

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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RAILROAD REVENUE ADEQUACY

**REPLY OF THE
SHIPPER COALITION TO
PETITION FOR ADMINISTRATIVE ACTION**

The American Chemistry Council (“ACC”), The Fertilizer Institute (“TFI”), the Corn Refiners Association (“CRA”) and The National Industrial Transportation League (“NITL”) (collectively the “Shipper Coalition”) hereby submit this reply to the “Petition for Administrative Action” (“Petition”) filed by the Western Coal Traffic League (“WCTL”) in this docket on August 24, 2022. In the Petition, WCTL requests that “the Board advance this proceeding to the notice of proposed rulemaking stage – and propose reasonable rules implementing the revenue adequacy constraint” adopted in *Coal Rate Guidelines* for determining the reasonableness of rail rates.¹ Petition at 10. The Shipper Coalition agrees with WCTL that there is a vital need for the Board to propose reasonable rules for implementing the revenue adequacy constraint and that there is a robust record in this proceeding for the Board to act now. Therefore, the Shipper Coalition supports the Petition.

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

I. **THERE IS A VITAL NEED FOR RULES THAT IMPLEMENT THE REVENUE ADEQUACY CONSTRAINT.**

The Interstate Commerce Commission (“ICC”) adopted the revenue adequacy constraint over 25 years ago in *Coal Rate Guidelines*. The ICC explained that, “the 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 . . . ‘revenue adequacy’ 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”² The ICC declared that “revenue adequacy is a long-term concept that calls for a company, *over time*, to average return on investment equal to its cost of capital” and linked long-term revenue adequacy to a business cycle.³ Because no rail carrier could satisfy that measure at the time, no shipper could invoke revenue adequacy as a constraint upon their rail rates. Consequently, there was no urgency for the agency to enact rules for applying the revenue adequacy constraint.

Over the ensuing decades, the financial condition of the rail industry has strengthened enormously. At least four Class I railroads unquestionably have achieved long-term revenue adequacy, and the others are very close.⁴ In recognition of the improved financial status of the rail industry, the Board initiated this proceeding in 2014 to consider, among other things, how

² *Id.* at 535-36.

³ *Id.* at 536 [emphasis in original].

⁴ BNSF Railway Company (“BNSF”), Canadian Pacific Railway Company (“CP”), Norfolk Southern Railway Company (“NS”), and Union Pacific Railroad Company (“UP”) currently have achieved revenue adequacy over a full business cycle; CSX Transportation, Inc., has achieved revenue adequacy for the most recent four consecutive years; and Canadian National Railway Company and The Kansas City Southern Railway Company trail the pack. *See* <https://www.stb.gov/wp-content/uploads/Revenue-Adequacy-chart-2020-2.pdf>. For 2021, *see* Docket No. EP 552 (Sub-No. 26), *Railroad Revenue Adequacy—2021 Determination* (served Sept. 6, 2022).

the revenue adequacy constraint would work in practice in large rail rate cases. At that time, only NS was plainly revenue adequate. With BNSF, CP, and UP joining NS over the past nine years, the need for the Board to act has intensified.

The need for Board action on the revenue adequacy constraint is further enhanced by the complexity, time, and expense of challenging a rail rate under the stand-alone cost constraint (“SAC”), which has been the only clearly defined standard for large rate cases over the past 25 years. The Board itself has acknowledged this problem for years. In 2016, former Chairman Begeman described the SAC process as “too costly, too time consuming, and too unpredictable,” and stressed that “[i]t may not be easy (or very fast) to ultimately develop a new approach, but it has to be a top Board priority.”⁵ Former Board member Miller made similar calls, stating in 2016 that “I believe that now is the time for the Board to begin a major review and discussion of alternatives to SAC.”⁶ With most Class I rail carriers having achieved revenue adequacy, it is an obvious alternative to SAC that is grounded in the same judicially affirmed constrained market pricing principles as SAC.⁷

The absence of rules for implementing the revenue adequacy constraint does not prohibit a shipper from invoking that constraint to challenge a rail rate, but it is a significant deterrent. Any shipper that pursues that path must propose a methodology without the benefit of much guidance from the Board and defend that methodology against attacks from the defendant rail

⁵ *Total Petrochemicals & Refining USA, Inc. v. CSX Transp.*, NOR 42121, slip op. at 48 (STB served Sept. 14, 2016) (Begeman, dissenting) (“*Total*”).

⁶ *Sunbelt Chlor Alkali P’ship v. Norfolk S. Ry.*, NOR 42130, slip op. at 44 (STB served Jun. 30, 2016) (Miller, concurring).

⁷ *Conrail*, 812 F.2d at 1449-50 (observing that *Guidelines* adopted a pricing system called “Constrained Market Pricing” that is comprised of four constraints and holding that all four constraints, including SAC and revenue adequacy, are consistent with the 4 R Act and Staggers Act).

carrier. Moreover, the rail industry has clearly signaled its intent to challenge the appropriateness of using revenue adequacy as a constraint upon rail rates,⁸ even though the constraint was adopted in *Guidelines*, which was a binding rulemaking proceeding.⁹ By adopting rules to implement the revenue adequacy constraint, the Board can eliminate much of this risk and uncertainty that currently exists through rules that will provide guidance and settle many of the issues that rail carriers continue to contest and recontest.

II. THERE IS A ROBUST RECORD IN THIS PROCEEDING FOR PROPOSING RULES TO IMPLEMENT THE REVENUE ADEQUACY CONSTRAINT.

The record in this docket contains a very detailed proposal for implementing the revenue adequacy constraint. In written testimony filed on November 26, 2019, ACC submitted a proposal for applying the revenue adequacy constraint that it called the “Benchmark Method.”¹⁰ Consistent with the *Guidelines*, the Benchmark method evaluates rate reasonableness based on the degree to which a captive rail shipper is forced to pay a higher rate than other shippers, and whether this differential is necessary to achieve and maintain revenue adequacy.

In support of the Benchmark Method, ACC included the Verified Statement of Dr. Kevin W. Caves, who developed the Benchmark Method using Confidential Costed Waybill Sample (“CCWS”) data obtained from the Board for that purpose and various publicly available data sources. Dr. Caves submitted his workpapers to the Board along with his testimony. ACC’s written testimony thus contained the substance of a petition for rulemaking, including detailed

⁸ See e.g., “Joint Carriers’ Opening Comments,” Docket No. EP 765, *Joint Petition for Rulemaking To Establish An Alternative Voluntary Arbitration Program For Small Rate Disputes*,” at 7-19 (filed Jan. 14, 2022).

⁹ *Conrail* at 1451-52 (rejecting ripeness claims that *Guidelines* was merely a non-binding, general statement of policy).

¹⁰ “Written Testimony of the American Chemistry Council,” Docket Nos. EP 761 and 722, at 7-48 (filed Nov. 26, 2019) (“ACC Testimony”).

data analyses, accompanied by an explicit request for the Board to initiate a rulemaking predicated upon its proposal.¹¹

The Benchmark Method employs a two-step approach to determining maximum reasonable rates of revenue-adequate rail carriers. Step One predicts the competitive benchmark rate for a captive movement, meaning the rate a shipper would expect to pay for that movement in a competitive market. Step Two determines the degree of differential pricing above the predicted competitive rate that is necessary to maintain the long-term revenue adequacy of the defendant rail carrier. The first step applies an econometric model (the “Benchmark Model”)¹² developed by Dr. Caves to predict competitive benchmark rate levels for captive movements based upon the characteristics of competitive movements that most explain their rates. The second step applies a concept called the “Competitive Threshold” (“CT”), which Dr. Caves designed to determine the degree of differential pricing above the predicted competitive benchmark rate that is necessary to maintain the long-term revenue adequacy of the defendant rail carrier. The maximum prescribed rate for a market dominant movement would be the predicted competitive benchmark rate determined in Step One as subsequently adjusted by the CT in Step Two. This can be summarized as follows: *Maximum Reasonable Rate = Competitive Benchmark Rate * CT (for defendant carrier)*

¹¹ ACC Testimony at 36 (“Through this testimony, ACC asks the Board to initiate an informal rulemaking proceeding to adopt the Benchmark as an economically-supported methodology for determining the reasonableness of rates published by revenue-adequate railroad on market dominant movements.”). ACC also submitted the Benchmark Method in Docket No. EP 755, *Final Offer Rate Review*, as a methodology ideally suited to the proposed FORR process. *See*, “Opening Comments of The American Chemistry Council, The Fertilizer Institute, The National Industrial Transportation League, The Chlorine Institute, and the Corn Refiners Association,” Docket No. EP 755, at 19-25 (filed Nov. 12, 2019).

¹² As used herein, the term “Benchmark Model” has a different meaning than “Benchmark Method.” The former refers to the regression model developed in Step One, whereas the latter refers to the entire process encompassed by Steps One and Two.

To implement the Benchmark Method on a consistent basis, as opposed to the ad hoc implementation that would occur on a case-by-case basis, the Board must adopt a specific econometric model and CT methodology. Dr. Caves developed the Benchmark Model for the Board's consideration. His methods, data, and assumptions are set forth in his verified statement for review and comment. Dr. Caves also developed a method for calculating the CT and presented a "proof of concept" illustration of how to apply the CT to the results of the Benchmark Model to obtain a maximum reasonable rate for any market dominant movement. Both the Benchmark Model and CT methodology can be modified as the Board deems appropriate after receiving public comment. The Board itself readily can update the model annually with the latest movement data from the CCWS and determine the appropriate CT multipliers for each revenue-adequate rail carrier.

In its written testimony, ACC presented the Benchmark Method in four parts.

- First, ACC identified the purpose and objectives underlying the Benchmark Method by demonstrating the need for an economically supported alternative rate case standard to SAC that is accessible to carload shippers, explaining how the Benchmark Method is both practical to apply and economically meaningful, and explaining why the Board can and should adopt the Benchmark Method as a matter of law and policy.¹³
- Second, ACC presented a detailed description of the econometric modeling that is the core of the rate benchmarking concept, the data sources that Dr. Caves used to development the proposed model, the method that Dr. Caves employed to identify

¹³ ACC Testimony at 7-18.

competitive traffic in the CCWS, the ultimate model itself, and the results of applying the model to the CCWS data.¹⁴

- Third, ACC demonstrated how to apply the results from the econometric model to determine a maximum reasonable rate, consistent with CMP, by applying the CT to determine how much the challenged rate needs to exceed the benchmark model's predicted competitive rate to maintain the long-term revenue adequacy of the defendant railroad.¹⁵ This evidence included a "proof of concept" illustration.
- Fourth, ACC asked the Board to initiate a formal rulemaking to adopt the Benchmark Method. As part of its request, ACC identified a list of subjects to be addressed in the rulemaking, including composition of the proposed Benchmark Model (*e.g.*, explanatory variables, data sources, time periods, competitive movement filters), calculation of the CT, rate prescription issues (*e.g.*, duration, indexing, recalibration), application to joint rates, and a process and timeline for Benchmark Method cases.¹⁶

Once the Board settles upon an econometric model, a method for calculating and applying the CT, and rules for rate prescriptions, the key components needed to apply the Benchmark Method in a rail case will be in place. ACC envisions a process by which an entire rate case under the Benchmark Method could be processed to a final decision in approximately 150 days at a fraction of the cost for even the simplest of existing rate case methods. Nearly all the discovery and litigation would pertain to market dominance. Once market dominance is established, the maximum reasonable rate is determined by inputting the key movement

¹⁴ *Id.* at 18-29.

¹⁵ *Id.* at 29-36

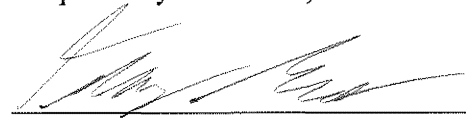
¹⁶ *Id.* at 36-48.

characteristics into the Benchmark Model to obtain the predicted competitive rate and multiplying that rate by the CT.

III. CONCLUSION

WCTL's Petition establishes a clear need for action by the Board to adopt a methodology to challenge rail rates based upon the revenue adequacy constraint adopted in *Guidelines*. The Shipper Coalition endorses that need and has provided additional support in Part I of this Reply. Moreover, as demonstrated in Part II, the record in this docket contains a very detailed proposal upon which to base a notice of proposed rulemaking. Therefore, for the foregoing reasons, the Shipper Coalition supports the WCTL Petition.

Respectfully submitted,



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