

Before the Surface Transportation Board

STB Docket No. EP 766

**Joint Petition for Rulemaking—Annual Revenue Adequacy
Determinations**

Opening Comments of Dow, Inc.

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Dow, Inc., submits these comments in response to the Surface Transportation Board's December 30, 2020, request in docket EP 766 for comments on the petition for rulemaking that Union Pacific Railroad Company (UP), Norfolk Southern Railway Company (NS), and the U.S. rail operating affiliates of Canadian National Railway Company (CN) (collectively, Joint Carriers) filed on September 1, 2020 to change the Board's revenue-adequacy methodology.

Dow is submitting these comments to urge the Board to focus on promoting competition and making rate challenges accessible by issuing final rules on competitive switching and Final Offer Rate Review (FORR) in dockets EP 711 (Sub-No. 1) and EP 755, respectively. A member of the American Chemistry Council (ACC), Dow fully supports the opening comments that ACC and other trade associations ("Joint Shippers") are jointly filing in response to the Board's request.

I. Identity

Dow is a leading multi-national manufacturer of chemical products that operates 106 manufacturing sites in 31 countries and employs approximately 36,000 people. It depends upon railroads to provide safe, secure, reliable, and economic transportation of raw materials and products to, from, and between sites throughout the United States.

II. The Board should focus on improving competition and providing meaningful access to rate review rather than tinkering with revenue adequacy.

Over the 40 years since Congress mandated annual revenue-adequacy determinations, Class I railroads have enjoyed a financial renaissance that has made them Wall Street darlings. Yet during this period, railroad competition has

deteriorated and challenges to unreasonable rail rates have proven impractical for most captive shippers. Dow is concerned that the Board is directing valuable resources toward a revenue-adequacy proposal intended to require railroads to attain financial health at superstar levels to be deemed revenue adequate while important reforms that would facilitate competition and access to rate challenges languish. Instead of entertaining an attempt by railroads to increase their bottom lines beyond what is necessary to attract the capital investment needed to maintain a sound rail transportation system, the Board should focus on issuing a final rule in EP 711 (Sub-No. 1) that would enhance competition through competitive switching and a final rule in EP 755 that would adopt a rate-case process that is more practical and accessible than existing processes.

A. The Board's revenue-adequacy determinations are consistent with other indicators of robust railroad financial health.

For at least the past decade, Class I railroads have had strong financial health. Over half of them consistently have been revenue adequate since 2013, with NS being consistently revenue adequate back to 2004. Also during this period, railroad stock prices have risen at least in step with the S&P 500 index and railroads have been involved in acquisition activity, both signaling that investors are willing to invest in railroads. Given that the Board's revenue-adequacy determinations are consistent with these and other indicators of financial health, adjusting the revenue-adequacy methodology is unnecessary, inappropriate, and a distraction from more pressing matters.

Since at least the Great Recession in 2009, Class I railroads have generated strong financial performance. This has not gone unnoticed by investors, who have caused stock prices for Class I railroads to outpace the S&P 500 index's gains over the same period. This long-term rise in stock prices not only indicates that investors see railroads as capable of producing adequate returns, but it also corroborates the Board's findings that most Class I railroads are revenue adequate.

Merger and acquisition activity involving Class I railroads further confirms that railroads are in sound financial condition. Two months ago, Canadian Pacific Railway (CP) announced its intent to merge with KCS.¹ Shortly after this announcement, CN made a competing bid for KCS, offering a healthy 21% premium on top of CP's offer.² CN has since made an enhanced offer, which won the acceptance of KCS's board of directors.³ Also, earlier this year, CSX Transportation filed an application with the Board to acquire Pan Am Systems, which is the largest regional rail system in the United States.⁴ Even one of the world's most renown

¹ Notice of Intent, *Canadian Pac. Ry.—Control—Kan. City S.*, Docket No. FD 36500 (Mar. 22, 2021)

² Press Release, Canadian Nat'l Ry., CN Makes Superior Proposal to Combine With Kansas City Southern (Apr. 20, 2021), <https://www.cn.ca/en/news/2021/04/cn-makes-superior-proposal-to-combine-with-kansas-city-southern/>.

³ Press Release, Canadian Nat'l Ry., CN Proposal Deemed Superior by Kansas City Southern (May 13, 2021), <https://www.cn.ca/en/news/2021/05/cn-proposal-deemed-superior-by-kansas-city-southern/>.

⁴ Application, *CSX Corp.—Control & Merger—Pan Am Systems, Inc.*, Docket No. FD 36472 (Feb. 25, 2021); Press Release, CSX Corp., CSX to Acquire Pan Am Railways in New England (Nov. 30, 2020), <https://www.csx.com/index.cfm/about-us/media/press-releases/csx-to-acquire-pan-am-railways-in-new-england/> (stating

investors, Warren Buffett, has invested in the railroad industry by having his company, Berkshire Hathaway Inc., acquire complete control of BNSF Railway in 2010.⁵ Recently, Mr. Buffett called BNSF one of Berkshire’s “jewels,” on par with Berkshire’s stake in Apple, Inc.⁶ These real-life examples of substantial investment activity in railroads confirms that Class I railroads are capable of raising needed equity capital and offer returns that investors find reasonable, which are key elements of revenue adequacy.⁷

At bottom, the Board’s revenue-adequacy methodology is not broken. It is producing results that are consistent with other supplemental indicators of revenue adequacy, and the railroad industry is in robust financial health. Making the major adjustments that Joint Carriers propose to the revenue-adequacy methodology is unnecessary and should not be a Board priority.

that Pan Am’s “rail-carrier subsidiaries comprise [sic] North America’s largest regional railroad”).

⁵ *W. Coal Traffic League—Petition for Declaratory Order*, FD 35506, slip op. at 1 (STB served July 25, 2013) (“On February 12, 2010, Berkshire Hathaway, Inc. . . . acquired BNSF Railway Company . . . in its entirety through a purchase of BNSF stock.”).

⁶ Letter from Warren E. Buffet, Chairman of the Board, Berkshire Hathaway Inc., to Shareholders of Berkshire Hathaway Inc. 6 (Feb. 27, 2021).

⁷ Congress defined revenue adequacy as revenue levels that are sufficient to, among other factors, provide a “reasonable and economic profit or return (or both),” “permit the raising of needed equity capital,” and “attract and retain capital in amounts adequate to provide a sound transportation system.” 49 U.S.C. § 10704(a)(2).

B. A top Board priority should be addressing declining rail competition by issuing a final rule on competitive switching.

The Board should make issuing a final rule on competitive switching in EP 711 (Sub-No. 1) a top priority. Over the past four decades, the distance over which shippers are captive has increased as Class I railroads consolidated. Because of this, Dow and many other companies and trade associations have for years called on the Board to enact competitive-switching reforms that would enhance competition. After the Board proposed competitive-switching reforms and completed the public-comment period on those reforms five years ago, the entire process abruptly and inexplicably came to a halt. There is no reason for the Board to continue to withhold action on a competitive-switching rule, especially not to consider revising its revenue-adequacy methodology to allow Class I railroads to further enrich themselves at the expense of captive shippers.

Since the 1980s, the rail industry has undergone extensive consolidation that has extended bottlenecks. In 1980, there were 42 Class I railroads;⁸ today there are 7.⁹ While the Board has placed conditions on many mergers to preserve competition lost at origins and destinations, the Board's review of mergers historically has not focused on the extension of bottlenecks (i.e., the portion of a movement served by a single carrier). As a result, Dow and other shippers have become captive over ever-increasing distances.

⁸ Interstate Commerce Comm'n, *94th Annual Report* 122 (1981).

⁹ *R.R. Revenue Adequacy—2019 Determination*, EP 552 (Sub-No. 24), slip op. at 3 (STB served Oct. 1, 2020).

Additional rail industry consolidation that is currently taking place and likely to occur in the future threatens to further extend bottleneck distances. As mentioned above, KCS has accepted a merger bid from CN. If the Board approves the merger, the result will be a transcontinental railroad linking Canada, Mexico, and the United States.

In Dow's experience, greater captivity has subjected its traffic to unnecessary inefficiencies, reduced resiliency, and higher rates. As Dow commented in EP 711, there are many instances where a carrier will transport captive traffic on circuitous routing.¹⁰ This requires Dow to use more railcars,¹¹ which in turn increases costs for Dow and increases the propensity for congestion. Also, in the face of service disruptions, the lack of competitive options prevents Dow from temporarily switching its traffic to a carrier not experiencing disruptions, which would help Dow avoid delays to its shipments and help ease congestion on the impacted carrier's line. Longer bottlenecks also lessens incentives for carriers to better implement operational changes, like precision scheduled railroading, the implementation of which has caused substantial disruptions to rail traffic. And longer bottlenecks prevent Dow and other shippers from avoiding pinch points in a railroad's system

¹⁰ Comments of Dow at 6-7, *Reciprocal Switching Rules*, EP 711 (Sub-No. 1) (Oct. 26, 2016).

¹¹ Dow has a large tank-car fleet that it provides to railroads at Dow's expense for the shipment of Dow's goods. Although railroads have an obligation under 49 U.S.C. § 11121 to provide shippers with railcars, shippers historically supply railroads with tank cars.

where cars tend to bunch, resulting in bunched deliveries that overwhelm destinations and lead to storage charges beyond the shipper's or consignee's control.

To help address the reduction in competition through longer bottlenecks that has occurred and may continue to occur in the rail industry, the Board should adopt rules that make competitive switching more accessible to shippers. Under 49 U.S.C. § 11102, the Board may require competitive switching where “necessary to provide competitive rail service.” But decisions by the Interstate Commerce Commission in the 1980s, as railroads were beginning their recovery from the financial distress they experienced in prior decades, effectively made obtaining competitive switching impossible. In *Midtec Paper Corp. v. Chicago & North Western Transportation Co.*, 3 I.C.C. 2d 171 (1986), the Commission held that competitive switching was not available under its rules unless the incumbent carrier “has engaged or is likely to engage in conduct that is contrary to the rail transportation policy or is otherwise anticompetitive.” Three years later, in *Vista Chemical Co. v. Atchison, Topeka & Santa Fe Railway*, 5 I.C.C. 2d 331, 335 (1989), the Commission further held that competitive switching “is available for the classical categories of competitive abuse: foreclosure; refusal to deal; price squeeze; or any other recognizable form of monopolization or predation.” Today, after decades of railroad consolidation and with high barriers to entry in the railroad industry, railroads can exercise substantial market power over captive traffic without engaging in the conduct that the Commission found necessary to warrant competitive switching. Thus, the Board needs to update its competitive-switching rules to enable captive shippers to

shorten bottleneck distances by accessing competitive options at the nearest available interchange with an alternative rail carrier.

Additionally, revising the competitive-switching rules to enhance competition would give effect to Congress's purpose in granting the Board's competitive-switching authority and would promote the Rail Transportation Policy at 49 U.S.C. § 10101. Congress plainly intended for competitive switching to be available to enhance competition, expressly making it available "where necessary to provide competitive rail service."¹² It also expressly authorized competitive switching where "practicable and in the public interest,"¹³ indicating that it should be available to address service disruptions and similar issues that impair the efficient function of the rail network. Also, facilitating competition through competitive switching would be consistent with the RTP, which directs the Board to, among other things, "allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail"¹⁴ and "minimize the need for Federal regulatory control over the rail transportation system."¹⁵

The Board is poised to enhance competition by issuing a final rule on competitive switching. It has already issued a notice of proposed rulemaking and received extensive comments on the proposed rule in 2016 and 2017.¹⁶ The Board

¹² 49 U.S.C. § 11102(c)(1).

¹³ *Id.*

¹⁴ 49 U.S.C. § 10101(1).

¹⁵ 49 U.S.C. § 10101(2).

¹⁶ *Reciprocal Switching*, EP 711 (Sub-No. 1), slip op. (STB served July 25, 2016).

also has engaged in numerous ex parte meetings with stakeholders about the proposed rule and has received extensive comments on the petition for rulemaking filed in 2011 asking for a competitive-switching rule. Given the extensive record before the Board and its work developing a proposed competitive-switching rule, nothing prevents the Board from issuing a final competitive-switching rule in short order.

After five years without action on competitive switching while revenue-adequate Class I railroads continue leveraging their market power over captive traffic through longer bottlenecks, it is time for the Board to make issuing a final competitive-switching rule a top priority.

C. The Board should prioritize reforms that would make rate cases practical.

For many carload shippers, challenging unreasonable rail rates is not an option because, as the Board has recognized, rate cases have become too impractical. The Board has begun to address this by proposing a Final Offer Rate Review (FORR) rule that establishes an accessible procedure for challenging unreasonable rail rates. But issuance of a final FORR rule has been delayed. To prevent further delay and provide shippers with meaningful access to rate challenges, the Board should prioritize issuing a final FORR rule.

Rate cases have evolved into costly, time-consuming, and unpredictable proceedings, especially for non-coal carload traffic. Since 1985, rate cases have been decided based on the stand-alone cost (SAC) standard that the Interstate Commerce

Commission developed for unit trains of coal traffic.¹⁷ SAC cases involve modeling a hypothetical stand-alone railroad, which has proven incredibly complex and costly in carload cases, since they typically involve multiple origins and destinations and low lane volumes when compared to unit-train cases. Because any one modeling decision or combination of them could potentially sink a case, the outcomes of SAC cases involving carload traffic are highly unpredictable. Additionally, new issues applying the SAC standard continually arise, resulting in additional complexity, uncertainty, and cost. Today, a carload shipper considering a SAC case must be prepared to spend millions of dollars and many years in litigation with little predictability over the potential outcome.

While the Board has adopted simplified rate-case methodologies with the intent to make rate challenges more accessible, these methodologies are still too costly especially in light of the restricted potential for relief. Few cases have been brought under these simplified methodologies, the last case nearly a decade ago.¹⁸

To address the inaccessibility of rate cases, the Board should make completing its FORR rulemaking a priority. Since the Board has already issued a proposed FORR rule¹⁹ and received comments on it from interested parties, it is in a position to issue a final rule expeditiously. Additionally, Congress has directed the

¹⁷ See *Coal Rate Guidelines, Nationwide*, 1 I.C.C. 2d 520, 521 (stating that the rate standards are for determining the reasonableness of rates charged to coal shippers).

¹⁸ Surface Transp. Bd., *Rail Rate Cases at the STB*, <https://prod.stb.gov/wp-content/uploads/Rate-Case-List-11-19-2019.pdf> (last visited May 17, 2021).

¹⁹ *Final Offer Rate Review*, EP 755, slip op. (STB served Sept. 12, 2019).

Board to “maintain 1 or more simplified and expedited methods for determining the reasonableness of challenged rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case.”²⁰ Delaying a FORR rule any longer while the Board considers adjustments to a revenue-adequacy standard that accurately depicts Class I railroads as financially sound is unjustifiable.

III. Conclusion

Shipper access to rate challenges and competition have been declining for decades while railroads have experienced a financial revival. With railroads in strong financial health, the Board should prioritize existing rulemakings to enhance competition through competitive switching and provide a meaningful process to challenge unreasonable rates. It should not be distracted from these necessary reforms by Joint Carriers’ request to overhaul the Board’s economically sound and accurate revenue-adequacy methodology, which would only make financially thriving Class I railroads appear as if they need to extract additional revenues from their captive shippers. For the reasons expressed in these comments and in the comments of the Joint Shippers, Dow respectfully requests that the Board terminate this rulemaking proceeding and prioritize issuing a competitive-switching rule in EP 711 (Sub-No. 1) and a FORR rule in EP 755.

²⁰ 49 U.S.C. § 10701(d)(3).

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