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**Before the
Surface Transportation Board
Washington, D.C.**

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Rail Rate Challenges in Small Cases) Ex Parte No. 646
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**Statement of the
United States Department of Transportation**

The Surface Transportation Board (“STB” or “Board”) in this proceeding has again invited comments and scheduled a public hearing for interested parties to express their views concerning appropriate processes for rail rate challenges not involving the “constrained market pricing” approach used in major rate cases. Notice served June 29, 2004. The United States Department of Transportation (“DOT” or “Department”) applauds this latest in a series of efforts to refine the handling of such rail rate cases.

For years the Board and its predecessor, the Interstate Commerce Commission, have striven to improve the regulatory processes applicable to these cases. Several fundamental goals have guided the STB in this effort. The first has been to identify a more simple analysis than constrained market pricing in order to provide meaningful regulatory access. The second has been to enable railroads to differentially price their services according to the demand characteristics of the traffic. The third has been to protect captive shippers from bearing an undue share of railroad revenue requirements. Ex Parte No. 347 (Sub-No. 2), Rate Guidelines -- Non-Coal Proceedings, (served December 1, 1995) at 15-16. The Department strongly supports continued reliance upon these bedrock principles.

Unfortunately, shippers have not used the approach available in small rate cases today, which employs multiple revenue-to-variable cost ("R/VC") benchmarks that rely upon average cost figures. Rate Guidelines -- Non-Coal Proceedings, 1 S.T.B. 1004 (1996).¹ Last year in this proceeding shippers explained to the Board that they avoided this approach because it was still too expensive, time-consuming, and uncertain. They and other parties offered various alternative suggestions, such as mandatory, non-binding mediation, accelerated discovery and information exchange procedures, and the possible adoption of a "bright line" standard to determine the eligibility of cases for non-constrained market pricing procedures. At that time DOT urged the STB to consider these options, and we do so again now.

The Department also wishes to bring another matter to the Board's attention that should be factored into any analysis of these matters: the increasingly strained capacity of the railroad industry. Although this factor has implications that go beyond small rate cases, it is important for all interested parties to begin to consider the effects of limited rail capacity in this and other proceedings.

In the more than twenty years since the passage of the Staggers Act, the railroad industry has changed markedly. As a result of these changes, the economics of serving different shippers may have changed in ways that are not reflected in the conventional measures used by the STB for determining rate reasonableness. Since the railroads were partially deregulated by the Staggers Act, intermodal shipments have grown to be one of

^{1/} There are three such benchmarks: the revenue shortfall allocation method, or RSAM (which is intended to reflect the defendant railroad's revenue needs); the revenue-to-variable cost comparison test, or R/VC_{COMP} (which reflects differential pricing principles), and the revenue-to variable cost percentage above 180% test, or R/VC_{>180} (which compares the average markups applied to traffic).

the largest rail markets. Shuttle trains and other service innovations have changed the economics of shipping a number of commodities. Railroads have attempted to enhance efficiency by “right-sizing” their infrastructure by eliminating much of the excess capacity that existed prior to Staggers. As a result of these developments, DOT believes the economics of serving various types of customers may have changed.

Some shippers have been able to capitalize on these changes and achieve savings in transportation costs at the expense of competitors who, for a variety of reasons, were unable to make similar adjustments. For example, the lowered cost of using unit coal trains from the Powder River Basin in Wyoming has allowed those mines to extend their markets ever farther east, making significant inroads into markets traditionally served by smaller Appalachian mines.

Growing demand for transportation services may have now reached the capacity of the rail system in certain markets and traffic lanes. In order to better manage their systems, both the Union Pacific and the Burlington Northern and Santa Fe railroads have announced plans to allocate certain services to shippers -- in effect, rationing rail service. If current traffic levels are sustained for the long run, carriers will have incentives to either raise rates or ration service still further, again disadvantaging certain shippers vis-à-vis others.

DOT suggests that the STB needs to explore how these changes have affected the various types of “small shippers” potentially eligible to use non-constrained market pricing methodology, and that any ratemaking model proposed by the Board be tailored to ensure that the effects of capacity constraints are not unduly imposed on one class of shipper more than another while, at the same time, providing incentives for railroads to

increase capacity. DOT looks forward to working with the Board to address these issues in the context of the ongoing evolution of the railroad industry.

Respectfully submitted,

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