

SERVICE DATE – MARCH 29, 2019

SURFACE TRANSPORTATION BOARD

DECISION

Docket No. EP 290 (Sub-No. 5) (2019-2)

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 Surface Transportation Board (Board) is required by law 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 second quarter of 2019.

Decided: March 28, 2019

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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<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).

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 second quarter of 2019 are shown in Table A of the Appendix to this decision. Table B shows the fourth quarter 2018 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.

By decision served on March 4, 2019, the Board noted that it had not yet issued the productivity change for 2017 and for the 2013-2017 averaging period and advised that AAR's quarterly filing should ensure that its methodology to account for that was clearly explained. Accordingly, in its March 5, 2019 filing, AAR used last year's productivity figures and noted in its pleadings and workpapers that it had done so. Shortly after AAR's filing in this docket, on March 11, 2019, the Board proposed to adopt 1.005 (0.5% per year) as the measure of average (geometric mean) change in railroad productivity for the 2013-2017 (five-year) period. This represents an increase of 0.9% from the average for the 2012-2016 period. Railroad Cost Recovery Procedures—Productivity Adjustment, EP 290 (Sub-No. 4) (STB served Mar. 11, 2019).

On March 18, 2019, Timothy D. Crowley, Executive Vice President of L.E. Peabody & Associates, Inc., submitted a comment in response to AAR's March 5, 2019 filing, in which he raised a concern about AAR's calculations. (Crowley Comment 1-2.) Mr. Crowley referred to the 2017 R-1 revisions (hereinafter, recalculated figures) submitted in response to the Board's decision in Railroad Revenue Adequacy—2017 Determination, EP 552 (Sub-No. 22) et al. (STB served Dec. 6, 2018), and stated that AAR had not used the recalculated figures in its calculations even though the recalculated figures were factored into the Board's 2017 productivity adjustment. (*Id.*) By decision served March 18, 2019, AAR was directed to submit both a response to Mr. Crowley's comment and updated calculations reflecting the current productivity figure by March 19, 2019. In its March 19, 2019 response, AAR stated that it did not use recalculated figures in its calculations. (AAR Response 1-2.) AAR also agreed with Mr. Crowley's assessment that using recalculated figures in the productivity adjustment but not in the quarterly RCAF calculations creates "an apparent mismatch." (*Id.* at 2.) AAR stated that it took "no position at this time as to whether the Board should properly use recalculated figures in the quarterly RCAF calculations and, if so, whether the numbers . . . in Mr. Crowley's e mail are correct." (*Id.*)

By decision served March 20, 2019, the Board directed AAR to resubmit its RCAF calculations using the recalculated figures by March 26, 2019. The Board also waived the provision at 49 C.F.R. § 1135.1 requiring that the Board's second quarter RCAF publication be served by the twentieth day of March. Lastly, the Board stated that the second quarter RCAF decision would establish a comment period to allow any interested person to submit comment on

the inclusion of the recalculated figures in the RCAF.<sup>2</sup> On March 26, 2019, AAR submitted the requested RCAF calculations using the recalculated figures.

AAR's calculations (updated to reflect the current productivity figure and recalculated figures) have been examined by the Board's Office of Economics, and the Board finds that AAR has complied with agency procedures. The Board finds that the second quarter 2019 RCAF (Unadjusted) is 1.065, an increase of 0.7% from the first quarter 2019 RCAF (Unadjusted) of 1.058. The RCAF (Adjusted) is calculated, in part, using the RCAF (Unadjusted) and a five-year moving geometric average of productivity change for U.S. Class I railroads from 2013-2017, which is 1.005 (0.5% per year). The RCAF (Adjusted) is 0.451, an increase of 0.7% from the first quarter 2019 RCAF (Adjusted) of 0.448.<sup>3</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 2012-2016, which is 0.996 (-0.4% per year). The RCAF-5 for the second quarter of 2019 is 0.422, an increase of 0.7% from the first quarter 2019 RCAF-5 of 0.419.<sup>4</sup>

This action is categorically excluded from environmental review under 49 C.F.R. § 1105.6(c).

Authority: 49 U.S.C. § 10708.

It is ordered:

1. The Board finds that the second quarter 2019 RCAF (Unadjusted) is 1.065, RCAF (Adjusted) is 0.451, and RCAF-5 is 0.422.
2. Comments on the inclusion of the recalculated figures in the RCAF may be submitted by April 18, 2019.
3. Notice of this decision will be published in the Federal Register.

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<sup>2</sup> This comment period will extend until April 18, 2019.

<sup>3</sup> The second quarter 2019 RCAF Adjusted (0.451) is calculated by dividing the second quarter 2019 RCAF Unadjusted (1.065) by the second quarter productivity adjustment factor (PAF) of 2.3621. The second quarter 2019 PAF is calculated by multiplying the first quarter 2019 productivity adjustment of 2.3593 by the fourth root (1.0012) of the 2013-2017 annual average productivity growth rate of 0.5%.

<sup>4</sup> The second quarter 2019 RCAF-5 (0.422) is calculated by dividing the second quarter 2019 RCAF Unadjusted (1.065) by the second quarter PAF-5 of 2.5210. The second quarter 2019 PAF-5 is calculated by multiplying the first quarter 2019 PAF-5 of 2.5235 by the fourth root (0.9990) of the 2012-2016 annual average productivity growth rate of -0.4%.

4. The effective date of this decision is April 1, 2019.

By the Board, Board Members Begeman, Fuchs, and Oberman.

**APPENDIX****TABLE A<sup>1</sup>**

**EP 290 (Sub-No. 5) (2019-2)**  
**All Inclusive Index of Railroad Input Costs**  
 (Endnotes Following Table B)

| <b>LINE NO.</b> | <b>INDEX COMPONENT</b>                               | <b>2017 WEIGHTS</b> | <b>FIRST QUARTER 2019 FORECAST</b> | <b>SECOND QUARTER 2019 FORECAST</b> |
|-----------------|--|---------------------|------------------------------------|-------------------------------------|
| 1               | LABOR  | 34.8%               | 440.3                              | 439.7                               |
| 2               | FUEL   | 12.9%               | 256.8                              | 259.2                               |
| 3               | MATERIALS AND SUPPLIES                               | 4.9%                | 268.3                              | 267.6                               |
| 4               | EQUIPMENT RENTS                                      | 5.7%                | 236.3                              | 237.1                               |
| 5               | DEPRECIATION   | 15.7%               | 226.1                              | 223.1                               |
| 6               | INTEREST   | 2.1%                | 62.4                               | 62.4                                |
| 7               | OTHER ITEMS <sup>2</sup>                             | 23.9%               | 235.8                              | 231.8                               |
| 8               | WEIGHTED AVERAGE                                     | 100.0%              | 306.1                              | 304.8                               |
| 9               | LINKED INDEX <sup>3</sup>                            |                     | 283.3                              | 282.1                               |
| 10              | PRELIMINARY RAIL COST ADJUSTMENT FACTOR <sup>4</sup> |                     | 107.1                              | 106.7                               |
| 11              | FORECAST ERROR ADJUSTMENT <sup>5</sup>               |                     | -0.013                             | -0.002                              |
| 12              | RCAF (UNADJUSTED) (LINE 10 + LINE 11)                |                     | 1.058                              | 1.065                               |
| 13              | RCAF (ADJUSTED)                                      |                     | 0.448                              | 0.451                               |
| 14              | RCAF-5   |                     | 0.419                              | 0.422                               |

**TABLE B**

**EP 290 (Sub-No. 5) (2019-2)**  
**Comparison of Fourth Quarter 2018 Index**  
**Calculated on Both a Forecasted and an Actual Basis**

| <b>LINE NO.</b> | <b>INDEX COMPONENT</b>      | <b>2017 WEIGHTS</b> | <b>FOURTH QUARTER 2018 FORECAST</b> | <b>FOURTH QUARTER 2018 ACTUAL</b> |
|-----------------|-----------------------------|---------------------|-------------------------------------|-----------------------------------|
| 1               | LABOR                       | 34.8%               | 439.2                               | 439.2                             |
| 2               | FUEL                        | 12.9%               | 283.9                               | 297.4                             |
| 3               | MATERIALS AND SUPPLIES      | 4.9%                | 269.8                               | 269.8                             |
| 4               | EQUIPMENT RENTS             | 5.7%                | 236.0                               | 235.7                             |
| 5               | DEPRECIATION                | 15.7%               | 223.8                               | 225.1                             |
| 6               | INTEREST                    | 2.1%                | 62.4                                | 62.4                              |
| 7               | OTHER ITEMS                 | 23.9%               | 235.5                               | 233.3                             |
| 8               | WEIGHTED AVERAGE            | 100.0%              | 308.9                               | 310.3                             |
| 9               | LINKED INDEX                |                     | 285.9                               | 285.3                             |
| 10              | RAIL COST ADJUSTMENT FACTOR |                     | 108.1                               | 107.9                             |

**Endnotes:**

<sup>1</sup> The values in Table A and Table B reflect AAR’s calculations updated to reflect the current productivity figure and recalculated figures.

<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 2017 weights beginning in the fourth quarter of 2018. The following formula was used for the current quarter’s index:

$$\frac{\text{2nd Qr. 2019 Index (2017 Weights)}}{\text{1st Qr. 2019 Index (2017 Weights)}} \text{ Times 1st Quarter Linked Index (1980 = 100 Linked) Equals Linked Index (Current Quarter)}$$

Or

$$\frac{304.8}{306.1} \times 283.3 = 282.1$$

<sup>4</sup> The first quarter 2018 RCAF was re-based using the October 1, 2017 level of 264.5 in accordance with the requirements of the Staggers Rail Act of 1980 (10/1/2017 = 100).

<sup>5</sup> The second quarter 2019 forecast error adjustment was calculated as follows: (a) fourth quarter 2018 RCAF using forecasted data equals 108.1; (b) fourth quarter 2018 RCAF using actual data equals 107.9; and (c) the difference equals the forecast error (b-a) of -0.2. Because the actual fourth quarter value is less than the forecast value, the difference is subtracted from the Preliminary RCAF.