

ENTERED
Office of Proceedings
August 26, 2016
Part of
Public Record

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Ex Parte 704 (Sub-No. 1)

REVIEW OF COMMODITY, BOXCAR, AND TOFC/COFC EXEMPTIONS

**REPLY COMMENTS OF
THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE**

Karyn A. Booth
David E. Benz
THOMPSON HINE LLP
1919 M Street, N.W., Suite 700
Washington, D.C. 20036
(202) 263-4108

*Counsel for The National Industrial
Transportation League*

Dated: August 26, 2016

TABLE OF CONTENTS

	<u>Page</u>
I. There is Broad Support for the Board’s Proposed Revocations	2
II. The Board May Revoke Class Exemptions Without Finding that Specific Instances of Market Power Abuse Have Occurred	6
III. The Board’s Use of R/VC Data is Consistent with Precedent, Voluminous Authority, and Railroad Practice.....	8
A. Congress, the Board, and the Courts Have Used R/VC Data to Evaluate Railroad Market Power	9
1. Railroad Rate Reasonableness Cases.....	10
2. Commodity and Traffic Exemption Proceedings	12
B. Railroads Have Long Relied on R/VC Data as Evidence in Commodity Exemption Proceedings	13
C. The Board Should Reject the Collateral Attacks on URCS and R/VC Ratios	14
IV. The Railroads’ Claims that the NPRM is Legally Deficient Have No Merit	16
V. The Passage of ICCTA Mooted One of the ICC’s Main Reasons for Originally Granting Commodity Exemptions	20
VI. Conclusion	21

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Ex Parte 704 (Sub-No. 1)

REVIEW OF COMMODITY, BOXCAR, AND TOFC/COFC EXEMPTIONS

**REPLY COMMENTS OF
THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE**

The National Industrial Transportation League (“NITL” or “League”) hereby files these Reply Comments in this Notice of Proposed Rulemaking (“NPRM”) proceeding issued by the Surface Transportation Board (“Board” or “STB”) in which the Board has proposed to revoke certain commodity exemptions under 49 U.S.C. § 10502(d) in order to carry out the Rail Transportation Policy (“RTP”) at 49 U.S.C. § 10101. As explained herein, the Board correctly found in the NPRM that substantially changed circumstances and increasing railroad market power warrant revocation of certain commodity exemptions described in the NPRM. NITL supports not only the revocations proposed by the Board in the NPRM but also the request of the American Forest & Paper Association (“AF&PA”) for revocation of the exemptions that apply to forest products (STCCs 24, 26, 42031, and 42041), as well as to forest products shipments in boxcars.¹

In this Reply, NITL demonstrates that the record in this proceeding includes widespread support from rail customers for adoption of the proposed revocations. NITL also responds to the arguments made by railroad parties in opposition to the proposed exemption revocations and shows that the proposed revocations are justified due to the dramatic transformation of the rail

¹ See Opening Comments of AF&PA (filed July 26, 2016).

industry since the exemptions were granted, which has enabled the railroads to increase market power over exempt traffic.

I. THERE IS BROAD SUPPORT FOR THE BOARD’S PROPOSED REVOCATIONS

There is broad support from rail customers for the Board’s proposed revocations. Although the Association of American Railroads (“AAR”) challenges the underlying basis for the Board’s NPRM by claiming it is based on a “stale” record,² there is ample justification for the Board to adopt its proposals. Following is a brief summary of the extensive support for the revocations at issue in this proceeding that is part of the current record, as well as support for the Board to evaluate the propriety of other existing class exemptions.

- The League strongly advocated for a review of existing commodity exemptions when the Board initiated its inquiry back in 2011,³ and it affirmed its support for the Board’s findings and revocation proposals in its opening comments. *See* NITL Opening Comments (filed July 26, 2016). The League explained why the proposed revocations are consistent with the statute and the present-day rail market and why regulatory oversight should be restored (“We strongly encourage the Board to restore to those industries the one avenue of redress from market power and competitive abuse that is available to non-exempt shippers: access to the Board’s remedies.”) NITL Opening Comments at 5. NITL supported not only the Board’s proposed exemptions but also encouraged the Board “to move forward aggressively to assess the current market conditions of the remaining exempt commodities and services to determine if any merit having their exemptions terminated.” NITL Opening Comments at 5.

² AAR Opening Comments at 40-41.

³ *See* NITL Notice of Intent to Participate and Written Testimony (filed Jan. 31, 2011).

- The Freight Rail Customer Alliance (“FRCA”), which represents more than 3,500 manufacturing and agricultural companies, electric utilities, and their customers, filed comments in support of the NPRM and stated its view that “the exemptions are no longer needed and have become counterproductive. . . .” FRCA Opening Comments at 1. FRCA expressed concern that exempt shippers are disadvantaged in addressing rail rate and service problems (“Exemptions represent a substantial barrier for an affected shipper seeking compliance with those statutory requirements by impeding their ability to seek rate and/or service relief before the Board.”) *Id.* Like NITL, FRCA encouraged the Board to evaluate whether other class exemptions should also be revoked (“FRCA supports the revocations proposed in the Board’s notice, but those proposed revocations should be only the starting point for further Board action.”) *Id.* at 3.
- The Rail Customer Coalition (“RCC”) representing a broad cross-section of manufacturing, agricultural, and energy industries with operations and employees throughout the United States, submitted comments strongly in favor of the Board’s proposals. The RCC asserted its view that rising rail rates and higher percentages of potentially captive traffic justify revocation of the exemptions. The RCC also supported the use of R/VC data as a reasonable measure of railroad market power (“RVC ratios, while not a perfect metric, provide a strong indication of railroad market power. When viewed in light of overall railroad trends discussed above, it provides a sound basis to conclude that railroad market power has increased, and that shippers of these

commodities should have access to the Board’s oversight and processes.”) RCC Opening Comments at 2.⁴

- In addition to the support from broad-based shippers’ organizations, other groups representing rail customers who ship the commodities at issue filed comments in support of the NPRM. Portland Cement Association (“PCA”), which represents more than 92% of the U.S. cement manufacturing capacity, reminded the Board that the cement industry supported revocation of the cement exemption back in 2011 based on “changed transportation and cement industry dynamics, including a reduction in cement manufacturing plants, reduced transportation options, reduced railroad competition, increased rail rates, and increased market power and abuses by railroads.” PCA Opening Comments at 4, citing PCA Comments (filed Jan. 31, 2011). In its more recent comments, PCA described changes in competition for transportation of cement products and the limited alternatives to shipping via rail which support revocation. PCA Opening Comments at 6. It also submitted its own waybill analysis which confirmed the Board’s findings that R/VC ratios for cement traffic have risen substantially since the exemption was granted decades ago.
- The Steel Manufacturer’s Association (“SMA”) and the American Iron and Steel Institute (“AISI”) advocated for revocation of the existing exemption for steel-related commodities (primary iron and steel, scrap, and coke produced from coal) based on substantial changes that have occurred to the governing statute and the competitive market. SMA/AISI Opening Comments at 10-15. The increasing market power of the

⁴ The RCC also submitted an analysis of the Public Use Waybill sample for all major commodity groups other than intermodal which demonstrates a general shift towards higher RVC ratios across commodity groups when comparing RVC data for the period 2005 through 2014. RCC Opening Comments (filed July 25, 2016).

railroads and basic tenants of fairness in the Board's regulatory processes were also reasons cited in support of revocation. SMA/AISI Opening Comments at 20-22.

- The Institute of Scrap of Recycling Industries, Inc. ("ISRI") filed comments strongly supporting revocation of the iron or steel scrap exemption because "[h]igh railroad prices are not the only concern for ISRI members....service reliability, equipment shortages, and a lack of investment in the gondola fleet hav been problematic for ISRI members." ISRI Opening Comments at 7. ISRI further stated that "lifting the exemption to allow ISRI's members access to the Board's regulatory processes and remedies is wholly consistent with the Rail Transportation Policy." ISRI Opening Comments at 1.
- AK Steel, a major steel producer, reiterated its support for revocation of exemptions for steel-related products, because the reasons for granting the exemptions, including to alleviate administrative burdens associated with tariff filing, were eliminated when Congress adopted the ICC Termination Act of 1995 ("ICCTA"). AK Steel Opening Comments at 4. AK Steel also commented that "[v]ery few shippers today have the resources to pursue both a partial revocation order and a request for merits relief." AK Steel Opening Comments at 6.
- Texas Crushed Stone ("TCS") filed in support of the Board's proposed revocation of the exemption for crushed or broken stone or rip rap explaining that the original shipper support for the exemption was based on the desire to reduce regulatory burdens that no longer exist today and, thus, there is no reason to maintain the exemption. TCS Opening Comments at 3. TCS explained the importance of having access to the Board's regulatory oversight in order to be able to sufficiently address unreasonable rail rates and practices. TCS Opening Comments at 6.

- AF&PA filed extensive comments with the Board in support of its request for the Board to also revoke the exemptions for paper and forest products. AF&PA explained the substantial market and regulatory changes that have occurred since those exemptions were granted many years ago, and provided an analysis of the changes in railroad pricing behavior between 1989 and 2014. The AF&PA analysis clearly showed that the railroad market power has increased substantially during that time period.⁵

The above summary demonstrates that there is widespread support amongst rail customers for the Board's proposed revocations, and there are many more detailed supporting arguments in the record. These arguments directly contradict AAR's claim that the Board's proposals are invalid because they are based on a stale or insufficient record.

II. THE BOARD MAY REVOKE CLASS EXEMPTIONS WITHOUT FINDING THAT SPECIFIC INSTANCES OF MARKET POWER ABUSE HAVE OCCURRED

Various railroad parties contend that the Board's proposed revocations are faulty because the Board did not find any specific abuse of market power by the railroad industry. The Association of American Railroads ("AAR") argued that the Board must find "concrete instances of abuse of market power" before acting.⁶ The Union Pacific Railroad ("UP") faulted the NPRM because "[t]here is no evidence of any competitive abuse."⁷ Norfolk Southern similarly complained that the "[t]here is no finding by the STB that railroads have in any way abused market power with respect to these commodities."⁸ These assertions are incorrect; no such market power abuse is required before an exemption may be revoked. The revocation statute

⁵ See Opening Comments of AF&PA (filed July 26, 2016).

⁶ AAR Opening Comments at 37.

⁷ UP Opening Comments at 4.

⁸ Norfolk Southern Opening Comments at 4. See also UP Opening Comments at 17 and 30-32.

requires *only* consideration of the national Rail Transportation Policy of § 10101. *See* 49 U.S.C. § 10502(d).

Precedent confirms that revocation can occur without evidence of particular instances of market power abuse. The Second Circuit previously addressed whether actual competitive injury is required in a revocation case. *Mr. Sprout, Inc. v. U.S.*, 8 F.3d 118 (2nd Cir. 1993). After the appellant argued that the ICC erred by requiring more than just a potential for competitive harm, the Second Circuit found that the ICC never required a “precise level of competitive harm” in the case. Instead, appellants merely needed to show potential injury “grounded in facts indicating a real possibility of competitive harm.” *Mr. Sprout*, 8 F.3d at 126. Thus, revocation is not necessarily intended to remedy past market power abuse, but to protect shippers from possible future market power abuse.

Legislative history also supports this view. In the Conference Report accompanying the legislation that became ICCTA, the conferees stated that “[w]hen considering a revocation request, the Board should continue to require demonstrated abuse of market power that can be remedied only by reimposition of regulation or that regulation is needed to carry out the national transportation policy.”⁹ This statement clearly demonstrates that there are alternative showings that can support revocation of an exemption and that evidence of market power abuse is one permissible showing but is not the only type of evidence that can support revocation of an exemption. The Board itself has said that, in deciding whether to revoke an exemption, it looks at “whether the shipper lacks sufficient intermodal alternatives and whether the carrier has

⁹ H. Rep. 104-422 at p. 169 (Dec. 18, 1995) (emphasis added).

market power that it *could abuse* with respect to the traffic, thus necessitating regulatory oversight.”¹⁰

After evaluating substantial changes to the dynamics of the rail market, as well as changes to railroad pricing behaviors, the Board evaluated the relevant factors of the national Rail Transportation Policy (“RTP”) and proposed certain commodity exemption revocations. *See* NPRM at 4 (“[W]ith respect to these commodities, the Board believes that reestablishing regulatory oversight is necessary to foster sound economic conditions in transportation, 49 U.S.C. § 10101(5), maintain reasonable rates where there is an absence of effective competition, § 10101(6), and prohibit predatory pricing and practices, avoid undue concentrations of market power, and prohibit unlawful discrimination, § 10101(12).”). Along with many other commenting parties, NITL agrees that the RTP supports revocation of various exemptions.¹¹ Certain railroad commenting parties have also cited to the RTP, but “it is up to the Board to arrive at a reasonable accommodation of the conflicting policies set out in the Staggers Act.”¹²

III. THE BOARD’S USE OF R/VC DATA IS CONSISTENT WITH PRECEDENT, VOLUMINOUS AUTHORITY, AND RAILROAD PRACTICE

The railroads strenuously object to the Board’s reliance on R/VC ratios as support for the revocations proposed in the NPRM. Norfolk Southern claimed the Board’s examination of traffic with an R/VC above 180% is “meaningless” because “an R/VC ratio of 180% lacks any

¹⁰ *Pejepscot Industrial Park, Inc. d/b/a Grimm Industries – Petition for Declaratory Order*, STB Docket No. 33989, slip op. at 7 (n. 15) (served May 15, 2003) (emphasis added).

¹¹ *See, e.g.*, AF&PA Opening Comments at 21-22; Opening Comments of The Institute of Scrap Recycling Industries, Inc. at p. 8-11 (filed July 26, 2016); Opening Comments of The Portland Cement Association at p. 5-13 (filed July 26, 2016).

¹² *Association of American Railroads v. STB*, 306 F.3d 1108, 1111 (D.C. Cir. 2002) (citation omitted).

economic significance.”¹³ UP criticized the Board’s alleged “near-exclusive reliance on R/VC ratios,” which the UP expert believes to be “too blunt.”¹⁴ BNSF argued that R/VC ratios “are not reliable indicators of market dynamics,” but, instead, they create “dangers” and “ignore[] market realities.”¹⁵ The AAR stated that reliance on R/VC ratios is “arbitrary,” and CSXT simply asserted that “[c]iting R/VC ratios...is no evidence of market power.”¹⁶ These criticisms are without merit.

The Board properly looked to R/VC data in its analysis of railroad market power. R/VC ratios have long been utilized by Congress, the courts, and the Board (and ICC) in evaluating the degree of market power held by railroads. Moreover, railroad parties themselves have repeatedly cited R/VC ratios in commodity exemption proceedings in the past when advocating for imposition of new exemptions.

A. Congress, the Board, and the Courts Have Used R/VC Data to Evaluate Railroad Market Power.

The railroads are simply incorrect in their assertion that R/VC ratios shed no light on market power and are economically meaningless. The relevance of R/VC data to railroad market power has been recognized repeatedly by Congress and the courts, and R/VC ratios are utilized by the Board for a variety of regulatory purposes related to railroad market power. Congress ordered this agency to conclusively find that railroads are not market dominant for purposes of rate cases when the relevant R/VC is less than 180%. *See* 49 U.S.C. § 10707(d)(1)(A). In contrast, if the relevant R/VC equals or exceeds 180%, the railroad might be market dominant

¹³ NS Opening Comments 14.

¹⁴ UP Opening Comments at 2 and 12.

¹⁵ BNSF Opening Comments at 2, 8, and 10.

¹⁶ AAR Opening Comments at 22; CSXT Opening Comments at 3. See also CSXT Opening Comments at 7 (“R/VC ratios are a very poor indicator of market power.”).

for purposes of a rate case. Hence, clearly, Congress has stated that R/VC ratios are informative when assessing railroad market power.

The relevance of R/VC ratios to railroad market power is reflected in numerous other regulatory contexts and statements from authorities, as shown below.

1. Railroad rate reasonableness cases.

In fulfilling its duties in adjudicating rail rate reasonableness cases, the Board utilizes R/VC ratios repeatedly, often in some relationship to railroad market power. For example, the Board has relied upon Revenue Shortfall Allocation Method (“RSAM”)¹⁷ and R/VC ratios when evaluating railroad market dominance in recent cases such as *M&G Polymers USA, LLC v. CSX Transportation, Inc.*, STB Docket No. 42123, slip op. at 13-21 (served Sept. 27, 2012) and *E.I. du Pont de Nemours and Company v. Norfolk Southern Railway Company*, STB Docket No. 42125, slip op. at 18-21 (served Mar. 24, 2014). Use of a quantitative measurement of railroad market power for the qualitative component of a market dominance evaluation has judicial approval. *See, e.g., CF Industries, Inc. v. STB*, 255 F.3d 816, 822 (D.C. Cir. 2001) (“While the Board’s market dominance guidelines contemplate the use of such qualitative considerations, they do not exclude the application of quantitative analysis as well.”) (citation omitted).

In implementing its rate reasonableness duties, the Board also uses R/VC ratios as part of the Maximum Markup Methodology (“MMM”) to allocate joint and common costs among the

¹⁷ RSAM represents “the average markup that the railroad would need to charge all of its ‘potentially captive’ traffic in order for the railroad to earn adequate revenues as measured by the Board.” *Simplified Standards for Rail Rate Cases – 2013 RSAM and R/VC > 180 Calculations*, STB Ex Parte No. 689 (Sub-No. 6), slip op. at 1 (served Sept. 3, 2015). For purposes of RSAM, “potentially captive traffic” means “all traffic priced at or above the 180% R/VC level.” *Id.* at 2. Thus, RSAM is an aggregated R/VC ratio based on a portion of the subject railroad’s traffic.

various shippers in a SARR traffic group.¹⁸ Of course, SARR traffic group members who receive a greater allocation of such costs have more inelastic demand, meaning that the relevant railroad has more market power over them. In other words, the R/VC ratios of the SARR traffic group represent the degree of railroad market power. *See, Major Issues in Rail Rate Cases*, STB Ex Parte No. 657 (Sub-No. 1), slip op. at 16 (served Oct. 30, 2006) (“the Maximum Markup Methodology reflects the important principle that a railroad should recover as much of its costs as possible from each shipper served before charging differentially higher rates to its captive shippers.”) (citation omitted).

Reference to MMM highlights another point – the concept of differential pricing. The Board’s large rate case standards are based partially upon this concept, which means that higher rates must be charged to shippers with inelastic demand. *See, e.g., BNSF Railway Company v. STB*, 526 F.3d 770, 774 (D.C. Cir. 2008) (“Because captive shippers have inelastic demand, the railroads can charge them higher rates with a lower risk of losing their business.”).¹⁹ Again, this concept is not far from the view that R/VC ratios are higher when railroads have market power.

Underpinning all these examples is the theory that rates will be higher when a service provider (such as a railroad) has market power. From an economics perspective, this should not be an earth-shattering conclusion and, in fact, it has been judicially recognized by the courts at various times. *CF Industries*, 255 F.3d at 823 (stating that an “accepted method of measuring

¹⁸ As the Board has said, “Congress regarded R/VC ratios as an appropriate measure for allocating joint and common costs among rail shippers.” *Major Issues*, slip op. at 14.

¹⁹ *See also Major Issues*, slip op. at 13 (“the SARR (and therefore the carrier) must be allowed to engage in demand-based differential pricing”) (citation omitted); *Consolidated Rail Corp. v. U.S.*, 812 F.2d 1444, 1454 (3rd Cir. 1987) (Stating that, in the *Coal Rate Guidelines*, “the ICC would permit carriers to charge captive shippers a higher share of unattributable costs than shippers in the competitive market share.”); *Coal Rate Guidelines – Nationwide*, 1 I.C.C.2d 520, 534 (1985) (Constrained Market Pricing “establishes constraints on the pricing freedom of the railroads which induce them to price all traffic efficiently. As with Ramsey pricing, services are priced according to market demand...”).

market power” is “based on the recognition that although a firm in a competitive market cannot raise its prices without a net loss of revenue, a firm with market power can”) (citation omitted); *Arizona Public Service Company v. United States*, 742 F.2d 644, 654 (D.C. Cir. 1984) (stating that “competitive pressure” is related to a railroad’s ability to raise prices). In the rate case context, the Board and the courts have also occasionally evaluated the railroad’s rates when determining whether rail service has effective competition from other modes.²⁰

2. Commodity and traffic exemption proceedings.

Opposition to the use of railroad R/VC ratios as an indicator of market power in the commodity exemption context is all the more baffling given that such ratios were repeatedly utilized when the exemptions were first adopted. *See, e.g., Petition to Exempt From Regulation the Rail Transportation of Scrap Paper*, 9 I.C.C.2d 957, 960 (1993) (the existence of low railroad R/VC ratios “indicates...that the traffic...is generally subject to significant competition”); *Rail General Exemption Authority – Exemption of Grease or Inedible Tallow, Etc.*, 10 I.C.C.2d 453, 460-461 (1994) (“We believe that an examination of shipper and rail contracting prices, rail pricing behavior, rate levels, and R/VC ratios in these markets indicates that railroads have not been able to assert any meaningful market power.”); *Rail General Exemption Authority – Exemption of Carbon Dioxide*, 10 I.C.C.2d 359, 363 (1994) (exempting carbon dioxide transportation because, among other things, “competing forces have acted to keep rail rates at competitive levels, *i.e.*, at average R/VC ratios less than 180%”); *Rail General Exemption Authority – Exemption of Ferrous Recyclables*, 1 STB 173, 176 (1996) (“We continue to believe that R/VC ratios are useful in analyzing the degree of market power by the railroad industry in connection with transportation of particular commodity groups.”); *Rail General*

²⁰ *See, e.g., FMC Wyoming Corp. v. Union Pacific Railroad Co.*, 4 STB 699, 719 (2000); *Arizona Public Service v. U.S.*, 742 F.2d 644, 650-651 (D.C. Cir. 1984).

Exemption Authority – Nonferrous Recyclables, 3 STB 62, 63 (1998) (“[t]he transportation of nonferrous recyclables is very competitive, as evidenced by the overall r/vc percentage,” the decline in revenue per ton mile, and the decline in rail market share).

The D.C. Circuit has previously found that agency reliance on aggregated R/VC data to be “justified” in a boxcar exemption analysis even though it may be “imperfect.” *Brae Corp. v. United States*, 740 F.2d 1023, 1040-1041 (D.C. Cir. 1984). Certainly aggregated R/VC data is not perfect, but no class-wide method of analysis ever can be. If class exemptions are to be utilized in the rail industry, then an aggregated method of analyzing the relevant transaction type or commodity is necessary.²¹

B. Railroads Have Long Relied on R/VC Data as Evidence in Commodity Exemption Proceedings.

The vehement resistance of several railroad commenting parties to the Board’s use of R/VC data in the NPRM is particularly ironic. When R/VC data has supported creation of commodity exemptions, as it did many years ago, railroads were not reluctant to submit such R/VC data to the agency as a means to convince the agency to create new exemptions. As just a few examples:

- Conrail submitted R/VC data to the ICC to advocate for a boxcar exemption. *Brae Corp. v. United States*, 740 F.2d 1023, 1040 (D.C. Cir. 1984).
- When the AAR and nine individual railroads petitioned the ICC to exempt scrap paper, they cited to the nine railroads’ R/VC ratios for that commodity. *Petition to Exempt from Regulation the Rail Transportation of Scrap Paper*, 9 I.C.C.2d 957, 960 (1993).

²¹ *Cf. CF Industries*, 255 F.3d at 823 (n. 12) (“Although techniques exist for measuring market power more directly, they involve data not typically available to courts or regulators, and data which the parties agree are not part of the record in this case.”) (citation omitted).

- When the AAR supported the ICC’s proposal to exempt salt and rock salt, its “chief argument” was that “R/VC ratios of salt and rock salt are far below the level of 180%.” *Rail General Exemption Authority – Exemption of Rock Salt, Salt*, 10 I.C.C.2d 241, 249 (1994).
- The AAR’s witness submitted commodity-level R/VC data to the ICC in support of a petition to exempt ferrous recyclables. *Rail General Exemption Authority – Exemption of Ferrous Recyclables*, 10 I.C.C.2d 635, 641-642 (1995).
- AAR submitted R/VC figures for cement traffic during the ICC’s consideration of whether to exempt that commodity. *Rail General Exemption Authority – Exemption of Hydraulic Cement*, 10 I.C.C.2d 649, 652 (1995).
- In advocating for exemption of nonferrous recyclables transportation, AAR claimed the market was “highly competitive and characterized by declining rates...and low revenue-to-variable cost (r/vc) percentages.” *Rail General Exemption Authority – Nonferrous Recyclables*, 3 STB 62, 63 (1998).

These examples reveal that the railroad commenting parties actually do believe (or once believed) that R/VC ratios are relevant to evaluation of commodity exemptions. It seems obvious that the substantial consolidation of the rail industry and the resultant increasing rates and market power that have led to higher R/VC ratios have caused the railroads to now assert that R/VC ratios are unreliable. The railroads “about-face” lacks credibility and must be rejected.

C. The Board Should Reject the Collateral Attacks on URCS and R/VC ratios.

As part of its effort to discredit the NPRM, the AAR engaged in a broad-based critique of the entire concept of an R/VC ratio, as well as the Uniform Rail Costing System (“URCS”)

utilized by the Board to calculate railroad variable costs. AAR Opening Comments at 23-27. This type of collateral attack on the Board's economic regulation is far outside the scope of this rulemaking. Indeed, the Board is currently considering changes to URCS in a separate rulemaking proceeding, *Review of the General Purpose Costing System*, STB Ex Parte No. 431 (Sub-No. 4). AAR's concerns about URCS should be filed in that proceeding or be the subject of a new Petition for Rulemaking to the Board.

As part of its wide-ranging attack, AAR cites a third-party report to criticize the Board's use of R/VC ratios to allocate railroad costs,²² but courts have approved of the Board's methods. *BNSF Railway Company v. STB*, 526 F.3d 770, 777-780 (D.C. Cir. 2008) (affirming use of Maximum Markup Methodology, which relies on R/VC ratios, to set rates in Stand-Alone Cost rate cases). In any event, AAR's broad-brush critique is well outside the bounds of this commodity exemption proceeding. For the same reasons, the AAR's invocation of various third-party studies regarding use of R/VC ratios and URCS costs is similarly off-the-mark. AAR Opening Comments at 22-29.

AAR also asserts that the Board's proposed revocation "directly contradicts" 49 U.S.C. § 10707 because of the Board's use of R/VC data. AAR Opening Comments at 23. AAR's assertion reflects confusion and a conflation of two different concepts. The cited statute concerns market dominance in rail rate cases – it does not govern commodity exemptions. The exemption statute does not bar the use of R/VC ratios in considering whether an exemption is appropriate; furthermore, R/VC ratios have long been used in commodity exemption proceedings by the ICC and the Board. *See* Sections III.A and III.B above.

²² AAR Opening Comments at 24-25.

The AAR also criticizes the Board's use of R/VC ratios by citing to its experts' conclusion that railroad rates can remain high even when a shipper is served by two Class I railroads, thereby allegedly showing the faulty nature of R/VC ratios. AAR Opening Comments at 28. This attempted "critique" fails miserably; in fact, it confirms the need for Board revocation in this proceeding – when the marketplace does not effectively constrain railroad pricing power, even where two railroads serve a shipper, then Board regulatory oversight is undoubtedly necessary. It would be incongruous to base a deregulatory action on a finding that railroads are successfully exploiting rail market power and significantly raising rates even when two carriers serve a given shipper.

IV. THE RAILROADS' CLAIMS THAT THE NPRM IS LEGALLY DEFICIENT HAVE NO MERIT

The AAR's Opening Comments include several other inapplicable, incorrect, or otherwise irrelevant claims that the Board must abandon its proposals because it has failed to follow reasonable rulemaking procedures. The Board can and should easily dispose of these attempts to deflect from the real issue at hand, which is increasing railroad market power over certain commodities, thus justifying the restoration of STB regulation and oversight.

There is an obvious mismatch in the AAR's criticism of the legality of the NPRM for the simple reason that the AAR attacks the Notice of *Proposed* Rulemaking with court precedent applicable to issuance of *Final* Rules and other *final* agency action. AAR Opening Comments at 36-41. The AAR Opening Comments are riddled with arguments and statements treating the NPRM as final agency action: "the Board now concludes" (p. 38), "the Board's decision to revoke these exemptions, in whole" (p. 39, quotation omitted), "the NPRM's conclusory observation" (p. 41), and "the Board's decision to press ahead with the blanket revocation" (p. 41). At the current stage of *this* proceeding, comments are still being submitted, Board

evaluation of those comments has not yet occurred, and the Board's determination of how to exercise its rulemaking authority has not been decided. The NPRM is not final agency action.²³ The Board has not "completed its decision-making process."²⁴ In short, AAR's treatment of the NPRM as final agency action is premature at best. If and when a final rule is issued, the Board must "cogently explain" its decision and engage in a "reasonable exercise" of its rulemaking authority.²⁵

AAR also contends that the NPRM is faulty because it relies on "stale, inadequate data." See AAR Opening Comments at 40. Regarding the alleged staleness of the data, the AAR is simply incorrect. The Board made clear that the NPRM is based on the most recent waybill data on file with the Board. NPRM at 3 (n. 5). The AAR also challenges the Board's reference to 2011 testimony in the NPRM, but, the staleness critique is ironic given that AAR itself and several other railroad parties have also cited 2011 evidence in support of their view that railroads lack market power. AAR Opening Comments at 9-11; NS Opening Comments at 18 and 31. The AAR also relies on the 2009 Christensen Report to argue that railroad market power is absent. AAR Opening Comments at 9 (n. 3). AAR's "staleness" and "inadequacy" critique is merely a continuation of the AAR's attempt to treat the NPRM as a final rule subject to appellate review. If and when the Board issues a final rule, its decisions will presumably be based upon the complete record before it, including all of the numerous new comments that it has received in

²³ Pursuant to 28 U.S.C. § 2342(5), courts of appeal only have jurisdiction over "rules, regulations, or final orders" of the Board.

²⁴ *Franklin v. Massachusetts*, 505 U.S. 788, 797 (1992).

²⁵ *Motor Vehicle Manufacturers Association of the U.S. v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 48-49 (1983) (citation omitted) (cogent explanation required when agency exercises its discretion); *Cuozzo Speed Technologies, LLC v. Lee*, 136 S.Ct. 2131, ___ U.S. ___, No. 15-446, slip op. at 17-20 (June 20, 2016) (affirming Patent Office's reasonable exercise of its rulemaking authority).

response to the NPRM, including the substantial evidence and comments that support its proposals.

Both the AAR and NS express considerable heartache over the Board's use of the "deliberative process privilege" to withhold certain documents from distribution. AAR Opening Comments at 41-42; NS Opening Comments at 5-13. Communications among Board staff, NS attorneys, and AAR attorneys reveal that the Board's FOIA Officer and the Board's Chairman carefully considered the objections to withholding raised in the Opening Comments and took pains to release all documents not covered by an applicable privilege. NS Opening Comments, Exhibit F (letter from Chairman Elliott to Mr. Geoffrey Sigler and Ms. Cynthia Richman, dated June 14, 2016).

The AAR also asserts that it was improper for the Board to invite comment on the possible exemption revocation for other commodities. AAR Opening Comments at 42-43. With this assertion, AAR forgets that "[a]gencies are not limited to adopting final rules identical to proposed rules"²⁶ and "[t]he final rule need not be the one proposed in the NPRM."²⁷ Obviously, the AAR was aware, at the time it filed its Opening Comments, of the possibility of other commodities being proposed by commenting parties. As the D.C. Circuit has stated, agencies are "free to adjust or abandon their proposals in light of public comments or internal agency reconsideration without having to start another round of rulemaking."²⁸ Of course, notice is required, and that is what the Board provided in the NPRM: it "alerted interested parties to the

²⁶ *National Mine Association v. Mine Safety & Health Administration*, 116 F.3d 520, 531 (D.C. Cir. 1997).

²⁷ *Agape Church, Inc. v. FCC*, 738 F.3d 397, 411 (D.C. Cir. 2013).

²⁸ *Kooritzky v. Reich*, 17 F.3d 1509, 1513 (D.C. Cir. 1994) (citation omitted).

possibility of the agency's adopting a rule different than the one proposed."²⁹ Consequently, exemption revocation as to other commodities, such as the forest products revocation exemption proposed by AF&PA, would represent a "logical outgrowth" of the NPRM.³⁰ To the extent that commenting parties used their Opening Comments to suggest other commodities that are ripe for exemption revocation, the AAR has had the opportunity to respond to those suggestions in its Reply Comments, and, therefore, the purposes of notice-and-comment have been served.³¹

The AAR's other contentions can be easily dismissed. The AAR contends that "[t]he NPRM's reasoning...marks an abrupt...departure from its settled precedents." AAR Opening Comments at 39. As mentioned above, the NPRM does not constitute final agency action, so it cannot function as a departure from precedent. Moreover, the commodity exemptions at issue in this proceeding have been in place for 20 years or more; there is nothing abrupt about a proposed revocation of the applicable exemptions. Even if the Board's final decision were to be considered a departure from its prior policies, such action is clearly permissible when the Board supplies a "reasoned analysis" that supports the policy that it seeks to implement under the substantially changed dynamics of the present-day rail market.³² The Supreme Court has recognized that "regulatory agencies do not establish rules of conduct to last forever" and, therefore, agencies "must be given ample latitude to adapt their rules and policies to the demands of changing circumstances....[because] the forces of change do not always or necessarily point in

²⁹ *Kooritzky v. Reich*, 17 F.3d 1509, 1513 (D.C. Cir. 1994).

³⁰ *Agape Church*, 738 F.3d at 411 (quotation and citation omitted).

³¹ *Small Refiner Lead Phase-Down Task Force v. EPA*, 705 F.2d 506, 547 (D.C. Cir. 1983) (evaluating "how well the notice that the agency gave serves the policies underlying the notice requirement"). *But see Fertilizer Institute v. EPA*, 935 F.2d 1303, 1312 (D.C. Cir. 1991) (agency itself must provide the notice, and agency cannot expect parties to read all other parties' comments).

³² *Motor Vehicle Manufacturers*, 463 U.S. at 42.

the direction of deregulation.” *Motor Vehicle Manufacturers*, 463 U.S. at 42 (citation and quotation omitted).

V. THE PASSAGE OF ICCTA MOOTED ONE OF THE ICC’S MAIN REASONS FOR ORIGINALLY GRANTING COMMODITY EXEMPTIONS

The railroad parties generally ignore the fact that commodity exemptions were originally adopted with the express goal of eliminating cumbersome administrative burdens associated with tariff and contract filing – a goal which was mooted with the passage of ICCTA.³³ In the pre-ICCTA time period, shippers wanted railroads to be free from the tariff filing constraints so that the shippers themselves could operate more efficiently and compete in the marketplace. As just one example, virtually all commenting shippers supported the lumber and wood products exemption considered by the ICC in 1991. These shippers told the ICC they “need to be able to respond immediately and flexibly to compete in their own markets” and, therefore, they complained about “regulatory delays which would be eliminated by this [proposed] exemption.” *Rail General Exemption Authority – Lumber or Wood Products*, 7 I.C.C.2d 673, 675 (1991).

Railroads, too, emphasized the removal of now-obsolete tariff filing and paperwork obligations as the primary reason for many commodity exemptions. *Rail Exemption General Authority – Miscellaneous Manufactured Commodities*, 6 I.C.C.2d 186, 188 (1989) (“AAR notes that this exemption, like previous exemptions, will promote efficiency and improve the railroads’ financial health by eliminating costly tariff filing requirements. AAR states that under the exemption carriers will be able to respond more quickly to shipper demand...”); *Petition to Exempt from Regulation the Rail Transportation of Scrap Paper*, 9 I.C.C.2d 957, 959 (n. 2) (1993) (“Petitioners [consisting of the AAR and nine railroads] state that an exemption would

³³ Opening Comments of The Institute of Scrap Recycling Industries, Inc. at p. 7-8 (filed July 26, 2016); AF&PA Opening Comments at 13-14.

enable railroads to compete more effectively with motor carriers by eliminating the delay and expenses of filing tariffs and complying with the administrative requirements connected with contracts executed under § 10713.”).

Furthermore, the existing exemptions were also customarily sought and supported by the shippers of the affected commodities due to their desire to eliminate the afore-mentioned administrative burdens and enable both railroads and shippers to respond expeditiously to market conditions in rate-setting and seeking new business.³⁴ Now, however, most rail customers commenting in this proceeding favor revocation, a fact the Board should consider when deciding how to proceed. “In determining whether regulation is necessary to protect shippers from an abuse of market power, a significant consideration is whether the participating shippers actually seeking transportation are concerned about an abuse of market power.” *Rail General Exemption Authority – Petition of AAR to Exempt Rail Transportation of Selected Commodity Groups*, 9 I.C.C.2d 969, 973 (1993).

VI. CONCLUSION

The rail industry has undergone an extraordinary transformation over the past two to three decades. Financial success for the railroads has become commonplace, rail rates have noticeably risen, motor carriers have been hampered by driver shortages and other challenges, and shippers have felt the effects of increasing railroad market power.³⁵ Significant regulatory changes have occurred during the same time period, eliminating burdensome and time-

³⁴ *Rail General Exemption Authority – Exemption of Ferrous Recyclables*, 10 I.C.C.2d 635, 636-637 (1995); *Rail General Exemption Authority – Lumber or Wood Products*, 7 I.C.C.2d 673, 675 (1991); *Rail General Exemption Authority – Miscellaneous Manufactured Commodities*, 6 I.C.C.2d 186, 187-188 (1989).

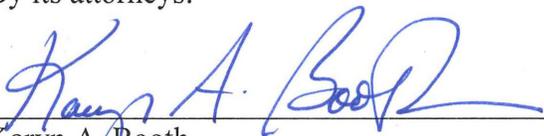
³⁵ These issues have already been addressed at length by various parties in their Opening Comments. AF&PA Opening Comments at 7-21. *See also* Opening Comments of The Institute of Scrap Recycling Industries, Inc. at p. 5-7 (filed July 26, 2016); Opening Comments of The Portland Cement Association at p. 6-13 (filed July 26, 2016).

consuming filing requirements for rail tariffs and contracts. When combined with the commodity-specific information and data cited in the NPRM and various parties' Opening Comments, these circumstances confirm that revocation of several commodity exemptions is warranted. For the foregoing reasons, NITL respectfully requests that the Board revoke not only the class exemptions identified in the NPRM, but also those applicable to paper and forest products, as requested by AF&PA.

Respectfully submitted,

THE NATIONAL INDUSTRIAL TRANSPORTATION
LEAGUE

By its attorneys:



Karyn A. Booth

David E. Benz

THOMPSON HINE LLP

1919 M Street, N.W., Suite 700

Washington, D.C. 20036

(202) 263-4108

Dated: August 26, 2016