

SERVICE DATE – JANUARY 14, 2008

SURFACE TRANSPORTATION BOARD

DECISION

STB Ex Parte No. 665

RAIL TRANSPORTATION OF GRAIN

Decision: January 10, 2008

On November 2, 2006, the Board held a hearing in this proceeding as a forum for interested persons to provide views and information about grain transportation markets. This hearing was prompted by concerns regarding rates and service issues related to the movement of grain raised by Members of Congress, grain producers and other stakeholders and a June 21, 2006, United States Government Accountability Office (GAO) preliminary report, *Freight Railroads: Preliminary Observations on Rates, Competition, and Capacity Issues*. GAO issued a final report on October 6, 2006, *Freight Railroads: Industry Health Has Improved, but Concerns about Competition and Capacity Should Be Addressed* (GAO report).<sup>1</sup> This decision discusses the steps the Board has taken as a result of the information gathered at the hearing and discontinues the proceeding.

BACKGROUND

Throughout this nation's history grain production has been important to our economy. In addition to its vital role in human food consumption, grain has been integral to other industries as feed for poultry and livestock and, more recently, a feedstock in the production of alternative fuel. Production, storage, shipping, and processing locations form a well-established network for delivery of grains, oilseeds and processed products from scattered points of origin to many points of consumption, often separated by great distances. Thus, many grain shippers and processors are captive to the railroads.

In the Staggers Rail Act of 1980 (Staggers Act), Congress engineered a careful balance between two important and potentially contradictory goals. On the one hand, the Act specifically authorized differential pricing and largely removed regulatory controls over railroad pricing for competitive traffic. At the same time, it made clear that captive shippers of certain essential commodities, for example grain and coal, are to be eligible for specific protections. As the Federal agency charged with implementing the Staggers Act and the Congressional intent embodied therein, the Board must strive to implement and carefully balance both of these goals.

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<sup>1</sup> On August 15, 2007, GAO issued a follow-up report that updated its findings with 2005 data and found that “[d]ata for 2005 confirm the trends and findings we reported and support the recommendations we made in October 2006.” *Freight Railroads: Updated Information on Rates and Competition Issues* at 9.

Thus, while the Staggers Act was largely deregulatory in its effect, it intentionally did not deregulate all aspects of railroad pricing and service, but instead left in place protections intended to ensure fair treatment for captive shippers of rail-dependent commodities.

The GAO report included observations on rates, competition, and capacity issues in the American rail freight industry. GAO reported that the changes that have occurred in the rail industry since the Staggers Act are widely viewed as positive. The financial health of the industry has improved substantially as railroads have cut costs and boosted productivity. GAO found that most rail rates have declined since 1985. However, one category of rates examined by GAO—grain rates—diverged from the industry trends. According to the GAO report, the amount of grain traffic with rates having comparatively high markups over the railroads' variable cost of providing transportation increased notably between 1985 and 2004, with grain rates having increased 9% in nominal terms over that time period.<sup>2</sup> Furthermore, GAO found that the amount of long-distance grain traffic traveling at rates yielding revenues over 300% of variable cost had substantially increased over 1985 levels.<sup>3</sup> In light of this observation, GAO recommended that the Board undertake a rigorous analysis of competitive markets to: (1) identify the state of competition nationwide; (2) in specific markets, determine whether the inappropriate exercise of market power is occurring; and, (3) where appropriate, consider the range of actions available to address problems associated with the potential abuse of market power.

By a notice served on October 11, 2006, and published in the Federal Register on October 17, 2006 (71 FR 61138-39), the Board announced that it would hold a public hearing to examine issues related to the transportation of grain by rail. In total, 26 parties submitted comments, and 16 parties participated in the hearing, including railroads, shippers, government interests, and labor unions. Following the hearing, the Board held the record open until January 2007, to allow for the filing of supplemental comments and information. Generally, parties discussed concerns about the issues raised in the GAO report and commented on the effect of transportation on the grain industry from their perspective. A summary of the major issues raised by the parties follows below.

Shippers. Shippers generally argue that there is no effective regulation for grain rates because there has not been meaningful access for captive grain shippers to the Board's rate reasonableness processes.<sup>4</sup> Shippers expressed the view that the Board's processes take too long

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<sup>2</sup> See GAO report at 9.

<sup>3</sup> See *id.* at 34-35

<sup>4</sup> Alliance for Rail Competition (ARC) Comments at 2; Montana Wheat & Barley Committee *et al.* (MWBC) Comments at 6; United States Dry Bean Council Comments at 1, 5; National Barley Growers Association *et al.* (NBGA) Comments at 2; North Dakota Grain Dealers Association (NDGDA) Comments at 5.

and are too expensive to be useful for most grain shippers.<sup>5</sup> According to some shippers, the grain industry is more sensitive than other industries to rail rates because grain shippers bear any increase in transportation costs.<sup>6</sup> Consequently, shippers also complain of high rates for shipments of grain,<sup>7</sup> largely exceeding, they assert, the threshold set by the Board for an unreasonable rate.<sup>8</sup> Shippers also call for the Board to lower the eligibility standards in small rate cases to allow smaller shippers to have the opportunity to efficiently challenge excessive freight rates.<sup>9</sup> Additionally, they want the Board to monitor and enforce the creation of new infrastructure investment, because capacity limits have allegedly led to poor service to shippers.<sup>10</sup>

Most shippers call for the Board to impose additional regulations protecting captive shippers, although one shipper interest cautions against overregulation.<sup>11</sup> One shipper calls for better dialogue between shippers and railroads,<sup>12</sup> and another states that grain rates reflect market conditions and help the United States compete in a global market place.<sup>13</sup>

Railroads. Railroads generally disagreed with the findings of the GAO report, and opposed any suggestion that the Board should act to remedy the disparity in grain rail rates.<sup>14</sup> Railroads argue that the increase in grain rates is the product of a reasonable operation of the competitive rail transport market and that the current rates allow the railroads to remain viable and effective.<sup>15</sup> Specifically, many railroads state that the grain market differs from markets for

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<sup>5</sup> National Corn Growers Association (NCGA) Comments at 7-8; ARC Comments at 5-8.

<sup>6</sup> Ag Processing Inc. Comments at 5; MWBC at 5; National Association of Wheat Growers et al. (NAWG) Comments at 2

<sup>7</sup> NDGDA Comments at 2.

<sup>8</sup> NBGA Comments at 2; MWBC Comments at 14; NAWG Comments at 2.

<sup>9</sup> National Grain and Feed Association (NGFA) Comments at 21.

<sup>10</sup> NCGA Comments at 10-12; NGFA Comments at 21.

<sup>11</sup> The Scoular Company Comments at 4.

<sup>12</sup> Dakota Dry Bean Comments at 3.

<sup>13</sup> Jay Elkins Comments at 3.

<sup>14</sup> See, e.g., Association of American Railroads (AAR) Comments at 30; The Kansas City Southern Railway Company (KCS) Comments at 6.

<sup>15</sup> See, e.g., BNSF Railway Company Comments at 1; KCS Comments at 5; Union Pacific Railroad Company (UP) Comments at 16.

other rail shipments.<sup>16</sup> UP also states that grain shippers have benefited since the Staggers Act because of specialized service provided by railroads, specifically, the transition to unit train service, which has lower rates per rail car movement than non-unit train shipments.<sup>17</sup> Norfolk Southern Railway Company (NS) states that the average grain rates do not exceed the threshold for the Board to have jurisdiction to hear a rate complaint.<sup>18</sup> Canadian Pacific Railway Company (CP) states that its rates within the United States are constrained by market competition.<sup>19</sup> Canadian National Railway Company (CN) contends that the moderate grain rate increases over the past 20 years suggest reasonable operation of the rail transportation market and notes that on an inflation-adjusted basis, rates for grain have declined.<sup>20</sup>

Government. The United States Department of Agriculture (USDA) calls for the Board to make sure that the shippers have access to adequate capacity and that there is transparency in all railroad rates. USDA also argues that the benefits of a less regulated rail industry favor the grain producers in regions with higher levels of intermodal competition. GAO testified at the hearing and submitted written comments regarding the accuracy of its October 2006 report.

Labor. The United Transportation Union General Committee of Adjustment (GO-386) submitted comments that questioned the findings of the October 2006 GAO report and stated that it provides little guidance on rail rates for grain shipments in BNSF territory.

## DISCUSSION AND CONCLUSIONS

The purpose of this proceeding was to explore in depth the many concerns that have been raised regarding rates and service issues by gathering information on the movement of grain by rail from different perspectives: shippers, carriers and other interests. It is clear that a highly competitive global marketplace controls the price paid for U.S.-grown grain. The cost to transport grain to market is borne in large part by the producer and reduces the amount he actually receives for his grain at the elevator. This fact makes the GAO report's findings — that grain rates have diverged from the industry trend toward lower rates and that the amount of grain rates with relatively high R/VC ratios has increased markedly — particularly troublesome, because it is the producer, not the ultimate consumer that bears that cost, at least initially. Because of the Staggers Act's particular concern for captive grain shippers, these findings are troubling. Consequently, we have taken several steps that address some of the pertinent issues identified by GAO and by the parties in this proceeding.

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<sup>16</sup> See, e.g., CSX Transportation, Inc. Comments at 1-2.

<sup>17</sup> UP Comments at 4-6; see AAR Comments at 17 (arguing that the shift to train loads and large volume operations is a response to market forces that call for efficiency).

<sup>18</sup> NS Comments at 2.

<sup>19</sup> CP Comments at 4-5.

<sup>20</sup> CN Comments at 3.

In September 2007, the Board completed an extensive rulemaking proceeding in Simplified Standards for Rail Rate Cases, STB Ex Parte No. 646 (Sub-No. 1) (STB served Sept. 5, 2007) (Simplified Standards) that overhauled the rate complaint process for cases where the value of the case does not justify litigating a full stand-alone cost case. This decision created new procedures designed to better allow shippers to pursue small and medium-sized freight rail disputes. Shippers can now use either the “Three-Benchmark” or the “Simplified Stand-Alone Cost” (Simplified-SAC) process to obtain rate relief. Under the Three-Benchmark approach, shippers could obtain an award up to \$1 million with an expedited procedural schedule that calls for a Board decision within approximately 8 months of filing a complaint. Under the Simplified-SAC process, shippers can obtain an award of up to \$5 million of relief within 17 months of filing a complaint. Additionally, in an effort to minimize litigation, Simplified Standards requires mediation in all rail rate disputes. These improved procedures should address some of the concerns expressed by grain shippers by easing the burden of bringing a small rate complaint.

The Board recently awarded a contract to Christensen Associates to conduct an independent study that will assess the current state of competition in the freight railroad industry in the United States. The study, entitled *Report to the U.S. STB on Competition and Related Issues in the U.S. Freight Railroad Industry*, will be completed and made public in the Fall of 2008. The study will focus on providing a comprehensive analysis of a wide range of issues relevant to grain transportation including competition, capacity, and the interplay between the two. The study will also include an examination of various regulatory policy alternatives and could lead to changes in our regulatory approach if appropriate.

As a result of these actions, grain shippers should have more meaningful access to the regulatory process to contest rates and practices where competition is lacking, and the Board and the public might gain a greater understanding of how competition affects the delivery of transportation services. As we have, for now, achieved our objectives in instituting this proceeding, the proceeding will be discontinued. Discontinuing the proceeding also removes restrictions on members of the Board from discussing the issues related to the proceeding with stakeholders. Although this proceeding will be closed, we will continue to monitor closely the relationship between railroads and grain interests. If in the future we conclude that further regulatory action should be considered, we will initiate another proceeding.

This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. This proceeding is discontinued.

2. This decision is effective on its date of service.

By the Board, Chairman Nottingham, Vice Chairman Mulvey, and Commissioner Buttrey. Commissioner Buttrey commented with a separate expression.

Anne K. Quinlan  
Acting Secretary

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COMMISSIONER BUTTREY, commenting

I am a true believer in deregulation. In my view, the passage of the Staggers Act was something akin to a stroke of genius. It firmly embedded the concept of differential pricing, which has allowed the revitalization of a previously deeply troubled U.S. railroad industry by removing many of the shackles of over-regulation. But at the same time, the Staggers Act makes clear that captive shippers of certain essential commodities like grain and coal are to have special status and protections. The findings in the GAO report and those raised on the record in this proceeding reinforce my belief that this Board needs to sharpen its focus on the concerns raised by captive grain shippers — many of which are small family farms.

I have visited with grain producers in their fields and in their offices and they have clearly confirmed to me that they are at the mercy of grain elevators and railroads as well as the powerful forces of the international grain market. The payment they receive for their product is typically reduced by costs of transportation passed through by the elevator, and yet the producers play no role in negotiating the transport costs and often do not know what they are at the time they sell their grain. This system has been around for a long time . . . perhaps too long.

I am also deeply troubled by specific concerns raised in this proceeding about the adequacy of the railroads' investment in the infrastructure needed to adequately serve captive grain shippers. This relates not only to the tension between rates and service provided to newer high-capacity shuttle-loading elevators compared to smaller elevators, but also to the maintenance of lighter-density lines needed for service to smaller communities, some of which have been allowed to become unfit for service, calling into question the modern day meaning of the common carrier obligation.

I am even more troubled by those in the grain business who seem to prefer to complain and wring their hands and wallow in the past rather than to come forward with some innovative and possibly revolutionary ideas for alleviating some of the fundamental unfairness of the current system. At our hearings, I begged for someone to come forward with something new and not one courageous soul ventured into the world of what might be. Clearly, there are some

involved in this dialogue who are financially and philosophically invested in the *status quo* and I am not referring to railroads. I do not think we can count on them to come forward with any enlightened approaches. But, I have met some very savvy people as I have been out and around grain producers and I want to encourage them to come forward with some of their ideas and not be frightened away by those who have no incentive to solve problems. The current Board has proved that it is not afraid to tackle tough and controversial issues. I have no patience for those who lack the courage of their convictions.

I fully support the steps the Board has taken thus far to reform its small rate case process and launch the outside study of competition. But, in addition to those steps, we may need to do more in order to ensure fair treatment of captive grain shippers. I am certainly willing to consider more far-reaching steps.