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SERVICE DATE – OCTOBER 26, 2009

SURFACE TRANSPORTATION BOARD

DECISION

STB Docket No. 42111

OKLAHOMA GAS & ELECTRIC COMPANY

v.

UNION PACIFIC RAILROAD COMPANY

Decided: October 23, 2009

By a decision served on July 24, 2009 (July decision), the Board found that the rates charged by Union Pacific Railroad Company (UP) yielded revenues that exceeded 180% of the variable cost of providing service to Oklahoma Gas & Electric (OG&E). The July decision also addressed how parties should calculate 180% of variable cost to determine the maximum lawful rate in future movements throughout the 10-year prescription period.

On August 13, 2009, UP filed a petition for clarification of the Board's July decision. In regard to calculating rates for the prescription period, UP seeks to clarify the following: which versions of the wage and price level indices (the Association of American Railroads (AAR) index and the Producer Price Index (PPI), respectively) are to be used; the date on which to begin charging new rates; and the process for updating the actual operating characteristics used to calculate new rates.

On August 20, 2009, OG&E replied and sought further clarification as to the establishment of maximum reasonable rates for the third quarter of 2009. OG&E also requested that the Board describe a quarterly verification process that would allow OG&E to verify UP's rate calculations throughout the rate prescription period. UP replied on August 25, 2009.

BACKGROUND

In its complaint, OG&E challenged the reasonableness of rates charged by UP to transport coal from the Southern Powder River Basin (SPRB) in Wyoming to OG&E's Muskogee Generating Station in Fort Gibson, OK. Through joint stipulation, the parties agreed that there was not effective competition from other carriers or other modes of transportation for the issue traffic and that the challenged rates exceeded the stand-alone cost constraint. Accordingly, the only disputed issues were whether the revenues produced by the challenged rates exceeded 180% of the variable costs of providing that transportation, and if so, how to calculate the 180% R/VC ratio, which the parties stipulated should be the maximum reasonable rate.

In its July decision, the Board calculated the variable cost of each challenged movement, using the most recent (2007) unadjusted Uniform Railroad Costing System (URCS) application. It then clarified how to index variable cost calculations to the relevant quarters and determined that the challenged rates exceeded 180% of UP's variable costs of transporting the issue coal. Based on stipulation of the parties, the Board then set the maximum lawful rates for coal moving from the SPRB to the Muskogee Station at the 180% R/VC ratio level for the first and second quarters of 2009.

Lastly, the Board declined the parties' request to establish a "true-up" process to account for the lag between the time when movements occur and when URCS costs for that specific time period become available. Rather, the Board set forth a method for calculating the maximum lawful rates UP could charge under its decision for the duration of the prescription period. Specifically, the Board directed:

UP must calculate variable costs in a given quarter by using the most recent URCS data indexed to that quarter by using the most recent AAR indexes and PPI. UP should then combine those data with the actual operating characteristics to estimate a given movement's variable cost. This is the best estimate of variable cost that will be available at the beginning of a quarter. UP should then multiply the maximum lawful R/VC ratio by the variable costs to calculate the rate to be charged in that quarter. UP is directed to update the maximum lawful rate quarterly in order to reflect the most recent URCS data and indexes.¹

The parties now seek clarification concerning matters arising from the July decision. The Board addresses these concerns below.

DISCUSSION AND CONCLUSIONS

Appropriate AAR index and PPI. UP seeks clarification as to the appropriate AAR index and PPI to be used for calculating a new quarterly rate. UP states its belief that the Board intended UP to use the PPI indices that become available in the first few weeks into a given quarter, rather than the indices available on the first day of a given quarter. Those indices became available during the prior quarter, reflecting cost levels from an even earlier quarter. UP's understanding is correct. For a given quarter, UP should use the AAR index supplied to the Board in the weeks prior to the beginning of a quarter and the PPI indices that became available in the beginning of that quarter (including revisions to previous quarters), even if these indices become available a few weeks into the given quarter. Specifically, as UP noted, it should use the AAR index and the average of the three most recent PPIs, with the most recent PPI reflecting cost levels from the previous month.

Date to Charge New Rates. UP also seeks clarification as to the appropriate date to begin charging new rates. UP interprets the Board's decision as requiring UP to charge rates no more than 10 days from the date the PPI indices become available, which would result in implementing new rates several weeks after a quarter begins. UP requests clarification that this

¹ July Decision at 11.

is what the Board intended, rather than having UP retroactively apply rates to the start of the quarter, once the indices become available. OG&E also seeks clarification on this point. UP's understanding is correct. Once the appropriate PPI indices become available a few weeks into a quarter, UP has 10 days to recalculate and issue the maximum lawful rate for the quarter. Though the new rate might not be issued on the first day of a given quarter, this method would still result in UP issuing new rates four times a year.

Actual Operating Characteristics. UP asks that the Board clarify two issues pertaining to the actual operating characteristics that should be used to update the maximum lawful rate calculation each quarter. First, UP asserts that the Board intended UP to calculate rates using actual operating characteristics for trains that moved in the 12-month period preceding the quarter in question. Using this 12-month rolling average, UP states, would make quarterly rate calculations less susceptible to short-term distortions. Second, UP seeks clarification as to which actual operating characteristics are to be used for movements that experienced no traffic the prior quarter. UP asserts that it should base its cost calculations on an average of the operating characteristics for all other origins from which traffic had moved under prescribed rates in the prior 12 months, but using the actual miles for the given origin.

OG&E agrees that clarification is necessary but argues that quarterly rate calculations should be based on the actual operating characteristics of the prior quarter. As for origins on which no traffic had moved the previous quarter, OG&E states that such rates should also be based on the average operating characteristics of all other traffic that had moved under the prescribed rates, but quarterly operating statistics, rather than annual statistics, should be used.

The Board intended UP to use the actual operating characteristics of the previous quarter to calculate its quarterly rates. This is consistent with the Board's intention for UP to use the most recently available information, including the most recently available AAR index and PPIs, to calculate the best estimate of variable cost for a given quarter. Likewise, for movements that experienced no traffic the prior quarter, UP should use the average operating characteristics for all other traffic that moved under the prescribed rates for the prior quarter, except UP should use the actual miles for the particular origin.

Rate Verification Process. In its reply, OG&E requests that the Board set forth a process or mechanism whereby OG&E would receive quarterly rate calculations from UP, verify UP's quarterly calculations, and resolve any disagreements. OG&E goes on to request that the Board require UP to provide actual operating characteristic data for the prior quarter to OG&E within 5 days of the end of the quarter. In its reply, UP argues that such information is not immediately known to UP and cannot be easily supplied, as OG&E suggests. Further, UP asserts that OG&E possesses much of the sought information. However, UP states that it is willing to voluntarily provide its supporting calculations, including operating statistics that it relied upon, to OG&E when new rates are established and confer with OG&E about any discrepancies that OG&E believes may exist and adjust the rates retroactively in the event of an error. Accordingly, the Board will hold UP to its representation and require UP to provide OG&E its rate calculations, including the relevant operating characteristics used for calculations, when new rates are established and to confer with OG&E should discrepancies arise and adjust the rates retroactively in the event of an error.

Maximum Lawful Rates for the Third and Fourth Quarters of 2009. OG&E requests that the Board clarify that under its July decision, rates for the third quarter of 2009 should have been established no later than July 24, 2009 (10 days after the release of the most recent PPI), and that these third quarter rates should be established at the same level as the rates for the second quarter of 2009. UP asserts that it cannot establish third quarter rates without Board clarification as to which actual operating characteristics are to be used, and regardless of whether annual or quarterly operating statistics are to be used, third quarter rates will not be identical to second quarter rates.

In accordance with this decision, UP is now ordered to establish rates for the third quarter of 2009 within 10 days from the effective date of this decision.² As described above, UP should calculate these rates using the AAR index that became available in late June and the PPI indices (including revisions to previous indices), which became available by July 14, 2009, and the actual operating characteristics of the second quarter of 2009.³ UP is also similarly ordered to establish rates for the fourth quarter of 2009 using the AAR index that became available in late September and the PPI indices (including revisions to previous indices) that became available in October and the actual operating characteristics of the third quarter of 2009.

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

It is ordered:

1. UP shall provide OG&E its rate calculations, including the operating statistics used, upon issuance of a new rate through the prescription period and confer with OG&E about any discrepancies and adjust the rates retroactively in the event of an error.
2. UP shall prescribe rates for the third and fourth quarters of 2009 in accordance with this decision by November 5, 2009.
3. To the extent necessary, UP shall pay reparations and interest for shipments moving prior to the establishment of reasonable rates pursuant to paragraph 2.

² The rates established in accordance with this decision will replace the rates UP issued in UP Tariff 4221, which became effective on September 22, 2009.

³ The calculations in Appendix C of the July Decision, “Results, Second Quarter 2009,” calculated second quarter variable costs using the actual operating characteristics jointly submitted by the parties, which reflected movements for the period November 1, 2007 to October 31, 2008. Therefore, UP’s calculations of variable costs for the third quarter, using actual operating characteristics of the second quarter of 2009, will not necessarily be identical to the second quarter’s rates.

4. This decision is effective on its date of service.

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

Anne K. Quinlan
Acting Secretary