UNITED STATES OF AMERICA

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SURFACE TRANSPORTATION BOARD

PUBLIC HEARING

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

EX PARTE 646 (SUB-NO. 1)

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WEDNESDAY, JANUARY 31, 2007

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The Public Hearing convened in Hearing Suite 760, 1925 K Street, N.W., Washington, D.C. 20423-0001, pursuant to notice at 9:00 a.m., Chairman Charles Nottingham, presiding.

SURFACE TRANSPORTATION MEMBERS PRESENT:

CHARLES NOTTINGHAM	Chairman
DOUGLAS BUTTREY	Vice Chairman
FRANCIS MULVEY	Commissioner

PANEL I: GOVERNMENT

PAUL S. SMITH	UNITED STATES DEPARTMENT OF TRANSPORTATION

PANEL II: SHIPPERS/TRADE ASSOCIATIONS

NICHOLAS J. DIMICHAEL	INTEREST PARTIES (JOINT SHIPPER GROUP)
ANDREW P. GOLDSTEIN	INTEREST PARTIES (JOINT SHIPPER GROUP)
THOMAS D. CROWLEY	INTEREST PARTIES (JOINT SHIPPER GROUP)
GERALD W. FAUTH III	INTEREST PARTIES (JOINT SHIPPER GROUP)

PANEL II: SHIPPERS/TRADE ASSOCIATIONS (cont.)

DAN MACK	NATIONAL GRAIN AND FEED ASSOCIATION
DOUG KRATZBERG	NATIONAL INDUSTRIAL TRAFFIC LEAGUE
CURT WARFEL	NATIONAL INDUSTRIAL TRAFFIC LEAGUE

PANEL III: SHIPPERS/TRADE ASSOCIATIONS

JEFFREY O. MORENO	DOW CHEMICAL COMPANY
STEVE SHARP	ARKANSAS ELECTRIC COOPERATIVE CORPORATION
MICHAEL W. SNOVITCH	ALLIANCE FOR RAIL COMPETITION
TOM O'CONNOR	SNAVELY KING MAJOROS O'CONNOR & LEE

PANEL IV: LABOR

GORDON P. MACDOUGAL	UNITED TRANSPORTATION UNION-GENERAL COMMITTEE OF ADJUSTMENT

PANEL V: RAILROADS

SAMUEL M. SIPE, JR.	ASSOCIATION OF AMERICAN RAILROADS
RICHARD E. WEICHER	BNSF RAILWAY COMPANY
LOUISE A. RINN	UNION PACIFIC RAILROAD COMPANY

PANEL VI: RAILROADS

THEODORE K. KALICK	CANADIAN NATIONAL RAILWAY COMPANY
TERENCE M. HYNES	CANADIAN PACIFIC RAILWAY COMPANY
G. PAUL MOATES	CSX TRANSPORTATION, INC. NORFOLK SOUTHERN RAILWAY COMPANY
WILLIAM A. MULLINS	KANSAS CITY SOUTHERN RAILWAY COMPANY

I-N-D-E-X

P-R-O-C-E-E-D-I-N-G-S

(9:00 a.m.)

CHAIRMAN NOTTINGHAM: Good morning. I'd like to extend a warm welcome to all of our panelists and other guests. Today we will be further examining our proposed procedures for addressing small rate cases. This proceeding reflects the second step in the Board's efforts begun by my fellow commissioners to use its rule making authority to reform the rail rate dispute resolution process.

In October of 2006, we concluded the first step in that initiative by revising the methodology used to address large rate disputes. We have now turned our attention to the task of reforming our procedures and standards for smaller disputes. Through this proceeding, we seek to bring some certainty to the questions of who has access to the small rate case process and how a case will be handled by the Board once a complaint is filed.

I recognize that there has already been an extensive record developed in this proceeding,

both through two prior hearings as well as through the large amount of comments received on the proposed procedures.

I look forward to hearing your testimony today, particularly with regard to the issues that were noticed in our January 22, 2007 decision. I'm especially looking forward to hearing your views on the eligibility standard as proposed in the initial rule as modified in our January 22nd decision or any other alternatives you might have. It is my goal to finalize procedures that are accessible, workable, affordable and fair to all parties.

On a separate matter, I'd like to make a public service announcement about the STB's relocation plans. As many of you are aware, we will be moving to a new headquarters located at 395 E Street Southwest sometime, they tell us, in late February or more likely early March. Please note that we will not only have a new address but new phone numbers as well. Our email addresses will remain unchanged. We'll keep our website updated with the current information so that you'll know how

to reach us. I believe that you will enjoy our new space, particularly our public spaces, the library, the hearing room and the filing room which will be readily accessible -- I'm sure this will be music to folks' ears this morning after waiting for elevators as I know we all did -- accessible on the ground floor.

While we'll do our best to minimize disruption during the move, you can expect that normal business operations will be suspended for approximately two business days during the move. During that time, we will not accept normal case filings and our email system will be down. But we will make certain that the agency can be reached should an emergency situation arise.

I also understand that our library's contents will be inaccessible over a two-week period immediately prior to the agency's move. We'll provide details in a press release that will be issued shortly, and you can keep your eye on our website for further information.

Now before we begin, let me just take a

few minutes to review a few procedural points about today's hearing. We will hear from panels with breaks as appropriate. We will hear from all the speakers on a panel. Speakers, you will see a green light when you have one minute remaining in your allotted time and a red light when your time has expired. After hearing from the entire panel, we will rotate with questions at five minutes per Board member until we've exhausted the questions. Consistent with Board practice, we will allow all the witnesses on each panel to make full presentations before the members ask any questions. Finally, just a reminder to please turn off your cell phones.

So with that, I certainly look forward to a very interesting day of testimony. I know I have some questions, and I'm sure that my fellow commissioners do as well. And with that, I will recognize Vice Chairman Buttrey for any opening statement he may have. Vice Chairman Buttrey?

VICE CHAIRMAN BUTTREY: Thank you, Mr. Chairman. This exercise is sort of reminiscent to

me of the attempts on the part of the Congress from time-to-time to revise the tax code. I don't know how many pages it is, but someone, I think, said it was 13,000 pages at some point, and the bill to revise the tax code was 23,000 pages -- so this effort has turned into a herculean task it seems. This is the volume of comments that we've reviewed for this hearing today, and we're looking forward to hearing all the witnesses that will appear. We obviously have to do what we're doing because the Congress told us we had to do it, and we'd probably be doing it anyway.

But I am very concerned, personally, about the situation that's presented by the issues in this case. They've been of interest to me even before I came here when I started to learn more about rail regulation, and they're of great interest to me. And I'm particularly concerned about shippers having access to a system that allows them some opportunity to address their concerns. And so that's going to be one of my major concerns as I listen to testimony today. Thank you, Mr. Chairman.

CHAIRMAN NOTTINGHAM: Commissioner Mulvey.

COMMISSIONER MULVEY: Thank you, Chairman Nottingham. I'd like to join Chairman Nottingham and Vice Chairman Buttrey in their remarks. The Congress has directed the Board to develop procedures that would allow shippers, the value of whose case would not justify bringing a case under our full stand-alone course guidelines, to have access to board review of railroad rates under less costly procedures.

Now this issue has been before the Board and its predecessor agency, the ICC, for over 20 years, and those making relatively small shipments are still without meaningful access. And this is simply unacceptable. I share the frustration of those who have long waited for the Board to clarify the current guidelines. And we have issued a notice of proposed rule making, and we have received a great many comments from shippers, railroads, trade associations and government agencies. And because of the extent of these comments and because

addressing many of them would entail significant changes to our proposed final rule, it is important that we have today's hearing before going forward. The stake's are simply too high not to get it right. And whatever the specifics of the final rules is that we adopt, it must satisfy three fundamental criteria.

First, it must meet the congressional directive that we make our procedures accessible to virtually any shipper whose traffic is regulated by the Board to bring a case if he or she believes their rate to be unreasonable. In the comments we receive, many shippers suggested that the proposed eligibility criteria would make it impossible for most shippers to justify bringing a case. I want those shippers to know that we hear their concerns and that we are taking them very seriously as we work towards a final rule. I hope that some of the new approaches we discuss here today will go a long way towards ensuring that we meet the spirt of the congressional directive.

Second, any final rule must be able to

withstand judicial review. Adopting a rule that would not be accepted by the courts will only further delay the establishment of a workable solution.

And finally, the rule must recognize the economics of the railroad industry and the right of railroads to charge rates via differential pricing that will, in the aggregate, allow them to cover costs and earn a fair return on invested capital. This is a tall order. It has required a tremendous amount of time and effort on the part of the Board's staff and for their continued dedication to this cause, I commend them.

In addition, I want to applaud the staff for their very difficult and critical work that they recently completed on the fuel surcharge issue.

With that, I look forward to hearing the testimony from today's witnesses and with those inputs, I am hopeful that we can soon come to a final rule. Thank you, Mr. Chairman.

CHAIRMAN NOTTINGHAM: Thank you, Commissioner Mulvey and Vice Chairman Buttrey.

We'll now proceed with the panels. Our first panel is a panel of one representing the United States Department of Transportation. I'd like to invite Paul S. Smith to come forward and address the Board for five minutes. Welcome, Mr. Smith. It's good to have you here.

MR. SMITH: Thank you, Chairman. Good morning, Chairman Nottingham, Vice Chairman Buttrey, Commissioner Mulvey. My name is Paul Samuel Smith, and today it is once again my distinct privilege to represent the United States Department of Transportation. The Surface Transportation Board in this proceeding continues the very difficult task of finding ways to provide meaningful opportunities for shippers to seek regulatory relief from rail rates they consider to be unreasonably high. The only process and standards today in use for that purpose, the stand-alone cost methodology, both incorporates fundamental principles of railroad economics, and it constrains the pricing of carriers who are otherwise in a dominant position with respect to their shippers. The problem, of course, is that the SAC

methodology is far too expensive for all but a handful of cases.

Mindful of the fact that the Department does not participate in usual rate adjudications and is therefore without some of the practical knowledge held by those who do, I want to briefly summarize the Department's basic position. First, of course, we applaud the various serious effort under way to adopt useless standards for shippers and carriers.

The Board's proposals to simplify and streamline rate cases have real promise, but they do require further clarification and particularly explanation or demonstration, show how they would work in practice in order to answer all manner of questions, particularly those considering the relationship between the outcomes in SAC cases and those that would arise from the pending proposals and their variations. Moreover, to the extent simplification entails increased reliance on broad industry costs, the accuracy and reliability of the regulatory URCS system that is the repository of that information becomes all the more important, and

so therefore warrants updating.

We have also expressed reservations about the proposed eligibility standards for each alternative to SAC, to simplify SAC and to modify three benchmark options and to the estimated costs of pursuing rate cases. We strongly favor mediation as a preliminary step in all cases generally. More recently, the Board has asked the parties to focus today on potential refinements of its original proposals, which refinements were put forth in response to comments already received, and I'll turn to these now.

First, the Department support further exploration of limiting the amounts recoverable in rate cases based upon shippers' identification of the actual value of their cases rather than upon their maximum.

Second, we favor elimination of the aggregation rule subject to revisiting that subject if there is actual evidence of manipulation by shippers in order to qualify for a less expensive and less accurate alternative.

Third, the Department does not believe that language in 49 U.S.C. 10701(d)(3), by its terms, limits the Board to a single non-SAC alternative. In these circumstances, the Board has ample discretion to interpret and apply the statutory language within reasonable bounds.

The Department also supports a presumption that the predominant route should be used in simplified SAC cases. Not only would this reduce costs but consistent use of a route by a railroad should tend to reflect its most efficient or optimal route. Shippers, however, should be free to offer rebuttal evidence of demonstrably more efficient alternative routes.

Finally, the Department does not favor limiting the source of comparison groups for use in modified three benchmark cases to defendant railroads only. The purpose of this exercise is to identify a sample of shipments with similar characteristics. Shippers may well need to draw shipments from several railroads in order to obtain a sample of sufficient size. We do, however,

consider that comparison groups should not be drawn from traffic moving pursuant to contracts. The array of terms and the inter-relationship of services, rates and other conditions render contract traffic qualitatively dissimilar to non-contract traffic for comparison purposes.

That concludes my brief prepared remarks. I'll now be pleased to try and answer any questions you may have.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Smith. If I could just lead, I'll be brief. You mentioned in your remarks that the appropriate interpretation of the statute need not constrain us, if I heard you correctly, to looking at just one SAC alternative?

MR. SMITH: That's our view, yes.

CHAIRMAN NOTTINGHAM: Could you expand on that a little bit just to make sure I understand fully what the -- what you had in mind?

MR. SMITH: We think that Congress would have been far more stringent, far more careful in its use of language in the statute if it had

intended for you to have only one alternative to the SAC methodology which, of course, covers such a very, very small percentage of shippers and shipments in the country. It just -- it's more reasonable to expect that, with the language they do use, in our opinion, that they allow the Board leeway to adopt reasonable measures that would encompass the very many thousands of shippers and the kinds of shipments that they have and that one size or just two sizes doesn't necessarily fit all.

CHAIRMAN NOTTINGHAM: Thank you. Just one more question. Your -- near the end of your remarks, you discussed the distinction between contract traffic and non-contract traffic and the Department's view that contract traffic should not be considered as part of the -- our analysis in these cases. Would your -- would that position change if a greater -- substantially greater proportion of overall traffic were to be moving under contract? I mean if you got to a point in time where, I don't know, just pick a big round number, 75 percent of traffic were to be moved --

moving under contract, would you -- could you get to a point in time where not looking at contract traffic doesn't -- you know, would prevent you from having sort of statistically significant samples, so to speak, to look at?

MR. SMITH: I couldn't foreclose that at this juncture. Certainly, one could hypothesize a situation in which it would be statistically extremely difficult to accumulate a valid enough sample size if such an overwhelming portion of traffic moved according to contracts only. We don't believe that's the case now, and so under the present circumstances, we just would not favor the use of contract traffic for these comparison groups.

CHAIRMAN NOTTINGHAM: Thank you. Vice Chairman Buttrey?

VICE CHAIRMAN BUTTREY: No questions.

CHAIRMAN NOTTINGHAM: Commissioner Mulvey?

COMMISSIONER MULVEY: Just briefly. It's been suggested that we test proposals for the three benchmark and the simplified SAC proposal

before we adopt them, or if we do adopt them, test them before we apply them. Do you see how the Board could actually test these before we apply them, and would the Department be able to assist the Board in whatever costs we'll incur in testing these proposals?

MR. SMITH: We would be very willing to assist the Board in any of these demonstrations. We think it is important because in this case, although, as I've said, we don't have the experience that comes with pursuing these cases ourselves, those who do have put before the Board in the record virtually a parade of horribles totally different, of course, as to what might happen if this variation or that variation were adopted.

We're somewhere in the middle. We don't know for sure how it will work out, but we think that since especially one of the main purposes, if not the main purpose of this entire proceeding is to expand the access which now really doesn't exist, it is to encourage participation, predictability and so forth. But the only way that could happen, in our

view, is if the Board does indeed conduct some demonstration projects to show how it would select a sample of comparison group, how it would -- how one issue adopted or not adopted would affect the outcome and how the parties are able to see, therefore, as well how the outcome would change and how close it would be or not close it would be to an SAC kind of outcome.

COMMISSIONER MULVEY: One of the difficulties is we probably would have to document several of them in order to show that under different circumstances, we still replicate as closely as possible the SAC outcomes, so it could be a --

MR. SMITH: Granted.

COMMISSIONER MULVEY: -- long and expensive proposition. Thank you.

CHAIRMAN NOTTINGHAM: Just that Commissioner Mulvey's question stimulated one more from me, Mr. Smith. Thank you for your patience. On that issue, that very question of whether or not the Board should test a simplified SAC process

before implementation, could you help me think through the benefits of that with any experience the Department might have in the context of your many complex rule makings on difficult issues? I know from my time at the Department, there are a few over there that cross the modes, and does the Department have some examples of testing rules to give stakeholders some peace of mind as to exactly how they would be implemented once the rules are finalized?

MR. SMITH: At this moment, I personally do not, but I'd like to seek permission to perhaps get back to you as soon as possible on that. I can make a quick survey of the various modal administrations. I know that we don't -- we are -- predominantly either a grant or a safety agency, and therefore, I guess I would project that we probably don't have too many, if any, rate making kinds of responsibilities, but let me do a quick check and see if there's anything that might be useful for you.

CHAIRMAN NOTTINGHAM: Please. That

would be helpful if you could. And I will note that the record in this proceeding will be open for some time. Towards the end of the month -- I believe it's the 26th of February it's posted, but -- so that would be helpful if you could. Thank you.

MR. SMITH: Certainly.

CHAIRMAN NOTTINGHAM: Any other questions from colleagues? Seeing none. Thank you, Mr. Smith, appreciate your time. We will now bring next panel up representing three groups. First and for the longest period of time, we have an interested parties group, a Joint Shipper Group represented by Nicholas J. DiMichael, Andrew P. Goldstein, Thomas D. Crowley and Gerald W. Fauth III, also, the National Grain and Feed Association represented by Dan Mack, and representing the National Industrial Transportation League, Doug Kratzberg and Mr. Curt Warfel. Welcome to all of you. I'll give you a minute to get settled there. We appreciate your participation, and we will be, I believe, starting from our left, your right end of the panel and working our way across if that works

for the group. Good. Without further ado, let me call on Mr. Warfel. Will you be taking the lead from your team?

MR. WARFEL: Yes, sir.

CHAIRMAN NOTTINGHAM: Okay. Please proceed and I note that you have ten minutes.

MR. WARFEL: Okay. Good morning. My name is Curt Warfel and I am a Manager, Logistics and Distribution at EKA Chemicals. I am also the chairman of the League. With me is Mr. Doug Kratzberg, Rail Planning and Operations Manager at Exxon Mobil Chemical Company. Mr. Kratzberg is the Chairman of the League's Railroad Transportation Committee composed of over 100 League members who are particularly interested in rail transportation.

First, we want to commend the Board for initiating this proceeding. The League participated in the proceeding which led to the adoption of the current guidelines in 1996 and has testified on the subject before the Board and Congress since then. While we are pleased that the Board has taken action, we have very serious concerns with the

current proposal. We believe that the changes that the Board has proposed will be of no value to almost all shippers and will likely worsen rather than solve the problems with the current rules and standards.

The League's views are contained in the comments of the interested parties which the League subscribed as well as in separate comments that the League submitted. Although the Board should consult these documents for the League's detailed views, key elements of our position include the following.

One, the League supports the Board's general concept that there should be a bright line eligibility standard for small rate cases with an opportunity to consider individual circumstances.

Two, the Board should withdraw its simplified stand-alone cost proposal.

Three, the Board should revise and increase its maximum value of the case or MVC eligibility threshold for full-SAC cases to 13.5 million dollars. If the Board retains a simplified SAC standard, the MVC threshold for such cases

should be 10.5 million dollars. All cases with an MVC less than these thresholds should be litigated under the three benchmark procedure.

Four, the Board should eliminate the aggregation rule.

Five, the League supports the Board's proposed revisions to the three benchmark standard although believes the Board should permit the introduction of other evidence.

Six, the League supports the Board's proposal to use unadjusted URCS in determining the three benchmark standard.

And seven, the League generally supports the Board's proposed procedures for three benchmark cases, but we believe the Board should permit a complainant access to information they need before the complaint is filed. The League also supports the railroad's suggestion for an expedited mandatory mediation process.

Now I'll talk just a few moments about some broader issues and concerns that have been raised by this case, and Mr. Kratzberg will discuss

some of the practical problems we see with the Board's proposed rules. Shippers need an effective, simple and expeditious method for resolving rate disputes. Most non-coal shippers do not transport sufficiently large quantities of goods in consistent volumes between the same two points for a long enough period of time to justify bringing a full stand-alone cost case. Moreover, because of the uncertainties in the current small case rules, shippers have been reluctant to enter into costly litigation when their eligibility for simplified procedures is unknown and when the likely outcome is far from clear. Thus, many shippers now have no effective way of satisfying their commercial need fora simple and expedited method for resolving rail rate disputes.

But the issues in this case are not just about the resolution of commercial disputes. It is also important relative to the continued use of rail transportation in the future. Unless rail shippers believe they can fairly, quickly and at a reasonable cost resolve rate disputes, they will be unwilling

to put their full confidence in rail transportation. They will ultimately find ways, as best they can, to avoid a mode where they have few commercial options and where they cannot resolve disputes quickly and effectively.

In a globalizing economy, it is more and more possible for them to manufacture goods elsewhere and ship finished products back here in containers. Now obviously the cost of rail transportation is only one of many factors that determine whether goods are made here or abroad, but make no mistake; it is a factor in the decision.

Rail shippers have an increasing need for a simple and expeditious method of resolving rate disputes. It is no secret that rail rates have been increasing rapidly as rail capacity has become constrained. The fact that prices go up when supply is tight is to be expected. Our members understand the laws of supply and demand. After all, they are in competitive markets and deal with this reality every day.

What is different about the rail

industry is that for many shippers, there are few competitive options to serve as a check on market power abuse. When there is no competition, how high is up? A balanced and effective regulatory review will provide an answer to that question to everyone's benefit.

The existence of a fast and simple method for resolving rate disputes will not result in a wave of litigation. Indeed, the very existence of a meaningful method to resolve rate disputes would be a vital tool to help shippers and carriers avoid those very disputes. Meaningful rate standards would permit shippers and carriers to predict a narrow range of probable outcomes for a case. This would provide incentives to both parties to reach a commercial agreement based upon that range, anticipated litigation costs and risks.

Conversely, the lack of a meaningful method for resolving rate disputes does not eliminate those disputes. It merely submerges them channeling them into unproductive commercial relationships and into increasingly urgent calls for

legislative action.

I'll now turn the discussion over to Mr. Kratzberg.

MR. KRATZBERG: Thank you, Curt. I'd like to speak for a few moments on some of the practical aspects of the Board's small rate case proposal. As you know, the Board has proposed small, medium and large case procedure. Litigation under the existing large-case stand-alone cost procedure takes three to four years and costs approximately 4 million dollars. The new medium case procedure which the Board calls simplified SAC is a less complex version of the full-SAC procedure, but it will still take approximately 18 months to litigate.

NIT League is aware that there is disagreement over the cost of the simplified SAC procedure. However, a large number of organizations, including the League, have submitted testimony that the litigation could cost well over 1 million dollars. The small-case category will cost much less and is proposed to take nine months.

Regarding eligibility that Chairman Nottingham and others have talked about already this morning, the Board's proposal establishes eligibility according to the concept of the maximum value of the case or the MVC. If the five-year MVC is more than $200,000.00, then the shipper is presumed to be ineligible for the small-size complaint procedure. Similarly, if the five-year MVC is more than 3.5 million, the shipper is presumed to be ineligible for the medium-size complaint procedure.

These proposed eligibility standards will prevent virtually every shipper from filing a case under the small rate case procedures. A movement of less than two carloads per month will likely move the shipper into the medium case category, a dispute that will require at least a year and a half and hundreds of thousands of dollars to resolve.

Similarly, a movement of less than one car per day will likely move the shipper into the large case category which, by the Board's own

estimation, will take three to four years and cost several million dollars.

The League believes that the Board's eligibility standards are off the mark and from a shippers perspective, they will provide relatively -- basically no benefit.

Now regarding the period of time to litigate a dispute, the time required to litigate a dispute under the Board's proposal, the time required for bringing a full stand-alone cost case renders the procedure useless for virtually all shippers and I just mentioned. The same is true of the simplified-SAC procedure. Litigation over a rail price that takes a minimum of 18 months would not be very useful to virtually all shippers.

That leaves the proposed small-case procedure which is proposed to be 270 days or less if there are no disputes regarding eligibility. The League would like to see that time period reduced to 180 days or less. As noted in the League's comments, a clearer eligibility standard would easily permit shortening of the proposed schedule.

On behalf of NIT League, Mr. Warfel and I have both remarked on the usefulness of the Board's full stand-alone cost procedure. With regard to the simplified-SAC procedure, a large group of industry associations have retained experts that have presented testimony to the Board that the cost for presenting a so-called simplified stand-alone case is many multiple times higher than the Board has estimated, likely well more than 1 million dollars. If the number is anywhere close to that figure or if there is a substantial uncertainty as to what the litigation cost will be, this will severely chill any desire for shippers to bring rate disputes to the Board.

I cannot close without talking briefly about the complexity to a shipper of the Board's proposed simplified stand-alone cost methodology. While perhaps these procedures were -- are simplified compared to the stand-alone cost procedures, the proposed simplified-SAC procedures are not simple under any definition of the word. The Board itself needed a 24-page, single spaced

appendix to explain just how to calculate two aspects of this simplified calculation.

The existing small-case procedures have the benefit of being grounded in comprehensible facts and numbers. Firstly, comparable rates. Second, rates and costs necessary to achieve revenue adequacy. And third, the amount of high rate of traffic on a railroad.

In contrast, the Board's so-called simplified-SAC procedures depend upon the calculation of a make believe railroad which, quite frankly, doesn't exist. From a shipper's standpoint, it's far better for the Board's maximum rate standard, at least in smaller cases, to be grounded on real and understandable facts.

In conclusion, while the League welcomes changes to the small-rate case methodology, the League is disappointed by proposed revisions. The Board's eligibility presumptions for both the small -- or both the medium and the small-case procedures are set so low as to effectively eliminate any chance that a smaller rate case would be brought

before the Board. Many rail rate disputes would fall into extremely expensive, lengthy and complex full stand-alone cost procedure. Those that don't would fall into the proposed simplified-SAC procedure that is also extremely complex, uncertain and expensive.

In summary, the League recommends a number of proposals as Curt outlined, and I won't go through those again. But based on the testimony that we provided and the written comments, we believe the League's recommendations effectively address the need to implement procedures that will result in an effective, simple and expeditious method for resolving rate disputes. Further, they guard against market power abuse and improved shipper access to the Board which I'll note were also items of comment in Mr. Hamburger's press release when he commented on shippers' input into this case. So I thank you for your time.

CHAIRMAN NOTTINGHAM: Thank you. We'll now proceed with Mr. Dan Mack from the National Grain and Feed Association. Welcome. Please

proceed.

MR. MACK: Chairman Nottingham, Vice Chairman Buttrey and Commissioner Mulvey, National Grain and Feed Association appreciates this opportunity to present its views on simplified standards for small rate cases. My name is Dan Mack. I am currently Chairman of the National Grain and Feed Association's Rail Shipper Receiver Committee and Vice President of Transportation for CHS, Incorporated.

NGFA's 900 member companies handle over two-thirds of the grains and oil seeds that are commercially marketed and processed in the United States. However, the regulatory significance and economic impacts of this proceeding extend well beyond NGFA's core membership to the hundreds of thousands of farmers that sell grain to our member companies and to the U.S. and international customers that purchase food and agricultural products.

NFGA's opening submission in this case was supported by 40 agricultural organizations

representing the vast majority of U.S. agricultural interests involved in grain and oil seed production and marketing. The strong interest from agriculture in this proceeding is driven by the knowledge that the United States competes with many other global suppliers in destination markets that force the production marketing chain to absorb much higher transportation costs to remain competitive. That means that a high percentage of increased transport costs are borne by the farmer through prices paid in local markets.

We know of no other STB or ICC proceedings since the Staggers Act was passed that have garnered this much public attention as it has become clear that current rules make regulatory review of rates beyond the reach of Ag. shippers. High rail rates are not a pervasive matter that affect everyone in agriculture. Indeed, an analysis of the 2005 waybill sample that NGFA submitted Ex Parte 665 indicates that less than half of raw agriculture commodities were shipped at rates above 180 percent of variable cost. Seven point five

percent of agriculture commodities were shipped at rates exceeding 300 percent of variable cost.

However, in real numbers, tens of thousands of carloads of unprocessed egg commodities are at rates over 180 percent, and the number is increasing rapidly. Grain products are in the same position. In those situations where high rates may pose a problem, either in terms of excessive cost to shipper and farmer customers or by creating a barrier to market access, reasonable regulatory oversight is necessary and clearly required by statute.

NFGA's view is that the three benchmark approach to the STB rate oversight is much more likely to be useful to agriculture shippers than the simplified stand-alone cost procedures provided that the 3B eligibility standard is reasonable. Cost experts estimate that bringing a simplified stand-alone cost case will impose costs of at least 1 million dollars and likely much higher. Coupled with the odds that winning some form of rate relief is probably no better than 50/50, it is very

unlikely that an agriculture shipper could ever justify bringing a simplified stand-alone cost rate case on any specific movement. Thus, the remainder of our comments will be directed at the 3B approach.

For 3B cases, the STB has proposed an eligibility standard of $200,000.00 as the maximum value of a case over a five-year time horizon. In our original submission, we illustrated why this extremely low level of eligibility virtually precludes any case being brought. Of the two costs experts that analyzed the expected cost to bring a case, the lowest estimated expense number to conduct a cost analysis was $115,000.00. Adding expected legal fees to this number virtually assures that the theoretical maximum payoff from such litigation could not reasonably be expected to cover the expenses of bringing a case.

This calculation does not take into account the litigation risk, internal cost of employee time, business relationship risks, and other costs and risk factors that would have to be overcome to justify a rate case.

Most of the carriers' testimonies tend to be supportive of the STB's $200,000.00 threshold proposal as reasonable. But very significantly, both Departments of the federal government offering testimony, those being the USDA and DOT, seriously questioned whether this number was considerably too low. DOT stated the Board should consider whether the financial amounts proposed for small and medium cases would be quickly exceeded. USDA stated USDA believes that the proposed eligibility criteria ceiling for medium size and small rate appeals procedures in the simplified standards are set much as too low. As a result, the expected cost of pursuing a rate appeal would often exceed the expected benefits precluding shippers from challenging unreasonable rates. We agree with DOT and USDA that the eligibility standard for 3B cases is obviously much too low and may be the most significant single matter before the STB in determining whether access to rate relief is actually being offered for small rate cases.

The possibilities raised in the January

22nd decision that the Board might drop the hard and fast aggregation rule and take a new approach towards litigation costs are steps in the right direction. But the Board should do everything within its power to ensure that there is a financial, realistic and worthwhile remedy available for every unreasonable jurisdictional rate.

NGFA does not favor setting the bar to rate relief so low that excessive litigation might occur. However, for a number of reasons, we heavily discount the possibility of an avalanche of litigation. We draw this conclusion because beyond the expense of legal and cost experts, there are many other barriers and risks that might be factored into businessmen's decisions whether to bring a case. Those factors include internal costs, internal business costs of employee and executive time, the fact that up front money will have to be invested by shippers for cost experts even before a realistic assessment can be made of the probability of winning and potential outcomes, the risk of souring the business relationship with the carrier,

uncertainty regarding how much time a case will require, the longer a case proceeds, the higher the cost, the uncertainty of a possible court appeal of an STB decision, the probability of winning which is likely no more than 50 percent and lastly, if the case is successful, the likely amount of potential rate concessions which, in all likelihood, is a mere fraction of the theoretical maximum case value. For all these reasons, we anticipate that under any reasonable eligibility standard, the use of small rate guidelines would be limited.

Since 1998, NGFA also has experienced an administrating and arbitration system for railroad and rail customer disputes which may offer some insights on what might be expected if the STB lowers the bar on small rail rate cases. The NGFA rail arbitration system provides for dispute resolution on a wide range of issues. All Class 1 carriers and several regional and short line carriers remain a part of the system through a voluntary commitment to abide by compulsory arbitration. This rail arbitration system establishes a much lower bar to

dispute resolution than what is being proposed by the STB under even the least costly 3B approach. And yet in its eight years of existence, the NGFA's rail arbitration process has generated only six completed and published cases.

This low number is not an indicator that the private rail arbitration system has not been useful or successful. To the contrary, I believe that most rail shippers and railroads alike would agree that the system has been extremely successful as a business tool to encourage private negotiation of disputes. Because the system exists, it permits either the carrier or the rail customer to easily and inexpensively initiate an arbitration proceeding which often leads to more serious negotiations in an expedited fashion. When both sides have an incentive to negotiate, litigation can often be avoided, and that is exactly what has happened with the NGFA arbitration.

But the business incentive to negotiate must exist, and if it doesn't naturally result from a competitive marketplace, it must come from another

source. We would submit that the STB can provide some reasonable business incentives to negotiate where those incentives may not exist today by developing reasonable rules and eligibility standards for small rate cases and therefore provide federal government support for a negotiated market solution. Thank you.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Mack. If I could just ask the witnesses to make sure you're speaking close into the microphone. I've seen some evidence of some straining ears behind you and up here as well. Just I know sometimes these mics can be extremely loud as mine seems to be this morning and other times they can be a little less loud. Thank you. We'll go to the next panel which is an unusually long panel. We've allotted 45 minutes of time but for very good reason as we'll hear, I'm sure, the range and depth of organizations and interests represented by the coalition. The Interested Parties Joint Shipper Group is quite broad and so we did want to accommodate their request. We'll start now with

Andrew P. Goldstein, and then I see that Nicholas J. DiMichael will actually be the first witness from this panel. Please proceed.

MR. DiMICHAEL: Good morning, Chairman Nottingham, Vice Chairman Buttrey, Commissioner Mulvey. I am Nicholas DiMichael. I appear here on behalf of the Interested Parties. With me is Mr. Andrew Goldstein who is co-counsel for the Interested Parties and also with me are Mr. Thomas Crowley and Mr. Gerald Fauth. Mr. Crowley and Mr. Fauth are cost experts whom the Interested Parties have retained for this proceedings.

The Interested Parties are composed, as you know, of 38 separate national and state associations and other parties who are vitally interested in this proceeding, and they include a very broad array of shipper interests.

First of all, we want to thank the Board for the opportunity to testify, and we want to thank the Board for initiating this proceeding. While the interested parties have some very serious concerns with several of the Board's proposals, we're very

pleased that the Board has begun to attempt to develop better rules for small rate cases. As the previous speakers have noted, there is a great need for a procedure for adjudicating smaller rate disputes, and we very much welcome this chance to discuss this matter with the Board.

We've read, with great interest, the Board's recent decision that posed a variety of questions, and we'll try to address a number of those in our testimony today. However, I would note that we have not had a chance to analyze all of the ramifications and the questions in the Board's recent order, and thus will be submitting further comments after the hearing as permitted by the Board's decision.

Our presentation today will be in several parts. Mr. Goldstein will first present several legal and policy issues, particularly those raised in the Board's recent decision. I will then discuss the Interested Parties' position on the substance of the Board's proposal in this proceeding and again attempt to answer a number of questions

posed in the Board's recent order. And that presentation will deal first of all with the eligibility matter. Secondly, we'll discuss the Board's proposed simplified-SAC proposal, then the changes to the Board's three benchmark standard. And if we have time, we'll get to some of the procedural questions raised. So that's kind of the order that we're thinking of here.

And I'll be calling on both Mr. Crowley and Mr. Fauth at various points in this presentation. I would note that we're frankly here to answer your questions, and we brought Mr. Crowley and Mr. Fauth to the table because we thought the Board might have some technical questions regarding the Interested Parties position that they would be in a best position to answer. So when the time comes, we certainly welcome questions.

Without further ado, let me turn to Mr. Goldstein who will discuss first several of the key legal and policy issues in this case.

MR. GOLDSTEIN: Thank you. Good morning, Mr. Chairman, members of the Board. I'm

going to address two areas of general concern. The first is the issue raised in the Board's January 22 decision about the three tier approach and whether the statute can be satisfied merely by adoption of a simplified-SAC procedure as proposed by Union Pacific or instead whether a simplified benchmark approach is necessary, which is our view. And the second issue is the recurring railroad theme that the Board must, at almost any cost, preserve railroad revenues in this proceeding.

The most direct answer to UP's argument is that simplified-SAC does not satisfy the statute with or without a three benchmark alternative. The statute, as you know, demands a simplified, and expedited process and simplified-SAC is neither simplified nor expedited. And if it doesn't meet both tests, it fails the statutory measure. A year and a half, which is the time table proposed for simplified-SAC is not an expedited process even if one made the totally unrealistic assumption that the 18-month time table would be met which has never proven to be the case with any full-SAC timetable.

An 18-month time table seems especially inappropriate when there is a truly expedited process available to the Board in the form of a three benchmark approach that will take nine months from beginning to end.

And neither is simplified-SAC truly simplified. It may be simpler than full-SAC, but that's not the same thing as simplified. The so-called simplified process is still a highly complicated case as Mr. Crowley and Mr. Fauth will explain. The process involves a major factual undertaking, extensive and detailed cost analysis and calculations requiring expert consultants. If the process were truly simplified, it shouldn't take 18 months. The proposed schedule for completion of the record in a simplified-SAC case is 12 months compared with just 7 months under the Board's rules for completing the record in a full-SAC case, and the 18 months that has been proposed for completion of a simplified-SAC case is two months longer than the 16 months now scheduled in the Board's rules for completion of a full-SAC case which hardly suggests

that the new process is simplified or particularly expedited.

The position of the interested parties with respect to the three tier approach is that there is no support for it in the statutory language and that there is not support for UP's position in the legislative history. The statute clearly measures the availability of the simplified procedure against a full-SAC case, but the proposed rules measure the availability of the three benchmark process against the standard that is not full-SAC.

The boundaries drawn by the Board, in effect, say that the benchmark process is unavailable if the so-called simplified process will do the trick even if a full-SAC case is too costly for the value of the benchmark case, and that is simply contrary to the statute.

Union Pacific seems to think it can obviate that entire issue by convincing the Board to do away with the benchmark test and retain only what is called the simplified-SAC process. The trouble

is that the simplified-SAC process by itself does not satisfy the statute, in part because it is neither simplified nor expedited, and in part because it will leave too many shipments without a rate remedy unless the Board wants to pretend that a simplified-SAC case can be brought for well under $200,000.00. The fact is that it will cost well over a million dollars even before adding a cushion for what the Board has recognized as a necessity to make sure that a complaining shipper recovers more than its mere costs of litigation.

There are a number of assumptions one can make about the implications of a million dollar plus simplified-SAC case cost. If, for example, a one and a half million dollar cost is spread over five years, it allows recover of a case value of $300,000.00 per year. No one's going to be bringing these expensive and risky cases in the expectation of recovering a mere hundred dollars or so per car.

So I'll assume a recovery of $500.00 per car in rate reduction. What that means is that the benefit of a simplified-SAC case on those

assumptions would be exhausted at the level of 600 cars per year. Six hundred cars in the grain industry amounts to slightly more than a 510-unit car train annually or only a part of what a facility can ship. If a facility ships more than that number of cars required to exhaust the case value, it loses access to rate relief altogether unless there is a three benchmark alternative availability. UP's proposal taking away the three benchmark process would leave that elevator without effective relief.

Also, the Board should not overlook the fact that the statute reflects a full awareness on the part of Congress when Section 10701(d)(3) was enacted that there was a proceeding that had been pending before the Board for many years to establish an alternative methodology to full-SAC, and that was Ex Parte 347(Sub. 2). Section 10701(d(3) actually commanded the Board to conclude that particular proceeding within one year, which is what the Board did in 1996. In Ex Parte 347(Sub. 2), the Board was expressly giving favorable consideration to a benchmark process quite similar to the benchmark

approach that UP wants the Board to jettison.

In its 1995 decision in Ex Parte 347, the Board, in fact, gave only passing consideration to an AAR proposed simplified-SAC approach that was not a benchmark process, and it rejected that simplified approach because it would have skewed the results in favor of the railroads by failing to take all operating efficiencies into consideration just as the Board now proposes to do under simplified-SAC.

It would be something of a stretch to accept UP's argument that Congress intended the Board to adopt the type of solution at this time that the Board had refused to adopt in 1995 just before Section 10701(d)(3) was enacted and to jettison the benchmark approach that Congress knew the ICC had viewed favorably.

The history of Section 10701(d)(3) clearly shows that the Board is not bound to adopt only that type of simplified process that applies constrained market pricing or SAC principles. The Board's 1996 decision reflects that very conclusion

and it remains legally sound today.

Section 10701(d)(3) entitles the Board to adopt a simplified and expedited alternative to full-SAC and the Board should do so.

Now the railroads argue that the Board should carefully contain the availability of the truly simplified benchmark process and even any simplified-SAC process because to do otherwise will erode railroad earnings. The railroads point to Table 2 of the Notice of Proposed Rulemaking to suggest that large segments of their traffic are potentially subject to rate reductions. Table 2 of the Notice of Proposed Rulemaking has been thoroughly discredited by Mr. Fauth and Mr. Crowley in their written statements.

Beyond that, however, the railroads' claims are nothing more than a Chicken Little, The Sky is Falling-type of argument. There is absolutely no reason to believe that every single shipper whose rates are over 180 percent of variable cost will bring a rate complaint or succeed if it does so, which is the basis of the railroad industry

argument.

In 1995, in Ex Parte 347, the ICC found that 18 percent of all rail shipments would be eligible for rate complaints and then went on to find that mere eligibility is a far cry from actually commencing the case.

In its own 1996 decision, the Board similarly rejected what it called the railroads' dooms day analysis and the Board should again do so.

Further, unless the railroads know something we don't know, even if every jurisdictionally eligible shipment matured into a rate complaint, it is impossible to measure any railroad industry rate reduction that will result. Neither simplified-SAC nor the three benchmark approach has been tested. The Board should not succumb to another railroad industry effort to suggest that effective rate regulation will be harmful to the railroad industry and instead should install a simplified and expedited remedy whenever full-SAC is too costly, which is what Congress intended.

And I'm turning it back to Mr. DiMichael now.

MR. DiMICHAEL: Thank you. Some of the legal issues discussed by Mr. Goldstein lead directly into the issue of eligibility for the various small case procedures proposed by Board and we'll turn to the eligibility issue right now.

First of all, although the interested parties do have extremely serious concerns over the level of the eligibility thresholds, we believe that the Board is absolutely correct in proposing a bright line eligibility standard combined with an opportunity for the complainant to argue that its particular case should fall within the small case category. In fact, we believe that the lack of a bright line standard has been a major factor in shippers not utilizing the current rules and, Chairman Nottingham, I would certainly note your statement at the beginning that the Board would like to bring some certainty to the question of who has access, and we certainly agree with that.

But a presumed eligibility standard has

to realistically evaluate the costs and risks of bringing a small case to the Board and should cover the large majority of cases for whom a full stand-alone cost case would be too costly given the value of the case. It would entirely defeat the purpose of the bright line standard if most cases would have to argue that they qualify on the basis of an individualized determination.

We see at least five problems with the Board's proposed thresholds. The Board, we think, has first of all underestimated the cost of a full-SAC case. We think it's underestimated the cost of a simplified-SAC case. We see problems with the Board's aggregation rules. We see the issue of a risk factor and the issue of the maximum versus the actual value of the case. And we'll look, Mr. Crowley, Mr. Fauth and I will deal with each of these in turn.

Concerning cost of SAC and simplified-SAC, the Board said, in its July decision, that a realistic cost of a full-SAC case would be 3.5 million, and the Board asked in its recent decision

whether it has over estimated the cost of a full-SAC case. We think the Board, in fact, has under estimated the cost of a full-SAC case. The most recent SAC decision entered by the Board was in the Otter Tail Power case, and in view of the importance of this issue, I've been authorized by Otter Tail Power Company to tell the Board that the cost to Otter Tail of the recent proceedings before the Board was $4.5 million or $1 million more than the cost assumed by the Board in its July decision in this proceeding. The Otter Tail proceeding was not unusual. Although there were three supplementary filings in that case, they dealt with narrow issues and were not extensive. The record in that case is probably something like about here (indicating) and the supplementary filings are actually right here (indicating). You can probably barely see them over the lip. I would note that the Board has recently suggested that Otter Tail, in fact, should have filed more expert evidence on one issue in the case.

The cost of SAC cases has risen astronomically over the past five years and really

has shown no signs of abating. You'll be hearing from railroad counsel later today and many of whom have litigated SAC in recent cases, and perhaps those parties may want to talk about their cost of litigation in recent SAC cases in order to give the Board a realistic measure of SAC litigation costs.

This raises the question of whether the Board's recent rules in Ex Parte 657 will likely cut the cost of a SAC case and derivatively the cost of a simplified-SAC, and I would like to have Mr. Crowley address that question. And I would also like Mr. Crowley and Mr. Fauth to address the second problem with the Board's proposed rules, the cost of the simplified-SAC case. I turn to Mr. Crowley.

MR. CROWLEY: Thank you, Nicholas. I've been asked to address the cost a shipper should expect to spend in order to bring a rate reasonableness case under the Board's simplified-SAC approach. The Board has proposed that rules that have maximum value of cases between $200,000.00 and $3.5 million should be judged using the proposed simplified-SAC procedures. The Board has created

these presumptive boundaries by assuming the minimum cost to bring a simplified-SAC case will be $200,000.00 and the cost to present a full-SAC case will $3.5 million. Based on my experience in preparing evidence for every full-SAC case heard before the ICC and the STB under the current guidelines, I believe the Board has substantially under estimated the cost to bring both a simplified-SAC case and a full-SAC.

The Board presumes that its recently adopted Ex Parte 657 SAC procedures will mitigate the cost of both full-SAC and simplified-SAC cases. I disagree. I will address the major changes brought about by the adoption of Ex Parte 657 procedures and describe, based on my years of experience, the impact the changes will have on the cost of a simplified-SAC case.

The first change was the allocation of revenues for SAR, stand-alone cross-over traffic. Historically, the ICC and the STB utilized a modified mileage pro rate methodology to approximate market-based divisions negotiated between railroads

to allocate cross-over revenue. Such an approach correctly viewed the SAR as a replacement for the incumbent railroad and treated the divisions as what would be negotiated between two independent rail service providers.

Under the new Average Total Cost, or ATC approach, the shipper must take into consideration both the total on-SAR cost as well as the incumbent carrier's total off-SAR cost, including its variable cost and allocated fixed cost. This is done by calculating the on-SAR and off-SAR variable cost for each movement on the stand-alone railroad and allocating the incumbent's fixed cost based on a density-adjusted allocation approach. The change from a modified mileage pro rate methodology to the ATC method adds a tremendous amount of complexity to the revenue allocation process in a full-SAC case and is multiplied by several factors in a simplified-SAC presentation.

Unlike coal cases which may have 200 movements or less in the SAR traffic group, the simplified-SAC procedures will require the inclusion

of all traffic moving over the SAR's route. This could mean the number individual movements could number in the tens or hundreds of thousands when non-unit train manifest traffic is included. While the railroads have argued that they will have to perform the initial calculation of ATC divisions and therefore they are absorbing the cost of the proposed procedures, the shipper will still need to spend the time and effort to verify these calculations. This will require going back to the base revenue and cost data, verifying the selection and inclusion criteria, determining the routing and line density for each movement and calculating the on-SAR and off-SAR variable and fixed cost.

The only way to truly verify the railroad's data is to evaluate every step of the process used by the railroads. This verification process will be extremely burdensome in the simplified-SAC process given the large number of movements handled by the stand-alone railroad.

Another item change in the Ex Parte 657 was the determination of the maximum rate. The

Board had historically used the percent reduction method to calculate the SAC rate. But as the Board correctly observed, the percent reduction method was open to manipulation by the railroads, and the STB developed the maximum markup method, or MMM, as a replacement.

I concur with the Board that the MMM is a better approach for determining a maximum SAC rate, but the approach is much more time consuming and costly to prepare than the percent reduction method. Unlike percent reduction, which only required the calculation of total stand-alone cost and aggregate SAR revenues to develop the SAC rate, the STB's MMM model requires valuating the rate and cost of every move included in the SAR system. As I stated earlier, this could mean the inclusions of tens or hundreds of thousands of movements in the rate determination process which will ultimately drive up the cost to prepare evidence.

The next item change was a shift from the inclusion of movement-specific adjustments and the determination of a movement's variable cost to

know movement-specific adjustments. The Board made various justifications for disallowing the continued us of movement-specific adjustments including a desire to reduce the cost of a maximum reasonable rate case. The calculation of variable cost in maximum reasonable rate cases has never been a driving cost factor, rather the cost of preparing the SAC evidence is the cost driver.

In my opinion, the changes brought about in the Ex Parte 657 decision and the proposed changes in this rulemaking will raise the cost to prepare a case much more than any savings brought about by eliminating movement-specific adjustments to variable costs. The changes brought about by the Ex Parte 657 decision will, I believe, ultimately increase the cost to prepare evidence in a full-SAC case or a simplified-SAC.

In addition, other changes proposed by the Board specific to this rulemaking will ultimately drive up the cost under simplified-SAC even further. For example, the Board proposes to require shippers and railroads to update their

traffic and cost analyses annual to reflect any changes every year of the five year prescribed rate period. As I explained above, the determination and verification of traffic revenues and costs will be one of the most costly areas of preparing a simplified-SAC case, if not the most costly item. By asking the shipper to repeat this exercise an additional four times will unfairly drive up the cost of the case.

Based on my experience, I estimate consulting fees alone for a simplified-SAC case will range between $1 and $2 million. When legal and other costs are added, the cost of a simplified-SAC case could abut the Board's cost estimates for a full-SAC case.

MR. FAUTH: Chairman Nottingham, Vice Chairman Buttrey, Commissioner Mulvey, it's an honor to be here today. As indicated by Mr. DiMichael, Mr. Goldstein, Mr. Crowley and others, we believe the Board's estimate $200,000.00 figure for a simplified-SAC case is significantly under estimated, and I agree. In my previous testimony, I

indicated that the proposed simplified-SAC procedure is not a simplified and expedited method. I described in detail some of the time-consuming and costly work that will be required in a simplified-SAC case. For example, the stand-alone cost railroad asset identification process has not been simplified, and this is one of the most time-consuming elements associated with a full-SAC case.

I submitted a detailed estimate of the economic consulting work that would be required in a simplified-SAC case. I identified 6 phases and 62 individual work elements which would be required to complete a simplified-SAC case. I estimated that the economic consulting work -- that the economic consulting fees alone would range between 500,000 and 1.25 million, but this excludes legal cost and the additional costs that Mr. Crowley has talked about associated with the 657 adjustments.

Some of the railroad have criticized my estimates. However, none have submitted detailed estimates of their own. Moreover, as I pointed out in my rebuttal statement, adjusting for their

criticisms would almost have no impact on my conservative estimates of between 3 and 7,000 hours of consulting time required in a simplified-SAC case. Most of the Class 1 railroads have defended full-SAC cases and at least know what their full-SAC litigation costs are which could have been introduced for comparison with shipper costs. The fact that none have done so infers that there is validity to our cost estimates.

The Board has failed to test simplified-SAC. I believe adequate testing of simplified-SAC would provide the Board with a better understanding of the cost and complexity associated with a potential application of the procedure. The Board's recent order asked for comments whether the Board's $200,000.00 estimate was understated assuming no rerouting of issue traffic. A no rerouting rule would not significantly reduce litigation expenses. The route evaluation and selection process would obviously be eliminated, but this would be only a small percentage of the total consulting and legal work required.

The more important question here is what is the tradeoff. A no rerouting rule would likely result in higher rates in most cases. As I indicated in my previous comments, the existing route may not always be the most optimally efficient route. A no rerouting rule would force shippers to pay for such inefficiencies.

The Board also asked whether it should abandon the aggregation proposal. My answer is yes. Included in my opening statement is a detailed analysis of the potential impact of the Board's aggregation proposal which demonstrates that the proposal would likely eliminate a huge amount of traffic from challenge. Specifically, I developed the maximum of the case of MVC for 42 individual movements of the same commodity from a single origin. On an individual movement basis, 32 movements would qualify for a simplified-SAC, 9 would qualify for three benchmark and 2 would be forced to use the full-SAC standard. Under the aggregation proposal, all would be forced to use the full-SAC standard even if it's too costly to use.

The Board indicates it is considering a case-by-case aggregation approach. The Board would retain discretion to address cases where a complainant was disaggregating a larger dispute into a number of small disputes in order to manipulate the agency's process. I suppose this could happen, but I am unaware of anyone ever trying to manipulate the Board's processes in such a way. Such potential aggregation problems would certainly be rare. As such, I believe that automatic STB aggregation reviews of each case will be unnecessary and that the Board instead should simply revisit this issue if and when it proves to be a problem.

Now I'll turn it back to Mr. DiMichael.

MR. DiMICHAEL: Chairman Nottingham, the fourth eligibility matter that we'd like to discuss is the so-called risk factor. Some parties have urged the Board to ignore this matter because it would get the Board into speculating about the probability of success. We don't think this is correct at all.

First, the Board has already agreed with

the need to recognize the risk of litigation. Back in 1996, the Board declared that a rate complaint would not be cost effective unless the value of the expected remedy exceeds the expected cost of obtaining a remedy by a sufficient margin to make it worthwhile to pursue the complaint. The Board said if the cost of pursuing a complaint would consume most of the expected recovery, the remedy would be a "hollow one." A risk factor is therefore necessary to avoid an outcome where the value of the complainant's recovery would not justify the cost of even meritorious litigation.

Thus, the question really is how large should the risk factor be and whether the Board should recognize a specific risk factor up front. Taking the second question first, we think the Board should recognize specific risk factor up front. The whole point of the Board's proposal in this case is to establish a bright line of eligibility to make clear who is eligible and who is not. Failure to adopt a risk factor would undermine the whole purpose of a bright line standard and leave the

parties in a land of uncertainty.

Moreover, we think that it's clear that a risk factor of two is not sufficient to achieve the quote "sufficient margin" close quote that the Board discussed in 1996. Of the last seven SAC decisions, two have resulted in some relief for the shipper, and the lack of a small case precedent itself argues for a substantial risk factor, because the uncertainties of the small cases at this point appear much greater than the uncertainties even of large cases. Clearly, large cases have certain risks, and small cases at this point, given the uncertainties, have even more.

Finally, we want to discuss the maximum value of the case concept. As the MVC concept was stated in the July proposal, it did not take into account the fact that both the simplified SAC procedure and the three benchmark procedure would not produce rates anywhere near the 180 percent revenue to variable cost level. The Interested Parties have partially adopted a railroad suggestion that as long as the Board has developed reasonable

thresholds on the basis of a realistic cost of litigation and the recognition of a reasonable risk factor and eliminated the aggregation rule so you can get as well as access to needed information, the problem with the MVC concept, as proposed, can be partially alleviated by the shipper being able to specify a case-specific MVC.

In its recent decision, the Board suggested a small claims model whereby the Board would put a limit on the amount of relief available under the various procedures. Just a few comments on that. We think the fairness of this procedure still depends, first of all, on the recognition by the Board of a realistic cost of litigation and a realistic litigation risk factor, elimination of the aggregation rule and things we just talked about. We also agree that the Board's suggestion that a complainant will need to be able to amend its complaint if the value of the case turns out to be more or less than originally contemplated, and the Board has stated that in its recent decision. The Interested Parties will be addressing this matter

further on February 26th, but with these caveats, the Interested parties are not opposed to exploring the Board's suggestion as a possible useful approach.

Regarding eligibility then, in summary, we think that the Board's general concept that there should a bright line of eligibility is correct combined with an opportunity to argue case specifics. We think that the MVC calculation should be revised as I mentioned before. We think that a realistic cost of a full-SAC litigation should be determined to be 4.5 million and a realistic cost of a simplified-SAC, considering the uncertainties, should be determined to be 3.5 million. We agree the Board should eliminate the aggregation rule. And in light of the caveats above, the presumed eligibility for full-SAC should be 13.5 million, and for simplified-SAC, should be 10.5 million.

Let me turn to discuss certain aspects of the Board's simplified-SAC proposal. In our written comments, we presented in detail why the Board's simplified-SAC proposal should be withdrawn.

Candidly, we believe the proposal is unfortunately just not ready for prime time. There are two aspects we'd like to highlight -- lack of testing, which the Department of Transportation talked about in some detail; and secondly, what appears to be a systematic skewing of the proposal that is inconsistent with the underlying principles of constrained market pricing and specifically stand-alone cost. I'd like Mr. Fauth to talk briefly about the issue of lack of testing.

MR. FAUTH: I urge the Board to consider the fact that the Board's proposed simplified-SAC procedure has not been adequately tested to verify that it is truly a simplified and expedited method, that it is a viable and workable approach, that it produces reasonable and realistic results and that it will protect captive shippers from paying unnecessarily high rates.

You should be concerned by this fact. One of the primary reasons that the ICC and STB and the court rejected the AAR's previously proposed simplified-SAC procedure was the fact that ICC

testing of the approach in the 1990's indicated that it resulted in revenue cost ratios exceeding 5,000 percent.

How do we know that the Board's proposed simplified-SAC procedure will not produce similar results?

The railroads maintain that the simplified-SAC requires no special testing because it is based on CMP and the SAC constraint. Simplified-SAC may have a similar name and some of the same elements as CMP and SAC, but it does not replicate and, indeed, significantly departs from CMP and SAC. The Board could test the proposed simplified-SAC procedure using the record and results in recent full-SAC cases referenced by the Board. However, testing the procedure on non-coal movements which are more likely to use the procedures is equally, if not more, important.

DOT agrees with the Interested Parties on this point. DOT states such an exercise would disclose whether SSAC, as proposed, would introduce biases favoring any particular party. It should be

the Board's responsibility to perform or supervise such testing. It would be very difficult for any independent part without access to internal railroad data to adequately perform such testing from publicly available information. Were the Board to undertake testing, I believe the Board would discover that the proposed simplified-SAC procedure is far less simplified than the Board suggests. Thank you.

MR. DiMICHAEL: I want to just very briefly, in light of the time, talk about some of the procedures that the Board has proposed as far as its simplified SAC and the fact that they seem to be consistently inconsistent with the SAC, especially in one direction.

The Board has said that basically all traffic needs to be included in the simplified-SAC procedure whereas in the SAC test itself, it said that grouping was essential to the theory of contestability and without grouping, SAC would not be a very useful test. The Board's simplified-SAC procedure basically forces the shipper to use the

existing traffic on the line thereby eliminating the possibility of achieving efficiencies in the grouping.

The -- I would not on this that there has -- there is obviously a tension here between simplification and accurate results. There is at least possibilities that a simplification may produce them. What we seem to be having here though is a consistent skewing, biasing in a sense, of the procedures to produce a higher answer. And it's a very troubling problem because we don't know, as Mr. Fauth said, just how this is going to work. And without testing, we don't know the result and the extent to which the Board's proposed simplified-SAC procedures would actually replicate or how accurately that they would replicate the results of a full-SAC.

The Interested Parties do not oppose simplification. They want simplification. That's what we've been talking about for the last half hour. But simplification without any testing that would permit the community to know what the answer

produced by the procedures is just not right. Simplification without demonstrated fairness is not a sound basis, we think, for a small case procedure.

Let me turn in the remaining time to the three benchmark approach. The Board asked for some comments on a couple of aspects of the three benchmark approach, especially the issue of racheting under the three benchmark approach, and the Interested Parties have some serious concerns with the issue of a confidence interval. And I'd like to ask Mr. Crowley to address both the racheting question and the confidence interval matter.

MR. CROWLEY: The Class 1 railroads have argued in their various filings in this rulemaking that the repeated application of the three benchmark method to the higher rates in the comparison group will reduce both the mean rate and the upper bound of the confidence interval of the comparison group and drive those rates towards the mean. In truth, the railroad's racheting arguments are based on several unproven assumptions.

First, the railroads assume that a comparison group is a unique and static entity in which all members of a comparison group for one movement will also be in the comparison group for every member of the original group. This clearly may not be true. For example, assume a shipper with a 500 mile movement brings a rate case using the three benchmark approach and included in the comparison group are 10 movements. The comparison group movements have the same operating characteristic as the issue movement, but their movement miles range from 475 miles to 525 miles. In other words, the comparison group miles are 5 percent greater or less than the issue movement miles.

Now assume the shipper with the 525 mile movement in the original comparison group decides to bring a rate case under the proposed three benchmark approach. Under the railroad's way of thinking, the comparison group with the prior case would also be the comparison group for this new rate case. This may not be the fact. If we use the same plus or

minus 5 percent mileage range as a way to identify movements for the second comparison group, the mileages would range for this new comparison from approximately 500 miles to 551 miles.

This new comparison group would exclude some of the movements from their prior group and may or may not bring rate relief for the shipper. This is because comparison groups are not mutually exclusive groupings that will always contain the same members. Comparison group membership can and will overlap leading to different group compositions and no guarantee of a racheting down of rates.

My next problem with the railroad's arguments is their assumption of an instantaneous impact on a rate judged unreasonable under the three benchmark approach on other members of the comparison group. In truth, the impact of a prescribed rate will not occur for at least a year due to the lag and the production of the STB's waybill sample. It may not be included at all if the prescribed rate is excluded from the waybill sample. The latter may be entirely possible due to

the stratified sampling pattern used to create waybill sample and the small size of shippers using the three benchmark method. In addition, rates are not static on a year-to-year basis. And while a comparison group may provide relief in one year, in the following year, the rates may have changed to such an extent that relief would not be forthcoming for the comparison group, even with the inclusion of the new prescribed rate.

As I stated earlier, comparison groups are not static unchanging entities and the inclusion of a prescribed rate in the comparison group will not necessarily lead to another finding of rate unreasonableness for another member of the group.

The next issue I've been asked to discuss is the addition of confidence interval on top of the average IVC calculation under the three benchmark approach. As I explained in my verified statement submitted as part of the Interested Parties opening statement in this rulemaking, I do not believe that the use of a confidence interval calculation, as proposed by the Board, is valid due

to the non-random nature of the comparison group. Some of the railroads have argued that because the STB's waybill sample approximates a random sample, that the use of a confidence interval is appropriate. Whether the issue waybill sample is truly random or not is debatable. This was never the issue. Rather, the issue was whether the comparison group was random, which it clearly is not.

Simply stated, a non-random sub sample drawn from a presumably random sample does not make the sub sample random. It is on this basis that I believe the STB's proposed methodology is in error.

MR. DiMICHAEL: Chairman Nottingham, I can't quite see the lights here, so I'm not sure whether I have time or not?

CHAIRMAN NOTTINGHAM: We do have, I'm advised, a temporary technical problem with the lights. I can give you just my own timekeeping sense which is that you are at the 45 minute mark right now.

MR. DiMICHAEL: That's fine.

CHAIRMAN NOTTINGHAM: Be happy to give you a minute to conclude if you'd like.

MR. DiMICHAEL: Surely. Thank you very much. We do, as I said, want to thank the Board for its time and attention in this case. We think these are very, very important issues and we're very, very pleased to be here. We certainly look forward to any questions that the Board has. Thank you.

CHAIRMAN NOTTINGHAM: Thank you. One of the issues that has been touched on by a number of witnesses today, and certainly was one that we called attention to in our recent notice, is the usefulness potentially or potentially lack of usefulness, we do want to hear on this, and we have heard some of mediation. I wanted to give Mr. Crowley, in particular, I understand has some experience with mediation, and invite anyone else after Mr. Crowley responds to just comment on that issue.

MR. CROWLEY: I think mediation has some benefit in the big cases. I'm not sure of the benefit in a small case. You could easily run up

the cost of litigating a small case through the mediation process and then have to turn and litigate again which would double the cost and make it somewhat impractical.

MR. DiMICHAEL: I would just maybe add, though, that we think that a mediation proposal would need to be quick and therefore inexpensive to be useful. The AAR suggested a 20-day period. If we can hold a mediation to that kind of quick time period, that might well be a proposal that would appear to make some sense. But I think you have to be careful that the mediation process does not sort of get out of hand and just drive up the cost of a small case.

CHAIRMAN NOTTINGHAM: Any other comments on that? I know I do, in a variety of areas of the Board's work, I gave a lot of thought to the costs that our work, our decisions, our proposals might be imposing on parties, on the economy overall. I'm sure my colleagues give a lot of thought to that issue as well. And I recognize that in a free society, in a free economy, the government ought not

typically to restrict what a private person may choose to spend on a lawful exercise of exploring the fairness or merits or demerits.

However, that being said, there's been a lot of commentary already, and I'll certainly explore this issue with other panels, I'm sure, about the cost of pursuing rate claim dispute resolution through the Board's process, both actual past costs and potential costs under our recently concluded large rate case rule and also under this proposed rule.

Help me just think through -- I would just welcome any of the -- we have a range of witnesses from folks perhaps on my far left who work for businesses who actually pay the bills to folks on down the row who may have another vantage point, receiving the fees so to speak. And where -- I guess where should the Board turn for impartial analyses, advice? Should we be concerned that some parties who have very strong and apparently thoughtful opinions on this issue also have a lot at stake, both personally and from a pecuniary

perspective?

And where should we and perhaps shippers and railroads, folks who are paying these bills turn for kind of that impartial sort of cost estimate as to what are the costs of these board's procedures? Because I worry that we could even give it our best shot and come up with just what we think and, you know, is the perfect balance, but guess what, we don't always necessarily feel in control of the actual bills that get sent out. That's a matter of private contract, private agreement presumably.

And I also would like to know -- know it's a long question -- I'll wrap up -- but would like to know if anyone's willing -- there's been some willingness today to talk about actual litigation costs in specific cases. I heard the Otter tail. That was of interest. Do -- is there any use out in the marketplace of a sort of fixed fee type arrangements between lawyers and consultants and shippers and/or railroads where the bill say payer gets some level of certainty going in as to what their exposure might be?

I'll welcome any of the panelists to address any of the issues I've just touched on.

MR. GOLDSTEIN: Let me partially try to respond to that, Mr. Chairman. It's been my experience that fixed fees are not generally employed in litigation, because you cannot predict what the other side is going to do. And so that's the reason why attorneys in these types of proceedings charge on an hourly basis. And I wish that we could overcome that. I think everyone would love to have a fixed fee situation, but it's not economically real. And I think that the Otter Tail experience has been particularly enlightening, and that's a real life example of what a case costs.

I don't think that the cost consultants who have put in estimates of the number of hours really would be acting in their own self interest to build up their costs unnecessarily of a proceeding, because it will just drive their clients away. I think that everyone wishes it could be done for a lot less money so that our statements about the costs, the high costs are, in many respects,

contrary to our own self interest. We would like to see lower costs.

MR. DiMICHAEL: I would just add perhaps a little bit about that also. I very much agree and it's very difficult in litigation to determine what the costs are going to be. I think, frankly, SAC cases, the history of them have been that parties have indicated that SAC cases will be less than they have been, and they turned out to be more. I was reading the Board's 1996 decision the other night, and the Board, in that case, was talking about the cost of a SAC case back in 1995 being somewhere between $250,000.00 and $1 million, and there was some dispute back then whether the million dollars was right. But even if it was, SAC cases have just, in ten years, quadrupled or quintupled or more.

And this is a result of the dynamic that has in these cases. Parties will put in, you know, x evidence and you didn't expect that. And so you have to respond with y evidence. And it just keeps going up and up and up. And I think that's a real issue with the Board's simplified-SAC proposal. It

looks -- if you look at it fast, it might work cheaper. But I think the same dynamic which has been at work for the past 15 or 20 years in SAC is going to be precisely at work in some simplified-SAC where things that start out looking inexpensive or may be inexpensive, especially if you don't really test them out, after a while it becomes much, much more expensive.

So there is kind of a litigation risk factor in the simplified-SAC proposal itself that I think is going to tend to drive things more expensively rather than less.

MR. GOLDSTEIN: And I think that would be especially true for the first cases that may be decided, because they will be extremely heavily contested, and every single imaginable argument is going to be raised by the parties.

MR. WARFEL: I believe part of your question, Chairman Nottingham, was what would shippers be willing to pay. My particular employer, we have master contracts with most of the Class 1 railroads. Only one of those contracts is a five-

year contract. Two of them are two-year contracts. The rest are all one. So from a practical standpoint, if you're talking a cost even as low as, say, a half million dollars for something like this, you have to question whether it's really worth doing it.

CHAIRMAN NOTTINGHAM: Okay. There was some reference, I think, by one of the witnesses to -- perhaps more to the perceived desirability of railroads divulging their actual litigation and consultant expenses in these cases. I'd just be curious to ask anyone on the panel who'd like to respond if a railroad were to take you up on that invitation and enter a number into the record today or later, can we expect that you would accept that at face value and that would be the end of the discussion on what railroad costs or are we going to have to go into some type of elaborate discovery process or something? Just sort of want to know where we go if we do think deeply on that topic. Anyone care to opine?

MR. DiMICHAEL: I've indicated what the

Otter Tail costs were. I think it would be -- I would certainly hope that the railroads would believe that that's the cost. I think that -- that is the cost. I would accept -- I would believe that they should be deeply as candid. And I think their costs are going to be similar or perhaps even higher.

CHAIRMAN NOTTINGHAM: Vice Chairman Buttrey, questions?

VICE CHAIRMAN BUTTREY: Thank you, Mr. Chairman. We got into this morning sort of what I would call the academic part of this discussion pretty quickly. And that's a very important process that we go through here is the academic and technical part. But there's a grassroots part to this issue as well, and that is this term that's sort of crept into the dialogue in this city in the last few days and weeks about who will be the decider. And it raises an issue in my mind, especially -- that was brought to life especially this week by a letter that I received from a shipper, I will not mention the name, of course, or

the location of the country, and the concern that that shipper had about being able to stay in business -- so we get quickly transported from the academic part of this discussion to the grassroots part of this discussion.

And I'd like to direct my question to Mr. Mack and Mr. Goldstein primarily. It concerns me that the carriers might be in a position to be the decider, if you will, of who stays in business and who doesn't. And I think it's an accepted fact in this country that small businesses, play a huge role, in the economy of this country and a preponderance of employees in this country are employees of small businesses. And some of those small businesses are captive rail shippers. So it behooves us to come up with some approach to this issue that gets to the grassroots level of this issue. And it concerns me who will be the decider of who stays in business and who doesn't. It concerns me. If you would, Mr. Mack or Mr. Goldstein, add any observations or comments that you might have to what I've said?

MR. MACK: I'll make a comment on that remark. You know, I think that's -- there's a lot of truth in your statements in regard to rail rates drive a lot of business, transportation rates drive a lot of business, not necessarily rail rates but transportation is a significant cost. My sense is that when there is something that is completely out of the ordinary that there needs to be some mechanism outside of one of those small businesses that you described to completely change the way they do business, you know, completely or go out of business. Three needs to be some mechanism that can address the issue at heart if that, in fact, is a transportation cost issue and at least an attempt to take a look at the situation that maybe a particular movement has been demarketed by a carrier.

So the point being that, I think, relief options need to be presented, and they need to be at a point where it's at least an option to attempt versus there's no alternative at all. And I think that's what we're seeking.

MR. GOLDSTEIN: I think the problem

you're raising is a vital problem, and I think it's becoming more acute as railroad capacity is smaller in relation to demand and as railroads can afford to become more selective in the traffic that they want to handle. And so Dan used a term, demarketing. What he's referring to is that we see quotations from railroads, rate quotations which are deliberately set at a level that is so high that they know the traffic won't move.

And it's possible that the proceedings in this case may provide an answer to some of those problems. We often hear the railroads say that what we're talking about right now isn't really a problem, because their customers are so much bigger than they are.

What we're really talking about, though, is not the size of a customer and whether the customer itself is big enough to take care of itself as the railroads like to say but whether the facility fits into -- that customer's facility fits into the railroad's plans. Railroads see that facility as being either inefficient as a

contributor of traffic or unnecessary because they can source the amount of traffic that their destinations need from someplace else.

And it's a real problem. I'm not sure that the entire problem can be addressed through rate relief, but I think to some extent it can be.

VICE CHAIRMAN BUTTREY: Anyone else like to speak to that issue? Thank you, Mr. Chairman.

CHAIRMAN NOTTINGHAM: Commissioner Mulvey?

COMMISSIONER MULVEY: Thank you, Mr. Chairman. I'm a little disappointed today that the testimonies did not really focus on our revised January 22nd, '07 decision. I appreciate that there'll be further evidence -- testimony submitted later on. I look forward to reading that, but I was hoping that it would focus on some of those things that were raised in our decision today.

Having said that, I'd like you all to respond to the proposal that we allow the shippers to choose amongst the three, full-SAC, modified -- simplified-SAC or three benchmark approach and

decide in advance what they think the value of the case would be and proceeding with that proposal in particular. Because that seems to get away from some of the eligibility issues if you would. Mr. DiMichael, you want to start?

MR. DiMICHAEL: Yes. WE -- and I briefly dealt with this in the prepared remarks, but I think basically we see that there is some real possibilities in that, but we -- in that approach. It certainly gets away from the problems of maximum value of the case versus actual value of the case. I think, Bill, for it to be workable, as I mentioned, it, I think, needs to recognize a realistic litigation cost, realistic litigation factor. Those -- the numbers need to be, in a sense, linked to those kind of realistic things in order for them to be workable.

I hesitate to kind of, you know, give you kind of a final word now, because we would like to think this through. But it seems to us to have some benefit, some promise, assuming those caveats would be included.

COMMISSIONER MULVEY: Yes. I point out, too, the 22nd of January, it was only nine, ten days ago, so -- eight, nine days ago, so therefore you didn't have all that much time to prepare and that's unfortunate. But these proposals that haven't advanced, I think, are substantial departures from our original NPRM, and they are proposals that we really want to get more feedback on.

Let me ask. Mr. Mack, you mentioned an arbitration processed used at the NGFA. Could you elaborate a little more on how that differs from what we're proposing for mediation?

MR. MACK: The one key difference, of course, is that rail rates are not a topic that can be arbitrated under the rules of the NGFA rail arbitration.

COMMISSIONER MULVEY: I understand that yes, but in terms of procedures.

MR. MACK: In terms of procedures, I'm not a hundred percent on the mediation, and if someone else could defer -- if I could defer that.

MR. GOLDSTEIN: The NGFA arbitration

procedures are far less formal than any of the procedures that have been proposed for small rate cases. They are normally -- in fact, I'm not aware that there's ever been discovery involved in them. They are normally handled by the submission of opening, reply and then rebuttal comments. And they're generally decided within six months. And so in some respects, in fact many respects, it's a much more simplified -- but as Dan said, they don't get to the issue of rates. They deal with such things as loss and damage claims, unreasonable practices, and the like, which may be simpler concepts than rates.

COMMISSIONER MULVEY: Thank you. Mr. Crowley, you were mentioning the costs associated with the simplified-SAC procedures and also the changes that were proposed -- in Ex Parte 657. In terms, of cross over traffic, the allocation of revenues to cross over traffic, you mentioned that you admit that the railroads are the ones who are responsible for developing those data but then you have to verify the data. That could be very, very

expensive, but couldn't you take a sample? -- You mentioned you have to verify every single piece of data, but wouldn't sampling be cheaper, more efficient and just as accurate? I mean you're a statistician, no.

MR. CROWLEY: Well, sampling is always a technique that can be used to verify data assuming you have the universe to sample from. But my concern would be that the information that you get to sample is simply the result of the railroad's analysis and not of the selection criteria they used or the elimination criteria they used in evaluating the traffic. If I'm asked to represent to one of my clients that the calculations and the procedures followed by the railroad are accurate, I think you have to get to the root data in order to make that representation. Now if the sampling procedures were coupled with access to the root data, I think you might be on to something.

COMMISSIONER MULVEY: Okay. Every time we try to make things simpler, we seem to make them more complicated and more expensive. Every time we

try to make them cheaper -- I'm sad to hear that you all think that the changes that were proposed in the Ex Parte 657, the large SAC cases, have not lowered the cost.

-- Some of the issues in the full-SAC case that will be reduced or eliminated using a simplified-SAC methodology, I had the staff prepare a list of all the things that would no longer need to be done or the cost of which would be very, very much reduced, and they do seem to be substantial. -- The jurisdictional threshold, for example; simply use an unadjusted URCS. The SARR configuration for track miles -- we're now going to use the predominant route or traffic, so you don't need to specify a route or figure out what route you might want to take. The traffic volumes and revenues are defined by actual traffic for the most part or, in some cases, like the rerouted traffic would no longer be an issue, we're using actual miles.

Operating expenses would all be based upon modified URCS operating expenses using actual traffic. You wouldn't need to postulate a

hypothetical railroad, for example, and all those operating expenses would no longer be remodeled.

Road property investment using rolling averages from prior cases, again, would be simpler and, I would think, reduce the costs. In fact, the only one that has no change in that category seems to be tunnels, and tunnels tend not to be typical, especially in western cases.

Discounted to cash flow analysis -- again, reduced to a one-year DCF, no debates over refinancing debt under the new proposals, et cetera, all of these would seem to substantially reduce, the cost of bringing these cases. Anyone want to respond to that?

MR. CROWLEY: I agree that those things will reduce the cost if you're starting at the right point. I think we heard this morning what it cost to litigate the Otter Tail case and I was part of that case. And what I'm telling you is that the cost to bring a simplified stand-alone case is half of that, maybe less than half of that, maybe a quarter of that. But that's still a substantial

amount of money. The things that you mention on your list are simpler but still require calculations.

The things that you didn't mention and that I didn't mention in my prepared remarks that are going to be very cumbersome, in addition to what I said, are things like grading. We're going to use the engineering approach as the guidelines suggest except for those places where there aren't engineering reports. And the engineering reports are not all-encompassing. To do an actual grading estimate is very complicated. It's very controversial. The cross subsidy testing, the more moves you have in your universe or in your SAC group, the more difficult it is to do the cross subsidy testing. That's going to be more complicated as well.

So while there are some things that are simple, I think we've taken that into account and given you our best guess as to what it's going to cost to litigate these things.

MR. DiMICHAEL: I would perhaps just add

to that also that in a coal case, what you're basically looking at is, you know, a movement from a particular origin to a particular destination, and the cross over traffic in those kind of movements, you get to pick. And so there is -- there tends to be a limited universe of cross over traffic. Still a fair amount but if you compare that to a non-coal case that will be moving from point x to point y over part of the railroad system and you're using all of the movements on those segments, as Mr. Crowley said, those cross over moves may be many, many multiples of the number of cross over movements that you have in a stand-alone case. So although you are in a sense simplifying some of the calculations, you're having many more calculations to do. So there is both pluses and minuses here.

CHAIRMAN NOTTINGHAM: I've got a few more questions and then I'll be happy to do another round at the pleasure of my colleagues. Just to pick up on one of the issues I was exploring earlier, if we were to -- just work with me here -- if we hypothesize that the Board comes up with what

each or most members on this panel would view as a very thoughtful -- this is a hypothetical, of course -- balanced and fair rule here, should we then expect over time, as hourly fees do go up, I presume, like they do in most other business models with inflation and cost of living, that in a few years or some period of time, that very good, thoughtful, fair balance may not look quite so good to folks paying the actual hourly bills and we would then be asked perhaps to come back and revisit the question? Should we be concerned with that? Is that a real reality and any -- I'd welcome any comment on that or related issue.

MR. DiMICHAEL: I believe the Board, in its proposal had talked about the possibility of indexing certain of the costs. I think that makes some sense. There is a whole series of things in the law that, not just obviously the transportation law that the Board is under, but other transportation statutes that have, in a sense, gone out of date as time has gone by, and I think an indexing process for some of those would make a fair

amount of sense and reduce the need for the Board to revisit what we certainly hope would be a fair and expedited process at the end of this proceeding.

MR. GOLDSTEIN: I think it would be helpful, generally, if in a decision that the Board issues it could indicate its willingness to be receptive to indications of change or abuses of the process as you go along. And I think that this is just one of the areas that perhaps needs to be revised over time, or math to be revisited over time with the benefit of experience. There may well be others of a substantive nature.

CHAIRMAN NOTTINGHAM: I'd like to give each of the panelists a chance to -- some have spoken very directly on this point, some somewhat less directly, on the question of thresholds -- I'd like to give each panelist an opportunity to -- and maybe to help move the questioning along, if I could, if -- this is a big if I realize -- if we assume that the Board were to settle on a three option approach, full-SAC, simplified or something like a simplified-SAC and then a more benchmark type

even simpler approach if we were to proceed with the three option model, and to take it further, to pick up on Commissioner Mulvey's comment, if we were to give shippers an opportunity to opt into the value level of any of those models for purposes of the case, what should the right -- what should the threshold be? I've head some different numbers but I haven't heard numbers from everyone. Clearly, this panel -- I've heard that 200,000, in your collective opinions, is not the right starting number, but give me a better one, if I could, just start maybe my left to right. And if you prefer not -- if you don't have a number, that's fine. I just want to get the benefit of your thoughts while I've got you here.

MR. WARFEL: We're talking a threshold number now?

CHAIRMAN NOTTINGHAM: Yes.

MR. WARFEL: In our testimony, we mentioned 13.5 and I believe 10.5 million and I'd stick with those numbers.

CHAIRMAN NOTTINGHAM: Anything on the

third lower end?

MR. WARFEL: Well, I mean it's -- I mean in theory, I mean you could actually -- well, you're not going to have a case, I think, that's brought on one or two carloads, but I know in our -- like using our immediate situation, most of our origin/destination pairs, you're only looking at between 750,000 and $1 million in revenue, and that's just on an O-D pair. And most complaints are probably going to be directed at one origin/destination pair. So perhaps say a half million dollars.

CHAIRMAN NOTTINGHAM: Thank you. Mr. Kratzberg?

MR. KRATZBERG: I guess I'd go back to one of the other comments that I made earlier in my testimony when I talked about the number of shipments on an annualized basis that really would apply, and I guess based on the proposed thresholds at this point in time, you know, looking at two carloads a month on an individual O-D pair is quite low. And so when you calculate that over a five-

year time period, you know, that's why we said that we really felt like $200,000.00 was really unrealistically low. And as we had stated that anything basically below the ten and a half million dollar threshold, we'd really be looking for that to apply to the three benchmark standard. So I think most shippers would, once again, need something that says I can aggregate those shipments or I can, you know, submit a case that may have multiple origin/destination pairs which, in themselves have only a couple shipments per month, but I've got enough latitude there to bring a little bit larger case if I've got, you know, three or four O/D pairs that I really feel or that the company feels needs to be changed.

MR. MACK: I think our statements were focusing primarily as it relates to egg commodities and egg products focusing primarily on the three benchmark. Our statements were obviously clear that we felt that $200,000.00 was too low. However, we have not formulated a limit that we would like to care to discuss at this point. We don't have that

number as of yet.

CHAIRMAN NOTTINGHAM: Okay. And it's certainly your option, Mr. Mack, but I will just point out for everyone's benefit, the record will be open until February 26th, and we certainly would invite you to give us your association's best number -- may be very helpful. And it's just hard for us to -- you know, if we don't have the benefit of folks' specific recommendations, it's just tougher for us to make the right call. But I appreciate your position today. Mr. Goldstein?

MR. GOLDSTEIN: Well, speaking on behalf of NGFA, we will submit some numbers for you. As part of the aggregate group, we've already suggested some numbers that we think are appropriate that Mr. DiMichael, I think, can reiterate. I think it's important to point out, though, that while these numbers may seem large, we're talking about five years worth of relief and so when you divide them by five, they shrink dramatically and then, of course, if you factor in what the Board has said needs to be factored in, which is some sort of a cushion,

because you can't expect people to litigate just to recover their costs, so when you get done with that, you get down to a number that we think is manageable.

MR. DiMICHAEL: And those numbers, to repeat basically, I think, what Mr. Warfel talked about, was that 3B benchmark would be up to 10.5, a simplified-SAC would be up to 13.5 and a case that is worth more than 13.5 would be under the full-SAC.

CHAIRMAN NOTTINGHAM: Thank you. Mr. Crowley?

MR. CROWLEY: I concur with Mr. DiMichael.

CHAIRMAN NOTTINGHAM: Okay. Mr. Fauth? All right. Thank you. This may be my last question, but I think it is an important one. There was some testimony about the, of course, the length of time of pursuing these cases. That's certainly very much in the forefront of our mind in trying to come up with the right balance here to try figure out a way to get through these cases expeditiously. I think most, if not all, of the statements I've

seen in the record from a variety of parties appreciate the importance of that.

Help me improve our work. Where -- any -- and I realize this may be more directed to the seasoned litigators on the panel, but I'll invite anyone else to join in. Where -- looking at our proposal, where do you see opportunities to cut off some time? And then a related question, I guess, in your experience, you know, in cases with the Board, generally speaking, do you see very often -- I'm learning as I continue my orientation process here -- about six months into the job -- that very often we start off with a very well-intentioned schedule and then various things happen, not the least of which parties ask for a different schedule -- how often in cases is the lengthening of the resolution process beyond the original schedule attributed to parties, railroads and shippers asking for delays, extensions? How often is it because the Board is, for whatever reason, just can't get its job done on time? Help me think through -- how much of a problem is it on my end that I need as a manager to

try to get at and how much is really just the -- maybe the inevitable give and take of the process that the parties have a right to ask for extensions?

MR. DiMICHAEL: Let me take a whack at that in really a couple of ways. First of all, the three benchmark approach, as proposed, would be -- and it's a little unclear exactly what the time period is, but I believe it's about a 270-day schedule, 50 days of that schedule is devoted to the eligibility question. If we could have a, you know, realistic and bright line test, you would knock out 50 days out of that 270 day schedule right off the bat if you could say, you know, a large percentage of shippers would be able to not have to go through an individualized eligibility process.

We look at the three benchmark approach, and it seems to be something that could move along fairly well. And we think that even if you go from the 270 to the 220, there are probably -- by knocking off the 50 days, there is still probably some means of getting that down a little bit further.

Now if you're going to the simplified-SAC, I think you're talking about a whole different kettle of fish. The history of SAC cases has tended to be that they start out with everyone's good intentions, including the Board's, trying to get them done x period of time and they've just expanded.

In, I know, the Otter Tail case, for example, that was not atypical. It took a little over, I think, about three, three and a half years, and there were several rounds of evidence in that case. One of them that was the result of a change in one of the Board's standards that one of the parties asked to respond to. A second, the Board's standard change again and another party asked to respond to. And the third, the Board itself asked the parties to submit. So some of that case was due to some changing standards and the Board itself asking for some additional evidence.

We think those are the kinds of things actually that are likely, more likely to take place in a simplified process rather than a three

benchmark process where the three benchmark process you've got, you know, two of the numbers that the Board is going to calculate, the third number is a comp number which, you'd think, would be able to be done fairly fast.

MR. GOLDSTEIN: I think what you're talking about has some potential, but from my personal point of view, there was some confusion as to the small claims approach. The original approach or suggestion for determining eligibility involved the use of presumptions, and the presumptions could be challenged by, presumably, either side in every case. It's not clear to me whether the small claims approach, allowing people to choose to fit into one slide or another also involves presumptions or whether they are no longer part of the picture. So I think part of the answer to the question, in my mind, lies in the answer to that particular issue.

Also, another part of it is whether what you call the aggregation rule, I think of as the aggravation rule, is dropped. And if it is, I think that will also help speed things up.

MR. CROWLEY: Let me just add that one way to hep out the small shippers is to get rid of the simplified stand-alone approach altogether. Embrace the three benchmark approach without aggregation, and I think you'll offer a tool that the small shippers will be able to use and will be quick.

CHAIRMAN NOTTINGHAM: Vice Chairman Buttrey, any additional questions?

VICE CHAIRMAN BUTTREY: No questions, just an observation, Mr. Chairman. The issue of indexes, we haven't had much luck with that in the recent past.

CHAIRMAN NOTTINGHAM: Commissioner Mulvey?

COMMISSIONER MULVEY: On this issue of whether or not we should drop the simplified-SAC, in our directive, it says that we need to develop an alternative to the full-SAC process, and that word full in the directive was, I think, important. And I don't know the entire legislative history of that, but that, you know, the choice of words could be

varied and that's sort of implied that a less than full-SAC but it's still a SAC process that's tied to the constrained market pricing principles was -- was supposed to be considered by the Board in coming up with an alternative. And, of course, we also have the three benchmark approach. Can you -- do you want to respond to, Mr. Crowley or Mr. Goldstein, that part of the directive from Congress?

MR. GOLDSTEIN: Well, I think it's clear that Congress did give very serious consideration to selecting the language that it used, and it did that after losing patience with the inability of the ICC to come up with an alternative. It's not an accident, we think, that Congress said that the standard was to be simplified and expedited and it didn't choose other words. It had plenty of opportunity to do that. And it didn't say, for example, that the Board was directed to adopt a simplified full-SAC to replace full-SAC. And instead it chose the words that it did use, so we don't think that you should read into the statute a directive to adopt a simplified full-SAC to replace

full-SAC.

COMMISSIONER MULVEY: Mr. Crowley -- same? Okay.

MR. CROWLEY: I couldn't have said it any better.

COMMISSIONER MULVEY: Thank you. Mr. DiMichael, you've stated that litigation costs have increased from $3.5 million to $4.5 million over the last few years and, in fact, you quoted from $1 million back in 1996 up to $3.5, $4 million today. And I suppose that we could presume that those costs will continue to rise. And we've talked about indexing these, if we do go for eligibility standards, to index them. There are, as Mr. Crowley knows, various indices that are developed by the Bureau of Labor Statistics, et al. Are there any indices for legal fees or for consulting fees that might be applicable for developing an adjustment that are less than four digits as well?

MR. GOLDSTEIN: I think there have been one or two antitrust decisions on that point.

COMMISSIONER MULVEY: I was just

wondering to be honest, actually. But it does do it for a lot of different industries. I mean you do have cost indices. Of course, we have them for the railroad industry and a lot of the railroad suppliers have separate indices, and I was just wondering if there was one for railroad or economic consulting.

MR. CROWLEY: I'm not aware of one but I've been looking for one. But I would note that you do have an index that you use every year to classify Class 1 railroads versus --

COMMISSIONER MULVEY: Right.

MR. CROWLEY: -- your Class 2 railroad, etcetera so.

COMMISSIONER MULVEY: This idea of developing some sort of factor to multiply the expected value of the cost by sticking to account risk, obviously someone mentioned only two of the last seven cases resulted in"wins" for the shipper. But I believe all that for of our SAC cases, it's about 50/50, so you come up with, say, you have a 50/50 chance of winning so there's your

justification for a factor of 2. But of course, the amounts that were awarded were not the full amounts that were desired, so therefore that also needs to be taken into consideration.

The number $13.5 million looks as though it's approximately three time the estimated cost and that's what you seem to have chosen. But do you think there's any way of getting a better handle as to what the number ought to be than two or three I mean some of the numbers I have seen would suggest something like 10 or 20 given the hope for award and the amount that was actually gotten?

MR. DiMICHAEL: Well, I think you're correct, Commissioner Mulvey. That's exactly how we came to this. It was the 4.5 million and then basically multiplied by risk factor of 3, and I don't think anyone will say that this is, you know, exact science here, that there's -- there's obviously some judgment. But exactly the kind of thought process that you just went through, I think, was the one that we went through in coming up with that number.

I think we were more affected not so much by cases that may have taken place or that may have been litigated 10 or 12 or 15 years ago but were really looking more at current experience, and it's not just the last couple of years, the last five or six years, so you're talking about at least a decent period of time. And as you mentioned, even the two cases that the shippers have won over the last seven, the relief given was not the total relief sought, so that has to be factored into the risk, too.

So if you take a look at all of that, it appears to us that a risk factor of more than two is a fair one.

COMMISSIONER MULVEY: One question on the racheting. Mr. Crowley, you were mentioning that the sample could change from year to year to year, and you gave an example of the confidence interval of plus or minus five percent. But this example was extremely hypothetical. Do you have any sense of what the size of the actual samples really would be and whether or not there would be

significant change in the groupings from year to year? Are there that many cases in these groups out there that you could have such substantial changes in the group that's being looked at?

MR. CROWLEY: Yes. We're solved these procedures, the three benchmark procedures for a number of folks using the public use waybill file. And admittedly, we don't have access to the actual data because of the masking factors, but just using the public waybill file and looking at the groups over a two or three or four-year period, you see a substantial change in the observations, size of the group, they can be -- you can get it as narrow as 10 or 12 moves and probably as big as 50 or 60 moves based on, again, the public use waybill.

COMMISSIONER MULVEY: Okay. Thank you.

CHAIRMAN NOTTINGHAM: Just a quick comment and one last question. Thanks for your patience, panel. Just in thinking about the suggested $10.5 million as the proposed bottom number for this new rule, I think we will -- this is more directed to my colleagues -- I think if we were

to accept that, we would definitely have to at least start to not use the term small claims court model, because I'm not sure that would stand the straight-face test. But that might not necessarily meet the problem. It's just a language issue there.

Let me just ask to quickly get folks on the record. Occasionally, I hear from stakeholders, visitors that we should be focused in proceedings such as this on small business. And in fact, my colleague, Vice Chairman Buttrey, addressed the importance of small businesses. Are any of you suggesting today that our focus in this rule should be on the size of the actual shipper? In small business tax law and policy, we often hear things like 50 employees or less, annual income of a certain level or less, and occasionally the government makes certain benefits available to businesses that are small. Of course, as you know, in this proceeding, the focus really has been on the shipment, not on the shipper. But I do want to get folks on the record, and I'll ask others later. Are we on the right track there, or should we be looking

at actually the shipper and how much income the shipper makes each year, how many employees the shipper has and those type of indicators? Mr. Warfel?

MR. WARFEL: I guess the short answer would be, in my opinion, no. You could have a complaint on one car, you could have a complaint on a thousand cars, and I don't think you should be restricted in your ability to file a complaint or to have an issue listened to.

CHAIRMAN NOTTINGHAM: Mr. Kratzberg?

MR. KRATZBERG: I agree. I think the approach that you're taking, taking a look at small shipments versus the size of the shipper is appropriate in this case. You know, recognizing the concerns that Vice Chairman Buttrey has voiced, I think that's been the position all along that -- I don't want to speak for NIT, but I guess that's the position that the Interested Parties and the NIT League has taken as well.

MR. MACK: My response to that is there should not be a size limitation on the business

side. Not unlike a lot of the grain businesses and grain companies, large or small, they generally act as somewhat of a decentralized entity in that they have assets spread out through the entire United States or North America or wherever may be, and each of those facilities essentially has to stand on its own. And at least from our company's perspective, is those individual facilities act as small individual business. They have their own P&L's. Yes, they have support and the backing of a larger corporate structure, but we're talking about specific O/D pairs here, and that has a dramatic impact on those individual origins if, in fact, rate structures impair their individual assets. So my anser is no.

MR. GOLDSTEIN: And of course, I agree with that. You've been on the right track. Your decisions have found that the statute is aimed at amount of traffic, not the size of the shipper, and I don't think we want to get to the point where we take a look at relative revenue between the railroad and the shipper or net profits and say that the one

with the largest revenue loses. You know, the railroads will lose a couple of cases to -- I shouldn't even -- win a couple of cases, some big shippers and under that measure should lose them all to everyone smaller to them? I don't think anyone is really talking about that.

MR. DiMICHAEL: The Board's on the right track on this question.

MR. CROWLEY: I agree.

CHAIRMAN NOTTINGHAM: Vice Chairman Buttrey, any questions?

VICE CHAIRMAN BUTTREY: Let me just clarify since this issue has come back up again. I was not necessarily suggesting this morning in my earlier comments that that's a direction that the Board should take. We are very careful, I think, here on this level anyway, to not poison the well, if you will, with respect to any of those issues. I was thinking primarily about a situation where a customer was told or suggested to the customer that it increase it's one and two-car spur line off and increase it to, say, a 20-car line in order to get

better service or better prices or whatever, and then upon doing that, got a 50 percent to 70 percent increase in rates just about the time they finished the 20-car spur line. So that's more of what I was talking about. Thank you.

CHAIRMAN NOTTINGHAM: Thank you. Commissioner Mulvey, any questions to this panel?

COMMISSIONER MULVEY: No.

CHAIRMAN NOTTINGHAM: Thank you. This panel's excused. Thank you for your patience and your testimony today and your answering the questions.

We will invite the next panel forward. Panel III representing Dow Chemical Company, Jeffrey O. Moreno; representing the Arkansas Electric Cooperative Corporation, Steve Sharp; representing the Alliance for Rail Competition, Michael W. Snovitch; and representing Snavely King Majoros O'Connor & Lee, Mr. Tom O'Connor, welcome and take your time and get settled and we'll proceed. Welcome. We'll do our best to keep track of time the old-fashioned way. Excuse the technical

difficulties. I don't believe the lights are still working but I believe that the time allocations were ten minutes for Mr. Moreno and MR. Sharp each and also Mr. O'Connor and seven minutes for Mr. Snovitch. I'll leave it to the panel. Do you have an arrangement already or should we just start with our customary from my left to right?

MR. MORENO: I think that's fine with us.

CHAIRMAN NOTTINGHAM: Please proceed.

MR. MORENO: Good morning. I am here today on behalf of the Dow Chemical Company. Also here from Dow Chemical in the audience is Ted Verheggen, Dow's legislative counsel. Dow is pleased that the Board has initiated this proceeding but is concerned with the direction of the proposals which would continue to leave shippers like Dow without regulatory rate protections.

Dow is a so-called large shipper with small cases. Large segments of Dow's business involves transportation of traffic in small volumes to hundreds of destinations. Both the destinations

and volumes have the potential to change frequently. Consequently, despite Dow's concerns over substantial rate increases on its traffic in recent years, the value of such rate cases does not begin to justify the time and expense of a full stand-alone cost presentation. Hence, Dow is among the captive shippers that Congress intended to protect through the small case process.

This proceeding is very important to Dow. Dow has been among the chorus of shippers seeking revisions to and clarification of the three benchmark standard. Since the adoption of the three benchmark approach as the standard for all small cases in 1996, shippers have sought guidance as to numerous uncertainties about the timing, cost and unspecified additional factors that the Board might consider. Consequently, no shipper has been willing to test the waters by filing a complaint, at least not until very recently, as rates have increased substantially over and beyond prior levels.

But in this proceeding, the Board has proposed to go back to the drawing board by devising

a new approach in the simplified-SAC that is far more complex than the three benchmark, more costly and more time consuming. In your opening comments this morning, Vice Chairman Buttrey, you referred to the Tax Code and its simplifications being somewhat -- appearing more complex than even the original. And that's exactly what Dow thinks has occurred here, the simplified-SAC is akin to the Tax Code that is more complex than what is -- than the code it's supposed to be simplifying.

Furthermore, while the Board has proposed revisions to the three benchmark approach in response to many of the longstanding concerns that have been raised, it has relegated that approach from being the small case standard to being the standard only for microscopic cases that are unlikely ever to be filed.

The importance of this proceeding to Dow and other captive shippers has been further enhanced by last week's fuel surcharge decision in Ex Parte 661. Although that decision was a very positive step in the protection of shippers, for captive

shippers, those protections will be only as good as the rules adopted in this proceeding. Railroads can, and they are, treating the fuel surcharge as a zero sum game by shifting the lost fuel surcharge revenue into their line haul rates. Unless this proceeding produces an effective and meaningful standard for small cases in order to determine the reasonableness of the line haul rate, the fuel surcharge decision will have been a hollow victory for captive shippers.

Dow's primary focus in this proceeding has been on the eligibility thresholds because even the best substantive standard is meaningless if the shipper does not qualify to use it. The proposed thresholds in this case are far too low and thus deny rate protection to most captive shippers. Contrary to various characterizations of shipper comments such as Dow's, Dow does not seek expanded regulations with guaranteed rate prescriptions. Dow seeks only a regulatory regime that extends protection to all captive shippers against monopoly pricing by market dominant rail carriers as promised

to those shippers by the statute.

This means that no shipper should be left without adequate regulatory protection because the cost of invoking that protection far exceeds the value of their case. If that is what the railroads mean by an expansion of regulation, then it is a long overdue expansion that is mandated by the statute.

Dow is concerned by the MVC approach because it overstates the actual value of the case, particularly for chemical shippers where the R/VCs on chemical traffic routinely exceed 300 and 400 percent. Thus, a prescribed rate is unlikely to ever approach the 180 percent jurisdictional threshold that is the basis for calculating the MVC.

Based on the comments in this proceeding, Dow could support a variation of what the railroads have suggested in their reply comments -- what a shipper is allowed to select its own MVC as long as it agrees to be captive by the rates in that. However, Dow's support for that approach is contingent upon having the information, including

access to the unmasked waybill sample, to make an educated and informed estimate of what it's MVC would be.

Dow also finds some merit in the Board's recently suggested small claims approach provided that the relief caps are set at levels comparable to the eligibility thresholds that shippers have advocated in this case. Currently, the eligibility thresholds proposed by the Board are too low. They should be based upon a reasonable estimate of full-SAC litigation cost multiplied by the risk factor of three that the Interested Parties suggested on the previous panel.

The Board's proposed $3.5 million eligibility threshold for full-SAC is far too low, because this amount is merely equal to what the Board estimates is the litigation cost of a full-SAC case would be. Thus, an MVC of 3.5 million, while still significant of value to the shipper, it becomes worthless when the litigation costs consume most, if not all, of that value. Furthermore, the STB's litigation cost estimates exclude many costs

that are true and important to the shipper such as their cost of complying with discovery, their expenses associated with travel and the lost management time and the distraction focused on a rate case.

A risk multiplier of three applied to the litigation cost estimate is necessary to establish eligibility thresholds when the cost of a full-SAC presentation is too costly given the value of the case.

The aggregation rule also is an unnecessary restriction eligibility. Although based on the premise of gaming by shippers, there is no evidence to indicate that such gaming is or would become a problem. Shippers have ample disincentives to waging multiple litigations for what are speculative benefits. The rule also has perverse consequences unrelated to gaming because it would require consolidation of a single case of traffic from the same origin that moves in completely opposite directions. The rule also impacts situations that are not, in fact, gaming such as

when the second movement is not known or is not a concern at the time the shipper challenges the first movement. Any concerns about gaming by disaggregating cases can be monitored and addressed by this board on a case-by-case basis without adopting the broad and sweeping aggregation rule.

Furthermore, the Board also needs to be alert to the potential for gaming from the carriers themselves. They have a lot of potential where they set the tariff rate. Dow is not advocating any hard and fast rule against that gaming but just as with the aggregation rule, the Board should monitor the situation an be receptive to evidence that the railroads are, in fact, gaming the eligibility process.

Dow supports retention of a modified three benchmark approach for all small cases. However, Dow rejects certain of the modifications proposed by the carriers including the exclusion of contract traffic from comparable groups. A per se exclusion of contracts is unwarranted. There are increasingly fewer factors to distinguish contracts

from tariffs. Contracts look more like tariffs. They typically incorporate tariffs. Issues such as volume commitments when you're a captive shipper really aren't a problem, because you're going to commit all your volume to that railroad anyway. Service commitments in contracts are very rare nowadays and to the extent they exist at all, they don't exceed the reasonable dispatch standard that applies to common carrier movements.

Shippers also must have access to the unmasked waybill sample, otherwise the railroads will have an unfair advantage in selecting which traffic to advocate as comparable. There is no need to treat the waybill sample as comparable to the gold in Fort Knox. This data is the same type of data that's already produced in full-SAC cases when the contracts themselves are produced to shippers. The same protective orders that protect that information in full-SAC cases will protect it in small cases.

Dow asks this board not to create unnecessary barriers to effective regulatory

protection through the small case standards. Simplified-SAC is an unnecessary sojourn into a quagmire of new uncertainties topped off by greater complexity, higher costs and more time than three benchmark approach. Attempting to adopt simplified-SAC before giving the modified three benchmark approach a chance to work is unnecessary and undesirable. Shippers only recently have shown a willingness to use the three benchmark approach.

Furthermore, the STB's proposed modifications in this proceeding will enhance the utility of that approach. Simplified-SAC's greater cost complexity and time will create the same, if not greater, uncertainty that the three benchmark approach has taken ten years to even begin to overcome. Please give the three benchmark approach a chance to work before turning the clock back on small classes.

Railroad concerns with the three benchmark approach are red herring, overblown, dooms day scenarios predicated on the notion of a deluge of three benchmark cases. There is no evidence that

such a deluge will occur and the railroads overestimate even the potential cases eligible for three benchmark because they have not considered that market dominance, contracts and exemptions will limit the pool of regulated traffic.

In summary, the Board can monitor the impact of the three benchmark approach and the eligibility standards on both the shippers address and retain whatever flexibility they need to address any of the concerns that have been raised by the parties in this proceeding. At this point in time, however, where small cases have been without effective regulatory protections for over 25 years, the Board should be tearing down barriers to small cases rather than erecting them on the basis of unfounded speculations. Thank you.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Moreno. We'll now turn to Mr. Steve Sharp from the Arkansas Electric Cooperative Corporation. Welcome, Mr. Sharp.

MR. SHARP: Thank you. Good morning Chairman Nottingham, Vice Chairman Buttrey and

Commissioner Mulvey. Appreciate the opportunity to speak to you all on these issues this morning. I am in charge of fuels and fuels transportation for Arkansas Electric Cooperative. Arkansas Electric Cooperative is a membership-owned generation transmission cooperative that serves about 460,000 of our customer members in virtually every corner of the State of Arkansas.

Our reliance on rail transportation and our interest in this proceeding were described in detail in our opening comments that have been filed that you all have. In the interest of being brief, I'll summarize by saying that our primary focus is in looking at the simplified-SAC procedure that has been proposed and its interface with the full-SAC procedure that is used in the large rate cases. As far as from the shipper side of things, we may be kind of the lone ranger, I guess, in not having a great deal of protest about the simplified-SAC proceeding. But our viewpoint is a little bit different perhaps than some of the other shippers, and we're viewing it as if we have the simplified-

SAC as an option that a shipper can avail themselves of and, of course, like I said, there's a lot of ifs, ands, buts and details to be worked out, but if we had a simpler option than the full-SAC in addition to the three benchmark option, we think that would certainly be an improvement, and we complement the Board for considering that.

I'll try to use the rest of my time allotted to address the issues that were highlighted by the Board for this hearing. First of all, eligibility. We commend the Board for its pursuit of the eligibility issues that have been raised. AECC believes that any eligibility scheme that leaves the railroad with influence over the selection of which of these methods might be used, simplified-SAC versus full-SAC, will tend to leave the railroad with most or all of the leverage that it holds from a shippers perspective on the full-SAC litigation costs. Kind of what was alluded to before by Vice Chairman, this sort of leaves the railroads in the decider position, if you will.

As we've discussed in detail in our

written comments, this leverage enables railroads to obtain revenues above those contemplated by the statutes and by the theory of constrained market pricing. This also keeps shippers from realizing the relief from full-SAC litigation costs that would motivate us to have something like the simplified-SAC in the first place.

In our prior written examples, we've included ways in which a railroad might be able to set initial rate in a manner that would ensure that it captures the shipper's full-SAC litigation cost under both the Board's original proposal and the railroad proposal that would have the shipper pre-specify a limit on the relief that it's seeking. The railroads are highly skilled at assessing the negotiating leverage of individual shippers whether that leverage comes from commercial or regulatory considerations.

If the Board were to adopt eligibility criteria for simplified-SAC, that enables the railroads to put this full burden of SAC litigation costs back on the shippers. The railroads would do

so. To ensure the simplified-SAC actually provides shippers with relief from the full-SAC litigation costs, the Board needs to ensure that the influence or control over eligibility for simplified SAC is not held by the railroads.

In looking at the new proposal that the Board advanced on January 22nd, our first impression is that there's really not enough information there for us to know whether or not this will enable the simplified-SAC to deliver meaningful relief from these litigation costs under full-SAC. Due to this, we would support the testing that's been proposed by the DOT and has been mentioned by others today. We think that would be a good idea and would help us all be able to understand the differences between full-SAC and simplified-SAC better.

If the Board specifies a limit for eligibility as a fixed dollar amount, we believe the railroad would still apparently be able to set their rates so as to capture this leverage that I discussed earlier. However, if the Board defines the limit with more flexibility, we believe this can

be avoided.

Specifically, we suggest that the Board allow simplified-SAC to be used without restriction whenever the relief in question does not justify the use of a full-SAC methodology. Initially, this would entail application of our proposal that no limits on the use of simplified-SAC be imposed for the combined full-SAC litigation costs of the parties exceeds the amount in dispute.

As more information becomes available, whether it's from testing or whether it's from experience over time with using the simplified-SAC procedure, the magnitude of the disparity between the simplified-SAC and the full-SAC methodologies will be better understood. And at that time, the Board should further apply this principle so that the incremental litigation costs of a full-SAC are not incurred unless justified by the magnitude of the expected error that would be associated with the use of the simplified-SAC.

We believe it would be sound public policy for the Board to approach to ensure that its

rules to not necessitate wasteful expenditures on litigation.

For shippers that elect to use simplified-SAC above the limits established by litigation cost considerations, the Board could limit relief by imposing whatever premium above the computed rate may be needed to account for perspective inaccuracies in the simplified-SAC methodology. For example, in a large case where a shipper chose to use simplified-SAC, the Board could incorporate a premium above the computed rate to ensure that the prescribed rate was not improperly low due to inaccuracies caused by the use of simplified-SAC. We believe any such premium would be small. The Board has already noted that the simplified-SAC procedure omits any possibility for future efficiency improvements relative to the defendant carrier current actual operations. So like I said, there are a lot of unknowns. Testing might help verify some of these things and as further information becomes available regarding the degree of correspondence between the simplified-SAC

method and the full-SAC methodology, this premium concept could be modified accordingly.

To facilitate this process, we endorse the comments of several parties to the effect that the Board needs to test the performance of any new methodology like simplified-SAC relative to full-SAC.

We were pleased to see that at least some of the railroad parties have embraced and cited our further proposal that the cost of litigating a rate dispute be shared equitably between the parties. Shippers who need to rely on the Board's rate reasonableness procedures are already in a situation where they don't benefit from effective competition, so they face the prospect of paying rail rates that are much higher than those paid by their cohorts. At the same time, they have to expend substantial resources on litigation that other shippers do not simply to establish a lawful rate level. Given that a rate case can also provide a railroad with information that is useful in its dealings with other customers, equity considerations

clearly appear to support some degree of litigation cost sharing.

Even with something as basic as the Board's fee for processing a rate complaint, the Board could require that some of that cost be shared. We believe such practices could help get both parties on the same page to agree on a rate that's consistent with the statutes with minimal unnecessary litigation.

On the aggregation issue or I guess we might call it the disaggregation issue, we believe that a shipper should be able to use any valid methodology on any portion of its traffic it wishes, of course, subject to whatever limitations on relief the Board may impose on these different methodologies. The Board can, of course, retain discretion to consider this issue on a case-by-case basis.

And also, on the simplified-SAC proposal, for reasons outlined in our written comments, we believe it's important that the Board retain the option for a shipper to specify the route

in simplified-SAC. Some of the railroad parties have tried to create the impression that the Board could safely rely on the carrier to route traffic efficiently and that any shipper speculation of an alternative route would be suspect. When the railroad has enough market power that the shipper must rely on the Board's rate reasonableness procedures, there are too many situations where use of this predominant actual route may legitimately be questioned. While we don't think this issue would come up in practice very often, the Board should not get rid of the only protection a shipper has when it has a problem of this type.

And again, appreciate the opportunity. Be happen to answer questions when it's appropriate.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Sharp. We'll now turn to Michael W. Snovitch of the Alliance for Rail Competition. Welcome, Mr. Snovitch. Please proceed.

MR. SNOVITCH: Thank you. Good morning, Mr. Chairman and members of the Board. My name is Michael Snovitch and I'm Executive Director of the

Alliance for Rail Competition and a veteran of the shipping industry. ARC appreciates the opportunity to testify at this hearing. I have tried to avoid duplicating the points being made by the speakers representing the Interested Parties since ARC joined in their comments and supports what those speakers are here to say.

The subject of this hearing is most important facing the Board since it can provide an understandable, affordable and effective way for the majority of American captive shippers to exercise their rights to challenge high railroad shipping rates as allowed by the Interstate Commerce Commission Act. The Board has other responsibilities under the Act, but shippers have received little from the Board in these areas.

For example, the Board has shown it has very limited ability to deal with service problems. It can require reports from the Board. That is has done in the past. But the Board has said it is reluctant to overrule railroad management on service for fear that ordering better service to shipper A

would result in worse service to shipper B. The Board's very limited in this action in this area has been consistent with this reasoning.

Another example is the Board could promote rail competition, but it may have painted itself into a corner. The Bottleneck and Mid-Tech decisions, various merger decisions and numerous decisions approving line sales subject to paper barriers mean that whatever the Board may do in the future may be a little too late. The Board recently issued the decision modernizing its SAC procedures, but SAC is only relevant to a very small handful of shippers, and the recent rulings by the STB, as previous testimony has indicated, questions whether filing has a chance of a shipper getting a reasonable rate.

While, ARC welcomes the Board's rail cost of capital and grain transportation proceedings, no action has been proposed in those proceedings to date. And the Board's action on the railroads cost of capital is not the same as clarifying how revenue adequacy constraint of

constrained market pricing will work. Therefore, the most important proceeding for the largest number of shippers is this one as many have testified.

If the Board fails to do the right thing here, small and non-coal shippers will be defenseless whenever railroads charge too much. Naturally, this will make the railroads happy and make them richer. The railroads may even use some of their profits from captive shippers to expand capacity. ARC certainly doesn't impose railroad investment or railroad profits, but there are right way and wrong ways for the railroads to invest and to obtain a fair profit. Money extracted through differential pricing from captive shippers should not be used primarily to benefit non-captive shippers paying lower rates. This is particularly objectionable for revenue adequate railroads that don't need more differential pricing.

There are also right ways and wrong ways for railroads to set rates for captive shippers. First, they should maximize the revenue from other traffic as the Board has recognized. Second, no

commodity or group of commodities should pay an unreasonable share. Third, no individual shipper should be singled out for excessive contribution. The Board's three benchmark approach generally addresses these criteria directly and ARC, therefore, favors it with some changes and minor clarification as described by the other witnesses.

However, simplified-SAC is clearly an indirect esoteric approach to these legal and common sense standards of rate reasonableness. As the other witnesses have stated, the simplified-SAC is more complex, more expensive and more demanding than the three benchmark approach. The railroads state it's superior. Of course, since they know it will rarely be used and may produce no relief if it is used. Everyone knows that a full-blown SAC can't be used in a small and non-coal rate case unless it is simplified. The proposal on the simplified-SAC by the STB does not get us there.

If small and non-coal shippers had an understandable, affordable means to challenge high rail rates, it will just mean they will no longer be

at the railroads mercy. This would create some bargaining leverage on the part of shippers that is sorely needed to offset the railroads power.

The railroads will and have claimed there will be a host of cases before the STB. This is nonsense. Any reasonable businessperson knows that litigation is only used as a last resort since the outcome is so uncertain. And I know that for a fact.

Railroad progress towards revenue adequacy will also survive adoption by the Board of a simplified expedited alternative to SAC. Capacity constraints are such on the railroads today that they are earning record revenues and profits with significant contributions from non-captive shippers. It is true that railroads will encounter greater resistance from captive shippers to very large rate increases which is the way it should be. No customer in a free market simply accepts a huge increase without looking at other options of which a captive shipper has none.

In summary, the Board's simplified

version of SAC is expensive and complex. In ARC's view, this is contrary to the intent of Congress which did not want captive shippers to be defenseless. It would be a grave mistake in the Board's most important proceeding. I thank you for your time and attention.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Snovitch. And I'll turn to Mr. Tom O'Connor from Snavely King Majoros O'Connor & Lee. Welcome. Please proceed.

MR. O'CONNOR: Thank you, Chairman Nottingham. Good morning, Chairman Nottingham, Vice Chairman Buttrey and Commissioner Mulvey, staff. We are pleased to be here today and I'm accompanied by Kim Hillebrand who is my coauthor on this entire proceeding, the several appearances that we've made. We're going to address in these charts today many of the points that you asked for comment on on January 22nd, and we'll give you additional comments in the February round as well.

On the first chart here, the key to the solution to these problems that we've been talking

about today is increased reliance, we believe, on marketplace strengths, marketplace dynamics. And we see an obvious opportunity to do more of that in increased access to and use of mediation. We're going to talk more about that as this presentation goes on. The mediation options, however, have to be combined with litigation options which pose a real alternative that both parties would be reluctant to embark on. If one of the parties, whichever party, sees litigation as a slam dunk, so to speak, for its side, that doesn't serve to motivate mediation. Mediation is really where the strength of this process lies.

The adequate litigation options, we think, would implement the Staggers Rail Act Long-Cannon factors. We have heard a little bit about that today. And the record is quite thorough in development of those factors.

Should address some sort of a remedy for captive shippers. That is the fundamental issue that needs to be addressed here, and it can be addressed at a number of different levels and it's a

global issue, if you will. On the one hand, and if we look at it microscopically or in a micro sense, if the railroads are in a captive shipper situation, it may appear to be that they have all of the power or most of the power. But if we step back a little bit and now consider the need to invest in the railroad assets and consider the need expressed by many of the railroads for some sort of financing help on that in the form of tax credits or what have you, then the picture changes a bit. And the fairness that one is asking for investment should be seen that same kind of fairness in equity in the treatment of the captive shippers.

But that particular problem remains to be solved. There's a lot of different ways to solve it. The Canadians solved it basically with a single word called inter-switching -- as a dramatic effect, easy to do.

In short, we have to learn from, I think, the experiences of the past and do a little bit better to make sure that we have an effective and equitable litigation option that'll energize the

mediation alternative which I believe is the real strength.

And we'll talk to you a little bit today about some of the specifics. Let's go to the maximum value of the case just at the get go. Here's what we're proposing here. To merge the small shipment and the medium shipment eligibility thresholds and increase them, we'll be back to you in February with what we think a reasonable will be on that combined threshold. But I assure you it will not be less than 3.5 million. So therefore, you would have one threshold that would apply to both medium and small, allow the complainant to choose which he's going to bring the case under. I predict that there will be a fair amount of cases brought over the years under the three benchmark method, and the simplified-SAC, I'd be surprised if you saw a single case. We'll talk to you more about that.

We've been showing this particular graph here for the last three or four years. We've presented it before you on a number of occasions and

we often use this graph. What this shows is if we had a $500,000.00 per year gain that was realized in a small shipment case, that is to say the rates were reduced by 500,000 or some gain or 500,000 per case. And then let's assume that we had 100 such cases -- now bear in mind we've had two -- we've been privileged enough to participate in both as has your staff, and I think quite well, too -- we have seen two in ten years. But let's assume that there were 100 such cases in a single year, all of them, each and every one of them realizing a $500,000.00 gain, that would amount to 1/10 of 1 percent of the rail revenue, 1/10 of 1 percent of the rail revenue, absolutely no threat to revenue adequacy.

Now that 1/10 of 1 percent is the figure we calculate with the 50 million. Fifty million is what we would get out of 500,000 times 100 cases. That's what we calculate using the 2002 waybill data, $40 billion in that number, 1/10 of 1 percent; 2005, it's up to 46 billion. Still 1/10 of 1 percent is a little bit -- we're out in the second or third decibel before we begin to pick up any

difference there -- 1/10 of 1 percent.

Also, there's kind of an implied comment on whether racheting has occurred. One would predict not.

Let's move on to the next slide. Simplified-SAC proposal -- the -- as I say again, the limits on the maximum value of the case for small and medium, we recommend combining them into a single threshold, increasing that threshold. We'll be back to you in February with what we see as a reasonable amount to set that threshold at and then let the shipper decide whether they bring it on three benchmark or bring it on simplified-SAC.

Now as I'm looking at simplified-SAC, it seems to me that it's not going anywhere. It's predicted pot -- and there's a little bit of history of here -- we've heard a little bit about the mid-90's attempt by the AAR that resulted in a --it was quoted this morning as 5,000 percent revenue cost ratio, but as memory serves me correctly, and I was not involved directly in that proceeding, but I want to say it was more like a 4600 percent revenue cost

ratio, not quite 5,000 -- but what was going on there was reductio ad absurdum, a method that could produce that kind of result and have that result be deemed as adequate, it basically disposed of the method. So again, we want to take a good look at testing before we go too far down the line with simplified-SAC.

But the predictable profit development which is what we're talking about in the bottom bullet is very easy to see. And Nick had some comments on this and other people have commented on it already. There's an almost automatic tendency of the parties to get the data and the analytic techniques more complicated, more thorough, more precise, more micro when you're moving in the direction of SAC. So the resting point of simplified-SAC is SAC.

So if you cannot solve your problem with SAC, with a little bit of development of simplified-SAC and the natural migration of it and the direction of SAC, you'll arrive at the same point, you'll have a complex process that basically meets

few needs. So I would -- and there again, the problem goes away if you let the shipper choose, let the complainant choose. I rather suspect there'll be very little choice for the simplified-SAC.

Litigation cost -- this is a point of clarification, we won't dwell on it -- a couple of places in the record, we are on the record as $50,000.00 consulting or consulting and legal fee. Think of that as a minimum. We have a little bit of experience in this, and it's safe to say that the $50,000.00, and that's, I believe the way that we said it, is the absolute minimum that you could do this on a good day with everything going in your favor. Now you can very easily get to 100,000 and above. Now we're talking small shipment.

Now think of it as a cost minimum, not an average cost, definitely not a cost maximum. It should not be used in either of those senses. The fact of the matter is that we had extensive experience working on behalf of both of those clients on whom we brought the small shipment cases. We knew their data very, very well. We knew

their operation very, very well, so there wasn't much of a -- wasn't much of a learning curve there. And we designed the cases to be solved in mediation and that is the way the first went to completion successfully in mediation. And I'm hopeful that the second case will go to completion successfully in mediation today.

Other issues -- aggregation. This is an easy one. The aggregation, I really recommend that you eliminate it. And in your January 22nd decision, if you will, you allow the opportunity to reinstall it if it becomes an issue. It's really just directed at abuse, and if you do not have abuse, then that should never come back up again. If you have abuse, you can deal with it very, very quickly. But if we have aggregation as a broad feature of the process, you're eliminating benefits that you could be providing. You could be solving problems for both the railroads and the shippers. So I would recommend dropping aggregation and return to it if, as and when it becomes an issue.

Routing of issue traffic -- not a

problem. I would definitely allow that. We've done a fair amount of network analysis of railroads over the years, and compared to the complexity of the proposed SAC methods, simplified-SAC methods, the routing alternatives are fairly straightforward. The problem that you run into is the need to cost on and off the stand-alone rail network. That's where the real problem is, and if we go back to an attempt that we made in another proceeding back in the 1980's, I can assure it can be done, but it is definitely not simple, and there is a great deal of opportunity for mistakes there.

Racheting -- we don't see that as a problem. Access to the unmasked waybill sample -- we see that as essential for both parties. The RSAM -- the new method we believe is better because it is more transparent and it includes all railroad traffic. When you were including all railroad traffic, an awful lot of problems go away. We don't have to worry about getting an upward bias by confining our traffic that we're looking to for guidance, if you will, in the sense of a comparable

RCR to that which is above 180 percent. Include all the traffic almost is a -- is like an axiomatic approach. And the same point on non-defendant traffic. Include all of the traffic.

Mediation -- this is what we believe. If you provide increased access to mediation, you will benefit all parties and you will benefit this Agency. You will succeed and so will the parties. And the reason is that it allows the parties to come together and produce a market solution working together collaboratively and creatively. And that's exactly what has happened in both of the cases that we have brought working with your senior staff in this fashion. This works. This works very well.

Moreover, it provides timely resolution. There is the number 20 days in the January 22nd piece. I would definitely recommend 30 days. And as I said earlier, we have -- Kim and I have a letter that would wrap up the second case today if we get the call from the client that the last little detail has been resolved. Otherwise, we'll probably ask for another week or two because we are that

close, we're that close. But we do need some time. I would say 30 days would be an adequate time. And as a matter of fact, I would think, too, that most of the energy, most of that time period, in fact, is going to be used in translating the agreement into a contract. It will not take long when people are pulling together to reach terms of agreement that'll be appealing to both. It takes a little bit longer to get it translated into a contract.

So additional benefits from mediation -- it is an economical alternative to litigation. Now bear in my mind, my low numbers contrasted with everybody else's high numbers, my low numbers are kind of based on a mediation approach to life, if you will -- three days, not three months, just three days. It provides confidentiality. That's part of the key to releasing that creative energy. Work together and not worry about whether you're going to have to face what you're proposing as a solution today in some adverse way downstream. And it's clearly win/win. Frankly, we see virtually now downside to it. It's very, very effective. And we

have used mediation here at the Board. We have used mediation elsewhere around the U.S., and it is my preferred method. We've used arbitration as well. I prefer mediation to arbitration.

Now in summary, we recommend rail rate reasonableness review based on the STB three benchmark guidelines. I would recommend letting your customers choose as to whether they want simplified-SAC or the three benchmark guidelines. I would predict virtually nobody will choose the simplified-SAC.

Now when you are pushing -- when you're leading people in the direction of mediation, there's something else occurring, too. I think that the constrained market pricing and stand-alone cost has met some needs. Clearly it's met some needs and it's morphed over the years, the last 20 years. That is a simulation of a hypothetical market. Mediation is the ability -- it provides you the ability to produce an actual market solution. You get the same strength without confining it to byzantine set of rules.

At any rate, as you have concluded by now, I'm quite a fan of mediation, and I recommend it highly to you. We've successfully used all of the techniques we recommend it in this presentation either here or in other mediation forums. And I can assure you they work. Thank you very much.

CHAIRMAN NOTTINGHAM: Thank you, Mr. O'Connor. And glad to hear the good news that there may be a second successful mediation concluded as early as today.

MR. O'CONNOR: That's my hope.

CHAIRMAN NOTTINGHAM: Congratulations and thank you for sharing that with us. Just I think aspects of your testimony were so important because it's a little told story that there are actually -- if I heard you correctly -- don't let me put, please, words in your mouth, but can I restate what you said basically is you've worked on two successful mediations, the costs, you know, range could be as low as 50,000 but, you know, maybe 100,000 but not that much higher if I heard you say?

MR. O'CONNOR: Yes. What I'll do,

Chairman Nottingham, is I will get the clearance from my clients --

CHAIRMAN NOTTINGHAM: And clearance -- I didn't mean to intrude on --

MR. O'CONNOR: -- put a number in, but the 50,000, if I were to start today, new case, but give me a case where it's a client that I've worked on over the years, and there are a number of those, we area definitely going to be saying to that client that we can do this for less than a hundred thousand dollars. We're definitely going to be under a hundred thousand dollars provided we can get it done in mediation and do not have to go over into the litigation phase.

CHAIRMAN NOTTINGHAM: Well, I think that's a message well worth hearing. We often do hear talk, at least, that it's just impossible to get justice, so to speak, before the Board for anything less than many millions of dollars, and I think you at least have a story that's very well worth hearing. And thank you for sharing that with us.

Let me ask -- in your mediation experience, how important was it, because I think I know the answer to this but I haven't personally gone through a mediation of this type, how important it is that all the parties come to the mediation really ready to give mediation a chance.

MR. O'CONNOR: Very, very important.

CHAIRMAN NOTTINGHAM: Sometimes we hear that it's not always the case. It's the litigation team has taken over, briefed their client on the four-year ordeal they're about to go off on, and they just want to get mediation behind them and are looking at the clock, so to speak, instead of across the table in good faith?

MR. O'CONNOR: That -- thank you very much for pointing that out, Chairman Nottingham. And that is a problem if and only one of the parties really is just kind of taking a brief detour on its way to litigation. But what we're suggesting here is that the litigation option should be sort of equally unappealing to both. And let's get them focused in the room on we can do the solution right

here. The -- there are three people in the room today, Rachel behind you is one, Kim is one, I'm the third who have firsthand experience with the first mediation and it concluded successfully I believe. I think all parties would agree on that and I expect the same kind of an outcome on the second one with a completely different case of characters. I mean only Kim and I are the same, the only two common ingredients in that.

CHAIRMAN NOTTINGHAM: Thank you. Mr. Snovitch, if I could ask -- one of your comments especially caught my attention about, if I heard you correctly, that you said something to the effect that differential pricing or rail revenues derived from differential pricing should only be invested to the, and I'm paraphrasing here, but to the direct benefit of the captive shippers who are being -- who are paying those differential prices?

MR. SNOVITCH: No. Not -- it's saying that its -- some of it should go to the captive shippers, not all of it should go to some of the shippers that aren't captive. In no way, shape or

form am I indicating all of it goes to captive shippers.

CHAIRMAN NOTTINGHAM: And this is all, of course, in the context, if I heard you correctly, of looking at investments that railroads say they need to make --

MR. SNOVITCH: Correct. This is --

CHAIRMAN NOTTINGHAM: -- maintenance, capital --

MR. SNOVITCH: Right. You must also contribute some of it toward the captive shippers, not only the shippers that aren't captive, for example, intermodal.

CHAIRMAN NOTTINGHAM: How would that -- how would we work through that in the real world. For example, a project that I had a chance to personally visit and we'll probably all familiar, somewhat, with at least is like the Chicago CREATE Project, one of the world's foremost traffic congestion points that causes increased costs in time and money for everybody, shippers, railroads, and is there -- maybe that's not the right example,

but could you imagine a scenario where a captive shipper wouldn't benefit from solving the CREATE mess just for example?

MR. SNOVITCH: I'm not indicating that that's -- some money shouldn't be spent on that project. Definitely captive shippers would benefit somewhat from that project, but you shouldn't just worry about, for example, a project that maybe services the intermodal traffic which is really a competitive type of traffic.

CHAIRMAN NOTTINGHAM: So let's say the Port of L.A. Long Beach happens to be the nation's busiest intermodal port, and it's fair to assume that a major reason the railroads are interested in investing in improved capacity in and around that port is to facilitate intermodal but maybe perhaps not the only reason, that presumably there is a big variety of traffic that goes through a busy port like that, how would we -- just I'm trying to sense how we would work through that, because is it -- it's, you know, the most extreme, I guess, interpretation of your remarks would be if a captive

shipper can't actually see the work crew --

MR. SNOVITCH: Right.

CHAIRMAN NOTTINGHAM: -- from his property line, then it ain't benefitting him?

MR. SNOVITCH: That's --

CHAIRMAN NOTTINGHAM: And the other extreme would be if it's in no way, shape or form could any reasonable hypothetical be developed that would show how the network on which that shipper depends would be benefitted -- you know, so there's these extreme -- I'm trying to get a sense how we would --

MR. SNOVITCH: Well --

CHAIRMAN NOTTINGHAM: -- work through that?

MR. SNOVITCH: -- the worse scenario is that the Board is responsible for dictating exactly where the money is spent by the railroads just because it's differential pricing money or captive shipper money versus non-captive shipper money. But the real situation here is I think captive shippers, if they feel they have opportunity at fair rates, a

way to get them, and especially the small captive shippers that we're talking about today, wouldn't be as concerned about where the money is spent providing they feel they have access to fair and equitable rates, they have a process in place, simplified, not very costly, very quick to complete. That's the key. But when they see they're -- they feel they're being exploited with very high rates and then on the other hand, they're not getting good service, and I testified at a hearing just recently by the grain shippers -- I'm talking about service -- and the issue was -- well, that revolved around that, that -- and they're one of the -- the parties out there that see themselves as being high rates and they get inadequate service. These are the ones -- they see it's unfair. Now if you solve the problem of rates, some of these other issues may go away.

CHAIRMAN NOTTINGHAM: Thank you. Let me just yield to Vice Chairman Buttrey for questions.

VICE CHAIRMAN BUTTREY: I was just going to ask Mr. O'Connor how he feels about Canadian

style arbitration?

MR. O'CONNOR: Well, I haven't arbitrated in Canada. I have testified in Canada and the Canadian situation has a number of differences between Canada and the U.S. One of the most important differences -- one of the most important differences is the availability of inter-switching where if we are within, I believe it's 30 kilometers of another option, you can request and receive -- if it gets that far along in the process, you can request and receive a competing bid. Let's say -- and typically we're talking CN versus CP here. Now I think there have been very, very few cases, if any, where it got all the way to receiving a competing rate that actually was moving traffic. But the very presence of a possible alternative alters the situation. When we bring additional alternatives to the transaction, everybody's thinking differently. Everybody thinks differently. It is the natural inclination of folks to want to capture all of the gains available for their side. Okay? And if they believe that you do not have an

alternative, their conception of those gains will be vastly greater than if they believe you have an alternative.

So in that regard I would say there are some aspects of what's going on in Canada that I think are beneficial here. It's been my experience over the years that we are typically leading Canada, if you will. In other words, what we're doing now, Canada may be doing five years hence. But in this one respect, I think they're leading us. And I see very -- the possible benefits of using that are immense. And it solves a problem which, if unsolved, will continue to percolate.

You know, legislative remedy that people were talking about three years ago, two years ago, one year ago, those legislative remedies begin to gather steam over time. I think the two pieces of legislation on the Hill, one of which would remove the antitrust exemption of the railroads, was a non-starter. I think it had one sponsor -- I don't even know who it was -- for like a year or two. Now the last time I looked at it, it had nine sponsors.

And the more moderate legislation that would require us, you, to take account of the presence or absence of competition in your rate reasonableness, that's all I'm suggesting here. That has, I think the last time I looked there, has about 20-some-odd sponsors. That one's getting close to having enough mass to become legislation. But it doesn't have to happen. You could solve it right now. You could take the impetus away from that bill right now.

CHAIRMAN NOTTINGHAM: Thank you for asking the question about pending legislation, Vice Chairman Buttrey. Thank you for your -- Commissioner Mulvey?

COMMISSIONER MULVEY: Yes. It sounds as though you're advancing the reciprocal switching up in Canada as a new form of contestability theory that you don't really need to have a service, just a threat of service could bring people to mediation and to resolution. We have mediation here in at the STB, of course. All of our large rate cases, start out with a mediation period. That has not fully

resolved any cases although it has been successful, in resolving some issues before we go to full litigation. But in terms of getting an absolute complete resolution, that hasn't happened. Both parties figured that, I guess, they could do better if they go for the full-SAC analysis. And those are the large cases where the amounts involved are fairly high.

Let me ask the group to comment on the exclusion of contract traffic from putting together the comparable groups. It's been suggested that the contract traffic is just too different. And I know some of you addressed it, but would other members want to address whether or not contract traffic should be included in the development of the comparable groups? Tom?

MR. O'CONNOR: I'll defer. Then I'll have comments on that.

MR. SNOVITCH: I go along with the testimony of Interested Parties.

MR. O'CONNOR: I think it should be included, no question about it. Yes, no question

about it.

COMMISSIONER MULVEY: So you don't think it's significantly different from the tariff traffic is that because of the changes that have occurred over the last ten years in the market for railroad services, or do you think that's naturally the case that there wouldn't be significant differences?

MR. O'CONNOR: Actually, it's both. I think that whenever we have 70, 80 percent of the universe, if you will, in a given category, then to exclude that category, we really run the risk of veering away from a good measure of the norm. And it's beyond question that contracting, which initially kind of got started slowly, then it has gain momentum since Staggers was passed in 1980, and now it is -- it's -- has been -- with a few exceptions that have popped up in the last couple of years, it has been the norm for how railroads prefer to handle the traffic and most shippers, I think, prefer to have it, too.

COMMISSIONER MULVEY: Although the lengths of the contracts have been shortening lately

as they've come due.

MR. SNOVITCH: That's correct.

COMMISSIONER MULVEY: One of the reasons why I think the staff developed the -- the simplified stand-alone cost concept, it's, in part, because the stand-alone cost concept has what stood court review, right? As you know, the Board has tried other approaches in the past, and they were struck down by the courts. One presumes that simplified stand-alone cost, would come closer to the full stand-alone cost, CMP approach, than would the three benchmark approach. Given that, don't you think that some shippers will choose to choose the SAC approach if indeed you would make the difference in the caps on recovery sufficiently different so that there would be an incentive to choose the SAC.

MR. O'CONNOR: I think if you've made the differences on the caps really dramatic so that, for example, you had the sort of cap that we're talking about on small -- and I don't think anybody really believes that that's a legitimate entry on the rates there -- but $200,000.00 is so small to

where it reducts you ad absurdum here, but if we had very, very tiny availability of eligibility, if you will, on the small, very high eligibility on the simplified-SAC, you'd almost push some of your market in that direction. But I think more of your market would just go away. Some of your market would still come to you in attempt to produce a workable result in mediation.

COMMISSIONER MULVEY: Well the $10.5 million and $13.5 million thresholds that were talked about by the previous panel is probably too narrow a threshold range to get anybody to choose a simplified-SAC. So if you went to say from 10.5 to say 21 or 25 --

MR. O'CONNOR: Right.

COMMISSIONER MULVEY: -- you might have more of an incentive to go for the simplified-SAC approach.

MR. O'CONNOR: Right. I can see simplified-SAC requiring that sort of a reward incentive. And almost it's a case, too, that you have to be geared up for it. Simplified-SAC, I

would say, is akin to war. I mean SAC is akin to war. There are no prisoners in that game. Whereas mediation is akin to a conversation among people working together. It's a different kind of a market.

COMMISSIONER MULVEY: Okay. Thank you.

CHAIRMAN NOTTINGHAM: Thank you, Commissioner Mulvey. Mr. Moreno, did I hear -- did you touch on the issue of contracts sometimes being a very -- resembling tariffs? Could you expand on that -- what you mean in saying that?

MR. MORENO: There are several perspectives to that. One is contracts in large part simply incorporate the tariffs by reference, and increasingly the contracts are getting shorter and relying more upon of the incorporation of the tariff terms. And even if they're not incorporating the tariffs, they are simply restating what the common carrier obligations would be if you were moving under a tariff rate. The contracts are also getting shorter duration which is allowing the railroads to change their rates upward almost as

quickly as they do with tariffs.

CHAIRMAN NOTTINGHAM: Thank you. Is -- and please don't take this question to be an effort to pry into anything that's confidential or strategic in the sense of business, but is there -- and I may ask Mr. O'Connor or anyone else to weigh in on this -- there is, of course, from the Board's perspective, at least one very meaningful difference between a tariff and a contract which is that one we have jurisdiction over and the other we don't. Do -- is that a consideration very often when you're talking about packaging up a tariff into a contract and then deciding how you label that page, as you use the C word or the T word? Or is that, you know, is that -- or is that even an issue in today's market?

MR. MORENO: I don't think it has been in the past. As more contracts are coming up for renewal, it's not becoming an issue simply because the railroads are refusing to enter into the contracts and moving over to tariffs. In the chemical industry, they are still entering into some

contracts. But as I said, those contracts are changing in form, duration to more closely resemble tariffs.

CHAIRMAN NOTTINGHAM: Okay. Mr. O'Connor, any experience in this regard -- you know, if we were to try to -- I realize I may be departing from the specific today, but it was raised and it got me thinking a little bit -- I mean is -- should the Board look for something meaningfully distinct between a contract and a tariff? Or are they all just the same, just different words used?

MR. O'CONNOR: They're quite differently actually. And what you see up until the last couple of years, as Jeff just indicated, is a pretty strong preference for contract on the part of both shipper and railroad. And if you'd -- I guess you'd have to ask the railroad members, whom you're going to talk with this afternoon, why they are less inclined to contract these days than they were early on. But there is a certainty that's available in the contract that's quite appealing, and it is more or less totally absent in the tariff. And the fact

that your rates could change within 20 days notice or less is a real problem.

And it's kind of an unusual example, but I had one instance in the last year or two where the rates changed kind of after the fact. It was kind of a procedural accounting type thing. The only problem was that the material had already been delivered, and ita was in a building owned by somebody else. And at that point, the rate went up on the freight, and one option would have been to get the building disassembled and backwards started but that wasn't terribly appealing, so they -- having a kind of a -- the ability to have short-term changes in the prices doesn't often get to you, too. That kind of a situation. But it is -- it's something to think about, especially if you're bidding a long job.

MR. MORENO: Chairman Nottingham, if I may supplement my additional response, I think one thing that would help you understand the relationship is how contracts, particularly in the chemical industry, are structured. They're often

entered into master agreements that may last for many years, but the rates themselves are set in lane agreements that are subsets of these master agreements. And these lane agreements are added as necessary as new lanes arise and typically may have a -- the rate may have a duration of one year subject to a renewal or cancellation on 30 days' notice. So in that form, the rates -- these lane agreements are often very closely resemble a tariff.

MR. O'CONNOR: I agree.

CHAIRMAN NOTTINGHAM: Thank you. Mr. Sharp, you had mentioned that we should be watchful for or concerned about the potential for railroads to actually influence the size of a case, shape the size, if I heard you correctly? Help me think through how that would happen? I just want to make sure I understood what you meant.

MR. SHARP: Yes. What I was referring to was -- and we've got an example that we gave in our prior written comments where the railroad can influence, if we have this hypothetical situation that we've set up here with simplified-SAC being

available versus full-SAC, that the railroads rates that they choose initially, you know, once it's known what the SAC and the simplified-SAC conditions are that would be imposed by the Board, it might be possible a the railroad prescribe an initial rate that they know would push you away from getting any savings out of the simplified-SAC.

CHAIRMAN NOTTINGHAM: Okay.

MR. SHARP: So in that sense, as I said, it kinds of puts them in the position of the decider as to which methodology would wind up being used.

CHAIRMAN NOTTINGHAM: Okay. Vice Chairman Buttrey, any questions?

VICE CHAIRMAN BUTTREY: Nothing further.

CHAIRMAN NOTTINGHAM: Commissioner Mulvey, any questions for this panel?

COMMISSIONER MULVEY: I just wanted to ask Steve didn't we address that point that you raised right now in the six changes we made to the full-SAC process just to try to get it so the railroads can't game the system by coming in with an excessive high rate? I thought that was one of the

things we addressed in the Ex Parte 657?

MR. SHARP: I think there were some things in 657 that helped that but in terms of looking at these -- this, like I said, what is now a hypothetical situation where we would have simplified-SAC versus full-SAC and the different options that we're looking at right now, we think there's still a possibility, there again dependent on the details the Board decides on ultimately. And I guess our main thing would just be to reinforce that we don't think it should be left that way. We think the determination of which of these methods to use should be completely in the hands of the complainant or the shipper.

COMMISSIONER MULVEY: And that's what we propose in our January 22nd decision. Thank you.

CHAIRMAN NOTTINGHAM: Mr. Sharp, just one more question if I could. Thank you for your patience. You described a concept or a recommendation, if I heard you correctly, or a proposal that we set no limits on a shipper's ability to avail him or herself of the simplified-

SAC process in cases where the cost of bringing such a case, if I heard you correctly, would exceed the actual award or damages. Help me under -- is that -- I don't want to -- I want to make sure I understood how you described that, because I just want to think through how that would play out and whether we would then need to be, as a board, looking at litigation cost to make sure that's -- it is as it's being purported. And I'm not -- it's a whole other area of work that we just want to make sure we fully appreciate before we venture too far down that way.

MR. SHARP: Sure. What I was saying was and what we recommend is that there not be any limits placed on the use of the simplified-SAC by a shipper where the combined full-SAC litigation costs do exceed the amount of the dispute.

CHAIRMAN NOTTINGHAM: Okay. So to play that out in a real hypothetical, if we use the $3.5 million benchmark just for discussion purposes, and a shipper incurred costs of $5 million bringing a case but only had, you know, $3 million or 3.4

million of actual damages, are you -- think they would avail themselves of the --

MR. SHARP: Well, we're just saying in that situation that there -- you know, that the Board shouldn't put any limits on the shipper's ability to choose the simplified-SAC.

CHAIRMAN NOTTINGHAM: Okay.

MR. SHARP: And if -- once you're in that situation where the benefits are not as great as what the full litigation cost is, we think the Board should make simplified-SAC available to the shipper without any other limitation.

CHAIRMAN NOTTINGHAM: And how would we know what the full litigation costs are? It would be something the parties would basically --

MR. SHARP: Well, that's -- like I said, there's been a lot of discussion about that today. I mean that's one of the things that we've all been commenting on and that's yet to be determined.

CHAIRMAN NOTTINGHAM: Okay. So it could be like sort of on an average in cases, not just particularly -- necessarily on one case or a case?

It could be some finding that on average, it costs a range. And we've hear some testimony today, but -- or are you indicating that it would be actually, you know, here's our law firm and consultant's bill, take a look at it STB and --

MR. SHARP: No. I would say it's more as you described, that there is some preconceived number or notion at least as to what these costs are and that in the determination of -- in these eligibility determinations that that gets taken into account.

CHAIRMAN NOTTINGHAM: Thank you. Any other questions for this panel? Thank you very much. This panel is dismissed. We appreciate your time and your testimony. We will call up our next panel. It's a panel of one. Mr. Gordon P. MacDougal from the United Transportation Union-General Committee of Adjustment who has requested three minutes, and we welcome you, Mr. MacDougal. Welcome, Mr. MacDougal. Please proceed.

MR. MacDOUGAL: Why thank you. I'm here in one issue. It's the issue of the compulsory

mediation non-binding before a member of this board, an employee of this board, in secret session. And member employees generally go along with the labor management. We have in all these rate cases with very few exceptions. But the employees are against secrecy. They want a transparent Agency, and they want, if there's going to be mediation, an independent mediator.

And we've made this -- Mr. Fistio has in four recent filings -- actually, not recent, in the last six years, Ex Parte 586, Ex Parte 638, Ex Parte 646 and Ex Parte 657, the idea of a big railroad and a big shipper, even though the big shipper has small shipments, and STB staff member getting together behind closed doors and deciding the welfare of rates in the country and things like that is just -- we're just against that.

If a carrier and a shipper want to have somebody in outside world mediate a dispute, they should not bring it here to staff. They can take it somewhere else if it's voluntary. But the proposal for a compulsory mediation -- if fact, we say -- I

say it's -- wasn't properly before the Board right now. It was not part of your initial notice back in July. It came up on January 22nd in a vague form and I don't think -- I think you have to put out for a new notice if you're really going to adopt a compulsory non-binding mediation before this -- before an employee of this Board.

The AAR in their comments support it, the Union-Pacific and jointly the Norfolk Southern and CSXT. You have not heard from, not in their comments -- it didn't go along with these three carriers, three Class 1, so far anyway -- did not hear from BNSF, Kansas City Southern, Canadian Pacific or Canadian National.

A little short history. You once had mediation. You had John Thune mediate. He was then with the Arent Fox government relations -- section of government relations with the Arent Fox law firm. That was in 2003. It was a BSNF rate case. You also had the next year Clyde Hart who was the vice president, government relations, of the American Bus Association as a mediator in another BSNF rate

cases.

The idea of having it compulsory is just -- just contrary to what the employees would want. We want an open society. If there's going to be -- it has to be transparent. Also, there's the independence thing. You had Congressman Thune and Clyde Hart were independent. If you have compulsory mediation at the FERC, there's an independent settlement judge, ALJ, assigned to it. It's an ALJ independent. If you do it at the Federal Communications Commission, you have a person who's also an ALJ, a settlement judge.

The idea of putting -- requiring mediation in secret before an employee of this agency just goes too far. You're going to have a great opportunity for scandal. And your employees are not angels. We had a problem in 1970 where the Congress, the Staggers committee, had hearings -- there's two volumes of it -- going into employee conduct in passenger train discontinuance cases. You had the shutdown of the ICC which was voted on by the Congress in 1994 because irregularities of

the -- of under charge, over charges could not be resolved. And you just -- to throw this to a staff situation, make it compulsory, you would just think won't work. that's all we have to say.

CHAIRMAN NOTTINGHAM: Thank you, Mr. MacDougal. Appreciate your testimony. Let me just think through it for a second if you could. I'll ask a question or two. Would you agree that -- what I hear you saying is that the UTU supports outsourcing in this case. Are you generally supportive of outsourcing across the Board?

MR. MacDOUGAL: Well, if people want to get together to try and solve their disputes, you're a carrier and a railroad, nobody can stop them and they should. They can arbitrate or they can mediate, call somebody else. That's not what -- they can do what Mr. O'Connor wants, have it a voluntary situation. But you're proposing to have it compulsory and before a staff member of this board in secret. That's what you're proposing, and it ain't going to work. I don't think it's going to work.

And other agencies put in safeguards you can rely on your staff. But they're not angels, and we've had problems in the years. Those of us that have practiced here know that staff, particularly a lot of them relatively inexperienced in rate making, and to give them that authority and put pressure on parties, and it affects employees because indirectly we are affected by what you do. We just think it isn't the American way to go.

CHAIRMAN NOTTINGHAM: Would you expect the overall cost of mediation under your proposal to be higher than they are under the way the Board currently handles mediation or --

MR. MacDOUGAL: Well, I'm not -- I'm just saying if they -- I'm not -- I'm saying they should not be required. There should not be any binding mediation period whether it's before this Board or otherwise. But parties are free, of course, to seek arbitration or mediation outside this Board as a voluntary decision on their part. I would not make it a requirement for small rate cases. In fact, we've opposed it even in large

cases. That's the citations I give to Mr. Fitzgerald's testimony since 2001.

CHAIRMAN NOTTINGHAM: But wouldn't you agree generally it would be a fair assumption that it would be more expensive to require folks to hire private sector independent mediators? And it may be well worth the expense given your beliefs but I just --

MR. MacDOUGAL: Well, the question is hire. I don't think you should hire anybody. It should not require anybody to be hired. It certainly should not be someone that's employed by this Board.

CHAIRMAN NOTTINGHAM: So there are -- I'm just not aware -- there are people out there who do this kind of work pro bono?

MR. MacDOUGAL: Oh, yes. There's all kinds of people. There's all kinds of retired rate sharks and people that'll do things like that. Sure.

CHAIRMAN NOTTINGHAM: Can we get them to handle SAC cases as well pro bono?

MR. MacDOUGAL: You can --

CHAIRMAN NOTTINGHAM: That would solve --

MR. MacDOUGAL: -- in fact, you ---

CHAIRMAN NOTTINGHAM: -- a lot of our problems we heard today.

MR. MacDOUGAL: You have a list for arbitration of a number of people, about 20 or even more experienced practitioners who have signified that they would like to be designated as available to resolve disputes. That's your private arbitration list.

CHAIRMAN NOTTINGHAM: Vice Chairman Buttrey, any questions? Commissioner Mulvey?

COMMISSIONER MULVEY: I have a few. Of course, our current mediation is compulsory, but it's non-binding and we're not proposing binding mediation. They can sit down, they can discuss it, and hopefully that they resolve some issues before they go to full litigation. But it's not --

MR. MacDOUGAL: Yes, it's --

COMMISSIONER MULVEY: -- it's not

binding.

MR. MacDOUGAL: -- if it's a major case in SAC cases.

COMMISSIONER MULVEY: Right.

MR. MacDOUGAL: And we were against that because you'd given that to a staff before you realized going to send it outside to John Thune and then to somebody else. You see? But then you -- when you bring it in to your own house, and don't give an ALJ to it, you're going to have problems.

COMMISSIONER MULVEY: What would you say is more important to you, The fact that we are doing it with an in-house staff person rather than a or a Clyde Hart rather or a John Thune or an ALJ or the transparency issue that it's done in closed doors?

MR. MacDOUGAL: Well, we're against it completely anyway. I would say the better thing would be to send it out to a person that's independent if you're going to do it -- that way.

COMMISSIONER MULVEY: And not have it in-house at all, even with an --

MR. MacDOUGAL: Not in-house at all.

COMMISSIONER MULVEY: Because you --

MR. MacDOUGAL: Because you don't have ALJ's, because if you set up an ALJ, your staff's going to be jealous with the ALJ. That's why you don't have it here.

COMMISSIONER MULVEY: Well, we looked at the possibility, as you know, in the last couple of years of whether or not we were going to bring on an ALJ, and we have given that some consideration -- so --

MR. MacDOUGAL: All right.

COMMISSIONER MULVEY: -- maybe we'll think about it again some more.

MR. MacDOUGAL: Other agencies have done that and they've split it within the ALJ's between settlement judges and regular judges.

COMMISSIONER MULVEY: Okay. Well, one of the problems with having somebody doing the mediation who's a staff person, that person then is recused from the case, and given how busy we are here and given our staff, we may want to try to avoid having people being recused from cases. Thank

you very much, Gordon.

MR. MacDOUGAL: Thank you.

CHAIRMAN NOTTINGHAM: Thank you, Mr. MacDougal. We will -- we have made good progress through the panels today, but we do need to take a break. We're going to break for exactly 60 minutes and return here at quarter 'till two o'clock and move right out with the next panels. We appreciate everybody's patience today.

(Whereupon, off the record at 12:49 p.m and back on the record at 1:49 p.m.)

CHAIRMAN NOTTINGHAM: Good afternoon. We will resume the hearing. We have our fifth panel, comprised of Mr. Samuel M. Sipe, Jr., representing the Association of American Railroads; Mr. Richard E. Weicher representing the BNSF Railway Company; and Ms. Louise A. Rinn representing the Union Pacific Railroad Company. Welcome and please proceed.

MR. SIPE: Thank you, Chairman Nottingham.

PANEL V: RAILROADS

MR. SIPE: It is a pleasure to be here this afternoon on behalf of the Association of American Railroads. This is an important proceeding. We recognize how much effort has gone into it on the part of the Board's staff and the Board members.

These issues are not easy issues. The various parties to this proceeding have been dealing with them and some might even say struggling with them for the better part of probably the last 15 years.

AAR has participated in the earlier stages of this proceeding in the hearings back in 2003 and 2004. And among other positions, we advocated back then the development of appropriate standards for case involving truly small shippers because we believed at the time that a lot of the concern about the Board's existing standards was whether they would accommodate the interests of truly small shippers.

As we heard this morning, the focus has shifted from truly small shippers to small cases.

And AAR is comfortable with and thinks that that focus is appropriate. In fact, we believe that if there are truly small shippers out there who need relief, they will bring truly small cases. And we support the Board's proposal to have two simplified standards: the simplified SAC standards that would address the intermediate cases and the three-benchmark standards that would address the truly small cases.

I'm going to direct most of my comments this afternoon, try to at least, to the questions the Board posed in its January 22nd decision. And I'm going to begin with the issue of eligibility, which, for the railroads is clearly a critical issue in this case.

And AAR approaches that critical issue really in terms of concept, rather than numbers, hard numbers, because the individual member railroads have probably somewhat differing views about hard numbers.

So I'm not going to be giving you numbers, but I am going to speak to the critical

issue underlying the eligibility criteria. And that is how much traffic should be exposed to rate scrutiny under standards that are simplified and less than the optimal standards that the Board has to determine rate reasonableness.

That's really what's at stake for us. You have constrained market pricing standards that the Board has repeatedly identified as the best and most reliable available to it. And everybody knows that stepping back to an alternative standard, particularly in this case the three-benchmark standard, is a step away from the most accurate standard that you have. And the question is, the line that you need to draw in our view is how much traffic should be exposed to scrutiny under standards that are less precise?

The persistent revenue adequacy of most of the Class I railroads and the pressing need for additional investment in rail capacity underscore the need for eligibility criteria that are no broader than absolutely necessary to permit rate cases where CMP is too costly.

Shippers in this proceeding have signaled a desire for eligibility thresholds that expose as much traffic as possible to the three-benchmark standard, which has no demonstrable connection to CMP. Nobody has tried to defend it on that basis. And we think that exposing the reach of an admittedly inferior standard is a short-sighted position for the shippers to be taking. And it's not in the long-term national interest of a sound rail system.

The Board's 1996 decision in this proceeding and its notice this year both indicated that the benchmark approach should be the method of last resort and with good reason.

A widespread departure from CMP would occur under expanded access to the three-benchmark approach. And that could adversely affect the railroad industry's financial prospects and its incentives and ability to invest in needed capacity.

Now, we heard this morning about concerns that the railroad's revenue, adverse revenue, impact concerns were exaggerated. And the

reality is none of us sitting in this room knows how many cases will be brought under revised rules. We may have our guesses, but nobody knows for sure.

However, the railroads have to be prudent in this proceeding. We have to guard against the potential down side. Having come so far and gotten to the verge and in some instances perhaps beyond the verge of being revenue-adequate, we can't afford to let that be dissipated by exposure to rate standards that are not consistent with the CMP approach. And that's really the basis of our position on eligibility.

There was a reference this morning to the Board's I believe table 2, which indicated that approximately 17 percent of the revenue on traffic above 180 percent of variable cost, would be exposed under the threshold, exposed to challenge under the threshold the Board has initially proposed in this proceeding.

And there was a statement that that table had been discredited. I don't think it's been discredited, not in our judgment, but I think it's

up to the Board and its staff to determine. Seventeen percent of the revenue -- and I'm not suggesting we would stand to lose all of that, but it's a non-trivial amount of traffic. And it reflects the basis of our concerns about that eligibility criteria.

Let me turn to the maximum value of the case proposal and the so-called small case model that was discussed in the January 22nd decision, which I believe is an outgrowth of a proposal that AAR made. And various member railroads endorsed the same approach. And our basic approach was a shipper who doesn't believe that he is likely to receive rate relief ranging all the way down to 180 percent of variable cost could, in effect, increase the amount of traffic that would be subject to challenge under the respective approaches by stipulating that he would not seek relief below a certain level.

So to make the example concrete, if a shipper had a movement with an R/VC ratio of 300 percent -- and the shipper can tell what his R/VC ratio is, he doesn't need waybill data to do that --

and doesn't believe or even necessarily desire to achieve a rate at 180 percent of variable cost, he could, in effect, stipulate to a floor of 240 percent of variable cost and, in effect, double the amount of traffic that would be eligible to consideration under whatever standard we were talking about. In my hypo, I guess it's the three-benchmark standard.

AAR is encouraged that the Board and other parties appear receptive to a proposal concerning the maximum value of the case that's similar to this stipulated approach that we talked about in our earlier comments. And we believe that the Board's proposed modification could make sense.

However, I agree with some of the shipper witnesses this morning. We can only say for sure whether it makes sense if we know what eligibility criteria it's tied to. I mean, if we're going to allow shippers who have movements generating revenue of millions of dollars a year, elect to proceed under the small benchmark approach on the theory that they're only going to go for a

portion of the relief, I don't think that's going to work. I don't think that's what the Board intended when it said the three-benchmark standard was, in effect, a standard of last resort.

So, although we would be comfortable with this approach, if it is linked to reasonable eligibility standards, we don't think it would be appropriate if the eligibility standards are raised anywhere near the levels that were being discussed by some of the shipper advocates this morning.

Now, the Board proposed in the January 22nd decision that a complainant would be free to change its mind about what type of case to bring until the filing of opening evidence. We're not comfortable with that. We think that that could result in wasted effort in these proceedings.

And there is a much simpler and more straightforward way to deal with this situation where the shipper decides that he has proceeded under the wrong standard. And that is to let him dismiss his complaint without prejudice and refile it under a different standard. But there is no

reason why defendants should have to contemplate the possibility of preparing for one kind of case and then shifting in midstream to defend a different kind of case.

On aggregation, AAR believes that it would be inappropriate for the Board to abandon its aggregation rules because they are a necessary tool for avoiding or policing abuse of the small rate case process.

However, we do think the rules could be made more flexible by creating a rebuttable presumption in favor of aggregation. In other words, the burden would be on the shipper to show that aggregation is not appropriate in an individual case, rather than on the railroad. And we think that makes sense because the shipper is the party bringing the case and deciding what movements to include in a rate reasonableness challenge and should have thought through that issue before the complaint is filed.

The AECC proposal to base eligibility on railroad as well as shipper costs is another

question that was posed in the January 22nd decision. We think their suggestion that eligibility limits should somehow be tied to the costs of railroads as well as shippers is not consistent with the statute, which clearly contemplates balancing the value of a case from the shipper's perspective against the costs that the shipper would incur to pursue the case.

The intent of the statute was to enable shippers to pursue cases. And the underlying logic is that developing an expensive, full, stand-alone cost presentation would not be worthwhile to the shipper if the expected gain or value from the case is less than the cost of pursuing the case. The cost to the railroad of defending the case is not relevant to the issue of value from the shipper's perspective.

AECC's argument involves a theoretical economic proposition about what constitutes efficient use of resources, but it has nothing to do with the statute and doesn't provide a principal basis for doubling the eligibility thresholds.

Simplified SAC, the Board asked whether the statute permits the possible use of two simplified rate standards and I believe also whether simplified SAC could permissibly be one of those standards given the language of the statute.

We think the answer to both those questions is yes. The statute as enacted directed the board to complete a pending rulemaking by a certain time period and to develop a simplified procedure in that rulemaking.

Nothing in the statutory scheme limits the Board's ability to develop additional or alternative simplified standards down the road. In fact, you did complete the rulemaking back in 1996. And this is a further step forward. And the statute certainly doesn't direct you to adhere only to one simplified standard.

I think in this connection, it's worth noting that SAC itself, which is the standard referred to in the statute, is only one of several constraints that a shipper can pursue under constrained market pricing. So as a logical matter,

there is no reason why there could not be multiple simplified constraints adopted by the Board.

We don't think there's any basis in the statute to assert that the simplified SAC approach or the simplified approach that's adopted must be disconnected by CMP and SAC. On the contrary, Congress made clear when it called for the development of a simplified procedure that it did not intent to erode the constrained market pricing principles adopted by the ICC for full SAC presentations.

The Board itself has repeatedly stated that CMP remains the most accurate and preferred methodology for evaluating the reasonableness of rates. And to the extent that simplified SAC borrows from and incorporates the logic of SAC, it's clearly closer to CMP than the three-benchmark approach.

Now let me turn briefly to a couple of points about the three-benchmark approach.

CHAIRMAN NOTTINGHAM: And, Mr. Sipe, if you could just wrap up in about a minute, it would

be helpful just to stay on track.

MR. SIPE: Sure.

CHAIRMAN NOTTINGHAM: I hate to cut you off, but I just --

MR. SIPE: No. That's fine. I --

CHAIRMAN NOTTINGHAM: Go ahead and wrap up.

MR. SIPE: I'm untethered here in terms of a light telling me where I am and --

CHAIRMAN NOTTINGHAM: I know. I'm sorry about the time. This is your just sort of one-minute notice. Go ahead and --

MR. SIPE: That's fine. I just want to make the point about access to waybill data. We feel strongly that the shippers' request to have pre-complaint access to waybill data is inappropriate. It's contrary to your precedent. It would have adverse policy implications in terms of potentially dampening the interest in contracts down the road.

In fact, we don't think you even need to get to that issue if you were to determine, as some

railroads and perhaps other parties have indicated, that contract rates should not properly be included in comparison group traffic.

And I will wrap up with that and turn it over to Mr. Weicher.

CHAIRMAN NOTTINGHAM: Mr. Weicher, welcome. And proceed.

MR. WEICHER: Thank you. Good afternoon. Thank you for the opportunity to address the Board, Chairman Nottingham, Vice Chairman Buttrey, and Commissioner Mulvey. I'm Richard Weicher on behalf of BNSF.

I will try to guide myself through the Board's order to make sure we cover those points and be happy to address any questions. First, in general, we support the Board's efforts to come up with small case standards that are expeditious and simpler. We think what they have on the table comes very close to doing that and is a feasible approach that should be moved forward.

The general issue raised in the January 22nd order of a sort of small claims complainant

would choose proposal, we think that could be workable, make sense. We don't oppose it. It would sort of take the edge off. Whatever witness Sharp was talking about this morning in terms of who is choosing what, the complainant would have control over remedy versus cost. It could make sense.

In terms of starting and stopping, we probably would endorse something like the AAR described. It's always possible to start over again. We don't think that if the shipper changes his mind we should be prejudiced in terms of the procedure and time frame, but he would control his destiny and the complainant could decide where they were going. We don't oppose that. We think that general package is a good idea.

On the eligibility or the general questions on aggregation, litigation costs, and so forth, first, as to the aggregation issue, we support the Board's original aggregation type of safeguards.

We don't think a so-called small case should be a Trojan horse for something else. That

seemed like a workable way to do it. A very practical way to soften that edge that keeps it in the Board's control is make it a presumption, make it a presumption that you can make it easy to rebut if it's troubling, and still leave in place the idea that there should not be a reasonable aggregation of just anything goes in this.

Litigation costs, which is sort of the bulwark, the logical connection with these categories, we think that has sense to it. It does relate to the access issue. That's supposed to be what these rules are about, to make access of different categories.

And we think these rules and thresholds should not encourage litigation. They should relate to the complainant's access issues. I don't think risk factor has anything to do with this. This is supposed to be a gaming exercise or something that drives to a point of an economic indifference.

If there is a problem, the shipper should perceive they have a problem. And we should be looking at the shipper's alleged or perceived

access issue, not some other construct. And it should be the complainant's costs that are relevant, not the railroad's.

I think it falls to BNSF to address the Otter Tail issue that was raised this morning and has been debated. I have tremendous respect for complainant's counsel in that case. They are experienced and fine counsel.

I think in this case, there is a great deal of hyperbole to suggest that that was a simple case. It didn't seem simple to us. We spent a lot more than the $3.5 million threshold on that case, but there's nothing typical of that case. Not only is it pre-six the new rules, and we'll come back to that because we think they should simplify SAC cases and make them less costly.

But in Otter Tail, it would be fair to characterize that as four stand-alone cases. They started in June of '03 with the first filing of the stand-alone railroad. And recall that the choice of the stand-alone railroad in the initiative -- I'm sorry to digress into this, but it's been raised.

There's a lot of talk. I'll make this as brief as I can, but it's very relevant if we're going to talk about the comparison of the stand-alone costs.

First they filed the stand-alone railroad. Within a month or two, they did an extensive errata, which was basically a whole new stand-alone railroad or a reworked one. We, of course, have to reply to these or figure out how to adapt to them at great cost to outside consultants and fine lawyers.

Then January of '04 they filed another stand-alone railroad with a new operating plan based on a revised traffic route. And then in April of '04, give or take, they filed another stand-alone railroad based on the operating model they adopted after the repudiation of the so-called strong model, which the Board and the staff will recall is another whole sideshow fight over what kind of model should drive all the operating revenue and expense assumptions in the stand-alone railroad, a lot of time, a lot of money, and a lot of efforts.

If you take their 4.5 million figure,

which they probably got a lot of good value from complainants' counsel and lawyers in that case for that, they could have done one round for probably a million and a half. But, be that as it may, it's the shippers' cost of what they choose to do.

From BNSF's standpoint, we have to vigorously defend these cases. In the particular circumstance of the last few years or the period of this case, we have the privilege to be before the Board on multiple cases and the honor of defending them. We have to look at the broad concepts. And when we're spending a lot of money in one case on string model development defense against some model or something, we're thinking of the big picture.

We do think the new guidelines, we shall see, have simplifications in various operating assumptions. URCS models things that should bring the costs of these cases down. That remains to be seen, but there is nothing to keep the Board from periodically revisiting what it establishes here, at least not that I'm aware of. These should be reasonable categories that relate to the true

shipper access issue.

Turning to the simplified SAC proposal -- excuse me -- the three-tier approach, we support the three-tier approach. We think three tiers make sense.

We think a small rate case, truly small, can work or we're willing to give it a try, this benchmark approach. It isn't linked as far, as we can see, to true constrained market pricing. But it could be rational if addressed in a truly small claims type of context, which is why it's important not to vitiate the category.

We are flexible on the 200,000 category. We can see some play there. Nobody knows what that's really going to cost, but that doesn't open the door to these, frankly, ridiculous multimillion-dollar ideas that have nothing to do with anything.

First of all, as the Board has observed, it's going to be pretty hard to characterize that as a small case-type thing, but also it makes no sense. It may cost a bit more than 200,000, but we don't

think it makes sense that you gut it by those kinds of proposals.

On the issues that you raise in the order on the three-tier approach on the routing at issue, traffic, three tiers can be reasonable. And we think on the routing issue, it makes sense to not have rerouting. There's less to argue about.

That's been a pretty contentious issue in some of our cases. It can add complication. And it is simple. And it is what is happening. So, I mean, it is not an unwarranted assumption to stay with what is there.

Finally, on some of the individual issues that you have raised on the three-benchmark approach, we think some of them are quite important. They are a very little bit in the weeds. But the rationing issue we think using the average or the average with confidence is in error.

What you're doing here we think in these comparative groups in this benchmark, I think, is you're looking for a way to find the outliers. It shouldn't be the purpose to melt it all down to some

average. That's not what the shipper should be entitled to. That completely ignores characteristics of the move.

We have suggested or endorsed an approach such as using a standard deviation, that the top of a range of a standard deviation, something that reflects what is going on but isn't just a rationing average. We think that would be a mistake and go farther from any concepts of differential pricing.

On the waybill sample issue you raised, we don't think the waybill access should be used as an opportunity for cruising, for fishing expeditions by the rate sharks to just find what's out there. That doesn't make sense. There are privacy, I think associated with the waybill, privacy issues and legal issues associated with the waybill sample.

It could be open in discovery with protective orders when there is a real case, if there is something of real validity to be looked at but not just something that is fished through.

If you are sitting out there and you

don't even feel you have an issue, why should someone be hired or someone be soliciting you based on their rummaging through the waybill sample?

The RSAM, the revenue shortfall allocation method. As part of the benchmark approach, we do think it would be a mistake to eviscerate the meaning and significance of RSAM by going to this broad average that ignores over 180 percent concept.

There isn't much linkage in the three-benchmark approach to the issue of railroads' revenue needs. I mean, we're being called upon for tremendous capital investment, to deal with infrastructure, to deal with demand.

The original RSAM concept at least deals with this issue of where the traffic over 180 or where it needs to be to generate adequate revenues. If you sort of gut RSAM or take it down to this general average, we think that's further weakened. And as a part of the elements that are looked at in this package, the original RSAM to us makes a lot more sense.

Non-defendant traffic and contract traffic. We think contracts are quite different. As a railroad, we enter into contracts for a variety of reasons. We do both contracts and tariff.

Contract can often come with equipment commitments. It comes with our commitment to be there, fix the -- contractually read upon what's in the rate, a commitment from the shipper. There could be service commitments. There could be liquidated damage commitments. There is a time frame. There is a defined fuel surcharge.

There are all kinds of things going on back and forth that affect the value. Those rates and that overall package are not necessarily comparable to a common carrier rate.

And, by the same token, non-defendant rates, somebody else's rates, we don't think should be either held against us or for us in a rate case involving BNSF Railroad. There are pluses and minuses in contracts. And somebody else's railroad is somebody else's railroad.

Finally, on the mediation question you

asked, we are very open to mediation. We have been in mediation in large rate cases. There has been a forum for communication. We haven't solved a couple of them that have been through major mediation.

That doesn't mean it can't work. We have had very good success in other contexts with mediation. It could well be more useful in a smaller case, where the cost of litigation is a different range and what is at stake is a different range.

We are always in favor of communication and working these things out privately with our customers and shippers. That's the way we would prefer to do it. For that matter, we're open to the and we have participated in the private sector arbitration and ADR things.

We're familiar with NGFA and short line things. We think there should always be left open the opportunity for private recourse. And to the extent the Board can facilitate that, we think through a mediation and a quickie one, we think that's a positive thing and certainly worth trying

and should not impose any substantial costs on the parties.

I think my time is up. I will stop.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Weicher.

Ms. Rinn, please proceed.

MS. RINN: Good afternoon, Chairman Nottingham, Vice Chairman Buttrey, and Commissioner Mulvey. Union Pacific is pleased to have the opportunity to appear at today's hearing to address these important issues.

I am going to begin briefly with a review of the principles that we have relied on to inform our comments in this proceeding before addressing three of the issues or questions that you raised in your January 24th order.

Union Pacific's positions in this proceeding have been guided by these principles: that low-cost, efficient, simplified procedures for small rate cases benefit both carriers and shippers; that these simplified procedures can best satisfy the Board's statutory mandates if they adhere

closely to constrained market pricing principles; and, finally, that simplified procedures should be designed to minimize disputes and to facilitate parties' ability to resolve disputes by negotiation or mediation.

We acknowledge that stating those principles is far, far easier than developing rules and procedures that implement those procedures, but we believe that the Board's proposals represent serious progress in that direction. And we have strived to provide constructive comments on how we can move closer towards those principles.

And I'm going to address a couple of issues, a couple of questions where we think that UP has a unique perspective. And those will be addressing the questions of the cost of full SAC cases; the cost of the simplified SAC; and, finally, dealing with practical drawbacks to reliance on the revenue to variable cost benchmark method.

In terms of the cost of a full SAC case, some of my comments were anticipated by both Commissioner Mulvey coming up with that extensive

list of things that have been simplified or taken out in a simplified stand-alone. Some of them have been anticipated by Mr. Weicher in dealing with some of the issues that were dealt with in the Otter Tail case.

So I'm going to focus on another actually controlled experiment and depart from my prepared remarks. And that would be I would like to draw your attention to the Wisconsin Power and Light and the Northern States Power case.

Both involved complaints against Union Pacific for the movement of Powder River Basin coal: one to Sheboygan, Wisconsin; the other to the Twin Cities area in Minnesota.

We lost Wisconsin Power and Light. I also want to say that Wisconsin Power and Light basically finished almost on schedule, as anticipated by the Board's rules.

The case began in January of 2000. The evidence was completed in September of 2000. And there was a decision out by October of 2001. It was delayed for two things. The Board abeyed the

proceeding briefly to see if the parties might be able to reach an agreement in light of the FMC decision. And then the shipper asked for additional time for its rebuttal.

The rate ended up being dictated by the jurisdictional threshold, 180 percent of variable costs. Therefore, I disagree with the statement by an earlier witness today that variable costs have never played a role in the decision of a major stand-alone rate case.

I disagree with another statement that these proceedings have never been able to finish on time. The chief contrast between Wisconsin Power and Light and Otter Tail is we were not arguing about how you allocate revenue.

We were not arguing about what the rate prescription method should be. We were not arguing by many of those very contentious and complicated issues that have been featured in recent stand-alone cases and which were addressed in the Board's 657 decision.

The next year we have the Northern

States Power case. Given the results in the Wisconsin Power and Light case, we said, "Why should we spend extra money on consultants and lawyers when we can read the tarot cards and we can see where this is going to end up?"

Union Pacific went to the shipper proposing, Let's jettison the stand-alone and do this on a variable cost basis. Better yet, we don't need three rounds of simultaneous filings on variable costs. We can do this in two rounds.

The shipper reluctantly agreed to jettisoning the stand-alone, but they did. They would not agree to reducing it to two rounds. They insisted on three rounds.

And I can tell you that -- and I believe we have made a record in the 657 proceeding and in the hearing on this same topic in April of 2004 -- that Wisconsin Power and Light cost us $3 and a half million.

I have been hoping that with the focus on the jurisdictional costing only, we would save most of that money, but we didn't because of the

shipper's insistence to do very aggressive discovery, to do three rounds when, frankly, the third round was regurgitating things we had already said before.

We ended up spending -- and I can't remember precisely this, and we will complete the record on this. We ended up spending a substantial amount of the money in Northern States Power that we did in Wisconsin Power and Light. And it was that experience which informed UP's prior testimony at some point that we thought that the savings by going to unadjusted URCS costs, even with some modest movement-specific adjustments we have proposed, would easily save one million dollars in a stand-alone rate case. So we think that that is also relevant to your consideration about the cost and the motivation of parties in order to save this case.

I want to come back to one final conclusion, and that is the observation that I believe that the parties on both sides are rational. I believe that they are represented by sophisticated

and well-meaning lawyers and consultants. And I believe that the reason that you have heard testimony about the cost of full-fledged stand-alone cases costing as much as they have is the value.

Those cases involve millions of tons of coal every year. They have until the 657 decision involved a rate prescription for 20 years. It's worth too much money for both parties not to go to extraordinary lengths of detail to address minor issues.

I submit that those same rational parties if they are going to be dealing with a case of a different value are going to make different litigation judgments about what drives the case and what it is worth concentrating their resources on.

So I am now going to turn to a second question you asked, which is whether the Board has underestimated the cost to litigate a simplified stand-alone case assuming no rerouting.

UP's position is we don't think that it has. We would also submit that another relevant question that, interestingly, no party has addressed

in this proceeding is, what is the cost of doing the revenue benchmark test?

And we think that it is telling -- please keep this figure in mind -- that we have testimony that doing a mediation by a consultant who is very familiar with the shipper and his traffic will cost $50,000. That's a mediation for a few days and getting it resolved.

How can a revenue to variable cost benchmark test, which is going to involve going into uncharted territory about waybill sample, cost less? It's going to have to cost more. So the important thing is to weigh what is the revenue to variable cost benchmark test going to cost relative to simplified stand-alone?

Now, as I said, I'm not going to repeat the things that Chairman Mulvey (sic.) and Mr. Weicher have already addressed, but I want to point out that we think that the shippers cost estimates in our experience are overstated. I have already explained why if you take out the variable costs you can save a lot of money.

I have contrasted the Wisconsin Power and Light experience to the Otter Tail experience, which I again believe gives you an idea of the order of magnitude of the difference in terms of trying these cases.

I am, finally, going to turn briefly to one slight factor, which deals with the way that shippers value risk. And now I am going to indulge or ask for your indulgence to talk about another rate case: Arizona Electric Power Cooperative.

Ultimately -- and I believe that the complainant in this admitted in either a brief before the Board or a brief before the D.C. Circuit about one-third of its route to move New Mexico coal to an Arizona power plant was moving on a low-density BNSF line to interchange with UP. Because of the existence of that low-density line, they contemplated that they were unlikely to be able to prove that the rate was reasonable.

Of course, I am not privy to what their litigation strategy is. I can only tell you what it looked like to me being on the other side of those

sophisticated counsel and consultants. They went to extraordinary and very creative lengths in order to avoid the primary issue of that case, which is, was the rate sufficient to cover the route, our investment in the entire route of the movement?

They tried to group Powder River Basin coal in, even though it had not moved to that plant previously. They tried to bring in single-line Colorado coal in order to group with those kinds of costs in the revenues that we had there. They routed it almost 50 percent out of its way to avoid that low-density line.

And we ended up not putting in a full stand-alone cost case because ultimately we weren't able to figure out what it was that they were doing and we thought that they had so far gone beyond the purposes of the stand-alone cost test that the record didn't satisfy it.

Ultimately this Board and the D.C. Circuit agreed with our decisions. So I can't tell you about the total cost of the case. I can tell you it was costly because we had to deal with all of

those detours.

Finally, you asked whether or not the Board may use the three-benchmark approach if it's exhausted all reasonable means of simplifying a SAC presentation. We don't think you can, and we don't think you should.

And, quite frankly, I'm surprised to have to be saying that. When your notice came out, I was of the view that "Okay. We can work with this revenue benchmark. We ought to explore it, see what we can do." And I was a little dismayed until I tried to understand how the simplified stand-alone approach was going to work.

Ultimately Union Pacific made the judgment that we could not in good conscience support the revenue to benchmark method because it is so untethered from the considerations of whether the comparison rates tell you anything, anything, about whether or not the railroads that established them are going to be able to recover and pay for their existing infrastructure, let alone replace those assets and meet future demand for those

customers.

I can figure out and I can provide my client, who obviously is going to want to maximize its revenue and earnings but wants to do so in a lawful manner.

We don't want rate cases. We are far better off from a relationship point of view, from a transaction cost point of view of not getting into rate cases. And that is where we want to be.

I can't tell my client if they establish a rate at a certain level above 180 percent using the revenue to variable cost benchmark whether or not they're safe or not. And let me explain why that is.

The benchmark is, in fact, no benchmark. It is untethered. And it is moving, making it impossible to map what are the boundaries of reasonable and unreasonable.

One reason is that the criteria for determining what is comparable are very vague. Moreover, I am confident that the standards that are found on what is with the factors that are relevant

and they're waiting are going to be one thing in a grain case. They're going to have different answers in a plastics case. And they're going to have different answers in an electrical generator case. And who knows what the next rate case after that is going to be.

But we're also dealing with a moving target. One thing that Mr. Crowley said today that I strongly agree with, the waybill sample is not static. So this year whatever that comparable traffic is -- and it could be like those dots in the ceiling up there -- it may be that square this year and it may be that square next year, but all those holes and those squares are different.

I have no way of giving my client advice as to whether or not they're going to be able to defend that rate in a rate case. That leads me to say that type of uncertainty, that type of dice game makes it impossible for us to figure out ahead of time whether or not we can defend a rate. It makes it impossible for our customer to figure out whether the rate is going to be reasonable or not.

And because neither side can reasonably predict a range of outcomes, I suspect that that is going to lead to more litigation, not less litigation, that people are going to try the dice game. And the very fact that they know that railroads have more at risk, that if a decision comes out and it says, "Oh, yeah, a 225 rate is not good. A 210 would be better," that that will encourage more rate cases.

The fact is nobody can tell you whether or not you will get a flood of rate cases because we can't tell you what the rules are going to be. We cannot tell you how individuals are going to factor into them.

What I can tell you is the first day I began at Union Pacific, March 30th, 1981, was the deadline for filing rate cases under the Staggers Rail Act. I was hired because we thought we would have a lot of rate cases, and we did.

Something in the neighborhood of 900 were filed on rates that customers previously had been happy with because they were uncertain about

what the Staggers Rail Act was going to bring. And they weren't filed yet at a point where the Board had no standard at that time for figuring out what was or was not a reasonable rate.

CHAIRMAN NOTTINGHAM: Ms. Rinn, if I could ask you to wrap up? Just take a few seconds to conclude. Thank you.

MS. RINN: Certainly. So under these circumstances, this is why we're concerned about the revenue to variable cost benchmark method. We believe it will encourage litigation. We believe that it makes it difficult for parties to avoid or negotiate their way out of the litigation. And we note that nobody has put in any evidence about how much it's going to cost to try one of those cases.

In contrast, the simplified stand-alone, we believe there is credible evidence about how it is substantially different than a full SAC and it is tied to measures. You can learn from it, and you can predict from it. And under those circumstances, we simply cannot support the benchmark method.

Thank you. And I would be pleased to

answer any questions.

CHAIRMAN NOTTINGHAM: Thank you, panelists. I've got just one or two questions. Each of you clearly has extensive experience in litigation here before the Board. We heard about some cases, specifically this afternoon.

In your assessment, in your experience -- and I'll ask each witness to speak to this, and it's a question I asked this morning of at least one of the panels -- we hear a lot about delays in the dispute resolution process, delays in meeting deadlines for bringing cases to conclusion. We just heard from this panel a little bit about some of the causes of those delays.

Generally speaking, in your experience, what does cause delay typically? Is it mostly STB Board member and staff indecisiveness, mediocre work habits? Is it mostly shippers asking for extensions or asking to try to make the case a different way? Is it mostly railroads wanting to run out the clock, figuring that the longer there is no decision, the better off they are because they're on the defense?

Is it all of the above or help me get a sense while we're here on the record today?

MR. SIPE: Well, I haven't litigated adjudications for AAR. So my answer is maybe in this context not connected to a particular client.

I think there is a little bit of -- in the large rate cases, there's a little bit of a culture of the participants and the decision-makers have collaborated, perhaps unwittingly, precisely because, as Ms. Rinn I think mentioned, these cases are worth so much.

I mean, what has driven the big SAC cases -- and you should understand that the majority of the SAC cases have not just been cases that well exceeded any threshold you're talking about in terms of what was at stake, but the amounts at issue have been many multiples of that.

And so parties for both sides are induced to leave no stone unturned. But there are different models of litigation. Some people in this room may have had the pleasure of practicing law in the Eastern District of Virginia. You know, there

are places, forums that are sticklers for getting it done on schedule.

The Board in certain contexts, such as discovery disputes in merger cases, is sticklers for getting it done on schedule. There are very, very precise and limited procedures for handling appeals. I think in the smaller cases the Board could say, "Look, this is not the SAC world. This is a simplified world. We have all agreed we are going to use less precise standards." We know from the outset the result is not going to be as precise as it would be under SAC.

Part of our compromise here in the interest of simplicity and expedience is this is going to be our schedule and we're going to get it done, and extensions will not be redeemed.

CHAIRMAN NOTTINGHAM: Thank you.

Mr. Weicher, would you care to respond?

MR. WEICHER: Certainly. I think there are a number of factors. I don't think it's any one thing. I certainly don't think there's any problem with the work habits of the Board or any of the

counsel in-house, outside consultants. Everybody works hard on these cases. There are reasons for extensions because there is so much to do. As Mr. Sipe said, there's a lot at stake in these cases.

I think something else that happened in the last few years in the series of cases before the latest rulemaking is we had the rules in the major SAC cases going back ten-plus years, the original rules, and a pattern was going on in the last few cases of case-by-case battling of some big new issue.

Guidelines haven't been fooled with in quite a while. So we're doing a case-by-case evolution, whether it's, just to pick the topics of the day, the string model or what you do with the adjustment or something to be going on in a case. Hopefully the new guidelines -- maybe there will be a break-in period for those, but hopefully that should end some of that.

Those problems shouldn't exist in the small rate case one. Certainly the first couple of cases have to have things worked out. But by their

nature, they adopt many of those simplifications already enacted.

It's certainly not in our interest as a railroad to see delay in big cases or small cases. The big cases are a cloud over our head. And we want things worked out with our customers.

And we're certainly not suggesting shippers have any different interest. They say and they want relief if they think they're entitled to it. I think it's a confluence of things that what the Board is doing could assist. More resources all around always help, but that's a different issue.

MS. RINN: I would say that my rule of thumb is the longer a case goes on, the more it costs and the more challenge I have explaining to my management why the law department budget is running so high.

There are times when it is unavoidable that you have to delay it. The Kansas City Power and Light case would be an excellent example. There it was certainly more cost-effective for the Board to put that case in abeyance last spring to allow

the 657 proceeding to get decided. And that meant that given where you ultimately came out, I anticipate that that case is going to move forward very quickly and be resolved on a much more straightforward basis as a result of 657.

There are times we have to ask for an extension. We avoid it if at all possible. And I am comfortable that in the cases that UP has litigated, the complainant has asked for an extension of time more frequently than we have.

I think that, finally, it is absolutely clear that as compared to the first few stand-alone cases, which dragged out for a very long period of time, the Board and its staff have adopted a more disciplined approach. And once the record closes, they have consistently turned out a decision within nine months.

CHAIRMAN NOTTINGHAM: Thank you. Ms. Rinn, if I could ask a question that's fairly specific to the Union Pacific, I believe? I believe in the record you are the only major railroad that has expressed deep concerns with doing anything that

looks like a three-benchmark option.

I don't want to put words in your mouth. Am I reading the record correctly? Is your client's position that we really shouldn't even go there at all?

MS. RINN: I would dearly love to be able to say that there is a simple, cheap, and fast way to come up with a reasonably good answer for whether or not a rate is reasonable. And if there were, we would be there 100 percent behind it.

And, as I indicated, we began this rulemaking trying to see that we could end up there. And ultimately, however, we ended up deciding that the benchmark method, as modified by this proceeding, took it further away from being reasoned rate-making that was tied into, are you balancing the railroad's need for adequate revenue to support the network that benefits these customers versus the protecting the shipper from abuse of pricing, that we believe that in this respect, the proposal is a step in the wrong direction. It is not progress. I honestly wish I could say otherwise.

CHAIRMAN NOTTINGHAM: Thank you. Just a follow-up to that. You understand, I know, the conundrum that would put us in theoretically if the prices are anywhere close to what we were hearing earlier this morning. And obviously those were witnesses with perspectives.

In your experience, basically how costly on average would it be for a shipper to pursue a simplified -- if the only option, then, were simplified SAC versus full SAC, you know, we were hearing this morning numbers up into the millions. And we hear a lot about the challenge of small shipments. Folks who have small shipments who feel the need to come to the Board in the past have said they haven't been able to. It was cost-prohibitive.

MS. RINN: We strongly disagree with those estimates. We think that they are seriously overstated because you are not dealing with as many contentious issues because they're resolved or the railroads are the ones who are providing the data.

We believe that the opportunities for things to argue about are significantly reduced

under the simplified stand-alone. And we also believe that when parties are looking at a case that's worth, say, $5 million, as opposed to $50 million, they're going to charge their counsel to be very carefully looking at what are the really important issues, what are the factors that really are going to be driving this result. And you focus your resources on that.

And then you certainly don't let it slide, but you basically do what is necessary but no more on the rest of the case, that I am expected to manage my litigation so that I'm not spending more than the litigation is worth. And you find a way of doing that.

I also submit that we believe that the simplified stand-alone cost is probably much closer to the 200,000, maybe below, maybe above, and that the revenue to variable cost benchmark is going to be a whole lot closer to the 200,000.

So if the problem is that the remedy costs too much, you need to address how much is the revenue to variable cost benchmark and is it going

to be significantly less costly than a simplified stand-alone cost.

We don't think that it is because going back to something that one of the shipper witnesses said, they thought that the revenue to variable cost benchmark test means that, instead of dealing with something esoteric, you're dealing with a real world fact.

Well, what are those real world facts? Those are revenue to variable cost ratios in a waybill sample, which, by the way, the shipper representative is not going to get to see, and that the railroad personnel are not going to get to see if they involve railroads other than the railroad he sets prices for.

So who is left with access to the information about the moves that they're looking at and what those revenue to variable cost ratios are for those moves? It's the lawyers and the consultants, who don't make railroad rates and they don't buy rail transportation. That does not sound real world to me.

And, again, Mr. O'Connor said with a client he knows very well -- he is familiar with their operations, has a front start in knowledge -- $50,000 to do a 3-day mediation. What is it, a 250-day schedule before you are closed with 3 rounds of evidence on the revenue to variable cost benchmark? How can that not be $200,000?

Therefore, I am not sure there is going to be a meaningful difference between the cost of the two. I am confident that a simplified stand-alone is going to give you a more defensible answer that actually balances both the carrier and the shipper interests.

I have no idea where a revenue to variable cost benchmark test is going to get you. And I can't tell you on a case-by-case basis. That's what has us concerned.

CHAIRMAN NOTTINGHAM: Thank you.

Vice Chairman Buttrey, questions?

VICE CHAIRMAN BUTTREY: You know, for a hearing that's about small rate cases, we're hearing a lot about SAC, too much, I think.

Let's assume for a second that the Board is going to have three different sizes of rate cases. What kind of limitations, Ms. Rinn, would you put around the smallest of those three?

MS. RINN: I believe I would approach it from the same approach that you have taken because I think that is informed by the statute. I think that you develop your estimate about what it is going to cost to do the revenue to variable cost benchmark method or what other simplified method that you come up with.

And you look at the value of the case. And you say, "That is where this is appropriate," but because it should be the method of last resort, you try to limit it as much as possible.

I think that you look at every way you can to streamline and make more efficient the methods for that methodology as well as for the simplified stand-alone.

And Union Pacific in its comments provided suggestions on how we could cut out a round of evidence, how you could cut time out with a

rerouting, which we think helps you bring the cost down.

And I believe that you encourage the parties to find a way of meeting their deadlines and to find a way of working together through the technical issues using the technical conference mechanisms that you introduced and I think used effectively in more complex litigation so that you're into a problem-solving mode as much as possible because whatever new standards you adopt, we are all going to have a learning curve. And we're going to get through that a whole lot better if we cooperate with each other.

VICE CHAIRMAN BUTTREY: Mr. Weicher, what about you?

MR. WEICHER: I think the framework the Board has proposed makes sense. I think the three categories make sense. I think the 200,000 could be viewed as too low. We support it. Our thinking can be valid. But I think there is a reason to give the benefit of the doubt to the fact that it could cost more. We don't know.

I respect UP's views on the fact we don't know what the bottom category will cost, but I am sure there are plenty of people who would do it cheaper than Mr. O'Connor this morning would do it. And that's a question of how hard you want to press on it.

I think the bottom one can be done for cheaper if you lift the 200,000 a little bit to reflect some margin of error. On what it might cost to have it done, I think you've got a good structure.

I think the 3.5 is plenty. If you fiddle with that, it should be only a little bit because the reality is stand-alone cost cases and the simplified basis, which I think the Board clearly has the statutory authority to do, it doesn't have to be that expensive.

VICE CHAIRMAN BUTTREY: Thank you.

CHAIRMAN NOTTINGHAM: Commissioner Mulvey?

COMMISSIONER MULVEY: Thank you. The Congress has directed us to find some way to give

access to the Board's procedures for those captive shippers for whom -- the value of the case is not worth the cost of litigation.

That's quite a few shippers, I would think. And many of them argue that the value of the case is nowhere near the tens of millions of dollars that are involved in the stand-alone cost analysis.

If we don't go through with a three-benchmark approach and we go with just the simplified stand-alone cost, would we be meeting the congressional directive to open our processes to the majority of captive shippers whose traffic is under the Board's regulation in your view?

MR. WEICHER: I don't want to say one way or the other precisely what meets the Board's mandate. I defer to them on that. I think it is defensible to have the three-benchmark and to do the bottom category.

It has to be for truly small rate cases. People toyed with the small shipper thing today in the morning, which was something the railroads were roasted for suggesting this meant at one point. So

I'm not promoting that, although I do think there is a distinction of issue there, a distinction in the issue.

I think the Board's direction in the statute to come up with something besides SAC opens the door for you to come up with reasonable things, including a simplified stand-alone or something a bit else as long as it's not completely unrelated to demand-based pricing.

COMMISSIONER MULVEY: Doesn't that argue that if we hadn't been testing these procedures, these processes, we could determine whether or not it would come out with results that were similar to what you would get under a SAC case and also get a feeling for how much they would cost? Do you think we get to both of those by testing?

MR. WEICHER: Commissioner, we have nothing against testing. If the Board wants to do it, that's fine. I am reluctant. BNSF doesn't want to promote delay. And I don't think testing should be a reason to not move forward with rules.

That isn't to say you couldn't adopt the

rules, do testing. And this Board has shown it knows how to act quickly in a rulemaking if it wants to or amend rules. You will have a framework in place. If you are unhappy with the results, including on these categories or the testing showed something was amiss, you could go back and change them in fairly short order in the scale of regulatory things.

COMMISSIONER MULVEY: Given how long we have been looking at the small rate case issue, taking a little more time to test or doing it sequentially with adopting new rules would probably make a lot of sense. There's no sense dragging this thing on forever and ever.

Let me ask you also about the issue of access to the unmasked waybills. Would it be possible to give access to the unmasked waybills to the shippers, consultants, et ceteras, in developing their case before and providing a signed protective order agreement? I mean, would that give you the confidence to allow that or is that a problem? I mean, we do that now anyway, right?

MR. WEICHER: You do that in two contexts. And I don't want to mix up the rules here. You do it in certain study contexts subject to a lot of safeguards. And you do it in protective orders in pending cases.

We don't think you should do it for fishing for rate cases. In fact, I think in one situation where a complainant's counsel or a consulting entity sought waybill access for those kinds of reasons, the Board properly turned it down as not a purpose.

Business promotion is a fine and wonderful thing that any company is entitled to participate in. But we don't think they should use the waybill sample, the unmasked waybill sample, for it.

COMMISSIONER MULVEY: Okay.

CHAIRMAN NOTTINGHAM: Just one last question for each of the panelists. There was much discussion this morning and in previous panels about the desirability of moving towards a $10 and a half million and $13 million and a half, two thresholds.

So basically if I heard it correctly, any dispute up to ten and a half million would be basically a small rate case.

Quick reaction to that? Is it --

MR. SIPE: I think it's completely off the wall. We're talking about a standard that doesn't produce a result that bears any resemblance to the result of SAC.

Let me work in a response to Commissioner Mulvey's question about testing. You don't need to test the three-benchmark approach to know that you're not going to get results anything like SAC because we all know that SAC is driven by density.

And if you're got a movement that qualifies for the three-benchmark test that is on a very low-density line, you probably wouldn't get relief under SAC or simplified SAC. If you've got a movement that is on a very high-density line, you might well get relief. Under three-benchmark, those two cases are likely going to come out the same or they could come out the same.

So the notion that you would allow millions of dollars in traffic to be tested under that standard I think is self-defeating. It would be the wrong way to go and inconsistent with what the Board itself said in 1996 about trying to limit the crudest standards. And that's the term the Board used, "the crudest standards to the maximum extent possible."

CHAIRMAN NOTTINGHAM: Mr. Weicher?

MR. WEICHER: I think those categories are absurd. I think you deserve a fairly direct answer to what categories you asked out of some of the panelists this morning.

This is a difficult situation because it's clearly within the Board's discretion to figure out what makes sense here. But the concept you started with was lowering the burden of access to the Board's remedies. Based on the costs to the complainant, that has sense to it.

The 200,000 probably conceivably could be low if there isn't enough competition in that business for consultants. The 10.5 million is

ridiculous.

If you added a couple of hundred thousand to the 200,000, if you went to 400 or, say, 500 thousand, 100,000 a year, that is a awful lot, leaves plenty on the table for this to be done and give very good access. I don't think I would do anything with the 3.5 million. You're going to adjust it for inflation. That's a tremendous amount of money.

You have to keep the standards rigorous for what you're doing in both categories. But this 10.5, 13.5, I can't make the math work out on the 13.5. But these multiples or looking at both sides' costs, risk factors, they don't have anything to do in our opinion with the problem you started out to solve.

Two hundred thousand. Add a little bit if you need to to give the benefit of the doubt to a new market entrant. A 3.5 is probably right on. Even Counselor DiMichael this morning I think they said 4 or 4.5. You're right in the range. That other stuff is unhinged from anything you started to

address in our view.

CHAIRMAN NOTTINGHAM: Give Ms. Rinn a chance.

MS. RINN: I would agree with everything Mr. Sipe and Mr. Weicher have said. In addition, I would add this. And that is that the shippers -- and I can understand their concern -- have been very focused on talking about it's going to cost far more than what you think. And, therefore, you're going to deprive us of a remedy.

But they have not offered very many constructive suggestions on how you can make cases faster or less expensive. Indeed, they tend to add bucks in everything.

For example, they're in favor of a bright-line rule on eligibility so long as they have an opportunity to argue other factors. That's a fuzzy line. That's not a bright line. And that's just one example.

We believe -- and we tried to come up with ways that you can streamline any rate case proceeding by making it faster, taking out steps,

taking out unnecessary rounds of evidence, two rounds simultaneous on variable costs, instead of three.

I would suggest that there are other ways that you can approach slicing that apple. One -- and we have seen this in a non-coal case. And it's not available for the smallest of the small shippers. I concede that. But I've got to tell you a really small shipper, the small business that is the backbone of growing the American economy, they don't have rate bills for $4.5 million a year.

You have folks who have a lot of traffic. They use the leverage of that traffic to try to get concessions from us. And they have opportunities to basically organize or combine those movements so that the value of the case would warrant getting a relief.

FMC is an excellent example of that. In fact, they packaged it so effectively that the risk that we faced in that case was far greater than some of what we have seen in an individual coal case.

And, yet, they manage to combine I think

6 different origins, 16 different moves in one rate case. Now, maybe they could have sliced it and diced it a little bit differently, but there are ways of combining that, not for all customers but for a lot of the customers who are currently saying that they don't have an effective remedy.

And I think that if you have rational standards of that basis and if they really believe that they're being exploited, as one of the witnesses said, they will find a way of using those remedies.

CHAIRMAN NOTTINGHAM: Mr. Mulvey, did you have a question?

COMMISSIONER MULVEY: Getting back to this maximum value, expected value of the case, I mean, if you talk about a shipper who wanted to bring a case and it's going to cost -- let's say it is going to cost three and a half million dollars.

No one would ever bring a case where the expected value of the case is equal to the cost of bringing the case. That would be irrational in the sense you've got some possibility of losing. And

now you have been recovering your costs.

So it seems to make some sense, pure economic sense, to me anyway to take it to account for some risk factor, even if you ignore the fact that you don't always get what you ask for in these cases, at least taking into account the risks. And that's one of the ways they developed as multiple of the costs of the case.

Do you think that's not something that should be taken into account in developing these if we have a guideline standard?

MR. WEICHER: From BNSF, no, I don't. I don't think it's the same kind of economic analysis of going to this more than point of indifference through the risk.

What is going on here, I mean, this is still rate litigation. There's still a lot of reason to bring the case. There are other alternatives that have floated around from time to time, you know, go to the English system about loser pays costs.

We're still going to have to defend

these cases win, lose, or draw. There's no symmetry if you go to that point where there's an extra incentive that it's justified based on the cost plus your expected return.

It is not a symmetrical thing where we are getting our costs back or we're going after shippers. The issue was, deal with the burden and if the burden is too hard allegedly and for small shippers or small rate cases, too much cost, this takes care of that.

There is no reason why the burden of some litigation should be removed and there be a free pass concept here. This more than makes it to the point where the burdens have gone, we think.

MR. SIPE: If I may, Commissioner Mulvey, that the problem I think with the risk factor is twofold. First of all, we have not heard in this proceeding and I'm not aware of a principled basis for determining what that risk factor is. If there is one, it's going to be arbitrary. And that's potentially a problem.

Second, there always are going to be

litigants who are situated such that cases are less attractive to them than other litigants given the amount at stake. I mean, that's the way it is throughout our judicial system. And there's no way the Board can sort of fix that and make everybody equally situated.

The biggest coal shipper who can bring a rate case where the potential returns are in the tens of millions is differently situated from a medium coal shipper, where the potential returns are in the millions. And the Board isn't going to equalize that.

I think we are concerned that if the Board gets into the business of specifying a risk factor, it has at least implicitly weighed in on the subject of the likely outcome of the case, which is not something the Board probably should be doing.

MS. RINN: I would also offer -- and, again, I believe that this was an observation made by one of the shipper witnesses this morning -- that when you're dealing with a larger customer who may have a lot of movements to individual

origin/destination pairs but who in the aggregate has a substantial amount of business and, in fact, we have more than one plant.

The rate case may be the issue that they could bring before you or that they're addressing in this proceeding, but ordinarily -- and this has been UP's experience -- there are usually other issues bundled up in that commercial relationship in the difference between the railroad and its customer and that if they decide to use the leverage of a rate case, they have also factored in if it sets an unfortunate precedent for other people, who can then come on, we face that risk in terms of that rate case or that we might want to avoid the hassle, that risk of precedent, in order to give them concessions regarding equipment or contract concessions that we have been unwilling to make.

It's more difficult for me to go into more detail than that without breaking some confines, but often, often, again, -- and I'm talking about the folks who are not running a small grain elevator or a small business. I'm talking

about some very sophisticated corporations, who have a lot of stuff going on in the transportation world.

A rate case is just one card in a deck of cards that they're playing in order to maximize their overall benefits and that that is hard to quantify. And, in fact, you may not see it, but that is also part of the risk-benefit equation by those shippers in deciding to file a rate case.

COMMISSIONER MULVEY: Thank you.

CHAIRMAN NOTTINGHAM: Ms. Rinn, just to pick up on that, are you suggesting, then, that it might be reasonable or sort of a reasonable business tactic if one were in your job but for a very large shipper, perhaps a shipper that is much larger even than your current employer, to actually roll the dice and pursue a rate claim with the full knowledge that even success might only bring a break-even on costs or even a loss in costs because you may have, as you just suggested, possibly 10, 20 other transactions pending or that it may give you leverage as a business in other ways?

MS. RINN: I'm going to have to think

carefully how I can give you a truthful answer that does not betray things I promised in writing I am not going to betray. But this is going to be based on actual experience.

I have been privy to a situation where rate cases have been threatened, rate cases have been brought, where the level of the rate was an issue of dispute between my client and our customer, but it was only one, and that the shipper, partly because they judge the odds of significant relief, were good enough that they were willing to go forward with it but that if you compared it to an overall package looking at a variety of issues where we believed we were offering them more value than they could get in the rate case, they turned us down. And this has happened more than once.

Now, I will say I think that the Board's decision in 657 and where you apparently are headed in this proceeding that says you're going to be using unadjusted URCS costs to establish the jurisdictional threshold reduces that possibility because I think it provides up-front information for

both the carrier and the shipper that's more objective about what the maximum value of the case was and that previously there may have been -- it was a difference in perception because I was coming up with where I thought the Board -- you know, the maximum relief was going to be and the shipper was asking us to give them value that exceeded the maximum relief and that the shipper was getting different information about what the maximum relief was going to be.

And they, of course, did not believe me who they were not paying. They believe the people they were paying. And I can understand that. I think I am hopeful that being more focused on straightforward URCS, that might reduce some of that gamesmanship, but the fact is we deal with a lot of very sophisticated consumers of transportation. And rail rates are only one part of that package.

CHAIRMAN NOTTINGHAM: Thank you.

Vice Chairman Buttrey, any questions?

VICE CHAIRMAN BUTTREY: So when you say they have turned you down, they called J. B. Hunt

and started shipping on trucks?

MS. RINN: There is another firm in this room who they did ship on. And they did have other options.

VICE CHAIRMAN BUTTREY: Trucking options?

MS. RINN: A combination of modes. And could they divert all of the traffic? Perhaps not. But marketing people get nervous about even having, oh, 10 or 15 percent of the traffic diverted.

You know, it's well-established that you don't have to win all of the market in order to set the price on the market, that the price is set at the margin.

MR. WEICHER: Vice Chairman Buttrey, if they went with Hunt, we hope it was with BNSF.

(Laughter.)

VICE CHAIRMAN BUTTREY: Say it again.

MR. WEICHER: If they went with Hunt, we hope it was with BNSF.

VICE CHAIRMAN BUTTREY: I'm sure. I'm sure.

CHAIRMAN NOTTINGHAM: The issue in the sensitivity of access to the unmasked waybill data that's come up -- and that is clearly a very serious issue -- I want to make sure I clearly understand where the witnesses here are on that.

It's certainly one thing to say, as Mr. Weicher has said quite eloquently, that we should not encourage or incentivize fishing expeditions for -- I think you used the word "sharks."

MR. WEICHER: Yes, sir.

CHAIRMAN NOTTINGHAM: I haven't been shark fishing in a while, but I think I follow your thinking there. At least I think I understand it.

After a case, though, after a shipper has filed a complaint and then subject to a normal protective order, would that be the appropriate time or would that be an inappropriate time for unmasked waybill data to be shared? And if not, when would that be, if ever?

MR. WEICHER: Chairman Nottingham, from our standpoint, I think that that would be the plausible time to address the issue. There's an

issue within an issue there in that if the Board rules that contract traffic is not relevant under the comparability standard, then there would not appear to be a reason, but if you permitted contract traffic, which we have argued you shouldn't, or there is some other reason that doesn't immediately occur to me why the information could be relevant or it's relevant for some other part of their case, yes, I think it would be reasonable to permit subject to the protective order safeguards some kind of limited access for that case.

MR. SIPE: Let me just point out a complexity here, Chairman Nottingham, that I think the Board and its staff may want to wrestle with a little bit. And that is access to this unmasked waybill data under your existing protective orders only goes to outside counsel and consultants.

So you've got a case under the three-benchmark standard. You can't share the data about individual shipper movements with the business people, who may be driving the case. That's on the shipper side.

So, in effect, what you are doing is you are saying to the shipper if he's relying on unmasked waybill data, you're putting the lawyers and consultants in the driver's seat, rather than the business people.

And there is a flip side of it if you talk about providing unmasked waybill data for movements other than the defendant railroad to the defendant railroad.

There again you can't give it to their business people. They're not allowed to see that data. There's a statutory provision that prohibits railroads from disseminating that information.

I think particularly with a simplified maximum rate standard that is designed, I think, to give the shipper some sense of empowerment, you need to be very careful about not letting their business people be in the driver's seat.

I think the best way to deal with this waybill problem is to obviate the problem by saying we're going to keep the contract traffic off limits.

CHAIRMAN NOTTINGHAM: Ms. Rinn?

MS. RINN: I would agree with that. I would also make the observation because I've been trying to figure out how you would do this. Let's say that you have the unmasked waybill sample available to the lawyers and the cost consultants. They're trying to work with their client to get a sense of how can we say this traffic is comparable or not comparable.

It is very hard to see how they can engage in detailed meaningful conversations to basically understand that person's understanding of the transportation market given the fact that you can't do a brain transplant without their asking questions that are ultimately going to reveal something if it's truly comparable traffic regarding the movements of either their competitors or their suppliers or their receivers.

And that is exactly why from time immemorial railroads have been prohibited from disclosing that type of information about the movement of one customer to another customer and why the Board has such very detailed regulations

protecting the confidentiality of contract rate information within the waybill sample.

We basically have customers because we're right in the middle of some markets. We deal with the receivers. We deal with the shippers. We deal with people who compete with each other. They basically trust us as business partners to get in their minds and understand where they're coming in from but to keep that information confidential. And it doesn't get any more confidential than contract rate information.

CHAIRMAN NOTTINGHAM: Thank you.

That concludes my questioning. Any other questions from my colleagues?

VICE CHAIRMAN BUTTREY: No.

CHAIRMAN NOTTINGHAM: Thank you, panel. You're dismissed. Thank you for your testimony today.

I will invite to come forward our next panel and final panel, panel number VI: representing the Canadian National Railway Company, Theodore K. Kalick; representing the Canadian

Pacific Railway Company, Terence M. Hynes; representing the CSX Transportation Company, G. Paul Moates. And Mr. Moates will also be speaking for the Norfolk Southern Railway. And Mr. Mullins, William A. Mullins, will be speaking on behalf of the Kansas City Southern Railway Company.

Each of the witnesses has been granted ten minutes. We will keep track of that the old-fashioned way in lieu of the lights not working. And if you just wait just a moment, Commissioner Mulvey will be back in just a second. And I will ask you to begin.

(Pause.)

CHAIRMAN NOTTINGHAM: Great. We will start with Mr. Kalick. And please proceed.

PANEL VI: RAILROADS

MR. KALICK: Good afternoon, Chairman Nottingham, Vice Chairman Buttrey, and Commissioner Mulvey. My name is Ted Kalick. And I am senior U.S. regulatory counsel for Canadian National Railway.

Like others earlier, CN would also like

to commend the Board for the effort and thought embraced within its proposals in this proceeding. And I thank the Board for the opportunity to appear here today.

While I will be available with my colleagues to address questions that the Board may have with regard to the questions in the January 22nd order, CN would like to explore further an issue not expressly listed in the Board's order but which remains a concern for CN and the rail industry nonetheless. That issue is the Board's prescription of adjustments to system average URCS costs, particularly as it may apply to cases brought under the simplified standards against rates for hazardous materials.

CN is aware of the Board's ruling in October in ex parte number 657(i) precluding adjustments the system average URCS and SAC cases. CN also understands the Board's challenge in this proceeding to balance simplicity and procedural access, on the one hand, with accuracy in its rate determinations and consistency with its

well-established rate-making principles, on the other.

In our view, this proceeding differs fundamentally from ex parte number 657(i). Unlike in SAC cases, the Board has proposed here that URCS system average costs will be used not only in the calculation of the jurisdictional threshold but also in the determination of reasonable rates themselves, an area in which we believe the Board has more limited discretion.

With the added and heightened role of system average URCS, CN respectfully submits that the Board should allow for consideration of the real and increasing costs above system averages involved for rail transport of certain limited categories of movements, such as hazmats, where costs that are actually incurred would be grossly understated or not accounted for under system average URCS.

By "hazmats," I mean toxic by inhalation hazards, other poisonous and flammable liquids, and various environmentally and time-sensitive chemicals and materials.

Not considering adjustments for such costs would elevate simplicity over accuracy to an inappropriate degree and effectively create a regulatory loophole that is likely to invite rate litigation in a way that CN suggests would be contrary to the Board's policies and proposal as well as ICCTA.

What kind of hazmat costs are we talking about here? They include the full cost of mileage allowances for use of specialized privately owned tank cars used to move most hazmats. They include the added insurance premiums for the significant and growing risk of moving many of these commodities, particularly in a post-9/11 world.

They also include the added costs associated with speed restrictions imposed on trains carrying these commodities, including additional crew and equipment costs, additional yard costs for extra switching and marshaling through the special blocking requirements, additional derailment cleanup costs, additional training and certification costs for personnel handling hazmat cars, and added

inspection and documentation costs. All of these costs are real. And most are readily measurable or ascertainable. But they would not be reflected in system average URCS.

In addition to these present costs, carriers are now or will soon be incurring significant added costs associated with implementing new security and safety regulations.

These include the security action items announced last year by the Department of Homeland Security's Transportation Security Administration for the movement through high-threat urban areas of the most hazardous of the hazmats, this such as chlorine and anhydrous ammonia. They also include the additional cost expected from the regulations proposed last month by TSA's and DOT's Pipeline and Hazardous Materials Safety Administration.

TSA's security action items direct railroads to reduce the risk of TIH transport by 25 percent, principally by reducing the dwell time of TIH cars in high-threat urban area.

Its proposed regulations would require

rail carriers to provide within one hour after the agency's request shipping and location information for cars on their networks containing these hazmats and certain other commodities, such as radioactive waste and some explosives.

They would also require carriers to assure the attended transfer of all such cars moving to and from shippers, receivers, and other carriers at transfer points inside and even outside high-threat urban areas so long as the car will at some point in transit eventually move through such a high-threat area.

PHMSA's proposed regulations will require carriers to report volume and route-specific data for cars containing these hazmats, conduct a safety and security risk analysis for each used route, identify a commercially practicable alternative route for each used route, and select for use the practical route posing the least safety and security risk.

The costs associated with additional security storage, inspection, monitoring, tracing,

reporting, and potential alternative routings for this traffic flowing from the TSA and PHMSA initiatives are expected to be significant.

CN along with the other railroads is not requesting that the Board afford a broad-scale opportunity to make movement-specific adjustments through system average URCS in the vast majority of simplified cases. Instead, it is suggesting that the Board provide the opportunity for a limited category of cases, such as hazmat, to establish costs that system average URCS will significantly misstate.

Even some shippers recognize the need for that kind of flexibility. This is particularly compelling for much hazmat traffic that rail carriers transport at significant risk of liability. The carriers have an obligation to haul these products. And most of the identified costs above system averages cannot be avoided

CN submits that the Board's consideration of URCS adjustments for a limited category of movements, consideration in which the

carrier proposing the adjustment must carry the burden of proof, can be addressed in our judgment without jeopardizing the agency's expedited consideration of simplified cases.

We believe this consideration could be embraced comfortably within either of the first two phases of the procedures for simplified SAC cases and within the first phase of the three benchmark cases.

Should the Board require mandatory mediation before the merits phase of the case, parties could be required to assert and respond to any claims to URCS adjustments. Then if mediation failed, the Board would have a record before it on which to rule expeditiously. CN plans to outline these possibilities in more detail in our supplemental comments on February 26.

Thus, in addition to the propriety of affording this opportunity, CN believes the Board could address questions of applicable adjustments involving limited matters, such as hazmat, in a reasonably efficient manner and without

over-complication.

Moreover, as the Board in individual cases provides guidance concerning the adjustments to system average URCS, it will accept and those that it may reject. It would not have the same issues to address over and over again.

As CN served in its written comments, as issues become settled and the Board and parties can experience the time and expense required to make adjustments, the system average URCS in individual cases should diminish.

I would be happy to answer any questions you may have at the appropriate time.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Kalick.

Mr. Hynes, please proceed.

MR. HYNES: Thank you.

Good afternoon, Chairman Nottingham, Vice Chairman Buttrey, Commissioner Mulvey. My name is Tery Hynes. And I would like to start by thanking you for giving me the opportunity to appear today on behalf of the Canadian Pacific Railway to

address the Board's proposed simplified rate procedures.

My remarks are going to focus on two topics. First I'll address an issue that was raised by Canadian Pacific and by the other railroads who provide cross-border rail service in their written comments. And that is the feasibility of applying these simplified procedures to move cases that involve cross-border movements.

Second, I will address several of the questions that appeared either in the January 22nd order that the Board put out or related questions that have come up during the course of the conversation today regarding the 3B methodology for small rate disputes.

Let me start with the issue of cross-border rate disputes. As CP and others have pointed out, the revenue and the cost data that are necessary to implement either the simplified SAC or the 3B methodology simply do not exist for traffic that moves between a point in the United States, on the one hand, and a point in Canada or Mexico, on

the other.

For example, one of the key simplifications in the simplified SAC methodology is to use the defendant carrier system average URCS cost to develop the operating and equipment cost. This will save time and money because it will avoid the need to develop case-specific operating and equipment costs in each instance.

However, the URCS data are derived from the R1 reports that are filed with this Board. And they are available only for rail operations that are conducted within the United States. Therefore, URCS cannot be used to determine the operating costs for the foreign portion of a cross-border through movement.

There is no regulatory equivalent to URCS in Canada or, to my knowledge, in Mexico that could be substituted for URCS in order to develop those foreign operating costs, nor would it be lawful for the Board to simply make the assumption that the URCS system average cost of the U.S. road that's participating on this side of the border in a

cross-border move are a sufficient surrogate for what would take place north of the border.

As you know, each railroad's URCS costs reflect that railroad's unique experience, its own traffic mix, the type and age of equipment it uses, the terrain over which it operates, the labor agreements that it has with its employees, and so forth, and other elements that affect cost. So the URCS costs of one carrier are not properly transmittable to another carrier.

The proposed 3B methodology is even more dependent than simplified SAC on data that simply doesn't exist in the context of cross-border traffic. Like simplified SAC, you would use the URCS database to develop the costs both for the issue traffic and for the movements in the comparison group.

In addition, the parties would use the car load waybill sample that is maintained by this Board to identify comparable shipments and to determine the revenues that are to be assigned both to the issue traffic and to the movements in the

comparison group.

But the car load waybill sample doesn't contain all the information that is necessary to perform these tasks in the context of a cross-border through movement. Specifically, the waybill sample does not include a complete sample of northbound U.S.-Canada traffic, nor does it include complete revenue information, even for the southbound movements that are reported in the database. KCS' written comments in this proceeding indicate that there is a similar problem with respect to U.S.-Mexican traffic.

In short, the essential building blocks that the Board has used to create its simplified procedures are simply incapable of providing the information that would be necessary to apply those procedures to the foreign portion of a cross-border movement. For this reason, CPR has asked the Board to make it clear in its final rules in this proceeding that the simplified SAC and 3B methodologies will not be applied in a case that involves cross-border issue traffic.

Now, it has been suggested by certain commenters that the Board might just put this question off for another day, might leave it open and decide whether or how it would apply one of the simplified procedures in a cross-border case when such a case is presented to it.

I would submit to you, however, that leaving the question undecided in your final decision in this case would be inconsistent with the Board's stated objectives in this proceeding.

In the January 22nd order, the Board stated clearly that "The over-arching purpose of the eligibility thresholds was to offer clearer guidance as to who may expect to qualify to use a simplified approach."

Chairman Nottingham, when you opened the hearing this morning, in your beginning remarks, you stated that one of the primary objectives of the Board in this proceeding in developing these rules is to create greater certainty for the parties.

And consistently this morning we heard from the shipper community that they want to see a

bright-line rule. So they also want a clear, totally certain statement as to what rules are going to apply when.

So if the Board fails to address this cross-border problem in its decision, you would create enormous uncertainty for both the carriers and shippers who were involved in those movements regarding what the Board might do in the event that it is faced with a cross-border case. Again I submit that that would defeat a fundamental purpose of this entire proceeding. We would ask you to address that issue in your decision.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Hynes. Oh, I'm sorry. I thought you were.

MR. HYNES: Not through, not through.

I would like to turn to the 3B methodology. There have been a number of questions that were posed both in the January 22nd order and in the course of the presentations this morning about whether the Board may lawfully use a methodology like 3B, to use the Board's words, once it has exhausted all reasonable means of simplifying

a SAC presentation.

CPR's position is that the 3B methodology is not simply a simpler procedure for handling rate cases. Rather, it represents a major substantive departure from the CMP-based rate-making standards that have been used by this Board and endorsed by the courts for many, many years.

The fundamental premise underlying the 3B test that the rate paid by a complaining shipper should never exceed by a significant margin the mean rate for the rates that are applicable to a supposedly comparable group of movements is fundamentally inconsistent with Congress' and this Board's prior recognition of the need for carriers to engage in differential pricing.

Now, the shippers this morning asked the Board to drop the simplified SAC standard in its entirety and to apply the 3B case very, very widely. Mr. Sipe recited earlier from the legislative history, which I will not repeat, which made it clear that Congress when it instructed this Board to develop simplified procedures -- and, again, you hit

the nail on the head this morning, Commissioner Mulvey -- that legislative history says in a case when a full SAC procedure is not practical. It didn't say a SAC procedure.

But Congress made it very clear, and their words were that they did not intend to erode CMP in creating simplified procedures. I would submit to you that the shipper's proposal, the one that seemed most popular this morning was a $10.5 million threshold, up to which you would use the 3B methodology, wouldn't simply erode CMP. It would obliterate it. There is absolutely no warrant in fact or in good public policy to adopt a threshold at that level.

Just think about it from a commercial standpoint. And, again, the shippers that appeared before you this morning, like Dow, they're big, sophisticated companies. And under their proposal, the $10.5 million threshold, they would be telling this Board that you take a dispute that is worth $9 or $10 million and you decide it on the basis of the not terribly rigorous crude methodology. And, to

boot, they have asked you to try to get that done in six months for them.

Now, in any other commercial context where companies have a dispute worth that kind of money and it's in the courts, I submit to you that it's common knowledge that you're not going to get a decision in six months or less and that the courts that are going to be deciding that case are going to be applying a rigorous standard and a rigorous analysis to making the decision on the merits. So CP's position is that the Board should adhere to the thresholds for eligibility that you set forth in your initial order.

In addition, if this Board decides it is going to go forward with the 3B methodology and decides the smallest cases on the basis of a crude R/VC ratio comparison, it must at least make an effort to ensure that the R/VC ratios that are being compared are accurate; that is, that they accurately reflect the true revenues and the true costs associated with the movements that you're looking at.

In order to do so, it is essential that this Board permit movement-specific adjustments to work system average costs in 3B cases. Unless you do so and if you decide strictly based on system average cost, I submit to you that in many cases, including the types of cases that Mr. Kalick just spoke of a moment ago, the Board would be making false comparisons because the cost side of the equation would be simply an average number, which didn't reflect the particulars of the movements that are involved. And I would further submit to you that prescribing rates on the basis of such false comparisons would be arbitrary and capricious.

Now, the question, of course, arises, can the Board do this without unduly complicating the process or unduly adding to the cost? I submit that you can.

I was very interested to hear Mr. Crowley this morning actually note that in connection with the Board's proposal to eliminate movement-specific adjustments in SAC cases that he didn't think that was going to save a whole lot of

money. And I tend to agree with him. But it certainly isn't going to add significantly to the cost of a 3B case for the Board to consider these types of adjustments.

By their nature, 3B cases are going to involve a relatively small number of issue movements and comparison movements, might be a dozen, might be two dozen, but it is certainly not going to be hundreds of different movements that you are going to be looking at. It would seem that making adjustments for such a relatively small number of movements, both the issue traffic and the comparison group would not be unduly expensive or time-consuming.

Furthermore, many of the adjustments that have been advocated by the parties in this proceeding are of the type, such as payments to third parties or the cost of compliance with safety and security regulations, that can be readily identified with a movement. It shouldn't be a great mystery as to whether a particular cost is or is not being incurred in connection with a particular

movement of the comparison group.

And, furthermore, I submit to you that it shouldn't be terribly controversial to determine the amount of those adjustments. I mean, if a railroad is making a payment to a third party, the amount of that payment should be readily discernible.

Finally, the Board can reduce the scope for disputes by providing guidance to the parties, either in its decision in this rulemaking proceeding or on a case-by-case basis as we go along under the 3B methodology, regarding the type of movement-specific adjustments that it will entertain. In all of these ways, I believe that the Board can improve the accuracy of its decisions in 3B cases without unduly complicating them or increasing their cost.

And, with that, I will stop and await your questions.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Hynes.

Mr. Moates, please proceed.

MR. MOATES: Thank you, Chairman Nottingham, Vice Chairman Buttrey, Commissioner Mulvey, and staff. Thank you for enduring this long day with us.

I will try not to use all of my 20 minutes. But lawyers being lawyers, there is a risk. We will see how it goes.

I do want to mention that I am obviously appearing on behalf of two of the major Class I railroads today: the two big Eastern railroads, CSX Transportation and Norfolk Southern. I would like to note that acknowledging those important this proceeding is to those railroads, some of those senior lawyers are here: From CSX, Mr. Peter Schudtz and Mr. Paul Hitchcock; and for Norfolk Southern, Mr. George Aspatore and Mr. John Scheib.

I want to start by responding to something that wasn't in my prepared remarks. And everybody has studiously avoided it this afternoon, but I can't, not with the I thought, frankly, inappropriate to some extent remarks made by Mr. MacDougal before the break.

I say this in the perspective of someone who has practiced before this agency since 1976 and your predecessor and as someone -- Mr. O'Connor forgot me -- who was a participant in the mediation in the BP Amoco case. I did represent Norfolk Southern in that case.

You may rest assured, as I'm sure you know, that your staff is honest, it's truthful, it's hard-working, and it possesses integrity. And we all know that the reference that Mr. MacDougal made to a very unfortunate event that occurred in the 1970s is in my view nothing more than the historical footnote interest and has nothing to do with the way you conduct business today.

My view, which is shared I know by the Norfolk Southern attorneys and business people who participated in the BP Amoco mediation, was the mediation was very effective and it was, frankly, successful in very large part because of the participation of your expert staff, who knew the issues, who understood the regulatory concepts, had more than passing familiarity, a lot more, with the

stand-alone costs and with the 347(ii) benchmarks, which is what that case was initially, of course, brought under. And they were extremely helpful at getting both sides to stand back and, you know, take another hard look at the positions that brought them there.

We are not only endorsers of mediation, not trying to steal the AAR's thunder, but I would point you to the CSX-Norfolk Southern opening comments, where we were one of the proponents from the very beginning in this proceeding of mediation.

I also was struck by Ms. Rinn's comment during her presentation that if there were some simple and cheap way to address these issues we're dealing with, she would be the first one to support them. It put me in mind -- and I think I've got this right -- of an old quote from H. L. Mencken, which goes something like "For every complex problem, there is a solution that is simple, neat, and wrong." And it is the concern about that last part of it that I think brings us all here today.

Norfolk Southern and CSX, as I think

these other railroads, are supportive of the STB's initiatives in this area. We are supporting of the concept of the three-tier approach. We do believe that you have the statutory authority to do that. Having said all of that, of course, like so many things, the devil is in the details. And some of the details concern us.

These two railroads, which, by the way, as you know, are vigorous competitors -- and why are we doing this together? From the outset of this thing, it has been very clear that these two railroads broadly share perspectives on the issues raised here. And we are mindful of trying not to overburden the agency with unnecessary, duplicative filings.

There are a very few little points on which the two railroads perhaps don't see exactly eye to eye, but I don't think they are -- I know they're not. And they have concluded those are not so significant as not to have their views presented jointly. So I'm not going to try to do this as I make points. I mean, you can assume that everything

I say unless I specifically indicate otherwise is made on behalf of both of these companies.

Our comments have all started, our written comments have all started, the same in that somewhere in the first several pages, we have indicated core principles the two railroads believe are critical to analyzing the issues here. I noticed Ms. Rinn has some core principles that Union Pacific embraces as well.

I think you'll find these at pages 1 and 2 of our opening and reply. And it's way back, pages 5 to 7, of our rebuttal. Depending on how you count some of them, there may be as many as ten of them. I commend them all to you and tell you we really do believe they are critical for guiding our view of this proceeding and the Board's view, but I'm not going to talk about all ten.

I would like to refer to three of them in particular because I think they relate pretty directly to the issues that you have asked about in your January 22 decision here.

First, our first core principle is, very

simply stated, the more revenue that's at stake in an individual rate case, the more important it is that the rate reasonableness standards employed adhere closely to CMP principles and produce SAC-like results, not exactly SAC results, Vice Chairman Buttrey. And I'm sorry I used the term again, but that is, we submit, the linchpin of where all this has to start from. If we wander too far from the good grounding of CMP and SAC, we are at great risk.

This is a broad "we." You are at great risk, frankly, of going back to some of the rate-making methodologies that the D.C. Circuit in prior times found to be not sufficiently tethered to the statute.

I like to think and I believe that you agree with that core principle. And I was struck this morning. Commissioner Mulvey, I hope I've got this right. I think you said in your opening remarks that the stakes are simply too high not to get it right.

We absolutely agree with you on that.

And we know that the Board is striving to do that. And we'll take our concerns and those of the other parties into consideration as you do that.

But one of our greatest concerns with the way this proceeding has developed -- and I have sat here all day like you did and listened to our good friends on the other side, and my concerns were not allayed by what I heard -- is their view that they seem to see this thing through the looking glass exactly on the opposite side of us.

Their goal appears to be pretty clearly to persuade you to define eligibility criteria standards, however you want to put that, that would permit them to shoehorn into the least CMP-tethered standard, the three-benchmark standard, as much traffic and at as high a level as they can possibly persuade you to go for.

I know again Mr. Sipe is right. We got chastised. We, the railroads, were talking earlier in this proceeding about the proceeding being focused on small shippers and not small shipments. Yes, small shipments -- and I know there are small

shippers. And we have small shippers on Norfolk Southern and CSX.

But I can't help overlooking that the two cases that have been brought under 347(ii) in the last two years have been by the "small shippers of BP Amoco Chemical Company," an affiliate of the Williams Companies. And speaking to you here today we had Exxon Mobil Chemical and Dow Chemical.

Obviously they're not little shippers. They absolutely believe they have what they would characterize as smaller shipments because they from their very large facilities are sending different types of products in sometimes single cars, sometimes multiple cars, sometimes larger blocks of traffic to lots of different places.

But, as Ms. Rinn and Mr. Weicher and others have already ably said in front of me, those companies do a pretty good job of taking care of themselves in negotiations for the railroads.

And generally I don't think that they are the folks that Congress was particularly concerned about when they admonished the agency to

get on with the 347(ii) proceeding and get out a simplified, less costly approach for the so-called small shipper and small shipment scenario, which brings me to our core principle number two.

And that is that no rate should be prescribed just on a formula. We're talking about formulas here. Obviously we don't write on a blank slate. We have 347(ii). Those are your standards here today until you finish this rulemaking and it survives in a potential judicial review.

So in the meantime the cases like BP Amoco and Williams Olefins are being filed under your existing standards. Those are our benchmarks. Those are the three benchmarks.

To the extent that you propose to now go to a more, if you will, formulaic approach and as you tinker with the benchmarks and decide where you may set the bar for where that eligibility criteria will be established, we urge you very much to keep in mind -- I have put it this way -- Norfolk Southern and CSX's support for the three-benchmark approach is conditioned on -- and this is not new.

This has been our comment from the beginning. It is absolutely conditioned upon: one, your minimizing the amount of the revenue that gets exposed. We think the $200,000 limit is absolutely appropriate. I've heard nothing here today to suggest to me that cases cannot be brought under those standards for that amount or less.

And, by the way, I saw here today -- I'm pleased to see them -- several consultants, cost consultants, that I literally hadn't seen in 20 or 25 years, people I worked with when I had less gray hair than I do today. And I thought, "Why are they here?"

Maybe we're going to get some more competition. Maybe some of those costs and rates will have a little more pressure applied to them because there's obviously beginning to be some sort of a feeling in the consultant bar, maybe the legal bar that, hey, we're going to have some rates. Maybe this isn't going to be an inert area. That could have some impact.

Rate reasonableness determinations based

on formulas alone, as you know, don't pass muster under the act. And the courts have said that in the past. At least as relevant, Norfolk Southern and CSX do not establish their rates on formulas.

These railroads devote a fairly extensive amount of their resources to understanding the markets in which they and their customers operate. You know they have marketing departments, fairly sophisticated departments with a lot of employees. They attempt to determine the demand for their services in these markets. They analyze a variety of factors that affect a particular transportation movement for which a rate is being requested or negotiated.

We would submit not to fill the pail, not to open Pandora's box and allow everything in but just to allow consideration of three formulaic benchmarks with no ability for the parties to introduce a limited number of other relevant criteria relating to the movements at issue would be wrong.

NS and CSX strongly advocate that you do

allow a railroad, which will usually be conceivably a shipper, to introduce any other relevant criteria relating to the reasonableness of the rate that they may wish to bring in.

Now, people will say, "Oh, my gosh. Then there's no standard. It's all open." No, it isn't. It's going to be in the railroad's own interest to limit that or rifle shot it.

I wouldn't certainly advise a client, "Don't just throw everything into the pot. The Board won't pay any attention." And if somebody does that, you certainly have the ability to deal with it. You can strike that evidence or you can just give it no weight.

But putting on blinders and pretending there are no other factors out there that affect pricing, we respectfully submit, would not be appropriate.

Core principle number three. Remember, I'm only going to talk about three of the ten. So relax. Rate regulation should not encourage litigation over negotiation. I think everybody in

this room would agree with that in the abstract. The trouble is when we move from the abstract to the concrete.

From our perspective, the shippers are demanding from you rate procedures and standards that would come with minimum cost and maximum certainty. And I understand why they're doing that.

But, again, formulaic rate-making procedures would not only be divorced from fundamental CMP principles. They would run afoul of the statute's admonition. I know you all know this language, "to allow to the maximum extent possible competition and the demand for services to establish reasonable rates for transportation by rail and to minimize the need for federal regulatory control over the rail transportation system."

So isn't it better -- hopefully this is rhetorical. Isn't it better that rather than embracing proposals to base rate determinations on formulas that you embrace, adopt a mediation proposal, which you put it before mandatory, non-binding mediation -- this is not binding. We

don't support binding mediation. The BP Amoco and, as I understand, the Williams ones are not binding, but they worked.

Market-based rate negotiation should be encouraged to the maximum extent possible to have negotiations, leadership or to seek your intervention, your help, a requirement that the parties take a short time-out period and engage in non-binding mediation prior to engaging in the formal rate litigation would be strongly in the public interest.

And, again, you know, two cases do not a long history make, but certainly you have good indications in those two cases that it is probably going to work.

A couple of the specific issues -- and I will try not to repeat things that have been said. We are very concerned about obviously keeping, as I said, the eligibility threshold where you have suggested they ought to be.

We think you have got it right in your notice. And we don't think there's anything that's

been put in this record that should cause you to change.

Your decision said "The over-arching purpose of the proposed presumptions that you talked about was to offer clear guidance as to who may expect to qualify to use a simplified approach and to provide captive shippers with small dispute, some practical means of challenging the reasonableness of the rates." That was a quote.

Here's what you didn't say. You didn't say that the purpose was to enhance the prospect, much less virtually guarantee that shippers would prevail in cases brought under the simplified standards, nor did you say that the purpose of this proceeding is to erode those rate-making standards.

Proceeding as we understand it and as I believe you formulated it is to develop procedures and adopt appropriate methodologies that would permit more ready access to the agency, more ready access to your procedures, not to erode the good rate-making standards that you and your predecessors literally took 20 or 25 years to develop and which

are applied with good effect in stand-alone cost cases.

We, therefore, think that you should adhere to your proposal to limit the duration of relief to five years. We think you should adhere to your proposal to curtail the scope of relief to the volume of the traffic identified by the complaint at the outset of the case. What about this new idea that you have asked us about in the January 22 decision, what I call a liberal pleading role?

Might it be appropriate, you ask, to allow the complainant to come in and amend its complaint and pick another methodology prior to the opening of the case? Emphatically no. Please don't do that. That would be incredibly unfair to the railroads.

You will literally see, I would predict, changes in methodology the day before evidence is due or a very short period of time before evidence is due when a railroad is preparing to defend a case on one basis and a shipper dumps over and says, "We're going to go with a simplified SAC" and a

railroad under your procedural schedule, a railroad under your second disclosure is coming up and you've got to produce all of that information relating to operating costs and construction and equipment and all of that. We're not going to be ready for that. It wouldn't be fair.

Something in the middle maybe, you know. I can't say that NS and CSX have authorized me to say here today that they would agree to a specific time period, but common sense suggests to me having done some of these cases over the years that if you're going to change the methodology on the brink of the filing, at a minimum, give the railroad 30 days.

I say why not tell the shipper in that circumstance there is a simple solution. You withdraw your complaint without prejudice. And you file a new case. We start the clock over. Shipper's decision.

We urge you to adhere to the aggregation rule. I don't think it is an aggregation rule. Opening the door to complaints, allowing them to

file multiple cases, covering traffic that properly should have been part of a full SAC or a simplified SAC case after a three-benchmark case has already been tried and decided, we shift the burden to us, the railroads, to complain about the strategy.

And when we did that, what if this happened and you allow this to go into effect? In the second case and the third case, we go "Oh, we see what is going on here." This all should have been one aggregated case in the beginning. What are we supposed to do?

We come to you and ask you to stop the new case, to do an investigation to determine whether we were right? And how do you decide if we are right? And if you determine we are right and there is merit, what are you going to do, reopen the prior case? Are you going to order the shipper that potentially got reparations and a prescription to pay the money back?

I think there are a whole host of issues there that have to be grappled with and have, frankly, some significant legal issues related to

them.

And, finally, I don't mean to be unfair about this, but I am struck, having participated in the Carolina Power and Light for Norfolk Southern, where this whole issue of alleged gaming of the setting of the rate because of the percentage reduction method first came up, having participated in the ex parte 657 proceeding, and now having participated in this proceeding, now the suggestion is that you can monitor abuses and fix it after the fact.

What we suggested to you in 657, that's exactly what you could do with concerns about gaming by railroads and rates under the PRM. The answer was, no, that isn't good enough. I don't understand that. I think that is an inconsistency, frankly, in your approach.

I'm not going to go into the questions. I've got a lot of nice stuff here about whether you overestimated SAC costs, underestimated simplified SAC. I agree with the prior guys. No, you didn't overestimate it.

I think there's every reason to believe those costs are going to come down if the 657 -- I can't call them reforms -- changes go into effect. I do think that simplified SAC, you know, we're all going to have to see, but three and a half million sounds like an awful lot to me.

Rerouting of issue traffic. I hope the barn door is coming closed on that one, but we really want to emphasize how much we would oppose that. We think that, frankly, makes these cases much more expensive, much more problematic.

You're going to have a whole big fight about whether some route that isn't being used actually can handle the traffic and what would the costs be on that route and will want to know why doesn't the railroad handle it that way today, a can of worms I don't think we need to get into.

On the access to the unmasked waybill sample, I endorse Mr. Sipe and Mr. Weicher. They said almost exactly what I had said here. I think that you've got to give very careful concern to the mischief that might result if you permit the access

of the unmasked data to be seen just by outside counsel and outside consultants.

I'm an outside counsel. That's great, you know, may be more business, but I don't want to be in the position of trying to tell my client why I made a determination about what some comparable traffic ought to be. That's not my area of expertise. That's why the business people get involved in these cases.

You don't want the lawyers and the consultants to be making those judgments. And that's what you would be pushed to if you have data that can't be seen by the business people at the shipper or the business people at the railroad.

Non-defendant traffic should absolutely be excluded from comparison groups. I do not understand how it's possible to tell my client that "Your reasonableness of your rates is going to be determined, at least in part, by the level of rates of your competitor railroad or some other railroad that is your connection."

We can make all kinds of assumptions,

maybe test the assumptions about how similar those railroads are or how similar the portions of their systems to which the rate for that movement applies. We're going to all be dancing on the head of the pin if we do that. And that will drive costs through the roof.

I will stop with just mentioning I like the idea of testing, by the way. That came up today. I wouldn't stop this either. I agree with Mr. Sipe. You know, we have been at this a long time. I think this has to move forward.

It would be interesting to know how the testing could be done. Are we going to go back to some adjudicated SAC cases and test those results against simplified SAC or three-benchmark? It seems like that is what we sort of have to do.

I'm not saying this is insuperable, but we all need to think together about what that means in terms of the Board even using some of the data that it has in those cases that was produced under protective orders and confidentiality agreements and the like.

And the last thing I want to mention is exempt traffic. It has been mentioned here today. We applaud what you said about it in the fuel surcharge decision. We think that is the right thing to do here, some kind of an automatic rollback of an exemption so a shipper of now-exempt traffic can bring a rate complaint.

And in some yet-undefined manner sort of litigate over whether that was a proper revocation while the rate case goes forward not only gets the cart before the horse. I think it invites lots of mischief, puts lots of burdens on the railroads.

And I would think that in the vast majority of cases, you're going to end up concluding anyway that the exempt traffic is exempt for a good reason. And, therefore, you will not revoke the exemption. But under the formulation in your original notice, the parties would be expending a lot of resources on a rate case until you came to that conclusion.

So that doesn't strike us at all as inappropriate that if a shipper of exempt traffic,

for whatever reason, thinks that the factors that led to that exemption being granted in the first instance no longer apply to his shipment in a particular way.

I understand we're talking class exemption and pulling out all the pieces for a particular shipper. It shouldn't be too great a burden to ask that shipper to come forward in the first instance and explain those facts, let the railroad respond. You decide. And then and only then if you decide to revoke the exemption, in part, then they have a rate case.

Thank you. I hope I didn't repeat too much.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Moates.

Now we'll turn to Mr. Mullins. Please proceed, Bill.

MR. MULLINS: Thank you, Chairman Nottingham, Vice Chairman Buttrey, Commissioner Mulvey. My name is Bill Mullins. I am appearing here today on behalf of Kansas City Southern Railway

Company.

I think, as you know, that since the adoption of SAC and the simplified cost reasonable standards and (ii), 53.47(ii), that KCS has never been the subject of a rate complaint under either one of those processes.

Accordingly, KCS doesn't really have a lot of direct experience with SAC or URCS. And so we have left it to some of the others to address some of the questions that you raised in your recent decisions.

And, Commissioner Mulvey, I am going to probably disappoint you in the sense that I can't address a lot of the questions that you have set forth in your most recent decision. But, nonetheless, the Board's proposal raises some significant concerns of KCS.

KCS supports the idea of reducing the cost associated with litigating rate cases. And considering the congressional mandate, the Board faces a hard task.

The staff and this Board ought to be

congratulated for the hard work. You put a lot of hard work into this. And it's very complicated, especially for railroads like us that don't have a lot of experience. And we thank you for that hard work.

We've got a lot of hard work to do ourselves. But we ask you that in modifying your rate cases and in developing these standards, that you consider the fact that not all railroads are the same.

The proposed standards, which appear to be shaped by the Board's Class I experience, could have a disproportionate impact on KCS and similarly situated Class II and Class III railroads.

We ask that you keep in mind that one size does not fit all. It would be more appropriate and more legally defensible in our view to apply different processes and assumptions in cases involving KCS and other similarly situated railroads.

And there's really three sort of reasons for this, three main concerns that KCS has. And

those are the use of unadjusted URCS, the cost impact on smaller railroads, and the impracticability of applying this to cross-border shipments.

Our primary concern is the use of unadjusted URCS. Both simplified SAC and the three benchmark procedures depend upon the use of unadjusted URCS.

The rail industry as a whole concurs that some adjustments to URCS must be allowed. And all parties, including the shippers, agree and admit that the use of an URCS system-wide average cost cannot account for all the actual costs of a movement.

And, for that reason, KCS joins with others for calling for a system that does allow for the adjustment of URCS in all these situations that you have heard.

The problem with the Board's proposal in not allowing the adjustments to URCS is even more disproportionate with respect to KCS and smaller railroads. This is because URCS is primarily a

mileage-based system. And because of the way URCS allocates the various inputs that go into the system, applying unadjusted URCS in cases against carriers like KCS and others would simply magnify the inaccuracies that already exist in URCS and could produce artificially low prescribed rates.

There are three main reasons for this effect. First, URCS understates the costs incurred by railroads like KCS, who have a large percentage of short-hauled movements that involve a significant amount of intensive activities, such as switching pickup and delivery services. This is in contrast to the longer-haul traffic characteristics of the much larger Class I's.

URCS being largely a mileage-based system, therefore, does not adequately account for time-intensive activities on systems like KS. And as evidence of this to sort of test this theory, we hired an expert, Mr. George Woodward, who working with KCS personnel examined sample traffic movements on KCS and compared those to unadjusted URCS costs.

And I believe that he found -- or not

that I believe, but he did find that the URCS-based costs produces rates that could be 30 percent lower than KCS-estimated costs. And I believe that this is the only study in the record that reflects the fact that URCS actually produces significant understatement of actual costs.

This isn't just the one to two percent difference that the Board noted when they did away with adjustments to URCS in SAC cases. We're talking 30 percent. And so this could significantly prevent KCS from being able to recover our fully allocated costs if you continue to apply unadjusted URCS in cases involving KCS.

The second reason why unadjusted URCS would be harmful to KCS is that URCS understates KCS' cost of capital. Although URCS purports to be an industry-wide average cost of capital, this figure is based upon the average cost of debt and equity for the largest Class I's: UP, BN, CSX, and NS. It does not factor in the U.S. operations of CN, CP, or KCS.

Yet, the four largest Class I carriers

have costs of capital that are lower than KCS'. For example, in 2005, the STB found that their average cost of capital was 12.2 percent. Yet, under the same methodology, KCS' weighted cost of capital is estimated to be in the 14 to 16 percent range. And, again, the evidence is on the record supporting that.

As a result, applying the industry average cost of capital in a rate dispute involving KCS, as URCS does and as the Board's proposal allows, will understate URCS KCS' cost and its revenue needs.

Finally, URCS does not accurately cost KCS movements because the econometric and statistical inputs and allocations that go into URCS are outdated and produce an inaccurate picture of actual costs.

For example, URCS relies on switching studies conducted in the 1940s and the 1950s. And this is a problem that is noted by the United States Department of Transportation in their comments. And we agree with DOT's concerns.

So obviously if the Board is going to heavily rely upon URCS in its simplified rate complaint cases, then URCS should be as accurate as possible. Well, it isn't. And KCS and others must be allowed to make adjustments to URCS to account for its inaccuracy.

While the use of unadjusted URCS is of primary concern to KCS, KCS has two other concerns: the cost that smaller railroads will bear in the event that the proposed standards are adopted and the difficulties associated in applying these standards to international through movements.

Vice Chairman Buttrey, you made comments about the impacts on small businesses. And I think it's a two-sided coin. There are significant impacts on smaller railroads and short Class I's, Class III's that are smaller. And I don't believe these proposals adequately account for those costs.

We don't even use URCS. We don't have familiarity with URCS. So we're going to have costs associated with just getting up to speed on that. We have costs getting up to speed and producing

discovery information based upon URCS and issue traffic. And you're going to have significant adjustments in the way that our railroad has to operate. And those costs aren't accounted for and aren't weighed. And we ask you to consider those costs.

We also believe that, as others have stated, shippers are going to use this as a way to gain leverage on the smaller Class I's and Class II and Class III railroads.

These large shippers that are ten times the size of our railroad will be able to use these processes to game the system and gain leverage on us. And we don't think that's accurately accounted for either.

And, finally, KCS' concern is one expressed by CP and CN that it's difficult to apply these standards to U.S.-Mexican cross-border traffic. As CP has observed, no party has actually opposed the idea of not applying the simplified methodologies to cases involving cross-border movements.

So we ask that if you apply the proposed standards, that you do not apply them to cross-border through movements or if you do, you should allow us, which we think would be almost impossible or impractical given the concerns Mr. Hynes has already expressed, but at a minimum, you would have to allow specific adjustments to URCS in those cases.

In conclusion, the Board should not rely upon unadjusted URCS in cases involving KCS. Under the proposed unadjusted URCS-based standards, KCS not only could be exposed to otherwise avoidable and inappropriate litigation, but it is quite possible that a challenged rate incorrectly could be found to be unreasonable. Similarly, a rate prescribed at the statutory threshold, in actuality, could be beneath what Congress has by statute deemed to be reasonable. In either case, KCS' efforts to become revenue-adequate are undermined.

If the Board has discretion to prohibit the use of movement-specific adjustments to URCS in the SAC cases, which the Board believes it does,

then it also has the discretion to allow such adjustments in cases involving KCS and other similarly situated carriers.

The Board's intent to move quickly to resolve disputes between shippers and carriers is admirable. And KCS appreciates the hard work in the furtherance of a very challenging congressional mandate. But in continuing that hard work, KCS urges the Board to reevaluate its proposals, consider its likely impacts upon railroads like KCS, Class II's and Class III's, and at least adopt our proposals and suggestions.

Thank you.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Mullins. Thank you, panel.

We'll turn to questions now. I had a question for Canadian Railroad witnesses. Thank you for being here. On the issue of cross-border movements, you both addressed that, I believe. I want to make sure I understand your concerns.

Why can't we use URCS and apply that to cross-border movements?

MR. HYNES: Because there are no URCS data for the northern portion. URCS is data. It's specific to each railroad. It's based on the R1 report that each railroad files. You don't have R1s for Canadian National or Canadian Pacific Railroad.

You do have Canadian Pacific Railroad's U.S. subsidiaries and Canadian National's U.S. subsidiaries. But they operate in different territories. And their costs are different. So the issue with URCS is that you simply don't have the numbers that would reflect the costs of the foreign portion of the movement.

CHAIRMAN NOTTINGHAM: And what about the idea of applying the U.S. portions of the travel or the U.S. subsidiary costs to the entire movement, including the Canadian portion?

MR. HYNES: Well, I address that in my remarks. Let's take a hypothetical movement, moving from Calgary on the Canadian Pacific across the border to Union Pacific down to Los Angeles, say. Okay?

And the proposal that you are positing

is that you would just take Union Pacific's URCS costs and apply those to the entire movement. Am I correct?

CHAIRMAN NOTTINGHAM: Yes.

MR. HYNES: We would argue that that would be arbitrary and terribly inaccurate. Union Pacific's URCS costs reflect Union Pacific's railroading experience: the traffic that it carries; the mix of commodities; the terrain over which it operates; the numbers and types of equipment in its fleet, you know, how old are its locomotives compared to how old our locomotives are; its labor agreements, which are different for us; the tax regime that they're living under versus the tax regie of Canada; and any other number of cost items that are different.

So Union Pacific's URCS, average URCS numbers, or Norfolk Southern's or CSX's would not accurately reflect the cost associated with Canadian Pacific and accurately reflect, you know, as a surrogate the cost of CP for moving the northern part of that movement.

CHAIRMAN NOTTINGHAM: Thank you.

A question for Mr. Moates. If I heard you correctly, Mr. Moates, you made the point that we should allow, the process should allow, a simplified process should allow more than just three benchmarks to be examined and that parties should be able to bring in more information.

Does that raise concerns for you about just endless discovery in cases we are obviously trying to simplify, streamline, expedite, et cetera? And I just want to make sure we're not stepping into something if we were to go with your recommendation.

MR. MOATES: Well, first of all, Chairman Nottingham, you heard me correctly. That is something that Norfolk Southern and CSX -- I think I indicated this -- expressly condition their support for a three-benchmark approach on because absent the ability to introduce, critical words here, limited relevant evidence regarding the movement at issue beyond just those three benchmarks, there is every reason to suspect, I would submit, that you are going to get results in

some cases that are going to be grossly, grossly wrong.

This doesn't work perfectly, but the Vice Chairman earlier today talked twice I think about an unnamed shipper he had heard from who had concerns. And the railroad convinced him to put in, I think he said, some sidetracks. And the idea would be to get a better rate. And, unfortunately, they didn't get a better rate. And obviously they don't know what those circumstances were.

What I'm aware of, have known about for decades in the railroad industry -- it started, I think, in the coal mining, but it's probably true in lots of other areas -- shipper wants to put in that sidetrack. He negotiates with a railroad. And then they enter into an agreement. And the shipper gets a rebate.

Once he invests the money and builds the track, he gets a rebate for his investment off the rate or if the railroad builds the track, it works the other way around. And that's going to be built into the amount he gets charged.

That side agreement is something that would be pretty darn relevant to know about if you were using that movement as one to compare to another guy who didn't build the sidetrack or made that investment. That may not be the best example, but it came to me when you made that comment, Vice Chairman.

I did try to say earlier -- and I'll say it again -- no, we're not trying to open Pandora's box. And I understand the concern. It's easy to attack this caveat on the grounds that that just means everything is in play. Not at all.

It would be in the railroad's interest and -- a shipper could do this, too, in some circumstances -- to a shipper's interest to make the other indicia relevant to the pricing of the movement very limited, very focused, and very relevant. And if they didn't, as I said, you could have a motion to strike it. You don't have to give it any weight.

And I think a party would be pretty ill-advised, frankly, to load up like a Christmas

tree with a bunch of other supposed extraneous factors if they were that worried about the three-benchmark result.

That is not what we are trying to suggest. We are trying to say, "Please don't blinder yourself by using just formulas." Again, my friend Mr. Mencken says, "Simple, cheap, and wrong isn't going to get it done for us."

CHAIRMAN NOTTINGHAM: Okay. Just one more question to Mr. Kalick and Mr. Hynes. Do you see any concerns that your railroads would be put at some type of advantage or be left to be treated so differently under this proposed process because of the cross-border movements if at any time, let's say, you hypothetically pick up auto parts on the Canadian side, take it to Detroit, then proceed with the finished product in Canada for part of routing them back into the U.S.?

And then do we need to be concerned here that if a small shipper were to say, "Hey, we want to avail ourselves of the small rate dispute resolution process," that you would be able to say,

"Well, you can't. You know, we're not part of that deal"?

MR. KALICK: Well, I think there's really a fundamental choice. Our position with CN differs a little bit from CP. The Board historically by Supreme Court precedent has jurisdiction over international through-route traffic.

So in the example that you gave, assuming that that is a continuous movement that the Board might have jurisdiction over, our position is that the Board has to recognize that URCS data doesn't exist on the Canadian side, number one.

But because you have jurisdiction, our feeling is you have to develop at some point given your directive here to provide a process for small cases some proxy at some point in time if a case comes down. I think the point from CN's point of view was we don't know if there are going to be any international through-route case. There haven't been very many here in a long time.

From our perspective, we can wait until

that happens and the Board can address that issue at the time. CP has a slightly different point of view.

But I think we agree on the fundamental principle that the Board has to recognize that the underlying elements, the inputs that will go into either the 3B test or the simplified SAC test, the informational inputs, just don't exist on the Canadian side.

CHAIRMAN NOTTINGHAM: Mr. Hynes?

MR. HYNES: Can I respond for CP? Your question was whether declaring these two methodologies ineligible in a cross-border case would somehow create an undue advantage for a Canadian road. I don't believe so for a number of reasons. And we have discussed this in somewhat detail in our rebuttal comments.

As an initial matter, doing so is not going to create a large regulatory gap. It's not going to affect a large number of shippers, who otherwise would invoke these procedures. Let me give you the reasons why: Coal and grain.

I think the numbers from our rebuttal evidence, 97 percent of the coal that moves on a CP line in the United States are domestic movements. So they're not affected. I think it's 94 percent for the grain. So for the two major commodities at least you have seen rate cases on before, it's essentially a non-issue.

With respect to other cross-border traffic, 84 percent of that traffic is competitive traffic. It's not captive. That's largely a function of the structure of the railroad industry in Canada. They serve pretty much the same places that we serve. Again, we compete with each other at most locations.

So that means for that 84 percent, a shipper couldn't bring a cross-border rate case on that movement at all anyway because there's no market dominance on that movement.

With respect to the remaining 16 percent, the vast majority -- I think it's three-quarters of it -- is southbound traffic. So it's a southbound cross-border movement that

originates in Canada by a Canadian shipper.

Canadian shippers already have remedies under Canadian law, including some that are more expedited than SAC. We have a final arbitration procedure, for example. So that shipper is not left out in the cold. So we're not really disadvantaged if simplified SAC or 3B isn't available on that one.

And I might remark that even for the small percentage of the northbound cross-border traffic that could be characterized as captive -- and in CP's case, that's no more than like two percent of our total cross-border traffic -- a U.S. shipper originating that traffic may under Canadian law invoke the final order for arbitration procedure. So even that shipper has somewhere to go.

And, having said all of that, you, of course, in 657 have taken measures to try to make the SAC procedure less expensive and more user-friendly.

And if you ever were faced with a SAC case involving one of these cross-border movements,

I mean, there are things that can be done: Technical conferences with the staff; the use of stipulations; mediation, which is another thing that was mentioned today. And I would say the Canadian Pacific generally would be in support of the concept of mediation. Those sorts of things will be available and helpful to the shipper.

But overall I don't think you're creating any undue advantage for the Canadian roads by addressing this issue now. And at the same time, I think you're doing good for both us and for the shippers by addressing it and at least letting people know what the rules are.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Hynes.

Vice Chairman Buttrey, questions?

VICE CHAIRMAN BUTTREY: Mr. Moates?

MR. MOATES: Sir?

VICE CHAIRMAN BUTTREY: Were you counsel for NS in the BP case? You said you were involved in it. Were you lead counsel?

MR. MOATES: Yes. I didn't mean to be

elliptical. We were counsel for Norfolk Southern.

VICE CHAIRMAN BUTTREY: I have a hypothetical question for you that has been troubling me for months. So now you get it.

MR. MOATES: I don't know about this one.

VICE CHAIRMAN BUTTREY: You happen to be here on the right day.

MR. MOATES: Or the wrong day.

VICE CHAIRMAN BUTTREY: I'm curious why there wasn't a motion filed to dismiss that case because BP is not a small shipper.

MR. MOATES: Like Ms. Rinn, I have to stop and think for a minute and make sure I don't say something I'm not supposed to say.

VICE CHAIRMAN BUTTREY: Ms. Rinn is still here. She is making notes right now.

(Laughter.)

VICE CHAIRMAN BUTTREY: Mr. Sipe is still here, too. He’s still within range.

MR. MOATES: My memory could be faulty here. I don't think it is. We agreed for purposes

of mediation only not to raise the question of whether BP Amoco was a small shipper. Does that sound right? I'm looking at our able mediator.

PARTICIPANT: That actually does sound pretty close.

MR. MOATES: I think that's right. I think you noted that in a footnote in your decision. I haven't looked at this in a while. I'm pretty sure that's right.

Whether we had mediation failed, would we then have made that motion? I know the answer to that one I don't think I can say without my client's permission.

It's a serious question, serious question.

VICE CHAIRMAN BUTTREY: Well, it seems to me that if it's not clear what something means on its face, then you go and look and see what the Congress might have thought that they said. And sometimes that's even hard to do, even if you can get the transcript of the debate on the floor.

It seems to me that one of the bedrock

issues here is the relative resources that are available to the plaintiff and the defendant in these proceedings. And it might be that we have just missed the point. The point being it's about resources. It's about who has power, who has market power, who has financial power, who has resources to procepursure these cases.

Nobody is going to contest the fact that the BPs of the world, the Dow Chemicals of the world or the Shells, the Amocos, and the Exxons and the ADMs and the Cargills and those guys all have the resources to fight these battles.

The point has been raised here today -- Ms. Rinn raised it herself -- that these customers, big shippers have a lot of power. And it could be that they might use a rate proceeding as leverage to get things that they want in the contract that they are not otherwise getting.

So it really troubles me, that we may be missing the point here. The point may be that the Congress meant that we're talking about small shippers and not small shipments, although all we've

heard about is small shipments.

Now, I would just like to hear what the panel or you or anyone else has to say about that issue. You said just a minute ago that it wasn't outside the realm of possibility that you would have filed a motion to dismiss if it hadn't been settled.

Well, now, that's true in a lot of litigation. I've been involved in a few lawsuits back when I was much younger where you were hoping you could settle this case because you didn't have any hopes at all you could possibly win it. And a lot of them get settled. And this one got settled.

So it seems to me that you might have had in the back of your mind that very thing, although you can't say it. I know you can't say it.

MR. MOATES: I can tell you it wasn't in the back of my mind.

VICE CHAIRMAN BUTTREY: It wasn't in the back of your mind. Okay.

(Laughter.)

MR. MOATES: There might even have been a draft motion.

VICE CHAIRMAN BUTTREY: So I am not The only salmon swimming upstream here.

MR. MOATES: No, sir. As I said before, I think if we look back in the history of this proceeding and the fairly recent history, for that matter, AAR and the railroads argued pretty ardently that these standards ought to address the small shipper problem.

We thought the political concern was focused. We were told pretty expressly by the agency not to change that paradigm and to focus on small shipments. So we know that literally the language of the statute talks about the cases where shipments that cannot support the cost of a full stand-alone presentation will be dealt with. And the statute uses the word "shipment."

So we have stopped carrying that caudal, but I would be pleased to paint it up again because I do believe that you just said is absolutely correct.

And, again, this is not meant to be pejorative. In fact, my law firm represents a lot

of these fine chemical companies you just mentioned in other contexts, but the Exxon Mobils and the BP Amocos and the folks seen here, Dow Chemical, you know, in the Williams Company, which is I think the case it was going to maybe settle today through mediation, these are sophisticated large companies with operations in lots of areas. And they do indeed have lots of leverage.

I do understand and respect where they come and say, you know, negotiation or otherwise, "Well, we're just focused on this commodity, this facility. It only moves out five cars every three days. So it's a small shipment." I understand that.

That doesn't mean that when they come to talk to us about that five cars moving every few days, as Ms. Rinn said, there isn't a whole lot more going on in that room.

VICE CHAIRMAN BUTTREY: Well, I don't think we would be sitting here today at all, none of us would be sitting here today, the Board wouldn't exist probably if it wasn't for the fact that the

Congress was very concerned about what is going to happen to people who don't have resources to deal with the captive shipper situation and the railroad situation after the ICC goes away. If that weren't the case, we wouldn't be sitting here today, none of us.

And it just occurs to me that we may have indeed missed the point that what we really ought to be talking about is small shippers and not small shipments.

That's all I have to say.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Moates, for letting the Vice Chairman sleep better tonight after all these many months.

Commissioner Mulvey?

COMMISSIONER MULVEY: Well, of course, the decisions will be in the margin. And you look at marginal costs and marginal revenues and the cost to the shipper as you pointed out, the cost of the case relative to the value of the court case. And whether there were other things going on behind the scenes is hard to predict.

But I do think that you ultimately have it right. It does have to be shipped. And whether or not that is what the Congress intended or not I don't know, but that seems to be where we are going. And I guess bringing that canard up again probably is not going to get us very far.

You mentioned the fact that we tried to streamline things in the 657 ex parte decision. And, of course, that wasn't exactly widely received with hurrahs on either the shipping side or the railroad side. Both sides were very, very critical, but we did that.

It does seem every time we do try and streamline and make less costly and make more efficient, people say, "Well, that's fine, but don't do this or don't do that," et al. So it has been very, very difficult for us to make a lot of progress in streamlining it.

I think at some point it wouldn't be a bad idea for us to sit down and say, "Well, what, in fact, can we do to really lower the cost of these SAC cases?"; maybe even further than the simplified

SAC cases that we have.

I wanted to ask a question about the thresholds for a moment. The shippers have argued that these thresholds are so low that only a handful of shippers would be eligible. For example, the $200,000 threshold is $40,000 a year.

My understanding is what the cost of moving a car is is about $2,000 a car. Is that a fair amount for a typical shipment? It would vary, of course, by distance and commodity and everything else obviously, but $2,000 sticks in my head as not being an unreasonable amount for moving a rail car.

That comes out to 20 cars a year or less than 2 cars a month. That's a pretty small number. Even at three and a half million dollars, you're only talking about three quarter of a million cars a car, which comes out to be two cars a day.

So if that's the case, doesn't that mean that the vast majority of shippers who ship we much more than that and would be forced into the full SAC case? And that does seem to run counter to what the Congress wanted when they directed us to find an

alternative.

MR. MOATES: First, I'm not sure about the 2,000, Commissioner, only because I think the average value of a shipment on Norfolk Southern, which is a railroad that obviously has done fairly well in recent times, is about $1,200. So I'll double check that. Maybe that's something we should submit for the record.

Not knowing who these other customers with the other shipments are, I'm not so sure my answer wouldn't be they ought to go under simplified SAC or they ought to be under full SAC.

Again, we have very grave concerns about where the 3B approach, which, again, I didn't hear anybody here today from the shipper side even make a desultory effort to try to claim that it bears some relationship to CMP, demand-based pricing, didn't hear any of those words. They won't try because they can't because it isn't.

So what we're really saying is we're swallowing real hard and saying we understand the political realities. And we are concerned, too,

about the truly small shippers. And so we can live with that at a low level of $200,000.

When you start bouncing that thing up anywhere near the levels they were talking about, way before that, we start screaming. And then yes, I'm sorry, but we're going to be off to court again if that's what happens. I can promise.

COMMISSIONER MULVEY: In terms of making specific adjustments for, we'll say, KCS, are the data collected from the URCS for individual railroads -- and those data could be railroad-specific -- would using railroad-specific or KCS-specific data from the URCS possible? Would that help get a better understanding of what KCS' costs would be in a rate case?

MR. MULLINS: That would help somewhat, Commissioner, but the problem is not so much the railroad-specific. The problem is in the way URCS itself calculates, allocates, weighs all of the formulas. It is a mileage-based system.

So when you have a railroad like KCS, where most of its traffic is not a long-haul traffic

but short-haul, time-intensive, lots of switching, lots of pickup and delivery, URCS doesn't accurately account for those costs, no matter whether you're looking at KCS costs or average costs, plus the cost of capital issue. So it's more of a problem with URCS itself.

And so if you're going to use URCS, then, by definition, you have to allow some adjustments to URCS in order to accurately reflect what our costs are.

COMMISSIONER MULVEY: And the same would be true also for hazmat movements? And you would have to make special provisions for hazmat movements and other movements that require special inspections and insurance and the like, I would suppose?

MR. KALICK: Well, I mean basically when CN files, like CP files, in states we file an R1 for all of our operations, it includes all of our costs. So when URCS numbers come out, they are system average costs, embracing all different kinds of movements.

You know, as we mentioned before, you

could really only adjust for those, really, in the context of a rate case as far as I'm aware. I mean, you don't really adjust for them in your R1 filing as special costs.

I mean, I guess you could. That may be an accounting nightmare. And I wouldn't want to pose that to our chief financial officer.

COMMISSIONER MULVEY: Well, you don't want to open Pandora's box, as somebody mentioned, to have every single cost adjusted. The idea of having these URCS unadjusted costs was to make the process more simple, but there are obviously special cases; for example, railroads that are relatively short-haul and railroads that carry hazmats, which have special costs, especially those now associated with the national security issues.

MR. KALICK: I would make the point, Mr. Weicher made the point in the last panel that whatever the Board adopts here is not going to be set in stone, that essentially this could be a work in progress and the Board can change based on experience.

As a result, I think it does make sense given the Board's statutory obligations, the fact that URCS is going to be used not just for the jurisdictional threshold but the actual calculation of the reasonable rate to, in essence, experiment, take a category of movements where you pretty much know, at least on a broad level, that these are measurable, pretty much ascertainable. And take two or three categories of those cases and develop a procedure and see what happens. It may work. It may not work. If it works, you may allow other kinds of adjustments to come in.

Over time, the Board would develop a process. Let's say even for hazmat, it would take some, reject some. There would be a body of precedent. So in that sense, that may be just a first step. And then two years from now, the Board could take a different step.

COMMISSIONER MULVEY: I wonder if there are enough issues here about the unadjusted URCS that the KCS and the smaller railroads, that maybe we need to have another proceeding looking at URCS

and whether or not we need to update the way we do URCS and make it more sophisticated so it can handle some of the special cases like KCS and the movement of hazmats.

URCS has been around a while in terms of the way it has been developed. And as someone said, some of the regressions that are used, some of the econometrics that have been used are getting pretty dated now.

MR. KALICK: My main comment to that would be, you know, there is nothing wrong with doing a rulemaking. In theory, that is another way to proceed.

I think the question has become based on the history that if you get into an URCS rulemaking, this is not an easy process, both from a resource point of view and a technical difficulty point of view. It may take at least a couple of years or more to really come up with an answer. In the meantime, you've got these cases.

You could do two tracks, but I certainly wouldn't hold any of these adjustments in abeyance

pending the completion of an URCS rulemaking.

MR. HYNES: There's also the question of whether the broader exercise is worth it. Will you get enough bang for your buck? Again, if you're talking about positioning yourself to being able to do it in a 3B case, as I said earlier, you're probably going to be dealing -- let's assume it's a hazmat 3B case.

You may be dealing with a dozen, maybe two dozen comparables. You know, you're not going to be dealing with a hundred or a couple of hundred. Otherwise something has gone terribly wrong in the selection process for the comparables.

Assuming that it's a manageable number and assuming that things like the security and safety costs are readily identifiable and you can put a number on them pretty easily, I would think that the task of doing that is a lot less work to get to an accurate result in that rate case than reopening URCS and trying to fix all problems.

MR. MOATES: I would add, if I could -- this is not just a Canadian and smaller railroad

issue. I think all of the Class I's and I know the Norfolk Southern and CSX have in all three rounds in this proceeding and in the 657 proceeding, where you weren't persuaded, argued that you should not go to complete unadjusted URCS.

What we have done, we have done two things. We have asked you, if you will do it, to specify a list. So it's not Pandora's box. But there are some specific frequently encountered and sometimes in the context of particular movements very important costly costs that don't get picked up.

One that comes to mind quickly is a payment to a short line, a third party payment. In one of our Eastern coal rate cases, we had movement where the costs were radically affected by how you treated payments that one of the defendant railroads was making to the coal company for the use of the conveyor to transport the coal basically through a mountain to get it over to the other side. There could be a fairly limited list.

We have suggested some things. The

shippers have suggested some things. And please bear this in mind. We're not on this one a railroad issue alone. The shippers don't like no adjustments either. We may disagree with some of their adjustments, but, hey, that's what you all are here to decide, you know, which ones to pick.

I would urge you to look hard and try to come up with that kind of a list of permissible or arguably permissible adjustments before you enter into another rulemaking dealing with URCS.

And I second Mr. Kalick on that having lived long enough to remember the one before. It will take a lot of your resources. It is very complicated. It is likely to go on for years. And I don't think that we need that to deal with the problem we're trying to articulate.

COMMISSIONER MULVEY: Thank you.

CHAIRMAN NOTTINGHAM: Any other questions?

COMMISSIONER MULVEY: No.

CHAIRMAN NOTTINGHAM: No? Before concluding, I just do want to thank the staff, both

the witnesses, first of all, and your staff that helped you be with us today. Thank you.

Here at the Board it takes a lot behind the scenes to put these hearings together. I do want to recognize the staff, whether it's the security folks downstairs or the folks taping and filming the proceeding and the other staff. So thanks to them. And thanks to the witnesses. And with that, this hearing is closed. Thanks.

(Whereupon, the foregoing matter was concluded at 4:37 p.m.)