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BEFORE THE
SURFACE TRANSPORTATION BOARD

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

RAIL TRANSPORTATION OF GRAIN, RATE REGULATION REVIEW

REPLY COMMENTS OF THE NATIONAL GRAIN AND FEED ASSOCIATION

Pursuant to the decisions served in this proceeding on December 12, 2013 (*EP 665-1 Decision*), and August 18, 2014, the National Grain and Feed Association ("NGFA") hereby submits its Reply Comments.

I. Introduction

In its Opening Comments and Evidence, the NGFA responded to the Board's request for "input from interested parties on grain shippers' ability to effectively seek relief for unreasonable rates, including proposals for modifying existing procedures, or new alternative rate relief methodologies, should they be necessary," *EP 665-1 Decision at 2*, by proposing a new methodology to test the reasonableness of railroad rates for the transportation of "Ag Commodities," as defined in the NGFA's opening filing. This methodology, the Ag Commodity Maximum Rate Methodology ("ACMRM"), builds on existing principles found in the Board's Three Benchmark Methodology, but also includes a means by which the "revenue adequate" status of a railroad under 49 U.S.C. §10702(a)(2) and (3) is factored into rate reasonableness review process. The goal of the ACMRM is to create an easily administered, inexpensive, and objective way to test the reasonableness of Ag Commodity rates. The NGFA's opening submittal also includes a proposed procedural schedule, and addresses other aspects of the rate review process, such as market dominance.

Subsequent to filing its Opening Comments and Evidence, the NGFA has engaged in discussions with many other agricultural organizations about the NGFA's ACMRM proposal and the other elements of its filing. These discussions have resulted in an outpouring of support from a broad array of agricultural producer and agribusiness organizations concurring that the Board's current rail rate reasonableness rules are not usable to test the reasonableness of railroad rates for agricultural commodities, as evidenced in the filings submitted in this reply round by numerous other agricultural associations and other stakeholders. These organizations also agree that the new ACMRM methodology proposed by the NGFA warrants serious consideration by the Board.

The Alliance for Rail Competition, along with numerous agricultural organizations (collectively "ARC") and the United States Department of Agriculture ("USDA") also responded to the Board's invitation for concrete ideas and proposals to improve the STB's rail rate reasonableness rules as applied to the transportation of agricultural commodities.

In sharp contrast to the NGFA, ARC, and USDA, the railroad parties that submitted opening comments in this proceeding offered no substantive suggestions or recommendations – instead choosing to argue that the Board retain the *status quo* – despite the fact (or because of it) no captive rail shipper of agricultural commodities has even *filed* a rate reasonableness complaint with the Board since 1980. Unfortunately, this general approach should come as no surprise to the Board, since arguments for maintaining the regulatory and so-called "market" *status quo* at all costs have become an all too familiar refrain in the filings by railroad parties in the numerous proceedings the Board has commenced in recent years to review railroad competition and the Board's regulatory authority, starting before EP 705, *Competition in the Railroad Industry* in

2011. Indeed, rail carriers have resisted virtually all efforts by the Board to take a serious look at the state of competition in the rail industry and whether and how the Board's rules and procedures should be realigned to better balance the twin goals of revenue adequacy for rail carriers with the ability of rail shippers, particularly captive rail shippers and receivers, to access the protections afforded under the Staggers Rail Act of 1980 to challenge what they believe are monopolistic and unreasonable rates and practices by railroads.

In this Reply, the NGFA briefly comments on the opening submissions of ARC and USDA, and responds to and refutes some of the factual assertions made by Association of American Railroads ("AAR") and individual railroad commenters supporting their consensus position that essentially, "all is well" concerning railroad rates for the transportation of agricultural commodities.

II. ARC and USDA

The opening comments of ARC and USDA provide a picture that is remarkably consistent with the NGFA's of the reasons why the Board's current rail rate reasonableness rules are not usable by captive shippers of agricultural commodities, and how the Board should address this serious deficiency. ARC and the NGFA urge the Board to adopt an inclusive definition of "grain" for purposes of this proceeding and new rail rate rules (USDA's opening is silent on this point). All three parties urge to Board to adopt a new approach for captive "grain" shippers because the current rules are useless for agricultural rail shippers. For example, USDA encourages the Board to adopt "an entirely new approach" that entails a process "that is easy to understand, preferably formula-based using data that is easy to obtain and deterministic in nature." USDA also states that "[i]t is conceivable a new set of rules governing rail rates for captive grain or the rate-challenge process for grain movements could be formulated that incorporate railroad revenue adequacy," and that "the Board should take into account" railroad revenue adequacy in conjunction with "whatever new mechanism it establishes for agricultural shippers."

Further, all three parties highlight that agricultural producers often bear the brunt of rail rate increases, and so should have standing to seek relief from the Board. While all three discuss how litigation costs contribute to making the current rules unusable for agricultural rail shippers, USDA, in particular, highlights in detail how the prospect of significant litigation costs acts as a powerful deterrent to formal rate challenges by agricultural entities.

As stated above, in addition to the NGFA's ACMRM and related proposals concerning the appropriate procedures for agricultural commodity rail rate cases, ARC and USDA have submitted specific proposals that also are aimed at improving access to the ability to challenge rail rates for agricultural commodities. Specifically, ARC and its expert have proposed modifying the current rules to create a "two-benchmark" methodology to test the reasonableness of rates of revenue-adequate railroads, and have proposed specific changes to the Three Benchmark Methodology if it is to continue to be used to test the reasonableness of railroads that are not considered revenue adequate under the Board's procedures. These changes include how agricultural commodity movements are costed using the Uniform Rail Costing System, as well as expanding the movements that could be included in the comparison group utilized under the R/VC_{COMP} benchmark. ARC also expresses concerns similar to the NGFA's about the use of the so-called "Limit Price" market dominance test in rate cases involving agricultural commodities.

USDA, in addition to its recommendation that the Board take railroad revenue adequacy into account in new rail rate rules for agricultural commodity shippers, has posited that arbitration may effectively play a greater role in resolving disputes over agricultural commodity rate levels.

As explained in detail in the NGFA's opening submission, it believes that the ACMRM and other aspects of the NGFA's submission would provide a reasonable and workable solution to the current hurdles facing captive agricultural shippers described in the opening submissions of the NGFA, ARC and USDA. Indeed, the NGFA submits that the ACMRM addresses several specific issues and requests raised by USDA, such as its request that new rules take railroad revenue adequacy into account, the need to reduce litigation costs, and the necessity to have rate rules that provide a measure of predictability of result. However, the NGFA also applauds the commitment and effort made by ARC and USDA to also provide well-thought-out, specific proposals to the Board in this proceeding. The NGFA believes each of these substantive submissions warrant careful analysis by the Board as this proceeding progresses to the public hearing stage, and eventually – the NGFA hopes – to the issuance of a notice of proposed rulemaking.

III. AAR and Individual Railroad Parties

In essence, the Opening Comments filed by the Association of American Railroads (AAR) and the other railroad parties either disregard or attempt to obfuscate that this proceeding is focused on exploring the development of a workable process for grain shippers and receivers to challenge rail rates they believe to be unreasonable in instances where those rail users are captive and where effective competition does not exist – a statutory protection expressly granted by Congress under the Staggers Rail Act of 1980. Instead, the AAR and other railroad parties would have the Board substitute the carriers' self-professed altruism and benevolence in rate-setting practices as a complete and total replacement for the statutory protections afforded captive agricultural rail users against predatory pricing practices.

The AAR and other railroad parties substantiate the arguments made in the NGFA's Opening Comments and Evidence as to why rail transportation of agricultural commodities is so vastly different from most non-agricultural commodities. For instance, AAR cites fluctuating crop sizes from year-to-year because of weather-driven yield variations, changing patterns of farmer and elevator merchandising based upon market prices and varying demand pulls from domestic and export users, and other factors that influence export demand – to which the NGFA would add fluctuating international currency valuations and geopolitical considerations that can influence the availability of export markets. AAR Opening at 6. See also, BNSF Opening at 3-4. These statements buttress statements in the NGFA's Opening Comments and Evidence highlighting an overriding principle when it comes to transportation movements of agricultural commodities: the existence of multiple origin-destination pairs that change frequently and often unpredictably during the course of a marketing year. Further, they point to the fundamental reason why the Board's existing methods for challenging unreasonable rail rates are unworkable and unusable for agricultural shippers: the process is too complex, takes too long to complete, and is too costly given the comparatively lower value and volume of agricultural shipments.

The NGFA in its Opening Comments and Evidence demonstrated that the three methods currently available to grain shippers to challenge unreasonable rates are unworkable and unusable because of these inherent differences between agricultural transportation movements compared to non-agricultural products, as well as the complexity, time-consuming nature and costs of the Board's current rate-challenge methods. The NGFA states these are the primary reasons why agricultural commodity rate cases have not been filed with the Board.

The AAR and other railroad parties instead argue that the reason agricultural commodity rail rates are not being challenged is because presumably all such rates are inherently reasonable, fair and based on competitive market forces, even in situations where shippers and receivers are captive and competitive alternative carriers or transportation modes are not present. For instance, Union Pacific contends any attempt it makes to set above-market rates "would simply result in grain traffic shifting away from UP and UP-served origins. Efforts to charge unreasonable rates would be self-defeating," UP adds, stating that it believes grain shippers are not filing rate complaints "because their rates are reasonable." UP Opening at 16, 20. These assertions, and similar assertions by the other railroad parties, are preposterous on their face, and ignore the fact that consolidation of the rail industry into regional duopolies has reduced competitive options significantly for shippers and receivers of many agricultural commodities, as well as the degree to which meaningful rail-to-rail competition occurs even where it is physically possible.

The NGFA does concur with AAR's assertion that the Board's rate reasonableness rules should not "artificially constrain the ability of railroads to price their services according to market demand where…competition is present." *See* AAR Opening at 2 (emphasis added). Indeed, in situations where rail rates are reasonable and disciplined by effective competition, railroads have nothing to fear from the NGFA's proposed ACMRM alternative. But as demonstrated in the NGFA's Opening Comments and Evidence, ineffective rate-reasonableness rules have enabled and emboldened railroads to extract excessive monopoly profits from captive agricultural commodity shippers.

Rate-setting practices also have been used by railroads to strongly influence where and when certain commodities can be transported and sold. Indeed, as stated in NGFA's Opening

Comments and Evidence, there have been numerous instances in which rail carriers have "de-marketed" traffic to domestic and export markets based upon their dictates and preferences on which types and sizes of facilities to serve, often based upon loading and unloading capacity or commodity dictates, simply by the unfettered use of freight rates set at levels that make commodities price-uncompetitive from certain facilities and in certain markets.

Railroad parties also argue in their opening submissions that the declining market share of railroads in transporting agricultural products is "strong evidence that market participants generally have competitive options, and that railroads do not possess excessive market power with regard to grain movements." AAR Opening at 8; UP Opening at 16. In point of fact, the ongoing decline in rail modal share for agricultural shipments since 1980 is more attributable to railroads restructuring and rationalizing their operations (including through abandonments of significant rail trackage) to improve profitability, as well as rationing service. It also is further evidence of railroad practices that "de-market" agricultural commodity traffic cited previously by the NGFA in its Opening Comments and Evidence and in this Reply.

AAR and another railroad party also attempt to dismiss the need for a workable approach to challenge unreasonable freight rates for agricultural commodities by citing the past two years of record net farm income. In fact, as the railroad parties know full well, net farm income is highly variable and can and does change dramatically from year-to-year – influenced heavily by farm gate prices that are dictated by domestic and world supply-and-demand conditions for different agricultural commodities, as well as transportation costs. Indeed, the U.S. Department of Agriculture (USDA) National Agricultural Statistics Service's (NASS) Agricultural Prices

Report[1] issued on July 31, 2014 shows that U.S. feed grain prices have declined 43 percent from July 2013, with corn prices down $3.80 per bushel. Similarly, for U.S. oilseeds, prices paid to farmers in July 2014 were down 17 percent from the previous year, with soybean prices declining $2.60 per bushel. Meanwhile, U.S. food grain prices have declined 12 percent when compared to July 2013, with wheat prices down 85 cents per bushel.

What explains this precipitous decline in agricultural prices that will be reflected in net farm income figures for grain producers in the 2014/15 marketing year? Excellent weather and growing conditions in the U.S. grain belt that will lead to record or near record harvests for many agricultural commodities are certainly major factors. U.S. soybean production is projected to reach a record 3.82 billion bushels in 2014, up 16 percent according to NASS's most recent Crop Production Report[2] issued August 11, 2014. Soybean planted acres are up 11 percent this year compared to 2013. Growing conditions also were conducive for U.S. corn growers, who are expected to produce a record-high crop of 14 billion bushels, up 1 percent from last year's record.

This increased production will help ease previously tight carry-over stocks of U.S. grains and oilseeds that characterized the 2012/13 and 2013/14 marketing years, as the United States rebuilt stocks following a drought year. NASS's most recent World Agricultural Supply and

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1 Agricultural Prices. ISSN: 1937-4216. National Agricultural Statistics Service. U.S. Department of Agriculture, July 31, 2014.
http://usda.mannlib.cornell.edu/usda/current/AgriPric/AgriPric-07-31-2014.pdf

2 Crop Production. National Agricultural Statistics Service. U.S. Department of Agriculture. August 11, 2014.
http://www.nass.usda.gov/Newsroom/Executive_Briefings/2014/08_12_2014.pdf

Demand Estimates report[3], issued August 12, 2014, projects that U.S. feed grain ending stocks for the 2014/15 marketing year will rebuild to 49.06 million metric tons compared to 23.5 million metric tons at the end of the 2012/13 marketing year. Similarly, U.S. oilseed ending stocks for 2014/15 marketing year are projected to reach 13.32 million metric tons compared to actual ending stocks of 5.76 million metric tons in 2012/13

But lower agricultural commodity prices paid to farmers this year also reflects much higher transportation costs, particularly for rail, given the service disruptions that have plagued many of the Class I rail carriers since mid- to late 2013, and which were quantified in the NGFA's statements submitted to the Board in EP 724..

Since rail carriers have posited a correlation between rail rates and net farm income, then it should logically follow that farmers and agricultural shippers and receivers should expect to receive empathy from rail carriers in the form of commensurate reductions in rail rates to reflect significantly lower farm gate prices brought on, in part, by service degradation in some regions in the East and West. That certainly is not the expectation of the NGFA's member companies. Nor is it the reality of what has occurred in the past or likely will occur in the future.

The AAR and commenting railroad parties' attempt to justify rail rate-setting practices based on net farm income should be seen for what it is – a diversionary tactic that again does not speak to the fundamental issue in this proceeding – the need to create a workable methodology for captive agricultural commodity shippers and receivers to challenge rail rates they believe to be unreasonable, rather than disenfranchising them from this fundamental right provided under the Staggers Act.

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3 World Agricultural Supply Demand Estimates. National Agricultural Statistics Service. U.S. Department of Agriculture. August 12, 2014. http://usda02.library.cornell.edu/usda/current/wasde/wasde-08-12-2014.pdf

AAR also states that "not all rail shippers, including grain shippers, have seen their rates behave in the same way . . . . For those limited instances where the Board is authorized by statute to regulate rates, that regulation should seek to simulate competitive outcomes, rather than artificially constrain railroad rates below where they would be in a competitive market." AAR Opening at 15. The NGFA does not disagree, and again notes that this proceeding is not about situations in which competitive alternatives exist; rather, it is for circumstances in which shippers and/or receivers are captive to a single railroad. However the AAR's statement begs the question as to how AAR proposes to define a "competitive market." Does it apply to facility locations where there is no competing railroad within 1,000 or more miles, or an alternative competitive transportation mode, where rail consolidation has created regional duopolies that "compete" in an imperfect market? Would AAR now seek to have the Board's rail rate-challenge rules simulate the duopolistic, non-competitive transportation environment that the rail industry itself has created in certain regions? The NGFA fundamentally disagrees with this approach, and urges the Board to reject it.

AAR also states that railroads cannot price their services on average costs, and notes that in some cases, rail rates are below average total costs but above variable costs. AAR Opening at 16. Later, AAR alleges that proposals to change the *status quo* are attempts "by interest groups seeking advantage for their particular constituency." *Id.* at 21. The NGFA again states that it is not seeking to have carriers base rates on average costs; that is not what this proceeding is about. Nor is the NGFA's proposed ACMRM methodology an attempt to seek an "advantage" for agricultural commodities. Rather, it is about establishing a workable and reasonably available rate-challenge mechanism for captive agricultural commodity shippers and/or receivers to exercise their statutory right to challenge unreasonable rail rates that exceed the 180 percent revenue-to-variable cost level at which the Board has jurisdiction.

Other railroad parties in their opening comments mirror many of the same erroneous, obfuscatory and unpersuasive arguments posited by AAR in an attempt to have the Board retain the *status quo* for rate-challenge procedures. For instance, BNSF Railway and the Verified Statement of Dr. William Wilson make the same ill-founded net farm income arguments refuted by the NGFA previously in this reply. BNSF Opening at 9. But Dr. Wilson goes a step further by alleging that increased efficiencies in a more integrated grain supply chain have resulted in large firms (that) have the size and leverage to prevent any attempt by railroads to exercise market power." *Id.* at 5, and Wilson V.S. at 19, 42. As virtually any agricultural producer and grain merchant can attest, competition in the grain handling and marketing system is intense, and features multiple market players in virtually all geographic areas. Indeed, there are approximately 8,000 to 10,000 grain handling facilities nationwide competing intensely on a daily basis for farmers' grain. Even the AAR recognizes and accepts this truism in its opening, when it states that "competition among the various players in the grain marketplace) is intense, as the various commercial entities involved act and react based on the particular market forces they face at particular points in time." AAR Opening at 3 (emphasis added). In actuality, railroads, even in competitive transportation environments, typically set rates and price their services to the maximum level they believe the market will bear, which means that an elevator or other rail grain user that is captive to a carrier cannot "discipline" the rates charged in any way other than by filing a challenge against rates they believe are unreasonable. Further, if larger grain companies have such profound "leverage" over rail carrier pricing practices, as Dr. Wilson argues, how does he explain the millions of dollars in fuel overcharges extracted by a major

Class I carrier that has resulted in the Board reassessing its rail fuel surcharge "safe harbor" provisions in EP 661 (Sub-No.2)?

BNSF's statement also raises the specter that any change from the *status quo* will undermine, if not destroy, its ability to invest in its rail infrastructure to increase needed capacity. BNSF Opening at 9, 16 and 17. In this regard, BNSF in particular notes the NGFA's positive comments made during the Board's rail service public hearing (EP 724) about BNSF's commendable investments in rail track, locomotives and additional crews in an effort to restore rail service and meet expanding demand from agricultural and other sectors. UP also points to its capital investment in its rail network, which it says will amount to approximately $4.1 billion in 2014. UP Opening at 13-14. The NGFA reiterates its strong support for rail infrastructure investment here, and reiterates that its proposed ACMRM rate methodology would not hinder such investment. As demonstrated in the NGFA's Opening Comments and Evidence, even if every shipper that possibly could challenge an unreasonable freight rate under this new methodology received all potentially available relief – an outcome that will never occur – no rail carrier's revenue-adequate status would change. Further, if BNSF does not exercise market power over grain rail rates, as it asserts, it will not face rate challenges and therefore has nothing to fear from the Board adopting new rules that would provide a workable framework for agricultural shippers and/or receivers to challenge rates that are within the Board's jurisdiction that they believe are unreasonable. BNSF Opening at 17.

BNSF also argues that grain producers, shippers and receivers "can respond to high transportation rates by holding grain back for sale in the future." *Id.* at 22. It is simply not credible to suggest that agricultural producers, shippers and receivers should (or even could) adopt as a business strategy restricting or shutting off sales and shipments that are being generated by strong market demand and risk becoming an unreliable supplier to domestic and export markets in order to try and counter rail carriers' unilateral rate-setting practices. That's no way to run a farming operation, grain business, or, in the NGFA's view, a railroad. Further, BNSF's statement directly contradicts numerous other assertions in BNSF's Opening Comments extolling how it works with its customers to implement rates that enable BNSF and its customers to find, secure and consistently serve new markets. Specifically, BNSF maintains that "in some areas where competitive constraints on rail rates are less effective or may be perceived as less effective. . . . BNSF has been careful to set rates at levels that will allow its customers to effectively participate in grain markets . . . ." *Id.* at 28 and Verified Statement of John Miller at 8-11, 14-15. Which is it? BNSF cannot have it both ways.

The railroad parties also regale the Board with narratives about situations in which they allegedly face effective competition from trucks and barges, and even in some limited cases, other carriers. BNSF Opening at 17-18, 21-22; UP Opening at 15-16. But the carriers leave the false impression that truck transportation is a viable competitive alternative regardless of the size of shipment or distance traveled – which in the fiercely competitive domestic and international grain marketplace is not the case. Further, barge transportation has been shown to discipline rail rate behavior only within 100 to 150 miles of a barge-loading elevator. And even that degree of competition can be undermined if navigation on the inland waterways is restricted or interrupted because of drought conditions, lock repairs or other disruptions, which in fact have occurred several times over the past three years. But yet again, this proceeding and the NGFA's proposed ACMRM methodology are not designed to address such situations where competitive transportation alternatives exist. Rather, the ACMRM is intended to provide a useable means to test the reasonableness of rail rates where effective competition from other transportation alternatives does **not** exist.

Railroad parties also complain that in the "complex" grain supply business, they are the only ones whose rates are subject to regulation. BNSF Opening at 22. That is false, as other agricultural businesses are subject to antitrust laws – which rail carriers are not – as well as other federal and state regulations that pertain to buying and selling activities. For example, under federal and state grain warehouse laws, grain elevators are required to publish and make public their tariff rates and other charges for storing and handling grain. Further, they can be challenged if those rates are excessive. For instance, the U.S. Warehouse Act (USWA) states, in relevant part, the "warehouse operator shall deal, in a fair and reasonable manner, with persons storing, or seeking to store, an agricultural product . . . ." 7 U.S.C. §247(a).

The following discussion elaborates on the contrast between rate freedom enjoyed by railroads compared to grain warehouse operators. Under USWA regulations, grain warehouse operators are required to file with USDA a copy of the public tariff (storage) rules and schedule of charges to be assessed to depositors (e.g., farmers) before the warehouse can even secure a license to operate. The warehouse operator also is banned from imposing unreasonable or exorbitant charges for services rendered. USDA reviews all warehouse operator tariffs to ensure the USWA rules are met. Warehouse operators also are required to post these tariff charges at a conspicuous location where they can be seen or accessed by the depositor – a transparency that does not exist in the rail marketplace. The warehouse operator also is required to file with USDA a new public tariff statement or schedule of charges before implementing any changes to such rules or charges. Further, no increase in charges or rates is allowed to apply to grain already in storage at the time the changes become effective, and that freeze stays in place for at least one year from the date the grain was deposited. In addition, federal- and state-licensed warehouse operators are subject to examinations and audits, as well as recordkeeping requirements.

Finally, it is precisely because Congress recognized the need to provide safeguards against unfettered exercise of market power by railroads that it included a regulatory threshold at which unreasonable rates could be challenged.

IV. Conclusion

The NGFA, ARC and USDA have responded to the Board's invitation by presenting specific proposals aimed at enabling shippers of agricultural commodities to effectively seek relief for unreasonable rail rates. The NGFA believes its proposed ACMRM addresses all of the current deficiencies in the Board's rate rules as applied to agricultural commodities. Taken in whole, it is clear from the railroads' opening comments that the rates they set for agricultural commodities are based on the maximum that they think the market will bear, not necessarily at a level to capture costs and a reasonable profit and return on investment. Where transportation market forces are not operating, as is the case of situations where shippers and receivers are captive to a rail carrier, no such "discipline" exists and the sole remedy available to the captive shipper or carrier is to have access to a workable process to challenge rates they believe are unreasonable.

For these reasons, the NGFA urges the Board to reject the railroads' plea to retain the *status quo*, and to proceed by developing and publishing a proposed rule containing the elements of the NGFA's proposed rail rate reasonableness methodology.

Respectfully submitted,

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