

EX PARTE NO. 347 (SUB-NO. 2)

RATE GUIDELINES -- NON-COAL PROCEEDINGS

Decided December 27, 1996

The Board adopts simplified evidentiary guidelines to be used in proceedings to determine the reasonableness of challenged rail rates charged on captive traffic where the Constrained Market Pricing guidelines cannot practicably be applied. These simplified guidelines employ three revenue-to-variable cost benchmark figures as starting points for a case-by-case reasonableness analysis. The RSAM benchmark reflects the defendant carrier's particular revenue needs (by examining the average markup that the carrier needs to charge its potentially captive traffic to meet those needs). The R/VC_{COMP} benchmark reflects demand-based differential pricing principles (by measuring the markups applied to similar traffic). The $R/VC_{>180}$ benchmark tests whether the traffic at issue bears a disproportionate share of the carrier's revenues (by examining the markups applied by the carrier to its other potentially captive traffic).

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ABBREVIATIONS USED

AAR	--	Association of American Railroads
AAR-SSAC	--	Simplified stand-alone cost model developed by AAR
AAR-SSMP	--	Shipper-specific market pricing test proposed by AAR
CARS	--	The Committee Against Revising Staggers
CLAY	--	U.S. Clay Producers Traffic Association, Inc.
CMF	--	Constrained market pricing
COAL	--	Western Coal Traffic League, Edison Electric Institute, Atlantic Electric, Carolina Power & Light Company, and Pennsylvania Power & Light Company, collectively
CRP	--	Cost recovery percentage
CTC	--	Computerized traffic control
DOE	--	Department of Energy
DOD	--	Department of Defense
DOT	--	Department of Transportation
DVC	--	Directly variable costs
FRC	--	Formula replacement costs
ICC	--	Interstate Commerce Commission
ICCTA	--	ICC Termination Act of 1995
KCS	--	Kansas City Southern Railway Company
LRMC	--	Long-run marginal costs
NDAC	--	North Dakota Public Service Commission and North Dakota Wheat Commission, collectively
NGFA	--	National Grain and Feed Association
NITL	--	The National Industrial Transportation League, Chemical Manufacturers' Association, Society of the Plastics Industry, Inc., and Ad Hoc Committee of Glass Producers, collectively
O-D	--	Origin-destination
OXYCHEM	--	Occidental Chemical Corporation
ROI	--	Return on investment
RSAM	--	Revenue shortfall allocation method (1 of 3 benchmark measures)
R/VC	--	Revenue-to-variable cost percentage
R/VC _{>180}	--	Revenue-to-variable cost percentage above 180 (1 of 3 benchmark measures)
R/VC _{COMP}	--	Revenue-to-variable cost comparison (1 of 3 benchmark measures)
SAC	--	Stand-alone cost
SHELL	--	Shell Oil Company and Shell Chemical Company, collectively
SRMC	--	Short-run marginal costs
TOFC/COFC	--	Trailer-on-flatcar/Container-on-flatcar
URCS	--	Uniform Railroad Costing System
UTU	--	United Transportation Union-Illinois Legislative Board
V.S.	--	Verified Statement

BY THE BOARD:

BACKGROUND

This proceeding was initiated by the former Interstate Commerce Commission (ICC) to develop simplified evidentiary procedures for rail rate reasonableness cases where the procedures adopted in *Coal Rate Guidelines*¹ cannot practicably be applied. The ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803 (1995) (ICCTA) directs the Board to complete this proceeding by January 1, 1997.² 49 U.S.C. 10701(d)(3).

The Need for Simplified Procedures

Under the Interstate Commerce Act, as revised by the ICCTA, we are charged with protecting individual captive shippers from unreasonably high and unfair rate levels. 49 U.S.C. 10101(6), 10701(d)(1). In doing so, we are specifically directed to consider the three so-called Long-Cannon factors,³ set forth in 49 U.S.C. 10701(d)(2). These factors are:

- (A) the amount of traffic transported at revenues which do not contribute to going concern value and the efforts made to minimize such traffic (Long-Cannon-1);
- (B) the amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic (Long-Cannon-2); and
- (C) the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues (Long-Cannon-3).

¹ *Coal Rate Guidelines--Nationwide*, 1 I.C.C.2d 520 (1985), *aff'd*, *Consolidated Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987).

² The ICCTA abolished the ICC, and transferred certain ICC functions and related pending proceedings (including those involving railroad rate reasonableness regulation) to this Board, effective January 1, 1996. Statutory references in this decision are to the current statute, as revised by the ICCTA.

³ So named for the two Senators who introduced the amendment that added these provisions to the Staggers Rail Act of 1980 (Staggers Act).

We are also directed to ensure that carriers have the opportunity to earn revenues that are adequate to cover costs, allow replacement of needed assets, and provide a fair return on investment. 49 U.S.C. 10101(3), 10704(a)(2).

These are not simple tasks, given the economic structure of the rail industry and the resultant pricing principles that need to be considered in regulating rail rates. As explained in the ICC's last decision in this proceeding (*1995 Decision*),⁴ and more fully in *Coal Rate Guidelines*, 1 I.C.C.2d at 526, inherent in the railroad industry cost structure are large amounts of joint and common costs that cannot be directly attributed to particular traffic.⁵ Because railroads serve a mix of competitive and captive traffic, a carrier cannot recover an equal or pro rata portion of those unattributable costs from all traffic. Accordingly, the ICC adopted Ramsey pricing principles as the cornerstone of its rate reasonableness tenets for the railroad industry. Under Ramsey pricing principles, carriers are expected to price traffic in inverse proportion to demand elasticity, up to the point at which a reasonable, adequate profit level is attained. In other words, a railroad should price its traffic differentially so as to recover a greater percentage of its unattributable costs from the traffic with a greater dependency on its service (*i.e.*, less price sensitivity for that service).

When there is a challenge to the reasonableness of a rail rate charged for captive traffic, our regulatory task is to determine whether the degree of differential pricing--*i.e.*, the amount by which the revenues derived from the traffic at issue exceed the long-run marginal cost (LRMC) of handling that traffic--is reasonable. We must be guided by Ramsey pricing principles and fundamental fairness in carrying out this regulatory task. But LRMC, attributable costs and elasticities of demand are economic concepts that are typically not directly measurable, and notions of fairness can be subjective. Our challenge is to reflect these economic and equitable principles, as best we can, in a practical, readily administrable test.

⁴ *Rate Guidelines -- Non - Coal Proceedings*, Ex Parte No. 347 (Sub-No. 2) (ICC served December 1, 1995).

⁵ Common costs are those shared by two or more services in variable proportion, such as a terminal. Joint costs are those shared by two (or more) services in fixed proportion, such as a fronthaul-backhaul arrangement. *Coal Rate Guidelines*, 1 I.C.C.2d at 526 n.13.

The *Coal Rate Guidelines*, adopted in 1985, provide the regulatory framework, known as Constrained Market Pricing (CMP),⁶ now used for analyzing rail rate challenges.⁷ CMP has been approved by the courts and applied in a number of cases, most often using a stand-alone cost (SAC) analysis.⁸ However, whether using an SAC analysis or CMP's alternative top-down approach⁹ (both of which are highly data-intensive), a CMP presentation can be quite expensive and thus not feasible where the amount of money at issue is not great enough to justify the expense. Accordingly, the ICC instituted this rulemaking in 1986 to search for simpler, less expensive procedures for assessing rate reasonableness in small cases.

As the ICC recognized, *1995 Decision*, slip op. at 4, any simpler method will necessarily be cruder than CMP. Accuracy must be sacrificed for simplicity. This trade-off is necessary to ensure that no shipper is foreclosed from exercising its statutory right to challenge the reasonableness of rates charged on its captive traffic.

The ICC expressed confidence that reliance on a cruder method would not significantly affect a carrier's overall ability to earn adequate revenues, because only a very small portion of rail traffic could be subjected to rate reasonableness

⁶ CMP imposes four constraints on a carrier's pricing of captive traffic. A captive shipper should not be required to pay more than is necessary for the carrier involved to earn adequate revenues (the revenue adequacy constraint). Nor should it pay more than is necessary for efficient service (the managerial efficiency constraint). A captive shipper should not bear the costs of any facilities or services from which it derives no benefit (the stand-alone cost constraint). Finally, changes in the rate structure should not be so precipitous as to cause severe economic dislocations (the phasing constraint).

⁷ Notwithstanding its title, the *Coal Rate Guidelines* procedures are not limited to coal cases. Because of the prevalence of coal rate challenges, and because coal cases typify captive, high-volume, repetitive rail traffic, they served as the springboard for the ICC's analysis of all such cases.

⁸ The SAC constraint is a bottom-up approach for testing for the presence of inefficiencies and cross-subsidies. It allows the complaining shipper to hypothesize a completely new and optimally efficient transportation system. If that hypothetical system could provide the needed service to the complaining shipper at a lower rate, while fully covering all costs (including a reasonable return), then the shipper is entitled to have the challenged rate reduced to the level that such a hypothetical, fully efficient carrier would charge.

⁹ In contrast to an SAC analysis, the revenue adequacy and managerial efficiency constraints of CMP represent a top-down approach for examining the defendant carrier's existing operations. If the defendant carrier is revenue adequate (earning sufficient funds to cover its costs and provide a fair return on its investment), or would be revenue adequate after subtracting out unnecessary costs resulting from specifically identified inefficiencies in its operations, a complaining shipper may be entitled to rate relief.

review using such simplified procedures. *1995 Decision*, slip op. at 4. Under 49 U.S.C. 10707(d)(1), the reasonableness of a rate cannot be challenged if the revenues generated by that rate are less than 180% of the variable costs¹⁰ associated with handling the traffic involved.¹¹ In addition, under 49 U.S.C. 10709(c), the reasonableness of a contract rate cannot be challenged.¹² Similarly, rates for traffic or services that are exempted from regulation pursuant to 49 U.S.C. 10502 or its predecessor (former 49 U.S.C. 10505) are free from challenge.¹³

In addition to these three readily measurable exclusions from rate challenge,¹⁴ the ICC noted that there are two other limitations that further circumscribe the rates that can be challenged. *1995 Decision*, slip op. at 5. One is the qualitative market dominance limitation of 49 U.S.C. 10707(a)-(b).¹⁵ The other is the grandfather provision of section 229 of the Staggers Act, which conferred regulatory immunity upon the rate levels that were in place at that time and not successfully challenged by a certain date.¹⁶

¹⁰ Under 49 U.S.C. 10707(d)(1)(B), variable costs are determined using the Uniform Railroad Costing System (URCS) developed by the ICC. The URCS costing formula is a well-established means of reflecting the extent to which the different categories of costs incurred in the rail industry have been found to change in direct proportion to changes in output.

¹¹ The ICC calculated that, based on 1993 rail industry traffic and revenue data, only 33% of rail traffic generates revenues that exceed this jurisdictional threshold. *1995 Decision*, slip op. at 4.

¹² Based on 1993 data, the ICC concluded that 28% of the traffic with revenues exceeding the threshold revenue-to-variable cost (r/vc) floor moved under a contract rate. *Id.* at 5.

¹³ Based on the 1993 data, the ICC calculated that 17% of traffic with revenues exceeding the threshold r/vc floor comes within a class of commodities or services that have been exempted from rate regulation. *Id.* at 4-5. (For a list of exempted commodities and services, see, 49 CFR 1039.)

¹⁴ After excluding these three measurable categories of traffic, the ICC concluded that no more than 18% of total 1993 rail revenues (55% of the 33% of traffic above the r/vc floor) could have been subjected to a rate challenge. *1995 Decision*, slip op. at 5.

¹⁵ Under the qualitative market dominance limitation, a rate cannot be challenged if there is effective competition for the transportation to which the rate applies, whether that competition comes from other rail carriers, from other modes of transportation, or from the complaining shipper's ability to shift to other product markets or other geographic markets. See, *Market Dominance Determinations*, 365 I.C.C. 118, 129 (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*, *Product and Geographic Competition*, 2 I.C.C.2d 1 (1985).

¹⁶ Section 229 of the Staggers Act established a cut-off date (180 days after October 1, 1980) for shippers to challenge rate levels that were in place on October 1, 1980. While section 229 of

(continued...)

Other factors also limit the potential impact of a simplified approach, as the ICC pointed out. *1995 Decision*, slip op. at 5-6. Much of the traffic eligible for a rate challenge would be reviewed under CMP.¹⁷ Finally, because there is no regulatory authority to require a rate to be set below the 180% jurisdictional threshold, the only portion of a carrier's revenues potentially at risk in a successful rate challenge would be the portion above the 180% r/vc floor. Thus, while the practical availability of relief through a simplified procedure will plainly benefit certain individual shippers, the ICC concluded that adoption of simplified guidelines would not likely have a material adverse impact on overall railroad earnings.

Even though the impact of simplified procedures would be limited, the ICC acknowledged that it did not have free rein in devising simplified reasonableness procedures. Rather, the simplified procedures must be equitable, must comport with the underlying statutory directives and guiding economic principles, and must produce realistic measurements. *1995 Decision*, slip op. at 6.

The Search for Simplified Procedures

For a decade, the ICC strived to meet these objectives. It initiated this proceeding in 1986, soliciting suggestions for how to decide rail rate cases where CMP (particularly SAC) is too costly or traffic too infrequent and dispersed for a SAC analysis.¹⁸ In 1987, the ICC proposed two alternative simplified tests that had been developed by its staff: formula replacement costs (FRC) and revenue-to-variable cost comparison (R/VC_{COMP}).¹⁹ The ICC tried

¹⁶(...continued)

the Staggers Act remains intact, provisions for indexing those rates by a quarterly rail cost adjustment factor--contained in former 49 U.S.C. 10707a(a), (b) (1995)--were repealed by the ICCTA.

¹⁷ The ICC pointed out that, in 1993, of the traffic exceeding the r/vc floor that was not removed from regulation by an exemption or a rate contract, 45% was transported in trainload or unit-train shipments, suggesting that there was a sufficient amount of traffic and money involved to warrant using CMP if those rates were challenged. Another 12.7% of that traffic moved in multiple-car shipments (groups of 2 to 26 cars per shipment) that may or may not have been sufficient for analysis under CMP. *1995 Decision*, slip op. at 5-6 n.7.

¹⁸ *Rate Guidelines -- Non - Coal Proceedings*, Ex Parte No. 347 (Sub-No. 2) (ICC served May 21, 1986).

¹⁹ *Rate Guidelines -- Non - Coal Proceedings*, Ex Parte No. 347 (Sub-No. 2) (ICC served April 8, 1987).

applying each of these tests to individual cases and ultimately concluded that neither measure, in and of itself, was suitable as a standard of reasonableness.

FRC would assign to the traffic at issue a pro rata allocation of the carrier's fixed costs (in addition to the variable cost of moving the traffic at issue). This measure was soon discarded because it did not provide for demand-based differential pricing.²⁰

R/VC_{COMP} looks at the markup (r/vc percentage) collected on traffic with demand characteristics comparable to those of the issue traffic (*i.e.*, movements of a similar commodity under similar circumstances) to estimate the appropriate amount of differential pricing for the traffic at issue. In attempting to use this measure, however, the ICC learned that it can be difficult, with some types of small or isolated shipments, to obtain a sufficient data base of similar traffic to use for comparison.²¹ Moreover, a reviewing court overturned the ICC's use of the R/VC_{COMP} test in the only case in which the ICC relied upon it solely.²²

Continuing its search for an appropriate test of reasonableness, ICC staff developed two other potential reasonableness measures: the revenue shortfall allocation method (RSAM) and the average revenue-to-variable cost percentage above 180 ($R/VC_{>180}$). $R/VC_{>180}$ measures the average markup actually charged by the defendant carrier on its high-rated traffic (traffic moving at r/vc percentages above 180). RSAM, on the other hand, calculates the average markup over variable cost that would be needed from all relatively demand-inelastic traffic (traffic moving at r/vc percentages in excess of 180) for the carrier to recover its total costs (including a reasonable profit component, as measured by the cost of capital for the railroad industry). In an effort to avoid cross-subsidization among traffic, RSAM as originally proposed would exclude the revenue shortfall resulting from pricing any traffic below the variable costs of serving that traffic.

In the meantime, the Association of American Railroads (AAR) developed and offered for consideration a computer program that it characterized as producing a simplified stand-alone cost number (AAR-SSAC). The program was designed to determine whether the revenues derived from a particular traffic

²⁰ *South-West R.R. Car Parts v. Mo. Pac. R.R.*, No. 40073 (ICC served December 12, 1988) (*Car Parts I*).

²¹ *South-West R.R. Car Parts v. Mo. Pac. R.R.*, No. 40073 (ICC served June 1, 1990) (*Car Parts II*).

²² *Burlington N.R.R. v. ICC*, 985 F.2d 589 (D.C. Cir. 1993), *remanding McCarty Farms, Inc. v. Burlington N., Inc.*, 4 I.C.C.2d 262 (1988).

group (selected automatically by preset program parameters) exceed the costs associated with providing rail service to that traffic group. As proposed by AAR, a shipper seeking to determine the reasonableness of a particular rate would need only to supply the necessary data on its traffic for input into the program (which resides on the mainframe computer of AAR's consultant) and would be notified of the results of the program run.

The ICC sought public comment on all of these measures in late 1992,²³ but subsequently postponed comments to enable interested parties to explore how each of these measures was produced.²⁴ The ICC hosted a technical workshop in February 1993 for its staff and AAR representatives to explain each measure. The ICC held a second workshop, in April 1993, for AAR to further explain and demonstrate the AAR-SSAC program.

Concerned that test runs conducted for the April 1993 workshop produced inordinately high numbers (under which a rate producing r/vc levels of 5,000% would be considered reasonable), the ICC asked AAR to explain why the AAR-SSAC program should receive further consideration.²⁵ AAR was afforded the opportunity to respond both in writing²⁶ and with an oral presentation.²⁷

The 1995 Decision

In the *1995 Decision*, slip op. at 10-15, the ICC concluded that it could not pursue the AAR-SSAC model because that model is inconsistent with CMP-SAC in key respects and biased towards the railroads in its assumptions. The ICC further concluded that, in a decade-long search, it had been unable to identify a satisfactory means of simplifying the CMP analysis in a way that would adhere to the theory, and approximate the results, of CMP. *Id.* at 15. Accordingly, the ICC decided that it must find some means other than CMP to meet the dual objectives of enabling a railroad to differentially price its traffic and protecting a complaining captive shipper from bearing an undue share of a

²³ *Rate Guidelines -- Non - Coal Proceedings*, Ex Parte No. 347 (Sub-No. 2) (ICC served November 16, 1992).

²⁴ *Rate Guidelines -- Non - Coal Proceedings*, Ex Parte No. 347 (Sub-No. 2) (ICC served April 6, 1993).

²⁵ *Rate Guidelines -- Non - Coal Proceedings*, Ex Parte No. 347 (Sub-No. 2) (ICC served December 17, 1993).

²⁶ AAR written submission filed March 17, 1994.

²⁷ AAR oral presentation heard March 30, 1994.

carrier's revenue requirements. *Id.* at 15-16. The ICC stressed that CMP is the most economically precise procedure available for evaluating the reasonableness of rates and should be used wherever possible. *Id.* at 15 n.25. A non-CMP procedure would be reserved for use only in those cases in which CMP cannot be used. *Id.* at 15.

The simplified procedures that the ICC proposed to use would combine the three r/vc benchmark measures--RSAM, $R/VC_{>180}$ and R/VC_{COMP} . 1995 *Decision*, slip op. at 16-30. The ICC explained that, while each of these measures has shortcomings, together they take into account all of the relevant pricing considerations, and each serves as a check on the others. *Id.* at 18-25. The ICC cautioned that, because these benchmarks share certain limitations, they can supply only a starting point, not the end result, of a rate reasonableness analysis. *Id.* at 16-17, 25, 30.

The ICC requested public comment on all aspects of its proposal. 1995 *Decision*, slip op. at 31. It specifically invited comment on whether to use a preset formula for presenting the combined benchmarks, *id.* at 25-31, and whether to attempt to define in advance those cases that would qualify for processing under the simplified procedures, *id.* at 30-31.

The Commenting Parties

In response to the 1995 *Decision*, comments were submitted by the following interested organizations: AAR; The Committee Against Revising Staggers (CARS);²⁸ the U.S. Clay Producers Traffic Association, Inc. (CLAY); the Western Coal Traffic League, jointly with Edison Electric Institute, Atlantic Electric, Carolina Power & Light Company, and Pennsylvania Power & Light

²⁸ CARS, a group of some 400 shippers by rail, was formed in 1985 "to protect the regulatory freedoms contained in the Staggers Act of 1980 from legislative attempts to limit those freedoms." (CARS Comments at 1.) The CARS shippers are concerned that the health of the railroad industry (and the concomitant ability of that industry to provide good service to rail shippers) not be compromised.

Company (collectively, COAL);²⁹ the Department of Energy (DOE);³⁰ the Department of Transportation (DOT); the North Dakota Public Service Commission, jointly with the North Dakota Wheat Commission (collectively, NDAK); the National Grain and Feed Association (NGFA); the National Industrial Transportation League, jointly with Chemical Manufacturers' Association, Society of the Plastics Industry, Inc., and Ad Hoc Committee of Glass Producers (collectively, NITL); Occidental Chemical Corporation (OXYCHEM); Shell Oil Company, jointly with Shell Chemical Company (collectively, SHELL); and the United Transportation Union-Illinois Legislative Board (UTU). In addition, most parties submitted reply comments.³¹

DISCUSSION

The AAR-SSAC Proposal

As explained in the *1995 Decision*, slip op. at 10, the AAR-SSAC model starts with the existing rail system used to move the complaining shipper's traffic from origin to destination. That system is then expanded beyond the particular line segments used for the complaining shipper's traffic so as to include other traffic that the model deems profitable. The model defines profitability so as to exclude traffic that does not, in addition to covering its own (variable) costs, generate sufficient revenues to bear a full pro-rata share of the nonvariable (fixed) costs of all of the other line segments that it uses.

The AAR-SSAC model derives its revenue figures from our Waybill Sample, a statistical sampling of railroad traffic that is collected and maintained by AAR (under our oversight) for use by the Board and the public (with appropriate restrictions to protect the confidentiality of individual traffic data). The AAR-SSAC model computes operating costs using URCS, with one

²⁹ The COAL shippers express a dual interest in this proceeding. They state that they may have some traffic that could be subject to the simplified procedures adopted here. Also, they express concern that simplified rate procedures and the rates resulting from them could have some effect on CMP procedures and the rates for high-volume coal shipments.

³⁰ DOE participated in this proceeding in its shipper capacity. DOE and the Department of Defense (DOD) have a rate complaint pending before us challenging the reasonableness of certain rates for moving radioactive materials by rail.

³¹ The COAL and NITL groups filed a joint reply. DOT and OXYCHEM did not submit reply comments.

modification. In place of historical depreciated asset costs for road and equipment, it substitutes current replacement cost obtained from Report 5 (a program developed by ICC staff to index historic costs to current reproduction costs).

AAR asserts that the AAR-SSAC model simulates a CMP-SAC calculation because it uses the same steps in the computational process. Indeed, AAR-SSAC shares some important attributes of CMP-SAC.³² But, as the ICC observed, *1995 Decision*, slip op. at 11-12, AAR-SSAC is inconsistent with CMP-SAC in two key respects which appear to distort the results in favor of the railroads.

First, whereas the purpose of CMP-SAC is to estimate the cost of a hypothetical and optimally efficient stand-alone transportation system designed to maximize efficiencies and production economies, the AAR-SSAC model is restricted to segments of the existing rail system. Moreover, all lines in the rail network are valued at full replacement cost, even though not all existing railroad assets should, or ever would, be replaced. Because it is doubtful that an optimally efficient carrier entering the market would use the same technology and same assets as the existing carrier, AAR-SSAC is not based on a fully efficient system.³³ Thus, the program fails one of the basic purposes of CMP-SAC, which is to determine the cost of an optimally efficient system. As a result, the model appears biased in the railroad's favor by using costs that are higher than those used by CMP-SAC.

Second, AAR-SSAC appears to be inconsistent with CMP-SAC because it does not permit the inclusion of, and hence cost sharing with, other traffic unless that traffic covers not only its own attributable costs but also a full pro rata share of the joint and common (unattributable) costs of every other line segment used

³² As the ICC noted, *1995 Decision*, slip op. at 11, by providing for grouping of traffic and expansion of the system beyond the immediate facilities and line segments used by the complaining shipper, the model reflects to some degree the economies of scope, scale and density that are available in the rail industry. It also contains a pre-programmed efficiency adjustment, to exclude traffic that it defines as unprofitable, and it adjusts the capacity of the hypothetical system to reflect the lower density after the exclusion of that unprofitable traffic. Like CMP-SAC, assets are valued at their current costs to allow for their replacement.

³³ For example, the railroads historically solved congestion problems by double tracking significant parts of their systems. With the advent of computerized traffic control (CTC), greater amounts of traffic can now be handled without double tracking. AAR-SSAC would replicate the existing double tracks even if CTC and passing siding were now optimal.

by that traffic.³⁴ The effect is to overstate the revenue requirements for those other lines and understate the potential revenue contribution to the stand-alone system from that traffic. Moreover, the result is inconsistent with sound railroad economic pricing principles. As a general rule, it is better for a railroad to carry any traffic that covers its own (attributable) costs and makes any contribution (no matter how slight) to joint and common costs. Indeed, most rail traffic is competitively priced and thus makes varying levels of contribution toward unattributable costs; but whatever portion is paid towards the unattributable costs benefits the shippers of captive traffic by relieving them from bearing that portion of the costs.

The ICC pointed to the results of one of the test runs conducted for the April 1993 workshop as illustrative of the apparent biases of the AAR-SSAC model. *1995 Decision*, slip op. at 12-14. That test involved hypothetical traffic moving over the main line of the Kansas City Southern Railway Company (KCS), one of the most profitable railroads in the country.³⁵ Because the test traffic was confined to a high-density main line, one would expect a substantial traffic group to be included in any SAC analysis. However, after successive passes through the AAR-SSAC profitability subroutine, the traffic group was reduced to less than 1% of the traffic now moving over the line.³⁶ As the ICC noted, *id.* at 13, this is an unrealistically small amount of traffic to include for main line service over a profitable railroad. Moreover, the extent of the revenue shortfall produced by the AAR-SSAC model exceeded the actual cumulative shortfall experienced by the KCS in the years 1988, 1989 and 1990. *Id.* As the ICC observed, *id.*, this would seem to suggest that the KCS main line, the core of this successful carrier's system, does not earn its reproduction cost and would be uneconomical to replace. Noting that healthy carriers continue to invest in their main lines, the ICC concluded that the anomalous results must be due to the AAR-SSAC model's exclusion of substantial amounts of profitable traffic. *Id.* Finally, the ICC noted that the rates on the test traffic could have been raised to an r/vc level of 5,000% and still have been deemed reasonable, because the AAR-SSAC model would not treat a challenged rate as unreasonably high

³⁴ Cf. *Bituminous Coal--Hiawatha, UT to Moapa, NV*, 10 I.C.C.2d 259 (1994).

³⁵ As the ICC noted, *1995 Decision*, slip op. at 12 n.22, in recent years KCS has neared or attained our measure of revenue adequacy.

³⁶ Of the 1.7 million carloads (or 117.5 million tons) identified as moving over that line, only 5431 carloads (or one-half million tons of traffic) was ultimately included in AAR-SSAC traffic group.

unless and until no revenue shortfall is shown in the entire system selected by the AAR-SSAC model.³⁷ *1995 Decision*, slip op. at 13-14. Allowing that result would give carriers earning less than our measure of revenue adequacy *carte blanche* to charge unreasonably high rates, contrary to the statute. As the ICC observed, under the statute, a rate may be unreasonable even if charged by a carrier that is far short of revenue adequacy. *Id.* at 14-15, citing *Coal Rate Guidelines*, 1 I.C.C.2d at 536-37.

The commenting shippers concur in these criticisms of the AAR-SSAC model. They stress that the model is not designed to produce the most efficient, least-cost transportation system--the objective of CMP-SAC. Instead, AAR-SSAC merely replicates existing facilities and automatically excludes most cost-sharing traffic. They regard the results that the AAR-SSAC model would produce (as illustrated by the test run) as *de facto* deregulation. They also strongly object to the proprietary nature of the AAR-SSAC model and complain that the program was never placed in the public domain. DOT shares this due process concern.

AAR claims that these are largely correctable shortcomings. AAR asserts that the AAR-SSAC programming is now available to shippers and that a complainant in an individual case could override the preset program parameters by specifying the traffic group to be included and by constructing mileage-prorated revenue divisions to represent the revenues contributed by traffic that is originated or destined off-line. AAR further suggests that, instead of using Report 5 replacement costs, a complainant could use construction unit-costs derived from recent CMP-SAC cases.

Even with such modifications, however, AAR now concedes that AAR-SSAC would not provide a useful rate reasonableness test for the type of traffic for which simplified procedures are needed.³⁸ According to AAR, that is because the low-volume shipper is least likely to be cross-subsidizing other traffic; to the contrary, the low-volume shipper benefits most from the economies of scale, scope, and density that characterize the rail industry.³⁹

³⁷ Citing *Coal Rate Guidelines*, 1 I.C.C.2d at 544, the ICC contrasted this result with CMP-SAC, where a complaining shipper is not limited to an aggregate result and may rebut the presumption that other traffic is optimally priced. *1995 Decision*, slip op. at 14 n.23.

³⁸ AAR Comments at 4, 29-30.

³⁹ Economy of scope refers to the fact that the rail plant is indivisible and can produce numerous services at less cost than those services could be produced by separate rail plants for each

(continued...)

Thus, even with grouping, AAR concedes that a SAC-type procedure would not offer rate relief to a low-volume shipper.

AAR's Alternative SSMP Proposal

AAR now offers a different test of reasonableness, which it calls Shipper-Specific Market Pricing (AAR-SSMP).⁴⁰ AAR-SSMP is based on the premise that, while railroads ordinarily optimally price their traffic, a railroad can misjudge the optimum rate level for its low-volume traffic because that traffic gets less of its pricing attention. AAR asserts that there are two possible ways in which a complaining shipper could show its rate to be unreasonable.⁴¹ One is to identify a specific, correctable inefficiency in the railroad's handling of the complainant's traffic that results in higher costs to the railroad for handling the complainant's traffic than need be incurred. The other is to show that the defendant railroad(s) would move more of the complainant's traffic and realize a higher total profit if the rate were lowered.⁴²

Shippers oppose AAR-SSMP as nothing more than a profit maximization tool for a monopolist rate-setter.⁴³ As DOE succinctly states, the AAR-SSMP test would convert what is supposed to be a shipper protection into a carrier

³⁹(...continued)

service. Economy of density refers to the fact that greater use of the fixed plant results in a declining average cost. (Thus, the marginal cost of rail service is less than the average cost, because the fixed plant is used in a progressively more efficient manner.) Economy of scale is present when the average cost of service declines as the size of rail plant increases. *Coal Rate Guidelines*, 1 I.C.C.2d at 526 & n.12.

⁴⁰ AAR Comments at 5, 30-33.

⁴¹ A third type of complaint mentioned by AAR--challenging a rate increase as too precipitous--would not provide a means for assessing the reasonableness of the ultimate rate level (or of a rate not recently increased). The phasing constraint is thus only a transitional measure.

⁴² As SHELL points out, this test would be unavailable to a shipper that is already at maximum production capacity and thus could not increase its traffic levels. (SHELL Reply, V.S. M. Hall at 19-20.) Moreover, AAR would apparently apply this test only where the complaining shipper can demonstrate that it is an efficient producer of its final product. (AAR Comments, V.S. Rocky/Klick at 6 n.8.) AAR suggests that this limitation is necessary so that AAR-SSMP would not be misused as a competitive tool to shift production from one producer to another by giving the second producer the advantage of lower transportation costs. (AAR Reply at 26 n.15.) Shippers object that such a shipper-efficiency limitation would turn a rail rate case into an inquiry into the complaining shipper's operations, rather than the defendant railroad's pricing. (NITL-COAL Reply at 11-12; NGFA Reply at 8; CLAY Reply, V.S. Fauth at 10.)

⁴³ COAL-NITL Reply at 9; NDAK Reply at 1-2; SHELL Reply, V.S. D. Hall at 12.

protection.⁴⁴ We share the shippers' assessment that AAR-SSMP constitutes unconstrained market pricing: it is structured to allow (indeed assist) a carrier to charge whatever the market will bear. Contrary to AAR's characterizations, the AAR-SSMP approach does not represent Ramsey pricing principles. Ramsey pricing principles (*i.e.*, pricing pegged to relative demand inelasticity) would establish an upper limit on individual prices.⁴⁵ See *Coal Rate Guidelines*, 1 I.C.C.2d at 526-27 & n.15. With AAR-SSMP, however, there is no apparent regulatory limit to what a carrier could extract from an individual shipper's captive traffic, only a market limit on the amount of traffic that would move at a particular rate level. Sworn allegiance to Ramsey pricing principles does not give railroads a license for unchecked pricing discretion where they enjoy monopoly pricing power.

Of course, there is nothing to preclude a shipper from seeking to have its rate lowered by making either of the two AAR-SSMP presentations in an appropriate individual case. Indeed, as AAR points out, a shipper with a valid AAR-SSMP case probably would not need to bring a formal complaint; if the shipper were to show the railroad how to lower the carrier's costs and/or raise the carrier's profits, the railroad would presumably take such action voluntarily (and pass at least some share of the savings along to the helpful shipper).⁴⁶ We find, however, that AAR-SSMP alone does not provide an adequate means of determining rate reasonableness.

The Multiple R/VC Benchmarks Proposal

Having concluded that neither one of AAR's proposals would provide satisfactory simplified rate reasonableness procedures, we turn to the Multiple R/VC Benchmarks proposal set forth in the *1995 Decision* and the comments

⁴⁴ DOE Reply at 12.

⁴⁵ Unfortunately, there is no way to directly measure a railroad's marginal cost or shipper's demand elasticity and hence the appropriate Ramsey markup to be assigned to each component of a railroad's traffic base. (If there were, CMP, including the SAC test, would not be needed.) Absent measurability, direct Ramsey pricing cannot supply a regulatory yardstick.

⁴⁶ AAR Comments at 30-31.

received on it. Shippers generally endorse this proposal,⁴⁷ while the railroads (through AAR) oppose it.⁴⁸

Even those commenting parties that endorse the Multiple R/VC Benchmarks proposal acknowledge the limitations inherent in each of the benchmarks. The comments reinforce our conclusion that none of the r/vc measures alone provides a sufficient, all-purpose test of rate reasonableness, and that, even in combination, these measures can only provide a starting point for what must become a more particularized analysis. After considering all of the comments, however, we are satisfied that these measures provide an appropriate frame of reference for our rate reasonableness analysis. They properly introduce all of the factors that must be looked at in our analysis:

- revenue adequacy and managerial efficiency (at least as reflected in the Long-Cannon-1 and Long-Cannon-2 tests), through the RSAM measure;
- demand-based differential pricing, through the R/VC_{COMP} measure; and
- basic principles of fairness (as reflected in the Long-Cannon-3 test), through the R/VC_{>180} measure.

Accordingly, the three r/vc benchmarks in combination supply the necessary springboard for a closer scrutiny of the more individualized pricing considerations that may apply to the particular traffic at issue.

We address the specific benefits and shortcomings of each of the three r/vc benchmarks individually, as well as various suggestions that have been made for adjusting or refining these measures, below. First, however, we address some general comments and concerns that relate to all three.

⁴⁷ Shippers are not uniform in their support of the proposal. As discussed below, DOE advocates use of RSAM as the sole test of reasonableness. CARS specifically objects to the efficiency adjustment contained in RSAM, and advocates the inclusion of an additional benchmark—a modified cost recovery percentage figure, also discussed below.

⁴⁸ In addition to AAR, UTU and DOT also argue against the use of these r/vc benchmarks. As discussed below, UTU advocates comparisons of rates, rather than r/vc ratios. DOT argues that we should focus more on a carrier's return on investment (ROI), rather than r/vc ratios, but DOT does not suggest an ROI-based test for determining the reasonableness of an individual rate.

Limited Departure from CMP

AAR objects to the Multiple R/VC Benchmarks approach on the ground that it is not a simplified form of CMP.⁴⁹ We must reject AAR's underlying assumption that CMP is susceptible to adequate simplification without losing its effectiveness, and that other (non-CMP) simplified procedures cannot be considered.

We recognize that CMP provides the only economically precise measure of rate reasonableness and therefore must be used wherever possible. We are persuaded, however, that other procedures can, and indeed must, be made available for those cases in which CMP simply cannot be used--because the traffic is so infrequent or widely dispersed that it is not susceptible to a SAC presentation or because the case is so small in value that the substantial expense of a CMP presentation (whether through the top-down approach or SAC's bottom-up approach) cannot be justified.⁵⁰

We understand that, because precision must be sacrificed for simplicity, any simplified procedures will necessarily be very rough and imprecise. Nevertheless, to afford any realistic measure of rate reasonableness protection for those cases in which CMP is unavailable, some form of comparatively quick and rough analysis must be acceptable. Because of their roughness, however, the simplified procedures must be used as sparingly as possible, reserved for only those cases where CMP is not a realistic option.

⁴⁹ AAR Comments at 22-23, 24-29.

⁵⁰ AAR suggests that alternative procedures may not be necessary; it suggests that a low-volume shipper could take advantage of SAC by inexpensively joining in a SAC complaint brought by a high-volume shipper. (AAR Reply at 6-7.) That suggestion, however, would make the relief available to a low-volume shipper dependent on a rate complaint brought by a neighboring shipper. For relief to be available, there would have to be a neighboring high-volume shipper capable of bringing and prepared to bring a SAC complaint--a shipper that does not have a contract covering its shipments, and that has traffic that is captive, and that is so dissatisfied with its rate levels on its captive traffic that it is prepared to pursue a SAC complaint. Moreover, to bring a complaint jointly, the two shippers would need to be aware of the rates and markups charged to each. Finally, for us to permit joinder in a rate complaint, there would have to be a sufficient nexus between the two shippers' traffic. Thus, shippers rightly view this as an inadequate or illusory avenue of rate relief. (DOE Reply at 9-10; NDAK Reply, V.S. Tolliver/Bitzan at 2-3.)

Use of Average Figures

AAR's foremost objection to the use of r/vc measures is that these measures are average or uniform numbers.⁵¹ AAR points out that capping rates at an average or uniform level would not allow for the degree of differential pricing that the railroad industry needs. Even within the portion of a railroad's traffic base consisting of r/vc percentages greater than 180 (the >180 traffic), there are varying degrees of shipper demand elasticity for the railroad's service. A railroad must therefore be able to price some of its >180 traffic (the more-captive traffic) at a higher-than-average markup, to make up for the fact that other >180 traffic must be priced below-average or else the carrier would lose that less-captive traffic.

AAR voices concern that the use of average or uniform r/vc measures would lead to a formulaic rate setting approach under which rates would be capped at an average level. AAR argues that, if rates were repeatedly lowered to an average level, the average itself would in turn be ratcheted down, causing a downward rate spiral all the way to the 180% jurisdictional floor. The resulting loss of revenues would soon require railroads to cut back on needed investment and service, and shippers would suffer.

We recognize the dangers inherent in relying on average numbers, and it is certainly not our intent to return to an era of rate equalization among different traffic. By its very nature, an average number, which is produced by combining numbers that are both above and below that level, does not provide an appropriate regulatory ceiling. That is why, as explained in the *1995 Decision*, the r/vc benchmarks can only provide the starting point for a rate reasonableness analysis, not the end result.

In making their respective benchmark r/vc presentations, we expect both shipper-complainants and defendant-railroads to present whatever additional information is available that bears on the reasonableness of the pricing of the traffic at issue. This could include a distribution analysis of the component numbers that produced the average figure. *1995 Decision*, slip op. at 23. It could also include an analysis of any relevant subset of numbers that more closely compares with the traffic at issue (for example, a subset that is limited to single-car shipments, if the issue traffic is so limited). *Id.* Finally, it should include any qualitative information regarding the issue traffic that might affect

⁵¹ AAR Comments at 7-8, 39-43.

the relative pricing of that traffic vis-a-vis the other traffic carried by the defendant railroads. *Id.* at 21.

In short, we do not envision a strictly formulaic approach where the outcome is a pre-assigned number. Nor is it our intent to cap railroad rates at an average level. Rather, the purpose of starting with the three r/vc benchmarks is to ensure that the analysis takes into consideration, in some fashion, each of the essential criteria for reasonableness in railroad pricing. We recognize that there are limitations in the three r/vc measures, both individually and collectively. (Indeed, the 1995 *Decision* was candid in outlining their deficiencies.) That is why these average r/vc measures should be supplemented in each case by the kinds of more individualized analyses described above.

While the resulting evidentiary presentations will be simplified, as compared to a CMP presentation, they will not be simple. A shipper-complainant cannot claim automatic eligibility to have an average number imposed as a rate cap. Instead, through the normal adversarial process, all parties can and must assist in developing a record as to the particular considerations that might affect whether the issue traffic reasonably should bear a higher-than-average or lower-than-average markup.

In other words, the analysis that we envision would not presume that, simply because a rate produces an r/vc ratio above the average level, it is thereby unreasonable.⁵² The nature of an average number--which is produced by combining numbers that are both above and below that level--does not permit such a presumption. Rather, what we must consider is whether the resulting markup is within a reasonable range or zone.

There is certainly room for parties to complain that the results of such an analysis are not (and cannot be) either precise or perfect. It has long been recognized, however, that any simplified approach entails a trade-off. The accuracy and precision available under CMP must be sacrificed for the simplicity needed where CMP is unavailable. Thus, all that we can do, where CMP is unavailable, is to make a rough, but reasoned call based on the evidence that is available.

We are satisfied that the proposed approach is a next-best approach. It is fair to both shippers and carriers and will allow us to discharge our statutory responsibilities. Moreover, no alternative approach has been identified for

⁵² To the extent that the 1995 *Decision*, slip op. at 30, suggested otherwise, we do not adopt that aspect of the ICC's proposal.

which the same could be said. In a decade of striving, neither the ICC nor any of the parties has been able to devise any other acceptable simplified approach. Under these circumstances, we cannot reject a reasonable, albeit imperfect, approach in hopes of finding a better one.⁵³ We agree with NITL's view that, in setting a statutory deadline for completing this proceeding, Congress has directed that we cease a fruitless search for a perfect approach.⁵⁴

Costing of Individual Movements

AAR also raises concerns about the reliance of the Multiple R/VC Benchmarks proposal on r/vc ratios that are drawn from URCS Waybill costing.⁵⁵ AAR points out that the Waybill Sample data is sometimes incomplete, and that URCS Waybill costing is better at measuring railroad costs on an aggregate basis than on an individual movement basis. We note, however, that the AAR-SSAC model would have relied on the same URCS costing formulas and Waybill Sample data.⁵⁶

While our Waybill costing abilities are admittedly imperfect, we believe that the use of the URCS Waybill costing procedures provides a sufficient (albeit rough) approximation of costs to be useful in a rate reasonableness analysis. URCS is the product of substantial regulatory analysis and industry input over many years. It is well established and heavily relied upon, by the railroads and industry observers, for many purposes. Indeed, Congress relied on these costing procedures, and the resulting r/vc ratios, for the threshold jurisdictional determination (*i.e.*, applying the 180% regulatory floor) on an individual-movement basis. *See* 49 U.S.C. 10707(d)(1)(B). In short, URCS is an accepted measure of movement profitability and revenue contribution for the rail industry.

We also recognize that there are limitations in the Waybill Sample data currently provided to us, including instances of incomplete or inaccurate

⁵³ We are mindful that "the best should not be the enemy of the good" and that we need not allow "the infeasible perfect to oust the feasible good." *Commonwealth of Pa. v. ICC*, 535 F.2d 91, 96 (D.C. Cir. 1976), *cert. denied*, 429 U.S. 834 (1976).

⁵⁴ NITL Comments at 11 n.9.

⁵⁵ AAR Comments at 45-46 & V.S. Rockey/Costing Officers at 4-25.

⁵⁶ AAR claims that, in actually setting and internally reviewing their rates, railroads use considerably more detailed and accurate costing procedures that are available to the railroads' marketing officers. (AAR Comments, V.S. Rockey/Costing Officers at 5.) However, AAR did not offer to make such procedures available for our use.

information regarding some of the sampled movements.⁵⁷ As SHELL points out,⁵⁸ however, some of these data deficiencies are ones that the railroads themselves can and should correct, either individually (as the sources of the data)⁵⁹ or collectively through AAR (as the administrator of the Waybill Sample under a contract with us).⁶⁰ Other deficiencies could be addressed by improving the design of the Waybill Sample.⁶¹ In any event, AAR has not persuaded us that the defects in the Waybill Sample data are so large or pervasive as to render unusable the same data that AAR itself was prepared to rely on in its AAR-SSAC proposal.⁶²

180% Line of Demarcation

AAR complains that all three r/vc benchmarks wrongly presume that all >180 traffic is captive, contrary to the admonition of 49 U.S.C. 10707(d)(2)(A).⁶³ While it is true that not all >180 traffic is necessarily captive, Congress has defined market dominance such that all traffic over which a carrier has market dominance will be in the >180 traffic group. 49 U.S.C. 10707(d)(1)(A). Thus, the >180 group constitutes all potentially captive traffic. Because we cannot practicably make a market dominance determination in an individual case as to all the other traffic handled by the carrier(s) involved, the

⁵⁷ AAR Comments, V.S. Rockey/Costing Officers at 15-24.

⁵⁸ SHELL Reply at 4.

⁵⁹ For example, some railroads are apparently including some incorrect revenue data, inaccurate mileages, and understated lading weight. See, AAR Comments, V.S. Rockey/Costing Officers at 23; SHELL Reply, V.S. M. Hall at 11-12.

⁶⁰ SHELL submits, for example, that AAR should be able to identify and properly reflect inter- and intra-terminal moves, interchanges, and transit privileges. See, AAR Comments, V.S. Rockey/Costing Officers at 21-22; SHELL Reply, V.S. M. Hall at 10-11.

⁶¹ For example, SHELL asserts that private car costs could be properly reflected by adding one more one-digit field to the Waybill Sample. See, AAR Comments, V.S. Rockey/Costing Officers at 17-18; SHELL Reply, V.S. M. Hall at 8.

⁶² As SHELL points out, AAR has not documented or attempted to quantify many of the defects that it now alleges. SHELL Reply at 10-11, 14.

⁶³ AAR Comments at 42-43. Section 10707(d)(2) states:

"A finding by the Board that a rate charged by a rail carrier results in a revenue-variable cost percentage for the transportation to which the rate applies that is equal to or greater than 180 percent does not establish a presumption that--

- (A) such rail carrier has or does not have market dominance over such transportation; or
- (B) the proposed rate exceeds or does not exceed a reasonable maximum."

1 S.T.B.

next best (and clearly reasonable) approach is to base our analysis on all potentially captive traffic. This does not violate the admonition in section 10707(d)(2)(A), because a railroad is not thereby required to defend the reasonableness of the rates it is charging to any traffic other than the traffic at issue (for which market dominance must be affirmatively shown).

AAR further complains that the r/vc benchmarks treat all potentially captive traffic as homogeneous, not providing for differing degrees of differential pricing within the >180 group.⁶⁴ That is simply not the case. As stated above, we do not intend for the rates on all challenged traffic to be set at an average level. Indeed, the purpose of the R/VC_{COMP} test is to consider the degree of differential pricing applied to traffic with similar demand characteristics. Moreover, as pointed out in the 1995 *Decision*, slip op. at 23, the R/VC_{>180} test can and should be refined, where possible, to focus on a comparable subset of traffic within the >180 group.

Some shippers regard the >180 group as too restrictive and argue that <180 traffic should be included.⁶⁵ That would be inconsistent with the statute, however, which contains an express legislative determination that no traffic with rates set below 180% is captive. 49 U.S.C. 10707(d)(1)(A). The shippers note that an SAC analysis can produce a maximum reasonable rate below 180% (in which case we set the rate at 180%).⁶⁶ However, that is because an SAC analysis computes the rate level for a completely different carrier (a hypothetical, optimally efficient carrier transporting only a highly select group of traffic).

We now turn to the three r/vc benchmarks.

⁶⁴ AAR Comments at 41-42.

⁶⁵ NITL Comments at 12-13; SHELL Comments, V.S. D. Hall at 12; CLAY Comments, V.S. Fauth at 38. COAL suggests using the approximately 150% fully allocated cost level that was computed under former 49 U.S.C. 10731 as the dividing point for profitability. (COAL Comments at 13.) However, that figure was a national-average fully allocated cost figure that did not allow for optimal demand-based differential pricing and has been discredited for any other use. Moreover, as a rate cap that was limited to certain recyclable materials, former section 10731 was intended to achieve very different policy goals than those involved here.

⁶⁶ See, *West Texas Utilities Company v. Burlington Northern RR Co.*, 1 S.T.B. 638 (1996), *Burlington Northern R. Co. v. Surface Transp. Bd.*, 114 F.3d 206 (D.C. Cir. 1997).

RSAM Benchmark

The RSAM benchmark measures the uniform markup above variable cost that would be needed from every shipper of potentially captive traffic (the >180 traffic group) in order for the carrier to recover all of its URCS fixed costs. RSAM supplies a key component of a simplified rate reasonableness analysis, because it accounts for a railroad's need to earn adequate revenues, as required by 49 U.S.C. 10704(a)(2).

Because the statutory objective is for railroads to attain only the level of revenues that would be adequate "under honest, economical, and efficient management," RSAM was designed to include a managerial efficiency adjustment. This adjustment removes all of the revenue shortfall that results from a carrier's pricing of any of its traffic below the URCS variable costs of that traffic (the <100 traffic group). The objective of the adjustment is to relieve captive shippers from cross-subsidizing any traffic not covering its own (attributable) costs. The adjustment seeks to do that by taking into account the factors that we are directed to consider under Long-Cannon-1 (traffic that does not contribute to the going-concern value of the carrier) and Long-Cannon-2 (traffic that contributes only marginally to the carrier's fixed costs).

As AAR correctly points out, however, the RSAM adjustment is hampered by our cost measurement limitations and hence does not correspond exactly with the economic principles addressed in the statute. In economic terms, railroad costs are divided into attributable costs (the incremental costs associated with handling particular traffic) and unattributable costs (the joint and common costs incurred by a railroad). Attributable costs are subdivided into LRMC (the costs that would be rendered unnecessary, over the long term, if particular traffic were not handled by the railroad) and short-run marginal costs (SRMC) (the immediate or short-term costs that would not be incurred but for a particular individual shipment). (The term "going-concern value" in Long-Cannon-1 refers to SRMC.)

Because the marginal costs associated with handling particular rail traffic are not readily measurable, we rely on the variable costs produced by the URCS formula as proxy for LRMC. (Variable costs are a measure of the portion of rail industry costs that generally vary with the level of output.) The remaining (nonvariable) portions of the rail industry's costs are characterized as fixed costs

and are used as a proxy for unattributable costs. (A subset of total variable costs, known as directly variable costs (DVC), is used as a proxy for SRMC.⁶⁷)

As noted above, these URCS cost formulas are accepted and widely used costing measures for the rail industry. Indeed, they were used by AAR in the AAR-SSAC model, which was also programmed to eliminate all <100 traffic from its analysis. Nevertheless, AAR objects to the exclusion of the <100 shortfall from the RSAM measure.⁶⁸

AAR now argues that URCS Waybill costing significantly overstates attributable costs, and that excluding all of the <100 traffic thus would be overly broad.⁶⁹ AAR suggests that a more appropriate adjustment would be to exclude only the revenue shortfall produced by carrying any traffic at less than its DVC--a very minimal adjustment.⁷⁰

We agree that the URCS variable costs may include a significant portion of what may actually be unattributable joint and common costs. As AAR points out, URCS treats fully 50% of road ownership costs, and 70% of total operating expenses on average, as variable (and thus attributable to specific movements).⁷¹ Moreover, AAR has catalogued various waybill and costing limitations that it claims could cause profitable traffic to appear to be unremunerative.⁷²

⁶⁷ DVC includes fuel, train labor, track maintenance, switching, and station clerical costs. Variable cost elements that are excluded from DVC include maintenance-of-way and -structures, other overhead components of line-haul costs, management expenses, depreciation, interest on debt, and return on investment. See, *Cost Standards for Railroad Rates*, 364 I.C.C. 898 (1982), *aff'd*, *Water Transport Ass'n v. ICC*, 684 F.2d 81 (1982).

⁶⁸ CARS joins in AAR's criticisms of the RSAM adjustment.

⁶⁹ AAR further argues that, because we do not make this efficiency adjustment in our annual revenue adequacy determinations under 49 U.S.C. 10704(a)(3) (in computing whether individual carriers achieved revenue adequacy status in a particular year), it would be inconsistent to do so here. The two calculations are somewhat different, however. The annual determination looks broadly at the performance of the company (and affiliated companies) as a whole, whereas the RSAM calculation by design focuses more narrowly on the rail freight operations of the individual carrier involved.

⁷⁰ According to AAR, only 2.3% of all rail traffic (accounting for 0.3% of industry revenues) fails to recover its DVC. These figures are based on AAR's calculation that, industry-wide, DVC constitutes only 32.6% of full variable costs. (AAR Comments, V.S. Rokey/Costing Officers at 26-27.)

⁷¹ AAR Comments, V.S. Rokey/Costing Officers, Exhibit 1 at 2.

⁷² AAR Comments, V.S. Rokey/Costing Officers at 15-24. SHELL has responded to each of the 15 categories of costing errors identified by AAR. (SHELL Reply at 7-14.) SHELL points out that some of the defects listed by AAR are readily correctable by the railroads, while others
(continued...)

Shippers acknowledge these shortcomings but argue that, even if not a perfectly accurate measure of cross-subsidization, exclusion of the <100 traffic provides a reasonable surrogate for other inefficiencies in the railroad system.⁷³ But the shippers offer no support for making such a connection or for a bald assertion that the amount of revenue shortfall attributable to the <100 traffic group provides a reasonable approximation of all types of inefficiencies.

We are persuaded that adjusting RSAM to exclude the full shortfall from all <100 traffic would understate the revenue requirements that should be borne by captive shippers. Conversely, we are concerned that failing to include any efficiency adjustment at all (or making only the very minimal <DVC adjustment suggested by AAR) would overstate the revenue requirements that should be borne by captive shippers. That is because, based on our general experience and knowledge of the rail industry, we do not believe that the industry has yet become so efficiently sized that all of its current assets are used and useful and would warrant replacement as they wear out. Accordingly, the revenue contribution that should be required of the captive shipper group is less than what would be needed to provide for the replacement of all existing assets.

In short, the correct measure lies somewhere between the two figures that we can readily compute: RSAM as originally proposed (with the <100

⁷²(...continued)

reflect inherent costing limitations. Neither party attempts to measure the extent of the potential distorting effect of these claimed costing flaws, however, and so we cannot gauge their potential significance.

⁷³ NITL-COAL Reply at 24. Shippers view the RSAM adjustment as too limited, because it directly measures only pricing inefficiencies, not inefficiencies in plant or operating practices. See, *Coal Rate Guidelines*, 1 I.C.C.2d at 537-42. That is because the other two types of inefficiencies are not readily susceptible to across-the-board measurement. If a shipper complainant is aware of particular, significant inefficiencies in a defendant carrier's plant or operating practices, it can and should bring them to our attention in an individual case. This is part of providing additional, more particularized information, beyond the starting benchmarks. Absent such particularized evidence, however, we have no way of identifying such inefficiencies.

Shippers suggest that we can presume the existence of significant inefficiencies. They point to the railroad industry's gains in productivity in recent years, and suggest that there are additional gains in productivity yet to be realized. NITL-COAL Reply at 23-24. While that may be the case, the railroads are certainly no longer as inefficient as they were before realizing the past productivity gains, and we have no way of quantifying (on either an industry-wide or carrier-specific basis) the amount of additional productivity gains that may be achievable.

adjustment) and an unadjusted RSAM figure.⁷⁴ Thus, for purposes of a rate reasonableness analysis, we will look at both figures (the adjusted and unadjusted RSAM figures) and treat them as the relevant starting range for our consideration. Parties can and should address any specific efficiency considerations that apply to the particular carrier defendant(s) that would serve to narrow that range.

We are satisfied that, as modified to reflect an efficiency range, the RSAM benchmark provides an appropriate framework for assessing the extent of a carrier's revenue needs that can and should be recovered through differential pricing. We do not agree with DOE, however, that RSAM could serve as a single, all-purpose standard of rate reasonableness.⁷⁵ DOE's approach is premised on the general notion that a railroad can and should charge a single, uniform markup to all of its captive shippers.⁷⁶ Such an approach is fundamentally inconsistent with demand-based differential pricing principles. Thus, the RSAM analysis cannot provide a sufficient rate reasonableness standard, standing alone, even though it provides a necessary component of a multiple benchmark approach.

The parties have raised several other concerns regarding the RSAM computation beyond the efficiency adjustment. AAR complains that the RSAM calculation is based on the book value (historical costs) of a carrier's assets,

⁷⁴ For practical purposes, we do not distinguish between an unadjusted RSAM figure and an RSAM figure with a <DVC adjustment. The difference between the two figures would be negligible, because almost all traffic covers DVC. Accordingly, the reprogramming costs that would be required to enable us to compute a <DVC adjustment for every shipment in the Waybill Sample would not be justified.

⁷⁵ DOE Comments at 3-7. DOE would not apply the RSAM markup rigidly, however. In applying the RSAM markup to its traffic, DOE advocates allowing "judgmental adjustments" that it argues are necessary to guard against inflated or unrealistic numbers, to phase in downward rate adjustments, and to address rate structure issues (so as to preserve existing territorial distinctions). (*Id.* at 15-17.) DOE also advocates applying the RSAM markup to the costs associated with any competitive route, not necessarily the route actually used for the traffic. (*Id.* at 12-15.)

⁷⁶ DOE Comments at 6. DOE suggests that charging one captive shipper more than any other would violate Long-Cannon-3. (*Id.* at 7.) We believe that DOE misreads Long-Cannon-3, which takes a commodity-by-commodity approach rather than the all-shippers-are-equal approach DOE would take.

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rather than the cost to replace the assets. That is consistent, however, with how our annual revenue adequacy calculations are made.⁷⁷

Shippers, on the other hand, object to the RSAM calculation being based on the acquisition cost (book value) of the assets of some recently merged carriers, rather than original cost, when the acquisition cost is higher than original cost.⁷⁸ The use of acquisition costs is acceptable, however, because it reflects a cost that was actually incurred by the carrier in acquiring the assets and provides a more accurate reflection of the remaining value of that asset.⁷⁹

Shippers also argue against the inclusion of special charges in the costs to be recovered in the RSAM computation.⁸⁰ Special charges are generally used to account for severance payments to terminated employees or to write off obsolete equipment or road property. Shippers argue that these are not normal operating expenses, but reflect restructurings, and as such should not be charged to captive shippers. AAR counters that these are legitimate business expenses that are reflected in the annual revenue adequacy calculations.⁸¹

Special charges are nonetheless not reflected in the RSAM computation. As a practical matter, the URCS formula (from which the RSAM calculation is derived) does not account for these one-time charges. Moreover, on a conceptual basis, we are not persuaded that all of these costs are the types of expenses that should be recovered from the captive shipper group through differential pricing.

Table I, set forth below, shows the most recent RSAM range (from the unadjusted to the adjusted RSAM levels) for each of the major (Class I) railroads in the country. In addition to the years 1990-1993, for which the RSAM (adjusted and unadjusted) figures were shown in the *1995 Decision*, slip op. at 20 & n.21, Table I includes RSAM figures for 1994, as well as the more recent 4-year average for 1991-1994.

⁷⁷ See, *Standards for Railroad Revenue Adequacy*, 3 I.C.C.2d 261, 275-84 (1986) (rejecting current cost accounting).

⁷⁸ COAL Comments at 9; NITL Comments at 16-17; NITL-COAL Reply at 23 n.15.

⁷⁹ The use of acquisition costs in the RSAM calculations is also consistent with their use in the annual revenue adequacy calculations.

⁸⁰ NITL Comments at 17; CLAY Comments, V.S. Fauth at 42.

⁸¹ AAR Reply at 23 n.14, citing *Railroad Revenue Adequacy--1988 Determination*, 6 I.C.C.2d 933, 944-45 (1990).

Table I
RSAM Markup Percentages
(Range With & Without Efficiency Adjustment)

Railroad	4-Year Average	1994	1993	1992	1991
ATSF	292-444	263-406	280-430	312-472	314-469
BN	198-261	170-217	193-258	205-281	222-288
CNWT ⁸²	293-341	217-243	326-382	328-388	301-352
CR	237-267	210-242	229-256	244-271	266-298
GTW	297-395	296-388	284-380	315-406	294-406
IC	172-209	132-147	179-205	188-239	190-247
KCS	181-215	199-232	175-213	180-222	171-193
SOO	295-378	335-419	282-337	287-390	276-366
NS	195-226	192-223	200-232	185-215	201-234
CSX	224-262	217-261	223-251	223-255	235-280
SP	379-576	316-476	420-650	391-587	389-590
UP	183-244	176-226	188-240	178-266	189-246

As Table I shows, a carrier's RSAM figures fluctuate from year to year within certain general parameters. This is not surprising given the cyclical nature of railroad traffic,⁸³ and the effect can be minimized by applying a multi-year average (we use a 4-year averaging period), so as to smooth out annual

⁸² CNWT was combined with its parent company, UP, in 1995. Thus, CNWT is no longer a reporting class I railroad. In the future its figures will be included in the UP calculations.

⁸³ We note that, in general, a carrier's RSAM figures (both adjusted and unadjusted) go up as its carloadings go down and there is thus less traffic contributing to the railroad's fixed costs. Also, the larger the carrier's >180 traffic base, the more stable its RSAM levels.

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variations and minimize the impact of any year that may have been aberrational for that carrier.

Table I also shows that RSAM levels vary significantly by carrier. This is to be expected; carriers have differing revenue needs due to differing costs, and the average markup that each carrier would need on its >180 traffic is affected by the amount of >180 traffic in its traffic base, as well as the contribution to fixed costs that it collects from its <180 traffic. This may mean that a captive shipper will be required to pay a higher or lower markup based upon which carrier serves its traffic.⁸⁴ That is entirely appropriate, given the statutory directive to consider the individual defendant carrier's revenue needs in assessing the reasonableness of a challenged rate.

In addition, Table I shows that the range between the adjusted and unadjusted RSAM figures is quite broad for some carriers (generally those with the higher RSAM levels), while it is a much narrower band for other carriers. This is also not surprising. The range reflects the extent to which a carrier handles traffic at rates that produce r/vc ratios below 100%. This can be much greater for some carriers than for others, based upon the composition of the carrier's traffic,⁸⁵ its pricing practices,⁸⁶ and the density of traffic on its lines.

Finally, we caution that, because the RSAM (and other benchmark) figures represent average markups, they are only a starting point in the analysis. How a particular carrier's revenue requirements can and should be allocated within its traffic base--i.e., the proper markup to be applied to individual traffic components--is affected by such factors as the mix of competitive and captive traffic handled by that carrier, the degree of competition that it faces on its

⁸⁴ As noted in the 1995 *Decision*, slip op. at 17, captive shippers can expect that, other factors being equal, the stronger a carrier's traffic base and the denser its routes, the lower the markup that the carrier will need to charge to individual captive shippers.

⁸⁵ For example, we note that a large amount of intermodal trailer-on-flatcar or container-on-flatcar (TOFC/COFC) traffic moves at low r/vc ratios. In the 1994 Waybill Sample, over half of the <100 traffic was TOFC/COFC traffic. Moreover, the average r/vc ratio for the <100 TOFC/COFC traffic was 65%, as compared to an average r/vc ratio of 75% for the remaining (non-TOFC/COFC) <100 traffic in the 1994 Waybill Sample.

⁸⁶ Some carriers may engage in more paired or companion pricing arrangements, under which the rates on some traffic may be set at an artificially low level but offset by higher rates on related traffic. Indeed, a third of the <100 traffic in the 1994 Waybill Sample was contract traffic, suggesting that the low return on this traffic was deliberate. The average r/vc ratio on the contract <100 traffic was 70%. (Less than half of the contract <100 traffic was TOFC/COFC traffic.)

competitive traffic, and the relative density of the routes that it operates. Moreover, the specific markup charged to particular traffic should reflect demand-based differential pricing principles.

R/VC_{COMP} Benchmark

The R/VC_{COMP} benchmark provides a means of reflecting demand-based differential pricing principles. The benchmark measures the markup taken on >180 traffic that involves similar commodities moving under similar transportation conditions. The test is admittedly crude; as noted in the *1995 Decision*, slip op. at 21, the comparison traffic is not likely to have precisely the same degree of demand elasticity. Nevertheless, it is the only simple means available to obtain even a rough measure of this very important pricing factor.

AAR argues that, because URCS does not accurately measure marginal costs, r/vc ratios do not accurately measure markups over marginal costs and thus do not provide a good measure of demand elasticity.⁸⁷ As we stated above, neither marginal costs nor demand elasticity is readily measurable. Consequently, railroads do not directly measure demand elasticity in setting their rates, and we too must resort to a next-best, indirect means of reflecting demand-based differential pricing principles in our rate reasonableness review. We are satisfied that comparison of r/vc ratios (a markup expressed in terms of variable costs), while not a refined measure, gives at least a rough indication of relative degree of captivity.⁸⁸ Moreover, the R/VC_{COMP} benchmark evidence can be supplemented, where appropriate, with specific evidence as to why the markup on the traffic at issue should be higher or lower than that of the comparison traffic. We believe this imperfect approach is far preferable to abandoning any effort to take demand-based differential pricing into account in a simplified analysis.

AAR further broadly asserts that a correct comparison group cannot be formed because similar transportation conditions do not necessarily indicate a

⁸⁷ AAR Comments at 47.

⁸⁸ A simple rate comparison, as advocated by UTU (UTU Comments at 2), would not accomplish the same purpose. A rate comparison (expressed in dollar terms) would not account for such variables as differing lengths of haul or other movement-specific costs (reflecting, for example, differing terrain or efficiency of operation).

similar relative degree of demand elasticity.⁸⁹ We recognize that we cannot measure demand elasticity precisely. Nevertheless, we believe that the markups applied to a similar commodity moving under similar transportation conditions can provide some rough indication of the relative degree of demand elasticity for that type of traffic,⁹⁰ if the comparison group contains a sufficient amount of traffic.⁹¹ However, if particular traffic is not truly comparable, the parties can and should bring that to our attention in an individual case.

There may well be some cases in which there is no readily identifiable traffic that is truly comparable.⁹² In those instances, we may have to forgo what the R/VC_{COMP} benchmark would add to the analysis if it were available, and be guided only by the other two benchmarks--the RSAM measure and the fairness of how the carrier is pricing that commodity in relation to other commodities that it handles (the $R/VC_{>180}$ measure, discussed more fully below). But we should not forgo an otherwise useful benchmark in all cases simply because it might be unavailable in some cases.

AAR complains that an R/VC_{COMP} test inherently presumes that, where comparison traffic is priced below the issue traffic, the issue traffic is

⁸⁹ AAR Comments at 50.

⁹⁰ To be similar traffic, the comparison traffic should involve a similar commodity handled in a similar product (and perhaps geographic) market moving similar distances at an r/vc level above 180. The comparison traffic must involve a commodity that is not readily susceptible to transportation by another available mode (at least at the distances involved in the complaint). Because rail-dependent traffic usually does not have a choice between two rail carriers for the entire move, a commodity that requires rail service is likely to be subject to a railroad's market power. It is thus fair to presume that properly-selected comparison traffic will have a similar degree of demand elasticity.

NDAK has offered an assertedly objective means of constructing a comparison group using statistical estimation procedures to capture the effect of various transportation characteristics on market power. (NDAK Comments, V.S. Tolliver/Bitzan at 5-12.) While a party is not precluded from presenting evidence in an individual case using the NDAK procedures, we do not adopt those procedures. If used, we would still need to examine the resulting traffic group critically to assure ourselves that it consists of reasonably comparable traffic.

⁹¹ AAR points out that, in some cases, the Waybill Sample might not contain sufficient records from which to draw a representative comparable traffic group. (AAR Comments, V.S. Rockey/Klick at 34.) CLAY suggests that, to obtain sufficient records, we require carriers to submit their complete traffic data tapes. (CLAY Comments, V.S. Fauth at 30.) Complete traffic tapes could be so massive and unwieldy, however, as to be inconsistent with the objective of simplified procedures.

⁹² For example, in *Car Parts II*, both sides challenged the comparison group that had been used by the ICC, but neither could identify an acceptable substitute comparison group.

overpriced, rather than the comparison traffic being underpriced.⁹³ AAR suggests that the R/VC_{COMP} figures would thus simply perpetuate the inadequate rate structure of carriers that have not yet achieved long-term revenue adequacy.⁹⁴ That may be a valid concern and is a result to be guarded against. That is why an R/VC_{COMP} test is not sufficient, standing alone, and must be supplemented with the RSAM measure, which takes the defendant carrier's revenue needs into account.

AAR further notes that the correct Ramsey pricing level is a factor not only of demand elasticity, but of railroad-specific elements as well.⁹⁵ The railroad-specific variables include the particular revenue requirements of each carrier and the available revenue contribution from other sectors of each carrier's traffic base. Where the comparison is actually affected significantly by such differences among carriers, however, that fact can and should be brought to our attention in an individual case.⁹⁶ In such instances, we might decide that we can adjust for such differences in our analysis, or we might conclude that there is no valid comparison available in that case.⁹⁷

AAR expresses continued concern about the potential feed-back effect of continued application of an R/VC_{COMP} benchmark, which could result in an eventual ratcheting down of rates.⁹⁸ We agree with shippers that downward ratcheting is a more theoretical than practical concern at this point, and is

⁹³ AAR Comments at 48-49. We note that the defendant carrier has an opportunity to rebut that presumption with particularized evidence in an individual case.

⁹⁴ AAR Comments at 49.

⁹⁵ AAR Comments at 48.

⁹⁶ NDAK suggests adjusting for each carrier's relative operating efficiency by comparing the percentage change in the productivity of each carrier (over the same 4-year period used for the RSAM and R/VC_{-180} benchmarks), as measured by the carrier's average variable cost per ton. (NDAK Comments, V.S. Tolliver/Bitzan at 12-17.) We take no position on whether such an adjustment would be practical and useful in an individual case. We will leave such a determination for a case in which a party decides to present such evidence.

⁹⁷ There may well be cases in which the R/VC_{COMP} benchmark cannot be included in the analysis for lack of appropriate comparison traffic. As the ICC noted, captive rail traffic moving in small or isolated shipments can be such unusual traffic that it may be difficult to obtain a sufficient data base of similar traffic to use for comparison. *1995 Decision*, slip op. at 7 & n.12, citing *Car Parts II*.

⁹⁸ AAR Comments at 49.

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something that we could address if and when it might occur.⁹⁹ The downward ratcheting argument assumes the unlikely occurrence of a succession of cases involving the same commodity, market dominance in each case, the use of a comparison group that ships the same commodity as the issue traffic,¹⁰⁰ and a Board prescription lowering the rates in each case.¹⁰¹ Moreover, it assumes that the R/VC_{COMP} measure would be determinative in a multiple-indicator analysis, which is not necessarily so. In any event, we could avoid the downward ratcheting result by excluding from the comparison group any traffic moving under prescribed rates.¹⁰²

Finally, AAR voices concern that there is the potential for inconsistency if the variable cost component is computed differently for the issue traffic than it is for the other traffic measured by the three r/vc benchmarks.¹⁰³ Accordingly, AAR argues that movement-specific cost adjustments should not be allowed for the issue traffic.¹⁰⁴ Shippers argue that the greater accuracy obtained through movement-specific costing is preferable to reliance on system-average

⁹⁹ COAL Comments at 13-14; NITL Comments at 20 n.14; CLAY Comments, V.S. Fauth at 33-35; NDAK Reply at 4.

¹⁰⁰ In an individual case, the comparison traffic could involve a similar commodity, as in *Car Parts I*, rather than exactly the same commodity as the issue traffic. In such a situation, any resulting rate prescription ought not to affect the comparison traffic.

¹⁰¹ CLAY counters that repetitive application of the R/VC_{COMP} test could have the opposite effect--it could lead to an upward rate spiral, if the comparison traffic should have a higher r/vc level than the issue traffic and the defendant carrier should decide to raise its markup to the level of the comparison traffic. CLAY Comments, V.S. Fauth at 35.

¹⁰² We also note that, as observed in the *1995 Decision*, slip op. at 30 n.37, use of the formula approach would avoid the potential for downward ratcheting. That is because the two measures that could be affected by any feedback (the R/VC_{COMP} and $R/VC_{>180}$) appear in both the numerator and denominator of the formula, so that future downward revisions should substantially cancel each other out. (The RSAM measure would be unaffected by rate prescriptions, as it is not derived from actual rates for >180 traffic.)

¹⁰³ AAR Reply, V.S. Rockey/Klick at 29.

¹⁰⁴ *Id.* at 29-30. It is well-established practice to allow movement-specific cost adjustments in rate cases for purposes of determining whether the 180% jurisdictional floor is exceeded. *E.g.*, *West Texas Utilities Company v. Burlington Northern RR Co.*, 1 S.T.B. at 717-730. Such adjustments--to reflect the actual cars used, actual lading weights, and actual train equipment, crew, and operations involved--are possible and appropriate where such information is known and differs from the carrier's system average data. Most such movement-specific adjustments are more likely to arise with unit-train traffic (because those train operations are more discrete and dissimilar from the carrier's general operations) than they are with the type of traffic that would be handled under simplified procedures.

costing.¹⁰⁵ They suggest that, to obtain consistency, the better approach would be to allow movement-specific cost adjustments for the comparison traffic where possible.¹⁰⁶ We agree that movement-specific costing is preferable¹⁰⁷ and should be allowed for both the issue traffic and the comparison traffic.

R/VC_{>180} Benchmark

The R/VC_{>180} benchmark adds a third component to the analysis. It measures the degree of differential pricing actually being practiced by that carrier, *i.e.*, the extent to which the carrier is marking up its >180 traffic on average. The purpose is to consider the fairness of the defendant carrier's rate structure, as judged by Long-Cannon-3, to ensure that the complaining shipper's traffic is not bearing a disproportionate share of the carrier's revenue requirements vis-a-vis other relatively demand-inelastic traffic without good cause.

AAR criticizes the R/VC_{>180} measure for ignoring the carrier's revenue needs and the demand elasticity of the traffic.¹⁰⁸ Those criticisms, however, merely underscore the fact that the R/VC_{>180} measure would not be an adequate test by itself and should be supplemented by the RSAM and R/VC_{COMP} measures.

AAR also criticizes the R/VC_{>180} measure as insensitive to traffic volumes and the actual distribution of markups within a carrier's >180 traffic.¹⁰⁹ That is why the R/VC_{>180} analysis ought not end with the average R/VC_{>180} figure. As explained in the *1995 Decision*, slip op. at 23-24, the R/VC_{>180} measure can be refined to focus on specific subsets of a carrier's traffic, and the parties can suggest more appropriate uses of the underlying data.

For example, if the traffic at issue moves in single-car shipments, the carrier's average markup on single-car >180 traffic may be more important to the

¹⁰⁵ COAL Comments at 15-16; COAL-NITL Reply at 33-36.

¹⁰⁶ COAL-NITL Reply at 36; CLAY Comments, V.S. Fauth at 33-34. AAR suggests that inconsistency is a problem not just with the R/VC_{COMP} measure, but with the RSAM and R/VC_{>180} measures as well. We do not believe that the RSAM and R/VC_{>180} measures would require movement-specific adjustments, however. Because the RSAM and R/VC_{>180} measures are themselves system average figures, we see no inconsistency in applying system average costs to obtain them.

¹⁰⁷ Indeed, AAR claims that railroad management costing tools are more accurate because they are movement-specific. AAR Comments, V.S. Marketing Officers at 6-7.

¹⁰⁸ AAR Comments at 51-52.

¹⁰⁹ AAR Comments, V.S. Rockey/Klick at 32-33.

rate reasonableness analysis than its average markup on all traffic (which include unit-train and multiple-car traffic). Or the $R/VC_{>180}$ analysis can include an assessment of the distribution of the carrier's markups. A statistical study showing that the markup for the complaining shipper's traffic is within a certain range of the average may be instructive in determining whether the carrier's pricing of the traffic at issue is out of line with its pricing of other demand-inelastic traffic. As these examples illustrate, a modified $R/VC_{>180}$ approach offers considerable flexibility to tailor the analysis to the particular case.

In short, an $R/VC_{>180}$ analysis would not automatically result in reducing rates to the average $R/VC_{>180}$ level, even if $R/VC_{>180}$ were the only test to be applied (which it would not be). Thus, AAR's downward rate ratcheting argument (discussed above in regard to the R/VC_{COMP} measure and repeated by AAR with respect to the $R/VC_{>180}$ measure) remains unpersuasive. It assumes widespread application of the $R/VC_{>180}$ measure to reduce rates to the average level, a prospect which we believe is not a practical concern at this point, and one that we are prepared to guard against.

Table II, set forth below, shows the most recent average $R/VC_{>180}$ levels for each of the major (Class I) railroads in the country. It is updated from the table in the *1995 Decision* to include 1994 figures, as well as the more recent 4-year average (for the period 1991-1994).

Table II

Average Existing Revenue-to-Variable Cost Percentages
For Traffic Above 180% R/VC

Railroad	4-Year Average	1994	1993	1992	1991
ATSF	268	294	265	265	250
BN	236	238	238	237	231
CNWT ¹¹⁰	297	362	286	283	256
CR	214	227	216	208	206
GTW	205	224	209	201	184
IC	285	294	282	284	281
KCS	201	222	217	198	168
SOO	255	223	240	284	272
NS	229	230	222	233	232
CSX	207	231	196	199	201
SP	257	280	248	253	248
UP	227	226	219	234	229

¹¹⁰ CNWT was combined with its parent company, UP, in 1995. Thus, CNWT is no longer a reporting class I railroad. In the future, its figures will be included in the UP calculations.

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Combined Application

AAR argues that each of the three benchmark measures fails its assigned purpose, and that combining the three does not make up for their individual failings.¹¹¹ We disagree with AAR's assessment of each benchmark, as discussed above. While none of the benchmarks is perfect, we are satisfied that each is instructive for a simplified rate reasonableness analysis. Taken together, they allow us to consider each of the relevant statutory factors. At the same time, each measure serves as a check on the other two. Moreover, as explained above, the three benchmarks are only the starting point for our analysis. They can and should be supplemented, as appropriate, with any particularized evidence that would qualify or modify what one or more benchmarks might otherwise indicate. We are confident that a careful analysis of these three benchmarks, together with whatever supplementary evidence is provided in a case, should enable us to meet our modest objective--to make at least a rough call as to rate reasonableness in those cases where a more precise determination is not possible.

The *1995 Decision* addressed two possible ways to combine these three measures in our rate reasonableness analysis. *1995 Decision*, slip op. at 25-30. One is to treat the three measures as multiple indicators that together provide a landscape of the relevant pricing considerations, without assigning preset weight to each figure. The other is to combine them into a predetermined formula that produces a single starting point for our reasonableness assessment.

The landscape approach recognizes that the facts and circumstances underlying each captive rate challenge will be unique, and allows for the circumstances of each case to drive the analysis from the outset. The landscape approach would thus leave it to the parties in each case to explain how, in light of the particular circumstances of that case, the information gained from each measure contributes to the ultimate rate reasonableness determination.¹¹² As noted in the *1995 Decision*, slip op. at 26, the considerable flexibility that this

¹¹¹ AAR Comments at 52-55.

¹¹² For example, as pointed out in the *1995 Decision*, slip op. at 26, it may be that a railroad is so far from the revenue adequacy goal that it should be allowed a greater degree of differential pricing on its captive traffic than might be indicated by the other factors. Or it may be that a captive shipper's rate reflects such a significantly higher and unjustified markup over variable cost than that assessed on the carrier's other >180 traffic that affording equitable relief under Long-Cannon-3 may become the most significant concern in a case.

approach offers can be viewed as a major advantage, or it can be seen as a serious drawback if a more predictable yardstick measure is desired.

For that reason, the ICC staff devised a formula to give more structure to the joint consideration of the three benchmarks. Because we have now decided to modify the RSAM benchmark, however, to encompass a range, the formula does not produce a precise solution. To reflect the RSAM range, the formula would need to be computed twice, once to reflect each end of the RSAM range. This two-step application of the formula would then yield not a single number, but a range.¹¹³ In this respect, the formula may be rendered less useful, in terms of providing a predictable yardstick, than originally envisioned.

The formula, as set forth in the *1995 Decision*, slip op. at 27, is as follows:

$$\text{Markup} = \frac{\text{RSAM}}{\text{R/VC}_{>180}} \cdot \text{R/VC}_{\text{COMP}}$$

The RSAM and $\text{R/VC}_{>180}$ figures are both measurements of an average markup on the same traffic (the >180 portion of the defendant carrier's traffic base). The relationship between these two figures--the fraction in the equation--thus serves as a revenue need adjustment factor that is then applied to the benchmark reflecting demand-based differential pricing principles ($\text{R/VC}_{\text{COMP}}$).

Where the average markup that the carrier would need on its >180 traffic in order to recover all of its URCS fixed costs (the RSAM measure) is higher than the average markup that the market permits the carrier to actually apply to its >180 traffic (the $\text{R/VC}_{>180}$ measure), the carrier is not achieving sufficient differential pricing to meet the revenue need standard represented by RSAM.¹¹⁴ The greater the difference between the two benchmarks, the greater the upward adjustment to the carrier's average rates on its >180 traffic that would be needed. A comparable upward adjustment to the level of the markup that would otherwise be indicated by the $\text{R/VC}_{\text{COMP}}$ measure would also appear to be supportable, to account for the particular revenue needs of the defendant carrier.

Conversely, where the RSAM figure (the average markup on the >180 traffic required for the carrier to recover all of its URCS fixed costs) is lower than the $\text{R/VC}_{>180}$ measure (the actual average markup on that traffic), the carrier

¹¹³ The range will be broader for some carriers than for others.

¹¹⁴ Comparing the latest 4-year average figures shown in Tables I and II above, we note that five of the 12 Class I carriers--Conrail, Grand Trunk Western, Soo, CSX, and Southern Pacific--had an RSAM range that, even at the lowest end, was higher than the carrier's $\text{R/VC}_{>180}$ measure.

is exacting a greater markup than necessary to meet the revenue need standard represented by RSAM.¹¹⁵ The greater the difference between the two benchmarks, the greater the downward adjustment to the carrier's average rates on its >180 traffic that would still permit it to meet the RSAM revenue need standard. A comparable downward adjustment to the level of the markup that would otherwise be indicated by the R/VC_{COMP} measure would also appear to be supportable, to account for the lesser revenue needs of the defendant carrier.

Finally, where the $R/VC_{>180}$ measure is within the RSAM range,¹¹⁶ the formula would be inconclusive. On the one hand, if the full RSAM efficiency adjustment were appropriate for the defendant carrier, then its differential pricing would be more than ample to meet the RSAM revenue need standard. On the other hand, if the carrier were pricing efficiently (so that no adjustment is warranted), its differential pricing of >180 traffic would be inadequate. Unless we were able to narrow the range within which the carrier needs to price its >180 traffic on average to meet the RSAM standard, the formula itself would not tell us whether the rate level indicated by the R/VC_{COMP} benchmark should be adjusted upward or downward (or not adjusted at all).

The fact that, with the introduction of an RSAM range, the formula may be indecisive in some cases would not invalidate its use in other cases. Indeed, the formula was never intended to provide a final result, but only the starting point for a more particularized analysis.

As explained in the *1995 Decision*, slip op. at 29, the formula can be expressed differently (without changing its numeric value) by algebraically rearranging its terms as follows:

¹¹⁵ Again comparing the latest 4-year average figures shown in Tables I and II above, we note that two of the 12 Class I carriers--Illinois Central and Norfolk Southern--had an RSAM range that, even at its highest (unadjusted) end, was lower than the carrier's $R/VC_{>180}$ measure.

We recognize that neither of these carriers was revenue adequate, according to our annual calculations, for the full 4-year period. That is because the unadjusted RSAM measure differs somewhat from our annual revenue adequacy calculation. For example, the unadjusted RSAM measure excludes costs that are not associated with ongoing rail operations and thus should not be borne by captive shippers through differential pricing.

¹¹⁶ According to the latest 4-year average figures shown in Tables I and II above, five of the 12 Class I carriers--Santa Fe, Burlington Northern, Chicago North Western, Kansas City Southern, and Union Pacific--had an $R/VC_{>180}$ measure that was within its RSAM range.

$$\text{Markup} = \frac{R/VC_{\text{COMP}}}{R/VC_{>180}} \cdot \text{RSAM}$$

Viewed in this way, the fraction in the equation--which compares the R/VC_{COMP} measure (the average markup applied to comparable traffic) with the $R/VC_{>180}$ measure (the average markup applied to the defendant carrier's >180 traffic base)--serves as a demand adjustment factor for differential pricing to be applied to the initial RSAM measure (the benchmark reflecting revenue need).

Where the average markup on comparable traffic (the R/VC_{COMP} measure) is higher than the defendant carrier's average markup on its >180 traffic (the $R/VC_{>180}$ measure), then the appropriate average markup that reflects the defendant carrier's revenue need (as represented in the RSAM range) is adjusted upward to account for the relatively greater demand inelasticity of the type of traffic at issue, as reflected by carrier pricing practices for comparable traffic. Demand-based pricing principles are accommodated through this adjustment to the revenue need (RSAM) benchmark. The greater the difference between the R/VC_{COMP} and $R/VC_{>180}$ measures, the greater the upward adjustment to the average markup that would otherwise be indicated by the RSAM measure that would appear to be supportable.

Conversely, where the markup for comparable traffic (the R/VC_{COMP} measure) is lower than the defendant carrier's average markup (the $R/VC_{>180}$ measure), then the benchmark that reflects the defendant carrier's revenue need (as represented by the RSAM range) is adjusted downward to account for the relatively lesser demand inelasticity of the type of traffic at issue. The greater the difference between the R/VC_{COMP} and $R/VC_{>180}$ measures, the greater the downward adjustment to the average markup that would otherwise be indicated by the RSAM benchmark that would appear to be supportable.

Again, with the introduction of an RSAM range, application of the formula will not produce a single number, but rather a range. That range is unaffected by which way the formula is expressed. Thus, where the rate charged produces a markup that is within the range resulting from the formula, application of the formula will continue to be inconclusive.

The commenting shippers were divided on whether, in applying the Multiple R/VC Benchmarks proposal, we should use the landscape or the

formula approach. Some prefer the landscape approach for its flexibility.¹¹⁷ Others voiced a preference for the formula approach because of its greater predictability.¹¹⁸ The predictability offered by the formula is somewhat diminished, however, by the introduction of an RSAM range.

We conclude that it ought not to matter whether a shipper complainant opens its case with a landscape or formula-based presentation.¹¹⁹ Under either approach, each of the benchmarks will be introduced and can be subjected to scrutiny. Moreover, under either approach, the benchmarks serve merely as the starting point of an analysis that should be further developed and tailored to the individual case.¹²⁰ Thus, the choice of which approach to use in the initial presentation ought not to affect the outcome.

Availability of the Simplified Procedures

The commenting parties have also addressed the issue of when the simplified procedures that are adopted here should be applied in a case. See *1995 Decision*, slip op. at 30-31. CLAY advocates a case-by-case approach, in which the procedures to be applied--CMP or the simplified procedures--would be determined in each case after the complaint is filed.¹²¹ Most other commenters advocate a bright-line test that would establish in advance presumptive eligibility requirements for use of these simplified procedures. There is no consensus, however, on what that test should be.

AAR advocates a value-of-remedy test and asserts that the simplified procedures should only be available in those cases in which the total amount of

¹¹⁷ See, COAL Comments at 16-18; CLAY Comments, V.S. Fauth at 43-44.

¹¹⁸ See, NITL Comments at 14-15; SHELL Comments, V.S. D. Hall at 15-16. NITL suggests that, in applying the formula to joint rates, we weight each carrier's participation by their portion of the total mileage of the movement. (NITL Comments at 15.) For merged carriers, NITL suggests that we weight each carrier's RSAM and R/VC₁₈₀ figures by their respective ton-miles. (*Id.*)

¹¹⁹ We note that the formula approach will not be possible where a suitable comparison group is not available.

¹²⁰ We note that SHELL's objection to the landscape approach--on grounds that it introduces issues for litigation and thereby increasing litigation costs--reflects the mistaken assumption that the formula approach would not permit or entail such litigation. (SHELL Comments, V.S. D. Hall at 15.) The NITL group, on the other hand, correctly recognizes that the formula only provides a starting point for a more searching rate reasonableness inquiry. (NITL Comments at 19-20.)

¹²¹ CLAY Comments, V.S. Fauth at 45-47; CLAY Reply, V.S. Fauth at 38.

reparations sought, together with the present value of the rate reductions sought to be prescribed for the future, is less than \$250,000.¹²² Shippers generally object to a value-of-remedy test. They argue that railroads could manipulate the amount at stake (by adjusting their rates or rate structure) so as to deprive a shipper of the opportunity to use the simplified procedures.¹²³ They also argue that a one-size-fits-all cut-off point for using CMP is not appropriate because the cost of a SAC presentation increases with each origin-destination (O-D) pair involved in the complaint.¹²⁴ Finally, they argue that a rate prescription becomes less useful or valuable over time, as underlying market conditions change, so that the valuation of a potential rate prescription should not include distant years.¹²⁵

COAL suggests that, if a value-of-remedy test were used, any case whose value is below \$2,500,000 should qualify for the simplified procedures.¹²⁶ Moreover, COAL would increase that ceiling by 10% for each additional O-D pair contained in the complaint, up to a maximum 200% increase, to reflect the increased costs of a SAC presentation.¹²⁷ COAL adds that there should be no ceiling in those cases where there are basic issues as to SAC's fundamental appropriateness and feasibility.¹²⁸

The commenting shippers generally advocate a test based on the tonnage of traffic and/or the number of O-D pairs involved in the complaint. NGFA proposes that the simplified procedures be available in those cases involving (a) less than 500,000 tons per O-D pair over a 5-year period (2 years of reparations and 3 years of a rate prescription) or (b) more than 5 O-D pairs.¹²⁹ NITL would make the simplified procedures available when the traffic included in the

¹²² AAR Reply at 4.

¹²³ COAL Comments at 19; NITL Comments at 23; CLAY Comments, V.S. Fauth at 46; DOE Reply at 35.

¹²⁴ COAL Comments at 19-20; DOE Comments at 18; NGFA Comments at 7; NITL Comments at 21-22.

¹²⁵ NGFA Comments at 12-13 (suggests 3-year valuation); NITL Comments at 23 & n.19 (same); CLAY Reply V.S. Fauth at 38 (5-year value). AAR's calculations evidently assume a 7-year valuation period, which NGFA argues is an unrealistically long commercial life expectancy for a rate prescription. (NGFA Reply at 15 n.7.)

¹²⁶ COAL Comments at 19.

¹²⁷ *Id.* at 19-20.

¹²⁸ *Id.* at 20.

¹²⁹ NGFA Comments at 14.

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complaint does not exceed 500,000 tons per year per O-D pair.¹³⁰ COAL would use a baseline figure of 600,000 tons per year per O-D pair, plus an additional 10% tonnage for each additional O-D pair, up to a maximum 200% increase in tonnage.¹³¹ SHELL originally proposed a figure of 750,000 tons per year per O-D pair.¹³² Finally, DOE suggests that the simplified procedures be available when the complaint involves less than 1,000,000 tons per year or involves shipments that are sporadic or scattered nationwide.¹³³

Other forms of measurement have also been suggested. DOT would base the availability of the simplified procedures on the size of the shipper, measured by either its total revenues or its total rail charges.¹³⁴ For example, DOT suggests that any shipper whose freight bill is less than \$1,000,000 per year should presumptively qualify for the simplified procedures.¹³⁵ SHELL, on the other hand, maintains that all captive traffic not moving in unit-train configurations should be eligible for the simplified procedures and that no other eligibility requirements should be imposed.¹³⁶

AAR argues that none of the bright-line tests suggested by the other commenters is supportable.¹³⁷ Moreover, AAR complains that each of the tests suggested by the other parties would bring almost all rail traffic in the country under the simplified procedures,¹³⁸ wrongly supplanting CMP where CMP can and should be used.¹³⁹

We agree that the various tonnage-based tests that have been suggested are unsupported and would be overly sweeping in their reach. The same is true of the size-of-shipper and less-than-unit-train tests that have been suggested. We are not prepared to adopt a bright-line value-of-remedy test either. A value-of-

¹³⁰ NITL Comments at 24.

¹³¹ COAL Comments at 19-20.

¹³² SHELL Comments, V.S. D. Hall at 16.

¹³³ DOE Reply at 34.

¹³⁴ DOT Comments at 13.

¹³⁵ *Id.*

¹³⁶ SHELL Reply, V.S. D. Hall at 10.

¹³⁷ AAR Reply at 11-15.

¹³⁸ *Id.* at 9-11.

¹³⁹ AAR points out that CMP can be and has been used in cases involving numerous O-D pairs and tonnages below 500,000. AAR Reply at 13, citing *Metropolitan Edison Co. v. Conrail, et al.*, 5 I.C.C.2d 385 (1989), and *McCarty Farms, Inc. v. Burlington N.R.R.*, No. 37809(Sub-No. 1), embraced in *McCarty Farms, Inc., et al. v. Burlington Northern, Inc.*, No. 37809 (a pending case).

remedy test is meant to identify those cases in which it would not be cost-effective to make a SAC presentation. It is not possible to delineate those cases in the abstract, however, because there is no standard cost for a SAC presentation.¹⁴⁰ Moreover, we are concerned that any such preset size-of-case test can be manipulated by shippers that are willing to structure individual complaints so as to shoehorn into whatever size limits may be set for the use of these simplified procedures.

We are unwilling to adopt any bright-line test that could inadvertently sweep in any cases in which CMP can and should be used. Some shippers suggest that a complainant that would qualify to use the simplified procedures under a bright-line test should have the option of proceeding under CMP.¹⁴¹ This wrongly implies that CMP is optional. To the contrary, CMP is the required method where it is available. We will not use a method that is inferior to CMP where we are satisfied that CMP could be applied.

Accordingly, any determination to apply the simplified procedures must be made on a case-by-case basis. In order for us to make that determination, a complaining shipper wishing to use the simplified procedures must demonstrate,

¹⁴⁰ In the *1995 Decision*, slip op. at 4 n.2, the ICC stated that estimates for presenting a SAC analysis range from \$250,000 to \$1,000,000. AAR asserts that these figures are overstated, while shippers argue that they are understated. AAR claims that a SAC presentation could be made for as little as \$25,000 to \$85,000. (AAR Reply at 4-5.) Shipper commenters, on the other hand, call the \$250,000 figure unrealistically low, and argue that the cost of a SAC presentation can easily exceed \$1,000,000 where there are long distances, multiple railroads or multiple O-D pairs involved. (NGFA Comments at 6-7; NITL Comments at 21-22.) None of the commenters, however, offers any evidence to support its cost estimates.

Shippers point out that the costs of preparing a SAC presentation are greater for a shipper complainant than for a railroad defendant, for several reasons. First, the defendant railroad already possesses most of the information needed to prepare a SAC analysis, whereas the shipper must engage experts and undertake discovery procedures to obtain that information from the carrier. Second, the defendant railroad has no incentive to seek out the least-cost most-efficient SAC scenario, so its analysis can be less searching and more streamlined than a shipper's. Third, the shipper complainant must make two SAC presentations (an opening and a rebuttal), whereas the defending railroad need only make one. (NITL-COAL Reply at 29-30.)

Finally, shippers note that a SAC presentation is not the only litigation cost that a shipper complainant incurs, and thus is not the only cost that must be factored into a cost-benefit analysis. The complaining shipper may also need to address in considerable detail the threshold jurisdictional requirement (the 180% r/vc test) and establish market dominance. Shippers assert that the costs of making and defending these showings can equal or exceed the cost of making a SAC presentation. (*Id.* at 30.)

¹⁴¹ COAL Comments at 18; NGFA Comments at 5.

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at the outset of a proceeding, that CMP is not available. The shipper should address the following factors:

- (1) The feasibility and anticipated cost of preparing a SAC presentation in that particular case. (A SAC presentation may not be feasible if the traffic is so sporadic or dispersed as to make a SAC presentation unmeaningful.) The evidence of anticipated cost may include actual quotations for preparing a SAC presentation in that specific case.
- (2) An estimate of the other costs to be incurred in pursuing the rate complaint, including participating in the jurisdictional threshold and market dominance aspects of a proceeding.
- (3) The full relief sought, including all reparations as well as the level and duration of any rate prescription.
- (4) The present value of the relief sought, obtained from applying an appropriate discount rate and appropriate time horizon to the relief sought.

As shippers point out, a SAC presentation would not be cost-effective unless the value of the expected remedy exceeds the expected cost of obtaining the remedy by a sufficient margin to make it worthwhile to pursue the complaint.¹⁴² If the costs of pursuing a complaint would consume most or all of the expected recovery, then the remedy would be a hollow one for the complainant.

Invoking the Simplified Procedures

Any issue as to whether a case will proceed under CMP or the simplified procedures must be resolved at the outset of the case. No separate determination is required if a complainant intends to proceed using CMP, because CMP is the required method where it is available. If a complainant seeks to use the

¹⁴² Some shippers suggest using a multiplier of three as the necessary margin between the expected costs and expected recovery. (NGFA Comments at 11-12; COAL-NITL Reply at 31.) We need not decide in the abstract what would be a sufficient margin in a given case. That determination can and should be made on a case-by-case basis.

simplified procedures, however, it should not only declare that intent,¹⁴³ but also present sufficient information to show that CMP is not available. Moreover, this information should be included in its initial complaint, so as not to delay the case.

Accordingly, in those cases in which a complainant seeks to use the simplified procedures, the initial complaint should contain, at a minimum, the following information:

- (1) A general history of the traffic at issue, including how the traffic has moved in the past, how it currently moves, and how it can and will be moved in the future. This information should address not only the physical movement of the traffic, but the type and level of rates actually used. It should include all carriers (rail and nonrail) who have participated in the transportation of this traffic or could do so.
- (2) The specific commodity description(s) for the traffic at issue, the shipping characteristics and requirements of the traffic, and the type of railroad cars required or used for the traffic.
- (3) All origins, destinations, and O-D pairs involved in the complaint, by commodity type.
- (4) The amount of traffic involved (by commodity type), including total annual carloadings, average tons per car, number of carloads per shipment, and number of carloads per week or per month.
- (5) Total or average revenue per carload paid to the defendant railroad(s), by commodity type.
- (6) The feasibility and anticipated cost of preparing a SAC presentation in this case.
- (7) An estimate of the other costs to be incurred in pursuing the rate complaint, including preparing necessary jurisdictional threshold and market dominance evidence.
- (8) The full relief sought, including all reparations as well as the level and duration of any rate prescription.
- (9) The present value of the relief sought.

Several commenters have suggested a procedural schedule under which the issue of whether to apply the simplified procedures would be resolved within 45

¹⁴³ See, 49 CFR 1111.1(a).

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days after the complaint is filed.¹⁴⁴ Under the schedule laid out by NGFA and NITL, the defendant railroad would have 15 days to file any opposition to the use of the simplified procedures (including any information and materials in support of its opposition position). The complainant would have 10 days to respond in full to the railroad position. The Board would then have 20 days in which to make its determination. This appears to be a reasonable schedule that would not unduly prolong a case, and we will pursue this proposal shortly in an appropriate proceeding to revise our procedural rules.¹⁴⁵

Impact of the Simplified Procedures

AAR expresses concern that the Multiple R/VC Benchmarks approach would lead to a flood of successful rate complaints that would jeopardize the health of the railroad industry.¹⁴⁶ We disagree with both its premises and its conclusions.

AAR complains that the Multiple R/VC Benchmarks approach would create a regulatory incentive for a shipper that is not otherwise dissatisfied with its rates to bring a rate complaint. AAR reasons that each shipper could readily compare the r/vc ratio for its traffic with the published RSAM and R/VC_{>180} figures for the carrier(s) serving it and, whenever its r/vc ratio exceeds one or both of those levels, a shipper would be remiss if it did not seek to have its rate lowered.¹⁴⁷

¹⁴⁴ NGFA Comments at 14-15; NITL Comments at 24; CLAY Comments, V.S. Fauth at 47.

¹⁴⁵ OXYCHEM further suggests that we adopt a time frame for resolving the merits of a rate reasonableness claim that is processed under the simplified procedures within 180 days of the filing of the complaint. (OXYCHEM Comments at 1.) While we intend to expedite these cases, we believe some experience is needed in applying the simplified procedures before setting a general schedule for such cases. Initially, therefore, we will set a procedural schedule on a case-by-case basis, with input from the affected parties.

¹⁴⁶ AAR Reply at 16-20.

¹⁴⁷ AAR points to the numerous complaints that were filed in response to section 229 of the Staggers Act, which established a 180-day cut-off period for shippers to challenge rates that were then in existence. (AAR Reply at 16.) Shippers respond that those complaints were prompted not by any new opportunity to challenge rates, but by the imminent extinguishment of that right. (COAL-NITL Reply at 20.)

We do not agree. As the CARS shippers illustrate, rail shippers value not just rates but service, and thus would not necessarily seek to extract the lowest rate. And even a cost-conscious low-volume shipper would not necessarily bother to calculate the r/vc ratio for its traffic if it has not been dissatisfied with its rates. Also, with the introduction of an RSAM range, the published figures cover a broader range, with less traffic exceeding the published figures.¹⁴⁸ Most importantly, however, a simple comparison with the two published benchmarks would not be sufficient to allow a shipper reliably to predict success in a prospective rate complaint. The third benchmark--the R/VC_{COMP} --is a case-specific number that could not be published in advance. Moreover, as explained above, a shipper could not expect its rates to be capped at an average level; because the benchmarks are only a starting point, a complaining shipper must be prepared to present a more detailed and case-specific analysis. In any event, even if a shipper has an r/vc ratio that exceeds one or more of the benchmarks, it cannot bring a rate complaint if its traffic is not captive.

Not only is AAR's premise faulty, but its doomsday projections of the potential financial impact of the Multiple R/VC Benchmarks approach are greatly overstated. AAR's various projections assume that all shippers of >180 traffic could bring a rate complaint (or successfully threaten to do so), even though AAR recognizes that not all >180 traffic is captive. Indeed, a significant portion of that traffic is unlikely to be captive. Based on the 1994 Waybill Sample, of the portion of the rail industry's revenues above the 180% jurisdictional floor received from non-exempt less-than-trainload traffic, one-third is from traffic moving less than 400 miles. At those short distances, trucks are generally an effective competitor for most types of rail traffic.¹⁴⁹

¹⁴⁸ Indeed, examining the portion of the rail industry's revenues above the 180% jurisdictional floor that is received from non-exempt less-than-trainload traffic, over half is from traffic with an r/vc ratio below 230% and one-quarter from traffic below 200%, based on the 1994 Waybill Sample.

We also note that, when multiple carriers are involved in transporting a shipper's traffic, a shipper could not forecast the likelihood of a successful complaint based on the published figures of only one of those carriers.

¹⁴⁹ We do not suggest that rail traffic moving distances greater than 400 miles is necessarily captive.

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AAR's various projections also wrongly assume that all of the non-exempt >180 traffic to which the Multiple R/VC Benchmarks approach is applied would eventually be driven down to the 180% r/vc level (or at least to the efficiency-adjusted RSAM level¹⁵⁰). As explained above, we do not intend to cap challenged rates at an average level, much less at the 180% jurisdictional floor. Thus, there is no basis for AAR's assumption.

Finally, AAR and CARS argue that the Multiple R/VC Benchmarks approach would adversely affect contracting under section 10709, either by creating a regulatory disincentive to enter into contract or by driving contract rates down to the efficiency-adjusted RSAM level. For the same reasons that the Multiple R/VC Benchmarks approach should not have the effect of driving down common carriage rates, we do not believe that it would drive down contract carriage rates. The simplified procedures do not create a single, readily calculable r/vc level that would constitute a regulatory rate ceiling. Moreover, not all contract traffic would be eligible for the simplified procedures if it moved in common carriage; some of that traffic is not captive and some would be required to use CMP if a common carriage rate challenge were brought. Finally, there are other incentives for entering into transportation contracts beyond rate concessions; a shipper may wish to enter into a contract in order to obtain car commitments or added service features.

Other Matters

AAR argues that the simplified procedures should not be allowed to be used for mileage scale rates or group rates that would affect other shippers' traffic.¹⁵¹ We can see no basis for such a limitation. Under the statute, no rate--other than a contract rate under section 10709, or one that has been exempted from regulatory review under section 10502 or its predecessor--can be immune from regulatory challenge by a shipper that establishes market dominance.

We share AAR's view, however, that a rate reasonableness determination in a case decided under the simplified procedures does not constitute precedent

¹⁵⁰ AAR's projections do not reflect the RSAM range that we are introducing here.

¹⁵¹ AAR Comments at 11.

that could be relied upon in future cases.¹⁵² Under the simplified procedures, the rate reasonableness analysis is tailored to the revenue needs of the particular carrier(s) involved and to the relative demand elasticity of the particular traffic involved vis-a-vis the rest of that carrier's traffic base. Thus, each rate complaint must be judged on its own merits and on its own record.

AAR argues that, where a complaining shipper uses the simplified procedures, the defending railroad(s) should be entitled to defend with a SAC, or even an AAR-SSAC, presentation.¹⁵³ We have rejected AAR-SSAC because we do not believe it provides an appropriate or reliable measure of rate reasonableness. As to the use of SAC, we will only allow the simplified procedures to be used where we find that a SAC presentation is not possible or feasible. Where a shipper is unable to employ a SAC presentation to establish its affirmative case, it is also unable to rebut a SAC presentation made by the railroad(s). Thus, the defending railroad may not attempt to transform the case into a SAC case. In any event, a SAC presentation by the defendant railroad(s) would not be persuasive, because the defendant railroad lacks the incentive to seek out the least-cost most-efficient stand-alone service--the objective of the SAC test.

NITL suggests that a shipper should be afforded access to the confidential Waybill Sample (subject to the standard protection of confidentiality agreement) before filing a complaint.¹⁵⁴ NITL argues that this is necessary and appropriate both for a shipper to determine whether to bring a complaint and to encourage pre-complaint settlements. AAR rightly objects to the release of confidential and commercially sensitive information absent an actual rate complaint.¹⁵⁵ AAR further points out that access to the Waybill Sample is not given to shippers, but only to outside consultants.¹⁵⁶ We note that data from the Waybill Sample is not needed for the information that must be included in the initial complaint. We agree with AAR that pre-complaint access to the confidential Waybill Sample is not only unnecessary, but would be an inappropriate use of the Waybill

¹⁵² AAR Comments at 37-38. Shippers argue that such holdings should have precedential effect, for reasons of policy, efficiency, and record simplification. NITL-COAL Reply at 32-33; NGFA Reply at 19; CLAY Reply, V.S. Fauth at 39; DOE Reply at 37-38.

¹⁵³ AAR Reply at 7 n.7, 21. Shippers object to this notion. NITL Comments at 21; NDAK Comments, V.S. Tolliver/Bitzan at 18; NGFA Comments at 4.

¹⁵⁴ NITL Comments at 18-19.

¹⁵⁵ AAR Reply at 28-29 n.17.

¹⁵⁶ *Id.*

Sample for a non-regulatory purpose if we were to foster its use in rate negotiations between shippers and carriers.

CLAY argues that a shipper complainant should not be limited to the Waybill Sample, but should be able to obtain the full traffic tapes of railroads (subject to the same confidentiality agreement that is used for access to the Waybill Sample).¹⁵⁷ We are not persuaded that full traffic tapes would be necessary or appropriate. We believe that the data would be so massive as to be unwieldy in small cases and contrary to the objective of simplified procedures. Finally, we are satisfied that the Waybill Sample is an adequate, statistically representative sampling of railroad traffic.

NGFA suggests that a complainant seeking to use the simplified procedures should have its filing fee returned if it is not allowed to use the simplified procedures and does not wish to proceed under CMP.¹⁵⁸ Filing fees, however, are not contingent on the outcome of the filing. 49 CFR 1002.2(c). Rather, the purpose of the filing fee is to reimburse this agency for a small portion (in the case of rail rate complaints) of the average expense incurred in processing such filings, regardless of the outcome to the filer. If we should determine in a particular case that a complainant should use CMP rather than the simplified procedures, considerable expense will have already been incurred in processing that case.¹⁵⁹

CARS suggests using an alternate or additional benchmark measure--the cost recovery percentage (CRP) of former section 10709(d)(1)(B)(i),¹⁶⁰ modified

¹⁵⁷ CLAY Reply, V.S. Fauth at 39.

¹⁵⁸ NGFA Comments at 15 n.12.

¹⁵⁹ Returning the filing fee in that situation might encourage the filing of casual complaints designed to test the regulatory waters, rather than serious complaints in which the shipper is prepared to shoulder its burden of proof.

We note that, if a shipper that has initially paid the filing fee for a simplified procedures complaint later proceeds under CMP, it must pay the difference between the simplified procedures fee already paid and the fee for a complaint handled under CMP in order to proceed, in view of the much greater expense that we incur in processing a CMP case.

¹⁶⁰ The cost recovery percentage of former 49 U.S.C. 10709(d)(1)(B)(i) (1995), which was not reenacted by the ICCTA, was defined as follows:

the lowest [r/vc] percentage which, if all movements that produced revenues resulting in [r/vc] percentages in excess of the [CRP] are deemed to have produced only revenues resulting in the [CRP], would produce revenues which would be equal, when combined with total revenues

(continued...)

to include the efficiency adjustment of RSAM (*i.e.*, removing any revenue shortfall from <100 traffic). What CRP measures is the amount by which a carrier's highest r/vc ratios could be lowered while still enabling the carrier to be revenue adequate. Thus, as AAR points out, a CRP measure is not available unless the carrier has greater revenues than needed to be considered revenue adequate.¹⁶¹ The <100 efficiency adjustment would broaden the group of carriers to which such a CRP measure could be applied, but we believe that adjustment is overstated, as discussed above. Even if a CRP measure could be applied to a carrier, however, it would provide relief only to the carrier's highest-rated traffic; it would not provide a mechanism for testing the reasonableness of the rates on any of the carrier's other traffic. Thus, CRP does not supply a proper yardstick for measuring the reasonableness of a carrier's rates.

The remaining concerns expressed by the commenters are more far-reaching. CLAY, for example, suggests revising our standards for railroad revenue adequacy determinations.¹⁶² Also, CLAY and OXYCHEM seek to introduce competitive access principles and remedies.¹⁶³ Proposals of this nature, however, which could fundamentally change the way in which rail rates are set and reviewed, would inevitably delay this proceeding far beyond the statutory deadline. Because these types of proposals are beyond the limited scope and purpose of this proceeding, they will not be addressed here.¹⁶⁴

CONCLUSION

As stated in *Coal Rate Guidelines*, 1 I.C.C.2d at 549, a system of just and reasonable rates must fairly reward the carrier for the expenses, investment, and risk it undertakes in providing service, but it must also protect captive shippers from paying unnecessarily high rates. While the simplified procedures outlined

¹⁶⁰(...continued)

produced by all other traffic transported by [the] rail carrier, to the total fixed and variable cost of the transportation of all traffic by [the] rail carrier.

¹⁶¹ AAR Reply, V.S. Rockey/Klick at 29 n.34.

¹⁶² CLAY Reply, V.S. Fauth at 15.

¹⁶³ CLAY Reply, V.S. Fauth at 34-35; OXYCHEM Comments at 2-3.

¹⁶⁴ We note that two other OXYCHEM proposals--that we require rates to be challenged within 180 days after they are established (OXYCHEM Comments at 2), and that we allow challenges to contract rates that are agreed to "under duress" (*Id.* at 3)--are beyond our statutory authority.

here are much cruder than CMP, we believe that they will also achieve that dual purpose (where CMP is not available), albeit in a less precise manner.

We certify that this action will not have a substantial adverse impact upon a significant number of small entities. Even though the cases to which this action are targeted as small as compared to those processed under CMP, neither the railroads nor shippers involved are likely to be small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 60,1 *et seq.* In any event, to the extent that small entities may be affected, the impact will be beneficial, because it will enable the affected shippers to avail themselves of their statutory right to challenge rates charged on captive rail traffic regardless of the size of the complaint.

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

COMMISSIONER OWEN, *commenting*: Too often issues of art are treated as if they are matters of science and that some precise answer, extended to multiple decimal places, is possible if only we go back to our desks and computers one more time.

Highly competent individuals have spent more than a decade searching for the one "correct" method in this proceeding. Older and wiser, we now have developed something more flexible by placing less emphasis upon exact science. I commend staff for this result.

There will be reason in the future to revisit our work. Although we have found that previous attempts by outside interests to devise the "best" method resulted instead in a method tilted in "that" party's favor, I continue to see merit in inviting outside counsel.

I recently suggested, for example, an informal symposium of experts to discuss railroad revenue adequacy and I remain hopeful that this will occur. I think it equally advisable to convene, in the future, an informal symposium of experts to discuss the application of our non-coal rate guidelines with an eye on further improving and simplifying our art.

It is ordered:

(1) The Board will be guided by the simplified procedures set forth in this decision in individual rail rate reasonableness cases in which it determines that CMP cannot be practicably applied.

(2) This decision will be effective January 31, 1997.

By the Board, Chairman Morgan, Vice Chairman Simmons, and Commissioner Owen. Commissioner Owen commented with a separate expression.