

SURFACE TRANSPORTATION BOARD

DECISION

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

(2019-3)

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 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 third quarter of 2019.

Decided: June 19, 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

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).

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

AAR's calculations² 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 third quarter 2019 RCAF (Unadjusted) is 1.057, a decrease of 0.8% from the second quarter 2019 RCAF (Unadjusted) of 1.065. 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 0.447, a decrease of 0.9% from the second quarter 2019 RCAF (Adjusted) of 0.451.³

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 third quarter of 2019 is 0.420, a decrease of 0.5% from the second quarter 2019 RCAF-5 of 0.422.⁴

Authority: 49 U.S.C. § 10708.

² The Board's second quarter 2019 RCAF decision, Quarterly Rail Cost Adjustment Factor, EP 290 (Sub-No. 5) (2019-2) (STB served Mar. 29, 2019), included AAR's resubmitted RCAF calculations, updated to reflect the current productivity figure and recalculated figures based on the 2017 R-1 revisions 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). The Board has confirmed that AAR's third quarter 2019 calculations incorporate the updated calculations from the Board's second quarter 2019 RCAF decision.

³ The third quarter 2019 RCAF Adjusted (0.447) is calculated by dividing the third quarter 2019 RCAF Unadjusted (1.057) by the third quarter productivity adjustment factor (PAF) of 2.3649. The third quarter 2019 PAF is calculated by multiplying the second quarter 2019 productivity adjustment of 2.3621 by the fourth root (1.0012) of the 2013-2017 annual average productivity growth rate of 0.5%.

⁴ The third quarter 2019 RCAF-5 (0.420) is calculated by dividing the third quarter 2019 RCAF Unadjusted (1.057) by the third quarter PAF-5 of 2.5185. The third quarter 2019 PAF-5 is calculated by multiplying the second quarter 2019 PAF-5 of 2.5210 by the fourth root (0.9990) of the 2012-2016 annual average productivity growth rate of -0.4%.

It is ordered:

1. The Board finds that the third quarter 2019 RCAF (Unadjusted) is 1.057, RCAF (Adjusted) is 0.447, and RCAF-5 is 0.420.
2. Notice of this decision will be published in the Federal Register.
3. The effective date of this decision is July 1, 2019.

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

APPENDIX

TABLE A

EP 290 (Sub-No. 5) (2019-3)
All Inclusive Index of Railroad Input Costs
(Endnotes Following Table B)

| LINE NO. | INDEX COMPONENT | 2017 WEIGHTS | SECOND QUARTER 2019 FORECAST | THIRD QUARTER 2019 FORECAST |
|-----------------|--|---------------------|-------------------------------------|------------------------------------|
| 1 | LABOR | 34.8% | 439.7 | 444.7 |
| 2 | FUEL | 12.9% | 259.2 | 269.0 |
| 3 | MATERIALS AND SUPPLIES | 4.9% | 267.6 | 273.1 |
| 4 | EQUIPMENT RENTS | 5.7% | 237.1 | 238.0 |
| 5 | DEPRECIATION | 15.7% | 223.1 | 229.5 |
| 6 | INTEREST | 2.1% | 62.4 | 62.4 |
| 7 | OTHER ITEMS ¹ | 23.9% | 231.8 | 232.2 |
| 8 | WEIGHTED AVERAGE | 100.0% | 304.8 | 309.2 |
| 9 | LINKED INDEX ² | | 282.1 | 286.2 |
| 10 | PRELIMINARY RAIL COST ADJUSTMENT FACTOR ³ | | 106.7 | 108.2 |
| 11 | FORECAST ERROR ADJUSTMENT ⁴ | | -0.002 | -0.025 |
| 12 | RCAF (UNADJUSTED) (LINE 10 + LINE 11) | | 1.065 | 1.057 |
| 13 | RCAF (ADJUSTED) | | 0.451 | 0.447 |
| 14 | RCAF-5 | | 0.422 | 0.420 |

TABLE B

EP 290 (Sub-No. 5) (2019-3)
Comparison of First Quarter 2019 Index
Calculated on Both a Forecasted and an Actual Basis

| LINE NO. | INDEX COMPONENT | 2017 WEIGHTS | FIRST QUARTER 2019 FORECAST | FIRST QUARTER 2019 ACTUAL |
|-----------------|-----------------------------|---------------------|------------------------------------|----------------------------------|
| 1 | LABOR | 34.8% | 440.3 | 440.3 |
| 2 | FUEL | 12.9% | 256.8 | 222.0 |
| 3 | MATERIALS AND SUPPLIES | 4.9% | 268.3 | 268.3 |
| 4 | EQUIPMENT RENTS | 5.7% | 236.3 | 235.4 |
| 5 | DEPRECIATION | 15.7% | 226.1 | 225.2 |
| 6 | INTEREST | 2.1% | 62.4 | 62.4 |
| 7 | OTHER ITEMS | 23.9% | 235.8 | 233.2 |
| 8 | WEIGHTED AVERAGE | 100.0% | 306.1 | 300.8 |
| 9 | LINKED INDEX | | 283.3 | 276.6 |
| 10 | RAIL COST ADJUSTMENT FACTOR | | 107.1 | 104.6 |

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

$$\frac{\text{3rd Qr. 2019 Index (2017 Weights)}}{\text{2nd Qr. 2019 Index (2017 Weights)}} \text{ Times } \text{2nd Quarter Linked Index (1980 = 100 Linked)} = \text{Equals Linked Index (Current Quarter)}$$

Or

$$\frac{309.2}{304.8} \times 282.1 = 286.2$$

³ 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).

⁴ The third quarter 2019 forecast error adjustment was calculated as follows: (a) first quarter 2019 RCAF using forecasted data equals 107.1; (b) first quarter 2019 RCAF using actual data equals 104.6; and (c) the difference equals the forecast error (b-a) of -2.5. Because the actual third quarter value is less than the forecast value, the difference is subtracted from the Preliminary RCAF.