Anthony J. LaRocca
202 429 8119
alarocca@steptoe.com

1330 Connecticut Avenue, NW
Washington, DC 20036-1795
202 429 3000 main
www.steptoe.com

Steptoe
STEPTOE & JOHNSON LLP

236508

ENTERED
Office of Proceedings
August 25, 2014
Part of
Public Record

August 25, 2014

BY E-FILING

Ms. Cynthia Brown
Chief, Section of Administration
Office of Proceedings
Surface Transportation Board
395 E Street, SW
Washington, DC 20423-0001

Re: *Rail Transportation of Grain, Rate Regulation Review*, STB Ex Parte No. 665 (Sub-No. 1)

Dear Ms. Brown:

Enclosed for electronic filing in the above-captioned matter is the non-confidential portion of the Reply Comments of BNSF Railway Company, which includes the supporting Reply Verified Statements of John H. Miller and William W. Wilson. Please note that the documents contain color images.

BNSF is filing under separate cover letter the highly confidential portion of its Comments, which consists of the Reply Verified Statement of Benton V. Fisher and Kaustuv Chakrabarti of FTI Consulting, Inc.

If you have any questions, please do not hesitate to contact me.

Regards,

Anthony J. LaRocca

Enclosures

BEFORE THE SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 665 (Sub-No. 1)

RAIL TRANSPORTATION OF GRAIN, RATE REGULATION REVIEW

REPLY COMMENTS OF BNSF RAILWAY COMPANY

BNSF Railway Company ("BNSF") submits these reply comments in the above-referenced docket. These reply comments are supported by reply verified statements of John Miller, Professor William Wilson, and Benton Fisher and Kaustuv Chakrabarti, each of whom appeared in support of BNSF's opening comments. BNSF also joins in the reply comments of the Association of American Railroads ("AAR").

The Board initiated this proceeding out of a concern that the lack of recent litigation over the rates charged for movements of grain signified a potential problem with the Board's rate reasonableness standards as applied to grain rates. On opening, BNSF explained that the most straightforward explanation for the lack of litigation over grain rates is that there is no significant problem with grain rates that would create a need to resort to litigation. While there continue to be periodic concerns over service and capacity in grain transportation markets, rate levels for grain transportation have not been a problem for grain shippers.

The parties recommending changes to the Board's rate reasonableness standards – NGFA, ARC[1] and USDA -- provide no evidence to the contrary. While they urge the Board to make fundamental changes to the rate regulation standards as applied to grain based on allegedly

[1] ARC refers to the Opening Comments submitted collectively by Alliance for Rail Competition and several grain groups.

high grain rates, they provide no evidence that there is a problem with the level of those rates. They urge the Board to abandon the economic principles that underlie the current rate regulation standards but they provide no basis for questioning the validity of those principles as they apply to grain transportation. They complain about the cost of litigating a rate reasonableness case under the current standards, but they vastly overstate the impact of litigation costs on access to rate relief and their proposed solution to the problem of litigation costs – a virtually automated system of rate regulation for grain transportation – is directly at odds with the notion of market-based rate setting that is the foundation of Staggers Act rate reasonableness principles.

In addition, the changes proposed by NGFA and ARC to the Board's current rate reasonableness standards are deeply flawed and legally indefensible. They are based on a repudiation of differential pricing and seek to remove virtually all railroad rate-setting initiative, thereby eliminating the role of market forces in railroad rate setting. They are a thinly veiled attempt to convert the Board's jurisdictional threshold into a cap on rates. Moreover, the methodological assumptions underlying the NGFA and ARC proposals conflict directly with conclusions reached by the Board when it adopted its existing Three Benchmark methodology, but NGFA and ARC provide no valid reason for reversing the Board's prior conclusions on the issues.

On the question of standing, NGFA asks the Board to clarify the legal standards for determining when a party that is indirectly affected by a railroad's allegedly unreasonable rate may file a complaint challenging the rate. It is well established that the only party entitled to seek damages in a rate reasonableness case is the person who paid the freight bill or was otherwise directly responsible for the freight charge. But the circumstances in which other parties may seek non-damages forms of relief are highly fact-specific and there is no record in this proceeding that would give the Board a basis for providing any guidance on that issue. BNSF would not oppose the Board's initiation of a proceeding to investigate the circumstances under which indirectly affected parties may seek relief other than damages in cases involving rates for grain transportation. But no valid guidance on standing could be provided based on the current record.

I. The Ag Interests Seek to Overhaul the Rate Regulatory Standards For Grain Based Upon An Unfounded Presumption That There Is a Problem With the Level of Grain Rates.

NGFA and ARC ("Ag Interests") are proposing significant modifications to the rate regulatory standards applied to grain traffic based upon an unfounded presumption there is a problem with the level of grain rates. They claim grain rates are too high but present no evidence to that effect. BNSF showed on opening that its grain rates are for the most part presumptively reasonable as a result of pervasive competition in the markets for the transportation of grain and, where competition is not as intense, through voluntary actions to keep rates at reasonable levels. The Ag Interests have presented no evidence to the contrary.

USDA presents no evidence at all regarding grain rate levels and simply assumes there is a problem with the Board's rate regulatory standards because virtually no grain cases have been brought. But as explained in BNSF's opening comments, the lack of grain rate cases is not evidence of a problem with grain rates. To the contrary, since rates for grain transportation generally are below levels that would be found to be unreasonable, the most plausible explanation for the lack of rate litigation is that shippers know that grain rates are not unreasonably high and that they would be unlikely to prevail in rate reasonableness litigation.

A. The Evidence Shows That BNSF's Grain Rates Are Generally Low

BNSF presented evidence on opening that BNSF's grain rates are generally low when measured on a revenue-to-variable cost ("R/VC") basis. Much of BNSF's grain traffic moves at rates below the Board's 180% R/VC jurisdictional threshold level.[2] Indeed, using the Carload Waybill Sample ("CWS") data provided by the Board in this proceeding, BNSF showed that the average R/VCs for its non-shuttle movements of corn, wheat, soybeans and other grain traffic from 2010 to 2012 were all below 180%.[3]

ARC and NGFA acknowledge that most grain rates are below the jurisdictional threshold level.[4] NGFA's witness Mr. Crowley presents data confirming the relatively low level of grain rates. Based on CWS data, Mr. Crowley shows that only a small percentage of agricultural commodities – corn, wheat and soybeans – had R/VCs above 250%.[5] That percentage of movements with R/VCs over 250% would be further reduced if BNSF's incentive payments were reflected in Mr. Crowley's data.[6]

Mr. Crowley's table 2 also demonstrates the relatively low level of grain rates by comparing those rates to the rates for ethanol, a product that has fundamentally different transportation market characteristics than grain commodities, as Professor Wilson explains.[7] Mr.

---

[2] Opening Verified Statement of John H. Miller at 16 (dated June 24, 2014) (hereinafter "Miller Opening VS"), attached to BNSF Opening Comments.

[3] *See* Opening Verified Statement of Benton V. Fisher and Kaustuv Chakrabarti at 4-6 and Exhibit FTI-10 (dated June 25, 2014) (hereinafter "FTI Opening VS"), attached to BNSF's Opening Comments.

[4] *See* Verified Statement of Gerald Fauth accompanying ARC Comments (hereinafter "Fauth VS") at 5 ("most grain and grain products movements have revenue-to-variable cost (R/VC ratios) falling below 180%."); Verified Statement of Thomas Crowley accompanying NGFA Comments (hereinafter "Crowley VS") at 3 (Table 1 shows that more than 50% of 2011-2012 corn and soybean movements and about 50% of wheat movements in those years have R/VCs below 180%).

[5] NGFA Comments, Crowley VS at 4, Table 2.

[6] As BNSF explained in its opening comments, the CWS data overstate the actual R/VC of shuttle grain movements since BNSF makes incentive payments to shuttle shippers that are not reflected in the waybill revenue. Miller Opening VS at 16; FTI Opening VS at 4-6 and Exhibits FTI-10, FTI-11.

[7] Professor Wilson's opening verified statement ("Wilson Opening VS") described the salient characteristics of grain transportation markets, including the volatility of shipping patterns, seasonality, dispersed origins and destinations, and recurring capacity concerns particularly

Crowley shows that a much higher percentage of ethanol shipments in 2011 and 2012 had R/VCs above 250% than grain shipments.[8] By comparison to ethanol rail rates, which reflect the market characteristics of completely different ethanol markets, rates for the rail transportation of grain commodities are quite low.

B. Evidence Purporting to Show BNSF's Grain Rates Are Unreasonably High is Flawed

ARC's witnesses attempt to present some evidence that BNSF's grain rates are unreasonably high but that evidence is flawed.

ARC's witness, Mr. Whiteside, tries to show that grain rates are unreasonably high by cherry-picking a handful of rates that he claims have particularly high R/VCs. Mr. Whiteside presents a few charts purporting to show high R/VCs on BNSF wheat shipments from a select group of origins to the Gulf and PNW.[9] But the fact that Mr. Whiteside points to only a handful of rates out of the thousands of common carrier grain rates offered by BNSF[10] with supposedly high R/VCs is evidence that the overall rate levels for grain are not unreasonably high.

Moreover, these charts from Mr. Whiteside are flawed and misleading. While the Board made Waybill data available to the parties, Mr. Whiteside chose not to use it. Moreover, it is impossible to determine the accuracy of the purported R/VC ratios because Mr. Whiteside does not provide workpapers showing the calculations, nor does he provide information regarding the

---

relating to car availability. As Professor Wilson explains in his reply verified statement ("Wilson Reply VS"), these characteristics are not shared by ethanol transportation or the transportation of derivative Ag products.

[8] NGFA Comments, Crowley VS at 4, Table 2.

[9] ARC Comments, Whiteside VS at 11, 13.

[10] *See* Reply Verified Statement of John H. Miller (filed August 25, 2014) (hereinafter "Miller Reply VS).

inputs used in those calculations such as the rates used (each route could have multiple rates depending on shipment size) or how variable costs were estimated.[11]

ARC's witness Mr. Fauth relies on short-haul movements to argue that some BNSF rail movements exhibit high R/VCs. Mr. Fauth presents data from the 2012 CWS showing the number of BNSF (and other railroad) corn and wheat movements in 2012 with R/VCs equal to or above 300% R/VC.[12] As noted above in connection with Mr. Crowley's grain rates data, the R/VCs calculated by Mr. Fauth are overstated because they do not reflect the substantial incentive payments made by BNSF to grain shippers. Moreover, as a review of Mr. Fauth's appendices shows, the identified movements constitute only a tiny fraction of BNSF's corn and wheat movements in those years, and most of them are shorter-haul movements of less than 500 miles; indeed, the vast majority of the movements are substantially shorter than 500 miles.

It is well known that short-haul movements tend to have higher R/VC ratios and lower absolute rates on a dollar per unit basis than longer haul movements. The Board noted in its 2009 Rate Study that "there are significant differences between long-haul and short-haul rates." Surface Transportation Board, Office of Economics, Environmental Analysis & Administration Section of Economics, *Study of Railroad Rates: 1985-2007*, at 4 (2009). The Board's study of waybill data for grain movements expressly found that that "rates on longer-distance shipments are, in general, lower per ton-mile than rates on shorter-distance shipments." *Id*. at 10 and Figure 4. Using the 2010-2012 CWS data provided in this proceeding, Messrs. Fisher and Chakrabarti

[11] *See* Reply Verified Statement of Benton V. Fisher and Kaustuv Chakrabarti at 10-12 (dated August 25, 2014) (hereinafter "FTI Reply VS"); Miller Reply VS.
[12] App. 3 and App. 4 to Fauth VS, included with ARC Comments.

showed on opening that BNSF's shorter-haul grain movements had higher R/VCs than BNSF's longer-haul grain movements.[13]

The relatively higher R/VCs on shorter-haul movements is not evidence of an abuse of market power. Indeed, the relatively higher R/VC ratios on short-haul movements typically reflect competition in the markets for those movements. Railroads are expected to set prices based on competitive factors and shipper demand for service. In many cases, short-haul grain shippers compete with grain shippers that must move traffic a longer distance. Their competitive advantage over longer-haul shippers is normally reflected in the fact that in absolute dollars, their rates are generally lower than the rates for the longer-haul shippers. However, the cost advantage that short-haul shippers have over their long-haul competitors means that they can pay rates that are higher on an R/VC basis than their long-haul competitors while maintaining their competitive advantage.

Relatively higher R/VC ratios on short-haul movements also reflect efficient pricing of rail service, in which a railroad seeks to maximize its contribution in excess of variable costs on each movement, regardless of length of haul. Even where the R/VC ratio on a long-haul movement is relatively low, the long-haul movement may generate a substantial amount of contribution over variable costs. Efficient pricing of rail services on short-haul movements would try to approximate the amount of contribution available on longer-haul movements, resulting in a relatively high R/VC ratio for the short-haul movement. Where capacity is constrained, as is often the case in grain markets, it would make no sense to favor short-haul movements by setting rates that generate relatively low contribution and lose the opportunity to

[13] FTI Opening VS at 6 and Exhibit FTI-12.

earn greater contribution from a longer-haul movement that competes for line-haul capacity with short-haul movements.

ARC's witness Mr. Whiteside also presents charts purporting to show that BNSF wheat rates for a small number of specific origin/destination pairs have increased dramatically over the past several years.[14] Once again, Mr. Whiteside's selection of a small number of movements is misleading. As demonstrated by BNSF's witnesses Messrs. Fisher and Chakrabarti, BNSF's average rate increases on wheat traffic have been below the average rate increases on most of BNSF's top commodities by revenue over the last ten years. Specifically, Messrs. Fisher and Chakrabarti show that for BNSF's top 30 commodities by 2013 revenue, wheat's annual average revenue per ton increase was less than those of most of BNSF's top 30 commodities, ranking 26th out of the top 30 commodities from 2004 through 2013.[15]

II. The Economic Principles Underlying The Existing Rate Reasonableness Standards Are Fully Applicable To Ag Movements.

The Board's current rate reasonableness standards are based on competitive market principles. Congress's objective in the Staggers Act, as reinforced by ICCTA, was to allow market forces and the principles of competition, rather than arbitrary regulatory decisions, to determine the level of rail rates. Thus, rail rates set in competitive markets should be free from regulation and, in those limited instances where a railroad can be shown to be abusing market power, regulation of individual rail rates should seek to simulate competitive market results. Shortly after the Staggers Act was enacted, the ICC adopted Constrained Market Pricing ("CMP") in Coal Rate Guidelines, Ex Parte No. 347 (Sub-No. 1), 1 I.C.C. 2d 520 (1985)

---

[14] ARC Comments, Whiteside VS at 14-16.

[15] FTI Reply VS at 10-11 and Figure FTI-4 (corn's revenue per ton increase ranked 24h out of the top 30 BNSF commodities and soybeans' revenue per ton increase ranked 11th out of the top 30 BNSF commodities).

(hereafter "Guidelines") to implement Congress's new competition-based rate regulation principles.

The stand-alone cost ("SAC") test, one of the constraints of CMP, was expressly designed to simulate a competitive rate in circumstances where existing competitive forces may not effectively constrain a railroad's exercise of market power.[16] As the Board has explained, the SAC analysis "produces a simulated competitive rate against which the Board judges the reasonableness of the challenged rate."[17] The Ag Interests offer no economic rationale for abandoning the competition-based rate reasonableness approach reflected in the SAC test for rates charged for movements of Ag commodities.

Two economic theories are at the heart of CMP and the SAC test. The first is that "the cost structure of the railroad industry necessitates differential pricing of rail services." Guidelines, 1 I.C.C. 2d at 526. The second is that "a captive shipper need not bear the costs of any facilities or services from which it derives no benefit." *Id.* at 528. Taken together, these economic principles mean that railroads must charge differential, demand-based prices to cover their full costs, but they cannot use differential pricing to force particular customers or customer groups to pay more than the costs associated with the services they receive so that other users of the rail network receive a cross-subsidy. These economic principles apply to Ag transportation markets to the same extent they apply to markets for the transportation of other commodities.

---

[16] Guidelines, 1 I.C.C. 2d at 542. Another constraint of CMP, the revenue adequacy constraint, is the subject of a different proceeding that is currently pending before the Board. *See Railroad Revenue Adequacy*, Ex Parte No. 722. NGFA states that it is not seeking "to propose a methodology to implement the revenue adequacy constraint for 'large' rate cases," which NGFA asserts is the subject of EP 722. *See* NGFA Comments at 3, note 2. Given the pendency of Ex Parte 722, BNSF does not address here the meaning of the revenue adequacy constraint of CMP or its potential implementation in rate reasonableness proceedings.

[17] *Rate Regulation Reforms*, Ex Parte No. 715 at 6 (served July 18, 2013) (hereinafter "EP 715").

The SAC and Simplified SAC rate reasonableness methodologies implement these economic principles. The economic theory underlying both the SAC and Simplified SAC tests is that firms in competitive markets must be able to recover the full costs of efficient service through the prices charged to their customers, but they cannot charge more than the amount necessary to cover their full costs without losing the business to a rival. Simplified SAC differs from SAC in the use of certain simplifying assumptions in the assessment of the cost of efficient service.

The Board's third rate reasonableness methodology, the Three Benchmark test, seeks indirectly to implement the competitive market principles underlying the SAC and Simplified SAC tests in a less accurate but highly simplified manner. Instead of requiring a complaining shipper to incur the litigation burden of estimating the defendant railroad's full costs to provide the transportation service at issue, the Three Benchmark approach assumes that a defendant railroad prices its service to shippers potentially subject to rate regulation at levels that are consistent with SAC. The Board explained that in the interest of simplifying the rate reasonableness process, "[w]e can assume that, in setting rail rates on captive traffic, a carrier will not exceed substantially the level permitted by the SAC constraint."[18] Since a defendant's rates to other similarly situated shippers are assumed to reflect the amount of contribution from shippers potentially subject to rate regulation that is necessary to cover full SAC costs, a comparison of the complaining shipper's rates to the rates paid by other similarly situated shippers allows the complainant to determine indirectly whether its rates exceed rates that would be permitted under the SAC test. As the Board explained, "[a] comparison approach can be instructive as to the reasonable level of contribution to fixed costs (the R/VC ratio) for a

[18] *Simplified Standards for Rail Rate Cases*, Ex Parte No. 646 (Sub-No. 1), at 73 (served Sept. 5, 2007) (hereinafter "*Simplified Standards*").

particular captive movement when a second, cost-based approach [*i.e.*, SAC or Simplified SAC] is also employed to constrain rail rates." *Id.*

The economic rationale underlying these three rate reasonableness methodologies has been upheld repeatedly by the courts of appeals.[19] Nevertheless, the Ag Interests ask the Board to disregard both of the foundations of market-based regulation -- the differential pricing and cross-subsidy principles – in assessing the reasonableness of Ag rates.

First, the Ag Interests claim that as railroads have become financially stronger, they no longer need to engage in differential pricing. NGFA claims simply that "as railroads reach revenue adequacy, their justification for charging their captive shippers higher rates through differential pricing is diminished, if not eliminated altogether." NGFA Comments at 20. ARC similarly argues that "[t]he achievement of revenue adequacy means there should be no further differential pricing of rail rate increases for captive shippers." ARC Comments, Fauth VS at 27.

In challenging differential pricing, the Ag interests are asking the Board to ignore the economic reality of railroad markets. As noted above, it has long been recognized that "the cost structure of the railroad industry necessitates differential pricing of rail services." Guidelines, 1 I.C.C. 2d at 526. Railroads have very high fixed and common costs that must be recovered through demand-based prices. If railroads sought to obtain the same amount of contribution to fixed and common costs from all shippers without accounting for differences in demand, railroads would lose shippers with elastic demand (e.g., shippers with multiple competitive options) to competitors. In contrast, under differential pricing, shippers with elastic demand will contribute less to fixed and common costs than shippers with inelastic demand, but all shippers

[19] *CSX Transportation, Inc. v. Surface Transportation Board*, No. 13-1230 (D.C. Cir. June 20, 2014); *CSX Transportation, Inc. v. Surface Transportation Board*, 584 F.3d 1076 (D.C. Cir. 2009); *Consolidated Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987).

are better off having some contribution from the demand elastic shippers rather than none. As the ICC noted shortly after the Staggers Act became law, "[d]ifferential pricing is ingrained and fundamental to the rail rate structure."[20] The question is not whether railroads may engage in differential pricing – they clearly must be able to do so if the industry is to survive over the long term -- but what limits on differential pricing are necessary to protect shippers from any abuse of market power. The Board's SAC test and its simplified variations identify the proper limits on differential pricing.

The Ag Interests also challenge the cost-recovery and cross-subsidy rationale underlying the SAC test. The Ag Interests' basic claim is that the rule against cross-subsidy set out in the *PPL* and *Otter Tail* decisions[21] makes it difficult or impossible for Ag shippers, who generally use low density rail lines, to show that they are entitled to relief under the SAC and Simplified SAC tests. *See* NGFA Comments at 13-14 ("Many facilities and elevators are located on low density rural branch lines or secondary lines. The Board's adoption in [*PPL* and *Otter Tail*] of rules that severely restricted the ability to include low-density lines of rail in SAC models made the SAC rate rules even more inaccessible to Ag Commodity rail shippers."); ARC Comments, Fauth VS at 18 (grain shippers "simply do not have the volumes and track densities necessary to make use of these expensive and time-consuming SAC tests.") The Ag Interests' complaint about the cross-subsidy rules adopted in *PPL* and *Otter Tail* is in effect an argument that rates for the transportation of agricultural products should be subsidized by other traffic.

---

[20] *Arkansas Power and Light – Petition to Institute Rulemaking – Implementation of Long Cannon Factors*, 365 I.C.C. 983, 994 (1982).

[21] *Otter Tail Power Co. v. BNSF Railway Co.*, STB Docket No. 42071 (served Jan. 27, 2006); *PPL Montana, LLC v. Burlington Northern and Santa Fe Railway Co.*, STB Docket No. 42054, 6 S.T.B 286 (2002).

Neither NGFA nor ARC provides evidentiary support for their assertions regarding the relative traffic densities of lines that handle Ag commodities.[22] But even if there were evidence that agricultural commodities tend to move over relatively low density rail lines, that would not justify resorting to an inferior rate reasonableness methodology untethered to CMP principles. The Board recognized in *PPL* and *Otter Tail* that a shipper seeking reduced rail rates must first show that the complaining shipper and other shippers that share facilities generate enough revenue to cover the cost of the facilities they use. The D.C. Circuit, in upholding the Board's decision in *PPL*, noted that "the Board's decision advances the reasonable proposition that the captive issue traffic cannot be improperly subsidizing other traffic if the issue traffic cannot even cover its own attributable costs. . . ."[23] A complainant using a discrete set of rail facilities must be able to show that those facilities are "self-sustaining" before the shipper is entitled to a rate reduction. *Id.* If the shippers using a particular set of rail facilities do not generate enough revenue to cover the cost of those facilities due to the fact that there is relatively little traffic using those facilities, the costs will not be covered and the facilities will not be sustainable over the long run. A rate reduction is clearly not appropriate in cases where the revenues generated by the shippers using low density rail lines do not even cover the cost of those facilities. Ag shippers cannot expect a railroad's other shippers to subsidize their service.

The Ag Interests also challenge the economic rationale of the Three Benchmark test as applied to agricultural commodities, arguing that it allows railroads to charge unreasonably high

[22] While many rail lines serving agricultural areas in the past were relatively low density lines, conditions have changed substantially over the past couple of decades as BNSF has consolidated traffic over fewer rail lines and implemented other practices that have increased the density of rail lines serving agricultural areas. Professor Wilson described in his opening statement in this proceeding BNSF's extensive efforts to improve the efficiency of grain transportation through higher volume loading sites, longer trains and consolidation of operations.

[23] *PPL Montana, LLC v. Surface Transportation Board*, 437 F.3d 1240, 1245-46 (D.C. Cir. 2006).

rates by engaging in broad, market-wide increases in rates. NGFA argues that "where a carrier uses its market power to impose a uniformly high rate across-the-board for certain commodities or groups of commodities, relief under the 3B rules becomes unavailable, since they are designed to remedy situations where a shipper is singled out for market abuse." NGFA Comments at 15. Similarly, ARC claims that "[i]f a railroad is charging a grain producer or shipper rates with R/VC percentages of 300, or 250, but is also charging similar rates to similarly situated shippers, the test is ineffective." ARC Comments at 23.

The Ag Interests' concern that railroads will evade rate constraints under the Three Benchmark test through broad-based rate increases is based on pure speculation – the Ag Interests present no evidence at all on the existence of supposedly uniform across-the-board rate increases -- and the allegation is inherently implausible given the realities of the market.[24] If a railroad wanted to impose widespread across-the-board rate increases that were not justified by market conditions, it could only do so if it had market power over the movements to which the rate increases applied. But as BNSF explained in its opening comments, there are very few areas where competitive forces do not constrain some, if not all rates for Ag traffic.[25] As BNSF further explained, in most areas where grain is produced, the grain producer has access to elevators located on competing railroads, barge options are widely available, trucks can be used to deliver grain to local processing facilities, and alternative destinations are available.[26] In addition, rail rates are constrained by the rates charged by other railroads, barges and trucks for

---

[24] Figure FTI-1 shows the diversity of grain rates on an R/VC basis before applying the proposed NGFA methodology. *See* FTI Reply VS at 7. It is clear that BNSF has not tried to create uniform grain rates in an effort to circumvent the Three Benchmark test.

[25] *See* Miller Opening VS at 13-14. In the discrete geographic regions where BNSF faces less modal or geographic competition, BNSF consciously and voluntarily constrains rates to levels consistent with the Board's rate reasonableness standards. *Id.* at 14-15.

[26] *See* Miller Opening VS at 13-14; *see also* Wilson Opening VS at 37-41.

movements from alternative origins, since unreasonably high rail rates for grain movements from a particular rail origin could make it impossible for the shipper to participate in the destination market. *Id.* Intense competition in export markets, the ultimate destination for most of BNSF's grain movements, also constrains the rates that BNSF can charge on movements to export facilities. *Id.* BNSF is not in a position to impose broad-based rate increases that are inconsistent with market forces on shippers potentially subject to rate regulation.

III. The Impact of Litigation Costs on Access to Rate Relief Is Overstated.

The primary focus of the Ag Interests' argument for a change in rate reasonableness standards is the cost of litigation under the existing standards. NGFA, ARC and USDA all claim that rate litigation under the existing standards is too expensive for grain shippers to justify bringing a rate reasonableness case. They claim that SAC and Simplified SAC cases cannot be brought by grain shippers because the cost of such cases dwarfs the relief that could be obtained if successful.[27] They also claim that the costs of a Three-Benchmark case under the current Three-Benchmark rules are prohibitively high.[28] USDA attempts to demonstrate how much a grain shipper would have to spend on rail transportation before it could afford to bring a Three-Benchmark case.[29]

The concerns expressed about the cost of bringing a rate reasonableness case for grain shippers are overstated. The unspoken premise of the Ag Interests' argument about litigation costs is an anachronistic view of Ag transportation markets that assumes a multitude of small shippers, moving relatively small numbers of cars from multiple different locations over a large number of low density rail lines. While these characteristics of Ag markets may have existed in

---

[27] *See* NGFA Comments at 13-14; ARC Comments at 21; USDA Comments at 4. The USDA Comments do not contain page numbers. For ease of reference, we have added page numbers (excluding the cover page).
[28] *See* NGFA Comments at 15; ARC Comments at 22; USDA Comments at 5-7.
[29] USDA Comments at 5-7.

the past, they do not characterize Ag markets today, as BNSF's witness Professor Wilson explained on opening and as BNSF's Group Vice President, Agricultural Products, Mr. Miller, explains further in his reply verified statement.

First, most of BNSF's Ag shipments are made by very large companies. As Mr. Miller explains, the vast majority of BNSF's grain shipments are made by a handful of customers, including CHS, Inc. ("CHS"), Cargill and Archer Daniels Midland ("ADM").[30] Firms like CHS, Cargill and ADM clearly have resources that would allow them to bring rate reasonableness cases if circumstances justified litigation.[31]

Second, the average shipment size of Ag shipments on BNSF has increased dramatically over the past several years as farmers and shippers have taken advantage of BNSF's shuttle program. Messrs. Fisher and Chakrabarti showed on opening that most of BNSF's traffic in the 2011 and 2012 Waybill traffic was shuttle-size, defined as 85 cars or more.[32] In their opening verified statements, Professor Wilson and Mr. Miller described in detail the evolution of BNSF's shuttle program, which Professor Wilson characterized as one of the most successful and efficiency-enhancing rail programs in U.S. rail history. As Professor Wilson explained, the use of high-volume and repetitive shuttle trains has allowed U.S. farmers to take increasing advantage of export markets, which have become critical to the success of grain producers and others in the grain supply chain. Shuttle operations have allowed grain movements to become much more concentrated.

---

[30] Miller Reply VS.
[31] The revenues of these firms often substantially exceed BNSF's revenues. In 2013, Cargill, ADM and CHS each generated more than twice the total revenues than BNSF. *See* Cargill: http://www.cargill.com/company/glance/; CHS: http://www.sec.gov/Archives/edgar/data/823277/000082327713000037/chscp10k83113.htm; ADM: http://www.adm.com/en-US/investors/Pages/sec_filing.aspx; BNSF: http://www.stb.dot.gov/econdata.nsf/FCStatistics?OpenView.
[32] FTI Opening VS at Exhibit FTI-9.

Third, in part due to the growth and success of shuttle operations, Ag commodities now tend to move over higher density lines. One reason that the grain shippers in the *McCarty Farms* case failed to show that the challenged rates exceeded reasonable maximum rates was the very high cost of gathering grain from dispersed origins over low density rail lines. But grain transportation markets are fundamentally different today, due to measures that BNSF has taken to improve the efficiency of grain transportation by concentrating grain origins and moving grain traffic over efficient, high density lanes.

USDA's attempt to show Three-Benchmark cases are too expensive for grain shippers is misleading and highly dependent on the assumptions made. Messrs. Fisher and Chakrabarti show that under USDA's analysis, a modest revision to USDA's assumptions regarding the cost of litigation, the likelihood of litigation success, and the magnitude of any rate reduction increases substantially the number of grain shippers that would have the incentive to bring a rate reasonableness challenge.[33]

In addition to complaining about the cost of litigation, NGFA and ARC claim that grain shippers might not have the incentive to bring a rate case because they pass on the cost of any unreasonable rail rate or rate increase to farmers who do not directly pay the rail rate.[34] But this assertion is also without merit. In his reply verified statement, Professor Wilson explains that many factors affect the extent to which a grain producer is affected by changes in rail rates. The simplistic assumption that grain elevators simply pass along rail transportation costs to producers is not consistent with the market. Moreover, the ability to pass on costs, in whole or in part, does not eliminate the incentive to litigate. Coal shippers are often able to pass through rail transportation costs to their rate payers but this has not discouraged them from bringing rate

[33] FTI Reply VS at 12-14 and Table FTI-5.
[34] NGFA Comments at 7-8; ARC Comments at 9.

reasonableness cases. Indeed, whether or not the shipper passes the cost of rail transportation on to some other party, the shipper will benefit from reparations if the rates are unreasonable. The prospect of reparations would provide an adequate incentive to bring rate cases in appropriate circumstances. Moreover, one of BNSF's largest customers, CHS, is a conglomerate of farmer cooperatives.[35] Since CHS acts on behalf of its farmer members, it has the incentive to assist its owners by bringing a rate case if it believes the rates it is paying are unreasonable.

As to BNSF's small grain shippers, the cost and distraction of litigating a rate reasonableness case at the Board might be more daunting for a small shipper than a large shipper. But concerns about access to rate relief by small grain shippers would not justify fundamental changes in the existing rate reasonableness standards. As BNSF showed on opening, non-shuttle grain shipments are a small fraction of BNSF's corn, wheat and soybeans shipments.[36] Moreover, those small grain shippers are the least likely shippers to pursue litigation because their rates are so low. As BNSF demonstrated, the average R/VCs of these small, non-shuttle-sized shipments were below 180%, the Board's jurisdictional threshold level, for all grain commodities.[37] There would be no reason to modify the Board's rate reasonableness standards or procedures to make it possible for small shippers to bring rate cases when those small shippers' rates are generally below the jurisdictional threshold necessary to bring a rate reasonableness challenge.

IV. The Rate Reasonableness Methodologies Proposed By NGFA and ARC Are Untethered from CMP Principles and Are Fundamentally Flawed.

In addition to their claims, addressed above, that the Board's current rate reasonableness rules are not useable by Ag shippers, NGFA and ARC urge the Board to abandon its existing rate

[35] Miller Reply VS.
[36] FTI Opening VS at Exhibit FTI-9.
[37] FTI Opening VS at Exhibit FTI-10.

reasonableness standards for Ag traffic on grounds that the railroads' achievement or imminent achievement of revenue adequacy justifies a change in rate reasonableness standards. Their reliance on considerations of railroad revenue adequacy is misplaced and premature. The Board will be exploring the meaning and implications of railroad revenue adequacy in a different proceeding. In any event, it is unnecessary to address NGFA and ARC's revenue adequacy arguments here because, whether a railroad is revenue adequate or not, the NGFA and ARC proposed methodologies are fundamentally flawed and result in arbitrary rates that have no rational basis.

A. NGFA Proposal

NGFA's proposed methodology, called the Ag Commodity Maximum Rate Methodology ("ACMRM"), would set regulated rates based on a comparison of the issue traffic rates to other supposedly comparable rates. NGFA's methodology, at bottom, is a modified and further simplified version of the Board's Three-Benchmark methodology. The methodology would apply to specified Ag commodities, which include ethanol and other grain processed products as well as grains themselves.[38] ACMRM differs from the Three-Benchmark test in several significant ways:

- there is no discretion in the selection of the comparison group; ACMRM requires the comparison group to include all movements in the CWS data that meet the selection criteria designated by NGFA (e.g., comparison group includes all movements of total distance within 20 percent (plus or minus) of issue movement's standard routing and all movements with same five-digit or seven-digit STCC as the issue movement);[39]

- the comparison group is based on movements from only one-year of CWS data, namely the most current year in existence when the complaint is filed;

- the comparison group includes movements from all railroads, not just movements from the respondent railroad(s) that meet the selection criteria;

[38] NGFA Comments at 2 n. 1 and Exhibit 2 to the attached Crowley VS.
[39] NGFA's proposed selection criteria are set forth on pages 6-7 of the Crowley VS.

- the comparison group includes all movements regardless of R/VC ratio that meet the selection criteria, including movements with R/VC ratios below 180 percent;

- no "other relevant factors" are taken into account;

- no "confidence-interval" adjustment are taken into account;

- there are no limits on the relief that could be received for a successful rate challenge.

In addition to the problems with many of the specific methodological assumptions underlying ACMRM, which are addressed below, there are fundamental conceptual flaws with the NGFA proposal.

First, the objective and effect of ACMRM are to produce regulated rates through a virtually automated process that would eliminate a railroad's rate-setting initiative and override any market forces that influenced the rates set by the railroad. ACMRM provides a means to identify in the abstract the maximum rate that can be charged to all of a railroad's potentially regulated traffic through a purely mechanical process. In place of the statutory regime of railroad-set rates, ACMRM would impose a comprehensive set of regulated rates for traffic above the jurisdictional threshold that could be obtained through little more than a showing of market dominance. Indeed, NGFA's witness Mr. Crowley shows how easy it would be to trump the statutory railroad rate-setting initiative with a regime of regulated rates. To show the supposed impact of ACMRM on railroad revenues, Mr. Crowley applied that methodology to calculate the maximum regulated rate for all but a few shipments included in the Carload Waybill Sample provided by the STB in this proceeding.[40]

[40] *See* NGFA Comments, Crowley VS at 15 and Crowley workpapers. Mr. Crowley did not determine the "maximum reasonable rate" for shipments missing movement characteristics in the CWS data or for shipments where a comparison group could not be developed. Crowley VS at 15, n. 11.

Such an approach to rate regulation is directly at odds with the principles set out in the Staggers Act for the regulation of rail rates, where the ICC and the Board were instructed to "allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail," *see* 49 U.S.C. §10101(1), and where railroads were provided by statute with the rate-making initiative to "establish any rate for transportation or other service provided by the rail carrier." *See* 49 U.S.C. § 10701(c). Congress did not intend for the Board to establish rate regulation procedures that would impose a comprehensive set of regulated rates on all traffic subject to the Board's jurisdiction, thereby preempting virtually all railroad rate-setting discretion as to those rates. Nor did Congress intend for the Board to establish rate reasonableness procedures that would wipe out the impact of diverse market forces on the level of grain rates. As Messrs. Fisher and Chakrabarti show in Tables FTI-2 and FTI-4 of their reply verified statement, ***the effect of ACMRM would be to eliminate the effect of market forces on rail rates by driving all rates to a uniform level at or close to the jurisdictional threshold.***

The second conceptual flaw with ACMRM is that it is a thinly veiled attempt to convert the Board's jurisdictional threshold into a rate ceiling. Congress did not establish a jurisdictional threshold as a means of capping rail rates. But Messrs. Fisher and Chakrabarti show that the impact of an initial round of the ACMRM methodology would be to drive maximum rates on all of BNSF's corn, wheat and soybean shipments to R/VC's much closer to 180%.[41] ACMRM would immediately eliminate most of BNSF's revenues above 180% for those commodities. *Id.* Messrs. Fisher and Chakrabarti also explain that after an initial round of rate reductions brought about by ACMRM, subsequent uses of ACMRM would produce even greater reductions in

[41] FTI Reply VS at 3-5 and Table FTI-2.

maximum rate levels, eventually driving all rates to the jurisdictional threshold.[42] This result is contrary to the governing statute which provides that rates with R/VC ratios above 180%, the jurisdictional threshold level, are not necessarily unreasonable. *See* 49 U.S.C. § 10707(d)(2). The existence of market dominance is only the starting point for the inquiry into rate reasonableness.

Moreover, driving rates through regulation to the jurisdictional threshold R/VC would create a disincentive for railroads to become more efficient and reduce their costs. Since regulated rates would be set based on a railroad's costs at the prescribed R/VC ratio, a railroad would be penalized for cost reductions because those cost reductions would result in lower regulated rates. Such a perverse incentive to maintain high costs that would be created by the ACMRM would be contrary to the public interest.

The third fundamental problem with ACMRM is that it provides most rate relief to large shuttle shippers who are in the best position to bring rate reasonableness cases, where justified, under existing standards. As discussed above, small shippers might have more concern over the cost of litigating rate reasonableness cases. But as Messrs. Fisher and Chakrabarti show, almost all rate relief under ACMRM would go to BNSF shuttle shippers who have no valid reason to bypass more accurate rate reasonableness standards that the Board currently uses.[43] Even if there were a valid concern over the cost to small shippers to litigate rate cases under the current standards, the ACMRM proposed methodology is not an appropriate way to address those concerns.

In addition to these disqualifying conceptual problems, there are several problems with specific aspects of NGFA's proposed methodology.

---

[42] FTI Reply VS at 9-10 and Table FTI-4.
[43] FTI Reply VS at 8-9 and Figure FTI-3.

1. Inclusion of Movements With R/VCs Below 180 Percent: As noted above, the ACMRM converts the jurisdictional threshold into a virtual rate cap on market dominant traffic. The most significant way in which ACMRM accomplishes this is by including all supposedly comparable traffic, including traffic with R/VCs below 180%, in the comparison group. The Board has already rejected such an approach as inconsistent with differential pricing. When it adopted the Three-Benchmark test, the Board decided that only traffic with R/VCs greater than 180% should be included in a comparison group, explaining that the "purpose of the R/VC benchmark is to use the R/VC ratios of other 'potentially captive traffic' (i.e., traffic priced above 180% R/VC level) as evidence of the reasonable R/VC levels for traffic of that sort. As such, the comparison group should consist of only captive traffic over which the carrier has market power. The rates available to traffic with competitive alternatives would provide little evidence on the degree of permissible demand-based differential pricing to provide a reasonable return on the investment."[44]

As explained above, differential pricing is a central feature of railroad economics. When it adopted the Three Benchmark approach, the Board sought to accommodate differential pricing by using in the comparison group traffic with similar demand characteristics, i.e., potentially captive traffic. By including all traffic in the proposed comparison group, ACMRM seeks to eliminate a railroad's ability to engage in differential pricing, contrary to the basic economics of the railroad industry.

Moreover, the ACMRM approach is not consistent with NGFA's rationale for including all traffic in the comparison group. NGFA argues that movements with R/VC ratios above 180% compete with movements with R/VCs below 180% and therefore excluding movements with

[44] *Simplified Standards* at 17.

R/VCs below 180% from the comparison group would mean there is not "a sufficient representation of the market rail rates for the commodity in question."[45] However, NGFA's methodology makes no attempt to ensure that the comparison group includes only movements that are actually in the same rail market as the issue traffic. To the contrary, under NGFA's proposal all movements of a particular commodity in a particular mileage band are included in the comparison group whether or not those movements participate in the same or similar markets. Thus, under NGFA's proposal, if a shipper is challenging the reasonableness of a wheat rate from Washington to the PNW, the comparison group will include all wheat movements to all destinations of the same approximate distance from anywhere in the country on any rail carrier. NGFA's meat axe approach does not address the concern that supposedly justifies expansion of the comparison group to include traffic with R/VC ratios below 180%.

Further, NGFA's proposal to include movements with R/VC ratios below 180% in the comparison group is improper because it will lead to a "ratcheting" down of R/VC ratios until the Board ends up prescribing all Ag commodity rates at 180% R/VC and 180% R/VC becomes the rate ceiling. Indeed, Messrs. Fisher and Chakrabarti show that in just the first round of rate reductions under NGFA's proposed methodology, BNSF's corn, wheat, and soybean movements with R/VCs above 180% in the 2011 and 2012 CWS would have their R/VCs reduced to levels close to the jurisdictional threshold,[46] and almost all of these movements would have their rates reduced.[47] After a second round of rate reductions, which would reflect the rate reductions produced in the initial use of ACMRM, the average R/VCs on BNSF corn, wheat and soybean

[45] NGFA Comments at 29.
[46] FTI Reply VS at 4-5 and Table FTI-2.
[47] FTI Reply VS at 7-8 and Figure FTI-2.

movements with R/VCs above 180% in the 2011 and 2012 CWS would have been reduced to just above the jurisdictional threshold level.[48]

In its 1993 *McCarty Farms* decision, the D.C. Circuit acknowledged the existence of this "ratcheting" problem, expressing concern that under an R/VC comparison method applied (in error) by the STB's predecessor, the agency would "find itself imposing 180% as a rate ceiling."[49] NGFA claims that subsequent to the 1993 D.C. Circuit decision the Board has "repeatedly rejected" the "ratcheting argument" and the D.C. Circuit has affirmed this rejection. *See* NGFA Comments at 19-20. The cited cases do not support NGFA's position. Indeed, in those cases the Board recognized that the problem of "ratcheting" could occur when an R/VC method was used but determined that "ratcheting" was unlikely to be a significant concern under the Three-Benchmark methodology due to certain limitations built into the Three-Benchmark methodology.[50] The Board stated that, among other things, "the potential for ratcheting will be severely constrained by the limit on the relief available under" the Three-Benchmark test and that ratcheting was unlikely to occur unless there were "an avalanche of rate cases" at the Board following the adoption of the Three-Benchmark test which the Board did not anticipate.[51] The Board further explained that it might need to revisit the issue of ratcheting if an avalanche of cases in fact occurred. *Id.*

NGFA has proposed to remove the very limitations that the Board relied upon in concluding that ratcheting was unlikely to occur if it adopted the Three-Benchmark approach. It has proposed to remove any limits on the amount of relief that complaining shipper(s) could

---

[48] FTI Reply VS at 9-10 and Table FTI-4.
[49] *Burlington Northern RR Co. v. Interstate Commerce Comm'n*, 985 F.2d 589, 597 (D.C. Cir. 1993).
[50] *Simplified Standards* at 73-74; EP 715 at 24-25.
[51] *Simplified Standards* at 73-74.

receive and has proposed to make the test essentially automated (as described above), increasing the likelihood that there will be a large number if not an “avalanche” of rate cases.

2. Inclusion of Non-Defendant Railroad Movements: NGFA proposes that the comparison group include movements on all railroads that meet the selection criteria, not just movements on the defendant railroad(s).[52] The Board has already explained in connection with its adoption of the Three Benchmark test why non-defendant railroad movements should not be included in a comparison group. As the Board explained, it

> exclude[d] non-defendant traffic from the comparison group because R/VC ratios of one carrier cannot fairly be compared with R/VC ratios charged by another railroad. The reasonable level of contribution to joint and common costs (reflected in the R/VC ratio) is first and foremost a function of the amount of joint and common costs that need to be recovered. This will vary between carriers, creating inevitable and proper differences in R/VC ratios. Moreover, the reasonable degree of differential pricing one carrier can exercise is also a function of the mix of traffic; for example a carrier with little revenue from competitive traffic will need to recover a larger share of joint and common costs from its potentially captive traffic. . . . Accordingly, we conclude that the R/VC ratio of potentially captive traffic of one carrier provides no useful indicia of the lawful contribution to fixed and common costs for another carrier.[53]

Mr. Crowley quibbles with the Board’s reasoning but provides no valid basis for revisiting those conclusions. First, Mr. Crowley claims that, contrary to the Board’s conclusion, R/VC ratios for various railroads are comparable because the percentage of joint and common costs that need to be recovered through differential pricing have remained “fairly consistent across railroads.” Crowley VS at 8. The STB already rejected this argument. Moreover, Mr. Crowley’s own workpaper underlying his analysis shows that the joint and common costs

---

[52] NGFA Comments at 28-29 and Crowley VS at 7-9.

[53] *Simplified Standards* at 82-83.

required to be recovered differ substantially from railroad to railroad.[54] This is not surprising since each railroad has its own unique network and cost structure.

Second, Mr. Crowley disputes the Board's conclusion in the Three-Benchmark proceeding that it would be improper to compare the R/VC ratios for movements from one railroad to those of another railroad because each railroad has a different mix of competitive and non-competitive traffic and the pricing levels on individual movements is in part a function of each railroad's traffic mix. The relative proportions of a railroad's competitive and non-competitive traffic may affect the amount of contribution that is needed from non-competitive carriers to cover the railroad's costs. It would produce an apples-to-oranges comparison to compare rates that reflect one carrier's revenue needs to the rates of a different carrier with different revenue needs. Mr. Crowley claims the Board's conclusion is inconsistent with the Board's view, expressed in other contexts, that railroads set prices based on market conditions rather than based on the amount needed to cover their costs. While that may be true for most traffic, it does not apply to all traffic. After all, if all rates were constrained by market forces, there would be no basis for any regulation of rail rates. Rates for some traffic may be set based on the revenue needs of a railroad, and including those rates in a comparison group to test the rates charged by a different rail carrier would not produce meaningful results.

Finally, Mr. Crowley argues that since the Board makes cross-railroad price and cost comparisons in other contexts it should allow cross-railroad comparisons in determining the reasonableness of grain rates. The only other context referenced by Mr. Crowley is the Board's annual assessment of the railroad industry cost of capital. But the fact that it may be appropriate to carry out an industry-wide analysis in one setting says nothing about the reasonableness of an

[54] FTI Reply VS at 3-4.

industry-wide analysis in a different setting. The Board explained why it makes no sense to carry out industry-wide rate comparisons when it adopted the Three Benchmark test, and NGFA has identified no valid reason to question the Board's conclusions.

3. Eliminate Other Relevant Factors: The Board has recognized that the Three-Benchmark methodology is not as accurate as the SAC or Simplified SAC methodologies for determining the reasonableness of rates.[55] Consequently, it allows a party to present evidence of "other relevant factors" to show that the maximum lawful rate should be higher or lower than the rate produced strictly by comparison to other comparable rates. The Board has imposed limits on the type of "other relevant factor" evidence that it will consider to keep Three-Benchmark cases manageable.[56]

NGFA proposes to eliminate entirely the ability to present "other relevant factors" evidence.[57] Since the use of "other relevant factors" evidence is intended to compensate for the potential inaccuracy of a strict comparison approach, the elimination of "other relevant factor" evidence would further undermine the accuracy of a rate reasonableness approach that already is acknowledged to be the least accurate of the existing rate reasonableness standards. Moreover, the use of such evidence is already limited by the Board, so its elimination would be unnecessary and inappropriate.

4. Remove Any Cap on Relief: Recognizing that the Three-Benchmark approach does not offer "as much precision and degree of confidence as a Full-SAC analysis," the Board nevertheless adopted the methodology to "address the concern that many shippers believe they cannot challenge their rail rates because the costs of litigation would exceed the amount in

[55] *Simplified Standards* at 5.
[56] *Simplified Standards* at 22.
[57] NGFA Comments at 31.

dispute."[58] The Board limited the rate relief available to shippers bringing a Three-Benchmark case to $1 million over a five-year period and recently increased that limit to $4 million over five years.[59] The Board found that a cap on relief struck "the appropriate balance" so that "[c]aptive shippers of any size can now avail themselves of our rate review processes, while carriers can be assured that a large rate dispute will not be subjected to a more simplified process than necessary to achieve that objective."[60]

Under NGFA's proposed methodology, there would be no limit on the relief a shipper could receive if successful.[61] By removing any limits on relief and also proposing a process that is even more simplified and less accurate than the Three-Benchmark methodology, NGFA's proposed methodology marginalizes more reliable standards adopted by the Board for determining rate reasonableness.

B. <u>ARC's Proposals</u>

ARC proposes different rate reasonableness methodologies depending upon whether the defendant railroad(s) are revenue adequate or revenue inadequate. ARC's proposals suffer from the same basic flaws as NGFA's proposals, discussed above, and therefore will not be analyzed in detail here.

For revenue inadequate railroads, ARC proposes that the Board modify the R/VCcomp benchmark of the Three-Benchmark test so that parties may include movements on non-defendant railroads and movements with R/VCs below 180% in the comparison group.[62] These

---

[58] *Simplified Standards* at 5.
[59] *Simplified Standards* at 28. Rate relief increased in Ex Parte 715, but on appeal, the D.C. Circuit remanded for Board consideration of whether its estimate for the Three Benchmark relief cap double-counted costs. *CSX Transportation, Inc. v. Surface Transportation Board*, No. 13-1230 (D.C. Cir. June 20, 2014).
[60] *Simplified Standards* at 28.
[61] NGFA Comments at 31.
[62] ARC Comments at 23-24 and accompanying Fauth VS at 22-24.

modifications to the existing Three Benchmark test were also the centerpiece of NGFA's proposed methodology and they are flawed for the reasons explained above.

For revenue adequate railroads, ARC proposes that the Board use a "Two-Benchmark" test, the mechanics of which are impossible to follow from ARC's description of the proposal. However, ARC explains that the objective of its "Two-Benchmark" approach is to eliminate differential pricing by getting rid of the R/VCcomp benchmark which, according to ARC, is a means of "reflecting demand-based differential pricing principles."[63] As discussed above, any methodology whose stated objective is to eliminate differential pricing runs afoul of the basic economics of railroad pricing, which require that rates be set based on shipper demand. The objective of a valid rate reasonableness methodology is to identify appropriate limits on differential pricing, not to eliminate differential pricing altogether.

ARC also claims that the elimination of the R/VCcomp benchmark would address the potential for railroads to avoid limits on rate increases under a rate comparison methodology by taking broad industry-wide rate increases. *See* ARC Comments at 23. As discussed above, the concern about broad, industry-wide rate increases is purely speculative and inconsistent with market realities. It does not justify fundamental changes to the Board's existing rate reasonableness standards.

ARC also claims that that the R/VC comp benchmark (and by implication, "other relevant factors" evidence) should be eliminated from consideration in rate reasonableness challenges against revenue adequate railroads because they are too costly and complex to litigate. *See* ARC Comments at 17. ARC's unsupported claim is contrary to the Board's own conclusion when it adopted the Three-Benchmark methodology that the cost and complexity associated with

[63] ARC Comments at 17.

the comparison approach and the "other relevant factor" evidence were not unduly costly or complex. ARC provides no reason to question those conclusions, which were reached after a thorough review of comments and argument relating to the Board's proposed Three Benchmark methodology.

Finally, while the mechanics of ARC's proposal for revenue adequate railroads are inscrutable, the result of the proposed ARC methodology is that rates for revenue adequate railroads would be capped at the RSAM level. Such an approach would inappropriately penalize railroads that managed to increase the amount of contribution they earned from competitive traffic through service improvements and market expansion. The RSAM factor reflects the amount of revenue that a railroad must generate from its non-competitive traffic to cover its full costs. If a railroad is successful in expanding its competitive traffic base and increasing the contribution it earns from competitive traffic, the amount of contribution it would need from non-competitive traffic would decline. Since less contribution would be needed from non-competitive traffic, the railroad's RSAM would also go down resulting in reduced rates on regulated traffic under ARC's proposed methodology. Thus, ARC's proposal would create a disincentive to expand competitive traffic through good business practices and result in an overall degradation of rail service, contrary to the public interest.

ARC also proposes several other modifications to the rate reasonableness standards for grain shippers. These proposals are little more than throw away comments with little supporting detail. They can be summarily dismissed.

1. <u>Grain Cost Adjustment Factors</u>: ARC proposes that the Board develop and adopt Grain Cost Adjustment Factors for use in rate reasonableness cases involving grains and grain

products.[64] The adjustments are supposed to deal with the fact that substantial grain traffic moves in efficient shuttle train operations. The Board is already looking at changes to the URCS costing methodology (Ex Parte 431 (Sub-No. 4)) to address the relative efficiency of unit train-type movements.

2. Grain Rail Performance Standards: ARC also proposes that the STB establish Grain Rail Performance Standards and consider limiting future rate increases based on established performance standards.[65] It is unnecessary to address the question whether service issues should be considered in rate reasonableness cases since ARC's proposal would vastly complicate rate litigation directly contrary to ARC's goal of simplifying the rate reasonableness process and making it less costly for grain shippers.

3. Export Grain Rate Adjustment: ARC also proposes that the Board adopt some undefined export grain rate adjustment that would lower the rail price of grain exports.[66] It would be inappropriate, if not unlawful, for the Board to deliberately seek to subsidize exports by artificially reducing rail rates on export movements. Moreover, as Professor Wilson and Mr. Miller explained in BNSF's opening evidence, BNSF has worked hard over the last several years to promote export movements of grain in light of the growing importance of export grain markets for U.S. farmers. No regulatory intervention is needed to promote export grain movements, even if it were authorized.

[64] ARC Comments at 21 and accompanying Fauth VS at 7-13.

[65] ARC Comments at 24 and accompanying Fauth VS at 29-30. Mr. Whiteside also presents a series of complaints regarding BNSF's service. *See* ARC Comments, Whiteside VS at 17-31. As explained by Mr. Miller, BNSF's recent service issues were caused by an unexpected huge increase in demand and severe weather and BNSF has been working hard to improve service on its system. *See* Miller Opening VS at 7-8.

[66] ARC Comments, Fauth VS at 30-32.

C. <u>USDA Comments</u>

The USDA does not propose an alternative rate reasonableness standard or methodology but instead recommends that the Board adopt specialized mediation and arbitration programs to handle rate challenges. USDA Comments at 9-11. USDA appears to favor arbitration, recognizing that arbitrations can deal conclusively with a dispute while mediation only provides an opportunity to discuss the issues in dispute with a mediator. USDA argues that arbitration would be a good alternative to formal rate reasonableness litigation before the Board because it would be less costly and less time-consuming and because it facilitates commercial discussions between the parties in dispute. *Id.* at 9-10.

In Ex Parte 699, the Board recently considered the possibility of subjecting rate reasonableness challenges to arbitration and concluded it would not be appropriate to require arbitration of rate disputes. The Board's initial proposal in Ex Parte No. 699 would have created an opt-out program in which Class I and Class II rail carriers would be required to arbitrate several types of disputes, including "other rail service-related matters." Notice of Proposed Rulemaking at 14-16, STB Docket No. EP 699, *Assessment of Mediation and Arbitration Procedures*, March 28, 2012. Union Pacific Railroad Company ("UP") argued that this broad catch-all provision should not include rate reasonableness challenges. UP pointed out that arbitrators may not have access to confidential waybill data and the staff resources required to evaluate it, that rate reasonableness proceedings typically seek prospective or injunctive relief which the Board recognized would not be appropriate for arbitration, and that rate proceedings may have policy implications by virtue of their impact on other shippers and rail carriers that should not be addressed through arbitration. Union Pacific Comments at 8-9, STB Docket No. EP 699, *Assessment of Mediation and Arbitration Procedures*, filed May 17, 2012; Union Pacific Reply Comments at 9, STB Docket No. EP 699, *Assessment of Mediation and Arbitration*

Procedures, filed June 18, 2012. The Board's final rules acknowledged UP's concerns and eliminated the "other rail service-related matters" catch-all provision, thus excluding altogether rate reasonableness cases from the scope of the new rules. Final Rules at 8, STB Docket No. EP 699, *Assessment of Mediation and Arbitration Procedures*, May 13, 2013.

In addition, as USDA acknowledges, BNSF has already established a mediation and arbitration program in Montana to resolve rate disputes. USDA Comments at 11. As BNSF explained in its opening comments, the program began in 2009 and is available to members of the Montana Grain Growers Association and the Montana Farm Bureau Federation. Miller Opening VS at 15. The process involves a two-tier mediation structure and, if necessary, arbitration under market-based standards. *Id.* Arbitration panels are empowered to mandate reparations and lower rates for up to one year. *Id.* As BNSF explained on opening, only two proceedings have been initiated under the program. The fact that grain producers have used the program sparingly suggests that there is no widespread need for alternative dispute resolution procedures.

V. There Is No Basis In the Record Here For Clarifying the Application of Standing Rules as Applied to Grain Producers.

NGFA argues that any rules or methodologies adopted for challenges to rail rates for grain transportation must "not curtail the ability of parties who are both directly and indirectly affected by high rail rates to have standing to challenge the reasonableness of the rate." NGFA Comments at 32. NGFA includes in the group of persons indirectly affected by rail rates agricultural producers, grain marketers and exporters. *Id.* ARC similarly requests the Board to confirm that grain producers with no "direct damage" have the right to file rate reasonableness cases. ARC Comments at 10. USDA does not specifically address the standing issue but appears to assume that agricultural producers have standing to bring rate reasonableness challenges in arguing that the Board should facilitate "collective action" by "groups of agricultural producers." USDA Comments at 9.

ARC and NGFA appear to believe that the language of 49 U.S.C. 11701(b), which provides that "the Board may not dismiss a complaint made against a rail carrier providing transportation subject to the jurisdiction of the Board under this part because of the absence of direct damage to the complainant," is the beginning and end of the standing inquiry. NGFA's position appears to be that the statute entitles any party to challenge conduct of a regulated rail carrier regardless of the party's relationship to the conduct at issue or the nature of the relief sought.

In fact, the law has been well settled since the beginning of the 20th Century that a party that is not directly responsible for paying the railroad for the transportation services does not have standing to seek damages (*i.e.*, reparations) and *cannot* be awarded damages in a rate reasonableness proceeding. Only the party paying the freight bill, or the party otherwise directly responsible for the freight charge (e.g., an agent for the ultimate freight purchaser), is eligible to be awarded reparations for unreasonable rates. *See Merriam & Millard Company v. Chicago & Alton R.R. Co.*, 39 I.C.C. 485, 486 (1915) (awarding reparations because "complainants and intervener made the shipments described and paid and bore the charges thereon at the rates herein found to have been unreasonable."); *Missouri Portland Cement Co. v. Director General, as Agent*, 88 I.C.C. 492, 495 (1924) (concluding that in order to be able to recover damages, a party must have privity with the carrier.).

More recent cases have followed this basic standing rule. In *Puerto Rico Mfrs. Ass'n v. Trailer Marine Transport Corp.*, 1990 WL 300490 (I.C.C. July 24, 1990), an association filed a complaint regarding rail-water and motor-water rates citing 49 U.S.C. § 11701 as the basis for standing to bring the complaint. *Id.* at *1. The ALJ found that the association had standing to file a complaint but it did not have standing to seek reparations, reasoning that the participation of individual members who actually paid the freight charges would have to participate in the proceeding, and therefore the association on its own did not have standing to seek reparations. *Id*. In *McCarty Farms, Inc. v. Burlington Northern, Inc.*, 91 F.R.D. 486, 488 (D. Mont. 1981), the court concluded the wheat growers had standing because they were consignors of the transported wheat and, therefore, presumably had a direct relationship with the railroad whose rates were being challenged.

The statutory provision relied on by ARC and NGFA suggests that parties other than the freight payor may have standing under some circumstances to seek relief other than damages in cases involving the reasonableness of a rail carrier's rates, but there are no cases indicating when such standing would be appropriate. It would make no sense from a policy standpoint to allow any party to pursue litigation relating to a rail carrier's rates regardless of the connection of that party to the transactions at issue. But the circumstances under which such standing might be appropriate for non-damages actions would have to be evaluated on a fact-specific basis. As Professor Wilson explains in his reply verified statement, the commercial relationships between grain producers and grain shippers are varied and complex in today's market. No valid guidance could be given by the Board based on the record in this proceeding on the application of standing principles to these varied types of relationships.

Nevertheless, BNSF would not be opposed to the Board's initiation of a proceeding to investigate the circumstances under which indirectly affected parties may seek relief other than damages in cases involving rates for grain transportation. If the Board believes that there are significant concerns in the agricultural community about the uncertainty in current standing law, such an investigation would give the Board the grounds for issuing guidance on the issue. But no valid guidance on standing could be provided based on the current record.

VI. Conclusion

The parties seeking changes in the Board's current rate reasonableness standards as applied to grain transportation have not identified any valid reason for substantive changes to the Board's current standards, and the alternatives they propose are flawed and directly contrary to the market-based rate reasonableness principles that are supposed to guide the Board's regulation of rates. As BNSF has shown, there has not been recent litigation involving grain rates because there is no significant problem with the level of grain rates that would justify rate litigation, not because of any flaws in the Board's standards.

Respectfully Submitted,

Linda S. Stein

Richard E. Weicher
Jill K. Mulligan
Suzanne Wellen
BNSF RAILWAY COMPANY
2500 Lou Menk Drive
Fort Worth, TX 76131
(817) 352-2353

Samuel M. Sipe, Jr.
Anthony J. LaRocca
Linda S. Stein
Frederick J. Horne
Nina S. Thanawala
STEPTOE & JOHNSON LLP
1330 Connecticut Avenue, N.W.
Washington, DC 20036
(202) 429-3000

Counsel for BNSF Railway Company

August 25, 2014

Reply Verified Statement of John H. Miller

BEFORE THE SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 665 (Sub-No. 1)

RAIL TRANSPORTATION OF GRAIN, RATE REGULATION REVIEW

REPLY VERIFIED STATEMENT OF JOHN H. MILLER

I am John H. Miller, Group Vice President, Agricultural Products at BNSF Railway Company ("BNSF"). I submitted a verified statement on behalf of BNSF that was included with BNSF's Opening Comments in this proceeding. In that opening verified statement, I described BNSF's grain traffic and the important overall role of grain transportation to BNSF's business. I discussed BNSF's commitment to grain as evidenced by its major investments of capital in rail infrastructure that serves grain traffic and by BNSF's commitment to resolving the current service issues affecting grain shippers. I also described how BNSF works with its grain customers to ensure those customers are able to compete in global and domestic markets, provided some recent examples of how BNSF worked with customers to expand grain shipments, and identified some BNSF innovative programs that have significantly improved the efficiency and reliability of BNSF's grain service. In response to the Board's question about the rarity of grain rate litigation, I explained that our grain customers have not pursued rate litigation against us because our grain rates our low. I explained that most of our grain rates are effectively constrained by modal or geographic competition and, where BNSF faces less competition for grain traffic, we voluntarily constrain our grain rates to allow our grain shippers to participate effectively in the grain market.

I am submitting this reply verified statement to address a few of the assertions made in the opening comments submitted by the National Grain and Feed Association ("NGFA") and the opening comments submitted by the Alliance for Rail Competition and several grain groups (collectively "ARC") that are unsupported, inaccurate or misleading.

In their opening comments, NGFA and ARC express concern about the ability of small farmers and grain producers to obtain relief under the Surface Transportation Board's current rate reasonableness standards. However, the vast majority of our grain shipments are not made by small farmers or grain producers. Indeed, our largest grain customer in recent years has been CHS, Inc. ("CHS"), which is a very large conglomeration of cooperatives owned by farmers and grain producers. Other large BNSF grain shippers include Archer Daniels Midland and Cargill. In the past several years, most of our wheat, corn and soybean shipments, approximately 70%, have been made by our five largest customers by revenue for each of those respective commodities. Approximately 85%-90% of our wheat, corn and soybean shipments have been made by our top 10 customers by revenue for each of those respective commodities. The image that NGFA and ARC seek to create of a vast number of shipments by small shippers is simply not accurate in today's market.

ARC and NGFA also make the ridiculous and unsupported claim that railroads have the ability to and have in fact used their market power to "demarket" grain shipments. This claim makes no sense in grain markets and it is unsupported by any evidence. As I explained on opening, BNSF has expanded the market opportunities for grain shippers. We help grain shippers find new markets and expand their market options. We do not shut down market opportunities or try to inhibit movement of grain on our network. Indeed, it would be contrary to our interests to "demarket" grain shipments. We do not make money unless we actually transport traffic.

Even in a state like Montana where ARC claims that BNSF faces less competition (*see* ARC Comments at 7), rail transportation of grain traffic is growing. According to the State of Montana, rail shipments of grain out of Montana have been growing overall since the 1980s. *See* *http://www.nass.usda.gov/Statistics_by_State/Montana/Publications/crops/GMRTREPORT.pdf*. Those Montana statistics further show that the railroads' share of the market for Montana grain shipments has been increasing while the trucks' share of that market has been declining since the 1980s. Far from demarketing grain shipments in Montana, railroads have been expanding the market for Montana grain.

Also contrary to NGFA and ARC's claims, BNSF does not dictate where grain traffic goes. The market, not BNSF, dictates the movement of grain and BNSF tries to facilitate that movement. As I explained in my opening verified statement, we are in close communication with our grain customers to better understand their issues and the dynamics our shippers are facing in their markets. We work with our grain customers to identify opportunities to expand grain shipments and to respond to market changes. I provided two recent examples where we worked with our grain customers, resulting in expanded opportunities for grain shipments. As explained in my opening verified statement, in 2010, we worked to grow opportunities for our customers to ship wheat to the Texas Gulf for export. In 2012-2013, we developed a new market for our customers to ship corn following a drought in prime corn production areas.

I also explained in my opening verified statement that the reason grain rate cases have not recently been brought, at least against BNSF, is that BNSF's grain rates are low and most of them are effectively constrained by competition. I understand that BNSF's witnesses Messrs.

Fisher and Chakrabarti submitted an analysis of the Board's Waybill Data showing that BNSF's grain rates are quite low, particularly for smaller sized shipments. In ARC's opening comments, Mr. Whiteside attempts to create the appearance of high BNSF grain rates by presenting charts with a handful of BNSF wheat movements that he claims have high revenue to variable cost ("R/VC") levels. *See* Whiteside VS at 11, 13. Mr. Whiteside's hand-picked rates do not provide the Board with any meaningful information about overall grain rate levels. BNSF establishes common carrier grain rates for thousands of origin/destination ("O/D") pairs throughout its rail system, including some O/D pairs where few or no grain shipments actually move. In addition, BNSF often establishes multiple rates for a particular O/D depending on, for example, the number of cars in the shipment. Out of the thousands of grain rates issued by BNSF, Mr. Whiteside's charts purport to reflect the R/VCs associated with individual rates (for an undefined shipment size) for just 12 BNSF origin/destination pairs. Mr. Whiteside provides no explanation as to why he chose these 12 O/D pairs, whether he accounted for any incentive payments that might be relevant to the movement at issue, or how he calculated the movement costs. Based on my review of shipment data for the BNSF O/D pairs selected by Mr. Whiteside, BNSF has not even transported any grain shipments in the last three years on two of the selected movements (Enid, OK to Brownsville and Moore, MT to Gulf). Those two O/D pairs have some of the lower R/VC levels on Mr. Whiteside's charts, but they have not even been used by BNSF's shippers. No conclusions can be reached from the data in Mr. Whiteside's charts.

Mr. Whiteside's focus on R/VC ratios is also misleading because it fails to account for the fact that BNSF sets its grain rates based on market conditions, not based on some mark-up to variable costs. Market factors that affect the level of our rail rates vary substantially among origins and destinations. Cost may be a factor in setting some prices – for example, longer-haul movements tend to have higher rates on a dollar per unit basis – but numerous other market factors drive our pricing decisions. As a result, the market rates established by BNSF for grain movements are at varying R/VC levels.

NGFA and ARC want the Board to adopt new rate reasonableness standards that would drive BNSF's rates down to an arbitrary R/VC level. Such an approach to rate regulation would completely wipe out the impact of market forces that determine the rates we charge today, creating substantial dislocations in grain transportation.

I declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Reply Verified Statement.

Executed on August 25, 2014

John H. Miller

Reply Verified Statement of William W. Wilson

Rail Transportation of Grain, Rate Regulation Review
Reply Verified Statement of Dr. William W. Wilson
August 25, 2014
Docket No. EP 665 (Sub-No. 1)

I am Dr. William W. Wilson. I submitted a verified statement on behalf of BNSF Railway Company ("BNSF") in the opening round of comments in this proceeding. My background and experience in grain market issues are described in my opening verified statement.

In my opening verified statement, I provided the Board with extensive background information on grain markets that are dynamic and complex. I described the unique characteristics of grain and grain transportation markets, the benefits that deregulation of rail transportation has brought to all participants in the grain marketing chain, the broad array of competitive constraints on the rates that railroads can charge for grain transportation, and the lack of evidence that railroads have abused market power in their treatment of grain shippers. I have reviewed the opening comments of the other participants in this proceeding, particularly the comments of the NGFA and ARC, who purport to represent the interests of grain shippers, and USDA. I was surprised to find that those comments are almost completely devoid of any discussion of the dynamics of grain markets. Nevertheless, the grain shipper interests make several assertions about grain markets and the role of railroads in those markets that are unsupported and inaccurate. I am submitting this reply verified statement to address those assertions.

1. <u>Existence of Railroad Market Power</u>

NGFA and ARC both claim that railroads exercise substantial market power in grain markets. NGFA claims that:

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

NGFA Comments at 11. ARC similarly asserts that railroads' pricing of grain transportation reflects the unconstrained exercise of market power:

> The STB needs to be mindful that the railroad here is making the price in the marketplace and the farm producers, coal producers, chemical producers, etc. are the ones paying for the transportation cost that is now dictated by captivity and not by market demands. Only a company with absolute power and little or no effective competition can price in this way.

ARC Comments, Whiteside VS at 32.

The shipper interests present no evidence to support these assertions about railroad market power. As I explained in my opening verified statement, I am aware of no evidence that railroads have or have abused market power in grain markets and, in fact, the evidence is to the contrary. As I explained, there are many examples of BNSF acting to expand grain transportation and to develop new grain markets. Mr. Miller, BNSF's Group Vice President, Agricultural Products, also provided examples of BNSF seeking to expand market opportunities for its grain shippers. The most notable example is BNSF's dramatic expansion of shipments of corn and soybeans to PNW export facilities. As I explained in my opening verified statement, BNSF managed to attract these shipments away from other transportation modes and from movement to other destinations through aggressive pro-competitive efforts. This is the very opposite of what would be expected of a railroad abusing market power.

For a monopoly to exploit market power, the monopoly would normally be expected to reduce capacity as a means of supporting prices, or otherwise raise prices to reduce output to levels lower than would be observed in market equilibrium. Yet we observe just the opposite in rail grain transportation markets. We have seen continued investment in capacity, at least by BNSF, and we are now observing the biggest expansion in capacity ever through massive capital investments by BNSF, as described in Mr. Miller's opening verified statement.

2. **Competition in Rail Markets**

NGFA and ARC also claim without any support that competitive constraints on rail rates are limited. ARC states that "[f]or many grain shippers and producers, competitive remedies are not effective . . . . [M]ost grain shippers are not close to navigable waterways. Nor is rail to rail competition commonly available." ARC Comments at 7. NGFA states that "[m]any shippers of Ag Commodities nationwide are captive or potentially captive to a single railroad for service." NGFA Comments at 10.

I explained on opening that competitive constraints on the rates that railroads can charge are pervasive. I described the competition that railroads face from other transportation providers and the important role of trucks as the first mover of grain from the farm in disciplining rail rates. To drive home the strength of this traditional form of competitive constraint on rail rates, I present as an exhibit to this statement a map of the State of Kansas prepared by the Kansas Department of Transportation that shows the rail lines crossing the State and the rail stations on those lines. The map also shows in highlighting where corn is grown in the State. The map shows that all farmers growing corn in the state are within relatively easy trucking distance of more than one railroad. For example, farmers in the concentrated corn-growing region at the northeastern corner of the state would have access to both BNSF and UP within an 80-mile radius. In addition, corn farmers in the State can ship their product to ethanol facilities distributed throughout the State. As of 2012, there were 12 ethanol plants in Kansas.[1]

The State of Kansas is representative of most but not all grain growing regions in the country. While there are some areas where such ready access to multiple railroads is not as widely available, such as areas in the State of Montana, BNSF's Mr. Miller explained on opening that in those areas BNSF deliberately prices its services with recognition of the need to allow grain shippers to participate effectively in grain markets and in recognition of the rate reasonableness standards that would apply if litigation were brought. Moreover, in that state an effective ADR program has been established.

I described in my opening statement other constraints on rail rates for grain, including strong geographic or intermarket competition and competition from global grain markets. I also described the intertemporal factors that constrain rail rates, which are unique to grain markets. These intertemporal factors cannot be underestimated. If a railroad seeks to charge high transportation rates, it may induce shippers simply to store their grain. This intertemporal competition is particularly acute at times, like the present, when the market is already favoring storage through futures price differentials which result in deferred prices being considerably higher than prices that would be paid

---

[1] Kansas Dep't of Agriculture, Grain Inspection Service, *Ethanol and Biodiesel Plant Activity in Kansas – September 2012* (2012), *available at* http://www.kansascommerce.com/DocumentCenter/Home/View/1230.

for spot sales or sales in the near future. In these cases growers will likely choose to not ship, and store instead.

In addition, the shipper interests' claim that competition is limited ignores the ability of large grain shippers to effectively prevent any exercise of market power by railroads. As I explained on opening, grain shipments are increasingly made by large, vertically integrated grain and food companies. My understanding is that most of BNSF's grain shipments are made by a relatively small number of very large firms. Concentration in this industry has increased sharply in the past decade. Indeed, many acquisitions have been denied or scaled-back due to Department of Justice concerns. Consolidation has nevertheless increased and many regions are dominated by a few vertically integrated players. These firms have rail freight trading divisions that operate as integrated business units that efficiently and effectively manage their freight logistics. These firms have deep pockets and are financially very strong.[2] They also have the ability to put pressure on railroads due to the multiple origins and destinations where they have shipping interests. The broad geographic scope of these companies allows them to apply commercial leverage over railroads by shifting origins or destinations, or for that matter, shifting the origination of grain from U.S. origins to off-shore origins (as happened in 2014 when U.S. shipments were cancelled and shifted to Brazil). All of these factors strongly discipline railroad pricing.

---

[2] Indeed, even during 2013/14 when many shippers and growers were complaining about rail service, many of these firms were quite profitable. CHS, which is one of the largest grain shippers in the United States and is a cooperative owned by farmers and grain elevators throughout the upper Midwest, reported substantial profits from trading freight during this period. Specifically, CHS has indicated that "[e]arnings for the CHS Ag segment increased through the third quarter as a result of strong logistical performance within grain marketing.…" CHS reports earnings through fiscal 2014 third quarter of $881.7 million Jul 9, 2014. See http://chsinc.mediaroom.com/2014-07-09-CHS-reports-earnings-through-fiscal-2014-third-quarter-of-881-7-million. See also http://www.sec.gov/cgi-bin/browse-edgar?type=&dateb=&owner=exclude&action=getcompany&CIK=0000823277.

3. Demarketing Allegations

NGFA and ARC also claim without any support that railroads use their market power to determine what grain moves and where it moves. NGFA states that "a rail carrier can 'de-market' traffic to domestic and export markets from individual or groups of agricultural facilities simply through the unfettered use of freight rates set at levels that make commodities price uncompetitive in those markets." NGFA Comments at 11. ARC's witness Mr. Whiteside claims that "[r]ail 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." ARC Comments, Whiteside VS at 9.

These demarketing claims are unsupported, implausible and incorrect. Railroads have no incentive to actively try to reduce the amount of grain they handle. Railroads are subject to substantial economies of scale and they have a strong incentive to handle as much traffic as possible to efficiently use their capacity. Railroads cannot make any profits if they don't handle freight. There is nothing about the characteristics of grain or grain transportation that would discourage railroads from handling grain traffic. It is also inconsistent for the shippers to complain that railroads are charging rates that are unreasonably high, yet at the same time suggest that the railroads do not have an incentive to move grain.

The evidence is directly contrary to these demarketing claims. As I have explained, over the past decades BNSF's shuttle and car allocation programs have lowered shipping costs and allowed BNSF's shippers to penetrate new and important international markets (e.g., sales of soybeans and corn to China). It is unlikely that these markets would have become as important to U.S. farmers as they are today without BNSF's innovations and investments. BNSF actively and aggressively sought to facilitate the movement of soybean and corn from the Upper Midwest to the PNW, and shipments of these products now originate from as far east as North Dakota, South Dakota and Minnesota to serve PNW export markets. BNSF's actions have attracted these grain shipments away from other ports, other railroads and barges. These are not the actions of a railroad seeking to demarket grain.

NGFA also claims that railroads "are in a position to determine winners and losers of that overall market through their rate-setting policies." NGFA Comments at 11. As I explained on opening, BNSF's actions over the past decades have been just the opposite – BNSF has worked hard to promote new markets and expand the options available to grain producers and shippers. There is no evidence that railroads have tried to limit market opportunities for their shippers and it would make no sense for them to do so. Mr. Miller describes the relationship between BNSF and its shippers as one where both parties seek out market opportunities for their mutual benefit. BNSF uses its pricing, investments and commercial programs to make sure that market opportunities exist so that BNSF will gain by moving the freight and its shippers will gain by being able to take advantage of those market opportunities.

4. <u>Impact of Rail Rates On Farmers</u>

I noted in my opening statement that it is often assumed incorrectly that there is a 1:1 relationship between changes in rail rates and changes in prices to growers. See my opening verified statement at 16. NGFA and ARC both make this inaccurate claim in their opening comments. NGFA states that "as rail rates are increased, the price that a captive elevator will pay for the farmer's crop usually decreases by a commensurate amount." NGFA Comments at 7. ARC states that it is "[t]he farm producers who bear rail rates and rate increases." ARC Comments at 9.

The extent to which a farmer's price for grain is influenced by the level of rail rates for transportation of grain is a complex issue that is not amenable to simplistic statements such as those in the NGFA and ARC comments. In a recent study of mine, I examined a number of factors that impact the price that a farmer receives.[3] In addition to rail rates, fuel surcharges and secondary car costs, several other important factors come together to determine local prices for grain. The factors include ocean rate spreads (rates for ocean shipping between different export facilities or regions), demand for export sales, outstanding car orders, the ratio of grain stocks in storage to the amount of storage capacity, and prices on futures markets. The claim that there is a 1:1 relationship between rail rate changes and grain producer prices ignore the array of factors that affects a producer's price.

The simplistic notion that farmers absorb rail rates is based on an assumption that the farmer is a price taker that has no alternatives when faced with supposedly high rail rates. But as I explained on opening, grain producers have numerous options in today's market. Grain can be trucked to local markets (e.g., four mills, ethanol plants or soybean crushers), or trucked to alternative rail transportation providers or barges. Grain can be sold for shipment to multiple destination markets. Grain sales can be made for shipping in near future time periods or deferred until periods significantly into the future.

---

[3] Wilson, W., and B. Dahl, 2011. "Grain Pricing and Transportation: Dynamics and Changes in Markets, *Agribusiness*, Vol. 27(4), 420-34 (2011).

In addition, the notion that farmers are directly responsible for the costs of rail transportation ignores the wide variety of commercial arrangements that exist in modern grain markets between grain producers and elevators that purchase the grain as well as between elevators and downstream purchasers of the grain. As I noted in my opening statement, in traditional grain markets, the local price for grain would be determined simply by deducting the rail tariff for delivery of grain to a grain terminal from a pre-determined terminal price for the grain. See my opening statement at 19. But modern grain markets have become much more complex than this traditional model. Grain producers now sell their grain through a wide range of commercial instruments. Spot sales may be made to an elevator planning to store the grain, in which case the transportation costs are not even known until a future time period when the shipment occurs. In other cases, sales are made without fixing the price that will be received by the farmer until a later time and the future price is determined based on a range of factors. Grain sales may be made to an elevator planning to sell the grain FOB elevator, where the receiver of the grain will be responsible for the transportation costs. Given the wide variety of possible commercial arrangements, the impact of rail transportation costs on a particular farmer could not be determined without a detailed examination of the facts at issue.

5. <u>Ethanol</u>

Some of the tables in the NGFA opening comments include ethanol along with grain commodities. NGFA also claims that ethanol (in addition to other inputs such as fertilizer) should be included in the scope of its proposed new rules for assessing the reasonableness of rail rates for grain transportation. But it would be a mistake to think about ethanol as a commodity similar to grain simply because ethanol is produced from corn. The market for the transportation of ethanol (and other grain derivative products) is fundamentally different from the market for grain transportation.

In my opening statement, I described the unique characteristics of grain markets, including the volatility and seasonality of grain shipments, the importance of export markets, the dispersed origins and destinations for grain, and the range of participants in the grain marketing chain. None of these characteristics apply to ethanol transportation markets. Indeed, movements of ethanol to refineries act like a processing supply chain: ethanol is produced and contracted in advance to one or two refineries, and as such there is less temporal volatility or geographical dispersion in shipments compared to grain. Demand characteristics are different and shipments are generally made in shipper-supplied cars. Moreover, the safety and liability characteristics of grain and ethanol transportation are fundamentally different.

6. <u>Promotion of Exports</u>

ARC's witness Mr. Fauth claims that it would be in the national interest to promote exports through more aggressive regulation of rail rates for grain. See ARC Comments, Fauth V.S. at 31. In fact, deregulation has been key to the growth of grain exports in the United States and more aggressive regulation of rail rates for grain would reverse the tremendous gains that have been achieved in the area of grain exports.

As I explained in my opening statement, one of the key benefits of deregulation has been that railroads, BNSF in particular, have had the incentive and ability to develop innovative commercial programs and shipping technologies (like shuttle trains) and to invest in capacity that has allowed U.S. farmers to take advantage of expanding export market opportunities. Artificial reductions in rail rates as proposed by Mr. Fauth would likely reverse these service improvements by discouraging innovation and investment in the grain network. I described in my opening statement the stark contrast between the efficient, low-cost grain supply chain in the United States, where regulation has been limited, to the inefficient and high-cost grain logistics systems in Canada and Brazil, two of the United States' most important competitors in global grain markets, where regulators have been heavy handed in seeking to manage the supply chain. It would not be in the interests of any participant in the U.S. grain supply chain to move toward a regulatory system like that in Canada or Brazil.

7. <u>Separate Regulatory Treatment Of Grain Rates</u>

I have not carried out a detailed review of the specific rate reasonableness methodologies that the NGFA and ARC propose to be applied to grain commodities. However, I would like to comment on the idea underlying the NGFA and ARC proposals that grain commodities should be subject to different rate regulation standards than other commodities. This approach has been taken in Canada, but the experience in Canada with a separate regulatory regime for grain transportation has been a disaster and should be a model for what the Board should avoid. I described the inefficiency and inflexibility of the Canadian grain logistics system in my opening comments. The problems with grain transportation in Canada stem directly from the practice in Canada of singling out grain transportation for separate regulatory treatment. The resulting onerous Canadian regulation of grain transportation has made investment in the grain network less attractive to railroads and others in the grain marketing chain. Through governmental fiat, rates for grain transportation have been kept down, but the result has been a grain transportation network that is characterized by excessive costs, lengthy delays and a grain car fleet that has had to be funded directly by the government(s) and that is now aging and needing more intervention. As I noted in my opening statement, despite the artificially low grain transportation rates that have been imposed through regulation, we have been experiencing near record levels of Canadian grain moving into the United States for shipment over the U.S. rail network because the Canadian system is not capable of efficiently handling it.

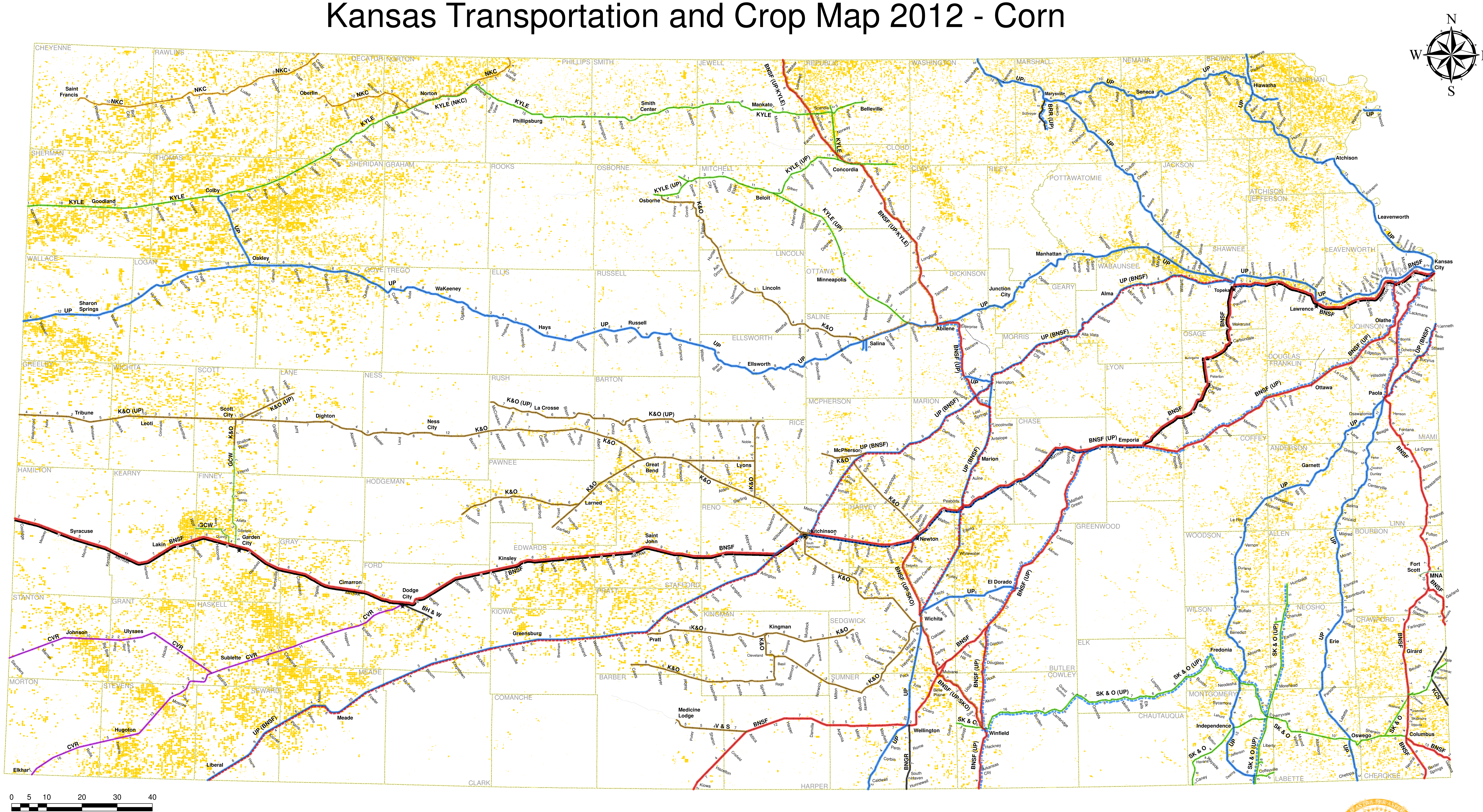
I declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

August 25, 2014

William W. Wilson
Professor of Agribusiness and Applied Economics
North Dakota State University

Exhibit 1 to Reply Verified Statement of William W. Wilson

Kansas Transportation and Crop Map 2012 - Corn



0 5 10 20 30 40
Miles

Corn 379,200,000 Bushels

- BNSF Railway 1237 miles
- Union Pacific 1535 miles
- KYLE Railroad System 269 miles
- KYLE Railroad System, Leased from UP 132 miles
- Kansas & Oklahoma Railroad 642 Miles
- Kansas & Oklahoma Railroad, UP leased 111 Miles
- Blackwell Northern Gateway Railroad 18 miles
- Blue Rapids Railroad 10 miles
- Boothill and Western Railway 10 miles
- Cimarron Valley Railway 182 miles
- Garden City Western Railway 45 miles
- Kansas City Southern 18 miles
- Missouri & Northern Arkansas 8 miles
- Nebraska Kansas Colorado Railway 122 miles
- South Kansas & Oklahoma 273 miles
- V & S Railway 24 miles
- New Century Aircenter Railroad 5 miles
- Wichita Terminal Association 3 miles
- Kansas City Terminal Railway 25 miles
- AMTRAK

USDA

Kansas Department of Transportation

PREPARED BY THE
KANSAS DEPARTMENT OF TRANSPORTATION
BUREAU OF TRANSPORTATION PLANNING
MAP CREATED WEDNESDAY, JULY 31, 2013