



# Freight Rail Customer Alliance

## **Oral Statement Outline**

**Surface Transportation Board  
Revenue Adequacy Hearing Testimony  
December 12-13, 2019  
Washington, DC**

**Docket No. EP 761, Hearing on Revenue Adequacy  
Docket No. EP 722, Railroad Revenue Adequacy**

### **1. INTRODUCTIONS**

- A. GOOD AFTERNOON (OR MORNING, IF DELAYED),  
CHAIRMAN BEGEMAN, VICE CHAIRMAN FUCHS, AND  
MEMBER OBERMAN.
- B. I AM SHELLEY SAHLING-ZART. I AM VICE PRESIDENT AND  
GENERAL COUNSEL OF LINCOLN ELECTRIC SYSTEM AND  
ALSO, PRESIDENT OF THE FREIGHT RAIL CUSTOMER  
ALLIANCE OR FRCA. FRCA IS ALLIANCE OF TRADE  
ASSOCIATIONS THAT IN TURN REPRESENT A DIVERSE  
GROUP OF MORE THAN 3,500 ELECTRIC UTILITY,  
AGRICULTURE, CHEMICAL, AND ALTERNATIVE FUEL  
SHIPPERS.

C. FRCA THANKS THE BOARD FOR HOLDING THIS HEARING ON REVENUE ADEQUACY AND FOR PROVIDING AN OPPORTUNITY FOR US TO ADDRESS THE RELATED PROPOSALS IN THE RATE REFORM TASK FORCE REPORT.

D. FRCA SUPPORTS MOST OF THOSE PROPOSALS IN CONCEPT, BUT BELIEVES SOME IMPROVEMENTS ARE VERY MUCH NEEDED.

**2. FRCA STRONGLY BELIEVES THAT THERE NEEDS TO BE A VIABLE AND EFFECTIVE REVENUE ADEQUACY CONSTRAINT AS PART OF THE BOARD'S OVERSIGHT.** BY STATUTE, RATES FOR CAPTIVE SHIPPERS ARE TO BE REASONABLE. THE BOARD'S ONLY PARTIALLY EFFECTIVE RATE CONSTRAINT TO DATE HAS BEEN STAND-ALONE COST. SAC WORKS FOR ONLY A SMALL GROUP OF SHIPPERS. I CAN ATTEST FROM PERSONAL EXPERIENCE THAT EVEN WHERE SAC IS UTILIZED, IT IS SLOW AND EXPENSIVE. FOR MOST SHIPPERS, SAC AND THE EXISTING ALTERNATIVES DO NOT WORK AT ALL.

3. **FRCA RECOGNIZES THAT RAILROADS NEED DIFFERENTIAL PRICING TO COVER THEIR COSTS AND SERVE AS MANY SHIPPERS AS POSSIBLE. BUT ONCE RAILROADS RECOVER THEIR COSTS AND ACHIEVE REVENUE ADEQUACY, ALLOWING FURTHER UNRESTRAINED RATE INCREASES DOES NOT GUARANTEE FURTHER INFRASTRUCTURE INVESTMENT BUT, RATHER, PUNISHES CAPTIVE SHIPPERS. THE ICC RECOGNIZED AND ESTABLISHED THIS PRINCIPLE IN 1985.**
4. **MEASURING REVENUE ADEQUACY BASED ON WHETHER A RAILROAD'S RETURN ON NET INVESTMENT EXCEEDS THE COST OF CAPITAL CAN BE A REASONABLE APPROACH, BUT OTHER MEASURES SHOULD BE CONSIDERED. BUT TO THE EXTENT THE BOARD RELIES ON RETURN ON INVESTMENT AND THE COST OF CAPITAL, BOTH MUST BE MEASURED ACCURATELY. FOR INSTANCE, RETURN IS NOT MEASURED ACCURATELY WHEN IT IGNORES RAILROAD TAX SAVINGS IN 2017 OF \$9 BILLION. ACCURACY IS ALSO COMPROMISED WHEN THE BOARD MEASURES THE COST OF CAPITAL AT 12% AND BNSF'S OWN EXECUTIVE CHAIRMAN SAYS THE NEEDED RETURN IS ONLY 7%.**

**5. FRCA BELIEVES THAT THE MEASUREMENT PERIOD SHOULD BE OF FIXED LENGTH AND THAT FIVE YEARS IS SUFFICIENT.**

TRYING TO CAPTURE THE BUSINESS CYCLE IS AN EXERCISE IN FUTILITY, AS ILLUSTRATED BY THE EXPERIENCE WITH THE RCAF PRODUCTIVITY ADJUSTMENT. VARYING THE LENGTH OF THE MEASURING PERIOD CAUSES DIFFERENT YEARS TO RECEIVE DIFFERENT WEIGHTS AND PRODUCES DISTORTION. FIVE YEARS IS LONG ENOUGH TO SMOOTH OUT MOST TROUGHS, AND AN EVEN LONGER AVERAGING PERIOD MAKES THE CONSTRAINT LESS REFLECTIVE OF CURRENT AND RECENT CONDITIONS.

**6. FRCA AGREES THAT A RATE INCREASE CONSTRAINT SHOULD BE A KEY ELEMENT OF REVENUE ADEQUACY**

**CONSTRAINT.** ONCE A CARRIER ACHIEVES REVENUE ADEQUACY, THE CARRIER DOES NOT GENERALLY NEED TO IMPOSE FURTHER RATE INCREASES ON ITS CAPTIVE TRAFFIC IN EXCESS OF CHANGES IN ITS COSTS IN ORDER TO REMAIN REVENUE ADEQUATE.

**7. UNFORTUNATELY, THE BOARD'S PROPOSED RATE PROTECTION WOULD APPLY ONLY TO SOME CAPTIVE RATES. THAT IS A BIG STEP BACKWARDS FROM THE PROTECTION ADOPTED IN THE *COAL RATE GUIDELINES* THAT APPLIES TO ALL CAPTIVE RATES OF A REVENUE ADEQUATE CARRIER.**

**8. MMM IS A USEFUL MECHANISM FOR ALLOCATING RATE REDUCTIONS, BUT THE REVENUE INCREASE CONSTRAINT DOES NOT REDUCE RATES, IT MERELY LIMITS FUTURE INCREASES. THE PROTECTION SHOULD APPLY TO ALL MOVEMENTS WHERE A CARRIER HAS MARKET DOMINANCE, UNLESS A CARRIER MAKES A SPECIFIC SHOWING THAT HIGHER RATES SHOULD APPLY TO AN INDIVIDUAL MOVEMENT. THE BOARD'S PROPOSAL IS ALSO UNDULY COMPLICATED IN THAT IT RELIES ON SYSTEM-AVERAGE URCS COSTS, WHICH ARE INHERENTLY IMPRECISE, AS THE TRB EXPLAINED.**

**9. FRCA ALSO SUPPORTS THE PROPOSED SUSPENSION OF THE BOTTLENECK RATE PROTECTIONS FOR REVENUE-ADEQUATE CARRIERS.** BOTTLENECK RELIEF MAY SOLVE MOST OF THE ISSUES WITH COMPETITIVE ACCESS. A CARRIER THAT IS REVENUE ADEQUATE SHOULD BE EXPECTED TO COMPETE. ALSO, A CARRIER SUBJECT TO BOTTLENECK RATE RELIEF WILL STILL HAVE OTHER PROTECTIONS SUCH AS MARKET DOMINANCE AND SAC.

**10. FRCA ALSO SUPPORTS ALLOWING A SHIPPER TO USE THE SIMPLIFIED ROAD PROPERTY INVESTMENT ANALYSIS IN A SIMPLIFIED SAC CASE AGAINST A REVENUE-ADEQUATE CARRIER.** HOWEVER, THAT SHOULD BE AT THE SHIPPER'S OPTION, AND THE SHIPPER SHOULD BE ALLOWED TO MAKE A FULL ROAD PROPERTY INVESTMENT SHOWING IF IT WANTS TO. A SHIPPER SHOULD NOT HAVE LESS PROTECTION BECAUSE IT IS SERVED BY A REVENUE ADEQUATE CARRIER.

**11. THE RATE REFORM TASK FORCE INDICATED THAT FOR REVENUE INADEQUATE CARRIERS, SIMPLIFIED SAC SHOULD BE REPLACED BY INCUMBENT NETWORK COST ANALYSIS OR INCA. AT THIS TIME FRCA DOES NOT SUPPORT ELIMINATION OF SIMPLIFIED SAC FOR REVENUE ADEQUATE CARRIERS, BUT FRCA LOOKS FORWARD TO LEARNING MORE ABOUT INCA. UNLIKE THE REVENUE INCREASE CONSTRAINT, INCA APPEARS TO HAVE THE POTENTIAL TO REDUCE RATES, WHILE AVOIDING AN EXPENSIVE REPLACEMENT COST ANALYSIS.**

**12. TO CONCLUDE, THE PROPOSALS ARE SIGNIFICANT AND HELPFUL. FRCA GREATLY APPRECIATES THE ATTENTION THE STB IS GIVING THESE ISSUES, BUT MODIFICATIONS ARE NEEDED. I LOOK FORWARD TO RESPONDING TO ANY QUESTIONS YOU MAY HAVE.**

## **POSSIBLE POINTS FOR Q&A**

1. THE RATE INCREASE CONSTRAINT IS NOT A CAP ON REVENUES OR EARNINGS. NO RATE WILL ACTUALLY BE INCREASED. IF THE RAILROADS BECOME MORE EFFICIENT OR GROW THEIR VOLUMES, THEY WILL BENEFIT.
2. FRCA IS CERTAINLY NOT OPPOSED TO THE IDEA THAT RAILROADS HAVE BECOME REVENUE ADEQUATE BECAUSE THEY CHARGE MORE THAN IS NEEDED TO COVER THEIR COSTS AND THAT THERE SHOULD BE SOME MECHANISM TO PROVIDE THAT RELIEF. BUT THE FIRST STEP IS TO PROTECT AGAINST FURTHER RATE INCREASES TO CAPTIVE TRAFFIC WHEN THE RAILROADS ARE ALREADY REVENUE ADEQUATE.
3. RATE REDUCTIONS CAN COME THROUGH OTHER MEANS SUCH AS BOTTLENECK COMPETITION, SIMPLIFIED SAC, FINAL OFFER RATE REVIEW, OR INCA, WHERE WE HOPE THE BOARD WILL MOVE FORWARD.
4. IN TERMS OF INCENTIVES, THE RAILROADS HAVE CLAIMED THAT REVENUE ADEQUACY MEASURES WILL GIVE THEM INCENTIVES TO UNDERINVEST AND OVERINVEST. THEY SHOULD MAKE UP THEIR MIND. IN OUR VIEW, THEY SHOULD STILL HAVE ADEQUATE INCENTIVE TO INVEST. EVEN WITH THE RATE INCREASE PROTECTION, THE CAPTIVE TRAFFIC IS GOING TO REMAIN PROFITABLE AND ATTRACTIVE. IN TERMS OF OVERINVESTMENT, THAT'S NOT THE WORST PROBLEM TO HAVE, ESPECIALLY CONSIDERING ALL THE PROBLEMS WITH THE CUTBACKS IN INVESTMENT AND SERVICE WITH PRECISION SCHEDULED RAILROADING.
5. WHY DOES FRCA SUPPORT ALLOWING THE RAILROADS TO SHOW THAT THERE SHOULD BE INDIVIDUAL EXCEPTIONS FROM THE RATE INCREASE CONSTRAINT? THAT WAS PART OF THE *COAL RATE GUIDELINES* DECISION IN 1985. THERE MAY BE INSTANCES WHERE A RAILROAD CAN SHOW THAT AN INCREASE IS REALLY NEEDED. THERE MAY BE A PARTICULAR SEGMENT THAT SERVES ONLY A FEW SHIPPERS THAT NEEDS SIGNIFICANT INVESTMENT.