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BEFORE THE
SURFACE TRANSPORTATION BOARD

DOCKET NO. EP 665 (Sub-No. 1)
RAIL TRANSPORTATION OF GRAIN, RATE REGULATION REVIEW

REBUTTAL COMMENTS OF

ALLIANCE FOR RAIL COMPETITION
MONTANA WHEAT & BARLEY COMMITTEE
NATIONAL FARMERS UNION
COLORADO WHEAT ADMINISTRATIVE COMMITTEE
IDAHO BARLEY COMMISSION
IDAHO GRAIN PRODUCERS ASSOCIATION
IDAHO WHEAT COMMISSION
MONTANA FARMERS UNION
NORTH DAKOTA CORN GROWERS ASSOCIATION
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SOUTH DAKOTA CORN GROWERS ASSOCIATION
SOUTH DAKOTA FARMERS UNION
MINNESOTA CORN GROWERS ASSOCIATION
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WISCONSIN FARMERS UNION
NEBRASKA CORN GROWERS ASSOCIATION
NEBRASKA WHEAT BOARD
OKLAHOMA WHEAT COMMISSION
OREGON WHEAT COMMISSION
SOUTH DAKOTA WHEAT COMMISSION
TEXAS WHEAT PRODUCERS BOARD
WASHINGTON GRAIN COMMISSION
WYOMING WHEAT MARKETING COMMISSION
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ARC et al. would like to commend the Board for holding its hearing in this proceeding, and for keeping the record open till June 24, 2015 for the filing of post-hearing comments. Thanks to this proceeding, along with EP 722 on revenue adequacy and EP 711 on competitive access, captive grain shippers and producers have some hope of meaningful regulatory recourse. The need for supplemental comments is particularly acute in view of the June 10 release of Transportation Research Board Special Report 318: Modernizing Freight Rail Regulation.[1]

Since the end of the McCarty Farms rate proceedings, captive grain producers and shippers have had little or no hope of invoking regulatory remedies when they have disputes with railroads. As USDA points out, they have been price takers, and vulnerable to abuses of railroad market power. Whether such abuses were actual or potential, captive grain customers have not been able to exercise real negotiating leverage with railroads because they had neither transportation alternatives nor regulatory remedies.

Rates aside, revenue adequacy standards, merger rules, inaction on paper barriers, deregulation and auctions of car supplies, and the difficulty of obtaining

[1] As Professor Schmalensee, Chair of the TRB Study Committee, made clear in his hearing testimony, many of the Report's recommendations may require action by Congress, which called for the TRB Report in SAFETEA-LU. However, many of the Report's findings are relevant to this proceeding and provide further support for adoption of reforms to be proposed for consideration in the next phase of this proceeding.

help with complaints of poor service and unreasonable railroad practices have added up to an environment in which regulation of major grain hauling railroads has been more apparent than real.

Assuming for argument's sake these policies of the ICC and STB were justified in light of the precarious financial condition of the railroad industry in the last decades of the last century, outdated policies need to be revised. Today the railroads' financial condition is strong, and almost certain to grow stronger even if the Board takes some modest steps toward a more level playing field in the next few years.

These days, worries about whether railroads can earn their cost of capital need to be better balanced with worries about whether captive shippers and producers of grain can reasonably be required to keep paying differentially more than their non-captive counterparts and competitors. There can be no doubt as to the ability of BNSF and UP to earn revenues sufficient to meet their cost of capital.

Service is also a major concern, as the Board knows from ARC comments here and in EP 724 (Sub-No. 4). But as the Board also knows, implementing regulatory solutions to service problems is not easy. The Board is better able to offer remedies for unlawful rates. The railroads argue that it is somehow inconsistent for captive grain customers to call for fewer excessive rail rates and for better rail service. No doubt, the railroads would like to use pricing to ration service in times of high demand. This is classic monopoly behavior.

However, the law does not (and should not) leave decisions about minimum service levels and maximum rate levels solely to the railroads, especially where effective competition is absent. Congress imposed a common carrier obligation, while also requiring that all rates on traffic found captive must be reasonable. 49 USC 10701(d)(1). Without these protections, railroads could use their ability to decide who gets service when, and at what cost, to influence success, failure and the size and location of markets for many commodities, including grain. As ARC Witness Fauth has shown, this danger is compounded by objectionable features of current URCS costing.[2]

Making grain rate regulation more effective will require several changes, and a key decision the Board must make in these proceedings involves answering two questions. First, are any major grain-hauling railroads long-term revenue adequate? Second, if so, how should attainment of revenue adequacy constrain such railroads' ability to charge differentially higher rates to captive grain customers?

[2] Though Mr. Fauth was less critical of URCS than the TRB Study Committee, some of their criticisms reinforce his. See, e.g., TRB Report at 72, discussing the make-whole adjustment.

Implementation of the revenue adequacy constraint of Constrained Market Pricing (and the related management efficiency constraint) would significantly ameliorate the current concerns of grain shippers and producers. Such customers might no longer be vulnerable to rate increases that exacerbate the disadvantages many captive grain customers face as compared with grain shippers and producers who are not captive.

The railroads oppose implementation of the revenue adequacy constraint, but the Board should ask why they are so opposed to any limits on their ability to apply differential pricing even after reaching revenue adequacy. The railroads go to great lengths to claim that they set rates on grain which do not disadvantage captive customers vis-à-vis other grain customers. If this claim is true, the revenue adequacy constraint is already being observed on an informal basis, and formal adoption by the Board should not hurt revenue adequate railroads.

In any event, it is hard to see what rate regulation the railroads would support, other than charging captive grain customers whatever the "market" will bear, i.e., unrestricted monopoly pricing by rail carriers with no competitors. The railroads have argued for years against regulation based on cost of service, and now they argue against any limits on their profits (other than stand-alone cost).

SAC has never worked for any grain customers. Most cannot afford SAC (or SSAC). And the R/VCcomp component of the Three Benchmark approach amounts to a vehicle for differential pricing of challenged rates based on other rates set by that same railroad.

At the June 10, 2015 hearing in this proceeding, Board members made clear that they are more interested in ensuring the existence of effective regulatory recourse for captive grain shippers and producers than in resolving disputes about whether current grain rates are or are not too high. The Board's focus on making effective remedies available to disenfranchised grain shippers and producers is sound. The existence of many reasonable grain rates does not negate the need for remedies for excessive rates, any more than the small number of final offer arbitration proceedings in Canada obviates the need for arbitration in Canada (where grain rates tend to be lower than in the US). When effective remedies can be invoked, private sector negotiations can resolve most disputes.[3]

The Board should also take note of the TRB Report's findings (at page 41) that in the period 2002-2013, rail rates on grain and oilseeds went up 80% for smaller

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[3] At the hearing, there was testimony regarding the benefits of the arbitration program negotiated by BNSF with certain Montana agriculture groups. As shown by our comments and statements in this proceeding, ARC, et al. support an arbitration option for grain rate disputes. Even Montana Governor Bullock, when he was Montana Attorney General, explored the BNSF – MGGA – MFBF Arbitration program in a 2009 letter, which is attached.

shipments (less than 50 cars) and 70% for larger shipments, more than for any commodity except coal. See also Report at 40, finding that by 2013, rail rates for smaller volumes of grain were some 35% higher than for larger volumes of 50 cars or more. Regulatory remedies for too many of these customers are essentially nonexistent.

A glaring defect in the railroads' comments in this proceeding is their indifference to the concerns of smaller grain producers and shippers. We are told of the high volumes shipped by the largest shippers. See, e.g., BNSF Reply at 10: "Approximately 85%-90% of our wheat, corn and soybean shipments have been made by our top 10 customers"; and UP Reply at 7: "For the period July 2013 through June 2014, UP's top 20 grain customers accounted for more than 82% of our grain revenues." The railroads' focus on such large customers may be understandable, but it implicitly supports the contention of ARC, et al. that smaller grain customers are especially vulnerable to high rates, poor service and demarketing. And it is therefore all the more important to clarify grain producer standing.

The railroads argue that product and geographic competition prevent abuses of railroad market power. However, this is just a further example of the fallacious argument that if a remedy is ever not needed, then it is never needed. As recently as two years ago, the Board rejected such arguments, finding that the railroads' real goal was to deter rate cases by making them more complex and costly. More fundamentally, the Board dismissed any injury to railroads "because shippers that have effective indirect competition alternatives would be unlikely to pursue a rate challenge, and because a rate level constrained by effective competition would be found to be reasonable".[4] These observations are particularly apt with respect to smaller grain shippers and producers, and should make consideration of indirect competition rarely, if ever, appropriate in rate arbitration proceedings.

Of course, the most striking recommendation in the TRB report is that regulation of rail rates should no longer permit differentially higher rates to be imposed on captive traffic, limited only by the SAC, SSAC and Three-Benchmark tests. Rather, the STB should look for its maximum rate standards at "unregulated, market-based rail prices", as to which the Board has extensive information in its confidential Waybill Sample. TRB Report at 91. Such competitive pricing data should be used to produce "models of rates developed under effectively competitive conditions", and rates exceeding such levels, or some designated percentage above it, should be the new benchmark. (Id.)

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[4] See the Board's decision served March 19, 2013 in EP 717, Petition of the AAR to Institute a Rulemaking Proceeding to Reintroduce Indirect Competition as a Factor Considered in Market Dominance Determinations for Coal Transported to Utility Generation Facilities, at page 2.

The railroads would appear to agree, given their frequent calls for market based rates[5] reflecting "sound economic principles" (which the TRB Report was designed to provide). However, reading between the lines, it is clear that what the railroads want is to keep charging differentially higher rates on captive grain traffic, subject to SAC-based (and therefore prohibitively expensive) limits. See BNSF Reply at 9-10, and numerous references by the railroads to "competitive market principles", by which they really mean noncompetitive market principles for captive customers. The last thing they want is final offer arbitration of the type recommended in the TRB Report. The Three Benchmark approach is marginally acceptable to the railroads only to the extent it remains a vehicle for differential pricing of captive grain traffic.

If Three Benchmark is seen as a means of addressing "outlier" rates, i.e., the isolated rate borne by a shipper or producer who pays far more than everyone else, the current R/VCcomp test might have some theoretical worth in some cases. However, problems far outweigh any usefulness. First, R/VCcomp drives up litigation cost and complexity substantially. Second, the "outlier" approach is a bad fit for grain, which tends to move under tariff rate structures. R/VCcomp turns into a justification of high rates if they apply to most or all shippers of a commodity in

[5] See, e.g., AAR Reply Comments at 6: "In those rare instances where regulation is necessary, the Board's regulation should mimic the outcomes of competitive markets." See also BNSF Reply at 8.

a state or region. Therefore, even if a shipper shows that its high grain rates are an isolated exception to the norm, the railroad can easily avoid losing the case by raising the "comparable" rates.

ARC, et al. have urged that R/VCcomp be dropped from the Three Benchmark approach in rate cases involving revenue adequate railroads. We have cited STB precedent in Ex Parte No. 347 (Sub-No. 2), Rate Guidelines, Non-Coal Proceedings, for this recommendation, and we rely in addition upon Ex Parte 347 (Sub-No.1) Coal Rate Guidelines – Nationwide, in which Constrained Market Pricing was based in part on the on the proposition that railroads should "not use differential pricing to consistently earn, over time, a return on investment above the cost of capital." 1 I.C.C. 2d 520, 536 (1985).

We reject the contention that involuntary transfers of funds from captive grain producers and shippers to market dominant railroads should continue, unabated and indefinitely, after long-term revenue adequacy has been achieved (or exceeded). We also reject claims by the railroads that revenue adequacy issues are not legitimately raised here (and can therefore be ignored in their filings), merely because revenue adequacy issues may also arise in a broader context in EP 722.

If the defendant railroad has not yet achieved long-term revenue adequacy, we urge the Board to broaden the comparison groups shippers may propose, to include similar shipments with R/VCs below 180%, or that move via other railroads. There should be no presumption (as there is today) that such traffic can never be comparable. Other railroads may have highly similar costs, and grain moving at non-jurisdictional rates may be similar to (or competing with) the issue traffic. Without such changes, railroads can use their pricing to set Three Benchmark limits essentially anywhere they like.

The STB determines which R/VCcomp group is preferable. As a result, the Board can decide, in actual rate cases, whether to treat as probative a shipper's evidence showing that a BNSF rate on captive grain shipments is higher than a UP rate on similar captive grain shipments, or higher than a BNSF rate on otherwise similar non-captive shipments. If the goal of protecting captive shippers from excessive rates is to receive more than lip service, such a comparison should not be rejected out of hand in favor of a BNSF rate comparison the eliminates "the outcomes of competitive markets", and offers only a comparison between two sets of BNSF's own captive grain rates in a single growing region.[6]

To be clear, we do not suggest that all rate comparisons are instructive. UP grain rate levels may say nothing about the reasonableness of CSX coal rates.

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[6] For this same reason, the Board should revisit, at least in grain cases, its preference for selecting "the comparison group most similar in the aggregate to the challenged movement". See Simplified Standards for Rail Rate Cases, decision served September 9, 2007, at pp. 17-18.

However, when the comparisons involve arguably similar grain shipments, the current R/VCcomp restrictions do more harm than good. Current Board precedent rejects expanding R/VCcomp beyond comparing one set of grain rates imposed on captive customers by a monopoly railroad with another set of grain rates imposed on other captive customers by that same monopoly railroad. This limitation enables the defendant railroad to control the outcome of most Three Benchmark cases involving grain.

A more expansive interpretation of the R/VCcomp benchmark will make transparency of grain rates even more important than it is today, and we are concerned that statements made by railroad witnesses during the recent hearing may require clarification. As ARC, et al. understand the current state of access to grain rates in railroad tariffs (and most grain moves under tariff, not contract rates, as the TRB Report found), tariff access is available to grain shippers, at least as to their own tariff rates and other tariff rates from their origins. However, even shippers may not be able to research grain rates other that those they do (or might) use.

Moreover, non-shippers, including cost consultants like ARC Witness Fauth (or Acting STB Chairman Miller) are not able to go on the BNSF website and review various grain rates.[7] Since an analysis by a cost consultant is likely to be part of any potential complainant's due diligence before invoking regulatory remedies, and may be a part of the process of attempting a negotiated solution based on available legal remedies, these restrictions on access to tariff rates amount to a significant disadvantage for captive grain shippers and producers.

At the June 10 hearing, a BNSF witness indicated that they allow access to their tariffs, but qualified that statement with a reference to access for BNSF shippers. This means that farm producers (who bear the freight charges deducted from prices paid to them for their grain), as well as those representing them, are barred by the BNSF firewall from access to and inspection of "public" grain tariffs. Montana's Department of Agriculture was denied access to BNSF grain tariffs as of the latest request, made June 18, 2015 to BNSF in Fort Worth. In contrast, UP grain tariffs are open and accessible to all on the UP website.

ARC, et al. therefore urge the Board to require improvements to the transparency of grain rates in tariffs, along with the improvements in performance data reporting under consideration in EP 724 (Sub-No. 4). Railroads are already required by 49 CFR Section 1300.5(c) to make tariffs available at their offices,

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7 While access might be granted promptly upon request by a member of the Board, or may be available without request through Board personnel, it should not be assumed that access to "public" tariff rates is available to anyone who is able to use a computer to visit BNSF's website.

during normal business hours, “to any person, without charge”, and Section 1300.5(a) requires greater accessibility for tariffs involving grain and other agricultural shipments. In today’s environment of electronic communications, there is no acceptable reason for BNSF or any other railroad to refuse to provide “to any person, without charge”, electronic disclosure of all grain tariffs, including rates, charges, service terms and tariff changes.

We also support permitting joint litigation of aggregated grain rate claims and recognition of farm producer standing. McCarty Farms was a class action involving similarly situated shippers and producers. Given its outcome, a new class action is unlikely anytime soon, but STB permission to aggregate claims could avoid the burden of obtaining class certification, if shipper groups are aggrieved.

Finally, the Board should recognize that even with the changes urged by ARC, et al., USDA and NGFA, rate litigation by grain producers and shippers will be rare. All concerned would rather resolve disputes with railroads through negotiation. However, until effective regulatory recourse becomes a reality, any such negotiations will seldom produce railroad concessions.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this 24th day of June, 2015, caused copies of the foregoing document to be served by first-class mail or by electronic means on all parties of record.

Terry C Whiteside

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Dear Mr. Nober & Mr. Kaufman:

Thank you for your visit to Montana to provide a copy of the arbitration agreement BNSF has reached with the Montana Grain Growers Association and the Montana Farm Bureau Federation (the "Agreement"). I appreciate your willingness to discuss the Agreement and BNSF service to Montana shippers.

Much has changed in the four-plus months between when BNSF entered into the Agreement and when you provided it to our office for discussion. Post-Agreement changes to the rate structure BNSF is charging to Montana producers, in tandem with base assumptions underlying the arbitration process, make it an unlikely avenue for providing meaningful relief for producers. These changes and assumptions have made it so that 60 percent of the grain shipped in Montana is ineligible for even passing consideration under the Agreement, and the 40 percent that would be eligible is limited in remedy to pennies on the bushel.

While the Arbitration has the potential to be a more streamlined process than a simplified rate case before the Surface Transportation Board, the changes appear to substantively diminish the availability of relief for producers. Specific concerns include:

1. **Eligibility.** The Agreement limits eligibility for relief to non-shuttle rates with revenue-to-variable cost (R/VC) ratios at or above 180 percent, and shuttle rates with ratios at or above 195 percent. Given the "market-based" criteria for determining rate reasonableness, these seem to be arbitrary floors for relief, although at least the 180 percent limit is consistent with existing law.

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2. **Inflation of Distance Traveled.** Relief under the Agreement is based on the ratio of the rate to the variable cost of the movement. However, the variable cost calculation uses a multiplier of 12.6 percent that artificially inflates distances above the actual mileage and routing for the movements at issue, according to BNSF's own published mileages.

3. **Change to Rate Structure.** Variable costs are also inflated by BNSF's recent decision--after the Agreement was signed--to limit non-shuttle loadings to a maximum of 48 cars. This is a curious decision, because it is my understanding that almost all non-shuttle facilities in this state were designed for 52 cars or more.

   Loading only 48 cars at Montana's 52-car grain elevators is plainly inefficient for BNSF and shippers alike, and has no apparent cost justification. The change treats grain loaded at 52-car elevators as if it incurs the high costs of "multiple" car movements containing as few as six cars, regardless of whether BNSF actually moves that grain to market as more efficient unit trains.

4. **Relief.** The Agreement limits relief to a window of fourteen months before and one year after the date of any award, and it excludes fuel surcharges. This short window for relief may discourage shippers from disputing all but the most unreasonable rates. There will still be significant costs involved in bringing a rate arbitration, and those costs are exacerbated by exposure to arbitrator and administrative fees if the arbitration panel, acting under the vague rate reasonableness factors, does not award relief. Moreover, the bar to relief where "a truck rate no higher than the contested rail rate is available," a separate factor from "existence of competitive alternatives," ignores whether trucking is a feasible alternative for the shipment volumes at issue, and whether the truck rate is only comparable because the rail rate is unreasonably high.

Unless I am missing something, these features of the Agreement all operate to the advantage of BNSF, making meaningful rate relief unavailable to the vast majority of Montana producers. Based on current rates and the most recent available shipping volumes and costs, and without BNSF's 48-car maximum, our review indicates that 75 percent of grain shipped would be eligible for rate reasonableness review at the STB, with a maximum annual potential overcharge of $30 million above the 180 percent R/VC jurisdictional threshold. However, only 39 percent of Montana grain shipped qualifies for arbitration under the Agreement's methodology, and the potential for rate relief is just $4 million. In practical terms, even if producers brought successful cases, this translates into little more than a few cents per bushel for the minority of producers who may qualify.

Worse, the Agreement and the new 48-car tariffs will allow rates to rise further still--several hundred dollars per car--with no possibility of review under the Agreement. Apparently, BNSF plans to do exactly that with its August 2009 and January 2010 rate increases. Thus, rather than giving producers a means to change rates to make them reasonable, it appears that the Agreement changes the meaning of reasonable to accommodate BNSF's current and future rates.

These are the principal, but certainly not only, concerns about the Agreement. At the end of the day, I want to ensure that every Montana producer's grain moves to market at reasonable rail rates. Arbitration should provide a cost-effective process to resolve rate disputes, but not at the expense of fair results consistent with shippers' legal right to reasonable rates. The Agreement's provision for producers to challenge directly the rates that they bear through grain elevator service is a step in the right direction, but other provisions fall short of affording meaningful relief from excessive rates for Montana grain shipments.

I remain committed to every possible means of enforcing BNSF's legal duty to provide reasonable rates for Montana shippers. And while the Department of Justice may assist producers and producer organizations who might consider mediation or arbitration under the Agreement despite its shortcomings, the Agreement cannot be expected to resolve Montana producers' rate issues. I will continue to support other efforts to level the playing field for Montana shippers, including federal legislation to repeal the railroads' special antitrust exemption and reform the Surface Transportation Board's rate relief process.

Thank you, again, and I look forward to working with you toward more reasonable rates for Montana producers.

Sincerely,

STEVE BULLOCK
Attorney General

sb/acj/bjh