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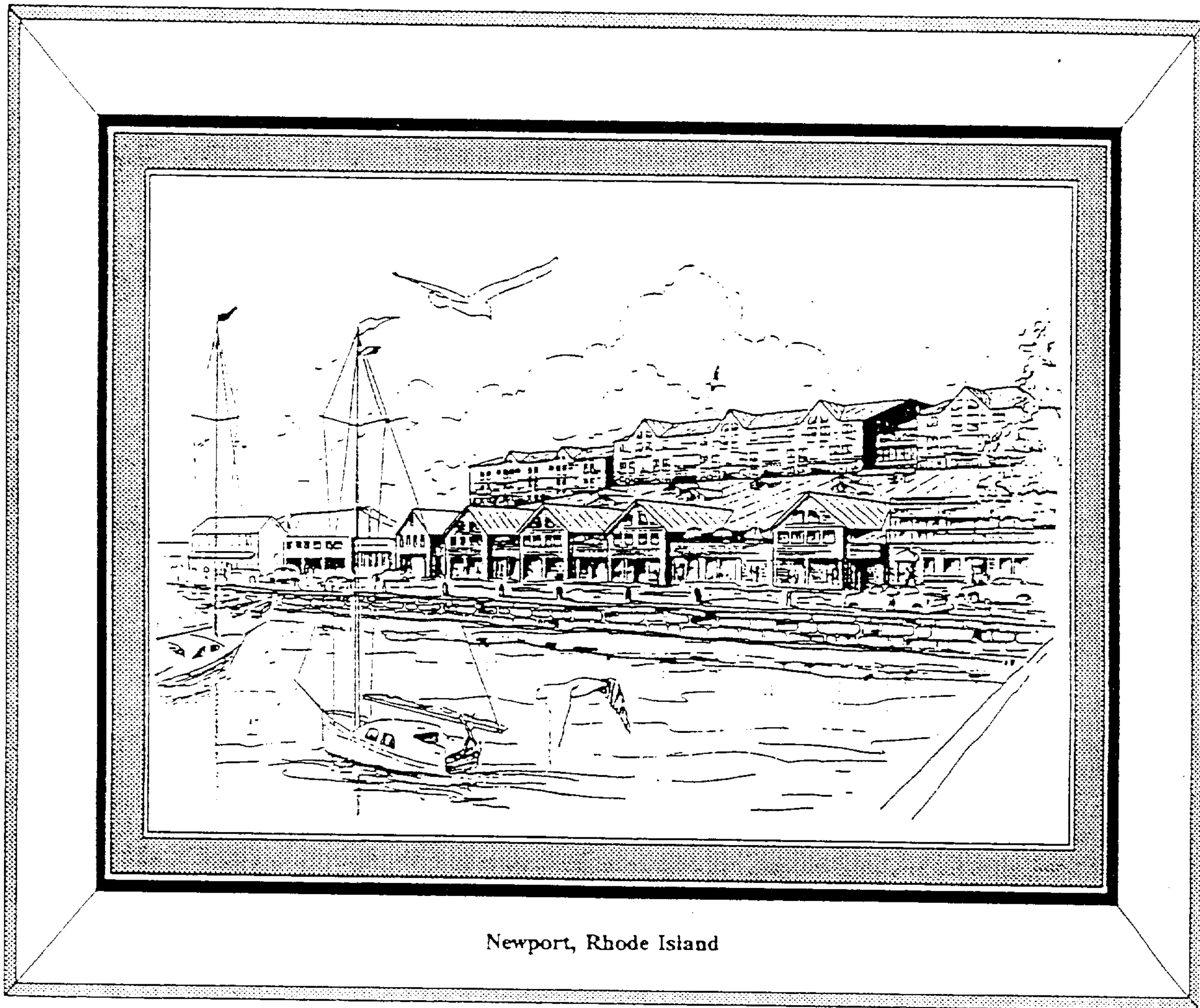

Newport, Rhode Island

67th Annual Meeting
Papers and Proceedings

RESTRUCTURING RAILROADS AND CHANGING REGULATION: WHAT'S A SHIPPER TO DO?

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INTRODUCTION

As the American railroad scene changes, the shipping community is faced with the challenge of obtaining and maintaining a competitive environment for the transportation of its commodities. Twenty-five years ago there where over seventy highly regulated Class I railroads in the United States. Today there are ten Class I railroads. As a practical matter these remaining Class I carriers are largely deregulated. By all indications, this declining trend in the number of Class I Railroads will continue.

Understanding the economic and legal components of the changing rail industry is obviously a critical element in the long-term viability of shippers that plan to use railroads to transport their commodities. As the number of large railroads declines, the market power of the remaining entities increases in a disproportionate manner. Stated a different way, as the number of railroads in a market declines, the more each railroad will know about the ratemaking and service practices of the other remaining railroads. The discussion below focuses on the recent rail merger activity and the range of impacts these mergers will have on rail rates and service. Additionally, recent regulatory changes[1] pose additional concerns for both the railroad and the shipping communities and take on new importance in the shrinking rail transportation market.

This article will review recent rail merger activity, as well as changes in the regulatory environment and conclude with some suggestions on how to avoid rail transportation problems while maximizing rail transportation opportunities.

RAIL MERGERS AND SHIFT IN MARKET POWER

A. Rail Industry Prior to and During Deregulation of the 1970s

One of the axiomatic principles of economics is that as the number and diversity of choices in commercial decisions decrease, so does the buyer's ability to apply competitive leverage in obtaining lower prices and superior service — unless counteractive measures are available that can effectively replicate competition. Since the advent of railroad deregulation activity in the 1970s, rail shippers have been faced with an unprecedented diminution in the number of Class I carriers competing for traffic. Only through strongly active and proactive measures by shippers have rail rates, particularly for larger volume shippers, been held at reasonable levels.

At the close of 1969 there were seventy-four Class I line-haul railroads operating in the United States. By 1980 there were forty-one

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[1]The ICC Termination Act of 1995, Pub.L. No. 104-88, 109 Stat. 803, became effective on January 1, 1996. Among other things, the new law replaced the Interstate Commerce Commission ("ICC") with the Surface Transportation Board ("STB").

Table 1

Financial Performance of Class I Carriers In 1970 and 1980

Item:	1970	1980
1. Freight Revenue (000)	$10,921,813	$26,349,722
2. Operating Expenses (000)	11,499,549	26,352,219
3. Net Railway Operating Income (000)	485,853	1,377,206
4. Rate of Return	1.93%	4.25%

Class I carriers.[2] As the table above indicates, despite significant increases in revenue, the overall financial condition of Class I carriers in the 1970 - 1980 period was nothing less than dismal.

The decade of the 70s was characterized by legislation designed to decrease the regulatory burden which, as was widely acknowledged, had been largely responsible for the railroads financial decline during the post-World War Two period.

Three landmark acts of Congress radically transformed the regulatory arena in which carriers and shippers operate. Whereas, prior to the enactment of this body of legislation, shippers only needed to file before the ICC in order for their complaints or protests to be heard, after its passage, only very limited regulatory recourse remained, and that recourse would come into play only after a number of tortuous, and expensive to prove, prerequisites had been satisfied.

Following is a brief summary of the objectives and major provisions of the 70s legislation:

- *The Regional Rail Reorganization Act of 1973*

The "3R Act" was aimed mainly at remediating the financial and physical condition of carriers in the Northeast and Midwest regions of the country. A number of these carriers were in bankruptcy at the time the 3R Act was passed. The essential objectives of the 3R Act were to:

1. Identify Northeastern and Midwestern rail lines which were required to meet regional and nationwide needs;

2. Reorganize the affected railroads into a viable system;

3. Establish the United States Railway Association ("URSA"), the planning organization responsible for the rationalization of the Northeast and Midwest roads;

4. Establish the Consolidated Rail Corporation to operate the properties of the former Penn Central System and other failing carriers; and

5. Assist states and other regional transportation authorities in the continuation of rail services threatened with discontinuance.

[2]Although mergers and acquisitions accounted for a substantial portion of the reduction in Class I carriers, changes in reporting standards also caused a number of carriers to drop out of the Class I category.

- *The Railroad Revitalization and Regulatory Reform Act of 1976*

The "4R Act" dealt specifically with rate level determinations, the ability of carriers to adjust price levels according to competitive circumstances, and, most importantly from the shipper standpoint, presented a number of constraints which limited a shipper's ability to bring issues before the regulatory forum. The purpose of the act was to:

1. Balance the needs of carriers, shippers and the public;
2. Foster competition among railroads and other modes of transportation;
3. Promote more adequate and efficient transportation services;
4. Stimulate investment in railroads;
5. Permit greater freedom for railroads to adjust rates for "services in competitive markets;"
6. Promote the establishment of railroad rate making responsive to "changes in the level of seasonal, regional and shipper demand;"
7. Promote separate pricing of distinct rail and rail-related services;
8. Develop standards and related guidelines for determining railroad revenue adequacy; and
9. Modernize and clarify the functions of railroad rate bureaus.

- *The Staggers Rail Act of 1980*

The Staggers Rail Act contained no less than fifty-nine provisions. These provisions, many of which could be correctly characterized as "revolutionary" (when considered within the context of previous regulation), were directed toward the following goals:

1. To assist the nation's railroads in the rehabilitation of the then current rail system in order to meet the demands of interstate commerce and the national defense;
2. To reform Federal regulatory policy so as to preserve a safe, economical, efficient and financially stable rail system;
3. To assist the rail system to remain viable in the private sector of the economy;
4. To assure a regulatory process that balances the needs of carriers, shippers and the public; and,
5. To assist in the rehabilitation and financing of the rail system.

B. The Rail Industry Today

The deregulation legislation discussed above has, in significant degree, enabled the nation's Class I rail carriers to achieve relative financial stability and, in some cases, outstanding financial performance, over recent years. For shippers, however, the outcome of the legislation is a "mixed bag." Although, through diligent action, many larger volume shippers now enjoy rail service delivered at a relatively reasonable price, these reasonable rates were achieved only through very substantial expenditures of time and money.

Through active participation during the formulation of guidelines under the 4R and Staggers Acts, shippers were able to reverse or favorably condition many of the more onerous interpretations which the pro-railroad ICC, backed by pro-railroad administrations, attempted to read into the legislation. However, because the legislation also facilitated the process of railroad mergers and acquisitions, shippers now face the ever increasing threat of diminished competition because of fewer and fewer competing carriers.

Table 4

Distribution Of Tonnage
In Western United States — 1994

	TOTAL TONS		COAL	
Railroad (1)	Tons (Millions) (2)	Distribution (3)	Total (Millions) (4)	Distribution (5)
1. Western Railroads	731.1	100%	236.7	100%
2. UPS[/]	210.2	29%	71.8	30%
3. SP	103.9	14%	19.8	8%
4. Subtotal (UP/SP)	314.1	43%	91.6	38%
5. BNSF	365.9	50%	136.6	58%
6. Subtotal (UP/SP-BNSF	680.0	93%	228.2	96%
7. Other Railroads (L1-L5)	51.1	7%	8.5	4%

[/] Includes CNW.

Source: Analysis of Class I statistics.

As shown in Table 4 above, after the merger UP/SP and BNSF will control ninety-three percent of the originations in the Western United States (Table 1, Line 6, Column (3)) and ninety-six percent of coal originations in the Western United States (Table 1, Line 6, Column (5)). While this distribution may change, as between UP/SP and BNSF, the UP/SP-BNSF access agreement related to the merger will not impact these overall concentrations of traffic.[3] This high concentration of market power is likely to result in higher rates to shippers due to a lessening of competition.

From an economic perspective, markets which are highly concentrated exhibit less competition. The seller (i.e., western railroads) can take various actions to avoid competition in a highly concentrated market. The avoidance of competition can take several forms: overt collusion, conscious parallelism or more unilateral actions in a structure characterized by oligopolistic interdependence. Simply stated, the UP/SP merger will not increase competition and, in all probability will lead to the avoidance of price competition.

Recent history in the western coal transportation markets teaches that certain western rail carriers have colluded when it suited their collective purposes, as is evidenced by the ETSI litigation.[4] In the ETSI litigation, the U.S. District

[3]In an effort to alleviate the admittedly anticompetitive effects of the UP/SP merger, these carriers have agreed to give BNSF access through trackage rights and line purchases to shippers located on almost 4,000 miles of UP and SP rail lines.

[4]*ETSI Pipeline Project, et al. v. Burlington Northern, Inc., et al.*, Civil Action No. B-84-979-CA, U.S. District Court for the Eastern District of Texas, 1989 U.S.Dist.LEXIS 18796.

Court in Texas concluded that several major western railroads had actively colluded in violation of the antitrust laws to prevent ETSI from constructing a coal slurry pipeline. That pipeline, if it had been built, would have provided a competitive alternative to rail transportation for many western coal shippers from the Powder River Basin of Wyoming to their generating stations.

A real likelihood exists that with only two major railroads in the west, and BNSF an ineffective surrogate for the SP at competitive locations, transportation rates will increase. The UP/SP have stated that it believes the merger is required to counteract the BN/SF merger, but the probability is that without a third carrier, competition between UP/SP and BNSF will be less, rather than more, aggressive.

In the current merger proceeding, UP/SP and BNSF claim that vigorous "head-to-head" competition will ensue from their access agreement. It is, however, difficult to understand what advantage the merger would hold for either railroad in the event that vigorous competition is actually instituted and maintained.

In order to capture traffic that is intrinsically available to both parties, each of the carrier entities must price their services at levels only marginally above variable costs. Although BNSF's tenant railroad costs are significantly higher than comparable UP/SP costs, and although this cost differential creates a higher "cost floor," stringent competition would, in theory, nonetheless inevitably drive prices below current levels, particularly for high-rated commodities such as Gulf Coast chemicals and plastics. If this competitive interplay occurs (and, as discussed below, we do not believe it will) the resulting decrease in rates would be to the obvious benefit of affected shippers. However, as is stated above, it is difficult to conceive how such "real" competition for a relatively finite volume of traffic, priced at marginally compensatory levels, would benefit carriers.

Although the merger may result in operational cost savings (the amount of which is a hotly disputed matter) it is highly doubtful that any such savings would more than fractionally offset the losses which would be incurred by the carriers through the competitive pricing which UP/SP and BNSF predict will result from the merger. Therefore, the logical observer must assume that the parties to the access agreement have identified advantages to the merger which are disassociated with the more straightforward aspects of the agreement.

The only way that UP/SP and BNSF could be assured that the merger and its attendant access agreement will work to their economic advantage would be the foreknowledge that "competitive" rates will not fall below a certain level. That "certain level" must obviously be substantially above truly competitive rates which would by definition be only marginally above the variable costs of operations.

As is widely acknowledged in a number of empirical studies relating to market concentrations short of overt monopoly, but involving only highly limited competitive choice,[5] the participants in highly concentrated markets will consciously work to protect and maintain levels of contribution and profit *at least equal* to those enjoyed in earlier markets. We believe that UP/SP and BNSF will act in this manner in order to at least preserve previously achieved levels of profitability. Otherwise, the merger

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[5]See, for instance the following literature: Leonard W. Wise, ed., *Concentration and Price* (1989), Richard Schmalensee, "Inter-Industry Studies of Structure and Performance," *Handbook of Industrial Organization*, vol. 2 (1989) and Timothy F. Bresnehan, "Empirical Studies of Industries with Market Power," *Handbook of Industrial Organization*, vol. 2 (1989). Bernheim and Whinston, "Multimarket Contract and Collusive Behavior," *RAND Journal of Economics* 21:1 (Spring 1990). Evans and Kessides. "Living By the 'Golden Rule': Multimarket Contact in the U.S. Airline Industry," *The Quarterly Journal of Economics* (May 1994).

would obviously work to the detriment, rather than advantage, of the carriers.

When ATSF and SP ("ATSF/SP") sought to merge in 1983, the ICC expressed concerns that market concentration would decrease competition. The ICC also did not believe that haulage rights for the benefit of a competitor to the ATSF/SP would provide the same level of competition as then existed between ATSF and SP. Specifically, the ICC had the following concerns regarding a proposed settlement agreement between ATSF/SP and BN:

a. BN's service could "never be better then or competitive with SPSF's" because of disadvantages in "scheduling, transit time, accessorial services, new or improved intermodal facilities, or service to new shipper facilities," (2 I.C.C. 2d at 811);

b. BN could not offer "full commodity or territorial service" (2 I.C.C. 2d at 811);

c. The cost to BN of transporting the covered traffic would be greater than that of SPSF, (2 I.C.C. 2d at 810), and SPSF would have knowledge of BN's costs;

d. The limited access to movements or commodities "would threaten to deprive the competing carrier [BN] of the traffic density needed to maintain effective competition," (2 I.C.C. 2d at 817).

The same problems as were apparent in the ATSF/SP proposed merger exist in the proposed UP and SP merger. The UP/SP-BNSF access agreement will not allow pure head-to-head competition. The following summarizes some of the reasons why the operation of the agreement will not offset the harm to competition that will be caused by the proposed merger for "2 to 1" customers. Of course the settlement agreement will have absolutely no beneficial effects for "3 to 2" situations.

a. UP/SP will know the exact amount of traffic lost to BNSF because of the trackage rights payments;

b. UP/SP will control the operation of BNSF trains thus preventing BNSF service from being superior and possibly making the service inferior;

c. UP/SP will have specific knowledge of a significant portion of the costs incurred by BNSF (i.e., the trackage rights payments);

d. On many lines, BNSF will have only limited access to the traffic which will prevent the densities required to be efficient;

e. UP/SP will have access to all current contracts involving either UP or SP thus having knowledge of the length of term and volume commitments. This will be an advantage for UP/SP over BNSF.

In summary, the UP/SP and BNSF will not compete with each other as strongly as the current configuration of BNSF, UP and SP.

D. The Rail Industry In The Future

The prospective UP/SP merger not only has important competitive and service implications in the area of the country west of the Mississippi River, if approved it likely would also have substantial impacts, both direct and indirect, in other parts of the nation. Indeed, the UP/SP merger may be but a prelude to future merger-related activities involving other railroads and other parts of the country as well. There is even speculation that a true transcontinental railroad system is in the offing.

The President and CEO of Burlington Northern Santa Fe Corporation, Robert D. Krebs, was profiled in a recent article published in *The Washington Post* (May 3, 1996). According to that article, Mr. Krebs has made no secret

of his desire to create the country's first transcontinental railroad by linking up with a major eastern line. Further, the article reports that, according to railroad and financial sources, Mr. Krebs is looking harder at Norfolk Southern Corporation than at the other two possibilities, Conrail and CSX Transportation, Inc. In his interview, Mr. Krebs is reported to have said that he would like to have more time before making any new merger moves, but that he would be ready to do so if the opportunity were to arise. He is quoted as saying, "The fact that we're working on putting these properties [Burlington Northern and Santa Fe] together doesn't stop us from doing something else."

If the BN/SF were to seek to merge with Norfolk Southern and succeed in doing so, the article speculates further, UP/SP and CSX likely would be forced to form a transcontinental link in defense. The question then would arise as to whether or not Conrail would be able to continue as a smaller regional railroad, as opposed to being divided up between the two transcontinental systems.

In short, is American railroading moving toward the Canadian model of two huge transcontinental systems? What rate and service implications would this development mean for American shippers? As we have emphasized earlier, with each reduction in the number of competing railroads, there is a significant loss of competition, and an increased likelihood of coordination between the remaining carriers.

EFFECT OF RECENT REGULATORY CHANGES

A. Changed Regulatory Conditions

A number of relatively recent changes in regulation will have decided effects upon both shipper and rail interests. As is usually the case these regulatory changes can be both beneficial or problematic depending upon the circumstances that attend the various issues which they address. Following is a brief summary of the changes and possible portents for shippers that they contain:

1. Elimination of Tariffs

The effective elimination of tariffs removes a highly complex and in many ways cumbersome aspect of rail rate determination. Tariff publication has been replaced largely through the establishment of contract rates (estimated to cover about seventy percent of all rail traffic). Residual rates which would have previously been covered through tariff publication are now provided by the carriers upon request.[6]

From the shipper standpoint (and particularly smaller or only periodic shippers who deal in small shipments not covered by contract) the absence of a pre-published rate may pose a disadvantage. The disadvantage may arise from the fact that the small shipper is only able to "shop" a rate through specific inquiry to specific carriers. It would therefore be difficult if not impossible for the shipper to determine if the quoted rate had been "adjusted" according to the level of leverage which the carrier determines is available to it. Previously, the published tariff rate absolutely governed the rate allowed to be charged.[7] The only method by which the rate could be changed was through republication which was made immediately available to interested parties. Mandatory tariff rate publication provided prompt notice of rate changes and allowed more or less instantaneous ability to challenge a rate if so desired. Under the new

[6] With the enactment of the ICC Termination Act of 1995, railroads are no longer required to publish their tariffs with the STB. However, carriers must make common carrier rates and service terms available to any shipper that requests them, and the carrier must respond promptly after receipt of the request in writing or in electronic form. *See*, 49 U.S.C. § 11101(b).

[7] Carriers are obligated to notify any shipper who has used or requested a rate within the past twelve months of any increase in rate levels or any change in other service terms. *See*, 49 U.S.C. § 11101(c).

system challenges can only be mounted following specific inquiry.

2. Line Abandonments Facilitated

The painstaking line abandonment regulatory process of the past has been replaced by a relatively streamlined methodology whereby lines can now be abandoned within months rather than much longer periods which the previous process required. *See*, 49 U.S.C. §§ 10903-10904; STB Ex Parte No. 537, Notice of Proposed Rulemaking, served March 15, 1996.

The obvious disadvantage to shippers of this streamlined process is that, with the decrease in the number of mandatory proofs required for abandonment, it becomes much more difficult to justify retention of service over candidate abandonment lines. Thus, the benefits derived from the facilitated line abandonment process apparently accrue to exclusive benefit of the carriers. However, rail line users and other interested persons still have an opportunity to prevent loss of rail service by offering financial assistance. *See*, 49 U.S.C. § 10904.

3. **Reduced Time Limits for STB Proceedings**

Statutory time frames under the ICC Termination Act of 1995 have been reduced significantly from previous time limits which were, in many instances, virtually open-ended. Major proceedings such as the merger or control of at least two Class I Railroads are limited to 455 days.[8] Time frames for smaller mergers range from 150 to 270 days. *See*, 49 U.S.C. § 11325.

With respect to time periods for rate reasonableness determinations on the part of the STB, the new law provides that the STB shall make its determination as to reasonableness of the challenged rate within nine months after the close of the administrative record if the determination is based upon a stand-alone cost presentation, or within six months after the close of the record if the determination is based upon the new, simplified and expedited rate reasonableness methodology, as discussed more fully below. *See*, 49 U.S.C. § 10704(c). Exemption proceedings also must be completed on an expedited schedule. The determination to institute an exemption proceeding must be made by the STB within ninety days of the filing of the exemption petition, and if an exemption proceeding is instituted, it must be concluded within nine months after the proceeding is begun. *See*, 49 U.S.C. § 10502.

The obvious advantage of shortened proceeding time frames for shippers and carriers alike is a probable decrease in litigation costs. The major disadvantage may be an incomplete record.

4. **Exemptions**

The major device by which the formal requirements normally associated with various proceedings before the STB may be foreshortened is the exemption process. This process is not only retained by the new law, its importance is reemphasized. In addition to imposing time limitations for processing exemption proceedings, as discussed above, the new § 10502(a) specifically directs the STB to use its exemption authority " . . . to the maximum extent." Thus, it can be expected that the exemption authority will be used fully with respect to various classes of commodities, car types, rate-related matters and other aspects of rail transportation.

The ability to file for exemptions is available to any party who wishes to do so. In many cases, relatively "short fused" exemption proceedings allow the parties, frequently with mutual consent, to resolve issues which would otherwise be more expensive and time consuming.

[8] The UP/SP merger proceeding is on a 255 day schedule indicating that the "statutory" time frames are mutable — at least to the extent that they can be shortened.

B. Rate Reasonableness Determinations for Large Volume Shippers

Under the new law, 49 U.S.C. § 10701, the new STB retains jurisdiction to adjudicate rate reasonableness disputes. With respect to high-volume, recurring movements of bulk commodities, such as coal, the STB has indicated that it will continue to utilize the standards adopted by the ICC in *Coal Rate Guidelines, Nationwide*, 1 I.C.C.2d 520 (1985), *aff'd sub nom., Consolidated Rail Corp. v. U.S.*, 812 F.2d 1444 (3d Cir. 1987). These guidelines impose a number of constraints as to the extent to which railroads may impose differentially higher rates on captive traffic. The three primary constraints are: (1) revenue adequacy, (2) management efficiency and (3) stand-alone cost (SAC). Under the revenue adequacy and management efficiency constraints, the focus is on the railroads' existing operations. If the carrier is revenue adequate, *i.e.*, it earns sufficient funds to cover its costs and provide a fair return on its investment, or would be revenue adequate if costs resulting from inefficient operations are eliminated, a complaining shipper may be entitled to rate relief. Under the SAC constraint, the focus is on the determination of the lowest cost at which a hypothetical, efficient carrier could serve the traffic at issue, together with other traffic that is selected to share the burden of the carrier's joint and common costs. The hypothetical stand-alone carrier is specifically tailored to an optimum traffic group with an optimum physical plant needed for the subject traffic. The rate that is challenged by the shipper is then compared with what the hypothetical carrier would have to charge to provide the needed service to the shipper while fully covering all of the carrier's costs, including a reasonable return.

While the development and presentation of a stand-alone case is time-consuming and expensive (the ICC has stated that a stand-alone case costs between $250,000 and $1,000,000), this approach has been used successfully on a limited number of occasions in order to secure rate relief by shippers.

For example, in a recent decision (served May 3, 1996), the STB has employed the stand-alone analysis, finding that the rate charged by the defendant railroad on the subject traffic was unreasonable. A maximum reasonable rate limit was set and reparations were ordered. Specifically, the STB acted in Docket No. 41191, *West Texas Utilities Company v. Burlington Northern Railroad Company*.[9] Because BN's current rates produced revenues above the level needed to provide and sustain efficient service to the subject traffic group, the STB concluded that BN was collecting excessively high rates on the traffic. It is important to note that the stand-alone rate developed in the *West Texas* proceeding was below the 180 percent revenue to variable cost threshold. Because the STB does not have jurisdiction over rail rates below that level, the STB set the maximum reasonable rate level for the subject traffic at 180 percent of BN's variable cost of providing service to the shipper.

In short, the methodology employed by the STB in the *West Texas* case, which was generally favorable to the shipper, provides an indication of how the STB will approach future rate reasonableness complaints involving high-volume,

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[9]Since the complaint in this proceeding was pending before the ICC prior to the effective date of the ICC Termination Act of 1995, the case was decided under the law in effect prior to January 1, 1996. However, it is clear that the STB will use the same stand-alone constraint analysis in cases filed after the effective date of the new law.

recurring shipments of bulk commodities.[10]

C. Rate Reasonableness Determinations for Small Volume Shippers

In contrast to the established evidentiary guidelines for high-volume commodities as discussed above, the STB, as did its predecessor, the ICC, is still grappling with the appropriate decisional standards to employ in rate reasonableness cases that do not involve high volume traffic and large sums of money. Indeed, the ICC had first commenced its search for simplified, less expensive methods for resolving such disputes nearly a decade ago when it instituted Ex Parte No. 347 (Sub-No. 2) *Rate Guidelines - Non-Coal - Proceedings*. The ICC served its most recent decision in this long-pending proceeding on December 1, 1995. The STB has inherited this proceeding and has received additional comments from interested parties concerning the proposed standards. Importantly, an end to this proceeding is in sight by virtue of the recently enacted ICC Termination Act of 1995. The new law specifically directs the STB to complete the pending Ex Parte No. 347 (Sub-No. 2) proceeding within one year of enactment, or by the end of 1996.

In its latest decision, the ICC identified and explained three separate revenue-to-variable cost tests that could be used to assess the reasonableness of rates for captive traffic in situations which do not involve high-volume, repetitive rail traffic (such as movements of unit-trains of coal). The three tests proposed for consideration in the most recent decision are: (1) the Revenue Shortfall Allocation Method (which calculates the uniform markup by a rail carrier over variable cost that would be needed from every movement of relatively demand-inelastic traffic for the carrier to earn adequate revenue if all its demand-inelastic traffic were charged the same markup); (2) the Revenue-to-Variable Cost Comparison Method (which uses the average markup that is collected on traffic movements of a similar commodity under similar transportation conditions as a limit on the markup that can be earned on the subject traffic); and (3) the Average Revenue-to-Variable Percentage Above 180 percent Method (which looks at the average markup charged by the railroad on its other high-rated traffic - traffic moving at revenue-to-variable cost percentages in excess of 180 percent - to determine whether the traffic at issue bears a disproportionately large share of the carrier's revenue requirement). The ICC's decision indicates that each of these tests, standing alone, would be an inadequate measure of the reasonableness of rail rates, but that applying them in combination would best enable the agency to meet its statutory objectives. Additionally, it is recognized in the decision that a rigid application of these tests would not necessarily produce fair and economically-justified results; thus, application of these tests would represent only the starting point, not the end result of the analysis.[11]

The issues in the pending Ex Parte No. 347 (Sub-No. 2) proceeding are hotly contested by interested parties. However, when the decision is issued by the STB later this year, it undoubt-

[10] In its *West Texas* decision, the STB also found that the BN had market dominance over the traffic at issue within the meaning of the former statutory provisions, 49 U.S.C. §10701a(b)(1) and §10709, which defines market dominance as "an absence of effective competition from other carriers or modes of transportation for the transportation to which a rate applies." The ICC Termination Act of 1995 likewise requires the threshold finding of market dominance on the part of the STB in order for it to have jurisdiction to adjudicate rate reasonableness. The STB will continue to use the ICC's evidentiary guidelines, as set forth in *Market Dominance Determinations*, 365 I.C.C. 118 (1981), *aff'd sub nom. Western Coal Traffic League v. United States*, 719 F.2d 772 (5th Cir. 1983)(*en banc*), *cert. denied*, 466 U.S. 953 (1984), *modified in Product and Geographic Competition*, 2 I.C.C.2d 1 (1985).

[11] In the December 1, 1995 decision, the ICC rejected the railroad industry's proposed method, the so-called simplified stand-alone cost method, finding that it appeared to distort the results in favor of the railroads. According to the decision, the railroads' model "appears biased in the railroad's favor . . . ." (Decision p. 11).

edly will have an important impact on captive rail shippers, assuming meaningful and realistic standards are adopted. The impact will be both direct and indirect in that such standards will not only be used by captive shippers directly in future rate reasonableness proceedings before the STB, but also indirectly as benchmarks in contract negotiations with the carriers.

D. Role of STB in a Changing Railroad Environment

In addition to the STB's continuing jurisdiction over rate reasonableness disputes, as discussed above, other important regulatory protections for shippers were retained by the ICC Termination Act of 1995.[12] These protections include: requirement of service on reasonable request (§ 11101), line construction and crossing authority (§ 10901), safe and adequate car service (§ 11121), continuous carriage of freight (§ 10744), switch connections (§ 11103), establishment of through routes (§ 10701, 10703, 10705), shipper right to designate routes (§ 10747), provision of facilities for interchange of traffic (§ 10742), reciprocal switching/terminal trackage rights (§ 11102), reasonable rules and classifications (§ 10702), reasonable charges or allowances for transportation services or facilities furnished by shipper (§ 10745), demurrage charges (§ 10746), and prohibition against discrimination by rail carriers (§ 10741). It is also appropriate to note that, while the authority to suspend and investigate rates (former § 10707) has been repealed, the STB has been given the authority to "issue an appropriate order to prevent irreparable harm." (49 U.S.C. § 721(a)(4)). While the precise scope of this new provision has not been tested and determined, it appears to be the functional equivalent of the former suspension power that had been available to the ICC.

Thus, the new law continues to provide shippers with certain regulatory protections to the extent they are needed in what is otherwise a largely deregulated transportation environment. It remains to be seen how the STB will interpret and apply its remaining regulatory authority, and to see if the new agency will depart in any meaningful sense from the approach taken by its predecessor, the ICC.

AVOIDING PROBLEMS WHILE MAXIMIZING OPPORTUNITIES

A. Each Situation Has Its Own Problems and Solutions

The topics discussed above all point toward a lessening in regulatory oversight and the need for astute planning to develop and maintain an advantageous transportation market position. Where possible this astute planning process should be employed on a preemptive basis. That is to say, in any matter which may involve rail transportation each and every operational and economic element which may influence, or be influenced by, rail transportation should be analyzed. Following is a brief summary of items which should be thoroughly analyzed and implemented in situations involving rail transportation.

1. Before any rate negotiation, contract or otherwise, fully explore rail transportation options available. Include consideration of competitive options at origins and destination and for possible bridge movements. Determine the level of rail service currently and/or potentially available for respective locations and volumes under analysis, including cycle times and rail plant and equipment adequacy. Where possible, be apprised of current rate levels for movements similar to those contemplated.

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[12] It is also important to note that the new law provides that pending proceedings are not affected insofar as the functions are continued by the new law. Further, orders of the ICC in effect on December 31, 1995 will continue in effect until modified or terminated by the STB. Also, pending lawsuits against the ICC are not affected, although any remanded proceedings would be decided by the STB under the new statutory provisions.

2. Before locating production facilities and/or supply sources make a full determination, through negotiations with alternative carriers, of prospective deals on service, rates and rate adjustment formulae. Then, if possible, obtain concrete commitments from the potential carriers. Be sure to include equipment (rolling stock) provisions in such negotiations.

3. Obtain an understanding of the respective carriers' costs. This knowledge will allow for the establishment of a "cost floor" for negotiations. Request that potential carriers provide variable cost estimates and compare these costs, if provided, with costs determined by an independent agent.

4. Be sure that very specific cost and other economic data is included in rail contracts. When implementing the contract, the more specific the data is (including example calculations) the lesser the chances of disagreement. If appropriate develop reopener provisions which would act to your economic advantage. Provide for the possibility that the rail contractor may merge or share control with another carrier.