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SERVICE DATE – NOVEMBER 8, 2006

SURFACE TRANSPORTATION BOARD

DECISION

STB Docket No. 41191 (Sub-No. 1)

AEP TEXAS NORTH COMPANY
v.
BNSF RAILWAY COMPANY

STB Docket No. 42088

WESTERN FUELS ASSOCIATION, INC., AND
BASIN ELECTRIC POWER COOPERATIVE
v.
BNSF RAILWAY COMPANY

Decided: November 7, 2006

In STB Docket No. 41191 (Sub-No. 1), AEP Texas North Company (AEP Texas), successor in interest to West Texas Utilities Company, challenges the reasonableness of rates charged by BNSF Railway Company (BNSF) for movements of coal from mines in the Powder River Basin (PRB) of Wyoming to AEP Texas' Oklaunion Generating Station near Vernon, TX. In STB Docket No. 42088, Western Fuels Association, Inc., and Basin Electric Power Cooperative, Inc., challenge the reasonableness of rates charged by BNSF for movements of coal from the PRB to Basin Electric's Laramie River Station near Wheatland, WY.

In both proceedings, extensive evidence has been submitted under the stand-alone cost (SAC) test set forth in Coal Rate Guidelines, Nationwide, 1 I.C.C.2d 520 (1985) (Guidelines), aff'd sub nom. Consolidated Rail Corp. v. United States, 812 F.2d 1444 (3d Cir. 1987). The SAC test seeks to determine the lowest cost at which a hypothetical, optimally efficient carrier – the stand-alone railroad (SARR) – could provide service to the complaining shipper, and to selected additional traffic that would use the same lines and facilities if the rail industry were free of barriers to entry and exit. Guidelines, 1 I.C.C.2d at 528.

On February 27, 2006, we issued a notice of proposed rulemaking in STB Ex Parte No. 657 (Sub-No. 1) to address major issues regarding the proper application of the SAC test in rail rate cases and the proper calculation of the floor for any rail rate relief.[1] Due to the potential implications of that rulemaking on STB Docket Nos. 41191 (Sub-No. 1) and 42088, we held

[1] See Major Issues in Rail Rate Cases, STB Ex Parte No. 657 (Sub-No. 1), et al. (STB served Feb. 27, 2006).

these proceedings in abeyance until the resolution of the rulemaking proceeding. On October 30, 2006, the final decision in the rulemaking was served, outlining several changes to the application of the SAC test.[2] To implement those changes, the supplemental evidence described below is needed from the parties in these two cases.

Movement-Specific Adjustments to URCS

As discussed in Major Issues, we have decided to disallow movement-specific adjustments to the Uniform Railroad Costing System (URCS) when calculating the 180% revenue-to-variable cost jurisdictional floor for rate relief. Instead, we will use the system-average variable cost generated by URCS, using the nine movement-specific factors inputted into Phase III of URCS. The only adjustments allowed to the URCS Phase III program will be those adopted in Ex Parte No. 431 (Sub-Nos. 1 and 2).[3]

Accordingly, BNSF is instructed to submit revised variable cost calculations using the Phase III URCS appropriate for the historical issue movements already of record (e.g., if a historical movement is in 2002, the 2002 Phase III URCS program should be utilized; if the historical period includes 2003 movements, the 2003 Phase III URCS program should also be utilized, etc.). BNSF must include a clear narrative discussion that describes any assumptions and all steps taken to derive these unadjusted URCS calculations, together with all necessary electronic and hardcopy workpapers needed to support its calculations.

Revenue Allocation

In Major Issues, we addressed the issue of how to allocate revenue from cross-over traffic between the facilities replicated by the SARR and those of the residual incumbent.[4] We decided to replace the existing method with a new, cost-based method (Average Total Cost, or ATC) for allocating revenue from cross-over traffic to reflect economies of density. See Major Issues at 31. ATC uses URCS variable[5] and fixed costs for the carrier, and the density and miles of each

[2] See Major Issues in Rail Rate Cases, STB Ex Parte No. 657 (Sub-No. 1) (STB served Oct. 30, 2006) (Major Issues). Although this decision will not become effective until November 29, 2006, we issue this order now to expedite the resolution of these two cases.

[3] See Review of the General Purpose Costing System, 2 S.T.B. 659 (1997). Those adjustments include the so-called “270” volume shipment adjustments, the make-whole adjustments, rail trailer-on-flatcar/container-on-flatcar adjustments, and RoadRailer adjustments. In addition, the circuity factor is always set to one when actual miles are used to calculate the variable costs.

[4] “Cross-over traffic” refers to movements included in the traffic group for which the SARR would not replicate all of the incumbent railroad’s current movement, but instead would interchange the traffic with the residual portion of the incumbent railroad’s system.

[5] As discussed above, unadjusted Phase III URCS costs should be used to calculate the variable costs.

segment, to develop the average total cost per segment of a move. The revenues from each portion of the movement are then allocated in proportion to average total cost. See id. at 34.

To enable the Board to implement ATC in these proceedings, BNSF is instructed to submit the following information for both on- and off-SARR traffic: (1) calculations of the variable and fixed costs for BNSF using unadjusted URCS; (2) calculations of the average total cost per segment; and (3) allocations of the revenues in accordance with ATC for each year in the SAC analysis period. The information must be submitted for the traffic group described in our earlier orders addressing supplemental evidence previously required to be submitted in these cases.[6]

BNSF should develop the revenue allocations using the base-year densities and URCS fixed and variable costs, which will be different in each case. If a non-issue movement is not in the traffic group in the base year, but would be forecast to be carried by the SARR in future years, BNSF should still cost the movement using the URCS that corresponds to the base year.[7] BNSF should then use the same revenue allocations for each year of the SAC analysis period. For example, if 25% of the revenue from a particular cross-over movement would be allocated to the facilities replicated by the SARR in the base year, then the revenue allocation for that movement would remain fixed at 25% over the entire SAC analysis period.

Where there is rerouted traffic, BNSF is instructed to develop the on-SARR traffic densities and URCS variable and fixed costs based on the reroute. Thus, the base-year traffic densities should include the rerouted traffic and the variable cost calculation should be determined using the SARR and residual BNSF mileages over the alternative routing. On-SARR traffic densities should not, however, include traffic that used those facilities in the base year that the complainant did not include in its traffic group.

[6] See Western Fuels Association, Inc., and Basin Electric Power Cooperative, Inc. v. BNSF Railway Co., STB Docket No. 42088 (STB served Mar. 17, 2006), and STB Docket No. 42088 (STB served Apr. 21, 2006) (denying BNSF's petition for reconsideration); AEP Texas North Co. v. BNSF Railway Co., STB Docket No. 41191 (Sub-No. 1) (STB served Mar. 17, 2006), and STB Docket No. 41191 (Sub-No. 1) (STB served Apr. 10, 2006) (denying BNSF's petition for reconsideration).

[7] In effect, we seek a revenue allocation for all movements using a single year's URCS and density information. To forecast the revenue allocation for future movements would entail forecasting off-SARR traffic densities (and URCS costs), a complication that does not appear to be warranted. However, in calculating the base-year traffic densities for the SARR, the parties should not include the tonnage of future movements that would not be carried by the SARR in the base year. (E.g., if the SARR would carry 100 million tons in the base year, and a new movement is forecast to be carried by the SARR in 5 years that would add 10 million tons, BNSF is to derive the revenue allocation using base-year URCS and on-SARR densities of 100 million tons). While the SARR's tonnage would increase when that new traffic would be carried, we assume an offsetting increase in non-SARR traffic levels.

If the parties conclude that these assumptions for implementing ATC are unreasonable, they may advocate alternative assumptions and submit alternative ATC calculations in addition to those using the assumptions set forth above.

There may be other unresolved technical issues in implementing this revenue allocation method. Parties are therefore instructed to provide a clear narrative discussion that describes any assumptions and all steps taken to apply this new revenue allocation methodology, together with all necessary electronic and hardcopy workpapers needed to support their calculations.[8]

Maximum Rate Determination

Finally, in Major Issues, we decided to replace the percent reduction method with a "maximum markup methodology" to calculate the maximum lawful rates if the total revenues expected to be earned by the defendant railroad exceed the revenue requirements of the SARR. See Major Issues at 14-15. To implement this method, we will need the unadjusted variable costs for all movements for the base year.

Accordingly, BNSF is instructed to calculate the variable cost for all movements (issue and non-issue movements) using the URCS Phase III movement costing program. The URCS program used should correspond to the base year in that case. If a movement in the traffic group is rerouted, the variable cost calculation should also assume the alternative route. If a movement is not in the base year, it should nonetheless be costed using the base-year unadjusted URCS. If necessary, the Board will index these variable cost calculations using the hybrid approach discussed in the rulemaking. See Major Issues at 14 n.19, 42-44.

Parties should provide a clear narrative discussion that describes any assumptions and all steps taken to cost these movements, together with all necessary electronic and hardcopy workpapers needed to support their calculations.

Schedule for Submissions

We do not ordinarily require the defendant railroad to provide the first round of evidence when supplemental evidence is needed in a SAC case. In this instance, however, the information being requested is in the possession of the railroad.[9] Therefore, BNSF should submit this supplemental information, together with all workpapers needed to support its calculations. The complainants in these two cases will then have an opportunity to review these technical

[8] In General Procedures For Presenting Evidence In Stand-Alone Rate Cases, 5 S.T.B. 441, 444 (2001), we reminded parties that in order to fully evaluate the evidence, we must be able to access and manipulate all spreadsheets. If a spreadsheet does not function (e.g., will not recalculate), the party filing the defective spreadsheet runs the risk that its evidentiary presentation will be treated as incomplete and ultimately unpersuasive.

[9] BNSF testified recently that application of ATC would not involve significant burdens. See STB Ex Parte No. 657 (Sub-No. 1), BNSF Supp. at 10-11 (filed Oct. 4, 2006).

calculations and submit reply evidence, and BNSF will have an opportunity to submit rebuttal evidence.

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

It is ordered:

1. The parties to STB Docket No. 41191 (Sub-No. 1) and No. 42088 should submit the requested information to the Board by the following dates:

BNSF’s supplemental evidence due: December 8, 2006.
Complainants’ replies due: January 8, 2007.
BNSF’s rebuttal due: January 22, 2007.

2. This decision is effective on its date of service.

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

Vernon A. Williams
Secretary