

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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**STB EX PARTE NO. 665 (Sub-No. 1)**

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**RAIL TRANSPORTATION OF GRAIN, RATE REGULATION REVIEW**

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**REPLY COMMENTS OF  
NORFOLK SOUTHERN RAILWAY COMPANY**

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**Dated: August 25, 2014**

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Norfolk Southern Railway Company (“NS”) respectfully submits these Reply Comments in the above captioned proceeding in addition to joining the Reply Comments of the Association of American Railroads (“AAR”). The Board opened this proceeding to seek input on “grain shippers’ ability to effectively seek relief for unreasonable rates.” *Rail Transp. of Grain, Rate Regulation Review*, EP 665 (Sub-No.1), slip op. at 2 (STB served Dec. 12, 2013). Although the Board just revised its general freight rail rate regulations last year, the Board seeks further dialogue due to suggestions that issues unique to grain transportation may be preventing grain shippers from effectively pursuing a claim to determine whether a particular rail rate is reasonable.

Commenters on opening presented four ideas that NS thinks may be worthy of further consideration:

- First, it may be helpful for the Board to reaffirm the statutory ability of third parties who do not directly pay for transportation to bring rate challenges.
- Second, although not specific to grain movements, the Board should respond to broad-based criticism of its “Limit Price Test” by disavowing its use in future cases.

- Third, the Board’s use of system-average costs in its Uniform Railroad Costing System (“URCS”) necessarily has impacts on the regulation of any commodity. However, any shift towards movement-specific adjustments for one commodity must be accompanied by adjustments for all commodities, including Toxic-by-Inhalation Hazard (“TIH”) chemicals, or else the costing system will not account for all of the railroad’s costs.
- Fourth, NS is always willing to discuss the concerns of its customers, and although it conducts those talks directly with those customers, nevertheless supports requests for non-binding mediation concerning grain rates.

The remainder of the proposals advanced on opening are meritless for several reasons.

First, the remaining proposals are not grounded in sound railroad economics, violating a fundamental principle of the Board’s rate regulatory regime, and in any case are not tailored to issues raised by grain transportation. The National Grain and Feed Association (“NGFA”) and the Alliance for Rail Competition (“ARC”) provide no economic support or even a coherent rationale for their proposed new methodologies. While such methodologies may meet commenters’ stated aims of cost-effectiveness, timeliness, and predictability, they lack any economic justification for distinguishing between reasonable and unreasonable rates in practice.

NGFA and ARC seem to confuse the Board’s charge to ensure that specific rates are reasonable with a prescription that shippers are entitled to rates no greater than the average of all “similar” movements. But looking at average rates provides no insight into issues like economies of density, scope, and scale, differential pricing, or any of the other fundamental economic principles that must support a valid rate reasonableness methodology. And requests to expand rate comparisons to include traffic on other railroads or moving below a revenue-to-variable cost ratio (“R/VC”) of 180% have been considered and rejected repeatedly by the agency. Such suggestions demonstrate the NGFA’s and ARC’s sole goal is widespread and significant reductions in grain rates.

In contrast, the discussions in the shipper comments confirm that most agricultural shipments are subject to diverse forms of competition, which is likely the leading reason that there are few grain rate cases brought.<sup>1</sup> For example, the opening comments are filled with acknowledgment and examples of geographic competition, yet commenters turn a blind eye to the actual effects of such competition in constraining railroads' pricing in those specific situations. Such examples of product and geographic competition are evidence of reduced need for regulatory intervention, not support for new or broader procedures.

Finally, the comments and proposed methodologies do not demonstrate any need or basis for the Board to single out grain movements within its rate reasonableness regime. Case in point, commenters harp on familiar complaints about the costs and length of rate cases, which the Board has seen repeatedly in prior filings from a wide range of shippers.<sup>2</sup> Part of the issue, as NS warned in its Opening Comments, is that grain transportation encompasses too many different markets and impacts to generate neatly segregated concerns uniquely applicable to grain commodities.<sup>3</sup> But such complaints also ignore the efforts of the Board to streamline rate case procedures, to improve the consistency of application of rules in stand-alone cost ("SAC") cases to provide more predictability on how individual issues in those cases will be resolved, and to devise not one but two alternatives to the SAC test (each with progressively less economic rigor). The direct effect is that the regulatory system is clearer to the regulated entities, which means it is easier for them to comply with that regime. As a result, the Board should expect fewer cases and, when cases are brought, that the regulated entity, which should work to comply

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<sup>1</sup> See 49 U.S.C. §§ 10701(d)(1), 10707 (making proof of market dominance a prerequisite to Board jurisdiction over rate reasonableness).

<sup>2</sup> See *infra* note 67.

<sup>3</sup> See NS Opening at 8-13. Unless otherwise noted, all comments cited herein were filed on opening in *Rail Transportation of Grain, Rate Regulation Review*, EP 665 (Sub-No. 1), on June 26, 2014.

with the law on rate reasonableness, will likely win more cases. In any case, the methodologies proposed do not address the substance of the complaints raised in the comments.

In short, the Board should limit any further action in this docket to those areas where further consideration may bring grain shippers some increased clarity. As for methodological changes, the comments fail to develop any theoretical support or economic justification for giving grain transportation special treatment by devising special rate reasonableness procedures only applicable to grain movements.

### **I. Commenters Pre-Judge Revenue Adequacy Issues**

Before turning to the substance of this proceeding, NS first must note that much of the argument made by ARC, NGFA, and the United States Department of Agriculture (“USDA”) on opening, along with large portions of their proposed methodologies, concerned concepts related to revenue adequacy.<sup>4</sup> As the Board and those commenters are well aware, opening comments in a separate proceeding devoted to examination of issues surrounding the concepts of revenue adequacy, *Ex Parte 722, Railroad Revenue Adequacy*, are due on September 5, 2014.<sup>5</sup>

Commenters here appear to have jumped the gun on those filings and prejudged many of the issues in that proceeding, including what constitutes revenue adequacy, and concluded both that the railroads are revenue adequate and, as a result, that some sort of rate constraint should be implemented based on the Board’s annual revenue adequacy calculation.

Of course, the issues of how to estimate revenue adequacy, whether the railroads are revenue adequate, and what, if any, consequences should flow from such a determination are firmly within the scope of *Ex Parte 722*. As the Board will hear in that proceeding, (1) nothing in the statute supports regulating rates on individual movements based on the overall profitability

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<sup>4</sup> See, e.g., ARC Opening at 11-20; NGFA Opening at 21-26; USDA Opening at 9-10.

<sup>5</sup> See *Railroad Revenue Adequacy*, EP 722, slip op. at 2 (STB served June 16, 2014).

of a railroad; (2) the current annual revenue adequacy calculation is incapable of forming a legitimate basis for any regulatory relief, due to its many inaccuracies, including its reliance on book value instead of replacement costs, the difficulty in estimating the cost of capital, and its backwards-looking review of a single year; and (3) attempting to craft or apply a company-wide revenue adequacy constraint to a railroad when a majority of rail traffic is competitive and constrained by the market presents fundamental economic problems and eliminates incentives for innovation and productivity improvements.

As a result, NS will not address any of the comments concerning revenue adequacy or the specific portions of the rate methodologies proposed to account for revenue adequacy in this docket.<sup>6</sup> Such considerations are premature and, in any case, are not uniquely relevant or restricted to grain transportation. NS looks forward to commenting in Ex Parte 722, and trusts that the Board will keep an open mind until all parties have the opportunity to properly present their comments on these and related issues.

## **II. Opening Comments Raised Some Issues that Warrant Further Board Inquiry**

NS has reviewed all of the opening comments in this proceeding and will focus its Reply Comments on the suggestions advanced by ARC, NGFA, and USDA. NS believes that a few issues raised by these groups warrant further consideration by the Board.

### ***A. Third Parties' Ability to Bring Rate Complaints***

ARC, NGFA, and USDA all expressed concerns and some confusion over the ability of third parties who do not directly pay for the transportation of a commodity to bring a case challenging the reasonableness of rail rates.<sup>7</sup> NS understands that for some agricultural commodities, grain elevators or other parties actually contract for the transportation, even though

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<sup>6</sup> This includes ARC's "Two Benchmark" test, as well as the overall application and projected impacts of NGFA's proposal, which includes a revenue adequacy adjustment.

<sup>7</sup> See ARC Opening at 10; NGFA Comments at 32; USDA Comments at 2-3.

farmers may be price takers and thus receive higher or lower prices for their crop based on the cost of transportation. NS notes, of course, that such concerns are commodity and market-specific.

NS does not believe that shippers are asking for anything different than what the statute already acknowledges. Under 49 U.S.C. § 11701(b), third parties have the ability to bring rate cases even when they do not pay directly for the challenged rail transportation.<sup>8</sup> NS has no issue with the Board reaffirming the principle that on a case-by-case basis a party can bring a rate challenge as to transportation for which it can demonstrate a sufficient nexus to the rate at issue, even if not directly paying the rate. However, standing should not be extended to parties with insignificant connections to the transportation, or to permit other attempts to combine unrelated transportation into a single rate challenge.<sup>9</sup> Nor could trade associations and similar entities that do not have any connection to the rates that are actually paid pursue rate challenges on their own. And a complainant's ability to seek rate reparations, rather than just a future rate prescription, necessarily turns on whether it was directly responsible for paying unreasonable freight rates.<sup>10</sup>

### ***B. Discard the Limit Price Test***

Although not unique to grain transportation, NS supports comments by ARC and NGFA seeking to eliminate the Board's "Limit Price Test" for qualitative market dominance.<sup>11</sup> The

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<sup>8</sup> See 49 U.S.C. § 11701(b) ("However, the Board may not dismiss a complaint made against a rail carrier providing transportation subject to the jurisdiction of the Board under this part because of the absence of direct damage to the complainant.").

<sup>9</sup> See *Rate Guidelines – Non-Coal Proceedings*, 1 ST.B. 1004, 1021 n.50 (Dec. 31, 1996) ("Finally, for us to permit joinder in a rate complaint, there would have to be a sufficient nexus between the two shippers' traffic.").

<sup>10</sup> See 49 U.S.C. § 11704(b) ("A rail carrier providing transportation subject to the jurisdiction of the Board under this part is liable to a person for amounts charged that exceed the applicable rate for the transportation.").

<sup>11</sup> See ARC Opening at 22; NGFA Opening at 35.

Limit Price Test has now been applied in three rate case proceedings.<sup>12</sup> NS finds it particularly instructive that the test, adopted absent any request or proposal from a regulated entity and without a formal opportunity for notice and comment, has been criticized by shippers and railroads alike in every proceeding in which it has arisen.<sup>13</sup> Indeed, the Board itself has recognized that “[t]he comments received were overwhelmingly critical from shippers, carriers, and economists.”<sup>14</sup> NS itself has repeatedly raised the economic flaws with the test and pointed out illogical results from its application.<sup>15</sup> The Board would be well served to take a cue from the unanimity of opposition and discard the test outright. At a minimum, the Board should follow Commissioner Begeman’s recommendation and open a proceeding to allow full public

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<sup>12</sup> See *M&G Polymers USA, LLC v. CSX Transp., Inc.* (hereinafter “*M&G Polymers*”), STB Docket No. 42123, slip op. at 3 (STB served Sept. 27, 2012) (case settled prior to merits determination); *Total Petrochems. & Refining USA, Inc. v. CSX Transp., Inc.*, STB Docket No. 42121, slip. op. at 16-29 (STB served May 31, 2013), *reconsideration denied* (STB served Dec. 19, 2013) (with Vice Chairman Begeman dissenting in both), *appeal docketed sub nom. CSX Transp., Inc. v. STB*, No. 13-1313 (D.C. Cir. Dec. 26, 2013); *E.I. du Pont de Nemours & Co. v. Norfolk S. Ry. Co.*, STB Docket No. 42125, slip op. at 6-10 (STB served Mar. 14, 2014).

<sup>13</sup> See, e.g., Comments of ARC at 17, *M&G Polymers*, STB Docket No. 42123 (filed Nov. 28, 2012) (“ARC, et al. believe the Board’s proposed limit price approach should not be adopted as a new test in STB market dominance determinations . . . .”); Comments of AAR at 4-5, *M&G Polymers*, STB Docket No. 42123 (filed Nov. 28, 2012) (arguing that adoption of the limit price test violated the Administrative Procedure Act, improperly established a presumption based on R/VC ratios, and applied RSAM in an irrational manner); CSX Reply to Petition for Reconsideration at 1, *Total Petrochems. & Refining USA, Inc. v. CSX Transp., Inc.*, STB Docket No. 42121 (filed July 12, 2012) (“While the Decision indeed contains material errors – primarily related to the Board’s adoption of an unlawful and economically irrational “limit price” rule for determining qualitative market dominance . . .”).

<sup>14</sup> *E.I. du Pont de Nemours & Co. v. Norfolk S. Ry. Co.*, STB Docket No. 42125, slip op. at 60 (STB served Mar. 14, 2014) (Vice Chairman Begeman concurring).

<sup>15</sup> See Comments of NS at 2, *M&G Polymers*, STB Docket No. 42123 (filed Nov. 28, 2012) (“[I]t is clear that the ‘limit price’ test as a presumption is unlawful, uneconomic, and bad policy.”); NS Reply at II-B-40 to -57, *E.I. du Pont de Nemours & Co. v. Norfolk S. Ry. Co.*, STB Docket No. 42125 (filed Nov. 30, 2012) (“Among other flaws, the limit price approach fails to consider relevant market information, including the impact of product and geographic competition; bases its conclusions upon an RSAM figure that does not incorporate any information about the competitiveness of particular markets; places undue reliance on variable cost measures that are inherently imprecise at the shipment-specific level; and would do nothing to simplify the market dominance inquiry.”).

comment before the Board considers applying this unsound and uneconomic test again in any future case.<sup>16</sup>

***C. Consider Reexamination of URCS System-Average Costs***

ARC argued in its comments that system-average costing for grain commodities under the Board's URCS systematically overstates costs for grain shipments and therefore results in suppressed R/VC values and more difficulty bringing rate challenges.<sup>17</sup> ARC points in particular to the move towards more efficient unit and shuttle train service and argues in favor of a downward adjustment to URCS for grain shipments.<sup>18</sup>

NS agrees that certain agricultural commodities may have seen efficiency gains and benefits through the move towards unit and shuttle train service. NS does not agree in the abstract, however, that ARC is correct in concluding that such trends necessarily result in overstated URCS costing for agricultural commodities. Certainly ARC's anecdotal assertions about the overall impact are insufficient to support any regulatory action. Moreover, such effects would not be true for agricultural commodities or shipments moving in single- or multi-car service – whose costs may actually be understated by URCS – so any purported general “grain adjustment” would be overly inclusive.

More broadly, however, NS agrees that the use of system-average costs necessarily can misrepresent the estimated cost of some transportation, because certain costs, like those for TIH shipments, are neither properly allocated nor fully captured.<sup>19</sup> Addressing allocation discrepancies like those alleged by ARC would require either specific costing adjustments for all

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<sup>16</sup> See *Total Petrochems. & Refining USA, Inc. v. CSX Transp., Inc.*, STB Docket No. 42121, slip. op. at 31 (STB served May 31, 2013) (Vice Chairman Begeman dissenting).

<sup>17</sup> See generally ARC Opening, Fauth V.S. at 4-13.

<sup>18</sup> ARC Opening, Fauth V.S. at 11

<sup>19</sup> See generally AAR Comments, *Class I Railroad Accounting and Financial Reporting – Transportation of Hazardous Materials*, EP 681 (filed Feb. 4, 2009).

commodities or a wholesale reexamination of URCS. The Board has resisted requests for adjustments to system-average costs in the past, reasoning that the use of system averages balances out across all traffic.<sup>20</sup> And contrary to ARC's claims here, allowing the "use of variable cost units different from the URCS system-wide average figure" for any subset of grain movements would be the very definition of a movement-specific adjustment the Board has repeatedly considered and prohibited.<sup>21</sup> In fact, if the Board permitted such adjustments for grain movements, it would face a real problem if it did not also adjust for other commodities. If the grain shippers are directionally correct that such adjustments would result in lower than system-average costs for grain, that means other traffic must have costs higher than the system-average. If the Board's prior holdings prohibiting adjustments to TIH and other understated traffic are not also reversed, railroads would not be permitted to recover their full costs.

Of course, the Board also has the option of performing a comprehensive reexamination of URCS. NS did not take a position when the Board last considered a general review of URCS, noting that no costing system is perfect and the Board should ensure that the benefits of such an inquiry would be worth the necessary time, manpower, and expense it would entail.<sup>22</sup> NS maintains the same view towards any comprehensive review at this time.

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<sup>20</sup> See *Simplified Standards for Rate Cases*, EP 646 (Sub-No. 1), slip op. at 58 (STB served Sept. 5, 2007) ("*Simplified Standards*") ("Thus, when URCS is used to calculate operating expenses for a broader traffic group--and in most cases, a challenge to hazmat shipments will be merely a portion of the traffic group, because the complainant will be required to include all the defendant's traffic that moves over the route in question--the underage for hazmat moves and overage for non-hazmat moves should to a large extent offset one another. Therefore, use of URCS system-average costs, even in cases involving a challenge to hazmat or high-and-wide shipments, should provide a reasonable approximation of the total operating expenses of the traffic group.").

<sup>21</sup> *Major Issues in Rail Rate Cases*, EP 657, slip op. at 48 (Sub-No. 1) (STB served Oct. 30, 2006).

<sup>22</sup> See NS Comments at 4, *Review of the Surface Transportation Board's General Costing System*, EP 431 (Sub-No. 3) (filed Apr. 23, 2009).

Overall, NS agrees that use of system-average URCS costing can have impacts on the regulation of some traffic and may justify some renewed examination by the Board. However, if the Board considers allowing movement-specific adjustments for grain shippers, the Board must allow such adjustments to URCS costing for all movements, including but not limited to TIH traffic, to permit the railroads to recover their full costs.

***D. Consider Non-Binding Mediation But Not Arbitration***

NS supports USDA's request for additional non-binding mediation between railroads and shippers.<sup>23</sup> The Board already has procedures in place for non-binding mediation, including mandatory mediation after a rate case is filed.<sup>24</sup> NS is always willing to sit down and talk with its customers and would support additional procedures to encourage such discussions.

However, the Board has no authority to pursue the USDA recommendation for binding arbitration to settle rate disputes.<sup>25</sup> The Board itself has previously recognized that current law does not permit binding arbitration of rate reasonableness complaints.<sup>26</sup> Under the Alternative Dispute Resolution Act, 5 U.S.C. § 570 *et seq.*, the Board lacks authority to delegate its rate regulation authority to another party absent voluntary agreement by both the railroad and shipper.<sup>27</sup> Of course, two parties to a dispute can certainly agree to binding arbitration, and the

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<sup>23</sup> See USDA Opening at 10.

<sup>24</sup> See 49 C.F.R. § 1109.1 *et seq.*

<sup>25</sup> See USDA Opening at 10-11.

<sup>26</sup> See *Arbitration – Various Matters Relating to Its Use as an Effective Means of Resolving Disputes That Are Subject to the Board's Jurisdiction*, Ex Parte 586, slip op. at 1 (STB served Oct. 26, 2001) (explaining “current law permits arbitration of disputes within the Board’s jurisdiction only where the parties agree to use that process”).

<sup>27</sup> NS Opening at 3-7, *Assessment of Mediation and Arbitration Procedures*, EP 699 (filed May 17, 2012); see also AAR Comments at 5-12, *Assessment of Mediation and Arbitration Procedures*, EP 699 (filed May 17, 2012) (detailing the Board’s lack of authority under 49 U.S.C. § 721 and the Alternative Dispute Resolution Act to impose arbitration “without the voluntary consent of the parties”).

Board's current rules both allow for such a practice and provide default procedures.<sup>28</sup> But any attempt to go further and force a railroad and shipper to enter binding arbitration to settle rate disputes without railroad consent in writing on a case-by-case basis would be unlawful.

### **III. Proposed Methodologies Do Not Reflect Sound Railroad Economics**

Proposals by ARC and NGFA that go beyond these areas are not supported by sound railroad economics and should be dismissed by the Board. NS explained on opening that the Board's past consideration of new rate methodologies, and the history of judicial review of those efforts, demonstrated that any new proposal must be grounded in sound railroad economics.<sup>29</sup> Such economics include the concepts of economies of density, scale and density,<sup>30</sup> and demand-based differential pricing of traffic.<sup>31</sup> Even a cursory review of the new methodologies put forward on opening finds them lacking in all respects.

#### ***A. Commenters' Guiding Principles are Insufficient***

Comments lay out similar rubrics for judging new grain methodologies, focusing on cost, timeliness, and predictability, and then assume the validity of their proposals after explaining how their methodologies accomplish these self-imposed criteria.<sup>32</sup> Yet many methodologies could be imagined that would meet such requirements. A presumption that all grain shipments with R/VC ratios above 180% are unreasonable would be cost-effective, timely, and predictable.

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<sup>28</sup> See 49 C.F.R. § 1108.1 *et seq.*

<sup>29</sup> NS Opening at 5-8.

<sup>30</sup> See *Rate Guidelines - Non-Coal Proceedings*, 1 S.T.B. at 1018, n.39 (describing economies); *Coal Rate Guidelines*, 1 I.C.C. 2d 520, 526 (Aug. 8, 1985) ("Most importantly, railroads exhibit significant economies of scope and density").

<sup>31</sup> See, e.g., *Coal Rate Guidelines*, 1 I.C.C. 2d at 526 ("In our February 1983 decision, we explained at some length our belief that the cost structure of the railroad industry necessitates differential pricing of rail services.").

<sup>32</sup> See, e.g., NGFA Opening at 4 ("Mr. Crowley explains in detail the economic and policy justifications for the proposed methodology, the goal of which is to create an easily administered, inexpensive and objective way to test the reasonableness of Ag Commodity rates . . ."); USDA Opening at 13 (requesting methods "that address cost, timeliness, and predictability").

So too would a rate reduction to seven percent above a rail carrier's fully allocated costs for a particular movement. Of course, the first is statutorily prohibited,<sup>33</sup> and the United States Court of Appeals for the D.C. Circuit ("D.C. Circuit") long ago rejected precisely the second.<sup>34</sup> Put another way, ensuring that a methodology is quick, cheap, and formulaic provides no insight into whether the methodology is valid or instead arbitrary. Validity comes from the generation of outcomes consistent with sound economics.

Clearly, these criteria are far from sufficient to establish a valid methodology. As the Board and United States Court of Appeals have consistently recognized, any valid rate reasonableness methodology must be based on sound economic theory that provides a supporting rationale for distinguishing between reasonable and unreasonable rates.<sup>35</sup>

### ***B. Proposals Lack Any Economic Support***

Yet ARC, NGFA, and USDA never address the fundamental question of what economic basis supports their refrain that most grain rates are unreasonable. USDA ignores the need for an economic rationale, calling for increased mediation and arbitration without any discussion of the standard to apply.<sup>36</sup> And NGFA and ARC assume that most grain rates are unreasonable and endeavor to create tests guaranteed to result in rate reductions for most grain shippers.<sup>37</sup> Neither

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<sup>33</sup> See 49 U.S.C. § 10707(d)(2)(B).

<sup>34</sup> See *City Pub. Serv. Bd. ex rel. San Antonio v. United States*, 631 F.2d 831, 850 (D.C. Cir. 1980).

<sup>35</sup> See, e.g., *Simplified Standards* at 13 ("The SAC test, which judges the reasonableness of a challenged rate by comparison to the rate that would prevail in a competitive market, rests on a sound economic foundation and has been affirmed by the courts . . . . Any simplified methodology for assessing the reasonableness of rail rates should be designed to achieve the same objective . . . .").

<sup>36</sup> See USDA Opening at 10-11.

<sup>37</sup> See, for example, ARC Opening at 24 ("[T]he explanation is not that there is any shortage of grain shippers or producers who regard their rail rates as excessive."), improperly conflating shippers views that their rail rates are high with a conclusion that they must be unreasonable.

has given the Board a supporting economic rationale for distinguishing between reasonable and unreasonable rates. Instead, both proposals function primarily by allowing grain shippers to reduce rates to the average rate charged by all of the railroads for transportation of the same commodity a reasonably similar distance. NGFA accomplishes this directly,<sup>38</sup> while ARC proceeds by proposing to reform the comparable sample in the 3B methodology.<sup>39</sup>

Unsurprisingly, ARC and NGFA provide no economic support for the implicit assertion that all grain rates that are above average must be unreasonable. Indeed, the very principles of sound economic theory affirmatively disprove such a conclusion. Demand-based differential pricing *requires* variation in rates so that the railroad can recover all of its costs. Economies of density *require* consideration of the amount of traffic on particular lines, not just a simple comparison of distance, to assess how much of the costs for that line the railroad should recover from each movement. Similarly, economies of scale and scope are impacted by plant size and may vary in effect when comparing different railroads.

Allowing all grain shippers to reduce their rates to a suppressed average will quickly lower that average, triggering further reductions for even greater numbers of shippers. This “ratcheting” effect is simple mathematics – unless or until all rates are the same, rates cannot all be at or below average. “[The D.C. Circuit] has rejected rate-comparison formulas due to their

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<sup>38</sup> See NGFA Opening, Crowley V.S. at 14 (“It is well established that the sample mean is a statistically unbiased point estimator of the corresponding population parameter, which in this case, is the average transportation rate for grain or an allied product given a certain set of circumstances.”).

<sup>39</sup> See ARC Opening, Fauth V.S. at 22.

ratcheting potential in the past.”<sup>40</sup> And ratcheting is a recognized concern with the Board’s “rough and imprecise” 3B methodology.<sup>41</sup>

In an attempt to provide a test that will result in lower rates for the most grain shippers, commenters’ proposals remove the few protections in the 3B methodology that the Board and the D.C. Circuit believed would prevent significant downward ratcheting of rates. In particular, the Board and the court pointed to the limit on relief, the restricted amount of eligible traffic, and the need for a large number of cases<sup>42</sup> to be filed with the Board.<sup>43</sup> But the proposals here, which are applicable to all grain movements, are expressly designed to incite widespread rate claims and reductions and would remove all relief limits.<sup>44</sup>

Perhaps recognizing the many economic flaws in the proposals or the ratcheting problem that has long concerned the Board and the D.C. Circuit, NGFA and ARC attempt to argue that the proposals’ impacts will be minimal because some shippers who would otherwise get relief

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<sup>40</sup> *CSX Transp., Inc. v. Surface Transp. Bd.*, No. 13-1230, 2014 U.S. App. LEXIS 11617, at \*23 (June 20, 2014).

<sup>41</sup> *See Simplified Standards* at 73-74.

<sup>42</sup> However, the prediction that an “avalanche” of cases would be needed to cause ratcheting is faulty because it ignores the fact that rate regulatory regimes affect rates even when cases are not filed.

<sup>43</sup> *See Rate Regulation Reforms*, EP 715, slip op. at 24 (STB served July 18, 2013) (“However, the agency did not believe that this should be a significant concern for several reasons that continue to apply here. With this decision, the potential for ratcheting will remain constrained by a limit on relief, albeit a higher one. Moreover, as the Board correctly observed, for the ratcheting potential to be realized, there would have to be an avalanche of rate cases brought to the agency. If we were to witness such an occurrence, we could reassess the advisability of this approach and take appropriate actions, if necessary.”); *Simplified Standards for Rail Rate Cases*, EP 646 (Sub-No. 1), slip op. at 27-28 (STB served July 28, 2006) (“We are aware of the concern that repeated application of a mean figure as the basis for a regulatory ceiling could have a feedback effect that could lower the mean for future cases. We believe, however, that this should not be a significant concern for two reasons. First, the revenue adequacy adjustment (the ratio of RSAM over R/VC[total]) would have a countervailing effect. More importantly, only a small percentage of a carrier’s traffic would likely be eligible to use the Three-Benchmark approach under our proposed eligibility criteria set forth below.”).

<sup>44</sup> *See* NGFA Opening at 31 (“There would be no limits on the amount of relief that the complaining shipper or group of shippers could receive if a rate challenge is successful.”).

will not “be able to demonstrate that qualitative market dominance also is present.”<sup>45</sup> This argument is nonsensical and inconsistent with the statute. First, these shippers would not otherwise be entitled to relief. The statute makes clear that the Board lacks jurisdiction over rates where the railroad is not market dominant.<sup>46</sup> Second, arguing for a regulatory regime that would mandate *lower* rates for a particular movement *unless* it faced market competition turns differential pricing completely on its head. Differential pricing, which has long been established as a fundamental principle of the Staggers Act and the economics underlying it, occurs when “the carrier charges *higher* rates to captive shippers than the rates offered shippers with competitive alternatives.”<sup>47</sup> The inescapable conclusion is that NGFA’s and ARC’s tests are aimed at simply and quickly reducing regulated grain rates to the jurisdictional threshold of 180% R/VC.<sup>48</sup>

Finally, ARC and NGFA also seek to remove protections in the selection of the comparison group in the 3B methodology. Both suggest that regulated traffic should be compared to traffic moving below a 180% R/VC ratio and that a defendant railroad’s rates

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<sup>45</sup> *Id.* at 36-37 (“Moreover, not every Ag Commodity Shipper who has rates in excess of 180% of the URCS variable costs of providing the service will be able to demonstrate that qualitative market dominance also is present.”); *see also* ARC Opening, Fauth V.S. at 15 (complaining that many grain movements “could have problems proving market dominance” because, for example, “they have two or more railroads serving the facilities”).

<sup>46</sup> *See* 49 U.S.C. §§ 10701(d)(1), 10707 (making proof of market dominance a prerequisite to Board jurisdiction over rate reasonableness).

<sup>47</sup> *Simplified Standards* at 76 (emphasis added).

<sup>48</sup> This effect has been noted by other shippers in this docket. *See* Texas Trading and Transportation Services, LLC Reply at 9 (filed Aug. 20, 2014) (observing that the consequences of the NGFA proposal “would be to compress average rail rates around 180% RVC . . .”). NGFA’s attempt to excuse this intended effect by recasting the Board’s jurisdictional threshold of a 180% R/VC ratio as a “revenue protection[]” provision, NGFA Opening at 29, is contradicted by the clear language of the statute that states the threshold addresses market dominance. *See* 49 U.S.C. § 10707(d)(1)(A).

should be compared to rates of other railroads.<sup>49</sup> Such suggestions are in no way unique to grain transportation and have been raised by shippers of a variety of commodities in the past.<sup>50</sup> In response, the Board has issued several reasoned decisions rejecting such requests and explaining that such comparisons would give no insight into whether the challenged rate was reasonable.<sup>51</sup> The economics that support that conclusion by the Board have not changed. There is no basis for comparing traffic over which the railroad is potentially market dominant to traffic over which the railroad is not market dominant by statute, or for assessing a reasonable R/VC ratio for traffic moving over one railroad by comparison to traffic moved by another railroad under a completely different cost structure.

### ***C. Arguments Also Confuse Other Economic Concepts***

These comments also confuse other economic concepts when attempting to justify the need for additional regulatory intervention. As NS explained in its Opening Comments, because many agricultural products are commodities, “the cost for transportation may be constrained by a variety of factors,” including in some instances the ability of buyers to purchase the same

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<sup>49</sup> See ARC Opening at 23-24; NGFA Opening at 28-29.

<sup>50</sup> See Comments of American Chemistry Council at 46, *Simplified Standards* (Feb. 26, 2007) (arguing that “a per se exclusion of non-defendant movements is unnecessary, undesirable, and arbitrary”); *Rate Guidelines – Non-Coal Proceedings*, 1 S.T.B. at 1026 (citing requests from the National Industrial Transportation League, Shell Oil Company, Shell Chemical Company, and the Western Coal League and other coal shippers to use comparisons to rates below 180% R/VC levels).

<sup>51</sup> See *Simplified Standards* at 17 (“The purpose of the R/VC[COMP] benchmark is to use the R/VC ratios of other ‘potentially captive traffic’ (i.e., traffic priced above the 180% R/VC level) as evidence of the reasonable R/VC levels for traffic of that sort. As such, the comparison group should consist of only captive traffic over which the carrier has market power. The rates available to traffic with competitive alternatives would provide little evidence on the degree of permissible demand-based differential pricing needed to provide a reasonable return on the investment.”); *id* at 83 (“Accordingly, we conclude that the R/VC ratio of potentially captive traffic of one carrier provides no useful indicia of the lawful contribution to fixed and common costs for another carrier.”); *Rate Guidelines – Non-Coal Proceedings*, 1 S.T.B. at 1026 (“Some shippers regard the >180 group as too restrictive and argue that <180 traffic should be included. That would be inconsistent with the statute . . .”).

product from other sources or to substitute different products when relative costs rise or fall.<sup>52</sup>

NGFA and ARC both give countless descriptions of such product and geographic competition.<sup>53</sup>

“[C]aptive AG Commodity producers and elevators, in particular, are competing in the marketplace against other AG Commodity shipments with rates above and below the 180% threshold.”<sup>54</sup> Other commenters also make this point:

While the majority of agriculture shippers are single-served, the majority are in no way economically captive to one railroad. The facts show that nearly all single-served agricultural shippers have material market economic alternatives. For example, most western carriers have parallel lines that run through the major agriculture states within 100-200 miles of each other – well within a competitive drawing arc – especially given secondary freight market premiums.<sup>55</sup>

Yet rather than recognize that such competition constrains many rail rates, ARC and NGFA instead suggest that competition is a cause for *increased* regulation.<sup>56</sup>

Indeed, ARC even goes so far as to ask the Board to upend the Staggers Act and further *relax* its market dominance standards, which already are limited to only intra- and intermodal

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<sup>52</sup> NS Opening at 11-12.

<sup>53</sup> See NGFA Opening at 8 (describing “the highly competitive marketplace in which this low-margin, high volume business operates in both domestic and international markets”); *id.* (“Significantly, as noted previously, Ag Commodity markets are both national and global in scope. For example, *captive wheat and other commodity* producers and elevators *compete* not only against each other to sell their crops, but also *with shippers and receivers from other states and Canadian provinces.*”) (emphasis added); *id.* at 9 (explaining that “delivery points to which many Ag Commodities are shipped often have multiple sources of supply”); NGFA Opening, Crowley V.S. at 7 (“Grain and allied products, unlike many other products transported by rail, are extremely fungible, and deviation from the average cost of production and transportation can effectively foreclose a grain shipment from market.”).

<sup>54</sup> NGFA Opening at 29.

<sup>55</sup> Texas Trading and Transportation Services, LLC, Reply at 6 (filed Aug. 20, 2014); *see also id.* at 9 (highlighting other sources of competition: “Railroads have to compete for corn with ethanol processors by lowering their rates. Wheat and soybeans also have considerable alternative processing markets.”).

<sup>56</sup> See, e.g., NGFA Opening at 29; NGFA Opening, Crowley V.S. at 7 (“The reason for the all-inclusive nature of the comparison group stems from the national and international market factors facing grain shipments.”).

competition.<sup>57</sup> That request is untenable. When declining to consider product and geographic competition as part of any market dominance determination, the Board claimed that the omission of those forms of competition would have minimal effects: “any hardship would not be substantial because shippers that have effective indirect alternatives would be unlikely to pursue a rate challenge, and because a rate level constrained by effective indirect competition would be found to be reasonable.”<sup>58</sup> Comments here refute that logic, arguing that although many grain shippers face competition that constrains their rates, the Board should regulate and further reduce rates on traffic subject to such competition.

Similarly spurious are complaints about the inability of grain shippers to use SAC or Simplified-SAC (“S-SAC”) because grain shippers are more frequently located on low-density lines than coal or other customers.<sup>59</sup> The claimed disadvantage is not a function of SAC or S-SAC, but rather a reflection of the economic reality that railroads must recover higher proportional costs when less traffic operates over a line due to economies of density. Valid rate reasonableness tests must reflect this economic reality.<sup>60</sup>

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<sup>57</sup> See ARC Opening, Fauth V.S. at 16.

<sup>58</sup> See *Petition of AAR to Institute a Rulemaking Proceeding to Reinroduce Indirect Competition as a Factor Considered in Market Dominance Determinations for Coal Transported to Utility Generation Facilities*, EP 717, slip op. at 2 (STB served Mar. 19, 2013).

<sup>59</sup> See, e.g., NGFA Opening at 13-14 (complaining that grain shippers “do not generate the tonnage necessary to meet traffic densities for a successful Full-SAC presentation” and that “[m]any facilities and elevators are located on low density rural branch lines or secondary lines” and that the Board’s rules have “restricted” the ability to include such lines in SAC cases); *id.* at 14 (“The SSAC rules apply the same ‘cross-subsidy’ rules as those in SAC cases, thereby raising the same obstacle to Ag Commodity shippers located on or using low-density rail lines.”); ARC Opening, Fauth V.S. at 18 (“Although many grain and grain products have high rates, they simply do not have the volumes and track densities necessary to make use of these expensive and time consuming SAC tests.”).

<sup>60</sup> See *Rate Guidelines - Non-Coal Proceedings*, 1 S.T.B. at 1018 & n.39.

#### **IV. Comments and Methodologies Do Not Support Grain-Specific Procedures**

Without any valid underlying economic rationale to examine, the Board has no need to give any further consideration to the proposals by ARC and NGFA. Even so, the methodologies also do not fulfill the stated purpose of this proceeding, namely identifying and accounting for any issues with current rate reasonableness procedures that make them specifically unavailing to grain shippers. Although ARC, NGFA, and USDA list many complaints in their opening comments about the Board's current rate methodologies, including the scarcity of filed cases,<sup>61</sup> the length and cost of bringing a case,<sup>62</sup> and the predictability of outcomes,<sup>63</sup> such concerns are hardly new or unique to grain. Indeed, NGFA's expert advanced many of these same concerns and proposed similar remedies just last year in Ex Parte 715, *Rate Regulation Reforms*, specifically on behalf of chemical shippers.<sup>64</sup> Moreover, such generalized complaints do not withstand critical examination, and commenters' proposals do not even address most of the perceived flaws. In short, the Board has been provided no valid basis in this proceeding for attempting to craft a grain-specific rate reasonableness approach.

##### ***A. Complaints Are Not Unique to Grain Transportation***

With few exceptions, the complaints raised on opening are not unique to grain. Rather, they are ubiquitous and echo past complaints from shippers of all commodities. ARC admits as

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<sup>61</sup> See, e.g., NGFA Opening at 3-4.

<sup>62</sup> See, e.g., USDA Opening at 5 ("The SAC test . . . is too costly and complex for grain shippers.").

<sup>63</sup> See, e.g., *id.* at 8.

<sup>64</sup> See Chlorine Institute Comments, Crowley V.S., *Rate Regulation Reforms*, EP 715 (filed Oct. 23, 2012) ("My Verified Statement describes how the STB's current procedures for the 3BM Methodology are not viable for chlorine shippers and the STB's proposed modification in EP 715 does not address these problems.").

much: “Many of the deficiencies in the status quo may not be unique to grain . . . .”<sup>65</sup> For example, commenters complain that the Board’s current methodologies cost too much and take too long.<sup>66</sup> But the Board has repeatedly considered complaints about the costs and length of SAC, S-SAC, and 3B, including just last year in Ex Parte 715.<sup>67</sup> Similarly, the Board has heard complaints from various shippers about “across the board” pricing under the 3B methodology.<sup>68</sup> Nor are grain commodities the only railroad movements that ever shift “with changing markets” or have “many origin-destination pairs.”<sup>69</sup> NS recently completed a SAC case concerning chemical shipments that involved more than a hundred different lanes.<sup>70</sup> And while the prevalence of grain shuttle trains may be a recent phenomenon, coal traffic has long moved in

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<sup>65</sup> ARC Opening at 9-10; *see also* ARC Opening, Fauth V.S. at 17 (complaining that SAC and S-SAC “are not viable options for most grain and grain products shippers, and the same is true for most non-coal shippers”).

<sup>66</sup> *See, e.g.*, ARC Opening, Fauth V.S. at 22; USDA Opening at 6-8 (calculating costs).

<sup>67</sup> *See, e.g.*, Consumers United for Rail Equity (“CURE”) Comments at 20, *Rate Regulation Reforms*, EP 715 (filed Oct. 22, 2012) (“The Board should be looking for ways to expedite rate challenges and make them less costly rather than make the proposals that it has made in this Decision.”); PPG Industries, Inc. Comments at 9, *Rate Regulation Reforms*, EP 715 (filed Oct. 23, 2012) (“PPG previously considered bringing a Three-Benchmark case, but determined that the relief available under the cap was grossly insufficient to justify the litigation cost and risk.”); U.S. Magnesium, Inc. Comments at 4, *Rate Regulation Reforms*, EP 715 (filed Oct. 23, 2012) (“These deficiencies, which include the Board’s significant underestimation of the cost and complexity of 3B and SSAC cases under the present version of the rules, are discussed below.”).

<sup>68</sup> *See, e.g.*, Chlorine Institute Comments at 7, *Rate Regulation Reforms*, EP 715 (filed Oct. 23, 2012) (“Specifically, beginning in 2005, the Class I railroads have engaged in massive, across-the-board rate increases that apply to all of their chlorine and other TIH shippers.”); Consumers United for Rail Equity Comments at 2, *Rate Regulation Reforms*, EP 715 (filed Oct. 22, 2012) (“Going forward, few captive shippers are likely to invoke the ‘Three-Benchmark’ guideline. The major reason is that challenged rates are often high but in the range of other, comparable rates for the same or similar commodities, so the ‘Three-Benchmark’ methodology likely will offer little if any relief from the challenged rate.”).

<sup>69</sup> *See* USDA Opening at 3.

<sup>70</sup> *E.I. du Pont de Nemours & Co. v. Norfolk S. Ry. Co.*, STB Docket No. 42125, slip op. at 60 (STB served Mar. 14, 2014).

unit trainloads.<sup>71</sup> In every proceeding that these recurring complaints have been raised, the Board has issued reasoned decisions considering and rejecting the nature of relief requested by grain shippers here.<sup>72</sup> This greatest hits rendition of rate reasonableness complaints provides no new basis for the Board to consider revisions or apply unique procedures to grain transportation.

***B. Complaints Are Not Common to All Grain Transportation***

Although the complaints are not new or unique, they also vary widely in their applicability to different types of grain transportation. NS explained on opening that grain is not a homogenous term because it potentially encompasses many different agricultural commodities and markets.<sup>73</sup> Tension is thus created when attempting to make any generalizations about “grain transportation” as a whole, especially when expanded to encompass grain products.

Opening comments confirm this by first demonstrating that grain transportation rates vary significantly. In fact, the one common thread is that most grain rates fall outside the Board’s jurisdiction. ARC confirms that “most grain and grain products have revenue-to-variable cost (R/VC) ratios falling below 180%.”<sup>74</sup> Relatedly, NGFA demonstrates the amount of traffic subject to the Board’s jurisdiction varies widely between agricultural commodities, “from a low of 17.5 percent for Soybean Meal and Hulls in 2011 to a high of 68.7 percent of 2011 ethanol.”<sup>75</sup> Commenters thus admit to requesting sweeping remedies for commodities that face significant competition and have disparate rate and market structures.

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<sup>71</sup> See generally *Coal Rate Guidelines - Nationwide*, 364 I.C.C. 360, 370 (1980) (discussing unit trains of coal and related costing).

<sup>72</sup> See, e.g., *Rate Regulation Reforms*, EP 715, slip op. at 24 (STB served July 18, 2013); *Simplified Standards*, Appendix C.

<sup>73</sup> See NS Opening at 8-13.

<sup>74</sup> ARC Opening, Fauth V.S. at 5.

<sup>75</sup> NGFA Opening, Crowley V.S. at 4.

Material differences arise even within specific agricultural commodities. For example, ARC highlighted that export grain shipments face drastically different competitive and market conditions than domestic transportation, going so far as to call for (unspecified) “export grain rate adjustments.”<sup>76</sup> Similarly, ARC reinforced NS’s observation that many commodities face significant modal competition, noting “[m]any large volume railroad grain movements involve relatively short distances to processing facilities and river terminals and many large grain destinations have two or more railroads serving the facilities.”<sup>77</sup> NGFA provided supportive statistics, noting for example that trucks moved more than twice as much corn and soybeans as rail, but handled far less wheat.<sup>78</sup> Geography matters too – certain western states ship agricultural commodities overwhelmingly by rail, a phenomenon not seen in the East.<sup>79</sup> Transportation conditions also vary; capacity in the Pacific Northwest does not necessarily mirror other parts of the country, a point also highlighted by NGFA.<sup>80</sup> Such concerns still only scratch the surface of some of the other differences between the markets for particular types of wheat, corn, corn products, etc. that NS briefly summarized on opening.<sup>81</sup>

Given these disparate markets, it’s hardly surprising only NGFA even attempted to define grain, and in doing so defined it as broadly as possible.<sup>82</sup> But the larger point is not the definition but that any attempt to group all these agricultural commodities together and claim

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<sup>76</sup> ARC Opening, Fauth V.S. at 30.

<sup>77</sup> *Id.* at 15.

<sup>78</sup> See NGFA Opening at 10.

<sup>79</sup> See *id.*

<sup>80</sup> See ARC Opening at 7; ARC Opening, Fauth V.S. at 28-29.

<sup>81</sup> See NS Opening at 8-13.

<sup>82</sup> See NGFA Opening at 27. ARC did not specifically discuss a definition of grain but did ask that any Board actions extend beyond the STCC 01-13 codes to certain grain products. See ARC Opening, Fauth. V.S. at 3.

they are commonly disadvantaged by the Board's rate reasonableness procedures defies the shippers' own descriptions of the varied and changing marketplaces in which they operate.

***C. Complaints Themselves Do Not Withstand Critical Examination***

The fact that the complaints raised on opening are not unique or common to all grain transportation undercuts the impetus for this grain-focused proceeding. Importantly, their repetition in other proceedings by shippers of other commodities also does not enhance their persuasiveness. A critical examination of each of the major complaints is important to assess the extent, if any, to which the Board should take such complaints as evidence of underlying limitations of current rate reasonableness procedures.

*i. Number of Cases*

Perhaps the most repeated concern in this proceeding is that too few grain rate cases have been filed. However, the premise that an effective rate reasonableness regime would result in increasing numbers of rate cases inverts the proper relationship – a successful regime should result in *fewer*, not more numerous, cases.

Immediately after the adoption of *Coal Rate Guidelines*, the agency expected that there would be few rate cases. “Further, we have been involved in only a few rate reasonableness proceedings, a reflection of the fact that our jurisdiction regarding rate review is circumscribed by 49 U.S.C. 10701a(b)(A).”<sup>83</sup> As NS pointed out on opening and again above, most of its grain traffic moves at rates below the Board's jurisdiction and much of it would fail the market

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<sup>83</sup> *Standards for Railroad Revenue Adequacy*, Ex Parte No. 393 (Sub-No 1), 3 I.C.C. 2d 261 (1986).

dominance inquiry.<sup>84</sup> And as shipper comments repeatedly point out, substantial competition – both direct and indirect – constrain rail pricing in many instances.<sup>85</sup>

Of course, a limited subset of NS's grain movements still remains within the Board's jurisdiction. NS prices to the market using the tools encouraged and preferred by the statute – private, market-based negotiation and contracts. *See, e.g.*, 49 U.S.C. § 10101(1), (2); *id.* § 10709. NS collaborates and negotiates with its customers while drawing upon its knowledge of specific markets and modal, product, and geographic competition to craft rail pricing which will allow its customers to compete, and for NS to handle their shipments.

At the same time, a regulatory system is in place as a backdrop of which NS and its customers are very aware. This understanding allows NS to price within the regulatory limits and allows shippers to assess if their rates remain reasonable under the Board's precedent. The Board has worked hard to improve the consistency of application of rules in SAC cases and to develop two alternatives to SAC. The direct effect of those efforts is that the regulatory system is clearer to the regulated entities, which means it is easier for them to comply with that regime. In the report *Reducing the Risk of Policy Failure: Challenges for Regulatory Compliance*, the Organization for Economic Cooperation and Development noted that:

Regulatory compliance in this report refers to *obedience by a target population with regulations*. Why do people obey any rule? Several conditions are needed. The first condition is that the target group has to be *aware of the rule* and *understand* it. For example, lack of clarity in a rule may bring about unintentional non-compliance.<sup>86</sup>

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<sup>84</sup> See NS Opening at 13.

<sup>85</sup> See *supra* notes 53-55 and accompanying text.

<sup>86</sup> Organization for Economic Cooperation and Development, *Reducing the Risk of Policy Failure: Challenges for Regulatory Compliance* at 11 (2000), available at <http://www.oecd.org/gov/regulatory-policy/46466287.pdf>.

Greater consistency in rulings in rate cases allows railroads (the regulated entity) to comply with the rate regulation regime when private market-based negotiations break down.

So, within this backdrop, it is unsurprising that a large number of disputes are not filed with the Board. When a case does appear, the rulings have generally followed a consistent path of review and resolution as the Board has applied the SAC rules in a more refined and practiced manner over time. Indeed, parties in recent rate challenges against NS likely knew that they had to go for broke and get the Board to overrule established precedent in order to win, which is why they attempted gambits like basing engineering and construction costs on a small, unrepresentative short line project in contravention of almost universal Board precedent applying Means costs.<sup>87</sup> As a direct result of greater clarity and consistency in precedent, the Board should expect fewer cases to require regulatory resolution.<sup>88</sup> In fact, the Board itself predicted that such would be the case:

[A] benefit of these guidelines is to enable both the shipper and the railroad to estimate the maximum rate we would prescribe if the matter were brought to us for adjudication. We believe that this will encourage contract solutions which (as shown below) may often be more efficient and more beneficial to both parties than a prescribed rate.<sup>89</sup>

Further, when rates are challenged, it is more likely that the regulated entity, which should work to comply with the law on rate reasonableness, will be following the clearer regulatory regime.

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<sup>87</sup> See *DuPont de Nemours & Co. v. Norfolk S. Ry.*, STB Docket No. NOR 42125, slip op. at 147-49 (STB served Mar. 24, 2014); *Sunbelt Chlor Alkali Partnership v. Norfolk S. Ry.*, STB Docket No. NOR 42130, slip op. at 106-08 (STB served June 20, 2014).

<sup>88</sup> Indeed, Vice Chairman Miller recently made clear that she understands this point: “My view is that when shippers have more information they can make better decisions and, as a consequence, fewer disputes will arise.” *Petition of Norfolk Southern Ry. Co. and CSX Transp. Inc., to Institute a Rulemaking Proceeding to Exempt Railroads from Filing Agricultural Transp. Contract Summaries*, EP 725, slip op. at 6 (STB served August 11, 2014) (V.C. Miller, concurring). The Board should have the same expectation for railroads when they have more information about how individual issues will be resolved in rates cases.

<sup>89</sup> *Coal Rate Guidelines*, 1 I.C.C. 2d at 524.

Therefore, the Board should also expect that the railroads will prevail in more cases reaching a final determination.

*ii. Cost and Timeliness*

Additional concerns about cost and timeliness are obviously related. To some extent, cost and time are inherent in any significant litigation. But they are also in part byproducts of applying sound economics in the regulation of rail rates. Although examination of railroad economic principles may at times be difficult, sound economics must be the foundation of any rate regulatory system that is not arbitrary.<sup>90</sup> The Board has worked hard to streamline SAC cases within this framework as well as devise two alternative, albeit less economically sound, rate reasonableness methodologies to address these concerns.

Still, NS has some sympathy for complaints about the length and cost of rate cases because it too does not like to spend additional time and money in litigation with its customers. However, in NS's recent experience, the complainant has been responsible for much of the additional time it took to resolve its recent rate cases. In fact, DuPont sought more than 6.5 months of extensions and caused further delay with late-filed "errata."<sup>91</sup> Complainants also have introduced additional complexities into the SAC process, such as "leap-frog" cross-over traffic.

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<sup>90</sup> See, e.g., *Simplified Standards* at 13 ("The SAC test, which judges the reasonableness of a challenged rate by comparison to the rate that would prevail in a competitive market, rests on a sound economic foundation and has been affirmed by the courts . . . . Any simplified methodology for assessing the reasonableness of rail rates should be designed to achieve the same objective . . . .").

<sup>91</sup> Motion to Dismiss at 2-5, *E.I. DuPont de Nemours & Co. v. Norfolk Southern Ry. Co.*, STB Docket No. NOR 42125 (filed Oct. 24, 2013). DuPont later attempted to blame the delay on its consultants. "Of those five cases, four involved the same counsel on both sides and all five involved the same consultants." Complainants Reply to Motion to Dismiss, *E.I. DuPont de Nemours & Co. v. Norfolk Southern Ry. Co.*, STB Docket No. NOR 42125 (filed Nov. 13, 2013). Additional delay in that case was attributable to the fact that it was the first case to deal with Security Sensitive Information and the Board had to work with other government agencies to determine the proper way for parties to disclose that information in rate litigation.

Thus, some of the responsibility for cost and timing concerns rests with litigating parties and not the process itself.

### *iii. Predictability*

Commenters also raise concerns about predictability. In examining these complaints, predictability sometimes appears to be code for the concept that shippers should win all or almost all of the cases they file.<sup>92</sup> Obviously, a valid regulatory regime cannot award relief simply because a shipper chooses to file a rate case; rather, the application of sound economics determines whether a railroad rate is unreasonable. Further, as noted above, one would expect that with more and more precedent, the railroad working to comply with the law will win more cases.

To the extent the shipper comments do focus on the ability to forecast results, predictability in and of itself is no standard. As noted above, many different rate reasonableness regimes would be “predictable.” But validity of the regime comes from the generation of outcomes consistent with sound economics.

### ***D. Proposals Are Not Tailored to Complaints***

Thus, close examination reveals that many of commenters’ complaints are not actually evidence of underlying limitations of the current rate reasonableness regime. Even more telling, the actual mechanics of the proposals from ARC and NGFA are disconnected from these expressed concerns. For example, despite complaints that new procedures are needed for grain shippers whose only current option is the 3B test, NGFA’s economically unfounded methodology would be available to all grain shippers, including those who generate more than

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<sup>92</sup> See, e.g., USDA Opening at 9 (“Any newly proposed processes or amendments to existing ones are likely to be met with skepticism by agricultural shippers if they believe these new processes will be characterized by unpredictability and subject to increasingly unobtainable preconditions.”).

sufficient traffic to support a SAC or S-SAC case.<sup>93</sup> Similarly, the proposals are touted as being less costly and more simplistic than the Board’s current 3B methodology, which already is a “rough and imprecise” method,<sup>94</sup> yet the new tests would permit unlimited recovery.<sup>95</sup> ARC’s proposal, far from simplifying rate reasonableness determinations, would increase the cost and complexity of the 3B methodology by requiring examination and evidence based on rates and costing from other railroads.<sup>96</sup> And NGFA requests recovery come in the form of a five-year rate prescription, despite complaints that rate prescriptions are of little value to grain shippers with varying Origin-Destination pairs and routes.<sup>97</sup> Setting aside all the other problems with these proposals, this complete disconnect demonstrates again the sole focus for commenters in this proceeding is lower rates, regardless of the method or justification.

## V. Other Issues

Commenters made reference to a few other requests for grain-related procedures. However, all lacked sufficient detail for NS to properly comment on them. For example, ARC’s discussion of a service metric and/or relief tied to service outcomes did not provide any supporting authority or mechanics.<sup>98</sup> The Board already has a service standard – reasonable dispatch. Any suggestion that the Board should apply a higher service requirement or attempt to bolt on an additional service component to rate reasonableness challenges would carry a host of associated problems, including penalizing railroads for things completely out of their control, like weather, and shifting a railroad’s incentives away from acting in the best and most efficient

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<sup>93</sup> See NGFA Opening at 30 (“The ACMRM would be utilized in lieu of the current SAC, SSAC, and 3B rules to test the reasonableness of Ag Commodity rates.”).

<sup>94</sup> See *Simplified Standards* at 73-74.

<sup>95</sup> See *id.* at 31 (“There would be no limits on the amount of relief that the complaining shipper or group of shippers could receive if a rate challenge is successful.”).

<sup>96</sup> See ARC Opening, Fauth V.S. at 23-24.

<sup>97</sup> See *id.* (“The rate prescription period would be five (5) years.”).

<sup>98</sup> See ARC Opening at 24; ARC Opening, Fauth V.S. at 29-32.

use of its network. Shippers would howl if the same logic was applied in reverse: railroads cannot receive higher rates from grain shippers because farmers have a bad harvest, lowering railroad revenues and idling railroad assets.

NS similarly is unsure of the exact intention of NGFA's discussion of corporate subsidiaries and consolidated balance statements outside of expressed concerns about Canadian National and Canadian Pacific,<sup>99</sup> addressed separately by the AAR. Nor did ARC present any concrete purpose for its generalized musings about the management efficiency and phasing constraints or export grain rates.<sup>100</sup> As a result, NS, like the Board, is left without any ability to reasonably respond to such statements.

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<sup>99</sup> See NGFA Opening, Fapp V.S. at 3-15.

<sup>100</sup> See ARC Opening at 13-14.

## VI. Conclusion

In conclusion, NS supports further Board consideration of issues surrounding third party standing, the Limit Price Test, URCS costing, and mediation. However, the opening comments made clear that the grain shipper proposals lack any sound economic basis, which renders them theoretically and legally deficient. The Board hardly needs NS to explain that above average rates are not *per se* unreasonable. Commenters provide no other justification for the Board to proceed with unique grain proceeding, as their complaints are neither new nor common to all grain transportation. As a result, the Board has no reason to pursue special treatment of rate reasonableness challenges for grain movements.

Respectfully submitted,



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