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SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 771

REPORT: ALTERNATIVES TO URCS

In an October 26, 2022 Notice and Request for Comments ("Notice"), the Surface Transportation Board ("Board") sought comments related to *Alternatives to URCS*, a report by Laurits R. Christensen Associates, Inc. ("Report"). The Association of American Railroads ("AAR") submitted comments on February 23, 2023. BNSF Railway Company, which joined in the comments of the AAR, also submitted its own comments. The only other interested parties to submit comments were the Western Coal Traffic League ("WCTL") and the American Petroleum Institute ("API").

1. <u>The Hybrid Alternative Approach Is a Flawed Model that Is Inappropriate for Railroad Costing</u>.

As explained by AAR in its opening comments, the Report did not conduct any updated empirical studies or solicit full input from current stakeholders.[1] Indeed, the Report itself acknowledges that, if the Board were to pursue an alternative (*e.g.*, Hybrid) model or otherwise update URCS, there remains substantial study to be undertaken and stakeholder involvement to be secured.[2]

[1] *See* AAR, *Report: Alternatives to URCS*, EP 771 (Feb. 23, 2023) ("AAR Opening Comments"), at 5, 9, 14, 16, 19.

[2] *See* Report at 179-189.

Further, AAR has three major concerns regarding the Report's findings. These concerns are detailed in AAR's Opening Comments and summarized briefly in this section. First, the Report's focus on an alternative Hybrid model that combines results from its New Empirical Industry Organization ("NEIO") revenue analysis with marginal cost estimates from an econometric cost analysis relies on the incorrect conclusion that short run or marginal costs are the appropriate standard for a regulatory costing model.[3] In addition, the approaches are unable to disentangle costs from the effects of market markup factors on rates, which is significant given that railroads price differentially.[4] In combination, these two flaws prove fatal to the proposed Hybrid model. Moreover, the Hybrid model lacks sufficient precision to determine costs in a rate reasonableness proceeding and, as such, is unfit for usage for the Board's regulatory purposes.[5] Indeed, the Hybrid model is unclear as to "what specific input would be required in a rate proceeding before the Board or what the specific regulatory answer for a particular shipment might be."[6]

Second, the Report incorrectly focuses on the elimination of step functions. While the proper use of step functions may merit additional study, the step function in URCS between through train and unit train costing has a solid logical foundation.[7] As previously explained by AAR, there is a justifiable difference in the use of average through train sizes and average

[3] *See* AAR Opening Comments at 5.

[4] *See id*.

[5] *See id*. at 8-9.

[6] *Id*. at 8; *see also* Verified Statement of Michael R. Baranowski ("Baranowski V.S.") at 17.

[7] *See id*. at 9; *see also* Baranowski V.S. at 11.

locomotive consists for through train shipments versus the URCS requirement for unit trains to maintain a specific input for the number of cars and scaled locomotive consists based on the system average.[8]

Third, the Report offers a flawed analysis of URCS regressions.[9] For example, the outcome of the Report's regressions on the combined URCS depreciation and return of investment results is a low correlation between the sum of depreciation expense and return on investment and changes in volume. However, because railroad assets are long-lived and some reported depreciation includes expenditures that occurred more than three decades ago, there can be little correlation between those expenditures and volume changes. Other analysis errors in the URCS regressions discussed in AAR's opening comments reflect a similar misunderstanding of the industry.[10] Instead of pursuing these, if the Board is inclined to develop detailed revisions to URCS through stakeholder input, AAR believes it should focus on corrections and updates to URCS that more appropriately reflect the modern railroad industry.

2. WCTL Supports the *Results* of the Hybrid Model, but Offers Little in Support of the Hybrid Model Beyond Collateral Attacks on the Present System.

In its comments, WCTL urges the Board to explore further the Hybrid model discussed in the Report.[11] While acknowledging that its analysis of the model has been frustrated by "the Board's determination not to make available the underlying workpapers and data,"[12] WCTL

[8] *See id*. at 9-10.

[9] *See id.* at 10-11.

[10] *See id.*

[11] *See* WCTL, *Alternatives to URCS*, EP 771 (Feb. 23, 2023) ("WCTL Opening Comments"), at 2,6.

[12] *Id.* at 2. AAR has similar concerns.

nonetheless offers its support for certain aspects of the Hybrid model—apparently because it likes the results that flow from the model.[13] Specifically, WCTL expresses interest in "updating the URCS Phase I variabilities" in order to "reduce the rate level at the statutory rate floor for shipments subject to the Board's jurisdiction, increasing the share of traffic with rates above the jurisdictional threshold."[14] If the Board is going to proceed with updating URCS, it should not base that update on a desire to increase (or decrease) the amount of traffic subject to Board jurisdiction. Rather, any revision should be undertaken in light of the statutory goal "to ensure the availability of accurate cost information in regulatory proceedings" and based on a thorough understanding of the model—which no party has here, given the Board's decision not to provide underlying workpapers and data.[15]

WCTL's stated desire to "increase . . . the share of traffic subject to regulatory oversight" is unsurprising, as it is an oft repeated refrain.[16] Indeed, WCTL itself acknowledges that it has a "long history" of "advocat[ing] for cost-finding principles and methodologies" that would result in additional regulation of railroad pricing.[17] With this as its primary goal, WCTL then advances

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[13] *See* WCTL Opening Comments at 3; *see also* Verified Statement of Thomas D. Crowley and Robert D. Mulholland ("Crowley & Mulholland V.S."), at 11-12.

[14] *Id*. at 11; *see also id.* at 3 ("[T]here may be good cause to update the URCS Phase I variabilities, and doing so should result in universally lower variable costs. This reduction in variable costs would, in turn, increase the revenue-to-variable cost ('R/VC') ratio for all shipments, cause more traffic to become eligible for rate relief (the R/VC ratios for some movements would be pushed above the jurisdictional threshold ('JT') of 180%), increase the rate relief that may be available (the JT rate level would decrease for all eligible shipments), and support increased review of the existing commodity exemptions (more traffic would fall above the JT and be eligible for rate relief).").

[15] 49 U.S.C. § 10101 (13).

[16] WCTL Opening Comments at 11-12; *see also id.* at 1-2 ("Since the enactment of the Staggers Act in 1980, WCTL has been constant in its contentions in both proceedings treating the subject of railroad cost-finding and in cases where railroad cost levels are in issue that for a litany of different reasons, the agency accepts as accurate, carrier cost levels that are in fact inflated and overstated.").

[17] *Id.* at 1.

arguments that are, ultimately, nothing more than complaints about the Board's current methodology for calculating the railroad cost of capital.[18]

As it has repeatedly done in past proceedings, WCTL attacks the Board's cost of capital methodology and claims without support that "carriers have strived to overstate the costs of their transportation services so as to avoid the regulation of their pricing" and that "the cost of capital that the Board utilizes in URCS and for other purposes remains substantially overstated."[19] As it has done repeatedly in the past, the Board should reject these collateral attacks on the cost of capital methodology.[20] The Board has consistently stated that attacks on the underlying methodology may only be properly litigated through a proceeding on revising the methodology. As such, WCTL's attacks are inappropriate in this information-seeking proceeding.

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[18] *See id.* at 4-6.

[19] *Id.* at 1, 4; *see also id*. at 2 (claiming that the Board "accepts as accurate, carrier cost levels that are in fact inflated and overstated").

[20] *See, e.g., Pet. of the W. Coal Traffic League to Inst. a Rulemaking Proceeding to Abolish the Use of the Multi Stage Discounted Cash Flow Model in Determining the R.R. Indus.'s Cost of Equity Capital*, EP 664 (Sub-No. 2), slip op. at 1-2 (STB served Sept. 28, 2018); *Pet. of the W. Coal Traffic League*, EP 664 (Sub-No. 2), slip op. at 2 (STB served Aug. 14, 2017); *Pet. of the W. Coal Traffic League*, EP 664 (Sub-No. 2), slip op. at 2, 5, 9, 11-13 (STB served Apr. 28, 2017); *Pet. of the W. Coal Traffic League*, EP 664 (Sub-No. 2), slip op. at 11, 14, 17-18, 20 (STB served Oct. 31, 2016); *Use of a Multi-Stage Discounted Cash Flow Model*, EP 664 (Sub-No. 1), slip op. at 11-13 (STB served Jan. 28, 2009).

3. **API Acknowledges the Flaws of the Hybrid Model.**

In a brief letter, the American Petroleum Institute argues that the URCS model should be replaced.[21] However, even as API shares its support for the Hybrid model advanced by Christensen Associates, it acknowledges that it is flawed. For example, API recognizes that the Report "suggests that the Hybrid model is not totally aligned with the Data Integrity principle."[22] Further, "API recognizes the Hybrid model's limited ability to cost movements by Class II and Class III railroads," as well as its "limited ability to distinguish commodity-specific effects on costs."[23] Thus, API concludes that, while the Hybrid model is the better of the two options, "there may be room for improvement."[24]

AAR certainly agrees with API that the Hybrid model has flaws.[25] Indeed, AAR and its railroad members support the Board's continued efforts to develop the best means of reforming URCS. However, such an effort must consider the operating realities of modern railroading.[26]

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[21] *See generally* American Petroleum Institute's Comments in Response to the Surface Transportation Board request for comments on Alternatives to URCS (Docket No. EP 771) (Feb. 23, 2023) ("API Opening Comments").

[22] *Id*. at 2.

[23] *Id.*

[24] *Id*.

[25] And a fulsome analysis of necessary improvements would benefit from the release of the Report's underlying workpapers and data.

[26] *See* AAR Opening Comments at 11-18.

Conclusion

For the foregoing reasons, as well as others articulated in AAR's opening comments, AAR and its members maintain that the Board should reject consideration of the Hybrid model as an alternative to URCS as it is inappropriate for railroad costing.

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