

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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HEARING ON REVENUE ADEQUACY

Docket No. EP 761

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RAILROAD REVENUE ADEQUACY

Docket No. EP 722

**SUPPLEMENTAL COMMENTS OF
NORFOLK SOUTHERN RAILWAY COMPANY**

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Dated: February 13, 2020

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Norfolk Southern Railway Company (“Norfolk Southern”) provides the following comments to supplement its Written Testimony filed in these proceedings on November 26, 2019, and the testimony given by Professor David Sappington of the University of Florida and Mr. John Friedmann, Norfolk Southern’s Vice President Network Planning and Optimization at the Surface Transportation Board’s (the “STB”) hearing on December 12, 2019. Norfolk Southern also joins in the supplemental comments submitted by the Association of American Railroads.

Norfolk Southern’s recent submissions in these proceedings focused on two of the four issues on which the STB sought comment: asymmetric earnings regulation of revenue adequate railroads, in the form of a rate increase constraint; and, the removal of the STB’s “Bottleneck protections” for revenue adequate railroads. Professor Sappington explained in both his Verified Statement and oral testimony why regulatory policy in other regulated industries has trended away from stringent earnings regulation towards performance based regulation. With respect to removal of the Bottleneck protections, Mr. Friedmann detailed how the threat of traffic

diversions would degrade Norfolk Southern's investment decision-making process and increase variability for network operations, increase network cost, and degrade service for all customers.

Testimony from other stakeholders at the STB's hearing confirmed these key conclusions. Professor Joseph P. Kalt from Harvard University echoed Professor's Sappington identification of the trend away from regulatory earnings constraints. *See* Hearing Transcript Day 1, at 48 ("This is the perennial problem that old style public utility franchise public utility regulation ran into and it's the reason that form of regulation is now so widely discredited."). And Ms. Cindy Sanborn, Union Pacific's Vice President, Network Planning and Operations, sounded the same alarms as Mr. Friedmann about the far-reaching impacts of artificially increasing handling events. *See* Hearing Transcript Day 2, at 237 ("By handling traffic and single line service, we avoid the unnecessary variability and inefficiency of interchange. Every unnecessary handling introduces inefficiency, not only for the cars being handled, but for the cars of other customers using the same service plan and infrastructure along the route.").

Notably, even proponents of further STB action did not directly contradict these conclusions at the December hearing. Dr. Caves, appearing on behalf of the American Chemistry Council ("ACC") and the only economist who testified from the shipper perspective, sought to distance ACC's proposal from system-wide earnings style regulation. Hearing Transcript Day 1, at 28-29 ("The flaw in the AAR's argument, however, is that it wrongly assumes that the only way to apply the revenue adequacy constraint, is by restricting system earnings. A revenue adequacy rate constraint, however, can be applied to individual movements without restricting overall system earnings."). And Mr. Chirumbole, Vice President of Global Integrated Supply Chain of Olin Corporation, in direct response to the operational concerns explained by Mr. Friedmann, admitted that the concerns were valid but sought to dismiss them

only because they would interfere with his goal of lowering rates through regulation. *Id.* at 312-313 (“Now, I don't mean that to mean it's not a valid one, but I don't have competition. And so, I'm looking for anything that will give us some ability to get lower rates.”).

Norfolk Southern does wish to respond further to Chairman Begeman’s question at the December hearing expressing concern that Norfolk Southern’s testimony about the effects of the removal of the Bottleneck protections emphasized the adverse consequences that necessarily flow from the loss of existing traffic without exploring the parallel possibilities of accessing new traffic. *Id.* at 339-40. To be clear, Norfolk Southern would have opportunities to attempt to obtain new business if the Bottleneck protections were removed and would pursue those opportunities that generated sufficient return on investment for its shareholders.

Rather, Mr. Friedmann’s focus on the adverse investment and operational impacts flowing from removal of the Bottleneck protections simply reflects that such consequences would apply to both newly accessible and existing traffic. The potential to secure new business would be outweighed by adverse changes to Norfolk Southern’s investment decision-making process and the need to mitigate the operational challenges that would result.

Take investment first. As Mr. Friedmann discussed in his written testimony, Norfolk Southern makes investment decisions based on its ability to forecast the returns it will generate from that investment. Removal of the Bottleneck protections will reduce investment by increasing the risk of traffic diversions and rate compression of existing traffic.

While the removal of the Bottleneck protections will also open up opportunities for new traffic, these opportunities will not neutralize Norfolk Southern’s risk. Put another way, while removal of the Bottleneck protections would remove certainty about Norfolk Southern’s retention of existing traffic, it also would not provide any certainty that Norfolk Southern would

realize new business, where such traffic might materialize, or that it would be able to retain such new business. Accordingly, the risk calculus for any investment decision-making process will still result in less investment in the network. After all, an uncertain prospect for new business is not a good trade for introducing a risk to existing business.

Importantly, this is not a concern based on the premise of preserving “monopolistic pricing,” in the way that Vice Chairman Oberman expressed concern. *See* Testimony Transcript Day 1, at 345. To be sure, more profitable traffic does support greater levels of investment than less profitable traffic. But the adverse investment impacts Mr. Friedmann sought to highlight would occur irrespective of whether Norfolk Southern ended up moving the same traffic and realizing the same contribution from that traffic in a given year. Similarly, addressing Chairman Begeman’s question, such impacts would occur irrespective of whether Norfolk Southern secured new business in a given year attributable to the removal of the Bottleneck protections that fully offset any contribution or traffic loss from diversions. Again, the point is that removal of the Bottleneck protections will introduce a risk to existing business – even if this risk is not always realized – that will drive divestment in fixed infrastructure that cannot be relocated or redeployed to other geographic locations. The simple possibility of securing some other new traffic simply does not change that calculus.

Mr. Friedmann’s concerns about operational impacts also have equal application to the potential for new traffic. As Mr. Friedmann noted, any new traffic will require at least one additional interchange with another carrier, and “interchanges are the weak link in the transportation network.” *Id.* at 341. This risk is most acute for the incumbent carrier, as it can be forced to convert single-line traffic to less efficient joint line service at an interchange selected by the customer.

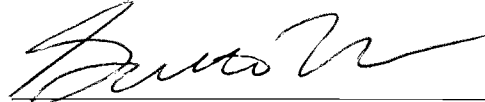
However, even the network of the receiving carrier, which retains greater operational control in the pursuit of new opportunities, will be subject to service impacts on account of new traffic. Velocity of the overall network slows by introducing new interchange events. Written Testimony of Norfolk Southern, Friedmann V.S. at 12, *Hearing on Revenue Adequacy*, Ex Parte 761 (filed Nov. 26, 2019). Moreover, receiving carriers have decreased visibility into the arrival of interchange traffic, introducing volatility that harms fluidity and service for other traffic in the same area. *See id.*, Exhibit B at 18 (“And a receiving railroad cannot monitor the other carrier's network, leaving its own operations susceptible to unanticipated variability even if the interchange location can handle the interchange volumes.”). As a consequence, other customers will suffer degraded service due to removal of the Bottleneck protections, whether their traffic moves on a line that is securing new traffic or experiencing diversions.¹

In short, it is not an equal trade for either investment or operation of the network to exchange certainty of traffic flows for the potential of additional irregular, and more operationally complex, flows. So while Chairman Begeman is correct that removal of the Bottleneck protections will bring opportunities to secure new traffic, those opportunities do not offset or lessen the importance of the adverse investment and operational impacts identified by Mr. Friedmann.

¹ Notably, especially in light of Chairman Begeman’s question, many *shippers* have actually argued that few diversions will occur to new carriers, in an attempt to downplay the inevitability of the operational impacts described by Mr. Friedmann. *See, e.g.*, Testimony of Frank Chirumbole, Hearing Transcript Day 1, at 342 (“The excuse is put up there well, it's going to mess up our network. Well, if you lower the price and keep it on your network, the network should be fine. That's what's not happening.”). One cannot have it both ways – any argument that the operational impacts will be minimal necessarily embraces that the positions that there will be significant investment impacts and no realization of meaningful new revenues.

For the reasons cited in the collective comments of Norfolk Southern and AAR, and based on the testimony presented at the December hearing, Norfolk Southern again respectfully asks the STB to abandon the notion of an independent revenue adequacy constraint

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Vanessa A. Sutherland', written over a horizontal line.

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