

# The Railroads and the Surface Transportation Board

- Created by the 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 of rail mergers
- Review rail rates and practices to ensure they are reasonable and not discriminatory
- Approval, including environmental review, of
  - 1. Construction of any new rail line or
  - 2. Abandonment of existing lines
- Motor carrier collective rate making 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 RR's common carrier obligation
- Ensure that rates charged captive shippers are reasonable
- Assist railroads in earning adequate revenues
- Calculate the railroads' cost of capital

# Current Activities of the Board Affecting U.S. Railroads

- Three pending large (coal) rate cases
- New small rate case guidelines
- New rules on fuel surcharges
- Reviewing our rate of return calculation
- Assessing need to address paper barriers
- Hearing on railroad infrastructure capacity on April 11, 2007

### Large Rate Case Resolution (Coal)

- Determination of market dominance
- Stand Alone Cost (SAC) 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 the railroad's need to ear adequate returns and shippers 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 shipments
- Alternative approaches to simplify large cases and broaden shipper access to STB processes



#### Ex Parte 657 –

### Rulemaking to Streamline Major Coal Rate Cases

#### STB Decision called for:

- 1. Replacing of the percent reduction approach for calculating maximum lawful rates to eliminate gaming
- 2. Adopting of an "average total cost" method to allocate revenue
- 3. Shortening the analysis period to 10 years
- 4. Changing the method of forecasting operating expenses to account for future productivity improvement
- 5. Limit cost adjustment
- 6. Adopting new standards to govern when to reopen rate cases

# Rate Case Resolution (Small Shipments)

- ICC adopted procedures for small rate cases in 1987 but courts struck them down
- STB adopted Simplified Guidelines in 1996 but never used them
- 20 years without finalizing the approach
- BP/Amoco 2005 settled through non-binding mediation but established procedural schedule
- 2007 Williams Olefins, LLC v. GTC mediated settlement

### Small Rate Cases – NPR

- Issued NPR on July 28, 2006
- Board proposed to:
  - 1. Create a simplified SAC procedure to use in medium-size rate disputes
  - 2. Retain the current "Three-Benchmark" method; focus on revenue to variable cost comparison
  - 3. Establish eligibility presumptions based on the maximum value of the case to distinguish between large, medium-size and small rail rate disputes
- Shipper and Railroad reactions

# Small Rate Case NPR January 22 Memo

- January 22 Memo new proposals raised by comments
  - "Small claims" model allowing
     complainant to select methodology used
    - 1. Full-SAC
    - 2. Simplified-SAC
    - 3. Three-Benchmark R/VC
- January 31 hearing on simplified standards for rate cases assessing comments on memo

## Railroad Cost of Capital

- STB generally finds RRs to be revenue inadequate
- STB combines cost of debt and cost of equity capital
- WCTL petition to reexamine our method-alleges that STB overstates cost of equity capital
- WCTL alleges that most analysts use CAPM approach not DCF

### New Fuel Surcharge Rule

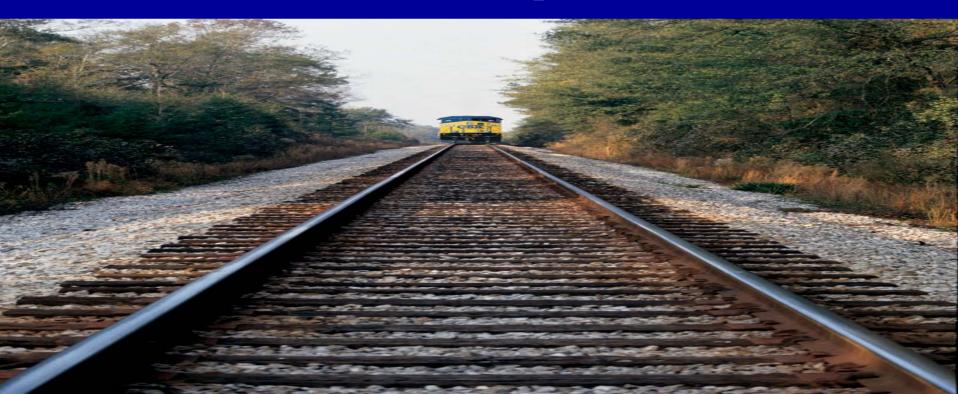
- January 26, 2007 Decision
  - Prohibits the assessment of fuel surcharges based on a percentage calculation of the base rate—must be better tied to actual cost changes
  - Prohibits "double-dipping"--applying to the same traffic both a fuel surcharge and a rate increase based on a cost index that includes a fuel component.
  - The Board is proceeding with a proposal to monitor the fuel surcharge practices of the rail industry by imposing mandatory reporting requirements on all large (Class I) railroads.

## Public Hearing on Methodology for Determining Rail Industry's Cost of Capital

- STB Hearing on February 15, 2007
- Issues raised
  - Problems with current Discounted Cost Flow (DCF) method
  - Comparison of DCF and Capital Asset Pricing Model (CAPM) approach
  - FERC two-step growth factor method
  - Use of a multi-stage DCF method
- Panel included
  - Federal Reserve
  - Association of American Railroads
  - RR and Industry Analysts

### Paper Barriers

- Contractual restriction that caps revenue levels at specific interchange points
- STB Hearing in 2006
- No action scheduled at present



Thank you. Questions?