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STB ISSUES COMPETITION AND RATE DECISIONS

The STB has issued decisions in two ex parte proceedings concerning competition and rates. The first proceeding, EP 715, proposes modifications to the rules governing rate cases brought by captive shippers. Currently, the STB uses either the stand-alone cost (SAC) test, the Three-Benchmark test or the Simplified-SAC test to determine whether a captive shipper's rate is unreasonable. In response to shippers' concerns regarding the high cost of litigating and the limited relief available, the STB proposes the following changes to its rate reasonableness rules: (1) refining the Simplified-SAC test to remove the limit on relief and increase the precision of the calculations; (2) raise the limit on relief for a case brought under the Three-Benchmark test from $1 million to $2 million; (3) limit the use of cross-over traffic in the Full-SAC test and modify the revenue allocation methodology; and (4) change the interest rate carriers must pay shippers when a rate is found unreasonable from the T-bill rate to the U.S. Prime Rate. All parties wishing to participate in this proceeding must file a notice with the STB by August 24, 2012. Comments to proposed rule are due by October 23, 2012. Reply comments are due by December 7, 2012 and rebuttal comments are due by January 7, 2013. A copy of the decision is attached.

In the second proceeding, EP 711, the STB is seeking public input on a proposal by certain shippers, lacking effective competitive transportation alternatives, to be granted access to a competing railroad if there is a working interchange within a reasonable distance (30 miles under the proposal). The STB is seeking empirical information about the impact of the proposal, specifically: (1) the impact on rail shippers' rates and service, including shippers that would not benefit under the proposal; (2) the proposal's impact on the rail industry, including its financial condition and network efficiencies; and (3) methodologies for the access price that would be used in conjunction with competitive switching. Interested parties are asked to perform a study of the competitive access proposal and submit reports of their studies' findings or other appropriate information and recommendations. Opening submissions are due by November 23, 2012 and responses are due February 21, 2013. A copy of the decision is attached.

Please contact Jeremy M. Berman at (312) 252-1500 if you have any questions.

SERVICE DATE – LATE RELEASE JULY 25, 2012

SURFACE TRANSPORTATION BOARD

DECISION

Docket No. EP 715

RATE REGULATION REFORMS

Digest:[1] Captive shippers have long stated that they cannot bring rate disputes to the Surface Transportation Board because of the prohibitive litigation costs and the tremendous complexity of rate cases. The agency responded in 1996 and 2007 by creating simplified procedures to reduce the time, complexity, and expense of rate cases. The goal was to make the agency more accessible to the average shipper. But in 2011 Board hearings, many stakeholders stated that these simplified alternatives were ineffective because of the limitations on relief that the Board placed on those simplified procedures.

Today, the Board proposes to modify its rules to remove the limitation on relief for one simplified approach, and to double the relief available under the other simplified approach. The Board also proposes to make some technical changes to the rate procedures, and to raise the interest rate that railroads must pay on reparations if they are found to have charged unreasonable rates. The overarching goal is to ensure that the Board's simplified and expedited tests for resolving rate disputes are more accessible to parties.

Decided: July 25, 2012

Where there is no competitive transportation market, Congress charged the Board with protecting the public from unreasonable pricing by freight railroads, while fostering a sound, safe, and efficient rail transportation system by allowing carriers to earn adequate revenues. Balancing these sometimes conflicting goals is no easy task. Over the past 30 years, we have worked to provide shippers a more accessible forum to bring rate disputes. For the most part, we have relied on a case-by-case evolution of our methodology, but occasionally have used rulemaking procedures to implement greater changes. The result is a comprehensive set of rules that provides a variety of constraints on railroad pricing.

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[1] The digest constitutes no part of the decision of the Board but has been prepared for the convenience of the reader. It may not be cited to or relied upon as precedent. Policy Statement on Plain Language Digests in Decisions, EP 696 (STB served Sept. 2, 2010).

At the heart of our rate rules lies the stand-alone cost (SAC) test. Under this test, also referred to as the Full-SAC test, the rate at issue cannot be higher than the rate a hypothetical efficient railroad would need to charge to serve the complaining shipper while fully covering all of its costs, including a reasonable return on investment. In other words, we judge the challenged rate against a simulated competitive rate a captive shipper would enjoy if a competitive transportation market existed.

While the SAC test is considered sound and has been affirmed repeatedly by the courts, it remains controversial among both shippers and railroads. Shippers view the test as too complex and too expensive. Some also object to the "hypothetical" nature of the inquiry, questioning why they must design an entirely hypothetical railroad to judge the reasonableness of a railroad's real world rates. Railroads, in turn, argue that the Board's attempt to reduce the complexity of the Full-SAC test with a device called "cross-over traffic" is distorting the test. The railroads also object to their rates being judged against hypothetical operations that, the railroads say, do not reflect the way railroads are run in the real world.

To provide rail customers with a lower cost, expedited alternative to the SAC test, Congress, in the ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803 (ICC Termination Act), directed the Board to promulgate simplified evidentiary procedures for rate cases where the SAC test could not practicably be applied. In response, the agency created the Three-Benchmark test, a benchmark approach that compares the markup being paid by the challenged traffic to the average markup assessed on other comparable traffic. See Rate Guidelines—Non-Coal Proceedings (Simplified Guidelines), 1 S.T.B. 1004 (1996).[2] Later, in 2007, the Board adopted the Simplified-SAC test. See Simplified Standards for Rail Rate Cases (Simplified Standards), EP 646 (Sub-No. 1) (STB served Sept. 5, 2007).[3] The Simplified-SAC test, like the Full-SAC test, was designed to allow the Board to determine whether a railroad is abusing its market power to extract monopoly profits or to force a captive shipper to cross-subsidize parts of the defendant's existing rail network that the shipper does not use. The Simplified-SAC test, unlike the Full-SAC test, does not look to a hypothetical railroad to judge the reasonableness of the defendant railroad's rates, but rather to the actual operations and services provided.

In Simplified Standards, the Board also placed limits on relief for the Three-Benchmark and Simplified-SAC methodologies of $1 million and $5 million over a 5-year period, respectively. These limits provided the chief basis for a petition for reconsideration jointly filed by numerous shippers. The Board denied the petition in 2008. Simplified Standards for Rail Rate Cases, EP 646 (Sub-No. 1) (STB served Mar. 19, 2008).

Last year, we held a public hearing to explore the current state of competition in the railroad industry and possible policy alternatives to facilitate more competition, where

[2] Pet. to reopen denied, 2 S.T.B. 619 (1997), appeal dismissed sub. nom. Ass'n of Am. R.Rs. v. STB, 146 F.3d 942 (D.C. Cir. 1998).

[3] Aff'd sub nom. CSX Transp., Inc. v. STB, 568 F.3d 236 (D.C. Cir.), vacated in part on reh'g, 584 F.3d 1076 (D.C. Cir. 2009).

appropriate. See Competition in the R.R. Indus., EP 705 (STB served Jan. 11, 2011). During that proceeding, we heard concerns from stakeholders that the complexity, high litigation costs, and current limits on relief for simplified alternatives were dissuading parties from bringing rate disputes to this agency. We continue to explore whether there are policy changes the Board could adopt that would promote more rail-to-rail competition and thereby allow competition and the demand for services to establish reasonable rates for transportation by rail, and thus minimize the need for Federal regulatory control. See Pet. for Rulemaking to Adopt Revised Competitive Switching Rules, EP 711 (STB served July 25, 2012). Regardless of the outcome of that inquiry, however, we must continue to improve our rate review process to ensure that it is as fair and accessible as possible.

Accordingly, today we issue this Notice of Proposed Rulemaking to propose six changes to our rate reasonableness rules. The centerpiece is a proposal to remove the limitation on relief for cases brought under the Simplified-SAC alternative. Our goal is to encourage shippers to use a simplified alternative to a Full-SAC analysis that is economically sound, yet provides a less complicated and less expensive way to challenge freight rates by discarding the requirement that shippers design a hypothetical railroad to judge a railroad's real world rates. In addition, we wish to facilitate the ability of shippers to seek redress economically and efficiently in disputes in cases involving smaller but still significant amounts. We also propose five other changes: doubling the relief available under the Three Benchmark method; curtailing the use of cross-over traffic in Full-SAC cases; modifying the approach used to allocate revenue from cross-over traffic in Full-SAC and Simplified-SAC cases; improving the accuracy of the Road Property Investment (RPI) component of the Simplified-SAC test; and raising the interest rate that the railroads must pay to complainants for, inter alia, reparations when the railroad has collected unreasonable rates.

CURRENT RATE REASONABLENESS STANDARDS

Statutory Framework

Where a railroad has market dominance—i.e., a shipper is captive to a single railroad—its transportation rates for common carrier service must be reasonable. 49 U.S.C. §§ 10701(d)(1), 10702. Market dominance is defined as an absence of effective competition from other rail carriers or modes of transportation for the transportation to which a rate applies. 49 U.S.C. § 10707(a). The Board is precluded, however, from finding market dominance if the revenues produced by a challenged rate are less than 180% of the carrier's "variable costs" of providing the service. 49 U.S.C. § 10707(d)(1)(A). Variable costs vary with the level of traffic, and are developed in rates proceedings by using the Board's Uniform Rail Costing System (URCS). See Adoption of the Unif. R.R. Costing Sys. as a Gen. Purpose Costing Sys. for all Regulatory Costing Purposes, 5 I.C.C. 2d 894 (1989).

When a complaint is filed, the Board may investigate the reasonableness of the challenged rate, 49 U.S.C. §§ 10704(b), 11701(a), or dismiss the complaint if it does not state reasonable grounds for investigation and action, 49 U.S.C. § 11701(b). If the Board finds a challenged rate unreasonable, it will order the railroad to pay reparations to the complainant for past movements and may prescribe the maximum rate the carrier is permitted to charge.

49 U.S.C. §§ 10704(a)(1), 11704(b). However, the Board may not set the maximum reasonable rate below the level at which the carrier would recover 180% of its variable costs of providing the service. W. Tex. Util. Co. v. Burlington N. R.R., 1 S.T.B. 638, 677-78 (1996), aff'd sub nom., Burlington N. R.R. v. STB, 114 F.3d 206, 210 (D.C. Cir. 1997).

In examining the reasonableness of a rate, the Board is guided by the rail transportation policy set forth at 49 U.S.C. § 10101. It must also give due consideration to the "Long-Cannon" factors contained in 49 U.S.C. § 10701(d)(2)(A)-(C).[4] And the Board must recognize that rail carriers should have an opportunity to earn "adequate revenues." 49 U.S.C. § 10701(d)(2). Adequate revenues are defined as those that are sufficient—under honest, economical, and efficient management—to cover operating expenses, support prudent capital outlays, repay a reasonable debt level, raise needed equity capital, and otherwise attract and retain capital in amounts adequate to provide a sound rail transportation system. 49 U.S.C. § 10704(a)(2).

As part of the ICC Termination Act, Congress added a new provision to the rail transportation policy calling for the "expeditious handling and resolution of all proceedings." 49 U.S.C. § 10101(15). Congress further instructed the Board to establish procedures for rail rate challenges in particular, including "appropriate measures for avoiding delay in the discovery and evidentiary phases of such proceedings." 49 U.S.C. § 10704(d). Moreover, Congress directed the Board to "establish a simplified and expedited method for determining the reasonableness of challenged rail rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case." 49 U.S.C. § 10701(d)(3).

Constrained Market Pricing Guidelines

The Board's general standards for judging the reasonableness of rail freight rates are set forth in Coal Rate Guidelines, Nationwide (Guidelines), 1 I.C.C. 2d 520 (1985), aff'd sub nom. Consolidated Rail Corp. v. United States, 812 F.2d 1444 (3d Cir. 1987). These guidelines adopt a set of pricing principles known as "constrained market pricing" (CMP). The objectives of CMP can be simply stated: a captive shipper should not be required to pay more than is necessary for the carrier involved to earn adequate revenues. Nor should it pay more than is necessary for efficient service. And a captive shipper should not bear the costs of any facilities or services from which it derives no benefit. Guidelines, 1 I.C.C. 2d at 523.

[4] The Long-Cannon factors were added to the Interstate Commerce Act in 1980 and direct the Board to give due consideration to (a) the amount of traffic which is transported at revenues which do not contribute to going concern value and the efforts made to minimize such traffic; (b) the amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic; and (c) the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues.

CMP contains three main limits on the extent to which a railroad may charge differentially higher rates on captive traffic.[5] The revenue adequacy constraint is intended to ensure that a captive shipper will "not be required to continue to pay differentially higher rates than other shippers when some or all of that differential is no longer necessary to ensure a financially sound carrier capable of meeting its current and future service needs." Id. at 535-36. The management efficiency constraint is intended to protect captive shippers from paying for avoidable inefficiencies (whether short-run or long-run) that are shown to increase a railroad's revenue need to a point where the shipper's rate is affected. Id. at 537-42. The SAC constraint is intended to protect a captive shipper from bearing costs of inefficiencies or from cross-subsidizing other traffic by paying more than the revenue needed to replicate rail service to a select subset of the carrier's traffic base. See id. at 542-46.

SAC Constraint

A SAC analysis seeks to determine whether a complainant is bearing costs resulting from inefficiencies or costs associated with facilities or services from which it derives no benefit; the SAC analysis does this by simulating the competitive rate that would exist in a "contestable market." A contestable market is defined as one that is free from barriers to entry. See Guidelines, 1 I.C.C. 2d at 528 (citing William J. Baumol, John C. Panzar & Robert D. Willig, Contestable Markets and the Theory of Industry Structure (1982)). The economic theory of contestable markets does not depend on a large number of competing firms in the marketplace to ensure a competitive outcome. Guidelines, 1 I.C.C. 2d at 528. In a contestable market, even a monopolist must offer competitive rates or potentially lose its customers to a new entrant. Id. In other words, contestable markets have competitive characteristics that preclude monopoly pricing.

To simulate the competitive price that would result if the market for rail service were contestable, the costs and other limitations associated with entry barriers must be omitted from the SAC analysis. Id. at 529. This removes any advantages the existing railroad would have over a new entrant that create the existing railroad's monopoly power. A stand-alone railroad (SARR) is therefore hypothesized that could serve the traffic at issue if the rail industry were free of entry barriers. Under the SAC constraint, the rate at issue cannot be higher than what the SARR would need to charge to serve the complaining shipper while fully covering all of its costs, including a reasonable return on investment. This analysis produces a simulated competitive rate against which the Board judges the challenged rate. Id. at 542.

To make a Full-SAC presentation, a shipper designs a SARR specifically tailored to serve an identified traffic group, using the optimum physical plant or rail system needed for that traffic. Using information on the types and amounts of traffic moving over the defendant

[5] A fourth constraint – phasing – is intended to limit the introduction of otherwise-permissible rate increases when necessary for the greater public good. Guidelines, 1 I.C.C. 2d at 546-47.

railroad's system, the complainant selects a subset of that traffic (including its own traffic to which the challenged rate applies) that the SARR would serve.

Based on the traffic group selected, the level of services provided, and the terrain to be traversed, a detailed operating plan must be developed for the SARR. Once an operating plan is developed that would accommodate the traffic group selected, the SARR's investment requirements and operating expense requirements must be estimated. The parties must provide appropriate documentation to support their estimates. The annual revenues required to recover the SARR's capital costs (and taxes) are combined with the annual operating costs to calculate the SARR's total annual revenue requirements.

The revenue requirements of the SARR are then compared to the revenues that the defendant railroad is expected to earn from the traffic group. If the present value of the revenues that would be generated by the traffic group is less than the present value of the SARR's revenue requirements, then the complainant has failed to demonstrate that the challenged rate levels violate the SAC constraint. If, on the other hand, the present value of the revenues from the traffic group exceeds the present value of the revenue requirements of the SARR, then the Board disperses the overage among the traffic group, and prescribes the resulting rate and/or reparations for the issue traffic.

Cross-Over Traffic

In recent SAC cases, complainants have relied extensively on the use of cross-over traffic to simplify their SAC presentations. Cross-over traffic refers to those movements included in the traffic group that would be routed over the SARR for only a part of their trip from origin to destination. In such circumstances, the SARR would not replicate all of the defendant railroad's service, but would instead interchange the traffic with the residual portion of that railroad's system. This modeling device, which was first accepted by the agency in 1994 in Bituminous Coal—Hiawatha, Utah, to Moapa, Nev., 10 I.C.C. 2d 259, 265-68 (1994), is now a well-established practice in SAC cases.[6] A continuing issue in SAC cases is how to allocate the total revenues the railroad earns from that cross-over traffic between the facilities replicated by the SARR and the residual network of the railroad needed to serve that traffic.

The goal in allocating revenue from cross-over traffic is to ensure that a truncated SAC analysis using cross-over traffic approximates the outcome of a Full-SAC analysis, which provides origin-to-destination service for the entire traffic group. A Full-SAC analysis compares the total SAC costs incurred to serve the selected traffic against the total revenues the carrier is expected to earn from that traffic group. A SAC presentation with cross-over traffic, however, calculates only part of the total SAC costs to serve the cross-over traffic. Thus, to distribute

[6] See, e.g., Otter Tail Power Co. v. BNSF Ry., NOR 42071, slip op. at 11-13 (STB served Jan. 27, 2006), aff'd sub nom. Otter Tail Power Co. v. STB, 484 F.3d 959 (8th Cir. 2007); Duke Energy Corp. v. CSX Transp., Inc., 7 S.T.B. 402, 422-24 (2004); Tex. Mun. Power Agency v. Burlington N. & Santa Fe Ry., 6 S.T.B. 573, 605 (2003).

revenues equitably in relation to the cost incurred to generate those revenues, the portion of the revenue allocated to those facilities replicated by the SARR ideally equals the total revenue from that movement, multiplied by the share of total SAC costs represented by the cross-over segments of the movement (i.e., multiplied by the ratio of the truncated SAC costs for the cross-over traffic to the Full-SAC costs for the cross-over traffic).

The Board recognized, however, that it would face a dilemma if it were to attempt to allocate revenues based on the relationship between a truncated and Full-SAC analysis. The total SAC costs for a particular cross-over movement cannot be judged without a Full-SAC analysis, an undertaking that would defeat the simplifying purpose of using cross-over traffic in the first place. Even if the Board knew the total replacement costs of the off-SARR segments used by cross-over movements, it would have no method for allocating a share of those investment costs to only the cross-over movements. The off-SARR segments would have other traffic flowing over those lines that would be expected to contribute to the investment costs, but whose contribution would depend on the profitability of that traffic.

The Board attempted to address this dilemma by focusing on the average costs that the defendant railroad currently incurs to haul the traffic over the relevant segments. Duke Energy Corp. v. Norfolk S. Ry., 7 S.T.B. 89, 104-106 (2003). The objective was to select a revenue allocation methodology that reflects, to the extent practicable, the defendant's relative average costs of providing service over the two segments (the segment replicated by the SARR, and the residual facilities needed to serve the traffic, at times referred to as the off-SARR segment). See id.

In Major Issues in Rail Rate Cases, EP 657 (Sub-No. 1), slip op. at 31 (STB served Oct. 30, 2006), the Board adopted an "Average Total Cost" (ATC) approach to allocate revenues from cross-over traffic between the facilities replicated by the SARR and those of the incumbent carrier. Using the URCS variable and fixed costs for the carrier, and the density and miles of each segment, parties can calculate the railroad's average total cost per segment of a move. The revenues from each portion of the movement would then be allocated in proportion to the average total cost of the movement on- and off-SARR. See Major Issues in Rail Rate Cases, EP 657 (Sub-No. 1) et al., slip op. at 19-20 (STB served Feb. 27, 2006).

In the first case to apply ATC, however, the Board concluded a modification was needed to address an unanticipated flaw. See W. Fuels Ass'n v. BNSF Ry. (Western Fuels), NOR 42088 (STB served Sept. 10, 2007). The Board noted that, in their submissions, the parties had applied ATC to the cross-over movements' total revenues. For a substantial number of these movements, the result of doing so was to drive below 100% the revenue-to-variable cost (R/VC) percentages—as measured by URCS—for the on-SARR portion.

This occurred because of two factors. First, the complainant had included considerable cross-over traffic in its traffic group with total revenue either below or barely above the variable costs of handling the traffic. Second, the off-SARR segments of these movements had lower traffic densities, and thus higher average total costs. By allocating revenues from these movements in proportion to average total costs, as required by ATC, a proportionally larger percentage of that revenue was allocated to the off-SARR segment. Id. at 14. The result was

that "the on-SARR revenue allocation for those movements would be insufficient to cover the variable costs (as calculated using URCS) of handling traffic for the highest-density portion of a movement." Id. This result, the Board said, was unintended and illogical because "[t]raffic must cover its variable costs before it can be expected to make any contribution to joint and common costs." Id.[7] The Board further explained that it had not contemplated this situation and that such a result (a revenue allocation below variable cost) "would plainly conflict with our express purpose to find a non-biased, cost-based method." Id.

To avoid allocating revenues at levels below URCS variable costs, the Board determined that it had to refine the ATC approach. Rather than applying ATC to total revenue, the Board concluded that it would apply ATC to total revenue contribution, i.e., revenue in excess of variable costs as calculated by URCS. Id. Under modified ATC, allocating revenue from cross-over traffic would involve a two-step process. First, sufficient revenue would be allocated to each segment to cover that segment's variable costs of providing service as measured by URCS. Second, remaining revenues, if any, would be allocated using the original ATC methodology.

Western Fuels was challenged in court, and the case was remanded to the Board to address whether modified ATC improperly double counts variable costs. BNSF Ry. v. STB, 604 F.3d 602, 613 (D.C. Cir. 2010). On remand, the Board, with Commissioner Begeman dissenting, explained the decision to use modified ATC. See W. Fuels Ass'n v. BNSF Ry. (Western Fuels Remand), NOR 42088 (STB served June 15, 2012). Based on its experience in that case, the Board concluded that there were two competing principles in play. First, the Board seeks a revenue allocation that takes into account the important role that economies of density should play in any cost-based revenue allocation approach. Second, it seeks a revenue allocation approach that does not create the implausible result of driving the revenue allocation below variable costs. The Board understood that modified ATC did not give the same weight to economies of density as did the original ATC approach. While it concluded that the modified approach was superior to original ATC, the Board also announced that it planned to begin a rulemaking to consider a methodology, similar to one suggested, but not advocated, by BNSF (on remand), for possible future cases.

This "alternative ATC" methodology would have two steps. First, the Board would apply original ATC to all movements. Second, for those movements that received on-SARR revenue allocations below the defendant's URCS variable costs for the movement over the on-SARR segment, the Board would allocate additional revenues to that segment based on the relative on-SARR and off-SARR variable costs up to 100%.

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[7] "Joint and common costs," sometimes referred to by the Board as "unattributable costs," are costs that cannot be assigned directly to specific movements by any conventional accounting methodology. See Guidelines, 1 I.C.C. 2d at 526. "Common costs" are costs shared by two or more services in variable proportion (e.g., terminal costs), while "joint costs" are costs shared by two or more services in fixed proportion (e.g., backhaul). Id. at 526 n.13.

Simplified Guidelines

Congress directed the Board to "establish a simplified and expedited method for determining the reasonableness of challenged rail rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case." 49 U.S.C. § 10701(d)(3). To respond to this directive, the Board adopted the guidelines set forth in Simplified Guidelines. A decade passed, however, without any shipper bringing a case under those simplified guidelines. In Simplified Standards, the Board modified the test described in Simplified Guidelines and created an additional simplified alternative that a complainant could elect to use where a Full-SAC analysis was too costly, given the value of the case. These two alternatives, discussed in detail below, are referred to as (1) Simplified-SAC and (2) Three-Benchmark. Since Simplified Standards, only a few Three-Benchmark cases have been decided by the Board, while no complaint has been litigated to completion under the Simplified-SAC alternative.

1. Simplified-SAC

A. Objectives

The principal objective of the SAC approach is to restrain a railroad from exploiting market power over a captive shipper by charging more than it needs to earn a reasonable return on the replacement cost of the infrastructure used to serve that shipper. A second objective of the SAC constraint is to detect and eliminate the costs of inefficiencies in a carrier's investments or operations.

It is the second objective that turns a Full-SAC presentation into an intricate, expensive undertaking. To replicate less than the existing rail infrastructure used to serve the captive shipper, the complainant must demonstrate that there would still be sufficient capacity to handle expected demand. This requires the complainant to first select an appropriate subset of the defendant railroad's traffic for the SARR to serve, then design an operating plan that shows how an efficient railroad would serve this traffic group, and determine the optimal network configuration. Complex computer programs are needed to model the hypothetical SARR and test the operating plan and configuration against the forecast demand of the traffic group. All these tasks are interrelated, such that changes to the traffic group may require reconfiguring the hypothetical network and revising the operating plan. The parties must then develop detailed evidence to calculate both the direct operating expenses (such as the costs of locomotives, crews, and railcars) and the indirect operating expenses (such as general and administrative, and maintenance-of-way). The time and expense associated with this inquiry dwarfs those needed to examine the replacement cost of the necessary rail infrastructure.

Accordingly, the inquiry under the Simplified-SAC method described below is limited to whether the captive shipper is forced to cross-subsidize other parts of the railroad's rail network or whether the defendant carrier is abusing its market power. Such an approach is a less thorough application of CMP in that it would not identify inefficiencies in the current rail operation. But it allows the Board to determine whether a captive shipper is forced to cross-subsidize parts of the defendant's existing rail network the captive shipper does not use. The Simplified-SAC method ensures that a railroad does not earn monopoly profits on its

investments. As railroads enjoy increasing market power with rising demand for their services, the SAC test (in either its full or simplified form) would provide a critical restraint on their pricing of captive traffic, without deterring railroads from making the investments in their rail networks that are needed to meet rising demand. Indeed, the Simplified-SAC method incorporates those new capital investments and ensures that the maximum lawful rate includes a reasonable return on the replacement cost of those investments.

B. Methodology

The Simplified-SAC method allows the Board to determine whether a captive shipper is forced to cross-subsidize parts of the defendant's existing rail network that the shipper does not use. To hold down the cost of a Simplified-SAC presentation, various simplifying assumptions and standardization measures were adopted.

- *Route*: The analysis examines the predominant route of the issue movements during the prior 12 months.

- *Configuration*: The facilities of the SARR consist of the existing facilities along the analyzed route (including all track, sidings, and yards). If a shipper presents compelling evidence that some facilities along the route have fallen into disuse by the railroad, and thus need not be replicated, those facilities are excluded from the Simplified-SAC analysis.

- *Test Year*: The Simplified-SAC analysis examines the reasonableness of the challenged rates based on a one-year analysis. The Test Year is the most recently completed four quarters preceding the filing of the complaint.

- *Traffic Group*: The traffic group consists of all movements that traveled over the selected route in the Test Year. No rerouting of traffic is permitted.

- *Cross-Over Traffic*: The revenue from cross-over traffic is apportioned between the on-SARR and off-SARR portions of the movement based on the revenue allocation methodology used in Full-SAC proceedings.

- *Road Property Investment*: The Board's findings in prior Full-SAC cases are used to simplify parts of the road property investment analysis.

- *Operating Expenses*: The total operating and equipment expenses of the SARR are estimated using URCS.

- *Discounted Cash Flow (DCF) Analysis*: The DCF analysis calculates the capital requirements of a SARR in the customary fashion, but then compares the revenues earned by the defendant railroad against the revenue requirements of the SARR only for the Test Year.

- *Internal Cross-Subsidy Inquiry*: The approach to identify an internal cross-subsidy set forth in PPL Montana, LLC v. Burlington Northern & Santa Fe Railway, 6 S.T.B.

286 (2003),[8] as refined in Otter Tail v. BNSF, is an affirmative defense, with the evidentiary burden of production and persuasion on the railroad.

- *Maximum Reasonable Rate*: The SAC costs (i.e., the revenue requirements of the SARR) are allocated amongst the traffic group based on the methodology used in Full-SAC cases.
- *Five-Year Rate Relief*: The maximum lawful rate is expressed as a ratio of revenue to variable costs (R/VC), with variable costs calculated using URCS without any movement-specific adjustments. This maximum R/VC ratio is then prescribed for a maximum five-year period.

2. Three-Benchmark

For some shippers who have small disputes with a carrier, the Board believed that the Simplified-SAC method would be too expensive, given the small value of their cases. The Board reasoned that these shippers must also have an avenue to pursue relief. Accordingly, the Board retained the Three-Benchmark method for those shippers, with refinements to lessen the uncertainties of the existing method.

Under the Three-Benchmark method, the reasonableness of a challenged rate is determined by examining the challenged rate in relation to three benchmark figures, each of which is expressed as an R/VC ratio. The first benchmark, the Revenue Shortfall Allocation Method (RSAM), measures the average markup over variable cost that the defendant railroad would need to charge all of its "potentially captive" traffic (traffic priced above the 180% R/VC level) in order for the railroad to earn adequate revenues as measured by the Board under 49 U.S.C. § 10704(a)(2). The second benchmark, the $R/VC_{>180}$ benchmark, measures the average markup over variable cost currently earned by the defendant railroad on its potentially captive traffic. The third benchmark, the R/VC_{COMP} benchmark, is used to compare the markup being paid by the challenged traffic to the average markup assessed on other comparable potentially captive traffic.

Once the Board has selected the appropriate comparison group for the R/VC_{COMP} benchmark, each movement in the comparison group will be adjusted by the ratio of RSAM ÷ $R/VC_{>180}$. The Board will then calculate the mean and standard deviation of the resulting R/VC ratios (weighted in accordance with the proper sampling factors). If the challenged rate is above a reasonable confidence interval around the estimate of the mean for the adjusted comparison group, it is presumed unreasonable and, absent any "other relevant factors," the maximum lawful rate will be prescribed at that boundary level. See Simplified Standards, slip op. at 21-22.

[8] Aff'd sub nom. PPL Mont., LLC v. STB, 437 F.3d 1240 (D.C. Cir. 2006).

3. Limits on Relief

The maximum potential rate relief available to a complainant that elects to use the Simplified-SAC method is limited to $5 million per case over a five-year period, and for a complainant that elects to use the Three-Benchmark method, relief is limited to $1 million per case over the same period.[9] The relief refers to the sum of the differences between the challenged rates and the maximum reasonable rates, whether in the form of reparations, a rate prescription, or a combination of the two. Any rate prescription automatically terminates once the complainant has exhausted the relief available. Thus, the actual length of the prescription may be less than five years if the available relief is used up in a shorter time. The complainant is barred from bringing another complaint against the same rate for the remainder of the five-year period.

Once a rate prescription expires, the carrier's rate-making freedom is restored with a regulatory safe harbor at the challenged rate for the remainder of the five-year period, with appropriate adjustments for inflation using the rail cost adjustment factor, adjusted for inflation and productivity (RCAF-A). See R.R. Cost Recovery Procedures-Productivity Adjustment, 5 I.C.C. 2d 434 (1989), aff'd sub nom. Edison Elec. Inst. v. ICC, 969 F.2d 1221 (D.C. Cir. 1992). If, however, a carrier establishes a new common carrier rate once the rate prescription expires, and the new rate exceeds the inflation-adjusted challenged rate, the shipper may bring a new complaint against the newly established common carrier rate.

Interest Rate on Overcharges

Under 49 U.S.C. § 10701(c), a rail carrier may establish any common carrier rate it chooses and has the freedom to increase its rates without precondition, except for the notice requirement of 49 U.S.C. § 11101(c). A shipper may seek a Board determination of the reasonableness of the rates, "but it may not withhold payment of a legally established rate." See AEP Texas N. Co. v. Burlington N. & Santa Fe Ry., NOR 41191 (Sub-No. 1), slip op. at 2 (STB served Mar. 19, 2004). Instead, if the Board determines that the rates are unreasonable it can order the railroad to reimburse the complaining shipper, with interest. Id. The level of interest is currently set at the T-Bill rate. 49 C.F.R. § 1141.1(a).

BOARD PROPOSALS

Our proposals are presented in four parts. **Section I** sets out proposed refinements to the Simplified-SAC test, where we propose to remove the limit on relief and increase the precision of the calculation of RPI. **Section II** sets forth our proposal to raise the limit on relief for a case brought under the Three-Benchmark test from $1 million to $2 million. **Section III** sets forth

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[9] Currently, the Board annually adjusts the $5 million and $1 million thresholds using the Producer Price Index (PPI), which measures the average change over time in the selling prices received by domestic producers for their output. Simplified Standards, slip op. at 28 n.36. These indexed thresholds are now $5,590,000 and $1,118,000, respectively.

our proposal to limit the use of cross-over traffic in the Full-SAC test and to modify the revenue allocation methodology. **Section IV** sets out a proposal to change the interest rate carriers must pay shippers when the rate charged has been found unlawfully high, from the current T-bill rate to the U.S. Prime Rate, as published in *The Wall Street Journal.*

I. Simplified-SAC

As mentioned earlier, the Board has created a simplified version of the SAC constraint for litigants who cannot justify the expense of the more detailed Full-SAC analysis. This constraint has numerous positive features. Unlike the Full-SAC analysis, it does not require shippers to design hypothetical railroads. Rather, the Simplified-SAC approach focuses on the operations of the actual defendant railroad to determine if the railroad is exploiting its market power to charge monopoly pricing. Because the approach does not require the complainant to design a hypothetical railroad from scratch, it is a far simpler and less costly approach. And unlike the Three-Benchmark analysis, the Simplified-SAC approach uses replacement cost to determine the maximum lawful rates a carrier may charge. We are offering proposals to encourage its use over the more complex, costly, and time-consuming Full-SAC test. Specifically, we propose to remove the $5 million monetary limitation on relief for cases pursued under the Simplified-SAC constraint.

Our rationale for this proposal rests on the key similarity between the Full-SAC constraint and the Simplified-SAC constraint. As noted above, the principal objective of the Full-SAC constraint is to restrain a railroad from exploiting market power over a captive shipper by charging more than it needs to earn a reasonable return on the replacement cost of the infrastructure used to serve that shipper. A second objective of the Full-SAC constraint is to detect and eliminate the costs of inefficiencies in a carrier's investments or operations.

Like the Full-SAC approach, the inquiry under the Simplified-SAC method is also designed to prevent the railroad from abusing its market power by charging unreasonably high rates. The Simplified-SAC test can provide a critical restraint on the railroad's pricing of captive traffic by allowing the Board to determine whether a captive shipper is being forced to cross-subsidize parts of the defendant's existing rail network the shipper does not use. In other words, the Simplified-SAC constraint ensures that a railroad does not earn monopoly profits on its investments.

If the Simplified-SAC analysis of a particular case detects a problem, we see no reason to curtail the relief that is available to the shipper to correct that problem. There is no basis to permit the railroads to earn monopoly profits simply because, unlike the Full-SAC model, the Simplified-SAC model does not detect the inefficiencies in rail operations that may further raise rates. This proposal is linked, however, to the change described below to also remove the simplification to the RPI component of the Simplified-SAC test. If there is no limitation on relief under Simplified-SAC, we believe the approach must calculate the replacement cost of the facilities used to serve the captive shipper with as much precision as a Full-SAC presentation.

We recognize that our decision here is a departure from the Board's prior rationale for imposing relief limits on the Simplified-SAC methodology. In Simplified Standards, slip op. at

28, the Board stated that "by placing limits on the relief available, we encourage shippers with larger disputes to pursue relief under the more appropriate methodology without the Board itself trying to determine the likely value of a case. Instead, the complainant must evaluate its own claim, decide for itself the expected value of the case, and balance the value against the litigation costs and the potential relief it may receive." The Board used this rationale to apply limits on the relief available under both the Simplified-SAC approach and the Three-Benchmark approach. We continue to believe that the Three-Benchmark approach should be reserved for small disputes where the litigant cannot justify the expense of a SAC analysis (either in Full or Simplified form). But if we improve the precision of the RPI components of the Simplified-SAC test, as discussed below, we cannot see any justification for continuing to curtail the relief where the analysis has detected that a carrier is abusing its market power and is earning more than a reasonable return on the replacement costs of the facilities being used to serve the captive shippers. In other words, regardless of the amount in dispute, the Full-SAC and Simplified-SAC approaches both appear to be an appropriate method to judge the reasonableness of the challenged rates, and there is no apparent reason to force the shipper to use the more expensive Full-SAC approach over the Simplified-SAC approach in cases where the shipper seeks more than $5 million in relief.

There still are reasons why a complainant may prefer to use the Full-SAC procedures instead of pursuing relief under a Simplified-SAC approach if unlimited relief is available. In a Full-SAC case, the challenged rates are judged based on the simulated competitive price that would exist in a contestable marketplace where there were no barriers to entry and the pricing of the defendant was constrained by the threat of a new entry by a hypothetical SARR. This simulated competitive price protects the complainant from paying for the costs of inefficiencies in a carrier's investments or operations. Therefore, if the complainant believes that there are enough inefficiencies in the defendant's rail operations to justify the added expense and complexity of a Full-SAC presentation, it may pursue relief using this hypothetical SARR analysis. By removing the limitation on relief for Simplified-SAC, we are not seeking to discourage complainants from using the Full-SAC approach if that is their litigation preference. Rather, we are proposing to make a simplified alternative more accessible to a shipper who believes it is being charged unreasonable rates, yet does not choose to go through the complex process of designing a hypothetical railroad to prove its case. Moreover, lifting the limitation on relief under the Simplified-SAC approach should address the concerns raised by many of our stakeholders that the Full-SAC is too complex, too expensive, and too impractical for most shippers.

The current Simplified-SAC test simplifies the RPI component by relying on findings from prior Full-SAC cases. Simplified Standards, slip op. at 15. We also seek public input on whether, if we remove the limitation on relief as discussed above, we should remove the RPI simplification. Complainants would be required to submit detailed expert testimony on the replacement costs of the facilities used to serve the complainant.

Our rationale is that we cannot retain the RPI simplification if we are going to remove the rate-relief cap under this approach. We understand that removing this simplification feature of the approach will raise costs and may require extending the procedural schedule. We propose to consider extensions of the procedural schedule on a case-by-case basis. As for costs, we believe

that a Simplified-SAC case, even without the RPI simplification, will remain far less expensive to litigate than a Full-SAC case. Nevertheless, because there will be some increased cost, we also propose to raise the monetary limit on relief for a Three-Benchmark case to allow all rate complainants who cannot justify using the Simplified-SAC approach to have a cost-effective option for rate relief.

II. Three-Benchmark

Currently, parties seeking relief under the Three-Benchmark test are limited to $1 million in relief over a five-year period (with the monetary limit indexed for inflation). The Board selected the $1 million cap on relief because, at the time, it was the best evidence of record for the cost of litigating a Simplified-SAC case. Because we anticipate that litigation costs for Simplified-SAC would rise under the proposal noted above, the limitation on relief under the Three-Benchmark case should also be similarly raised. See Simplified Standards, slip op. at 28, 31 (basing the limit on relief for Three-Benchmark cases on the best available estimate of the litigation cost to pursue relief under the Simplified-SAC method).

By way of background, in Simplified Standards, we estimated that it costs about $5 million to bring a Full-SAC case. Simplified Standards, slip op. at 30-31. We added that, while "difficult to discern" precisely, the cost to litigate a Simplified-SAC case with the RPI simplification should be "dramatically less than the cost of presenting a Full-SAC case." Id. at 31. Based on the record before it, the Board estimated the cost to litigate such a Simplified-SAC case at $1 million, and therefore adopted that as the limitation on relief for Three-Benchmark cases.

Today, two considerations lead us to propose a $2 million limitation on relief for Three-Benchmark cases. On the one hand, as we acknowledged when first proposing Simplified-SAC, developing RPI evidence is "expensive." Simplified Standards for Rail Rate Cases, EP 646 (Sub-No. 1), slip op. at 39 (STB served July 28, 2006). This suggests that a substantial increase above the current $1.2 million (in current dollars) limit is warranted. On the other hand, we have acknowledged that the main driver of litigation costs in Full-SAC cases is the search for inefficiencies in the defendant's investments or operations, Simplified Standards, slip op. at 13, a process that involves modeling a hypothetical railroad from scratch. Because a Simplified-SAC case does not involve this expensive search for inefficiencies, the cost to bring a Simplified-SAC case, even without the RPI simplification, should be significantly less than 50% of the cost to bring a Full-SAC case (i.e., less than $2.75 million in current dollars). We note, however, that those who litigate rate cases before the Board are in the best position to provide details regarding litigation costs. We thus seek public input on whether it would be reasonable to raise the limitation on relief in Three Benchmark cases to $2 million in 2012 dollars (with the monetary limit indexed for inflation thereafter).

III. Full-SAC

The Full-SAC test has been the most heavily utilized method for challenging the reasonableness of rail rates. One reason that it is used more often is that a complainant is

permitted great flexibility in the design of its hypothetical SARR to detect inefficiencies in rail operations and the infrastructure. The approach is complicated, however. As such, since 1994 the Board has permitted complainants to use cross-over traffic, which enables these Full-SAC cases to focus on the facilities and services that are used by the complainant shipper and prevents Full-SAC cases from becoming unmanageable. See Pub. Serv. Co. of Colo. v. Burlington N. & Santa Fe Ry., 7 S.T.B. 589, 600-03 (2004). In 2004, the agency concluded that "[w]ithout cross-over traffic, captive shippers might be deprived of a practicable means by which to present their rate complaints to the agency." Id. at 603. At the time, the Board acknowledged that, as with any simplifying assumption, "the inclusion of cross-over traffic necessarily introduces some degree of imprecision into the SAC analysis." Id. But the agency concluded that "the value of this modeling device—both in keeping the analysis focused on the facilities and services used by the complainant shipper, and in streamlining and simplifying already complicated undertakings—outweighs the concerns raised by [the defendant railroad]." Id. Complainants first began by utilizing the device by including cross-over traffic that was predominantly trainload service. More recently, however, complainants have begun to include in the SAC analysis a significant amount of carload and multi-carload cross-over traffic.[10]

The inclusion of large amounts of carload and multi-carload cross-over traffic has revealed a significant and growing concern. There is a disconnect between the hypothetical cost of providing service to these movements over the segments replicated by the SARR and the revenue allocated to those facilities. When the proposed SARR includes cross-over traffic of carload and multi-carload traffic, it generally would handle the traffic for only a few hundred miles *after* the traffic would be combined into a single train. As such, the "cost" to the SARR of handling this traffic would be very low. In recent cases, litigants have proposed SARRs that would simply hook up locomotives to the train, would haul it a few hundred miles without breaking the train apart, and then would deliver the train back to the residual defendant. All of the costs of handling that kind of traffic (meaning the costs of originating, terminating, and gathering the single cars into a single train heading in the same direction) would be borne by the residual railroad. However, when it comes time to allocate revenue to the facilities replicated by the SARR, URCS treats those movements as single-car or multi-car movements, rather than the more efficient, lower cost trainload movements that they would be. As a result, the SAC analysis appears to allocate more revenue to the facilities replicated by the SARR than is warranted.

Without a means of correcting or minimizing the bias that is created by the disconnect between the revenue allocation and the costs of providing service, we need to address the use of cross-over traffic in Full-SAC cases. Accordingly, we propose and invite public comment on the following two options for Full-SAC cases: (1) restricting the use of cross-over traffic to

[10] See, e.g., Ariz. Elec. Power Coop., Inc. v. BNSF Ry., NOR 42113, slip op. at 35 (STB served Nov. 22, 2011) (noting concern that "while a majority of AEPCO's traffic group moves in trainload service, most of the variable costs calculated for that group were costed assuming it moved in carload and multi-car service"), appeals docketed sub nom. Ariz. Elec. Power Coop., Inc. v. STB, No. 12-1045 (D.C. Cir. Jan. 23, 2012); BNSF Ry. v. STB, No. 12-1042 (D.C. Cir. Jan. 23, 2012); Union Pac. R.R. v. STB, No. 12-1046 (D.C. Cir. Jan. 23, 2012).

movements for which the SARR would either originate or terminate the rail portion of the movement, or (2) restricting the use of cross-over traffic to movements where the entire service provided by the defendant railroad in the real world is in trainload service.

The first limitation would require the SARR to replicate more of the services being provided by the defendant railroad. If the SARR would either originate or terminate the traffic, then there may be less of a disconnect between the hypothetical cost to provide service over the segments replicated by the SARR and the revenue allocated to those facilities from cross-over traffic. Alternatively, the second limitation would limit the use of cross-over traffic to trainload movements, where the cost of providing service over any particular segment of the movement may be sufficiently homogenous that there would be less of a disconnect between the hypothetical costs of providing service in the SAC analysis and the actual costs of providing service used to allocate revenue to those segments. Parties are encouraged to comment on which alternative is superior, or to offer alternative solutions to the handling of cross-over traffic of carload and multi-carload traffic in Full-SAC cases.[11]

Similar limitations on the use of cross-over traffic in Simplified-SAC cases do not appear necessary. In those cases, the hypothetical SARR is replicating the existing facilities and existing operations of the defendant railroad. Because URCS is used in those cases to estimate both the operating costs of the SARR and of the incumbent railroad, there does not appear to be the same kind of disconnect between the operating costs of providing service and the revenue allocation. In other words, if URCS is significantly overestimating (or underestimating) the costs of operating over a particular segment, it will correspondingly overestimate (or underestimate) the revenue that should be allocated to that particular segment. However, parties in Full-SAC cases may not use URCS to estimate the operating costs of the hypothetical SARR because the SARR is not replicating the existing facilities and existing operations of the defendant railroad, as is the case in the Simplified-SAC proceeding. Instead, the complainants develop the operating costs of the SARR based on the particular services offered to the selected traffic group, but then use URCS operating costs for purposes of the revenue allocation, which creates the disconnect between the hypothetical operating costs of the SARR and the revenue allocation.

The Board also proposes to modify the ATC method used to allocate revenue from cross-over traffic. The revised ATC methodology would have two steps. First, using the URCS variable and fixed costs for the carrier, and the density and miles of each segment, parties would calculate the railroad's average total cost per segment of a move. The total revenues from each portion of the movement would then be allocated in proportion to the average total cost of the movement on- and off-SARR. This first step would thus follow the original ATC proposal adopted in Major Issues. A second step would then be performed to ensure that the revenue allocated to both the facilities replicated by the SARR and those of the residual defendant

[11] We do not propose to apply any new limitation retroactively to existing rate prescriptions that were premised on the use of cross-over traffic or to any pending rate dispute that was filed with the agency before this decision was served. We do not believe it would be fair to those complainants, who relied on our prior precedent in litigating those cases.

carriers would not be driven below the defendant's URCS variable costs for the movement over those segments. If the revenue allocation to the on-SARR (or off-SARR) segment would result in revenues falling below URCS variable costs for that segment, the revenue allocation to the on-SARR (or off-SARR) segment would then be raised to equal 100% of the defendant's URCS variable costs of providing service over that segment. If the total revenue from the cross-over movement were below our measure of total variable cost for the entire movement, revenue would be allocated between the two segments to maintain the existing total R/VC ratio on both segments.

This alternative method might better address two competing principles in the selection of a cross-over traffic methodology. First, as discussed earlier, we seek a revenue allocation that takes into account the important role that economies of density should play in any cost-based revenue allocation approach. Second, we seek a revenue allocation approach that does not create the implausible result of driving the revenue allocation on any segment below variable costs. While our current modified ATC approach also accommodates those two principles, this alternative approach, brought to our attention in Western Fuels Remand, avoids driving the revenue allocation below variable costs while giving more weight to the important role that economies of density should play in any cost-based revenue allocation approach.[12] We therefore seek public comment on whether we should adopt this modification to ATC for use in all future SAC and Simplified-SAC proceedings and whether it provides a more suitable methodology that would better accommodate the two competing principles than the current ATC approach. Parties may also propose alternative approaches that would better accommodate these two competing principles than the current modified ATC approach or the alternative described above.

IV. Interest Rate on Rate Overcharges

When the Board determines that a railroad has charged rates that are unreasonable, it may establish a rate prescription, as well as direct the railroad to reimburse the complaining shipper, with interest. Currently, the level of interest is set at the T-Bill rate. 49 C.F.R. § 1141.1(a).

It is our responsibility to establish an interest rate that encourages compliance with our rules and correlates to market interest rates over a comparable time frame. We are concerned that the T-Bill rate (currently at 0.10%) may be insufficient. Therefore, we propose to change the interest rate to the U.S. Prime Rate, as published in *The Wall Street Journal*. The U.S. Prime rate (currently at 3.25%) is the interest rate that the banks charge to their most creditworthy customers, and may serve as a more appropriate rate for calculating interest owed to shippers for rates found by the Board to be unreasonable.

[12] This proposal is similar, but not identical, to that proposed by BNSF in Western Fuels Remand. This proposal examines the revenue allocation to the on-SARR and off-SARR segments, whereas BNSF's proposal examined only the on-SARR segment.

CONCLUSION

We believe that the proposals contained here should further promote the rail transportation policy to protect captive shippers from unreasonable rates, 49 U.S.C. § 10101, without precluding rail carriers from earning revenues that are adequate under honest, economical, and efficient management, 49 U.S.C. § 10704(a)(2). We also believe that several of these changes would enable the agency to better follow the directive from Congress to "provide for the expeditious handling and resolution of all proceedings required or permitted to be brought under this part." 49 U.S.C. § 10101(15); see also 49 U.S.C. § 10704(d) (requiring the agency to establish "procedures to ensure expeditious handling of challenges to the reasonableness of railroad rates"). We therefore invite public comment on each of these proposals.

Changes to the Code of Federal Regulations needed to implement this proposal are set forth in **Appendix A** and will be published in the Federal Register.

The Regulatory Flexibility Act of 1980, 5 U.S.C. §§ 601-612, generally requires a description and analysis of new rules that would have a significant economic impact on a substantial number of small entities. In drafting a rule, an agency is required to: (1) assess the effect that its regulation will have on small entities; (2) analyze effective alternatives that may minimize a regulation's impact; and (3) make the analysis available for public comment. 5 U.S.C. §§ 601-604. In its notice of proposed rulemaking, the agency must either include an initial regulatory flexibility analysis, 5 U.S.C. § 603(a), or certify that the proposed rule would not have a "significant economic impact on a substantial number of small entities," 5 U.S.C. § 605(b). The impact must be a direct impact on small entities "whose conduct is circumscribed or mandated" by the proposed rule. White Eagle Coop. Ass'n v. Conner, 553 F.3d 467, 480 (7th Cir. 2009). An agency has no obligation to conduct a small entity impact analysis of effects on entities that it does not regulate. United Dist. Cos. v. FERC, 88 F.3d 1105, 1170 (D.C. Cir. 1996).

This proposal would not have a significant economic impact upon a substantial number of small entities, within the meaning of the Regulatory Flexibility Act.[13] The proposal imposes no additional record keeping by small railroads or any reporting of additional information. Nor do these proposed rules circumscribe or mandate any conduct by small railroads that is not already required by statute: the establishment of reasonable transportation rates. Small railroads have always been subject to rate reasonableness complaints and their associated litigation costs. And they have been subject to the simplified rate procedures since 1996, when the simplified procedures were first created. Finally, as the Board has previously concluded, the majority of

[13] The Small Business Administration's (SBA) Office of Size Standards develops the numerical definition of a small business. See 13 C.F.R. § 121.201. The SBA has established a size standard for rail transportation, stating that a line-haul railroad is considered small if its number of employees is 1,500 or less, and that a short line railroad is considered small if its number of employees is 500 or less. Id. (industry subsector 482).

railroads involved in these rate proceedings are not small entities within the meaning of the Regulatory Flexibility Act. See Simplified Standards, slip op. at 33-34. In the 32 years since the passage of the Staggers Act—when Congress limited the Board's rate reasonableness jurisdiction where a carrier has market dominance over the transportation at issue—virtually all rate challenges have involved large Class I carriers. Therefore, the Board certifies under 5 U.S.C. § 605(b) that this proposed rule, if promulgated, will not have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act.

This proposal would also not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. All parties wishing to participate in this proceeding should file a notice with the Board by August 24, 2012.

2. Submissions addressing the proposals discussed herein are due by October 23, 2012. Reply submissions are due by December 7, 2012. Rebuttal submissions are due by January 7, 2013.

3. An original and 20 copies of each submission should be filed with the Board and one copy sent to each party who has filed a notice of intent to participate.

4. Notice of this decision will be published in the Federal Register.

5. A copy of this decision is being provided to the Chief Counsel for Advocacy, Small Business Administration.

6. This decision is effective on July 25, 2012.

By the Board, Chairman Elliott, Vice Chairman Mulvey, and Commissioner Begeman.

APPENDIX A – CHANGES TO CODE OF FEDERAL REGULATIONS

For the reasons set forth in the decision, the Surface Transportation Board proposes to replace part 1141 of title 49, chapter X, of the Code of Federal Regulations in its entirety with the following regulation:

49 C.F.R. PART 1141—PROCEDURES TO CALCULATE INTEREST RATES

Authority: 49 U.S.C. 721.

§ 1141.1 Procedures to calculate interest rates.

(a) For purposes of complying with a Board decision in an investigation or complaint proceeding, interest rates to be computed shall be the most recent U.S. Prime Rate as published by The Wall Street Journal. The rate levels will be determined as follows:

(1) For investigation proceedings, the interest rate shall be the U.S. Prime Rate as published by The Wall Street Journal in effect on the date the statement is filed accounting for all amounts received under the new rates.

(2) For complaint proceedings, the interest rate shall be the U.S. Prime Rate as published by The Wall Street Journal in effect on the day when the unlawful charge is paid. The interest rate in complaint proceedings shall be updated whenever The Wall Street Journal publishes a change to its reported U.S. Prime Rate. Updating will continue until the required reparation payments are made.

(b) For investigation proceedings, the reparations period shall begin on the date the investigation is started. For complaint proceedings, the reparations period shall begin on the date the unlawful charge is paid.

(c) For both investigation and complaint proceedings, the annual percentage rate shall be the same as the annual nominal (or stated) rate. Thus, the nominal rate must be factored exponentially to the power representing the portion of the year covered by the interest rate. A simple multiplication of the nominal rate by the portion of the year covered by the interest rate would not be appropriate because it would result in an effective rate in excess of the nominal rate. Under this “exponential” approach, the total cumulative reparations payment (including interest) is calculated by multiplying the interest factor for each period by the principal amount for that period plus any accumulated interest from previous periods. The “interest factor” for each period is 1.0 plus the interest rate for that period to the power representing the portion of the year covered by the interest rate.

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SERVICE DATE – LATE RELEASE JULY 25, 2012

SURFACE TRANSPORTATION BOARD

NOTICE

Docket No. EP 711

PETITION FOR RULEMAKING TO ADOPT REVISED
COMPETITIVE SWITCHING RULES

Digest:[1] This decision begins a proceeding to consider a proposal submitted by The National Industrial Transportation League (NITL) to increase rail-to-rail competition. Under its proposal, certain shippers located in terminal areas that lack effective competitive transportation alternatives would be granted access to a competing railroad, if there is a working interchange within a reasonable distance (30 miles under NITL's proposal). The Surface Transportation Board (the Board) is seeking empirical information about the impact of the proposal, if it were to be adopted. Specifically, the Board is seeking public input on the proposal's impact on rail shippers' rates and service, including shippers that would not benefit under NITL's proposal; the proposal's impact on the rail industry, including its financial condition and network efficiencies; and methodologies for the access price that would be used in conjunction with competitive switching.

Decided: July 25, 2012

In 2011, the Surface Transportation Board (the Board) held a hearing to consider the state of competition in the railroad industry and what steps, if any, we should take to increase rail-to-rail competition. See Competition in the Railroad Industry, Docket No. EP 705. Among wide-ranging testimony, various commenters focused on the Board's authority to direct switching, urging modifications to the Board's mandatory reciprocal switching standards. Under 49 U.S.C. § 11102(c), the Board may compel a railroad to enter into a switching agreement "where it finds such agreements to be practicable and in the public interest, or where such agreements are necessary to provide competitive rail service." 49 U.S.C. § 11102(c).

After last year's hearing, The National Industrial Transportation League (NITL) came forward with a proposal to modify the Board's standards for mandatory competitive switching. NITL suggests that we mandate switching where a captive shipper (located in a terminal area) is within 30 miles of a working interchange and the transportation rate charged by the Class I carrier from origin to destination exceeds 240% of its variable costs of providing service.[2] This

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[1] The digest constitutes no part of the decision of the Board but has been prepared for the convenience of the reader. It may not be cited to or relied upon as precedent. Policy Statement on Plain Language Digests in Decisions, EP 696 (STB served Sept. 2, 2010).

[2] The specific details and limitations behind NITL's proposal are summarized later in
(continued . . .)

proposal has the potential to promote more rail-to-rail competition and reduce the agency's role in regulating the reasonableness of transportation rates. It could permit the agency to rely on competitive market forces to discipline railroad pricing from origin to destination, and regulate only the access price for the first (or last) 30 miles.

While NITL's proposal is thoughtful and responsive to the Competition in the Railroad Industry, Docket No. EP 705 proceeding, we cannot fully gauge its potential impact. For example, we do not know how many shippers would be able to take advantage of mandatory competitive switching, nor has NITL provided such data in its submission. We must also consider an appropriate methodology for access pricing that would be used in conjunction with competitive switching. The access price would be a significant factor in determining the impact of such a broad competitive switching requirement, but that critical element also was not included in NITL's petition. Therefore, additional information is needed before we can determine how to proceed.

We begin this proceeding to receive empirical evidence on the impact of the proposal on shippers and the railroad industry. Specifically, interested parties are invited to submit information on the following: (1) the impact on rates and service for shippers that would qualify under the competitive switching proposal; (2) the impact on rates and service for captive shippers that would not qualify under this proposal (because they are not located in a terminal area or within 30 miles of a working interchange); (3) the impact on the railroad industry, including its financial condition, and network efficiencies or inefficiencies (including the potential for increased traffic); and (4) an access pricing proposal.

We will make our most recent confidential Waybill Sample available, under customary protective orders (see 49 C.F.R. § 1244.9 (f)), as well as allow reasonably tailored discovery, as needed, for commenters to conduct the empirical analyses requested. We also encourage the commenters to submit evidence to show what would happen if we modified NITL's proposal, such as: by changing the 30-mile distance limitation, and/or by changing the revenue to variable costs ratio that would be used for the conclusive presumption in favor of competitive access relief, or using some other method, such as a carrier's 4-year average Revenue Shortfall Allocation Methodology (RSAM) benchmark. It may be appropriate to consider an R/VC threshold that is related to the revenue needs of the carrier and the amount of demand-based differential pricing that the carrier needs to earn a reasonable return on its investments.

BACKGROUND

Statutory Framework

Competitive access generally refers to the ability of a shipper or a competitor railroad to use the facilities or services of an incumbent railroad to extend the reach of the services provided

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(. . . continued)
this decision and are described in more detail by NITL in its petition.

by the competitor railroad. The Interstate Commerce Act makes three competitive access remedies available to shippers and carriers: through routes, terminal trackage rights and reciprocal switching. Under 49 U.S.C. § 10705(a), the Board may require a carrier to interchange traffic with another railroad and provide a through route and a through rate for that traffic. Under 49 U.S.C. § 11102(a), the Board may require an incumbent carrier to grant physical access over its lines so that the trains and crews of a competing carrier can serve shippers located in the incumbent carrier's terminal facilities. Under 49 U.S.C. § 11102(c)—the provision that NITL's proposal would engage—the Board may require an incumbent carrier to transport the cars of a competing carrier and to switch those cars between the two lines for a fee. Reciprocal switching, or as it is more generally termed "competitive switching" because it is not always a reciprocal arrangement between carriers, thus enables the competing railroad to offer its own single-line rate, even though it cannot physically serve the shipper's facility, to compete with the incumbent's single-line rate. The Board's current policy is that all of the competitive access remedies require a showing that the "the prescription or establishment is necessary to remedy or prevent an act that is contrary to the competition policies of 49 U.S.C. 10101 or is otherwise anticompetitive, and otherwise satisfies, the criteria of either 49 U.S.C. 10705 or 11102."[3]

Hearing on Competition in the Railroad Industry (Docket No. EP 705)

On January 11, 2011, the Board issued a notice seeking comments and announcing a public hearing to explore the current state of competition in the railroad industry and possible policy alternatives to facilitate more competition, where appropriate. Competition in the R.R. Indus., EP 705 (STB served Jan. 11, 2011). In the notice, the Board urged commenters to focus on, among other things, competitive switching, inviting commenters to discuss "how to construe [49 U.S.C. § 11102(c)] in light of current transportation market conditions." Id. at 6.

On April 12, 2011, NITL filed individual and joint comments in Docket No. EP 705. In its filings, NITL urged the Board to implement changes to its rules on competitive switching. On June 22 and 23, 2011, after receiving numerous other written comments, the Board held a public hearing in that proceeding.

NITL's Proposal

On July 7, 2011, NITL filed a petition requesting that we institute a rulemaking under 5 U.S.C. § 553 to replace the Board's existing competitive access rules with new rules, proposed by NITL, for competitive switching under 49 U.S.C. § 11102(c). In a decision served November

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[3] The Board's existing competitive access rules are codified at 49 C.F.R. § 1144. They were originally adopted by the Interstate Commerce Commission (ICC), the Board's predecessor agency, in the mid-1980s. Intramodal Rail Competition, 1 I.C.C. 2d 822 (1985), aff'd sub nom. Balt. Gas & Elec. v. United States, 817 F.2d 108 (D.C. Cir. 1987), applied in Midtec Paper Corp. v. Chi. & Nw. Transp. Co., 3 I.C.C. 2d 171 (1986), aff'd sub nom. Midtec Paper Corp. v. United States, 857 F.2d 1487 (D.C. Cir. 1988); Cent. Power & Light v. S. Pac., et al., 1 S.T.B. 1059 (1996) (Bottleneck I), clarified, 2 S.T.B. 235 (1997) (Bottleneck II), aff'd sub nom. MidAmerican Energy Co. v. STB, 169 F.3d 1099 (8th Cir. 1999).

4, 2011, we deferred a decision on whether to begin a rulemaking pending review of the issues and arguments presented in Docket No. EP 705. Pet. for Rulemaking to Adopt Revised Competitive Switching Rules, EP 711 (STB served Nov. 4, 2011).

The Board's existing rules make competitive switching available as a remedy for the abuse of market power by railroads. Under NITL's proposal, the Board would move away from a competitive-abuse standard toward a market-power standard by promulgating a new Part 1145 to Title 49 of the Code of Federal Regulations, captioned "Competitive Switching Under 49 U.S.C. § 11102(c)." Competitive switching by a Class I rail carrier would be mandatory if four conditions were met: (1) the shipper (or group of shippers) is served by a single Class I rail carrier; (2) there is no effective intermodal or intramodal competition for the movements for which competitive switching is sought; (3) there is or can be "a working interchange" within a "reasonable distance" of the shipper's facility; and (4) switching is safe and feasible, with no adverse effect on existing service. Central to NITL's proposed rules is the establishment of conclusive presumptions with respect to whether a shipper lacks effective intermodal or intramodal competition for the movements at issue, and whether there is a working interchange within a reasonable distance of the shipper's facilities.

Pointing to the experience of shippers in litigating the issue of market dominance in rate reasonableness cases, NITL argues that conclusive presumptions regarding whether effective competition exists for the transportation of a shipper's goods are necessary because, without such presumptions, the complexity, costs, and time-consuming nature of litigating competitive switching would deter shippers from bringing meritorious cases. Therefore, NITL proposes, first, that we find conclusively that a shipper lacks effective intermodal or intramodal competition where the rate for the movement for which switching is sought has a revenue-to-variable cost ratio of 240% or more ($R/VC_{\geq 240}$). NITL argues that $R/VC_{\geq 240}$ is a level of profitability that represents a very high likelihood that the carrier is exercising market power over the shipment. NITL states that $R/VC_{\geq 240}$ is well above the railroads' fully allocated costs and the Board's jurisdictional threshold of revenue-to-variable cost greater than 180% ($R/VC_{>180}$). Moreover, NITL argues that $R/VC_{\geq 240}$ represents the average markup above variable costs earned by Class I rail carriers on their "very-highest-rated traffic"—that is, the railroads' "potentially captive traffic" with an R/VC ratio greater than 180%.[4]

Second, NITL proposes that a shipper would be conclusively presumed to lack effective intermodal and intramodal competition where the Class I carrier serving the shipper's facilities for which switching is sought has handled 75% or more of the transported volumes of the movements at issue for the twelve-month period prior to the petition requesting that the Board order switching. NITL relies on judicial and administrative precedent in antitrust cases that equates a 75% market share with substantial market power and a lack of effective competition.[5]

[4] NITL also notes that the Board has prescribed maximum reasonable rates at or below $R/VC_{\geq 240}$. NITL Pet. 49.

[5] NITL Pet. 50-52.

NITL would also have the Board establish two conclusive presumptions to determine whether a workable interchange exists within a reasonable distance of a shipper's facility. First, NITL would have the Board conclusively presume that a workable interchange exists where a shipper's facilities are within the geographic boundaries of a terminal established by a Class I rail carrier (incumbent carrier) serving the shipper, and cars are regularly switched between the incumbent carrier and the carrier for which competitive switching is sought.[6] NITL argues that it is appropriate to establish a conclusive presumption that a workable interchange exists when the incumbent carrier has itself established the geographic boundaries of a terminal at which cars are regularly switched.

NITL's second conclusive presumption regarding workable interchanges addresses what is a reasonable distance between a shipper's facilities and the interchange at issue. Specifically, NITL proposes that the Board conclusively presume that 30 miles is a reasonable distance, provided that the interchange is one where cars are regularly switched between the incumbent carrier and the carrier for which switching is sought. To support its use of a 30-mile distance, NITL primarily relies on recommendations from the U.S. Department of Agriculture in Docket No. EP 705, a 2009 policy paper by the Railroad-Shipper Transportation Advisory Council (RSTAC),[7] and the geographic scope of various existing interchange arrangements between carriers.

Response of AAR and Class I Railroads

The Association of American Railroads (AAR), which represents the Class I railroads, opposes NITL's proposal and argues that the record in Docket No. EP 705 has not demonstrated that changes to the Board's competitive access regulations are needed or justified. Its response on behalf of the railroad industry argues that NITL's proposal is neither limited nor a middle ground, but amounts instead to a scheme of access on demand for many shippers served by a single railroad.[8] AAR claims that NITL's proposal would replace the existing conduct-based standards for competitive access with a scheme based on conclusive presumptions of market power that, in fact, have nothing to do with market power and are readily subject to manipulation. AAR also argues that NITL's proposal is incomplete because it does not include a proposal on access pricing, and likewise fails to address the impact on investment in the rail network from loss of revenue caused by mandatory access.

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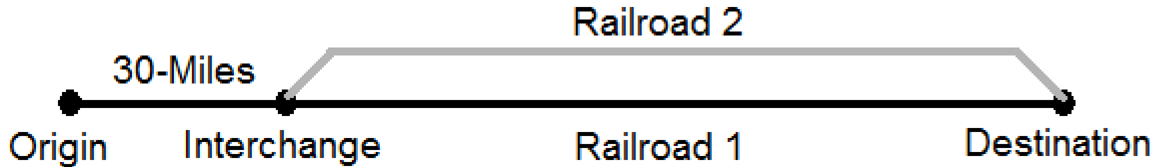
[6] NITL Pet. 55-56. The presumption would apply to terminals in existence on the date of NITL's petition (July 7, 2011) and to terminals established by Class I railroads in the future.

[7] R.R.-Shipper Transp. Advisory Council, White Paper on New Regulatory Changes for the Railroad Industry (Oct. 16, 2009). Congress created RSTAC for the purpose of advising Congress, the U.S. Department of Transportation, and the Board on rail transportation policy, with particular emphasis on rail issues affecting small shippers and small railroads. The representatives of Class I railroads are not voting members of RSTAC. See 49 U.S.C. § 726.

[8] Additionally, Norfolk Southern Railway Company and CSX Transportation, Inc. filed brief responses that adopted AAR's response and incorporated by reference their prior comments and testimony from Docket No. EP 705.

DISCUSSION AND CONCLUSIONS

NITL's proposal, if adopted, could change the competitive rail service landscape by making mandatory competitive switching more widely available to a subset of currently captive shippers. The following schematic illustrates the basic objective of NITL's proposal.



As illustrated, a captive shipper transports its goods from "Origin" to "Destination" using the services provided by "Railroad 1," the only railroad that serves Origin. Currently, if Railroad 1 charges rates that the shipper believes are too high, the shipper's only choices are to construct 30 miles of new track to reach "Railroad 2" (a competitor railroad), to truck the product to Railroad 2 for transloading, or to pursue rate relief before this agency if the transload option does not provide effective competition.

Under NITL's proposal, Railroad 1 would be required to give Railroad 2 access to the origin by "switching" the traffic for Railroad 2 if either: (1) the rate charged by Railroad 1 from Origin to Destination were greater than or equal to 240% of the variable cost of providing that service; or (2) Railroad 1 carried 75% or more of the shipper's traffic between Origin and Destination. Under this proposal, because both Railroad 1 and Railroad 2 could quote rates from Origin to Destination, there may be no market dominance, and hence the Board may not regulate the reasonableness of those rates. Rather, its role would be limited to regulating the "access price" (i.e., the price Railroad 1 may charge to provide the shipper with access to the competitor service provided by Railroad 2). Under the assumption that competition between Railroad 1 and Railroad 2 would ensure reasonable rates and service between Origin and Destination, we could focus our resources only on the access price for the first 30 miles of the movement under NITL's proposal.

NITL's proposal is premised on the potential benefits to shippers of creating rail-to-rail competition between Railroad 1 and Railroad 2 for transportation between Origin and Destination: more choices, better service, and lower rates. An additional benefit of NITL's proposal is that it would reduce governmental intervention by limiting regulation to the access price and relying on demand and the marketplace to set rates and judge the service provided by the railroads.

The policies governing railroad regulation require the Board to balance a variety of factors reflecting the tension between the desire for competitive rates for shippers, on the one hand, and adequate revenues for railroads, on the other. See 49 U.S.C. §§ 10101(1)-(6); 49 U.S.C. § 10704(a).

NITL's proposal does not provide enough information for the Board to determine fully its effect on qualifying shippers, as we do not yet have an estimate of how many shippers would be able to take advantage of mandatory competitive switching. NITL has indicated that it has sought to minimize the potential negative effects of its proposal on the financial health of the railroad industry by designating limitations on the traffic for which competitive access relief would be mandatory.[9] NITL's petition itself, however, does not include detailed evidence or analysis of the likely benefits to shippers that could obtain mandatory switching that would result from its proposal, nor does it address how remaining shippers might be affected. And, it does not include a methodology for access pricing, which we believe would be a significant factor in determining the extent to which a broad competitive switching requirement could affect qualifying shippers, as well as the financial strength of the railroad industry.

In addition to the benefit-to-shippers analysis, this Board must consider the impact of the proposal on the financial health of the railroad industry. To remain financially sound, carriers must be allowed to engage in "demand-based differential pricing"—that is, in order to recover the substantial joint and common costs of its network, a railroad must be able and permitted to charge different customers different prices based on their different levels of demand for transportation services. If a railroad is unable to recover these joint and common costs, it will not be able to earn adequate revenues. Coal Rate Guidelines, Nationwide, 1 I.C.C. 2d 520, 526 (1985), aff'd sub nom. Consol. Rail Corp. v. United States, 812 F.2d 1444 (3d Cir. 1987). Much of the traffic that moves by rail has competitive alternatives. If a carrier were required to charge all of its shippers the same markup over cost, the competitive traffic with lower-cost alternatives would be diverted to those other modes of transportation. This, in turn, could require the carrier to charge the remaining traffic even higher rates to recover joint and common costs.

Because we cannot project the extent of any net revenue loss to railroads that would result from NITL's proposal, we also cannot predict whether, or by how much, the remaining captive traffic would likely be charged to make up for any revenues that would otherwise be lost to the carriers. AAR argued that broadly curtailing the ability of carriers to engage in demand-based differential pricing through competitive access would produce real-world consequences that "could be dramatic and would adversely affect all shippers and the Nation's economy as a whole."[10] That concern merits careful consideration, as we want to ensure the rail industry is able to continue to invest adequately in rail network infrastructure improvements. On the other hand, as noted above, the effect on revenues from lower prices might be offset, at least in part, from increased demand. But we cannot overlook the possibility that, to make up for lost revenues, a carrier might charge its remaining captive shippers considerably more.[11] Therefore,

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[9] The most significant limitations in NITL's proposal are the distance limitation (the conclusive presumption in favor of mandated competitive switching does not apply to movements that are over 30 miles to a working interchange) and the R/VC limitation (movements with a R/VC below 240% are generally ineligible for competitive switching absent a showing of market dominance).

[10] AAR Open. Comment 45, Competition in the Railroad Industry, EP 705 (filed April 12, 2011).

[11] Under our stand-alone cost (SAC) rate analysis, a carrier may be able to justify higher

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the extent to which a program of broad competitive access could affect other captive shippers who may not participate in the program must also be examined.[12]

Finally, we need more precise information about whether increasing the availability of mandatory competitive switching would affect efficiencies or impose costs on the railroads' network operations. AAR and Class I railroads submitted considerable testimony in Docket No. EP 705 from internal operating personnel stating a concern that inefficiencies would result, which, in their view could offset the benefits to qualifying shippers while also impeding the fluidity of the rail network as a whole. The Board and interested stakeholders would benefit from more empirical evidence to quantify the impact on network efficiency if the Board's competitive access rules were modified to make mandated competitive switching more widely available.

The discussion concerning the overall benefits to shippers of competitive access and its impact on railroads has been ongoing since the 1980s. Yet the Board still does not have the empirical evidence it needs to determine the merits of either NITL's or AAR's claims of the potential impact of NITL's proposal. In Docket No. EP 705, we asked commenters to submit empirical evidence of the anticipated impact of any proposal on the railroad industry. NITL states that its proposal will not harm the rail industry, but it has not yet provided detailed evidence to support its claim.[13] By the same token, the railroads have offered little in the way of quantitative evidence to support their claims that mandated competitive switching on the scale contemplated by NITL's proposal would have severe adverse effects on the financial health of

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rates to remaining captive shippers if other formerly captive shippers obtain rate reductions. The SAC test determines the maximum amount of differential pricing a carrier needs to earn a reasonable return on the facilities used to serve the captive shipper. This becomes the limit on what the railroad can charge that shipper. But the maximum amount of differential pricing the SAC test will permit depends in part on the revenues the railroad earns from other traffic that shares those facilities. Holding everything else constant, if the carrier earns more revenue, the amount of differential pricing needed falls, and vice versa. Therefore, under the SAC test, a captive shipper could be responsible for paying *even more* of the joint and common costs of the facilities used to serve that shipper if the railroad can no longer recover as much revenue from formerly captive traffic that obtains rate reductions under NITL's proposal.

[12] This concern is not just hypothetical. For example, it appears unlikely that NITL's proposal would help agricultural shippers in the states of Montana and North Dakota, as virtually none of those shippers is located within 30 miles of a competitor railroad, nor would it benefit the many utility companies that similarly are not located within 30 miles of a competitor railroad.

[13] NITL relies on language in the Board-commissioned Christensen Report for the proposition that competitive switching is unlikely to harm the industry. NITL Pet. 28-29 (citing Laurits R. Christensen Assoc., Inc., A Study of Competition in the U.S. Freight Railroad Industry and Analysis of Proposals That Might Enhance Competition 22-12 to -14 (rev. 2009)). The Christensen Report, however, did not analyze rigorously specific proposals and did not provide evidentiary support for its conclusions regarding industry effects.

the industry. And no party has addressed the potential effect on other captive shippers that would not be covered under NITL's proposal.

Therefore, we will seek further study and comment about these issues. To provide commenters with sufficient time to produce hard facts and rigorous empirical analyses, we will adopt an extended procedural schedule. The extended period also should allow the participants to seek Board resolution of any discovery issues that may arise during that time. If, however, parties need more time, they should petition for an extension. We will make the 2010 Waybill Sample available to participants, under customary protective orders (see 49 C.F.R. § 1244.9), and we will entertain requests that participants' pleadings be filed under seal so that confidential information is protected. If participants are permitted to file their pleadings under seal, they will be required also to file a public version with confidential information redacted.

To narrow the scope of the undertaking, any railroad or shipper interest may choose to focus on the impact of this proposal on one of the 4 largest U.S. Class I railroads (Union Pacific Railroad, BNSF Railway Company, CSX Transportation, Inc., or Norfolk Southern Railway Company) as illustrative of the impact on the industry, instead of performing a study of the impact on the entire industry.[14] Commenters should fully address and quantify, to the extent practicable, the following issues concerning the rail carrier (or carriers) included in the study:

1. Identify the existing terminals and shippers located within the boundaries of those terminals. Explain whether the shippers can currently obtain competitive switching and any restrictions or limitations on the shippers' competitive switching rights.
2. Identify how many additional shippers and what amount of revenues earned by the incumbent Class I rail carrier from those shippers would be subject to competitive switching under NITL's proposal.
3. Based on the commenter's assumed access pricing methodology, by how much would NITL's proposal lower rates for the shippers identified in the study that would qualify for competitive access? How much revenue would the incumbent Class I rail carrier lose as a result of NITL's proposal? How much of this revenue loss could be offset through traffic increases or other gains?
4. What would be the economic and regulatory impacts of NITL's proposal on the captive shippers served by the incumbent Class I rail carrier or carriers included in the study that would not be covered by NITL's proposal and, therefore, would continue to be served only by the incumbent carrier? Would their rates increase, and, if so, by how much, to offset the reduced rates to others?
5. How would rail network efficiency be affected by NITL's proposal?

[14] We believe that the broad mix of traffic (both geographically and type of traffic) handled by any of the 4 largest U.S. Class I railroads is sufficiently representative of the railroad industry as a whole that one could draw reasonable inferences from a study of one of those carriers on the industry-wide impact.

Commenters should study the impact of NITL's proposal under whatever access pricing proposal they believe the Board should adopt. Commenters may also provide the analysis needed to assess the impact of this proposal if the 30-mile "reasonable distance" were changed. And they may provide the analysis needed to assess the impact of this proposal if the $R/VC_{\geq 240}$ or the 75% market-share eligibility requirements were changed. As noted, NITL's proposal creates a conclusive presumption in favor of competitive access relief to those shippers where the R/VC ratio of the through movements is equal to or greater than 240%, or where the incumbent railroad has handled 75% of the origin-to-destination traffic for which switching is sought over the most recent 12 months. While $R/VC_{\geq 240}$ is a core limitation to NITL's proposal, one might conclude that the R/VC threshold should be related to the revenue needs of the carrier and the amount of demand-based differential pricing that the carrier needs to earn a reasonable return on its investments. Thus, an alternative approach might be to limit any competitive access relief to shippers for which their R/VC ratio exceeds the 4-year average RSAM benchmark published annually by the Board for the carrier in question, or some other reasonable R/VC threshold. We encourage commenters to submit evidence to show what would happen if we adopted this alternative approach, or any other alternative approach.

CONCLUSION

Since the hearing in Competition in the Railroad Industry, Docket No. EP 705, we have been considering the wide range of ideas and options that were discussed to determine how best to promote a competitive and economically viable rail network. NITL submitted the proposal at issue here, which is a part of the competition and service issues brought to the Board in the EP 705 proceeding. Today, we have also proposed rules to reform our rate regulation process, as reflected in the notice of proposed rulemaking in Docket No. EP 715. In addition, we continue to evaluate other competitive issues, including what actions to take in connection with commodity exemptions which were the subject of a separate hearing in Docket No. EP 704, and how to improve our rules in transactions involving interchange commitments.

As part of this ongoing effort, we have conducted preliminary analysis of NITL's proposal, which has led to our conclusion that it would be in the public interest to solicit further information here before we move forward with any formal rulemaking. The empirical information we are now requesting would be used to augment the Board's ongoing analysis of NITL's proposal, as well as to evaluate issues raised in the Competition in the Railroad Industry hearing. We also believe that soliciting empirical studies from stakeholders at this stage will enable the Board to balance efficiently its responsibilities in this docket with those in other ongoing proceedings.

This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. A proceeding is instituted to consider NITL's competitive access proposal.

2. We invite interested commenters to perform a study of the competitive access proposal submitted by NITL and to submit reports of their studies' findings or other appropriate information and recommendations.

3. Opening submissions are due by November 23, 2012. Responses are due February 21, 2013. Pleadings containing confidential information must be filed under seal, along with public versions with confidential information redacted.

4. Notice of this decision will be published in the Federal Register on July 30, 2012.

5. This decision is effective on the date of service.

By the Board, Chairman Elliott, Vice Chairman Mulvey, and Commissioner Begeman.