

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

EP 740
EP 661 (Sub-No. 2)
EP 722
EP 736
EP 711 (Sub-No. 1)
EP 704 (Sub-No. 1)

STB Ex Parte No. 740

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***PETITION BY THE WESTERN COAL TRAFFIC LEAGUE TO TERMINATE THE
REGULATORY FREEZE IN FOUR PENDING PROCEEDINGS***

**COMMENTS OF
NORFOLK SOUTHERN RAILWAY COMPANY**

ENTERED
Office of Proceedings
August 31, 2017
Part of
Public Record

In response to the petition (the “Petition”) filed by the Western Coal Traffic League (“WCTL”) in this proceeding, Norfolk Southern Railway Company (“Norfolk Southern”) joins the comments of the Association of American Railroads and also files these separate comments to address the Petition’s rationale for calling upon the Board to rush its consideration of EP 711 (*Reciprocal Switching*), EP 722 (*Railroad Revenue Adequacy*), and EP 736 (*InterVISTAS Study*).¹ For the reasons set forth below, there is no substantive basis to grant the relief sought by WCTL in any of these proceedings, much less to do so quickly.

The Petition is premised on the notion that the proceedings in *Reciprocal Switching*, *Railroad Revenue Adequacy*, and *InterVISTAS Study* are necessary “to address fundamental inequities in the Board’s current regulation of railroads.” Petition at 2. But careful examination reveals that this premise is false. Specifically, with respect to *Reciprocal Switching*, WCTL laments that the Board “arbitrarily preclude[s] shippers from obtaining reciprocal switching relief,” but it is far from “arbitrary” to require a shipper to demonstrate a market failure before awarding the extraordinary remedy of forced switching. As to *Railroad Revenue Adequacy*,

¹ These comments do not specifically address EP 661 (Sub-No. 2) (Rail Fuel Surcharges) because Norfolk Southern has not individually participated in that proceeding.

WCTL complains that the Board “provide[s] no guidance to shippers on how to properly apply the Board’s revenue adequacy constraint,” which incorrectly presupposes that a constraint on railroad rates based on firm-wide revenue adequacy is sound economic policy in the first instance. Finally, as to *InterVISTAS Study*, WCTL decries that the Board “provide[s] no meaningful maximum rate protections for many shippers,” which is at best an odd reaction to an independent report commissioned by the Board that supports the Board’s existing rate reasonableness tests and provides no support for altering them.²

1. The Petition is incorrect that it is “arbitrary” to require a shipper to demonstrate a market failure before awarding the extraordinary remedy of forced switching.

Under the current standard for obtaining forced switching, which the Petition describes as “arbitrary,” a shipper must demonstrate that a railroad engaged in anticompetitive conduct by using its market power to extract unreasonable terms, deprive a shipper of a more efficient route, or disregard the shipper’s needs by rendering inadequate service. *Midtec Paper Corp. v. I.C.C.*, 3 I.C.C.2d 171, 181-82 (1986) (“*Midtec II*”). Far from being “arbitrary,” the current standard evolved over decades of carefully balanced policy considerations. As Norfolk Southern explained in its comments in EP 711:

The ICC recognized the statutory right of a carrier to the long haul. The ICC therefore understood that forcing an alternative through route, switching, or terminal access was only appropriate as a remedy for anticompetitive conduct. See *Midtec II*, 3 I.C.C.2d at 181-82. And the ICC made it clear that forced access could not be used as an alternative to rate regulation. *Midtec Paper Corp. v. I.C.C.*, 1 I.C.C.2d 362, 365 (1985) (“*Midtec I*”); see also *Entergy Arkansas, Inc. & Entergy Services, Inc. v. Union Pac. R.R. Co. et al.*, Docket No. 42104, at 15 (served March 15, 2011) (“[T]he competitive access rules were promulgated not to provide shippers with an alternative form of rate relief, but to offer a competitive remedy where a bottleneck carrier has exploited its market power.”). The agency understood that using forced access as alternative rate regulation would fundamentally restructure the freight rail industry and undermine one of the central objectives of the Staggers Act – permitting demand-based differential

² See *InterVISTAS, An Examination of the STB’s Approach to Freight Rail Rate Regulation and Options for Simplification* (Sept. 14, 2016) (“*InterVISTAS Report*”).

pricing. If a railroad was providing reasonable single-line service over an efficient route, at reasonable rates, the ICC wisely would not intrude.

Opening Comments of Norfolk Southern Railway Company, STB Docket No. EP 711 (Sub-No. 1), at 9.

Not only is the Petition wrong that the current standard for obtaining forced switching is “arbitrary,” as Norfolk Southern explained in its comments in EP 711, the Board’s proposal in EP 711 is unjustified, unlawful and unwise. See *Id.* First, the Board’s proposal in EP 711 provides no adequate justification for reversing longstanding policies that have engendered serious reliance interests. The Board’s proposal also is an unlawful, backdoor attempt to use forced access provisions to achieve lower rates in violation of judicial precedent and congressional directives. And the Board’s proposal ignores the adverse impacts it would cause on the financial health of the industry, rail operations and efficiency, and future investments. Moreover, the Board’s vague compensation proposals violate the Staggers framework, sound economic principles, and the Constitution by denying a railroad the ability to engage in lawful differential pricing to recover the joint and common costs of its network necessary for long-term investment and a safe and efficient rail system. See *Id.*

Rather than hasten the pace of EP 711, the Board should abandon this ill-conceived proposal to re-write the reciprocal switching rules (and upend the railroad industry in the process).

2. The Petition incorrectly presupposes that a constraint on railroad rates based on firm-wide revenue adequacy is sound economic policy.

The Petition asks the Board to rush forward into a consideration of EP 722 to provide “guidance to shippers on how to properly apply the Board’s revenue adequacy constraint.”

Petition at 2. The revenue adequacy constraint that the Petition is in a hurry for guidance on has

been on the books in an unaltered state since it was established by the ICC in 1985, and has never been applied to a railroad nor had its economic validity reviewed by a court.³ In point of fact, the independent, top-down revenue adequacy constraint should be abandoned for the six reasons explained by Norfolk Southern in its comments in EP 722:

1. Earning a return on investment equal to a firm's cost of capital is the minimum necessary to attract and maintain capital and, therefore, is inappropriate as a ceiling on earnings.

2. SAC and Simplified SAC already serve as "revenue adequacy" constraints targeted to the traffic served by a complaining shipper rather than a carrier's system wide health, and there is no rational justification for forcing rates lower than those adjudged reasonable under SAC or Simplified SAC.

3. A top-down revenue adequacy constraint is pure rate-of-return regulation, and this kind of regulation has been discredited in the years since the ICC adopted it in 1985 due to the incentive problems it engenders.

4. The incentive problems of rate-of-return regulation would stifle innovation, productivity, capital investments, and competition in the railroad industry.

5. Technical obstacles – such as measurement errors in annual revenue adequacy findings due to, among other things, the failure to use current replacement costs, and the fact that a revenue adequacy constraint would be plagued by inevitable prohibited internal cross-subsidies – doom the use of a top-down revenue adequacy constraint.

³ See *Consolidated Rail Corp. v. U.S.*, 812 F.2d 1444 (3d Cir. 1987). The revenue adequacy constraint was applied in one pipeline case, but in that case the appellant made clear that it was challenging the Board's application of the constraint and not the constraint itself. *CF Indus., Inc. v. Surface Transp. Bd.*, 255 F.3d 816 (D.C. Cir. 2001); see *CF Industries, Inc. v. Koch Pipeline Co., L.P.*, 4 S.T.B. 637 (2000).

6. The existing rate regulatory regime constrains the rates that railroads offer to shippers on the front-end because railroads know that rates will be found unreasonable if they would not pass muster under SAC and Simplified SAC.

Accordingly, rather than rushing to provide guidance to shippers on how to apply a revenue adequacy constraint, the STB should continue to pursue its statutory mandate to assist railroads in achieving revenue adequacy. Further, it should use the EP 722 proceeding to abolish the revenue adequacy constraint altogether because the STB already has the most economically sound tests for rate reasonableness, as confirmed by the InterVISTAS Report.

3. The InterVISTAS Report does not support the Petition's claim that the Board "provide[s] no meaningful maximum rate protections for many shippers."

The Petition claims that what is at issue in *InterVISTAS Study* is the notion that STB rules "provide no meaningful maximum rate protections for many shippers." Petition at 2. The InterVISTAS Report acknowledges that "[s]ome shippers have complained that STB's rate-review process is inaccessible to them," and that the STB has recognized this issue. *See* InterVISTAS Report at 2. But the InterVISTAS Report does not conclude that these complaints are valid.

To the contrary, the InterVISTAS Report found that the SAC test "has stood the test of time," while acknowledging that the Three-Benchmark and Simplified-SAC approaches "may be a better option for shippers in many cases." *Id.* at 134. The InterVISTAS Report also found that "simplification of either the Three-Benchmark or Simplified-SAC tests risks moving the approaches further away from the bedrock CMP principles, undermine the reliability of the tests, and would not necessarily incentivize shippers to use those tests." *Id.* at xvii. In looking at alternative rate regulatory regimes used in other industries and other countries, the InterVISTAS Report concluded that the only alternative to these tests that might work in the railroad industry

is an access regime, but that “(a) the shipper would lose access to maximum rate regulation, (b) there would still need to be a regulator to set carrier-to-carrier access prices, and (c) unless Congress is willing to abandon carrier revenue adequacy as a major objective, the rate reasonableness methodology for access charges will still be SAC or some equivalent for the most common disputes, such as coal rates.” Id at 134.

Taking all of this into account, the Petition’s desire to rush the Board into action on EP 736 is curious given that the InterVISTAS Report provides strong support for the Board’s existing rate reasonableness tests and no support for altering them.

* * *

As demonstrated above, the Petition’s substantive complaint that EP 711 (*Reciprocal Switching*), EP 722 (*Railroad Revenue Adequacy*) and EP 736 (*InterVISTAS Study*) are necessary to address “fundamental inequities” is unfounded. And, given that the Petition’s rationale is baseless, its call for speedy deliberation is equally dubious. Instead, the Board should heed the comments filed by the Association of American Railroads and not move forward with these proceedings in haste.

Respectfully Submitted,

A large, stylized handwritten signature in black ink, appearing to read 'John M. Scheib', is written over a horizontal line.

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