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,

- v. -

UNION PACIFIC RAIL COMPANY,

DEFENDANT. :

------------------------------------------x

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

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

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

Speakers, please note that the timing lights are in front of me. You will
see a yellow light when you have one minute remaining and a red light when your time has expired. The yellow one-minute light will be accompanied by a single chime, and the red light signifying that your time has expired will be accompanied by two chimes.

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

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

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

MR. WILCOX: Good morning. My name is Thomas Wilcox, for US Magnesium. I
I have elected to reserve seven minutes for rebuttal.

Before I start, I want to let the Board know that accompanying me today is Mr. Howard Kaplan. He's with us, with US Magnesium. He's Vice President of Chemicals and Byproducts. He's been with the Company for 17 years, on the end of the table there. Mr. Kaplan appeared and testified in Ex Parte number 677 on the common carrier obligation in the transport of hazardous materials.

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

But USM has taken the additional step of coming to the STB and seeking formal rate relief. It's the type of small shipper
that we think the rules were adopted to
protect, clearly captive to UP, relatively low
volume, low revenue.

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

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

There's an extensive record in the
case. I am going to basically address three
points, emphasize three points. The first one
is that USM believes that our final offer
chlorine TIH commodity comparison group fully
complies with the Simplified Standards and
what the Board did in the DuPont case in terms
of adopting a composite chlorine and TIH
shipment commodity group.
We believe that our commodity -- or, excuse me, comparison groups are most similar in the aggregate to the issue movements, and we've shown that in this case the TIH and chlorine movements, as in DuPont, have the same operating characteristics and the same transportation demand characteristics other -- other TIH community shipments have the same characteristics as chlorine.

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

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

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

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

CHAIR ELLIOTT: Sure.

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

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

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<tr>
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<th>Union Pacific</th>
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<tr>
<td>14 Rebilled</td>
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{ } = Highly confidential Subject to Protective Order

**Source**

1/ UP Workpaper "UP Comparison Group at 300 and 200 Miles - Reply.xlsx" and USM Workpaper "UP Comp Group Analysis.xlsx"
2/ Hillenbrand Reply Exhibit (KNH-14)
3/ Hillenbrand Reply Exhibit (KNH-15)
4/ Total Exp. Revenue (Col. 14) + Total Exp. Carloads (Col. 12)
5/ Total Exp. Var. Cost (Col. 15) + Total Exp. Carloads (Col. 12)
transportation and submits it and delivers it to the destination.

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

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

The re-billed movements in this case is actually the -- I think it's the first time the Board has looked at re-billed movements in a three-benchmark case. We do
not believe they were an issue in DuPont.

Now, as we said in our evidence,

we've cited how the variable costs are very
different for a re-billed movement, and that's
a combination of factors. The variable costs
are lower, and UP, in their evidence, said you
can include re-billed movements because
they're lower variable cost, but that, because
under Simplified Standards, you can have
movements that have different cost
characteristics and lower cost, but it's
presumed that the rates will come down and the
margins will stay the same.

But that's not what happened with
the re-billed movements in this case. The
combination of higher revenues and lower
variable cost have resulted in the left column
over here, where you -- and the reason I'm
speaking generally is that, as you can see,
the issue -- the exhibit contains highly
confidential information on revenues and
costs, and so I can always -- I can't cite the
exact numbers, but you can see that for the
re-billed movements, when you take, as the
references down below, if you take the
evidence in the record in terms of aggregate
revenues, aggregate variable costs that are in
the parties' work papers and in the evidence
and you reduce it to a per car level, you can
see what, in more precise, what we were
going to in our evidence, that the actual
revenues for the re-billed movements are a lot
higher.

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

They're a lot closer, which shows
that we are correct that the TIH other than chlorine movements have the same -- roughly the same demand characteristics, transportation demand characteristics, as chlorine.

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

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

We believe we've countered that in our evidence to show that wasn't the case and also the amici associations have also refuted UP's claim that there was some sort of
understanding that these rate increases were
due directly to PTC. And even UP, in their
rebuttal at 40, says that their ramp-up in
rates over the past few years is not solely
due to PTC, and they say it's not even the
primary reason.

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

You have the AAR making a
statutory challenge to the FRA's rules, saying
that, counter to what the FRA has, how the FRA
has interpreted the statute, it's not where
the TIH and passenger traffic is in 2008. It
should be where it is in 2015, which leaves
many years for the UP and other railroads to -
- yes, sir?

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

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

You have the -- the FRA issued its
national transportation plan right around the
time we were submitting rebuttal evidence, and
that cites a recent statute where there is now
going to be federal and passenger partnerships
where there'll be more passenger traffic on
freight lines and vice versa.

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

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

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

The third premise, just very
quickly, is that UP won't recover any of USM's
share of the future PTC costs -- excuse me, UP
won't recover any of the future costs in the
rate prescription process. We've shown that under the Board's procedures there will be cost recovery, and there is a lag, but the variable costs will be recovered.

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

Thank you.

CHAIR ELLIOTT: Thank you.

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

MR. ROSENTHAL: Thank you, and good morning, Chairman Elliott, Vice Chairman Nottingham, Commissioner Mulvey. My name is Michael Rosenthal, and I'm representing Union Pacific Railroad.
Joining me at counsel's table is Louise Rinn, Union Pacific's Associate General Counsel. And I'd like also to introduce Bob Worrell, Union Pacific's Senior Assistant Vice President, Chemicals, and Michael Hemmer, Union Pacific's Senior Vice President, Law, and General Counsel, who are in the audience today.

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

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

To apply the three-benchmark method in this case, Union Pacific first developed comparison groups for the issue traffic, movements of chlorine from Rowley,
Utah to Sahuarita and Eloy, Arizona, by identifying other chlorine traffic with cost characteristics similar to those of the issue traffic.

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

US Magnesium, on the other hand, misapplied the three-benchmark methodology. US Magnesium did not limit its comparison groups to chlorine traffic. Instead, its comparison groups consist almost entirely of movements of commodities other than chlorine. Chlorine is only 1 percent of US Magnesium's comparison group for the
challenged rate to Sahuarita and just 4 percent for the challenged rate to Eloy. As a result, if the Board selected USM's comparison groups, the reasonableness of the challenged rates would be based almost entirely on the demand characteristics and cost characteristics of transportation of commodity other than chlorine.

CHAIR ELLIOTT: Mr. Rosenthal,

with respect to the analysis of the demand characteristics, it seems that US Magnesium is looking more at the transportation characteristics and that you are looking more, as they put it in their brief, the end use characteristics.

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

MR. ROSENTHAL: I think both are relevant. The three-benchmark methodology is
designed to identify the appropriate amount of demand-based differential pricing for the comparison for the issue traffic. It's designed to identify the appropriate level of contribution to joint and common cost for the issue movements.

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

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

And our answer is chlorine traffic, because the factors that affect the markups that Union Pacific can charge are different for chlorine traffic and other
traffic. Demand for chlorine is subject to different market forces than demand for the other TIH commodities in US Magnesium's comparison groups.

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

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

CHAIR ELLIOTT: Mr. Rosenthal, how do you respond to their de-marketing claim that -- I noted in the beginning of their brief they claim that the rates have increased, doubled from last year to this year
on this subject line. How do you respond to that?

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

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

We have voluntary contracts. The traffic is moving under rates that are comparable to the rates that we're arguing
about in this proceeding, that we're trying to charge US Magnesium.

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

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

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

MR. ROSENTHAL: We had Dr. Marius Schwartz, Professor of Economics at Georgetown University, analyze Union Pacific's waybill data and look at exactly that, look at the pattern of movements and variable costs in revenues. And he concluded that Union
Pacific's pricing is consistent with the pursuit of greater profit rather than driving away TIH traffic.

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

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

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

MR. ROSENTHAL: When you look at the pattern of chlorine movements over time, you do see in some periods some decrease as rates have increased, but that's entirely consistent with maximizing profits.
That's what companies do. They raise price. Sometimes quantity goes down. But as long as the contribution is going up, as long as the contribution they're receiving from this traffic is going up, that's not driving traffic off the system. That's not pricing irrationally or pricing at levels that aren't commercially justifiable.

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

Now, US Magnesium has come up with -- has tried to argue in other ways that our comparison groups are not appropriate for this case. They've argued that the comparison groups are too small, but our evidence shows that they're similar in size to some of the comparison groups that the Board used in the DuPont case.
They're larger than the 23 movements that were used to evaluate the nitrobenzene movements. They're about the size of the 28-movement group that was used in one of the chlorine cases involving the movement of chlorine to Niagara Falls.

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

And then, finally, US Magnesium has tried to argue that, well, Union Pacific treats chlorine the same as TIH in that we're trying to de-market it all. We're trying to treat it as having the same demand elasticity. So therefore the Board should look at markups on all of this traffic as the same.
But, as I just explained, it's clearly not the case. It's clearly not the case that we're trying to de-market these commodities. The testimony in this case is that we're not pricing them the same. We're looking at each commodity and each movement depending on its particular characteristics and setting market-level rates.

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

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

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

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

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

Now, US Magnesium's decision to include non-chlorine traffic in its comparison groups, we feel, is much more significant, much more significant than Union Pacific's decision to include re-billed movements or movements with a longer range.
And, as the Board explained in Simplified Standards, movements with different cost characteristics may be included in the comparison group, because the key issue is markup. The key issue is not the actual level of cost, but the markup over the cost that the railroad is charging.

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

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

On reply, US Magnesium presented a series of calculations in which it tried to show that, again, UP's comparison groups had a wider range of cost variations. But its
calculations depended on a good number of assumptions that ignored the actual characteristics of the movements.

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

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

But we would submit that we have demonstrated that there is a real reason to be concerned on the demand side about the difference between chlorine traffic and all of
the other non-chlorine traffic that US Magnesium included in its comparison groups. That's where there's some real evidence of a demand side difference.

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

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

MR. ROSENTHAL: I believe -- I do not know the answer to that. I don't know whether the data are even publicly available that would let me know the answer to that.
But, again, the Board's theory of looking at demand-based pricing and markups says, "Let's look at the commodities with the demand characteristics that are the same."

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

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

If you look at that compared to the discount on termination charges for unit-train movements and multiple-train movements, and the other factors that come into play when
you're using unit-train movements and multiple-train movements, the cost differences here are less significant than the example that the Board gave.

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

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

If you trust your URCS costing system, you're looking at the markups over those costs. And even if you don't trust URCS, there's a reason, I mean, there's certainly a reason why you would prefer a
comparable group that is more similar in terms of cost characteristics.

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

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

You say the demands are different, but in terms of the transportation demand, both of them are highly, highly inelastic, up to a point that it's sort of an all-or-nothing
demand curve. You really don't have any alternatives.

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

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

And certainly the shipper's demand for its product depends on more than just the strict transportation characteristics of the commodity. And so the same way that a shipper's markup depends on more than just the 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
anhydrous ammonia does have alternatives, and that you can use anhydrous ammonia as a fertilizer or there are other substitutes.

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

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

MR. ROSENTHAL: Well, I don't think so. I mean, I think what we're seeing with respect to Clorox is that, as you point, companies are recognizing the risks and costs associated with transporting these products, and I'm not sure the way this day is going I'm
going to have time to talk too much about PTC, which is what we're trying to do, but, no, I mean, again, I think you have to look much beyond simply the transportation characteristics of the product.

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

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

Where do all these products fall within that range? It's too difficult to tell. And it's not just products. You would have to think about the particular geographic competition. As you point out, there are
different movements that are subject to
different forces, depending on where they are.

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

So what you can do is you can
choose products with similar demand
characteristics, products that you believe
should be the same based on the key factors,
adjust as you can for costs, and, again, even
setting aside this question of -- well, even
with this question, not setting it aside, even
with the re-bills, even with the larger
mileage range, Union Pacific's comparison
groups are more similar in terms of cost, more
similar in terms of costs, more similar in
terms of demand characteristics. They should
be the ones that you've accepted.
VICE CHAIR NOTTINGHAM: Mr. Rosenthal, how do you respond to the argument that if a railroad were to select a comparison group that arguably was quite narrow and systemically decided to game this process by pricing all of their customers in that market, for example all chlorine customers, 500-plus percent is the ratios we're looking at in this case, I believe, rather than just do variable costs, and then you get challenged in a case and you say, "Well, look, it's very comparable. All our customers are paying 500-plus percent. There's not a problem here."

How do you respond to that argument?

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

Second, the facts in this case show that the rates are in contracts, and
they're negotiated, presumably commercially
justifiable rates if they're in contracts.
So, again, I think it's very difficult to say
that rates like that have been gamed.

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

CHAIR ELLIOTT: Mr. Rosenthal, why
don't we give you a few extra minutes here?
We didn't get into the PTC matter, which
obviously is a very important issue. And if
you could kind of be very specific with
respect to some of Mr. Wilcox's statements,
especially with respect to has there been any
capital allotted for these specific lines,
along those lines, and also with respect to
his statements that is it possible that the
return on investment with respect to PTC can
be employed to other customers, not just the
chlorine shippers.

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

And US Magnesium says chlorine
rates and TIH rates have increased, have
surged or whatever term they used, and our
answer is, yes, that's the problem. The
problem is if you're comparing rates that
exist today to rates that exist then they're
going to look different, and if you use markups that existed back then to determine the rates that Union Pacific can charge today, they're not going to appropriately reflect the rates that are in the marketplace today.

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

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

And there may be questions about what the ultimate final cost will be for PTC, but Union Pacific developed its adjustment using very conservative, very conservative measures. We did not --
CHAIR ELLIOTT: Is there any specific cost allocated with respect to these movements that you're aware of?

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

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

Now, whether somebody has been out on the particular line or spur used for this particular movement, I don't know. But the types of costs that are being incurred right now are the startup costs that should be equally applicable to everybody who's going to benefit from PTC.
COMMISSIONER MULVEY: Are you basing the estimate of PTC costs on making PTC compliant with the entire system, or only those parts of the system that carry passenger traffic and also carry TIH traffic, which I believe is what the law requires?

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

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

We did assume substantial levels of public funding. The way we did the numbers and allocated the costs, we assumed that our
lines that had commuter traffic, the commuter rail lines, would bear 100 percent of the costs, and on the lines where there was Amtrak traffic and TIH traffic that Amtrak would bear 25 percent of the costs.

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

And then in our rebuttal we took the further step, and we said, you know, maybe there is some uncertainty about exactly where PTC is going to be required. Maybe there'll be some de minimis exceptions. And so we just took off a substantial chunk. We took off
$400 million. And we said, even if you do
that and you apply our adjustment you're going
to find that the rates are reasonable.

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

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

COMMISSIONER MULVEY: So you're
saying that for the $1.5 billion that Union
Pacific thinks it's going to have to spend to
become PTC compliant, large parts of that will
be borne by the commuter railroads and by
Amtrak as well as TIH shippers. But, when you
look at the amount going to TIH, you take into
account the amounts that are likely going to be covered by the commuter railroads, public sector and the like.

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

So we did, in building this adjustment, consider a substantial amount of public funding, and, again, when you compare it to the legislation, a very substantial amount of public funding that we were, we think, very conservative in that estimate, as well.
COMMISSIONER MULVEY: And then one last follow-up on that, do you assume that any of the traffic, any of the costs should be borne by other traffic than TIH traffic because to the extent that there is an accident or to the extent that PTC makes the railroad more efficient and more safe that other traffic should also bear part of the benefit or part of the cost?

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

And we assumed that, for purposes of one of our calculations, we said, well, what if Union Pacific got all those benefits, the sort of operating benefits? And still we set aside the 15 percent FRA estimate of costs
that it will cost to maintain the system. And we showed that even under those circumstances, if you applied our adjustment, the challenged rates would be found to be reasonable. So we took it into account in that way, as well.

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

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

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

MR. ROSENTHAL: No, I don't think
I'm saying that. I'm just saying I don't really know what the situation is with respect to our passenger railroads. I don't know what the contracts are. I don't know when they were entered into. And I don't know to what extent they would allow us to make these changes.

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

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

VICE CHAIR NOTTINGHAM: And, please understand, I think the argument that
the PTC mandate is real, it's in federal law,
and it's very expensive as it currently
exists, unless that's amended or adjusted by
statute.

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

I guess what I'm looking for is
how to answer sort of the timing question. In
other words, did you just conveniently pick up
that argument because you got caught assessing
500-plus percent rates over variable costs in
this case, or can you show and demonstrate the
type of corporate communication one would
expect to see if a railroad were rolling out
a dramatic new pricing arrangement to account
for a $1.4-billion new federally enacted unfunded mandate, things like letters to all customers, possibly a new accounting handling where you're setting up a trust fund to reserve those funds over years so they'll be available in the future so you can demonstrate both to your shareholders and to your regulators and customers that you have a serious program to set aside the funding needed?

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

And it's pretty hard for anybody to be spending big-time money on a PTC mandate that actually doesn't technically exist right now other than it is in law, so it's coming, but my understanding is you couldn't -- if we gave you $1.4 billion you couldn't meet the
so-called PTC mandate now because there's so much left to be known.

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

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

Now, in this particular case, when we're talking about the issue that we're trying to address by the PTC adjustment, PTC is part of it. The real issue is that the rates that are being used to set the markups
in this case, that's rates based on traffic
that moved between 2004 and 2007, are
different than they are today. They're
different for a number of reasons, a lot of
them dealing with new regulations apart from
PTC.

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

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

And that's all we're asking the
Board to do is to apply its three-benchmark
methodology to look at this as an other relevant factor and to give us the opportunity.

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

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

VICE CHAIR NOTTINGHAM: Mr. Rosenthal, if I could follow up on that general line of inquiry, why do you think
Congress specifically included TIH traffic in
the PTC mandate? We all are aware of the
horrible passenger rail accident in the Los
Angeles area shortly before the PTC mandate
was put into law.

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

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

So I think they understood, I'm
guessing that they understood the sort of
devastation that can be caused by releases of
these commodities. And if you look at the
FRA's analysis, if you look at their economic
analysis, of the costs to install PTC versus
the benefits, what the FRA says is even
considering all these things it doesn't make
economic sense.

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

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

MR. ROSENTHAL: I think that's
what the statute tells us. That's why when
you look at where PTC is mandated, it's
passenger and it's TIH. That's what the
statute says. If it didn't say TIH we
wouldn't be incurring --
VICE CHAIR NOTTINGHAM: I'll take that as a yes. Thanks. So, UP is, if you follow the common carrier obligation rationale and line of case law, UP is, in essence, required to handle and carry and transport a uniquely hazardous substance known generally as TIH, recognized as uniquely hazardous in statute by Congress, and clearly there are costs associated with carrying something uniquely hazardous.

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

So you've got a challenge of how to capture. You've got things like insurance, presumably, possibly both commercial insurance and self-insurance. You've got things like extra maintenance or safety precautions that 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 --
MR. ROSENTHAL: Yes, no, I mean, I think you're absolutely right. I think a very important issue and one that Union Pacific is wrestling with now is how to capture these costs.

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

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

And in some of Union Pacific's evidence before, in the -- one of the subproceedings, we did try to explain how we've been trying to capture some of the investment costs, some of the additional
training costs and try to reduce it to a per-car level.

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

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

And we think that might very well be appropriate for the types of costs that we're incurring not just for PTC but for a lot of the other operating changes that have to be made and a lot of the other investments that are being made as a result of these many new safety regulations that --
VICE CHAIR NOTTINGHAM: Do you believe, just to follow up on that, do you believe that the Board's, this Board's current data collection processes and data sorts properly -- allow railroads to properly account for the unique, as recognized by Congress, risk premium associated with being required to transport TIH?

MR. ROSENTHAL: Well, no, I don't think they do. I think one of the problems that's happening and one of the reasons why somebody will come up and say, "Look at your RVC ratios, they're so very high," I think part of the problem is that the costs that should be more properly attributed to TIH traffic are being spread on a system average basis over all traffic, and that if you actually captured the costs and assigned them appropriately that the markups wouldn't be as high as they may seem. They'd be different in relation to the costs if they were properly allocated.
COMMISSIONER MULVEY: When you refer to properly allocated costs of the TIH movements, are you including also the insurance premiums associated with catastrophic risk, or are you referring more to the direct increased costs of handling TIH materials?

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

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

And I think there's also an element of the risk of the uninsured cost if something actually happens, and that's a cost, too. And I think that's probably -- that may
well be beyond the Board's capability to account for. I don't know. But at this point I don't think the system accounts for either the insurance costs, the actual dollars paid, or the operating-type costs.

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

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

MR. ROSENTHAL: No, I think what
the evidence shows and what we discussed in our opening evidence is that Union Pacific and other railroads have been looking at PTC for years and have spent a substantial amount of money testing it.

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

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

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

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

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

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

CHAIR ELLIOTT: Sure.

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

Just, I just want to make sure, because I think this is critical to a big picture understanding of the puzzle we have before us here, I hear you, I believe I hear you say, Mr. Rosenthal, that the Board's current revenue data that we collect, which
really serves as the underpinning or the foundation on which we make rail rate complaint decisions, doesn't actually allow railroad to demonstrate and account for, or does not account for very real costs of carrying something that's recognized in statute by Congress that is uniquely hazardous and risky, and that puts a railroad, arguably, if I follow your line of argument, in a pretty tough position, because you've got real costs.

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

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

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

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

MR. ROSENTHAL: Absolutely. I
mean, I think there are two issues. One is
that how do we deal with it now because it's
not in the Board's system is we've set our
rates and we find ourselves defending a rate
case.
And so we have done our best working within the Board's three-benchmark methodology in this case to try to show what some of these costs are and how they should be properly attributed to the commodities that are causing them.

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

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

And, yes, we are trying to negotiate provisions that better allocate the liability in the event that there is a release, that the railroad is not held -- that reflects the fact that some of the damage is caused because of the extremely
hazardous nature of the commodity and not necessarily because of anything the railroad does. So it's a matter of all those things. As a rate matter, we try to work within the Board's framework and justify the rates that we're charging, and on a practical matter on a number of fronts the railroad is doing what it can to reduce the risks, to encourage shippers to take actions to reduce the risks, and to try to make sure that it's not stuck bearing all the costs if an incident occurs because of losses caused by the extremely hazardous nature of the commodities it's carrying.

CHAIR ELLIOTT: Thank you, Mr. Rosenthal.

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

MR. WILCOX: Sir, I would like just a fraction of that additional time is fine with me. So is there a number or should
I just -- I need to keep that in mind. I have lots of notes from what was just, just transpired.

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

MR. WILCOX: That's fine.

CHAIR ELLIOTT: Is that acceptable?

MR. WILCOX: Sure.

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

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

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

It's charging its -- by their own
admission they're charging their current TIH chlorine shippers and other TIH shippers 400, 500 percent revenue variable cost ratios. The rates have gone extremely high.

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

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

And that's important, because the case, the three-benchmark methodology, has the RC comp and the RSAM and the calculations, but then the other relevant factors are very specific.
It says in order to get relief or rebut the presumption at the unreasonable rate and either raise or lower it you have to be able to quantify what those amounts are. And we don't think they can be -- the PTC -- UP chose PTC.

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

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

He said there are critical rail
projects that might be pursued if additional resources were available. This is particularly true for joint freight passenger improvements where the benefit for either mode may not be enough to justify a project, although the total benefit would warrant it.

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

And that kind of -- that starts to blend, as I said earlier, how these things are going to be paid for. USM does not dispute that PTC is out there and there's a statute that says that some PTC has to be implemented. But whoever mentioned the timing issue, that is the issue.
What exactly is going to happen remains to be seen. And as far as whether it happens at all, Mr. Mobley, that was a very interesting point, because we recently had a transportation forum here where the TSA representatives were talking about how they have taken measures to eliminate it was a very high percentage of what they call risk out of the system in terms of just managing rail cars, keeping an eye on them, and just managing the system better in terms of eliminating a lot of the risk that is perceived.

So we acknowledge, USM and I think all shippers acknowledge that PTC is out there, but the extent to which it can be brought into this case and quantified and meet the standard of the Simplified Standards we don't think that UP did it in this case. And this type of issue, as was evident from the discussion, is a very big policy issue 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
USM's rates, to try to get out of the, or be excused from the common carrier obligation of providing rates to transport over certain distances.

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

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

VICE CHAIR NOTTINGHAM: Mr. Wilcox, could I -- excuse the interruption, but on your point about de-marketing, that's obviously a very serious allegation, one that I believe personally would be more appropriate for an unreasonable practice complaint, however.
Whether or not UP -- let's assume just for the moment that UP, we were to find that UP's rates were unreasonably high in this case, I don't think we're obligated to assign motive to that, whether it was an accident, somebody in accounting messed up and added a couple of zeroes to your rate, or whether they had sinister motives to de-market. I mean, if it's unreasonable, it's unreasonable, correct?

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

MR. WILCOX: Well, I think USM believes that UP is indifferent as to whether USM continues to transport chlorine. I think
that in terms of a de-marketing or profit maximization-type argument, the main point was to show that UP is treating all these commodities the same in terms of a comparison group of showing that the transportation demand characteristics are the same.

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

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

MR. WILCOX: Right, and the way we've approached it in the case is that it's more along the reasonable rate analysis, but
we also believe that in terms of the request for the damage, increase the damage limit, that there are two arguments there.

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

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

COMMISSIONER MULVEY: But they are profit maximizers. I mean, that's their purpose is to maximize profits and to, in this case, to accomplish that through differential pricing, and to the extent that
there are additional costs associated with handling chlorine, then wouldn't profit maximization suggest that these rates do need to be higher?

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

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

MR. WILCOX: Well, in terms of the profit maximization versus -- well, in terms
of the liability, the -- USM does not, I guess, and other shippers don't disagree that they should pay their fair share of the costs for moving their commodity. I think the issue in this case is whether what UP has proposed is fair in the context of this case.

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

MR. WILCOX: Well, no. The composition of the comparison group was driven by the combination of the waybill sample and then the factors of the issue movements. The waybill sample had less than 3 percent of chlorine movements that were very closely comparable in terms of UP single-line movements origin to destination. And so both parties in terms of putting together comparison groups had that.
to start with. We chose to go the route that
the Board accepted in DuPont of saying you
can prepare a comp group that contains mixed
chlorine and TIH movements of the same
distance origin to destination.

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

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

I mean, UP did say that, well,
they have sufficient numbers, and comparing
it to others that there were sufficient
numbers in the movements to Eloy and the
other movement for comparison purposes.

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

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

VICE CHAIR NOTTINGHAM: Mr.
Wilcox, would you agree that it's difficult
for a railroad to capture all of its risk,
I'll call it risk premium costs, associated
with contingencies of an accident involving a railcar carrying TIH, and furthermore that our STB data that we collect on revenues doesn't do a very good job of allowing those costs to get directly inputted into documents like R-1 and URCS?

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

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

In other words, just fight these out in individual cases as opposed to getting some type of restatement of the Board's position on these more macro issues that might not be properly -- we might not be able
MR. WILCOX: Well, I believe that the issue of PTC costs and how URCS captures hazardous-type costs is an issue that is before the Board now, and I think that it's an issue, more of a global issue, that the Board should pursue, and not within this case in particular, just because of, primarily for timing in terms of the uncertainty of the PTC costs, which is before the Board at this case. But I think that those issues are more suitable for an overall proceeding.

VICE CHAIR NOTTINGHAM: Thank you. And just the last follow-up, if UP or other railroads were to, in recognition of the difficulty in pinpointing all of those costs dealing with contingencies, some of which are slightly remote contingencies, but, as I said earlier, not a question of if but when the next accident is going to happen, and if that is a difficult exact number to pinpoint and pass on to rail customers to contribute to,
isn't that why we see throughout transportation of different modes, transportation of hazardous goods in particular, things like indemnification provisions, where a shipping company with an oceangoing vessel doesn't have to fight it out with the individual shipper before the ship leaves, weighs anchor and leaves port about exactly all the scenarios that could happen for carrying something?

They agree on indemnification provision, let's say 50/50. The producer of the hazardous material will be responsible for 50 percent of accident-related costs and the carrier the other 50, and so they both remain highly, completely highly motivated to be as safe as possible because they're on the hook, but it recognizes that they're basically, in essence, partners in the supply chain of a very important, in your client's case, I would say, a very important commodity that the economy depends on to function.
MR. WILCOX: Right. And I would say USM would consider --

VICE CHAIR NOTTINGHAM: In exchange for lower rates, presumably.

Obviously, you would --

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

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

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

VICE CHAIR NOTTINGHAM: So

indemnification is -- it does happen
currently in isolated cases? It is already a
routine, fairly routine business practice in
the rail transportation of TIH?

MR. WILCOX: In rail

transportation generally, yes,
indemnification is part of most transactions.

In TIH, again, from a common carrier

standpoint, UP does, in speaking of UP

specifically, they do have a provision
dealing with indemnification. Most railroads
do have provisions that address that.

VICE CHAIR NOTTINGHAM: Thank you.

CHAIR ELLIOTT: Thank you.

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

Our next oral argument will be
January 26, 2010, and we will -- the meeting
of the Board is now adjourned.

(Whereupon, at 11:00 a.m., the foregoing matter was adjourned.)
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