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SURFACE TRANSPORTATION BOARD

DECISION

STB Ex Parte No. 657 (Sub-No. 1)

MAJOR ISSUES IN RAIL RATE CASES

Docket No. 41191

WEST TEXAS UTILITIES COMPANY
v.
BNSF RAILWAY COMPANY

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

AEP TEXAS NORTH COMPANY
v.
BNSF RAILWAY COMPANY

STB Docket No. 42088

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

STB Docket No. 42095

KANSAS CITY POWER AND LIGHT COMPANY
v.
UNION PACIFIC RAILROAD COMPANY

Decided: February 27, 2006.

BY THE BOARD:

We are instituting a rulemaking proceeding in STB Ex Parte No. 657 (Sub-No. 1) to address major issues regarding the proper application of the stand-alone cost (SAC) test in rail rate cases and the proper calculation of the floor for any rail rate relief. In this proceeding, we seek comments on proposals we have developed to address six issues that have been raised in recent SAC cases. First, we present two alternatives to the "percent reduction" method to determine maximum reasonable rates to address concerns that the existing method can be unfairly manipulated by the railroads. Second, we propose a new cost-based method for allocating revenue from "cross-over traffic" to reflect economies of density. Third, we propose a method for forecasting future operating expenses of a stand-alone railroad (SARR) that would reflect anticipated future productivity gains. Fourth, we propose to no longer permit movement-specific adjustments to the Board's Uniform Railroad Costing System (URCS) when calculating the 180% revenue-to-variable cost (R/VC) jurisdictional floor for rate relief, as such adjustments appear inconsistent with URCS, may distort the variable cost calculation, and contribute inordinately to the complexity and expense of rail rate cases. Fifth, we propose to shorten the time frame for our SAC analyses and corresponding rate prescriptions from 20 years to 10 years. Sixth, we propose new standards for reopening and vacating a prior Board decision (including any resulting rate prescription) that is based on a SAC analysis.

These proposals are designed to ensure that both the SAC test and the jurisdictional floor for rate relief are applied fairly and in conformity with our statutory responsibilities. Because the issues they address go to the heart of the SAC test and have industry-wide significance for rail carriers and their captive shippers, all interested parties will have an opportunity to comment on these proposed changes. The changes we adopt here will be applied in future SAC rate cases, as well as to STB Docket No. 42095 (the KCP&L case), a pending SAC case in which the record has not yet begun to be developed. Accordingly, the procedural schedule for discovery and the submission of evidence in the KCP&L case is suspended.

Because several of these issues have been raised or are implicated in the rail rate cases pending before us, we are holding STB Docket No. 41191 (Sub-No. 1) (the AEP Texas case) and STB Docket No. 42088 (the Western Fuels case) in abeyance while we examine these important issues. The parties to those proceedings are invited to comment here on whether or to what extent it would be inequitable to apply the changes proposed herein, or parts thereof, to their pending cases. With regard to the first three issues (percent reduction, cross-over traffic, indexing operating expenses), we intend to apply whatever new methodology we adopt (if any) in this rulemaking proceeding to these two pending SAC cases. If a party in either of those cases wishes to have a proposal that it has already submitted on any of these three issues considered in its case, it must submit its proposal as comments in the STB Ex Parte No. 657 (Sub-No. 1) proceeding. As yet, we have formed no opinion on the equities of barring movement-specific adjustments in these two pending cases. But, absent comment from the parties, we do not propose to shorten the SAC analysis period in the pending cases, where the record has been developed based on a SARR designed to handle peak demand in a 20-year analysis period. Shortening the analysis period could require the submission of an essentially new SAC case.

We advise the parties to the AEP Texas case and the Western Fuels case that the Board will be issuing a compliance order in the next few weeks in each of those proceedings to obtain needed information to address significant gaps or inconsistencies in the record in those cases. The compliance orders will direct the parties to re-run their operating models using the same version of the Rail Traffic Controller model to incorporate new coal volume forecasts released this month by the Energy Information Administration, U.S. Department of Energy, with some guidance from the Board over how to model the operations of their respective SARRs. Although submission of this additional information will overlap with submission of comments on the rulemaking, supplying the information now will assist the Board in resolving those cases promptly at the conclusion of the rulemaking. Also, at the end of this rulemaking, the parties in the AEP Texas case and the Western Fuels case will be afforded an opportunity to submit supplemental evidence that comports with whatever changes we decide to adopt in the rulemaking, if any. Thus, because there will be further evidentiary proceedings in each of those cases, the timeframes for issuing a Board decision in those two cases are tolled.

The procedural schedule for this rulemaking proceeding will be expedited in the interest of fairness to the parties in the pending cases. All parties wishing to participate in the STB Ex Parte No. 657 (Sub-No. 1) proceeding should file a notice of intent to participate with the Board by March 20, 2006. Comments on the proposals set forth here are due on May 1, 2006, with a copy served on all parties participating in this proceeding. Reply comments will be due on May 31, 2006, and final rebuttal comments due June 30, 2006. We intend to issue our final decision within 120 days after all comments have been received. We will then issue an order in the AEP Texas and Western Fuels cases regarding the supplemental evidence needed in those cases, and issue a new procedural schedule in the KCP&L case.

Set forth below is a basic overview of our rate reasonableness standards and our proposals on the six issues on which we seek public comment.

RATE REASONABLENESS STANDARDS

Regulatory Framework

Where a railroad has market dominance, its transportation rates must be reasonable. 49 U.S.C. 10701(d)(1), 10702. Market dominance is defined as an absence of effective competition from other rail carriers or modes of transportation for the transportation to which a rate applies. 49 U.S.C. 10707(a). The Board is precluded from finding market dominance if the revenues produced by a challenged rate are less than 180% of the carrier's variable costs of providing the service. 49 U.S.C. 10707(d)(1)(A).

The Board has exclusive jurisdiction to determine if a railroad's rate is unreasonable. 49 U.S.C. 10501(b). When complaints are filed, the Board may investigate the reasonableness of the challenged rate, 49 U.S.C. 10704(b), 11701(a), or dismiss any complaint "it determines does not state reasonable grounds for investigation and action." 49 U.S.C. 11701(b). If, after a full

hearing, the Board finds the challenged rate unreasonable, it will order the railroad to pay reparations to the complainant for past movements, 49 U.S.C. 11704(b), and may prescribe the maximum rate the carrier is permitted to charge for future movements, 49 U.S.C. 10704(a)(1). However, the Board may not set the maximum reasonable rate below the level at which the carrier would recover 180% of its variable costs of providing the service.[1]

In examining the reasonableness of a rate, the Board is guided by the multifaceted rail transportation policy set forth at 49 U.S.C. 10101. It must also give due consideration to the "Long-Cannon" factors contained in 49 U.S.C. 10701(d)(2)(A)-(C). And the Board must recognize that rail carriers should have an opportunity to earn "adequate revenues." 49 U.S.C. 10701(d)(2). Adequate revenues are defined as those that are sufficient – under honest, economical, and efficient management – to cover operating expenses, support prudent capital outlays, repay a reasonable debt level, raise needed equity capital, and otherwise attract and retain capital in amounts adequate to provide a sound rail transportation system. 49 U.S.C. 10704(a)(2).

A Board action may be reconsidered or reopened pursuant to 49 U.S.C. 722(c). The Board has broad discretion to reopen a proceeding or change a Board action at any time upon a showing of "material error, new evidence, or substantially changed circumstances." 49 U.S.C. 722(c). Further, the Board "may change, suspend, or set aside [Board] action on notice." 49 U.S.C. 722(b). The Board also has broad authority to issue appropriate orders to prevent irreparable harm. 49 U.S.C. 721(b)(4).

Constrained Market Pricing

The Board's general standards for judging the reasonableness of rail freight rates are 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). These guidelines adopt a set of pricing principles known as "constrained market pricing" (CMP). The objectives of CMP can be simply stated. A captive shipper should not be required to pay more than is necessary for the carrier involved to earn adequate revenues. Nor should it pay more than is necessary for efficient service. And a captive shipper should not bear the cost of any facilities or services from which it derives no benefit. Guidelines, 1 I.C.C.2d at 523-24.

CMP contains three main constraints on the extent to which a railroad may charge differentially higher rates on captive traffic.[2] The revenue adequacy constraint ensures that a

[1] Burlington N. R.R. v. STB, 114 F.3d 206, 210 (D.C. Cir. 1997); West Texas Util. v. Burlington N. R.R., 1 S.T.B. 638, 677-78 (1996) (West Texas).

[2] A fourth constraint – phasing – can be used to limit the introduction of otherwise-permissible rate increases when necessary for the greater public good. Guidelines, 1 I.C.C.2d at 546-47.

captive shipper will "not be required to continue to pay differentially higher rates than other shippers when some or all of that differential is no longer necessary to ensure a financially sound carrier capable of meeting its current and future service needs." Id. at 535-36. The management efficiency constraint protects captive shippers from paying for avoidable inefficiencies (whether short-run or long-run) that are shown to increase a railroad's revenue need to a point where the shipper's rate is affected. Id. at 537-42. The SAC constraint protects a captive shipper from bearing costs of inefficiencies or from cross-subsidizing other traffic by paying more than the revenue needed to replicate rail service to a select subset of the carrier's traffic base. Id. at 542-46. Most captive shippers seek relief under the SAC test.

The SAC Test

A SAC analysis seeks to determine whether a complainant is bearing costs resulting from inefficiencies or costs associated with facilities or services from which it derives no benefit; it does this by simulating the competitive rate that would exist in a "contestable market." A contestable market is defined as one that is free from barriers to entry. The economic theory of contestable markets does not depend on a large number of competing firms in the marketplace to assure a competitive outcome. Id. at 528. In a contestable market, even a monopolist must offer competitive rates or lose its customers to a new entrant. Id. In other words, contestable markets have competitive characteristics which preclude monopoly pricing.

To simulate the competitive price that would result if the market for rail service were contestable, the costs and other limitations associated with entry barriers must be omitted from the SAC analysis. Id. at 529. This removes any advantages that the existing railroad would have over a new entrant that create the existing railroad's monopoly power. A SARR is therefore hypothesized that could serve the traffic at issue if the rail industry were free of entry barriers. Under the SAC constraint, the rate at issue cannot be higher than what the SARR would need to charge to serve the complaining shipper while fully covering all of its costs, including a reasonable return on investment. This analysis produces a simulated competitive rate against which we judge the challenged rate. Id. at 542.

To make a SAC presentation, a shipper designs a SARR specifically tailored to serve an identified traffic group, using the optimum physical plant or rail system needed for that traffic. Using information on the types and amounts of traffic moving over the railroad's rail system, the complainant selects a subset of that traffic (including its own traffic to which the challenged rate applies) that the SARR would serve.

Based on the traffic group to be served, the level of services to be provided, and the terrain to be traversed, a detailed operating plan must be developed for the SARR. Once an operating plan is developed that would accommodate the traffic group selected by the complainant, the SARR's investment requirements and operating expense requirements (including such expenses as locomotive and car leasing, personnel, material and supplies, and administrative and overhead costs) must be estimated. The parties must provide appropriate documentation to support their estimates.

It is assumed that investments normally would be made prior to the start of service, that the SARR would continue to operate into the indefinite future, and that recovery of the investment costs would occur over the economic life of the assets. The Board's SAC analyses are limited to a finite period of time – currently 20 years – and examine the revenue requirements for the SARR based on the operating expenses that would be incurred over that period and the portion of capital costs that would need to be recovered during that period. A computerized discounted cash flow (DCF) model simulates how the SARR would likely recover its capital investments, taking into account inflation, Federal and state tax liabilities, and a reasonable rate of return. The annual revenues required to recover the SARR's capital costs (and taxes) are combined with the annual operating costs to calculate the SARR's total annual revenue requirements.

The revenue requirements of the SARR are then compared to the revenues that the railroad is expected to earn from the traffic group. There is a presumption that the revenue contributions from non-issue traffic should be based on the revenues produced by the current rates. Traffic and rate level trends for that traffic group are forecast into the future to determine the future revenue contributions from that traffic.

The Board then compares the revenue requirements of the SARR against the total revenues to be generated by the traffic group over the full SAC analysis period. Because the analysis period is lengthy, a present value analysis is used that takes into account the time value of money, netting the annual over-recovery and under-recovery as of a common point in time. If the present value of the revenues that would be generated by the traffic group is less than the present value of the SARR's revenue requirements, then the complainant has failed to demonstrate that the challenged rate levels violate the SAC constraint.

On the other hand, if the present value of the revenues from the traffic group exceeds the present value of the revenue requirements of the SARR, then the Board must decide what relief to provide to the complainant by allocating the revenue requirements of the SARR among the traffic group and over time. Under Guidelines, a carrier's joint and common costs – i.e., those costs that cannot be attributed to particular traffic and thus are to be shared by all of the traffic using the facilities and services – should be allocated among the traffic using those facilities and services based on Ramsey pricing principles. Guidelines, 1 I.C.C.2d at 546. Ramsey pricing is an economic theory of how to efficiently allocate unattributable joint and common costs.

When the SAC test was adopted, our predecessor, the Interstate Commerce Commission (ICC), did not attempt to prescribe a hard-and-fast formula for developing and applying the constraint. It knew that the workability of the guidelines would have to be evaluated in light of experience, as CMP is based on rather sophisticated economic theories that require careful interpretation and application. As such, the SAC test has been fleshed out in individual proceedings. Yet the ICC warned the industry that it "may well find, after some experience with applying the guidelines, that modifications are needed to make this approach to maximum rate regulation . . . fully workable." Id. at 525.

BOARD PROPOSALS

Set forth below are our proposals with regard to six issues common to virtually all SAC cases. These issues are: (1) how to allocate the total revenue requirements of the SARR among the traffic group; (2) how to allocate the revenues from cross-over traffic between the SARR and residual incumbent; (3) how to index the operating expenses of the SARR; (4) whether to permit movement-specific adjustments to URCS when determining the jurisdictional floor for rate relief; (5) how long of a SAC analysis is appropriate; and (6) when the Board should reopen or vacate an older SAC decision (including any resulting prescription).

I. Maximum Rate Determination

Background

Once the Board has calculated the total revenue a SARR would require to serve the traffic group including a reasonable return on investment (the "SAC costs"), the Board must allocate the total SAC costs among all of the movements in the traffic group to determine if the challenged rate is unreasonable, and if so by how much. In Guidelines, 1 I.C.C.2d at 546, the ICC left this inquiry to a case-by-case assessment.

In prior SAC cases, the Board has used an allocation process known as the "percent reduction" method. Under that approach, the Board has required the railroad to reduce the challenged rate for each year of the DCF period by the same percentage by which the railroad's total revenues in that year from the SAC traffic group exceed the total SAC costs. For example, if the revenues the railroad is expected to earn in 2006 from the SAC traffic group would be 20% higher than the SAC cost in that year, then the challenged rate would be ordered reduced in 2006 by 20%. The underlying rationale for the percent reduction approach has been that allocating the SAC costs among the traffic group in proportion to the existing rate structure would implicitly reflect the varying demand elasticities within the SAC traffic group.[3]

A critical problem with the percent reduction approach – which has been brought to light in recent SAC cases – is that a railroad could manipulate the outcome of the Board's regulatory process. A complainant's share of the SAC costs is a function of the starting point – the challenged rate. Accordingly, the higher the railroad sets the challenged rate, the higher the complainant's share of the SAC costs is deemed to be and the higher the resulting prescribed rate. Therefore, a carrier could ensure itself of a favorable rate prescription even if the challenged rate were found unreasonable – just by setting the challenged rate at a high enough level. The following table illustrates the problem.

[3] See Arizona Pub. Serv. Co. v. Atchison, T. & S.F. Ry., 2 S.T.B. 367, 392 (1997) (APS); Coal Trading Corp. v. Baltimore & Ohio R.R., 6 I.C.C.2d 361, 380 (1990).

Table 1

	Example 1	**Example 2**	**Example 3**
Challenged Rate (per ton)	**$10.00**	$12.00	$1.00
Issue Traffic (million tons)	2	2	2
Revenue – Issue Traffic (million)	$20	$24	$2
Revenue – Non-Issue Traffic (million)	$300	$300	$300
Total Revenues (million)	$320	$324	$302
SAC Costs (million)	$270	$270	$270
Over-Recovery (million)	$50	$54	$32
Percent Reduction Factor	15.63%	16.67%	10.60%
Prescribed Rate (per ton)	$8.44	**$10.00**	$0.89

Each of these examples involves an identical amount of issue traffic (2 million tons), non-issue traffic revenue ($300 million), and SAC costs ($270 million). The only difference between them is the initial rate charged by the railroad. As shown in Example 1, if the challenged rate were set at $10, the SAC rate for the issue traffic would be $8.44 per ton. But if the railroad were to set the rate at $12 per ton, as in Example 2, the net over-recovery would increase only modestly, because the issue traffic would represent a small fraction of the total revenues from the SAC traffic group. The prescribed rate would be $10, the level of the challenged rate in Example 1.

Thus, under the percent reduction method, a railroad acting strategically could set a rate that it expects to be challenged at a much higher level than it expects to sustain, in order to end up with a prescribed rate level that is to its liking. As the complainant in the CP&L case aptly stated, the railroad could "lose the battle" over the reasonableness of the challenged rate but "win the war" with respect to the rate level that it can charge. Indeed, the railroad in that case conceded that the regulatory process could be manipulated in this manner.[4]

The percent reduction approach is also subject to manipulation by a shipper. Given a traffic group with sufficiently highly rated non-issue traffic, the percent reduction approach could brand any rate level established by a railroad as unreasonable. In Example 3 above, if the railroad were to set the challenged rate at just $1 per ton, the revenues from the entire traffic group would still exceed the SAC costs by 11%, again because the issue traffic represents only a small fraction of the total revenues from the SAC traffic group. Were it not for the statutory threshold for regulatory review, the Board could conclude that a rate of just $1 dollar per ton is unreasonably high and prescribe a maximum rate of 89¢. The fact that the percent reduction approach could otherwise lead to such an absurd result reflects a serious shortcoming inherent in that approach. This shortcoming could encourage a shipper to challenge a reasonable rate by grouping its traffic with other traffic charged high rates.

[4] See Carolina Power & Light Co. v. Norfolk S. Ry., STB Docket No. 42072, slip op. at 31 (STB served Dec. 23, 2003) (CP&L).

In sum, the parties have exposed a flaw with the rate prescription method used in the past. Although we cannot necessarily be certain of a railroad's motives in selecting the level of a challenged rate, it should not be necessary for us to conduct such an inquiry. The percent reduction method has been shown to be susceptible to manipulation by the parties: by a railroad in setting a challenged rate at an artificially high level, and by a complaining shipper in grouping a challenged rate with non-issue traffic that is much higher rated to generate a larger rate reduction. As the Board has stated, this is sufficient to warrant a change; the maximum reasonable rate that can be charged to a complaining captive shipper should be determined by the Board based upon the evidence and applicable precedent, not by parties' litigation tactics.[5]

Board Proposals

To allocate the total SAC costs among the traffic group, we propose replacing the percent reduction approach with either a Maximum Contribution Methodology (MCM) or Maximum Markup Methodology (MMM).[6] Both approaches would calculate a maximum contribution from each movement in the traffic group such that the total contribution from the traffic group would equal the total SAC costs, and with no movement assigned a contribution higher than the rate charged for that movement.

A. Maximum Contribution Methodology

To calculate the maximum contribution (in each year of the DCF analysis) the total SAC costs in each year would first be apportioned amongst the selected traffic group on a ton-mile basis.[7] The Board would then check to see if the share of the SAC costs assigned to any movement in the traffic group would exceed what the SARR could actually charge that movement. We would assume that the rates charged by the railroad for non-issue traffic reflect the profit maximizing rates. If a movement's share of the SAC costs is higher than what the railroad actually charges, the MCM approach would reapportion the difference to the remaining traffic in the traffic group (an appropriate application of demand-based differential pricing). This would increase the contribution level for the remaining traffic. This analysis would be repeated, and the contribution level ratcheted upwards, until no movement in the traffic group is assigned a higher share of the SAC costs than the SARR could profitably levy on that movement in the marketplace.

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[5] CP&L at 32.

[6] These approaches are a refinement of an approach, called the Maximum Competitive Contribution Methodology, discussed in Guidelines that the ICC found consistent with CMP but too complicated to apply. See Guidelines, 1 I.C.C.2d at 560.

[7] We are not proposing to make any changes to the pattern of capital recovery over the DCF analysis period adopted in FMC Wyoming Corp. v. Union Pacific R.R., 4 S.T.B. 699, 740-41 (2000) (FMC).

Under MCM, the result would be a maximum contribution per ton-mile that would distribute the total SAC costs amongst the traffic group, while ensuring that no movement is expected to cover more of the SAC costs than it currently pays the railroad.

Illustration of MCM

The following illustration is offered to show the difference between the percent reduction approach and MCM. Assume five shippers are collectively paying $630 in transportation charges, but a SARR could serve that same traffic group for $500. The shippers are therefore collectively paying $130 more than is necessary for the SARR to recover all of its costs, including a reasonable return on its capital investment. Using the percent reduction approach, the Board would assume that rates on all traffic in the group had been set too high and it would order the challenged rate to be reduced by 21% ($130 ÷ $630).

To calculate the maximum reasonable rate under MCM requires more analysis, however. Assume the five shippers in the traffic group have the following characteristics:

Table 2
Traffic Group Characteristics

Traffic Group	Rate per ton	Tons	Miles	Ton-Miles	Revenue	Revenue per Ton-Mile
Complainant	$25	10	100	1,000	$250	25¢
Shipper 2 (captive)	$20	8	100	800	$160	20¢
Shipper 3 (captive)	$15	6	75	450	$90	20¢
Shipper 4 (captive)	$10	8	75	600	$80	13¢
Shipper 5 (non-captive)	$5	10	100	1,000	$50	5¢
		42		3,850	$630	

The first step of MCM would be to allocate the total SAC costs of $500 among the five shippers on a ton-mile basis. This would result in an assigned contribution of 13.0¢ per ton-mile ($500 ÷ 3,850 ton-miles). But some shippers would not pay that assigned contribution. In particular, the non-captive shipper (Shipper 5) could not be expected to pay 13.0¢ per ton-mile, or $130, as it currently only pays $50 for its service. We assume the railroad is already charging Shipper 5 the highest price that traffic can bear. Thus, for the SARR to cover the total SAC costs, it would need to recover the resulting shortfall from the other four shippers as an appropriate application of differential pricing. When that $80 shortfall is distributed among the other four shippers, the assigned contribution would increase from 13.0¢ to 15.8¢ per ton-mile. That, however, would be more than the SARR could collect from Shipper 4. When the small shortfall from Shipper 4 is allocated to the remaining three shippers, the result would be a sustainable maximum assigned contribution of 16.44¢ per ton-mile for the remainder of the traffic group.

Table 3 contrasts the result under the existing percent reduction method against the result under the MCM method.

Table 3
Comparison of MCM and Percent Reduction

Traffic Group	Rate per ton	Total Revenue	SAC Rate per ton[8]		Contribution Towards SAC Costs[9]	
			Percent Reduction	MCM	Percent Reduction	MCM
Complainant	$25	$250	$19.84	$16.44	$198	$164
Shipper 2 (captive)	$20	$160	$15.87	$16.44	$127	$132
Shipper 3 (captive)	$15	$90	$11.90	$12.33	$71	$74
Shipper 4 (captive)	$10	$80	$7.94	$10	$63	$80
Shipper 5 (competitive)	$5	$50	$3.97	$5	$40	$50
		$630			$500*	$500

* The total does not add up due to rounding.

As shown in **Table 3**, the total contribution towards SAC costs from the traffic group would be the same under either approach, as any approach must allocate the total SAC costs (here $500) among the traffic group. But under the MCM approach, only the rates charged to the higher-rated traffic would be above the SAC rate. If Shipper 4 were to file its own complaint, using the same SAC evidence, it would get no relief.

Features of MCM

An important feature of MCM is that it would provide railroads the opportunity to earn adequate revenues by permitting demand-based differential pricing. A railroad could justify charging a higher rate to the complainant as an appropriate application of differential pricing – but only to the extent needed to cover SAC costs that could not be covered by a uniform allocation among all the traffic in the traffic group.

Moreover, the MCM approach has three advantages over the percent reduction method. First, it would remove the ability of either party to engage in the sort of "gaming" discussed above. A railroad could not affect the complainant's SAC rate by increasing the common carrier rate. The higher it set the challenged rate, the greater the rate relief to which the complainant

[8] To calculate the SAC rate per ton under the percent reduction approach, multiply the rate per ton charged by 1 – ($130 ÷ $630) (i.e., reduce the rate charged by 21%). To calculate the SAC rate per ton under MCM, take the maximum contribution of 16.44¢ per ton-mile and multiply by the total miles of each movement in **Table 2** (e.g., 16.44¢ per ton-mile × 75 miles = $12.33 per ton). However, the SAC rate per ton under MCM for Shipper 4 and Shipper 5 is the rate charged, because those rates are below the maximum assigned contribution.

[9] To calculate the contribution towards SAC costs, under either the percent reduction of MCM, multiply the corresponding SAC rate per ton by the tons associated with that movement, shown in **Table 2**.

would be entitled. And for its part, a complainant would have to show not only that the collective revenue of the entire traffic group it has selected exceeds the SAC costs for providing service to that group, but also that the challenged rate is itself too high.

Second, the MCM approach reflects the important principle that a railroad should recover as much of its costs as possible from each shipper served before charging differentially higher rates to its captive shippers.[10] The percent reduction approach does not reflect this goal. As shown in **Table 3** above, the contribution towards SAC costs from Shipper 4 under the percent reduction method would be only $63, while it could pay as much as $80. The effect of not maximizing the contribution from this shipper would be to force the complainant to bear more of the SAC costs.

Finally, use of the MCM approach should facilitate rate case settlements and private negotiations. The possible manipulation of the percent reduction approach prevents prior rate cases from providing guidance during negotiations on what specific rate prescription a complainant could expect if it brought a complaint. Under MCM, the maximum contribution level in a particular case would provide information parties could use to predict the outcome of their own disputes, because the maximum contribution level would be independent of the level of the rate the railroad might set should negotiations break down. Such information should help the parties negotiate a mutually agreeable rate.

We acknowledge that MCM would not reflect pure Ramsey pricing. However, as the ICC recognized, Ramsey pricing is too complicated to be applied directly in SAC cases, because we could not determine the marginal cost of every movement in the traffic group or evaluate relative demand elasticities.[11] Moreover, while Ramsey pricing represents the most efficient way to price above marginal cost, reliance on pure Ramsey pricing would not be consistent with the Long-Cannon factors of the statute because it would not maximize the revenue contribution from traffic with more-elastic demand (competitive traffic) before calling on traffic with less-elastic demand (captive traffic) to make a differentially higher revenue contribution. Finally, as the ICC concluded, the allocation of SAC costs should be done in accordance with Ramsey pricing principles, not Ramsey pricing theory itself. By Ramsey pricing principles, the ICC meant that the SARR (and therefore the carrier) must be allowed to engage in demand-based differential pricing as necessary to recover the total SAC costs. As stated in Guidelines, 1.I.C.C.2d at 523:

> [W]e concluded that a meaningful maximum rate policy could not be founded on a strictly cost-based approach. Because competition

[10] See 49 U.S.C. 10701(d)(2) (the Long-Cannon factors); Guidelines, 1 I.C.C.2d at 539 ("Under CMP, a carrier must charge its competitive traffic as much of the unattributable costs as demand will permit.").

[11] Guidelines, 1 I.C.C.2d at 527.

> compels the railroads to price some of their services below an arbitrarily assigned "cost," they must be able to price other services above their assigned "cost" in order to compensate. Otherwise, the carriers may never be able to cover all their costs and earn adequate revenues.

Because both MCM and the variant described below would permit such demand-based differential pricing, we believe they would be consistent with CMP, Ramsey pricing principles, demand-based differential pricing principles, and our statutory responsibilities.

B. Variant Proposal – Maximum Markup Methodology

MCM would work best where the traffic group selected for the SAC analysis is homogeneous, such that the variable costs per ton-mile would be roughly the same for every movement in the traffic group. It is less-well suited to cases where the traffic group is diverse, such as where it is comprised of both short-haul and long-haul traffic, or both unit-train and manifest traffic. In those cases, the traffic in the group could have differing cost structures per ton-mile. Yet MCM would treat these movements similarly for purposes of their contribution towards the total SAC costs.

We, therefore, also seek public comment on a variant of the MCM approach that could be applied to either a homogeneous or diverse traffic group. We call this alternative the Maximum Markup Method (MMM). This alternative would use URCS to estimate the variable cost of every movement in the traffic group, and then express the maximum contribution towards SAC costs as a markup over variable cost. Under this alternative approach, the maximum contribution might be expressed as 225% of the variable cost of the movement, instead of just a flat amount per ton-mile. Under MMM, a movement with a higher variable cost per ton would have a higher maximum contribution toward total SAC costs, and vice-versa.

Illustration of MMM

The following illustration is offered to show the difference between MCM and MMM. We use the same traffic data as in the example above, but now include an estimate of the variable cost of serving that traffic, which would be calculated using unadjusted URCS. The additional variable cost information is shown in **Table 4**.

Table 4
(Traffic Group Characteristics)

Traffic Group	Rate (per ton)	URCS VC (per ton)	R/VC Ratio	Tons	Total VC
Complainant	$25	$8.33	300%	10	$83
Shipper 2	$20	$8.00	250%	8	$64
Shipper 3	$15	$7.50	200%	6	$45
Shipper 4	$10	$6.67	150%	8	$53
Shipper 5	$5	$4.55	110%	10	$45
					$291*

* The total does not add up due to rounding.

The first step of MMM would be to calculate the average R/VC ratio that would cover the total SAC costs. This would equal 172% of the collective URCS variable costs to serve these five shippers ($500 ÷ $291). Again, however, some shippers could not pay their assigned contribution. In particular, Shippers 4 & 5 could not pay a markup over variable cost of 172%, as those shippers currently only pay a 150% and 110% markup, respectively. We would assume the railroad is already charging these shippers the highest markup over variable cost that traffic can bear. Thus, for the SARR to cover the total SAC costs, it would need to recover the resulting shortfall from the other three shippers as an appropriate application of differential pricing. When that $40 shortfall is distributed among the other three shippers, the assigned contribution would increase from a 172% to a 192% markup over variable cost. The result under MMM would be a sustainable maximum assigned contribution for the remainder of the traffic group of 192% of the variable cost of each movement.

Table 5 contrasts the result under the existing percent reduction method against the result under the MMM method.

Table 5
Comparison of MMM and Percent Reduction

Traffic Group	Rate (per ton)	MMM		Percent Reduction		Contribution To SAC Costs	
		SAC Rate	Rate Relief	SAC Rate	Rate Relief	MMM	Percent Reduction
Complainant	$25	$16.03	36%	$19.84	20.63%	$160	$198
Shipper 2	$20	$15.39	23%	$15.87	20.63%	$123	$127
Shipper 3	$15	$14.43	4%	$11.90	20.63%	$87	$71
Shipper 4	$10	$10	0%	$7.94	20.63%	$80	$63
Shipper 5	$5	$5	0%	$3.97	20.63%	$50	$40
						$500	$500*

* The total does not add up due to rounding.

As shown in **Tables 3 & 5**, the total contribution towards SAC costs from the traffic group would be the same under either the MCM or MMM approach. The MMM approach also

shares the four features of MCM described above. But under MMM, more of the SAC costs would be allocated to the traffic with a higher variable cost. This is conceptually sound, as a shipper with a higher variable cost would be responsible for a greater share of the total SAC costs, which include both the capital return on investment and the operating expenses of the SARR.

To this point, we have expressed MMM in terms of an R/VC ratio, but it could also be expressed in terms of a dollar markup above variable cost. This alternative approach would also use URCS to estimate the variable cost of every movement in the traffic group. But instead of expressing the maximum contribution as a ratio of the variable cost of a movement, this alternative would calculate a maximum dollar contribution above the variable cost. If there were two otherwise identical movements in the traffic group, one in railroad-supplied cars and the other in privately supplied cars, and the URCS variable cost per ton was $1 lower for the movement in privately supplied cars, the difference between the SAC rates would be $1. Each movement would have to cover its own variable cost, but the expected contribution above variable cost to cover unattributable joint and common costs would be the same.

There may be good reason to express the SAC rate as an R/VC ratio. The share of joint and common costs assigned to a movement would be based on its relative share of the services provided by the SARR, as measured by URCS variable costs. For example, when 100 tons of coal and chemicals are transported 100 miles by rail, each reflects 10,000 ton-miles of rail transportation. But while the 100 tons of coal would typically move in single (comparatively inexpensive) open-hopper cars in unit-train service, the same amount of chemicals would typically be transported in two (more expensive) tank cars in (far more expensive) manifest service. Also, Congress has regarded R/VC ratios as an appropriate measure for allocating joint and common costs among rail shippers, as reflected in the 180% R/VC jurisdictional floor for rate relief.

But there may also be good reason to use a dollar markup above variable cost instead. A railroad may be able to affect somewhat, to its advantage, the variable cost of serving a captive shipper. It may choose to use railroad-supplied railcars rather than privately supplied railcars,[12] or to provide train-load or unit-train service.[13] Or a railroad might choose to offer service to a

[12] See Atchison, T. & S.F. Ry. v. United States, 232 U.S. 199, 214-15 (1914) (railroads have the right to use their own railcars so long as they can meet their common carrier obligations with those cars); Shippers Comm., OT-5 v. Ann Arbor R.R., 5 I.C.C.2d 856, 865 (1989), aff'd, Shippers Comm. OT-5 v. ICC, 968 F.2d 75 (D.C. Cir. 1992) (same).

[13] See Texas Mun. Power Agency v. Burlington N. & S.F. Ry., STB Docket No. 42056, slip op. at 6 (STB served Sept. 27, 2004) ("[H]ow a railroad satisfies its common carrier obligation is left to the railroad to decide in the first instance. So long as the railroad offers service that satisfies its common carrier obligations (the critical inquiry), it need not provide the

(continued . . .)

shipper in steel railcars rather than aluminum railcars. Expressing a maximum rate in terms of its ratio to the variable cost of serving the traffic could mean that a dollar increase in variable cost would increase the SAC rate by more than a dollar, and vice versa. Thus, setting the maximum contribution towards the SAC costs in proportion to variable cost could create a disincentive for a railroad to introduce productivity-enhancing measures that would lower its cost of providing service.

Parties are invited to comment on whether, if the MMM approach is adopted, the SAC costs should be allocated among the traffic group based on a dollar markup over variable cost, rather than in proportion to variable cost. Parties are also invited to comment on whether, if a dollar markup is used, the dollar markup should be expressed on a car-mile or ton-mile basis. If the traffic group were comprised of a single commodity, the car-mile/ton-mile distinction would not matter. But where a mix of traffic is involved, the distinction could be significant. For example, two trains, one carrying only coal and the other carrying only chemicals, might consist of an equal number of cars and travel an equal distance on the SARR, yet the coal train, which is heavier, would represent more ton-miles. More trains, crews, and rail capacity would be needed to haul a million tons of the lighter commodity. Thus, where the traffic group is mixed, a car-mile approach would appear to be a more suitable way to express a maximum dollar markup above variable cost.

Regardless of how it might be expressed, MMM would reflect the different cost structures of traffic in the SAC traffic group. It would, however, be more complicated to apply, as it would require the parties to estimate the variable cost in the base year of every movement in the traffic group and project this forward to encompass every year in the DCF analysis period. Moreover, it would seem inadvisable to apply this alternative approach if we continue to permit movement-specific adjustments to URCS for the issue traffic. In such circumstances, we might need to permit movement-specific adjustments to all movements in the traffic group – which would be wholly impractical – to avoid an apples-to-oranges comparison in the allocation of SAC costs. The cost of bringing a full SAC case would increase exponentially. But if we conclude that movement-specific adjustments for issue traffic are no longer warranted in these proceedings – a proposal discussed below – we could use the MMM approach to allocate the total SAC costs among the traffic group.[14]

(continued . . .)
particular service that the shipper would prefer."); Potomac Elec. Power Co. v. Penn Central Transp. Co., 356 I.C.C. 815 (1977), aff'd in relevant part, Potomac Elec. Power Co. v. United States, 584 F.2d 1058 (D.C. Cir. 1978) (railroads do not have a common carrier obligation to provide unit-train service in railroad-supplied cars).

[14] To project initial (base-year) URCS variable costs forward, we propose using the method the Board determines, in this proceeding, to be the proper method of projecting the SARR's operating expenses.

II. Revenue Allocation for Cross-Over Traffic

Background

In recent SAC cases, complainants have relied extensively on the use of "cross-over" traffic to simplify their SAC presentations. Cross-over traffic refers to movements for which the SARR would not replicate all of a railroad's service, but would instead interchange the traffic with the residual portion of the railroad's system. This modeling device, which was first accepted by the Board in 1994 in the Nevada Power case, is now a well-established practice in SAC cases.[15] A continuing issue in SAC cases is how to allocate the total revenues the railroad earns from that cross-over traffic between the facilities replicated by the SARR and the residual network of the railroad needed to serve that traffic.

In allowing the use of cross-over traffic, we seek to make the analysis more manageable without introducing bias. Thus, the goal in allocating revenue from cross-over traffic should be to ensure that a simplified SAC analysis using cross-over traffic will approximate a full SAC analysis, which provides origin-to-destination service for the entire traffic group. A full SAC analysis compares the total SAC costs against the total revenues the carrier is expected to earn from the traffic group. A SAC presentation with cross-over traffic, however, calculates only part of the total SAC costs to serve the selected traffic. Thus, the portion of the revenue allocated to those facilities replicated by the SARR should ideally equal the total revenue from that movement multiplied by the share of total SAC costs represented by the cross-over segments of the movement (i.e., multiplied by the ratio of the SAC costs using cross-over traffic to the total SAC costs without cross-over traffic).

We face a dilemma, however, if we attempt to allocate revenues based on the relationship between a simplified and full SAC analysis. The full SAC costs for a particular cross-over movement cannot be judged without a full SAC analysis, an undertaking that would defeat the purpose of using cross-over traffic in the first place. Even if we knew the total replacement costs of the off-SARR segments used by cross-over movements, we have no method for allocating a share of those investment costs to just the cross-over movements. The off-SARR segments would have other traffic flowing over those lines that would be expected to contribute to the investment costs, but whose contribution would depend on the profitability of that traffic.

[15] See, e.g., Otter Tail Power Co. v. BNSF Ry., STB Docket No. 42058, slip op. at 11-13 (STB served Jan. 27, 2006) (Otter Tail); Duke Energy Corp. v. CSX Transp., Inc., STB Docket No. 42070, slip op. at 20-22 (STB served Feb. 4, 2004) (Duke/CSXT); Texas Mun. Power Agency v. Burlington N. & S.F. Ry., STB Docket No. 42056, slip op. at 17 (STB served Mar. 24, 2003) (TMPA); Bituminous Coal – Hiawatha, UT To Moapa, NV, 10 I.C.C.2d 259, 265-68 (1994) (Nevada Power).

In Duke/NS, the Board addressed this dilemma by focusing on the average costs that the railroad currently incurs to haul the traffic over the relevant segments. As stated there, the objective should be to select a revenue allocation methodology that reflects, to the extent practicable, the carrier's relative average costs of providing service over the two segments.[16] By focusing on the ratio of actual costs incurred by the carrier, the revenue allocation method should maintain, to the extent possible, the relationship between revenues and costs that would exist in a full SAC analysis. In the prolonged debate over how to allocate revenue from cross-over traffic, no party has yet offered a better approach.

Historically, the Board has used a mileage-based allocation procedure to allocate cross-over traffic revenues between the SARR and the residual incumbent. Under the current approach, the "Modified Straight-Mileage Prorate" (MSP), revenue is allocated based on the relative mileage hauled over the facilities replicated by the SARR and the residual facilities needed to serve that traffic, adding a 100-mile block or credit for the additional costs of originating or terminating the traffic.

Parties have pointed out that MSP, while simple and practical to apply, does not meet the stated objective. The MSP approach allocates revenues according to a crude estimate of the relative variable costs of hauling the traffic over the relevant segments, rather than the total costs. The approach therefore fails to take into account the defining characteristic of the railroad industry – economies of scale, scope and density.[17] There is no reason to believe that economies of density in this industry have been exhausted.[18] Yet only under such an assumption would a mileage-based approach provide an allocation based on average total costs.

In recent cases, the railroads have advocated an alternative to the MSP approach they call the "Density Adjusted Revenue Allocation" (DARA) method. Under DARA, one would first use URCS to calculate the variable cost to haul the cross-over traffic over the facilities replaced by the SARR and over the residual incumbent's portion of the movement. Then one would compute each movement's total contribution to joint and common costs (the revenue in excess of

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[16] See Duke Energy Corp. v. Norfolk S. Ry., STB Docket No. 42069, slip op. at 18-20 (STB served Nov. 6, 2003) (Duke/NS).

[17] See Guidelines, 1 I.C.C.2d at 531 ("there are at least some production economies in the rail industry, even though their nature and extent are the subject of debate and have not been established precisely").

[18] See, e.g., Ivaldi & McCullough, Density and Integration Effects of Class 1 U.S. Freight Railroads, 19 J. Reg. Econ. 161 (2001).

variable costs) and allocate that contribution to each segment in proportion to that segment's relative distance and in inverse proportion to density. The longer the distance and the lighter the density of lines used, the more revenue DARA would attribute to that segment. The basic premise of the approach is that more revenue should be allocated to segments that are lighter-density lines, because those segments, holding other factors constant, will have higher average total costs.

As discussed in Xcel, however, DARA is insensitive to the actual economies of density associated with particular movements over specific line segments.[19] Like all capital-intensive industries, the railroad industry is characterized by economies of density, meaning the average total cost for a network of a given size initially decreases with increases in output. But economies of density also diminish with higher output and at some point are exhausted. Therefore, the economies of density achieved by shifting from a 10 million gross ton (MGT) line to a 20 MGT line would be stronger than those achieved by moving from a 50 MGT to a 100 MGT line. Yet DARA would treat these two dissimilar situations as identical. By focusing only on which of the two segments has higher traffic densities, the DARA formula ignores the principle of diminishing economies of density. Because the railroads had failed to justify a departure from agency precedent, the Board continued to use MSP, despite its acknowledged flaws, in prior SAC cases.[20]

Board Proposal

As an alternative to MSP, we seek comments on using an "Average Total Cost" (ATC) approach for allocating cross-over traffic revenues. Using the URCS variable and fixed costs for the carrier, and the density and miles of each segment, parties can calculate the railroad's average total cost per segment of a move. The revenues from each portion of the movement would then be allocated in proportion to the average total cost of the movement on- and off-SARR. While this approach is similar to DARA, it does not suffer from the deficiency that led to the Board's rejection of DARA. Thus, this approach should address the railroads' legitimate concerns about the need to take into account economies of density when allocating revenue from cross-over traffic.

The following simplified example is offered to illustrate the basic approach. Assume there is a movement for which the railroad charges $10 per ton to haul the traffic 1,000 miles. Assume further that the SARR designed by the complainant would only carry that traffic 500 miles to a fictional interchange point with the residual railroad. To allocate the revenue from

[19] See Public Serv. Co. of Colo. d/b/a Xcel Energy v. Burlington N. & S.F. Ry., STB Docket No. 42057, slip op. at 9-11 (STB served Jan. 19, 2005).

[20] See, e.g., Otter Tail at 13.

that cross-over movement, the parties would have to estimate the average total cost (ATC) incurred by the railroad to haul that traffic over the 500-mile segment replicated by the SARR, and over the 500-mile segment of the residual railroad. First, the railroad's average variable cost (AVC) per ton to haul the traffic over each segment would be estimated using unadjusted URCS (as was the first step with DARA). The parties would then need to calculate the average fixed cost (AFC) per ton of traffic using the various segments. They would do so by calculating the railroad's system-average fixed cost per route mile, using URCS to determine the railroad's total fixed costs and dividing this figure by the total route miles of track operated by the railroad. This system-average fixed cost per route mile could then be combined with the route miles and the traffic density of any particular segment of the railroad's network to estimate an AFC per ton associated with that segment. The ATC for any particular segment would be the sum of AVC and AFC for that segment.

If the ATC for the segment replicated by the SARR were $2 per ton, and the ATC for the residual system were $5 per ton, then 28% ($2 ÷ ($5 + $2)) of the revenues from the cross-over movement would be allocated to the segment replicated by the SARR. In that fashion, the revenue allocation would be in proportion to the relative total cost of providing service to the cross-over movement, and would reflect the presence (or absence) of any economies of density. If the evidence showed that the economies of density had been exhausted, so that the ATC of the two segments was roughly equal, this alternative approach would allocate the revenue from cross-over traffic equally between the 500-mile movement on the SARR and the residual railroad.

III. Indexing Operating Expenses

Background

A contested issue in all recent SAC cases has been how the Board should index the SARR's base-year operating expenses over the DCF period. The parties most often take totally opposite positions. Shippers urge the Board to use forecasts of adjusted RCAF (RCAF-A), a rail cost adjustment factor adjusted for industry-wide productivity improvements. Railroads urge the Board to use forecasts of unadjusted RCAF (RCAF-U), a rail cost adjustment factor with no productivity adjustment.

Facing a choice between one or the other, the Board has chosen RCAF-U. The Board has recognized that use of RCAF-U is imperfect, particularly in the more distant years of the DCF analysis. But the Board has concluded that it is better to use RCAF-U than RCAF-A, which would overstate the SARR's anticipated productivity in every year of the DCF analysis. Because the SARR is designed to be an efficient replacement for the railroad, it would not be able to realize the same productivity gains as the rest of the industry, particularly in the early years of the DCF. For example, railroads realize productivity gains in locomotives as they replace old locomotives with newer technologies. The SARR would not experience those same productivity gains in the short term because it would begin its operations with all new locomotives.

We believe, however, that the index used to project the SARR's operating expenses should reflect some anticipated productivity improvements for the SARR. Even a SARR

designed to take advantage of all of the most recent technologies should experience some productivity improvements over an extended time frame. All companies "learn by doing," achieving incremental productivity improvements. And the SARR would be able to take advantage of future technological improvements as they occur, just as the existing railroads will.

Board Proposal

We propose to use a hybrid of the two indexes, starting with RCAF-U and phasing in the productivity gains projected in RCAF-A incrementally over 20 years. Specifically, the Board would use 100% of RCAF-U to project the SARR's operating expenses in the first year following the base year. The next year's index would be based on 95% of RCAF-U and 5% of RCAF-A. This pattern would continue, switching over in 5% increments each year, until in Year 20 the operating expenses of the SARR would mirror the productivity gains forecast for the railroad industry (100% of RCAF-A).

We believe it is reasonable to assume that the hypothetical SARR and the railroad industry would be similarly situated in 20 years. The rail productivity measured by RCAF-A takes two forms. There are the infrastructure efficiencies associated with increased use of existing rail infrastructure and abandonment of unprofitable lines. And there are the operating efficiencies associated with technological improvements and increasing labor productivity. The SARR would, by year 20, be using the same types of locomotives and railcars, with a comparable mix of depreciated and new equipment. And as the railroad industry continues to shed any excess or inefficient infrastructure, it is reasonable to assume that within the next 20 years the infrastructure utilization of the rail industry will catch up with that of the SARR. A 20-year phasing-in of RCAF-A therefore appears to be a fair compromise between the opposite positions of the railroads and shippers.

This proposal is not tied to the length of our SAC analysis period. Under this proposal, if we use a shorter SAC analysis period – a proposal discussed below – we would still phase-in the index from RCAF-U to RCAF-A in 5% increments each year.

IV. Movement-Specific Adjustments to URCS

Background

Under the statute, the Board may investigate the reasonableness of a challenged rate only if the carrier has market dominance over the traffic involved. The statute precludes a finding of market dominance where the carrier shows that the revenues it receives for transporting the movements at issue are less than 180% of its variable costs of providing that service. Furthermore, the variable costs associated with the traffic at issue also determine the floor for rate relief, because the Board cannot prescribe a rate that is below the jurisdictional floor.

Under 49 U.S.C. 10707(d)(1)(B), a carrier's variable costs are to be determined using URCS – the Board's "general purpose costing system for all regulatory costing purposes"[21] – with adjustment only where the Board finds it appropriate. In particular, the statute reads:

> variable costs for a rail carrier shall be determined only by using such carrier's unadjusted costs, calculated using the Uniform Rail Costing System cost finding methodology (or an alternative methodology adopted by the Board in lieu thereof) and indexed quarterly to account for current wage and price levels in the region in which the carrier operates, with adjustments specified by the Board. (emphasis added)

Thus, in this jurisdictional inquiry, Congress instructed the parties to use "unadjusted" URCS costs, with the decision whether to permit movement-specific adjustments committed to the agency's discretion.

The URCS model determines, for each Class I railroad, what portion of each category of costs shown in that carrier's Annual Report to the Board (STB Form R-1) represents its system-average variable unit cost for that cost category for that year. URCS consists of a series of computer programs and manual procedures organized into three phases. Phase I compiles the raw data into a useable format, and then uses statistical estimation procedures to determine the proportion of specific expense account groupings that vary with changes in the volume of activity (such as running track maintenance, which varies with gross ton-miles). These relationships are then used in Phase II to develop the unit variable costs that can be used to cost specific rail movements. Finally, Phase III permits expeditious application of these unit costs to the specific movements. This application can be performed using the Phase III program, an interactive computer program that permits the user to enter data for the specific movements under consideration.

In considering whether to allow adjustments to the system-average variable costs produced by URCS, the Board evaluates whether the party proposing to use a different figure has shown that its proposed figure would better reflect the variable costs of serving the particular traffic at issue than the URCS system-average figure. These adjustments are known as "movement-specific" adjustments. Shippers advocate movement-specific adjustments that would reduce the variable costs and increase the resulting R/VC ratios, while railroads advocate adjustments that would increase variable costs and reduce the resulting R/VC ratios.

[21] See Adoption of the Uniform Railroad Costing System As A General Purpose Costing System For All Regulatory Costing Purposes, 5 I.C.C.2d 894, 899 (1989) (Adoption of URCS).

With ICCTA,[22] Congress stressed the need to expedite cases. It added a new provision to the rail transportation policy calling for the "expeditious handling and resolution of all proceedings."[23] It further instructed the Board to establish procedures to ensure expeditious handling of rail rate challenges in particular, including "appropriate measures for avoiding delay in the discovery and evidentiary phases of such proceedings."[24]

Calculating variable costs using URCS is a quick and administratively simple process. The advance work is performed by the Board annually. The Board then offers the Phase III computer program to the public at a minimal cost. Nevertheless, in all recent SAC cases, the parties have expended substantial resources in advocating movement-specific adjustments to URCS.

Board Proposal

We believe that movement-specific adjustments to the system-average unit costs should be discontinued in rate reasonableness cases. Although it has been the longstanding practice of this agency to permit such adjustments, they do not appear to serve a useful public purpose for a variety of reasons.

First, railroads do not consistently keep certain types of information that shippers have relied on for favorable movement-specific adjustments.[25] Such an imbalance between the accounting practices of the railroads risks biasing the result of our jurisdictional inquiry in favor of a railroad that decides not to gather or keep the information. And requiring all railroads to maintain the necessary information would not comport with Congress's directive to minimize the need for Federal regulation[26] and to minimize the burden on the railroads of developing and

[22] ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803 (1995).

[23] 49 U.S.C. 10101(15).

[24] 49 U.S.C. 10704(d).

[25] Compare Public Serv. Co. of Colo. d/b/a Xcel Energy v. Burlington N. & S.F. Ry., STB Docket No. 42057, slip op. at 136 (STB served June 7, 2004) (Xcel) (using railroad's investment data for individual line segments to develop movement-specific adjustment), with CP&L at 127 (using URCS system-average costs because the railroad did not keep comparable line-specific investment data).

[26] See 49 U.S.C. 10101(2).

maintaining the costing information needed to ensure accuracy in regulatory proceedings.[27] The Board already requires that railroads maintain extensive cost information, which is audited by the Board and is the foundation of our annual URCS calculations.

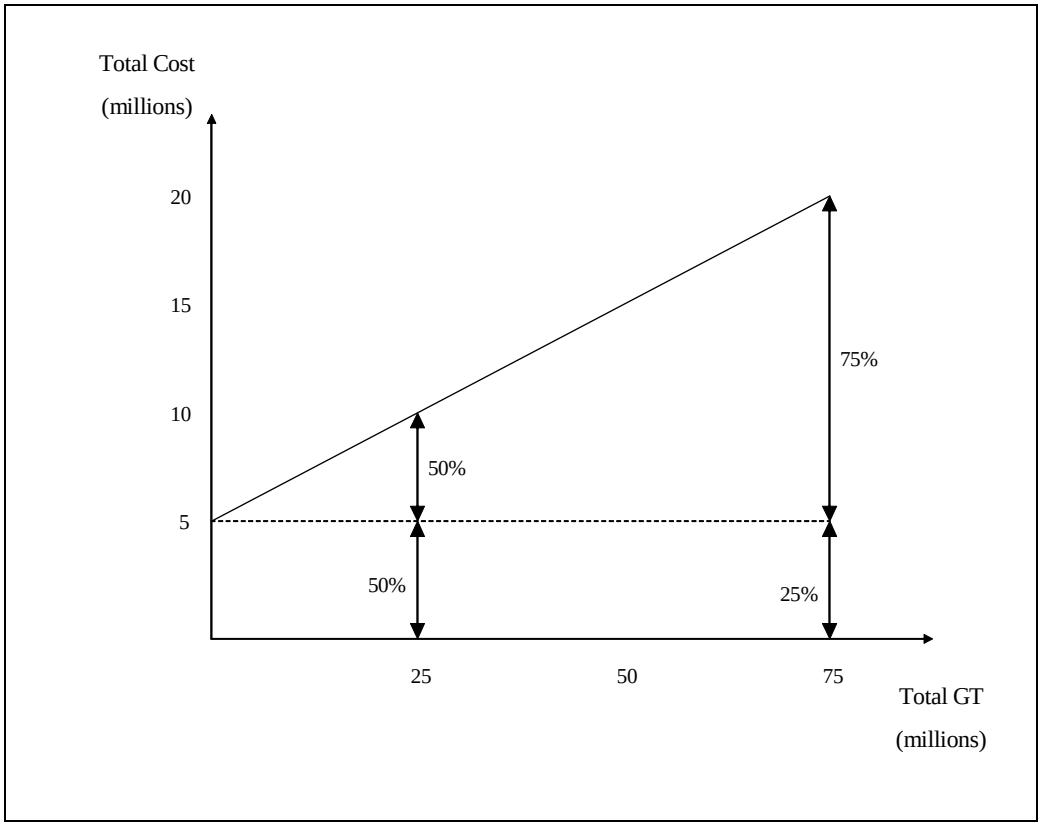
Second, adjustments to URCS may not provide more reliable results than using the system-average expenses. The regression models in URCS provide estimates of the percent of each expense category that is variable. That variability parameter is then combined with the total expense category to estimate the variable component.[28] Although parties routinely seek to substitute a movement-specific cost in place of a system-average cost, they apply the system-average variability parameter to calculate the proposed movement-specific adjustment. Such an approach is improper, as the variability parameter will increase when traffic increases on a network. In other words, for movements over high-density segments, the variability percentage should be higher than for the "system-average" movement. But such adjustments to the variability percentage are not made when parties submit proposed movement-specific adjustments.

This theoretical concern was presented to the agency in the Xcel case, where the railroad properly noted that the variability factor that is applied to an expense category such as return on road property investment is premised on system-average density. The railroad explained that, because URCS costs assume a linear relationship between total costs and traffic volume, the proportion of total cost that is variable increases as density increases. The following graph was offered to illustrate the conceptual error in permitting movement-specific adjustments.

[27] See 49 U.S.C. 10101(13).

[28] See generally Otter Tail at 26-27.

Variability Factor



This chart depicts a linear cost function in which costs are 50% variable at the system-average density of 25 million tons. On a segment with a density of 25 million tons, the average variable cost would be 20¢ per ton ($10 million in total cost, multiplied by the 50% variability factor, and divided by 25 million tons). However, on a segment with three times as much traffic, variable costs would represent 75% of total cost. If the variability factor were adjusted to 75% to reflect this relationship, then the average variable cost at the 75 million ton density would be the same (20¢ per ton) as at the 25 million ton density. But as the railroad noted, if no adjustment were made to the variability factor, the movement-specific adjustment would yield a variable cost per ton of 13.3¢ per ton, distorting the actual average variable cost per ton. The railroad noted that, assuming a linear relationship between the expense category and output, which is the specification used in URCS, the average variable cost per ton would not change as traffic levels increase (although the average total cost would fall with increasing output until economics of density were exhausted). While recognizing this theoretical concern, the Board did not permit the railroad to use this argument selectively, as a weapon to attack those movement-specific adjustments proposed by the shipper, while the railroad itself sought movement-specific adjustments that appeared to suffer the same analytical flaw. See Xcel at 136-37.

Third, piecemeal or incomplete adjustments to URCS are suspect. There are hundreds of individual expense categories that URCS uses to estimate the variable cost of a movement and the parties do not seek to adjust all of them. Indeed, many of the expense categories could not be

changed, because movement-specific information is unavailable. Yet selective replacement of system-average costs with movement-specific costs may bias the entire analysis, rendering the modified URCS output unreliable.

Fourth, the analysis of proposals for movement-specific adjustments is complex, expensive, and time consuming. Massive discovery is required. Detailed adjustments to the URCS program are needed and exhaustive analysis of the reliability of the evidence is performed, even if the final result, after all adjustments are made, would be a variable cost estimate that closely mirrored the unadjusted URCS calculations.[29] Neither party dares rest its case on an unadjusted URCS calculation, lest there be a lopsided adjustment in favor of the other party. And disputes over variable costs force parties (and the Board) to divert resources from the core issue in these cases – whether the challenged rate is unreasonable.

Fifth, we believe Congress intended, in adopting the 180% R/VC limitation on Board rate review, to create an administratively quick and easy-to-determine regulatory safe harbor for the railroads. If a railroad chooses to price its traffic within this safe harbor, it should not need to worry about regulatory intervention. This goal is ill-served by allowing exhaustive discovery, volumes of evidence, significant consulting fees, and months of effort before parties can determine whether the Board has jurisdiction to consider the reasonableness of a rate. Indeed, the purpose of having an econometrician develop the Board's elaborate URCS model was to have a robust costing model that front-loaded the work. When called upon to cost a movement, the Board could then do so expeditiously. Yet in recent SAC cases the Board has devoted months of staff resources to perform what should be a quick and uncomplicated threshold jurisdictional inquiry.

Sixth, the URCS program already tailors the variable cost calculation to the movement at issue. To determine the variable cost of a particular movement, the user inputs a number of operating characteristics of the shipment.[30] Thus, numerous movement-specific operating

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[29] See BP Amoco Chemical Co. v. Norfolk S. Ry., STB Docket No. 42093, slip op. at 9 (STB served June 6, 2005).

[30] URCS Phase III requires the user to input nine types of information about the particular movement: (1) the railroad; (2) loaded miles (which should include loop track miles); (3) shipment type (local, originated delivered, bridge, received terminated); (4) number of freight cars; (5) tons per car; (6) commodity (for loss and damage expense only); (7) type of movement (single, unit, multiple); (8) car ownership (railroad or private), and (9) type of car. There are a number of adjustments or calculations URCS Phase III then makes to estimate the cost of a specific shipment based on the nine user inputs noted above. These include, but are not limited to, the calculation of round trip miles; the number of locomotives; switching costs, clerical cost, way train miles, tare weight of the car, and railroad and private line car costs. URCS also calculates the additional costs required to move trailer-on-flatcar traffic, such as the cost and

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characteristics are already incorporated into the URCS analysis. Moreover, URCS has an adjustment that reduces the cost of unit-train shipments to reflect the efficiencies of such movements. Thus, unit trains are not costed the same way as other shipments.

Finally, prohibiting movement-specific variable cost adjustments would eliminate substantial uncertainty in the current rail rate adjudication process. Thus, the potential for either pre- or post-filing settlements would increase.

When the ICC adopted URCS, it did not foreclose the use of alternative cost-estimating procedures in rate reasonableness proceedings where the agency had traditionally accepted such evidence.[31] We now have far more knowledge and experience in how URCS is used in these proceedings, and the kinds of adjustments advocated by both parties. For the reasons discussed above, such adjustments significantly complicate these proceedings and we are not persuaded that the increased cost and complexity created by these adjustments is justified. Prohibiting movement-specific adjustments would have the same positive effect of streamlining rail rate cases as the Board's action to remove consideration of product and geographic competition from the market dominance inquiry.[32] And this proposal is consistent with the basic objective of URCS to be the Board's "general purpose costing model for all regulatory purposes."[33]

For all these reasons, we propose to limit the parties to the use of the URCS Phase III movement costing program and to disallow movement-specific adjustments other than those made automatically by URCS. If a party believes that URCS could be improved, or better tailored to particular movements, it should request a separate rulemaking in which it offers its specific proposal and the proposal is subjected to industry-wide comment and, if adopted, uniform application. That is how URCS has evolved since its initial adoption in 1989. But in an individual rate reasonableness proceeding, the Board proposes to use its existing URCS model, without further movement-specific adjustment, to make the jurisdictional inquiry and to set the floor for regulatory relief.

(continued . . .)
weight of the container, tie and untie cost, and pickup and delivery cost. This is also true for costs associated with other types of specialized services.

[31] See Adoption of URCS, 5 I.C.C.2d at 899 n.12.

[32] Market Dominance Determinations–Product & Geographic Competition, 3 S.T.B. 937 (1998), aff'd, AAR v. STB, 306 F.3d 1108 (D.C. Cir. 2002).

[33] See Adoption of URCS, 5 I.C.C.2d at 899 (emphasis added).

V. Stand Alone Cost Analysis Period

Background

In SAC cases, the agency uses a multi-year analysis in lieu of a single-year analysis. See Guidelines, 1 I.C.C.2d at 545.[34] It does so to deal with taxes, which are a function of the flow of revenue over the analysis period and permissible deductions under state and Federal tax laws, and to accommodate the impact of business cycles.[35] Thus, the Board uses a DCF analysis to compare the revenue requirements of the SARR against the total revenues to be generated by the traffic group over the full SAC analysis period. An illustration and description of the DCF analysis can be found in recent SAC cases.[36] If the DCF analysis demonstrates that the challenged rate is unreasonable, the Board will generally exercise its discretion under 49 U.S.C. 10704(a)(1) and prescribe the maximum lawful rate to govern future shipments for the duration of the SAC analysis period. The Board has never, however, prescribed the number of years that should be included in this multi-year DCF analysis.

Historically, the parties have used a 20-year analysis period. There have been instances, however, where parties have asked the Board to shorten the analysis period. In one such instance, railroads advocated a 1-year analysis period,[37] and in another case a shipper asked the Board to truncate the analysis period once forecast revenue fell below the revenue requirements of the SARR.[38] While the Board was not persuaded by either of those proposals, for the reasons discussed below, we have come to believe that the SAC analysis period should be shorter than 20 years.

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[34] The Railroad Accounting Principles Board endorsed the use of a multi-year SAC analysis period. See Railroad Accounting Principles Board – Final Report, Vol. 2., pp. 67-70 (Sept. 1987). That Board was established by Congress to evaluate issues associated with rail costing and to propose principles to govern the estimation of such costs. See former 49 U.S.C. 11161-11163 (1995).

[35] See Coal Trading, 6 I.C.C.2d at 411.

[36] See Otter Tail at E1-E6; see also Nevada Power, 10 I.C.C.2d at 274-77.

[37] See UP/BNSF Joint Motion for Limited Consolidation, STB Docket Nos. 42054, 42056, 42057, 42058 (filed July 5, 2001).

[38] See Duke Energy Corp. et al. v. Norfolk S. Ry. et al., STB Docket Nos. 42069, 42070, 42072, slip op. at 18 (STB served Oct. 20, 2004).

Board Proposal

We propose to shorten the analysis period to 10 years in SAC cases for several reasons. First, as a practical matter the benefits of a 20-year analysis and potential rate prescription are illusory. Rate prescriptions have tended to endure no longer than 10 years because of inevitable and substantial changes in circumstances. The logistics industry is dynamic, with changes in market conditions rendering obsolete the underlying assumptions in older SAC analyses well before the 20-year analysis period has ended. This eventuality, in turn, would require that parties either relitigate SAC cases on reopening or petition the Board to take the more drastic measure of vacating the outdated prescription altogether. For example, the railroad in APS sought to have the rate prescription vacated within 10 years of the initial decision; and the shipper in West Texas sought the same relief within 10 years of that decision. There is no reason that future rate prescriptions will be less prone to obsolescence for one reason or another. Thus, the added value (to the shipper or railroad) of the rate prescription from Year 10 to Year 20 is questionable.

Second, a 20-year analysis period is not necessary either to address taxes or to capture an average business cycle. In all recent cases, the hypothetical SARR would have begun paying full taxes within 10 years of the base year.[39] And a 20-year analysis period is twice what is needed to incorporate the effects of a business cycle. There have been 32 business cycles between 1854 and 2001, with an average cycle of 55 months (4.5 years).[40] Since 1960, the average length of a business cycle was 82 months (about 7 years). Although business cycles have been getting longer (July 1981 – July 1991, July 1991 – March 2001), a 10-year analysis will still capture a full business cycle.

Third, a shorter SAC analysis period would reduce both the expense and complexity of the SAC analysis by limiting disputes over forecasted trends for traffic volumes, revenues, and operating expenses. Reducing the expense of making a SAC presentation could make our CMP guidelines available to more shippers. Moreover, by shortening the analysis period, the maximum lawful rate would depend less on predictions of distant events and more on known market conditions.

Fourth, a shorter period for our SAC analysis and shorter duration of the resulting rate prescriptions would conform our regulatory process to the trend in the rail industry towards

[39] See, e.g., Otter Tail (tax credits exhausted by Year 9); Xcel (Year 8); CP&L (Year 7); TMPA (Year 7).

[40] Information on business cycles in the American economy is available publicly from the National Bureau of Economic Research. See http://www.nber.org/cycles/cyclesmain.html.

shorter contract terms. When rail transportation contracts were first sanctioned in the Staggers Rail Act of 1980,[41] parties entered into contracts for terms as long as 20 years. However, as noted in a recent Congressional Budget Office (CBO) report, in recent years "as both railroads and electric companies have been buffeted by regulatory and market changes, they have been more reluctant to enter into such lengthy contracts."[42] These CBO findings are confirmed by the contract agreements submitted to the Board, on a confidential basis, in recent SAC proceedings.[43]

Fifth, this proposal would remove the need for shippers to hypothesize a SARR with sufficient infrastructure to handle traffic forecasts that might be realized decades later. In recent SAC cases, complainants have constructed SARRs with sufficient capacity to handle the peak week of the peak year of a 20-year analysis period. Because demand for rail transportation service is forecast to increase over that time period, the peak period forecast is often two decades in the future. But for practical reasons – given the difficulty and considerable expense of designing and modeling incremental capital investments in each year – shippers have chosen to design a SARR with sufficient capacity in Year 1 to handle a level of traffic that may not be realized until Year 20. But by curtailing the SAC analysis period, the SARR would reflect that amount of rail capacity needed to handle current market demand, rather than to reflect capital investments to meet demand growth, investments that the railroad itself has typically yet to make. As the Board has stated, it is plainly unfair to force today's ratepayers to pay for costs that may not be accurately calculated, and that would be generated, if at all, by service to ratepayers 20 years in the future.[44]

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[41] Pub. L. No. 96-448, 94 Stat. 1895 (1980).

[42] Congressional Budget Office, Freight Rail Transportation: A Review of the 2004 Experience at 12 (May 2005). See also Congressional Budget Office, Freight Rail Transportation: Long-Term Issues at 15 n.75 (Jan. 2006) (same finding).

[43] See, e.g., Wisconsin Power & Light Co. v. Union Pac. R.R., 5 S.T.B. 955, 978 (2001) (WPL) (new transportation contracts were for an average of 4 years); see also TMPA at 29 n.72 (railroad argued that its shippers were negotiating shorter contracts).

[44] West Texas Util. Co. v. Burlington N. R.R., STB Docket No. 41191, slip op. at 4 (served June 25, 1996) (declining to extend the SAC analysis beyond 20 years); see also FMC, 4 S.T.B. at 741 ("[W]e do not believe that it would be fair or proper to set the rates that [a railroad] can now charge based on economies of density and revenue contributions that do not yet exist.").

A 10-year SAC analysis period appears to strike a more reasonable balance. It covers an average business cycle but removes unreliable distant forecasts from our core analysis. This is not to suggest that the revenue requirements of a SARR over the 10-year period would need to recover the full capital investment, often billions of dollars, within that 10-year window. Just as is currently done in a 20-year analysis,[45] we would continue to calculate a "terminal value" at the end of the shorter SAC analysis period. Parties are invited not only to comment on this time period but on how the electronic spreadsheets used in these cases should be modified to make this change if adopted.

VI. Uniform Standard for Reopening, Vacating & Filing a New Case

Background

Reopening A SAC Proceeding

The basic standard for reopening a Board proceeding is set forth in 49 U.S.C. 722(c), which requires a showing of material error, new evidence, or substantially changed circumstances.[46] In deciding whether a litigant has justified the reopening of a SAC case, the Board balances concerns of fairness, accuracy and repose, taking into account the considerable time and expense required to adjudicate the reasonableness of a rate under the SAC test, as well as the fact that the SAC test relies substantially on long-range forecasts. The Board has reopened a SAC case to correct an obvious error,[47] or to update and revise the record regarding the long-term forecasts used,[48] but it has declined to reopen a SAC case to address short-term, year-to-year fluctuations that do not undermine the long-term projections that were used.[49]

If the Board determines that a reopening is warranted, a further question is raised regarding the scope of the reopening. The Board has sought to confine a reopened SAC case to

[45] See, e.g., Otter Tail at E1.

[46] See also 49 CFR 1115.4.

[47] See West Texas Util. Co. v. Burlington N. R.R., STB Docket No. 41191, slip op. at 3 (STB served May 28, 2003) (West Texas-May 2003).

[48] See, e.g., Arizona Pub. Serv. Co. v. Atchison, T. & S.F. Ry., STB Docket No. 41185, slip op. at 5 (STB served May 12, 2003) (APS-May 2003).

[49] See Arizona Pub. Serv. Co. v. Atchison, T. & S.F. Ry., 3 S.T.B. 70, 75 (1998).

addressing the basic SAC analysis that was originally presented in the case.[50] Parties have not been allowed in a reopened proceeding to expand the geographic scope of the SARR on which the SAC analysis was based, or to alter substantially the composition of the traffic group used in the SAC analysis.

The most recent application of this limited reopening policy for SAC cases was in the APS case. By 2003, it was clear that coal reserves at the McKinley mine the SARR had been designed to serve (near Gallup, NM) would be depleted long before the conclusion of the 20-year SAC period upon which the Board's 1998 rate prescription had been based. Both parties agreed that these changed circumstances warranted reopening the proceeding. APS–May 2003 at 3. However, they took radically different positions as to what the Board should consider in a reopened SAC analysis. The railroad (BNSF) argued that the Board should limit the reopening to consider only the impact of the depletion of the McKinley mine on the prior SAC analysis. Its justification for a very narrow reopening was its assumption that, once the McKinley coal supply was depleted (before the end of the original SAC analysis period), the entire SARR would become obsolete. The shipper (Arizona Public Service) disagreed. It argued that the original SARR could transport replacement coal coming from the nearby Lee Ranch mine as interchange traffic received at Defiance, NM, without needing to change the configuration of the SARR. However, the shipper also sought to expand the configuration of the SARR system and to change the traffic group it had selected in its initial case against BNSF, as well as to introduce evidence of all changed circumstances since 1998.

The Board concluded that it could reexamine the SAC rate for remaining shipments from the McKinley mine without altering the configuration of the SARR. Rather, by assuming that the SARR (as originally configured) would transport the replacement coal, under an interchange arrangement, for the portion of the movement conducted over lines replicated by the original SARR, the appropriate amount of revenues and costs associated with the replacement coal traffic could be reflected in a reopened SAC analysis. Parties were also permitted to update the forecasts used in the original proceeding. But Arizona Public Service was not permitted to otherwise change the traffic group to add other overhead traffic, as it had requested.

The Board acknowledged the concerns associated with forcing parties to make initial SARR configuration and traffic decisions that will bind them for unreasonable lengths of time. APS-Oct. 2003 at 6. Thus, the Board advised Arizona Public Service that, if it was not satisfied with the limited scope of the reopening, the shipper could present an entirely new SAC analysis, based on a new SARR configuration and traffic group, by first having the prior prescription

[50] See APS-May 2003 at 5-6; Arizona Pub. Serv. Co. v. Atchison, T. & S.F. Ry., STB Docket No. 41185, slip op. at 4-6 (STB served Oct. 14, 2003) (APS-Oct. 2003); West Texas-May 2003 at 4; West Texas Util. Co. v. Burlington N. R.R., STB Docket No. 41191, slip op. at 6 (STB served June 26, 2003) (West Texas-June 2003); West Texas Util. Co. v. Burlington N. R.R., STB Docket No. 41191, slip op. at 3 (STB served July 23, 2003) (West Texas-July 2003).

vacated and then filing a new rate complaint against whatever rate BNSF might choose to set. Id.

Arizona Public Service elected to proceed with the limited reopening rather than pursue a new case. Based on that reopening, the Board concluded that a rate prescription was no longer necessary or appropriate and vacated the prior rate prescription (whose prescriptive effect had been suspended pending the outcome of the reopening). See Arizona Pub. Serv. Co. v. The Atchison, T. & S.F. Ry., STB Docket No. 41185, slip op. at 8 (STB served Dec. 13, 2004) (APS-Dec. 2004).

Vacating A Rate Prescription

When a railroad seeks to have a rate prescription vacated, it must first demonstrate that the standard in section 722(c) for reopening the prior case has been met. And to justify vacating the rate prescription – rather than reopening the case to recalculate the rate prescription – the railroad has been required to demonstrate that the factual and legal underpinnings of the original prescription no longer continue to have validity. San Antonio, Tx. v. Burlington N., Inc., 364 I.C.C. 887, 896 (1981).

In contrast, when a complaining shipper seeks to have a rate prescription vacated, the Board's policy has been to grant the request without requiring a particular showing. In West Texas Util. Co. v. Burlington N. R.R., STB Docket No. 41191, slip op. at 3 (STB served Mar. 19, 2004) (West Texas-Mar. 2004), the Board explained that, as "the proponent and beneficiary of the rate prescription, the complaining shipper should be entitled to have that prescription vacated upon request, without having to show that the prescription is now defective." The Board reasoned that this policy appropriately "ensured that a captive shipper who prevails on its rate complaint in the first instance does not later end up in a worse position – by having to bear a higher rate than would be justified under a new SAC analysis." Id.

West Texas Remand

The railroad challenged the Board's decision in West Texas-Mar. 2004 to vacate the rate prescription without first determining that the shipper had satisfied the reopening standard of section 722(c). It argued that a carrier also benefits from the certainty afforded by a rate prescription and that the Board should not have different standards for vacating a prescription depending upon which party requests the action.

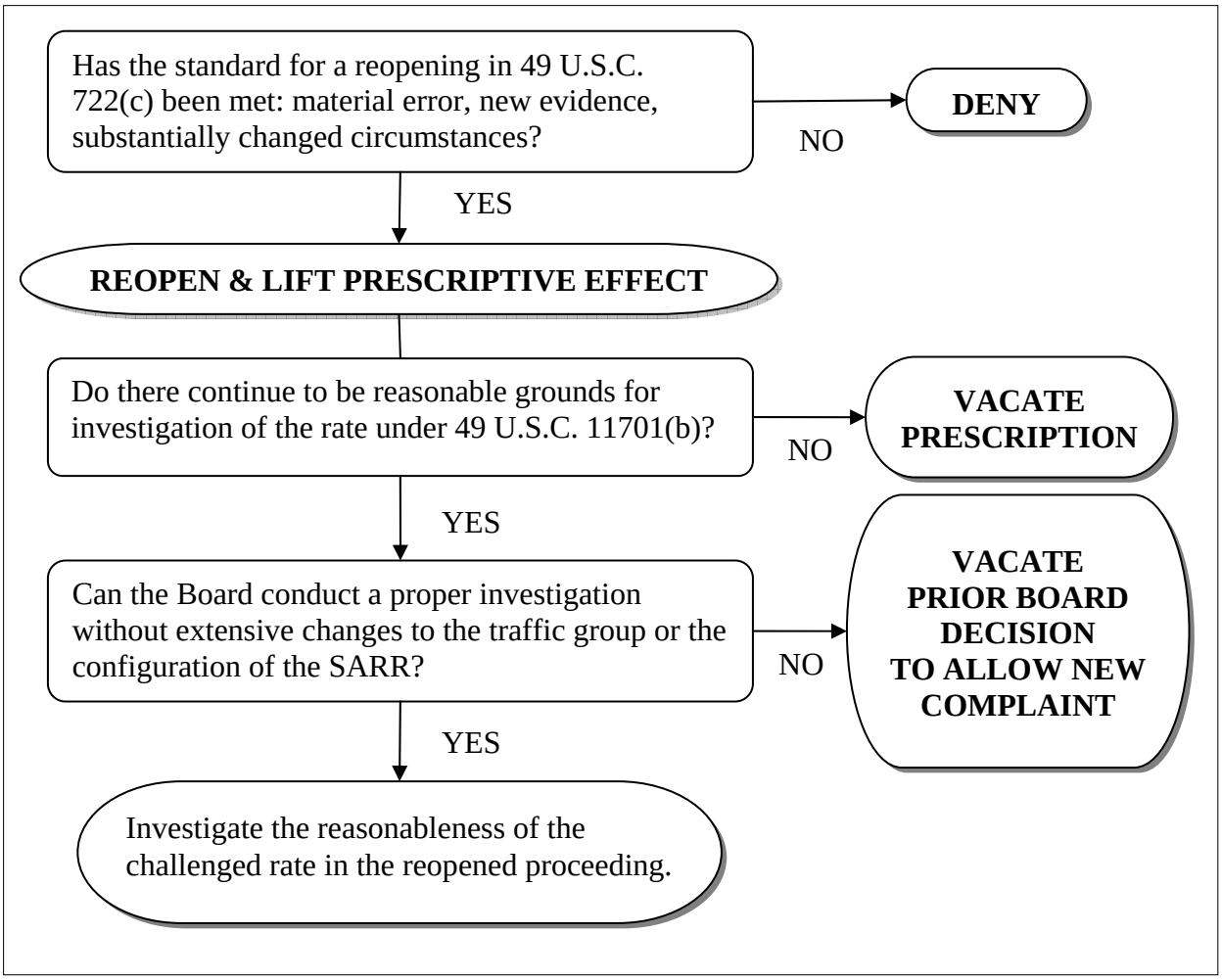
The court agreed with the railroad that both the carrier and shipper are protected by a rate prescription. Burlington N. & S.F. Ry. v. STB, 403 F.3d 771, 777 (D.C. Cir. 2005) (West Texas Remand). The court concluded that the Board had not justified applying different standards depending upon which party requested the vacatur. Id. at 777-78. And the court rejected the argument that requiring an evidentiary showing by the shipper that had obtained the prescription would result in unequal treatment vis-à-vis a shipper that had been unsuccessful in an earlier rate

complaint. Rather, the court cited agency precedent for the proposition that an unsuccessful litigant may not bring a new rate complaint without making the showing that would be needed to reopen a prior case. Id. at 777. Accordingly, the court vacated the West Texas – Mar. 2004 decision and remanded that case to the Board. Id. at 778.

Board Proposals

In addressing the court's remand, we must take into account the ramifications for other Board policies. Thus, we have given considerable thought not only to the particular matters discussed by the court and returned to us on remand, but also to the implications for related policies. Whereas the Board's policies on these interrelated subjects have been developed on a case-by-case basis, we have reexamined them in a coordinated, comprehensive manner to achieve a cohesive set of policies that are suited to the SAC test. Our continuing goal is to strike the "appropriate balance between the interests of fairness to all parties and of administrative finality and repose." APS, 3 S.T.B. at 75. We seek to ensure that rate prescriptions that rest upon a dated SAC analysis remain valid and effective, while guarding against repeated litigation.

The flowchart below depicts the steps we propose to take when either a shipper or a railroad seeks to reopen or vacate a SAC proceeding. The details of and rationale for the proposal follow.



Having considered the court's decision in West Texas Remand, we adopt the holding that either party should be required to demonstrate that reopening is warranted based on the standard set forth in section 722(c) (material error, new evidence, or substantially changed circumstances) when seeking either to reopen a proceeding or to vacate an existing rate prescription. Similarly, an unsuccessful litigant should have to make that showing before it may reopen a case or have the prior decision vacated so that it may file a new complaint challenging the same common carrier rates it had previously challenged.

Once a party has justified reopening a rate case under section 722(c), the Board must then consider whether the changes can be reasonably addressed in a reopened proceeding, or if the further step of vacatur is required. The Board should first consider whether there continue to be reasonable grounds for investigation of the rate under 49 U.S.C. 11701(b). For example, if the new evidence shows that the carrier no longer has market dominance over the transportation at issue, there would be no basis for the Board to review the level of the rate. In that circumstance, any outstanding rate prescription would need to be vacated, because the legal underpinnings of the rate prescription no longer have validity.

Where there continue to be reasonable grounds for a rate investigation, the Board should examine the factual underpinnings of the prior SAC analysis (and any resulting rate prescription) to determine if it could suitably conduct the investigation within the framework of the old SAC analysis (in a reopened proceeding), or if a new SAC analysis (after vacatur) would be needed. Some types of changes can be integrated into an old SAC analysis without undue complications and without compromising the integrity of the SAC analysis. Examples would be updating revenue forecasts or adjusting the indexes used to inflate the operating expenses and road property investment of the SARR. Other kinds of changes may be ill-suited to working within the framework of an old SAC analysis. For example, extensive changes to the SARR configuration would require analysis of significant additional investment and new track construction costs. And extensive changes to the traffic group could affect the SAC analysis in a fundamental way, requiring the submission of a new operating plan for the SARR. In such instances, extensive discovery may be required.[51] At some point, attempting to interweave the old and new SAC presentations would be so complicated and convoluted that it would be preferable to vacate the old decision and permit the complainant to design a new SARR in a new SAC proceeding. In that circumstance, a new SAC analysis would be less complex and would yield a more reliable result.

Therefore, upon reopening, the Board would vacate the old rate decision (and any resulting rate prescription) if it concludes that extensive changes to the traffic group or the configuration of the SARR would be needed to conduct a proper investigation into the challenged rates. Similarly, an unsuccessful litigant would be permitted to file a new rate complaint, and present a new SAC analysis, if the Board were to conclude that extensive changes to the traffic group or SARR configuration were needed to conduct a proper investigation into the challenged rates. Because we expect that changes substantial enough to warrant vacatur would entail in nearly all instances extensive changes to either the traffic group or SARR configuration, we have focused our proposed vacatur standard upon these two core components of a SAC analysis.

The decision to vacate a prior Board decision is unavoidably discretionary and must be made on a case-by-case basis. But once a party has justified a reopening, it is the Board's responsibility to determine whether a new investigation can be conducted within the framework of the old SAC analysis, or whether the broader public interest is better served by starting afresh through vacatur and a new SAC analysis presented in a new complaint. This is consistent with this agency's regulatory responsibility to be "the 'guardian of the general public interest,' with a duty to see that this interest is at all times effectively protected."[52] Thus, it is the Board's duty to

[51] See APS-Oct. 2003 at 6 n.7.

[52] H.R. Doc. No. 678, Practices and Procedures of Governmental Control of Transportation, 78th Cong., 2d Sess., at 53 (1944); see also Southern Class Rate Investigation, 100 I.C.C. 513, 603 (1925) ("The Commission is the guardian of the general public interest, and (continued . . .)

"weigh alternatives and make its choice according to its judgment of how best to achieve and advance the goals of the National Transportation Policy."[53]

Our proposal here should address the court's concerns in the West Texas Remand. It would eliminate disparate treatment of parties and would reflect a return to prior agency precedent regarding the applicability of the section 722(c) standards to requests to vacate[54] and to efforts by an unsuccessful complainant to relitigate the reasonableness of the rates for that traffic.[55] And by placing limits on a shipper's ability to file a new complaint, this proposal would protect railroads from the threat of repetitive litigation by unsuccessful litigants who can demonstrate no more than a desire to make a better case. The need for some repose in rate investigations reflects "the sound and obvious principle of judicial policy that a losing litigant deserves no rematch after a defeat fairly suffered. . . ." Astoria Fed. Sav. & Loan Ass'n v. Solimino, 501 U.S. 104, 107 (1991). Otherwise, the resources of this agency would be drained with rate disputes resisting resolution. Id. at 107-08.

Finally, we propose that, upon reopening a proceeding, the Board would lift the prescriptive effect of the rate prescription. As in APS-May 2003, the railroad would be instructed to maintain the status quo, the parties would be directed to keep account of the amounts paid during the pendency of the rate investigation, and, upon completion of the investigation, one party would then be required to make the other party whole. We propose to take this step to avoid causing irreparable harm to either party during the pendency of the reopened proceeding.

The Board has the express authority under 49 U.S.C. 721(b)(4) to prevent irreparable harm. We believe that the Board also has the implicit authority under 49 U.S.C. 722(b) and 10704(a)(1) to lift the prescriptive effect of a rate prescription (the imposition of which was discretionary in the first place) once there has been a showing of new evidence, substantially

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(continued . . .)
it must have in mind not only the carriers and the larger shipping interest but also the smaller communities and the great body of consumers.").

[53] Baltimore & Ohio R.R. v. United States, 386 U.S. 372, 429 (1967) (Brennan, J., concurring).

[54] See San Antonio v. Burlington N., 364 I.C.C. 887 (1981); Ark. Rice Traffic Bureau v. Aberdeen & Rockfish R.R., 219 I.C.C. 5, 46-47 (1936); Cherry-Burrell Corp. v. Atchison, T. & S.F. Ry., 210 I.C.C. 148 (1935).

[55] See Traugott Schmidt & Sons v. Michigan Central R.R., 23 I.C.C. 684 (1912).

changed circumstances, or material error that calls into question the SAC analysis upon which the prescription was based.

It has been said that, where there is a dispute about the appropriate rate prescription, the equities favor allowing the carrier's rate to control pending this agency's resolution of the dispute. See Burlington Northern, Inc. v. United States, 459 U.S. 131, 141-42 (1982). But with the protective procedure outlined here, which was used in the APS case, we do not believe the equities require that action. Moreover, immediately restoring rate making initiative to the carrier, which may prove to be only temporary, would punish the shipper for seeking to reopen a rate prescription and, in our view, would be contrary to the public interest. The keep-account and make-whole procedure we propose to use should protect both parties from harm resulting from the delay inherent in the process of reopening and revising the SAC analysis.

We also believe that lifting the prescriptive effect of a rate prescription once the evidence justifies reopening a case, and then at the end of the investigation changing a rate prescription retroactive to the date of the reopening, is consistent with Arizona Grocery Co. v. Atchison, T. & S.F. Ry., 284 U.S. 370 (1932). There, the Supreme Court held that the ICC could not award reparations to a complaining shipper with respect to past shipments that had moved under previously approved and prescribed rates. The Court reasoned that the rate prescription was an action that was legislative in nature and thus had the force of a statute in establishing the lawful rate. Id. at 386-87. The ICC was bound to recognize the validity of the rule of conduct approved by it and could not repeal its own enactment with retroactive effect. Id. at 389. In other words, "the carrier is entitled to rely upon the declaration as to what will be a lawful, that is, a reasonable, rate." Id.

Thus, the lawfulness of rates approved and prescribed pursuant to 49 U.S.C. 10704(a)(1) cannot be challenged with respect to traffic that has moved prior to the date of a reopening. But the evidence that justifies a reopening will also raise genuine questions about the proper rate prescription for the future. We believe that, by placing the parties on notice that once a proceeding has been reopened the prescriptive effect of a rate prescription will be lifted, while requiring the carrier to maintain the status quo, the Board can then lawfully change the rate prescription back to the date of the reopening without violating the prohibition against retroactive ratemaking. The situation on reopening would be analogous to the implicit power of the Board to change retroactively a rate prescription when the agency's order is reversed by a reviewing court. Cf. United Gas Improvements Co. v. Callery Properties, 382 U.S. 223, 229 (1965); Natural Gas Clearinghouse v. FERC, 965 F.2d 1066, 1076-75 (D.C. Cir. 1992); Iowa Power & Light Co. v. United States, 712 F.2d 1292 (8th Cir. 1983). Just as a carrier or shipper cannot "rely upon the declaration as to what will be a lawful, that is, a reasonable, rate" (Arizona Grocery, 284 U.S. at 389) until the administrative and judicial review process has been exhausted, similarly the parties would be on notice that they could no longer rely on a rate prescription as a declaration of what is lawful once new evidence has persuaded the Board that reopening the case is warranted.

This action should not have a significant economic impact upon a substantial number of small entities, within the meaning of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.). To the extent that small entities may be affected, the impact should be beneficial, because these proposals will resolve several contentious issues in SAC proceedings, and simplify the jurisdictional inquiry. We invite, however, comments on whether there would be effects on small entities that should be considered.

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

It is ordered:

1. All parties wishing to participate in the STB Ex Parte No. 657 (Sub-No. 1) proceeding should file a notice of intent to participate with the Board by March 20, 2006.

2. Submissions addressing the proposals discussed herein are due by May 1, 2006. Reply submissions are due by May 31, 2006. Rebuttal submissions are due by June 30, 2006.

3. A service list, identifying all parties that have filed notices of intent to participate, will be available at the Board's website, www.stb.dot.gov by March 31, 2006.

4. An original and 20 copies of each submission should be filed with the Board. Each party submitting a filing must serve a copy on each person indicated on the service list.

5. The procedural schedule in KCP&L, STB Docket No. 42095, for discovery and the submission of evidence is suspended until the close of this proceeding.

6. The records in AEP Texas, STB Docket No. 41191 (Sub-No. 1), and Western Fuels, STB Docket No. 42088, are reopened. The timeframe for a decision in those proceedings is therefore tolled.

7. Notice of this decision will be published in the Federal Register.

8. This decision is effective on February 27, 2006.

By the Board, Chairman Buttrey and Vice Chairman Mulvey.

Vernon A. Williams
Secretary