Has the STB Changed Course?

Intro – Has the STB Changed Course? Depends on your vantage point --- some say we have changed course of late, some say we have not changed enough. I view our progress over the past 4 years as an adaptation to the changing economics of the rail industry. Many of the purported changes that the Board has made have been in the works for several years or more.

Let me speak about two of the core areas of our jurisdiction where we’ve been active recently, as well as some changes we’ve made to our procedures and processes.

I. Line Acquisitions and Competition

- Interchange commitments – I have been an outspoken critic of these agreements, especially those with indefinite timeframes. We’ve finished our investigation into the concerns about the appropriateness of certain “interchange commitments” (also known as “paper barriers”) that large carriers may enter into when they sell or lease light-density portions of their lines to smaller carriers. New rules require disclosure of future commitments, and facilitate disclosure of existing commitments for potential challenge. In the first case filed challenging an existing interchange commitment (Entergy v. UP and Missouri & No. Arkansas), discovery has closed and the opening statement is due mid-July.

- Acquisitions – We are reviewing the proposal by the Canadian Pacific Railway to acquire the Dakota, Minnesota & Eastern Railroad, as well as the Canadian National Railway’s proposal to acquire the Elgin, Joliet & Eastern Railway. The Board has three categories of transactions: major, significant, and minor. I have been critical of “significant” transactions as the null set. The Board found the CP-DME transaction
to be “significant” --- only the second time since 1993 that the agency has designated a merger in this category.

• Board members went out to Chicago to visit the EJ&E and St. Charles Air Line last week. We are conducting a full Environmental Impact Statement (EIS) on the CN-EJ&E merger -- atypical for a “minor” transaction. The designation as a minor transaction was the majority view of the Board, not mine. CN has requested the Board establish a timeframe for the EIS. NEPA appears to require that a timeframe be set when one is requested, but not necessarily the specific one requested.

• In December 2007, we denied the petition of Michigan Central Railway, LLC for authority to acquire and operate railroad lines of Norfolk Southern because we found that NS would have retained sufficient control of Michigan Central such that the transaction would not come within the scope of a start-up acquisition (a new shortline created under section 10901).

• A recent proposal by NS and Pan Am Railways to create a “Meridian Speedway” type of corridor, called the Patriot Corridor, is currently pending before the Board. Again, the Board classified this as a “minor” transaction despite the potential wide-ranging impact on New England and Northeast rail traffic. It may well be that Congress should re-examine the standards for classifying these transactions.

II. Rates

• In October 2006, we reformed the rate review process for large rate cases to streamline the process (because of high cost of and long duration of litigating cases); these six changes to the process were affirmed by the U.S. Court of Appeals for the D.C. Circuit in May 2008.

  o Since 2007, we’ve been in the process of deciding our first few cases under these revised rules. Our first final decision, Kansas City Power &
Light v. Union Pacific, issued a few weeks ago, resulted in an estimated $30 million in rate reductions and reparations ordered to the shipper. AEP Texas North and Western Fuels remain pending on limited remaining issues (i.e., impact of new cost of capital method).

- About half of the relief to KCPL is attributable to our switch to a Capital Asset Pricing Model instead of a single-stage Discounted Cash Flow model in calculating cost of equity to determine the 2006 cost of capital. KCPL might not be predictive of other cases because of its particular circumstances and UP’s agreement to hold any unreasonable rates to the 180% Revenue to Variable Cost (R/VC) threshold.

- In September 2007, we overhauled the procedures for handling small rail rate cases so that all shippers will have a practical and feasible means of challenging rail rates; these rules are on appeal. There are two approaches depending on the value of the case and limits set on recovery. The Simplified SAC limits recovery to $5 million over five years. The 3 Benchmark approach can be decided more quickly, but recovery is limited to $1 million over five years.

- Our decisions in the first three cases (the DuPont v. CSXT cases) were served earlier today. DuPont challenged seven movements in three cases and asked for review under the 3 Benchmark approach. We found the rates unreasonably high in six of the seven movements at issue, but that the railroad did not have market dominance in the seventh movement because the majority (90%) of the chlorine in that lane moved by barge. Rate reductions of 5%-40%. Cases likely to be appealed.

- In January 2007, we found railroad fuel surcharge methods to be an unreasonable practice. We proscribed rate-based surcharges in favor of cost-based, and proscribed “double dipping.” No retroactive reparations because no specific claims brought. We are in the process of adjudicating the first challenge to a specific carrier’s fuel surcharge in the Dairyland Power v. Union Pacific case.
• In January 2008, we completed the major phase of a rulemaking proceeding to modernize the way we calculate the railroad industry’s cost of capital to more accurately reflect the financial health of the rail industry.

  o We adopted the Capital Asset Pricing Model, or CAPM --- as opposed to the single stage Discounted Cash Flow, or DCF, model we had been using since 1981 --- because CAPM is a simpler, more transparent, current, and precise technique that is an acceptable and widely used method for estimating the cost of equity.

  o To overcome the difficulties of the single stage model, the railroads have recently proposed a multi-stage DCF model for use in conjunction with CAPM, in a related rulemaking.

  o And, the railroads have proposed that we change from using “book” or historical values of assets to using a replacement cost method in calculating revenue adequacy.

• We are in the midst of a rulemaking proceeding addressing the current ambiguity as to whether certain types of arrangements between rail carriers and shippers reflect contracts (for which regulatory remedies are unavailable), or whether they reflect common carrier service subject to Board regulation.

• The Board is now seeking comments on whether to use pre or post tax revenues in calculating how it measures the Revenue Shortfall Allocation Method (RSAM), which is used as a component in the simplified standards for judging the reasonableness of rates (for instance, in the DuPont v. CSXT cases).

III. Procedures and Processes
Over the past several years, the Board has made a concerted effort to make its procedures and processes more open and transparent to the public. Examples of these efforts include:

- Requiring carriers seeking Board authorization for the sale of shortlines to disclose any interchange commitments (as I noted earlier);

- Requiring railroads to report fuel surcharge metrics on a quarterly basis (the reports are posted on the Board’s website);

- We’ve proposed requiring railroads to enter fuel surcharge information in a separate column, rather than as a miscellaneous expense, in the Waybill sample;

- Providing shippers access to the confidential Waybill sample so they can understand and monitor how the agency calculates RSAM and R/VC<sub>180</sub>, two key benchmarks used in small rate cases;

- Requiring parties to use publicly available data in calculating the cost of capital, to promote greater transparency of that annual determination;

- Posting on the Board’s website summaries of railroad contracts entered into for the transportation of agricultural products that carriers are required to file with the agency;

- Reorganizing our offices of compliance and governmental affairs to expand our rail consumer assistance program and better address inquiries from the public and governmental organizations;

- Holding informational hearings on topics of concern to the agency and our stakeholders: 25<sup>th</sup> anniversary of Staggers Act; grain; rail capacity and infrastructure requirements; rail transportation of resources critical to the nation’s
energy supply; common carrier obligation; upcoming transportation of hazardous materials hearing;

- Establishing the Rail Energy Transportation Advisory Committee (RETAC); and

- In response to a GAO study, we have engaged an independent economic consulting firm, Christensen Associates, to conduct a study of rail competition-related issues. The report is due in Fall 2008. I had recommended that the Transportation Research Board of the National Academies conduct a study of the Board and its mandate, and that was authorized in SAFETEA-LU technical corrections bill in 2005. Unfortunately, the funds have not been available to conduct the study yet.

So, have we been more proactive over the past several years? Yes, we probably have been. But that is because “times have changed” since the Board began its work under the ICC Termination Act of 1995.