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November 26, 2019

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ENTERED
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Part of
Public Record

Re: STB Ex Parte Nos. 761 & 722, Written Testimony of Union Pacific Railroad Company

Dear Ms. Brown:

Union Pacific Railroad Company hereby submits its written testimony in the referenced matters. Union Pacific's testimony is contained in two separate documents. The first document is the written testimony of Cindy Sanborn, Union Pacific's Vice President, Network Planning and Operations, who addresses investment and operating issues presented by the "Bottleneck changes" described in the Board's Notice. The second document consists of written testimony addressing legal issues raised by certain of the proposals described in the Board's Notice.

Please contact the undersigned if you have any questions.

Sincerely,

/s/ Michael L. Rosenthal

Michael L. Rosenthal

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Docket No. EP 761

HEARING ON REVENUE ADEQUACY

Docket No. EP 722

RAILROAD REVENUE ADEQUACY

**WRITTEN TESTIMONY OF UNION PACIFIC RAILROAD COMPANY
REGARDING BASIC LEGAL ISSUES RAISED BY THE PROPOSED
RATE INCREASE CONSTRAINT AND *BOTTLENECK* CHANGES**

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Date of Submission: November 26, 2019

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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Docket No. EP 761

HEARING ON REVENUE ADEQUACY

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**WRITTEN TESTIMONY OF UNION PACIFIC RAILROAD COMPANY
REGARDING BASIC LEGAL ISSUES RAISED BY THE PROPOSED
RATE INCREASE CONSTRAINT AND *BOTTLENECK* CHANGES**

Union Pacific Railroad Company submits this written testimony in response to the Board's Notice served September 12, 2019. The Notice invites interested persons to provide input on certain recommendations by the Rate Reform Task Force ("RRTF") that the Board consider policy changes regarding revenue adequacy. In this testimony, we explain why the RRTF's proposed rate increase constraint and "suspension" of railroads' right to provide single-line service are contrary to law. We are also separately filing the written testimony of Cindy M. Sanborn, Union Pacific's Vice President, Network Planning and Operations, to explain why a rule allowing shippers with single-line service to force us to provide alternative interline service would undermine our ability to provide timely, reliable, and safe service for all our customers.

INTRODUCTION

The Board should not pursue the development of constraints designed to limit returns of railroads deemed to have achieved long-term revenue adequacy. We have previously explained why imposing such constraints is unjustified and would harm shippers and the national economy. See Opening Comments of Union Pacific Railroad Company, *Railroad Revenue Adequacy*, EP 722 (Sept. 5, 2014); Reply Comments of Union Pacific Railroad Company, *Railroad Revenue*

Adequacy, EP 722 (Nov. 4, 2014). Nothing in the factual or legal landscape has changed in the intervening time to alter the reasoning in our previous explanation. In the Notice, the Board invited comments on its latest two proposals designed to limit returns of revenue adequate railroads: a rate increase constraint and changes to railroads' right to provide single-line service. For many reasons, adoption of either proposal would be unambiguously contrary to the rail transportation policies Congress set forth in 49 U.S.C. § 10101. In this testimony, however, we focus on an even more basic problem with the proposals: they are contrary to the ICC Termination Act ("ICCTA").

I. The RRTF's proposed rate increase constraint is contrary to law.

The RRTF's proposed rate increase constraint is contrary to law because it is an arbitrary means of capping rail rates, rather than an economically sound method for determining whether a challenged rate is consistent with competitive market principles. Under the RRTF's proposal, the Board's rate reasonableness determinations would have no connection to competitive market principles. They could hinge on nothing more than whether the challenged rate is a new rate or an increased rate. In other words, under the RRTF's proposal, the same rate charged by the same railroad to the same shipper for moving the same commodity from the same origin and to the same destination could be found reasonable if the railroad had not previously established a rate for the traffic, but unreasonable if the railroad was increasing an established rate. Such results would be wholly inconsistent with the regulatory framework Congress established in the Railroad Revitalization and Regulatory Reform Act of 1976 (the "4R Act")¹ and Staggers Rail Act of 1980 (the "Staggers Act"),² and reinforced in the ICCTA.

¹ Pub. L. 94-210, 90 Stat. 31 (1976).

² Pub. L. No. 96-448, 94 Stat. 1895 (1980).

The ICCTA simply does not allow the Board to adopt a rule that would broadly constrain rate increases. Congress’s enactment of the 4R Act, and specifically the provision that the ICC could regulate maximum rates only if it first determined a railroad had market dominance over the issue traffic,³ established that the touchstone for rate reasonableness determinations is the replication of outcomes that would be produced in a competitive market. The replication of competitive market outcomes requires engaging in individualized analyses using economically sound methodologies that account for demand and supply conditions affecting the issue traffic.

Congress reaffirmed its commitment to a market-based, individualized approach to rate regulation in the ICCTA. Under the ICCTA, a railroad generally may establish “any rate” for the transportation it provides. 49 U.S.C. § 10701(c). Only if a railroad has market dominance over the transportation must its rate be “reasonable.” *Id.* § 10704(d)(1). However, “a finding of market dominance does not establish a presumption that the proposed rate exceeds a reasonable maximum.” *Id.* § 10707(c). Rather, the Board must conduct a “full hearing,” *id.* § 10704(a)(1), in which it assesses whether the challenged rate reflects competitive market principles using either its stand-alone cost (“SAC”) test or its “more simplified and expedited methods for determining the reasonableness of challenged rates,” *id.* § 10701(d)(3). If the Board concludes the challenged rate is not reasonable, it “may prescribe the maximum rate . . . to be followed.” *Id.* § 10704(a)(1). The RRTF’s proposal has nothing in common with rate regulation permitted under the ICCTA.

The RRTF’s proposal clashes with the regulatory framework established by Congress. *First*, the RRTF’s proposed constraint would not judge rate reasonableness using market-based

³ Pub. L. 94-210, § 202(b).

criteria. Instead, the rate increase constraint (“RIC”) levels would simply reflect average R/VCs for broad “categories” of traffic,⁴ which would then be reduced through an allocation of so-called railroad “net surplus” to implement a concept that “all commodities” should “derive benefit from the rate increase constraint.”⁵ Nothing in the RIC calculation is designed to ensure rates at RIC levels would bear any resemblance to rates that would be established for issue traffic under competitive market principles.⁶

Second, the RRTF’s proposed constraint would not be an individualized approach to rate regulation. A railroad’s RIC levels would be calculated in advance of any case and would apply to broad categories of traffic.⁷ The Board would apply the constraint without the “full hearing” to determine reasonableness required under § 10704(a)(1). The only issue in any case would be market dominance, even though a finding of market dominance should “not establish [even] a presumption that the proposed rate exceeds a reasonable maximum.” 49 U.S.C. § 10707(c). Nothing in the RRTF’s proposal allows the Board to consider whether individual challenged rates reasonably respond to actual market conditions.

The RRTF’s proposal thus has nothing in common with the Board’s SAC test or either of the agency’s two “more simplified and expedited methods for determining the reasonableness of

⁴ The RRTF’s proposal contemplates use of “a defined set of commodity-service characteristic combinations,” RRTF Report at 37, that would apparently encompass a much broader range of traffic than would be used to form “comparison groups” under the Board’s Three Benchmark method. See *Simplified Standards for Rail Rate Cases*, EP 646 (Sub-No. 1) (STB served Sept. 5, 2007), *aff’d sub nom. CSX Transp., Inc. v. STB*, 568 F.3d 236 (D.C. Cir.), *vacated in part on reh’g*, 584 F.3d 1076 (D.C. Cir. 2009).

⁵ RRTF Report at 37.

⁶ Notably, the RRTF’s proposal would apparently include traffic priced below the 180% R/VC level in calculating the RIC, which is inconsistent with the Board’s prior conclusion that only traffic priced above the 180% R/VC level is evidence of the reasonable R/VC level for traffic over which railroads have market dominance. See *Simplified Standards* at 17.

⁷ RRTF Report at 37; see also *id.* at 38, Table 5.

challenged rates.” *Id.* § 10701(d)(3). Indeed, the RRTF’s proposed rate constraint would *not* be a “method[] for determining the reasonableness of challenged rates.” The Board could not apply it where a railroad previously had not established a rate for the issue traffic. Instead, it is exactly what it purports to be: a means of constraining *increases* to existing rates on broad categories of traffic with no evaluation of the actual rate’s reasonableness. But the ICCTA does not permit the Board to engage in such sweeping and blind regulation of rates. And the Board cannot grant itself power not contained in its governing statute simply by declaring *ipse dixit* that increases to rates exceeding arbitrary R/VC levels – that is, R/VC levels that do not themselves identify the appropriate, market-based rates for the issue traffic – would create “unreasonable” rates.

II. The RRTF’s proposed forced interchange requirement is contrary to law.

Contrary to the suggestion implicit in the Notice’s language, “*Bottleneck* protections” for a railroad offering single-line service are not something the Board could “suspend.” Notice at 3.⁸ The protections are established by statute. *See* 49 U.S.C. § 10705(a)(2). As the Board has explained:

[T]he right of a rail carrier not to be short-hauled, 49 U.S.C. 10705(a)(2), originated in the Mann-Elkins Act of 1910 and protects a railroad, at the outset, from . . . “hav[ing] to carry over its lines traffic originating on, or destined to, another line when the entire carriage could as well have taken place on its own line.”

Bottleneck II, 2 S.T.B. at 241 (internal citation omitted) (*quoting Chi., Milwaukee, St. Paul & Pac. R.R. v. United States*, 366 U.S. 745, 757 (1961)). In other words, the RRTF’s proposal is simply a non-starter, because “Congress chose not to provide for the open routing” described in the proposal. *Bottleneck I*, 1 S.T.B. at 1067.

⁸ These protections are addressed in detail in the Board’s “*Bottleneck*” decisions. *See Cent. Power & Light Co. v. S. Pac. Transp. Co.* (“*Bottleneck I*”), 1 S.T.B. 1059 (1996), *clarified*, *Cent. Power & Light Co. v. S. Pac. Transp. Co.* (“*Bottleneck II*”), 2 S.T.B. 235 (1997), *aff’d sub nom. MidAmerican Energy Co. v. STB*, 169 F.3d 1099 (8th Cir. 1999).

The protections Congress granted in § 10705(a)(2) cannot be overridden, except in accordance with the statute, which allows the Board to prescribe a through route only if a single-line route would be unreasonably long or if the through route is needed to provide relief from inadequate service. Specifically, under § 10705(a)(2), the Board may override the statutory short-haul protection only when:

- (A) required under section 10741, 10742, or 11102 of this title [*i.e.*, 49 U.S.C.];
- (B) inclusion of those lines [*i.e.*, the incumbent railroad's lines between the terminals of the route] would make the through route unreasonably long when compared with a practicable alternative through route that could be established; or
- (C) the Board decides that the proposed through route is needed to provide adequate, and more efficient or economic transportation.

In addition, a shipper seeking to override a railroad's short-haul protection would have to show the railroad engaged in anticompetitive acts. *See* 49 C.F.R. § 1144.2(a)(1); *see also Bottleneck I*, 1 S.T.B. at 1068–72.

Even setting to one side the Competitive Access Rules, the Board could not override the short-haul protection to advance its rate regulatory objectives. Each of the statutory grounds for overriding the short-haul protection requires the Board to make fact-specific findings regarding the actual route and service at issue. The Board could not adopt a rule under which it would conclusively presume the existence of the necessary factual predicates based on a railroad's achievement of long-term revenue adequacy because the critical findings are unrelated to the achievement of revenue adequacy.

Specifically, § 10705(a)(2)(C) requires proof the proposed through route is “needed” to provide “adequate” transportation. The Board could not say the mere existence of an alternative to single-line service is, by definition, needed to provide adequate transportation, because such a

rule would defeat the basic purpose of the statutory short-haul protection. And no reason exists to presume a shipper would need a through route to obtain adequate transportation just because its serving railroad achieves long-term revenue adequacy. Moreover, § 10705(a)(2)(C) requires the through route's proponent to show not only that single-line service is not adequate, but also that the proposed through route would be "more efficient or economic." Such showings could only be made on a case-by-case basis (if they could be made at all, given the widely recognized benefits of single-line service as compared to joint-line service).

Section 10705(a)(2)(B) also could not be the basis for a rule overriding the short-haul protection once a railroad achieves long-term revenue adequacy. Section 10705(a)(2)(B) asks whether the single-line route would be "unreasonably long when compared with a practicable alternative through route that could established." This provision plainly focuses on differences in transit times, route miles, and costs relating to time and mileage – none of which would be affected by a railroad's achievement of long-term revenue adequacy.

Section 10705(a)(2)(A) also does not provide any basis for overriding the short-haul protection based on achievement of long-term revenue adequacy. Section 10705(a)(2)(A) allows overrides when required by three other statutory provisions: sections 10741, 10742 and 11102. Only § 11102 is potentially relevant here. (The other provisions address circumstances in which a railroad has already established at least one through route.) Under § 11102(c), the Board "may require carriers to enter into reciprocal switching arrangements," which are, in essence, through routes where interchange takes place in the terminal used to serve the shipper. But § 11102(c), like the other terminal access remedies in § 11102, can be used only to provide relief where an incumbent railroad is providing inadequate service, not as an alternate means of regulating rates. See H.R. Rep. 96-1430, at 116 (1980) ("In areas where reciprocal switching is feasible, it provides

an avenue of relief for shippers where only one railroad provides service and it is inadequate.”). Congress intended the Board to regulate rates under § 10701, not by prescribing through routes.⁹ It certainly did not intend § 11102 to broadly override § 10705’s short-haul protection. To the contrary, “as an integral part of Congress’ goal of revitalizing the rail industry, [the 4R Act and Staggers Act] largely freed carriers to ‘rationalize their route structures making maximum use of efficient routings and eliminating others.’” *Bottleneck I*, 1 S.T.B. at 1065 (quoting *Interchange Provisions at Jacksonville, FL, SCL & SRS*, 365 I.C.C. 905, 916 (1982)). And Congress plainly did not intend to promote railroads’ achievement of revenue adequacy by freeing carriers to rationalize their route structures, only then to allow the Board to undo its legislative efforts by restoring the failed “open-routing” system if railroads actually achieved long-term revenue adequacy.¹⁰

The RRTF focused on § 10705(a)(2)(C) and claimed “[a] finding that a different routing from that offered by the [single-line] carrier would promote efficient or economic transportation by resulting in greater competition and lower rates would appear to meet the express terms of § 10705.”¹¹ But the RRTF apparently overlooked the required finding that a through route is “needed” to provide “adequate” transportation. The RRTF also did not explain how the Board could possibly justify a sweeping finding that interline service is “more efficient or economic” than single-line service, particularly given the agency’s repeated recognition that single-line

⁹ See also *Midtec Paper Corp. v. United States*, 857 F.2d 1487, 1505 (D.C. Cir. 1988) (rejecting shipper contention that “section [11102] was intended to be an alternative means of obtaining rate relief”).

¹⁰ See also *Midtec*, 857 F.2d at 1507 (“If the Commission were authorized . . . to prescribe reciprocal switching . . . whenever such an order could enhance competition between rail carriers, it could radically restructure the railroad industry. We have not found even the slightest indication that Congress intended the Commission in this way to conform the industry more closely to a model of perfect competition.”).

¹¹ RRTF Report at 41.

service is more efficient and economic than interchange service. *See, e.g., Burlington N., Inc.—Control & Merger—St. Louis-San Francisco Ry.*, 360 I.C.C. 788, 940 (1980) (“Interchanging traffic adds to the total cost of handling traffic Interchanging freight also adds significantly to delivery time”); *CSX Corp.—Control—Chessie Sys., Inc. & Seaboard Coast Line Indus., Inc.*, 363 I.C.C. 521, 553 (1980) (“Interchange operations can be eliminated, reducing both operating and overhead costs and transit time; transaction costs are reduced; and incentives to provide less than efficient service . . . are reduced. Thus, speed, reliability, and handling are enhanced.”); *Norfolk S. Corp.—Control—Norfolk & W. Ry. & S. Ry.*, 366 I.C.C. 173, 194–95 (1982) (“Shippers, however, prefer single-system service. Single-system service offers the opportunity to improve speed and reliability of service and equipment utilization and distribution.”); *Union Pac. Corp.—Control—Mo. Pac.; W. Pac.*, 366 I.C.C. 462, 489 (1982) (“Shippers prefer single line or single system service because it improves reliability and transit times, and equipment availability.”); *Union Pac. Corp.—Control—Chi. & N.W. Transp. Co.*, FD 32133, slip op. at 66-67 (ICC served Mar. 7, 1995) (“There are substantial efficiencies in single-line service compared to joint-line service.”).

Finally, the RRTF overlooked Congress’ elimination of the open-routing system that its proposal would recreate by enacting the 4R Act and the Staggers Act. *See Bottleneck I*, 1 S.T.B. at 1067. The RRTF suggested its proposal is consistent with competition and reliance on market forces.¹² The opposite is true. As the Board explained when a similar position was taken by the complaining utilities in the *Bottleneck* cases, the result would not be a deregulatory, market-based solution, but rather “full regulatory intervention”:

[The utilities] argue that the prescription of local rates and requirement for competitive routings would minimize the need for

¹² RRTF Report at 41.

future regulatory relief. Nevertheless, what the utilities propose, in the name of regulatory forbearance, is full regulatory intervention; they see through regulation to deprive carriers of their statutorily-recognized long-haul and their traditional routing discretion. Thus, theirs is not a deregulatory initiative.

Bottleneck I, 1 S.T.B. at 1067. The Board may not adopt rules that would countermand the deregulatory enactments of Congress.

CONCLUSION

The Board should not pursue the development of constraints designed to limit returns of railroads deemed to have achieved long-term revenue adequacy. However, if the Board proceeds down that path, it must ensure its proposals are consistent with the law and sound transportation policy. The RRTF's proposed rate increase constraint and *Bottleneck* changes do not clear even the first essential hurdle.

Respectfully submitted,

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