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SURFACE TRANSPORTATION BOARD

DECISION

STB Ex Parte No. 646 (Sub-No. 1)

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

Decided: July 26, 2006

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BY THE BOARD:

In 1995, Congress directed the Board to “establish a simplified and expedited method for determining the reasonableness of challenged rail rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case.” 49 U.S.C. 10701(d)(3). In 1996, the Board adopted the guidelines set forth in Rate Guidelines – Non-Coal Proceedings, 1 S.T.B. 1004 (1996) (Simplified Guidelines). A decade has passed, however, without any shipper presenting a case that has been decided under Simplified Guidelines.¹ The Board held public hearings in April 2003 and July 2004 to examine why those guidelines have not been used by shippers and to explore ways to improve those guidelines.² The Board heard the views of rail shippers, railroads, rail labor, state governments, and other parts of the federal government. In general, the shipper community perceives those guidelines as too vague, and as requiring prolonged litigation over whether a shipper even qualifies to use them. Parties urged changes to make the process more workable, but they disagreed on what those changes should be.

We continue to pursue changes to the simplified guidelines that would achieve the dual statutory goals of providing captive shippers meaningful access to regulatory remedies for rail rates that are unreasonable, while recognizing the need for railroads to earn a reasonable return on their investments so that they will have the resources to make the investment needed to continue to serve the transportation needs of their customers. Therefore, we now propose to:

1. Create a simplified stand-alone cost (Simplified-SAC) procedure to use in *medium-size rate disputes* for which a full stand-alone cost (Full-SAC) presentation is too costly, given the value of the case.
2. Retain the “Three-Benchmark” method of Simplified Guidelines, with certain modifications and refinements, for *small rate disputes* for which even a Simplified-SAC presentation would be too costly, given the value of the case.
3. Establish *eligibility presumptions* based on the maximum value of the case to distinguish between large, medium-size, and small rail rate disputes.

We set forth below a basic overview of our current rate reasonableness standards and our proposals to modify Simplified Guidelines.

¹ In one instance, a shipper filed a case under Simplified Guidelines, but the parties settled the dispute, with the assistance of Board mediation, before presenting any evidence. BP Amoco Chem. Co. v. Norfolk S. Ry., STB Docket No. 42093 (STB served June 28, 2005).

² See Rail Rate Challenges In Small Cases, STB Ex Parte No. 646 (STB served June 29, 2004) (notice of 2004 public hearing); Rail Rate Challenges In Small Cases, STB Ex Parte No. 646 (STB served Mar. 26, 2003) (notice of 2003 public hearing).

CURRENT RATE REASONABLENESS STANDARDS

Regulatory Framework

Where a railroad has market dominance, its transportation rates for common carrier service must be reasonable. 49 U.S.C. 10701(d)(1), 10702. Market dominance is defined as an absence of effective competition from other rail carriers or modes of transportation for the transportation to which a rate applies. 49 U.S.C. 10707(a). The Board is precluded, however, from finding market dominance if the revenues produced by a challenged rate are less than 180% of the carrier's "variable costs" of providing the service. 49 U.S.C. 10707(d)(1)(A). Variable costs are the portion of railroad costs that have been determined to vary with the level of traffic, using the Board's Uniform Rail Costing System (URCS).³

Only the Board may determine if a common carrier rate is unreasonable.⁴ 49 U.S.C. 10501(b). When a complaint is filed, the Board may investigate the reasonableness of the challenged rate, 49 U.S.C. 10704(b), 11701(a), or dismiss the complaint if it does not state reasonable grounds for investigation and action. 49 U.S.C. 11701(b). If, after a full hearing, the Board finds a challenged rate unreasonable, it will order the railroad to pay reparations to the complainant for past movements, 49 U.S.C. 11704(b), and may prescribe the maximum rate the carrier is permitted to charge, 49 U.S.C. 10704(a)(1). However, the Board may not set the maximum reasonable rate below the level at which the carrier would recover 180% of its variable costs of providing the service.⁵

In examining the reasonableness of a rate, the Board is guided by the multifaceted rail transportation policy set forth at 49 U.S.C. 10101. It must also give due consideration to the "Long-Cannon" factors contained in 49 U.S.C. 10701(d)(2)(A)-(C).⁶ And the Board must recognize that rail carriers should have an opportunity to earn "adequate revenues." 49 U.S.C. 10701(d)(2). Adequate revenues are defined as those that are 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 in amounts adequate to provide a sound rail transportation system. 49 U.S.C. 10704(a)(2).

³ See Adoption of the Uniform Railroad Costing System As A General Purpose Costing System For All Regulatory Costing Purposes, 5 I.C.C.2d 894 (1989) (Adoption of URCS).

⁴ The Board does not have regulatory authority over rates established in a rail transportation contract entered into by the railroad and shipper. See 49 U.S.C. 10709(c).

⁵ Burlington N. R.R. v. STB, 114 F.3d 206, 210 (D.C. Cir. 1997) (Burlington); West Texas Util. v. Burlington N. R.R., 1 S.T.B. 638, 677-78 (1996) (West Texas).

⁶ The Long-Cannon factors direct the Board to give due consideration to (a) the amount of traffic which is transported at revenues which do not contribute to going concern value and the efforts made to minimize such traffic; (b) the amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic; and (c) the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues.

In 1995, Congress enacted legislation,⁷ which added a new provision to the rail transportation policy calling for the “expeditious handling and resolution of all proceedings.” 49 U.S.C. 10101(15). It further instructed the Board to establish procedures to ensure expeditious handling of rail rate challenges in particular, including “appropriate measures for avoiding delay in the discovery and evidentiary phases of such proceedings.” 49 U.S.C. 10704(d). As previously stated, Congress also directed the Board to “establish a simplified and expedited method for determining the reasonableness of challenged rail rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case.” 49 U.S.C. 10701(d)(3).

Constrained Market Pricing Guidelines

The Board’s general standards for judging the reasonableness of rail freight rates, which will continue to be applied to large rail rate disputes, are set forth in Coal Rate Guidelines, Nationwide, 1 I.C.C.2d 520 (1985) (Guidelines), aff’d sub nom. Consolidated Rail Corp. v. United States, 812 F.2d 1444 (3d Cir. 1987). These guidelines adopt a set of pricing principles known as “constrained market pricing” (CMP). The objectives of CMP can be simply stated. A captive shipper should not be required to pay more than is necessary for the carrier involved to earn adequate revenues. Nor should it pay more than is necessary for efficient service. And a captive shipper should not bear the cost of any facilities or services from which it derives no benefit. Guidelines, 1 I.C.C.2d at 523-24.

CMP contains three main constraints on the extent to which a railroad may charge differentially higher rates on captive traffic.⁸ 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.” Id. at 535-36. 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. Id. at 537-42. The stand-alone cost (SAC) constraint protects a captive shipper from bearing costs of inefficiencies or from cross-subsidizing other traffic by paying more than the revenue needed to replicate rail service to a select subset of the carrier’s traffic base. Id. at 542-46.

A SAC analysis seeks to determine whether a complainant is bearing costs resulting from inefficiencies or costs associated with facilities or services from which it derives no benefit; the SAC analysis does this by simulating the competitive rate that would exist in a “contestable market.” A contestable market is defined as one that is free from barriers to entry. The economic theory of contestable markets does not depend on a large number of competing firms in the marketplace to assure a competitive outcome. Id. at 528. In a contestable market, even a monopolist must offer competitive rates or lose its customers to a new entrant. Id. In other words, contestable markets have competitive characteristics which preclude monopoly pricing.

⁷ See ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803 (1995).

⁸ A fourth constraint – phasing – can be used to limit the introduction of otherwise-permissible rate increases when necessary for the greater public good. Guidelines, 1 I.C.C.2d at 546-47.

To simulate the competitive price that would result if the market for rail service were contestable, the costs and other limitations associated with entry barriers must be omitted from the SAC analysis. *Id.* at 529. This removes any advantages which the existing railroad would have over a new entrant that create the existing railroad's monopoly power. A stand-alone railroad (SARR) is therefore hypothesized that could serve the traffic at issue if the rail industry were free of entry barriers. Under the SAC constraint, the rate at issue cannot be higher than what the SARR would need to charge to serve the complaining shipper while fully covering all of its costs, including a reasonable return on investment. This analysis produces a simulated competitive rate against which we judge the challenged rate. *Id.* at 542.

To make a SAC presentation, a shipper designs a SARR specifically tailored to serve an identified traffic group, using the optimum physical plant or rail system needed for that traffic. Using information on the types and amounts of traffic moving over the railroad's rail system, the complainant selects a subset of that traffic (including its own traffic to which the challenged rate applies) that the SARR would serve.

Based on the traffic group to be served, the level of services to be provided, and the terrain to be traversed, a detailed operating plan must be developed for the SARR. Once an operating plan is developed that would accommodate the traffic group selected by the complainant, the SARR's investment requirements and operating expense requirements (including such expenses as locomotive and car leasing, personnel, material and supplies, and administrative and overhead costs) must be estimated. The parties must provide appropriate documentation to support their estimates.

It is assumed that investments normally would be made prior to the start of service, that the SARR would continue to operate into the indefinite future, and that recovery of the investment costs would occur over the economic life of the assets. The Board's SAC analysis, however, only examines a set period of time – usually 20 years.⁹ The analysis estimates the revenue requirements for the SARR based on the operating expenses that would be incurred over that period and the portion of capital costs that would need to be recovered during that period. A computerized discounted cash flow (DCF) model simulates how the SARR would likely recover its capital investments, taking into account inflation, Federal and state tax liabilities, and the need for a reasonable rate of return. The annual revenues required to recover the SARR's capital costs (and taxes) are combined with the annual operating costs to calculate the SARR's total annual revenue requirements.

The revenue requirements of the SARR are then compared to the revenues that the railroad is expected to earn from the traffic group. There is a presumption that the revenue contributions from non-issue traffic, that is, the traffic of non-complaining shippers, should be based on the revenues produced by the current rates. Traffic and rate level trends for the traffic group are forecast into the future to determine the future revenue contributions from that traffic.

⁹ The appropriate SAC analysis period is being reexamined. See Major Issues in Rail Rate Cases, STB Ex Parte No. 657 (Sub-No. 1), slip op. at 28-31 (STB served Feb. 27, 2006) (Major Issues).

The Board then compares the revenue requirements of the SARR against the total revenues to be generated by the traffic group over the SAC analysis period. Because the analysis period is lengthy, a present value analysis is used that takes into account the time value of money, netting the annual over-recovery and under-recovery as of a common point in time. If the present value of the revenues that would be generated by the traffic group is less than the present value of the SARR's revenue requirements, then the complainant has failed to demonstrate that the challenged rate levels violate the SAC constraint.

If, on the other hand, the present value of the revenues from the traffic group exceeds the present value of the revenue requirements of the SARR, then the Board must decide what relief to provide to the complainant by allocating the revenue requirements of the SARR among the traffic group and over time.¹⁰

Simplified Guidelines

Under Simplified Guidelines, the reasonableness of a challenged rate is to be determined by examining that challenged rate in relation to three benchmark figures. Each benchmark is expressed as a ratio of revenues to variable costs of providing rail service. The revenue-to-variable cost ratio is referred to as an R/VC ratio.

The first benchmark is called RSAM (Revenue Shortfall Allocation Method). As currently designed, this benchmark measures the average markup that the railroad would need to charge all of its "potentially captive" traffic in order for the railroad to earn adequate revenues as measured by the Board under 49 U.S.C. 10704(a)(2). Potentially captive traffic is defined as all traffic priced above the 180% R/VC level – which is the statutory floor for regulatory rail rate intervention.¹¹

The second benchmark is called R/VC_{>180}. As currently designed, this benchmark measures the average markup applied by the defendant railroad on its potentially captive traffic. It can 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.

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.

The Board publishes tables each year showing the most recent RSAM range¹² and the most recent R/VC_{>180} ratio for each Class I railroad, as well as regional averages. The R/VC_{COMP}

¹⁰ The proper method for making that determination is also being reexamined. See Major Issues at 7-17.

¹¹ See 49 U.S.C. 10707(d); Burlington, 114 F.3d at 210; West Texas, 1 S.T.B. at 677-78.

¹² 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 that the railroad would need if it were to replace all of its assets as they wear out. The lower end subtracts out any shortfall related to movements priced below the 100% R/VC level. The lower end is an attempt to capture managerial inefficiencies. In Simplified Guidelines, however, the Board

ratios for appropriate comparison traffic are to be computed after a shipper files a rate complaint, using traffic data from the rail industry Waybill Sample,¹³ and applying URCS costing.

The Board described these three benchmarks as “the starting point for a rate reasonableness analysis, not the end result.” Simplified Guidelines, 1 S.T.B. at 1022. The Board 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.” Id. 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 call as to rate reasonableness in those cases where a more precise determination is not possible.” Id. at 1041.

Simplified Guidelines was challenged in court by the Association of American Railroads (AAR). The court dismissed the appeal, however, without ruling on the lawfulness of those guidelines, because the court concluded that it would benefit from seeing how the guidelines would be applied in a case. See Association of Am. R.R. v. STB, 146 F.3d 942 (D.C. Cir. 1998).

As previously stated, the Board held public hearings in April 2003 and July 2004 to examine why Simplified Guidelines has not been used by shippers and to explore ways to improve those guidelines.¹⁴ Shippers offered a variety of suggestions, mostly to clarify who would qualify to use Simplified Guidelines. They offered other suggestions as well, ranging from mandatory mediation to creating a public advocate office within the Board.

Following the first public hearing, the Board asked for specific suggestions regarding what eligibility test it might adopt and other ways to improve upon Simplified Guidelines. In response, AAR suggested that the Board identify a sub-class of cases brought by “truly small shippers” that would automatically qualify for access under Simplified Guidelines. For all other shippers, AAR proposed that the Board continue the case-by-case eligibility analysis called for in

recognized that an R/VC ratio below 100% does not necessarily reflect improper pricing or a money-losing service. 1 S.T.B. at 1028-29. The precise RSAM benchmark the agency would use was therefore left unresolved, but was expected to fall within this range. Id. at 1029.

¹³ The Waybill Sample is a statistical sampling of railroad waybills that is collected and maintained for use by the Board and by the public (with appropriate restrictions to protect the confidentiality of individual traffic data). See 49 CFR 1244.

¹⁴ At the April 2003 hearing, the following parties submitted testimony: American Chemistry Council (ACC), AAR, Colorado Wheat Administrative Committee (CWAC), The Fertilizer Institute (TFI), Idaho Barley Commission (IBC), Idaho Wheat Commission (IWC), Kansas Wheat Commission (KWC), Montana Wheat and Barley Committee (MWBC), National Grain and Feed Association (NGFA), National Industrial Transportation League (NITL), North Dakota Grain Dealers Association (NDGDA), North Dakota Wheat Commission (NDWC), North Dakota Public Service Commission (NDPSC), South Dakota Wheat Commission (SDWC), United Transportation Union, United States Department of Transportation, Washington Wheat Commission (WWC), and Washington Barley Commissions (WBC). A similar spectrum of parties participated in the July 2004 hearings.

Simplified Guidelines. However, AAR offered no specifics on how to define an automatically qualifying sub-class.

In July 2003, a group of 17 shipper organizations¹⁵ (referred to as the Joint Shippers) also responded to the Board's request. That group stressed the need for a simple, predictable and relatively inexpensive process for resolving small rate cases. To that end, the Joint Shippers advocated creation of a bright-line test for shipper eligibility to use the simplified guidelines, based on the shipper's annual freight bill for the commodity in question between each origin-destination pair. The Joint Shippers also asked the Board to clarify the substantive standard adopted in Simplified Guidelines by explaining how the Board would rule on a series of hypothetical cases posed in their comments. Finally, the Joint Shippers recommended that the Board further simplify and expedite its procedures for handling small rate cases.

At the 2004 hearing, the concerns voiced in the 2003 hearing were reiterated by the same groups of interested shippers, railroads, and public officials.

We agree that revisions to the existing simplified guidelines are warranted. Our proposals and reasons for them are described below.

BOARD PROPOSALS

Our proposals are presented in three parts. **Section I** sets forth our proposal to use a Simplified-SAC method to assess the reasonableness of challenged rates in medium-size rail rate disputes where the cost of a Full-SAC presentation cannot be justified. **Section II** sets forth our refinements to the Three-Benchmark method, which we propose to apply for those rail rate disputes where the value of the case cannot justify even the cost of a Simplified-SAC presentation. **Section III** sets out proposed eligibility criteria to distinguish between large, medium-size, and small rail rate disputes.

I. Methodology for Medium-Size Rail Rate Disputes

CMP, with its SAC constraint, continues to be our preferred and the most accurate procedure available for determining the reasonableness of rail rates where there is an absence of effective competition.¹⁶ The SAC test, which judges the reasonableness of a challenged rate by comparison to the rate that would prevail in a competitive market, rests on a sound economic foundation and has been affirmed by the courts. Under the SAC test, rate relief is available only where a captive shipper demonstrates that it is cross-subsidizing other parts of the defendant's rail network or is bearing the costs of a carrier's inefficient service.

¹⁵ ACC, CWAC, TFI, IBC, IWC, KWC, MWBC, NGFA, NITL, NDGDA, NDWC, NDPSC, SDWC, WWC, WBC, Alliance for Rail Competition, and Consumers United for Rail Equity.

¹⁶ See Simplified Guidelines, 1 S.T.B. at 1021 ("CMP provides the only economically precise measure of rate reasonableness and therefore must be used wherever possible."); see also McCarty Farms, Inc. v. Burlington N., Inc., 3 I.C.C.2d 822, 839-40 (1987); Rate Guidelines – Non-Coal Proceedings, Ex Parte No. 347 (Sub-No. 2), slip op. at 1-2 (ICC served Apr. 8, 1987).

Any simplified methodology for assessing the reasonableness of rail rates should be designed to achieve the same objective, albeit in a less precise manner. In 1996, AAR advocated that the Board use a simplified SAC approach,¹⁷ but at that time the Board was unable to design a feasible way to simplify the SAC test sufficiently to be cost-effective for smaller rail rate disputes. In the court challenge to Simplified Guidelines, AAR argued that the agency had prematurely abandoned the search for a streamlined method consistent with CMP and SAC.¹⁸ AAR has not pursued a simplified SAC approach since then, but the National Industrial Transportation League (NITL) has suggested that the Board “investigate whether a radically simplified SAC is possible.”¹⁹

Our experience and expertise with SAC cases has grown substantially since Simplified Guidelines to the point where it is now possible to craft a Simplified-SAC approach.

In the following discussion, we first describe the mechanics of the Simplified-SAC approach that we propose. We then explain the need to simplify the jurisdictional inquiry by prohibiting movement-specific adjustments to URCS. We next outline a proposed procedural schedule for a Simplified-SAC proceeding. Finally, we set forth our proposal to expedite discovery and resolution of discovery disputes, and to shift the burden of production of certain key information needed for this approach to the railroads.

1. Simplified-SAC

A. *Objectives of a Simplified-SAC Method*

The principal objective of the SAC constraint is to restrain a railroad from exploiting market power over a captive shipper by charging more than it needs to earn a reasonable return on the replacement cost of the infrastructure used to serve that shipper. A second objective of the SAC constraint is to detect and eliminate the costs of inefficiencies in a carrier’s investments or operations.

It is the second objective that turns Full-SAC presentations into an intricate, expensive undertaking. 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

¹⁷ See Simplified Guidelines, 1 S.T.B. at 1014. AAR had proposed a computer model that would start with the existing rail system used to move the complaining shipper’s traffic from origin to destination. The computer model would then expand the SARR to include other traffic that the model deemed profitable. The computer model excluded traffic that would not generate enough revenue to cover a full pro-rata share of the fixed costs of the non-SARR line segments that it would use.

¹⁸ AAR Br. at 14 (filed with the D.C. Circuit Jan. 2, 1998) (“While AAR is not here contesting the rejection of its [simplified SAC] computer model, it is very much contesting the Board’s rejection, without any persuasive explanation, of AAR’s extensive sworn evidence . . . that it is perfectly feasible to develop a low-cost, streamlined approximation of SAC that can be used by small shippers.”).

¹⁹ NITL Apr. 2003 Testimony at 12-14.

expected demand. This requires the complainant to first select an appropriate subset of the railroad's traffic for the SARR to serve, then design an operating plan that shows how an efficient railroad would serve this traffic group, and determine the optimal network configuration. Complex computer programs are needed to model the hypothetical SARR and test the operating plan and configuration against the forecast demand of the traffic group. All these tasks are interrelated, such that changes to the traffic group may require reconfiguring the hypothetical network and revising the operating plan. 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). The time and expense associated with this inquiry dwarfs those needed to examine the replacement cost of the necessary rail infrastructure.

Accordingly, the inquiry under the Simplified-SAC method described below would be limited to whether the captive shipper is being forced to cross-subsidize other parts of the railroad's rail network. Such an approach would be a less precise application of CMP, because it would not identify inefficiencies in the current rail operation. But it would allow us to determine whether a captive shipper is being forced to cross-subsidize parts of the defendant's existing rail network the shipper does not use. To keep this critical inquiry as simple as possible, we would assume that all of the existing infrastructure along the route selected by the complainant would be needed to serve the traffic moving over that route.

We believe this is a reasonable simplifying approach. We recognize that in 1996 the Board rejected a different simplified SAC method that would have required a complainant to replicate the existing infrastructure. Simplified Guidelines, 1 S.T.B. at 1015. But times have changed. Railroads no longer are burdened by substantial excess capacity; rather, the rail industry now faces the opposite situation. Rail capacity is strained, demand for transportation service is forecast to increase, and railroads must make capital investments to meet that demand.

Moreover, while a Simplified-SAC method may not fully implement CMP principles, see id., it more closely tracks CMP than the Three-Benchmark approach. The Simplified-SAC method we propose would assure that a railroad does not earn supra-competitive profits on its investments. As railroads enjoy increasing market power with rising demand for their services, the SAC test (in either its full or simplified form) would provide a critical restraint on their pricing of captive traffic, without deterring railroads from making the investments in their rail networks that are needed to meet rising demand. Indeed, the Simplified-SAC method would incorporate those new capital investments and ensure that the maximum lawful rate includes a reasonable return on the replacement cost of those investments.

We believe that the Three-Benchmark method should be reserved for use only as a last resort, once we have exhausted reasonable measures to simplify the SAC analysis, as CMP with its SAC test remains our preferred method for assessing the reasonableness of a challenged rate where there is an absence of effective competition. See Simplified Guidelines, 1 S.T.B. at 1021 ("Because of [its] roughness, however, the [Three-Benchmark method] must be used as sparingly as possible, reserved for only those cases where CMP is not a realistic option.").

We do not believe using this Simplified-SAC method would create incentives for railroads to make inefficient investments. Our regulatory authority over rail rates is limited and

competition controls the rates for most of a railroad's traffic. Thus, railroads would have little incentive to deliberately gold-plate their rail infrastructure or make inefficient investments to influence the returns and rates this agency would permit under a Simplified-SAC constraint.²⁰ Rather, competition will force railroads to make prudent capital investments to meet forecast increases in demand for transportation services. And even if the management of some railroads is not as economical and efficient as possible, the burden of uncovering and quantifying existing inefficiencies is so substantial as to be impracticable in all but the largest rail rate disputes.

In any event, under this proposal, described in detail below, there would be some limited opportunities for a complainant to eliminate some costs associated with inefficiencies. A complainant could argue that some existing facilities (e.g., track, sidings, yards) along the selected route have fallen into disuse and need not be replicated. Commenters in this rulemaking may suggest other ways to revise the proposed Simplified-SAC method to remove costs associated with inefficiencies. Commenters should keep in mind, however, the ultimate objective here: to craft a *simplified* and *expedited* method for determining whether a railroad is exercising its market power to charge more than necessary to earn adequate revenues.

B. Methodology

The Simplified-SAC presentation we propose would differ 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 would address the replacement cost of the existing facilities used to serve the captive shipper and the return on investment a hypothetical SARR would require to replicate those facilities. We would then seek to determine whether the traffic using those facilities is paying more than needed to cover operating expenses and a reasonable return on the replacement value of those facilities.

To hold down the cost of a Simplified-SAC presentation, various simplifying assumptions and standardization measures are essential. Towards that end, we propose the following:

- *Route*: In its complaint, the shipper would identify its preferred route for the challenged movements. The selected route need not be the route actually used by the railroad for the traffic at issue, but if the selected route has not been used in the prior 12 months for the traffic at issue, the shipper would need to demonstrate that the route selected has sufficient existing capacity to handle the additional traffic.
- *Configuration*: The facilities of the SARR would consist of the existing facilities along the selected route (including all track, sidings, and yards). If a shipper presents compelling evidence that some facilities along the route have fallen into disuse by the railroad, and thus need not be replicated, those facilities would be excluded from the SAC analysis.

²⁰ See Association of Am. Railroads v. ICC, 978 F.2d 737, 741 (D.C. Cir. 1992) (noting that railroads are not a "heavily regulated utility" and most rates are not subject to maximum rate regulation).

- *Test Year*: The Simplified-SAC analysis would examine the reasonableness of the challenged rates based on a 1-year analysis. The Test Year would be the most recently completed four quarters preceding the filing of the complaint.
- *Traffic Group*: The traffic group would consist of all movements that traveled over the selected route in the Test Year. No rerouting of non-issue traffic would be permitted.
- *Cross-Over Traffic*: The revenue from cross-over traffic would be apportioned between the on-SARR and off-SARR portions of the movement based on the revenue allocation methodology used in Full-SAC proceedings.²¹
- *Road Property Investment*: The Board’s findings in prior Full-SAC cases would be used to simplify parts of the road property investment (RPI) analysis. A more detailed discussion of how we propose to simplify the RPI inquiry is set forth in **Appendix A**.
- *Operating Expenses*: The total operating and equipment expenses of the SARR would be estimated using URCS. This would avoid the substantial debates over the operating plans and network configurations that consume much of a Full-SAC analysis. A more detailed discussion is set forth in **Appendix B**.
- *Discounted Cash Flow Analysis*: Only one change is proposed to the way the DCF analysis is used to calculate the capital requirements of a SARR: the comparison of the revenues earned by the defendant railroad to the revenue requirements of the SARR would be shortened to a single year. A more detailed discussion is set forth in **Appendix C**.
- *Internal Cross-Subsidy Inquiry*: The internal cross-subsidy test set forth in PPL,²² as refined in Otter Tail,²³ would be an affirmative defense, with the evidentiary burden of production and persuasion on the railroad.
- *Maximum Reasonable Rate*: The SAC costs (i.e., the revenue requirements of the SARR) would be allocated amongst the traffic group based on the methodology used in Full-SAC cases.²⁴
- *5-Year Rate Relief*: Final future rate prescriptions would not be calculated in a Simplified-SAC proceeding. Instead, where the analysis shows that the challenged

²¹ “Cross-over” traffic refers to movements for which the SARR would not replicate all of the defendant railroad’s current movement, but would instead interchange the traffic with the residual portion of the railroad’s system. The appropriate method to allocate revenue from cross-over traffic in Full-SAC cases is now being addressed. See Major Issues at 17-20.

²² PPL Montana, LLC v. Burlington N. & S.F. Ry., STB Docket No. 42054 (STB served Aug. 20, 2002), aff’d sub nom. PPL Montana, LLC v. STB, 437 F.3d 1240 (D.C. Cir. 2006).

²³ Otter Tail Power Co. v. BNSF Ry., STB Docket No. 42058, slip op. at 11-13 (STB served Jan. 27, 2006) (Otter Tail).

²⁴ The appropriate method for Full-SAC cases is now being reevaluated. See Major Issues at 7-16.

rate was unreasonable in the Test Year, the parties would be instructed to apply the same method to determine the maximum lawful rate for other years, but for not more than a 5-year period (inclusive of any reparations period). The railroad would be required to confer annually with the shipper and re-calculate the maximum lawful rate for that year to reflect the actual changes in traffic volumes, revenues, and URCS costs.²⁵ In this fashion, the maximum rate during the 5-year period would adjust in sync with any business cycles actually experienced by the carrier and with changing operating costs. This part of our proposal is discussed further in **Appendix C**.

Under this Simplified-SAC proposal, if a captive farmer or grain elevator in the Upper Midwest, for example, challenged the rate charged to haul grain to the West Coast for export, it would first identify the route its traffic would flow over the defendant railroad. All other traffic that shared those facilities would be included in the traffic group to defray the capital expenses of that infrastructure. In other words, to the extent the Upper Midwest is a “bridge” region – with large volumes of intermodal and other traffic that neither originates nor terminates in that region, but flows over the rail network to other destinations – that bridge traffic would be included in the SAC analysis and would reduce the contribution needed from the local grain shippers. Operating costs and RPI costs would be estimated as described in **Appendix A** and **Appendix B**. The Simplified-SAC analysis would then determine if that captive shipper was being forced to cross-subsidize parts of defendant carrier’s rail network that the shipper did not use.

Similarly, if a captive chemical shipper in the Gulf Coast challenged rates charged for movements to the West Coast, the SARR would replicate the infrastructure used to serve that traffic, and all traffic (coal, intermodal, manifest) that shared those facilities would be included in the traffic group. The simplified methods for estimating operating cost and RPI described in this decision would then be utilized. If the analysis showed that the defendant carrier was earning unreasonable returns on the facilities used to serve that captive shipper, we would then determine the maximum lawful rate the railroad could charge.

2. Jurisdictional Inquiry

Under the statute, the Board may investigate the reasonableness of a challenged rate only where the revenues the carrier receives for transporting the movements at issue exceed 180% of its variable costs of providing the service. This jurisdictional threshold for rail rate regulation also serves as the floor for regulatory relief, because the Board cannot prescribe a rate below the jurisdictional threshold.²⁶

By statute, a carrier’s variable costs are to be determined using URCS with adjustment only where the Board finds it appropriate. In particular, the statute reads:

²⁵ See, e.g., Wisconsin Power & Light Co. v. Union Pac. R.R., 5 S.T.B. 955, 985 (2001) (instructing the parties to calculate the maximum lawful rate for future movements, which was set by the Board at 180% of the variable cost of the issue movement).

²⁶ See 49 U.S.C. 10707(d); Burlington, 114 F.3d at 210; West Texas, 1 S.T.B. at 677-78.

variable costs for a rail carrier shall be determined only by using such carrier's *unadjusted* costs, calculated using the Uniform Rail Costing System cost finding methodology (or an alternative methodology adopted by the Board in lieu thereof) and indexed quarterly to account for current wage and price levels in the region in which the carrier operates, *with adjustments specified by the Board.*²⁷

In other words, for this jurisdictional inquiry, Congress instructed the parties to use “unadjusted” costs calculated under URCS – the Board’s “general purpose costing system for all regulatory costing purposes”²⁸ – with the decision whether to permit movement-specific adjustments committed to this agency’s discretion.

The URCS model determines, for each Class I railroad,²⁹ what portion of each category of costs shown in that carrier’s Annual Report to the Board (STB Form R-1) represents its system-average variable unit cost for that cost category for that year. URCS consists of a series of computer programs and manual procedures organized into three phases. Phase I compiles the raw data into a useable format, and then uses statistical estimation procedures to determine the proportion of specific expense account groupings that vary with changes in the volume of activity (such as running track maintenance, which varies with gross ton-miles). These relationships are then used in Phase II to develop the unit variable costs that can be used to cost specific rail movements. Finally, Phase III permits expeditious application of these unit costs to the specific movements. This application can be performed using the Phase III program, an interactive computer program that permits the user to enter data for the specific movements under consideration.

In individual cases, parties have sought to make a wide variety of “movement-specific” adjustments. Shippers advocate adjustments that would have the effect of reducing the variable costs and increase the resulting R/VC ratios, while railroads advocate adjustments that would have the opposite effect. The Board has examined each proposed adjustment to determine whether the party proposing the adjustment has shown that its proposed figure would better reflect the variable costs of serving the particular traffic at issue than the URCS system-average figure. As we explained in Major Issues at 23-27, this adjustment-by-adjustment inquiry has been enormously complex and time-consuming, has required substantial discovery, and has produced a hodgepodge of results.

In contrast, calculating variable costs based solely on URCS is a quick and administratively simple process. The advance work is performed by the Board annually, and the Phase III computer program is available to the public at a minimal cost.

²⁷ 49 U.S.C. 10707(d)(1)(B) (emphasis added).

²⁸ Adoption of URCS, 5 I.C.C.2d at 899.

²⁹ A Class I railroad is one with annual operating revenues of at least \$250 million, in 1991 dollars. 49 CFR 1201.

In Major Issues, we have proposed to disallow movement-specific adjustments in all rate cases. But even if we should decide to continue to permit some movement-specific adjustments in large rail rate disputes, we propose to disallow such adjustments in medium-size rail rate disputes, given the need for a less expensive, simplified process for those cases.³⁰ Reducing the expense of this threshold jurisdictional inquiry would increase the number of disputes that could use the Simplified-SAC method.

3. Procedural Schedule

We propose a tight procedural schedule for a Simplified-SAC proceeding, using designated Board staff to assist in resolving discovery disputes and to chair technical conferences. The proposed schedule is set forth below. Under the proposed schedule, if a deadline falls on a weekend or holiday, that deadline would be extended until the next business day, and the remaining deadlines would remain unchanged. The Board would consider deviations from this procedural schedule only upon a good cause showing by the party.

Phase 1	
Complaint (including evidence and argument on eligibility)	Day 0
Complainant Initial Disclosure	Day 0
Answer to Complaint; Reply to Eligibility	Day 20
Railroad Initial Disclosure	Day 20
Complainant Rebuttal on Eligibility	Day 30
Board Decision on Eligibility	Day 50

Phase 2	
Discovery Begins	Day 50
Opening Evidence on Selected Route	Day 80
Railroad Reply on Selected Route	Day 100
Complainant Rebuttal on Selected Route	Day 110
Staff Decision on Route	Day 140
Railroad Second Disclosure	Day 170
Discovery Closes	Day 180

³⁰ The only adjustments allowed to the URCS Phase III program would be those adopted in Ex Parte No. 431 (Sub-No 2). See Review of the General Purpose Costing System, 2 S.T.B. 754 (1997); Review of the General Purpose Costing System, 2 S.T.B. 659 (1997). Those adjustments include the so-called “270” volume shipment adjustments, the make-whole adjustments, TOFC/COFC adjustments, and RoadRailer adjustments. In addition, the circuitry factor is always set to one when actual miles are used to calculate the variable costs.

Phase 3	
Opening Evidence	Day 250
Reply Evidence	Day 310
Rebuttal Evidence	Day 340
Technical Conference (Market Dominance & Merits)	Day 350
Final Briefs	Day 360
Board Decision Within 6 Months Thereafter	

This procedural schedule envisions a decision at three separate stages of a case. Parties would have the opportunity to present evidence and argument in each phase of the case.

In the first phase, the complainant would have to demonstrate that its case is eligible to use the Simplified-SAC method. The railroad would have the opportunity to argue in its answer whether or not the case is eligible for the Simplified-SAC method. The Board would decide that threshold issue within 50 days of the filing of the complaint.

In the second phase, designated Board staff would have authority to resolve any disputes over the route of the SARR, if the complainant proposes to base its case on a different route than the carrier uses for the issue traffic. If the parties agree on the route, the Phase II inquiry would be unnecessary, but the discovery deadlines would still apply and the Phase III deadlines would not change.

Once the route (and thus the configuration and traffic group) of the SARR have been set, the parties would submit their evidence, in the third phase, on both the issue of market dominance (i.e., whether the Board has authority under 49 U.S.C. 10707 to rule on the reasonableness of the rate) and the merits of the case.

If the traffic at issue is part of a class of traffic that has been exempted from Board regulation pursuant to 49 U.S.C. 10502(a), the complainant would need to include with its complaint a separate request for a partial revocation of the pertinent class exemption for the traffic at issue pursuant to 49 U.S.C. 10502(d). The railroad would need to file with its answer a separate response to that request. Evidence would continue to be submitted under the schedule set forth above while the Board considered the request.

4. Discovery

To streamline the discovery process in medium-size cases, we propose certain standardized discovery that would be required to be produced with the complaint and answer, as well as the use of technical conferences to resolve factual disputes early. These and other proposals are set forth below.

Staff Conferences. As has been our practice in Full-SAC cases, we propose to use designated Board staff to facilitate voluntary resolution of discovery disputes and to conduct technical conferences. The designated Board staff would act as a mediator to facilitate settlement of matters that are the subject of those conferences.

Meet and Confer Requirement. We propose that parties meet and confer on discovery and procedural matters within 7 business days after the Board determines that a case is eligible for handling under the Simplified-SAC method. As soon as possible, the parties would be required to inform the Board whether there are unresolved disputes that require Board intervention and, if so, the nature of those disputes.

Complainant's Initial Disclosures. The complainant would be required to provide certain initial disclosures concurrent with the filing of its complaint. At that time, the shipper would provide to the railroad its preliminary estimate of the variable cost of the challenged movements, using the unadjusted figures produced by the URCS Phase III program. This would require the complainant to identify the following annual characteristics of each movement covered by the complaint in order to calculate the variable cost of the challenged movements: (1) the carrier or region identifier; (2) the type of shipment (local, received-terminated, etc.); (3) the one-way distance of the shipment; (4) the type of car (by URCS code); (5) the number of cars; (6) the car ownership (private or railroad); (7) commodity type (STCC code); (8) the weight of the shipment (in tons per car); and (9) the type of movement (individual, multi-car, or unit train). The complainant would also be required to provide to the railroad all documents that it relied upon to determine the inputs to the URCS Phase III program. In addition, the complainant would be required to include with its complaint a narrative addressing whether there is any feasible transportation alternative for the challenged movements, and to disclose to the railroad all documents relied upon in formulating that assessment.

Railroad's Initial Disclosure. The railroad would likewise be required to provide initial disclosures to the complainant concurrent with filing its answer. Like the shipper, the railroad would need to produce its preliminary estimate of the variable cost of each challenged movement, using the unadjusted figures produced by the URCS Phase III program. And the railroad would be required to provide to the complainant all documents that it relied upon to determine the inputs used in the URCS Phase III program.

Railroad's Second Disclosure. Once the Board has resolved any disputes over the route of the SARR, the railroad would be required to provide the following additional information to the complainant:

- Identification of all traffic that moved over the routes replicated by the SARR in the Test Year;
- Information about those movements, in electronic format, aggregated by origin-destination pair and shipper, showing the origin, destination, volume, and total revenues from each movement;
- Total operating and equipment cost calculations for each of those movements, computed in accordance with **Appendix B**, and provided in electronic format, so the complainant can readily estimate the total operating and equipment costs of the SARR;

- Revenue allocation for the on-SARR portion of each cross-over movement in the traffic group, developed in accordance with the methodology used in Full-SAC cases, provided in electronic format; and
- All workpapers and documentation necessary to support these calculations.

Motions to Compel. Motions to compel would be governed by 49 CFR 1114.31 (a)(2)-(4). Any appeals to the Chairman of a ruling by Board staff on a motion to compel would be due within 3 business days of the ruling. Replies to the appeal would be due within 3 business days after the appeal is filed. Criteria set forth in 49 CFR 1115.9(a) would govern the standard of review for such interlocutory appeals.

II. Methodology for Small Rail Rate Disputes

For some shippers who have small disputes with a carrier, even this Simplified-SAC method would be too expensive, given the small value of their cases. These shippers must also have an avenue to pursue relief. Accordingly, we would retain the Three-Benchmark method for those shippers, with refinements to lessen the uncertainties of the existing method.

We propose the following changes to the method described in Simplified Guidelines:

- *R/VC_{COMP}*: use a final-offer procedure to select the comparison group most similar in the aggregate to the challenged movement;
- *RSAM*: use an unadjusted RSAM figure and revise the way this benchmark is calculated;
- *R/VC_{>180}*: change the way this benchmark is calculated and re-name it as R/VC_{total} ;
- *Rate Reasonableness Determination*: adjust each movement in the comparison group by the ratio of $RSAM \div R/VC_{total}$, calculate a “confidence interval” around the estimate of the mean of the adjusted comparison group, and find unreasonable a challenged rate that is above this confidence interval;³¹
- *Variable Cost Calculations*: use only unadjusted URCS to calculate the variable cost of the issue movement and all movements in the comparison group;
- *Procedural Schedule*: use a two-phase procedural schedule under which eligibility is determined within 50 days, and a final decision on the merits within 1 year of the date of the complaint;

³¹ A “confidence interval” is a statistical term. It reflects an attempt to quantify the uncertainty in a measurement, such as the uncertainty in the measurement of the comparison group. The interval will show an upper and lower bound, which is the range of values within which one can be 90% or 95% sure that the true measurement lies. A broad confidence interval indicates lower precision and more uncertainty, while a tight confidence interval reflects greater precision and less uncertainty.

- *Discovery*: streamline the discovery process and provide for staff conferences and initial disclosures by both parties; and
- *Waybill Sample*: provide for the automatic release of certain (masked) Waybill Sample data upon a finding that the complainant is eligible to use the Three-Benchmark method.

We discuss each of these changes in turn.

1. Comparison Group – Final Offer

Under this proposal, the shipper and railroad would simultaneously tender their initial evidence regarding an appropriate comparison group. The movements would be drawn from the Waybill Sample provided to the parties by the Board. Shortly after receipt of the initial tenders, designated Board staff would convene a technical conference with the parties to discuss and attempt to resolve any disputes as to the appropriateness of movements in the comparison groups.

Each party would then tender its “final offer” group of movements it believes should comprise the comparison group. Only movements that had previously been submitted by one of the parties in its initial tender could be included in the final offer groups. In other words, each party could select its final comparison group only from movements contained either in its first tender or in the first tender of the other side. Any movement set forth in both sides’ initial tenders would be required to be included in each side’s final comparison group, unless the parties agreed to exclude the movement.

After the submission of the final offer comparison groups, each party would be given an opportunity to challenge the other party’s comparison group and support its own in simultaneous rebuttal filings. The Board would then select the comparison group that it concludes is most similar in the aggregate to the issue movements. Comparability would be determined by reviewing a variety of factors, such as length of movement, commodity type, terrain involved, and other factors which could affect demand characteristics and operating costs. See Simplified Guidelines, 1 S.T.B. at 1035 n.90 (a properly selected comparison traffic will have a similar degree of demand elasticity). However, the analysis and arguments must rest on publicly available information or on (non-rate) information provided in the Waybill Sample.

The Board would then select one of the two groups as the most reasonable comparison group, which would then be used to calculate the R/VC_{COMP} benchmark. This would be an “either/or” selection, with no modifications by the Board.³² Generally, the Board does not simply select one party’s evidence or another’s in rate reasonableness inquiries, given our role as the guardian of the public interest.³³ In this case, however, we believe that a final offer procedure for determining the comparison group is in the public interest. This approach should encourage both parties to submit a reasonable comparison group. Any final tender that is skewed

³² See BP Amoco Chem. Co. v. Norfolk S. Ry., STB Docket No. 42093, slip op. at 11-12 (STB served June 6, 2005) (BP Amoco).

³³ See Public Serv. Co. of Colo. d/b/a Xcel Energy v. Burlington N. & S.F. Ry., STB Docket No. 42057, slip op. at 3-6 (STB served Jan. 19, 2005).

too far in one direction might well result in the selection of a more reasonable final tender presented by the opposing party. By having two rounds of simultaneous tenders and a technical conference, both sides would participate in the winnowing process. Each side therefore should be able to provide a reasonable final offer comparison group, even if the two sides' groups differ. Thus, the Board would only have to determine which group is more reasonable. This should enable a prompt, expedited resolution of the comparison group selection. This approach will work as intended only if the parties know that the agency will not attempt to find a compromise position somewhere in the middle. To create the proper incentives for the litigants not to take extreme positions, we must commit to selecting the more reasonable of the two groups as tendered.

2. RSAM Range

The RSAM benchmark is intended to measure the average markup above variable cost that the carrier would need to charge to meet its own revenue needs. However, when Simplified Guidelines were adopted in 1996, the Board did not settle on a single formula for computing this benchmark. The Board explained that it “[did] not believe that the industry ha[d] yet become so efficiently sized that all of its current assets were used and useful and would warrant replacement as they wear out,” and it suggested that the necessary revenue contribution was therefore less than what would be needed to provide for the replacement of all existing assets. Simplified Guidelines, 1 S.T.B. at 1029. Accordingly, the Board decided to look at the effect on a carrier’s revenue needs of subtracting out any shortfall related to movements priced below the 100% R/VC level, which the Board referred to as a “managerial efficiency adjustment,” even though the Board acknowledged that an R/VC ratio below 100% does not necessarily reflect improper pricing or a money-losing service. Id. at 1028. The end result was publication of an RSAM range that would form “the relevant starting range for [the Board’s] consideration.” Id. at 1030. Therefore, the RSAM benchmark the agency would use in a particular case was left unresolved, but was expected to fall within this range.

The substantial uncertainty surrounding what RSAM benchmark would be used in a particular case does not appear justified for several reasons. First, the concern that a railroad may elect not to replace some assets as they wear out does not appear to support a managerial efficiency adjustment. If a carrier makes a prudent investment in a rail line or facility that will last many years, it should be entitled to earn a reasonable return on the depreciated value of that investment over the entire life of that asset, even if it might elect not to replace that asset when it wears out. Congress defined adequate revenues as the level of revenues “that are adequate, under honest, economical, and efficient management, to cover operating expenses, including depreciation *and obsolescence*, plus a reasonable and economic profit or return (or both) on capital employed in the business.” 49 U.S.C. 10704(a) (emphasis added).

Second, the Board’s 1996 assessment of the state of the rail industry’s assets is outdated. There is no longer significant excess capacity in the rail industry. Indeed, the rail service crisis in the western United States in the late 1990’s was directly related to outdated and insufficient

infrastructure.³⁴ And concerns have been expressed about inadequate rail infrastructure in recent Congressional testimony.³⁵

Finally, the amount of revenue shortfall attributed to traffic with an R/VC ratio below 100% cannot provide a reasonable approximation or useful surrogate for other inefficiencies in a carrier's system. Simplified Guidelines, 1 S.T.B. at 1029. And any attempt to measure carrier-specific inefficiencies under the Three-Benchmark method would add undue cost and complexity to an inquiry that must necessarily sacrifice some precision to achieve simplicity.

We are mindful that, when determining whether a rate is reasonable, the Board should give "due consideration" to the amount of traffic transported at revenues that do not contribute to going concern value and the efforts made to minimize such traffic.³⁶ But we see no feasible way to incorporate such an analysis into a method for resolving small rate disputes without raising litigation expenses and rendering the "simplified" method too expensive. The mere fact that a movement is below URCS variable costs – an intermediate/long-run variable cost measure – does not mean that the revenues from the movement do not contribute to going concern value, which is a short-run cost measure. And we believe that in today's marketplace of tight rail capacity a railroad is not likely to carry any traffic that does not contribute to going concern value. But even if there are some such rare instances, we cannot provide for broad-based discovery on the railroads to unearth evidence of such traffic without adding significant additional costs.

For all these reasons, we propose to publish and use a single, unadjusted RSAM figure.

3. Method To Calculate RSAM And R/VC_{total}

We also propose to change the way RSAM and $R/VC_{>180}$ are calculated to address a flaw in the existing method. Currently, RSAM is calculated by computing the uniform mark-up above variable cost that would be needed from every shipper of potentially captive traffic (i.e., traffic priced above the 180% R/VC level) "in order for the carrier to recover all of its URCS fixed costs." Simplified Guidelines, 1 S.T.B. at 1027.³⁷ When a carrier is not "revenue adequate" under the Board's annual calculations, its RSAM figure (what it needs to collect) should be greater than its $R/VC_{>180}$ figure (what it is actually collecting). Conversely, when a carrier is revenue adequate under that determination, its RSAM figure should be lower than its $R/VC_{>180}$ figure.

³⁴ See Joint Petition for Service Order, STB Service Order No. 1518 (STB served Feb. 25, 1998).

³⁵ E.g., Coal-Based Generation Reliability, Hearing Before the Senate Committee on Energy and Natural Resources, May 25, 2006.

³⁶ 49 U.S.C. 10701(d)(2)(A); see generally Arkansas Power & Light Co., et al. – Petition to Institute Rulemaking Proceeding – Implementation of Long-Cannon Amendment To The Staggers Rail Act, 365 I.C.C. 983 (1982).

³⁷ The method for calculating RSAM was explained in detail in the appendices in Rate Guidelines – Non-Coal Proceedings, Ex Parte No. 347 (Sub-No. 2) (ICC served Nov. 16, 1992).

But this relationship between RSAM and $R/VC_{>180}$ does not hold true under our current calculations. For example, the 2002 RSAM and $R/VC_{>180}$ figures show that the unadjusted RSAM figure for the Norfolk Southern Railway Company (NS) (216%) was less than its $R/VC_{>180}$ figure (221%), suggesting that NS was revenue adequate.³⁸ Yet NS was not revenue adequate in that year.³⁹ The opposite, erroneous relationship between RSAM and $R/VC_{>180}$ can be seen in the most recent calculations, where the relationship between RSAM and $R/VC_{>180}$ would indicate that NS was revenue inadequate in 2004, even though NS in fact earned the target rate of return (the railroad industry's average cost of capital) that year.⁴⁰

To address this situation, we propose to alter these two calculations so that they would reflect all traffic (not just traffic priced above the 180% R/VC level) and would be based on publicly available data.⁴¹ Each Class I railroad files an annual report with the Board that provides its total freight revenues for that year.⁴² URCS provides the carrier's total variable expenses for the same year.⁴³ We propose to use these annual reports and our annual revenue adequacy findings to calculate these two benchmarks. R/VC_{total} (renamed because it would examine system-wide R/VC levels) would be derived from the total revenue reported to the Board (REV_{total}) and the total variable costs of the railroad (VC_{total}). R/VC_{total} would be calculated as follows:

³⁸ See Rate Guidelines – Non-Coal Proceedings, STB Ex Parte No. 347 (Sub-No. 2) (STB served May 21, 2004).

³⁹ See Railroad Revenue Adequacy – 2002 Determination, STB Ex Parte No. 552 (Sub-No. 7) (STB served July 2, 2003). In Simplified Guidelines, the Board had noted the same anomalous result for two of the then-Class I carriers. 1 S.T.B. at 1043 n.115. The Board stated that this was because “the unadjusted RSAM measure differs somewhat from our annual revenue adequacy calculation. For example, the unadjusted RSAM excludes costs that are not associated with ongoing rail operations and thus should not be borne by captive shippers through differential pricing.” *Id.* It is now clear, however, that this is not the source of the anomaly, as even when there are no special costs to take into account, the expected relationship between the RSAM and the $R/VC_{>180}$ figures for a carrier may not hold true.

⁴⁰ See Rate Guidelines – Non-Coal Proceedings, STB Ex Parte No. 347 (Sub-No. 2) (STB served Apr. 25, 2006); Railroad Revenue Adequacy – 2004 Determination, STB Ex Parte No. 552 (Sub. No. 7) (STB served Nov. 23, 2005).

⁴¹ The current benchmarks are drawn from data in the Waybill Sample, which includes movements governed by confidential rail transportation contracts. Carriers are permitted to mask the revenue information for a contract movement, but must provide an encryption key to the Board. It is not the agency's practice to disclose the unmasked revenue information to parties. However, without access to the *unmasked* Waybill Sample, parties would have no means of independently verifying the current RSAM and $R/VC_{>180}$ calculations.

⁴² Total actual revenue earned by a carrier would be the sum of all revenues from line 13 of Schedule 210 of the R-1. The total revenue needed to earn the target return rate would be the adjusted net investment of a carrier multiplied by the railroad industry's average cost of capital.

⁴³ See Line 614 of the Board's annual URCS run, available to the public upon request.

$$R/VC_{\text{total}} = REV_{\text{total}} \div VC_{\text{total}}$$

To calculate RSAM, we would add to the numerator the carrier's revenue shortfall (or subtract any overage) shown in our annual revenue adequacy determination ($REV_{\text{short/overage}}$). RSAM would then be calculated as follows:

$$RSAM = (REV_{\text{total}} + REV_{\text{short/overage}}) \div VC_{\text{total}}$$

Recalculated in this manner, the ratio of RSAM to R/VC_{total} would more accurately reflect how far the railroad is over or under the revenue adequacy target.

For example, under this proposal the 2004 RSAM and R/VC_{total} benchmarks for NS would be derived as follows. The total revenues reported by NS in 2004 were \$7,311,869,000 (REV_{total}) and its total URCS variable costs for the same year were \$5,415,165,000 (VC_{total}). Dividing the revenues earned by the total URCS variable costs produces an R/VC_{total} of 135%.

To calculate RSAM, we must calculate the revenue shortfall or overage from our annual revenue adequacy determination. In 2004, NS had a total investment base of \$11,141,510,000, and the industry cost of capital was 10.1%, such that the required net return on investment was \$1,125,293,000. In 2004, NS's net return on investment was \$1,295,945,000, creating a revenue overage of \$170,652,000 ($REV_{\text{short/overage}}$). Subtracting this overage from the revenues NS earned in 2004, and dividing by the total URCS variable costs, produces an RSAM of 132%. The RSAM and R/VC_{total} calculations for the other Class 1 carriers are set forth below in **Table 1**.

Because, as discussed *infra*, we propose to use the relationship between RSAM and R/VC_{total} as a ratio by which to adjust the level of the comparison movements, it would seem to be both unnecessary and improper to include only traffic priced above the 180% R/VC level.⁴⁴ The existing approach places responsibility for the entire shortfall (or overage) on only the traffic with an R/VC ratio above 180%. While one could argue that only rates for such potentially captive traffic could be increased to achieve revenue adequacy, the current rate practices of the railroads suggest otherwise, as they have raised rates on competitive traffic as demand for rail transportation has increased. Moreover, railroads presumably maximize profits on all their traffic, whether competitive or captive, such that there is no money deliberately "left on the table." Therefore, it seems proper, and more consistent with the Long-Cannon factors (49 U.S.C. 10701(d)(2)(A)-(C)), to allocate responsibility for a carrier's revenue shortfall amongst all the traffic it carries.

Table 1 shows the impact of these proposed changes on the relationship between the two benchmarks for a sample year (2004). In a rate case, we would not rely on the figures from a single year, but would continue to use a 4-year average.

⁴⁴ Nor would it be proper to tailor the R/VC_{total} benchmark to focus on specific subsets of the carrier's traffic, as was suggested in Simplified Guidelines, 1 S.T.B. at 1038. That is the role of the R/VC_{COMP} benchmark. Thus, we propose to use just the published R/VC_{total} benchmark with no adjustments.

Table 1
Benchmark Comparison (2004)

Railroad	Current Approach (with range)			Proposed Approach (as recalculated)		
	RSAM (1)	R/VC _{>180} (2)	Ratio (3)=(1)÷(2)	RSAM (4)	R/VC _{total} (5)	Ratio (6)=(4)÷(5)
BNSF	215 - 266	234	0.92 - 1.14	139	130	1.07
CSXT	254 - 292	197	1.29 - 1.48	137	124	1.10
GTC	322 - 375	233	1.42 - 1.60	151	134	1.12
KCS	241 - 298	259	0.93 - 1.15	146	142	1.03
NS	197 - 226	212	0.93 - 1.07	132	135	0.98
SOO	234 - 331	261	0.90 - 1.27	148	132	1.12
UP	245 - 306	210	1.17 - 1.46	136	124	1.10

4. Rate Reasonableness Determination

In Simplified Guidelines, 1 S.T.B. at 1041, the Board described how it would apply the three benchmarks as follows:

[T]he three benchmarks are only a starting point for our analysis. They can and should be supplemented, as appropriate, with any particularized evidence that would qualify or modify what one or more benchmarks might otherwise indicate. We are confident that a careful analysis of these three benchmarks, together with whatever supplementary evidence is provided in a case, should enable us to meet our modest objective – to make at least a rough call as to rate reasonableness in those cases where a more precise determination is not possible.

The shipper community has asked for more guidance on how this standard would be applied. They state that they do not expect complete certainty of the outcome, but rather seek enough guidance to make an informed estimate of possible outcomes before filing a complaint.

We offer the following proposal. Once the Board finds that the railroad has market dominance over the movements at issue, it would select the appropriate comparison group through the final-tender process described above. Each movement in the comparison group would then be adjusted by the ratio of $RSAM \div R/VC_{total}$, which would serve as a revenue-need adjustment factor.⁴⁵ The Board would then calculate the mean and standard deviation of the

⁴⁵ See Simplified Guidelines, 1 S.T.B. at 1042. If the comparison group included movements from different carriers, the appropriate $RSAM \div R/VC_{total}$ ratio for the carrier involved would be applied to each movement. If a movement is handled by more than one carrier, we would use a weighted average of the ratios of the carriers involved, weighted by the distance carried by each carrier.

R/VC ratios for the adjusted comparison group (weighted in accordance with the proper sampling factor).

If the challenged rate is above a reasonable confidence interval around the estimate of the mean for the adjusted comparison group, it would be deemed unreasonable and the maximum lawful rate would be prescribed at that boundary level. Using the mean (R/VC_{COMP}) and standard deviation (S) of the adjusted comparison group, along with the number of movements in the comparison group (n), the upper boundary of a reasonable confidence interval around the estimate of the mean would be derived as follows:⁴⁶

$$\text{upper boundary} = R/VC_{COMP} + t_{n-1} \times (S \div (n-1)^{1/2})$$

This confidence interval would be a function of the number of movements in the comparison group and the standard deviation of those adjusted R/VC ratios. A small standard deviation or large number of observations would produce a tighter confidence interval, so that we could have more “confidence” in the accuracy of our estimate of the mean of the comparison group.

We believe it is a permissible simplifying measure, in the absence of any other suitable measure, to deem a rate unreasonable if it is above a reasonable confidence interval around the adjusted mean of the comparison group. A comparison group would provide a range of rates, as in a simplified proceeding we cannot possibly gather sufficient evidence to hold constant all factors that account for differences in rates. Moreover, if a carrier is not currently revenue adequate, one can presume that the carrier is not (on average) charging its potentially captive traffic as much as the statute would permit. In that circumstance, the revenue adequacy adjustment (the ratio of $RSAM \div R/VC_{total}$) would raise the R/VC ratios of the comparison group

⁴⁶ This formula for a confidence interval around a mean can be found in most statistics textbooks. See, e.g., Robert V. Hogg and Allen T. Craig, Introduction to Mathematical Statistics at 214 (4th ed. 1978). We propose using a “one-sided” hypothesis test, such that we can have 90% confidence as to whether the challenged rate exceeds a reasonable norm. We use a “one-sided” test because we are interested in whether the issue movement is above the mean. (If we were interested in whether the issue movement was above or below the mean, we would use a “two-sided” hypothesis test.) A 90% confidence interval is a standard level of confidence used in statistical analysis. The parameter t_{n-1} will range from 3.078 to 1.28 depending on the number of movements in the comparison group. The precise number can be found in statistical tables for the Student T Distributions. See, e.g., William H. Green, Econometric Analysis at 731 (2nd ed. 1993).

We understand that the confidence interval around a mean drawn from a finite population, in this case actual rail movements, is also a function of the portion of the population sampled. Furthermore, by truncating the population from which the comparison group is drawn, we may distort modestly the confidence interval. We believe, however, that use of the formula set forth above is sufficiently precise for our purposes.

If parties propose alternative statistical tests, we caution them not to turn what is intended to be a streamlined, simplified method for resolving small rate disputes into a battle between competing statisticians.

by a measure of the average revenue shortfall. We could then assume that the adjusted R/VC ratios would fairly reflect the maximum lawful rates the carrier could charge those potentially captive movements. While this is admittedly a crude adjustment, “because precision must be sacrificed for simplicity, any simplified procedures will necessarily be very rough and imprecise.” Simplified Guidelines, 1 S.T.B. at 1021.

The question then is where in that range of the adjusted R/VC ratios the Board should look to determine the maximum reasonable rate for the issue movement. There are only two practical alternatives – the mean or the highest R/VC ratio in the comparison group – as there would be no reasoned basis for selecting a point in-between. Selecting the upper boundary of the comparison group would not be appropriate, however, as it would ignore all the other movements in the comparison group. As all movements in the comparison group should be similar to the issue movement, although not identical, there is no reason to presume that the movement with the highest R/VC ratio is any more probative of the proper maximum lawful rate for the issue movement than the movement with the lowest R/VC ratio.

Rather, the more reasoned approach is to use the average of the (adjusted) comparison group to determine the maximum reasonable rate. By using the average, we would accord equal weight to each R/VC ratio in the comparison group. It is well settled that an average is “an obvious place to begin when there is no information that would incline the decision-maker to prefer one estimate over another.” Tennessee Gas Pipeline Co. v. FERC, 926 F.2d 1206, (D.C. Cir. 1991). And there would be no reasoned basis to depart from that mean figure, because the Board would have already reviewed the parties’ evidence and argument regarding the proper “comparison” group for analysis and would have selected the best comparison group of record.

Moreover, while there will be some risk that using the mean would understate the maximum reasonable rate, we believe there is a far greater risk of overstating the maximum reasonable rate if we were to use the highest rate in the comparison group.⁴⁷

We are aware of the concern that repeated application of a mean figure as the basis for a regulatory ceiling could have a feedback effect that could lower the mean for future cases.⁴⁸ We

⁴⁷ Use of the mean does not suggest that every non-issue movement in the comparison group above the mean is unreasonably high. Rather, we would presume that all rates in the (adjusted) comparison group reflect the maximum lawful rate for their particular movements. The variation in the range of observed R/VC ratios would reflect inevitable differences between movements that a simplified approach cannot hope to capture. The fact that a particular non-issue movement is above the mean would not imply it would be deemed unlawful if that shipper were to itself file a complaint, because even if it was eligible to use the Three-Benchmark approach, its comparison group would almost certainly be different. For example, in one case a shipper with a challenged movement of 400 miles might look to comparable movements of between 300 and 500 miles; while a shipper with a movement of 500 miles that was included in that comparison group would itself have a different comparison group of movement between 400 and 600 miles. So while there would be overlap, the comparison groups would likely differ in all cases unless two movements were identical in all respects – in which case, the two movements should have the same maximum lawful rate.

⁴⁸ This was a concern expressed by the court in Burlington Northern Railroad v. ICC,

believe, however, that this should not be a significant concern for two reasons. First, the revenue adequacy adjustment (the ratio of RSAM over R/VC_{total}) would have a countervailing effect. More importantly, only a small percentage of a carrier's traffic would likely be eligible to use the Three-Benchmark approach under our proposed eligibility criteria set forth below. Thus, most traffic in the comparison group would likely be constrained (potentially or actually) by some form of the SAC test – either the Full-SAC or Simplified-SAC test. Therefore, while this Three-Benchmark approach would not replicate directly the results of a SAC analysis, it would import that constraint indirectly by comparing the challenged rate against rates for other potentially captive movements that are constrained by some form of the SAC test.

In the end, we must remain mindful that “the best should not be the enemy of the good” and that we should not to allow “the infeasible perfect to oust the feasible good.” Commonwealth of Pa. v. ICC, 535 F.2d 91, 96 (D.C. Cir. 1976). Rather, “the pursuit of precision in rate proceedings, as in most things in life, must at some point give way to the constraints of time and expense, and it is the agency's responsibility to mark that point.” BNSF Ry. v. STB, 2006 WL 1651041 (D.C. Cir. 2006). Here, Congress has specifically instructed the agency to establish a simplified and expedited method to determine the reasonableness of challenged rail rates where the cost of a SAC presentation is too expensive, given the value of the case. 49 U.S.C. 10701(d)(3). We have taken every reasonable step to make our SAC process, in either its full or simplified form, available to captive shippers. For the remaining cases, this admittedly imperfect approach is necessary to provide captive shippers with small disputes some practical means of challenging the reasonableness of their rail rates.⁴⁹

5. Jurisdictional Inquiry

Although the Board in Simplified Guidelines indicated that movement-specific adjustments to URCS variable costs would be allowed for both the issue traffic and the comparison traffic, upon further reflection we believe that our mandate to create simplified guidelines is best achieved by adhering strictly to the URCS model to calculate variable costs. We have made a similar proposal for all rail rate cases, set forth in Major Issues at 23-27, which we incorporate by reference here. But even if we were to continue to allow movement-specific adjustments in Full-SAC cases, or even Simplified-SAC cases, we do not believe they should be allowed in this category of cases. Our experience in SAC cases demonstrates how substantial the discovery and litigation over movement-specific adjustments can be and it is imperative that we keep costs down to a bare minimum in small rail rate disputes. Moreover, any adjustments that were permitted would also need to be made to movements in the comparison groups, so as not to distort the comparison. But the similar movements would likely get similar adjustments, which

985 F.2d 589, 597 (D.C. Cir. 1993).

⁴⁹ To the extent that the Board's prior statements, see, e.g., Simplified Guidelines, 1 S.T.B. at 1033, reflect a different opinion about the value of a less formulaic approach, using a mean figure as a basis for a regulatory ceiling, or the need for individualized evidence beyond that described herein, we have reexamined the issues and concluded for the reasons set forth above that it is a permissible and appropriate simplifying measure to deem a rate unreasonable in a small rail rate dispute if it is above a reasonable confidence interval around the adjusted mean of the comparison group.

could cancel each other out. See Burlington, 985 F.2d at 601 (“Thus, if the adjustment were made on both sides, it might well be pointless; if on only one side, it would create phony discrepancies.”).

Therefore, we propose to calculate the variable cost of the movements covered by the complaint, as well as the variable costs of all movements included in the comparison group, using only the Phase III URCS program.⁵⁰ By relying exclusively on the URCS Phase III program to calculate variable costs, we can eliminate the very significant expense and delay associated with discovery and the use of costing experts to propose adjustments and to respond to adjustments proposed by the opposing party. The information needed to run the URCS Phase III program is readily available and the parties would be required to provide this information to one another in their initial disclosures.

6. Procedural Schedule

We propose an even tighter procedural schedule for small rate disputes, using designated Board staff to assist in resolving discovery disputes and to chair technical conferences. The proposed schedule is set forth below. If a deadline falls on a weekend or holiday, that deadline would be extended until the next business workday, but the remaining deadlines would remain unchanged. The Board would consider deviations from this procedural schedule only upon a good cause showing by the party.

Phase 1 – Eligibility	
Complaint (including evidence and argument on eligibility)	Day 0
Complainant Initial Disclosure	Day 0
Answer to complaint and reply to eligibility	Day 20
Railroad Initial Disclosure	Day 20
Rebuttal on eligibility	Day 30
Board Decision on Eligibility	Day 50

Phase 2 – Discovery	
Board Production of Waybill Sample to Parties	Day 50
Discovery Commences	Day 50
Discovery Closes	Day 100

⁵⁰ The only adjustments allowed to the URCS Phase III program would be those adopted in Ex Parte No. 431 (Sub-No 2). See n.30, *infra*.

Phase 3 – Merits		
Opening (Complainant)	Initial Tender of Comparison Group Market Dominance Opening	Day 120
Opening (Railroad)	Initial Tender of Comparison Group	
Technical Conference	Comparison Group	Day 125
Reply (Complainant)	Final Tender	Day 150
Reply (Railroad)	Final Tender Market Dominance Reply	
Rebuttal (Complainant)	Reply to Railroad Final Tender Market Dominance Rebuttal	Day 180
Rebuttal (Railroad)	Reply to Complainant Final Tender	
Board Decision Within 3 Months Thereafter		

The procedural schedule envisions a Board decision at two separate stages of a case. The parties would have the opportunity to make arguments and present evidence in each phase. In the first phase, the complainant would need to demonstrate that its case is eligible to use the Three-Benchmark method. The railroad would have the opportunity to argue in its answer that the case is not eligible for the Three-Benchmark method, and that either the simplified or Full-SAC method should be used instead. The Board would decide that threshold issue within 50 days of the filing of the complaint.

After discovery closes, the question of market dominance and the appropriate comparison group would be litigated. With regard to market dominance, the complainant would open, followed by reply evidence from the railroad, and rebuttal evidence from the complainant.

With regard to the comparison group, each party would tender its initial proposed comparison group for use in applying the R/VC_{COMP} benchmark simultaneously. A technical conference would then be held, chaired by Board staff, to discuss the differences in the proffered comparison groups. If the parties fail to agree on a comparison group, a second final tender would be submitted and the Board would select which of the proffered groups to use. The proposed procedures to be followed for the submission of the comparison group are discussed in more detail above.

Whether final briefs would also be necessary would be decided on a case-by-case basis.

If the traffic at issue is part of a class of traffic that has been exempted from Board regulation pursuant to 49 U.S.C. 10502(a), the complainant would need to include with its complaint a separate request for a partial revocation of the pertinent class exemption for the traffic at issue pursuant to 49 U.S.C. 10502(d). The railroad would need to file with its answer a separate response to that request. Evidence would continue to be submitted under the schedule set forth above while the Board considered the request.

7. Discovery

To streamline the discovery process for small disputes, certain standardized discovery would be required to be produced with the complaint and answer, and technical conferences

would be conducted to resolve factual disputes early. These and other proposals are set forth below.

Staff Conferences. The Board would designate staff to facilitate the voluntary resolution of discovery disputes and to conduct technical conferences. The designated Board staff would act as a mediator to seek settlement of the matters that are the subject of these conferences.

Meet and Confer Requirement. The parties would be required to meet and confer on discovery and procedural matters within 7 business days after the Board determines that a case is eligible for handling under the Three-Benchmark method. As soon as possible thereafter, the parties would be required to inform the Board whether there are unresolved disputes that require Board staff intervention and, if so, the nature of those disputes.

Complainant's Initial Disclosures. The complainant would be required to provide certain initial disclosures concurrent with the filing of its complaint. At that time, the shipper would produce its preliminary estimate of the variable cost of the challenged movements, using the unadjusted figures produced by the URCS Phase III program. This would require the complainant to identify the following annual characteristics of each movement covered by the complaint in order to calculate the variable cost of the challenged movements: (1) the carrier or region identifier; (2) the type of shipment (local, received-terminated, etc.); (3) the one-way distance of the shipment; (4) the type of car (by URCS code); (5) the number of cars; (6) the car ownership (private or railroad); (7) commodity type (STCC code); (8) the weight of the shipment (in tons per car); and (9) the type of movement (individual, multi-car, or unit train). The complainant would also be required to produce to the railroad all documents that it relied upon to determine the inputs to the URCS Phase III program. In addition, the complainant would be required to include with its complaint a narrative addressing whether there is any feasible transportation alternative for the challenged movements, and to disclose to the railroad all documents relied upon in formulating that assessment.

Railroad's Initial Disclosure. The railroad would likewise be required to provide initial disclosures with its answer to the complainant. Like the shipper, the railroad would need to produce its preliminary estimate of the variable cost of each challenged movement, using the unadjusted figures produced by the URCS Phase III program. And the railroad would be required to produce to the complainant all documents that it relied upon to determine the inputs used in the URCS Phase III program.

Discovery and Interrogatory Requests. We propose to limit the number of discovery requests that either party could submit to the other party without obtaining advance authorization from the Board. Each party would be limited to ten interrogatories (including subparts), ten document requests (including subparts), and one deposition. The parties would be expected to make their initial tenders of material as soon as possible. Any discovery disputes would be handled by designated Board staff on an expedited basis.

We believe these limitations are reasonable. In these simplified proceedings, the railroads would likely need some discovery of the shipper on the issue of market dominance and the feasible transportation alternatives available to the shipper. By limiting the number of discovery requests, we hope to balance the burden on shippers in the small rate disputes against

the need for carriers to obtain needed information. Because we propose to require the comparison group to be drawn from the Waybill Sample, and to prohibit movement-specific adjustments to the variable cost calculation, we do not envision that a shipper would require significant discovery from the defendant carrier to litigate a case under the Three-Benchmark approach.

Motions to Compel. Motions to compel would be governed by 49 CFR 1114.31 (a)(2)-(4). Any appeals to the Chairman of a ruling by Board staff on a motion to compel would be due within 3 business days of the ruling. Replies to the appeal would be due within 3 business days after the appeal is filed. Criteria set forth in 49 CFR 1115.9(a) would govern the standard of review for such interlocutory appeals.

8. Release of Waybill Sample Data

The Waybill Sample is a sample of carload waybills for terminating shipments by all rail carriers that terminate at least 4,500 carloads or 5% of the carloads in any one state. The Waybill Sample identifies originating and terminating freight stations, the names of all railroads participating in the movement, the point of all railroad interchanges, the number of cars, the car types, the weight in tons, the commodity type, and the freight revenues. The names of the shipper and consignee are not included in the data set. Other data in the sample, however, may permit the identification of a shipper and consignee. Therefore, railroads may encrypt (mask) revenue information associated with contract shipments to safeguard the confidentiality of the contract rates, as directed by 49 U.S.C. 11904.

The Board's rules for releasing confidential information in the Waybill Sample are set forth at 49 CFR 1244.9.⁵¹ Transportation practitioners and consultants may obtain access to the Waybill Sample to prepare testimony in formal agency or state proceedings. To obtain access, the requestor must demonstrate (1) that the Waybill Sample is the only single source of data or that obtaining the data from other sources would be burdensome or costly; (2) the data desired are relevant to issues in a pending formal proceeding; and (3) the scope of data requested is narrowly tailored to what is "absolutely essential" to the preparation of testimony. See Waybill Release, 4 I.C.C.2d at 200; 49 CFR 1244.9(b)(4). In addition, strict protective rules govern the use of this data, to ensure that practitioners and consultants do not release competitively sensitive information to any railroad or shipper client. See Waybill Release, 4 I.C.C.2d at 202; 49 CFR 1244.9(f), (g). Finally, it has been the Board's practice not to release unmasked contract revenue information to practitioners and consultants.⁵²

Under our proposal here, once we find that a complainant is eligible to use the Three-Benchmark method, we would release to lawyers and consultants who have signed the necessary

⁵¹ See Procedure on Release of Data From The ICC Waybill Sample, 4 I.C.C.2d 194 (1987) (Waybill Release).

⁵² See, e.g., CSX Corporation and CSX Transportation, Inc., Norfolk Southern Corporation and Norfolk Southern Railway Company—Control and Operating Leases/Agreements—Conrail, Inc. and Consolidated Rail Corporation, STB Finance Docket No. 33388 (STB served Oct. 3, 1997).

confidentiality agreement all movements in the most recent Waybill Sample that have the same 2-digit STCC code as the issue movement and an R/VC ratio above 180%. Confidential contract revenue information would continue to be encrypted. To facilitate the release of this information, a signed confidentiality agreement would need to accompany the complaint and answer. See 49 CFR 1244.9(b)(4)(v).

At the end of the proceeding, we would unmask revenue information only for movements within the comparison group selected by the Board. The parties could then examine the underlying data used to determine the reasonableness of the challenged rate. Litigants would not, however, have broader or earlier access to unmasked revenue information, as that highly confidential information would not be necessary to formulate a reasonable comparison group. The comparability of a movement should depend on the characteristics of the movement, not the level of the rate for that movement.

Finally, we would not provide for disclosure of any confidential Waybill Sample data in advance of a complaint being filed. See Simplified Guidelines, 1 S.T.B. at 1054-55.

III. Eligibility Criteria

Under this proposal, the Board would have three rail rate standards, of decreasing degrees of complexity, based on the size of the rail dispute. In a *large dispute* the complainant would continue to be required to present a Full-SAC analysis; in a *medium-size dispute* the complainant could present a Simplified-SAC analysis; and in a *small dispute* the complainant could use the Three-Benchmark method, revised as described above. We propose to apply rebuttable presumptions to determine which method a complainant could use in a particular case.

1. Proposal

The eligibility criteria would be based on the Maximum Value of the Case (MVC): the maximum rate relief the shipper could attain over 5 years if the challenged rates were reduced to the jurisdictional floor (i.e., the level at which the R/VC ratio equals 180%). To compute the MVC, the Board would multiply the difference between the challenged rate and the rate floor by the annual volume of the traffic at issue. The annual volume would be based either on historical traffic patterns or on the representations of the shipper in its complaint with respect to anticipated future traffic. The Board would then use the most recent cost-of-capital figure for the railroad industry, which the Board publishes annually, as the discount factor to obtain the net present value. If a complaint challenges multiple rates covering different origins and destinations, the Board would aggregate the MVC for each set of movements covered by the complaint. In this fashion, the MVC would equal the net present value, as of the time of the filing of the complaint, of the maximum relief that the shipper could obtain.

If the MVC exceeds \$3.5 million, the Board would presume that the complaint could present a Full-SAC presentation. If the MVC is between \$200,000 and \$3.5 million, the complainant could use either the Full-SAC or Simplified-SAC method, but the Board would presume it could not use the Three-Benchmark method. Finally, if the MVC is less than \$200,000, the complainant could use the Three-Benchmark method. For the future, the Board would index annually the \$3.5 million and \$200,000 thresholds using the Producer Price Index

(PPI), which measures the average change over time in the selling prices received by domestic producers for their output.

To avoid any incentive to understate the MVC, the MVC calculation would serve to limit any prospective rate relief available under either a Simplified-SAC or Three-Benchmark presentation. Rate prescriptions would be capped at the shipper's representation of the annual tonnage at issue. For example, if a shipper represented in its complaint that the volume of traffic at issue was 100,000 tons per year, the prescription would set the maximum rate the carrier could charge for the first 100,000 tons of traffic in a particular year; the challenged rate could continue to be charged for any additional tonnage in that year. Additionally, any rate relief – whether in the form of reparations for past shipments or rate prescription for future shipments – would be limited to 5 years.

Disaggregating claims that could and should be brought in a single complaint to manipulate the MVC calculation would not be permitted. To discourage a shipper from manipulating the MVC of a case, all claims brought within a 2-year period (the statute of limitations period under 49 U.S.C. 11705(c)) that involve the same defendant railroad and the same captive origin or destination would be aggregated. For example, if Shipper A files a complaint against Railroad X, challenging the movement from its captive plant to Destination 1, and the MVC of that complaint was \$100,000, the shipper would be eligible to use the Three-Benchmark approach. But if within 2 years the same shipper filed a second complaint against the same defendant, challenging a movement from the same captive plant to Destination 2, and the MVC of the second complaint was \$150,000, the shipper would be presumed eligible to use the Simplified-SAC method for the second complaint, but not the Three-Benchmark approach. In this way, a shipper would be prevented from using a more simplistic and less accurate procedure to challenge rates on movements which, if included in the initial eligibility inquiry, would not have qualified for using that procedure.

The shipper could rebut these eligibility presumptions based on the likely actual (as opposed to maximum) value of the case. For example, a shipper with a MVC exceeding \$3.5 million might seek to use the Simplified-SAC method by demonstrating that a Full-SAC presentation would be unusually expensive for that dispute. Similarly, a complainant with an MVC exceeding \$200,000 could use the Three-Benchmark method if it can show that a Simplified-SAC presentation would not be feasible given the actual value of a Simplified-SAC case. Finally, if the complainant has disaggregated claims, it could argue that the actual value of all its aggregated claims could not justify the type of case it would otherwise be required to present.

If, however, a complainant were to file a case where the MVC is less than \$3.5 million, its right to use the Simplified-SAC method would be absolute. Similarly, if the MVC is less than \$200,000, the complainant would be entitled to use the Three-Benchmark method.

2. Explanation

In Simplified Guidelines, 1 S.T.B. at 1045-49, the Board elected not to adopt a bright-line test to determine who might use the guidelines. Proponents had suggested various tests, based on the tonnage in dispute, the value of remedy available, or the size of the complaining shipper.

The Board was unwilling to adopt any test that might inadvertently sweep in a case whose value could justify a Full-SAC presentation. The Board believed that there was no standard cost for presenting a Full-SAC presentation and that it was therefore not possible to delineate in the abstract those cases where it would not be cost-effective to make a Full-SAC presentation. Accordingly, the Board stated that it would decide who may use the Simplified Guidelines on a case-by-case basis, and it set forth various factors that a shipper should address. See Simplified Guidelines, 1 S.T.B. at 1049.

The shipper community has urged us to provide more guidance on who may use a simplified approach. They assert that the ambiguity over who can use these guidelines is a principal reason why no shipper has used these guidelines.

We are persuaded that further guidance on who may use these guidelines is needed and appropriate. Although there is no standard cost for bringing a SAC case, our growing experience with these cases convinces us of the great litigation expense of such cases. The purpose of the proposed presumptions is to offer clearer guidance as to who may expect to qualify to use a simplified approach.

AAR does not oppose the notion of a bright-line test for eligibility in small rate cases, but it argues that such a test should embrace only “truly small cases,” measured by a shipper’s size and annual freight bill. However, under the statute eligibility must be based on the value of the case. Congress directed the Board to “establish a simplified and expedited method for determining the reasonableness of challenged rail rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case.” 49 U.S.C. 10701(d)(3). The proposed eligibility presumptions would apply that Congressional measure.

The proposed eligibility presumptions are based on the *maximum* value of a case. This permits a simple, objective calculation based on the level of the challenged rates, the volume of traffic at issue, and the variable cost of the movements. All of the components of the test are readily available to a shipper prior to filing the complaint. Without hiring industry experts, an aggrieved shipper could calculate the maximum value of its case and determine which rate method would be presumed to apply.

The proposed 5-year analysis period is designed to reflect the dynamic nature of the transportation markets to which a simplified approach would likely be applied. A point made repeatedly during the public hearings was that most small shippers are not like large utility companies, which have a relatively constant demand for transportation between two fixed points (from the coal mine to the generating plant). Rather, most captive shippers operate in a more fluid market environment, where their transportation needs and traffic patterns are more varied, less predictable, and more changeable. Thus, the lengthy rate prescriptions available in a Full-SAC proceeding would be of limited value to these shippers. We also note that even large utilities have seen the value of such relief diminish, as materially changed circumstances prompt reevaluation of older rate prescriptions. Thus, rate relief that is more than 5-years distant can be too speculative to value.

The proposed \$3.5 million eligibility presumption is based on evidence from captive shippers regarding the cost of a Full-SAC presentation. In their July 16, 2004 filing, the Joint

Shippers assert that the cost to bring a Full-SAC case “now exceeds \$3 million, and is heading upwards.”⁵³ We are aware of recent public assertions that the costs of recent Full-SAC presentations have exceeded this \$3.5 million figure. But we are taking significant steps to simplify and reduce the cost of Full-SAC presentations.⁵⁴ Thus, we believe that the proposed \$3.5 million figure reflects a reasonable estimate of the cost required to litigate a case using a Full-SAC presentation.

The proposed \$200,000 figure that would serve as a presumptive ceiling for using the Three-Benchmark approach is drawn from expert testimony in the original rulemaking in Ex Parte No. 347 (Sub-No. 2). In that proceeding, experts testified that it would be possible to conduct a Simplified-SAC presentation for between \$25,000 and \$85,000.⁵⁵ The Simplified-SAC presentation contemplated by those experts was comparable to that proposed herein: use of system-wide figures to estimate operating costs,⁵⁶ and use of prior Full-SAC proceedings to estimate construction costs.⁵⁷ Their estimate, however, appears to have included only the cost of consultants, and did not address the cost of counsel to litigate the case or the cost of discovery. By having the railroads develop and provide to the shipper key cost and revenue division information in its second production, the cost to a shipper of making a Simplified-SAC presentation should be modest in comparison to a Full-SAC presentation. But there would remain litigation expenses that we do not believe were incorporated in the prior testimony, and the expenses must be increased for inflation. While we anticipate updating this threshold figure as our experience with the Simplified-SAC proceedings grows, we propose a \$200,000 estimate of the cost to make a Simplified-SAC presentation.

The \$3.5 million and \$200,000 figures should be indexed annually for inflation so that these estimates do not become stale. We propose using the PPI index for this purpose. If, in the future, parties believe this index does not reflect changes in the litigation expenses associated with either a Full-SAC or Simplified-SAC presentation, they could petition the Board either to reassess the level at which the presumptions should be set or to use an alternative inflation index.

Finally, as discussed above, three measures are proposed to prevent manipulation of this eligibility standard. First, we would limit the duration of rate relief to 5 years, to encourage complainants with relatively stable origin-to-destination traffic patterns to present a Full-SAC case, rather than seek the short-term relief available under the Simplified Guidelines. Second, we would curtail the scope of rate relief to the volume of traffic identified by the complainant at the outset. Otherwise, a complainant could seek to manipulate the maximum value of its case by deliberately understating the amount of traffic at issue. Third, we would not permit complainants to disaggregate a rate complaint that might be appropriate for a Full-SAC presentation into numerous smaller rate cases in order to qualify for simplified treatment. Our proposal to

⁵³ Joint Shipper Testimony at 8-9 (filed July 16, 2004).

⁵⁴ See Major Issues at 7-31.

⁵⁵ See Ex Parte No. 347 (Sub-No. 2), Reply Verified Statement of Craig F. Rockey and John C. Klick (filed Mar. 19, 1996), at 20-26.

⁵⁶ See id. at 21.

⁵⁷ See id. at 25.

aggregate the MVC of claims brought within the 2-year statute-of-limitations period is designed to encourage complainants to consolidate claims against the same defendant involving the same captive origin or destination into a single complaint.

3. Eligibility Estimate

We have examined the most recent Waybill Sample to estimate the percentage of regulated movements (i.e., non-exempted traffic with an R/VC ratio above 180%) that would be presumed eligible to use a Simplified-SAC or Three-Benchmark approach. To calculate the MVC of each movement in the 2004 Waybill Sample, we used the 2004 industry cost-of-capital (10.1%) as the discount factor. **Table 2** shows the results.

Table 2
Eligibility Estimate
(2004 Revenue in Thousands)

Description	All Regulated	Large Disputes		Medium-Size Disputes		Small Disputes	
Farm Products	\$ 942,701	\$ 140,960	15%	\$ 589,934	63%	\$ 211,807	22%
Metallic Ore	\$ 199,375	\$ 131,922	66%	\$ 59,997	30%	\$ 7,456	4%
Coal	\$3,168,171	\$1,937,001	61%	\$1,058,386	33%	\$ 172,784	5%
Crude Petroleum	\$ 2,403	\$ -	0%	\$ 993	41%	\$ 1,410	59%
Non-Met. Minerals	\$ 111,508	\$ 16,135	14%	\$ 65,984	59%	\$ 29,389	26%
Ordnance	\$ 7,267	\$ 2,858	39%	\$ 3,979	55%	\$ 430	6%
Food Products	\$ 280,429	\$ 23,591	8%	\$ 156,673	56%	\$ 100,165	36%
Chemicals	\$2,534,099	\$ 267,842	11%	\$1,627,608	64%	\$ 638,649	25%
Petroleum Prods.	\$ 516,563	\$ 107,579	21%	\$ 260,906	51%	\$ 148,078	29%
Transp. Equip.	\$ 23,158	\$ 9,327	40%	\$ 8,817	38%	\$ 5,014	22%
Waste or Scrap	\$ 40,906	\$ 5,884	14%	\$ 30,732	75%	\$ 4,290	10%
Misc. Frt.	\$ 103,195	\$ 37,262	36%	\$ 62,894	61%	\$ 3,039	3%
Misc. Mix	\$ 7,667	\$ 4,309	56%	\$ 2,948	38%	\$ 410	5%
Small Pkg. Frt.	\$ 2,375	\$ -	0%	\$ 2,375	100%	\$ -	0%
Hazardous Wastes	\$ 20,895	\$ -	0%	\$ 13,064	63%	\$ 7,831	37%
Total	\$7,960,712	\$2,684,670	34%	\$3,945,290	50%	\$1,330,753	17%

CONCLUSION

We believe that the proposals contained here would address many of the concerns raised about Simplified Guidelines. They should help provide shippers meaningful access to regulatory relief in those cases where a Full-SAC case is too costly, given the value of the case. They should promote the rail transportation policy to protect captive shippers from unreasonable rates, 49 U.S.C. 10101, without precluding rail carriers from earning revenues that are adequate under honest, economical, and efficient management, 49 U.S.C. 10704(a)(2).

Changes to the Code of Federal Regulations needed to implement this proposal are set forth in **Appendix D** and will be published in the Federal Register.

This proposal would not have a significant economic impact upon a substantial number of small entities, within the meaning of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.). This proposal would not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. All parties wishing to participate in the STB Ex Parte No. 646 (Sub-No. 1) proceeding should file a notice with the Board by September 1, 2006.
2. Submissions addressing the proposals discussed herein are due by September 29, 2006. Reply submissions are due by October 30, 2006. Rebuttal submissions are due by December 1, 2006.
3. An original and 20 copies of each submission should be filed with the Board and one copy sent to each party who has filed a notice to participate.
4. Notice of this decision will be published in the Federal Register.
5. A copy of this decision is being provided to the Chief Counsel for Advocacy, Small Business Administration.
6. This decision is effective on July 28, 2006.

By the Board, Chairman Buttrey and Vice Chairman Mulvey.

Vernon A. Williams
Secretary

APPENDIX A – ROAD PROPERTY INVESTMENT

In a Full-SAC case, parties submit detailed evidence on the RPI costs to construct the SARR. Producing and analyzing this evidence is an expensive and time-consuming process. Alternatives to such an analysis could reduce the complexity and cost to all parties.

Towards that end, we contemplated using the total RPI cost per mile from prior Full-SAC cases as a surrogate for a Simplified-SAC presentation. The RPI component of our Full-SAC analysis has remained fairly consistent in recent cases, even though the average investment includes a mix of heavy and light density lines, as well as yards along the route. Indeed, segregating our recent decisions regionally results in a very consistent set of RPI costs (indexed to 2005). For example, as shown below the average RPI cost per track mile has varied less than 10% in the last five western SAC cases.

Table A-1

Total RPI Cost (2005 Dollars)

	Total RPI (\$ Millions)	Track Miles	Cost per Track Mile
Otter Tail	\$2,865	1,563	\$1,883,146
Xcel	1,396	678	2,058,877
TMPA	4,850	2,403	2,018,220
PPL	618	296	2,086,374
WPL	3,713	1,765	2,103,695

However, differences in geography and configuration can have a significant impact on the investment costs, as seen by comparing the RPI figures of the western SAC cases to those of the eastern SAC cases. Thus, using an aggregate investment cost per mile could sacrifice too much accuracy for simplicity.

Nonetheless, we believe that significant simplification of the current RPI analysis is possible using the findings of the Board in prior Full-SAC proceedings. We therefore propose to use the results from prior Full-SAC cases wherever possible to simplify the RPI analysis in a medium-size rail rate dispute. For example, the parties could identify the total acreage of the SARR and we could then use a rolling average of the cost per acre to estimate land values. Similarly, parties could identify the number and length of bridges (by type) along the right-of-way, and we could then use a rolling average of the cost per bridge to estimate bridge costs. In this fashion, we could use those elements from prior cases that should not change significantly from case-to-case (like the unit cost to construct a particular type of bridge), and tailor the Simplified-SAC RPI analysis to those features of the route being replicated that would vary significantly from case-to-case (like the number of bridges, miles of track, and acres of land).

I. Board Proposal

In Full-SAC proceedings, the total RPI is broken down into the following categories: (1) land, (2) roadbed preparation, (3) track, (4) tunnels, (5) bridges and culverts, (6) signals and communication, (7) buildings and facilities, (8) public improvements, (9) mobilization, (10) engineering, and (11) contingencies. See, e.g., Otter Tail at E1-E6. Our proposal to simplify each of these categories is set forth below.

A few general points apply to most categories. First, in a particular Simplified-SAC presentation, the parties would be required to account for inflation by applying an appropriate index to the findings from prior cases. (The numbers reported below have not been indexed.) Second, we propose to use a rolling average from past cases, such that as new Full-SAC cases are issued by the Board, older cases would be dropped from the comparison in subsequent Simplified-SAC proceedings. Finally, we would not include decisions prior to TMPA in the rolling average, as the earlier decisions do not reflect the more sophisticated RPI analysis performed in recent Full-SAC cases. Nor would we include decisions that did not resolve all of the disputes between the parties, such as in PPL.

1. Land

We propose to use a rolling-average cost per acre from prior rate cases. **Tables A-2** below shows the Board's land cost per acre findings, by category of land:⁵⁸

Table A-2

Comparison of Per Acre Land Costs by Category

	Year ⁵⁹	Agricultural	Residential	Industrial	Commercial
Otter Tail	2002	\$533	\$13,006	\$14,844	\$32,423
Duke/NS	2002	4,088	3,853	76,611	204,849
Duke/CSXT	2002	4,141	6,982	39,842	94,656
CP&L	2002	3,932	4,913	83,253	130,900
Xcel	2001	446	22,157	13,797	42,549
TMPA	2001	4,932	24,709	47,234	74,344

⁵⁸ Commercial property is designed for use by retail, wholesale, office, hotel, or service users (e.g., shopping centers, office buildings, hotels and motels, resorts or restaurants). Industrial property is used for industrial purposes (e.g., factories, heavy manufacturing buildings, or research and development parks). Residential property is owner occupied housing. Agricultural property is used for farming or mining.

⁵⁹ The year noted is not the year of the decision, but rather the year the RPI cost data was submitted for, which would then be used to index the Board's findings in that particular case to current dollars. The years set forth in **Table A-2** apply to all tables in this appendix.

We recognize that land prices are affected by location, but we believe the costs to present individualized valuation evidence outweigh the benefits. The cost for a narrow corridor of land that is in virtually all cases predominately in rural areas is a very small part of the total RPI. Thus, even a large change in land cost per acre would not have a significant impact on the overall analysis. Moreover, developing land valuation evidence is expensive, as parties must hire an appraiser to conduct real estate appraisals for land across thousands of miles. This typically includes paying the expert to survey the entire right-of-way (ROW). On balance, we believe that for a Simplified-SAC presentation, simplifying this component of the RPI analysis is warranted as the added precision does not justify the high costs of developing more accurate land valuations.

2. Roadbed Preparation

This is a significant category of RPI that is less subject to simplification on a route-mile basis than the others, as it can be affected by both the terrain and makeup of the route being replicated. For example, there are significant economies in preparing roadbed for double track rather than single track. And roadbed preparation for a rail line over a mountain is much more costly than roadbed preparation for a rail line through the flat, American heartland.

Major simplifications remain possible, however. We would have the parties continue to use the ICC Engineering Reports as the basis for determining the underlying quantities of material for line segments where that data has been reported. The parties would be responsible for collecting and analyzing the ICC data. The parties would convert the ICC quantities to current engineering standards using the methodology currently in use in Full-SAC cases. (The Board would make available sample spreadsheets from prior Full-SAC cases for parties to use upon request.) For line segments for which there is no ICC data, the parties would need to present evidence on the quantities of material needed under current engineering standards. Following current Board precedent in Full-SAC cases, we would assume that ditches should be 2 feet by 2 feet in size, that the ROW would be 100 feet across, that adequate access roads are reflected in the current quantities, and that side slopes would be 1.5 to 1 for Simplified-SAC cases.

Once the parties have undertaken this analysis, the unit costs for earthwork – by far the largest component of roadbed preparation – would then be based on the rolling average from past Full-SAC cases. The Board has been consistent in the mix of required equipment to perform roadbed preparation. These costs can be expressed in unit cost per cubic yard of material for excavation, loose rock, solid rock, borrow, and in some cases, fine grading. **Table A-3** below shows the Board’s roadbed preparation unit cost findings from prior Full-SAC cases. (Fine grading costs per unit are available only for the Otter Tail and Xcel decisions.)

Table A-3**Comparison of Earthwork Unit Costs (per cubic yard)**

	Common	Loose	Solid	Borrow	Fine Grading
Otter Tail	\$3.90	\$6.57	\$9.22	\$12.35	\$0.33
Duke/NS	3.32	8.75	9.09	9.84	
Duke/CSXT	3.29	8.67	9.09	9.81	
CP&L	3.34	8.81	9.20	9.89	
Xcel	3.43	8.00	9.57	12.26	0.15 slope 0.32 subgrade
TMPA	3.19	4.51	7.15	10.46	

The remaining miscellaneous earthwork costs (such as seeding and topsoil) would be estimated on a route-mile basis. While there is some variation in this expense category between cases, the total cost of these miscellaneous earthwork costs is a relatively minor part of the overall RPI analysis, such that more precise estimates would have only a modest, if any, impact on the SAC analysis. **Table A-4** below shows the Board's findings from prior Full-SAC cases.

Table A-4**Comparison of Other Earthwork Unit Costs**

	Total Cost (\$ Millions)	Route Miles	Cost per Route Mile
Otter Tail	\$43.8	\$1,208	\$36,260
Duke/NS	91.6	1,108	82,643
Duke/CSXT	93.8	1,197	78,399
CP&L	79.1	818	96,555
Xcel	21.7	367	59,027
TMPA	54.3	1,629	33,303

3. Track

We would use the rolling average track cost per track mile from prior rate cases. **Table A-4** below shows the Board's total track cost per track mile findings.

Table A-5**Comparison of Track Construction Costs**

	Total Cost (\$ Millions)	Track Miles⁶⁰	Cost per Track Mile
Otter Tail	\$860.7	1,563	\$550,644
Duke/NS	778.6	1,382	563,401
Duke/CSXT	829.9	1,510	549,626
CP&L	570.5	1,073	531,706
Xcel	399.0	678	588,465
TMPA	1,448.9	2,403	602,974

4. Tunnels

We do not propose to simplify this part of the RPI analysis. There have been only a few Full-SAC cases dealing with the cost of tunnels, costs which are specific to each individual tunnel. Thus, if there is a tunnel on the ROW replicated by the SARR, the parties would have to submit evidence on the current replacement cost of that tunnel.

5. Bridges and Culverts

We would use the rolling average bridge cost per linear foot from prior rate cases. As all bridges are not the same, we would use the bridge cost for the appropriate type of bridge. The parties would need to submit evidence on the total length (by type) of the bridges along the ROW being replicated, but could then use the rolling-average unit costs from prior cases. Type 1 bridges are pre-stressed concrete girder bridges. Type 2 bridges are steel deck plate girder bridges. Type 3 bridges are steel through plate girder bridges. We would assume that inclusion of assets in the ICC Engineering Reports is adequate proof of bridge ownership. **Table A-6** below shows the Board's prior bridge cost per linear foot findings, by type of bridge.

Table A-6**Comparison of Bridge Construction Costs**

	Type 1 Cost per foot	Type 2 Cost per foot	Type 3 Cost per foot
Otter Tail	\$2,315	\$2,552	\$4,300
Duke/NS	6,044	3,405	3,813
Duke/CSXT	4,892	3,924	3,993
CP&L	5,790	3,967	3,701
Xcel	1,793	2,690	4,427
TMPA	2,225	3,862	4,409

⁶⁰ Track miles includes main track, yards, set-out, spurs and any other rail required to build the SARR. We exclude additional material needed to prepare relay rail for crossing.

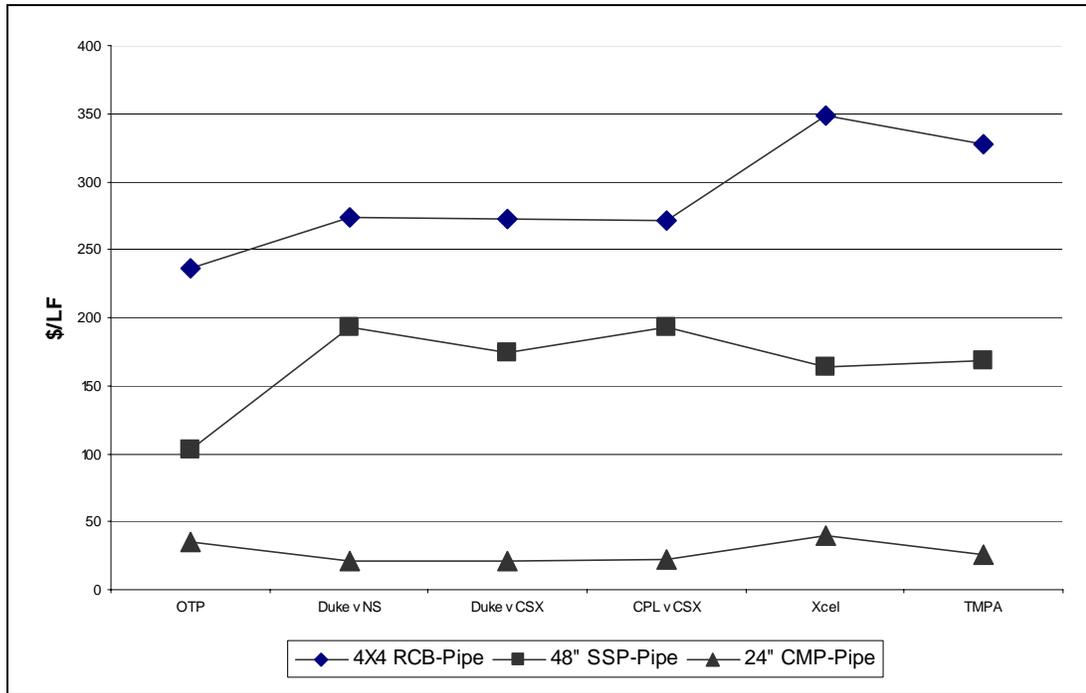
We would also use the rolling average culvert cost per linear foot from prior rate cases. As all culverts are not the same, we would use the culvert cost for the type of culvert involved: corrugated metal pipe (CMP-pipe), reinforced concrete pipe (RCB-pipe) and structural steel plate (SSP-pipe). As each of the types of culverts are utilized on railroads in a plethora of different sizes, most of the culvert evidence that has been submitted in previous Full-SAC cases includes a linear equation that correlates the cross-sectional area of the culvert opening with the unit cost of the culvert. We would utilize these linear regressions to determine the cost per foot of all the various sizes of culverts that will be utilized in our simplified analysis. The parties would have to submit evidence on the total length (by type) of culverts along the ROW being replicated, but could then use the rolling-average unit cost (from the regression equations) from prior cases. **Table A-7** below shows the Board's findings on the regression equations for culvert cost per linear foot by type of culvert.

Table A-7**Comparison of Culvert Construction Costs (per LF)**

	CMP-pipe Culvert	RCB-pipe Culvert	SSP-pipe Culvert
	y=\$/LF x=sq in	y=\$/LF x=sf	y=\$/LF x=sq in
Otter Tail	y=0.0392x+17.606	y=4.017x+172.3	y=0.0171x+72.524
Duke v. NS	y=0.0277x+8.89	y=8.681x+134.609	y=0.0162x+145.59
Duke v. CSX	y=0.0276x+8.89	y=8.671x+134.295	y=0.0161x+145.66
CPL v. NS	y=0.025x+11.322	y=4.563x+198.47	y=0.0161x+163.875
Xcel	y=0.0304x+26.399	y=3.886x+286.052	y=0.00934x+155.158
TMPA	y=0.0237x+14.695	y=3.726x+266.77	y=0.0127x+145.201

For example, assume the SARR in a Simplified-SAC presentation would replicate 2,000 feet of CMP-pipe culverts with a diameter of 10 square inches. First, the parties would use the six equations above to calculate the CMP-pipe culvert construction cost per linear foot. The parties would then index those unit costs by the appropriate index. We would then use the rolling average of those (indexed) costs per linear foot, multiplied by 2,000 feet, to derive the culvert construction costs for the SARR. The following chart shows the data consistency.

Chart A-1
Sample Culvert Unit Costs



6. Signals and Communication

The overall cost of signals and communication are consistent across cases. However, complainants in Full-SAC cases have constructed SARRs where the majority of lines would have centralized traffic control (CTC) signalling. Taking that signalling cost per mile and applying it to the entire ROW replicated by the SARR in a Simplified-SAC proceeding could overstate this expense category, particularly when the railroad does not itself use CTC signalling along that ROW.

Therefore, we propose that where CTC signalling is used by the railroad along the ROW replicated by the SARR, parties would use the rolling average signal and communications cost per route mile from prior rate cases. If, however, the railroad instead uses an automatic block system (ABS) along the selected route of the issue movement, the parties would have to submit evidence on the replacement cost of facilities needed for that signalling technology. If a complainant were satisfied that the cost per mile from our prior findings would be a suitable surrogate or would not be material to the outcome, it could elect to use the rolling-average cost per mile from prior Full-SAC cases for the entire SARR. Parties electing not to use the rolling average costs for signalling would also have to present evidence on the communications costs. **Table A-8** below shows our findings on signalling and communications costs per route mile.

Table A-8

Comparison of Signalling & Communications Costs

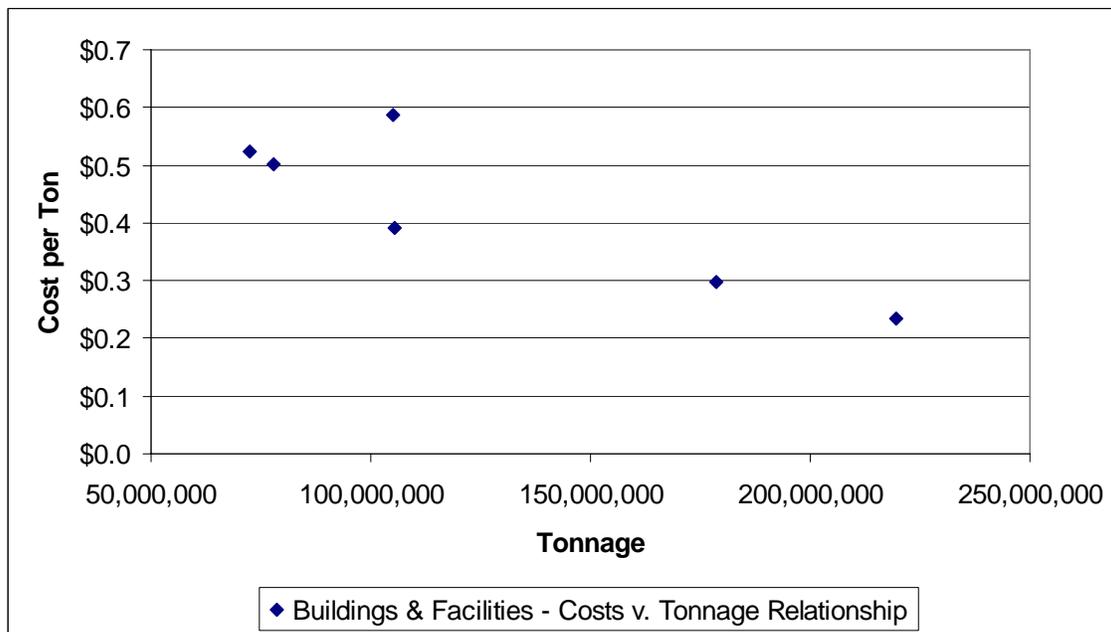
	Total Cost (\$ Millions)	Route Miles	Cost per Route Mile
Otter Tail	\$203.8	1,208	\$168,669
Duke/NS	154.8	1,108	139,689
Duke/CSXT	187.8	1,197	156,914
CP&L	138.7	818	169,578
Xcel	76.8	367	209,142
TMPA	133.4	1,629	81,883

7. Buildings and Facilities

Upon review of the cost of buildings and facilities per ton (total traffic volume), we observed a trend in the data. **Chart 2** below reveals noticeable economies associated with the cost of buildings and facilities.

Chart A-2

Buildings & Facilities Costs



While the cost of buildings and facilities do increase with more traffic (reflecting the larger workforce of the SARR), the cost per ton falls. As such, doubling the size of the SARR does not double the size and cost of buildings and facilities needed to support the staff.

Accordingly, rather than using a rolling average from past cases, we propose that the parties estimate the relationship between cost per ton and tonnage using a simple regression

analysis of the costs from prior rate cases. We would assume that the relationship between the cost per ton and tonnage is linear. Once this relationship is estimated using the data from the most recent cases, the parties would use this estimated relationship, combined with the total tons flowing over the SARR in the Test Year, to develop the buildings and facilities costs. **Table A-9** below shows the Board's findings regarding buildings and facilities cost per ton (in the base year of those SAC presentations), which the parties would use to perform the regression analysis.

Table A-9

Comparison of Building & Facilities Costs

	Total Cost (\$ Millions)	Forecast Volume (Millions)	Cost per Ton
Otter Tail	\$51.3	219.6	\$0.234
Duke/NS	39.0	77.9	0.500
Duke/CSXT	62.0	104.9	0.591
CP&L	37.9	72.3	0.524
Xcel	41.2	105.3	0.391
TMPA	53.2	178.6	0.298

8. Public Improvements

We propose to use the rolling-average public improvement cost per route mile from prior rate cases. Public improvements less separations is the smallest cost category within road property investment – averaging approximately \$25,000 per route mile. The large disparity between case unit costs is primarily due to fencing costs as well as geographic differences between eastern and western cases. Although there is a variance from case-to-case, we note that the Board's most recent decisions estimate unit costs very close to the overall average.

Grade separations, however, are a large and location-specific cost item within public improvements. (A grade separation is where a rail line crosses a road using either an overpass or underpass.) Therefore, we would calculate a rolling average cost for public improvements (without grade separation costs) on a route mile basis and calculate a separate rolling average cost for grade separations, weighted by the number separations. The Board has accepted 10% of the cost of constructing grade separations in past Full-SAC cases where the railroad shows some level of investment and would do so in a Simplified-SAC proceeding.

Tables A-10 and **A-11** show those findings.

Table A-10**Comparison of Public Improvement Costs (Without Grade Separations)**

	Total Cost (\$ Millions)	Route Miles	Cost per Route Mile
Otter Tail	\$29.5	1,208	\$24,391
Duke/NS	17.3	1,108	15,575
Duke/CSXT	3.7	1,197	3,549
CP&L	7.6	818	9,313
Xcel	12.3	367	33,597
TMPA	75.8	1,629	46,521

Table A-11**Comparison of Grade Separation Costs**

	Total Cost (\$ Millions)	Number of Separations	Cost per Separation
Otter Tail	\$9.6	17	\$561,877
Duke/NS	16.9	8	2,117,957*
Duke/CSXT	3.7	7.9	469,857
CP&L	3.3	6	554,317
Xcel	8.8	16.3	539,225
TMPA	23.3	28	832,437

* We note the outlier nature of this observation. Parties are invited to comment on whether this observation should be excluded from the rolling average.

9. Mobilization, Engineering, and Contingencies

Mobilization would be fixed at 3.5% of the cost of road preparation, track, tunnels, bridges and culverts, signals and communications, buildings and facilities, and public improvements. Engineering would be fixed at 10% of the same RPI expense categories. Contingencies would be fixed at 10% of road preparation, track, tunnels, bridges and culverts, signals and communications, buildings and facilities, public improvements, mobilization, and engineering. This would follow our practice in Full-SAC proceedings.

APPENDIX B – TOTAL SARR OPERATING EXPENSES

This appendix describes our proposal to calculate total operating expenses and equipment costs for the SARR in a Simplified-SAC proceeding.⁶¹

I. Background

In a Full-SAC case, parties develop operating expenses based upon three components: the traffic group, network configuration, and operating plan. The traffic group determines the volume of traffic the SARR would need to carry, expressed in tons, and the associated revenues of that traffic. The network configuration defines the route miles, track miles, yards, joint facilities, grades, curves, etc. of the SARR network. The operating plan defines the types of service provided, train sizes, types of locomotives, types of railcars, train speeds, loading times, unloading times, interchange times, crew change locations and times, dwell times at yards, inspection locations, train control systems, and signal systems of the SARR.

In more recent Full-SAC cases, information regarding the traffic group, network configuration and operating plan have been input into the Rail Traffic Control (RTC) model to develop transit times and other operating statistics. The RTC model simulates actual operations of the SARR – coordinating the meets and passes of trains much like dispatchers do operating a real railroad – to determine the feasibility of the operating plan and the resulting operating statistics. Those operating statistics are then used to develop operating expenses.

In Full-SAC cases, operating expenses are separately calculated for 15 different categories of costs.⁶² Developing these operating expenses is a complex process, with parties filing volumes of evidence supporting their respective positions. Parties argue at great length over the inputs used to calculate operating expenses. The complexity adds greatly to the expense of bringing, defending and adjudicating rate cases. The proposal set forth below is designed to dramatically simplify this analysis by using the Board's general purpose costing model (URCS).

II. Board Proposal

Under our proposal, in a Simplified-SAC case methodology the traffic group would be made up of the actual traffic traveling over the segment of track of the defendant's rail network identified by the complainant as the preferred route for the challenged movements. In addition, the configuration would be the actual configuration of that part of the defendant's network. Therefore, system-average operating expenses of the railroad should be a reasonable surrogate for the operating expenses to handle this traffic group.

⁶¹ This appendix does not address how to calculate variable costs for issue traffic to determine the Board's jurisdiction to consider the rate complaint. See 49 U.S.C. 10707(d)(1)(A).

⁶² Those categories are: train and engine personnel; locomotive lease expense; locomotive maintenance expense; locomotive operating expense; railcar lease expense; material and supply operating; ad valorem taxes; joint facilities; training and start-up; operating managers; general and administrative; IT systems and communications; loss and damage; insurance; and maintenance-of-way.

We can use system-average URCS costs because the traffic that would share the SARR facilities should reflect a mix of traffic with some combination of unit train traffic, intermodal traffic, and general merchandise traffic. Some traffic may use more than the system-average number of locomotives, for example, while other traffic may use fewer than the system-average number of locomotives. But the combined operating characteristics of the traffic should be close to the system-average. Thus, the system-average operating characteristics should provide a reasonable surrogate for calculating the operating expenses for all of the traffic traveling over the SARR.

Significant adjustments to the URCS values would be needed for this task, however. First, the values produced by URCS would need to be modified to reflect *total*, rather than *variable*, operating expenses. Second, because RPI would be calculated separately, the values produced by URCS would need to be adjusted to exclude those costs. Third, because many costs would be addressed in the DCF analysis, the URCS values would need to be adjusted to remove those expenses. Finally, there are a few types of expenses that a railroad may incur that are not included in a full SAC analysis and likewise should be excluded from a Simplified-SAC analysis. These adjustments are outlined below.

There is one category of operating expenses used in Full-SAC cases – training and start-up costs – that will be understated by using URCS. Training costs are included in URCS only to the extent railroads have on-going training expenses. However, start-up costs of the sort reflected in recent Full-SAC cases are not included in URCS because the Class I railroads, as existing entities, do not incur these costs on a yearly basis. Moreover, there appears to be no reasonable way to introduce these start-up expenses into a Simplified-SAC analysis. Therefore, only actual training expenses incurred by the railroad would be included in a Simplified-SAC analysis. This cost component is only a small component of the overall operating expenses of a SARR in a Full-SAC case, and the omission of the cost should not significantly affect the outcome of a Simplified-SAC analysis.

1. Calculation of Equipment Expenses

In Full-SAC cases, parties submit evidence on the current replacement cost of equipment, which is generally all new equipment. In contrast, URCS calculates equipment expenses based on the historic, book value of equipment purchased by the railroad, less depreciation. URCS then applies a *nominal* cost of capital (which equals the real cost of capital plus a component for expected inflation) to this depreciated-book value to develop the return on equipment each year.

The use of historic costs, rather than current costs, would seem to be a reasonable approach for a Simplified-SAC proceeding. The generic issue was examined at length by the Railroad Accounting Principles Board (RAPB).⁶³ As explained in its final report, while using current costs is preferable to using historic costs, the use of historic costs combined with the nominal cost of capital is reasonable where it is impractical to develop current costs. The report explained:

⁶³ The RAPB was created by statute to evaluate issues associated with rail costing and to propose principles to govern the estimation of such costs. See former 49 U.S.C. 11161-11163 (1995).

Using the historical value of assets in combination with the nominal cost of capital *provides for general price level changes*. General price level changes are implicitly a portion of the current nominal cost-of-capital rate. Investors are compensated for general price level changes through the cost-of-capital rate.⁶⁴

We propose to ignore any depreciation of equipment investment, such that the value of equipment would be just the book value, not the book value less depreciation. This appears to be the approach recommended by the RAPB.⁶⁵ We note, however, that CMP and SAC principles do not require that a SARR purchase new equipment. It could use the same mix of used and old equipment as is used by the railroad. We therefore invite comment on whether and how to value this mix of new and old equipment.

2. Specific Modifications to URCS

The following list describes how specific elements within URCS would be handled in Simplified-SAC cases:

A. Accumulated Deferred Tax Credits.

This URCS item would be *excluded* from URCS for Simplified-SAC cases because the DCF accounts for the impact of taxes. Including accumulated deferred tax credits would be a double count.

B. Construction Work In Progress - Account 90.

This URCS item would be *excluded* for Simplified-SAC cases. It is an expense item that would not apply to the SARR because there would be no construction work in progress once the SARR is built.

C. Dismantling Retired Road Property.

This URCS item would be *excluded* for Simplified-SAC cases because over the time period of the SAC analysis, this expense would not be incurred by the SARR.

D. Equipment Capital Cost.

This URCS item would be *included* for Simplified-SAC cases, but at the historic book value, without deducting depreciation for the reasons discussed above.

E. Interest During Construction - Account 76.

This URCS item would be *excluded* for Simplified-SAC cases, as interest during construction is included in the DCF model.

⁶⁴ Railroad Accounting Principles, Final Report, September 1, 1987, Volume 2 – Detailed Report, at 42 (Final Report) (emphasis added).

⁶⁵ Final Report at 66.

F. Other Elements of Investment - Account 80.

This URCS item would be *excluded* for Simplified-SAC cases, as there would be no applicable expense for the SARR.

G. Road Property Investment.

This URCS item would be *excluded* from the operating expense calculation, as it would be separately accounted for in the Simplified-SAC analysis.

H. Roadway Machines - Property Account 37.

This URCS expense item would be *included* as an operating expense because it is part of roadway maintenance and would not be reflected in the RPI analysis.

I. Shop Machinery Investment - Property Account 44.

This URCS expense item would be *excluded* for Simplified-SAC cases because it would be included in the RPI analysis.

J. Working Capital.

This URCS item would be *excluded* for Simplified-SAC cases as it is not included in Full-SAC cases. The DCF does not explicitly include working capital as part of the investment base.

K. 100% Flow Thru Mode.

We propose to run the URCS program in the 100% Flow Thru mode for Simplified-SAC cases. This is a technical adjustment to URCS that sets the variability parameter to 100% for all expense categories. In so doing, URCS would provide a *total* operating cost estimate rather than a *variable* cost estimate (which would exclude fixed costs that should be included in the SAC analysis). The alternative would be to use a constant cost markup ratio. However, we believe that the constant cost markup ratio that this modified URCS would produce could be corrupted by the adjustments described above. Moreover, some types of traffic are more variable than others. The application of a single markup ratio could overstate or understate the costs where the mix of traffic for the line segments involved is different from the defendant railroad's overall traffic mix. Thus, we believe using the 100% Flow Thru in URCS would be the best way to modify the program to produce total, rather than variable, operating costs.

3. Application of a Modified URCS Phase III Program

We propose to have Board staff perform all these adjustments to URCS by adjusting the data files used by URCS. These data modifications would be performed on an annual basis and would be made available to the public. In effect, then, the Board would provide two versions of URCS: the normal URCS and the modified URCS. Parties would be directed to use the normal URCS for deriving the variable costs of the movements in the traffic group, as needed, for

purposes of determining the Board's jurisdiction to consider the rate complaint, and the modified URCS for calculating the total operating expense of the SARR.

APPENDIX C – DISCOUNTED CASH FLOW

In a Full-SAC case, in the DCF model we first estimate the revenue stream that the SARR would need to cover operating costs and provide a reasonable return on capital. We then compare the revenue requirements of the SARR to the revenue the defendant railroad earns, to determine if the revenues produced by the traffic in the group (based on existing rate levels) would be greater or less than the amount required by the SARR. See generally Otter Tail at E1-E6; Bituminous Coal – Hiawatha, UT To Moapa, NV, 10 I.C.C.2d 259, 274-77 (1994).

In a Simplified-SAC case, the second step would be shortened from a 20-year to a single-year comparison by using a representative Test Year. We discuss this proposal below, after first describing the DCF process in more detail.

I. Background

1. Revenue Requirements of the SARR

The estimated revenue requirements of the SARR must be sufficient to cover expected operating expenses and provide a reasonable return on the capital investment the SARR would make if it entered the marketplace to serve the selected traffic group. Entry is not instantaneous, so the revenue requirements must also cover the estimated interest on debt during the construction period of the SARR. Finally, the revenue requirements must include the estimated programmed maintenance needed to maintain the rail network once constructed.

The need to deal with taxes complicates the estimation of the SARR's revenue requirements, because tax rates are a function of the flow of revenue over the analysis period, and not just the present value of revenue. This means that we must determine the flow of capital recovery that, after taxes and operating expenses, would have a present value equal to the present value of the initial RPI, plus interest during construction, together with the present value of scheduled programmed maintenance of the railroad. It is the necessity of dealing with taxes that makes the DCF model complicated and in Full-SAC cases precludes the use of a simpler model that would directly compute the SAC constraint without reference to the pattern of capital recovery over time.

The DCF model uses an iterative approach to determine the pattern of capital recovery that would attract entry in a contestable market. The first step is to assume an amount of capital recovery in the first year. This annual capital recovery is then indexed for inflation over the SAC analysis period, typically 20 years. Indexes for the various components of RPI (such as land, grading, rail) are used in the analysis.

The second step is to estimate the value of the SARR at the end of the SAC analysis period. Because the assets the SARR would construct would have a longer useful life, the assets would have residual economic value, and the SARR would not need to recover the full investment in rail assets in the first 20 years (or whatever length of time was used by the Board). When using a 20-year analysis period, this "terminal value" of the SARR equals the capital recovery in the 20th year divided by the estimated real cost of capital. This calculation yields the value (at year 20) of a perpetual income stream held constant (in real terms) at the capital return projected for the 20th year.

The third step is to estimate the taxes the SARR would pay. The starting point is the capital recovery in a particular year, which conceptually is the net revenue (total revenues less operating expenses) for tax purposes. The DCF model incorporates a complex tax analysis that estimates the taxes, which are a function of interest on debt, depreciation of assets, and the applicable state and federal taxes. Because the SARR could take advantage of various tax loss provisions, the SARR typically would pay no taxes for the first few years of operation.

The DCF model then calculates the present value of the projected capital recovery over the 20-year analysis period, together with the present value of the terminal value, minus the present value of taxes. If this total is less than the initial capital investment, plus interest, adjusted for depreciation and programmed maintenance, then the projected capital recovery is too low to provide a reasonable return on investment and would not entice a SARR to enter. In that case, the initial capital recovery in the first year is adjusted upwards (or downwards if the flow of capital recovery is too high) and the steps described above are repeated. This iterative process continues until the model finds the point at which the flow of capital recovery would, after taxes, provide a reasonable return on the initial capital investment. Once the necessary amount of capital recovery has been determined using this iterative process, the total revenue requirements of the SARR are determined by combining the capital recovery plus the projected operating expenses.

This total revenue requirement reflects the total rate level that would prevail in a contestable market, against which we then judge the defendant's rates.

2. Overall Comparison Analysis

The second part of the DCF analysis compares the revenues the defendant is expected to earn from the traffic group against what the SARR would need to serve the same traffic. In general, if the present value of the defendant's revenue stream is less than the SARR's revenue requirements, then the analysis has not demonstrated that the challenged rate is unreasonable. If the opposite is true, then the Board must decide what relief to provide to the complainant by allocating the revenue requirements of the SARR among the traffic group and over time.

II. Board Proposal

As this discussion shows, the 20-year DCF period currently used in Full-SAC cases is a misnomer. The current DCF model is in reality an in-perpetuity model. The SAC test assumes that the SARR would not terminate operations at the end of the analysis period (be it 10 or 20 years), but would instead continue to operate indefinitely. In computing the capital component of the revenue requirement of the SARR, the DCF model provides for periodic replacement of rail assets as those assets are projected to wear out and computes the future value of a perpetual income stream at the end of the analysis period (i.e., the terminal value of the SARR).

The 20-year analysis period currently used in Full-SAC proceedings is simply the time period over which the SAC costs (including both the capital component and the operating expenses) are compared to the revenue the defendant railroad is expected to earn from the traffic group. In a Simplified-SAC analysis, we intend to look only at a Test Year, although we still would assume that the SARR would continue indefinitely.

For Simplified-SAC cases, we propose only two minor changes to the current DCF model. First, the operating expenses of the SARR would be estimated only for the Test Year, using the approach set forth in **Appendix B**. Second, the spreadsheets that compare the revenue requirements of the SARR against the revenue the railroad earns from the traffic group would be truncated to avoid any netting and to compare only the revenue requirements of the SARR in the Test Year against the revenues earned by the defendant railroad in the Test Year.

This proposal follows the suggestion of commenters in Major Issues on how to shorten the DCF period from 20 to 10 years, who presented testimony of two consultants with extensive knowledge of the workings of the DCF model. They agreed that, because the SARR would continue on, there would be no need to change the calculations related to the SARR's capital recovery requirements. They have a modest disagreement over whether shortening the comparison period would necessitate shortening the period for amortization of debt. We propose to maintain our current practice on that issue, as there is no apparent correlation between the SAC comparison period and the proper period over which to amortize debt.

Parties are invited to comment on whether other features of the DCF model can and should be simplified. Parties are specifically invited to comment on whether it would be appropriate to simplify the analysis by estimating an effective tax rate, using a rolling average from prior Full-SAC cases, or whether it would be appropriate to dispense with the interest during construction analysis by using prior cases to estimate this cost as a percentage of total RPI investment.

Finally, because examining revenues and SAC costs only in the Test Year would not address possible business cycles in the rail industry, we propose to require the parties to automatically update the analysis each year once historical information becomes available. The analysis of the capital recovery period would be held constant under the terms of the Board's decision. The parties would then calculate the operating costs and perform the comparison approach as the information becomes available. In this fashion, the maximum lawful rate would adjust in response to business cycles. For example, if traffic levels fell, the capital requirements would be spread over a smaller traffic group, automatically increasing the rate prescription. This approach would also automatically address actual changes in costs and rail productivity, both of which would be captured in URCS, although with an unavoidable regulatory lag. We would propose that the parties perform this annual update for no more than 5 years, such that the shipper would receive 5 years of relief, including any reparations period.

We do not propose that the shipper pay the challenged rate in the interim, however. Rather, the Board would index the maximum lawful rate from the Test Year by a forecast of RCAF-A (to be provided by the parties). We believe that using a forecast of RCAF-A is appropriate as a fair estimate of what the actual URCS-based operating expenses of the SARR would be in years beyond the Test Year. Because a Simplified-SAC proceeding is modeling the existing rail operations of the railroad, we believe the index should forecast expected increases in cost, including offsetting productivity improvements.

The shipper would be required to pay this indexed rate, subject to the rate being revised at the end of the year. If the maximum lawful rate were higher than forecast, the shipper would be required to compensate the railroad, with interest. The adjusted rate could not, however,

exceed the challenged rate in the tariff (indexed in accordance with the terms of the tariff). If the maximum lawful rate were lower than forecast, the railroad would be required to compensate the shipper, with interest. The adjusted rate could not fall below the 180% jurisdictional threshold, however.

APPENDIX D – CHANGES TO CODE OF FEDERAL REGULATIONS

For the reasons set forth in the decision, the Surface Transportation Board proposes to amend parts 1111, 1114, 1115 and 1244 of title 49, chapter X, of the Code of Federal Regulations as follows:

PART 1111 – COMPLAINT AND INVESTIGATION PROCEDURES

1. The authority citation for Part 1111 continues to read as follows:

AUTHORITY: 49 U.S.C. 721, 10704, and 11701.

2. Amend §1111.1 as follows:

- A. Revise paragraphs (a)(1) through (11).
- B. Redesignate current paragraphs (b) through (d) as paragraphs (c) through (e).
- C. Add new paragraph (b).

§1111.1 *Content of formal complaints; joinder*

(a) * * *

- (1) The carrier or region identifier.
- (2) The type of shipment (local, received-terminated, etc.).
- (3) The one-way distance of the shipment.
- (4) The type of car (by URCS code).
- (5) The number of cars.
- (6) The car ownership (private or railroad).
- (7) The commodity type (STCC code).
- (8) The weight of the shipment (in tons per car).
- (9) The type of movement (individual, multi-car, or unit train).
- (10) A narrative addressing whether there is any feasible transportation alternative for the challenged movements.
- (11) Evidence and argument on eligibility.

(b) *Disclosure with simplified standards complaint.* The complainant must provide to the respondent all documents relied upon in formulating its assessment of a feasible transportation alternative and all documents relied upon to determine the inputs to the URCS Phase III program.

* * * * *

3. Amend §1111.4 as follows:

- A. In paragraph (a), add a new sentence to the end of the paragraph.
- B. Redesignate current paragraphs (b) through (d) as paragraphs (c) through (e).
- C. Add new paragraph (b).

§1111.4 *Answers and cross complaints.*

* * * * *

(a) * * * In response to a complaint filed under the simplified standards, the answer must include the defendant's preliminary estimate of the variable cost of each challenged movement calculated using the unadjusted figures produced by the URCS Phase III program.

(b) *Disclosure with simplified standards answer.* The defendant must provide to the complainant all documents that it relied upon to determine the inputs used in the URCS Phase III program.

4. Revise §1111.9 to read as follows:

§1111.9 *Procedural schedule in cases using simplified standards*

(a) *Procedural schedule.* Absent a specific order by the Board, the following general procedural schedules will apply in cases using the simplified standards:

- (1) In cases relying upon the Simplified-SAC methodology:

Phase 1

- Day 0—Complaint filed (including evidence and argument on eligibility and disclosure).
- Day 20—Defendant's answer to complaint (including reply on eligibility and initial disclosure).
- Day 30—Complainant's rebuttal on eligibility.
- Day 50—Board decision on eligibility.

Phase 2

Day 50—Discovery begins.
Day 80—Complainant’s opening evidence on selected route.
Day 100—Defendant’s reply on selected route.
Day 110—Complainant’s rebuttal on selected route.
Day 140—Staff decision on route.
Day 170—Defendant’s second disclosure.
Day 180—Discovery closes.

Phase 3

Day 250—Opening evidence.
Day 310—Reply evidence.
Day 340—Rebuttal evidence
Day 350—Technical conference (market dominance and merits).
Day 360—Final briefs.

(2) In cases relying upon the Three-Benchmark method:

Phase 1

Day 0—Complaint filed (including evidence and argument on eligibility and complainant’s disclosure).
Day 20—Defendant’s answer to complaint (including reply on eligibility and initial disclosure).
Day 30—Complainant’s rebuttal on eligibility.
Day 50—Board decision on eligibility.

Phase 2

Day 50—Board production of Waybill Sample to parties. Discovery commences.
Day 100—Discovery closes.

Phase 3

Day 120—Complainant’s opening (initial tender of comparison group and opening evidence on market dominance). Defendant’s opening (initial tender of comparison group).
Day 125—Technical conference on comparison group.
Day 150—Parties’ final tenders on comparison group. Defendant’s reply on market dominance.
Day 180—Parties’ replies to final tenders. Complainant’s rebuttal on market dominance.

(b) *Defendant’s Second Disclosure*. In cases using the Simplified-SAC methodology, the defendant must make the following initial disclosures to the complainant by Day 170 of the procedural schedule.

(1) Identification of all traffic that moved over the routes replicated by the SARR in the Test Year.

(2) Information about those movements, in electronic format, aggregated by origin-destination pair and shipper, showing the origin, destination, volume, and total revenues from each movement.

- (3) Total operating and equipment cost calculations for each of those movements, provided in electronic format.
- (4) Revenue allocation for the on-SARR portion of each cross-over movement in the traffic group provided in electronic format.
- (5) All workpapers and documentation necessary to support the calculations.

(c) *Conferences with parties.* The Board may convene a conference of the parties with Board staff to facilitate voluntary resolution of discovery disputes and to address technical issues that may arise.

5. Amend §1111.10 as follows:

A. In paragraph (a), revise the first sentence.

B. In paragraph (b), revise the heading and first sentence.

§1111.10 *Meeting to discuss procedural matters.*

(a) *Generally.* In all complaint proceedings, other than those challenging the reasonableness of a rail rate based on stand-alone cost or the simplified standards, the parties shall meet, or discuss by telephone, discovery and procedural matters within 12 days after an answer to a complaint is filed.

(b) *Stand-alone cost or simplified standards complaints.* In complaints challenging the reasonableness of a rail rate based on stand-alone cost or the simplified standards, the parties shall meet, or discuss by telephone, discovery and procedural matters within 7 days after an answer to a complaint is filed. * * *

PART 1114—EVIDENCE; DISCOVERY

6. The authority citation for Part 1114 continues to read as follows:

AUTHORITY: 5 U.S.C. 559, 49 U.S.C. 721.

7. Amend §1114.21 by adding new paragraph (a)(3) to read as follows:

§1114.21 *Applicability; general provisions*

(a) * * *

(3) In cases using the simplified standards Three-Benchmark method, the number of discovery requests that either party can submit are limited as set forth in §§1114.22, 1114.26, and 1114.30, absent advance authorization from the Board.

* * * * *

8. Amend §1114.22 by adding new paragraph (c) to read as follows:

§1114.22 *Deposition.*

* * * * *

(c) *Limitation under simplified standards.* In a case using the Three-Benchmark methodology, each party is limited to one deposition absent advance authorization from the Board.

9. Amend §1114.26 by adding new paragraph (d) to read as follows:

§1114.26 *Written interrogatories to parties.*

* * * * *

(d) *Limitation under simplified standards.* In a case using the Three-Benchmark methodology, each party is limited to ten interrogatories (including subparts) absent advance authorization from the Board.

10. Amend §1114.30 by adding new paragraph (c) to read as follows:

§1114.30 *Production of documents and records and entry upon land for inspection and other purposes.*

* * * * *

(c) *Limitation under simplified standards.* In a case using the Three-Benchmark methodology, each party is limited to ten document requests (including subparts) absent advance authorization from the Board.

11. Amend §1114.31 by revising paragraphs (a)(1) through (4) to read as follows:

§1114.31 *Failure to respond to discovery*

(a) * * *

- (1) *Reply to motion to compel generally.* Except in rate cases to be considered under the stand-alone cost methodology or simplified standards, the time for filing a reply to a motion to compel is governed by 49 CFR 1104.13.
- (2) *Reply to motion to compel in stand-alone cost and simplified standards rate cases.* A reply to a motion to compel must be filed with the Board within 10 days thereafter in

a rate case to be considered under the stand-alone cost methodology or under the simplified standards.

- (3) *Conference with parties on motion to compel.* Within 5 business days after the filing of a reply to a motion to compel in a rate case to be considered under the stand-alone cost methodology or under the simplified standards, Board staff may convene a conference with the parties to discuss the dispute, attempt to narrow the issues, and gather any further information needed to render a ruling.
- (4) *Ruling on motion to compel in stand-alone cost and simplified standards rate cases.* Within 5 business days after a conference with the parties convened pursuant to paragraph (a)(3) of this section, the Secretary will issue a summary ruling on the motion to compel discovery. If no conference is convened, the Secretary will issue this summary ruling within 10 days after the filing of the reply to a motion to compel. Appeals of a Secretary's ruling will proceed under 49 CFR 1115.9, and the Board will attempt to rule on such appeals within 20 days after the filing of the reply to the appeal.

PART 1115—APPELLATE PROCEDURES

12. The authority citation for Part 1115 continues to read as follows:

AUTHORITY: 5 U.S.C. 559, 49 U.S.C. 721.

13. Amend §1115.9 by revising the first sentence of paragraph (b) to read as follows:

§1115.9 *Interlocutory appeals.*

* * * * *

(b) In stand-alone cost complaints or in cases filed under the simplified standards, any interlocutory appeal of a ruling shall be filed with the Board within three (3) business days of the ruling. * * *

* * * * *

PART 1244—WAYBILL ANALYSIS OF TRANSPORTATION OF PROPERTY—RAILROADS

13. The authority citation for Part 1244 continues to read as follows:

AUTHORITY: 49 U.S.C. 721, 10707, 11144, 11145.

14. Amend §1244.9 as follows:

A. Redesignate paragraph (b)(5) as (b)(6) and add new paragraph (b)(5).

B. In paragraph (c), remove the word “(b)(5)” and add, in its place, the word “(b)(6)”.

C. In paragraph (d), remove the word “(b)(5)” and add, in its place, the word “(b)(6)”.

§1244.9 *Procedures for the release of waybill data.*

* * * * *

(b) * * *

(5) *Transportation practitioners, consulting firms and law firms in simplified standards cases.* Once the Board determines that a complainant is eligible to use the Three-Benchmark method, the Board, without any further request from the parties, would release all movements in the most recent Waybill Sample of the same 2-digit STCC code as the issue movement and with a revenue-to-variable cost ratio above 180%. Confidential contract rate information will be encrypted. A signed confidentiality agreement consistent with paragraph (b)(4)(v) of this section must accompany the parties’ complaint and answer.

* * * * *