



U.S. Department of
Transportation

General Counsel

400 Seventh St., S.W.
Washington, D.C. 20590

205962

July 31, 2002



Vernon A. Williams, Secretary
Surface Transportation Board
Suite 700
1925 K Street, N.W.
Washington, D.C. 20423-0001

Re: Ex Parted No. 589

Dear Secretary Williams:

Enclosed herewith are the original and ten copies of the Reply Comments of the United States Department of Transportation in the above-referenced proceeding. Also included is a computer diskette of this document, converted into Word Perfect. I have included as well an additional copy of the Department's comments that I request be date-stamped and returned with our messenger.

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Sincerely,

Dale C. Andrews
Deputy Assistant General Counsel
for Litigation

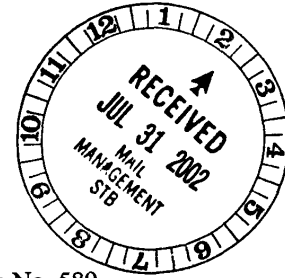
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Before the
Surface Transportation Board
Washington, D.C.



CALCULATION OF VARIABLE COSTS IN
RATE COMPLAINT PROCEEDINGS INVOLVING
NON-CLASS I RAILROADS

Ex Parte No. 589

Reply Comments of the United States Department of Transportation

Introduction

The Surface Transportation Board ("STB" or "Board") in this proceeding will decide how to determine the variable costs of transportation services provided by small railroads, which are critical in establishing the STB's jurisdiction to hear cases challenging the reasonableness of rail rates. Decision served April 30, 2002 ("Decision"); 67 Fed. Reg. 21321. ¹ In its initial comments the United States Department of Transportation ("Department" or "DOT") expressed support for the Board's traditional approach, pursuant to which the variable costs of small railroads are estimated on the basis of comprehensive cost and operating data supplied by large rail carriers. After considering the submissions of other parties, that remains DOT's position.

The Record

Several railroads and one large shipper group filed comments. The railroad parties all generally favor the traditional approach of estimating variable costs. They

^{1/} The STB has jurisdiction over rates for movements in which the revenue produced is not less than 180% of the carrier's variable cost of providing the transportation service. 49 U.S.C. § 10707(d)(1).

conclude that the alternative -- maintaining cost and operating data according to the Uniform Rail Costing System ("URCS"), in the manner of the large Class I railroads -- would impose a major financial burden on what are relatively small companies. *See* Comments of the American Shortline and Regional Railroad Association; Transtar, Inc.; Duluth, Missabe & Iron Range Railway/Bessemer & Lake Erie Railroad ("DMIR/BLE"); RailAmerica, Inc.² These parties point out that the smaller railroads were relieved of this burden because it served no regulatory purpose, that they have long since maintained their records in a fashion appropriate to small businesses, and that in any event there has been little need for the data because historically there have been so few rate cases brought against such carriers. *Id.*

Two railroad parties seek modifications to the Board's use of estimated costs. Transtar favors a mechanism that adjusts these costs to more precisely reflect those of small carriers, although it does not put forward a specific proposal. Comments of Transtar at 5. DMIR/BLE urges the Board to require shippers filing complaints against small railroads to show that the challenged rate not only meets the jurisdictional threshold, but exceeds it by a significant margin. Comments of DMIR/BLE at 5. DMIR/BLE intends this requirement in order to avoid expensive discovery, reserve public and private resources for more significant disputes, and prevent use of regulatory processes as a means to distort rate negotiations. *Id.* at 5-6.

A major shippers group offers a different view. The Western Coal Traffic League ("WCTL") disputes the very existence of a regulatory policy favoring estimated costs in

^{2/} The Association of American Railroads, representing Class I carriers, does not object to this use of the data supplied by its members, so long as "no conclusions relating to Class I railroads" are derived from the information.

these cases, contests the true extent of the burden of maintaining URCS cost and operational data, and argues that many Class II and III carriers are either not small businesses or are actually part of large corporations. Comments of WCTL at 5-6. WCTL believes that shippers have a "right" to obtain carrier-specific costs, and therefore proposes that complaining shippers should be given the option of requiring the use of estimated costs or carrier-specific URCS unit costs in their rate cases. Id. at 7.

Discussion

The Department continues to support the use of estimated costs derived from Class I railroad data in rate cases involving small rail carriers. The parties' submissions overall provide ample reason for the Board to adhere to its previously expressed preference for this approach, and offer no basis to modify or depart from that approach.

First, although the record contains no evidence about the extent to which maintaining detailed cost and operational records according to URCS standards imposes additional costs, it is clear that this approach does so and that these costs are not trivial. The Board itself deems them "substantial." Decision at 5.³ Second, just as there was no reason to continue to impose these recordkeeping obligations in the past, there is no obvious reason to reimpose them now. Rate complaints against small railroads are few and far between, and no party has even suggested another regulatory purpose for this requirement.⁴ Third, it seems clear that some accuracy is sacrificed through the use of cost estimates rather than carrier-specific URCS unit costs, but there is no evidence either

^{3/} The apparent widespread use by small carriers of other recordkeeping methods also suggests that an URCS-compliant approach is more expensive and/or otherwise less appropriate to their businesses.

^{4/} The WCTL cites no legal authority for the proposition that shippers have a "right" to carrier-specific data, and DOT is aware of none. Federal statutory law only obliges carriers to charge "reasonable" rates without specifying how such rates are to be ascertained. 49 U.S.C. § 10701.

quantifying the extent of this inaccuracy or establishing that it consistently favors either side in rate cases.⁵ Moreover, parties are free to offer adjustments to these estimated costs if they seem not to reflect the actual costs of the carrier involved.

The absence of any quantifiable evidence as to either the greater expense or the increased accuracy associated with utilizing URCS unit costs in small railroad rate cases, and the infrequency of such cases, counsel against adopting this approach. These circumstances, combined with the lack of any clear systemic bias in the estimated cost approach, and the ability to adjust cost estimates to more closely reflect individual carrier costs, prompt DOT to support continued use of estimated regional costs derived from Class I data.⁶

The Department also opposes the modifications suggested by DMIR/BLE and the WCTL. The DMIR/BLE proposal to require complaining shippers to demonstrate a substantially higher revenue-to-variable cost ratio would tend to allow rail carriers an added margin in which to raise rates before the threat of regulatory intervention becomes realistic. By contrast, the STB (like the ICC before it) has long tried to ease shipper access to regulatory procedures. Similarly, the WCTL proposal to give shippers the ability to force railroads to bear significant added recordkeeping costs whenever a

⁵/ Presumably WCTL believes that small railroads actually have lower costs than Class I carriers, or it would favor continued use of estimated costs derived from Class I data. DMIR/BLE, on the other hand, contends that small railroads face higher costs of capital and do not enjoy the economies of scale or scope of the large carriers.

⁶/ Rates for small railroads are often established by Class I railroads. Comments of RailAmerica at 4. In rate cases involving both Class I and smaller railroads on a joint move, variable costs for the Class I portion of a movement should be determined under existing Class I procedures.

complaint is filed would tend to pressure carriers to reduce rates simply to avoid this burden.⁷

Conclusion

The approach to determining variable costs supported by the Department and preliminarily favored by the Board is not perfect. Estimated costs derived from data submitted by much larger railroads do not precisely reflect the actual costs of small carriers. The issue in this proceeding, however, is whether imposing additional recordkeeping costs on small railroads is justified in order to provide a more accurate assessment. The record compiled to date does not quantify the benefits that would be obtained or the costs that would be imposed by a switch to carrier-specific URCS unit costs. There is no demonstrable systemic bias in the use of estimated costs, and parties may attempt to adjust these costs to increase their accuracy. Finally, there is only rarely an occasion to for the Board to consider such issues with respect to small carriers. In these circumstances the Department supports the continued use of estimated costs in rate cases involving Class II and III railroads.

Respectfully submitted,



KIRK K. VAN TINE
General Counsel

July 31, 2002

^{7/} This may have happened in the Minnesota Power case, which the parties settled after the Board ordered the railroad to compile cost and operational data according to URCS. Decision at 3, note 11.

CERTIFICATE OF SERVICE

I hereby certify that on this date I caused a copy of the Reply Comments of the United States Department of Transportation in STB Docket Ex Parte No. 589 to be served by first class mail, postage prepaid, upon all parties in this proceeding.


Dale C. Andrews

July 31, 2002