

SERVICE DATE - APRIL 30, 2002

SURFACE TRANSPORTATION BOARD

DECISION

STB Ex Parte No. 589

CALCULATION OF VARIABLE COSTS IN
RATE COMPLAINT PROCEEDINGS INVOLVING
NON-CLASS I RAILROADS

Decided: April 22, 2002

We institute this proceeding to settle how we intend to estimate the variable costs of non-Class I railroads—carriers that are not required to keep their accounting records in accordance with our Uniform System of Accounts (USOA)¹ or to file annual reports containing the information needed to calculate variable costs using the Uniform Railroad Costing System (URCS)²—in any future rail rate cases.

BACKGROUND

A user of rail transportation can file a complaint with the Board challenging the reasonableness of a rate charged for common carriage rail transportation. 49 U.S.C. 11701(b). However, we may consider the reasonableness of a challenged rail rate only if the carrier has “market dominance” over the traffic at issue.³ A market dominance analysis contains both quantitative and qualitative components. Quantitatively, the statute precludes a finding of market dominance where the revenue produced by the movement is less than 180% of the carrier’s “variable cost” of providing the service.⁴ In other words, Congress has determined that a railroad does not exercise undue market power when it prices traffic below the 180% revenue-to-variable cost (r/vc) level. Pricing traffic above this threshold level, however, does not create a

¹ 49 CFR 1201.

² 49 U.S.C. 10707(d)(1)(B) requires variable costs to be determined using URCS or an alternative methodology adopted by the Board.

³ 49 U.S.C. 10701(d)(1), 10707. Market dominance is “an absence of effective competition from other carriers or modes of transportation for the transportation to which a rate applies.” 49 U.S.C. 10707(a). A finding of market dominance does not in itself establish a presumption that the rate is unreasonable, however. 49 U.S.C. 10707(c).

⁴ 49 U.S.C. 10707(d)(1). Variable costs are those railroad expenses that have been found to vary with the level of service provided by the carrier.

presumption that the carrier has market dominance over the traffic.⁵ Rather, if the 180% threshold is exceeded, we conduct a qualitative analysis to ascertain whether there are effective competitive alternatives available to the shipper.⁶ If competition in the marketplace effectively constrains a railroad's pricing discretion, then the carrier does not have market dominance over the challenged transportation. We cannot examine the reasonableness of a rate level unless we have first determined that both the qualitative and quantitative market dominance tests are met. Furthermore, even when it has been established that a carrier has market dominance and its rate is unreasonably high,⁷ we cannot set a maximum rate that results in an r/vc of less than 180%.⁸

When the transportation is provided by a Class I railroad,⁹ cost and operational data filed annually with the Board permit a determination under URCS of the carrier's system-wide average variable cost of providing service.¹⁰ A railroad's system-average URCS costs can be adjusted, to more closely reflect the service provided for a particular shipper, by substituting some movement-specific expenses, statistics and operating parameters that relate more directly to that particular service. However, when the rates of a non-Class I railroad are challenged, as they were most

⁵ 49 U.S.C. 10707(d)(2)(A).

⁶ 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, Market Dominance Determinations—Product & Geographic Competition, 3 S.T.B. 937 (1998), modification reaffirmed on remand, STB Ex Parte No. 627 (STB served Apr. 6, 2001), pet. for judicial review pending sub nom. Association of Am. Railroads v. STB, No. 01-1213 (D.C. Cir. filed May 15, 2001).

⁷ Our general standards for judging the reasonableness of rail freight rates are set forth in Coal Rate Guidelines, Nationwide, 1 I.C.C.2d 520 (1985), aff'd sub nom. Consolidated Rail Corp. v. United States, 812 F.2d 1444 (3d Cir. 1987). When our general standards cannot practically be applied, alternative standards are available. See Rate Guidelines—Non-Coal Proceedings, 1 S.T.B. 1004 (1996), pet. for judicial review dismissed sub nom. Association of Am. Railroads v. STB, 146 F.3d 942 (D.C. Cir. 1998).

⁸ See Wisconsin Power & Light Co. v. Union Pac. R.R. STB Docket 42051 (STB served Sept. 13, 2001), slip op. at 33 (reparations ceiling and rate prescription floor based on 180% of variable costs).

⁹ For regulatory purposes, railroads are classified by size, as measured by the amount of their annual operating revenues. Class I railroads are carriers with annual operating revenues of at least \$250 million (in 1991 dollars). 49 CFR 1201 General Instruction 1-1(a).

¹⁰ Class I railroads are required to file annually a variety of cost and operating statistics that are used as inputs in URCS to develop system-average variable costs. 49 CFR 1241-1248.

recently in Docket No. 42038,¹¹ the detailed, uniform cost and operational data that are needed to develop variable costs using URCS are not available because non-Class I carriers are not required to maintain their records as prescribed by the USOA.¹²

Historically, when variable costs data were not available for a non-Class I railroad, the agency has used average regional variable costs of Class I railroads¹³ as a surrogate for the non-Class I carrier's variable costs in a variety of proceedings (including proceedings challenging the reasonableness of a non-Class I railroad's rates).¹⁴ Indeed, prior to enactment of the ICC Termination Act of 1995 (ICCTA),¹⁵ the statute specifically sanctioned the use of regional URCS

¹¹ Minnesota Power, Inc. v. Duluth, M.&I.R. Ry., STB Docket No. 42038 (dismissed Jan. 5, 2001 following settlement of the rate dispute).

¹² In Elimination of Accounting & Reporting Requirements of Class II Railroads, No. 37614 (ICC served Feb. 25, 1982), our predecessor, the Interstate Commerce Commission (ICC) relieved Class II railroads from the accounting and reporting requirements because "the information filed by Class II railroad[s] . . . was not used on a regular basis for analysis or monitoring purposes." Slip op. at 2. Class III railroads had been relieved of those requirements in 1981, in accordance with a policy that "[i]nformation needed occasionally will be collected only when the specific need arises." Reduction of Accounting & Reporting Requirements, No. 37523 (ICC served Dec. 15, 1980), slip op. at 2. Even prior to the elimination of reporting requirements for non-Class I railroads, however, the less-detailed information then required of Class II and Class III carriers was insufficient to permit the calculation of system-wide variable costs using Rail Form A, the predecessor to URCS.

¹³ We annually develop average variable costs for the composite rail operation of Class I railroads operating in the Eastern and Western United States. Western regional URCS costs represent the composite operations of The Burlington Northern and Santa Fe Railway, Kansas City Southern Railway, Canadian Pacific Railway (U.S. West) Limited (formerly Soo Line Railroad), and Union Pacific Railroad. Eastern regional costs are a composite of the operations of the Grand Trunk Western Railroad, Norfolk Southern Corporation, CSX Transportation, Inc., and Illinois Central Railroad.

¹⁴ See United States Dept. of Energy, et al. v. Baltimore & O.R.R. et al., 10 I.C.C.2d 112, 146 (1994); Rate Guidelines—Non-Coal Proceedings, 2 S.T.B. 229 (1997) (noting that regional data would be used in small rate cases involving non-Class I carriers); Adoption of Uniform Railroad Costing System as a General Purpose Costing System for All Regulatory Purposes, 5 I.C.C.2d 894, 917-18 (1989) (Adoption of URCS) (while not requiring use of Class I regional costs for non-Class I carriers, ICC expressed its view that such a procedure appeared to be the "best approach").

¹⁵ Pub. L. No. 104-88, 109 Stat. 803 (1995).

costs for evaluating joint-rate surcharges and cancellations for non-Class I carriers.¹⁶ Furthermore, our rail line abandonment regulations have long provided that a non-Class I railroad can develop off-branch costs based either on the carrier's own individual URCS data, or if such data are not available, on regional URCS data.¹⁷

Notwithstanding the historical use of regional average Class I railroad costs as a surrogate for non-Class I railroad costs, in Docket No. 42038 we had reservations about the accuracy of using the regional URCS costs proffered by the defendant non-Class I railroad to estimate its variable costs. In that rate complaint, not only was the calculation of variable costs necessary for the quantitative market dominance determination but also, by stipulation of the defendant railroad, for the determination of the reasonableness of the rate.¹⁸ Because of the unusually important role that variable costs would have played in that case, we took the unprecedented step of placing the proceeding in abeyance and directing the non-Class I railroad to keep its records in conformance with our USOA for a 12-month period and to collect and file a year's worth of detailed financial and operating data normally required only from Class I railroads. At the end of the 12-month period, the case was to be reactivated and the data collected would be inputted into the URCS costing algorithm to develop carrier-specific variable costs.

The defendant railroad sought reconsideration of that order and asked us to remove the accounting/record-keeping requirement as unduly burdensome. The American Short Line and Regional Railroad Association (ASLRRA), an organization of smaller (non-Class I) railroads, intervened, urging a less burdensome and more cost-efficient solution for those instances in which the variable costs of a small railroad become an issue.

Because of the industry-wide implications associated with requiring a non-Class I railroad to maintain its accounts in accordance with the USOA and to collect certain operating statistics solely for the purpose of adjudicating a rate complaint, we stayed the accounting/record-keeping

¹⁶ See Adoption of URCS, 5 I.C.C.2d at 917, citing former 49 U.S.C. 10705a(m)(2) (1995). The ICCTA deleted section 10705a not because Congress no longer believed that regional costs for Class I railroads were an appropriate surrogate for non-Class I carrier variable costs but because "Section 10705a—which governs rail joint-rate surcharges and cancellation— . . . has already achieved its purpose (to provide carriers an avenue of relief from unremunerative joint rates) and would not be needed with the elimination of most rail tariffs." S. Rep. No. 176, 104th Cong., 1st Sess. 21 (1995).

¹⁷ See 49 CFR 1152.32(n)(4); Use of URCS in the Calculation of Off-Branch Costs, 8 I.C.C.2d 203, 204 (1991).

¹⁸ The defendant railroad had stipulated that, if it was found to have market dominance over the transportation, the challenged rate should be limited to the 180% r/vc regulatory threshold.

requirement pending our resolution of the petition for reconsideration. However, before we could rule on that petition, the parties settled their rate dispute and the case was dismissed. Nonetheless, the issue of whether, as a general matter, it is appropriate and administratively practical in rate cases involving non-Class I railroads to place such a case in abeyance for an extended period of time and to subject a carrier to the expense of developing URCS-compatible data for a single case has not been resolved. In this proceeding, we propose to return to a policy of estimating non-Class I carriers' variable costs using Class I regional average variable costs, and we seek comments of interested parties on this proposal and/or any alternative proposal they may wish to make.

DISCUSSION

Having been confronted with the need to develop variable costs for non-Class I railroads, we see two general choices. We could, as we did in Docket No. 42038, require a carrier to compile its own accounting and operating statistics that would be used to develop URCS variable costs for the defendant railroad; or we could rely, as we have historically, on regional average Class I carrier variable costs to estimate the defendant carrier's variable costs.

In its petition for reconsideration in Docket No. 42038, the defendant railroad contended that the accounting/record-keeping requirements that we had earlier imposed would be unduly burdensome and that the added costs associated with collecting the required data would far outweigh the potential value of the case. The carrier explained that the added costs would include setting up a new, separate financial accounting system for this one-time use, reprogramming its computers and training its personnel to use that new accounting system, and devoting personnel time to collect and record the data that would be required for the operating statistics. The railroad claimed that the total costs would exceed \$1 million.¹⁹

The complaining shipper disputed the \$1 million estimate and noted that in 1991, in commenting on the proposal to raise the revenue threshold for Class I status to its current level, the defendant's parent company had represented that the costs associated with maintaining the records and reporting the information required of Class I railroads would be \$100,000.²⁰ But whatever the exact cost associated with such record-keeping and reporting, it is apparent from the parties' submissions that this accounting/record-keeping cost—which would be only part of the overall cost to the railroad of defending itself—would be substantial. We are concerned that this litigation cost, if it were imposed, and the delay that would necessarily follow in a case against a non-Class I railroad, could be inordinate. And, as ASLRRRA rightly pointed out, we must be cognizant of the

¹⁹ In Docket No. 42038, the defendant railroad collected only approximately \$700,000 annually under the challenged rate.

²⁰ Montana Rail Link, Inc. and Wisconsin Central Ltd., Joint Petition for Rulemaking with Respect to 49 C.F.R. Part 1201, 8 I.C.C.2d 625, 628 (1992).

practical effects of imposing such an accounting/record-keeping requirement on smaller railroads.²¹

We understand that precision in rail costing is a desirable goal, but “the best should not be the enemy of the good [and we should not allow] the infeasible perfect to oust the feasible good.”²² Therefore, we must balance the costs and other burdens against the degree of precision to be achieved in handling our rate case docket. We have had to sacrifice some accuracy for simplicity where necessary to ensure that our rate complaint processes are accessible to shippers. Towards that end, we have adopted simplified evidentiary procedures for adjudging rate reasonableness in those cases where more sophisticated procedures are too costly or burdensome, “to ensure that no shipper is foreclosed from exercising its statutory right to challenge the reasonableness of rates charged on its captive traffic.”²³ More recently, we have simplified the market dominance phase of rail rate complaints by excluding product and geographic competition from consideration, “so as to remove a substantial obstacle to the shippers’ ability to exercise their statutory rights.”²⁴ It follows that railroads should also not be subjected to inordinate adjudicatory expenses that could effectively foreclose them from exercising their statutory right to defend their rates when challenged.

Moreover, given our recent experience with this issue, it is evident that we could obtain URCS cost data from a non-Class I defendant railroad only by holding a proceeding in abeyance for a minimum of a year.²⁵ Such delays seem inappropriate, given the express intent of Congress to

²¹ While rate complaints involving non-Class I carriers have been infrequent, there could be more in the future in the wake of our determination in Central Power & Light Co. v. Southern Pac. Transp. Co., 1 S.T.B. 1059 (1996), clarified, 2 S.T.B. 235 (1997), aff’d sub nom. MidAmerican Energy Co. v. STB, 169 F.3d 1099 (8th Cir. 1999), cert. denied sub nom. Western Coal Traffic League v. STB, 1205 S.Ct. 372 (1999), and the court’s holding in Union Pac. R.R. v. STB, 202 F.3d 337 (D.C. Cir. 2000), that a bottleneck-segment rate can be separately challenged if the non-bottleneck portion of through transportation is provided under contract. Thus, small carriers that provide origin or termination bottleneck service may be more likely to face challenges to the level of their bottleneck-segment rates than they have in the past.

²² Pennsylvania v. ICC, 535 F.2d 91, 96 (D.C. Cir.), cert. denied, 429 U.S. 834 (1976).

²³ Rate Guidelines—Non-Coal Proceedings, 1 S.T.B. at 1008.

²⁴ Market Dominance Determinations—Product & Geographic Competition, 3 S.T.B. at 949.

²⁵ Even after a carrier collects a year’s worth of data, there could well be disputes as to whether the data collected during that period was representative of the variable costs. While the intent of our accounting/record-keeping order in Docket No. 42038 was to develop the best

(continued...)

expedite rail rate cases, see 49 U.S.C. 10101(15). Further, we believe that all parties benefit from procedures that do not require a delay of more than a year awaiting the one-time collection of special data needed only for a particular rate adjudication. Therefore, absent the submission of a practical alternative, we intend to return to a policy of determining non-Class I railroads' variable costs using readily available regional URCS cost data of Class I carriers.

While it is true that a non-Class I carrier's costs and those of the Class I carriers operating in either the Eastern or Western United States could differ, those differences potentially can be limited by substituting available data of the defendant non-Class I railroad for data in the regional URCS.²⁶ Therefore, in addition to soliciting comments on the propriety of using regional average Class I costs to estimate the variable costs of non-Class I carriers, we also welcome suggestions on how the URCS costs of such carriers can practically be adjusted to better reflect the operations of non-Class I railroads.

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

We tentatively conclude that our action will not have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act.

²⁵(...continued)

estimate of variable costs, we recognized that reliance on a single year of data had potential pitfalls. As noted in our order, URCS uses as much as 5 years of data to develop variable costs. Because it is likely that certain expenses used to develop variable costs would vary from year to year, the argument could be advanced that variable costs constructed from only one-year's worth of data are unrepresentative. Indeed, depending on the level of variable costs developed from only one-year's worth of data, one party or the other would likely perceive a litigation advantage from arguing that the results are not representative.

²⁶ For example, the regional URCS could be adjusted to reflect the actual car type and ownership, number of locomotives, wages, and switching characteristics.

It is ordered:

Comments of all interested parties are due July 1, 2002. Replies, if any, by interested parties are due July 31, 2002.

By the Board, Chairman Morgan and Vice Chairman Burkes.

Vernon A. Williams
Secretary