

Rail Relief Processes for Shippers

Chapter 11

Chapter 11: Rail Rate Relief Processes for Shippers

In the legislative language requiring this study on agricultural transportation issues, Congress requested a discussion on “the accessibility to shippers in rural areas of Federal processes for the resolution of grievances arising within various transportation modes.”²¹⁷ Our reading of this requirement is that Congress desired information about how shippers can contest rates, and whether these processes are practical and effective. Over the years, shippers have raised many concerns about the grievance processes for rail rates. It is important to note that truck and barge rates are not regulated by the Federal government and are driven by competitive markets. Captive rail rates—those where there is no cost-competitive transportation alternative—are subject to regulation by the Surface Transportation Board (STB). A grievance process is available to shippers who use ocean-going common carriers, and is described in Chapter 14. This chapter limits its scope to the rate relief processes for rail shippers.

Figure 11-1: The STB seal



Source: Department of Transportation

Regulating Railroads

The Interstate Commerce Commission (ICC) began regulating railroads in 1887. Those early regulations controlled rail rates, prohibited most forms of price discrimination, published tariffs and enforced adherence to them, and prohibited the practice of pooling. Over time, ICC regulation of the railroads evolved to the point where almost every action by a railroad required prior approval by the ICC, including track construction, route abandonment, rates, and even the method for depreciation of capital investment. By the latter half of the twentieth century, railroads had begun to decline, at least in part due to stifling economic regulation; by the 1970s the industry was in desperate straits.

The Railroad Revitalization and Regulatory Reform Act of 1976 and the Staggers Rail Act of 1980 (Staggers Act) sought to revitalize the financial health of railroads by minimizing Federal regulatory control and providing flexibility in establishing rates, which could allow railroads to generate adequate revenues. When Congress enacted the Staggers Act, it made clear that it wanted to alter significantly the balance between regulation and the forces of the competitive marketplace.

To improve the financial prospects of railroads, the Staggers Act transformed the regulatory process, allowing, “to the maximum extent possible, competition and demand for services to establish reasonable rates for transportation by rail.”²¹⁸ In this regard, the Act provided for confidential contracts between shippers and their rail carriers, authority for the ICC to exempt classes and types of rail transportation from regulation when not needed to foster competitive rates and service, and set rate thresholds below which the Commission had no jurisdiction to regulate rates. These reforms effectively exempted a substantial percentage of traffic (estimates range from 75 to 85 percent) from economic regulation. Residual rate regulation focused on maintaining reasonable rates where there was an absence of effective competition.

Some regulatory provisions were, however, retained. At a very basic level, U.S. carriers retained a “common carrier obligation,” requiring them to provide transportation services on “reasonable request.” Railroads remain under general obligations to serve all customers without discrimination, charge reasonable rates, and interchange traffic with connecting carriers. Notwithstanding this requirement, shippers have frequently complained that railroads can—and quite often do—price movements beyond the range of economic feasibility to discourage or eliminate traffic they want to avoid.

Differential Pricing

Flexibility in setting rates also afforded railroads the opportunity to use differential pricing to raise sufficient revenues to operate, maintain, and (where appropriate) expand their networks. To recover fixed costs more effectively across the system, differential pricing allows a railroad to impose higher rates on traffic with fewer transportation alternatives, even though the characteristics of the movement may be the same as those for a shipper facing more competitive transportation options.

The ICCTA

The Interstate Commerce Commission Termination Act of 1995 (ICCTA) replaced the ICC with a much smaller STB.* The ICCTA imposed time limits on rate proceedings and required the STB to establish rate reasonableness standards to apply to cases involving smaller shippers. In December 1996, the STB adopted Simplified Guidelines that used three revenue-to-variable cost benchmarks as starting points for rate reasonableness analysis. These Simplified Guidelines were not used by shippers as they did not consider them cost-effective and were unsure how the benchmarks would be applied. In 2008, STB established new small rate appeals procedures, which have been affirmed by the district court after appeals from both railroad and shippers.

In addition, the ICCTA eliminated the requirement for railroads to file tariffs with the STB and does not allow the STB to suspend any rail rates except to prevent irreparable harm. A railroad’s common carriage rates and service terms for all commodities have to be disclosed upon request and published in some form for agricultural products and fertilizer. Increases in these rates or changes in service terms require that 20 days advance notice be given to any person who had requested such rates or made arrangements for shipment under the rate.

* TP.L. 104-88, December 29, 1995

Differential pricing assumes that when it lowers its rates, the railroad can attract additional business from shippers who may otherwise transport via alternate modes. Generally these lower rates under differential pricing cover the directly attributable variable costs of the movement and a relatively minor contribution to the railroad's overall fixed costs.

Customers with few or no practical alternatives to the railroad—captive shippers—are asked to pay a greater proportion of fixed costs. Although those with more transportation alternatives pay a lower share of the railroad's fixed costs, their smaller contribution reduces the share of those costs that captive shippers would pay absent that traffic. Despite the fact that the presence of competitive traffic on the railroad effectively lowers the captive shipper's share of fixed costs, the concept of differential pricing is viewed by some shippers as inherently discriminatory.

Differential pricing does not mean, however, that a railroad can charge a captive rail customer any price they wish. Under the Staggers Act, railroads can generally charge any customer whatever rate they want, but if the railroad has market dominance for the shipment and the rate exceeds 180 percent of the variable (direct) cost to the railroad, the rate can be challenged at the STB. The fact that Congress directed the ICC, then later the STB, to establish a rate challenge process means Congress intended to place limits on differential pricing to prevent unrestrained rail rates for captive customers. The debate

Railroads Are No Longer a Decreasing-cost Industry

Recent data indicates that railroads are no longer a decreasing cost industry, which is an industry in which average costs per unit of output decrease as output expands. While revenue ton-miles of output decreased 15 percent during the first 9 months of 2009 compared to the same period in 2008, operating costs decreased 25 percent. Although these percentage changes varied for each of the U.S. Class I railroads, all seven U.S. Class I railroad operating costs decreased more rapidly than output.

According to this recent data, costs will increase—rather than decrease—as the economy recovers from recession unless the railroads make sufficient investments in additional capacity. It is apparent that the rapid growth of rail traffic since 2004 has exhausted the economies of traffic density available to railroads. In addition the Christensen study commissioned by STB in 2008 found that recent railroad rate increases were largely the result of increased costs.

Historically, railroads have been a decreasing-cost industry. Since railroads were a decreasing cost industry, some economists were concerned that the presence of too much rail-to-rail competition could result in prices decreasing to the extent that their fixed costs would not be covered. Railroads face high fixed and common costs to maintain an extensive network, including the costs of right-of-way acquisition, roadbed preparation, installation of track and signals, etc. This network must be in place before any freight can move. Once an initial investment has been made to provide a given level of capacity, per-unit costs decline as production increases, up to capacity. As output increases to that point, per-unit fixed costs and common costs decrease because they are spread over more and more units. Conversely, as railroad traffic shrinks, fixed and common costs are spread over a smaller traffic base, resulting in higher costs per unit. As traffic expands beyond capacity, as indicated by recent data, per-unit costs rise as output expands.

before Congress and the Executive today is whether this rate challenge process is workable and allows captive rail customers a reasonable chance to obtain relief from rates that are unreasonably high.

Differential pricing is credited with fostering a viable railroad industry with average rates that have declined for twenty years, but it has not meant universally lower rates for every shipper. Captive shippers generally have not shared in the rate reductions that shippers with transportation alternatives have enjoyed. Consequently, captive shippers feel that they have borne a disproportionate part of the burden of revitalizing the rail industry and have complained that rate relief remedies have been unavailable in practice due to the cost and time required to resolve rate complaints. Some believe that the rail regulation remaining today is still too expensive and time-consuming for carriers, shippers, and the STB.

Balancing the conflicting objectives of ensuring reasonable rates for shippers against the railroads' needs to obtain adequate revenues has not been easy. Rates that are too high can harm rail-dependent businesses, while rates that are too low deprive railroads of the revenues necessary to fund the infrastructure investments necessary to promote efficient service and improve rail capacity. Shippers—particularly grain and coal shippers—have called for regulatory relief, including removal of burdensome, costly, and unresponsive barriers to regulatory relief. In response, Congress in 1995—through the ICCTA—added a new provision to the rail transportation policy calling for the “expeditious handling and resolution of all proceedings.”²¹⁹ It ordered the STB to establish procedures to ensure expeditious handling of rail rate challenges, focusing on resolving delay in the discovery and evidentiary phases of proceedings. Congress also directed the STB to establish a simplified and expedited method for determining reasonableness in cases where a full stand-alone cost analysis is too costly, given the value of the relief sought.²²⁰

STB's Rate Regulation

To alleviate concerns about the imposition of differential pricing, the Staggers Act established a rate relief process whereby shippers could contest rates they believed to be unreasonable. To successfully pursue a rate challenge, a shipper must first demonstrate that the rate for the traffic is subject to STB jurisdiction—that the traffic has not been exempted and is not under contract (with the exception of some specific agricultural commodities). After clearing these hurdles, the rate must meet the statutory jurisdictional threshold, set at 180 percent of the variable cost to the railroad for the movement in question, and the shipper must show that the railroad has market dominance over the traffic at issue.

Jurisdiction

Under federal rules, railroads are required, upon request, to quote to shippers a rate for common carriage transportation.²²¹ The STB has jurisdiction (subject to some exceptions for exempt commodities) over disputes arising out of common carriage (non-contract tariff) rates.²²² Contract rates are generally not subject to challenge before the STB; the exclusive remedy for any alleged breach of a contract is in an appropriate State court or United States district court, unless the parties otherwise agree. Grain or grain product contract issues can be arbitrated through the National Grain and Feed Association's (NGFA) rail arbitration system if either the shipper or the carrier is an NGFA member and both parties agree to arbitration.

Although STB has no jurisdiction over contract rail rates or service terms, it has oversight responsibilities on contracts for the movement of agricultural commodities (including grain, soybeans, sunflower seeds, grain products, and fertilizer) that are not specifically exempted from regulation. Rail carriers are required to file with the STB a summary of each contract for the transportation of agricultural products.²²³ Any shipper or port has 18 days after the contract summary is filed to file a complaint with the STB. The STB may disapprove the contract if it finds the contract unreasonably discriminates against a port or shipper, the contract impairs the ability of the railroad to meet its common carrier obligation to a shipper, or that it constitutes a destructive competitive practice.²²⁴ With such a finding, the STB can also order the rail carrier to provide rates and service substantially similar to the contract with such differentials in terms and conditions as are justified by the evidence. However, some assert this oversight is limited because there is often too little time to file a complaint and not enough information in the contract summary.

Many agricultural commodities—but not grain, soybeans, and sunflower seeds—are exempt from STB regulation. This includes such items as meat, poultry, fish, sugar beets, and dairy products.²²⁵ However, according to the 2006 Waybill Sample, grain, soybeans, and sunflower seeds constitute almost 95 percent of the tonnage of farm products carried by rail. The STB also has exempted certain boxcar movements from rate regulation. In addition, intermodal rail transport of commodities has been exempted from STB rate regulation. However, STB has the authority, upon receipt of a request from a complainant, to revoke the exemption for specific traffic where necessary to achieve the regulatory objectives of the statute.

Contracts

More recently, railroads have offered contracts that are priced at tariff rates and the same service terms as shipments moving at tariff rates. Due to shipper concerns regarding this practice, and the inability to appeal contract rates, this practice resulted in a STB proceeding regarding the definition of contracts. Although contract service terms as well as rates historically have been negotiated—which has differentiated contracts from tariff rail rates—railroads have begun to exercise their market power by not negotiating with shippers regarding contract service terms. Without rate or service benefits, there is nothing to distinguish many of these contracts from service under tariff rail rates, except for the inability to file rate appeals with the STB. In 2009, the STB proposed a rule that would require the railroad to specify that it is a contract on the front page for it to be considered a contract.

Rate Reasonableness Complaints—Finding Market Dominance

For complaints involving the reasonableness of tariff (non-contract) rates, the STB first determines if the specific rail carrier has market dominance over the transportation to which the rate applies.²²⁶ Market dominance is defined as an absence of effective competition from other rail carriers or modes of transportation (trucks, barge, and pipelines) for the movement to which a rate applies.²²⁷

The second prerequisite for the STB’s jurisdiction is whether the proposed rate produces revenues that exceed 180 percent of the movement’s variable costs. Consideration of product or geographic competition—the availability of substitute products from other carriers or the ability to ship the same product from other sources or to other destinations—was repealed by the STB in a December 1998 decision. In the decision, STB determined that discovery regarding product and geographic competition had become a source of process abuse, unduly complicating the market dominance determination and acting as a litigation obstacle to a shipper's ability to pursue a rate complaint. The burden of proof is on the shipper to show that there is no effective form of competition. If intermodal competition exists, the STB has no authority to review the rate challenge, even if the revenues exceed 180 percent of the variable costs of providing the service.

If the two conditions are met, the STB may then consider if a common carrier rate is unreasonable, via appropriate tests. Should the STB ultimately determine that the challenged rate is unreasonable, it will order the railroad to pay reparations to the complainant for past movements, and prescribe the maximum rate the carrier is permitted to charge for future movements.²²⁸ Some examples of when the STB has ordered reparations and set new rates for the future are provided in Coal Rate Guidelines.

However, the STB may not set the maximum reasonable rate below the level at which the carrier would recover 180 percent of its variable costs of providing the service. The STB must recognize that rail carriers should have an opportunity to earn “adequate revenues,” defined as those 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 sufficient to provide a sound rail transportation system.

Types of Cases

The STB distinguishes two types of rate cases: “coal rate” and “non-coal-rate.” Coal rate cases are those involving large volumes of traffic; non-coal-rate cases involve shippers that transport either smaller shipments or large shipments transported infrequently. To provide greater flexibility for shippers in challenging a rate, recent STB reforms allow a complainant to select the methodology under which it wants the rate to be judged: Full Stand-Alone Cost (SAC), Simplified SAC, or Three-Benchmark. However, a limit is imposed on the rate relief available under each method.

Standard Guidelines for Assessing Rate Reasonableness— Coal Rate Guidelines

To assess whether rates are reasonable, the STB whenever possible uses a concept known as “constrained market pricing” (CMP) set forth in the Coal Rate Guidelines.²²⁹ CMP principles limit a carrier's rates to levels necessary for an efficient carrier to make a reasonable profit. CMP principles recognize that, in order to earn adequate revenues, railroads need the flexibility to price their services differentially by charging higher mark-ups on captive traffic, but the CMP guidelines impose constraints on a railroad's ability to price differentially.

Stand-Alone Cost

The most commonly used CMP constraint is the Stand-Alone Cost (SAC) test. Under the SAC test, a railroad may not charge a shipper more than it would cost to build and operate efficiently—at current costs—a hypothetical new railroad, tailored to serve a traffic group that includes the complainant's traffic. CMP protects the captive shipper from bearing the cost of any facilities or services from which it derives no benefit and from cross-subsidizing other traffic. The SAC analysis requires that the shipper construct a hypothetical, perfectly efficient railroad that would replace the shipper's current carrier, and simulate the competitive rate that would exist in a “contestable market” free from legal or financial barriers to entry and exit.

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 first to select an appropriate subset of the railroad's traffic for the hypothetical stand-alone cost railroad (SARR) to serve, design an operating plan that shows how an efficient railroad would serve this traffic group, and determine the optimal network configuration. Parties use complex computer programs to simulate the hypothetical SARR and test the operating plan and configuration against the forecast traffic group. The parties must then develop detailed evidence to calculate both the direct operating expenses (such as the costs of locomotives, crew, and railcars) and the indirect operating expenses (such as general and administrative and maintenance-of-way).

STB compares the challenged rate to a newly derived contestable market rate. As part of the lengthy rate relief process, both the railroad and the shipper have the opportunity to seek discovery of evidence, and present facts and views to STB. Although the STB has used this test to resolve rate complaints, the time and expense associated with the process have encouraged settlement of some rate complaint cases and discouraged others entirely. Although the stand-alone cost is a conceptually sound methodology, the regulatory process involved in a maximum rate case can be daunting, long, and costly. The complexity and costs of litigating an SAC case have increased over time; shippers' litigation costs in recent Full-SAC cases have approached \$5 million and consumed 2–4 years.

Over time, the STB has modified, refined, and endeavored to reduce the burden associated with the SAC analysis. Recently, the STB revised procedures for deciding large rate relief cases, imposing restraints on the evidence and arguments allowed in these cases, replacing the

percent reduction approach with a "maximum markup methodology" to calculate maximum lawful rates, adopting an "average total cost" approach to allocate revenue from cross-over traffic, and shortening the analysis period to 10 years. The revisions reflect STB's ongoing effort to reduce litigation costs, create incentives for private settlement of disputes, and shorten the time required to develop and present large rail rate cases to the STB.

From the shippers' perspective, however, the STB's efforts have not provided effective, practical, or worthwhile relief under the SAC standard. Whenever it takes a shipper 2 to 4 years and millions of dollars to bring a case, the rate challenge is too burdensome for most rail customers, who deem it to be patently unfair. Furthermore, because agricultural production is widely spread and is shipped to many destinations there are too many origin-destinations pairs to analyze to make the SAC test workable for agricultural shippers.

Other CMP Constraints

Constrained market pricing embodies two additional constraints: the revenue adequacy constraint ensures 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"—i.e., when a carrier is revenue adequate. Although several railroad firms have been revenue adequate when using the Capital Asset Pricing Model for a number of years, STB has still not determined how long a railroad has to be revenue adequate before using this constraint. The management efficiency constraint protects 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.

SAC Process is Complex and Expensive

The complexity and evolution of the SAC process is best illustrated by the landmark McCarty case.²³⁰ Originating as a class action suit in the United States District Court for the District of Montana on behalf of approximately 10,000 Montana farmers and grain elevators (the McCarty group), the court referred the matter to the ICC where a formal complaint was filed on March 27, 1981.* The McCarty group sought reparations on past shipments of wheat transported by Burlington Northern (BN) from origins in Montana to ocean ports in the Pacific Northwest (PNW) and establishment of reasonable rates for future moves. In an initial decision served December 14, 1981, an Administrative Law Judge found that BN had market dominance over the wheat and barley traffic at issue, and that the rates assessed were unreasonable. Numerous delays and challenges ensued while the parties pursued discovery and the ICC reevaluated its rate reasonableness standards. It was not until May 27, 1987, that the ICC found that BN had market dominance over the movement of wheat and barley from Montana to PNW ports and subsequently ordered reparations and rate prescription. BN further contested this decision and in August 1997, STB reversed itself, concluding that the rates had not been shown to be unreasonable, and dismissed the complaint.

* In 1981, the ICC had not yet settled on its rate challenge guidelines. The coal rate guidelines were not adopted until 1985. The STB did not establish non-coal guidelines until 1996.

The shippers sought judicial review, but ultimately the decision was reaffirmed almost 20 years after the initial complaint. This complaint action cost the producers and the State over \$3.4 million in out-of-pocket costs for economic modeling; attorney fees were estimated to reach millions of dollars more.

For years, shippers complained that ICC and STB rate reasonableness decisions seemed to be skewed in favor of the railroads. The record shows that since 1996 seven SAC cases have been decided in favor of shippers and eight SAC cases decided against shippers.²³¹

An example of a favorable shipper ruling is the West Texas Utilities Company decision in May 1996, using the SAC test. The STB found a Burlington Northern Santa Fe Railway (BNSF) rate from a mine near Gillette, Wyoming, to a generating station in Vernon, TX, to be unreasonably high. As a consequence, the STB limited the rate that could be charged for that transportation in the future, and required payment of approximately \$11 million in reparations for past shipments. STB's decision was challenged by the railroad and affirmed in court.

Finding the challenged rates unreasonably high, the STB also ruled in favor of shippers in various other cases, including its July 1997 decision for the Arizona Public Service Commission against BNSF, and its 2003 decision in favor of the Texas Municipal Power Agency (TMPA) against BNSF.

In May 2008, STB issued its first decision under the 2007 revisions to rules calculating the rail industry's cost of capital. In a rate challenge by Kansas City Power & Light (KCPL) against Union Pacific (UP), STB found that the rates paid by KCPL's Montrose Generating Station for coal moves from Wyoming's Powder River Basin were unreasonable. STB ordered UP to pay an estimated \$30 million to the shipper in reduced rates and reparations. Approximately half of the referenced relief in this case was attributable to the STB's revision of the calculation of the railroad industry's cost of capital, using a Capital Asset Pricing Model (CAPM) instead of the single-stage Discounted Cash Flow (DCF) model that had been used in the past.

In February 2009, STB ruled in favor of Basin Electric Power Cooperative and the Western Fuels Association on what it called "the single largest reduction in rail rates ever ordered by the agency." In its decision, STB found the transportation rates BNSF charged were roughly six times the variable cost of providing service and the rates were ruled to be unlawfully high. Using the SAC test, STB required BNSF Railways to reduce rates by about 60 percent, through

Cost of Capital Models

In January 2009, STB modified their initial decision to exclusively use CAPM and decided instead to use a simple average of CAPM and a multi-stage DCF to determine revenue adequacy. Although initially this change results in a higher estimated cost of capital, over time the use of this average is expected to minimize the variability in the cost of capital calculations. In addition, there may be years when the use of the average results in a lower cost of capital than estimated with CAPM alone. Theoretically, over the long term, the cost of capital estimates should average out to be nearly the same under either method.

2024, for the coal delivered from mines in Wyoming’s Powder River Basin to the Laramie River Station, near Wheatland, WY, and provide reparations and rate reductions of an estimated \$345 million.

STB also has reversed its decisions in several cases where additional evidence was submitted that altered an initial determination of rate reasonableness. In a May 26, 2006, decision, the STB found on reconsideration that the BNSF rate challenged by Otter Tail Power Company²³² was not unreasonably high. In October 2004, STB issued a decision reversing its prior finding that rates had been unreasonable for three cases referred to collectively as the Eastern cases, which were consolidated for consideration due to similarities in the evidence and issues at hand.²³³ STB revisited its calculations of cost of capital, and tonnage and revenue projections for Appalachian coal, which altered the findings of the SAC test.

In the course of reviewing complaints, the STB has made a number of alterations to the SAC analysis to perfect the model’s ability to reflect more accurately the actual railroad operating environment. For the STB, rate relief consideration is a dynamic process.

New Simplified Guidelines for Assessing Reasonableness— Non-Coal Rate Guidelines, or Small Dispute Cases

Although the CMP guidelines provide the most authoritative procedures for evaluating the reasonableness of rail rates from an economic perspective, a rate challenge using CMP (particularly SAC) can be quite complex, expensive to litigate, time consuming and impractical; often the money at issue is not enough to justify the expense of such an evidentiary presentation. The Interstate Commerce Commission Termination Act of 1995 (ICCTA) directed STB to develop a simplified alternative procedure to CMP.²³⁴

Accordingly, in December 1996, STB adopted Simplified Guidelines that, although upheld in a court challenge, provided no perceived effective relief.²³⁵ Shippers expressed concerns about the uncertainties of the new rules, and brought no cases under them. Subsequently, in September 2007, the STB issued revised Simplified Guidelines with the intent of streamlining and expediting procedures to make the rate relief process more feasible for those with smaller disputes.

These revised Simplified Guidelines provide two avenues to pursue in seeking rate relief; the first is geared toward medium sized disputes. It uses a modified and simplified SAC test, is to be decided by the STB within 17 months of complaint, and limits potential cost recovery to \$5 million over 5 years. The second vehicle, called the Three Benchmark approach, is an abbreviated process that is to be decided within 8 months of filing a complaint and limits recovery to \$1 million over five years. While neither approach offers as much precision and degree of confidence as a Full-SAC analysis, these alternative dispute resolution procedures address the concerns of many shippers that they cannot challenge rail rates because the costs of litigation would exceed the amount in dispute.

Both shippers and railroads have appealed the STB's decision in district court. Shippers contended that the monetary limits for each simplified rate appeal procedure were set too low, which could result in shippers receiving little, if any, more than the cost of using these procedures if they win the rate appeal. Furthermore, the shipper risks losing the rate appeal while investing the cost of pursuing the simplified rate appeals procedures. The Court affirmed the STB decision in this case.²³⁶

For both simplified approaches, STB requires the parties to engage in non-binding mediation for 20 days before it will consider the case. The mediation requirement encourages railroads and shippers to reach consensus on issues and avoid costly litigation. For example, a small rate case involving Williams Olefins, LLC, and Grand Trunk Corporation was resolved privately within only a few weeks pursuant to mediation by STB staff.

STB staff are appointed to mediate these disputes. To protect the confidentiality of mediation discussions, the appointed STB staff is recused from all subsequent involvement in the case if it is not fully resolved through mediation. The entire mediation process is confidential, including all material used or exchanged and positions taken by the parties. The mediation period can be extended at the consent of the parties. Designated representatives from the parties with authority to settle the dispute participate in all meetings unless the STB-appointed mediator concludes such involvement is not necessary. To facilitate settlement, STB releases the confidential Waybill Sample, subject to the proper protective orders, before mediation begins.

STB Analysis of Simplified Procedures

The STB performed an analysis of a Waybill Sample, and concluded that a Full-SAC presentation would be impractical for 73 percent of potentially captive traffic and a Simplified SAC presentation would be too costly for 45 percent of potentially captive traffic. STB estimated that Simplified Procedures would provide a meaningful forum for the resolution of rail rate disputes arising out of the at least 73 percent of traffic that previously was prevented from bringing rate complaints to the STB due to the high costs of developing a Full-SAC presentation.

To simplify the process compared to a standard rate case, the Simplified Guidelines use standard industry averages for revenue data, rather than construction of a hypothetical efficient railroad. Accuracy suffers somewhat but time is expedited. For both processes, the STB has established limits on discovery to avoid protracted delays in deciding the case.

Simplified SAC

Constrained Market Pricing, with its SAC constraint, has been affirmed by courts and is deemed the most accurate procedure available for determining the reasonableness of rail rates where there is an absence of effective competition. As indicated earlier, the rigors of the procedure lead to great expense in both litigation and time. And while the reforms adopted for the Full-SAC procedure in the Coal Rate Guidelines (see previous section) are intended to reduce litigation costs, the potential reductions are still insufficient to provide a feasible vehicle to contest rates for medium-sized shipments.²³⁷ Simplified SAC attempts to create a cost-effective alternative for smaller rail rate disputes. However, challenging a rate under the Simplified SAC methodology is still estimated to cost about \$1 million.

The Simplified SAC approach retains some of the advantages of a standard SAC analysis to detect market abuses. It focuses on whether the captive shipper is being forced to subsidize parts of the defendant's rail network from which it derives no benefit. To maintain simplicity, STB assumes that given current rail system capacity constraints, all existing infrastructure along the predominant route used to haul the complaint traffic is needed to serve the traffic moving over that route. Simplified SAC incorporates new capital investments (no gold plating) and ensures that the maximum lawful rate incorporates a reasonable return on the replacement cost of those investments. This process assumes that competition will force railroads to make prudent capital investments to meet forecast increases in demand for transportation services but provides only limited opportunity for the shipper to dispute costs associated with inefficiencies. For example, a shipper might successfully dispute costs in a case where some existing facilities along the selected route have fallen into disuse and should not be included in the analysis.

The Simplified SAC presentation differs from a Full-SAC presentation by eliminating or restricting the evidence parties can submit on certain issues. The core analysis in a simplified SAC proceeding addresses the replacement cost of the existing facilities used to serve the captive shipper and the return on investment that a hypothetical SARR would require to replicate those facilities. STB then determines whether the traffic using those facilities is paying more than needed to cover operating expenses and gain a reasonable return on their replacement value. To constrain the cost of a simplified SAC presentation, STB has established various simplifying assumptions and standardization measures, including:

- The reasonableness of the challenged rates for a single year (the four quarters preceding the filing of the complaint) on the predominant route used to transport the contested traffic; no rerouting of traffic is permitted.

- 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.
- The analysis includes the existing facilities (including all track, sidings, and yards) along the analyzed route, unless the complainant can demonstrate a facility is unnecessary or in disuse.
- The total operating and equipment expenses will be estimated using the STB's Uniform Rail Costing System (URCS); depreciation on equipment is excluded when calculating operating expenses.
- Because the railroad is not allowed to use the shipper's traffic to cross-subsidize other shippers, traffic moving at higher rates is not allowed to cross-subsidize the shipper's traffic.
- The maximum lawful rate will be expressed as a ratio of revenue to variable costs (R/VC), with variable costs calculated using unadjusted URCS. This maximum R/VC ratio would then be prescribed for a maximum 5-year period.
- The entire process will conclude in a decision by the STB within 510 days.

Simplified SAC also imposes procedural requirements to expedite the processing of the complaint. To streamline the discovery process, certain standardized discoveries are required to be submitted by both parties with the complaint and answer. Technical conferences facilitated by STB staff are held to resolve factual disputes within 7 business days after the required mediation period ends.

At the initial filing, the complainant provides to the railroad its preliminary estimate of the variable cost of the challenged movements, using the unadjusted figures produced by the URCS program, demonstrating that the STB's jurisdictional threshold has been met. In addition, the complainant provides documenting evidence with its complaint, and a narrative addressing whether there is any feasible transportation alternative for the challenged movements. The railroad will provide to the complainant its preliminary estimate of the variable cost of each challenged movement. For its second disclosure, the railroad will provide identification of all traffic that moved over the routes replicated by the SARR in the test year, information aggregated by origin-destination pair and shipper, volume, and total revenues from each movement. They will also provide total operating and equipment cost calculations for each of those movements, revenue allocations for cross-over traffic, and total trackage rights payments.

If the STB finds the rate unreasonable, the limit on relief applies to the difference between the challenged rate and the maximum lawful rate, either in the form of reparations or a rate prescription, or a combination of the two. Any rate prescription automatically terminates once the complainant has exhausted the relief available, even if, due to large volumes, that period is less than 5 years. The complainant is barred from bringing another complaint against the same rate for the remainder of the 5-year period.

Three Benchmarks

For some shippers who have smaller disputes with a carrier, even this Simplified SAC method would be too expensive, given the more limited potential return for a successful rate challenge. These shippers can avail themselves of a less rigorous, more expedited relief process with a less lucrative potential remedy. The Three Benchmarks approach looks at the carrier's overall revenue needs, how the railroad prices its other captive traffic, and how comparable traffic is priced.

Under Simplified Guidelines, the reasonableness of a challenged rate is to be determined by evaluating that challenged rate in relation to three benchmarks. Each benchmark is expressed as a ratio of revenues generated from particular traffic to the variable costs of providing the rail service—the revenue-to-variable cost, or R/VC ratio, using the STB's Uniform Rail Costing System (URCS).

First Benchmark

The first benchmark is the Revenue Shortfall Allocation Method (RSAM). It allows the STB to account for the defendant railroad's overall revenue needs by measuring the average markup above a carrier's variable cost that the carrier would need to charge all its potentially captive traffic (traffic priced above 180 percent of variable costs) in order for the carrier to recover all of its non-variable costs under URCS. RSAM accounts for a railroad's need to earn adequate revenues, as required by law.²³⁸ Simplified Guidelines provided for the calculation and publication of an RSAM range. The upper end of the range reflects the average markup above variable cost the railroad would need if it replaced all its assets as they wear out. The lower end subtracts out any shortfall related to movements priced below the 100 percent R/VC level. The lower end is an attempt to capture managerial inefficiencies. In Simplified Guidelines, however, the STB recognized that an R/VC ratio below 100 percent does not necessarily reflect improper pricing or a money-losing service. The RSAM benchmark the agency would use was therefore left unresolved, but was expected to fall within this range.

Second Benchmark

The second benchmark is called R/VC>180. The R/VC>180 percentage represents the average mark-up above variable cost that a carrier receives on its captive high-rated traffic (traffic priced above 180 percent of variable cost). It could be more narrowly tailored to focus on a subset of the railroad's traffic that has transportation characteristics similar to the traffic moving under the challenged rate.

Third Benchmark

The third benchmark is called R/VC_{COMP}. This benchmark is used to compare the markup being paid by the challenged traffic to the average markup assessed on other potentially captive traffic involving the same or a similar commodity moving similar distances.

STB described these three benchmarks as “the starting point for a rate reasonableness analysis, not the end result.”²³⁹ STB anticipated that both the shipper and railroad would present “whatever additional information is available that bears on the reasonableness of the pricing of the traffic at issue.”²⁴⁰ The agency expressed confidence that careful analysis of these three benchmarks, together with whatever supplementary evidence is provided in a case, should enable the agency “to make at least a rough determination as to rate reasonableness in those cases where a more precise determination is not possible.”²⁴¹

STB updates the RSAM and R/VC>180 tables annually for each Class I railroad, as well as regional averages. The R/VC_{COMP} ratio for appropriate comparison traffic is to be computed after a shipper files a rate complaint, using traffic data from the rail industry Waybill Sample and applying URCS costing. Upon filing a complaint, the shipper is provided access to the unmasked, confidential Waybill Sample for the traffic of the defendant carrier. Non-defendant traffic is excluded from comparison group analysis. STB then calculates the variable cost of the traffic covered by the complaint, as well as the variable costs of all movements included in the comparison group using the URCS model. To maintain simplicity and eliminate extensive delays in discovery and litigation over movement specific adjustments, STB does not consider movement-specific costing.

The entire process concludes in a decision by the STB within 240 days.

To calculate the R/VC_{COMP} benchmark, the parties to the complaint are required to submit initial evidence regarding an appropriate comparison group of movements of traffic. Any movement set forth in both sides’ initial tenders would be automatically included in each side’s final comparison group, unless the parties later agreed to exclude the movement. After a conference with the STB staff to resolve disputes in the selection of an appropriate comparison group, each party submits its final offer, contests the opponent’s traffic selections, and STB selects the most reasonable comparison group, which is then be used to calculate the R/VC_{COMP} benchmark.

In Three-Benchmark cases, STB limits the number of discovery requests that either party can submit to the other party without obtaining advance authorization from STB. Each party is limited to ten interrogatories (including subparts), ten document requests (including subparts), and one deposition.

The first rate case considered pursuant to the simplified Three Benchmark test was filed on May 23, 2005, by BP Amoco challenging the reasonableness of rates for the shipment of paraxylene from Decatur, AL, to Kingsport, TN.²⁴² Shortly after filing, the complaint was dismissed when resolution was reached via mediation.

The first substantive test of the revised Three Benchmark approach was an amended complaint filed on October 30, 2007, wherein DuPont challenged the reasonableness of rates charged by CSX Transportation for three movements:

- The movement of synthetic plastic powder from Amthill, VA, to Wyandotte, MI, a distance of approximately 820 miles
- The movement of plasticizers from Heyden, NJ, to Duart, NC, a distance of approximately 714 miles
- The movement of plasticizers from Heyden, NJ, to Washington, WV, a distance of approximately 646 miles

STB found the rates challenged to be unreasonable and prescribed maximum reasonable rates and reparations (with interest) for DuPont. DuPont followed up its victory with the first three cases filed under Three-Benchmark rules by filing a large number of rate complaints covering commodities moving over most of a single Class I railroad's network, a case that would have been impossibly complex and expensive to address using SAC or Simplified SAC. Before the proceeding could begin, agreement between DuPont and the railroad was reached in arbitration.

The Three-Benchmark procedures were specifically designed to address movements from a variety of origins to diverse destinations, by avoiding the need to specify a route as in SAC and Simplified SAC. STB believes agricultural shippers should be able to make effective use of the Three-Benchmark process, which is simple and relatively quick, to address rate disputes with railroads. While this procedure was essentially designed for agricultural shippers, they have not taken advantage of it to date because they are concerned that the resulting rate relief, if any, would not adequately compensate for the time and expense of bringing such a case.

Conclusions

Tariff rail rates can be challenged before the STB when revenue exceeds variable cost by 180 percent and the railroad has market dominance. Rail rates for contract and exempt movements may not be challenged; STB has no jurisdiction over those movements.

STB has developed three methods to appeal rate cases:

- The Stand-Alone Cost (SAC) method takes millions of dollars and two to four years to pursue. There are no restrictions on the amount of the award if the rate is higher than 180 percent of the railroad's variable costs.
- The Simplified SAC method requires a mandatory 20-day non-binding mediation before the case can be filed. It is limited to a potential cost recovery of \$5 million over five years and must be decided within 17 months of the complaint.
- The Three-Benchmark approach also requires non-binding mediation. It limits recovery to \$1 million over five years and must be decided within 8 months of the complaint.

Development of the latter two procedures was mandated by Congress in response to shipper's complaints about the cost in both time and money required by the SAC method. STB hopes that by improving the Full-SAC approach, creating the Simplified SAC process, and refining the Three-Benchmark approach, it has provided meaningful relief for rail shippers.

Shippers contend that the monetary limits for the Simplified SAC and Three-Benchmark procedures are too low and could result in shippers receiving little more than the cost of using these procedures. In addition, shippers believe that the cost of pursuing these rate appeal procedures is too expensive for many agricultural shippers, eliminating them from effective relief. Chemical companies have successfully used the Simplified Procedures, but no agricultural shipper has yet appealed rates using them.

