

BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 657 (SUB 1)

MAJOR ISSUES IN RAIL RATE CASES

COMMENTS OF
THE OFFICE OF REGULATORY STAFF

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Date: May 1, 2006

I. AUTHORITY AND INTEREST

The South Carolina Office of Regulatory Staff (“ORS”) is charged by law with the duty to represent the public interest of South Carolina pursuant to S.C. Code § 58-4-10(B) (added by Act 175). S.C. Code § 58-4-10(B)(1) through (3) read in part as follows:

...‘public interest’ means a balancing of the following:
(1) concerns of the using and consuming public with respect to public utility services, regardless of the class of customer;
(2) economic development and job attraction and retention in South Carolina; and
(3) preservation of the financial integrity of the State’s public utilities and continued investment in and maintenance of utility facilities so as to provide reliable and high quality utility services.

ORS represents the interests of consumers as well as the public utilities in South Carolina. Because the rates charged by the utilities in South Carolina include transportation costs, ORS has an interest in ensuring that the transportation rates paid by the public utilities in South Carolina are reasonable. The regulated public utilities in South Carolina are permitted to flow the transportation costs through to consumers. Transportation costs account for approximately ten percent (10%) of the electric service rates paid by South Carolinians. However, if the public utilities are unable to obtain efficient and competitive transportation, ORS is concerned that the resulting negative impact to the public utilities (i.e. increased rail rates) is borne by South Carolina rate payers; harms the financial integrity of the public utilities; and slows economic development and job attraction.

II. BACKGROUND

The Surface Transportation Board (the “Board”) instituted a Notice of Proposed Rulemaking (“NOPR”) in this docket on February 27, 2006, to examine major issues concerning the proper allocation of the stand-alone cost (“SAC”) test in rail rate cases and the proper calculation of the floor for any rail rate relief. In *Ex Parte No. 657*, the Board held a hearing on April 26, 2005, on rail rate challenges under the SAC methodology. On March 15, 2006, ORS filed its Notice of Intent to Participate in *Ex Parte No. 657 (Sub-No, 1)*.

ORS will not address each issue raised by the Board’s NOPR but will focus only on those matters of greatest importance to ORS. ORS generally supports the Comments filed by the Concerned Captive Coal Shippers (“CCCS”). For those issues not addressed by ORS below, ORS generally agrees with the Board’s proposal set forth in the NOPR.

III. RECOMMENDATIONS

As an initial comment, ORS recommends that the Board should consider whether the SAC test is a reasonable and viable rate methodology. The time and expense involved in litigating a SAC case appears to be enormous, and small shippers may not have the means to file a complaint with the Board. ORS, however, recognizes that the Board has requested comments on certain issues affecting the SAC test. ORS’ comments focus on the percent reduction method, the proposed average total cost method, and the proposal to eliminate movement-specific adjustments.

A. Maximum Rate Determination

Currently, if the Board finds that total stand-alone revenues exceed total stand-alone costs, it determines the measure of rate relief using the “percent reduction” method. The Board has acknowledged that the percent reduction method is open to gaming. Because the percent reduction rule starts with the shipper’s existing rate, a railroad could “game” the outcome of a case by setting a very high rate, which even after reduction would be at an inaccurate, yet satisfactory level to the railroad. Conversely, a shipper in a traffic group with highly rated non-issue traffic, can make a railroad’s tariffs look unfair even if they are quite low because the shipper’s business is a small portion of the total. In *Ex Parte No. 657 (Sub-No, 1)*, the Board proposes to eliminate the percent reduction method and substitute one or both of two alternatives to remedy the distortions created by gamesmanship.

The first method, called the Maximum Contribution Methodology or “MCM,” would allocate total SAC among members of the Stand Alone Railroad (“SARR”) traffic group on the basis of each member’s ton-miles. The MCM would calculate the total SAC costs in a given year, apportion them among the selected traffic group on a ton-mile basis, and then determine whether any traffic-movement’s cost exceeded what the SARR could actually charge. If a member’s allocated share of SAC would be higher than the rate it is currently paying, then the contribution would be capped at that level and the excess re-allocated among other members of the group. This process would be repeated until all costs had been allocated and no movement in the traffic group is assigned a higher share of the costs than the SARR could charge in the marketplace. The Board acknowledges that MCM would distort the results whenever a heterogeneous traffic

group – one with a mixture of long- and short-haul traffic or of unit-haul and manifest traffic was involved.

The second method, named the Maximum Markup Methodology or “MMM,” would estimate the variable cost of each movement in the traffic group and express the maximum SAC contribution as a percentage markup over variable cost, again based on each movement’s current rate. Under MMM, a movement with higher variable costs generally would have a higher maximum SAC contribution. MMM has its own shortcoming: the railroads could manipulate it to a degree. For example, the railroad could affect variable cost by choosing different cars, such as rental versus owned.

ORS supports the elimination of the percent reduction method because of the opportunity for gaming. ORS supports the MCM and MMM alternatives as they would be an improvement to the current system. However, ORS requests that the Board permit shippers to use alternative methods and to refrain from adopting MCM and MMM alternatives as the exclusive methods for determining rate relief. Based on the particular facts and circumstances of each individual case, shippers should have the ability to request and support alternative methodologies that may be superior in individual cases to either MCM or MMM.

B. Revenue Allocation for Cross-Over Traffic

In most recent coal rate proceedings, the complainant has used a SARR traffic group that includes “cross-over traffic,” which is traffic that is handled for part of its movement by the SARR, then is handed over to the incumbent railroad at a hypothetical interchange. When cross-over traffic is included, the revenue that the incumbent earns on the actual movement must be divided between the SARR and the incumbent.

The current method for allocating the cross-over traffic revenue between the SARR and the incumbent railroad is the Modified Straight Mileage Prorate or “MSP” methodology. MSP divides the revenue between the SARR and the incumbent on the basis of each carrier’s share of the total mileage, with the originating and terminating carrier receiving an extra 100-mile allocation to account for terminal costs.

The railroads have proposed an alternative method: Density Adjusted Revenue Allocation (“DARA”), which would take into account economies of scale arising from higher traffic on some segments and the lack of such economies on more lightly used segments. The Board has taken the position that DARA is inaccurate because economies of scale decline after a point; however, DARA uses a strict inverse proportion to density to adjust for cross-over traffic.

In its NOPR, the Board proposes to discontinue use of MSP and adopt the Average Total Cost or “ATC” method. Under ATC, parties would calculate the average variable costs and average fixed costs per ton for each segment of a cross-over movement. Revenue would be divided between the SARR and the incumbent railroad in proportion to each party’s ATC. Because the formula assumes that average fixed costs per mile are identical on all parts of the incumbent’s system, ATC assigns a greater share of cross-over revenue to lighter density lines, which in most cases would be the incumbent’s line segments.

ORS has determined that MSP is a better option than ATC because the ATC method is biased toward the incumbent railroad. ORS recommends that the Board use MSP as the method of allocating revenues on cross-over traffic.

C. Variable Cost Adjustments

In its NOPR, the Board notes that the variable costs associated with the traffic at issue determine the floor for rate relief because the Board cannot prescribe a rate that is below the jurisdictional floor. As part of the jurisdictional inquiry, the Board has permitted movement-specific adjustments. Shippers advocate movement-specific adjustments that would reduce the variable costs and increase the resulting revenue/variable cost ratios; however, the railroads advocate adjustments that would increase variable costs and reduce the resulting revenue/variable cost ratios. Unit train coal transportation is widely recognized as being considerably more efficient and less costly (on a unit basis) than the railroads' "average" traffic. The Board has traditionally accepted evidence of movement-specific adjustments to railroads' system average Uniform Railroad Costing System ("URCS") costs in determining variable costs in coal rate proceedings.

The Board proposes to eliminate movement-specific adjustments and base all future variable cost determination on system averages alone. In support of its proposition the Board references the complexity, cost, and the railroads' differing practices related to retaining the data needed to develop movement-specific adjustments to URCS costs.

ORS respectfully disagrees with the Board's proposal. If a party is able demonstrate that its figures are based on more accurate cost determinations than a system average, the Board should permit the use of those figures. ORS is concerned that the Board's proposal favors the railroads to the detriment of the shippers in calculating variable costs. ORS recommends that the parties be permitted to choose whether to seek movement-specific adjustments.

IV. CONCLUSION

ORS supports the Board's proposal to use MCM and MMM alternatives but requests that shippers be permitted to use additional alternatives. However, ORS opposes the Board's proposal to adopt ATC and to disallow movement-specific adjustments to variable costs.

Respectfully submitted,

/s/

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Dated: May 1, 2006

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CERTIFICATE OF SERVICE

This is to certify that I, Pamela J. McMullan, an employee with the Office of Regulatory Staff, have this date served one (1) copy of the **COMMENTS** in the above-referenced matter to the person(s) named below by causing said copy to be deposited in the United States Postal Service, first class postage prepaid and affixed thereto, and addressed as shown below:.

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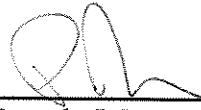
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May 1, 2006
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