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SURFACE TRANSPORTATION BOARD

DECISION

No. 37809¹

McCARTY FARMS, INC., ET AL.
v.
BURLINGTON NORTHERN, INC.

Decided: May 8, 1998

In a decision served August 20, 1997 ('97 Decision), we found that the rates charged by the Burlington Northern Railroad Company (BN) for transporting export wheat and barley from Montana to ocean ports in the Pacific Northwest had not been shown to be unreasonable. We reached this decision based on an application of the stand-alone cost (SAC) test for evaluating the reasonableness of the rates at issue.

Following our decision, the complainants (collectively, McCarty) filed a petition for judicial review with the United States Court of Appeals for the District of Columbia Circuit.² In its brief to the court, filed April 10, 1998, McCarty contends for the first time that certain of our subsidiary SAC calculations contained errors and that our decision mischaracterized certain evidence. Upon examining McCarty's assertions and the record in this case, we find that McCarty's assertions of error are for the most part unfounded. However, we agree that there were certain errors in the '97 Decision and, on our own motion, we reopen this proceeding, pursuant to 49 U.S.C. 10327(g)(1) (1995),³ to correct those errors and supplement the '97 Decision as discussed below.

¹ This proceeding embraces McCarty Farms, Inc. v. Burlington N.R.R., No. 37809 (Sub-No. 1), and Mont. Dep't of Agric. v. Burlington N. Inc., No. 37815S.

² McCarty Farms, Inc. v. Surface Transp. Bd., No. 97-1632 (D.C. Cir. filed Oct. 14, 1997).

³ Because this case was pending at the time the ICC Termination Act of 1995 was enacted, we apply the law in effect prior to January 1, 1996 to resolve this proceeding. See Section 204(b)(1) of the ICC Termination Act. We retain the authority to reopen a proceeding at any time under the current law, at 49 U.S.C. 722(c)(1) (1997).

SAC cases involve the resolution of myriad technical, fact-based issues regarding the construction and operation of a railroad, a multitude of complex computer calculations, and the review of thousands of pages of evidence. While we make every effort to ensure that our final decisions accurately reflect all of the relevant evidence, some inadvertent errors do occur. We stand ready to correct any errors that come to our attention, and parties normally seek administrative reconsideration and correction prior to seeking judicial review.⁴ It is unfortunate that McCarty, upon discovering technical errors in this decision, did not follow this procedure. Nevertheless, having learned of errors in our prior decision, we will correct those errors and reevaluate the case in light of those corrections. We are taking this action immediately, so as to avoid further, unnecessary delays in this long-running case and to facilitate the court's review of the case.⁵

Investment Costs for the Stand-Alone Railroad

In presenting its SAC case, McCarty designed a hypothetical new stand-alone railroad, called the Farmers Railroad (FRR), with what it chose as the optimum physical plant needed to serve the traffic group that it selected. A major focus of the evidence was on the costs that would be required to build the FRR. As relevant to McCarty's claims of error, we had to resolve disputes as to whether the tunnels on the FRR system would need a single or double set of tracks, as well as to determine the cost of purchasing subballast for the entire FRR. While we agreed with McCarty that the FRR could handle all its traffic with single-tracked tunnels ('97 Decision at 42), we inadvertently included \$19 million of excess investment associated with the construction of tunnels. Similarly, our analysis incorrectly incorporated a \$4.06 per cubic yard cost figure for subballast, rather than the \$2.67 figure agreed upon by the parties. These errors had the effect of increasing our cost calculations for constructing the FRR by nearly \$18 million.⁶

McCarty also correctly points out that our treatment of depreciation expense for tunnels and grading differed from that in prior SAC cases. In the '97 Decision, we inappropriately accumulated depreciation expense for tunnels and grading beyond the 20-year analysis period. This was an inadvertent error. As a result, the SAC was overstated by approximately \$15 million. The

⁴ See, e.g., Arizona Pub. Serv. Co. v. Atchison, T.&S.F. Ry., No. 41185 (STB served Apr. 17, 1998) (reopening a SAC proceeding to correct computational errors and further explain the basis for our decision on issues that the petitioner there asserted were incorrectly decided).

⁵ Our action here will not interfere with the court's jurisdiction. American Farm Lines v. Black Ball Freight Serv., 397 U.S. 532, 541 (1970). Agency self-correction is more expeditious and efficient than judicial review, Commonwealth of Pennsylvania v. ICC, 590 F.2d 1187, 1194 (D.C. Cir. 1978), and eases the burden on the reviewing court.

⁶ We concluded that the total construction costs for the FRR would be nearly \$5 billion. '97 Decision at 33, Table C-1.

combined effect of these overstatements, however, falls far short of eliminating the nearly \$500 million revenue shortfall that we identified in the '97 Decision.⁷

Revenues Available to the Stand-Alone Railroad

In determining the amount of revenues that the FRR could be expected to earn over the period 1979-1998, it was necessary to estimate what share of revenues the FRR would earn from its participation in the transportation of interline traffic. McCarty's opening evidence assumed that revenues would be divided among the carriers on a straight mileage proration method. In its reply evidence, BN suggested that a modified mileage proration method should be used. Under this modified approach, "additional shares of the revenues would be assigned to carriers for originating, terminating, or interchanging the freight car." '97 Decision at 9. In our decision, we accepted the modified proration method, in part because we incorrectly believed that "McCarty ha[d] not objected to these modifications." *Id.* McCarty's court brief points out that McCarty had objected on rebuttal to the use of the modified approach.

We need not decide which proration method should have been used, however, because even if we were to use the straight mileage proration method advocated by McCarty, the FRR still would not come close to covering all of its costs over the 20-year analysis period. As the table below shows, the combined result of correcting the errors discussed above and of assuming that interline revenues would be divided among carriers on a straight mileage proration basis would only reduce the minimum shortfall that the FRR would experience over the 1979-1998 period to \$420 million.⁸

⁷ To reach that figure, we used a discounted cash flow calculation to determine whether the sum of the annual revenues that the FRR would earn over the 20-year analysis period would be sufficient to cover all of the costs that would be incurred by the FRR over that same period of time. However, instead of resolving every cost dispute, as to many, we gave McCarty the benefit of the doubt. After examining several significant disputed cost categories, we concluded that there would be a substantial revenue shortfall, even if all other cost disputes were resolved in favor of McCarty. Therefore, for administrative economy and efficiency, we used an "assuming arguendo" analysis for the remaining cost disputes, selecting the lowest cost estimates without regard to whether they were adequately substantiated. '97 Decision at 14, 19 n.55. Had we analyzed and resolved all of the operating expense issues, it is possible that the shortfall in revenues would have been even greater.

⁸ The '97 Decision (at 19 Table 3) reported a shortfall of \$499,562,000. In revising the discounted cash flow (DCF) calculation to correct for errors pointed out by McCarty, we have discovered that the tonnage figures for 1994-1998 reflected in Table 3 were not the tonnages used in the DCF calculation. Based on the tonnages for 1994-1998 reported in Table 3 (the correct tonnage figures), the shortfall calculated in the '97 Decision should have been \$508,970,000. Correcting the errors pointed out by McCarty has the effect of reducing the shortfall to \$419,974,000.

REVISED DISCOUNTED CASH FLOW - FRR
(000)

Year	Group Tons	Group Revenues	Road Property Capital Costs	Operating Expenses	Total Annual Expenditures	Overpayment or (Shortfall)	Present Value of Overpayments and Shortfalls
1979	\$43,253	\$653,121	\$304,251	\$352,789	\$657,040	(\$3,919)	(\$3,713)
1980	48,164	788,922	383,632	401,122	784,755	4,167	3,544
1981	46,901	868,135	413,712	419,422	833,134	35,001	26,382
1982	42,665	849,623	399,756	400,416	800,172	49,451	32,488
1983	43,065	888,907	417,036	396,166	813,202	75,706	43,522
1984	45,406	994,747	453,055	434,341	887,396	107,352	54,359
1985	42,180	918,382	429,779	424,183	853,962	64,420	28,893
1986	43,651	966,047	453,441	455,074	908,516	57,532	23,094
1987	54,394	1,080,601	570,259	537,281	1,107,540	(26,938)	(9,733)
1988	60,796	1,171,546	668,738	560,891	1,229,629	(58,083)	(18,924)
1989	64,070	1,202,996	731,276	583,059	1,314,336	(111,340)	(32,731)
1990	67,277	1,275,990	799,246	621,383	1,420,629	(144,639)	(38,344)
1991	67,220	1,285,405	885,657	624,066	1,509,723	(224,318)	(53,553)
1992	67,679	1,305,414	979,024	642,410	1,621,434	(316,019)	(67,925)
1993	69,152	1,352,875	1,015,440	651,706	1,667,146	(314,272)	(60,767)
1994	73,484	1,441,947	1,113,944	700,570	1,814,515	(372,568)	(64,666)
1995	73,824	1,452,957	1,123,157	737,909	1,861,066	(408,109)	(63,551)
1996	76,602	1,512,155	1,225,632	784,115	2,009,747	(497,593)	(69,618)
1997	78,231	1,548,956	1,316,777	802,581	2,119,358	(570,402)	(71,730)
1998	80,633	1,601,292	1,428,195	854,345	2,282,539	(681,247)	(77,000)
Cumulative Present Value of Overpayments and Shortfalls							(\$419,974)

For us to find that BN's rates are unreasonably high, there could be no shortfall in the revenues produced by the SAC test. Thus, correcting the errors in investment costs identified by McCarty, together with developing interline revenue estimates using a straight mileage proration methods, does not alter our ultimate conclusion that the rates charged by BN have not been shown to be unreasonable.

Operating Plan of the Stand-Alone Railroad

In its appeal, McCarty points to certain inaccuracies in the '97 Decision in our description of its operating plan evidence. As discussed below, we have reviewed the claimed errors. Although we reject many of McCarty's claims, we agree that the prior decision contained some minor errors, but

find that they do not materially affect our overall conclusion that the operating plan for the FRR proposed by McCarty would not be feasible.⁹

In the '97 Decision (at 12 n.34), we incorrectly stated that McCarty's plan assumed that coal shippers would have switched from steel to aluminum (shipper-owned) coal cars in 1979, whereas McCarty actually assumed such a switch in 1989. Indeed, the evidence of both parties indicates that the FRR would use steel coal cars from 1979 through 1988, and the reference clearly should have been to 1989, not 1979. Our analysis, however, was not affected by the year in which it was assumed by McCarty that all shippers on the FRR would switch to aluminum coal cars. As we pointed out, it is entirely unrealistic to assume that shippers would voluntarily incur additional costs (whether in 1979 or 1989) to convert their entire fleet of steel coal cars to aluminum cars without some form of incentive or compensation.¹⁰

McCarty is correct that, in note 34,¹¹ we incorrectly stated that the grain cars that McCarty assumed the FRR would use were not available until 1991. This misstatement, however, does not invalidate our overall conclusion that McCarty failed to support its assumption that the FRR could achieve significantly higher load factors than those achieved historically by BN.¹² As we explained

⁹ While operations of the FRR need not mimic those of BN, the proposed operations nevertheless must be shown to be feasible. Coal Rate Guidelines, Nationwide, 1 I.C.C.2d 520, 543 (1985). Thus, in reviewing the operating plan, we evaluated whether the proposed operations could achieve the efficiencies assumed by McCarty. Primarily because McCarty's operating plan relied on the offering of incentives to shippers to achieve highly efficient operations but failed to account for such incentives, we concluded that the FRR operations proposed by McCarty would be unrealistic. '97 Decision at 12-14.

¹⁰ McCarty's evidence shows that in 1989 (when it assumed that steel cars would be replaced with aluminum cars), over 50% of the coal cars that would be required by the FRR were owned by shippers. Rebuttal verified statement of Andrew, Exhibit GMA 18. Furthermore, actual traffic data reflects that shippers using that part of the BN system that was replicated for the FRR continued to use steel cars after 1989.

¹¹ McCarty suggests that in note 34, we also failed to recognize that, on rebuttal, McCarty had corrected the inappropriate assumption in its opening evidence that barley cars would be loaded beyond capacity. However, the grain cars that the FRR would utilize have a capacity of 4750 cubic feet and, based on McCarty's witness Lyman's statement that a bushel of barley (1.24 cu. ft.) weighs 48 pounds, (Rebuttal verified statement of Lyman at 15), these cars could only hold approximately 92 tons of barley. Thus, McCarty's assumption on rebuttal that 98 tons of barley could fit in the FRR grain cars is erroneous.

¹² McCarty based the FRR load factor for grain and general merchandise traffic on BN's experience for 1991. However, the 1991 average load factor for BN was not typical, but was higher
(continued...)

in the '97 Decision, loading factors in many instances would be beyond the FRR's control. Much of the traffic that the FRR would transport would be received in interchange from other railroads, and there is no basis for assuming that shippers situated on other carriers would alter their shipping practices in order to accommodate the efficient operation of the FRR absent sufficient incentives. Nor is there reason to believe that shippers situated on the FRR would alter their shipping practices without suitable incentives.¹³

For intermodal traffic, McCarty assumed that all intermodal trains would carry their full capacity of trailers and containers, notwithstanding that BN has never achieved a utilization of more than 88%. This would require that intermodal and general merchandise shippers tender the exact amount of traffic to allow the FRR always to have trains run fully loaded and to the maximum train length, or alternatively that shippers tolerate delays by waiting for enough traffic to become available to fill a train before that train is dispatched. Such an assumption is simply unrealistic. As the parties acknowledge, intermodal and general merchandise traffic is time sensitive and shippers must know when their traffic will move and when it will arrive at destination. Consequently, trains must depart on schedule whether or not they are full.¹⁴

Finally, we have reexamined McCarty's adjustments to the cycle time study performed by BN, in light of McCarty's assertion that our analysis was factually incorrect, and we are satisfied that our analysis was proper.¹⁵ McCarty contends that we failed to recognize that, when BN

¹²(...continued)
than the average experienced historically by BN.

¹³ McCarty implicitly assumed that shippers would change their loading practices when it assumed that the FRR would earn the same revenues as BN even though it would move fewer cars. But, as we observed in the '97 Decision, McCarty failed to account for such incentives.

¹⁴ Intermodal shipments are time sensitive because the railroads compete with motor carriers for this type of traffic. If movements were delayed to maximize train length, the traffic could be diverted to motor carriers. Therefore, a railroad must dispatch trains on a regular schedule without waiting to maximize train size.

¹⁵ One of the problems we had, and continue to have, with McCarty's cycle time study is that it appears to have eliminated statistically valid data merely because it tended to increase the cycle time. To demonstrate the inappropriateness of McCarty's exclusion of certain data used by BN in the cycle time study, we noted, as an example, that "708 observations for the empty transit of coal cars from Casselton, ND, to Big Horn, MT, in 1994 were eliminated [by McCarty], and average hours for the study period were based on only 2 observations from other years." '97 Decision at 13 n.40. McCarty admits that this adjustment was incorrect. This example demonstrates why many of McCarty's other adjustments were also inappropriate. BN's cycle time study relied on by McCarty did not use data for any movements between two points that had less than 10 observations in any

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developed empty transit time for the cycle time study, it assumed that cars would always return to the origin. We have again reviewed the program used to compute empty return time and find no merit to McCarty's allegation.¹⁶ In any event, as we observed in the '97 Decision, McCarty adjusted the empty return portion of the study by a mileage-based factor. To be valid, this requires assuming that all cars once unloaded will be needed for reloading elsewhere on the FRR and that cars will never be idle. McCarty made this assumption because it assumed that traffic would flow evenly throughout the year. But as we found in the '97 Decision, grain traffic in particular is subject to wide fluctuations, as McCarty's evidence demonstrates. Rebuttal verified statement of Crowley, exhibit TDC-12.

In sum, notwithstanding McCarty's claims that we misconstrued or misunderstood its evidence, we continue to find beyond any doubt that McCarty's basic assumptions as to how the FRR would operate were not feasible.

CONCLUSION

We affirm our prior finding that McCarty failed to meet its burden to demonstrate that its proposed operations for the FRR would be feasible. For that reason, and because the FRR will experience a huge revenue shortfall, we conclude that BN's rates have not been shown to be unreasonable.

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

It is ordered:

1. Our conclusion in the '97 Decision that BN's rates have not been shown to be reasonable is affirmed.

¹⁵(...continued)

year. Thus, in the Casselton to Big Horn example, the only year with more than 10 observations was 1994, but McCarty considered this data as an outlier and instead used data with fewer than 10 observations. Likewise, with other movements McCarty inappropriately used averages for years with only a few observations as the basis for rejecting statistically significant data.

¹⁶ McCarty claims that, in the COBOL program ADDHOURS.CBL, "[t]he loaded origin becomes an empty termination and the loaded termination becomes an empty origin for the purpose of assigning average cycle transit hours for the empty direction." Rebuttal verified statement of Andrew at 13 n.4. This is true, but in the LKUP-MT subroutine of that same program (at lines 535-549), the loaded termination simply becomes the empty origin for purposes of developing the time a car remains empty. The program does not assume that, once unloaded, a car returns to the same place where it was initially loaded.

No. 37809 et al.

2. This decision is effective on May 11, 1998.

By the Board, Chairman Morgan and Vice Chairman Owen.

Vernon A. Williams
Secretary