

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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**STB DOCKET NO. EP 761
HEARING ON REVENUE ADEQUACY**

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**STB DOCKET NO. EP 722
RAILROAD REVENUE ADEQUACY**

**WRITTEN TESTIMONY OF
THE FERTILIZER INSTITUTE**

(Contains Color Images)

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Table of Contents

I. STATEMENT OF INTEREST.....	2
II. THE BOTTLENECK DECISIONS.....	2
III. CHANGES SINCE THE BOTTLENECK DECISIONS.....	4
IV. REVERSING THE BOTTLENECK DECISIONS.....	7
V. CONCLUSION.....	10

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The Fertilizer Institute (“TFI”) hereby submits this written testimony in response to the Notice of Public Hearing served by the Surface Transportation Board (“Board”) in the above-captioned proceedings on September 12, 2019 (“Notice”). The Notice solicits input on four recommendations regarding revenue adequacy that have been presented in a Report issued by the Board’s Rate Reform Task Force (“RRTF”) on April 25, 2019 (“RRTF Report”). In this testimony, TFI focuses upon the discussion in the RRTF Report that concludes the Board could advance the statutory objectives by reversing the Bottleneck Decisions¹ as to revenue-adequate rail carriers.² TFI whole-heartedly endorses this conclusion. As a member of The National Industrial Transportation League, TFI also supports the written testimony that the League has submitted in this proceeding as to the full panoply of revenue adequacy recommendations in the RRTF Report.

¹ See *Cent. P & L Co. v. S. Pac. Transp. Co.*, 1 S.T.B. 1059 (1996) (“*Bottleneck I*”), *clarified*, 2 S.T.B. 235 (1997), *aff’d sub nom. MidAmerican Energy Co. v. STB*, 169 F. 3d 1099 (8th Cir. 1999) (“*Bottleneck Appeal*”).

² RRTF Report at 39-41.

I. STATEMENT OF INTEREST.

TFI represents the nation's fertilizer industry, which includes companies that are engaged in all aspects of the fertilizer supply chain. TFI's full-time staff, based in Washington, D.C., serves its members through legislative, educational, technical, economic information and public communication programs. TFI's members play a key role in producing and distributing vital crop nutrients, such as nitrogen, phosphorus and potassium. These products are used to replenish soils throughout the United States and elsewhere to facilitate the production of healthy and abundant supplies of food, fiber and fuel. Fertilizer is a key ingredient in feeding a growing global population, which is expected to surpass 9.5 billion people by 2050. Half of all food grown around the world today is made possible by fertilizer, hence its value to the farmer.

Overall, the U.S. fertilizer industry generates more than \$154 billion in economic benefit annually and provides approximately 89,000 direct jobs and 406,000 indirect jobs for a total of 495,000 U.S. jobs. A reliable transportation network is vital to moving fertilizer around the nation, as a majority of all fertilizers (56 percent of ton-miles) move by rail throughout the year.

II. THE BOTTLENECK DECISIONS

The Bottleneck Decisions rejected attempts by three electric utilities, each with different facts, to short-haul the bottleneck carrier so they could use the services of an alternate carrier over the non-bottleneck portion of the route. The clearest and easiest to understand example was that of MidAmerican Energy which transported coal over a 750-mile route from mines in Wyoming to a generating station in Sergeant Bluff, Iowa. Mid-American had direct access to both Union Pacific Railroad ("UP") and BNSF Railway ("BNSF") at the origin but was captive

to UP for the final 90 miles to the destination extending from Council Bluffs to Sergeant Bluff.³ Theoretically, this gave MidAmerican access to a competitive alternative for the first 660 miles of the route, thereby restricting UP's monopoly to the final 90-mile bottleneck segment. UP, however, refused to quote a rate for just its bottleneck service, instead insisting upon providing single-line service for the entire 750 miles. This had the practical effect of foreclosing any competition from BNSF by extending UP's 90-mile bottleneck over the entire 750-mile route.⁴

The Board upheld UP's refusal to quote a bottleneck rate based upon a railroad's statutory right to determine, at the outset, which routes it will use to respond to service requests.⁵ In doing so, however, the Board noted that this statutory right is not absolute; but it also held that it would grant a request for an alternative route only under the competitive access rules at 49 C.F.R. Part 1144.⁶ In reaching this conclusion, the Board rejected shipper arguments that the procompetitive objectives of the Staggers Act should overcome a railroad's route-setting prerogative in circumstances where that prerogative is exercised to foreclose competition.⁷ Thus, the Board concluded that "carriers may generally protect their single-line or existing through routes by declining to establish other possible through routes, unless it can be shown that the alternative routes sought are more efficient, or that the carriers have exploited their market power by providing inadequate service over their existing through routes."⁸

³ *Bottleneck I* at 1078-79.

⁴ *Bottleneck Appeal*, 169 F. 3d at 1103.

⁵ *Bottleneck I* at 1065, citing 49 U.S.C. § 10705(a).

⁶ *Bottleneck I* at 1065-66.

⁷ *Id.* at 1067.

⁸ *Id.* at 1066.

On appeal, the Eighth Circuit affirmed the Bottleneck Decisions as a reasonable exercise of the Board's discretion. The Court noted that the statute "guarantees that shippers will receive rail service at reasonable rates, and it allows carriers to provide such service in a manner that achieves revenue adequacy."⁹ The Court also acknowledged the statute's preference to rely upon free competition over regulation to protect shippers against unreasonable rates,¹⁰ and it declared the agency "is also responsible for ensuring that free competition is preserved to the greatest extent possible on non-bottleneck segments."¹¹ But, in addition, the Court observed that "an important part of achieving revenue adequacy is differential pricing" and that "exploiting bottlenecks by refusing to provide separately challengeable bottleneck rates also assists carriers in achieving revenue adequacy."¹² The Court concluded that it owed deference to the Board's view that requiring carriers to provide bottleneck rates "would impede the industry's efforts to achieve revenue adequacy" because carriers' ability to differentially price would be restricted to short bottleneck segments.¹³ Because nothing in the statute explicitly *required* carriers to provide bottleneck rates, the Court deferred to the Board's reconciliation of these competing statutory policies in favor of allowing carriers to exploit their bottleneck segments to charge differentially higher rates across the entire route.

III. CHANGES SINCE THE BOTTLENECK DECISIONS

There is no denying that the rail industry is far stronger financially today than it was when the Board decided the Bottleneck Decisions. Back in 1996, no Class I railroad had

⁹ *Bottleneck Appeal* at 1106.

¹⁰ *Id.* at 1105.

¹¹ *Id.* at 1105-06.

¹² *Id.* at 1107.

¹³ *Id.* at 1109.

achieved a sustained level of revenue adequacy over time. From year-to-year, a carrier might earn its cost-of-capital, but by-and-large the industry collectively fell far short of that mark. Contrast that with today when UP, BNSF and NS have been revenue-adequate for most, if not all, of the past decade and railroads generally have been the darlings of Wall Street.¹⁴ This undeniable change weakens the Board's rationale in the Bottleneck Decisions for allowing rail carriers to refuse bottleneck rate requests.

The substantially improved financial condition of the rail industry allows the Board to more evenly balance the conflicting rail transportation policies of revenue adequacy and enhanced competition. As a railroad achieves a sustained level of revenue adequacy, there is less justification for allowing that carrier to refuse bottleneck rate requests. Specifically, there is less need for railroads to exploit their bottleneck segments to achieve revenue adequacy by extending their market power over non-bottleneck segments.

In addition, the rail industry has become more concentrated. When Bottleneck I was decided in 1996, the Board had approved the merger of UP and Southern Pacific just four months earlier and the merger of BN with the Atchison, Topeka & Santa Fe Railway only one year before that. The division of Conrail between CSX and Norfolk Southern was two years in the future. The consequences of those mergers were not yet known. It is much more clear in hindsight that rail industry consolidation reduced competitive routing options and extended the

¹⁴ RRTF Report at 35, Table 4. This is based on the Board's own measure of revenue adequacy. The shipping community has long argued that the Board has set the revenue-adequacy bar artificially high given that the industry has had no problems attracting capital even when not earning its cost-of-capital as measured by the Board. BNSF was a case-in-point when Berkshire Hathaway purchased the entire company well before BNSF had achieved revenue adequacy as measured by the Board, effectively providing BNSF with all the private capital that it required.

distances over which captive shippers are subject to differential pricing because of their captivity.

Although the Board imposed conditions to protect against the loss of direct competition at origin and destination locations served by both merging carriers (so-called “2-to-1” locations), rail consolidation has caused subtler, but no less harmful, reductions in competition over downstream route segments that have accumulated with multiple mergers over time. Prior merger decisions took no heed of extended bottlenecks at origins and destinations because the agency only protected competition lost at the end-points of a move. But a captive location in the 1980’s and early 1990’s was far more likely to be captive for a shorter distance than that same location is captive today because of consolidation. This loss of competition is evident in the following example, which also is illustrated in Exhibit 1:

- Assume a location that tenders traffic for rail transportation over 800 miles from Point A to Point D.
- In the 1980’s, assume a three rail carrier move from Points A to B (25 miles), B to C (750 miles), and C to D (25 miles).
- Assume that two or more rail carriers served the middle segment from Points B to C.
- Today, assume that rail consolidation has made this either a two carrier move covering segments A to C and C to D, or even a single carrier move from A to D.

Although the origin at Point A has remained captive to a single rail carrier over the entire time, the shipper has lost a competitive rail alternative for 750 miles of this 800-mile movement. In merger proceedings, however, the STB did not address this loss of competition because it did not occur at the origin or destination.

There are many permutations of this basic illustration. Some movements started with more than just three carriers; distances varied for each segment; carrier routes may have only partially overlapped; and the loss of competition likely was incremental and cumulative over the

course of multiple mergers. Regardless of the specific details of individual movements, the ultimate result foreclosed competitive options in the middle of a route, often over substantial portions of the entire route. Rail carriers thus were able to exploit those extended bottleneck segments to exercise a greater degree of differential pricing than otherwise would have been possible absent mergers.

IV. REVERSING THE BOTTLENECK DECISIONS.

The foregoing rail industry changes merit revisiting the Bottleneck Decisions at least as to revenue adequate carriers. For the past 39 years since the Staggers Act, the Board has reconciled the often-competing rail transportation policies and statutory provisions in favor of promoting revenue adequacy over enhancing competition. To the extent that a carrier has achieved revenue adequacy, the pendulum must swing towards a more equal balance to realize the full promise of Staggers. One way to do that is to require revenue adequate carriers to provide bottleneck segment rates.

The Board's authority to require bottleneck rates is hardly questionable. The statute permits the Board to short-haul a carrier when certain conditions are satisfied.¹⁵ The RRTF Report correctly references 49 U.S.C. § 10705(a)(2)(C) as "permit[ting] the agency to direct a short-haul if it concludes 'that the proposed through route is needed to provide adequate, and more efficient or economic, transportation.'"¹⁶ It is axiomatic that competition fosters more efficient or economic transportation than a monopoly. Thus, if the Board finds that competition over the non-bottleneck segment will result in more efficient or economic transportation, it *may* require rail carriers to quote bottleneck rates. When the bottleneck carrier is revenue adequate,

¹⁵ 49 U.S.C. § 10705(a)(2).

¹⁶ RRTF Report at 41, *quoting* § 10705(a)(2)(C).

there is less need for that carrier to exploit its bottleneck to differentially price otherwise competitive non-bottleneck segments to achieve revenue-adequacy. Therefore, the Board *should* require those rail carriers to quote bottleneck rates so that competition and demand for services is allowed, to the maximum extent possible, to establish reasonable rates for transportation by rail.¹⁷

This is not the only exception to the statutory long-haul provision. Reciprocal switching, pursuant to 49 U.S.C. § 11102(c), also is an identified exception at 49 U.S.C. § 10705(a)(2)(A). Indeed, a reciprocal switch is nothing more than a short distance bottleneck segment. The Board may require reciprocal switching when it finds such switching “to be practicable and in the public interest” or “necessary to provide competitive rail service.”¹⁸ This provides the most direct support in the statute for employing bottleneck rates as a tool to enhance competition.

In the attached Exhibit 2, TFI illustrates how several bottleneck scenarios would enhance competition. Figure 1 is the scenario presented in the Bottleneck Decisions by the MidAmerican movement, in which a short bottleneck segment enables a carrier to extend its bottleneck monopoly over the entire route. Figure 2 illustrates a situation where the bottleneck carrier extends its monopoly beyond the bottleneck segment to a more distant interchange that gives the bottleneck carrier its long-haul at the cost of foreclosing competition over a significant portion of the route. Figure 3 is like Figure 2, except that both the origin and destination carriers have bottleneck segments. In both scenarios, the competition created through bottleneck rates provides an incentive for all the carriers to compete for their long-haul. It is notable that only Figure 1 creates a potentially less efficient second interchange, whereas Figures 2 and 3 merely

¹⁷ See 49 U.S.C. § 10101(1)

¹⁸ 49 U.S.C. §§ 10705(a)(2)(A) & 11102(c)(1).

change the location of the existing interchange. In Figure 1, the shipper is unlikely to use the bottleneck rate unless the alternate route offers enough efficiency gain to offset any efficiency loss from the added interchange.

Although TFI strongly supports reversing the Bottleneck Decisions for revenue-adequate rail carriers, TFI recognizes that the Board may desire to provide more balance to the RRTF suggestion by considering other factors in addition to the revenue adequacy of a rail carrier. The Board, for example, could consider additional factors like those it has proposed in Docket No. EP 711 (Sub-No. 1), *Reciprocal Switching* (“EP 711-1”), when deciding whether to require revenue adequate carriers to quote a bottleneck rate.

TFI offers the following factors for the Board to consider when determining whether to grant a shipper’s request for a bottleneck rate by prescribing a through route that short-hauls a revenue-adequate carrier under 49 U.S.C. § 10705(a)(2)(A) or (C):

1. The carrier must be “long-term revenue adequate.” The definition of “long-term revenue-adequacy” proposed in the RRTF Report is a conservative definition that should give the Board ample confidence that carriers meeting that standard are financially very healthy.
2. No other transportation mode provides effective competition over the route. This showing would restrict bottleneck rates to circumstances where they would do more than add to competition that already exists from an alternate mode.
3. The Board will only require a carrier to quote a bottleneck rate to an existing interchange. It will not require the carrier to establish a new interchange where none currently exists.

4. The Board will not require a bottleneck rate to an interchange that is not operationally feasible or would be unsafe for the traffic to which the rate would apply. This last factor would be the railroad's burden to prove.

The foregoing factors will place appropriate conditions on a railroad's obligation to provide a bottleneck rate where no other mode offers an effective competitive alternative and will restrict bottleneck rates to feasible interchanges that enable the shipper to benefit from meaningful competition that otherwise would not exist.

Finally, implementing these bottleneck changes will foster the Board's objective in EP 755 and EP 756 of making rate reasonableness determinations more accessible to the shipping community by reducing their size and scope. Although a bottleneck rate allows competition to work over the non-bottleneck route segments, the bottleneck segment itself remains captive and thus the bottleneck rate remains in need of regulatory protections to ensure it is reasonable. If a shipper believes the bottleneck rate is unreasonable, it can challenge that rate under any of the methodologies the Board has made available. A bottleneck rate challenge, because it applies to a much shorter route segment, can be far more practicable than challenging a rate over the full route for carload shippers. Thus, bottleneck rates both reduce the need for rate challenges and render rate challenges more accessible when they are necessary.

V. CONCLUSION

TFI agrees with the findings in the RRTF Report that changes to the bottleneck rule are warranted for revenue adequate rail carriers. The rationale underlying the Bottleneck Decisions is that rail carriers need to extend their market power to non-bottleneck route segments to achieve revenue adequacy. That rationale dissipates, if not completely evaporates, when a carrier achieves long-term revenue adequacy as defined in the RRTF Report. Furthermore, there is a need for bottleneck rates to restore and enhance competition that has been lost through

mergers that have extended the adverse effects of origin and destination bottlenecks over great distances beyond the physical bottleneck itself. TFI has offered a reasonable set of criteria for the Board to consider when deciding whether to require a revenue-adequate carrier to quote a bottleneck rate. The Board should move forward with a rulemaking that would modernize past Bottleneck Decisions and establish an updated process and standards for shippers to obtain bottleneck rate quotes from revenue-adequate carriers.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Jeffrey O. Moreno", is written over a horizontal line.

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Exhibit 1

Bottleneck Extensions Through Mergers

Pre-Merger



Post-Merger Scenario 1



Post-Merger Scenario 2



EXHIBIT 2
BOTTLENECK SCENARIOS

Fig. 1

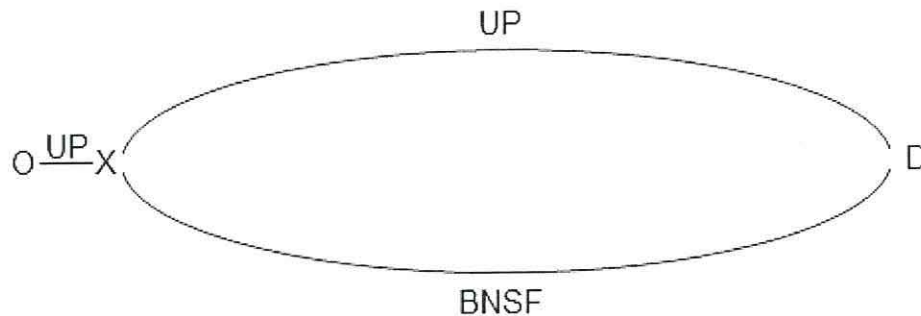


Figure 1 converts single-line service to two-carrier service. Shippers are likely to request a bottleneck rate in this circumstance only when the competitive carrier offers other efficiencies to offset the additional handling.

Fig. 2

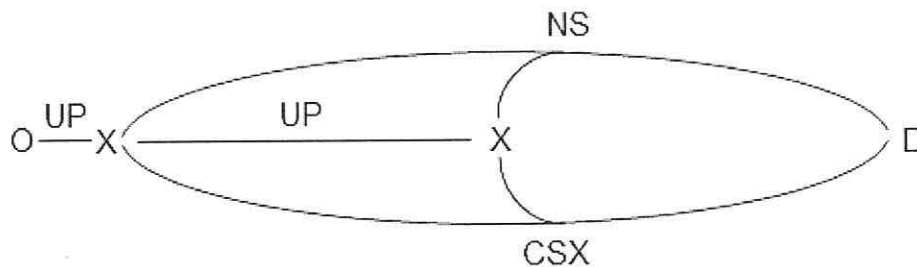
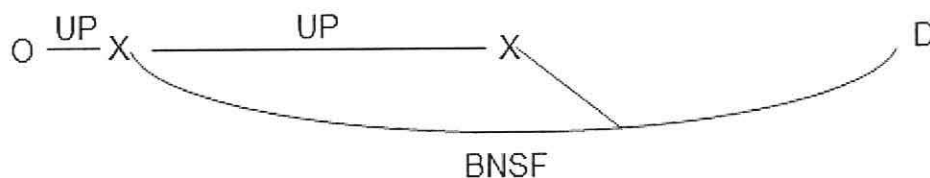


Fig. 3



Figures 2 and 3 reflect more common scenarios where bottleneck rates do not increase the number of interchanges or carriers in the route, but merely change the interchange location.

- ❖ Figure 2 is a movement that occurs on east-west (and vice-versa) gateway movements where the origin carrier achieves its long-haul by handling the traffic in the north-south direction (and vice versa) for the longest distance that is practical before interchanging to the east-west carrier.
- ❖ Figure 3 is common in the west between BNSF and UP, in the east between NS and CSX; and along the Mississippi River between BNSF, UP, CN and KCS.
- ❖ In both Figures, bottleneck rates allow the destination railroads that participate in the route to claim a longer haul when they can be more efficient, without any additional handling.