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June 26, 2014

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VIA E-FILING

Ms. Cynthia T. Brown
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Surface Transportation Board
395 E Street, S.W.
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ENTERED
Office of Proceedings
June 26, 2014
Part of
Public Record

Re: STB Docket No. EP 665 (Sub-No. 1), Rail Transportation of Grain, Rate Regulation Review

Dear Ms. Brown:

Accompanying this letter for e-filing in the above-referenced docket is the Public Version of the Opening Comments and Evidence of The National Grain and Feed Association ("NGFA"). Because some of the Exhibits of the Verified Statement of Thomas D. Crowley being submitted with this filing contain Confidential Waybill Sample data supplied to the undersigned counsel and to L.E. Peabody & Associates, Inc. pursuant to a February 7, 2014 letter agreement and Protective Order, a Highly Confidential version of this filing is also being made via hand-delivery of three (3) copies to the Board. This package also contains three (3) CD's containing the workpapers of Mr. Crowley and three (3) CD's containing the workpapers of Mr. Daniel L. Fapp. Mr. Fapp's workpapers do not contain any Highly Confidential material.

Please note that the material redacted from the Public Version consists of Confidential Waybill Sample data that has been aggregated, but the NGFA has nevertheless elected to submit under seal out of an abundance of caution so as not to inadvertently disclose competitively sensitive data. The NGFA urges the Board and its staff to review the Highly Confidential version of the NGFA's filing and determine that all or part of the redacted material in fact does not disclose competitively sensitive data, and to make this material part of the public record upon making such a determination. 49 C.F.R. §1244.9(b)(4)(iv).

GKG Law, P.C.

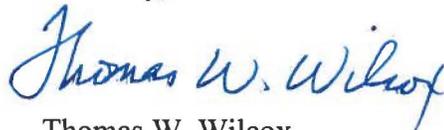
Ms. Cynthia T. Brown

June 26, 2014

Page Two

Please feel free to contact me with any questions.

Sincerely,



Thomas W. Wilcox

*Attorney for The National Grain and Feed
Association*

Enclosures

cc: All Parties of Record

PUBLIC VERSION

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB Docket No. EP 665 (Sub-No. 1)

RAIL TRANSPORTATION OF GRAIN, RATE REGULATION REVIEW

**OPENING COMMENTS AND EVIDENCE OF
THE NATIONAL GRAIN AND FEED ASSOCIATION**

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June 26, 2014

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Exhibit 1 - Procedural Rules to Govern Ag Commodity Rate Cases Under the Ag Commodity Maximum Rate Methodology

Verified Statement and Exhibits of Daniel L. Fapp, a Vice President of L.E. Peabody & Associates, Inc.

Verified Statement and Exhibits of Thomas D. Crowley, President of L.E. Peabody & Associates, Inc.

PUBLIC VERSION
BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Docket No. EP 665 (Sub-No. 1)

RAIL TRANSPORTATION OF GRAIN, RATE REGULATION REVIEW

OPENING COMMENTS AND EVIDENCE OF
THE NATIONAL GRAIN AND FEED ASSOCIATION

Pursuant to the announcement of the Surface Transportation Board ("STB" or "Board") in its decision in Docket EP 715, *Rate Regulation Reform*, served on July 18, 2013 (*EP 715 Decision*), followed by the decision served in this proceeding on December 12, 2013 (*EP 665-1 Decision*), the National Grain and Feed Association ("NGFA") hereby submits its Opening Comments and Evidence ("Opening").

The NGFA is a U.S.- based nonprofit trade association, established in 1896, that consists of more than 1,050 member companies from all sectors of the grain elevator, animal feed and feed ingredient manufacturing, integrated livestock and poultry, grain processing, biofuels and exporting businesses. The NGFA members operate about 7,000 facilities nationwide that handle more than 70 percent of all U.S. grains and oilseeds. The NGFA also consists of 26 affiliated State and Regional Grain and Feed Associations, has a joint operating and services agreement with the North American Export Grain Association, and has a strategic alliance with the Pet Food Institute.

The NGFA commends the Board for commencing this long-overdue review of the regulatory changes it should implement "to ensure that the Board's rate case procedures are fully

accessible to grain shippers and provide relief for excessive rates, where appropriate." *EP 665-1 Decision* at 2. The NGFA is pleased the Board has recognized that its current rate case procedures and rules are not amenable to challenges to rail rates for agricultural commodities¹ and that the Board is willing to consider the adoption of rate rules and procedures that are specific to those rates, taking into account the unique aspects of the agricultural industry and commodity markets.

The NGFA further believes that the fact that the Class I railroads have achieved "revenue adequacy" as envisioned by Congress when the Staggers Rail Act of 1980 was enacted presents an opportunity for the Board, with the input of industry stakeholders, to develop rules to examine the reasonableness of Ag Commodity rail rates that take this revenue adequacy status, or the near achievement of this status, by the defendant railroad as determined by the Board into account. Accordingly, in response to the Board's invitation, the NGFA presents in this Opening a specific, multi-faceted proposal designed to ensure the Board's rate complaint procedures are accessible to Ag Commodity shippers and to provide such shippers with effective protection against unreasonable freight rail transportation rates. This proposal includes a new rate reasonableness methodology that would be applied to Ag Commodity rail rates over which the Board had jurisdiction.² The NGFA urges the Board to follow this preliminary phase of this proceeding

¹ As discussed in Part V of this Opening, neither the *EP 665-1 Decision*, nor this proceeding's predecessor Ex Parte No. 665, *Rail Transportation of Grain*, defined the agricultural commodities encompassed by the term "grain." The NGFA's proposal includes a description of the commodities it covers, which are the commodities covered by the NGFA's Rail Arbitration Rules, and listed in Exhibit 2 to the Verified Statement of Thomas D. Crowley. This Opening refers to those commodities as "Ag Commodities" in lieu of "grain."

² On April 2, 2014, the Board served a decision that in part started a proceeding in Docket EP No. 722, *Railroad Revenue Adequacy*, in which the Board announced it would receive comments "to explore the Board's methodology for determining revenue adequacy, as well as the revenue adequacy component used in judging the reasonableness of freight rates." Decision at 1. The Board clarified that the latter inquiry was to explore "how the revenue adequacy constraint

with the issuance of a notice of proposed rulemaking to take comments on the methodology and other aspects of the NGFA's proposal.³

I.

ORGANIZATION OF OPENING COMMENTS AND EVIDENCE

The remainder of this Opening is divided into six (6) parts. In Part II, the NGFA provides a summary description of the agricultural industry and agricultural commodity markets, and why they always have presented unique challenges to the Board and rail shippers in terms of how to assess the reasonableness of railroad rates for agricultural commodities.

In Part III, the NGFA reviews why the STB's current rail rate rules are not usable by agricultural commodity shippers. Indeed, the Board has not seen a formal complaint challenging a rail rate for an agricultural commodity since the infamous *McCarty Farms v. Burlington Northern Inc.* case ("*McCarty Farms*"),⁴ which started as a class action lawsuit that was referred

would work in practice in large rate cases," in lieu of the stand-alone cost constraint. *Id.* at 4. Neither of the areas covered by Docket EP No. 722 is addressed in this Opening, which is responsive to the Board's invitation in this docket. First, the NGFA is not proposing any specific changes to the Board's current methodology for determining revenue adequacy in this proceeding. Second, although the Ag Commodity Maximum Rate Methodology explained in Part V of this Opening would be available to assess the reasonableness of rates for any eligible Ag Commodity movement or group of movements, the value of the vast majority of such rate cases cannot be considered "large." Accordingly, although the Ag Commodity specific proposal covered by this filing entails taking into account the revenue-adequate status of the defendant railroad, it is not an attempt to propose a methodology to implement the revenue adequacy constraint for "large" rate cases as discussed in *Coal Rate Guidelines, Nationwide*. 1 I.C.C. 2d 520 (1985), *aff'd sub nom. Consol. Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987).

³ To the extent necessary under the Board's rules and the posture of this proceeding, which was commenced in part to solicit "proposals for modifying existing procedures, or new alternative rate relief methodologies," *EP 665-1 Decision* at 2, the NGFA asks that its request for a rulemaking proceeding on its proposed methodology be considered a petition for rulemaking under 49 C.F.R. §1110.2(b).

⁴ The *McCarty Farms* case produced numerous agency and decisions over its 18-year history, the key ones being ICC Docket No. 37809, *McCarty Farms, et al v. Burlington Northern Inc.*, 3 I.C.C. 2d 822(1987)("McCarty Farms I") and 4 I.C.C. 2d (1988)("McCarty Farms II"); *remanded, Burlington Northern R. Co. v. ICC.*, 985 F.2d 589 (D.C. Cir. 1993); and Decision

to the Interstate Commerce Commission ("ICC") in 1980, was litigated at the ICC, the Board, and the Court of Appeals for the District of Columbia Circuit for over 18 years, and ultimately resulted in no relief to the approximately 10,000 Montana wheat and barley farmers and elevators on whose behalf the complaints comprising the case were brought.

Part IV discusses the Board's authority for adopting rate rules specific to Ag Commodities and the justification for the Board to adopt rate reasonableness rules for Ag Commodities that take into account the revenue-adequate status of the Class I railroads. Part IV also summarizes the components of rail rate reasonableness rules and procedures that must be present to ensure they can be usable by captive Ag Commodity shippers.

Part V of this Opening outlines the NGFA's proposed Ag Commodity Maximum Rate Methodology ("ACMRM") and the rationale behind it, including an explanation of the NGFA's rationale for its selection of Ag Commodities constituting the definition of "grain" for purposes of this proceeding. This Part is supported by the Verified Statements of Thomas D. Crowley and Daniel L. Fapp, President and a Vice President, respectively, of the economic consulting firm of L.E. Peabody & Associates, Inc., of Alexandria, Virginia. In his Verified Statement ("Crowley V.S."), Mr. Crowley explains in detail the economic and policy justifications for the proposed methodology, the goal of which is to create an easily administered, inexpensive and objective way to test the reasonableness of Ag Commodity rates by combining aspects of the Board's Three-Benchmark Methodology ("3B") with the defendant's status as a revenue-adequate or inadequate railroad under the Board's test for revenue adequacy developed under 49 U.S.C. §10704. To provide specific examples of how the ACMRM would work in practice, its potential effect on captive agricultural commodity shippers, and the minimal impact it would have on

served in Docket No. 37809 and 37809 (Sub-No.1) on August 14, 1997, *aff'd*, *McCarty Farms, Inc. v. Surface Transp. Bd.*, 158 F.3d 1294 (D.C. Cir. 1998)(*McCarty Farms III*).

Class I railroads, the Crowley V.S. is supported by analyses and examples drawn from 2011 and 2012 Confidential Waybill Sample data on five key Ag Commodities: corn, wheat, soybeans, soybean meal and co-products, and ethanol.

In Mr. Fapp's Verified Statement ("Fapp V.S."), he provides verified testimony supporting the NGFA's contention that, given the current state of the railroad industry, including the manner in which the Canadian National Railway ("CN") and Canadian Pacific Railway ("CP") now conduct business operations in the United States and North America, it is appropriate for the Board to modify its current practices and henceforth determine the revenue-adequate status of the U.S. affiliates of CN and CP based upon whether the revenues of the entire North American operations of CN and CP exceed their respective costs of capital. This policy change would analyze more accurately the revenue adequacy for these carriers, and would remove the competitive advantage the CN and CP otherwise maintain over the U.S. Class I railroads by having the Board's revenue adequacy formula applied only to the corporate entities the CN and CP railroads have established in the United States. Part V also addresses certain standing and-market dominance issues associated with implementing the proposed methodology, and includes a proposed procedural schedule, based upon the current schedule for 3B cases, that would enable challenges of Ag Commodity rail rates to be decided within 170 days or less.

Part VI of this Opening explains how the adoption of the ACMRM would not cause any appreciable reduction in the revenues of the Class I railroads, nor adversely affect the revenue-adequate status of any of them.

Finally, Part VII summarizes the NGFA's conclusions and recommendations, which include a request that the Board institute a rulemaking proceeding to solicit comments from interested parties on the ACMRM proposal and related issues set forth in this Opening. It further

emphasizes how the adoption of workable rate rules for agricultural commodity shipments must be part of an integrated regulatory approach that has as its goal maximizing competition between the railroads and protection of captive rail shippers.

II.

SUMMARY DESCRIPTION OF THE AG COMMODITY MARKETS AND THE NEED FOR RAIL RATE REASONABLENESS RULES THAT ARE UNIQUE TO MOVEMENTS OF AG COMMODITIES⁵

A. Overview of Agricultural Commodity Markets

The U.S. agricultural sector is extremely important to the U.S. and world economy. U.S. agricultural producers – and the grain handling, processing and export industry that services them – supply almost 98 percent of the grains, oilseeds and co-products consumed domestically. They also account for almost 20 percent of the quantity of such grain-based products consumed worldwide.

The U.S. Department of Agriculture's Economic Research Service notes that agriculture and agriculture-related businesses contributed \$775.8 billion to the U.S. gross domestic product ("GDP") in 2012, with the output from America's farms accounting for \$166.9 billion of this sum. But in reality, the overall contribution of the U.S. agriculture sector to the nation's GDP is even larger, because sectors related to agriculture rely upon agricultural inputs (such as fertilizer, seed and other farm inputs) to contribute additional value to the U.S. economy.

In 2012, 16.5 million full- and part-time jobs were related to agriculture – about 9.2 percent of total U.S. employment. In addition, U.S. agricultural products represent one of the only positive contributors to the U.S. balance of trade. Exports account for as much as one-third

⁵ Parts II and III of this Opening update similar information provided to the Board by the NGFA and numerous other agricultural organizations in 2006 in Ex Parte No. 646 (Sub - No. 1), *Simplified Standards for Rate Cases ("Simplified Standards")*. See Opening Comments of the NGFA, et al, filed October 24, 2006 at 4-12 ("*EP 646 Opening Comments*").

of total usage of U.S. feed grains and 50 percent of total usage of U.S. wheat and soybeans – either as raw commodities or as value-added products, such as meat, poultry, milk and eggs. In 2013, U.S. agricultural exports reached a record \$141 billion, resulting in a \$37.1 billion net positive contribution to the U.S. balance of trade.⁶ Every \$1 billion in U.S. agricultural exports generates approximately 9,000 U.S. jobs.

The U.S. agricultural industry is comprised of numerous sectors: (1) farmers and ranchers, of which there are approximately 1.5 million⁷ (2) grain elevators and other aggregators of raw agricultural commodities; (3) grain merchandisers, who buy and sell commodities; (4) animal feed and pet food manufacturers; (5) grain and oilseed processors, including corn and flour mills and oilseed processors; (6) finished-product producers like ethanol and biodiesel plants that take a raw product (*i.e.*, corn and soybeans) and convert them into biofuels; (7) exporters; and (8) end users, such as livestock and poultry integrators.

Grain elevators aggregate the crops grown on farms they serve, which typically are delivered to the elevator primarily by truck. Unlike "producers" in other industries (*e.g.*, a coal mine), there is typically no direct rail service available, or provided, to the farmers who grow the commodity being transported. Rather, the rail transportation rates and terms are established between the elevator/aggregator and the railroad, with the cost of rail transportation typically being borne ultimately by the producer/farmer in the price paid by the elevator for the crop. Consequently, the producer/farmer incurs the direct impact of unreasonable rail rates paid by a captive elevator either through forward cash contracts or spot bids reflected at the time of delivery of their crops to an elevator. As rail rates are increased, the price that a captive elevator

⁶ *Outlook for U.S. Agricultural Trade*, U.S. Department of Agriculture Economic Research Service, AES-81 (February 20, 2014).

⁷ USDA's National Agricultural Statistics Service, 2012.

will pay for the farmer's crop usually decreases by a commensurate amount, given the highly competitive marketplace in which this low-margin, high-volume business operates in both domestic and international markets. On the other hand, the elevator/aggregator bears the impact of increases in rail rates that occur after the producer has contracted for sale and delivery of his or her crop.

Grain and oilseed processors, which include ethanol production facilities, soybean oil and meal facilities, flour mills and other, similar operations, sometimes receive inbound grain by rail as well as truck. But frequently they are captive to a single railroad for service, and have no viable or effective alternative to rail for transportation of outbound product.

The markets for Ag Commodities are fluid. Buy and sell transactions, which include the cost of rail transportation, can be frequent and short in duration. Commodity prices frequently change over a relatively short period of time. Thus, there can be times when transactions can be made, terminated or modified while a shipment is in transit. Significantly, as noted previously, Ag Commodity markets are both national and global in scope. For example, captive wheat and other commodity producers and elevators in Montana compete not only against each other to sell their crops, but also with shippers and receivers from other states and Canadian provinces.

Unlike other physical commodities that have relatively stable supplies in the short-term, the output of Ag Commodities is highly variable because of their dependence upon weather, variable producer-planting decisions in response to market signals and other factors, and government policies. In contrast, the year-to-year production of a mined commodity will be comparatively steady and largely will depend upon the cost of production versus the expected

sales price and demand.⁸ The supply and thus price of an agricultural commodity like corn, wheat or soybeans, however, may fluctuate significantly between or within crop years because of an unforeseen drought in a critical growing area of the world, or a government closing its borders to trade in a particular commodity in response to regulatory policy (e.g., a biotech-enhanced trait not yet approved in a foreign country), or to protect its producers from less-expensive foreign supplies, or in a misguided attempt to hoard its supplies when there is a world-wide shortage.

Many Ag Commodity shipments also are characterized by multiple origin-and-destination (“O/D”) pairs that are influenced heavily by fluctuating market demand by purchasers and receivers. Demand for Ag Commodities can be highly inelastic and relatively stable for some end-users in the short run. For instance, a feedlot operator is unlikely to make quick, wholesale ingredient shifts in its feeding ration for a herd of cattle. But demand from other end users of agricultural products can be highly elastic and unstable, as was the case for U.S. corn exports to China in 2013 and 2014, which abruptly ended after a period of strong use. While these unpredictable purchases from end-users of agricultural products create uneven use, delivery points to which many Ag Commodities are shipped often have multiple sources of supply, which means that the volumes or carloads ascribed to a particular O/D pair rarely are constant and predictable on a year-to-year basis.

B. The Agricultural Industry’s Use of the Nation’s Rail System

The U.S. agricultural industry is a large user of the nation's rail system. In 2011, railroads hauled approximately 28 percent of all commercial movements of whole U.S. grains and oilseeds. While that was down significantly from the 50 percent share hauled by rail at the

⁸ In the case of coal, U.S. production consistently has ranged between 1.1 and 1.2 billion short tons between 2002 and 2011, the last 10 years reported. Energy Information Admin. Annual Energy Review 2011 at 201, Table 7.2.

time of enactment of the Staggers Rail Act of 1980, rail still represents a significant modal share for major Ag Commodities. U.S. Class I railroad revenues for STCC 01 Farm Products and STCC 20 Food Products equaled \$10.54 billion and \$10.60 billion in 2011 and 2012, respectively.⁹ This represented 16.1 percent of Class I railroad revenues in 2011 and 15.5 percent of the revenues in 2012.¹⁰

Rail is the only viable transportation mode available to many agricultural producers and shippers. As examples, nearly all the grains and oilseeds produced in Montana, more than 70 percent of the commodities produced in North Dakota, and more than half of the Ag Commodities produced in Arizona, Oklahoma and South Dakota are transported by railroad.¹¹ In addition, an average of 72 percent of U.S. wheat moved to domestic and export markets by rail from 2007 to 2011, as did an average 56 percent of U.S. barley. For total corn movements during the same five-year period, a still-significant 26 percent moved by rail (compared to 11 percent by barge and 63 percent by truck), while 24 percent of all U.S. soybeans moved by rail (compared to 20 percent by barge and 55 percent by truck).¹²

Many shippers of Ag Commodities nationwide are captive or potentially captive to a single railroad for service. Some facilities have access to only a single railroad to transport their commodities sometimes hundreds of miles to an interchange point with another railroad or a final destination.

⁹ Crowley V.S. at 3.

¹⁰ *Id.*

¹¹ *Study of Rural Transportation Issues*, U.S. Department of Agriculture and U.S. Department of Transportation (April 2010).

¹² *Transportation of U.S. Grains, A Modal Share Analysis, 1978-2011 Update*, U.S. Department of Agriculture Agricultural Marketing Service (May 2013).

C. The Railroads Control the Ability of Rail Captive Market Participants to Take Advantage of Market Opportunities

The Class I railroads are only one component of the integrated, international market environment for agricultural commodities produced by America's farmers. Yet, because there is presently no effective regulatory constraint on what they can charge their captive Ag Commodity shippers, railroads are in a position to determine winners and losers of that overall market through their rate-setting policies. In addition to the overall problem that ineffective rate reasonableness rules enable railroads to extract excessive monopoly profits from captive Ag Commodity shippers, rate-setting practices also can be used by the railroads to strongly influence where certain commodities are transported and sold. For example, a rail carrier can "de-market" traffic to domestic and export markets from individual or groups of agricultural facilities simply through the unfettered use of freight rates set at levels that make commodities price-uncompetitive in those markets.

Railroads' exercise of market power, combined with the lack of a meaningful regulatory backstop to challenge rates believed to be unreasonable, has resulted in an overall Ag Commodity market in which many commodity producers, elevators, intermediaries, and processors captive to a single railroad at origin(s) and/or destination(s) have little or no ability to expand their businesses and to try to develop and/or sustain local communities.

The solution to this imbalance, which the ACMRM proposal seeks to achieve, is for the Board to have rate-reasonableness rules and processes in place for Ag Commodities that, if utilized, would establish maximum reasonable rates for captive shippers that provide the Class I railroads with sufficient profits and incentives to continue to invest in their respective rail systems to the benefit of carriers and shippers alike, while at the same time not overly restricting producers, elevators, processors and others from participating in markets for their commodities

and products, and in so doing denying them the opportunity to expand and sustain their businesses and associated rural communities. By establishing such rules that are cost-effective, objectively based, and provide timely resolution of rate challenges, the Board would alter the current dynamic in a positive way from one that empowers railroads to dictate winners and losers in the marketplace through their rate-setting power to one where an aggrieved shipper or group of shippers could seek formal rate relief, but also where shippers and railroads could mutually negotiate beneficial transportation terms and conditions and avoid costly and time-consuming litigation.

III.

WHY THE BOARD'S CURRENT RATE RULES ARE NOT USABLE TO TEST THE REASONABLENESS OF AG COMMODITY RAIL RATES

The NGFA and other agricultural industry stakeholders have commented previously that the lack of rate complaints dealing with Ag Commodity rail rates in the 30-plus years since *McCarty Farms* was first filed at the ICC is because the Board's current rules, as administered by the Board, arguably have never provided a meaningful and workable way for rail shippers of Ag Commodities to challenge unreasonable rail rates.¹³ The reasons for this are briefly reviewed below. These reasons have been compounded by the consolidation of the rail industry to the point where a handful of Class I railroads enjoy regional duopolies in the western and eastern portions of the United States.

¹³ Ex Parte No. 646, *Rail Rate Challenges in Small Cases*, Testimony of Dr. Kendell W. Keith on behalf of the NGFA, filed April 16, 2003; *Ex Parte 646 Opening Comments, supra*; Ex Parte No. 665, *Rail Transportation of Grain*, Comments of the NGFA, filed October 30, 2006; Ex Parte No. 680, *Study of Competition in the Freight Rail Industry*, Joint Comments of the NGFA and other agricultural interests, filed December 22, 2008; Ex Parte No. 705, *Competition in the Rail Industry*, Reply Comments of the NGFA, filed May 27, 2011, and Testimony to the Surface Transportation Board, filed June 10, 2011.

A. The Stand-Alone Cost Rules and Procedures as Currently Implemented Will Not Work for Ag Commodity Movements

It is well established by now that testing the reasonableness of rail transportation rates under the Board's Stand-Alone Cost ("SAC") rate reasonableness rules and procedures makes economic sense only for a very small group of rail shippers with high volume, limited O/D pairs, and/or extremely high-priced rail movements.¹⁴ The reasons why SAC rules are useless for agricultural commodity movements, an assertion which essentially has not been disputed by any party in any of the Board's proceedings, are briefly summarized again below for the Board's convenience.¹⁵

1. The average cost of a SAC case dwarfs the average overcharges an Ag Commodity shipper would pay in the typical circumstance.

2. Ag Commodity movements often are characterized by multiple origins and destinations, which, along with annual volumes, can vary from year to year. This characteristic makes the attempt to prepare a stand-alone railroad presentation required by the SAC rules extremely costly, complicated and burdensome.

3. Ag Commodity shippers do not generate the tonnage necessary to meet traffic densities essential for a successful Full-SAC presentation.

4. Many facilities and elevators are located on low density rural branch lines or secondary lines. The Board's adoption in NOR 42054, *PPL Montana, LLC v. The Burlington Northern and Santa Fe Railway Co.*, 6 S.T.B. 286 ("PPL"), and NOR 42071, *Otter Tail Power Co. v. BNSF Railway Co.* (served January 27, 2006)("Otter Tail"), of rules that severely

¹⁴ See, e.g., Ex Parte No. 646 (Sub. No. 1) *Simplified Standards for Rail Rate Cases*, Joint Written Rebuttal Comments of the NGFA and numerous other associations, filed January 11, 2007, at 2; *CSX Transp., Inc. v. Surface Transp. Bd.*, 568 F.3d 236 (D.C. Cir. 2009), citing *Simplified Standards for Rail Rate Cases*, STB Ex Parte No. 646 (sub-no. 1), at 31 (STB Served Sept. 5, 2007); and *Rate Guidelines—Non-Coal Proceedings*, 1 S.T.B. 1004, 1008 n. 7 (1996).

¹⁵ See also *EP 646 Opening Comments* at 9-12.

restricted the ability to include low-density lines of rail in SAC models made the SAC rate rules even more inaccessible to Ag Commodity rail shippers.

5. The fluidity of the agricultural commodity markets described above is completely inapposite to the long timelines for processing a SAC case, which can include lengthy and expensive determinations of qualitative market dominance.

B. The Board's Revised Simplified Stand-Alone Cost Rules Pose Similar Obstacles to Ag Commodity Shippers

The Board's Simplified Stand-Alone Cost ("SSAC") rules, even as modified recently in the *EP 715 Decision*, also are not useable by the vast majority of Ag Commodity shippers for the reasons summarized below:

1. The average value of an Ag Commodity case is well below the cost of a SSAC case, which the Board has estimated to be approximately \$2 million.

2. The Board made no substantive changes to its SSAC rules in the *EP 715 Decision* that would ease the evidentiary burdens for captive Ag Commodity shippers. To the contrary, the new rules increase the evidentiary burden by requiring rail shippers to conduct a complete road-property analysis.

3. The SSAC rules require the complaining shipper to reconstruct all of the tracks making up the "predominant route of movement" covered by the challenged rate, with no ability to remove the costs of inefficiencies. This is an extremely difficult, cumbersome and expensive task for Ag Commodity movements, especially where the challenged rate represents more than a simple point-to-point movement from origin to one destination.

4. The SSAC rules apply the same "cross-subsidy" rules as those in SAC cases, thereby raising the same obstacle to Ag Commodity shippers located on or using low-density rail lines.

5. The SSAC rules limit a shipper's relief to the amount of traffic identified in the complaint for the most recently completed four quarters preceding the filing of the complaint. However, as explained above, the volumes in Ag Commodity movements change constantly from year to year, and even within a given year.

C. Class I Railroad Pricing Behavior and Flaws in the 3B Methodology Have Eliminated the 3B Rules as an Effective Deterrent to Unreasonable Ag Commodity Rail Rates

Finally, as the Board heard from the NGFA and other parties in EP 715, pricing practices of the Class I railroads since the Board's adoption of the 3B rules have rendered them ineffective for the purpose of determining rate reasonableness. Specifically, where a carrier uses its market power to impose a uniformly high rate across-the-board for certain commodities or groups of commodities, relief under the 3B rules becomes unavailable, since they are designed to remedy situations where a shipper is singled out for market abuse.¹⁶ The fact that under the current 3B rules, only the movements of the defendant railroad may be included in a comparison group compounds this flaw in the methodology.

Also, in the more recent of the few 3B cases filed at the Board, the railroad defendants raised numerous expert-intensive arguments on "other relevant factors" and arguments for the use of current waybill data in the possession of the defendant railroad, which greatly increased the complexity and costs of those cases.¹⁷ This has increased the uncertainty for future potential complainants who might consider testing the reasonableness of their rates under the 3B methodology.

¹⁶ See Ex Parte No. 715, *Rate Regulation Reforms*, Opening Comments of the NGFA, filed October 23, 2012, at 11. See, also, Ex Parte No. 646, *Rail Rate Challenges in Small Cases*, comments of U.S. Department of Transportation, filed February 26, 2007, at 6-7.

¹⁷ See Ex Parte No. 715, *Rate Regulation Reforms*, Opening Comments of the NGFA, filed October 23, 2012, at 9.

D. The Necessary Characteristics of Rules and Procedures for Ag Commodity Rate Challenges

Given the foregoing discussion of the unique nature of the Ag Commodity markets and the deficiencies in the current rate rules as applied to Ag Commodity transportation, the NGFA submits that there are several necessary components to a workable rail rate regime for Ag Commodity rail shippers that lack effective transportation alternatives:

1. The rules must be inexpensive to administer and preferably based upon an objective formula to provide a forum for complainants with smaller claims.
2. The rules must provide a meaningful constraint on the current unfettered ability of railroads to control unilaterally the access of captive Ag Commodities to markets through pricing and other measures, while reasonably preserving railroad revenues and incentives to invest in their systems.
3. Fluidity of the national and global agricultural markets requires rules that entail an expedited evidentiary presentation and final decision.

To achieve the twin policy goals of providing railroads with sufficient revenues while protecting the ability of captive shippers to access desired markets for their particular commodity, rate rules for Ag Commodities must set maximum reasonable rail rates taking into account a consideration of the rail transportation costs all other shippers of the same commodity are incurring to access the overall market. This should provide opportunities for captive producers, elevators, processors and exporters to expand the market for their commodities.

IV.

THE BOARD HAS AUTHORITY TO ADOPT RATE RULES SPECIFIC TO AG COMMODITIES, AND THE NGFA'S PROPOSAL APPROPRIATELY TAKES INTO ACCOUNT RAILROAD REVENUE ADEQUACY AND INDUSTRY REALITIES

A. The Board Has the Authority to Adopt Rail Rate Rules and Procedures that Apply Specifically to Ag Commodities.

The Board's authority to promulgate regulations to review the reasonableness of rail rates stems from 49 U.S.C. §10701, guided by the Rail Transportation Policy ("RTP") in 49 U.S.C.

§10101 and §10704. Section 10701(d)(1) states that, if the Board determines that a carrier has market dominance over the transportation to which a particular rate applies, "the rate established by such carrier for such transportation must be reasonable." The Board, when determining rate reasonableness, is required to give due consideration to the "Long Cannon" factors in §10701(d)(2), and to recognize the policy that railroads "shall earn adequate revenues, as established by the Board under section 10704(a)(2) of this title." *Id.* at §10701(d)(2). The RTP requires the Board to expeditiously handle and resolve rate proceedings, 49 U.S.C. 10101(15), and §10704(d) directs the Board, in part, to "establish procedures to ensure expeditious handling of challenges to the reasonableness of railroad rates." Nothing in these, or any other statutory provisions, precludes the Board from adopting rate rules that would apply to one group of commodities where, as with Ag Commodities, circumstances dictate it.

The NGFA's response to the Board's invitation in this proceeding is to urge the Board to adopt a new rate regulatory methodology and process to test the reasonableness of Ag Commodity rates, separate from, and in addition to, its existing rail rate rules. The proposed new methodology discussed in this Opening therefore is not being presented as an amendment to the current SSAC and 3B rules. These rules were adopted pursuant to 49 U.S.C. §10701(d)(3), which directed the Board to complete the rulemaking it started in Ex parte No. 347 (Sub-No. 2), *Rate Guidelines, Non-Coal Proceedings*. As such, §10701(d)(3) is arguably inapplicable to the NGFA's proposal.¹⁸

¹⁸ Even if §10701(d)(3) is determined to be applicable to the Ag Commodity specific proposal submitted in this Opening, the United States Court of Appeals for the District of Columbia Circuit has recently confirmed that this provision permits the Board to adopt rate reasonableness regulations that are less complicated and more expeditious for all rail rate cases, regardless of "the value of the case," and the Board is not required to only apply Full-SAC rules when the value of the case reaches a certain level. Case No. 13-1320, *CSX Transp., Inc., et al v. STB* (Opinion issued June 20, 2014)("EP 715 Opinion").

Finally, the various agency and appellate court decisions issued in *McCarty Farms* over its 18-year odyssey do not constrain the ability of the Board to adopt the Ag Commodity rate rules proposed in this Opening. Indeed, the ultimate result in *McCarty Farms* affirmed the futility of attempting to use SAC rules in place *at that time* to test the reasonableness of agricultural commodity rates, and changes to those rules in intervening years have made the SAC rules even *less* accessible to Ag Commodities and the SSAC rules also unusable.

In *McCarty Farms* an ICC administrative law judge, and then the ICC, found that the Burlington Northern Railroad Company's ("BN") rates for wheat and barley from Montana origins to the Pacific Northwest ("PNW") were unreasonable. In *McCarty Farms II*, the ICC rejected the application of SAC and Constrained Market Principles ("CMP") to the challenged movements for some of the reasons stated above in Part III.A, and instead found the rates to be unreasonable using a methodology that compared the revenue to variable cost ratio ("R/VC") of the issue movements to R/VC ratios produced on movements of similar traffic.¹⁹

Both BN and the McCarty parties appealed the ICC's decisions, which eventually resulted in the D.C. Circuit remanding the cases back to the ICC in 1993.²⁰ The court acknowledged that "[o]bviously the Commission is free to make reasonable trade-offs between the quality and cost of possible regulatory approaches. Reasonableness depends on how much quality is sacrificed for how much saving in cost, and of course we owe the Commission's judgment on the point great deference."²¹ However, the court rejected the ICC's use of the R/VC test as an alternative to SAC/CMP, ruling that the ICC had "not intelligibly explained why the

¹⁹ *McCarty Farms II* at 262.

²⁰ *Burlington Northern RR Co. v. Interstate Commerce Comm'n.*, 985 F.2d 589 (D.C. Cir. 1993).

²¹ *Id.* at 597.

trade-off chosen was reasonable.”²² Rather than litigate this issue further, the parties later voluntarily agreed to use SAC to test the reasonableness of the rates. This eventually led to a determination by the STB in *McCarty Farms III* that the rates were reasonable when the SAC test was applied.

The D.C. Circuit’s 1993 opinion confirms that under §10701 the Board has wide latitude in adopting rules to test the reasonableness of rail rates. However, the opinion otherwise has little or no application to the Board’s potential adoption of the Ag Commodity-specific methodology proposed by the NGFA, as the underpinnings and rationale of the court’s decision largely have been superseded by subsequent events and rulings.

First, the *McCarty Farms* cases were filed and the reasonableness of BN’s rates considered during a period when, unlike its successor in interest BNSF, BN clearly was not revenue adequate, which meant greater concern by the court for preserving railroad revenues. *See id.*, at 598 (“But as Burlington’s revenues were inadequate . . . it is not altogether clear why the rates charged constituted an abuse of market power within the Staggers Act frame of reference, with its heavy stress on revenue adequacy.”). This concern influenced the court’s finding of a “fundamental conceptual problem” with the R/VC method, specifically the notion that multiple cases that used the methodology for testing rail rates “would reduce rates to the lowest R/VC in the comparison group.”²³ The Board has since repeatedly rejected this “ratcheting” argument, first when it adopted its current 3B Rules in 2007,²⁴ and again in 2013 in the *EP 715 Decision*.²⁵ More significantly, the D.C. Circuit in its June 20, 2014 *EP 715*

²² *Id.*

²³ *Id.* at 597.

²⁴ STB Ex Parte No. 646 (Sub-No.1), *Simplified Standards for Rail Rate Cases*, Served September 5, 2007) at 74.

²⁵ *EP 715 Decision* at 24-25.

Opinion, after citing to its 2003 opinion in *McCarty Farms*, affirmed the Board's rejection of the railroads' ratcheting argument.²⁶ Indeed, the small number of cases that have been filed seeking to test rail rates using the 3B methodology has confirmed the correctness of the Board's rejection of the "ratcheting" arguments, and demonstrates that the D.C. Circuit's "fundamental conceptual problem" in *McCarty Farms* was solved by subsequent real-world actions. Moreover, as railroads reach revenue adequacy, their justification for charging their captive shippers higher rates through differential pricing is diminished, if not eliminated altogether, so the ratcheting argument has even less merit today.

The court also based its decision on a conclusion that "the relation of R/VC to revenue adequacy is most obscure."²⁷ The implication of such a statement was that BN's charging of rates with high R/VC ratios could not be considered an abuse of market power because BNSF was not revenue-adequate during the period they were charged.²⁸ This rationale no longer is applicable since BNSF *is* revenue-adequate. Moreover, the statement is contrary to the well-established rule that a railroad's rates can be found to be unreasonable even if that railroad is not revenue-adequate.²⁹

Finally, the court also rejected the ICC's practical "cost" basis for using its R/VC methodology instead of SAC/CMP in *McCarty Farms*. Specifically, the court did not accept the ICC's rationale that "when, as here, there are multiple, scattered points of origin, it is very costly (or perhaps impossible) to develop stand-alone figures for rates under review," *Id.* at 598, and that SAC worked best for coal shipments, not wheat and barley. In rejecting these reasons for the ICC's decisions, the court pointed to two coal cases that it stated were "apparently analogous"

²⁶ *Id.* at 17.

²⁷ 985 F.2d at 597.

²⁸ *Id.* at 598.

²⁹ See e.g., *McCarty Farms II* at 280. *Coal Rate Guidelines, Nationwide*, 1 I.C.C. 2d at 536.

to the *McCarty Farms* facts in terms of multiple origins and/or destinations and volumes.³⁰ Of course, this rationale later proved to be flatly wrong, given the failed attempt to later apply the SAC rules to the *McCarty Farms* cases, and the lack of any other subsequent SAC cases for agricultural commodity rates over the next 21 years.

The court's rationale for rejecting the ICC's "cost" basis has no application to the methodology proposed by the NGFA for other reasons. First, the court's conclusions were narrowly based on the fact that the *McCarty Farms* case entailed the aggregation of "272 origins to a handful of destination points in the Pacific Northwest Coast."³¹ Thus, the rationale, even if valid, would have no application to the vast majority of Ag Commodity cases which would be brought by a single rail shipper or even a group of rail shippers.³² Moreover, the current application of the court's rationale to even the very narrow case in which individual claims were aggregated to the extent they were in *McCarty Farms* has been undermined by changes to the SAC rules since 1993 that have made them even less accessible to Ag Commodity movements. These include the "cross-subsidy" rules in *Otter Tail* and *PPL* discussed above in Part III, which invalidate SAC railroad models containing low-density lines, and which essentially have eliminated the use of the SAC rules to test the reasonableness of Ag Commodity rail rates.

B. The Nation's Class I Railroads Are Either Revenue-Adequate or Are Close Enough to Reaching Revenue Adequacy to Justify a Rate-Reasonableness Process Based upon Revenue Adequacy Principles

1. The U.S. Class I Railroads Must Be Considered Revenue-Adequate by the Board for Rate Reasonableness Review Purposes

³⁰ *Metropolitan Edison Co. v. Conrail*, 5 I.C.C. 2d 385 (1989) and *Coal Trading Corp v. Baltimore & Ohio RR*, 6 I.C.C. 2d 361 (1990). *Id*

³¹ *Id.* at 598.

³² *Id.* at 599.

The NGFA concurs with many other parties who believe the Class I railroads have achieved "revenue adequacy" as envisioned by the drafters of the Staggers Rail Act of 1980, and that the Board's formula for determining the revenue adequacy of the Class I railroads is flawed and not representative of the true financial health of the Class I railroads. For years, the railroads' true robust financial health has been observed by Wall Street analysts³³ and by other outside observers, exemplified by a 2013 report issued by the staff of the Senate Committee on Science, Commerce, and Transportation, which was an update of a 2010 report on the same subject.³⁴ The Board now is seeking public comments and evidence on its revenue adequacy methodology in EP 722, and in EP 664 (Sub-No. 2), *Petition of the Western Coal Traffic League to Institute a Rulemaking Proceeding to Abolish Use of the Multi-stage Discounted Cash Flow Model in Determining the Railroad Industry's Cost of Capital*.

Even under the Board's current flawed methodology, however, the U.S. Class I railroads are either revenue adequate, or very close to being so. On January 2, 2014, the Board served several decisions that determined that three of the four U.S. Class I railroads – Union Pacific Railroad Company ("UP"), Norfolk Southern Railway ("NS"), and BNSF Railway Company ("BNSF") - were all revenue-adequate for the years 2011 and 2012, and that UP was also revenue-adequate in 2010. Moreover, according to the Board's present methodology, a fourth

³³ See Fapp V.S. at 16-17.

³⁴ Committee on Commerce, Science, and Transportation, Office of Oversight and Investigations Minority Staff, *Update on the Financial State of the Class I Freight Rail Industry*, Staff Report for Chairman Rockefeller, November 21, 2013.

Class I railroad, CSX Transportation Company, has hovered around the revenue adequacy level for the last three years.³⁵

The NGFA believes that the achievement of revenue adequacy by most of the Class I railroads, and the near-revenue adequacy of others, even under the Board's current formula, presents the Board with a unique opportunity to explore alternative rate reasonableness rules that take into account the revenue-adequate status of the defendant railroad. The proposed ACMRM incorporates such concepts.

2. The Board Should Revise Its Determination of Revenue Adequacy for CP's and CN's U.S. Affiliates to Include Data on the CP and CN as a Whole

As stated previously, the NGFA is not, in this Opening, proposing any specific changes to the Board's current methodology for determining railroad revenue adequacy. The Board has asked for such suggestions in EP 722, which should proceed on a separate track from this proceeding. However, the NGFA maintains that rail rate reasonableness for Ag Commodity rates that incorporate railroad revenue adequacy concepts must be accompanied by a reevaluation by the Board of how it determines the revenue adequacy of the CN and CP, both of which transport significant volumes of Ag Commodities in the U.S., ostensibly through corporate subsidiaries. These subsidiaries - Grand Trunk Corporation for CN, and Soo Line Corporation for CP - are determined consistently under the Board's current procedures to be substantially less revenue adequate than U.S. Class I railroads because the current procedures require only that CN and CP provide data in R-1 reports for their consolidated U.S. operations.³⁶

³⁵ In 2010, CSXT's return on investment was 0.17 percent below the industry cost of capital. In 2011, the difference in CSXT's ROI and the industry cost of capital fell to 0.03 percent, while in 2012, the difference was 0.31 percent.

³⁶ Fapp V.S. at 17. See e.g., Docket EP 552 (Sub-No. 17), *Railroad Revenue Adequacy - 2012 Determination* (Served January 2, 2014), Appendix A.

Yet, when the revenue adequacy of the CN and CP as a whole is examined, these railroads would be, or would soon become, revenue adequate even under the Board's current flawed methodology.³⁷ The NGFA submits that the time is ripe for the Board to reexamine how it determines the revenue adequacy of CN and CP, since continuation of the *status quo* - whereby these two Class I railroads would continue to be treated as revenue inadequate for purposes of U.S. rate-reasonableness determinations while all other Class I railroads operating in the U.S. are considered revenue adequate - could lead to inequities and unwarranted competitive advantages for these two railroads.

Reviewing the consolidated operations of CN and CP for revenue-adequacy determinations would be consistent with Board precedent. Specifically, in Ex Parte No. 393 (Sub-No. 1) *Standards for Railroad Revenue Adequacy*, 3 ICC 2d 261 (1986), the ICC reviewed the question of railroad affiliates and determined it would "continue to endorse the concept of consolidation for revenue adequacy purposes."³⁸ It left open the possibility of determining revenue adequacy separately for affiliated Class I railroads, but only in cases where "two railroads could, for example, be under common control but, nevertheless be independently managed and form separate and distinct rail systems. In that situation, consolidation would be

³⁷ Fapp V.S. at 17-20. In maintaining its focus on responding to the Board's inquiry in this proceeding, this Opening narrowly addresses the NGFA's belief that the Board should determine revenue adequacy for the CN and CP by reviewing the revenue adequacy of each company as a whole since they transport significant quantities of Ag Commodities. However, the testimony and information provided by Mr. Fapp in his Verified Statement on corporate structuring by the Class I railroads and their parents and subsidiaries could be useful to the Board should it desire to take a broader view of how it factors in corporate structure in determining revenue adequacy for all Class I railroads.

³⁸ *Id.* at 302.

inappropriate, since it is highly unlikely that a decision affecting one railroad would also affect the other railroad."³⁹

The NGFA submits that neither Grand Trunk Lines nor Soo Line Railroad are presently "separate and distinct rail systems" which are managed independently from their Canadian parent company railroads. As only a few examples, (1) neither U.S. subsidiary has tariffs nor common carrier documents in its own name. Rather, requests for rates and service terms are made to CN and CP marketing departments, which issue the rates and negotiate the contracts and other terms; (2) railroad operating personnel and staff dealing with U.S. customers are invariably CN and CP employees; (3) locomotives and other rail equipment of CP and CN are utilized all over their respective North American systems; and (4) disputes concerning land use and access over CP tracks and land owned by CP in the United States are directed to and handled by CP's real estate department. It therefore is highly likely that any decision affecting the Soo Line or Grand Trunk companies directly will affect CP or CN, respectively, and vice versa. Thus, STB precedent would support discontinuing the policy of determining the revenue-adequate status of CN and CP by reviewing only data provided for their U.S.-affiliate companies.

Finally, 49 U.S.C. §10704(a)(2) states that the Board's revenue-adequacy determination shall be made "for rail carriers providing transportation subject to its jurisdiction under this part," and that the Board shall "assist those carriers in attaining revenue levels prescribed under this paragraph." Under §10501(a)(1) and (2), the Board has jurisdiction over "transportation by a rail carrier" and this jurisdiction applies "only to transportation in the United States" This should not prevent the Board from revising its rules for determining revenue adequacy to review

³⁹ *Id.* at 303.

the consolidated CN and CP systems, however, if CN and CP provide "transportation" functions in the United States. Specifically, "transportation" is broadly defined as

(A) a locomotive, car, vehicle, vessel, warehouse, wharf, pier, dock, yard, property, facility, instrumentality, or equipment of any kind related to the movement of passengers or property, or both, by rail, regardless of ownership or an agreement concerning use; and

(B) services related to that movement, including receipt, delivery, elevation, transfer in transit, refrigeration, icing, ventilation, storage, handling, and interchange of passengers an property;

As noted above, CN and CP provide locomotives, railcars, facilities, and other services to their U.S. customers that fall within this broad definition. The NGFA submits that the Board should seek public comments on these and other issues related to the revenue adequacy calculations for CN and CP, either in a notice of proposed rulemaking in this proceeding or in EP 722.

V.

THE NGFA'S PROPOSED "GRAIN"-SPECIFIC RAIL RATE REASONABLENESS METHODOLOGY

A. The Appropriate Definition of "Grain" for Purposes of this Proceeding

In the *EP 665-1 Decision*, the Board invited public comment on "how to ensure the Board's rate-complaint procedures are accessible to grain shippers and provide effective protection against unreasonable freight rail transportation rates."⁴⁰ The Board did not define the agricultural commodities encompassed by term "grain." Nor was the term "grain" defined in the predecessor to this proceeding - EP 665, *Rail Transportation of Grain* - or the 2006 United

⁴⁰ *EP 665-1 Decision* at 2.

States Government Accountability Office report that prompted that prior proceeding.⁴¹ The term "grain" is defined at 7 U.S.C. §75 as including "corn, wheat, rye, oats, barley, flaxseed, sorghum, soybeans, mixed grains, and any other food grains, feed grains, and oilseeds for which standards are established under Section 76 of this title." This group of agricultural commodities is included within the broader category of "agricultural products" to which the railroads' rate-establishment obligations found at 49 U.S.C. §11101(d) are applicable. Under this provision, "agricultural products" include "grain" as defined above "and all products thereof, and fertilizer."

The NGFA submits that the definition of "grain" for purposes of this proceeding should be broad and inclusive of agricultural commodities that move by railroad. As stated previously, the NGFA proposes that the term should encompass Ag Commodities, which are all of the commodities listed in the National Grain and Feed Association's Rail Arbitration Rules, and listed in Exhibit 2 of the Crowley V.S.

B. Summary of the Ag Commodity Maximum Rate Methodology

1. Introduction

Because the current rules to test the reasonableness of rail rates have proven to be unusable for Ag Commodity rail rates, the NGFA undertook the time, effort and expense to develop a new methodology to propose to the Board that addressed the industry and market issues discussed in Part II of this Opening, while creating a low cost, efficient means to seek rate relief from the Board if an Ag Commodity shipper or group of shippers believed its or their rail rate(s) were unreasonably high. This proposed methodology - the ACMRM - and its conceptual underpinnings are discussed in detail by Mr. Crowley in his Verified Statement at pages 7- 18.

⁴¹ United States Government Accountability Office, *Report to Congressional Requesters, Freight Railroads – Industry Health has Improved, but Concerns about Competition and Capacity Should be Addressed*, GAO-07-04 (October 6, 2006).

The ACMRM would be utilized in lieu of the current SAC, SSAC, and 3B rules to test the reasonableness of Ag Commodity rates. As explained in more detail below and in the Crowley V.S., the ACMRM builds upon current rules and principles utilized by the Board in its 3B rules. For example, the ACMRM entails the submission of evidence based upon the Confidential Waybill Sample (Unmasked). In addition, the ACMRM would entail the analysis of the rates of comparable traffic.

However, the ACMRM would modify certain current STB rate-review policies to account for the national and international characteristics of the Ag Commodity markets discussed previously, and to counter the "across-the-board" rate-setting practices of railroads and other factors that have rendered the 3B methodology largely useless to Ag Commodity shippers. First, the ACMRM would entail an analysis of comparable traffic drawn from the waybill data for all railroads, not just the defendant railroad(s). Expanding the comparable traffic group to include all other comparable shipments of the commodity in question by other railroads would address the "across-the-board" pricing practices that have undermined the 3B, and provide a more complete view of the benchmark rail rate for certain commodities moving certain distances. By determining a benchmark "market" rate for comparable movements, the methodology would address, to some extent, the current ability and practice of the Class I railroads to limit the ability of a captive shipper or a group of captive shippers to reach desired markets for Ag Commodity shipments by setting rail rates that largely dictate where the shipper's commodity goes on that railroad's system.

The NGFA realizes that the inclusion of comparable movements from non-defendants in the Waybill Sample in a comparison group would be a departure from the Board's decision in

Simplified Standards to exclude non-defendant traffic from comparison groups in 3B cases.⁴² However, for the reasons stated above, and those contained in the *Crowley V.S.* at pages 9 -11, the NGFA maintains that reasonable grounds exist for the Board to apply a different policy when promulgating the ACMRM.

A second policy change encompassed within the ACMRM is to include all comparable movements in the comparison group, even those with R/VC ratios less than 180%. This feature is essential because captive Ag Commodity producers and elevators, in particular, are competing in the marketplace against other Ag Commodity shipments with rates above and below the 180% threshold. They do not just compete against other captive Ag Commodity shippers. As such, limiting the comparable group to only movements that exceed a 180% R/VC ratio would not provide a sufficient representation of the market rail rates for the commodity in question.⁴³ Accordingly, under the ACMRM, all comparable movements in the Confidential Waybill Sample would be included in a comparison group, regardless of their R/VC ratio. However, the maximum reasonable rate produced by the analysis would be subject to the statutory 180% floor. Thus, while the ability of a captive Ag Commodity shipper to access certain markets might improve in certain cases by examining the reasonableness of the rail rate against the "market" rail rate for that commodity and rail movement, the increased access would still be constrained by the 180% floor, and the defendant railroad would continue to receive the revenue protections afforded by §10707(d)(1)(A).

⁴² *Simplified Standards* at 82.

⁴³ *Crowley V.S.* at 9.

Other aspects of the current 3B rules also would be modified for the purpose of simplifying and streamlining the process. Specifically, the “confidence interval” would be eliminated, and there would be no consideration of “other relevant factors.”⁴⁴

Finally, the ACMRM would take into account the revenue-adequate status of the defendant railroad and other railroads transporting comparable traffic, as determined by STB procedures, by making appropriate, commodity-specific adjustments to the R/VC ratios of rates in the comparable group based upon the Revenue Adequacy Adjustment Factor (“RAAF”) described in more detail in Subsection 2 below and in the Verified Statement of Mr. Crowley.

To summarize, the maximum reasonable rate for a captive Ag Commodity rail rate would be determined as follows under the NGFA-proposed ACMRM methodology:

- The reasonableness of rates would be determined by analyzing the rates of comparable traffic⁴⁵ of all railroads as reported in the Board’s unmasked Confidential Waybill Sample in existence when the complaint was filed. Neither the railroad defendant nor the complainant would be permitted to use current railroad waybill data so as to keep the process simple and the cost of rate challenges reasonable.
- The comparable group would be based on the 5- or 7-digit STCC code of the issue traffic, and would be drawn from all movements of that STCC Code with similar operating factors.⁴⁶
- Comparable distance would be established at +/- 20% of the issue traffic distance.
- Because all comparable movements in the Confidential Waybill Sample provided to the parties would be included in the comparable group for determining the maximum reasonable rate(s), the Board’s current selection process utilized in the 3B method should not be needed.

⁴⁴ *Id.* at 16-17.

⁴⁵ *Id.* at 8, listing the comparability criteria.

⁴⁶ The use of 5-digit STCC or 7-digit STCC will depend upon how the commodity at issue is defined. For example, the NGFA Rail Arbitration Rules define ethanol by a 7-digit STCC, while the majority of the other products are defined by 5-digit STCC.

- Variable costs would be calculated based upon the Uniform Railroad Costing System ("URCS") Phase III model with no movement-specific adjustments other than the STB-specified nine (9) inputs.
- Movement specific R/VC ratios would be developed, and then adjusted by a commodity specific Revenue Adequacy Adjustment Factor ("RAAF").
- To meet the requirement that captive Ag Commodity rate cases should be decided quickly, and at reasonable cost, there would be no "confidence-interval" adjustment, and no determination of "other relevant factors" as currently called for in 3B cases.
- There would be no limits on the amount of relief that the complaining shipper or group of shippers could receive if a rate challenge is successful.
- The rate prescription period would be five (5) years.
- Prescribed maximum reasonable rates, expressed as an R/VC ratio, would be adjusted pursuant to the current maximum reasonable rate adjustment procedures utilized by the Board.⁴⁷

2. The Revenue Adequacy Adjustment Factor

The RAAF would be used to adjust the R/VC ratios of the movements in the comparable group to account for the revenue adequacy status of each railroad. The RAAF would be calculated by the Board annually for each Ag Commodity for each railroad based upon the STB's revenue adequacy determination, and other publicly available information produced by the Board. The formula for determining the RAAF is set forth in Exhibit 5 of the Crowley V.S. Under the formula, which would be relatively simple and transparent to administer and apply, the RAAF for a railroad that has been determined to be revenue adequate by the Board's procedures would be a negative number, while the RAAF for a railroad that has not been determined by the Board's procedures to be revenue adequate would be a positive number.

Under the methodology, the rate for each movement in the comparable group would be adjusted, up or down, by the RAAF calculated for the applicable railroad for that commodity.

⁴⁷ Crowley V.S. at 18-20.

The average of the RAAF-adjusted rates then would be used to produce a RAAF-Adjusted R/VC ratio that, subject to the jurisdictional floor of 180% of URCS Phase III variable costs, would be used to establish the RAAF Adjusted Issue Traffic Rate. This rate would be the maximum reasonable rate that could be charged for the issue movement for the five year prescription period, while maintaining the defendant's revenue-adequate status. Examples of the application of the ACMRM for hypothetical challenged rates of each the five commodities focused on by the NGFA in this Opening are included in the Crowley V.S. at Exhibit 6.⁴⁸

3. Standing, Market Dominance and Procedural Rules

a. Parties Directly or Indirectly Harmed by the Ag Commodity Rail Rate Would Continue to Have Standing to Seek Rate Relief

The rate rules the Board adopts for Ag Commodity shippers must not curtail the ability of parties who are both directly and indirectly affected by high rail rates to have standing to challenge the reasonableness of the rate. Because of the structure of the Ag Commodity industry, potential parties harmed by unreasonably high rail rates can include (1) individual farmers, farmer cooperatives, grain elevators and marketers, processors, commodity receivers, exporters and other market participants, as well as (2) groups of these and other market participants, whether filing on their own behalf or under complaints filed by state agencies or attorneys general. The standing of parties who are directly and indirectly injured by unreasonable rates is governed by 49 U.S.C. §11701(b), which provides in relevant part that “the Board may not dismiss a complaint made against a rail carrier providing transportation subject to the jurisdiction of the Board under this part because of the absence of direct damage to the complainant.”

⁴⁸ The movements in the comparable group for each example are drawn from the Confidential Waybill Sample, but the example group is truncated to simplify the examples for demonstration purposes.

The inclusion of Section §11701(b) in ICCTA was a continuation of prior law and ICC policy. As noted previously in this Opening, the *McCarty Farms* case began as a class action suit filed in the U.S. District Court for the District of Montana on behalf of 10,000 Montana farmers and grain elevators (referred to collectively as "McCarty" by the STB). When the original case was referred to the ICC by the district court, McCarty filed another complaint at the ICC alleging that other BN rates for wheat, and certain rates for barley, also were unreasonable. The two complaints subsequently were consolidated with a third complaint, filed by the Montana Department of Agriculture and the Montana Wheat Research and Marketing Committee challenging the reasonableness of wheat and barley rates from Montana to the PNW.

Arguments in those cases by BN that the plaintiff wheat growers lacked individual standing because they were one or more commercial transactions removed from the rail transportation under the challenged rates were rejected by the U.S. District Court for the District of Montana, which found that the wheat-growers established they had sustained "injury in fact" and their interests were within the scope of interests protected by the Interstate Commerce Act.⁴⁹ This is consistent with ICC precedent considering standing issues. In *Wakefern Food Corporation v. Southwest Freight Lines, Inc.*, 3 I.C.C. 814 (1987), the ICC rejected the defendant carrier's argument that Wakefern, a wholesale food distributor, did not have standing to challenge its rates because the rates at issue were quoted to San Antonio Foreign Trading Company, a food broker, rather than to Wakefern itself. In doing so, the ICC noted that San Antonio was Wakefern's agent and, moreover, Wakefern ultimately was liable for the freight charges, whether directly or indirectly).⁵⁰

⁴⁹ *McCarty Farms, Inc. v. Burlington Northern, Inc.*, 91 F.R.D. 486 (1981).

⁵⁰ See also *James Riffin D/B/A/ the Northern Central Railroad – Acquisition and Operation Exemption – In York County, PA*, STB Docket No. 34552 (STB Served Feb. 23, 2005) (holding

b. Determinations of Qualitative Market Dominance in Ag Commodity Cases Must Reflect the Need for Expeditious Resolution of Cases

The ACMRM is designed to be an easily administered, inexpensive means to test the reasonableness of Ag Commodity rail rates. As described below, the NGFA in this Opening has suggested a procedural schedule which is based upon the current schedule for processing 3B cases, but as modified can produce a final decision in 170 days or less. It therefore is imperative that the rules for determining whether a railroad has qualitative market dominance over a movement or group of movements covered by a complaint are consistent with these objectives, and do not instead serve as a means to drag out the processing of the case and increase its costs, thereby cancelling out the benefits of the other components.

In some instances, such as complaints filed by, or on behalf of, a grain elevator or other facility that clearly has no other intermodal alternatives to the defendant railroad, qualitative market dominance may well be conceded by the defendant carrier. However, in other cases, qualitative market dominance might be disputed, requiring evidentiary submissions to be made. The NGFA submits that the Board's long-standing precedent on determining "effective" competition under 49 U.S.C. §10707,⁵¹ combined with an affirmative commitment by the Board to decide market-dominance issues within the time allotted by the proposed procedural schedule,

that the State of Maryland had standing to seek a revocation of a notice for exemption to acquire a rail line, where the party seeking the exemption would ultimately use its resulting authority as authorization to construct facilities on property in Maryland). In the *Riffin* case, the STB applied a three-part test devised and widely accepted by the courts to determine whether a party has standing to bring a complaint: (1) the party must have suffered an injury in fact; (2) the injury must be fairly traceable to the defendant's challenged conduct; and (3) the injury must be one that is likely to be redressed through a favorable decision. *See Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-61 (1992).

⁵¹ *See, e.g., McCarty Farms I* at 827-32; *Ariz. Pub. Serv. Co. v. United States*, 742 F.2d 644, 650-51 (D.C. Cir. 1984); *Market Dominance Determinations & Consideration of Prod. Competition*, 365 I.C.C. 118, 129 (1981).

should be the default process for making qualitative market-dominance determinations in Ag Commodity rate cases.

The NGFA does not support testing qualitative market dominance in Ag Commodity rate cases using the so-called "Limit Price" test for qualitative market dominance developed by the Board and first applied in *M&G Polymers USA, LLC v. CSX Transp., Inc.*, NOR 42123 ("*M&G*"), and then applied again by a split Board on its own motion in *Total Petrochemicals & Refining USA, Inc. v. CSX Transp., Inc.*, NOR 42121 ("*Total*"). This test appears to have been developed and applied by the Board to address the specific facts before it in two very complicated SAC adjudications involving non-agricultural commodities, one of which (*M&G*) settled prior to issuance of a final, unappealable decision. In the *Total* case, CSXT has appealed the Board's *sua sponte* use of the "Limit Price" test to the D.C. Circuit.⁵² The NGFA maintains that, before the "Limit Price" test, or some version of it, is proposed to be applied more broadly to determine qualitative market dominance in rate cases involving other commodities, particularly Ag Commodities, the Board first should receive additional public comment on the test and its theoretical underpinnings.⁵³ In the meantime, the Board should apply the established rules for determining "effective" competition that it historically has applied in rail rate cases, combined with a commitment to expeditiously decide qualitative market dominance disputes.

c. The Board's Procedural Rules for Ag Commodity Cases Must Reflect the Need for Inexpensive, Expedited Consideration of Complaints

The rules proposed above describe an objective, uncomplicated, formula-based process that easily could be administered by the Board and utilized by the parties to evaluate potential

⁵² *CSX Transportation, Inc. v. STB*, No. 13-1313 (D.C. Cir. Filed Dec. 26, 2013). Final briefs were filed in that case on June 12, 2014, and oral argument is scheduled for September 22, 2014.

⁵³ *Total*, Decision served May 31, 2013 at 30-31 (Begeman Dissent).

cases and present them to the Board in a formal proceeding. This is consistent with the requirement that Ag Commodity rate complaints must be inexpensive and quickly processed. In furtherance of this objective, the NGFA has proposed procedural rules that would enable an Ag Commodity rate proceeding to be completed and a decision rendered within 170 days or less. This schedule uses the existing 3B methodology procedural schedule at 49 C.F.R. §1111.9(a)(2) as its starting point, and then makes a few changes consistent with the issues raised and the proposed ACMRM presented in this Opening. In addition, the schedule would make mediation optional upon filing the complaint in order to accelerate the submission of evidence and reaching of a decision. The proposed procedural schedule is attached as Exhibit 1 to this Opening.

VI.

THE ACMRM WOULD HAVE LIMITED IMPACT ON RAILROAD REVENUES

The NGFA does not believe that the adoption ACMRM methodology would result in large numbers of captive Ag Commodity rail shippers rushing to file rate complaints at the Board. Indeed, the Board has seen relatively small numbers of rate cases under any of its rate reasonableness rules. Moreover, many considerations go into a decision to engage in rate reasonableness litigation, including whether a meaningful commercial resolution can be achieved. Rate rules that have at least the semblance of being accessible and usable, in the sense that they provide a rail shipper with a fair and cost-effective means to potentially obtain rate relief, can facilitate such non-litigated resolutions to rate disputes. Indeed, that has been the NGFA's experience under its Rail Arbitration Rules, which provide a mechanism for shippers to challenge certain rail practices. For rail rate cases, other considerations for Ag Commodity shippers include whether filing a complaint will result in retaliation by the railroad defendant, or strain future business relationships. Moreover, not every Ag Commodity shipper who has rates

in excess of 180% of the URCS variable costs of providing the service will be able to demonstrate that qualitative market dominance also is present.

However, even if every potential Ag Commodity shipper with rail rates with R/VC ratios greater than 180% filed a complaint and received the full amount of relief available under the ACMRM methodology, the reduction in Class I railroad revenues would range only from 8% to 18%.⁵⁴ Further, such a "worst case" scenario would have no effect on the current revenue adequate status of any of the Class I railroads.⁵⁵

VII.

CONCLUSIONS AND SUMMARY OF RECOMMENDATIONS

The NGFA again commends the Board for commencing this proceeding, and reiterates that the NGFA has responded to the Board's invitation by attempting to fashion a substantive new proposal for Ag Commodity rate reasonableness rules and procedures to resolve many of the issues that have prevented the current rate rules from being usable by captive Ag Commodity shippers. The NGFA respectfully requests that the Board issue a notice of proposed rulemaking to enable public comments on the various components of its proposal, and to expeditiously move toward promulgating final rules that include the ACMRM and related components discussed in this Opening. The NGFA respectfully submits that the failure to do so will continue the unacceptable status quo of leaving captive Ag Commodity rail shippers and other parties affected by high rail rates with no meaningful way to exercise their statutory right to seek determinations of whether those rates are reasonable.

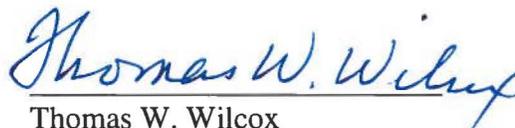
In addition, the NGFA submits that the new procedural and substantive rules for testing the reasonableness of rail rate rules for Ag Commodities will be affected directly by, and are

⁵⁴ Crowley V.S. at 17-18 and Exhibit 7.

⁵⁵ *Id.*, Exhibit 8.

closely interrelated with, other aspects of railroad regulation the Board is examining. These include the issues being explored in EP 722. However, the Board's consideration of whether to issue proposed rules to govern "competitive switching" standards in EP 711, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules*, also is significant for captive Ag Commodity shippers, since improvement in the ability to access alternative carriers and routings for Ag commodities should be expected to impact railroad rates. Rate-reasonableness rules also are directly affected by the Board's ongoing efforts to improve and update its URCS. Thus, the NGFA encourages the Board to continue to take an integrated approach that recognizes the importance of each of these interrelated components.

Respectfully submitted,



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June 26, 2014

CERTIFICATE OF SERVICE

I hereby certify that on this 26th day of June 2014, I served a copy of the foregoing Opening Comments and Evidence of The National Grain and Feed Association on all parties of record via first-class mail.


Thomas W. Wilcox

Exhibit 1

Procedural Rules to Govern Ag Commodity Rail Rate Cases under the Ag Commodity Maximum Rate Methodology

A. Contents of Complaint

1. Include information presently called for in 1111.1(a)(1) - (10)(URCS Phase III inputs).

2. Include information called for by 1111.1(b)(all documents demonstrating the lack of effective transportation alternatives, and the documents supporting the Phase III input data. The Board's "limit price" market dominance test would not apply).

B. Schedule if Mediation (Based on 3B schedule in 1111.9(a)(2))

Day 0 - Complaint filed (including complainant's disclosure)

Day 10 - Mediation begins if requested by a party within 5 days of the Complaint being filed (STB produces unmasked Waybill Sample for all railroads to Complainant based on 5-digit or 7-digit STCC)

Day 20 - Defendant's Answer to Complaint (including disclosure of the R/VC ratios for the subject movements and all supporting documents to the Phase III inputs)

Day 30 - Mediation ends; discovery begins (Discovery would be limited as is currently for 3B cases)

Day 37 - Conference between the parties pursuant to 1111.10(a) to discuss discovery and procedural matters

Day 60 - Discovery closes

Day 85 - Complainant's Opening (tender of RAAF-adjusted comparison group and opening evidence on market dominance); Defendant's opening (initial tender of RAAF-adjusted comparison group)

Day 95 - Mandatory Technical Conference on comparison group evidence

Day 115 - Parties' final comparison groups; Defendant's reply on market dominance

Day 140 - Parties reply to final tenders. Complainant's rebuttal on market dominance

Day 170 - Final decision

Exhibit 1, cont'd

C. Schedule if no mediation (Based on 3B schedule in 1111.9(a)(2))

Day 0 - Complaint filed (including complainant's disclosure)

Day 5 - Discovery begins (Discovery would be limited as is currently for 3B cases)

Day 10 - (STB produces unmasked Waybill Sample for all railroads to Complainant based on 5-digit or 7-digit STCC)

Day 20 - Defendant's Answer to Complaint (including disclosure of the R/VC ratios for the subject movements and all supporting documents to the Phase III inputs)

Day 27 - Conference between the parties pursuant to 1111.10(a) to discuss discovery and procedural matters

Day 60 - Discovery closes

Day 75 - Complainant's Opening (tender of RAAF-adjusted comparison group and opening evidence on market dominance); Defendant's opening (initial tender of RAAF-adjusted comparison group)

Day 85 - Mandatory Technical Conference on comparison group evidence

Day 105 - Parties' final comparison groups; Defendant's reply on market dominance

Day 130 - Parties reply to final tenders. Complainant's rebuttal on market dominance

Day 160 - Final decision

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LIST OF EXHIBITS

<u>Exhibit No.</u>	<u>Title</u>
(1)	(2)
1	Statement of Qualifications
2	Canadian National Railway Return On Investment – 2011 and 2012
3	Canadian Pacific Return On Investment – 2011 and 2012

I. INTRODUCTION

I am Daniel L. Fapp, an economist and a Vice President of L. E. Peabody & Associates, Inc., an economic consulting firm that specializes in solving economic, transportation, marketing, financial, accounting and fuel supply problems. I have been employed by L. E. Peabody & Associates, Inc. since 1997 where my consulting assignments regularly involve working with and determining various facets of railroad financial issues, including cost of capital determinations, asset valuations and capital budgeting. Prior to joining L. E. Peabody & Associates, Inc., I was employed by BHP Copper Inc. in the role of Transportation Manager - Finance and Administration, where I also served as an officer and Treasurer of the three BHP Copper Inc. common carrier subsidiary railroads. I have lectured in under graduate and graduate level finance and economics classes discussing corporate capital theory and costs of equity determination, and am a member of the Professional Advisory Council for the Eller School of Management Finance Department at the University of Arizona. A copy of my credentials is included as Exhibit No. 1 to this verified statement (“VS”).

I have been requested by the National Grain and Feed Association (“NGFA”) to address several issues related to corporate structure and revenue adequacy determinations. First, the NGFA requested that I discuss railroad corporate structures and the reasons for the establishment of subsidiary companies. Second, I have been requested to discuss consolidated and unconsolidated financial statements and how the Surface Transportation Board’s (“STB” or “Board”) consolidation process works for Annual Report Form R-1 reporting. Third, I have been asked to explain how different corporate structures can impact a railroad’s revenue adequacy, particularly on the two Canadian Class I railroads, the Canadian National Railway Company (“CN”) and Canadian Pacific Railway (“CP”), and how using holding parent company financial metrics can provide a truer picture of the railroads’ actual financial performances.

I address the issues summarized above under the following topical headings:

- II. Corporate Structure
- III. Consolidated Financial Statements
- IV. Revenue Adequacy

II. CORPORATE STRUCTURE

As business enterprises grow in size and complexity, it is common to find them owning and/or controlling one or more subsidiary organizations. A subsidiary is a separate company that is completely or partly owned by another corporation that owns more than half of the subsidiary's common equity. The controlling entity is commonly called a parent company, parent, or holding company, and can own any number of subsidiary corporations.¹ Subsidiaries can take many different corporate forms including corporation and limited liability companies.

In describing corporate structures for larger, complex organizations, the terms "first-tier subsidiary," "second-tier subsidiary," "third-tier subsidiary" etc. are often used to describe multiple levels of subsidiaries. A first-tier subsidiary means a subsidiary/daughter company of the ultimate parent company, while a second-tier subsidiary is a subsidiary of a first-tier subsidiary. Consequently, a third-tier subsidiary is a subsidiary of a second-tier subsidiary—a "great-granddaughter" of the main parent company. Cross-tier ownership is also possible, where two second-tier subsidiaries could each hold a 50 percent interest in a third-tier subsidiary.

The benefits of such tiered corporate structures are numerous. As such, the railroad industry is dominated by tiered corporate structures. I explain the reasons for this below.

A. BENEFITS OF SUBSIDIARIES

Configuring a new or acquired business as a subsidiary instead of a separate business unit has three primary benefits. First, parent companies can obtain substantial tax benefits and savings by creating subsidiary organizations rather than creating new divisions of the existing parent company. Second, companies who have subsidiaries also have added legal protection

¹ Subsidiaries can be described in several ways. A wholly-owned subsidiary is one in which a parent company owns 100 percent of the common stock of the subsidiary. An indirect wholly-owned subsidiary is one in which a parent company owns 100 percent of a subsidiary, and in turn, that subsidiary owns 100 percent of another subsidiary.

from potential plaintiffs and creditors. Third, parent companies will form subsidiaries to take advantage of regulatory benefits and/or avoid regulatory oversight.

1. Tax Benefits

The principal tax benefit associated with adopting a subsidiary structure is the ability of a company, on federal income tax returns, to offset profits in one part of the business with losses in another while shielding itself from certain liabilities. For example, if a parent company records a profit of \$100 million dollars in 2013 and one of its subsidiaries records a loss of \$50 million dollars in the same year, the company can file a consolidated tax return and offset the profit from one company with the loss from the other. By filing the consolidated returns, the company would owe federal income taxes on \$50 million, not \$100 million. At a statutory corporate tax rate of 35%, that equals a savings of \$17.5 million. The parent company could simply operate the subsidiary as an unincorporated division of the parent, in which case any losses by one operation would automatically offset profits in the other. However, as I discuss below, the parent company would lose some of the legal protections inherent in the subsidiary structure, such as the ability of the parent to insulate itself from the liabilities of the subsidiary company.

Forming a subsidiary business structure can also provide tax benefits at the state level. Many states tax businesses on all of their income, regardless of where it was generated. But some states, including, but not limited to, Pennsylvania and Michigan, allow subsidiaries to file returns that tax only the profits generated within the state's borders, not those generated by operations in other locations.² The same is also true in some states with regard to the collection and filing of sales and use taxes. Even if a company files a consolidated tax return at the federal level, it does not mean that it must file on a combined basis in every state.³ In addition,

² See Myers, R., "Is a Subsidiary in Your Future?" *Journal of Accountancy*, June 2002 ("Myers") at page 1.

³ See *Myers* at page 2.

approximately half of the states recognize exemptions from sales and use tax applicable to certain purchases made by common carriers, or public or for-hire transportation companies. Depending on the state, exemptions may apply to purchases, repair and replacement parts, rolling stock, and other equipment.⁴

Companies that operate internationally can also set up foreign operations as separate subsidiaries, which can lead to substantial tax savings. Typically, the profits of those subsidiaries that are outside that of the parent company are taxed in the country where the subsidiary is incorporated and will not be subject to taxes in the parent company's home country.

2. Legal Protection

In addition to the tax benefits of forming a subsidiary, many companies crave the legal protections from potential plaintiffs and creditors it can provide. Because of the separate nature of subsidiary companies, liabilities and creditor claims of a subsidiary are sometimes "trapped" in that subsidiary and cannot be passed on to the parent company without a great deal of legal effort and resources. As a result, if the subsidiary runs into financial or legal trouble, the parent company's assets and its credit rating have greater protection than if the offending subsidiary were a division of the parent.

Many transportation companies have found it beneficial to separate their companies into subsidiaries because they can take greater control over their compliance and safety documents and procedures. Many transportation companies feel that separating into different subsidiaries can help them better manage dispatch operations, keep registrations current, and monitor equipment. Also, separating transportation operations into a different entity provides protection

⁴ See Paul, S. H., & Strickland, F. D., "Loads of Benefits Delivered by a Transportation Subsidiary" *Feed & Grain Magazine*, March 5, 2013 ("Paul and Strickland") at page 2.

for a company's remaining assets from liabilities arising from transportation activities, where some of the greatest exposure often exists.⁵

3. Regulatory Actions

Companies will also form subsidiaries to take advantage of tax and regulatory benefits unique to their industry. In the life insurance industry, for example, mutual-owned life insurance companies often set up a mutual holding company and then put their operating units into subsidiaries that are structured as stock life insurance companies. By doing so, the insurance companies avoid the negative impact of reduced tax deductions. Using the subsidiary structure also minimizes the complexity of dealing with insurance regulations that vary from state to state.⁶

Similarly, companies will establish subsidiary companies to avoid issues with retirement plan regulations or to provide different retirement plans to different employees. For example, a corporation may form a subsidiary to facilitate the implementation of different nonqualified benefit plans for individual business operations and their managers.

Also, corporations will establish subsidiary organizations to avoid exposing their parent corporations to certain regulations or to manipulate the regulatory process. This used to occur quite often in the banking and financial services industries where financial service firms would establish subsidiary banks or trading firms to shield their parent companies from certain regulations.⁷ Companies will also establish subsidiaries to take advantage of quirks in regulations that would not be available to the parent company, or structure their companies into

⁵ *Paul and Strickland* at page 4.

⁶ See *Myers* at page 3.

⁷ After the passing of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (July 21, 2010), which tightened the regulations, many financial service firms and banks dropped subsidiaries that no longer shielded them from stricter regulation.

regulated and non-regulated sections to avoid regulatory scrutiny for certain portions of a business.

**B. CORPORATE STRUCTURE
OF THE CLASS I RAILROADS**

Given their large sizes and complexity of operations, it is no wonder that the Class I railroads utilize multi-tier corporate structures to enjoy the benefits of diversified corporate ownership discussed above. Each of the seven (7) Class I railroad operating companies governed by the STB are in fact subsidiaries of parent corporations that own the railroads, as well as other directly and indirectly owned subsidiaries. Table 1 below lists the seven Class I railroads and their parent holding companies.

Table 1 <u>STB Reporting Railroads and Their Parent Companies</u>	
STB Reporting Entity	Parent Company
(1)	(2)
1. BNSF Railway Company	Berkshire Hathaway, Inc. 1/
2. CSX Transportation	CSX Corporation
3. Grand Trunk Corporation	Canadian National Railway
4. Kansas City Southern Railway	Kansas City Southern
5. Norfolk Southern Railroad	Norfolk Southern Corporation
6. Soo Line Corporation	Canadian Pacific Railway Ltd.
7. Union Pacific Railroad	Union Pacific Corporation

1/ Berkshire Hathaway, Inc. is the parent company of Burlington Northern Santa Fe, LLC, which is the successor of the Burlington Northern Santa Fe Corporation. BNSF Railway is a wholly owned subsidiary of Burlington Northern Santa Fe, LLC.

As shown in Table 1 above, each of the Class I railroads overseen by the STB is a subsidiary of a parent company. In addition, each of the reporting Class I railroads is itself a parent to lower-tier subsidiary corporations. Table 2 below lists the number of lower tier subsidiary corporations for each Class I railroad as reported in the railroads' 2013 Annual Report Form R-1.

Table 2
Number of Reporting Subsidiaries For Class I Railroads

<u>STB Reporting Entity</u>	<u>Number of Subsidiaries</u>
(1)	(2)
1. BNSF Railway Company	26
2. CSX Transportation	38
3. Grand Trunk Corporation	23
4. Kansas City Southern Railway	6
5. Norfolk Southern Railroad	50
6. Soo Line Corporation	13
7. Union Pacific Railroad	56

Source: 2013 Annual Report Form R-1s.

As shown in Table 2 above, the number of subsidiary organizations for the Class I railroads range from 6 to 56 subsidiary companies. I need to point out that these are simply the subsidiary organizations that are reported to the STB for the Class I railroads, and not the subsidiaries for the Class I railroad parent organizations. The number of subsidiary corporations for the parents of the railroad companies are higher.

The Class I railroads and their parent companies utilize these multi-tier corporate structures for the three primary reasons I listed above, i.e., to lower taxes, insulate themselves from liability and to maximize regulatory benefits while minimizing regulatory oversight. One example of the liability shielding aspects of multi-tier corporate structure is the use of wholly-owned, bankruptcy-remote, subsidiary companies to facilitate the securitizing of accounts receivables.⁸ Many of the Class I railroads or parent holding companies have such special purpose subsidiaries, and explicitly use these subsidiaries to mitigate the risk of bankruptcy and general claims. As described in Union Pacific Corporation's ("UPC") 2013 Securities and Exchange Commission ("SEC") Form 10-K:

⁸ Bankruptcy-remote entities are subsidiary companies whose actions are limited to the acquisition and financing of specific assets, and have an asset/liability structure and legal status that makes their obligations secure even if the parent company goes bankrupt.

The Railroad maintains a \$600 million, 364-day receivables securitization facility under which it sells most of its eligible third-party receivables to Union Pacific Receivables, Inc. (UPRI), a wholly-owned, bankruptcy-remote subsidiary that may subsequently transfer, without recourse an undivided interest in accounts receivable to investors. The investors have no recourse to the Railroad's other assets except for customary warranty and indemnity claims. Creditors of the Railroad do not have recourse to the assets of UPRI.⁹

As noted by UPC, the use of the bankruptcy-remote subsidiary insulates the investors in the railroad's receivables from the remainder of the company so that any claim against the receivables company stays within that subsidiary. Similarly, UPC has isolated its receivables in a way that protects them if there were ever a claim against the parent company.

In addition, the railroad companies use their multi-tier corporate structures to avoid or minimize their tax burdens by creating subsidiary organizations to meet the requirements of state or Federal tax laws. CSX Corporation ("CSX") used such an approach in Florida to minimize its state property tax bill.¹⁰ CSX created a new subsidiary company, CSX Intermodal, Inc. ("CSXI") from two companies that had been federally certified as "motor-carriers." Being designated as a motor carrier company and not a railroad company meant the new subsidiary was not subject to federal railroad regulations. As a result, CSX argued to Florida state tax assessors that CSXI should not be taxed by state or local governments as a railroad property, but instead as a trucking company. The state of Florida accepted CSX's position for many years leading to a reduction in property taxes below what have been assessed if CSXI were viewed as a railroad company. In other words, CSX used the creation of its CSXI subsidiary to reduce its Florida state property tax bill.

⁹ Union Pacific Corporation 2013 SEC Form 10-K at page 38. Similar subsidiaries are described in CSX Corporation's 2013 SEC Form 10-K at page 43, Norfolk Southern Corporation's 2013 SEC Form 10-K at page K60.

¹⁰ See Freedberg, S. P., "Blunders Derail Tax Bill For CSX," *Tampa Bay Times*, August 12, 2007.

Railroads also use subsidiary corporations to avoid certain regulatory practices and regulatory agencies. Unlike most workers in the U.S., most railroad workers do not pay into the Social Security Trust Fund, but instead make payments to the Railroad Retirement Board (“RRB”). The RRB is an independent agency in the executive branch of the United States government created to administer a social insurance program providing retirement benefits to the country's railroad workers. Consequently, railroad workers do not participate in the United States Social Security program. However, given the higher employment costs associated with RRB coverage than Social Security and standard retirement plans now available on the market, railroads will seek ways to exclude employees from RRB covered positions when possible. If, for example, a railroad company wished to start a new business selling computer services, that railroad could avoid coverage by the RRB by establishing a new subsidiary corporation for this purpose. If the RRB finds this new subsidiary does not perform a service in connection with railroad transportation, it will deem the new company a non-covered employer and exempt it from RRB regulation.

In sum, the Class I railroad companies, and their corporate parents, are sophisticated organizations that will, like all sophisticated organizations, seek to maximize their returns while minimizing their losses. One way in which they can help reach these goals is through the organization of their corporate structure. The railroads have established their organizational structures to minimize their exposure to liabilities while maximizing their returns.

III. CONSOLIDATED FINANCIAL STATEMENTS

When one corporation acquires a voting interest of more than 50 percent in another corporation, it is said to have a controlling interest in the subsidiary. Having more than 50 percent ownership in the subsidiary provides the parent with legal control of the subsidiary organization and means it can effectively direct all of the subsidiary's actions.¹¹ Because of the control that can be exerted by the parent company, Generally Accepted Accounting Principles ("GAAP") and Federal regulations require the consolidation of the parent's and subsidiary companies' financial statements.

Consolidated financial statements present the financial position and results of operations for a parent (controlling entity) and one or more of the subsidiaries as if the individual entities actually were a single company. The STB, pursuant to its role as economic regulator of the railroads, deviates from this controlling entity idea of financial statement consolidation and requires only the consolidation of railroad related entities in the preparation of financial statements under the Board's control. I discuss below why GAAP and Federal regulations usually require consolidated financial statements and why the Board deviates from this norm.

A. BENEFITS OF CONSOLIDATED FINANCIAL STATEMENTS

There are several benefits for the presentation of consolidated financial statements between a parent company and its subsidiaries. Consolidated financial statements often represent the only means of obtaining a clear picture of the total resources of the combined entity that are controlled by the parent company. This is a large benefit to shareholders, creditors and other capital and resource providers of the parent corporation. Say, for example, a corporation

¹¹ An investor corporation may hold an interest of less than 50 percent in an investee corporation, but still exert influence through representation on the subsidiary's board of directors, participation in policy-making processes or technological dependence. Even with this influence, legal control usually lies with the controller of more than 50 percent of the stock.

seeks a loan from a bank. To truly assess the creditworthiness of the corporation, the bank needs to assess the existing financial position of the corporation in total, including all of the corporation's subsidiaries. It is much easier to analyze one set of consolidated financial statements for the combined organization than to assess the individual statements for the corporate parent and each of the subsidiary companies.

Additionally, the use of consolidated financial statements can help reduce management's manipulation of the true financial position of the corporation. There is no effective limit on the number of subsidiaries that a company can own. Given this, it is easy to see that unscrupulous managers could attempt to manipulate the true financial position of the overall entity by creating scores of subsidiary organizations in an endeavor to hide the true financial position of the total company. Alternatively, the managers could make one subsidiary shine financially to the detriment of another subsidiary by loading the latter with all of the corporation's debt.¹² The ability to manipulate reported financials in this way is reduced with the use of consolidated financial statements.

Companies prepare consolidated financial statements by starting with the separate financial statements of the parent corporation and all of the subsidiary companies. The corporation then adds the separate statements together, and begins the process of adjustments and eliminations to eliminate the impact of intra-corporate transactions. In simple terms, a company cannot own itself, cannot owe money to itself and cannot make money by selling to itself. Therefore, adjustments and eliminations are made to the consolidated financial statements to remove intercorporate stockholdings, intercompany receivables and payables, and intercompany

¹² An extreme example of this was the Enron saga. Enron used special purpose entities—limited partnerships or companies created to fulfill a temporary or specific purpose—to fund or manage risks associated with specific assets. The company elected to disclose minimal details on its use of "special purpose entities". In total, by 2001, Enron had used hundreds of special purpose entities to hide its debt.

sales. The use of these adjustments and eliminations removes the ability for corporate management to artificially raise the total value of the company by having one subsidiary invest in another, or increase profits by selling products between two subsidiaries.

B. CONSOLIDATION FOR STB REPORTING PURPOSES

The STB requires each Class I railroad under its jurisdiction in the U.S. to file an Annual Report Form R-1 (“R-1”) by March 31 of each year for the 12 months ending December 31 of the preceding year.¹³ The Board requires the railroads to include in their R-1 reports financial and operating statistics for the consolidated railroad entity. A railroad entity is defined by the Railroad Accounting Principles Board (“RAPB”) as all affiliated railroads and all railroad-related affiliates.¹⁴ The RAPB also stated that the railroad entity shall measure and report information about the railroad-related activities in conformance with GAAP, where possible. This infers that when developing the financial statements included in their R-1, the railroads are required to present consolidated financial statements reflecting the operations of the railroads and all railroad related subsidiary companies.

The definition of a “railroad-related entity” draws a distinction between the consolidated financial statements the railroad holding companies present to shareholders and the consolidated financial statements the railroad companies include in the R-1 reports. GAAP and Federal regulations require the parent companies to consolidate the activities of all subsidiary companies. In contrast, the STB, evoking the entity principle, requires the consolidation of only railroads and railroad related companies with operations primarily in the U.S. This results in the financial information presented in the R-1 being a select subset of the consolidated financial statements for the parent companies.

¹³ See 49 CFR 1241.1.

¹⁴ See RAPB Final Report, Volume 1, September 1, 1987 at page 16.

The decision of what constitutes a railroad and rail-related affiliate, and therefore what and what not to include in the R-1, ultimately lies with the parent companies of the railroads. As an example, I indicated above that Union Pacific Railroad Company (“UP”) includes 56 subsidiary and affiliated companies in its R-1 data. However, UP’s parent corporation, (“UPC”) owns other subsidiary companies that it does not consolidate into the UP R-1 financial reports, but yet are clearly transportation and rail-related. Transentric, Inc. is a subsidiary of UPC that provides supply-chain technology solutions to support transportation operations and inter-enterprise supply chains, including two railroads listed on its client list.¹⁵ Insight Network Logistics, LLC is a third party logistics provider and developer of technology based supply-chain solutions, and a wholly-owned subsidiary of UPC.¹⁶ P.S. Technology, Inc. is a technology company that develops and maintains software for the railroad industry, and which UPC acquired in 1996 as an indirectly owned subsidiary.¹⁷ All three of these UPC subsidiaries clearly have operations that relate to or support railroad operations, but are not listed as railroad affiliates included in the UP R-1 data. This decision ultimately rests with UPC management.

In addition, the STB in its role as regulator of railroad economic issues in the U.S., has chosen to require railroads to report only on their U.S. based operations. This means for the two Canadian railroad holding companies that own U.S. Class I affiliates, the Canadian National Railway (“CN”) and the Canadian Pacific (“CP”), they only need to report on the performance of the U.S. portions of their operations, Grand Trunk Corporation and Soo Line Corporation,

¹⁵ See <http://www.transentric.com/companyoverview.html>.

¹⁶ See https://www.insightnl.com/PR/BUG_2538_Corporate%20Fact%20Sheet.pdf.

¹⁷ See <http://www.rrb.gov/blaw/bcd/bcd08-22.asp>.

respectively.¹⁸ As I will discuss in the next section of my VS, this can have a significant impact on the railroad's reported financial performance.

¹⁸ The Grand Trunk Corporation subsidiaries include, but are not limited to, the Grand Trunk and Western Railroad Company, the Wisconsin Central Transportation Corporation and the Illinois Central Railroad. The Soo Line Corporation includes the Soo Line Railroad Company and the Dakota, Minnesota and Eastern Railroad Corporation.

IV. REVENUE ADEQUACY

There is little doubt that most objective observers believe the U.S. and Canadian railroad companies are either now, or will be in the near future, revenue adequate. Wall Street financial firms have, for several years, found that the publicly traded Class I railroads had returns on investment (“ROI”) or returns in invested capital (“ROIC”) greater than their estimates of the railroad’s cost of capital.¹⁹ As noted by Standard & Poor’s in assessing NS’s performance in October 2012:

ROIC narrowed to 9.2% during 2009 on account of the recession and a sharp decline in freight traffic, before recovering to 11.8% in 2010 and 17.1% for 2011. As of December 2011, we calculated that NSC's average cost of capital was approximately 8.2%.²⁰

Standard & Poor’s had a similar assessment of UP in early 2013:

Improved freight pricing, along with stock repurchases and accelerated depreciation incentives, helped ROIC rise from 8.5% in 2005 to 19.2% in 2011, in our opinion. UNP's ROIC in 2011 (latest available) was above our estimate for the company's weighted average cost of capital, currently near 9.6%.²¹

Standard & Poor’s also felt CN’s return would exceed its cost of capital:

We calculate that return on invested capital (ROIC), using operating profits less cash taxes, has over the past ten years averaged 14.2% at CNI, versus 11.6% for the leading Class I railroads. Based on its network structure and cost focus, we expect CNI's long-term sustainable ROIC to remain above average for the industry, surpassing its weighted average cost of capital, which we estimate at 9.7%.²²

¹⁹ ROI is generally defined as net earnings divided by net fixed assets. ROIC is a relatively new measure which takes net operating profit after tax (“NOPAT”) and divides it by the invested capital. NOPAT is defined as operating profit (revenues less operating expenses) multiplied by one (1) minus the tax rate. Invested capital equals fixed assets plus non-cash working capital. Most analysts and academics believe ROIC provides a clearer picture of how efficiently a company is using its capital, and whether it is creating or destroying value. See “Return on Capital (ROC), Return on Invested Capital (ROIC) and Return on Equity (ROE): Measurement and Implications,” Aswath Damodaran Stern School of Business, July 2007.

²⁰ See Standard & Poor’s Norfolk Southern Corporation October 6, 2012 Stock Report at page 2.

²¹ See Standard & Poor’s Union Pacific Corporation January 28, 2013 Stock Report at page 2.

²² See Standard & Poor’s Canadian National Railway Company February 2, 2013 Stock Report at page 2.

While Wall Street analysts appear to believe the railroad companies are generating returns that exceed their costs of capital, the STB's revenue adequacy procedures still find the majority of the railroads to be revenue inadequate. This is due to a number of factors. First, the STB's cost of capital methodology produces cost of capital estimates significantly higher than that used by independent analysts. The Standard & Poor's passages I cited above place the 2011 cost of capital for the various railroads between 8.2 and 9.7 percent. In contrast, the STB placed its railroad industry cost of capital estimate at 11.57 percent.²³

Second, financial analysts look at not just the railroad companies, but at the consolidated parent organizations as a whole when developing their financial assessments. This is a key factor. As I explained above, the railroad parent companies have wide discretion when it comes to corporate structure and the arrangement of their subsidiary organizations. What the railroads consider to be a railroad-affiliated subsidiary and what is not a railroad-affiliated subsidiary may have an influence on whether the railroad is considered revenue adequate or not under the STB's methodology.

Third, the location of the rail operations has a significant impact on revenue adequacy when it comes to the two Canadian railroads. As I indicated above, the R-1 reports the CN and the CP file with the STB only reflect their consolidated U.S. rail operations and disregard their non-U.S. operations. As such, the annual revenue adequacy determinations produced by the STB only reflect a small part of the Canadian carriers' overall operations and do not reflect the true financial position of the two companies.

To demonstrate the discrepancies between the STB's ROI for the two Canadian railroads and the ROI for the Canadian carriers as a whole, I have calculated the 2011 and 2012 CN and

²³ See Ex Parte No. 558 (Sub-No. 15) *Railroad Cost of Capital - 2011*, served September 13, 2012.

CP ROI for the companies as a whole using the STB's ROI procedures.²⁴ The results of these calculations are shown for CN and CP in Exhibit No. 2 and Exhibit No. 3 to this VS, respectively, and summarized in Table 3 below.

Railroad	Return on Investment (ROI)	
	2011	2012
(1)	(2)	(3)
1. Canadian National Railway 1/	13.04%	14.25%
2. Grand Trunk Corporation 2/	8.74%	10.19%
3. Canadian Pacific 3/	7.86%	7.82%
4. Soo Line Corporation 2/	7.13%	5.15%

1/ Exhibit No. 2.
2/ Ex Parte No. 552 (Sub-No. 16) *Railroad Revenue Adequacy - 2011 Determination*, served January 2, 2014, and Ex Parte No. 552 (Sub-No. 17) *Railroad Revenue Adequacy - 2012 Determination*, Served January 2, 2014.
3/ Exhibit No. 3.

As shown in Table 3 above, 2011 and 2012 ROI figures for CN and CP as a whole are higher than the ROI for their U.S. subsidiary railroads.²⁵ If the STB were to review the totality of the two Canadian carriers' operations instead of just a sub-set of the companies operating in the U.S., it would find the railroads are, or soon will be, revenue adequate even under the Board's methodology.²⁶

²⁴ The data the railroads provide to the STB in their R-1 Schedule 250 for the revenue adequacy determinations includes specific adjustments that are not customarily reported in consolidated financial statements. Where possible, I attempted to replicate these adjustments using publicly available data.

²⁵ The 2012 Soo Line and 2012 CP ROI calculations are adversely impacted by a C\$265 impairment charge the railroads' write-off of the abandoned expansion of the railroad into the Powder River Basin and certain locomotives. In addition, CP took a C\$53 million charge for future labor resurrecting and a \$C38 million charge tied to the exit of the company's former Chief Executive Officer. Without these charges, I estimate the 2012 CP ROI would have been approximately 10.0 percent.

²⁶ The KCS is another unique case. Like CN and CP, the KCS has extensive rail operations in another country, in this case Mexico through its Kansas City Southern de México subsidiary. When viewed as a whole, KCS's ROI in 2011 and 2012 was 11.35 percent and 10.93 percent, respectively. In both years, the KCS's ROI as a whole was higher than the ROI for KCS's U.S. subsidiary.

Given the ability of the railroad holding companies to structure their organizations to highlight or shield certain aspects of their railroad operating companies, a better approach for assessing railroad revenue adequacy is to use the financial statistics for the railroad holding companies instead of the railroad operating subsidiaries. This would provide a more holistic picture of the railroads' financial positions, and mitigate using corporate structure as a way to downplay the companies' true financial health.

As I explained above, one of the purposes of requiring corporations to file consolidated financial statements is to obtain a clearer picture of the total resources of the railroads and their parent companies. It is obvious based on the comparison of the ROI shown in Table 3 above that the ROI for the CN's U.S. subsidiary, the Grand Trunk Corporation, is no way reflective of the true financial position of the CN as a whole. The total return CN generates is clearly above its cost of capital (a fact confirmed by Standard & Poor's), yet under the STB's current approach, Grand Trunk Corporation is still approximately 100 basis points away from being deemed revenue adequate.

Using the audited financial statistics for the parent companies as a whole would also better align revenue adequacy with the STB's determination of the railroad industry cost of capital. The STB relies upon the common equity, preferred equity and total debt of the publicly traded railroad holding companies when determining the railroad industry cost of capital.²⁷ It then turns around and measures this cost of capital against only the railroad operating companies' ROI in its revenue adequacy determination. This is a clear disconnect. The cost of capital developed by the STB incorporates the financial positions of the railroad holding companies in total. A true apples to apples comparison requires comparing this cost of capital for the holding companies to the holding companies' ROI.

²⁷ See Ex Parte No. 558 (Sub No.-16), *Railroad Cost of Capital – 2012*, served August 2, 2013 at page 3.

Some may argue that using the holding companies' ROI in the revenue adequacy determination would improperly impute non-railroad subsidiary operating statistics to the railroad operating entities. Such an argument may have had merit 20 years ago when the railroad holding companies were much more diversified, but it does not hold much water today. With the exception of the BNSF Railway Company ("BNSF") and its parent company Berkshire Hathaway, Inc. ("Berkshire Hathaway"), all of the other railroad holding companies have divested the majority of their non-railroad related ancillary businesses. A review of the holding companies' SEC filings and annual reports show that the majority of the reported subsidiary operations are in fields directly tangential to the railroad operations.²⁸ Gone are the days when the holding companies owned airlines and ocean going vessel companies.

As to BNSF, even though it is now an indirect wholly-owned subsidiary of Berkshire Hathaway, Inc., its direct parent company within Berkshire Hathaway, Burlington Northern Santa Fe, LLC, still files Form 10-K with the SEC.²⁹ The STB therefore has a choice of using the financial performance of Berkshire Hathaway in its determination, or the direct parent of the BNSF, the Burlington Northern Santa Fe, LLC.

Each of the railroad holding companies develop consolidated financial statements that are audited by outside accounting experts and filed pursuant to SEC regulations and oversight, and reflect the true financial positions of the organizations.³⁰ In addition, it is obvious that the

²⁸ For example, NS subsidiary Triple Crown Service Company provides intermodal transportation services. KCS subsidiary Pabtex, Inc. provides bulk handling facilities that transfers petroleum coke from rail cars to ocean going vessels. CSX operates CSX Intermodal Terminals, which owns and operates intermodal terminals primarily on the East Coast.

²⁹ As part of its acquisition of the BNSF, Berkshire Hathaway acquired the outstanding shares of the Burlington Northern Santa Fe Corporation, the publicly traded parent of BNSF. Berkshire Hathaway then merged the Burlington Northern Santa Fe Corporation into Berkshire Hathaway holding company, and renamed the merged companies Burlington Northern Santa Fe, LLC. Burlington Northern Santa Fe, LLC owns 100 percent of the shares of the BNSF and its affiliates.

³⁰ The U.S. companies file Form 10-K with the SEC. The two Canadian companies file Forms 40-F and 6-K that contain their audited consolidated financial statements.

railroad companies are in better financial positions than is reflected in the STB's revenue adequacy determination. This is especially true of the two Canadian railroads. Some of this difference is attributable to the railroad holding companies' abilities to structure their organizations to shield or highlight the railroad operating companies as needed. Using the parent company financial statistics can mitigate the impact of the diverse corporate structures and provide a more accurate picture of the companies' financial health.

VERIFICATION

I, Daniel L. Fapp, verify under penalty of perjury that I have read this Verified Statement on behalf of the National Grain and Feed Association, that I know the contents thereof, and that the same are true and correct. Further, I certify that I am qualified and authorized to file this statement.



Daniel L. Fapp

Executed on June 23, 2014

STATEMENT OF QUALIFICATIONS

My name is Daniel L. Fapp. I am a Vice President of the economic consulting firm of L. E. Peabody & Associates, Inc. The firm's offices are located at 1501 Duke Street, Suite 200, Alexandria, VA 22314; 760 E. Pusch View Lane, Suite 150, Tucson, Arizona 85737; and 21 Founders Way, Queensbury, New York 85737.

I received a Bachelor of Science degree in Business Administration with an option in Marketing (cum laude) from the California State University, Northridge in 1987, and a Master of Business Administration degree from the University of Arizona's Eller College of Management in 1993, specializing in finance and operations management. I am also a member of Beta Gamma Sigma, the national honor society for collegiate schools of business.

I have been employed by L. E. Peabody & Associates, Inc. since December 1997. Prior to joining L. E. Peabody & Associates, Inc., I was employed by BHP Copper Inc. in the role of Transportation Manager - Finance and Administration, and where I also served as an officer and treasurer of the three BHP Copper Inc. subsidiary railroads, The San Manuel Arizona Railroad, the Magma Arizona Railroad (also known as the BHP Arizona Railroad) and the BHP Nevada Railroad. I have also held operations management positions with Arizona Lithographers in Tucson, AZ and MCA-Universal Studios in Universal City, CA.

While at BHP Copper Inc., I was responsible for all financial and administrative functions of the company's transportation group. I also directed the BHP Copper Inc. subsidiary railroads' cost and revenue accounting staff, and managed the San Manuel Arizona Railroad's and BHP Arizona Railroad's dispatchers and the railroad dispatching functions. I served on the company's Commercial and Transportation Management Team and the company's Railroad Acquisition Team where I was responsible for evaluating the acquisition of new railroads,

STATEMENT OF QUALIFICATIONS

including developing financial and economic assessment models. While with MCA-Universal Studios, I held several operations management positions, including Tour Operations Manager, where my duties included vehicle routing and scheduling, personnel scheduling, forecasting facilities utilization, and designing and performing queuing analyses.

As part of my work for L. E. Peabody & Associates, Inc., I have performed and directed numerous projects and analyses undertaken on behalf of utility companies, short line railroads, bulk shippers, and industry and trade associations. Examples of studies which I have participated in organizing and directing include, traffic, operational and cost analyses in connection with the rail movement of coal, metallic ores, pulp and paper products, and other commodities. I have also analyzed multiple car movements, unit train operations, divisions of through rail rates and switching operations throughout the United States. The nature of these studies enabled me to become familiar with the operating procedures utilized by railroads in the normal course of business.

Since 1997, I have participated in the development of cost of service analyses for the movement of coal over the major eastern and western coal-hauling railroads. I have conducted on-site studies of switching, detention and line-haul activities relating to the handling of coal. I have also participated in and managed several projects assisting short-line railroads. In these engagements, I assisted short-line railroads in their negotiations with connecting Class I carriers, performed railroad property and business evaluations, and worked on rail line abandonment projects.

I have been frequently called upon to perform financial analyses and assessments of Class I, Class II and Class III railroad companies. I have determined the Going Concern Value

STATEMENT OF QUALIFICATIONS

of privately held freight and passenger railroads, including developing company specific costs of debt and equity for use in discounting future company cash flows. My consulting assignments regularly involve working with and determining various facets of railroad financial issues, including cost of capital determinations. In these assignments, I have calculated railroad capital structures, market values, cost of railroad debt, cost of preferred railroad equity and common railroad equity. I am also well acquainted with and have used financial industry accepted models for determining a firm's cost of equity, including Discounted Cash Flow Model ("DCF") models, Capital Asset Pricing Model ("CAPM"), Farma-French Three Factor Model and Arbitrage Pricing Models. I have also lectured in graduate level finance and economics classes discussing corporate capital theory and costs of equity determination, and am a member of the Professional Advisory Council for the Eller School of Management Finance Department at the University of Arizona.

In my tenure with L. E. Peabody & Associates, Inc., I have presented stand-alone cost evidence, including discounted cash-flow models and cost of capital determinations, in numerous proceedings before the STB, and presented evidence on railroad fuel surcharges in STB in Ex Parte No. 661, *Rail Fuel Surcharges*. I have submitted evidence on cost of capital determinations and related issues in Ex Parte No. 558 (Sub-No. 10), *Railroad Cost of Capital – 2006*, Ex Parte No. 558 (Sub-No. 11), *Railroad Cost of Capital – 2007*, Ex Parte No. 558 (Sub-No. 12), *Railroad Cost of Capital – 2008*, Ex Parte No. 558 (Sub-No. 13), *Railroad Cost of Capital – 2009*, Ex Parte No. 558 (Sub-No. 14), *Railroad Cost of Capital – 2010*, Ex Parte No. 664, *Methodology To Be Employed In Determining The Railroad Industry Cost Of Capital*, Ex Parte No. 664 (Sub-No.1), *Use Of A Multi-Stage Discounted Cash Flow Model In Determining*

STATEMENT OF QUALIFICATIONS

The Railroad Industry's Cost Of Capital, and Ex Parte No. 664 (Sub-No. 2), *Petition of the Western Coal Traffic League to Institute a Rulemaking Proceeding to Abolish Use of the Multi-Stage Discounted Cash Flow Model in Determining the Railroad Industry's Cost of Capital*. In addition, my reports on railroad valuations have been used as evidence before the Nevada State Tax Commission.

Canadian National Railway Return On Investment - 2011 and 2012
(in Canadian millions)

<u>Item</u> (1)	<u>Source</u> (2)	<u>2011</u> (3)	<u>2012</u> (4)
1. Net revenues from railway operations	CN 2012 Annual Report Page 52	\$3,296	\$3,685
2. Income taxes on ordinary income	CN 2012 Annual Report Page 77	368	527
3. Provision for deferred taxes	CN 2012 Annual Report Page 77	<u>531</u>	<u>451</u>
4. Net operating income (loss)	Line 1 - Line 2 - Line 3	\$2,397	\$2,707
5. Net Investment In Properties - Beginning of Year	CN 2011 and 2012 Annual Reports Pages 52	\$22,917	\$23,917
6. Net Investment In Properties - End of Year	CN 2011 and 2012 Annual Reports Pages 52	23,917	24,541
7. Average Net Investment In Properties	(Line 5 + Line 6) ÷ 2	23,417	24,229
8. Working Capital - Beginning of Year	Page 2 of 2	210	201
9. Working Capital - End of Year	Page 2 of 2	201	230
10. Average Working Capital	(Line 8 + Line 9) ÷ 2	206	216
11. Accumulated Deferred Net Tax Credits - Beginning of Year	CN 2011 and 2012 Annual Reports Pages 77	5,152	5,333
12. Accumulated Deferred Net Tax Credits - End of Year	CN 2011 and 2012 Annual Reports Pages 77	5,333	5,555
13. Average Deferred Tax Credits	(Line 11 + Line 12) ÷ 2	<u>5,243</u>	<u>5,444</u>
14. Tax Adjusted Net Investment Base	Line 7 + Line 10 - Line 13	\$18,380	\$19,001
15. Tax Adjusted Return On Investment	Line 4 ÷ Line 14	13.04%	14.25%

Canadian National Railway Working Capital Calculation - 2010 to 2012
(in Canadian millions)

<u>Item</u> (1)	<u>Source</u> (2)	<u>2010</u> (3)	<u>2011</u> (4)	<u>2012</u> (5)
Current Operating Assets				
1. Freight Accounts Receivable	CN 2011 and 2012 Annual Reports	<u>\$585</u>	<u>\$630</u>	<u>\$674</u>
2. Total Current Operating Assets	Line 1	\$585	\$630	\$674
Operating Revenue				
3. Freight operating revenue	CN 2011 and 2012 Annual Reports	<u>\$7,417</u>	<u>\$8,111</u>	<u>\$8,938</u>
4. Total Operating Revenues	Line 3	\$7,417	\$8,111	\$8,938
5. Average daily operating revenues	Line 4 / 360 days	20.6	22.5	24.8
6. Days of operating revenue in current operating assets	Line 4 / Line 2	28.4	28.0	27.1
7. Revenue delay days plus buffer	Line 6 + 15 days	43.4	43.0	42.1
Current Operating Liabilities				
8. Trades Payable	CN 2011 and 2012 Annual Reports	\$383	\$445	\$386
9. Payroll Related Accruals	CN 2011 and 2012 Annual Reports	292.0	343.0	340.0
10. Accrued Charges	CN 2011 and 2012 Annual Reports	97.0	121.0	135.0
11. Income and Other Taxes	CN 2011 and 2012 Annual Reports	<u>170.0</u>	<u>130.0</u>	<u>294.0</u>
12. Total Current Operating Liabilities	Sum of Lines 8 through 11	\$942	\$1,039	\$1,155
Operating Expenses				
13. Operating expenses	CN 2011 and 2012 Annual Reports	\$5,273	\$5,732	\$6,235
14. Depreciation	CN 2011 and 2012 Annual Reports	834.0	884.0	924.0
15. Cash related operating expenses	Line 13 - Line 14	4,439.0	4,848.0	5,311.0
16. Average daily expenditures	Line 15 / 360 days	12.3	13.5	14.8
17. Days of operating expenses in current operating liabilities	Line 12 / Line 16	76.4	77.2	78.3
18. Days of working capital required	Line 7 - Line 17 if greater than 0, else 0	0.0	0.0	0.0
19. Cash working capital required	Line 16 x Line 18	0.0	0.0	0.0
20. Cash and temporary cash balance	CN 2011 and 2012 Annual Reports	490.0	101.0	155.0
21. Cash working capital allowed	Lesser of Lines 19 or 20	0.0	0.0	0.0
Materials and Supplies				
22. Total Materials and supplies	CN 2011 and 2012 Annual Reports	\$210	\$201	\$230
23. Total Working Capital	Line 21 + Line 22	\$210	\$201	\$230

Note: Based on STB Schedule 245 Working Capital Methodology

Canadian Pacific Return On Investment - 2011 and 2012
(in Canadian millions)

<u>Item</u> (1)	<u>Source</u> (2)	<u>2011</u> (3)	<u>2012</u> (4)
1. Net revenues from railway operations	CP 2012 Annual Report Page 86	\$967	\$949
2. Income taxes on ordinary income	CP 2012 Annual Report Page 97	-60	12
3. Provision for deferred taxes	CP 2012 Annual Report Page 97	187	140
4. Net railway operating income (loss)	Line 1 - Line 2 - Line 3	\$780	\$809
5. Net Investment In Properties - Beginning of Year	CP 2012 Annual Report Page 102	\$11,997	\$12,752
6. Net Investment In Properties - End of Year	CP 2012 Annual Report Page 102	12,752	13,013
7. Average Net Investment In Properties	(Line 5 + Line 6) ÷ 2	12,375	12,883
8. Working Capital - Beginning of Year	Page 2 of 2	114	138
9. Working Capital - End of Year	Page 2 of 2	138	136
10. Average Working Capital	(Line 8 + Line 9) ÷ 2	126	137
11. Accumulated Deferred Tax Credits - Beginning of Year	CP 2012 Annual Report Page 98	2507	2,645
12. Accumulated Deferred Tax Credits - End of Year	CP 2012 Annual Report Page 98	2,645	2,703
13. Average Deferred Tax Credits	(Line 11 + Line 12) ÷ 2	<u>2,576</u>	<u>2,674</u>
14. Tax Adjusted Net Investment Base	Line 7 + Line 10 - Line 13	\$9,925	\$10,346
15. Tax Adjusted Return On Investment	Line 4 ÷ Line 14	7.86%	7.82%

Canadian Pacific Working Capital Calculation - 2010 to 2012
(in Canadian millions)

<u>Item</u> (1)	<u>Source</u> (2)	<u>2010</u> (3)	<u>2011</u> (4)	<u>2012</u> (5)
Current Operating Assets				
1. Freight Accounts Receivable	CP 2011 and 2012 Annual Reports	\$327	\$380	\$410
2. Total Current Operating Assets	Line 1	\$327	\$380	\$410
Operating Revenue				
3. Freight operating revenue	CP 2011 and 2012 Annual Reports	\$4,853	\$5,052	\$5,550
4. Total Operating Revenues	Line 3	\$4,853	\$5,052	\$5,550
5. Average daily operating revenues	Line 4 / 360 days	13.5	14.0	15.4
6. Days of operating revenue in current operating assets	Line 4 / Line 1	24.3	27.1	26.6
7. Revenue delay days plus buffer	Line 6 + 15 days	39.3	42.1	41.6
Current Operating Liabilities				
8. Trades Payable	CP 2011 and 2012 Annual Reports	\$226	\$387	\$321
9. Payroll Related Accruals	CP 2011 and 2012 Annual Reports	242.0	179.0	169.0
10. Accrued Charges	CP 2011 and 2012 Annual Reports	191.0	245.0	325.0
11. Income and Other Taxes	CP 2011 and 2012 Annual Reports	<u>31.0</u>	<u>39.0</u>	<u>36.0</u>
12. Total Current Operating Liabilities	Sum of Lines 8 through 11	\$690	\$850	\$851
Operating Expenses				
13. Operating expenses	CP 2011 and 2012 Annual Reports	\$3,865	\$4,210	\$4,428
14. Depreciation	CP 2011 and 2012 Annual Reports	489.0	490.0	539.0
15. Cash related operating expenses	Line 13 - Line 14	3,376.0	3,720.0	3,889.0
16. Average daily expenditures	Line 15 / 360 days	9.4	10.3	10.8
17. Days of operating expenses in current operating liabilities	Line 12 / Line 16	73.6	82.3	78.8
18. Days of working capital required	Line 7 - Line 17 if greater than 0, else 0	0.0	0.0	0.0
19. Cash working capital required	Line 16 x Line 18	0.0	0.0	0.0
20. Cash and temporary cash balance	CP 2011 and 2012 Annual Reports	361.0	47.0	333.0
21. Cash working capital allowed	Lesser of Lines 19 or 20	0.0	0.0	0.0
Materials and Supplies				
22. Total Materials and supplies	CP 2011 and 2012 Annual Reports	\$114	\$138	\$136
23. Total Working Capital	Line 21 + Line 22	\$114	\$138	\$136

Note: Based on STB Schedule 245 Working Capital Methodology

PUBLIC VERSION

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LIST OF EXHIBITS

Exhibit No.	Title
(1)	(2)
1	Thomas D. Crowley Statement of Qualifications
2	List of Ag Commodities
3	Summary of R/VC Ratios of 2011 and 2012 Shipments for Five Commodities
4	Summary of Average Rates For Potentially Captive Ag Commodity Traffic - 2011 and 2012
5	Revenue Adequacy Adjustment Factor - 2011
6	Example of Application of Ag Commodities Maximum Rate Methodology - STCC 01132 – Corn; STCC 01137 – Wheat; STCC 01144 – Soybean; STCC 20923 – Soybean Meal/Hulls; STCC 2818445 – Ethanol
7	Revenue Adjustments By Carrier - US Movements Only and Cross–Border Movements
8	Tax Adjusted Revenue Adequacy

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I. INTRODUCTION

I am Thomas D. Crowley, an economist and the President of L. E. Peabody & Associates, Inc., an economic consulting firm that specializes in solving economic, transportation, marketing, financial, accounting and fuel supply problems. I have spent most of my consulting career of over forty (40) years evaluating fuel supply issues and railroad operations, including railroad costs, prices, financing, capacity and equipment planning issues. My assignments in these matters were commissioned by railroads, producers, shippers of different commodities, and government departments and agencies. A copy of my credentials is included as Exhibit No. 1 to this verified statement (“VS”).

I was requested by the National Grain and Feed Association (“NGFA”) to help NGFA develop a proposed new rate regulatory regime that would apply to the shipments of “Ag Commodities” as defined in Section II of this VS. The proposed new approach provides a means for the Surface Transportation Board (“STB” or “Board”) to improve the accessibility and administration of its review of the rail rates of Ag Commodities shippers by providing an alternative to the current maximum rate methodologies that have proved in practice to preclude meaningful rate relief for the vast majority of shippers of agricultural products. In addition, the proposed new approach, which is summarized in this VS, explicitly takes into consideration the revenue adequacy status of the Class I railroads. I address the fundamentals of the proposed new maximum rate approach under the following topical headings:

- II. Ag Commodities Included Within “Grain”
- III. Proposed Ag Commodities Maximum Rate Methodology

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II. AG COMMODITIES INCLUDED WITHIN "GRAIN"

The agricultural commodity market in the United States is significant, and a large user of the rail system. In 2011 and 2012, the latest two years for which comprehensive data is available from the STB's Confidential Waybill Sample, U.S. Class 1 railroad revenues for STCC 01 Farm Products and STCC 20 Food Products equaled \$10.54 billion and \$10.60 billion, respectively.¹ This represented 16.1 percent of the Class 1 revenues in 2011 and 15.5 percent of the revenues in 2012.

A key subset of the agricultural commodity market is grain, feed and allied products, including ethanol. There is no one definition of "grain" and allied agricultural products. What some may consider being a grain or feed product may not necessarily be considered a grain or feed product by others. The STB has not defined "grain" for purposes of this proceeding. Because the STB has not provided a definition, I was instructed by the NGFA to rely upon the grain, feedstuffs and grain products included in the NGFA Rail Arbitration Rules to identify the agricultural commodities to be covered by these proposed procedures.

For purposes of this proceeding, counsel for NGFA has provided me with the STB 2011 and 2012 Confidential Waybill Sample ("Waybill Sample") data for 68 grain, feed and allied products based on five (5) and seven (7) digit Standard Transportation Commodity Code ("STCC") designations. I have included a list of the requested commodities in Exhibit No. 2 to this VS. I next placed the STB's Waybill data into a relational database, and using Structured Query Language ("SQL") developed the summary and analyses presented in this VS.

To simplify the presentation of the data for this proceeding, I was requested to limit my analyses to five (5) grain, feed and allied products that reflect some of the most frequently shipped agricultural commodities. These commodities include:

¹ 2011 and 2012 STB Commodity Revenue Stratification Reports.

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- Corn – STCC 01132;
- Wheat – STCC 01137;
- Soybean – STCC 01144;
- Soybean Meal and Hulls – STCC 20923; and
- Ethanol – STCC 2818445

Exhibit No. 3 (separately for 2011 and 2012) to this VS contains summaries of the revenues, tons, carloads and STB URCS Phase III variable costs included in the STB’s Waybill Sample for these five products. I separated the statistics included in the Waybill Sample by U.S. Class I railroads, and into another category called “Other” that includes data for non-Class I U.S. based railroads and for non-U.S. carriers.

I also segregated the statistics by revenue to variable cost (“R/VC”) ratios. First, I identified all of the presumptively captive traffic with R/VC ratios greater than or equal to the 180 percent jurisdictional threshold level. I summarized the amount of traffic based on revenue that is presumptively captive in Table 1 below.

Table 1
Percentage of Selected Agricultural Shipments with R/VC Ratios Greater Than 180 Percent – 2011 and 2012

Commodity (1)	Percentage of Traffic With R/VC Greater Than 180 Percent 1/	
	2011 (2)	2012 (3)
1. Corn	24.1%	30.9%
2. Wheat	52.0%	48.8%
3. Soybean	28.2%	42.9%
4. Soybean Meal and Hulls	17.5%	20.6%
5. Ethanol	68.7%	64.6%

Source: Exhibit No. 3.
1/ Percentage of agricultural shipments included in the STB Waybill Sample based on revenues with R/VC ratios greater or equal to 180 percent.

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As shown in Table 1 above, the percentage of traffic included in the Waybill Sample that is presumptively captive ranges from a low of 17.5 percent for Soybean Meal and Hulls in 2011 to a high of 68.7 percent of 2011 ethanol.

In addition to identifying the potentially captive traffic that have R/VC ratios greater than 180 percent, I also identified the traffic for the selected commodities with R/VC ratios greater than 250 percent. This traffic represents movements that are providing the highest contributions to the Class I railroads. I summarized the amount of traffic with R/VC ratios greater than 250 percent in Table 2 below.

Commodity (1)	Percentage of Traffic With R/VC Greater Than 250 Percent 1/	
	2011 (2)	2012 (3)
1. Corn	5.3%	5.8%
2. Wheat	13.3%	13.1%
3. Soybean	3.4%	2.8%
4. Soybean Meal and Hulls	2.4%	3.5%
5. Ethanol	39.0%	31.5%

Source: Exhibit No. 3.
1/ Percentage of selected agricultural shipments included in the STB Waybill Sample based on revenues with R/VC ratios greater or equal to 250 percent.

As shown in Table 2 above, the percentage of the selected commodities providing the highest contributions ranges from 2.4 percent for soybeans in 2011 to 39.0 percent for ethanol in 2011.

I also analyzed the average rates paid by those potentially captive grain and allied shippers as captured in the STB 2011 and 2012 Waybill Samples. As shown in Exhibit No. 4 to this VS, the averages were generally consistent between the two sample years.

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III. PROPOSED AG COMMODITIES MAXIMUM RATE METHODOLOGY

The STB, and its predecessor agency the Interstate Commerce Commission (“ICC”), have only heard one (1) maximum reasonable rate case² involving grain and allied products since 1982. That case, *McCarty Farms, et al v. Burlington Northern, Inc.*, (“*McCarty Farms*”), took over 18 years to resolve and was adjudicated under several different rate reasonableness methodologies. The STB finally decided the case in 1997 using stand-alone cost (“SAC”) principles, which found the railroad’s rates to be reasonable.

McCarty Farms highlights the need for a different maximum reasonable rate standard for agricultural commodities. The grain industry is made up of farmers, elevators, marketers, processors and transporters. Unlike other industries, there is typically no direct rail service provided to the actual farms of the commodity being transported, but instead grain elevators aggregate the crops grown on farms they service, which is typically delivered to them by truck. This leads to the rail transportation rates and terms being established between the elevator and the railroad, with the cost of rail transportation being ultimately borne by the farmer in the price paid by the elevator for the crop. This ultimately leads to reduced incomes for the farmer as the impact of high transportation rates established prior to the sale of their crops to an elevator reducing prices paid by the elevator to the farmer. However, even though the increase in rail transportation rates directly impacts a farmer’s bottom line, the farmer has little ability to bring a maximum reasonable rate case given the high costs of maximum reasonable rate proceedings under the Board’s current maximum rate procedures. They also have limited intermodal and intramodal competition options as the grain market is characterized by extremely isolated shippers usually with access to only a single railroad to transport their commodities to an interchange point with another railroad or a final destination.

² Ex Parte No. 347 (Sub-No. 1), *Coal Rate Guidelines, Nationwide*, 1 ICC 2d 530 (“*Coal Rate Guidelines*”).

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Because of the unique nature of the grain and allied product markets, I was requested to develop an alternative maximum rate methodology that may be used by grain and allied product shippers. The proposed Ag Commodities Maximum Rate Methodology (“ACMRM”) outlined below utilizes both railroad revenue adequacy determinations and the current markets for the issue traffic to develop maximum reasonable rates for issue movements. While similar to the STB’s current Three Benchmark Methodology for small shippers in that it also uses a comparison group of similar movements, ACMRM will use comparable traffic drawn from all railroads, specifically all traffic with similar operating characteristics. In addition, the proposed ACMRM would make commodity specific adjustments to reflect each Class I railroad’s revenue adequacy status. I describe the proposed methodology in detail below.

A. COMPARABLE GROUP SELECTION

As is currently the process with the Board’s Three Benchmark Methodology, the complaining shipper would gain access to the STB’s Waybill Sample upon the filing of a complaint with the Board, and executing the required confidentiality agreements and protective orders. The shipper would then select from the Confidential Waybill Sample all comparable moves that meet the selection criteria for the movement at issue. The shipper will base comparability to the issue movement on the following factors:

1. Distance – A movement will be considered comparable if its total distance on all carriers is within plus or minus 20 percent of the issue movement’s standard routing;
2. Commodity – Comparability will be based on movements with the same five-digit or seven-digit Standard Transportation Commodity Code (“STCC”) as the issue movement;
3. Railcar Type – A movement will be included in the comparison group if it moves in the same type of railcar as the issue movement as defined by Association of American Railroads’ (“AAR”) equipment type;
4. Railcar Ownership - A movement will be included in the comparison group if its railcar ownership (system or private) is the same as the issue movement’s railcar ownership; and

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5. Movement Type - Movements included in the comparison group will have the same movement type as the issue at movement as defined by Board's URCS shipment selection criteria. These include Single Carload Movements (up to five (5) cars tendered on a single waybill), Multi Carload Movements (six (6) or more cars usually tendered under one waybill), or Unit Train Movements (fifty (50) or more freight cars).

While the proposed methodology will draw its comparable group from the Board's Waybill Sample as does the STB's Three Benchmark Approach, the comparison group under the proposed ACMRM will not be so limited. The Board's Three Benchmark Approach limits the comparison group to movements with R/VC ratios greater than 180 percent handled by the defendant railroad. In contrast, the comparison group under the proposed ACMRM will not consist of only potentially captive traffic handled by the defendant railroad, e.g., movements with R/VC ratios greater than 180 percent, over which the carrier presumptively has market power, but will include all shipments moving on all railroads appearing in the Confidential Waybill Sample meeting the comparison requirements, regardless of the comparable movement's R/VC ratio. The reason for the all-inclusive nature of the comparison group stems from the national and international market factors facing grain shipments. Grain and allied products, unlike many other products transported by rail, are extremely fungible, and deviation from the average cost of production and transportation can effectively foreclose a grain shipment from market.

In STB Ex Parte No. 646 (Sub No. 1), *Simplified Standards For Rail Rate Cases*, served September 5, 2007 ("EP 646"), the STB stated that the inclusion of non-defendant traffic in the Three Benchmark comparison group was inappropriate under the belief that the R/VC ratios of one carrier cannot be truly compared to the R/VC ratios of another carrier.³ The Board based its belief on two premises. First, the Board believed that a movement's R/VC ratio is based, in part, on the amount of joint and common costs each particular railroad needs to recover, and that these

³ See EP 646 at pages 82 to 83.

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parameters will vary between carriers. The need to recover differing amounts of joint and common costs will thus inevitably lead to differences in R/VC ratios. Second, the STB believed that the degree of differential pricing a railroad can exercise is a function of the railroad's traffic mix. Since, each railroad has a different mix of traffic, and therefore levels of differential pricing, the STB concluded comparing the R/VC ratios from one railroad would not provide useful indication of appropriate R/VC ratios on another railroad.

As to the first belief held by the Board, that each of the railroads may have different amounts of joint and common costs, an analysis of the Class I railroads cost structures shows that the relative level of common costs compared to total costs is fairly consistent across railroads. The STB's URCS calculates both the total railway expense for each Class I railroad and the total variable railway expenses.⁴ Subtracting the total variable expenses from the total expenses leaves, by default, the total fixed railway expenses, which are roughly equivalent to the joint and common costs incurred by the carriers. As shown in my work papers, the fixed costs incurred by the railroads as a percentage of total costs has remained in a fairly stable range between the high 20 to low 30 percent of total costs over the latest 11 years available.⁵ In other words, the percentage of costs that are required to be recovered through differential pricing have remained fairly consistent across the railroads.

The Board's second belief, that pricing levels on individual movements is a function of each railroad's traffic mix, is inconsistent with the STB's pricing stance taken in market dominance determinations. As profit maximizing organizations, the railroads charge each movement the maximum amount possible subject to limitations imposed by competitive forces and operating constraints. When assessing whether a railroad possess qualitative market

⁴ See URCS Worktable D8, Part 6, Lines 613 and 614.

⁵ See e-workpaper "Fixed Cost as a Percent of Total - 2002 to 2012.xlsx." Some years may be above or below this range, but these outliers quickly move back into the relevant range in subsequent years.

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dominance in a rate reasonableness proceeding, the STB does not investigate whether the mix of traffic limits the price of the movement. Instead, the STB looks at the pricing level for the issue movement based on intermodal and intramodal competition since it is these individual constraints that limit the price, not the traffic mix.

While the Board states that cross-railroad price and cost comparisons are illogical and economically unsound, it routinely uses such cross-carrier comparisons in other STB proceedings. The prime example is the STB's annual revenue adequacy determination. While the STB calculates the return on investment ("ROI") for the individual railroads, it then compares the individual ROI to the average cost of capital based on cost inputs from different railroads to decide if a railroad is revenue adequate within a particular year. There is no arguing that each railroad has its own cost structures and capital costs.⁶ However, notwithstanding this, the Board has decided to use a cross-carrier comparison to determine revenue adequacy. The fact that the STB routinely uses a cross-carrier comparison in its regulatory role shows that there is no real impediment to using cross-carrier comparisons in other matters before the Board, including maximum rate determinations.

B. REVENUE ADEQUACY ADJUSTMENT FACTOR

There is little doubt that the Class I railroads have reached revenue adequate levels based on objective metrics and market interpretations. With that being said, the STB's current Revenue Adequacy standards still finds the majority of the Class I railroads revenue inadequate on an annual basis. Moreover, revenue adequacy is such a keynote issue with the STB that it is a key component of the Board's Three Benchmark Methodology.

⁶ See, e.g., the AAR's evidence in Ex Parte No. 558 (Sub No. 17), *Railroad Cost of Capital – 2013*, which shows different Multi-Stage DCF, costs of debt and capital structures for each one of the railroads included in the cost of capital group.

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The Three Benchmark Methodology takes into consideration each Class I railroad's revenue adequacy status through the use of the railroad's RSAM and $R/VC_{>180}$ ratios and marginal tax rates.⁷ The first benchmark, RSAM, measures the average markup that the railroad would need to charge all of its "potentially captive" traffic in order for the railroad to earn adequate revenues as measured by the Board. The RSAM benchmark is calculated by adding the carrier's revenue shortfall (or subtracting the overage) shown in the STB's annual revenue adequacy determination, adjusted for taxes, to the numerator of the $R/VC_{>180}$ benchmark. The STB calculates the simple average of the last four year RSAM benchmarks to develop the 4-year average RSAM used in the Three Benchmark process.

The second benchmark is $R/VC_{>180}$. This benchmark measures the average markup over variable cost earned by the defendant railroad on its potentially captive traffic. The $R/VC_{>180}$ benchmark is calculated using the Board's Waybill Sample data by dividing the total revenues earned by the carrier on potentially captive traffic by the carrier's total variable costs for that traffic. As with the RSAM ratio, the Board calculates the 4-year average of the $R/VC_{>180}$ for use in its Three Benchmark approach.

The ratio of the 4-year average RSAM to $R/VC_{>180}$ ratios provides an estimate of how much more or less the railroad would need to charge its potentially captive traffic to be revenue adequate. The STB then applies the ratio of the RSAM to $R/VC_{>180}$ to each of the movements in the comparison group. For railroads where the 4-year average RSAM ratio is less than the 4-year average $R/VC_{>180}$, the resultant ratio will be less than 1.0 and the R/VC ratios of the movements in the comparison group will be lowered. For railroads where the 4-year average RSAM ratio is greater than the 4-year average $R/VC_{>180}$, the resultant ratio will be greater than 1.0 and the R/VC ratios of the movements in the comparison group will be increased.

⁷ See EP 646 at pages 19 to 21.

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While the approach used by the STB in the Three Benchmark methodology does take into consideration each railroad's revenue adequacy status as currently defined by the STB, it has several flaws. First, the Board's current approach relies upon system total revenue and costs figures for both the RSAM and the $R/VC_{>180}$ ratios, but does not take into consideration the impact of the specific commodities at issue. Second, the use of a 4-year average to develop the RSAM and the $R/VC_{>180}$ ratios over weighs the railroads' historic financial performances and under weighs the most recent. Simply stated, a railroad that has reached revenue adequacy, as measured by the STB's procedures in the most recent years, could still have a Three Benchmark adjustment factor greater than 1.0 if it was deemed revenue inadequate four years ago.

To adjust for these flaws in the STB's revenue adequacy procedures, I propose to include in ACMRM a revised revenue adequacy factor that takes into consideration not only the relative revenues of each commodity, but also to give 100 percent of the weight to the most recent railroad financial performance as reported to the Board. The revised factor, which I call the Revenue Adequacy Adjustment Factor ("RAAF") is developed as follows:

$$\text{RAAF} = \{[(\text{COC} - \text{ROI}) \times \text{RRIB}] \div (1 - \text{Tax Rate})\} \times (\text{STCC Rev}_{>180} \div \text{RR Rev}_{>180}) \div \text{STCC Rev}$$

Where:

RAAF	=	Revenue Adequacy Adjustment Factor
COC	=	Railroad Industry Cost of Capital
ROI	=	Railroad Specific Return on Investment
RRIB	=	Railroad Specific Tax Adjusted Net Investment Base
Tax Rate	=	Railroad Specific Marginal Tax Rate
STCC Rev _{>180}	=	Railroad Specific Revenue by STCC from Movements with R/VC Ratios Greater Than 180%
RR Rev _{>180}	=	Railroad Specific Revenues from Movements with R/VC Ratios Greater Than 180%
STCC Rev	=	Railroad Specific Revenues by STCC

The adjustment factor, which will be calculated for each Class I railroad and each commodity using only the most recent year available, will then be applied to movements on that

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railroad in the comparison group. In other words, BNSF Railway Company (“BNSF”) shipments included in the comparison group will be adjusted by the BNSF RAAF, while Union Pacific Railroad Company (“UP”) movements will be adjusted by the UP RAAF. Movements on short-line and regional railroads included in a comparison group will not receive RAAF adjustments.

The use of the RAAF addresses the two flaws with the Board’s Three Benchmark adjustment approach. First, the approach takes into consideration the amount of issue commodity traffic that is ostensibly captive to the railroad through the use of the STCC Rev _{>180} in the RAAF, and allocates the burden of helping achieve revenue adequacy to those commodities that provide the most revenue. Second, it removes the overweighing of the railroad’s historic financial performance by using the most current financial data reported to the Board.

Calculating the RAAF is a straight forward process that should not create any impediment to the proposed ACMRM rate process as the STB already calculates the majority of the RAAF inputs as part of its usual regulatory processes. For example, the STB calculates the railroad industry cost of capital in its annual Ex Parte No. 558 *Railroad Cost of Capital* proceedings, and railroad specific ROI as part of its Ex Parte No. 552, *Railroad Revenue Adequacy* determinations.⁸ In addition, the STB publishes the individual railroad marginal tax rates and Rev_{>180} for its annual RSAM calculations, and places the data on its website.⁹ The two factors that are not developed by the STB on an annual basis, STCC Rev _{>180} and STCC Rev, are easily calculated from the Confidential Waybill Sample data provided upon the filing of a

⁸ See, for example, Docket No. EP 558 (Sub-No. 16), *Railroad Cost Of Capital—2012*, served August 30, 2013, and Docket No. EP 552 (Sub-No. 17), *Railroad Revenue Adequacy—2012 Determination*, served January 2, 2014.

⁹ See http://www.stb.dot.gov/stb/industry/econ_reports.html.

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complaint by a shipper. I have included examples of the RAAF calculations in Exhibit No. 5 to this VS.

Like the adjustment factor the Board uses in its Three Benchmark approach, the RAAF will provide a downward adjustment when the railroad is deemed revenue adequate under the STB's revenue adequacy methodology, and an upward adjustment when the railroad is revenue inadequate. However, the RAAF will take into consideration the amount of revenue a specific commodity is providing to a railroad's revenue adequacy, or lack thereof, and allocate the relief or burden to that particular commodity.

C. DEVELOPMENT OF THE AG COMMODITIES BENCHMARK RATIO

The next step in the proposed ACMRM is the calculation of the comparison group R/VC ratio to which the issue traffic R/VC ratio will be compared. The comparison group R/VC will be calculated using the following approach:

1. For each movement in the comparison group, the revenues associated with the movement will be identified from the Waybill Sample, and the railroad specific RAAF applied to all revenues associated with Class 1 railroads. RAAF adjustments will not be made to the revenues for non-Class 1 railroads;
2. The RAAF-adjusted revenues will then be summed to develop each movement's total adjusted revenues;
3. The URCS Phase III costs included in the Board's Waybill Sample will next be summed to develop the movement's total variable costs;
4. Each movement's RAAF-adjusted revenue will then be divided by the movement's aggregate URCS Phase III variable costs to develop an adjusted R/VC ratio; and
5. The simple average of the adjusted R/VC ratios in the comparison group will be calculated and used as the comparison group benchmark R/VC ratio.

The above process is similar to the STB's Three Benchmark approach wherein the issue traffic R/VC ratio is compared against a comparison group R/VC ratio. However, unlike the

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Board's Three Benchmark approach, the proposed maximum rate methodology does not include a confidence interval adjustment after the calculation of the comparison group mean R/VC ratio.

It is well established that the sample mean is a statistically unbiased point estimator of the corresponding population parameter, which in this case, is the average transportation rate for grain or an allied product given a certain set of characteristics. The addition of the confidence interval adjustment to the comparison group R/VC ratio turns the point estimate into an interval estimate in which the parameter at issue, i.e., the population average transportation rate, is likely to fall. The interval estimate only indicates with a certain percentage of confidence that the parameter at issue lies within its bounds. It does not indicate where within the interval the parameter lies. The addition of a confidence interval therefore artificially raises the rate reasonableness bar by moving the comparison group R/VC ratio to the upper boundary of the interval. This can lead to a rate being deemed reasonable even though the issue traffic R/VC ratio is larger than the comparison group R/VC ratio without a confidence interval adjustment. Removing the confidence interval adjustment removes the possibility of the Board finding an unreasonable grain rate reasonable based only on a statistical assumption.

D. RATE REASONABLENESS DETERMINATION

After the calculation of the comparison group R/VC benchmark ratio, the reasonableness of the rate is determined by comparison of the issue traffic R/VC ratio to that of the comparison group R/VC ratio. If the issue traffic R/VC ratio is greater than the comparison group benchmark R/VC ratio, then the issue rate is deemed unreasonable and set equal to the comparison group benchmark R/VC ratio or the 180 percent jurisdictional threshold, whichever is greater. If the issue traffic R/VC ratio is less than the comparison group benchmark R/VC ratio, the issue rate is deemed reasonable. Exhibit No. 6 to this VS contains examples of the

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Grain Rate Methodology for each one of the five (5) commodity groups requested for this analysis.

Unlike the Three Benchmark approach, no additional factors will be considered in the proposed rate reasonableness process. The current Three Benchmark approach allows for examination of “other relevant factors”, such as traffic densities along the routes involved, and demand elasticity of the movements. However, in the few Three Benchmark cases filed at the Board, the railroads have attempted to add more factors, which greatly added to the complainants’ litigation costs. Inclusion in the comparison group under the proposed methodology will be limited to the factors outlined above. This will reduce the time to determine the comparison group and eliminate ambiguity in the selection process.

Exclusion of the “other relevant factors” evidence will not lead to a free for all of maximum reasonable rate cases that will severely impact the railroad’s bottom line. I have included as Exhibit No. 7 to this VS the impact on 2011 and 2012 expanded railroad revenues included in the Waybill Sample for the five (5) issue commodities if the ACMRM were applied to all potentially captive shippers with R/VC ratios greater than 180 percent.¹⁰ Stated differently, I have applied the proposed ACMRM to all shipments included in the Waybill Sample, and identified where the issue traffic R/VC ratio was higher than the adjusted comparison group R/VC ratio. Where the issue traffic R/VC ratio was larger than the comparison group R/VC ratio, I set the issue traffic R/VC ratio equal to the higher of the comparison group R/VC ratio or the 180 percent jurisdictional threshold, and recalculated the issue traffic revenues.¹¹ The result was a reduction in revenues ranging from 8 to 18 percent.

¹⁰ The Exhibit is separated by U.S. only shipments and cross-border shipments.

¹¹ There were numerous instances where I could not develop a maximum reasonable rate for a shipment included in the Waybill Sample. In some cases this was due to missing movement characteristics from the Waybill Sample. In other cases it was due to an inability to develop a comparison group based on the shipment characteristics.

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This reduction is of course a worst case scenario in which every Ag Commodity shipper with a rate that had a R/VC ratio greater than 180 percent sought relief. Such a scenario will never take place. However, even it did occur, the overall impact on the railroads and their revenue adequacy as calculated under the STB's current methodology, would be minimal. I have estimated the impact on the railroads' 2011 and 2012 Ex Parte No. 552 Revenue Adequacy Determinations if ACMRM were applied to all eligible movements included in the five (5) agricultural commodities evaluated, and relief were available. As shown in Exhibit No. 8, the three (3) railroads the STB determined to be revenue adequate in 2011 and 2012, BNSF, UP and Norfolk Southern Railway Company ("NS"), would continue to be ruled revenue adequate under the STB's methodology, while the four (4) other Class I railroads, CSX Transportation ("CSX"), Kansas City Southern Railway Company ("KCS"), Canadian National Railway ("CN") and Canadian Pacific Railway ("CP") would still be deemed revenue inadequate under the STB's revenue adequacy approach.¹²

E. RATE ADJUSTMENTS

The proposed ACMRM discussed above determines whether an existing Ag Commodity rate is reasonable, and, if not deemed reasonable, the maximum rate that the railroad can charge for the issue movement. The next question is how will the newly established rates be adjusted moving forward? The Board's current methodology, whether the prescribed rates are developed in a Full SAC case, a Simplified SAC case or a Three Benchmark case, is to adjust the rates

Where I could not develop a comparison group R/VC ratio for a movement, I left the revenues for that movement unadjusted in the analysis.

¹² The analysis included in Exhibit No. 8 to this VS reflects the impact on the carriers' revenue adequacy if the ACMRM is applied to the five (5) agricultural commodities evaluated. I have also applied the ACMRM to the 2011 and 2012 STB Confidential Waybill traffic for all of the commodities included in the NGFA Arbitration Rules, and determined that BNSF, NS and UP would still be revenue adequate in both years if the ACMRM were applied to eligible traffic. See e-workpaper "Impact on Revenue Adequacy - All NGFA Commodities.xlsx."

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based on the change in the movement's URCS Phase III variable costs as applied to the prescribed R/VC rate level.¹³

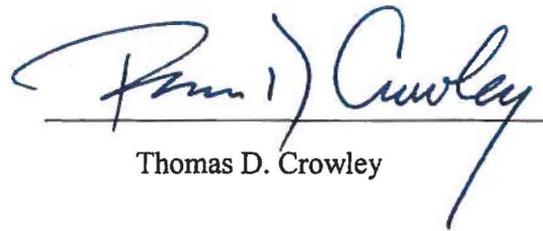
The STB specified the procedures used to calculate the issue movement's URCS Phase III variable costs in its decision in Docket No. 42111, *Oklahoma Gas & Electric Company v. Union Pacific Railroad Company*, served July 24, 2009 ("OG&E"). Under the procedures established in *OG&E*, the carrier calculates the Phase III URCS variable costs on a quarterly basis using the most recent URCS data indexed to that quarter by using the most recent wage and price level indices published by the Association of American Railroads ("AAR") and the Producers Price Index – All Commodities ("PPI") published by the U.S. Bureau of Labor Statistics. The carrier then combines those data with the actual operating characteristics for the issue movement to estimate the movement's variable cost, and then multiplies the proscribed R/VC ratio or the 180 percent jurisdictional threshold by the variable costs to calculate the rate to be charged in that quarter.

I believe the *OG&E* approach is an acceptable methodology to adjusting rates proscribed under the proposed ACMRM. The *OG&E* procedures account for changes in the railroad's underlying costs through the use of the URCS Phase III variable costs, and will therefore take into consideration any fundamental changes in the incumbent railroad's operations and cost structure. The *OG&E* procedures also account for changes in railroad input prices, including fuel, through the quarterly adjustments based on the AAR indices and the PPI. The *OG&E* procedures also protect the shipper by passing through a portion of any productivity gains made by the railroad that lower the carrier's URCS Phase III variable costs.

¹³ In a Full SAC cases and Simplified SAC cases, the prescribed R/VC ratios are set using the Maximum Markup Methodology, while in the Three Benchmark Approach the prescribed R/VC is set based on the comparison group R/VC ratios.

VERIFICATION

I, Thomas D. Crowley, verify under penalty of perjury that I have read this Verified Statement on behalf of the National Grain and Feed Association, that I know the contents thereof, and that the same are true and correct. Further, I certify that I am qualified and authorized to file this statement.


Thomas D. Crowley

Executed on June 23, 2014

THOMAS D. CROWLEY
STATEMENT OF QUALIFICATIONS

My name is Thomas D. Crowley. I am an economist and President of the economic consulting firm of L. E. Peabody & Associates, Inc. The firm's offices are located at 1501 Duke Street, Suite 200, Alexandria, Virginia 22314, 760 E. Pusch View Lane, Suite 150, Tucson, Arizona 85737, and 7 Horicon Avenue, Glens Falls, New York 12801.

I am a graduate of the University of Maine from which I obtained a Bachelor of Science degree in Economics. I have also taken graduate courses in transportation at George Washington University in Washington, D.C. I spent three years in the United States Army and since February 1971 have been employed by L. E. Peabody & Associates, Inc.

I am a member of the American Economic Association, the Transportation Research Forum, and the American Railway Engineering and Maintenance-of-Way Association.

The firm of L. E. Peabody & Associates, Inc. specializes in analyzing matters related to the rail transportation of all commodities. As a result of my extensive economic consulting practice since 1971 and my participation in maximum-rate, rail merger, service disputes and rule-making proceedings before various government and private governing bodies, I have become thoroughly familiar with the rail carriers that move coal over the major coal routes in the United States. This familiarity extends to subjects of railroad service, costs and profitability, cost of capital, railroad capacity, railroad traffic prioritization and the structure and operation of the various contracts and tariffs that historically have governed the movement of traffic by rail.

THOMAS D. CROWLEY
STATEMENT OF QUALIFICATIONS

As an economic consultant, I have organized and directed economic studies and prepared reports for railroads, freight forwarders and other carriers, for shippers, for associations and for state governments and other public bodies dealing with transportation and related economic problems. Examples of studies I have participated in include organizing and directing traffic, operational and cost analyses in connection with multiple car movements, unit train operations for coal and other commodities, freight forwarder facilities, TOFC/COFC rail facilities, divisions of through rail rates, operating commuter passenger service, and other studies dealing with markets and the transportation by different modes of various commodities from both eastern and western origins to various destinations in the United States. The nature of these studies enabled me to become familiar with the operating practices and accounting procedures utilized by railroads in the normal course of business.

Additionally, I have inspected and studied both railroad terminal and line-haul facilities used in handling various commodities, including unit train coal movements from coal mine origins in the Powder River Basin and in Colorado to various utility destinations in the eastern, mid-western and western portions of the United States and from the Eastern coal fields to various destinations in the Mid-Atlantic, northeastern, southeastern and mid-western portions of the United States. These operational reviews and studies were used as a basis for the determination of the traffic and operating characteristics for specific movements of numerous commodities handled by rail.

THOMAS D. CROWLEY
STATEMENT OF QUALIFICATIONS

I have frequently been called upon to develop and coordinate economic and operational studies relative to the rail transportation of various commodities. My responsibilities in these undertakings included the analyses of rail routes, rail operations and an assessment of the relative efficiency and costs of railroad operations over those routes. I have also analyzed and made recommendations regarding the acquisition of railcars according to the specific needs of various shippers. The results of these analyses have been employed in order to assist shippers in the development and negotiation of rail transportation contracts which optimize operational efficiency and cost effectiveness.

I have developed property and business valuations of privately held freight and passenger railroads for use in regulatory, litigation and commercial settings. These valuation assignments required me to develop company and/or industry specific costs of debt, preferred equity and common equity, as well as target and actual capital structures. I am also well acquainted with and have used the commonly accepted models for determining a company's cost of common equity, including the Discounted Cash Flow Model ("DCF"), Capital Asset Pricing Model ("CAPM"), and the Farma-French Three Factor Model.

Moreover, I have developed numerous variable cost calculations utilizing the various formulas employed by the Interstate Commerce Commission ("ICC") and the Surface Transportation Board ("STB") for the development of variable costs for common carriers, with particular emphasis on the basis and use of the Uniform Railroad Costing System ("URCS") and its predecessor, Rail Form A. I have utilized URCS/Rail form A

THOMAS D. CROWLEY
STATEMENT OF QUALIFICATIONS

costing principles since the beginning of my career with L. E. Peabody & Associates Inc. in 1971.

I have frequently presented both oral and written testimony before the ICC, STB, Federal Energy Regulatory Commission, Railroad Accounting Principles Board, Postal Rate Commission and numerous state regulatory commissions, federal courts and state courts. This testimony was generally related to the development of variable cost of service calculations, rail traffic and operating patterns, fuel supply economics, contract interpretations, economic principles concerning the maximum level of rates, implementation of maximum rate principles, and calculation of reparations or damages, including interest. I presented testimony before the Congress of the United States, Committee on Transportation and Infrastructure on the status of rail competition in the western United States. I have also presented expert testimony in a number of court and arbitration proceedings concerning the level of rates, rate adjustment procedures, service, capacity, costing, rail operating procedures and other economic components of specific contracts.

Since the implementation of the *Staggers Rail Act of 1980*, which clarified that rail carriers could enter into transportation contracts with shippers, I have been actively involved in negotiating transportation contracts on behalf of shippers. Specifically, I have advised shippers concerning transportation rates based on market conditions and carrier competition, movement specific service commitments, specific cost-based rate adjustment provisions, contract reopeners that recognize changes in productivity and cost-based ancillary charges.

THOMAS D. CROWLEY
STATEMENT OF QUALIFICATIONS

I have been actively engaged in negotiating coal supply contracts for various users throughout the United States. In addition, I have analyzed the economic impact of buying out, brokering, and modifying existing coal supply agreements. My coal supply assignments have encompassed analyzing alternative coals to determine the impact on the delivered price of operating and maintenance costs, unloading costs, shrinkage factor and by-product savings.

I have developed different economic analyses regarding rail transportation matters for over sixty (60) electric utility companies located in all parts of the United States, and for major associations, including American Paper Institute, American Petroleum Institute, Chemical Manufacturers Association, Coal Exporters Association, Edison Electric Institute, Mail Order Association of America, National Coal Association, National Industrial Transportation League, North America Freight Car Association, the Fertilizer Institute and Western Coal Traffic League. In addition, I have assisted numerous government agencies, major industries and major railroad companies in solving various transportation-related problems.

In the two Western rail mergers that resulted in the creation of the present BNSF Railway Company and Union Pacific Railroad Company and in the acquisition of Conrail by Norfolk Southern Railway Company and CSX Transportation, Inc., I reviewed the railroads' applications including their supporting traffic, cost and operating data and provided detailed evidence supporting requests for conditions designed to maintain the competitive rail environment that existed before the proposed mergers and acquisition.

THOMAS D. CROWLEY
STATEMENT OF QUALIFICATIONS

In these proceedings, I represented shipper interests, including plastic, chemical, coal, paper and steel shippers.

I have participated in various proceedings involved with the division of through rail rates. For example, I participated in ICC Docket No. 35585, *Akron, Canton & Youngstown Railroad Company, et al. v. Aberdeen and Rockfish Railroad Company, et al.* which was a complaint filed by the northern and mid-western rail lines to change the primary north-south divisions. I was personally involved in all traffic, operating and cost aspects of this proceeding on behalf of the northern and mid-western rail lines. I was the lead witness on behalf of the Long Island Rail Road in ICC Docket No. 36874, *Notice of Intent to File Division Complaint by the Long Island Rail Road Company.*

List of Ag CommoditiesSTCC and Commodity

(1)

1. 01-131 Barley
2. 01-132 Corn
3. 01-133 Oats
4. 01-135 Rye
5. 01-136 Sorghum Grains
6. 01-137 Wheat
7. 01-139 Grain, NEC
8. 01-141 Cottonseeds
9. 01-142 Flaxseeds
10. 01-143 Peanuts Meal
11. 01-144 Soybeans
12. 01-149 Oil Kernels, nuts or seeds
13. 01-152 Popcorn
14. 01-159 Seeds
15. 01-191 Fodder Hay or Roughage
16. 01-341 Beans, Dry Ripe
17. 01-342 Peas, Dry
18. 01-343 Cowpeas, Lentils or Lupines
19. 01-992 Alfalfa Meal
20. 20-111 Cottonseed Oil
21. 20-143 Grease/Inedible tallow
22. 20-411 Wheat Flour
23. 20-412 Wheat bran, middlings
24. 20-413 Corn meal or flour
25. 20-414 Rye flour
26. 20-415 Oat flour
27. 20-418 Grain mill by-products
28. 20-419 Flour or other grain mill products, NEC
29. 20-421 Prepared Feeds
30. 20-461 Corn syrup
31. 20-462 Corn starch
32. 20-463 Corn sugar
33. 20-464 Dextrine, corn, tapioca or other
34. 20-465 Corn oil

STCC and Commodity (continued)

(2)

35. 20-466 Other starch
36. 20-467 Wet process corn or similar mill by-products
37. 20-469 Wet process corn milling or by-products
38. 20-471 Bird Food or Seed, Domestic
39. 20-511 Bakery Products/Sweepings
40. 20-61625 Molasses
41. 20-619 Beet Pulp Pellets
42. 20-823 Spent Grains
43. 20-831 Malt
44. 20-832 Malt Flour or Sprouts
45. 20-839 Malt Products
46. 20-859 Distillers By-Products
47. 20-914 Cottonseed Meal or By-Products
48. 20-921 Soybean oil
49. 20-923 Soybean meal and hulls
50. 20-92336 Soapstock (for feed use only)
51. 20-933 Nut or Vegetable Oils
52. 20-939 Oil Seed Meals and By-Products, NEC
53. 20-942 Fish Meal
54. 20-144 Animal Protein Products
55. 01-134 Rough Rice
56. 20-449 Milled Rice, Rice By-Products, etc.
57. 20-442 Rice Flour
58. 20-933 Rice Oil
59. 20-442 Rice Bran
60. 37-422 Freight cars moving on own-wheels
61. 28-12630 Limestone (for feed use only)
62. 28-184 Biodiesel
63. 28-18445 Ethanol
64. 28-185 Glycerin
65. 28-19910 Dical and monocal phosphate
66. 28-99112 Salt (for feed use only)
67. 28-994 Distillate (fatty acids)
68. 30-41290 Millrun

Summary of R/VC Ratios of 2011 Shipments for Five Commodities

<u>Carrier</u> (1)	<u>All Waybills</u>					<u>Waybills With R/VC >= 180%</u>					<u>Waybills With R/VC >= 250%</u>				
	<u>Revenue 1/</u> (2)	<u>Tons 2/</u> (3)	<u>Carloads 3/</u> (4)	<u>Variable Cost 4/</u> (5)	<u>R/VC 5/</u> (6)	<u>Revenue 1/</u> (7)	<u>Tons 2/</u> (8)	<u>Carloads 3/</u> (9)	<u>Variable Cost 4/</u> (10)	<u>R/VC 5/</u> (11)	<u>Revenue 1/</u> (12)	<u>Tons 2/</u> (13)	<u>Carloads 3/</u> (14)	<u>Variable Cost 4/</u> (15)	<u>R/VC 5/</u> (16)

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Summary of R/VC Ratios of 2012 Shipments for Five Commodities

<u>Carrier</u> (1)	<u>All Waybills</u>					<u>Waybills With R/VC >= 180%</u>					<u>Waybills With R/VC >= 250%</u>				
	<u>Revenue 1/</u> (2)	<u>Tons 2/</u> (3)	<u>Carloads 3/</u> (4)	<u>Variable Cost 4/</u> (5)	<u>R/VC 5/</u> (6)	<u>Revenue 1/</u> (7)	<u>Tons 2/</u> (8)	<u>Carloads 3/</u> (9)	<u>Variable Cost 4/</u> (10)	<u>R/VC 5/</u> (11)	<u>Revenue 1/</u> (12)	<u>Tons 2/</u> (13)	<u>Carloads 3/</u> (14)	<u>Variable Cost 4/</u> (15)	<u>R/VC 5/</u> (16)

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Summary of Average Rates For Potentially Captive Ag Commodity Traffic - 2011 and 2012

<u>Carrier</u>	2011				2012			
	<u>Carloads 1/</u>	<u>Average Miles 2/</u>	<u>Avg. Rate Per Ton- Mile (mills) 3/</u>	<u>Avg. Rate Per Car- Mile 4/</u>	<u>Carloads 1/</u>	<u>Average Miles 2/</u>	<u>Avg. Rate Per Ton- Mile (mills) 3/</u>	<u>Avg. Rate Per Car- Mile 4/</u>
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)

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Revenue Adequacy Adjustment Factor - 2011

A. RAAF Formula

$$\text{RAAF} = \{[(\text{COC} - \text{ROI}) \times \text{RRIB}] \div (1 - \text{Tax Rate})\} \times (\text{STCC Rev}_{>180\%} \div \text{Railroad Rev}_{>180\%}) \div \text{STCC Rev}$$

Where:

- RAAF = Revenue Adequacy Adjustment Factor
- COC = Railroad Industry Cost of Capital
- ROI = Railroad Specific Return On Investment
- RRIB = Railroad Specific Tax Adjusted Net Investment Base
- Tax Rate = Railroad Specific Marginal Tax Rate
- STCC Rev_{>180%} = Railroad Specific Revenue by STCC From Movements With R/VC Ratios Greater Than 180%
- Railroad Rev_{>180%} = Railroad Specific Revenues From Movements With R/VC Ratios Greater Than 180%
- STCC Rev = Railroad Specific Revenues by STCC

B. RAAF Examples

<u>Item</u>	<u>UP Corn</u>	<u>UP Wheat</u>	<u>CP (US) Corn</u>	<u>CP (US) Wheat</u>
(1)	(2)	(3)	(4)	(5)
1. Railroad Industry Cost of Capital <u>1/</u>	11.57%	11.57%	11.57%	11.57%
2. Railroad Return on Investment <u>2/</u>	13.11%	13.11%	7.13%	7.13%
3. Railroad Investment Base <u>2/</u>	\$27,104,342	\$27,104,342	\$2,716,949	\$2,716,949
4. Tax Rate <u>3/</u>	38.92%	38.92%	39.78%	39.78%
5. Total Revenues For STCC <u>4/</u>	{ }	{ }	{ }	{ }
6. Revenues >180% For STCC <u>5/</u>	{ }	{ }	{ }	{ }
7. Revenues >180 <u>6/</u>	{ }	{ }	{ }	{ }
8. Total Shortfall/(Overage) <u>7/</u>	-\$683,377	-\$683,377	\$200,311	\$200,311
9. STCC Shortfall <u>8/</u>	{ }	{ }	{ }	{ }
10. STCC Specific RAAF <u>9/</u>	{ }	{ }	{ }	{ }

1/ STB Ex Parte No. 558 (Sub-No. 15), *Railroad Cost of Capital -- 2011*, decided, September 11, 2012.

2/ STB Ex Parte No. 552 (Sub-No. 16), *Railroad Revenue Adequacy -- 2011 Determination*, decided, September 11, 2012.

3/ STB Ex Parte No. 682 (Sub-No. 3), *2011 Tax Information*, decided June 5, 2012.

4/ Source: STB Costed Waybill Sample. Reflects total STCC revenues.

5/ Source: STB Costed Waybill Sample. Reflects total STCC revenues on movements with R/VC greater than 180%.

6/ Total railroad revenues from traffic with R/VC ratios greater than 180% as reported in Ex Parte 347 (Sub-No. 2), *Rate Guidelines - Non-Coal Proceedings*.

7/ [(Line 1 - Line 2) x Line 3] ÷ (1 - Line 4).

8/ Line 8 x (Line 6 ÷ Line 7).

9/ Line 9 ÷ Line 5.

Example of Application of Ag Commodities Maximum Rate Methodology - STCC 01132 - Corn

A. Issue Movement Parameters

- 1. 5-Digit STCC 01132 - Corn
- 2. Distance
- 3. Total Revenue per car
- 4. Variable Cost (per car)
- 5. Revenue to Variable Cost ("R/VC") Ratio
- 6. Jurisdictional Threshold (per car)

B. Comparable Group Analysis

<u>Movement</u>	<u>Carrier #1</u>							<u>Carrier #2</u>							<u>All Carriers</u>			
	<u>Railroad</u>	<u>Distance</u>	<u>Revenue</u>	<u>RAAF</u>	<u>Adjusted Revenue 1/</u>	<u>Variable Cost</u>	<u>Adjusted R/VC Ratio 2/</u>	<u>Railroad</u>	<u>Distance</u>	<u>Revenue</u>	<u>RAAF</u>	<u>Adjusted Revenue 1/</u>	<u>Variable Cost</u>	<u>Adjusted R/VC Ratio 2/</u>	<u>Distance</u>	<u>Total Adjusted Revenue 3/</u>	<u>Variable Cost /4</u>	<u>Adjusted R/VC Ratio 5/</u>
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)

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Example of Application of Ag Commodities Maximum Rate Methodology - STCC 01137 - Wheat

A. Issue Movement Parameters

- 1. 5-Digit STCC 01137 - Wheat
- 2. Distance
- 3. Total Revenue per car
- 4. Variable Cost (per car)
- 5. Revenue to Variable Cost ("R/VC") Ratio
- 6. Jurisdictional Threshold (per car)

B. Comparable Group Analysis

<u>Movement</u>	<u>Carrier #1</u>							<u>Carrier #2</u>							<u>All Carriers</u>			
	<u>Railroad</u>	<u>Distance</u>	<u>Revenue</u>	<u>RAAF</u>	<u>Adjusted Revenue 1/</u>	<u>Variable Cost</u>	<u>Adjusted R/VC Ratio 2/</u>	<u>Railroad</u>	<u>Distance</u>	<u>Revenue</u>	<u>RAAF</u>	<u>Adjusted Revenue 1/</u>	<u>Variable Cost</u>	<u>Adjusted R/VC Ratio 2/</u>	<u>Distance</u>	<u>Total Adjusted Revenue 3/</u>	<u>Variable Cost /4</u>	<u>Adjusted R/VC Ratio 5/</u>
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)

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Example of Application of Ag Commodities Maximum Rate Methodology - STCC 01144 - Soybean

A. Issue Movement Parameters

- 1. 5-Digit STCC 01144 - Soybean
- 2. Distance
- 3. Total Revenue per car
- 4. Variable Cost (per car)
- 5. Revenue to Variable Cost ("R/VC") Ratio
- 6. Jurisdictional Threshold (per car)

B. Comparable Group Analysis

Movement	Carrier #1							Carrier #2							All Carriers			
	Railroad	Distance	Revenue	RAAF	Adjusted Revenue 1/	Variable Cost	Adjusted R/VC Ratio 2/	Railroad	Distance	Revenue	RAAF	Adjusted Revenue 1/	Variable Cost	Adjusted R/VC Ratio 2/	Distance	Total Adjusted Revenue 3/	Variable Cost /4	Adjusted R/VC Ratio 5/
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)

HIGHLY CONFIDENTIAL INFORMATION REDACTED

Example of Application of Ag Commodities Maximum Rate Methodology - STCC 20923 - Soybean Meal/Hulls

A. Issue Movement Parameters

- 1. 5-Digit STCC 20923 - Soybean Meal/Hulls
- 2. Distance
- 3. Total Revenue per car
- 4. Variable Cost (per car)
- 5. Revenue to Variable Cost ("R/VC") Ratio
- 6. Jurisdictional Threshold (per car)

B. Comparable Group Analysis

<u>Movement</u>	<u>Carrier #1</u>							<u>Carrier #2</u>					<u>All Carriers</u>					
	<u>Railroad</u>	<u>Distance</u>	<u>Revenue</u>	<u>RAAF</u>	<u>Adjusted Revenue 1/</u>	<u>Variable Cost</u>	<u>Adjusted R/VC Ratio 2/</u>	<u>Railroad</u>	<u>Distance</u>	<u>Revenue</u>	<u>RAAF</u>	<u>Adjusted Revenue 1/</u>	<u>Variable Cost</u>	<u>Adjusted R/VC Ratio 2/</u>	<u>Distance</u>	<u>Total Adjusted Revenue 3/</u>	<u>Variable Cost /4</u>	<u>Adjusted R/VC Ratio 5/</u>
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)

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Example of Application of Ag Commodities Maximum Rate Methodology - STCC 2818445 - Ethanol

A. Issue Movement Parameters

- 1. 5-Digit STCC 2818445- Ethanol
- 2. Distance
- 3. Total Revenue per car
- 4. Variable Cost (per car)
- 5. Revenue to Variable Cost ("R/VC") Ratio
- 6. Jurisdictional Threshold (per car)

B. Comparable Group Analysis

Movement	Carrier #1							Carrier #2							All Carriers			
	Railroad	Distance	Revenue	RAAF	Adjusted Revenue 1/	Variable Cost	Adjusted R/VC Ratio 2/	Railroad	Distance	Revenue	RAAF	Adjusted Revenue 1/	Variable Cost	Adjusted R/VC Ratio 2/	Distance	Total Adjusted Revenue 3/	Variable Cost /4	Adjusted R/VC Ratio 5/
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)
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Revenue Adjustments By Carrier - US Movements Only

<u>Commodity</u> (1)	2011			2012		
	<u>Unadjusted Revenues 1/</u> (2)	<u>Adjusted Revenues 2/</u> (3)	<u>Difference 3/</u> (4)	<u>Unadjusted Revenues 1/</u> (5)	<u>Adjusted Revenues 2/</u> (6)	<u>Difference 3/</u> (7)

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Revenue Adjustments By Carrier - Cross-Border Movements

<u>Commodity</u> (1)	2011			2012		
	<u>Unadjusted Revenues 1/</u> (2)	<u>Adjusted Revenues 2/</u> (3)	<u>Difference 3/</u> (4)	<u>Unadjusted Revenues 1/</u> (5)	<u>Adjusted Revenues 2/</u> (6)	<u>Difference 3/</u> (7)

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Tax Adjusted Revenue Adequacy

	<u>Railroad</u> (1)	<u>2011</u> (2)	<u>2012</u> (3)
<u>BNSF</u>			
1. Net Railway Operating Income <u>1/</u>		3,173,564,000	3,609,577,000
2. Revenue Reduction From Grain Rate Procedures <u>2/</u>		117,529,687	143,900,121
3. Railroad Marginal Tax Rate <u>3/</u>		40.584%	40.567%
4. Tax Impact on Rate Reduction <u>4/</u>		47,698,248	58,375,962
5. Net Impact on Net Railway Operating Income <u>5/</u>		69,831,439	85,524,159
6. Adjusted Net Railway Operating Income <u>6/</u>		3,103,732,561	3,524,052,841
7. Tax Adjusted Investment Base <u>1/</u>		25,608,495,000	26,794,285,000
8. Tax Adjusted Return on Investment <u>7/</u>		12.12%	13.15%
9. Revenue Adequate Before Adjustment <u>1/</u>		Yes	Yes
10. Revenue Adequate After Adjustment <u>8/</u>		Yes	Yes
<u>CN (US)</u>			
11. Net Railway Operating Income <u>1/</u>		586,012,000	697,888,000
12. Revenue Reduction From Grain Rate Procedures <u>2/</u>		6,560,189	11,210,289
13. Railroad Marginal Tax Rate <u>3/</u>		43.089%	43.078%
14. Tax Impact on Rate Reduction <u>4/</u>		2,826,720	4,829,168
15. Net Impact on Net Railway Operating Income <u>5/</u>		3,733,469	6,381,121
16. Adjusted Net Railway Operating Income <u>6/</u>		582,278,531	691,506,879
17. Tax Adjusted Investment Base <u>1/</u>		6,707,420,000	6,847,750,000
18. Tax Adjusted Return on Investment <u>7/</u>		8.68%	10.10%
19. Revenue Adequate Before Adjustment <u>1/</u>		No	No
20. Revenue Adequate After Adjustment <u>8/</u>		No	No
<u>CP (US)</u>			
21. Net Railway Operating Income <u>1/</u>		193,749,000	146,156,000
22. Revenue Reduction From Grain Rate Procedures <u>2/</u>		9,925,041	8,462,793
23. Railroad Marginal Tax Rate <u>3/</u>		42.350%	42.351%
24. Tax Impact on Rate Reduction <u>4/</u>		4,203,255	3,584,078
25. Net Impact on Net Railway Operating Income <u>5/</u>		5,721,786	4,878,716
26. Adjusted Net Railway Operating Income <u>6/</u>		188,027,214	141,277,284
27. Tax Adjusted Investment Base <u>1/</u>		2,716,949,000	2,838,188,000
28. Tax Adjusted Return on Investment <u>7/</u>		6.92%	4.98%
29. Revenue Adequate Before Adjustment <u>1/</u>		No	No
30. Revenue Adequate After Adjustment <u>8/</u>		No	No
<u>CSXT</u>			
31. Net Railway Operating Income <u>1/</u>		1,888,195,000	1,806,489,000
32. Revenue Reduction From Grain Rate Procedures <u>2/</u>		8,629,310	7,183,620
33. Railroad Marginal Tax Rate <u>3/</u>		40.660%	40.588%
34. Tax Impact on Rate Reduction <u>4/</u>		3,508,677	2,915,688
35. Net Impact on Net Railway Operating Income <u>5/</u>		5,120,633	4,267,932
36. Adjusted Net Railway Operating Income <u>6/</u>		1,883,074,367	1,802,221,068
37. Tax Adjusted Investment Base <u>1/</u>		16,359,385,000	16,709,692,000
38. Tax Adjusted Return on Investment <u>7/</u>		11.51%	10.79%
39. Revenue Adequate Before Adjustment <u>1/</u>		No	No
40. Revenue Adequate After Adjustment <u>8/</u>		No	No

Tax Adjusted Revenue Adequacy

<u>Railroad</u> (1)	<u>2011</u> (2)	<u>2012</u> (3)
<u>KCS</u>		
41. Net Railway Operating Income <u>1/</u>	232,143,000	227,659,000
42. Revenue Reduction From Grain Rate Procedures <u>2/</u>	6,033,062	2,312,326
43. Railroad Marginal Tax Rate <u>3/</u>	41.139%	40.877%
44. Tax Impact on Rate Reduction <u>4/</u>	2,481,942	945,210
45. Net Impact on Net Railway Operating Income <u>5/</u>	3,551,121	1,367,117
46. Adjusted Net Railway Operating Income <u>6/</u>	228,591,879	226,291,883
47. Tax Adjusted Investment Base <u>1/</u>	2,158,254,000	2,385,808,000
48. Tax Adjusted Return on Investment <u>7/</u>	10.59%	9.48%
49. Revenue Adequate Before Adjustment <u>1/</u>	No	No
50. Revenue Adequate After Adjustment <u>8/</u>	No	No
<u>NS</u>		
51. Net Railway Operating Income <u>1/</u>	2,006,621,000	1,903,834,000
52. Revenue Reduction From Grain Rate Procedures <u>2/</u>	5,206,495	8,743,904
53. Railroad Marginal Tax Rate <u>3/</u>	40.942%	40.891%
54. Tax Impact on Rate Reduction <u>4/</u>	2,131,643	3,575,470
55. Net Impact on Net Railway Operating Income <u>5/</u>	3,074,852	5,168,434
56. Adjusted Net Railway Operating Income <u>6/</u>	2,003,546,148	1,898,665,566
57. Tax Adjusted Investment Base <u>1/</u>	15,589,300,000	16,578,622,000
58. Tax Adjusted Return on Investment <u>7/</u>	12.85%	11.45%
59. Revenue Adequate Before Adjustment <u>1/</u>	Yes	Yes
60. Revenue Adequate After Adjustment <u>8/</u>	Yes	Yes
<u>UP</u>		
61. Net Railway Operating Income <u>1/</u>	3,552,997,000	4,119,851,000
62. Revenue Reduction From Grain Rate Procedures <u>2/</u>	117,781,690	94,762,755
63. Railroad Marginal Tax Rate <u>3/</u>	41.035%	40.970%
64. Tax Impact on Rate Reduction <u>4/</u>	48,331,716	38,824,301
65. Net Impact on Net Railway Operating Income <u>5/</u>	69,449,973	55,938,454
66. Adjusted Net Railway Operating Income <u>6/</u>	3,483,547,027	4,063,912,546
67. Tax Adjusted Investment Base <u>1/</u>	27,104,342,000	28,044,659,000
68. Tax Adjusted Return on Investment <u>7/</u>	12.85%	14.49%
69. Revenue Adequate Before Adjustment <u>1/</u>	Yes	Yes
70. Revenue Adequate After Adjustment <u>8/</u>	Yes	Yes

1/ Sources: Docket No. EP 552 (Sub-No. 16), *Railroad Revenue Adequacy - 2011 Determination*, served January 2, 2014, and Docket No. EP 552 (Sub-No. 17), *Railroad Revenue Adequacy - 2012 Determination*, served January 2, 2014.

2/ Source: Attachment No. 4

3/ Source: Docket No. EP 682 (Sub-No. 4), *2012 Tax Information For Use In The Revenue Shortfall Allocation Method*, served June 7, 2013.

4/ Revenue Reduction From Grain Rate Procedure multiplied by railroad marginal tax rate.

5/ Revenue Reduction From Grain Rate Procedure less Tax Impact on Rate Reduction.

6/ Net Railway Operating Income less Net Impact on Net Railway Operating Income.

7/ Adjusted Net Railway Operating Income divided by Tax Adjusted Investment Base.

8/ Column (2) is "Yes" if Tax Adjusted Return on Investment is greater than 11.57 percent, and Column (3) is "Yes" if Tax Adjusted Return on Investment is greater than 11.12 percent.