Before the
Surface Transportation Board
Washington, D.C.

Rail Rate Challenges Under the Stand-Alone Cost Methodology	)	Ex Parte No. 657

STATEMENT OF THE UNITED STATES DEPARTMENT OF TRANSPORTATION

The United States Department of Transportation ("Department" or "DOT") welcomes this opportunity to comment on rail rate challenges under the stand-alone cost ("SAC") methodology, and commends the Surface Transportation Board ("Board" or "STB") for addressing this issue. DOT looks forward to reviewing the statements of other interested parties on this important subject. For our part, we urge the STB to consider whether and to what extent railroad capacity constraints might require adjustments to the methodology by which major rail rate cases are resolved.

Background

The Board's general standards for judging the reasonableness of rail freight rates are set forth in Coal Rate Guidelines, Nationwide, 1 I.C.C. 2d 520 (1985) ("Guidelines"). Under these standards, large shippers have brought cases and received reduced rates and reparations for rates found unreasonable. While the Board, shippers, railroads, and other parties, including DOT, have struggled to craft useable processes for determining rate reasonableness in smaller cases, these standards are generally viewed as a workable method for determining the reasonableness of rail rates for large shippers.

The Guidelines decision yielded standards based on pricing principles known as "Constrained Market Pricing" ("CMP"). Under CMP, a captive shipper (one that is dependent upon rail transportation and that is served by a single railroad) should not be required to pay more than is necessary either for the carrier involved to earn adequate revenues or to be served efficiently. As the Board noted recently:

> CMP contains three main constraints on the extent to which a railroad may charge differentially higher rates on captive traffic. The revenue adequacy constraint ensures that a captive shipper will "not be required to continue to pay differentially higher rates than other shippers when some or all of the differential is no longer necessary to ensure a financially sound carrier capable of meeting its current and future service needs." Guidelines, 1 I.C.C.2d at 535-36. The management efficiency constraint protects captive shippers from paying for avoidable inefficiencies (whether short-run or long-run) that are shown to increase a railroad's revenue need to a point where the shipper's rate is affected. Id. at 537-42. The "stand-alone cost" ("SAC") constraint protects a captive shipper from bearing costs of inefficiencies or from cross-subsidizing other traffic by paying more than the revenue needed to replicate rail service to a select subset of a carrier's traffic base. Id. at 542-546. A fourth constraint – phasing – can be used to limit the introduction of otherwise-permissible rate increases when necessary for the greater public good. Id. at 546-47.

Public Service Company of Colorado D/B/A XCEL Energy v. The Burlington Northern and Santa Fe Railway Company, Docket No. 42057, Decision served June 7, 2004 at 9.

Discussion

After nearly twenty years of the Guidelines, we agree with the STB that it is time to consider whether revisions are needed to accommodate changes that have occurred during this period in the railroad industry and freight markets, and to address present and likely future demands on the industry that may affect the suitability of the present-day SAC methodology in the future.

Although many important changes have occurred in the rail industry during the twenty year period in which the Guidelines decision has been in effect, perhaps the most significant for present purposes concerns railroad system capacity. Over this period, there is anecdotal and other evidence that railroads that once had excess capacity in many areas are now apparently facing increasing capacity constraints. [1] When an industry with high entry barriers faces capacity constraints, it is generally able to raise prices and increase profits. The increased profits may be used to finance capacity increases or may be put to other uses, depending on the opportunities open to firms. If demand for rail freight services continues to increase, investments in additional capacity should be profitable and railroads would be expected to undertake them.

Capacity constraints seem to have become an issue for surface freight transportation as a general matter. The trucking industry continues to struggle to find sufficient numbers of qualified drivers. Moreover, highway congestion is reducing truck speeds. Barges face bottlenecks at certain locks on the river system. Ports, including the nation's largest at Los Angeles/Long Beach, are unable to expand fast enough to handle traffic growth. Further, a growing economy and a growing volume of trade continue to place greater demands on the national transportation system. [2]

At a time when all modes of transportation are struggling to meet consistently rising demand, it is clearly in the public interest for railroads to have adequate capacity. The Department believes that it is important that the railroad rate reasonableness

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[1]/ This has not escaped the STB's notice; its own website references recent speeches by Chairman Nober that discuss the causes and effects of short-term and long-term rail capacity limitations. See http://www.stb.dot.gov/

[2]/ See, e.g., Freight-Rail Bottom Line Report, American Association of State Highway and Transportation Officials 2003 (Cambridge Systematics) available at http://www.camsys.com/casek02.htm

methodology employed by the Board assure that carriers have the opportunity to achieve the revenues necessary to make appropriate investments in capacity, now and in the future, as required by the CMP, while continuing to ensure the mobility needed by shippers.

But increasing capacity to meet current and projected demand costs money, and infrastructure investments are limited by income, current debt loads, and other factors. For example, the Canadian Pacific Railway believes that inadequate capacity and capital investment present the greatest challenge now facing the industry. See http://www8.cpr.ca/cms/English/Media/Speeches/2004/Solutions+for+North+America.htm The Union Pacific Railroad Company plans to double-track its Sunset Route between Southern California and El Paso, a source of major congestion; unfortunately, it currently envisions completing only about fifty miles a year due to a limited capital budget, a pace that will require eight years to finish the job. [3] In the meantime, lack of capacity (whether from a scarcity of trained crews, inadequate track capacity, yard restrictions, or other sources) has led railroads to alert customers to reduced service levels and, reportedly, efforts to limit traffic growth. [4]

DOT accordingly submits that the time is ripe to explore in more detail the existence and dimensions of rail capacity constraints -- particularly their causes, effects, and anticipated duration. To the extent the findings reflect a broad, long-term problem, the Board should then re-examine the SAC methodology and the Guidelines decision in order to determine what, if any, changes may be warranted to assure that decisions on rail

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[3]/ See http://www.uprr.com/newsinfo/srps/koraleski_070904.shtml

[4]/ See http://www.uprr.com/customers/updates/041504.shtml

rate reasonableness remain fair but do not impair the industry's ability to invest in needed capacity expansion. The Board should encourage participants in this proceeding to identify any issues they see as relating to the provision of adequate capacity and to suggest possible solutions. The Department intends to assist in the exploration of this area and looks forward to the views of others.

Conclusion

The Department stands ready to work with the rail industry, shippers, the STB, and others to determine whether and how the standards adopted in Guidelines might need to be modified, both to facilitate proper levels of investment in the railroad industry and to ensure that shippers are not asked to pay unreasonable rates for the efficient service our economy requires.

Respectfully submitted,

JEFFREY A. ROSEN
General Counsel

April 20, 2005