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BEFORE THE

SURFACE TRANSPORATION BOARD

STB DOCKET NO. EP 665 (Sub-No 1)

RAIL TRANSPORTATION OF GRAIN, RATE REGULATION REVIEW

COMMENTS AND EVIDENCE OF

TEXAS TRADING AND TRANSPORTATION SERVICES, LLC, DBA TTMS GROUP

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And

MONTANA GRAIN GROWERS ASSOCIATION

Pursuant to the announcement by the Surface Transportation Board ("STB" or "Board") in its decision in Docket EP 715, Rate Regulation Reform, served on July 18, 2013 (EP 715 Decision), followed by the decision served on this proceeding on December 12, 2013 (EP 665-1 Decision), the Texas Trading and Transportation Services, LLC, ("TTMS Group"), together with the Montana Grain Growers Association, hereby submit these reply comments and evidence.

TTMS Group is a limited liability Company, established in the state of Texas in 2014 whose purpose is to provide fact-based information to producer groups about (a) price risk management (trading) (b) transportation and (c) marketing.

As part of our transportation portfolio, we provide oversight for railroad rate pricing, practices and service. In addition, we carefully monitor STB procedures and oversight to evaluate whether these are reasonable and appropriate and that unintended consequences do not result from otherwise good-intentioned regulation.

Opening Comments

TTMS Group is interested in preserving the United States' comparative global transportation cost advantage for agriculture which makes it the envy of the world. Said advantage has been estimated to benefit the US grain producer between $40 and $60 per metric ton. Part of this advantage is the result of a largely free-market rail transportation environment which adequately incents US railroads to consistently reinvest in agriculture transportation in spite of the difficult-to-forecast returns derived from an agricultural market which is inherently volatile. Historically, the railroads' relationship with their agriculture shippers has also been volatile due to the cyclical nature of agriculture and the lag time between railroad capital investment and improved service. During times of high commodity prices and reasonable railroad service, contention has been minimal. However, during times of capacity rationing when railroad service has not been able to keep up with agriculture and other demand, calls for additional regulation have become more strident. In addition, there is general agreement that current STB rail rate regulation is inappropriate for agriculture. Thus, when railroads disappoint their shippers with unacceptable service, it is natural for the shipping community to look to rate regulation as a punitive but misguided means to express dissatisfaction.

TTMS Group understands this shippers' erosion of confidence in their railroad provider and the natural tendency to look at additional regulation as the quickest cure. However, there exists a careful market balancing act between adequate economic incentives for railroad investment in the agriculture logistics supply chain and reasonable rates at reasonable request for reasonable service. Because the agriculture industry successfully functions on the basis of transparent open markets, and the cash relationship to the futures market is inherently transportation-based, it is incredibly important that rail transportation—within the logistics supply chain—also functions within that market-based paradigm.

Nobody can argue against the fact that, post-Staggers, the agriculture rail transportation system in the United States has become increasingly productive and efficient. The risk, therefore, in spite of recurring rail transportation issues, is that additional one-size-fits-all government rate regulation for agriculture will destroy this economic balance and lead to negative consequences for the US agriculture industry and its competitive place in the world. It also seems to us that the focus on attacking rail rates is misplaced. The current issues seriously affecting agriculture seem to be primarily service-related. Would an altered rate regulatory environment materially improve service? We have serious doubts. Would the proposed rate regulation scheme disincent railroad investment in agriculture and, therefore, negatively affect service for producers? Yes! It will motivate railroads to pick winners and losers and, like the situation in Canada, the railroad stockholders will demand that railroads invest in that which is most profitable. While service will not be eliminated, lanes that yield the highest returns will be prioritized.

We believe that because agriculture is a complex and dynamic market-based industry and requires a transparent market-based rail transportation system to be productive and efficient, we do not think that even an agriculture-specific government regulatory system will ever effectively respond to the needs of the industry and its transportation providers. While we agree that the current system is flawed, we do not believe that the proposed changes to the current system will necessarily improve anything and will likely make things worse. Therefore, in the following, we will advocate what the NGFA should be advocating: a private sector-administered rail arbitration system that mirrors their administered, existing arbitration system, *and which already includes rail arbitration!* Its very success, within the complicated paradigm that is agriculture, proves that it is not necessary to demand a less satisfactory alternative solution from a regulatory agency that lacks the necessary US grain business expertise.

We applaud the National Grain and Feed Association (“NGFA”) for their willingness to engage on this important issue. And, given the fact that they largely represent the US grain business, we think that it is reasonable for us to use their filing as a base for our participation in this debate.

Part I: Concurrence With Specified Sections of filing by NGFA dated June 26, 2014

1. We largely agree with their characterization of Agricultural Commodity Markets (Section 2A) especially the fact that agricultural markets are highly volatile in both price and volume and, therefore, very difficult to forecast. This is especially significant given the number of independent variables which impact pricing in both domestic and export agriculture markets. In addition, said volume volatility makes it very difficult for railroads and other service providers to forecast scarce capital resource allocation and compensating earnings.
    - **a.** We disagree with their characterization of “Captive Shipper” which we will address in Part ll (1) (below)
    - **b.** We disagree with their statement that all transportation costs are always passed to the farmer. This too is variable and dependent upon whether a particular market is “supply-push” or “demand-pull”.
    - **c.** We note that NGFA did not include any reference to the impact of grain company consolidation, and its impact on increasing elevator margins and its impact on farmer returns. We will address this in 2, 3, and 4(a) (below)
2. We largely agree with their assertion in Section 2B that the agriculture industry is heavily dependent upon railroad service to move their commodities to market except and insofar they utilize their definition of shipper “captivity”.
3. In general, we agree with their assertion in III that current STB rules are not usable to test agriculture rate reasonableness

Part II: Dissent With Specified Sections of filing by National Grain and Feed Association ("NGFA") Filing dated June 26, 2014

1. We strongly disagree with NGFA's usage and definition of "captive shipper". NGFA--like many others before them—are guilty of using the word, "captive shipper" as a dogmatic metaphor. Its usage manufactures an image of an agriculture shipper chained to cruel railroads and forced to pay uneconomic rents. 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. Just look at this past year: Clearly, as the BNSF Railway experienced service problems, they lost considerable market share to the Union Pacific as elevators trucked their grain to the other railroad. In addition, there is the huge demand for corn-for-ethanol. More than twice as much corn goes for ethanol than for export, and most of it is trucked. Therefore, railroads have to compete for corn with ethanol processors by lowering their rates. Wheat and soybeans also have considerable alternative processing markets.

   We have found only a limited number of agricultural shippers who are truly economically captive. And these lie mostly in the state of Montana and Western North Dakota where geography and population density significantly limit shipper alternatives. And, even in Montana, there are places where alternative markets exist. It should be noted that in this state, BNSF Railway executed a mediation and arbitration agreement with Montana's economically captive producers.

2. We note that NGFA neglected in its filing to mention that the economic impact of elevator margins upon farmer income is greater than rail transportation costs. On August 22, 2011, Distinguished Professor William Wilson of North Dakota State University published a study entitled, <u>Grain Pricing and Transportation: Dynamics and Changes in Markets,</u> which shows that over the previous five years, the increase in elevator margins had a greater impact on farmer income than changes in railroad rates, mostly due to their own consolidation. Therefore, we are concerned that agricultural shippers are being disingenuous by claiming that railroad rates are unreasonable in an environment in which they have actually raised their economic rents at a greater pace than the defendant railroads. Based upon this fact, we could cynically look at their filing as a mere attempt at promoting a revenue transfer. How would this improve service and how would it benefit the American farmer?
3. Under II c, we disagree with the NGFA characterization that railroads prevent captive shippers from participating in market opportunities. Again, they misuse the word, "captive", and make broad assumptions that railroads manipulate rates in order to create more favorable markets. NGFA, whose business is market based and who has a vast understanding of agriculture markets, should especially understand the fact that no one entity is bigger than the market. History is full of examples of entities who tried and failed to control markets for their gain. A railroad is in the business of moving freight. It is in the business of matching its supply of resources to the demand for them from a customer with the resulting rate fitting within the whole economic paradigm.

Having said that, there are numerous times when a shipper and a railroad differ in opinion and understanding of a certain market. For example, TTMS Group has experience with shippers who were upset with a railroad for not being willing to provide a rate. However, upon further study, the customer wanted a rate that was less than a truck alternative and would provide zero return for the railroad. Clearly, in most cases, railroads want a customer's business and so it is illogical that the norm would be that a railroad would deny service.

4. We reject NGFA's proposed prescription for rail rate judicial review as destructive to US farmer interests. The proposed methodology would make it significantly easier for agricultural shippers to challenge railroad rates and gain a material reduction over a longer period of time by using a prescribed formula that would essentially average all rates for all commodities—based upon a mileage scale—across the United States. While we have no doubt that it would reduce railroad rates, the appropriate and logical question is, for what purpose? Would such a scheme improve service? Will more agriculture shipper favorable judicial review actually improve the status quo? And what would be the natural resulting consequences to the agriculture industry and its underlying transparent trading paradigm? Further, what would be the natural consequences to access to railroad service, railroad investment in agriculture and transparent, market-based rates?

    a. Their proposal, if adopted, would result in a material revenue transfer from the railroads to the grain shipper. And, who would be the most likely beneficiary of this largesse? The large grain companies with the most to gain from a rate reduction-based revenue transfer. Further, this transfer would likely result in further consolidation and elevator margin growth. How much would be passed to the producer/farmer? A decidedly immaterial amount as there is a direct correlation between margin growth and consolidation. There is nothing material in the NGFA proposal for the grain producer.

b. Their proposal, if adopted, would result in a significant earnings loss to the railroads from agriculture. The result? A material de-marketing of agriculture investment by the railroads, resulting in a long-term deterioration of railroad service. Look no further than north to Canada. What has been the net result to railroad service as their government has capped rates?

c. Their proposal, if adopted, would result in a disincentive for railroads to increase productivity and efficiency in the grain industry. Railroads would actually be incented to increase their costs for agriculture commodity shipping. The likely unintended consequence would be to compress average rail rates around 180% RVC thus significantly increasing current non-unit train rates while reducing unit train rates. The net result would be reduced productivity and higher costs for small shippers.

d. Their proposal, if adopted, would incent railroads to enter into favorable regional transportation contract arrangements with large grain companies that would further elevator consolidation, reduce market transparency and disadvantage small shippers and farmers.

Part III: TTMS Prescription for appropriate agriculture rail rate and service judicial review and remedies

NGFA has more than one hundred years of successful experience with alternative dispute resolution ("ADR"). In fact, the NGFA arbitration process is cited frequently as the model for successful application of the principles of ADR. Their process is administered by its members and is based upon a clear set of rules that have been agreed to by their membership. Further, as a condition for membership, each member must agree to be bound by the process.

The success of the US grain industry is based upon having a transparent and market-based trading paradigm that allows price-discovery to operate efficiently. Part of the success of this process is the fact that there is also an imbedded, underlying market-based transportation system that allows the grain industry to make commitments knowing their underlying costs and timing for receipt and delivery. It is the envy of the world. However, for the process to function efficiently, Adam Smith's "invisible hand" must be allowed—with its myriad of dependent and independent variables—to operate efficiently upon a known playing field without structured bias for its participants. And this is why regulation is so difficult for agriculture: Even well-meaning regulation changes the playing field and automatically creates winners and losers. This complexity requires that a regulator actually has the experience to understand the nature of the business and act appropriately. Thus, a successful judicial review process requires (a) a process with extreme flexibility and ability to make decisions on a micro-basis (b) judges who understand the complexity of the industry (c) judges that have the confidence of the participants and (d) sufficient resources to permit the process to operate expeditiously.

NGFA has successfully incorporated, for many years, all of the necessary elements to successfully adjudicate complex grain industry disputes. Why could that same NGFA process not be used to solve the current agriculture railroad judicial review and oversight problem existing today? NGFA currently has a rail dispute arbitration process! It has been limited for years to only resolve disputes about what a rule says and not about the rule itself. Further, most its railroad members have refused to expand its jurisdiction to include rates. But that does not mean that the process is flawed. That only means that some of its railroad members would rather submit to existing one-size-fits-all STB judicial review process than submit to a peer review process within an NGFA arbitration process. The fact is that the NGFA ADR process is (a) generally accepted to be efficient, reasonable, fair and appropriate by both the agriculture and railroad industries (b) legally tested and validated (c) replicable. Therefore, given the fact that (a) such a proven paradigm exists and is available and (b) a STB or government administered process would be less attractive, we strongly advocate that the NGFA rail arbitration process be reviewed and proposals submitted to make it mandatory and viable for general agriculture rail rate ***and*** service oversight. Within or without the NGFA, replication of these key elements is crucial.

We can further attest to the success of NGFA-like ADR by referring you to the existing and successful Montana Producer-BNSF Railway ADR Agreement which was largely developed around the existing NGFA arbitration model.