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Gibson, Dunn & Crutcher LLP

1050 Connecticut Avenue, N.W.
Washington, DC 20036-5306
Tel 202.955.8500
www.gibsondunn.com

Cynthia Richman
Direct: +1 202.955.8234
Fax: +1 202.530.9691
CRichman@gibsondunn.com

August 26, 2016

Ms. Cynthia T. Brown
Chief, Section of Administration
Office of Proceedings
Surface Transportation Board
395 E Street, S.W.
Washington, DC 20423

Re: EP 704 (Sub-No 1), *Review of Commodity, Boxcar, and TOFC/COFC Exemptions*

Dear Ms. Brown:

Enclosed for filing in the above-referenced proceeding are the reply comments of the Association of American Railroads.

Thank you for your assistance in this matter.

Sincerely,

/s/Geoffrey Sigler
Geoffrey Sigler

/s/ Cynthia Richman
Cynthia Richman

Enclosure

BEFORE THE SURFACE TRANSPORTATION BOARD

Ex Parte No. 704 (Sub-No. 1)

Review of Commodity, Boxcar, and TOFC/COFC Exemptions

REPLY COMMENTS OF THE ASSOCIATION OF AMERICAN RAILROADS

Thomas H. Dupree, Jr.
Geoffrey M. Sigler
Cynthia E. Richman
Gibson, Dunn & Crutcher LLP
1050 Connecticut Avenue NW
Washington, DC 20036
(202) 955-8500

Kathryn D. Kirmayer
Timothy J. Strafford
Association of American Railroads
425 Third Street, SW
Suite 1000
Washington, DC 20024
(202) 639-2100

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INTRODUCTION

The Association of American Railroads ("AAR") respectfully submits its reply comments in this proceeding associated with the Surface Transportation Board's ("STB" or "Board") Notice of Proposed Rulemaking, EP 704 (Sub-No. 1), *Review of Commodity, Boxcar, and TOFC/COFC Exemptions* (STB served Mar. 23, 2016) ("NPRM"). AAR's Reply Comments are supported by the Reply Verified Statements of (i) Mark Israel and Jonathan Orszag ("Israel/Orszag Reply VS") and (ii) Michael R. Baranowski and Benton V. Fisher ("Baranowski/Fisher Reply VS").

The comments submitted by various shippers and shippers' associations (referred to generally as "shippers") do nothing to remedy the numerous deficiencies in the Board's proposal, which should be set aside for the reasons explained here and in AAR's opening comments. Like the Board's proposal, the shippers give short shrift to key elements of the rail transportation policy ("RTP") promoting competition through deregulation, disregard the express statutory requirement to show regulation is "necessary" to revoke an exemption, and double down on the Board's fundamentally flawed reliance on R/VC calculations that Commissioner Begeman called a "waybill-based hunch." NPRM at 15-16 (Commissioner Begeman, dissenting). Accordingly, even with the shippers' opening comments, the record here remains wholly insufficient to support the proposed rule.

The shippers offer only farfetched interpretations of the ICCTA that run counter to its deregulatory thrust, vague concerns of "fairness" and "common sense" that bear no relation to the RTP, and isolated anecdotes unaccompanied by evidence that fail to support the NPRM. They also offer nothing to undermine the railroads' econometric evidence and concrete facts demonstrating that the exemptions for these five commodities are proper because of ample intramodal, intermodal, product, and geographic competition. Indeed, rather than bolster the NPRM, the shippers' comments only serve to magnify its shortcomings.

Accordingly, for reasons set out herein, in AAR's opening comments, and in the comments of its members, the Board should abandon its proposed revocations. The NPRM is procedurally and substantively flawed, and none of the shippers' comments supplement the record in a manner that remedies the NPRM's many shortcomings.

The Board should also reject the invitation of commenters seeking revocation of additional exemptions for forest products—products with respect to which Vice Chairman Miller has already concluded revocation is inappropriate. *See* NPRM at 14 (Vice Chairman Miller, concurring). Revoking the exemptions for forest products in this proceeding would be unlawful under the underlying statutory scheme, the Administrative Procedures Act ("APA"), and the Due Process Clause, because there is no support whatsoever under the law or the factual record to revoke these exemptions. *AAR Opening Cmt.* at 42-43 (July 26, 2016) ("*AAR*").

DISCUSSION

I. Like The Board's Proposal, The Shippers' Comments Improperly Rely On R/VC As A Determinant Of Market Power

Shippers' comments in support of revocation suffer from the same flaw as the NPRM: instead of performing meaningful economic analysis of marketplace conditions, they simply assume, contrary to the statutory scheme (49 U.S.C. § 10707(d)(2)), evidence in the record, numerous economic studies, and established economic principles, that R/VC ratios over 180 percent demonstrate market power and justify revoking the exemptions at issue. They are wrong.

R/VC ratios over 180 percent do not demonstrate market power. AAR and its members submitted extensive expert testimony and evidence proving this in their comments and verified statements back in 2011, and they did so again more recently in response to the NPRM. The Board, too, commissioned an economic study that reached the same conclusion. *See* Laurits R. Christensen Associates, Inc. Report, Vol. 2 – Analysis of Competition, Capacity, and Service Quality, Ch. 11, 11-25 (Nov. 2009) ("Christensen Report").

Other opening comments recognized this as well. The Department of Transportation, for example, expressed skepticism with the Board's proposal, stating that R/VC ratios "may not be a sufficiently robust indicator of whether revocation of a commodity exemption is warranted." *U.S. Dep't of Transp. Cmt.* at 2 (July 26, 2016). Accordingly, it cautioned the Board not to "plac[e] undue reliance upon any single measure as a proxy for market conditions," and noted that it had "concerns about the adequacy of the existing record." *Id.* And the Freight Rail Customer Alliance, despite advocating for revocation, correctly recognized that "the Board's focus on average revenue to variable cost (R/VC) ratios for particular traffic segments is too narrow." *Freight Rail Customer Alliance Opening Cmt.* at 2 (July 25, 2016) ("*Freight Rail Customer Alliance*").

AAR has already shown through two verified statements (and multiple independent studies) that the Board's reliance on R/VCs over 180 percent to support revocation in this proceeding is flawed as a matter of law and economic theory. *AAR* at 25-28. And analyses submitted by individual railroads confirm this conclusion. *See, e.g.*, *Union Pac. RR Co. Opening Cmt.* at 12 (July 26, 2016) ("*Union Pac.*") ("R/VC ratios are not reliable indicia of whether rates are constrained by competition" because the "Board's costing system is too blunt an instrument to properly incorporate and accurately measure the true resource and opportunity costs that railroads incur when serving particular shippers." (quoting Verified Statement of Kevin M. Murphy at 7 (July 26, 2016))).

Like the Board, however, shippers adopt the same flawed assumption regarding R/VC's over 180 percent with no supporting evidence. They then build their argument from there, never questioning its foundation. For instance, the Institute for Scrap Recycling Industries ("ISRI") and AK Steel simply replicate the Board's R/VC analysis. *See, e.g.*, *ISRI Opening Cmt.* at 5 (July 26, 2016) ("*ISRI*"); *AK Steel Corp. Opening Cmt.* at 5 (July 26, 2016) ("*AK Steel*"). But replication is a mere mathematical exercise; it does not demonstrate that the Board's analysis was meaningful. The same is true of the R/VC analysis submitted by the Portland Cement Association ("PCA") and the Steel Manufacturers Association ("SMA"), which largely reproduces the Board's analysis with additional years of data. *PCA Opening Cmt.* at 9-11 (July 26, 2016) ("*PCA*"); *SMA Opening Cmt.* at 18-19 (July 26, 2016) ("*SMA*"). Updating the Board's analysis provides no more basis for revocation than the Board's NPRM because it fails to grapple with R/VC's theoretical and empirical shortcomings, as well as the statutory prohibition on drawing conclusions about market dominance from R/VC ratios. 49 U.S.C. § 10707(d)(2).

Emblematic of the shippers' flawed approach to R/VC ratios is their reliance on a report from Escalation Consultants, Inc. *See ISRI* at 6; *Rail Customer Coalition Opening Cmt.* at 1 (July 25, 2016) ("*RCC*"). This analysis not only ignores the theoretical problems with R/VC as a purported indicator of market power, but employs the Public Use Waybill File, a dataset (1) bearing no relationship to reality on the revenue side of the R/VC calculation since it contains masked revenues that overstate actual revenues and therefore overstate R/VC ratios,[1] and (2) lacking cost information, which forced Escalation Consultants to estimate variable costs

[1] This masking is far from inconsequential. Baranowski and Fisher estimate that masking results in overstating industry-wide revenues by $17 billion (22%) in 2014. Baranowski/Fisher Reply VS at 10.

through a proprietary method that is necessarily wrong due to the underlying dataset. Israel/Orszag Reply VS at 8-10; Baranowski/Fisher Reply VS at 9-11.[2] This flawed analysis stands in stark contrast to Baranowski and Fisher's analysis describing how the cost component of the R/VC formula (the Uniform Railroad Costing System or "URCS") is calculated and how it has changed over time. That analysis concluded that the more recent R/VCs, on which the Board's conclusions (and also the shippers') are based, are substantially *overstated* as a result of the limitations of URCS. Verified Statement of Michael Baranowski and Benton Fisher in Support of AAR Opening Cmt. at 7-8 (July 26, 2016) ("Baranowski/Fisher Statement"). *See also* Wesley W. Wilson & Frank A. Wolak, *Freight Rail Costing and Regulation: The Uniform Rail Costing System*, 49 Rev. Ind. Org. 229, 248, 258 (May 2016) (finding "tremendous variation in URCS variable costs for the *same* shipment across railroads," and that URCS calculation of variable costs creates results "inconsistent with rational behavior by the railroad" (emphasis added)). Once the URCS methodology is refined to properly allocate costs, "the actual increases in the R/VC ratios from 1992 to 2013 were less than one-half as large as the Board observed for all but one of the NPRM commodities." Baranowski/Fisher Reply VS at 4-5 (Figure FTI-1).

Even assuming R/VC ratios over 180 percent contributed something to the Board's analysis of market power, they cannot carry the burden required to overcome the Congressional directive favoring market forces over regulation when competition is present. The Board's Christensen Report did not mince words: "R/VC, aggregated by commodity and county . . . should *not* serve as a stand-alone measure of market-dominant behavior," because it is "in fact weakly correlated with railroad and water competition measures." Christensen Report at 11-25

[2] Escalation Consultants' calculation of rate "premiums" is also devoid of any merit because it is derivative of R/VC ratios.

(emphasis added). As the report explained, the R/VC ratio "inextricably combines local market structure factors with various other cost and demand-related factors," and is not even methodologically consistent year-to-year, making comparisons over time unreliable. *Id*. at 11-25, 26.

In short, the Board and the commenters are misguided in relying on R/VCs as the basis for revoking commodity exemptions. The NPRM should be set aside, these proceedings discontinued, and the exemptions left in place.

II. Shippers' Comments Are Not Grounded In The Proper Legal Framework

Revocation is available only when *necessary* to carry out the RTP as set forth in Section 10101. *See* 49 U.S.C. § 10502(a), (d). The shippers, however, largely ignore the RTP's fifteen specific elements. They instead attempt to argue that the history of this statutory scheme supports revocation because the ICCTA, which was enacted in 1995, undermines the case for exemptions. They also attempt to argue that reregulation is justified by "common sense," "fairness," and the railroads' purported "financial strength." In doing so, the shippers' comments fail to address the RTP factors that the Board is required to consider under the statutory framework, further reinforcing that the Board's proposal should be set aside and the exemptions should be left in place.

A. The ICCTA Does Not Support Revocation

Contrary to the shippers' assertions, Congress did not undermine the case for exemptions through the ICCTA; rather, Congress left in place the exemptions and policies supporting them. Congress also enhanced and sharpened its deregulatory mandate in a variety of ways, including supplementing the Board's instructions with a directive to exempt traffic from regulation to the "maximum extent." *See* ICC Termination Act of 1995, Pub. L. No. 104-88 § 10502, 109 Stat. 803, 808 (1995). Congress set this policy for the newly-formed STB based on its determination that "exemptions have proven highly beneficial to shippers and railroads," while simultaneously "protecting significant shipper and national interests." S. Rep. No. 104-176, at 6, 8 (1995).

Several shippers contend that the ICCTA's removal of tariff-filing requirements supports revoking the exemptions. *See, e.g.*, *AK Steel* at 4; *SMA* at 10-12. They argue that, "commodity exemptions were justified in substantial part based on administrative costs and burdens associated with tariff and contract filing," but Congress subsequently "eliminated carrier tariff filing requirements" via the ICCTA. *SMA* at 10. As a result, they claim that "the transportation policy findings . . . with respect to administrative tariff and contract filing requirements are all no longer valid," "a substantial basis behind the [exemptions] . . . has been rendered moot," and the Board should be less reluctant to revoke the exemptions. *Id.* at 11-13*; see also PCA* at 6.

This argument gets things backward. *First*, the ICCTA's express purpose and effect was to further *de*regulate the freight railroad industry. *See, e.g.*, S. Rep. No. 104-176, at 2 ("The bill also significantly reduces regulation of surface transportation industries in this country."); *id.* at 8 (the bill will "strengthen th[e] exemption authority"). The same Act that *expressly directed* the STB to deregulate "to the maximum extent" (and reaffirmed the centrality of Section 10101 in the STB's exemption and revocation considerations) cannot be read to *imply* an unstated directive to revisit that mandate. Section 10101 permits regulation, but strongly encourages deregulation by making clear that the Board should regulate only when it is necessary. *See, e.g.*, 49 U.S.C. § 10101(6) (contemplating regulation in the *absence* of effective competition).

Second, shippers overstate the significance of the removal of tariff-filing requirements. The central purpose of the exemptions was not merely to address this one aspect of regulation, but more broadly to promote fair, free-market competition. This is evident from Congress's decision to leave in place—and indeed to fortify—the statutory provisions supporting exemptions at the same time that it removed the tariff filing requirements. The statute itself also makes clear that the exemptions serve this broader purpose: "The Board may revoke an exemption . . . when it finds that [regulation] . . . is *necessary* to carry out the [rail] transportation policy," and not simply when ancillary benefits diminish or disappear. 49 U.S.C. § 10502(d) (emphasis added). Moreover, they ignore that revocation of these commodity exemptions would impose affirmative regulatory requirements pursuant to 49 U.S.C. § 11101 and 49 C.F.R. Parts 1300.1 through 1300.4 (obligations to establish rates upon request, to disclose rates to any person and to provide minimum prior notice). In contrast, motor carriers—railroads' chief competitors for movements of these commodities—have no similar requirements.[3]

Despite what shippers claim, tariff filing was never the "chief burden," *AK Steel* at 4, of railroad regulation, and especially not for the five commodities here. AK Steel seeks support in a fragment from an irrelevant regulatory proceeding, *Rail Gen. Exemption Auth. – Exemption of Paints, Enamels, Lacquers, Shellacs, Etc.,* EP 346 (Sub-No. 33), slip op. at 6 (STB served Apr. 20, 1998). But in full, the sentence is qualified and reads: "*Inasmuch as no complaints have been filed by paint shippers against the railroads in recent years*, the chief burden imposed by regulation was the requirement that tariffs be filed." *Id.* (emphasis added). Indeed, the tariff-filing requirement was merely "[a]nother factor that should be taken into account," and was appended at the end of the decision—on an irrelevant commodity. *Id.*

The exemption decision for iron and steel scrap further demonstrates the relative unimportance of the tariff-filing requirement. For those commodities, the ICC determined that

[3] This disparate treatment is contrary to the policy objectives "to minimize Federal regulatory control," in 49 U.S.C. § 10101(2), " to ensure effective competition . . . between rail carriers and other modes," *id*. § 10101(5), and "to reduce regulatory barriers to entry into and exit from the industry," *id.* § 10101(7).

"the proposed exemption will promote the goals of" seven separate subsections of Section 10101a (the pre-ICCTA precursor to Section 10101), only one of which had anything to do with the burden of tariff filing. *See Rail Gen. Exemption Auth. – Exemption of Ferrous Recyclables*, EP 346 (Sub-No. 35), 1995 WL 294272, at *3 (I.C.C. served May 16, 1995).[4]

Similarly, when the ICC exempted hydraulic cement, it determined that "the costs associated with tariff and contract rate establishment and management" was just one of the six RTP bases for the exemption. *Rail Gen. Exemption Auth. – Exemption of Hydraulic Cement*, EP 346 (Sub-No. 34), 1995 WL 438371, at *4 (I.C.C. served July 26, 1995). Again, the other factors all continue to support the exemptions, and neither the NPRM nor the shippers address them.[5]

For the other three commodities, far from being the STB's (or ICC's) "chief" justification for the exemptions, tariff filing was mentioned primarily as a concern of the *shippers*. Regarding coke and primary iron, the ICC mentioned the burden of tariff filings only in its summation of the comments received from a shipper. *See Rail Gen. Exemption Auth. – Petition of AAR to Exempt Rail Transp. of Selected Commodity Grps.*, Ex Parte No. 346 (Sub-No. 29), 9 I.C.C. 2d 969, 978 (Sept. 17, 1993) (coke) ("The American Iron and Steel Institute asserts that . . . an

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[4] The six elements of the RTP not involving tariffs but found to support exemption were: allowing competition "to the maximum extent possible," "minimiz[ing] the need for Federal regulatory control," encouraging effective competition, "allow[ing] rail carriers to earn adequate revenues," and encouraging energy conservation. *Exemption of Ferrous Recyclables*, 1995 WL 294272, at *4 (citing 49 U.S.C. § 10101a(1), (2), (3), (4), (5), (15)).

[5] The five elements of the RTP not involving tariffs but found to support exemption were: allowing competition "to the maximum extent possible," "minimizing the need for Federal regulatory control," encouraging effective competition, and "allow[ing] rail carriers to earn adequate revenues." *Exemption of Hydraulic Cement*, 1995 WL 438371, at *4 (citing 49 U.S.C. § 10101a(1), (2), (3), (4), (5)).

exemption would 'reduce the administrative burden associated with tariff and contract filing'"); *id*. at 979-80 (primary iron) (same).

And tariff filings were never mentioned in explaining the ICC's exemption for crushed stone. *See id*. at 974-75.

The shippers' argument based on the ICCTA should therefore be rejected. It disregards the text and purpose of the ICCTA and the overall statutory scheme, and it also overstates the significance of tariff filing burdens in the Board's original rationale for exempting these commodities.

B. Shippers Rely On Considerations Lacking Legal And Factual Support

In addition to upending the statutory scheme to support their regulatory preferences, some shippers invoke considerations ungrounded in law or fact. For example, "[c]ommon sense," *AK Steel* at 5, and "[f]undamental fairness," *SMA* at 21, purportedly mandate revocation of certain exemptions. But these phrases are both nebulous and nowhere to be found in Section 10101's Congressionally mandated policy considerations. Congress's value judgments are reflected in the statutory scheme that contemplates exemptions for some commodities and regulation for others, and requires the Board to consider certain factors when making exemption decisions. The Board therefore cannot revoke an exemption merely based on a particular shipper's self-serving notions of common sense and fairness. Indeed, appeals to "fundamental fairness" ignore that Congress specifically intended that *competition* would be the most effective way to ensure fairness—and that only in the absence of competition would certain commodities be subject to regulation.

Also ungrounded is the shippers' argument for revocation based on vague generalizations about the "financial strength" of the railroad industry. *See, e.g.*, *AFPA* at 9-13. Financial stability for the railroads was, of course, exactly what Congress *intended*. *See, e.g.*, Railroad

Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94-210, 90 Stat. 31 (1976). In enacting these provisions, Congress did not provide that they would sunset once the industry had recovered; nor would it have made sense to do so. Moreover, Congress has never directed the Board to discontinue exemptions because rail financial performance has improved. To the contrary, nearly twenty years after Congress first granted the ICC the authority to exempt traffic from regulation in the 4-R Act of 1976, and after considerable improvement in financial health of rail carriers, Congress through the ICCTA *strengthened* its directive to the Board to exempt "to the maximum extent possible." Thus, even accepting the shippers' generalizations of financial health as true (and they have hardly shown this through reliable evidence), it demonstrates only that the statutory scheme seems to be working as Congress intended; it is certainly not a basis to reverse course.

Furthermore, the railroads' current financial status does not support a return to regulation because, as the Reply Verified Statement of Israel/Orszag explains, a period of profitability is not inconsistent with a well-functioning market. *See* Israel/Orszag Reply VS at 15 ("In industries like rail, characterized by large, long-term, fixed investments, returns will fluctuate."). So too a well-functioning market will have variations in rail rates. While shippers focus on a recent increase in rail rates, the fact is that rail rates generally declined for more than twenty years after the enactment of the Staggers Act, including the first five years after enactment of the ICCTA. *See* STB, *Study of Railroad Rates: 1985-2007*, at 1-2 (Jan. 16, 2009) ("inflation-adjusted rail rates declined in every year but one from 1985 through 2004"); *see also* STB, *Rail Rates Continue Multi-Year Decline*, at 1 (Dec. 2000) (inflation adjusted rail rates in 2000 were 45%

lower than rates in 1984).[6] There is nothing in the record to suggest that recent financial progress after decades of underperformance, or an increase in rail rates, is the result of anything but healthy competition; indeed, the railroads' financial progress actually underscores the need to adhere to the deregulatory statutory scheme that Congress maintained and reaffirmed across three decades.

III. Various Forms Of Competition Constrain Railroads' Pricing Power

An "exemption will be revoked [only] where regulation is shown to be *necessary*," and "[t]hat showing cannot be made" where the carrier "lacks market dominance over the . . . movements at issue." *FMC Wyo. Corp. v. Union Pac. R.R. Co.*, EP 346 (Sub-No. 29A), 2000 WL 33527851, at *5 n.17 (STB served May 12, 2000) (emphasis added). The shippers therefore argue, as they must, that the railroads possess market power with respect to the subject commodities. But the shippers (like the Board) fail to address "all competitive transportation factors that restrain rail carriers' actions and that affect the market for transportation of the particular commodity or type of service for which revocation has been requested." H.R. Conf. Rep. 104-422, at 169 (1995), *reprinted in* 1995 U.S.C.C.A.N. 850, 854. They offer nothing comparable to AAR's opening comments, which were supported by a comprehensive, data-driven and economically sound assessment showing that competition remains strong with regard

[6] Some shippers argue that revocation is also necessary so they can register complaints about the railroads' other purportedly unreasonable practices or service reliability. *See, e.g.*, *Freight Rail Customer Alliance* at 2; *ISRI* at 7, 9. The shippers, however, fail to tie these isolated service issues with any exercise of market power. For example, ISRI argues that they face a problem of lack of investment in a gondola fleet, *ISRI* at 7, but as CSX makes clear, the lack of investment is due to questions about economic viability as a result of competition, not market power. *CSX Transp. Inc. Opening Cmt.* at 7-8 (July 26, 2016). In any event, at most, these are precisely the types of complaints where limited revocation as opposed to total revocation would be more consistent with the RTP if a need for regulation were demonstrated because it would "maintain reasonable rates," 49 U.S.C. § 10101(6), while still allowing competition "to the maximum extent possible," *id.* § 10101(1), and "minimiz[ing] the need for Federal regulatory control," *id.* § 10101(2).

to the at-issue commodities. *See AAR* at 32-36; Verified Statement of Mark Israel and Jonathan Orszag in Support of AAR Opening Cmt. at 17-28 (July 26, 2016) ("Israel/Orszag Statement"). For this reason, the ICC's and the Board's previous decisions concluding that exempting these commodities would advance numerous elements of the RTP and have other positive effects are equally applicable today as they were when they were issued.[7]

A. Significant Intramodal Competition Exists For The Commodities At Issue

Several shippers point to consolidation among certain Class I railroads as a purported basis for revocation. *See Texas Crushed Stone* ("*TCS*") at 4; *ISRI* at 6; *Rail Customer Coalition* at 1-2; *PCA* at 7. But their assertions are unsupported by data analysis or other reliable evidence. And as Table II.1 of the Israel/Orszag Reply Verified Statement shows, Class I railroad consolidation did *not* result in a reduction in intramodal competition; the proportion of traffic with multiple railroads at both ends has largely remained stable or increased since the 1990s. *See* Israel/Orszag Reply VS at 12-13.

Markets that have experienced consolidation still enjoy robust intramodal competition. This was by design. As the Department of Transportation has stated, the Board "ensure[d] that no rail shipper that was [previously served by] at least two carriers received less than that" after railroad mergers; for that reason, there has been no "merger related gain in the number of captive shippers." Transcript of Hearing at 22-23, *The 25th Anniversary of the Staggers Rail Act of 1980: A Review and Look Ahead*, STB Ex Parte No. 658 (Oct. 19, 2005) (remarks of Paul Samuel Smith on behalf of Dep't of Transp.). This is presumably why no shipper or shipper

[7] *See Exemption of Ferrous Recyclables*, 1995 WL 294272, at *3-4 (exemption would, among other things, minimize the need for federal regulatory control, promote adequate revenues for railroads, and encourage energy conservation by attracting traffic from trucks); *Petition of AAR to Exempt Rail Transp. of Selected Commodity Grps.*, 9 I.C.C. 2d at 973 (similar); *see also Norfolk S. RR. Co. Opening Cmt.* at 38-39 (July 26, 2016) (discussing specific RTP elements advanced by exemption).

group provides *any* example of a specific customer—let alone substantial numbers of them—who experienced a demonstrated reduction in competition as a result of consolidation. Indeed, even TCS notes that it enjoys "direct connections to BNSF Railway (BNSF) and Union Pacific Railroad," which "expands [its] market reach." *Texas Crushed Stone Co. Opening Cmt.* at 2 (July 27, 2016) ("*TCS*").[8]

B. Intermodal Competition Remains Robust

Shippers' arguments minimizing the competitive significance of trucking are unsupported, conclusory, and internally inconsistent. While some comments merely repeat the assertions in the NPRM, *see e.g.*, *ISRI* at 5, those that go further nevertheless fail to supplement the record with any meaningful data indicating that trucks do not provide effective competition for transportation of the commodities at issue.

Crushed Stone (STCC 14-2): Notwithstanding the fact that *only 6% of crushed stone is transported by rail*, Israel/Orszag Reply VS at 14; *see also* Verified Statement of James R. Schaaf in Support of Norfolk S. Cmt. at 2 (July 26, 2016) ("Schaaf VS"), Texas Crushed Stone complains that railroads have market power over shipments of this commodity and that when "[f]actoring in the volumes and costs, it is not practical to truck farther than about 60 miles."

[8] Rail Customer Coalition claims that an increase in rates beginning a few years after the last Class I merger proves that consolidation reduced competition. *Analysis of 2014 Freight Rail Rates for U.S. Shippers Prepared for RCC* at 3-4. The evidence is wholly to the contrary. As a study by the Board in 2009 concluded, the rise in rates was caused by increasing input costs and lower productivity gains—"not enhanced railroad market power." STB, *Study of Railroad Rates: 1985-2007*, at 1-2 (Jan. 16, 2009). This is consistent with the fact that when most mergers were occurring, rates were actually *decreasing*. *Id.* ("inflation-adjusted rail rates declined in every year but one from 1985 through 2004"); *see also* STB, *Rail Rates Continue Multi-Year Decline*, at 1 (Dec. 2000). And RCC has no explanation for *why*—especially given the merger processes' focus on preserving competition—consolidation would all of the sudden cause rates to rise in 2004 when they remained flat or declined for nearly two decades. Moreover, the temporal correlation shown in RCC's graph is overstated, as the last Class I rail merger was consummated in 1999, not 2001, meaning that the increase in rates did not occur until half a decade after the last major consolidation event.

TCS at 4. This assertion suffers from multiple shortcomings. First, TCS neglects to explain how it arrives at "about 60 miles" as the maximum distance for which trucking is "practical." The Board cannot rely on a single shipper's anecdotal assertions, particularly those that are unaccompanied by any verified statement or other supporting facts, to justify a commodity-wide revocation. Second, TCS does not attempt to address the contradiction between its own 60-mile estimate and the Board's (also unsupported) conclusion that trucking is competitive at much longer distances. The ICC previously concluded that crushed stone's "average short haul of 154 miles . . . makes it subject to motor carrier competition." *Petition of AAR to Exempt Rail Transp. of Selected Commodity Grps.*, 9 I.C.C. 2d at 975. Yet even if 60 miles were the maximum distance, that would still create significant competition because trucks have the ability to deliver from terminals that are close to the end customer and receive inbound shipments of stone from other railroads or water carriers.

TCS's unsupported assertions continue. "TCS estimates the total crushed limestone in [its] rail served market to be 15,000,000 people times 7 tons per capita or 105,000,000 tons per year . . . [and] there are not enough trucks or drivers to handle those volumes." *TCS* at 4. But TCS neglects to explain the basis or relevance of this back-of-the-envelope calculation. The annual volume calculation, even if accurate, relates only to TCS's strawman argument that since trucking cannot accommodate *all* of the crushed limestone volume, it is not competitive for *any* of it. *Cf. Aluminum Ass'n, Inc. v. Akron, Canton & Youngstown RR Co.* 367 I.C.C. 475, 489 (1983) (effective geographic competition does not require receivers to be able to acquire identical tonnages from other sources). This conclusion is not only illogical so far as it goes; it also fails to counter the fact that just 6% of crushed stone tonnage is shipped by rail, a proportion that has remained stable for the past 40 years. *See* Israel/Orszag Statement at 24. If any of

TCS's assertions regarding trucking—including distance limitations and any driver shortage—were in fact constraining the competitive impact of trucking, the share of product shipped by rail would have increased. Israel/Orszag Statement at 13-14.[9]

<u>Primary Iron or Steel Products (STCC No. 33-12); Coke Produced from Coal (STCC No. 29-914); Iron or Steel Scrap (STCC No. 40-211)</u>: AK Steel claims that "the size, weight, and other characteristics of" coke, primary iron products, and scrap, mean that "the *majority* of AK Steel's traffic *must* be shipped by rail" instead of truck. *AK Steel* at 3 (emphases added). This is plainly false, as the data show that since 2010 the *majority* of coke, primary iron products, and scrap is *not* shipped by rail in any given year. *See* Israel/Orszag Statement at 24.

Meanwhile, the Steel Manufacturers Association insinuates that trucking is less competitive for shipping coke than previously because "the average length of haul by rail has increased from 369 miles in 1992 to 380 miles in 2014." *SMA* at 16. But neither this association nor anyone else offers any reason to believe that such a small (3%) increase in the average length of haul, after more than 20 years, could possibly mean that railroads now possess market power.[10] In fact, because this slight increase in the average length of haul is likely driven by the creation of mini-mills and the decreased need for short-distance inter-mill shipments, there is no indication that shippers are requiring longer hauls for which trucking cannot compete. Schaaf VS at 4. In any event, railroads have adduced evidence demonstrating that trucking remains a competitive alternative to rail even at longer distances. Verified Statement of Brad A. Thrasher

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[9] Union Pacific in its initial comment further explains the investments it has made specifically to compete with trucking in Texas. *See Union Pac.* at 5.

[10] The same is true for the SMA's claim that the average length of haul for primary iron/steel products increased by 9.5% between 1992 and 2014, from 639 miles to 700 miles. *SMA* at 15-16.

in Support of Union Pac. RR Co. Cmt. at 17-19 (July 26, 2016); *see also generally Union Pac. Reply Cmt.* at 10-11 (Aug. 26, 2016).

Much like TCS's theories on intermodal competition, ISRI's theories are anecdotal, muddled, and contradictory. ISRI states that the ICC considered "the mean length of haul and percentages of tons moving less than *600* miles" when it exempted iron and steel scrap. *ISRI* at 4 (emphasis added). Yet it also claims that trucking is no longer competitive because the average rail length of haul for scrap was *420* miles in 2013. *See id.* at 5. Ultimately, however, these figures are inconsequential to ISRI; it argues that trucking is no longer competitive because "*some* traffic must move by rail," and for "*some* members" rail is necessary "at distances of 100 or 200 miles, whereas for others it's 500 miles." *Id.* at 7 (emphases added). Even if true, this does not support revocation because ISRI explains neither what proportion of scrap traffic is purportedly captive to rail nor how a regulator could possibly assess intermodal competition.

<u>Hydraulic Cement (STCC No. 32-4)</u>: As AAR made clear in its opening comment, there is significant intermodal competition for hydraulic cement, as rail accounts for the transport of only around 25 percent of cement shipments. *See* Israel/Orszag Statement at 24 (based on Carload Waybill Sample, Minerals Yearbooks, and numerous other sources); *AAR* at 5. This is confirmed by PCA's own 2014 data and the confidential masked waybill sample, which together show that 22.3% of production moves by rail.[11] PCA nevertheless attempts to refute this figure by claiming that "[d]ata from the 2013 U.S. Geological Survey shows that 50% of all shipments between cement plants and distribution terminals are made by railroad." *PCA* at 6-7 (citing U.S. Geological Survey, U.S. Dep't of the Interior, *2013 Minerals Yearbook, Cement* at 16.17 (Dec.

[11] This figure is calculated by dividing the total rail tons delivered in 2014 according to the masked confidential waybill sample by PCA's 2014 figure for U.S. cement production as converted to short tons.

2015). This data in fact only further *affirms* AAR's 25 percent figure and the presence of competition. PCA's 50% calculation includes only "plant to terminal" volume, which is a small fraction of the *overall* PCA shipments volume: according to the data set it was 23.1 million metric tons in 2013, whereas "plant to customer" volume was 43.1 million metric tons. And only 1.44 million metric tons (3.3%) of the plant to customer volume was shipped by rail. *See 2013 Minerals Yearbook, Cement*, at 16.17. That is, even using the data referenced in PCA's comment, only 19.5% of cement volume emanating from a plant in 2013 was transported by rail.[12] Moreover, the 50% figure is essentially unchanged from the proportion of shipments between plant and terminal by rail in 1993 (48%), the earliest year for which data are available, *see* U.S. Geological Survey, U.S. Dep't of the Interior, *1994 Minerals Yearbook, Cement*, at Table 8, and it is *less* than the proportion in 2004 (51%). *See* U.S. Geological Survey, U.S. Dep't of the Interior, *2004 Minerals Yearbook, Cement* at 16.14. In short, truck competition for cement remains as vigorous as when the ICC exempted it from regulation.

C. Shippers Fail To Address Product And Geographic Competition

Shippers fail to address the fact that in addition to intermodal and intramodal competition, railroad rates are constrained by the availability of substitute products (product competition) and the availability of identical products from other places (geographic competition). These forms of competition were properly considered in the original exemption

[12] According to this dataset, plant to terminal railroad shipments were 11.5 million metric tons out of a total of 23.1 million metric tons; plant to customer railroad shipments were 1.44 million metric tons out of a total of 43.1 million metric tons. As a result, total shipments moving from a plant by rail were 12.94 million metric tons, out of a total of 66.2 million metric tons. And although the total metric tons shipped does not equal the aggregated figure derived from the masked confidential waybill data, there is no indication that this materially alters the reliability of proportional metrics such as percentage of shipments from a plant by rail. Indeed, that this metric as calculated using this dataset is substantially similar to the same metric calculated using confidential waybill data demonstrates its reliability.

decisions and remain a market reality. As the Israel/Orszag study—as well as the testimony of numerous railroad marketing officers—exhibited, there is substantial product competition for coke, iron and steel scrap, and hydraulic cement; and substantial geographic competition for crushed stone, primary iron and steel products, iron and steel scrap, and hydraulic cement. *See* Israel/Orszag Statement at 25-28.

IV. The Board Failed To Consider Existing And More Limited Measures

None of the comments provide any reason why the existing process under 49 U.S.C. § 10502(d) for seeking a more targeted revocation is insufficient to protect against any existing exercise market power. And most or all of the specific complaints offered in these comments, *if* they could be properly supported, plainly could be addressed through this existing process. *See, e.g.*, *TCS* at 4.

Some shippers nevertheless insist that commodity-wide revocation is appropriate because the Section 10502(d) process requires a phased proceeding and is therefore "an insurmountable barrier for most shippers to even try to obtain regulatory relief." *AK Steel* at 5-7; *see also ISRI* at 9-10. That assertion is dubious on its face: the shippers offer no reason why a phased proceeding—an approach that is common—is somehow insurmountable (as opposed to less convenient for shippers). And their assertions are further undermined by the fact that none of them claim ever to have attempted to enforce their remedies through this process—let alone tried to change any aspect of it that they view as "insurmountable."

The shippers also are incorrect that the Section 10502(d) process *requires* a phased proceeding in which they must separately litigate the exemption revocation and the administrative relief they seek. *See AK Steel* at 5-6. The Board has in fact made clear that while it will "*generally* hold any rate complaint in abeyance . . . while parties litigate the merits of the request for partial revocation," it specifically "reserve[s] the right to permit a rate case to proceed concurrently with a request for partial revocation where simultaneous review would conserve resources and expedite the matter." *Simplified Standards for Rail Rate Cases*, EP 646 (Sub-No. 1), 2007 WL 2493509, at *82 (STB served Sept. 4, 2007) (emphasis added). As the commenting shippers do not appear to have ever even attempted to utilize the Section 10502(d) to seek partial revocation, the only "insurmountable" aspect of the process appears to be their desire to try.

Shippers also argue for commodity-wide revocation on the basis that "the mere opportunity . . . to bring a service complaint before the Board, again without having to first litigate the exemption revocation issue, would simply [put exempt] shippers on equal footing with other non-exempt shippers who can readily seek redress at the Board when necessary." *ISRI* at 9-10. But nothing in the statute requires the process to be the same for all shippers; to the contrary, the statute *requires* different treatment here unless revoking the exemption is "necessary." As the Board stated, it is not "in the public interest to expose the railroads to the potentially significant burdens of rate litigation absent evidence that . . . revocation is justified." *Simplified Standards for Rail Rate Cases*, 2007 WL 2493509, at *82.

Additionally, there are other avenues for obtaining redress from the Board, including the Rail Consumer Assistance Program and the Rail Shipper Transportation Advisory Council. *See AAR* at 38-39. As Chairman Begeman explained, "[e]ven if a commodity is exempt . . . the Board is not uninterested." NPRM at 16 (Commissioner Begeman, dissenting). Similarly, the Freight Rail Customer Alliance recognized that "[t]he Board has taken an interest in the treatment of exempt traffic from time to time, such as during the service problems of 2013-2014." *Freight Rail Customer Alliance* at 2. With the Board willing and able to assist shippers of exempt commodities, revocation on a commodity-wide basis is not necessary to provide shippers with remedies that the currently have access to.

The Board has a legal obligation to consider "responsible alternatives to its chosen policy and to give a reasoned explanation for [their] rejection." *City of Brookings Mun. Tel. Co. v. FCC*, 822 F.2d 1153, 1169 (D.C. Cir. 1987). And here the existing processes are more than sufficient to protect shippers' interests. Thus, unless and until the Board considers and explains why these processes are inadequate—which it cannot do on this record—the NPRM is legally invalid.

V. The American Forest And Paper Association's Comments Fail To Justify An Additional Proposed Revocation For Forest Products

In response to the Board's request for "comments regarding the possible revocation of other commodity class exemptions," NPRM at 1, American Forest and Paper Association ("AFPA") and Wisconsin Central Group ("WCG") request revocation of the exemptions applicable to forest and paper products, as well as the boxcar exemption to the extent it applies to rail shipments of forest products. Doing so, however, would not only violate the APA and the Due Process Clause's procedural guarantees, but would be substantively erroneous as well.

As AAR explained in its opening comment, "[t]he APA requires that an agency's proposed rules fairly apprise interested parties of the subjects and issues addressed in the proceeding, and the agency's final rule must be the 'logical outgrowth' of its proposal." *AAR* at 42 (quoting *CSX Transp., Inc. v. Surface Transp. Bd.*, 584 F.3d 1076, 1079-80 (D.C. Cir. 2009)). A final rule exempting forest products, however, would fail this "logical outgrowth" test, because there was no effective notice in the NPRM that forest products were at issue and should be addressed in the initial comment period. To revoke these exemptions, a new rulemaking is required.

The current record also provides no basis for initiating a rulemaking regarding the exemptions for these other products. AFPA's and WCG's comments comprise the entirety of the public record attempting to demonstrate that the forest products exemption should be revoked. And to the extent that the Board relies on additional analysis concerning forest products from the Board's Office of Economics in evaluating their request, stakeholders will not be afforded an opportunity to comment on this analysis in violation of the APA. *See Am. Radio Relay League, Inc. v. FCC*, 524 F.3d 227, 237 (D.C. Cir. 2008) (studies "must be made available during the rulemaking in order to afford interested persons meaningful notice and an opportunity for comment"). In any event, it seems that the secret analysis touching on forest products would *not* support revocation, even under the faulty reasoning of the NPRM. NPRM at 14 (Vice Chairman Miller, concurring) (stating that she "believe[s] that the railroads have likely not increased market power for any exempt commodities other than those addressed in this decision").

In any event, the comments do not support expanding the scope of the NPRM; indeed, they suffer from the same deficient analysis as the NPRM and other shippers' comments. AFPA, for example, leans heavily on R/VC to demonstrate market power, arguing that ratios over 180% "strongly indicate . . . that the railroads have substantial market power." *AFPA* at 16. But drawing conclusions about market power from this metric is flawed for the reasons set forth *supra* at 2-6 and in AAR's opening comment.[13] In any event, changes in the R/VC ratios that AFPA describes are misleading. *AFPA* at 19. Applying their analysis from their opening statement to forest and paper products and correcting for URCS's methodological problems, Baranowski and Fisher concluded that the average R/VC ratio above 180 actually *decreased* between 1992 and 2013, and that most increases are attributable to URCS's inability to adjust for

[13] In addition, AFPA's use of R/VC cherry-picks the data, focusing on a small subset of traffic that is purportedly "captive," while paying no attention to the fact that among movements of exempt forest products whose R/VC ratios exceeded 180%, the average R/VC ratio was "virtually the same in 1989 as in 2014"—in fact, it declined. *AFPA* at 19.

changes in railroad traffic mix over the last two decades. Baranowski/Fisher Reply VS at 5-8. Separately, AFPA argues that market power is demonstrated by the "rail industry['s] financial str[ength]," but again, this metric does not indicate market power. *See supra* at 10-12.

In fact, rail rates for paper products are constrained by four types of competition: intramodal, intermodal, product, and geographic. Analysis of waybill data demonstrates that intramodal competition for forest products has remained vibrant since the forest products exemption, with the percentage volume of the commodities shipped on rail lines with intramodal competition at both ends remaining constant. Israel/Orszag Reply VS at 19-20 (Table III.1). Intermodal competition also constrains market power: As AFPA explains, there has been a "decrease in the carloads of forest products shipped by rail" (a decline of 43.3%) due to "forest product shipments [going] off the rail system completely" in favor of other shipping methods. *AFPA* at 2, 17-18. Even AFPA admits that much of the exempt cargo "can more easily move via truck." *Id.* Moreover, on top of this inter- and intra-modal competition, there is geographic and product competition that the ICC recognized when granting the exemptions, and that AFPA has not questioned. Israel/Orszag Reply VS at 22-23.

CONCLUSION

The Board's NPRM rests on flawed legal and economic analysis, and lacks any evidentiary support. And the comments from proponents of revocation do nothing to remedy these faults. For the reasons discussed above, and for the reasons stated in AAR's opening comment, the Board should withdraw this proposal and decline to use these proceedings as a form for adopting further revocations.

Dated: August 26, 2016

Respectfully submitted,

Thomas H. Dupree, Jr.
Geoffrey M. Sigler
Cynthia E. Richman
Gibson, Dunn & Crutcher LLP
1050 Connecticut Avenue NW
Washington, DC 20036
(202) 955-8500

Kathryn D. Kirmayer
Timothy J. Strafford
Association of American Railroads
425 Third Street, SW
Suite 1000
Washington, DC 20024
(202) 639-2100

BEFORE THE
SURFACE TRANSPORTATION BOARD

REVIEW OF COMMODITY, BOXCAR, AND TOFC/COFC EXEMPTIONS

Docket No. EP 704 (Sub-No. 1)

REPLY VERIFIED STATEMENT OF

Mark Israel
and
Jonathan Orszag

August 26, 2016

I. INTRODUCTION AND STATEMENT OVERVIEW

A. Witness Introduction

Mark Israel is a Senior Managing Director at Compass Lexecon. Prior to joining Compass Lexecon, Dr. Israel served as an Associate Professor at Northwestern University's Kellogg School of Management. Dr. Israel received his Ph.D. in Economics from Stanford University in 2001.

Jonathan Orszag is a Senior Managing Director and member of the Executive Committee of Compass Lexecon. Mr. Orszag holds a M.Sc. from Oxford University, which he attended as a Marshall Scholar. Mr. Orszag holds a degree in economics from Princeton University, where he graduated summa cum laude.[1]

B. Purpose and Summary of Findings

We filed a Verified Statement in the previous round of this proceeding regarding the March 2016 proposal from the Surface Transportation Board ("STB" or "the Board") to revoke exemptions on "crushed or broken stone or rip rap; hydraulic cement; and coke produced from coal, primary iron or steel products, and iron or steel scrap, wastes, or tailings."[2] In our Statement, we documented the lack of economic evidence to support a conclusion that shippers of the subject commodities need regulation to protect them from purported rail market power. More specifically, we found that R/VC is not a reliable indicator of market power and that an appropriately detailed analysis of all

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[1] For our full qualifications, see, Verified Statement of Mark Israel and Jonathan Orszag, Ex Parte 704 (Sub.-No. 1) - Review of Commodity, Boxcar, and TOFC/COFC Exemptions, July 26, 2016 (hereinafter, "Israel/Orszag VS").

[2] Comments supporting (in full or in part) the Board's March 2016 Notice of Proposed Rulemaking were received from: AK Steel Corporation, Freight Rail Customer Alliance, Institute of Scrap Recycling Industries Inc., Portland Cement Association, Rail Customer Coalition, Steel Manufacturers Association and Iron and Steel Institute, and Texas Crushed Stone.

relevant competitive options, including intramodal, intermodal, product, and geographic alternatives, demonstrates that railroads face multiple forms of competition for each of the subject commodities. Hence, we concluded that there is no economic basis for revoking the exemption from regulation for the subject commodities.

Simultaneous with our filing, multiple parties filed opening comments in support of the Board's proposal. In addition, the American Forest and Paper Association ("AF&PA") and the Wisconsin Central Group ("WCG") filed comments requesting the Board also revoke the exemptions on several forest and paper products and on boxcars, to the extent forest and paper products are shipped in boxcars.[3]

We have been asked by the Association of American Railroads ("AAR") to assess, from an economic perspective, whether the comments filed by parties supporting the Board's proposal change our conclusions and to respond to certain economic arguments presented in the filings.

The comments that have been filed change none of our conclusions. Indeed, the filings fail to provide any reliable evidence of market power to counter the detailed analysis of competitive alternatives presented in our prior statement. As such, all of our analyses and conclusions from our initial statement stand.

We focus this reply statement on three categories of arguments advanced by commenters in support of the Board's initial proposal, the first two of which we also refuted directly in our initial statement in this matter: (i) that R/VC analysis demonstrates that railroads have market power in the transportation of the subject commodities; (ii) that railroads face insufficient competition, particularly with respect to intra- and intermodal alternatives (commenters offer no analysis of product or

[3] Comments of The American Forest & Paper Association, Ex Parte 704 (Sub.-No. 1) - Review of Commodity, Boxcar, and TOFC/COFC Exemptions, July 26, 2016 (hereinafter, "AF&PA Comments").

geographic alternatives); and (iii) that improved financial performance of the railroads is indicative of market power and is evidence that exemptions are no longer required.

Separately, we will respond to arguments advanced by the American Forest and Paper Association and the Wisconsin Central Group in their proposal to revoke exemptions on a variety of forest and paper products. AF&PA's proposal suffers from many of the same infirmities found in the Board's initial Notice of Proposed Rulemaking ("NPRM").

Regarding these topics, we conclude that:

(i) **R/VC is Not a Reliable Indicator of Market Power.** Commenters rely heavily on the Board's R/VC analysis as evidence of market power and, therefore, as justification for revoking exemptions on the subject commodities. As discussed in detail in our initial statement, R/VC cannot be used to reach any reliable conclusions regarding market power.[4]

(ii) **Commenters' Analysis of Competitive Alternatives is Incomplete and Insufficient.** Commenters assert a diminution in intra- and intermodal competition. These assertions are made without any meaningful analytical support and are contradicted by the analysis we presented in our initial statement. Further, commenters largely ignore the importance of product and geographic alternatives. In contrast, railroads' opening comments provide detailed data demonstrating intramodal competition among rail carriers and intermodal competition between rail carriers and other transportation options for each of these commodities, as well as descriptions of important product and geographic alternatives.

(iii) **Improved "Financial Health" is Not a Basis on which to Re-Regulate These Commodities.** The financial performance of individual railroads or of the rail industry generally does not provide guidance regarding the specific competitive circumstances relevant to the commodities in question, is not evidence of market power, and is not an appropriate basis on which to re-regulate the five subject commodities.

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[4] Israel/Orszag VS at 9-10.

(iv) **There is No Evidence to Support the AF&PA Proposal**. Commenters AF&PA and WCG presented no reliable analysis demonstrating rail market power with respect to the forest product commodities they have identified. Our analysis of the relevant competitive alternatives finds forest and paper products have access to competitive alternatives.

In sum, Commenters do not present any reliable evidence that supports an inference of market power for the commodities in question, including for forest and paper products, and thus, there remains no economic basis for revoking the exemption from regulation for any of these commodities.

II. RESPONSE TO COMMENTS IN SUPPORT OF THE BOARD'S INITIAL PROPOSAL

A. Summary

With regard to the five subject commodities initially identified by the Board, the comments filed in this proceeding generally advanced three main arguments: (1) R/VC levels demonstrate rail market dominance; (2) competitive alternatives, particularly intramodal and intermodal alternatives, are ineffective and have been eroded to such an extent that railroads now possess market power; and (3) the improved financial health of the railroad industry renders exemptions unnecessary.

Of these three, the recitation of R/VC statistics was the most prominent. Nearly all comments filed in support of the Board's proposal rely heavily on the unreliable R/VC metric as evidence of market power and as justification for revoking exemptions. But as we explained in our initial statement, quoting R/VC statistics does not constitute an analysis and R/VC is not even a reliable metric of market power. To the extent any additional analysis is offered, it falls well short of the type of rigorous analysis required to support a finding of market power. The Department of Transportation's opening comments also endorse the need for analysis beyond R/VC, suggesting that the Board "remain open to considering all available evidence, without placing undue reliance upon any single measure as a proxy for market conditions."[5]

If, instead, one conducts a proper, detailed, individual analysis of all relevant sources of competition (as is consistent with well-settled economic principles) including analyzing intramodal, intermodal, and product and geographic alternatives, as we did in our opening statement, the conclusion is clear: Railroads face significant competition for each of the five commodities identified by the Board in their March 2016 Notice of Proposed Rulemaking. And as we explain in detail, below, the fact that railroads have improved their financial performance relative to the unsustainably poor performance of the pre-Staggers era and thus are generating a return on their enormous capital investment does not reverse this conclusion but rather is consistent with a competitive marketplace.

B. Commenters' Evidence of Market Power

1. R/VC

Many comments simply refer to or verify the Board's R/VC statistics.[6] For example, Portland Cement Association submitted an analysis conducted by James Heller of Hellerworx that reproduced the Board's R/VC calculations with respect to hydraulic

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[5] Opening Comments of the United States Department of Transportation, Ex Parte 704 (Sub.-No. 1) - Review of Commodity, Boxcar, and TOFC/COFC Exemptions, July 26, 2016 (hereinafter, "DOT Comments") at 2.

[6] See, for example, Letter from Freight Rail Customer Alliance, Ex Parte 704 (Sub.-No. 1) - Review of Commodity, Boxcar, and TOFC/COFC Exemptions, July 25, 2016 (hereinafter "Freight Rail Customer Alliance Comments"); Comments of AK Steel Corporation, Ex Parte 704 (Sub.-No. 1) - Review of Commodity, Boxcar, and TOFC/COFC Exemptions, July 26, 2016 (hereinafter "AK Steel Comments"); Comments of Steel Manufacturers Association and American Iron and Steel Institute, Ex Parte 704 (Sub.-No. 1) - Review of Commodity, Boxcar, and TOFC/COFC Exemptions, July 26, 2016 (hereinafter "Steel Manufacturers Comments").

cement and expanded the time period of that analysis to include 2014.[7] On the basis of these calculations, Portland Cement concludes that Mr. Heller's work "clearly supports and reinforces" the Board's proposal. Mr. Heller submitted similar calculations, reproducing the Board's own statistics, with respect to primary iron or steel products, scrap, and coke produced from coal, on behalf of the Steel Manufacturer's Association.[8] Comments submitted by Freight Rail Customer Alliance, AK Steel, and the Institute of Scrap Recycling Industries also simply endorse the Board's R/VC calculation without any effort to justify the robustness of the ratio as a measure of market power.

In addition to being merely repetitive of material already in the record, such references to R/VC are not probative. As we discussed in our initial statement in detail, and summarize briefly below, economic theory and empirical evidence demonstrate that R/VC is not a reliable indicator of market power and cannot be used as justification for re-regulating the subject commodities.

R/VC is not a true economic margin. Only a true economic margin – one that measures the true increase in costs (including capital cost) associated with an incremental shipment – could even potentially serve as a reliable metric of market power. The variable costs used in the R/VC calculation are allocations of system-wide average costs, not a measure of the actual incremental costs of a specific shipment, and do not properly account for other important factors relevant to setting rates, including quality and investment. Further, the idea that competitive prices are equal to marginal costs is an economic concept predicated on strong assumptions that rarely occur in practice and do not apply to the rail industry.[9]

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[7] Comments of The Portland Cement Association, Ex Parte 704 (Sub.-No. 1) - Review of Commodity, Boxcar, and TOFC/COFC Exemptions, July 26, 2016 (hereinafter "Portland Cement Comments") at 9-13.
[8] Steel Manufacturers Comments at 16-20.
[9] For a more detailed discussion, see Israel/Orszag VS at 9-12.

Independent Studies Demonstrate Flaws in R/VC. Several independent studies, including the Christensen Study commissioned by the Board, have found that R/VC calculations based on URCS variable cost produce non-sensible results, including implying that significant volumes move at rates lower than costs, and are not meaningfully related to market structure.[10] For example, Christensen finds that R/VC is not an effective proxy for "conceptually…appropriate market structure measures" [11] and goes on to note that:

> The weak relationships between R/VC ratios and market structure factors imply that correctly assessing the presence of market-dominant behavior requires direct assessment of relevant market structure factors. Thus, regulatory reforms that would establish R/VC tests as the sole quantitative indicator of a railroad's market dominance are inappropriate.[12]

Empirical Analysis Demonstrates Flaws in R/VC. In our prior statement, we presented the results of two analyses that demonstrated that R/VC is not a reliable indicator of market dominance. These findings are consistent with Christensen (and others) who reported weak relationships between R/VC and market structure factors. We showed that R/VC does not consistently fall **–** and in many cases, ***increases*** **–** in instances where competition has clearly increased.[13] We also analyzed jointly-served STCC-destination pairs and demonstrated that R/VCs on these demonstrably-competitive routes are often above 180 and, therefore, subject to being falsely labeled as subject to market power. [14]

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[10] See Israel/Orszag VS at 12-14 for a discussion of additional economic literature related to R/VC.
[11] Christensen Associates issued an update to their initial study in January 2010: Laurits R. Christensen Associates, Inc., *An Update to the Study of Competition in the U.S. Freight Railroad Industry, Final Report* (Madison, WI, November 2009) (hereafter "Christensen Rail Study – 2009") at 11-28.
[12] Christensen Rail Study – 2009 at 11-29.
[13] See Israel/Orszag VS at 15-16 and Table III.2.
[14] See Israel/Orszag VS at 14-15 and Table III.1.

Finally, since our opening comments, we have conducted analyses of intermodal traffic that strengthen our conclusions. Despite the fact that intermodal traffic is widely considered to be among the most competitive traffic on the rail network, we find that approximately 18 percent of intermodal traffic moves at R/VC ratios above 180, further indicating that the 180 threshold for identifying traffic subject to market power is unreliable.[15]

The implications of these findings with respect to this proceeding are two-fold. First, R/VC is a flawed metric of market power and is no substitute for detailed, case-by-case analysis of the competitive conditions relevant to specific commodities. Second, empirical evidence demonstrates that the 180 threshold in particular does not reliably isolate market dominant traffic and that relying on the 180 threshold as if it does will lead to flawed conclusions.

One commenter, Rail Customer Coalition ("RCC"), goes beyond replicating the Board's R/VC calculations and offers additional R/VC calculations conducted by Escalation Consultants.[16] In addition to being predicated on the flawed assumption that R/VC is indicative of market power, the analysis of R/VC presented in the Escalation Consultants report submitted by RCC is unreliable for additional reasons. Most fundamentally, the Escalation Consultants report submitted by RCC relies on the Public Use Waybill File to calculate R/VC ratios, but the revenues reported in the Public Use Waybill File are not actual revenues; they are adjusted (or "masked") by individual

[15] Analysis based on the confidential 2013 Carload Waybill Sample. For more detail on the calculations, see the Highly Confidential workpapers that accompany this report. We note that the Verified Statement of Michael R. Baranowski and Benton V. Fisher identifies challenges in costing intermodal shipments that, if corrected, would increase this percentage. See Verified Statement of Michael R. Baranowski and Benton V. Fisher, Ex Parte 704 (Sub.-No. 1) - Review of Commodity, Boxcar, and TOFC/COFC Exemptions, July 26, 2016 (hereinafter, "Baranowski/Fisher VS") at 8-18.

[16] Jay Roman of Escalation Consultants filed a different report in the proceeding in support of the American Forest and Paper Association's proposal to revoke exemptions on a variety of forest and paper products. I discuss that report in Section III, below.

railroads using unknown "masking factors" to protect sensitive rate information.[17] The use of masked revenues in the Public Use Waybill File renders the revenue portion of the R/VC ratios presented in Escalation Consultants study completely unreliable.[18]

The Escalation Consultants report submitted by the RCC also presents an analysis of rail rates, purporting to show rate increases resulting from rail mergers, as evidence of rail market power.[19] The analysis presents rates, as measured by the average revenue per car, for the industry as a whole for the period 1980-2014.[20] This measure is far too aggregated to be of any value in determining whether the individual commodities at issue in this proceeding are subject to market power. Only detailed analysis of the type presented in our opening comments and supported by individual railroad opening comments provides the level of detail necessary to evaluate questions of market power.

Further, demonstrating that the average revenue per car has increased over time is not informative of market power because it fails to control for any factors that might cause the average revenue per car to increase over time, including; for example, changes in traffic mix, costs, length-of-haul, or tons per car; higher fuel prices and associated fuel surcharges; improved service offerings, increased demand; and/or capacity constraints. For example, because Average Revenue per Car does not account properly

[17] See, https://www.stb.dot.gov/stb/industry/econ_waybill.html, which notes: "Please be aware that revenue reported in the freight revenue field may be masked and not equal to the actual revenue on the freight waybill. If freight is moving under a transportation contract, the revenues are confidential and not subject to public disclosure."

[18] See the Reply Verified Statement of Michael R. Baranowski and Benton V. Fisher for a more detailed discussion of the masked revenues in the Public Use Waybill File.

[19] See, "Analysis of 2014 Freight Rail Rates for U.S. Shippers," Prepared for Rail Customer Coalition by Escalation Consultants, Inc., June 2016, at 3-4 as attached to Comments of the Rail Customer Coalition, Ex Parte 704 (Sub.-No. 1) - Review of Commodity, Boxcar, and TOFC/COFC Exemptions, July 25, 2016 (hereinafter, "RCC Comments").

[20] A similar analysis of average revenue per car is presented in Verified Statement of Henry Julian Roman, Ex Parte 704 (Sub.-No. 1) - Review of Commodity, Boxcar, and TOFC/COFC Exemptions, July 21, 2016 (hereinafter "Roman VS") at 7-9 and referenced by AF&PA Comments at 14-15. Our criticisms here apply to this analysis as well.

for changes in length of haul or tons per car due to use of higher capacity cars, it will produce an increase in Average Revenue per Car even if other measures of rates (such as revenue per revenue-ton-mile) are flat or decline. In this regard, the average revenue per car is an even worse metric than R/VC, which at least tries (but fails) to control for costs.

Even setting aside these issues, the analysis itself does not support the argument. Although the Escalation Consultants' report (and later Mr. Roman, in his statement on behalf of AF&PA) argues that the average revenue per car has increased as a result of rail mergers, the chart incorrectly identifies 2001 as the start of the 'post-mergers' period. In fact, Class I mergers took place over a long period beginning in the early 1980s, with the final Class I merger consummated in 1999. The figure shows average revenue per car falling and then largely flat during the period of intense rail merger activity suggesting, at minimum, that a more in-depth analysis is required before ascribing increases in average revenue per car beginning in 2001 to merger-related market power.

2. Competitive Alternatives

A proper analysis of competition – which is necessary to reach a conclusion regarding market power – considers all relevant sources of competitive discipline. On this point, the comments filed by the Department of Transportation echo our conclusion: "[E]ach exemption should be evaluated on its merits, and that each exemption should be based on a careful, case-by-case review."[21] The DOT went on to note:

> As these proceedings continue, DOT suggests that the Board remain open to considering all available evidence, without placing undue reliance upon any single measure as a proxy for market conditions. As one example, although the NPRM focuses in large

[21] DOT Comments at 2.

> part upon changes in the revenue/variable cost ratio for the specified commodities, that measure, while useful, may not be a sufficiently robust indicator of whether revocation of a commodity exemption is warranted.[22]

The railroads' opening comments provided exactly the detailed, robust, case-by-case review called for by the DOT. For example, in our opening statement, we provided a detailed discussion of the relevant competitive alternatives and presented evidence demonstrating that railroads faced significant competition from one or more of these alternatives for each of the subject commodities. That analysis was amply supported by statements filed by individual railroads offering detailed examples of competition.[23]

In contrast, commenters supporting the Board's proposal failed to analyze these alternative sources of competition, rendering their conclusions unreliable as a matter of economics. Although some commenters address intra- and intermodal competition, these alternatives are dismissed on the basis of broad generalizations or unsupported assertions rather than detailed and comprehensive analysis. Further, commenters generally ignore the importance of product and geographic alternatives.

Intramodal Competition: Several commenters assert that there is insufficient intramodal competition with regard to the subject commodities. These assertions are

[22] DOT Comments at 2.

[23] See, for example, Verified Statement of Brad A. Thrasher, Ex Parte 704 (Sub.-No. 1) - Review of Commodity, Boxcar, and TOFC/COFC Exemptions, July 26, 2016 (hereinafter "Thrasher VS"); Verified Statement of James R. Schaaf, Ex Parte 704 (Sub.-No. 1) - Review of Commodity, Boxcar, and TOFC/COFC Exemptions, July 26, 2016 (hereinafter "Schaaf VS"); Verified Statement of Rob N. Zehringer, Ex Parte 704 (Sub.-No. 1) - Review of Commodity, Boxcar, and TOFC/COFC Exemptions, July 26, 2016; Verified Statement of Russ Epting Ex Parte 704 (Sub.-No. 1) - Review of Commodity, Boxcar, and TOFC/COFC Exemptions, July 26, 2016; Verified Statement of Michael Rutherford, Ex Parte 704 (Sub.-No. 1) - Review of Commodity, Boxcar, and TOFC/COFC Exemptions, July 26, 2016; Verified Statement of Louis Muldrow, Ex Parte 704 (Sub.-No. 1) - Review of Commodity, Boxcar, and TOFC/COFC Exemptions, July 26, 2016.

supported with reference to industry consolidation, generally,[24] or with anecdotal reference to increases in the number of "captive" shippers.[25]

Although it is true that the number of Class I railroads in the United States has decreased over time this fact alone is not sufficient to conclude anything about the competitive circumstances relevant to the subject commodities. Each merger was subject to intense regulatory scrutiny and was approved with conditions ensuring that any shipper with access to two railroads pre-merger retained access to two railroads post-merger. Commenters asserting a decrease in intramodal competition as a result of mergers have offered no evidence that that these conditions have been ineffective.

Further, commenters have offered no analysis to support their assertions that there has been any significant decrease – merger-related or not – in intramodal competition for the subject commodities. Indeed, such assertions are contradicted by data presented in our opening statement. As Table IV.1 from our original report (and included, below, as Table II.1) shows, the share of subject commodities moving on routes with multiple rail options on both ends of the move has remained relatively stable. If there was, in fact, a substantial increase in the number of solely-served shippers at either origins or destinations, we would expect to see that reflected as a decrease in the proportion of volumes served by multiple railroads at both ends of a move.

[24] See, e.g., Comments of the Institute of Scrap Recycling Industries, Ex Parte 704 (Sub.-No. 1) - Review of Commodity, Boxcar, and TOFC/COFC Exemptions, July 26, 2016 (hereinafter "ISRI Comments") at 6; RCC Comments at 1.

[25] See, e.g., Portland Cement Comments at 7, AK Steel Comments at 1, RCC Comments at 1, and ISRI Comments at 6.

Table II.1 - Volume (in Tons) of Subject Commodities Moving by Rail on Routes with Multiple Railroads at Each End

	1990	1991	1992	1993	1994	2010	2011	2012	2013	2014
Crushed or Broken Stone or Rip Rap	4%	9%	4%	3%	6%	7%	7%	10%	9%	8%
Coke Produced from Coal	41%	44%	36%	34%	35%	29%	32%	7%	12%	33%
Primary Iron or Steel Products	45%	38%	41%	33%	39%	39%	42%	45%	39%	43%
Hydraulic Cement	15%	18%	13%	16%	23%	16%	18%	18%	21%	22%
Iron or Steel Scrap, Wastes or Tailings	32%	33%	29%	30%	29%	37%	35%	32%	35%	34%

Source: Carload Waybill Sample

Notes: Routes defined at 6-digit SPLC level; routes were included if Carload Waybill Sample reported multiple railroads serving the SPLC in a given year.

Intermodal Competition: Several commenters dismiss intermodal competition, particularly competition from trucks, with assertions that increased lengths-of-haul, capacity constraints related to the availability of trucks and drivers, and regulatory changes in the trucking industry have resulted in significantly less competition from trucks relative to the pre-exemption period.[26] For example, ISRI[27], Portland Cement Association[28], and Steel Manufacturers[29] each raise concerns that increased length-of-haul has made trucks less competitive with rail and Freight Rail Customer Alliance[30] and Steel Manufacturers[31] specifically cite driver shortages and new regulation as evidence of limited truck competition. Importantly, however, no commenters have provided detailed analysis or empirical support for these claims.

Narrow focus on specific characteristics that may or may not affect truck competition in certain circumstances does not answer the relevant question regarding the extent of intermodal competition. Instead, all of these assertions – that rail faces less competition from other modes because of increased lengths-of-haul, driver shortages, or

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[26] See, e.g., Portland Cement Comments at 6; Steel Manufacturers Comments at 14-16; and Comments of Texas Crushed Stone, Ex Parte 704 (Sub.-No. 1) - Review of Commodity, Boxcar, and TOFC/COFC Exemptions, July 26, 2016 (hereinafter "TCS Comments") at 4.
[27] ISRI Comments at 5.
[28] Portland Cement Comments at 6.
[29] Steel Manufacturers Comments at 15-16.
[30] Freight Rail Customer Alliance Comments at 2.
[31] Steel Manufacturers Comments at 14-15.

new truck regulations – can and should be evaluated by analyzing the importance of alternative modes of transportation, as a whole, to each of the commodities in question, as we did in in our prior statement.[32] Table II.2, below, reproduces that analysis. If – for whatever reason – railroads are in fact facing less competition from alternative modes today as compared to the years preceding the exemptions that will be reflected in the data as higher rail shares of total transportation relative to the pre-exemption period. However, Table II.2 shows that – contrary to commenters' assertions – the share of subject commodities moving by non-rail alternatives is largely consistent with pre-exemption levels. This refutes assertions that trucks – and other modes more generally – have become less competitive with rail as a result of increased lengths-of-haul, driver shortages, or for any other reason.

Table II.2: Share of Subject Commodity Production Transported by Rail (in Tons)

STCC	Commodity	1975	1980	1985	1990	2010	2011	2012	2013	2014
14-2	Crushed or Broken Stone, Riprap	5%	5%	4%	5%	6%	6%	6%	6%	6%
29-914	Coke produced from Coal	36%	32%	65%	80%	33%	31%	37%	37%	34%
33-12	Primary Iron or Steel Products (1)	40%	39%	30%	38%	49%	47%	47%	46%	42%
32-4	Hydraulic Cement (2)	22%	16%	17%	19%	25%	24%	25%	25%	25%
40-211	Iron or Steel Scrap, Wastes, Tailings (3)	n/a	48%	43%	34%	37%	39%	42%	39%	n/a

Sources: Carload Waybill Sample, Verified Statement of Craig F. Rockey (Ex Parte No. 346, 1992), Verified Statement of Paul S. Posey (Ex Parte No. 346 (Sub-No. 35), 1994), United States Geological Survey Minerals Yearbook (2010-2014), United States Geological Survey Mineral Commodities Summaries (2010-2014), United States Energy Information Administration Quarterly Coal Reports (2010-2014)

Notes: Rail percent is calculated as expanded tons as reported in the Carload Waybill Sample divided by production and imports.

(1) Production of iron/steel products is estimated by steel mill products for 2010-2014; included blast furnace products, primary iron or steel products, and iron or steel castings for 1975-1990. (2) Includes portland cement and masonry cement; portland cement represents 97% hydraulic cement traveling by rail in the Carload Waybill Sample in 2014. (3) Included blast furnace product and steel shipping containers as ferrous recyclables 1975-1990; limited to ferrous scrap 2010-2014; data unavailable for 1975 and 2014.

[32] Israel/Orszag VS at Table IV.2 (p 24).

3. Railroad Financial Results

Some commenters argue that railroad financial performance is a relevant factor in determining whether exemptions should be revoked. For example, AK Steel writes: "[m]ajor railroads are extraordinarily profitable, while many industries the railroads serve, like the steel industry, are struggling. The STB can and should do everything it can to insure the health of railroad customers, and one way it can do so is to revoke the class exemptions on Coke, Steel and Scrap."[33] The AF&PA comments also address this argument, stating: "The ICC granted the exemptions based on the need to assist the rail industry in earning adequate revenues, which was in a financially-fragile condition at that time. However, today the rail industry is financially strong."[34]

Even if a railroad's profits could be properly characterized as "extraordinary," that claim alone is not evidence of market power and is not an appropriate basis on which to re-regulate the subject commodities.[35] In competitive markets, firms should earn reasonable returns, including returns on capital investment. It is precisely these returns that drive investment and innovation within the industry.[36]

The fact is that periods of success that follow on periods of poor financial performance are a particularly poor rationale for regulation. In industries like rail, characterized by large, long-term, fixed investments, returns will fluctuate. Periods of very strong performance are necessary to offset periods of very weak performance. Using short-term "financial health" measured over a period of years to justify rate-

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[33] AK Steel Comments at 7.
[34] AF&PA Comments at 4.
[35] Fisher, Franklin M. and John J. McGowan, "On the Misuse of Accounting Rates of Return to Infer Monopoly Profits," *The American Economic Review* (March 1983) at 82-97.
[36] See, Verified Statement of Joseph P. Kalt, Ex Parte 722 – Railroad Revenue Adequacy, September 5, 2014 at 33-34.

suppressing regulation guarantees that firms can't earn reasonable returns over the long term. Such policies would mean that firms are bearing the full risk of losses in periods of weak performance but realizing none (or only a fraction) of gains to off-set those losses in strong periods. Such policies greatly reduce investment incentives – firms will not be willing to bear the risk of sub-par returns in periods of weak performance if they fear the good times will be used to justify regulation.[37]

Finally, industry-wide measures of financial performance are too aggregated to answer the relevant question of rail market power for the specific commodities in this proceeding. Overall railroad financial performance does not speak to the specific competitive circumstances of the subject commodities and offers no insight into the veracity of competition that railroads face for the transportation of the subject commodities. For example, examining the overall profits of a railroad does not establish that the rates charged to any individual shipper are subject to market power.

C. Implications for this proceeding

None of the comments filed in support of the Board's proposal offered rigorous economic analysis, presented reliable or persuasive evidence of market power, or provided analyses that call any of the findings from our initial statement into question. Hence, they provide no economic basis to support the Board's proposal to revoke exemptions for the five subject commodities.

[37] See, Verified Statement of David Sappington, Ex Parte 722 – Railroad Revenue Adequacy, September 5, 2014 at 7-8.

III. REQUESTS FOR ADDITIONAL EXEMPTIONS

A. Summary of American Forest & Paper Association and Wisconsin Central Group's Argument

The American Forest and Paper Association requests that the Board lift commodity exemptions on (1) lumber or wood products; (2) pulp, paper, or allied products, and wallboard; (3) wood scrap or waste; and (4) paper waste or scrap. The AF&PA further requests that the boxcar exemption be revoked to the extent it applies to forest products.[38] The Wisconsin Central Group ("WCG") filed separate comments in support of this proposal.

The AF&PA makes several arguments in support of their request, most of which echo the arguments refuted above. First, AF&PA and their expert, Jay Roman, rely heavily on computation of R/VC levels as evidence of market dominance.[39] Second, AF&PA argues that the financial health of the railroads warrants revocation.[40] Third, AF&PA argues that shippers of forest products have limited intra- and intermodal options.[41]

We address each of these arguments below and also demonstrate that a detailed analysis of competitive alternatives shows important competition for the shipment of the forest and paper products in question.

B. R/VC

AF&PA, supported by the Verified Statement of Jay Roman, relies heavily on R/VC calculations to demonstrate market dominance. They assume that R/VC above

[38] See AF&PA Comments at 1, 3-4, and 25.
[39] See AF&PA Comments at 19-21 and Roman VS at 4-6.
[40] See AF&PA Comments at 9-13 and Roman VS at 7-9 and 11-12.
[41] See AF&PA Comments at 7-9 and Roman VS at 8.

180 is evidence of market power and, on this basis, conclude that railroad market power has increased since the time of the exemptions.

We have addressed the flaws with R/VC analysis both above and in our opening statement. Of particular relevance to arguments made by Mr. Roman, is our analysis demonstrating that non-trivial amounts of ***competitive*** traffic move at R/VCs above 180.[42] Our analysis demonstrates that R/VC above 180 is not a meaningful threshold for identifying market power and that relying on it as though it is may lead to misidentifying competitive traffic as subject to market power.

C. Financial Health

AF&PA and Mr. Roman also assert that the overall financial performance of the rail industry is somehow relevant to the question of whether railroads are market dominant in the transportation of forest and paper products. As we detailed above, simply noting that the railroad industry as a whole is earning "adequate revenues" as measured by the STB is not evidence of market power. Further, aggregate measures of industry performance do not indicate whether, with respect to forest and paper products, railroads face sufficient competition to protect shippers from market power.

D. Analysis of Competitive Alternatives

In granting the initial exemptions on forest products, the ICC cited intramodal, intermodal, and product and geographic alternatives as important sources of competition for railroads. For example, with respect to lumber, the ICC cites "substantial intermodal and intramodal competition" and "strong geographic competition… prohibiting

[42] See Section II.B.1, above, and Israel/Orszag VS at 9-17, especially Table III.1.

railroads' ability to abuse their economic advantage on long-haul traffic."[43] Similar statements noting "pervasive" motor carrier competition and "substantial" product and geographic competition were made by the ICC in the decision exempting scrap paper.[44] AF&PA's proposal fails to present any evidence or analysis demonstrating a significant change in the intramodal and intermodal alternatives available to shippers of forest products and essentially ignores the importance of product and geographic alternatives. Our analysis of these alternatives shows that railroads face significant competition for transporting forest products.

1. Intramodal Competition

Table III.1 shows that, for forest and paper commodities, the volume of traffic with multiple options on both ends of the move in the past five years is largely consistent with the proportion having multiple options at the time the exemptions were granted.[45] Hence, contrary to assertions by AF&PA and Mr. Roman that industry consolidation has resulted in less rail-to-rail competition for shippers[46], there is no evidence of a decrease in intramodal competition for these commodities.

[43] Ex Parte 346 (Sub-No. 25) "Rail General Exemption Authority – Lumber or Wood Products," Interstate Commerce Commission, 7 ICC 2nd 673, July 1, 1991 at 3-4.
[44] Ex Parte 394 (Sub-No. 12) "Petition to Exempt from Regulation The Rail Transportation of Scrap Paper," Interstate Commerce Commission, 9 ICC 2nd 957, October 15, 1993, at 2.
[45] For the purposes of this analysis, origins and destinations were defined as 6-digit SPLCs. The drop in the proportion of paper scrap or waste moving on routes with competitive options on both ends in 2011 occurs because of variation in Waybill sampling.
[46] AF&PA Comments at 7-8 and Roman VS at 8.

Table III.1: Volume (in Tons) of Forest Products Moving by Rail on Routes with Multiple Railroads at Each End

STCC	STCC Description	1990	1991	1992	1993	1994	2010	2011	2012	2013	2014
24	Lumber or Wood Products	9%	15%	11%	10%	19%	19%	17%	18%	18%	19%
26	Pulp, Paper or Allied Products, and Wallboard	21%	25%	24%	22%	25%	24%	23%	24%	25%	26%
40241	Paper Scrap or Waste	27%	28%	27%	27%	28%	35%	7%	33%	34%	33%

Source: Carload Waybill Sample

Notes: Routes defined at 6-digit SPLC level; routes were included if Carload Waybill Sample reported multiple railroads serving the SPLC in a given year. Wood scrap (STCC 40231) was excluded because it was not sampled regularly after 2007 and made up less than 1% of total forest product volume in 2013.

2. Intermodal Competition

Table III.2 shows significant intermodal competition for transportation of forest products.[47] In fact, contrary to claims by AF&PA and Mr. Roman that driver shortages, regulatory changes, and other factors have reduced truck competition for forest products[48] there has been a ***decrease*** in rail share of primary forest products compared to shares at the time exemptions were granted. This fact is confirmed by Mr. Roman and AF&PA who note a significant shift towards trucks in recent years.[49] Though Mr. Roman asserts that the result of this shift is that all remaining rail volumes are "captive", that argument is refuted in Table III.1, above, which shows that there has been no significant decrease in the volume of forest products with competitive rail options on both ends of their move.

[47] In the table, we infer the proportion of production not moved by rail is moved by other modes, likely truck and/or water. Also, due to limited data for Wood Scrap and Paper Scrap or Waste these commodities are not included in the table. Together, they represent less than three percent of total rail volume of forest products in 2013.

[48] AF&PA Comments at 7-8.

[49] AF&PA Comments at 18. Roman VS at 9.

Table III.2: Share of Forest Product Production Transported by Rail (in Tons)

STCC	Commodity	1975	1980	1985	1990	2010	2011	2012	2013	2014
24-1	Primary Forest and Wood Products	40%	29%	20%	16%	8%	8%	8%	7%	n/a
26	Pulp, Paper or Allied Products, and Wallboard	n/a	n/a	n/a	n/a	20%	21%	21%	21%	20%

Sources: Carload Waybill Sample, Verified Statement of Craig F. Rockey (Ex Parte No. 346, 1992), United States Department of Agriculture U.S. Timber Production, Trade, Consumption and Price Statistics, 1965 - 2013, Food and Agriculture Organization of the United Nations Statistics Division (2010-2014)
Notes: Rail percent is calculated as expanded tons as reported in the Carload Waybill Sample divided by production plus imports. For pulp, paper, or allied products (STCC 26), historic shares were not reported in exemption decisions. Current shares are calculated as volume reported in the Carload Waybill Sample (expanded tons) divided by production and import quantity calculated by the UN FAO.

Taken together, the data on the availability of alternative rail options (Table III.1) and alternative modes (Table III.2) demonstrate that the forest and paper products identified by AF&PA have access to competing transportation alternatives. Indeed, both AF&PA and WCG themselves acknowledge significant and effective intra- and intermodal competition. WCG notes a "major" shipper moved their business from "direct rail freight to a truck-rail transload (over 100 mile dray) to a shortline and Union Pacific connections."[50] AF&PA notes that significant volumes of forest and paper products that have moved off rails, in part because that traffic received more attractive prices from alternative transportation options.[51]

These intra- and intermodal alternatives provide important discipline on rail rates both for those who can access an alternative provider and for those who cannot: If rail rates for shippers without alternatives increase to the point that their prices are no longer competitive with shippers who have alternatives, the shipper and the railroad will lose business.

[50] WCG Comments at 5.
[51] AF&PA Comments at 18.

3. Product and Geographic Competition

AF&PA and WCG ignore, for the most part, both product and geographic alternatives. This is despite the fact that the ICC references important product and geographic competition for several products in their decisions granting these exemptions, including paper scrap[52], primary wood and forest products[53], and lumber or wood products.[54] For example, in granting the exemption for scrap paper, the ICC notes:

> Petitioners also demonstrate the presence of substantial geographic and product competition. Geographic competition occurs because scrap paper is generated throughout the Nation. Product competition occurs because there is no difference between recycled fibers originating in the various regions.[55]

AF&PA have offered no evidence outlining any changes in the substantial product and geographic competition noted by the ICC. Indeed, the same conditions that the ICC cited as generating significant geographic and product competition remain important in the industry, especially with respect to paper and lumber, which comprise a large portion of total rail shipments of forest products.

- ISRI reports that recovered paper is one of the most widely recycled products and is "sold and transported to paper mills at home and worldwide," including exports to "more than 85 countries." [56]

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[52] Ex Parte 394 (Sub-No. 12) "Petition to Exempt from Regulation The Rail Transportation of Scrap Paper," Interstate Commerce Commission, 9 ICC 2nd 957, October 15, 1993 at 2.

[53] Ex Parte 346 (Sub-No. 29) "Rail General Exemption Authority – Petition of AAR to Exempt Rail Transportation of Selected Commodity Groups," Interstate Commerce Commission, 9 ICC 2nd 969, September 17, 1993 at 5.

[54] Ex Parte 346 (Sub-No. 25) "Rail General Exemption Authority – Lumber or Wood Products," Interstate Commerce Commission, 7 ICC 2nd 673, July 1, 1991 at 4.

[55] Ex Parte 394 (Sub-No. 12) "Petition to Exempt from Regulation The Rail Transportation of Scrap Paper," Interstate Commerce Commission, 9 ICC 2nd 957, October 15, 1993, at 2.

[56] Institute of Scrap Recycling Industries, Inc. "The Scrap Recycling Industry: Paper," 2016, available at http://www.isri.org/docs/default-source/commodities/fact-sheet---paper.pdf?sfvrsn=12 , site visited August 17, 2016.

- Recycled paper plants, which process scrap paper as a primary input, continue to be located throughout the country with the top 20 scrap recyclers operating well over 300 plants in North America.[57]
- There are hundreds of lumber manufacturers in the US[58] and over 300 lumber distribution yards in the US, offering both distributors and end customers a wide range of options from which to purchase lumber.[59]

E. Implications for Forest & Paper Products

We find no economic basis to conclude that shippers of forest products need re-regulation to protect them from rail market power. We have demonstrated that forest and paper products benefit from significant competition from several competitive alternatives, a fact confirmed by AF&PA who note that railroads have lost significant volumes to intermodal competitors in recent years.

Finally, we note that AF&PA's argument appears to be that exemptions on these products should be revoked because all shippers do not have direct access to competitive alternatives. However, as we discussed in our prior report, competitive alternatives benefit all shippers, even if they don't have direct access to alternatives.[60] And further, granting exemptions on these products would require the Board to impose regulation on large volumes of ***competitive*** traffic.

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[57] Recycling Today, "Reigning Supreme," April 2013, available at http://www.recyclingtoday.com/article/rt0413-largest-paper-stock-dealers/, site visited August 17, 2016.
[58] U.S. Lumber Coalition, "About the U.S. Lumber Industry," 2015, available at http://www.uslumbercoalition.org/general.cfm?page=31, site visited August 17, 2016.
[59] Buehlmann, Urs, Omar Espinoza, Matthew Bumgardner, and Bob Smith. "Trends in the US Hardwood Lumber Distribution Industry: Changing Products, Customers, and Services." Forest Products Journal 60, no. 6 (2010) at 547-53, available at http://www.nrs.fs.fed.us/pubs/jrnl/2010/nrs_2010_buehlmann_002.pdf.
[60] Israel/Orszag VS at 18-19.

IV. CONCLUSION

Nothing that has been presented by commenters changes our initial conclusion that there is no economic basis for re-regulating any of the commodities at issue in this proceeding. Commenters fail to present any reliable evidence of market power with respect to either the five commodities originally identified by the Board or the forest and paper products identified by AF&PA. The R/VC metrics cited by numerous parties are not reliable indicators of market power and no parties presented any other comprehensive analysis or reliable evidence of market power.

VERIFICATION

I declare under penalty of perjury that the foregoing is true and correct. I further certify that I am qualified and authorized to sponsor and file this testimony.

Executed on August 26, 2016

Mark A. Israel

Mark Israel

VERIFICATION

I declare under penalty of perjury that the foregoing is true and correct. I further certify that I am qualified and authorized to sponsor and file this testimony.

Executed on August 26, 2016

Jonathan Orszag

BEFORE THE
SURFACE TRANSPORTATION BOARD

REVIEW OF COMMODITY, BOXCAR, AND TOFC/COFC EXEMPTIONS

Docket No. EP 704 (Sub-No. 1)

REPLY VERIFIED STATEMENT OF

Michael R. Baranowski
and
Benton V. Fisher

August 26, 2016

I. Introduction

A. Overview

We are Michael R. Baranowski and Benton V. Fisher, Senior Managing Directors at FTI Consulting's Network Industries Strategies practice. We filed a joint verified statement in the opening round of this proceeding (our "opening Statement"). Our qualifications are set forth in our opening Statement.

We have been asked by the Association of American Railroads ("AAR") to address portions of comments submitted by certain shipper organizations in the opening round of this proceeding. First, we expand the analysis that we submitted in our opening Statement to examine claims by the American Forest & Paper Association ("AF&PA") regarding R/VC ratios for exempt forest and paper product commodities.[1] Second, we correct calculations by the Steel Manufacturers Association and American Iron and Steel Institute ("SMA/AISI") of the 2014 R/VC ratios for three of the commodities at issue in this proceeding. Finally, we address a study the Rail Customer Coalition ("RCC") performed using the Board's Public Use waybill file.

B. Summary of Findings

<u>Changes in R/VC Ratios Across 20+ Years</u>: In the opening round of comments, shipper organizations embraced the Board's reliance on increases in average R/VC ratios between 1992 and 2013 to justify re-regulation of the commodities at issue (the "NPRM commodities"). We explained in our opening Statement that the vast majority of the Board's observed R/VC increases can be explained by the generalized approach and limited flexibility of the Board's

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[1] AF&PA indicates that the primary exempt forest products are identified by four broad STCC groupings: 24, 26, 40231, and 40241. AF&PA Comments at 3. AF&PA's expert specifies 177 separate commodities at the 7-digit STCC level. Roman VS at 3, and Appendix B.

Uniform Rail Costing System ("URCS"), and the specific inability of URCS's system-average variable cost allocations to properly address the explosive growth in intermodal traffic.[2] We showed how certain refinements to the allocation of variable costs would result in lower R/VC ratios for the NPRM commodities in 2013. The lower R/VC ratios for 2013 in turn indicate that the Board's observed increases in R/VC ratios were significantly overstated, as summarized in Figure FTI-1 to our opening Statement (which is reproduced in the next section).

<u>Impact of URCS Refinements for Shipments of AF&PA Commodities</u>: Our review of the confidential waybill sample records reveals that for several exempt forest and paper commodities, either there were no shipments in 2013 with R/VC ratios above 1.80, or the average R/VC>1.80 declined from 1992 to 2013.[3] For the remaining commodities, we determined that a substantial portion of the observed R/VC increases can be attributed to the same dramatic shifts in railroad traffic mix and other changes that we described in our opening Statement.

<u>SMA/AISI's Overstated R/VC>180 Ratios for 2014</u>: The average R/VC>1.80 ratios for 2014 presented in the SMA/AISI comments for STCC 40211 Iron or Steel Scrap, STCC 3312 Primary Iron or Steel Products, and STCC 29914 Coke from Coal, were not calculated in the same fashion that the Board typically uses – and used in this proceeding – and significantly overstate the average R/VC>1.80 ratios.

[2] Opening Statement at 2-6.

[3] WP "2013 URCS Variable Cost Refinements_Reply_HC.xlsx," tab "Cover."

RCC's Misplaced Reliance on the Board's Public Use Waybill Files: RCC's reliance on an "Analysis of 2014 Freight Rates for U.S. Shippers" is misplaced because that study was based on the Board's Public Use waybill files, which contains masked revenue data and does not contain sufficient information to permit accurate estimation of variable costs using the Board's URCS costing program.

II. Analysis

A. Shippers Largely Embraced Reliance on the Flawed Comparison of R/VC Ratios Between 1992 and 2013 as the Basis for Revoking Exemptions.

As explained in our opening Statement, the vast majority of the observed increases in R/VC ratios for the NPRM commodities between 1992 and 2013 can be attributed to URCS's inability to account for dramatic shifts in railroad traffic mix and other changes that have occurred over the past two decades.[4] Specifically, the URCS system-average results incorporated in the Board's comparison of R/VC ratios 1) mis-assign variable costs between intermodal and carload shipments; 2) fail to assign all switching costs; and 3) do not control for other changes that have occurred since 1992. We identified $1.64 billion of variable costs for 2013 carload shipments that were assigned to intermodal shipments due to URCS's lack of granularity and another $733 million in variable costs that were not assigned to 2013 carload shipments due to other changes.[5] Figure FTI-1 below summarizes the results of our analysis of the NPRM commodities that were presented in our opening Statement. The figure shows that when the URCS allocations are refined, the actual increases in the R/VC ratios from 1992 to 2013 were less than one-half as large as the Board observed for all but one of the NPRM commodities.

[4] *See* Opening Statement at 13-26.

[5] Opening Statement at 19-20, 24-25.

Figure FTI-1
Average R/VC>180%, 2013 NPRM Commodities[6]

NPRM STCC	STB 2016 NPRM	% Change from 1992	Refined Estimate	% Change from 1992	% of Observed Increase Explained by Refinements
14-2	2.55	10%	2.40	3%	66%
29-914	2.48	10%	2.34	4%	60%
32-4	2.40	15%	2.26	8%	45%
33-12	2.37	8%	2.22	1%	84%
40-211	2.30	2%	2.20	-4%	>100%

In sum, URCS's inability to account for dramatic shifts in industry-wide dynamics precludes any meaningful comparison of R/VC ratios between 1992 and 2013.

B. The Average R/VC>1.80 Ratio for Commodities Identified by the AF&PA Have Generally Decreased Between 1992 and 2013, and Most Increases Can be Attributed to URCS's Inability to Capture Changes in Railroad Traffic Mix Over the Last Two Decades.

AF&PA's comments, which were supported by a verified statement from Henry Julian Roman of Escalation Consultants, request that the Board revoke the commodity exemptions for forest and paper products ("F&P products") and the boxcar exemption as it applies to rail shipments of those commodities. Mr. Roman identified 177 F&P products at the seven-digit STCC levels, but he focused his analysis on 10 STCCs that he identified using the Board's confidential waybill data as having the highest traffic volumes in 2014 (the "Top Ten"). He calculated the change in the share of F&P products that had R/VC ratios above 1.80 and the change in the average R/VC ratio for such R/VC>1.80 shipments between 1989 and 2014. Mr. Roman's analysis showed that for the Top Ten commodities 1) the average R/VC ratio for

[6] WP "2013 URCS Variable Cost Refinements_HC.xlsx," worksheet "Cover." We re-submit the workpapers supporting our opening Statement on the external hard drive provided with this filing.

R/VC>1.80 shipments of F&P products *decreased* over the last 25 years, from 2.14 in 1989 to 2.12 in 2014; and 2) only 18% of F&P products moved at R/VC ratios above 1.80 in 2014.[7]

With regard to AF&PA's Top Ten commodities, we applied the same refinements to URCS allocations that we described in our opening Statement. Figure FTI-2 below summarizes the results.[8] For four of the ten commodities, there were either no non-boxcar shipments with R/VC ratios above 1.80 in 2013 (2 commodities), or the average R/VC>1.80 decreased from 1992 to 2013 (2 commodities).[9] For three of the remaining six commodities, the entire increase in the R/VC ratio over the period can be attributed to URCS's inability to account for shifts in railroad traffic mix and other changes that have occurred since 1992.[10] Figure FTI-2 also shows that for the other 167 F&P products included in AF&PA's analyses, the average R/VC>1.80 *decreased* from 2.22 in 1992 to 2.12 in 2013; refinements to the 2013 URCS variable costs only widen this decrease, resulting in an average R/VC ratio of 1.98 overall. For the 177 AF&PA commodities in aggregate, the average R/VC>1.80 decreased from 2.13 in 1992 to 2.10 in

[7] *See* AF&PA Comments at 19, Roman Appendices C and D.

[8] This Figure summarizes the results of the analysis of shipments of exempt commodities that moved in non-exempt equipment, *i.e.*, the Figure excludes shipments in boxcars and intermodal equipment. This is consistent with the Board's treatment of such shipments for the analyses supporting its NPRM. *See* STB WP "EP 704-1 STB Public Workpaper.xlsx" ("Note: All of these tables are based on totals without any traffic exempt for intermodal or car type reasons.")

[9] In order to comply with the Three-FSAC aggregation requirement for disclosing information from the confidential waybill sample, Figure FTI-2 presents the results in total for the Top Ten commodities. The detailed calculations and results by individual commodity can be found in our workpapers. *See* WP "2013 URCS Variable Cost Refinements_Reply_HC.xlsx," tabs "Cover" and "Results_AFPA."

[10] The term ">100%" indicates cases where incorporating certain URCS refinements results in a decrease in the R/VC ratio from 1992 to 2013.

2013,[11] and further falls to 1.98 for 2013 after incorporating the URCS refinements presented in our opening Statement.

Figure FTI-2
Average R/VC>180%, 2013 AF&PA Commodities
Carload Traffic Excluding Boxcars[12]

AF&PA STCC	2013 R/VC (System-Average URCS)	% Change from 1992	2013 R/VC (Refined Estimate)	% Change from 1992	% of Increase Explained by Refinements
Top Ten	2.09	2%	1.98	-4%	>100%
Other 167	2.12	-4%	1.98	-11%	No Increase
All F&P Products	2.10	-1%	1.98	-7%	No Increase

In an attempt to support its request to revoke the exemption for traffic moving in boxcar equipment, AF&PA observes that four of its Top Ten commodities move predominantly in boxcars, potentially creating the impression that most boxcar shipments are moving at R/VC ratios above 1.80.[13] Such is not the case. Figure FTI-3 below shows that in fact the vast majority of boxcar shipments for these four commodities – more than 75% for each – have R/VC ratios below 1.80.

[11] We note that AF&PA's analysis relies upon 1989 and 2014 results, which differs slightly from the 1992-2013 period analyzed by the Board and by us. Notwithstanding the different vintages, the average R/VC>1.80 ratios for the F&P products across either two+ decade period are flat, as Mr. Roman also calculated a slight decrease overall, from 214% in 1989 to 212% in 2014. *See* AF&PA Comments at 19.

[12] WP "2013 URCS Variable Cost Refinements_Reply_HC.xlsx," worksheet "Cover."

[13] *See* AF&PA Comments at 24.

Figure FTI-3
2014 Carloads for AF&PA's Highlighted Boxcar Commodities
By R/VC 1.80 Group[14]

STCC	R/VC>=1.80	R/VC<1.80	Total	% R/VC<1.80
2631117	54,532	221,848	276,380	80%
2432158	7,640	23,040	30,680	75%
4024115	3,200	28,828	32,028	90%
2499610	3,400	11,840	15,240	78%
Total	**68,772**	**285,556**	**354,328**	**81%**

C. Other Shipper Comments

1. Mr. Heller Miscalculates the Average R/VC>1.80 Ratio for 2014 for the Three Commodities He Analyzed for the Steel Manufacturers Association and American Iron and Steel Institute.

In support of the SMA/AISI comments, James N. Heller of Hellerworx conducted an analysis of the Board's Carload Waybill Sample for three of the NPRM commodities (40211 Iron or Steel Scrap, 3312 Primary Iron or Steel Products, and 29914 Coke from Coal). [15] For each commodity for each year, Mr. Heller calculated two measures – the average R/VC ratio and the proportion of traffic with R/VC ratios above 1.80 – and asserted that these results verify the 1992 to 2013 results that the Board calculated. Mr. Heller also calculated each commodity's average R/VC>1.80 ratio for 2014.[16]

In performing the average R/VC>1.80 calculations for SMA/AISI, Mr. Heller breaks from the standard Board approach. Rather than divide the total revenues for shipments with

[14] WP "2014 AF&PA Boxcar Commodity Analysis_HC.xlsx." We note slight differences between the totals that we generated from the Board's Carload Waybill Sample and those found in AF&PA's workpaper.

[15] *See* Comments of the Steel Manufacturers Association and American Iron and Steel Institute, at 16-20.

[16] *See* SMA/AISI Comments at 20.

R/VC ratios above 1.80 by the corresponding URCS variable costs assigned to those shipments, Mr. Heller calculated a simple average of the R/VC ratios across individual records in the Carload Waybill Sample. In other words, he determined the R/VC ratio for each record, and then calculated the simple average of those ratios. His use of the simple average is at odds with the approach that is employed by the Board when it determines R/VC>1.80,[17] and also with the approach that he used to calculate the average R/VC ratios for the 1992-2013 period.[18] Figure FTI-4 below summarizes the impact of calculating the R/VC>1.80 ratios under each approach, illustrating that Mr. Heller's SMA/AISI figures overstate the results generated by the standard Board approach.

Figure FTI-4
Average R/VC>180%, 2014 SMA/AISI Commodities

Commodity	Heller Simple Average	STB Approach
3312 Primary Iron or Steel Products	245%	230%
40211 Iron or Steel Scrap	244%	234%
29914 Coke from Coal	297%	253%

2. The Rail Customer Coalition's Comments Rely on an Analysis that Is Based on Estimated Revenues and Costs for All Commodities and Does Not Provide a Meaningful Basis for Evaluating the Specific Commodities for which Shippers have Requested that the Board Revoke the Exemption.

The RCC submitted comments supporting the Board's proposal to revoke exemptions for certain commodity groups. The comments contain an analysis that relies on the Board's 2005

[17] *See*, *e.g.*, the Board's February 26, 2016 decision in Ex Parte 689 (Sub-No. 7) at 2 ("The R/VC>180 benchmark is calculated using the Board's confidential Waybill Sample data by dividing the total revenues earned by the carrier on potentially captive traffic by the carrier's total variable costs for that traffic."); and the Board's annual RSAM calculations ("RSAM Computation_2014_Locked.xlsx")

[18] *See* SMA/AISI Comments at 17-18.

and 2014 Public Use waybill files and estimates of revenues and variable costs.[19] There are three specific reasons that reliance on that analysis is misplaced.

a. The 2014 Public Use Waybill File Includes Masked Revenues that Overstate Actual Industry-Wide Revenues by $17 Billion.

The Public Use waybill file includes the actual shipment revenues for only a subset of the records – those that moved under common carrier or public tariff rates. For shipments that moved under contract or other private rates, the public file reports revenues that have been adjusted, or "masked."[20] Further, it is not possible using the information in the public file to distinguish which category each record falls.[21] The result is that both the R/VC and revenue per carload figures – two key components of RCC's analysis – will be distorted. RCC's analysis attempts to address the masking problem by suggesting that masking impacts non-competitive and competitive shipments in the same manner.[22] Overall, the inclusion of masked revenues in the 2014 Public Use waybill file serve to overstate the industry-wide total by $17 billion, or 22%.[23] While revenue masking will apply to both groups of movements, the impact of

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[19] *See* Comments of the Rail Customer Coalition at 1-2, "Analysis of 2014 Freight Rail Rates for U.S. Shippers" at 8.

[20] The Board's 2014 Carload Waybill Sample Reference Guide states "Railroads are permitted to 'mask' contract revenue with a calculated figure. Because these figures may not represent actual revenue, use of this revenue data in any type of comparison may lead to wrong or misleading results." Reference Guide at 3. https://www.stb.dot.gov/stb/docs/Waybill/2014%20STB%20Waybill%20Reference%20Guide.pdf

[21] Unlike the Public Use waybill file, the confidential waybill file includes a "Calculated Rate Flag" field that distinguishes whether a record's revenues are masked or unmasked.

[22] *See* Analysis of 2014 Freight Rail Rates for U.S. Shippers, Appendix 1, at iii ("To the extent that revenue masking occurs it would apply to the rates for both non-competitive and competitive movements.").

[23] We compared the total revenues reported in the public use waybill file provided on the Board's website ($96 billion) to the total from the unmasked, confidential version of the waybill file provided by the Board under protective order for this proceeding ($79 billion); 96/79 = 1.22. Both files contained records for 37 million carloads. WP "Other Analyses_HC.xlsx," tab "RCC."

significantly overstated revenues is that masking results in 1) mischaracterizing non-competitive as competitive shipments and 2) overstating the calculated revenue difference between non-competitive and competitive shipments – each of which serves to erroneously inflate the results of the RCC's analysis, calling into question any conclusions that are drawn.

b. Since the Public Use Waybill File Does Not Identify Railroads, Let Alone Report Variable Costs, Unspecified Assumptions Were Required to Estimate Variable Costs.

As RCC's analysis relies heavily on R/VC ratios, the variable cost for each shipment is also a critical component in the calculations. The Public Use waybill file does not report any variable-cost information. Indeed, the Public Use waybill file does not even report the identity of the railroad or, in the case of interline shipments, the multiple railroads that participate in each shipment. As a result, assumptions had to be made for which railroads, and therefore which costs, should be applied. Further, while the Public Use file includes some of the relevant shipment parameters that would be input to the URCS costing program, it does not include all of the movement characteristics that are necessary. In addition to the absence of specific railroads, the Public Use file does not identify the actual miles or the Rebill Code (which could be used to identify that a move was handled in interline service) – each of which is a relevant input for calculating URCS variable costs. While it is unclear how the variable costs in RCC's analysis were estimated, it is clear that information contained in the Public Use file does not allow use of the Board's URCS costing program.

c. Even if the Revenues and Costs were Correct, the Analysis of Myriad Other Commodities is Meaningless to the Issues before the Board in This Proceeding.

Notwithstanding the focus of this proceeding on a limited set of specific commodities – namely the five identified by the Board – RCC's analysis covers the wide range of carload shipments reported in the Public Use waybill file. The calculations for broad groups of other commodities offer no relevant insights to the shipment of commodities for which the Board proposes to revoke the exemption.

VERIFICATION

I declare under penalty of perjury that the foregoing is true and correct. I further certify that I am qualified and authorized to sponsor and file this testimony.

Executed on August 26, 2016

Michael R. Baranowski

VERIFICATION

I declare under penalty of perjury that the foregoing is true and correct. I further certify that I am qualified and authorized to sponsor and file this testimony.

Executed on August 26, 2016

Benton V. Fisher

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