December 12, 2019

Dear Members of Congress:

U.S. freight railroads safely move roughly 40 percent of intercity ton-miles of freight, ship one-third of U.S. exports and support more than one million jobs across the nation's most critical sectors. Freight railroads operate in a highly competitive transportation market which changes by the day and is marked by significant and steady deployment of technologies across all modes.

The rail industry is doing its part to keep pace, investing in new solutions and spending some $68 million per day to maintain and modernize its 140,000-mile network. The goal is twofold: continue its run of historical safety performance while efficiently and reliably serving the industry's customers.

Ensuring the continued viability of railroads and their customers hinges partly on a public policy framework that relies on natural market forces to manage interactions between railroads and customers. Core tenets of this system, however, are at risk through several proposed regulations from the U.S. Surface Transportation Board (STB). **I write to make you aware of this situation, most especially a potential for the STB to cap railroad rates in place of the natural marketplace**.

It is critical that the STB exercise caution so as not to dramatically disrupt the movement of goods. The industry greatly values and respects the role of the STB in setting policy and wants to be a valuable partner in its modernization. We believe that current board members are well suited to tackle pressing challenges, including the potential to streamline the complicated rate dispute process.

Broadly speaking, we hope policymakers do not view our industry's improved financial health as a sign of market failure that demands the return of ineffective regulation. As noted in Section 16 of the STB Reauthorization Act of 2015, the STB is expected to govern in a manner that establishes "revenue levels for rail carriers to be adequate for the infrastructure and investment needed to meet the present and future demand for rail services." We hope the STB understands that business cycles ebb and flow over time, and that there is no guarantee that today's market realities will hold true in the future.

We have seen firsthand that markets generally move faster than their regulators. For instance, coal, which a decade ago accounted for nearly half of U.S. electrification but today is down to 25 percent, has correspondingly gone from 23 percent of freight rail revenue in 2008 to 14 percent in 2018.

While railroads are stronger than before and optimistic about the future, the industry is currently experiencing market softness. This is as a reminder that regulation must not only be considered when an industry is at full strength, but also when the economy is weaker. This is especially true for capital-intensive industries, such as rail, in which safety and service depends on continued investment.

At the heart of this discussion is the issue of revenue adequacy – historically a measure of financial health that the STB may use to regulate rates in the future.

As previously mentioned, current law directs the STB to enact policies that enable railroads to earn adequate revenues to operate and maintain their networks and attract investment in capital markets like all other private businesses in the economy. The STB and its predecessor, the Interstate Commerce Commission, have made revenue adequacy determinations annually for nearly 40 years. A railroad is deemed revenue adequate when its rate of return on net investment (ROI) equals or exceeds the industry's cost of capital (COC). Put another way, a railroad is deemed revenue adequate in a given year when it earns enough to cover the costs of efficient operation, including a competitive return on invested capital. Only recently and only for some railroads has ROI collectively exceeded COC, with individual railroads varying when and how often they have been deemed revenue adequate.

Rather than calculating the minimum amount of revenue needed for a healthy rail system, a process that has allowed railroads to thrive, the STB is potentially considering an about-face. The STB could convert this measure of financial health into a threshold finding that a railroad is earning "excessive" revenue. The STB would then use that determination to regulate rates for individual rail customers, regardless of market conditions. This would mean that if a railroad is revenue adequate and a shipper challenges a railroad's rate as too high, the STB could cap the railroad's rates to some of its customers.

Such a scheme runs contrary to basic economics, would unduly pick winners and losers and endangers the network relied upon by *all* rail shippers – including the smaller ones the STB is focused on in many of their other proposed regulations. Moreover, earning regulation, or constraints based on system-wide earnings, is an antiquated and discredited form of regulation for private enterprises. There is no rational way to connect overall firm-wide earnings with a determination of whether a single rate for a single customer is reasonable. Railroads are not public utilities and should not be regulated as such.

Indeed, drastic action, such as revenue adequacy regulation, could produce major repercussions. The unavoidable consequences of diminished investment and distorted commercial actions are a gradual reduction in the scope and robustness of the rail network over time and a decline in the quality of rail service. Safety, which requires robust investment, could also potentially suffer.

Keep in mind: in almost 40 years under the current regulatory framework, freight railroads have spent more than $685 billion – 40 cents out of each revenue dollar – on capital expenditures and maintenance expenses related to infrastructure and equipment. In this same period, rates have decreased while safety has improved. Rates today are equal to those in 1992. The train accident rate in 2018 was down 36 percent from 2000; and the employee injury rate was down 48 percent over the same period.

All the while, railroads remain the most environmentally sound way to move freight over land. U.S. railroads move a ton of freight an average of 473 miles per gallon of fuel. Moving freight by rail instead of truck reduces greenhouse gas emissions by up to 75 percent, on average. And, because one train can replace hundreds of trucks, railroads help to reduce gridlock and the need for tax dollars for highways.

There is **a better path for the STB to take**. Congress should encourage the STB to:

- Consider conducting cost-benefit analysis on any regulation, including revenue adequacy;
- Concentrate on areas where there is a demonstrated need for action;
- Recognize that railroads need freedom to operate like other private businesses; and
- Prioritize the continued private investments of railroads.

Sincerely,
Ian Jefferies

President and CEO
Association of American Railroads