

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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Ex Parte 704 (Sub-No. 1)

REVIEW OF COMMODITY, BOXCAR, AND TOFC/COFC EXEMPTIONS

**REPLY COMMENTS OF
THE AMERICAN FOREST & PAPER ASSOCIATION AND
THE PAPER AND FOREST INDUSTRY TRANSPORTATION COMMITTEE**

Karyn A. Booth
David E. Benz
THOMPSON HINE LLP
1919 M Street, N.W., Suite 700
Washington, D.C. 20036
(202) 263-4108

*Counsel for
The American Forest & Paper Association and*

*The Paper and Forest Industry Transportation
Committee*

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The American Forest & Paper Association (“AF&PA”) and the Paper and Forest Industry Transportation Committee (“PFITC”)¹ submit these Reply Comments to the Surface Transportation Board (“STB” or “Board”) in this Notice of Proposed Rulemaking (“NPRM”) concerning the proposed revocation of commodity class exemptions that were adopted decades ago by the Board’s predecessor, the Interstate Commerce Commission (“ICC”).² In its Opening Comments, AF&PA responded to the Board’s inquiry regarding whether additional exempt commodities satisfy the standards for exemption revocation at 49 U.S.C. § 10502(d) and, thus, should be included in the Board’s exemption revocation proposal. AF&PA submitted data and information to the Board which compared rail movements of exempt paper and forest products in 1989 with movements in the year 2014 and such comparison demonstrated that there has been a

¹ The Paper and Forest Industry Transportation Committee is a non-profit action group that helps North American-based paper and forest product companies address their logistics and transportation challenges. PFITC was founded in 2002 when industry leaders came together to cement the value and benefit of collaboration and communication between respective companies. The purpose of PFITC is to increase the service and safety of all modes of transportation domestically and globally, improve the quality and quantity of equipment available to service our customers, and ensure that the North American paper and forest products industry remains competitive throughout the world. Additional information regarding the PFITC membership and mission can be found at www.pfitc.org.

² The Board modified the due dates for comments in a scheduling decision served May 6, 2016.

substantial reduction in the volume of exempt paper and forest products that are moving by rail but a corresponding huge shift in the volume of such traffic that is now being priced at captive rate levels, i.e. above 180% revenue-to-variable cost (“R/VC”).³ Specifically, AF&PA’s comments showed that there has been a **550%** increase in the amount of exempt paper and forest products traffic that is priced at captive rate levels and that the railroads have been able to capture a **940%** increase in captive revenue derived from such shipments. Based on the dramatic shift toward captive pricing with respect to exempt paper and forest products, coupled with the fact that some portion of these products must be shipped by rail,⁴ AF&PA asked the Board to revoke the exemptions for paper and forest products covered by STCCs 24, 26, and 40, as well as the boxcar exemption as it applies to rail shipments of paper and forest products. As detailed in AF&PA’s Opening Comments, restoring the Board’s regulatory oversight as to paper and forest product shipments would be entirely consistent with the Rail Transportation Policy (“RTP”).⁵ PFITC strongly supports the revocations proposed by AF&PA in its Opening Comments, and now joins in these Reply Comments.

In this Reply, AF&PA and PFITC respond to the Opening Comments submitted by the Association of American Railroads (“AAR”) and individual railroad parties in opposition to the Board’s proposal to revoke certain outdated commodity exemptions that are no longer justified under the revocation statute. The railroads’ comments represent nothing more than a thinly-veiled attempt to preserve the status quo as to *all* exempt traffic, in order to maximize opportunities to exert market power and extract higher revenues over traffic that lacks immediate

³ AF&PA’s Opening Comments were supported by a Verified Statement from Mr. Jay Roman, President of Escalation Consultants, which included an analysis and comparison of the 1989 and 2014 Confidential Waybill Samples.

⁴ AF&PA Opening Comments at 8.

⁵ See 49 U.S.C. §§ 10502(d) and 10101. See also AF&PA Opening Comments at 21-22.

access to potential regulatory remedies. Remarkably, the railroads refuse to acknowledge that *any* changes have occurred to the dynamics of the rail industry over the past 30 years, since the ICC first began exempting classes of traffic from regulation, including the dramatic consolidation of the market, the vastly improved financial health of the rail industry, and statutory changes adopted in the ICC Termination Act of 1995 (“ICCTA”) that have eliminated any exemption benefits that previously existed.⁶

The railroads’ narrow interpretation of the revocation statute and proposed limitations on the Board’s authority simply lack merit or support in the law. In fact, the Board has properly applied the revocation statute in its proposal and justified the need to restore regulatory oversight over some exempt traffic. The railroads’ attacks on the Board’s use of R/VC data to evaluate railroad market power when determining if “regulation is necessary” as to certain exempt traffic are contradicted by the long-standing recognition by Congress, the Board, and the courts that R/VC data is a useful and reasonable indicator of railroad pricing power; and by the fact that the railroads themselves have relied upon R/VC data to support the granting of exemptions. Obviously, when the railroads do not like the indications of R/VC data which show their increasing exercise of market power over exempt traffic, they seek to criticize the Board’s reliance on such information—but this transparent and self-serving criticism must be rejected by the Board. Further, as shown in the Rebuttal Verified Statement of Mr. Henry Julian Roman (Jay Roman) (“Roman Rebuttal V.S.”), President of Escalation Consultants, the expert testimony submitted by the AAR’s witnesses, Dr. Israel and Mr. Orszag, lacks credibility because it includes flawed analyses that vastly overstate the fluctuations in R/VC ratios that were relied

⁶ See AF&PA Opening Comments at 7-15.

upon by the AAR to undermine the reliability of such data. Mr. Roman's Rebuttal V.S. is attached as Exhibit 1.

Moreover, the Board's procedures and findings in the NPRM are fully consistent with the Administrative Procedures Act ("APA"), and the addition of paper and forest products in its revocation proposals is entirely permissible as a natural outgrowth of the original NPRM, based on the compelling evidence provided by AF&PA in its Opening Comments. *See* Section IV below.

I. THE BOARD PROPERLY APPLIED THE REVOCATION STATUTE IN ITS NPRM

Under the revocation statute, the Board "may revoke an exemption, to the extent it specifies, when it finds that application in whole or in part of a provision of [the statute] to the person, class, or transportation is necessary to carry out the transportation policy of section 10101." *See* 49 U.S.C. § 10502(d). This standard provides the Board with broad discretion to determine when it is necessary to restore regulation over rail transportation of an entire class of traffic that is currently exempt from regulation.

In opposing the Board's revocation proposals, the AAR places an exaggerated emphasis on the RTP factor which concerns a need to minimize Federal regulatory control over the rail transportation system, but ignores the Board's duty to balance that factor with other potentially competing RTP factors as applied to the current rail market.⁷ The Board's finding that regulation should be restored where there have been substantial changes in the dynamics of the transportation market and there is clear evidence of rising rail market power over a particular

⁷ *Intramodal Rail Competition*, 1 I.C.C.2d 822, 823 (1985); Petition for Rulemaking to Adopt Revised Competitive Switching Rules, STB Ex Parte No. 711, slip op. at 15 (served July 27, 2016).

segment of traffic is a reasonable exercise of its broad discretion and is entirely consistent with other RTP factors that require the Board “to ensure the development and continuation of a sound rail transportation system with effective competition among rail carriers and with other modes to meet the needs of the public”; “to foster sound economic conditions in transportation and to ensure effective competition and coordination between rail carriers and other modes”; “to maintain reasonable rates where there is absence of effective competition,” and “to prohibit predatory pricing and practices, avoid undue concentrations of market power, and prohibit unlawful discrimination.” *See* 49 U.S.C. § 10101(4), (5), (6), and (12); NPRM at 4. As the Board found, revocation is consistent with the RTP of 49 U.S.C. § 10101. NPRM at 4. Other commenting parties agree that the RTP supports revocation of various commodities.⁸ Certain railroad parties have also cited to the RTP, but “it is up to the Board to arrive at a reasonable accommodation of the conflicting policies set out in the Staggers Act”⁹ which it clearly has done in its NPRM.

To support its contention that the Board’s exemption revocation proposals are inconsistent with congressional intent,¹⁰ AAR emphasizes the standards to be applied by the Board when *granting* an exemption under 49 U.S.C. § 10502(a), but this emphasis is simply irrelevant here, since this proceeding is focused on the Board’s clear authority to *revoke* a class exemption under section 10502(d).¹¹ The mere existence of the exemption revocation statute

⁸ *See, e.g.*, Opening Comments of The Institute of Scrap Recycling Industries, Inc. at p. 8-11 (filed July 26, 2016); AF&PA Opening Comments p. 21-22; Opening Comments of The Portland Cement Association at p. 5-13 (filed July 26, 2016).

⁹ *Association of American Railroads v. STB*, 306 F.3d 1108, 1111 (D.C. Cir. 2002) (citation omitted).

¹⁰ AAR Opening Comments at 17-21.

¹¹ For the same reasons, the AAR’s assertion that the Board is attempting to rewrite the statutory scheme to create a policy in favor of re-regulation is also irrelevant (*see* AAR Opening

contradicts the railroads' claims that section 10502 may only be used to deregulate rail traffic to the maximum extent possible, since it's very purpose is to restore regulatory oversight when necessary to protect rail shippers from the potential unreasonable exercise of rail market power. Thus, there was a clear recognition by Congress when it adopted the exemption statute that circumstances may change and the reapplication of regulation may be necessary to carry out the RTP.

The Board's proposals and approach to implementing the revocation statute are clearly supported by substantial changes to the structure of the rail industry and the corresponding increased pricing power of the railroads that have occurred since the exemptions were granted more than 30 years ago, but AAR completely ignores such changes in its comments. AAR relies upon court and agency decisions issued in the 1980s, which predate the dramatic changes to the rail industry to support its interpretation of the statute,¹² and fails to acknowledge that the rail industry that existed in 1980 when the Staggers Rail Act was adopted is not the rail industry that exists in 2016. In the NPRM, the Board has properly fulfilled its responsibility to apply its exemption revocation authority based on current circumstances in the present-day rail industry.

As properly recognized by the Board in its NPRM, the substantial market changes that have occurred over the past 30 years, coupled with evidence of changes in railroad pricing behavior that indicate an increased likelihood of railroad market power, justify revocation of some class exemptions. Indeed, as AF&PA clearly demonstrated in its Opening Comments, there have been dramatic changes in the railroads' pricing power with respect to paper and forest products, such that more truck-competitive traffic has been shed from the rail system but the

Comments at 19), as it glosses over Congress' clear grant of revocation authority to the Board, which always contemplated the potential for restoration of Board oversight where consistent with the RTP.

¹² AAR Opening Comments at 18.

remaining traffic that is more dependent on rail service is now being priced at captive rate levels.¹³ For this portion of paper and forest products traffic, access to the Board's regulatory processes and remedies is necessary to carry out the RTP.

Additionally, AAR misinterprets the revocation statute and cites to selected passages of legislative history to support the assertion that the Board must determine that specific rail market power abuses have occurred before it can revoke a class exemption. AAR Opening Comments at 6-7. This assertion lacks any merit as it is inconsistent with the express wording of the revocation statute, the legislative history read as a whole, and case precedent.

A. The Railroads' Assertion that the Board Must Find Particular Instances of Market Power Abuse in Order to Revoke a Class Exemption is Incorrect

The AAR and several individual railroads have asserted that the Board's proposed commodity revocations are improper because the Board did not find any specific abuse of market power by the railroad industry. For example, AAR contends "[n]or does the Board make a finding that railroads possess (much less that they have abused) market power with respect to the traffic at issue..."¹⁴ Norfolk Southern complained that the "[t]here is no finding by the STB that railroads have in any way abused market power with respect to these commodities."¹⁵ UP stated that "[t]here is no evidence of any competitive abuse."¹⁶

A finding of actual market power abuse is not required before revocation can occur. As noted above, the exemption revocation statute requires only consideration of the RTP factors set forth at 49 U.S.C. § 10101 when determining if regulation as to a particular class of rail traffic is

¹³ AF&PA Opening Comments at 15-25.

¹⁴ AAR Opening Comments at 20-21.

¹⁵ Norfolk Southern Opening Comments at 4. *See also id.* at 17 and 30-32.

¹⁶ UP Opening Comments at 4.

necessary.¹⁷ Precedent also confirms that revocation can occur without particular instances of market power abuse. The Second Circuit previously addressed whether actual competitive injury is required in a revocation case. *See Mr. Sprout, Inc. v. U.S.*, 8 F.3d 118 (2nd Cir. 1993). In *Mr. Sprout*, after the appellant argued that the ICC erred by requiring more than just a potential for competitive harm, the Second Circuit found that the ICC never required a “precise level of competitive harm” in the case. Instead, appellants merely needed to show *potential* injury “grounded in facts indicating a real possibility of competitive harm.” *Mr. Sprout*, 8 F.3d at 126. At the most, then, revocation is not intended to remedy past market power abuse, but to protect shippers from *possible* future market power abuse. The Board itself has also said that, in deciding whether to revoke an exemption, it looks at “whether the shipper lacks sufficient intermodal alternatives and whether the carrier has market power that it *could abuse* with respect to the traffic, thus necessitating regulatory oversight.”¹⁸

Moreover, the evidentiary showing that would support a finding that regulation is necessary to address an individual shipper’s exempt traffic is not necessarily the same as the showing needed to support revocation of a class exemption, which would apply regulation more broadly. The legislative history of the revocation statute supports this view. In the Conference Report accompanying the legislation that became ICCTA, the conferees clarified that alternative evidentiary showings are possible to satisfy the revocation standard. Specifically, the Conference Report stated “[w]hen considering a revocation request, the Board should continue to

¹⁷ *See* 49 U.S.C. § 10502(d).

¹⁸ *Pejepscot Industrial Park, Inc. d/b/a Grimm Industries – Petition for Declaratory Order*, STB Docket No. 33989, slip op. at 7 (n. 15) (served May 15, 2003) (emphasis added). *See also Caldwell Railroad Commission – Exemption from 49 U.S.C. Subtitle IV*, STB Docket No. 32659 (Sub-No. 1), slip op. at 2 (served Nov. 26, 2014) (“the Board will revoke an exemption if a petitioner has demonstrated conduct that frustrates the RTP and the Board has determined that the reinstated regulatory provisions could ameliorate the alleged harms”).

require demonstrated abuse of market power that can be remedied only by reimposition of regulation **or that regulation is needed to carry out the national transportation policy.**¹⁹ A reasonable interpretation of this statement would be that the first alternative showing of a demonstrated abuse of market power is more appropriately applied when an individual shipper asks the Board to apply regulation to address a *specific* concern regarding its rail traffic. However, the second more broad showing that regulation is needed to carry out the national transportation policy would apply to revocation of a class exemption for an entire commodity group. In fact, applying the revocation standard in the manner proposed by the railroads would be unworkable, and would potentially result in extremely complicated and costly litigation before the Board.

Here, the Board appropriately evaluated the relevant factors of the RTP in light of substantial market changes that have occurred since the exemptions were granted. The Board also properly performed its own study of confidential waybill data to support its findings of an increased likelihood of the exercise of railroad market power. *See, e.g.*, NPRM at 4 (finding that “[t]he purpose of this proposal is to restore shippers’ access to the Board’s regulatory oversight and processes—in particular, shippers of those commodities where evidence indicates that the competitive landscape has changed significantly enough to indicate that renewed regulation is necessary to carry out the RTP.”). Following the Board’s approach, AF&PA has submitted compelling evidence in its opening comments which supports revocation the class exemption for paper and forest products, based upon dramatic transportation changes and the increased exercise of rail market power over such traffic that has occurred since 1989. AF&PA Opening Comments at 15-25. These changes justify access to the Board’s regulatory processes by paper and forest

¹⁹ H.Rep. 104-422 at p. 169 (Dec. 18, 1995) (emphasis added).

products shippers. As the ICC has stated, “[i]n determining whether regulation is necessary to protect shippers from an abuse of market power, a significant consideration is whether the participating shippers actually seeking transportation are concerned about an abuse of market power.” *Rail General Exemption Authority – Petition of AAR to Exempt Rail Transportation of Selected Commodity Groups*, 9 I.C.C.2d 969, 973 (1993).

B. Sufficient Evidence Exists for the Board to Revoke the Exemptions

AF&PA, PFITC, and numerous other commenting parties have submitted significant data, witness statements, expert testimony, and other information in support of the proposed revocations, further bolstering the Board’s findings and disproving the railroads’ claim that inadequate supporting evidence exists.²⁰ The Board has the discretion to weigh the evidence submitted during this proceeding, resolve any conflicts in the evidence, and decide how to proceed. *See, e.g., Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984) (“a court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency”). The Board must merely “articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made.” *Motor Vehicle Manufacturers Association of the United States, Inc. v. State Farm Mutual Automobile Insurance Company*, 463 U.S. 29, (1983) (quotation and citation omitted). Clearly, the evidence in the record of this rulemaking proceeding (including the Board’s findings, AF&PA’s Opening Comments, including its analysis

²⁰ For example, Norfolk Southern criticized the Board’s reliance on “anecdotes,” but then submitted its own anecdotal evidence – alleged “examples of customers citing trucking prices or other competitive options in negotiating rates.” *See* NS Opening Comments at 15 and 28. In contrast to NS’s critique of anecdotal evidence, BNSF wanted more anecdotes from the Board. *See* BNSF Opening Comments at 11 (contending that the NPRM included a “relative dearth of supporting anecdotal evidence”). The AAR criticized the Board for the “inadequate data” and the “limited anecdotes” on which it relied. AAR Opening Comments at 31 and 40.

of the Waybill, and the further analysis of AF&PA and PFITC in these Reply Comments), combined with the comments and testimony provided to the Board at the 2011 public hearing, are more than adequate to support revocation of the paper and forest products exemptions.²¹

As AF&PA explained in its Opening Comments, the regulatory and commercial changes that have occurred since the paper and forest products exemptions were granted also support their revocation.²² The dramatic transformation of the commercial environment, as evidenced by railroad financial strength, rising transportation rates, and motor carrier stagnation, have already been addressed at length by various parties in their Opening Comments.²³ As noted, the railroads simply refuse to acknowledge the occurrence of *any* market changes since the exemptions were granted decades ago.

Further, shippers of paper and forest products supported adoption of the exemptions over twenty years ago based on the benefits that would be achieved from removing cumbersome tariff filings and similar regulatory obligations. In the pre-ICCTA time period, shippers wanted railroads to be free from the tariff filing constraints and other regulatory burdens so that the shippers themselves could operate more efficiently and compete more effectively in the marketplace. For example, virtually all commenting shippers supported the lumber and wood products exemption considered by the ICC in 1991. These shippers told the ICC they “need to be able to respond immediately and flexibly to compete in their own markets” and, therefore, they complained about “regulatory delays which would be eliminated by this [proposed]

²¹ See, e.g., Notice of Intent to Participate and Written Testimony of AF&PA and PFITC in STB Ex Parte No. 704 (filed Jan. 31, 2011); Notice of Intent to Participate and Written Testimony of the National Industrial Transportation League in STB Ex Parte No. 704 (filed Jan. 31, 2011).

²² AF&PA Opening Comments at 7-15.

²³ See, e.g., Opening Comments of The Institute of Scrap Recycling Industries, Inc. at p. 5-7 (filed July 26, 2016); AF&PA Opening Comments at 7-21; Opening Comments of The Portland Cement Association at p. 6-13 (filed July 26, 2016).

exemption.” *Rail General Exemption Authority – Lumber or Wood Products*, 7 I.C.C.2d 673, 675 (1991).

Railroads, too, emphasized the removal of now-obsolete tariff filing and paperwork obligations as the primary reason for many commodity exemptions. *See, e.g., Rail Exemption General Authority – Miscellaneous Manufactured Commodities*, 6 I.C.C.2d 186, 188 (1989) (“AAR notes that this exemption, like previous exemptions, will promote efficiency and improve the railroads’ financial health by eliminating costly tariff filing requirements. AAR states that under the exemption carriers will be able to respond more quickly to shipper demand...”); *Petition to Exempt from Regulation the Rail Transportation of Scrap Paper*, 9 I.C.C.2d 957, 959 (n. 2) (1993) (“Petitioners [consisting of the AAR and nine railroads] state that an exemption would enable railroads to compete more effectively with motor carriers by eliminating the delay and expenses of filing tariffs and complying with the administrative requirements connected with contracts executed under § 10713.”). However, the very benefits to be achieved from the exemptions ceased to exist when Congress passed ICCTA and eliminated tariff filing and other administrative requirements for all commodities. Thus, today there is no benefit conferred upon shippers of exempt traffic but only the detriment that results from the loss of access to STB oversight.

II. THE BOARD’S USE OF R/VC DATA IS CONSISTENT WITH THE STATUTE, PRECEDENT, AND RAILROAD PRACTICE

The railroads strenuously object to the Board’s reliance on changes to R/VC ratios as support for the commodity revocations proposed in the NPRM. BNSF argued that R/VC ratios “are not reliable indicators of market dynamics,” but, instead, they create “dangers” and “ignore

[] market realities.”²⁴ Union Pacific criticized the Board’s alleged “near-exclusive reliance on R/VC ratios,” which the UP expert believes to be “too blunt.”²⁵ Norfolk Southern claimed the Board’s examination of traffic with an R/VC above 180% is “meaningless” because “an R/VC ratio of 180% lacks any economic significance.”²⁶ The AAR stated that reliance on R/VC ratios is “arbitrary,” and CSXT simply asserted that “[c]iting R/VC ratios...is no evidence of market power.”²⁷

The railroads’ attacks on the Board’s use of R/VC data are misguided. R/VC ratios have long been utilized by Congress, the courts, the Board, and its predecessor in evaluating railroad market power. Here, the Board has reasonably relied in part upon changes in R/VC ratios to determine that an increased likelihood of railroad market power exists with respect to the commodities included in its revocation proposal. AF&PA has also submitted substantial evidence in its Opening Comments, including an analysis of the substantial increase in the amount of paper and forest products traffic subject to captive R/VC levels, which is consistent with the Board’s NPRM and the revocation statute. The railroads’ opposition to use of R/VC ratios is disingenuous, since they have repeatedly used R/VC ratio evidence in commodity exemption proceedings in the past to demonstrate a *lack* of rail market power when advocating for imposition of new commodity exemptions. Further, as shown in Mr. Roman’s Rebuttal V.S., expert testimony provided by the AAR to cast doubt on the reliability of R/VC ratios as an indicator of railroad market power is based on flawed analyses and, thus, lacks credibility.

²⁴ BNSF Opening Comments at 2, 8, and 10.

²⁵ UP Opening Comments at 2 and 12.

²⁶ NS Opening Comments 14.

²⁷ AAR Opening Comments at 22; CSXT Opening Comments at 3. *See also* CSXT Opening Comments at 7 (“R/VC ratios are a very poor indicator of market power.”).

A. Congress, the Board (and ICC), and the Courts have used R/VC Ratios to Evaluate Railroad Market Power

The railroads are simply incorrect in their assertion that R/VC ratios shed no light on market power and are economically meaningless. The relevance of R/VC data to railroad market power has been recognized repeatedly by Congress and the courts, and R/VC ratios are utilized by the Board for a variety of regulatory purposes related to railroad market power. Congress ordered this agency to conclusively find that railroads are not market dominant for purposes of rate cases when the relevant R/VC is less than 180%. *See* 49 U.S.C. § 10707(d)(1)(A). In contrast, if the relevant R/VC equals or exceeds 180%, the railroad might be market dominant for purposes of a rate case. Hence, Congress has clearly established that R/VC ratios are informative when assessing railroad market power.

The relevance of R/VC ratios to railroad market power is reflected in numerous other regulatory uses and statements from authorities, as shown below.

1. Railroad rate reasonableness cases

In adjudicating rail rate reasonableness cases, the Board utilizes R/VC ratios in several contexts, often in some relationship to railroad market power. For example, in addition to the application of R/VC ratios as the quantitative market dominance standard, the Board has relied upon Revenue Shortfall Allocation Method (“RSAM”)²⁸ and R/VC ratios when evaluating railroad market dominance in recent cases such as *M&G Polymers USA, LLC v. CSX Transportation, Inc.*, STB Docket No. 42123, slip op. at 13-21 (served Sept. 27, 2012) and *E.I.*

²⁸ RSAM represents “the average markup that the railroad would need to charge all of its ‘potentially captive’ traffic in order for the railroad to earn adequate revenues as measured by the Board.” *See, e.g., Simplified Standards for Rail Rate Cases – 2013 RSAM and R/VC > 180 Calculations*, STB Ex Parte No. 689 (Sub-No. 6), slip op. at 1 (served Sept. 3, 2015). For purposes of RSAM, “potentially captive traffic” means “all traffic priced at or above the 180% R/VC level.” *Id.* at 2. Thus, RSAM is an aggregated R/VC ratio based on a portion of the subject railroad’s traffic.

du Pont de Nemours and Company v. Norfolk Southern Railway Company, STB Docket No. 42125, slip op. at 18-21 (served Mar. 24, 2014). Use of a quantitative measurement of railroad market power for the qualitative component of a market dominance evaluation has judicial approval. *See, e.g., CF Industries, Inc. v. STB*, 255 F.3d 816, 822 (D.C. Cir. 2001) (“While the Board’s market dominance guidelines contemplate the use of such qualitative considerations, they do not exclude the application of quantitative analysis as well.”) (citation omitted).

In rate reasonableness adjudications, the Board also uses R/VC ratios as part of the Maximum Markup Methodology (“MMM”) to allocate joint and common costs among the various shippers in a SARR traffic group.²⁹ Of course, SARR traffic group members who receive a greater allocation of such costs have more inelastic demand, meaning that the relevant railroad has more market power over them. In other words, the R/VC ratios of the SARR traffic group represent the degree of railroad market power. *See, e.g., Major Issues*, slip op. at 16 (“the Maximum Markup Methodology reflects the important principle that a railroad should recover as much of its costs as possible from each shipper served before charging differentially higher rates to its captive shippers.”) (citation omitted).

Reference to MMM highlights another point – the concept of differential pricing. The Board’s large rate case standards are based partially upon this concept, which means that higher rates must be charged to shippers with inelastic demand. *See, e.g., BNSF Railway Company v. STB*, 526 F.3d 770, 774 (D.C. Cir. 2008) (“Because captive shippers have inelastic demand, the

²⁹ As the Board has said, “Congress regarded R/VC ratios as an appropriate measure for allocating joint and common costs among rail shippers.” *Major Issues*, slip op. at 14.

railroads can charge them higher rates with a lower risk of losing their business.”).³⁰ Again, this concept is not far from the view that R/VC ratios are higher when railroads have market power.

Underpinning all of these examples is the theory that rates will be higher when a service provider (such as a railroad) has market power. From an economics perspective, this is a logical conclusion and, in fact, it has been judicially recognized by the courts. *See, e.g., CF Industries, Inc. v. STB*, 255 F.3d 816, 823 (D.C. Cir. 2001) (stating that an “accepted method of measuring market power” is “based on the recognition that although a firm in a competitive market cannot raise its prices without a net loss of revenue, a firm with market power can”) (citation omitted); *Arizona Public Service Company v. United States*, 742 F.2d 644, 654 (D.C. Cir. 1984) (stating that “competitive pressure” is related to a railroad’s ability to raise prices). In the rate case context, the Board and the courts have occasionally evaluated the railroad’s rates when determining whether rail service has effective competition from other modes.³¹

2. Commodity and rail traffic exemption proceedings

The rail industry’s opposition to the use of railroad R/VC ratios as an indicator of market power in the commodity exemption context is all the more baffling given that such ratios were repeatedly cited to demonstrate a lack of rail market power when various commodity exemptions were first adopted. *See, e.g., Petition to Exempt From Regulation the Rail Transportation of*

³⁰ *See also, Major Issues in Rail Rate Cases*, STB Ex Parte No. 657 (Sub-No. 1), slip op. at 13 (served Oct. 30, 2006) (“the SARR (and therefore the carrier) must be allowed to engage in demand-based differential pricing”) (citation omitted); *Consolidated Rail Corp. v. U.S.*, 812 F.2d 1444, 1454 (3rd Cir. 1987) (Stating that, in the *Coal Rate Guidelines*, “the ICC would permit carriers to charge captive shippers a higher share of unattributable costs than shippers in the competitive market share.”); *Coal Rate Guidelines – Nationwide*, 1 I.C.C.2d 520, 534 (1985) (Constrained Market Pricing “establishes constraints on the pricing freedom of the railroads which induce them to price all traffic efficiently. As with Ramsey pricing, services are priced according to market demand...”).

³¹ *See, e.g., FMC Wyoming Corp. v. Union Pacific Railroad Co.*, 4 STB 699, 719 (2000); *Arizona Public Service v. U.S.*, 742 F.2d 644, 650-651 (D.C. Cir. 1984).

Scrap Paper, 9 ICC.2d 957, 960 (1993) (the existence of low railroad R/VC ratios “indicates...that the traffic...is generally subject to significant competition”); *Rail General Exemption Authority – Exemption of Grease or Inedible Tallow, Etc.*, 10 ICC.2d 453, 460-461 (1994) (“We believe that an examination of shipper and rail contracting prices, rail pricing behavior, rate levels, and R/VC ratios in these markets indicates that railroads have not been able to assert any meaningful market power.”); *Rail General Exemption Authority – Exemption of Carbon Dioxide*, 10 I.C.C.2d 359, 363 (1994) (exempting carbon dioxide transportation because, among other things, “competing forces have acted to keep rail rates at competitive levels, *i.e.*, at average R/VC ratios less than 180%”); *Rail General Exemption Authority – Exemption of Ferrous Recyclables*, 1 STB 173, 176 (1996) (“We continue to believe that R/VC ratios are useful in analyzing the degree of market power by the railroad industry in connection with transportation of particular commodity groups.”).

The D.C. Circuit has also found that the agency’s reliance on aggregated R/VC data to be “justified” in a boxcar exemption analysis even though it may be “imperfect.” *Brae Corp. v. United States*, 740 F.2d 1023, 1040-1041 (D.C. Cir. 1984). Certainly aggregated R/VC data is not perfect, but no class-wide method of analysis ever can be. If class exemptions are to be utilized in the rail industry, then an aggregated method of analyzing the relevant transaction type or commodity is necessary.³² Further, as demonstrated above, the Board is not required to find actual market power abuses in order to revoke an exemption under section 10502(d). Rather, its use of R/VC ratios as a reasonable indicator of the potential exercise of rail market power is

³² *Cf. CF Industries*, 255 F.3d at 823 (n. 12) (“Although techniques exist for measuring market power more directly, they involve data not typically available to courts or regulators, and data which the parties agree are not part of the record in this case.”) (citation omitted).

consistent with its duty to determine if the restoration of regulation is necessary to carry out the RTP.

B. Railroads Have Long Relied on R/VC Data as Evidence in Commodity Exemption Proceedings

The vehement resistance of the railroads to the Board's use of R/VC data in the NPRM is particularly disingenuous. When R/VC data has supported creation of commodity exemptions, as it did many years ago, railroads were not reluctant to submit R/VC data to the agency as evidence of a lack of market power in order to convince the agency to create new exemptions.

As just a few examples:

- Conrail submitted R/VC data to the ICC to advocate for a boxcar exemption. *Brae Corp. v. United States*, 740 F.2d 1023, 1040 (D.C. Cir. 1984).
- When the AAR and nine individual railroads petitioned the ICC to exempt scrap paper, they cited to the nine railroads' R/VC ratios for that commodity. *Petition to Exempt from Regulation the Rail Transportation of Scrap Paper*, 9 ICC.2d 957, 960 (1993).
- When the AAR supported the ICC's proposal to exempt salt and rock salt, its "chief argument" was that "R/VC ratios of salt and rock salt are far below the level of 180%." *Rail General Exemption Authority – Exemption of Rock Salt, Salt*, 10 ICC.2d 241, 249 (1994).
- The AAR submitted commodity-level R/VC data to the ICC in support of a petition to exempt ferrous recyclables. *Rail General Exemption Authority – Exemption of Ferrous Recyclables*, 10 ICC.2d 635, 641-642 (1995).
- The AAR submitted R/VC data for cement traffic during the ICC's consideration of whether to exempt that commodity. *Rail General Exemption Authority – Exemption of Hydraulic Cement*, 10 ICC.2d 649, 652 (1995).

These examples reveal that the railroad commenting parties actually once believed that R/VC ratios are relevant to an evaluation of rail market power in the commodity exemption context when such data supported their regulatory objectives. Today, in an era of a highly concentrated rail market and increased rail rates, they now oppose use of R/VC data, since they well know that such data will indicate increased market power and support the restoration of regulation in certain cases. The railroads cannot have it both ways, and their sudden “about face” on the use of R/VC data, when they do not like the results of such data, lacks credibility.

C. The Board Should Reject Collateral Attacks on R/VC Data

As part of its effort to discredit the NPRM, the AAR engages in a broad-based critique of the entire concept of an R/VC ratio, as well as the Uniform Rail Costing System (“URCS”) utilized by the Board to calculate railroad variable costs. AAR Opening Comments at 23-27. This type of collateral attack on the Board’s economic costing regulation is far outside the scope of this rulemaking. Indeed, the Board is currently considering changes to URCS in a separate rulemaking proceeding, *Review of the General Purpose Costing System*, STB Ex Parte No. 431 (Sub-No. 4). AAR’s concerns about URCS should be filed in that proceeding or be the subject of a new Petition for Rulemaking to the Board.

AAR cites a third-party report to criticize the Board’s use of R/VC ratios to allocate railroad costs,³³ but courts have approved the Board’s methods. *BNSF Railway Company v. STB*, 526 F.3d 770, 777-780 (D.C. Cir. 2008) (affirming use of Maximum Markup Methodology, which relies on R/VC ratios, to set rates in Stand-Alone Cost rate cases). In any event, AAR’s broad-brush critique is well outside the bounds of this commodity exemption proceeding. For

³³ AAR Opening Comments at 24-25.

the same reasons, the AAR's invocation of various third-party studies regarding use of R/VC ratios and URCS costs is similarly off-the-mark. AAR Opening Comments at 22-29.

AAR also asserts that the Board's proposed revocation "directly contradicts" 49 U.S.C. § 10707 because of the Board's use of R/VC data. *See* AAR Opening Comments at 23. AAR's assertion reflects confusion and a conflation of two different concepts. The cited statute concerns market dominance in rail rate cases – it does not govern commodity exemptions. The exemption statute does not bar the use of R/VC ratios in considering whether an exemption is appropriate; furthermore, R/VC ratios have long been used in commodity exemption proceedings by the ICC and the Board. *See* Section II.A above.

The Board should also ignore the AAR's wide-ranging criticism of R/VC ratios because it relies heavily upon poorly designed and/or insufficiently supported statistical analyses. First, AAR cited to its experts' finding that railroad rates can remain high even when a shipper is served by two Class I railroads, thereby allegedly showing the faulty nature of R/VC ratios. See AAR Opening Comments at 28. This attempted "critique" fails miserably; in fact, it confirms the need for Board revocation in this proceeding – when the marketplace does not effectively constrain railroad pricing power, even where two railroads serve a shipper, then Board regulatory oversight is undoubtedly necessary.

Moreover, the AAR experts' finding is flawed and misleading due to the construction of the data analyses, as explained in Mr. Roman's Rebuttal V.S. In performing certain R/VC analyses, the AAR's experts improperly assumed that rail competition existed for certain selected movements based only on multi-carrier access to the destination, thus ignoring whether the origin was captive. Roman Rebuttal V.S. at 4-5. If an origin is captive, there can be no competition for the entire origin-to-destination movement and the AAR experts' conclusion is

unsound. The study also rested on the assumption that, if two railroads transporting a particular STCC serve a large railroad station such as Houston, then all movements of that STCC from Houston are competitively-served. Roman Rebuttal V.S. at 5-6. Obviously, such an assumption is fatally flawed because Houston is filled with multiple shippers for many common commodities. The erroneous mixing of captive and competitively-served shippers is exacerbated by the AAR experts' use of five-digit STCC codes instead of the more precise seven-digit codes. Roman Rebuttal V.S. at 6.

The AAR's experts also included high-rated TIH commodities in their analysis, which inevitably skewed the results because TIH commodities, due to liability concerns, tend to have high railroad rates regardless of competition factors. Roman Rebuttal V.S. at 5. Finally, the AAR experts purported to remove gateways from the analysis in order to eliminate the effect of Rule 11 rates, but Mr. Roman found that many common gateways were still included in the study parameters. Roman Rebuttal V.S. at 7.

The AAR experts' conclusion in the Conrail study is also of questionable value. *See* AAR Opening Comments at 28. The experts allegedly determined that many captive Conrail shippers saw an increase in rail rates when they obtained access to both NS and CSXT, but their analysis is based on data that raises more questions than it answers. It is unknown whether the AAR's experts controlled for changes in STCCs, whether truck or water transportation competition existed at the time of Conrail service, and the extent to which high-rate TIH movements were included in the analysis. Roman Rebuttal V.S. at 8-9. In other words, insufficient data and explanation exists for the conclusions drawn by the AAR's experts, rendering these conclusions dubious at best.

Moreover, Mr. Roman has shown that overall rail rates have risen substantially over the past fifteen years, and at a rate much faster than motor carrier rates. Roman Rebuttal V.S. at 9. It would be incongruous to base a deregulatory action on a finding that railroads are successfully exploiting rail market power and significantly raising rates regardless of whether two carriers serve a given shipper.

III. THE REVOCATION STATUTE IS NOT LIMITED TO INDIVIDUAL CASE-BY-CASE DETERMINATIONS

The AAR seeks to preserve the status quo as to exempt traffic by arguing that, before a class exemption could be revoked, the Board must first require individual shippers to file individual requests for revocation of an exemption that must be litigated on a case-by-case basis. AAR Comments at 37-38. This contention requires an unreasonably narrow interpretation of the revocation statute and lacks any merit. AAR's assertion is directly contradicted by the very words of the statute, which allows the Board to revoke *any* exemption as applied to either an individual shipper's rail traffic or entire class of traffic: "The Board may revoke an exemption, to the extent it specifies, when it finds that application in whole or in part of a provision of this part **to the person, class, or transportation** is necessary to carry out the transportation policy of section 10101 of this title." *See* 49 U.S.C. § 10502(d) (emphasis added). AAR fails to cite to any authority that would support its strained interpretation of section 10502(d) because there is none. Following the AAR's logic, there could be no amount of market changes or market power asserted over a category of traffic that could justify revocation of a class exemption until countless numbers of individual petitions for revocation have been filed. This notion is ridiculous and should be rejected out of hand.

AAR also cites to the Board's informal dispute resolution process as an effective substitute for rail customers' access to the Board's formal adjudicatory processes to address rate,

service, or other rail-related concerns. AAR Opening Comments at 38-39. While shippers support the existence of the RCAP as an informal and cost-effective mechanism to try and resolve disputes with their serving railroads, the fact that railroads must voluntarily agree to participate in the informal dispute resolution process, as well as the lack of any enforcement authority on the part of the Board over such disputes, renders these options much less effective than access to the Board's adjudicatory processes and procedures. Finally, AAR seems to argue that the lack of prior petitions having been filed at the Board to revoke an exemption as to a particular commodity somehow eradicates the authority and responsibility of the Board to evaluate on its own whether substantially changed market conditions require a review of existing class exemptions; or, similarly, that a lack of requests by individual shippers for exemption revocations in the past, in essence, has resulted in a waiver of the right to request revocation of a class exemptions today. *See, e.g.*, AAR Opening Comments at 37-38. Again, there is simply no merit or support for such an interpretation of the revocation statute.

IV. A SEPARATE RULEMAKING PROCEEDING IS NOT REQUIRED UNDER THE APA TO REVOKE THE PAPER AND FOREST PRODUCTS CLASS EXEMPTIONS

The AAR also asserts that it was improper for the Board to invite comment on the possible exemption revocation for other commodities. AAR Opening Comments at 42-43. With this assertion, AAR forgets that “[a]gencies are not limited to adopting final rules identical to proposed rules”³⁴ and “[t]he final rule need not be the one proposed in the NPRM.”³⁵ Obviously, the AAR was aware at the time it filed its Opening Comments of the possibility that other shippers of exempt traffic or their representatives may request revocation. *See* NPRM at 4 (“The

³⁴ *National Mine Association v. Mine Safety & Health Administration*, 116 F.3d 520, 531 (D.C. Cir. 1997).

³⁵ *Agape Church, Inc. v. FCC*, 738 F.3d 397, 411 (D.C. Cir. 2013).

Board also welcomes interested parties to file comments regarding the possible revocation of other commodity class exemptions; such comments should address any marketplace changes comparable to the ones described below.”). *See also* NPRM at 11. This is especially true in the case of AF&PA and PFITC given their direct involvement in this proceeding going back to the Board’s public hearing in 2011. Thus, exemption revocation as to paper and forest products is a “logical outgrowth” of the NPRM.³⁶ Also, because the AAR (and its members) have the opportunity to respond directly to AF&PA’s request for revocation in its (their) Reply Comments, the purposes of notice-and-comment have been served.³⁷ Moreover, the opening of a new rulemaking proceeding as to the revocation of the class exemptions for paper and forest products would be completely duplicative of this rulemaking proceeding and a waste of the Board’s and industry’s resources. The interested stakeholders would be required to refile and re-litigate the same issues at significant and unnecessary expense.

³⁶ *Agape Church*, 738 F.3d at 411 (quotation and citation omitted).

³⁷ *Small Refiner Lead Phase-Down Task Force v. EPA*, 705 F.2d 506, 547 (D.C. Cir. 1983) (evaluating “how well the notice that the agency gave serves the policies underlying the notice requirement”). *But see Fertilizer Institute v. EPA*, 935 F.2d 1303, 1312 (D.C. Cir. 1991) (agency itself must provide the notice, and agency cannot expect parties to read all other parties’ comments).

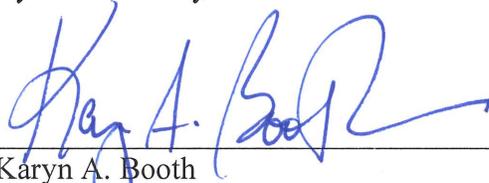
V. CONCLUSION

For the foregoing reasons, AF&PA and PFITC respectfully request that the Board revoke the commodity exemptions for paper and forest products shipped under STCCs 24, 26, and 40, as well as the boxcar exemption as it applies to rail shipments of paper and forest products.

Respectfully submitted,

*Counsel for
The American Forest & Paper Association and
The Paper and Forest Industry Transportation
Committee*

By their attorneys:



Karyn A. Booth
David E. Benz
THOMPSON HINE LLP
1919 M Street, N.W., Suite 700
Washington, D.C. 20036
(202) 263-4108

Dated: August 26, 2016

EXHIBIT 1

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 704 (Sub-No. 1)

REVIEW OF COMMODITY, BOXCAR, AND TOFC/COFC EXEMPTIONS

REBUTTAL VERIFIED STATEMENT

of

HENRY JULIAN ROMAN

August 25, 2016

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REVIEW OF COMMODITY, BOXCAR, AND TOFC/COFC EXEMPTIONS

REBUTTAL STATEMENT

of

HENRY JULIAN ROMAN

I. INTRODUCTION

My name is Henry Julian Roman (Jay Roman). I am President of Escalation Consultants, Inc., which is located at 4 Professional Drive Suite 129, Gaithersburg, MD 20879. Escalation Consultants is a consulting firm engaged in economic analysis and consultation related to prices and price movement for shipping products by rail. Since founding Escalation Consultants in 1979, I have assisted a large number of companies in analyzing the best options for their rail traffic and in controlling the cost of rail transportation.

I regularly perform studies of rail rates for companies with movements in the U.S. and Canada. Some of the industries I work with are: Coal, Chemicals, Petroleum, Automobile, Grain, Steel, Fertilizer, Farm and Food Products, Paper Products and Forest Products. I am knowledgeable about the current cost of rail transportation in the marketplace as I annually assist companies in rail negotiations and bid evaluations totaling more than a billion dollars in rail spend.

I have testified as an expert on pricing issues involving coal and rail transportation issues before the U.S. Federal Energy Regulatory Commission, in federal courts, in state courts, before the National Energy Board of Canada, and in arbitration proceedings in the U.S. and Canada as well as before the U.S. Surface Transportation Board (“STB” or “Board”). I previously issued a verified statement in this proceeding in support of the American Forest & Paper Association Comments submitted in this proceeding on July 26, 2016. My curriculum vitae is attached to my prior testimony in Appendix A.

II. DESCRIPTIONS OF TASKS ASSIGNED

The American Forest & Paper Association and the Institute of Scrap Recycling Industries, Inc. asked me to analyze the verified statement of Dr. Mark Israel and Mr. Jonathan Orszag (“Israel/Orszag”) which was submitted to the STB in support of the Association of American Railroads (“AAR”) assertion that Revenue to Variable Cost (R/VC) ratios do not accurately measure the market power of railroads.

My analysis of the Israel/Orszag testimony focused on the data and underlying analysis used to generate Table III.1 and Table III.2 on pages 15 and 16 of their testimony and the conclusions they reached based on the two tables. The claimed purpose for each of these tables in the Israel/Orszag testimony is as follows.

Table III.1 - This table was used to demonstrate that R/VCs (and the 180% R/VC statutory benchmark in particular) is not a reliable indicator of market power.

Table III.2 - This table was used to demonstrate that R/VC ratios do not consistently fall in cases where competition has increased.

III. CONCLUSIONS FROM ANALYSIS

My analysis of the footnotes (shown on pages 15 and 16) that describe how Tables III.1 and III.2 were assembled and the underlying support provided by Dr. Israel and Mr. Orszag for these tables demonstrates the following:

- **Dr. Israel's and Mr. Orszag's conclusion that R/VC ratios do not accurately measure railroad market power is inaccurate because the R/VC ratio fluctuations shown in Tables III.1 and III.2 of their testimony have more to do with problems in how the tables were compiled than they do with how accurate R/VC ratios measure competition for rail movements.**
- **The Israel/Orszag analysis mixes up which rail moves are captive and which are competitive and this results in R/VC ratios that make little sense. This is the fundamental problem with the methodology used to calculate the information in Tables III.1 and III.2 in their testimony.**

IV. ANALYSIS OF TABLE III.1: JOINTLY-SERVED DESTINATIONS WITH R/VC RATIOS ABOVE 180%

Dr. Israel and Mr. Orszag use Table III.1 on page 15 of their testimony to show that R/VC ratios and the 180% statutory benchmark in particular, is not a reliable indicator of railroad market power because that benchmark can result in routes with significant competition as having R/VC ratios above 180% and, thus, such routes would improperly be considered to be subject to railroad market power. Table III.1 is used to show that jointly served STCC-destination combinations have one or both railroads with R/VC ratios above 180% for the same commodity. Dr. Israel and Mr. Orszag, therefore, reached the conclusion that because R/VC ratios are above

and below 180% at stations which are shown as competitive in his analysis, the R/VC for a movement is not indicative of the level of competition for a movement.

My analysis of the manner in which they performed their analysis demonstrates that a major reason for R/VC ratios being above and below 180% is not that R/VC ratios do not accurately measure a railroad's market power for a movement. Instead the underlying support for Table III.1 demonstrates that the way the Israel/Orszag analysis was performed causes the R/VC ratios at the STCC-destination combinations to, by default, have R/VC ratios both above and below 180%. The problem is, therefore, not with the R/VC ratios but with the analysis that was performed to generate the R/VC data included in Table III.1. The following issues demonstrate the problems with the Israel/Orszag analysis and the conclusions reached from Table III.1.

Issue 1: The footnote beneath Table III.1 on page 15 of their testimony shows that the analysis was only performed based on competition at the destination station.¹ The results in this table, therefore, only consider competition for commodities at the destination for movements. However, the level of the R/VC for a movement is often determined by whether the origin for a commodity is captive to a single railroad. For example, if most origins for a commodity in an area are captive to one railroad, the degree of competition at a destination is frequently meaningless. Sodium Compounds (STCC 28123) moves, which are included in Table III.1, are a good example of this, as almost all origins of this commodity are captive to one railroad and the rates are developed accordingly.² Origin competition can be the most significant factor in determining the

¹ The footnote for Table III.1 states "STCC-Destination pairs with 2+ terminating RRs over 2000-2014 period; highest-volume terminating carrier up to 80%, second highest-volume terminating carrier at least 20%; 6000+ total carloads; and excludes intermodal and gateways (e.g. Chicago, St. Louis)."

² Sodium Compounds (STCC 28123) moves are included in the Table III.1 results and almost all origins for this commodity are captive to a single railroad.

level of an R/VC ratio and, because Table III.1 does not consider the origin for movements, this distorts the summary R/VC results and makes conclusions reached from those results inaccurate.

Issue 2: Table III.1 includes Chlorine (STCC 28128) and Anhydrous Ammonia (STCC 28198) and these are Toxic Inhalation Hazardous Material movements (“TIH Moves”). Due to the railroads’ well known potential liability concerns with TIH Moves they will normally have very high R/VC ratios regardless of the competition at a destination. This type of hazardous move needs to be excluded from any analysis as to how accurately R/VC ratios measure market power for such movements, because the R/VC ratios for these types of moves have more to do with potential liability than the level of competition for movements.

Issue 3: Table III.1 assumes that if two railroads have moves on the Waybill out of a station for a five-digit Commodity Code (STCC) this means that all industries served from that station for a type of commodity have access to both railroads. Though this can be a reasonably accurate assumption for moves terminating at a small rail station, this is simply not an accurate assumption to make in assessing competition at large rail stations. For example, Houston TX has by far the largest number of carloads (1,664,109) terminating at a station in the Israel/Orszag analysis based on the supporting data underlying Table III.1. Houston TX is a very large station that has a large number of industries served out of this station and some industries are captive to one railroad, while others have access to two railroads.

The Israel/Orszag analysis assumes that if there is more than one railroad shipping a commodity at the five-digit STCC level into a large station like Houston, then this means there is competition for all movements of this commodity at the station.

However, he does not consider that by including large stations in his analysis he is capturing R/VC ratios for movements that terminate at both captive and competitive industries served out of a station like Houston TX.

Issue 4: Because commodity shipments at large stations in the Israel/Orszag analysis are summarized at the five-digit Commodity Code level and not the seven-digit level, this exacerbates the problem with mixing up captive and competitive industries at rail stations. There will be a large number of R/VC's for captive moves being shown as R/VC's for competitive moves when data is summarized at the five-digit STCC level at large stations. For example, five-digit STCC 28211 for Plastic Materials has thirty-five (35) seven-digit codes that make up its values and there are 907,000 Plastic moves included in Table III.1. Different captive and competitive industries served out of a station can receive different types of Plastics and accumulating data at the seven-digit STCC will show this. Because Dr. Israel only summarized data at the five-digit STCC level he combines all Plastic shipments together and never accounts for some types of Plastics going to captive industries, while other types of Plastics go to competitive industries at a station like Houston. The five-digit STCC issue is significant as large stations represent the largest number of records used in Table III.1. Stations with more than 200,000 carloads represent 13.5 million carloads or 54.4% of the total carloads used to calculate the values in Table III.1.

Issue 5: The footnote to Table III.1 states that the table eliminates gateways (e.g., Chicago and St. Louis). However, the support provided for the table shows that it includes movements shown as terminating at large gateways like Kansas City KS, Birmingham AL, Buffalo NY, Salem IL and Brownsville TX. These are large gateways and many of these moves are logically Rule 11 moves that are not terminating at these gateways. This is a significant problem with Table III.1 because, in my experience, the R/VC ratios for Rule 11 moves at a gateway/station are normally different than R/VC's for through moves that terminate at a captive industry served by a gateway/station.

There are 680,572 carloads shown as terminating at these five gateways in the support for Table III.1 and this has distorted the Israel/Orszag R/VC results and led to inaccurate conclusions about the accuracy of R/VC ratios as a measure of competition for rail movements.

V. SUMMARY OF PROBLEMS WITH TABLE III.1

There are a number of problems with the support used to calculate Table III.1. Based upon my analysis, I find that the major reason for R/VC fluctuations in rail moves which Dr. Israel and Mr. Orszag show as being competitive in Table III.1 is that their analysis does not control for competitive shipments correctly. If you perform an analysis that mixes up which moves are captive and which are competitive you will get R/VC ratios that make little sense. This is the problem with the analysis used to calculate the R/VC results in Tables III.1. My analysis of Table III.1 demonstrates that the problems with the way Dr. Israel and Mr. Orszag performed their data analysis have resulted in improper conclusions about the reliability of R/VC ratios to reasonably measure the degree of competition for rail movements.

VI. ANALYSIS OF TABLE III.2 – CHANGE IN R/VC RATIOS ON SOLE-TO-DUAL ROUTE-COMMODITY COMBINATIONS

Table III.2 on page 16 of the Israel/Orszag testimony includes a summary of R/VC ratios for rail movements that went from sole-served (by Conrail) to dual served (by CSXT and NS) after the Conrail acquisition transaction. Dr. Israel and Mr. Orszag assert that R/VC ratios are not a reliable indicator of market power because the R/VCs for these movements do not fall as they should with the introduction of competition.

It is difficult to comment on the accuracy of the results in Table III.2 as I found no data, documentation or other information that would support the analysis or the results for anything in this table based on my review of the underlying data provided by witnesses.³ Due to the lack of support, I do not know the base year for the changes in Table III.2. In addition, I do not know the answers to the following issues to critique Table III.2:

- Whether Table III.2 is based on a sample of moves or all moves in the shared access area.
- The SPLC codes for moves used to calculate Table III.2.
- Whether the STCCs for RVCs in the base year are different from the STCC's for RVC's in 2014. The analysis does not appear to consider the STCCs for the R/VC changes it is measuring and if that is the case, R/VC ratios will change for reasons other than railroad's market power over this traffic.
- The mileage and STCCs for movements are needed to determine if movements in Table III.2 in the base time frame were actually captive to Conrail or whether

³ Numbers for the table were value copied in the support provided. The source for these values was not provided.

Conrail's R/VCs for movements were low because it needed to compete against truck or lake vessel competition.

- Whether both the origins and destinations for all movements are for Conrail sole served points pre-merger and NS and CSXT competitive points within the shared access area after the merger.

Without the type of information referenced above, it is difficult to critique the results of Table III.2 in the Israel/Orszag testimony in detail. However, based upon my analysis of Table III.1, I would expect that Table III.2 includes the R/VC results for TIH movements and other hazardous material movements which can have R/VCs determined more from liability concerns than rail competition.

It also needs to be emphasized that rail rates have increased dramatically since the year of 2001 and this has resulted in higher R/VC ratios for both captive and competitive rail traffic. As shown in my July 21st testimony for AF&PA⁴, the average revenue per car, using the AAR's own numbers, increased 102% between 2001 and 2014. This dramatic increase in rail rates logically results in R/VCs increasing for both captive and competitive traffic. Based upon the market power NS and CSXT have been able to exert in the marketplace it is logical that the R/VCs for their moves in the shared access area would also increase.

⁴ Page 7 of Roman Testimony for AF&PA.

Rail rates have increased 3.5 times more than long haul truck rates since 2004⁵, so it is logical that the R/VCs for truck competitive traffic on Conrail would have had substantial increases by 2014 on CSXT and NS.

VII. SUMMARY OF PROBLEMS WITH TABLE III.2

Fundamental questions exist regarding the conclusions drawn by Dr. Israel and Mr. Orszag from Table III.2 and, due to the lack of documentation supporting the table, a complete analysis of the data in Table III.2 is impossible. Nonetheless, it is undoubtedly true that rail rates have increased substantially since 2001. The fact that railroads' R/VC ratios have increased with rate increases of 102% between 2001 and 2014 is logically an outcome resulting from the large rate increases NS and CSXT have been able to obtain from their customers. To then turn around and use the large rate increases railroads have been able to obtain from their customers as a reason for not removing the exemption of a commodity is simply counterintuitive.

⁵ Page 9 of Roman Testimony for AF&PA.

VERIFICATION

I, Henry Julian Roman, verify under penalty of perjury that I have read this Verified Statement, that I know the contents thereof, and that the same are true and correct based on my knowledge, information and belief. Further, I certify that I am qualified and authorized to file this Statement.


Henry Julian Roman

Executed on 8/25/2016