



Francis P. Mulvey
Commissioner
U.S. Surface Transportation Board

The STB & the Nation's Railroads
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The Railroads and the Surface Transportation Board

- Created by the ICC Termination Act of 1995
- Born out of the deregulation movement
- Residual economic regulation of the railroads
- Far smaller staff and scope of authority



STB Mission

- Exclusive authority to approve of rail mergers
- Review rail rates and practices to ensure they are reasonable and not discriminatory
- Approval, including environmental review, of
 1. Construction of any new rail line or
 2. Abandonment of existing lines
- Motor carrier collective rate making activities
- Rates for non-contiguous domestic water trade
- Rates for pipelines not carrying energy products

STB Responsibilities over Rates and Service

- Oversee and monitor railroad practices nationally
- Enforce the RR's common carrier obligation
- Ensure that rates charged captive shippers are reasonable
- Assist railroads in earning adequate revenues
- Calculate the railroads' cost of capital

Current Activities of the Board Affecting U.S. Railroads

- Three pending large (coal) rate cases
- New small rate case guidelines
- New rules on fuel surcharges
- Reviewing our rate of return calculation
- Assessing need to address paper barriers
- Hearing on railroad infrastructure capacity on April 11, 2007

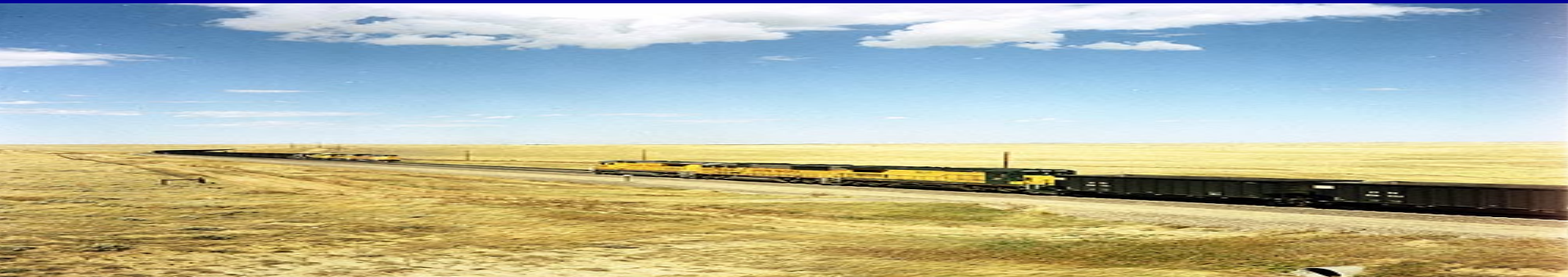


Large Rate Case Resolution (Coal)

- Determination of market dominance
- Stand Alone Cost (SAC) Test – *Fact-based approach rooted in economic reasoning and approved by the courts*
- No substitute for preparing a strong case with solid evidence
- Strive for a balance between the railroad's need to earn adequate returns and shippers need for fair and reasonable rates

Alternative Approaches

- SAC approach has been criticized as artificial and overly complex
- SAC approach is very costly and time consuming
- Only feasible for large shipments
- Alternative approaches to simplify large cases and broaden shipper access to STB processes



Ex Parte 657 –

Rulemaking to Streamline Major Coal Rate Cases

STB Decision called for:

1. Replacing of the percent reduction approach for calculating maximum lawful rates to eliminate gaming
2. Adopting of an "average total cost" method to allocate revenue
3. Shortening the analysis period to 10 years
4. Changing the method of forecasting operating expenses to account for future productivity improvement
5. Limit cost adjustment
6. Adopting new standards to govern when to reopen rate cases

Rate Case Resolution (Small Shipments)

- ICC adopted procedures for small rate cases in 1987 but courts struck them down
- STB adopted Simplified Guidelines in 1996 but never used them
- 20 years without finalizing the approach
- BP/Amoco 2005 – settled through non-binding mediation but established procedural schedule
- 2007 – Williams Olefins, LLC v. GTC - mediated settlement

Small Rate Cases – NPR

- Issued NPR on July 28, 2006
- Board proposed to:
 1. Create a simplified SAC procedure to use in medium-size rate disputes
 2. Retain the current “Three-Benchmark” method; focus on revenue to variable cost comparison
 3. Establish eligibility presumptions based on the maximum value of the case to distinguish between large, medium-size and small rail rate disputes
- Shipper and Railroad reactions

Small Rate Case NPR

January 22 Memo

- January 22 Memo – new proposals raised by comments
 - “Small claims” model allowing complainant to select methodology used
 1. Full-SAC
 2. Simplified-SAC
 3. Three-Benchmark – R/VC
- January 31 hearing on simplified standards for rate cases assessing comments on memo

Railroad Cost of Capital

- STB generally finds RRs to be revenue inadequate
- STB combines cost of debt and cost of equity capital
- WCTL petition to reexamine our method-- alleges that STB overstates cost of equity capital
- WCTL alleges that most analysts use CAPM approach not DCF

New Fuel Surcharge Rule

- January 26, 2007 Decision
 - Prohibits the assessment of fuel surcharges based on a percentage calculation of the base rate—must be better tied to actual cost changes
 - Prohibits "double-dipping"--applying to the same traffic both a fuel surcharge and a rate increase based on a cost index that includes a fuel component.
 - The Board is proceeding with a proposal to monitor the fuel surcharge practices of the rail industry by imposing mandatory reporting requirements on all large (Class I) railroads.

Public Hearing on Methodology for Determining Rail Industry's Cost of Capital

- STB Hearing on February 15, 2007
- Issues raised
 - Problems with current Discounted Cash Flow (DCF) method
 - Comparison of DCF and Capital Asset Pricing Model (CAPM) approach
 - FERC two-step growth factor method
 - Use of a multi-stage DCF method
- Panel included
 - Federal Reserve
 - Association of American Railroads
 - RR and Industry Analysts

Paper Barriers

- Contractual restriction that caps revenue levels at specific interchange points
- STB Hearing in 2006
- No action scheduled at present



Thank you. Questions?