Freight Rail
Customer Alliance

Revenue Adequacy

FRCA POSITION

FRCA supports the efforts of the Surface Transportation Board (STB or Board) in Docket No. EP 722, *Railroad Revenue Adequacy*.

A goal of the Staggers Rail Act of 1980 was to restore financial stability to the U.S. rail system. By all accounts, this goal has been achieved, as demonstrated by the industry's continued high levels of capital investment and shareholder returns including dividends, buybacks, and stock appreciation. However, FRCA has long been concerned that the Board's annual determinations of "revenue adequacy" for Class I carriers does not reflect the true health of the overall rail industry and its individual carriers.

As a part of this and other STB rulemakings, FRCA continues to:

- Support eliminating the statutory requirement for the annual determination because it believes that 1) the carriers' falsely- perceived lack of adequate revenues has served to shield the railroads' exercise of their monopoly pricing power from STB scrutiny; and 2) has prevented shippers from obtaining appropriate relief.
- Strongly oppose railroad efforts (via legislation or proceedings) to evaluate revenue adequacy on the basis of replacement costs.

ISSUE BACKGROUND

The *Railroad Revitalization and Regulatory Reform Act of 1976* (separating freight rail from passenger rail) mandated that the STB's predecessor, the Interstate Commerce Commission (ICC), promulgate and thereafter, revise and maintain standards and procedures for establishing railroad revenue adequacy.

The *Staggers Rail Act of 1980* (which partially de-regulated the freight rail industry), revised the nation's freight rail transportation policy to promote a safe and efficient rail transportation system by allowing freight rail carriers to earn adequate revenues, as determined by the agency. Moreover, the *Staggers Act* required the ICC to begin determining annually which rail carriers are earning adequate revenues. To implement this requirement, the ICC began a proceeding to adopt standards for determining railroad revenue adequacy. In that proceeding, the ICC concluded that "the only revenue adequacy standard consistent with the requirements of [Staggers] is one that uses a rate of return equal to the cost of capital."

These U.S. Congressional mandates still govern the STB (like the ICC before it) when annually determining which rail carriers are revenue adequate by comparing a carrier's rate of return with the cost of capital. Over the years, the ICC/STB has adjusted the methodologies used in determining revenue adequacy.

The ICC declared that once a railroad has become revenue adequate over a period of time, shippers should be able to challenge the railroad's rates on the ground that the railroad is financially healthy, thus, not needing to charge such high rates. However, the methods used by STB (or the previous ICC) to measure revenueadequacy have major flaws and do not accurately reflect today's market conditions. Moreover, neither the ICC nor the STB have fully defined the process for shippers when challenging a rate on this basis.

When reviewing just the past few years alone, STB determined that four of the seven Class I carriers were "revenue adequate," while two others fell shy of meeting the determination in 2015 and 2014. In 2013, five of the Class I carriers were deemed "revenue adequate."

The concept of revenue adequacy is also a component of the STB's standard for judging the reasonableness of rail freight rates, as set forth in the Coal Rate Guidelines.

Regarding the "replacement cost methodology matter,", it has been examined repeatedly, including by the Railroad Accounting Principles Board. The use of replacement cost methodologies has always soundly been rejected. Given the financial strength of the railroads today, including publicly available information indicating that the railroad industry is revenue adequate, there is no plausible basis for the STB to adopt a replacement cost approach to evaluate revenue adequacy or limit the availability of rate relief.

It should be noted that in in 2008 the Association of American Railroads (AAR) submitted a petition to the STB requesting that the Board use replacement cost methodologies when evaluating revenue adequacy (Docket No. EP 679, Replacement Cost). In addition, CSX Transportation falsely asserted that Section 16 (Criteria) of the *STB Reauthorization Act of 2015*, P.L. 114-110, directs the STB to use replacement cost methodologies when evaluating revenue adequacy in its evidence filed March 7, 2016 in the Consumers Energy Company Rate Case (Docket No. NOR 42142).

On March 31, 2016 Senator John Thune, R-SD, chairman of the Senate Commerce, Science and Transportation Committee, sent a letter to the STB Members providing various observations on how the new law is being implemented. Of note, the Chairman emphasized that Section 16 (Criteria) does not require any change in how STB evaluates railroad revenue adequacy – either in statutory language or accompanying report language (or via congressional intent). This letter can be accessed via www.stb.gov/stb/docs/Reauthorization/Monthly%20Implementation%20Reports/U.S.%20Senate%20Committee%20on%20Commerce,%20Science%20and%20Transportation,%20March%2031,%202016.pdf

Please refer to the FRCA position paper, "Congressional Oversight – Implementation of the Surface Transportation Board Reauthorization Act of 2015", for more information.

STATUS

The STB is considering public comments as a part of the Board's own efforts in exploring its methodology for determining railroad revenue adequacy, as well as the revenue adequacy component used in judging the reasonableness of rail freight rates in Docket No. EP 722, *Railroad Revenue Adequacy*.

The STB requested written Comments and Reply Comments in Docket Nos. EP 722, and EP 664 during July and August 2014, respectfully. The STB held a public hearing the following year in July 2015, where FRCA submitted comments. Further action on Docket No. EP 722 is now not expected until at least June 2017. [It should be noted that the Board initially announced the Revenue Adequacy Docket EP 722 proceeding would be initiated in 2013.]

In a related proceeding, Docket No. 664 (Sub-No.2), concerning the railroad industry cost of capital used to measure revenue adequacy and for the other purposes, the Board denied the Western Coal Traffic League's (WCTL) petition that the agency abolishes the use of the multi-stage discounted cash flow model in determining the railroad industry's cost of equity capital on October 31, 2016. The WCTL filed a petition for reconsideration of the STB's decision on the cost of capital methodology on November 21, 2016. At the current time, it is not known when further STB action on this matter might occur.