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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB Ex Parte No. 646 (Sub-No. 3)

**WAYBILL DATA RELEASED IN THREE-BENCHMARK
RAIL RATE PROCEEDINGS**

**SUPPLEMENTAL COMMENTS OF
CANADIAN PACIFIC RAILWAY COMPANY**

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Dated: November 23, 2010

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Pursuant to the decision served in the above-captioned proceeding on October 22, 2010 (the "*October 22 Decision*"), Canadian Pacific Railway Company and its U.S. rail carrier affiliates, Soo Line Railroad Company, Dakota, Minnesota and Eastern Railroad Corporation and Delaware and Hudson Railway Company, Inc. (collectively, "CP") submit these Supplemental Comments regarding the Board's proposal to permit parties to rate proceedings brought under the Board's "Three Benchmark" methodology to select their comparison traffic group from the defendant's unmasked Waybill Sample data for the four (4) years corresponding with the most recently published Revenue Shortfall Allocation Method ("RSAM") figures. The *October 22 Decision* "republished" the Notice of Proposed Rulemaking previously issued in this proceeding on April 2, 2010 (the "*April 2 NPRM*"), and supplemented the *April 2 NPRM* with a statement of the Board's rationale and regulatory objectives in proposing that change to the Three Benchmark methodology. For the reasons set forth below, CP urges the Board not to adopt the proposed rule, and to instead require parties to select their comparison groups from the single most recent Waybill Sample.

As these Supplemental Comments (and CP's prior comments) demonstrate, the proposed rule would further undermine the reliability of a rate reasonableness methodology that already

sacrifices a great deal of accuracy in the name of “simplicity.”¹ Rather than judging a challenged rate by comparing the R/VC ratio produced by that rate to the rates and corresponding R/VC ratios for similar movements in the most currently available Waybill Sample (as the Board originally stated it intended to do), the proposed rule would sanction an analysis based upon rates and R/VC ratios that, due to the lag in publishing the Waybill Sample, could be as much as six years old. If adopted, this change would fundamentally alter the standard for rate reasonableness under the Three Benchmark methodology, by basing outcomes not on whether the challenged rate is comparable to other contemporaneous market rates for similar movements, but rather on how the challenged rate compares to an average of historical rates that may have been established under very different economic conditions. The *October 22 Decision* does not articulate any legitimate reason why adopting such an arbitrary standard is either necessary or desirable. To the contrary, the record evidence indicates that, in most cases, the most recent Waybill Sample would be sufficient to provide parties with an ample supply of movements from which to select their comparison traffic group.

I. THE PROPOSED RULE WOULD UNDERMINE THE RELIABILITY OF RATE REASONABLENESS DETERMINATIONS IN THREE BENCHMARK CASES.

The Three Benchmark methodology is, in essence, a “rate comparison” approach. As the Board observed in *Simplified Standards*, “[t]he whole purpose of the Three Benchmark approach is to determine where the challenged rate falls in comparison to other similarly situated traffic.”² Consistent with this stated purpose, the primary “benchmark” employed by the Board under that

¹ CP previously filed Opening Comments on May 3, 2010 (“CP Opening Comments”) and Reply Comments on June 1, 2010 (“CP Reply Comments”). CP hereby incorporates those prior submissions by reference .

² Ex Parte No. 646 (Sub-No. 1), *Simplified Standards for Rail Rate Cases*, Decision served September 5, 2007 (“*Simplified Standards*”) at 80 (emphasis added).

methodology is a comparison of the R/VC ratio for the challenged rate with the mean R/VC ratio for a group of comparable movements drawn from the Waybill Sample.

The record in this proceeding demonstrates convincingly that rates and costs attributable to rail shipments that occurred several years prior to the issue movement may not be “similarly situated” in any meaningful sense. Studies – including those commissioned by the Board – have consistently shown that both rates and costs fluctuate significantly over time. For example, a recent Board study showed that real revenue per ton-mile fell by 33% during the six-year period between 1985 and 1991, and rose by more than 15% during the three-year period between 2004 and 2007.³ A study by GAO likewise found that real, inflation-adjusted rail rates generally declined from 1985 through 1998; increased in 1999; dropped again in 2000; and increased in 2001 and 2002.⁴ More recently, the Christiansen Associates report commissioned by the Board found that rates rose from 2004 through 2008, but fell in 2009.⁵ These studies provide substantial quantitative proof that railroad rates and costs can, and often do, fluctuate significantly over any given multi-year period.

Even more importantly, the studies show that rates and costs do not necessarily rise and fall in tandem or proportionally. To the contrary, the Christiansen report concluded that “revenue per ton-mile and marginal cost tend to move together, but not in proportion or consistently.”⁶ Thus, the relationship between rates and costs (as reflected in R/VC ratios) for a

³ See Surface Transportation Board, Office of Economics, Environmental Analysis and Administration, Section of Economics, Study of Railroad Rates: 1985-2007, at 1-2 (Jan. 2009), available at <http://www.stb.dot.gov/industry/1985-2007RailroadRateStudy.pdf>.

⁴ U.S. Government Accountability Office, Freight Railroads: Industry Health Has Improved, But Concerns about Competition and Capacity Should Be Addressed, GAO 07-94, at 11-12 (Oct. 2006), available at <http://www.gao.gov/new.items/d0794.pdf>.

⁵ See Laurits R. Christiansen Associates, Inc., An Update to the Study of Competition in the U.S. Freight Railroad Industry, at i, 2-5 (Jan. 2010).

⁶ *Id.* at 4-2 (emphasis added); see also *id.* at 4-3.

shipment that occurred several years prior to an issue movement of the same commodity may be significantly different than the rate and cost levels prevailing in the current marketplace.

For these reasons, R/VC ratios for movements that occurred four, five or even six years ago are simply not a reliable benchmark for determining “where the challenged rate falls in comparison to other similarly situated traffic.” (*Simplified Standards* at 80.) The Board’s proposal to permit parties to develop “comparable” traffic groups based upon Waybill Sample data for periods up to six years prior to the issue movement, rather than the most recent available data, would seriously undermine the Three Benchmark methodology’s ability to evaluate with any degree of accuracy the reasonableness of a challenged rate in light of prevailing market conditions. *See* CP Opening Comments at 4-7; CP Reply Comments at 2-3. *See also* NS/CSXT Opening Comments at 10-14. Indeed, the proposed rule would produce rate comparisons, and rate reasonableness determinations, based upon a standard (historical average R/VC ratios) that is fundamentally inconsistent with the Board’s stated objective in adopting the Three Benchmark methodology (i.e., to make available a simplified procedure for determining rate reasonableness based upon a comparison with similar contemporaneous movements).

The arbitrary nature of the proposed rule is exacerbated by the Board’s refusal to provide any mechanism for adjusting the rates and costs associated with comparison group movements to current levels. Several commenting parties urged the Board to include such a mechanism in the Three Benchmark methodology, but the Board declined to do so.⁷ Moreover, the comparability factors that the Board has indicated it will consider in evaluating the parties’ proposed comparison groups does not include any measure based upon the time lag between a comparison

⁷ *See, e.g.*, NS/CSXT Opening Comments at 16-18.

movement and the issue movement.⁸ Although the Board has hinted at times that a party might proffer such temporal adjustments as “other relevant evidence,” in practice the Board has applied strict evidentiary rules that have made it all but impossible to present such evidence of changing rates and costs. *See, e.g., E.I. du Pont de Nemours & Co. v. CSX Transp., Inc.*, STB Docket No. 42100, slip op. at 15-16 (served June 27, 2008).⁹ As a result, the Board’s proposed four-year rule for comparison group selection will almost certainly lead to distorted comparisons that take no account whatsoever of significant changes in market conditions in the years leading up to the challenged movement.

II. THE RATIONALE SET FORTH IN THE *OCTOBER 22 DECISION* IS NOT SUFFICIENT TO SUPPORT ADOPTION OF THE PROPOSED RULE.

CP and several other commenters objected to the Board’s *April 2 NPRM* on the grounds that the Board failed to articulate its rationale for expanding the permissible comparison group period from one year to four years. *See, e.g.*, CP Opening Comments at 2-4. In response to those comments, the Board “republished” its proposal in the *October 22 Decision*, for the purpose of providing “an expanded discussion of its rationale and regulatory objectives.” *October 22 Decision* at 1. As the following discussion demonstrates, neither of the two justifications cited by the Board for permitting parties to select their comparison groups from four years of Waybill Sample data provides a rational basis for adopting the proposed rule.

⁸ *Simplified Standards* at 17 (“comparability will be determined by reviewing a variety of factors, such as length of movement, commodity type, traffic densities of the likely routes involved, and demand elasticity”).

⁹ In *DuPont*, the Board explicitly refused to consider the defendant’s evidence showing that comparison group rates and costs had increased significantly over time on the grounds that the resulting adjusted R/VC_{COMP} could not be considered unless the defendant also made corresponding adjustments to the RSAM and $R/VC_{>180}$ benchmarks. *Id.* at 16. Such a requirement, which would necessitate adjustments to many hundreds of individual movements, all but ensures that no party will be able to put forward evidence to adjust historical revenues and costs to current levels.

A. Allowing Outdated Waybill Sample Data To Be Used For Comparison Group Selections Would Not Be “Consistent” With Other Benchmarks.

The first reason offered by the Board for adopting a four-year comparison group selection period is that

“[t]he use of multiple years of data for the Waybill Sample would be consistent with the Board’s current practice in other contexts in Three-Benchmark cases. The Board already uses a 4-year averaging period to determine the two other benchmark components used in a Three-Benchmark case: the RSAM and R/VC_{>180} benchmarks.” *October 22 Decision* at 3 (emphasis added).

As an initial matter, the Board’s assertion that the proposed rule would create “consistency” between the R/VC_{COMP} benchmark, on the one hand, and the RSAM and R/VC_{>180} benchmarks, on the other hand, is, at best, highly dubious. While the Board always calculates a defendant carrier’s RSAM and R/VC_{>180} figures on the basis of a four-year averaging period, the proposed rule imposes no such requirement on the parties in developing their comparison traffic groups. To the contrary, the proposed rule is intended only to offer parties the “flexibility” to use up to four years of data, not to require that they do so. *October 22 Decision* at 3. Indeed, the Board has made clear that parties are free to proffer a comparison group based on movement data derived from a single year, or any combination of data based upon one, two, three or four years of Waybill Sample data.¹⁰ Thus, the proposed rule does not, in fact, produce the methodological “consistency” that the Board cites as a reason for adopting it.

More fundamentally, the Board’s purported search for consistency in the measurement of the RSAM, R/VC_{>180} and R/VC_{COMP} benchmarks ignores the fact that they are very different measures designed for very different purposes. As the Board has explained, RSAM “measures

¹⁰ See *April 2 NPRM* at 3 (“The rule proposed here would be permissive, not mandatory: i.e., it would provide a rate complainant and the defendant railroad (possibly small entities) the option of using more data, but the proposed rule would not force them to use all of that data.”)

the average markup over variable cost that the railroad would need to charge all of its 'potentially captive' traffic in order for the railroad to earn adequate revenues." *Simplified Standards* at 10 (emphasis added). Likewise, the $R/VC_{>180}$ benchmark "measures the average markup over variable cost earned by the defendant railroad on its potentially captive traffic." *Id.* Thus, both RSAM and $R/VC_{>180}$ are intended to measure a carrier's progress toward achieving revenue adequacy, by estimating the average markup that the carrier needs to charge (RSAM) and is actually charging ($R/VC_{>180}$) across all potentially captive traffic system-wide. Because the concept of "revenue adequacy" is intended to measure a carrier's ability to earn its cost of capital over time (and not just in any single year), the Board correctly incorporates a multi-year averaging period into the calculation of RSAM and $R/VC_{>180}$ in order to "smooth out annual variations and minimize the impact of any year that may have been aberrational for that carrier." *October 22 Decision* at 3.

By contrast, the purpose of the R/VC_{COMP} benchmark is to evaluate the reasonableness of an individual challenged rate by comparing the R/VC ratio produced by that rate to the R/VC ratios for "similarly situated traffic." Because rates and costs can, and do, fluctuate significantly over any given multi-year period, any reliable comparison-based rate reasonableness methodology must utilize a comparison group that is contemporaneous with, and shares shipment characteristics similar to, the issue traffic. Adoption of a multi-year comparison group period would undercut the reliability of the Three Benchmark test's rate comparison component, by permitting the introduction of movements that may have occurred during a period in which economic conditions (and, correspondingly, railroad rates and costs) were significantly different than those that prevailed at the time the challenged movement occurred.¹¹

¹¹ The Board itself acknowledges the adverse impact that older comparison data would have on the accuracy of Three Benchmark rate determinations, saying that its proposal to limit the

In short, the Board's assertion that the proposed rule is intended to produce "consistency" among the three components of the Three Benchmark methodology ignores the fundamental differences between the nature and purpose of the RSAM and $R/VC_{>180}$ benchmarks, on the one hand, and the R/VC_{COMP} benchmark, on the other hand. Moreover, the proposed rule would not, in any event, achieve such consistency because it permits, but does not mandate, a four-year comparison traffic group period.

B. Allowing Outdated Waybill Sample Data Is Not Necessary For Parties To Develop Appropriate Comparison Traffic Groups.

The Board's second justification for the proposed rule – i.e., that it would "provide parties more data from which to choose," and that reliance upon a single year's data "could cause the comparison groups to be too small" (*October 22 Decision* at 3), is likewise unsupported by the record. No party has made a credible showing that a Three Benchmark proceeding, involving any commodity, could not be conducted with a comparison traffic group selected from the most recent year's Waybill Sample. Indeed, there is no evidence to suggest that parties need access to a broader set of Waybill Sample data in order to develop an appropriate comparison group, even for lower-volume movements such as some toxic-by-inhalation ("TIH") commodities. Having never encountered a Three Benchmark case in which a comparison group drawn from a single year's Waybill Sample data proved problematic, the Board cannot credibly conclude that such a pool of data would not, in most cases, be entirely adequate.

Moreover, the Board already has taken steps to address potential concerns about the sufficiency of comparison group data. For example, it has been suggested that the Waybill

comparison group to four years of Waybill Sample data "would prevent the use of data that are too old to be reliable." *October 22 Decision* at 3 (emphasis added). However, neither the record evidence nor the Board's decisions in this proceeding provide any quantitative proof that the data permitted by the Board's proposed rule – which could be up to six years old at the time it is used as a basis for comparison with the challenged rate – are not likewise "too old to be reliable."

Sample may not contain sufficient movements of certain TIH commodities to permit parties to create a robust comparison group in cases challenging rates for TIH traffic. The Board has proposed to change its rules governing waybill sample reporting to require railroads to include all waybill information for their TIH movements. See *Waybill Data Reporting for Toxic Inhalation Hazards*, STB Ex Parte No. 385 (Sub-No. 7), (served Jan. 28, 2010) at 4. That proposal, if adopted, will resolve any concerns about having a sufficient number of TIH shipments in a single year's Waybill Sample, by insuring that all TIH shipments that occur in a given year are included in the Waybill Sample.

In addition, *Simplified Standards* itself provided a mechanism for supplementing the most recent Waybill Sample data in the (unlikely) event that it does not contain a sufficient number of comparable movements. Specifically, the Board stated that “[i]f a particular movement is so unique that there are insufficient comparable movements in the Waybill Sample, we will entertain a reasonably tailored request for comparable movements from the defendant’s own traffic tapes.” *Simplified Standards* at 83. In providing this potential remedy, the Board recognized that the circumstances in which a single year’s Waybill Sample might be inadequate would be confined to a very few “unique” movements. There is simply no justification for undermining the reliability of rate comparisons in all Three Benchmark proceedings for the sake of avoiding a hypothetical data sufficiency issue in an isolated case. Rather, the Board should adopt regulations that maximize the accuracy of its Three Benchmark methodology (by requiring that comparison traffic groups be drawn from the most recent Waybill Sample), while providing procedures to address any unique data problems that may arise on a case-by-case basis.

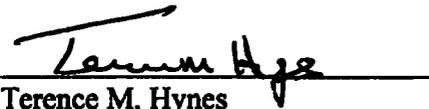
Finally, expanding the period for selecting the comparison traffic group from one to four years solely to “allow parties more flexibility” (*October 22 Decision* at 3) could undermine the Board’s primary objective in adopting the Three Benchmark test – i.e., to reduce the cost and

complexity of litigating smaller rate disputes. Permitting the introduction of R/VC ratios based upon Waybill Sample data that are as much as six years old would, in all likelihood, complicate the selection process, generate disputes regarding the comparability of rates that prevailed under different economic conditions, and thereby increase the expense of litigating Three Benchmark cases. For that reason, the Board's current proposal is inconsistent with its overarching objective of "simplifying" the rate litigation process.

III. CONCLUSION

For the reasons stated in these Supplemental Comments and in CP's prior submissions, the Board's proposal to adopt a four-year comparison group selection period in Three Benchmark cases should not be adopted.

Respectfully submitted,



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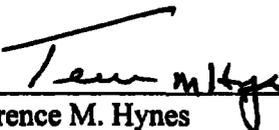
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Dated: November 23, 2010

CERTIFICATE OF SERVICE

I hereby certify that I have caused a copy of the foregoing Supplemental Comments of Canadian Pacific Railway Company to be served by first class mail, postage prepaid, this 23rd day of November 2010 to all parties of record.



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