

SURFACE TRANSPORTATION BOARD IMPROVES PROCESS FOR DECIDING LARGE RAIL RATE CASES

The Surface Transportation Board today announced that it has concluded a major rulemaking proceeding to improve the STB's procedures for deciding large railroad rate cases. The changes adopted in the rulemaking will ensure that the standards both for deciding whether a rate is too high and for setting the floor for rate relief -- the lowest level to which rates can be ordered reduced -- are applied fairly and in conformity with the agency's statutory responsibilities.

In commenting on the decision, STB Chairman Charles Nottingham said:

"Today's announcement marks a significant milestone in the STB's ongoing effort to reduce litigation costs, create incentives for private settlement of disputes, and shorten the time required to develop and present large rail rate cases to the STB. The procedures established in this rulemaking will save shippers and railroads millions of dollars per case in consultant and legal fees -- funds that will now be available for more productive job creation, investment and transportation purposes."

This new rulemaking updates guidelines that were adopted by the agency 20 years ago to govern large rate disputes. In recent years and in numerous STB cases, it became apparent that the STB's rate dispute resolution process had evolved into an overly expensive and time consuming process, with cases typically requiring three years or longer to resolve at an estimated cost of over \$3 million for each side. These new rules reform STB processes to make its rate docket more manageable -- both for the agency and the parties -- by placing reasonable restraints on the evidence and arguments it would allow parties to submit in a particular case. With today's decision, the expense and delay in resolving rate disputes should diminish appreciably, and the results of the rate reasonableness inquiry should become more accurate.

Chairman Nottingham added:

"I congratulate the staff in their dedicated effort to complete the rulemaking within the aggressive schedule promised when the proceeding was begun. I also commend my colleagues for having initiated this important rulemaking earlier this year."

The STB also announced that it will now turn its attention to the task of reforming its procedures and standards for smaller rate disputes. That effort is already well under way, with final comments on proposed new guidelines due in late December 2006. After the agency reviews the public comments, it expects to issue guidelines for small cases that rely on the same principles used in large cases, albeit in a less expensive, less complex manner.

The STB's final decision [in Major Issues in Rail Rate Cases, STB Ex Parte No. 657 \(Sub-No. 1\)](#), is available for viewing and downloading via the STB's Web site at under "E-Library," then under "Decisions & Notices," beneath the date "10/30/06." A printed copy of today's decision also is available for a fee by contacting ASAP Document Solutions, 9332 Annapolis Rd., Suite 103, Lanham, MD 20706, telephone (202) 306-4004, or via . A fact sheet is attached.

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FACT SHEET

Major Issues in Rail Rate Cases, STB Ex Parte No. 657 (Sub-No. 1)

The Surface Transportation 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*), *aff'd sub nom. Consolidated Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987). These guidelines adopt a set of pricing principles known as "constrained market pricing" (CMP). Under those guidelines, captive shippers should not be required to pay more than is necessary for the carriers involved to earn adequate revenues. Nor should they pay more than is necessary for efficient service. And captive shippers should not bear the cost of any facilities or services from which they derive no benefit.

Most captive rail shippers seek relief under CMP's stand-alone cost (SAC) test. The SAC test 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 the carrier's traffic base. A stand-alone railroad (SARR) is hypothesized that could serve the traffic at issue if the rail industry were free of entry barriers. Under the SAC constraint, the rate at issue cannot be higher than what the SARR would need to charge to serve the complaining shipper while fully covering all of its costs, including a reasonable return on investment.

In this proceeding, the STB sought comments on proposals it had developed to address six issues raised in recent SAC cases. *First*, the STB presented two alternatives to the "percent reduction" method to determine maximum reasonable rates. Parties had expressed concerns that the percent reduction approach can be unfairly manipulated by the railroads because it contemplates the agency setting the maximum level of a new rate by ordering that the existing rate -- regardless of its level -- be reduced by a certain percentage. *Second*, the STB proposed a new cost-based method for allocating revenue from "cross-over traffic" (traffic that would be transported by the SARR for only a portion of the movement) to reflect economies of density. *Third*, the STB proposed a method for forecasting operating expenses of a SARR that would reflect anticipated future productivity gains. *Fourth*, the STB proposed to disallow parties from proposing adjustments to the agency's Uniform Railroad Costing System (URCS) when calculating the 180% revenue-to-variable cost jurisdictional floor for rate relief. *Fifth*, the STB proposed to shorten the time frame for its SAC analyses and corresponding rate prescriptions from 20 years to 10 years to simplify the analysis. *Sixth*, the STB proposed new standards for reopening and vacating a prior decision (including any resulting rate prescription) that was based on a SAC analysis that would require the party seeking to reopen to show new evidence, changed circumstances, or material error in the underlying decision, regardless of which party seeks reopening.

Using system-average variable cost numbers generated by unadjusted URCS, without further movement-specific adjustments, will save each party approximately one million dollars in consultant and legal fees per case. Resolving this and other hotly litigated methodological issues by this rulemaking will also decrease the expense and time required to bring a large rail rate case.

These proposals were intended not only to simplify the rate review process, but also to ensure that both the SAC test and the jurisdictional floor for rate relief are applied fairly and in conformity with the agency's statutory responsibilities. Because the issues they addressed went to the heart of the SAC test and would have industry-wide significance for rail carriers and their captive shippers, all interested parties were invited to comment on these proposed changes, and pending rate case were held in abeyance pending the outcome of this rulemaking. The STB received public comments on these proposals from over 20 parties,

including the United States Department of Transportation; several state public service commissions; trade associations representing shippers, as well as several individual shippers; water and rail carriers; and an economic consulting firm.

After reviewing the comments, the STB decided to: (1) replace the percent reduction approach with a "maximum markup methodology" to calculate maximum lawful rates; (2) adopt an "average total cost" approach to allocate revenue from cross-over traffic; (3) shorten the analysis period to 10 years; (4) change its method of forecasting operating expenses to account for future productivity; (5) use its unadjusted uniform rail costing system to determine if rail rate levels are below the jurisdictional floor; and (6) adopt the proposed new standards to govern when to reopen rate cases.

Through these changes, the STB accomplishes two important objectives: (1) it improves the soundness of its SAC decisions (by replacing the percent reduction method, adopting a cost-based method for allocating revenue from cross-over traffic to reflect economies of density, and accounting for productivity gains when forecasting operating expenses); and (2) it reduces the complexity and expense of these rate proceedings (by shortening the time frame for the SAC analysis from 20 to 10 years, simplifying the jurisdictional inquiry by using unadjusted URCS figures, and resolving three major methodological issues). The STB concluded that these steps were necessary to reduce the expense of seeking relief before the agency, and to protect the integrity of the rate review process.

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