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SURFACE TRANSPORTATION BOARD

DECISION

STB Ex Parte No. 589

CALCULATION OF VARIABLE COSTS IN
RATE COMPLAINT PROCEEDINGS INVOLVING
NON-CLASS I RAILROADS

Decided: March 21, 2003

The Surface Transportation Board concludes that it will determine the variable costs of non-Class I railroads in rail rate reasonableness cases using Class I railroad regional average costs and making appropriate adjustments to those average costs on a case-by-case basis.

We instituted this proceeding to settle how to determine the variable costs of non-Class I railroads¹ in rail rate reasonableness cases. After considering the comments submitted, we have concluded that the best policy is to estimate those variable costs using Class I railroad regional average costs and make appropriate adjustments to those average costs on a case-by-case basis.

BACKGROUND

Variable costs, which are those railroad expenses that vary with the level of service provided by the carrier, are key components in the analysis of a rate reasonableness case for two reasons. First, we may consider the reasonableness of a challenged rail rate only if the carrier has “market dominance” over the traffic at issue,² and the statute precludes a finding of market dominance where the railroad shows that the revenue produced by the movement is less than 180% of the carrier’s variable cost of

¹ Non-Class I railroads are carriers with annual operating revenues of less than \$250 million in 1991 dollars. 49 CFR 1201, General Instruction 1-1(a).

² 49 U.S.C. 10701(d)(1), 10707. Market dominance means “an absence of effective competition from other carriers or modes of transportation for the transportation to which a rate applies.” 49 U.S.C. 10707(a). A finding of market dominance does not in itself suggest that the rate is unreasonable, however. 49 U.S.C. 10707(c).

providing the service.³ Second, when we find that a carrier has market dominance and that its rate is unreasonably high,⁴ we may not prescribe a maximum rate that is less than 180% of the variable cost of providing the service at issue.⁵

Class I railroads are required to keep records in accordance with our Uniform System of Accounts (USOA) and to file annual reports and other cost and operational data. These data permit us to determine a carrier's system-wide average variable cost of providing service, using our Uniform Railroad Costing System (URCS).⁶ Non-Class I carriers are not, however, required to maintain their accounting records in accordance with our USOA⁷ or to file reports containing the information that we would need to calculate variable costs using URCS.⁸ Therefore, when rates of a non-Class I railroad

³ 49 U.S.C. 10707(d)(1)(A). If the variable cost threshold is met, we must still conduct a "qualitative" analysis to ascertain whether there are effective competitive alternatives available to the shipper. 49 U.S.C. 10707(d)(2)(A).

⁴ Pricing traffic above the 180% threshold level does not create a presumption that the rate is too high. 49 U.S.C. 10707(d)(2)(B). If we find that a carrier has market dominance over the traffic at issue, we generally apply the standards for judging the reasonableness of rail freight rates that are set forth in Coal Rate Guidelines, Nationwide, 1 I.C.C.2d 520 (1985), aff'd sub nom. Consolidated Rail Corp. v. United States, 812 F.2d 1444 (3d Cir. 1987). When those cannot practically be applied, alternative standards are available. See Rate Guidelines—Non-Coal Proceedings, 1 S.T.B. 1004 (1996), pet. for review dismissed, Association of Am. Railroads v. STB, 146 F.3d 942 (D.C. Cir. 1998).

⁵ See, e.g., FMC Wyoming Corp. et al. v. Union Pacific R.R., STB Docket No. 42022 (STB served May 12, 2000), at 183.

⁶ 49 CFR 1241-1248. Under 49 U.S.C. 10707(d)(1)(B), variable costs are to be determined using URCS or an alternative methodology adopted by the Board.

⁷ 49 CFR 1201, General Instruction 1-1(c).

⁸ See Elimination of Accounting & Reporting Requirements of Class II Railroads, No. 37614 (ICC served Feb. 25, 1982), at 2 (relieving Class II railroads from accounting and reporting requirements); Reduction of Accounting & Reporting Requirements of Class III Railroads, No. 37523 (ICC served Dec. 15, 1980), at 2 (relieving Class III railroads from accounting and reporting requirements).

are challenged (as they were most recently in the Minnesota Power case⁹), the detailed cost and operational data needed to develop individual carrier variable costs using URCS are not available.

In circumstances where the data are not available to develop carrier-specific variable costs, we have used the regional average variable costs of Class I railroads¹⁰ as a surrogate.¹¹ In Minnesota Power, however, we took the unprecedented step of placing the proceeding in abeyance and directing the non-Class I railroad to keep its records in conformance with the USOA for a 12-month period and to collect and file a year's worth of the detailed financial and operating data normally required only from Class I railroads.¹² At the end of the 12-month period, the case was to be reactivated and the data collected used to develop carrier-specific URCS variable costs.

The defendant railroad sought reconsideration of that order and asked us to remove the special accounting/record-keeping requirement for that case as unduly burdensome. Because of the industry-

⁹ Minnesota Power, Inc. v. Duluth, Missabe & Iron Range Ry., STB Docket No. 42038.

¹⁰ We annually develop average variable costs for the composite rail operations of Class I railroads operating in the Eastern and Western United States, respectively. The Western regional URCS averages represent the composite operations of the Burlington Northern and Santa Fe Railway, Kansas City Southern Railway, Canadian Pacific Railway (U.S. West) Limited (formerly Soo Line Railroad), and Union Pacific Railroad. The Eastern regional averages are a composite of the operations of the Norfolk Southern Corporation, CSX Transportation, Inc., and Canadian National (US).

¹¹ See Trainload Rates on Radioactive Materials, East. Railroads, 362 I.C.C. 756, 765-66 (1980), aff'd sub nom., Consolidated Rail Corp. v. ICC, 646 F.2d 642 (D.C. Cir. 1982) (ICC relied on 1976 territorial average unit costs for representative movements in setting rates caps for certain spent nuclear fuel shipments). See also Rate Guidelines—Non-Coal Proceedings, 2 S.T.B. 229 (1997) (noting that Class I regional data would be used in small rate cases involving non-Class I carriers); Adoption of Uniform Railroad Costing System as a General Purpose Costing System for All Regulatory Purposes, 5 I.C.C.2d 894, 917-18 (1989) (use of Class I regional costs for non-Class I carriers considered to be the “best approach”); 49 CFR 1152.32(n)(4) (in rail abandonment applications non-Class I carriers may use regional URCS data to compute their off-branch costs); former 49 U.S.C. 10705a(m)(2)(1995) (in evaluating joint-rate surcharges and cancellations, for non-Class I railroads, the variable costs of a non-Class I railroad “shall be presumed to be the average variable costs of all [C]lass I rail carriers in the region”).

¹² Minnesota Power, Inc. v. Duluth, Missabe & Iron Range Ry., STB Docket No. 42038 (STB served Mar. 6, 2000), at 9.

wide implications associated with requiring a non-Class I railroad to maintain its accounts in accordance with the USOA and to collect operating statistics solely for the purpose of adjudicating a rate complaint, we stayed the accounting/record-keeping requirement pending our resolution of the petition for reconsideration.¹³ Before we could rule on that petition, the parties settled their rate dispute and the case was dismissed.¹⁴ Consequently, we have not resolved the issue of whether, as a general matter, it is appropriate and administratively practical to place a case in abeyance for an extended period of time and to subject a non-Class I carrier to the expense of developing URCS-compatible data for a single case.

After reviewing our experience in Minnesota Power, we tentatively concluded that it would be impractical and too costly to require smaller carriers to develop and maintain records solely for the purpose of resolving rate cases. Therefore, we instituted this proceeding and proposed that in such cases we would instead estimate non-Class I carriers' variable costs using Class I regional average variable costs. We invited comments from interested parties on this proposal, any alternative proposal they might wish to offer, or both. We received comments from: Transtar, Inc. (Transtar); the Association of American Railroads (AAR); the American Short Line and Regional Railroad Association (ASLRRA); the Duluth Missabe and Iron Range Railway Company and Bessemer and Lake Erie Railroad Company (collectively, DM&IR); the United States Department of Transportation (DOT); RailAmerica, Inc. (RailAmerica); the Western Coal Traffic League (WCTL); and the United Transportation Union-General Committee of Adjustment GO-386 (UTU/GO-386).¹⁵

The railroad interests and DOT support reliance on regional average URCS costs for estimating non-Class I variable costs in rate complaint cases. They agree that the burdens associated with requiring the type of record-keeping ordered in Minnesota Power would be prohibitive and the delays inordinate. WCTL, the only shipper interest to submit comments, suggests giving a complaining shipper the option of relying upon Class I regional average URCS costs or demanding that a defendant railroad compile carrier-specific data.

¹³ Minnesota Power, Inc. v. Duluth, Missabe & Iron Range Ry., STB Docket No. 42038 (STB served Apr. 18, 2000), at 2.

¹⁴ Minnesota Power, Inc. v. Duluth, Missabe, and Iron Range Ry., STB Docket No. 42038 (STB served Jan. 5, 2001).

¹⁵ UTU/GO-386 did not file initial comments. In its reply comments, UTU/GO-386 suggests that we revisit and reduce the annual revenue requirements for treatment as a Class I carrier. UTU/GO-386's suggestion is both beyond the scope of this rulemaking and unsupported.

DISCUSSION AND CONCLUSIONS

Based on our experience in Minnesota Power, and the comments submitted here, we conclude that requiring a non-Class I railroad to compile carrier-specific data for an individual rate case would be so burdensome as to outweigh any potential benefit. In its petition for reconsideration in Minnesota Power, the defendant railroad explained that it would have to set up a new, separate financial accounting system for this one-time use, reprogram its computers and train its personnel to use that new accounting system, and devote substantial time and effort to collect and record the data that would be required to compile the necessary operating statistics.¹⁶ It became apparent that the accounting/record-keeping cost associated with these activities—which would be only part of the overall cost to the railroad of defending itself—would be substantial. The comments submitted in this proceeding confirm that, since reporting requirements were removed, many Class II and Class III railroads have adopted new accounting systems that do not separately keep track of many of the cost items and operating statistics that Class I railroads must separately itemize, and that imposition of USOA data collection and development requirements on non-Class I railroads would be unduly burdensome.

Moreover, given our recent experience with this issue in Minnesota Power, it is evident that requiring non-Class I railroads to compile such data for an individual rate case would result in inordinate delay.¹⁷ To obtain the equivalent URCS cost data from a non-Class I defendant railroad, we would have to hold a proceeding in abeyance for a minimum of a year. Even after a carrier collects a year's worth of data, there would likely be disputes as to whether the data collected during that period were representative because variable costs can vary significantly from year to year. URCS uses as much as 5 years of data to develop certain variable cost components. One party or the other would likely perceive a litigation advantage from arguing that variable costs developed from only 1 year's worth of

¹⁶ In Minnesota Power, the defendant railroad claimed that the total cost would exceed \$1 million; the complaining shipper claimed the cost would be \$100,000. Either figure would have been cost-prohibitive, given that the total annual revenues collected by the defendant railroad under the challenged rate were only approximately \$700,000.

¹⁷ WCTL suggests that discovery disputes can already delay cases and our concern about delay, thus, misses the mark. We are seeking to streamline the discovery process in rate cases, however, to avoid the kind of delays to which WCTL refers. See Procedures to Expedite Resolution of Rail Rate Challenges to be Considered Under the Stand-Alone Cost Methodology, STB Ex Parte No. 638 (STB served Sept. 4, 2002); Hearing Before the Surface Transportation Board: Procedures to Expedite Resolution of Rail Rate Challenges to be Considered Under the Stand-Alone Cost Methodology, STB Ex Parte No. 638 (Feb. 27, 2003). It would be counter to our goal of prompt resolution of rate cases to create new or further delays by the imposition of an additional record-keeping requirement.

data are unrepresentative, and that the proceeding should be held in abeyance longer than a year so that additional information could be compiled. Such delays would be contrary to the express intent of Congress to expedite rail rate cases.¹⁸ Over the long run, expediting rate cases benefits all parties.

We understand that holding cases up for a year (or a period of years) could produce data that may enhance accuracy in particular rate adjudications. But we must balance the costs and delay of imposing an additional record-keeping requirement in non-Class I rate cases against the degree of precision to be achieved in handling our rate case docket. We have had to sacrifice some accuracy for simplicity where necessary to ensure that our rate complaint processes are accessible to shippers.¹⁹ It follows that railroads should also not be subjected to inordinate adjudicatory expenses that could effectively foreclose them from exercising their statutory right to defend their rates when challenged. Reliance on URCS regional average cost data, which is equally available to small railroads and shippers, will not create delay in rate proceedings. Moreover, it will reduce uncertainty associated with the variable cost computation used in regulatory proceedings, which in turn should assist parties in their rate negotiations.

Because regional average URCS data are based upon the costs actually incurred by railroads, albeit Class I railroads, those costs bear some relationship to the costs of non-Class I carriers. Of course, no two carriers' operations are identical and certain costs incurred by the large carriers will tend to be higher or lower than those incurred by smaller carriers. For this reason, we will permit the parties in an individual case to propose adjustments to the regional average URCS costs²⁰ to better reflect the operations of the particular railroad and the particular movements involved in the case. For example, regional URCS could be adjusted to reflect the actual labor costs of the carrier involved.

¹⁸ See 49 U.S.C. 10101(15).

¹⁹ Towards that end, we have adopted simplified evidentiary procedures for adjudicating rate reasonableness in those cases where more sophisticated procedures are too costly or burdensome, "to ensure that no shipper is foreclosed from exercising its statutory right to challenge the reasonableness of rates charged on its captive traffic." Rate Guidelines—Non-Coal Proceedings, 1 S.T.B. at 1008. More recently, we have simplified the market dominance phase of rail rate complaints by excluding product and geographic competition from consideration, "so as to remove a substantial obstacle to the shippers' ability to exercise their statutory rights." Market Dominance Determinations—Product & Geographic Competition, 3 S.T.B. 937, 949 (1998).

²⁰ Transtar and ASLRRRA suggest that such adjustments should be accomplished by some sort of identifiable mechanism, but there are over 500 regional and short line railroads with highly individualized operations, and thus, adjustments inherently require a case-specific inquiry.

And, of course, the average costs should be adjusted for such movement-specific matters as the actual car type and ownership, number of locomotives, and switching characteristics of the traffic at issue.

As an alternative to a blanket policy of relying upon regional average URCS costs, WCTL suggests that complainant shippers be given the option of either relying on regional average URCS costs or demanding that a defendant railroad compile carrier-specific URCS unit costs in non-Class I rate reasonableness cases. But WCTL's proposal addresses neither the delay nor cost burdens imposed in compiling carrier-specific URCS unit costs in non-Class I rate cases. Thus, we find that a uniform policy of reliance upon URCS regional costs is preferable, because that information is readily available to small railroads and shippers and does not impose unreasonable delay or cost.

DM&IR suggests, as an additional step in non-Class I rate cases, that we require a complaining shipper to demonstrate that the revenues collected under a challenged rate exceed 200% of the URCS regional average variable costs before it may go forward with its case. DM&IR claims that this threshold would ensure that parties would incur costly discovery and evidentiary costs only where a significant rate differential was in dispute. DM&IR's suggestion is beyond the scope of this proceeding.

CONCLUSION

Our policy henceforth will be to rely upon regional URCS costing data in determining variable costs in proceedings involving non-Class I railroads, with adjustments permitted to the costs as appropriate on a case-by-case basis.

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

We conclude that our action will not have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act. No new reporting requirements will be required. Only Class I railroads will continue to be required to provide data for use in URCS. The impact on small entities, if any, will be to provide them with a less burdensome method for developing evidence in rate complaint cases.

It is ordered:

1. We will estimate the variable costs of non-Class I railroads in rate reasonableness cases using Class I railroad regional average costs, with appropriate adjustments to those average costs made on a case-by-case basis.
2. Notice of this decision will be published in the Federal Register on March 28, 2003.

3. This decision will be effective on April 27, 2003.

By the Board, Chairman Nober and Commissioner Morgan.

Vernon A. Williams
Secretary