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March 19, 2019

Ms. Cynthia T. Brown
Chief, Section of Administration
Office of Proceedings
Surface Transportation Board
395 E Street, S.W.
Washington, DC 20423

Re: EP 290 (Sub-No. 5), *Quarterly Rail Cost Adjustment Factor*

Dear Ms. Brown:

By this letter, the Association of American Railroads (“AAR”) hereby responds to the decision served yesterday by the Surface Transportation Board (“STB” or “Board”) in the above captioned proceeding. As directed in the decision, the AAR has updated its calculation of the all-inclusive index of railroad input prices to reflect the productivity adjustment that was established in *Railroad Cost Recovery Procedures – Productivity Adjustment*, EP 290 (Sub-No. 4) (STB served Mar. 11, 2019). The AAR’s revised calculations and materials related to the revision are attached as an appendix to this letter. These updated calculations affect the two productivity-adjusted versions of the RCAF: the RCAF-A and the RCAF-5.

The Board’s decision also directed the AAR to respond to comments made by Mr. Timothy Crowley of L.E. Peabody & Associates in an e-mail to Board staff regarding the AAR’s calculation of the quarterly Rail Cost Adjustment Factor (“RCAF”) in this docket. Mr. Crowley asserts that the “the AAR has not updated the 2017 weights used in the RCAF calculations based on the revised R-1 ’s submitted by the Class I railroads in response to EP 552 (Sub-No. 22) Railroad Revenue Adequacy-2017 Determination.” The AAR’s response follows.

The AAR submitted its quarterly RCAF filing on March 5, 2019 before the Board issued its productivity adjustment decision. The AAR did not include recalculated R-1 figures in that original submission because the Board’s decision in *Railroad Revenue Adequacy—2017 Determination*, EP 552 (Sub-No. 22) *et al.* (STB served Dec. 6, 2018), made “one-time adjustments to its 2017 annual cost-of-capital determination, revenue adequacy determination, and Uniform Railroad Costing System calculations to remove the accounting impacts of the Tax Cuts and Jobs Act on rail carriers’ deferred tax liability to more accurately reflect the rail

carriers' financial state for 2017." *Railroad Revenue Adequacy—2017 Determination*, EP 552 (Sub-No. 22) *et al.* (STB served Dec. 6, 2018), slip op. at 2 (emphasis added). The Board did not adjust the carriers' 2017 R-1 filings, nor did it order carriers to refile or revise their R-1 reports. Instead, the Board accepted the AAR's offer that Class I carriers would submit recalculated figures to transparently illustrate the accounting implications of the Board's adjustment on other R-1 reporting schedules, including Schedule 410 (Railway Operating Expenses).

The Board then issued its productivity adjustment decision in EP 290 (Sub-No. 4), and, on its own motion, used recalculated Schedule 410 figures in the operating expenses portion of its 2017 productivity calculation. *See Railroad Cost Recovery Procedures-Productivity Adjustment*, EP 290 (Sub-No. 4) (STB served Mar. 11, 2019), slip op. at 4. Mr. Crowley now asserts that this action should "result in changes to the 2017 weights relied upon by the AAR in calculating the 4Q 18-2Q 19 all-inclusive indexes, which leads to further changes in the RCAF (Unadjusted) and RCAF-5."

Mr. Crowley provides no explanation as to why the relative weights in the quarterly RCAF necessarily should be adjusted as a result of the Board's use of recalculated figures in the productivity adjustment. The AAR agrees that using recalculated figures in the productivity adjustment calculation but not in the weights in the quarterly RCAF creates an apparent mismatch, but we take no position at this time as to whether the Board should properly use recalculated figures in the quarterly RCAF calculations and, if so, whether the numbers in the chart in Mr. Crowley's e-mail are correct. A thoughtful response is not possible in the time allowed, though the AAR would be happy to provide a more detailed response after reviewing the issue more closely.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read 'K. D. Kirmayer', with a stylized flourish at the end.

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ASSOCIATION
OF AMERICAN
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John T. Gray
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March 19, 2019

Appendix A

This replaces the Cover Letter, Page 5, and Page 6 of the 2019Q2 RCAF filed on March 5, 2019. The last 2 pages contain the Index Calc workpaper, which replaces the workpaper of the same name in the Workpapers document filed on March 5, 2019.

This submission is the AAR forecast of the second quarter 2019 All-Inclusive Index and Rail Cost Adjustment Factor, filed in Ex Parte No. 290 (Sub-No. 5) (2019-2) *Quarterly Rail Cost Adjustment Factor*. The versions of RCAF-related indices covered in this filing are: the All-Inclusive Index (initiated in the second quarter of 1985), the Unadjusted RCAF (produced since October 1982), the Adjusted RCAF (first published in the second quarter of 1989), and the RCAF-5 (created by the STB in its Ex Parte No. 290 (Sub-No. 7) decision served October 3, 1996). The table below summarizes the second quarter 2019 results and compares to the previous quarter. Both quarters are shown on a 4Q\2017=100 base.

	<u>2019Q1</u>	<u>2019Q2</u>	<u>% Change</u>
All-Inclusive Index	107.1	106.6	-0.5
Preliminary RCAF	1.071	1.066	-0.5
Forecast Error Adjustment	-0.013	-0.003	
RCAF (Unadjusted)	1.058	1.063	0.5
Productivity Adjustment Factor	2.3593	2.3621	
RCAF (Adjusted)	0.448	0.450	0.4
PAF-5	2.5235	2.5210	
RCAF-5	0.419	0.422	0.7

Productivity

Late on March 4, 2019, the Board served a decision regarding the Railroad Cost Recovery Procedures - Productivity Adjustment that stated "the Board has not yet issued the productivity change for 2017 and for the 2013-2017 averaging period". The decision directed the AAR to choose a methodology for applying a productivity adjustment to the March 5, 2019 filing, and to clearly note what method was chosen. The AAR chose to use last year's productivity figures in its original 2019Q2 March 5 filing.

On March 11, 2019, the Surface Transportation Board served a decision which proposed to adopt 0.5 percent as the geometric average productivity change for the five most recent years available. Their five year rolling geometric average calculation added the year 2017 and removed the year 2012. The components of this average annual value are shown on the following table in ratio format – therefore, 1.005 is the same as an increase of 0.5 percent. Productivity changes are calculated by multiplying each of the five productivity changes together and taking the result to the one-fifth power. The productivity adjustment factors (PAF) for each quarter are calculated by increasing the previous quarter's PAF by quarterly versions of the annual rate, which are the fourth root of the geometric average annual growth rate. The difference between the PAF and the PAF-5 is the timing of the five-year productivity trend. The tables below show the current productivity numbers that would have been used in the March 5 filing if they had been available. Late on March 18, 2019, the Board served a decision which directed the AAR to submit updated calculations with the new productivity figures which were released on March 11.

Comparison of Output, Input, & Productivity			
2013 - 2017			
Year	Output Index (1)	Input Index (2)	Productivity Changes (3)
2013	1.022	1.018	1.003
2014	1.055	1.036	1.018
2015	0.913	0.972	0.939
2016	0.955	0.941	1.015
2017	1.045	0.992	1.053
Average			1.005
Previous Average (2012-2016)			0.996

Calculation of PAF and PAF-5			
For 2013-2017, use fourth root of avg. productivity change = 1.0012			
For 2012-2016, use fourth root of avg. productivity change = 0.9990			
Quarter	Year	PAF	PAF-5
Q1	2019	2.3593	2.5235
Q2	2019	2.3621	2.5210
Q3	2019	2.3649	2.5185
Q4	2019	2.3677	2.5160
Q1	2020	2.3705	2.5190

Rail Cost Adjustment Factor

Second Quarter 2019

Four RCAF values are presented in this filing. Two are not modified for productivity (Preliminary RCAF and RCAF Unadjusted), and two incorporate a productivity calculation (RCAF Adjusted and RCAF-5). The All-Inclusive Index and all four RCAF values, plus the percent change for each, are shown below. Note that beginning with the 2018Q1 index, the All-Inclusive Index was rebased to a 2017Q4=100 basis as required in the applicable statute.

	Previous 2019Q1	Current 2019Q2	Percent Change
All-Inclusive Index ¹	107.1	106.6	-0.5
Preliminary RCAF ²	1.071	1.066	-0.5
Forecast Error Adjustment ³	<u>-0.013</u>	<u>-0.003</u>	
RCAF (Unadjusted) ⁴	1.058	1.063	0.5
Productivity Adjustment Factor ⁵	<u>2.3593</u>	<u>2.3621</u>	
RCAF (Adjusted) ⁶	0.448	0.450	0.4
PAF-5 ⁷	2.5235	2.5210	
RCAF-5 ⁸	0.419	0.422	0.7

¹ See All-Inclusive Index on page 3.

² All-Inclusive Index divided by the All-Inclusive Index in the base period (100.0).

³ The current figure is from Forecast vs. Actual All-Inclusive Index in this filing (page 4). The previous quarter figure is shown in a similar section of the previous quarter's filing.

⁴ Preliminary RCAF plus the forecast error adjustment.

⁵ See Productivity on page 5.

⁶ RCAF (Unadjusted) divided by the Productivity Adjustment Factor (PAF).

⁷ See Productivity on page 5.

⁸ RCAF (Unadjusted) divided by the PAF-5.

RCAF All-Inclusive Index's Labor Index Based on 2017 Benchmarks

	17 Wts.	3Q/18	3Q/18 Rebenchd As Info Only	% Chg	4Q/18	% Chg	1Q/19	% Chg	2Q/19	% Chg	3Q/19	% Chg
Straight Time		\$35.154	\$35.524	1.1%	\$35.537	1.1%	\$35.857	0.9%	\$35.857	0.0%		--
PFTNW		\$6.839	\$6.933	1.4%	\$6.936	1.4%	\$6.956	0.3%	\$6.956	0.0%		--
Total		\$41.993	\$42.457	1.1%	\$42.473	1.1%	\$42.813	0.8%	\$42.813	0.0%	\$0.000	--
Adjustments												
Lump Sum		\$0.390	\$0.401		\$0.400		\$0.399		\$0.539			
Back Pay		\$1.232	\$1.268		\$1.283		\$0.773		\$0.584			
Other		\$0.177	\$0.182		\$0.182		\$0.182		\$0.182			
Total Wages		\$43.792	\$44.308	1.2%	\$44.338	1.2%	\$44.167	-0.4%	\$44.118	-0.1%	\$0.000	--
Pre-Tax Reduction		(\$1.361)	(\$1.362)		(\$1.362)		(\$1.362)		(\$1.362)			
Taxable Wages		\$42.431	\$42.946		\$42.976		\$42.805		\$42.756		\$0.000	
H & W		\$8.101	\$8.229	1.6%	\$8.229	1.6%	\$8.302	0.9%	\$8.302	0.0%		--
RR Ret & Medicare		\$8.867	\$9.064	2.2%	\$9.069	2.3%	\$9.124	0.6%	\$9.116	-0.1%		--
Unemp. Insurance		\$0.365	\$0.360	-1.4%	\$0.360	-1.4%	\$0.333	-7.5%	\$0.333	0.0%		--
Other		\$0.288	\$0.297	3.1%	\$0.146	-49.3%	\$0.234	60.3%	\$0.212	-9.4%		--
Total		\$17.621	\$17.950	1.9%	\$17.804	1.0%	\$17.993	1.1%	\$17.963	-0.2%	\$0.000	--
Adjustments												
Total Supplements		\$17.621	\$17.950	1.9%	\$17.804	1.0%	\$17.993	1.1%	\$17.963	-0.2%	\$0.000	--
Total Labor		\$61.413	\$62.258	1.4%	\$62.142	1.2%	\$62.160	0.0%	\$62.081	-0.1%	\$0.000	--
Wage Rate Index	0.6950	374.8	379.2	1.2%	379.4	1.2%	378.0	-0.4%	377.6	-0.1%	0.0	--
Supplements Index	0.3050	651.2	663.3	1.9%	657.9	1.0%	664.9	1.1%	663.8	-0.2%	0.0	--
Total Labor Index '16 Wts.		455.5										
Total Labor Index '17 Wts.		459.1	465.9	1.5%	464.3	1.1%	465.5	0.3%	464.9	-0.1%	0.0	--
Labor Index (Linked)		434.3			439.2	1.1%	440.3	0.3%	439.7	-0.1%	0.0	-100.0%

All Inclusive Index and RCAF using 2017 Benchmarks and Weights

	17 Wts.	3Q/18	17 Wts. 3Q/18	% Chg	4Q/18	% Chg	1Q/19	% Chg	2Q/19	% Chg	3Q/19	% Chg
Labor	0.350	434.30	434.3	0.0%	439.2	1.1%	440.3	0.3%	439.7	-0.1%	0.0	-100.0%
Fuel	0.130	291.00	291.0	0.0%	283.9	-2.4%	256.8	-9.5%	259.2	0.9%		--
M&S	0.049	263.70	263.7	0.0%	269.8	2.3%	268.3	-0.6%	267.6	-0.3%		--
Equip. Rents	0.052	230.50	230.5	0.0%	236.4	2.6%	236.7	0.1%	237.5	0.3%	0.0	-100.0%
Depreciation	0.158	223.50	223.5	0.0%	223.8	0.1%	226.1	1.0%	223.1	-1.3%		--
Interest	0.021	60.50	60.5	0.0%	62.4	3.1%	62.4	0.0%	62.4	0.0%	62.4	0.0%
Other	0.240	231.50	231.5	0.0%	235.5	1.7%	235.8	0.1%	231.8	-1.7%		--
Weighted Avg.	1.000	306.60	306.9	0.1%	309.3	0.8%	306.6	-0.9%	305.2	-0.5%	1.3	-99.6%
Linked		283.60			285.8	0.8%	283.3	-0.9%	282.0	-0.5%	1.2	-99.6%
	Basing Factor											
10/1/80 basis	102.7	276.1			278.3	0.8%	275.9	-0.9%	274.6	-0.5%	1.2	-99.6%
10/1/82	120.9	234.6			236.4	0.8%	234.3	-0.9%	233.3	-0.4%	1.0	-99.6%
4Q/87	132.2	214.5			216.2	0.8%	214.3	-0.9%	213.3	-0.5%	0.9	-99.6%
4Q/92	156.9	180.8			182.2	0.8%	180.6	-0.9%	179.7	-0.5%	0.8	-99.6%
4Q/97	173.2	163.7			165.0	0.8%	163.6	-0.8%	162.8	-0.5%	0.7	-99.6%
4Q/02	192.1	147.6			148.8	0.8%	147.5	-0.9%	146.8	-0.5%	0.6	-99.6%
4Q/07	245.9	115.3			116.2	0.8%	115.2	-0.9%	114.7	-0.4%	0.5	-99.6%
4Q/12	297.6	95.3			96.0	0.7%	95.2	-0.8%	94.8	-0.4%	0.4	-99.6%
4Q/17 basis	264.5	107.2			108.1	0.8%	107.1	-0.9%	106.6	-0.5%	0.5	-99.5%
Car Hire	0.615	210.40	210.4	0.0%	216.9	3.1%	217.2	0.1%	221.1	1.8%		--
Lease Rents	0.385	231.50	231.5	0.0%	235.5	1.7%	235.8	0.1%	231.8	-1.7%	0.0	--
Weighted Avg Eq Rents		219.20	218.5	-0.3%	224.1	2.6%	224.4	0.1%	225.2			
Linked Equipment Rents		230.50			236.4	2.6%	236.7	0.1%	237.5			
Preliminary RCAF		1.072			1.081	0.84%	1.071	-0.9%	1.066			
Forecast Error Adj.		(0.011)			(0.002)		(0.013)		(0.003)			
RCAF Unadjusted		1.061			1.079	1.70%	1.058	-1.9%	1.063			
PAF		2.3641			2.3617	-0.10%	2.3593	-0.10%	2.3621			
RCAF Adjusted		0.449			0.457	1.78%	0.448	-2.0%	0.450			
PAF-5		2.5298			2.5260	-0.15%	2.5235	-0.10%	2.5210			
RCAF-5		0.419			0.427	1.91%	0.419	-1.9%	0.422			

STB Decision served March 11, 2019 contained new productivity numbers, which were not available in time for the original 2019Q2 RCAF.