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SURFACE TRANSPORTATION BOARD

DECISION

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

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

Decided: March 17, 2008

The requests to reconsider various aspects of the Board's simplified rail rate guidelines are denied.

BY THE BOARD:

In a decision served September 5, 2007 (Simplified Standards),¹ the Board modified its simplified rail rate guidelines, creating a simplified stand-alone cost (Simplified-SAC) method for medium-size rail rate disputes and revising its "Three-Benchmark" method for smaller rail rate disputes. The Board also placed limits on the total relief available over a 5-year period under these two simplified methods. With these new guidelines, the Board sought to make its rail rate dispute resolution process more affordable and accessible to shippers with small- and medium-size rate disputes, while ensuring a rational basis for the resulting rate determinations.

A group of shippers that had participated in the rulemaking (referred to herein as Interested Parties)² filed a timely petition for reconsideration of certain aspects of the new

¹ Simplified Standards For Rail Rate Cases, STB Ex Parte No. 646 (Sub-No. 1) (STB served Sept. 5, 2007), pet. for review docketed, No. 07-1369, et al. (D.C. Cir. Sept. 18, 2007).

² Am. Chemistry Council, Am. Forest & Paper Ass'n, Am. Soybean Ass'n, Colorado Wheat Admin. Comm., Fertilizer Inst., Glass Producers Transp. Council, Idaho Barley Comm'n, Idaho Wheat Comm'n, Inst. of Scrap Recycling Indus. Inc, Montana Wheat & Barley Comm., Nat'l Ass'n Of Wheat Growers, Nat'l Barley Growers Ass'n, Nat'l Corn Growers Ass'n, Nat'l Council Of Farmer Coop., Nat'l Farmers Union, Nat'l Grain & Feed Ass'n, Nat'l Indus. Transp. League, Nat'l Oilseed Processors Ass'n, Nat'l Petrochemical & Refiners Ass'n, Nebraska Wheat Board, North Am. Millers' Ass'n, North Dakota Grain Dealers Ass'n, North Dakota Public Service Comm'n, North Dakota Wheat Comm'n, Oklahoma Wheat Comm'n, Paper & Forest Industry Transp. Comm., PPL Energyplus, South Dakota Wheat Comm'n, Texas Wheat Producers Board, Washington Wheat Comm'n, Alliance For Rail Competition, Consumers United For Rail Equity, Nat'l Sorghum Producers, USA Rice Fed'n, and the Honorable Brian Schweitzer, Governor, State of Montana.

guidelines. While they raise a number of issues, discussed below, their core complaint is that the limits on relief available under the simplified procedures are too low. The Arkansas Electric Cooperative Corporation (AECC) also seeks reconsideration, echoing this same concern. The Association of American Railroads (AAR) and the American Short Line and Regional Railroad Association (ASLRRRA) oppose the reconsideration requests.

We have carefully reviewed the requests submitted by Interested Parties and AECC to increase the limits on relief, and we conclude that the limits on relief set in Simplified Standards are reasonable and proper at this time. The remaining issues are a rehash of arguments that we have already considered and properly rejected in the rulemaking. Accordingly, the petitions for reconsideration will be denied.³

BACKGROUND

Constrained Market Pricing

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), as modified in Major Issues in Rail Rate Cases, STB Ex Parte No. 657 (Sub-No. 1) (STB served Oct. 30, 2006) (Major Issues), pet. for review docketed, No. 06-1374, et al. (D.C. Cir. Nov. 13, 2006).

Guidelines adopted a set of pricing principles known as "constrained market pricing" (CMP). CMP contains three main constraints on the extent to which a railroad may charge differentially higher rates on captive traffic. 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." Guidelines, 1 I.C.C.2d 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 market that is free from barriers to entry. In a contestable market, even a monopolist must offer competitive rates or lose its customers to a new entrant. Id.

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

³ Interested Parties asked that we have a hearing on their reconsideration requests. After reviewing their petition, we conclude that another hearing in this proceeding is not warranted.

the SAC analysis. Id. at 529. This removes any advantages that 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 Full-SAC presentation under Guidelines, 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 defendant 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.⁴ 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.

⁴ An analysis period of 10 years for future Full-SAC cases was established in Major Issues in Rail Rate Cases, STB Ex Parte No. 657 (Sub-No. 1), slip op. at 28-31 (STB served Oct. 30, 2006) (Major Issues), pet. for review docketed, No. 06-1374, et al. (D.C. Cir. Nov. 13, 2006).

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.⁵

Simplified Standards

Congress has 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). To respond to this directive, the Board adopted the guidelines set forth in Rate Guidelines – Non-Coal Proceedings, 1 S.T.B. 1004 (1996). A decade passed, however, without any shipper presenting a case decided under those simplified guidelines. Simplified Standards reflects our attempt to modify and reform those guidelines.

A. Simplified-SAC Method

The Simplified-SAC method allows the Board to determine whether a captive shipper is being forced to cross-subsidize parts of the defendant's existing rail network that the shipper does not use.⁶ To hold down the cost of a Simplified-SAC presentation, various simplifying assumptions and standardization measures are essential. Toward that end, the following restrictions are imposed on a Simplified-SAC presentation:

- *Route*: The analysis examines the predominant route of the issue movements during the prior 12 months.
- *Configuration*: The facilities of the SARR consist of the existing facilities along the analyzed 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 are excluded from the Simplified-SAC analysis.
- *Test Year*: The Simplified-SAC analysis examines the reasonableness of the challenged rates based on a 1-year analysis. The Test Year is the most recently completed 4 quarters preceding the filing of the complaint.
- *Traffic Group*: The traffic group consists of all movements that traveled over the selected route in the Test Year. No rerouting of traffic is permitted.

⁵ The proper method for making that determination was set in Major Issues at 7-17.

⁶ Unlike the Full-SAC test, the Simplified-SAC procedure generally does not allow the complaining shipper to address inefficiencies in the current rail operation.

- *Cross-Over Traffic*: The revenue from cross-over traffic is apportioned between the on-SARR and off-SARR portions of the movement based on the revenue allocation methodology used in Full-SAC proceedings.⁷
- *Road Property Investment*: The Board's findings in prior Full-SAC cases are used to simplify parts of the road property investment analysis.
- *Operating Expenses*: The total operating and equipment expenses of the SARR are estimated using the Board's Uniform Rail Costing System (URCS).
- *Discounted Cash Flow Analysis*: The DCF analysis calculates the capital requirements of a SARR in the customary fashion, but then compares the revenues earned by the defendant railroad against the revenue requirements of the SARR only for the Test Year.
- *Internal Cross-Subsidy Inquiry*: The internal cross-subsidy test set forth in PPL,⁸ as refined in Otter Tail,⁹ is 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) are allocated amongst the traffic group based on the methodology used in Full-SAC cases.¹⁰
- *5-Year Rate Relief*: The maximum lawful rate is expressed as a ratio of revenue to variable costs (R/VC), with variable costs calculated using URCS without any movement-specific adjustments. This maximum R/VC ratio is then prescribed for a maximum 5-year period.

B. Three-Benchmark Method

Under the Three-Benchmark method, the reasonableness of a challenged rate is determined by examining the challenged rate in relation to three benchmark figures, each of which is expressed as an R/VC ratio. The first benchmark, the Revenue Shortfall Allocation Method (RSAM), measures the average markup over variable cost that the defendant railroad would need to charge all of its "potentially captive" traffic (traffic priced above the 180% R/VC level) in order for the railroad to earn adequate revenues as measured by the Board under 49 U.S.C. 10704(a)(2). The second benchmark, the R/VC_{>180} benchmark, measures the average markup over variable cost currently earned by the defendant railroad on its potentially captive traffic. The third benchmark, the R/VC_{COMP} benchmark, is used to compare the markup being

⁷ "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 is set forth in Major Issues at 17-20, as refined and clarified in Western Fuels Ass'n v. BSNF Ry., STB Docket No. 42088 (STB served Sept. 10, 2007).

⁸ 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).

⁹ Otter Tail Power Co. v. BNSF Ry., STB Docket No. 42058, slip op. at 11-13 (STB served Jan. 27, 2006), aff'd sub nom. Otter Tail Power Co. v. STB, 484 F.3d 959 (8th Cir. 2007).

¹⁰ The appropriate method is set forth in Major Issues at 7-16.

paid by the challenged traffic to the average markup assessed on other comparable potentially captive traffic.

Once the Board has selected the appropriate comparison group for the R/VC_{COMP} benchmark, each movement in the comparison group will be adjusted by the ratio of $RSAM \div R/VC_{>180}$. The Board will then calculate the mean and standard deviation of the resulting R/VC ratios (weighted in accordance with the proper sampling factors). If the challenged rate is above a reasonable confidence interval around the estimate of the mean for the adjusted comparison group, it will be presumed unreasonable and, absent any “other relevant factors,” the maximum lawful rate will be prescribed at that boundary level.

C. Limits on Relief

The maximum potential rate relief available to a complainant that elects to use the Three-Benchmark method will be limited to \$1 million per case over a 5-year period, and for a complainant that elects to use the Simplified-SAC method it will be limited to \$5 million per case over the same period.¹¹ These limits are based on parties’ testimony regarding the likely litigation cost to pursue relief under the next more complicated but more precise method. By permitting any shipper to use either of these simplified methods, we ensure that the rate complaint process will be available for any size rate dispute. But by placing limits on the relief available, we encourage shippers with larger disputes to pursue relief under a more appropriate methodology without the Board attempting to predetermine the likely value of a case. The complainant must evaluate its own claim, decide for itself the expected value of the case, and balance the value against the litigation costs and the potential relief it may receive.

The relief refers to the sum of the difference between the challenged rates and the maximum lawful rates, whether in the form of reparations, a rate prescription, or a combination of the two. Any rate prescription will automatically terminate once the complainant has exhausted the relief available. Thus, the actual length of the prescription may be less than 5 years if the available relief is used up in a shorter time. The complainant will be barred from bringing another complaint against the same rate for the remainder of the 5-year period. In this way, we encourage parties to use the most precise methodology applicable to their expected level of relief.

Once a rate prescription expires, the carrier’s rate making freedom will be restored with a regulatory safe harbor at the challenged rate for the remainder of the 5-year period, with appropriate adjustments for inflation using the rail cost adjustment factor, adjusted for inflation and productivity (RCAF-A).¹² If, however, a carrier establishes a new common carrier rate once the rate prescription expires, and the new rate exceeds the inflation-adjusted challenged rate, the shipper may bring a new complaint against the newly established common carrier rate. In this

¹¹ We will index annually the \$5 million and \$1 million 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.

¹² See Railroad Cost Recovery Procedures-Productivity Adjustment, 5 I.C.C.2d 434 (1989), aff’d sub nom. Edison Electric Institute v. ICC, 969 F.2d 1221 (D.C. Cir. 1992).

way, the shipper will be discouraged from using a cruder methodology than the value of the case warrants, but a railroad does not get a potentially massive regulatory windfall from an exhausted prescription.

We decided against adopting a formal mechanism to police against attempts to evade the limits on relief by dividing a large dispute into multiple smaller disputes. Instead, the Board reserves the discretion to protect the integrity of its processes from abuse by addressing and remedying on a case-by-case basis any improper attempts to disaggregate a large claim into a number of smaller claims.

DISCUSSION AND CONCLUSIONS

A party may seek Board reconsideration of a decision by submitting a timely petition that either presents new evidence or changed circumstances that would materially affect the prior decision or that demonstrates material error in the prior decision. 49 U.S.C. 722(c); 49 CFR 1115.3. Here, Interested Parties and AECC seek reconsideration of six aspects of Simplified Standards: (1) the limits on relief, (2) the lack of pre-complaint access to the Waybill Sample, (3) the application of the Three-Benchmark method to local traffic on shortlines, (4) the use of a confidence interval in the Three-Benchmark method, (5) the inclusion of the managerial efficiency adjustment to RSAM, and (6) the creation of the Simplified-SAC method. Each issue is discussed in turn below.

1. Limits on Relief

As discussed in Simplified Standards, the Board placed limits on the relief available under these simplified procedures to encourage complainants to use the method best suited to the amount in dispute. In particular, complainants that proceed under the Three-Benchmark method will be limited to \$1 million of rate relief per case over a 5-year period, and complainants that elect to proceed under the Simplified-SAC method will be limited to \$5 million of relief per case over the same period. The Board reasoned that these limits provide a sufficient cushion between the cost of bringing the case and the relief available, while simultaneously encouraging shippers seeking more relief to use a more precise methodology. Simplified Standards at 26-33.

Interested Parties contend that these limits are too low and will eliminate relief for a significant number of complainants. They focus on a narrow subset of shippers—those with a case worth between \$1.75 and \$3 million over 5 years. Specifically, the Interested Parties claim that, if a shipper believes its case is worth \$2 million, it would be faced with a Hobson's choice. Were it to pursue relief under the Three-Benchmark method, it would relinquish over half the value of its case (as relief would be capped at \$1 million). Alternatively, were it to use the Simplified-SAC method, the expected value of the case (\$2 million) would exceed the expected litigation costs (\$1 million) only by a factor of 2, which Interested Parties contend is insufficient to justify the more expensive method. To address this situation, they ask for an increase in the limits on relief caps—to \$3 million for the Three-Benchmark method and \$10 million for the Simplified-SAC method.

We do not agree that such an increase is warranted at this time. Not all \$2 million cases will be the same. Some will be stronger than others. A shipper that is either not confident of its

case or is satisfied that the potential relief would be low in any event should elect to use the Three-Benchmark method. But a shipper that is more confident of its prospects for obtaining greater relief should be encouraged to present its case under the more precise Simplified-SAC method. The shipper must evaluate the strength of its claim and decide for itself the chance of success, and balance those odds against the litigation costs and the potential relief it may obtain.

Our goal is not to set the limits in such a way as to give shippers with questionable claims an incentive to bring a case under their preferred method. Rather, our goal is to balance simplicity against the need to use the method that is best suited for the dispute. According to Interested Parties' own evidence (at Table 1C), the \$1 million and \$5 million limits provide every shipper with a potential case with sufficient net relief after litigation costs to justify bringing a complaint under Three-Benchmark or Simplified-SAC method.¹³ Thus, every complainant will have a vehicle to pursue its complaint regardless of the value of the case.

The fact that some shippers may face a difficult choice of which method to use would be true at any level at which the limits might be set. Any shipper that believes its case falls near the upper end of the relief available under a particular method would face this choice. Ultimately, we do not think it is improper for there to be some trade-off involved in using a simpler, faster, and less costly method that is inherently less precise. We believe the limits we have set strike the appropriate balance so that we do not open the door to excessive litigation under methods that are not justified for the amount at dispute.

Finally, we reject AECC's argument that the limits on relief under the Simplified-SAC method should be set at a level that would be at least equal to the combined litigation costs of the complainant and the defendant. The statute requires a simplified and expedited method for those cases "in which the full stand-alone cost presentation is too costly, given the value for the case." 49 U.S.C. 10701(d)(3). We agree with the AAR that, in using the term "presentation is too costly," what Congress was concerned with was the cost to the shippers of bringing the case.

2. Pre-Complaint Access To Confidential Waybill Sample

The Waybill Sample is a database maintained by the Board that consists of an annual sample of carload waybills for 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 (or "mask") revenue information associated with contract shipments to safeguard the confidentiality of the contract rates, as required by 49 U.S.C. 11904.

It has been the Board's practice not to release unmasked contract revenue information to practitioners and consultants. But in Simplified Standards, we agreed to change that policy in

¹³ See Interested Parties Petition at 7.

Three-Benchmark cases and provide complainants access to the unmasked Waybill Sample of the defendant carrier. We concluded that a complainant would need this information to present its case and that our protective orders should be sufficient to protect the confidential contract information. However, we also concluded that providing that access before a complaint is filed would be improper. Simplified Standards at 80.

Interested Shippers ask that we reconsider that policy and provide pre-complaint access to the unmasked Waybill Sample. They contend that, without this information, a shipper cannot assess the merits of a potential claim. They suggest that we condition access to this confidential data on the shipper certifying that it is considering filing a rate case.

We agree with AAR that the potential for abuse from release of this confidential data prior to the filing of a complaint far outweighs the benefits that might come from it. We do not believe the suggested certification procedure would be sufficient to prevent “litigation shopping” spurred on by those with incentives to promote litigation.¹⁴

The Waybill Sample contains sensitive commercial data for the railroads, and having this information prior to filing a complaint is not vital. Indeed, shippers currently negotiate rail contracts without this data. Moreover, the filing requirements for a complaint are not onerous, especially under the Three Benchmarks method. And a shipper that has filed a complaint may re-assess its claim after obtaining the Waybill Sample data and decide either to proceed with its complaint using a different method or to withdraw its complaint. Id. at 28.

The complaint requirement provides an important check against needless and therefore inappropriate access to the Waybill Sample. A shipper of traffic that does not qualify for Board rate regulation should not have access to this sensitive information. There are various reasons that traffic may not qualify for rate regulation: the traffic may have been exempted from regulation under 49 U.S.C. 10502; the revenues produced by the rates on the traffic may be less than 180% of the variable costs and therefore below the regulatory floor established in 49 U.S.C. 10707(d); the traffic may move under a rail transportation contract and therefore be outside the Board’s jurisdiction (see 49 U.S.C. 10709); or the shipper may have a feasible transportation alternative and therefore not be entitled to rate review (see 49 U.S.C. 10707(b)). The shipper may not always realize that one of these limitations applies. And the Board would have no reason to know of any such limitation unless until the complaint is filed. The complaint thus provides an important safeguard against an improper release of waybill data.

Accordingly, we will not provide for pre-complaint access to the unmasked, confidential, information contained in the Waybill Sample.

3. Application of Three-Benchmark Method to Local Movements on Shortlines

In Simplified Standards, we explained that the Three-Benchmark method would not be available for a movement performed solely by a Class II or Class III carrier. Two of the three benchmarks needed for that method—R/VC_{>180} and RSAM—would not be available without

¹⁴ AAR Reply at 9.

substantial additional data collection and analysis. We could find no way to modify the Three-Benchmark method to render it suitable for purely local shortline movements without increasing the cost to near that of a Simplified-SAC presentation. Thus, for a purely local movement of a Class II or Class III carrier, the only simplified procedure would be the Simplified-SAC method.

Interested Parties acknowledge that there may be practical problems with the use of the Three-Benchmark method for a local movement on a Class II or Class III carrier. But they argue that, rather than preclude the Three-Benchmark entirely, we should allow a shipper to suggest an appropriate way to apply the Three-Benchmark criteria to a local movement on a shortline. They offer no specific proposal, however.

Their suggestion runs counter to the purpose of creating the simplified guidelines. To attempt to devise an appropriate way to apply the Three-Benchmark method to a local movement on a shortline within the confines of a specific case would not only take additional time, but it would cost the shipper (who would carry the burden of persuasion) more money and resources. It would also burden the railroad, which would need to scrutinize the proposed methodology to determine whether it is a reasonable application of the Three-Benchmark criteria to local movements.

Moreover, the Three-Benchmark method is unsuited for small disputes involving local movements on shortlines. Because the Board does not maintain URCS variable cost data or calculate revenue adequacy for smaller carriers, two of the three benchmarks, $R/VC_{>180}$ and RSAM, are not available in such cases without considerable expense and it is questionable whether the Waybill Sample would even contain any “comparable” traffic on the defendant shortline. We are hopeful that a Simplified-SAC presentation would not be as complex or expensive when the movement being challenged is a short, local movement on a shortline. But in any event, we have searched in vain for any viable way to apply the Three-Benchmark method to assess the reasonableness of a rate for a local movement on a shortline. We believe that shippers seeking to challenge the rates of local movements on shortlines are better served by devising ways to reduce the litigation costs of a Simplified-SAC presentation.

Should a shipper find a reasonable and inexpensive way to apply the Three-Benchmark method to local movements on a shortline, it should present its proposal to us in a petition for rulemaking. We could then institute a sub-docket in STB Ex Parte No. 646 to examine its proposal.

4. Confidence Interval

As explained in Simplified Standards, under the Three-Benchmark method, if the Board finds that the railroad has market dominance over the movements at issue, the Board will then select the appropriate comparison group through the final-tender process. See Simplified Standards at 21-22. Each movement in the comparison group will then be adjusted by the ratio of $RSAM \div R/VC_{>180}$. The Board will then calculate the mean and standard deviation of the R/VC ratios for the adjusted comparison group (weighted in accordance with the proper sampling factors).

If the challenged rate is above a reasonable confidence interval around the estimate of the mean for the adjusted comparison group, it will be presumed unreasonable and, absent any “other relevant factors,” the maximum lawful rate will 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:¹⁵

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

This confidence interval will 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 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. We also understand that, by truncating the population from which the comparison group is drawn, we may distort modestly the confidence interval, and that the selection process introduces some non-randomness to the observed comparison movements. But there is uncertainty as to the true mean of a comparison group even when the movements are drawn from a random sample. Accordingly, we stated we would only presume that a rate is unlawful if it falls outside a reasonable confidence interval around the mean.

Interested Parties seek reconsideration of this aspect of our decision. They argue that without a random selection process, there is no statistical basis for the use of a confidence interval.

We continue to believe using the confidence interval is appropriate. A comparison group selected based on objective criteria from a random sample (here the Waybill Sample) is itself a random sample. For example, if one were trying to estimate the mean R/VC ratio of chemical movements between 400 and 600 miles, the first step could be to exclude all movements that were not chemical movements as well as chemical movements that traveled greater or less distance. What is left is a random sample of chemical movements of the desired distance. Those observations are not rendered “non-random” simply because one applied certain objective selection criteria to focus the inquiry. We acknowledge that parties may use more subjective

¹⁵ This formula for a confidence interval around a mean can be found in most statistics textbooks. We proposed using a “one-sided” hypothesis test, such that we could have 90% confidence as to whether the challenged rate exceeds a reasonable norm. We used 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 have used a “two-sided” hypothesis test.) A 90% confidence interval is a standard level of confidence used in statistical analysis. The Student’s t-distribution 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’s t-Distributions.

criteria to select their proposed comparison group, which could introduce some non-randomness into the comparison group. This could be mitigated to some extent by the final tender selection process. In any event, we continue to believe the confidence interval formula is sufficiently precise for these purposes.

Interested Parties alternatively contend that use of the confidence interval is improper because the true mean of the comparison group could be above or below the sample mean. While this is true, we believe the use of a confidence interval is nonetheless appropriate. If the challenged rate is very close to the mean of the sampled comparison group, we cannot find with any confidence that the challenged rate is truly above the mean rather than a result of a sampling error. And the smaller the sample size, or the larger the variation within the comparison group, the less confidence we can have. It would not be reasonable to declare a rate unlawful when we have no real confidence that the rate is actually above the mean of the sample comparison group. Using a confidence interval will provide a standard statistical technique for deciding when we can have sufficient confidence to presume the challenged rate is unreasonable.

5. RSAM and Efficiency Adjustment

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. When simplified guidelines were first adopted in 1996, the Board did not settle on a single formula for computing this benchmark. Rather, the Board decided to look at the effect on a carrier's revenue needs by 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. The end result was publication of an RSAM range that would form the relevant starting range for the Board's consideration. The RSAM benchmark the agency would use in a particular case was left unresolved, but was expected to fall within this range.

In the NPRM, the Board proposed to eliminate the range and use the unadjusted RSAM in the rate comparison approach. As no party appeared to oppose that proposal, the Board adopted it for the reasons set forth in the NPRM. Simplified Standards at 19.

Interested Parties seek reconsideration, arguing that the elimination of the RSAM with the efficiency adjustment ignores the so-called "Long-Cannon" requirement that the Board give due consideration to the amount of traffic that does not contribute to going concern value and the efforts made to minimize such traffic. See 49 U.S.C. 10701(d)(2)(A). They ask that we permit parties to present particularized evidence in a case to demonstrate that the RSAM should be lower due to managerial inefficiency.

However, Interested Parties appear to raise this objection for the first time on reconsideration; they fail to cite to where this objection to the proposal to eliminate the managerial efficiency adjustment was raised in the record. Additionally, more than a passing

reference is needed to raise their objection to our attention.¹⁶ And new arguments that could have been presented earlier cannot be raised for the first time on reconsideration.

Moreover, Interested Parties ask for something we have already granted. Under the Three-Benchmark method, parties may submit evidence of “other relevant factors” to demonstrate that the maximum lawful rate should be higher or lower, such as evidence “that the railroads are not operating as efficiently as possible.” Simplified Standards at 22.

In these circumstances, we did not commit material error by removing the managerial efficiency adjustment to RSAM.

6. Simplified-SAC Method

In Simplified Standards, we adopted the Simplified-SAC method for medium-sized disputes to fill a gap between the Full-SAC and the Three-Benchmark methods. The Simplified-SAC method is designed to provide a reasonable means of retaining, in simplified form, the primary advantage of a Full-SAC presentation: the ability to detect abuses of market power whereby a railroad forces a captive shipper to pay more than is necessary for the carrier involved to earn adequate revenues and thereby forces the captive shipper to cross-subsidize parts of the defendant’s rail network it does not use or benefit from. Id. at 5.

We rejected the shipper arguments that the method is not sufficiently expedited and simplified, or that it cannot be adopted until it has been tested. Id. at 52-55. We explained that this method is clearly simpler and more expedited than the Full-SAC method and that there is no requirement, either in the statute or in our precedent, that the agency test guidelines in advance. More fundamentally, we explained that it would be practically impossible for the Board to test the Simplified-SAC method in any meaningful fashion. Instead, we committed to continue refining and improving the method as we gain better knowledge and experience through application to individual cases. Id. at 55.

Interested Parties continue to object to the Simplified-SAC method. They reiterate their position that the method is neither simplified nor expedited and, in any event, should be tested before adopted. We have already addressed these arguments in full in our original decision. Interested Parties have not addressed our reasoning or analysis of this issue, and simply restate their position in cursory terms. Because we continue to believe that the Simplified-SAC method fills a useful role between the Full-SAC and Three-Benchmark methods, we will not reconsider our decision to provide that intermediate option.

For the reasons set forth above, Interested Parties and AECC have not demonstrated that the Board materially erred in its prior decision.

As the guidelines are tested through application to actual rail rate disputes, we will garner greater understanding of the litigation costs of these approaches and whether the proposed structure and limits on relief are working as intended. And the creation of a body of precedent

¹⁶ See Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519, 553-54 (1978).

will provide guidance to the rail community on some of the remaining ambiguities in the approach. Nonetheless, we intend to carefully monitor the application of these guidelines, and remain vigilant that the goals of simplification are not thwarted as parties begin to litigate cases under these guidelines. While these new guidelines reflect an important step forward in creating a workable structure for resolving rate disputes of all sizes, we anticipate that further steps will be needed as the application of the guidelines reveals unanticipated issues or shows that more or less simplification is warranted.

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

It is ordered:

1. The motions for reconsideration are denied.
2. This decision is effective on its date of service.

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

Anne K. Quinlan
Acting Secretary