

Office of Proceeding  
December 7, 2012  
Part of Public  
Record

BEFORE THE  
SURFACE TRANSPORTATION BOARD

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EX PARTE NO. 715

RATE REGULATION REFORMS

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REPLY COMMENTS OF

ALLIANCE FOR RAIL COMPETITION  
MONTANA WHEAT & BARLEY COMMITTEE  
COLORADO WHEAT ADMINISTRATIVE COMMITTEE  
IDAHO BARLEY COMMISSION  
IDAHO WHEAT COMMISSION  
MONTANA FARMERS UNION  
NEBRASKA WHEAT BOARD  
OKLAHOMA WHEAT COMMISSION  
SOUTH DAKOTA WHEAT COMMISSION  
TEXAS WHEAT PRODUCERS BOARD  
WASHINGTON GRAIN COMMISSION

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Dated: December 7, 2012

The Opening Comments filed October 23, 2012 in this proceeding reflect a deep divide between captive shipper interests and railroad interests. In its July 25, 2012 Decision initiating this proceeding, the Board states “Over the past 30 years, we have worked to provide shippers a more accessible forum to bring rate disputes.” Decision at 1. For their part, captive shippers, including ARC, et al., support the goal of more accessible regulatory recourse. However, there are doubts about how effective regulation has been in the past, and about how the changes currently under consideration by the Board, in this and other proceedings, will affect rail rate regulation.

For their part, the railroads support the status quo, and oppose more effective STB rate regulation. Accordingly, they oppose the aspects of the Board’s “reform” proposals that could help captive shippers. These are the proposals to raise the relief cap for Three Benchmark cases, to eliminate the relief cap for Simplified SAC (SSAC) cases, and to increase the interest paid on reparations, all of which would increase the benefit to shippers of success in rate cases. However, the railroads support the Board’s other proposals, which shippers uniformly regard as undermining shippers’ chances of obtaining real relief in rate cases.

The Opening Comments of ARC, et al. in this proceeding discussed, at some length, the Board’s proposal for a small increase in the relief cap for Three Benchmark cases. See Opening Comments at pp. 6-12, and the Verified Statement of Witness G.W. Fauth, at pp. 3-9. This focus reflects the number of captive shippers represented by ARC, et al. who cannot afford to bring Full-SAC cases, or even SSAC cases. As noted, the Board is proposing changes to SAC-based remedies that, if adopted, will increase the cost and reduce the value of these options for shippers.

Though ARC, et al. supported the Board's proposal to increase the Three Benchmark relief cap as a step in the right direction, we also described the proposed increase as insufficient, and called for elimination of any relief cap in such cases. Even without a relief cap, Three Benchmark does too little to protect smaller captive shippers from the abuse of railroad market power, is too vulnerable to being neutralized, and fails to satisfy the statutory mandate in 49 USC § 10701(d)(3). More can and should be done to protect such shippers. ARC, et al. also supported the proposed increase in interest rates. These continue to be the positions of ARC, et al.

ARC, et al. also represent major shippers of coal, sand and other commodities in unit train or trainload volumes, including PPL, Western Fuels and Otter Tail, on whose behalf the Full-SAC and SSAC changes were addressed. ARC, et al. also supported the comments filed by WCTL and Concerned Captive Coal Shippers, which address SAC issues in greater depth.

The opening comments filed by the railroads say remarkably little about the Three Benchmark test. At page 16 of its comments, the AAR avoids addressing the Board's proposed \$2 million (over 5 years) relief cap increase by saying "The AAR cannot meaningfully comment on the proposal without an evidentiary basis for the Board's conclusion regarding the costs to bring a Simplified SAC case." KCS takes a similar position (opening comments at 11), saying it has no experience with Three Benchmark or SSAC cases. (The main function of the KCS comments appears to be to argue against access remedies of kind that may eventually be considered in Ex Parte No. 711.)

BNSF, for its part, says (at pp. 2-3) that a higher relief cap in Three Benchmark cases might be acceptable if the Board eliminates consideration of cross-over traffic in Full SAC cases. And UP opposes any change in Three Benchmark case relief caps in a single sentence. Its

rationale is that this proposal is tied to proposed SSAC changes that UP opposes. UP opening comments at 18.

The only railroads commenting at any length on the Three Benchmark proposal were CSX and NS, filing jointly. However, their comments were dismissive of the concerns of shippers unable to afford Full-SAC or SSAC. According to CSX and NS, not only should the Three Benchmark relief cap not be increased, but it should be reduced to \$200,000. Opening Comments at 24-25.

CSX and NS attempt to justify such a low relief cap, and no increase in relief, based on what amounts to the fact that Three Benchmark is not SAC-based. This is correct but legally inadequate, and ignores the statutory command that the Board adopt a “simplified and expedited method for determining the reasonableness of challenged rail rates in those cases in which a full stand-alone cost presentation is too costly, given the value of the case.”

CSX and NS go on to argue that “an overly simplified approach” [i.e. Three Benchmark] “should not be applied to a case when the amount in dispute justifies the use of a more robust and precise approach.” Comments at 21. There are several problems with this argument.

First, and most fundamentally, experience with the Three Benchmark test indicates that the relief available, relief cap aside, is severely constrained. In Docket NOR 42114, US Magnesium, LLC v. Union Pacific Railroad Co., decision served January 28, 2010, relief was awarded only to the extent that the challenged rail rates exceeded 350% of variable cost.

Second, the relief cap exacerbates the limited usefulness of Three Benchmark. Third, the cost of the only other “simplified” standard, SSAC, is far higher than the Board estimated, and is set to rise even higher in light of changes proposed in this proceeding. Thus, in proposing that small shippers with more than \$200,000 at stake be required to bring SSAC cases, CSX and NS are

effectively calling for deregulation of most of the captive shipper rates in the U.S. This may benefit the railroads, but monopolies should be subject to effective regulation where they are not subject to effective competition.

The foregoing considerations, which make it impossible to take seriously the “small claims” option favored by CSX and NS, are of course exacerbated by prospective developments in Docket No. 42123, M&G Polymers USA, LLC v. CSX Transportation, Inc., decision served September 27, 2012, and in Ex Parte No. 711, Petition for Rulemaking to Adopt Revised Competitive Switching Rules, decision served July 25, 2012.

In M&G Polymers, the Board has proposed new standards of market dominance (opposed in significant respects by ARC, et al.) that are likely to prevent many smaller shippers from even being able to invoke the Three Benchmark Test. In Ex Parte No. 711, the Board has taken such a small step toward possibly, someday, increasing competition among railroads as to ensure that captive shippers must rely, for the foreseeable future, on STB regulation as their only way of opposing abuses of railroad market power.

Given the reticence of most railroads as to Three Benchmark relief in their opening comments, and the absurd hostility of CSX and NS, little more can be said by ARC, et al. at this Reply stage of this proceeding. After reviewing the railroads’ reply comments, ARC, et al. expect to have further comments at the Rebuttal stage.

That said, the fact remains that Three Benchmark is an inadequate response to the Congressional directive in 49 USC § 10701(d)(3), even if the relief cap is eliminated entirely. And SAC and SSAC are receding as remedies for most shippers that do not ship millions of tons between a handful of points. Accordingly, ARC, et al. reiterate their call for the more effective rate regulation that is so urgently needed.

The most promising option in this regard appears to be an effective revenue adequacy constraint. As described almost 30 years ago in Coal Rate Guidelines, Nationwide, 1 I.C.C. 2d 520, 536 (1985):

A railroad seeking to earn revenues that would provide it, over the long term, a return on investment above the cost of capital would have to demonstrate with particularity: (1) a need for the higher revenues; (2) the harm it would suffer if it could not collect them; and (3) why captive shippers should provide them.

The AAR, in its opening comments in this proceeding (at 2-3) cites as a bedrock principle “that railroads must be permitted to apply demand-based differential pricing in order to allow them the opportunity to recover their cost of capital.” For decades, the ICC and STB have agreed, and the perceived revenue inadequacy of railroads has too often been outcome-determinative in rulemaking proceedings as well as rate cases.

The result has been the building up over time of layers of obstacles to regulation that effectively protects shippers against abuses of railroad market power. Railroads have been allowed to minimize competition through mergers, paper barriers, the Midtec decision, etc., while rarely being held accountable for excessive rail rates and unreasonable railroad practices. Restrained neither by effective competition nor by effective regulation, major railroads have raised rates and charges, shifted costs and burdens to shippers, neutralized short lines, and restricted service, with captive shippers suffering the most.

Now, however, the ability of railroads to “recover their cost of capital,” or more than their cost of capital, is increasingly clear, with Berkshire Hathaway’s acquisition of BNSF serving as a prime example of the value of Class I railroads in the eyes of Wall Street. Accordingly, it is time (past time, in the view of ARC, et al.) for the Board to begin to undo the

steep tilt towards railroads that has been engineered into the playing field since the Staggers Act became law.

The necessary changes will not be accomplished by raising the Three Benchmark relief cap to \$2 million, even if that adjustment will help some shippers. And some current proposals, including the changes relating to cross-over traffic and Road Property Investment in this proceeding, the “limit price approach” (as proposed for most situations) in M&G Polymers, and the restoration of product and geographic competition as proposed by the AAR in Ex Parte No. 717, represent clear steps in the wrong direction.

In contrast, an effective revenue adequacy constraint would relieve smaller captive shippers of some of the almost insurmountable burdens they face in rate challenges today. Market dominant railroads, that for too long have had the benefit of the doubt in rate cases, would have to justify further increases in captive shippers’ rates, and might thereby be induced to look more to “competitive” shippers, and less to captive shippers, for future revenue gains.

ARC et al. do not mean to suggest that an effective revenue adequacy constraint would be a panacea. At best, already high rates on captive traffic would be harder to raise to even higher levels. Nor would an effective revenue adequacy constraint do away with obstacles captive shippers face in challenging unreasonable railroad practices, or unreasonable railroad charges, or poor service quality or the lack of effective competition among railroads. However, an effective revenue adequacy constraint would do more to reform rate regulation than anything the Board proposed to do when it initiated this proceeding.

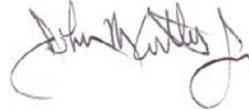
For the foregoing reasons, and the reasons set forth in the opening comments of ARC, et al. and in the comments filed by WCTL and Concerned Captive Coal Shippers, the Board should raise interest rates and eliminate relief caps in Three Benchmark and SSAC rate cases. It should

not adopt its proposed changes as to cross-over traffic and Road Property Investment. And it should consider other, more far reaching responses to the problem of ineffective rail rate regulation.

Respectfully submitted,



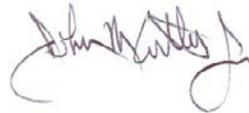
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**CERTIFICATE OF SERVICE**

I hereby certify that I have this 7<sup>th</sup> day of December, 2012, served copies of the foregoing document on all parties listed on the STB service list by first-class mail, postage prepaid.



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John M. Cutler, Jr.