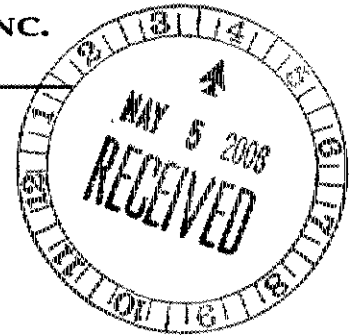




May 5, 2006



Ms. Marilyn Levitt  
Designated Official, Information Quality Guidelines  
Surface Transportation Board  
1925 K Street, N.W. 7<sup>th</sup> Floor  
Washington, DC 20423-0001

Re- Request for Correction of Errors per Ex. Parte No. 587

Dear Ms. Levitt:

Enclosed herewith are the original and ten copies of our request for reconsideration of the finding by Mr. Leland Gardner regarding errors in the calculation of the 2002 and 2003 Revenue Shortfall Allocation Method (RSAM<sup>TM</sup>) benchmarks for the Grand Trunk Corporation. Mr. Gardner's letter, dated April 6, 2006 indicated that the primary cause of the great increase in the GTC's RSAM's relative to those of the pre-existing constituent railroads was the revaluation of the Illinois Central's investment at the time of its purchase by the Canadian National Railway.

The details of our request for reconsideration are set forth in the attached eight-page letter. We believe that it is unreasonable to reflect the markup of the IC's investment, which resulted principally from the large amount of unregulated traffic on the IC, in the benchmarks that are used to test the reasonableness of rates for regulated traffic.

Accordingly, we respectfully request that the Board either (1) remove the IC acquisition markup from the calculation of the GTC's RSAM, or (2) convene an evidentiary proceeding in which it will determine whether and, if so, how much of that markup should be included in the GTC's RSAM benchmark.

Either I or Tom O'Connor would be happy to respond to any questions or comments you or the STB staff may have concerning this request.

Sincerely,

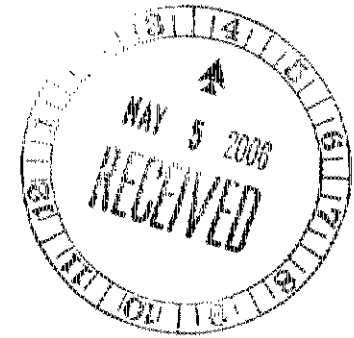


Charles W. King

cc: Chairman Buttrey  
Vice Chairman Mulvey

**SK Snavely King Majoros O'Connor & Lee, Inc.**

Economic and Management Consultants



May 5, 2006

Ms. Marilyn Levitt  
Data Quality Officer  
Surface Transportation Board  
1925 K Street, N.W., 7<sup>th</sup> Floor  
Washington, DC 20423-0001

Re: Request for Reconsideration of Findings per Ex Parte No. 587

Dear Ms. Levitt:

Pursuant to ¶7c of the Information Quality Guidelines adopted by the Surface Transportation Board ("STB" or "Board") on October 1, 2002 in Ex Parte No. 587, Snavely King Majoros O'Connor & Lee, Inc. ("Snavely King") respectfully requests reconsideration of the April 6, 2006 finding by Mr. Leland Gardner concerning the 2002 and 2003 Revenue Shortfall Allocation Method ("RSAM") indicators for the Grand Trunk Corporation ("GTC"). Mr. Gardner found that these RSAM factors were not in error. That finding was submitted in response to our Request for Correction of Errors, dated January 12, 2006. Pursuant to the requirements of ¶7c, the original request is Attachment A hereto, and Mr. Gardner's response is Attachment B.

As explained by Mr. Gardner in his April 6 letter,<sup>1</sup> the increase in the GTC's RSAM results principally from the revaluation of the capital investment of the Illinois Central ("IC"). The purchase of the IC by the Canadian National Railway ("CN") involved a markup to a price substantially above the IC's original book value. Prior Board decisions have authorized the inclusion of acquisition markups in the calculation of revenue adequacy on the grounds that a very large proportion of rail traffic is not subject to any STB maximum rate regulation. However, that STB rationale indicates it is unreasonable to reflect prohibitively high acquisition markups in computing the measures that determine the reasonableness of rates for the limited traffic that is subject to such regulation. In effect, the CN markup of the IC investment renders the CN operations in the US immune to US rail rate regulation.

Snavely King respectfully requests that the Board either (1) remove the IC acquisition markup from the calculation of the GTC's RSAM, or (2) convene an evidentiary proceeding to determine whether, and if so, how much of that markup should be reflected in the GTC's RSAM benchmark.

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<sup>1</sup> This and all subsequent references to Mr. Gardner are to the letter that is Attachment B to this petition. We note that the officers and staff of Snavely King have worked with Mr. Gardner for many years and hold him in the highest regard.

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The Snavely King Petition

Our initial request was motivated by evidence that the RSAM factors for the GTC for the years 2002 and 2003 appeared unreasonably high relative to (1) the three constituent railroads that were combined to make up the GTC and (2) all other Class I railroads

Specifically, we noted that in the year prior to the consolidation of the three CN subsidiaries, 2001, the IC's RSAM was 182 percent (with efficiency adjustment) and the Grand Trunk Western's RSAM was 146 percent. In 2002, the first year when the reporting for these two railroads plus the Wisconsin Central was consolidated in to the GTC, the efficiency-adjusted RSAM was 415 percent. In 2003 it was 390 percent.

These inflated RSAM benchmarks have persisted. Based on the most recent RSAM released by the STB on April 24, 2006 the efficiency-adjusted GTC RSAM was reported by the STB as 322 percent, 88 percentage points higher than the national average. Without the efficiency adjustment the GTC RSAM was reported by the STB as 497 percent for 2002, 486 percent for 2003 and 375 percent for 2004.

We also noted that the GTC's RSAMs were totally out of line with the rest of the railroad industry. In 2002, the average efficiency-adjusted RSAM for all Class 1 railroads, including the GTC, was 221 percent, as compared with the GTC's 415 percent. In 2003, the Class 1 average RSAM was 222 percent, while that of the GTC was 390 percent. In 2004, the Class 1 average RSAM was 234 percent, while that of the GTC was 322 percent.

The RSAM Benchmark

The RSAM was adopted by Commission Order on December 27, 1996 in Ex No. 347 (Sub-No. 2) *Rate Guidelines – Non-Coal Proceedings*. It was defined in that order as follows:

The RSAM benchmark measures the uniform markup above variable cost that would be needed from every shipper of potentially captive traffic (the >180 traffic group) in order for the carrier to recover all of its URCS fixed costs.

URCS was adopted by the ICC on September 8, 1989 in Ex Parte 431 (Sub No. 1).<sup>2</sup> In its order, the ICC addressed the issue of merged railroads. It found appropriate the application of data from two railroads that were subsequently merged, rather than the composite data of the merged railroad. One of the principal authors of URCS, Dr. Daniel Westbrook, had added the costs of the Southern Railway and the Norfolk & Western

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<sup>2</sup> 5 I.C.C. 2d 894 (1989).

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Railroad, rather than employ the composite data for the merged Norfolk Southern.<sup>3</sup> He had also eliminated Conrail from his calculations on the grounds that it was a “cost outlier” owing to its heavy investment in rehabilitation.<sup>4</sup> By its actions in writing up the IC investment, CN has unilaterally created an outlier.

URCS is based primarily on cost and operations reports submitted annually by each railroad, the “R-1 Data.” Those reports in turn conform to the Board’s Uniform System of Accounts (“USOA”). In his response, Mr. Gardner indicated that the reason for the sudden increase in the GTC consolidated RSAM relative to that of the constituent railroads was a revaluing of the IC’s assets. That revaluing reflected the CN’s acquisition of the IC in 2000 at a marked up purchase price considerably higher than the value carried on the books of the IC. Mr. Gardner stated that the purchase accounting transaction was recorded in accordance with the USOA.

Although we have not fully examined the basis for the calculations, it appears that Mr. Gardner’s brief recap is not inconsistent with the USOA. Paragraph (c)(1) of 49 C.F.R 1201, Sub. Part A, 2-15 states as follows:

When the acquisition results from a purchase . . . the amount includable in account 731, *Road and equipment property*, shall be the cost at the date of acquisition to the purchaser of the transportation property acquired. The cost assigned the property, as well as other assets acquired, shall be the amount of the cost consideration given.

The Test of Rate Reasonableness

Notwithstanding the nominal conformance of the RSAM calculation with the USOA, this treatment of the acquisition value of the GTC’s railroad property in the calculation of the RSAM eliminates any realistic possibility of evaluating the reasonableness of the GTC’s rates. This is clearly in conflict with the obligation and intent of the Board and its predecessor, the ICC, which is to provide a means for evaluating the reasonableness of rail rates. When such a conflict arises, the USOA should be adjusted to comply with regulatory objectives, mandate and intent. Those regulatory objectives, the mandate and the intent should govern the USOA, not the reverse.

To determine whether original cost or some markup over that value is appropriate in testing the reasonableness of rates, it is useful to examine the principles laid down in the Supreme Court’s 1944 decision in *Hope Natural Gas Co.*<sup>5</sup> In reversing the Circuit Court of Appeals, the Supreme Court found that the Federal Power Commission was

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<sup>3</sup> Id. at 918.

<sup>4</sup> Id. at 917.

<sup>5</sup> *Federal Power Commission v. Hope Natural Gas Co.* 320 U.S. 593 (1944) (“*Hope*”).

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correct in using original cost, rather than a higher measure of “fair value” in setting rates. As the Court explained,

“fair value” is the end product of the process of rate-making not the starting point as the Circuit Court of Appeals held. The heart of the matter is that rates cannot be made to depend upon “fair value” when the value of the going enterprise depends on earnings under whatever rates may be anticipated.<sup>6</sup>

In other words, if the valuation of the enterprise is determined by the results of regulation, it is circular to base rates on that valuation. The investor is entitled to a fair return only on the investment initially put into the enterprise. This principle permeates the regulation of the utility industries, where acquisition markups are separately identified in the respective USOAs and are allowed in the utility rate base only if the utility can demonstrate that the acquisition benefited its customers.<sup>7</sup>

When the ICC first addressed the issue of “revenue adequacy,” as required by the Staggers Act, it adhered to the *Hope* principles by rejecting any “fair value” representations of railroad investment as the base upon which returns would be calculated. In its decision of March 26, 1981, the ICC emphatically adopted original cost as the basis for revenue adequacy determination:

In making our revenue adequacy findings in this proceeding, we have assessed the value of the rate base as the sum of the original cost of the track assets plus betterments to track, plus the depreciated book value of all other assets.<sup>8</sup>

This issue was again addressed when the ICC reconsidered its revenue adequacy standards in 1986. In an order dated December 16, 1986, the ICC rejected the railroads’ proposal to adopt Trended Net Original Cost in favor of “a net investment base derived from the straight line historical cost accounting method.”<sup>9</sup>

However, in 1990, the ICC reversed its longstanding adherence to original cost and determined that the markup (or markdown) resulting from an acquisition could be reflected in the determination of revenue adequacy:

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<sup>6</sup> *Id.* at 601.

<sup>7</sup> Over the course of its 36-year history, in addition to its appearances in transportation proceedings, Snavely King has participated in over 1000 telephone, electric, gas and water utility proceedings before federal and state regulatory agencies.

<sup>8</sup> *Standards for Railroad Revenue Adequacy*, Ex Parte No. 393, 264 I.C.C.803, 821(1981) (emphasis supplied).

<sup>9</sup> *Standards for Railroad Revenue Adequacy*, Ex Parte No. 393 (Sub No. 1), 3 I.C.C. 2d 261, at 283 (1986).

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We conclude that we cannot ignore acquisition cost and adhere to frequently outdated predecessor values. Accepting predecessor values in the face of more current probative evidence of value arrived at in arms length negotiations would not only sacrifice accuracy, but could cause the very capital flight which AAR fears.<sup>10</sup>

As for *Hope's* circularity issue, the ICC had this to say:

We are unpersuaded that the price paid for railroads is determined primarily by regulatory constraints and that use of acquisition costs will produce a downward spiral of acquisition costs for railroads. While such an argument has force with respect to a heavily regulated utility, most rail rates are not subject to maximum rate regulation.<sup>11</sup>

In its 1990 *Revenue Adequacy* decision, the ICC considered acquisition costs below book value. In 1998, the Board was faced with the reverse condition regarding the acquisition of Conrail by the CSX and the Norfolk Southern. Again, it found that the circularity problem does not exist:

Because relatively few shippers were captive to rail even before this transaction, CSX and NS could not successfully pursue a strategy of making up a revenue shortfall simply by increasing their rates to captive shippers.

Presumably, these prior STB decisions underlie the current provision of the USOA that acquisition costs can be included in the rail property accounts.

The Board's rationale relies on its belief that only a relatively limited amount of traffic is subject to maximum rate regulation.<sup>12</sup> The Board believes that this condition renders irrelevant the *Hope* circularity issue. Whatever the propriety of this belief, the Board has failed to address the impact of its valuation policy on the traffic that is subject to maximum rate regulation.

Implicit in the Board's reasoning is the proposition that the value of the railroad would be significantly different if maximum rate regulation were pervasive. Under pervasive regulation, the IC would be subject to overall revenue levels determined by an

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<sup>10</sup> *Railroad Revenue Adequacy – 1988 Determination*, 6 I.C.C.2d 919, at 940 (1990).

<sup>11</sup> *Id.* 941.

<sup>12</sup> The STB assumption as to the amount of traffic eligible for rate regulation can be challenged. Traffic that is captive to rail transportation should be subject to rate regulation. Moreover, the sequence of rail mergers has significantly increased the pricing power of the individual remaining railroads. Snavely King's years of experience in analyzing rail shipments supports the need for greater access to rate reasonableness regulation.

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allowed rate of return on the original cost of the railroad's assets, as required by *Hope*. It is unlikely that the IC would have had the high value that the CN ascribed to it. The very large difference between the original cost of the IC's investment and its acquisition value results primarily from the fact that the STB declines to regulate most of its traffic.

If *de facto* unregulated pricing accounts for the high value of the IC's plant, then it is not appropriate to apply that inflated value in determining the maximum rates of the limited amount of traffic that the STB does regulate. Captive shippers of regulated traffic should not be saddled with the marked-up valuations caused by unregulated traffic.

The Effect of the IC Acquisition Adjustment

Mr. Gardner's response identified the effect of including the acquisition premium that the CN paid for the IC. In 2001, the net investment value of the IC and the GTW together was \$1,441,638. In the next year, 2002, the net investment value of the newly consolidated GTC was \$4,364,525, an investment over three times as large as the IC and GTW had recorded on their books of account.

While a small portion of this increase may be related to the addition of the Wisconsin Central Railroad, by far the largest component was the acquisition premium that resulted from the purchase of the IC by the CN at a price several times the recorded book value of the IC's assets.

Mr. Gardner's letter indicates that capital expense per ton-mile increased 56 percent between 2001 and 2002, while other operating expenses per ton-mile increased by 6 percent. Subsequently, we requested workpapers which revealed that the actual increase in capital-related costs was not 56 percent, but 86 percent. The workpapers also showed that non-capital related variable costs increased not by the "rather flat"<sup>13</sup> 6 percent, but by the "somewhat large"<sup>14</sup> 25 percent. The revised 25 percent increase calls into question Mr. Gardner's conclusion that:

The better stability of the non-capital variable expenses supports the conclusion that the change in waybill accounting methods did not have a major effect on the estimate of variable costs.<sup>15</sup>

Moreover, the revision of the capital-related variable cost increase from 56 percent to 86 percent strengthens the conclusion that the marked-up value of the IC assets contributed strongly to the purported increase in variable costs.

The sudden inflation of the GTC's capital costs relative to those of the pre-existing constituent railroads produces unreasonable results that are questionable under

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<sup>13</sup> See Attachment B, page 2

<sup>14</sup> STB Workpapers, page 1.

<sup>15</sup> See Attachment B, page 2.

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the “arms-length” principle and counter to the basic reality of the railroads’ operations. More importantly, allowing this sudden inflation in value to flow into the RSAM is a practice that is grossly unreasonable to shippers seeking regulatory rate relief.

First, the acquisition of the IC by a single unopposed bidder, CN, may not meet the “arm’s length” test. This possibility is reinforced by the evidence we presented in our initial request which demonstrated that the acquisition of Conrail by two competing bidders, Norfolk Southern and CSX, produced very minor changes in the RSAM factors when NS and CSX RSAM factors are compared before and after the acquisition.

The unreal aspect of the 2002 RSAM ratios is demonstrated by comparing GTC RSAM changes to the changes in the Revenue-to-Variable-Cost factors. As noted in the Statement of Tom O’Connor that accompanied our initial Request for Correction of Errors, the RSAM for the IC and the GTW more than doubled from a simple average of 204 percent during the period 1991-2001 to 415 percent in 2002 and 390 percent in 2003. Yet, the GTC R/VC >180 benchmark did not significantly change between 2002 and 2004.<sup>16</sup> The dynamics of the RSAM mean that with this relatively stable R/VC >180, the GTC must have experienced a large and persistent surge in non-compensatory traffic to produce such high RSAMs beginning in 2002.

Thus, the revaluation of the IC’s investment has implications beyond just high-priced traffic. Specifically, the Long-Cannon factors would require a broad-based effort to maximize contribution from the traffic with R/VC below 180 before turning to higher rates on traffic above 180 R/VC. There is meager evidence that the CN has engaged in this effort.

Of course, the basic track configuration, rail operations and maintenance practices of these railroads did not change materially between 2001 and 2002. Operational continuity notwithstanding, the newly consolidated railroad in 2002 is presented as a much more costly, less profitable enterprise than the constituent railroads in 2001. Not only does the markup needed to cover URCS fixed costs increase, but the non-compensatory traffic excluded from the efficiency-adjusted RSAM (the <100 Revenue Variable Cost (R/VC) traffic group) increases, which widens the spread between efficiency-adjusted and unadjusted RSAMs.

Most important is the impact of the acquisition markup on those shippers and industries that are captive to the GTC and need protection from excessive rail rates. For them, the unilateral tripling of the IC’s investment value in RSAM calculations effectively determines that GTC rates will not be subject to rate reasonableness review or regulation.

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<sup>16</sup> The GTC R/VC >180 benchmark was 228 percent in 2002, 252 percent in 2003, and 233 percent in 2004.



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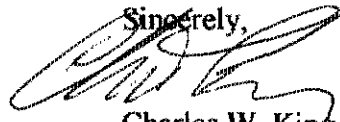
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This is an unreasonable practice, specifically with respect to the chemical industry. The American Chemistry Council (ACC) has entered evidence repeatedly, most recently in Ex Parte 661, *Railroad Fuel Surcharges*, stating that the proportion of captive traffic in the chemical industry is well above 60 percent.<sup>17</sup> Snavely King's years of experience analyzing rail shipments corroborates the ACC finding.

As we showed in our initial request, no other railroads or regions have RSAM results anywhere close to the GTC. The GTC RSAM data simply fail to pass the test of reasonableness. The unreasonableness and unfairness of this practice to shippers experiencing high rates is obvious. The actual costs of such traffic did not change significantly between 2001 and 2002, but the opportunity to apply the rate reasonableness guidelines to receive rate relief was seriously eroded, if not foreclosed altogether. The shippers' diminished access to rate reasonableness review is not driven by the economics, operational efficiency, or profitability of the railroads. Rather, it is the result of an acquisition of one railroad by another at a price well in excess of the book value of the assets. No one, other than the two railroads, had any meaningful input into the derivation of that price. No one explicitly determined or accepted the propriety of passing the inflated costs on to shippers. Yet, by accepting the acquisition markup as a restatement of the IC's capital costs, the Board would implicitly make that unreasonable determination and acceptance.

For the foregoing reasons, Snavely King respectfully requests that the Board either (1) remove the IC acquisition markup from the calculation of the GTC's RSAM, or (2) convene an evidentiary proceeding in which it will determine whether and, if so, how much of that markup should be included in the GTC's RSAM benchmark.

Sincerely,



Charles W. King

Admitted to practice April 10, 1967

cc: Mr. Leland L. Gardner, Director  
Office of Economics, Environmental Analysis and Administration  
Surface Transportation Board  
1925 K Street, N.W., 7<sup>th</sup> Floor  
Washington, DC 20423-0001

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<sup>17</sup> See ACC filing in Ex Parte 661, *Railroad Fuel Surcharges*, April 27, 2006.



**SNAVELY KING MAJOROS O'CONNOR & LEE, INC.**  
ECONOMIC AND MANAGEMENT CONSULTANTS

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# Attachment A



**SNAVELY KING MAJOROS O'CONNOR & LEE, INC.**  
ECONOMIC AND MANAGEMENT CONSULTANTS

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January 12, 2006

Ms. Marilyn Levitt  
Designated Official, Information Quality Guidelines  
Surface Transportation Board  
1925 K Street, N.W. 7<sup>th</sup> Floor  
Washington, DC 20423-0001

Re- Request for Correction of Errors per Ex. Parte No. 587

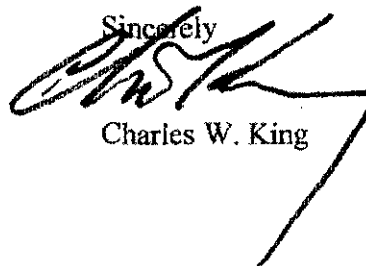
Dear Ms. Levitt:

Enclosed herewith is the request for correction of errors pertaining to the consolidated costs of the Grand Trunk Corporation, the U.S. portion of the Canadian National rail system. The details of our request are set forth in a four page letter of request and in the testimony of Tom O'Connor of our firm.

The purpose of this letter is to inform you that a week ago, we transmitted a copy of the requesting letter to the Canadian National's Washington representatives. We have subsequently met with those representatives in an effort to resolve informally the data inconsistencies noted in our request. We were informed that the substance of this request has been transmitted to the Canadian National's Montreal offices. No satisfactory explanation for the anomalies noted therein has yet been forthcoming. The CN staff continues to examine the matter, but we have no assurance whether or when an adequate response will be forthcoming.

For this reason, we are filing this request for Board action on the matter. We remain open to any and all opportunities to resolve the issues presented in our request.

Sincerely



Charles W. King

cc: Chairman Buttrey  
Vice Chairman Mulvey

Economic and Management Consultants

Jan. 12, 2006

Jan. 12, 2006

Ms. Marilyn Levitt  
Designated Official, Information Quality Guidelines  
Surface Transportation Board  
1925 K Street, N.W., 7<sup>th</sup> Floor  
Washington, DC 20423-0001

Re: Request for Correction of Errors per Ex Parte No. 587

Dear Ms. Levitt:

Pursuant to ¶ 7a of the Information Quality Guidelines adopted by the Surface Transportation Board ("STB") on October 1, 2002 in Ex Parte No. 587, Snavely King Majoros O'Connor & Lee, Inc. (Snavely King or SK) hereby submits a Request for Correction of Errors. This Request for Correction of Errors relates to the Revenue Shortfall Allocation Method ("RSAM") factors that the STB has calculated for the Grand Trunk Corporation ("GTC") for the years 2002 and 2003.

Paragraph 1a requires that any request for correction of errors contain four items of information, as follows:

1. An explanation of how the requestor is affected by the information error.

In its December 27, 1996 Decision in Ex Parte No. 347 (Sub 2) *Rail Rate Guidelines – Non-coal Proceedings*, the STB identified three benchmarks by which it will test the reasonableness of rail rates for small shipments of captive shippers. One of those benchmarks is the Revenue Shortfall Allocation Method ("RSAM") factor. This factor was defined as follows:

"The RSAM benchmark measures the uniform markup above variable costs that would be needed from every shipper of potentially captive traffic (the >180 traffic group) in order for the carrier to recover all of its URCS fixed costs"

As explained in the accompanying testimony of Tom O'Connor, Snavely King clients have a number of traffic lanes that might qualify for the small shipment rate guidelines set forth in the Board's December 27, 1996 decision. If the RSAM for any railroad is incorrectly calculated so as to be extraordinarily

1220 L Street, N.W. Suite 410, Washington, DC 20005

(202)371-1111 FAX: (202) 842-4966 [www.snavely-king.com](http://www.snavely-king.com)

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Jan. 12, 2006

high, then Snavely King, its clients, and others are deprived of an opportunity to challenge the rates of that railroad. As explained herein, Snavely King and at least one of its clients believe that the RSAMs for the Grand Trunk Corporation ("GTC") are extraordinarily and incorrectly high; either due to being incorrectly calculated, or due to being based on incorrect cost inputs.

2. A description of the factual error or noncompliance with STB or Office of Management and Budget (OMB) guidelines, including the name or number of the document in which it appears and how it was disseminated to the affected person.

As described in greater detail in Mr. O'Connor's testimony, the RSAM factors for the GTC for the years 2002 and 2003 appear extraordinarily and unreasonably high relative to (1) the three constituent railroads that have been combined to make up the GTC and (2) all other Class I railroads. These factors are calculated annually by the STB from cost and performance data submitted by each railroad in STB Report Form R-1. The RSAM factors are calculated by the STB with and without an "efficiency adjustment" and are disseminated each year in public notices titled "Rate Guidelines – Non-Coal Proceedings" under the caption of Ex Parte 347 (Sub 2).

In 2002, the Canadian National Railway consolidated the cost reporting for its three U.S. railroads, the Illinois Central ("IC"), the Grand Trunk Western ("GTW") and the Wisconsin Central ("WC"). The consolidated railroad, the GTC, was thus a composite of three railroads, two of which had previously submitted separate R-1 forms. In the last year prior to the consolidation, 2001, the IC's RSAM was 182 percent (with efficiency adjustment) and the GTC's RSAM was 146 percent. In stark contrast, during the first year of consolidated reporting, 2002, the GTC's efficiency-adjusted RSAM was 415; and in 2003 it was 390 percent.

The only possible factor that could account for this dramatic increase would be the addition of the WC to the consolidated cost report. That is highly unlikely. First, the WC is a Class II railroad and therefore relatively small in comparison to the two Class I railroads. Moreover, there is no indication that the WC was a high-cost operation. To the contrary, the WC's operating ratio during the 1996-2000 period prior to consolidation averaged about 76 percent, well below all Class I railroads, except CN. Based on the data presented in Mr.

1220 L Street, N.W. Suite 410, Washington, DC 20005

(202)371-1111 FAX: (202) 842-4966 [www.snavely-king.com](http://www.snavely-king.com)

Economic and Management Consultants

Jan. 12, 2006

O'Connor's testimony, CN achieved an even lower cost average operating ratio of 75 percent during the 1996-2000 period, followed by an unprecedented low cost average operating ratio of 68 percent during the 2001 - 2005 year to date period.

Not only are the consolidated GTC RSAM percentages unreasonably high relative to those previously reported for the constituent railroads, but they are totally out of scale with the rest of the railroad industry. In 2002, the average efficiency-adjusted RSAM of all Class I railroads, including GTC, was 221 percent, and in 2003 it was 222 percent. In each year, GTC's RSAM was more than 125 percentage points higher than the next highest railroad.

3. The factual basis for the assertion that the Board-disseminated information contains an error, including a recommended correction, if possible.

Snavely King submits that the foregoing analyses of operating ratios and comparisons with the RSAMs of the GTC constituent railroads and the other Class I railroads indicate that the GTC composite RSAMs are incorrect. Snavely King has reviewed the underlying RSAM work papers made available by the STB. However Snavely King defers to the STB, at this time, on estimating the correct RSAM factors. Such correction requires detailed investigation into the basis and calculation of the source cost and performance data, which is the proper role of the STB. Snavely King would be glad to work with the STB in those analyses.

4. Contact information for the affected person, including name, address, daytime telephone number, and e-mail address.

Tom O'Connor or Charles W. King  
Snavely King Majoros O'Connor & Lee, Inc.  
1220 L Street, N.W. Suite 410  
Washington, DC 20005  
(202)371-9149 or (202)371-9156  
FAX: (202)842-4966  
SKMOLTom1@aol.com; charlieking@snavely-king.com

1220 L Street, N.W. Suite 410, Washington, DC 20005

(202)371-1111 FAX: (202) 842-4966 www.snavely-king.com

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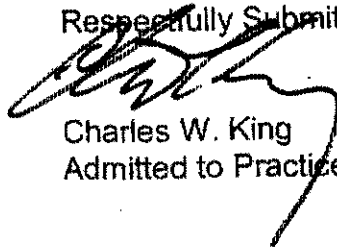
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Jan. 12, 2006

Accordingly Snavely King respectfully requests the Board, in a timely manner, to:

1. Investigate the revenue and cost reporting of GTC,
2. Correct the revenue and cost data and
3. Restate the RSAM benchmarks for GTC for both 2002 and 2003.

Respectfully Submitted,



Charles W. King  
Admitted to Practice, April 10, 1967

cc: Chairman Buttrey  
Vice Chairman Mulvey

1220 L Street, N.W. Suite 410, Washington, DC 20005

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(202)371-1111 FAX: (202) 842-4966 [www.snavely-king.com](http://www.snavely-king.com)

BEFORE THE  
SURFACE TRANSPORTATION BOARD  
In Ex Parte No. 587

Formal Request for Correction  
And Restatement of  
Revenue Shortfall Allocation Method  
(RSAM) Factors of the Grand Trunk Corp.  
For Use in Ex Parte 347 (Sub No. 2)

Verified Statement of

**TOM O'CONNOR**  
Vice President  
Snavely King Majoros O'Connor & Lee, Inc.  
1220 L Street, N.W.  
Washington, D.C.

January 12, 2006

STB Ex Parte No. 587



**STB Ex Parte No. 587  
Formal Request for Correction and Restatement  
Of Revenue Shortfall Allocation Method (RSAM) Factors  
of the Grand Trunk Corp. For Use in Ex Parte 347 (Sub No. 2)**

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STB Ex Parte No. 587

## I. Introduction

My name is Tom O'Connor. I am Vice president of Snavely King Majoros O'Connor & Lee, Inc. (Snavely King or SK). Snavely King is an economic and management consulting company focusing on transportation and utilities. Snavely King has been in business for more than 35 years, serving transportation clients including railroads, shippers and government agencies, in the United States, Canada and Europe. Appendix A contains my resume and a summary of my testimony before the Surface Transportation Board (STB), the Interstate Commerce Commission (ICC), as well as State Courts, Federal Courts and Arbitration and Mediation panels.

This Request for Correction of Errors results from research building on the small shipment rate reasonableness approach I suggested in previous testimony before the Surface Transportation Board<sup>1</sup> and applied in the first small shipment case ever brought before the Board.<sup>2</sup> The development and application of this successful approach reflected consideration of a number of key factors including:

- Chairman Nober's March 31, 2004 statements before Congress and the Chairman's January 12, 2005 presentation to the Midwest Association of Rail Shippers. These statements confirmed that rate reasonableness is an essential part of the mission for the STB and affirmed the interest of the STB in solving rate reasonableness challenges.
- Experience as a witness in numerous Interstate Commerce Commission (ICC) and Surface Transportation Board (STB) cases, and experience as an advisor in numerous rail rate and service negotiations.
- Experience as AVP Economics of the Association of American Railroads (AAR), as part of the railroad team that advocated and helped install rail deregulation. Our recommended approach highlights the importance of the three Long Cannon Factors, an essential part of the design for rail deregulation.

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<sup>1</sup> See Tom O'Connor Verified Statement in Ex Parte 646, June 2004; and Comments in Ex Parte 657, April 2005

<sup>2</sup> See STB Docket NOR 42093, evidence filed by Tom O'Connor on behalf of BP Amoco. This case was filed in May 2005, the first small shipment rate reasonableness case ever filed with the STB. The case was successfully resolved through mediation in June 2005.

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- Decades of experience working with railroad data both in the ICC and STB accounting systems and in internal railroad management accounting systems

This formal request for correction and restatement of the RSAM factors of the Grand Trunk Corporation ("GTC") is filed under STB Ex Parte No. 587; Correction of Errors in Information Disseminated by the Board.<sup>3</sup> Our request is prompted by anomalies discovered in preparing a rate reasonableness case for filing in Ex Parte 347 (Sub No. 2).

The STB Information Quality Guidelines set forth three main aspects of information quality:<sup>4</sup>

- Utility and usefulness
- Objectivity- accuracy, completeness, reliability, clarity and lack of bias
- Integrity

The evidence indicates that the GTC's RSAM data fails on all of these counts.

The STB and GTC data we present shows clearly the disabling effect of the misstated GTC RSAM factors. Not only the SK clients, but all CN rail shippers are disadvantaged by this error. Moreover the GTC RSAM error also disadvantages all other railroads which have reported accurate and reliable data for use in the STB rate reasonableness review.

This is a serious, pervasive and persistent error. We request prompt review of the RSAM data and processes reflected in the GTC RSAM parameters and we request timely correction of the errors in those data and processes.

As the STB noted in its 1996 decision, Ex Parte 347 (Sub No. 2) was initiated by the ICC to develop simplified evidentiary procedures for rail rate reasonableness cases where the procedures adopted in Coal Rate Guidelines<sup>5</sup> cannot practicably be applied.

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<sup>3</sup> See Information Quality Guidelines STB Decision, Ex Parte 587, Service Date October 1, 2002

<sup>4</sup> STB Decision, Ex Parte 587, October 1, 2002

<sup>5</sup> Coal Rate Guidelines--Nationwide, 1 I.C.C.2d 520 (1985), aff'd, Consolidated Rail Corp. v. United States, 812 F.2d 1444 (3d Cir. 1987).

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1220 L St NW Washington, DC, 20005  
202 371-9149 ■ www.Snavely-King.com ■ email skmoltom1@aol.com

Under the Interstate Commerce Act, as revised by the ICCTA<sup>6</sup>, The STB was charged with protecting individual captive shippers from unreasonably high and unfair rate levels. 49 U.S.C. 10101(6), 10701(d) (1). In doing so, the STB was specifically directed to consider the three "Long-Cannon factors",<sup>7</sup> set forth in 49 U.S.C. 10701(d) (2). The Long-Cannon factors are:

- Long-Cannon-1. The amount of traffic transported at revenues which do not contribute to going concern value and the efforts made to minimize such traffic;
- Long-Cannon-2. The amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic; and
- Long-Cannon-3. The carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues.

The STB was also directed to ensure that carriers have the opportunity to earn revenues that are adequate to cover costs, allow replacement of needed assets, and provide a fair return on investment. 49 U.S.C. 10101(3), 10704(a) (2).

## II. Findings

The specific lanes on which one of the Snavely King clients planned to register a formal complaint are small shipment lanes originating at a point at which Canadian National's subsidiary U.S. railroad, the GTC, offers the only rail service connecting the origin facility and the destination location. The GTC also offers the only rail service from the origin facility to the interchange point, connecting there with rail service to the destination location. Due to various impediments,

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<sup>6</sup> The ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803 (1995) (ICCTA) directed the Board to complete Ex Parte 347 Sub No.2 by January 1, 1997. 49 U.S.C. 10701(d)(3).

<sup>7</sup> The factors were named for Senator Long and Senator Cannon who introduced the amendment that added these provisions to the Staggers Rail Act of 1980 (Staggers Act).

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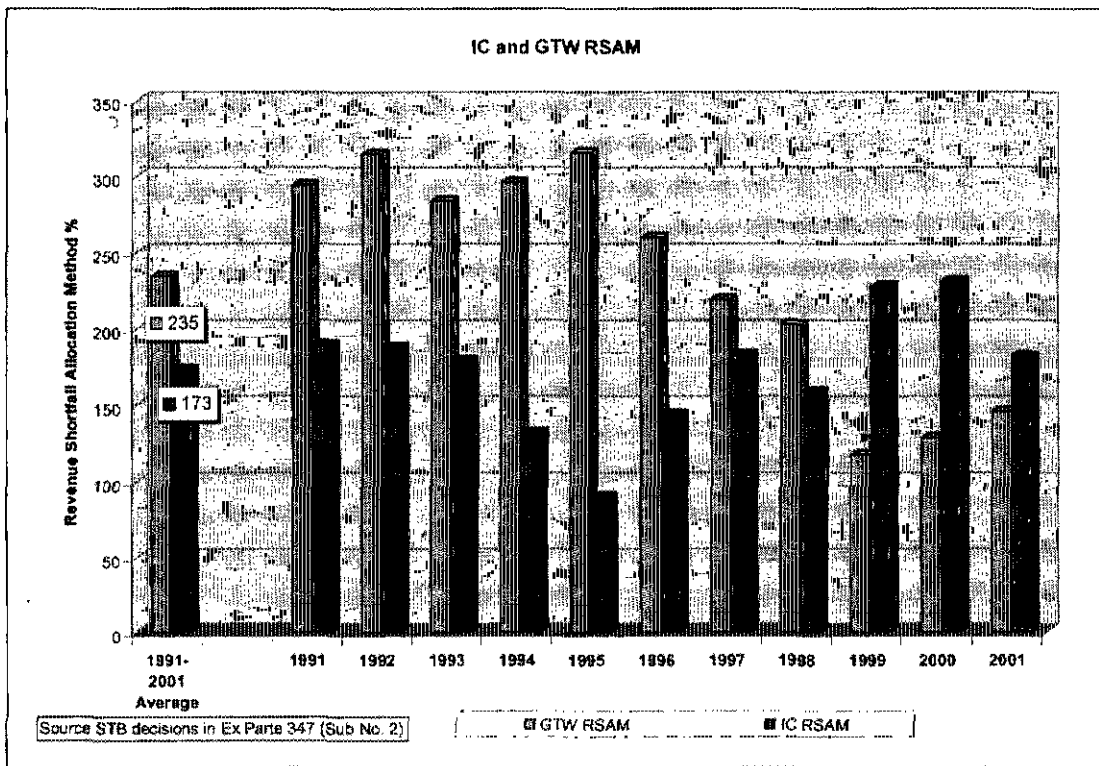
truck, barge and pipeline transportation is either not available or not economically feasible.

Our client requested that SK analyze the rail rates and costs on these lanes with a view to determining the reasonableness of the rates. SK was asked to prepare to present its findings to the Board, if negotiations with CN failed to resolve the rates reasonableness issues.

We analyzed those lanes and began testing the rates against the RSAM benchmarks calculated by the STB. After initially finding some of the RSAM parameters to be anomalous, we conducted further investigation of the RSAM data and the processes. Based on those analyses, we have found some of the RSAM parameters to be defective. In fact, the flaws in the GTC RSAM factors are so severe as to render the GTC RSAM factors unusable for their intended purpose of rate reasonableness review.

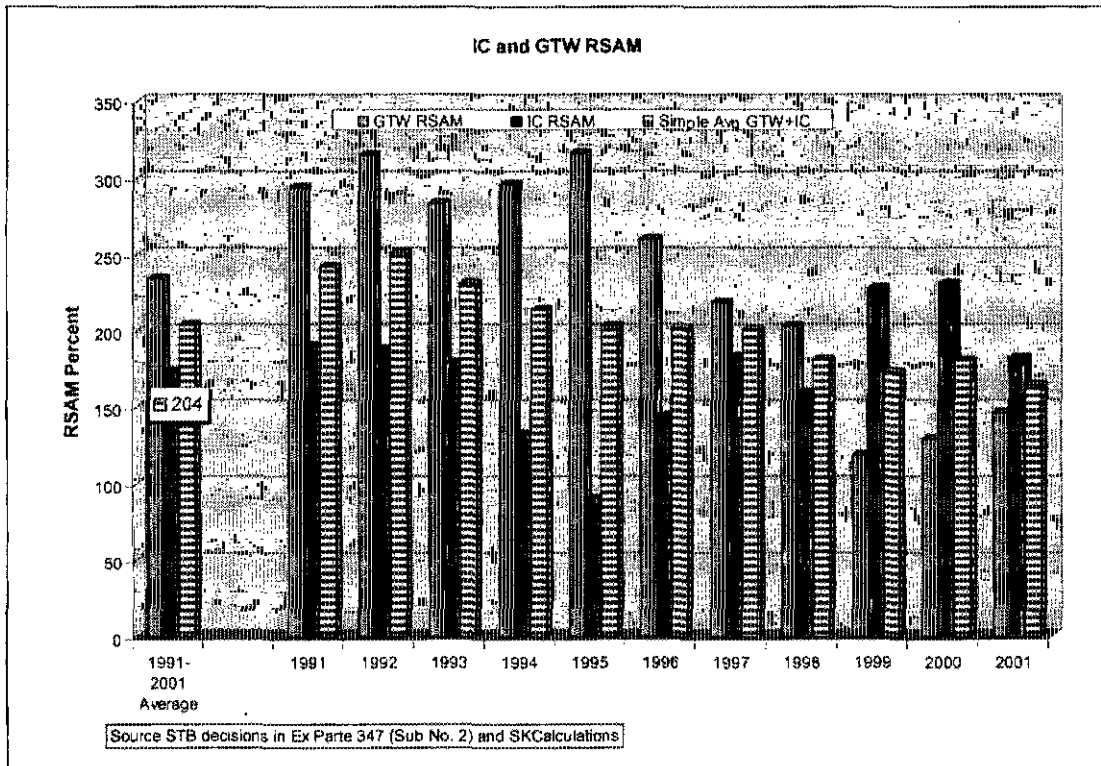
GTC is a combination of the three U.S. railroads owned by the Canadian National Railway; the Illinois Central (IC), the Grand Trunk Western (GTW) and the Wisconsin Central (WC). In 2002, the CN consolidated its cost and performance reporting for these railroads into a single report, now the GTC. The following charts show the RSAMs of IC and GTW. We find a sharp and unexplained discontinuity between GTC and the predecessor IC and GTW.

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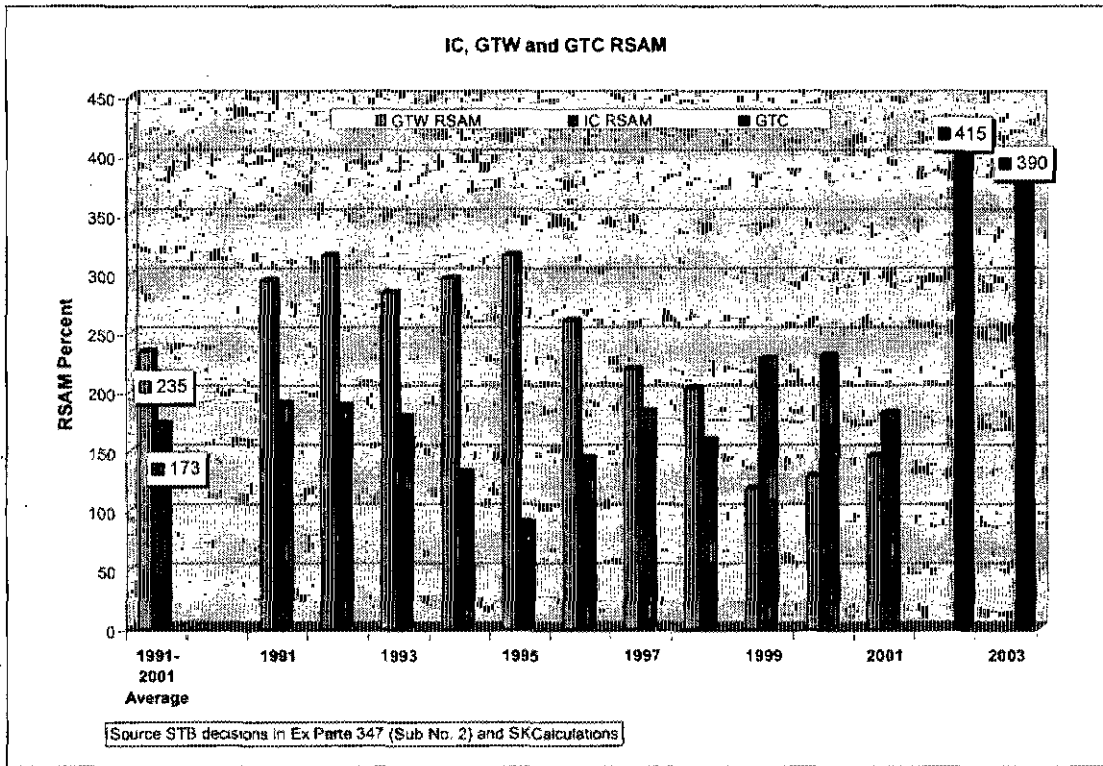
As the preceding chart indicates, the IC has produced low levels of RSAM since the inception of the measure. The GTW RSAM, while higher in some years, has also been at moderate levels. Over the 1991 – 2001 period the average IC RSAM was 173 percent and the average GTW RSAM was 235 percent.

The following chart reports the simple average RSAM of IC and GTW.



The preceding chart shows that on average the combined values of the IC and GTW RSAM averaged 204 percent. The two individual RSAM's would have been applied separately. The combined average is merely for comparison purposes; to assist in evaluating the GTC RSAM introduced in 2002

The GTC RSAM, as shown in the following chart, is much higher than either the IC or GTW RSAMs. This is an incongruous result given the fact that the GTC is presented as a combination of the IC, the GTW and the Wisconsin Central (WC). As we will show, the WC is a low cost railroad with less revenue than either the IC or the GTW. The WC can not be the cause of the dramatic upward surge in GTC RSAM. That GTC RSAM discontinuity is both unsupported and unexplained.



The disconnect between the predecessor IC and GTW RSAM's and the successor GTC RSAM's is abundantly clear. Inclusion in GTC of the Wisconsin Central (WC) does not explain the difference and the disconnect. WC is a low cost carrier. By definition, as a Class II carrier, WC has revenue levels well below the Class I IC and GTW. As shown in the following table, WC is a very low cost carrier by Class I standards, posting operating ratios as low as 73 percent in recent years.

Wisconsin Central Operating Ratio					
Line	1996	1997	1998	1999	2000
1 Revenues (\$ Thousands)	\$ 278,397	\$ 333,510	\$ 344,062	\$ 362,744	\$ 372,114
2 Rail Operating Ratio	81%	77%	73%	75%	75%

Source: Wisconsin Central 2000 10-k

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The core issue in these incongruous results is the accounting of the CN-GTC<sup>8</sup> costs. These costs flow into the calculation of the Uniform Rail Costing System (URCS) unit costs, and the URCS costs are used to calculate the STB's Ex Parte 347 sub-2 benchmark parameters.<sup>9</sup> Higher URCS unit costs lead to lower Revenue to Variable Cost (R/VC) ratio for given lanes. Lower R/VC's move more traffic below the 180% R/VC (or Revenue Cost Ratio- RCR) threshold. This in turn leads to a higher RSAM benchmark. Higher RSAM benchmarks make a small shipment rate case less feasible. Based on SK initial review, the 2004 CN/GTC URCS unit costs, while lower than previous years, are still well above other Class I Railroads unit costs<sup>10</sup>. This result runs counter to all the available evidence which shows CN as the lowest cost railroad in North America.

The following table shows CN operating ratios, consistently the lowest in the North American Rail industry.

Line	CN Financial Data					
	1995	1996	1997	1998	1999	2000
1 Revenues (cn\$ millions)	\$ 3,862	\$ 3,911	\$ 4,283	\$ 5,137	\$ 5,236	\$ 5,428
2 Operating Expenses	\$ 3,437	\$ 3,323	\$ 3,355	\$ 3,856	\$ 3,769	\$ 3,780
3 Rail Operating Ratio (Ln. 2 / Ln. 3)	89%	85%	78%	75%	72%	70%
	2001      2002      2003      2004      2005					
1 Revenues (cn\$ millions)	\$ 5,652	\$ 6,110	\$ 5,884	\$ 6,548	\$ 5,354	
2 Operating Expenses	\$ 3,872	\$ 4,240	\$ 4,107	\$ 4,380	\$ 3,448	
3 Rail Operating Ratio (Ln. 2 / Ln. 3)	69%	69%	70%	67%	64%	

Notes: 1 - 1995 to 1997 figures exclude the IC  
 2 - 1998 figures have been presented on a pro - forma basis. Pro forma refers to the consolidation of the financial data of Illinois Central Corporation (IC) assuming the acquisition and control of IC occurred on January 1, 1998  
 3 - The 2001 figures include Wisconsin Central Transportation Corporations from October 9, 2001  
 4 - 2004 includes Great Lakes Transportation LLC's railroads and related holdings (GLT) and BC Rail from May 10 and July 14, respectively  
 5 - 2005 reflects the first 9 months of the year

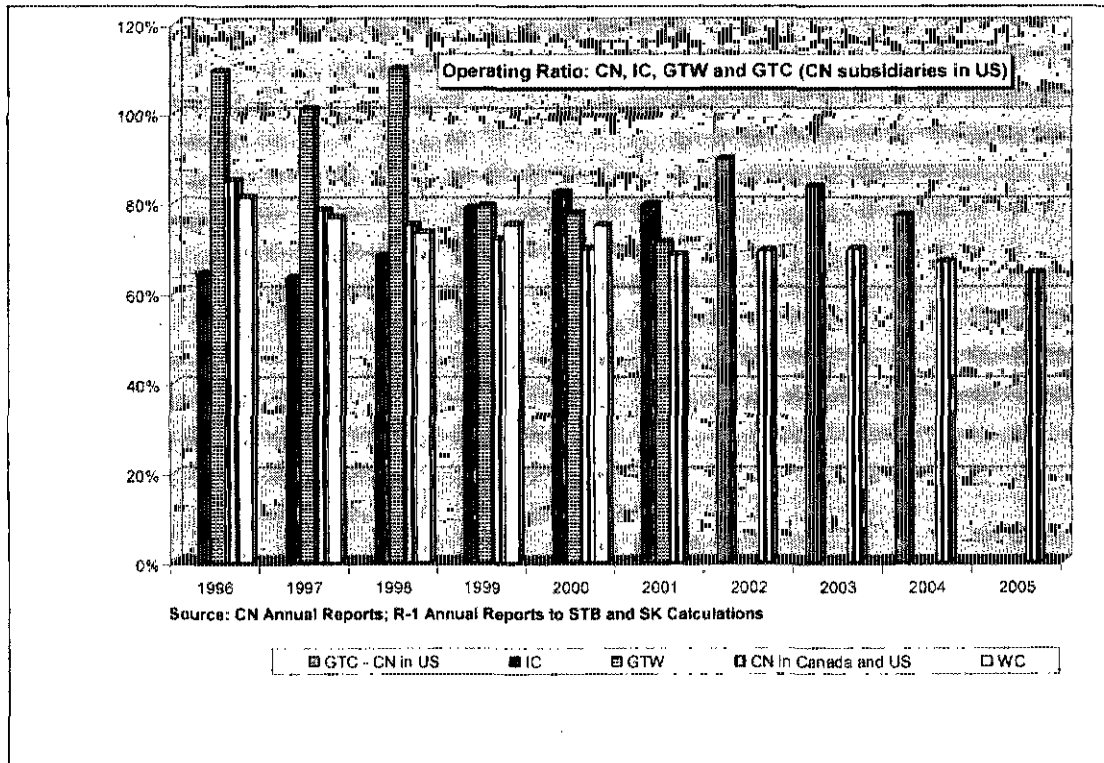
Source: CN Investor Fact Books and Annual Reports 2000 to 2005

The following chart presents the operating ratios of all of the carriers involved in the GTC RSAM; CN, IC, GTW, WC and GTC, which is CN subsidiary operations in the US consisting of the combination of IC, GTW and WC. The operating ratio data stands in clear contrast to the inexplicable surge in GTC RSAM.

<sup>8</sup> CN-GTC is the subsidiary of the Canadian National (CN). The CN-GTC is made up of the Illinois Central, Grand Trunk Western, and the Wisconsin Central.

<sup>9</sup> URCS is the Uniform Regulatory Costing System adopted as the standard rail costing system by the ICC and the STB and all Class I railroads.

<sup>10</sup> Further analysis of CN-GTC 2004 Unit costs is needed



With the sole exception of the GTW during the 1996 -1998 period, all of these carriers show consistently low operating ratios. Such operating ratios are inconsistent with the egregiously and inexplicably high 2002 and 2003 GTC RSAM's.

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Before any CN shipper makes a decision to go forward with a rate complaint, the unexplained CN-GTC accounting anomalies and the related incongruous RSAMs need to be resolved. That simple fact has led to the filing of this complaint under the auspices of STB Ex Parte 587.

In Ex Parte 587 the STB adopted final Information Quality Guidelines (I.Q. Guidelines). As the STB stated in its October 1, 2002 decision, the I.Q. Guidelines set out STB management procedures for reviewing and substantiating the quality of information before it is disseminated to the public. The guidelines also contain the procedures for obtaining a correction of information that does not comply with the I.Q. Guidelines. We are following and applying those procedures for obtaining a correction of GTC RSAM factors.

Since the consolidation of CN's US railroad operations we have found recurring issues with the CN allocation of costs in its US regulatory STB filings. The STB R-1 filings are used in the calculation of URCS and the RSAM benchmark. The anomalies and the resulting higher unit costs have put CN's US subsidiaries out of reach of the Surface Transportation Board's rate reasonableness regulatory procedures. Moreover, use of data from the R-1 filings in commercial negotiations with GTC can put all GTC shippers, including SK clients, at a significant disadvantage. Simply put, the apparently incorrect GTC data prevents accurate analysis of rates either in negotiations or in litigation.

Prior to any rate reasonableness cases against CN, the accounting issues need to be addressed, and they are best addressed separately from those cases. Raising the accounting issues in a rate reasonableness proceeding or choosing to use a substitute set of unit costs such as IC or Region 4 (East) unit costs would complicate the process and could lead to prolonged litigation with a needlessly uncertain outcome. Accordingly we have brought the defective data for correction in this Information Quality proceeding.

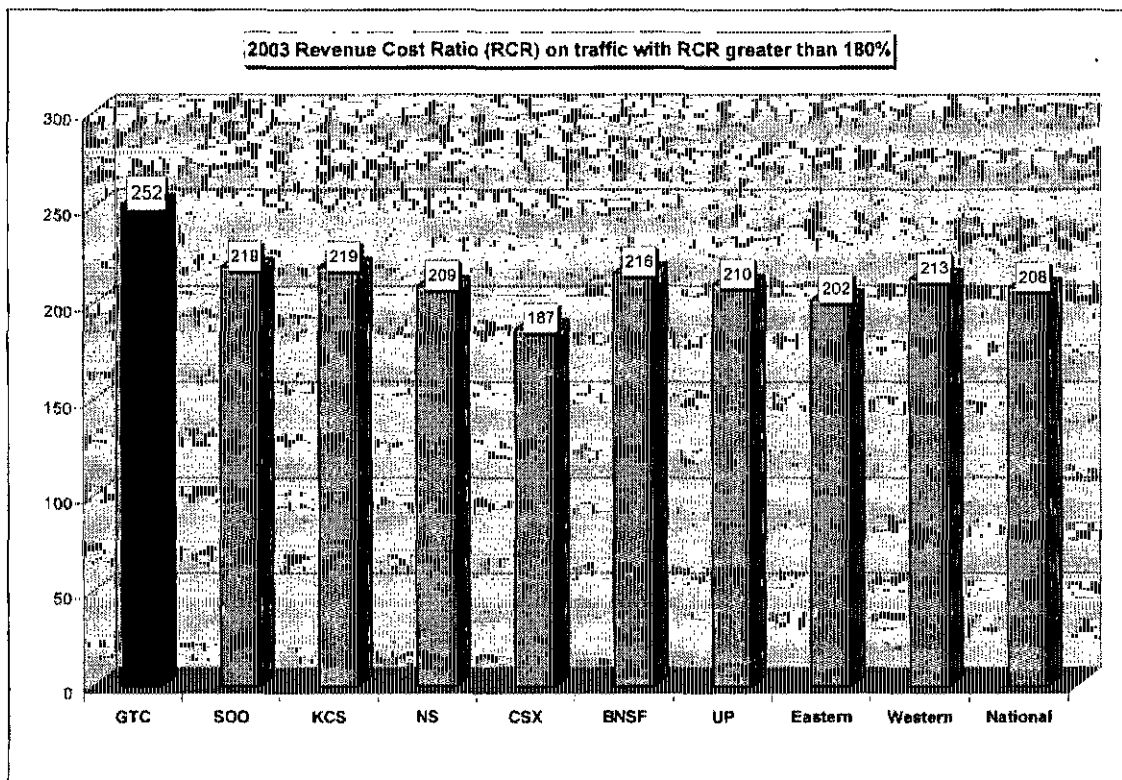
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In contrast to the RSAM pattern, we see more moderate results when we examine the GTC pattern for actual RCR's above 180%; as the following table and chart shows.

<b>Actual Average Mark-up Percentages for Traffic Above 180% R/VC</b>					
<b>Railroad / Region</b>	<b>4 - Year Average</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>
<b>GTC</b>		<b>252</b>	<b>228</b>		
<b>SOO</b>	<b>227</b>	<b>219</b>	<b>205</b>	<b>256</b>	<b>228</b>
<b>KCS</b>	<b>241</b>	<b>219</b>	<b>238</b>	<b>263</b>	<b>242</b>
<b>NS</b>	<b>212</b>	<b>209</b>	<b>221</b>	<b>219</b>	<b>200</b>
<b>CSX</b>	<b>194</b>	<b>187</b>	<b>207</b>	<b>192</b>	<b>191</b>
<b>BNSF</b>	<b>252</b>	<b>216</b>	<b>258</b>	<b>266</b>	<b>266</b>
<b>UP</b>	<b>226</b>	<b>210</b>	<b>236</b>	<b>234</b>	<b>222</b>
<b>Eastern</b>		<b>202</b>	<b>214</b>		
<b>Western</b>	<b>238</b>	<b>213</b>	<b>247</b>	<b>249</b>	<b>242</b>
<b>National</b>		<b>208</b>	<b>234</b>		

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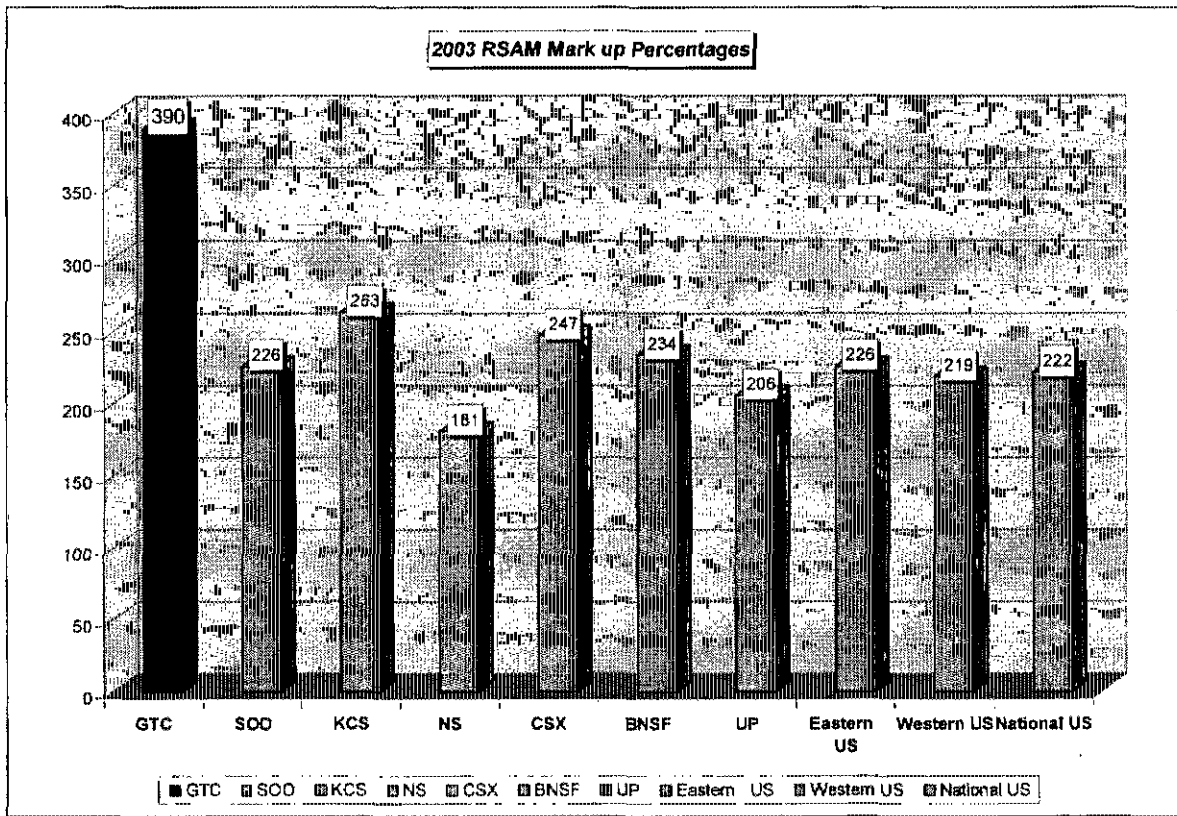
The following charts report the RCR>180 data, for each railroad or region:



The pattern for RCR>180 is clearly different from the incongruous and unexplained RSAM pattern, which is shown in the following chart:

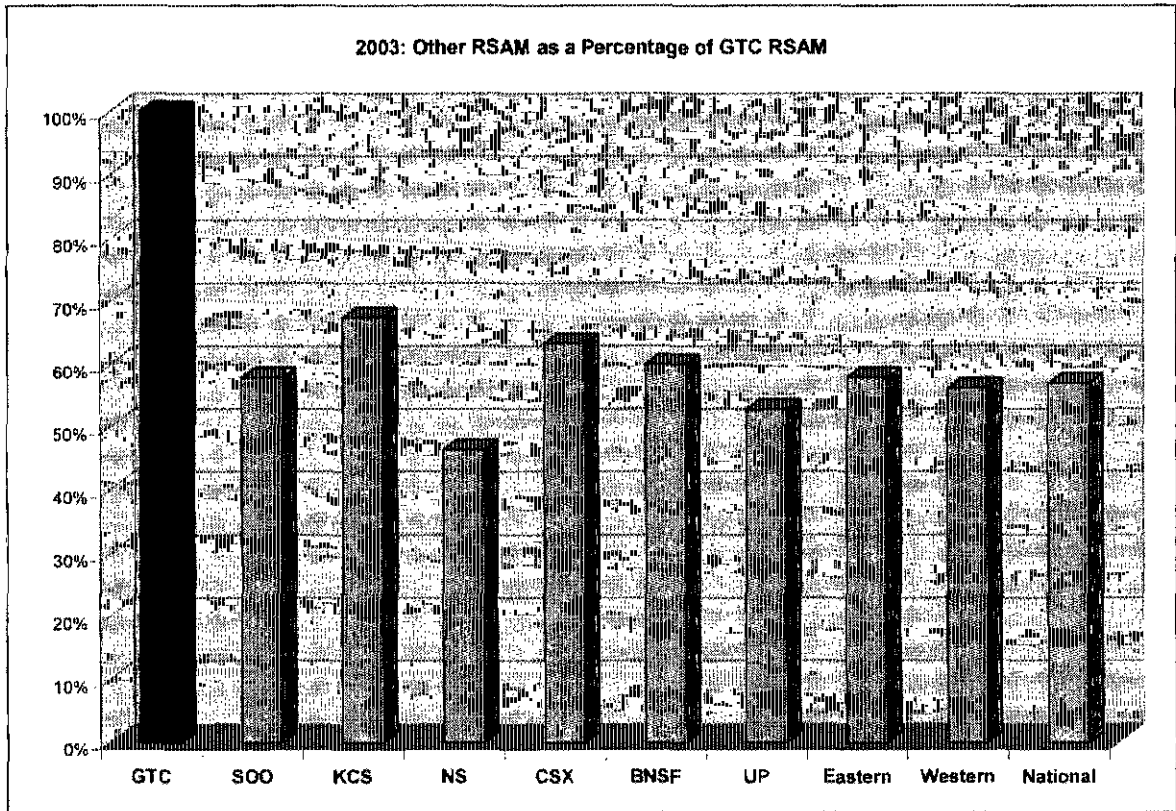
<b>RSAM With efficiency Adjustment As % of GTC RSAM</b>			
		<b>2003</b>	<b>2002</b>
<b>GTC</b>		<b>100%</b>	<b>100%</b>
<b>SOO</b>		<b>58%</b>	<b>57%</b>
<b>KCS</b>		<b>67%</b>	<b>64%</b>
<b>NS</b>		<b>46%</b>	<b>43%</b>
<b>CSX</b>		<b>63%</b>	<b>54%</b>
<b>BNSF</b>		<b>60%</b>	<b>66%</b>
<b>UP</b>		<b>53%</b>	<b>47%</b>
<b>Eastern</b>		<b>58%</b>	<b>52%</b>
<b>Western</b>		<b>56%</b>	<b>54%</b>
<b>National</b>		<b>57%</b>	<b>53%</b>

GTC RCR>180 parameters are high. However some railroads or regions came close to GTC in 2002 in terms of RCR>180. In stark contrast, no other railroads or regions have RSAM results anywhere close to the CN GTC. Again the GTC RSAM data fail to pass the test of reasonableness.



The preceding graph and the following graphs show quite clearly the imbalance in GTC RSAM data:

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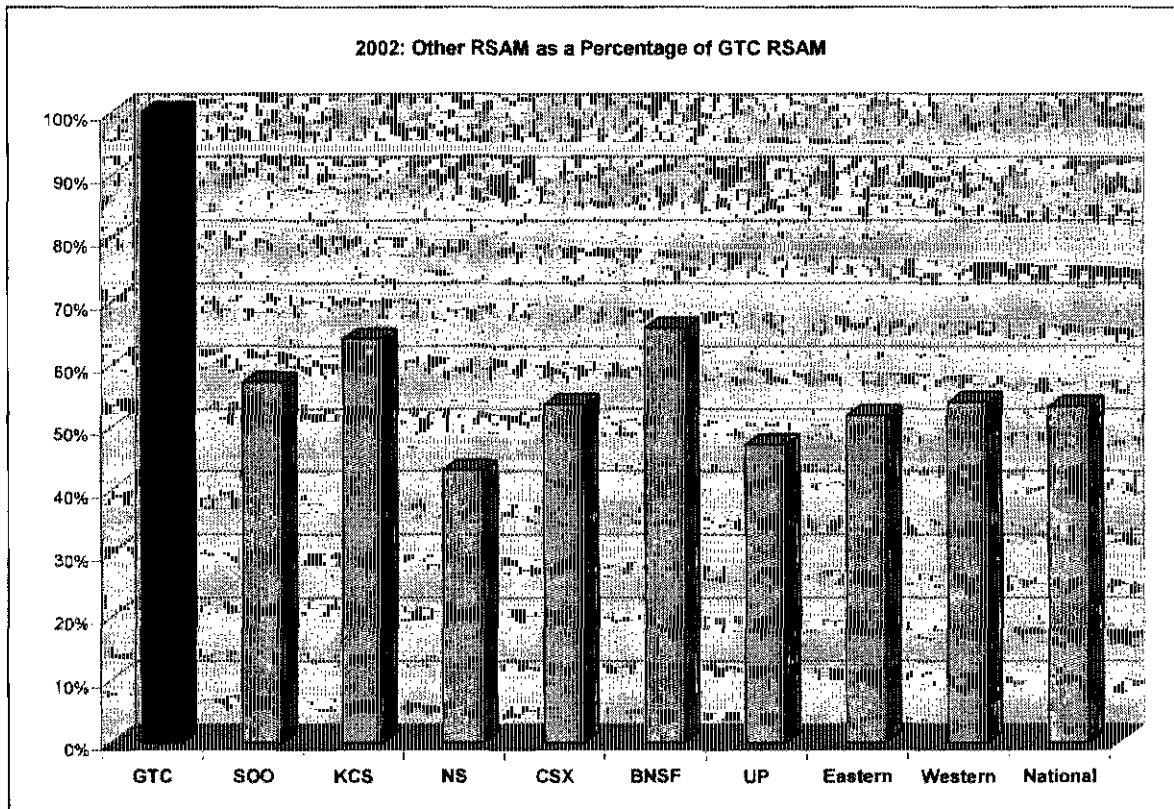
The GTC RSAM bears no resemblance to the RSAM's of any other railroad or region, or to the US rail industry as a whole.

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1220 L St NW Washington, DC, 20005  
202 371-9149 ■ [www.Snavely-King.com](http://www.Snavely-King.com) ■ email [skmoltom1@aol.com](mailto:skmoltom1@aol.com)



We see the same disturbing pattern in the 2002 GTC RSAM data:



The GTC RSAM parameters bear little resemblance to the other RSAM results.

**Regulatory Policy Implications**

The regulatory policy implications of these findings are significant. The absence of accurate GTC RSAM parameters is a clear break with the STB IQ Guidelines. Moreover, this defective data renders the CN immune from small shipment rate reasonableness review. This immunity from regulation places CN shippers at a distinct disadvantage compared to shippers served by other carriers. Both railroads and shippers are harmed by the incorrect data. The CN immunity from regulation places other railroads at a distinct disadvantage since, unlike CN, those other railroads are subject to STB small shipment rate reasonableness review.

Snavely King requests expedited review by the Surface Transportation Board of the data and evidence presented in this filing. Our client and many other US rail shippers are seriously disadvantaged by rate increases imposed by the GTC, without recourse to STB small shipment rate reasonableness review.

**Surface Transportation Board (STB) Large Case Rate Regulation Access Criteria**

To qualify for rate reasonableness review the traffic at issue must meet the following criteria:

- The revenues generated by that rate are more than 180% of the variable costs associated with handling the traffic involved.
- The traffic is not under contract. Under 49 U.S.C. 10709(c), the reasonableness of a contract rate cannot be challenged.
- The commodity is not exempt. Rates for some traffic and services are exempted from regulation pursuant to 49 U.S.C. 10502 or its predecessor (former 49 U.S.C. 1050).
- The qualitative market dominance limitation of 49 U.S.C. 10707(a)-(b) requires that the traffic not have access to effective transportation competition.
- The traffic is not exempted under the grandfather provision of section 229 of the Staggers Act, which conferred regulatory immunity upon the rate levels that were in place at that time and not successfully challenged by a certain date.

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As noted above, the lanes we have analyzed meet these criteria.

**Eligibility for Small Shipment Rate Reasonableness Review**

To determine eligibility for the STB small shipment rate reasonableness review, we briefly summarize in the following table, how the GTC lanes would meet the criteria for access to STB rate reasonableness assistance and show how the GTC RSAM errors disadvantage the GTC shippers and other railroads.

**Surface Transportation Board (STB) Small Shipment Case Rate Regulation Criteria**

<b>Check List of Requirements to Secure STB Rate Reasonableness Assistance</b>	
<b>1</b>	The lane(s) must meet the Revenue Cost Ratio (RCR) threshold criteria for access to rate regulation.
<b>2</b>	The lane(s) must meet and does meet the requirement that the lane not be under contract. The prior contract on the lane expired on [REDACTED], 2005 and GTC has declined to offer an acceptable contract at this time.
<b>3</b>	<p>The lanes also meet the STB simplified guidelines recommended by SK in July 2004 testimony, based on three revenue-to-variable cost (RVC or RCR) benchmark figures as starting points for a case-by-case reasonableness analysis.</p> <ul style="list-style-type: none"> <li>• SK has reviewed some of the work papers underlying the RSAM's. Concurrently with this petition, SK has requested access to all of the STB data and workpapers underlying the STB Ex Parte 347 Sub No. 2 RCR and RSAM parameters. SK has also requested access to the entire costed STB waybill sample to enable us to review and analyze the RCR's on comparable rail freight. Such data is necessary to evaluate compliance with the Long Cannon factors mandated by the Staggers Rail Act.</li> </ul>
<b>3</b>	<ul style="list-style-type: none"> <li>• The STB Revenue Shortfall Allocation Method (RSAM) benchmark reflects the carrier's particular revenue needs by examining the average markup that the carrier might charge its potentially captive traffic to meet those needs.</li> <li>• SK has identified serious flaws in the GTC RSAM data, which preclude use of that data in rate reasonableness reviews.</li> <li>• The IC and GTW RSAM markups bear little relationship to the GTC RSAM markups which were offered as the combination of IC, GTW and Wisconsin Central.</li> </ul>
	<ul style="list-style-type: none"> <li>• With the efficiency adjustment, the IC RSAM markups ranged from 90% to 231%.</li> <li>• With the efficiency adjustment, the GTW RSAM markups ranged from 118% to 316%.</li> <li>• The 2002 – 2003 GTC RSAM markup was significantly above this level and ranged from 390% to 415%.</li> <li>• The 1991 – 2001 Simple Average of the IC + GTW RSAM markup is 204%.</li> <li>• The 2002- 2003 average GTC markup is almost double the predecessor level: 403%.</li> <li>• The increase in the GTC RSAM is not explained by the addition of the Wisconsin Central which is a low cost carrier.</li> </ul>

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<b>Check List of Requirements to Secure STB Rate Reasonableness Assistance</b>	
3b	<ul style="list-style-type: none"> <li>The STB Revenue Variable Cost Actual Average Mark Up Percentage (RCR&gt;180) benchmark reflects the carrier's actual average markup that the carrier charges on traffic with RCR above 180%. The RVC&gt;180 benchmark tests whether the traffic at issue bears a disproportionate share of the carrier's revenues by examining the markups applied by the carrier to its other potentially captive traffic. The 2002 GTC RCR&gt;180 markup was 252% in 2003 and 228% in 2003.</li> </ul>
3c	<ul style="list-style-type: none"> <li>The STB process also may use a Revenue Variable Cost Mark Up Percentage on comparable traffic (RVC comp or RCR comp). The RCR comp benchmark reflects demand-based differential pricing principles (by measuring the markups applied to similar traffic). This benchmark reflects the defendant carrier's actual average markup that the carrier charges on traffic similar to the issue traffic.</li> </ul>
	<ul style="list-style-type: none"> <li>SK has requested access to the costed STB waybill sample to test and validate this benchmark.</li> <li>The requested complete access to the waybill sample is vital to evaluating the application of the Long Cannon factors</li> </ul>
4	<ul style="list-style-type: none"> <li>After resolving the accounting and RSAM issues we will demonstrate that on this lane the SK client does <u>not</u> have access to effective transportation competition. The effective transportation competition test determines whether the traffic at issue could move by competing rail or by alternative modes</li> </ul>
4a	<ul style="list-style-type: none"> <li>SK analyses rule out truck, barge and pipeline competition based on interviews with the SK client managers. Those interviews focused on product characteristics, investment in loading and unloading facilities, road and bridge conditions, road congestion, difficulties associated with permitting and other impediments.</li> </ul>

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The preceding table shows the central role of the RSAM and the disabling effect of the misstated RSAM factors. All CN rail shippers are disadvantaged by this error. Moreover the GTC RSAM error also disadvantages all other railroads subject to STB rate reasonableness review. Accordingly, the data deficiencies in the GTC's RSAM factors must be resolved before any GTC rate reasonableness review can proceed.

### **III. Summary**

We conclude with the main point of this filing. Small shipment rate reasonableness reviews are based on the availability of reliable and accurate data. We have shown that the GTC RSAM data is deficient in both areas. The data are neither accurate nor reliable. That data quality gap must be filled before any STB rate reasonableness review involving GTC can proceed.

The STB Information Quality Guidelines set forth three main aspects of information quality:<sup>11</sup>

- Utility and usefulness
- Objectivity- accuracy, completeness, reliability, clarity and lack of bias
- Integrity

The evidence indicates that the CN GTC RSAM data fails on all of these counts.

The STB and GTC data we have presented shows clearly the disabling effect of the misstated GTC RSAM factors. Not only the SK client, but All CN rail shippers are disadvantaged by this error. Moreover the GTC RSAM error also disadvantages all other railroads which have reported accurate and reliable data for use in the STB rate reasonableness review.

This is a serious, pervasive and persistent error. We request prompt review of the RSAM data and processes reflected in the GTC RSAM parameters and we request correction of the errors in those data and processes.

Respectfully Submitted,

Tom O'Connor

cc: Chairman Buttrey  
Vice Chairman Mulvey

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<sup>11</sup> STB Decision, Ex Parte 587, October 1, 2002

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Economic and Management Consultants

Jan. 12, 2006

#### IV. VERIFICATION

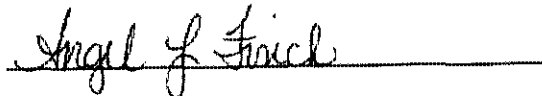
I, Tom O'Connor, declare that the foregoing statement is true and correct and was prepared by me or at my direction. Further, I certify that I am qualified and authorized to file this statement.

Executed on January 12, 2006.



Tom O'Connor

Subscribed and sworn to before me this 12th day of December 2006 in the District of Columbia.



Notary Public

My Commission expires: March 14, 2006

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Jan. 12, 2006

**Certificate of Service**

I certify that this filing was served this day on all parties of record by first class US Mail or more expeditious method of delivery.

January 12, 2006.



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Tom O'Connor

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1220 L St NW Washington, DC, 20005  
202 371-9149 ■ [www.Snavely-King.com](http://www.Snavely-King.com) ■ email [skmoltom1@aol.com](mailto:skmoltom1@aol.com)



**V. Capabilities**

**Resume**

**Of**

**Tom O'Connor  
Vice President**

**Snavely King Majoros O'Connor & Lee, Inc.**

**1220 L St NW  
Washington DC 20005**

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**Snavely King Majoros O'Connor & Lee, Inc., Washington, DC****• Vice President (1988-Present)**

Mr. O'Connor has more than twenty-five years experience in business and economic analysis. His experience includes key and increasingly responsible management and policy positions with government agencies and private industry.

Mr. O'Connor has authored a series of guidelines on transportation negotiations and contracting and has conducted transportation negotiations and contracting seminars for a wide range of clients. Mr. O'Connor has also designed and helped lead transportation contract negotiations resulting in tens of millions in cost savings.

Mr. O'Connor has also appeared as an expert witness in successful Stand Alone Cost (SAC) transportation rate litigation, achieving millions of dollars in savings for the client.

He has also created and managed numerous computerized transportation management and regulatory systems to address complex problems and is a widely recognized expert on costing and economics.

He has conducted extensive analyses of truck transportation as well as analyses of tug and barge operations, both inland and off shore, for private sector clients.

Mr. O'Connor has conducted analyses for the Government of Canada used to shape policy for freight transportation and studies for the U.S. Government used to shape Freight and Passenger transport Policy.

For the Government of Bulgaria, in the Balkans, he developed the Master Plan for Management Information Systems, including telecom and computer facilities designed to operate, measure, manage and monitor both rail freight and rail passenger operations of the Bulgarian State Railways, in Bulgaria and the Balkan peninsula.

Mr. O'Connor has analyzed more than 45 rail merger scenarios and cases. He has provided expert testimony before state and federal courts and commissions in the U.S. and Canada on economic and policy issues. He has also testified as an expert on computerized transportation analytical systems, rail operations, anti trust issues and transportation economics and costing. Mr. O'Connor has served

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Economic and Management Consultants

Jan. 12, 2006

as an impartial and expert monitor of data and processes at issue in litigation on transportation.

Mr. O'Connor has also conducted management audits, focused on identifying the cause and effect relationships underlying claimed cost incidence. The management audits were directed toward testing the cost basis of claims asserted by major railroads.

His experience in telecoms spans the period since 1995. During this period, on a succession of government and commercial projects, Mr. O'Connor directed and participated in the review, design and operation of telecoms systems.

He also designed and developed the business and operations plan for an Eastern European telecoms startup company, BDZCOM. Mr. O'Connor designed and presented the plan and conducted liaison with international commercial, banking and government interests in the United States and Europe.

#### **DNS Associates Inc., Washington, DC**

- **Vice President (1982 - 1988)**

Mr. O'Connor directed and participated in numerous projects including merger analyses, transportation infrastructure analyses, plant and network rationalization and feasibility studies.

He designed and implemented mainframe and microcomputerized systems for analyzing rail, truck load, LTL and barge logistics. The computerized cost systems Mr. O'Connor created gained widespread use throughout the United States and Canada.

Mr. O'Connor also advised the U.S. Rail Accounting Principles Board on the costing aspects of regulatory reform policies.

He provided expert testimony on coal rates, computerized data bases and cost systems and rail cost issues before the Interstate Commerce Commission.

#### **Association of American Railroads, Washington, DC**

- **Assistant Vice President, Economics (1979 - 1982)**

Managing a large staff of professionals, Mr. O'Connor designed and managed major economic analysis projects. He helped formulate industry economic policy positions culminating in the Staggers Rail Act of 1980. He submitted expert

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testimony on behalf of the railroad industry in numerous cases before the Interstate Commerce Commission and state regulatory commissions. He also appeared regularly in national forums on economic issues.

Mr. O'Connor directed the most significant computerized industry Costing System project in 40 years, URCS, the cost system now used by all major US railroads. He also conducted industry seminars on URCS and related economic issues.

Mr. O'Connor also testified before the Interstate Commerce Commission on the design and application of this pathbreaking rail cost system since adopted by the Commission and the rail industry.

He also directed development and installation of a commercial computerized economic and market analysis system now used by virtually all major US railroads.

#### **Consolidated Rail Corporation, PA**

- **Assistant Director, Cost & Economics (1977 - 1979)**

Managing a staff of about 30 professionals, Mr. O'Connor was responsible for all Conrail management and regulatory cost analyses in both freight and passenger areas. He testified before the ICC on the development of subsidy standards now widely used in the US railroad industry.

He also finalized the design, installed and managed Contribution Simulator and Calculator (COSAC), a computerized internal management economic analysis system at Conrail. The COSAC system uses specific management accounting data to develop economic costs. COSAC replaced earlier systems and was used to guide virtually all transportation management decisions, including service design, equipment acquisition, strategic initiatives, line abandonments and service discontinuance.

Mr. O'Connor also participated in cost allocation negotiations between Amtrak and Conrail on cost sharing of joint facilities on the North East corridor. He initiated and directed profit maximization and plant rationalization programs. He also designed and implemented computerization and improvement of a wide range of economic and cost analysis systems used to manage and turn around this multi-billion dollar corporation.

**R.L. Banks & Associates Inc., Washington, DC**

- **Consultant (1976 - 1977)**

Mr. O'Connor conducted and directed numerous transportation- related projects in the U.S. and Canada ranging from national logistics analyses to site-specific studies. He specialized in costing systems and appeared as an expert witness on such systems in a precedent setting proceeding before a Canadian Crown Commission.

**U.S. Railway Association, Washington, DC**

- **Manager, Local Rail Service Planning (1974 - 1976)**

In a project of unprecedented scope and historic implications, Mr. O'Connor developed, computerized, and implemented the light density lines cost analysis system, which defined Conrail. This system was used to reach line service decisions for thousands of miles of track, including service throughout New York. He served as liaison with congressional staffs and shipper groups, as well as federal, state, and local governments, and planning agencies. The system he created was a major element in the design and implementation of the streamlined Midwest-Northeast regional rail system. After leaving USRA, Mr. O'Connor subsequently was called back to appear as an expert witness to present and defend the operation of the USRA costing system.

**Interstate Commerce Commission,**

- **Economist, Washington, DC (1973-1974)**

Mr. O'Connor served as a staff economist and authored a report analyzing industry investment patterns and ICC regulatory policy, including ICC use of cost evidence.

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**Education**

- University of Massachusetts, Amherst, B.A. Economics
- University of Wisconsin, Graduate Course Work, Economics
- University of Delaware, Graduate Course Work, Business Management
- The American University, Graduate Course Work, Computer Science

**Professional Organizations**

- Transportation Research Board
  - Past Chairman of the Transportation Regulation Committee
- Transportation Research Forum
  - Past President of the Cost Analysis Chapter
- National Defense Transportation Association
  - Past Member of Board of Directors, National Capital Chapter

**Academic honors**

- Phi Kappa Phi academic honors society
- Phi Beta Kappa academic honors society

**Military**

- U.S. Army; Sergeant, Combat Engineers

**Security Clearance**

- Secret

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1220 L St NW Washington, DC, 20005  
202 371-9149 ■ [www.Snavely-King.com](http://www.Snavely-King.com) ■ email [skmoltom1@aol.com](mailto:skmoltom1@aol.com)

**Summary of Expert Testimony**

**Of**

**Tom O'Connor  
Vice President**

**Snavely King Majoros O'Connor & Lee, Inc.**

**1220 L St NW  
Washington DC 20005**

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Tom O'Connor is Vice-President of Snavely King Majoros O'Connor & Lee (Snavely King), an economic and management consulting company. He has been engaged in the business of economic analysis for more than thirty years, beginning in 1973 as an economist with the Interstate Commerce Commission (now the Surface transportation Board) and later in economic consulting and management positions of increasing responsibility with the United States Railway Association, Conrail, the Association of American Railroads and, from 1982 through 1988 with DNS, Associates and since 1988 with Snavely King Majoros O'Connor & Lee, (Snavely King), an economic and management consulting company focusing on telecommunications and transportation. Mr. O'Connor was Vice President and principal at DNS Associates and has been Vice President and principal of Snavely King since joining the firm in 1988.

He has provided testimony in a number of proceedings before courts and regulatory commissions in the United States and Canada including:

- Interstate Commerce Commission,
- Surface Transportation Board,
- United States Railway Association,
- Regulatory Commission in Indiana,
- Regulatory Commission in New York,
- Regulatory Commission in Pennsylvania,
- State Court in Indiana,
- State Court in Montana,
- State Court in Virginia,
- Arbitration Panel in New York
- Mediation Panel in Massachusetts
- Mediation Panel in Washington
- Canadian Crown Commission.
- US District Court for Eastern District of Virginia,
- US District Court for Arizona

Tom O'Connor's practice centers on transportation with specific focus on litigation, negotiations and infrastructure issues including rationalization and redesign of the railroad infrastructure in the US as well as rebuilding of the railway infrastructure in Eastern Europe. Mr. O'Connor's work in Eastern Europe focused on both transportation and telecommunications.

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**Tom O'Connor Testimony in Federal Regulatory Cases**

- **The comparative merits of the Interstate Commerce Commission's Uniform Rail Costing System (URCS) and Cost Center Accounting** submitted to the ICC on behalf of the US Railroad industry in February 1980 in Docket No. 37203.
- **The economics and computer technology of the Light Density Line Methodology used to define Conrail**, submitted to USRA before a special hearing in 1980.
- **Computerized transportation database design and use.** Verified statement was submitted to ICC on behalf of the US Railroad industry in Nov 1980 in Ex Parte No. 385.
- **The comparative merits of two regulatory rail-costing systems, URCS and Rail Form A**, submitted to the ICC on behalf of the US Railroad industry in March 1981, in Ex Parte 399.
- **Testimony on the Preliminary 1979 Rail Cost Study as released by the ICC, calling for adopting and improving URCS.** This was submitted to the ICC on behalf of the US Railroad industry in Docket No. 37203 in February 1982.
- **Rail costing using Rail Form a costs applied to service units generated by a computerized rail network model.** This verified statement was submitted to the ICC on behalf of a shipper located in Nevada in July 1985 in ICC Docket Nos. 37809 and 37815S.
- **Rail costing, also using Rail Form A costs applied to service units generated by computerized network model.** This verified statement was submitted to ICC on behalf of a shipper located in Nevada in November, 1986 in Docket No. 37809, 37815S.
- **Stand Alone Rail Costing, for use in rate reasonableness, using service units developed with a series of computerized network model.** This verified statement was submitted to the ICC on behalf of the Association of American Railroads in September, 1988 in Docket No. 38239S

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- **Rail merger conditions, developed using rail costs and a computerized network model.** This verified statement was submitted to the ICC in March 1994 in Finance Docket No. 21215 (Sub. No. 5)
- **The effects of computerized methods on rail operations and costs.** This verified statement was submitted to the ICC on behalf of Coletto Creek Utility in July 1994 in Docket No. 41242.
- **The cost of rail coal transportation using URCS costs and A Stand Alone Network.** This verified statement was submitted to the ICC on behalf of West Texas Utilities in April 1995 in Docket No. 41191.
- **Further testimony on the cost of rail coal transportation using URCS costs and a Stand Alone Network.** This verified statement was submitted to the ICC on behalf of West Texas Utilities in July 1995 in Docket No. 41191.
- **Oral Argument on the effects of the BN-SF merger on rail costs and service presented before the full Commission in August, 1995** on behalf of Universal Forest Products in Finance Docket No. 32549.
- **The effects of the UP-SP merger on costs, infrastructure and operations.** Verified statement was submitted to ICC on Behalf of Kansas City Southern Railroad in March 1996 in Finance Docket No. 32760.
- **Competitive truck transportation market.** Joint Verified Statement with James Wells was submitted to Surface Transportation Board (STB) on behalf of TJ MAXX on June 22, 1998 in Docket No. 41192
- **The investment plans of UP-SP to remedy effects of the UP-SP merger.** Verified statement was submitted to STB on Behalf of Kansas City Southern Railroad in June, 1998 in Finance Docket No. 32760 UP-SP Merger Oversight Proceeding
- **The Arkansas and Missouri Railroad Request For Discontinuance Waiver** Filed on Behalf of Kansas City Southern Railroad. Verified

STB Ex Parte No. 587

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statement was submitted to Surface Transportation Board (STB) in November 1998 in Finance Docket No. 32670.

- **Further testimony on the competitive truck transportation market.** Joint Verified Statement with James Wells was submitted to Surface Transportation Board (STB) on behalf of TJMAXX in January, 1999 in Docket No. 41192
- **Rail Merger Guidelines to develop new and improved merger analysis processes.** Verified statements were submitted to Surface Transportation Board (STB) on behalf of OxyChem, Oxy Vinyls, BASF and Williams Energy Services in May 2000 in Ex Parte 582.
- **Reply Testimony on Rail Merger Guidelines to develop new and improved merger analysis processes.** Reply Verified statements were submitted to Surface Transportation Board (STB) on behalf of OxyChem, Oxy Vinyls, BASF and Williams Energy Services in June 2000 in Ex Parte 582.
- **Testimony on Rail Costs and Rates.** Verified statement was submitted to Surface Transportation Board (STB) on behalf of Peabody Energy Company June 2003 in Docket 42077.
- **Testimony on Rail Costs and Rates.** Verified statement was submitted to Surface Transportation Board (STB) June 2004 in Ex Parte 646.
- **Testimony on Rail Costs and Rates.** Oral testimony was presented to Surface Transportation Board (STB) July 2004 in Ex Parte 646.
- **Testimony on Rail Costs and Rates.** Written and Oral testimony was presented to Surface Transportation Board (STB) May and June 2005 on behalf of BP Amoco in STB Docket NOR 42093, the first ever small shipment rate case brought before the STB.

STB Ex Parte No. 587

**Tom O'Connor -- State, Regional and Canadian Testimony**

- **Expert Testimony Centering On Transportation Rates And Costs for transportation of Medicaid passengers.** This testimony involved research and development of computerized cost and rate analyses for medical passenger transportation service within Indiana. The evidence focuses on developing compensatory rates meeting market conditions and regulatory review. This evidence was developed and submitted on behalf of Medicaid transportation providers in September, 2005 with oral testimony at deposition in October 2005. The case was adjudicated in Superior Court, Marion County, Indiana. The court adopted the rates we proposed, deciding in favor of the Medicaid transportation providers in November, 2005.
- **Expert Testimony Centering On Transportation Rates And Costs And The Implications For Antitrust Matters.** This testimony involved research and development of computerized cost and rate analyses for rail and truck service to Arizona and surrounding areas. The evidence is focuses on resolving antitrust allegations regarding certain construction materials. This evidence was developed and submitted on behalf of Solcon in May, 2003 with oral testimony at deposition in 2003. The case was under adjudication as Case No. CIV 01 01269 PHX ROS, United States District Court for the District of Arizona and has been settled.
- **Expert Testimony Centering On Commuter Railroad Operations And Costs.** This testimony involved design and development of computerized costing models of commuter rail operations. The evidence was central to arbitration to resolve subsidy disputes between New York and Connecticut. This evidence was developed and submitted on behalf of Metro North Commuter Railroad in August 1996 with oral testimony presented in February 1997. The case was decided successfully in favor of the client.
- **Expert testimony centering on the effects of a series of explosions on transportation operations and costs.** This was submitted on behalf of Washington Construction Company in a damages case filed by Burlington Northern Railroad in state court in Montana, First Judicial District Court, and Cause Number ADV 91-

STB Ex Parte No. 587

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Economic and Management Consultants

Jan. 12, 2006

1885. The case went to a jury trial and was decided successfully in favor of the client in September 1993.

- **Expert testimony centering on computerized network models.** This was submitted in an antitrust case filed on behalf of Geoplex in U.S. District Court for the Eastern District of Virginia, *Geoplex Corporation v. CACI, Inc.* Civil Action No. 89-610-A. This evidence was developed and submitted in November 1989.
- **Expert testimony centering on transportation operations and costs.** This was submitted on behalf of the Canadian provinces of Alberta, Manitoba and Saskatchewan before a Canadian Crown Commission in a series of hearings held in Winnipeg, Manitoba and Regina, Saskatchewan in 1976. This led to an historic change in Canadian transportation regulation.
- In addition to these cases, while AVP of Economics at the AAR Mr. O'Connor submitted testimony on rail costs and operations on behalf of the rail industry before State regulatory commissions in Indiana, Pennsylvania and New York.

STB Ex Parte No. 587

# Attachment B

**SURFACE TRANSPORTATION BOARD  
OFFICE OF ECONOMICS, ENVIRONMENTAL ANALYSIS,  
AND  
ADMINISTRATION**

April 6, 2006

Mr. Charles W. King  
Snavely King Majoros O'Connor & Lee, Inc.  
Economic and Management Consultants  
1220 L Street, NW Suite 410  
Washington, DC 20005

Dear Mr. King:

This letter responds to your complaint, originally filed with this Board dated January 12, 2006 and perfected on February 6, 2006, in which you make a request for correction of errors pertaining to the consolidated costs of the Grand Trunk Corporation (GTC). Your request was referred to my Office by Marilyn Levitt, the Board's Information Quality Officer.

In your request you assert that the RSAMs for the GTC are extraordinarily and incorrectly high: due either to being incorrectly calculated or to being based on incorrect cost inputs. Specifically, you requested that the Board timely (1) investigate the revenue and cost reporting of the GTC; (2) correct the cost data; and (3) restate the RSAM benchmarks for GTC for both 2002 and 2003.

The complaint is accompanied by a report written by Mr. Tom O'Connor of your office. Mr. O'Connor provides a detailed examination of the RSAMs computed for the GTC and its predecessor railroads Illinois Central (IC) and Grand Trunk Western (GTW) for the years 1996-2003. In that report, Mr. O'Connor points out that the RSAM for GTC in 2002 is much larger than the RSAMs for both GTW and IC in 2001. He further points out that the acquisition of Wisconsin Central (WC) during that year could not possibly account for such a large difference in the RSAMs, as WC was a much smaller railroad. He concludes that a significant error in the computation of variable costs for GTC must have occurred. According to Mr. O'Connor, only such an error could lead to the observed increase in RSAM.

My Office has completed a thorough investigation of the cost inputs and calculation of the RSAM figures for the years 2002-2003. The cost inputs are developed from the waybill sample and the R-1 data filed by GTC. The R-1 annual report is verified by independent public accountants applying agreed-upon procedures developed by the Board. We found no material errors in the reporting of revenue and cost data by the GTC for the years cited in your complaint.

Further, we considered the possibility that changes in the techniques used to account for international traffic may have had an effect on the variable cost estimate. A significant change in that technique did occur between 2001 and 2002. We investigated that change in technique to determine if it could have skewed the estimate of variable costs for GTC. In 2001, variable costs were summed for all traffic terminating in the United States (traffic originating in the United States but terminating in Canada was excluded). In 2002, the technique was changed so that costs were summed only for the United States portion of every shipment. Analysis of the waybill data for the two years, however, indicates that the resulting changes were not significant enough to give rise to the RSAM differences cited in your request.

We find that your assertion that the GTC RSAM figures were "extraordinarily and incorrectly high" is not the result of erroneous cost inputs or an erroneous computation of variable costs, but rather, is caused by a revaluation of IC assets. When Canadian National (CN) acquired IC in 2000, its assets were revalued to reflect the purchase price CN paid to acquire IC. The revalued assets were significantly higher than the asset values that were carried on the books of the IC prior to the acquisition. This was a purchase accounting transaction recorded in accordance with the Board's Uniform System of Accounts (USOA).

For regulatory purposes, IC and GTW remained separate railroads reporting separate R-1's to the STB through year-end (December 31) 2001. In 2002, for the first time, GTC became the reporting carrier for R-1 purposes. The write-up of the IC assets was incorporated into the R-1 report of GTC, which, as the holding company for the US subsidiaries of CN, was the company that recorded the write-up at the time IC was purchased.

Writing-up the value of the assets leads to a higher RSAM for the following reasons:

1. When assets have a higher value, the annual depreciation and return on investment (capital) expense increases. This leads to higher variable costs. In URCS, equipment depreciation is 100% variable and road property depreciation is 50% variable.
2. A higher asset value leads to a higher Tax-Adjusted Net Investment Value. Multiplying this higher value by the railroad's cost of capital leads to a higher required profit.

Because of this large increase in the book value of the railroad, there was a large increase in the railroad's variable cost, a large increase in the railroad's fixed cost, and a large increase in RSAM. The following table shows the change in asset valuations from 1999-2003 for the IC, GTW, and GTC:

**Table 1. Tax Adjusted Net Investment Values for IC, GTW, and GTC  
(Dollars in Thousands)**

Year	GTW	IC	GTW+IC	GTC
1999	\$ 325,908	\$1,113,006	\$1,438,914	
2000	\$ 431,817	\$1,078,943	\$1,510,760	
2001	\$ 420,251	\$1,021,387	\$1,441,638	
2002				\$4,364,525
2003				\$4,439,085

The Tax Adjusted Net Investment Value of the GTC in 2002 was three times the value of the IC and GTW railroads taken together in 2001. As Mr. O'Connor pointed out in his report, this could not have been caused by the acquisition of the much-smaller WC. This was due, however, to the write-up in 2000 of the IC assets. This caused the variable capital expenses to increase by a large amount while remaining expenses (on a unit cost basis) remained rather flat.

The following table shows the cost per ton-mile for the waybills from GTW, IC, and GTC for 2001 and 2002. For 2001, the amounts are for GTW and IC added together. For 2002, the amounts are for GTC. The second column shows the variable portion of capital expenses per ton-mile, and the third column shows the remaining variable expenses per ton-mile. As Table 2 clearly shows, the non-capital variable expenses per ton-mile remained more stable between the two years, increasing less than 6%, while the variable capital expenses increased by more than 56%. The better stability of the non-capital variable expenses supports the conclusion that the change in waybill accounting methods did not have a major effect on the estimate of variable costs, while the dramatic increase in variable capital expense supports the conclusion that the write-up in value of the IC assets contributed strongly to an increase in variable costs.

**Table 2. Expenses per Ton-Mile for 2001 and 2002**

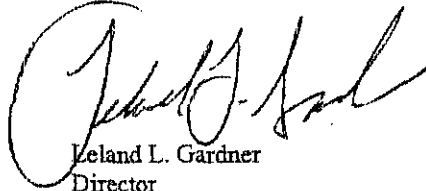
Year	Capital Expense per Ton-Mile	Remaining Expense per Ton-Mile
2001	0.35 cents	0.66 cents
2002	0.56 cents	0.70 cents



We believe that our analysis of the data and information, and our interpretation of the results, satisfactorily resolve the disputed elements outlined in your complaint. No materially significant errors were found in cost inputs used or in methodologies and calculations applied in the development of the RSAM numbers; therefore, no restatement of the RSAM is required.

We have fully complied with currently effective Information Quality Guidelines in responding to your complaint. If you are dissatisfied with our response to your request, you may submit a Request for Reconsideration within 30 calendar days of the dated response to the original request.

Respectfully,

A handwritten signature in black ink, appearing to read "Leland L. Gardner", written over a large, light-colored circular mark.

Leland L. Gardner  
Director

Office of Economics, Environmental Analysis and  
Administration

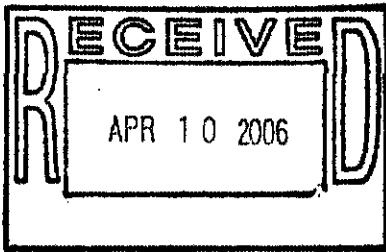
cc: Marilyn Levitt

# **Working Papers**

## **Response to Snavely-King**

### **Regarding RSAM Computation for GTC**

April 10, 2006



These working papers provide the data used to prepare the response to Snively-King with respect to their request for correcting errors in the calculation of the Revenue Shortfall Allocation Method (RSAM) ratios prepared for the Illinois Central, the Grand Trunk Western, and the Grand Trunk Corporation railroads over the last several years. In organizing these work papers, we have noticed that the increase in costs per GTM between 2001 and 2002 for the corporation is larger than originally noted. The revision shows that the capital related variable costs actually increased about 86% between 2001 and 2002. Non-capital variable costs increased about 25%, which is somewhat large, but accounts for much less of the increase in costs than the capital portion of the variable expenses.

Illinois Central 2001

1WORKTABLE D8 PART 6 Annual URCS Process for Illinois Central 18-Sep-02  
 PAGE-417

GENERAL OVERHEAD AND CONSTANT COSTS  
 CALCULATION OF GENERAL OVERHEAD AND CONSTANT COST MARKUP RATIOS

LINE	IDENTIFICATION	SOURCE OF C1	AMOUNT (1)
601	VARIABLE EXPENSE-OPR D8	L326C5	63553
602	VARIABLE EXPENSE-DL D8	L355C5	11865
603	VARIABLE EXPENSE-ROI D8	L369C5	2954
604	VARIABLE EXPENSE-OPR D1-7	L435C1	221141
605	VARIABLE EXPENSE-DL D1-7	L435C2	55353
606	VARIABLE EXPENSE-ROI D1-7	L435C3	75966
607	GOH MARKUP RATIO-OPR	(L601/L604)+1.0	1.28739
608	GOH MARKUP RATIO-DL	(L602/L605)+1.0	1.21435
609	GOH MARKUP RATIO-ROI	(L603/L606)+1.0	1.03889
610	VARIABLE EXPENSE-TOTAL-D8	L601+L602+L603	78372
611	VARIABLE EXPENSE-TOTAL, D1-7	L604+L605+L606	352460
612	GENERAL OVERHEAD MARKUP RATIO-AVERAGE	(L610/L611)+1.0	1.22236
613	TOTAL RAILWAY EXPENSE	L136C1	626162
614	TOTAL VARIABLE RAILWAY EXPENSE	L610+L611	430833
615	VARIABLE PORTION OF TOTAL EXPENSE	L614/L613	.68805
616	CONSTANT COST PORTION OF TOTAL EXPENSE	1.0-L615	.31195
617	CONSTANT COST MARKUP RATIO	L613/L614	1.45338

50285732

SCH 755

GROSS TON MILES-TOTAL

123 GTM

GTC 2002

LINE	IDENTIFICATION	SOURCE OF C1	AMOUNT (1)
601	VARIABLE EXPENSE-OPR D8	L326C5	213175
602	VARIABLE EXPENSE-DL D8	L355C5	11231
603	VARIABLE EXPENSE-ROI D8	L369C5	5842
604	VARIABLE EXPENSE-OPR D1-7	L435C1	520595
605	VARIABLE EXPENSE-DL D1-7	L435C2	208882
606	VARIABLE EXPENSE-ROI D1-7	L435C3	348334
607	GOH MARKUP RATIO-OPR	(L601/L604)+1.0	1.40948
608	GOH MARKUP RATIO-DL	(L602/L605)+1.0	1.05377
609	GOH MARKUP RATIO-ROI	(L603/L606)+1.0	1.01677
610	VARIABLE EXPENSE-TOTAL-D8	L601+L602+L603	230249
611	VARIABLE EXPENSE-TOTAL D1-7	L604+L605+L606	1077812
612	GENERAL OVERHEAD MARKUP RATIO-AVERAGE	(L610/L611)+1.0	1.21363
613	TOTAL RAILWAY EXPENSE	L136C1	1991726
614	TOTAL VARIABLE RAILWAY EXPENSE	L610+L611	1308061
615	VARIABLE PORTION OF TOTAL EXPENSE	L614/L613	.65675
616	CONSTANT COST PORTION OF TOTAL EXPENSE	1.0-L615	.34325
617	CONSTANT COST MARKUP RATIO	L613/L614	1.52265

123 GTM

GROSS TON MILES-TOTAL

SCH 755

104578312

CONFIDENTIAL

## Analysis of Capital-Related Variable Costs for IC, GTW, and GTC (2001 and 2002)

	2001			2002		
	Total VC	Capital VC	Other VC	Total VC	Capital VC	Other VC
IC	430833	146138	284695			
GTW	239333	85636	153697			
IC+GTW	670166	231774	438392			
GTC				1308061	574289	733772

	2001	2002
	Ton-Miles	Ton-Miles
IC	50286	
GTW	28115	
IC+GTW	78401	
GTC		104578

	2001			2002		
	Total VC	Capital VC	Other VC	Total VC	Capital VC	Other VC
IC	8.567653	2.906137	5.661516			
GTW	8.5126445	3.045919	5.466726			
IC+GTW	8.5479267	2.956263	5.591663			
GTC				12.50799	5.49149	7.016504
					0.857578	0.254815

	IC	2001		2002	
		GTW	IC+GTW	GTC	GTC
Line 602	11865	4479	16344	11231	
Line 603	2954	1976	4930	5842	
Line 605	55353	41551	96904	208882	
Line 606	75966	37630	113596	348334	
Total Cap VC	146138	85636	231774	574289	

**Notes**

- 1 All numbers in the tables above (except years) represent dollars in thousands
- 2 The data provided on Rows 31-34 above are from the Uniform System of Accounts for each railroad.. The account titles are as follows:
  - Line 601 Variable Expense - DL
  - Line 602 Variable Expense - ROI
  - Line 603 Variable Expense - DL
  - Line 604 Variable Expense - ROI
- 3 In the previous note, DL means "Depreciation and Lease" and ROI means "Return on Investment". Each is shown twice as they represent different subsets of expenditures. Even though the expenses are associated with investment they are not considered fixed as they vary with output quantity.

ORIGINAL

## Analysis of Capital-Related Variable Costs for IC, GTW, and GTC (2001 and 2002)

	2001			2002		
	Total VC	Capital VC	Other VC	Total VC	Capital VC	Other VC
IC	430833	146138	284695			
GTW	239333	85636	153697			
IC+GTW	670166	231774	438392			
GTC				1308061	574289	733772

	2001	2002
	Ton-Miles	Ton-Miles
IC	37900	
GTW	28115	
IC+GTW	66015	
GTC		104578

	2001			2002		
	Total VC	Capital VC	Other VC	Total VC	Capital VC	Other VC
IC	11.367625	3.855884	7.511741			
GTW	8.5126445	3.045919	5.466726			
IC+GTW	10.151723	3.510929	6.640794			
GTC				12.50799	5.49149	7.016504
					0.564113	0.056576

	2001			2002
	IC	GTW	IC+GTW	GTC
Line 602	11865	4479	16344	11231
Line 603	2954	1976	4930	5842
Line 605	55353	41551	96904	208882
Line 606	75966	37630	113596	348334
Total Cap VC	146138	85636	231774	574289

**Notes**

- 1 All numbers in the tables above (except years) represent dollars in thousands
- 2 The data provided on Rows 31-34 above are from the Uniform System of Accounts for each railroad. The account titles are as follows:
  - Line 601 Variable Expense - DL
  - Line 602 Variable Expense - ROI
  - Line 603 Variable Expense - DL
  - Line 604 Variable Expense - ROI
- 3 In the previous note, DL means "Depreciation and Lease" and ROI means "Return on Investment". Each is shown twice as they represent different subsets of expenditures. Even though the expenses are associated with investment they are not considered fixed as they vary with output quantity.