BEFORE THE

SURFACE TRANSPORTATION BOARD

Docket No. EP 761

HEARING ON REVENUE ADEQUACY

Docket No. EP 722

RAILROAD REVENUE ADEQUACY

AMERICAN FUEL & PETROCHEMICAL MANUFACTURERS TESTIMONY

I. INTRODUCTION

American Fuel & Petrochemical Manufacturers ("AFPM") respectfully submits its testimony for this Hearing on Revenue Adequacy. On September 12, 2019, the Surface Transportation Board ("STB" or "Board") issued a Notice of Public Hearing ("Notice") for December 12, 2019 on revenue adequacy issues raised in the report issued by the Board's Rate Reform Task Force ("RRTF"). AFPM sincerely thanks the Board for having this hearing on a matter that is extremely important to our members. Presently, AFPM members have limited to no feasible recourse when a rate is unreasonable and commends the Board for attempting to find better ways to challenge a rate in this proceeding and in the Final Offer Rate Review and Market Dominance Streamlined Approach proceedings.[1]

In January 2018, the Board established the RRTF with the objectives of developing recommendations to reform and streamline the Board's rate review process for large cases and determining how to best provide a rate review process for smaller cases. After holding informal meetings throughout 2018, the RRTF issued a report on April 25, 2019 ("RRTF Report"). The RRTF Report recommended, among other things, that the Board consider policy changes regarding revenue adequacy.[2]

In the Notice, the Board asked interested persons to provide input on the RRTF's recommendations regarding railroad revenue adequacy. The Board specifically asked participants to address the following RRTF recommendations in their written testimony at the hearing:

- ***Definition of long-term revenue adequacy:*** The RRTF recommended determining long-term revenue adequacy by looking at the annual determinations over "the shortest period

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1 *See* Comments of the American Fuel & Petrochemical Manufacturers, STB Docket No. EP 755 "Final Offer Rate Review" and STB Docket No. EP 655 (Sub-No.2) "Expanding Access to Rate Relief."

2 *See* "Rate Reform Task Force, Report to the Surface Transportation Board" ("RRTF Report") pages 12-13, 32-42. Published April 25, 2019, https://www.stb.gov/stb/rail/Rate_Reform_Task_Force_Report.pdf.

of time, not less than five years, that includes both a year in which a recession began and a year that follows a year in which a recession began."[3]

- ***Rate increase constraint:*** The RRTF recommended considering a rate increase constraint for long-term revenue-adequate carriers, which would identify a point beyond which further application of differential pricing would be unwarranted.[4]

- ***Bottleneck changes:*** The RRTF recommended considering suspension of the Board's Bottleneck protections as applied to long-term revenue-adequate carriers.[5]

- ***Simplified Stand-Alone Cost (Simplified-SAC) changes:*** For purposes of considering whether a long-term revenue-adequate carrier's rate is reasonable under Simplified-SAC, the RRTF recommended reinstating the simplification of the Road Property Investment analysis.[6]

II. AFPM INTEREST IN THIS PRECEDING

AFPM is a trade association representing virtually all the U.S. refining and petrochemical manufacturing capacity. Our members produce the fuels that drive the U.S. economy and the chemical building blocks integral to millions of products that make modern life possible. To produce essential goods, AFPM members rely on a safe, reliable and efficient rail system to move materials to and from refineries and petrochemical facilities. Rail transportation is vital to our members, as well as to manufacturers and customers downstream who depend on our products. Approximately 3.7 million carloads of our members' feedstocks and products — crude oil, natural gas liquids, refined products, plastics, and synthetic resins — were delivered by rail in the U.S. in 2018.[7] To that end, three principles guide AFPM's efforts around transportation and infrastructure issues impacting our members:

1. Safety & Security - Ensure the ability to ship feedstocks and products, safely and securely.
2. Free & Open Markets - Promote free and open energy markets that benefit the economy.
3. Ability to Build & Repair - Ensure the ability to build, use, repair, maintain and replace energy infrastructure.

Refineries and petrochemical manufacturers across the country rely on a healthy rail network as an essential part of their supply chains. Over 75% of refiners and petrochemical manufacturers are served by a single railroad (e.g., captive) and thus have been negatively impacted by excessive freight rail rates, escalating and poorly communicated demurrage and

3 *Id.* 13, 33.
4 *Id.* 13, 36 39.
5 *Id.* 13, 39-41
6 *Id.* 13, 41-42, & app. B.
7 Rail Traffic Data - Association of American Railroads. (2019). Retrieved from https://www.aar.org/datacenter/rail-traffic-data/

accessorial fees, and a lack of competitive rail service for too long.[8] The STB's revenue adequacy inquiry, along with other concurrent proposed reforms, are a positive step toward improving how the STB addresses freight rail rate reasonableness issues. AFPM is eager to work with the STB on modernizing and streamlining outdated regulations.

AFPM acknowledges that the STB has an important oversight role in reviewing the impact of freight rail policies on rail shippers and is encouraged that the STB is seeking ways to improve the rate dispute process in line with the intent of Congress.[9] While in this testimony we provide comments on revenue adequacy, we encourage the STB to examine any, and all, rate review improvements at its disposal. AFPM is encouraged by the objectives of this inquiry; however, we have also offered our comments to the Final Offer Rate Review and Market Dominance Streamlined Approach proposals.[10] We look forward to working with you to address these challenges.

III. DEFINITION OF LONG-TERM REVENUE ADEQUACY

The first recommendation the Board asks AFPM to address is the definition of long-term revenue adequacy. As noted, the RRTF recommended determining long-term revenue adequacy by looking at the annual determinations over "the shortest period of time, not less than five years, that includes both a year in which a recession began and a year that follows a year in which a recession began."[11] Generally, AFPM is supportive of this approach but suggests broadening it to ensure it captures all revenue adequate carriers that are financially healthy by adding the right for affected parties to submit additional probative evidence on revenue adequacy and an STB-determined range around the cost of capital calculation that would take into account the inexact nature of the process.

Under 49 U.S.C. § 10701(d)(2), when determining whether a rate is reasonable, the Board is directed to give due consideration to three factors, recognizing the policy that "rail carriers shall earn adequate revenues." The Board is required to "annually determine which rail carriers are earning adequate revenues."[12] This annual determination is distinct from long-term revenue adequacy, which "calls for a company, *over time*, to average return on investment equal to its cost of capital."[13]

Each year, the Board determines the railroad industry's cost of capital and then uses this figure in a variety of regulatory proceedings, including the annual determination of railroad

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8 See Escalation Consultants, "Competition at U.S. Freight Rail Stations by State." https://railvoices.org/wpcontent/uploads/2012/12/US-Map.pdf. Accessed October 24, 2019.
9 See ICC Termination Act of 1995 (Public Law 104-88) and Surface Transportation Board Reauthorization Act of 2015 (Public Law 114-110).
10 *See* Comments of the American Fuel & Petrochemical Manufacturers, STB Docket No. EP 755 "Final Offer Rate Review" and STB Docket No. EP 655 (Sub-No.2) "Expanding Access to Rate Relief." *See* Comments of the American Fuel & Petrochemical Manufacturers, STB Docket No. EP 756, "Market Dominance Streamlined Approach."
11 *See* RRTF Report 13, 33.
12 *See* 49 U.S.C. § 10704(a)(3); *see e.g.,* R.R. Revenue Adequacy—2017 Determination, EP 552 (Sub-No. 22) (STB served Dec. 21, 2018).
13 *See* Coal Rate Guidelines, Nationwide, 1 I.C.C.2d 520, 536 (1985).

revenue adequacy. The Board calculates the cost of capital as the weighted average of the cost of debt and the cost of equity. While the cost of debt is observable and readily available, **the cost of equity (the expected return that equity investors require) can only be estimated.** [14] Thus, "estimating the cost of equity requires relying on appropriate finance models."[15]

As the Board has stated previously, **there is no single simple or correct way to estimate the cost of equity for the railroad industry**, and many model options are available.[16] The Board has acknowledged that "by using multiple models that are based on different perspectives and rely on different inputs, the Board benefits because anomalies affecting one model are less likely to affect the other."[17] The Board has previously determined that a methodology that uses multiple models is more robust than a methodology that utilizes only one model, not because one model is "conceptually or pragmatically superior to the other," but rather because each has different strengths and weaknesses.[18] Since 2009, the Board has found that the simple average of the Capital Asset Pricing Model ("CAPM") and the Morningstar/Ibbotson Multi-Stage Discounted Cash Flow Model ("MSDCF") has produced a reasonable estimate of the cost of equity used to gauge the financial health of the railroad industry.

This annual cost of capital determination has been the subject of much controversy and debate over the years, including various challenges and changes to the process. In fact, the Board presently has a proceeding pending before it in EP 664 (Sub-No. 4), Revisions to the Board's Methodology for Determining the Railroad Industry's Cost of Capital, regarding a proposal to incorporate an additional model, called the "Step MSDCF" to complement its use of the CAPM and Morningstar/Ibbotson MSDCF approaches. AFPM is supportive of the proposed rule in this proceeding but urges the Board to have some additional flexibility in its approach when determining long-term revenue adequacy instead of closely following these annual determinations that the Board concedes are not exact because the cost of equity determination is merely an estimate.

In making a decision regarding long-term revenue adequacy, the Board should consider that most economists and financial analysts presently do not consider any Class I railroad to be revenue inadequate. In a congressionally mandated report, a distinguished committee of economists put together by the Transportation Research Board ("TRB') declared their belief that the rail industry is now revenue adequate.[19] It even recommended that the STB discontinue issuing annual reports on the revenue adequacy of individual railroads and replace them with periodic studies of economic and competitive conditions in the rail industry. [20] Moreover, the

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14 *See* Methodology to be Employed in Determining the R.R. Indus.'s Cost of Capital, EP 664, slip op. at 3 (STB served Jan. 17, 2008).
15 *See* Pet. of the W. Coal Traffic League to Inst. a Rulemaking Proceeding to Abolish the Use of the Multi-Stage Discounted Cash Flow Model in Determining the R.R. Indus.'s Cost of Equity Capital, EP 664 (Sub-No. 2), slip op. at 2 (STB served Oct. 31, 2016).
16 *See* Use of a Multi-Stage Discounted Cash Flow Model, EP 664 (Sub-No. 1), slip op. at 15; see also Pet. of the W. Coal Traffic League, EP 664 (Sub-No. 2), slip op. at 2, 20 (STB served Oct. 31, 2016)
17 *See* Pet. of the W. Coal Traffic League, EP 664 (Sub-No. 2), slip op. at 3 (STB served Apr. 28, 2017)
18 *See* Pet. of the W. Coal Traffic League, EP 664 (Sub-No. 2), slip op. at 11 (STB served Oct. 31, 2016)
19 National Academies of Sciences, Engineering, and Medicine 2015. *Modernizing Freight Rail Regulation*. Washington, DC: The National Academies Press. https://doi.org/10.17226/21759.
20 National Academies of Sciences, Engineering, and Medicine 2015. *Modernizing Freight Rail Regulation*. Washington, DC: The National Academies Press. Page 212, https://doi.org/10.17226/21759.

U.S. Senate Commerce Committee issued a report, "*The Current Financial State of the Class I Freight Rail Industry"*, in 2010, that found the railroad industry to be revenue adequate and that "the goal of restoring the financial health of the rail industry has been achieved." .[21]

In fact, CSX in May of this year had its stock price top $80, increasing from a price of $14 in December of 2007. Moreover, CSX's operating ratio in 2018 reached an all-time low of 58.7%. However, the Board recently in a revenue adequacy constraint rate case found CSX not to be revenue adequate despite its obvious good health.[22] While CSX was close to being revenue adequate in the Board's annual determinations during the present business cycle, it never achieved that standard which resulted in this confusing finding of revenue inadequacy despite the railroad's skyrocketing stock price and record low operating ratio.

Now, as noted, the Board proposes to define long-term revenue adequacy by looking at these annual determinations over "the shortest period of time, not less than five years, that includes both a year in which a recession began and a year that follows a year in which a recession began."[23] While this approach is compelling in its straightforwardness and simplicity, CSX still would not have been found to be revenue adequate if the Board had used this approach in Consumers. Obviously, this result seems irrational and needs to be fixed in some fashion.

Consequently, AFPM urges the Board to use its proposed test, but it should add in two additional parts. First, AFPM suggests that the Board accept additional probative evidence of revenue adequacy or inadequacy to be submitted by the parties in these cases. This suggestion follows the existing precedent in these types of proceedings regarding revenue adequacy which permits this type of evidence.[24] However, the Board should reevaluate how it could possibly find a company like CSX to be revenue inadequate despite receiving ample additional evidence of its extremely good financial health. Otherwise, the revenue adequacy constraint may lie fallow like the Stand-Alone Cost constraint presently does.

One way to ensure that railroads are considered to be revenue adequate when they are earning a return just below the cost of capital standard is to create a range around this number. AFPM suggests the board consider a sliding range that is dependent upon the debt rating for the railroads from the various rating agencies. For example, if Moody's gave an investment grade rating to a railroad then the range could be 5% or if the debt rating for a railroad is not investment grade then the range could be lower at 2%.

While some may suggest this method "double counts" the cost of debt and underweights the cost of equity for the existing capital structure, AFPM notes that many of the railroads have an investment grade rating due to their low debt to equity ratios. This means that the existing cost of capital method results in an artificially high value because the railroads would not need to issue equity – instead they would only issue debt. Investment grade railroads have a

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21 U.S. Senate Committee on Commerce, Science, & Transportation, "*The Current Financial State of the Class I Freight Rail Industry"* published September 15,2010 https://www.commerce.senate.gov/2010/9/the-current-financial-state-of-the-class-i-freight-rail-industry

22 *See* Consumers Energy Company v. CSX Transportation, Inc., NOR 42142, slip op. at 21 (STB served Jan. 11, 2018 and updated Mar. 14, 2018)

23 *See* RRTF Report 13, 33

24 *See* Consumers, slip op. at 5-6.

conservative capital structure that means that the cost of capital calculation is too high and the burden on shippers in rate case is excessive. Further, while the cost of debt is observable and readily available, the cost of equity (the expected return that equity investors require) can only be estimated. AFPM also suggests the minimum range be set at 2% as this would have resulted in the correct finding in Consumers and would fix a clear flaw in the process.

AFPM again commends the Board for having this discussion about a standard when a railroad is considered to be long-term revenue adequate. However, it urges the Board to consider all probative and competent evidence when reaching this result and to provide some flexibility in making this determination by establishing some type of cost of capital range when deciding whether a railroad earned its cost of capital over a business cycle.

IV. RATE INCREASE CONSTRAINT

As noted, the RRTF recommended considering a rate increase constraint for long-term revenue-adequate carriers, which would identify a point beyond which further application of differential pricing would be unwarranted.[25] The RRTF reasoned that "the purpose of this proposal is 'to maintain reasonable rates where there is an absence of effective competition and where rail rates provide revenues which exceed the amount necessary to maintain the rail system and to attract capital.'"[26] AFPM again thanks the Board for this opportunity to discuss this recommendation, which provides a form of relief for rail shippers when long-term revenue adequacy is found.

The RRTF explained that this constraint is an identification of the point at which the existing application of differential pricing is enough. However, in applying this constraint, the Board would not rebate any money to shippers and would not reduce the rates shippers are currently paying beyond the level identified. Moreover, carriers could continue to charge their existing rates to their existing customers; the constraint would impose no change on their existing rate structure. For shippers whose rates exceed the rate increase constraint, carriers would be forbidden from raising non-contract, non-exempt rates by more than the rate of inflation, as measured by Railroad Cost Recovery Factor (RCAF-U).[27] Long-term revenue adequate carriers would be free to raise non-contract, non-exempt rates below the threshold, but only up to the threshold, not beyond it. No constraint would be enforced as to commodities or services that are exempt or pursuant to a contract as described in 49 U.S.C. § 10709(a). The

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25 *See* RRTF Report 13, 36-39.

26 RRTF Report 36 (quoting 49 U.S.C. § 10101(6)); see also Coal Rate Guidelines, 1 I.C.C.2d at 535-36 ("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 this 'revenue adequacy' level. 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 capable of meeting its current and future service needs.")

27 The Railroad Cost Recovery Factor is a forecast index of U.S. railroad expenses that is developed by the Association of American Railroads (AAR) and approved by the Board. It is published quarterly. The Board's predecessor, the Interstate Commerce Commission (ICC), outlined the procedures for calculating the all-inclusive index of railroad input prices and the method for computing the rail cost adjustment factor in Railroad Cost Recovery Procedures, 1 I.CC.2d 207 served in 1984.

threshold level would vary based on the category of transportation and would rise and fall each year as the carrier's revenue above the long-term revenue adequacy threshold rises or falls.[28]

In other words, the Board would prospectively constrain long-term revenue adequate railroads from raising rates but would not provide a shipper any relief from an existing unreasonable rate prospectively or retrospectively. While this constraint would be an extremely useful tool for shippers to help them control the unreasonable rate increases which seem to have become a matter of course in the rail industry, it would not solve the existing or past problem of an unreasonable rate. As a result, AFPM urges the Board to adopt this constraint and also to make competitive access more available to shippers as discussed in the following section. AFPM does acknowledge there will be a limited number of scenarios in which a rate cap may need to be waived. STB should consider such scenarios and tie increases to an index except when the operator has an investment outside of normal business to support new business requirements.

V. BOTTLENECK CHANGES

The RRTF recommended considering suspension of the Board's Bottleneck protections as applied to long-term revenue-adequate carriers.[29] AFPM applauds this proposal and only asks the Board to take one further step by also making reciprocal switching more available to shippers by using a more equitable standard to obtain this relief than the existing competitive harm standard when applied to long-term revenue-adequate carriers.[30]

As background, "competitive access" refers to inter-railroad cooperative arrangements under which railroads participate in "through routes" with other railroads, offer shippers "joint rates" on such routes, use other railroads' terminal trackage facilities, and "switch" cars in the service of other railroads to and from track sidings where shippers are located. A through route is an arrangement under which a shipment is transported to its ultimate destination by two or more railroads in succession.

After the enactment of the Staggers Rail Act of 1980, the Interstate Commerce Commission ("ICC") adopted regulations regarding competitive access substantially similar to a proposal submitted by joint agreement between certain shippers and railroads.[31] These regulations set out the standards the ICC and now the Board use in determining whether to prescribe through routes and joint rates, and establish switching arrangements: the ICC will step in only where necessary to remedy or prevent acts that are "contrary to the competition policies of 49 U.S.C. [Sec.] 10101a or [are] otherwise anticompetitive."[32] Since the enactment of this strict regulatory standard, shippers have rarely utilized this remedy because it has been proven unattainable.

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28 *See* RRTF Report 36-37.
29 *See* RRTF Report 13, 39-41.
30 AFPM continues to support the Board's reciprocal switching proposal in Reciprocal Switching, EP 711 (Sub-No. 1). However, it makes this suggestion for reciprocal switching here based on its uncertainty about how that matter will proceed.
31 *See* Intramodal Rail Competition, EP 445 (Sub-No. 1) (served Oct. 31, 1985).
32 *See* 49 C.F.R. Sec. 1144.5(a)(1)(i) (1986).

As mentioned above, one means of competitive access that is available to a shipper and is at issue in this recommendation is a through route under 49 U.S.C. § 10705 which is subject to the Bottleneck protections. This remedy can be used when a rail bottleneck arises. The RRTF explained that a rail bottleneck arises when more than one railroad may be involved in providing service from an origin to a destination, but only one—the bottleneck carrier—can serve either the origin or the destination. In the late 1990s, the Board handled the three Bottleneck cases,[33] in which a utility company sought to compel the bottleneck carrier to establish a "local rate" for the segment of the through movement that was served by that carrier so that the utility could combine that local rate with a rate for the remainder of the movement by another carrier. The idea was that, rather than having to challenge the full origin-to-destination rate in its entirety, as generally required by Great Northern Railway v. Sullivan,[34] the utility could create competition for the bulk of the movement and separately challenge the reasonableness of the local (bottleneck) rate, presumably resulting in lower charges overall.

In its decisions, the Board found that a shipper cannot force a bottleneck carrier to use a routing over the line of the non-bottleneck carrier without making a full-blown "competitive access" case subject to the strict regulatory test established in Intramodal Rail Competition, even if such a routing could result in lower rates. Otherwise, the Board found that a shipper could direct a bottleneck carrier that could provide origin-to-destination rail service to "shorthaul" itself by routing traffic over the lines of the non-bottleneck carrier if it obtained a rail contract under 49 U.S.C. § 10709 for the non-bottleneck segment. The Board's decisions were affirmed in MidAmerican.

Concluding that they reflected a "permissible" reading of the statute, the MidAmerican court found that the Board's Bottleneck decisions "grappled with the tension between two competing policies expressed in the Interstate Commerce Act": carrier discretion in setting rates and routing traffic[35] so that railroads could "achieve revenue adequacy by competing on a free-market basis," on the one hand; and the requirement that market-dominant carriers charge only reasonable rates[36] on the other.[37] The reviewing court's decision was based in part on the Board's conclusion that permitting the maximum differential pricing at bottlenecks would "assist[] carriers in achieving revenue adequacy."[38] Indeed, the MidAmerican court found that permitting the maximum differential pricing at bottlenecks would assist carriers in "achiev[ing] revenue adequacy by competing on a free-market basis."[39]

The RRTF stated that this rationale in the Bottleneck cases loses its force for carriers that have already achieved long-term revenue adequacy and for a part of an industry that is viewed as quite profitable.[40] The RRTF explained that given the significant improvement in the rail industry's finances, a change making it easier to require revenue-adequate carriers to short-haul

33 *See* Cent. Power & Light Co. v. S. Pac. Transp. Co., 1 S.T.B. 1059 (1996), clarified, 2 S.T.B. 235 (1997), aff'd sub nom. MidAmerican Energy Co. v. STB, 169 F.3d 1099 (8th Cir. 1999).
34 294 U.S. 458, 463 (1935).
35 *See* 49 U.S.C. § 10701(c).
36 *See* 49 U.S.C. § 10701(d).
37 169 F.3d at 1104-05.
38 *Id.* at 1107
39 *See* 169 F.3d at 1105-07.
40 *See* RRTF Report 41.

to promote competition for a portion of a movement might well be another permissible reading of the statute.[41]

AFPM believes this recommendation to make a through route more available when a carrier is found to be long-term revenue adequate is indisputably within the Board's statutory power as explained in the RRTF Report.[42] Also, because the rail industry is clearly revenue adequate, the suspension of the Bottleneck decisions (that have essentially stopped the through route remedy to this point) makes complete sense. The vibrant and healthy rail industry today and the ailing and stagnant rail industry in the 1980s are completely different environments. Therefore, due to this change in the state of the industry, the Board should implement this new standard making through routes more available by suspending the Bottleneck protections under these circumstances.

However, the Board should not stop there. Changing the standard for bottleneck situations alone would be a great first step; however, this remedy would not be as useful for some shippers as it would be for others. As the Board noted, if a shipper obtained this access, it might still have to bring a rate case to obtain relief on the shorter captive portion of the route against the incumbent carrier. Of course, the hope would be that the shipper would now have more negotiating power due to the availability of this remedy, but as the Board knows and is the point of the RRTF Report, bringing a rate case is not a simple matter and might render this proposal less effective. As a result, AFPM also believes the Board should reverse its decisions to use the existing stringent competitive access standard discussed above to obtain the reciprocal switching remedy, thereby giving shippers another option when a railroad is found to be long-term revenue adequate.

Under reciprocal switching, or as it is sometimes called, "competitive switching," an incumbent carrier transports a shipper's traffic to an interchange point, where it switches the cars over to the competing carrier. The competing carrier pays the incumbent carrier a switching fee for bringing or taking the cars from the shipper's facility to the interchange point, or vice versa, which is incorporated into the competing carrier's total rate to the shipper. Reciprocal switching thus enables a competing carrier to offer its own single-line rate to compete with the incumbent carrier's single-line rate, even if the competing carrier's lines do not physically reach a shipper's facility.

Reciprocal switching can occur as part of a voluntary arrangement between carriers, or it may be ordered by the Board. The statutory provision governing the Board's authority to order reciprocal switching arrangements was first enacted by Congress in the Staggers Rail Act of 1980,[43] That provision now states as follows:

> The Board may require rail carriers to enter into reciprocal switching agreements where it finds such agreements to be practicable and in the public interest, or where such agreements are necessary to provide competitive rail service. The rail carriers entering into such an agreement shall establish the conditions and compensation applicable to such

41 *Id.* at 40.
42 *Id. at* 40-41.
43 *See* Pub. L. 96-448, 94 Stat. 1895.

> agreement, but, if the rail carriers cannot agree upon such conditions and compensation within a reasonable period of time, the Board may establish such conditions and compensation.[44]

In 1986, the ICC decided its first reciprocal switching case under the strict competitive access regulations discussed above. In Midtec Paper Corp. v. Chicago & North Western Transportation Co.,[45] the ICC denied a shipper's petition for competitive access either via terminal trackage rights or reciprocal switching. In so doing, the ICC elaborated on the rules it adopted in Intramodal Rail Competition and their relation to the statute:

> (W)e think it correct to view the Staggers (Act) changes as directed to situations where some competitive failure occurs. There is a vast difference between using the Commission's regulatory power to correct abuses that result from insufficient intramodal competition and using that power to initiate an open-ended restructuring of service to and within terminal areas solely to introduce additional carrier service.[46]

Thus, although "(u)nder (§ 11102(c)), awarding reciprocal switching is discretionary," the ICC explained that the key issue under its then-new regulations was whether the incumbent railroad "has engaged or is likely to engage in conduct that is contrary to the rail transportation policy or is otherwise anticompetitive."[47]

Since adoption of the agency's stringent competitive access regulations in 1985 discussed above, the regulations have not changed substantively. Few requests for reciprocal switching have been filed with the agency since then, and in none of those cases has the Board granted a request for reciprocal switching.[48] Therefore, like with the Bottleneck cases, this competitive access remedy has been rendered somewhat useless to captive shippers since Intramodal Rail Competition and Midtec Paper Corp.

As noted, the health of the rail industry has improved substantially since these competitive access policies were imposed in 1985. In the 1980s, the rail industry was barely alive due to decades of inefficiencies and bankruptcies. In the TRB Committee Report, it was noted that "[t]he U.S. freight rail industry has undergone a remarkable transformation since the enactment of the Staggers Rail Act of 1980," and exclaimed that "the industry has evolved and the railroads' financial viability has drastically improved."[49] Therefore, for the same reasons the RRTF suggested suspending the Bottleneck decisions when a carrier is found to be long-term revenue adequate, the Board should also apply that rationale to reciprocal switching. The Board should suspend the use of a single anticompetitive standard for reciprocal switching cases when a railroad is found to be long-term revenue adequate and a less stringent standard like the one proposed in EP 711 (Sub-No. 1) or used in Canada should be applied.

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44 *See* 49 U.S.C. § 11102(c)(1) (emphasis added) (previously codified at 49 U.S.C. § 11103(c) (1980)).
45 *See* 3 I.C.C.2d 171 (1986).
46 *Id.* at 174.
47 *Id.* at 181.
48 *See* e.g., Midtec Paper Corp, 3 I.C.C.2d 171; Vista Chem. Co. v. Atchison, Topeka & Santa Fe Ry., 5 I.C.C.2d 331 (1989).
49 *See* National Academies of Sciences, Engineering, and Medicine 2015. *Modernizing Freight Rail Regulation*. Page 1-2. Washington, DC: The National Academies Press. https://doi.org/10.17226/21759.

Moreover, reciprocal switching is commonly viewed as the least intrusive of the competitive access remedies available to the Board. The less intrusive nature of this remedy, the great improvement to the health of the rail industry since the 1980s, and the complexities of a bottleneck case make the addition of this remedy a perfect fit for the Board's intent to make the regulatory process more effective for captive shippers who now have no options available.

AFPM anticipates the Class I railroads will argue that making these competitive access remedies available upon a finding of long-term revenue adequacy will be a financial and operational blow. However, one must merely look to Canada to see that the use of these remedies will have very little effect on the financial and operational health of large railroads. In Canada, "competitive line haul rates" and "interswitching" have proven to be successful policies for the protection of shippers and have had no adverse effect financially, operationally, or otherwise on the rail industry. In fact, the Canadian rail industry has long been a favorite of financial analysts with operating ratios in 2018 below 60%, generally better than their U.S. counterparts, except ironically for CSX.

Consequently, AFPM asks the Board to add this additional competitive access change to the Bottleneck cases recommendation in the event of long-term revenue adequacy by a railroad. This addition would make the Board's recommendation more effective and would provide captive shippers with the protection they need from rail market dominance. When the ICC imposed the stringent competitive harm standard for these access remedies, it did so to protect an industry that was reeling from bankruptcies and inefficient operations. Now, the rail industry has strongly recovered, and these policies of the past are no longer necessary. In fact, the pendulum has completely swung to the other side with shippers having nearly no access to rate relief or competitive access remedies that Congress intended to be used for their protection. As a result, these changes making bottleneck relief and reciprocal switching more available are crucial to a regulatory scheme that seemingly has lost its way during the rail renaissance over the past few decades.

VI. SIMPLIFIED STAND-ALONE COST CHANGES

As noted, the Board also asked for testimony on the RRTF recommendation reinstating the simplification of the Road Property Investment Analysis for purposes of considering whether a long-term revenue-adequate carrier's rate is reasonable under Simplified-SAC.[50] While AFPM is more interested in having these other recommendations discussed above being imposed, it fully supports this proposed changes to Simplified-SAC, including a streamlined Road Property Investment Analysis, which could possibly result in this process being used in the future. As mentioned in the RRTF Report, Simplified-SAC has never been litigated to a final decision. Therefore, any mechanism that might breathe some life into this process would be welcomed.

50 "Road Property Investment Analysis" refers to when the Board determines the investment that would be required to build the Stand-Alone Railroad's physical facilities in a Stand-Alone Cost rate case. The STB considers the following to determine construction costs: Land, Roadbed Preparation, Culverts, Track, Bridges, Signals & Communications, Building & Facilities, Public Improvements, Mobilization, Engineering, and Contingencies. Streamlining the analysis would potentially open the Stand-Alone Cost rate case process to more parties.

VII. CONCLUSION

AFPM once again thanks the Board for taking this important step to define when a railroad is considered to be long-term revenue adequate and to determine what regulatory action should then occur. As discussed herein, AFPM supports the recommendations by RRTF listed in the Notice but also seeks a slight broadening of the proposed long-term revenue adequacy standard and the addition of reciprocal switching to the Bottleneck protections change. With the imposition of these rules for a revenue adequacy constraint and the rules proposed in Final Offer Rate Review and Market Dominance Streamlined Approach, AFPM believes the Board will begin to be able to regulate the railroad industry in the manner Congress intended. As a result, AFPM asks the Board to take these needed steps and bring back some balance to a regulatory scheme that has failed to adequately protect railroad shippers. AFPM shares STB's goal of ensuring the flow of commerce on our nation's rail system and looks forward to continued collaboration. Please contact me at (202) 457-0480 or rbenedict@afpm.org if you wish to discuss these issues further.

Sincerely,

Rob Benedict,
Senior Director Petrochemicals, Transportation, and Infrastructure
American Fuel & Petrochemical Manufacturers