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SURFACE TRANSPORTATION BOARD

DECISION

Docket No. EP 715

RATE REGULATION REFORMS

Digest:[1] The Board is raising the limitations on relief for rate reasonableness complaints brought by a shipper against a carrier under both of the agency's simplified procedures. The Board also is making several technical changes to the rate complaint procedures, including how revenues are allocated, and how the parties must present evidence of the value of road property investment. Finally, the Board is changing the interest rate that railroads must pay on reparations if they are found to have charged unreasonable rates, and announcing future proceedings on options for addressing cross-over traffic and on proposals to address the concerns of small agricultural shippers.

Decided: July 18, 2013

Where there is no competitive freight rail transportation market, Congress has charged the Board with protecting the public from unreasonable pricing by freight railroads, while at the same time fostering a sound, safe, and efficient rail transportation system by allowing carriers to earn adequate revenues. Balancing these sometimes conflicting goals is no easy task. Over the past 30 years, the agency has worked to provide shippers with a more accessible forum to bring rate disputes to the Board. This rulemaking, announced in Rate Regulation Reforms (RRR Proposal), EP 715 (STB served July 25, 2012), is designed to further improve our procedures.

This reevaluation of our rate reasonableness procedures is itself an outgrowth of the broader hearings we held in 2011 to explore the state of competition in the railroad industry. See Competition in the R.R. Indus., EP 705 (STB served Jan. 11, 2011). In those hearings, we heard from a number of parties that our rate reasonableness proceedings were effectively only available to very large shippers and that smaller shippers had no viable means of challenging freight rail rates. These shipper interest groups therefore asked us to consider revising our competitive access rules so that the forces of competition could protect all captive shippers, instead of the regulatory hand that they perceive is protecting a more limited subset of captive shippers. The railroad industry uniformly opposed any change to existing competitive access rules that might promote more rail-to-rail competition. Instead, the Union Pacific Railroad Company (UP)

[1] The digest constitutes no part of the decision of the Board but has been prepared for the convenience of the reader. It may not be cited to or relied upon as precedent. Policy Statement on Plain Language Digests in Decisions, EP 696 (STB served Sept. 2, 2010).

suggested raising the limitations on relief for simplified rate disputes and the interest rate that applies to reparations payments to address the public's concerns.[2]

We instituted this proceeding primarily to review the limitations on relief in simplified rate procedures that appeared, in hindsight, to have been overly restrictive. In our notice, we explained that the stand-alone cost (SAC) test is central to our rate regulation rules. Under this test, also referred to as the Full-SAC test, the rate at issue cannot be higher than the rate a hypothetical efficient railroad would need to charge to serve the complaining shipper, while fully covering all of its costs, including a reasonable return on investment. But Congress also directed the Board to promulgate simplified evidentiary procedures for rate cases where the SAC test could not practicably be applied, given its costs. In response, the Board created the Three-Benchmark test, a benchmark approach that compares the markup being paid by the challenged traffic to the average markup assessed on other comparable traffic.[3] Later, in 2007, the Board also adopted the Simplified-SAC test.[4] The Simplified-SAC test, unlike the Full-SAC test, does not look to a hypothetical railroad to judge the reasonableness of the defendant railroad's rates, but rather to the actual operations and services provided by the carrier. However, the Board also placed limits on relief for the Three-Benchmark and Simplified-SAC methodologies of $1 million and $5 million over a five-year period, respectively.

With the goal of improving our rate review process to ensure that it is as fair and accessible as possible, we proposed six changes to the Board's rate reasonableness procedures: (1) removing the limitation on relief for cases brought under the Simplified-SAC alternative; (2) improving the accuracy of the Road Property Investment (RPI) component of the Simplified-SAC test; (3) raising the relief available under the Three-Benchmark method to $2 million; (4) curtailing the use of cross-over traffic in Full-SAC cases; (5) modifying the approach used to allocate revenue from cross-over traffic; and (6) raising the interest rate that the railroads must pay, inter alia, for reparations when the railroad has collected unreasonable rates.

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[2] Supplemental Comments of UP, EP 705 (filed July 25, 2011) ("The comments of many complaining shippers in this proceeding made clear that their primary interest in seeking changes to the Board's competitive access rules is to obtain rate relief. Union Pacific believes that, if the Board perceives problems with its rules regarding rate relief, it would be more appropriate to address those issues directly. Specifically, based on comments made at the hearing, Union Pacific believes the Board could consider changes in two areas. First, the Board could consider raising the limits on relief in Simplified-SAC and Three-Benchmark cases. This would address specific shipper complaints that the limits are too low and make simplified procedures available for more rates. Second, the Board could consider raising the interest rate that applies to reparations payments. This might help address specific shipper complaints about the rates they must pay while their cases are pending.").

[3] See Rate Guidelines—Non-Coal Proceedings (Simplified Guidelines), 1 S.T.B. 1004 (1996), pet. to reopen denied, 2 S.T.B. 619 (1997), appeal dismissed sub nom. Ass'n of Am. R.Rs. v. STB, 146 F.3d 942 (D.C. Cir. 1998).

[4] See Simplified Standards for Rail Rate Cases (Simplified Standards), EP 646 (Sub-No. 1) (STB served Sept. 5, 2007), aff'd sub nom. CSX Transp., Inc. v. STB, 568 F.3d 236 (D.C. Cir.), vacated in part on reh'g, 584 F.3d 1076 (D.C. Cir. 2009).

We received many comments from interested parties on these proposals.[5] The shipper community expressed support for the proposals to raise or remove the limits on relief and the interest rate paid on reparations. They opposed, however, any limit on the use of cross-over traffic in Full-SAC cases or the proposed change to the revenue allocation methodology. The railroad industry, including UP, opposed any increase in relief under either simplified rate procedure or any increase in the interest rate that applies to reparations payments. However, BNSF Railway Company (BNSF) stated that it would not oppose a modest increase in the relief available, but only if the agency agreed to eliminate entirely the use of cross-over traffic in Full-SAC cases. The proposal to curtail the use of cross-over traffic was supported by some railroads, but others argued that the curtailment was not necessary because the concern the Board was attempting to address could be managed in other ways. The railroad industry generally supported the proposed change to the revenue allocation methodology.

We concluded that a number of the steps we proposed should be taken to improve our rate reasonableness procedures. Based on the comments received, we have decided to: remove the relief limit in Simplified-SAC cases entirely and require the use of full RPI presentations; raise the relief limit in Three-Benchmark cases to $4 million; leave cross-over traffic unchanged; adopt alternative "Average Total Cost" (ATC) as the Board's revenue allocation method for cross-over traffic; and change the interest rate in 49 C.F.R. § 1141.1 to the U.S. Prime Rate. Our reasoning for each of these actions is discussed below.

[5] The following parties submitted comments in this proceeding: U.S. Department of Agriculture (USDA); Consumers United for Rail Equity (CURE); Union Pacific Railroad Company (UP); Occidental Chemical Corporation (Occidental); American Short Line and Regional Railroad Association (ASLRRA); Western Coal Traffic League, Concerned Captive Coal Shippers, American Public Power Association, Edison Electric Institute, National Rural Electric Cooperative Association, Western Fuels Association, Inc., and Basin Electric Power Cooperative, Inc. (collectively, Coal Shippers); National Grain and Feed Association (NGFA); CSX Transportation, Inc., and Norfolk Southern Railway Company (collectively, CSXT/NSR); BNSF Railway Company (BNSF); Kansas City Southern Railway Company (KCS); Alliance for Rail Competition, Montana Wheat & Barley Committee, Colorado Wheat Administrative Committee, Idaho Barley Commission, Idaho Wheat Commission, Montana Farmers Union, Nebraska Wheat Board, Oklahoma Wheat Commission, South Dakota Wheat Commission, Texas Wheat Producers Board, and Washington Grain Commission (collectively, ARC); Arkansas Electric Cooperative Corporation (AECC); PPG Industries, Inc. (PPG); US Magnesium, LLC (USM); Association of American Railroads (AAR); American Chemistry Council, The Fertilizer Institute, The National Industrial Transportation League, Arkema, Inc., The Dow Chemical Company, Olin Corporation, and Westlake Chemical Corporation (collectively, Chemical Shippers); The Chlorine Institute (Chlorine Institute); and United Transportation Union-New York State Legislative Board.

CURRENT RATE REASONABLENESS STANDARDS

Statutory Framework

Where a railroad has market dominance—i.e., a shipper is captive to a single railroad—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 vary with the level of traffic, and are developed in rates proceedings by using the Board's Uniform Rail Costing System (URCS). See Adoption of the Unif. R.R. Costing Sys. as a Gen. Purpose Costing Sys. for all Regulatory Costing Purposes, 5 I.C.C. 2d 894 (1989).

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 the Board finds a challenged rate unreasonable, it will order the railroad to pay reparations to the complainant for past movements and may prescribe the maximum rate the carrier is permitted to charge for a defined period. 49 U.S.C. §§ 10704(a)(1), 11704(b). 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. W. Tex. Util. Co. v. Burlington N. R.R., 1 S.T.B. 638, 677-78 (1996), aff'd sub nom. Burlington N. R.R. v. STB, 114 F.3d 206, 210 (D.C. Cir. 1997).

In examining the reasonableness of a rate, the Board is guided by the 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).

As part of the ICC Termination Act, Congress 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). Congress further instructed the Board to establish procedures for 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). Moreover, Congress

[6] The Long-Cannon factors were added to the Interstate Commerce Act in 1980 and 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.

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 are set forth in Coal Rate Guidelines, Nationwide (Guidelines), 1 I.C.C. 2d 520 (1985), 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 costs of any facilities or services from which it derives no benefit. Guidelines, 1 I.C.C. 2d at 523.

CMP contains three main limits on the extent to which a railroad may charge differentially higher rates on captive traffic.[7] The revenue adequacy constraint is intended to ensure 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 is intended to protect 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 SAC constraint is intended to protect 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. See id. at 542-46.

SAC Constraint

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." The economic theory of contestable markets does not depend on a large number of competing firms in the marketplace to ensure a competitive outcome. Guidelines, 1 I.C.C. 2d at 528. In a contestable market, even a monopolist must offer competitive rates or potentially lose its customers to a new entrant. Id. In other words, contestable markets have competitive characteristics that preclude monopoly pricing, despite the absence of competitors in the market.

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 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

[7] A fourth constraint—phasing—is intended 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.

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 the Board judges the challenged rate. Id. at 542.

To make a Full-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 defendant railroad's 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 selected, the level of services 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, the SARR's investment requirements and operating expense requirements must be estimated. The parties must provide appropriate documentation to support their estimates. 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 defendant railroad is expected to earn from the traffic group. 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 disperses the overage among the traffic group, and prescribes the resulting rate and/or reparations for the issue traffic.

Cross-Over Traffic

In recent SAC cases, complainants have relied extensively on the use of cross-over traffic to simplify their SAC presentations. Cross-over traffic refers to those movements included in the traffic group that would be routed over the SARR for only a part of their trip from origin to destination. In such circumstances, the SARR would not replicate all of the defendant railroad's service, but would instead interchange the traffic with the residual portion of that railroad's system. This modeling device, which was first accepted by the agency in 1994 in Bituminous Coal—Hiawatha, Utah, to Moapa, Nev. (Nevada Power), 10 I.C.C. 2d 259, 265-68 (1994), is now a well-established practice in SAC cases.[8] A continuing issue in SAC cases is how to allocate the total revenues the railroad earns from that cross-over traffic between the facilities replicated by the SARR and the residual network of the railroad needed to serve that traffic.

The goal in allocating revenue from cross-over traffic is to ensure that a truncated SAC analysis using cross-over traffic approximates the outcome of a Full-SAC analysis, which

[8] See, e.g., Otter Tail Power Co. v. BNSF Ry. (Otter Tail), NOR 42071, 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); Duke Energy Corp. v. CSX Transp., Inc., 7 S.T.B. 402, 422-24 (2004); Tex. Mun. Power Agency v. Burlington N. & Santa Fe Ry., 6 S.T.B. 573, 605 (2003).

provides origin-to-destination service for the entire traffic group. A Full-SAC analysis compares the total SAC costs incurred to serve the selected traffic against the total revenues the carrier is expected to earn from that traffic group. A SAC presentation with cross-over traffic, however, calculates only part of the total SAC costs to serve the cross-over traffic. Thus, to distribute revenues equitably in relation to the cost incurred to generate those revenues, the portion of the revenue allocated to those facilities replicated by the SARR ideally equals the total revenue from that movement, multiplied by the share of total SAC costs represented by the cross-over segments of the movement (i.e., multiplied by the ratio of the truncated SAC costs for the cross-over traffic to the Full-SAC costs for the cross-over traffic).

The Board recognized, however, that it would face a dilemma if it were to attempt to allocate revenues based on the relationship between a truncated and Full-SAC analysis. The total SAC costs for a particular cross-over movement cannot be judged without a Full-SAC analysis, an undertaking that would defeat the simplifying purpose of using cross-over traffic in the first place. Even if the Board knew the total replacement costs of the off-SARR segments used by cross-over movements, it would have no method for allocating a share of those investment costs to only the cross-over movements. The off-SARR segments would have other traffic flowing over those lines that would be expected to contribute to the investment costs, but whose contribution would depend on the profitability of that traffic.

The Board attempted to address this dilemma by focusing on the average costs that the defendant railroad currently incurs to haul the traffic over the relevant segments. Duke Energy Corp. v. Norfolk S. Ry. (Duke/NS), 7 S.T.B. 89, 104-106 (2003). The objective was to select a revenue allocation methodology that reflects, to the extent practicable, the defendant's relative average costs of providing service over the two segments (the segment replicated by the SARR, and the residual facilities needed to serve the traffic, at times referred to as the off-SARR segment). Id.

In Major Issues in Rail Rate Cases (Major Issues), EP 657 (Sub-No. 1), slip op. at 31 (STB served Oct. 30, 2006), the Board adopted an ATC approach to allocate revenues from cross-over traffic between the facilities replicated by the SARR and those of the incumbent carrier. Using the URCS variable and fixed costs for the carrier, and the density and miles of each segment, parties can calculate the railroad's average total cost per segment of a move. The revenues from each portion of the movement would then be allocated in proportion to the average total cost of the movement on- and off-SARR. See Major Issues in Rail Rate Cases, EP 657 (Sub-No. 1) et al., slip op. at 19-20 (STB served Feb. 27, 2006).

In the first case to apply ATC, however, the Board concluded a modification was needed to address an unanticipated flaw. See W. Fuels Ass'n v. BNSF Ry. (Western Fuels), NOR 42088 (STB served Sept. 10, 2007). The Board noted that, in their submissions, the parties had applied ATC to the cross-over movements' total revenues. For a substantial number of these movements, the result of doing so was to drive below 100% the revenue-to-variable cost (R/VC) percentages—as measured by URCS—for the on-SARR portion.

This occurred because of two factors. First, the complainant had included considerable cross-over traffic in its traffic group with total revenue either below or barely above the variable costs of handling the traffic. Second, the off-SARR segments of these movements had lower traffic densities, and thus higher average total costs. By allocating revenues from these movements in proportion to average total costs, as required by ATC, a proportionally larger percentage of that revenue was allocated to the off-SARR segment. Id. at 14. The result was that "the on-SARR revenue allocation for those movements would be insufficient to cover the variable costs (as calculated using URCS) of handling traffic for the highest-density portion of a movement." Id. This result, the Board said, was unintended and illogical because "[t]raffic must cover its variable costs before it can be expected to make any contribution to joint and common costs." Id.[9] The Board further explained that it had not contemplated this situation and that such a result (a revenue allocation below variable cost) "would plainly conflict with our express purpose to find a non-biased, cost-based method." Western Fuels, slip op. at 14.

To avoid allocating revenues at levels below URCS variable costs, the Board determined that it had to refine the ATC approach. Rather than applying ATC to total revenue, the Board concluded that it would apply ATC to total revenue contribution, i.e., revenue in excess of variable costs as calculated by URCS. Id. Under modified ATC, allocating revenue from cross-over traffic would involve a two-step process. First, sufficient revenue would be allocated to each segment to cover that segment's variable costs of providing service as measured by URCS. Second, remaining revenues, if any, would be allocated using the original ATC methodology.

Western Fuels was appealed to the United States Court of Appeals, District of Columbia Circuit, and the case was remanded to the Board to address whether modified ATC improperly double counts variable costs. BNSF Ry. v. STB, 604 F.3d 602, 613 (D.C. Cir. 2010). On remand, the Board, with Commissioner Begeman dissenting, explained the decision to use modified ATC. See W. Fuels Ass'n v. BNSF Ry. (Western Fuels Remand), NOR 42088 (STB served June 15, 2012). Based on its experience in that case, the Board concluded that there were two competing principles in play. First, the Board seeks a revenue allocation that takes into account the important role that economies of density should play in any cost-based revenue allocation approach. Second, it seeks a revenue allocation approach that does not create the implausible result of driving the revenue allocation below variable costs. The Board understood that modified ATC did not give the same weight to economies of density as did the original ATC approach. While it concluded that the modified approach was superior to original ATC, the Board also announced that it planned to begin a rulemaking to consider a methodology, similar to one suggested, but not advocated, by BNSF (on remand), for possible future cases.

Simplified Guidelines

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). To respond to this directive, the Board adopted the guidelines set forth in Simplified Guidelines. A decade passed, however, without any shipper bringing a case under those simplified guidelines. In Simplified Standards, the Board modified the test described in Simplified Guidelines and

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[9] "Joint and common costs," sometimes referred to by the Board as "unattributable costs," are costs that cannot be assigned directly to specific movements by any conventional accounting methodology. See Guidelines, 1 I.C.C. 2d at 526. "Common costs" are costs shared by two or more services in variable proportion (e.g., terminal costs), while "joint costs" are costs shared by two or more services in fixed proportion (e.g., backhaul). Id. at 526 n.13.

created an additional simplified alternative that a complainant could elect to use where a Full-SAC analysis was too costly, given the value of the case. These two alternatives, discussed in detail below, are referred to as (1) Simplified-SAC and (2) Three-Benchmark. Since Simplified Standards, only a few Three-Benchmark cases have been decided by the Board, while no complaint has been litigated to completion under the Simplified-SAC alternative as the few cases that have been filed have settled.

1. Simplified-SAC

A. Objectives

The principal objective of the SAC approach 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 a Full-SAC presentation 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 expected demand. This requires the complainant to first select an appropriate subset of the defendant 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, crews, 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 is limited to whether the captive shipper is forced to cross-subsidize other parts of the railroad's rail network or whether the defendant carrier is abusing its market power. Such an approach is a less thorough application of CMP in that it would not identify inefficiencies in the current rail operation. But it allows the Board to determine whether a captive shipper is forced to cross-subsidize parts of the defendant's existing rail network the captive shipper does not use. The Simplified-SAC method assures that a railroad does not earn monopoly 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 incorporates those new capital investments and ensures that the maximum lawful rate includes a reasonable return on the replacement cost of those investments.

B. Methodology

The Simplified-SAC method allows the Board to determine whether a captive shipper is forced to cross-subsidize parts of the defendant's existing rail network that the shipper does not use. To hold down the cost of a Simplified-SAC presentation, various simplifying assumptions and standardization measures were adopted.

- *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 one-year analysis. The Test Year is the most recently completed four 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.

- *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.

- *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 URCS.

- *Discounted Cash Flow (DCF) 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 approach to identify an internal cross-subsidy set forth in PPL Montana, LLC v. Burlington Northern & Santa Fe Railway, 6 S.T.B. 286 (2003), aff'd sub nom. PPL Mont., LLC v. STB, 437 F.3d 1240 (D.C. Cir. 2006) as refined in Otter Tail, 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.

- *Five-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 five-year period.

2. Three-Benchmark

The Board recognized that the Simplified-SAC method would be too expensive for some shippers, given the small value of their cases. The Board reasoned that these shippers must also have an avenue to pursue relief. Accordingly, the Board retained the Three-Benchmark method for those shippers.

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 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 ÷ $R/VC_{>180}$. 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 is presumed unreasonable and, absent any "other relevant factors," the maximum lawful rate will be prescribed at that boundary level. See Simplified Standards, slip op. at 21-22.

3. Limits on Relief

Concluding that complainants themselves were in the best position to evaluate the value of their cases, the Board adopted a limit-to-relief approach for using these simplified and expedited methodologies. Adopting a conservative approach, the Board set the limits on relief for both the Simplified-SAC and Three-Benchmark approaches based on the estimated cost to litigate the next most complicated methodology. Based on the best evidence in the record before it, the Board estimated that it would cost $1 million to bring a Simplified-SAC case and $5 million to bring a Full-SAC case. Accordingly, the maximum potential rate relief available to a complainant that elects to use the Simplified-SAC method is limited to $5 million per case over a five-year period, and for a complainant that elects to use the Three-Benchmark method, relief is limited to $1 million per case over the same period.[10] The relief refers to the sum of the

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[10] Currently, the Board annually adjusts the $5 million and $1 million thresholds using the Producer Price Index (PPI), which measures the average change over time in the selling

(continued . . .)

differences between the challenged rates and the maximum reasonable rates, whether in the form of reparations, a rate prescription, or a combination of the two. Any rate prescription automatically terminates once the complainant has exhausted the relief available. Thus, the actual length of the prescription may be less than five years if the available relief is used up in a shorter time. The complainant is barred from bringing another complaint against the same rate for the remainder of the five-year period.

Once a rate prescription expires, the carrier's rate-making freedom is restored with a regulatory safe harbor at the challenged rate for the remainder of the five-year period, with appropriate adjustments for inflation using the rail cost adjustment factor, adjusted for inflation and productivity (RCAF-A). See R.R. Cost Recovery Procedures-Productivity Adjustment, 5 I.C.C. 2d 434 (1989), aff'd sub nom. Edison Elec. Inst. v. ICC, 969 F.2d 1221 (D.C. Cir. 1992). 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.

Interest Rate on Overcharges

Under 49 U.S.C. § 10701(c), a rail carrier may establish any common carrier rate it chooses and has the freedom to increase its rates without precondition, except for the notice requirement of 49 U.S.C. § 11101(c). A shipper may seek a Board determination of the reasonableness of the rates, "but it may not withhold payment of a legally established rate." See AEP Tex. N. Co. v. Burlington N. & Santa Fe Ry., NOR 41191 (Sub-No. 1), slip op. at 2 (STB served Mar. 19, 2004). Instead, if the Board determines that the rates are unreasonable it can order the railroad to reimburse the complaining shipper, with interest. Id. The level of interest is currently set at the T-Bill rate. 49 C.F.R. § 1141.1(a).

REVISIONS TO THE BOARD'S STANDARDS AND PROCEDURES

Revisions to our existing rate reasonableness standards and procedures are presented as follows. **Section I** addresses refinements to the Simplified-SAC test (we remove the limit on relief and require a more precise calculation of RPI). **Section II** addresses an increase to the limit on relief for a case brought under the Three-Benchmark test to $4 million. **Section III** discusses our decision not to curtail the use of cross-over traffic in the Full-SAC test at this time, and to modify the revenue allocation methodology. **Section IV** sets out the change in the interest rate carriers must pay shippers when the rate charged has been found unlawfully high (from the current T-bill rate to the U.S. Prime Rate, as published in the *Wall Street Journal*). **Section V** describes our concern that even with the changes to the limitations on relief for simplified rate cases, shippers of agricultural commodities may still not have a viable means of challenging rail rates. We announce our intent to institute a separate proceeding to explore this concern more closely. Finally, **Section VI** provides our regulatory flexibility analysis.[11]

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prices received by domestic producers for their output. Simplified Standards, slip op. at 28 n.36. These indexed thresholds are now $5,825,000 and $1,165,000, respectively.

[11] Several commenters discuss issues unrelated to or beyond the specific proposals
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I. Simplified-SAC

A. Limitation on Relief

1. *Board Proposal*

The Board created the Simplified-SAC constraint for litigants who cannot justify the expense of the more detailed Full-SAC analysis. This simplified approach has numerous positive features. Unlike the Full-SAC analysis, it does not require shippers to design hypothetical railroads. Rather, the Simplified-SAC approach focuses on the operations of the defendant railroad to determine if the railroad is exploiting its market power to charge monopoly prices. Because the approach does not require the complainant to design a hypothetical railroad, we expect it to be a far simpler and less costly approach. And unlike the Three-Benchmark analysis, the Simplified-SAC approach uses replacement cost to determine the maximum lawful rates a carrier may charge. Seeking to encourage its use over the more complex, costly, and

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outlined in RRR Proposal. Multiple shippers ask that the Board develop a methodology for determining maximum reasonable rates for captive traffic being carried on revenue adequate railroads. CURE Opening 7; ARC Opening 18. Other shippers ask the Board to address carrier practices, such as bundling and the unwillingness of carriers to compete for traffic. Occidental Opening 2; Chlorine Institute Opening 8-9. Chemical Shippers propose to extend automatically the rate prescription period when a complaint remains unresolved for three years. Still other shippers request that the Board extend the five-year rate prescription period in Simplified-SAC cases to 10 years. Chemical Shippers Opening 25; USDA Opening 3; NGFA Opening 8. Some shippers argue that the Board should remove the relief cap altogether in Three-Benchmark cases. Chemical Shippers Opening 28; Chlorine Institute Opening 9; PPG Opening 9-10. ARC recommends that the Board not modify the market dominance standards that it proposed in M&G Polymers v. CSX Transportation, NOR 42123 (STB served Sept. 27, 2012). ARC Opening 12. NGFA and ARC both argue that the changes proposed in the RRR Proposal do not provide meaningful relief to grain shippers. NGFA Opening 4-5; ARC Opening 6-12.

Carriers also discuss issues beyond the scope of this proceeding. UP proposes two additional limitations to cross-over traffic: that complainants be prohibited from shifting non-issue traffic from its actual route unless the SARR's operation would be at least as efficient as the existing operation and the SARR would handle the traffic from origin to destination; and that a complainant that reroutes the issue traffic be required to design its SARR to handle any non-issue traffic on the new route from origin to destination. UP Opening 11. CSXT/NSR ask that the Board remove the burden on the railroads to help develop the complainant's evidence through the second disclosure in Simplified-SAC cases. CSXT/NSR Opening 12. CSXT/NSR also ask the Board to prohibit the use of what it calls "leapfrog" cross-over traffic, which is an issue raised in a pending rate case in which NSR is the defendant carrier. Id. at 18.

None of these comments pertains to the specific proposals in RRR Proposal. In many cases, the comments refer to issues raised in other proceedings that the Board will address in those proceedings. With one exception explained in **Section V – Rail Transportation of Grain**, we decline to discuss these concerns here, as they are beyond the scope of this proceeding.

time-consuming Full-SAC test, we proposed to remove the $5 million monetary limitation on relief for cases pursued under the Simplified-SAC constraint.

Our rationale for this proposal rested on a comparison of the Simplified-SAC constraint to the Full-SAC constraint. Like the Full-SAC approach, the inquiry under the Simplified-SAC method is designed to prevent the railroad from abusing its market power by charging unreasonably high rates. The Simplified-SAC test can provide a critical restraint on the railroad's pricing of captive traffic by allowing 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.

However, unlike the Full-SAC methodology, the Simplified-SAC methodology is not designed to detect the inefficiencies in rail operations that may further raise rates. In effect, a shipper utilizing the Simplified-SAC methodology foregoes some potential for relief in exchange for a simplified process. If we improved the precision of the RPI components of the Simplified-SAC test, as discussed below, we could not see any justification for continuing to curtail the relief where the analysis has detected that a carrier is abusing its market power and is earning more than a reasonable return on the replacement costs of the facilities being used to serve the captive shippers. In other words, regardless of the amount in dispute, the Full-SAC and Simplified-SAC approaches both appeared to be an appropriate method to judge the reasonableness of the challenged rates. Thus, we saw no apparent reason to force the shipper to use the more expensive Full-SAC approach over the Simplified-SAC approach in cases where the shipper seeks more than $5 million in relief.

2. *Public Comments*

Shippers support the removal of the relief cap in Simplified-SAC, agreeing with the Board that relief is more limited than in a Full-SAC case because of the built-in simplifications.[12] Carriers argue that the changes proposed to Simplified-SAC go against statutory directives, claiming that the express language of 49 U.S.C. § 10701(d)(3) requires that application of any method other than Full-SAC must be limited.[13] They argue that the statute requires the Board to consider both the value and cost of the case in determining whether a simplified and less accurate approach should be allowed.[14] Carriers claim that a case whose potential value to the complainant is several multiples of the cost of a Full-SAC presentation could hardly be characterized as being too costly in relation to its value.[15] According to carriers, if Congress intended to authorize the Board to allow all cases to proceed under a simpler, less accurate methodology, it would not have limited its directive to "those cases that are too costly" to litigate under Full-SAC.[16]

[12] Chemical Shippers Opening 24-25; USM Opening 11.

[13] CSXT/NSR Opening 3; KCS Opening 5, 7; AAR Opening 12-13.

[14] CSXT/NSR Opening 3; KCS Opening 7; AAR Opening 13.

[15] CSXT/NSR Opening 4.

[16] Id. at 5.

Carriers further argue that if the Board wants to raise the limit on Simplified-SAC, it should follow the procedures from Simplified Standards that allow for parties to petition the Board to adjust the limit on relief with supporting evidence regarding the costs of bringing a Full-SAC case. Absent a separate proceeding analyzing that data, carriers argue that any change to the recovery limit would be unsupported and arbitrary.[17]

Carriers also claim that there is an inequity in litigation costs unique to Simplified-SAC cases created by the "second disclosure," a requirement in our rules. Specifically, this rule requires that the carrier develop, document, and provide full support for most of the key evidence and calculations required for the Simplified-SAC analysis.[18] Carriers argue that the proposal to abolish the limit on relief in Simplified-SAC cases would eliminate the only meaningful check on shippers' ability to abuse this litigation cost inequity.[19] Furthermore, carriers argue, because Simplified Standards allows a party to invoke a different rate reasonableness test at any time until opening evidence is filed, shippers could use Simplified-SAC as a low-cost way to evaluate whether to pursue a Full-SAC rate reasonableness case.[20] KCS argues that the Board does not have enough experience with Simplified-SAC or Three-Benchmark cases to determine whether those case procedures need to be modified.[21] KCS further argues that the Board has not considered the impact of the proposed changes on rail carriers.[22]

ASLRRA claims that URCS costs, which the Board uses for a variety of costing purposes in rate proceedings, do not represent the costs of small carriers, but are based on Class I carriers that move longer distances. Therefore, ASLRRA argues, the proposal to raise or eliminate the limit of damages in simplified proceedings will encourage shippers to bring more rate cases against small carriers that must defend themselves using URCS costs that are lower than the small carriers' true costs.[23]

3. *Board Action*

The Simplified-SAC approach is designed to offer a robust method to determine the reasonableness of challenged rail rates. It does not require shippers to design hypothetical railroads; rather, it focuses on the operations of the defendant railroad to determine if the railroad is exploiting its market power to charge monopoly prices. And unlike the Three-Benchmark analysis, the Simplified-SAC approach uses replacement cost to determine the maximum lawful rates a carrier may charge.[24] If the Simplified-SAC analysis of a particular case detects that the

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[17] CSXT/NSR Opening 13; KCS Opening 7-9; AAR Opening 16-17.

[18] CSXT/NSR Opening 5-9; UP Opening 17-18.

[19] CSXT/NSR Opening 9; UP Opening 17-18.

[20] CSXT/NSR Opening 11-12.

[21] KCS Opening 4.

[22] Id. at 8.

[23] ASLRRA Opening 4.

[24] As the ICC observed in the early 1980s, in theory "replacement cost valuation can be preferable to original cost valuation," because "regular and continuing calculation of depreciation charges and inflation adjustments under the replacement cost method may better

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railroad is charging more than is needed to earn a reasonable return on the replacement cost of the facilities used to serve the complainant, we see no reason to curtail the relief that is available to the shipper. There is no basis to permit the railroads to earn excessive profits simply because, unlike the Full-SAC method, the Simplified-SAC method does not detect the inefficiencies in rail operations that may further raise rates.

The railroad industry challenges our proposal to remove the limitation on relief. The carriers' principal argument is that we lack the statutory authority to remove the limitation on relief. Specifically, carriers argue that § 10701(d)(3) precludes the Board from permitting the use of a simplified and expedited method unless it is "too costly" to make a Full-SAC presentation. In that provision, Congress directed the agency "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." The railroads argue that this provision bars us from allowing the use of a simplified methodology in a particular case unless we can show that a Full-SAC analysis is too costly for that case.[25] According to their restrictive reading of the statute, "[t]he Board's statutory authority to develop simplified methodologies to determine the reasonableness of rail rate disputes contemplates the use of simplified methods only in cases of limited value."[26]

We disagree with the railroads' narrow reading of this statutory directive. A straightforward reading of the language makes it clear that we must provide a simplified method to protect shippers with complaints about unreasonable rates on lower revenue movements. But the statute contains no limiting language. The carriers' argument—that the statutory directive to provide a simplified method where a Full-SAC case is too costly bars the Board from providing a simplified method when a Full-SAC case is not too costly—is an example of the logical fallacy

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reflect the true economic costs associated with an investment. Further, the replacement cost method is preferable because it comes closer to the competitive result." Standards for R.R. Revenue Adequacy, 364 I.C.C. 803, 841 (1981); see also Final Report of the R.R. Accounting Principles Bd., Vol. II at 60-61 (1987) ("current market valuation is preferable to historical valuation from a theoretical economic viewpoint"). We do not use replacement costs in our annual revenue adequacy determination or in our URCS model because it is impractical to update the book value of railroad assets to replacement costs on an annual basis. See Ass'n of Am. R.R.s—Petition Regarding Methodology for Determining R.R. Revenue Adequacy, EP 679, slip op. at 7 (STB served Oct. 24, 2008) ("the railroad proponents have failed to overcome the practical difficulties associated with using a replacement-cost approach to perform the annual revenue adequacy determination"); see also Standards for R.R. Revenue Adequacy, 3 I.C.C. 2d 261, 277 (1986) ("[w]hile current cost accounting is theoretically preferable to original cost valuation, it cannot be practically implemented in a manner that we can be confident would produce accurate and reliable results.")

[25] See, e.g., CSXT/NSR Opening at 4 ("A case whose potential value to the complainant is several multiples of its cost could hardly be characterized as being 'too costly' in relation to its value.").

[26] AAR Opening at 11.

"denying the antecedent."[27] An order to perform a certain action is not an order to perform that action and no others. So while Congress directed the agency to establish a simplified and expedited method for certain types of cases (where Full-SAC is too costly), Congress did not thereby prohibit the agency from making the same method available more broadly. Indeed, if the carriers' logic were correct, the Board could not have established both the Simplified-SAC and the Three-Benchmark methodologies. Under the carriers' logic, because the statute directs the Board to establish "a simplified and expedited method," the statute must therefore preclude the Board from creating more than one simplified and expedited method. Yet the reviewing court affirmed the Board's creation of both the Simplified-SAC and Three-Benchmark methods.[28] Moreover, if there is a robust method for determining the reasonableness of challenged rail rates that is also simplified and expedited, we see no reason that Congress would order the agency to prevent captive shippers from using that alternative approach.

Alternatively, the railroad industry challenges our conclusion that the Simplified-SAC approach is sufficiently robust to justify removing the limitation on relief. For example, AAR maintains that, while changing the RPI analysis would increase the precision of Simplified-SAC, this change is insufficient because "other factors" introduce imprecision into the analysis.[29] The two examples offered are the use of URCS system average costs to establish operating expenses and use of a one-year test year (compared to Full-SAC's use of a 10-year analysis period).

We do not find these features of the Simplified-SAC procedures sufficient to justify limiting the relief available. First, all regulatory procedures to regulate rates necessarily entail some degree of imprecision. Indeed, although a Full-SAC presentation is more "precise" than a Simplified-SAC presentation, it is so only in the sense that, through a highly complex and detailed presentation involving a hypothetical railroad, it ferrets out operating inefficiencies. But the two methods do a comparable job of detecting whether a carrier is abusing its market power through the identification of impermissible cross-subsidization. Second, our use of URCS does not justify a limitation on relief. The railroads never explain what feature of URCS introduces so much imprecision in Simplified-SAC—as compared to Full-SAC, where URCS also plays a role in the revenue allocation method (ATC) and rate prescription methodology (Maximum Markup Methodology)—to warrant a limitation on relief. In any event, URCS is our general purpose costing model adopted for all regulatory costing purposes, and as the Board explained in Simplified Standards, slip op. at 57-61, using URCS system-average costs "should provide a reasonable approximation of the total operating expenses of the traffic group." Finally, the use of a single test year does not warrant a limitation on relief. Again, the railroads have not

[27] New England Power Generators Ass'n v. FERC, 707 F.3d 364, 370 (D.C. Cir. 2013) (explaining that petitioners committed the logical fallacy of "denying the antecedent" by arguing that, "because the existence of a contract rate mandates the application of [a particular] presumption, the absence of a contract rate precludes it").

[28] CSX Transp., Inc., 568 F.3d at 244 (noting that as long as Simplified-SAC qualifies as "a simplified and expedited method," nothing required the Board to promulgate the Three-Benchmark method at all, but that, having done so, the Board had to do so nonarbitrarily, which it did).

[29] AAR Opening 13.

developed this argument or explained why, should the test year prove to be unrepresentative of the traffic levels in future years (a fact that will only become apparent after the case is decided), the ability to reopen and revise the rate prescription would not address this concern.[30] We are not persuaded that these features of the Simplified-SAC analysis justify curtailing the relief available when that analysis has detected that the railroad is charging more than is needed to earn a reasonable return on the replacement cost of the facilities used to serve the complainant. Under core CMP principles, such a rate is unreasonable.

The Class I carriers also express concerns regarding the second disclosure associated with Simplified-SAC cases and the ability of the shipper to change the methodology of a rate complaint before opening evidence is filed. They maintain that these concerns would be exacerbated if the limit were removed. We disagree. The disclosure requirements remain appropriate regardless of the available relief. As the Board explained in Simplified Standards, slip op. at 68:

> [T]he discovery procedures here are not significantly different from the discovery procedures in Full-SAC cases, with which the carriers have been able to comply adequately. Moreover, most of the data necessary for a SAC analysis (be it Full-SAC or Simplified-SAC) resides with the railroad, so requiring the railroad to bear more of the discovery burden is unavoidable given the nature of these cases and represents a cost of doing business in a regulated industry. At any rate, the carriers' claim that the railroad will essentially be making a shipper's case for it is exaggerated. A complaining shipper still must take the data that is provided by the carrier to craft its case-in-chief, as in a Full-SAC case.

Indeed, "[r]ail rate cases are not ordinary commercial litigation, given the regulated nature of rail rates charged to captive shippers. Operating in an industry subject to regulatory oversight of rates charged on captive traffic, railroads have a responsibility to provide information needed by

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[30] In FMC Wyoming Corp. v. Union Pacific Railroad, 4 S.T.B. 699, 741 (2000), the Board observed that if traffic forecasts upon which the rate prescriptions are based do not materialize, "the parties may either agree upon appropriate revisions to these prescriptions that are consistent with our procedures here or submit an appropriate petition to us to reopen the record in this proceeding." See also Wis. Power & Light Co. v. Union Pac. R.R., 5 S.T.B. 955, 984 (2001). However, we do not reopen based on any discrepancy because it is inevitable that actual traffic volumes and revenues will not necessarily correspond to the levels assumed in our SAC analysis. Ariz. Pub. Serv. Co. v. Atchison, Topeka & Santa Fe Ry., 3 S.T.B. 70, 75 (1998). We approach petitions to reopen "cautiously, on a case-by-case basis, striving to achieve an appropriate balance between the interests of fairness to all parties and of administrative finality and repose. We must consider not only the magnitude, but also the cause and duration of the discrepancies before deciding whether they warrant reopening and revision of the underlying SAC calculations." Id. But given the ability to reopen if the traffic levels, costs, or revenues in the test year do not materialize during the pendency of the rate prescription, AAR has failed to explain how this feature of the Simplified-SAC approach warrants a limitation on the relief available when the analysis shows the carrier is earning monopoly profits.

the Board." Ariz. Elec. Power Coop. v. BNSF Ry., NOR 42058 (STB served Nov. 18, 2003). The second disclosures reflect an exercise of our authority to require the regulated entities to provide information they possess to the complainant in a usable fashion so that, ultimately, we can determine whether the carrier has abused its market power. We will, of course, carefully monitor and protect the integrity of our process.

BNSF and KCS argue that the Board should not remove the limit on relief until it has had more experience with Simplified-SAC cases.[31] We find this suggestion unpersuasive, as the current relief limit appears to be a primary cause of our lack of experience with Simplified-SAC.

Finally, the short line industry has expressed concerns with use of the Simplified-SAC approach. Short line carriers argue that the Simplified-SAC approach relies on URCS to develop operating expenses, and those URCS costs are for large Class I carriers whose operating costs are unrepresentative of the smaller short line railroads. This concern has merit, although we note that URCS also plays a role in Full-SAC cases too. But the concern raised does not merit special treatment for short lines. We have already exempted the short line industry from the Three-Benchmark approach and cannot further exempt them from the Simplified-SAC approach, thereby placing their rates outside any simplified regulatory review. Moreover, as the Board noted in Simplified Standards, slip op. at 34, some form of simplified guidelines have been in place since 1996. In that time, we have seen no evidence of shippers targeting short lines in rate complaints. Should a pattern develop where smaller carriers become more heavily involved in rate disputes, the Board can then consider modifying this approach to permit the short line railroad to tailor URCS costs to better estimate its operating costs.

B. Road-Property Investment (RPI) Analysis

1. *Board Proposal*

Currently, the Simplified-SAC test streamlines the RPI analysis by relying on findings from prior Full-SAC cases to determine the railroad's fixed costs. Simplified Standards, slip op. at 15. In the RRR Proposal, we sought public input on whether, if we adopted the proposal to remove the limitation on relief in Simplified-SAC, we should remove the RPI simplification, requiring complainants to submit detailed expert testimony on the replacement costs of the facilities used to serve the complainant. Our rationale for that proposal was that, without a limit on relief, there was no longer a rationale for limiting the cost of developing a full RPI analysis.

2. *Public Comments*

Carriers support this proposal while the shipper community opposes it. The railroads argue that the increase in accuracy is worth the price of increased discovery and evidence costs.[32] The two large eastern railroads, CSXT and NSR, support the RPI proposal, arguing that it has been nearly a decade since a Full-SAC case involving an eastern railroad has been decided and that, accordingly, the rolling RPI average from those cases is outdated and would not truly represent their costs.[33] BNSF claims that a full RPI assessment would ensure that the SAC

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[31] BNSF Opening 16; KCS Opening 8.

[32] CSXT/NSR Opening 16.

[33] Id. at 15.

analysis is based on current cost information and on cost information that is relevant to the specific types of facilities used to provide the service at issue in a Simplified-SAC case.[34]

Shippers counter that the requirement of a full RPI analysis would be a significant disincentive for any shipper to use the Simplified-SAC methodology.[35] Shippers add that the Board is directed by Congress in two separate parts of the National Transportation Policy, 49 U.S.C. §§ 10101(2), (15), to engage in expeditious proceedings, and this proposed change, they argue, is contrary to that directive.[36] Further, shippers argue that the imprecision of the RPI simplification is *de minimis* because the RPI simplification does not significantly detract from the robustness of the Simplified-SAC analysis, and because the simplifying factors in that analysis lead to higher prescribed rates than a Full-SAC analysis.[37] Shippers cite to Simplified Standards, claiming that the RPI cost per track mile typically varies less than 10% from one case to the next.[38] KCS argues that requiring a full RPI analysis in Simplified-SAC cases would hurt a shipper seeking relief between $2 and $5 million because of higher litigation costs (assuming that the limit for Three-Benchmark cases were set at $2 million).[39]

As an alternative, AECC proposes that rather than require a full RPI calculation in every Simplified-SAC case, the Board should establish a presumption that the RPI simplification method may be used, but allow either party to present evidence to rebut that presumption by showing that a full RPI analysis yields a significantly different result in that case.[40]

3. *Board Action*

We will modify the analysis in Simplified-SAC proceedings to require a full RPI presentation. The complete removal of the limit on relief in Simplified-SAC cases warrants a more exact methodology, and the increased cost of developing a full RPI analysis is more than offset by the increase in the relief available. Furthermore, carriers have identified some valid concerns about the adequacy of the rolling average RPI and its ability to represent fixed costs accurately. For instance, actual costs may vary greatly from the averages, depending on location, such as differences in land value and construction costs between urban and rural areas. These concerns outweigh the shippers' argument that the RPI simplification has a minimal effect on accuracy. Moreover, the Board notes that, even with this revision, the Simplified-SAC procedures would remain dramatically streamlined when compared with a Full-SAC case. For example, in Simplified-SAC, a complaining shipper need not (and, indeed, cannot) develop, test, adjust, retest, etc., multiple physical configurations and associated operating plans—an often massive undertaking in Full-SAC cases. Given the removal of the relief limit, Simplified-SAC would remain a "fair and expeditious" avenue to rate relief. See 49 U.S.C. § 10101(2).

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[34] BNSF Opening 15.

[35] Chemical Shippers Opening 26; PPG Opening 8.

[36] PPG Opening 8.

[37] Chemical Shippers Opening 27.

[38] Id. at 25.

[39] KCS Opening 6-7.

[40] AECC Opening 3.

We are not convinced that AECC's suggestion—to use the rolling average RPI as a default but to allow parties to present evidence that a full analysis is better—would result in less litigation cost to the parties. Rather, it would add another Board determination to the process and would likely significantly lengthen the proceeding.

II. Three-Benchmark

1. *Board Proposal*

Under Simplified Standards, parties seeking relief under the Three-Benchmark test are limited to $1 million in relief over a five-year period (with the monetary limit indexed for inflation). The Board selected the $1 million cap on relief because, at the time, it was the best evidence of record for the cost of litigating a Simplified-SAC case. Because we anticipated that litigation costs for Simplified-SAC would rise should we adopt the proposal to require a full RPI analysis in Simplified-SAC cases, we proposed that the limitation on relief under the Three-Benchmark case should also be similarly raised. RRR Proposal, slip op at 15 (citing Simplified Standards, slip op. at 28, 31 (basing the limit on relief for Three-Benchmark cases on the best available estimate of the litigation cost to pursue relief under the Simplified-SAC method)). We thus sought public input on whether it would be reasonable to raise the limit on relief in Three-Benchmark cases to $2 million in 2012 dollars (with the monetary limit indexed for inflation thereafter).

2. *Public Comments*

Shippers support a raise in the award limit but argue that $2 million is not sufficient. They argue that the Board has grossly underestimated the cost of adding full RPI analysis to Simplified-SAC cases,[41] and maintain that the Board initially miscalculated the cost to bring Simplified-SAC and Three-Benchmark cases in Simplified Standards.[42] Some shippers argue that the Board should remove the relief cap altogether, because the shortcomings of the Three-Benchmark process provide the incentive for shippers to select the most appropriate methodology for their cases.[43] They reason that the Three-Benchmark approach, which compares rates to other traffic that is often captive itself, results in a higher rate prescription than either Simplified-SAC or Full-SAC would provide.[44] CURE argues further that carrier actions have already caused similar commodities to have comparably high rates, so the incentive to pursue a Three-Benchmark case is already low.[45]

Carriers oppose the change, arguing that the Three-Benchmark approach is marked by serious flaws and imprecision, and that the Board should not expand its use.[46] Carriers argue that

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[41] Chemical Shippers Opening 27; USM Opening 6-7.

[42] Chemical Shippers Opening 27; USM Opening 6-7; USDA Opening 3; NGFA Opening 9.

[43] Chemical Shippers Opening 28; Chlorine Institute Opening 9; PPG Opening 9-10.

[44] Chemical Shippers Opening 28; Chlorine Institute Opening 9; PPG Opening 9-10.

[45] CURE Opening 2.

[46] CSXT/NSR Opening 23.

these flaws mirror those in previous rate comparison formulas that were rejected in Burlington Northern Railroad v. ICC, 985 F.2d 589, 597 (D.C. Cir. 1993).[47] Carriers also argue that raising the limit undermines the Board's rationale in Simplified Standards that the potential problem of an iterative, ratcheting down of rates by a litany of successive cases was alleviated by the low limit on damages.[48] Furthermore, carriers argue that raising the cap limit to $2 million would make the majority of the traffic under the Board's regulation available for relief under an imprecise methodology."[49] Finally, carriers argue that the Board overestimates the increased costs to Simplified-SAC and does not have any evidence to support its estimate.[50] AAR recommends that the Board should follow the procedures it announced in Simplified Standards regarding the process to increase the limit based on a record of verified statements and discovery on litigation costs so that it can set an accurate limit.[51]

3. *Board Action*

It is the Board's responsibility to ensure that captive shippers have a meaningful forum to bring rate disputes before the agency. Full-SAC and Simplified-SAC methods provide a viable means for many, but not all, shippers to bring disputes to our attention. And while the Three-Benchmark approach may be less precise than either of the SAC-based approaches, captive shippers with smaller cases cannot be left without any effective remedy when the marketplace fails to provide competitive rates.

The approach the Board adopted in Simplified Standards set the limitation on relief in Three-Benchmark cases at the estimated cost of pursuing a case under the Simplified-SAC approach. In this proceeding, we are continuing to follow that same approach and underlying rationale. In this proceeding, we sought public comments on whether the prior cost estimate of $1 million (currently $1.2 million with inflation) remained a reasonable estimate, and proposed raising the limitation to $2 million. In response, a broad group of shipper interests commented that this revised estimate of the cost to pursue a Simplified-SAC case was too low, and urged the Board to raise the limitation to $4 million,[52] while the railroad industry generally opposed any increase in the limitation on relief.

Based on the public comments, we conclude that $4 million reflects a more reasonable, and more current, estimate of the cost to pursue a Simplified-SAC case for two reasons. First, credible testimony in this proceeding revealed that the Board's estimate in Simplified Standards of $1 million was too low. USM is the only party to have pursued relief under the Simplified-SAC approach. Although the disputes ultimately settled, USM submitted testimony that the estimated legal and expert costs just for completing discovery and preparing opening evidence

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[47] Id.; BNSF Reply 7-8.

[48] CSXT/NSR Opening 23.

[49] Id. at 25.

[50] Id. at 26.

[51] AAR Opening 16-17.

[52] Chemical Shipper Opening 27; NGFA Reply 6.

was $750,000 and that the total projected cost was $2 million.[53] UP, the defendant in that litigation, did not provide any information on its own litigation costs. It attributed USM's high costs to difficulties UP experienced in producing the required second disclosures, and "sees no reason why the costs of subsequent cases should not be in line with the Board's estimates in Simplified Standards."[54] But the litigation brought by USM represented a relatively straight-forward Simplified-SAC case of a single commodity from a single origin to 12 destinations. If anything, USM's estimated litigation costs are likely on the low side, as USM incurred no expense in establishing market dominance because the defendant had conceded that issue.

Second, the cost to pursue a Simplified-SAC case will increase with the requirement of a full RPI presentation.[55] Chemical Shippers submitted expert testimony that the cost of a full RPI analysis in Full-SAC cases was often approximately one-third of the total litigation cost.[56] Employing this estimate, which is the only estimate in this record, our decision to remove the RPI simplification would raise the cost of litigating a Simplified-SAC case by $1.9 million (one-third of $5,590,000). Carriers object that the Chemical Shippers' estimate is speculative or unsupported.[57] We do not agree. The estimate is supported by testimony from experts who have considerable experience with our Full-SAC process. We also note that the railroads could have submitted their own estimate of the increased cost associated with a full RPI analysis. The railroads have submitted RPI evidence in dozens of Full-SAC cases and presumably have such litigation cost information available. Indeed, AAR submitted testimony from a leading railroad expert on the SAC process, responding to new proposals made by WCTL's experts regarding methodologies for allocating revenue from cross-over traffic.[58] Accordingly, the claim by AAR that it "cannot meaningfully comment on the proposal without an evidentiary basis for the Board's conclusion regarding the cost to bring a Simplified-SAC case"[59] is meritless. Based on our own experience with processing the RPI component of Full-SAC cases, we find reasonable the Chemical Shippers' estimates of the increased costs associated with a full RPI analysis.

Given the evidence submitted here, we reject the arguments presented by CSXT/NSR that we should not raise the limitation on relief no matter how much the cost of pursuing relief under the Simplified-SAC model has risen.[60] CSXT/NSR believes that the current indexed

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[53] USM Opening, V.S. Kaplan 6.

[54] UP Reply 14.

[55] Even some of the railroads participating in this proceeding acknowledge this. See BNSF Opening 17 ("The modest increase in costs to pursue relief that could result from these refinements would justify a modest increase in the relief limits in Simplified SAC and Three Benchmark cases, such as a doubling of the limit in both cases."); KCS Opening 6-7 (requiring a full RPI analysis in Simplified-SAC cases would hurt a shipper seeking relief between $2 and $5 million because of higher litigation costs).

[56] Chemical Shippers Opening, V.S. Crowley & Mulholland 60.

[57] BNSF Reply 5; CSXT/NSR Reply 27.

[58] AAR Reply, V.S. Baranowski 1.

[59] AAR Opening 16.

[60] CSXT/NSR Opening 20-27.

limitation of $1.2 million more than satisfies the goal of creating a last-resort simple methodology for shippers with small disputes, while encouraging shippers with higher-value disputes to use a more rigorous methodology. They describe imprecision in the approach that they believe justifies leaving the current relief cap in place, or alternatively should require the lowering of the relief cap to $200,000, a level they argue "would be more appropriate."[61]

CSXT/NSR's argument rests on their belief that raising the award limitation above the current cap "would allow the crude Three-Benchmark comparison approach to be used in many higher-value cases where a more rigorous SAC or Simplified-SAC approach can and should be used."[62] We disagree. The dearth of Simplified-SAC cases brought before the Board undermines CSXT/NSR's argument that the Simplified-SAC method can effectively be utilized for relatively low-value cases. Raising the limit for Three-Benchmark cases is appropriate given that shippers with lower value cases could not justify the estimated $4 million in litigation costs to make a Simplified-SAC presentation.[63] In short, the Simplified-SAC approach is too expensive where the value of the case is less than $4 million. For those cases, the Three-Benchmark approach is the only economically viable option.

Alternatively, CSXT/NSR argue that raising the relief limitation subjects more traffic to the Three-Benchmark constraint and therefore increases concerns about ratcheting down rates.[64] The Board previously acknowledged that, in theory, repeated application of the Three-Benchmark approach could have a feedback effect that could act to lower the mean for future cases. Simplified Standards, slip op. at 73-74. However, the agency did not believe that this should be a significant concern for several reasons that continue to apply here. With this decision, the potential for ratcheting will remain constrained by a limit on relief, albeit a higher one. Moreover, as the Board correctly observed, for the ratcheting potential to be realized, there would have to be an avalanche of rate cases brought to the agency. If we were to witness such an occurrence, we could reassess the advisability of this approach and take appropriate actions, if necessary. Furthermore, we must balance our concerns about possible ratcheting with Congress's clear intent that shippers with smaller disputes have a means of challenging their rates. As we said in Simplified Standards:

> In the end, we must balance the weaknesses of this comparison approach (including the theoretical potential for ratcheting) against the intent of Congress that simplified procedures be made available to captive shippers with smaller disputes. We have taken reasonable steps to make the SAC process, in either its full or simplified form, available to captive shippers. For the remaining cases, use of this admittedly imperfect comparison approach is necessary to provide captive

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[61] Id. at 24.

[62] Id. at 20-21.

[63] There may be instances where a complainant with a case that marginally exceeds this $4 million limit on relief will be faced with a difficult choice between forgoing some of the potential value of a dispute or pursuing greater relief under the Simplified-SAC approach despite increased costs. See Simplified Standards, slip op. at 29.

[64] CSXT/NSR Opening 23.

> shippers with small disputes some practical means of obtaining rate review and relief. We cannot . . . simply leave captive shippers with small commercial disputes to the mercy of the carriers.

Simplified Standards, slip op. at 74.

Taken together, these public comments support raising the limitation on relief in Three-Benchmark cases to $4 million. In our judgment, this action is necessary to offer captive shippers a practical means of obtaining rate review where the value of the case cannot justify the expense of pursuing relief with either a Full-SAC or Simplified-SAC presentation.

III. Cross-over Traffic

A. Single-Car and Multi-Car Traffic

1. *Board Proposal*

The Full-SAC test has been the most heavily utilized method for challenging the reasonableness of rail rates. One reason that it is used more often is that a complainant is permitted great flexibility in the design of its hypothetical SARR to detect inefficiencies in rail operations and the infrastructure. The approach is complicated, however. As such, since 1994 the Board has permitted complainants to use cross-over traffic, which enables these Full-SAC cases to focus on the facilities and services that are used by the complainant shipper and prevents Full-SAC cases from becoming unmanageable. See Nevada Power, 10 I.C.C. 2d at 265-68. In 2004, the agency concluded that "[w]ithout cross-over traffic, captive shippers might be deprived of a practicable means by which to present their rate complaints to the agency." Pub. Serv. Co. of Colo. v. Burlington N. & Santa Fe Ry., 7 S.T.B. 589, 603 (2004). At the time, the Board acknowledged that, as with any simplifying assumption, "the inclusion of cross-over traffic necessarily introduces some degree of impression into the SAC analysis." Id. But the agency concluded that "the value of this modeling device—both in keeping the analysis focused on the facilities and services used by the complainant shipper, and in streamlining and simplifying already complicated undertakings—outweighs the concerns raised by [the defendant railroad]." Id. Complainants first began utilizing the device by including cross-over traffic that was predominantly trainload service. More recently, however, complainants have begun to include in the SAC analysis a significant amount of carload and multi-carload cross-over traffic.[65]

The inclusion of large amounts of carload and multi-carload cross-over traffic has revealed a significant and growing concern. There is a disconnect between the hypothetical cost of providing service to these movements over the segments replicated by the SARR and the revenue allocated to those facilities. When the proposed SARR includes cross-over traffic of carload and multi-carload traffic, it generally would handle the traffic for only a few hundred miles *after* the traffic would be combined into a single train. As such, the "cost" to the SARR of

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[65] See, e.g., Ariz. Elec. Power Coop., Inc. v. BNSF Ry., NOR 42113, slip op. at 35 (STB served Nov. 22, 2011) (noting concern that "while a majority of AEPCO's traffic group moves in trainload service, most of the variable costs calculated for that group were costed assuming it moved in carload and multi-car service"), appeals docketed sub nom. Ariz. Elec. Power Coop., Inc. v. STB, No. 12-1045 (D.C. Cir. Jan. 23, 2012); BNSF Ry. v. STB, No. 12-1042 (D.C. Cir. Jan. 23, 2012); Union Pac. R.R. v. STB, No. 12-1046 (D.C. Cir. Jan. 23, 2012).

handling this traffic would be very low. In recent cases, litigants have proposed SARRs that would hook up locomotives to the train, would haul it a few hundred miles without breaking the train apart, and then would deliver the train back to the residual defendant. All of the costs of handling that kind of traffic (meaning the costs of originating, terminating, and gathering the single cars into a single train heading in the same direction) would be borne by the residual railroad. However, when it comes time to allocate revenue to the facilities replicated by the SARR, URCS treats those movements as single-car or multi-car movements rather than the more efficient, lower cost trainload movements that they would be. As a result, because ATC allocates revenues based on costs, it appears the facilities replicated by the SARR receive more revenue than is warranted.

Without a means of correcting or minimizing the bias that is created by the disconnect between the revenue allocation and the costs of providing service, we proposed to address the use of cross-over traffic in Full-SAC cases. Specifically, we proposed and invited public comment on the following two options for Full-SAC cases: (1) restricting the use of cross-over traffic to movements for which the SARR would either originate or terminate the rail portion of the movement, or (2) restricting the use of cross-over traffic to movements where the entire service provided by the defendant railroad in the real world is in trainload service.

The rationale for these proposals was that they would minimize the disconnect between the SARR's costs and the revenues it receives. The first option would require the SARR to replicate more of the services being provided by the defendant railroad, and therefore incur more similar costs. The second limitation would allow as cross-over traffic only trainload movements, where the cost of providing service across the entire movement is sufficiently homogenous that hypothetical and actual costs would more closely mirror each other on any segment.

2. *Public Comments*

The shipper community opposes the proposal to limit cross-over traffic. They argue that if a SARR cannot select the same traffic available to the incumbent, then the SAC analysis cannot truly replicate the incumbent railroad and the economies of densities it achieves.[66] Shippers further claim that either limitation would require shippers to expand SARRs to overly complex and expensive proportions, or forego the use of certain traffic.[67] Chemical Shippers and Coal Shippers argue that the true problem the Board is trying to remedy is not with cross-over traffic, instead claiming that the basis for the Board's concern is that termination, switching, and destination charges are not allotted correctly and the SARR is therefore avoiding paying those costs.[68] Chemical Shippers and Coal Shippers argue that this is a problem with URCS and how it quantifies and distributes costs over the line.[69] Chemical Shippers and Coal Shippers state that the Board has rejected using SARR costs in the past, and the proper fix would be to revisit URCS and how it allocates costs, not to restrict cross-over traffic.[70]

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[66] Chemical Shippers Opening 5.

[67] Id. at 6.

[68] Chemical Shippers Opening 10-14; Coal Shippers Opening, V.S. Crowley/Fapp 41-50.

[69] Chemical Shippers Opening 10-14; Coal Shippers Opening, V.S. Crowley/Fapp 41-50.

[70] Chemical Shippers Opening 10-14; Coal Shippers Opening, V.S. Crowley/Fapp 41-50.

CSXT/NSR argue that "[c]ontrary to the Board's suggestion," there is an alternative way to correct or minimize the bias that is created by the disconnect between the revenue allocation and the costs of providing service for this kind of cross-over traffic.[71] Those carriers argue that the problem the Board is trying to address with its proposed changes to cross-over traffic rules comes from the disconnect between the hypothetical cost of providing service for the SARR section of carload and multi-carload traffic, and the revenue allocation methodology.[72] Therefore, CSXT/NSR argue, the Board would not need to restrict cross-over traffic if it adjusts the revenue allocation method to account for the unique attributes and characteristics of each SARR, particularly, by allowing movement-specific adjustments to URCS.[73] According to CSXT/NSR, only if the Board is "unwilling or unable" to perform the necessary adjustments to URCS would it be justified in adopting one or both of the proposed limits on the use of carload and multi-carload cross-over traffic.[74]

Otherwise, the carriers generally argue that the Board should disallow the use of cross-over traffic altogether in Full-SAC cases. In the alternative, BNSF agrees that the Board should disallow the use of non-trainload traffic in Full-SAC cases.[75] AAR and UP argue that in the event cross-over traffic remains available to complainants, the Board should adopt the two proposed limitations as alternatives, giving complainants the option to employ one or the other.[76] UP further argues that the adopted proposals should apply to pending cases if the Board concludes that the proposals are in the public interest and would improve the quality of the SAC analysis.[77]

3. *Board Action*

We continue to have reservations about the growing use of carload and multi-carload cross-over traffic in Full-SAC cases. This kind of traffic is more expensive for the railroad industry to handle than the trainload traffic that travels from origin to destination in a single train. The presence of multi-carload traffic in Full-SAC cases is new, and we must consider whether it creates any unintended bias in the result.

In the <u>RRR Proposal</u>, slip op. at 16-17, we stated that shippers had started to include more single- and multi-car shipments and noted the concern that the resulting revenue disconnect, if not remedied, could tilt the balance towards the need to restrict the use of cross-over traffic. But shippers and a significant portion of the carrier community agree that the disconnect can be cured by a more accurate allocation of costs to the SARR, and that restrictions on such traffic are unnecessary assuming allocation improvements are made.

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[71] CSXT/NSR Opening 17-18; CSXT/NSR Reply 21.

[72] CSXT/NSR Opening 17-18; CSXT/NSR Reply 21.

[73] CSXT/NSR Opening 17-18; CSXT/NSR Reply 21.

[74] CSXT/NSR Opening 17-18; CSXT/NSR Reply 21.

[75] BNSF Opening 12.

[76] AAR Opening 19; UP Opening 6-7.

[77] UP Opening 16.

Because many shippers and some railroads agree that there may be ways to address our concerns without limiting the useful simplifying tool, we will not adopt either proposed limitation on the use of this kind of cross-over traffic at this time. Instead, the Board plans to institute a separate proceeding to explore options for addressing this issue. We will seek broader public input on approaches that have been proposed by litigants in pending cases, but which would require adjustments to our costing model to implement. In addition, parties in pending cases are free to advocate in their individual proceedings ways to address this issue.

B. Revenue Allocation

1. *Board Proposal*

In its notice, the Board proposed to modify the ATC method used to allocate revenue from cross-over traffic. The revised ATC methodology would have two steps. First, using the URCS variable and fixed costs for the carrier, and the density and miles of each segment, parties would calculate the railroad's average total cost per segment of a move. The total revenues from each portion of the movement would then be allocated in proportion to the average total cost of the movement on- and off-SARR. This first step would thus follow the original ATC proposal adopted in Major Issues. A second step would then be performed to assure that the revenue allocated to both the facilities replicated by the SARR and those of the residual defendant carriers would not be driven below the defendant's URCS variable costs for the movement over those segments. If the revenue allocation to the on-SARR (or off-SARR) segment would result in revenues falling below URCS variable costs for that segment, the revenue allocation to the on-SARR (or off-SARR) segment would then be raised to equal 100% of the defendant's URCS variable costs of providing service over that segment. If the total revenue from the cross-over movement were below our measure of total variable cost for the entire movement, revenue would be allocated between the two segments to maintain the existing total R/VC ratio on both segments.

We explained that this alternative method should better address two competing principles in the selection of a cross-over traffic methodology. First, we seek a revenue allocation that takes into account the important role that economies of density should play in any cost-based revenue allocation approach. Second, we seek a revenue allocation approach that does not create the implausible result of driving the revenue allocation on any segment below variable costs. We explained that this proposed approach would avoid driving the revenue allocation below variable costs while giving more weight to the important role those economies of density should play in any cost-based revenue allocation approach.

We sought public comment on whether this modification to ATC for use in all future SAC and Simplified-SAC proceedings would better accommodate the two competing principles than the current ATC approach. Parties were also invited to propose alternative approaches, if any, that would better accommodate these two competing principles.

2. *Public Comments*

Carriers generally prefer alternative ATC or original ATC to modified ATC. Specifically, CSXT/NSR's joint comments argue that either original ATC or alternative ATC would produce more accurate results than modified ATC, yet both still produce imperfect revenue allocations.[78] Furthermore, CSXT/NSR do not believe that having R/VCs below 100% is implausible or irrational.[79] UP prefers alternative ATC to modified ATC, but proposes that the Board abandon ATC altogether and use a methodology called efficient component pricing (ECP) instead.[80]

Shippers generally prefer modified ATC, arguing that it ensures first that cross-over traffic revenue is sufficient to cover each segment's variable costs before allocating excess revenues to defray fixed costs and contribute to profits.[81] Chemical Shippers argue that both original and alternative ATC make low density lines more profitable on a per-ton basis than high density lines, contrary to the fundamental economic principle that economies of density result in higher profits.[82]

Coal Shippers argue that alternative ATC is not "demonstrably superior" to modified ATC for several reasons. Coal Shippers first claim that alternative ATC produces "illogical and unintended" results when applied to low, medium, and high contribution moves.[83] Coal Shippers allege "[a]lternative ATC 'produce[s] absurd results by making low-density lines more profitable on a per ton basis than high-density lines' and illogically 'transfer[s] the profitability associated with traffic moving on high-density lines to traffic moving on low-density lines, in effect robbing the high-density lines of the very scale economies that incented the railroads to invest in capacity enhancements on those high-density lines in the first place.'"[84] Coal Shippers also claim that modified ATC properly weights economies of density.[85] Finally, Coal Shippers claim that constant changing of cross-over traffic revenue allocation methodologies to decrease SARR revenues is manifestly unfair to captive coal shippers.[86] In lieu of alternative ATC, Coal Shippers propose three alternatives: (1) Corrected Modified ATC; (2) Three Step ATC; and (3) Variable Cost Allocation.[87]

AECC proposes that the economic and "real-world" treatment of traffic in analyses of potential abandonments provides a reasonable template for cross-over traffic analyses.[88] AECC argues that in an abandonment case, the contribution from affected traffic is weighed against the

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[78] CSXT/NSR Opening 17.

[79] Id.

[80] UP Opening 12, 16.

[81] Coal Shippers Opening 53; Chemical Shippers Opening 22.

[82] Chemical Shippers Opening 21-23.

[83] Coal Shippers Opening 52.

[84] Id. at 57, V.S. Crowley/Fapp 23-24.

[85] Coal Shippers Opening 52.

[86] Id.

[87] Id. at 69.

[88] AECC Opening 9.

value associated with salvaging the line, while in SAC analyses it is weighed against the value of replacing the line.[89]

3. *Board Action*

The Board is adopting its proposal to change the revenue allocation approach used to allocate revenue from cross-over traffic. The total revenues from each portion of the cross-over traffic movement will be allocated in proportion to the average total cost of the movement on- and off-SARR. But if the revenue allocation to the on-SARR (or off-SARR) segment would result in revenues falling below URCS variable costs for that segment, the revenue allocation to the on-SARR (or off-SARR) segment would then be raised to equal 100% of the defendant's URCS variable costs of providing service over that segment.[90]

We remain convinced that this approach will better accommodate two principals: (1) the important role that economies of density should play in any cost-based revenue allocation approach; and (2) the avoidance of the revenue allocation on any segment being below variable costs. If the original ATC approach worked as intended in Major Issues—meaning it allocated revenue in accordance with relative average costs and thereby maintained the relationship between revenue and costs that would exist in a complete SAC analysis *without* driving the revenue allocation below variable costs—then we would use that revenue allocation. If, however, use of that approach on low-rated traffic resulted in driving the revenue allocation below variable cost, then (and only then) we would make an adjustment to correct that feature. This approach therefore gave the maximum weight to relative economies of density while avoiding the illogical result of driving the revenue allocation on any segment below the variable costs of providing service over that segment. As alternative ATC is simply a variation on ATC—in which we have now defined the exact computational method—in future decisions we will refer to the method simply as the Board's ATC methodology.

Our responses to the parties' arguments in favor of alternative methods are set forth below.

a. Coal Shippers' Objection to Alternative ATC

Coal Shippers' argue that alternative ATC is not superior to modified ATC and should not therefore be adopted. First, they argue that the approach produces "illogical and unintended results." When applied to low contribution moves, the approach may result in all of the available contribution (revenues in excess of variable costs) being allocated to the lighter density segment.[91] Coal Shippers also object to the application of this approach to medium and high contribution movements because, by allocating more revenue to the lighter-density lines, the approach supposedly "skews profit allocations in a manner that defies economic principles."[92]

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[89] Id.

[90] If the total revenue from the cross-over movement were below our measure of total variable cost for the entire movement, revenue would be allocated between the two segments to maintain the existing total R/VC ratio on both segments.

[91] Coal Shippers Opening 52-55.

[92] Id. at 55-58.

We do not find these objections to alternative ATC convincing. For the low contribution movements, Coal Shippers claim that there "is no logical reason why all movement contribution should be allocated to a low-density segment in cases where the total movement revenues exceed total movement variable costs."[93] In Major Issues, the Board stated that its goal was to reflect the relative average costs of providing service over the two segments and therefore maintained the relationship between revenue and costs that would exist in a complete SAC analysis. Allocating revenue in relation to the average cost of providing service over the two segments is why it is possible that, for certain low rated traffic, the majority or even entirety of the available contribution is allocated to the lighter density line because of the associated higher average total costs of providing service over that portion of the total movement.

For medium and higher contribution traffic, Coal Shippers (and Chemical Shippers) object because alternative ATC (when compared with modified ATC) might reduce the "profitability" of the higher density segment. This is essentially the same policy argument raised by Coal Shippers in Major Issues, and rejected by the Board. In that proceeding, Coal Shippers similarly objected to ATC because it would allocate more revenue to lighter-density lines. They argued that Guidelines calls for shippers to design "least cost" SARRs that "maximize" traffic densities, but the ATC divisions will arbitrarily allocate disproportionate shares of SARR divisions to lower-density off-SARR lines. The agency rejected this concern because the goal in allowing cross-over traffic is to simplify the analysis without introducing bias. "A successful allocation of cross-over revenues would produce the same revenue-to-cost relationship as would be produced if the complainant modeled the entire movement. Rather than arbitrarily allocating revenue to low-density lines, the ATC method more accurately is keyed to the defendant carrier's relative costs of providing service over the two segments." Major Issues, slip op. at 35. Coal Shippers have cloaked this same policy argument in the guise of economic theory, claiming "a fundamental principle of economics is that a carrier's profit increases as its average total cost decreases."[94]

Moreover, Coal Shippers' economic argument suffers from two fundamental flaws. First, the allocation inquiry is a hypothetical exercise to allocate total revenue from a single movement between various rail facilities needed to serve that traffic. Holding everything else constant, a railroad's profits on a particular movement will increase as its average total cost of providing service decreases. But while this principle is true for the *entire* movement, this observation provides no meaningful way to allocate available contribution to cover fixed costs between higher density and lower density segments when both segments (and thus all the fixed costs) are needed to serve the entire movement. Any approach that allocates more revenue towards the lighter density lines will inevitably reduce the perceived "profitability" of the higher-density line. Second, their economic argument runs counter to the underlying goal in Major Issues to create a revenue allocation method based on the average total costs of providing service over each segment. The Board's intent was to ensure that low density line segments, with their higher average total costs, are allocated relatively more revenue from each individual movement to help cover fixed costs. Major Issues, slip op. at 35.

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[93] Id. at 54-55.

[94] Coal Shippers Opening 55.

Alternatively, Coal Shippers argue that modified ATC already properly weighs economies of density and that it would be inappropriate to give further weight to economies of density in the revenue allocation process. Again, however, this argument is inconsistent with the basic goals and objectives behind the ATC approach. As the Board explained, "Economies of density reflect how average total costs for a network of a given size initially decrease with increases in output. Accordingly, any approach that seeks to account for economies of density must examine the average total costs, rather than the average variable costs." Id. at 34. ATC is designed to meet that goal and to allocate revenue in accordance with existing economies of density (i.e., in accordance with the relative average total costs of providing service). Alternative ATC follows that approach, but with a modest adjustment only as needed to ensure that the revenue allocation does not drive the allocation below the variable cost of providing service over a particular segment. In our judgment, alternative ATC therefore does a superior job of allocating revenues in accordance with economies of density than modified ATC.

Coal Shippers also argue that alternative ATC (or any method premised on economies of density) is unnecessary because the railroad industry has exhausted economies of density, citing the Christensen Study. This argument does not justify abandoning alternative ATC. First, the information Coal Shippers cite is for the railroad industry as a whole. Whether the exhaustion premise is true or not, this industry information says nothing about whether economies of density exist within a given railroad's network. Second, if economies of density have been exhausted, that effect will be automatically captured by the ATC approach.[95] Finally, and by way of example, we reject the implicit argument that the average total cost to provide service in the Powder River Basin (one of the highest density freight rail segments in the world) is the same or higher than the average total cost to provide service over light-density feeder rail lines.

Finally, Coal Shippers' express concern regarding the prejudice to complainants when the revenue allocation changes. We appreciate that complainants cannot be expected to litigate in regulatory quicksand, with the standard for relief constantly changing and shifting. Nor, however, can we decline to adopt a superior rate setting methodology simply because complainants prefer the status quo, if we believe that the change creates a more accurate or appropriate result. Here, after notice and comment, we adopt a version of ATC that better approximates the appropriate revenue distribution, and any argument that a change could adversely affect either shippers or carriers does not override our concern for reaching the proper outcome in rate cases.

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[95] ATC allocates revenue in accordance with the relative average total cost of providing service over the segments at issue. For example, if the average total cost of the lighter density segment was $10 per ton and the average total cost of the heavier density segment was $5 per ton (thus reflecting strong economies of density), then two thirds of the total revenue would be allocated to the lighter density segment. If the average total cost was roughly equal because the economies of density had been exhausted for those segments, then the ATC method would allocate revenues equally between the two segments.

b. Coal Shippers' Three Alternatives

In lieu of alternative ATC, Coal Shippers propose three alternatives: (1) Corrected Modified ATC; (2) Three Step ATC; and (3) Variable Cost Allocation.[96] The first two approaches rest on the belief that our current approach does not estimate the average fixed cost per route mile correctly. Rather than estimate the average fixed cost per route mile, Coal Shippers would allocate the fixed costs per track mile. Under these two approaches, a 100-mile segment that is all double track would have twice the fixed costs of a 100-mile segment that is all single track. The third alternative is premised on the belief that economies of density have been exhausted.

Fundamentally, we reject Coal Shippers' three proposed alternatives because they fail to achieve the objectives set forth in Major Issues and RRR Proposal. Corrected Modified ATC and Three Step ATC reflect a complete abandonment of the theory behind ATC: to reflect the relative average costs of providing service over the two segments and therefore maintain the relationship between revenue and costs that would exist in a complete SAC analysis. Moreover, these two approaches improperly assume that line segments with more track miles should be assigned more fixed costs in a directly proportional manner.[97] The Board has already concluded that because URCS system-average variable costs reflect all railroad costs that vary with volume, the remaining costs (i.e., fixed costs that do not vary with volume) would be the same on average for low-density as for high-density lines. RRR Proposal, slip op. at 8. Finally, the third proposal, Variable Cost Allocation, would allocate revenues based on variable costs alone,[98] which is premised on the belief that economies of density have been exhausted everywhere within every railroad's network. We find this to be an implausible assumption but note that, even if true, would be reflected in the alternative ATC approach anyway.

c. Full-Contribution Method

AECC asks the Board to revisit the methodology it previously advocated in Major Issues.[99] AECC argues again that the ATC method is inconsistent with contestability theory and could also produce incentives for economically inefficient conduct by the SARR and/or by the residual incumbent to capture contribution from cross-over traffic. AECC submits that the treatment of revenue on cross-over traffic should emulate the view of a hypothetical new entrant standing in the shoes of the defendant carrier and consider the defendant carrier's investment in the facilities used to handle the subject traffic. AECC again offers an alternative proposal that would provide the SARR with the full contribution over total variable costs realized by the incumbent on the entire through movement. In other words, all the available contribution from the movement would be allocated to the facilities replicated by the SARR. AECC argues that this methodology relies on a sound analytical framework, is computationally straightforward, is consistent with industry practice, and provides a foundation for consistent treatment of ancillary issues.

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[96] Coal Shippers Opening 69.

[97] Id. at 69-72.

[98] Id. at 73-74.

[99] AECC Opening 6-10.

We are rejecting AECC's proposal for the same reason the Board rejected it in Major Issues: it is based on the notion that the SARR and the incumbent would try to "capture" contributions from cross-over traffic and that the incumbent should, effectively, only retain enough revenue to cover its variable costs. AECC's approach would thus over-allocate revenue in favor of the SARR. Major Issues, slip op. at 37 n.95. As AECC has offered no reasonable basis to reconsider this conclusion, we will again reject its full contribution approach.

d. Efficient Component Pricing

UP advocates an alternative ECP revenue allocation methodology that has been twice rejected by this agency. Most recently, in Major Issues, the Board rejected this approach for three reasons. First, the approach assumes post-entry retaliation by the incumbent railroad, which conflicts with the basic precepts of contestable market theory. Second, even if the objective were to replicate the revenue allocation that would occur in a contestable market, ECP does not do so. See Major Issues, slip op. at 37-39 (stating that in a true contestable market both the SARR and incumbent would compete, and neither side would enjoy the lion's share of revenue, as is the outcome in ECP). Finally, and most importantly, the approach would inject bias in favor of the railroads and render cross-over traffic ineffectual in simplifying the SAC analysis. As UP has offered no reasonable basis to reconsider these conclusions, we will again reject the ECP approach.

IV. Interest Rate

1. *Board Proposal*

When the Board determines that a railroad has charged rates that are unreasonable, it may establish a rate prescription, as well as direct the railroad to reimburse the complaining shipper, with interest. Until now, the level of interest in these circumstances, among others, was set at the T-Bill rate. 49 C.F.R. § 1141.1(a).

It is our responsibility to establish an interest rate that reimburses shippers for the lost opportunity to invest the money to which they are entitled through reparations, encourages compliance with our rules, and correlates to market interest rates over a comparable time frame. In the RRR Proposal, concerned that the T-Bill rate (currently at 0.10%) was insufficient, we proposed to change the interest rate to the U.S. Prime Rate, as published in *The Wall Street Journal*. The U.S. Prime Rate (currently at 3.25%) is the short term interest rate that the banks charge to their most creditworthy customers.

2. *Public Comments*

In general, shippers strongly support the proposal to change the interest rate on overcharges from the T-Bill to the U.S. Prime Rate. Some shippers note though that the most recent railroad cost of debt is 3.97% in 2011, significantly higher than the 3.25% U.S. Prime Rate, meaning that railroads would still receive a windfall.[100]

Chemical Shippers also offer a new proposal to account for their view that shippers are penalized by extended proceedings because they must pay the higher rate while litigation is ongoing. They propose that the Board should extend the rate prescription by a year for every

[100] Chemical Shippers Opening 30-31; CURE Opening 6-7.

year, or portion thereof, for any time in excess of three years after the filing of the complaint, until the Board issues a final appealable decision.[101]

The railroads object to the Board's proposal to varying degrees. BNSF opposes raising the interest rate in light of the length of time it takes to resolve rate reasonableness complaints.[102] KCS notes that the risk-free rate of return standard is currently used because reparations should reflect a return of monies overpaid by complainant for transportation charges, which come from cash, short term government securities, short term certificates of deposits, or money market accounts.[103] Therefore, KCS argues, the interest rate applicable in reparations should reflect the rate of return applicable to such short-term working capital.[104] However, KCS also offers a modified proposal that would adopt higher rates. KCS argues that if the Board wants to ensure that interest on reparations correlates to market rates over a comparable timeframe, it should use averages that best represent interest rates for the applicable methodology.[105] For example, a Three-Benchmark case is supposed to take 240 days, so the Board could use a blend of the interest rate of the 26- and 52-week T Bills.[106] In its comments, UP changes course from the idea it proposed in EP 705 and now "opposes the Board's proposal to change the standard used to calculate interest owed to shippers in rate reasonableness cases."[107] UP maintains that the interest rate on overcharges "should reflect the rate of return the shipper lost because it did not have the funds available."[108] UP believes that the T-Bill rate reflects the level of return that a shipper could obtain from a risk-free investment.

The AAR opposes the proposal to raise interest rates. It observes that the agency has addressed the appropriate interest rate in several proceedings and adopted the T-Bill rate because it was perceived as "a universally accepted short-term baseline opportunity cost rate for all companies, regardless of the industry." Procedures to Calculate Interest Rates, 9 I.C.C. 2d 528, 534 (1993). The AAR maintains that the interest rate should be a *risk free* rate (U.S. T-Bill), not the U.S. Prime Rate which "is a higher risk rate, albeit still generally low risk, that banks charge low credit risk customers for short term loans."[109]

3. *Board Action*

We are adopting the U.S. Prime Rate as the interest rate for reparations because it correlates to market interest rates for a similar risk and term (i.e., high credit worthiness for short-term borrowing). While the interest rate is intended to be neither punitive, nor provide

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[101] Chemical Shippers Opening 32.

[102] BNSF Opening 18.

[103] KCS Opening 12. See also UP Opening 19.

[104] Id.; see also AAR Opening 24-25, UP Opening 19.

[105] KCS Opening 13.

[106] Id.

[107] UP Opening 18-19.

[108] Id.

[109] AAR Opening 25.

leverage in rate negotiations, it should be more attuned to a complaining shipper's opportunity cost and encourage compliance with our rules. It is now our opinion that the U.S. government-backed T-Bill rate is too low, and that the Prime Rate more closely addresses the shippers' opportunity cost. The railroads' argument that reparations are equivalent to risk-free government-backed investments is not persuasive. While an ultimately meritorious complaint is pending before the Board, shippers are denied the right to invest the money to which they are entitled through reparations. Shippers should be reimbursed for this lost opportunity, and not penalized because their funds are captive to the defendant railroad while the rate complaint is adjudicated. Moreover, compliance with our rules will be encouraged when the consequence for failing to do so is not equated with the risk-free borrowing rate of the U.S. government.

We acknowledge that this decision reflects a departure from the Interstate Commerce Commission's (ICC) conclusion that the risk-free T-Bill rate is the appropriate interest rate to be paid on reparations. See Procedures to Calculate Interest Rates, 9 I.C.C. 2d 528, 534 (1993); Revised Procedures to Calculate Interest Rates, 42 Fed. Reg. 20,701 (April 21, 1977). We disagree, however, with the fundamental premise in those proceedings that a complainant—who has suffered harm from the railroad's violation of federal law—is only entitled to the *risk free* rate of interest. Rather, we agree with Chemical Shippers that the predicate that a rate case is risk free is wrong.[110] Not only is bringing a rate case itself a risky proposition (even for meritorious claims), but investment in the railroads is not risk free, as evidenced by the railroad industry cost of debt, which is analogous to the U.S. Prime Rate. We also concur with the general proposition proposed by both UP and the AAR that we should use an interest rate that represents the opportunity cost to the complainant. Yet the risk-free U.S. T-Bill rate is plainly too low to represent the relevant opportunity cost. AAR maintains that "reparation payments represent an essentially risk-free 'investment' of funds."[111] In the end, nothing submitted by AAR dissuades us that the more appropriate measure to use is the U.S. Prime Rate (currently at 3.25%), which is a low risk interest rate that the banks charge to their most creditworthy customers. Accord Natural Gas Policy and Procedures, Final Regulation and Request for Comments, 44 Fed. Reg. 53,493, 53,494 (Sept. 14, 1979) (adopting the U.S. Prime Rate).

Finally, we are not persuaded by KCS's proposal to use interest rate averages that correlate to the duration of a rate case. We believe that such a proposal, while creative, unnecessarily complicates a relatively straightforward part of our rate process and leaves open for debate too many questions regarding which interest rate should be utilized over which time period. Moreover, this interest rate provision applies to more than just rate cases; it applies to any circumstance where the railroad is found to have harmed a party due to its non-compliance with the statute (e.g., unreasonable practices or unreasonable demurrage charges). In all such instances we find that a clear and simple interest rate calculation is warranted.

V. Rail Transportation of Grain

The concerns raised by agricultural shippers merit a preliminary discussion here. NGFA and ARC both argue that the changes proposed in the RRR Proposal do not provide meaningful

[110] Chemical Shippers Reply 9.

[111] AAR Opening 25-26.

relief to grain shippers.[112] NGFA notes that, despite increases in rates, no grain shipper has sought rate relief at the Board since 1981, and that the Board should consider providing more substantial modifications to provide a mechanism for grain shippers to challenge rates.[113] We believe it is time to investigate whether regulatory changes can be implemented to provide alternatives for rail rate relief to grain shippers.

On November 2, 2006, the Board held a hearing in Rail Transportation of Grain, Docket No. EP 665, as a forum for interested persons to provide views and information about grain transportation markets. The hearing was prompted by concerns regarding rates and service issues related to the movement of grain raised by Members of Congress, grain producers and other stakeholders. The Board closed that proceeding in January 2008, stating, among other reasons, that Simplified Standards had recently been served, providing a new avenue for rate relief. Rail Transp. of Grain, EP 665, slip op. at 5 (STB served Jan. 14, 2008). We noted further that we would continue to monitor the relationship between carriers and grain interests, and that if future regulatory action were warranted, we would open a new proceeding. Id.

Since our simplified methodologies were instituted, no agricultural rate cases have been filed. Yet, as ARC and NGFA note, agricultural shippers continue to voice concerns regarding the level of their rates. We believe it is time to take a fresh look at rate relief procedures available to grain shippers. Within three months of the service of this decision, the Board will open a new proceeding to obtain input from interested parties on grain shippers' ability to effectively seek relief for unreasonable rates, as well as proposals for modifying existing procedures, or new alternative rate relief methodologies, should they be necessary.

VI. Regulatory Flexibility Act

The Regulatory Flexibility Act of 1980 (RFA), 5 U.S.C. §§ 601-612, generally requires a description and analysis of new rules that would have a significant economic impact on a substantial number of small entities. In drafting a rule, an agency is required to: (1) assess the effect that its regulation will have on small entities; (2) analyze effective alternatives that may minimize a regulation's impact; and (3) make the analysis available for public comment. 5 U.S.C. §§ 601-604. The impact must be a direct impact on small entities "whose conduct is circumscribed or mandated" by the proposed rule. White Eagle Coop. Ass'n v. Conner, 553 F.3d 467, 480 (7th Cir. 2009). An agency has no obligation to conduct a small entity impact analysis of effects on entities that it does not regulate. United Dist. Cos. v. FERC, 88 F.3d 1105, 1170 (D.C. Cir. 1996). Under § 605(b), an agency is not required to perform an initial or final regulatory flexibility analysis if it certifies that the proposed or final rules will not have a "significant impact on a substantial number of small entities."

In the RRR Proposal, we certified that these rules will not have a significant economic impact on a substantial number of small entities within the meaning of the RFA. Coal Shippers challenge this certification, arguing that the Board incorrectly concluded that the RFA only applies to entities regulated by the Board—here, the railroads.[114] Coal Shippers read Mid-Tex

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[112] NGFA Opening 4-5; ARC Opening 6-12.

[113] NGFA Opening 3-4.

[114] Coal Shippers Opening 77-79.

Electric Cooperative v. FERC, 773 F.2d 327, 340-343 (D.C. Cir. 1985), as holding that the RFA applies to small entities that are "subject to the requirements of the rule" being proposed. Here, Coals Shippers claim, the RFA applies because the proposals would impose requirements on shippers, a number of which they argue are small entities, including new SAC rules and a more thorough RPI analysis in Simplified-SAC.[115]

We do not agree with Coal Shippers' argument. Their reading of Mid-Tex Electric Cooperative ignores the plain language of the subsequent decision, United Distribution Cos., 88 F.3d at 1170, which specifically held that the RFA does not require an agency to perform an analysis on entities that it does not regulate. The Board does not have the jurisdiction to regulate shippers, although they may avail themselves of our processes. Rail carriers, however, are directly subject to our jurisdiction and regulations.

We believe that our reading of the RFA as applying only to small entities over which we have jurisdiction is by far the more sensible one. As a practical matter, the Board would be unable to perform a small entity analysis on the entire shipper community. Such an analysis would encompass every small business in the United States that could avail itself of rail service, a group so large that the Board could not delineate it, much less perform an economic analysis on it. The impracticability of such an approach is supported by Cement Kiln Recycling Coalition v. EPA, 255 F.3d 855, 869 (D.C. Cir. 2001). There, the United States Court of Appeals for the District of Columbia acknowledged that the rules in that case would "have economic impacts in many sectors of the economy," but nonetheless affirmed its prior holding that "to require an agency to assess the impact on all of the nation's small businesses possibly affected by a rule would be to convert every rulemaking process into a massive exercise in economic modeling, an approach we have already rejected." Id. (citing Mid-Tex Elec. Coop., 773 F.2d at 343).

Even if the RFA applied to non-jurisdictional small entities, the rules adopted here alleviate many of the concerns about increased burden that Coal Shippers identified in their comments. Although the full RPI analysis will be required in Simplified-SAC proceedings, shippers will also have the ability to receive $2 million of relief in Three-Benchmark cases and $5 million of relief if we adopt our $5 million proposal. This proposed level would coincide with the level established for Simplified-SAC cases in Simplified Standards. Thus, although Simplified-SAC costs may increase, shippers could obtain $5 million in damages under a less expensive model than they could previously. The other modifications to the SAC process, changes to the ATC methodology and the interest rate, do not impose any additional burden in bringing a rate complaint than did the previous versions.

Thus, our certification continues to be appropriate. The rule changes adopted here will not have a significant economic impact upon a substantial number of small entities, within the meaning of the RFA.[116] The changes impose no additional reporting or record-keeping

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[115] Coal Shippers Opening 77-79.

[116] The Small Business Administration's (SBA) Office of Size Standards develops the numerical definition of a small business. See 13 C.F.R. § 121.201. The SBA has established a size standard for rail transportation, stating that a line-haul railroad is considered small if its number of employees is 1,500 or less, and that a short line railroad is considered small if its number of employees is 500 or less. Id. (industry subsector 482).

requirements on small railroads. Nor do these changes circumscribe or mandate any conduct by small railroads that is not already required by statute: the establishment of reasonable transportation rates. Small railroads have always been subject to rate reasonableness complaints and their associated litigation costs. And they have been subject to simplified rate procedures since 1996. Finally, as the Board has previously concluded, the majority of railroads involved in these rate proceedings are not small entities within the meaning of the RFA. See Simplified Standards, slip op. at 33-34. In the 32 years since the passage of the Staggers Act—when Congress limited the Board's rate reasonableness jurisdiction to where a carrier has market dominance over the transportation at issue—virtually all rate challenges have involved Class I carriers. Therefore, the Board certifies under 5 U.S.C. § 605(b) that these rules will not have a significant economic impact on a substantial number of small entities within the meaning of the RFA.

CONCLUSION

Since the 2011 hearing in Competition in the Railroad Industry, we have been considering a range of ideas and options to determine how best to promote a competitive and economically viable rail network. Recently, we overhauled our mediation and arbitration rules to encourage greater use of alternative dispute resolution procedures. Assessment of Mediation & Arbitration Procedures, EP 699 (STB served May 13, 2013). Today, we are adopting revisions to improve our rate reasonableness procedures, while continuing to foster a sound, safe, and efficient rail transportation system by allowing carriers to earn adequate revenues. In addition, we continue to evaluate other competitive issues, including how to improve our rules in transactions involving interchange commitments, what actions to take in connection with commodity exemptions which were the subject of a separate hearing in Docket No. EP 704, and whether to alter our competitive access rules as proposed by the National Industrial Transportation League in Docket No. EP 711.

We believe that these changes to our rate procedures will promote the rail transportation policy to protect captive shippers from unreasonable rates, 49 U.S.C. § 10101(6), without precluding rail carriers from earning revenues that are adequate under honest, economical, and efficient management, 49 U.S.C. § 10704(a)(2). We also believe that several of these changes will enable the agency to better follow the directive from Congress "to provide for the expeditious handling and resolution of all proceedings required or permitted to be brought under this part." 49 U.S.C. § 10101(15); see also 49 U.S.C. § 10704(d) (requiring the agency to establish "procedures to ensure expeditious handling of challenges to the reasonableness of railroad rates").

Changes to the Code of Federal Regulations are set forth in **Appendix A** and will be published in the Federal Register.

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

It is ordered:

1. The Board will be guided in individual rail rate reasonableness determinations by the methodological and procedural changes set forth in this decision.

2. Notice of this decision will be published in the Federal Register.

3. A copy of this decision is being provided to the Chief Counsel for Advocacy, Small Business Administration.

4. This decision is effective on August 17, 2013.

By the Board, Chairman Elliott, Vice Chairman Begeman, and Commissioner Mulvey.

Appendix A – Changes to Code of Federal Regulations

For the reasons set forth in the decision, the Surface Transportation Board replaces part 1141 of title 49, chapter X, of the Code of Federal Regulations in its entirety with the following regulation:

49 C.F.R. PART 1141—PROCEDURES TO CALCULATE INTEREST RATES

Authority: 49 U.S.C. § 721.

§ 1141.1 Procedures to calculate interest rates.

(a) For purposes of complying with a Board decision in an investigation or complaint proceeding, interest rates to be computed shall be the most recent U.S. Prime Rate as published by The Wall Street Journal. The rate levels will be determined as follows:

(1) For investigation proceedings, the interest rate shall be the U.S. Prime Rate as published by The Wall Street Journal in effect on the date the statement is filed accounting for all amounts received under the new rates.

(2) For complaint proceedings, the interest rate shall be the U.S. Prime Rate as published by The Wall Street Journal in effect on the day when the unlawful charge is paid. The interest rate in complaint proceedings shall be updated whenever The Wall Street Journal publishes a change to its reported U.S. Prime Rate. Updating will continue until the required reparation payments are made.

(b) For investigation proceedings, the reparations period shall begin on the date the investigation is started. For complaint proceedings, the reparations period shall begin on the date the unlawful charge is paid.

(c) For both investigation and complaint proceedings, the annual percentage rate shall be the same as the annual nominal (or stated) rate. Thus, the nominal rate must be factored exponentially to the power representing the portion of the year covered by the interest rate. A simple multiplication of the nominal rate by the portion of the year covered by the interest rate would not be appropriate because it would result in an effective rate in excess of the nominal rate. Under this "exponential" approach, the total cumulative reparations payment (including interest) is calculated by multiplying the interest factor for each period by the principal amount for that period plus any accumulated interest from previous periods. The "interest factor" for each period is 1.0 plus the interest rate for that period to the power representing the portion of the year covered by the interest rate.