

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

**REVIEW OF COMMODITY,
BOXCAR, AND TOFC/COFC
EXEMPTIONS**

)
)
)
)
)
)
)

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

**REPLY COMMENTS OF THE
STEEL MANUFACTURERS ASSOCIATION AND
AMERICAN IRON AND STEEL INSTITUTE**

The Steel Manufacturers Association (“SMA”) and the American Iron and Steel Institute (“AISI”)¹ hereby submit these Reply Comments in support of the Notice of Proposed Rulemaking (“NPRM”) proposing to remove the exemptions for primary iron or steel products (STCC No. 33-12), iron or steel scrap, wastes, or tailings (STCC No. 40-211), and coke produced from coal (STCC No. 29-914) (collectively, the “Steel Commodities”).

I.

SUMMARY

In their Opening Comments, Steel Shippers showed that substantial changes in the competitive and regulatory landscape for transportation shipments that have occurred in the two plus decades since the Board adopted the Steel Commodity exemptions fully warrant revocation of the exemptions. SMA/AISI Comments, at 10-22.

¹ In these Joint Comments, SMA and AISI collectively are sometimes referred to as “Steel Shippers.”

Other steel shippers highly dependent on the railroads also filed opening comments, consistent with those filed by SMA/AISI. The Institute of Scrap Recycling Industries, representing more than 1,300 scrap commodity companies urged the Board to revoke the iron or steel scrap exemption, and AK Steel Corporation, a major steel producer, asked the Board to revoke each of the Steel Commodity exemptions. These stakeholders agree that eliminating barriers to accessing regulatory protection measures, through removing the exemptions for the Steel Commodities, is necessary and fully warranted to carry out the Rail Transportation Policy (“RTP”) at 49 U.S.C. § 10101.

The Association of American Railroads (“AAR”), and some of its individual members, have filed voluminous comments on the NPRM.² While the railroad comments differ slightly, the participating railroads are united in their overall position: the Board should decline to revoke any of the five limited commodity exemptions as proposed, including the Steel Commodity exemptions, because doing so would allegedly result in an unwarranted “blanket re-regulation of the railroad industry.” AAR Comments at 19.

While citing no specific new regulations, regulatory burdens, or pricing limitations that might be associated with removal of the Steel Commodity exemptions, the participating railroads all agree that the Board should bar Steel Shippers from participating as full stakeholders in any current or future agency proceeding as is afforded

² In addition to AAR, opening comments by railroads were filed by Union Pacific Railroad Company (“UP”); BNSF Railway Company (“BNSF”); CSX Transportation, Inc. (“CSXT”); Norfolk Southern Railway Company (“NS”); Kansas City Southern (“KCS”); and the American Short Line and Regional Railroad Association (“ASLRRA”).

to other railroad consumers. The railroads also strongly disagree that the Board’s NPRM proposal to allow Steel Shippers access to the Board’s regulatory oversight and processes, including the ability to obtain common carrier rates service upon reasonable request, the maintenance of reasonable practices and rates, and the provision of adequate service, is necessary or appropriate. Instead, the railroads contend that affording such non-discriminatory regulatory access would be “dangerous,” and produce “an unprecedented and concerning shift toward re-regulation.” AAR Comments at 2.

Steel Shippers urge the STB to reject the railroads’ unjustified requests to block the NPRM’s proposed revocation of the limited Steel Commodity exemptions. As SMA/AISI emphasized in their Opening Comments, revocation will help facilitate the full and fair participation of steel shippers in current and future regulatory proceedings and minimize regulatory burdens on shippers seeking administrative relief – while not increasing regulatory burdens on carriers.

These Reply Comments focus on the principal arguments raised in opposition by the railroad parties, and are supported by the reply analysis of James N. Heller of Hellerworx, as reflected below.

II.

REPLY COMMENTS

A. The Railroads Misconstrue the Revocation Standards and the Rail Transportation Policy

The Board has broad discretion to revoke an exemption under 49 U.S.C. § 10502(d), which provides that “[t]he Board may revoke an exemption, to the extent it

specifies, when it finds that application in whole or in part of a provision of this part to the person, class, or transportation is necessary to carry out the transportation policy of section 10101 of this title.” Under the ICC Termination Act, “the revocation power is a central feature of section 10502.” *Arbitration of Certain Disputes Subject to the Statutory Jurisdiction of the Surface Transportation Board*, 2 S.T.B. 564, 567 (1997).

While acknowledging these revocation standards, the railroads still contend that the Board’s discretion is still quite limited, when read in connection with the deregulation goals of the Staggers Rail Act. In particular, the railroads contend that Congress made a “policy judgment in favor of *de*-regulation of the railroad industry” (AAR Comments at 17) that overrides any countervailing needs of the Steel Shippers to be able to fully participate before the Board and engage in its regulatory processes. However, Congress passed the Staggers Rail Act of 1980 not as a one-sided measure solely to promote the goals of the railroad industry, but also to “provide a regulatory process that balances the needs of carriers, shippers, and the public.” Pub. L. No. 96-448, 94 Stat. 1897.

The railroads assert that two of the Rail Transportation Policy (“RTP”) goals, at 49 U.S.C. §§ 10101(1) (“RTP-1”) and 10101(2) (“RTP-2”), “mandate” continued deregulation of the Steel Shipper commodities, and require denial of the Board’s NPRM. However, that is clearly not what these provisions require, especially when read in connection with the other RTP goals. RTP-1 addresses competition that produces “reasonable rates.” *Id.* (emphasis added). *See also Arizona Pub. Serv. Co. v.*

United States, 742 F.2d 644, 651 (D.C. Cir. 1984) (ineffective competition does not produce “reasonable” rail rates). Competitive rail traffic yields average revenue to variable cost (“R/VC”) ratios “at levels much closer to variable costs.” *Mr. Sprout, Inc. v. U.S.*, 8 F.3d 118, 124 (2nd Cir. 1993).

As shown in the Steel Shippers Comments (at 16-20), average R/VC ratios for each of the Steel Commodities have grown significantly (up to 208.4% for coke from coal, 2014), and the percentage of potentially captive traffic has also grown significantly for the commodities (up to 71% for coke from coal, 2014). In 2014, the average R/VC ratio for potentially captive traffic of the Steel Commodities is 244.9% for primary iron or steel products (STCC No. 33-12); 244% for iron or steel scrap, wastes, or tailings (STCC No. 40-211); and is 296.9% for coke produced from coal (STCC No. 29-914). These rate levels are nowhere near competitive levels, and the “forces of deregulation” are obviously not generally setting rates for many steel shippers anywhere near carrier costs. Additionally, the railroads’ RTP-1 construction also renders superfluous other RTP policies such as the policy calling for the STB “to maintain reasonable rates where there is an absence of effective competition.” 49 U.S.C. §10101(6) (“RTP-6”).

The goal of RTP-2 is “to minimize the need for Federal regulatory control over the rail transportation system and to require fair and expeditious regulatory decisions when regulation is required.” However, regulatory oversight of the Steel Commodities is clearly required. Also, the railroads’ contentions that RTP-2 mandates the implementation and maintenance of one-sided deregulation, at the expense of other RTP

goals, are clearly wrong. Under relevant precedent, “[w]e do not find in Section 10502 a clear expression of congressional intent to create a one-way ratchet, permitting deregulation only, without subsequent adjustment.” *Ass’n of Am. R.Rs. v. STB*, 161 F.3d 58, 63 (D.C. Cir. 1998). As further recognized by the courts:

[i]nherent within the power to create exemptions from the regulatory scheme is the power to limit the scope of those exemptions. We agree that the STB may not create new regulations in the guise of deregulation. However, it may, consistent with Section 10502, amend its original scheme of deregulation if it finds that the transportation policies so require. *See, e.g., Illinois Commerce Commission v. ICC*, 787 F.2d 616, 632–33 (D.C. Cir. 1986) (discussing with approval reconsidering and then restricting the scope of an initial grant of eligibility for exemption).

Id.

Additionally, the railroads ignore the fact that the Board has already taken actions to remove many of the last vestiges of “regulatory control” over railroads, and any regulatory burdens which were once a central basis for the Steel Commodity exemptions have been removed. SMA/AISI Comments, at 10-13. As SMA/AISI set forth at length in their Comments, following the ICC Termination Act, and subsequent agency implementing decisions, there are no longer agency tariff filing requirements, contract filing requirements, or contract summary filing requirements potentially inhibiting carrier ratemaking freedoms. *Id.* Nor are there any investigation or suspension remedies available to potentially hinder carrier ratemaking freedoms. *Id.* Instead, railroads have full flexibility today to provide expeditious rates and service terms to all shippers, whether through tariff or contract, and to expeditiously respond to competition

without any regulatory encumbrances.³ This is confirmed by the myriad forms of “hybrid” pricing authorities developed and utilized by the railroads today for their traffic, including, for example, UP’s unilateral contracts and Circulars (*e.g.*, Circular 111), NS’s “signatureless contracts” (NSSCs), and CSXT’s “private price quotations” (PPQs) – some of which are “regulated” and some of which are not. *See Interpretation of the Term “Contract” in 49 U.S.C. 10709*, (STB Ex Parte No. 669) (STB served Mar. 12, 2008) at 3.

Additionally, as SMA/AISI explained in their Comments (at 10-13), because of these significant changes, the transportation policy findings of the Board in the *Steel Commodity Exemption Decisions*⁴ with respect to elimination of regulatory control and associated filing requirements are clearly no longer valid, and have been rendered moot through Congressional and administrative action⁵:

³ The railroads do not dispute the Board’s NPRM findings (at 12) that “regulation would not impose new reporting requirements directly or indirectly . . . –ICCTA removed regulatory paperwork burdens (with limited exceptions) on rail carriers to file tariffs or contract summary filings for rail shipments, exempt or non-exempt.” *Id.* at 12.

⁴ *See Rail Gen. Exemption Auth. – Exemption of Ferrous Recyclables*, Ex Parte No. 346 (Sub-No. 35), 1995 WL 294272 (ICC served Apr. 28, 1995) (iron or steel scrap, wastes, or tailings) (“*Ferrous Recyclables Exemption*”); *Rail Gen. Exemption Auth. – Pet. of AAR to Exempt Rail Transp. of Selected Commodity Groups*, 9 I.C.C.2d 969, 987 (1993) (coke produced from coal, primary iron or steel products) (“*Coke & Iron & Steel Prods. Exemption*”); *Rail Gen. Exemption Auth. – Misc. Manufactured Commodities*, 6 I.C.C.2d 186, 206 (1989) (primary iron or steel products). (Collectively “*Steel Commodity Exemption Decisions*”).

⁵ It is for this reason, in principal part, the Board has refused to grant any new exemptions in recent years. *See Rail Gen. Exemption Auth. – Exemption of Paints, Enamels, Lacquers, Shellacs, Etc.*, STB Ex Parte No. 346 (Sub-No. 33) (STB served Apr. 20, 1998) at 6 (“[T]he chief burden imposed by regulation was the requirement that

- Regulatory exemption is no longer necessary to “allow[] rail carriers to earn adequate revenues” by improving the speed and flexibility with which they can respond to competition or quote rates as the market may require (49 U.S.C. § 10101(3));
- Regulatory exemption is no longer necessary “to encourage honest and efficient management of railroads” (49 U.S.C. § 10101(9)) by enabling rail management to respond more quickly to changing market conditions, and by reducing the administrative costs associated with the filing of tariffs and contract summaries; and
- Regulatory exemption is no longer necessary to help enable the railroads to attract traffic from motor carriers, in order “to encourage and promote energy conservation” (49 U.S.C. § 10101(14)).

B. The Railroads’ URCS and R/VC Criticisms Are Unjustified

In their Comments, Steel Shippers described at length the change in market conditions since the enactment of the Steel Commodity exemptions and the lack of effective competition for many shipments supporting revocation of the exemption for the Steel Commodities. SMA/AISI Comments at 13-20. As discussed above, among other things, Steel Shippers showed that shipping rates have increased significantly, as verified by the Steel Shippers’ independent analysis. *Id.* R/VC ratios for the Steel Commodities have increased by up to 99% between 1988 to 2014, with average R/VC ratios now between 165% and 208% (2014). *Id.* Between 44% and 71% of each of the commodities are now potentially captive (2014), and those numbers have been increasing. *Id.* In 2014, the average R/VC ratio for potentially captive traffic of the Steel Commodities is

tariffs be filed. With that requirement eliminated, the principal obligation imposed on the railroads has been removed. . . . [E]specially since the removal of regulation of rail transportation of [the commodity] appears to offer small benefit to rail carriers’ post-ICCTA, we will not exempt the rail carriage of [the commodity] from regulation under the ICCTA at this time.”).

244.9% for primary iron or steel products (STCC No. 33-12), 244% for iron or steel scrap, wastes, or tailings (STCC No. 40-211), and is 296.9% for coke produced from coal (STCC No. 29-914).

In their comments, the railroads assert that any reliance on R/VC as the basis for revocation is arbitrary because R/VC ratios based on the Board's Uniform Rail Costing System ("URCS") are not a reliable indicator of market power. AAR Comments at 22-39; UP Comments at 11-13; BNSF Comments at 2-15; NS Comments at 30-32. However, the railroads R/VC ratio contentions are wrong and in direct contradiction of their use of such factors when petitioning for the exemptions, and the Board's reliance on such metrics when granting the exemptions, including the Steel Commodity exemptions.

The railroads' witnesses rigidly assert that "R/VC is a flawed indicator of market power as a matter of economic theory and empirical evidence" and that "reliance on R/VC to determine market power will lead to flawed conclusions." AAR Comments, *Israel/Orszag V.S.*, at 9-10. *See also* UP Comments, *Murphy V.S.* at 7, 11 ("R/VC ratios are not reliable indicia of whether rates are constrained by competition" and "[r]eliance on such a flawed measure of cost leads to unreliable conclusions"). However, when seeking the Steel Commodity exemptions, the testifying economist for the railroads relied on the very same R/VC ratios, derived from URCS, as crucial evidence to establish the lack of railroad market power:

Intermodal and intramodal competition for shipment of ferrous recyclables is also reflected in rail rates. . . . The 1991 Waybill was costed by the Commission using the Uniform Rail Costing System, with multiple car and make whole

adjustments. *With an overall R/VC of 139.4% for 1991, ferrous recyclable rates are far below the Commission's jurisdictional threshold of 180%, indicating that market forces are working to keep rates low.*

AAR Petition to Exempt from Regulation the Rail Transportation of Ferrous Recyclables, Verified Statement of Paul S. Posey, at 4, ICC Ex Parte No. 346 (Sub-No. 35) (filed Apr. 25, 1994) (emphasis added). The ICC relied on these same R/VC ratios in assessing and finding market power in its decision granting the exemption:

If a railroad were to raise its rates to one shipper, either the shipper could send the recyclables to another market, or the receiver could secure its supply from another shipper, or both situations could occur. In any case, the railroad would be deprived of all of the revenue from those shipments. *The evidence suggests that these competitive market forces act effectively to keep rail rates for these commodity groups at competitive levels, i.e., at average revenue-to-variable cost (R/VC) ratios far below 180.0%, the threshold for the Commission's regulatory jurisdiction.*

....

Witness Posey provides 1991 Waybill data showing that . . . this traffic moved at R/VC ratios of 139.5% for iron and steel scrap

....

“[T]he iron and steel scrap traffic R/VC ratios of 139.5% for 1991 and 138.6% for 1992 are both more than 40 percentage points less than the Commission's jurisdictional threshold level. With the average R/VC ratios for all iron and steel scrap shipments being well below the 180.0% threshold level, it is not unreasonable to assume that the majority of the individual carload R/VC ratios are below this threshold.

Ferrous Recyclables Exemption, 1995 WL 294272, at *3-*4 (emphasis added).

The railroads' dramatic change in position on the reliability of R/VC ratios to determine market power for the Steel Commodities is unaddressed and unexplained. However, their reversal can seemingly lead to only two logical results. First, if the Board finds that railroads are now right on the subject of R/VC ratios, then their economists' prior reliance on these ratios to establish the lack of market power used to support the railroads' petitions for the Steel Commodity exemptions is no longer valid on the grounds that such ratios are "a flawed indicator of market power as a matter of economic theory and empirical evidence." Also, the ICC's findings and basis for the *Steel Commodity Exemption Decisions*, relying on the same "flawed" R/VC ratios, are clearly invalid and unsupportable. Therefore, the *Steel Commodity Exemption Decisions* should be overturned, and declared void *ab initio*, because they are based upon what the railroads now admit are "unreliable conclusions" and misleading information.⁶

This issue is especially important, because, in its *Steel Commodity Exemption Decisions*, the ICC relied on aggregated data and market share analyses – not customer or movement specific findings – to support its exemption decisions. For example, in its *Coke & Iron & Steel Prods. Exemption* decision, the ICC relied, *inter alia*,

⁶ Under 49 U.S.C. § 10502(d), an exemption may be revoked when revocation is necessary to ensure the integrity of the Board's processes. *See, e.g., SF&L Ry., Inc. – Acquisition and Operation Exemption – Toledo, Peoria & W. Ry. Co. Line Between Rochester and Argos, IN*, STB Finance Docket No. 32162 (STB served Jan. 30, 1998). Additionally, the exemption is treated as void *ab initio* if it contains false or misleading information. *See, e.g., The St. Louis Sw. Ry. Co. – Abandonment Exemption – in Gasconade, Maries, Osage, Miller, Cole, Morgan, Benton, Pettis, Henry, Johnson, Cass, and Jackson Counties, MO*, ICC Docket No. AB-39 (Sub-No. 18X) (ICC served Apr. 1, 1994).

on generalized, “broad market share data” (9 I.C.C. 2d at 979); general railroad witness testimony that “these commodities generally move between locations served by more than one railroad” (*id.* at 980); and testimony that many of these commodity movements were covered by contracts and the “exemption would ‘reduce the administrative burden associated with tariff and contract filing’” (*id.*). If crucial components of the *Steel Commodity Exemption Decisions* are no longer valid as the railroads now strongly suggest, then the decisions should no longer be allowed to stand.

Second, in the more likely scenario that the railroads are incorrect on the subject of R/VC ratios evidencing market power, then revocation of the Steel Commodities exemption is clearly justified as evidenced by the high R/VC ratios and other evidence presented by the Steel Shippers providing a compelling basis for the NPRM. *See* SMA/AISI Comments at 13-22.

The railroads’ new R/VC ratio arguments are clearly misguided. For example, in order to determine variable costs associated with providing a service, Congress has directed the agency to use R/VC ratios based on URCS. *See* 49 U.S.C. § 10707(d)(1)(B) (“Variable costs for a rail carrier shall be determined only by using such carrier’s unadjusted costs, calculated using the Uniform Rail Costing System cost finding methodology”). R/VC ratios are used in determining railroad market dominance in rate cases on the issue of whether the “rate charged results in a revenue-variable cost percentage for such transportation that is less than 180 percent.” 49 U.S.C. §

10707(d)(1)(A). R/VC ratios are also used to establish maximum reasonable rates, including rates set at the Board’s jurisdictional threshold level or at stand alone costs.⁷

As the Board has stated, “for regulatory purposes, including rate reasonableness cases, costs are determined by URCS.” *Total Petrochemicals & Refining USA, Inc. v. CSX Transp., Inc.*, STB Docket No. NOR 42121 (STB served Dec. 23, 2010) at 3 (“*Total Petrochemicals*”). The Board and the courts have also found that URCS is a valid and reliable measure of railroad market power over a particular commodity. *Rate Guidelines – Non-Coal Proceedings*, 1 S.T.B. 1004, 1024 (1996) (“URCS is an accepted measure of movement profitability and revenue contribution for the rail industry”); *Mr. Sprout, Inc.*, 8 F.3d at 124 (use of R/VC ratios is “a valid and reliable measure of market power in the rail industry”). In fact, the railroads themselves have long favored using URCS over use of actual railroad costs (internal railroad costs) in regulatory proceedings. The railroads have strongly resisted shipper requests seeking to obtain actual internal railroad costing data in regulatory proceedings, contending that such data is irrelevant and unnecessary because of the preferred availability and use of URCS for all pertinent regulatory costing purposes, and insisting that URCS produces accurate and fair results.⁸

⁷ See, e.g., *Arizona Elec. Power Coop., Inc. v. BNSF Ry. Co. and Union Pac. R.R. Co.*, STB Docket No. NOR 42113 (STB served Aug. 19, 2016) at 3 (“[t]he parties are directed to use the 2014 URCS to calculate the rate prescription for 2014” at the jurisdictional threshold level); *W. Fuels Ass’n v. BNSF Ry.*, STB Docket No. NOR 42088 (STB served Feb. 18, 2009) at 30 (maximum reasonable rates prescribed at stand alone costs, with overcharges determined using a methodology based on the defendant’s variable costs, using URCS).

⁸ See, e.g., *Total Petrochemicals*, (STB served Dec. 23, 2010) at 3 (denying shipper request for railroad internal costing information on grounds that “[t]here is no irreparable

Additionally, as discussed above, the railroads' commodity and traffic exemption petitions, and the ICC's decisions granting the exemptions, have relied on R/VC ratios, based on URCS, in determining lack of market power. *See, e.g., Ferrous Recyclables Exemption*, 1995 WL 294272, at *3-*4 (STB relies on average R/VC ratios provided by railroads in finding a lack of market power); *Rail Exemption Authority—Nonferrous Recyclables*, STB Ex Parte No. 561 (STB served Apr. 21, 1998) (same); *Rail General Exemption—Exemption of Rock Salt, Salt*, 10 I.C.C.2d 241 (1994) (same); *Rail General Exemption Authority—Exemption of Grease or Inedible Tallow*, ICC Ex Parte No. 346 (Sub-No. 31) (ICC served Dec. 9, 1994) (same); *Rail General Authority—Exemption of Hydraulic Cement*, ICC Ex Parte No. 346 (Sub-No. 34) (ICC served Oct. 21, 1993) (same); *Rail General Exemption Authority—Exemption of Carbon Dioxide*, ICC Ex Parte No. 346 (Sub-No. 32) (ICC served Nov. 18, 1994) (same); *Rail Exemption Authority—Lumber or Wood Products*, 7 I.C.C.2d 673 (1991) (same); *Exemption from Regulation—Boxcar Traffic*, 367 I.C.C. 425 (1983) (same).

The railroads must provide a reasoned basis for the Board to depart from the use of URCS in this proceeding, and they have not provided any such basis. In addition, the railroads' attacks on URCS in this proceeding are misdirected and are a

harm or undue prejudice given that [complainant] may use URCS, just as the Board does, for any costing determinations in this proceeding"); *see also* CSX Transportation, Inc.'s Reply in Opposition to Motion to Compel of Total Petrochemicals USA, Inc., STB Docket No. NOR 42121 (filed Nov. 16, 2010) at 10 ("the appropriate measure of railroad costs is not costs derived from an internal management costing system, but rather URCS system average costs").

collateral attack on the directives of Congress requiring the use of URCS (*see* 49 U.S.C. § 10707(d)(1)(B)) and/or the Board’s pertinent proceedings that have, and are continuing to directly consider railroad costing matters. *See Review of the General Purpose Costing System*, STB Docket No. EP 431 (Sub-No. 4). Any railroad complaints about use or components of URCS should be directed to Congress or to the pertinent, pending regulatory costing proceedings.

C. Additional Metrics, Including those Favored By the Railroads, Support Revocation of the Steel Commodity Exemptions

The railroads argue that R/VC ratios do not establish any presumption of railroad market dominance, pointing to the Board’s rate case “quantitative” market dominance provisions at 49 U.S.C. § 10707(c). However, Steel Shippers do not contend that R/VC ratios for the Steel Commodities would establish market dominance in a rate reasonableness case, which requires both a quantitative and qualitative finding of “an absence of effective competition from other rail carriers or modes of transportation for the transportation to which a rate applies.” 49 U.S.C. § 10707(a). Instead, the Steel Shippers’ analysis shows that the R/VC ratios are a strong and compelling indicator that much of the Steel Commodity traffic is fully subject to captive pricing, rates have been increasing significantly in recent years, and far above costs – reflecting the lack of effective competition for many steel shippers.⁹

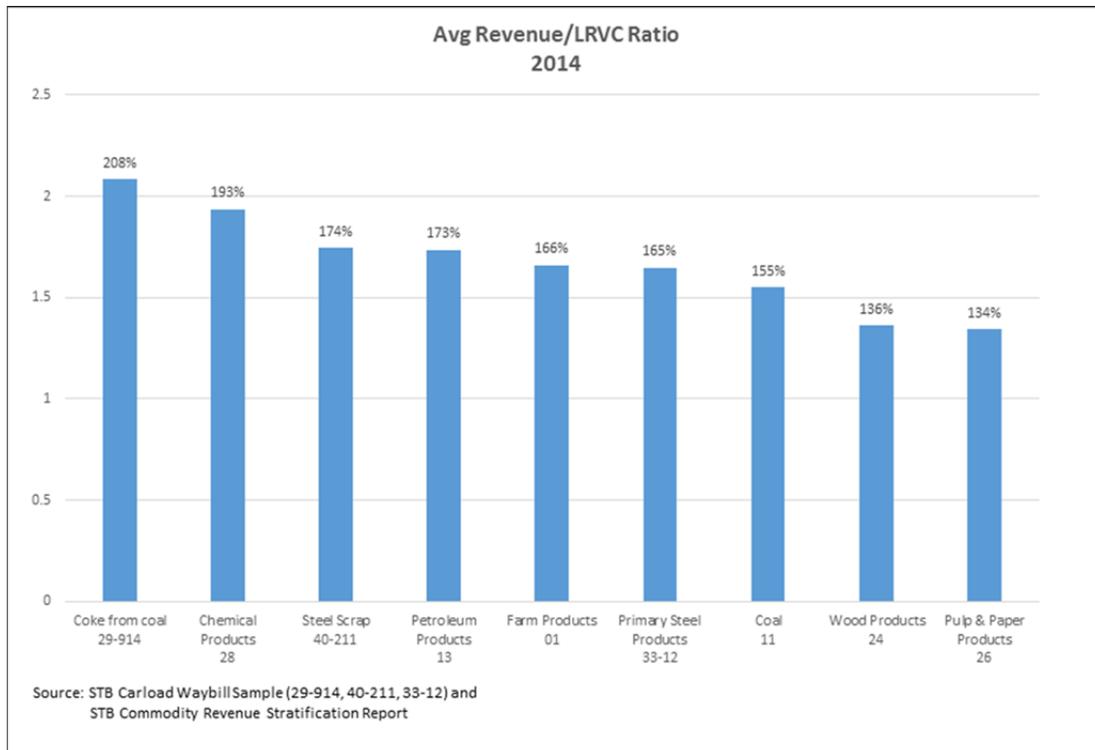
⁹The railroads’ *market dominance* objections notwithstanding, the Board has found that presumptions on market power may be derived from R/VC ratios, and that “[h]ad Congress wished to prevent the establishment of any and all potential R/VC-based

Competitive traffic is shown to produce average R/VC ratios “at levels much closer to variable costs.” *Mr. Sprout*, 8 F.3d at 124. Conversely, traffic subject to railroad market power produces R/VC ratios at levels moving away from variable costs as SMA/AISI have shown for the Steel Commodities. For example, in the Board’s most recent exemption revocation decision, the Board refused to grant a new commodity exemption for certain paint products, finding railroad market power where the R/VC ratios were in the 160% R/VC range.¹⁰ These R/VC levels are below those of the Steel Commodities, with the R/VC ratios for the Steel Commodities producing ratios that far exceed variable costs, reflecting substantial railroad market power.

Mr. James N. Heller of Hellerworx, has undertaken for SMA/AISI a review of the average R/VC ratios for the three Steel Commodities against other commodities. As reflected in the below analysis, the R/VC ratios for each of the Steel Commodities is very close to or exceeds the levels of other regulated traffic such as coal and farm products, and it remains substantially above the levels of other exempted commodities, such as wood products and pulp & paper products:

presumptions . . . it could have done so easily and clearly.” *Total Petrochemicals*, (STB served May 31, 2013, updated Aug. 19, 2013) at 21 n.69.

¹⁰ See *Rail Gen. Exemption Auth. – Exemption of Paints, Enamels, Lacquers, Shellacs, Etc.*, STB Ex Parte No. 346 (Sub-No. 33), (STB served Apr. 20, 1998), 1998 WL 181664, at *3 (Board finds average R/VC ratios of 163% and determines that, based on the R/VC ratios “the record therefore shows that a significant segment of paint traffic moves at a ratio of price to cost that suggests that the railroads possess sufficient market power to justify continuing to provide shippers with recourse to challenge the rates charged for the transport of this traffic”).



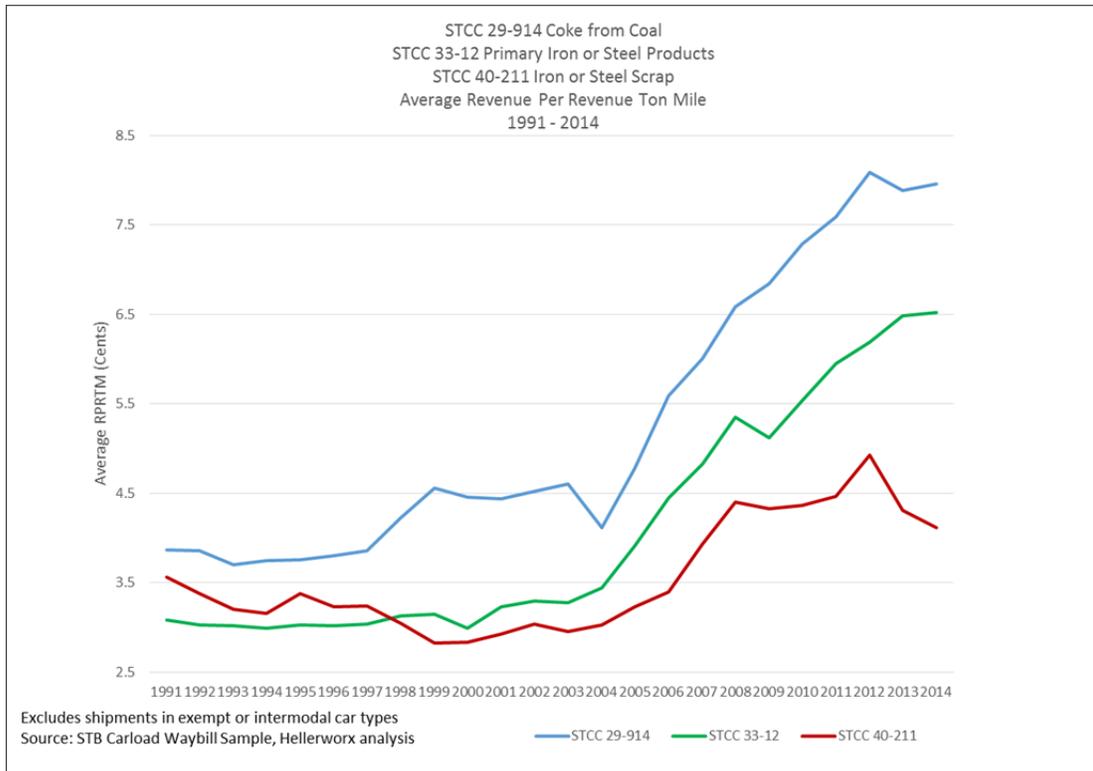
1. Revenue Per Ton Mile Analysis

Besides R/VC ratios, one other indicator of market power relied on by the railroads in seeking the Steel Commodity exemptions was average rail revenue per ton mile (“RPTM”) data.¹¹ The Board relied on this data reflecting very low increases in RPTM over a multi-year period, measured against the Rail Cost Adjustment Factor, as evidence of “pricing [] consistent with the existence of competition.” *Coke & Iron & Steel Prods. Exemption*, 9 I.C.C.2d at 978. The AAR has recently asserted that “[r]ail revenue per ton-mile . . . is a useful surrogate for rail rates,” and that it is also useful to

¹¹ See AAR Petition to Exempt from Regulation the Rail Transportation of Ferrous Recyclables, Ex Parte No. 341 (filed Apr. 25, 1994) at 12 (“The cumulative effect of this competition on railroad rates is reflected in a decrease in railroads’ revenue per ton-mile for these commodities between 1981 and 1991. V.S. Posey. These rate patterns are clear evidence that railroads do not have a dominant market share; to the contrary, they show that the rail share, and therefore rail market power, is modest indeed.”).

measure RPTM against the RCAF, because “increases in rail rates over the years have closely tracked increases in the costs of inputs to rail operations.” AAR Comments, *Rail Transportation of Grain, Rate Regulation Review*, STB Ex Parte No. 665 (Sub-No. 1) (filed June 26, 2014) at 12.

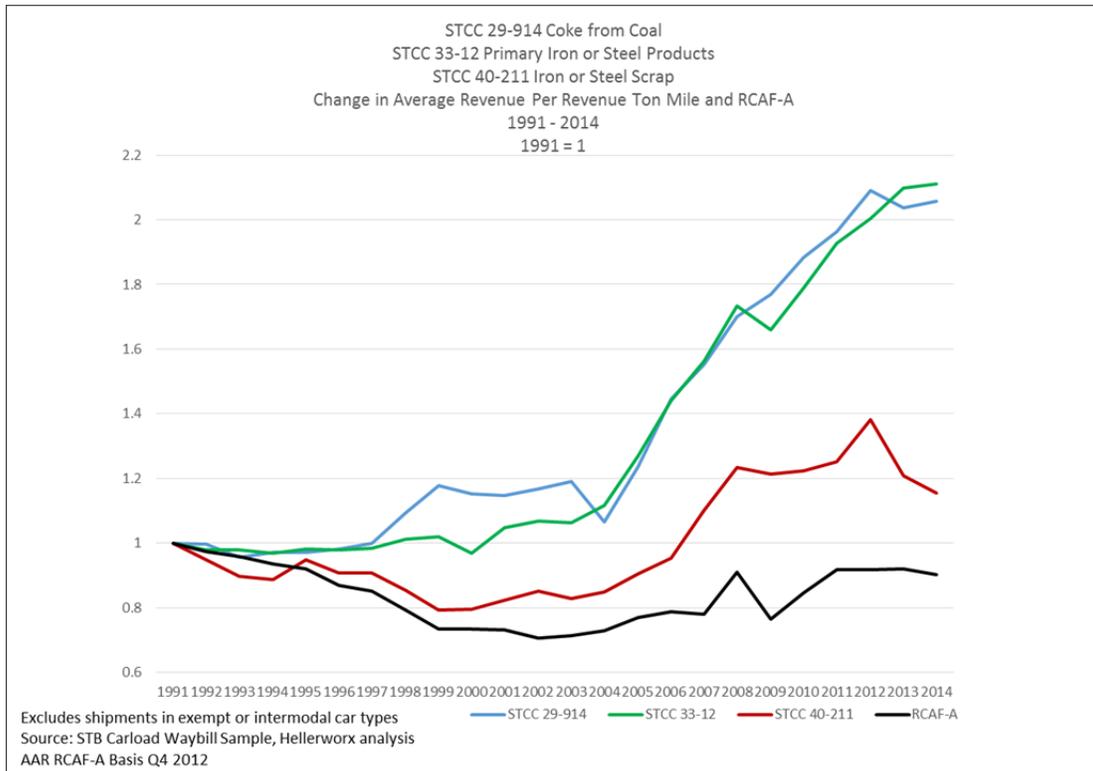
Using the Board’s Carload Waybill Sample data, Mr. Heller has undertaken an additional RPTM analysis for each of the Steel Commodities. Mr. Heller’s analysis for each of the commodities from 1992 to the present, are reflected below:



Mr. Heller’s analysis further supports the prior R/VC analysis results, reflecting significant increases in Steel Commodity rates. Additionally, as discussed in SMA/AISI’s Comments (at 15-16), the average length of haul by rail for each of these commodities has grown appreciably from 1992 to 2014 (for iron and steel scrap, from

300 miles to 419 miles, for primary iron or steel products, from 639 miles to 700 miles, and for coke produced from coal, from 369 miles to 380 miles). Other things being equal, an increase in ton miles should result in a decline in the RPTM, but that obviously is not the case for the Steel Commodities.

Mr. Heller has also undertaken to measure the RPTM increases over the same period against the RCAF, adjusted for railroad productivity, as reflected in the following chart:



As shown above, rail rates measured on a RPTM basis have risen appreciably above rail costs for the Steel Commodities, further reflecting the railroads growing market power.

D. The Railroads' Alternative "Case-by-Case" Revocation Proposal is an Inadequate Substitute for Revocation of the Steel Commodity Exemptions

The railroads contend that the Board should leave in place the existing "case-by-case" evaluation of exemption revocation as a more reasonable and limited option to full revocation. However, as evidenced by the railroads' voluminous filings in this proceeding on complex theories of antitrust law and esoteric indirect forms of competition, consideration of revocation on a case-by-case basis would be costly, burdensome, time-consuming, and significantly impede the efficient processing of cases.¹² It also would clearly deter shippers from availing themselves of the Board's regulatory processes. As the Board has found, "[a] railroad need not be able to prevail on its . . . competition arguments for the costs of litigating those issues – in terms of time, money, and other resources – to act as a barrier to rate complaints."¹³

As the Transportation Research Board has further found: "[t]he standards and procedures used by the ICC and STB for ruling on the reasonableness of challenged rates have proved to be slow, costly, and inappropriate to many shippers' circumstances over three decades. Thus, they prevent shippers from having equal and effective access to the law's maximum rate protections. Efforts to streamline and expedite the process . . .

¹² See, e.g., *Market Dominance Determinations – Product and Geographic Competition*, STB Ex Parte No. 627 (STB served July 2, 1999) at 6 ("AAR's claim that the burdens associated with consideration of product and geographic competition have not been excessive stands in sharp contrast to our own experience as well as the overwhelming evidence and argument submitted by the shipping community") (footnote omitted).

¹³ *Id.* at 8.

have not overcome these deficiencies and in some respects have made matters worse.”

Transp. Research Bd., Special Report 318, *Modernizing Freight Rail Regulation* (2015) (“TRB Report”), at 6-7, <http://onlinepubs.trb.org/onlinepubs/sr/sr318.pdf>. (“TRB Report”)¹⁴

The railroads insistence on pursuing complex, antitrust-style evidentiary proceedings at the outset of a proceeding on revocation does not comport with Congress’ intent that the Board “provide for the expeditious handling and resolution of all proceedings required or permitted to be brought under this part” (49 U.S.C. § 10101(15)) and “to maintain reasonable rates where there is an absence of effective competition” (*Id.*, §10101(6)). Moreover, the common carrier obligation to provide “transportation or service on reasonable request” (49 U.S.C. § 11101(a)), does not apply to exempt commodities.¹⁵ A Steel Commodity shipper should not have to bring a full-blown revocation case just to obtain a common carrier rate, or to receive service under that rate.

As Steel Shippers referenced in their Comments, fundamental fairness and the public interest also necessitates that the railroads maintain reasonable practices and

¹⁴ See also United States Government Accountability Office, *Freight Railroads: Industry Health Has Improved, But Concerns About Competition and Capacity Should Be Addressed*, GAO-07-94 (Oct. 2006) at 41, <http://www.gao.gov/assets/260/252473.pdf> (“Despite STB’s efforts, there is widespread agreement that STB’s standard rate relief process is inaccessible to most shippers and does not provide for expeditious handling and resolution of complaints. The process remains expensive, time consuming, and complex.”).

¹⁵ See *Pejepscot Indus. Park, Inc. d/b/a Grimmel Indus. – Petition for Declaratory Order*, STB Finance Docket No. 33989 (STB served May 15, 2003) at 6 n.13; *accord Rail Transp. of Contracts Under 49 U.S.C. 10709*, STB Ex Parte No. 676 (STB served Jan. 22, 2010) at 4.

rates, and that they provide adequate rail service for Steel Commodity shippers,¹⁶ especially given the fact that the Steel Shippers are facing railroad rates that meet or exceed many other “regulated” commodities, as shown above. Notions of fairness and non-discriminatory treatment require that Steel Commodity shippers be able to participate as full stakeholders in any current or future agency proceeding, without having to bring a full-blown revocation action.

Further, exemption removal as proposed by the Board will not equate to actual new massive regulation as the railroads contend, and instead, would actually streamline and minimize regulatory burdens on shippers seeking administrative relief. Additionally, any claim that exemption removal will increase regulatory burdens on carriers is without merit. Exemption revocation would not overturn ICCTA and force railroads to once again file tariff or contract summaries with the Agency, remove carrier rate-setting prerogatives, subject railroads to renewed rate suspension and investigation activities, or otherwise engage in any new agency reporting requirements.

Finally, in making a revocation determination, “a significant consideration is whether the participating shippers actually seeking transportation are concerned about an abuse of market power.” *Coke & Iron & Steel Prods. Exemption*, 9 I.C.C.2d at 973. Here, in addition to the members of SMA, comprising over 75 percent of domestic steelmaking capacity and constituting the nation’s largest recyclers, and the members of

¹⁶ See, e.g., TRB Report at 6 (“many shippers have not been able to avail themselves of the rate relief process. The result has been large and prolonged inequalities in shipper access to the law’s maximum rate protections.”).

AISI, accounting for approximately 70 percent of U.S. steelmaking capacity, Steel Commodity exemption revocation is supported by the Institute of Scrap Recycling Industries, representing more than 1,300 scrap commodity companies, and by AK Steel Corporation, a major steel producer. The support of these shippers further demonstrates that there is a strong need and compelling basis for the Board's proposed revocation of the exemption for the Steel Commodities at this time.

III.

CONCLUSION

For the reasons set forth above, and in their Opening Comments, SMA/AISI respectfully submit that the Board should adopt its NPRM proposal to removal of each of the Steel Commodity exemptions, which is well justified and supported.

Respectfully submitted,

/s/

Peter A. Pfohl

Dan M. Jaffe

Katherine Waring

Bradford J. Kelley

Slover & Loftus LLP

1224 Seventeenth Street, N.W.

Washington, D.C. 20036

(202) 347-7170

Attorneys for

Steel Manufacturers Association

American Iron and Steel Institute

Dated: August 26, 2016

VERIFICATION

I am James N. Heller, founder and president of Hellerworx, Inc., with offices at 4803 Falstone Avenue, Chevy Chase, Maryland, 20815. Hellerworx provides strategic and economic consulting services to shippers, receivers, and transportation companies. I have prepared the analysis contained in the Opening and Reply Evidence of the Steel Manufacturers Association and American Iron and Steel Institute in STB Docket No. EP 704 (Sub-No. 1) where I am identified as having performed the analysis.

I verify under penalty of perjury that I have read the specific portions of the Opening and Reply Evidence of the Steel Manufacturers Association and American Iron and Steel Institute in this proceeding that I have prepared, as described in the foregoing paragraph, that I know the contents thereof, and that the same are true and correct. Further, I certify that I am qualified and authorized to file this statement.



James N. Heller

Executed on: August 24, 2016