

224974



**ASSOCIATION OF
AMERICAN RAILROADS**

Law Department
Louis P. Warchot
Senior Vice President-Law
and General Counsel

April 23, 2009

Honorable Anne Quinlan
Acting Secretary
Surface Transportation Board
395 E St., S.W.
Washington, DC 20423

Re: STB Ex Parte No. 431 (Sub-No.3), Review of the Surface Transportation Board's
General Costing System

NOTICE OF INTENT TO PARTICIPATE

Dear Acting Secretary Quinlan:

Pursuant to the Notice served by the Board on April 6, 2009 in the above proceeding, the Association of American Railroads ("AAR") hereby submits its Notice of Intent to Participate and appear at the hearing in the proceeding on April 30, 2009.

The AAR will be represented by Edward R. Hamberger, its President and Chief Executive Officer. A time of ten minutes is requested for the AAR's testimony.

If the Board establishes panels of witnesses for the hearing, the AAR requests that it be placed on a panel with other railroads who will be appearing.

Respectfully submitted,

Louis P. Warchot
Counsel for the Association of
American Railroads

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB EX PARTE NO. 431 (Sub No. 3)

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

**WRITTEN TESTIMONY OF
THE
ASSOCIATION OF AMERICAN RAILROADS**

George A. Aspatore
John J. Brennan, III
William A. Callison
Allison M. Fergus
Paul A. Guthrie
Paul R. Hitchcock
Theodore K. Kalick
Jill K. Mulligan
David C. Reeves
Louise A. Rinn
Peter J. Shudtz
John M. Scheib
Peter J. Shudtz
Richard E. Weicher

Louis P. Warchot
Association of American Railroads
50 F Street, NW
Washington, DC 20001
(202) 639-2502

Kenneth P. Kolson
10209 Summit Avenue
Kensington, M.D. 20895

*Counsel for the Association of
American Railroads*

April 23, 2009

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB EX Parte No. 431 (Sub-No. 3)

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

**WRITTEN TESTIMONY OF
THE
ASSOCIATION OF AMERICAN RAILROADS**

Introduction

By Notice served April 6, 2009, the Surface Transportation Board ("Board") scheduled a public hearing for April 30, 2009 to examine issues related to the Board's Uniform Rail Costing System ("URCS"). In its Notice, the Board stated that it believes it is time for a comprehensive review of URCS. Accordingly, the Board is seeking comment on "how best to revise the existing URCS model". (Notice, pg 2) In response to the Board's Notice, the Association of American Railroads ("AAR") hereby submits this written testimony on behalf of its member railroads.

The AAR appreciates the opportunity to provide its views to the Board regarding whether and to what extent modifications to the existing URCS model are needed to reflect current Board procedures and to improve URCS system outputs. With the limited

time available for comment in this proceeding, the AAR's testimony will, by necessity, focus on general observations, concepts and principles that should guide further analyses of the issues. Before the AAR can make or support specific proposals regarding changes in the URCS process, it will need additional time to assess the potential costs and benefits and provide the Board with more detailed views.

Guiding Principles

If the Board determines that it should pursue changes to URCS, such efforts should seek to improve the accuracy of URCS's application to specific movements and cause its results to more accurately reflect the full costs incurred by rail carriers in their provision of service to customers. The AAR believes that this concept should guide the Board in its assessment of any modifications undertaken during the course of this process. This concept of the improvement of accuracy in the cost collection and allocative processes leads to five guiding principles that AAR believes should be the objectives of any Board review of URCS:

1. URCS should fully reflect all costs associated with rail transportation movements or categories of movements, and these costs should be fully allocated as precisely as possible to those movements or movement categories that give rise to those costs;
2. URCS should reflect the full variability of all costs and, to the fullest extent possible, variability percentages should be based upon current, actual data, not incorrect default values so that the total of variable costs for each individual movement on a rail carrier equals the total URCS variable cost for that rail carrier;

3. The structure of URCS should be sufficiently flexible to ensure that future changes in railroad operating conditions can be readily accommodated;
4. The capital portion of variable cost should be based on replacement cost methodology rather than a return on investment calculated on the depreciated value of book assets; and,
5. Changes in the accounting and reporting processes that support any revisions to URCS should be effected in a manner which minimizes, to the fullest extent possible, administrative burdens and systems adaptations.

In short, the Board's goal if there is a proceeding should be to seek to develop an URCS system that ensures that all variable costs, including replacement capital costs, are captured and applied, is reflective of current rail conditions (not a static past), and can be readily and cost effectively implemented by the rail carriers.

Discussion

Although the Board has inquired in Ex Parte No. 681, Class I Railroad Accounting and Financial Reporting – Transportation of Hazardous Materials, about the full costs of transporting toxic inhalation hazards, the need to recognize the full costs related to the provision of specific categories of transportation should not be limited to hazardous materials transportation – even though this type of rail traffic is among the more obvious areas where substantial costs are not being identified with the appropriate movements. Examples of other potential areas for investigation include the relationship between costs borne by carload business and intermodal and unit train service. Proper treatment of switching costs also appears to be an area that could benefit from greater accuracy in allocation. Ensuring that cost relationships are correctly identified and that

their costs are properly assessed takes on increasing importance with the implementation of the Board's new guidelines in Ex Parte No. 646 (Sub-No. 1), Simplified Standards for Rail Rate Cases.

An important part of the process of having each service bear the full cost of its provision is to ensure that all costs which are variable with the service provided are identified as such. Railroad operating conditions can change over time. For example rail infrastructure is much more intensely utilized both in terms of the total tonnage moving over line segments and the nature of the commodities transported. When URCS was originally developed, the primary rail traffic was carload merchandise moving in relatively small average carload sizes. Today, a much higher percentage of business is comprised of heavy haul bulk and double stack intermodal traffic and even the carload business moves in much heavier railcar loads. Average main line tonnage density has also doubled since 1980. As such, the time frame in which this type of business wears out track and structures is much shorter than in the past and it is very probable that a significantly higher percentage of the costs of infrastructure replacement are clearly variable with traffic, even in the short run.

This new railroad cost reality also moves at a faster pace. Today, much of URCS is based on statistical relationships and estimates that are several decades old, which may or may not have continued validity. Much has changed in railroad management and cost relationships during that time. Not only does URCS need to properly reflect the cost situation faced by today's carriers, it needs to be flexible enough to also adapt to new changes as they inevitably take place.

For example, the Federal Rail Safety Improvements Act of 2008 mandated the installation, by 2015, of Positive Train Control ("PTC") on all mainlines carrying toxic inhalation hazardous substances or handling passenger trains. Thus, in the near future, the installation of this technology will increase the costs of the railroad business. However, today it cannot be predicted what impacts PTC technology may have on longer term future costs and cost structures of rail carriers.

URCS should also reflect the fact that replacement cost methodology is the appropriate basis for the capital component of variable costs. As the Board and the Interstate Commerce Commission before it, have recognized, replacement costs are the economically correct method for identification of the value of a railroad's infrastructure and equipment. It is also the value on which a carrier must earn an economic return if it is to sustain its business. As a part of the URCS updating process, the Board should ensure that concepts of replacement costing can be incorporated into any structure that emerges.

Finally, it is important to ensure that the accounting and reporting requirements necessary to support a revised URCS structure do not place an undue burden on the Class I rail carriers. To the extent possible, the Board should attempt to make use of the current reporting framework. Where changes are needed to support revised URCS methodologies, every attempt should be made to minimize additional requirements and to ensure that those new requirements are derived from data that the carriers currently maintain to manage their businesses. And, where special studies are deemed to be needed for better allocations, they should be undertaken using methods that minimize their intrusiveness and cost. The Board should also recognize that, as more data becomes

necessary to underpin URCS, the potential need for confidentiality to protect that data increases in importance.

Many of the thirteen areas of investigation proposed by the Board meet all or most of these criteria in that they seek to make costs more precise and attributable to the proper service, seek to reflect full variability and seek timely application. However, replacement cost concepts are not mentioned in the Board's notice and the ability of the proposals to minimize their administrative impact will depend upon how the Board decides to proceed with their review and implementation.

AAR believes that it will become important for an analytic triage to be performed for the Board to determine what, if any, issues can be justified for inquiry when examined through the lens of the cost of the inquiry. The available resources should then be focused upon improvement of these areas of interest to ensure that they reflect actual conditions to as great an extent as possible.

Conclusion

The issues involved with any potential changes to URCS are complex and the limited time frame for comment (less than three weeks) allows for only preliminary views at this juncture. Before the AAR can make definitive statements as to specific proposals regarding changes to the URCS process, there would need to be additional time to analyze any such proposals as well as to determine the ability of individual rail carriers to accommodate the proposed changes within the Uniform System of Accounts.

In this context, the Board should seek as an objective to ensure that its decisions at all stages of the process be predicated on a sound, real-world evidentiary footing (as well as on sound financial reporting and accounting principles) and that the URCS

process effectively captures and appropriately allocates all costs in the specific URCS areas analyzed. The URCS review process will necessarily be lengthy and costly and will require significant work by the Board and the parties over a considerable period of time. The AAR would urge the Board in any review of a proposed URCS modification to avoid quick-fix solutions that do not fully address or resolve the specific issues examined.

Finally, any URCS changes proposed by the Board should reflect “the most efficient and least burdensome means by which the required information may be developed for regulatory purposes.” (See 49 U.S.C. §11161.) Not only will the URCS review process require a significant commitment of time and resources by the Board, the rail industry and interested parties, but changes to URCS are also likely to require significant attendant changes in individual carrier accounting processes and expense reporting. The URCS changes proposed should not exceed the ability of rail carriers to provide the information or make the reporting process unnecessarily cumbersome.

The AAR looks forward to further participation in this proceeding, should the Board choose to move forward.