

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 766

JOINT PETITION FOR RULEMAKING—
ANNUAL REVENUE ADEQUACY DETERMINATIONS

REPLY COMMENTS OF THE
ASSOCIATION OF AMERICAN RAILROADS

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Pursuant to decisions served in this proceeding on December 22, 2020, and June 4, 2021, the Association of American Railroads respectfully submits these reply comments.

In opening comments filed on May 17, 2021, the AAR set forth the concept of adequate revenues in the historical context in which it was added to the statute. The AAR comments also explained how the Board's current methodology to determine which rail carriers have earned adequate revenues in a given year overstates railroad revenue adequacy in three ways: by using accounting book value, instead of replacement cost, to measure the economic value of railroads' asset bases; by not including a reasonable economic profit; and, by not properly accounting for the value of deferred taxes in that measure. Finally, the AAR comments demonstrated that the statutory concept of adequate revenues should not be used to cap railroad rates based on firmwide earnings or returns.

AAR submits the following reply comments in response to comments filed by certain entities advocating on behalf of some rail customers, specifically, comments filed by the Joint

Shippers, U.S. Department of Agriculture, and Dow, Inc. (collectively, the “Comments”).¹ Each of the Comments in some way suggests the Board should not entertain the joint petition’s proposal and should instead focus its efforts on completing unrelated rulemakings. The Comments seek to inappropriately expand the scope of the proceeding and argue for their favored policy proposals, including Final Offer Rate Review and forced switching. Doing so is beyond the scope of this proceeding and for the reasons stated below is strongly opposed by AAR.

I. Final Offer Rate Review

In a separate proceeding, on September 12, 2019, the Board issued a notice of proposed rulemaking on its Final Offer Rate Review (“FORR”) proposal.² As AAR previously outlined, FORR “violates the Board’s governing statute, implicates Constitutional issues of fundamental fairness and due process, fails to account for either of the rulemaking’s cost or benefits, and misses the Board’s express policy targets” of achieving small rate case reform.³ In its opening comments, AAR urged withdrawal of the proposal, and continues to do so, because FORR is not authorized by, and even conflicts with, the governing statutes.⁴ Congress simply has not

¹ See Joint Shipper Comments, *Joint Petition for Rulemaking—Annual Revenue Adequacy Determinations*, EP-766, at 13-16 (May 17, 2021); USDA Comments, *Joint Petition for Rulemaking—Annual Revenue Adequacy Determinations*, EP-766, at 7 (May 17, 2021); Dow Comments, *Joint Petition for Rulemaking—Annual Revenue Adequacy Determinations*, EP-766, at 9-11 (May 17, 2021).

² See *Final Offer Rate Review*, EP 755 (STB served Sept. 12, 2019) (“FORR”).

³ Letter from Ian Jefferies, President and CEO, AAR, to Hon. Ann D. Begeman, Chairman, STB, et al, dated Oct. 21, 2019.

⁴ AAR Opening Comments, *Final Offer Rate Review*, EP 755, at 8-15 (Nov. 12, 2019) (“AAR FORR Opening”).

authorized the Board to adjudicate railroad rate cases through baseball-style arbitration.⁵

Indeed, the Board has acknowledged that it lacks the power to impose arbitration without statutory authority from Congress.⁶ The STB Reauthorization Act required the Board to “initiate a proceeding to assess procedures that are available to parties *in litigation before courts* to expedite such litigation and the potential application of any such procedures to rate cases.”⁷ Final-offer decision making, however, is not a litigation practice used before courts. Judges, like the Board under its rate review authority, must exercise their expertise and discretion to determine the appropriate outcome under the particular law. FORR actually forces the Board to **not** exercise its expert, “independent judgment[,] and instead confine[s] the decisional range to the two outcomes proposed by the litigants.”⁸

This poses particular concern in the rate reasonableness context, because the statute requires the Board to make “an adequate and continuing effort” to ensure adequate revenues when judging the reasonableness of rates after a “full hearing.”⁹ By statute, the Board must also give “due consideration” to the Long-Cannon factors, which include “the amount of traffic which is transported at revenues which do not contribute to going concern value and the efforts made to minimize such traffic; the amount of traffic which contributes only marginally

⁵ AAR FORR Opening, at 8; *see* Rate Reform Task Force, Report to the STB, at 15 (Apr. 25, 2019) (“RRTF”) (“Mandatory arbitration would resolve this issue, but the Board has held that the statute does not permit it to mandate arbitration of a dispute.”) (emphasis omitted); *FORR*, at 5.

⁶ *See FORR*, at 5; *Arbitration—Various Matters Relating to its Use as an Effective Means of Resolving Disputes that are Subject to the Board’s Jurisdiction*, EP 586, slip op. at 3 n.7 (STB served Sept. 20, 2001).

⁷ *Surface Transportation Board Reauthorization Act of 2015*, § 11(c) (emphasis added).

⁸ AAR Reply Comments, *Final Offer Rate Review*, EP 755, at 1 (Jan. 10, 2020) (“AAR FORR Reply”).

⁹ 49 U.S.C. § 10704(a)(1)-(2).

to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic; and the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues."¹⁰ Under FORR, the Board will not be applying its own "informed judgment" in assessing the reasonableness of rates and applying the statutorily required factors to its decision; rather, it will simply choose which of the parties' two proposals comes closer to the result the Board would have selected if it had exercised its own informed judgment.¹¹ The Board simply cannot undertake the law's mandated considerations nor exercise its discretion-- much less meet the "full hearing" requirement -- because FORR restricts the Board's decisions to one of two proposals supplied by the parties.

Moreover, the AAR has shown that the Board's proposal is also arbitrary and capricious, and unconstitutionally vague.¹² By refusing to set forth a methodology to be utilized in resolving the rate reasonableness dispute, and by not providing any meaningful standards for how it will make that determination, FORR is unconstitutionally vague and deprives railroads of fair notice as to what the Board may deem unreasonable in any particular case. FORR is, in effect, a standardless standard, because the Board claims it will "allow for innovation with respect to rate review methodologies" and lead to the "creation of precedent through an adversarial process" that "creates incentives for methodological improvements over time."¹³ While the Supreme Court has said that regulation must inform those regulated "what is

¹⁰ 49 U.S.C. § 10701(d)(2).

¹¹ See AAR FORR Reply, at 2-3.

¹² See AAR FORR Opening, at 17-21.

¹³ *FORR*, at 11-12.

required of them so they may act accordingly”, FORR gives no knowledge in advance of what the Board may deem reasonable or how it will decide reasonableness, because it allows the parties to propose methodologies to be used, with no ability for the Board to decide otherwise.¹⁴ Such a construct is arbitrary and capricious and fails to provide parties proper notice. Even though AAR recognizes the FORR proposal is not before the Board in this proceeding, the AAR reiterates that for the foregoing reasons, the Board should withdraw its FORR proposal, and not move forward with it instead of proceeding with this matter, as argued in the Comments.

II. Forced Switching

A. The Forced Switching Rule is Unlawful and Not the Product of Reasoned Decision Making.

Several commenters also raise the Board’s proposal to force one rail carrier to turn over traffic to its competitors in the context of this proceeding, even though that subject is also beyond the scope. As AAR has argued previously, the forced switching proposal is deficient and should be withdrawn.¹⁵ The proposed forced switching rule was the flawed product of a proceeding that began over ten years ago, with the notice of proposed rulemaking itself being served by the Board nearly five years ago on July 27, 2016.¹⁶ The Board should not advance the proposal, nor institute any other similar proceeding, because doing so would be unlawful and because the staleness of the record would not result in reasoned decision-making.

¹⁴ *FCC v. Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012); see AAR FORR Opening, at 17-21.

¹⁵ See AAR Opening Comments, *Reciprocal Switching*, EP 711 (Sub-No. 1), at 7-45 (Oct. 26, 2016) (“AAR Switching Comments”); AAR Reply Comments, *Reciprocal Switching*, EP 711 (Sub-No. 1), at 5-20 (Jan. 13, 2017) (“AAR Switching Reply”).

¹⁶ *Reciprocal Switching*, EP 711 (Sub-No. 1) (STB served July 27, 2016) (“Switching NPRM”).

Foremost, the proposed forced switching rules are unlawful, as they do not require a showing of need for the STB to order forced access, which is contrary to long-established precedent and the statute itself. Instead, the proposal would allow switching on-demand, frustrating rail operations and disincentivizing investment. As AAR has previously set forth, the Board proposal relaxes the switching standards, yet does so without identifying any defects in the substance of the long-standing competitive abuse standard that has been upheld by reviewing courts as solidly grounded in the Rail Transportation Policy.¹⁷ In adding the switching provision to the Staggers Rail Act, Congress recognized that “in areas where reciprocal switching is feasible, it provides an avenue of relief for shippers served by only one railroad *where service is inadequate*.”¹⁸ There must, then, be a need (i.e., inadequate service) prior to the granting of forced access by the agency. In furtherance of this intent, Congress noted that the standard used in applying the “practicable and in the public interest” test for reciprocal switching would be “the same standard the Commission has applied in considering whether to order the joint use of terminal facilities.”¹⁹ This meant, as the ICC explained, that a standard of “actual necessity” applies to grants of reciprocal switching, yet the Board’s proposal requires no such finding.²⁰ Accordingly, the 2016 forced switching proposal violates the statute and the original congressional intent of the switching provision.

¹⁷ See AAR Switching Comments, at 7-19.

¹⁸ S. Rep. No. 96-470, 96th Cong. 1st Sess., at 42 (1979) (emphasis added).

¹⁹ H.R. Rep. No. 96-1430, 96th Cong. 2d Sess., at 116-17 (1980); see also S. Rep. No. 96-470, at 42 (1979); *Central States Enterprises, Inc. v. ICC*, 780 F.2d 664, 668 (7th Cir. 1985).

²⁰ *Delaware & Hudson Railway Co. v. Consolidated Rail Corp.*, 367 I.C.C. 718, 720 (1983).

In addition to the legal requirement that a shipper show the need for the remedy of forced access, is the corollary that the statute does not provide for access merely “on demand,” or simply because the shipper would prefer to be served by two rail carriers rather than one. In the Switching NPRM, the Board acknowledged this fact, stating the “statute requires a showing of need for access remedies and does not permit such remedies merely ‘on demand.’”²¹ Moreover, the Board recognized that “[t]here is no indication that Congress intended the agency to prescribe reciprocal switching whenever it would enhance competition.”²² Yet, the Switching NPRM violates these principles, whereas, the existing competitive harm standard accommodates both by requiring a showing of need and precluding forced switching on demand.²³

Further, the proposal suffered from the legal flaw that it failed to set forth a coherent rationale for shifting away from forced switching as a remedy for harm to a model where access can be granted by the agency without a demonstration of need. Even though the Administrative Procedure Act requires a reasoned explanation of an agency’s change in policy, the Switching NPRM provided no rational explanation for changing the forced switching rules.

This failure to articulate a reasonable justification for reversing established regulatory policy is accompanied by the proposal’s inexplicable failure to conduct any assessment of the likely impact of its proposed switching rules. While the Board collected extensive information from a variety of parties in its original EP 711 proceeding, the Switching NPRM proceeded to

²¹ *Switching NPRM*, at 15 (citing *Review of Rail Access & Competition Issues*, EP 575, at 6 (STB served Apr. 17, 1998)).

²² *Id.* (citing *Midtec Paper Corp. v. United States*, 857 F.2d 1487, 1507 (D.C. Cir. 1988)).

²³ See AAR Switching Comments, 8-12.

ignore that information and evidence.²⁴ Although the Supreme Court has noted the importance of assessing costs and impacts of regulations, the Switching NPRM contained no analysis of the potential benefits and costs of the proposed rules.²⁵ Even despite its failure to address the evidence of impact in EP 711, the Board acknowledged concerns over possible service impacts of forced switching, yet appears to believe that those concerns can be addressed on a case-by-case basis. This is simply not the case.²⁶ The rail network and cumulative effects of regulatory intervention are difficult, if not impossible, to predict in individual cases. Especially in a situation where on-demand access is being granted, it is all the more important to limit access remedies to those situations where there is a compelling need for switching.

In addition, the Board should not engage in new rulemaking in this area of forced access policy, given the impact on rail infrastructure and investment decisions which cannot be adequately addressed in individual cases and would create uncertainty for the regulated community. Forced access policies would frustrate investment decisions by railroads, who from

²⁴ *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, EP 711 (STB served July 25, 2012).

²⁵ *See Michigan v. EPA*, 135 S. Ct. 2699 (2015); AAR Switching Comments, at 29-41.

²⁶ *See Entergy Arkansas, Inc. & Entergy Services, Inc. v. Union Pac. R.R.*, NOR 42104 at 15 (STB served Mar. 15, 2011) ("The competitive access rules were promulgated not to provide shippers with an alternative form of rate relief, but to offer a competitive remedy where a bottleneck carrier has exploited its market power.") Similarly, the ICC previously explained with regard to the Staggers Rail Act's switching provision:

There is a vast difference between using the Commission's regulatory power to correct abuses that result from insufficient [sic] 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.

Midtec Paper Corp. v. Chicago & Northwestern Transportation Co., 3 I.C.C.2d 171, 174 (1986) ("*Midtec II*"), *aff'd*, *Midtec Paper Corp. v. United States*, 857 F.2d 1487 (D.C. Cir. 1988).

1980 to 2020 spent nearly \$740 billion on capital investment and maintenance spending. Spending has averaged around \$25 billion per year in recent years. Unlike trucks, barges, and airlines, America's freight railroads rely overwhelmingly on their own private capital—not taxpayer funds—to pay for the construction and maintenance of their infrastructure, so it is especially important that railroads have the resources they need to provide safe, reliable service. The uncertainty created by forced switching's, and similar such policies', impacts on railroads and investment will also stymie the shared goal of shifting more freight from truck to the more environmentally friendly mode of rail. Furthermore, railroads purposely concentrate and move traffic along certain routes to maximize operational efficiencies and network fluidity, which allows for more freight traffic to move by rail. These routing practices, honed over decades, take into account the health and operation of the entire network to the benefit of all customers, not just a select few. Forced access policies, including the forced switching proposal, risk upsetting these network benefits.

B. Shipper Interests Will Use the Forced Switching Rule as Backdoor Rate Regulation in Violation of the Law.

The comments of shipper advocates in this proceeding and the forced switching proceeding illustrate that, in fact, shipper interests want forced switching to be used as a backdoor rate regulation tool.²⁷ Shippers and their advocates clearly do not view the proposal as a remedy to address a market failure or an abuse of market power, but instead as an ill-gotten weapon that could be leveraged to fulfill their desire for lower rates through government intervention into railroad operations. Contrary to long-settled precedent, the

²⁷ See AAR Switching Reply, at 5-15.

Switching NPRM proposed to offer certain favored shippers, especially those that can satisfy the Board's market dominance test, the opportunity to obtain a mandatory switching order simply to attempt to reduce their rates.²⁸ The statute provides very detailed, substantive requirements to address the reasonableness of rates, which were central to the Staggers Act. Yet, the Switching NPRM proposal would allow a shipper unhappy with rate levels to seek a rate reduction through a grant of forced switching, thereby evading the law's rate reasonableness provisions.²⁹ In doing so, the Board skirts its congressional directive that it rely on market forces to establish reasonable rail rates, which is the bedrock of rail economic regulation since the 4R Act and Staggers.³⁰

In 49 U.S.C. § 10101(1) Congress made it the policy of the U.S. Government "to allow, to the maximum extent possible, competition and *the demand for services* to establish reasonable rates for transportation by rail." (emphasis added). This does not mean that the Board should

²⁸ See *Id.*, at fn. 10 (citing the numerous commenters that saw forced switching as a means to lower rates).

²⁹ See *Midtec*, 857 F.2d at 1506-07 ("If the Commission were authorized, as Midtec's argument entails, to prescribe reciprocal switching or terminal trackage whenever such an order could enhance competition between rail carriers, it could radically restructure the railroad industry. We have not found even the slightest indication that Congress intended the Commission in this way to conform the industry more closely to a model of perfect competition. We therefore think it is entirely consistent with the purposes of the Staggers Act that [railroads] enjoy some degree of 'market power,' enabling the railroad to price its services above marginal costs.").

³⁰ See H.R. Rep. No. 96-1430, 96th Cong. 2d Sess., at 80 (1980) ("In general, the title *assures railroads substantially more rate freedom* than is afforded them under existing law. It continues the policy started under the Railroad Revitalization and Regulatory Reform Act of 1976 of *substantially eliminating rate regulation of railroads* where there is effective competition.") (emphasis added); S. Rep. No. 96-470, 96th Cong. 1st Sess., at 7, 16-17 (1979) ("Title I of the bill provides new standards and procedures for the regulation of rail rates. It reaffirms the basic concept of the 4-R Act—greater pricing flexibility for the railroads where there is effective competition from other carriers or modes of transportation.... [The goal is] to provide protection for captive shippers where necessary in the public interest and to *provide pricing freedom* for the railroads in the many areas where competition exists. In the latter situation, *free market forces should determine the prices* to be paid and the conditions of service.") (emphasis added).

create competition on demand, but instead it should *allow existing market forces* to determine rail rates. In those rare instances where there is an absence of competitive forces, rate regulation should mimic the outcomes of competitive markets, as evidenced by section 10101(6) that states it is the policy of the U.S. Government “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.” (emphasis added). This is done through demand-based differential pricing, as applied through the stand-alone cost test. When Congress reauthorized the STB for the first time in its history, it reiterated that demand-based differential pricing is a central feature of the Staggers Rail Act regulatory regime, permitting “railroads to charge lower rates to their customers who operate in a competitive environment and higher rates to customers who are ‘captive’ to one railroad for transportation service (i.e., demand-based differential pricing).”³¹ Allowing a shipper to evade this rate-reasonableness test amounts to unlawful regulatory intervention that would weaken the rail sector vis-à-vis its trucking counterparts, thereby forcing more freight to the less environmentally sound trucking industry.³² This would hinder the industry and Board’s

³¹ S. Rep. No. 114-52, 114th Cong. 1st Sess., at 2 (2015). In section 11 of the STB Reauthorization Act, Congress reiterated its approval of, and preference for, demand-based differential pricing in adding new section 10701(d)(3) that mandated that the “Board shall maintain 1 or more simplified and expedited methods for determining the reasonableness of challenged rates in those cases in which *a full stand-alone cost presentation is too costly*, given the value of the case.” 49 U.S.C. § 10701(d)(3).

³² See Testimony of Jason Mathers, Director, Vehicle and Freight Strategy, Environmental Defense Fund, “Where’s My Stuff?: Examining the Economic, Environmental, and Societal Impacts of Freight Transportation”, the Subcommittee on Highways and Transit and the Subcommittee on Railroads, Pipelines, and Hazardous Materials of the House Transportation and Infrastructure Committee, at 3, 5 (explaining “[w]ithin freight, heavy trucks are—by far—the most significant source of climate pollution.... [And b]ecause rail is about 3.5 times more fuel efficient than trucks, companies can lower costs at least 15-20% with intermodal rail based primarily on fuel savings.”)

shared goal of growing rail's share of freight to meet the nation's economic needs and its ability to adapt to changing market conditions, especially as automation becomes more prevalent in the trucking sector.³³ Accordingly, though the focus of this proceeding is not on the forced switching proposal, AAR reiterates its position that the forced switching proposal must be withdrawn, nor should any similar such proceeding be instituted.

CONCLUSION

For the reasons stated above the Board should not entertain shipper advocates' invocation to finalize unrelated, unnecessary, and harmful proposed rules.

(http://blogs.edf.org/energyexchange/files/2019/12/EDF_JMATHERS_IMPACTS_OF_FREIGHT_JOINT_HEARING.pdf).

³³ See, e.g., Fisher, John, *Autonomous Truck Testing Heats Up Under the Texas Sun*, Fleet Owner (May 27, 2021) (explaining "[m]ore and more trucking technology companies are moving from conceptual to actual self-driving tractors as the industry gets closer to taking the human out of the cab to move freight in the U.S. by the middle of the decade.") (emphasis added) (<https://www.fleetowner.com/industry-perspectives/trucks-at-work/blog/21165424/autonomous-truck-testing-heats-up-under-the-texas-sun>); Smith, Jennifer, et al., *Autonomous-Truck Developer TuSimple Plans Driverless Road Test This Year*, The Wall St. Journal (Apr. 15, 2021) (noting "Chief Executive Cheng Lu said the company is planning to conduct a "driver-out" pilot program without anyone at the wheel in the fourth quarter on a roughly 100-mile run between Tucson and Phoenix.") (emphasis added) (<https://www.wsj.com/articles/autonomous-truck-developer-tusimple-plans-driverless-road-test-this-year-11618528979>); Clevenger, Seth, *Waymo Provides Look Inside Self-Driving Truck Testing*, Transport Topics (Mar. 25, 2021) ("Waymo's trucking program, named Waymo Via, is actively testing and developing technology designed to enable SAE Level 4 automated driving, meaning the truck would be able to drive itself with no human input or backup under certain conditions.") (emphasis added) (<https://www.ttnews.com/articles/waymo-provides-look-inside-self-driving-truck-testing>); Lee, Morgan, *Daimler Trucks Tests Self-driving Vehicles in US Southwest*, AP News (Sept. 4, 2020) ("Daimler's Autonomous Technology Group has taken aim at commercializing self-driving trucks within a decade, and the new testing location complements ongoing research on roadways in Virginia with milder weather and fewer steep hills.") (emphasis added) (<https://apnews.com/article/va-state-wire-az-state-wire-nm-state-wire-9d803146d08497d4bfb6a1d89a778959>); Hirsch, Jerry, *Waymo Begins Testing Autonomous Heavy-Duty Trucks in Texas*, Trucks.com (Aug. 25, 2020) (<https://www.trucks.com/2020/08/25/waymo-autonomous-truck-tests/>).

Respectfully submitted,

A handwritten signature in blue ink, appearing to read 'K. D. Kirmayer', with a stylized flourish at the end.

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