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SURFACE TRANSPORTATION BOARD DIRECTS CLASS II RAILROAD TO MAINTAIN ACCOUNTS TO PERMIT DEVELOPMENT OF ACCURATE COST DATA IN RAIL RATE CASE

Surface Transportation Board (Board) Chairman Linda J. Morgan announced today that the Board, in connection with a rate complaint filed by Minnesota Power, Inc. (MPI), has directed the Duluth, Missabe and Iron Range Railway Company (DMIR) to maintain its accounts in a way that will permit the development of accurate cost data. The Board will hold this case in abeyance until DMIR has collected one year's data that can be used to assess its underlying costs of providing the service at issue.

The rate complaint involves coal that is carried by the Burlington Northern and Santa Fe Railway Company (BNSF) in contract service from western mines to Keenan, Minnesota, where it is interchanged with DMIR for delivery to MPI's Laskin Energy Center (Laskin) near Colby, MN. DMIR's common carriage rate[FOOTNOTE 1: A rate offered to the general public, as opposed to a rate under contract agreed to by a shipper and a railroad] from Keenan to Laskin is separately challengeable under the Board's "bottleneck" principles (see Surface Transportation Board "News" release No. 99-4, issued February 11, 1999, and No. 00-11, issued February 17, 2000), because the shipper has a rail transportation contract with BNSF from the mines to Keenan. Thus, MPI's rate complaint focuses on the DMIR rate for service from Keenan to Laskin.

Most railroad rate cases are handled under "constrained market pricing" principles, under which the Board usually is called upon to determine the"stand-alone cost" (SAC), the rate that a hypothetical, optimally efficient railroad would need to charge a particular shipper for the service at issue. In this case, however, DMIR has entered into a partial settlement under which rates would be capped at a level that would produce revenues equal to 180 percent of the variable costs associated with the operation[FOOTNOTE 2: "Variable" costs are costs that vary with output.]--which is the lowest level at which the law would permit the Board to prescribe rates under a SAC analysis--if the Board finds that the challenged rates are subject to its regulation.[FOOTNOTE 3: Rail rates are subject to regulation only if there is not effective competition from other carriers for the transportation at issue and the rates are not below the 180% revenue-to-variable cost regulatory floor. The Board's preliminary analysis in this case indicates that there is not effective competition from other carriers for the movements at issue.] Thus, the determination of variable costs is crucial in this case.

The Board has a standard methodology, known as the Uniform Rail Costing System (URCS), for computing a railroad's variable costs. URCS relies on data compiled under the Uniform System of Accounts (USOA), which is an accounting system prescribed by the Board. Since 1982, however, only the larger (so-called "Class I") railroads have been required to file data and maintain their records in accordance with USOA. Class I railroads account for about 92% of U.S. rail freight traffic (measured by carloadings), and prior rate challenges have been directed almost exclusively to their rates.

DMIR, as a Class II (medium-sized) railroad, maintains its own accounting system that, it turns out, is not compatible with USOA. Because current USOA data were not available to construct individual carrier URCS costs, the parties decided to attempt to compute variable costs for use in this case through other means. DMIR used the composite average costs of all Class I railroads operating in the western half of the Nation, while MPI sought to develop DMIR-specific unit costs based on DMIR accounting data that it obtained in discovery.

After reviewing the evidence, the Board reluctantly concluded that, in this particular case, neither party's approach was sufficiently reliable. The Board found that the regional cost data of the larger railroads are not representative of the costs for DMIR, which is a regional carrier that transports few commodities (principally iron ore and taconite pellets) over flat terrain for very short distances in shuttle-type trainload/unit train service. At the same time, the Board found that the DMIR-specific URCS costs that MPI attempted to construct were unreliable, because DMIR does not maintain certain costs and operating statistics required for the development of unit costs under URCS. The Board thus concluded that, in this particular case, accurate costs could not be developed without specific USOA accounting data.

Accordingly, the Board directed DMIR to temporarily maintain its accounts under USOA and to file a report containing the data needed for a DMIR URCS computation. Although URCS costs typically involve data for a multi-year period, to expedite this case the Board directed USOA reporting for one year. After the one-year period is over, the Board will give the parties the opportunity to make a more precise showing and will resume processing of the case.

The Board's decision was issued on March 6, 2000, in *Minnesota Power, Inc. v. Duluth, Missabe and Iron Range Railway Company*, STB Docket No. 42038. It is available on the Board's web site at **www.stb.dot.gov**.

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