads.

## II. USM'S COMPARISON GROUPS FULLY COMPLY WITH THE BOARD'S GUIDANCE IN *SIMPLIFIED STANDARDS* AND *DUPONT*

Under *Simplified Standards* and its predecessors, the R/VC<sub>COMP</sub> test “measures the markup taken on demand-inelastic traffic involving *similar* commodities moving under *similar* transportation conditions.”<sup>3</sup> The R/VC<sub>COMP</sub> benchmark provides an estimate of transportation “demand based differential pricing principles (by measuring markups applied to similar traffic).”<sup>4</sup> The R/VC<sub>COMP</sub> test looks at the markup collected on traffic with transportation demand characteristics “comparable to those of the issue traffic (*i.e.*, movements of a similar commodity under similar circumstances) to estimate the appropriate amount of differential pricing for the traffic at issue.”<sup>5</sup> In short, the R/VC<sub>COMP</sub> test seeks to compare the issue movements with movements of similar commodities that are subject to roughly the same transportation market conditions in order to obtain “at least a rough indication of relative degree of captivity.”<sup>6</sup> The relevant inquiry is about the elasticity of demand for the transportation and the relative markups by the railroad. The R/VC<sub>COMP</sub> test has never been intended to require or expect comparison groups to be comprised of the *same* commodity as the issue movements, and indeed in *DuPont*, the Board rejected an attempt by the defendant railroad to use a chlorine-only comparison group in a case involving a challenged to chlorine rail rates under the Three-Benchmark Methodology.

In *Simplified Standards*, the Board confirmed that “comparability will be determined by reviewing a variety of factors, such as length of movement, commodity

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<sup>3</sup> Ex Parte No. 347 (Sub- No. 2), *Rate Guidelines – Non Coal Proceedings*, 1 S.T.B. 1004, 1034 (1996)(“*Guidelines*”) (emphasis added).

<sup>4</sup> *Id.* at 1034.

<sup>5</sup> *Id.* at 1011.

<sup>6</sup> *Id.* at 1034.

type, traffic densities of the likely routes involved, and demand elasticity (although the comparison group need not have movements with identical demand).<sup>7</sup> Moreover, the selection of the best comparison group will be governed by which group the Board concludes provides the best evidence as to the reasonable level of contribution to joint and common costs for the issue movement.

As set forth in USM's Opening and Reply Evidence, and addressed in this Rebuttal Evidence, USM has adhered to the *Simplified Standards* and *DuPont* and assembled comparison groups based on a variety of comparability factors that together provide the Board with the best evidence of the reasonable level of contribution to joint and common costs to be applied to the issue movements. UP, on the other hand, has proceeded from a predisposition to propose a comparison group composed entirely of chlorine movements, at the expense of key comparability factors, an effort that results in a comparison group that is not comparable to the issue movements, and does not therefore provide a credible estimate of the reasonable level of contribution to joint and common costs.

**A. USM's Comparison Groups are Composed of Similar Commodities Moving Under Similar Transportation Conditions**

USM's groups contain a mix of chlorine and other TIH commodity movements. Such a mix of TIH traffic can clearly be used in Three-Benchmark cases as long as it presents the Board with the best view of "the markup taken on demand-inelastic traffic involving *similar* commodities moving under *similar* transportation conditions." The loaded miles of the issue chlorine movements to Eloy and Sahuarita are 1250 and 1290,

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<sup>7</sup> *Simplified Standards* at 17.

respectively. USM's chlorine is transported from USM's Rowley facility to these destinations in single line, UP service. Single line UP chlorine movements of this length are few in number in the Waybill Sample provided to the parties in this proceeding.<sup>8</sup> USM maintains this is due in large part to the efforts of UP to eliminate chlorine movements generally, and to shorten the length of chlorine movements through pricing and other measures. Accordingly, while UP chlorine movements made up { } of the movements in the Waybill Sample provided to the parties in this case<sup>9</sup> that percentage dropped to { } at the issue movement mileage range of 1000-1500 miles.<sup>10</sup> Moreover, out of these remaining movements, only { } were UP single line chlorine movements that originate and terminate on UP. USM has included in its comparison groups all UP single line chlorine movements of comparable length to the issue movements appearing in the Waybill Sample.

The markups and variable costs of non-UP single line chlorine movements in the Waybill Sample movements are not comparable to the issue movements, primarily due to operational and cost differences.<sup>11</sup> Given the absence of a sufficient sample size of comparable, single line chlorine movements on UP's system, and the very similar transportation demand elasticities and operating characteristics of UP single line movements of other TIH commodities (discussed more below), USM assembled comparison groups comprised of UP single line transportation of chlorine and other TIH

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<sup>8</sup> Hillenbrand Rebuttal V.S. at 8-9.

<sup>9</sup> UP Reply Evidence at 9.

<sup>10</sup> Hillenbrand Rebuttal V.S. at 9.

<sup>11</sup> For example, 58 % of the movements in UP's Final Offer comparison group are "rebilled" movements, in which UP participates in one segment of an overall joint line movements. As explained below in section II.C., UP's inclusion of rebilled movements as part of its strained effort to assemble a chlorine only comparison group was wrong and intended to significantly skew the Three-Benchmark analysis result in UP's favor.

commodities (anhydrous ammonia, anhydrous hydrogen fluoride, and ethylene oxide) of comparable length and operating characteristics to the issue movements. As stated in USM's Reply Evidence, the issue of whether anhydrous ammonia and other TIH commodities are considered a sufficiently similar commodity to chlorine for purposes of the R/VCCOMP prong of the Three-Benchmark Methodology has already been litigated and decided in the affirmative by the Board in *DuPont*.<sup>12</sup> However, USM has also pointed out the reasons for the Board to adhere to its decision in *DuPont* in this case:

First, USM has demonstrated, and UP has confirmed in its Reply Evidence, that TIH commodities, particularly TIH movements of the same distances of the issue movements, have generally the same demand elasticity and level of differential pricing on UP's system. UP has stated publicly, and privately to USM, that it does not want to transport TIH commodities. Over the time period covered by the Waybill Sample in this case, and continuing to present day, UP has acted on this position through a very aggressive pricing strategy, which has resulted in UP ridding itself of TIH movements that have alternative transportation options and thereby narrowing the TIH shipments on UP to movements with highly inelastic demand characteristics. Just some examples of this position cited in the record in this case include the following:

- The testimony of Howard I. Kaplan of USM in this case that he was told by UP personnel that if the law did not require UP to transport USM's chlorine, it would not do so, and that "UP continued to state in our discussions and meetings and calls that it no longer wanted to ship chlorine; and that UP was pricing chlorine freight rates in order to de-market chlorine and end its shipment by railroad."<sup>13</sup>

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<sup>12</sup> USM Reply Evidence at 9-12.

<sup>13</sup> Kaplan Opening V.S. at 7. In his Rebuttal Verified Statement, Mr. O'Connor provides additional factual support of UP's attitude toward USM and USM's objections, which date back to 2006.

- Testimony of UP before the Board in Ex Parte No. 677 (Sub. No.1) *Common Carrier Obligation of Railroads – Transportation of Hazardous Materials*.<sup>14</sup>
- UP's Petition for Declaratory Order in Finance Docket No. 35219 – in which UP sought an order from this Board approving UP's denial of rates and service terms to USM from Rowley, Utah to four Gulf Coast destinations.
- A March 23, 2009 statement by the president and CEO of the Association of American Railroads that railroads would not haul TIH commodities if they were not required to by law.<sup>15</sup>
- A December 17, 2004 UP document stating UP was  
}
- A February 28, 2005 statement by UP's {  
... } .
- A June 25, 2007 statement by UP's {  
}

In the Reply Verified Statement of Mr. Robert Worrell, he confirms the equal demand elasticity of captive TIH commodity shipments on UP's system. Specifically, Mr. Worrell confirms that UP applies the same criteria for pricing and negotiating rates "for transporting chlorine and other TIH commodities," and that "the risk profiles of these commodities" makes such negotiations challenging.<sup>19</sup> Mr. Worrell also confirms

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<sup>14</sup> USM Opening Evidence at 12.

<sup>15</sup> *Id.*

<sup>16</sup> USM Opening Evidence, Counsel's Exhibit 2, UP-USMAG3B-0034960.

<sup>17</sup> *Id.*; UP-USM3B-0033256.

<sup>18</sup> *Id.*; UP-USMAG3B-0028970.

<sup>19</sup> Worrell Reply V.S. at 2.

that UP has sought to reduce the amount of TIH that UP carries,<sup>20</sup> and that UP has “been aggressive in trying to ensure that we price TIH commodities in accordance with the thinking and principles outlined above.”<sup>21</sup> Moreover, Mr. Worrell confirms that UP {

} but he

notably does not state that UP sought to regain this business when overall demand fell precipitously in 2008 and 2009.

UP has responded to USM’s assertions by re labeling its pricing strategy regarding TIH shipments as “profit maximization” rather than “demarketing,” but whatever moniker the practice is given, it demonstrates that all TIH commodities have generally the same transportation demand elasticity on UP’s system, and a comparison group that includes chlorine and other TIH commodities is therefore appropriate to show the contributions to joint and common costs that should be applied to the issue movements.

Second, the operational characteristics of rail shipments of anhydrous ammonia, anhydrous hydrogen fluoride, and ethylene oxide are very similar to the issue rail movements of chlorine.<sup>22</sup> All are shipped in specialized tank cars supplied by the customer in single car service. USM has demonstrated that the specific, 22,000 gallon car size comparability factor UP has used to select its comparison group in this case is merely a byproduct of UP’s predisposition to propose a chlorine-only comparison group, and that the broader tank car comparability factor utilized by USM is consistent with the

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<sup>20</sup> *Id.* at 5.

<sup>21</sup> *Id.*

<sup>22</sup> Hillenbrand Reply V.S. at 17-18; Hillenbrand Rebuttal V.S. at 10-11.

Board's acceptance of the use of a broader TIH comparison group.<sup>23</sup> The operational similarities of chlorine and other TIH rail movements are not refuted by UP in its Reply Evidence.

Third, at the distance of the issue movements, anhydrous ammonia and other TIH commodities have very few transportation alternatives to railroad.<sup>24</sup>

Fourth, the regulatory scheme that applies to chlorine and other TIH commodities is also very similar, and this Board has previously concluded that there is no justification for treating the rail transportation of chlorine differently from the transportation of any other commodity from a risk standpoint, including other TIH materials.<sup>25</sup> The risks are not considered by the government to be greater for chlorine.

In summary, USM has confirmed the Board's previous finding in *DuPont* that an appropriate comparison group in a Three-Benchmark Methodology case involving the challenge to rates for transporting chlorine is a group made up of chlorine and other TIH commodities.

In its Reply Evidence UP seeks to justify the use of its chlorine-only comparison group despite the Board's prior acceptance of a broader chlorine and TIH group in *DuPont* by primarily (1) attempting to distinguish UP's TIH marketing practices from those of CSX Transportation, Inc. ("CSXT") in *DuPont*; and (2) attempting to resurrect a discredited and ultimately abandoned application of the R/VC<sub>COMP</sub> benchmark in ICC

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<sup>23</sup> Hillenbrand Rebuttal V.S. at 10-11.

<sup>24</sup> UP asserts on page 11 of its Reply that "less than half of the anhydrous ammonia used in this country moves by rail," but this statement avoids entirely the fact that movements of anhydrous ammonia over 1000 miles move almost exclusively by railroad. See USM Reply Evidence at 11; Hillenbrand Rebuttal V.S. at 9; See generally *CF Industries, Inc. v. Koch Pipeline Co. L.P.*, 4 S.T.B. 637 (2000).

<sup>25</sup> Finance Docket No. 35219, *Union Pacific Railroad Company – Petition for Declaratory Order* (served June 11, 2009); Hillenbrand Rebuttal V.S. at 10-11.

Docket No. 40073, *South-West Railroad Car Parts Company v. Missouri Pac. R.R.* (ICC Served December 1, 1988)(“*SWRCP I*”).

As for the first issue, USM has demonstrated in this proceeding that UP’s pricing strategy regarding chlorine and other TIH commodities has the same intent and purpose of CSXT’s pricing strategy in *DuPont*, and that the transportation demand characteristics and the operating characteristics of chlorine and other TIH commodities are sufficiently similar that a comparison group of UP single line TIH movements of comparable length to the issue movements is more appropriate than a chlorine-only comparison group made up of movements with widely disparate cost and operations characteristics.

As to the second point, in its Reply Evidence UP follows up its Opening Evidence and continues to cite to *SWRCP I* for the proposition that the *end use* demand characteristics, rather than the *transportation* demand characteristics, are the paramount consideration in determining a comparison group.<sup>26</sup> These assertions form the basis for UP’s arguments that chlorine and anhydrous ammonia movements in particular cannot be in the same comparison group because they have different end uses in “product markets.” Such reliance on *SWRCP I* and the attempt to place the emphasis on the end use of the commodity as opposed to its comparability from a transportation demand elasticity standpoint is misplaced.

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<sup>26</sup> Specifically, in its Reply Evidence, UP relies on language in *SWRCP I* to the effect that “it is far more critical and important that comparison group traffic and the issue traffic have similar demand characteristics than similar cost characteristics;” UP Reply Evidence at 7; “differences in transportation shipment characteristics . . . are not critical;” *Id.*; and “the traffic [in a comparison group] should involve commodities that are the same or that are substitutes for one each other.” *Id.*; See also UP Opening Evidence at 25.

In *SWCRP I*, a case filed in 1985, a severely split ICC<sup>27</sup> tried, ultimately without success, to apply the then-newly proposed “Revenue to Variable Cost Ratio Approach” for rate reasonableness to a very unique rail movement: the transportation of retired railcars, moving on their own wheels, to a scrap yard to be dismantled and sold for scrap.<sup>28</sup> A majority of the ICC commissioners *sua sponte* created a comparison group of a completely different commodity -- loaded scrap iron and steel traffic hauled in railcars -- and then sought to apply the newly proposed R/VC method despite criticism from both parties and from fellow commissioners about the applicability of the method to such a unique commodity with unique transportation characteristics. The majority sought to justify its comparison group by (1) suggesting that “scrap from rail cars competes with scrap from other sources when sold to ultimate users, so that demand for transportation of scrap should be comparable,”<sup>29</sup> and (2) necessarily eliminating the significance of all other comparability factors, in particular transportation operating characteristics, since there was no similarity between the respective transportation characteristics of the two commodities.<sup>30</sup>

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<sup>27</sup> Commissioners Simmons, Lamboley, and Phillips all filed separate statements dissenting from the majority’s comparison group determination.

<sup>28</sup> *SWRCP I* at 1.

<sup>29</sup> *Id.* at 5.

<sup>30</sup> See e.g., *Id.* at 12, Dissenting Opinion of Commissioner Lamboley (the majority’s comparison group analysis was “well off the mark. In doing so the majority relies solely on allegedly similar commodity demand characteristics rather than any commodity transportation characteristics.”).

The 1988 decision in *SWRC I* was judicially appealed by both parties,<sup>31</sup> to which the ICC put up no defense and instead reopened the case in 1990. But instead of revisiting its flawed analysis in that particular case, “the ICC renewed its search for a suitable simplified method for evaluating the reasonableness of cases where the Coal Rate Guidelines are inappropriate.”<sup>32</sup> Six years later, the STB finally abandoned the ICC’s rationale in *SWCRP I* altogether and concluded a suitable comparison group could not be identified because “neither the nature of the commodity *nor the transportation conditions* were similar.”<sup>33</sup>

The ICC’s application of an R/VC comparison test in *SWRCP I* therefore stands as a discredited anomaly that has no precedential value. The emphasis on the end use of commodities as the primary indicator of whether different commodities are sufficiently similar has not been followed in any other case, nor is *SWRCP I* even mentioned in the *Simplified Standards*, which specifically states that “comparability will be based on a variety of factors.”<sup>34</sup> UP’s effort to resurrect the ICC’s discredited and ultimately abandoned rationale in *SWRCP I* undermines UP’s entire Final Offer comparison group presentation.<sup>35</sup>

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<sup>31</sup> Docket No. 40073 (STB served December 31, 1996) (“*SWRCP IF*”) at 3. The parties challenged (1) the validity of the comparison group selected by the ICC; (2) “the apparent lack of a majority consensus among the ICC Commissioners for use of that particular comparison group,” and (3) the propriety of the R/VC Comp test as a maximum rate standard.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* at 8. (emphasis added). The complaint was eventually dismissed in 1998 based on a finding that the STB lacked jurisdiction over the rates because the defendant lacked market dominance over the transportation at issue.

<sup>34</sup> *Simplified Standards* at 17.

<sup>35</sup> Similarly, UP wrongly asserts that “the Board has recognized that the best way to guarantee that comparison group traffic and the issue traffic have similar demand characteristics is to ensure that the comparison group traffic and the issue traffic involve

**B. USM's Comparison Groups of Similar Commodities move Similar Distances to the Issue Movements**

USM's comparison groups include movements that are within 200 miles, plus or minus, of the actual miles of the issue movements. As stated in USM's Opening and Reply evidence, and further addressed in the Rebuttal Verified Statement of Mr. Hillenbrand, this range is comparable to the range accepted by the Board in *DuPont*, which was plus or minus 150 miles for movements of 600-800 miles.<sup>36</sup> The mileage range utilized by USM is closely comparable to the issue movements, and therefore provides the best evidence of markups and costs for comparable UP single line TIH movements.

In contrast, UP's predisposition to assemble a chlorine-only comparison group required it to significantly compromise the comparability factors of distance and operating characteristics. First, due to the lack of long distance, UP single line chlorine movements in the Waybill Sample, UP was required to greatly expand the mileage range accepted in *DuPont* to plus or minus 400 miles of the issue movements to increase its group's sample size. UP admits in its Reply Evidence that this expansion brings into the group movements with operating characteristics that are not comparable to the issue

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commodities with the same or a similar product market." UP Reply Evidence at 7 citing *Guidelines* at 1035, note 90. This paraphrasing of the predecessor proceeding to *Simplified Standards* mischaracterizes and misstates the actual passage by embellishing it with the words as "best," "same" "guarantee" and "ensure." The referenced footnote merely contains the suggestion that that comparison group should "involve a similar commodity handled in a similar product (or perhaps geographic) market moving similar distances at an r/vc level above 180." UP's selective paraphrasing also omitted that "[t]he comparison group must involve a commodity that is not readily susceptible to transportation by another mode (at least at the distances involved in the complaint)" a requirement that is clearly met by anhydrous ammonia and other TIH commodities.

<sup>36</sup> Hillenbrand Opening V.S. at 10; Hillenbrand Rebuttal V.S. at 14.

movements.<sup>37</sup> UP attempts to justify this deficiency by stating that it complies with the Board's supposed "specific instructions in *Simplified Standards*" that it is more appropriate to expand the comparison group to include like commodity movements of different operational characteristics "than by including commodities in different product markets."<sup>38</sup> No such instructions appear in *Simplified Standards*, and, as this assertion also relies on UP's attempt to resurrect the discredited "end use" emphasis of *SWRCP I*, it has no validity.<sup>39</sup>

**C. USM's Decision to Not Include Re-Billed Traffic in its Comparison Groups was Appropriate and Produces a More Accurate Estimate of the Appropriate Mark-ups for the Issue Traffic**

Consistent with *Simplified Standards*' requirement that comparison groups contain movements of similar commodities with similar operating characteristics and transportation demand, USM did not include "re-billed" movements in its Final Offer comparison groups. UP has retained re-billed movements in its Final Offer comparison

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<sup>37</sup> UP Reply Evidence at 18.

<sup>38</sup> *Id.* at 17.

<sup>39</sup> UP also claims its mileage range is sufficient to prevent the so-called "feed-back effect" when reviewing the mileage of comparison group movements. However, the Board has consistently dismissed the "feedback" issue as "theoretical" and unlikely to ever be a factor in a Three-Benchmark case. *See Guidelines* at 1036-37 ("[t]he downward ratcheting argument assumes the unlikely occurrence of a succession of cases involving the same commodity, market dominance in each case, the use of a comparison group that ships the same commodity as the issue traffic, and Board prescription lowering the rates in each case.); *accord, Simplified Standards* at 73 ("... in theory, repeated application of the Three-Benchmark Approach could have a feedback effect that could lower the mean for future cases," but concluding "we do not believe that this should be a significant concern . . . ." *Id.* UP's "feedback" claim is particularly ironic in this case, where UP has identified USM as its only customer that ships chlorine under common carrier rates. Thus, any potential "feedback" on UP's chlorine rate structure from this case truly is theoretical. UP's feedback argument is merely a pretense for filling out UP's chlorine-only comparison group with movements that are not comparable in distance and operating characteristics to the issue movements.

group. Re-billed movements are by definition not comparable to the issue UP single line movements because they are only UP's portion of joint line chlorine movements involving other railroads, where UP bills the shipper separately for the transportation over UP's segment. The remaining characteristics of the movement, and the overall rail rate actually paid by the shipper, are not discernable from the Waybill Sample.<sup>40</sup> As USM demonstrated in its Reply Evidence, not only are re-billed movements not comparable to the issue movements, such segmented movements are costed differently than single line movements by the STB's URCS costing program. As a result, the inclusion of re-billed movements in a R/VC<sub>COMP</sub> group would heavily distort the Three-Benchmark analysis by producing significantly higher R/VC results, thereby presenting an erroneous picture of the mark-ups that should be applied to issue single line traffic.<sup>41</sup> UP's use of re-billed movements in this case is particularly egregious. As part of its strained effort to assemble a chlorine-only comparison group, UP has included 14 re-billed movements in its 24-movement Final Offer comparison group – 58% of the total movements.<sup>42</sup> Inclusion of these 14 movements is responsible for a significant percentage of the 433% R/VC ratio produced by the Three-Benchmark Methodology as

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<sup>40</sup> For example, 11 of UP's re-billed movements in its Final Offer group "originate" in Portland, Oregon. The Waybill Sample shows the movements as "Received – Terminated" by UP. However, from 2004-2007, there was no operating chlorine produced in Portland Oregon. Hillenbrand Rebuttal V.S. at 14-15: This leads to questions of whether the chlorine being shipped actually originated in Canada, making the overall movement a cross-border movement which would otherwise be excluded from the comparison group, and at a minimum even less comparable to the issue movements. See UP Reply Evidence at 15. ("UP's proposed groups do not include any movements that are shown on the Waybill Sample as originating or terminating in Canada or Mexico").

<sup>41</sup> Hillenbrand Reply V.S. at 12-13.

<sup>42</sup> UP Reply Evidence at 20; UP Opening Evidence at 21.

applied by UP.<sup>43</sup> Specifically, removal of rebilled movements from UP's Final Offer comparison group results in this R/VC ratio dropping precipitously to { }.<sup>44</sup> Despite the material impact of re-billed movements on its analysis, UP provides no explanation in either its Opening Evidence or Reply Evidence why such movements should be accepted as comparable to the single line movements at issue, other than to claim that the Waybill Sample reflects only the rate charged to the shipper by UP.<sup>45</sup> For example, UP has not provided any explanation how the demand elasticities of such segmented joint-line movements in which UP is a participant are sufficiently comparable to the demand elasticities of the issue movements to pass muster under the R/VC<sub>COMP</sub> test. In contrast, USM's use of only UP single line, origin to destination TIH movements more accurately reflects (1) the operational and costing aspects of the movements; and (2) the demand characteristics and differential pricing of UP for such movements, thereby providing the Board with a more accurate view of the appropriate markups that should be applied to the issue traffic.

**D. The Inclusion of Movements to Curtiss, Arizona**

Consistent with the requirements of *Simplified Standards*, USM relied upon the data in the Waybill Sample provided to the parties and public information to select its comparison groups. Included in USM's comparison groups are UP single line TIH movements that, according to the Waybill Sample, terminate on UP in Curtiss, Arizona. Curtiss also appears as a UP destination in public sources, such as the Official Railway

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<sup>43</sup> UP Opening Evidence at 31.

<sup>44</sup> Hillenbrand Rebuttal V.S. at 15.

<sup>45</sup> UP Reply Evidence at 20; UP Opening Evidence at 21.

Guide and UP's Freight Station Accounting Code.<sup>46</sup> There was no readily apparent reason for USM, given its inclusion in the Waybill Sample, to question whether Curtiss, Arizona is a destination served by UP in single line service.<sup>47</sup> In its Reply Evidence, UP has asserted for the first time that the Waybill Sample is in fact not correct as to this destination, and that in reality even though UP sets the line-haul rate from origins all the way to Curtiss, and appears as the only railroad on the route as if the entire movement was UP single line service, a short line railroad acts as a handling carrier for the transportation from Benson, Arizona to Curtiss, a distance of around seven miles. UP states it pays a handling fee to this short line.<sup>48</sup> Notwithstanding the inclusion of Curtiss as a UP destination in the Waybill Sample, -- and more importantly, UP's failure to point out this apparent error in the Waybill Sample at an early stage of this case -- UP now asserts the error should have been "readily apparent" to USM, and that the inclusion of these movements lessens the degree to which USM's comparison groups are comparable to the issue movements.<sup>49</sup>

The existence of this error was not "readily apparent" to USM's experts, and it apparently was not "readily apparent" to the Board either, since Board staff decided it was not necessary to convene a technical conference to discuss the parties' respective opening comparison group submissions.<sup>50</sup> But this is beside the point, which is that UP,

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<sup>46</sup> Hillenbrand Rebuttal V.S. at 15-16.

<sup>47</sup> *Id.*

<sup>48</sup> UP Reply Evidence at 21-22.

<sup>49</sup> *Id.* at 22.

<sup>50</sup> Under *Simplified Standards*, Board staff may convene a technical conference "shortly after receipt of initial tenders" to address the parties' respective opening comparison group submissions. *Simplified Standards* at 18. Such technical conferences, which are to "discuss and attempt to resolve any disputes as to the appropriateness of movements in the comparison groups," were originally proposed to be mandatory under

the party with actual knowledge of this error, had an affirmative duty to disclose it to USM and the Board immediately upon issuance of the Waybill Sample in May, 2009, or at the very latest when USM filed its opening comparison group submission. Instead, UP apparently decided to wait until a stage of the proceeding when UP believed disclosure of the error would benefit UP.

The Board recognized in formulating the simplified rate standards that the Waybill Sample can include “instances of incomplete or inaccurate information regarding some of the sampled movements” and that “some of these data deficiencies are ones that the railroads themselves can and should correct . . . .”<sup>51</sup> A defendant railroad’s failure to disclose inaccuracies and anomalies in the Waybill Sample in a Three-Benchmark Methodology case is also contrary to the intent of the Board in adopting the final offer procedure in *Simplified Standards*, which the Board envisioned would entail “both sides” and the Board “participat[ing] in the winnowing process” leading up to the submission of Final Offer comparison groups.<sup>52</sup> It is also contrary to the overriding purpose of the Three-Benchmark Methodology, which is to provide an efficient, relatively inexpensive means to obtain a determination of rate reasonableness, even if that determination is less precise than the more sophisticated and costly Simplified Stand-Alone Cost and Stand-Alone Cost methods. It is much more efficient, particularly in a proceeding involving a compressed procedural schedule and a “final offer procedure,” for the railroad submitting the data to the STB to reveal any known errors or anomalies in the Waybill Sample in the first instance, than to put the burden on the complainant to review every potential

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the *Simplified Standards*, but were made subject to the Board staff’s discretion in the final rules.

<sup>51</sup> *Guidelines* at 1024-25.

<sup>52</sup> *Simplified Standards* at 18.

movement for such errors or anomalies, particularly when on the face of the Waybill Sample data and commonly referenced public sources there are no issues.

Instead of revealing the inaccuracy as to the Curtiss destination, UP said nothing and waited until the parties submitted their respective Final Offer comparison groups, and now seeks to benefit from the inaccuracy. Under the circumstances, the Board should rule that UP is estopped from asserting any objections to the inclusion of these movements in USM's comparison groups.

Even if the Board were to determine that UP is not estopped from questioning the inclusion of the apparent UP single line movements to Curtiss in USM's comparison groups, their inclusion in the Final Offer comparison groups has very little impact and does not lessen the overall superiority of USM's comparison groups. The affected movements are, for all but seven miles of movements of approximately 1000 miles in length, a single line UP movement of TIH commodities, and the rate provided by UP is all the way from origin to destination. UP does not provide the amount of the handling fee at issue, nor does it calculate the differential in variable costs, but such differential appears *de minimis*. Inclusion of these movements in USM's comparison groups has less than a 2% impact on the R/VC ratios produced by application of the Three-Benchmark Methodology for the Sahuarita movement, and less than 9% on the result for the Eloy movement.<sup>53</sup> This stands in sharp contrast to UP's inclusion of re-billed movements in its comparison group, which increase the R/VC's produced by UP by nearly 30%. USM's comparison groups in aggregate still provide the best evidence as to the

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<sup>53</sup> Hillenbrand Rebuttal V.S. at 16-17.

reasonable level of contribution to joint and common costs for the issue movements.  
*Simplified Standards* at 18.

### III. USM'S ADJUSTMENT OF THE MAXIMUM REASONABLE RATES FOR OTHER RELEVANT FACTORS

USM has demonstrated in this proceeding that UP's overall TIH pricing strategy, whether it is called "de-marketing" or "profit maximization" is intended to (1) drive chlorine and other TIH commodities off of UP's system to other rail carriers and modes of transportation, and (2) to price the remaining TIH commodities UP is legally required to transport 49 U.S.C. §11101 so high as to deter or cease such transportation, with the only cap on such rates being the STB's maximum rate jurisdiction. After demonstrating that the rates for the issue movements are presumptively unlawful after applying the Three-Benchmark Methodology, USM has further demonstrated that an "other relevant factor" as defined in the *Simplified Standards* justifies a further reduction in the rates. This is because the Confidential Waybill Sample confirms that as a result of UP's TIH pricing strategy, the rates UP charges to haul these commodities in single line service in private tank cars contributes a disproportionately high amount to UP's overall revenues.<sup>54</sup> As the Board stated in *Simplified Standards*, "if the railroad is earning more than it needs to earn a reasonable return on its investments, the carrier is engaged in excessive differential pricing and the comparison rates need to be adjusted downwards."<sup>55</sup> Having demonstrated that UP is engaging in excessive differential pricing of chlorine and other

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<sup>54</sup> USM Opening Evidence at 20-21. To conduct the analysis for all UP single line TIH movements in the Waybill Sample moving in private tank cars in order to demonstrate their overall revenue contribution, USM applied its comparison group criteria except for the mileage limit. USM Opening Evidence at 21. This analysis is very straightforward, yet UP attempts to find something nefarious about it. UP Reply Evidence at 25, note 15.

<sup>55</sup> *Simplified Standards* at 81.

TIH commodities, USM has proposed a means to reduce the maximum reasonable rates in this case.

UP's criticisms of this analysis and USM's proposed reduction in its Reply Evidence are off the mark. In the first place, *Simplified Standards* do not address this potential application of the "other relevant factors" aspect of the Three-Benchmark Methodology. Rather, *Simplified Standards*, to the extent it addresses this issue at all, refers to using a subset of the overall potentially captive traffic in the Three-Benchmark Methodology in the first instance, not after the  $R/VC > 180$  benchmark has been applied to determine the presumed maximum reasonable rate levels. This is a critical distinction, as the "other relevant factor" prong of the Three-Benchmark Methodology only potentially comes into play after the presumed maximum reasonable rates have been established. Accordingly, an analysis of a subset of the traffic in the context of an "other relevant factors" to rebut that presumption does not affect that initial result. In his Rebuttal Statement, Mr. Hillenbrand (1) addresses how UP's proposal of a similar RSAM and  $R/VC > 180$  benchmark for its unwarranted PTC adjustment is contrary to *Simplified Standards*, and (2) demonstrates, in response to UP's arguments in its Reply Evidence, that USM's adjustment appropriately accounts for the fact that TIH shipments supplied a disproportionately high share of the joint and common costs of UP rail service during the 2004-2007 period covered by the Waybill Sample in this case warranting the proposed downward adjustment.<sup>56</sup>

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<sup>56</sup> Hillenbrand Rebuttal V.S. at 18-20.

**IV. CALCULATIONS OF MAXIMUM R/VC RATIOS**

USM's Final Offer comparison groups for the issue movements are superior to UP's single comparison group and should be adopted for use in the case. Further, the rates charged by the UP are unreasonable under the application of the Three Benchmark methodology as described under *Simplified Standards*. The table below summarizes the maximum rate and R/VC calculations made by USM in this Rebuttal filing and Mr. Hillenbrand's Rebuttal Verified Statement.

Table IV Maximum Rate and R/VC 1Q 2009			
Ln	Item	Eloy	Sahuarita
1	Issue Rate per Carload	\$13,396	\$10,410
2	Variable Cost - 1Q 2009	\$2,549	\$2,485
3	R/VC	5.26	4.19
<b>Maximum Reasonable Rate</b>			
4	Maximum R/VC	311%	302%
5	Maximum Rate per Carload	\$7,920	\$7,501
<b>Maximum Reasonable Rate with TIH Adjustment</b>			
6	Maximum R/VC	{ }	{ }
7	Maximum Rate per Carload	{ }	{ }
Source			
Ln.1 Table I			
Ln.2 Table II			
Ln.3 = Ln.1 ÷ Ln.2			
Ln.4 Exhibit__ (KNH-19) and Exhibit__ (KNH-20)			
Ln.5 = Ln.2 x Ln.4			
Ln.6 Exhibit__ (KNH-21) and Exhibit__ (KNH-22)			
Ln.7 = Ln.2 x Ln.6			

**V. THE RELIEF CAP IN THIS CASE SHOULD BE INCREASED TO \$2,000,000**

In its Opening Evidence USM described how UP, knowing it faced potential litigation at this Board under the Three-Benchmark Methodology of the *Simplified*

*Standards*, responded to USM's request for common carrier rates by doubling the rates it had charged USM for this service only a year before in 2008.<sup>57</sup> These rates are extraordinarily high relative to UP's costs of providing this service, as the R/VC for the Eloy movement is 526% and the R/VC for the Sahaurita movement is 419%. USM established in its Opening Evidence -- and UP Reply witness Worrell confirms -- that UP recognized the potential threat of litigation under the Three-Benchmark Methodology but decided to insist on significantly increasing USM's rates anyway.<sup>58</sup> USM further demonstrated that UP, upon making this decision, *increased* the offered rate levels even higher in response to USM's request for common carrier rates.<sup>59</sup> In its Reply Evidence UP responds to USM's claims by adhering to its overall assertion that UP was merely "profit maximizing" and/or bringing USM up to the "market" levels UP was establishing for other TIH shippers through its overall pricing strategy. However, UP's actions in setting the issue rates so high in the face of litigation at this Board clearly demonstrate that UP was seeking to discourage USM's use of the Three-Benchmark Methodology to challenge the reasonableness of those rates. This is precisely the behavior the Board reserved the discretion to address in *Simplified Standards* by increasing the damages limit.<sup>60</sup> In his Rebuttal Verified Statement Mr. O'Connor rebuts several factual statements made by UP witnesses concerning the parties' negotiating history and UP's pricing strategy, including (1) that increases in shipments of chlorine by USM during the 2004-2008 timeframe in the face of UP's actions was due to increased magnesium

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<sup>57</sup> USM Opening Evidence at 22-25; Kaplan Opening V.S. at 7. Moreover, for the Sahaurita movement 2008 rate was 130% higher than the 2007 rate for this service (UP did not supply a 2007 rate for the Eloy movement).

<sup>58</sup> UP Reply Evidence at 36-37; Worrell Reply V.S. at 10.

<sup>59</sup> Kaplan Opening V.S. at 8.

<sup>60</sup> *Simplified Standards* at 33; USM Opening Evidence at 22.

production, of which chlorine is a co-product; (2) that UP's expressions to USM of UP's lack of desire to transport TIH commodities and USM's strong objections to this began back in 2006, and (3) UP documents articulating its de-marketing strategy generally and as applied to USM.<sup>61</sup>

Raising the damage limit is also necessary in this case because UP's TIH pricing strategy, particularly as applied to USM, "games" the Three-Benchmark Methodology through pricing behavior based on a desire to demarket the transportation at issue, as opposed to more rational behavior associated commodities that the railroad wants to carry.<sup>62</sup> As stated above and shown in the record of this case, it is undisputed that UP (1) does not wish to transport chlorine and other TIH commodities; (2) only transports these commodities out of a statutory obligation to do so; and (3) is at most indifferent to whether it continues to transport USM's chlorine and in fact has attempted through its petition for declaratory order to eliminate certain movements from USM's Rowley facility from its system. These and the other facts developed in the record belie UP's repeated assertions that it is merely maximizing profits in setting USM's rates. Rather, UP's rate setting for USM reflects UP's lack of any desire to transport chlorine, resulting in extremely high rates which, when analyzed correctly using the Three-Benchmark Methodology, produce maximum reasonable R/VC ratios and rate levels that are significantly lower than the challenged rates. As USM demonstrated in its Opening Evidence, based on the current volume projections for the issue movements, the total differential between the maximum reasonable rates and the challenged rates over the

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<sup>61</sup> O'Connor Rebuttal V.S. at 3-7.

<sup>62</sup> USM Opening Evidence at 25.

prescription period could well exceed the \$1,000,000 limit.<sup>63</sup> The Board should raise the damage limits in this case to \$2,000,000 to compensate for UP's pricing strategy to demarket USM's chlorine.

## VI. CONCLUSION

In conclusion, USM is the only remaining manufacturer of magnesium in North America. It must have reasonable rail rates for the transportation of chlorine co-produced from its operations in order to remain viable. USM has demonstrated in this case that USM's "Final Offer" comparison groups are fully compliant with the *Simplified Standards* and controlling precedent, are far superior to UP's Final Offer comparison group, and should be selected by the Board for the R/VC<sub>COMP</sub> aspect of the application of the Three-Benchmark Methodology to the issue movements. USM has also demonstrated that application of the Three-Benchmark Methodology using its comparison groups demonstrates that the common carrier rate levels established by UP for the Eloy and Sahuarita movements are presumptively unreasonable. USM has further demonstrated (1) that the presumed maximum reasonable rate levels should be reduced by the "other relevant factor" of UP's TIH pricing strategy as developed in USM's Opening, Reply and this Rebuttal Evidence; and (2) that the Board in this case should increase the limit on rate relief that would otherwise apply in a Three-Benchmark proceeding.

Accordingly, USM hereby respectfully asks the Board to:

(1) find that UP's common carrier rates applicable to the transportation of chlorine between Rowley, UT and Eloy, AZ and Sahuarita, AZ are unreasonable;

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<sup>63</sup> USM Opening Evidence at 22-23; O'Connor Opening V.S. at 9-10, Opening Exhibit No. \_\_\_\_ (TOC 6); O'Connor Rebuttal V.S. at 8-9.

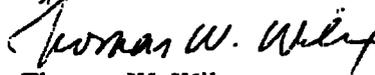
(2) prescribe just and reasonable rates for the future applicable to the rail transportation of USM's traffic, pursuant to 49 U.S.C. §§ 10704(a)(1) and 11701(a);

(3) award USM reparations, plus applicable interest, in accordance with 49 U.S.C. § 11704 for unlawful rates set by UP for the period beginning March 3, 2009 to the date UP establishes just and reasonable rates prescribed by the Board in this proceeding;

(4) order that the limit on relief in this proceeding shall be \$2,000,000 over the five year prescription period; and

(5) grant to USM such other and further relief as the Board may deem proper under the circumstances.

Respectfully submitted,



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Jason M. Setty

Brian J. Heisman

GKG Law, P.C.

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Suite 200

Washington, DC 20007

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*Attorneys for Complainant US Magnesium  
L.L.C.*

Dated: October 22, 2009

**Congress of the United States**  
**Washington, DC 20515**

October 2, 2009

Chairman John W. Olver  
Subcommittee on Transportation, Housing  
and Urban Development, and Related Agencies  
Room 2358-A Rayburn House Office Building  
Washington, DC 20515

Ranking Member Tom Latham  
Subcommittee on Transportation, Housing  
and Urban Development, and Related Agencies  
1016 Longworth House Office Building  
Washington, DC 20515

Chairman Patty Murray  
Subcommittee on Transportation, Housing  
and Urban Development, and Related Agencies  
142 Dirksen Senate Office Building  
Washington, DC 20515

Ranking Member Christopher Bond  
Subcommittee on Transportation, Housing  
and Urban Development, and Related Agencies  
142 Dirksen Senate Office Building  
Washington, DC 20515

Dear Chairmen Olver and Murray and Ranking Members Latham and Bond:

As you work to reconcile the differences between the House and Senate versions of H.R. 3288, the Fiscal Year 2010 Transportation, Housing and Urban Development, and Related Agencies Appropriations Act, we urge you to maintain the level of funding contained in the Senate-passed bill for the development and installation of Positive Train Control (PTC) technology. PTC is a safety overlay system designed to prevent train-to-train collisions and other train accidents.

The Rail Safety Improvement Act (RSIA) of 2008 mandated a large scale implementation of PTC on all rail main lines used to carry passengers or certain highly hazardous materials. Currently, all of the affected railroads are aggressively pursuing development of the PTC implementation plans required by RSIA and are adapting their individual PTC systems to maximize interoperability. The likely cost of the mandate to the rail industry is staggering—the Federal Railroad Administration (FRA) recently estimated the price tag at \$10 billion. Even at the higher ranges of earlier estimates by the FRA and other stakeholders, cost estimates were less than half of what the latest FRA cost-benefit analysis shows.

The Senate-passed version of H.R. 3288 fully funds the \$50 million authorized in FY 2010 for the Rail Safety Technology Grant Program, which is anticipated to be used primarily for development and installation PTC technology. While this funding level is encouraging, if the Congress is truly committed to the law it passed last year, significant additional public dollars will be needed to help meet this challenge. If the rail industry must fully bear the cost of this mandate, it will likely come at the expense of capacity expansion and, potentially, other maintenance or safety technology expenditures. Therefore, we urge you to maintain the Senate level of funding of \$50 million for the Rail Safety Technology Grant Program.

We appreciate your past support for funding policies that will improve the safety and security of our nation's rail system. We look forward to working with you to fund this next important step.

Sincerely,



GARY G. MILLER  
Member of Congress



LUCILLE ROYBAL-ALLARD  
Member of Congress



ELTON GALLEGLY  
Member of Congress



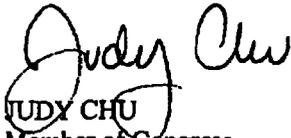
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HENRY A. WAXMAN  
Member of Congress



HOWARD L. BERMAN  
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JUDY CHU  
Member of Congress



BOB FILNER  
Member of Congress



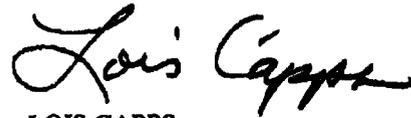
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Member of Congress



LAURA RICHARDSON  
Member of Congress



GRACE NAPOLITANO  
Member of Congress



LOIS CAPPS  
Member of Congress



ZOE LOFGREN  
Member of Congress



JACKIE SPEIER  
Member of Congress



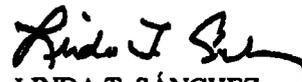
LORETTA SANCHEZ  
Member of Congress



ELIJAH E. CUMMINGS  
Member of Congress



BRAD SHERMAN  
Member of Congress



LINDA T. SANCHEZ  
Member of Congress

Chairmen Olver and Murray and Ranking Members Latham and Bond

October 2, 2009

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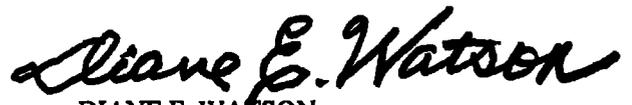
MICHAEL M. HONDA  
Member of Congress



JANE HARMAN  
Member of Congress



MARK H. SCHAUER  
Member of Congress



DIANE E. WATSON  
Member of Congress

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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US MAGNESIUM, L.L.C.  
238 North 2200 West  
Salt Lake City, UT 84116-2921

Complainant,

v.

UNION PACIFIC RAILROAD COMPANY  
1400 Douglas Street  
Omaha, NE 68179

Defendant.

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Docket No. NOR 42114

**PART II – REBUTTAL VERIFIED STATEMENTS**

- 1) Rebuttal Verified Statement of Kim N. Hillenbrand, Senior Analyst at the economic consulting firm of Snavelly, King, Majoros, O'Connor & Bedell, Inc., Washington, D.C.
  
- 2) Rebuttal Verified Statement of Tom O'Connor, Vice President at the economic consulting firm of Snavelly, King, Majoros, O'Connor & Bedell, Inc., Washington, D.C.



**PUBLIC VERSION**

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### **List of Exhibits**

<b><u>Exhibit</u></b>	<b><u>Description</u></b>
Exhibit__(KNH-18)	Mileage Range Analysis
Exhibit__(KNH-19)	USM Rowley, UT to Eloy AZ Final R/VC <sub>COMP</sub> Group (Highly Confidential)
Exhibit__(KNH-20)	USM Rowley, UT to Sahuarita AZ Final R/VC <sub>COMP</sub> Group (Highly Confidential)
Exhibit__(KNH-21)	USM TIH R/VC <sub>&gt;180</sub> Benchmark Adjusted Rowley, UT to Eloy AZ Final R/VC <sub>COMP</sub> Group (Highly Confidential)
Exhibit__(KNH-22)	USM TIH R/VC <sub>&gt;180</sub> Benchmark Adjusted Rowley, UT to Sahuarita AZ Final R/VC <sub>COMP</sub> Group (Highly Confidential)

## **I. Introduction**

My name is Kim N. Hillenbrand of Snavely King Majoros O'Connor & Bedell, Inc. I am same Kim N. Hillenbrand who filed an Opening Verified Statement in this proceeding on August 24, 2009 and a Reply Verified Statement on September 22, 2009 on behalf of U.S. Magnesium L.L.C ("USM"). My qualifications and experience are summarized in Exhibit \_\_\_(KNH-1) to my Opening Verified Statement.

USM's complaint in this docket seeks the establishment of reasonable rates and the payment of reparations for shipments of chlorine from USM's Rowley, Utah facility to the following two (2) destinations:

- Eloy, Arizona ("Eloy Movement")
- Sahuarita, Arizona ("Sahuarita Movement")

USM has elected to evaluate the reasonableness of the rates for the issue movements listed above using the Three Benchmark ("3B") Methodology described and adopted in STB Ex Parte 646, *Simplified Standards for Rail Rate Cases* (served September 5, 2007) ("*Simplified Standards*").

In my Opening Verified Statement, I (1) calculated the Revenue to Variable Cost Ratios ("R/VC") for the issue movements; (2) applied the 3B Methodology to determine the maximum R/VC and rate for each issue movement; and (3) explained how, pursuant to *Simplified Standards*, other relevant factors warranted adjustments to the maximum R/VC and rate produced by my analysis. My Reply Verified Statement analyzed and discussed deficiencies in UP's Opening Evidence and described USM's "Final Offer" comparison groups and showed why they are superior to UP's single comparison group.

For this Rebuttal Verified Statement, I reviewed the Reply Evidence submitted by UP in this proceeding and I comment on and rebut certain aspects of that evidence. I also provide further explanation of USM's Final Offer comparison groups and further demonstrate why they are superior to UP's single comparison group.

## **II. Revenue to Variable Cost Ratios for the Issue Movements**

### **A. The Challenged Rates**

USM and UP agree that the total challenged rate levels, including fuel surcharges, for the Eloy and Sahuarita movements are \$13,396 and \$10,410 per car load, respectively.<sup>1</sup>

### **B. URCS Phase III Variable Costs**

In their Opening Evidence, the parties agreed on eight of the nine inputs used to calculate the variable costs of the Eloy and Sahuarita movements using the STB's Uniform Railroad Costing System ("URCS") without adjustments ("unadjusted URCS").<sup>2</sup> The one difference was loaded miles. USM's loaded miles calculation for the issue movements were higher than UP's. Table I in my Reply Verified Statement compares the differences between USM's and UP's loaded miles.

In its Reply Evidence, USM accepted UP's calculation of the loaded miles for the issue movements. As explained in my Reply Verified Statement, I calculated the loaded miles for the issue movements using summary trip plans from UP's {  
  
} result, track charts, and time tables provided by UP in its initial disclosures and

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<sup>1</sup> See Table I and UP Opening Evidence at 18.

<sup>2</sup> 49 U.S.C. § 10707(d)(1)(B); Ex Parte 657 (Sub-No.1), *Major Issues in Rail Rate Cases* (Served October 30, 2006) at 60 ("*Major Issues*"); *Simplified Standards* at 26.

discovery.<sup>3</sup> UP calculated the loaded miles using UP's {

}, which calculated the route miles between USM's Rowley facility and the issue destinations.<sup>4</sup> I believe UP's calculation of the loaded miles reflects a more precise calculation of the actual one way miles for the issue movements, since this data is known to and generated by UP.

Both parties agree that 2007 URCS unit costs should be used to calculate the variable costs and USM has accepted UP's indexing procedures.<sup>5</sup>

**C. Issue Movement R/VC Ratios**

In my Replied Verified Statement, I recalculated the variable costs using the loaded miles as calculated by UP, and the resulting 1Q2008 Variable Costs and R/VC ratios are reproduced in Table I below:

<u>Table I</u>				
<u>Ln</u>	<u>Destination</u>	<u>Total Rate per Carload</u>	<u>Restated USM 1Q2008 Variable Cost</u>	<u>Restated USM 1Q2008 R/VC</u>
[1]	[2]	[3]	[4]	[5]=[3]/[4]
1.	Eloy	\$13,396	\$2,549	526%
2.	Sahuarita	\$10,410	\$2,485	419%
<u>Source</u>				
[3] Hillenbrand Opening VS, Table I				
[4] Hillenbrand Reply VS, Table V				

<sup>3</sup> Hillenbrand Reply V.S. at 5-6; See electronic workpaper "UP-USMAG3B-0000795.PDF".

<sup>4</sup> See UP Opening Evidence Highly Confidential Electronic workpapers "Mileage Calculations.doc".

<sup>5</sup> See Hillenbrand Reply V.S. at 6.

The R/VC ratios for the Eloy and Sahuarita movements are 526% and 419%, respectively.

### **III. Final Offer Comparison Groups and Maximum Reasonable Rates for the Issue Movements**

Following the methodology specified in *Simplified Standards* and applied by the Board in other rate cases using the *Simplified Standards*,<sup>6</sup> USM tendered its Final Offer comparison groups with its Reply Evidence. For the reasons discussed in USM's Reply Evidence, USM's Final Offer comparison groups were the same as its opening comparison groups. UP also submitted a Final Offer comparison group, which was also identical to its opening submission. Both parties included movements in their Final Offer groups that were included in their respective opening comparison groups.

In this section, I review UP's Final Offer comparison group and explain how USM's Final Offer comparison groups are superior. I also rebut several UP criticisms of USM's comparison groups. This demonstration and my analysis and development of the maximum reasonable rate for the issue movements are described in the following three sections. In Section A, I compare the final offer R/VC<sub>COMP</sub> groups and describe the areas the parties agree on. Section B describes differences between the two groups and why USM's selection criteria are more appropriate than UP's. The final section, Section C, calculates the maximum reasonable R/VC ratio and rates for the issue movements.

#### **A. Agreed Upon Selection Criteria**

The parties still agree on the following comparability factors: (1) the final comparison groups include only movements with R/VC ratios greater than 180%; (2) the

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<sup>6</sup> STB Docket Nos. 42099, 42100, and 42101, *E.I DuPont de Nemours and Co. v. CSXT Transportation, Inc.*, (all served June 27, 2008).

final offer groups include only movements in privately owned tank cars; and (3) the final offer groups do not include the issue traffic.<sup>7</sup>

USM's Final Offer R/VC<sub>COMP</sub> group for the Eloy movement contained 89 movements while UP's Final Offer R/VC<sub>COMP</sub> group contained only 24 movements, of which there were only 4 movements in common with USM's Eloy R/VC<sub>COMP</sub> group. USM's Final Offer R/VC<sub>COMP</sub> group selected for the Sahuarita movement contained 162 comparable movements with only 2 movements in common with UP's Final Offer R/VC<sub>COMP</sub> group of 24 movements.

## **B. Differences between USM and UP R/VCCOMP Groups**

### **1. Commodity**

USM's comparison groups include chlorine and other TIH commodities; UP's includes only movements of chlorine. One of UP's criticisms of USM's comparison group selection process on Reply is the amount of chlorine movements in the USM comparison group compared to the total amount of chlorine movements on the UP system. However, as UP's knows and its own comparison group reflects, at the long distances traveled by the issue movements, there are very few chlorine movements on UP's system that are sufficiently comparable to the issue movements. As length of haul increases, the percentage of chlorine shipments among other TIH commodities decreases.

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<sup>7</sup> Hillenbrand Reply V.S. at 11-12; UP Reply Evidence at 13-14. No movements of the issue traffic were included in the Waybill Sample provided by the Board. Though it was not listed as a comparability factor, both parties acknowledged that to the fact that the vast majority of the chlorine and Toxic Inhalation Hazard ("TIH") commodities move by rail transportation contract, their respective comparison groups are comprised of all contract shipments. UP has proposed a "common carrier rate adjustment factor" to the maximum reasonable rates produced by its application of the 3B methodology in this case. I demonstrated why this adjustment is unjustified at pages 21 – 22 of my Reply Verified Statement.

For example, UP states that chlorine makes up 38% of UP's system-wide TIH movements.<sup>8</sup> However, the Confidential Waybill Sample provided to the parties in this case shows that at the mileage range of 1000 – 1500 miles, chlorine made up only { }% of all movements (including UP's portion of joint line movements and rebilled movements) between 2004 and 2007. Chlorine movements such as the issue movements that UP originates and terminates on its system in single line service made up only { }% of all TIH movements. The chart below shows the mileage distribution of all segments of TIH commodities transported by UP during the period covered by the Waybill Sample.<sup>9</sup>

**CHART REDACTED**

At the distances transported by the issue movements, there is a distinct lack of transportation alternatives to railroad for TIH commodities. UP has also been clear that it treats all TIH commodities the same in terms of UP's lack of desire to transport TIH

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<sup>8</sup> UP Reply Evidence at 5.

<sup>9</sup> See Exhibit \_\_\_(KNH-18).

commodities at all, and its associated rate-setting practices, which apply generally to TIH commodities as a group. As such, other TIH commodity movements have very similar demand and operating characteristics to chlorine, and are therefore appropriate for inclusion in a R/V<sub>COMP</sub> group in a 3B Methodology rate case involving chlorine. All of the TIH commodity movements in the USM final comparison group selected according to the Confidential Waybill Sample are transported in UP single line service from origin to destination, move in privately owned tank cars, have similar cost characteristics, and are transported distances that are within 200 miles of the actual loaded miles of the issue movements.

On Opening and Reply, UP discusses how chlorine is a riskier product to transport than other TIH commodities. In addition to the risks of transporting chlorine, UP claims that because chlorine and other TIH commodities serve different “product markets,” they are not comparable. According to UP, these comparability factors are more important than similar cost characteristics.<sup>10</sup> As I stated in my Reply Verified Statement, the STB addressed this very issue in *DuPont*, where the Board concluded:

a more appropriate comparison group should include all TIH shipments, rather than a narrowly tailored group of chlorine movements alone. CSXT has offered no evidence that chlorine must be handled differently than any other TIH chemical moving in tank cars. Indeed, the Federal Railway Administration and the Pipeline and Hazardous Materials Safety Administration do not treat the transportation of chlorine differently from the transportation of any other TIH product.<sup>11</sup>

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<sup>10</sup> UP Opening Evidence at 6-9 and Reply Evidence at 10.

<sup>11</sup> *DuPont* at 9-10 (footnote omitted): “Chlorine is indeed a dangerous chemical, and accidents involving chlorine expose railroads to litigation risk. But there are many other dangerous chemicals, and we believe that a broader comparison group that includes these other TIH chemicals would provide a more reasonable guide for the contribution to joint and common costs that the movements at issue should bear.”

UP has not shown that the cost and risks of transporting differ among TIH commodities. Nor has it shown that, despite chlorine's unique toxicity and dispersion properties, its handling and pricing is any different than other TIH commodities.

UP's decision to include only chlorine movements is an effort to produce a higher maximum reasonable rate using the 3B Methodology, but UP's final comparison group is not comparable to the issue movements for the following reasons: (1) the inclusion of rebilled movements that have different operating and cost characteristics; (2) the wide mileage range used by UP brings in movements with different operating and cost characteristics that are not comparable to the issue movement; and (3) the exclusion of any single line TIH movements other than chlorine.

## 2. Car Type

In UP's initial and Final Offer comparison group, UP applied a car-type selection criteria narrowly limited to privately owned tank cars with a capacity less than 22,000 gallons (URCS Code 15).<sup>12</sup> UP concedes on Reply that its narrow car capacity selection criteria is directly linked to its "chlorine only" comparison group, because all chlorine cars move in that particular car type.

In my Reply Verified Statement, I explain that there is very little difference in the variable costs associated with movements using the two car types for TIH shipments (i.e., cars less than 22,000 gallons of capacity and cars greater than 22,000 gallons of capacity).<sup>13</sup> As such, a broader car-type capacity selection produces costs that are very comparable to the costs of transportation for the issue movements, and therefore, USM's

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<sup>12</sup> UP Reply at 15.

<sup>13</sup> Hillenbrand Reply V.S. at 13-14; Exhibit \_\_\_\_ (KNH - 13).

inclusion of privately owned tank cars of other capacities for other TIH movements is consistent with a comparison group containing chlorine and other TIH commodities.

### 3. Length of Haul

The selection criteria for USM's comparison groups applied a range of plus or minus 200 miles of the loaded miles of the issue movements.<sup>14</sup> USM selected a range that would be large enough to capture a sufficient representative sample of chlorine and similar TIH movements and associated transportation characteristics. Also, USM's 200 mile range around the issue movements' 1250 and 1290 actual loaded miles is comparable to the 150 mile range utilized in *DuPont* on issue traffic with actual loaded mile range of 600-800 miles. In its Reply Evidence, UP adhered to a range of plus or minus 400 miles of the loaded miles of the issue movements for its final comparison group, twice as large as the USM range. UP's mileage range is too broad and was selected merely to increase the sample size of UP's chlorine-only comparison group. If the mileage selection criteria in USM's 200 mile range is applied to UP's comparison group, 13 movements, or 54%, would be eliminated using Eloy and Sahuarita's loaded miles. When rebilled movements (see following discussion) are removed from the remaining 13 movements, respectively, the UP sample drops to 2 movements.<sup>15</sup> USM's TIH comparison group, with a larger sample size and more comparable mileage range, is superior to UP's chlorine only comparison group with its smaller sample size and less comparable mileage range.

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<sup>14</sup> See Hillenbrand Opening V.S. at 9-11 and Hillenbrand Reply V.S. at 14-15.

<sup>15</sup> See electronic workpaper "UP Comp Group Analysis.xls". This does not included the two common movements found in USM and UP's opening comparison groups.

UP argues, in its Reply Evidence, that the correct mileage range should reflect two conditions: it should be “large enough to include a sufficiently representative sample of comparable movements, but small enough to avoid the feedback effect described by the Board in *Simplified Standards*.”<sup>16</sup> The real issue is comparability. In my Reply Verified Statement, I demonstrated that UP’s large mileage range included movements with different cost characteristics that produce a much higher average cost per ton mile than the issue movements and a comparison group of similar movements.<sup>17</sup>

There is no realistic “feedback effect” issue in the selection of mileage range for a comparison group. In *Simplified Standards*, the STB “acknowledged the concern that, in theory, repeated application of the Three-Benchmark approach could have a feedback effect that could lower the mean for future cases. However, we do not believe that this should be a significant concern for several reasons.”<sup>18</sup>

Finally, UP claims in its Reply Evidence, that, had UP adopted USM’s 200 mile range or a 300 mile range, the 3B Methodology analysis would have produced a more favorable result for UP. However, the shorter mileage range would have significantly reduced the comparison group sample size, and the results would still be skewed because UP selected rebilled movements that are not comparable to the issue movements.

#### 4. Rebilled Movements

USM did not include “rebilled” movements in its Final Offer comparison groups because these movements have very different operating and cost characteristics than the issue movements, which leads to an overstatement of the mark ups that should be applied

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<sup>16</sup> UP Reply at 17.

<sup>17</sup> Hillenbrand Reply V.S. at 16.

<sup>18</sup> *Simplified Standards* at 12-13.

to the issue traffic.<sup>19</sup> UP included 14 rebilled movements in its 24 movement chlorine-only comparison group, over 58% of the total. I believe UP included rebilled movements mainly because its efforts to propose a chlorine-only comparison group would have been significantly compromised due to the small number of movements excluding rebilled movements would have produced, but also because doing so skews the 3B Methodology in UP's favor.

As the parties have explained in their Reply Evidence filings, "rebilled" movements are UP's segment of a longer joint line movement involving other railroads. Rebilled movements are, therefore, very different from the issue movements. While UP issues the rate for its segment of the move, the movement and cost characteristics are not the same as those of the issue movements.

In its Reply Evidence, UP included 11 rebilled movements in its final comparison group that originate in Portland, Oregon and terminate in Southern California.<sup>20</sup> These movements are classified on the Waybill Sample as "Received – Terminated" by UP. During the years covered by the Waybill Sample provided by the Board, there was no operating chlorine plant in Portland. In 2001, Atofina (now Arkema) shut down its chlor-alkali plant. Until 2006, when Equa-Chlor started production in Longview, Washington, there were no chlorine producers in the Pacific Northwest during the Waybill Sample years. The majority of the rebilled shipments occurred before 2006. During this time period, the closest chlorine producer was Canexus, located in Vancouver, British Columbia. UP, in its Reply Evidence, stated that movements originating and terminating in Canada and Mexico were not included in its final comparison group. Without further

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<sup>19</sup> Hillenbrand Reply V.S. at 12-13.

<sup>20</sup> See electronic workpaper "UP Comp Group Analysis.xls".

information not contained in the Waybill Sample, these Portland movements may not satisfy UP's comparison group selection criteria. Additionally, without further information, these movements are not comparable to the issue movements.

The issue movements, along with the other single line UP movements in USM's final comparison group, originate and terminate on the UP, meaning that each movement has an origin and destination switch. In the case of rebilled movements, each movement contains an interchange switch and either an origin switch or a destination switch on UP's segment. These movements have significantly higher R/VC ratios than other single line movements. The unadjusted simple average R/VC ratio for local UP chlorine movements in UP's comparison group is { }%. This is much lower than the average R/VC ratio for rebilled movements, which is { }%. Significantly, the average R/VC ratio of { }% for the local chlorine movements in UP's group is similar to the average unadjusted R/VC ratio of both of USM's final comparison groups composed of chlorine and other TIH movements, which is { }% for Eloy and { }% for Sahuarita. When rebilled movements are excluded from UP's comparison group, the maximum reasonable rate produced by UP's application of the 3B Methodology would be reduced to an R/VC ratio of { }%.<sup>21</sup>

#### 5. Short Line Movements

In its Final Comparison group, USM has included UP single-line movements that terminate in Curtiss, Arizona. These movements are listed in the STB Confidential Carload Waybill Sample as movements that originate and terminate on UP. Industry sources I reviewed in conjunction with the Waybill Sample, such as the Official Railway

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<sup>21</sup> See electronic workpaper "UP Comp Group Analysis.xls".

Guide, show UP as serving Curtiss. UP also has as Freight Station Accounting Code (“FSAC”) that USM used to identify the location for Curtiss. Nothing in the information I reviewed in the ordinary course gave any indication that UP did not serve this location as single line service.

In its Reply Evidence, UP reveals that it does not directly serve any shippers at Curtiss and that one of the railroads it acquired, the Southern Pacific, sold the former UP line between Beason, AL and Curtiss, AZ to the San Pedro Railroad Operating Company (“SPROC”) in 1994. Because UP has revealed it has a “handling agreement” with SPROC, UP claims the movement should be treated as an interline movement not comparable to the issue movements. The issue of UP serving Curtiss through a “handling arrangement” is not apparent from the Waybill sample, which is the data the complainants are directed to use to select the comparison groups. On Reply, UP claims that USM should have known that UP did not serve any customers in Curtiss, this fact should have been “readily apparent,” and that USM could have discovered this fact from a system map on UP’s website, density maps, and the STB website. The system map UP refers to does not confirm UP’s assertions, and because the other publicly available information I reviewed gave no indication of this arrangement, there was no apparent reason to search in detail UP’s density maps and the STB website.

The inclusion of Curtiss in USM’s final comparison groups has only a minor effect on the maximum reasonable rate. For example, when all movements terminating at Curtiss are removed from Sahuarita’s final comparison group, the maximum reasonable R/VC ratio increases only slightly, from 302% to 306%, resulting in a increase in the

maximum reasonable rate of only 1.3 percent.<sup>22</sup> If the Curtiss movements are removed from the Eloy final comparison group, the maximum reasonable R/VC ratio only increases from 311% to 337%, resulting in a increase in the maximum reasonable rate of only 8.3 percent.<sup>23</sup> This impact is not nearly as drastic as UP's inclusion of rebilled movements in its comparison group. Despite the inclusion of Curtiss, USM's comparison groups are still overall far more appropriate than UP's chlorine only group.

**C. Maximum R/VC Ratios and Rates**

Table II below shows my computations of the presumed maximum reasonable rates and maximum R/VC ratios for USM's Eloy and Sahuarita movements, using UP's mileage as discussed above.<sup>24</sup>

Table II <u>Maximum Rate and R/VC 1Q 2009</u>			
Ln	Item	Eloy	Sahuarita
1.	Issue Rate per Carload	\$13,396	\$10,410
2.	Variable Cost - 1Q 2009	\$2,549	\$2,485
3.	R/VC	526%	419%
4.	Maximum R/VC	311%	302%
5.	Maximum Rate per Carload	\$7,920	\$7,501
6.	Rate Reduction per Carload	\$5,476	\$2,909
<b>Source</b>			
Ln.1	Table I		
Ln.2	Table III		
Ln.3	Ln.1 ÷ Ln.2		
Ln.4	Exhibit __ (KNH-19) and Exhibit __ (KNH-20)		
Ln.5	Ln.2 x Ln.4		
Ln.6	Ln.1 - Ln.5		

<sup>22</sup> See electronic workpaper "Sahuarita Final Comp Group without Curtiss.xls".

<sup>23</sup> See electronic workpaper "Eloy Final Comp Group without Curtiss.xls".

<sup>24</sup> See Exhibit \_\_ (KNH-19) and Exhibit \_\_ (KNH-20).

#### **IV. Other Relevant Factors**

##### **A. USM's Proposed Reduction of the Presumed Maximum Reasonable Rates**

USM's application of the 3B Methodology has produced the presumptive maximum lawful rates, expressed as an R/VC ratio, set forth above. Under the *Simplified Standards*, a party can seek to rebut the presumption and argue that "other relevant factors" justify decreasing or increasing the rate, but the Board has placed strict limits on such a showing. One such limit requires that the party seeking such an adjustment quantify the evidence it introduces. In my Opening Verified Statement in this case, USM sought to rebut the presumption by quantifying the extent to which TIH commodities bore a disproportionately high share of the joint and common costs of UP rail service throughout the 2004-2007 timeframe covered by the Waybill Sample provided to the parties in this case.<sup>25</sup> This quantification was made by analyzing the markups on all the UP TIH movements in the Waybill Sample and comparing them to the R/VC >180 benchmark for all commodities. My analysis concluded that, because the R/VC TIH > 180 benchmark was higher than the R/VC >180 benchmark for all traffic, the revenue need adjustment should be lower than the average revenue need adjustment to reflect the additional revenue contribution provided by the presumed maximum reasonable rates, and I quantified the extent of the reduction in Table VIII of my Opening VS.

UP objects to this analysis for a variety of reasons in its Reply Evidence, including an assertion that this approach was rejected in *Simplified Standards*. This and the other objections UP raises are unwarranted. In the first place, I do not read the *Simplified Standards* to address this potential application of the "other relevant factors"

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<sup>25</sup> Hillenbrand Opening V.S. at 15-18.

aspect of the 3B Methodology. Rather, *Simplified Standards*, to the extent it addresses this issue at all, refers to using a subset of the overall potentially captive traffic in the 3B Methodology in the first instance, not after the  $R/VC > 180$  benchmark has been applied to determine the presumed maximum reasonable rate levels. This is a critical distinction, as the “other relevant factors” prong of the 3B Methodology only potentially comes into play after the presumed maximum reasonable rates have been established. Accordingly, an analysis of a subset of the traffic does not affect that result.

On the other hand, UP’s proposal of a similar RSAM and  $R/VC > 180$  benchmark for its unwarranted PTC adjustment is directly contrary to the *Simplified Standards*. UP claims that its adjustment is warranted because:

UP proposed a broader adjustment designed to account for a significant change in market conditions that was not reflected in traffic data in the 2004-2007 Waybill Samples, and thus “not reflected in the comparison group average RSAM and  $R/VC > 180$  benchmarks.”<sup>26</sup>

The potential implementation of PTC by December 31, 2015 and its estimated costs are not a “significant change in market conditions” that fall within the scope of an “other relevant factor” in a 3B Methodology case. In any event, UP’s proposed adjustment attempts to apply speculative prospective investments that are scheduled to be completed by 2015 to those periods and therefore functions like the regulatory lag adjustment the STB rejected in *Simplified Standards* and *DuPont*.<sup>27</sup> USM’s adjustment reflects market conditions “not reflected in the comparison group average RSAM and  $R/VC > 180$  benchmarks” for local UP TIH movements for corresponding waybill years. As shown in

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<sup>26</sup> UP Reply at 24 (citation omitted).

<sup>27</sup> *Simplified Standards* at 85 and *DuPont* at 16-17.

the table below, both USM's and UP's TIH R/VC>180 benchmark show the dramatic change in pricing conditions compared to the average benchmark.

Table III UP R/VC>180 Benchmarks			
Year	UP R/VC>180 Benchmark	USM UP TIH R/VC>180 Benchmark	UP TIH R/VC>180 Benchmark
[1]	[2]	[3]	[4]
2004	232%	{ }	{ }
2005	229%	{ }	{ }
2006	233%	{ }	{ }
2007	230%	{ }	{ }
4 Year Average	231%	{ }	{ }
Source			
[2] Ex Parte No. 689, <i>Simplified Standards for Rail Rate Cases - 2007 RSAM and R/VC&gt;180 Calculations</i> , Decided May 12, 2009			
[3] Electronic Workpaper "TIH RVC180 Benchmark Calculations.xls"			
[4] UP Electronic Workpaper "UP PTC RSAM Revenue Adj Calculations - Reply.xls"			

The mark up between the average R/VC>180 benchmark and UP's TIH R/VC>180 Benchmark is much greater than USM's. Had USM decided to use an all TIH benchmark instead of UP's, the downward adjustment would be greater.

UP argues that commodities with higher mark ups than the average cannot be considered "unreasonable" due to differential pricing because they "expected to set markups that vary in accordance with demand."<sup>28</sup> For TIH commodities, this is not the case, as demand measured by volume fell when prices increased. Between 2004 to 2007, TIH originating and terminating on UP (including rebilled traffic) fell from { } carloads in 2004 to { } carloads in 2007, while UP's average revenue per car increased from { } per carload to { } per carload during that same time

<sup>28</sup> UP Reply at 26.

period.<sup>29</sup> UP's own TIH R/VC>180 adjustment shows how mark ups on TIH rates are unreasonably high. The other change reflecting market conditions is that for 2006 and 2007, the RSAM+UP TIH R/VC>180 adjustment is almost equal or below one, meaning that UP was earning almost enough or more than it needed from the mark ups on TIH traffic.<sup>30</sup> USM has taken a balanced approach in calculating its TIH R/VC>180 benchmark to quantify the market conditions not reflected in the comparison group of the average RSAM and R/VC>180 benchmarks.<sup>31</sup>

#### **V. Maximum Reasonable Rate – Conclusion of the Analysis**

For the above reasons, I conclude that USM's Final Tender comparison groups for the issue movements are superior to UP's single comparison group and should be adopted for use in the case. Further, the rates charged by UP are unreasonable under the application of the Three Benchmark methodology as described in *Simplified Standards*. Table IV below summarizes the maximum rate and R/VC calculations in this statement.

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<sup>29</sup> Schwartz Reply V.S. at 4.

<sup>30</sup> 2006 -  $268 \div \{267\} = 1.003$  and 2007 -  $278 \div \{283\} = 0.982$ .

<sup>31</sup> See Exhibit \_\_\_ (KNH-21) and Exhibit \_\_\_ (KNH-22).

**Table IV**  
**Maximum Rate and R/VC 1Q 2009**

Ln	Item	Eloy	Sahuarita
1	Issue Rate per Carload	\$13,396	\$10,410
2	Variable Cost - 1Q 2009	\$2,549	\$2,485
3	R/VC	526%	419%
 <u>Maxium Reasonable Rate</u>			
4	Maximum R/VC	311%	302%
5	Maximum Rate per Carload	\$7,920	\$7,500
 <u>Maxium Reasonable Rate with TIH Adjustment</u>			
6	Maximum R/VC	{ }	{ }
7	Maximum Rate per Carload	{ }	{ }

**Source**

Ln.1 Table I

Ln.2 Table II

Ln.3 = Ln.1 ÷ Ln.2

Ln.4 Exhibit\_\_(KNH-19) and Exhibit\_\_(KNH-20)

Ln.5 = Ln.2 x Ln.4

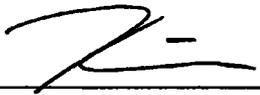
Ln.6 Exhibit\_\_(KNH-21) and Exhibit\_\_(KNH-22)

Ln.7 = Ln.2 x Ln.6

**Verification**

**I declare under penalty of perjury that the foregoing is true and correct. I further certify that I am qualified and authorized to sponsor and file this testimony.**

**Executed on October 21, 2009**



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**Kim N. Hillenbrand**

**HIGHLY CONFIDENTIAL**  
**EXHIBIT \_\_\_\_ (KNH-18) REDACTED**

**HIGHLY CONFIDENTIAL  
EXHIBIT \_\_\_\_ (KNH-19) REDACTED**

**HIGHLY CONFIDENTIAL**  
**EXHIBIT \_\_\_\_ (KNH-20) REDACTED**

**HIGHLY CONFIDENTIAL**  
**EXHIBIT \_\_ (KNH-21) REDACTED**

**HIGHLY CONFIDENTIAL**  
**EXHIBIT \_\_\_\_ (KNH-22) REDACTED**

**PUBLIC VERSION**

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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US MAGNESIUM, L.L.C.	)	
	)	
	)	
Complainant,	)	
	)	
v.	)	Docket No. NOR 42114
	)	
UNION PACIFIC RAILROAD COMPANY	)	
	)	
	)	
Defendant.	)	
_____	)	

**Rebuttal Verified Statement**

**of Tom O'Connor**

## **I. Introduction**

My name is Tom O'Connor. I am Vice President of Snavelly King Majoros O'Connor & Bedell, Inc. ("Snavelly King" or "SK"). Snavelly King is an economic and management consulting company with offices located at 1111 14<sup>th</sup> Street NW, Suite 300, Washington DC 20005. Throughout Snavelly King's 39 year history our practice has been focused on the transportation, telecom and public utility industries. A statement of my qualifications and experience was included in my Opening Verified Statement as Exhibit No. (TOC \_\_\_1)

U.S. Magnesium, LLC ("USM") has filed a rate complaint with the Surface Transportation Board ("STB" or "the Board") prompted by a rate dispute involving USM and the Union Pacific Railroad Company ("Union Pacific" or "UP"). USM has requested that the STB, using the Three-Benchmark approach adopted by the STB pursuant to 49 U.S.C. §10701(d)(3), in Ex Parte No. 646 (Sub-No.1), *Simplified Standards for Rail Rate Cases* (served September 5, 2007) (*Simplified Standards*), prescribe reasonable rates and award damages, plus interest, to the extent that USM has paid common carrier rates in excess of a reasonable maximum for the transportation of chlorine (Standard Transportation Commodity Code or STCC 2812821) for the following issue movements:

- Rowley, Utah to Eloy, Arizona ("Eloy" movement)
- Rowley, Utah to Sahuarita, Arizona ("Sahuarita" movement)

In preparing this Rebuttal Verified Statement ("RVS") I have reviewed the Reply Evidence submitted by UP, and I address the following aspects of UP's Reply Evidence.

1. UP's characterization of its demarketing strategy for Toxic by Inhalation Hazardous ("TIH") Commodities as "profit maximizing"
2. How UP's demarketing strategy has been applied to USM

3. Why UP's behavior provides justification for the damages limit being increased in this case.

## **II. UP's TIH Demarketing Strategy**

USM's Opening Evidence demonstrated that UP, like other Class I railroads, no longer wants to transport TIH commodities, and starting in the 2005 timeframe embarked on a strategy consistent with this decision.<sup>1</sup> USM has demonstrated, and UP has confirmed in its Reply Evidence in this proceeding, that UP has aggressively sought to achieve this goal through pricing practices that involved substantially increasing the rates to TIH shippers to discourage the movement of such commodities. UP does not dispute that its strategy called for ceding TIH business to other rail carriers and other modes for those customers who had transportation alternatives to UP. Now UP primarily transports TIH commodities for shippers captive to UP for service at either destination or origin, such as USM, only because it is required to pursuant to its common carrier obligation. Moreover, UP has actively sought to limit the scope of that obligation in order to further reduce the amount of TIH commodities on its system.

Contrary to UP's statements in its Opening and Reply Evidence, the record in this case demonstrates that the significant rate increases on TIH transportation imposed by UP are not based on any understanding between TIH shippers and UP, in particular between USM and UP, that such increases are necessary to fund UP's future obligation to install Positive Train Control technology on its system, or any other "market" changes that

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<sup>1</sup> See UP Reply Evidence at 34 and RVS Exhibit No. (TOC1) and Exhibit No. (TOC 2).

would fall under the “other relevant factors” component of the Three-Benchmark methodology.<sup>2</sup>

UP claims that it is maximizing profits, not demarketing chlorine and other TIH commodities. That is not the case. Profit maximization entails an underlying assumption that the railroad desires to transport the commodity at issue. In the case of chlorine and other TIH commodities there is another dimension, that is, the stated preference of UP not to carry the product. It is notable that nowhere in the record of this proceeding does UP affirmatively state that it desires to transport TIH commodities, and that they are a valued part of UP’s business plans.

The UP claim that {  
} does not mean that UP is not trying to demarket TIH shipments from smaller customers where it can. This was demonstrated by the Petition for Declaratory Order UP filed with the STB<sup>4</sup> and UP’s refusal to quote rates to USM for transportation to several Gulf Coast destinations in violation of the statute.

Not only has UP articulated its aversion to transporting TIH, but UP witness Worrell has described in his Reply Verified Statement how UP implements its strategy of de-marketing:<sup>5</sup>

We are also seeking to reduce the amount of TIH that we carry by supporting policies that promote product substitution and on-consumption-site production, encouraging producers to consider selling to closer customers, encouraging producers to consider product swaps as an alternative to long distance transportation; and we have tried to make sure

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<sup>2</sup> See USM Reply Evidence, Section III, pages 16-25.

<sup>3</sup> *Id.* at 3, 33.

<sup>4</sup> See STB Finance Docket No. 35219 *Union Pacific Railroad Company -Petition For Declaratory Order* (served February 18, 2009).

<sup>5</sup> See UP Reply Evidence, Worrell Reply Verified Statement at 5. (citations omitted).

that our rates are consistent in reflecting our assessment of costs and demand, so that we do not inadvertently encourage unnecessary transportation of TIH.

UP's assertions in its Reply Evidence that it is not seeking to demarket chlorine and other TIH commodities are also rebutted by the following additional documents and facts:

RVS Exhibit No. \_\_\_ (TOC1) is a January 12, 2005 {

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Exhibit No. \_\_ (TOC 2) to this RVS is another document produced by UP entitled { ,} which further expands on the UP strategy of selectively demarketing chlorine shipments. Specifically, this document demonstrates that by the 2008-2009 timeframe:

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7}

Exhibit No. \_\_ (TOC 2) also demonstrates that the aggressive pricing practiced by UP was accompanied by {

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### III. Application of UP's Demarketing Strategy to USM

In addition to the discussion on this point already included in the record, in this section I rebut two statements made by UP and its witnesses in UP's Reply Evidence concerning the application of UP's demarketing strategy to USM. In my view, UP is at a minimum indifferent as to whether USM remains in business, and in actuality is trying to force USM to cease shipping chlorine by setting the rates UP must provide pursuant to law so high as to make such shipments economically infeasible for USM.

First, UP states in its Reply Evidence that USM's chlorine volumes have increased between 2005 and 2008,<sup>8</sup> inferring that USM's rail rates are not excessive. While this is not an incorrect statement, it is also misleading. USM's chlorine production

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<sup>7</sup> UP subsequently sought unsuccessfully to deny USM the option of shipping to Houston and other distant points by refusing to provide the rates requested by USM and then asking the Board to declare UP did not have to legally provide this service. *See* STB Finance Docket No. 35219 *Union Pacific Railroad Company -Petition For Declaratory Order* (served February 18, 2009).

<sup>8</sup> UP Reply Evidence at 3; Worrell Reply Verified Statement at 6.

is determined by its production of magnesium. USM does not have transportation options and has very limited car storage. USM cannot vent the chlorine into the air.<sup>9</sup> Accordingly, as USM is successful in marketing its primary magnesium business product, its need to market and transport chlorine increases.

The following table shows the pattern of USM production for magnesium and chlorine and the USM shipments of Chlorine.

**Table I**

Fiscal year	Magnesium production (electrolytic)	Chlorine production	Chlorine shipments
2004	{ }	{ }	{ }
2005	{ }	{ }	{ }
2006	{ }	{ }	{ }
2007	{ }	{ }	{ }
2008	{ }	{ }	{ }
2009 ytd (Nov-Sep)	{ }	{ }	{ }
Average 2004-2008	{ }	{ }	{ }

Thus, increases in chlorine shipments by USM are not indicative of any satisfaction with the rates UP charged for this service.

Second, UP's Reply Evidence infers that until the filing of this rate case in 2009 USM was not unhappy with the rates and rail service it received from UP. This is a mischaracterization of USM's evidence and an inaccurate picture of the facts. On the contrary, the past four years have been marked by UP's reluctance to provide rates to USM at all, and then only very high rates, and USM's steadfast resistance to UP's actions. In addition to the verified written testimony of Howard Kaplan and associated documents in USM's Opening and Reply Evidence, Exhibit No. \_\_\_ (TOC 3) attached to

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<sup>9</sup> See Kaplan Opening V.S. at 3 – 4.

this RVC demonstrates that USM has been resisting UP's demarketing efforts since at least 2006, when UP was informing USM that {

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#### **IV. UP's Application of its Demarketing Strategy to USM Justifies an Increase in the Damage limit in this case**

In this case, USM has requested that the \$1 million cap over the five year prescription period for maximum reasonable rate relief should be raised to \$2 million.<sup>10</sup> The relief is the difference between the challenged rate and the maximum lawful rate multiplied by volume. UP admits that it has raised rates for USM by applying "substantial rate increases."<sup>11</sup> UP more than doubled USM's 2008 rates. It is of secondary importance whether UP's motivation is to extract additional revenue from USM or to raise USM to a higher rate level already applied to others. In either case, a pricing strategy based on indifference to whether the traffic moves at all "games" the Three-Benchmark methodology, and in any event the proposed rate increases are not justified by any reasonable measure of cost. USM demonstrated in its Opening Evidence that the challenged tariff rates, when reduced to their maximum reasonable levels by a proper application of the Three-Benchmark Methodology, result in overall damages over the five year prescription period well in excess of \$1,000,000.<sup>12</sup>

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<sup>10</sup> USM Opening Evidence at 22-25.

<sup>11</sup> UP Reply Evidence at 30.

<sup>12</sup> USM Opening Evidence; O'Connor V.S. at 9-10; Opening Exhibit No. \_\_ (TOC 6).

The Board should resolve the issue in this case by increasing the rate relief cap and it has the authority to do so in the *Simplified Standards*. The relief cap should be increased to \$2,000,000 to compensate for unilateral rate increase actions such as we see in this case and to preserve the efficacy of the rate relief process.

As noted above, the data in this case and my experience shows that by setting the tariff rates at sufficiently high levels the railroad can preempt and exhaust the rate relief offered by the Three-Benchmark process. The data presented in this proceeding demonstrates that the maximum value of the case should be increased significantly to correct this imbalance and offset the effects of UP's efforts to demarket USM's business.

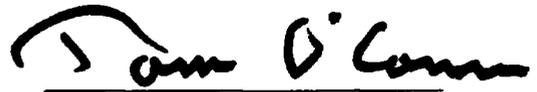
#### **V. Conclusion**

USM is the last domestic producer of magnesium in the United States. Despite UP's labeling of its TIH pricing practices as "profit maximizing," those practices, particularly as applied to USM, are intended to demarket USM's chlorine business. If unrestrained by regulatory intervention UP's chlorine pricing policies and practices could drive USM chlorine from the rail transportation market.

**Verification**

**I declare under penalty of perjury that the foregoing is true and correct. I further certify that I am qualified and authorized to sponsor and file this testimony.**

**Executed on October 21, 2009**

A handwritten signature in black ink that reads "Tom O'Connor". The signature is written in a cursive style with a large, sweeping initial "T".

**Tom O'Connor**

**HIGHLY CONFIDENTIAL**  
**EXHIBIT \_\_\_\_ (TOC-1) REDACTED**

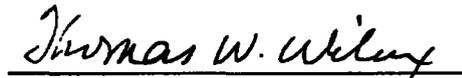
**HIGHLY CONFIDENTIAL**  
**EXHIBIT \_\_\_\_ (TOC-2) REDACTED**

**HIGHLY CONFIDENTIAL**  
**EXHIBIT \_\_\_\_ (TOC-3) REDACTED**

**CERTIFICATE OF SERVICE**

I hereby certify that on this 22<sup>nd</sup> day of October, 2009, I have served a copy of the foregoing Complainant's Rebuttal Evidence by e-mail and regular mail upon counsel for Defendant at the following address:

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