STB DOCKET NO. 42054

PPL MONTANA, LLC
v.
THE BURLINGTON NORTHERN AND SANTA FE RAILWAY COMPANY

Decided March 21, 2003

The Board granted a petition for reconsideration of a finding that rail rates had not been shown to be unreasonably high and reopened the record for additional evidence.

BY THE BOARD:

In a decision in this proceeding, *PPL Montana, LLC v. Burlington Northern & Santa Fe Railway Co.*, 6 S.T.B. 286, (2002) (*2002 Decision*), we found that PPL Montana, LLC (PPL) had failed to demonstrate that the challenged rates of The Burlington Northern and Santa Fe Railway Company (BNSF) are unreasonably high. PPL has filed a petition for reconsideration, which BNSF opposes.[1] We grant in part and deny in part PPL's petition for reconsideration.

BACKGROUND

On July 6, 2000, PPL filed a complaint challenging the reasonableness of common carriage rates charged by BNSF for trainload movements of coal from 17 mines in the Powder River Basin (PRB) of Wyoming and Montana to PPL's Corette electricity generating facility at Billings, MT. In our *2002 Decision*, we

[1] North Dakota Grain Dealers' Association (NDGDA) has filed a petition to intervene, accompanied by a petition for clarification or reconsideration. In accordance with 49 CFR 1112.4(a), we will allow it to intervene, but not to broaden the issues in this proceeding. As we explained in our decision in this case *PPL Montana, LLC v. Burlington Northern & Santa Fe Railway Co.*, 5 S.T.B. 1105 (2001) at 1109, issues regarding proper application of the stand-alone cost test are best analyzed on a case-by-case basis, rather than in the abstract.

found that BNSF has market dominance over this traffic,[2] and proceeded to consider PPL's challenge to the reasonableness of these rates under the standards set forth in *Coal Rate Guidelines, Nationwide*, 1 I.C.C.2d 520 (1985) (*Guidelines*), *aff'd sub nom. Consolidated Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987).

A. Our Rate Reasonableness Standards

In *Guidelines*, our predecessor, the Interstate Commerce Commission (ICC), established a set of rail pricing principles known as "constrained market pricing" (CMP). CMP imposes three main constraints on the extent to which a railroad may charge differentially higher rates on captive traffic: revenue adequacy, management efficiency, and stand-alone cost (SAC). The revenue adequacy and management efficiency constraints employ a "top-down" approach, examining the defendant carrier's existing operations. If the carrier is "revenue adequate" (earning sufficient funds to cover its costs and provide a fair return on its investment), or if it would be revenue adequate after eliminating unnecessary costs from specifically identified inefficiencies in its operations, the complaining shipper may be entitled to rate relief. In contrast, the SAC constraint uses a "bottom-up" approach, under which the analysis is confined to those rail lines and facilities needed to serve the complaining shipper (and other traffic using those lines and facilities if the complainant wishes to take advantage of cost-sharing). The SAC analysis calculates what an entirely new, optimally efficient carrier would need to charge to the complaining shipper. The complainant may choose which of these two approaches it will use.

In this case, PPL elected to present its case using the SAC test. That test is designed to ensure that a captive shipper does not cross-subsidize other traffic by bearing the costs of facilities from which it derives no benefit.[3] A SAC analysis seeks to determine the lowest cost at which a hypothetical carrier could provide service to the complaining shipper, and to selected other traffic that would use the same lines and facilities,[4] if the rail industry were free of barriers

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[2] We may consider the reasonableness of a challenged rate only if we find that the carrier has market dominance over the traffic involved. 49 U.S.C. 10701(d)(1), 10707(c). Market dominance is "an absence of effective competition from other carriers or modes of transportation for the transportation to which a rate applies." 49 U.S.C. 10707(a).

[3] *Guidelines*, 1 I.C.C.2d at 528.

[4] Grouping with other traffic permits the complaining shipper to take advantage of the economies of scope, scale and density associated with shared facilities by spreading the joint and (continued...)

to entry or exit. Under the SAC constraint, the challenged rate cannot be higher than what the hypothetical carrier would need to charge to serve the complainant (and the other selected traffic) in order to fully cover its costs and earn a reasonable return on its investment.

The complaining shipper designs a "stand-alone railroad" (SARR) specifically tailored to serve the selected traffic group, using the optimum physical plant or rail system needed for that traffic. The costs of building and operating the SARR are compared to the revenue stream that the SARR could reasonably expect from that traffic.[5] Using a discounted cash flow (DCF) model to simulate how the SARR would likely recover its capital investments over time,[6] we determine whether there would be an over- or under-recovery of costs. If the sum of over-recoveries exceeds the sum of the under-recoveries,[7] we can conclude that the existing rate level is too high.[8] Conversely, if the present value analysis produces a net loss, the challenged rate has not been shown to be unreasonable.[9]

B. The *2002 Decision*

In this case, PPL based its SAC presentation upon a hypothetical SARR called the Wyoming Montana Coal Railroad (WMCRR), a map of which is set forth in the Appendix to this decision. As designed by PPL, part of the WMCRR would extend north from Converse, WY to Donkey Creek (serving PRB origins in southern Wyoming) and Campbell, WY; and from Campbell, a short leg of the WMCRR would extend further north to serve PRB mines in northern Wyoming (all of which we refer to as the north-south part of the WMCRR). The WMCRR would also extend from Campbell to Dutch, WY; from Dutch north to reach PRB

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[4](...continued)
common costs among a larger traffic base. *Guidelines*, 1 I.C.C.2d at 532. The complainant's selection of traffic for inclusion in the group, however, is open to challenge. *Id.* at 544.

[5] Absent better evidence, we presume that traffic could contribute revenues based on current rates, *Guidelines*, 1 I.C.C.2d at 544, adjusted for forecasted changes in tonnage and rate levels. SAC analyses are generally for a 20-year period, but provide for sufficient investment to enable the SARR to operate into the indefinite future.

[6] The DCF model takes into account variables such as inflation, Federal and State tax liabilities, and a reasonable rate of return.

[7] Because the analysis period is lengthy, a present value analysis is used to take into account the time value of money, netting annual over-recoveries and under-recoveries as of a common point in time.

[8] *See*, *e.g.*, *West Texas Util. v. Burlington N.R.R.*, 1 S.T.B. 638, 677 (1996).

[9] *See*, *e.g.*, *McCarty Farms, Inc. v. Burlington N., Inc.*, 2 S.T.B. 460, 485-86 (1997).

mines in southern Montana; and from Dutch west to Huntley and from Huntley (over a line of the Montana Rail Link via trackage rights) to Laurel, MT (all of which we refer to as the western part). The (approximately 99-mile) north-south part would carry high volumes of non-issue traffic, most of which would not move over the western part. The (approximately 241-mile) western part would have much lighter traffic density.

BNSF argued that PPL's SAC presentation should be rejected because it relied on excess revenues from non-issue[10] "cross-over"[11] traffic that would use only the north-south part of the WMCRR to cross-subsidize traffic using the western part, including PPL's traffic.[12] BNSF compared the costs associated with the north-south part with the revenue contributions that PPL assumed for traffic using only that part[13] and calculated that those revenues would exceed the costs for the north-south part of the WMCRR by approximately $163 million in the base year (2000) and by similarly high differentials in each succeeding year of the 20-year SAC analysis period. BNSF contended that traffic using only the north-south part should not pay for facilities and services from which it would derive no benefit.

PPL responded in several ways. It first argued that, even though as a complaining captive shipper it was not required to cross-subsidize facilities from which it receives no benefit, there was no comparable prohibition against other (non-issue) traffic subsidizing its traffic. Alternatively, it argued that use of a percentage reduction method for prescribing rates would eliminate the possibility of a cross subsidy.[14] Finally, PPL complained that the cross-subsidy analysis suggested by BNSF would require us to perform a separate SAC analysis of non-

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[10] Non-issue traffic is traffic that the complainant selects for inclusion in the SAC analysis in addition to its own traffic (the issue traffic).

[11] Cross-over traffic is traffic for which the WMCRR would not replicate BNSF's service completely, but would instead hand-off to a "residual BNSF" at a hypothetical new interchange point.

[12] BNSF pointed out that 76% of the SARR's traffic would move no more than 26 miles on the WMCRR before being (hypothetically) interchanged with the residual BNSF at Converse or Donkey Creek.

[13] BNSF also argued that PPL had allocated too much of the revenues from cross-over traffic to the WMCRR and had not shown that the revenues allocated to the residual BNSF to complete the transportation would be sufficient to cover the residual BNSF's stand-alone costs associated with those movements.

[14] We rejected that argument, noting that a rate reduction for traffic whose revenues do not cover directly attributable costs, and thus which do not make any positive contribution to any other shipper's joint and common costs, would not eliminate a cross-subsidy but only exacerbate it. *2002 Decision*, 6 S.T.B. at 295 n.17.

issue traffic. PPL's witness suggested a different way to approach the cross-subsidy issue:[15]

> Assuming [the possibility that non-issue traffic on the SARR would be subsidizing issue traffic] is a legitimate concern in light of the STB's limited jurisdiction, there is a more direct test for cross subsidy that would not impose prohibitive litigation burdens and expenses on complainants. One must determine that elements of traffic carried on the SARR generate sufficient revenue to cover their attributable cost. Traffic that is covering its attributable cost is not being subsidized. This would do away with the need for costly SAC calculations applied to non-issue traffic.

In our *2002 Decision*, 6 S.T.B. at 294-95, we rejected PPL's broad suggestion that there is no prohibition against non-issue traffic subsidizing the issue traffic. We also rejected BNSF's suggestion that we base a cross-subsidy inquiry on whether traffic using only the north-south part would generate revenues in excess of a SAC calculated for that traffic only. Instead, we followed PPL's suggestion that we focus on the part of the system that BNSF claimed would be cross-subsidized (the western part) to determine if the traffic using that part of the WMCRR would generate sufficient revenues to cover its attributable costs and thereby avoid a cross-subsidy. We found that, even were we to accept PPL's evidence on most of the disputes regarding the revenues and costs for the WMCRR, the revenues generated by the traffic using the western part would not be sufficient to cover its attributable costs. As a result, we concluded that PPL's SAC presentation was fatally flawed, and we dismissed the complaint.

DISCUSSION AND CONCLUSIONS

In its petition for reconsideration, PPL challenges our cross-subsidy analysis, which it claims sets a new and inappropriate standard for SAC cases. Alternatively, PPL argues that our application of the cross-subsidy analysis to this case was flawed.

I. Our Cross-Subsidy Analysis

In challenging our cross-subsidy analysis, PPL argues that there is no basis for it in *Guidelines* or in case precedent; that it is not sound public policy; and that, in any event, it represents a new test that should not have been applied in

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[15] Borts, Rebuttal V.S. at 10.

this case without advance notice and an opportunity to respond. As we will discuss, none of these arguments is well-founded.

The cross-subsidy analysis that we applied in our *2002 Decision* is not only consistent with, but is also compelled by, *Guidelines*. *Guidelines* provides for cost sharing (the grouping of traffic to share the joint and common, *i.e.* unattributable, costs of providing rail service),[16] but denounces cross-subsidization (the recovery of a shipper's attributable costs from other shippers).[17] A fundamental principle of CMP is that "a captive shipper need not bear the costs of any facilities or services from which it derives no benefit."[18] Indeed, a primary purpose of the SAC test is to avoid costs associated with such cross-subsidization.[19] But the CMP principle against cross-subsidization is not limited to the SAC test. *Guidelines*, 1 I.C.C.2d at 537-38 (the management efficiency constraint can also be used to protect captive shippers from paying for uneconomic facilities). It would turn the CMP principle against cross-subsidization on its head to protect a captive shipper from subsidizing other traffic, while at the same time allowing that shipper's rates to be subsidized by other traffic.

Thus, in examining PPL's SAC presentation to determine whether a cross-subsidy was embodied in it, we did not change a controlling standard of law, as PPL asserts.[20] This is the first case in which a railroad has claimed that the shipper's SAC evidence relied on a cross-subsidy. PPL responded to that claim by asserting that there is no prohibition against non-issue traffic subsidizing issue traffic. In rejecting PPL's argument, we simply applied CMP principles to this case. *Guidelines* do not envision that a captive shipper may shift responsibility

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[16] 1 I.C.C.2d at 534.

[17] *Id.* at 540.

[18] *Guidelines*, 1 I.C.C.2d at 528.

[19] *Id*.

[20] Pet. for Recon. at 5. This case is readily distinguishable from *Metropolitan Edison Co. v. Conrail, et al.*, 5 I.C.C.2d 385 (1989), relied upon by PPL (Pet. for Recon. at 3 n.2). In that case, the complainant had originally made a SAC presentation in which a single SARR would have served issue traffic movements from various origins to two destinations. After an administrative law judge found that the SARR's costs would exceed its revenues, the complainant asked the ICC to evaluate each issue traffic movement separately, based on an arbitrary allocation of SAC costs to individual movements. The ICC found that request to be inconsistent with SAC methodology. Likewise, nothing in *McCarty Farms v. Burlington N., Inc.*, 4 I.C.C.2d 262 (1988) or *Bituminous Coal – Hiawatha, UT to Moapa, NV*, 6 I.C.C.2d 1 (1989) (*Nevada Power*) (Pet. for Recon. at 3 n.2) can be read as permitting a cross-subsidy of a line by traffic that does not use that line. Indeed, in *Nevada Power*, 6 I.C.C.2d at 44, we expressly noted that traffic grouping assumptions are open to scrutiny in individual cases.

for paying for facilities it uses to other shippers who do not benefit from those facilities.[21]

Contrary to PPL's characterization, we did not employ a "segmented SAC" test. In contrast to what we do in a SAC analysis, in our threshold cross-subsidy analysis, we purposely excluded unattributable costs from the analysis, and looked only at whether the revenues generated by western-part traffic would be sufficient to cover costs *not* shared by shippers only using the north-south part of the WMCRR.[22] Had PPL's SARR satisfied the threshold cross-subsidy analysis, we would have proceeded to perform a SAC analysis, comparing total WMCRR revenues to total WMCRR costs.

Our cross-subsidy analysis reflects sound public policy. It is necessary to assure that no cross-subsidy would result here, in order to avoid misapplying a test whose very purpose is to eliminate cross-subsidization. A shipper should not seek to have its rate reduced by shifting any part of the costs of the lines or facilities that it needs onto traffic that does not use those lines or facilities.

Finally, PPL is hardly in a position to claim surprise here, as its own witness suggested the cross-subsidy analysis that we used.[23] Nor should it have been surprised that the railroad raised the cross-subsidy issue. PPL's chosen SAC model lent itself to a cross-subsidy challenge given the striking disparity in the size and density of these two parts of the WMCRR system. (The western part would constitute approximately 70% of the WMCRR system in length, but would carry only approximately 15% of the traffic.)

II. Application To This Case

PPL claims that, had it known that we would apply this cross-subsidy analysis, it would have presented different evidence. It asks us to reopen the case so that it may submit different evidence now. It identifies three aspects of the cross-subsidy analysis that it claims need correction. Specifically, it claims that our analysis (1) relied upon incorrect figures for the western-part traffic

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[21] *Guidelines*, 1 I.C.C.2d at 523-24 ("responsibility for facilities or services *which are shared* (to its benefit) by other shippers should be apportioned [among those shippers]") (emphasis added).

[22] As long as the traffic on the western part could make any contribution to the carrier's unattributable cost, the railroad would be better off participating in the transportation than not participating in it. *See Rate Guidelines – Non-Coal Proceedings*, 1 S.T.B. 1004, 1016 (1996).

[23] In any event, it is well established that an agency has the discretion to develop legal standards and administer its governing statute through case-by-case adjudications, rather than by advance rulemaking. *SEC v. Chenery Corp.*, 332 U.S. 194, 203 (1947); *Cassell v. FCC*, 154 F.3d 478 (D.C. Cir. 1998).

volumes; (2) wrongly assumed that the lighter-density western part would require as extensive a level of investment as the higher-density north-south part; and (3) failed to take into account differences between PPL's opening and rebuttal evidence that affected the allocation of operating costs.[24] PPL claims that, if it is allowed to correct these alleged deficiencies in the record, the traffic using the western part of the WMCRR would be shown to earn revenues greater than its attributable costs.[25]

As discussed above, we are not persuaded by PPL's claim of surprise, as *Guidelines* clearly proscribe cross-subsidization and PPL's own witness suggested the cross-subsidy analysis that we used. Nevertheless, we examine each of the three areas identified to determine if we erred in applying the record that was before us in this case.

A. Traffic Levels on Western Part

PPL's opening evidence assumed that 29.1 million tons (of the 184.4 million tons of total WMCRR traffic) would move on the western part of the WMCRR. In its reply, BNSF challenged PPL's routing of 10.9 million tons over the western part. Specifically, BNSF argued that, for cross-over traffic destined to three locations in Minnesota and Wisconsin, routing the traffic for interchange with a residual BNSF at Moran Junction would be contrary to how that traffic currently moves.[26] BNSF asserted that this traffic should be interchanged with a residual BNSF at either Donkey Creek or Converse Junction (in which case that traffic would not move over any of the western part of the WMCRR). On rebuttal, PPL accepted BNSF's corrected routing for 8.4 million tons of this traffic, but rejected BNSF's routing claim as to 2.5 million tons of the traffic.[27]

PPL now argues that, had it known that we would separately examine revenues and attributable costs for the western part of the WMCRR (as its own witness had suggested), it would not have acceded to BNSF's routing. PPL further claims that the traffic tapes that BNSF had supplied to it in discovery reveal that 51% of the traffic to those three destinations was actually routed through Moran Junction (on the western part of the WMCRR) in the first 6 months of 2000.

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[24] Pet. for Recon. at ii.
[25] Crowley V.S. at 2.
[26] Ellis/Mueller V.S. at 67.
[27] *See* McDonald Rebuttal V.S. at 23 ("I have reviewed Ellis/Mueller's train routings and for the most part, I have accepted them.").

PPL cannot shift responsibility for its own submissions in this case. As the complainant seeking rate relief, PPL had every incentive from the outset of the case to maximize revenues for the WMCRR as a whole, and one way to do this would be to keep joint-line traffic on the WMCRR system for the greatest percentage of the haul possible.[28] Thus, PPL had every reason to carefully scrutinize BNSF's assertions regarding the actual routing of this traffic. And it had a full opportunity to examine the traffic tapes carefully and thoroughly before responding on rebuttal to the issue of the proper routing of this traffic. Indeed, PPL did not simply accept BNSF's routing argument uncritically or completely; for some of the movements PPL on rebuttal did not adopt BNSF's routing claim. We must be able to rely on the evidence submitted to us by the parties, and PPL has not shown why it was improper for us to rely on its evidence.

B. Level of Investment

PPL also argues that it was wrong to assume that the lighter-density western part would require as extensive a level of investment in equipment as the higher-density north-south part.[29] PPL offers only one example. It now claims, for the first time, that the western part would not need a centralized traffic control (CTC) system, and that a less expensive signaling system, such as an Automatic Block System (ABS), would suffice.[30]

Again, PPL cannot shift the responsibility for the choices it made. It is the shipper's responsibility, and in the shipper's interest, to design the least costly, most efficient SARR.[31] From the outset, the traffic density on the western part of the SARR was dramatically lower than the density on the north-south part. Thus, from the outset, PPL could have used a combined CTC/ABS system in its SAC presentation, if that were a more cost efficient design. (Existing rail systems often use a combination of CTC on some line segments and ABS on other line segments.) PPL chose to provide for CTC on the entire WMCRR system, and at no time did PPL suggest that CTC would not be warranted for a part of the WMCRR. PPL has failed to show why it was improper for us to rely

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[28] Even if the cross-subsidy analysis served to heighten that incentive, PPL has only itself to blame if it did not in its rebuttal seek to maximize revenues on the western part of the WMCRR so as to avoid a cross-subsidy. PPL was put on notice, with BNSF's reply evidence, that cross-subsidization of the western part would be an issue in this case.

[29] Pet. for Recon. at ii.

[30] Crowley V.S. at 3-4.

[31] *Guidelines*, 1 I.C.C.2d at 542.

on its own evidence and assumptions regarding the type of traffic control system (or other types of investment) for the WMCRR.

C. Allocation of Operating Expenses

PPL's final claim of error concerns the manner in which we calculated the portion of the WMCRR operating expenses attributable to the traffic using the western part. In its reply, BNSF had submitted evidence showing what portion of the total operating expenses included in PPL's opening evidence would be attributable to traffic only using the north-south part. We used that unrebutted evidence to develop a ratio, for each category of operating expenses, of the portion of the expense for traffic using the western part to the total operating expense of the entire WMCRR. We then applied those ratios to the operating expense evidence submitted by PPL on rebuttal.

As PPL correctly points out, the ratio we used was based on the higher western-part traffic volumes contained in PPL's opening evidence, but was applied to cost evidence that was based on the lower western-part traffic volumes contained in PPL's rebuttal evidence (reflecting PPL's shifting of 8.4 million tons of traffic off of the western part). The reduction in operating costs for the western-part traffic that resulted from the change in routing on rebuttal would have altered the ratio of western-part traffic to total traffic expenses. As a result, there was a mismatch between the cost ratio (which was based on PPL's opening evidence) and the figure to which that ratio was applied (which was based on PPL's rebuttal evidence). This error caused an overstatement of operating expenses for western-part traffic in our cross-subsidy analysis.

There may also have been understatement of the expenses attributable to western-part traffic, however, due to the omission from our calculation of certain types of expenses that vary with the size of a carrier's system and thus a portion of which may be attributable to the western-part traffic collectively. These expense categories were operating managers, general administrative staff, loss and damage, and maintenance-of-way.[32] We lacked evidence as to what portion, if any, of those expenses would not need to be incurred if the western part were not included in the WMCRR.

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[32] Certainly some portion of total maintenance-of-way would be incurred on the western part. In addition, fewer managerial and administrative personnel might be needed if the western part were not included. Finally, with less traffic there could be fewer loss and damage claims. The costs avoided would be attributable to the western-part traffic.

We cannot determine, on the existing record, whether the overstatement of operating expenses due to our mismatching error was so large as to alter the outcome of our analysis, nor whether it would be offset by the understatement resulting from the omission of four expense categories. Therefore, we will reopen the record for the limited purpose of obtaining the necessary evidence to enable us to correct our error and determine what, if any, effect the error had on our ultimate determination in this case. On this limited reopening, the parties should submit evidence as to the appropriate split of operating expenses between traffic using the western part and traffic using only the north-south part, based upon the traffic volumes used on rebuttal. In addition, the parties may submit evidence on the proper allocation of the four categories of operating expenses that were omitted from our prior analysis, so that our final cross-subsidy analysis will be as complete as possible.

After receiving this additional evidence, we will re-apply the cross-subsidy analysis set forth in our *2002 Decision*.[33] If we again find that a cross-subsidy would exist, we will dismiss PPL's complaint. If, however, we find that there would not be an impermissible cross-subsidy, we will proceed with a full SAC analysis of the WMCRR.

CONCLUSION

We reaffirm the propriety of conducting a threshold cross-subsidy analysis and of our application of that analysis to this case in our *2002 Decision*. We reject the argument that PPL must be allowed to alter portions of its case-in-chief in light of our threshold cross-subsidy analysis, which merely applied well established principles to the particular facts and issues presented to us in this case. Were we to allow a disappointed party to revise its case in response to our rulings, there could be no end to an administrative proceeding. Therefore, the appropriate procedure for a complainant who believes that it could make a better case, if given the opportunity, is to file a new complaint.

Accordingly, we reopen the record in this case only for the limited purpose of correcting our error in our allocation of operating expenses between traffic using the western part and the traffic using only the north-south part of the

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[33] In conducting the cross-subsidy analysis in our *2002 Decision*, we relied upon analytical shortcuts where an issue did not need to be resolved because the outcome of the analysis would not be affected. For example, we relied upon all of PPL's figures and assumptions with respect to tonnages and revenues without considering BNSF's challenges to that evidence. We might not be able to rely on such analytical shortcuts when we analyze the supplemented record.

WMCRR. Parties should submit evidence regarding the proper allocation of these expenses, based upon the traffic volumes relied upon in the *2002 Decision*.

It is ordered:

1. PPL's motion for reconsideration is granted to the extent described above.

2. PPL shall submit its opening evidence on May 23, 2003; BNSF shall submit its reply evidence on July 7, 2003; and PPL shall submit its rebuttal evidence on August 6, 2003.

3. This decision is effective April 23, 2003.

By the Board, Chairman Nober and Commissioner Morgan.

APPENDIX