**BEFORE THE SURFACE TRANSPORTATION BOARD**

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**EX PARTE NO. 761 HEARING ON REVENUE ADEQUACY**

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**EX PARTE NO. 722, RAILROAD REVENUE ADEQUACY**

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# WRITTEN TESTIMONY ON BEHALF OF NATIONAL COAL TRANSPORTATION ASSOCIATION

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National Coal Transportation Association (NCTA) respectfully submits the following as its written testimony in response to the public hearing scheduled Thursday December 12, 2019, on railroad revenue adequacy issues raised by the Surface Transportation Board (Board) in its Rate Reform Task Force (RRTF) report issued on April 25, 2019, and served in the above-captioned proceedings on September 12, 2019. NCTA previously filed a notice of appearance for its Executive Director, John N. Ward, to appear at the hearing.

1. NCTA is a national organization consisting of electric utilities, coal producers, and entities that have an interest in the production and transportation of coal for the purpose of generating electricity. This group includes entities that produce, repair, and manage all facets of railcar components parts and systems, and also those entities that provide services and products for various operations and environmental compliance requirements at the power plant site. NCTA members have a continuing interest in the direct and ancillary costs of operating and maintaining a modern fleet of railcars to transport coal. NCTA members are also very interested in the fair treatment of shippers

regarding the total cost of service, including the cost of building and maintaining the shipper's facilities as well as the cost of transporting coal.

2. NCTA sincerely appreciates and commends the Board for this opportunity to submit written comments and provide testimony in regard to the very challenging and complex question of railroad revenue adequacy. We view this opportunity to respond and provide testimony in this proceeding along with the several other notices of proposed rulemakings impacting shippers issued recently as a new and very welcome approach by the Board to have an open dialogue with shippers and carriers to address operational issues and a reformation of the Board's rate review processes.

3. NCTA understands the Board wishes for participants to address the four RRTF recommendations listed in the docket. NCTA will not be able to address all four recommendations with much technical information, but would like to respond with the following comments that we hope will address NCTA's concerns regarding the issue of rate reform and the impacts of any Board decision regarding revenue adequacy determination on the NCTA coal shipper community.

4. NCTA understands the RRTF recommended, among other things, that the Board establish a definition of long-term revenue adequacy, limit rate increases by revenue adequate carriers, suspend the STB's bottleneck rate protections for revenue adequate carriers, and reinstate the simplification of the road property investment in Simplified Stand-Alone Cost rate cases.

5. Many of NCTA's coal shippers who transport coal for the purposes of generating fairly priced electricity are considered captive to one railroad, and due to

lack of competition in the market are therefore at the mercy of that single railroad's pricing. Other NCTA shippers have, at most, limited rail competition from two carriers and also experience the effect of market dominance. When the market presents limited transportation service and/or pricing options, shippers often can obtain only inadequate service and at high rates. Since transportation costs are often the major cost component of the delivered cost of coal, the impacts to electricity rates for the utility customer at the receiving end can be substantial. Those shippers that choose to challenge a rate need a fair and equitable determination of revenue adequacy of the railroad. For captive shippers and small shippers, a meaningful rate constraint is needed to challenge the railroad rates that they are forced to pay.

6. At the same time, NCTA and fellow shippers need the railroads to be financially sound and therefore able to respond to shipper requests for service, particularly the transportation of coal by rail. NCTA appreciates that the rail carriers need to earn a return based on an appropriate cost of capital in order to be incented to reinvest in their networks and enable them to provide adequate service for and support of the many commodities that move across our country by rail. It is important to note that NCTA coal shippers have invested a significant amount of capital themselves in rail infrastructure at mines and power plants to facilitate coal handling. NCTA coal shippers have also invested heavily in the ownership, leasing and control of massive fleets of privately owned rail car equipment which our members provide, at no extra cost, to the railroads in unit trains of up to 150 cars. This constitutes millions in railroad capital costs that have been effectively outsourced to the shippers, essentially reducing the railroad's

own capital cost obligations.  NCTA members also spend millions on annual maintenance and repairs of their rail infrastructure and rail car fleets. These rail car fleets represent about 45% of coal cars in service in the eastern U.S. and close to 90% of the coal cars in service in the western U.S.

7. Unfortunately, NCTA utility car fleets are shrinking in size, with many privately owned cars being sold off for pennies on the dollar, stored in expensive long-term storage facilities, or converted to other car commodity types and even sold for scrap due to:  1) competing volatile energy market forces; 2) financial difficulties including declarations of bankruptcy from the coal producers; and, 3) the impacts of adversarial public policy on the consumption of coal in general.  NCTA, while still a healthy and robust organization of over 120 members, is faced with such financial challenges itself that obtaining expert legal and economics assistance to respond to technical issues in this Docket is difficult for this community of shippers at this time.

8. NCTA recognizes there is a disparity in the perception of rail carrier financial profitability.  The prevailing view of rail carriers regarding railroad financial health has not changed significantly since the Staggers Act in 1980, with a perspective that carriers still:  1) are not covering their cost of service; 2) are not making enough to cover the necessary investment in maintaining and expanding railroad infrastructure; and, 3) are not earning above their cost of capital.  These views about the financial health of the railroad industry are simply wrong as it relates to revenue adequacy. Some standards were revised, and, as of 2008-2009 many Class 1 railroads were determined actually revenue-adequate and continue to be determined as such today by the Board's own

revenue adequacy calculation. The NCTA shipper community believe the railroads actually are financially healthy and have become so at the expense of the shippers. This is particularly difficult for NCTA coal shippers who are struggling just to keep coal mines operating, pay employees a fair market wage, keep fleets of cars in service and in good operating condition, and manage coal stockpiles at adequate levels at the power plant site. The Board's own models for determining revenue adequacy are now overstating and distorting the calculation of railroad cost of capital that is used in the revenue adequacy determination.

9. The NCTA understands that the Board has used a computation of 12.22% for the year 2018 in determining rail cost of capital. This figure is the same as proposed by the American Association of Railroads (AAR) but exceeds by more than 5 percentage points what was computed by Wall Street analysts and even recently noted by Matt Rose, while he was still BNSF's Executive Chairman. Using a cost of capital figure that is overstated by 70% is a distortion of the Board's analysis. NCTA also notes that the Board had ignored the more than $9 billion of income that the Class 1 railroads achieved in 2017 in its annual revenue adequacy determination for that year as it could have caused a distortion of income from adjacent years in the multi-year period used.

10. The Board should consider a fair, legitimate and updated methodology for measuring rail capital costs, rates of return, and revenue adequacy. We at NCTA, as shippers of coal, a commodity necessary for the safe, reliable and sustainable production of electricity for millions of Americans, request the Board use its best practices and authority to revise its methodology, and then use this methodology to

ensure that shippers seeking rate relief will be treated fairly and equitably through solid rules and transparent processes.

11. The NCTA proposes the following for the Board to use in revising and improving its revenue adequacy determination methodologies.

a. The Board should consider the distortion effect that the recent widespread adoption of Precision Schedule Railroading (PSR) may have on railroad growth rates in determining revenue adequacy. The growth rates factor into the cost of capital, which factors into the revenue adequacy determination.

b. The Board has proposed a method for determining a carrier's revenue adequacy that will consider whether a carrier's net return on investment exceeds the railroad industry average cost of capital by using a multiple-year average of varying length. The Board should instead consider use of a rolling average period of a *fixed* length such as five years or longer to more accurately reflect investor expectations and more correctly capture the business cycle.

c. The proposed rate increase constraint should apply fully and equitably to all captive rates and not just selectively as the RRTF proposes. Once a shipper is able to demonstrate a case of market dominance by a carrier, there should not be further differential pricing imposed once a carrier is shown to have achieved revenue adequacy on a long-term basis.

d. Suspension of the Board's Bottleneck protections as applied to long-term revenue adequate carriers (allowing a second railroad to supply captive shipper rates over bottleneck segments) is appropriate.

12. NCTA firmly believes the Board must ensure there is fairness and reciprocity of risk, rewards, and performance between carriers and coal shippers. NCTA respectfully requests the Board make the recommended modifications to the revenue adequacy methodology and rules. Modifications are needed to balance inequities that exist between the railroads and shippers by recognizing the massive capital investments made by coal shippers in their mine and power plant rail infrastructure, all of which benefit rail carriers.

Respectfully submitted,

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