

SURFACE TRANSPORTATION BOARD

Decision

STB Ex Parte No. 290 (Sub-No. 5) (2006-3)

QUARTERLY RAIL COST ADJUSTMENT FACTOR

Decided: June 19, 2006

In Railroad Cost Recovery Procedures, 1 I.C.C.2d 207 (1984), the Interstate Commerce Commission (ICC) outlined the procedures for calculating the all-inclusive index of railroad input prices and the method for computing the rail cost adjustment factor (RCAF). Under the procedures, the Association of American Railroads (AAR) is required to calculate the index on a quarterly basis and submit it on the fifth day of the last month of each calendar quarter. In Railroad Cost Recovery Procedures, 5 I.C.C.2d 434 (1989), aff'd sub nom. Edison Electric Institute, et al. v. ICC, 969 F.2d 1221 (D.C. Cir. 1992), the ICC adopted procedures that require the adjustment of the quarterly index for a measure of productivity.

The provisions of 49 U.S.C. 10708 direct the Surface Transportation Board (Board) to continue to publish both an unadjusted RCAF and a productivity-adjusted RCAF. In Productivity Adjustment-Implementation, 1 S.T.B. 739 (Productivity Adjustment), the Board decided to publish a second productivity-adjusted RCAF called the RCAF-5. Consequently, three indices are now filed with the Board: the RCAF (Unadjusted), the RCAF (Adjusted), and the RCAF-5. The RCAF (Adjusted), which reflects national average productivity changes as originally developed and applied by the ICC, is currently based on a 5-year moving average. The RCAF-5 reflects national average productivity changes as if a 5-year moving average had been applied consistently from the productivity adjustment's inception in 1989.

The index of railroad input prices, RCAF (Unadjusted), RCAF (Adjusted), and RCAF-5 for the third quarter 2006 are shown in Table A of the Appendix to this decision. Table B shows the first quarter 2006 index and the RCAF calculated on both an actual and a forecasted basis. The difference between the actual calculation and the forecasted calculation is the forecast error adjustment.

Both the RCAF (Adjusted) and the RCAF-5 are currently calculated using a moving 5-year average of productivity change for U.S. Class I railroads. An average productivity change rate of 1.019 (1.9% per year) for the period 2000-2004 is currently used for the RCAF (Adjusted). In accordance with Productivity Adjustment, 1 S.T.B. at 748-49, the RCAF-5 will continue to use the 1999-2003 average productivity change rate of 1.029 (2.9%) until January 1, 2007.

We have examined AAR's calculations for compliance with our procedures and find that the third quarter 2006 RCAF (Unadjusted) is 1.192, an increase of 1.2% from the second quarter 2006 RCAF of 1.178. The RCAF (Adjusted) is 0.566, an increase of .7% from the second quarter 2006 RCAF (Adjusted) of 0.562. The RCAF-5 is 0.540, an increase of .6% from the second quarter 2006 RCAF-5 of 0.537.

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

Pursuant to 5 U.S.C. 605(b), we conclude that our action will not have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act.

AUTHORITY: 49 U.S.C. 10708.

It is ordered:

1. The Board has approved the third quarter 2006 Rail Cost Adjustment Factor (Unadjusted) of 1.192, RCAF (Adjusted) of 0.566, and RCAF-5 of 0.540.
2. Notice of this decision will be published in the Federal Register.
3. The effective date of this decision is July 1, 2006.

By the Board, Chairman Buttrey and Vice Chairman Mulvey.

Vernon A. Williams
Secretary

APPENDIX

TABLE A
Ex Parte No. 290 (Sub-No. 5) (2006-3)
All Inclusive Index of Railroad Input Costs
(Refer to Endnotes Page 5)

| LINE NO. | INDEX COMPONENT | 2004 WEIGHTS | SECOND QUARTER 2006 FORECAST | THIRD QUARTER 2006 FORECAST |
|----------|------------------------------------------------------|--------------|------------------------------|-----------------------------|
| 1 | LABOR | 36.0% | 292.5 | 292.1 |
| 2 | FUEL | 12.1% | 227.9 | 265.2 |
| 3 | MATERIALS AND SUPPLIES | 4.4% | 187.5 | 197.2 |
| 4 | EQUIPMENT RENTS | 8.9% | 186.8 | 187.3 |
| 5 | DEPRECIATION | 10.6% | 180.9 | 191.9 |
| 6 | INTEREST | 3.0% | 92.7 | 92.7 |
| 7 | OTHER ITEMS ¹ | 25.0% | 185.3 | 186.3 |
| 8 | WEIGHTED AVERAGE | 100.0% | 226.0 | 232.3 |
| 9 | LINKED INDEX ² | | 223.8 | 230.0 |
| 10 | PRELIMINARY RAIL COST ADJUSTMENT FACTOR ³ | | 116.5 | 119.7 |
| 11 | FORECAST ERROR ADJUSTMENT ⁴ | | 0.013 | -0.005 |
| 12 | RCAF (UNADJUSTED) (LINE 10 +LINE 11) | | 1.178 | 1.192 |
| 13 | RCAF (ADJUSTED) ⁵ | | 0.562 | 0.566 |
| 14 | RCAF-5 ⁶ | | 0.537 | 0.540 |

TABLE B

**Ex Parte No. 290 (Sub-No. 5) (2006-3)
Comparison of First Quarter 2006 Index
Calculated on Both a Forecasted and an Actual Basis**

| Line No. | INDEX COMPONENT | 2004 WEIGHT | FIRST QUARTER 2006 FORECAST | FIRST QUARTER 2006 ACTUAL |
|-----------------|-----------------------------|--------------------|------------------------------------|----------------------------------|
| 1 | LABOR | 36.0% | 292.1 | 292.1 |
| 2 | FUEL | 12.1% | 226.4 | 219.8 |
| 3 | MATERIALS AND SUPPLIES | 4.4% | 185.6 | 185.6 |
| 4 | EQUIPMENT RENTS | 8.9% | 184.6 | 185.1 |
| 5 | DEPRECIATION | 10.6% | 195.0 | 183.1 |
| 6 | INTEREST | 3.0% | 92.7 | 92.7 |
| 7 | OTHER ITEMS | 25.0% | 182.1 | 182.7 |
| 8 | WEIGHTED AVERAGE | 100.0% | 226.1 | 224.3 |
| 9 | LINKED INDEX | | 223.9 | 223.1 |
| 10 | RAIL COST ADJUSTMENT FACTOR | | 116.6 | 116.1 |

Endnotes:

¹ “Other Items” is a combination of Purchased Services, Casualties and Insurance, General and Administrative, Other Taxes, Loss and Damage, and Special Charges, price changes for all of which are measured by the Producer Price Index for Industrial Commodities Less Fuel and Related Products and Power.

² Linking is necessitated by a change to the 2004 weights beginning in the fourth quarter 2005. The following formula was used for the current quarter’s index:

$$\frac{\text{3rd Qr. 2006 Index (2004 Weights)}}{\text{2nd Qr. 2006 Index (2004 Weights)}} \text{ Times 2nd Quarter Linked Index (1980 = 100 Linked) Equals Linked Index (Current Quarter)}$$

Or

$$\frac{232.3}{226.0} \times 223.8 = 230.0$$

³ The first quarter 2003 RCAF was rebased using the October 1, 2002, level of 192.1 in accordance with the requirements of the Staggers Rail Act of 1980 (10/1/2002 = 100).

⁴ The 3rd quarter 2006 forecast error adjustment was calculated as follows: a. first quarter 2006 RCAF using forecasted data equals 116.6; b. first quarter 2006 RCAF using actual data equals 116.1; c. The difference equals the forecast error (b-a) of -0.5. Since the actual first quarter value is less than the forecast value, the difference is subtracted from the Preliminary RCAF.

⁵ The third quarter 2006 RCAF Adjusted (0.566) is calculated by dividing the third quarter RCAF Unadjusted (1.192) by the third quarter productivity adjustment factor of 2.1061. The third quarter 2006 productivity adjustment factor is calculated by multiplying the second quarter 2006 productivity adjustment of 2.0962 by the fourth root (1.0047) of the 2000-2004 annual average productivity growth rate of 1.9%.

⁶ The third quarter 2006 RCAF-5 (0.540) is calculated by dividing the third quarter 2006 RCAF Unadjusted (1.192) by the third quarter productivity adjustment factor-5 (PAF-5) of 2.2087. The third quarter 2006 productivity adjustment factor is calculated by multiplying the second quarter 2006 PAF-5 of 2.1929 by the fourth root (1.0072) of the 1999-2003 annual average productivity growth rate of 2.9%.