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BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 431 (Sub-No. 3)

Review of the Surface Transportation Board's General Costing System

TESTIMONY OF

GERALD W. FAUTH III
G. W. FAUTH & ASSOCIATES, INC.
116 South Royal Street
Alexandria, Virginia 22314

sponsored by

MONTANA WHEAT & BARLEY COMMITTEE
COLORADO WHEAT ADMINISTRATIVE COMMITTEE
IDAHO WHEAT COMMISSION
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NEBRASKA WHEAT BOARD
SOUTH DAKOTA WHEAT COMMISSION
OKLAHOMA WHEAT COMMISSION
TEXAS WHEAT PRODUCERS BOARD
WASHINGTON WHEAT COMMISSION

Dated: April 23, 2009

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The MONTANA WHEAT & BARLEY COMMITTEE, COLORADO WHEAT ADMINISTRATIVE COMMITTEE, IDAHO WHEAT COMMISSION, IDAHO BARLEY COMMISSION, NEBRASKA WHEAT BOARD, SOUTH DAKOTA WHEAT COMMISSION, OKLAHOMA WHEAT COMMISSION, TEXAS WHEAT PRODUCERS BOARD, WASHINGTON WHEAT COMMISSION ("Wheat and Barley Commissions") are sponsoring and submitting to the Board the testimony of Mr. Gerald W. Fauth III, President of G. W. Fauth & Associates, Inc., Alexandria, Virginia, in response to the questions posed by the Board in its Notice of Public Hearing dated April 6, 2009 in this proceeding ("Notice").

In its Notice, the Board noted that its Uniform Rail Costing System ("URCS") is utilized in a variety of regulatory proceedings to determine the variable costs of rail transportation services. URCS was initially adopted in 1989 and was partially reviewed and revised in 1997. Notice, p. 1. The Board noted that a periodic review of URCS is called for in 49 U.S.C. 11161. In its Notice, the Board indicated that it believes that the time has come for a second and more comprehensive review of URCS, to determine whether and to what extent modifications are needed to account for recent changes in Board procedures and to improve the system outputs. The Board has proposed thirteen (13) specific changes to URCS and asked parties for "suggestions on additional aspects or features of URCS the Board should revisit."¹

The Wheat & Barley Commissions have sponsored the attached testimony of Mr. Gerald Fauth, which addresses the questions asked by the Board. Additionally, Mr. Fauth recently completed a team study of Railroad Rates and Services Provided to Montana Shippers for Montana Attorney General Steve Bullock,². The Wheat & Barley Commissions wish to expand, for the Board's review, on several current issues that need to be considered by the Board in considering revisions to the existing URCS model.

The Wheat & Barley Commissions believe that the primary focus of the Board in this proceeding should be development of improvements that make URCS more accurate. "Accuracy" should be the main issue here. However, as outlined in Mr. Fauth's statement, the Wheat & Barley Commissions do not agree that URCS necessarily needs to be reformulated to achieve this goal. A comprehensive review of URCS could be undertaken, and many improvements could be made to URCS, without a complete reformulation of URCS. If accuracy

² <http://www.doj.mt.gov/news/releases2009/20090226railroadreport.pdf>

is the issue, it is clear that much more accurate results can be achieved, and URCS could be greatly improved, through changes in the Board's rules and policies combined with some minor changes to URCS.

In the past, the Board has restricted adjustments in URCS, stating that these restrictions were necessary to reduce rate case costs and delays. However, there has been a reduction in the accuracy of the resulting variable costs, and that loss of accuracy has benefited railroads, by depriving shippers of recourse to the Board. As Mr. Fauth shows, a better balance between accuracy and ease of use is not hard to develop, and should be adopted.

Alternatively, if the Board decides to initiate a complete revision of URCS, it will need federal funding adequate to support a review of all aspects of URCS. An independent panel could help the Board control the costs and expedite the process and it is vitally important that the process should include strong shipper as well as railroad representation. The rationale and supporting evidence for any changes in URCS and STB rail costing must be fully accessible to the public throughout the process.

The Wheat and Barley Commissions request 15 minutes of time at the hearing scheduled for April 30, 2009, for Mr. Fauth to present his views.

Respectfully submitted,



REGISTERED PRACTITIONER - REPRESENTING:
MONTANA WHEAT & BARLEY COMMITTEE
COLORADO WHEAT ADMINISTRATIVE COMMITTEE
IDAHO WHEAT COMMISSION
IDAHO BARLEY COMMISSION
NEBRASKA WHEAT BOARD
SOUTH DAKOTA WHEAT COMMISSION
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TEXAS WHEAT PRODUCERS BOARD
WASHINGTON WHEAT COMMISSION

Dated: April 23, 2009

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

EX PARTE NO. 431 (SUB-NO. 3)

**REVIEW OF THE SURFACE TRANSPORTATION BOARD'S
GENERAL COSTING SYSTEM**

**VERIFIED STATEMENT
OF
GERALD W. FAUTH III**

My name is Gerald W. Fauth III. I am President of G. W. Fauth & Associates, Inc., an economic consulting firm with offices at 116 South Royal Street, Alexandria, Virginia 22314. A statement describing my qualifications, background and experience is attached hereto as Appendix GWF-1.

The purpose of this Surface Transportation Board (STB or Board) proceeding is to examine issues related to the STB's Uniform Railroad Costing System (URCS). The Board believes that it is time for a "more comprehensive review" of URCS in order to determine if modifications are needed to the costing system.³ The Board has proposed thirteen (13) specific

³ STB Ex Parte No. 431 (Sub-No. 3), Review of the Surface Transportation Board's General Costing System, served April 6, 2009, page 2.

changes to URCS and asked parties for “suggestions on additional aspects or features of URCS the Board should revisit.”⁴

I have been asked by MONTANA WHEAT & BARLEY COMMITTEE, COLORADO WHEAT ADMINISTRATIVE COMMITTEE, IDAHO WHEAT COMMISSION, IDAHO BARLEY COMMISSION, NEBRASKA WHEAT BOARD, SOUTH DAKOTA WHEAT COMMISSION, OKLAHOMA WHEAT COMMISSION, TEXAS WHEAT PRODUCERS BOARD, WASHINGTON WHEAT COMMISSION (“Wheat and Barley Commissions”) to review the Board’s decision and prepare and submit these comments concerning the proposed comprehensive review of URCS.

As indicated in Appendix GWF-1, I have over 30 years of hands-on experience working with URCS and its predecessor, Rail Form A (RFA). My experience includes developing URCS and RFA unit cost data for Class I railroads and applying the URCS and RFA unit cost data in costing many thousands of individual railroad movements. As a result, I believe that I have developed a good understanding about the problems associated with the development and application of URCS.

COMPREHENSIVE REVIEW VERSUS REFORMULATION

One cannot dispute that URCS and the STB’s general costing system are out of date in some respects. URCS has not been modified in over a decade and those modifications were relatively minor and primarily involved intermodal traffic.⁵ A more comprehensive review has

⁴ *Ibid.* page 3.

⁵ There are two types of railroad intermodal traffic: Trailer-on-Flat Car and Container on Flat Car (TOFC/COFC) and Roadrailer traffic. Roadrailer traffic generally involves lower tare weight and train costs.

not been made since URCS was first developed over 25 years ago and one of the major STB-approved adjustments to URCS was developed in the early 1970's.⁶

The railroad industry has significantly changed since URCS was first developed. The railroad industry has consolidated, which has eliminated interchange costs, created many synergies and resulted in many other cost efficiencies. There has also been an increased use of private equipment, which has changed the railroads' capital structure. The industry's traffic mix has also changed with significant increases in efficient, long-haul Powder River Basin (PRB) coal movements and intermodal traffic.

The U.S. Department of Transportation (DOT) maintains that URCS needs to be "reformulated:"⁷

The second point is one the Department has express concern about previously. The Board uses URCS, *inter alia*, to estimate the variable costs of Class I rail carrier movements in order to determine its rate jurisdiction and for other regulatory purposes.³ ***The STB recently decided to use unadjusted URCS costs in rate cases, which makes the accuracy of the cost information derived from URCS ever more important.***⁴ In each proceeding DOT urged that URCS be updated to reflect the current rail industry and its costs.⁵ The Study finds that a representative R/VC ratio for a shipment is dependent on a "good alignment of actual and measured costs." Study, Vol.2 at 11-26. ***The issue here is the accurate "measurement" of those costs.*** URCS now performs this function, and, as the Department has repeatedly noted, the inability of R/VC ratios as currently produced to reliably identify rail market dominance indicates that URCS does not measure variable cost accurately. ***Thus, URCS needs to be reformulated.*** (emphasis added) (footnotes excluded)

I agree with DOT that "accuracy" should be the main issue here. However, I do not agree that URCS necessarily needs to be reformulated to achieve this goal. A comprehensive review of URCS could be undertaken, and many improvements could be made to URCS, without

⁶ See Ex Parte No. 270 (Sub-No. 4), Investigation of Railroad Freight Rate Structure – Coal (345 I.C.C. 71) (1974).

⁷ DOT letter D.J. Gribbon, General Counsel to STB dated December 19, 2008 in STB Ex Parte No. 680, Study of Competition in the Freight Railroad Industry, pages 2 and 3.

a complete reformulation of URCS. If accuracy is the issue, it is clear that much more accurate results can be achieved, and URCS could be greatly improved, with some changes in the Board's rules and policies combined with some minor changes to URCS and without a complete reformulation of URCS.

**THE BOARD SHOULD ESTABLISH
AN INDEPENDENT PANEL OF EXPERTS**

Chairman Mulvey was also recently quoted as saying the “*Fixing*” URCS is “not a small undertaking,”⁸ Some of the Board's 13 proposals involve relevantly simple changes in the computations while several others would require complicated new studies and analyses. How any new studies and analyses are performed and who performs them are obviously important in order to achieve accurate results. In other words, “fixing” URCS depends a great deal on how the fixing is done and who is doing the fixing.

Assuming federal funding is obtained, I recommend that the Board create an independent panel of experts from the railroad industry to look at the problems associated with URCS, oversee the numerous studies that are required and develop solutions to these problems. This panel could also review the proposed changes to URCS recently set forth in Ex Parte No. 681, Class I Railroad Accounting and Financial Reporting – Transportation of Hazardous Materials. Such a panel should not only include knowledgeable representatives from the Class I railroads, but also include representatives from the STB, shipper groups, and other interested parties. The ICC created such a panel during the URCS adoption process.

I understand from press reports that Chairman Mulvey is hoping that Congress will allocate up to \$4 million for a project to improve URCS and he estimates that it may take three

⁸ April 7, 2009 *Journal of Commerce* article.

years to complete.⁹ These appear to be reasonable estimates of the time and money which it should take for such an undertaking. An independent panel could help the Board control the costs and expedite the process.

PROPOSED ADDITIONAL IMPROVEMENTS TO URCS

I have reviewed the Board's 13 proposed changes. I believe that most of the Board's proposals have merit. I have prepared short comments regarding each of the Board's proposals which are set forth herein. However, there are several additional ways to make URCS costing more accurate and more reflective of modern railroading – many of which require no substantive changes to or reformulation of URCS. These changes include:

1. **Allow Limited Additional Adjustments** - The Board should allow shippers to make a limited number of additional adjustments to URCS system average costs, especially in jurisdictional costing determinations. These adjustments should include use of: actual train characteristics; actual switching time; actual car costs; actual crew costs; and other actual costs. These and other adjustments are relatively straightforward, easy to develop and usually non-controversial in nature. To insure this, the Board could establish work papers for the computation of these actual characteristics and costs. This would eliminate the need to use URCS system average costs for major cost components and would result in much more accurate movement costing. By disallowing such adjustments, the Board has eliminated a significant amount of railroad traffic from STB jurisdiction.

2. **Exclude Non-Recurring Special Charges From URCS** - It has always been STB policy to remove non-recurring special charges that are included in the R-1 Annual reports from the STB's URCS Phase I and II unit cost calculations. Apparently, when the STB calculated the 2007 URCS data, most of these special charges were improperly included, which artificially inflated the resulting 2007 URCS unit cost data.

⁹ *Ibid.*

3. **Improve URCS Make-Whole Calculations** - The STB should review and improve the URCS Make-Whole calculations. The STB's Make-Whole adjustments are essentially the cost reductions or savings associated multiple-car and unit train movements which are added back to multiple-car and single car movements in order they come back to (or make-whole) the total URCS cost. The two main sources for these Make-Whole adjustments are URCS and the Waybill Sample. Problems associated with the costed Waybill Sample, such as improperly costed "Rebill" movements and zero (\$0) cost records, create problems with the resulting Make-Whole adjustments. This "garbage in – garbage out" problem can be corrected with proper auditing of the Waybill Sample and without major changes to URCS.
4. **Segregate Railroad Fuel Costs** - The STB should revise its URCS Phase III costing program by adding a separate cost component for fuel. Currently, fuel cost is included as a cost component in URCS switching, gross-ton-mile and locomotive unit mile cost. Such a segregation of fuel costs would allow for more accurate evaluations of railroad fuel surcharges and rates.
5. **Make Other Minor Changes to URCS Phase III** - The STB should make some minor changes to its URCS Phase III costing program which would make the movement costing more accurate and more user friendly. For example, shippers often make the common mistake of not adjusting the URCS circuitry factor to "1.0" when using actual miles. The STB's program automatically applies the URCS circuitry factor by car type (e.g., 1.126 for BNSF covered hoppers). If this URCS factor is not manually adjusted, the resulting URCS costs will be overstated.

These proposed changes and improvements would require no substantive or major changes to or reformulation of URCS, yet would yield much more accurate railroad movement costing results.

ALLOW LIMITED URCS ADJUSTMENTS

The best way to "fix" URCS is not to use URCS. The Board should not mandate the use of unadjusted URCS costs when more accurate cost information is available and should allow for the use of limited additional adjustments. If accuracy is the Board's true goal here (which it should be), the Board should not force parties to use unadjusted URCS values when more accurate costs and data are available.

By statute, jurisdictional cost determinations are based on unadjusted URCS with “adjustments specified by the Board.”¹⁰ These URCS adjustments were specified in Ex Parte No. 646 (Sub-No.1), Simplified Standards For Rail Rate Cases, served September 5, 2007:

The Board will use its unadjusted URCS model to determine the variable costs for a rail carrier. If the carrier is not a Class I carrier, the Board will use the most appropriate regional URCS data. The only adjustments allowed to the URCS Phase III program would be those adopted in Ex Parte No. 431 (Sub-No 2). See Review of the General Purpose Costing System, 2 S.T.B. 754 (1997); Review of the General Purpose Costing System, 2 S.T.B. 659 (1997). Those adjustments include the so-called “270” volume shipment adjustments, the make-whole adjustments, TOFC/COFC adjustments, and RoadRailer adjustments. In addition, the circuitry factor is always set to one when actual miles are used to calculate the variable costs. (page 26)

The Board has specified that only few limited adjustments, such as the “270” and “make-whole” adjustments. If the Board expanded this list and allowed limited additional adjustments, the URCS costing results would be much more accurate.

In fact, the statute appears to indicate that shippers should be allowed to make such adjustments:

For purposes of this section, variable costs for a rail carrier shall be determined only by using such carrier's unadjusted costs, calculated using the Uniform Rail Costing System cost finding methodology (or an alternative methodology adopted by the Board in lieu thereof) and indexed quarterly to account for current wage and price levels in the region in which the carrier operates, with adjustments specified by the Board. A rail carrier may meet its burden of proof under this subsection by establishing its variable costs in accordance with this paragraph, ***but a shipper may rebut that showing by evidence of such type, and in accordance with such burden of proof, as the Board shall prescribe.*** 49 U.S.C 10707 (d)(1)(B) (emphasis added)

If shippers are forced to use the Board’s approach, then there is nothing for shippers to rebut. For example, the STB’s allowed adjustment for multiple car switching cost is 50% of

¹⁰ 49 U.S.C. 10707(d)(1)(B)

URCS system average. The shipper may have evidence that the actual switching cost is only 10% of the URCS system, but the Board's rules do not allow the shipper the right to rebut the 50% adjustment. Under the Board's rules, the shipper is stuck with 50%.

The main problem with URCS is that it represents system average costs. Therefore, it necessarily distorts the costs associated with movements which are well above or below the system average. For that very reason, STB's Phase III URCS costing program was designed to be *flexible* and to allow the user to change certain URCS system average values when actual and more accurate specific data and costs are available. The STB's URCS Phase III costing program allows the user to revise and adjust 45 different URCS detailed parameters, such as: circuitry; miles between I&I switch; empty loaded ratio; through and way locomotives; through and way train weight; freight car days; etc.

Although the STB's URCS Phase III program is flexible and allows for user adjustments, the Board's rules are rigid and force parties to use unadjusted URCS system averages, even where more accurate data is available and such data could be easily incorporated the URCS Phase III costing results.. In fact, the STB only allows parties to adjust one (1) of the 45 URCS detailed parameters (i.e., circuitry factor).

The STB's limitation on allowable URCS adjustments can produce very inaccurate results. There are several adjustments that are relatively easy to develop and make and could be used with URCS to develop much more accurate railroad movement costs. Examples of these adjustments include:

- ◆ **Train Characteristics** - Instead of forcing parties to use URCS system average train size and number of locomotives for single and multiple car movements, allow parties to reflect the actual average train size and locomotives associated with the movements;
- ◆ **Switching Cost Adjustment** - Instead of forcing parties to use URCS system average switching costs (with limited adjustments allowed for multiple car and

unit train movements), allow parties to develop the switching cost based on the average switching time associated with the service;

- ◆ **Car Cost Adjustment** - Instead of forcing parties to use URCS system average car cost, allow parties to develop railroad car costs based on actual cars used in the service and the average age and value of those cars; and
- ◆ **Crew Cost Adjustment** - Instead of forcing parties to use URCS system average crew cost, allow parties to develop the crew cost based on the actual number of crews used in the service and average railroad crew cost reported in the railroads' wage statistics.

The Board is essentially forcing parties to use an inaccurate costing approach by disallowing such adjustments in rate cases. By doing so, the Board is essentially deregulating a substantial amount of jurisdictional traffic by not allowing parties to properly reflect the economies associated with their railroad movements. By allowing these limited adjustments and using URCS to determine the remaining costs, the resulting movement costing would be substantially more accurate than the Board's current unadjusted URCS approach.

As an example, I point to problems associated with costing efficient BNSF shuttle trains and coal unit trains movements. For example, wheat traffic often moves in efficient 110-car shuttle trains with dedicated high-capacity "286" covered hoppers cars and dedicated locomotives. Coal moves in even larger unit trains and with a greater use of private equipment. The numerous efficiencies associated with this shuttle and unit train service (such as reduced switching and transit time which reduces crew and car costs) cannot be adequately reflected using URCS system average costs. As a result, too much cost is allocated to this traffic, which suppresses the resulting R/VC ratios and eliminates some traffic from STB jurisdiction.

Likewise, the costs associated with non-shuttle wheat traffic are also overstated using the Board's approach. Non-shuttle wheat traffic often moves in 26-car and 52-car shipments, which are often combined from nearby elevators to create efficient 104-car (or larger) trainloads for the

majority of the movements. Using the Board's approach, however, parties are not allowed to reflect the actual train size, which substantially overstates the actual cost of service and eliminates many wheat movements from STB jurisdiction.

It should be noted that an adjustment to reflect actual train characteristics would not involve any adjustments to the STB's developed URCS unit costs. The adjustment would merely change the way that the movement is costed and more accurately reflect the actual movement characteristics. Likewise, allowing the use of actual switching time involves changing a movement parameter and would not involve any adjustments to URCS unit costs. Allowing for the use of actual car and crew cost would involve eliminating the need to use URCS car and crew cost, but would not involve any adjustments to URCS unit costs.

The Board maintains that its "no adjustment" approach is required to keep cases "*manageable*."¹¹ I understand the Board's concern, however, by keeping cases "manageable" the Board is also eliminating many movements from STB jurisdiction.

The Board could resolve this issue by specifying that certain limited URCS adjustments should be allowed and specifying methodologies concerning the development of allowed adjustments. For example, the Board could easily establish set formulas (which could be incorporated into the STB's Phase III costing program) for developing car costs based on the average age and value of the actual cars used in the service or crew costs based on the actual number of crew which could be accepted by the Board in rate cases.

¹¹ Ex Parte No. 646 (Sub-No. 1), page 22.

**STB'S "NO ADJUSTMENT" APPROACH
ALLOWS THE RAILROADS TO
MANIPULATE THE URCS PROCESS**

BNSF has recently taken advantage of no-adjustments to URCS "loop-hole" by revising wheat tariffs to reflect a 48-car minimum rather than the 52-car minimum¹². Since the many non-shuttle elevator sidings have a 52-car or greater car capacity, BNSF has historically used 52-car minimum rates. By making this recent switch to 48 cars, BNSF is promoting less efficient operations (i.e., moving 4 less cars) and not taking full advantage of the existing 52-car capacity, which, one would think, would not make economic sense and thus would not be in BNSF's best interest.

BNSF made the switch to take full advantage of the Board's unadjusted URCS costing approach, which: (1) reduces the R/VC ratios of this traffic by over 100%; (2) eliminates the majority of the traffic from STB jurisdiction and (3) subjects the traffic to increased rates.

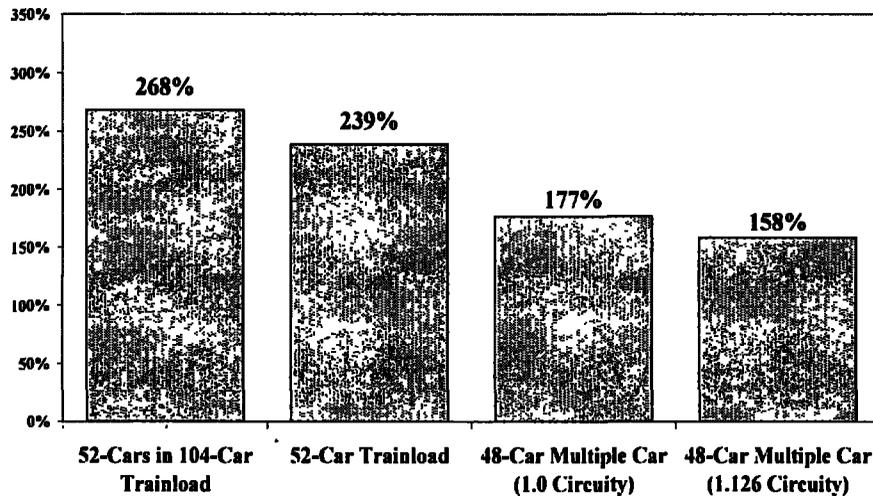
The STB's URCS Phase III costing program includes default value which assumes that shipments of 50 cars or greater are considered unit trains, which are not subject to the STB's Make-Whole adjustments. As a result, URCS considers a 52-car shipment as moving in a 52-car unit train. Since most of these 52-car shipments are combined with other 26-car and 52-car shipments to create much larger trainloads, this approach usually overstates the actual cost associated with this traffic.

BNSF's new 48-car rates take advantage of this 50-car URCS default value since 48-car shipments are costed as multiple car movements in an average trains, which are subject to the Board's Make-Whole adjustments. BNSF's new 48-car approach further overstates the costs

¹² BNSF Tariff Number 4022-L, Item 43413, Rev 0; & Item 43613 Rev.1, Effective 6/1/08

associated with this traffic and eliminates much of it from STB jurisdiction. The following chart demonstrates the impact of this problem:

**EXAMPLE OF BNSF'S ATTEMPTED MANIPULATION OF RATES
TO TAKE ADVANTAGE OF STB'S URCS COSTING PROGRAM IN
ORDER TO ARTIFICIALLY LOWER MONTANA WHEAT R/VC RATIOS
(CARTER, MT TO PORTLAND, OR)**



In reality, there should be little difference in the costs associated with a 52-car and 48-car shipments. The increase or decrease of four cars per shipment should not dramatically impact the cost or the resulting R/VC ratio. However, by switching to 48 cars and taking advantage of the Board's approach, BNSF can lower the R/VC ratio substantially (e.g. from 268% to 158%).

**EXCLUDE NON-RECURRING
SPECIAL CHARGES FROM URCS**

It has always been the STB's policy to remove so-called special charges that are included in the R-1 Annual reports from the STB's URCS Phase I and II unit cost calculations. However, many of these non-recurring special charges were apparently improperly included in the STB's 2007 URCS calculations, which artificially inflated the resulting URCS 2007 unit cost data.

Special charges are extraordinary charges which are usually taken by the railroads in the Fourth Quarter, but are for future, non-recurring expenses and not normal operating expenses for

the period. The STB addressed this issue in Ex Parte No. 347 (Sub-No. 2), Rate Guidelines – Non-Coal Proceedings, (1 S.T.B. 1004, 1031) (1996):

Shippers also argue against the inclusion of special charges in the costs to be recovered in the RSAM computation.⁸⁰ Special charges are generally used to account for severance payments to terminated employees or to write off obsolete equipment or road property. Shippers argue that these are not normal operating expenses, but reflect restructurings, and as such should not be charged to captive shippers. AAR counters that these are legitimate business expenses that are reflected in the annual revenue adequacy calculations.⁸¹

Special charges are nonetheless not reflected in the RSAM computation. As a practical matter, the URCS formula (from which the RSAM calculation is derived) does not account for these one-time charges. Moreover, on a conceptual basis, we are not persuaded that all of these costs are the types of expenses that should be recovered from the captive shipper group through differential pricing.

Although it has always been STB policy to exclude these special charges, it is my understanding from conversations with STB staff members that special charges were *not* excluded in the STB's development of the 2007 URCS. I have not had the opportunity to confirm this fact by reviewing the STB's underlying URCS Phase I inputs and workpapers and analyzing the reported special charges (which represent hundred of millions of dollars). However, UCRS movement studies that I have prepared using both the STB's 2006 and 2007 data indicates a substantial increase in BNSF's URCS costs, which indicates that there may be a problem with the data. For example, BNSF's URCS locomotive unit mile (LUM) cost increased by 25% and gross-ton-mile (GTM) cost increased by 16%.

One of the problems here is the complexity of the issues. Non-recurring special charges are rarely labeled as such and there are often differences between parties as to which charges should be excluded. In addition, they are often allocated to various expense accounts and are difficult to properly remove from these accounts. For example, the BNSF's 2007 R-1 contains

20 pages of notes and explanations to its Financial Statement.¹³ Therefore, it is difficult for STB staff (or anyone else for that matter) to determine and make to proper adjustments to account for these non-recurring special charges.

This problem could be resolved by better reporting of the non-recurring special charges. These charges should be properly identified and labeled as such and properly excluded from the railroad operating expenses by the reporting railroads. The STB should be able to use inputs for URCS directly from the R-1 that are properly adjusted and should not be required to perform a special study to remove these charges. In the meantime, the Board should determine if the STB's 2007 URCS calculations were properly developed to exclude these special charges and revise the URCS data, if necessary.

IMPROVE URCS MAKE-WHOLE CALCULATIONS

The STB should review and improve the STB's URCS Make-Whole calculations. The STB's Make-Whole adjustments are essentially the cost reductions or savings associated multiple-car and unit train movements which are added back to multiple-car and single-car movements in order they come back to (or make-whole) the total URCS cost. These Make-Whole adjustments result in added costs to single-car and multiple-car movements.

The two main sources for these Make-Whole adjustments are URCS and the Waybill Sample. There are several problems with the STB's Waybill Sample which have an impact on these Make-Whole adjustments. For example, the Waybill Sample often includes many zero (\$0) cost records, i.e., records which have no URCS costs allocated to the movements. Often, these zero cost records are associated with Canadian or Mexican

¹³ See BNSF 2007 Annual Report R-1, Schedule 200, pages 15A to 15M.

movements. Since no costs are allocated to these movements, the costs associated with these movements are allocated to the other Waybill Sample records under the STB's Make-Whole procedures.

The STB's Waybill Sample costing also often allocates too much cost to so-called "Rebill" shipments, which can impact the Make-Whole adjustments. Many of these Rebill shipments involve movements via Chicago. For example, a wheat movement from Montana to New York may appear in the Waybill Sample as two movements: from Montana to Chicago; and from Chicago to New York. Such a movement would be allocated URCS origin and destination terminal costs in Chicago, when, in fact, less costly URCS interchange costs should be allocated to the movement.

Problems associated with the costed Waybill Sample, such as improperly costed "Rebill" movements and zero (\$0) cost records, create problems with the resulting Make-Whole adjustments. This "garbage in – garbage out" problem can be corrected with proper auditing of the Waybill Sample costing process and without major changes to URCS.

SEGREGATE RAILROAD FUEL COSTS

The STB should revise its URCS Phase III costing program by adding a separate cost component for fuel. Currently, fuel cost is included as a cost component in URCS switching, gross-ton-mile and locomotive unit mile cost. Such a segregation of fuel cost would not involve a major change to the URCS calculations, but would allow for more accurate evaluations of railroad fuel surcharges and rates.

MAKE OTHER MINOR CHANGES TO URCS PHASE III

The STB should make some minor changes to its URCS Phase III costing program which would make the movement costing more accurate and more user friendly. Users of the STB's publically available URCS Phase II costing program often make the common mistake of not adjusting the URCS circuitry factor to "1.0" when using actual miles. The STB's program automatically applies the URCS circuitry factor by car type (e.g., 1.126 for BNSF covered hoppers). If this URCS factor is not manually adjusted, the resulting URCS costs will be overstated.

Another common mistake by users of the STB's program is not including railroad fuel surcharges in the inputted shipment charges. Railroad fuel costs are included in URCS, therefore, the exclusion of any fuel surcharges from the total shipment charges understates the resulting R/VC ratio. The Board should revise the program to account for fuel surcharge revenue.

There are probably many current computer programming "bells and whistles" which could be added to the STB's URCS Phase III program which would make it more user friendly and more accurate. One additional suggestion that I have concerns the URCS output results. The Board's program usually generates a 19-page report of the URCS results, which is confusing to most users. The results could be presented in a much more concise and effective manner and in a much shorter report (which would reduce URCS's carbon footprint).

STB'S 13 URCS PROPOSALS

My comments concerning the Board's 13 proposal and my additional proposals are set forth below:

1. Improve the efficiency adjustments associated with unit-train and multi-car movements;

This proposal concerns the so-called “Ex Parte No. 270” cost adjustments which were first applied by the ICC in 1974.¹⁴ These adjustments are shown below:

Ex Parte No. 270 Cost Adjustments¹⁵

| <u>Multiple Car</u> | <u>Unit Train</u> |
|--|--|
| ◆ Reduce switching cost by 50% at origin and destination. | ◆ Reduce switching cost by 75% at origin and destination. |
| ◆ Reduce variable freight train car costs per carload by 50% at origin and destination | ◆ Reduce variable freight train car costs per carload by 50% at origin and destination |
| ◆ Reduce station clerical cost assuming that 75% is associated with the car and 25% is associated with the shipment. | ◆ Reduce station clerical cost assuming that 75% is associated with the car and 25% is associated with the shipment. |
| ◆ Remove interchange costs on a car-mile basis and substitute actual interchange costs. | ◆ Remove interchange costs on a car-mile basis and substitute actual interchange cost reduced by 50%. |
| | ◆ Remove intertrain / intratrain switching cost per car-mile. |

These Ex Parte No. 270 cost adjustments are based on simplistic assumptions that multiple car and unit train movements have lower switching cost, car costs and clerical costs. These adjustments essentially represent educated guesses as to the economies associated with multiple car and unit train movements. Since these adjustments were essentially based on assumptions, there is no question that these adjustments could be improved.

¹⁴ Ex Parte No. 270 (Sub-No. 4); Investigation of Railroad Freight Rate Structure – Coal (345 I.C.C. 71) (1974).

¹⁵ ICC Bureau of Accounts, Uniform Railroad Costing System, Phase II Movement Costing Program User’s Manual, Appendix E, dated April, 1983.

In Ex Parte No. 431 (Sub-No. 2), Review of the General Purpose Costing System, served October 1, 1997, the Board stated that the ICC had proposed “a nationwide study to update the switching special study factors used in URCS” in the 1980’s, but abandoned the idea after it was estimated that the costs associated with such a study would exceed \$1 million.¹⁶

The Ex Parte No. 270 adjustments usually result in an overstatement in the URCS costs that should be allocated to multiple car and unit train movements. There is often very little or no industry switching associated with multiple car and unit train movements. In the last 25 years, more and more shippers have taken over the industry switching operations. Many coal origins and destinations have constructed and operate loop tracks which essentially eliminated industry switching.

Wheat shipments commonly move in 110-car shuttle trains and in 26-car and 52-car multiple car cuts. Theoretically, the total railroad terminal switching time associated with a 110-car shuttle or a 26-car or 52-car shipments should not be significantly different than a single car. Instead of switching a single car, the railroad switches a single unit of 26, 52 or 110 cars. As can be seen from the following table, however, the STB’s Ex Parte No. 270 cost adjustments allocate substantially more time to 26, 52 and 110 car shipments:

¹⁶ Footnote 6

GWF Table 1

Example of Application of Ex Parte No. 270 Cost Adjustments

| <u>Ln.</u> | <u>Item</u> | <u>Source</u> | <u>Single Car</u> | <u>26 Cars</u> | <u>52 Cars</u> | <u>110 Cars</u> |
|------------|--|---------------|-------------------|----------------|----------------|-----------------|
| 1 | BNSF SEM Per Industry Switch | BNSF URCS | 4.4621 | 4.4621 | 4.4621 | 4.4621 |
| 2 | Ex Parte No. 270 Adjustment ¹⁷ | URCS | 1.00 | 0.50 | 0.25 | 0.25 |
| 3 | Adj. BNSF SEM Per Industry Switch | L.1xL.2 | 4.4621 | 2.2311 | 1.1155 | 1.1155 |
| 4 | Carloads Originated and Terminated | Given | 2 | 52 | 104 | 220 |
| 5 | Spotted & Pulled Ratio | URCS | 2.00 | 2.00 | 2.00 | 2.00 |
| 6 | Total Industry SEM Allocated ¹⁸ | L.3xL.4xL.5 | 17.85 | 232.03 | 232.02 | 490.82 |
| 7 | Total Industry SEM Hours Allocated | L.6 / 60 Min. | 0.30 | 3.87 | 3.87 | 8.18 |

As this table shows, over 8 hours of switching would be allocated to a 110-car shuttle train and 3.87 hours would be allocated to 26-car and 52-car movements compared to only 0.30 hours for a single car.

One easy way to “fix” this problem is to allow for the use of additional adjustments - at least in jurisdictional costing determinations.¹⁹ For example, instead of adjusting URCS system average Switch Engine Minutes (SEM) by 50% or 25%, parties could easily use the actual SEM for the industry switching. It is usually relatively easy to determine the average switching time for unit train movements, many of which have little or even no switching cost. Most unit train and many multiple car shippers have a good

¹⁷ STB’s URCS Phase III costing program contains a default value which assumes that any movement of 50 cars or more is considered a unit train.

¹⁸ The STB’s so-called “make-whole” adjustments effectively allocate additional time to single and multiple car movements (which is not reflected here) by allocating the reduced switching time associated with multiple and unit train movements back to single car and multiple car movements.

¹⁹ Admittedly, it would be difficult to employ such movement specific adjustments when costing the Waybill Sample, which is used in the STB’s new rate reasonableness standards. However, if the railroads were required to estimate the SEM’s associated with each Waybill Sample record, such an adjustment could be made.

idea of the amount of switching performed at their locations and many keep detailed records of these operations. Of course, the railroads also have this information.

Since STB jurisdiction is at stake, such cost determinations should be as accurate as possible. The current Ex Parte No. 270 cost adjustments do not adequately reflect the economies associated with multiple car and unit train movements. The STB's current adjustments result in cost overstatements which can result in the difference between recourse to remedies provided by Congress for captive shippers or no such recourse.

Assuming general adjustments, such as the Ex Parte No. 270 adjustments, are necessary when costing the Waybill Sample and other purposes, the Board should consider developing and applying such adjustments by five-digit Standard Transportation Commodity Code (STCC).

As previously stated, many coal origins and destinations have constructed and operate loop tracks which essentially eliminate industry switching. Unit train coal shipments from and to loop track facilities use less switching than even other low-switching shipments. For example, BNSF also serves many grain elevators that are classified as shuttle train facilities with a minimum of 110-car track capacity.²⁰ The shuttle train movements may involve some limited switching associated with spotting and pulling the 110-shuttle into and out of the shuttle train facilities for loading and unloading whereas the locomotives and crews would generally stay with a 110-car unit coal train involving a loop track loading and unloading.

Likewise, a significant amount of wheat moves in non-shuttle train service, often in 26-car and 52-car shipments. These non-shuttle wheat movements are larger than multiple car movements of other commodities. For example, a multiple car movement of chemicals may involve a shipment of 10 to 15 cars.

²⁰ See <http://www.bnsf.com/markets/agricultural/elevator/shuttle/shuttle.html>

In addition to the development of such adjustments by STCC code, the Board should also consider developing such adjustments by railroad. Using coal as an example again, the switching associated with BNSF and UP coal movements may be significantly different from switching associated with NS or CSX coal movements. Loop tracks are more prevalent on BNSF and UP coal origins and destinations. Most of the NS and CSX coal origins have 100-plus car track capacity, but are not loop tracks.

2. Update the historical studies used in URCS

The Board proposes to “update the historical studies used in URCS,” but the specific “historical studies” are not listed. I assume that the Board is referencing the extensive statistical regression analyses used in URCS. Obviously, in most cases it is preferable to use the most current studies available. These historical studies can have a significant impact on the URCS results. Therefore, these studies should be identified and any changes should be carefully developed and applied.

3. Improve the costing of trailer or container on flat car (TOFC/COFC) traffic

TOFC/COFC or intermodal traffic is exempt from regulation. However, the costing of this traffic impacts other URCS costs and costing of the Waybill Sample, and therefore, indirectly impacts the URCS costs allocated to other traffic

Changes in Class I reporting requirements may be required to improve the costing of this traffic. The most significant problem involves CSX’s reporting of intermodal revenues and expenses. The following table compares CSX’s reporting of operating revenues and expenses to the SEC and STB:

GWF Table 2
Comparison of CSX 2007
SEC and STB Reporting

| <u>Item</u> | <u>CSX 2007</u> | | |
|---|-----------------|----------------|----------------|
| | <u>SEC 10-K</u> | <u>STB R-1</u> | <u>Diff.</u> |
| 2007 Rail Operating Revenue | \$8,674 | --- | --- |
| <u>2007 Intermodal Operating Revenue</u> | <u>\$1,356</u> | --- | --- |
| 2007 Total Operating Revenue | \$10,030 | \$9,039 | (\$991) |
| 2007 Rail Operating Expenses | \$6,683 | --- | --- |
| <u>2007 Intermodal Operating Expenses</u> | <u>\$1,096</u> | --- | --- |
| 2007 Total Operating Expenses | \$7,779 | \$7,354 | (\$425) |
| 2007 Rail Operating Income | \$1,991 | | |
| <u>2007 Intermodal Operating Income</u> | <u>\$260</u> | | |
| 2007 Total Operating Income | \$2,251 | \$1,685 | (\$566) |

Based on this comparison, it appears that CSX has significantly under-reported the revenues and expenses associated with its intermodal traffic to the STB. This would obviously have an impact on URCS costing of intermodal traffic.

Since intermodal traffic has increased so much since URCS was developed, additional reporting of intermodal revenue, expenses and operating characteristics may be required.

4. Update the URCS national car tare weight calculation to account for the number of car miles that each car type operates;

This appears to be a good idea, which should be relatively easy and straight-forward to do using Railinc's UMLER file.

5. Update the number of miles between non-intermodal intertrain/intratrain (I&I) switches by URCS car type;

URCS currently uses an arbitrary and uniform number of 200 miles per non-intermodal I&I switch.²¹ There is normally no I&I switching associated with unit or shuttle train movements. There would be I&I switching associated with multiple car and single car movements. Certainly, an updated study of I&I switching would be appropriate. In addition, the Board should allow for the use of the actual number of I&I switches for a specific movement, which would yield the most accurate results.

The Board has proposed to determine the number of I&I switching by car type, however, there may be a stronger relationship between I&I switching and the commodity type. For example, the I&I switching associated with wheat movements in covered hoppers from Montana (most of which travel long distances in large trains to the PNW) may be very different from I&I switching associated with corn movements in covered hoppers from Iowa (most of which move to processors in and around Iowa). Coal and intermodal traffic usually involve very little, if any, I&I switching.

6. Disaggregate loss and damage information by carrier and by two-digit Standard Transportation Commodity Code (STCC) groupings;

It is probably a good idea to disaggregate loss and damage information by carrier, since each carrier has different operating practices and safety records. However, it probably should be done at a 5-digit rather than 2-digit STCC level. For example, STCC 01, includes a diverse group of commodities ranging from corn, wheat, soybeans, rice,

²¹ In Ex Parte No. 430 (Sub-No. 2), Review of General Purpose Costing System, served December 12, 1997, the Board adopted a figure of 4,163 miles per TOFC/COFC I&I switch.

tobacco, fruit, vegetables and livestock. As can be seen from the following table, the prices of these commodities can vary significantly:

GWF Table-3
Comparison of Field Crop Prices Per Ton

| Field Crops (STCC 01-1) | STCC | Price Per Ton |
|------------------------------------|-------------|--------------------------|
| Cotton | 01-12 | \$1,132.00 |
| Barley | 01-131 | \$214.58 |
| Corn | 01-132 | \$139.29 |
| Oats | 01-133 | \$193.75 |
| Rice | 01-134 | \$330.00 |
| Rye | 01-135 | \$225.71 |
| Sorghum Grains | 01-136 | \$139.00 |
| Wheat | 01-137 | \$226.67 |
| Flax Seed | 01-142 | \$436.67 |
| Cottonseeds | 01-141 | \$223.00 |
| Peanuts | 01-143 | \$1,538.00 |
| Soybeans | 01-144 | \$308.33 |
| Tobacco | 01-193 | \$3,730.00 |
| Sweet Potatoes | 01-194 | \$430.00 |
| Potatoes | 01-195 | \$189.20 |
| Sugar Beets | 01-197 | \$41.90 |
| Sugar Cane | 01-198 | \$28.70 |

Loss and Damage is usually not a big cost item, but it would probably be more accurate if

URCS Loss and Damage costs were developed on a carrier and 5-digit STCC basis.

- 7. Revise the Train Switching Conversion factor used to place all road train crew wages on a common mileage basis;**

Good idea.

- 8. Require carriers to report their average switch engine speeds in order to better reflect switching expenses;**

Good idea.

- 9. Revise the ratio of urban and rural land values to allocate expenses between running and switching;**

Good idea.

- 10. Revise the URCS car types to eliminate outdated car types and add new car types to reflect those currently used in the railroad industry;**

Good idea.

- 11. Revise the spotted to pulled factor for each car type;**

Good idea.

- 12. Revise the approach used in individual proceedings to index URCS in order to use the Rail Cost Adjustment Factor indexes published by the Board;**

By statute, the Board is required to use a specified index:

... indexed quarterly to account for current wage and price levels in the region in which the carrier operates, with adjustments specified by the Board. 49 U.S.C. 10707 (d)(1)(B)

The Board's RCAF index is a nationwide figure which is not broken down by region, which is required by statute. The AAR's Quarterly Index of Materials Prices and Wages (QMPW) is often used to update URCS costs and conforms to the statute since it is developed by region.

One of the "adjustments specified by the Board" to the index should include an adjustment for productivity.

- 13. Update the various statistical relationships used in URCS, including the variability estimates.**

Good idea.

CONCLUSION

The railroad industry has changed since URCS was developed and URCS has not been updated to reflect these changes. However, a complete reformulation of URCS is not necessary in order to achieve more accurate results using URCS. Accuracy should be the goal of any review. An independent panel would help insure that URCS yields fair, accurate and meaningful results. In the meantime, I urge the Board to relax its rules and allow parties to make the limited adjustments described herein which would yield much more accurate results.

Respectfully submitted,

Gerald W. Fauth III, President

G.W. Fauth & Associates, Inc

**STATEMENT OF QUALIFICATIONS
OF
GERALD W. FAUTH III**

My name is Gerald W. Fauth III. I am President of G. W. Fauth & Associates, Inc. (GWF), an economic consulting firm with offices at 116 S. Royal Street, Alexandria, Virginia 22314. I have over 30 years experience in the private sector and in the Federal government as a recognized expert on transportation issues. The majority of experience has involved economic, regulatory, public policy and legislative issues primarily associated with, or related to, the U. S. railroad industry.

This statement describes my background and experience in general and in more detail in regard to the Surface Transportation Board's (STB) Uniform Railroad Costing System (URCS) and its railroad rate reasonableness guidelines and standards.

I am highly experienced in the complex economic and analytical issues associated with the STB's current railroad rate reasonableness guidelines and standards. I have prepared and submitted testimony and evidence in railroad rate reasonableness cases, evaluated testimony and evidence submitted in railroad rate reasonableness cases, and participated in the decision-making process in railroad rate reasonableness cases at the STB. As a result, I have developed a comprehensive understanding and knowledge of the history, economic development, application, procedures, problems and other issues associated with the STB's current railroad rate reasonableness guidelines and standards.

Most of my experience has involved regulatory proceedings, litigations, arbitrations and related projects before, or related to, the STB and its predecessor, the Interstate Commerce Commission (ICC), which was eliminated effective January 1,

1996. I have submitted expert testimony before ICC, STB, state regulatory commissions, courts and arbitration panels on a wide-variety of issues in numerous proceedings. In addition, I was employed for 3½ years at the STB on the staff of former Board Member Wayne Burkes where I reviewed, analyzed and made recommendations on over 600 written formal decisions that were decided by the entire Board. These proceedings involved all matters of STB jurisdiction and had an impact on the transportation industry and the national economy.

I was actively involved in the initial regulatory proceedings over 20 years ago in which the ICC first proposed and established guidelines which have since evolved into the STB's current railroad rate reasonableness guidelines. I was also actively involved in several of the first cases to test the ICC's proposed guidelines. My work and testimony in those initial proceedings helped shape the STB's current guidelines.

The Board's current simplified rate reasonableness guidelines were initially established by the ICC in Ex Parte No. 347 (Sub-No.2), Rate Guidelines – Non-Coal Proceedings. An ICC complaint proceeding involving railroad switching charges for empty, one-way movements of railroad cars (i.e. ICC Docket No. 40073, South-West Railroad. Car Parts Co. v. Missouri. Pacific Railroad) was the *first* case to test the ICC's proposed simplified guidelines, which are now known as the STB's Three-Benchmark approach. I was the primary expert witness in ICC Docket No. 40073.

Many of our projects have involved the development of railroad cost analyses based on the application of URCS and its predecessor, Rail Form A (RFA). URCS is an integral component of the STB's Full-SAC method, new Simplified-SAC standard and recently modified Three-Benchmark approach. I have an extensive working knowledge

of the development and application of URCS and RFA. I have prepared URCS cost analyses for thousands of individual railroad movements. I also submitted expert testimony in ICC Ex Parte No. 431 (Sub-No.1), Adoption of the Uniform Railroad Costing System as a General Purpose Costing System for Regulatory Costing Purposes.

Another integral component of each of the STB's current and proposed rate reasonableness standards is the STB's Waybill Sample. This database is an expanded sample of carload waybills for terminating shipments which includes over 600,000 records. I am extremely familiar with this database. Over the years, I have performed hundreds of analyses using the STB's Waybill Sample. These analyses have been used as evidence in major merger proceedings and other proceedings before the Board.

I am a 1978 graduate of Hampden-Sydney College in Hampden-Sydney, Virginia where I earned a Bachelor of Arts degree. My major areas of study were history and government. My senior paper in college dealt with the History of Railroad Deregulation. I am a 1974 graduate of St. Stephen's School for Boys (now St. Stephen's and St. Agnes School), located in Alexandria, Virginia. My senior project and paper in high school dealt with the ICC and the Energy Crisis of 1973. I have also taken and completed post graduate courses in Statistics at George Washington University and Real Estate Principles at Northern Virginia Community College.

I am a member of the Transportation Research Forum and the Association of Transportation Law Professionals.

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City of Alexandria)

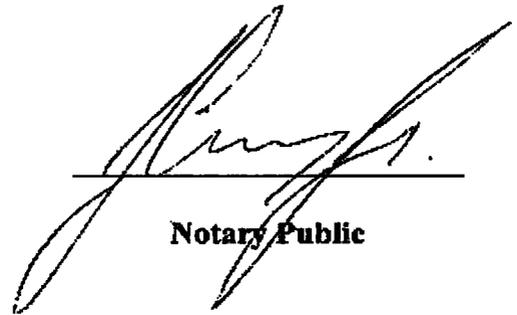
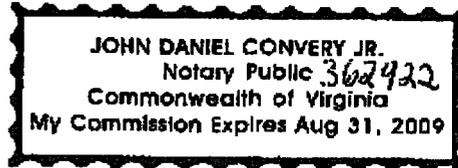
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Gerald W. Fauth III, being duly sworn, deposes and says that he has read the foregoing document and attachments thereto and knows the contents thereof, and that all matters and things set forth therein are true.



Gerald W. Fauth III

Subscribed and sworn to before me this twenty-third (23) day of April, 2009



Notary Public

My Commission expires August 31, 2009