SURFACE TRANSPORTATION BOARD

DECISION

Docket No. NOR 42113

ARIZONA ELECTRIC POWER COOPERATIVE, INC.
v.
BNSF RAILWAY COMPANY AND
UNION PACIFIC RAILROAD COMPANY

Digest:[1] The parties are directed to submit new costing evidence in this rail rate reasonableness proceeding.

Decided: June 24, 2011

Arizona Electric Power Cooperative, Inc. (AEPCO) filed a complaint challenging the reasonableness of the rates established by BNSF Railway Company (BNSF) and Union Pacific Railroad Company (UP) (collectively, defendants) for unit train coal transportation service from New Mexico and the northern portion of the Powder River Basin in Wyoming and Montana, to AEPCO's Apache Generating Station located near Cochise, Ariz. AEPCO seeks rate relief using the Board's stand-alone cost (SAC) methodology. BNSF and UP have answered the complaint, and the parties have submitted evidence and filed closing briefs. An oral argument before the Board was held in this proceeding.

The Board uses its Uniform Railroad Costing System (URCS) to determine a carrier's variable costs in a variety of regulatory proceedings. 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, 898-99 (1989). In a SAC analysis, URCS is used for a number of purposes, including determining the variable cost of each movement in the traffic group that moves over a hypothetical stand-alone railroad (SARR). Revenues for the on-SARR portion of a given movement are then divided by the movement's variable costs, so that rates can be expressed as a ratio (R/VC ratio) that is utilized in one aspect of the Board's rate reasonableness analysis, known as the Maximum Markup Methodology (MMM).

Railroads are allowed to engage in demand-based differential pricing, but only to ensure that they cover their costs and receive a reasonable return on their investment. Much of the SAC analysis is used to quantify these costs, and in turn, determine the total reasonable revenues that a

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[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).

railroad may collect. Under MMM, traffic group members' rates are arrayed on an R/VC ratio basis. Major Issues in Rail Rate Cases (Major Issues), EP 657 (Sub-No. 1), slip op. at 14-15, (STB served Oct. 30, 2006). MMM then utilizes an iterative process to determine a benchmark R/VC level. Id. at 14. The benchmark R/VC level is initially set at the average R/VC ratio for the SARR traffic group movements. Id. This initial level is then adjusted upward (if necessary) to the R/VC ratio at which, if all traffic with R/VC ratios above the benchmark were reduced to the benchmark R/VC level, and all other rates were left unchanged, the SARR would cover its SAC costs. Id.

To develop the variable costs used to calculate the R/VC ratio for the movements in the traffic group, the parties use URCS to apply the defendant carrier's unadjusted system-average variable costs to each movement. Id. at 47-48. In the proceeding before us, the Board is concerned with how the parties have developed the variable costs for the traffic movements on the SARR submitted by AEPCO. Here, most of AEPCO's traffic group moves in trainload service, but most of the variable costs calculated for that group are costed assuming it is moved in carload and multi-car service. The defendants' evidence features this mismatch as well. In addition, defendants calculated costs based on system averages they developed for the SARR, as opposed to the defendants' own system averages. However, this approach is inconsistent with Major Issues, which stated that the Board would use defendants' own costs for this purpose. Id. As a result, neither the complainant nor the defendants have provided an MMM calculation that we can use to reach a final result. In both cases, improper costing affects the R/VC ratios and works its way into the MMM, affecting the final rate prescription.

Accordingly, AEPCO is instructed to submit revised variable costs calculations, reflecting actual operating characteristics of the movements on the SARR, for the traffic group submitted on rebuttal, by July 11, 2011. Defendants may reply to AEPCO's evidence by 14 days after its submission. AEPCO may submit a rebuttal by 7 days after defendants' reply. Alternatively, the parties may submit joint evidence in accordance with the direction provided in this decision. The parties' submissions should be limited to the improper costing of the traffic group discussed in this decision.

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

It is ordered:

1. AEPCO, or the parties jointly, shall submit revised variable costs calculations in accordance with the direction in this decision by July 11, 2011.

2. Defendants may file a reply to AEPCO's evidence by 14 days after AEPCO's submission.

3. AEPCO may submit a rebuttal by 7 days after defendants' reply.

4. This decision is effective on the date of service.

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