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**U.S. Department of
Transportation**
Office of the Secretary
of Transportation

General Counsel

**400 Seventh St., S.W.
Washington, D.C. 20590**

April 23, 2009

Vernon A. Williams, Secretary
Surface Transportation Board
395 E Street, S.W.
Washington, D.C. 20423

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

Dear Secretary Williams:

Submitted herewith pursuant to the Notice served April 6, 2009, is the Hearing Statement of the United States Department of Transportation in the above-referenced proceeding. The Department does not seek to participate at the public hearing in this matter.

Respectfully,

A handwritten signature in cursive script, appearing to read "Paul Samuel Smith".

PAUL SAMUEL SMITH
Senior Trial Attorney

(202) 366-9280

Enclosure

**Before the
Surface Transportation Board
Washington, D.C.**

REVIEW OF THE SURFACE TRANSPORTATION
BOARD'S GENERAL COSTING SYSTEM

) Ex Parte No. 431 (Sub-No. 3)
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**Hearing Statement of the
United States Department of Transportation**

Introduction

For seventy years the Surface Transportation Board ("STB" or "Board") has used a General Purpose Costing System ("GPCS") to provide variable cost estimates of railroad operations for regulatory purposes. Since 1989 that function has been served by the Uniform Railroad Costing System ("URCS"). In this proceeding the STB has decided to revisit URCS; it has asked interested parties to address particular issues and to offer their own suggestions for improvement as well. Notice served April 6, 2009 ("Notice"). The United States Department of Transportation ("DOT" or "Department") commends the Board for initiating this necessary review. We urge in particular that the historical engineering studies and statistical relationships that underlie URCS be clarified and updated, and that URCS be periodically updated to incorporate significant and ongoing changes in industry costs in the future.¹

¹/ The STB will also accept comments responsive to those submitted on the record in this proceeding for 30 days after the scheduled hearing on April 30. Notice at 3. DOT will review the initial filings of other parties and may offer responsive comments of its own.

Updating URCS is Necessary

The Board and its predecessor, the Interstate Commerce Commission ("ICC"), have relied on URCS costing estimates in regulatory proceedings that address such matters as the reasonableness of rail rates, rail line abandonments, and fuel surcharges. To obtain results that are faithful to applicable law and policy in such cases, it is essential that those estimates accurately reflect railroad costs and cost allocations as much as they feasibly can. See Review of the General Purpose Costing System, 2 S.T.B. 659, 660-62 (1997); 49 U.S.C. § 11161 (cost accounting rules must comport with regulatory purposes). There are ample reasons to support the STB's current effort.

The ICC first adopted URCS after compiling an extensive record on technical topics such as the proper functional form and cost estimation method to employ.² Twenty years later URCS is still largely using these same econometric methodologies and programs, and therefore does not take into account changes in rail operations over this period that have direct implications for the allocation of costs to particular movements, such as increased use of double-stack cars and unit-trains, economies of scale and efficiencies arising from the substantially smaller number and larger size of Class I carriers, transloading, etc.³ Although updated statistical relationships can improve URCS cost estimates, available advancements in computer technology and

²/ Adoption of the Uniform Railroad Costing System As A General Purpose Costing System For All Regulatory Costing Purposes, 5 I.C.C.2d 894 (1989).

³/ The STB's recently released Christensen Associates study of competition in the rail industry confirmed the shortcomings of URCS when it found only a weak correlation between current revenue-to-variable cost ratios above the Board's jurisdictional threshold and railroad market dominance. A Study of Competition in the U.S. Freight Railroad Industry and Analysis of Proposals that Might Enhance Competition. Volume 2 at 11-25.

computational power can simplify the use of these tools and make the process more transparent for all users.⁴

Moreover, ensuring the accuracy of URCS estimates has increased in importance in recent years as a result of changes the STB has made to the rules governing rail rate cases. For both “major” disputes involving the expensive but relatively more accurate stand-alone cost analysis, and for proceedings with smaller sums at risk, involving a simplified stand-alone cost analysis or the so-called “three benchmark” approach, the Board now requires the use of URCS cost estimates for the traffic in question without allowing movement-specific adjustments. As DOT stressed in the course of those proceedings, eliminating these adjustments makes accurate URCS cost allocations all the more important to avoid skewed results.⁵

Recommended Revisions

URCS suffers not only from outdated data and methodologies, but also a lack of transparency. Two of the 13 different elements the Board has offered for comment -- the “historical [engineering] studies” and “various statistical relationships” used in URCS⁶ -- underlie URCS by determining how the various costs are allocated over different types of modes. These elements broadly influence the more specific issues singled out, such as the costing of container traffic (item number 3) and unit train operations (item number 1), yet their particulars are basically unknown to participants in regulatory proceedings employing

⁴/ For example, the internet and personal computing power should allow shippers to easily estimate their variable cost under URCS and determine if their move differed in any significant way from that used in the updated URCS to estimate the cost.

⁵/ DOT Rebuttal Comments in Ex Parte No. 657 (Sub-No. 1), filed June 30, 2006; DOT Supplemental Comments in Ex Parte No. 646 (Sub-No. 1), filed February 26, 2007; DOT Comments in Ex Parte No. 680, filed December 19, 2008.

⁶/ Notice at 2-3 (items numbered 2 and 13).

URCS because the current software and model structure do not provide this information, nor do they explain how that information affects the specific measurement of rail movements costs.

New engineering studies would assist the Board in gaining a more complete understanding of the true cost relationships in the industry. A proper understanding of those relationships would in turn aid the agency in both identifying the information needed from rail carriers and in collecting that data appropriately to begin the process of allocating costs.

In short, to capture and allocate costs accurately, this proceeding will need to generate information about the nature of the operations that influence rail movement costs. That information will also include data about the physical plant and equipment currently in use and about ongoing operational practices so as to allow the accurate allocation of variable costs.

The Resulting Costing System Must be Adaptable

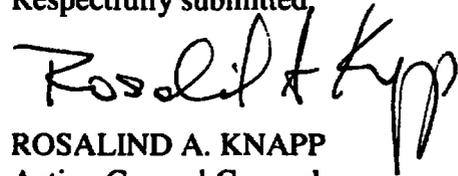
Any number of factors can influence the cost structure of the railroad industry over time: legislation, technological advancements, and demand for services, to name a few. The Rail Safety Improvement Act of 2008 and the Passenger Rail Investment and Improvement Act of 2008, for instance, require DOT (through the Federal Railroad Administration) to implement various new safety and passenger rail measures that will affect carrier costs. P.L. No. 110-432 (Division A), 122 Stat. 4848 and P.L. No. 110-432 (Division B), 122 Stat. 4907, respectively. URCS should be adaptable, so as to take into account circumstances that bring about significant and enduring increases or decreases in industry costs. Only in this way can URCS continue to produce the accurate variable cost

estimates required by law and sound policy. Future legislative or regulatory decisions, technological changes, and demand for rail services are speculative. But at least some relevant and material circumstances will change over time, and when they do the revised GPCS must be capable of incorporating them.

Conclusion

The proper application of relevant federal law demands that the Board's GPCS produce variable cost estimates that accurately reflect industry reality. Only in this way can shippers be protected from truly unreasonable rates and railroads become and remain revenue adequate. URCS has fallen short of that standard over time, and it is incumbent upon the STB to take corrective action now. Chief among the changes required, in DOT's view, are the clarification and updating of the historical engineering studies and statistical relationships that are central to URCS. Whatever changes may be made in this proceeding, it is no less important that the Board periodically update URCS so that its variable cost estimates continue to accurately mirror rail industry reality.

Respectfully submitted,



ROSALIND A. KNAPP
Acting General Counsel

April 23, 2009