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Surface Transportation Board
Attn.: Docket No. EP 761
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Washington, DC 20423-0001

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Dear Members of the Board:

On behalf of National Taxpayers Union (NTU) I am pleased to submit the following brief comments on EP 761, "Railroad Revenue Adequacy." These remarks are confined to NTU's interactions with tax and regulatory policies in other areas of government that we hope the Surface Transportation Board (STB) may find useful in its own deliberations.

Introduction: The Taxpayers' Stake in STB Policy

As we have noted in previous comments to the Board,¹ Taxpayers have a major interest in a robust freight rail sector that allows both railroads and their customers to prosper. Railroads must have the resources to continue private investment, and customers must be able to secure affordable, market-based shipping services. Without this synergy, taxpayers will witness another decline in one of the nation's most vital infrastructure components, and with it, increased pressure for direct federal involvement with loans, subsidies, and other strictures. The result would be, in our view, tantamount to another Amtrak-style scheme – which currently (outside of the Northeast Corridor) benefits neither rail travel innovation nor its customers, all while surviving on taxpayer support approaching \$2 billion annually. Indeed, such concerns were the primary reasons NTU strongly supported the Staggers Act of 1980, which among other steps provided greater latitude for railroads and their customers to negotiate freight-hauling rates. That law was, along with airline and trucking regulatory reform, a sweeping effort to encourage infrastructure competition and innovation, and has largely answered to these vital purposes.

From the outset, NTU wishes to make clear that many of the fundamental concerns driving the April 25, 2019 Rate Reform Task Force (RRTF) report – whose findings are central to EP 722 and EP 761 – could benefit from legislative input. Some free-market purists might argue that the "revenue adequacy" concept should serve neither as a floor nor as a ceiling for railroads in a sector that has changed so dramatically since the Staggers Act, and that Congress should revise the entire regulatory structure of the sector. Although the RRTF report does make some legislative recommendations, such a wide-ranging Congressional discussion is beyond the purview of EP 671. At issue with this docket is a plethora of concerns expressed by various parties, including: the limits of STB's statutory authority to take actions such as proposing a Rate Increase Constraint or the Bottleneck Rule; whether or how the revenue adequacy constraint should be constructed for overall rate regulation; and whether dispute procedures should be modified.

¹ See National Taxpayers Union Comments on EP 755/EP 665 (Sub-No. 2), "Final Offer Rate Review/Expanding Access to Rate Relief" and EP 756, "Market Dominance Streamlined Approach," November 12, 2019.

While NTU cannot possibly dissemble and address all the arguments and counter-arguments by railroads and customers over those and other issues, we offer the following observations in the hope that they could benefit everyone with an interest in the future of freight rail.

Seek “Systematic Projectable Evidence” on How the SAC Process Has Failed – and Why Simplified SAC and Three-Benchmark Are Underutilized

In NTU’s experience with other agencies such as the Federal Trade Commission (FTC), rigorous standards for information-gathering have not only improved the quality of regulation, but have also helped authorities to determine whether and where regulation ought to be applied in the first place. The result is a system that better serves taxpayers and consumers while improving administrability for government.

It is clear from its report that RRTF received a great deal of input from stakeholders attesting to flaws in the Stand-Alone Cost (SAC) test for filing rate cases, as well as accessibility issues with alternatives including Simplified SAC and the Three-Benchmark method. Some of these anecdotes are patently absurd but nonetheless credible; NTU has observed similar bureaucratic debacles in other contexts. One party filed comments referring to a SAC case involving “arguments over the details of the imaginary restrooms needed for the imaginary crew for the imaginary railroad.”² For its own part RRTF reported that litigation costs for both shippers and carriers in these matters have risen: “litigation in more recent cases – including the market dominance process ... -- have *reportedly* cost as much as \$10 million” (italics NTU’s). It is unclear to us what the term “reportedly” means – was the expense an average of several cases surveyed, or an estimate from one source, or some other kind of projection? While this figure is important and quite plausible, how could better data at this ground level of policymaking be more useful? Other parts of the RRTF report pertaining rate negotiations use terms such as “an alarming number” of interests expressing concerns. Can this number be better quantified and put to constructive use?

One example dates back nearly four decades but remains instructive today. In the 1980s Timothy J. Muris, the FTC’s then-Director of the Consumer Protection Bureau, analyzed a spate of FTC rulemaking proceedings subsequent to the Magnuson-Moss Act, and found that most were withdrawn, made obsolete, or delayed. Muris compared and contrasted several of these rules, concluding that most failures stemmed from two factors: 1) A lack of clear theory to show how a given practice violated the law and why a government remedy is superior to the market; and 2) A lack of “systematic projectable evidence” that confirms, not just coincides with, the theory. Muris cited two cogent accounts to illustrate his point – proposed rules that would lift states’ restrictions on advertising for eyeglasses and regulations disclosing funeral home pricing. In the former case, the FTC relied on systemic projectable evidence that states with advertising proscriptions had “significantly higher prices” than those offering consumers more access to information. In the latter, the FTC plowed ahead with requiring price disclosures via telephone and point of sale, relying on “no more than a score of anecdotes” in a funeral industry with (at that point) some 2 million transactions a year.

Muris’ guidance for FTC, from 1982, is applicable to any agency in the year 2020:

[A] proposal should not become a rule until systematic evidence has been collected to test its factual premises. Anecdotes, the Commission’s own expertise, and the testimony of experts rarely, if ever, provide the necessary confirmation. Such evidence may be consistent with the theory, but cannot test it. And an untested theory should not be imposed on society at large.³

² Cited in *Consumers Energy Co. v. CSX Transportation, Inc.*, NOR 42142, STB Proceeding (2018).

³ See Muris, Timothy J., “Rules without Reason: The Case of the FTC,” American Enterprise Institute, *Regulation*. September/October 1982, pp. 20-26.

As NTU noted in our November 12 comments to the Board, disuse of a given dispute procedure in a normally contentious environment may be prima facie evidence that it has failed in its purpose, but *why* it has failed may not be as obvious. For example, RRTF’s conclusion that “mandatory arbitration would resolve” the lack of interest in utilizing the 20-plus-year-old voluntary procedure the Board has offered. This is of course a tautology, but did the Board first attempt to gather systematic projectable evidence about other reasons for the voluntary option’s lack of attractiveness? Apparently, this opportunity was rejected years ago.

There is no better time than now to chart a new course. In the case of the SAC procedure, this could entail a systematic survey of litigants involved in cases over the past 10 years, based on a pre-established matrix of standard costs. In addition, other evidence, based on properly sampled surveys, willingness-to-pay methodologies, or other studies from relevant interagency or international sources could provide actionable evidence to support or refute the utility of various reforms, such as:

- Modifications to waybill sampling and aggregation of claims limits on the Three-Benchmark process;
- The presence of mutually agreed-upon third party experts or administrative law judges during key parts of the discovery process;
- Time and set criteria limits on market dominance analyses; or
- Modifications to the comparison group procedure for small rate disputes.

Consider External Tax and Regulatory Factors as well as Market Conditions Fully in Developing Any New Models or Procedures for Challenging Rates

One consistent problem NTU has encountered in dockets across agencies and throughout levels of government is properly measuring the impact of tax and regulatory burdens on the financial circumstances of market participants – burdens that directly impact the factors an entity like STB must consider, even if the entity has little control over those burdens. These include environmental regulations (especially for shippers), labor regulations (especially for railroads), property tax classification and situs rules, and increasing scrutiny of business-to-business transactions by tax authorities. Even further are questions surrounding the measurement of economic opportunity and social welfare costs that businesses as well as individuals consider in the tax and regulatory realms. After many years of relative stasis, interest in how to best capture these costs in various sectors has increased, along with sophistication in measuring them.⁴ STB should avail itself of as much of this information as possible.

But another dimension of this problem revealed itself in one party’s comments on EP 761 – reliance on measurements which, in and of themselves, could become heavily dependent on policy changes in coming years. In calculating revenue adequacy results, the commenter noted, the Board’s current policy of excluding deferred taxes from the investment base of a given railroad “overstates the attractiveness of railroad industry investments.” More to the point, however, is that recent corporate federal tax rate reductions “would have suggested a one-year phantom surge in railroad profitability, as the net operating incomes would be inflated to reflect the change in accumulated deferred taxes.” The author observed that despite STB’s manual adjustment to account for this surge, “one can anticipate the rate changing in future administrations, leaving the Board’s revenue adequacy measurement at the mercy of changes in future corporate tax rates.”⁵

As an organization deeply involved with the Tax Cuts and Jobs Act (TCA) of 2017, NTU can attest to the possibility of future fluidity in corporate tax policy. Although the federal rate was largely static (and in our

⁴ See, for example, discussion of various methodologies in Fichtner, Jason, Gale, Bill, and Trinca, Jeff, “Tax Administration: Compliance, Complexity, and Capacity,” Bipartisan Policy Center, 2019, <https://bipartisanpolicy.org/library/tax-administration-compliance-complexity-and-capacity>.

⁵ See Comments of the Association of American Railroads to STB, November 26, 2019, Citing Professor Joseph P. Kalt.

opinion too high) for more than 30 years until 2017, budgetary “scoring” exigencies compelled TCJA’s drafters to construct the legislation with various phaseouts. Although the actual corporate tax rate is part of “permanent” law, these “cliffs” affective other parts of TCJA, combined with pressure from political opponents of the original law, will provide many more legislative opportunities to attempt additional changes in the rate than pre-2017 history would suggest.

Navigating and planning for these vagaries in whatever rate reasonableness policies STB may implement will always be challenges. However, with sufficient input from both carriers and shippers, a tax and regulatory burden can be established for their respective portions of the rail sector that would serve not as an “average” or “yardstick” to apply across the board, but rather as a general common reference point from which parties in future cases could add or subtract factors that most accurately reflect their unique situations. Each party would, in essence “show their math” from the general to the specific in logical progression. A common “funnel-based” as opposed to “pyramid-based” approach could streamline discovery, which RRTF identified as one of the biggest problems with SAC.

In addition, STB’s future approach to rate regulation and consumer welfare standards will need to confront a problem that other regulators – from the IRS to the FTC – are facing now as well: rapidly changing market conditions. In the case of tax authorities, this has meant designing systems for reporting, examination, enforcement, and dispute resolution surrounding developments such as the “gig economy” and virtual currency. For the FTC, it has meant understanding the importance of the “Internet of Things,” and in the case of mergers, how recent tech consolidations can defy the traditional “vertical/horizontal” paradigm. STB is not immune from considerations like these. For instance, what will the advent of autonomous vehicles mean for the viability of truck freight for shippers who might have larger loads over longer distances that make traditional truck options too expensive? Does the development of independent, integrated shipping networks (such as Amazon’s decision to rely less on the U.S. Postal Service for last-mile delivery) have any similar implications? Good regulations will provide sufficient flexibility and nimbleness to support these trends, and can even make future regulations for trends yet to be discovered less volatile.

Any Additional STB Actions in this Area, whether through Formal Rulemaking or Subregulatory Proceedings, Should be Guided by the Spirit of the Latest Executive Orders on Transparency and Accountability

It is perfectly legitimate for any regulatory agency to periodically review the models and methodologies underpinning its decision-making. RRTF’s report and the subsequent proposals in EP 761 have elicited a number of views along these lines, from suggestions for modest adjustments to entire substitutions of entirely new models.

NTU may discuss the merits of these approaches if future rulemakings warrant it, but all can be better informed by an exploratory process that allows for testing, critical evaluation by those with relevant experience in other sectors, and perhaps even by pilot implementation as opposed to wholesale application to the industry.

In 2017, STB formed a Regulatory Reform Task Force (not to be confused with the Rate Reform Task Force) so as to “comply with the spirit of Executive Order 13777”⁶ in improving “implementation of regulatory reform initiatives” and identifying “regulations for repeal, replacement, or modification.” The Board deserves great credit for this action, and should continue its wise and commendable course by embracing the precepts of more recent EOs that have direct bearing on EP 761.

⁶ See <https://prod.stb.gov/regulatory-reform-task-force/>.

For example, requests from some witnesses in these proceedings to conduct an informal rulemaking aimed at formalizing the Benchmark Method for certain rate reasonableness cases.⁷ If the Board decides to engage in such an informal proceeding, NTU would strongly urge Members to review and implement the procedures outlined in Executive Order 13891, “Promoting the Rule of Law Through Improved Agency Guidance Documents” and Executive Order 13892, “Promoting the Rule of Law Through Transparency and Fairness in Civil Administrative Enforcement and Adjudication.”⁸ Though not necessarily applicable in every case to what STB might undertake, the following provisions of these orders are quite relevant:

- Publicly post and make accessible all guidance documents;
- Provide public notice and comment for “significant” guidance whose overall economic impact is above \$100 million (a threshold that NTU contends would be more than adequately met in the case of the actions contemplated under EP 722/761);
- Create due process mechanisms for any enforcement actions resulting from guidance, so as to avoid “unfair surprise,” including grievance procedures;
- Allow affected parties to formally petition for rescission or modification of guidance;
- Clarifying which precepts of past guidance are still applicable and which are not.

Again, whether formal or not, additional STB rulemaking going forward should be as transparent and accountable as possible, adhering to the greatest feasible degree to these and other tenets expressed in the EOs.

Conclusion: More Learning Is Ahead

In November 26, 2019 comments to the Board on EP 761, Professor Jerry Ellig of the George Washington University Regulatory Studies Center provided views on questions such as the Rate Increase Constraint and the market dominance streamlined approach, which would arouse support and opposition from either carriers and shippers, depending upon the topic at hand. He suggested, for example, a “holistic and in-depth assessment of industry conditions” as a necessary complement to proposals that would calculate railroad revenue adequacy over multi-year intervals, while calling for STB resources to be directed a regulatory impact analysis of the market dominance streamlined approach and the final offer process for small rate disputes.

Yet, the overall thrust of his comments on the need for robust, thoughtful additional research on the economics of the RRTF report and resulting proposals should appeal to all members of the railroad community. As he concluded, “Given the unfortunate history of rate regulation in the pre-Staggers era and the difficulty of making credible commitments to limit price regulation, the STB should exercise extreme caution in regard to any proposal for more extensive general rate regulation.” Taxpayers would likely agree.

Thank you for your consideration of these comments, and should you have any questions, I am at your service.

Sincerely,

A handwritten signature in black ink, appearing to read 'Pete Sepp', with a stylized flourish at the end.

Pete Sepp, President

⁷ See American Chemistry Council Comments to STB, November 26, 2019.

⁸ For text of the Executive Orders, see 84 FR 55235 and 84 FR 55239.