



Creating Competition or Repeating History: Is Staggers Staggering?

STB Commissioner
Francis P. Mulvey

Midwest Regional & Short Line
Railroad Conference
July 16, 2007



The Surface Transportation Board and the Railroads

- 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
 - Construction of any new rail line or
 - 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



2006 STB Caseload (Decisions Served)

- Carrier Consolidations – 38
- Review of Labor Arbitral Decisions - 10
- Rates and Services – 49
- Constructions – 22
- Abandonments – 481
- Other Line Transactions
 - Line Consolidations – 64
 - Line Acquisitions Under 49 U.S.C. 10901 - 70



Current Activities of the Board Affecting U.S. Railroads

- Two pending large (coal) rate cases
- New large rate case guidelines
- New small rate case guidelines
- New rules on fuel surcharges
- Reviewing our rate of return calculation
- Assessing need to address paper barriers



Current Activities of the Board Affecting U.S. Railroads

- Hearing on railroad infrastructure capacity on April 11, 2007
- July 18 Hearing - *Rail Transportation of Resources Critical to the Nation's Energy Supply*
- NPR - STB Ex Parte No. 669 – *Interpretation of the Term “Contract” in 49 U.S.C. 10709*



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



Ex Parte 657 – Rulemaking to Streamline Major Coal Rate Cases

STB October 2006 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



New Fuel Surcharge Rules

- 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.
 - Most changes took effect on April 26, 2007



Rate Case Resolution (Small Shipment)

- 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



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

- STB Hearing January 31, 2007
- Issues raised
 - Eligibility
 - Selection of methodology for rate case
 - Aggregation
 - Litigation costs
- Parties testifying
 - US DOT
 - National Grain and Feed Association
 - National Industrial Transportation League
 - Various rail shippers
 - Railroads
 - Labor



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
- STB held hearing – Feb 15, 2007



Railroad Industry Cost of Capital and ROI 1996-2005

	Cost of Capital	BNSF	CSXT	NS	UP	KCS	SOO	GT
1996	11.9%	8.6%	8.9%	13.0%	9.3%	7.2%	23.5%	0.0%
1997	11.8%	8.4%	9.8%	13.1%	5.2%	3.6%	12.3%	5.2%
1998	10.7%	9.7%	8.1%	10.5%	2.9%	9.1%	4.9%	3.0%
1999	10.8%	9.5%	3.8%	5.2%	6.8%	6.4%	2.5%	25.4%
2000	11.0%	8.8%	3.6%	5.5%	6.9%	6.3%	5.6%	5.9%
2001	10.2%	7.1%	4.6%	8.3%	7.6%	7.0%	5.9%	4.9%
2002	9.8%	6.4%	5.2%	9.1%	8.6%	6.5%	5.7%	3.1%
2003	9.4%	6.2%	4.0%	9.1%	7.3%	3.7%	0.01%	4.5%
2004	10.1%	5.8%	4.4%	11.6%	4.5%	8.3%	3.3%	6.0%
2005	12.2%	10.3%	6.2%	13.2%	6.3%	5.9%	8.9%	8.1%



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

- STB Hearing on February 15, 2007
- Issues raised
 - Problems with current Discounted Cost 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



Pending Legislation Involving the STB

- H.R. 2125 - Attempts to
 - Increase competition in the rail industry
 - Increase the reliability of rail service
 - Provide customers with additional processes for challenging rate and service disputes
- H.R. 1300 – STB expanded jurisdiction over shared track between passenger and freight rail
- S. 1125 – Rail Infrastructure Investment Tax Credit
- S. 294 – Amtrak Reauthorization – expanded STB role in mediating the parties for Amtrak access