

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

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

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

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

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1 our business.

2 We have been engaged in this business  
3 for about 34 years. I've been with this company for  
4 17 years. I have participated in numerous  
5 negotiations, and I have appeared as a witness in  
6 two stand-alone cost cases. One of them -- I think  
7 of them both as successful, but ultimately in  
8 *McCarty Farms*, after a decade or so of appeal, went  
9 the other way. The other case was a coal case,  
10 which was successful.

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

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

20 The first slide. First of all, I  
21 believe that small shipment rail rates is an  
22 important economic issues. There are many small

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1 shipment rail rates, small shipment as we're  
2 defining it, that are extraordinarily high.

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

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

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

19 That may move up or down, depending on  
20 the commodity that we're talking about, depending on  
21 the area of the country or what have you. So the  
22 baseline RCR that we'll encounter for a given

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1 shipper's traffic base will vary.

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

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

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

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

19           If we were to use a different year or a  
20 different group of years, these patterns would hold.  
21 Overall, the actual RCR off-rate in this particular  
22 year was 133 percent. On the highest rated freight,

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1 that is to say the freight that has a revenue-cost  
2 ratio greater than 180 percent, we find the RCRs  
3 that are described here, which are considerably  
4 higher.

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

9 Now another way to look at that, and  
10 this again, this is STB data that I'm presenting to  
11 you, if you look at the share of revenue -- this is  
12 off the waybill sample, the non-confidential sample  
13 -- if we look at the share of revenue with RCR above  
14 180 percent, we find that it varies widely by  
15 commodity.

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

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

21 MR. O'CONNOR: Sure.

22 CHAIRMAN NOBER: I'm holding everybody

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1 to their time today.

2 MR. O'CONNOR: Okay, let me go to the  
3 next slide, because I want to show you one thing.  
4 Back one slide. Chemicals as a commodity, 61  
5 percent. If those chemicals go offshore and come  
6 back as intermodal, then only four percent of that  
7 traffic group is going to have an RCR above 180  
8 percent.

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

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

19 Now looking at the remedies. We've  
20 heard a fair amount of discussion about this already  
21 this morning. Commercial negotiations can be very  
22 challenging in captive lines. That's predictable.

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1                   The STB maximum rate case, \$3 million  
2                   and a three-year delay for an uncertain outcome  
3                   really isn't feasible for small shipments. STB-  
4                   assisted mediation, I would welcome that.

5                   I would also make it binding, but make  
6                   it voluntary. I didn't specify those two points in  
7                   my testimony. I would make it binding and  
8                   voluntary.

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

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

21                  We're doing fine, and usually we will  
22                  not need your help. In the vast majority of cases

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1 we will not need your help, and we will not ask for  
2 it. But where we do ask for it, we like for it to  
3 have STB-assisted mediation.

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

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

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

19 So I'm trying to address here the market  
20 dominance requirements, and the regulatory threshold  
21 requirements. Secondly, the traffic would not be  
22 exempt, would not be under contract, it would not be

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1 one of the exempt commodities. That again is going  
2 to eliminate a fair amount of traffic.

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

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

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

21 From my standpoint, I'm not engaged in  
22 public policy. I'm engaged in trying to get one

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1 transaction done after another. The fact that this  
2 resource and recourse is not available to me is  
3 regrettable, and I would like to -- in this  
4 recommendation I would like to make it available to  
5 you.

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

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

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

20 CHAIRMAN NOBER: Okay. Well again,  
21 thank you both for your thoughtful presentations.  
22 Commissioner Mulvey, you're up.

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1                   VICE CHAIRMAN MULVEY: Thank you.  
2                   Gordon MacDougall, first to you. I want to  
3                   apologize to you for not having copies of the  
4                   testimony beforehand.

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

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

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

21                  MR. MACDOUGALL: I think there's no  
22                  problem with staff, you know, assisting you. But to

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1 have a hearing, a public hearing out in Wisconsin or  
2 wherever, conducted by a person who doesn't have the  
3 qualification or tenure that an ALJ has, or that the  
4 public responsibility that the commissioner has, to  
5 instead have an ordinary staff person.

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

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

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

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

22 MR. MACDOUGALL: They don't have the

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1 tenure that an ALJ has.

2 VICE CHAIRMAN MULVEY: I understand  
3 that. You mentioned about how rates are determined,  
4 and you know, basically the rates today are largely  
5 market-determined rather than cost-determined.

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

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

14 So I wasn't quite sure what you were  
15 saying. I didn't understand you.

16 MR. MACDOUGALL: Well, you may be right.  
17 But you may find that rates aren't made that way,  
18 that the way you judge rates are not the way rates  
19 are made. In the real world, it's rate comparisons.  
20 What's the other guy getting?

21 You may find that, if you get into it,  
22 that maybe the old system still applies today, and

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1 the rates are not based on cost. They're based on  
2 markets. They're based on geographic competition,  
3 market competition.

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

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

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

18 You mean the rail to variable ratio,  
19 right?

20 MR. O'CONNOR: Sure, that's right.

21 VICE CHAIRMAN MULVEY: So 180 is 80  
22 percent of variable costs. 180 would be the RVC, in

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1 your terms, of what we would use, 80 percent above  
2 variable costs.

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

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

11 MR. O'CONNOR: That's correct.

12 VICE CHAIRMAN MULVEY: Okay. That's all  
13 I wanted. Okay.

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

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

19 VICE CHAIRMAN MULVEY: Oh, okay. I have  
20 another question, then, if you don't mind. You were  
21 talking here about some of the commodities that are  
22 going offshore.

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1                   Are you saying that these commodities  
2                   are going offshore largely because they, because of  
3                   railroad rates, and that this is a driving factor in  
4                   us losing, say, chemical manufacturing? Are there  
5                   really a lot of other issues driving this, rather  
6                   than simply railroad rates.

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

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

21                  So this is not a good pattern. Not a  
22                  good pattern for chemicals, not a good pattern for

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1 U.S. labor, not a good pattern for the railroads if,  
2 when it comes back, if you give me that previous  
3 slide, if they are losing traffic that's generating  
4 RCRs, 61 percent of which are above 180 percent, in  
5 order to win the return trip on miscellaneous mixed  
6 shipments.

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

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

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

22 MR. O'CONNOR: Here's where I would take

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1 that, Vice Chairman Mulvey. In the mediation in  
2 which I've participated, it concluded, that  
3 particular case, which I won't go into the details  
4 of, concluded a dispute that had been going on for  
5 more than a decade.

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

11 CHAIRMAN NOBER: I'm not sure the  
12 difference between binding mediation and  
13 arbitration. But I'm sure --

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

17 CHAIRMAN NOBER: What's binding in the  
18 mediation? The mediator's decision?

19 MR. O'CONNOR: Yes. The mediator will  
20 walk the one party to the other.

21 CHAIRMAN NOBER: Do you know what  
22 arbitration would be?

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1 MR. O'CONNOR: I'm sorry?

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

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

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

13 CHAIRMAN NOBER: It's more interactive.

14 MR. O'CONNOR: Exactly. That's the key,  
15 is the back and forth.

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