

Recommended Improvements in Rail Economic Regulation For Rate Challenges in Small Rate Cases

**Presented By
Tom O'Connor
Snavelly King Majoros O'Connor & Lee, Inc.
1220 L St NW
Washington, DC 20005**

(202) 371 9149 email SKMOLTom1@aol.com

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Small Shipment Rail Rates is An Important Economic Issue

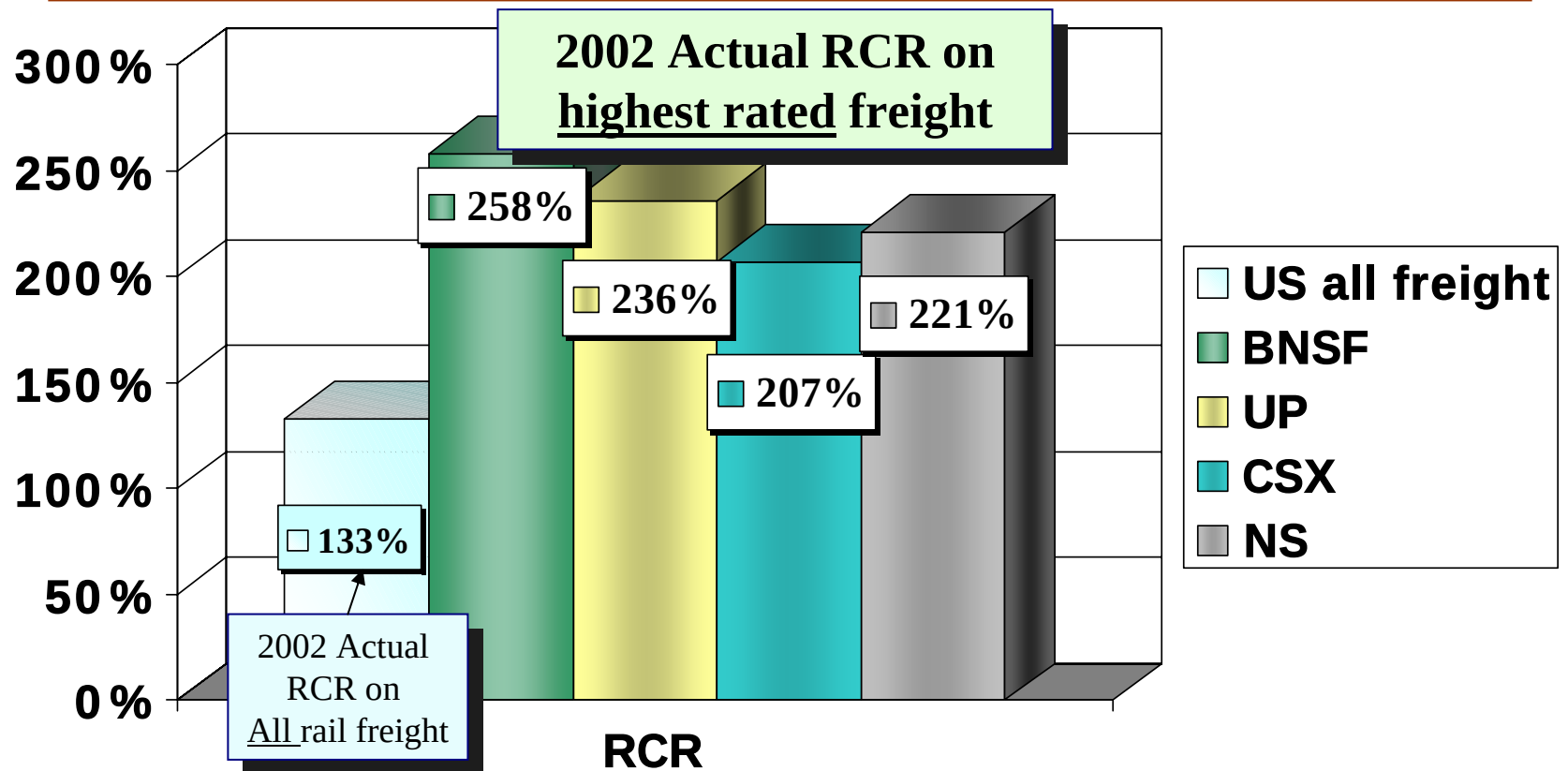
- ❑ Many small shipment rail rates are extraordinarily high
 - ❑ The Revenue Cost Ratios (RCR) on some small shipment lanes range up to hundreds of RCR points greater than the STB Regulatory Threshold RCR of 180 percent
 - ❑ $RCR = \text{Rail Revenue} \div \text{Rail Variable Costs}$
- ❑ The primary approach for resolving this situation is private commercial negotiations
- ❑ Availability of a supplemental regulatory remedy is advisable as a resource where impasse looms

Background: Rail rates often are higher when access to competitive rail service is limited

Competitive Rail Access at Origin	Revenue Cost Ratio
<u>Open:</u> Access to more than one railroad	Baseline RCR
<u>Captive:</u> Access to only one railroad ^{1/}	80 to 100 RCR points above baseline ^{2/}
<u>Restricted:</u> Access to more than one railroad via trackage rights or haulage rights	10 to 30 RCR points above baseline
^{1/} Other transportation modes are often not economically or commercially practical at captive locations ^{2/} 100 RCR points covers all rail variable costs	

Source: SK Analyses

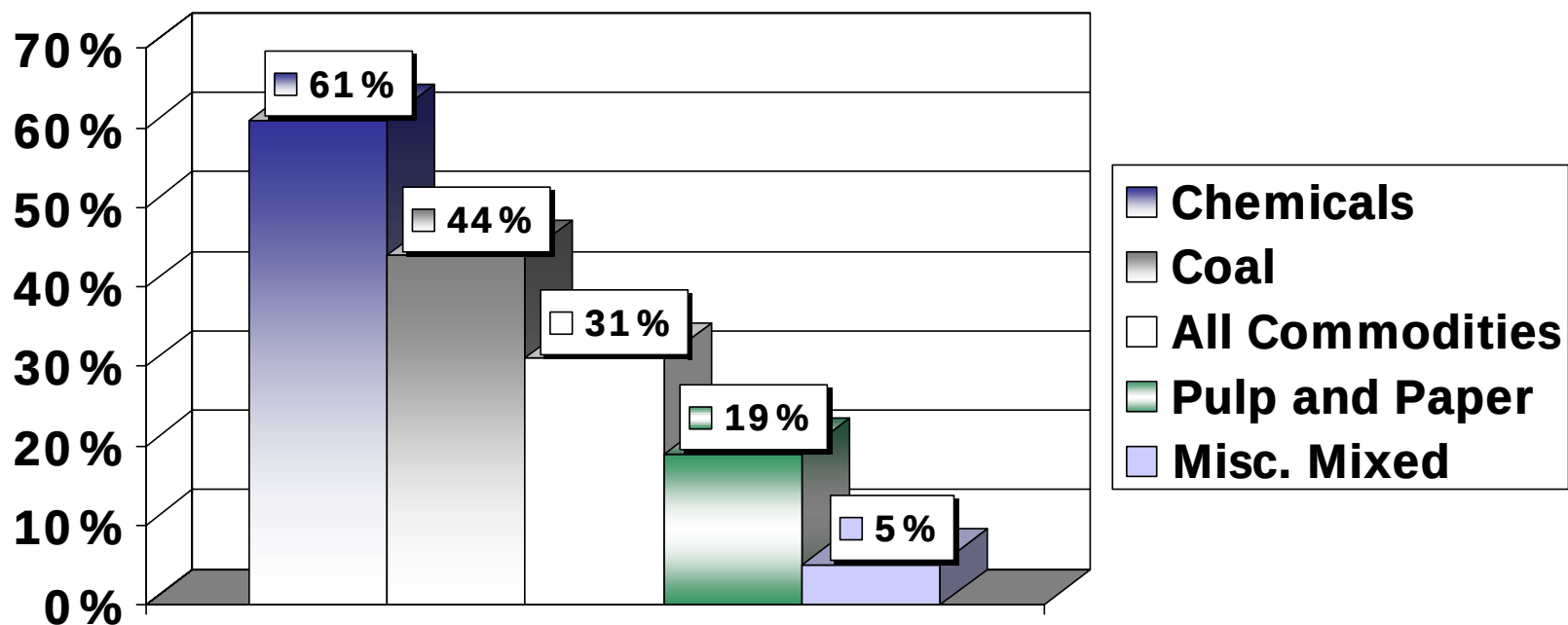
**The Highest Rate Shipments pay rates with RCR's 70 to 125
RCR points greater than the average for all commodities.
RCR= Rail Revenue Divided by Rail Variable Costs**



Source: STB Waybill Sample and STB Table II R/VC Percentages 1999-2002; Ex Parte No. 347 (Sub-No. 2); May 17, 2004

The Share of Revenue with RCR above 180 % varies widely by Commodity

Percentage of Revenue with RCR above 180 %



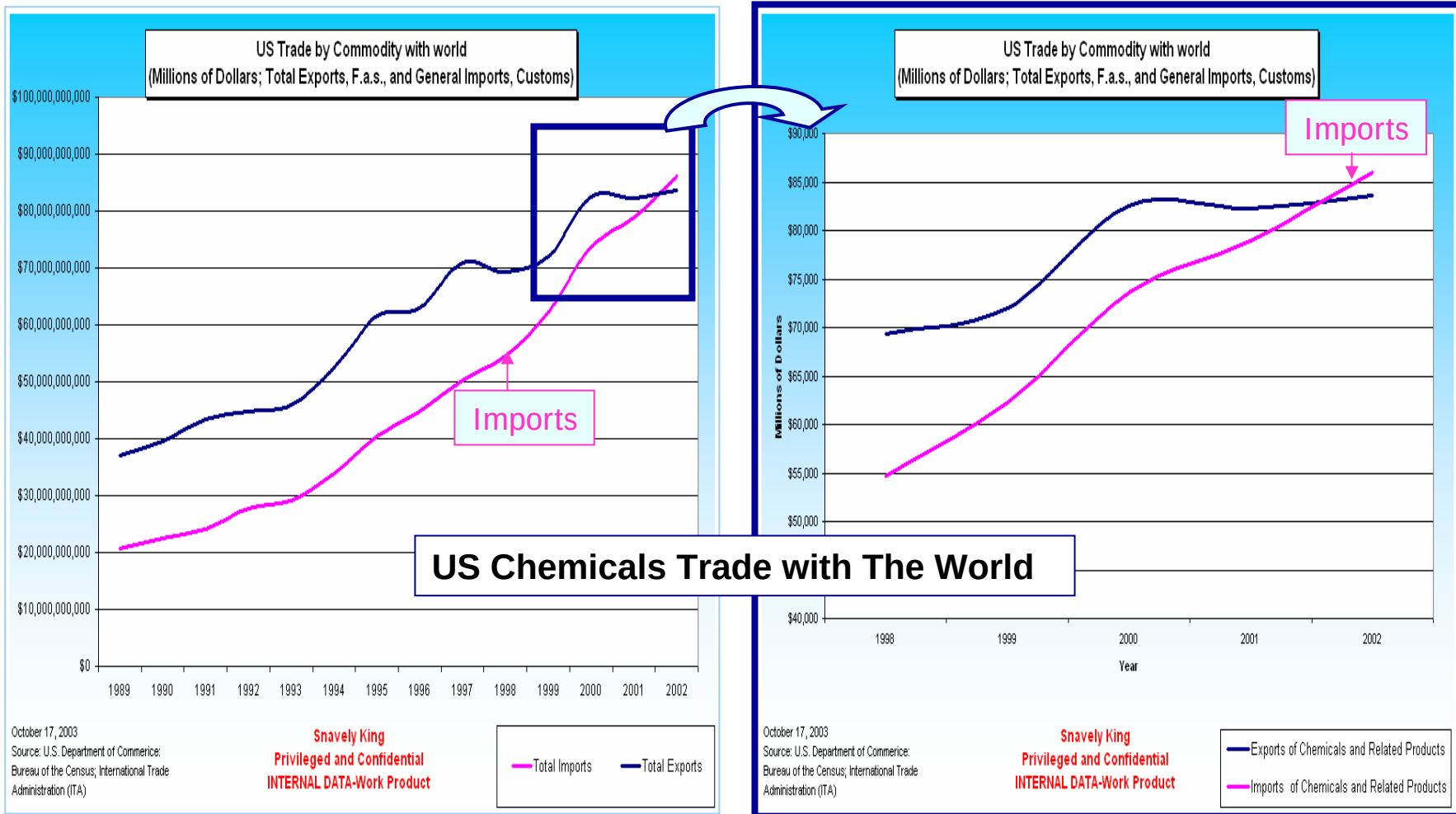
Source: 2002 STB Waybill Sample

Commodity Revenue Cost Ratios (RCR) Below 100 % and above 180 %

Commodity producing \$1 billion or more in Annual Rail Revenue	Percent of Commodity Revenue with 1/	
	RCR Below 100 %	RCR Above 180 %
Chemicals	6%	61%
Coal	4%	44%
Farm Products	9%	35%
Misc. Mixed Shipments	62%	4%
Petroleum or Coal Products	9%	44%
Pulp Paper and Allied Products	15%	19%
All Commodities	18%	31%

1/ Source: STB 2002 Waybill Sample

Some of These High RCR Commodities are under pressure.
For Example, Global Balance of Trade in U.S. Chemical Imports and Exports
Has Been Declining at an Increasing Pace



Alternative Remedies for Small Shipments with High RCR's

- ❑ Commercial Negotiations
 - ❑ Can be very challenging in captive lanes
- ❑ STB Maximum Rate Case
 - ❑ Economically infeasible for small shipments
- ❑ STB-Assisted Mediation
 - ❑ A welcome addition to the STB services
- ❑ STB- Assisted Arbitration

Recommended Remedies

- ❑ Commercial Negotiations
 - ...with availability as needed to:
- ❑ STB-Assisted Mediation
- ❑ STB-Assisted Arbitration

SK Recommended Action Plan

- 1. Focus on specific rail lanes with (a) Revenue Cost Ratios greater than the regulatory threshold where (b) rail or other modal competition is not available or not economically or commercially practical. Meeting conditions (a) and (b) satisfies the market dominance prerequisite for accessing Surface Transportation Board (STB) regulatory rate relief and indicates that regulatory rate relief may be appropriate.**
- 2. Demonstrate that small rail shipments are eligible to pursue Surface Transportation Board Maximum Rate Relief under the STB regulations in Ex Parte 347 Sub No. 1. (i.e. traffic is not exempt from regulation)**
- 3. Demonstrate that the small shipment rates at issue would be found as excessive in rate reasonableness analyses using the STB small shipper RCR guidelines in Ex Parte 347, Sub No. 2.**
- 4. Many have observed that the STB small shipper guidelines have never been applied. Yet these guidelines provide a good base for negotiations and if needed, mediation.**
- 5. SK recommends a synthesized alternative: a solution based on STB small shipper guidelines with discussions mediated by the STB.**

Support Slides

The Revenue Cost Ratios on some small shipment lanes are higher than RCR's on the highest rated rail traffic (Rail traffic with RCR's above 180 %)

Railroad or Region	STB 2002 and Four Year Average Actual RCR on Traffic with RCR Above 180 % ^{1/}	
	4 -Year Average RCR For 1999-2002	2002 RCR
US	Not Available	234 %
BNSF	263 %	258 %
CSXT	200 %	207 %
NS	212 %	221 %
UP	232 %	236 %

1/ Source: STB Table II R/VC Percentages 1999-2002; STB Ex Parte No. 347 (Sub-No. 2); May 17, 2004

Global Trends of U.S. Chemical Exports and Imports

- ❑ From 1989 to 1995 U.S. Chemical exports maintained a 40% or \$18 Billion surplus over chemical imports into the U.S.
- ❑ Since 1995 the trade surplus has diminished dramatically
- ❑ By 1999 the trade gap had narrowed to 14% or \$9.5 billion.
- ❑ By 2002 there was a negative balance of -3% or \$2.5 billion
- ❑ Trends indicate that negative trade balance will continue into the future
- ❑ Over time, in part due to global economic conditions, alternatives to US chemical production have been increasing.
- ❑ Global production capacity is growing as developing countries are industrializing and building their own facilities
- ❑ **US direct investment abroad in chemicals has risen from \$38 billion to \$86 billion over the past decade as US companies are shifting production from the US to overseas.**