

## **SURFACE TRANSPORTATION BOARD ADOPTS IMPROVEMENTS TO RAIL RATE-REASONABLENESS PROCEDURES**

The Surface Transportation Board today issued a unanimous decision in Rate Regulation Reforms, Ex Parte 715, adopting revised rules to its railroad rate-reasonableness procedures. The decision marks another in a series of steps to improve the Board's rate regulation process, particularly the procedures governing the resolution of smaller rail rate disputes.

The Board's decision removes limitations on relief for medium-sized rate disputes and raises to \$4 million the relief available under small rate disputes. The decision also makes technical changes to its rate complaint procedures and sets the U.S. Prime Rate as the interest rate on reparations that railroads must pay to shippers for charging unreasonable rates. Future proceedings will be held to address cross-over traffic as well as the concerns of small agricultural shippers.

In announcing the decision, Board Chairman Daniel Elliott stated: "For years, the shipper community has argued that only the largest freight rail shippers can justify the time and expense to bring rate disputes to our agency. The Board has worked diligently to address that concern and offer captive shippers a simplified, expedited, and practical way to bring smaller rate disputes to the agency. Today we are taking another much-needed step to provide captive shippers with better access to a neutral forum to judge the reasonableness of their freight rates, as Congress intended."

"Today's decision is a good first step toward addressing a number of concerns expressed during Competition in the Railroad Industry, EP 705," commented Vice Chairman Ann D. Begeman. "I strongly support the Board's plan to open a proceeding specifically to address small agricultural shippers' concerns, which is long overdue. We need to ensure that the Board's rate case procedures are available to all captive shippers, including those that transport agricultural products."

Commissioner Francis P. Mulvey stated, "The Board has taken significant steps in the last several years to make the rate review process more accessible and today's decision continues that positive trend. I am particularly pleased that the Board has addressed the issue of the award limitations in our simplified rate case procedures and raised the interest rate on reparations. I hope that our decision today will allow more rail shippers to consider the Board an open venue if rate negotiations with their railroad partners prove unsuccessful."

Since its 2011 hearing, Competition in the Railroad Industry, Ex Parte 705, the Board has considered a wide range of concepts to determine the best way to promote a competitive and economically viable rail network. In its May 13, 2013 decision in Assessment of Mediation and Arbitration Procedures, Ex Parte 699, the Board overhauled its mediation and arbitration rules to encourage greater use of alternative dispute resolution procedures among its rail industry stakeholders. The Board continues to evaluate other competitive issues, including reviewing our rules for interchange commitments, competitive access and commodity exemptions.

The Board's decision in [Rate Regulation Reforms, Ex Parte 715](#), may be viewed and downloaded at the Board's website, [www.stb.dot.gov](http://www.stb.dot.gov), under "E-LIBRARY / Decisions & Notices / 07/18/13".

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**Attachment: FACT SHEET**

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**FACT SHEET**

**Rate Regulation Reforms, EP 715**

**Background**

To judge the reasonableness of rail freight rates, the Surface Transportation Board generally uses the "stand-alone cost" (SAC) test – a stand-alone railroad (SARR) is hypothesized that could serve the traffic at issue. Under the SAC test, the rate at issue cannot be higher than what the hypothetical SARR would need to charge to serve the complaining shipper while fully covering all of its costs, including a reasonable return on investment.

The Board also has simplified evidentiary procedures for rate cases where the SAC test could not practicably be applied. The Three-Benchmark approach, created for small rate cases, compares the markup over cost paid by the challenged traffic to the average markup on other comparable traffic. The Simplified-SAC test, provided for larger rate cases, judges the reasonableness of the challenged rate by looking at the actual operations and services provided. Initially, the Board placed relief limits on these simplified evidentiary procedures of \$1 million and \$5 million over a five-year period, respectively.

**Current Rulemaking Proceeding**

To improve its rate reasonableness procedures, the Board announced a rulemaking in Rate Regulation Reform, EP 715 (STB served July 25, 2012), and sought comments on six proposed changes:

- (1) removing the limitation on relief for cases brought under the Simplified-SAC alternative;
- (2) improving the accuracy of the Road Property Investment (RPI) component of the Simplified-SAC test;
- (3) raising the relief available under the Three-Benchmark method to \$2 million;
- (4) curtailing the use of "cross-over traffic" in Full-SAC cases;
- (5) modifying the approach used to allocate revenue from cross-over traffic; and
- (6) raising the interest rate that the railroads must pay when reparations are assessed because the railroad has collected unreasonable rates.

The limitations on relief in the simplified rate procedures appeared, with the benefit of subsequent experience, to be overly restrictive. The Board also undertook technical changes to its rate complaint procedures, and proposed changing the interest rate that railroads must pay on reparations to more accurately reflect the true opportunity cost to the shippers.

Because the issues addressed have industry-wide significance for rail carriers and shippers, all interested parties were invited to comment on these proposed changes. The STB received

public comments on these proposals from over 15 parties, including the United States Department of Agriculture; several trade associations representing shippers and railroads; several state organizations; and individual shippers and rail carriers.

### **Today's Actions**

After reviewing the comments, the Board decided to take five actions.

**1. Remove the relief limit in Simplified-SAC cases.** *Rationale:* The Simplified-SAC was designed to provide a robust method to determine the reasonableness of challenged rail rates. Unlike Full-SAC—a more costly, complex and time-consuming analysis—Simplified-SAC does not require the shipper to design a hypothetical railroad. Simplified-SAC, however, is not designed to detect inefficiencies in rail operations, and the shipper will forgo some potential for relief in exchange for a simplified process. Because Simplified-SAC provides the shipper with lower recovery than it could typically obtain under full SAC, a limit on relief is not necessary, especially if revised procedures improved the precision of the RPI component.

**2. Require the use of full RPI presentations in Simplified-SAC cases.** *Rationale:* The Board had earlier permitted parties to use a simplified RPI analysis, because it found that a full RPI analysis was too costly given the limited amount of relief available. But given the decision to remove the relief limit in Simplified-SAC cases, the increased cost of developing a full RPI analysis would be more than offset by the increase in relief available, and it is requiring the use of the full RPI in Simplified-SAC cases.

**3. Raise the relief limit in Three-Benchmark cases to \$4 million.** *Rationale:* Because it costs a shipper about \$4 million to pursue a Simplified-SAC case, the Simplified-SAC approach is not likely to be suitable for cases where the value of the case is less than that amount. The Board therefore is raising the limit on relief to offer captive shippers a practical means of obtaining rate review where the value of the case cannot justify the expense of pursuing relief with either a Full-SAC or Simplified-SAC presentation.

**4. Adopt alternative "Average Total Cost" (ATC) as the Board's revenue allocation method for crossover traffic.** *Rationale:* The use of cross-over traffic – that is, traffic for which the SARR would not replicate all of the defendant railroad's movements, but instead would interchange at some intermediate point – as a way to make the Full-SAC analysis more manageable (but still reliable). In its decision issued today, the Board adopts Alternative ATC because it better addresses and balances the importance of economies of density, while not creating the implausible result of driving the revenue allocation on any segment below variable costs.

**5. Raise the interest rate that a railroad must pay to complainants when the carrier has charged unreasonable rates.** *Rationale:* The agency is raising the interest rate paid on reparations to the level of the U.S. Prime Rate, which better reimburse shippers for the lost opportunity cost of investing money to which they are entitled through reparations than does the current government-backed risk-free T-Bill rate. The interest rate on reparations is intended to be neither punitive nor provide leverage in rate negotiations. The U.S. Prime Rate correlates to market interest rates for a similar risk and term (i.e., high credit worthiness for short-term borrowing). Railroad investments are not a risk-free proposition, and using the equivalent of a risk-free government-backed investment is too low. The U.S. Prime Rate, as published in the Wall Street Journal, is currently 3.25%.

### **Future Steps**

Although the agency declined to place any restriction on the use of carload and multi-carload cross-over traffic at this time, it has continued reservations about the growing use of carload and multi-carload cross-over traffic in Full-SAC cases, and whether this creates any unintended bias in the results (i.e., a disconnect between the revenue allocation and costs of

providing service). Many shippers and some railroads agree, however, that there may be ways to address this concern without restricting the use of this simplifying tool. Accordingly, the Board deferred consideration of any restriction on the use of this kind of cross-over traffic and instead will institute a separate proceeding to address this potential disconnect between revenue allocations and costs.

The Board will also initiate a proceeding to address concerns of small agricultural shippers with regard to rate reasonableness.

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