



ASSOCIATION OF
AMERICAN RAILROADS

Ian N. Jefferies

Office of the President
President and Chief Executive Officer

July 11, 2019

Honorable Ann D. Begeman
Chairman
U.S. Surface Transportation Board
325 E Street, S.W.
Washington, DC 20423-0001

Honorable Patrick J. Fuchs
Vice-Chairman
U.S. Surface Transportation Board
325 E Street, S.W.
Washington, DC 20423-0001

Honorable Martin J. Oberman
Board Member
U.S. Surface Transportation Board
325 E Street, S.W.
Washington, DC 20423-0001

Dear Chairman Begeman, Vice-Chairman Fuchs, and Board Member Oberman:

The Association of American Railroads writes with regard to the Rate Reform Task Force Report prepared by Board staff and made available publicly on April 25, 2019. In recent correspondence between the Board and members of the United States Senate Committee on Commerce, Science and Transportation, the Board invited stakeholder input as it considers next steps on the report.

AAR continues to share the Board's, and Congress's, goal of reforming the process by which rate reasonableness disputes are handled, especially for complaints brought by small customers. All agree the process for resolving the most complex of cases is – as is true for most complex litigation – long and expensive, and changes that result in a more efficient and effective process for resolving rate cases would benefit all stakeholders. As the May 23, 2019, letter from Senate Commerce Committee members reflects, reform of rate case procedures was the intent of the STB Reauthorization Act, and the Board's response stated that such reforms will be the Board's top priority and focus as it moves forward.

AAR continues to believe that the goal of improved rate reasonableness procedures is achievable. However, to make meaningful progress on that challenge in a reasonable time frame, it will be essential for the Board to listen to and seriously consider the views, inputs and ideas of *all* stakeholders, and to identify true root causes before designing or implementing new or additional fixes. As explained below, although the staff report is not encouraging in that respect, the railroads remain fully committed to participating immediately and collaboratively in that effort.

More importantly, though, it is also critical for the Board to recognize the difference between process reform intended to increase effective access to rate relief where such relief is warranted, and new regulation intended to change outcomes. Nothing in the STB Reauthorization Act changed the balanced,

market-based directives that Congress has established for the Board and that underpin the current health of the freight rail industry. It remains the case that Congress has authorized the Board to regulate only in instances of market failure. The staff report assumes both market failure and also failure of existing regulatory options from anecdotal (and often anonymous) shipper association complaints and perceptions regarding railroad financial health, and from those assumptions makes recommendations for sweeping changes to existing legal and economic principles. The Board must engage in evidence-based analysis of whether there has been a market failure and a failure of existing regulations before it can regulate and, only if actual evidence supports that conclusion, consider the appropriate regulatory response. Acting without such evidence, and instead leaping to remedies, is not only unlawful, it risks the current health and stability of the rail freight transportation network.

Rate Case Process Reform

AAR met with the RRTF in June of last year, and brought input and ideas on rate case reform to that meeting that we believe will improve the process by which rate cases are resolved, including for small customers. AAR offered specific proposals regarding the use of joint third-party experts to develop evidence outside the core competencies of the Board, and for resolving by rulemaking several recurring issues that have nothing to do with the facts of individual disputes.

AAR also suggested that the Board should investigate the existing simplified rate case methods to see why they are not being used. The Board and stakeholders have already expended significant amounts of time and resources trying to tackle this problem, and the railroads have engaged constructively in rulemakings that resulted in two alternatives to traditional SAC: Simplified SAC and the Three-Benchmark Test. Both were designed as solutions to the complexity and cost of rate cases; as the Board has observed, neither method has been widely utilized. Before devoting more resources to attempt to solve the same issue, it is appropriate for the STB to gather information, in a neutral, fair and representative way, directly from shippers about why those tools are not being used. To date, the Board has simply concluded that “for small disputes, the litigation costs required to bring a case under the Board’s existing rate reasonableness methodologies can quickly exceed the value of the case.” *Expanding Access to Rate Relief*, EP 665 (Sub-No. 2) (STB served Aug. 31, 2016).

Virtually none of AAR’s suggestions to improve the rate case process were incorporated into the RRTF recommendations. More disturbing, and uncharacteristic for the Board, the staff report lacked balance and a neutral, fact-finding tone, and instead often reported disputed shipper advocacy positions as fact without any supporting evidence. There was little if any acknowledgement of the railroads’ perspectives or suggestions, or of the railroads’ legitimate interests in ensuring that changes in rate case rules and procedures do not in fact operate to tilt the substantive tables.

Proposed Overhaul of Rate Regulation Principles

With regard to substantive principles, the report disregards the fundamental economic principles upon which the Board’s rate reasonableness procedures rest, and instead embraces antiquated and discredited notions of fully-allocated cost utility regulation. In so doing, the staff report ignores the Board’s most recently commissioned study on its rate reasonableness process, the InterVISTAS Report (Sept. 2016). After reviewing the STB’s current rate methodologies, rail rate methodologies employed by other countries, and regulatory regimes applied to other network industries, the InterVISTAS Report found: (1) the research did not point to a simpler methodology than the Board’s current three tests; (2) further simplification of Three Benchmark and Simplified SAC could undermine the reliability of those tests; and (3) full SAC has “stood the test of time as a maximum rate reasonableness methodology.” In contrast, the report’s proposals for wholesale changes to existing methodologies and new alternatives, like the so-called Incumbent Network Cost Analysis, were based on little or no factual basis, data, or deep analysis. While

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AAR finds this lack of economic analysis to be troubling throughout, AAR wishes to address in more detail two of its principal areas of concern: revenue adequacy and market dominance.

In the EP 722 proceeding, AAR set forth two principles regarding the concept of revenue adequacy. First, railroads are a vital engine of growth for the nation's expanding economy and must continue to have the opportunity, ability, and incentives to invest in their networks. Second, railroad revenue adequacy is a congressional goal that must be viewed by the Board as a floor, not as a ceiling. A rate constraint on the basis of overall financial health is contrary to the statutory framework. If Congress intended firm-wide rate caps on regulated traffic, it would have explicitly provided for it; instead, the statute expressly requires a finding that the challenged rate is unreasonable after a full hearing before the Board may prescribe an alternative rate.

The Board staff's proposed "Rate Increase Constraint" flies in the face of these principles and would impose draconian price controls on railroads deemed revenue adequate. As leading economists have explained, restraining any company from earning more than its cost of capital reduces or eliminates the incentive to invest in capacity expansion and system replenishment, to pursue cost saving innovations and to respond to the opportunities presented by emerging market developments. By instituting caps for specific commodities based on revenue to variable cost ratios, the Board would be picking winners and losers among railroad customers and would be dramatically increasing the importance of the Board's Uniform Railroad Costing System. Rate caps based on revenue adequacy stray far from the goal of improving the Board's rate reasonableness procedures, and instead fall into the category of fundamental overhaul to regulatory policy. Likewise, the staff report provides no economic analysis as to why proposals to change the legal principles governing access and routing issues are at all appropriate in the context of revenue adequacy.

With regard to market dominance, AAR believes a productive debate can be had about how to reform the methods the Board uses to evaluate whether there is effective competition in a particular transportation market. However, there is no statutory basis for the Board to sidestep the analysis of market dominance required under 49 U.S.C. § 10707. The rate reasonableness paradigm designed by Congress is based on the fact that railroads operate in competitive markets for transportation services. As explained in the AAR's comments in EP 665 (Sub-No. 2), the Board's authority to judge the reasonableness of rates is limited by statute to cases where it makes a finding that the carrier possesses market dominance. Section 10707 requires that the Board make an affirmative finding that the transportation to which a challenged rate applies lacks effective competition before it can judge the reasonableness of a rail rate. Undercutting the core legal principle of market dominance has nothing to do with common-sense and achievable improvements to rate case process and procedure.

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AAR looks forward to continuing to work with the Board and with rail customers as the Board moves forward with reforms of its rate case processes, especially those for smaller customers. We stand ready to meet with individual Board members to discuss the staff report in more detail and explore constructive next steps.

Sincerely,



Ian N. Jefferies
President and CEO