

SURFACE TRANSPORTATION BOARD

DECISION

Docket No. EP 290 (Sub-No. 5) (2012-3)

QUARTERLY RAIL COST ADJUSTMENT FACTOR

Digest:<sup>1</sup> 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 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 2012.

Decided: June 20, 2012

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—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 5-year moving average. The RCAF-5 is an index that also reflects national average productivity changes; however, those productivity changes are calculated as if a 5-year moving average had been applied consistently from the productivity adjustment's inception in 1989.

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<sup>1</sup> 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).

The index of railroad input prices, RCAF (Unadjusted), RCAF (Adjusted), and RCAF-5 for the third quarter of 2012 are shown in Table A of the Appendix to this decision. Table B shows the first quarter 2012 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 during April, one railroad revised Materials & Supplies (M&S) pricing data that had been used in the first and second quarter 2012 calculations. According to AAR, both revisions caused the M&S component to be 0.1 points lower than previously reported. AAR proposes that the Board use this quarter's forecast error calculation to account for any differences caused by the first quarter 2012 revision. In the fourth quarter filing AAR plans to use the fourth quarter 2012 forecast error calculation to account for any differences caused by the second quarter 2012 revision.

The Board has used the forecast error adjustment procedure to remedy similar errors, and we believe it is the best available method to account for the corrected M&S component figures.<sup>2</sup> Therefore, we will not restate the first or second quarter 2012 RCAF figures, but rather will allow the corrections to be made using the forecast error calculations. As a result, the third quarter 2012 forecast error calculation will include the original 263.7 figure as the "forecast" version of the first quarter 2012 M&S component, and the corrected 263.6 figure as the "actual" version of the first quarter 2012 M&S component. In the fourth quarter index calculation, the fourth quarter 2012 forecast error calculation will include the original 274.1 figure as the "forecast" version of the second quarter 2012 M&S component, and the corrected 274.0 figure as the "actual" version of the second quarter 2012 M&S component. In the current third quarter 2012 RCAF calculations, the M&S component has been calculated as if the second quarter 2012 version had used the corrected figure.<sup>3</sup>

We have examined AAR's calculations and we find that AAR has complied with our procedures. We find that the third quarter 2012 RCAF (Unadjusted) is 1.171, a decrease of 1.2%

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<sup>2</sup> See 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 M&S component using the first quarter 2012 forecast error calculation); see also 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).

<sup>3</sup> The Western Coal Traffic League (WCTL) filed a letter on June 7, 2012, in response to AAR's submission addressing the revised M&S pricing data. As WCTL notes, our use of the forecast error adjustment "follows past practice" for addressing a party's errors in the calculation of M&S component figures. WCTL Letter 1. In addition, no party has asked the Board to restate any of the previously published figures, and WCTL does not propose an alternative approach to resolving the issue now before the Board. As such, here, we will account for the corrected errors in the M&S component figures as described above.

from the second quarter 2012 RCAF of 1.185.<sup>4</sup> The RCAF (Adjusted) is calculated, in part, using the RCAF (Unadjusted) and a 5-year moving geometric average of productivity change for U.S. Class I railroads from 2006-2010, which is 1.008 (0.8% per year). We find the RCAF (Adjusted) is 0.513, a decrease of 1.3% from the previously reported second quarter 2012 RCAF (Adjusted) of 0.520.<sup>5</sup>

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 2005-2009, which is 1.014 (1.4% per year). We find the RCAF-5 for the third quarter of 2012 is 0.485, a decrease of 1.4% from the previously reported second quarter 2012 RCAF-5 of 0.492.<sup>6</sup>

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 has approved the third quarter 2012 RCAF (Unadjusted) of 1.171, RCAF (Adjusted) of 0.513, and RCAF-5 of 0.485.
2. Notice of this decision will be published in the Federal Register.
3. The effective date of this decision is July 1, 2012.

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

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<sup>4</sup> The percent changes for the third quarter 2012 RCAF (Unadjusted), RCAF (Adjusted), and the RCAF-5 are all based on the original second quarter 2012 figures.

<sup>5</sup> The third quarter 2012 RCAF Adjusted (0.513) is calculated by dividing the third quarter 2012 RCAF Unadjusted (1.171) by the third quarter productivity adjustment factor of 2.2815. The third quarter 2012 productivity adjustment factor is calculated by multiplying the second quarter 2012 productivity adjustment of 2.2769 by the fourth root (1.0020) of the 2006-2010 annual average productivity growth rate of 0.8%.

<sup>6</sup> The third quarter 2012 RCAF-5 (0.485) is calculated by dividing the third quarter 2012 RCAF Unadjusted (1.171) by the third quarter productivity adjustment factor-5 (PAF-5) of 2.4146. The third quarter 2012 PAF-5 is calculated by multiplying the second quarter 2012 PAF-5 of 2.4062 by the fourth root (1.0035) of the 2005-2009 annual average productivity growth rate of 1.4%.

**APPENDIX****TABLE A**

**EP 290 (Sub-No. 5) (2012-3)**  
**All Inclusive Index of Railroad Input Costs**  
 (Endnotes Following Table B)

<b>LINE NO.</b>	<b>INDEX COMPONENT</b>	<b>2010 WEIGHT</b>	<b>SECOND QUARTER 2012 FORECAST</b>	<b>THIRD QUARTER 2012 FORECAST</b>
1	LABOR	33.3%	385.8	391.4
2	FUEL	18.0%	409.4	353.4
3	MATERIALS AND SUPPLIES	5.0%	274.0 <sup>1</sup>	274.8
4	EQUIPMENT RENTS	6.2%	204.8	205.8
5	DEPRECIATION	12.8%	211.4	211.7
6	INTEREST	2.9%	90.6	90.6
7	OTHER ITEMS <sup>2</sup>	21.8%	218.8	221.6
8	WEIGHTED AVERAGE	100.0%	305.9	298.5
9	LINKED INDEX <sup>3</sup>		296.6	289.4
10	PRELIMINARY RAIL COST ADJUSTMENT FACTOR <sup>4</sup>		120.6	117.7
11	FORECAST ERROR ADJUSTMENT <sup>5</sup>		-0.022	-0.006
12	RCAF (UNADJUSTED) (LINE 10 + LINE 11)		1.184	1.171
13	RCAF (ADJUSTED)		0.520	0.513
14	RCAF-5		0.492	0.485

**TABLE B**

**EP 290 (Sub-No. 5) (2012-3)**  
**Comparison of First Quarter 2012 Index**  
**Calculated on Both a Forecasted and an Actual Basis**

<b>LINE NO.</b>	<b>INDEX COMPONENT</b>	<b>2010 WEIGHT</b>	<b>FIRST QUARTER 2012 FORECAST</b>	<b>FIRST QUARTER 2012 ACTUAL</b>
1	LABOR	33.3%	379.4	379.4
2	FUEL	18.0%	387.7	375.7
3	MATERIALS AND SUPPLIES	5.0%	263.7	263.6 <sup>6</sup>
4	EQUIPMENT RENTS	6.2%	203.4	205.3
5	DEPRECIATION	12.8%	208.7	210.3
6	INTEREST	2.9%	90.6	90.6
7	OTHER ITEMS	21.8%	215.6	218.3
8	WEIGHTED AVERAGE	100.0%	298.3	297.0
9	LINKED INDEX		289.2	287.6
10	RAIL COST ADJUSTMENT FACTOR		117.6	117.0

**Endnotes:**

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<sup>1</sup> The second quarter 2012 forecast includes a revision made to the Materials & Supplies component.

<sup>2</sup> “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.

<sup>3</sup> Linking is necessitated by a change to the 2010 weights beginning in the fourth quarter of 2011. The following formula was used for the current quarter’s index:

$$\frac{\text{3rd Qr. 2012 Index (2010 Weights)}}{\text{2nd Qr. 2012 Index (2010 Weights)}} \text{ Times 2nd Quarter Linked Index (1980 = 100 Linked) Equals Linked Index (Current Quarter)}$$

Or

$$\frac{298.5}{305.9} \times 296.6 = 289.4$$

<sup>4</sup> The first quarter 2008 RCAF was rebased using the October 1, 2007 level of 245.9 in accordance with the requirements of the Staggers Rail Act of 1980 (10/1/2007 = 100).

<sup>5</sup> The third quarter 2012 forecast error adjustment was calculated as follows: (a) first quarter 2012 RCAF using forecasted data equals 117.6; (b) first quarter 2012 RCAF using actual data equals 117.0; (c) the difference equals the forecast error (b-a) of -0.6. Because the actual first quarter value is less than the forecast value, the difference is subtracted from the Preliminary RCAF.

<sup>6</sup> The forecast error adjustment calculation for the third quarter of 2012, which is based on figures from the first quarter of 2012, uses the original version of the M&S component (263.7) as the “forecast” figure and the corrected version of the M&S component (263.6) as the “actual” figure.