

BESSEMER AND LAKE ERIE RAILROAD COMPANY

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205748

June 28, 2002



The Honorable Vernon A. Williams
Secretary
Case Control Branch
Surface Transportation Board
1925 K Street, N.W.
Washington, DC 20006-1105

RE: STB Ex Parte No. 589
Calculation of Variable Costs in Rate Complaint
Proceedings Involving Non-Class I Railroads

Dear Mr. Williams:

Enclosed for filing are the original and ten copies of the Comments of Duluth, Missabe & Iron Range Railway Company and Bessemer & Lake Erie Railroad Company.

Very truly yours,

Leean Greenwald

Leean Greenwald

Enclosures

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BEFORE THE
SURFACE TRANSPORTATION BOARD



CALCULATION OF VARIABLE COSTS IN)
RATE COMPLIANCE PROCEEDINGS) Ex Parte No. 589
INVOLVING NON-CLASS I RAILROADS)

**COMMENTS OF DULUTH MISSABE & IRON RANGE RAILWAY COMPANY AND
BESSEMER & LAKE ERIE RAILROAD COMPANY**

Duluth, Missabe & Iron Range Railway Company ("DM&IR") and Bessemer & Lake Erie Railroad Company ("B&LE") submit these comments in support of the Board's proposal to estimate the variable costs of non-Class I railroads by using regional-average variable costs. DM&IR and B&LE further propose that the Board require any shipper challenging the reasonableness of a non-Class I rate to submit with its complaint a computation showing that the revenue-to-variable-cost ratio of the challenged rate exceeds a specified level using regional-average variable costs.

DM&IR is a Class II rail carrier that operates approximately 438 miles of track in northeastern Minnesota and northwestern Wisconsin. DM&IR serves major mining areas throughout the Missabe Iron Range between Colerain, MN, on the west and Hoyt Lakes, MN, on the east. It extends southward to the ports of Two Harbors and Duluth on Lake Superior, with connections in Wisconsin to BNSF, CN, UP, CP and WC. It employs 553 people. DM&IR's principal traffic comprises iron ore, taconite pellets, coal and limestone. DM&IR was the defendant railroad in Minnesota Power v. DM&IR, Docket No. 42038 ("Minnesota Power"), the most recent challenge to a non-Class I railroad's freight rates. As the defendant, DM&IR faced

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the threat of having to convert for a period of one year to a costly and disruptive accounting methodology to determine variable costs.

B&LE is also a Class II rail carrier, as well as DM&IR's sister company. Located in western Pennsylvania and northeastern Ohio, B&LE operates a main line from North Bessemer, PA, to its bulk material handling facility at Conneaut, OH, on Lake Erie, along with other trackage totaling 344 miles of track. It employs only 240 employees, and handles primarily bulk commodities such as iron ore, coal, and limestone for approximately 50 shippers.

A. The Board Should Use Average Regional URCS Costs to Calculate Variable Costs of Non-Class I Railroads

As the Board recognized in Minnesota Power and again in its call for comments, requiring non-Class I carriers to compile data like a Class I railroad would be unreasonable. Neither DM&IR nor B&LE has maintained records in the forms required for R-1 reports or for calculating a carrier-specific application of the Uniform Rail Costing System. DM&IR has not prepared an R-1 report since 1985, and B&LE has not prepared an R-1 report since 1984, when they ceased to qualify as a Class I carrier. DM&IR and B&LE operate a consolidated finance department and structure their records, data systems, and methods of accounting solely for their business purposes, in reliance on ICC decisions relieving smaller carriers from compiling an annual R-1. See Elimination of Accounting & Reporting Requirements of Class II Railroads, No. 37614, Decision served Feb. 25, 1982; Reduction of Accounting & Reporting Requirements, No. 37523, Decision served Dec. 15, 1980.

Neither railroad has gathered many of the cost items and operating statistics required of Class I railroads, whether on a systemwide, segment-specific, or movement-specific basis. Examples of operating statistics that DM&IR and B&LE do not collect include gross ton-

miles, locomotive unit-miles, train miles, train hours, and maintenance-of-way statistics by line segment. Instead, DM&IR and B&LE have maintained only the information they need to conduct day-to-day operations and to prepare internal reports for their corporate parent.

As the Board recently observed, the added cost to non-Class I railroads of collecting and recording the operating and other statistics for R-1 reports and generating carrier-specific URCS would be inordinate and would thwart Congress's intent to expedite rail rate cases. Calculation of Variable Costs in Rate Complaint Proceedings Involving Non-Class I Railroads, Ex Parte No. 589, Decision served Apr. 30, 2002, at 5-6. In Minnesota Power, DM&IR submitted evidence that it would cost the railroad \$1 million to comply with Class I reporting requirements for just one year, while the total annual revenue it received from the challenged shipment was only \$700,000. Id. at 589 at 5.¹

This disproportionate cost is the principal reason why relying on the average regional data reported in the Board's regional URCS is the best alternative for non-Class I rate disputes. When it adopted URCS, the ICC noted that any method of determining the variable cost of movement should not impose burdens on carriers disproportionate to the usefulness of that method for resolving disputes:

Costs and related information should be feasible to obtain, efficiently determined, and material in amount. To be feasible, information must be physically possible to obtain at an acceptable level of accuracy. To be efficiently determined, information must generate benefits that exceed the costs of providing it. To be material in amount, information must have such bearing on the

¹ Many years earlier, DM&IR had estimated that the extra cost of preparing an R-1 report would be approximately \$100,000 per year. DM&IR subsequently eliminated the personnel and data systems that would have made compiling an R-1 less expensive than it would be today.

issue that its absence would lead to a significantly different outcome . . . [The Board must] take into account the capability of carriers to provide information, the relative benefits and costs of its provision, and the means by which required economic accuracy can be achieved with the least information at the least expense.

Adoption of the Uniform Railroad Costing System, 5 I.C.C.2d at 908-09 (emphasis added).

Indeed, the STB calculates regional URCS for the sole purpose of assisting smaller railroads in determining variable costs. The regional averages calculated by the Board are irrelevant to the Class Is because their operating expenses and other cost inputs are readily available.

Using regional URCS costs offers several advantages. It supplies an unbiased costing methodology approved by the Board and not designed to help one party or another in a particular rate case. The Board's regional URCS averages are equally available to railroads and shippers and can be utilized by both when negotiating rates. Consistent use of the Board's regional URCS will allow railroads and shippers to predict whether a rate will be found to be above or below the Boards' jurisdictional threshold. This type of predictability will facilitate commercial resolution of rate disputes and should reduce the number of rate cases.

The alternative to using regional URCS, that is, requiring non-Class I carriers to convert their data systems in order to capture additional cost data, would be inequitable, cost-prohibitive, and disruptive. The non-Class I carriers have relied upon the fact that they are not required to maintain cost information for an R-1 report. Should the Board adopt the alternative, these carriers will be required to obtain new data systems and hire additional and otherwise unneeded personnel. The time and labor commitments necessary to effectuate the conversion may, as was the case in Minnesota Power, exceed the revenue generated by the challenged rate. If the smaller railroads face spending huge sums to defend rate cases, they will be compelled to make rate concessions that do not reflect market conditions.

B. The Board Should Require a Threshold Showing of Unreasonableness Before Initiating a Rate Proceeding Against a Non-Class I Carrier

DM&IR and B&LE propose an additional step to reduce the burdens of potential rate cases on non-Class I carriers. DM&IR and B&LE propose that the Board require shippers to submit a proffer with any complaint showing that applying regional URCS costs, the revenue-to-variable-cost ratio of the challenged rate exceeds a specified level. For reasons described below, DM&IR and B&LE suggest that this threshold level be set at 200 percent of variable costs.

Without such a proffer, rate proceedings could impose prohibitive and unwarranted costs on non-Class I carriers, even if the Board adopts the use of regional URCS costs as its basis for cost computations. This is so because shippers may attempt to show through discovery that specific costs of the non-Class I carrier exceed those of the regional URCS carriers. If shippers are allowed to pursue discovery regarding specific costs before demonstrating that the rate is of questionable legality, they could impose enormous discovery burdens on smaller railroads. These burdens could force the non-Class Is to make concessions in rate negotiations.

The procedure in Class I carrier rate cases demonstrates this risk. Under the Board's procedure in Class I rate cases, shippers routinely file dozens of discovery requests to obtain carrier-specific information about virtually every type of cost. Notwithstanding public complaints by shippers about the burdens of rate cases, this procedure imposes enormous burdens primarily on the carriers, which must produce information about operations, employee activities and compensation, purchases of supplies, maintenance practices, mechanical activities, and numerous other types of costs. If DM&IR and B&LE were required to gather and produce

records on all of these types of costs for even one disputed movement, they would incur costs that would materially affect their annual earnings, even though the rate might be reasonable.

The proposed threshold computation would accomplish at least three goals. Most importantly, it would ensure that if the parties did ultimately undergo costly discovery and evidentiary filings, those costs would be incurred only for disputes in which a significant rate differential is in dispute. The information gathered would therefore be more likely to “generate benefits that exceed the costs of providing it.” Adoption of the Uniform Railroad Costing System, 5 I.C.C.2d 894, 908-09 (1989). The threshold also would allow the Board to confine its efforts to cases where there is a significant chance that regulatory action is required. Finally, it would reduce the risk that costs of regulation would distort marketplace decisions.

DM&IR and B&LE recommend that the threshold for rate complaints be set at 200 percent. This threshold would confine rate cases to those instances where there is a significant possibility that the rate is unlawful. Otherwise, smaller carriers will face the threat of disproportionate discovery costs that are unlikely to justify any modest recovery that might result.

Although shippers may argue in their comments that regional URCS understate non-Class I carrier costs, the opposite is often true. Smaller carriers do not enjoy the economies of scale and scope of their larger counterparts. For example, the cost of capital for smaller railroads is often higher than the capital costs of Class I railroads, because most smaller railroads are riskier investments with more marginal operations and greater exposure to market changes. Smaller railroads also have higher unit costs for track maintenance, because they cannot afford to use efficient system rail and tie gangs, to purchase expensive track maintenance equipment, or to

use new technologies such as concrete ties. Because of lower traffic densities on most non-Class I carriers, unit operating costs also are often higher than for Class I carriers. DM&IR presents a prime example of unusual costs, because it confronts some of the coldest winter conditions encountered by any U.S. carrier. In Minnesota Power, the shipper's data showed that DM&IR's system-average cost per ton-mile was more than twice the average cost per ton-mile for the Western Region Class Is. These cost differentials suggest that the Board should, as a matter of sound policy, set the threshold showing above the jurisdictional minimum.

CONCLUSION

DM&IR and B&LE support the Board's proposed policy of using regional-average URCS costs to estimate the variable costs of non-Class I railroads. They urge the Board to adopt the additional procedure of requiring shippers to show at the outset of a rate dispute that the costs and burdens associated with discovery and evidentiary filings are economically justified.

Respectfully submitted,



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June 28, 2002

VERIFICATION

I, Peter D. Stephenson, hereby verify that the facts in the foregoing Comments of Duluth Missabe & Iron Range Railway Company and Bessemer & Lake Erie Railroad Company reflect my personal knowledge and are true and correct. As Vice President and General Manager of the Northern Business Unit, I am qualified and authorized to state those facts.

P D Stephenson