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

Re: STB Docket No. EP 665 (Sub-No. 1), *Rail Transportation of Grain, Rate Regulation Review*

Dear Ms. Brown:

Pursuant to the notice served in this proceeding on December 12, 2013 and subsequent decisions served on February 10, 2014 and April 18, 2014, attached please find the comments of the Association of American Railroads.

Respectfully submitted,

Timothy J. Strafford  
Counsel for the Association of  
American Railroads

BEFORE THE  
SURFACE TRANSPORTATION BOARD

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STB Ex Parte No. 665 (Sub-No. 1)

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RAIL TRANSPORTATION OF GRAIN,  
RATE REGULATION REVIEW

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COMMENTS OF THE  
ASSOCIATION OF AMERICAN RAILROADS

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June 26, 2014

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SURFACE TRANSPORTATION BOARD

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COMMENTS OF THE  
ASSOCIATION OF AMERICAN RAILROADS

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The Association of American Railroads (“AAR”) submits these comments in response to the Surface Transportation Board’s (“Board”) notice served on December 12, 2013 seeking input on the Board’s rate reasonableness complaint procedures related to the transportation of grain by rail. The freight railroad members of the AAR account for the vast majority of North American freight railroad traffic (including grain), mileage, employees, and revenue. As such, the AAR has a strong interest in ensuring that the Board’s rate reasonableness processes for all commodities are grounded in sound economics and allow, “to the maximum extent possible, competition and the demand for services establish reasonable rates for transportation by rail.” 49 U.S.C. § 10101(1).

Freight railroads operating in the United States move more freight, more efficiently, and at lower rates than any other freight rail system in the world. They account for approximately 40 percent of our nation’s intercity freight ton-miles and serve nearly every agricultural, industrial, wholesale, retail, and resource-based sector of our economy. The global superiority of U.S. railroads is a direct result of a regulatory system that allows market-based competition to establish rate and service standards. Indeed, the Board has very limited

jurisdiction over rail rates, with the majority of rail shipments facing competition with rates constrained by market forces. This tailored regulation has allowed railroads to improve their financial performance from anemic levels prior to 1980, which in turn has allowed the railroads to spend some \$550 billion on improving the scope and performance of their infrastructure and equipment. These investments have been an immense benefit to railroads' customers (including their grain customers) and to our nation at large. The railroad industry's ability to continue to invest revenue earned today to provide capacity needed to meet future demand is critical to our nation's economic prosperity and our ability to compete successfully in the global marketplace. Thus, the Board's rate reasonableness rules for all commodities must reflect the fundamental competitiveness of transportation markets and not artificially constrain the ability of railroads to price their services according to market demand where such competition is present. By adhering to the general guiding principles that railroads must be able to engage in demand-based differential pricing, and that rate reasonableness procedures should simulate the competitive outcomes of contestable markets, the Board will help ensure that any action it takes in consideration of the issues raised in this proceeding is consistent with its governing statute and with the compelling public interest in continued improvement in the nation's rail infrastructure.

This statement is divided into three broad parts. Part I provides an overview of how grain markets vary across commodity type and over time. Part II explains how grain transportation markets must be resilient to respond to market demand. Part III sets forth the principle that demand-based differential pricing is necessary and benefits all shippers that use the rail network.

## I. Grain Markets Vary Across Commodity And Over Time

The United States is the world's top grain producer — average annual U.S. grain production from 2004-2013 was 524 million tons<sup>1</sup> — but what crops are grown, where, and in what quantities, and how, when, and to where they are transported, is determined by a complex interaction of factors. These factors include weather and soil conditions, but also a complicated interplay of many groups — including farmers, various transportation modes and providers, elevator operators, grain marketing companies, grain consumers large and small (both in the United States and abroad), as well as local, national, and foreign governments — each with its own goals and interests. Competition among the various players is intense, as the various commercial entities involved act and react based on the particular market forces they face at particular points in time.

Most grain, of course, is grown to be eaten, most often by animals that are eventually eaten by humans (e.g., cows, pigs, and chickens) or by humans directly, and often after being processed in one way or another (wheat is milled into flour, soybeans are crushed to produce soybean oil and soybean meal, corn is milled to produce corn starch which is further processed to produce corn syrup, and so on).

**Table 1: U.S. Grain Production by Type of Grain**

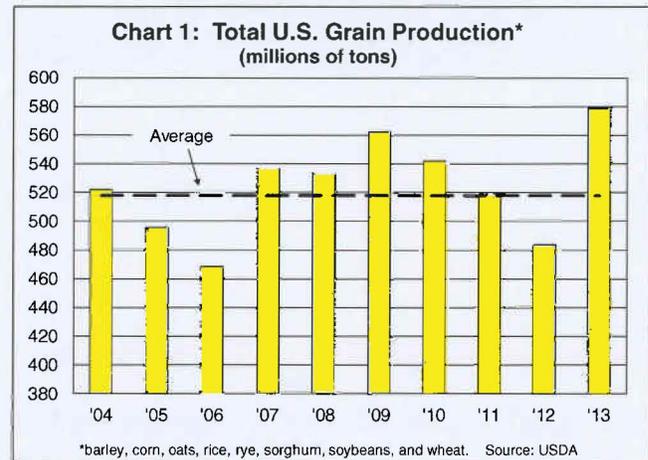
Type of Grain	millions of tons									
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Barley	6.8	5.1	4.4	5.1	5.8	5.5	4.4	3.8	5.4	5.2
Corn	330.6	311.2	294.9	365.1	338.6	366.6	348.5	346.1	301.8	389.9
Oats	1.9	1.8	1.5	1.4	1.4	1.5	1.3	0.9	1.0	1.1
Rice	11.5	11.0	9.6	9.8	10.1	10.8	12.0	9.1	9.9	9.4
Rye	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Sorghum	12.7	11.0	7.8	13.9	13.2	10.7	9.7	6.0	6.9	10.9
Soybeans	93.7	91.9	95.9	80.3	89.0	100.8	99.9	92.8	91.0	98.7
Wheat	64.7	63.1	54.3	61.5	75.0	66.5	66.2	60.0	68.0	63.9
Total	522.1	495.4	468.4	537.3	533.3	562.6	542.1	518.8	484.1	579.2

Source: USDA

<sup>1</sup> Data on grain production and consumption in this section come from the U.S. Department of Agriculture's National Agricultural Statistics Service, especially its annual crop production summary reports, and/or from the USDA's Economic Research Service's periodic outlook reports for the various types of grain.

The variety of forces that impact grain production and consumption make it abundantly clear that making generalized conclusions about grain is exceedingly problematic. Simply put, there is no homogenous “grain market” in the United States. For that matter, there is no homogenous “corn market” or “soybean market” or “wheat market” in the United States either.

Some aspects of the grain market are generally predictable — e.g., poultry farms in the southern United States will always need large amounts of grain for feed — but many aspects of the grain market are marked by pervasive volatility. For example, large fluctuations in grain production are common



from one year to the next. From 2004 to 2013, U.S. grain production ranged from 468 million tons to 579 million tons, a 24 percent spread (see Chart 1).

Moreover, the various types of grain — defined in this submission as barley, corn, oats, rice, rye, sorghum, soybeans, and wheat — have unique characteristics and are also marked by volatility.

*Corn*, for example, is grown in large quantities in many different states, but mainly in the Midwest. Corn accounted for 65 percent of U.S. grain production, on average, from 2004 to 2013, but because the amount of corn produced can change drastically from year to year, the corn share over this period varied from 62 percent to 68 percent and the volume produced varied by 95 million tons. Corn consumption patterns change too. In 2004, feed accounted for approximately 58 percent of U.S. corn consumption and ethanol just 12 percent. By 2012,

feed accounted for just 39 percent of corn consumption, while the ethanol share had surged to 42 percent.

*Soybeans*, meanwhile, accounted for 17 percent of U.S. grain production from 2004 to 2013, far less than corn, though the soybean share varied from 14 percent to 19 percent. Over that period, exports accounted for 41 percent of soybean utilization — close to three times the share for corn — and less than 5 percent went to animal feed. Nearly all of the remainder was crushed at processing plants located throughout the country to produce soybean oil and soybean meal. Soybeans are generally produced in large quantities in the same states that produce large quantities of corn.

*Wheat*, on the other hand, is grown mainly (depending on the type of wheat) in the northern tier of U.S. states, including the Dakotas, Montana, and Idaho, or the plains of Kansas, Oklahoma, and Texas. Wheat accounted for 12 percent of U.S. grain production from 2004 to 2013. In a typical year, nearly half of the U.S. wheat crop is exported, more than soybeans and far more than corn. Wheat that is not exported is mostly processed to produce food for human consumption, including (again depending on the type of wheat) bread, pastries, and pasta.

Unlike U.S. corn and soybean production, U.S. wheat production rose from 2011 to 2012, then fell in 2013 (see Table 1), a function of how regional variances add considerable complexity to the grain market as well — hot dry spells or floods may suppress grain yields in one region (e.g., corn and the Midwest in the summer of 2012), while other regions might be enjoying average or exceptional growing conditions at the same time.

Further complexity in grain markets comes from the difficulty in forecasting crop size, even when the forecasts are made close to harvest time. Forecast inaccuracies make planning that much more difficult for those involved in grain logistics.

Timing adds yet more complexity. Those who possess grain seek to sell it to the highest bidder. At harvest, a farmer might choose to sell his or her crop immediately — perhaps to a local processor, or perhaps to a local elevator — or the farmer might choose to store all or part of the crop on the farm in anticipation of a better price later. Likewise, an elevator might choose to sell the grain to, say, an overseas buyer, or could instead choose to store the grain in anticipation of a better deal later on.

Like U.S. grain production generally, U.S. grain exports fluctuate sharply because they are a function of many complex market and regulatory factors including global grain production; economic conditions in importer countries; crop yields in competing grain exporting countries; exchange rates; grain prices; government policies; and ocean freight rates. All of these can change significantly from one year to the next or even from month to month, resulting in grain exports that can vary tremendously.

Indeed, total U.S. grain exports averaged 129 million tons per year from 2004 to 2013, but during this period exports ranged from 112 million tons to 143 million tons. Table 2 shows U.S. grain exports by type of grain since 2007 and illustrates the variability in grain exports. For example, corn exports fell 31 percent (15.7 million tons) from 2011 to 2012 and another 24 percent in 2013 from 2012, but are sharply higher in the first four months of 2014 compared with the same period in 2013.

	2007	2008	2009	2010	2011	2012	2013	Jan.-Apr.	
								2013	2014
Corn	62.7	59.2	52.4	55.7	50.3	34.6	26.4	6.6	19.1
Wheat	36.4	33.1	24.2	30.4	36.2	28.4	36.3	11.4	9.9
Soybeans	32.8	37.3	44.5	46.6	37.9	47.8	43.1	13.3	18.8
Rice	3.8	4.2	3.8	4.9	4.1	4.2	4.1	1.6	1.3
Sorghum	6.2	5.8	4.1	4.2	3.7	1.9	2.3	0.6	2.4
Other*	0.8	0.7	0.2	0.2	0.3	0.2	0.2	0.0	0.1
<b>TOTAL</b>	<b>142.7</b>	<b>140.3</b>	<b>129.1</b>	<b>142.1</b>	<b>132.4</b>	<b>117.0</b>	<b>112.5</b>	<b>33.6</b>	<b>51.6</b>

\*barley, oats and rye Source: USDA

## **II. Grain Transportation Networks Must Be Resilient To Respond to Market Demand**

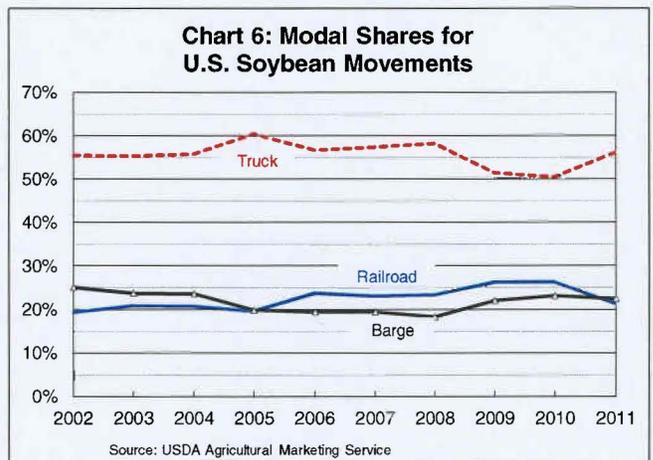
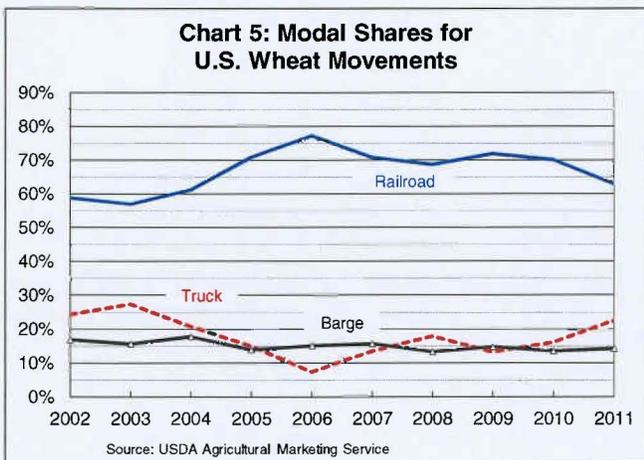
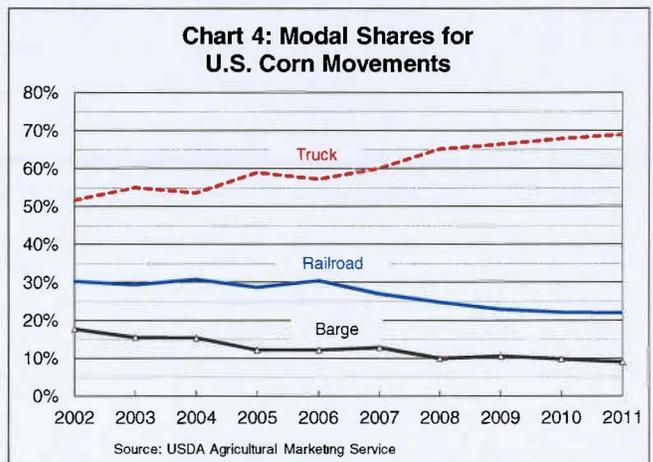
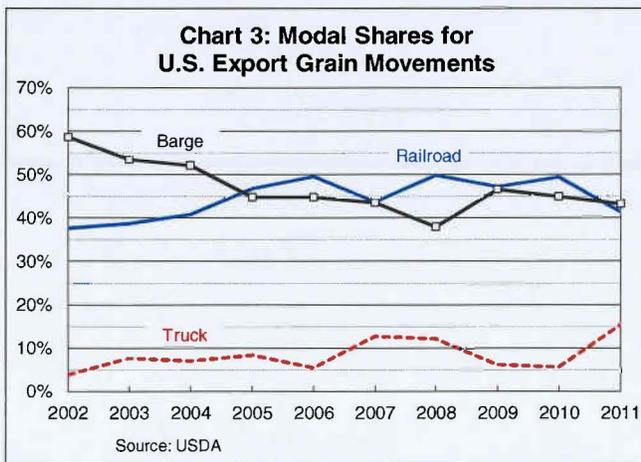
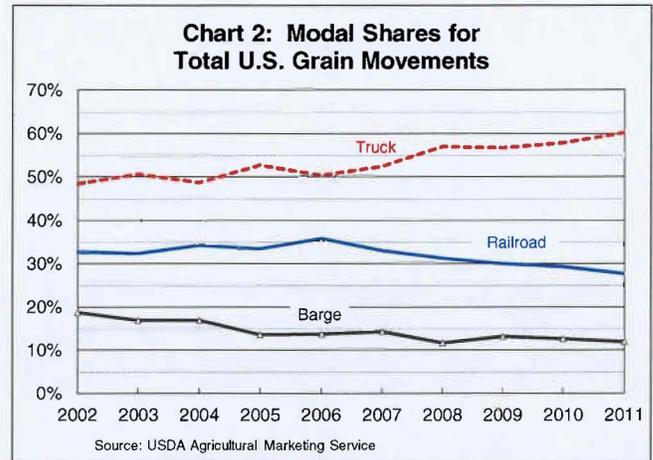
The nature of U.S. grain production and consumption patterns means that the grain logistical chain in the United States, by necessity, must be complex and resilient. As noted above, grain production, movement to storage, and movement out of storage to domestic and export markets depend on a variety of interdependent factors. Railroads, along with barges and trucks, are a critical part of this chain. The fact that the grain logistical chain generally functions smoothly is a testament to the tremendous efforts that transportation providers, including railroads, put forth in support of their grain-related customers.

Today, grain shippers benefit from strong competition among railroads, trucks, and barges to carry grain. According to USDA data, the truck share of total U.S. grain transport was 60 percent in 2011 (the most recent year for which data are available), compared with just 28 percent for railroads and 12 percent for barges (see Chart 2).<sup>2</sup> The fact that the truck share has been rising for several years — it was 50 percent as recently as 2006 — is strong evidence of the intensity of the competition that railroads face for grain traffic.

<sup>2</sup> U.S. Department of Agriculture, Agricultural Marketing Service, Transportation of U.S. Grains: A Modal Share Analysis 1978-2011 Update, May 2013.

Much of the growth in the truck share of corn movements in recent years (see Chart 4) is attributable to local shipments of corn to ethanol plants, but even for wheat (Chart 5) and soybeans (Chart 6), rail market share has either been steady or declining. Declining market share is strong evidence that market

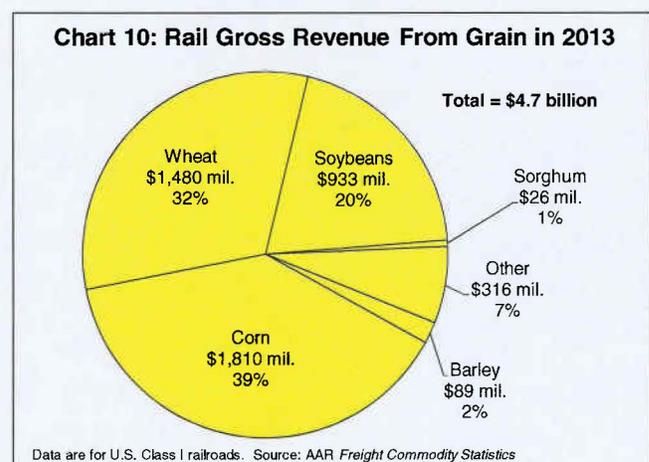
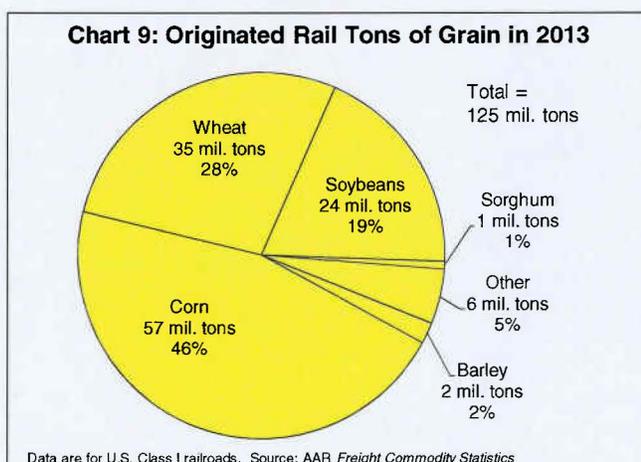
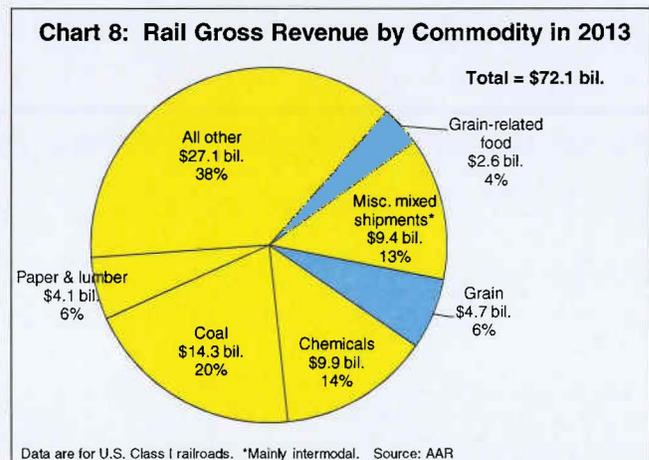
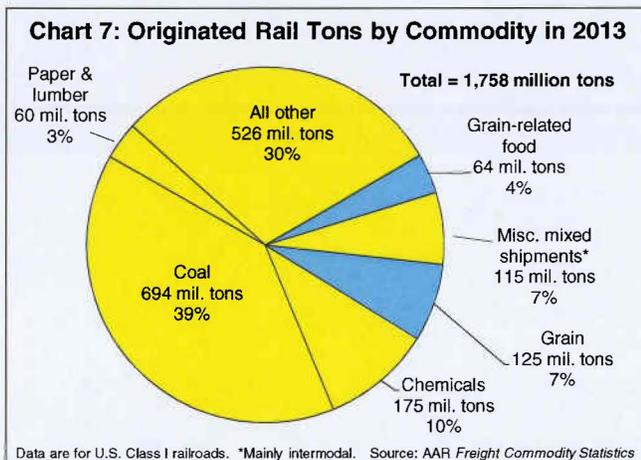
participants generally have competitive options, and that railroads do not possess excessive market power with regard to grain shipments. These charts also show that modal shares for different grains vary significantly, further confirming that there is no single “grain market.”



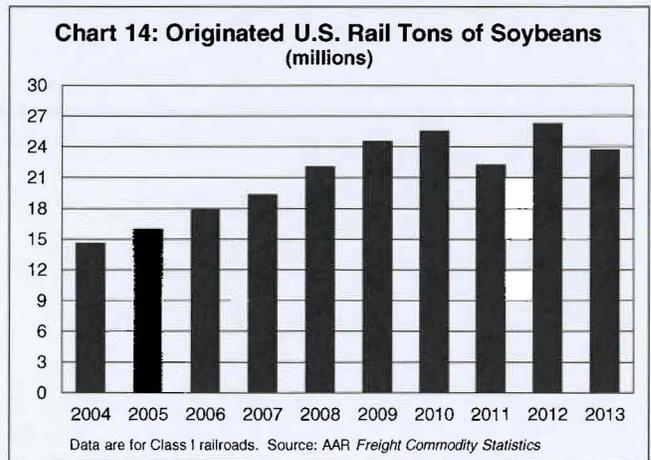
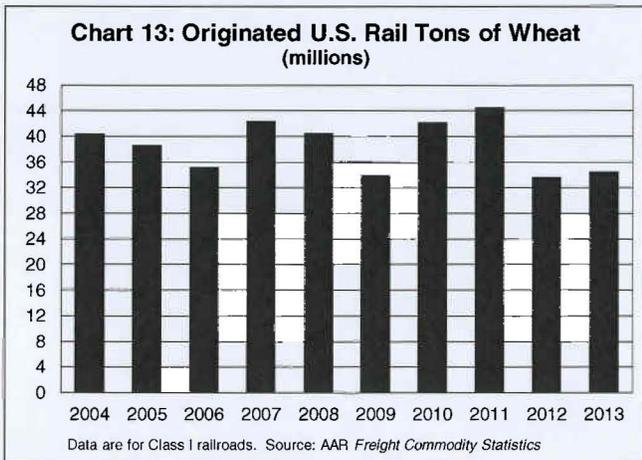
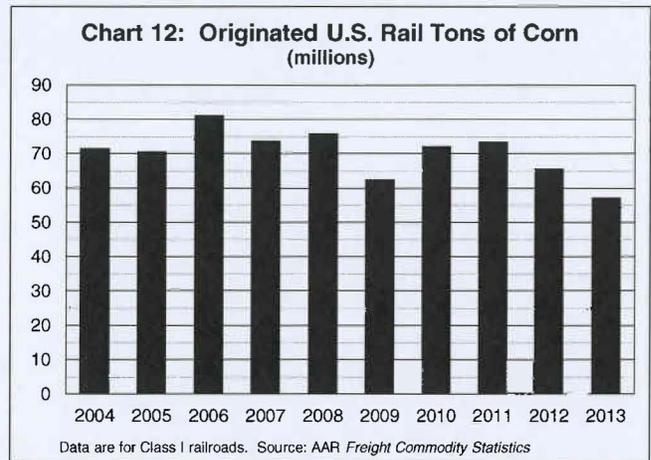
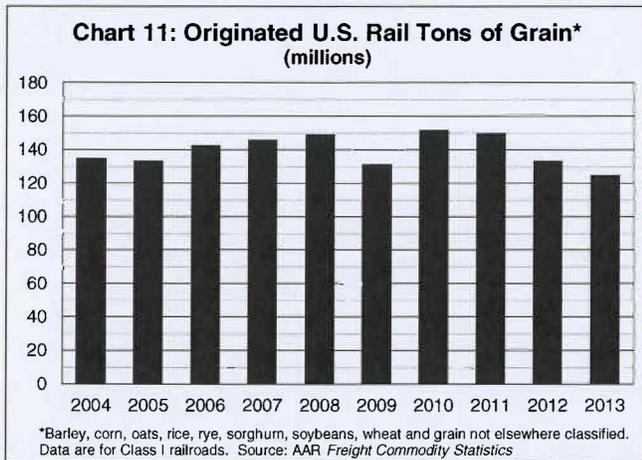
## Overview of Railroads and Grain

In 2013, Class I railroads originated 1.3 million carloads of grain (4.6 percent of total carloads) carrying 124.5 million tons (7.1 percent of total tonnage — Chart 7) and earning gross revenue of \$4.7 billion (6.5 percent of total revenue — Chart 8). Grain-related food products, which consist of a wide variety of commodities such as flour, animal feed, soybean oil, and corn syrup, accounted for another 4 percent of rail tonnage and revenue in 2013.

U.S. freight railroads carry more corn than any other type of grain. From 2009-2013, corn accounted, on average, for 66.1 million tons (48 percent of total rail grain tonnage) and \$2.0 billion in gross revenue (43 percent of total grain revenue), well ahead of wheat (37.7 million tons, \$1.4 billion) and soybeans (24.5 million tons, \$859 million). Charts 9 and 10 show the shares for the various types of grain in 2013.

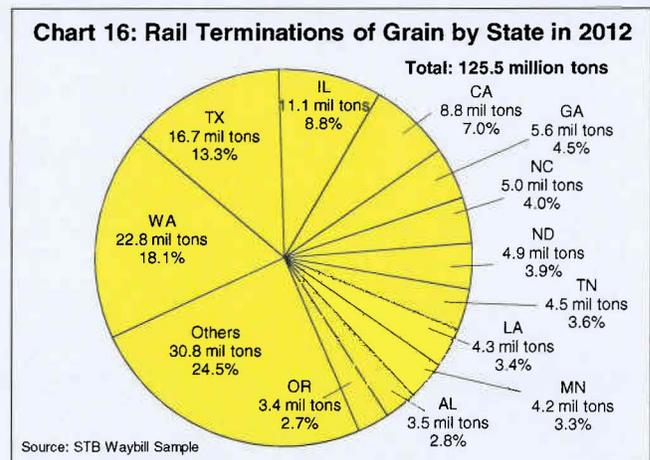
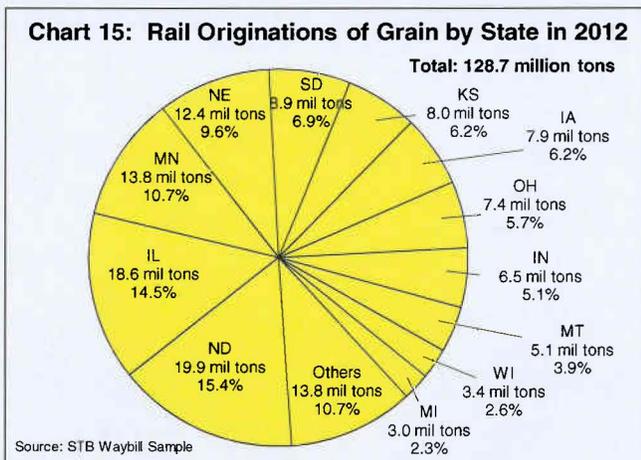


Charts 11 through 14 below detail rail tonnage for Class I railroads for the past 10 years. Total grain tonnage was 124.5 million in 2013, the lowest total since 1998. Rail corn volumes were especially low in 2013 — originated tonnage totaled 57.1 million, the lowest since 1994 — consistent with much lower corn production in 2012.



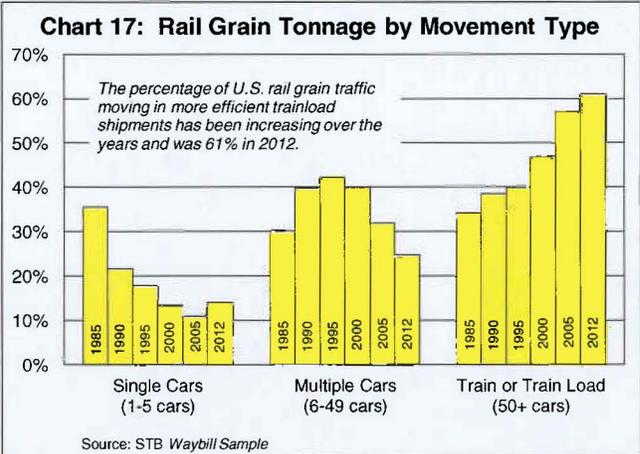
The share of total rail grain traffic accounted for by specific types of grain varies from year to year depending on how much of the various grains are produced and the market dynamics associated with the various types of grain. From 2011 to 2012, for example, rail soybean volume rose, while rail corn and wheat volume both fell.

The top states for rail originations of grain are typically Illinois, Minnesota, Nebraska, and North Dakota, which in 2012 accounted for half of all originated rail tons of grain (see Chart 15). The top states in terms of rail terminations of grain are typically Washington, Texas, Illinois, and California, which accounted for nearly half of all rail grain terminations in 2012 (see Chart 16).



### Railroad Grain Service Programs

Railroads offer a variety of rail service options (single car, multiple cars, trainload, or shuttle trains) to grain shippers, and data show a clear trend toward more efficient grain movement types. Single car movements (typically defined as 1–5 cars) accounted for 36 percent of total U.S. grain carloads in 1985; in 2012, they were 14 percent (see Chart 17). Multiple car

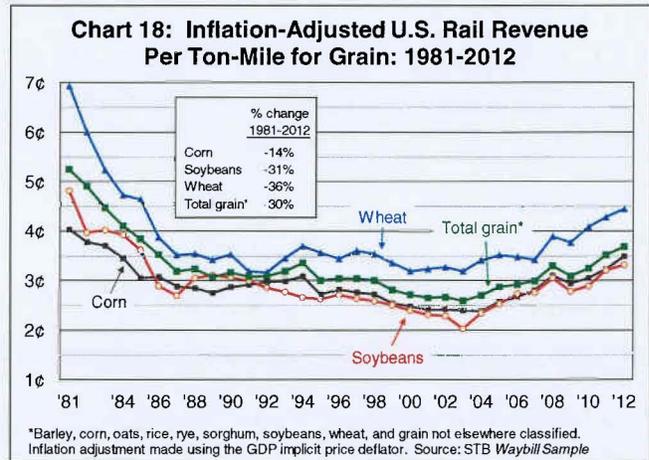


shipments (6–49 cars) fell from 30 percent in 1985 to 25 percent in 2012. Trains with 50 or more cars include conventional trainload and shuttle trains; they rose from 34 percent in 1985

to 61 percent in 2012. Large, more efficient long-hauls for grain drive down costs. The continuing trend toward such shipments is driven by competition and reflects market forces that call for grain transportation to be as efficient as possible.

Rail Rates for Grain

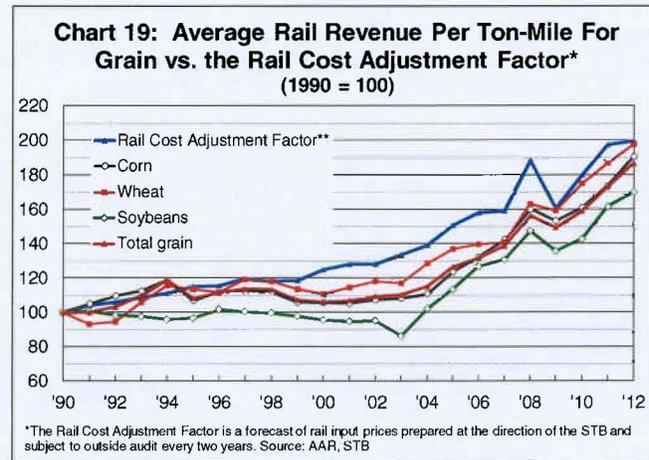
There is no question that the vast majority of rail rates — including rail rates for transporting grain — are driven by competition. Rail revenue per ton-mile (“RPTM”) is a useful surrogate for rail rates. Chart 18 shows that RPTM for grain overall was 30 percent lower on an inflation-adjusted basis in 2012 than in 1981. RPTM is lower for the major individual types of grain as well.



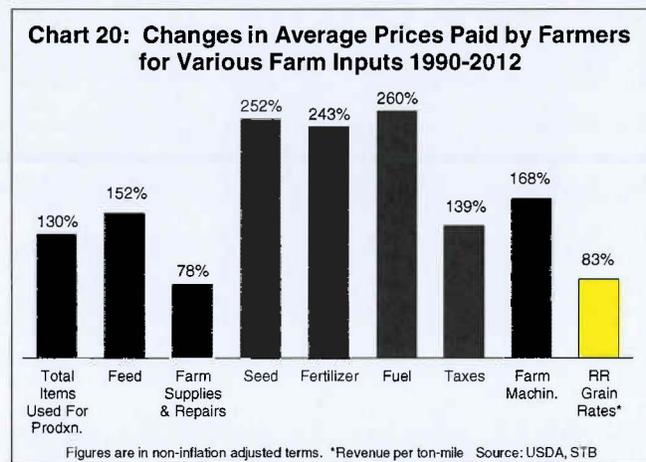
In recent years, average rail rates for grain have increased. Generally speaking, competitive industries in the United States, like railroads, set their prices based on the value they provide to their customers, not on their input costs. This market-based approach to pricing allows railroads to balance the desire of each customer to pay the lowest possible rate with the requirement that railroads be able to attract capital and pay for all the things needed to keep their networks functioning now and growing in the future.

That said, increases in rail rates over the years have closely tracked increases in the costs of inputs to rail operations. Chart 19 shows the very close positive correlation between average rail rates for grain (as measured by revenue per ton-mile) and the Rail Cost Adjustment Factor (RCAF) since 1990. The RCAF is an index that measures rail inflation in

much the same way that the consumer price index measures inflation in the overall economy. The RCAF is prepared by the AAR under the direction of the Board and subject to independent outside audit every two years. Chart 19 shows that overall rail grain rates since 1990, and rail rates for corn, wheat, and soybeans, have risen less rapidly than rail input costs.



Moreover, according to USDA data, from 1990-2012 the average prices that farmers paid for most of their supplies rose much faster than the rail rates to move their grain. For example, over this period, the cost of seed rose 252 percent (not adjusted for inflation); fuel, 260 percent; and fertilizer, 243 percent (see Chart 20).<sup>3</sup> Average rail rates to ship grain (in revenue per ton-mile not adjusted for inflation) rose only 83 percent over the same period.

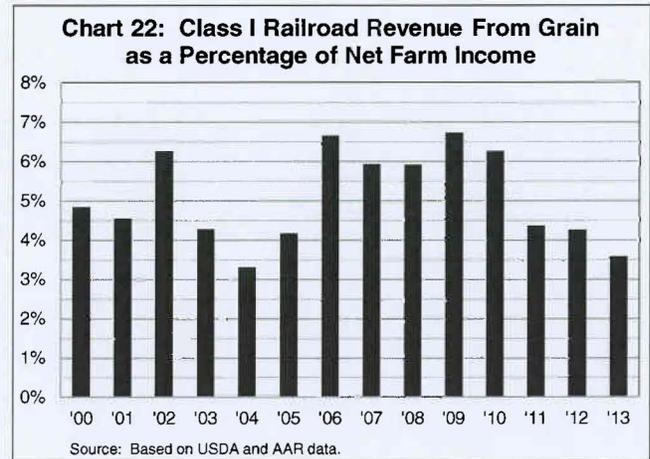
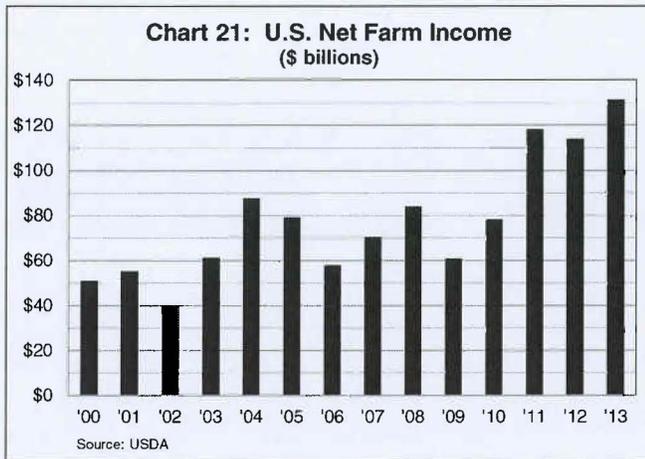


Another way to consider rail rates for grain is in the context of net farm income. In recent years, net farm income has set new annual records, including \$114 billion in 2012 and \$131 billion in 2013 (see Chart 21).<sup>4</sup> Chart 22 shows that rail revenue from grain as a percentage of net farm income has fallen sharply in recent years, and in 2013 was the lowest

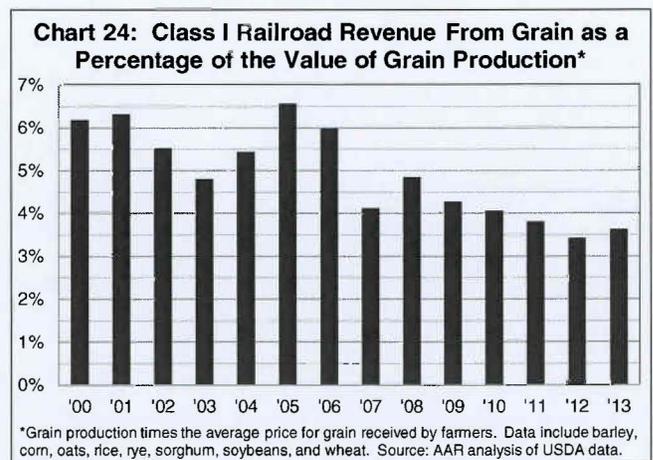
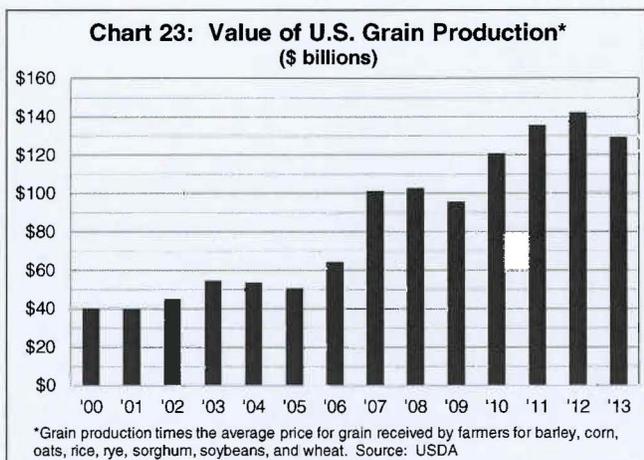
<sup>3</sup> U.S. Department of Agriculture, National Agricultural Statistics Service, Agricultural Prices and Agricultural Prices Summary, various periods.

<sup>4</sup> U.S. Department of Agriculture, Economic Research Service, U.S. Farm Sector Financial Indicators: 2010-2014F.

it's been since 2004. This fact supports the view that a broad overhaul of the Board's rate reasonableness procedures for grain is not needed.



Likewise, Chart 23 shows that the value of grain production — defined as the average price received by farmers for their grain times the amount of grain produced — has trended sharply higher over the past 10 years. Chart 24 shows that rail revenue from grain as a percentage of the value of farm production has been trending steadily downward over that same period, falling to 3.4 percent in 2012 and 3.6 percent in 2013 — the lowest this metric in has been since at least 1994.



### **III. Regulation of Rail Rates For the Transportation of Grain Should Reflect Market Demand to Allow for Necessary Investment to Meet Future Demand**

#### Freight Railroads Provide Diverse Services For Grain Customers With Most Rates Governed By Market Constraints

Freight railroads in the United States must meet the needs of an extremely diverse set of shippers, moving tens of thousands of railcars to and from thousands of origins and destinations every day. In this regard, grain is just one of many industries that railroads serve — with finite resources and limited capacity. Indeed, the average weekly carloads of grain from January 2006 through December 2013 was slightly more than 30,000 for U.S. and Canadian railroads.<sup>5</sup> All remaining carloads plus intermodal units — a composite “units hauled by rail” figure — averaged 615,000 since 2006, a figure that dwarfs the corresponding grain figure. Even in the Midwest, grain typically accounts for a majority of rail traffic originated in just a couple of states, and in no state does grain account for a majority of terminated rail traffic.

Not all rail shippers, including grain shippers, have seen their rates behave in the same way. In part, this is because, as noted above, railroads price their services according to market demand. The vast majority of rail shipments are governed by the marketplace and not by regulation. For those limited instances where the Board is authorized by statute to regulate rates, that regulation should seek to simulate competitive outcomes, rather than artificially constrain railroad rates below where they would be in a competitive market.

#### Railroads Cannot Price to Average or Marginal Costs

Moreover, it is important to understand why railroads cannot simply price to cost, whether marginal or average. Because economies of scale exist in the railroad industry (that is, the costs of transportation decline as traffic volume increases), marginal costs are usually

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<sup>5</sup> As calculated from AAR Weekly Railroad Traffic report.

lower than average costs. In other words, the cost to the railroad of handling an additional unit of traffic is usually less than the average cost of handling each unit of traffic. Because of their high fixed costs associated with track, facilities, and equipment, railroads cannot price all their traffic at marginal cost and still cover their fixed costs. Any firm that cannot cover all costs, including fixed costs, ultimately cannot survive.

Nor can railroads price on the basis of average costs. Because of competition, much rail traffic moves at rates below average total costs but above variable costs. Any traffic moving at rates above variable cost makes at least some contribution to fixed costs and is, therefore, better than no traffic at all. If the rates on that traffic were raised to the average total cost level, much of it would be diverted to other modes and that traffic's contribution to fixed costs would be lost. If this happens, railroads must either raise rates on their remaining traffic to make up for the contribution of the lost traffic to fixed costs or reduce their fixed costs by shedding lines or other means.

#### Differential Pricing Is Necessary and Benefits Shippers Who Use The Rail Network

Only by recognizing and pricing in accordance with the varying demands for rail service can a railroad have any opportunity to recover its full costs. Indeed, differential pricing benefits all shippers who utilize the rail network because lower (differential) prices generate revenue which otherwise would not be realized.

The principle that railroads should be allowed to price differentially based on demand in order to allow them the possibility of recovering their total costs of service (including the cost of capital) has long been recognized by the Board and the Interstate Commerce Commission ("ICC") before it. In adopting Constrained Market Pricing ("CMP") as the guiding principles governing rail rate regulation, the ICC concluded that "the cost structure of

the railroad industry necessitates differential pricing of rail services.” *Coal Rate Guidelines - Nationwide*, 1 I.C.C.2d 520,526 (1985) (“*Coal Rate Guidelines*”), *aff’d sub nom.*

*Consolidated Rail Corp. v. United States*, 812 F.2d 1444 (3d Cir. 1987). The ICC held that differential pricing is “central” to CMP principles, and stated that “[a]ny means of allocating [unattributable] costs among shippers other than *actual market demand* is arbitrary and may not permit a carrier to cover all of its costs.” *Id.* at 525-526 (emphasis added).

Since the adoption of CMP in the *Coal Rate Guidelines*, these sound economic principles have been reaffirmed by the ICC and Board, and approved by the courts, in numerous cases.<sup>6</sup> Without differential pricing, the rail industry could not have achieved its tremendous gains in operating efficiency and financial health, which allowed railroads to make massive investments in their networks, accommodate large increases in freight volume, offer competitive rates, and provide improved service to shippers. Moreover, the Staggers Act’s mandate to allow railroads to price differentially was not a *temporary* remedy to address the financial state of the industry. Rather, demand-based pricing was a *structural* reform that reflects fundamental railroad economics and Congressional intent in limiting regulation.

Thus, in considering the issues in this proceeding, the Board should take care to ensure fidelity to first principles of rail rate regulation, including sound, time-tested and judicially approved principles of demand-based differential pricing. These principles remain vital to the

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<sup>6</sup> See, e.g., *Consolidated Rail Corp. v. United States*, 812 F.2d at 1448-49; *Potomac Electric Power Co. v. ICC*, 744 F.2d 185, 193 (D.C. Cir. 1984) (in enacting the Staggers Act, Congress understood the “necessity of such differential pricing”); see *id.* at 194 (the “concept of differential pricing ... necessarily contemplates that the carrier will maximize its profits on traffic for which it has no competition so as to offset its lower earnings on competitive traffic”); *MidAmerican Energy Co. v. STB*, 169 F.3d 1099, 1106 (8th Cir. 1999) (affirming application of differential pricing to so-called “bottleneck” shippers; noting that the “Board has recognized that an important part of achieving revenue adequacy is differential pricing”); STB Docket No. 42072, *Carolina Power & Light Co. v. Norfolk Southern Ry. Co.*, slip op. at 33 (served Dec. 23, 2003) (“[d]emand-based differential pricing is essential in the railroad industry because railroads serve a mix of captive and competitive traffic”; non-demand-based cost apportionment methods do not necessarily permit carriers to recover costs) (reconsideration granted on other grounds in STB Decision served October 20, 2004).

financial health and continued viability of the rail industry and the essential service it provides to its customers.

The AAR submits that the Board's rate case procedures are currently accessible to grain shippers and recent changes to those procedures were intended to make them more so. Advocates for grain shippers sometimes contend that the stand alone cost test can only be utilized by repetitive unit-train shipments of coal. While historically most rate cases at the Board dealt with such traffic, recent history belies the assertion that only shippers of unit trainloads of coal have access to the Board's processes. Since the Board made changes to both its large rate case procedures in 2006<sup>7</sup> and modified its simplified case procedures in 2007,<sup>8</sup> 13 of the 23 cases concluded by the Board have involved non-unit train chemical traffic, with the shipper involved in 11 of those cases either reaching a settlement or prevailing in a judgment.

The Board has also repeatedly made changes to its procedures to expedite its processes and ensure that they were available to shippers.<sup>9</sup> For example, the Board has declined to consider economically valid product and geographic evidence out of concerns that the complexities of litigating the issue were too expensive and time-consuming for complainants.<sup>10</sup> The Board most recently reexamined the accessibility of its processes when it revised its rate case processes in EP 715. The Board made a number of changes favorable

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<sup>7</sup> *Major Issues in Rail Rate Cases*, EP 657 (Sub-No. 1) (STB served Oct. 30, 2006)

<sup>8</sup> *Simplified Standards for Rail Rate Cases*, EP 646 (Sub-No. 1)(STB served Sept. 5, 2007)

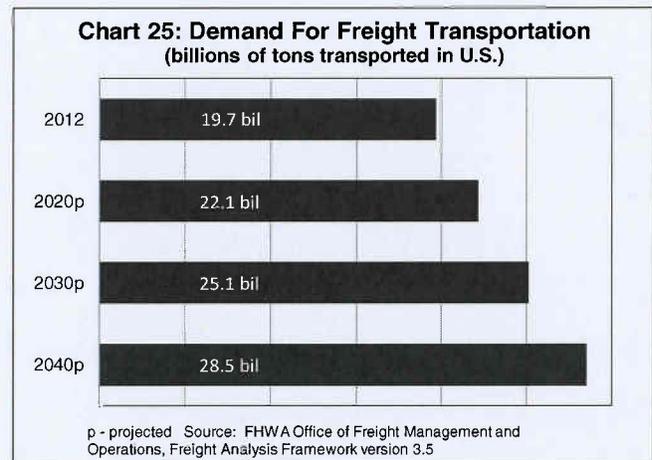
<sup>9</sup> See, e.g., *Procedures to Expedite Resolution of Rail Rate Challenges to be Considered Under the Stand Alone Cost Methodology*, EP 638 (STB served April 3, 2003); *Railroad Cost Recovery Procedures-Productivity Adjustment*, 5 I.C.C.2d 434 (1989), *aff'd sub nom. Edison Electric Institute, et al. v. ICC*, 969 F.2d 1221 (D.C. Cir. 1992).

<sup>10</sup> *Market Dominance Determinations—Product and Geographic Competition*, 3 S.T.B. 937, *remanded sub nom. Assn. of American Railroads v. STB*, 237 F.3d 676 (D.C. Cir. 2001); See also *Petition of the Association of American Railroads to Institute a Rulemaking Proceeding to Reintroduce Indirect Competition as a Factor Considered in Market Dominance Determinations for Coal Transported to Utility Generation Facilities*, EP 717 (STB served Mar. 19, 2013).

to shippers over the objection of carriers, including removing the limitation on relief for Simplified-SAC cases, nearly quadrupling the limit on relief for Three-Benchmark cases, and changing the interest rate in 49 C.F.R. 1141.1 to the U.S. Prime Rate.<sup>11</sup>

### Continued Spending Back Into the Rail Network

There is no escaping the reality that, absent governmental subsidies, shippers — including grain shippers — must pay for the rail service they demand. Over the long term, transportation demand will grow and new rail capacity will be needed. Recent forecasts from the Federal Highway Administration found that total U.S. freight shipments will rise from an estimated 19.7



billion tons in 2012 to 28.5 billion tons in 2040 — a 45 percent increase (see Chart 25).

Freight railroads are the best way to meet this demand.

This demand will incentivize railroad investment in their networks – but only if rates are allowed to respond to the marketplace demand to increase supply. That’s crucial, because unlike trucks, barges, and airlines, which travel on highways, waterways, and airways that the government provides and pays for, America’s freight railroads operate almost exclusively on infrastructure that they own, build, maintain, and pay for themselves. In recent years, America’s privately owned freight railroads have been putting more money back into their networks than ever before. From 1980 through 2013, they spent \$550 billion — their own

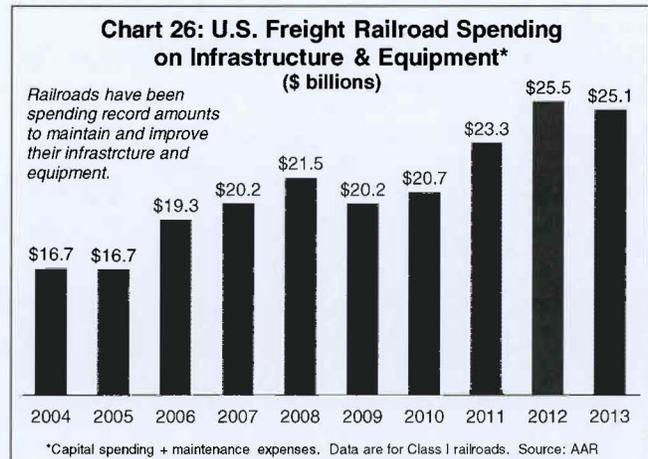
<sup>11</sup> *Rate Regulation Reforms*, EP 715 (STB served July 18, 2013), *aff'd in part and remanded in part*, *CSX Transportation and Norfolk Southern Railway vs. Surface Transportation Board*, (D.C. Cir. June 20, 2014).

funds, not taxpayer funds — on renewal, maintenance, and expansion of their infrastructure and equipment (see Chart 26). That's more than 40 cents out of every rail revenue dollar.

Recently at the public hearing and in written comments to the Board in EP

724, it was suggested that railroads need to invest more in capacity to alleviate the service issues that occurred in parts of the country this winter. While the Board heard extensive testimony that this winter posed a historically difficult set of challenges to the railroads, it is beyond question that the railroad industry remains committed to making investments in the network designed to meet the demand for rail service now and in the future. The nation's freight railroads project that they will spend approximately \$26 billion this year to maintain, upgrade and to increase capacity in their nationwide rail network. Railroads also expect to hire more than 12,000 people in 2014.

In the years to come, railroads will be asked to continue to grow capacity for grain shippers and for all their other current and potential customers. How well railroads can do this will depend in part on actions by policymakers at the Board and elsewhere in Washington. The revenues needed to fund the necessary capacity growth should not be artificially constrained by rate reasonableness procedures that depart from sound economics. Adequate investments can only be made if rail earnings are robust enough to attract the capital needed to pay for these investments.



## Conclusion

America's freight railroads do a remarkable job meeting the needs of an extremely diverse set of shippers. The vast majority of rail shipments, including grain shipments, arrive in a timely manner, in good condition, and at lower average rates than shippers elsewhere in the world. Looking ahead, the United States cannot prosper in an increasingly competitive global marketplace if our freight railroads are unable to meet our growing transportation needs, and having adequate railroad capacity is critical in meeting these needs.

The Board should carefully consider any proposed changes to its processes put forth by interest groups seeking advantage for their particular constituency. In order for railroads to continue to invest at levels necessary to meet increasing demand for rail service, a necessary predicate is a regulatory environment that will not undercut the industry's ability to do so. Any policy changes that would have the effect of artificially cutting rail earnings would severely harm railroads' ability to reinvest in their networks, inhibit capacity growth, and degrade rail service. This would be a serious problem at any time, but it would be an especially serious problem today when railroads are being called upon more than ever to help meet the diverse and growing transportation needs of our nation. Such proposals would be contrary to the public interest and should be rejected.

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