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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Docket No. 42123

M & G POLYMERS USA, LLC

v.

CSX TRANSPORTATION, INC.

COMMENTS OF
BNSF RAILWAY COMPANY

BNSF Railway Company ("BNSF") has joined in the comments of the Association of American Railroads ("AAR") regarding the Surface Transportation Board's ("Board") new methodology for assessing qualitative market dominance announced by the Board in decisions served on September 27, 2012 ("September Decision") and October 25, 2012 ("October Decision") in the above-referenced rate reasonableness proceeding. BNSF submits the following comments as *amicus curiae* on its own behalf to supplement the comments of AAR.[1] As explained below, BNSF has serious concerns about the substance of the Board's new qualitative market dominance methodology and about the manner in which the Board adopted the new methodology.

I. It Is Inappropriate to Assess Qualitative Market Dominance by Reference to a Railroad's Costs.

The purpose of the Board's qualitative market dominance test is to determine whether the rates charged by a rail carrier for a particular movement are constrained by effective competition.

[1] Pursuant to footnote 10 in the October Decision, BNSF only expresses its views on the new qualitative market dominance methodology described in the Board's September Decision. BNSF takes no position on the application of the new methodology in this private rate dispute.

Until now, the Board has assessed qualitative market dominance by examining relevant market factors such as the existence of feasible alternatives to the rail carrier's service and the competitive interaction between the rail carrier and those alternatives. The Board's new methodology assesses qualitative market dominance by examining market prices relative to the rail carrier's variable costs. Under the new methodology, the Board determines the highest price the railroad could theoretically charge without causing a "significant amount" of issue traffic to divert to a feasible competitive alternative, converts that "limit price" to an R/VC ratio based on the rail carrier's URCS variable costs, and then compares that R/VC ratio to the rail carrier's most recent Revenue Shortfall Allocation Method (RSAM) ratio. *See* September Decision at 13-14. The RSAM is the R/VC ratio that the rail carrier would have to maintain on average on movements that have R/VC ratios over 180% for the rail carrier to earn a return on investment equal to the cost of capital. If the R/VC ratio of the "limit price" exceeds the rail carrier's RSAM ratio, the Board presumes that the transportation alternative is not an effective competitive constraint on the rail carrier's prices.

The ratios used in the new methodology to assess qualitative market dominance compare revenues to the rail carrier's URCS variable costs. The basic assumption underlying the new methodology is that a rail carrier's market power can be assessed by reference to the level of rates charged for a particular service relative to the rail carrier's variable costs. This assumption is wrong. BNSF sets rates based on market conditions, not based on costs. Market conditions may permit rates that are high or low relative to BNSF's costs. The relationship between those market rates and BNSF's costs says nothing about BNSF's market power or the existence of effective competitive alternatives to BNSF's service.

The use of R/VC ratios to assess the existence of effective competitive alternatives to a rail carrier's service would produce results that often make no sense. For example, BNSF competes directly with barges for grain transportation in certain regions, such as the transportation of grain from Midwest origins for export from Gulf Coast ports. Indeed, BNSF has made substantial investments in grain shuttle facilities in the Midwest in recent years to compete with barges for transportation to Gulf export facilities, and demand for rail transportation has increased. The existence of vigorous competition between railroads and barges for this transportation service is undeniable. But barge rates for grain transportation are driven by supply and demand, and in grain markets these factors fluctuate substantially. When demand for barge freight drives barge prices up, nothing has changed in the direct and vigorous head-to-head competition between rail carriers and barges for that transportation. But if market conditions produce barge "limit price" R/VC ratios that exceed BNSF's RSAM, the change in market conditions would lead to an irrational presumption under the Board's new methodology that BNSF suddenly acquired market dominance over the grain movements.

A methodology that assesses qualitative market dominance based on a rail carrier's variable cost is not only arbitrary, but it also creates perverse disincentives for a rail carrier to make capital investments that will improve rail productivity. Capital investments may substantially reduce a railroad's operating costs and therefore its URCS variable costs. For example, capital investments that reduce congestion or improve fuel efficiency can have a direct impact on a railroad's URCS variable costs. Indeed, a primary objective of such an investment may be to reduce direct operating costs. Without any change in the rates, a reduction of direct operating costs produces an increase in the railroad's R/VC ratios. In those circumstances, nothing has changed for the shipper, except possibly that it will now benefit from more efficient transportation. Moreover, there has been no change in the railroad's market power or the rates offered by the transportation alternative. But the R/VC ratio of the "limit price" of a railroad's competitor would go up because the Board's new methodology calculates that "limit price" R/VC ratio using the rail carrier's costs, which have gone down because of the enhanced productivity. The higher R/VC ratios on a competitor's "limit price" that result from the rail carrier's beneficial capital investments would subject the railroad to expanded rate regulation since the Board would find fewer competitive alternatives to be an effective constraint on the railroad's rates. An increased emphasis on R/VC-focused regulation -- here by the new "limit price" methodology -- creates a disincentive for railroads to make the very type of capital investments that the Board should be encouraging.

The new qualitative market dominance methodology is also inconsistent with the statutory scheme governing rail transportation. To advance Congress' desire to reduce intrusive rate regulation by the regulatory agency (*see* 49 U.S.C. § 10101(1)), Congress made a finding of market dominance a prerequisite for the agency to have jurisdiction to assess the reasonableness of a railroad's rates. 49 U.S.C. § 10707(b). Congress intended to limit the ability of the regulator to impose on the market the regulator's views of proper rate levels where there is a functioning competitive market. But under the new methodology, the Board's view on the proper level of rates is the central element in determining market dominance, not the existence of competition. The new methodology assumes that a "limit price" R/VC ratio that exceeds a rail carrier's RSAM is too high, whether or not there is a functioning competitive market. The Board's view is that an "effective" competitive market should keep rates below the rail carrier's RSAM. But Congress did not give the Board the authority to determine what rate levels should be in competitive markets. If a market is competitive, Congress intended that the Board stay out of the market. The new methodology violates Congress' intent.

II. **The Board Should Consider Changes to Its Market Dominance Rules in a Rulemaking Proceeding.**

BNSF is also concerned about the Board's adoption of a new qualitative market dominance methodology in the M&G rate reasonableness proceeding rather than in a rulemaking proceeding. The new methodology will affect all rail carriers whose rates are potentially subject to rate reasonableness review by the Board. But the new approach was adopted without any input by rail carriers and shippers. Moreover, the structure of the new approach may have been influenced by the specific market circumstances described in confidential evidence submitted in the M&G proceeding, but non-parties do not have access to all of the underlying confidential data relating to those circumstances.

The Board's decision to allow other interested parties to submit comments as *amici* on the approach already adopted by the Board in the M&G proceeding in a short time period is an inadequate substitute for a full consideration of proposed rules in a rulemaking proceeding with broad participation by railroads and shippers. In a notice and comment rulemaking, parties have sufficient time to address the proposed rules and an opportunity to review and respond to comments filed by other participants. Here, the full development of a record is not possible.

In this proceeding, the Board should take the opportunity to clarify and adopt a consistent approach for making changes in rate reasonableness methodologies. The Board's practice in this area in recent years has been arbitrary, as illustrated by BNSF's experience in the *WFA/Basin* rate reasonableness case, STB Docket No. 42088. A key issue in the various stand-alone cost analyses carried out in that case has been the proper methodology for allocating revenue on cross-over traffic. Before issuing its first decision in the *WFA/Basin* proceeding, the Board adopted the Average Total Cost ("ATC") revenue allocation methodology in Ex Parte No. 657 (Sub-No. 1), *Major Issues in Rail Rate Cases* (STB served Oct. 2006) ("*Major Issues*"), a notice and comment proceeding that had broad industry participation. But in the Board's 2007 decision in the *WFA/Basin* proceeding -- the first decision applying the new methodologies adopted in *Major Issues* -- the Board modified the ATC methodology without seeking input from other parties. *Western Fuels Ass'n v. BNSF Ry.*, STB Docket No. 42088, (STB served Sept. 10, 2007). BNSF challenged the validity of the Board's modified ATC methodology and the Board recently acknowledged flaws with its modified ATC approach and has sought public comment on a proposed alternative approach. Ex Parte 715, *Rate Regulation Reforms*, slip op. at 17-18 (STB served July 25, 2012). However, the Board has refused to make those changes in the *WFA/Basin* proceeding, even though the Board originally adopted its flawed modified ATC approach in the *WFA/Basin* proceeding. *Western Fuels Ass'n v. BNSF Ry.*, STB Docket No. 42088, slip op. at 12-13 (STB served June 15, 2012).

The Board's practice for modifying rate reasonableness methodologies has been arbitrary and inconsistent. BNSF urges the Board to use the M&G proceeding to clarify the process that it will use going forward to make changes in rate reasonableness methodologies.

Respectfully Submitted,

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

Counsel for BNSF Railway Company

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

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Comments of BNSF Railway Company has been served this 28th day of November, 2012 via first-class mail, postage prepaid, upon all parties of record in STB Docket No. NOR 42123.

Keith Decker