SURFACE TRANSPORTATION BOARD

DECISION

Docket No. EP 290 (Sub-No. 5) (2014-3)

QUARTERLY RAIL COST ADJUSTMENT FACTOR

Digest:[1] The rail cost adjustment factor (RCAF) is an index formulated to
represent changes in railroad costs incurred by the nation's largest railroads over a
specified period of time. The statute requires the Surface Transportation Board
(Board) to publish the RCAF on at least a quarterly basis. Each quarter, the
Association of American Railroads computes three types of RCAF figures and
submits those figures to the Board for approval. The Board has reviewed the
submission and adopts the RCAF figures for the third quarter of 2014.

Decided: June 20, 2014

In Railroad Cost Recovery Procedures, 1 I.C.C. 2d 207 (1984), the Interstate Commerce
Commission (ICC) outlined the procedures for calculating the all-inclusive index of railroad
input prices and the method for computing the rail cost adjustment factor (RCAF). Under the
procedures, the Association of American Railroads (AAR) is required to calculate the index on a
quarterly basis and submit it to the agency on the fifth day of the last month of each calendar
quarter. In Railroad Cost Recovery Procedures—Productivity Adjustment, 5 I.C.C. 2d 434
(1989), aff'd sub nom. Edison Electric Institute v. ICC, 969 F.2d 1221 (D.C. Cir. 1992), the ICC
adopted procedures that require the adjustment of the quarterly index for a measure of
productivity.

The provisions of 49 U.S.C. § 10708 direct the Surface Transportation Board (Board) to
continue to publish both an unadjusted RCAF and a productivity-adjusted RCAF.
In Productivity Adjustment—Implementation, 1 S.T.B. 739 (1996), the Board decided to publish
a second productivity-adjusted RCAF called the RCAF-5. Consequently, three indices are now
filed with the Board: the RCAF (Unadjusted); the RCAF (Adjusted); and the RCAF-5. The
RCAF (Unadjusted) is an index reflecting cost changes experienced by the railroad industry,
without reference to changes in rail productivity. The RCAF (Adjusted) is an index that reflects
national average productivity changes as originally developed and applied by the ICC, the
calculation of which is currently based on a five-year moving average. The RCAF-5 is an index
that also reflects national average productivity changes; however, those productivity changes are

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[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).

calculated as if a five-year moving average had been applied consistently from the productivity adjustment's inception in 1989.

The index of railroad input prices, RCAF (Unadjusted), RCAF (Adjusted), and RCAF-5 for the third quarter of 2014 are shown in Table A of the Appendix to this decision. Table B shows the first quarter 2014 index and the RCAF calculated on both an actual and a forecasted basis. The difference between the actual calculation and the forecasted calculation is the forecast error adjustment.

In its submission, AAR states that on May 23, 2014, one railroad revised fringe benefit data used by the AAR to calculate the Other Supplements portion of the Labor Index, which directly affected Total Supplements for 2012Q3 and 2013Q3. AAR also states that the revisions caused changes to the 2012 benchmark for Health & Welfare, which caused small decreases for Health & Welfare in all quarters that have used the 2012 benchmark.[2]

In the past, the Board used the forecast error adjustment procedure to remedy similar errors, and we continue to believe it is the best available method to correct the Labor Index.[3] Therefore, we will not restate the first or second quarter 2014 RCAF figures, but rather will allow the corrections to be made using the forecast error calculations. The revision had no impact on the Labor Index for the first quarter of 2014, and therefore, the third quarter 2014 forecast error calculation will include the original 386.2 figure as the "forecast" version of the first quarter 2014 Labor component, and the same 386.2 figure as the "actual" version of the first quarter 2014 Labor component. In the fourth quarter 2014 index calculation, the fourth quarter 2014 forecast error calculation will include the original 388.1 figure as the "forecast" version of the second quarter 2014 Labor component, and the corrected 388.1 figure as the "actual" version of the second quarter 2014 Labor component.[4] In the current third quarter 2014 RCAF calculations, the Labor component has been calculated as if the second quarter 2014 version had used the corrected figure.

We have examined AAR's calculations and we find that AAR has complied with our procedures. We find that the third quarter 2014 RCAF (Unadjusted) is 0.985, an increase of 1.0% from the second quarter 2014 RCAF of 0.975. The RCAF (Adjusted) is calculated, in part, using the RCAF (Unadjusted) and a five-year moving geometric average of productivity change

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[2] AAR's filing (dated June 5, 2014), Appx. AA.

[3] See Quarterly Rail Cost Adjustment Factor, EP 290 (Sub-No. 5) (2012-3), slip op. at 2 (STB served June 20, 2012); Quarterly Rail Cost Adjustment Factor, EP 290 (Sub-No. 5) (2011-4), slip op. at 2 (STB served Sept. 20, 2011) (correcting, but not restating, the third quarter 2011 Materials & Supplies component using the first quarter 2012 forecast error calculation); Quarterly Rail Cost Adjustment Factor, EP 290 (Sub-No. 5) (2001-1), slip op. at 2 (STB served Dec. 20, 2000) (noting that the forecast error adjustment was the best available method for correcting a previously overstated RCAF calculation and not restating the previously overstated RCAF).

[4] The 388.1 figure does not change due to rounding.

for U.S. Class I railroads from 2008-2012, which is 1.010 (1.0% per year). We find the RCAF (Adjusted) is 0.424, an increase of 0.7% from the second quarter 2014 RCAF (Adjusted) of 0.421.[5]

In accordance with Productivity Adjustment—Implementation, 1 S.T.B. at 748-49, the RCAF-5 for this quarter will use a productivity trend for the years 2007-2011, which is 1.009 (0.9% per year). We find that the RCAF-5 for the third quarter of 2014 is 0.401, an increase of 1.0% from the second quarter 2014 RCAF-5 of 0.397.[6]

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

Authority: 49 U.S.C. § 10708.

It is ordered:

1. The Board approves the third quarter 2014 RCAF (Unadjusted) of 0.985, RCAF (Adjusted) of 0.424, and RCAF-5 of 0.401.

2. Notice of this decision will be published in the Federal Register.

3. The effective date of this decision is July 1, 2014.

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

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[5] The third quarter 2014 RCAF Adjusted (0.424) is calculated by dividing the third quarter 2014 RCAF Unadjusted (0.985) by the third quarter productivity adjustment factor of 2.3226. The third quarter 2014 productivity adjustment factor is calculated by multiplying the second quarter 2014 productivity adjustment of 2.3168 by the fourth root (1.0025) of the 2008-2012 annual average productivity growth rate of 1.0%.

[6] The third quarter 2014 RCAF-5 (0.401) is calculated by dividing the third quarter 2014 RCAF Unadjusted (0.985) by the third quarter productivity adjustment factor-5 (PAF-5) of 2.4588. The third quarter 2014 PAF-5 is calculated by multiplying the second quarter 2014 PAF-5 of 2.4534 by the fourth root (1.0022) of the 2007-2011 annual average productivity growth rate of 0.9%.

APPENDIX

TABLE A

EP 290 (Sub-No. 5) (2014-3)
All Inclusive Index of Railroad Input Costs
(Endnotes Following Table B)

LINE NO.	INDEX COMPONENT	2012 WEIGHT	SECOND QUARTER 2014 FORECAST	THIRD QUARTER 2014 FORECAST
1	LABOR	31.2%	388.1	395.4
2	FUEL	22.3%	386.2	375.9
3	MATERIALS AND SUPPLIES	4.9%	274.8	271.2
4	EQUIPMENT RENTS	5.6%	212.6	212.2
5	DEPRECIATION	11.9%	216.9	217.1
6	INTEREST	2.0%	76.6	76.6
7	OTHER ITEMS[1]	22.1%	225.2	222.9
8	WEIGHTED AVERAGE	100.0%	309.7	309.0
9	LINKED INDEX[2]		296.8	296.1
10	PRELIMINARY RAIL COST ADJUSTMENT FACTOR[3]		99.7	99.5
11	FORECAST ERROR ADJUSTMENT[4]		-0.022	-0.010
12	RCAF (UNADJUSTED) (LINE 10 + LINE 11)		0.975	0.985
13	RCAF (ADJUSTED)		0.421	0.424
14	RCAF-5		0.397	0.401

TABLE B

EP 290 (Sub-No. 5) (2014-3)
Comparison of First Quarter 2014 Index
Calculated on Both a Forecasted and an Actual Basis

LINE NO.	INDEX COMPONENT	2012 WEIGHT	FIRST QUARTER 2014 FORECAST	FIRST QUARTER 2014 ACTUAL
1	LABOR	31.2%	386.2	386.2
2	FUEL	22.3%	377.9	367.4
3	MATERIALS AND SUPPLIES	4.9%	265.9	265.9
4	EQUIPMENT RENTS	5.6%	208.7	209.7
5	DEPRECIATION	11.9%	217.8	216.9
6	INTEREST	2.0%	76.6	76.6
7	OTHER ITEMS	22.1%	220.5	221.2
8	WEIGHTED AVERAGE	100.0%	305.7	303.4
9	LINKED INDEX		293.0	290.2
10	RAIL COST ADJUSTMENT FACTOR		98.5	97.5

Endnotes:

[1] "Other Items" is a combination of Purchased Services, Casualties and Insurance, General and Administrative, Other Taxes, Loss and Damage, and Special Charges, price changes for all of which are measured by the Producer Price Index for Industrial Commodities Less Fuel and Related Products and Power.

[2] Linking is necessitated by a change to the 2012 weights beginning in the fourth quarter of 2013. The following formula was used for the current quarter's index:

$$\frac{\text{3rd Qr. 2014 Index (2012 Weights)}}{\text{2nd Qr. 2014 Index (2012 Weights)}} \quad \text{Times} \quad \frac{\text{2nd Quarter Linked Index}}{(1980 = 100 \text{ Linked})} \quad \frac{\text{Equals Linked Index}}{(\text{Current Quarter})}$$

Or

$$\frac{309.0}{309.7} \quad \text{X} \quad 296.8 \ = \ 296.1$$

[3] The first quarter 2013 RCAF was rebased using the October 1, 2012 level of 297.5 in accordance with the requirements of the Staggers Rail Act of 1980 (10/1/2012 = 100). In compliance to our November 27, 2013 decision, AAR has restated the October 1 2012, level of 297.5 to 297.6.

[4] The third quarter 2014 forecast error adjustment was calculated as follows: (a) first quarter 2014 RCAF using forecasted data equals 98.5; (b) first quarter 2014 RCAF using actual data equals 97.5; (c) the difference equals the forecast error (b-a) of -1.0. Because the actual first quarter value is less than the forecast value, the difference is subtracted from the Preliminary RCAF.