

Legislative and Regulatory Developments Involving Railroad Transportation

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Presentation Outline

- A New Administration
- Background Information
- STB Reauthorization Act of 2015 (S. 808)
- Rail Competition Issues at the STB
- Rail Rate Issues at the STB (including InterVISTAS)
- Revenue Adequacy
- Transportation Research Board
- Fuel Surcharge Issues
- Positive Train Control
- Differing Approaches Among Board Members?
- Conclusions and Importance of Shipper Involvement

A New Administration

- Elections (especially Presidential elections) matter
- We have a slightly conservative Supreme Court, with a new Justice whose opinions suggest less deference to administrative agencies
- The Administration has left many slots unfilled to this point, including 4th and 5th STB Members
- Will there be new STB nominees “soon”?
- Action on policy matters delayed until there is a Republican majority on the STB?
- Administration anti-regulatory attitude, which RRs support at STB – adverse impact on shippers?
- Hiring freeze was also in place, STB staffing down

Background Information

- Staggers Rail Act of 1980: deregulation, competition instead of regulation “to the maximum extent possible”
- Abandonments, mergers, deregulatory and pro-RR policies → reduced competition
 - 80% of traffic served by one RR
 - Non-jurisdictional contracts for most movements
- “Revenue-adequate” RRs?

STB Reauthorization Act of 2015 (S. 808)

Procedural History

- Senator Thune introduced reauthorization bill
- Stripped out pro-shipper substantive provisions of S. 2777
- Shipper associations, RRs supported bill, Senate passed by voice vote
- House passed same bill, President signed

STB Reauthorization Act of 2015 (S. 808)

Summary of Contents

- Makes STB independent
- Adds 2 new STB board member seats (for total of 5)
- STB Board members may discuss matters w/o public
- Deadlines for rate challenges (which may be unrealistic)
- Encourages STB to resolve pending matters quickly
- More investigatory authority, rates still require complaints
- STB arbitration (for rates) voluntary, damages limited (\$25 million rates, \$2 million service, over five years)
- Instructs STB to consider RRs' investment needs

STB Reauthorization Act of 2015 (S. 808)

Implications for Shippers

- Bill is largely process-oriented, reflecting Senator Thune's preferences; no real substance in favor of shippers
- Positive development – Senator Thune getting regular reports from STB, STB pushed to implement bill, speed up proceedings (except now policy proceedings)
- STB's increased investigation authority perhaps will be useful if service deteriorates again, but what more can the STB do about service problems? (Its informal inquiries apparently were quite helpful.)
- There is a great need for shippers to educate Members of Congress about problems with STB processes

Rail Competition Issues at the STB

Procedural History

- Abandonments, mergers, lack of competitive switching as in Canada → rail-to-rail competition is often totally lacking, or at best ineffective
- Ex Parte No. 711: NITL petition for rulemaking
- STB required NITL to do study, hearing held in March 2014
- STB proposed rules July 27, 2016 (in Ex Parte No. 711 (Sub-No. 1))
- Opening comments Oct. 26, 2016; reply comments Jan.13, 2017
- Under new statute, Board Members may meet with public; no deadline for such meetings. Some meetings have occurred
- Our client INEOS was the first to attend, in early Feb.; meeting summaries are on STB website. Based on INEOS meetings and others, discussion of particular circumstances matters greatly
- Shippers supportive, rail labor not; railroads have not met yet
- Board has not said when rulemaking conclude, but at least 2H17

Rail Competition Issues at the STB

Summary

- STB proposed two standards, tracking statute:
 - (1) practicable and in the public interest, or
 - (2) necessary to promote rail-to-rail competition
- Much complexity to first prong, but second may be workable for shippers who can show “market dominance”
- This second approach could work for more shippers, provided rates are over 180%, they are otherwise market-dominant, and there is a safe, efficient, non-congested terminal with which to interchange traffic on the competitor RR within a reasonable distance of shipper’s plant

Rail Competition Issues at the STB

Implications for Shippers

- Could help some shippers, but lots of complexity
- Shippers should advocate:
 - (1) simple, *prima facie* affirmative case, based on publicly available information, for competitive switching; if made,
 - (2) burden shifts to RR to show (if it can) that remedy not safe, or practical, or adversely impact other shippers, or other reasons
- Then limited discovery, only on matters RR puts at issue
- Shipper can then rebut RR showing
- Approach does not work for small shippers (due to cost), and short-lines exempt; need to find ways to expedite
- STB apparently regards 2% of RR revenues as significant, so apparently it does not intend this approach to apply to too much traffic; need to change STB's mindset on that
- AAR 9/27/16 letter to Congress objects to STB's proposed rules (and its proposed repeal of certain exemptions in Ex Parte No. 704)
- Post-election statements by AAR suggest movement in its direction

Rail Rate Issues at the STB

Status Update

- Challenges to “stand-alone cost” methodology
- Ex Parte No. 665
 - Sub. 1: considers new rate-challenge process for grain shippers
 - Sub. 2: ANPRM re: rate reasonableness methodology for very small disputes (STB rejected proposals by shipper groups)
- Coal-rate challenge – *Consumers Energy v. CSX* – raises “revenue adequacy constraint” issue; won’t be decided until next year; with CSX “revenue-inadequate” according to STB (but other proof allowed), not clear if STB will determine “constraint”
- “Bundling issue” discourages rate challenges

Rail Rate Issues at the STB: InterVISTAS Study on Stand-Alone Cost Methodology

- Commissioned under S. 808. Issued September 22, 2016
- Purpose: perform independent assessment of STB's stand-alone cost rate reasonableness methodology and identify possible alternatives
- Conclusions (favor RRs by recommending status quo):
 - Full SAC remains preferred approach in many cases
 - Simplified SAC and three-benchmark test are upheld as well
 - Definition of “most efficient network” could be simplified
 - Suggests reducing the contribution of cross-over traffic
- Next steps:
 - STB economic roundtable
 - Then-STB Chairman Elliott hoped to schedule a public hearing after the roundtable, open to all stakeholders

Rail Rate Issues at the STB

Implications for Shippers

- “Stand-alone cost” challenges – seemingly not suitable for chemical shippers with single-car shipments
 - (*M & G* settled; *Dupont v. NS*, *Sunchlor Belt Alkali v. NS*, and *Total v. CSX* all adverse to shippers)
- Ex Parte No. 665 (Sub. No. 1) proposal: challenges more difficult and more costly for all shippers, not just grain
- Ex Parte No. 665 (Sub. No. 2):
 - Acknowledges that “three-benchmark” methodology doesn’t work because transaction costs quickly exceed amounts at stake
 - Proposal would only apply to Class I RRs – but what if “the last mile” is spun off to Class II or III?
 - Vice Chairman Miller: proposal would do nothing to solve problems with the “stand-alone cost” methodology, because it would apply only to small shipments

Revenue Adequacy Status Update

- “Revenue adequacy” standards are not realistic (Ex Parte No. 722 – Next STB action postponed from October 2016 to June 2017, at least)
- “Revenue adequacy” rate constraint must be defined; STB considering improvements to Cost of Capital methodology (Ex Parte No. 664)
- RRs: not revenue-adequate, using replacement costs
- But replacement costs not used for revenue adequacy
- Replacement costs used in SAC because hypothetical RR incurs replacement costs. Not used for actual RRs
- Ex Parte No. 552 (Sub-20): 4 Class I RRs (BNSF, Grand Trunk (CN), Soo Line (CP), UP) rev-ad in 2015. Others close (CoC was 9.61%, CSX and NS were at or over 9%)

Revenue Adequacy

Implications for Shippers

- Shippers advocate alternatives to stand-alone costs, argue it is not the only economically justifiable measure for determining rate reasonableness
- Railroads have defended ICC/STB determinations that SAC is the only economically rational methodology for setting rail rates
- Revenue-to-Variable Cost Ratio rate cap?
- Return-on-investment-type ratemaking?
- With rebuttable presumptions?
- Others?

Transportation Research Board Report Status Update and Implications for Shippers

- Report commissioned by Congress; issued June 10, 2015
- Finds STB processes dysfunctional, urges replacement by system of “baseball arbitration,” quick resolution
- Fails to address Constitutional issues, appeals to STB, judicial review, discovery, standards (except apparently a competitive benchmark approach, undefined)
- Would require replacement of Uniform Rail Costing System methodology, which would be costly, and there would be winners and losers
- No one seems to be pushing on Hill, but Report could be very useful to show the need for reform

Fuel Surcharge Issues

Status Update and Shipper Implications

- Cargill proved BNSF over-recovered but no relief
- “Safe harbor” concept intended to benefit shippers
- STB not bound to deny relief to Cargill
- RR fuel costs less than the STB’s “safe harbor”
- STB: alter policy to avoid over-compensating RRs
- Fuel surcharge case (includes only contracts) awaiting new class-certification decision
- Shippers will be able to “opt out,” pursue separate actions if they wish

Positive Train Control Status Update and Implications for Shippers

- Due to Congressional action in 2015, deadline now is December 31, 2018, with limited possible further extensions if a showing of good cause
- Then Acting Administrator testified no discretion not to impose civil penalties on RRs for failure to comply
- RRs' responses, in letters to Senator Thune, stated that they will **stop carrying TIH materials and passengers on non-PTC compliant lines**
- Litigation before USDC, STB re: legality was dismissed, but issue may come up again
- Common carrier obligation issues

Differing Approaches Among Board Members

- *Tri-City Railroad Company – Petition for Declaratory Order* (Docket No. FD 35915) (service date: September 14, 2016)
- Holding: Cities' condemnation of RR right-of-way for at-grade crossing of proposed road is preempted
- Vice Chairman Miller's comment:
 - Legally correct result, but STB should have exhausted all options to keep the road project alive, including requiring parties to engage in mediation
 - STB is unable to handle cases quickly under its current process
 - Stated that then-STB Chairman Elliott unwilling to consider changes to improve timeliness, adopt performance metrics

Conclusions

Importance of Shipper Involvement (1)

- RR financial health improved dramatically, especially over the last 10 years
- However, it turned in the wrong direction in 2015; 2016?
- Still, STB seems to concede that RRs are doing better, despite the downturn in volumes
- TRB Report supports need for change
- Competitive switching – competition was presumed in Staggers Rail Act of 1980, but not the result
- Rate-reasonableness – needs to be an alternative to “stand-alone costs” – will STB respond?
- Common carrier obligation issues

Conclusions

Importance of Shipper Involvement (2)

- Pressures that shippers are under have increased because of higher rates
- Until recently, RRs don't have to work to compete or become more efficient to raise revenues; RRs only needed to raise rates, did so inexorably
- Having achieved revenue adequacy (except CP, CSX and KCS, maybe), non-SAC rate challenges may now be more likely to prevail – but will the facts change again?
- InterVISTAS Report has been embraced by RRs, shippers will need to comment, suggest alternative approaches, participate in upcoming STB hearing

Q&A

Questions or Comments?

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