



U.S. Department of
Transportation

General Counsel

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

ENTERED
Office of Proceedings

JUL 1 2002

Part of
Public Record

July 1, 2002



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

Re: Ex Parte No. 589

Dear Secretary Williams:

Enclosed herewith are the original and ten copies of the Comments of the United States Department of Transportation in the above-referenced proceeding. There is also a computer diskette of this document, convertible 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 the messenger.

Respectfully submitted,

Paul Samuel Smith
Senior Trial Attorney

Enclosures

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

Comments of the United States Department of Transportation

Introduction

The Surface Transportation Board ("STB" or "Board") in this proceeding has asked for comment on how best to determine the variable costs of small railroads. Decision served April 30, 2002 ("Decision"); 67 Fed. Reg. 21321. Variable costs are critical in cases brought by shippers challenging the reasonableness of rail rates, since they determine whether the STB has jurisdiction to hear the dispute. The Board has outlined the two main approaches that it has used to determine the variable costs of small rail carriers in the past: the traditional approach of estimating these variable costs on the basis of the comprehensive cost and operating data supplied by large carriers, or, an approach used in at least one case, of requiring a small carrier to maintain relevant information in the same comprehensive detail that large railroads do. *Id.* at 3-5.

The United States Department of Transportation ("DOT" or "Department") appreciates that there are drawbacks to each approach. Nonetheless, in the absence of an obviously superior alternative we share the Board's initial preference for the traditional approach. It balances the cost and other considerations at issue and produces what is in

our view a suitable surrogate for regulatory adjudication purposes. DOT also looks forward to reviewing the submissions of other parties in hopes that they might offer additional suggestions.

Background

Federal law has long imposed on railroads the requirement that their rates must be reasonable. 49 U.S.C. § 10701. Under current law the level of a railroad's variable costs is a critical element in determining whether the Board has jurisdiction to hear a challenge to a rail rate. 49 U.S.C. § 10707(d)(1). Moreover, the same fundamental requirements apply to cases challenging the reasonableness of rates whether they are brought against large (Class I) or small (Class II or III) railroads.¹ A shipper challenging a given rail rate must first demonstrate that the rail carrier has "market dominance" (*i.e.*, that the railroad faces a lack of effective competition) over the traffic at issue. 49 U.S.C. §§ 10701(d)(1), 10707. A necessary condition for demonstrating market dominance is that the revenue produced by the movement in question must be not less than 180% of the carrier's variable cost of providing the service. 49 U.S.C. § 10707(d)(1).² Below this level the Board has no jurisdiction. "In other words, Congress has determined that a railroad does not exercise undue market power when it prices traffic below the 180% revenue-to-variable cost (r/vc) level." STB Decision at 1.

^{1/} Class I carriers are those with annual operating revenues of at least \$250 million (in 1991 dollars); Class II carriers are those with annual operating revenues between \$20 million and \$250 million; Class III carriers have annual operating revenues below \$20 million. 49 C.F.R. § 1201 General Instruction 1-1(a). When we refer to "small" rail carriers herein, we mean Class II or Class III railroads.

^{2/} This is not a sufficient condition, for even when the r/vc ratio in a given case exceeds the statutory threshold, the STB must still explore whether there are effective competitive alternatives for the traffic.

The variable cost for a given rate (the denominator of the r/vc ratio) can be determined for any Class I railroad under the Uniform Rail Costing System ("URCS"). 49 U.S.C. § 10707(d)(1)(B).³ Detailed cost and operational data are maintained and filed with the STB by Class I railroads. Pursuant to URCS, this information is used to calculate each Class I carrier's system-wide average variable cost of providing service. These system-average URCS costs are then adjusted to more closely reflect the service provided to the individual shipper involved in a rate case. *Id.* at 2.

However, only Class I railroads are required to maintain records that allow variable costs to be determined under URCS. *Id.* at 3. The relative expense of maintaining information in this detail, and the relative infrequency of rate complaints against small carriers, led the STB's predecessor to use average regional variable costs of the Class I railroads as surrogates for the smaller railroads' variable costs. *Id.* The drawback with this approach is that it sacrifices a certain degree of precision in the interest of reducing regulatory burdens.

In a recent rate case involving a small rail carrier, the STB was sufficiently concerned about the inaccuracy of this approach that the agency required the railroad involved to maintain the relevant data as if it were a Class I carrier. *See Id.*; Docket No. 42038. The opposition provoked by that decision eventually led the Board to institute this proceeding. Here the STB has outlined the two approaches noted above, and has tentatively determined to return to the former method of estimating small railroad variable costs on the basis of data from larger carriers. The STB also notes that it would

³/ URCS consists of costing formulae developed to estimate the variable costs (fuel, labor, etc.) associated with a unit of output such as a ton-mile.

welcome suggestions as to how such regional average variable costs can practically be adjusted to better reflect the operations of non-Class I railroads. Id. at 2.

Discussion

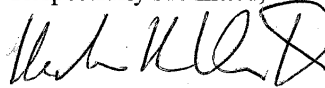
The Department welcomes the ongoing efforts by the STB to simplify applicable processes and standards and thereby make its regulatory adjudication more accessible to small shippers and small carriers alike. It is well known that the cost of bringing a conventional rate case is clearly a burden for many shippers. It is perhaps less well appreciated that this is also true for many small carriers. Indeed, for a small railroad dealing with a large shipper the rail carrier may be less able to bear the burden of high litigation costs.

Barring the development of more attractive suggestions from other parties, the Department at this point supports the preliminary position favored by the STB. Reverting to the use of regional Class I average costs appears to be a reasonable compromise that takes into account the costs of detailed record-keeping on the part of smaller railroads, the relative paucity of complaints against such carriers, and the need to protect shippers from unreasonable rates. Inviting comment affords an opportunity for both shippers and railroads to present their views on any biases or limitations inherent in the Board's tentative view and to suggest superior alternatives.

Conclusion

The Department at this juncture shares the Board's preliminary preference for continuing to estimate small railroad variable costs on the basis of available Class I carrier data. We look forward to reviewing the submissions of other parties in hopes that they may offer other viable approaches.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Kirk K. Van Tine", written over a horizontal line.

KIRK K. VAN TINE
General Counsel

July 1, 2002