

SURFACE TRANSPORTATION BOARD

DECISION

Docket No. EP 715

RATE REGULATION REFORMS

Digest:¹ In response to a court remand, the Board explains its view that the double count of certain costs informing its decision to raise the cap for Three-Benchmark rate reasonableness cases does not justify changing the \$4 million cap. Parties may comment on the Board's resolution of the double-count issue.

Decided: December 1, 2014

In 2012, the Board began a rulemaking to revise its procedures for rate reasonableness cases in several respects, two of which are pertinent here. First, the Board proposed to remove the existing \$5 million limit on relief for "Simplified-SAC" cases,² while, at the same time, improving the accuracy of Simplified-SAC by requiring a full analysis of one of the inputs, known as "Road Property Investment" (RPI). The proposal to change the simplified RPI analysis requirement to a full RPI analysis requirement was intended to ensure that the Simplified-SAC test would be more accurate when much larger sums would be in dispute. However, the Board recognized that requiring a full RPI analysis would increase the complexity—and thus the cost—of litigating a Simplified-SAC case. Because the Board uses the cost of litigating a Simplified-SAC case as the limit for relief under its most simplified procedure—the "Three-Benchmark" methodology³—the Board took the second action relevant

¹ The digest constitutes no part of the decision of the Board but has been prepared for the convenience of the reader. It may not be cited to or relied upon as precedent. Policy Statement on Plain Language Digests in Decisions, EP 696 (STB served Sept. 2, 2010).

² In a "stand-alone cost" (SAC or Full-SAC) case, the Board considers both whether the captive shipper is being forced to cross-subsidize other parts of the railroad's rail network and whether the existing operations could be conducted more efficiently. It ultimately determines rate reasonableness by looking at the costs that would be incurred by a hypothetical, optimally efficient rail carrier providing the service at issue with the actual revenues the defendant carrier receives for providing that service. Simplified-SAC also looks at whether there is a cross-subsidy by comparing costs and revenues, but it eliminates the inquiry into the defendant's efficiency by assuming that all existing infrastructure along the predominant route used to haul the complainant's traffic is needed to serve the traffic on that route.

³ In a Three-Benchmark case, the Board determines rate reasonableness by examining the challenged rate in relation to three "benchmark" figures, each expressed as a ratio of

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here: it proposed to raise the limit on relief in Three-Benchmark cases from \$1 million to \$2 million.

The Board ultimately determined that, based on the evidence submitted during the comment phase, a \$2 million relief cap would be too low, as the Board's basis for the relief cap—its estimate of the cost of litigating a Simplified-SAC case—was itself too low. During the rulemaking proceeding, U.S. Magnesium, LLC (USM), the only shipper to have brought a Simplified-SAC case, submitted evidence that, had the case not settled, its litigation costs under the original procedures (i.e., with a simplified RPI analysis) would have been \$2 million, not \$1 million as the Board had previously estimated. The Board also received comments from the American Chemistry Council (ACC), which contained information the Board used to calculate that the cost to perform a full RPI analysis would be \$1.9 million. Combining that estimate (which the Board rounded up to \$2 million) with the revised estimate to litigate a Simplified-SAC case under the old rules (also \$2 million), the Board determined that the cost to litigate a Simplified-SAC case with a full RPI analysis would be \$4 million. Accordingly, the Board set the limit on relief in Three-Benchmark cases at \$4 million. Rate Regulation Reforms, EP 715 (STB served July 18, 2013).

The Board adopted this and several other changes in its final rules to improve the rate review process. On appeal to the United States Court of Appeals for the District of Columbia Circuit, CSX Transportation, Inc., and Norfolk Southern Railway Company (collectively, the Eastern Railroads) challenged four aspects of the new rules. With regard to the relief cap in Three-Benchmark cases, the Eastern Railroads argued that, in estimating the cost of litigating a Simplified-SAC case under the new procedures (i.e., with a full RPI analysis), the Board had double counted some costs of performing an RPI analysis by including the costs of performing both a simplified and full analysis. In its decision, the court rejected all of the Eastern Railroads' other arguments, but found that the Board had not adequately addressed the double-count argument. Rather than vacate, however, the court said it would remand the matter back to the agency because "the Board may be able readily to cure a defect in its explanation." CSX Transp., Inc. v. STB, 754 F.3d 1056, 1066 (D.C. Cir. 2014) (internal quotations omitted).⁴ This decision will explain the Board's intended resolution of the double-count issue.

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revenues to variable costs of providing rail service.

⁴ The court denied the other challenges raised in the petition for review. Specifically, the court determined that the Board had adequately addressed the argument that the new Three-Benchmark limit would cause a ratcheting down of rail rates and that the Board had erred in estimating that the cost to litigate a Simplified-SAC case under the old rules was \$2 million. The court also rejected challenges to the Board's decision to remove the limitation on relief in Simplified-SAC cases, to adopt a new revenue-allocation methodology for use in Full-SAC and Simplified-SAC cases, and to change the interest rate on reparation awards.

DISCUSSION AND CONCLUSIONS

When it adopted the Three-Benchmark test, the Board established the initial \$1 million cap by looking to the cost to litigate the next most complicated procedure, Simplified-SAC. In this proceeding, the Board revised the limit for relief in Three-Benchmark cases by following the same general procedure, except that it looked to the estimated cost to litigate a Simplified-SAC case with a full RPI analysis, and concluded that the cap should be set at \$4 million. Rate Regulation Reforms, slip op. at 22-23. As the Eastern Railroads pointed out in their brief to the court, however, the original cost estimate for a Simplified-SAC case already included the costs associated with conducting a simplified RPI analysis. Therefore, they argued, when the Board added the estimated cost of conducting a full RPI analysis to the agency's revised estimate of the cost to litigate a Simplified-SAC case with a simplified RPI analysis, it should have subtracted the costs for a simplified RPI analysis.

We agree that the cost of performing a simplified RPI analysis should have been subtracted from our calculation. However, even with this subtraction of costs, we still believe that a relief cap of \$4 million for Three-Benchmark cases is appropriate, for the reasons discussed below.⁵

In Simplified Standards, slip op. at 93, the Board originally estimated that the total cost to litigate a Simplified-SAC case was about \$970,000, which the Board rounded up to \$1 million. The Board derived the \$970,000 figure from a shipper group's detailed, line-item estimate of the various costs associated with litigating a Simplified-SAC case, with some adjustments made by the Board. Id. at 92. Using this line-item estimate, which the Eastern Railroads concede is accurate,⁶ we can deduce how much of that \$970,000 figure was attributable to preparing a simplified RPI analysis. In the line item for developing a simplified RPI analysis, the Board estimated that that task would take between 240 and 600 consultant hours. Simplified Standards, at 93 (citing American Chemistry Council, et al., Opening Comments, V.S. Fauth, Ex. GWF-2, at 3, Simplified Standards for Rail Rate Cases, EP 646 (Sub-No. 1) (filed Oct. 24, 2006)). As it did for almost all of the various line items, the Board adopted the average of the consultant's high and low estimates, which, for RPI, came to 420 hours. Simplified Standards, slip op. at 93 (using the average of the high and low consultant costs). Based on the evidence in the record, the Board also estimated that consultants would charge \$175 per hour. Id. Thus, included in the Board's \$970,000 estimate was \$73,500 for consultants to prepare a simplified RPI analysis (420 hours x \$175/hour).

⁵ In accordance with Board precedent, the Three-Benchmark relief cap is indexed annually for inflation using the Producer Price Index. Simplified Standards for Rail Rate Cases (Simplified Standards), EP 646 (Sub-No. 1), slip op. at 28 n.36 (STB served Sept. 5, 2007), aff'd sub nom. CSX Transp., Inc. v. STB, 568 F.3d 236 (D.C. Cir.), vacated in part on reh'g, 584 F.3d 1076 (D.C. Cir. 2009).

⁶ See Pet'rs' Final Reply Br. 18-19, CSX Transp., Inc. v. STB, No. 13-1230 (filed Feb. 26, 2014).

The Board also determined in Simplified Standards that, in addition to consultants' fees, there would be lawyers' fees for reviewing the consultants' work and presenting it to the Board through legal filings. The Board estimated that generally lawyers' fees would be about 75% of the consultants' fees. Id. Thus, included in the \$970,000 figure was \$55,125 in lawyers' fees associated with presenting a simplified RPI analysis ($\$73,500 \times 0.75$).

Combining these consultant and lawyers' fees ($\$73,500 + \$55,125$), we determine that, out of the \$970,000 estimate to litigate a Simplified-SAC case, \$128,625, or about 13.26%, was attributable to preparing and presenting a simplified RPI analysis. Applying this percentage to our revised estimate of the cost to litigate a Simplified-SAC case under the old rules—\$2 million—we estimate that a simplified RPI analysis would cost \$265,206. Subtracting that figure from the \$4 million figure results in an estimated cost of litigating a Simplified-SAC case of about \$3.73 million.⁷

We believe it is appropriate to round that estimate up to \$4 million, keeping in place the relief cap that we previously adopted. First, all of the figures on which the Board's calculation is based are themselves estimates, rather than precisely known costs, and rounding to the nearest million dollars comports with how the Board has rounded in the past. The Board rounded up to the nearest million dollars when setting relief limits in Simplified Standards, and, indeed, for Simplified-SAC the Board did so by a larger percentage than we are doing here. There, the Board rounded up by approximately 11% when setting the limit for Simplified-SAC. See Simplified Standards, slip op. at 30-31 (rounding from \$4.5 million to \$5 million). Here, we are rounding up by approximately 7% (from \$3.73 million to \$4 million).⁸

Second, rounding up to \$4 million would help promote the goal that prompted this rulemaking in the first place, namely, "improving our rate review process to ensure that it is as fair and accessible as possible" to all shippers, even those with relatively smaller cases. Rate Regulation Reforms, slip op. at 2 (emphasis added); see also id. at 24 ("The dearth of Simplified-SAC cases brought before the Board [under the old rules] undermines CSXT/NSR's arguments that the Simplified-SAC method can effectively be utilized for relatively low value cases.").

Any party that wishes to comment on our intended resolution of the issue remanded by the court should file comments by December 23, 2014. In a subsequent decision, the Board will

⁷ As noted above, the \$4 million figure from Rate Regulation Reforms was the product of rounding the estimated cost of a full RPI analysis from \$1.9 million to \$2 million. If we were to use the unrounded figure of \$3.9 million, resulting in an estimated cost of \$3.63 million (rather than \$3.73 million) to litigate a Simplified-SAC case with a full RPI analysis, we would still round up to \$4 million for the reasons discussed herein.

⁸ Even using the \$3.63 million estimate discussed in footnote 7, we would be rounding by about 10% here. We also note that the basis for our estimate here—U.S. Magnesium's estimate of the cost to litigate a Simplified-SAC case under the old rules—was expressed in 2010 dollars. Indexing that figure to 2013 dollars would produce an estimate to litigate a Simplified-SAC case under the new rules of approximately \$3.92 million.

address any filed comments. If no comments are filed, the Board will adopt this approach without change.

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

It is ordered:

1. Comments on the Board's intended resolution of the issue remanded by the Court of Appeals are due December 23, 2014.

2. This decision is effective on the date of service.

By the Board, Chairman Elliott, Vice Chairman Miller, and Commissioner Begeman.