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SERVICE DATE - MARCH 6, 2000

SURFACE TRANSPORTATION BOARD

DECISION

STB Docket No. 42038

MINNESOTA POWER, INC.

v.

DULUTH, MISSABE AND IRON RANGE RAILWAY COMPANY

Decided: March 3, 2000

This complaint was filed by Minnesota Power, Inc. (MPI) on December 30, 1998, challenging the reasonableness of the rate charged by the Duluth, Missabe and Iron Range Railway Company (DMIR) for transporting coal from a connection with the Burlington Northern and Santa Fe Railway Company (BNSF) at Keenan, MN, to MPI's Laskin Energy Center, a coal-fired electric generating facility near Colby, MN. Because BNSF provides its portion of the through service under a rail transportation contract, we lack regulatory authority over the BNSF portion.¹ Therefore, the common carriage rate for the DMIR segment of the movements can be separately challenged.²

This case revolves primarily around costing issues. However, the "Class I" carrier regional average costs that DMIR has used to present its case do not appear to be representative of the costs actually experienced by DMIR. Likewise, the more carrier-specific costs that MPI sought to develop are unreliable, because DMIR's expenses are not collected under our Uniform System of Accounts (USOA), and the operating statistics are based in part on 1984 DMIR operations that do not appear to be comparable to current operations. Rather than summarily dismissing this case on burden-of-proof grounds, we will seek to obtain accurate cost data by ordering DMIR to conform its records to USOA and to report appropriate cost data for a 12-month period beginning May 1, 2000.

BACKGROUND

¹ 49 U.S.C. 10709(c). DMIR also provided its portion of the service under a rail transportation contract until its contract expired on December 31, 1998.

² See Union Pac. R.R. v. STB, No. 98-1058 (D.C. Cir. Feb. 15, 2000); Central Power & Light Co. v. Southern Pac. Transp. Co., 1 S.T.B. 1059 (1996), clarified, Nos. 41242 et al. (STB served Apr. 30, 1997), aff'd on other grounds sub nom. MidAmerican Energy Co. v. STB, 169 F.3d 1099 (8th Cir. 1999), reh'g denied (Apr. 20, 1999), cert. denied sub nom. Western Coal Traffic League v. STB, 1205 S.Ct. 372 (1999).

We may consider the reasonableness of a challenged rail rate only if the carrier has “market dominance” over the traffic at issue.³ A market dominance analysis contains both quantitative and qualitative components. Quantitatively, the statute precludes a finding of market dominance where we find that the revenue produced by the movement is less than 180% of the carrier’s “variable cost” of providing the service.⁴ In other words, Congress has determined that a railroad does not exercise any undue market power when it prices traffic below the 180% revenue-to-variable cost (r/vc) level. Pricing traffic above the 180% r/vc level, however, does not create a presumption that the carrier has market dominance over the traffic.⁵ Rather, we conduct a qualitative analysis to determine whether the carrier indeed has market dominance over the traffic involved. In the qualitative analysis, we examine whether effective intra- or intermodal competitive alternatives are available to the shipper.⁶ We cannot examine the reasonableness of a rate level unless we have first determined that both the qualitative and quantitative market dominance tests are met.⁷

³ 49 U.S.C. 10701(d)(1), 10707. Market dominance is “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).

⁴ 49 U.S.C. 10707(d)(1).

⁵ 49 U.S.C. 10707(d)(2)(A).

⁶ Market Dominance Determinations, 365 I.C.C. 118 (1981), aff’d sub nom. Western Coal Traffic League v. United States, 719 F.2d 772 (5th Cir. 1983) (en banc), cert. denied, 466 U.S. 953 (1984), modified, Market Dominance Determinations—Product & Geographic Competition, STB Ex Parte No. 627 (STB served Dec. 21, 1998), pet. for judicial review pending sub nom. Association of Am. Railroads v. STB, No. 99-1354 (D.C. Cir. filed Aug. 30, 1999). “Intramodal competition” refers to competition from another railroad that can transport the same commodity between the same points. 365 I.C.C. at 132. “Intermodal competition” refers to competition with other modes that can transport that commodity between the same points. 365 I.C.C. at 133.

⁷ Here, our preliminary analysis indicates that there are not effective intra- or intermodal competitive alternatives for transporting large volumes of coal from Keenan to the Laskin facility, and hence the qualitative market dominance test is met. In the interest of advancing this case expeditiously, we are issuing this decision before preparing a detailed discussion of the qualitative market dominance analysis. We will address that evidence in a later decision if we find, on a revised record, that the quantitative market dominance test is met.

The r/vc calculation has added importance in this case because DMIR has stipulated⁸ that, if we find that it has market dominance over this traffic, the challenged rate should be considered unreasonable to the extent that it exceeds the 180% r/vc level. Our acceptance of this approach does not represent any policy determination on our part as to the level at which these rates should be considered unreasonable. Indeed, the statute expressly prohibits us from making any presumption that a rate above the 180% r/vc level is unreasonably high.⁹ DMIR's stipulation merely reflects the carrier's own choice not to defend its rate above that level if it is found to have market dominance. In other words, its stipulation is a partial voluntary settlement of the complaint. Because we encourage voluntary resolution of disputes, we will honor that settlement if we find that there is market dominance in this case.

The determination of whether this rate yields an r/vc level above 180% turns on the computation of the variable costs of providing the service at issue.¹⁰ Ordinarily, variable costs are determined by applying unit costs that are developed specifically for the individual carrier under our Uniform Railroad Costing System (URCS).¹¹ The URCS costing formulas — developed by our predecessor, the Interstate Commerce Commission (ICC), to replace the Rail Form A costing methodology — reflect the extent to which different types of costs incurred in the rail industry have been found to change in direct proportion to changes in output.¹² Because a carrier's systemwide average costs are not necessarily representative of the costs of providing a particular service, however, appropriate adjustments are made in individual rate cases to determine as nearly as possible the costs attributable to providing the service at issue.¹³

To derive unit costs for a particular carrier for a specific time period under URCS, we rely upon data that is contained in the annual reports submitted to us by that carrier in conformance with

⁸ See Defendant's Objections and Responses to Complainant's Request for Production of Documents (dated Feb. 8, 1999) at 4 (submitted as attachment 2 to MPI's Motion to Compel Discovery, filed Feb. 16, 1999).

⁹ 49 U.S.C. 10707(d)(2)(B).

¹⁰ The other part of the fraction — the amount of the revenues that are collected from this traffic — are not in dispute.

¹¹ 49 U.S.C. 10707(d)(1)(B). See 49 U.S.C. 11161-11164 (authority to prescribe uniform rail cost accounting system).

¹² See Uniform Railroad Costing System, 5 I.C.C.2d 894 (1989) (Costing).

¹³ See, e.g., West Tex. Util. v. Burlington N. R.R., 1 S.T.B. 638, 717 (1996); Arizona Pub. Serv. Co. et. al. v. Atchison, T.&S.F. Ry., No. 41185 (STB served July 29, 1997), slip op. at 44.

our USOA.¹⁴ Since 1982, however, only Class I railroads¹⁵ have been required to file those reports and to maintain their records in accordance with USOA.¹⁶ Excusing smaller railroads from our accounting and reporting requirements has not caused any regulatory problems until now, as Class I railroads account for about 92% of U.S. rail freight traffic (measured by carloadings) and prior rate challenges have been directed almost exclusively to their rates. We are confronted with a problem here, however, because DMIR, which is a Class II carrier, not only does not file annual reports but has chosen to maintain an accounting system that is not compatible with USOA.

The parties have attempted to construct variable costs for use in this case through other means. DMIR used the composite average costs of all Class I railroads operating in the western half of the nation.¹⁷ MPI, on the other hand, sought to develop DMIR-specific unit costs based on DMIR's own accounting data, which MPI obtained through discovery. We reluctantly conclude that, in this particular case, neither party's approach has produced sufficiently reliable figures.

DISCUSSION

Western Regional URCS. The regional cost data used by DMIR are not representative of DMIR costs. As MPI notes, the operations of the Class I carriers in the Western region differ substantially from those of DMIR. The Class I railroads transport a multitude of goods in varying types of service (intermodal, single-carload, multiple-car, and unit-train) over various distances. In

¹⁴ The Annual Report Form R-1 (R-1) provides uniform guidance for developing operating statistics for rail carriers. Carriers filing the R-1 are also required to submit a report from an independent public accountant stating that specified data in the R-1 have been examined, using agreed-upon procedures, and found to be in compliance with our USOA. See Certification of Railroad Annual Rpt. R-1 by Indep. Accountant, 1 I.C.C.2d 902 (1985); 49 CFR Part 1201, Subpart A (USOA).

¹⁵ Class I carriers are those with annual gross revenues exceeding \$250 million in 1991 dollars (indexed up to reflect inflation). See 49 CFR 1201, General Instruction 1-1.

¹⁶ In Elimination of Accounting & Reporting Requirements of Class II Railroads, No. 37614 (ICC served Feb. 25, 1982) ("Elimination of Accounting"), the ICC relieved Class II railroads from the accounting and reporting requirements because "the information filed by Class II railroad[s] . . . was not used on a regular basis for analysis or monitoring purposes" (slip op. at 2), but "emphasize[d] that this [action did] not eliminate the reporting of pertinent accounting information when requested" (slip op. at 3). Class III railroads had been relieved of those requirements in 1981, in accordance with a policy that "[i]nformation needed occasionally will be collected only when the specific need arises." Reduction of Accounting & Reporting Requirements, No. 37523 (ICC served Dec. 15, 1980), slip op. at 2.

¹⁷ These include the Union Pacific, BNSF, Kansas City Southern, and Soo Line railroads.

contrast, DMIR is a regional carrier that transports few commodities (principally iron ore and taconite pellets) over very short distances in shuttle-type trainload/unit train service. In addition to these differences in traffic mix and types of service, as MPI points out, DMIR's operations differ from those of the western Class I railroads in that DMIR operates in a limited geographic area with flat terrain; the preponderance of its traffic (84%) is local traffic; DMIR has no classification yards and performs less switching than the Class I railroads; its average load per car is substantially higher than that of the Class Is; its plant and equipment (track structure, locomotives and cars) are considerably older than those of the major Western railroads; and its investment base is lower.

Because of these differences, the composite cost structure of the Class I carriers in the Western region cannot be viewed as representative of DMIR's costs. Indeed, while we would expect that some of the unit costs for the Class I railroads would be higher than DMIR's, others could be lower. We do not believe that the movement-specific adjustments made by the parties correct for the differences in unit costs. Thus, we cannot confidently rely upon Western regional average URCS costs to reflect the particular movements at issue here.¹⁸

DMIR-Specific URCS. MPI's presentation is substantially flawed, because it is based on cost data that are unreliable. Because DMIR does not maintain its accounting records in accordance with the USOA, certain costs and operating statistics required for the development of unit costs under URCS simply cannot be constructed. MPI purports to have calculated some of the necessary statistics based on DMIR's cost structure in 1984—the last year that DMIR filed reports as a Class I carrier. However, DMIR has forcefully refuted MPI's assertion that DMIR's operations have not changed substantially since 1984.¹⁹ Thus, 1984 data cannot provide an acceptable surrogate for

¹⁸ DMIR asserts that Costing mandated the use of Regional URCS costs for Class II carriers. That decision mandated the use of Regional costs for Class I statistical outliers, not for Class II carriers. Costing, 5 I.C.C.2d at 916-18.

We recognize that in some other contexts regional costs have been accepted as a surrogate when carrier-specific URCS costs are unavailable. The use of regional URCS costs was formerly prescribed for evaluating joint rate surcharges and cancellations for Class II and III carriers, by former 49 U.S.C. 10705a(m)(2), which was repealed by the ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803. Our rail line abandonment regulations provide that a Class II or III railroad can develop off-branch costs based either on the carrier's own individual URCS data or, if such data are not available, on regional URCS data. See 49 CFR 1152.32(n)(4); Use of URCS in the Calculation of Off-Branch Costs, 8 I.C.C.2d 203, 204 (1991). But surcharges are no longer an issue, and in abandonment cases, variable costs, while important, carry less weight than they do here. In abandonments, costs are one of several relevant issues; in this case, by contrast, the r/vc calculation can determine whether we have jurisdiction, and it will also be dispositive of the maximum reasonable rate under the carrier's stipulation.

¹⁹ DMIR presented the testimony of a former DMIR operating officer (now an official of its
(continued...))

current operating statistics, and without such statistics we have no way to apply an URCS variable cost analysis.

The inadequacy of the underlying data here is illustrated by DMIR's attempted restatement of MPI's purported DMIR-specific URCS-based presentation. DMIR reassigned certain operating expenses to what it argues are the proper account categories and developed what it claims are more accurate 1998 operating statistics (service units). The results are strikingly different from MPI's figures²⁰ and serve to reinforce our conclusion that, without specific USOA expense account classifications dictating the original accounting journal entries, each party's attempts to assign expenses from a non-USOA accounting system can only be viewed as arbitrary.²¹

¹⁹(...continued)

parent company, Transtar) contrasting the operations then and now. DMIR also showed that the figures created by MPI bear no statistical correlation with data reported by other carriers on a national, regional or individual-carrier level. Finally, DMIR presented a comparison of MPI's figures with the data reported by DMIR in 1982-84, which shows no trend that would suggest the sort of continuity that MPI assumes.

²⁰ It is apparent from their results that each party assigned costs in a manner most favorable to its position. The following table depicts the parties' respective r/vc calculations after movement-specific adjustments.

Comparison of DMIR-Specific R/VC Percentages

	<u>MPI</u>	<u>DMIR</u>
Time period (quarter)	1998	Restated 1998
1Q99	305%	149%
2Q99	300%	148%
3Q99	295%	Not supplied by DMIR

²¹ In a decision served May 11, 1999, we granted MPI's request that it be permitted to attempt to develop URCS variable costs based on DMIR's costs. However, we were not aware at that time of the actual method(s) by which DMIR kept its accounting records, and we did not realize (nor did any party suggest) that DMIR's accounting system would make our task virtually impossible.

(continued...)

CONCLUSIONS

Because a complainant bears the burden of proof, we could simply find that MPI has not made its case and dismiss its complaint. However, it appears that DMIR's operations meet the qualitative test for market dominance (see n. 7, supra). Moreover, the available data do not permit an accurate estimate of DMIR's variable costs. Therefore, we will not summarily dismiss this case. Rather, we believe that the parties should be afforded the opportunity to make a more precise r/vc showing in this case.

In originally excusing non-Class I railroads from the accounting and reporting requirements, the ICC explicitly reserved the right to require individual carriers to comply with those requirements where, as here, the information is needed in an individual case.²² In this case, we reluctantly conclude that a carrier-specific URCS computation grounded in our USOA is needed for us to

²¹(...continued)

MPI notes that the ICC was able to convert one system of accounts to another for purposes of developing Rail Form A variable cost calculations after the ICC changed the prescribed accounting system in 1978. Those conversions, however, were from a prior ICC accounting system, not from a unique accounting system never adopted by the ICC. Here, we do not know enough about how DMIR has kept its accounts to permit us to verify that entries from that system have been appropriately converted to USOA entries.

MPI also relies on the ICC's acceptance of carrier-specific data for the Utah Railway in Bituminous Coal—Hiawatha, UT to Moapa, NV, 6 I.C.C.2d 1 (1989), and in Westmoreland Coal Sales Co. v. Denver & R.G.W. R.R., No. 38301S (Sub No. 1) (ICC served Sept. 26, 1988). In those cases, the carrier explained in greater detail how it had assigned expenses and the complainant accepted those expense allocations. Based on the parties' agreement, the ICC used the carrier's own cost formula (known as the Utah Cost Formula, or UCF). However, the ICC did not endorse the general procedures used to develop the UCF. Thus, MPI's reliance on those cases is misplaced.

²² See Elimination of Accounting at 3 ("We emphasize that this rule does not eliminate the reporting of pertinent accounting information when requested Before eliminating current accounting capabilities, . . . [c]arriers should . . . consider potential [ICC] requests for information Blind abandonment of the Class II Uniform System of Accounts without an appropriate substitute may ill serve the carrier . . . "). See also, Montana Rail Link, Inc. & Wisconsin Central, Ltd., 8 I.C.C.2d 625, 634 (1992) (a case in which DMIR's parent participated): "We recognize that from time to time, accounting and statistical data may be needed from Class II or III railroads in order to carry out Commission functions. For example, in the past we considered informational needs in rate proceedings as a substantial factor in assessing appropriate reporting requirements. . . . If we need this information to decide an individual case or to address a particular position we can and will require it then."

determine the variable costs to DMIR of serving this traffic.²³ Accordingly, we will hold this proceeding in abeyance and require DMIR to conform its records to USOA for a 12-month period, beginning May 1, 2000, and to report appropriate cost data for that 12-month period. To minimize the potential delay and resulting hardship on the parties, we will base the variable cost determination in this case on that single year of data.²⁴ Moreover, we have limited the information that DMIR must include in its report to the minimum necessary for our URCS computations. (See Appendix for the information that DMIR is required to file.) After we have received the necessary data and developed DMIR's URCS-based unit costs, the parties will have a renewed opportunity for discovery and for the submission of new r/vc evidence.

It is ordered:

1. DMIR must keep its records in compliance with our Uniform System of Accounts for the 12-month period beginning May 1, 2000.
2. Ninety days after the close of the accounting period, DMIR must file a report containing the information listed in the Appendix to this decision.
3. With its report, DMIR must submit a certification from an independent public accountant that the information in the report has been examined, using agreed-upon procedures, and found in compliance with our Uniform System of Accounts.
4. Within 15 days after the report is filed, the parties shall submit jointly a proposed procedural schedule for further discovery and the submission of new cost evidence consistent with the findings made herein.
5. This proceeding is held in abeyance pending receipt of the filings provided for in this decision and the subsequent issuance of a revised procedural schedule.
6. This decision is effective on April 5, 2000.

²³ See An Introduction to The Uniform Rail Costing System: Its Development, Functions and Regulatory Role (ICC Bureau of Accounts, undated), at 9, 33-34 (addressing the importance of USOA and its interrelationship with URCS).

²⁴ Ordinarily, we require 3 years of data for equipment maintenance accounts, and 5 years of data for maintenance-of-way accounts, in order to compensate for the cyclical nature of those expenditures. We recognize that prior years' data probably cannot be reconstructed here and that holding this case in an abeyance for up to 5 years would not be appropriate. However, should the expenses incurred in the 12-month period be abnormal, the parties should so indicate and propose appropriate adjustments.

STB Docket No. 42038

By the Board, Chairman Morgan, Vice Chairman Burkes, and Commissioner Clyburn.

Vernon A. Williams
Secretary

APPENDIX

REQUIRED INFORMATION FOR REPORT TO BE FILED BY DMIR

The following portions of Annual Report Form R-1 for the reporting period:

Schedule 200
Schedule 210
Schedule 245
Schedule 335
Schedule 342
Schedule 352B
Schedule 410
Schedule 412
Schedule 414
Schedule 415
Schedule 417
Schedule 510
Schedule 700
Schedule 755
Verification

Report of Freight Commodity Statistics for DMIR for the reporting period.

Equipment Report, Cars Loaded and Cars Terminated (AAR form CS-54-1) for DMIR for the reporting period.