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HEARING ON REVENUE ADEQUACY

**TESTIMONY OF
THE NATIONAL GRAIN AND FEED ASSOCIATION**

Pursuant to the Notice served in this docket on September 12, 2019, the National Grain and Feed Association (“NGFA”) hereby files this written testimony in advance of the December 12, 2019 public hearing on several issues related to railroad revenue adequacy raised in the April 25, 2019 report issued by the Surface Transportation Board’s (“Board” or “STB”) Rate Reform Task Force (“RRTF”). This written submission will be summarized and supplemented by oral testimony provided by NGFA’s witnesses at the hearing.

I. Identity and Interest of NGFA

The NGFA, established in 1896, is the nation’s largest and most all-encompassing agribusiness trade association. Its more than 1,100-member companies operate between 7,000 to 8,000 facilities that annually store, handle, market, process and export approximately 70 percent of the U.S. grain and oilseed crop. Its membership includes grain elevators; feed and feed

ingredient manufacturers; biofuels companies; grain and oilseed processors and millers; exporters; livestock and poultry integrators; and associated firms that provide goods and services to the nation's grain, feed and processing industry. The NGFA also consists of 33 affiliated State and Regional Agribusiness Associations. In addition, the NGFA has a strategic alliance and is co-located with the North American Export Grain Association and has a strategic alliance with the Pet Food Institute.

II. General Background

The NGFA again commends the Board for establishing the RRTF to take a fresh look at, critically evaluate, and make recommendations to improve the Board's existing rate-review standards and processes. The NGFA believes that the RRTF's recommendations will assist the STB to modify its existing rules and processes to make them more attuned to the realities of the current transportation marketplace. The RRTF produced a thought-provoking, meaningful and impactful report that accurately portrays the systemic problems and flaws with each of the STB's existing rate-challenge methodologies and processes, which for the most part create insurmountable barriers to rail customers, especially small shippers, seeking to exercise their statutory right to challenge rail rates they believe are unreasonably high. The NGFA particularly was pleased that the RRTF report contained a suite of new, innovative and intriguing concepts and recommendations, including those addressing the nexus between revenue adequacy and rate regulation.

As NGFA noted in its prior submissions to the Board in other proceedings, and cited again its Opening Comments in EP 755, *Final Offer Rate Review*, NGFA-member companies believe unreasonably high rail rates have become more prevalent and significant as a result of the consolidation of the North American rail marketplace – with carriers exercising duopolistic market

power in the East and West. More recently, higher rates have accompanied the implementation of the so-called revenue-generating, cost-cutting “precision scheduled railroad” operating model by six of the seven Class I railroads, which reinforces the importance and timeliness of the STB’s review of these matters.

In its Opening and Reply Comments in Docket No. EP 665 (Sub-No. 1), the NGFA provided extensive documentation and rationale regarding the need for such an accessible and workable rail rate challenge methodology for shippers of grains, oilseeds and other agricultural commodities, whose characteristics differ in fundamental ways from shipments of non-agricultural commodities, such as coal, ores and chemicals.¹ No shipper of agricultural commodities has filed a rate case under any of the Board’s existing rules in nearly 40 years. To address the unworkability of the Board’s current rate-challenge methodologies and procedures, the NGFA in 2014 developed and proposed in Docket EP 665 (Sub-No.1) a new, simplified rate-challenge methodology intended to be workable for agricultural shippers and receivers. This methodology included a component that accounted for the extent to which the defendant railroad was revenue adequate pursuant to the STB’s formulas implemented pursuant to 49 U.S.C. §10704(a)(2).

For the aforementioned reasons, as well as those set forth in more detail herein, the NGFA continues to support strongly the efforts by the Board to improve its rules for reviewing the reasonableness of railroad rates and to make them more workable, timely, cost-effective, accessible and useful for agricultural shippers. In this regard, the NGFA offers the following comments on the four recommendations of the RRTF included in the public hearing notice.

¹ EP 665 (Sub-No. 1) NGFA Opening Comments and Evidence, at 6-10.

III. Definition of Long-Term Revenue Adequacy

The NGFA agrees with the RRTF that the Board’s annual calculations of revenue adequacy under EP 552, *Railroad Revenue Adequacy Determination*, is a “one-year snapshot” of a carrier’s revenue status and were “never intended to identify whether rate relief is available under the revenue adequacy constraint announced in *Coal Rate Guidelines*.”² RRTF Report at 33. This aspect of the Board’s revenue-adequacy determinations has given rise to disagreement and uncertainty over when the revenue-adequacy constraint or other methodologies that take into account a railroad’s achievement of revenue-adequate status apply in determining the reasonableness of the carrier’s rates. The NGFA concurs with the RRTF’s finding that “[a]t the core of the rate reasonableness discussion is the concept of ‘revenue adequacy’” in individual rate proceedings, and that the “time is ripe for the Board to pronounce a working definition of long-term revenue adequacy.” *Id.* at 3 and 33, respectively.

The NGFA, therefore, appreciates the Task Force’s recommendation that the Board develop a first-ever definition of rail carriers’ “long-term” revenue adequacy as a mechanism for constraining the exercise of market power by Class I railroads. The NGFA at this time has no recommendation for altering the RRTF’s recommendation that long-term revenue adequacy be defined as “the shortest period of time, not less than five years, that includes both a year in which a recession began and a year that follows a year in which a recession began.” *Id.* at 33.

More fundamentally, however, the NGFA believes the Board needs to take a much broader, more comprehensive, and holistic examination of the entire concept of “revenue adequacy” as the

² ICC 2d 520, 1985 WL 56819 (ICC) August 8, 1985.

industry approaches the 40-year anniversary of the Staggers Rail Act of 1980, in which the nation's rail industry has modernized and restructured, become extremely profitable and financially stable, and exercised tremendous market power. This clearly is evidenced by Class I carriers' strong publicly traded stock values and increasingly robust operating ratios. In addition, all railroads have their internal metrics regarding return on investment capital and a target percentage above their cost of capital, are held accountable for those returns by shareholders and are doing quite well in achieving or exceeding them.

Specific to the Board's annual revenue adequacy determinations, the National Academies of Sciences' Transportation Research Board ("TRB"), in its landmark *Special Report 318* published in 2015, found that the Board's "annual pass/fail appraisal of revenue adequacy has become ritualistic while offering little substantive information for regulators and policymakers in monitoring the industry's economic and competitive conditions...." TRB Report at 8. In this regard, the Board has a pending proceeding (EP 722) in which a substantial record has been compiled in response to the Board's request for input on its methodology for determining railroad revenue adequacy and the use of revenue adequacy in rate reasonableness cases. There also is an important relevant ongoing STB proceeding (EP 664) under which the Board is reevaluating its cost of equity capital calculation. These proceedings, which included a previous public hearing, have been ongoing since 2014. The NGFA urges the Board to complete action on these interrelated proceedings.

Finally, the NGFA urges the Board to consider its RRTF's recommendation on long-term revenue adequacy as an initial, albeit critical step toward developing a more comprehensive, accurate and defensible approach for evaluating the financial soundness of Class I railroads in the current era of duopolistic market power and reduced rail-to-rail competition.

IV. Rate Increase Constraint

The NGFA believes that the clear intent of Congress when enacting the Staggers Rail Act was to encourage and facilitate railroads achieving revenue adequacy through market-based innovation and competition, as well as differential pricing to captive shippers (subject to a reasonableness standard). However, it was also clearly the intent of Congress that once revenue adequacy was achieved, the carriers' freedom to differentially price captive shippers would be curtailed. In any case, the NGFA does not believe Congress intended the achievement of revenue adequacy to have no effect on a railroad's pricing freedom. The NGFA, therefore, appreciates the RRTF's exploration of a potential "rate increase constraint" (RIC) that would be applicable to rail carriers determined to be long-term revenue adequate. The NGFA also supports RRTF's recommendation that for shippers whose rates exceed the RIC, carriers would be banned from raising their non-contract, non-exempt rates beyond an established threshold by more than the rate of inflation, thereby limiting the ability of revenue-adequate carriers to differentially price traffic.

In addition, the NGFA urges the Board to use this opportunity to fix its much-criticized Uniform Rate Costing System (URCS). The TRB report is instructive on this point, as well, stating in relevant part: "... STB's URCS-derived R/VC formula does not indicate whether a rate is unusually high relative to rates of comparable shipments in competitive markets." The report further opined that "comparing the arbitrarily defined URCS variable cost with an actual rate is not a sound basis for screening shippers for eligibility for relief. It cannot be justified on economic grounds that has led to the development of a rate relief system that is characterized by large inequalities in shipper access to relief." TRB Report at 141.

As noted in the TRB report, a "wealth of information on unregulated, market-based rail prices" now exists in the STB's carload waybill sample, as well as detailed information on

important characteristics of individual shipments. The NGFA concurs with the TRB that these data, supplemented with information on the competitive structure of individual markets, provide a solid basis to develop models of rates determined under effectively competitive conditions.” *Id.*

V. Bottleneck Changes

The NGFA supports the RRTF’s proposal that so-called “bottleneck rule” protections should not be available to railroads determined to be long-term revenue adequate. As defined by the STB, a bottleneck rail segment is the portion of a rail movement for which no alternative rail route is possible. Bottleneck segments are typically at either the destination or origin³ portion of a potential joint line rail movement that could involve carriers other than the bottleneck railroad. Under rules adopted by the Board in the late 1990s, bottleneck carriers that can serve the same origin as an alternative carrier can refuse a shipper’s request to provide a rate over only the bottleneck segment and provide only a joint or proportional rate for the overall movement from origin to destination, unless the shipper can demonstrate it meets the requirements for obtaining “competitive access” under 49 C.F.R. Part 1144 and Board precedent. Entering into a contract for the non-bottleneck portion of the movement is a key factor the Board takes into consideration, but it is not dispositive. The policy purpose for these rules primarily is to accommodate the bottleneck railroad’s usual preference to provide the long-haul transportation service from origin to destination. *See* 49 U.S.C. §10705.

In cases where the bottleneck railroad does not serve the origin, the policy basis for protecting the bottleneck carrier’s desire for long-haul movements is not present; thus, the

³ The bottleneck rules apply to origin, as well as destination, bottlenecks. But these comments address destination bottlenecks for simplicity.

bottleneck railroad must provide the requested rate over the bottleneck segment, but only if the interchange with the carrier serving the origin is feasible as agreed upon by the two carriers or directed by the STB. As with the rules governing instances where the carriers serve the same origin, a contract over the non-bottleneck portion is a factor in the analysis, but not dispositive.

The RRTF has recommended that the bottleneck rules should be reversed or suspended for railroads determined to be long-term revenue adequate. Presumably, this would mean that rail rates could be provided for transportation over bottleneck segments without (1) having to make a case for “competitive access” in situations where the bottleneck carrier and the alternative carrier serve the same origin; and (2) first entering into a contract for the non-bottleneck portions of the overall movement. The NGFA concurs with the RRTF’s recommendation. There is no need to impose the barrier of the competitive-access rules to protect a long-term revenue adequate railroad’s desire for long-haul revenues. In addition, in today’s industry, most agricultural commodities are transported pursuant to common-carrier rates and service terms, so maintaining a set of rules that entail the prerequisite of a rail transportation contract to obtain any relief unfairly excludes a majority of aggrieved parties. The NGFA, therefore, supports the RRTF’s recommendation, and suggests that implementing this recommendation should encompass the following additional elements for shippers of agricultural commodities:

- First, in cases where the bottleneck railroad and alternative railroads regularly have utilized the interchange that would be associated with a bottleneck rate and movement, there should be a rebuttable presumption that the interchange is physically and operationally feasible and the burden should be on the railroad to rebut this presumption, as opposed to the shipper proving such feasibility.

- Second, the suspension of the bottleneck rules for long-term revenue adequate railroads should not be accompanied by a conclusion or belief on the part of the Board that “effective competition” is present for the non-bottleneck segments of overall movements, thereby divesting the Board of jurisdiction over the reasonableness of rates for that transportation movement. As the NGFA has stated in past Board proceedings, in today’s rail industry the mere fact that two railroads may serve a given origin, destination or interchange point in no way means that they will effectively compete to obtain the shipper’s business. Specifically, in EP 711, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, the NGFA and other interested agricultural parties pointed out that the Board was in error if it presumed that if switching were mandated because the proposed conclusive presumptions were met, “there may be no market dominance, and hence the Board may not regulate the reasonableness of” the rates of the switching railroad and the alternative railroad from the interchange point to the destination. NGFA, Other Interested Agriculture Parties Joint Opening Statement, March 1, 2013 at 15.

The NGFA and other interested agricultural parties further stated that railroads should not have a free hand to cut off existing access to markets (i.e., “demarket traffic”) through absolute closures of intersection points or by establishing switch charges beyond a reasonable level. *Id* at 3. In addition, the extensive record compiled in EP 705, *Competition in the Railroad Industry*, demonstrates that the Board should not “constructively presume” that access to an alternative Class I railroad via mandatory switching will result in effective competition between the Class I railroad conducting switching and the alternative Class I railroad in all cases, or that any competition that does occur “would ensure reasonable rates and service.” Joint Comments of NGFA and Other

Interested Parties, filed April 12, 2011. Consequently, the rates for segments other than bottleneck segments still potentially would be subject to the Board's rate-reasonableness jurisdiction, and subject to the same rules governing determinations of market dominance.

VI. Simplified Stand-Alone Cost (Simplified-SAC) Changes for Long-Term Revenue-Adequate Carriers

The NGFA believes application of the Simplified Stand-Alone Cost methodology in rate cases has limited, if any utility to agricultural shippers and receivers. However, it supports any efforts to improve and simplify that methodology. The NGFA therefore supports the Task Force's recommendation to reinstate the simplification of the Road Property Investment calculation that the Board eliminated in 2013 when removing the cap on Simplified-SAC relief.

VII. Conclusion

The NGFA again commends and appreciates the work being done by the Board and its Rate Reform Task Force in fundamentally reevaluating the approach to rate regulation in the dramatically different post-Staggers rail environment that exists today, and the priority attention the Board is giving to this matter. The NGFA respectfully requests that the Board give due consideration to NGFA's comments and recommendations submitted herewith in crafting a proposed rule or rules on how to account for railroad revenue adequacy in rate-reasonableness determinations. Such rules should be part of a suite of changes – including, but not limited to, the final offer rate review and streamlined market dominance concepts – to discipline Class I railroads' market power and provide rail customers with a workable, timely, cost-effective and accessible process to challenge unreasonable rail rates.

Respectfully submitted,



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