

**BEFORE THE  
SURFACE TRANSPORTATION BOARD      233644**

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**Docket No. EP 715**

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**RATE REGULATION REFORMS**

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**REBUTTAL COMMENTS OF UNION PACIFIC RAILROAD COMPANY**

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Union Pacific Railroad Company (“UP”) is filing these rebuttal comments to address the reply comments that have been submitted in this proceeding.<sup>1</sup> In this rebuttal, as in its opening and reply, UP’s focus is on the Board’s proposals to restrict the use of cross-over traffic in Full-SAC cases.<sup>2</sup>

**I. The Board should restrict the use of cross-over traffic in Full-SAC cases.**

UP’s opening comments supported the Board’s proposals to restrict the use of cross-over traffic in Full-SAC cases and encouraged the Board to undertake a more substantial reevaluation of the use of cross-over traffic in Full-SAC cases. UP explained that Full-SAC results are being determined by allocations of cross-over revenue, not the reasonableness of challenged rates, and that shippers are using their control of the SARR design and traffic selection process to bias the results. UP also explained that these problems cannot be resolved by refining the Board’s ATC method because there is *no* non-arbitrary means of allocating a defendant railroad’s revenues to specific portions of a line-haul movement. UP encouraged the Board to consider: (i) prohibiting

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<sup>1</sup> UP endorses the Rebuttal Comments filed by the Association of American Railroads.

<sup>2</sup> See Opening Comments of Union Pacific Railroad Company (“UP Opening”); Reply Comments of Union Pacific Railroad Company (“UP Reply”).

entirely the use of cross-over traffic in Full-SAC cases; (ii) reducing the influence of cross-over traffic on Full-SAC results by imposing new limits on rerouting issue and non-issue traffic; and (iii) reducing shippers' ability to game Full-SAC results by replacing ATC with efficient component pricing ("ECP").

**A. The use of cross-over traffic can be outcome-determinative.**

UP's comments regarding cross-over traffic were addressed in reply comments submitted by the "Chemical Companies"<sup>3</sup> and the "Coal Shippers."<sup>4</sup> Neither the Chemical Companies nor the Coal Shippers dispute that allocations of cross-over revenue are necessarily arbitrary or that results in Full-SAC cases are being determined by those arbitrary allocations, yet neither group offers any solution. The Chemical Companies assert that the Board is justified in ignoring the issues "because the entire SAC analysis approximates something that doesn't exist, the stand-alone railroad." (Chemical Companies Reply at 6 n.4.) But the issues cannot be ignored: the methods used to conduct SAC analyses matter tremendously to both railroads and shippers because Full-SAC results have a very real impact on rail rates.

The opening evidence that Intermountain Power Agency ("IPA") recently filed in its pending rate case against UP illustrates UP's concern that the use of cross-over traffic and ATC's arbitrary revenue divisions are distorting Full-SAC results. IPA had previously filed a case challenging UP's rates for transporting coal to IPA's plant from one mine and one coal

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<sup>3</sup> See Joint Reply Comments of The American Chemistry Council, The Fertilizer Institute, The National Industrial Transportation League, Arkema, Inc., The Dow Chemical Company, Olin Corporation, and Westlake Chemical Corporation ("Chemical Companies Reply").

<sup>4</sup> See Reply Submission of Western Coal Traffic League, Concerned Captive Coal Shippers, American Public Power Association, Edison Electric Institute, National Rural Electric Cooperative Association, Western Fuels Association, Inc., and Basin Electric Power Cooperative, Inc. ("Coal Shippers Reply").

loadout located on a UP line east of Provo, Utah, and from an interchange in Provo between UP and Utah Railway Company. After UP filed its reply evidence, IPA recognized that it could not prevail using a SARR that replicated the UP line serving the mine and loadout and dismissed its case. *See Intermountain Power Agency v. Union Pac. R.R.*, NOR 42127 (STB served Nov. 2, 2012). IPA then filed its new case challenging only UP's Provo rate. In the new case, IPA's SARR no longer replicates UP's line east of Provo; instead, the SARR handles coal originating on that line, as well as other traffic that moves over that line, as cross-over traffic. *See Opening Evidence of Complainant Intermountain Power Agency at III-A-5, Intermountain Power Agency v. Union Pac. R.R.*, NOR 42136 (Dec. 17, 2012). It is by no means clear that IPA will prevail in its new challenge, but if it does, it would be because of its decision not to replicate UP's line east of Provo while taking advantage of ATC's allocation of cross-over revenue from traffic moving over that line. This cannot be what the Board intended when it described the use of cross-over traffic as a device for "approximat[ing] the outcome of a full SAC analysis, which provides origin-to-destination service for the entire traffic group." *Major Issues in Rail Rate Cases*, EP 657 (Sub-No. 1), slip op. at 24 (STB served Oct. 30, 2006).

**B. If the Board continues to allow the use of cross-over traffic, ECP-based revenue divisions can protect the integrity of Full-SAC results.**

The Chemical Companies also assert that ATC "cannot be manipulated." (*Id.* at 6.) But they do not deny that shippers use their control over SARR design and traffic selection to select for their SARRs only those movements for which ATC's arbitrary revenue divisions favor the SARR. (UP Opening at 4-5.) Nor do the Chemical Companies deny that use of ECP would prevent shippers from exploiting the arbitrary nature of ATC. (*Id.* at 12-13.) The Chemical Companies echo assertions previously made by shipper interests that ECP is "biased in favor of the railroad." (Chemical Companies Reply at 7.) But they offer no response to UP's showing on

opening that ECP contains an important feature that precludes any such bias – a shipper can always elect to build its SARR to capture the defendant’s full contribution for any movement – while ATC lacks a comparable mechanism to protect a defendant from a shipper’s exploitation of ATC’s arbitrary divisions. (UP Opening at 13.) The Chemical Companies also incorrectly assert that ECP necessarily assumes that the SARR is a competitor of the defendant railroad, rather than a replacement. (Chemical Companies Reply at 7.) Use of ECP requires no such assumption. ATC and ECP are both methods to allocate cross-over revenue, but ECP provides much greater confidence in the integrity of Full-SAC results than ATC.

**C. The Board should eliminate the use of cross-over traffic.**

The Chemical Companies do not address UP’s proposal to prohibit the use of cross-over traffic in Full-SAC cases, but the Coal Shippers object, claiming that they “demonstrated in their opening submission that [even] the Board’s Full-SAC proposals would effectively end maximum rate regulation for most captive coal shippers.” (Coal Shippers Reply at 5.) In fact, the Coal Shippers never proved their doomsday claim, nor could they, because it is not true. Adopting the Board’s proposals or UP’s proposal would not alter the substance of the Full-SAC test. The proposals would not reduce the amount of traffic that complainants could include in SARR traffic groups. The proposals would just limit use of cross-over traffic as a simplifying device, a device that the Interstate Commerce Commission (“ICC”) never even contemplated when it adopted the *Coal Rate Guidelines*. See *Major Issues in Rail Rate Cases*, EP 657 (Sub-No. 1), slip op. at 31 (STB served Oct. 30, 2006).

The Coal Shippers also assert that the ICC's decisions in *OPPD*<sup>5</sup> and *Arkansas Power*<sup>6</sup> provide historical support for unlimited use of cross-over traffic. (Coal Shippers Reply at 12.) But those decisions applied even stronger protections against shipper exploitation of cross-over revenue than the Board is proposing in this proceeding, yet shippers still obtained rate reductions in both cases. In *Arkansas Power*, the SARR did not carry any non-coal cross-over traffic. *See Arkansas Power*, 3 I.C.C.2d at 774. In *OPPD*, the SARR traffic group included non-coal cross-over traffic, but revenue from that traffic was allocated to the SARR using ECP. *See OPPD*, 3 I.C.C.2d at 136 (“Non-coal traffic was assumed to cover its variable costs, but was not assigned a constant-cost component.”). With regard to coal traffic, the complainants in both cases were required to show that the off-SARR portion of the cross-over revenue allocations provided the defendant with sufficient revenue to cover its off-SARR costs associated with the traffic, *see id.* at 141-42; *Arkansas Power*, 3 I.C.C.2d at 774-75, a showing that the Board no longer requires complaints to make, *see Otter Tail Power Co. v. BNSF Ry.*, NOR 42071, slip op. at 11-12 (STB served Jan. 27, 2006). Use of ECP to allocate revenue for non-coal cross-over traffic, together with a rule requiring complainants to demonstrate that revenue allocations for cross-over traffic would cover the defendant railroad's off-SARR costs, would go a long way toward resolving UP's concerns.

**D. Limits on the use of cross-over traffic are a step in the right direction.**

The Coal Shippers also object to UP's proposal that the Board consider imposing new limits on shippers' ability to increase the amount of cross-over traffic on SARRs by rerouting

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<sup>5</sup> *Omaha Pub. Power Dist. v. Burlington N.R.R.*, 3 I.C.C.2d 123 (1986), *aff'd*, 3 I.C.C.2d 853 (1987).

<sup>6</sup> *Ark. Power & Light Co. v. Burlington N.R.R.*, 3 I.C.C.2d 757 (1987).

issue and non-issue traffic. (Coal Shippers Reply at 15.) But the Coal Shippers miss the point by arguing that rerouting is “well-established.” (*Id.*, quoting *Ariz. Elec. Power Coop. v. BNSF Ry.*, NOR 42113, slip op. at 10 (STB served Nov. 22, 2011).) UP did not propose to prohibit rerouting: complainants could reroute non-issue traffic, as long as the SARR would handle the traffic from origin to destination, and they could reroute the issue traffic, as long as the SARR handles non-issue traffic on the new route from origin to destination. (UP Opening at 11-12.)<sup>7</sup> UP just asked the Board to limit the use of cross-over traffic as a shortcut when a shipper reroutes traffic to increase the size of its traffic group.

UP would go further than the Board has proposed to address problems associated with the use of cross-over traffic, but UP continues to support the Board’s current proposals as a step in the right direction. The Chemical Companies and the Coal Shippers repeat on reply their claims that the Board’s proposals assume, contrary to precedent, that *SARR* operating costs are relevant to revenue allocations under ATC. (Chemical Companies Reply at 2; Coal Shippers Reply at 7-8). However, as UP observed in its reply, the Board appears to be focused on *defendants’* costs – *i.e.*, in certain circumstances, ATC revenue allocations do not accurately reflect the costs of the services that the defendant is providing on the portions of its route being replicated by the SARR and the costs of the services that the defendant is providing on the portions of its route that are not being replicated by the SARR. (UP Reply at 6 n.6.) Unless ATC revenue allocations leave the defendant with sufficient revenue to cover its off-SARR costs, the defendant is effectively being required to subsidize the SARR.

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<sup>7</sup> In using the terms “origin” and “destination,” UP includes the points at which UP interchanges the traffic with another carrier. In other words, UP would not require a complainant to construct a SARR that replicates portions of a non-defendant railroad’s network in order to include interline traffic in its traffic group.

UP also disagrees with the Coal Shippers' assertion that the Board's concerns should be addressed "through modifications to the calculation of URCS variable costs used in ATC." (Coal Shippers Reply at 5). Even if the Board's concerns could be addressed by modifying URCS – and no party has proposed a specific solution in their comments so far – modifying URCS would be an expensive, time-consuming undertaking, and it would still require reliance on arbitrary revenue allocations. As UP explained on reply, by addressing the problem directly – that is, by restricting the use of cross-over traffic, the Board can be confident that it will obtain more accurate Full-SAC results than if it tried to address its concerns by modifying URCS. (UP Reply at 6-7.)

**E. The Board should apply any limits on cross-over traffic that it adopts in this proceeding to pending rate cases.**

Finally, UP argued on opening that any limits on cross-over traffic that the Board adopts here should apply in *Intermountain Power Agency v. Union Pacific Railroad*, NOR 42136. (UP Opening at 14-16.) The Coal Shippers assert that such a result would be inappropriate because rules can only be applied prospectively. (Coal Shippers Reply at 16.) However, new rules can be applied to pending cases as long as the parties have "an opportunity to introduce evidence bearing on the new" rule. *See Hatch v. FERC*, 654 F.2d 825, 835 (D.C. Cir. 1981). IPA has addressed the proposed limits on cross-over traffic in its opening evidence in NOR 42136 and also in this proceeding through the comments of the Coal Shippers. (Coal Shippers Opening, Att. 1 at 2 (disclosing that IPA is one of the Coal Shippers).) Moreover, parties in pending rate cases cannot claim detrimental reliance on the established legal regime because the restrictions on cross-over traffic have been in flux for years and new restrictions could have been applied in their individual cases. *See Intermountain Power Agency v. Union Pac. R.R.*, NOR 42136, slip op. at 4 (STB served Dec. 14, 2012) ("The parties should have been, and continue to be, on

notice that use and application of cross-over traffic, as well as ATC revenue allocation methodologies, are potential issues in individual rate cases, and that parties are entitled to raise and respond to substantive arguments regarding those methodologies within those proceedings.”). In the interest of administrative efficiency, the Board should make clear that any new restrictions on cross-over traffic that it adopts in this proceeding will apply in pending rate cases.

**II. The Board should adopt “proposed alternative” ATC or restore “original” ATC.**

UP’s opening comments supported the Board’s proposed modification to its ATC method of allocating revenue from cross-over traffic, assuming the Board continues to allow the use of cross-over traffic and to apply a variation on its ATC method of allocating cross-over revenue. (UP Opening at 16-17.) UP’s reply addressed the Coal Shippers’ and the Chemical Companies’ objections to the Board’s proposal and showed why the Board should reject new proposals for allocating cross-over revenue that were offered by the Coal Shippers and Arkansas Electric Cooperative Corporation. (UP Reply at 7-12.) None of the shipper parties provided any substantive discussion of the different variations of ATC on reply.

**III. The Board should not modify the limits for relief under Simplified-SAC.**

UP’s opening and reply comments opposed the Board’s proposal to modify the limits for relief under Simplified-SAC. (UP Opening at 17-18; UP Reply at 12-13.) In their replies, The Chlorine Institute (“CI”) and The National Grain and Feed Association (“NGFA”) say that UP would be amenable to raising the limits for relief if the Board adopted rules to prevent shippers from using the substantial discovery and disclosure burdens that Simplified-SAC procedures impose on railroads as fishing expeditions or as leverage in rate negotiations. (CI Reply at 3; NGFA Reply at 5.) To be clear, UP urged the Board to adopt rules to prevent shipper gaming of the Simplified-SAC process *if* the Board were to raise the relief limits. (UP Opening at 18.) UP

opposes any change to the limits for relief under the Simplified-SAC test, unless the change is based on the principles that the Board adopted when setting the initial limits in *Simplified Standards for Rail Rate Cases*, EP 646 (Sub-No. 1) (STB served Sept. 5, 2007).

**IV. The Board should not modify the limits for relief under the Three-Benchmark test.**

In its opening comments, UP opposed the Board's proposal to modify the limits for relief under the Three-Benchmark test because the proposal was tied to the Board's proposal to modify the Simplified-SAC test in ways that UP opposes. (UP Opening at 18.) On reply, UP responded to claims that railroads should not care whether the limits for relief were raised by pointing out that: (i) application of the Three-Benchmark test might produce lower prescribed rates than application of the Simplified-SAC or Full-SAC tests; (ii) application of the Three-Benchmark test might result in a rate prescription when application of the Simplified-SAC or Full-SAC tests would have shown that challenged rates were reasonable; and (iii) proposals to remove the limits for relief would be inconsistent with the Board's recognition that it is appropriate and necessary to limit application of this crude test of rate reasonableness to the smallest cases. (UP Reply at 13.) UP's reply also addressed arguments that higher limits for relief were justified because Simplified-SAC cases are more costly than the Board anticipated by explaining why the Board should not draw conclusions about Simplified-SAC costs from the one example that shippers discussed. (*Id.* at 14.)

In their replies, the Chemical Shippers refer the Board to their opening comments for removing the limits for relief, and CURE repeats its argument for removing the relief limits. (Chemical Shippers Reply at 8; CURE Reply at 17-20.) CI and NGFA argue that the Board should raise the relief limits because the costs of bringing a Three-Benchmark case have proven

to be higher than the Board anticipated. (CI Reply at 4-5; NGFA Reply at 6-7.)<sup>8</sup> However, the limits for relief in Three-Benchmark cases are based on the costs of Simplified-SAC cases, not the costs of Three-Benchmark cases. *See Simplified Standards*, slip op. at 28 (“Each limit is based on our estimates of the litigation cost to pursue relief under the next more complicated, and more precise method.”). UP continues to oppose any change to the limits for relief under the Three-Benchmark test unless the change is based on the principles the Board adopted in *Simplified Standards*.

**V. The Board should not modify the interest rate on reparations payments.**

In its opening comments, UP opposed the Board’s proposal to modify the interest rate on reparations payments. UP explained that the T-Bill rate is the appropriate measure of the rate of return a shipper loses because it does not have the overcharged amounts available because the T-Bill rate reflects the level of return a that shipper could obtain from a risk-free investment. (UP Opening at 18-19.) On reply, the Chemical Companies assert that shippers should be entitled to a higher rate of return because rate cases are not “risk free” in that, if a shipper loses, “the entire tariff premium is kept by the railroad.” (Chemical Companies Reply at 9.) However, as UP explained on reply, a complainant is not making a risky investment when it pays freight rates, even if they are later determined to be excessive: if the complainant prevails, it is guaranteed to

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<sup>8</sup> CI also claims it is “undisputed” that “Class I railroads” have raised rates for TIH commodities “to minimize the rail transportation of these commodities.” (CI Reply at 5.) UP does dispute such claims. Indeed, UP has submitted evidence demonstrating that such claims were plainly untrue in regard to UP’s pricing practices, in *US Magnesium, L.L.C. v. Union Pacific Railroad Company*, NOR 42114. *See* Reply Evidence of Union Pacific Railroad Company at 28-35 & Reply Verified Statement of Marius Schwartz at 1-7, *US Magnesium, L.L.C. v. Union Pacific Railroad Company*, NOR 42114 (Sept. 22, 2009). UP also submitted testimony disputing such claims in *Competition in the Railroad Industry*, EP 705. *See* Reply Comments of Union Pacific Railroad Company at 15-16 & Reply Verified Statement of John J. Koraleski at 41, *Competition in the Railroad Industry*, EP 705 (May 27, 2011).

recover any overpayment. (UP Reply at 15-16.) Nor is it appropriate to view complainants as facing a risk of losing what the Chemical Companies characterize as the “tariff premium” if they do not prevail: if the railroad prevails, that means its tariff rates were not unreasonable – the railroad thus retains only what it was entitled to in the first place (and it is out the costs of its defense). (*Id.* at 16.) Accordingly, the fact that railroads prevail in some rate cases provides no reason to apply extra-high interest rates in cases in which complainants prevail.

In its reply, the Coal Shippers repeat their assertion that the Board should adopt the Prime Rate because that is the interest rate used by the Federal Energy Regulatory Commission. (Coal Shippers Reply at 23-24.) The only substantive justification the Coal Shippers offer is that the Prime Rate “should provide a positive incentive for all parties to seek an early resolution of rate proceedings.” (*Id.* at 24, quotation omitted.) But raising the interest rate on reparations would shift incentives from shippers to railroads, and there is no evidence in the record that railroads are causing proceedings to be protracted. Indeed, at least two railroads have agreed to forego presenting SAC evidence in at least four cases and stipulated to a rate prescription at the 180% R/VC level if the challenged rates were found to exceed that level.<sup>9</sup> In addition, in UP’s experience, most schedule extensions stem from shipper requests or mutual requests of the parties. Moreover, railroads do not control the time it takes to issue decisions, but under the proposal to increase the interest rates, they would be penalized for any delays in issuing decisions.

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<sup>9</sup> See *Okla. Gas & Elec. Co. v. Union Pac. R.R.*, NOR 42111 (STB served July 24, 2009); *Kansas City Power & Light Co. v. Union Pac. R.R.*, NOR 42095 (STB served May 19, 2008); *N. States Power Co. Minnesota d/b/a Xcel Energy v. Union Pac. R.R.*, NOR 42059 (STB served May 24, 2002); *Minnesota Power, Inc. v. Duluth, Missabe & Iron Range R.R.*, NOR 42038 (STB served Mar. 3, 2000).

The Board's use of the T-Bill rate ensures that shippers are appropriately compensated when they prevail in rate cases. There is no justification in the record for adopting a different measure of the appropriate interest rate.

Respectfully submitted,

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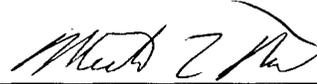
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January 7, 2013

**CERTIFICATE OF SERVICE**

I hereby certify that on this 7th day of January, 2013, I caused a copy of the foregoing Rebuttal Comments of Union Pacific Railroad Company to be served by first-class mail, postage prepaid, on all parties of record in this proceeding.



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Michael L. Rosenthal