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Ms. Cynthia Brown
Chief, Section of Administration
Office of Proceedings
Surface Transportation Board
395 E Street, S.W.
Washington, DC 20423-0111

Re: Ex Parte No. 761, *Hearing on Revenue Adequacy*
Ex Parte No. 722, *Railroad Revenue Adequacy*

Dear Ms. Brown:

Enclosed for filing in the referenced proceedings, please find the Statement of The Western Coal Traffic League and the Written Testimonies of Bette Whalen and Kelvin J. Dowd.

Thank you for your attention to this matter.

Respectfully submitted,

Robert D. Rosenberg
An Attorney for The
Western Coal Traffic League

Enclosures

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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HEARING ON REVENUE ADEQUACY	)	Ex Parte No. 761
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RAILROAD REVENUE ADEQUACY	)	Ex Parte No. 722
	)	
	)	

**STATEMENT OF
THE WESTERN COAL TRAFFIC LEAGUE**

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Dated: November 26, 2019

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**BEFORE THE
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**STATEMENT OF
THE WESTERN COAL TRAFFIC LEAGUE**

In accordance with Board’s Notice served September 12, 2019 in the captioned proceedings (“Notice”),¹ the Western Coal Traffic League (“WCTL”) submits this Statement as a supplement to the written testimony filed this date by the representatives of WCTL who have been granted time to appear at the hearing before the Board scheduled to begin on December 12, 2019.

IDENTITY AND INTEREST

WCTL is a voluntary association formed in 1976, whose regular members consist of utility shippers of coal mined west of the Mississippi River. WCTL members² currently ship and receive nearly 90 million tons of coal by rail each year. Many WCTL

¹ These proceedings have not been consolidated.

² WCTL’s members are listed on Attachment 1 hereto.

members are dependent on a single railroad for the transportation and/or delivery of their essential coal fuels, and thus must depend on the regulatory structure administered by the Board to constrain monopoly rail pricing practices.

WCTL has been a leading participant in every proceeding before the agency and its predecessor, the Interstate Commerce Commission (“ICC”), concerning railroad revenue adequacy and its role in the rail regulatory process since before the enactment of the *Staggers Rail Act of 1980*, including Ex Parte No. 338, *Standards and Procedures for the Establishment of Adequate Railroad Revenue Levels*; Ex Parte No. 393, *Standards for Railroad Revenue Adequacy*; Ex Parte No. 664, *Methodology to be Employed in Determining the Railroad Industry’s Cost of Capital*; Ex Parte No. 664 (Sub-No. 1), *Use of a Multi-Stage Discounted Cash Flow Model in Determining the Railroad Industry’s Cost of Capital*; Ex Parte No. 664 (Sub-No. 2), *Petition of the Western Coal Traffic League to Institute a Rulemaking Proceeding to Abolish the Use of the Multi-Stage Discounted Cash Flow Model in Determining the Railroad Industry’s Cost of Capital*; and Ex Parte No. 664 (Sub-No. 3), *Revisions to the Cost-of-Capital Composite Railroad Criteria*. WCTL has also participated in the annual revenue adequacy and cost of capital proceedings, starting with Ex Parte No. 353, *Adequacy of Railroad Revenue (1978 Determination)*, and was a key party to the proceedings leading to the adoption of the *Coal Rate Guidelines*.³ Most recently, WCTL was a principal

³ *Coal Rate Guidelines, Nationwide*, 1 I.C.C. 2d 520 (1985), *aff’d sub nom. Consol. Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987).

participant in *Ex Parte No. 722*, submitting detailed Opening and Reply Comments on September 5, 2014 and November 4, 2014, respectively, appearing at the Board hearing on July 22, 2015, and subsequently participating in stakeholder discussions organized by the Rate Reform Task Force (“RRTF”) on June 18, 2018. *See Ex Parte No. 722, Railroad Revenue Adequacy* (STB served Mar. 28, 2018) at 1-2.

SUMMARY

In its Notice, the Board sought public comment on four (4) recommendations made by the RRTF regarding implementation of the *Coal Rate Guidelines*’ Revenue Adequacy Constraint, as set out in the RRTF’s “Report to the Surface Transportation Board” dated April 25, 2019 (“*RRTF Report*”). In brief, the recommendations were:

1. Define “revenue adequacy” by reference to the comparison of a railroad’s return on investment to the Board-determined rail industry cost of capital over varying numbers of years keyed to the start of national economic recessions. *RRTF Report* at 13, 33.
2. Adopt a rate constraint on revenue adequate carriers that deploys the Board’s Maximum Markup Methodology (“MMM”) to set differing threshold revenue-to-variable cost (“R/VC”) ratios for different freight commodity groups. *Id.* at 13, 36-39.
3. Relax the relief restrictions in the Board’s “Bottleneck Rate” rules when the defendant carrier is revenue adequate. *Id.* at 13, 39-41.
4. Reinstate the Road Property Investment (“RPI”) simplification convention for cases brought under the Simplified Stand-Alone Cost (“Simplified SAC”) methodology in cases where the defendant is revenue adequate.

As set out in detail below, and summarized in WCTL’s written testimony,

WCTL’s positions in response to each RRTF recommendation are as follows:

1. Reliance on a multi-year comparison of a railroad’s return on investment to the industry cost of capital (“ROI=COC”) should be used to establish a *presumption* of revenue adequacy; but a complainant should be permitted to submit other evidence – including funds flow analysis – to establish revenue adequacy. In lieu of the RRTF’s recommendation to use study periods of varying lengths depending on the timing of economic recessions, the Board should adopt a rolling five-year period for application of the presumption.
2. Consistent with the principles enunciated in *Coal Rate Guidelines*, the Board should adopt a revenue adequacy constraint that limits rate increases *on an individual movement basis* to the rate of inflation as measured by the Rail Cost Adjustment Factor, adjusted for changes in railroad productivity (“RCAFA”). The Board should not adopt the RRTF’s “commodity group” constraint, which is predicated on an allocation of a revenue adequate railroad’s “surplus” revenue that conflicts with a central constraint principle in the *Coal Rate Guidelines* by protecting only a subset of captive movements, rather than all of the railroad’s captive shippers.
3. Relaxation of the Board’s “bottleneck” rate policy by eliminating the requirement that a complaining shipper must show entitlement to relief under the agency’s “competitive access” rules would be an appropriate, non-exclusive alternative remedy to constrain pricing by a revenue adequate carrier. However, the Board should go further and hold that in cases where a shipper has not already secured a contract with a non-bottleneck railroad, the shipper can obtain and challenge a rate on the bottleneck segment separately from a rate or rates applicable to the entire through movement.
4. WCTL supports the RRTF’s recommendation that the Board restore use of a simplified RPI convention in Simplified SAC cases brought against revenue adequate railroads, so long as that use is optional, at the election of the complaining shipper.

STATEMENT

There are two (2) key guideposts that the Board should follow in its deliberations in these proceedings. The first is the mandate of the *Coal Rate Guidelines* that “[a] *captive shipper* should not be required to pay more than is necessary for the carrier(s) involved to earn adequate revenues,”⁴ and that “[c]arriers do not need greater revenues than this standard permits, and we believe that, in a regulated setting, they are not entitled to any higher revenues.”⁵

The second is the fact that application of the Revenue Adequacy Constraint, and any other rate relief, is limited by statute to the class of shippers who lack effective, competitive alternatives to their serving railroad. *See* 49 U.S.C. §§ 10701(c) and (d). As WCTL proposed in *Ex Parte No. 722*⁶ and the RRTF recommended,⁷ the Revenue Adequacy Constraint only would be applied upon formal complaint by a shipper that demonstrates *both* that the issue traffic is subject to market dominance under 49 U.S.C. § 10707, and that the defendant railroad is revenue adequate. Because the *Guidelines*’ mandate is so clear and the scope of the Constraint’s application is so narrow, the Revenue Adequacy Constraint should not be unduly complex or difficult to administer. In contrast to the SAC Constraint, it can and should be a low-cost alternative

⁴ *Coal Rate Guidelines*, 1 I.C.C. 2d at 523 (emphasis supplied).

⁵ *Id.* at 535.

⁶ *See* *Ex Parte No. 722, Railroad Revenue Adequacy*, Op. Comments of the Western Coal Traffic League, et al., Sept. 5, 2014 (“*WCTL Comments*”) at 30.

⁷ *RRTF Report* at 37.

source of rate relief for qualified captive shippers. The Board's resolution of the issues raised in its Notice should be predicated on these principles.

A. Determining Revenue Adequacy

In its Comments in *Ex Parte No. 722*, WCTL advocated assessing revenue adequacy over a multi-year period for purposes of applying the *Guidelines'* Revenue Adequacy Constraint.⁸ The RRTF likewise recommends a multi-year standard.⁹ WCTL proposed considering a railroad's ROI relative to the COC over a four (4) consecutive year period for purposes of establishing a non-exclusive presumption of revenue adequacy. However, the RRTF would have the Board rely *solely* on the relationship of a railroad's ROI to the industry average COC over varying time periods, 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."¹⁰

WCTL supports adoption of a presumption that a railroad whose average ROI over the most recent five (5)-year period exceeds the average industry COC over the same period would be deemed revenue adequate under the *Coal Rate Guidelines*. However, the Board should not approve the RRTF's recommendation to rely *solely* on

⁸ *WCTL Comments* at 23-25.

⁹ *RRTF Report* at 33.

¹⁰ *Id.* The RRTF would rely on the National Bureau of Economic Research's determination of when recessions begin and end. *Id.*

the ROI-COC relationships over shifting periods of differing durations based on the timing of recessions.

In *Consumers Energy Company v. CSX Transportation, Inc.*,¹¹ the Board made clear that for purposes of applying the *Guidelines*' Revenue Adequacy Constraint, the annual ROI=COC test was *not* "conclusive evidence of a railroad's revenue adequacy in rate reasonableness proceedings, which may include other competent and probative evidence related to that issue."¹² See also *Bituminous Coal – Hiawatha, Utah to Moapa, Nevada*, 6 I.C.C. 2d 1, 7 n.24 (1989); *R.R. Revenue Adequacy – 1987 Determination*, 4 I.C.C. 2d 731, 734 (1988); *R.R. Revenue Adequacy – 1984 Determination*, 1 I.C.C. 2d 615, 620 (1986). These precedents preclude adoption of the RRTF's recommendation to use the relationship between a carrier's ROI and the industry COC as the only determinant of revenue adequacy. In *Ex Parte No. 722*, WCTL and its expert witnesses demonstrated how the provisions of 49 U.S.C. § 10704, prior agency precedent and analysis, and sound economic theory all supported reliance on additional measures of railroad financial health in appropriate circumstances, including funds flow analysis and a variety of financial ratios.¹³ Rather than reiterate these authorities and evidence again here, WCTL incorporates its previous Comments and Reply Comments and the

¹¹ NOR 42142 (STB served Jan. 11, 2018) at 4.

¹² *Id.*

¹³ See *WCTL Comments* at 17-23 and V.S. Levine at 6-11 and Table 1. See also *Ex Parte No. 722*, Joint Reply Comments of the Western Coal Traffic League, et al., Nov. 4, 2014 at 32-35.

accompanying expert testimony by reference, and commends them to the Board's favorable consideration. Under the law, the Board would need to provide a clear explanation in order to depart from its established precedent regarding application of the Revenue Adequacy Constraint. *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 514 (2009). No such explanation appears in either the *RRTF Report* or the Notice.

Further, to the extent that the Board relies on the ROI=COC test to measure revenue adequacy, the ROI and the COC both must be calculated accurately. Accuracy is not achieved when the ROI ignores \$9 billion in income that the Class I railroads realized in 2017 due to the income tax reduction enacted that year, and the associated reduction in their deferred tax liabilities. The Board is directed to rely upon generally accepted accounting principles to the maximum extent practicable. Even if the Board concluded that the tax cut would have a disruptive effect on the 2017 returns viewed in isolation, that concern dissipates when the income is weighed over a multiple-year basis, as the Notice proposes. Accuracy also is not achieved when the Board utilizes a COC that is substantially higher than what investors perceive as the opportunity cost of capital for the railroad industry. In particular, the Board recently ascertained a 12.22% COC for 2018, while BNSF's Executive Chairman Matthew Rose identified a 7% value, creating a disparity of five (5) percentage points, or 70%, between the COC perceived by the investment community and the COC utilized by the Board.¹⁴

¹⁴ Mr. Rose's comments are reported at <https://www.commtrex.com/tony-hatch-articles/gwr-seeks-gold-in-high-valuations-rail-meetings-in-the-southwest-swars->

WCTL also submits that the Board should reject the RRTF's proposal to rely on study periods of varying length, depending on the timing of recessions, and instead adopt a presumption that a carrier whose average ROI over the most recent five-year period equals or exceeds the average COC over the same period will be deemed revenue adequate.¹⁵ The Board should decline to accept the RRTF's recommendation for at least two (2) reasons.

First, from the standpoint of a rate constraint under the *Guidelines*, revenue adequacy is principally (though not exclusively) a forward-looking concept.¹⁶ However, the lack of reliable forecast data to assess a railroad's future financial health necessitates reliance on previous performance. Within the realm of the historic past, the most probative data would be that for the most recent years. The RRTF's proposal contemplates measuring periods of varying length, longer during protracted economic expansions and shorter when there are episodes of contraction. As a result, the statistical weight or significance of individual years is diluted during expansions and concentrated when there are more frequent recessions. The lengthening and shortening of the

ref/takeaways and <https://www.railwayage.com/financeleasing/matt-rose-at-ref-2019-its-about-growth-not-cutting/>.

¹⁵ As noted herein and explained by WCTL in *Ex Parte No. 722*, any ROI=COC test applied under the *Guidelines* must be non-exclusive, and a complaining shipper should be free to submit other evidence responsive to the criteria set out in 49 U.S.C § 10704(a)(2). See *WCTL Comments* at 6-8, 20-23.

¹⁶ See, e.g., *Standards for Railroad Revenue Adequacy*, 364 I.C.C. 803, 815 (1981).

measurement period will give individual years different weights, but the bias will be to give expansion years less weight and contraction years more.

The Board's predecessor encountered this problem when it initially attempted to measure productivity for the RCAF based on a full business cycle. The measurement period started with five (5) years, expanded to nine (9) years, and then was truncated to five (5) years, with regular inclusion of new and removal of old years. The agency recognized the futility of attempting to track the elusive "business cycle":

We conclude that a fixed averaging period is preferable to one such as that suggested by AAR, in which the periods vary from business cycle to business cycle.... [U]nder AAR's proposed method the productivity change in each year would not receive equal weight over an equal number of years.... Use of a single fixed period, by contrast, ensures as a mathematical certainty that each period's change in rail productivity will be fully reflected in the RCAF, and that no particular period's change will be given too much weight.

Productivity Adjustment – Implementation, 9 I.C.C. 2d 1072, 1077-78 (1993). The Board subsequently established a second productivity-adjusted RCAF, the RCAF-5, whose values would not be tainted by the historical variability of the length of the measuring periods and fluctuations when new data was added. *See* Ex Parte No. 290 (Sub-No. 7), *Productivity Adjustment – Implementation* (STB served Oct. 3, 1996).

Second, the RRTF offers no data to support the alleged correlation between railroad business cycles and the lengths of modern economic expansions, and indications are that any connection is attenuated at best. For example, according to the National Bureau of Economic Research, the most recent general U.S. economic recession began in

December 2007, and ended when the current expansion began in June 2009.¹⁷ However, while the general economy was contracting throughout 2008, ROIs for each of the four (4) major Class I railroads (BNSF Railway, CSX Transportation, Inc., Norfolk Southern Railway and Union Pacific Railroad) *increased* over their respective 2007 values.¹⁸ As the U.S. economy then accelerated through 2009, the major railroads' ROIs *declined* from 2008 levels, before turning upwards again in 2010.¹⁹ Particularly given the distorting effects of expanded and truncated study periods referenced above, the lack of a clear connection between the timing of general recessions and changes in railroad financial performance argues against the RRTF's recommended approach.

B. Rate Increase Constraint

The principal remedial recommendation made by the RRTF with respect to enforcement of the *Guidelines*' Revenue Adequacy Constraint is a limit on rate increases on *some* captive traffic by revenue adequate railroads. Under the RRTF proposal,²⁰ a revenue adequate carrier's "surplus" of net operating income over the required ROI for each year in its recommended analysis period would be calculated, indexed to the present

¹⁷ See bls.gov/spotlight/2012/recession/pfd/recession_bls_spotlight.pdf.

¹⁸ Compare Ex Parte No. 552 (Sub-No. 12), *Railroad Revenue Adequacy – 2007 Determination* (STB served Sept. 26, 2008), with Ex Parte No. 552 (Sub-No. 13), *Railroad Revenue Adequacy – 2008 Determination* (STB served Oct. 26, 2009).

¹⁹ Compare Ex Parte No. 552 (Sub-No. 14), *Railroad Revenue Adequacy – 2009 Determination* (STB served Nov. 10, 2010), with Ex Parte No. 552 (Sub-No. 15), *Railroad Revenue Adequacy – 2010 Determination* (STB served Nov. 3, 2011).

²⁰ See RRTF Report at 36-39.

year,²¹ and summed. The total surplus (if there is one) then would be divided by the number of years in the study period to produce an “average annual real surplus.” The RRTF would allocate the surplus over an undetermined number of different “commodity-service characteristic combinations” based on each category’s share of total revenues with R/VC ratios over 180%,²² and use the Board’s MMM process to reduce the highest R/VC ratios in each category until the category’s assigned “surplus” is exhausted. If a captive movement’s R/VC ratio equals or exceeds the reduced R/VC ratio for its category, the defendant railroad would only be permitted to increase the rate by changes in the Rail Cost Adjustment Factor, unadjusted for productivity (“RCAFU”).²³ If the complainant’s ratio is lower than the MMM-determined R/VC ratio for the category, the railroad would be free to increase the rate up to that ratio before the constraint would apply.²⁴

WCTL supports a rate increase constraint as a primary implementation mechanism under the *Guidelines*’ Revenue Adequacy Constraint, and proposed such a remedy in *Ex Parte No. 722*.²⁵ However, the version advanced by the RRTF is

²¹ The RRTF proposes indexing using the Gross Domestic Product Implicit Price Deflator. *RRTF Report* at 37.

²² The RRTF suggests that there would be more than 67 different categories. *Id.* at 37 n.38.

²³ *Id.* at 36.

²⁴ *Id.* at 37.

²⁵ *See WCTL Comments* at 26-30.

inconsistent with and inferior to the *Guidelines* and applicable precedent, is unduly complex, and will provide no relief for many individual captive shippers. The Board should adopt the simpler and more straightforward approach proposed by WCTL in 2014.

The *Coal Rate Guidelines* represent a regulatory structure designed to assess the reasonableness of *individual* rates. As the Board's predecessor explained:

The objectives of [Constrained Market Pricing] can be simply stated. A *captive shipper* should not be required to pay more than is necessary for the carrier(s) involved to earn adequate revenues. Nor should it pay more than is necessary for efficient service. A *captive shipper* should not bear the costs of any facilities or services from which it derives no benefit.

Id., 1 I.C.C. 2d at 523 (emphasis supplied). The agency went on to address specifically the issue of differential pricing, and held that the achievement of revenue adequacy would raise a bar to a carrier's continuing to charge differentially higher rates to a captive shipper:

[T]he logical *first constraint* on a carrier's pricing is that its rates not be designed to earn greater revenues than needed to achieve and maintain this "revenue adequacy" level. In other words, captive shippers should not be required to continue to pay differentially higher rates than other shippers when some or all of that differential is no longer necessary to ensure a financially sound carrier capable of meeting its current and future service needs.

Id. at 535-36 (emphasis supplied). In the only decision to date where the Revenue Adequacy Constraint was applied, the Board – with court approval – held that it precluded a revenue adequate carrier from increasing the transportation rates paid by a

complaining captive shipper. *CF Industries, Inc. v. Koch Pipeline Co., L.P.*, 4 S.T.B. 637, 663 (2000) (“Applying the CMP revenue adequacy constraint, we find that Koch’s rate increases...are unreasonable because Koch’s revenues are adequate under its pre-rate increase structure.”), *aff’d sub nom. CF Industries, Inc. v. Surface Transportation Board*, 255 F.3d 816 (D.C. Cir. 2001).

The RRTF’s recommendation squarely conflicts with this precedent. Under its proposed rate constraint, a revenue adequate carrier would be allowed to impose a selective rate increase on a complaining captive shipper’s traffic, beyond the level required for the shipper to achieve and maintain revenue adequacy, so long as *other* shippers in the same “commodity-service characteristic” category were paying rates with higher R/VC ratios. Contrary to the mandate of the *Guidelines* that revenue adequacy should act to limit pricing on all captive movements, many shippers in a given category would be vulnerable to rate increases, and a revenue adequate carrier would be allowed to continue to increase its revenue adequacy surplus so long as it limited its rate increases on the most captive traffic within a given category up to the MMM-adjusted level. Rate increases would be limited – if at all – by reference to that rate’s fortuitous relationship to the R/VC ratios for rates on traffic not before the Board, grouped into what easily could be quite arbitrary categories.²⁶ Moreover, each category’s protected R/VC ratio could –

²⁶ The *RRTF Report* (at 38) offers an example of the “category average R/VC” approach that employs mileage and “service type” characteristics that simply are assumed. No explanation is offered for why mileage divisions are set at 500 and 1,000 mile segments, and the “service type” is defined solely by the number of cars in a shipment. No provision is made for, *e.g.*, tons per car, car ownership, or myriad other traffic and operating characteristics relevant to determining the cost of providing service.

and very likely would – change from year to year, depending on the average level of the surplus, setting up the prospect that a shipper protected from a selective rate increase in one year could be subject to renewed differential pricing the next, even if the serving railroad remained revenue adequate.²⁷

In its *Guidelines* decision, the Board’s predecessor carved out a specific exception to the rule that a revenue adequate carrier can no longer differentially price its captive traffic. If a railroad could show “with particularity” that (i) it needed revenues above the “adequacy” level, (ii) it would suffer demonstrable harm if it could not collect them, and (iii) there were sound reasons why captive shippers should provide them, then an exception to the differential pricing limitation might be granted. *Id.*, 1 I.C.C. 2d at 536 n.36. The RRTF proposal effectively adds another, far broader exception: if a complaining captive shipper’s rate produces an R/VC ratio that falls below the protected surplus-adjusted ratio in a to-be-determined “peer group,” its revenue adequate carrier would be free to impose additional differential pricing on the subject traffic. The Board should decline this proffered distortion of the Revenue Adequacy Constraint, as it clearly was defined in the *Guidelines*.

Any legitimate effort to separate the diversity and breadth of the railroads’ overall traffic bases into logical and fixed categories would be a very complex, expensive and time-consuming undertaking.

²⁷ While it is possible that a revenue adequate railroad could cease to be so over time, under the rate increase constraint proposed by WCTL, the change in status would impact all of the carrier’s captive customers equally.

A second major flaw in the RRTF's recommended approach is its reliance on a series of complex determinations and calculations that are rife with prospects for dispute and litigation. For example, the *RRTF Report* does not address who would calculate a carrier's "average net surplus," determine the relevant "commodity-service characteristic" categories, or perform the surplus allocation and MMM functions. If that is left to the parties to a rate challenge, questions of data access and integrity, burdens of proof, and rights of reply or rebuttal, among many others, would have to be resolved. If the Board was to take on responsibility for some or all of the necessary calculations, there are legitimate issues of administrative process, adequacy of agency resources, and public participation, all of which could be compounded by the potentially serious consequences of the Board's determinations. Even if the process precluded public input prior to a Board decision,²⁸ petitions for reconsideration nevertheless could follow determinations perceived as unfavorable to rail carriers or particular groups of captive shippers. These calculations, as well as determining the size of a revenue adequacy surplus, would be unnecessary if the Board simply adhered to the Revenue Adequacy Constraint adopted almost thirty-five (35) years ago in the *Guidelines*.

²⁸ The Board's annual finding concerning the railroad cost of capital – a key component of the determination of revenue adequacy – is subject to notice and public comment. The agency's annual Revenue Shortfall Allocation Methodology determinations, by contrast, are not the product of public comment, but remain subject to *post hoc* review under the Rules of Practice. See, e.g., 49 C.F.R. Parts 1115.1(c) and 1115.3.

The RRTF’s heavy reliance on R/VC ratios is an additional defect in its proposal. The Board has contemplated an overhaul of its general costing system for several years, and has solicited competing consultants’ proposals for a comprehensive review and possible revision of its methodology for calculating movement-specific variable costs.²⁹ Just last month, a group of distinguished economists who had served as a committee of experts convened by the National Research Council of the National Academy of Sciences to advise the Board, and who in 2015 published a detailed report entitled *Modernizing Freight Rail Regulation*, wrote that “URCS-based variable cost figures are inherently inaccurate and unreliable.”³⁰ Commenting specifically on the RRTF’s revenue adequacy proposals, the economists opined that “using URCS-based R/VC ratios to calculate rate increase constraints is likely to introduce significant errors, capping increases in rates that may be reasonable and permitting increases in rates that may be unreasonable.”³¹ The Board is compelled by statute to rely upon URCS costs in calculating jurisdictional thresholds for market dominance determinations,³² and those costs already are embedded in various elements of the *Guidelines*’ Stand-Alone Cost

²⁹ See U.S. Department of Transportation Request for Proposals No. RFQ138384660, Aug. 8, 2018.

³⁰ Ex Parte No. 761, Public Interest Comment of Kenneth D. Boyer, et al., Oct. 29, 2019 at 3.

³¹ *Id.* Consistent with WCTL’s positions *supra*, the economists also concluded that the RRTF proposal to implement a rate increase constraint based on an allocation of “surplus” revenues “has no rational basis in economics.” *Id.*

³² See 49 U.S.C. § 10707(d)(1)(B).

Constraint and the Board’s simplified “Three Benchmark” methodology. However, there is no reason to newly expand the reach of URCS into the Revenue Adequacy Constraint, when the accuracy of the costing methodology has been called into serious question and currently is the subject of close scrutiny.

WCTL’s rate increase constraint proposal in *Ex Parte No. 722* is straightforward to administer, requires no new or additional regulatory proceedings or evidentiary findings, and squares completely both with the *Guidelines* and applicable precedent (*CF Industries*). If a shipper files a formal complaint under 49 U.S.C. § 11701 and administrates (i) that its transportation is subject to market dominance under 49 U.S.C. § 11701, and (ii) that its serving railroad is revenue adequate, then common carrier rates *for that shipper* could not be increased beyond actual inflation, as measured by the productivity-adjusted Rail Cost Adjustment Factor.³³ See *WCTL Comments* at 30-33. This rule would be subject to the specific exception set out in the *Guidelines*: if the railroad can show by clear evidence that (i) it needs higher revenues; (ii) it would be specifically harmed if it could not collect them; and (iii) it cannot raise them from any source other than captive traffic,³⁴ then the Board could entertain a request for approval

³³ The RRTF would allow a revenue adequate railroad’s captive rates to increase by the RCAFU (*RRTF Report*, at 36), but as the Board’s predecessor acknowledged in 1993, the RCAFU is an input *price* index, not an “index measuring the cost of producing rail output” (*i.e.*, inflation). *Productivity Adjustment*, 9 I.C.C. 2d at 1073. Neither the *RRTF Report* nor the Notice advances any justification for using the RCAFU and not the RCAFA.

³⁴ See *Guidelines*, 1 I.C.C. 2d at 536 n.36.

of rates to recover a fair and equitable share of the needed revenues from the complainant. *Id.* at 32. The Board should adopt WCTL’s proposed rate increase constraint in preference to the complex, redistributionist approach suggested by the RRTF, which is in conflict with the *Guidelines*’ mandate.

C. Bottleneck Rate Relief

Among the remedial suggestions offered by the RRTF in light of the current trend toward long-term railroad revenue adequacy is that the Board “open up” its policy governing so-called “bottleneck” rate relief, in circumstances where the bottleneck carrier is revenue adequate. *See RRTF Report* at 39-41. As currently enforced, that policy holds that where two (2) carriers may provide potentially competitive service from origin mines to a common interchange point, but only one (1) of them provides service from the interchange to the shipper’s facility (the bottleneck segment), the shipper can only compel the second carrier to establish a separate rate for the bottleneck segment if it successfully secures the establishment of a new through route under the Board’s restrictive “competitive access” rules.³⁵ *Central Power & Light Co. v. Southern Pacific Transp. Co., et al.*, 1 S.T.B. 1059, 1068-70 (1996), *aff’d sub nom. Mid-American Energy Co. v. S.T.B.*, 169 F.3d 1099 (8th Cir. 1999). Entering into a contract for service from the origin to the interchange point with the carrier that does not serve the destination is probative – but not necessarily dispositive – evidence of entitlement to relief. *Id.* at 1070.

³⁵ Those rules currently are set out at 49 C.F.R. Part 1144.

Principally citing *Mid-American*, the RRTF correctly notes that the Board based its bottleneck policy in large part on its perceived balancing of what the Eighth Circuit termed “two competing policies” under the governing statute: (1) granting railroads greater flexibility and freedom in establishing rates and routes in an effort to achieve revenue adequacy; and (2) enforcing the agency’s reserved regulatory authority to protect shippers from abuse of railroad market power. *RRTF Report* at 40; citing *Mid-American*, 169 F.3d at 1104-05. The RRTF concluded:

Given the significant improvement in the rail industry’s finances, a change making it easier to require revenue-adequate carriers to short-haul to promote competition for a portion of a movement might well be another permissible reading of the statute.

RRTF Report at 40. The RRTF did not identify specific steps that the Board could take in order to “open up” greater opportunities for bottleneck relief. However, based on the elements of the Board’s current policy that are the product of the agency’s interpretation of its governing statute – as distinguished from specific statutory directives or binding court decisions – the most effective would be elimination of the requirement that a captive shipper prove entitlement to relief under the competitive access rules as a precondition to compelling a bottleneck carrier to establish a common carrier rate from an identified interchange to the freight destination point:

The competitive access rules were promulgated...to offer a competitive remedy where a bottleneck carrier has exploited its market power by providing inadequate service over its own lines or foreclosing more efficient service over another carrier’s lines.... Although the competitive access rules were the product of shipper/carrier negotiation, we perceive a sense among the shippers that, as construed in such cases as

Baltimore Gas and Midtec, they stacked the deck against shippers ever obtaining “competitive access” relief.

Central Power & Light Co., 1 S.T.B. at 1068.

The Board’s rules do not necessarily require a shipper to run the full competitive access gauntlet if the shipper first secures a contract with the non-bottleneck carrier for service from the origin(s) to the designated interchange with the bottleneck railroad: “...through the use of contracting, shippers seeking ‘through route access’ may be able to establish underlying facts on comparative service inadequacies and/or efficiencies necessary to support such relief under the requirements of our rules.” *Id.* at 1070. However, it has been the consistent experience of WCTL members over the past two (2) decades that the major western railroads resist or even reject the notion of negotiating a separate contract for the “upstream” portion of a route in order to establish a basis for compelling publication of a bottleneck rate. The principal reason appears to be concern by one carrier that if it broke ranks and agreed to an origin contract that threatened the other carrier’s bottleneck monopoly, the latter would retaliate by taking similar action on another route where *it* was the upstream railroad. While rational from the standpoint of preserving market share, this consciously parallel behavior effectively has neutered the “contract exception,” and forced most captive shippers to contend with the highly restrictive competitive access rules. WCTL therefore supports in principle the RRTF’s recommendation that the Board liberalize its bottleneck policy in cases where the monopoly railroad is revenue adequate. To be effective as a remedy for market power

exploitation, however, the revised policy must go beyond freeing captive shippers from the proof requirements of the competitive access rules.

As the Board has acknowledged, if a bottleneck rate is established in the context of a contract covering the upstream portion of the route, the shipper may be able to invoke the Board's rate regulation authority over the bottleneck segment only, greatly simplifying the rate review process and providing the shipper with meaningful leverage to negotiate a reasonable delivery rate with the bottleneck carrier. *Id.*, 1 S.T.B. at 1074. *See also Mid-American*, 169 F.3d at 1107. However, in a situation where a through route via the bottleneck interchange is directed and there is no upstream contract, the Board in *Central Power & Light Co.* ruled that a captive shipper would *not* be able to challenge a bottleneck rate alone, but instead would have the burden of proving the unreasonableness of the combination of the upstream and bottleneck rates considered as a whole. *Central Power & Light Co.*, 1 S.T.B. at 1073. The Board based this ruling primarily on its interpretation of the Supreme Court's 1935 decision in *Great Northern Ry. v. Sullivan*, 294 U.S. 458, 463 (1935), and the agency's own decision in *Metropolitan Edison Co. v. Conrail*, 5 I.C.C. 2d 385, 400-01 (1989). Given the undisputed complexity and cost associated with maximum rate litigation under the *Coal Rate Guidelines*, especially with respect to longer hauls, the upshot of this aspect of the Board's bottleneck rate policy is that a captive shipper effectively cannot take advantage of upstream competition by first securing a delivery rate, so that it can evaluate proposals for the longer, upstream portion of the haul on a direct, head-to-head basis.

WCTL submits that the Board should reconsider this aspect of its bottleneck rate policy, and affirm that at least with respect to cases where the carrier in question is revenue adequate, a rate established for a bottleneck segment can be challenged separately from any rate in effect for the upstream segment, regardless of whether the upstream rate was previously set by contract. Such a policy change is necessary to give full effect to the RRTF's recommendation, and facilitate a genuine expansion of competition as a corollary to sustained railroad revenue adequacy.

D. Simplified Stand-Alone Cost Changes

The RRTF's final recommendation with respect to revenue adequate carriers is to restore the simplification convention for calculating Road Property Investment ("RPI") costs under the Board's Simplified Stand-Alone Cost methodology. *See RRTF Report* at 41-42. Under this convention, the various components of RPI in a Simplified SAC case would be determined by reference to averages of findings made by the Board in prior, "full SAC" proceedings. *Ex Parte No. 715, Rate Regulation Reforms* (STB served July 18, 2013) at 10.³⁶ According to the RRTF, reinstating the RPI convention would make the Simplified SAC remedy more accessible to complainant shippers challenging rates established by a revenue adequate carrier. *RRTF Report* at 42.

WCTL does not oppose the RRTF's proposal, so long as use of the RPI convention is at the *option* of a complainant. It is quite plausible that, depending on the

³⁶ The Board had eliminated the convention when it updated its Simplified SAC approach to remove a prior limitation on available relief. *Ex Parte No. 715, Rate Regulation Reforms* (STB served Mar. 13, 2015) at 1.

route(s) to which a challenged rate applies, reliance on rolling or other averages of prior STB determinations of RPI could yield higher estimated stand-alone-costs than a specific analysis of the actual RPI components for the complainant's hypothetical stand-alone railroad. In other cases, a shipper may decide to avoid the additional legal and expert witness costs associated with a full RPI showing. A captive shipper should not be compelled to incur higher litigation costs because a carrier has achieved revenue adequacy. In such circumstances, the complainant should have the opportunity to present its best evidentiary case.

CONCLUSION

The Board should adopt and incorporate the foregoing recommendations by WCTL in implementing the Revenue Adequacy Constraint under the *Coal Rate Guidelines*.

Respectfully submitted,

THE WESTERN COAL TRAFFIC LEAGUE

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Dated: November 26, 2019

List of Members of The Western Coal Traffic League

Ameren Missouri

Arizona Electric Power Cooperative, Inc.

Austin Energy (City of Austin, Texas)

CLECO Corporation

CPS Energy

Entergy Services, Inc.,

Kansas City Power & Light Company

Lower Colorado River Authority

MidAmerican Energy Company

Minnesota Power

Nebraska Public Power District

Western Fuels Association, Inc.

Wisconsin Public Service Corporation

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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HEARING ON REVENUE ADEQUACY	)	Ex Parte No. 761
	)	
	)	
	)	
	)	
RAILROAD REVENUE ADEQUACY	)	Ex Parte No. 722
	)	
	)	

WRITTEN TESTIMONY OF BETTE WHALEN

My name is Bette Whalen, and I am the Principal Fuels Specialist for the Lower Colorado River Authority, based in Austin, Texas. I also am President of the Western Coal Traffic League, an association of major consumers of western coal and western rail transportation that is very familiar to the Board. WCTL members ship and pay the freight for over 100 million tons of coal per year, and we are the only organization that focuses primarily on the transportation interests of utility coal consumers and their rate payers. I am joined today by WCTL counsel Kelvin Dowd.

Whether they are investor-owned utilities, municipal authorities, or public power agencies, all WCTL members operate under mandates to provide reliable energy to their rate payers at a reasonable cost. For electricity generated from coal, the cost of transportation is a major component of what ultimately is paid by our consumers in their

monthly bills. Responsive rail service at reasonable rates is essential to serving the public interest in reliable and affordable energy.

WCTL was an active participant in the Board's Revenue Adequacy proceeding in 2014 and 2015, and I personally was part of a WCTL delegation that met with the Rate Reform Task Force in June of 2018 to discuss how the Board should implement the Revenue Adequacy Constraint under its *Coal Rate Guidelines*. In my position at LCRA, I have been involved with issues related to the rail transportation of coal for many years. Based on my experience, the major railroads' perceived poor financial health historically was used to justify higher rates on coal and other shippers who depend most heavily on rail service. I also understand that in the *Guidelines*, the Board made clear that once a railroad earned adequate revenues, that kind of differential pricing would no longer be allowed.

Back in 2014 and 2015, WCTL presented considerable evidence to the Board showing that for many years, the heavily concentrated rail industry had shown strong profit growth, lower operating ratios, and a ready ability to attract and retain capital investment. Our position is that the time is right for the Board to adopt a meaningful and effective approach to provide captive shippers the protections they were promised under the *Guidelines*.

While captive coal shippers may constitute a minority, it has been my experience and that of other WCTL members that the STB's policies and regulations regarding rates on market dominant traffic have a meaningful impact on the railroads' overall rate structures, as there are only four (4) major rail systems in the U.S. today, and

the opportunities and incentives for concerted or parallel pricing are significant. So all of us in WCTL have an interest in the outcome of these hearings.

The Rate Reform Task Force Report earlier this year partially endorsed one of WCTL's proposals in the prior proceeding. However, we have serious concerns with respect to other aspects of the Task Force's recommendations, which Kelvin will address. On behalf of WCTL, we appreciate the opportunity to share our concerns with the Board.

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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	)	
HEARING ON REVENUE ADEQUACY	)	Ex Parte No. 761
	)	
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	)	
RAILROAD REVENUE ADEQUACY	)	Ex Parte No. 722
	)	
	)	

WRITTEN TESTIMONY OF KELVIN J. DOWD

Chairman Begeman and members of the Board, I have the privilege of serving as counsel to the Western Coal Traffic League, and I join League President Whalen in thanking you for the opportunity today to represent the millions of consumers served by WCTL members regarding the issue of railroad revenue adequacy, and its role in constraining rates on captive rail traffic under the Board's *Coal Rate Guidelines*.

In Ex Parte No. 722, WCTL presented a complete proposal for enforcing the *Guidelines*' Revenue Adequacy Constraint, which included a presumption of revenue adequacy based on consecutive years of return on investment in excess of the industry-wide cost of capital; an option to demonstrate revenue adequacy using recognized alternative measures of railroad financial health; a rate increase constraint for market dominant revenue adequate carriers; and the preservation of existing regulatory remedies under the *Guidelines* and the Board's Simplified and Three-Benchmark models.

The Rate Reform Task Force's recommendations echo the League's proposals in certain ways, including a multi-year measure of revenue adequacy, and the use of a rate increase constraint as the principal remedy for shippers that can demonstrate they are subject to railroad market dominance. However, in key respects, the RRTF's proposals fall short of providing captive shippers with the rate protections that they are due under the *Coal Rate Guidelines*. Those shortcomings are detailed in the League's separate written Statement that was submitted on November 26. I'd like to summarize them briefly here today, and then answer any questions that you may have.

On the subject of measuring railroad revenue adequacy under the *Guidelines*, we agree with the RRTF that it should be a multi-year analysis, and the League would be willing to extend its proposed four consecutive year presumption for carriers whose return on investment exceeds the industry average cost of capital to five years, as the RRTF suggested. However, other elements of the RRTF's proposal should be rejected. First, the RRTF would have revenue adequacy under the *Guidelines* determined solely on the basis of the Board's snapshot test of return on investment as compared to the cost of capital. This squarely conflicts with established Board precedent, including most recently the 2018 decision in the *Consumers Energy* case. Affirming decisions reaching back to 1986, in *Consumers* the Board held that while the ROI=COC test was relevant, it should not be the sole determinant, and a captive shipper should have the opportunity to present specific and alternative evidence of a carrier's revenue adequacy under the governing statutory criteria and the purposes of the *Guidelines*. As the Board knows well, the question how to best measure the railroads'

cost of capital is a contentious one, and however one comes down on the issue, the current approach cannot be considered the final word. As a matter of reason, the Board should not put undue weight on its annual snapshot. As a matter of law, the Board should reject this component of the RRTF's recommendation.

Second, by endorsing an ever-shifting measuring cycle, the RRTF invites biases and distortions that threaten the effectiveness of the Revenue Adequacy Constraint as a tool for captive shippers. This is not the first time that the Board or its predecessor has considered expanding and contracting study periods under the auspices of replicating a business cycle. In the 1990s, the ICC wrestled with the problems resulting from measuring railroad productivity using different length measuring periods, and ultimately settled on a fixed period so that no particular change between years would be given too much or too little weight. Additionally, in this case, the Coal League showed in its written Statement that the ROIs of the major Class I railroads did not closely correlate to general U.S. economic trends as reported by the National Bureau of Economic Research. For example, while the general economy contracted during 2008, the ROIs for BNSF, UP, NS, and CSXT all increased over 2007 values. Taken together, the distortion and bias risks, coupled with serious concerns regarding accuracy, argue strongly against the RRTF's proposed floating study period, and in favor of a fixed period where the ROI=COC test serves as a presumption, but where, consistent with established Board precedent, the question of an individual railroad's revenue adequacy under the *Guidelines* remains a matter of individual evidentiary showings.

The *Coal Rate Guidelines* are clear that once a carrier achieves revenue adequacy, its captive shippers no longer should bear the economic burden of differential pricing. In Ex Parte No. 722, WCTL proposed a straightforward method for implementing the Revenue Adequacy Constraint: a revenue adequate railroad would only be permitted to increase any captive shipper's pre-existing rate by a reasonable measure of actual railroad cost inflation: the RCAF adjusted for changes in productivity. The RRTF Report recommends a rate increase limitation as well. However, its limit only would apply to *some* captive shippers, and its implementation would require a complex and contentious series of calculations that easily could leave deserving captive shippers without meaningful relief.

The RRTF proposes to determine a revenue adequate carrier's present value surplus of net operating revenue over required returns measured over varying time periods, then allocate that surplus over an undetermined but very large number of arbitrarily-determined commodity service groups, using the Maximum Markup Methodology employed under the *Guidelines'* Stand Alone Cost Constraint. Whether a particular captive shipper's rate would be constrained would depend on the relationship of its rate's revenue/variable cost ratio to the threshold ratio for its commodity service group. In addition to building in multiple layers of easily disputed evidentiary findings (with no guidance as to burdens of data production or proof), the RRTF approach conflicts with the *Guidelines'* focus on the reasonableness of individual rates, and is squarely at odds with the only court-approved precedent concerning implementation of the Revenue Adequacy Constraint. The RRTF would permit continued differential

pricing on captive traffic by a revenue adequate carrier – in violation of the *Guidelines*’ governing principle – and it would tie a shipper’s rate relief not to the revenue adequate status of its serving railroad, but to the level of rates paid by other, non-complaining shippers who happened to fall within the complainant’s defined commodity service group.

The *Coal Rate Guidelines* carved out a very specific and limited exception to the rule that revenue adequate railroads would not be permitted to engage in further differential pricing: the railroad had to show the need for additional revenues, the specific harm that it would suffer if it could not raise those revenues, and the reasons why captive shippers were the only available source of those revenues. The RRTF proposal ignores this mandate, and opens the door to widespread continued differential pricing by revenue adequate carriers. It is wholly inconsistent with the central tenets of the *Coal Rate Guidelines*, and should not be adopted. In contrast, the remedy proposed by the Coal League hews closely to those *Guidelines*, and is both effective and easily administered. We continue to commend it to the Board.

As an alternative remedy, the RRTF proposed that the Board relax its “Bottleneck Rate” rules where the bottleneck carrier is revenue adequate. As a threshold matter, the League agrees that this should be an alternative, though non-exclusive, remedy. We submit that the rate increase constraint as proposed by the League should be the principal option for implementing the Revenue Adequacy Constraint. Properly designed, however, the RRTF’s conceptual bottleneck proposal could afford an effective second avenue of relief for certain shippers.

The Board's current policy – which was predicated in significant part on the perceived revenue inadequate status of the major Class I railroads – requires that in order to compel a railroad with exclusive control over service to a particular destination to establish a separate rate for use in combination with an upstream competitor, a shipper first must demonstrate that the dominant carrier has engaged in “anticompetitive conduct” or failed to provide adequate service under the Board's Competitive Access rules. This proof burden has amounted to a nearly insurmountable barrier for captive shippers to clear, leading to a perpetuation of closed bottlenecks and corresponding monopoly pricing. While the RRTF did not suggest specific steps to open up greater opportunities for bottleneck relief, WCTL submits that the most effective reform would be to eliminate the Competitive Access proof requirement in cases where the bottleneck railroad is revenue adequate.

It is true that the Board carved out something of an exception to the full Competitive Access requirement in circumstances where a shipper can secure a contract with an upstream carrier for service from an origin to the bottleneck interchange. However, over the past 20 years it has been the experience of WCTL members that the western railroads in particular have little interest in negotiating such contracts, apparently out of a rational concern that if one did so it would invite retaliation in markets where that carrier controlled the bottleneck. Therefore, in addition to liberalizing the evidentiary requirements for bottleneck relief when a railroad is revenue adequate, the Board should make separate bottleneck pricing available without regard to whether a shipper has first secured an upstream contract. Such a policy would promote increased

competition, and streamline the regulatory process in those cases where the bottleneck rate is set at an unreasonably high level.

Finally, the RRTF proposes that the Board restore the simplification convention for calculating Road Property Investment under the Simplified Stand-Alone Cost methodology. According to the RRTF, this change would make the Simplified SAC remedy more accessible to more shippers.

The Coal League does not oppose the RRTF's recommendation, so long as using the simplification convention is at the option of a complaining shipper. We can easily imagine circumstances where reliance on average RPI costs from previously decided cases could yield higher stand-alone costs than a specific analysis of the actual route over which the challenged rate applies, such that a complainant was willing to incur the additional litigation expense to pursue a better outcome. In other cases, of course, the cost-benefit balance could tip the other way. The key is to leave the determination to the individual captive shipper.

In closing, we would like to emphasize again a key point made by the League in its filings in Ex Parte No. 722: the Revenue Adequacy Constraint as proposed by WCTL will only apply to that narrow class of captive shippers who undertake to file formal rate complaints, and are able to demonstrate that they are subject to railroad market dominance. If successful, those shippers also would secure nothing more than an inflation-adjusted limit on further increases to established rates. Despite what was argued by some of the railroads in Ex Parte No. 722, and may be reprised in this proceeding, the adoption of an effective, efficient and substantive Revenue Adequacy Constraint will not

threaten future railroad investment, financial health or service reliability. Instead, it will breathe timely life into a key element of the *Coal Rate Guidelines*, for the deserved benefit of captive shippers and – in the case of WCTL – the electric ratepayers that they serve.

We thank the Board for the opportunity to appear today, and we would welcome your questions.