

SERVICE DATE – SEPTEMBER 20, 2016

SURFACE TRANSPORTATION BOARD

DECISION

Docket No. EP 290 (Sub-No. 5) (2016-4)

QUARTERLY RAIL COST ADJUSTMENT FACTOR

Digest:<sup>1</sup> The rail cost adjustment factor (RCAF) is an index formulated to represent changes in railroad costs incurred by the nation's largest railroads over a specified period of time. The Surface Transportation Board (Board) is required by law to publish the RCAF on at least a quarterly basis. Each quarter, the Association of American Railroads computes three types of RCAF figures and submits those figures to the Board for approval. The Board has reviewed the submission and adopts the RCAF figures for the fourth quarter of 2016.

Decided: September 19, 2016

In Railroad Cost Recovery Procedures, 1 I.C.C.2d 207 (1984), the Interstate Commerce Commission (ICC) outlined the procedures for calculating the all-inclusive index of railroad input prices and the method for computing the rail cost adjustment factor (RCAF). Under the procedures, the Association of American Railroads (AAR) is required to calculate the index on a quarterly basis and submit it to the agency on the fifth day of the last month of each calendar quarter. In Railroad Cost Recovery Procedures—Productivity Adjustment, 5 I.C.C.2d 434 (1989), aff'd sub nom. Edison Electric Institute v. ICC, 969 F.2d 1221 (D.C. Cir. 1992), the ICC adopted procedures that require the adjustment of the quarterly index for a measure of productivity.

The provisions of 49 U.S.C. § 10708 direct the Surface Transportation Board (Board) to continue to publish both an unadjusted RCAF and a productivity-adjusted RCAF. In Productivity Adjustment—Implementation, 1 S.T.B. 739 (1996), the Board decided to publish a second productivity-adjusted RCAF called the RCAF-5. Consequently, three indices are now filed with the Board: the RCAF (Unadjusted); the RCAF (Adjusted); and the RCAF-5. The RCAF (Unadjusted) is an index reflecting cost changes experienced by the railroad industry, without reference to changes in rail productivity. The RCAF (Adjusted) is an index that reflects national average productivity changes as originally developed and applied by the ICC, the calculation of which is currently based on a five-year moving average. The RCAF-5 is an index that also reflects national average productivity changes; however, those productivity changes are

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<sup>1</sup> 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).

calculated as if a five-year moving average had been applied consistently from the productivity adjustment's inception in 1989.

The index of railroad input prices, RCAF (Unadjusted), RCAF (Adjusted), and RCAF-5 for the fourth quarter of 2016 are shown in Table A of the Appendix to this decision. Table B shows the second quarter 2016 index and the RCAF calculated on both an actual and a forecasted basis. The difference between the actual calculation and the forecasted calculation is the forecast error adjustment.

The weights for each major cost component of the all-inclusive cost index, on which the RCAF is based, are updated annually to reflect the changing mix of index components. See 49 U.S.C. § 10708. This includes rebenchmarking the wages and supplemental rates used in the labor index in the fourth quarter of each year. The weights used by AAR are based on the distribution of railway expenses for the year 2015. Similarly, AAR has used wage and supplemental rates for the year 2015 to calculate hourly labor rates that reflect the changing mix of employees.

AAR's calculations have been examined, including its reweighting and rebenchmarking calculations, and the Board finds that AAR has complied with agency procedures with respect to the available data for 2015. The Board finds that the fourth quarter 2016 RCAF (Unadjusted) is 0.881, an increase of 4.6% from the third quarter 2016 RCAF of 0.842. The RCAF (Adjusted) is calculated, in part, using the RCAF (Unadjusted) and a five-year moving geometric average of productivity change for U.S. Class I railroads from 2010-2014, which is 1.014 (1.4% per year). The RCAF (Adjusted) is 0.371, an increase of 4.2% from the third quarter 2016 RCAF (Adjusted) of 0.356.<sup>2</sup>

In accordance with Productivity Adjustment—Implementation, 1 S.T.B. at 748-49, the RCAF-5 for this quarter will use a productivity trend for the years 2009-2013, which is 1.007 (0.7% per year). The RCAF-5 for the fourth quarter of 2016 is 0.352, an increase of 4.5% from the third quarter 2016 RCAF-5 of 0.337.<sup>3</sup>

This action is categorically excluded from environmental review under 49 C.F.R. § 1105.6(c).

Authority: 49 U.S.C. § 10708.

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<sup>2</sup> The fourth quarter 2016 RCAF Adjusted (0.371) is calculated by dividing the fourth quarter 2016 RCAF Unadjusted (0.881) by the fourth quarter productivity adjustment factor of 2.3750. The fourth quarter 2016 productivity adjustment factor is calculated by multiplying the third quarter 2016 productivity adjustment of 2.3667 by the fourth root (1.0035) of the 2010-2014 annual average productivity growth rate of 1.4%.

<sup>3</sup> The fourth quarter 2016 RCAF-5 (0.352) is calculated by dividing the fourth quarter 2016 RCAF Unadjusted (0.881) by the fourth quarter productivity adjustment factor-5 (PAF-5) of 2.5059. The fourth quarter 2016 PAF-5 is calculated by multiplying the third quarter 2016 PAF-5 of 2.5016 by the fourth root (1.0017) of the 2009-2013 annual average productivity growth rate of 0.7%.

It is ordered:

1. The Board finds that the fourth quarter 2016 RCAF (Unadjusted) is 0.881, RCAF (Adjusted) is 0.371, and RCAF-5 is 0.352.
2. Notice of this decision will be published in the Federal Register.
3. The effective date of this decision is October 1, 2016.

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

**APPENDIX****TABLE A**

**EP 290 (Sub-No. 5) (2016-4)**  
**All Inclusive Index of Railroad Input Costs**  
 (Endnotes Following Table B)

<b>LINE NO.</b>	<b>INDEX COMPONENT</b>	<b>2015 WEIGHTS</b>	<b>THIRD QUARTER 2016 FORECAST</b>	<b>FOURTH QUARTER 2016 FORECAST</b>
1	LABOR	35.0%	415.2	405.1
2	FUEL	13.4%	195.6	200.1
3	MATERIALS AND SUPPLIES	5.4%	240.6	245.8
4	EQUIPMENT RENTS	5.8%	216.8	223.4
5	DEPRECIATION	13.9%	226.5	225.1
6	INTEREST	1.9%	57.5	60.6
7	OTHER ITEMS <sup>1</sup>	24.6%	217.4	216.9
8	WEIGHTED AVERAGE	100.0%	283.2	280.6
9	LINKED INDEX <sup>2</sup>		263.0	260.6
10	PRELIMINARY RAIL COST ADJUSTMENT FACTOR <sup>3</sup>		88.4	87.6
11	FORECAST ERROR ADJUSTMENT <sup>4</sup>		-0.042	0.005
12	RCAF (UNADJUSTED) (LINE 10 + LINE 11)		0.842	0.881
13	RCAF (ADJUSTED)		0.356	0.371
14	RCAF-5		0.337	0.352

**TABLE B**

**EP 290 (Sub-No. 5) (2016-4)**  
**Comparison of Second Quarter 2016 Index**  
**Calculated on Both a Forecasted and an Actual Basis**

<b>LINE NO.</b>	<b>INDEX COMPONENT</b>	<b>2014 WEIGHT</b>	<b>SECOND QUARTER 2016 FORECAST</b>	<b>SECOND QUARTER 2016 ACTUAL</b>
1	LABOR	31.7%	416.4	416.4
2	FUEL	20.9%	148.7	157.8
3	MATERIALS AND SUPPLIES	5.2%	246.9	246.9
4	EQUIPMENT RENTS	5.4%	215.1	216.5
5	DEPRECIATION	12.6%	227.2	225.0
6	INTEREST	1.5%	57.5	57.5
7	OTHER ITEMS	22.7%	215.1	216.6
8	WEIGHTED AVERAGE	100.0%	265.8	267.9
9	LINKED INDEX		253.7	255.0
10	RAIL COST ADJUSTMENT FACTOR		85.2	85.7

**Endnotes:**

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<sup>1</sup> “Other Items” is a combination of Purchased Services, Casualties and Insurance, General and Administrative, Other Taxes, Loss and Damage, and Special Charges, price changes for all of which are measured by the Producer Price Index for Industrial Commodities Less Fuel and Related Products and Power.

<sup>2</sup> Linking is necessitated by a change to the 2015 weights beginning in the fourth quarter of 2016. The following formula was used for the current quarter’s index:

$$\frac{\text{4th Qr. 2016 Index (2015 Weights)}}{\text{3rd Qr. 2016 Index (2015 Weights)}} \text{ Times 3rd Quarter Linked Index (1980 = 100 Linked) Equals Linked Index (Current Quarter)}$$

Or

$$\frac{280.6}{283.2} \times 263.0 = 260.6$$

<sup>3</sup> The first quarter 2013 RCAF was rebased using the October 1, 2012 level of 297.5 in accordance with the requirements of the Staggers Rail Act of 1980 (10/1/2012 = 100). In compliance with our November 27, 2013 decision, AAR has restated the October 1, 2012 level of 297.5 to 297.6.

<sup>4</sup> The fourth quarter 2016 forecast error adjustment was calculated as follows: (a) second quarter 2016 RCAF using forecasted data equals 85.2; (b) second quarter 2016 RCAF using actual data equals 85.7; and (c) the difference equals the forecast error (b-a) of 0.5. Because the actual second quarter value is greater than the forecast value, the difference is added to the Preliminary RCAF.