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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

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

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 reply comments of the Association of American Railroads.

Respectfully submitted,

Timothy J. Strafford
Counsel for the Association of
American Railroads

BEFORE THE
SURFACE TRANSPORTATION BOARD

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

RAIL TRANSPORTATION OF GRAIN,
RATE REGULATION REVIEW

REPLY COMMENTS OF THE
ASSOCIATION OF AMERICAN RAILROADS

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BEFORE THE
SURFACE TRANSPORTATION BOARD

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

RAIL TRANSPORTATION OF GRAIN,
RATE REGULATION REVIEW

REPLY COMMENTS OF THE
ASSOCIATION OF AMERICAN RAILROADS

Pursuant to the schedule established by the Surface Transportation Board ("Board") in a notice served on December 12, 2013,[1] and in subsequent decisions served in this proceeding,[2] the Association of American Railroads ("AAR") respectfully submits these reply comments.

In its opening comments filed on June 26, 2014, the AAR described how grain markets vary significantly across commodity type and over time and how grain transportation networks, including railroads, must be resilient to respond to market demand. The AAR noted that to allow railroads the flexibility necessary to achieve this resiliency the Board's regulation of rail rates for grain, like its regulation of rates for all commodities, must reflect market principles and allow for necessary investment in rail capacity. The AAR submitted that the Board's existing rate case procedures are currently accessible to grain shippers and recent changes to those procedures were intended to make them more so. Finally, the AAR cautioned that any policy changes that

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[1] *Rail Transportation of Grain, Rate Regulation Review*, EP 665 (Sub-No. 1)(STB served Dec. 12, 2013)("Notice").

[2] The Board extended the procedural schedule in decisions served on February 10, 2014, and April 18, 2014.

would have the effect of artificially reducing rail earnings would severely hamper railroads' ability to invest in their networks, inhibit capacity growth, and degrade rail service and therefore should be rejected.

Opening comments were filed in this proceeding by AAR members BNSF Railway Company, CSX Transportation, Inc., Norfolk Southern Railway Company, and Union Pacific Railroad Company. Opening comments were also filed by the U.S. Department of Agriculture ("USDA"), the National Grain and Feed Association ("NGFA") and by the Alliance for Rail Competition *et al.* ("ARC") (collectively, "Agricultural Interests").

In the discussion below, the AAR responds to the opening comments filed by the Agricultural Interests in this proceeding. The AAR's response focuses on five main points. First, the Board should defer consideration of the issues associated with revenue adequacy until it reviews the record that will be developed in EP 722, *Railroad Revenue Adequacy*. Second, the record in this proceeding does not support singling out any commodity or group of commodities for special treatment. Third, the specific proposals advanced by the Agricultural Interests for substantive changes to the Board's rate reasonableness standards are contrary to the law and sound economics and should be rejected. Fourth, though alternative dispute resolution methods can be useful tools, the Board cannot require arbitration of rail rate disputes absent the parties' voluntary agreement. Finally, it is unnecessary for the Board to opine on standing, as the governing principles are clear and the analysis of a particular party's standing will depend on the individual facts of the case.

ARGUMENT

I. Issues Associated With Revenue Adequacy Should be Considered Holistically in EP 722

At the outset, the AAR notes that the opening comments filed in this proceeding by the Agricultural Interests call on the Board to create special rules for grain rates based on claims that the railroad industry or individual railroads are, or are close to, "revenue adequate." *See, e.g.*, USDA Comments at 3; NGFA Comments at 21-22; ARC Comments at 11-14. Revenue adequacy is a multi-faceted, complex concept with the potential for wide ranging implications to the railroad industry, its customers, and the nation's economy that the Board has already invited public comment on in EP 722, *Railroad Revenue Adequacy*. The AAR intends to submit extensive testimony on revenue adequacy as it relates to the general condition of railroad financial health, the annual determination required by the Interstate Commerce Act, as amended ("ICA"), and the constraint on railroad pricing discussed by the agency in *Coal Rate Guidelines, Nationwide*, 1 I.C.C.2d 520 (1985) (*Coal Rate Guidelines*).[3] Agricultural Interests have not put forth any rationale explaining why such issues should be considered in this proceeding first or why grain transportation requires special consideration of revenue adequacy for those shipments. As such, the AAR will address issues associated with revenue adequacy in EP 722 and focus its reply comments in this proceeding on issues raised by the Board in the Notice.

The AAR notes, however, that NGFA has specifically requested that the Board revise its standards for the annual revenue adequacy determination to include data from Canadian railroads' operations outside the United States. NGFA Comments at 23. The AAR believes that there is no justification for such a change and that it would be beyond the Board's jurisdiction.

[3] The AAR notes that any discussion of revenue adequacy must focus on the long-term financial health of the railroad industry and that snapshot looks at a railroads' financial performance, like NGFA's Revenue Adequacy Adjustment Factor that focuses on only a single year of data, are not appropriate regulatory tools. *See* NGFA Comments, Crowley V.S. at 11.

The Board, indeed the United States Government, has no authority to regulate the revenues of a railroad in a foreign country. *See* 49 U.S.C. § 10501(a)(2) ("jurisdiction under paragraph (1) applies only to transportation *in the United States* . . .") (emphasis added); *Proposal to Require Consolidated Reporting by Commonly Controlled Railroads*, EP 634 (STB served Nov. 7, 2001), slip op. at 4 ("we seek information primarily to assist us in the regulation of the matters within our jurisdiction, which is rail transportation in the United States. As CN points out, Canadian rail operations are 'governed by different regulatory and labor regimes,' which can affect the cost structure and earnings of the carriers. So as not to distort the results of those United States rail operations that we regulate, we will continue to require reporting only on rail operations within the United States").

II. The Record In This Proceeding Does Not Support Singling Out A Commodity or Group of Commodities For Special Treatment

A. Sound Economics Must Be the Foundation of Maximum Rate Regulation For All Commodities

The AAR supports the Board's stated intent to "consider what regulatory changes could be implemented to ensure that the Board's rate case procedures are fully accessible to grain shippers and provide effective relief from excessive freight rail rates, as appropriate." Notice at 2. The Board has demonstrated a continuing concern that its processes are accessible to all stakeholders by seeking to finds ways to reduce delay and expense associated with rate complaints. *See Simplified Standards for Rail Cases*, EP 646 (Sub-No. 1) (STB served Sept. 5, 2007) (*Simplified Standards*); *Rate Regulation Reforms*, EP 715 (STB served July 18, 2013). *See also Sunbelt Chlor Alkali Partnership v. Norfolk Southern Railway Company*, NOR 42130 (STB served June 20, 2014) slip op. at 30 (stating that the objective of this EP 665 (Sub-No. 1) proceeding is to ensure that grain shippers have access to the Board's rate procedures (Chairman Elliott, commenting)).

To the extent that the comments by the Agricultural Interests in this proceeding reflect a desire to work with the Board to find ways to streamline those processes for all shippers, without discarding the economic foundation of the current rate reasonableness tests, *see, e.g.*, NGFA Comments at 16, the AAR joins in that sentiment. However, the Agricultural Interests go beyond seeking to expedite case processing and ask the Board to change the substantive rules related to rate reasonableness to advantage grain shippers over other commodities and set rates without regard to sound economics and market forces. AAR cannot agree that the record in this proceeding has demonstrated that the rules of sound economics should not apply to the regulation of grain traffic.

The AAR opposes the efforts of the Agricultural Interests to obtain special treatment for their constituents. These groups are offering proposals designed to drive rail rates for favored shippers below competitive levels. They are asking the Board to adopt methodologies that the ICC and Board have correctly rejected in the past as inconsistent with the ICA and unsound as a matter of economics and transportation policy. Unlimited revenue to variable cost ("R/VC") ratio comparisons, particularly those relying on comparisons to R/VC ratios below the Board's jurisdictional floor and between different railroads have been rejected by the agency for nearly thirty years. *See Rate Guidelines – Non-Coal Proceedings*, EP 347 (Sub-No. 2) (ICC served April 8, 1987).

The Board's rate reasonableness standards are founded on solid economic principles and its governing statute. The Board's rules reflect Congressional intent to allow competition and demand for transportation services to establish rail rates and regulate rates only in those rare instances where competitive markets for transportation services are absent. *See Assoc. of Am, Railroads v. ICC*, 978 F.2d 737, 741 (D.C. Cir. 1992) (noting that railroads are not a "heavily regulated utility" and most rates are not subject to maximum rate regulation). In those rare instances where regulation is necessary, the Board's regulation of rates should mimic the outcomes of competitive markets.

The constrained market pricing (CMP) principles adopted in *Coal Rate Guidelines* do so by reflecting the economic structure of the railroad industry and an understanding of contestable markets. Traditional utility rate of return regulation is inappropriate in the rail industry in part because of the large amounts of joint and common costs that cannot be directly attributed to particular traffic.[4] Because railroads serve a mix of competitive and captive traffic, a carrier must price its services according to "Ramsey pricing" principles, in inverse relation to demand elasticity. *Coal Rate Guidelines*, 1 I.C.C.2d at 256. In particular, the stand-alone cost ("SAC") test mimics competitive outcomes by capping rates at the level that would induce a competitor to enter the market, if there were no barriers to entry or exit.

The agency has long acknowledged that CMP should apply to all commodities and be applied wherever possible. "Notwithstanding its title, the *Coal Rate Guidelines* Procedures are not limited to coal cases." *Rate Guidelines – Non-Coal Proceedings*, 1 S.T.B. 1004, 1008 & n.7 (1996) (*Simplified Guidelines*). "CMP, with its SAC constraint, continues to be [the Board's] preferred and the most accurate procedure available for determining the reasonableness of rail rates where there is an absence of effective competition." *Simplified Standards* at 13 (citing *Simplified Guidelines*, 1 S.T.B. at 1021 ("CMP provides the only economically precise measure of rate reasonableness and therefore must be used wherever possible."); *see also McCarty*

[4] There are other reasons utility rate regulation is inappropriate as well – some of which the ICC and STB have previously discussed – including the lack of any guaranteed rate of return.

Farms, Inc. v. Burlington N., Inc., 3 I.C.C.2d 822, 839-40 (1987); *Rate Guidelines – Non-Coal Proceedings*, EP 347 (Sub-No. 2), slip op. at 1-2 (ICC served Apr. 8, 1987).

Rates regulated by CMP lead to efficient economic outcomes in the public interest because they reflect market demand. Shippers with higher demand pay differentially higher rates, allocating scarce resources efficiently. Moreover, such differential rates are consistent with the ICA's mandate that the Board "allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail." 49 U.S.C. § 10101(1) and that its regulation of rail rates be consistent with its "adequate and continuing effort to assist" rail carriers in earning adequate revenues. 49 U.S.C. § 10702(d)(2); § 10704(a)(2). Even shippers' with more inelastic demand benefit from a railroad's economies of scale and density as long as the maximum lawful rate is at or below the contestable market entry price as measured by the SAC test. Because the SAC test is principally a measure of cross subsidy,[5] a particular shippers' rate that does not exceed SAC cannot possibly be subsidizing another part of the network that it does not use.

The AAR has long recognized the cost and complexity of the SAC test as applied by the Board,[6] but stresses that the economic principles underlying the Board's procedures remain valid for all commodities. The Board has attempted to deal with this cost and complexity by introducing a Simplified SAC methodology that retains the goal of approximating the result of a

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[5] The SAC test also searches for inefficiencies in the defendants' operations, *See Rail Rate Reforms*, EP 715 (STB served July 18, 2013) slip op. at 5, but, as the Board explained the railroads response to deregulation after the Staggers Act has been to rationalize their networks and dramatically increase productivity. "Railroads no longer are burdened by substantial excess capacity; rather the rail industry now faces the opposite situation. Rail capacity is strained, demand for transportation service is forecast to increase, and railroads must make capital investments to meet that demand." *Simplified Standards* at 14.

[6] *See* AAR Comments, *Rate Guidelines – Non-Coal Proceedings*, EP 347 (Sub-No. 2) (filed Aug. 20 1987)

contestable market and retaining a Three Benchmark test for those disputes where even a Simplified SAC case would be too expensive, given the value of the case. *Simplified Standards* at 5. The Board has tried to tether the Three Benchmark test to CMP principles by assuming that rates for some traffic in the comparison group would be constrained by market forces or SAC and limiting the amount of relief available. *See Simplified Standards* at 73-74.

B. The Testimony of Shipper Witnesses and Experts Indicate That Most Grain Traffic Is Subject to Competition

The record in this proceeding demonstrates that most grain movements by rail face pervasive competition. As shipper witnesses concede, most grain rates are below the statutory threshold of 180% for Board jurisdiction to even consider rate reasonableness complaints of 180%. *See* NGFA Comments, Crowley V.S. at 3; ARC Comments, Fauth V.S. at 5. Moreover, the Agricultural Interests note that railroads compete for grain traffic and acknowledge the incontrovertible fact that grain can and does also move by truck and barge. *See, e.g.*, NGFA Comments at 9-10. And USDA studies establish that trucks have a greater market share than railroads for grain transportation. *See* USDA, Transportation of U.S. Grains: A Modal Share Analysis, 1978-2011 Update (2013). In addition to providing origin to destination transportation, such truck transportation can be used to reach competing railroads. "Many large volume railroad grain movements involve relatively short distances to processing facilities and river terminals and many large grain destinations have two or more railroads serving their facilities." ARC Comments, Fauth V.S. at 15; NGFA Comments at 7 ("Grain elevators aggregate the crops grown on farms they serve, which typically are delivered to the elevator primarily by truck.").

Moreover, as conceded by the shippers, railroads face geographic competition for grain transportation. Though the Board has refused to consider geographic competition in market dominance determinations for administrative efficiency reasons, these forces constrain rail rates in the real world and should not be ignored in proceedings considering whether to make far reaching changes to substantive rules. NGFA points out that wheat and other commodity shippers solely served by one railroad in one state, "compete not only against each other to sell their crops, but also with shippers and receivers from other states and Canadian provinces." NGFA Comments at 8. Further, NGFA admits that "delivery points to which many Ag Commodities are shipped often have multiple sources of supply," NGFA Comments at 9. Shippers and receivers can also substitute products in some instances. These competitive forces indicate that the Board should have a limited role to play in regulating rail rates for grain.

Contrary to ARC's claims, ARC Comments Whiteside V.S. at 12, rate increases in the marketplace do not suggest the exercise of market power or that there is a problem with the regulatory structure. It is an economic fact that when demand rises for a capacity constrained service, prices go up. *See, e.g., Brooke Group Ltd. V. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 232 (1993) ("If prices rise in response to an excess of demand over supply . . . the market is functioning in a competitive manner."). Moreover, R/VC ratios do not indicate the presence of market power. *See Western Coal Traffic League v. United States*, 694 F.2d 378, 387 (5th Cir. 1983), *aff'd en banc Western Coal Traffic League v. United States*, 719 F.2d 772 (5th Cir. 1983). *See also* CSX Comments, NOR 42123, Joint Verified Statement of B. Kelly Eakin and Mark E. Meitzen (filed Oct. 29, 2012) at 12 (noting weakness of R/VC ratios as indicators of market power).

C. <u>The Number of Rate Cases Before the Board is Not The Proper Metric For the Success of The Rate Reasonableness Standards</u>

The Board should reject calls to judge the success of its rate reasonableness standards based on the number of cases on its docket. *See, e.g.,* NGFA Comments at 12. Given the limited universe of rail rates subject to Board jurisdiction, one would not expect a large number of cases to be filed before the Board. Most grain rates are not subject to the Board's statutory rate regulation jurisdiction either because the rate generates an R/VC ratio that falls beneath the statutory floor of 180% or because the traffic moves subject to a transportation contract pursuant to 49 U.S.C. § 10709. That pool of possible complainants is further limited by excluding those commodities that the Board has exempted from regulation because rail transportation faces completion and by those movements where the rail carrier lacks market dominance under 49 U.S.C. § 10707 because the carrier faces effective competition. As discussed below, the Agricultural Interests admit that the application of economically rational tests show that the remaining rates are reasonable.

This result should come as no surprise. Railroads price their services according to market demand like other industries, and are constrained by a host of factors beyond those considered in Board cases. Further, where there are disputes over the reasonableness of common carrier rates, clear regulatory rules facilitate private sector negotiation and resolution. It is in all parties' interest to avoid litigation if possible. The goal of any regulatory regime should be compliance to the rules and not excessive litigation.[7]

D. Criticism of Existing Rate Reasonableness Methodologies Do Not Warrant Special Treatment for Grain Traffic

NGFA claims that the SAC test is "useless" for agricultural commodity movements, NGFA Comments at 13, and that "the average cost of a SAC case dwarfs the average overcharges an Ag Commodity shipper would pay in the typical circumstance." *Id.* The agency and Congress have long been concerned with the cost and complexity of the SAC test, *see* 49

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[7] In that regard, the Board should consider whether there would be any cases at all if it were to adopt a mathematical formula to judge the reasonableness of rates as advocated by ARC. *See, e.g.,* ARC Comments, Fauth V.S. at 25-26.

U.S.C. § 10702(d)(3). The AAR has consistently advocated that the Board streamline its procedures, while maintaining their underlying economic rationality. *See Rate Guidelines – Non Coal Proceedings*, EP 347 (Sub-No. 2) (ICC served April 8, 1987) slip op. at 2. That the SAC procedure may not be cost effective for a case with limited stakes should come as no surprise to the Board. Indeed, the cost and complexity of the SAC test is the sole justification for the Three Benchmark test refined by *Simplified Standards*. *See* 49 U.S.C. § 10701(d)(3).

But the heart of NGFA's desire for rate reasonableness rules that favor grain shippers over the shippers of other commodities is not the cost and complexity of the SAC test, but that the economic analysis of rail rates under a SAC or Simplified-SAC test for those movements would show that the rates are not unreasonable. NGFA argues that "Ag Commodity shippers do not generate the tonnage necessary to meet traffic densities essential for a successful Full-SAC presentation" and "[m]any facilities and elevators are located on low density rural branch lines or secondary lines." NGFA Comments at 13. "Although many grain and grain products have high rates, they simply do not have the volumes and track densities necessary to make use of these expensive and time consuming SAC tests." ARC Comments, Fauth V.S. at 18. "It would be difficult to obtain any relief for most grain and grain products shippers under these SAC tests because the annual volumes associated with specific movements are generally much lower than coal movements." ARC Comments, Fauth V.S. at 22.

The fact that a SAC analysis would show that a particular shipper's rate is reasonable means that that shipper is not paying to subsidize other parts of the network it does not use and is not paying for inefficiencies in the carrier's operations. That is, under any economic theory those shippers with high demand located on light density lines must make a significant contribution to fixed costs to continue to make the operation of those lines economically viable.

Only by gaming the SAC process and removing the tests for cross subsidy applied in *PPL Montana, LLC v. The Burlington N. and Santa Fe Rwy Co*, 6 S.T.B. 286 (2002) and *Otter Tail Power Co. v. BNSF Rwy. Co.*, NOR 42071 (STB served Jan. 27, 2006) could the SAC process be manipulated enough to show otherwise reasonable rates to be unreasonable.

The Board should take seriously contentions raised in this proceeding and elsewhere that the process around SAC cases can continue to be improved and streamlined for all parties. No participant in such cases, shipper or railroad, benefits from delay and millions of dollars of litigation costs. The challenge of the cost and complexity associated with litigation is not unique to the Board or SAC cases, however. *See* Judicial Conference Advisory Committee on Civil Rules and the Committee on Rules of Practice and Procedure, *Report to the Chief Justice of the United States on the 2010 Conference on Civil Litigation*, (2010) at 1. The Federal judiciary is also grappling with the time and expense of litigation in the courts. *See, e.g.,* 2010 Civil Litigation Conference http://www.uscourts.gov/RulesAndPolicies/rules/archives/projects-rules-committees/2010-civil-litigation-conference.aspx (last accessed Aug. 14, 2014). Large, multi-million dollar, complex cases often take years to resolve in courts. *See* Civil Case Processing in the Federal District Courts: A 21st Century Analysis, The Institute for the Advancement of the American Legal System at the University of Denver (IAALS) available at: http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/Duke%20Materials/Library/IAALS,%20Civil%20Case%20Processing%20in%20the%20Federal%20District%20Courts.pdf

Moreover, a study of litigation costs in civil cases showed that higher stakes cases, cases with longer processing times, and factual complexity were associated with higher litigation costs. *Litigation Costs in Civil Cases: Multivariate Analysis*, Report to the Judicial Conference Advisory Committee on Civil Rules (March 2010). Litigation costs continue to rise across all litigation, not just SAC cases. *See* Litigation Cost Survey of Major Companies, Statement submitted by Lawyers for Civil Justice, Civil Justice Reform Group, U.S. Chamber Institute for Legal Reform, 2010 Conference on Civil Litigation Duke Law School (May 2010). Thus, where rail rate disputes have substantial money at stake and where complex factual questions regarding rail infrastructure and operations must be resolved, litigation costs and processing times may be warranted.

The Board should consider looking at what particular issues drive this cost and complexity. While the Board does resolve a multitude of minute details in the course of a SAC case, such as the number of pick-up trucks necessary for certain types of crews, such matters probably do not drive costs significantly higher and are not particularly difficult to resolve. To the extent the Board is consistent in its resolution of such issues, explains its decisions, and cites its precedent, parties can reasonably gauge what evidence to submit. Instead, other issues are more likely to drive the cost and complexity. The use of so-called "cross-over" traffic to "simplify" the SAC analysis actually requires a complainant to test whether particular low-rated movements should be included in the traffic group and whether high-cost aspects of the network should be replicated in its SAC analysis in an iterative, time-consuming process requiring the expertise of specialized consultants. The Board should follow through with its promise in EP 715 that it would explore issues related to the proper use of cross-over traffic in a separate rulemaking. *See Rate Regulation Reforms*, EP 715 (July 18, 2013), slip op. at 28.

Beyond that, the AAR submits that the Board should also consider whether there are procedural steps that it can take in order to expedite the processing of SAC cases. In this vein, the AAR notes the recommendations of The Institute for the Advancement of the American

Legal System at the University of Denver (IAALS) to expedite the processing of civil litigation in the Federal courts:

1. Setting firm dates early in the pretrial process for the close of discovery, the filing of dispositive motions, and trial, and maintaining those dates except in rare and truly unusual circumstances,
2. Ruling expeditiously on motions, even when the motions are denied;
3. Limiting the number of extensions sought by the parties during any phase of the case;
4. Working to foster a local legal culture that accepts efficient case processing as the norm, and enforcing that culture through active judicial case management; and
5. Tracking the status of cases and motions through internal statistical reporting; and disseminating the results internally and externally as appropriate.

Id. at 9-10. Consideration of these recommendations of these and other studies of litigation may be helpful to the Board in considering how to improve its processes.

E. Arbitrary Assumptions Regarding the Desirability of Individual Litigation Decisions Should Not Underlie Any Change to the Board's Processes

USDA attempts to quantify the litigation cost level at which grain shippers might be expected to bring complaints at the Board, but in so doing makes a number of unwarranted and arbitrary assumptions. USDA assumes, without explanation, that shippers expect rate reductions of 5-10% when bringing a complaint. USDA Comments at unmarked page 5. USDA further assumes that it will cost the complainant $500,000 to bring the complaint and will have a 50% chance of success. *Id.* at unmarked page 6. Based on these arbitrary and unsupported assumptions, USDA concludes that the Board should establish a grain-specific rate reasonableness methodology that does not cost more than $50,000. *Id.* This formula does not provide any information that should lead the Board to conclude that changes to its methodologies or procedures is warranted.

III. Shipper Proposals in this Proceeding for New Methodologies For Judging the Reasonableness of Rates for Grain Traffic Are Contrary to Law and Sound Economics

As discussed above, the AAR does not believe that the law, sound economics, or this record support the conclusion that the Board should establish rate reasonableness rules designed to advantage grain shippers. However, if the Board were inclined to attempt to fashion such procedures, the proposals put forth by ARC and NGFA are deeply flawed and should not be adopted.

A. Both NGFA and ARC Would Define "Grain" Too Broadly

Both ARC and NGFA would define grain too broadly. In seeking a grain-specific rate reasonableness methodology, NGFA proposes that agricultural commodities should include all of the commodities listed in the National Grain and Feed Association's Rail Arbitration Rules. NGFA at 27. Similarly, ARC asks the Board to extend any action it might take in this proceeding beyond the STCC 01-13 codes to grain products including wheat flour STCC 20-411, corn syrup STCC 20-0461, soybean meal STCC 20-923 and ethanol ATCC 28-184. ARC comments, Fauth V.S. at 3.

Such a broad definition would be unwarranted. Grains and grain products have operational, safety, and cost differences that undermine grain shippers' argument that substantive rule changes are necessary. For example, ARC notes that approximately 70% of corn and 77% of soybeans moved in trainload shipments, whereas 44% of ethanol shipments did so. ARC Fauth V.S. at 9. Moreover, ethanol has unique safety characteristics. *See, e.g.,* Pipeline and Hazardous Materials Safety Administration, *Hazardous Materials: Enhanced Tank Car Standards and Operational Controls for High-Hazard Flammable Trains*, 79 Fed. Reg. 45015, 4017 (Aug. 1, 2014) ("Currently, as shipped, crude oil and ethanol are typically classified as

Class 3 flammable liquids"). As such, unique costs related to the operating and capital cost of compliance with safety and security railroad procedures and regulatory rules, which are poorly reflected in the Board's Uniform Railroad Costing System ("URCS"), separate ethanol from other grain related commodities.

A. The Board And The Courts Have Recognized That Rate Comparisons Do Not Comport With CMP And Are Not Appropriate Rail Rate Reasonableness Standards Standing Alone

Fundamentally, both NGFA and ARC propose rate comparison tests untethered from economic theory and unconstrained by any limits on relief. In so doing, they propose flawed methodologies that the ICC and the Board have considered and rejected in the past. In *McCarty Farms* the ICC tried to shortcut an economic analysis of the rates at issue and instead looked at whether the R/VC ratio generated by those rates was higher than those of comparison benchmark traffic. *Burlington Northern R.R. Co. v. Interstate Commerce Comm 'n,* 985 F.2d 589, 595 (D.C. Cir. Feb. 9, 1993). That decision was overturned on appeal and the court of appeals for the D.C. Circuit found that the ICC's approach and explanation lacked "supporting principle or intellectual coherence" and the agency "had not intelligibly explained why the trade-off chosen was reasonable." *Id.* at 597. The Court concluded that "the jettisoning of CMP/SAC cannot pass for reasoned decision making," and the Court remanded the case to the ICC. *Id.* at 599.

The courts and the Board have been rightly concerned that rate comparisons do not pass economic muster. *See, e.g., Simplified Standards* at 72-74 (noting that the Three-Benchmark test is "crude" and the "the weakness of this comparison approach."); *Union Pacific R.R. Co. v. STB,* 628 F.3d 597 (D.C. Cir. 2010) ("The Three Benchmark, final-offer process does not facilitate a 'search for the truth' . . . . Indeed, there is good reason to believe that judgments rendered pursuant to the Three Benchmark framework more often than not will be antithesis of mathematical certainty."). Rate comparisons are at best a necessary evil that have been justified only on the basis of being applied to a small subset of railroad traffic in "cases in which a full stand-alone cost presentation is too costly, given the value of the case." *Simplified Standards* at 74 (citing 49 U.S.C. § 10702(d)(3). Even then, both shipper and railroad parties advocated that the Board mitigate the crudeness of rate comparisons by considering other relevant factors in Three-Benchmark proceedings. *Simplified Standards* at 76-78.

B. Comparisons to Traffic Moving Below 180% of Variable Cost Eliminate Demand-Based Differential Pricing

In *Simplified Standards*, the Board concluded that comparison groups for Three Benchmark cases should consist of only traffic moving at R/VC ratios in excess of 180%. In order to judge the amount of contribution to joint and common costs that the complaining shipper should be responsible for, the Board explained that "[t]he rates available to traffic with competitive alternatives would provide little evidence on the degree of permissible demand-based differential pricing needed to provide a reasonable return on the investment." *Simplified Standards* at 17. *See also Simplified Guidelines*, 1 S.T.B. at 1026. NGFA and ARC completely ignore these differential pricing concerns in suggesting comparison groups including traffic moving below R/VC ratios of 180% in contradiction to the Board's prior holdings.

C. Comparisons to Revenue to Variable Cost Ratios for Traffic Moving on Other Railroads Do Not Accurately Establish the Appropriate Contribution to The Defendant Railroad's Fixed Costs

Both NGFA and ARC also seek to base comparisons of challenged rates to R/VC ratios on other railroads. NGFA Comments, Crowley V.S. at 6; ARC Comments, Fauth V.S. at 22. The Board should reject these calls on the same grounds that it has done so in the past: comparisons of R/VC ratios of different carriers defeat the purpose of trying to determine the appropriate contribution that the complaining shipper should be making to joint and common costs. As the Board stated,

> We will exclude non-defendant traffic from the comparison group because R/VC ratios of one carrier cannot fairly be compared with the R/VC ratios charged by another railroad. The reasonable level of contribution to joint and common costs (reflected by the R/VC ratio) is first and foremost a function of the amount of joint and common costs that need to be recovered. This will vary between carriers, creating inevitable and proper differences in R/VC ratios. Moreover, the reasonable degree of differential pricing one carrier can exercise is also a function of the mix of traffic. . .

Simplified Standards at 82. The Board correctly concluded that "the R/VC ratio of potentially captive traffic of one carrier provides no useful indicia of the lawful contribution to fixed and common costs for another carrier." *Id.* at 83.

Moreover, the ARC and NGFA proposals harken back to the discredited era of rate bureaus and rate equalization among different railroads.

> But Congress, in the Railroad Revitalization and Regulatory Reform Act of 1976, Pub.L. No. 94-210, 90 Stat. 35, and in subsequent legislation, effectively steered the ICC (and now the Board) away from the pre-1976 practice of regulating so as to equalize rates. *See American Short Line Railroad Ass'n v. United States*, 751 F.2d 107, 109-110 (2d. Cir. 1984). Indeed, the antidiscrimination provisions of what is now 49 U.S.C 10741 were expressly amended to sharply limit rate equalization practices. *See., e.g.*, the Conference Report accompanying the Staggers Rail Act of 1980, H.R. Rep. no. 1430, 96th Cong., 2d. Sess. at 104 (1980).

Arizona Pub. Svc. Co. v. Burlington N. & Santa Fe Rwy. Co., NOR 42077 (STB served Oct. 14, 2003). The Board expressly disavowed any intent "to return to an era of rate equalization among different traffic" in 1996. *Simplified Guidelines*, 1 S.T.B. at 1022.

D. <u>ARC's Other Proposals Should Be Rejected</u>

ARC makes several other unsound proposals that should also be rejected. For example, ARC proposes to eliminate the consideration of comparable traffic in a so-called "Two Benchmark Test." ARC would have the Board look only at whether the R/VC ratio generated by the challenged rate exceeds the average of all traffic with revenues above 180% of variable cost, then cap above-average rates at the carrier's RSAM. *See* ARC Comments, Fauth V.S. at 25-26. But such an approach would remove any consideration of market demand from the Board's analysis. *See Simplified Guidelines* at 1020, 1034.

ARC also calls on the Board to utilize a poorly defined export grain adjustment. Such an approach would be unworkable. In effect, ARC calls on the Board to subsidize export grain through the indirect means of artificially constraining rail rates, though it does not propose a specific methodology to do so. If the United States chooses to subsidize a particular sector of the economy, it has the means to do that directly, and the Board should not place its thumb on the scale of rail rates to do so indirectly. Moreover, such an approach would seem inconsistent with NGFA's stated goal of reducing and eliminating trade-distorting and export subsidies. *See* NGFA, Profile: International Trade/Ag Policy, http://www.ngfa.org/2014/02/21/profile-international-tradeag-policy/ (last accessed Aug. 11, 2014).

ARC also proposes that the Board develop a grain cost adjustment factor because it believes that URCS overstates the variable costs associated with grain shipments. Fauth V.S. at 7-12. ARC points to the fact that URCS understates the cost of certain shipments, such as the shipments of hazardous materials, Fauth V.S. at 11, and concludes that URCS must overstate the costs of other non-hazardous materials. The AAR agrees that URCS understates hazardous material costs, *see* AAR Comments, *Class I Railroad Accounting and Financial Reporting—Transportation of Hazardous Materials,* EP 681 (filed Feb. 4, 2009), and continues to support Board efforts to utilize URCS to more accurately cost specific rail movements. *See* AAR Comments, *Review of the General Purpose Costing System*, EP 431 (Sub-No. 4) (filed June 20, 2013). The extensive use of system-wide average costs throughout the regulatory regime, however, counsels strongly against piecemeal adjustments or favoring grain shippers over shippers of other commodities. If the effect of such an approach were to lower the URCS calculation of variable costs for grain shipments, as it is no doubt intended to be, Board action addressing only grain traffic could have the perverse result of preventing railroads from recovering all of their costs because the costing of other traffic would remain based on system averages that did not reflect adjustments for grain. *See Major Issues for Rail Rate Cases*, EP 657 (Sub-No. 1) (Oct. 30, 2006), slip op. at 58.

E. The AAR Agrees With Grain Shippers That the Limit Price Test For Qualitative Market Dominance Is Inappropriate

One area where the agricultural interest groups filing comments in this proceeding and the AAR agree is that the Board should not utilize the "Limit Price" test for qualitative market dominance applied in *M&G Polymers USA, LLC v. CSX Transportation*, NOR 42123 and *Total Petrochemicals USA, Inc. v. CSX Transportation, Inc.*, NOR 42121. NGFA Comments at 35; ARC Comments, Fauth V.S. at 13-16.[8] In its *amicus curiae* comments in *M&G Polymers USA, LLC v. CSX Transportation*, NOR 42123, the AAR fully set forth the problems with the "Limit Price" test and argued that the Board's replacing the qualitative market dominance violated the Administrative Procedure Act ("APA") and was contrary to precedent and sound economics. Congress and the ICC had previously concluded that rail carriers should not be presumed to possess market dominance based on R/VC ratios, 49 U.S.C. § 10707(d)(2), and the law requires a qualitative analysis of whether or not traffic with a higher R/VC ratio is subject to effective competition. *See, e.g.*, *Market Dominance Determinations* at 119. The agency has properly

[8] The AAR does not agree, however, that "[t]he STB should consider relaxing its market dominance standards for grain and grain products." ARC Comments, Fauth V.S. at 16. Instead, the Board should apply the test mandated by 49 U.S.C. § 10707 for all commodities: whether the transportation at issue faces "effective competition from other rail carriers or modes of transportation."

rejected formulas and defined this qualitative investigation as "one based on a variety of qualitative and quantitative evidence separate from the price/cost jurisdictional threshold and not dependent on predetermined statistical measures." *Id.* at 119 & n. 5. Moreover, the use of RSAM as a measure of market dominance has no rational basis. RSAM is not a measure of whether there is actual competition or how robust that competition is for any particular movement. In fact, there is no basis for the Board to conclude anything about an R/VC ratio above RSAM other than it is above the average amount the Board calculates that a particular carrier would need to charge its traffic that currently moves at rates above 180% of its system average variable costs, as calculated by URCS, to be considered revenue adequate in a given year under the Board's annual determination of revenue adequacy.

F. <u>The Negative Impacts to the Rail Network As A Result of Either Proposal Would be Significant</u>

The Board should be concerned that the proposals before it would make it significantly more difficult for railroads to invest in capacity. Taking NGFA's own analysis of its proposal, a significant amount of revenue would be at stake. *See* NGFA Comments, Crowley V.S. at 15. Based on a review of the information available in the Board's Commodity Revenue Stratification Report for 2012,the AAR estimates that that a reduction in railroad revenues from rates that generate R/VC ratios over 180% for STCC codes 01132 (corn), 01133 (oats) , 01136 (sorghum grains), 001137 (wheat), 01139 (grain, nec), 01144 (soybeans), 20923 (soybean cake, flour, manufacturing oils), and 2818445 and 2818446 (ethyl alcohol) by 18%, would translate into nearly half a billion dollars in in annual rail revenues. Notably, NGFA proposes that its methodology be applied to rates for 68 different STCC codes putting significantly more revenues at stake.

Such a reduction in revenue could cause a significant reduction in capital expenditures.

> Compared with other major industries, today's freight railroads invest one of the highest percentages of revenue to maintain and add capacity to their system, the majority of this investment is for maintenance to ensure the state of good repair with approximately 15-20 percent of capital expenditures, on average, used to enhance capacity. The capacity enhancements made during the recent economic downturn has positioned the railroads to meet the short-term, but not long-term capacity concerns. Key investments will be needed to meet future growth in freight demand. . .

U.S. DOT, National Rail Plan: Moving Forward A Progress Report (Sept. 2010) at 15. "There is no doubt that freight demands will increase and the need to safely and efficiently move freight will grow significantly." *Id.* at 16.

Artificially and uneconomically constraining rail revenues below competitive levels would never be a good idea, but it would be particularly unwise for the Board to consider taking such action at a time when shippers are actively calling for *increased* capital investment to improve service as demand increases. *See* NGFA Comments, *United States Rail Service*, EP 724 (filed April 7, 2014); ARC Comments, Whiteside V.S. at 28-30. Recently, the Board held a hearing in *United States Rail Service Issues*, EP 724 and heard from many shippers who recognize that an important part of the remedy for a capacity constrained rail network is capital investment. Statements at the hearing included:

- "For our part, to address demand over the long term we will continue to carry the message to Minnesota senators and representatives and to answer the Administration in support of policies and encourage investment in expanding rail capacity." Testimony of Lance Peterson, American Soybean Association, EP 724 (Apr. 10, 2014) Transcript at 129-30.
- "This is going to take a lot of time, and a lot of money, reinvestment into this rail system. From what I've heard on the railroads, they are reinvesting up to the level of their increase in business. On my farm, if I take on a bunch of new business, or new land, I've got to put a lot of money into the equipment and not just maintain. We feel there needs to be a lot of more reinvestment in the rail system than what is being planned at this point."

Testimony of Hal Clemensen, South Dakota Wheat Growers Cooperative, EP 724 (Apr. 10, 2014) Transcript at 369.

Recently, current U.S. DOT Secretary Anthony Foxx and 11 former DOT Secretaries noted in a letter to Congress that "over the next generation, more will be demanded of our transportation system than ever before. By 2050, this country will be home to up to 100 million new people. And we'll have to move 14 billion additional tons of freight, almost twice what we move now."[9] This bipartisan collection of transportation officials sees a clear solution to this challenge: investment in capacity. "Without increasing in investment in transportation, we won't meet these challenges. According the American Society of Civil Engineers [("ASCE")], we need to invest $1.8 trillion by 2020 just to bring our surface transportation infrastructure to an adequate level."[10] That ASCE report noted that rail had improved over its last report and that it was ahead of other modes. ASCE attributed railroad success to private investments which have resulted in greater rail efficiency and connectivity as a key reason for the improved grade. ASCE included several policy recommendations, such as the need to "support a regulatory and financial environment that encourages continued private investment in the nation's freight railroad system."[11]

IV. The Board Lacks Authority To Compel Railroads to Arbitrate Rates Absent A Voluntary Agreement

USDA believes an alternative to the Board's formal rate challenge processes that could be more fully utilized is private-sector mediation and arbitration. The AAR has consistently advocated private sector resolution of disputes and acknowledged that alternative dispute resolution, including voluntary arbitration arrangements, can serve as a useful supplement to

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[9] Letter from Sec. Foxx *et al.* to U.S. Congress (July 21, 2014).

[10] *Id.*

[11] *Id.*

Board regulation. *See* AAR Comments, *Rate Guidelines – Non-Coal Proceedings*, EP 347 (Sub-No. 2) (filed Aug. 20, 1987) at 32; AAR comments, *Assessment of Mediation and Arbitration Procedures*, EP 699 (filed May 17, 2012) at 12. Indeed, AAR members have engaged in private, voluntary efforts at arbitration and opted-in to the Board's recently redefined arbitration program. But the AAR has also long cautioned, and the Board has recognized in the past, that the Board has no authority to require parties to agency proceedings to submit rate and service disputes to binding arbitration. *See e.g., Arbitration--Various Matters Relating to Its Use As an Effective Means of Resolving Disputes That Are Subject to the Board's Jurisdiction*, EP 586 (STB served Oct. 26, 2001), Slip op. at 1 ("current law permits arbitration of disputes within the Board's jurisdiction only where the parties agree to use that process").

According to USDA, "[a] major benefit of arbitration is that it has the potential to offer less-time consuming and lower cost rail-rate challenge procedures than formal Board processes." USDA Comments at unmarked page 10. The AAR would note that the Board has in recent years lowered its filing fee for all complaints to $350. USDA offers no rationale why the cost of trying to persuade an arbitrator or arbitration panel that lacked the Board's substantive expertise or access to relevant data would be any less expensive than litigating before the Board.[12]

V. Board Precedent Sets Forth What Parties Have Standing to Bring a Rate Complaint

The Agricultural Interests' comments ask the Board to clarify what parties have standing to bring a complaint to the Board. *See e.g.,* NGFA Comments at 32. The AAR submits that such a statement is unnecessary because agency precedent adequately sets forth the general principles

[12] Some studies comparing the costs of arbitration and litigation have shown that arbitration is not necessarily less costly than litigation. *See, e.g.,* Michael Z. Green, Debunking the Myth of Employer Advantage from Using Mandatory Arbitration for Discrimination Claims, 31 Rutgers L.J. 399, 401, 421-22 (Winter 2000; *see also, e.g.,* Gary Grenley, *Weigh Cost of Arbitration as Carefully as Cost of Trial*, Portland Business Journal, (September 26, 2008)(available at: http://www.bizjournals.com/portland/stories/2008/09/29/focus7.html last accessed August 22, 2014).

of standing before the Board and because standing in individual cases will be fact-specific to the particular case at issue.

Under 49 U.S.C. § 11701(b), "[a] person, including a governmental authority, may file with the Board a complaint about a violation of this part by a rail carrier providing transportation or service subject to the jurisdiction of the Board. . . ." If a complainant states reasonable grounds for investigation and action, the Board "may not dismiss a complaint made against a rail carrier . . . because of the absence of direct damages." *Id.* Thus, a party with a sufficient nexus to the rate at issue that can state reasonable grounds for Board investigation and action has standing to bring a complaint alleging unreasonable rail rates against a market dominant carrier, *Simplified Guidelines*, 1 S.T.B. at 1021 & n. 50.

It is also clear that not every entity that has standing to bring a complaint before the Board is eligible for an award of reparations. Though Section 11704(b) states, "[a] rail carrier providing transportation subject to the jurisdiction of the Board under this part is liable to a person for amounts charged that exceed the applicable rate for the transportation," the general rule under the ICA has been that the person or persons that were responsible for the freight charges could be awarded reparations for unreasonable rates. *Baer Brothers Mercantile Co. v. Denver & Rio Grande R.R. Co.*, 233 U.S. 479, 487-88 (1914); *Merriam & Millard Company v. Chicago & Alton R.R. Co.*, 39 I.C.C. 485, 486 (1915).

Standing to sue for damages generally requires that a plaintiff has suffered an injury in fact. *Southern Pacific Co. v. Darnell-Taenzer Lumber Co.*, 245 U.S. 531 (1918). "The general tendency of the law, in regard to damages at least, is not to go beyond the first step." *Id.* at 534. The *Darnell-Taenzer Lumber* court contrasted the complainant with its purchasers and the ultimate purchasers of goods that lacked privity with the carrier who could not recover. "Behind the technical mode of statement is the consideration . . . of the endlessness and futility of the effort to follow every transaction to its ultimate result." *Id.*

The ICC considered whether *Darnell-Taenzer* required it to confine awards of reparation to parties who actually bore the freight charges directly in *Missouri Portland Cement Company v. Director General, as Agent*, 88 I.C.C. 492 (1924). The ICC stated that "[t]he court has made proximate rather than ultimate damage the test, and has said that proximately the losses accrue when the charges are paid." *Id.* at 495. The ICC concluded that in order to be able to recover, a party must have privity with the carrier. *Id.* The ICC noted that privity could lie with either the consignor or consignee of goods depending on who paid the charges. *Id.* at 496.[13]

More recently, in considering whether to certify the class in *McCarty Farms*, the court considered both the standing requirements under the ICA, related cases and antitrust law. Specifically, it considered whether rule of *Hanover Shoe v. United Shoe Machinery*, 392 U.S. 481 (1968) and *Illinois Brick Co. v. State of Illinois*, 431 U.S. 720 (1977), precluded plaintiffs' standing, by analogy. Briefly, *Hanover Shoe* and *Illinois Brick* dealt with treble damage actions brought under § 4 of the Clayton Act, 15 U.S.C. § 15, for alleged antitrust violations. In *Hanover Shoe*, the Supreme Court espoused the general rule, that as a matter of law an antitrust violator may not interpose as a defense that a direct purchaser has not been injured because it has "passed-on" the illegal overcharge to its own customers. *Illinois Brick* espoused a rule of symmetry that only a direct purchaser has standing to bring such an action. The court in McCarty Farms stated that, "[t]he principal basis upon which both *Hanover Shoe* and *Illinois Brick* were founded lay in the Court's belief that to allow the use of "pass-on" in either context

[13] Despite the fact that in the case the consignee had paid the freight in *Missouri Portland Cement Company*, the Commission awarded reparations to the consignor based on the theory that an agent may sue in his own name, when the principal is unknown and makes no objection. *Id.*

would greatly complicate and reduce the effectiveness of treble damages proceedings if they were to include an analysis of the price and output decisions of a direct purchaser to determine how much of the illegal overcharge was absorbed by it and how much was passed on." *McCarty Farms, Inc. v. Burlington Northern, Inc.*, 91 F.R.D. 486 (1981). Ultimately, a particular party's standing to seek damages for a rate it alleges to be unreasonable will be a case-specific inquiry that will require the Board to establish whether the complainant was damaged in fact because it paid unreasonable freight rates.

In contrast to the Board's power to order reparations under 49 U.S.C. § 11704(b), the AAR is unaware of any application of the Board's authority to prescribe rates under 49 U.S.C. § 10704(a)(1) on the basis of a complaint by a party other than a shipper. The statute and agency precedent is clear, though, that the Board only has authority to consider the reasonableness of rates of a rail carrier that possesses "market dominance over the transportation to which the rate applies," 49 U.S.C. § 10707(c) and that "[t]he Board does not establish maximum rates for classes of railroad rates." *Western Coal Traffic League – Petition for Declaratory Order*, FD 35506 (STB served July 25, 2013). Section 10704(a)(1) states that when the Board finds that a carrier possesses market dominance and concludes that "a rate charged or collected by a rail carrier . . . will violate this part, the Board may prescribe the maximum rate." The Board has stated that the question of whether to prescribe rates in a particular case is within its discretion. "Thus, in contrast to reparations – to which a complainant that has paid an unreasonably high rate for past movements has a statutory right to be awarded – the complainant has no similar right to a rate prescription for future movements. Rather, the Board has discretion as to whether or not to prescribe rates for future movements." *AEP Texas N. Co. v. BNSF Ry.* Co., NOR 41191

(Sub-No. 1) (STB served May 15, 2009). Such discretionary action is not amenable to the one size fits all generalized statement that the Agricultural Interests are seeking.

CONCLUSION

In light of the foregoing, the Board should take no further action in this proceeding.

Respectfully Submitted,

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