

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

	)	
Simplified Standards for Rail Rate Cases	)	Ex Parte No. 646 (Sub-No. 1)
	)	

**Initial Comments of the
United States Department of Transportation**

Introduction

The Surface Transportation Board (“STB” or “Board”) in this proceeding seeks to make regulatory relief more widely accessible to shippers who believe railroads are charging them unreasonably high rates. Decision served July 28, 2006 (“Decision”). The Board has proposed to make the size of the dispute -- measured by “the value of the case” -- determinative of the appropriate method of adjudication. Under this approach, the largest cases would continue to employ the very costly but theoretically better grounded Stand-Alone Cost (“SAC”) methodology to assess the reasonableness of rail rates, but different rules, standards, and procedures would govern newly-defined “medium” and “small” disputes.

The United States Department of Transportation (“DOT” or “Department”) supports this effort. In previous proceedings DOT favored both enhanced shipper access to the Board’s regulatory mechanisms and clear standards to determine a case’s eligibility for non-SAC treatment. The STB’s instant proposals address these and other goals, and they deserve careful consideration, particularly by those parties with real-world exposure to both the transportation marketplace and rate adjudication. The Department lacks such experience, and thus we await the opportunity to consider the submissions of other parties

before taking final positions on specific issues presented. We offer our preliminary views on the STB's proposals below.

As the Board formulates its final approach, DOT also urges that the agency be guided by the following principles in its decisionmaking process:

- Predictability – participants in a rate dispute should have a reasonable expectation of the likely methodology and results in their case. The clearer the rules and procedures for determining outcomes, the greater the likelihood that the parties will resolve their differences privately rather than via litigation.
- Lack of bias – standards and procedures used to adjudicate small- and medium-sized rate disputes should produce results roughly similar to those expected from a full SAC presentation. Accepting that the results must vary at least to some degree, the difference in results should not routinely favor one side or the other.
- Cost – access to regulatory relief should depend far more upon the merits of a case than upon the cost of bringing one.
- Precision – the greater the amount in controversy, the greater should be the emphasis upon reaching a result similar to that produced via a full SAC analysis while remaining consistent with the principles of Constrained Market Pricing.
- Timeliness – the time required to resolve cases must be reduced as much as possible to better align the adjudicatory process with fluid business practices.
- Incentives – rules must avoid undercutting railroad incentives to increase productivity, expand capacity, and improve service.
- Symmetrical burdens – the costs and associated burdens in a rate case should be similar for both sides insofar as practical. To avoid structural bias, neither party should face a much higher burden in presenting or defending its case than the other.

Finally, the STB notes that if a rate complaint concerns traffic that is exempt from regulation, the shipper would have to include a separate request for a partial revocation of the exemption, the defendant carrier would file a response, and the Board would consider this point as the case went forward. Decision. at 17. To the extent this proposal intends

only to point out the standard necessity for those seeking to revoke exemptions to bear the usual burden of proof in meeting the statutory standard, DOT has no objection. But we would oppose any suggestion that these exemptions may be dispensed with on some other basis simply because they arise in the context of rate regulation.

The Eligibility Standard

The Board has proposed to use the “maximum value of the case” (“MVC”) as a bright-line test to determine the appropriate methodology for processing a rate complaint. Decision at 33.¹ The greater the size of the dispute, the more exacting and precise must be the process used to assess the reasonableness of the applicable rail rate. *Id.* Through reliance on the MVC rather than on the size of the shipper or some other factor, the STB is attempting to comply with Congress’ command to establish a “simplified and expedited” alternative to the SAC methodology when that methodology is “too costly, given the value of the case.” 49 U.S.C. § 10701(d)(3); Decision at 3.²

The Board has estimated the cost of pursuing a full-fledged SAC case at \$3.5 million. *Id.* at 35-36.³ MVCs higher than that amount would mark “large” cases and would continue to require a full SAC presentation. The STB projects the cost of conducting a rate case under a proposed simplified iteration of traditional SAC

¹/ MVC is defined as “the maximum rate relief the shipper could attain over 5 years if the challenged rates were reduced to the jurisdictional floor (*i.e.*, the level at which the R/VC [revenue-to-variable cost] ratio equals 180%.” *Id.* Through various adjustments, the MVC would equal “the net present value, as of the time of the filing of the complaint, of the maximum relief that the shipper could obtain.” *Id.*

²/ Shippers have avoided the only existing non-SAC alternative in part because there has been no bright-line standard for eligibility. See Decision at 3, 9, 19. The Board adopted this alternative in Rate Guidelines – Non-Coal Proceedings, 1 S.T.B. 1004 (1996) (“Simplified Guidelines”).

³/ This takes into account cost-reducing revisions under consideration in Ex Parte No. 657 (Sub-No. 1), Major Issues in Rail Rate Cases, served February 27, 2006.

methodology (called “Simplified-SAC”) at \$200,000. Id. at 36. Thus, MVCs between \$200,000 and \$3.5 million would be considered “medium” size disputes, and would be eligible to use the Simplified-SAC approach. Id. at 33-36. Finally, MVCs below \$200,000 would be deemed “small” cases; they would qualify to use a proposed revised version of the existing “three benchmark” approach. Id. at 33. These demarcations serve as presumptions only, and are rebuttable according to the evidence in each instance, in order to take into account the circumstances in a given case. Id. at 34. ⁴

The SAC approach remains the preferred methodology for determining the reasonableness of railroad rates while permitting differential pricing, and is thus generally favored by the Board as the financial dimensions of rate controversies increase. To avoid any incentive shippers may have to lower their MVC in order to use methodologies that are much less expensive but also less accurate, the STB would impose three additional conditions in determining the appropriate size of a case: (1) limiting the period of rate relief to 5 years; (2) applying any rate relief only to the traffic referenced in the complaint; and (3) refusing to permit disaggregation of claims. Id. at 33-36. ⁵

The Board projects that under its proposed eligibility measures 34% of regulated traffic disputes would qualify as “large,” presumptively requiring full SAC presentations; 50% of regulated traffic disputes would be considered “medium,” presumptively employing the Simplified-SAC approach; and disputes over the rates applicable to the

⁴/ The MVC demarcations are also to be indexed for inflation. Id.

⁵/ The five year period also reflects “the dynamic nature of transportation markets” and the “more fluid market environment” in which many smaller shippers operate. Id. at 35. The second condition would cap any rate prescriptions to the shipper’s representation of the annual tonnage at issue. Id. at 34. Finally, all claims brought within a two-year period that involve the same railroad and the same captive origin or destination would be aggregated. Id.

remaining 17% of regulated movements would be “small,” presumptively using the revised “three benchmark” treatment. *Id.* at 37, Table 2.⁶

As noted, the Department has long supported clear eligibility standards to reduce uncertainty (and litigation) about the applicable regulatory methodology in any given case. These MVC proposals are therefore a definite improvement over the status quo. DOT favors the Board’s “sliding scale” approach, relating the cost and precision of analytical methods to the size of the dispute at issue. Our preliminary view, however, is that the Board should consider whether the financial amounts proposed for small and medium cases would be quickly exceeded.

Unfortunately, the Department’s lack of familiarity with the details of shipper operations and how they relate to the Board’s proposals, as well as with the realities of prosecuting and defending rate cases, does not allow us to make any realistic assessment at this time of how likely or widespread these perceived problems may be. We look forward to reviewing the comments of other parties as we refine our views.

“Small” Rate Cases

The traditional non-SAC methodology for small shippers compares the challenged rate in relation to three benchmarks, each of which is expressed as a ratio of revenues to variable costs of providing rail services. *Id.* at 7. The first two ratios, called “RSAM” and “ R/VC_{total} ,” make relatively small adjustments in the final ratio based on the revenue adequacy of the defendant carriers. The pivotal ratio is called “ R/VC_{COMP} ,”

^{6/} DOT notes that it cannot duplicate the numbers in Table 2 from the waybill. If Table 2 includes traffic that is exempt or under contract, it may give an inaccurate impression of the impact of the proposed methodologies.

and it is designed to compare the markup on the movement covered by the challenged rate to the average markup applied to other traffic “involving the same or a similar commodity moving similar distances.” Id.

For the R/VC_{COMP} , both the complaining shipper and the defendant railroad would tender a comparison group of traffic. In order to counter the parties’ natural incentives to proffer a group with R/VC s favorable to their desired outcome, the Board would use a “final offer” format to select, without modification, the comparison group “most similar in the aggregate” to the traffic at issue. Id. at 20. The agency would then calculate the mean and standard deviation of the R/VC ratios for this comparison group. If the challenged rate is above a “reasonable confidence interval” around the estimated mean, that rate would be deemed unreasonable. Id. at 26.⁷ At that point the STB would reduce the challenged rate to the mean of the comparison group.

The Department shares the Board’s goal of establishing a truly accessible remedial mechanism for rate disputes of all sizes, but we also join in the concern that repeated use of this procedure could tend to lower the mean and reduce all rates to that level. Id. at 27. Such an outcome would clearly have a detrimental effect on railroad incentives to make capital investments and improve service.

In the interests of further clarity and predictability, we suggest that additional guidance from the STB would be particularly helpful in the compilation of comparison groups of traffic. The two factors characterizing such groups -- length of haul and

^{7/} The Board explains that a “confidence interval” is a statistical methodology that attempts to quantify the level of uncertainty in a measurement. Id. at 19, note 31. Confidence intervals have upper and lower boundaries, within which lie a range of values of the certainty one can have in finding the true measurement. A large interval between the upper and lower bounds indicates a greater uncertainty level and less precision; a small interval indicates the reverse. Id.

similarity of commodities -- themselves raise several questions. These include whether comparison groups have to move on the same (defendant) railroad and what size should the sample be?⁸ Moreover, the STB has proposed to gauge the similarity of commodities by Standard Transportation Commodity Code (“STCC”) at the two-digit level. *Id.* at 33.⁹ Yet this very generalized level embraces a broad swath of traffic that may have only nominal commonality and very justifiably different rates.¹⁰

Additional clarification of how this procedure would work would thus provide helpful guidance. Once again, of course, DOT is interested in reviewing comments from other interested, experienced parties on these issues.

“Medium” Rate Cases

A full SAC presentation investigates in great detail whether the challenged rate forces the complaining shipper to subsidize other parts of the defendant railroad’s network and whether there are inefficiencies in the defendant carrier’s operations or investments. *Id.* at 10. The second objective generates most of the complexity and expense in these cases, so the Board has proposed to eliminate it as an issue in medium-sized disputes. The STB would also modify other elements of the SAC methodology in

⁸/ The larger the sample size, the lower its expected variance and the smaller the difference between the upper and lower boundaries of the confidence interval. Shippers contesting a rate, therefore, would be expected to have an incentive to use a large sample for the comparison group, while defendant railroads’ incentive would be for a small comparison group. Yet it may be difficult for some shippers to find sufficient comparable traffic to produce a representative sample.

⁹/ The STCC is a numeric code published by the Association of American Railroads that represents a great many commodity groups. The codes proceed up to seven digits, with each additional digit (or level) more narrowly identifying a commodity.

¹⁰/ For example, STCC 28 identifies “Chemicals or allied products.” That two-digit level describes both the innocuous (salt, detergent, etc.) and the hazardous (chlorine); rates for the former would tend to be much lower than for the latter, and properly so.

the interests of simplicity and reduced cost. Id. at 10-19.¹¹ The result is a Simplified-SAC that seeks to eliminate supra-competitive profits yet preserve the railroads' incentive and wherewithal for capital investments. Id. at 11.

The Department's preliminary view is that, overall, Simplified-SAC appears a reasonable, economically acceptable method of ascertaining the reasonableness of rail rates at a lower cost. That cost seems likely nonetheless to be substantial in this category of cases, and if so the question of the true accessibility of regulatory relief would remain. We again look forward to the submissions of other interested parties with greater expertise in this regard.

DOT is also concerned with the apparent disparity in the information burden borne by the railroads in this category of cases. The proposal would require rail carriers to provide "total operating and equipment cost calculations," revenue allocations for crossover traffic segments, and information about the specifics of the route in question. Id. at 18-19. This information is not readily available, but must be produced by the railroads in every case; to the extent its production entails significant expenditure of resources this may become leverage or a bargaining tool in rate negotiations.

Moreover, Simplified-SAC employs many of the components of the full SAC methodology, which methodology is also the subject of an ongoing rulemaking in Ex Parte No. 657 (Sub-No. 1), supra. The Board should consider whether, and to what extent, the final decisions in that proceeding should have application to Simplified-SAC.

¹¹/ The modifications include restricting evidence on certain issues, use of unadjusted industry data, and existing infrastructure and routes, etc. Id. at 12-14.

Conclusion

The Department has long supported regulatory mechanisms that provide meaningful access to the overwhelming portion of the nation's shippers. Although DOT at this point can express only very preliminary views, it appears that the Board has made a promising start toward the development of such mechanisms through proposals that would reduce costs and uncertainties and increase clarity and predictability. We urge the STB to consider carefully, however, whether the proposed MVC demarcation amounts would be quickly exceeded. We also have questions about the intended operation of some of the STB's proposals and their implications for railroads' financial prospects and continued capital investment. The Department looks forward to refining its views through consideration of the comments of other parties.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Rosalind A. Knapp". The signature is fluid and cursive, with a large, stylized "K" at the end.

ROSALIND A. KNAPP
Acting General Counsel

October 24, 2006

CERTIFICATE OF SERVICE

I hereby certify that on this date I have caused a copy of the Initial Comments of the United States Department of Transportation in Ex Parte No. 646 (Sub-No. 1) to be served by first class mail, postage prepaid, upon all Parties of Record in this proceeding.

A handwritten signature in cursive script, reading "Paul Samuel Smith".

Paul Samuel Smith

October 24, 2006