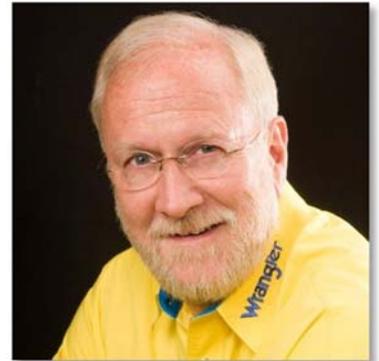


# STB HEARING REPORT

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## Hearing on Ex Parte No. 722, Revenue Adequacy before The Surface Transportation Board

### Backgrounder:

Simply put, the ICC/STB set a standard called Revenue Adequacy for the U.S. Railroads called for in the Staggers Rail Act of 1980 – that when the revenues of the railroads covered their full cost of capital – they, the railroad would be ‘Revenue Adequate’. In the meantime the railroads would be allowed to differentially price (charge higher) rail rates on captive shippers (non-competitive situations) until they, the railroad, reached Revenue Adequacy. Therefore the captive shippers have, over the years, been bearing a higher revenue base to increase the U.S. Railroad revenues. The “good” news is that 6 of the 7 major railroads have become ‘revenue adequate’ and this proceeding by the STB upon petition by the Western Coal Traffic League was initiated to establish STB policies on revenue adequacy – and differential pricing going forward. Representatives of the Western Coal Traffic League, which successfully filed the underlying petition urging the STB to review the

agency's methodology for determining whether a railroad is revenue adequate to ensure it better measures the financial health of the rail sector, urged the STB to revise its approach to rate rail regulation, both now and prospectively.

## **Ex Parte No. 722 - Hearing**

Rail carriers and shipper representatives presented starkly contrasting views on the degree to which railroads should be able to continue to differentially price rail service to captive shippers once they reach revenue-adequate status during a July 22-23, 2015 hearing conducted by the Federal Surface Transportation Board (STB).

The ICC adopted Constrained Market Pricing five years after Staggers Rail Act passed in 1980, in a case entitled Coal Rate Guidelines, Nationwide, establishing the Stand-Alone Cost ("SAC") test used by captive utility coal shippers to obtain rate relief. The idea behind this ruling was that one of the major goals of the Staggers Rail Act was to increase the financial viability of the railroads while also protecting those shippers that were or would become captive. However, it would be more than a decade later, and sixteen years after Staggers, before the Board issued a rate reasonableness methodology designed for the more than 90% of captive rail shippers (including grain) for whom SAC cases are prohibitively expensive or otherwise ineffective. See Ex Parte No. 347 (Sub-No.2), Rate Guidelines – Non-Coal Proceedings, 1 S.T.B. 1004 (1996).

That decision came out at the end of 1996 **only because Congress**, in the ICC Termination Act of 1995, **gave the Board a deadline for establishing a**

**“simplified and expedited method for determining the reasonableness of challenged rail rates in those proceedings in which a full stand-alone cost presentation is too costly, given the value of the case.”** 49 USC

10701(d)(3). The Three-Benchmark test first adopted in 1996 has not been workable for grain shippers and producers, or for many other smaller captive shippers, despite subsequent modifications to the test.<sup>1</sup>

The statute commands that all rates on captive traffic must be reasonable. It also requires “a simplified and expedited method for determining the reasonableness of rail rates in those cases in which a full stand-alone cost case is too costly, given the value of the case.” 49 USC Section 10701(d)(3).

But the Association of American Railroads (AAR), rail carrier representatives and their academic economists and cost consultants argued at the hearing, that merely because railroads are or are becoming revenue adequate should have absolutely no bearing on whether they should be restricted from imposing differential pricing on captive shippers or other rail customers and this Board (STB) should not follow the ICC/STB regulatory standards outline in 1996 in Ex Parte No. 347 (Sub-No.2), Rate Guidelines – Non-Coal Proceedings, 1 S.T.B. 1004 (1996). Regulating revenue-adequate railroads’ overall revenue, either by capping excessive rates imposed on captive shippers or by providing rebates to such shippers at some level would be tantamount to implementing price controls, the AAR argued. AAR

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<sup>1</sup> See the decisions in EP 646 (Sub-No.1), Simplified Standards for Rail Rate Cases, served September 5, 2007, in which the Board adopted Simplified SAC (“SSAC”) as an alternative to Three-Benchmark, and EP 715, Rate Regulation Reforms, served July 18, 2013, in which it raised the Three-Benchmark relief cap.

stated that revenue adequacy instead should be viewed solely as an “***aspirational goal***” that provides “some understanding of railroads’ economic health,” rather than representing any type of “trigger” for constraining rail rates, revenues or rail pricing practices. The AAR trying to influence the STB in the public domain ran ads in local papers in DC outlining their positions all week during the hearings.

“Now comes a handful of (shipper) interest groups that want you (the STB) to cut their transportation costs by direct government intervention at the expense of the greater good,” testified AAR President Ed Hamberger. “Let’s call it what it is: they want you to institute a regime of wide-ranging price controls on freight railroads,” adding that such a development would represent a threat to the future of the U.S. economy.

The AAR’s Hamberger contended that any overreaching regulation of rail rates tied to revenue adequacy would undermine the rail industry’s ability to improve rail safety, efficiency and reliability; increase U.S. exports; support U.S. energy independence; and effectively provide a “health rail network relied upon by millions of daily Amtrak and commuter rail passengers.”

Shipper representatives countered that the AAR offered no solutions to the flaws in the STB’s current methodology for determining rail revenue adequacy, and instead was proposing to negate the statutory concept adopted in 1996 from having any meaning or consideration at the agency. Shipper representatives estimated that no more than 20 percent of rail traffic volume would even be subject to potential rate challenges – consisting of the 5 percent of traffic currently eligible plus the approximately 14 percent of

traffic that currently is ineligible because it is hauled under rail contracts (which are exempt from STB review), but which could shift to tariff rates if there was a perceived benefit by shippers to subject them to STB oversight. Shippers also reminded the STB that this movement to shifting the burden from captive shippers to the railroads was right in line with ICC/STB promised made in Ex Parte No. 347 (Sub-No.2), Rate Guidelines – Non-Coal Proceedings, 1 S.T.B. 1004 (1996) and it is time that railroads be required to lift this differential pricing in future rates on captive shippers.

Under the Staggers Rail Act, rail users are authorized to challenge rates for revenue-adequate railroads that have market dominance and whose rates exceed 180 percent of the variable cost of providing the service. The AAR argued that there was no legal basis under the Staggers Act that creates an “expectation that differential pricing would be abated once a railroad reaches revenue adequacy.

The Alliance for Rail Competition/Montana Wheat and Barley Committee representing 15 other entities<sup>2</sup> sought balance between STB promotion of railroad revenue adequacy and protection against excessive rates for captive shippers needs to be adjusted to meet changing realities. “While new access remedies are a step in the right direction, they are not a substitute for implementation of an effective revenue adequacy constraint.”

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<sup>2</sup> Montana Wheat and Barley Committee, Colorado Wheat Administrative Committee, Oklahoma Wheat Commission, South Dakota Wheat Commission, Washington Grain Commission, Oregon Wheat Commission, Idaho Barley Commission, Idaho Wheat Commission, Wyoming Wheat Marketing Commission, Nebraska Wheat Board, and Texas Wheat Producers Board and Montana Farmers Union.

“For more than 30 years, the Railroads, uniquely in this country, have successfully avoided effective regulation and neutralized effective competition (through mergers and paper barriers) by arguing that they were revenue inadequate” stated ARC et al. “In the early years, such arguments may not have been meritless, particularly given the statutory directive to help railroads achieve revenue adequacy. However, Congress did not intend or provide for complete deregulation of monopoly railroads even when they were far weaker financially than they are today, and the ICC and STB have always recognized that “a rate may be unreasonable even if the carrier is far short of revenue adequacy”. Rate Guidelines – Non-Coal Proceedings, 1 S.T.B. 1004, 1017 (1996). Nevertheless, successive decisions in ICC and STB rulemaking proceedings resulted in regulation that offered effective rate relief to too few shippers in too few cases.”

“From the Railroads’ perspective, conditions were ideal for growth and profitability. Neither competition nor regulation significantly affected rail rates on captive traffic, or rail practices or rail service. Railroads could and did act as monopolists, charging whatever the traffic would bear for service on the Railroads’ terms.”

The STB commissioners, while reserving judgment, did appear to generally indicate that a review was necessary. Newly reinstated STB Chairman Dan Elliott opened the hearing by noting that the nation was in the midst of a “rail renaissance” and financially healthy, and that he had initiated the proceeding to review the STB’s core policies to see if they remained appropriate to this new environment. Vice Chairman Ann Begeman noted she had definite views on the subject, but was remaining “open minded” and not looking “to turn the clock back on the rail industry.” Meanwhile, the newest STB member, Debra Miller, stated that it was “time to give meaning to the concept of revenue adequacy” and reiterated her earlier statements made at the June 10<sup>th</sup> STB hearing at which the NGFA and ARC et al testified on the agency’s grain rail rate proceeding that it was time to review revenue adequacy and rail rate policy in the context of other ongoing STB proceedings, including one on competitive switching.