

UNITED STATES OF AMERICA
SURFACE TRANSPORTATION BOARD

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ORAL ARGUMENT

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 IN THE MATTER OF: :

US MAGNESIUM, L.L.C., :

COMPLAINANT, : STB Docket
 No. 42114

- V. - :

UNION PACIFIC RAIL COMPANY, :

DEFENDANT. :

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Monday,
November 23, 2009

Surface Transportation
Board

Hearing Room
395 E Street, S.W.
Washington, D.C.

The above-entitled matter came on
for hearing, pursuant to notice, at 9:30 a.m.

BEFORE:

DANIEL R. ELLIOTT, III Chairman
 CHARLES D. NOTTINGHAM Vice Chairman
 FRANCIS P. MULVEY Commissioner

APPEARANCES:

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Adjourn

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2 (9:30 a.m.)

3 CHAIR ELLIOTT: Good morning.

4 Welcome. Today we will hear oral arguments in
5 one proceeding currently pending here at the
6 Board. No bomb threats today, so we're going
7 off on time. This case today is captioned US
8 Magnesium versus Union Pacific Railroad, in
9 STB Docket No. NOR 42114.

10 In an effort to move things along,
11 the Board members will not be making opening
12 remarks this morning, but I wanted to cover a
13 few procedural matters before we begin.

14 We have asked each party to make a
15 short statement of their arguments, but
16 counsel should be prepared to answer questions
17 from the Board at any time during your
18 allotted time. I assure you that we have read
19 all of your pleadings, and there is no reason
20 to repeat every argument.

21 Speakers, please note that the
22 timing lights are in front of me. You will

1 see a yellow light when you have one minute
2 remaining and a red light when your time has
3 expired. The yellow one-minute light will be
4 accompanied by a single chime, and the red
5 light signifying that your time has expired
6 will be accompanied by two chimes.

7 Please keep to the time you have
8 been allotted. When you see the red light and
9 hear the double chime, please finish your
10 thought and take a seat.

11 Additionally, just a reminder to
12 everyone, please turn off your cell phones.
13 That was always a big thing I was nervous
14 about when I was in your spot, that that would
15 ever happen.

16 Counsel for US Magnesium, you have
17 been allotted 20 minutes. Please step up to
18 the podium, introduce yourself, indicate if
19 you have reserved any time for rebuttal, and
20 then begin.

21 MR. WILCOX: Good morning. My
22 name is Thomas Wilcox, for US Magnesium. I

1 have elected to reserve seven minutes for
2 rebuttal.

3 Before I start, I want to let the
4 Board know that accompanying me today is Mr.
5 Howard Kaplan. He's with us, with US
6 Magnesium. He's Vice President of Chemicals
7 and Byproducts. He's been with the Company
8 for 17 years, on the end of the table there.

9 Mr. Kaplan appeared and testified
10 in Ex Parte number 677 on the common carrier
11 obligation in the transport of hazardous
12 materials.

13 USM is one of many unhappy TIH
14 shippers that the Board has heard from in the
15 past few years. The Board has heard from
16 several more, or in fact three trade
17 associations in this proceeding, as well,
18 regarding the railroads' practices regarding
19 TIH commodities.

20 But USM has taken the additional
21 step of coming to the STB and seeking formal
22 rate relief. It's the type of small shipper

1 that we think the rules were adopted to
2 protect, clearly captive to UP, relatively low
3 volume, low revenue.

4 It's also a shipper of a commodity
5 that UP has publicly stated it no longer wants
6 to carry and it's pricing accordingly. And
7 USM's rates have skyrocketed in the past three
8 years.

9 USM is seeking relief in this case
10 under the three-benchmark case, three-
11 benchmark methodology, but believes the facts
12 and circumstances fully justify raising the
13 damage limit to \$2 million in this case.

14 There's an extensive record in the
15 case. I am going to basically address three
16 points, emphasize three points. The first one
17 is that USM believes that our final offer
18 chlorine TIH commodity comparison group fully
19 complies with the Simplified Standards and
20 what the Board did in the DuPont case in terms
21 of adopting a composite chlorine and TIH
22 shipment commodity group.

1 We believe that our commodity --
2 or, excuse me, comparison groups are most
3 similar in the aggregate to the issue
4 movements, and we've shown that in this case
5 the TIH and chlorine movements, as in DuPont,
6 have the same operating characteristics and
7 the same transportation demand characteristics
8 other -- other TIH community shipments have
9 the same characteristics as chlorine.

10 And we don't believe there's any
11 reason to depart from DuPont, words in the
12 DuPont, in terms of adopting composite
13 comparison groups over a chlorine-only
14 comparison group.

15 The second point is that UP's
16 chlorine-only comp group is not comparable.
17 And we've cited lots of reasons in the record
18 why this is not the case. But in this
19 argument I'd like to emphasize one primary
20 reason, which is the re-billed movements,
21 which UP has characterized in their rebuttal
22 as a minor costing issue but we believe is far

1 from that.

2 And I guess at this point I have
3 an oral argument exhibit, but I couldn't tell
4 whether -- is the Board accepting those in
5 this proceeding? Basically summarizing the
6 data already in the record.

7 VICE CHAIR NOTTINGHAM: Hopefully
8 not if it's chlorine and it's raw.

9 CHAIR ELLIOTT: Sure.

10 MR. WILCOX: As we've discussed in
11 the evidence, re-billed movements are by
12 definition not exactly comparable to the issue
13 movements, because they are part of an overall
14 movement. The issue movements are single-line,
15 UP origin-to-destination movements.

16 They're about 1,300 miles long,
17 and UP handles the traffic all the way, from
18 origin all the way to destination. Re-billed
19 movements are part of the movement. It's
20 where UP receives the materials at an
21 interchange point and then issues another bill
22 for the commodity and then, or for the

**STB Docket No. 42114,
US Magnesium, LLC v. Union Pacific Railroad Company**

Highly Confidential Subject to Protective Order
 [REDACTED]

	<u>Impact of Rebilled Movements</u>			
	<u>Union Pacific</u>		<u>USM</u>	
	<u>14 Rebilled Movements ^{1/}</u>	<u>10 Single Line Movements ^{1/}</u>	<u>Eloy ^{2/}</u>	<u>Sahaurita ^{3/}</u>
Avg. Distance (Miles)	1,138	1,339	1,191	1,145
Avg. Revenue/Car ^{4/}	{ }	{ }	{ }	{ }
Avg. VC/Car ^{5/}	{ }	{ }	{ }	{ }
WTD Avg. R/VC	337%	214%	215%	211%
R/VCCOMP	475%	301%	304%	298%
Upper Boundary	502%	327%	311%	302%
<p>{ } = Highly confidential Subject to Protective Order</p>				
<p><u>Source</u></p> <p>1/ UP Workpaper "UP Comparison Group at 300 and 200 Miles - Reply.xls" and USM Workpaper "UP Comp Group Analysis.xls"</p> <p>2/ Hillenbrand Reply Exhibit (KNH-14)</p> <p>3/ Hillenbrand Reply Exhibit (KNH-15)</p> <p>4/ Total Exp. Revenue (Col. 14) ÷ Total Exp. Carloads (Col. 12)</p> <p>5/ Total Exp. Var. Cost (Col. 15) ÷ Total Exp. Carloads (Col. 12)</p>				

1 transportation and submits it and delivers it
2 to the destination.

3 Fourteen of UP's 24 movements in
4 their comparison group -- they characterize it
5 as two comparison groups but it's really one
6 group of chlorine-only shipments -- 14 of
7 those are re-billed movements, and we have
8 cited in the evidence how including the re-
9 billed movements skews the result in favor --
10 well, it skews the result because the re-
11 billed movements have a higher revenue to
12 variable cost ratio.

13 And in our rebuttal evidence we
14 show how if you remove the re-billed movements
15 how the remaining chlorine-only movements in
16 UP's group, how that RVC ratio drops fairly
17 close to what USM's comparison groups produced
18 under the three-benchmark methodology.

19 The re-billed movements in this
20 case is actually the -- I think it's the first
21 time the Board has looked at re-billed
22 movements in a three-benchmark case. We do

1 not believe they were an issue in DuPont.

2 Now, as we said in our evidence,
3 we've cited how the variable costs are very
4 different for a re-billed movement, and that's
5 a combination of factors. The variable costs
6 are lower, and UP, in their evidence, said you
7 can include re-billed movements because
8 they're lower variable cost, but that, because
9 under Simplified Standards, you can have
10 movements that have different cost
11 characteristics and lower cost, but it's
12 presumed that the rates will come down and the
13 margins will stay the same.

14 But that's not what happened with
15 the re-billed movements in this case. The
16 combination of higher revenues and lower
17 variable cost have resulted in the left column
18 over here, where you -- and the reason I'm
19 speaking generally is that, as you can see,
20 the issue -- the exhibit contains highly
21 confidential information on revenues and
22 costs, and so I can always -- I can't cite the

1 exact numbers, but you can see that for the
2 re-billed movements, when you take, as the
3 references down below, if you take the
4 evidence in the record in terms of aggregate
5 revenues, aggregate variable costs that are in
6 the parties' work papers and in the evidence
7 and you reduce it to a per car level, you can
8 see what, in more precise, what we were
9 getting to in our evidence, that the actual
10 revenues for the re-billed movements are a lot
11 higher.

12 And so the margin, the markup, is
13 actually much higher on the re-billed
14 movements than they are for the remaining
15 lines. And so it shows that -- it shows a
16 couple of things, that the UP comp group has -
17 - is not comparable to the issue movements,
18 and it also shows that our movements with the
19 combined chlorine-TIH movements are more
20 comparable when you look at the 10 single-line
21 remaining chlorine movements.

22 They're a lot closer, which shows

1 that we are correct that the TIH other than
2 chlorine movements have the same -- roughly
3 the same demand characteristics,
4 transportation demand characteristics, as
5 chlorine.

6 The third point I wanted to raise
7 in my opening remarks is on PTC, UP's request
8 to have basically their estimated investment
9 in PTC folded into -- some of that investment
10 folded into USM's rates. That claim is based
11 on, in our view, three false premises.

12 The first one is that the large
13 increases in chlorine and TIH rates in the
14 recent years, as UP said in their evidence,
15 was due to some sort of understanding between
16 rail shippers and the UP that their rates
17 would be increased to reflect their
18 understating of PTC costs.

19 We believe we've countered that in
20 our evidence to show that wasn't the case and
21 also the amici associations have also refuted
22 UP's claim that there was some sort of

1 understanding that these rate increases were
2 due directly to PTC. And even UP, in their
3 rebuttal at 40, says that their ramp-up in
4 rates over the past few years is not solely
5 due to PTC, and they say it's not even the
6 primary reason.

7 The second premise is that the
8 amount UP will pay for PTC can be presently
9 accurately quantified. And we've cited many
10 examples and evidence saying that, or
11 countering the fact that it is certain,
12 because we believe it's very uncertain what
13 costs UP will pay for PTC at the end of the
14 day, where it's going to be installed on their
15 system, the extent to which there'll be public
16 funding for PTC versus UP paying for it all
17 itself.

18 You have the AAR making a
19 statutory challenge to the FRA's rules, saying
20 that, counter to what the FRA has, how the FRA
21 has interpreted the statute, it's not where
22 the TIH and passenger traffic is in 2008. It

1 should be where it is in 2015, which leaves
2 many years for the UP and other railroads to -
3 - yes, sir?

4 COMMISSIONER MULVEY: I was going
5 to say, if, indeed, the FRA can determine what
6 PTC costs are actually going to be and what
7 share of those costs is legitimately the
8 result of moving TIH as opposed to passenger
9 traffic, would you agree that at that point US
10 Magnesium and other TIH shippers should bear
11 that part of the cost?

12 MR. WILCOX: Well, USM is not --
13 they've borne costs for safety at their plants
14 and -- I think the issue, one of the biggest
15 issues for PTC is who is going to pay for it,
16 the extent to which there's going to be public
17 funding.

18 You have the -- the FRA issued its
19 national transportation plan right around the
20 time we were submitting rebuttal evidence, and
21 that cites a recent statute where there is now
22 going to be federal and passenger partnerships

1 where there'll be more passenger traffic on
2 freight lines and vice versa.

3 So the lines of where passenger
4 and TIH and freight traffic, other freight
5 traffic are going to be operated on are
6 starting to become even more blurred, we
7 believe.

8 And UP has in its evidence, they
9 had initial estimate of \$1.4 billion, and they
10 said, well, even if we drop it to \$1 billion,
11 that leaves a lot of money to be accounted
12 for.

13 But we don't believe it's beyond
14 the realm of possibility that number could go
15 to zero. There's a lot of money being
16 allocated for the government paying for things
17 these days, and \$1.4 or \$1 billion is not a
18 lot of money these days.

19 The third premise, just very
20 quickly, is that UP won't recover any of USM's
21 share of the future PTC costs -- excuse me, UP
22 won't recover any of the future costs in the

1 rate prescription process. We've shown that
2 under the Board's procedures there will be
3 cost recovery, and there is a lag, but the
4 variable costs will be recovered.

5 UP's statement that it will not be
6 able to recover any of its fixed costs or any
7 of its non-capital costs under the Board's
8 prescription period just ignores the fact that
9 even under our analysis those rates will be
10 over 300 percent around -- depending on which
11 movement, around 300 percent of their variable
12 cost, which leaves quite a bit of money for
13 investment or whatever UP wants to do with it.

14 Thank you.

15 CHAIR ELLIOTT: Thank you.

16 Counsel for Union Pacific, you
17 have been allotted 20 minutes.

18 MR. ROSENTHAL: Thank you, and
19 good morning, Chairman Elliott, Vice Chairman
20 Nottingham, Commissioner Mulvey. My name is
21 Michael Rosenthal, and I'm representing Union
22 Pacific Railroad.

1 Joining me at counsel's table is
2 Louise Rinn, Union Pacific's Associate General
3 Counsel. And I'd like also to introduce Bob
4 Worrell, Union Pacific's Senior Assistant Vice
5 President, Chemicals, and Michael Hemmer,
6 Union Pacific's Senior Vice President, Law,
7 and General Counsel, who are in the audience
8 today.

9 Union Pacific's evidence in this
10 proceeding reflects a straightforward
11 application of the three-benchmark methodology
12 that the Board adopted in its Simplified
13 Standards decision.

14 Union Pacific is simply asking the
15 Board to evaluate its evidence under the rules
16 adopted in Simplified Standards, and if it
17 does, the Board will conclude that the
18 challenged rates are reasonable.

19 To apply the three-benchmark
20 method in this case, Union Pacific first
21 developed comparison groups for the issue
22 traffic, movements of chlorine from Rowley,

1 Utah to Sahuarita and Eloy, Arizona, by
2 identifying other chlorine traffic with cost
3 characteristics similar to those of the issue
4 traffic.

5 Then, as contemplated by the
6 Board's methodology, UP submitted evidence to
7 demonstrate that the maximum lawful rates
8 should be higher than the presumed maximum
9 rates to account for two other relevant
10 factors: Union Pacific's obligation to
11 install positive train control, or PTC; and
12 the fact that all of the other traffic in the
13 comparison groups moved under contract rates
14 rather than common carrier rates.

15 US Magnesium, on the other hand,
16 misapplied the three-benchmark methodology.
17 US Magnesium did not limit its comparison
18 groups to chlorine traffic. Instead, its
19 comparison groups consist almost entirely of
20 movements of commodities other than chlorine.

21 Chlorine is only 1 percent of US
22 Magnesium's comparison group for the

1 challenged rate to Sahuarita and just 4
2 percent for the challenged rate to Eloy. As
3 a result, if the Board selected USM's
4 comparison groups, the reasonableness of the
5 challenged rates would be based almost
6 entirely on the demand characteristics and
7 cost characteristics of transportation of
8 commodity other than chlorine.

9 CHAIR ELLIOTT: Mr. Rosenthal,
10 with respect to the analysis of the demand
11 characteristics, it seems that US Magnesium is
12 looking more at the transportation
13 characteristics and that you are looking more,
14 as they put it in their brief, the end use
15 characteristics.

16 How do you respond to their
17 argument with respect to that issue? Is that
18 the way you perceive these guidelines to work
19 is that you should look at the transportation
20 or the end use?

21 MR. ROSENTHAL: I think both are
22 relevant. The three-benchmark methodology is

1 designed to identify the appropriate amount of
2 demand-based differential pricing for the
3 comparison for the issue traffic. It's
4 designed to identify the appropriate level of
5 contribution to joint and common cost for the
6 issue movements.

7 And the three-benchmark
8 methodology does this by looking at the
9 markups collected on traffic with demand
10 characteristics that are comparable to the
11 issue traffic, that is, movements of a similar
12 commodity under similar circumstances, to
13 determine the reasonableness of the markups
14 for issue traffic.

15 So the question in this case
16 becomes, what traffic is sufficiently similar
17 to US Magnesium's chlorine traffic to reflect
18 reasonable markups?

19 And our answer is chlorine
20 traffic, because the factors that affect the
21 markups that Union Pacific can charge are
22 different for chlorine traffic and other

1 traffic. Demand for chlorine is subject to
2 different market forces than demand for the
3 other TIH commodities in US Magnesium's
4 comparison groups.

5 Chlorine and other TIH commodities
6 have different risk profiles and different
7 risks associated with their transportation.
8 Chlorine is less susceptible to transportation
9 by other modes, and chlorine is less
10 susceptible to product substitution.

11 And, again, all of these factors
12 are what play into the markups Union Pacific
13 can charge for chlorine, and they explain why
14 the markups charged for other commodities
15 would not provide meaningful information about
16 the markups that should be charged for
17 chlorine traffic. Now --

18 CHAIR ELLIOTT: Mr. Rosenthal, how
19 do you respond to their de-marketing claim
20 that -- I noted in the beginning of their
21 brief they claim that the rates have
22 increased, doubled from last year to this year

1 on this subject line. How do you respond to
2 that?

3 MR. ROSENTHAL: The de-marketing
4 issue has obviously been litigated extensively
5 in this case, mostly because what US Magnesium
6 is trying to do is trying to bring this case
7 into the framework of the DuPont case, where
8 the Board said that it was using a comparison
9 group based on all TIH traffic because DuPont
10 had admitted that it was pricing chlorine at
11 levels that were not commercially justifiable.
12 And so we certainly address that issue in this
13 case.

14 And the evidence shows that this
15 case is nothing like the DuPont case. First,
16 the evidence shows that Union Pacific is not
17 de-marketing chlorine. Union Pacific has
18 entered into contracts with every chlorine
19 shipper other than US Magnesium.

20 We have voluntary contracts. The
21 traffic is moving under rates that are
22 comparable to the rates that we're arguing

1 about in this proceeding, that we're trying to
2 charge US Magnesium.

3 US Magnesium's own expert witness
4 described UP's pricing as an effort to
5 maximize profits, which is what the Board said
6 in the DuPont case that railroads should be
7 doing.

8 Dr. Kaplan testified for US
9 Magnesium that Union Pacific's rates have been
10 generally reasonable and fair prior to 2008,
11 which is inconsistent with US Magnesium's
12 current claim that we've been trying to de-
13 market chlorine since 2005.

14 CHAIR ELLIOTT: Have you seen any
15 type of decrease in movements with respect to
16 chlorine traffic?

17 MR. ROSENTHAL: We had Dr. Marius
18 Schwartz, Professor of Economics at Georgetown
19 University, analyze Union Pacific's waybill
20 data and look at exactly that, look at the
21 pattern of movements and variable costs in
22 revenues. And he concluded that Union

1 Pacific's pricing is consistent with the
2 pursuit of greater profit rather than driving
3 away TIH traffic.

4 And we had Mr. Worrell testify for
5 Union Pacific that the rates for chlorine and
6 other TIH commodities reflect Union Pacific's
7 assessment of market-level rates.

8 And so when you look at the
9 evidence in this case, when you look at the
10 evidence from our testimony, to their experts,
11 to their witnesses, to the waybill sample
12 data, none of the evidence supports the claim
13 that we're de-marketing chlorine.

14 CHAIR ELLIOTT: So you're saying
15 there has not been a decrease in the number of
16 movements? The economy's had an effect, but -
17 -

18 MR. ROSENTHAL: When you look at
19 the pattern of chlorine movements over time,
20 you do see in some periods some decrease as
21 rates have increased, but that's entirely
22 consistent with maximizing profits.

1 That's what companies do. They
2 raise price. Sometimes quantity goes down.
3 But as long as the contribution is going up,
4 as long as the contribution they're receiving
5 from this traffic is going up, that's not
6 driving traffic off the system. That's not
7 pricing irrationally or pricing at levels that
8 aren't commercially justifiable.

9 That's what companies are supposed
10 to do to maximize profits. So we entirely
11 reject claims that Union Pacific is somehow
12 pricing to de-market. The evidence shows that
13 Union Pacific is pricing chlorine in a
14 commercially justifiable manner.

15 Now, US Magnesium has come up with
16 -- has tried to argue in other ways that our
17 comparison groups are not appropriate for this
18 case. They've argued that the comparison
19 groups are too small, but our evidence shows
20 that they're similar in size to some of the
21 comparison groups that the Board used in the
22 DuPont case.

1 They're larger than the 23
2 movements that were used to evaluate the
3 nitrobenzene movements. They're about the
4 size of the 28-movement group that was used in
5 one of the chlorine cases involving the
6 movement of chlorine to Niagara Falls.

7 US Magnesium also claimed at some
8 point in its arguments that the DuPont case
9 somehow compelled the use of chlorine-only
10 comparison groups. But I think we showed from
11 the Board's own brief to the District of
12 Columbia Court of Appeals that the Board at
13 least told the D.C. Circuit that it was
14 willing to accept a chlorine-only comparison
15 group.

16 And then, finally, US Magnesium
17 has tried to argue that, well, Union Pacific
18 treats chlorine the same as TIH in that we're
19 trying to de-market it all. We're trying to
20 treat it as having the same demand elasticity.
21 So therefore the Board should look at markups
22 on all of this traffic as the same.

1 But, as I just explained, it's
2 clearly not the case. It's clearly not the
3 case that we're trying to de-market these
4 commodities. The testimony in this case is
5 that we're not pricing them the same. We're
6 looking at each commodity and each movement
7 depending on its particular characteristics
8 and setting market-level rates.

9 And we've provided in our rebuttal
10 a look at the waybill sample data over the
11 years that shows a clear difference in markups
12 between chlorine and other TIH that shows
13 there's a constantly higher markup for
14 chlorine. It's not as though we're treating
15 them as having the same demand elasticity.

16 CHAIR ELLIOTT: How do you respond
17 to Mr. Wilcox's argument regarding the re-bill
18 issue in his exhibit?

19 MR. ROSENTHAL: There are two
20 issues that the Board is looking at, I think,
21 when it's asking about the most appropriate
22 comparison group. There's the demand side and

1 there's the cost side.

2 And US Magnesium argued that its
3 comparison groups are superior because its
4 costs are more similar to those of the issue
5 traffic, and they criticized the re-bills,
6 they criticized our 400-mile range. We used
7 a 400-mile range from which to draw comparable
8 movements.

9 But the evidence when you do the
10 costing shows that the traffic in Union
11 Pacific's comparison groups has a narrower
12 range of cost characteristics than the traffic
13 in USM's groups, and that the average cost of
14 the traffic moving in Union Pacific's
15 comparison groups is more similar to the issue
16 traffic than the costs of US Magnesium's.

17 Now, US Magnesium's decision to
18 include non-chlorine traffic in its comparison
19 groups, we feel, is much more significant,
20 much more significant than Union Pacific's
21 decision to include re-billed movements or
22 movements with a longer range.

1 And, as the Board explained in
2 Simplified Standards, movements with different
3 cost characteristics may be included in the
4 comparison group, because the key issue is
5 markup. The key issue is not the actual level
6 of cost, but the markup over the cost that the
7 railroad is charging.

8 In other words, a chlorine
9 movement with lower variable costs may have a
10 lower rate than a chlorine movement with
11 higher costs, but there's no reason to expect
12 the markups to be different.

13 In this case, though, the Board
14 doesn't have to choose between movements --
15 between the comparison group with the closer
16 cost characteristics and the closer demand
17 characteristics. UP's comparison groups are
18 superior in both dimensions.

19 On reply, US Magnesium presented a
20 series of calculations in which it tried to
21 show that, again, UP's comparison groups had
22 a wider range of cost variations. But its

1 calculations depended on a good number of
2 assumptions that ignored the actual
3 characteristics of the movements.

4 And when those assumptions are
5 replaced with actual data, which is what Union
6 Pacific did in its rebuttal testimony, then
7 you see the answer that we got, that our
8 comparable groups have a narrower range of
9 differences and are, on average, more similar
10 in cost to the issue traffic.

11 Now, there's also a demand side at
12 least hinted at issue with respect to the re-
13 billed movements, but it's not really
14 developed in any of US Magnesium's evidence.
15 It's hinted at in their rebuttal testimony
16 that perhaps there's something different in
17 the nature of these re-billed movements that
18 we should be concerned about.

19 But we would submit that we have
20 demonstrated that there is a real reason to be
21 concerned on the demand side about the
22 difference between chlorine traffic and all of

1 the other non-chlorine traffic that US
2 Magnesium included in its comparison groups.
3 That's where there's some real evidence of a
4 demand side difference.

5 With regard to re-billed
6 movements, US Magnesium doesn't even hint what
7 that might be. Why is there any reason to
8 believe that the markups on re-billed
9 movements should be different than the markups
10 on the other movements? There's no reason
11 that US Magnesium has given to dismiss the
12 evidence that's provided by these other
13 movements of chlorine.

14 COMMISSIONER MULVEY: We don't
15 have a lot of experience in the small rate
16 case approach so far, but we do have the
17 DuPont cases. Were there any re-billed
18 movements in the Dupont case?

19 MR. ROSENTHAL: I believe -- I do
20 not know the answer to that. I don't know
21 whether the data are even publicly available
22 that would let me know the answer to that.

1 But, again, the Board's theory of looking at
2 demand-based pricing and markups says, "Let's
3 look at the commodities with the demand
4 characteristics that are the same."

5 And in that type of analysis,
6 again, cost is less significant. It's
7 important as a baseline for measuring the
8 markups. But what the Board said, one of the
9 Board's examples was that you could use
10 multiple-car movements in rates involving unit
11 trains.

12 Well, if you look at the factors
13 that are applied on the cost side between
14 multiple-car movements and unit trains,
15 they're much more significant than the factors
16 here, the difference between a re-billed
17 movement, where you're treating one end as an
18 interchange rather than a termination.

19 If you look at that compared to
20 the discount on termination charges for unit-
21 train movements and multiple-train movements,
22 and the other factors that come into play when

1 you're using unit-train movements and
2 multiple-train movements, the cost differences
3 here are less significant than the example
4 that the Board gave.

5 COMMISSIONER MULVEY: Well, the
6 example that was submitted a few moments ago
7 by USM suggests that using re-billed movements
8 generates a pretty substantial cost
9 difference. Do you have any evidence to
10 suggest that some of the other things that you
11 mentioned are at least this large?

12 MR. ROSENTHAL: Well, again, I
13 think you have to -- I was just given this
14 exhibit when you were, so I haven't had a
15 chance to look at it, but looking at the cost
16 differences, again, those should not be
17 relevant under the Board's methodology.

18 If you trust your URCS costing
19 system, you're looking at the markups over
20 those costs. And even if you don't trust
21 URCS, there's a reason, I mean, there's
22 certainly a reason why you would prefer a

1 comparable group that is more similar in terms
2 of cost characteristics.

3 But if it's a choice between that,
4 if it's a choice between re-billed movements
5 with some cost characteristics that might be
6 slightly different and a comparison group
7 that's comprised 99 percent or 96 percent of
8 non-chlorine traffic, where should you be more
9 concerned that you're not reflecting the
10 demand characteristics? I submit it's the
11 comparison group that has hardly any chlorine,
12 not the fact that you've got some re-billed
13 movements in there.

14 COMMISSIONER MULVEY: This does get
15 to the comparability of movements. I guess
16 anhydrous ammonia is what we're really talking
17 about as a large part of the comparison group
18 traffic that's in USM's case.

19 You say the demands are different,
20 but in terms of the transportation demand,
21 both of them are highly, highly inelastic, up
22 to a point that it's sort of an all-or-nothing

1 demand curve. You really don't have any
2 alternatives.

3 You were suggesting that there are
4 reasonable alternatives for moving anhydrous
5 ammonia. The anhydrous ammonia that, in fact,
6 moves by rail, (I know much of it does move by
7 barge and by pipeline,) but the question is
8 what's moving by rail, does that really have
9 a non-rail alternative when it has to move?

10 MR. ROSENTHAL: I mean, first of
11 all, when you're looking at the transportation
12 demand characteristics, we had Dr. Schwartz
13 testify about this in our rebuttal testimony,
14 the demand for -- shipper's demand for
15 transportation is derived from demand for its
16 product.

17 And certainly the shipper's demand
18 for its product depends on more than just the
19 strict transportation characteristics of the
20 commodity. And so the same way that a
21 shipper's markup depends on more than just the
22 transportation characteristics of the product,

1 a railroad's markup is going to depend on more
2 than just the transportation demand.

3 And so it's not just a question of
4 can this be transported, when you're looking
5 at the transportation demand and the demand
6 for transportation. It's not just a question
7 of can it be transported some other way.

8 It's directly affected by the
9 demand for the product, which is, again, why
10 we chose chlorine rather than something with
11 all other comparison groups. And Dr. Schwartz
12 goes through all the various Marshall-Hicks-
13 Allen factors that affect the derived demand
14 for transportation.

15 And certainly the alternative
16 transportation sources is one of them. But
17 it's one of them, and the others depend, and
18 this one also depends on the nature of the
19 product, not just the nature of the
20 transportation.

21 COMMISSIONER MULVEY: Well, you
22 make a good point in the sense that the

1 anhydrous ammonia does have alternatives, and
2 that you can use anhydrous ammonia as a
3 fertilizer or there are other substitutes.

4 But now we have, in the case of
5 chlorine, one of its major uses, the use of
6 household bleach, etc., the Clorox company has
7 said that it is going to no longer use
8 chlorine, it's going to no longer ship
9 chlorine, it's going to come up with a
10 substitute.

11 So don't we have chlorine also
12 becoming much more like anhydrous ammonia in
13 becoming a product that has substitutes, and
14 therefore the demand for the product having
15 more of the same characteristics as anhydrous
16 ammonia?

17 MR. ROSENTHAL: Well, I don't
18 think so. I mean, I think what we're seeing
19 with respect to Clorox is that, as you point,
20 companies are recognizing the risks and costs
21 associated with transporting these products,
22 and I'm not sure the way this day is going I'm

1 going to have time to talk too much about PTC,
2 which is what we're trying to do, but, no, I
3 mean, again, I think you have to look much
4 beyond simply the transportation
5 characteristics of the product.

6 That's the whole point of the
7 Board's three-benchmark methodology of looking
8 at markups and what markups the railroad can
9 charge and allowing demand-based differential
10 pricing.

11 And demand-based differential
12 pricing, which is necessary for railroads to
13 recover their cost, depends not just on the
14 particular product. Just because you have
15 captive coal doesn't mean you should be
16 pricing it at the same level as captive
17 chlorine or captive ammonia.

18 Where do all these products fall
19 within that range? It's too difficult to
20 tell. And it's not just products. You would
21 have to think about the particular geographic
22 competition. As you point out, there are

1 different movements that are subject to
2 different forces, depending on where they are.

3 But that analysis is just too
4 complicated, and that's what the Board
5 recognized by going to something like the
6 three-benchmark methodology. To actually
7 figure out what the proper level of demand-
8 based differential pricing is is just too
9 complicated.

10 So what you can do is you can
11 choose products with similar demand
12 characteristics, products that you believe
13 should be the same based on the key factors,
14 adjust as you can for costs, and, again, even
15 setting aside this question of -- well, even
16 with this question, not setting it aside, even
17 with the re-bills, even with the larger
18 mileage range, Union Pacific's comparison
19 groups are more similar in terms of cost, more
20 similar in terms of costs, more similar in
21 terms of demand characteristics. They should
22 be the ones that you've accepted.

1 VICE CHAIR NOTTINGHAM: Mr.
2 Rosenthal, how do you respond to the argument
3 that if a railroad were to select a comparison
4 group that arguably was quite narrow and
5 systemically decided to game this process by
6 pricing all of their customers in that market,
7 for example all chlorine customers, 500-plus
8 percent is the ratios we're looking at in this
9 case, I believe, rather than just do variable
10 costs, and then you get challenged in a case
11 and you say, "Well, look, it's very
12 comparable. All our customers are paying 500-
13 plus percent. There's not a problem here."
14 How do you respond to that argument?

15 MR. ROSENTHAL: Well, first, the
16 gaming allegation has been directly made in
17 this case, and I think the facts completely
18 refute the gaming allegation. I won't go
19 through them again because I have very limited
20 time, but the facts completely refute them.

21 Second, the facts in this case
22 show that the rates are in contracts, and

1 they're negotiated, presumably commercially
2 justifiable rates if they're in contracts.
3 So, again, I think it's very difficult to say
4 that rates like that have been gamed.

5 And, finally, this is how the
6 three-benchmark methodology works is you're
7 comparing it to other rates that are in the
8 marketplace. And the Board has other
9 methodologies if they believe -- if shippers,
10 who have pushed for this three-benchmark
11 methodology, if the shippers believe that it
12 doesn't work, there are other alternative ways
13 to dealing with these issues.

14 CHAIR ELLIOTT: Mr. Rosenthal, why
15 don't we give you a few extra minutes here?
16 We didn't get into the PTC matter, which
17 obviously is a very important issue. And if
18 you could kind of be very specific with
19 respect to some of Mr. Wilcox's statements,
20 especially with respect to has there been any
21 capital allotted for these specific lines,
22 along those lines, and also with respect to

1 his statements that is it possible that the
2 return on investment with respect to PTC can
3 be employed to other customers, not just the
4 chlorine shippers.

5 MR. ROSENTHAL: Sure. And I'll
6 try to make this very quick, and please
7 interrupt me with questions if I'm straying.
8 But the problem that we were trying to address
9 with the PTC adjustment is that the rates, the
10 maximum rates in this case, the presumed
11 maximum rates, are based on rates that were
12 out in the marketplace between 2004 and 2007,
13 and that's what we're looking at to figure out
14 what the appropriate markup should be. And
15 the marketplace has changed substantially
16 since then.

17 And US Magnesium says chlorine
18 rates and TIH rates have increased, have
19 surged or whatever term they used, and our
20 answer is, yes, that's the problem. The
21 problem is if you're comparing rates that
22 exist today to rates that exist then they're

1 going to look different, and if you use
2 markups that existed back then to determine
3 the rates that Union Pacific can charge today,
4 they're not going to appropriately reflect the
5 rates that are in the marketplace today.

6 Now, to the question of whether
7 Union Pacific is spending money, is there
8 capital going into it, the answer is our
9 evidence shows that it's going to be
10 approximately \$1.4 billion to install PTC by
11 the end of 2015.

12 But Union Pacific is certainly
13 working now to meet that deadline. It spent
14 tens of millions of dollars this year, and
15 it's going to spend hundreds of millions of
16 dollars more in the next several years to meet
17 that deadline. So money is being spent.

18 And there may be questions about
19 what the ultimate final cost will be for PTC,
20 but Union Pacific developed its adjustment
21 using very conservative, very conservative
22 measures. We did not --

1 CHAIR ELLIOTT: Is there any
2 specific cost allocated with respect to these
3 movements that you're aware of?

4 MR. ROSENTHAL: I don't think
5 there has been -- as far as I know there has
6 not been budgeting on a -- the costs that we
7 presented in our evidence were developed
8 looking at a line-by-line breakdown of what is
9 Union Pacific going to have to do to comply
10 with the particular rules.

11 And certainly a lot of the money
12 that Union Pacific has been spending so far
13 has gone into the sort of preparation work
14 that's going to be necessary to deploy PTC
15 across its entire system.

16 Now, whether somebody has been out
17 on the particular line or spur used for this
18 particular movement, I don't know. But the
19 types of costs that are being incurred right
20 now are the startup costs that should be
21 equally applicable to everybody who's going to
22 benefit from PTC.

1 COMMISSIONER MULVEY: Are you
2 basing the estimate of PTC costs on making PTC
3 compliant with the entire system, or only
4 those parts of the system that carry passenger
5 traffic and also carry TIH traffic, which I
6 believe is what the law requires?

7 MR. ROSENTHAL: The estimates that
8 we developed were based on what the law
9 required and what, at the time the estimates
10 were developed, looking at the traffic that
11 was moving on the lines. I think it was the
12 2007 data, because that's what we had, but
13 based on what the law required in 2008.

14 But, again, we were very
15 conservative in the way we applied this by
16 omitting entirely the cost to maintain the
17 system, which the FRA estimates is going to be
18 about 15 percent of the sort of base
19 installation costs.

20 We did assume substantial levels
21 of public funding. The way we did the numbers
22 and allocated the costs, we assumed that our

1 lines that had commuter traffic, the commuter
2 rail lines, would bear 100 percent of the
3 costs, and on the lines where there was Amtrak
4 traffic and TIH traffic that Amtrak would bear
5 25 percent of the costs.

6 And I think the numbers may be
7 confidential, but if you look at the
8 percentages and you look at the numbers they
9 imply, it's a substantial number that, while
10 it's not entirely the amount in the
11 legislation that Mr. Wilcox cited, which is,
12 I believe, \$250 million, if you assume that
13 Union Pacific's experience would be repeated
14 with other railroads, that \$250 million would
15 very quickly be exhausted. So we were very
16 conservative there.

17 And then in our rebuttal we took
18 the further step, and we said, you know, maybe
19 there is some uncertainty about exactly where
20 PTC is going to be required. Maybe there'll
21 be some de minimis exceptions. And so we just
22 took off a substantial chunk. We took off

1 \$400 million. And we said, even if you do
2 that and you apply our adjustment you're going
3 to find that the rates are reasonable.

4 And the Board doesn't to have to
5 pick a single point estimate here. The Board
6 doesn't need to adopt its estimate of what
7 it's going to cost Union Pacific to install
8 PTC. The question in this case is simply
9 whether the challenged rates here are
10 reasonable.

11 And what we showed is that under a
12 very wide range of assumptions, if you take
13 Union Pacific's best estimate or if you take
14 a number that's substantially lower, the rates
15 in this case would be reasonable.

16 COMMISSIONER MULVEY: So you're
17 saying that for the \$1.5 billion that Union
18 Pacific thinks it's going to have to spend to
19 become PTC compliant, large parts of that will
20 be borne by the commuter railroads and by
21 Amtrak as well as TIH shippers. But, when you
22 look at the amount going to TIH, you take into

1 account the amounts that are likely going to
2 be covered by the commuter railroads, public
3 sector and the like.

4 MR. ROSENTHAL: The estimate that
5 -- the \$1.4 billion was Union Pacific's
6 estimate for what it would cost to install
7 PTC. When we were developing what we think
8 it's fair to be assigned to US Magnesium in
9 judging its reasonable rates, we assumed that
10 a portion of that \$1.4 billion would be
11 covered by some source, perhaps it's public
12 funding, where you have these commuter rail
13 lines. Again, we assumed it would be 100
14 percent to the commuters and 25 percent to
15 Amtrak.

16 So we did, in building this
17 adjustment, consider a substantial amount of
18 public funding, and, again, when you compare
19 it to the legislation, a very substantial
20 amount of public funding that we were, we
21 think, very conservative in that estimate, as
22 well.

1 COMMISSIONER MULVEY: And then one
2 last follow-up on that, do you assume that any
3 of the traffic, any of the costs should be
4 borne by other traffic than TIH traffic
5 because to the extent that there is an
6 accident or to the extent that PTC makes the
7 railroad more efficient and more safe that
8 other traffic should also bear part of the
9 benefit or part of the cost?

10 MR. ROSENTHAL: I'd like to
11 address that in two ways. First, as part of
12 our rebuttal, when we looked at different
13 variations on how costs might be lower than
14 what we had estimated or how the benefits
15 might be higher, we did take into account the
16 Federal Railroad Administration's analysis of
17 the benefits of PTC.

18 And we assumed that, for purposes
19 of one of our calculations, we said, well,
20 what if Union Pacific got all those benefits,
21 the sort of operating benefits? And still we
22 set aside the 15 percent FRA estimate of costs

1 that it will cost to maintain the system.

2 And we showed that even under
3 those circumstances, if you applied our
4 adjustment, the challenged rates would be
5 found to be reasonable. So we took it into
6 account in that way, as well.

7 VICE CHAIR NOTTINGHAM: Mr.
8 Rosenthal, have you begun to raise rates to
9 your passenger rail customers in the various
10 pricing agreements you have with them to
11 account for the new PIH, excuse me, PTC
12 mandate?

13 MR. ROSENTHAL: I don't know the
14 answer to that. I don't know what our various
15 agreements would allow us to do with the
16 passenger carriers.

17 VICE CHAIR NOTTINGHAM: So are you
18 saying there's sort of a selective or random
19 process whereby UP is deciding to recoup some
20 potential costs from some customers but not
21 others?

22 MR. ROSENTHAL: No, I don't think

1 I'm saying that. I'm just saying I don't
2 really know what the situation is with respect
3 to our passenger railroads. I don't know what
4 the contracts are. I don't know when they
5 were entered into. And I don't know to what
6 extent they would allow us to make these
7 changes.

8 I know, for example, I've seen
9 Amtrak's public statements where they say they
10 don't believe that under the standards that
11 apply to their rates they should be required
12 to bear any of the costs associated with
13 installing PTC on other railroad lines. I've
14 seen that.

15 And, as I said, I think that's one
16 of the reasons why our assumption that Amtrak
17 would bear 25 percent of the cost is rather
18 conservative. But I don't know specifically
19 what our arrangements are with other commuter
20 carriers.

21 VICE CHAIR NOTTINGHAM: And,
22 please understand, I think the argument that

1 the PTC mandate is real, it's in federal law,
2 and it's very expensive as it currently
3 exists, unless that's amended or adjusted by
4 statute.

5 And someone's going to have to pay
6 those costs, and it would appear that it would
7 end up being freight rail customers, and
8 probably, I would assert, primarily the
9 freight rail customers who are the direct link
10 or cause to that new mandate, namely your TIH
11 and your passenger customers. So it's a
12 compelling argument you raise in the other
13 relevant factors part of your case.

14 I guess what I'm looking for is
15 how to answer sort of the timing question. In
16 other words, did you just conveniently pick up
17 that argument because you got caught assessing
18 500-plus percent rates over variable costs in
19 this case, or can you show and demonstrate the
20 type of corporate communication one would
21 expect to see if a railroad were rolling out
22 a dramatic new pricing arrangement to account

1 for a \$1.4-billion new federally enacted
2 unfunded mandate, things like letters to all
3 customers, possibly a new accounting handling
4 where you're setting up a trust fund to
5 reserve those funds over years so they'll be
6 available in the future so you can demonstrate
7 both to your shareholders and to your
8 regulators and customers that you have a
9 serious program to set aside the funding
10 needed?

11 Can you point to some of those
12 what I'd call indicia of corporate strategy to
13 seriously tackle this? Or, if not, would it
14 be because there are no regulations yet? We
15 don't even know what technology FRA is going
16 to endorse.

17 And it's pretty hard for anybody
18 to be spending big-time money on a PTC mandate
19 that actually doesn't technically exist right
20 now other than it is in law, so it's coming,
21 but my understanding is you couldn't -- if we
22 gave you \$1.4 billion you couldn't meet the

1 so-called PTC mandate now because there's so
2 much left to be known.

3 MR. ROSENTHAL: First of all, just
4 as a fact, UP is spending big-time money now
5 to comply with the PTC mandate. US Magnesium
6 and some of these other groups say, "Well,
7 maybe there'll be an amendment, maybe there'll
8 be this, maybe there'll be that."

9 Union Pacific is dealing with a
10 statute that requires it to install PTC on the
11 lines required by law by the end of 2015.
12 They can't start to do that on December 30,
13 2015. It is spending money now. Union
14 Pacific's also made a commitment to install
15 PTC in the Los Angeles Basin area by I think
16 it's the end of 2012, and it's spending money
17 to do that.

18 Now, in this particular case, when
19 we're talking about the issue that we're
20 trying to address by the PTC adjustment, PTC
21 is part of it. The real issue is that the
22 rates that are being used to set the markups

1 in this case, that's rates based on traffic
2 that moved between 2004 and 2007, are
3 different than they are today. They're
4 different for a number of reasons, a lot of
5 them dealing with new regulations apart from
6 PTC.

7 We went through a long list in our
8 opening evidence of the new regulations from
9 the Transportation Safety Administration and
10 the -- Security Administration, the Pipeline
11 Hazardous Material Safety Administration,
12 these things that have been raising our costs
13 that have been reflected in higher rates.

14 PTC is one of them. It's the most
15 recent, and it's certainly the most dramatic.
16 And it happens to be the one, because of those
17 characteristics, because it's dramatic, that
18 we were able to quantify it in this case and
19 meet the Board's very stringent guidelines set
20 up under the three-benchmark methodology.

21 And that's all we're asking the
22 Board to do is to apply its three-benchmark

1 methodology to look at this as an other
2 relevant factor and to give us the
3 opportunity.

4 And, again, we're not saying that
5 -- the Board doesn't have to pick a rate. The
6 Board does not tell us what we can charge. It
7 tells us the maximum, but it doesn't allow us
8 to charge a particular rate to US Magnesium.
9 It doesn't require US Magnesium to pay any
10 particular rate to us. The market ultimately
11 makes those decisions.

12 What we're saying is that in
13 setting the maximum reasonable rates in this
14 case the Board should follow its three-
15 benchmark methodology and give us the
16 opportunity to recover the very real, very
17 substantial costs to install PTC from the
18 traffic that's causing us to incur those
19 costs.

20 VICE CHAIR NOTTINGHAM: Mr.
21 Rosenthal, if I could follow up on that
22 general line of inquiry, why do you think

1 Congress specifically included TIH traffic in
2 the PTC mandate? We all are aware of the
3 horrible passenger rail accident in the Los
4 Angeles area shortly before the PTC mandate
5 was put into law.

6 Obviously, not many of us were
7 surprised to see passenger rail as a focus for
8 that new technology deployment for increased
9 safety. Why specifically do you think
10 Congress added TIH and really nothing else?

11 MR. ROSENTHAL: Well, I mean, I
12 can't sit here and completely understand
13 what's in Congress's mind, but when you look
14 back at the legislative history they were
15 concerned not only about the passenger
16 incident, but they were also concerned about
17 the chlorine release in Graniteville, South
18 Carolina. There were records of other
19 releases of anhydrous and chlorine.

20 So I think they understood, I'm
21 guessing that they understood the sort of
22 devastation that can be caused by releases of

1 these commodities. And if you look at the
2 FRA's analysis, if you look at their economic
3 analysis, of the costs to install PTC versus
4 the benefits, what the FRA says is even
5 considering all these things it doesn't make
6 economic sense.

7 But I assume that why Congress
8 would've imposed this sort of burden is
9 because they understood the massive amounts of
10 risks that are associated with PTC, with TIH,
11 sorry, with TIH in particular. That's what I
12 can see would justify this type of program.

13 VICE CHAIR NOTTINGHAM: If I could
14 summarize, is your point that Congress
15 recognized in the statute that included the
16 PTC mandate that TIH is uniquely risky?

17 MR. ROSENTHAL: I think that's
18 what the statute tells us. That's why when
19 you look at where PTC is mandated, it's
20 passenger and it's TIH. That's what the
21 statute says. If it didn't say TIH we
22 wouldn't be incurring --

1 VICE CHAIR NOTTINGHAM: I'll take
2 that as a yes. Thanks. So, UP is, if you
3 follow the common carrier obligation rationale
4 and line of case law, UP is, in essence,
5 required to handle and carry and transport a
6 uniquely hazardous substance known generally
7 as TIH, recognized as uniquely hazardous in
8 statute by Congress, and clearly there are
9 costs associated with carrying something
10 uniquely hazardous.

11 What options or alternatives does
12 UP have to both capture and identify those
13 costs and then to recoup them? Because
14 clearly I don't think anyone expects you to
15 just absorb real business costs that even
16 Congress is recognizing.

17 So you've got a challenge of how
18 to capture. You've got things like insurance,
19 presumably, possibly both commercial insurance
20 and self-insurance. You've got things like
21 extra maintenance or safety precautions that
22 you might need to deploy because of this

1 uniquely hazardous material that you're
2 transporting.

3 How does, I mean, how do our
4 reports that we collect, for example, allow a
5 railroad to capture and show those costs so
6 that when we're looking at your rates --
7 because the idea generally here is we're
8 supposed to capture all the key cost elements
9 in documents like the R-1 report, and that
10 feeds into URCS, the Uniform Rail Costing
11 System.

12 And presumably over time one
13 reason this line of questioning, I think, is
14 important is that when you have real
15 investments that are being made to implement
16 the PTC mandate, those would be captured, as
17 all other major lines of railroad investments
18 are captured, in reports like the R-1 that
19 feeds into URCS that then underlies our rate
20 complaint adjudication process. I know I've
21 given you a lot to work with there, but I want
22 to --

1 MR. ROSENTHAL: Yes, no, I mean, I
2 think you're absolutely right. I think a very
3 important issue and one that Union Pacific is
4 wrestling with now is how to capture these
5 costs.

6 And the Board has noticed a couple
7 of proceedings, one dealing specifically with
8 TIH and one dealing more generally with URCS,
9 in which it has, I guess, started the process
10 of asking how do we capture these costs in the
11 accounting systems?

12 And Union Pacific has participated
13 in both proceedings, and we've said that we
14 will, we are very happy to work with the Board
15 in trying to capture these sorts of costs and
16 better reflect them, because they are very
17 substantial.

18 And in some of Union Pacific's
19 evidence before, in the -- one of the
20 subproceedings, we did try to explain how
21 we've been trying to capture some of the
22 investment costs, some of the additional

1 training costs and try to reduce it to a per-
2 car level.

3 But it's a complicated exercise,
4 and it's difficult to tease out these costs,
5 and we think that the proceedings started by
6 the Board would be useful in helping to get
7 these costs in a more systematic way into the
8 rail costing system.

9 And there are other examples, as
10 we pointed out in our opening evidence. There
11 are examples where the Board's accounting
12 system tries to look separately at intermodal
13 terminal costs, for example, and certain
14 passenger costs, and tries to capture them in
15 accounts.

16 And we think that might very well
17 be appropriate for the types of costs that
18 we're incurring not just for PTC but for a lot
19 of the other operating changes that have to be
20 made and a lot of the other investments that
21 are being made as a result of these many new
22 safety regulations that --

1 VICE CHAIR NOTTINGHAM: Do you
2 believe, just to follow up on that, do you
3 believe that the Board's, this Board's current
4 data collection processes and data sorts
5 properly -- allow railroads to properly
6 account for the unique, as recognized by
7 Congress, risk premium associated with being
8 required to transport TIH?

9 MR. ROSENTHAL: Well, no, I don't
10 think they do. I think one of the problems
11 that's happening and one of the reasons why
12 somebody will come up and say, "Look at your
13 RVC ratios, they're so very high," I think
14 part of the problem is that the costs that
15 should be more properly attributed to TIH
16 traffic are being spread on a system average
17 basis over all traffic, and that if you
18 actually captured the costs and assigned them
19 appropriately that the markups wouldn't be as
20 high as they may seem. They'd be different in
21 relation to the costs if they were properly
22 allocated.

1 COMMISSIONER MULVEY: When you
2 refer to properly allocated costs of the TIH
3 movements, are you including also the
4 insurance premiums associated with
5 catastrophic risk, or are you referring more
6 to the direct increased costs of handling TIH
7 materials?

8 MR. ROSENTHAL: Well, both, and I
9 think there's a third. I think there are
10 direct handling costs related to TIH
11 materials, there are new regulations involving
12 positive handoff, involving monitoring,
13 involving tracking and reporting.

14 I think there are higher insurance
15 premium costs because I think it stands to
16 reason that we're paying more in insurance
17 because we're carrying chlorine and other TIHs
18 than we would if we weren't carrying those.

19 And I think there's also an
20 element of the risk of the uninsured cost if
21 something actually happens, and that's a cost,
22 too. And I think that's probably -- that may

1 well be beyond the Board's capability to
2 account for. I don't know. But at this point
3 I don't think the system accounts for either
4 the insurance costs, the actual dollars paid,
5 or the operating-type costs.

6 COMMISSIONER MULVEY: Yes, the
7 catastrophic risk is very, very difficult to
8 estimate, and I appreciate that. But one
9 other thing, you were talking about the amount
10 of time that the UP and other railroads have
11 to comply with the legal mandate to install
12 PTC, the end of 2015.

13 Isn't it also true that PTC has
14 been on, and the only railroad one on, the
15 NTSB's top 10 lists for about 20 years now,
16 and that the NTSB, the Safety Board, has been
17 arguing for the need for PTC, and that there
18 really has been time for UP and the other
19 railroads to begin planning for this or begin
20 taking this recommendation seriously, or did
21 you figure that it might just go away?

22 MR. ROSENTHAL: No, I think what

1 the evidence shows and what we discussed in
2 our opening evidence is that Union Pacific
3 and other railroads have been looking at PTC
4 for years and have spent a substantial amount
5 of money testing it.

6 One of the reports that we use as
7 the basis of our evidence is a test project
8 that was going on in the Illinois area. It
9 has been tested. Railroads have spent money
10 on it.

11 What they've been testing is a
12 slightly different system, because the system
13 that they were ultimately -- if they had
14 installed it, given the time, might've given
15 some benefits, as well.

16 CHAIR ELLIOTT: Mr. Rosenthal, in
17 the interest of fairness I think we'll
18 probably move on at this point. I think
19 we've kind of gone over, especially to Mr.
20 Wilcox. I think he might go to sleep over
21 there after --

22 VICE CHAIR NOTTINGHAM: Mr.

1 Chairman, just on a procedural question,
2 timing, are we going to have Mr. Rosenthal
3 back before us under any kind of rebuttal, or
4 -- because I just had one final question I
5 wanted to try to get on the record book
6 before he leaves us, if that's possible.

7 CHAIR ELLIOTT: No, we won't have
8 any rebuttal.

9 VICE CHAIR NOTTINGHAM: Is it
10 possible to just do one wrap-up question?

11 CHAIR ELLIOTT: Sure.

12 VICE CHAIR NOTTINGHAM: Thanks. I
13 appreciate the Board's and the Chairman's
14 patience. I know I've taken up a fair amount
15 of time. And, Mr. Wilcox, I appreciate your
16 patience, too, and Mr. Rosenthal.

17 Just, I just want to make sure,
18 because I think this is critical to a big
19 picture understanding of the puzzle we have
20 before us here, I hear you, I believe I hear
21 you say, Mr. Rosenthal, that the Board's
22 current revenue data that we collect, which

1 really serves as the underpinning or the
2 foundation on which we make rail rate
3 complaint decisions, doesn't actually allow
4 railroad to demonstrate and account for, or
5 does not account for very real costs of
6 carrying something that's recognized in
7 statute by Congress that is uniquely
8 hazardous and risky, and that puts a
9 railroad, arguably, if I follow your line of
10 argument, in a pretty tough position, because
11 you've got real costs.

12 You can't get them into the STB's
13 revenue databank, so to speak, and you're
14 susceptible, then, to rate challenges, but
15 you can't actually point and say, "There it
16 is. It's built in the R-1 data and the URCS
17 data."

18 What does that leave a railroad to
19 do I guess is what I'm getting at? Isn't
20 indemnification then kind of the natural
21 option?

22 If you can't -- if a process

1 doesn't work to actually collect meaningful
2 data and you've got real risk that nobody
3 seems to really be arguing, because, after
4 all, it's not a question of if there's going
5 to be an accident involving TIH, it's just a
6 question of when. I think everyone agrees
7 railroading inherently has some risk to it,
8 even though it's the safest mode of transport
9 available.

10 We've had major releases in recent
11 years. The only thing in doubt is will the
12 next major release of TIH from a rail
13 accident be today or next month or next year,
14 and how does a railroad -- what about
15 indemnification? Do you have anything to say
16 on that point, or partial indemnification?

17 MR. ROSENTHAL: Absolutely. I
18 mean, I think there are two issues. One is
19 that how do we deal with it now because it's
20 not in the Board's system is we've set our
21 rates and we find ourselves defending a rate
22 case.

1 And so we have done our best
2 working within the Board's three-benchmark
3 methodology in this case to try to show what
4 some of these costs are and how they should
5 be properly attributed to the commodities
6 that are causing them.

7 As far as what Union Pacific is
8 doing as a practical matter, we talk a lot in
9 our evidence about what we are doing to try
10 to reduce the risks associated with shipping
11 these commodities.

12 We are trying to encourage
13 shippers to reduce unnecessary long
14 shipments. We are taking steps with our own
15 safety processes and procedures to make it as
16 safe as possible.

17 And, yes, we are trying to
18 negotiate provisions that better allocate the
19 liability in the event that there is a
20 release, that the railroad is not held --
21 that reflects the fact that some of the
22 damage is caused because of the extremely

1 hazardous nature of the commodity and not
2 necessarily because of anything the railroad
3 does. So it's a matter of all those things.

4 As a rate matter, we try to work
5 within the Board's framework and justify the
6 rates that we're charging, and on a practical
7 matter on a number of fronts the railroad is
8 doing what it can to reduce the risks, to
9 encourage shippers to take actions to reduce
10 the risks, and to try to make sure that it's
11 not stuck bearing all the costs if an
12 incident occurs because of losses caused by
13 the extremely hazardous nature of the
14 commodities it's carrying.

15 CHAIR ELLIOTT: Thank you, Mr.
16 Rosenthal.

17 Mr. Wilcox, you have seven minutes
18 on rebuttal, but I'll give you a little bit
19 more time.

20 MR. WILCOX: Sir, I would like
21 just a fraction of that additional time is
22 fine with me. So is there a number or should

1 I just -- I need to keep that in mind. I
2 have lots of notes from what was just, just
3 transpired.

4 CHAIR ELLIOTT: I don't know
5 exactly what, how far we went over. Do you
6 have any idea? Fifteen minutes sound --

7 MR. WILCOX: That's fine.

8 CHAIR ELLIOTT: Is that
9 acceptable?

10 MR. WILCOX: Sure.

11 CHAIR ELLIOTT: If the questions
12 continue in the manner that they just did,
13 you may end up there all day.

14 MR. WILCOX: That's fine also. I
15 have as much time as you want.

16 I guess I'll start with PTC. Mr.
17 Rosenthal said that UP is starting to spend
18 money now and it needs money to do the -- to
19 make these investments. I would argue that
20 UP has plenty of money to make these
21 investments.

22 It's charging its -- by their own

1 admission they're charging their current TIH
2 chlorine shippers and other TIH shippers 400,
3 500 percent revenue variable cost ratios.
4 The rates have gone extremely high.

5 We believe that is not because
6 they, as Chairman Nottingham noted, they did
7 not announce that they were going to do this
8 because of PTC. We believe they did it
9 because of their de-marketing efforts, which
10 I'll get to in a second.

11 Now, the other thing is to keep in
12 mind, this is in the context of the three-
13 benchmark case. Now, Mr. Rosenthal mentioned
14 that UP believes it's spending a lot of other
15 money, spending money on other regulatory and
16 safety-type issues that it did not include in
17 the three-benchmark case.

18 And that's important, because the
19 case, the three-benchmark methodology, has
20 the RC comp and the RSAM and the
21 calculations, but then the other relevant
22 factors are very specific.

1 It says in order to get relief or
2 rebut the presumption at the unreasonable
3 rate and either raise or lower it you have to
4 be able to quantify what those amounts are.
5 And we don't think they can be -- the PTC --
6 UP chose PTC.

7 They said in their evidence, "We
8 can't quantify all the other stuff, but we're
9 going to try to quantify PTC." We think they
10 fell very short. We think that there's a lot
11 of uncertainty.

12 And in terms of public funding,
13 Mr. Rosenthal mentioned the \$250 million that
14 is in the Railroad Safety Act. The
15 transportation plan, I've got to get the
16 title right, the National Rail Plan,
17 preliminary National Rail Plan, talks in
18 terms of financing, which we believe this is
19 in addition to the \$250 million which
20 directly applies, the way this is written,
21 directly applies to things like PTC.

22 He said there are critical rail

1 projects that might be pursued if additional
2 resources were available. This is
3 particularly true for joint freight passenger
4 improvements where the benefit for either
5 mode may not be enough to justify a project,
6 although the total benefit would warrant it.

7 They're talking about projects of
8 national significance, and in terms of they
9 want to evaluate alternative strategies for
10 financing freight and passenger rail needs.
11 And that implies or sort of indicates that to
12 the extent you have joint freight-rail
13 operations, and if there are issues like PTC,
14 where the benefits do not exceed the costs,
15 that public funding will occur.

16 And that kind of -- that starts to
17 blend, as I said earlier, how these things
18 are going to be paid for. USM does not
19 dispute that PTC is out there and there's a
20 statute that says that some PTC has to be
21 implemented. But whoever mentioned the
22 timing issue, that is the issue.

1 What exactly is going to happen
2 remains to be seen. And as far as whether it
3 happens at all, Mr. Mobley, that was a very
4 interesting point, because we recently had a
5 transportation forum here where the TSA
6 representatives were talking about how they
7 have taken measures to eliminate it was a
8 very high percentage of what they call risk
9 out of the system in terms of just managing
10 rail cars, keeping an eye on them, and just
11 managing the system better in terms of
12 eliminating a lot of the risk that is
13 perceived.

14 So we acknowledge, USM and I think
15 all shippers acknowledge that PTC is out
16 there, but the extent to which it can be
17 brought into this case and quantified and
18 meet the standard of the Simplified Standards
19 we don't think that UP did it in this case.
20 And this type of issue, as was evident from
21 the discussion, is a very big policy issue
22 and may or may not be suitable for a three-

1 benchmark case.

2 And one of the things that the
3 Simplified standard says is that the board
4 will take a close look as these cases develop
5 as to what is appropriate for an other
6 relevant factor, and if it's going to drive
7 up the cost and the overall process for the
8 three-benchmark methodology maybe it won't
9 be, that type of thing won't be included.

10 But I think at the end of the day
11 our view is UP did not meet its burden as far
12 as quantifying PTC. And, again, we believe
13 that to the extent UP does invest over the
14 prescription period to invest in PTC, those
15 costs, UP even admits some of those costs in
16 the short term will be captured in URCS over
17 the prescription period.

18 To the extent the Board revises
19 URCS over the next couple of years, the
20 changes in URCS will fold into the
21 calculation of the prescribed rates, and the
22 fact that you have a 300 percent starting

1 point provides UP with money to make that
2 investment.

3 So in terms of, well, let's see,
4 de-marketing, we believe that the evidence
5 shows that UP is de-marketing. And a lot of
6 the things that UP is doing is the same thing
7 CSX was doing in DuPont.

8 UP is, over the last, over the
9 waybill period, as part of this, in this
10 proceeding, 2004 to 2007, it got rid of
11 movements where there was another railroad
12 that could handle the business.

13 They have evidence showing they
14 allowed that to go to the competitor and they
15 didn't try to get it back when rail volumes
16 or rail demand died. They show that they
17 want to have customers move chlorine, or TIH
18 and other -- chlorine and other TIH
19 commodities shorter distances.

20 They talk about pricing so there's
21 no unnecessary transportation. They filed a
22 petition with the Board, with USM, four of

1 USM's rates, to try to get out of the, or be
2 excused from the common carrier obligation of
3 providing rates to transport over certain
4 distances.

5 And that, if the petition had been
6 granted, would have had wider ramifications
7 and turned into a proceeding where a lot of
8 people, a lot of associations, weighed in.

9 So, as we point out, the profit
10 maximization part, I mean, if, essentially,
11 UP is trying to de-market the extent to which
12 it handles TIH commodities, but they do
13 recognize that they have to carry some, and
14 so they are raising the prices as high as
15 possible, and they do --

16 VICE CHAIR NOTTINGHAM: Mr.
17 Wilcox, could I -- excuse the interruption,
18 but on your point about de-marketing, that's
19 obviously a very serious allegation, one that
20 I believe personally would be more
21 appropriate for an unreasonable practice
22 complaint, however.

1 Whether or not UP -- let's assume
2 just for the moment that UP, we were to find
3 that UP's rates were unreasonably high in
4 this case, I don't think we're obligated to
5 assign motive to that, whether it was an
6 accident, somebody in accounting messed up
7 and added a couple of zeroes to your rate, or
8 whether they had sinister motives to de-
9 market. I mean, if it's unreasonable, it's
10 unreasonable, correct?

11 Are you trying to make kind of a
12 motive argument here, and why not the
13 unreasonable practice if you think you've got
14 the case to make on that? Because it is a
15 very serious charge, and I would encourage
16 shippers to bring an unreasonable practice
17 complaint if they can demonstrate real de-
18 marketing of a common carrier obligation-
19 covered movement.

20 MR. WILCOX: Well, I think USM
21 believes that UP is indifferent as to whether
22 USM continues to transport chlorine. I think

1 that in terms of a de-marketing or profit
2 maximization-type argument, the main point
3 was to show that UP is treating all these
4 commodities the same in terms of a comparison
5 group of showing that the transportation
6 demand characteristics are the same.

7 So, but we do believe that there
8 is some de-marketing in terms of managing the
9 market that is going on. Now, in terms of
10 the --

11 COMMISSIONER MULVEY: Well, are
12 you saying that the de-marketing is being
13 carried out by the rate process and that's
14 why this is sort of blended? Vice Chairman
15 Nottingham suggested it's a practice, and de-
16 marketing could be a practice. On the other
17 hand, if it's being pursued through higher
18 rates, then it's sort of blending the
19 practice with the rate issue.

20 MR. WILCOX: Right, and the way
21 we've approached it in the case is that it's
22 more along the reasonable rate analysis, but

1 we also believe that in terms of the request
2 for the damage, increase the damage limit,
3 that there are two arguments there.

4 One, we believe UP did set the
5 rates at a very high level in order to try to
6 dissuade USM from using the three-benchmark
7 methodology.

8 The second argument is that the
9 pricing practices, however they're
10 characterized, we don't believe that the
11 three-benchmark methodology contemplated a
12 situation where the railroad was raising
13 rates 100 percent, 200 percent per year,
14 because if you look back, you see you're
15 going to end up with a huge gap even if you
16 prevail in terms of the reasonable rate
17 versus what the damages are measured off of.

18 COMMISSIONER MULVEY: But they are
19 profit maximizers. I mean, that's their
20 purpose is to maximize profits and to, in
21 this case, to accomplish that through
22 differential pricing, and to the extent that

1 there are additional costs associated with
2 handling chlorine, then wouldn't profit
3 maximization suggest that these rates do need
4 to be higher?

5 MR. WILCOX: Well, but profit
6 maximization assumes, doesn't it, that the
7 railroad wants to handle the traffic? UP has
8 said they do not want to handle TIH
9 movements. And so --

10 COMMISSIONER MULVEY: I guess the
11 issue is that you do not want to handle it
12 unless you can be fully compensated for all
13 the costs associated with TIH movements as
14 opposed to not wanting to handle it period,
15 no matter how profitable it could be, I think
16 if USM would agree that, look, we will be
17 fully responsible for any catastrophic
18 accident that occurs from handling it, my
19 suspicion would be UP would be more than
20 happy to take you up on that offer.

21 MR. WILCOX: Well, in terms of the
22 profit maximization versus -- well, in terms

1 of the liability, the -- USM does not, I
2 guess, and other shippers don't disagree that
3 they should pay their fair share of the costs
4 for moving their commodity. I think the
5 issue in this case is whether what UP has
6 proposed is fair in the context of this case.

7 CHAIR ELLIOTT: Can I follow up on
8 that? With respect to your comparison group,
9 it had a very small percentage of chlorine
10 shipments. Is that strictly as a result of
11 what you consider to be this de-marketing
12 claim?

13 MR. WILCOX: Well, no. The
14 composition of the comparison group was
15 driven by the combination of the waybill
16 sample and then the factors of the issue
17 movements. The waybill sample had less than
18 3 percent of chlorine movements that were
19 very closely comparable in terms of UP
20 single-line movements origin to destination.

21 And so both parties in terms of
22 putting together comparison groups had that

1 to start with. We chose to go the route that
2 the Board accepted in DuPont of saying you
3 can prepare a comp group that contains mixed
4 chlorine and TIH movements of the same
5 distance origin to destination.

6 UP went a different route, where
7 they included -- they widened the distance to
8 capture more UP single-line movements, they
9 had 10, and then the re-billed movements,
10 which we believe should not have been in
11 there, and the fact that they are in there
12 skew the results and are not -- end up with
13 an overall comparison group that's not
14 comparable at all to the issue movements.

15 COMMISSIONER MULVEY: Do you feel
16 that the absolute number of movements in the
17 UP comparison group is also a problem, that
18 there's just too few movements because it's
19 limited to the single commodity, unlike
20 DuPont and unlike what you did, where it was
21 a mix of both anhydrous and chlorine?

22 I mean, UP did say that, well,

1 they have sufficient numbers, and comparing
2 it to others that there were sufficient
3 numbers in the movements to Eloy and the
4 other movement for comparison purposes.

5 MR. WILCOX: Well, in terms of
6 absolute numbers, that's an evidentiary
7 question, I think, as these cases move on,
8 but, or you see more cases. But I think if
9 you're trying to do a comparison based on a
10 very large waybill sample, then I think more
11 examples are better than few. Not to say
12 that a few couldn't be found to be
13 comparable.

14 We think that the fact that we --
15 essentially, we took our -- the comparability
16 factors and applied it, applied them to all
17 TIH movements in the waybill sample that met
18 the comparability factors for each movement.

19 VICE CHAIR NOTTINGHAM: Mr.
20 Wilcox, would you agree that it's difficult
21 for a railroad to capture all of its risk,
22 I'll call it risk premium costs, associated

1 with contingencies of an accident involving a
2 railcar carrying TIH, and furthermore that
3 our STB data that we collect on revenues
4 doesn't do a very good job of allowing those
5 costs to get directly inputted into documents
6 like R-1 and URCS?

7 MR. WILCOX: Well, I know that the
8 issue of how to capture those type of costs
9 is before the Board right now. Whether I
10 believe that they're sufficiently calculated
11 now I actually don't -- or captured now I
12 really don't have an opinion on that.

13 VICE CHAIR NOTTINGHAM: Do you
14 think it would be helpful to shippers
15 generally to have the Board clarify those
16 related issues, or do you think the status
17 quo is fine?

18 In other words, just fight these
19 out in individual cases as opposed to getting
20 some type of restatement of the Board's
21 position on these more macro issues that
22 might not be properly -- we might not be able

1 to fully address in a simplified case.

2 MR. WILCOX: Well, I believe that
3 the issue of PTC costs and how URCS captures
4 hazardous-type costs is an issue that is
5 before the Board now, and I think that it's
6 an issue, more of a global issue, that the
7 Board should pursue, and not within this case
8 in particular, just because of, primarily for
9 timing in terms of the uncertainty of the PTC
10 costs, which is before the Board at this
11 case. But I think that those issues are more
12 suitable for an overall proceeding.

13 VICE CHAIR NOTTINGHAM: Thank you.
14 And just the last follow-up, if UP or other
15 railroads were to, in recognition of the
16 difficulty in pinpointing all of those costs
17 dealing with contingencies, some of which are
18 slightly remote contingencies, but, as I said
19 earlier, not a question of if but when the
20 next accident is going to happen, and if that
21 is a difficult exact number to pinpoint and
22 pass on to rail customers to contribute to,

1 isn't that why we see throughout
2 transportation of different modes,
3 transportation of hazardous goods in
4 particular, things like indemnification
5 provisions, where a shipping company with an
6 oceangoing vessel doesn't have to fight it
7 out with the individual shipper before the
8 ship leaves, weighs anchor and leaves port
9 about exactly all the scenarios that could
10 happen for carrying something?

11 They agree on indemnification
12 provision, let's say 50/50. The producer of
13 the hazardous material will be responsible
14 for 50 percent of accident-related costs and
15 the carrier the other 50, and so they both
16 remain highly, completely highly motivated to
17 be as safe as possible because they're on the
18 hook, but it recognizes that they're
19 basically, in essence, partners in the supply
20 chain of a very important, in your client's
21 case, I would say, a very important commodity
22 that the economy depends on to function.

1 MR. WILCOX: Right. And I would
2 say USM would consider --

3 VICE CHAIR NOTTINGHAM: In
4 exchange for lower rates, presumably.
5 Obviously, you would --

6 MR. WILCOX: -- no, would consider
7 itself a partner of UP in that respect, in
8 terms of safety. They worked with UP and
9 received their Pinnacle Award for Safety for
10 how many years, four years.

11 In terms of allocating risk, you
12 have the DOT Hazmat regulations that allocate
13 who is liable for what in terms of the chain
14 of loading it, of loading the materials. You
15 have railcar specifications. You have --
16 there is allocation of risk in contracts
17 between railroads and shippers.

18 There was a discussion earlier, I
19 believe over the summer, between in fact UP
20 and chemical shippers in terms of the
21 indemnification provision in one of UP's
22 tariffs as to how to properly allocate risk

1 between the parties.

2 VICE CHAIR NOTTINGHAM: So
3 indemnification is -- it does happen
4 currently in isolated cases? It is already a
5 routine, fairly routine business practice in
6 the rail transportation of TIH?

7 MR. WILCOX: In rail
8 transportation generally, yes,
9 indemnification is part of most transactions.
10 In TIH, again, from a common carrier
11 standpoint, UP does, in speaking of UP
12 specifically, they do have a provision
13 dealing with indemnification. Most railroads
14 do have provisions that address that.

15 VICE CHAIR NOTTINGHAM: Thank you.

16 CHAIR ELLIOTT: Thank you.

17 Thank you very much, Mr. Wilcox,
18 and thank you very much, both of you, for
19 your excellent arguments today and your
20 patience with our little extra time today.

21 Our next oral argument will be
22 January 26, 2010, and we will -- the meeting

1 of the Board is now adjourned.

2 (Whereupon, at 11:00 a.m., the

3 foregoing matter was adjourned.)

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