Railroads and Capacity Problem: Public/Private Approaches

STB Commissioner Francis P. Mulvey

Fuel Management Strategies Conference

Denver, Colorado--June 21, 2005
The Railroads and the Surface Transportation Board

Created by ICC Termination Act of 1995

Born out of the Deregulation Movement

Residual Economic Regulation of the Railroads

Far Smaller Staff and Scope of Authority
STB Mission

Exclusive authority to approve rail mergers
Review rail rates and practices to ensure they are reasonable and not discriminatory
Approval, including environmental review, of:
(i) construction of any new rail line or
(ii) abandonment of existing lines
Motor carrier collective ratemaking activities
Rates for non-contiguous domestic water trade
Rates for pipelines not carrying energy products
STB Responsibilities over Rates and Service

Oversee and Monitor Railroad Practices Nationally

Enforce the Railroads’ Common Carrier Obligation

Ensure that Rates Charged Captive Shippers are Reasonable

Assist Railroads in Earning Adequate Revenues

Calculate the Railroads’ Cost of Capital
Rate Case Resolution-Large Shipments

Determination of Market Dominance

Stand Alone Cost Test—*Fact-based approach rooted in economic reasoning and approved by the courts*

No Substitute for Preparing a Strong Case with Solid Evidence

Strive for a Balance between Railroad’s Need to Earn Adequate Returns and Shipper’s Need for Fair and Reasonable Rates
Alternative Approaches

SAC approach has been criticized as artificial and overly complex

SAC approach is very costly and time consuming

Only feasible for large shippers

Is it time to look for alternative approaches?
-- Recent Board decisions suggest openness to proposed rulemaking on SAC changes
-- April 26th hearing on the SAC process
The Genesis of the RR Capacity Problem

Improved Earnings Still not Revenue Adequate
Railroads “Punished” by Wall Street for Making Capital Investments
Railroads Often Found that Infrastructure Investments Failed to Generate Sufficient Income

Long term Strategy to Reduce Size of Workforce

Added Rail Infrastructure is Long-Lived While Demand Increases can be Short-Lived
Growth and Decline of Railroad Mileage
Railroad Employment 1939-2003 (in thousands)
Railroad ROI 1970-2003
### Railroad Cost of Capital and ROI

Sources: Annual R-1 Reports and AAR

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The Developing Rail Capacity Crisis

Shrinking Workforce and Infrastructure Partly Offset by Productivity Improvements

But Continuous Increase in Traffic Begins to Absorb “Excess Capacity”

Network becomes More Vulnerable to Stochastic Events

A Perfect Storm or the Rail Version of Global Warming
2003-2004 Capacity Problems

Expanding Economy Led to Surge in Imports
Large Grain Harvests in 2003 and 2004
Growth in Export Coal Market
Crew Shortages due to Wave of Retirements
Equipment Shortages due to Reduced Purchases
Cutbacks in Capital Spending Programs
Tight Capacity in Trucking Industry due to Driver Shortages, Higher Fuel Costs, HOS Rules, etc.
Class I Capital Expenditures
(in billions of current $)

1997 1999 2001 2003
Demand and Capacity for the Near Term

Intermodal Expected to Increase this Year But Rate of Growth is Slowing

Grain Carloadings to Date are Unchanged from Last Year, but Demand Could Rise if Barge Option “Dries Up”

Coal Traffic Remains Strong, but PRB Derailments and Maintenance Issues will Limit Performance

Railroad Operating Metrics Are Improving, Though Problems Remain
Carrier Responses to Recent Capacity Problem

More Cars and Locomotives Bought and Leased

Accelerated Hiring and Training of Train Crews

Some Infrastructure Expansion Efforts

Price Rationing of Available Capacity

Railroads Choosing who they will Serve and the Common Carrier Obligation
Long-Term Rail Capacity Constraint Factors

Demand for Freight Rail Transport Projected to Grow by 60%-70% over Next Two Decades

Railroads’ Inability to Earn Cost of Capital

Pressure from Wall Street to Reduce Capital Costs and Improve ROI

Long-Term Contracts Limit Railroad Pricing Flexibility

Railroads tend to Bid Long Term Contract Rates Down to Long Run Marginal Costs
What is The Role of the Public Sector?

Railroads Support Limited Role—Public/Private Partnerships (Alameda Corridor, CREATE)

Railroad Trust Fund Concept

Investment Tax Credits
- Short Lines and the 286K lb. Car Problem
- Class I Access and Limited Fiscal Capacity
- RIM and RIFF
Railroad Regulation and Capacity

STB’s Role has Centered on Rate Reasonableness for Regulated Traffic

Most Commodities are Exempt from Regulation and/or Modally Competitive

Interstate Commerce Laws and Doctrine Address Reasonableness of Rates and Service

Shippers want “Fairness”

What Can and Should the Board Do?
STB’s Service Initiatives

Board carefully monitors rail trends and performance metrics

Urge open communication between railroads and shippers in 2004 held carrier/shipper fora in San Francisco, Atlanta, Kansas City and Houston and will help sponsor with AAR a railroad/shipper meeting in St. Louis in mid-September

Asked railroads in 2004 to submit their fall peak plans and on June 15th asked for this year’s plans

Worked with railroads and shippers on service issues
STB – 2005 Priorities

Handle first small shipment rate case(s)

Reassess SAC Approach for Large Shipment Cases

Improved Customer Service from Carriers

Examination of Capacity Constraints

Amtrak Directed Service Mandate
Rail Consumer Assistance Program

Facilitates informal solutions to disputes with RR’s
Brings issues to RR’s attention rapidly
Solves Problems without Litigation
Promotes Rail Service Improvements
120 Rail Consumer complaints handled in 2004
Over 420 handled since program began in 2000
Is It Time to Review Rail Regulatory Policy?

Focus on 25th Anniversary of Staggers Act and 10th Anniversary of the creation of the STB

Proposed TRB study of railroads and regulation in the 21st Century
Thank You, Any Questions?