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SERVICE DATE – SEPTEMBER 20, 2006

SURFACE TRANSPORTATION BOARD

DECISION

STB Ex Parte No. 290 (Sub-No. 5) (2006-4)

QUARTERLY RAIL COST ADJUSTMENT FACTOR

Decided: September 14, 2006

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 on the fifth day of the last month of each calendar quarter. In Railroad Cost Recovery Procedures, 5 I.C.C.2d 434 (1989), aff'd sub nom. Edison Electric Institute, et al. 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 (Productivity Adjustment), 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 (Adjusted), which reflects national average productivity changes as originally developed and applied by the ICC, is currently based on a 5-year moving average. The RCAF-5 reflects national average productivity changes as if a 5-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 fourth quarter 2006 are shown in Table A of the Appendix to this decision. Table B shows the second quarter 2006 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.

The Board's rules mandate that the weights for each major cost component of the all-inclusive cost index, on which the RCAF is based, be updated annually in order to reflect the changing mix of index components. The procedure also requires the wages and supplement rates used in the labor index to be rebenchmarked in the fourth quarter of each year. See Railroad Cost Recovery Procedures, 364 I.C.C. 841 (1981). The weights used by the AAR are based on the distribution of railway expenses for the year 2005. Similarly, AAR has used wage and

supplemental data for the year 2005 to calculate hourly labor rates that reflect the changing mix of employees. We have reviewed the reweighting and rebenchmarking calculations performed by AAR, and we find that they comply with the prescribed method.

Both the RCAF (Adjusted) and the RCAF-5 are currently calculated using a moving 5-year average of productivity change for U.S. Class I railroads. An average productivity change rate of 1.019 (1.9% per year) for the period 2000-2004 is currently used for the RCAF (Adjusted). In accordance with Productivity Adjustment, 1 S.T.B. at 748-49, the RCAF-5 will continue to use the 1999-2003 average productivity change rate of 1.029 (2.9% per year) until January 1, 2007.

We have examined AAR's calculations for compliance with our procedures and find that the fourth quarter 2006 RCAF (Unadjusted) is 1.250, an increase of 4.9% from the third quarter 2006 RCAF of 1.192. The RCAF (Adjusted) is 0.591, an increase of 4.4% from the third quarter 2006 RCAF (Adjusted) of 0.566. The RCAF-5 is 0.562, an increase of 4.1% from the third quarter 2006 RCAF-5 of 0.540.

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

Pursuant to 5 U.S.C. 605(b), we conclude that our action will not have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act.

AUTHORITY: 49 U.S.C. 10708.

It is ordered:

1. The Board has approved the fourth quarter 2006 Rail Cost Adjustment Factor (Unadjusted) of 1.250, RCAF (Adjusted) of 0.591, and RCAF-5 of 0.562.
2. Notice of this decision will be published in the Federal Register.
3. The effective date of this decision is October 1, 2006.

By the Board, Chairman Nottingham, Vice Chairman Mulvey, and Commissioner
Buttrey.

Vernon A. Williams
Secretary

APPENDIX

TABLE A

Ex Parte No. 290 (Sub-No. 5) (2006-4)
All Inclusive Index of Railroad Input Costs
 (Refer to Endnotes Page 5)

LINE NO.	INDEX COMPONENT	2005 WEIGHTS	THIRD QUARTER 2006 FORECAST	FOURTH QUARTER 2006 FORECAST
1	LABOR	35.3%	292.1	293.0
2	FUEL	16.0%	265.2	287.0
3	MATERIALS AND SUPPLIES	4.6%	197.2	204.3
4	EQUIPMENT RENTS	8.2%	187.3	189.5
5	DEPRECIATION	11.1%	191.9	190.6
6	INTEREST	3.1%	92.7	96.9
7	OTHER ITEMS ¹	21.7%	186.3	190.9
8	WEIGHTED AVERAGE	100.0%	234.6	239.9
9	LINKED INDEX ²		230.0	235.2
10	PRELIMINARY RAIL COST ADJUSTMENT FACTOR ³		119.7	122.4
11	FORECAST ERROR ADJUSTMENT ⁴		-0.005	0.026
12	RCAF (UNADJUSTED) (LINE 10 +LINE 11)		1.192	1.250
13	RCAF (ADJUSTED) ⁵		0.566	0.591
14	RCAF-5 ⁶		0.540	0.562

**APPENDIX
TABLE B**

**Ex Parte No. 290 (Sub-No. 5) (2006-4)
Comparison of Second Quarter 2006 Index
Calculated on Both a Forecasted and an Actual Basis**

Line No.	INDEX COMPONENT	2004 WEIGHT	SECOND QUARTER 2006 FORECAST	SECOND QUARTER 2006 ACTUAL
1	LABOR	36.0%	292.5	292.5
2	FUEL	12.1%	227.9	252.8
3	MATERIALS AND SUPPLIES	4.4%	187.5	187.5
4	EQUIPMENT RENTS	8.9%	186.8	187.1
5	DEPRECIATION	10.6%	180.9	188.1
6	INTEREST	3.0%	92.7	92.7
7	OTHER ITEMS	25.0%	185.3	185.7
8	WEIGHTED AVERAGE	100.0%	226.0	229.9
9	LINKED INDEX		223.8	228.7
10	RAIL COST ADJUSTMENT FACTOR		116.5	119.1

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 2004 weights beginning in the fourth quarter 2005. The following formula was used for the current quarter’s index:

$$\frac{\text{4th Qr. 2006 Index (2005 Weights)}}{\text{3rd Qr. 2006 Index (2005 Weights)}} \text{ Times 2nd Quarter Linked Index (1980 = 100 Linked) Equals Linked Index (Current Quarter)}$$

Or

$$\frac{239.9}{234.6} \times 230.0 = 235.2$$

³ The first quarter 2003 RCAF was rebased using the October 1, 2002, level of 192.1 in accordance with the requirements of the Staggers Rail Act of 1980 (10/1/2002 = 100).

⁴ The fourth quarter 2006 forecast error adjustment was calculated as follows: a. second quarter 2006 RCAF using forecasted data equals 116.5; b. second quarter 2006 RCAF using actual data equals 119.1; c. The difference equals the forecast error (b-a) of 0.026. Since the actual second quarter value is larger than the forecast value, the difference is added to the Preliminary RCAF.

⁵ The fourth quarter 2006 RCAF Adjusted (0.591) is calculated by dividing the fourth quarter RCAF Unadjusted (1.250) by the fourth quarter productivity adjustment factor of 2.1160. The fourth quarter 2006 productivity adjustment factor is calculated by multiplying the third quarter 2006 productivity adjustment of 2.1061 by the fourth root (1.0047) of the 2000-2004 annual average productivity growth rate of 1.9%.

⁶ The fourth quarter 2006 RCAF-5 (0.562) is calculated by dividing the fourth quarter 2006 RCAF Unadjusted (1.250) by the fourth quarter productivity adjustment factor-5 (PAF-5) of 2.2246. The fourth quarter 2006 productivity adjustment factor is calculated by multiplying the third quarter 2006 PAF-5 of 2.2087 by the fourth root (1.0072) of the 1999-2003 annual average productivity growth rate of 2.9%.