

Minutes
Rail Energy Transportation Advisory Committee
December 2, 2008

Rail Energy Transportation Advisory Committee (RETAC) convened at the Surface Transportation Board (STB) offices in Washington, DC, on December 2, 2008. Jeff Wallace and Alan Shaw, co-chairs, called the meeting to order at 9:00 a.m. The meeting agenda and copies of documents presented during the meeting are attached separately to these minutes.

Attendance:

Surface Transportation Board:

Charles D. Nottingham, Chairman
Francis P. Mulvey, Vice-Chairman
W. Douglas Buttrey, Commissioner
Scott Zimmerman, Designated Federal Official

RETAC Members:

Jeff Wallace, Co-chair
Alan Shaw, Co-chair
David Rohal, Secretary/Treasurer
James Redding Ed McKechnie Darin Selby
Susan Arigoni Betsy Monseu Dan Sabin
John Carr Dan Kuehn William Berg
Mark Spitzer Stevan Bobb Robert Gabbard
Henry Rupert Paul Hammes Kent Smith
Sameer Gaur John Hall Mark Huston
Daryl Haack

Absent:

James Brunkenhoefer Robert Hulick Darrell Wallace

STB Chairman Nottingham, Vice Chairman Mulvey, and Commissioner Buttrey welcomed the committee with remarks on the challenging economic times and the busy agenda in front of the STB including the CN/EJE merger in final review and ramping up to administer new provisions in the Amtrak reauthorization bill. The board is looking forward to the appointment of a new Secretary of Transportation and other changes accompanying the inauguration of a new administration.

Minutes of the RETAC meeting on September 17, 2008, were approved.

Committee treasurer David Rohal reported that after paying for lunch, the committee fund held \$2,037.

The meeting was dedicated primarily to several presentations and sub-committee discussions. Presentation documents are attached.

Mark Meitzen presented an overview and facilitated a discussion of the Christensen study of railroad competition. A full copy of the study is available on-line at: <http://www.stb.dot.gov/stb/elibrary/CompetitionStudy.html>.

The study came to the following conclusions:

- Economies of density and fixed costs require railroad pricing above short-run marginal cost to achieve revenue sufficiency. Railroads use differential pricing to recover their total costs.
- For most years in the 1987 to 2006 period of our study, the Class I railroad industry does not appear to be earning above normal profit.
- The increase in railroad rates experienced in recent years is the result of declining productivity growth and increased costs rather than the increased exercise of market power. Railroad productivity growth spiked in the 80's, narrowed in the 90's, and was essentially no different than the overall economy in the 00's.
- Different commodity groups face different markups of railroad rates over marginal costs. Within commodity groups, shippers with no or very limited transportation options tend to pay higher rates than shippers with the same shipment characteristics who enjoy more or better transportation alternatives.
- The ratio of revenue to URCS variable cost (R/VC) is weakly correlated with market structure factors that affect shipper "captivity," and is not a reliable indicator of market dominance. (The Board is looking at whether URCS data needs to be reevaluated.)
- Capacity "tightness" is primarily due to congestion at terminals or other specific network locations. Terminal congestion in the 2003-2005 period was linked to service performance declines during that time period. The study found no evidence of connection between capacity and increased exercise of market power.
- Current market circumstances imply that providing significant rate relief to certain groups of shippers will likely result in rate increases for other shippers or threaten railroad financial viability. Railroad revenue sufficiency rebounded from a low point in 2004 with significant increases in 2005 and 2006. (Data through 2006 was available for the study, and the STB is looking at reviewing more recent data as it comes available.)
- Incremental policies such as reciprocal switching and terminal agreements have a greater likelihood of resolving shipper concerns via competitive response, and have a lower risk of leading to adverse changes in industry structure, costs, and operations.
- Capacity investment has increased in both nominal and real terms.
- Some shippers will not benefit from efforts to enhance railroad competition, implying the necessity of continued regulatory oversight.

Several RETAC members questioned the impact of legacy contracts on the data and noted that the timing of contract expirations could affect individual railroad customers in ways not apparent in the overall data.

In an analogy to utility markets, the FERC commissioner asked if price signals are being sent to build in the right places. The data was not studied at that corridor and commodity-

specific level. The railroad industry studies capacity on a corridor by corridor basis based on the number of expected trains and seems to put investments in areas where they can get returns, but some areas (such as Chicago) are subject to non-economic impacts that influence decision-making.

Meitzen concluded that like many studies, the insights from the Christensen study suggested areas for further inquiry such as studying equity in addition to economic efficiency in areas with tough issues such as bottleneck rates or access charges.

Subcommittee reports:

Capacity Planning – Henry Rupert

This subcommittee is developing a white paper currently in draft form containing views on how large investments in railroad capacity can be made given economic and regulatory uncertainty, including reserve capacity to accommodate market changes. The railroads and shippers agree that further investment is needed, and a tax credit is not opposed by shippers. The subcommittee was urged to expand the concept beyond where tax credits are seen as the means of ensuring needed capacity investments are made.

In discussion, we noted that railroads and utilities are both capital-intensive but operate to different sets of obligations resulting in different handling of temporal issues, reserve capacity, and the need for flexibility.

Performance Measures -- Betsy Monseu

This subcommittee is putting together a dashboard of measurements based on publicly-available data on coal production, coal consumption, and coal inventories. The committee is reviewing available data and debating the merits of potential measurements and will be including data on (AAR) transportation metrics, including coal.

Best Practices – Susan Arigoni

This subcommittee has met to identify and refine issues across the energy supply chains that affect the productivity and efficiency of the entire chain. The lack of a common understanding of business practices and unawareness of the benefits of optimal business practices results in sub-optimal performance of the supply chain. The subcommittee is drafting a white paper around the following productivity improvement areas: improved information flows, the use of technology, and economic benefits. The subcommittee is opening channels of communications by discussions of terms, analyzing and evaluating practices that could benefit the entire supply chain.

Communications – Ed McKechnie

This subcommittee is drafting a white paper and is looking for a representative from the utility sector to complete a full perspective.

Open discussion of topics of interest in the energy transportation industry were tabled due to lack of time.

RETAC member Daryl Haack summarized an overview of the uses of anhydrous ammonia and the importance of rail transportation to those industries, and Michael McBride of Van Ness Feldman talked about the common carrier obligations of railroads in the transportation of hazardous materials. Due to pending cases before the board, the STB were not present for these presentations.

The next RETAC meeting will be Wednesday, March 4, at 9:00 a.m., at STB headquarters in Washington, DC.