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SURFACE TRANSPORTATION BOARD

EX PARTE NO. 771

REPORT: ALTERNATIVES TO URCS

COMMENTS OF BNSF RAILWAY

On October 26, 2022, the Surface Transportation Board (“STB” or “Board”) issued a notice requesting comments on a report prepared by Laurits R. Christensen Associates, Inc. (“Christensen Associates”), entitled, *Alternatives to URCS* (“Christensen Report”). BNSF Railway Company (“BNSF”) appreciates the Board’s continued focus on the Uniform Railroad Costing System (“URCS”) and also appreciates the opportunity to comment on the report and the ways that URCS can be updated and improved. BNSF joins in the comments of the Association of American Railroads (“AAR”) opposing the replacement of URCS with an alternative model based not on actual cost information, but on an econometric analysis of prices. BNSF submits these comments to highlight some important additional issues that the Board should keep in mind as it considers potential changes to regulatory costing.

BNSF has long advocated that the Board rely less upon revenue to variable cost (“R/VC”) ratios in carrying out its various regulatory functions because such

measures cannot fully capture the realities of the complex markets in which BNSF participates.¹ Recognizing that R/VC ratios and the need for a railroad costing system are nonetheless statutorily embedded in the Board's regulatory toolbox, BNSF has also long advocated for continuous improvement of the Board's costing system to more accurately reflect the reality of modern rail operations and the markets in which they occur.² For the reasons set forth below and in the AAR comments, BNSF does not believe that the proposals contained in the Christensen Report represent a valid approach to railroad costing. While there are many aspects of URCS that bear improving, it still represents an established, understood, and far superior approach to railroad costing. If the Board is inclined to update its variable costing system, rather than devote Board resources to further analysis of the proposals in the Christensen Report, BNSF believes the Board should devote those resources to improving URCS as described herein.

I. The importance of costing to the regulatory framework counsels caution when considering potential alternatives.

Accounting for railroad costs and allocating those costs to specific movements has long been an important part of the economic regulation of railroads. After years of significant study and analysis by experts and stakeholders, the Board's predecessor, the Interstate Commerce Commission ("ICC"), adopted URCS in 1989

¹ See, e.g., BNSF Comments, EP 665 (Sub-No. 2) at 14 (filed on Nov. 14, 2016) (explaining the need for "other relevant factors" to reflect market realities in expedited rate cases using R/VC comparisons); BNSF Comments, EP 704 (Sub-No. 1) at 2 (filed on Jan. 29, 2021) (noting that "[t]he Board has repeatedly heard from economists and rail experts that R/VC ratios are driven by many factors that have little or nothing to do with the exercise of market power by railroads.").

² See, e.g., BNSF Comments, EP 431 (Sub-No. 3) (filed June 1, 2009).

as the regulatory costing system and successor to Rail Form A to be used to estimate the variable costs of individual rail movements.³ From the very beginning, however, the ICC noted that further study was needed on several issues related to URCS and that on-going review of the costing assumptions and underlying data would be appropriate.⁴

Efforts to improve URCS over the years have proved challenging and produced little progress.⁵ About a decade ago, the Board discussed undertaking a review of URCS in an effort to improve the accuracy of the costing system. In a 2010 report to Congress, the Board explained that it saw several different options for reviewing URCS, which ranged from a comprehensive review to more limited reviews of various aspects of the costing system.⁶ In addition to considering updates to URCS, the report stated that the Board was also in the preliminary stages of considering the alternative costing models recently reviewed by Christensen Associates to replace URCS, noting several concerns with these alternatives.⁷ Though the Board has successfully implemented a number of technical improvements to URCS since the 2010 report, a proceeding to improve the

³ *Adoption of the Uniform Railroad Costing System as a General Purpose Costing System for all Regulatory Costing Purposes*, 5 I.C.C.2d 894 (1989).

⁴ *Id.* at 922.

⁵ *Review of the General Purpose Costing System*, 2 S.T.B 659 (1997).

⁶ Surface Transportation Board Report to Congress Regarding Uniform Rail Costing System, (May 27, 2010) (hereafter “2010 URCS Report”).

⁷ *Id.* at 28.

so-called “make-whole” adjustment that accounts for shipment size did not result in any changes to URCS.⁸

Despite the challenges involved with updating and improving URCS, the agency’s reliance on the costing system has grown over time. In addition to its only Congressionally-mandated use as safe harbor from rate reasonableness review of rates that generate a revenue to variable cost ratio of less than 180%, the Board has expanded the utilization of URCS to include it as a tool to measure market power in exemption proceedings, qualitative market dominance and maximum lawful rates in rate reasonableness cases, comparable route efficiency in routing cases, and avoidable costs in line valuation cases. As the use of URCS has grown, BNSF has advocated for its improvement and consistently expressed concern regarding the potential for over reliance on variable cost calculations and R/VC ratios in setting maximum reasonable rates. In particular, BNSF has consistently implored the Board to recognize the limits on inferences that can be drawn about rail market power from R/VC ratios. BNSF shares the view of the many economists and rail experts that have expressed to the Board that R/VC ratios are driven by many factors that have little or nothing to do with the exercise of market power by railroads.⁹

⁸ See <https://www.stb.gov/reports-data/uniform-rail-costing-system/>; *Review of the General Purpose Costing System*, EP 431 (Sub-No. 4) (STB served June 6, 2019).

⁹ See, e.g., BNSF Comments, EP 704 (Sub-No. 1) (filed on Jan. 29, 2021).

BNSF has also been concerned that the demand-based pricing framework underlying the Board's maximum rate standards is being increasingly displaced by reliance on simpler but less economically sound approaches based on variable cost calculations, even in large cases. Formulaic reliance on R/VC ratios will lead to incorrect results as a relatively high or increasing R/VC ratio may not necessarily indicate that a particular rate is unreasonable. Instead, it could reflect that the transportation has become more efficient or reflect peculiarities of how URCS costs the traffic. Moreover, a maximum rate paradigm that overly emphasizes R/VC ratios disincentivizes investments that make railroads more efficient. A R/VC-based test rewards the highest cost, least efficient railroad and penalizes railroads that increase productivity and efficiency. Board policy should do the opposite: incentivize railroads to make investments to innovate and lower costs because railroads that increase productivity and efficiency can compete more vigorously with trucks, capture traffic from the highways, and grow volumes.

Regardless, the widespread and continued use of variable cost calculations throughout the regulatory system counsels strongly in favor of caution in considering wholesale changes to the Board's approach to costing. This is particularly true in light of the recently adopted Final Offer Rate Review ("FORR") process, which imposes essentially no restrictions on the rate reasonableness theories that a party can advance. FORR cases allow for only a radically short time period for submission of evidence and parties will be hard pressed to convey to the Board the complex market forces that affect a rail rate in the time allowed. As

such, costs are likely to play an outsized role in parties' submissions. URCS, despite its flaws, is transparent and known to stakeholders. BNSF continues to believe that FORR is unlawful due to its lack of standards and procedural defects, but if the Board were to embark on a fundamental departure to its approach to costing while the FORR rules are in place, it would only serve to inject more uncertainty to the rate reasonableness process and further untether the Board's FORR processes from market realities. It is particularly important now that Board stakeholders continue to have access to reliable and transparent cost information as part of regulatory proceedings.

II. The Board and its stakeholders would be better served by improving, not abandoning, URCS.

Due to the importance of URCS to the regulatory paradigm, BNSF believes that if the Board wants to improve its variable costing system, it should focus on updating URCS. Importantly, and in contrast to the alternatives considered in the Christensen Report, URCS is built on a foundation of empirical data from studies of real-world railroad operations and annual input of railroad accounting information.¹⁰ But many of the studies on which URCS costs are based were conducted decades ago, prior to the enormous changes in the structure, operations and efficiency of the railroad industry that were brought about by the 4R Act, the

¹⁰ See Sec. 307, Railroad Revitalization and Regulatory Reform Act of 1976, P.L. 94-210 (1976) ("4R Act"); Railroad Accounting Principles Board, Final Report, at 10 (1987) (calling on the agency to look for causal relationships to costs "through direct observation, engineering analysis, and/or statistical techniques."); *Adoption of the Uniform Railroad Costing System as a General Purpose Costing System for all Regulatory Costing Purposes*, 5 I.C.C.2d 894 (1989).

Staggers Rail Act of 1980, and decades of investment by the rail industry. For example, train load and unit train movements are significantly more common in recent periods than they were when the costing studies underlying URCS were done. In addition, traffic densities have increased across rail networks as a result of traffic growth, abandonments, and line sales. These and other fundamental changes in the railroad industry could have important implications for key elements of URCS costs, such as the size of the train load adjustment and the variability of road property costs.

BNSF certainly recognizes that it is difficult to develop a costing system that yields accurate costs for particular rail movements under the myriad of circumstances in which rail traffic moves. The task of designing such a system is complex and challenging, and requires a great deal of data analysis. As such, if the Board's aim is to improve its costing system, it should carefully scope a public process to modernize URCS and prioritize the most effective and impactful improvements that both BNSF and the AAR have identified in prior URCS proceedings, including:

1. Examining the URCS cost assumptions relating to intermodal traffic. URCS's treatment of intermodal traffic was inadequate even when it was created due to the limited volume of intermodal traffic when the original cost studies underlying URCS were conducted. Those inadequacies have only grown over time.

2. Updating the URCS cost allocations and adjustments that were developed from now-outdated historical studies, in particular, the allocation of costs associated with single-car, multi-car and unit-train shipments.
3. Revisiting and update the variability studies and regression analyses that are the foundation of URCS, particularly the assumption that road property costs are 50% variable. The 50% variability assumption built into URCS is a default variability based on historic treatment of these costs.

BNSF also believes that focusing on the following items could lead to potential improvements to URCS:

1. Investigate the normalization periods used in certain areas, particularly maintenance of way and equipment repairs.
2. Review how URCS reflects payments made by railroads to third parties, including payments to short line railroads and switching fees.
3. Consider the feasibility of using current replacement costs to calculate a railroad's variable road property costs as the most economically valid measure.
4. Modify URCS to allocate the insurance costs attributable to the transportation of toxic by inhalation materials (“TIH”) directly to shipments of TIH. This change can be made immediately and does not require the Board to address all of the issues identified in EP 681, *Class I Railroad Accounting and Financial Reporting - Transportation of Hazardous Materials*.

III. Conclusion

BNSF applauds the continued focus of the Board on regulatory costing. Rather than embark on a wholesale change in the approach to costing, however, any efforts by the Board to update its variable costing system should focus on improving the empirical-data-based URCS model. BNSF recognizes that there are no easy fixes to update and modernize URCS, but stands ready to participate fully and aid the Board in any effort to do so.

Respectfully submitted,

/s/ Timothy J. Strafford

Tamara Middleton
Adam Weiskittel
Jill M. Rugema
BNSF Railway Company
2500 Lou Menk Drive
Fort Worth, Texas 76131

Anthony J. LaRocca
Linda S. Stein
Timothy J. Strafford
Steptoe & Johnson LLP
1330 Connecticut Avenue NW
Washington DC 20036

Attorneys for BNSF Railway Company

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