

SERVICE DATE - APRIL 1, 1997

SURFACE TRANSPORTATION BOARD<sup>1</sup>

DECISION

EX PARTE NO. 290 (SUB-NO. 7)  
PRODUCTIVITY ADJUSTMENT-IMPLEMENTATION

Decided: March 18, 1997

This decision addresses a petition filed by the Association of American Railroads (AAR), an organization of railroads, and by Burlington Northern Santa Fe Corporation (BNSF), an individual railroad, asking us to reopen this proceeding, to accept new evidence, and to reconsider our prior decision served October 3, 1996 (the Oct. 3 decision), so that we can correct material error. In our Oct. 3 decision, we determined that we would periodically calculate the productivity-adjusted Rail Cost Adjustment Factor (RCAF) using two slightly different sets of data, rather than just one.<sup>2</sup> AAR and BNSF (collectively the railroads) assert that we acted improperly in calculating two productivity-adjusted RCAF's, in violation of the Congressional directive that our calculation be "authoritative." They argue that we should calculate only one productivity-adjusted RCAF, using the methodology that apparently favors them in their private contract litigation.

Western Coal Traffic League and Edison Electric Institute (WCTL/EEI or the shippers) have filed a joint reply in opposition

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<sup>1</sup> The ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803 (ICC Termination Act or ICCTA), which was enacted on December 29, 1995, and which took effect on January 1, 1996, abolished the Interstate Commerce Commission (ICC) and transferred certain ICC functions to a newly created Surface Transportation Board (Board). Section 204(b)(1) of the ICC Termination Act provides, in general, that proceedings pending before the ICC on the effective date of that legislation shall be decided under the law in effect prior to January 1, 1996, insofar as they involve functions retained by the new law. This decision relates to a proceeding that was pending with the ICC prior to January 1, 1996, and to functions that are subject to Board jurisdiction pursuant to 49 U.S.C. 10708. In this decision, we will address both pre- and post- ICC Termination Act law, as appropriate.

<sup>2</sup> The RCAF is an index published on a quarterly basis measuring changes in railroad costs. Initially, the ICC published the RCAF without considering productivity changes, so that the index measured only the prices paid by railroads for the goods and services they used. In 1989, the ICC adopted a productivity adjustment, so that the index could also measure the costs of producing rail service. Since 1989, the ICC, and now the Board, have published two RCAF figures, one that is not adjusted for productivity [called the RCAF (Unadjusted)], and one that reflects productivity changes [called the RCAF (Adjusted)]. Since the ICC Termination Act took effect, the RCAF has had no regulatory significance.

to the railroads' petitions to reopen.<sup>3</sup> The shippers' basic position is that, although they would have preferred the Board to have published a single productivity-adjusted RCAF (using the methodology that apparently favors them in their private contract litigation), the Board has the discretion, which it exercised reasonably under the circumstances of this proceeding, to publish two productivity-adjusted RCAF's.

Because we find that the Oct. 3 decision did not contain material error, the railroads' request for reconsideration will be denied.

#### BACKGROUND

The ICC and the Board have published the RCAF for many years. Periodically, the RCAF methodology has been changed. Although the ICC had the authority to go back and "fix" the RCAF retroactively,<sup>4</sup> generally -- largely because of the regulatory consequences associated with the RCAF -- the ICC did not incorporate methodological changes retroactively. Rather, finding that the methodology used before the change was not "wrong," and that "restatement" of the RCAF<sup>5</sup> could render vulnerable rates that had been protected from challenge, the ICC typically continued to use existing RCAF values up to the point of the methodological change; at that point, it then began to calculate future RCAF values using the new methodology. That is how the ICC made the transition from an unadjusted RCAF to an RCAF that was adjusted for productivity. See Railroad Cost Recovery Procedures-Productivity Adjustment, 5 I.C.C.2d 434, 468-73 (1989), aff'd, Edison Electric Institute v. ICC, 969 F.2d 1221 (D.C. Cir. 1992) (Edison Electric). See also the Oct. 3 decision at 5-6, in which we noted that restatement of the RCAF to reflect old productivity, even if it had been feasible, could have required railroads to pass through productivity twice. As we have noted, since passage of the ICCTA, the RCAF no longer has any regulatory significance.

The ICC action that produced the controversy here revolves around the development of the period over which productivity changes would be averaged in calculating the productivity-adjusted RCAF. In 1989, the ICC's first productivity-adjusted RCAF measured average productivity over a 5-year period. Rather than continuing to use a "rolling" 5-year averaging period, however, under which the data for the oldest year would be dropped when the next new year's data became available, the ICC decided initially to expand the averaging period each year as new

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<sup>3</sup> Additional replies in opposition to the railroads' petitions were filed by Western Farmers Electric Cooperative, Inc.; Houston Lighting & Power Company; and The Detroit Edison Company.

<sup>4</sup> See Railroad Cost Recovery Procedures, 3 I.C.C.2d 60 (1986) (Cost Recovery), aff'd, Alabama Power Co. v. ICC, 852 F.2d 1361 (D.C. Cir. 1986) (under its newly developed "forecast error adjustment," ICC corrected errors in forecasting costs when the actual costs became available a few months later).

<sup>5</sup> By "restatement," we refer to the recalculation of RCAF values for prior periods using the newly adopted methodology.

data became available.<sup>6</sup> In 1993, the ICC determined that the use of an expanding period was not appropriate, and it decided instead to use a rolling 5-year average after all.

The effect of changing from a continually expanding period to a 5-year rolling averaging period was that the productivity data for certain years were not weighted evenly; some years' experience was given excessive weight, and some too little.<sup>7</sup> Because each RCAF calculation essentially builds upon the prior calculation, an abrupt transition from a continually expanding averaging period to a rolling 5-year averaging period permanently builds into the process the uneven weighting of data, and thus the inaccurate reporting of productivity, for the period between 1989 and 1993. Accordingly, certain shipper interests asked the ICC to restate the index in a way that reports productivity more accurately.

In responding to the shippers' requests in the Oct. 3 decision, we had some misgivings about maintaining, as our only productivity-adjusted RCAF, a figure that we knew was, at least technically, "incorrect" because it did not accurately reflect the productivity data that the ICC had collected since 1989. Nevertheless, given the ICC's general policy on restatement, we decided not to declare that the existing productivity-adjusted RCAF values were "wrong," and that only a set of restated values would be correct.

The Oct. 3 decision noted that the RCAF had essentially lost all of its regulatory significance, and that, as a result, previously protected tariff rates would essentially be unaffected by any RCAF index we might publish. Therefore, we decided to maintain two productivity-adjusted cost indexes: one [called the RCAF (Adjusted)] that would use the original 1989-1993 values, and then convert to the values for subsequent years using a rolling 5-year average; and another [called the RCAF-5] that would restate the productivity-adjusted RCAF values using a 5-year rolling average since 1989.<sup>8</sup> Such an approach, we noted, would best maintain our neutrality by giving parties that had pegged their private contracts to the RCAF the flexibility to determine which calculation best reflected their intent in entering into their contracts. Id. at 8.

The railroads have asked us to reopen and reconsider that decision, on the ground that it involves material error. They have argued that it contravenes the statutory language and the

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<sup>6</sup> Thus, the ICC used a 5-year period when it first adopted the productivity adjustment, a 6-year period beginning in late 1989, a 7-year period beginning in late 1990, and so forth. See Oct. 3 decision at 3-4.

<sup>7</sup> For a more detailed discussion of the weighting problems associated with switching from a continually expanding averaging period to a rolling 5-year averaging period, see the Oct. 3 decision at 4-5, especially n. 10, and at 8.

<sup>8</sup> The Oct. 3 decision (at 6) found that, notwithstanding the fact that it would result in the carrying forward of some productivity values that were not accurate, "the ICC's judicially approved policy against restating the RCAF to reflect regulatory changes was reasonable when it was first applied; in our view, it is still a reasonable way of measuring cost changes."

legislative intent; that it improperly produces litigation over contract rates; that it was arbitrary and capricious; and that it is misleading. We will address each of their arguments in turn.

#### DISCUSSION AND CONCLUSIONS

A. The Statutory Language; Authoritativeness. The railroads' fundamental legal objection to the Oct. 3 decision is that it is inconsistent with the statutory language and that it does not carry out the statutory intent. The statutory language, the railroads say, permits only one productivity-adjusted RCAF value; moreover, publication of two indexes fails to follow the Congressional directive<sup>9</sup> that we be both "neutral" and "authoritative" in administering the RCAF.

We disagree. First, the statutory language does not direct us to publish only a single RCAF index. The provisions of 49 U.S.C. 10708(a) do direct the Board to publish "a rail cost adjustment factor." The provisions of 49 U.S.C. 10708(b), however, explicitly direct the Board to publish at least two RCAF indexes, one that "shall take into account changes in railroad productivity," and one that "does not take into account changes in railroad productivity." The fact that Congress expressly contemplated more than one RCAF index strongly militates against a conclusion that the statutory language categorically precludes the Board from publishing two productivity-adjusted indexes.

We recognize that an RCAF that is adjusted for productivity and one that is unadjusted -- each of which the statute specifically requires us to publish -- are somewhat different in nature. Nevertheless, that does not mean that the statute precludes us from publishing a second adjusted RCAF. To the contrary, before the passage of the ICCTA, the statute (former 49 U.S.C. 10707a(a)(2)(B) directed the ICC to publish "a rail cost adjustment factor." Yet, the ICC's determination to publish two RCAFs, one adjusted and one unadjusted, was upheld in Edison Electric. The statutory language gives us discretion to publish more than one productivity-adjusted RCAF.

The railroads argue that our determination violates the legislative intent that our RCAF process be both neutral and authoritative. They concede that our decision, by leaving matters of contract interpretation to the courts, where they belong, maintains our neutrality. But they argue that, by declining to select a single productivity-adjusted RCAF, and to declare that it is the only productivity-adjusted RCAF that can be used in interpreting contracts, we were not authoritative enough.

We disagree. Our decisions authoritatively declare how the RCAF indexes are to be calculated. The only way to calculate the RCAF (Unadjusted), the RCAF (Adjusted), or the RCAF-5 is the way in which we have determined that each should be calculated. If AAR does not follow our methodology in submitting data, we will correct or reject its submission. If it submits figures that are mathematically incorrect, we will correct them. Consistent with the legislative history, our role with respect to the RCAF is authoritative, notwithstanding the fact that more than one calculation is involved.

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<sup>9</sup> See H.R. Rep. No. 104-422, at 175 (1995).

B. Effect on Contracts. AAR and BN also complain that the decision to publish two productivity-adjusted indexes was improper because it might generate litigation that they conclude is unnecessary. BN notes that, as to certain contracts, the parties have already begun to question whether the RCAF (Adjusted) or the RCAF-5 ought to govern as the rate escalation factor. AAR expresses its view that any attempts by shippers to apply the RCAF-5 to preexisting contracts would be "meritless" (AAR petition at 18),<sup>10</sup> but it complains that our prior decision was improper because it will require the railroads to expend resources litigating them in any event.<sup>11</sup>

We do not agree that the determination to publish two indexes generates unnecessary litigation, or that any litigation that may ensue should foreclose us from making the right decision. The Oct. 3 decision was issued in response to a request by certain shippers that we change the RCAF. It is of course true that, by responding the way we did and publishing two productivity-adjusted RCAF indexes, we have given shippers the opportunity to argue in court that the RCAF-5 (the index that more accurately reflects all productivity data collected by the agency since 1989) is the type of escalator that was contemplated by a particular contract. But if we had agreed with AAR that we can publish only a single index, and had "authoritatively" adopted the RCAF-5 as the only productivity-adjusted RCAF, then AAR would be faced with the same type of litigation it is faced with now, and would still have to litigate claims that it has here declared to be "meritless."<sup>12</sup>

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<sup>10</sup> AAR's categorical assertion that such litigation would be meritless seems inconsistent with its acknowledgement that, in certain cases, courts have found that preexisting contracts were subject to escalation in accordance with the productivity-adjusted RCAF, rather than the unadjusted RCAF first adopted, even though the RCAF (Adjusted) was not developed until after operations under the contracts had begun.

<sup>11</sup> AAR asserts (AAR petition at 16-17) that parties relied on the existing methodology for several years, and that therefore it would be unfair to "inject[] uncertainty where there was none." Yet, our adoption of the RCAF-5 here does not upset settled expectations any more than our adoption of the productivity adjustment did in 1989. As was the case in 1989, the railroads cannot reasonably contend here that there was no uncertainty about the RCAF until the Oct. 3 decision, or that they could have presumed that RCAF values calculated between 1989 and 1993 would never be open to reevaluation. From the start, there were doubts as to how the averaging period issue would be resolved, and when the ICC finally declared, in 1993, that it would return to a 5-year rolling average, it reminded the parties that its position, from the start, had been that it "was always amenable to make any adjustments necessary to redress injustice or unfairness in our methodology." 9 I.C.C.2d at 1080 n.20.

<sup>12</sup> By the same token, if we had refused to publish any further adjustment to the RCAF, such as the one embodied in the RCAF-5, and had instead continued to publish only the RCAF (Adjusted) as the only valid index, the railroads and the Board would likely be faced with litigation initiated by shippers challenging that decision.

Where, as here, substantial sums of money are affected by rate escalation clauses, there is little that we can do to prevent litigation. Our role, as we see it, is to implement the statute faithfully. Here, we continue to believe that, even though the RCAF (Adjusted), which the railroads favor, fails to measure productivity as accurately as possible, we can best fulfill our role under the statute by publishing both the RCAF (Adjusted) and the RCAF-5 and letting the parties resolve in individual contract interpretation proceedings questions over which ought to apply.

C. The Prior Decision is not Arbitrary and Capricious. The railroads assert that the Oct. 3 decision is arbitrary and capricious because it does not adequately explain why the agency failed to select a single productivity-adjusted RCAF, and thus the agency failed to exercise any discretion it may have. As we have noted, on this issue, we gave the railroads the benefit of the doubt: even though the RCAF (Adjusted) does not measure productivity as accurately as possible, we did not want to shut railroads out entirely by declaring their preferred index null and void. Our determination to maintain a sense of neutrality toward contract matters, and to give railroads an opportunity to argue for their preferred index in contract litigation, does not make our decision arbitrary and capricious. Moreover, to the extent that adoption of the RCAF-5 represented a change from prior practice, the reason for the change was adequately explained.

Nor can the railroads legitimately say that we failed to exercise our discretion. As WCTL/EEI point out, we exercised discretion in a variety of ways: by declining to provide for a pass-through of 1982-1985 productivity, as shippers had requested; by tailoring a remedy addressing a specific problem that had been disclosed; and by balancing the interests of both sides and permitting the railroads continued access to the RCAF (Adjusted), even though we recognized its flaws.

D. Notice. The railroads argue that the Oct. 3 decision is invalid because parties had no notice that the agency might adopt the remedy ultimately selected. Further notice, and public comment, AAR suggests, might have convinced the Board to pursue a different approach.

We believe that the outcome here, while not explicitly proposed in any prior notice, is clearly a "logical outgrowth" of the original proceeding. Thus, there can be no failure of notice in the sense that notice is required under the Administrative Procedure Act. In 1993, the ICC switched RCAF methodologies. After its decision was issued, questions were raised about its transition from one scheme to the other. The shipper parties argued for restatement to a point before 1989, while the railroads argued for maintenance of the RCAF (Adjusted). For the shippers, the Board provided a partial restatement, and for the railroads, it continued to publish the RCAF (Adjusted). Surely the compromise position adopted is within the contemplation of the parties to these proceedings.<sup>13</sup>

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<sup>13</sup> In any event, having received further comment from a variety of railroad and shipper interests, we continue to believe that our approach is permissible and appropriate. Therefore,  
(continued...)

E. The Prior Decision is not Misleading. AAR asserts (Petition at 14) that the Oct. 3 decision is misleading because it "incorrectly conflates data from two different RCAF statutory rebasing periods." Apparently, AAR's point is that the statute [former 49 U.S.C. 10707a(A)(2)(B)] required the agency periodically to "rebase" the RCAF, that is, to "reset" the denominator of the index at 1. As a result of this technical manipulation required by the statute, when the RCAF was rebased at the end of 1992, its absolute level declined, even though costs had not. AAR states that, because the Oct. 3 decision set forth the RCAF-5 and the RCAF (Unadjusted) without explaining that they had been rebased at the end of 1992, parties to particular contracts might improperly claim that costs had gone down rather than up.

We do not view AAR's expressed concerns as realistic. The RCAF has been rebased in the past, and yet we are aware of no prior claims that, as a result, the published values were misleading.<sup>14</sup> The parties to rail contracts are sophisticated. All are capable, before an appropriate tribunal (which we are not), of performing the simple arithmetic tasks necessary to convert the RCAF index into a rate escalation index, just as AAR did in its pleading. No further action is necessary on our part in this regard.

F. Conclusion.

After we returned to a 5-year averaging period in 1993, the shippers raised a real problem with the transition from the old system to the new one. We did not adopt the shippers' proposed solution -- restatement of the index to capture all productivity experienced since 1981 -- because, in our view, it went beyond the harm produced by the transition. We did, however, devise a remedy that fit the problem. Even though we recognized that the railroads' preferred index was flawed, to maintain our neutrality as to contract matters, we gave individual carriers the opportunity to argue that the RCAF (Adjusted) should nevertheless apply to their escalation clauses. The railroads' claim that, because we also gave shippers the opportunity to argue that the more accurate RCAF-5 should apply in particular cases, we were not decisive enough is without merit. Our decision was both decisive and neutral. Because it represents an appropriate exercise of our role under the statute, as amended by the ICCTA, the railroads' petition for reconsideration will be denied.

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

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<sup>13</sup>(...continued)  
further comment at this point would be of no value, and the railroads have been given more than adequate opportunity to attempt to persuade us to adopt their view.

<sup>14</sup> On one occasion, certain railroads argued that when base rates themselves were rebased at the end of 1989 [updated to "lock in" only those protected rate increases taken in the prior 5-year base-rate basing period, see former 49 U.S.C. 10707a(a)(1)(A)], carriers could take substantial rate increases even though costs during the period had declined. The ICC rejected the argument. Quarterly Rail Cost Adjustment Factor, ICC Ex Parte No. 290 (Sub-No. 5) (Dec. 22, 1989).

It is ordered:

1. The petition for reopening and reconsideration is denied.
2. This decision is effective on April 1, 1997.

By the Board, Chairman Morgan and Vice Chairman Owen.

Vernon A. Williams  
Secretary