MR. O’CONNOR: I think we’re ready to go, and thank you very much. I appreciate the opportunity to appear before you today. The slide presentation that I’ve got up on the screen, and I apologize for not giving you advance copies. I finished this this morning, and I was on another case yesterday.

I’ll be glad to provide copies, and put copies into the record if you’d like, and I have provided copies for all the commissioners and staff, and AAR this morning, just a few minutes ago.

What the slide presentation does basically is it summarizes the points that we made in the testimony that we filed, and just a few additional points in there that, I think, support the advisability of going with the recommendations that we’ve made.

First of all, I’m appearing before you today on behalf of my company. We have more than a passing interest in the procedures that impact rail negotiations and litigation. It’s a large part of
our business.

We have been engaged in this business for about 34 years. I’ve been with this company for 17 years. I have participated in numerous negotiations, and I have appeared as a witness in two stand-alone cost cases. One of them -- I think of them both as successful, but ultimately in McCarty Farms, after a decade or so of appeal, went the other way. The other case was a coal case, which was successful.

Throughout that process, however, our practice relies primarily on commercial litigation, private negotiations, private negotiations. Very seldom if ever do I even consider bringing a matter to the Board.

What I would like to do is to recommend to you a fairly small adjustment in your process, that would enable my clients to access the wisdom that’s built up here at the Board.

The first slide. First of all, I believe that small shipment rail rates is an important economic issues. There are many small
shipment rail rates, small shipment as we’re defining it, that are extraordinarily high.

Now what I’m describing is similar to the database or the experience base that Mr. Rennicke referred to a few minutes ago, i.e., he was referring to his experience, and I’m relying on mine.

Over the years, I’ve analyzed thousands of lanes for dozens of companies. The data that we find there is that frequently we will find very high RCRs on some of these lines.

Next slide. I also agree with Mr. Rennicke that the rates, some are high, some are low. Here’s the pattern that we find. Where we have competitive rail access at the origin, hopefully also at the destination but even at the origin, we will develop a baseline RCR for that particular traffic group.

That may move up or down, depending on the commodity that we’re talking about, depending on the area of the country or what have you. So the baseline RCR that we’ll encounter for a given
shipper’s traffic base will vary.

However, what tends not to vary is the effect of the absence of competition. If we have a situation where there is access to only one railroad, then we can look for a fairly substantial increase in the RCR as we enter the situation.

If we have a situation where there is restricted access to competition, which I define as trackage rights or haulage rights, then they’ll be a slight increase typically in the base level RCR.

So even the presence of moderate competition has a fairly noticeable effect.

Now these are basically STB (ph) data. What we have here is the actual RCR as reported. The footnote that’s at the bottom of the screen, refers back to the STB decision on May 17th in this particular case. These patterns hold over the years.

If we were to use a different year or a different group of years, these patterns would hold. Overall, the actual RCR off-rate in this particular year was 133 percent. On the highest rated freight,
that is to say the freight that has a revenue-cost ratio greater than 180 percent, we find the RCRs that are described here, which are considerably higher.

The point that I’m driving at here is the balance of the burden, if you will, between off rate, lower rated freight, and the freight which is bearing the highest revenue-cost ratio.

Now another way to look at that, and this again, this is STB data that I’m presenting to you, if you look at the share of revenue -- this is off the waybill sample, the non-confidential sample -- if we look at the share of revenue with RCR above 180 percent, we find that it varies widely by commodity.

If we have chemicals at issue, and this again -- these relationships are very stable.

CHAIRMAN NOBER: Okay. You have to go to your recommendations and try to wrap up. Let me go to the next --

MR. O’CONNOR: Sure.

CHAIRMAN NOBER: I’m holding everybody
to their time today.

MR. O’CONNOR: Okay, let me go to the next slide, because I want to show you one thing.

Back one slide. Chemicals as a commodity, 61 percent. If those chemicals go offshore and come back as intermodal, then only four percent of that traffic group is going to have an RCR above 180 percent.

Let me show you one more graph, and then we’ll go to the recommendations. This graph is showing you chemicals trade. It’s showing you that imports have now outpaced exports.

It’s going in the wrong direction. When that particular traffic group, when that production capacity goes offshore, it tends to stay offshore. When it comes back into the U.S., it will tend to come back, from the railroad standpoint now, as lower rated traffic.

Now looking at the remedies. We’ve heard a fair amount of discussion about this already this morning. Commercial negotiations can be very challenging in captive lines. That’s predictable.
The STB maximum rate case, $3 million and a three-year delay for an uncertain outcome really isn’t feasible for small shipments. STB-assisted mediation, I would welcome that.

I would also make it binding, but make it voluntary. I didn’t specify those two points in my testimony. I would make it binding and voluntary.

Now over the years we’ve participated in, it’s hard to say, dozens, maybe hundreds of negotiations. The two SAC cases that I’ve mentioned to you. We have also participated as an expert witness in mediation, and have also participated as an expert witness in arbitration. So I have experience in all four of those.

The one that I would prefer and recommend to you, largely for the reasons you’ve already heard today, is mediation. So the recommended remedies, commercial negotiations. I would let that run.

We’re doing fine, and usually we will not need your help. In the vast majority of cases
we will not need your help, and we will not ask for it. But where we do ask for it, we like for it to have STB-assisted mediation.

Now finally the recommended action plan, which is virtually verbatim out of my testimony; it appears in there three or four times.

First of all the predicate is that we go first to commercial negotiations. We do not come first to the STB.

Secondly, we focus on lanes. That is to say, I would recommend bringing to you only those lanes where we cannot negotiate; we’ve reached an impasse and we cannot negotiate to an agreement, a mutually acceptable agreement, and the revenue-cost ratio is at greater than the regulatory threshold, and rail or other modal competition is not available, not economically and practically available.

So I’m trying to address here the market dominance requirements, and the regulatory threshold requirements. Secondly, the traffic would not be exempt, would not be under contract, it would not be
one of the exempt commodities. That again is going
to eliminate a fair amount of traffic.

I think if I was following correctly the
numbers that Craig had, he had contract numbers in
his $3 billion. Of course, you would not address a
contract case. Then we would use the RCR guidelines
as a fact base upon which to begin discussions to
call on in recommended mediation. So we need a fact
base.

I would use the three that you’ve
developed. The RCR on comparable moves, your RCM
benchmark with an efficiency adjustment. Then part
of what you would mediate and discuss would be
whether it applies and if so, under what efficiency
would you be operating. And then your RCR actual.

Those are the numbers that I showed you
earlier today, in the earlier slide. Now the fourth
point, a lot of the prior witnesses have commented
upon, and from a public policy standpoint it almost
cries out for some kind of a change.

From my standpoint, I’m not engaged in
public policy. I’m engaged in trying to get one
transaction done after another. The fact that this resource and recourse is not available to me is regrettable, and I would like to -- in this recommendation I would like to make it available to you.

I have the greatest respect for the STB. Indeed, I began my career here many years ago, and I understand the railroad viewpoint. I was formally a VP of Economics. I was Craig’s predecessor, and as a matter of fact recruited Craig to replace me, with some resistance, I might add.

Prior to that, I was assistant director of Cost and Economics for Conrail. Prior to that, I was on the team that created Conrail out of what was deemed to be a hopeless situation.

I think this is doable. Getting this fixed is doable. Tougher things have been done, and I think you can do it. With that, I conclude my remarks.

CHAIRMAN NOBER: Okay. Well again, thank you both for your thoughtful presentations.

Commissioner Mulvey, you’re up.
VICE CHAIRMAN MULVEY: Thank you.

Gordon MacDougall, first to you. I want to apologize to you for not having copies of the testimony beforehand.

I think it’s useful if the people that are participating have seen what the others are going to be saying, so that they can respond to that. I think it could improve the overall dialogue.

This particular case, because of an internal glitch, I didn’t get the copies myself until fairly late. But I think it’s a good idea for you to get the stuff in advance.

You commented that we shouldn’t have staff-led hearings. I would like if you wanted to expand on that a little bit, because to some extent, we look at staff-led hearings, in part, because we have resource constraints and time constraints, and sometimes the staffs are the ones who are capable of doing it, in some situations.

MR. MACDOUGALL: I think there’s no problem with staff, you know, assisting you. But to
have a hearing, a public hearing out in Wisconsin or wherever, conducted by a person who doesn’t have the qualification or tenure that an ALJ has, or that the public responsibility that the commissioner has, to instead have an ordinary staff person.

Particularly when the staff is not a separated staff. You’ll have the staff of an aggregate case judging a case. I just think that this agency could have a higher qualified individual for hearings than just an ordinary staff person.

I might say the FRA has staff people hearings. I’ve been to some of those. Those are on very technical matters in the field. It’ll be like a grade crossing or something like that.

Even there, the staff doesn’t get the same respect that you would with a person like an administrative law judge coming out there or some Board member coming out.

VICE CHAIRMAN MULVEY: Yes. I would call them extraordinary staff rather than ordinary staff, but --

MR. MACDOUGALL: They don’t have the
tenure that an ALJ has.

VICE CHAIRMAN MULVEY: I understand

that. You mentioned about how rates are determined,
and you know, basically the rates today are largely
market-determined rather than cost-determined.

You mentioned Ripley’s formula or
Ripley, rather. Of course, Ripley developed his
formula for a railroad cost. At that time during
the ICC regulation, it was cost that drove rates.

We tend to rely on the market today,
than only rely on the cost analyses when we have a
market dominance and we have cases where market we
have market failure.

So I wasn’t quite sure what you were
saying. I didn’t understand you.

MR. MACDOUGALL: Well, you may be right.

But you may find that rates aren’t made that way,
that the way you judge rates are not the way rates
are made. In the real world, it’s rate comparisons.

What’s the other guy getting?

You may find that, if you get into it,
that maybe the old system still applies today, and
the rates are not based on cost. They’re based on markets. They’re based on geographic competition, market competition.

You may find that this thing here is just not the real world, what’s going on here at the STB. It’s really not in the real world. Maybe that’s why the shippers don’t want to file complaints, the small shippers. They look at it and say what’s this? You know, what is all this. That’s not how rates are made.

Maybe you’ll find, maybe I’m wrong. But I suspect a little research might be helpful.

VICE CHAIRMAN MULVEY: Tom, I had a question. On page three, I was a little bit confused about your presentation here, when you said the revenue to cost ratio, and then that 100 RCR points covers all other variable costs.

You mean the rail to variable ratio, right?

MR. O’CONNOR: Sure, that’s right.

VICE CHAIRMAN MULVEY: So 180 is 80 percent of variable costs. 180 would be the RVC, in
your terms, of what we would use, 80 percent above variable costs.

MR. O’CONNOR: Yes. Let’s just refresh on the map there. If we have a revenue cost ratio of 100 percent, that means that that movement is covering all of its variable costs, as determined by IRCs.

VICE CHAIRMAN MULVEY: Then on your page four, the 280, 236, 207 means they’re all covering more than twice variable costs?

MR. O’CONNOR: That’s correct.

VICE CHAIRMAN MULVEY: Okay. That’s all I wanted. Okay.

CHAIRMAN NOBER: Well, I have no questions, and I think Commissioner Buttrey has one.

MR. O’CONNOR: I have a clarification. The resistance to Craig came from Craig. Everybody else was on board with that.

VICE CHAIRMAN MULVEY: Oh, okay. I have another question, then, if you don’t mind. You were talking here about some of the commodities that are going offshore.
Are you saying that these commodities are going offshore largely because they, because of railroad rates, and that this is a driving factor in us losing, say, chemical manufacturing? Are there really a lot of other issues driving this, rather than simply railroad rates.

MR. O’CONNOR: There are a lot of issues. Rail rates is a contributing factor here, and the tenor of the discussion with the railroads is also a contributing factor. I think that both of those would be assisted by your involvement, because you would be able to break an impasse that could contribute to this.

This is quite an unfortunate pattern, and in fact it has been -- we’ve been negative with Europe for quite some time. We’re negative with parts of Asia now and losing ground in the race. The only place where we have a positive trade with chemicals is in Africa, and we are investing hugely with chemical production in Africa.

So this is not a good pattern. Not a good pattern for chemicals, not a good pattern for...
U.S. labor, not a good pattern for the railroads if, when it comes back, if you give me that previous slide, if they are losing traffic that’s generating RCRs, 61 percent of which are above 180 percent, in order to win the return trip on miscellaneous mixed shipments.

Now that is not all intermodal, but it’s, we believe, substantially intermodal. You could check that with your staff. Only four percent of that is above 180. That’s not a good trade from the railroad perspective. This should be something we can work together and solve.

VICE CHAIRMAN MULVEY: Well, one last point. Your system for mediation calls for it being binding and voluntary, whereas the AAR was non-binding but mandatory.

It strikes me that the AAR’s suggestion, would result in a lot of talk but does not require us to do anything. In your situation, you’re required to do something, but you’re not required to talk.

MR. O’CONNOR: Here’s where I would take
that, Vice Chairman Mulvey. In the mediation in which I’ve participated, it concluded, that particular case, which I won’t go into the details of, concluded a dispute that had been going on for more than a decade.

The parties were not 100 percent happy with the outcome. But they had finally exhausted themselves so much that they agreed to binding mediation, and they walked away from it, and the deal stayed done. So that’s what I’m driving at.

CHAIRMAN NOBER: I’m not sure the difference between binding mediation and arbitration. But I’m sure --

MR. O’CONNOR: Arbitration really is more like litigation. You have -- and here’s the basic premise.

CHAIRMAN NOBER: What’s binding in the mediation? The mediator’s decision?

MR. O’CONNOR: Yes. The mediator will walk the one party to the other.

CHAIRMAN NOBER: Do you know what arbitration would be?
MR. O’CONNOR: I’m sorry?

CHAIRMAN NOBER: And the difference between that and arbitration then is?

MR. O’CONNOR: Arbitration, you basically put your case on, and you hope you have been persuasive to your arbitration panel. But they are really in quite a similar position to the three commissioners now.

You will decide. You will take the evidence before you and you will decide, as opposed to trying to construct, working with the parties that have come to you --

CHAIRMAN NOBER: It’s more interactive.

MR. O’CONNOR: Exactly. That’s the key, is the back and forth.