PUBLIC VERSION

BEFORE THE
SURFACE TRANSPORTATION BOARD

DOCKET NO. EP 665 (Sub-No. 1)
RAIL TRANSPORTATION OF GRAIN, RATE REGULATION REVIEW

REPLY COMMENTS OF

ALLIANCE FOR RAIL COMPETITION
MONTANA WHEAT & BARLEY COMMITTEE
NATIONAL FARMERS UNION
COLORADO WHEAT ADMINISTRATIVE COMMITTEE
IDAHO BARLEY COMMISSION
IDAHO GRAIN PRODUCERS ASSOCIATION
IDAHO WHEAT COMMISSION
MONTANA FARMERS UNION
NORTH DAKOTA CORN GROWERS ASSOCIATION
NORTH DAKOTA FARMERS UNION
NORTH DAKOTA GRAIN DEALERS ASSOCIATION
SOUTH DAKOTA CORN GROWERS ASSOCIATION
SOUTH DAKOTA FARMERS UNION
MINNESOTA CORN GROWERS ASSOCIATION
MINNESOTA FARMERS UNION
WISCONSIN FARMERS UNION
NEBRASKA CORN GROWERS ASSOCIATION
NEBRASKA WHEAT BOARD
OKLAHOMA WHEAT COMMISSION
OREGON WHEAT COMMISSION
SOUTH DAKOTA WHEAT COMMISSION
TEXAS WHEAT PRODUCERS BOARD
WASHINGTON GRAIN COMMISSION
WYOMING WHEAT MARKETING COMMISSION
USA DRY PEA AND LENTIL COUNCIL
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I. INTRODUCTION

In these Reply Comments, including the reply Verified Statements of Witnesses Whiteside and Fauth, ARC, et al., consisting of Alliance for Rail Competition and the agricultural producer and shipper interests listed on the cover[1] respond to opening comments filed by other parties to this proceeding.

We begin by noting that ARC, et al., The National Grain and Feed Association ("NGFA") and the U.S. Department of Agriculture (USDA), in their opening comments, addressed shortcomings in current STB grain rate regulation, and offered constructive suggestions for improving the effectiveness of rail regulation. The Railroad parties, including Association of American Railroads ("AAR") and the four major US Class I railroads, did not make any constructive suggestions, preferring to emphasize situations in which regulation may not be needed, as if this justifies maintaining the status quo with no changes.

ARC, et al., have reviewed the opening comments of NGFA and USDA with interest, and we generally support their suggestions. For revenue adequate railroads, ARC, et al., continue to prefer a simple Two-Benchmark approach based on the RSAM and R/VC>180 benchmarks published by the STB, explained more fully in the reply VS of Witness Fauth. For revenue inadequate railroads, we prefer expanding the R/VCCOMP benchmark , and making other

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[1] National Corn Growers Association ("NCGA"), Colorado Wheat Administrative Committee, Idaho Barley Commission, Idaho Grain Producers Association, Idaho Wheat Commission, Minnesota Corn Growers Association, Minnesota Farmers Union, Montana Farmers Union, Montana Wheat & Barley Committee, Nebraska Corn Growers Association, Nebraska Wheat Board, North Dakota Corn Growers Association, North Dakota Farmers Union, North Dakota Grain Dealers Association, Oklahoma Wheat Commission, Oregon Wheat Commission, South Dakota Corn Growers Association, South Dakota Farmers Union, South Dakota Wheat Commission, Texas Wheat Producer Board, Washington Grain Commission, Wisconsin Farmers Union, Wyoming Wheat Marketing Commission and U.S. Dry Pea & Lentil Council.

regulatory improvements. Like ARC, et al., NGFA recommends expanding the R/VC_{COMP} benchmark to include more shipments by other railroads, as well as certain shipments with R/VC percentages below 180. As part of its proposed Ag Commodity Maximum Rate Methodology, NGFA would modify and streamline Three-Benchmark by applying a Revenue Adequacy Adjustment Factor for all railroads transporting comparison group shipments, , whether or not they have been found revenue adequate. ARC, et al., would support further exploration of the NGFA approach if the Board were to decide against further consideration of the changes we have recommended.

Similarly, ARC, et al., support more effective private sector solutions, including mediation and arbitration as urged by USDA, so long as the applicable rate reasonableness standard rests on a regulatory approach like that of ARC, et al. or NGFA, which could work for grain producers and shippers and is otherwise fair and simple to use. In his reply VS, Witness Whiteside discusses arbitration, including the final offer arbitration ("FOA") that is supported by Canadian grain producers and shippers.

Arbitration and mediation along these lines, accompanied by expedited procedures that do not reward withholding of data or driving up costs by Railroads, could help shippers and offer an alternative to litigation that even Railroads could find valuable. Arbitration that merely transposes SAC, SSAC or the existing Three-Benchmark approach to an alternative dispute resolution context would provide none of these benefits.

Finally, there is the issue of railroad revenue adequacy. ARC, et al., NGFA and USDA all address the implications of revenue adequacy for STB grain rate regulation. The Railroads' opening comments are virtually silent on the subject, though it appears from the AAR opening comments that the Railroads believe attaining or exceeding revenue adequacy should have no effect whatever on differential pricing of captive traffic by market dominant railroads. ARC, et al. expect to learn more when we see the Railroads' replies in this proceeding, and the opening and reply comments to be filed in EP 722, Railroad Revenue Adequacy.

Grain shippers and producers are, to a degree not generally true of other commodities, vulnerable to rate increases and other abuses of market power by monopoly railroads. Accordingly, ARC, et al. urge the Board to continue pursuing regulatory improvements applicable to grain transportation in a future phase of this proceeding, regardless of whether it prefers the approach of ARC, et al., NGFA or USDA, and regardless of actions that may grow out of EP 722. Contrary to the claims of the Railroads, the status quo must change.

II. ARGUMENT

It is not surprising that the Railroads, in their opening comments in this proceeding, attempt to defend the status quo. They currently enjoy conditions that could hardly be improved, from their perspective. They face ineffective competition for much of the grain transportation they provide, particularly in the West. Many shippers and producers cannot reach markets by truck, and barge loading facilities are too far away for many shippers. As for intramodal competition from other railroads, most shippers cannot take advantage of competition among major railroads. For many shippers, a second rail carrier is too far away to compete effectively, short lines are prevented by paper and physical barriers from competing effectively, or railroads that could compete elect not to do so.

The Railroads like to cite, in support of minimal regulation, contestable market theory for the proposition that theoretical or potential competition can be as effective as real competition. See, e.g., the AAR opening comments in this proceeding at 2. But in EP 705, Competition in the Railroad Industry, we learned of the problematic obverse of contestable market theory. Shippers had spent hundreds of thousands of dollars to break their own captivity, building out new rail lines to a second major railroad, only to find that the railroads had no interest in competing with each other by offering lower rates or better service.

Doubtless there are exceptions, and the Railroads highlight these in their opening comments. But the trend is clearly away from effective competition, as railroads promote rail-dependent shuttle origins to the detriment of smaller elevators, and as export grain markets grow around rail-served port elevators. See Whiteside reply VS at 6 and 18-21. This may be the reason the Railroads devote so much of their opening comments to discussing product and geographic competition as constraints on excessive rail rates.

The Board recently denied Railroad efforts to revive such factors in market dominance determinations in coal rate cases, in its decision served March 19, 2013 in EP 717, Petition of AAR to Institute a Rulemaking Proceeding to Reintroduce Indirect Competition as a Factor Considered in Market Dominance Determinations for Coal Transported to Utility Generating Stations. ARC, et al. hope no similar effort by the Railroads will be made as to grain transportation. Most grain shippers and producers are far less able to afford the requisite antitrust type analyses than utility coal shippers, and more fundamentally, the proposition that grain shippers with effective competition are bringing too many rate cases to challenge low rail rates is absurd. The problem is rather that captive grain interests have no effective recourse as to high rail rates.

In EP 711, Petition for Rulemaking to Adopt Revised Competitive Switching Rules, the Railroads have fiercely opposed any changes in ICC and STB precedents and policies undermining the intramodal rail competition called for in 49 USC Section 11102. They are careful to avoid acknowledging that access remedies may help few shippers at best, and will help even fewer if railroads provided access decline to serve new customers, or refuse to compete with incumbent railroads. Rather, the Railroads argue that access remedies will, necessarily and everywhere, adversely affect the efficient operation of their networks. To the extent that credence is given to these arguments, it seems axiomatic that more effective regulation is needed to counterbalance less effective competition. And yet the Railroads continue to try to minimize both competition and regulation, using revenue inadequacy as a rationale when possible, but downplaying attainment of revenue adequacy when that might undermine a favorable status quo.

A service industry that plays a key role in supporting the rest of the US economy, and that is characterized by duopolies in the West (BNSF and UP) and in the East (NS and CSX), which collectively control some 95% of rail shipments of essential commodity groups like grain, coal, chemicals, etc., cannot seriously argue against reasonable regulation. No similar industry – not electric power, natural gas, or telecommunications – would be allowed to operate without effective competition, effective regulation or both.

However, for more than 30 years, the Railroads, uniquely in this country, have successfully avoided effective regulation and neutralized effective competition (through mergers and paper barriers) by arguing that they were revenue inadequate. In the early years, such arguments may not have been meritless, particularly given the statutory directive to help railroads achieve revenue adequacy. However, Congress did not intend or provide for complete deregulation of monopoly railroads even when they were far weaker financially than they are today, and the ICC and STB have always recognized that "a rate may be unreasonable even if the carrier is far short of revenue adequacy". Rate Guidelines – Non-Coal Proceedings, 1 S.T.B. 1004, 1017 (1996). Nevertheless, successive decisions discussed in more detail in the opening comments of ARC, et al. (at pp. 3-9) resulted in regulation that offered effective rate relief to too few shippers in too few cases. Grain shippers were not among the beneficiaries of such regulation as was available from the ICC and STB.

On the contrary, in area after area – rates, practices, car supply, service – grain shippers and producers were excluded from recourse to effective rail regulation. The Railroads in their opening comments have discussed at length the role of car auctions in addressing grain shippers' need for equipment. Unmentioned are concerns such as the following, from National Grain and Feed Ass'n v. United States, 5 F.3d 306 (8th Cir. 1993):

> Evidence in the record suggests that non-COT shippers endure unreasonable delays in receiving car service during shortages. That these shippers might feasibly switch to the premium tariff COT service is not the relevant inquiry; rather, the Commission must determine if the COT program so affects the service for conventional shippers as to prevent or frustrate its ability to meet its common carrier obligations through that conventional tariff service.

From the Railroads' perspective, conditions were ideal for growth and profitability. Neither competition nor regulation significantly affected rail rates on captive traffic, or rail practices or rail service. Railroads could and did act as monopolists, charging whatever the traffic would bear for service on the Railroads' terms.

As Witness Whiteside has explained, quoting a Railroad CEO, this has sometimes meant second-class service for agricultural commodities, which Railroads apparently feel they can transport when convenient for carriers, not when convenient for shippers or producers. Whiteside opening VS at 25-26. More recently, Railroads' inattention to grain transportation has driven car costs borne by shippers and producers to record levels. Whiteside reply VS at 15-17; Fauth reply VS at 17-22. ARC, et al. are aware of no other explanation for the current service problems on BNSF. Blaming heavy snow is no longer credible almost half a year after the end of winter.

The Railroads argue (e.g., AAR opening comments at 19-20) that shippers and producers of grain cannot complain about poor service and simultaneously call for more effective regulation of high rail rates. Their implication is that grain rates must increase, subject only to the current, ineffective regulatory constraints, or else Railroads will not invest in capacity and equipment to improve service.

But adequate service levels cannot lawfully be made contingent on the Railroads' continued ability to price as they see fit, free of any effective regulatory constraints. Operations by Class I railroads are subject to public interest requirements and to the common carrier obligation. And ineffective (or nonexistent) rate regulation is not a right for market dominant railroads. The Act plainly states that when railroad market dominance is found, "the rate established by such carrier for such transportation <u>must</u> be reasonable." 49 USC Section 10701(d)(1), emphasis added.

The absence of effective remedies for grain shippers is a function of decades in which the agency's focus was more on helping to promote railroad revenue adequacy than on preventing abuses of railroad market power. Now that railroad revenue adequacy is here or almost here, the Board's priorities must be re-examined.

Abuses of railroad market power are not limited to imposition of grossly excessive grain rates. In fact, a monopolist acting in its own self-interest will rarely charge so much that its customers go out of business. An obvious exception could be when railroad pricing jeopardizes the survival of smaller companies whose freight will shift to larger companies, permitting railroads to keep volumes high while operating more efficiently over a smaller, higher density network.

Abuses of market power can also take the form of poor service, diversion of equipment, unreasonable practices, forcing captive shippers to shoulder costs and burdens formerly borne by railroads or covered by line-haul rates, multiplying and raising accessorial charges, and imposing surcharges that are unregulated profit centers. In addition, railroads can abuse market power by using higher rates or other charges or practices to discourage services and routings they would rather not provide, thereby encouraging businesses to buy, ship and sell in ways that suit the railroad, whether or not those patterns suit railroad customers.

Products that should gain market share in competitive markets might lose ground because a monopoly railroad's interests would be better served by the success of inferior products from preferred markets, or by reducing the number of participants in a market, with winners determined by location and railcar flow patterns. See the filings in Docket NOR 42139, James Valley Grain, LLC v. BNSF Railway. Smaller and more isolated producers and shippers of wheat, corn and soybeans, and producers and shippers of lower volume agricultural commodities, such as barley, peas, lentils, etc., are particularly vulnerable. Congress intended the Board to provide reasonable oversight of railroad operations upon request, and to provide recourse to adversely affected captive shippers.

The focus of this proceeding is grain rate regulation, and the Railroads spend much of their opening comments discussing grain rates that, for various reasons, are below, or only a little above, the Board's jurisdictional threshold of 180% of variable cost. What is absent from the

Railroads' opening comments is any acknowledgment that STB rate regulation is ineffective, or any suggestions for improvements. Also missing is any discussion of the implications for grain rates of the attainment, even under excessively conservative STB standards, of railroad revenue adequacy. This last omission is particularly striking for BNSF and UP, by far the nation's largest grain haulers. The most recent (2012) RSAM levels for BNSF and UP are 177% and 182%, respectively. See the Board's April 4, 2014 decision in EP 689 (Sub-No. 5), Simplified Standards for Rail Rate Cases – 2012 RSAM and R/VC>180 Calculations.

Witness Whiteside points out, correctly, that the Railroads demand federal intervention to ensure that they earn adequate revenues, but oppose STB intervention needed to protect captive shippers from excessive rates or other abuses of Railroad market power.

As noted above, the Railroads have an obvious self-interest in preserving the status quo, which is why they have chosen to emphasize discussion of grain shipments where, due to lack of market power, rail rates are relatively low. However, such discussions are based on a glaring non-sequitur: the implication that because many shippers do not qualify for, or do not need rate regulation, effective rate regulation is not needed for any shippers.

See, for example, the opening comments of BNSF, at 17-23, where we are told of grain shippers with access to barges, or other railroads, or end users like ethanol plants or feed lots. We are also told that volatility and seasonal volume changes, as well as world markets, can constrain rail rates.

Notably, BNSF argues (at 23) that grain producers may not benefit from more effective rail rate regulation anyway, because grain elevators "with market power could simply take advantage of artificially reduced rail rates to improve their own profitability." In fact, there being far more competition among elevators than among Class I railroads, this is not a compelling argument for ineffective rail rate regulation. In addition, it is one reason ARC, et al. (and NGFA and USDA) urge the Board to acknowledge the right of grain producers to file rate complaints on their own.

In addition, as Witness Fauth points out in the ARC, et al. opening comments, URCS costing anomalies lead to understated grain rate R/VC percentages, calling into question the Railroads' claims of so many low grain rates. Fauth opening VS at 5-10.

In any event, none of these factors, where they exist, change the fact that railroads are price makers and grain shippers are, as USDA points out, price takers. Railroads still charge whatever the market will bear; there are just some markets in which profit maximizing rail rates are lower and some in which they are higher. Moreover, as Witnesses Fauth and Whiteside have testified (Fauth opening VS at 30-31; Whiteside reply VS at 19-25), rail rates on grain have risen consistently, for many years, whether or not volumes are in a peak or trough, and whether market prices for wheat rise or fall.

The Interstate Commerce Act, the STB and this proceeding do not exist for shippers who enjoy effective competition, low rates and good service. At issue here are grain shippers for whom regulation offers little or no protection, and who are now paying high rates and charges (or may do so anytime a market dominant railroad decides to charge more) and enduring poor service.

It should be clear from the opening comments of ARC, et al., NGFA and USDA that the SAC, Simplified SAC and Three-Benchmark tests are not affordable and do not work for the overwhelming majority of grain producers and shippers who may need a defense against abuses of railroad market power. Even if no shippers or producers were subject to such abuses (and many are), these deficiencies would still warrant STB action.

The statute commands that all rates on captive traffic must be reasonable, and does not permit indifference to some captive shippers so long as others are okay. It also requires "a simplified and expedited method for determining the reasonableness of rail rates in those cases in which a full stand-alone cost case is too costly, given the value of the case." 49 USC Section 10701(d)(3). For too many grain producers and shippers, SSAC and Three-Benchmark fail this test.[2]

In their opening comments, ARC, et al., NGFA and USDA have proposed improvements for the Board to explore further in the next phase of this proceeding. The Railroads have not. USDA emphasizes the need for inexpensive, expeditious approaches, and we agree. ARC, et al. also think mediation and arbitration would be used by grain producers and shippers who might shy away from litigation, and that the option to arbitrate would facilitate negotiations with rail carriers. ARC, et al. support alternative dispute resolution so long as the procedures are expedited and fair (i.e., so long as railroads do not have an incentive to drive up costs and abuse discovery procedures) and so long as the standards for the arbitration are consistent with the need for effective remedies for excessive grain rates.

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[2] In their opening comments, the Railroads are unstinting in their praise for Full SAC, the approach that costs the most and is least accessible to grain producers and shippers. It should be recognized that, for all its claimed precision, SAC relief depends to a large extent on the ability of a complainant shipper to maximize volumes and minimize mileage through careful design of the stand-alone group, which the railroad defendant invariably attacks. Without grouping, SAC would still cap rates at the cost to the shipper of providing its own rail service, but that cost would be extremely high. As the ICC said in Coal Rate Guidelines, 1 I.C.C 2d at 544, "Without grouping, SAC would not be a very useful test…." In any event, Section 10701(d)(3) does not say that the Board's simplified and expedited alternative can be ineffective, because of a supposed inferiority to SAC.

In reply comments filed August 20, 2014, Texas Trading and Transportation Services, LLC ("TTMS Group"), whose principals appear to include a former BNSF official who managed grain transportation as well as two members of Montana Grain Growers Association, supported grain shipper complaints and argued for an expanded version of the arbitration program provided under the auspices of NGFA. ARC, et al. agree that NGFA arbitration has often worked well for shippers. As with Canadian FOA, the ability to invoke arbitration has frequently facilitated settlement of disputes without arbitration.

As Witness Whiteside explains (reply VS at 29-30), final offer arbitration has worked well for Canadian grain shippers and producers, and major Canadian railroads are financially healthy (though they would no doubt prefer ineffective shipper remedies).[3] Accordingly, ARC, et al. disagree with the TTMS criticisms of Canadian regulatory policies favoring grain producers and shippers. [4] See also Fauth reply VS at 7-8 and 27. However, mediation or arbitration based on SAC, SSAC or an unmodified Three Benchmark approach would do nothing to address legitimate concerns of captive grain producers and shippers.

NGFA, for its part, obviously shares many of the concerns of ARC et al., particularly as to the shortcomings of the R/VC_{COMP} benchmark under the Board's current Three-Benchmark approach. Both grain shipper groups believe that R/VC_{COMP} should be expanded to include grain

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[3] In this regard, ARC, et al., support NGFA's call (opening comments at 23-26, and opening VS of NGFA Witness Fapp) for a new approach to revenue adequacy determinations for US affiliates of Canadian Pacific and Canadian National. Current treatment of Grand Trunk Lines and Soo Line as separate from their corporate parents in Canada is unwarranted. See the reply VS of Witness Fauth at 26-27.

[4] We also disagree with the TTMS contention that a focus on lowering excessively high grain rates will lead Railroads to demarket, pick winners and losers and provide poor service. Those things are already happening, and rail customers have little ability to resist. Giving grain shippers and producers more leverage in negotiations, through better regulatory and/or arbitration options, is the only way to get monopoly railroads to take customer concerns more seriously.

shipments via other railroads as well as relevant shipments moving at rates below 180% of variable cost. However, instead of eliminating R/VCCOMP for revenue adequate railroads, as ARC et al., recommend, NGFA would replace today's Three Benchmark approach to grain rates with its Ag Commodity Maximum Rate Methodology, and would expand (within certain parameters) the shipments for inclusion in the comparison group. NGFA opening comments at 28-30 and opening VS of NGFA Witness Crowley at 6-9.

ARC, et al. believe a simplified Two-Benchmark approach based on STB published data will improve protection for captive grain shippers while recognizing the need for the Railroads to earn adequate revenues. In our judgment, BNSF and UP will not just meet, but will significantly exceed revenue adequacy, with the excess increasing in years to come. Under these circumstances, R/VCCOMP, which is designed to reflect demand-based differential pricing, is no longer needed. Nevertheless, if the STB elects not to pursue a Two-Benchmark solution, or to propose the revisions supported by ARC, et al. in Three-Benchmark as applied today, ARC, et al., would urge the Board to consider seeking further public comments on NGFA's Ag Commodity Maximum Rate Methodology in the next phase of this proceeding.

See the accompanying reply VS of Witness Fauth for additional discussion of the Two-Benchmark approach. It has its origins in Rate Guidelines – Non-Coal Proceedings, 1 S.T.B. at 1042-43. The Board's explanation there (as somewhat simplified here) was that when the RSAM level (which measures markups on >180 traffic needed for revenue adequacy) is lower than the R/VC>180 level (which measures actual markups on >180 traffic), then the railroad is exacting greater than necessary markups, and the greater the spread, the more rates can be reduced without jeopardizing adequate revenues. Conversely, if a railroad's R/VC>180 level is lower than RSAM, the greater the upward adjustment of the railroad's average rates on >180 traffic that should be allowed.

R/VC$_{COMP}$ was designed to add to the foregoing analysis a factor recognizing the higher or lower elasticity of demand for >180 traffic, in recognition of revenue inadequate railroads' need for differential pricing of their >180 traffic. ARC, et al., have not called for elimination of R/VC$_{COMP}$ for revenue inadequate railroads, though we (and NGFA) regard the current limitations on potential comparison groups as too restrictive. Allowing comparison groups to include some comparable grain traffic on other railroads, and some grain shipments with R/VC percentages below 180%, would make Three Benchmark more useful for more grain shippers and producers. See Fauth opening VS at 20-24.

However, we do not see a role for R/VC$_{COMP}$ as to grain rates of revenue adequate railroads that is not outweighed by the deficiencies of the R/VC$_{COMP}$ benchmark. Demand-based differential pricing, with captive shippers charged more than shippers with competitive options, has played a role in helping railroads achieve revenue adequacy, as the railroads have argued in their opening comments. See, e.g., the AAR opening comments at 17, n. 6. However, differential pricing's benefits for revenue inadequate railroads are not achieved without harm to captive customers, who may not be able to make a go of their businesses paying rail rates significantly higher than rates paid by their competitors.

Consider also BNSF's comment quoted above at page 10, to the effect that lower rail rates on grain might translate into higher profits for grain elevators, which might or might not pay more to producers. In fact, producers follow rail rates closely, and may have more leverage with elevators than with railroads, but the point here is that differential pricing helps railroads, and imposes greater financial burdens on some railroad customers than on others.[5]

To the extent that a railroad cannot afford on its own to meet operating costs, differential pricing of captive traffic has been permitted, subject to reasonableness constraints that are more apparent than real for virtually all captive shippers. However, "captive shippers should not be required to continue to pay differentially higher rates than other shippers when some or all of that differential is no longer necessary to ensure a financially sound carrier capable of meeting its current and future service needs." Coal Rate Guidelines, Nationwide, 1 I.C.C. 2d 520, 535-36 (1985), aff'd sub nom. Consolidated Rail Corp. v. United States, 812 F.2d 1444 (3d Cir. 1987).

In an apparent preview of arguments that can be expected from the Railroads, the AAR argues in its opening comments that "the Staggers Act's mandate to allow railroads to price differentially was not a temporary remedy to address the financial state of the industry. Rather, demand-based differential pricing was a structural reform that reflects fundamental railroad economics and Congressional intent in limiting regulation." AAR opening comments at 17, emphasis in original.

There are numerous problems with this contention. First, even if there were a good reason for continuing today's levels of differential pricing of captive traffic, that would not justify ineffective regulation of grain rates that does more to protect monopoly railroads than captive grain producers or shippers.

5 The Railroads say they don't use differential pricing on grain traffic as much as they could, in order to maximize overall grain volumes. This may benefit the most captive grain interests to some extent, but it also results from profit-maximizing railroad behavior, not altruism.

In addition, the Railroads have cited old ICC and court decisions on the value of differential pricing in helping railroads achieve revenue adequacy, and more arguments along those lines will surely be forthcoming. However, it does not follow that this justification for high rail rates on captive grain traffic should continue to apply, unmodified, once railroad revenue adequacy has been achieved. As noted above, the higher rates that help railroads can hurt the captive grain producers and shippers who pay them, and rates can be unlawful even if a railroad is far from revenue adequacy. Talk of "market-based" pricing is doublespeak when shippers and producers are captive to a single railroad, and other railroads do not compete anyway.

Under what legal theory is it necessary to preserve differential pricing that is arguably appropriate for financially weak railroads after they are financially strong, and able to recover high revenue levels from non-captive traffic? Prices set by competition are the goal, and allowing supra-competitive profits to be collected by monopolies can be justified, if at all, only in exceptional circumstances, such as obtained in the late 1970s and early 1980s, when the railroad industry was struggling.

The AAR argument ignores the revenue adequacy constraint discussed in Coal Rate Guidelines, and discussed further in the opening comments of ARC, et al., NGFA and USDA. Coal Rate Guidelines was decided just 5 years after enactment of the Staggers Act, and limits on differential pricing were exactly what Congress intended to preserve, consistent with the "policy of this part that rail carriers shall earn adequate revenues, as established by the Board under section 10704(a)(2) of this title." See 49 USC Section 10701 (d)(2), the "Long-Cannon Amendment".

AAR's argument also undermines the Three-Benchmark test which, despite serious shortcomings, the Railroads defend as adequate to protect captive shippers. Unrestricted differential pricing allows the Railroads to neutralize the R/VCCOMP benchmark by making all rates or all R/VCs similar in entire states or regions. It also enables the Railroads to raise the R/VC>180 benchmark by increasing markups far more than necessary to satisfy RSAM revenue need levels.

In addition, captive grain shippers and producers have spent more than 30 years contributing to railroad revenue adequacy, often paying rates that might have been found unlawful if more effective regulatory recourse had been available. Must they spend 30 more years paying high grain rates so the Railroads can exceed revenue adequacy? By how much and for how long?

In any event, grain shippers do not seek elimination of all differential pricing, nor could we. Rather, the choice presented to the Board is between reasonable limits on differential pricing of captive grain traffic, as sought by grain interests, and differential pricing of captive grain traffic without any regulatory limits, as sought by the Railroads.

The STB cannot order reductions of grain rates to levels with R/VC percentages below 180%, and the threshold of the Board's jurisdiction preserves a significant amount of differential pricing of captive traffic.[6] And while the Railroads like to characterize every move toward more effective regulation as leading inexorably to all rates on captive traffic ending up at 180% of variable cost, any such outcome is so unlikely as to be nothing more than a scare tactic.

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[6] At the time of enactment of the Staggers Act, it was calculated that if all rail rates were set at 150% of variable cost, railroads would be revenue adequate. The 180% jurisdictional threshold was phased in because they were not.

Many shippers with no effective competitive alternative will never file a rate case. They cannot afford to establish market dominance, or cannot show market dominance because of the appearance (though not the reality) of effective competition. ARC et al. are particularly concerned about erroneous findings of effective competition under the new limit price approach. We would also point out that if a shipper fails to establish market dominance, not only does the challenge to existing high rate levels fail, but the shipper is vulnerable to further rate increases that cannot be challenged. Railroads found market dominant, in contrast, may still win the rate case.

There are also many shippers who might bring a successful rate case but will not do so where the R/VC of the existing rate does not exceed the jurisdictional threshold by enough to justify the risks and costs of litigation. Grain shippers and producers are especially leery of litigation, having seen the outcome of McCarty Farms,[7] and having other uses for their scarce resources.

Other shippers with potentially meritorious cases might not file complaints because they can pass on high rail costs to their own customers in product prices, or might not keep all the benefits of success. Grain producers understand that grain elevators, which deduct rail costs from amounts paid to producers, may sometimes have less incentive to challenge high rail rates than producers would. High grain rates are always of great concern to farm producers. Rate challenges may also be settled. Under all of these scenarios, the Railroad would retain some, and possibly all, differential pricing in its existing rates.

The Board's Three-Benchmark approach obviously preserves significant differential pricing, especially in its present form. No grain rate cases have been filed, and in Docket NOR 42114,

[7] See McCarty Farms, Inc. et al. v. Burlington Northern, Inc., 3 S.T.B. 102 (1998), and Witness Whiteside's reply VS at 26-27.

U.S, Magnesium, LLC v. Union Pacific RR, decision served January 28, 2010, aff'd sub nom. Union Pacific R.R. v. S.T.B., 628 F.3d 597 (D.C. Cir. 2010), the relief awarded to the successful shipper complainant under Three-Benchmark merely prevented UP rates from exceeding 350% of variable cost. There is significant differential pricing in rates at 180% of variable cost, and far more when R/VCs are almost twice that high.

If, under the revenue adequacy constraint of Coal Rate Guidelines, the Board finds that further differential pricing of captive traffic through future rate increases is unlawful for revenue adequate railroads, or allows increases only upon compelling justification by the railroad, it does not follow that the Railroads will lose either the proceeds of past differential pricing, or future collection of differentially higher prices built into base rates (as opposed to rate increases) collected from captive shippers.

Even under the Two-Benchmark approach favored by ARC, et al. for revenue adequate railroads, the use of RSAM and R/VC>180 levels based on 4-year averages will preserve some differential pricing, as will any maximum reasonable rate the Board sets, even if that rate is set at the jurisdictional threshold (which includes differential pricing).

Accordingly, even if the Board were to adopt the most straightforward version of a Two-Benchmark approach, as discussed above at pp. 13-14, with rates able to rise to 4-year average RSAM levels when R/VC>180 levels are lower, and challenged rates on captive traffic prevented from exceeding 4-year RSAM levels when average R/VC>180 levels are higher, differential pricing would not be eliminated.

Moreover, there are other ways a Two-Benchmark approach could be implemented. A maximum reasonable rate level based on averaging RSAM and R/VC>180 levels (using 4-year averages for both), would increase the permissible level of differential pricing for revenue adequate railroads, as would other variations. In his reply VS at page 32, Witness Fauth discusses an approach under which the 4-year average levels for the RSAM and R/VC>180 benchmarks would be used in assessing the reasonableness of the rates charged on captive grain shipments by railroads which have reached revenue adequacy. If the market dominant railroad's RSAM level is lower than its R/VC >180 level, rates found excessive would be subject to reduction to RSAM levels, i.e., revenue adequacy levels. As recognized in Coal Rate Guidelines, 1 I.C.C 2d at 535: "Carriers do not need greater revenues than this standard permits, and we believe that, in a regulated setting, they are not entitled to any higher revenues."

III. CONCLUSION

It is difficult at this point in time, prior to the outcome of the Board's proceeding in EP 431 (Sub-No. 4), Reform of the General Purpose Costing System, and prior to exchanges of comments in EP 722, Railroad Revenue Adequacy, to provide definitive answers to the question of how to define maximum rate reasonableness for revenue adequate railroads. More refinement of economic and legal positions will be possible as time passes.

However, it should be evident that the regulatory status quo for grain producers and shippers is inadequate, and fails to meet statutory requirements. The Three-Benchmark approach, with its inherently defective R/VC_{COMP} benchmark and other flaws, has not been rendered effective by the Board's recent increase in the relief cap, because too few grain shippers and producers can obtain any relief at all, no matter how high their rates. Three-Benchmark in its present form cannot be the only affordable option the Board provides for captive grain producers and shippers. Accordingly, we urge that the Board consider carefully the proposals made in this proceeding by grain interests, and that it institute further proceedings based on improved regulatory approaches like those proposed by ARC, et al., NGFA and USDA.

Respectfully submitted,

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Attorney for ARC, et al.

Dated: August 25, 2014

CERIFICATE OF SERVICE

I hereby certify that I have this 25th day of August, 2014, caused copies of the foregoing Public Version of the Reply Comments of ARC, et al., to be served on all parties of record by first class mail or by electronic means, with similar service where authorized of the version of these Reply Comments containing Confidential or Highly Confidential material subject to Protective Order.

Terry Whiteside

BEFORE THE

SURFACE TRANSPORTATION BOARD

DOCKET NO. EP 665 (SUB-NO. 1)

RAIL TRANSPORTATION OF GRAIN, RATE REGULATION REVIEW

REPLY VERIFIED STATEMENT
OF
TERRY WHITESIDE

My name is Terry Whiteside. I am Principal in Whiteside and Associates, a transportation and marketing consulting firm with offices at 3203 Third Avenue North, Suite 301, Billings, Montana. I previously submitted an Opening Verified Statement in this Surface Transportation Board (STB or Board) proceeding on June 26, 2014.

The agricultural interests are well represented in this proceeding and are unified in reporting that the STB's current rail rate challenge procedures do not provide effective protection against unreasonable rail transportation rates for grain. The uniqueness of the agricultural sector coupled with the diverse needs of producers and shippers participating in the agricultural sector clearly necessitate revision of existing rate regulatory procedures.

We have been asked by the National Corn Growers Association (NCGA), Alliance for Rail Competition (ARC), Colorado Wheat Administrative Committee, Idaho Barley Commission, Idaho Grain Producers Association, Idaho Wheat Commission, Minnesota Corn Growers Association, Minnesota Farmers Union, Montana Farmers Union, Montana Wheat & Barley Committee, Nebraska Corn Growers Association, Nebraska Wheat Board, North Dakota Corn Growers Association, North Dakota Farmers Union, North Dakota Grain Dealers Association, Oklahoma Wheat Commission, Oregon Wheat Commission, South Dakota Corn

Growers Association, South Dakota Farmers Union, South Dakota Wheat Commission, Texas Wheat Producer Board, Washington Grain Commission, Wisconsin Farmers Union, Wyoming Wheat Marketing Commission and U.S. Dry Pea & Lentil Council to submit these reply comments in this proceeding.

This proceeding concerns "what regulatory changes could be implemented to ensure that the Board's rate case procedures are fully accessible to grain shippers and provide effective relief from excessive freight rail rates, as appropriate."[1] The Board instituted this proceeding to seek "input from interested parties on grain shippers' ability to effectively seek relief for unreasonable rates, including proposals for modifying existing procedures, or new alternative rate relief methodologies, should they be necessary."[2]

TCW Opening Verified Statement

In my Opening Verified Statement, I described the many problems faced by grain and grain products shippers associated with the Board's current jurisdiction costing and rate reasonableness methodologies. I outlined numerous ways in which the needs of grain shippers and producers for regulatory recourse align poorly, or not at all, with STB rate reasonableness procedures. When such shippers and producers are captive to a single railroad, *Congress intended that rail carriers establish rates that "must be reasonable"* 49 USC Section 10701(d)(1), emphasis added

In trying to comply with the Congressional directive to develop rate reasonableness methodologies for shippers who cannot afford the SAC methodology designed for shipments of million tons of coal, the STB developed the Three-Benchmark test in 1996.

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[1] STB Docket No. 665 (Sub-No.1), Rail Transportation of Grain, Rate Regulation Review, served December 12, 2013, page 2.
[2] *Ibid.*

However, Three-Benchmark has proven not to be workable for grain shippers and producers despite subsequent modifications to the test.

The Opening Statement of ARC, et al. clearly points out that for many grain shippers and producers, competitive remedies are not effective. Destination markets are often too far away for significant use of truck transportation, or destination facilities, such as export facilities at Pacific Northwest ports, are set up for rail deliveries, not truck deliveries. Some grain shipments move by barge on rivers, particularly the Mississippi to the Gulf, but most grain shippers are not close to navigable waterways. Additionally, rail-to-rail competition is not commonly available.

My Opening Statement outlined how the railroads continue to encourage grain shipments in shuttle trains of 100 cars or more, and have discouraged shipments from the mid-sized elevators handling less than shuttle shipments, including the mid-sized elevators handling roughly 50-cars that the railroads encouraged shippers to build.

The grain industry is very concerned at this time about the willingness of railroads to get the current harvest picked up and delivered to markets in time to make room for the next harvest. Thousands of shipments are behind schedule, and the growing cycle will not wait for railroads to resolve their service problems. New shipments will need to move, just as they always have, and rail carriers will need to move older stocks to make room for storage of newer production.

Timely corn deliveries are needed for ethanol production and for feedlots supporting livestock and meat production. Wheat and barley shipments that are not for export are necessary for breads, pastas, beers and other products. The ripple effects of poor rail service and high rail rates on grain shippers and producers are significant.

As I outlined in the Opening Statement, rail rates that go up in good markets rarely seem to come down when grain prices fall. (See Section 8 of this Reply Statement.) But many shippers or grain elevator companies are reluctant to complain to regulators for fear that their requests for rail service will not be met, or will be delayed further and complaints to the carriers may have negative impacts at other company owned facilities served by the same railroad.

The farm producers who bear rail rates and rate increases indirectly are particularly vulnerable. In contrast, as ARC, et al. previously pointed out, "if rail rates on merchandise shipments rise, the cost may be borne by millions of customers paying a few cents more at Walmart and similar stores. For grain, the rail rate buck tends to stop with farmers." The farm producers bear the cost of transportation (transportation costs are deducted from the price received at the elevator) while the elevator or grain merchandiser directly pays the railroad. This creates a uniqueness in the marketing of grain, unlike virtually any other industry, where the party bearing the freight doesn't pay the freight.

In response to the Board's request, we suggested several "regulatory changes" to the Board's current methodologies and procedures which would help "ensure that the Board's rate case procedures are fully accessible to grain shippers and provide effective relief from excessive freight rail rates, as appropriate." For example, the Opening Statement of Witness Fauth suggested (at page 11) that "the STB could develop Grain Cost Adjustment Factors (GCAF), which would be '*better tailored*' to grain and grain products movements and would account for the efficiencies in the form of lower than average switching costs, lower than average car costs, and higher than average train sizes associated with most grain and grain products movements." We also suggested that the Board consider potential modifications to the Three-Benchmark test for revenue-inadequate railroads which could potentially improve the application the Three-Benchmark test for grain and grain products shippers:

- Allow for the use of similar rail traffic via other railroads in RVC_{COMP} groups; and
- Allow for the use of similar R/VC<180% traffic in the RVC_{COMP} groups.

In addition to proposed modifications to the STB's existing costing and rate reasonableness methodologies and procedures, we suggested potential "new alternative rate relief methodologies" which the STB could consider.

Because of the problems associated with the application of the RVC_{COMP} component of the Three Benchmark test to railroad movements of grain and grain products, ARC, et al. suggested that the STB should consider the use of a Two Benchmark test using the other components of the Three Benchmark test, i.e., the RSAM and $RVC_{>180}$ percentages, for grain rate cases involving railroads that are revenue adequate.

Since railroad service is critically important to grain and grain products shippers (many of which face short seasonal growing and rail shipping periods) and since many grain and grain products shippers have recently experienced a combination of deterioration of rail service and an increase in costs and rail rates, we also proposed that the STB should consider limiting future rate increases on grain and grain products based on established performance standards, even if a railroad has not yet been found revenue adequate. See Fauth opening VS at 30-31:

"Since exports are such a large part of the grain products movements are there is a recognized economic relationship between grain prices and grain exports (i.e., when grain prices decrease, exports increase), we also suggested that a methodology which promotes exports via lower export rail rates would benefit grain and grain products shippers and the railroads and be in line with President Obama's 2010 National Export Initiative."

ARC, et al., would also request confirmation by the Board that grain producers, as the bearers of the freight, have the legal right to file rate complaints, and that such complaints are not subject to dismissal due to the allegation of absence of direct damage to the complainant.

Today with revenue adequacy either achieved or imminent for all major railroads, the time has come for the Board to begin to level the playing field, revisiting policies and precedents that too often left captive shippers defenseless against market dominant railroads.

Even with a focus limited to rate regulation, revenue adequacy should be the most significant rail development for grain shippers and producers in more than 30 years. When a railroad reaches revenue adequacy, as the BNSF, NS and UP have, there would be a shift of evidentiary burdens to the railroads, which would have to justify increasing rates for captive shippers.

MOVEMENT, EFFICIENTLY AND REASONABLY PRICED, OF AGRICULTURAL PRODUCTS TO MARKETS OUTSIDE THE STATE OF PRODUCTION IS CRITICAL TO CREATING VALUE FOR AGRICULTURAL PRODUCERS

As outlined in my Opening VS, agricultural producers and shippers have two major markets for their products: domestic consumption and markets accessible from tidewater transfer points (export). What is common to both of these two markets is that in order for agricultural production to have or create value to the farm producing industry, the farm products must be moved from the field to the ultimate markets. The distance of move and the amount of harvest can vary from a few miles and a few truckloads to thousands of miles and hundreds of thousands of carloads. Generally agricultural commodities require movement in bulk quantities. One cannot begin to move from the Northern Plains to the PNW over 300+ million bushels of grain via truck to meet export needs. That would be equivalent to over 3 million semi-trucks per year just from this one area.

The railroads, which have become extremely profitable and have achieved or are on the verge of achieving long term revenue adequacy, claim that any change by this Board that increases the ability of grain producers and shippers to oppose excessive rail rates will prevent railroads from obtaining the capital necessary to meet the needs of shippers. But Congress did not intend market dominant railroads to be able to act as unregulated monopolies even when they were revenue inadequate, let alone when they no longer need further differential pricing of captive traffic.

OUTLINE OF TERRY WHITESIDE REPLY VERIFIED TESTIMONY:

1. Are the railroads an industry like any other industry?
2. . Service metrics continue to show a fitful and struggling service recovery marked by lower past due cars but increased concentration of the past due car levels in the Northern Tier states
3. Service metrics also show average speed on the BNSF is continuing to decrease.
4. BNSF poor service for the past year has forced curtailments in service to and from PNW - Cold train service is being discontinued – PNW intermodal service schedules to Chicago are being lengthened.
5. BNSF's poor service has caused both the primary and secondary markets for cars to remain at record levels. Primary and secondary railcar market bids are costs to the agricultural producers
6. BNSF appears to be reducing back orders on shuttle movements but the less-than-shuttle facilities (non-shuttle) continue to struggle with lengthy car back orders.
7. This Board needs to be ever-cognizant that the carriers' goals lead to conflicts with rail customers in the transport of farm production.
8. Rail rate histories show a steady rise of rates even when grain prices fall.
9. Continuing need for regulatory rate relief procedures that can be obtained quickly, at low cost.
10. Difficulties in bringing about "group action and state involvement" recommended by USDA make it important for the STB to provide regulatory alternatives for rate negotiation for agricultural producers.
11. In recent years, and especially the last decade, more and more shippers have complained of numerous reductions in rail service by major railroads and their inability to utilize the current STB rate standards to access regulatory review.

12. Arbitration should be a tool in the agricultural farm producer/shipper tool box to facilitate both alternative rate dispute resolution and fair procedures for establishment of rate structure after a railroad reaches revenue adequacy.
13. Rail carriers now believe it is their right to set the market price of the commodity they are transporting. This has led to rail carriers demarketing certain shippers while promoting others and limiting their access to their markets

1. ARE THE RAILROADS AN INDUSTRY LIKE ANY OTHER INDUSTRY?

With all of this rhetoric, the railroads continue to claim they are just like every other industry. This claim is untenable.

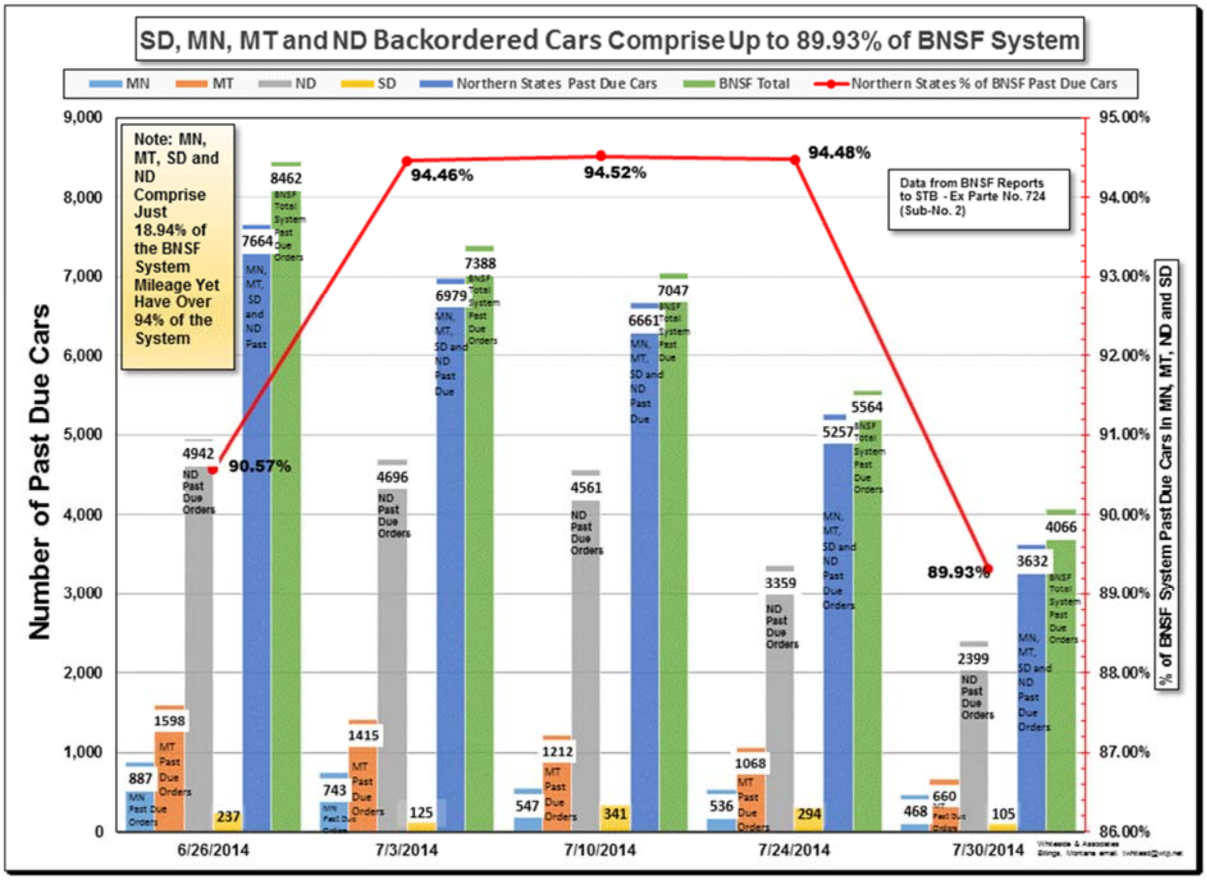
- Unlike most other companies, the railroads are granted a federal franchise. They operate as monopolies in some areas and oligopolies in others.
- Unlike most other companies, the railroads operate in many areas of the country with little or no competition for their services. The railroads like to point to competition but the reality is that they have vast areas of the grain belt where the distances to market are great, and other forms of competition (such as truck) are not viable. When one sees numbers showing truck movements of grain, be reminded that virtually all grain must move to a railhead gathering point by truck. The railroads operate as monopolies and it is that monopoly franchise territory that they utilize to anchor their operations.
- Unlike most other companies, the railroads are greatly affected with the public interest as the courts have repeatedly found.
- Unlike most other companies, producers and shippers of agricultural products do not have competitive alternatives or alternative ways to get to their markets and create value.
- Unlike most other industries, railroads do not have worldwide competition affecting their markets or service.
- Unlike most other industries, railroads do not have competition to produce "market based" competitive alternatives for their services. Yet time and again, we hear the railroads jump up and down insisting the railroad industry "is just like every other industry."

When the Board and rail customers, farm producers and shippers generally hear these continued protestations that the railroads are "just like every other industry", one should realize that this is a story fabricated by railroads to deflect examination of how the effects of monopolistic service and pricing by the railroads adversely affect their captive shipper customers. The fact remains that the railroad industry, like the trucking, ocean shipper and air carrier industries, exists to serve its customers and not vice versa.

2. **SERVICE METRICS CONTINUE TO SHOW A FITFUL AND STRUGGLING SERVICE RECOVERY MARKED BY LOWER PAST DUE CARS BUT INCREASED CONCENTRATION OF THE PAST DUE CAR LEVELS IN THE NORTHERN TIER STATES**

BNSF metrics that the STB now requires both BNSF and CP to provide each week show that captive shippers in the northern plains in Montana, Minnesota, North Dakota and South Dakota are once again experiencing the effects of poor service by BNSF. The MT, MN, ND, and SD backordered cars vs BNSF backordered cars have, over the last 4 weeks, have been as high as 94.52%, yet the four states have only 18.94% of the BNSF tracks. This is another example of why the captive agricultural producers of this country need the STB step up and improve access to the regulatory remedies for agricultural shippers.

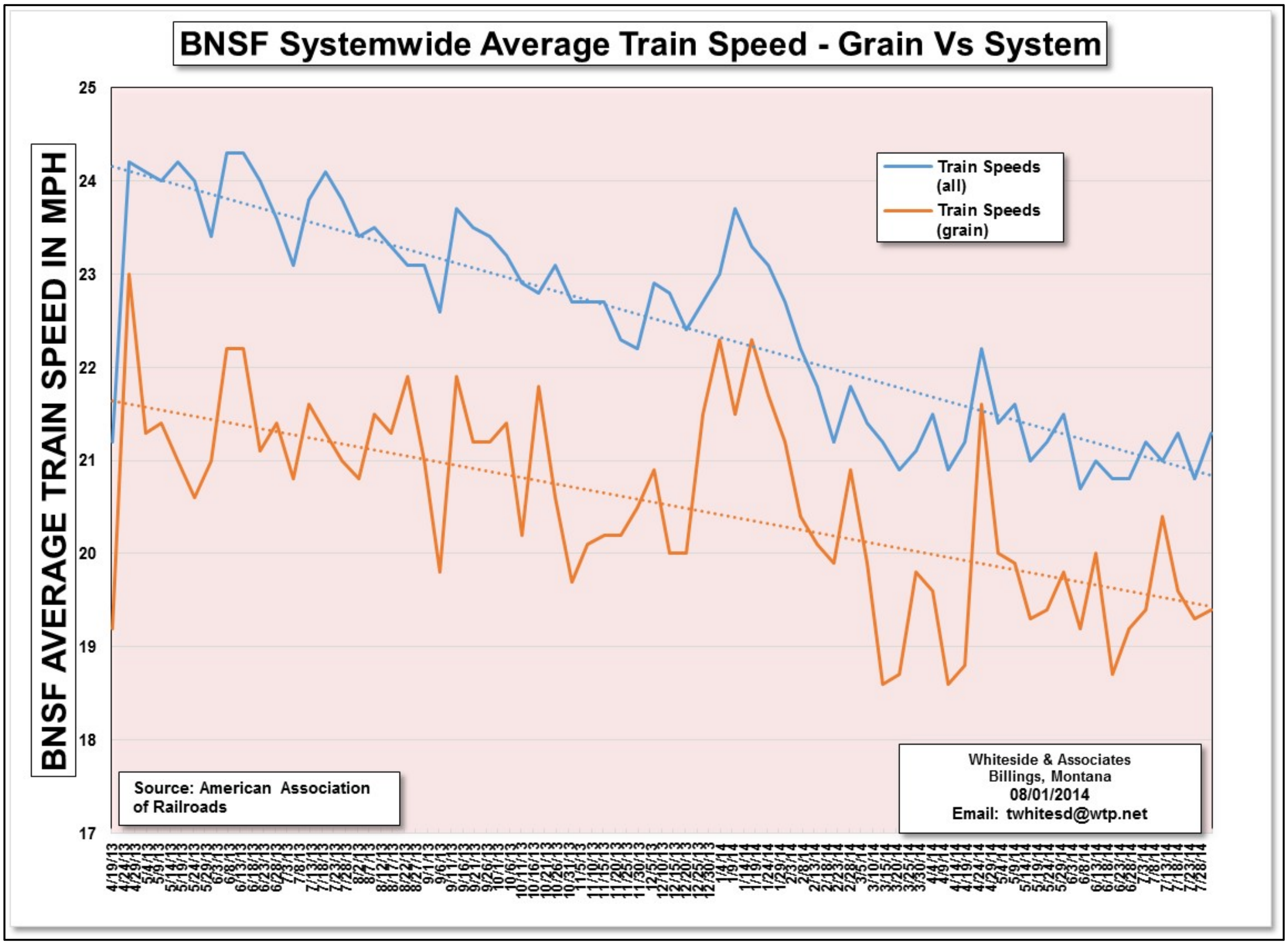
Chart I



3. SERVICE METRICS ALSO SHOW AVERAGE SPEED ON THE BNSF IS CONTINUING TO DECREASE

Not only is the BNSF burdening the agricultural shippers of the northern plains with the concentration of back ordered cars, the BNSF System wide Average Train Speed (All and Grain) is continuing to show no improvement over the last 18 months and some of the lowest average speeds in decades. This continued decline in average train speed is most concerning. We are also starting to see lower average speeds on other carriers including the UP. Whether that is a long term trend is yet to be determined.

Chart II BNSF System wide Average Train Speed



4. **BNSF POOR SERVICE FOR THE PAST YEAR, HAS FORCED CURTAILMENTS IN SERVICE TO AND FROM PNW**
   - **COLD TRAIN SERVICE IS BEING DISCONTINUED**
   - **PNW INTERMODAL SERVICE SCHEDULES TO CHICAGO ARE BEING LENGTHENED**

Continued poor service as shown by available metrics has hurt and is continuing to hurt agricultural producers and shippers in their ability to compete in their traditional markets. Transit times have sky-rocketed, supply of cars (past due cars) has continued to hurt farm producers' bottom lines, primary and secondary car market costs have skyrocketed, and the agricultural base has gone into the tank for the last year. Here are several recent reports showing the negative effects of the prolonged service crisis.

FROM A REPORT IN THE AUGUST 8, 2014 ISSUE OF RAILWAY AGE.

Cold Train cites BNSF congestion, suspends service

Written by Bruce Kelly

Earlier this year, congestion and trackwork on its Northern Corridor forced BNSF to increase transit times for intermodal shipments between the Pacific Northwest and Chicago, a move which has driven some customers to ship via Union Pacific. Now, a segment of Northwest perishables traffic is looking elsewhere as well.

On Aug. 7, 2014 Cold Train announced it has suspended shipment of double stacked, containerized fruits, vegetables, and other food products from its terminal in Quincy, Wash. The company blames congestion on the Northern Corridor, along with intermodal service adjustments that BNSF implemented in April. Cold Train says, "BNSF not only reduced expedited intermodal service to only one train a day from Washington State, but the service immediately became about two to three days slower from Seattle/Quincy to Chicago. As a result of BNSF's decision to terminate Cold Train's three-day service and replace it with six-day service, it now takes twice as much equipment, refrigeration fuel, etc., to move the same freight."

HTTP://WWW.RAILWAYAGE.COM/INDEX.PHP/INTERMODAL/COLD-TRAIN-SUSPENDS-SERVICE-BLAMES-BNSF-CONGESTION.HTML?CHANNEL=48

In another article published in The Journal of Commerce, on May 8, 2014, Mark Szakonyi, Senior Editor, reported: "BNSF's expedited intermodal service from Seattle to Chicago used to take about 84 hours, said Tom Finkbiner, a noted intermodal consultant. Now, the transit time for an expedited trailer or container to hit the Midwest hub from Seattle is closer to 120 hours, according to BNSF service goals released on May 2. Service goals show customers cut-off times for shipments and the estimated time it will take to ship to various destinations. The transit for expedited containers and trailers from Portland to Chicago now takes about 135 hours, according to BNSF service goals.

The apparent increase in BNSF transit times between the Pacific Northwest and Chicago is the latest sign that a backlog of carload freight — caused by severe winter weather and an uptick in volume, much of it tied to the domestic energy boom — is impacting intermodal service. It is also clear that BNSF is making choices in the customer's service that it is providing and those decisions continue to have economic consequences on agricultural producers."

As is typical in discussion of facts with the railroad, the "BNSF declined to comment on the historical average transit times for both routes, saying it was competitive information. The railroad did, however, say it has created new schedules for intermodal service in the Pacific Northwest, following higher traffic on the lanes and expectations of more growth to come."

5. BNSF'S POOR SERVICE HAS CAUSED BOTH THE PRIMARY AND SECONDARY MARKETS FOR CARS TO REMAIN AT RECORD LEVELS

PRIMARY AND SECONDARY RAILCAR MARKET BIDS ARE COSTS TO THE AGRICULTURAL PRODUCERS

Another unique feature of the agricultural market is the creation of both primary and secondary rail car markets. The railroads control and benefit from the Primary Railcar Market as outlined below.

Shippers worry about a repeat in rail service problems at harvest and are securing space directly from rail carriers this year. Unlike premiums paid in the secondary railcar market, which are transferred between shippers and do not affect railroad profits, premiums paid in the primary market accrue directly to the rail carrier. Bids in the secondary market are trading in a similar price range for service placement from August through December. The next two months will be a critical period for railroads to move the remaining grain backlog in anticipation of the projected record harvest this year. Although BNSF has shown promising signs of recovery over the past month, outstanding shipments on CP continue to cause concern for grain shippers and producers. Furthermore, the vast majority (over 94%) of the BNSF backorders continue to be in MN, MT, ND and SD. (See the Fauth Reply Statement for further analysis of car markets)

Shippers of grain have seen prices of pool cars on the BNSF escalate to over $4,000 per car and current prices running about $3,000 per car.

The strains on BNSF's capacity have already resulted in added costs for grain shippers. BNSF maintains a Certificate of Transportation (COT) program, which it maintains "allows" customers "to bid for covered hopper cars according to a weekly schedule, subject to availability." The COT system is said to provide customers with "a car placement date guarantee" and a "rate-lock" option. COT car reservations are awarded to the highest bidders and require a nominal pre-payment. The COT program is also said to be “the most frequently used way for BNSF Agricultural Products shippers to reserve cars in advance.” BNSF says that its program has “built in flexibility for the COT holder” and that COTs can be bought or sold in a “secondary market.” BNSF participates in the primary railcar market, but states that it “does not manage or participate in this secondary market.”[3] In its Opening Statement, BNSF states that “BNSF does not share in any revenue from certificate sales on the secondary market. (BNSF page 13). UP has a similar system known as the Grain Car Allocation System (GCAS).[4]

This again is a unique aspect of the agricultural market, and the increased vulnerability of rail-dependent agricultural producers and shippers is one reason the STB initiated this proceeding. Last year, prices in the secondary market began to skyrocket from near $0 to a high of nearly $6,000 per car for shuttle trains. This dramatic increase is illustrated in the following Chart:

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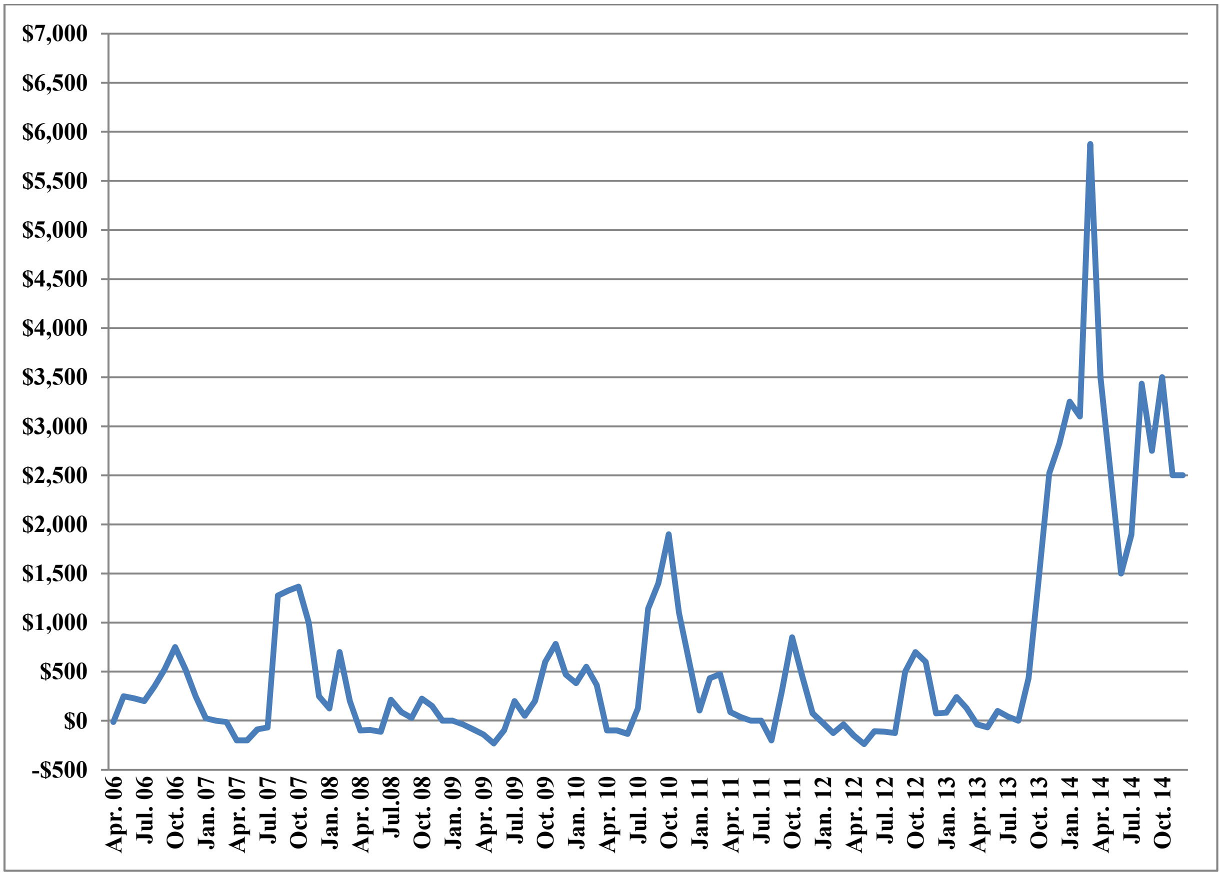
[3] http://www.bnsf.com/customers/what-can-i-ship/grains-feed/faq.html
[4] https://www.uprr.com/customers/ag-prod/gcas/index.shtml

Chart III

BNSF Maximum Shuttle Bids in the Secondary Market



According to USDA, bids in the *primary* railcar market have also been trading at historic highs since late May, 2014 for guaranteed railcar placement for grain shipments in August, September, and October. Bids for the week ending July 17 ranged between $2,700 and $3,200 per car for BNSF's guaranteed grain car placement in September and between $2,800 and $3,000 per car for placement in October. In the previous 10 years, we saw very little monthly trading and bids rarely exceeded $700.[5] It should be noted that the primary car market premiums accrue to the railroads while the secondary car market premiums accrue to the grain marketing industry and are not reflected in URCS costing.

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[5] http://www.ams.usda.gov/AMSv1.0/getfile?dDocName=STELPRDC5108470

6. **BNSF APPEARS TO BE REDUCING BACK ORDERS ON SHUTTLE MOVEMENTS BUT THE LESS-THAN-SHUTTLE FACILITIES (NON-SHUTTLE) CONTINUE TO STRUGGLE WITH LENGTHY CAR BACKORDERS**

As BNSF concentrates efforts on reducing back orders, it appears that shuttle (110 car) service may be improving at the expense of the smaller elevators and is continuing to impose economic hardship on those smaller elevators that are particularly important in the marketing of peas, lentils, beans, barley, and all rotational crops. The importance of these smaller elevators in providing markets for these and other crops, makes them an essential resource for farm producers seeking the ability to grow and market a variety of crops throughout the farm belt.

These smaller elevators are thus an important component in agricultural production and marketing. Reports from the smaller elevators tell of backorders on cars running 60 to over 120 days behind in the Northern plains.

7. **THE BOARD NEEDS TO BE EVER-COGNIZANT THAT THE CARRIERS' GOALS LEAD TO CONFLICT WITH RAIL CUSTOMERS IN THE TRANSPORT OF FARM PRODUCTION.**

A main goal of railroad carriers is to maximize profit. Railroads serving agricultural America desire to move agricultural commodities in trainload quantities to market (highest return to railroads). There is continued resistance to moving stratified farm products (multiple grades, alternative crops or non-homogeneous mixes) and products that do not lend themselves to trainload shipments including peas, lentils, pulse, other grains such as durum wheat, barley and developing varieties (such as white wheat, etc.) Stratification of farm production through diversification creates greater returns to farm production and producers but railroads provide disincentives to such actions. What would the railroads find most appealing? For the farm producers to grow wheat on wheat – namely, wheat every year on the same ground. Such action is not economically possible and is destructive to future productivity and sound use of farmland.

Today, railroad profit goals do not necessarily coincide with long term profitability for farm production. There is the ability of revenue adequate railroads to invest more for traditional commodities such as grain. There is also the ability of railroads to cater to the diversity of agriculture without driving segments crucial to long-term farm economics into financial ruin.

Because of the conflicts in goals between railroads and grain producers and because of the railroads' use of lobby and political persuasion, grain interests must work together if they are to have any hope of counterbalancing the influence of major railroads. In my work over the years, based on my direct experience in working with the State of Montana and other states and many farm groups throughout the farm belt, we have been able to coalesce around unity of thought and purpose in many cases. Such common purpose has been developed by years of trust and hard work, but railroad political influence makes group action and state involvement very difficult to obtain. The Board therefore needs to be receptive to such coordinated efforts among farm producers.

8. RAIL RATE HISTORIES SHOW A STEADY RISE OF RATES EVEN WHEN GRAIN PRICES FALL

BNSF and UP also dominate key grain production areas (such as railroad movements of wheat from Montana, North Dakota, Washington, Idaho, Colorado, Nebraska, Kansas, Oklahoma and Texas and corn and soybean movements from the Upper Plains) and the key export grain markets (such as corn, soybeans and wheat movements to Asia via the export grain terminals in the Pacific Northwest (PNW)). The BNSF dominance and flow of grain traffic is demonstrated by BNSF's Exhibit FTI-4 of their Opening Statement, which shows BNSF's "predominant" grain traffic flows. Despite BNSF's domination of the railroad grain transportation market, BNSF states that it "does not charge unreasonably high rates on grain movements." (BNSF page 2). However, the grain rates have continued to increase year over year at levels well in excess of inflation and in spite of the fact that grain prices fluctuate up and down over time. Note in the charts below, during the recession that has pulled down the U.S. economy, the market dominant railroads have be able to increase by over 100% during the last 10 years, despite the fact that prices normally fall or stay flat during recessions. . Additionally, the railroads have added fuel surcharges and premium car costs that have recently serve to drive up the rates up to 100% above the rates shown in these charts.

When faced with the recession of 2008, it is clear that railroad pricing power, driven by monopoly/oligopoly pricing power – not demand or costs – has been driving rates higher.

Railroads in this proceeding continue to argue out of both sides of their mouths. First, Railroads argue that government intervention is necessary to insure that they earn "adequate revenues." At the same time, railroads argue, as in this proceeding, that NO GOVERNMENT intervention is necessary to limit their monopoly power!

The AAR and the railroads in this proceeding make the claim over and over that grain shippers don't file rate complaints because their rates are "reasonable." Yet, in my Opening Verified and the Opening Statement of Witness Fauth we show many rates that exhibit very high R/VC levels. The theory that the railroads follow appears to be if they hear no complaints and see no complaints then there must not be any!

The STB is here to see and hear and adjudicate rate reasonableness. It is clear that railroads do not want any challenge to rate reasonableness and want to make it so difficult and complicated that thousands of smaller shippers or small shipments cannot afford to file rate reasonableness complaints. Again the market dominant railroads protecting their government given franchise cling to the principle that NO GOVERNMENT intervention is necessary to limit their monopoly power.

Our Opening Comments showed many routings with RVC ratios over 300%. These are not just specially selected rates but examples of the rate structures that exist today. The current system of regulatory oversight is not accessible to the farm producers paying these 300+% RVC rates.

Chart IV

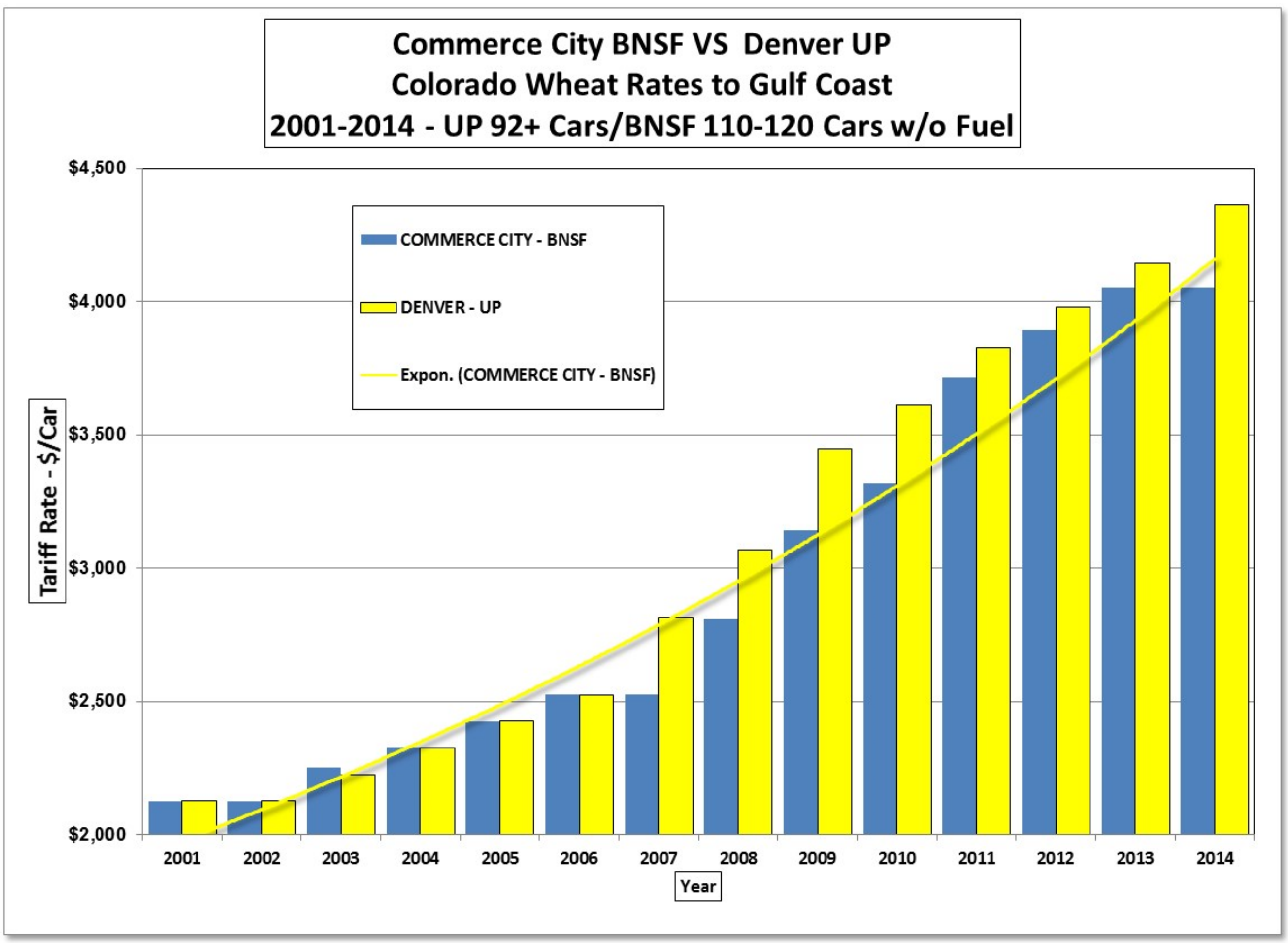


Chart VI

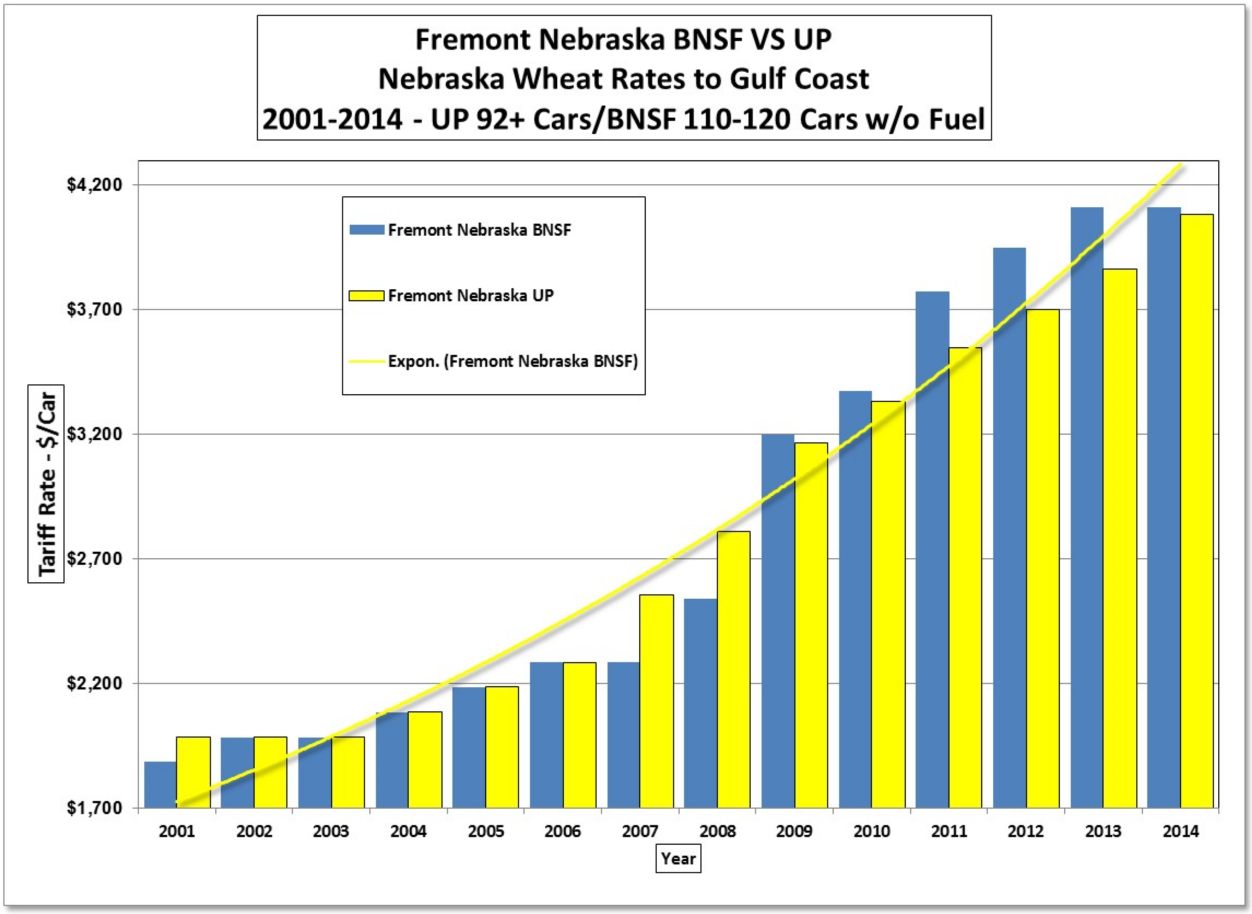
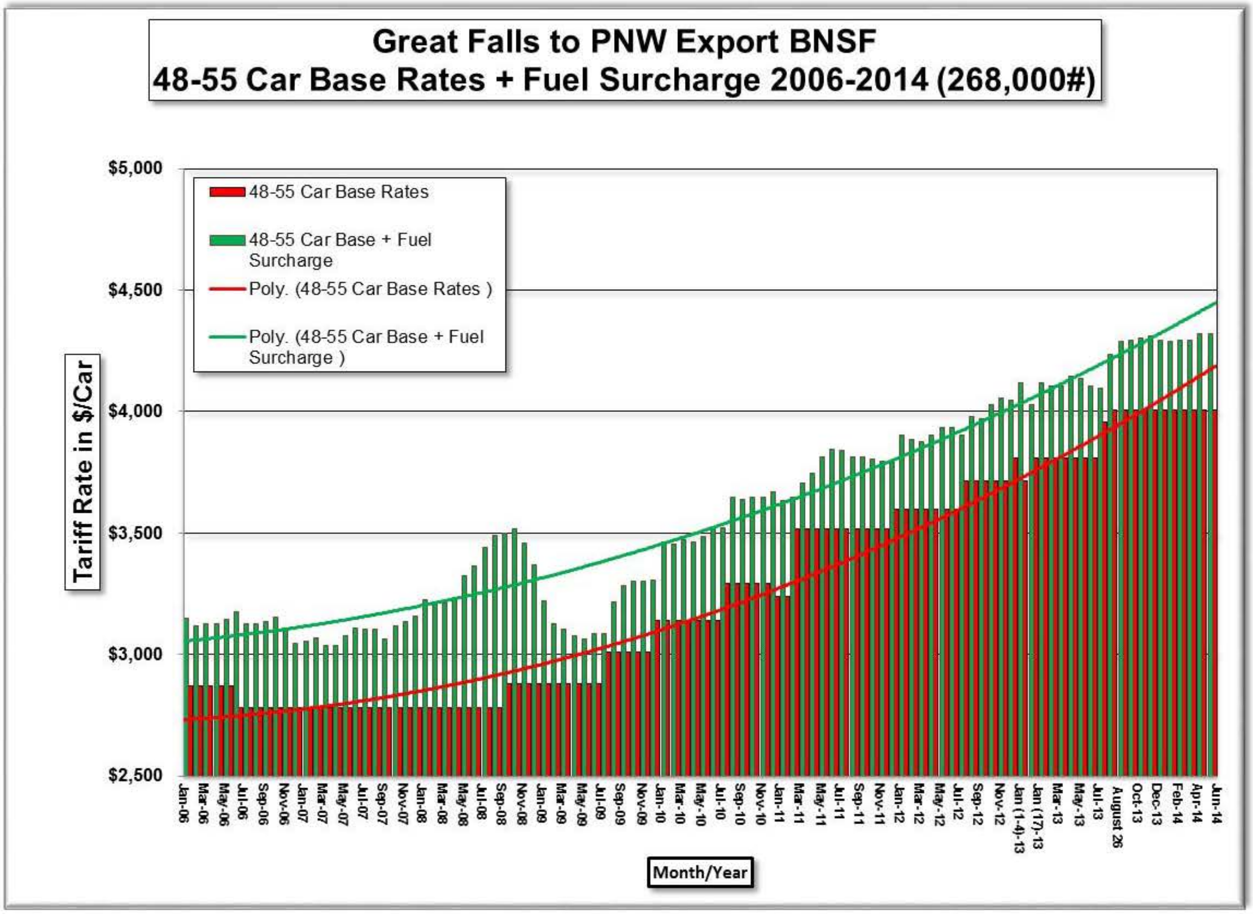

Fremont Nebraska BNSF VS UP
Nebraska Wheat Rates to Gulf Coast
2001-2014 - UP 92+ Cars/BNSF 110-120 Cars w/o Fuel
Fremont Nebraska BNSF
Fremont Nebraska UP
Expon. (Fremont Nebraska BNSF)
Tariff Rate - $/Car
$4,200
$3,700
$3,200
$2,700
$2,200
$1,700
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
Year

Chart VII


Great Falls to PNW Export BNSF
48-55 Car Base Rates + Fuel Surcharge 2006-2014 (268,000#)
48-55 Car Base Rates
48-55 Car Base + Fuel Surcharge
Poly. (48-55 Car Base Rates)
Poly. (48-55 Car Base + Fuel Surcharge)
Tariff Rate in $/Car
$5,000
$4,500
$4,000
$3,500
$3,000
$2,500
Jan-06
Mar-06
May-06
Jul-06
Sep-06
Nov-06
Jan-07
Mar-07
May-07
Jul-07
Sep-07
Nov-07
Jan-08
Mar-08
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Mar-11
May-11
Jul-11
Sep-11
Nov-11
Jan-12
Mar-12
May-12
Jul-12
Sep-12
Nov-12
Jan (1-4)-13
Jan (17)-13
Mar-13
May-13
Jul-13
August 26
Oct-13
Dec-13
Feb-14
Apr-14
Jun-14
Month/Year

Chart VIII

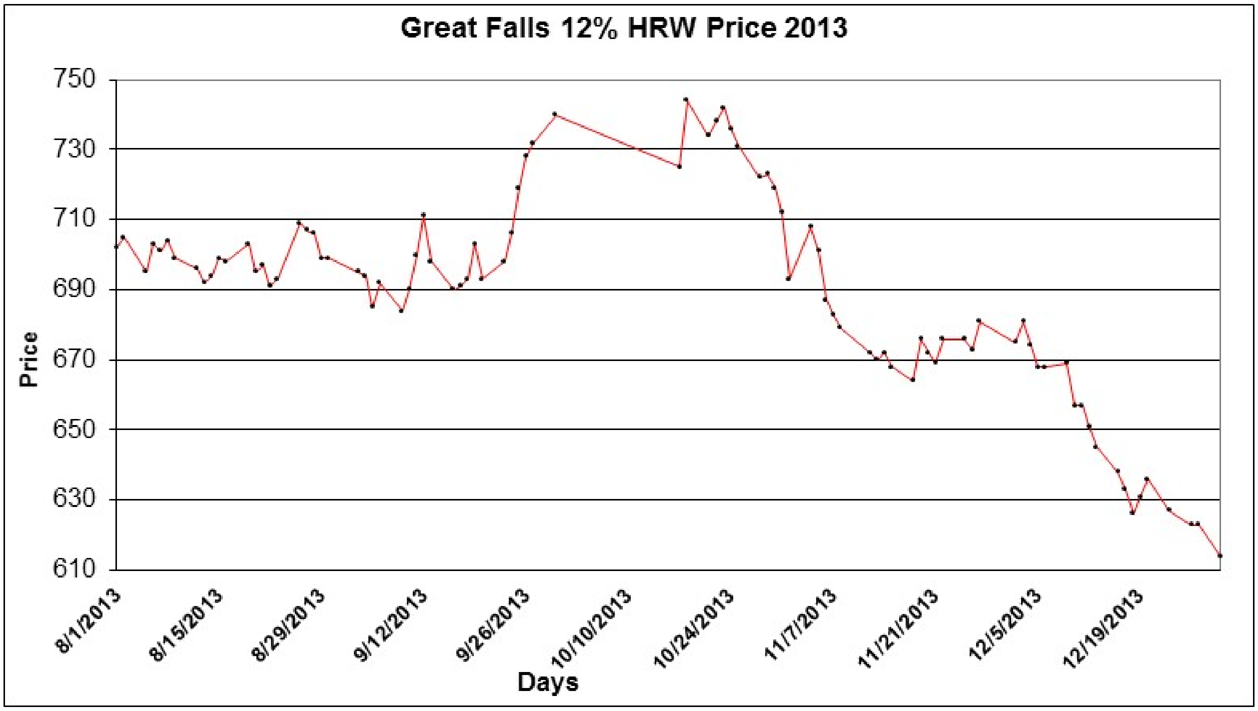
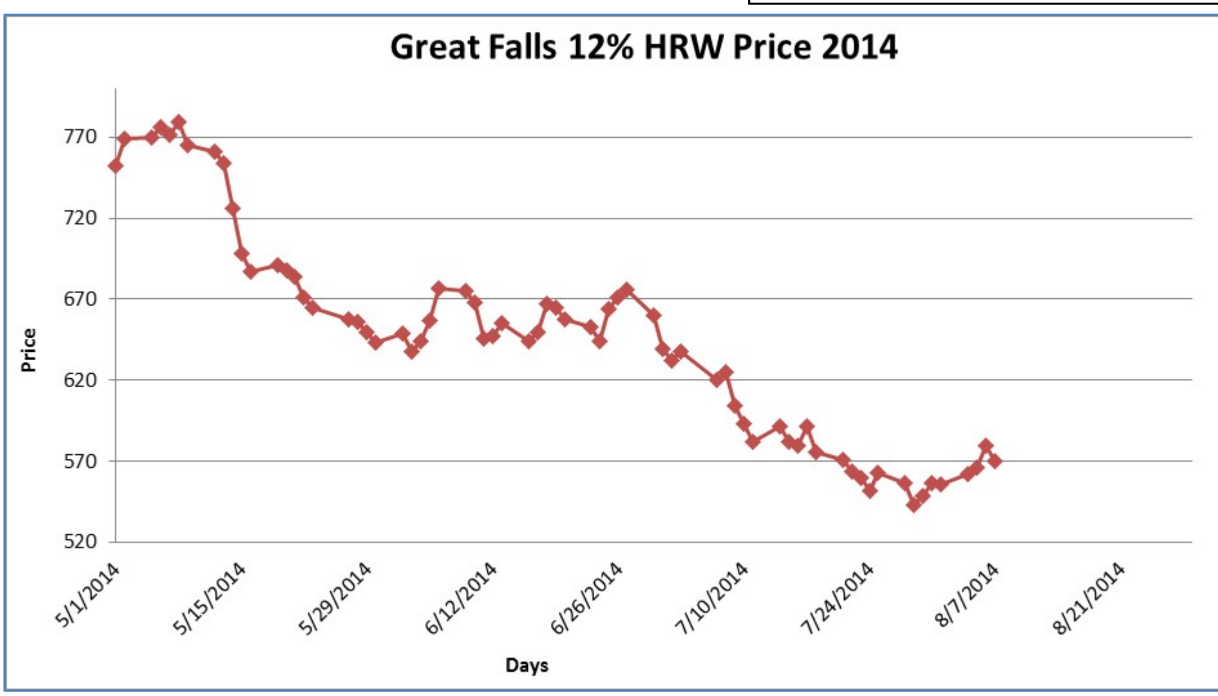


Chart IX

Source: Montana Wheat and Barley Committee – August 2014



The rail grain rates have continued to increase year over year at levels well in excess of inflation and in spite of the fact that grain prices fluctuate up and down over time. The falling

12% HRW (Hard Red Winter) prices during 2013 and 2014 are in stark contrast to ever increasing rail rate charges.

9. CONTINUING NEED FOR REGULATORY RATE RELIEF PROCEDURES THAT CAN BE OBTAINED QUICKLY, AT LOW COST.

Agricultural producers/shippers general are characterized by smaller rate challenges. They are faced on the other side with financially mature railroads and the financial health of the railroads is markedly better today than when the Staggers Rail Act was passed in 1980.

As outlined in the USDA Opening Statement, the most promising ways for the STB to "encourage greater use by agricultural shippers of its new rate challenge procedures for agricultural shippers are through: (1) significantly lowering the costs associated with the procedure, and (2) demonstrating a commitment to a predictable set of outcomes through the development of a process that is simple to use and easy to understand, preferably formula-based using data that is easy to obtain and deterministic in nature.[6]"

USDA offers "concepts for potential consideration as the Board considers its options in the development of new rate complaint procedures for agricultural shippers."

USDA also suggests the Board include in its rate challenge procedures, processes that would allow groups of agricultural producers, group of elevators, State Attorneys General to act on behalf of agricultural producers in that State.

The USDA believes another approach to the formal rate challenge process is to utilize private-sector mediation and arbitration. (See Item 12 below).

[6] USDA Opening Statement at page 9.

10. DIFFICULTIES IN BRINGING ABOUT THE "GROUP ACTION AND STATE INVOLVEMENT" RECOMMENDED BY USDA MAKES IT IMPORTANT FOR THE STB TO PROVIDE REGULATORY ALTERNATIVES FOR RATE NEGOTIATIONS FOR AGRICULTURAL PRODUCERS

In a paper for the Montana Law Review, Anthony Johnstone, Adjunct Professor, The University of Montana School of Law, in 2009, summarized the McCarty Farms case and its 18 year crawl through the ICC, the Courts, the STB and the changing of regulatory standards 3 times. I was involved in the original Section 229 case that became combined at the ICC with the McCarty Farms case when it was referred to the ICC for adjudication. I have developed in Appendix I, a chronological history of the McCarty Farm case journey. This analysis provides a backdrop and a historical perspective of one of the reasons, farm producers have lost faith in the Board's ability to provide reasonable access to rate regulatory review. It was a long time ago, but the more than $3million expended by both the farm producers and the State of Montana coupled with the changing standards during the case, left a bitter taste with the farm community.

"A few weeks before President Carter signed the Staggers Act into law, a class of 10,000 Montana farmers and grain elevators sued Burlington Northern in the *McCarty Farms* case[7]. The farmers alleged that the railroad charged them unreasonably high freight rates for wheat shipments from Montana to port terminals in the Pacific Northwest over the preceding two years, in violation of the Interstate Commerce Act's requirement that interstate shipping rates remain "reasonable[8]." Thus began the case's 18- year "crawl through the legal system.[9]" At the case's outset, the parties agreed the Interstate Commerce Commission (ICC) had exclusive jurisdiction

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[7] *McCarty Farms I*, 91 F.R.D. at 487
[8] 49 U.S.C. § 10701 (a) (1980)
[9] *Burlington N. R.R. v. I.C.C.* 985 F. 2d 589, 592 (D.C. Cir. 1993 [hereafter McCarty Farms V]

to determine the reasonableness of the freight rates, but the plaintiff class included both grain elevators who paid freight rates directly and farmers who did not transact directly with the railroad. Burlington Northern objected that the farmers lacked standing to challenge rates they did not pay. As a matter of antitrust law under the Clayton Act[10] to avoid "a serious risk of multiple liability for defendants," indirect purchasers like the farmers could not recover from the railroad if it was also liable to a direct purchaser like the grain elevator.[11] However, the district court declined to apply this "indirect purchaser" rule to a rate case because it could allocate reparations for unreasonable rates between the direct and indirect shippers already included within the plaintiff class.[12]

Based on my direct experience in working with the State of Montana, the Montana Attorney General, the State of Montana Legislature and several other prominent wheat producing states and many of the farm groups over the years, when bringing actions to the STB, there are issues that arise when producers and shippers coalesce as a group. The history of the 17+ year experience with the McCarty Farms case has had a chilling effect on farm producers bringing rate actions before the regulatory Board. Politics and railroad political influence make group action and unity difficult to obtain. However, we have been able on occasion to obtain the needed cohesive group. Accessible standards for adjudication are crucial for equitable treatment of captive shippers and producers in this unique market place called agriculture.

11. IN RECENT YEARS, AND ESPECIALLY IN THE LAST DECADE, MORE AND MORE SHIPPERS HAVE COMPLAINED OF NUMEROUS REDUCTIONS IN RAIL SERVICE BY MAJOR RAILROADS AND THEIR INABILITY TO

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[10] 15 U.S.C § 15 (2006)
[11] *Ill. Brick Co. v. Ill.*, 431 US.720, 730 (1977)
[12] *McCarty Farms I*, 91 F.R.D. at 491

UTILIZE THE CURRENT STB RATE STANDARDS TO ACCESS REGULATORY REVIEW.

Rail rates and charges that exceed maximum lawful levels cannot be justified by service quality, no matter how good. High rates are even more objectionable when accompanied by poor service. Given their market power throughout the grain agricultural region, the railroads have been able to restructure the way wheat and other grains move to market. A railroad with the market power is in a position to use its control of pricing and service to encourage some routings and shipments, and to discourage others, influencing which products move where. As testified to in a recent hearing before this Board, an eastern Montana elevator which has been shipping grain for over 100 years from a location near the heart of Bakken oil boom was told by a BNSF employee that servicing their grain account was becoming 'annoying.' This is one of the same elevators that the railroad demanded for over a year (2013-2014), that they must 'find and marry' any 48 car movements from their elevator to a competing elevator's movement going to the same destination in order to qualify for the historical multi-car car rate. Otherwise, single-car rates would apply. After vigorous complaints, the railroad in question has, effective August 1, 2014, decided to let this onerous provision expire. Unfortunately one of the affected less-than-shuttle elevators closed during the year due primarily to the economic effects of so called, 48 car marriage rule. Unfortunately, one less than shuttle facility shut down that was subject to the 48 car marriage rule, did shut its doors, primarily because of the effects of the rule on their operations.

This exercise of restrictive economic power by the railroad over smaller elevators is exactly why this case and its outcome are so very important to the farm producers. These smaller elevators are extremely crucial in providing markets for rotational and other economically viable crop producing practices that the large shuttle facilities are not set up to handle.

12. ARBITRATION SHOULD BE A TOOL IN THE AGRICULTURAL FARM PRODUCER/SHIPPER TOOL BOX TO FACILITATE BOTH ALTERNATIVE RATE DISPUTE RESOLUTION AND FAIR PROCEDURES FOR ESTABLISHMENT OF RATE STRUCTURES AFTER A RAILROAD REACHES REVENUE ADEQUACY

The USDA believes another approach to the formal rate challenge process is to utilize private-sector mediation and arbitration.

One of the most successful railroad rate arbitration systems recently developed is the Canadian Final Offer Arbitration (FOA) (aka baseball style) arbitration system, which provides a means of resolving rate and service disputes through the use of an arbitrator or a panel of three arbitrators. Under the Canadian system, unless the parties agree to a different time frame, arbitration must be completed within 60 days, or 30 days for disputes involving freight charges of less than $750,000 (Canadian).[13] However, the railroads are unlikely to voluntarily agree to such a FOA system (although they could) and imposition of a mandatory FOA system may be beyond STB jurisdiction and most likely would require Congressional approval.

Final Offer Arbitration (FOA) can be utilized in all Canadian shipper/rail disputes - FOA requires each party to submit its final offer to the arbitrator who then must pick one of the offers as the settlement. There is no "splitting the baby". This simple process forces each party to not give an unreasonable offer since it will not pass the "smell test" and will be quickly ruled out by the arbitrator. This would result in the other party's offer being adopted. Once both parties abandon extreme positions, disputes can often be settled.

[13] https://www.otc-cta.gc.ca/eng/publication/final-offer-arbitration1

Final offer arbitration has significant advantages to both parties. They are:

- Reasonable costs since there is no long and drawn-out regulatory procedure such as developing a stand alone cost railroad
- Easy to understand methodology
- A quick decision

13. RAIL CARRIERS NOW BELIEVE IT IS THEIR RIGHT TO SET THE MARKET PRICE OF THE COMMODITY THEY ARE TRANSPORTING. THIS HAS LED TO RAIL CARRIERS DEMARKETING CERTAIN SHIPPERS WHILE PROMOTING OTHERS AND LIMITING THEIR ACCESS TO THEIR MARKETS.

In a Senate Commerce Committee hearing in April, 2002 a VP of Grain for a major Class I railroad in the West made the following statement,

> "What we do as a rail transportation provider is look at the difference between the value of the grain at the origin and value of the grain at the destination, and try and determine the level of charges for transportation with margin for the elevators to operate and make money."
>
> "The fact that winter wheat off Texas gulf at the destination has a lower value than hard Spring wheat off the PNW…it is clear Spring wheat has a higher value. Therefore, it can stand a higher transportation cost and still move in the marketplace."

This practice is what the railroads refer to when they call their pricing system, "market based pricing." The Farm Producers and the Board need to be mindful that the railroad here is making the statement that they set the price in the marketplace for the goods they are transporting, furthermore they will set the extent of market penetration they will allow and the farm producers are the ones paying for the transportation cost that is now dictated by his/her captivity not by market demands.

Only a company with absolute power and little or no effective competition or regulatory oversight can price in this way.

Having both informal and formal processes that are specifically designed for the needs of agriculture would provide the mechanisms to tackle the wide range of problems that exist today.

As the Board has discovered, there is not a single rail rate challenge process that works best for all shippers under all circumstances. Similarly, it would seem that having a choice of rate challenge options due to the uniqueness of the farm producer in the market place, may be optimal for grain shippers.

Mediation and arbitration would most likely be the preferred solution from the perspectives of shippers, producers, and rail carriers as this would preserve business relationships and avoid the costs of litigation. The keys to success in such a system are the ability and willingness of all parties to seek solutions that arbitration/mediation can bring to the table, and procedures and standards that cannot be dominated by the rail carrier to its advantage.

Also having a more formal process at shippers' disposal would serve in instances where mediation and arbitration are impractical and the parties are unwilling to find a solution for whatever reason. One of the realities that a good, effective arbitration provides is to encourage railroads and shippers to pursue negotiation over mediation and arbitration. I am advised that this is true in Canada, where the capability of the shipper to call for Final Offer Arbitration is often enough to result in negotiated settlements in rate disputes, and may act to discipline uncompetitive markets, helping avoid the need for any rate challenge in the first place.

SUMMARY

ARC, et al. urge the Board to give serious consideration to (1) USDA's recommendations on mediation and arbitration, (2) the ACMRM proposed by NGFA, and (3) the expanded R/VC_{COMP} test if the Three-Benchmark test is preserved for revenue inadequate railroads, along with a Two-Benchmark test proposed by ARC, et al. for revenue adequate railroads. These are all practicable theories to ensure rail rate challenge procedures are more available and effective for grain shippers and producers. These three proposed concepts address cost, relevance, and practicable predictability, which ARC, et al. and the other agricultural producer and shipper interests filing opening comments have acknowledged as the area's most in need of improvement in the Board's established procedures. The fact that both ACMRM and Two-Benchmark have a revenue adequacy component and address the uniqueness of agricultural marketing should give further impetus to further exploration of these proposals in the next phase of this proceeding.

VERIFICATION:

I hereby certify that the foregoing is true and correct on penalty of perjury.

S/ Terry W Whiteside Date: August 25, 2014

By Terry Whiteside, Registered Practitioner
Whiteside & Associates
3203 Third Avenue North, Suite 301
Billings, Montana 59101
Phone: (406) 245-5132
Email: twhitesd@wtp.net

Subscribed and sworn to me this twenty fifth day (25) of August 25, 2014

Heidi K. Morgan
Notary Public

HEIDI K MORGAN NOTARIAL SEAL STATE OF MONTANA
HEIDI K MORGAN
NOTARY PUBLIC for the
State of Montana
Residing at Billings, Montana
My Commission Expires
March 04, 2016

My Commission Expires: 3/4/2016

Appendix TCW – I

THE PROCEDURAL HISTORY OF McCARTY FARMS, INC. v. BURLINGTON NORTHERN, INC.	
Sept. 11, 1980	Montana grain farmers brought class action suit against Burlington Northern (BN) in U.S. District Court challenging rates charged for transporting wheat from Montana to Portland, Oregon. Court refers case to Interstate Commerce Commission (ICC) as appropriate forum. See McCarty Farms, Inc. v. Burlington Northern, Inc., 91 F.R.D. 486 (D. Mont. 1981).
Mar. 16, 1981	District Court orders action maintained as a class action suit and refers the matter to the ICC for a determination of the reasonableness of the wheat rates.
Mar. 27, 1981	McCarty Farms files a complaint with the ICC alleging that BN's rates on wheat, and on barley as well, were unreasonable.
Aug. 10, 1981	District Court grants parties standing to maintain class action suit.
Dec. 14, 1981	Administrative Law Judge (ALJ) finds BN had market dominance and that its rates were unreasonable. 200% revenue to variable cost ratio maximum reasonable rate to be charged but BN charging close to 300%.
Jan. 14, 1982	BN appeal of ALJ decision to ICC.
July 30, 1 982	ICC decision reopens record of case for 'possible' submission of further evidence, plie case into two parts to consider wheat and barley rates separately.
Jan., 1983	ICC managing ALJ asserts that the case must conclude by end of third year (approx. May 2, 1983, or case will be automatically dismissed by statutory decree.
Jun. 2, 1983	ICC in separate case, directed parties to this case to file comments on the extent to which coal rate standards should be applied to grain and other commodities. McCarty farms urged the ICC to decide the appeal of BN in the case before it. BN argued that ICC market dominance decisions had changed and urged a further evidentiary phase.
Nov. 14, 1983	ICC decides to hold farmers case in abeyance until final decision on coal rate guidelines. Farmers ask Court to order ICC to decide case.
June, 1984	Plaintiffs file for Writ of Mandamus asking the Federal District Court in Montana to force the ICC to proceed.
Sept. 11, 1984	ICC reopened proceedings for submission of further evidence. See 1984 ICC LEXIS 307 (Sept. 7, 1984). Parties request clarification of ICC decision to reopen proceeding.
Dec. 21, 1984	ICC decides that all market dominance factors are at issue.
Feb., 1986	ICC Chairman Gradison testifies that McCarty Farms case 'among the group of cases that is in the top priority, and it will be decided in the next 300 days.' Chairman Dingell says that delay is 'intolerable' and Mrs. Gradison agrees.
April 15, 1986	ICC Chairman ruled on discovery motions from September 1984 order reopening proceedings and affirms its decision to reopen the case to consider changes in market dominance and coal rate guidelines.
July 30, 1986	ICC Chairman Gradison tells Montana audience that ICC believes BN and grain shippers should negotiate differences, ICC will not intervene. Montana shippers are "lucky to be captive to somebody who's honorable and knowledgeable and willing to negotiate." See T.J. Gilles, GREAT FALLS TRIBUNE (July 30, 1986).

Sept. 18, 1986	ICC Chairman Gradison denies McCarty Farms motion to vacate April 15 order, but granted a one-month continuance in light of settlement discussions.
Oct. 9, 1986	McCarty appeals denial of motion to vacate.
Dec. 19, 1986	ICC denies McCarty appeal of Chairman Gradison's denial of motion to vacate April 15, 1986 order and closes record to 'proceed expeditiously to a decision on the market dominance aspect of this proceeding.' See. 1986 ICC LEXIS 23, *9 (Dec. 1 2, 1 986).
April 8, 1987	ICC proposes rate guidelines for non-coal commodities.
May 27, 1987	ICC tentatively finds BN to be market dominant and Montana wheat and barley rates charged by BN to be unreasonable applying the r/vc test proposed in the Non-Coal Guidelines and directed the parties to provide any data to be used to prescribe maximum rate levels and order reparations. See 3 I.C.C.2d 822 (1987).
June 8, 1987	BN petitions ICC to vacate May 27 tentative findings on rate reasonableness and request postponement on the submission of comments needed for further determinations on the maximum rate levels until final standards are developed in the Non-Coal Guidelines.
June 25, 1987	ICC denies BN's petition of June 8, 1987. See 1987 ICC LEXIS 240.
Aug. 7, 1987	Parties file opening statements on rate reasonableness to the ICC.
Oct. 2, 1987	Parties file reply briefs.
Nov. 16, 1987	Parties file final arguments before the ICC.
Feb. 12, 1988	ICC decides that BN's rate structure on McCarty's wheat and barley was unreasonably high and directed BN to compute a proposed quantification of reparations in compliance with the decision and issue a proposed modification of its existing rate structure. See 4 I.C.C.2d 262 (1988); 1988 ICC LEXIS 76 (Feb. 5, 1988).
Mar. 3, 1988	McCarty Farms request to reopen the proceeding to correct material error in the proceedings.
May 5, 1988	ICC denies McCarty's petition to reopen the proceeding.
May 12, 1988	BN submits statement that no reparations are due.
June 15, 1988	Farmers rebut BN's submission and demonstrate that BN owes as much as $72 million.
Feb. 3, 1989	ICC corrects costing problems, recomputes r/vc benchmarks, and provides additional guidance on the computation of reparations. ICC orders BN to recompute proposed quantification of reparations and submit to ICC within 90 days. ICC also orders BN to modify its existing rate structure on the traffic at issue. See 4 I.C.C.2d 262 (1 988); 1989 ICC LEXIS 38 (Feb. 3, 1989).
Mar. 21, 1991	ICC calculates the amount of reparations at $9.7 million through 1986, additional amounts from 1986 forward, and interest. ICC also sets forth the future rate prescription procedure. See 1991 ICC LEXIS 69 (March 20, 1991).

March 27, 1991	BN files motion to hold proceeding in abeyance pending completion of the rulemaking proceeding in the Non-Coal Guidelines.
April 10, 1991	LEXIS 77 (April 10, 1991). ICC denies BN's motion to hold proceeding in abeyance. See 1991 ICC
April 16, 1991	McCarty petitioned to reopen the proceedings alleging that the ICC had committed material error in the March 27 decision.
June 17, 1991	ICC denies McCarty petition to reopen the proceedings. See 1991 ICC LEXIS 142 (June 17, 1991).
June 17, 1991	BN files *Notification of Reparations and Interest Due Under the Commission's March 27, 1991 Decision,* indicating that the reparations and interest through July 1, 1991 total $16.56 million. BN then petitioned the ICC for a determination of the limits of its liability.
Nov.20, 1991	ICC rules on the BN petition and clarifies its March 27, 1991 decided that BN's calculations of reparations and interest were correct, and, by its own motion, the ICC vacated the rate prescription order. See 1991 ICC LEXIS 274 (Nov. 20, 1991).
	Both BN and McCarty petitioned the D.C. Circuit Court of Appeals for review of ICC's decisions.
Feb. 9, 1993	In Burlington Northern R.R. Co. v. I.C.C., 985 F.2d 589 (D.C. Cir. 1993), the D.C. Circuit held that while the calculation of interest was proper, the ICC failed to justify its substitution of methods for determining the reasonableness of the rates BN charged McCarty. The Circuit court remanded the case back to the ICC for consideration consistent with its findings.
March 26, 1993	ICC issues order reopening these proceedings pursuant to the remand from the D.C. Circuit and requests from parties on how to proceed.
July 22, 1993	ICC orders that discovery should begin using the Constrained Market Pricing (CMP) methodology to evaluate the reasonableness of the rates instead of the r/vc methodology which had been used previously. The ICC also assigned the case to an ALJ to oversee the discovery and required a statement from the ALJ within 45 days detailing the status of the discovery. See 1993 ICC LEXIS 140 (July 14, 1993).
Aug. 20, 1993	Parties jointly propose a schedule (McCarty farms would have 120 days after the completion of discovery against BN to file opening evidence, and BN would be allowed 120 days thereafter to reply, McCarty would then have 90 days for rebuttal, and final briefs would be due 30 days after rebuttal was filed.
Aug. 15, 1994	ALJ issues decision that most of discovery had been completed
Oct. 28, 1994	McCarty Farms filed opening evidence on rate reasonableness.
Nov. 7, 1994	BN filed a petition to establish a procedural schedule, requesting 90 days to conduct discovery against McCarty Farms and 180 days thereafter to file a reply.

Nov. 8, 1994	Secretary served schedule that the parties had jointly proposed on Aug. 20, 1993.
Nov. 10, 1994	BN filed appeal from the Secretary decision.
Nov. 16, 1994	McCarty filed a reply to BN's Nov. 7 petition to establish a procedural schedule.
Dec. 1, 1994	ICC Chairman denied the BN appeal of Nov. 10, 1994.
Dec. 8, 1994	BN filed an appeal to the Dec. 1, 1994 ICC decision denying its appeal of Nov. 10, 1994.
Jan. 19, 1995	BN file a motion to dismiss the complaints on the grounds that McCarty Farms had failed to make a prima facie case.
Feb. 13, 1995	ICC denies motion to dismiss complaints and ordering McCarty Farms to answer certain interrogatories and granting BN's appeal from the December 1 decision to the extent of providing an additional 30 days to file reply evidence. See 1995 ICC LEXIS 22 (Feb. 1, 1995).
March 29, 1995	BN files reply evidence.
May 2, 1995	ICC Secretary issues decision denying motion of BN to strike certain revised Stand Alone Cost (SAC) evidence and extending the due date for McCarty Farms' rebuttal.
May 11, 1995	BN appeals ICC Secretary decision of May 2, 1995.
May 23, 1995	BN files revisions to reply evidence.
June 13, 1995	ICC denies BN appeal of May 11, 1995. See 1995 MCC LEXIS 47 (June 1, 1995).
July 17, 1995	McCarty Farms files rebuttal evidence.
Aug. 16, 1995	Parties file simultaneous briefs.
Jan. 1, 1996	Pursuant to the ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803 (the ICCTA) the ICC was abolished and certain functions and proceedings transferred to the Surface Transportation Board (STB).
Aug 14, 1997	STB decides the case finding that under the application of the SAC test, the rates at issue do not exceed a maximum reasonable level. See McCarty Farms, Inc., et al. v. Burlington Northern, Inc., Surface Transportation Board Decision No. 37809, August 14, 1997.

PUBLIC VERSION

BEFORE THE

SURFACE TRANSPORTATION BOARD

DOCKET NO. EP 665 (SUB-NO. 1)

RAIL TRANSPORTATION OF GRAIN, RATE REGULATION REVIEW

REPLY VERIFIED STATEMENT

OF

GERALD W. FAUTH III

My name is Gerald W. Fauth III. I am President of G. W. Fauth & Associates, Inc., an economic consulting firm with offices at 116 South Royal Street, Alexandria, Virginia 22314. I previously submitted an Opening Verified Statement in this Surface Transportation Board (STB or Board) proceeding on June 26, 2014. A statement describing my background, experience and qualifications is attached thereto as Appendix GWF-1.

I have been asked by the National Corn Growers Association, Alliance for Rail Competition, Colorado Wheat Administrative Committee, Idaho Barley Commission, Idaho Grain Producers Association, Idaho Wheat Commission, Minnesota Corn Growers Association, Minnesota Farmers Union, Montana Farmers Union, Montana Wheat & Barley Committee, Nebraska Corn Growers Association, Nebraska Wheat Board, North Dakota Corn Growers Association, North Dakota Farmers Union, North Dakota Grain Dealers Association, Oklahoma Wheat Commission, Oregon Wheat Commission, South Dakota Corn Growers Association, South Dakota Farmers Union, South Dakota Wheat Commission, Texas Wheat Producer Board, Washington Grain Commission, Wisconsin Farmers Union, Wyoming Wheat Marketing Commission and U.S. Dry Pea & Lentil Council to submit these reply comments in this proceeding (ARC, et al.).

This proceeding concerns "what regulatory changes could be implemented to ensure that the Board's rate case procedures are fully accessible to grain shippers and provide effective relief from excessive freight rail rates, as appropriate."[1] The Board instituted this proceeding to seek "input from interested parties on grain shippers' ability to effectively seek relief for unreasonable rates, including proposals for modifying existing procedures, or new alternative rate relief methodologies, should they be necessary."[2]

GWF Opening Verified Statement

In my Opening Verified Statement, I described the many problems faced by grain and grain products shippers associated with the Board's current jurisdiction costing and rate reasonableness methodologies. I described how many grain and grain products shippers are disadvantaged by the STB's URCS make-whole adjustments and the unadjusted URCS jurisdictional costing approach (which drives many R/VC ratios below 180% and beyond STB jurisdiction). I described how grain and grain products shippers are also harmed by the STB's recently adopted "Limit Price" approach, under which the issue R/VC ratios may need to exceed the STB's published "RSAM" percentages (which range from 216% to 362%) in order for the Board to find market dominance.[3] These jurisdictional hurdles make it very difficult for the vast majority of railroad grain and grain products shippers to get in the STB's door in order to utilize its rate reasonableness guidelines.

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[1] STB Docket No. 665 (Sub-No.1), Rail Transportation of Grain, Rate Regulation Review, served December 12, 2013, page 2.

[2] *Ibid.*

[3] See STB Docket No. NOR 42121, Total Petrochemicals & Refining USA, Inc. v. CSX Transportation, Inc., served May 31, 2013 and updated August 19, 2013.

Given the uniqueness of agricultural transportation, the Board opened this proceeding to develop a rail rate challenge process that works for agriculture rail transportation. USDA, NGFA and ARC have shown in their Opening Comments that there is not a single rail rate challenge process that works best for all shippers under all circumstances. In regard to the STB current railroad rate reasonableness methodologies, I described how the STB's Full-SAC and Simplified-SAC tests are not viable options for most grain and grain products shippers (and most non-coal shippers) and the many problems associated with the simpler and cheaper Three-Benchmark test.

In response to the Board's request, I suggested several "regulatory changes" to the Board's current methodologies and procedures which would help "ensure that the Board's rate case procedures are fully accessible to grain shippers and provide effective relief from excessive freight rail rates, as appropriate." For example, I suggested that the STB could develop Grain Cost Adjustment Factors (GCAF), which would be "*better tailored*" to grain and grain products movements and would account for the efficiencies in the form of lower than average switching costs, lower than average car costs, and higher than average train sizes associated with most grain and grain products movements. I also suggested that the Board consider potential modifications to the Three-Benchmark test which could potentially improve the application the Three-Benchmark test for grain and grain products shippers:

- Allow for the use of similar non-defendant rail traffic in the R/VC_{COMP} groups; and
- Allow for the use of similar R/VC<180% traffic in the R/VC_{COMP} groups.

In addition to proposed modifications to the STB's existing costing and rate reasonableness methodologies and procedures, I suggested potential "new alternative rate relief methodologies" which the STB could consider.

Because of the problems associated with the application of the RVC_{COMP} component of the Three Benchmark test to railroad movements of grain and grain products, I also suggested that the STB should consider the use of a Two Benchmark test using the other components of the Three-Benchmark test, i.e., the RSAM and $RVC_{>180}$ percentages, for grain and grain products, for cases involving railroads that are revenue adequate.

Since railroad service is critically important to grain and grain products shippers (many of which face short seasonal growing and rail shipping periods) and since many grain and grain products shippers have recently experienced a combination of deterioration of rail service and an increase in costs and rail rates, I proposed that the STB should also consider limiting future rate increases on grain and grain products based on established performance standards, even if a railroad has not yet been found revenue adequate.

Since exports are also important to many grain and grain products shippers and there is a recognized economic relationship between grain prices and grain exports (i.e., when grain prices decrease, exports increase), I also suggested that a methodology which promotes exports via lower export rail rates would benefit grain and grain products shippers and the railroads and be in line with President Obama's 2010 National Export Initiative.

Opening statements were also submitted by the U.S. Department of Agriculture (USDA), National Grain & Feed Association (NGFA), Association of American Railroads (AAR), BNSF Railway Company (BNSF), CSX Transportation, Inc. (CSX), Norfolk Southern Railway Company (NS) and Union Pacific Railroad Company (UP). I have been asked to review these opening statements and submit these reply comments concerning the statements and proposals set forth therein.

USDA's Opening Statement

USDA submitted an Opening Statement in this proceeding. I agree with many of the points made by USDA. USDA points to the success of The Staggers Act of 1980, which has enabled the four major Class I railroads to achieve "returns on revenue and operating revenues that make them among the most profitable businesses in the country." (USDA, page 2) USDA points out that the "railroad industry has been investing record amounts into much needed capital projects" and " have been able to double dividend payments and spend billions to repurchase their stock." (USDA, page 2).

Despite the dramatic financial improvement of the railroad industry, USDA states that "most agricultural shippers continue to be left with no practically accessible means to challenge rail rates, much less seek redress." (USDA, page 2) USDA emphasizes an area which is important to grain producers and farmers. As indicated in my Opening Verified Statement (GWF, page 7), although grain producers and farmers are economically impacted by high rail rates, they may not be considered as the "shipper" and thus may not know whether they access to the STB's rate procedures. USDA states that "It is well established that transportation costs can have a direct impact on agricultural producers' profits, but the producer's ability to appeal rates has been limited." (USDA, page 4). USDA states that "the rate challenge processes proffered by all parties in this proceeding should seek to be inclusive of both grain elevators and agricultural producers." (USDA, page 4).

USDA maintains that "None of the current rail rate appeals procedures are suitable for agricultural shippers." (USDA, page 6). As a result, USDA "believes a new approach is necessary and warranted, and should be explored." (USDA, page 2) USDA states that "Agricultural shippers need specially designed rail rate challenge procedures." (USDA, page 4)

USDA does not propose a new approach, but instead offers "*concepts*" for potential consideration. These "concepts" include: an approach which incorporates railroad revenue adequacy; the facilitation of "group action and state involvement"; and mediation and arbitration. If a railroad is revenue adequate, USDA believes "the Board should take this into account in conjunction with whatever new mechanisms it establishes for agricultural shippers." (USDA, page 9)

In my Opening Verified Statement, I suggested that the STB should consider the use of a Two Benchmark test using the other components, i.e., the RSAM and $RVC_{>180}$ percentages, for grain and grain products, for cases involving railroads that are revenue adequate. I believe that such a simplified rate reasonableness approach would be in line with the USDA's revenue adequacy concept.

USDA suggests the Board "could also amend its rate challenge procedures in order to facilitate groups of agricultural producers, groups of elevators, or State Attorneys General to act on behalf of agricultural producers in that State. Such collective action would increase the ability of individual shippers to access the Board's rate challenge procedures, who might otherwise not be able to initiate such a challenge due to the prohibitive costs faced by a single shipper." (USDA page 10). The Reply Verified Statement of Terry C. Whiteside describes the difficulty in bringing about such "group action and state involvement" based on his direct experience in working with the State of Montana and other states and groups over the years. The Board should therefore do what it can to facilitate regulatory recourse by groups and states on behalf of producers and shippers whose small size makes individual rate challenges almost impossible.

In terms of USDA's "private-sector mediation and arbitration" concept, USDA points to examples of arbitration systems that already exist, i.e., NGFA's rail arbitration system and the Montana-BNSF mediation/arbitration system. (USDA, page 10). Although USDA describes the limitations associated with these systems and the railroads' reluctance to arbitrate rates, USDA maintains that "Nevertheless, they serve as good examples of how such systems can effectively resolve disputes and foster good business relationships." (USDA, page 10). USDA recommended in its opening comments support for private-sector mediation and arbitration, based upon the criteria of fair, easily understood, accessible, and affordable. The STB and the shippers will have to encourage railroads to participate in most rate dispute resolution methodologies

The NGFA's arbitration system has been used to arbitrate many disputes between NGFA's members over the years and has established a foundation in the successful use in non-rate disputes between NGFA members and railroads. The Montana rate arbitration system referenced by USDA (which does apply to rates) has been applied to a wheat movement in Montana. A copy of a letter from former Montana Attorney General Steve Bullock to BNSF, which expressed concerns about the Montana railroad rate arbitration system, is attached hereto as Reply Appendix GWF-1.

A more tested railroad rate arbitration system is the Canadian Final Offer Arbitration (FOA) system, which provides a means of resolving rate and service disputes through the use of an arbitrator or a panel of three arbitrators. Under the Canadian system, unless the parties agree to a different time frame, arbitration must be completed within 60 days, or 30 days for disputes involving freight charges of less than $750,000 (Canadian).[4]

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[4] https://www.otc-cta.gc.ca/eng/publication/final-offer-arbitration1

In reply comments filed on August 20, 2014, Texas Trading and Transportation Services, LLC, (TTMS Group), together with the Montana Grain Growers Association (MGGA) (a newly-formed group that includes a former BNSF employee responsible for grain transportation and two persons active with Montana Grain Growers Association) states that the NGFA rail arbitration process should be "reviewed and proposals submitted to make it mandatory and viable for general agriculture rail rate and service oversight. Within or without the NGFA, replication of these key elements is crucial." (TTMS/MGGA Reply Comments, page 10). It is possible that the NGFA arbitration system could be expanded and used as an alternative to a FOA approach. However, it is doubtful that railroads would accept any rate arbitration approach so long as captive grain shippers and producers have no effective litigation option. In addition, the system would have to be significantly expanded to include farm producers, many of whom are not NGFA members. Making arbitration mandatory likely would require legislation and Congressional and Presidential approval.

AAR's Opening Statement

AAR's opening statement provides "an overview of how grain markets vary across commodity type and over time." (AAR, page 2) AAR "explains how grain transportation markets must be resilient to respond to market demand." (AAR, page 2) AAR uses the recent changes in the corn market as an example. AAR sets forth the "principle that demand-based differential pricing is necessary and benefits all shippers that use the rail network." (AAR, page 2) In other words, AAR maintains that high railroad grain and grain products rates are good for everyone!

Contrary to the Board's request in this proceeding for proposals concerning "what changes could be implemented to ensure that the Board's rate case procedures are fully accessible to grain shippers and provide effective relief from excessive freight rail rates, as appropriate," AAR does not provide any suggestions on ways to improve the STB's current tests (e.g., Full-SAC, Simplified-SAC and Three-Benchmark) nor does AAR propose a new methodology. AAR states that "Any policy changes that would have the effect of artificially cutting rail earnings would severely harm railroads' ability to reinvest in their networks, inhibit capacity growth, and degrade rail service." (AAR page 21) In other words, AAR believes that no changes are necessary.

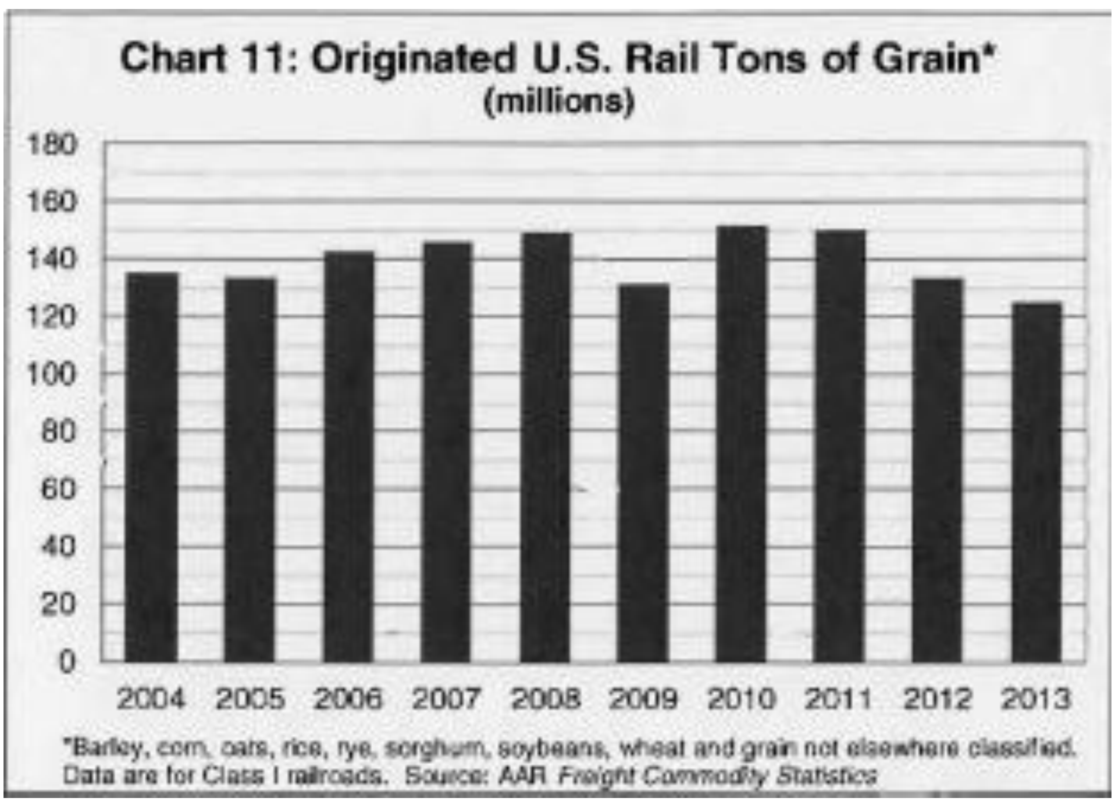
As justification for the status quo, AAR describes a complex and volatile U.S. grain market. AAR states that "what crops are grown, where, and in what quantities, and how, when, and to where they are transported, is determined by a complex interaction of factors." (AAR page 3). These "complex" interacting factors include "weather and soil conditions, but also a complicated interplay of many groups- including farmers, various transportation modes and providers, elevator operators, grain marketing companies, grain consumers large and small (both in the United States and abroad), as well as local, national, and foreign governments." (AAR page 3). AAR states that "many aspects of the grain market are marked by pervasive volatility." and cites recent changes in the corn market as an example. (AAR page 4 and 5). AAR claims the "forecasting" crop sizing and "timing" add to the complexity. (AAR page 6). AAR also notes that grain exports can "fluctuate sharply" and "vary tremendously." (AAR page 6).

While it may be true that some aspects of the grain market are complex and some may be marked by volatility during certain seasonal and historical periods, the grain *railroad transportation* market is far less complex and volatile and far more voluminous and predictable.

The railroads serve a limited number of grain origins and destinations and the majority of the grain traffic moves from a relative hand-full of high-volume 110-car shuttle elevators and moves to a relatively small number of large grain destinations. Railroad shipments are pre-arranged with scheduled service. The railroads have a good sense of how much grain to expect from the rail origins they serve. In fact, some grain moves under contracts, some of which are likely to contain annual volume commitments. The annual fluctuation of railroad grain traffic from each origin may be limited to a single train or a small number of additional or fewer trains or shipments per year. Railroad grain volumes obviously fluctuate from year to year, but have remained at consistently high levels for many years as demonstrated by AAR's Chart 11(e.g., well over 120 million tons each year):

Table 1

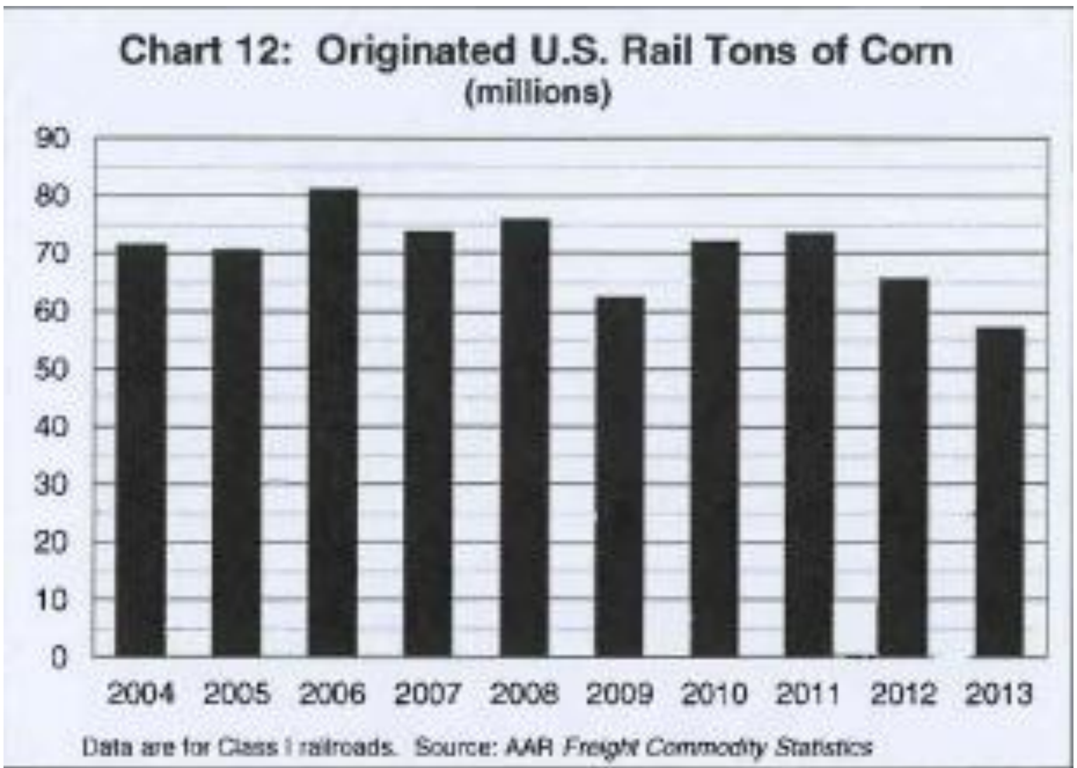
<u>AAR's Chart 11</u>



AAR's Chart 11 does not look like a complex and volitale rollercoaster ride described in AAR's comments. As a example of volatility in the grain transportation market, AAR cites recent changes in the corn market resulting from the market increase, shift and emphasis on ethanol movements. The market shift to ethanol was dramatic and likely contributed to a reduction in corn tons originated by rail. However, as AAR's Chart 12 shows, the railroad corn volumes still remain very high and will likely level off in the near future:

Table 2

<u>AAR's Chart 12</u>

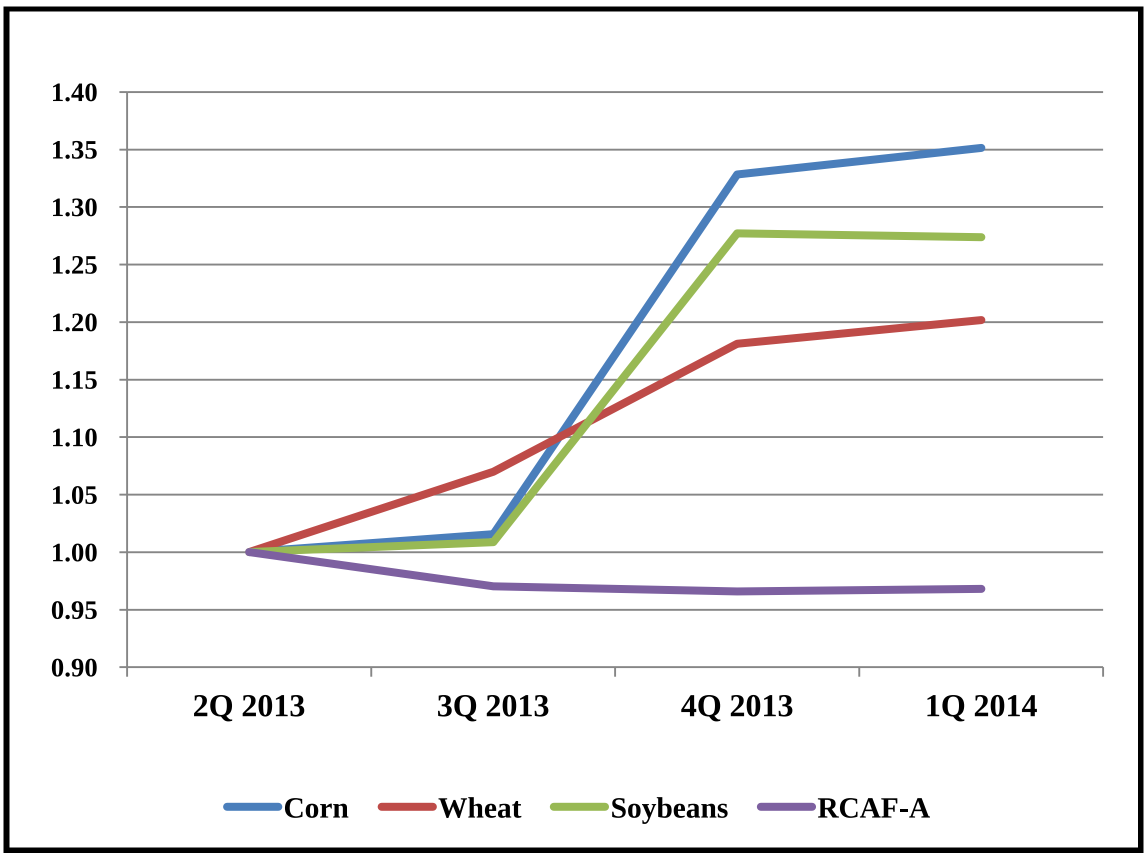


AAR's points to a "Declining market share" (mostly caused by the increase in corn for ethanol movements) as "strong evidence that market participants generally have competitive options, and that railroads do not possess excessive market power with regard to grain shipments." (AAR, page 8)

Despite the suggested increase in competition and purported lack of market power, while the railroads' market share may have decreased, railroad rates on grain have steadily increased in the last ten years (see AAR Chart 18). Witness Terry Whiteside also describes railroad grain rate increases in recent years. Based on the most recent data reported to and available from the STB, railroad grain rates have significantly increased in the last two quarters (4Q 2013 and 1Q 2014 Freight Commodity Statistics). This is illustrated in the following graph, which compares recent increases in BNSF's revenue per ton carried for corn, wheat and soybeans with the change in the STB's Rail Cost Adjustment Factor, Adjusted (RCAF-A) (2Q 2013 = 100):

Table 3

Recent Increases in BNSF Grain Rates Per Ton Carried



AAR also fails to point out that while railroad corn volumes and revenues have decreased in recent years, this decrease has been offset by significant increases in railroad ethanol volumes and revenues, which are generally more profitable than corn movements. For example, the STB's 2012 Expanded Stratification report indicates that railroad jurisdictional corn movements STCC 01-132) have an average R/VC ratio of 216% compared to 237% for jurisdictional alcohol movements (STCC 28-184, which included ethanol) in tank cars.

In summary, the railroad grain transportation market is far less complex and far less volatile than the market portrayed by AAR. In fact, the railroad grain and grain products transportation market is fairly consistent, voluminous and very profitable for the railroads.

BNSF's Opening Statement

BNSF's Opening Comments do not provide any suggestions on ways to improve the Board's existing procedures nor does it propose a new alternative rate relief methodology. Like AAR, BNSF maintains that no changes are necessary.

BNSF states that it "hauls more grain than any other U.S. Class I freight railroad." (BNSF page 2). BNSF is being modest. BNSF, in fact, dominates the Class I railroad movement of grain. In 2013, BNSF handled over 48 million tons of wheat (22 million tons), corn (17.9 million tons) and soybeans (9.5 million tons), which generated $1.86 billion in railroad freight charges.[5] In comparison, the next largest Class I railroad, UP, handled only 29 million tons of wheat, corn and soybeans in 2013, which generated approximately $1 billion in revenue.[6] BNSF also dominates key grain production areas, such as railroad movements of wheat from Montana

[5] BNSF 2013 Freight Commodity Statistics
[6] UP 2013 Freight Commodity Statistics

and corn and soybean movements from the Upper Plains, and the key export grain markets, such as corn, soybeans and wheat movements to Asia via the export grain terminals in the Pacific Northwest (PNW). This is demonstrated by BNSF's Exhibit FTI-4, which shows BNSF "predominant" grain traffic flows.

Despite BNSF's domination of the railroad grain transportation market, BNSF states that it "does not charge unreasonably high rates on grain movements." (BNSF page 2). In other words, BNSF claims to be a benevolent monopolist which does not take advantage of its market dominance over railroad grain movements. Included as Appendices GWF-3 and GWF-4 in my Opening Verified Statement are tables which list numerous corn and wheat records of railroad movements included in the 2012 Confidential Waybill Sample with R/VC ratios in excess of 300%. Many of the listed corn movements and most of the listed wheat movements are BNSF movements. These tables demonstrate that BNSF is not always so benevolent and that there are many instance in which BNSF charges railroad grain rates which generate very high and profitable R/VC ratios.

BNSF statement that it "does not charge unreasonably high rates on grain movements" cannot be tested, however, since there are no effective STB rate reasonableness methodologies for grain shippers to use in order to demonstrate that the rates are unreasonable. Certainly, very few, if any, grain movements could pass the STB's Full-SAC and Simplified-SAC tests and the Three-Benchmark test has a very limited potential for grain shippers. BNSF maintains that "the lack of grain rate litigation signifies that there is not a problem with grain rates." (BNSF page 2) The lack of a simple and effective STB rate reasonableness methodology for grain shippers is the primary reason for the lack of grain rate litigation.

As Appendices GWF-3 and GWF-4 demonstrate (which list railroad corn and wheat movements with R/VC rations of 300% or more), there is no lack of potentially unreasonable railroad grain rates.

BNSF states that the "real issue" is "the ability of railroads to provide sufficient capacity to move grain to market in a timely manner." (BNSF page 2). BNSF cites the STB's EP 724 (Sub-No.2), United States Rail Service Issues – Grain, as evidence of this fact. Although it may not be the "real issue," the "ability of the railroads to provide sufficient capacity to move grain to market in a timely manner" is a serious and important issue to grain and grain products shippers and producers.

As indicated in my Opening Verified Statement, railroad service is critically important to grain and grain products shippers, many of which face short seasonal growing and rail shipping periods. Grain and grain products shippers have recently experienced a combination of deterioration of rail service and an increase in costs and rail rates.[7] In a recent decision in STB Docket No. EP 724 (Sub-No. 2), served June 20, 2014, the STB required BNSF and CP to file reports and plans to resolve the backlog of grain car orders on its network. Rail capacity on BNSF, the largest grain hauler (and on CP, also a large grain hauler), has tightened as a direct result of a significant increase in Bakken crude oil shipments, primarily from North Dakota.

As can be seen from the following graph, in three (3) short years, the number of BNSF originated corn, wheat and soybean carloads has been surpassed by originated oil and sand carloads:

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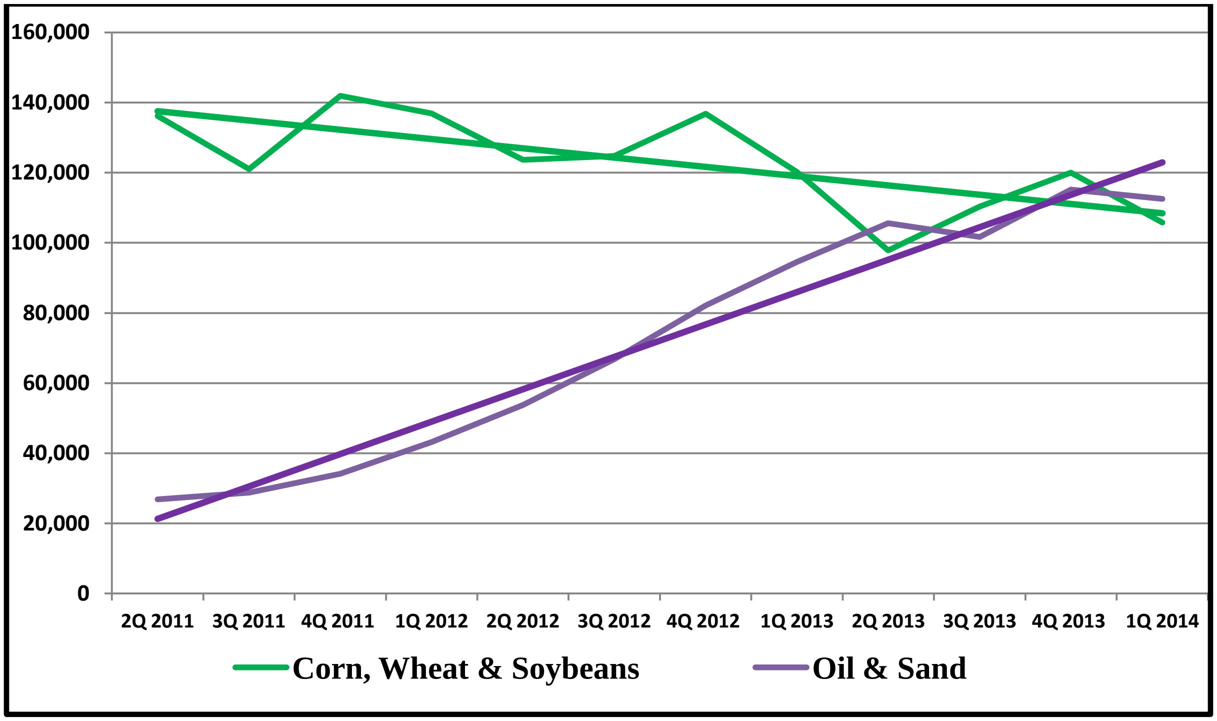
[7] See, for example, http://www.jsonline.com/business/slow-trains-delay-great-plains-grain-b99270987z1-259664221.html and http://online.wsj.com/news/articles/SB10001424052702303480304579579652612482622

Table 4

BNSF Originated Carloads Per Quarter of
Corn, Wheat and Soybeans Compared to Oil and Sand[8]



BNSF's capacity will continue to tighten as a result of an increase in profitable and voluminous Bakken oil shipments. Moreover, BNSF's capacity will likely become significantly constrained as export coal movements to the PNW continue to increase. It appears likely that two new major export coal terminals in Washington (Cherry Point, near Bellingham, WA and Longview, WA) may be approved in the not too distant future, which could result in over 100 million tons of coal moving over BNSF's lines from the PRB to the PNW. Additionally, there are several proposed oil terminals in the PNW that appear to be on a fast track for loading Bakken oil. These are the same lines used for the majority of BNSF export grain movements via PNW export grain terminals.

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[8] Based on BNSF's Quarterly Freight Commodity Statistics reports to the STB.

BNSF maintains that "*capacity*" is the real issue, but it ignores the economic relationship between railroad rates and capacity. With the recent dramatic increase in profitable oil movements and the expected increase in proposed export coal movements to the PNW, BNSF capacity will continue to tighten. If there is no effective regulation, it is likely that rail rates for the remaining capacity will increase, especially for railroad grain and grain products movements over the same lines.

BNSF indicates that it has invested billions in order to improve capacity for grain shippers. For example, BNSF cites approximately $600 million in its 2014 capital budget for terminal and line expansion projects in the northern corridor "where the majority of BNSF's grain traffic moves" and its plans to hire 5,000 new people, many of whom will be dedicated to the northern corridor. (BNSF page 17) While grain shippers may eventually receive some residual benefits associated with BNSF's improvements and increased hiring, the improvements have been primarily designed to facilitate the anticipated increase in movement of profitable and voluminous Bakken oil shipments and the proposed increase in export coal movements to the PNW and not designed to improve railroad grain service.

In the meantime, the BNSF system delays associated with the maintenance and improvements work will only result in more delays and added costs for grain and grain products shippers. As indicated in the Reply Verified Statement of Terry Whiteside, BNSF's average train speed for grain trains has been consistently lower than average and been dropping in the last year. The average grain train speeds will likely not significantly improve for many years.

The strains on BNSF's capacity have already resulted in added costs for grain shippers. BNSF maintains a Certificate of Transportation (COT) program, which it maintains "allows" customers "to bid for covered hopper cars according to a weekly schedule, subject to availability." According to BNSF, the COT system provides customers with "a car placement date guarantee" and a "rate-lock" option. COT car reservations are awarded to the highest bidders and require a nominal pre-payment. BNSF says the COT program is "the most frequently used way for BNSF Agricultural Products shippers to reserve cars in advance," the COT has "built in flexibility for the COT holder," and COTs can be bought or sold in a "secondary market." BNSF participates in the primary railcar market, but states that it "does not manage or participate in this secondary market."[9] In its Opening Statement, BNSF states that "BNSF does not share in any revenue from certificate sales on the secondary market. (BNSF page 13). UP has a similar system known as the Grain Car Allocation System (GCAS).[10]

Last year, prices in the secondary market began to skyrocket from near $0 to a high of nearly $6,000 per car for shuttle trains. This dramatic increase is illustrated in the following table:

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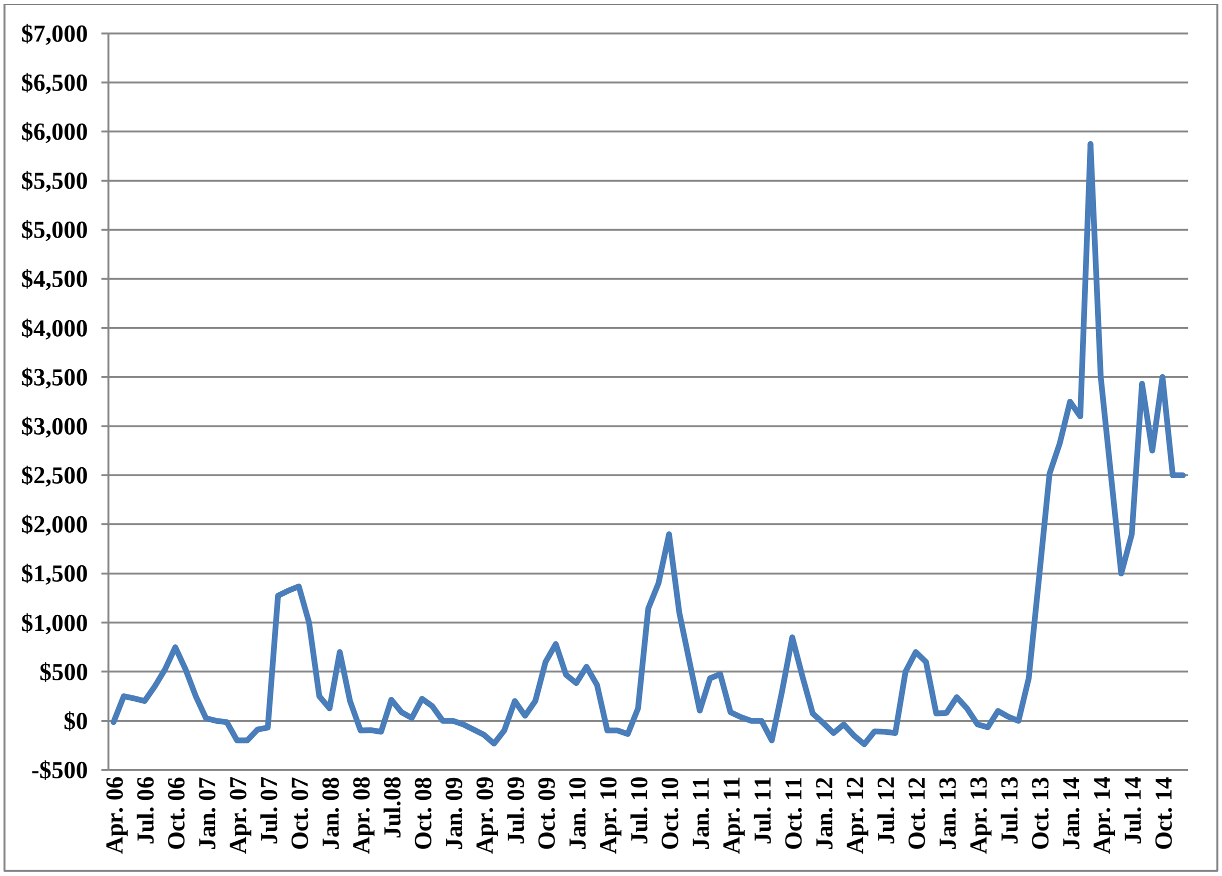
[9] http://www.bnsf.com/customers/what-can-i-ship/grains-feed/faq.html

[10] https://www.uprr.com/customers/ag-prod/gcas/index.shtml

Table 5

BNSF Maximum Shuttle Bids in the Secondary Market



According to USDA, bids in the *primary* railcar market have also been trading at historic highs since late May, 2014 for guaranteed railcar placement for grain shipments in August, September, and October. Bids for the week ending July 17 ranged between $2,700 and $3,200 per car for BNSF's guaranteed grain car placement in September and between $2,800 and $3,000 per car for placement in October. In the previous 10 years, there was very little monthly trading and bids rarely exceeded $700.[11]

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[11] http://www.ams.usda.gov/AMSv1.0/getfile?dDocName=STELPRDC5108470

Although BNSF states that it does not share in any revenue from certificate sales on the secondary market, BNSF Witness William D. Wilson acknowledges that "from the shipper's perspective, the total cost of transportation, which includes BNSF's tariff rate plus the additional cost paid by the shipper in the secondary market for the certificate, will have increased during these periods of high demand per car." Witness Wilson states that "the purchase of rail cars in the secondary market is not a function of the rates charges by the railroad and not a source of income to the railroad." (BNSF Wilson opening VS at 28)

Witness Wilson fails to mention that the purchase of railcars in the primary market *is* a source of income for the railroad. The following table demonstrates the impact that these record high primary prices could have grain shippers and producers:

Table 6

Example of the Impact of the Recent Increase in
Primary COT Prices on BNSF Shuttle Train Profitability

Ln.	Item	Wheat	Corn
1	Railroad	BNSF	BNSF
2	Origin	Marion, SD	Marion, SD
3	Destination	Rivergate, OR	Rivergate, OR
4	Miles	1,749	1,749
5	Fuel Surcharge Miles (to Seattle)	1,698	1,698
6	Cars Per Shipments	110.00	110.00
7	Tons Per Car	111.00	111.00
8	Total BNSF Unadjusted URCS Variable Cost	$3,100.00	$3,100.00
9	BNSF Unadjusted URCS Car Cost	$360.16	$360.16
10	BNSF Unadjusted URCS - Other Costs	$2,739.84	$2,739.84
11	BNSF Rate Per Car	$5,240.00	$4,674.00
12	BNSF Fuel Surcharge Per Mile	$0.36	$0.36000
13	BNSF Fuel Surcharge Per Car	$611.28	$611.28
14	BNSF Total Jurisdictional Revenue Per Car	$5,851.28	$5,285.28
15	BNSF Jurisdictional R/VC Ratio	188.75%	170.49%
16	BNSF Primary COT Price	$3,000.00	$3,000.00
17	BNSF COT Pre-Pay	$200.00	$200.00
18	BNSF Adjusted Primary COT Price	$2,800.00	$2,800.00
19	BNSF Total Adjusted Revenue Per Car	$8,651.28	$8,085.28
20	BNSF Adjusted R/VC Ratio	279.07%	260.82%

As can be seen, if BNSF's revenues are properly adjusted upward to include BNSF's Primary COT price (see lines 16 – 19), the R/VC ratios for these movements of wheat and corn from Marion, SD to Rivergate, OR would increase from levels near (188.75%) or below (170.49%) STB jurisdiction (see line 15) to levels far above 180% and well above BNSF's RSAM level of 217% (279.07% and 260.82%) (see line 20).

As can be seen from this example, the record primary COT prices (which excludes the additional secondary market prices paid by grain shippers) significantly increases the R/VC ratio and BNSF's profits. Since URCS reflects all car costs incurred by the railroads, these added primary car prices, like fuel surcharges, should be added to the freight rate when calculating the jurisdictional R/VC levels and in the evaluation and determination of maximum reasonable rate levels. The STB should consider this fact in establishing an improved rate reasonableness approach for grain shippers. The STB should also consider requiring the inclusion of primary COT prices in the Waybill Sample data submitted by the railroads in order to more accurately reflect the profitability of the movement.

UP's Opening Comments

UP's Opening Comments describes UP's grain traffic, grain origins and destination markets, grain handling, grain pricing and grain transportation alternatives. The descriptions of UP's grain traffic and marketplace, like AAR's and BNSF's Opening Comments, are generally not responsive to the Board's request for suggestions on ways to improve the Board's existing rate reasonableness procedures or a proposal for a new alternative rate relief methodology. Like AAR and BNSF, UP maintains that the Board "should not adopt special rate case procedures for grain shippers" and that the "Board's existing rules provide ample opportunity for grain shippers to pursue rate relief." (UP page 19). UP maintains that "Grain shippers could also obtain relief under these methodologies - if their rates were set at unreasonable levels." (UP page 19). Like BNSF, UP maintains that "grain shippers are not filing rate complaints because their rates are reasonable." (UP page 20)

Appendices GWF-3 and GWF-4 in my Opening Verified Statement are tables which list numerous corn and wheat records of railroad movements included in the 2012 Confidential Waybill Sample with R/VC ratios in excess of 300% of the listed corn movements and wheat movements are UP movements. There are thus many instances in which UP charges railroad grain rates which generate very high and profitable R/VC ratios. Although many of these R/VC ratios are very high, it is ridiculous to assume that any of these UP grain rates could be challenged by a single shipper in a rate reasonableness case utilizing the STB's Full-SAC or Simplified-SAC methodologies.

As indicated in my Opening Comments, there are several problems associated with the Board's Three-Benchmark test which make it very difficult, if not nearly impossible, for most grain shippers to obtain meaningful rate relief under that standard.

NS's Opening Comments

NS's Opening Comments urge the Board to "keep in mind two fundamental principles of its rate reasonableness methodology: any determination of the reasonableness of a rail rate must consider a particular rate for a movement over a particular lane, and any test for rate reasonableness must reflect sound railroad economics." (NS page 2) NS states that "The Board should not take any further steps away from grounding its regulatory policy and authority in sound economic theory here." (NS page 7) NS maintains that "Any rate reasonableness challenge must begin by specifying a particular rate for a particular movement from origin to destination." (NS page 3)

NS provides and overview of the grain market which it admits is "simplistic and incomplete." (NS page 13). NS states that grain transportation is "Not Homogenous" and that "Grain transportation needs, options, and experiences can and do vary widely." (NS page 8). NS maintains that "traffic flows vary widely among different grains and grain products and even within single commodities." (NS page 9). Certainly, there are differences among commodities, but there are also many important similarities in their railroad transportation characteristics. For example, most railroad corn, wheat, soybeans, barley and most other grain movements move in railroad covered hoppers and have similar loads per car. In most cases, the grain commodities do not require any special railroad handling and the railroad crews and locomotives moving the grain cars don't care if they are moving corn or soybeans, unlike a tank car movement which may contain a non-hazardous or a hazardous commodity. Many grain movements originate and terminate from locations which handle other grains, for example, an elevator in Montana may originate wheat and barley, an elevator in Illinois may originate corn and soybeans and export terminal may handle all grains.

Like AAR, BNSF and UP in their Opening Comments, NS does not provide any suggestions on ways to improve the Board's existing procedures, nor does it propose a new alternative rate relief methodology.

CSX's Opening Comments

In a relatively short Opening Statement, CSX generally describes its grain transportation market. CSX states that "Grain transportation is an important, although comparatively modest, market for CSXT. Over the past two years, CSXT has handled approximately 155,000 carloads of grain (corn, soybeans, and wheat) per year, which constitutes approximately 40% of CSXT's Agricultural Products market." (CSX page 1).

CSX, like AAR, BNSF, UP and NS, fails to provide any suggestions on ways to improve the Board's existing procedures nor does it propose a new alternative rate relief methodology.

In fact, CSX's Opening Comments do not even mention the Board's rate reasonableness guidelines and CSX admits that its Opening Comments are merely a "restatement" of comments it made in another STB proceeding nearly 8 years ago. (CSX page 1).

NGFA's Proposed New ACMRM Approach

NGFA has proposed a new methodology based on the application of Revenue Adequacy Adjustment Factors (RAAF) to grain and grain products traffic included in the STB's Confidential Waybill Sample records by 5-digit Standard Transportation Commodity Code (STCC). NGFA's approach, which it has named the Ag Commodity Maximum Rate Methodology or ACMRM, is similar in some respects to the STB's RVC_{COMP} test, in that it would rely on the STB's Confidential Waybill Sample and involve the evaluation of similar traffic (i.e., same 5-digit STCC) moving a similar distance (i.e., plus or minus 20%).

NGFA's proposed new methodology appears to be economically sound and is a logical and interesting approach. The Board should give it serious consideration.

NGFA's comparison groups would include all other railroad movements and thus would not be limited to the defendants R/VC>180 traffic. In my Opening Verified Statement, I proposed a modifications to the Three Benchmark approach which would allow for the inclusion of non-defendant traffic and non-jurisdictional traffic (i.e., R/VC<180%). These proposed modifications are built into NGFA's proposed methodology.

Under this approach, comparability would be based on the following factors (Witness Crowley, page 6 and 7):

NGFA Comparability 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

5. **Movement Type** – Movements included in the comparison group will have the same movement type as the issue movement as defined by the 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) and Unit Train Movements (fifty (50) or more freight cars).

These comparability factors are straightforward and logical and would capture most of the comparable rail movements included in the waybill sample. The use of the proposed comparability factors would eliminate arguments over what movements would be included in the comparison groups and result in a more simplified and straightforward methodology.

In connection with its proposed new rate reasonableness approach, NGFA has also proposed a revision of the STB's revenue adequacy determination for the Canadian National Railway (CN) and Canadian Pacific Railway (CP). Currently, in the determination of the tax adjusted ROI for CN and CP, the STB only uses the values (such as net railway operating income and net rail assets) reported by CN and CP for their U.S. operations and not the values for their entire and vast North American systems. Such a policy change should result in more accurate ROI calculations and preclude CN and CP from playing financial games by shifting revenues, expenses and investments between its U.S. and Canadian carriers.

TTMS/MGGA states that if NGFA's proposal is adopted it "would result in a significant earnings loss to the railroads from agriculture. The result? A material de-marketing of agriculture investment by the railroads, resulting in a long-term deterioration of railroad service. Look no further than north to Canada." (TTMS/MGGA Reply Comments, page 9). In looking north to Canada, I see that CN recently reported record earnings and CP's stock price recently hit a record high.[12]

Proposed Grain Cost Adjustment Factors (GCAF)

In my Opening Verified Statement, I proposed that the STB develop and adopt Grain Cost Adjustment Factors (GCAF) in order to account for the problems and issues associated with the URCS costing procedures and the Board's unadjusted URCS approach. I proposed that these developed GCAF factors would be applied to the STB's URCS Phase III Costing program for railroad movements of grain and grain products and which would more accurately reflect the fact that these movements generally have lower than system average switching, crew, locomotive, car and other costs. If properly developed and applied, such GCAF adjustments would increase the amount of grain and grain products traffic which would be potentially subject to STB rate jurisdiction.

[12] http://www.zacks.com/stock/news/144769/canadian-national-railway-hits-new-high-on-strong-q2-earnings - http://www.wkrb13.com/markets/359728/canadian-pacific-railway-limited-reaches-new-52-week-high-at-200-19-cp/

In support of the development and adoption of such GCAF adjustments, I note that the Opening Comments of the railroads include many references to the efficiencies associated with grain movements. For example:

- AAR – "Railroads offer a variety of rail service options (single car, multiple cars, trainload, or shuttle trains) to grain shippers, and data show a clear trend toward more efficient grain movement types." (AAR, page 11)

- AAR – "Large, more efficient long-hauls for grain drive down costs. The continuing trend toward such shipments is driven by competition and reflects market forces that call for grain transportation to be as efficient as possible." (AAR page 12)

- BNSF – "Since the enactment of the Staggers Act in 1980, rail grain operation have become much more efficient." (BNSF, page 8)

- BNSF - "The use of shuttle trains is now a major form of transportation on BNSF." (BNSF, page 8)

- BNSF – "The increase in shipment size resulted in more efficient operations and lower cost per unit of traffic shipped." (BNSF, page 8)

- BNSF – The COTs program introduced in 1988 "allows cars to be allocated more efficiently based on demand and also provides BNSF with information on expected future equipment needs to better plan for service during periods of high demand." (BNSF, page 12)

- BNSF – "The COT's and shuttle programs have led to significant improvements in the allocation of grain cars and the efficiency of grain transportation." (BNSF, page 13)

- UP – "Over the past 35 years, rail grain transportation has evolved to place much greater reliance on trainload service. This evolution was driven by marketplace demands to create a more productive and efficient transportation." (UP, page 7)

- UP – "Shuttles are therefore able to cycle back and forth between origin and destination very rapidly, which allows them to handle large amounts of grain quickly and efficiently." (UP, page 8)

- CSX – "CSXT's core feed grain business continues to grow and become more efficient." (CSX, page 7)

Analysis of Proposed Two- Benchmark Approach

Because of the problems associated with the application of the RVC_{COMP} component of the Three-Benchmark approach, I proposed in my Opening Verified Statement that STB should consider the use of a Two- Benchmark test using the STB-published RSAM and $RVC_{>180}$ percentages for grain and grain products cases involving railroads that are revenue adequate.

Since the STB develops and publishes the RSAM and $RVC_{>180}$ percentage for each Class I carrier, a Two-Benchmark test would be relatively easy to administer and would be especially appropriate for grain and grain products, which have problems with the RVC_{COMP} component of the Three-Benchmark Test. The following table shows the most current 4-year benchmarks published by the STB:

Table 7

Current STB 4-Year RSAM and RVC>180% Benchmarks

Railroad	4-Year RSAM	4-Year RVC≥180%
BNSF	217%	221%
CN U.S.	318%	260%
CP U.S.	362%	229%
CSXT	280%	265%
KCS	306%	243%
NS	283%	276%
UP	222%	233%

The railroads may argue that such a simple Two-Benchmark test would result in the end of the world brought about by the downward "ratcheting" of rail rates, a return to revenue inadequacy and a lack of funding for capital improvements. In response to such a "chicken little" argument, it must be remembered that such a proposed Two- Benchmark test would be limited to:

- Revenue adequate railroads. Only BNSF, UP and NS currently appear to fall into that category, and they will probably argue that they are not "long-term" revenue adequate;

- Grain and grain products movements on revenue adequate railroads. (I have proposed the application of such a test to the commodities listed in the NGFA arbitration agreement, but the STB could further limit its use to a limited number of commodities or STCC codes.)

- Grain and grain products movements on revenue adequate railroads with R/VC ratios exceeding 180% (More likely, due to the STB's recently adopted Limit Price test, limited to movements with R/VC ratios exceeding the carrier's RSAM percentage, which range from 217% to 283% for the revenue adequate railroads.)

- Non-contract grain and grain products movements on revenue adequate railroads with R/VC ratios exceeding 180% or RSAM (While most grain rates move under published rates, some grain and grain products movements move under contract rates, which would not be subject to such a test.)

As a result of this very limited potential application, such a Two-Benchmark approach would have very little impact on a carrier's overall revenue adequacy or on its ability to make capital improvements.

In order to demonstrate the potential limited impact of a Two-Benchmark test on railroad revenues, I have prepared a stratification of BNSF's direct wheat movements included in the STB's 2012 Confidential Waybill Sample in the following table:

Table 8

Stratification of BNSF-Direct 2012 Wheat Movements

Ln.	Item	Cars	Tons	Revenue (000)	Variable Cost (000)	R/VC
1	R/VC<100%					
2	R/VC>100%<180%					
3	Total R/VC<180%					
4	R/VC<180% Percent					
5	RVC>180%<217%					
6	Total R/VC<217%					
7	R/VC<217% Percent					
8	RVC>217%<221%					
9	RVC>217%<221% Percent					
10	RVC>221%					
11	RVC>221% Percent					
12	Total RVC>217%					
13	RVC>217% Percent					
14	Total BNSF Direct Wheat					

In order for the STB to have jurisdiction over a rate and potentially be subject to a Two-Benchmark test, the R/VC ratio must exceed 180%. As can be seen (line 4), __% of BNSF's revenues from direct wheat movements have R/VC ratios below 180%. Based on the STB's new Limit Price approach, the R/VC ratio might have to exceed a carrier's RSAM percentage in order to be found market dominant. As can be seen (line 7), __% of BNSF's revenues from direct wheat movements have R/VC ratios below BNSF's 217% RSAM.

Therefore, the maximum BNSF wheat revenues which could potentially be impacted represent approximately __% of the total BNSF direct wheat revenues (line 13). If one assumes that *all* BNSF direct wheat movements with R/VC ratios in excess of BNSF's RSAM percentage (217%) are reduced to a 217% maximum level (a very unlikely scenario), the resulting maximum revenue reduction would be approximately $__ million per year or approximately $___ per carload. Aside from being unlikely, such a decrease in railroad revenues would not be unavoidable because there is no limit on rates or rate increases on traffic for which market dominance has not been found.

The *maximum* potential impact of the proposed Two-Benchmark would be minimal as some rates could decrease and some rates could increase. In reality, however, the actual economic impact would be very small since a shipper would have to file a rate complaint and establish market dominance to obtain rate relief, and the revenue adequate railroad could adjust its pricing on non-captive traffic with no fear of regulatory constraints. Moreover, any potential rate savings would be offset by litigation costs, which could be significant and play a role in the decision to file a complaint.

It should be noted that there are different ways to apply such a Two-Benchmark test. In my opening statement, I suggested an approach under which if the defendant's R/VC ratio exceeded the 4-year average $R/VC_{>180}$ benchmark, the STB could establish the rate at the RSAM level. The RSAM and $R/VC_{>180}$ levels could be used in assessing the maximum reasonableness of grain rates, which, upon successful challenge, should not exceed the RSAM level of a market dominant railroad that has reached revenue adequacy, so long as the defendant railroad's RSAM level is lower than its $R/VC_{>180}$ level.

In my opening statement, I also suggested that Grain Rail Performance Standards (GRPS) (or something similar) could be developed and maintained by the STB and incorporated into the grain rate reasonableness methodology. Under the STB's Managerial Efficiency Constraint, a captive shipper should not "pay more than is necessary for efficient service." Service delays and poor service should not be considered as "efficient service" under STB standards. The STB should consider limiting future rate increases on grain and grain products based on established performance standards, even if a railroad has not yet been found revenue adequate.

VERIFICATION

The foregoing statement is true and accurate to the best of my belief and knowledge.

Gerald W. Fauth, III

Subscribed and sworn to before me this twenty-second (22) day of August, 2014.

Notary Public

Howard E. Spratt
NOTARY PUBLIC
Commonwealth of Virginia
Reg. #362921
Com. Exp. July 31, 2017

My commission expires: 7-31-17

ATTORNEY GENERAL
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August 17, 2009

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Dear Mr. Nober & Mr. Kaufman:

Thank you for your visit to Montana to provide a copy of the arbitration agreement BNSF has reached with the Montana Grain Growers Association and the Montana Farm Bureau Federation (the "Agreement"). I appreciate your willingness to discuss the Agreement and BNSF service to Montana shippers.

Much has changed in the four-plus months between when BNSF entered into the Agreement and when you provided it to our office for discussion. Post-Agreement changes to the rate structure BNSF is charging to Montana producers, in tandem with base assumptions underlying the arbitration process, make it an unlikely avenue for providing meaningful relief for producers. These changes and assumptions have made it so that 60 percent of the grain shipped in Montana is ineligible for even passing consideration under the Agreement, and the 40 percent that would be eligible is limited in remedy to pennies on the bushel.

While the Arbitration has the potential to be a more streamlined process than a simplified rate case before the Surface Transportation Board, the changes appear to substantively diminish the availability of relief for producers. Specific concerns include:

1. **Eligibility.** The Agreement limits eligibility for relief to non-shuttle rates with revenue-to-variable cost (R/VC) ratios at or above 180 percent, and shuttle rates with ratios at or above 195 percent. Given the "market-based" criteria for determining rate reasonableness, these seem to be arbitrary floors for relief, although at least the 180 percent limit is consistent with existing law.

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2. **Inflation of Distance Traveled.** Relief under the Agreement is based on the ratio of the rate to the variable cost of the movement. However, the variable cost calculation uses a multiplier of 12.6 percent that artificially inflates distances above the actual mileage and routing for the movements at issue, according to BNSF's own published mileages.

3. **Change to Rate Structure.** Variable costs are also inflated by BNSF's recent decision--after the Agreement was signed--to limit non-shuttle loadings to a maximum of 48 cars. This is a curious decision, because it is my understanding that almost all non-shuttle facilities in this state were designed for 52 cars or more.

   Loading only 48 cars at Montana's 52-car grain elevators is plainly inefficient for BNSF and shippers alike, and has no apparent cost justification. The change treats grain loaded at 52-car elevators as if it incurs the high costs of "multiple" car movements containing as few as six cars, regardless of whether BNSF actually moves that grain to market as more efficient unit trains.

4. **Relief.** The Agreement limits relief to a window of fourteen months before and one year after the date of any award, and it excludes fuel surcharges. This short window for relief may discourage shippers from disputing all but the most unreasonable rates. There will still be significant costs involved in bringing a rate arbitration, and those costs are exacerbated by exposure to arbitrator and administrative fees if the arbitration panel, acting under the vague rate reasonableness factors, does not award relief. Moreover, the bar to relief where "a truck rate no higher than the contested rail rate is available," a separate factor from "existence of competitive alternatives," ignores whether trucking is a feasible alternative for the shipment volumes at issue, and whether the truck rate is only comparable because the rail rate is unreasonably high.

Unless I am missing something, these features of the Agreement all operate to the advantage of BNSF, making meaningful rate relief unavailable to the vast majority of Montana producers. Based on current rates and the most recent available shipping volumes and costs, and without BNSF's 48-car maximum, our review indicates that 75 percent of grain shipped would be eligible for rate reasonableness review at the STB, with a maximum annual potential overcharge of $30 million above the 180 percent R/VC jurisdictional threshold. However, only 39 percent of Montana grain shipped qualifies for arbitration under the Agreement's methodology, and the potential for rate relief is just $4 million. In practical terms, even if producers brought successful cases, this translates into little more than a few cents per bushel for the minority of producers who may qualify.

Worse, the Agreement and the new 48-car tariffs will allow rates to rise further still--several hundred dollars per car--with no possibility of review under the Agreement. Apparently, BNSF plans to do exactly that with its August 2009 and January 2010 rate increases. Thus, rather than giving producers a means to change rates to make them reasonable, it appears that the Agreement changes the meaning of reasonable to accommodate BNSF's current and future rates.

These are the principal, but certainly not only, concerns about the Agreement. At the end of the day, I want to ensure that every Montana producer's grain moves to market at reasonable rail rates. Arbitration should provide a cost-effective process to resolve rate disputes, but not at the expense of fair results consistent with shippers' legal right to reasonable rates. The Agreement's provision for producers to challenge directly the rates that they bear through grain elevator service is a step in the right direction, but other provisions fall short of affording meaningful relief from excessive rates for Montana grain shipments.

I remain committed to every possible means of enforcing BNSF's legal duty to provide reasonable rates for Montana shippers. And while the Department of Justice may assist producers and producer organizations who might consider mediation or arbitration under the Agreement despite its shortcomings, the Agreement cannot be expected to resolve Montana producers' rate issues. I will continue to support other efforts to level the playing field for Montana shippers, including federal legislation to repeal the railroads' special antitrust exemption and reform the Surface Transportation Board's rate relief process.

Thank you, again, and I look forward to working with you toward more reasonable rates for Montana producers.

Sincerely,

STEVE BULLOCK
Attorney General

sb/acj/bjh