32310 SERVICE DATE - NOVEMBER 27, 2001
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SURFACE TRANSPORTATION BOARD

DECISION

STB Docket No. 42054

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

STB Docket No. 42056

TEXAS MUNICIPAL POWER AGENCY
v.
THE BURLINGTON NORTHERN AND SANTA FE RAILWAY COMPANY

STB Docket No. 42057

PUBLIC SERVICE COMPANY OF COLORADO d/b/a EXCEL ENERGY
v.
THE BURLINGTON NORTHERN AND SANTA FE RAILWAY COMPANY

STB Docket No. 42058

ARIZONA ELECTRIC POWER COOPERATIVE, INC.
v.
THE BURLINGTON NORTHERN AND SANTA FE RAILWAY COMPANY
AND UNION PACIFIC RAILROAD COMPANY

Decided: November 26, 2001

The Burlington Northern and Santa Fe Railway Company (BNSF) and the Union Pacific Railroad Company (UP) jointly filed a motion requesting that we consolidate the above captioned cases for the limited purpose of addressing certain issues assertedly common to each of these four stand-alone cost (SAC) rate complaint proceedings. We conclude that the general issues that the railroads would have us examine in the abstract either have been addressed in prior decisions or will be better addressed as the issues are raised and argued in the specific factual settings in which they arise. Accordingly, the BNSF/UP joint motion is denied.

BACKGROUND

Our general standards for judging the reasonableness of rail freight rates were developed in Coal Rate Guidelines, Nationwide, 1 I.C.C.2d 520 (1985) (Coal Rate Guidelines), aff'd sub nom. Consolidated Rail Corp. v. United States, 812 F.2d 1444 (3d Cir. 1987). Those guidelines impose a set of pricing principles known as "constrained market pricing" (CMP).[1] They contain three main constraints[2] on the extent to which a railroad may charge differentially higher rates on captive traffic: revenue adequacy,[3] management efficiency,[4] and SAC. The joint motion is addressed only to the application of the SAC constraint.

A SAC analysis seeks to determine the lowest cost at which a hypothetical, optimally efficient carrier could provide the service to the complaining shipper free from any costs associated with inefficiencies or cross-subsidization. A stand-alone railroad (SARR) is hypothesized by the complaining shipper that could efficiently serve selected traffic (including all of the traffic that is the subject of the complaint) in a rail marketplace free of barriers to entry or

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[1] 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. A captive shipper should not bear the cost of any facilities or services from which it derives no benefit. And responsibility for payment for facilities or services that are shared by other shippers should be apportioned according to the demand elasticities of the various shippers. Coal Rate Guidelines, 1 I.C.C.2d at 523-524.

[2] A fourth constraint—phasing—can be used to limit the introduction of otherwise-permissible rate increases if they would have an undue inflationary impact and would result in dislocation of important economic resources. Id. at 546-47.

[3] The revenue adequacy constraint is designed to ensure that a 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.

[4] The management efficiency constraint is designed to protect captive shippers from paying for costs associated with identified avoidable inefficiencies that are shown to increase a railroad's revenue need such that the shipper's rate is affected. The management efficiency constraint takes into account both short-run and long-run efficiency considerations. Id. at 537-42.

exit. (It is such barriers that can make it possible for railroads to engage in monopoly pricing absent regulatory constraint.) Under the SAC constraint, the challenged rate of the defendant railroad 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 the capital invested.

In making 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.[5] The evidentiary presentation is necessarily highly detailed, involving numerous complex issues. The evidence must address the cost of designing the SARR[6] and the feasibility of that design.[7] It must include the cost of constructing the myriad facilities that would be needed to provide efficient transportation service to the selected traffic group, as well as the costs that would be associated with maintaining and operating the SARR.[8] In addition to developing the cost of designing, building and operating the SARR, estimates of the revenues the SARR could expect from providing the transportation services must be developed.[9]

By comparing the total costs of the stand-alone system to the total revenues that would be available to the SARR over an appropriate analysis period (a 20-year period has been used in most cases), we determine whether there would be over- or under-recovery of costs. Because the analysis period can be lengthy, we use a present value, discounted cash flow analysis to take into account the time value of money, netting the annual over-recoveries or under-recoveries as of a common point in time. If the sum of the present values of over-recoveries exceeds the under-recoveries, we conclude that the challenged rates are higher than they need to be.[10] We then determine the extent to which the overall revenues of the traffic group would need to be reduced

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[5] The complainant attempts to select an efficient rail network and a traffic group for the SARR that would share the joint and common costs of the network.

[6] See, e.g., West Texas Util. v. Burlington N.R.R., 1 S.T.B. 638, 673, 700-10 (1996) (West Texas), aff'd sub nom. Burlington N.R.R. v. STB, 114 F.3d 206 (D.C. Cir. 1997) (Burlington N.).

[7] See, e.g., id., 1 S.T.B. at 685-86.

[8] See, e.g., McCarty Farms v. Burlington N., Inc., 2 S.T.B. 460, 479-85, 494-522 (1997) (McCarty Farms).

[9] See, e.g., FMC Wyoming Corp. et al. v. Union Pac. R.R., STB Docket No. 42022 (STB served May 12, 2000) (FMC), slip op. at 27-36.

[10] See, e.g., FMC at 42, 181-82.

so that, over the analysis period, there would be no net over- or under-recovery,[11] and then we allocate a share of that reduction to the traffic that is the subject of the complaint in order to award damages for unreasonably high rates paid on past shipments and prescribe the maximum reasonable rate to be charged for future shipments. However, because our maximum rate jurisdiction is limited to those rates that generate revenues of at least 180% of the carrier's variable cost of providing service, we cannot prescribe a rate (or award damages) below the 180% revenue-variable cost (R/VC) level. Therefore, when establishing a prescription we set the maximum rate at the higher of the SAC rate or the rate yielding a 180% R/VC level.[12]

DISCUSSION

BNSF/UP contend that, even though a wide range of complex and theoretical issues relating to the application of the SAC test have been resolved through individual adjudications since 1985, we should now depart from our case-by-case approach and separately address in general terms several selected issues that have arisen in recently decided or pending cases. The railroads assert that, while they and their shippers are now able to gauge how we will resolve most issues relating to the cost of constructing and operating a stand-alone railroad, it is more difficult for parties to predict how we will resolve issues relating to the revenues that can be assigned to the hypothetical railroad. This uncertainty, the carriers argue, lessens the chances that parties can reach negotiated solutions and thus increases the likelihood of litigation over rail rate levels.

To reduce the asserted uncertainty surrounding application of the SAC test, the carriers request that we obtain comments from all interested parties on several broad issues implicated in recent or pending rate complaint cases. First, the railroads contend that the long-term traffic forecasts required by multi-year SAC analyses are inherently unreliable and they suggest that we consider using a one-year SAC analysis instead. Second, the railroads charge that certain shipper SAC presentations have included in the traffic group non-issue traffic that improperly subsidizes the issue traffic. This cross-subsidization occurs, the railroads assert, when the revenues that it is assumed the SARR would receive for handling traffic hypothetically interchanged with the defendant railroad (so-called cross-over traffic) is overstated or when the revenues from non-issue traffic are used to cover the costs of facilities (required by the issue traffic) that the non-issue traffic would not use. The carriers suggest that we develop procedures for identifying and removing such cross-subsidies. Finally, UP and BNSF assert that a hypothetical railroad would require a more accelerated recovery of investment than recognized by our prior decisions, and the railroads ask that we reconsider the propriety of applying a real options adjustment in SAC cases to meet that objective.

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[11] Id. at 183-99.

[12] See, e.g., Wisconsin Power & Light v. Union Pac. R.R., STB Docket No. 42051 (STB served Sept. 13, 2001) (WPL), slip op. at 33.

We have carefully considered whether the processing of pending and future cases would be aided by breaking out and separately examining some or all of the issues identified by the railroads in a general rulemaking-type proceeding. While the railroads have raised significant issues, some of which are not yet fully resolved, about how we should apply SAC in our maximum rate reasonableness adjudications, we conclude that it is preferable to continue our general policy of addressing these types of issues as they arise in individual adjudications.

Single-Period SAC Analysis

Contending that any long-range forecast of traffic is inherently unreliable, the railroads argue that it would be simpler and preferable to evaluate SAC evidence for a representative test year. They have not described that procedure in detail in their joint motion; rather they offer to provide additional detail on how such a procedure might be implemented if and when we launch a general inquiry on this subject.

The merits of using a multiple-year versus a single-year SAC analysis have already been examined. Indeed, in Coal Rate Guidelines, both the railroad and shipper interests agreed that a multiple-year approach was preferable to a single-period analysis. 1 I.C.C.2d at 545. Moreover, the Railroad Accounting Principles Board endorsed the use of a multi-period analysis for evaluating the rates on captive rail traffic.[13] And a multi-year analysis has been used in all SAC rate complaints filed after the adoption of the Coal Rate Guidelines.[14]

In short, the merits of a multi-year analysis are well-established. The fact that recent cases have required forecasts of as much as 19 years, rather than for the shorter forecast periods in some earlier cases (in which the evidentiary presentations included a number of years in which the traffic at issue had already moved under the challenged rate), does not by itself provide a compelling basis for reexamining this long-standing practice. That is not to say, however, that a 20-year analysis period is required or appropriate for all cases. We have never prescribed the number of years that should be included in a multi-year analysis, and we remain open to varying analysis periods based on the circumstances of each individual case. Accordingly, we conclude that the suitable length for the analysis period is a matter that is best addressed on an individual case basis.

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[13] See Railroad Accounting Principles Board—Final Report, Vol. 2, pp.67-70 (Sept. 1987). The Railroad Accounting Principles Board was created by statute 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).

[14] See Burlington N.R.R. v. STB, 114 F.3d 206, 215 (D.C. Cir. 1997) (approving of the use of 20 years of estimated cash flows).

Cross-Subsidization Issues

While a complaining shipper has wide latitude to design a stand-alone railroad and to select the traffic group that the hypothetical system would serve, the railroads assert that a shipper should not be able to include in the group non-issue traffic that serves to cross-subsidize the rates to be charged to issue traffic. The railroads describe various scenarios that they contend could give rise to such cross-subsidies. In particular, BNSF and UP charge that variants of the cross-subsidy issue are presented in the PPL Montana case[15] (in which, they assert, the shippers have made unrealistic assumptions concerning the revenue contributions that cross-over traffic would make to the SARR) and in the Arizona Electric case[16] (in which, they assert, non-issue traffic has been included that would not use the same facilities as the issue traffic). The railroads ask that we develop procedures to deal with these and other assertedly impermissible cross-subsidy scenarios.

We do not believe that it would be wise or a good use of our resources (or those of the parties) to attempt to identify and develop in the abstract all-purpose procedures to apply to all situations where arguments as to the presence of impermissible cross-subsidies could be made. Issues concerning what revenues a SARR could expect to receive have been hotly contested in many SAC cases, and the focal points of the arguments have shifted from case to case. At times, the arguments have been focused on whether the SARR should be entitled to any revenue contribution from traffic that would be interchanged with another carrier absent evidence that the connecting carrier is covering some particular level of costs. Other times the parties have argued over the level of revenues the SARR could be expected to receive when existing contracts expire. And the issue raised in the joint motion as to the appropriate revenue contribution from cross-over traffic has been hotly disputed in prior proceedings.[17] Indeed, the procedure complained of by BNSF and UP here—the so-called modified mileage proration that was used in the recently decided WPL case to apportion to the SARR revenues from cross-over traffic—was one that had initially been suggested by the railroads for use in SAC cases.[18] In each instance, the specific facts of the case have helped to elucidate the issues and guide us in making our determination.

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[15] STB Docket No. 42054.

[16] STB Docket No. 42058.

[17] See, e.g., McCarty Farms, 2 S.T.B. at 471-72.

[18] See McCarty Farms, 2 S.T.B. at 472. The modified mileage proration process is an accepted and widely used tool for apportioning revenues between carriers. But if that procedure is not appropriate to use in a particular case, the parties to that case can let us know, and we will use whatever is the most appropriate procedure for apportioning revenues for that case.

We do not have a hard-and-fast rule for how to assign revenue contributions from cross-over traffic, as illustrated by the fact that in the pending PPL Montana case much of the railroad's presentation is addressed to how such revenue allocation should be made in that case. The evidentiary phase of the case has been completed, and to break out that issue for separate consideration in a broader context, as suggested by BNSF and UP, would not be administratively efficient and would unduly prolong the litigation.[19] Moreover, we have no reason to believe that a general examination of the issue would diminish the disputes over this issue in future cases, as the amount of revenues that a SARR could expect to receive is to a large extent dependent on the specific facts of each case. Because it would be extremely difficult to anticipate all the specific sub-issues and arguments concerning revenue apportionment that could arise in individual adjudications, we believe that it is better to continue to address and resolve such issues as they arise in individual proceedings.

The other specific cross-subsidy concern raised in the joint motion—that inclusion in the traffic group of non-issue traffic that does not use the facilities needed by the issue traffic would result in an impermissible cross-subsidy of the rates for the issue traffic—is raised in the pending Arizona Electric case. Here too, it would be difficult, in a more general inquiry as requested by the railroads, to anticipate all of the situations in which a carrier could assert that inclusion of certain non-issue traffic in the stand-alone traffic group would result in impermissible cross-subsidization of the issue traffic. And here too, we believe the surrounding facts will be important in helping us to address and resolve this type of cross-subsidy issue. Accordingly, we believe this issue is also best left to consideration in the context of individual cases and we will continue to address this issue on a case-by-case basis.

Capital Recovery—Real Options Adjustment

Finally, the railroads renew their contention that investors in an enterprise that would have significant sunk investment while operating in a contestable market would demand "recovery of a greater proportion of the investment at the beginning of the investment period." Joint Mot. at 34. The railroad sought to factor a "real options" adjustment into the SAC analysis in the recent FMC and WPL cases to account for this, by increasing the required capital recovery charge by a set percentage for each year of the SAC analysis period.[20] In each case, we rejected the carrier's proposed real options adjustment, explaining that a SARR should not be assumed to bear costs

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[19] If any resulting general pronouncement were to be applied to PPL Montana, then procedural fairness might dictate that the parties in that case be given an opportunity to supplement the record prior to application of any general standard adopted.

[20] In FMC, the railroad argued that the capital recovery charge should be increased by 9% each year, and in WPL by 8.73% per year.

that are not faced by the defendant railroad and that this well-established principle[21] applies with equal force to costs associated with risks not faced by the defendant railroad's investors.[22] We see no reason to revisit this matter here.

It is ordered:

1. The motion to consolidate the captioned cases for consideration of selected issues is denied.

2. This decision is effective December 27, 2001.

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

Vernon A. Williams
Secretary

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[21] See West Texas, 1 S.T.B. at 668-73 (1996); Burlington N., 114 F.3d at 214.

[22] See FMC at 179; WPL at 31-33.