

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB EX PARTE NO. 665 (SUB-NO. 1)

RAIL TRANSPORTATION OF GRAIN, RATE REGULATION REVIEW

REPLY COMMENTS OF CSX TRANSPORTATION, INC.

236516
ENTERED
Office of Proceedings
August 25, 2014
Part of
Public Record

Peter J. Shutz
Paul R. Hitchcock
Steven C. Armbrust
John P. Patelli
CSX Transportation, Inc.
500 Water Street
Jacksonville, FL 32202

G. Paul Moates
Matthew J. Warren
SIDLEY AUSTIN LLP
1501 K Street, N.W.
Washington, DC 20005
(202) 736-8000

Counsel to CSX Transportation, Inc.

August 25, 2014

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB EX PARTE NO. 665 (SUB-NO. 1)

RAIL TRANSPORTATION OF GRAIN, RATE REGULATION REVIEW

REPLY COMMENTS OF CSX TRANSPORTATION, INC.

CSX Transportation, Inc. (“CSXT”) respectfully submits these Reply Comments to address points made by parties offering comments in response to the Surface Transportation Board’s (“Board’s”) December 12, 2013 notice regarding the application of the Board’s rate reasonableness procedures to grain shipments. The Opening Comments in this proceeding provided compelling evidence that there is no need for an overhaul of rate reasonableness procedures for grain shipments and that grain rates are generally restrained by competitive forces. *See* Association of American Railroads (“AAR”) Opening Comments at 12-19.

Nevertheless, some grain advocacy groups responded to the Board’s notice by proposing dramatic changes to existing rate reasonableness challenges that would create two classes of shippers: a privileged class of grain shippers entitled to artificially low rates based on cross-subsidies from other shippers, and a class of non-grain shippers expected to pay relatively higher rates to support the privileged grain shippers. The proposals by the National Grain and Feed Association (“NGFA”) and the Alliance for Rail Competition (“ARC”) would give grain shippers significantly more favorable treatment than shippers of any other commodity and would enable grain shippers to obtain rate reductions even for rates that would be reasonable using

sound transportation economics. Such a two-tiered scheme is inherently arbitrary and unjust, and the Board should reject it out of hand.

CSXT values its grain customers, and it acknowledges that the agricultural industry is important to the Nation's economy. But there is no basis for the Board to give special treatment to any group of shippers, particularly when they have produced no evidence that the Board's existing rate reasonableness procedures are not effective to ensure reasonable rates for grain shipments. Market competition and the Board's existing procedures are more than sufficient to ensure reasonable grain rates, and the Board should reject NGFA's and ARC's proposals to add an inherently biased grain alternative to its suite of rate reasonableness remedies.

I. TRANSPORTATION MARKETS FOR GRAIN MOVEMENTS ARE SUBJECT TO ROBUST COMPETITION.

CSXT's Opening Comments described CSXT's grain business and the significant direct and indirect competition that characterizes that business. *See* CSXT Opening Comments at 1-7. CSXT's customers typically have multiple sourcing options and flexibility to obtain the lowest-cost option. For example, most of the feed mills served by CSXT can purchase local corn for truck delivery, and many have the ability to shift production between multiple facilities served by different railroads. *See id.* at 2-3. These market factors require CSXT's pricing to be both flexible and competitive. For example, CSXT described how changes in the grain market in 2012 required CSXT to work with its customers to reduce rates for import shipments. *See id.* at 3.

Other Opening Comments confirmed that grain transportation is subject to substantial competition. AAR's Opening Comments showed that railroads are responsible for only 28 percent of U.S. grain transportation, as compared to 60 percent for trucks and 12 percent for barges. *See* AAR Opening Comments at 7 (citing USDA modal share analysis). Even NGFA

and ARC admit that many grain shippers have multiple competitive options. *See* ARC Opening Comments, V.S. Fauth at 15 (admitting that many grain movements “could have problems proving market dominance” because they “involve relatively short distances” or because “two or more railroads serve the facilities”); NGFA Comments at 9 (admitting that railroads handle only 28 percent of all commercial grain movements). These admissions comport with the agency’s longstanding conclusions that the market for most grain movements is “effectively competitive.” *Nat’l Grain & Feed Ass’n v. Burlington N. R.R. Co.*, 8 I.C.C.2d 421, 453 (1992) (“Our experience in monitoring grain markets over recent years has shown that, although there are market dominant shipments, a large proportion of grain shipments take place in an effectively competitive market.”).¹

Indeed, all the evidence submitted in Opening Comments on trends in grain rates confirms that there is no reason for the Board to be concerned about rates in the grain industry. While ARC complains that post-Staggers regulatory policy has caused railroads to achieve financial stability at the expense of grain shippers,² the reality is that inflation-adjusted grain rates have decreased by 30 percent since 1981. *See* AAR Opening Comments at 12, Chart 18. And while average rail rates for grains have slightly increased in recent years, those increases have closely tracked increases in rail cost inputs. *See id.* at 12-13, Chart 19 (comparing changes in grain rates since 1990 to changes in the Rail Cost Adjustment Factor over that period). In short, the evidence shows that changes in the rates railroads charge for serving grain customers have not outpaced changes in the cost of providing that service. Moreover, AAR shows that the

¹ *See also LO Shippers Action Comm. v. ICC*, 857 F.2d 802, 805 (D.C. Cir. 1988) (describing the market for “grain shipments” as “a highly competitive market”).

² *See, e.g.*, ARC Opening Comments at 11.

modest increase in rail transportation rates for grain shipments since 1990 is dwarfed by the increases in other farm inputs over that period. *See id.* at 13, Chart 20.

Further evidence of the competitiveness of grain transportation and the constraints that this competition places on rail rates is the fact that a substantial amount of grain traffic moves at rates below the jurisdictional threshold of a 180% revenue-to-variable-cost ratio (“R/VC”). ARC’s witness admits that “most grain and grain products movements have revenue-to-variable-cost ratios falling below 180%.” ARC Opening Comments, V.S. Fauth at 4. Mr. Fauth’s verified statement calculates that 61% of the top four major grain commodities and 69% of the top four grain products move at R/VCs below 180%. *See id.*; *see also* NGFA Opening Comments, V.S. Crowley at 3-4 & Table 2.³ The inherently competitive rates at which most grain traffic moves belies ARC’s and NGFA’s contention that grain shippers as a class are being treated so unfairly as to warrant special treatment.⁴

The Board often has heard generalized rhetoric about how grain shippers face unfair and oppressively high rail transportation rates. There is a good reason why that rhetoric is almost always vague and unsupported by specific facts—the actual data cited by AAR shows that grain shippers are not paying unusually high rates. It is certainly true that some grain rates are higher than others and that some grain shippers may feel that their rates are unreasonably high. But the Board has developed adequate tools for such shippers to use, which have been designed to work

³ *See also* ARC Opening Comments at 7 (admitting that “there are shipments moving at rates below the STB jurisdictional threshold, and others moving at rates with R/VCs only slightly higher”).

⁴ ARC laments that shippers are unable to challenge the reasonableness of rates falling below 180% R/VC. *See* ARC Opening Comments, V.S. Fauth at 5. The complaint that most grain rates are not high enough to permit STB rate review is odd, to say the least. The reason that Congress excludes those rates from the Board’s jurisdiction is precisely because of a legislative judgment that rates below that level are being constrained by market forces. The Board obviously has no reason or authority to question that congressional judgment.

even for relatively small shipments of regulated commodities. There is no need to create a special set of rules for grain shippers—and certainly no need to adopt the sort of one-sided rules that NGFA and ARC propose.

II. THE BOARD’S EXISTING RATE REASONABLENESS PROCEDURES PROVIDE SUFFICIENT PROTECTION FOR GRAIN SHIPPERS.

The premise of NGFA’s and ARC’s demand for a new grain-specific methodology is that the Board’s existing procedures do not work effectively for grain shippers. But NGFA and ARC present little evidence to support their rhetoric, and none at all that could justify treating grain shippers more favorably than shippers of other commodities. The Board has invested considerable time and effort to design simplified rate reasonableness rules for use in relatively smaller cases, and these established methodologies are available to any grain shipper that believes its rates are unreasonably high. NGFA’s and ARC’s criticisms of the Board’s existing methodologies lack merit.

A. SAC and Simplified SAC Are Effective Remedies for Grain Cases of Sufficient Size.

The Stand Alone Cost (“SAC”) test developed as part of the Board’s Constrained Market Pricing (“CMP”) framework is the foundation of the Board’s rate reasonableness regulations for good reason. It is founded on sound economics and has been repeatedly approved by the courts.⁵ The Board has recognized that “CMP is the most economically precise procedure available for

⁵ See *Simplified Standards For Rail Rate Cases*, Ex Parte 646 (Sub-No. 1) (Sept. 5, 2007), at 13 (“*Simplified Standards*”) (“The SAC test, which judges the reasonableness of a challenged rate by comparison to the rate that would prevail in a competitive market, rests on a sound economic foundation and has been affirmed by the courts”); *Burlington No. R.R. Co. v. ICC*, 985 F.2d 589, 596 (D.C. Cir. 1993) (“CMP, with its SAC constraint, is the most accurate procedure available for determining the reasonableness of rates in markets where the rail carrier enjoys market dominance” (internal quotation marks omitted)).

evaluating the reasonableness of rates and should be used whenever possible.”⁶ CSXT notes that SAC has been significantly streamlined and refined in recent years in ways that reduce litigation costs. For example, the Board eliminated the use of movement-specific adjustments to URCS in an effort to “reduce the expense of litigating before the agency.”⁷ And the Board’s rulemaking refinements have continued to reduce SAC litigation costs by settling long-running disputes about revenue allocation for crossover traffic and methodologies for cost escalation and rate prescriptions.⁸ While CSXT did not agree with all these refinements, they indisputably have narrowed the range of issues that can be contested in SAC cases and thereby have reduced litigation costs.⁹

CSXT recognizes that many grain shippers do not have a sufficient volume of traffic to merit the time and expense of a SAC challenge, but Simplified SAC is an option that requires substantially less in litigation costs.¹⁰ And many of NGFA’s complaints about SAC and

⁶ See *Rate Guidelines—Non-Coal Proceedings*, 1 S.T.B. 1004, 1013 (1996).

⁷ See *Major Issues in Rail Rate Cases*, Ex Parte No. 657 (Sub-No. 1), at 59-60 (served Oct. 30, 2006) (“*Major Issues*”).

⁸ See *Major Issues* at 5 (noting that a key objective of Ex Parte 657 changes was “to reduce the complexity and expense of these rate proceedings by shortening the time frame for the SAC analysis from 20 to 10 years, simplifying the jurisdictional inquiry by using unadjusted URCS figures, and resolving three major methodological issues”); *Rate Regulation Reforms*, Ex Parte No. 715 (July 18, 2013) (“*Rate Regulation Reforms*”).

⁹ For example, in the recent *DuPont* and *SunBelt* cases the litigants devoted considerable arguments to the proper Average Total Cost (“ATC”) methodology. The Board’s adoption of Alternative ATC in *Rate Regulation Reforms* effectively settled that dispute for future SAC cases.

¹⁰ CSXT notes that the \$4 million estimate of the cost of a Simplified SAC case the Board used to establish a relief limit for Three Benchmark cases in Ex Parte 715 contained a double-count of expenses and relied on plainly exaggerated cost estimates. See Opening Br. of CSXT and Norfolk Southern Ry. Co. at 29-33, *CSXT v. STB*, No. 13-1230 (filed Dec. 2, 2013). The infirmity of the Board’s calculation is demonstrated by the fact that the D.C. Circuit remanded the Three Benchmark relief cap for further consideration despite the significant deference that the Court affords to agency judgments. See *CSX Transp. v. STB*, No. 13-1230, at 16 (D.C. Cir. June 20, 2014).

Simplified SAC have nothing to do with the cost of the procedures. Rather, NGFA's primary concern is that in many cases grain shippers might be unable to prove that their rates in fact exceed the stand-alone costs of their service. For example, NGFA argues that grain shippers might have difficulty developing a successful SAC or Simplified SAC presentation because grain shipments often use low-density portions of a railroad's network. *See* NGFA Comments at 13, 14 ("Ag Commodity shippers do not generate the tonnage necessary to meet traffic densities essential for a successful Full-SAC presentation"). But that is another way of saying that these grain shippers are not actually being charged rates that exceed the stand-alone cost of providing service. Like any other complainant, a grain shipper is entitled to select non-issue traffic for its SARR to share in the costs of the SARR's facilities. If the combination of revenue from a complainant's traffic and other selected traffic is unable to meet the revenue requirements of a SARR serving that traffic group, then by definition the defendant railroad is not charging more than it needs to cover the full stand-alone costs of its service.

Similarly, NGFA complains that grain shippers might not be able to satisfy the Board's rules prohibiting internal cross-subsidies. *See* NGFA Comments at 13, 14. That again is just another way of saying that some grain complainants could not demonstrate that their rates are unreasonable without assuming that other shippers would impermissibly cross-subsidize part of the facilities used by the complainant's traffic.

The supposed "problems" NGFA sees in applying SAC and Simplified SAC to grain shipments are thus only problems that NGFA has with sound railroad economics and basic regulatory principles. But grain shippers should not be able to play by a different set of rules than other shippers. The foundation of the Board's regulatory scheme is the recognition that shippers are responsible for their fair share of the costs of the infrastructure and services used to

serve those shippers. If a shipper cannot design a successful SARR without positing an impermissible cross-subsidy, that is just evidence that the challenged rate is not unreasonable.

B. Three Benchmark Remedies Are Effective for Smaller Cases.

The Board's Three Benchmark remedies are an effective option for any shipper that believes that SAC or Simplified SAC is too costly. While CSXT continues to have concerns about a methodology that is as "crude," "rough and imprecise," and divorced from economic principles as the Three Benchmark methodology,¹¹ it is undeniably a cheap and simple alternative. Indeed, Three Benchmark was designed in part to provide a remedy "for small grain shippers." *Simplified Standards for Rail Rate Cases*, Ex Parte No. 646 (Sub-No. 1) at 36 (Sept. 5, 2007) ("*Simplified Standards*") (V.C. Buttrey, concurring). NGFA bears a heavy burden to show that a methodology that was specifically designed for use by small grain shippers is nonetheless inadequate. Yet NGFA's entire argument for the supposed insufficiency of the Three Benchmark method consists of a mere five sentences. *See* NGFA Opening Comments at 15. NGFA's claims that the Three Benchmark method is not effective for grain cases lack merit.

First, NGFA claims that the Three Benchmark approach will not work in grain cases because "uniformly high rate[s]" have been applied "across the board" to grain shipments. NGFA Opening Comments at 15. ARC similarly claims that grain rates "tend to produce uniform R/VCs" and thus that the Three Benchmark method would be ineffective. ARC Opening Comments at 17. But the evidence shows that this is not the case. ARC's own witness produced purported studies of R/VC ratios for 2014 grain movements that showed substantial fluctuations—not "uniformity." *See* ARC Opening Comments, V.S. Whiteside at 11, 13. NGFA's witness similarly found a substantial lack of uniformity among grain R/VCs—with

¹¹ *Simplified Standards* at 73.

most below 180%, some between 180% and 250%, and a small percentage over 250%. *See* NGFA Opening Comments, V.S. Crowley at 3, 4. Grain rates are plainly not “uniformly high,” and there is no reason why the Three Benchmark method could not be used for grain rate challenges.

Second, NGFA complains that the Three Benchmark approach is unduly complicated because of “the railroad defendants” raising arguments about “other relevant factors” and about the appropriate timeframe for waybill data. NGFA Opening Comments at 15; *see also* ARC Opening Comments, V.S. Fauth at 26. Neither claim has merit. In the first place, both complainants and railroads have made “other relevant factor” arguments in every decided Three Benchmark case, and there is nothing unduly complex about those arguments.¹² Moreover, the Board’s rulings on other relevant factors in prior Three Benchmark cases have helped to define the appropriate scope of that evidence and should reduce litigation costs in this area for future cases. And NGFA’s citation of prior litigation about the appropriate timeframe of waybill data from which to draw comparable movements is a red herring. This question was definitively settled by the Board in Ex Parte 646 (Sub-No. 3), and the fact that it was debated by parties in prior cases creates no “uncertainty” for future litigants.¹³

The Three Benchmark methodology has been used—and used successfully—in several cases involving small-volume shipments of chemicals and plastics. There is no reason that the methodology could not be used with similar success for other commodities, including grain.

¹² *See U.S. Magnesium, LLC v. Union Pac. R.R. Co.*, STB Docket No. NOR 42114, at 15-19 (Jan. 28, 2010); *E.I. du Pont de Nemours & Co. v. CSX Transp., Inc.*, STB Docket No. NOR 42099, at 17-19 (June 30, 2008). *E.I. du Pont de Nemours & Co. v. CSX Transp., Inc.*, STB Docket No. NOR 42100, at 15-18 (June 30, 2008). *E.I. du Pont de Nemours & Co. v. CSX Transp., Inc.*, STB Docket No. NOR 42101, at 14-16 (June 30, 2008).

¹³ *See Waybill Data Released in Three-Benchmark Rail Rate Proceedings*, Ex Parte 646 (Sub-No. 3) (Mar. 12, 2012).

Since the *Simplified Standards* were adopted, shippers have prevailed in one Three Benchmark case and obtained settlements in four others. And there are uncounted cases where the background availability of a Three Benchmark remedy likely strengthened shippers' leverage to negotiate satisfactory commercial terms with railroads. Not only is a satisfactory commercial settlement a successful outcome for a shipper, it is an ideal outcome for the Board and all interested parties.

NGFA and ARC also repeat the fallacy that a lack of grain rate cases proves that the regulations are not working. *See* NGFA Opening Comments at 12; ARC Opening Comments at 24. On the contrary, a well-functioning regulatory system should result in fewer cases, not more—particularly when much of the traffic at issue is subject to market competition. Most of CSXT's grain customers have significant market options and negotiating leverage, and they have ample ability to obtain satisfactory commercial solutions. This is something to celebrate, not to lament.

III. THE BOARD HAS NO REASON TO CREATE NEW RULES BIASED IN FAVOR OF GRAIN SHIPPERS.

Even if there were some reason to create special modified grain rules (and there is not), there is no possible justification for adopting the biased and unfair rules proposed by NGFA and ARC. NGFA's proposal would set up grain shippers as a class of most-favored-shippers entitled to rate reductions on the backs of other shippers of other commodities. In almost every instance, NGFA's and ARC's proposals are not proposals to make it procedurally easier or less costly for grain shippers to seek rate relief; they are rather proposals to make it easier for grain shippers to win. As AAR shows in its reply comments, NGFA's and ARC's proposals would eliminate demand-based differential pricing for grain traffic, prevent the Board from determining appropriate contribution to fixed costs, and "adjust" URCS in ways that would blatantly favor

grain shippers over other shippers.¹⁴ A rate regime that allows one set of shippers to achieve below-market rates necessarily means that other shippers will end up bearing an unfair share of the burden.

IV. NGFA’S COMMENTS ARE FURTHER REASON TO ABANDON THE LIMIT PRICE TEST.

CSXT notes that both NGFA and ARC ask for a special exception to the limit price test for grain shipments—presumably because some grain shippers might wish to argue that railroads have qualitative market dominance over shipments that would produce a limit price R/VC below the defendant’s RSAM. *See* NGFA Opening Comments at 34-35; ARC Opening Comments at 21-22. While CSXT disagrees with NGFA and ARC about the existence of effective competition for grain shipments, these groups are right that a comparison of a limit price R/VC ratio to RSAM has no meaningful relationship to whether effective competition exists.¹⁵ The Board should discard this misguided test.

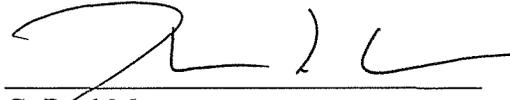
CONCLUSION

The Board should respond to the comments received in the proceeding by reaffirming that grain shippers who believe their rates may be unreasonable can avail themselves of the Board’s existing rate reasonableness remedies, and the Board should discontinue this proceeding with no further action.

¹⁴ CSXT refers the Board to the AAR’s Reply Comments being filed today for discussion of these errors.

¹⁵ *See, e.g.*, CSXT Pet. for Reconsideration at 17, Ex. 2 at 7-8, *Total Petrochemicals USA, Inc. v. CSX Transp., Inc.*, STB Docket No. NOR 42121 (filed June 20, 2013). As the Board knows, CSXT’s appeal of the Board’s use of the limit price test in the *TPI* case is pending before the U.S. Court of Appeals for the D.C. Circuit. *See CSX Transp., Inc. v. STB*, No. 13-1313 (oral argument scheduled for Sept. 22, 2014).

Respectfully submitted,



G. Paul Moates
Matthew J. Warren
SIDLEY AUSTIN LLP
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000
(202) 736-8711 (fax)

Peter J. Shutz
Paul R. Hitchcock
Steven C. Armbrust
John P. Patelli
CSX Transportation, Inc.
500 Water Street
Jacksonville, FL 32202

Counsel to CSX Transportation, Inc.

Dated: August 25, 2014